



Many People

One Bank

After 123 years of solid service, the HNB brand is deeply intertwined with the lives of thousands of Sri Lankans from all over the island, many of whom have held their accounts with us for generations. From a child's minor savings account to corporate credit and project financing extending to billions of rupees, HNB remains the bank that thousands trust as their **Partner in Progress**.

Together we have woven a financial network binding together a nation and its people, reinforced by decades of experience and strengthened by the loyalty of many business partnerships that have deepened over time.

Every customer we serve is special and every relationship is unique. This is why we believe that our business is more than just a series of transactions. It's about developing long-term, strategic partnerships. It's about being responsive, caring and treating people with respect. It's about making sure that everyone has the opportunity to change their lives and make their dreams real.

Our employee numbers are in the thousands.
So are our stakeholders.

We are many, but we are one.
Many people. One bank.

**Many People.
One Bank.**

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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



Many People. One Bank.

FINANCIAL GOALS AND PERFORMANCE

DEPOSITS
Rs 284 Bn +21.4%

GROSS NPA 3.9%
IMPROVED BY 13.0%

PAT Rs 5.6 Bn
+24.8%

ADVANCES
Rs 264 Bn +25.8%

**TOTAL CAPITAL
ADEQUACY 14.5%**

Results for the year	2007	2008	2009	2010	2011	Medium Term Goals
Return on Average Assets (%)	1.4	1.3	1.6	1.5	1.6	Over 1.5
Return on Average Shareholders' Funds (%)	19.3	16.5	19.6	17.4	17.3	Over 20.0
Cost / Net Income Ratio (Excl. Financial VAT) (%)*	54.7	52.6	52.7	54.9	57.7	Below 50.0
Dividend per Share (Rs)**	3.50	4.00	6.50	7.00	7.50	Over 4.00
Capital Adequacy						
Tier 1 Capital Ratio (%) (Statutory Minimum Ratio Required is 5%)	10.32	9.25	11.10	10.99	12.76	9.00
Total Capital Ratio (%) (Statutory Minimum Ratio Required is 10%)	12.08	11.40	13.16	12.64	14.51	12.50

* Operating expenses consist of personnel expenses, premises equipment and establishment expenses and other expenses.
Net income consists of net interest income, foreign exchange profit, fee and commission income, dividend income and other income.

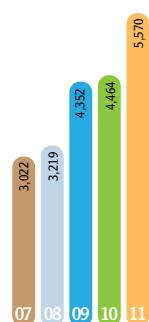
** 2011 final dividend consist of a cash dividend of Rs 3.00 per share and a scrip dividend of Rs 3.00 per share.

FINANCIAL HIGHLIGHTS

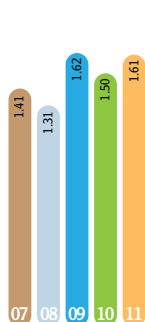
	Bank				Group			
	2011 Rs Mn	2010 Rs Mn	% Change		2011 Rs Mn	2010 Rs Mn	% Change	
Results For the Year								
Income	37,969	34,870	+	8.9	41,168	37,393	+	10.1
Net profit before income tax	7,768	6,731	+	15.4	8,483	7,252	+	17.0
Income tax on profits	2,197	2,267	-	3.1	2,249	2,365	-	4.9
Net profit after taxation	5,570	4,464	+	24.8	6,234	4,887	+	27.6
Gross Dividends*	2,914	1,650	+	76.7	2,914	1,650	+	76.7
Profit available after appropriation	2,656	2,814	-	5.6	3,320	3,237	+	2.5
At the Year End								
Shareholders' funds (Capital and Reserves)	37,088	27,274	+	36.0	40,374	29,978	+	34.7
Deposits from customers	284,146	234,074	+	21.4	283,712	233,883	+	21.3
Advances to customers including Leasing, Bills of Exchange and Commercial paper (Gross)	264,287	210,068	+	25.8	262,679	208,070	+	26.2
Total Assets	378,151	313,994	+	20.4	388,586	323,339	+	20.2
Information per ordinary share								
Earnings (Rs)	15.08	12.08	+	24.8	16.64	13.47	+	23.6
Dividends (Rs)*	7.50	7.00	+	7.1				
Dividend Yield (%)	4.96	1.75	+	183.2				
Net asset value (Rs)	95.44	114.61	-	16.7	169.66	125.97	+	34.7
Market value (Rs) - Voting	151.30	399.90	-	62.2				
Market value (Rs) - Non voting	83.20	214.60	-	61.2				
Ratios								
Return on average shareholders' funds (%)	17.31	17.45	-	0.8	17.48	16.99	+	2.9
Price earning (Times)	10.03	31.84	-	68.5	9.09	29.69	-	69.4
Dividend cover (Times)	1.91	2.71	-	29.4	2.14	2.96	-	27.8
Capital Adequacy Ratios								
Tier 1 (%) (Statutory minimum ratio required is 5%)	12.76	10.99	+	16.1	12.90	10.96	+	17.7
Total Capital Ratio (%) (Statutory minimum ratio required is 10%)	14.51	12.64	+	14.8	14.77	12.73	+	16.0

* 2011 final dividend consist of a cash dividend of Rs 3.00 per share and a scrip dividend of Rs 3.00 per share.

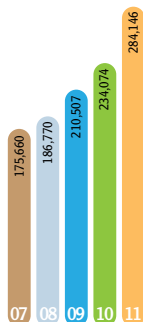
Net Profit
After Taxation
Rs Mn



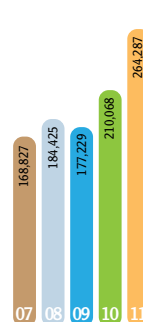
Return on
Average Assets
%



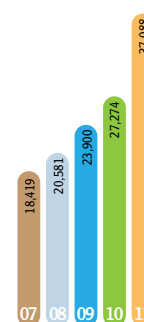
Total
Deposits
Rs Mn



Total
Advances
Rs Mn



Shareholders'
Funds
Rs Mn



CHAIRPERSON'S MESSAGE

As another financial year of accomplishments comes to an end, it gives me great pleasure to welcome all of you to the forty third Annual General Meeting of Hatton National Bank PLC and to present to you the audited Financial Statements and Annual Report for the year 2011.

In the year under review, the Bank has reached new heights in terms of performance and by being a conduit of value creation through its involvement as “Partner in Progress” to the nation. It stood true to its values and century long heritage in propagating sustainable livelihoods, catalysing economic gain and providing access to finance across every tier of the socio-economic scale in all four corners of the country. By standing tall and being the very foundation of our customers’ successes, Hatton National Bank has ably earned itself a reputation as a bank that assists the people and furthers national progress. Its actions fully resonate, without doubt, and gives full meaning to “One Bank. Many People”.

A year of global economic discontent

The year 2011 was by far one of the most challenging years for the global economy. Despite previous forecasts that the world economy would signal recovery in 2011, we continued to witness a protraction of recessionary pressures. By mid-year, growth forecasts have been scaled down and fears of an economic crisis loomed over Europe, as the sovereign debt crisis challenged the Eurozone plummeting the world economy into a very difficult phase characterised by significant downside risks and fragility.

The financial turmoil generated by the intensification of the debt crisis in Europe spread to high-income, developing as well as emerging economies, causing problems on a wide scale. As the advanced economies reeled from further shocks, the domino effect placed the rest of the world in vulnerability and challenged efforts made to insulate themselves from exigent pressures.

Capital flows to developing countries declined significantly compared to 2010, while growth in several major countries (Brazil, Russia and China) slowed, though partly in reaction to domestic policy tightening. As a result, global growth and world trade slowed sharply, while the world economy faced a defining



Dr Ranees Jayamaha - Chairperson

15.4%
increase in
profit before
tax to Rs. 7.8
billion



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Many People. One Bank.



CHAIRPERSON'S MESSAGE

continued

moment during 2011. With a scaled down growth forecast of 3.3%, the world economic outlook for 2012 would also be bleak.

Sri Lanka's economy bucks the trend

Fortunately, the pervasive effects of the persisting and worsening global economic downturn had limited impact on Sri Lanka's economic performance in 2011. Though hardly insulated from the global trends, Sri Lanka commendably mitigated the impact through timely monetary and fiscal policy adjustments and was largely shielded by the dominance of India and China, as they led the region on a positive growth trajectory.

The Sri Lankan economy witnessed accelerated growth in 2011 with an estimated GDP expansion of 8.3%, the second consecutive year of over 8% growth. With strong macroeconomic fundamentals and timely monetary policies in place, and returns from investments made in the pre-conflict years of 2008/2009, Sri Lanka continued to demonstrate a positive economic trend with the likelihood of maintaining growth momentum in the medium term.

International confidence in the nation was on the rise as Foreign Direct Investment into Sri Lanka in 2011 exceeded USD 1 Bn for the first time and the nation's fourth international sovereign bond, issued in July 2011, was oversubscribed by 7.5 times. GDP per capita is estimated to have reached USD 2,830 during the year and is forecast to rise to USD 4,000 by 2016, a trend that places Sri Lanka well on its projected path.

In 2011, Sri Lanka also achieved a mid-single digit level inflation rate. Year-on-year inflation declined to 4.9% in December 2011 from 6.8% in December 2010. In 2011, the Government of Sri Lanka was successful in its fiscal consolidation efforts leading to a fiscal deficit that

In mapping its strategy for the financial services sector in the medium term, the Central Bank of Sri Lanka has outlined a series of far-sighted strategies to enhance financial system stability. These include measures to diversify the sources of funding and business operations; strengthening integration with regional and international financial markets; a concerted concentration on cost efficiency and resource utilisation to improve profitability; and more importantly, the addressing of human capital issues including increased staff requirements and improved management to cater to the evolving financial environment.



was estimated to be below 7 % of GDP, down from 8% in 2010 mainly due to a tight control on expenditure and spending policies despite the maintenance of public investment at 6% of GDP.

Banking Industry weathers the storm

The Government's investment in areas of public services, infrastructure development and conducive policy adoption in stimulating the private sector to take the lead in economic productivity bore fruition with enhanced credit demand evident as a result of increased confidence and expanding economic activities. Nevertheless, the banking and financial services industry continued to grapple with the intensifying impact of global economic events. To meet the growing demand for credit, many of the larger financial service providers sought capital enhancement through a diversity of instruments.

During the year, the banking sector recorded substantial overall growth. The soundness of financial institutions improved and confidence in the financial system was enhanced. The financial markets remained stable and active even though the capital market witnessed a significant market correction. Efficiency in Payment and Settlement systems improved and the Central Bank of Sri Lanka further strengthened the regulatory framework in a bid to enhance the banking sector's compliance requirements especially in light of the turbulence in world financial markets.

Central Bank maps future strategy

In mapping its strategy for the financial services sector in the medium term, the Central Bank of Sri Lanka has outlined a series of far-sighted strategies to enhance financial system stability. These include measures to diversify the sources of funding and business operations; strengthening integration with regional and international financial markets; a concerted concentration on cost efficiency and resource utilisation to improve profitability; and more importantly, the addressing of human capital issues including increased staff requirements and improved management to cater to the evolving financial environment. At Hatton National Bank, we are committed to support these strategies for the future.

Given the overwhelmingly confident targets and strategies that have been envisioned, I am confident that Sri Lanka's financial sector is on a robust growth trend. As one of the leading private banks in Sri Lanka, we remain unmatched in how we have aligned our corporate strategies to those of the national strategy in perpetuating wealth creation not only for ourselves as a bank, but also for the nation at large. We will continue to reiterate this commitment to national objectives in the future. **Hatton National Bank has one vision for national development and multiple means to achieve it.**

One Bank. Many People.

In 2011, we stood strong and tall for our clients, depositors and shareholders in an uncertain world. Our passion to perform and fresh thinking helped deliver business solutions that met our client specific commercial needs across the entirety of the branch network last year, with no compromise on quality; building lasting and fulfilling

relationships with customers from all walks of life. During the year, approximately 2.5 Mn customers selected to bank or partner with us as their bank of choice.

We further fortified our position as the second largest private bank during the year, growing our loan base to Rs 258 Bn and asset base to Rs 378 Bn. At year-end, our network stood at a commendable 240 customer centres - the largest network amongst the private commercial banks - that have penetrated even to the most deep-seated rural communities, and our ATM network of 400 stands as one of the largest networks in Sri Lanka. As at end of December 2011, the Bank accounted for approximately 9% of the total banking sector assets. Our segmentation strategy - where our customer base comprises of a blended and well diversified portfolio from top corporates to SMEs and micro-entrepreneurs at grass root levels - enables us to leverage our services across a broad spectrum, and sets us in good stead to expand into large-scale Public Private Partnerships in the years ahead. The year in essence was one where Hatton National Bank consolidated its position and processes in readiness to tap future potential.

During the financial year, we witnessed sound loan growth approximating at 26%. We had a good year in our recovery efforts with the Gross Non Performing Loan (NPL) ratio reducing from 4.5% to 3.9%. This reflects our stringent risk management and recovery process. To facilitate the rapid loan growth, the Bank achieved a substantial rupee deposit growth of 23% and a foreign currency deposit growth of 14%. The Bank also secured capital from the capital markets in 2011. A Rights Issue in July 2011 enabled Hatton National Bank to raise Rs 6 Bn of its Tier I capital. A part of the Tier II capital requirement was also realized in 2011, raising the total capital adequacy ratio of the Bank to 14.5% as at the end of 2011. The enhanced fund base at the end of the financial year therefore placed the Bank on a sound position and in complete compliance with BASEL II. With Tier II capital expected to be fully augmented by several foreign funding sources, the Bank will be able to cater to the growing loan demand, large-scale projects and core banking activities in the year ahead and the medium term.

2011 was a special year for the Bank in the arena of technological innovation. Our core banking activities were upgraded with the integration of advanced IT based solutions and frameworks that deployed and delivered state of the art services. The 400 ATMs were fully automated with speedy settlements.

Through discipline, teamwork and agility, we assisted our clients to navigate and secure important businesses and managed challenges successfully. We remained focused on our customers and their needs - from products to service and support. We opened three "Crystal" units and enhanced "Club" operations to cater to our high net-worth customers, further propagating our signature service which is both personal and professional.

Without doubt, the Bank's strength is drawn from its diversified and relationship-based business model. This diversity has assisted the Bank to achieve consistent growth in profits exceeding Rs 5.5 Bn in 2011 compared to Rs 4.46 Bn in 2010. We are now in a sound position to further increase our profits in the years ahead.



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As a consolidated Group, we have continued to maximize the future opportunities arising in Sri Lanka's fast growing financial services industry. Towards this end, in 2011, we have taken advantage of our corporate financing solutions to develop business across the country. Sithma Development (Pvt) Ltd, a wholly owned subsidiary of Hatton National Bank has resoundingly demonstrated the avenues for sustainable commercial property investment. In partnership with HNB Assurance PLC, the Bank has effectively propagated BancAssurance across the nation, whilst Acuity Partners (Pvt) Ltd handled the Bank's portfolio investments. The sound and stable performances of subsidiary and joint venture operations have defined the success of the Group this financial year, as we continued to create wealth through investments, credit and banking solutions, and asset management.

Throughout our history, our focus on SME banking has helped define Hatton National Bank's role in SMEs. As a leading financier of SMEs, thousands of people around the country depend on our SME facilities and entrepreneurial grooming. Through these pioneering efforts, the Bank has been able to create and sustain livelihoods through access to finance for even those at the lowest rung of the socio-economic scale.

Compliance for greater governance

Significant changes were made to our governance and risk structures in 2011, in a bid to enhance the Bank's perspective of risk, regulation and compliance. We continued to place depositor, shareholder, customer and others stakeholder interest at the very forefront of our operations, and looked to safeguard their multiple interests through the adoption of measures that enhanced the perspective of governance, transparency, risk management and compliance with overall focus on the application of practical measures. We continued to report to the Central Bank of Sri Lanka in every sphere of the regulatory requirements and readied for the proposed policies for financial sector stability in the medium term.

Many People. One Bank.



CHAIRPERSON'S MESSAGE

continued

Sustainable business for stable growth

As a responsible corporate, the Hatton National Bank balances its ambitions with its conscience. While it continued to work hard towards sustainable business, our guiding principles and ethical banking practices influenced how we did business in 2011.

In the area of sustainability, we have consistently stayed ahead of the curve. Hatton National Bank once again proved its leadership in 2011, by defining responsible environmental management by the introduction of "Green Banking" with the opening of Sri Lanka's first green bank branch in Nittambuwa. Our long-standing sustainability efforts with the community, our engagement of customers, suppliers, our relations with investors, and employees were all based on consistent dialogue and engagement.

An eye on future value creation

I have discussed how the challenging financial landscape has affected banking performance and despite the adversities how we have managed to sustain our operations to deliver a commendable performance. The Bank in 2011 was recognised as one of the top ten corporates in Sri Lanka not only in the financial services sector but across the board in all sectors. Hatton National Bank has also been the overall winner of : the Bronze Award for the best presented Annual Report 2010; the Silver Award for the best presented Annual Report in Banking Sector in 2010; the Silver Award for the best presentation in Management Discussion and Analysis at the Annual Report Awards 2011 of the Institute of Chartered Accountants of Sri Lanka; and Best Retail Bank in Sri Lanka 2010 presented by the Asian Banker. These accolades may partly be due to Hatton National Bank's vision; leadership; its robust business model; comprehensive intelligence of the market; and its ability to execute its strategies effectively. Moreover, the Bank's reputation for dedicated client focus and its specialised expertise have assisted it to remain at the top.

The effective implementation of our strategic plan for the next three years will see Hatton National Bank, developing new relationships through financing of public private partnerships and infrastructure projects. We look to expand in the areas where there is a stark deficiency, such as in the capacity of seed and venture capital in the Northern and Eastern provinces. We remain poised for growth and hope to align our product and service developments towards meeting the nation's vision for hub status in knowledge, energy, commercial, naval/ maritime and aviation.

In 2012, competition will no doubt be intense. In line with Central Bank of Sri Lanka's guidance, we will explore new markets and steer our human resource development to meet opportunities. In 2012, we plan to open our doors to new markets, new businesses and to continue to hold it open for our customers both new and existing. We will continue to fly the Hatton National Bank's flag of confidence and be your "Partner in Progress".

From an industry perspective, it is essential that peer support be the foundation for the future of Sri Lanka's financial services sector. The industry must come together and work in solidarity to move against the

global challenges. For the future stability of the sector therefore, consolidation is key, as the sector needs to be solid and robust to meet both the national growth imperatives as well as impending global challenges.

Appreciations

I would like to take this opportunity to thank Mr Rienzie T. Wijetilleke former Chairman of the Bank who has contributed immensely to bring the Bank to the present position. I also thank Mr MV Theagarajah and Mr Ranjeevan Seevaratnam for their valuable contribution to the Board. I wish to appreciate the guidance and support given by Mr D H S Jayawardena and Mr R K Obeyesekere during their long tenure at the Board and for sharing their expertise towards the betterment of the Bank.

I welcome Dr WW Gamage and Dr L R Karunaratne to the Board and thank my fellow Directors who have supported me at the Board level and the Management Staff for their tireless pursuit of the Bank's strategic expectations and goals.

Our customers have stood by us for many decades and have truly demonstrated the meaning of loyalty. We are proud and privileged to serve you. Thank you for placing your trust in us.

I thank His Excellency the President and Minister of Finance and Planning Mahinda Rajapaksa, Mr Geethanjana Gunawardana - Deputy Minister of Finance, Dr P B Jayasundera - Secretary to the Treasury and Mr Ajith Nivard Cabraal - the Governor of the Central Bank of Sri Lanka and Central Bank officials for their guidance and continued support during the year.

Throughout the history, our shareholders have been a source of strength to the Bank and I thank all of you for your investments into this Bank. Your belief in the Bank's potential is a reflection of our passion to achieve.

We stay committed to serve all our stakeholders. On behalf of the Board of Directors, I pledge that we will continue to add shareholder value through the execution of prudent business strategies, whilst ensuring that we contribute towards the achievement of national priorities.



Raneer Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2012

CHIEF EXECUTIVE OFFICER'S REVIEW

“Sri Lanka Can” optimism outdoes global scepticism

The financial year under review was essentially a year of mixed feelings. Certainly, the overwhelmingly negative global scenario was a cause of concern to the domestic financial services sector, but the prevailing post-conflict optimism drove the national economy to greater heights. The favourable GDP expansion witnessed during the year 2010 catalysed investor sentiment in 2011, precipitating growth across all sectors. Reconstruction and rehabilitation gathered momentum in previously conflict-afflicted areas during the year and commercial activity within these communities further added to the nation's productive efficiency and output.

Throughout the financial year, Sri Lanka's economy remained buoyant. Investor confidence surged and was converted into tangible commercial outcomes. This positivism served to insulate the national economy from the triggers of recession that were otherwise pervasive across the world's major economies especially the United States and in the latter part of the year, the Euro Zone.

The Bank as a change agent

In 2011, as in previous years, Hatton National Bank continued to play a critical role in augmenting the national economy. With a legacy that extends over 123 years, the Bank has been instrumental in awakening and empowering rural communities. Having started operations in the small tea-producing hamlet of Hatton, the Bank's corporate DNA has the signature of being a change agent. In 2011, our focus was essentially to further penetrate the rural sector, and as such we followed a concerted strategy of network penetration with a view to not only enhance our footprint across the Island but also to bring the concept of banking to the very doorsteps of every rural community. Our initiatives towards absorbing individuals even at the lowest tier of the socio-economic group have opened vistas of opportunities to communities who have for generations lived beyond the poverty line. We have empowered them and developed them into productive resources for the nation. That is the very essence of what Hatton National Bank stands for, and we have been proud to partner our customers across every change of their lives, while we ourselves have changed to serve them better. That, I believe, is why we are one bank that has touched and changed the lives of many.

The Bank sharpened its focus during the year on the following five strategic priorities,

- Operational excellence and cost optimisation,
- Strong sales culture and high fee income,
- Profitable Balance sheet growth;
- Competent, Engaged and motivated Team;
- and Governance, Transparency,
- Compliance and Corporate Social Responsibility

We believe that clustering strategic priorities in this manner will enable flawless execution of the Bank's medium term strategic plan with a strong alignment towards shareholder expectations.

24.8%
increase in
post tax profit
to Rs 5.6 billion



Rajendra Theagarajah - Managing Director / CEO



Our initiatives towards absorbing individuals even at the lowest tier of the socio-economic group have opened vistas of opportunities to communities who have for generations lived beyond the poverty line. We have empowered them and developed them into productive resources for the nation. That is the very essence of what Hatton National Bank stands for, and we have been proud to partner our customers across every change of their lives, while we ourselves have changed to serve them better. That, I believe, is why we are one bank that has touched and changed the lives of many.

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CHIEF EXECUTIVE OFFICER'S REVIEW

continued

Financial and Operational Performance

The financial year 2011 delivered sound returns for the Bank. I am pleased to note that your Bank posted a pre tax profit growth of 15.4% and post tax profit growth of 24.8%. The Bank posted an after tax profit of Rs 5.57 Bn, whilst Group after tax profit stood at Rs 6.28 Bn.

General optimism with regard to economic stability fuelled solid growth opportunities in credit across all sectors, during the year. Encouragingly, credit demand across all provinces, especially outside of the Western Province was evident, signalling productive economic activity outside of the conventional framework. However, this enlarged demand for lending served to place pressure on liquidity as loan growth outpaced deposit growth significantly during the year, largely as a result of the low interest rate regime. This disparity necessitated an enhanced utilisation of the Central Bank of Sri Lanka's (CBSL) Repo window and required the Bank to review and revisit its Tier I and Tier II capital requirements.

During the year, a capital augmentation plan was conceptualised and approved by the Board of Directors, with the intention to raise approximately Rs 11 Bn. Of this, in mid 2011, approximately Rs 8 Bn was secured through a Rights Issue and long term subordinated debentures. Presently, plans have been concluded to secure an additional Rs. 2.85 Bn in Q1 of the financial year 2012. Hatton National Bank continued to maintain a healthy capital base with Tier 1 capital ratio at 12.76% and Total Capital Adequacy ratio at 14.51% at the end of the financial year under review.

Asset quality remained an area of critical focus. The Bank worked towards the achievement of a significantly reduced NPA portfolio and in this regard it is indeed pleasing to note that the Bank successfully bettered the NPA of 5% achieved in 2010 to a commendable 3.9% in 2011. The Bank continued with a persistent strategy towards NPA contraction and the levels achieved in 2011 remain the lowest achieved in over a decade. The Bank's diligent and relentless pursuit of portfolio quality continued to pay dividends in 2011 as in the previous financial year. Moreover, recoveries contributed well towards income during the period under review with a total of Rs 529 Mn arising from specific provision reversals.

The Bank continued to execute its strategies for future growth with urgency and priority with the intention to build capacity in readiness for future growth. As such, the Bank's strategy towards enhanced accessibility through a concerted channel distribution drive was well supported during the year, with the Bank commissioning 35 customer centres across Sri Lanka, bringing the total network to 240 units. The Bank's ATM network reached 400 in 2011, making it one of the largest in the country. The channel distribution was particularly focused on sustaining an equitable rural, semi urban reach of the Bank's services. The enhanced distribution network is undoubtedly a platform for greater mobilisation of services going forward and is a strategic initiative that is well aligned with the Bank's strategy for rural and semi-urban empowerment.

The Bank views Information Technology as a critical support pillar in moving forward from the conventional banking platform to a more innovative, interactive and inclusive banking model. As such, in 2011, the Bank invested heavily into IT with a view to building a more robust and scalable IT infrastructure that will not only assist core-banking activities but also create a foundation for a sound base in risk management, and business decision making. During the year, approximately Rs. 500 Mn was invested towards this end. The investment will benefit Risk Management, yield overall performance enhancements, and support core



The Bank continued to execute its strategies for future growth with urgency and priority with the intention to build capacity in readiness for future growth. As such, the Bank's strategy towards enhanced accessibility through a concerted channel distribution drive was well supported during the year, with the Bank commissioning 35 customer centres across Sri Lanka, bringing the total network to 240 units.

banking in the areas of leasing, credit, card management, Asset-Liabilities management and the mobile and internet banking capabilities. Concrete evidence of tangible benefit from the investment will be realised in the upcoming financial year. In 2011, the Bank witnessed the completion and commissioning of the new E-Banking module, an initiative that has enlarged the e-banking customer base to approximately 43,000 customers.

Despite only modest increases in staff costs at 5.0% and operating expenditure at 10.6% during the financial year, the cost to income ratio remained well above that of the Bank's peers at 58% and remained a key concern. Whilst over the past five years, the Bank has been conscious of the need to break through the psychological barrier of 50%; the continued marginal growth of the ratio remains a critical area of concern. Key focus in 2012 therefore, will be to enlarge the net income which could be supported by maintaining the existing fixed cost structure.

The Bank's commendable financial performance in the year under review is by and large as a result of a solid contribution from core banking activities. However, Group performance was enhanced considerably during the year with a majority of the subsidiaries posting commendable returns. The insurance subsidiary HNB Assurance PLC posted robust growth in turnover and profitability, with a Gross Written Premium growth of 27% in General and 19% growth in Life business. Acuity Partners continued to retain its leadership in the industry as one of the leading full serviced investment banking firms in Sri Lanka. Despite the rather tumultuous year for Sri Lanka's capital market, Acuity Partners accrued a commendable year-end turnover and profitability, largely as a result of its reputation as a technically competent and versatile investment-banking firm coupled with astute investment strategies. Likewise, Sithma Development (Pvt) Ltd., performed exceptionally during the year posting a commendable profitability in excess of Rs 270 million in 2011. Overseas subsidiary performed with promise; Majan Exchange (Oman) performed well in terms of volumes and during the year commissioned a second branch. However, despite the expectation to break-even in 2011, changes in the regulatory framework in Oman did not augur well for profitability. Majan is now expected to break-even during the upcoming financial year. The Bank remains committed to the development of Majan in the year ahead.

The Bank continued to maintain and manage its strategic investment portfolio judiciously. Whilst its investment in DFCC Bank is strategic in nature, the Bank also has investments valued at over Rs 1 Bn that are managed by NDB Aviva Wealth Management Ltd. Despite the fragility of the capital market in 2011 and the consequent reduction in market values, the Bank believes that the value of its long term investments in fundamentally strong stocks is within its risk appetite.

Changes in risk and accounting frameworks necessitated the Bank to take major preparatory steps towards compliance in 2011. The Bank placed due emphasis on the full integration of BASEL II to be implemented by 2012 whilst also being attentive to the requirements of the BASEL III road map to be implemented by 2019. In addition, the Bank steadfastly pursued its preparation leading towards the adoption of Sri Lanka Financial Reporting Standards (SLFRS) from January 2012. The change in the accounting framework by 2012 will require a shift away from historical cost accounting to market based and the Bank has invested into complying with the new Sri Lanka Financial Reporting Standards through considerable review of its accounting processes and resources.

The Central Bank of Sri Lanka (CBSL) in 2011 introduced a Customer Charter. The Bank is appreciative of the consultative process facilitated by CBSL prior to finalising the Charter. Extensive preparation was undertaken in-house by Hatton National Bank to meet the requirements of staff training in a bid to be compliant with the Charter.

Sustainability Leadership

The Bank's sustainability focus is fully aligned to its business goals. Thus, sustainable action is an integral component of sustainable business. This dual and interdependent focus has enabled the Bank to be a leader in sustainability especially in the financial services sector. Our livelihood development programmes such as "Divi Saviya" are not purely based on philanthropy; they are essentially multi-faceted programmes that provide opportunities for long-term and sustainable solutions to employment, poverty and youth productivity. In 2011, we took our experience from financial literacy and entrepreneur development to develop "Yauwanabhimana" and "Adhistanaya" both of which are programmes that rekindle hope through empowerment and entrepreneurship. 2011 was also a year in which the opportunity to "build in" a livelihood component to post conflict reconstruction efforts in the North and Eastern provinces became a reality.

We demonstrated leadership in the area of environmental sustainability by pioneering the concept of "green banking" by opening Sri Lanka's very first green bank branch in Nittambuwa, during the year. Certified as a "Leadership in Energy and Environmental Design" by the United States Green Building Council, the branch has been designed and built to minimise its operational impact on Mother Nature. The Bank's Head Office building "HNB Towers" was also recognised as an environmental champion during the year at the National Energy Efficiency Awards.

In 2011, the Bank played host to "Asian Bankers Association General Meeting & Conference" in a bid to enhance the image of the nation and Sri Lanka's banking community in the eyes of over 200 leading bankers and bank regulators from around the Asia-Pacific region. Held for the first time in over 27 years in South Asia, the conference focussed on "Asia Taking The Lead In The Global Economy: A Bankers' Perspective".

Mapping Future Business

I firmly believe that for the future sustainability of the banking business, we need to rethink the business model, moving away from the traditional banking model. While, the process in itself cannot be overly accelerated, we need to be mindful of the necessity to achieve a better balance of asset growth with liquidity and capital buffers. Profitability should not be compromised merely for the sake of top-line growth and financial solutions need to become more focused on banking ethics as opposed to pure product based selling. Finally, one of the central needs will be a critical re-examination of the reliance on the high fixed cost distribution model whilst mapping distribution more effectively based on lifestyles of customers. Therefore, in strategising for the future, the Bank needs to assess the opportunities and challenges posed by an evolving customer base and deliver distribution and value that are relevant to each whilst balancing the Bank's fixed costs.

Changes to the Board of Directors

During the financial year, the Bank's Board Structure witnessed significant change. Mr Rienzie T. Wijetilleke, Mr MV Theagarajah and Mr Ranjeevan Seevaratnam stepped down from their Board positions in March 2011, followed by Mr R K Obeyesekere in December 2011. Mr D H S Jayawardena ceased to be a director from 31st December 2011. I take this opportunity to thank these Gentlemen for their guiding spirit and their show of dedication to make Hatton National Bank an icon of banking excellence. I would also like to welcome our new Chairperson Dr Raneer Jayamaha, and Directors Dr WW Gamage and Dr L R Karunaratne to the HNB family. They have blended in well with the culture of the Bank, and I am confident that they will play a key role in shaping the future of Hatton National Bank through their dedication and support towards the flawless execution of strategy.

Appreciations

I would like to extend my sincere appreciation to the Governor of the Central Bank of Sri Lanka and his able staff for their tremendous support throughout this financial year. My deepest gratitude to the Chairperson and my fellow Board Directors for their continuous and consistent support, encouragement, wisdom, input and guidance. To my HNB team, thank you for your persistent perseverance and passion; you have been the reason for our Bank's successes. We have many more great things to achieve together for the future, and I am confident that we will leave Hatton National Bank's indelible mark on Sri Lanka's future prosperity.



Rajendra Theagarajah
Managing Director / CEO

Colombo, Sri Lanka
21st February 2012

Many People. One Bank.



BOARD OF DIRECTORS

1. **Dr Raneer Jayamaha**
Chairperson (Non-Executive Director) / H / N / R
2. **Mr Rajendra Theagarajah**
Managing Director / Chief Executive Officer
(Executive Director) / R
3. **Mr D H S Jayawardena**
(Non-Executive Director) / N / A
4. **Mr R K Obeyesekere**
(Non-Executive Director) / H / N
5. **Ms Pamela C Cooray**
(Non-Executive / Independent Director) / H / A
6. **Mr N G Wickremeratne**
(Non-Executive / Independent Director) / H / A
7. **Ms M A R C Cooray**
(Non-Executive / Independent Director) / R / A
8. **Dr W W Gamage**
(Non-Executive / Independent Director) / H / N / R
9. **Dr L R Karunaratne**
(Non-Executive / Independent Director) / R
10. **Ms Indrani Goonesekera**
Board Secretary



H Member of HR & Remuneration Committee
N Member of Nomination Committee
R Member Board Integrated Risk Management Committee
A Member of Audit Committee



In line with Central Bank of Sri Lanka’s guidance, we will explore new markets and steer our human resource development to meet opportunities. In 2012, we plan to open our doors to new markets, new businesses and to continue to hold it open for our customers both new and existing. We will continue to fly the Hatton National Bank’s flag of confidence and be your “partner in progress”.



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BOARD OF DIRECTORS

continued

Dr Ranees Jayamaha - Chairperson

B.A. (Hons) (University of Ceylon, Peradeniya), MSc. (University of Stirling, U.K.), Ph.D (University of Bradford, U.K.)

Appointed Director and Chairperson on 31st March 2011. She had been the Deputy Governor in charge of Financial System Stability of the Central Bank of Sri Lanka from 2004 up to her retirement at end of May 2009. She has over 37 years of extensive experience in the fields of economics, banking, finance, regulation and administration, having held a number of positions in the Central Bank and outside. She is currently an Advisor to His Excellency the President.

On release from the Central Bank, she has served as Secretary – Presidential Commission on Finance & Banking, Advisor – Financial Sector Reform Committee, Ministry of Finance, and Special Advisor (Economic) – Commonwealth Secretariat, London, U.K.

She has been a Member of the Securities & Exchange Commission of Sri Lanka, the Insurance Board of Sri Lanka, the Chairperson of the Credit Information Bureau of Sri Lanka and the National Payments Council. Dr Jayamaha has been a Member of the Working Group on General Payment System Development of the Bank for International Settlements, Member of the Global Payments Forum, Member of the Advisory Panel of the G-8 Remittances Working Group and Member of the Expert Panel of the Safeguard Assessment Policy Review 2010 of the IMF. She had been providing advisory services to a number of International financial institutions and Central Banks in the Region.

Mr Rajendra Theagarajah Managing Director / Chief Executive Officer

F.C.M.A. (U.K.), F.C.A (Sri Lanka), M.B.A. (Cranfield)

Appointed Director /General Manager / Chief Executive Officer in December 2004. He was appointed Managing Director in December 2005. Member of the Corporate Management of HNB since 1997. He counts over 27 years in Banking including overseas assignments. Acting Chairman of HNB Assurance PLC, Chairman of Acuity Partners (Pvt) Ltd, Acuity Stock Brokers (Pvt) Ltd and Acuity Securities Ltd. Director of Sithma Development (Pvt) Ltd, Guardian Acuity Asset Management (PVT) Ltd, Lanka Financial Services Bureau Ltd and Lanka Clear (Pvt) Ltd. He was a past Chairman of Sri Lanka Banks' Association (Guarantee) Ltd and Financial Ombudsman Sri Lanka (Guarantee) Ltd, Chairman

of the Asian Bankers Association. Member of the Sri Lanka Accounting & Auditing Standards Monitoring Board, Committee member of the Ceylon Chamber of Commerce, Vice Chairman of the Chartered Institute of Management Accountants Governing Board Sri Lanka and Council Member of the Sri Lanka Institute of Directors.

Mr D H S Jayawardena - Director

Director since 1988. He is the Chairman of Stassen Group of Companies, Aitken Spence Group of Companies, Lanka Bell (Pvt) Ltd, Periceyl (Pvt) Ltd, the Chairman and Chief Executive Officer of Distilleries Company of Sri Lanka PLC, Lanka Milk Foods (CWE) PLC, Balangoda Plantations PLC, Madulsima Plantations PLC and Browns Beach Hotels PLC and the Chairman of the Ceylon Petroleum Corporation. He is also the Consul-General for Denmark in Sri Lanka. He was awarded the Knight Cross of Dannebrog by Her Majesty the Queen of Denmark.

Mr R K Obeyesekere - Director

Director since 1998. He was former Deputy Chairman - Sri Lanka Insurance Corporation. He is a Director of Stassen Group of Companies, Lanka Milk Foods (CWE) PLC, Distilleries Company of Sri Lanka PLC, Madulsima Plantations PLC and Lanka Dairies (Pvt) Ltd.

Ms Pamela C. Cooray - Director

LL.B. University of Ceylon, Peradeniya, Sri Lanka

Appointed Director in April 2004. She was a past Director of the Board of Investment of Sri Lanka and Associated Battery Manufacturers (Ceylon) Ltd.

Mr N G Wickremeratne - Director

B.Sc University of Ceylon, Peradeniya, Sri Lanka

Appointed Director in July 2009. Former Chairman of Hayleys PLC and Chief Executive of Dipped Products PLC from its inception to 2007. He is a Director of Finlays Colombo PLC.

He had chaired the Sri Lanka Association of Manufacturers and Exporters of Rubber Products, served as a Committee Member of the Ceylon Chamber of Commerce and had been its representative on the National Labour Advisory Council. He is the past President of the Sri Lanka-France Business Council.

Ms M A R C Cooray – Director

B.A. (Hons.) University of Ceylon, Peradeniya, Sri Lanka, MSc. Strathclyde University, U.K.

Appointed Director in February 2010. She is a retired Deputy Governor of the Central Bank of Sri Lanka where she served for over 35 years. She is a Director of Ceylon Guardian Investment Trust PLC and Ceylon Investment PLC.

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

She has functioned as the Vice Chairperson of the Institute of Bankers of Sri Lanka for 5 years and has served on a number of committees at national level covering a variety of subjects representing the Ministry of Finance and the Central Bank.

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

Dr W W Gamage – Director

B.Sc (University College of London, U.K.), M.Sc (University of Colombo), PhD. (Rajarata University)

Appointed Director on 31st March 2011. Dr Willie W. Gamage currently serves as the Secretary to the Ministry of State Resources & Enterprises Development, while serving as the Chairman / CEO of the Strategic Enterprise Management Agency (SEMA).

He has over 30 years of wide experience in the public, private and non-governmental organisations, having served several such organisations in different capacities. He has extensive experience in formulating and implementing several projects on poverty alleviation, local economic development, promoting alternative energy generation and enhancing capacities in public enterprises.

Dr Gamage has also contributed immensely to the local and regional development initiatives in the areas of Rural Water Supply and Sanitation, Small Scale Fisheries Development, Community Development, Municipal Solid Waste Management, Rural Enterprise Development and Rural Housing Development.

Dr L R Karunaratne – Director

B.E. (India), T.Eng. (CEI), MIE (Lon.), MBA (UK), Ph.D (UK), FIIM (HK), FCI0B

Dr Rohan Karunaratne, a Consultant Engineer, is the incumbent President of the Ceylon Institute of Builders (CIOB), engaged in developing the construction industry and construction builders in Sri Lanka. He is the Managing Director of A.K.K. Engineers (Pvt) Ltd., an Engineering Company specialised in building construction, civil engineering, water supply and waste water, construction of swimming pools and now in road construction, the Chairman of Associated Motor Finance Co. Ltd. and is also the Deputy Chairman of the International Institute of Management.

He has over 27 years of experience in Civil Engineering, Building Construction, Engineering Consultancy, Construction Training, Lecturing in Civil Construction, Designing & Planning. He was the past Chairman of the National Construction Association of Sri Lanka and was the first Chairman of Human Resources Development (Pvt) Ltd and Advance Construction Training Academy.

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

Ms Indrani Goonesekera – Board Secretary

Attorney-at-Law

Appointed Board Secretary in April 2001. She is the Deputy General Manager (Legal) of the Hatton National Bank PLC and is a member of the Corporate Management of the Bank for over 15 years. She was the Board Secretary of HNB Assurance PLC up to 6th September 2011 and Sithma Development (Pvt) Ltd up to 7th September 2011.

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CORPORATE MANAGEMENT

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1. Rajendra Theagarajah M.B.A. (Cranfield), F.C.M.A.(UK), F.C.A. (Sri Lanka) - Managing Director / Chief Executive Officer
2. A J Alles M.B.A. Finance (Stirling), A.I.B. (Sri Lanka) - Deputy Chief Executive Officer
3. J M J Perera F.C.I.B. (London) - Senior Deputy General Manager - Business Development & International Relations
4. J D N Kekulawala M.B.A. (Manchester), F.C.I.B.(London), F.C.A.(England & Wales) - Senior Deputy General Manager - Strategy & Compliance
5. C P Abeywickrema B.Com. (Special) Sri Lanka - Deputy General Manager - Marketing & Retail Banking
6. Ms I Goonesekera Attorney-at-Law & Notary Public - Deputy General Manager (Legal) / Board Secretary
7. Ms I R D Thenabadu F.C.I.B. (London), F.C.M.A.(UK) - Deputy General Manager - Corporate Banking
8. J R P M Paiva B.A. (Hons) Ceylon - Deputy General Manager - Human Resources & Administration
9. Ms L L C C Thambiah - Deputy General Manager - Network Management
10. P D Hennayake M.B.A. (A.I.T.)Thailand, P.G. Dip. (Eng.), B.Sc. Eng. (Hons) Moratuwa, C.Eng., M.I.E. (Sri Lanka) - Deputy General Manager - Services
11. D P N Rodrigo M.B.A. (Cranfield), F.C.M.A.(UK), F.C.C.A. (UK) - Deputy General Manager - Risk & Credit Quality
12. P Sridharan - Assistant General Manager - Personal Financial Services



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CORPORATE MANAGEMENT

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13. R H Abayasekara - Assistant General Manager - Correspondent Banking & International Operations
 14. A Ratnasabapathy F.P.M.A. - Assistant General Manager - Corporate Banking
 15. M Asokan F.C.A. (Sri Lanka), A.C.M.A.(UK), C.I.S.A. (USA), C.I.A. (USA) - Head of Internal Audit
 16. A P L Fernando M.B.A. (Colombo), F.I.B. (Sri Lanka), Dip. in Bank Mgmt. - Assistant General Manager - Recoveries & Credit Quality Management
 17. D A deVas Gunasekara F.C.A. (Sri Lanka), F.C.M.A. (Sri Lanka) - Chief Financial Officer
 18. D St E Fernando - Assistant General Manager - Operations
 19. N U Jumat F.I.B. (Sri Lanka) - Assistant General Manager - Trade Services
 20. R JThambirajah - Assistant General Manager - SME, Metro & Colombo Region Branches
 21. R M P Dayawansa M.B.A. (Sri J.), F.I.B. (Sri Lanka), F.C.I.M. (UK), F.S.L.I.M. - Assistant General Manager - Specialised Financial Services
 22. Ms S Gnanapragasam BSc. (Hons), F.C.M.A.(UK) - Assistant General Manager - Treasury & Markets
 23. Ms L C Cooray Dip. in HR (IPMSL), I.P.M.A. - CP (USA) - Assistant General Manager - Human Resources
 24. Ms K A LT Ranaweera Attorney at Law, LL.M. (Cambridge), Dip. in Int'l Affairs (BCIS) - Assistant General Manager - Legal
 25. S N Wijeratne M.B.A. (Sri J.), B.Sc. (IT) - UK - Chief Information Officer / Head of IT

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SENIOR MANAGEMENT

1. K L Wijesooriya LL.B (Sri Lanka) - Chief Manager - Remittances
2. V Vijayakumar M.Sc. (IT) UK., A.I.B. (Sri Lanka), M.I.M.I.S. (Lond.), A.M.I.A.P. (Lond.), M.A.A.T. (Sri Lanka), M.B.C.S. - Chief Manager - IT Operations
3. B K Wijeratne B.Sc. (Physical Science) Colombo - Chief Manager - Leasing
4. P G Wilson B.Sc. (Kelaniya), Dip. in IT (N.I.B.M.), M.C.S.E. - Security - Chief Manager - Network Infrastructure
5. S Sivalingam A.C.I.B. (London) - Chief Manager - Procurement & Logistics
6. A Goonesekere M.B.A. (Sri J.), F.C.A. (Sri Lanka), F.C.M.A. (Sri Lanka) - Chief Accountant
7. R B Warnakulasuriya M.B.A. (Sri J.), B.Com. (Special) Kelaniya, M.A.A.T., A.I.C.M. - Chief Manager - Greater Colombo Region
8. V Ratnasabapathy A.C.I.B. (London) - Chief Manager - Credit Risk
9. U N I Elapata B.A. (Hons) - Uni. of Texas (Austin) - Chief Manager - Card Centre
10. Ms R Prabhakaran A.I.B. (Sri Lanka) - Chief Manager - Treasury / International Operations
11. Ms N M C P Wettasinha Attorney-at-Law & Notary Public - Senior Manager - Legal
12. S Udayakumar D.B.A. (UK), B.Sc. (AM), F.C.M.I. (Lond.), M.S.L.I.M., Dip. in Busi. Mgmt & Admin (UK), M.C.P.M. (Sri Lanka), Dip. in Sales Mgmt & Marketing (UK), A.I.T.D. (Sri Lanka) - Senior Manager - Audit (Branch Operations)
13. Ms M K Rambukwella M.B.A. (Sri J.), M.Sc. (Pera.), B.A. (Hons) - (Pera.), A.C.I.M. (UK), M.S.L.I.M., A.M.I.T.D. (Sri Lanka) - Senior Manager - Training & Development
14. A G Gomez - Senior Manager - Treasury
15. Ms K Balasubramaniam LL.B (Sri Lanka) - Senior Manager - Human Resource Management
16. H J A Ferdinando - Senior Manager - Centralized Operations
17. L S C L R Fernando A.I.B. (Sri Lanka) - Senior Manager - SME
18. N M Kulatunga M.B.A. (Sri J.), A.I.B. (Sri Lanka) - Senior Manager - Credit Administration
19. W J T Fernando M.B.A. (Sri J.), A.I.B. (Sri Lanka) - Regional Head - North Western Region



20. D S L Ferdinando - Senior Manager - Corporate Account Relationship
21. A R Uduwela M.B.A. (Sri J.), B.Sc. Special (Pera.) - Senior Manager - Operations
22. P H K S C Ranasinghe B.Sc. (Eng.) Moratuwa, A.C.M.A. (UK) - Senior Manager - IT Strategy & Solutioning
23. W M C O Panditharatne - Senior Manager - Employee Remuneration & Benefits
24. L S Sameera C.Eng., M.B.C.S., C.I.T.P., M.C.S. (Sri Lanka), C.M.A. (Australia) - Senior Manager - IT Software Development
25. R L Maheswaran - Senior Manager - Cinnamon Gardens
26. Ms G Arjuna F.C.M.A. (UK) - Senior Manager - Personal Financial Services
27. NY Liyanage N.D.T. (Civil Eng.) - Moratuwa, P.G. Dip. in Project Mgmt. (Moratuwa), A.M.I.E. (Sri Lanka), M.S.S.E. (Sri Lanka) - Senior Manager - Premises & Engineering
28. P Paranathan P.G. Exe.Dip. in Bank Mgmt. (IBSL) - Senior Manager - Pawning
29. AV Abeygunasekara M.B.A. (Colombo), B.Sc. (Colombo), A.C.M.A. (UK) - Senior Manager - Treasury
30. Ms A F M Fernando - Senior Manager - Corporate Account Relationship
31. Ms A C De Silva Gallage M.B.A. (Sri J.), B.B.A. (Special) - Colombo, A.C.M.A. (UK), C.P.A. (Australia), Dip. in Commerce (Uni. of PNG), I.C.A. Licentiate - Senior Manager - Head Office Branch
32. J K N M Perera - Regional Head - North Central Region
33. N R Somasiri M.B.A. (Sri J.), B.Sc. (Colombo) - Senior Manager - Credit Supervision & Recoveries
34. BV F Mendis - Senior Manager - City Office
35. M K N S Perera M.B.A. (Manipal) - Regional Head - Central Region
36. R M D J Ratnayake M.B.A. (Wales) - Senior Manager - Priority Banking / Greenpath Branch
37. B K Achan M.Sc. (Bombay), B.Sc. (Hons) (Calcutta), C.A.I.I.B. (India) - Chief Representative Officer - Chennai
38. Kausar Ali B.Com. - Chief Representative Officer - Karachi

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**Many Functions.
One Purpose.**

Management Reports

MANAGEMENT DISCUSSION & ANALYSIS

Strategic Priorities

At the beginning of 2011, the Bank set the strategic direction based on the following key priorities:

- Profitable Balance Sheet growth
- Operational Excellence & Cost Optimisation
- Strong Sales Culture and Higher Fee Income
- Governance, Transparency, Compliance and Social Responsibility
- Competent, Engaged and Motivated Team

The above strategic priorities have remained unchanged and will continue to receive our focus in 2012 as we execute and build on the momentum of these strategies.



Profitable Balance Sheet Growth

- Maximise utilisation of funding and capital
- Ensure the strength and security of the business by improving capital and funding positions
- Sustain the mobilisation of low cost funding

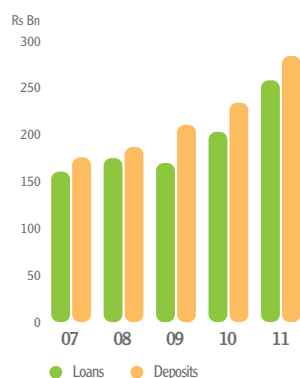
2011 highlights

- Recorded a strong growth of 25.8% in the loan book
- Posted a growth of 5.5% in net interest income despite pressures on margins
- Maintained above industry Net Interest Margin (NIM) amidst stiff competition
- Improved NPA ratio from 4.5% in 2010 to 3.9% in 2011
- Maintained CASA (Current and Savings account as a percentage of Total deposits) at 49.5%
- Strengthened capital base by raising over Rs 8 Bn through Tier I and Tier II funding

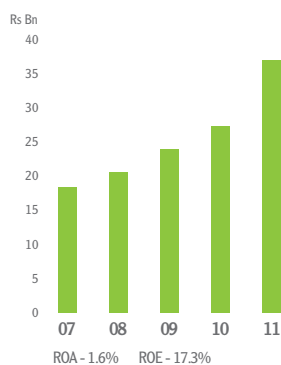
Focus going forward

- Continue to optimise the deployment of funding and capital across the network
- Mobilising funds to support anticipated growth in credit

Advances & Deposits



Capital



Operational Excellence & Cost Optimisation

- Continuously improve key areas of customer service
- Streamline systems and processes
- Ensure efficient cost management
- Upgrade technology in line with business strategy

2011 highlights

- Awarded the 'Best facilitator in Cheque Clearing Operations' among Commercial Banks in Sri Lanka by LankaClear.
- Successfully completed centralisation of high volume repetitive functions
- Contained controllable expenses despite aggressive expansion drive
- Progressed towards implementing IT initiatives in the areas of customer insight, risk, regularity support and system scalability

Focus going forward

- Strive to improve efficiency of processes
- Responsible management of costs within growth
- Enhance system capability to support perceived business growth

Best facilitator in Cheque Clearing Operations among Commercial Banks in Sri Lanka

Strong Sales Culture and Higher Fee Income

- Build momentum in Personal Banking business through a differentiated strategy
- Improve rates of cross-selling across the distribution network
- Focus on increasing non funded (fee) income

2011 highlights

- Outstanding growth in all product categories under personal financial services maintaining market leadership in key products
- 32% growth in total fee and commission income

Focus going forward

- Continue emphasis on cross-selling
- Continue focus on increasing fee based income
- Ensure that customers are aware of the benefits of the full suite of our products and services

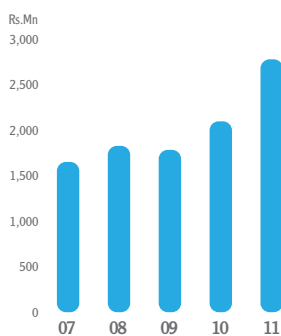
No. 1 in Leasing in the Banking sector

No.1 in Housing loan products by private sector banks

No. 1 in merchant card acquisitions

Increase in fee income by 32%

Fee Income



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MANAGEMENT DISCUSSION & ANALYSIS

continued



Governance, Transparency, Compliance & Social Responsibility

- Adherence to governance standards
- Compliance with regulatory requirements
- Maintain highest level of transparency through business philosophy and responsible reporting
- Address broader responsibility towards society with regard to financial inclusion, financial literacy and responsible lending

2011 highlights

- During the year the Board composition included five of the nine members who were independent and Non-executive
- 2nd Runner Up at the Top 10 Best Corporate Citizens Award 2011 and Category Award Winner for Governance & Economic Contribution awarded by the Ceylon Chamber of Commerce
- Overall Bronze award winner for the Best presented Annual Report 2010 awarded in 2011 by the Institute of Chartered Accountants, Sri Lanka
- Runner Up (Large category) at the ACCA - Sustainability Reporting Awards 2010 presented in 2011.

Focus going forward

- Continue introducing best corporate governance practices
- Introduce the Advanced Internal Risk Based Approach in meeting with BASEL II requirements and work with the Central Bank of Sri Lanka towards its BASEL III roadmap
- Continue to focus on financial inclusion and financial literacy in the wider community

Category Winner
 Governance Award
 presented by the Ceylon Chamber of Commerce at the Best Corporate Citizens Awards 2011



Competent, Engaged and Motivated Team

- Investing in our people for skill development, leadership development and diversity
- Encourage initiatives and new thinking at all levels.
- Being an unbiased, transparent and empathetic employer

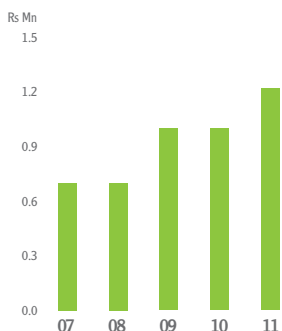
2011 highlights

- Profit per employee up by 18.5%
- Low attrition rates at all levels and zero attrition above senior management level during the year.

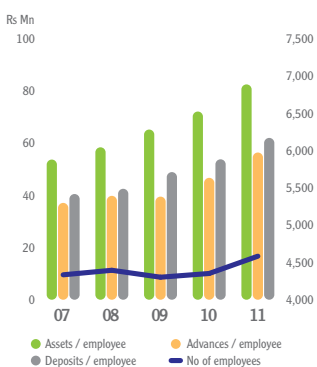
Focus going forward

- Create a more diverse team
- Continue to focus on employee development
- Continue to follow best HRM practices

Profit per Employee



5 year balance sheet growth per employee



CORPORATE BANKING

Did you Know?

In 2011 Hatton National Bank's corporate banking division supported more than 150 commercial projects across the nation at a value of Rs 55 Bn benefiting critical economic sectors such as tourism, power generation, infrastructure development, capital markets, agriculture and trade.

Focus for 2011:

To achieve strategic growth through supporting national growth priorities

On the back of strong domestic economic activity, as the full impact of interest rate cuts and other governmental policy stimuli introduced in the year 2010 precipitated a higher rate of national investment, the Bank's corporate banking division witnessed unprecedented growth during the first three quarters of the financial year. In the last quarter however, a prudent decision was taken to ease lending to achieve a sustainable annual growth which reflected a GDP growth multiple of approximately 3 times.

As the year commenced, expectations for growth in funding capital market activities were high especially in the form of margin trading facilities for the corporate sector. However, subsequent to tightening of Central Bank regulations pertaining to capital market funding, the Bank shifted its focus away from this product by developing an internal "cap". The Bank however, successfully carried out a number of securitisations during the financial year.

Sri Lanka's corporate sector continued to witness a series of consolidations during the year, with conglomerates merging as a result of stock movement. The Bank played a pivotal role in financing many of these consolidations through an array of financing products.

In view of the commendable growth in tourist arrivals and receipts during the year, and the strategic expectations of the sector in contributing to the overall health of the national economy in the years ahead, the Bank looked to actively support the tourism sector. In this respect, the Bank successfully converted tourism sector related financing opportunities that arose in the previous financial year whilst exploring further new opportunities in the year under review. As one of the largest private sector financial facilitators in the country, the Bank took a leading step towards supporting tourism development in the Eastern Province under the Government's "Nagenahira Navodaya" accelerated reconstruction programme. As a result, the Bank served as the sole financier of the first boutique resort and spa to be completed and opened in the tourism development zone of Passikudah. Tourism related projects propelled the growth of the loan book during the year. The Bank was also the sole financier of the first private sector sponsored water development project in Passikudah area on a "build, own and operate" basis.

Power generation continued to be a core area of focus as in previous financial years with particular interest in sources of alternative energy generation. As such, in 2011 the Bank supported a number of hydropower and wind power generation plants through project financing. The Bank's continued interest in these sectors has been precipitated by the growing global, socio-economic debate on the need for green energy especially as

the global population has crossed the 7 Bn mark in October 2011. During the year, the Bank laid emphasis on garnering a greater level of involvement in the renewable energy sector especially as it has been recognised as a strategic value driver, going forward.

Renewed interest in real estate and niche market condominium projects led to a spike in construction-led financing opportunities, precipitating financing of selected large-scale projects by the Bank. The ongoing focus on infrastructure development led to the Bank continuing its focus on infrastructure financing through provision of long-term finance. Moreover, the increased role of private sector participation in infrastructure development enabled the Bank to service a more diverse range of capital needs including project-wise leasing requirements.

The Bank took on board an increased percentage of trade business and opportunities across the country in 2011.

In the arena of Small and Medium Industries, focus was directed at developing opportunities in the tourism sector. In this regard, the Bank supported a growing base of small-scale tourism related service operators. Financing of the tea smallholder sector was viewed with optimism at the start of the financial year; however, the growing uncertainty pertaining to the vivacity of the global economy together with changing domestic weather patterns dampened the pace of investment into the Tea sector during the latter part of the year. Nevertheless, the Bank will continue to observe both the Tea and Tourism sector development in the year ahead given their demonstrated capability for growth.

Astute, yet innovative strategies, a focus on quality, enhanced portfolio monitoring, controls and continuous prudent evaluations, were the hallmarks for Corporate Banking operations during the year under review.

Objective for 2012:

To maintain portfolio growth and health despite global challenges

The financial year ahead is expected to be one of challenges largely due to continuous global economic downturn and its resultant effects on the domestic economy. The vulnerability of the Euro zone nations may heighten caution in the domestic economy, thereby hampering optimism and demand for finance.

Nevertheless, the Bank is confident that the national economy will continue to perform commendably as per expectations and in view of this, the Bank's corporate banking will continue to focus on supporting thrust sectors in the medium term.

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MANAGEMENT DISCUSSION & ANALYSIS

continued

SMALL AND MEDIUM ENTERPRISES

Did you Know?

Hatton National Bank disbursed over Rs 20 Bn to SME individuals and entities in 2011.

Focus for 2011:

To establish and empower SME cells in each province of the country to effect a quantum change in SME services.

Recognising the importance of small and medium scale entrepreneurs to the growth of the national economy, Hatton National Bank positioned itself during the year under review as the Small & Medium Enterprise Development Partner (SMEDP), in an attempt to foster sustainable development across the nation. The development of the Bank's SME service offer was in direct alignment with the Governments' vision for precipitated economic development and the recognition of SMEs as a critical component of economic progress for the nation.

Despite having served the SME segment through Development Banking and Micro Lending for over 40 years, the Bank strived to meet specific SME needs during the year 2011 through the establishment of a dedicated SME division and a network of SME cells across the country. Offering a full range of financial solutions together with an array of benefits and advantages, the Bank sought to provide SMEs engaged in different types of businesses with the opportunity to realise their full potential and achieve their goals of business expansion and personal growth.

Launched with the intention of raising small and medium scale enterprises to a national level by building a stronger and a more structured SME community, the Bank specifically tailored the benefits on offer to suit the needs of SMEs. Further value additions such as inclusion of insurance enabled the Bank to garner a greater portion of the SME business. The Bank commenced its programme of full financial assistance by offering support to new, existing and start up ventures in agro industries, animal husbandry, horticulture, food processing, fisheries, construction, wood based products, retail and other small service business categories.

From a functional perspective, during the year under review, processes were systemised and the Bank established SME cells in each Province. The cells were armed with SME specific skills and expertise, enabling the Bank to carry out technically sound appraisals and evaluation of service needs and credit proposals. The success of the new management approach to the SME function was evident by the end of the financial year, with the Bank disbursing credit in excess of Rs 20.0 Bn through the SME network, totalling over 20% of the Bank's loan book whilst containing the NPA from 8% in 2010 to 5.1% in 2011 for SME related credit.

With a view to enhance accessibility to SMEs, the Bank entered into a Memorandum of Understanding with the Federation of Chambers of Commerce of Sri Lanka (FCCISL) during the year, to promote a range of financial services to its membership. The signing of the MOU is considered a critical milestone in the development of "The Small & Medium Enterprises Development Partner" (SMEDP) as a product as well as the development of the SME category in Sri Lanka. FCCISL is the apex organization for the Chambers and Associations in the country and incorporates 59 Chambers and 29 Regional Chambers. For the past three decades it has actively been involved in SME development. With access to over 40,000 FCCISL members island-wide, the signing of the MOU between the Bank and FCCISL is considered a key step forward in the development for SMEs in Sri Lanka as it opens doors to many SMEs who require comprehensive financial solutions, thus partnering the rise of an entrepreneurial nation.

Furthermore, a SME entrepreneur training programme developed with the support of IFC was inaugurated in collaboration with the Matara Chamber of Commerce. This programme will continue.

Objective for 2012:

To further strengthen the Bank's SME structure and hierarchy whilst enhancing the scope and scale of services.

In keeping with the Government's vision of developing the SME segment and making it the growth engine of Sri Lanka, the Bank plans to continue to upgrade SMEDP by broadening the SME sectors under its purview whilst also enhancing the range of services on offer.

Whilst creating a quantum change in the approach and focus of financial assistance to SMEs, the Bank looks to continually develop the SME structure to build a more robust and efficient system that has the capability to absorb greater capacity for service enhancements. The ultimate objective is to formalise a hierarchy for SME function, thereby giving greater impetus through a SME Committee comprising of both network and head office representation, focused risk management team and a recoveries team. The main objective of this transition is to create dedicated resources whilst retaining greater agility in catalysing SMEDP growth.

PERSONAL FINANCIAL SERVICES

Did you Know?

In 2011, Hatton National Bank's personal financial services portfolio grew by over Rs. 23 Bn through enhanced access to finance and product development, supporting thousands of people to pursue their dreams.

Focus for 2011:

To propagate access to finance as a means of national wealth creation

Throughout its operational history, Hatton National Bank has strived to infuse the people of Sri Lanka with greater entrepreneur empowerment - across every stratum of demography and geography - by providing solutions that empower and enhance livelihoods. Its ability to empathise with the people of the nation has earned it the recognition of being a financial institution that goes beyond mere banking to an undisputed "partner in progress" of people's lives. With a commitment to evolve the Bank's customers' aim for new heights, Hatton National Bank continues to leap forward with innovative products and services.

In recognition of this commitment to excellence, Hatton National Bank was named the Best Retail Bank in Sri Lanka in 2010 at the 10th International Excellence in Retail Financial Services Awards Programme for the 4th consecutive year. The Bank received the award at the International Excellence in Retail Financial Services 2011 Awards ceremony, held in conjunction with the region's most prestigious retail banking event, the Excellence in Retail Financial Services Convention. The awards programme, administered by The Asian Banker and refereed by prominent global bankers, consultants and academics, is the most prestigious of its kind. The transparent award evaluation process uses a balanced scorecard approach and a comprehensive methodology to evaluate the strength of individual bank's retail banking businesses that involve extensive research and probing interviews, and taps the combined experience of a team of experienced researchers.

As a Bank that has from its inception been driven by the needs of its retail customer base, the Bank's personal financial portfolio comprises of products that cover a spectrum of retail banking services designed to meet every financial need of a retail customer. In 2011, the Bank persisted towards its strategic objectives by focusing on the realisation of strong penetration of retail banking services across the nation, whilst maintaining lending portfolio quality. In living up to its positioning of being a "partner in progress", the Bank accelerated penetration and accessibility across the nation to even the most remote of locations with financial solutions and financial literacy programmes that have enabled Hatton National Bank to truly justify its market position as a leader.

Developing accessibility to finance through geographic penetration

In 2011, the Bank increased its network to 240 customer centers across Sri Lanka from 205 in 2010. During the year, 35 new centers were added to the network whilst 7 relocations aided greater access to customers. During the year, in support of national growth strategies and with a view to catalyse economic activity, the Bank focused its network expansion efforts across the nation with penetration into the less accessible regions.

The network upgrade was implemented during the year with a view to enhance customer service at every point of customer access. With greater responsibility meted out to extension offices, the Bank believes that the customers will be better served with access to a larger portfolio of services even in the most remote of locations.

The Bank looks to continue to execute an enhanced network strategy with the intention to operate extended-hour banking across all regions. This will entail the operation of Sunday banking centres, seven - day banking branches in 2012, and the commencement of specialist centres that focus on a limited number of financial services for the retail customer.

Automated Teller Machine (ATM) Penetration hits 655 points

The Bank, during the year under review, remained committed to its strategy of precipitating accessibility by aggressively expanding its electronic delivery channels, specifically through enhanced penetration of the ATM network. The Bank is well regarded as having the widest reach of ATMs within Sri Lanka. The network caters not only to the Bank's own debit and credit card holders, but also provides access to VISA, and MasterCard credit and debit cardholders.

In 2011, it reached a milestone with the commissioning of the 400th ATM. During the year, 50 new ATM locations were added to the network, which at the end of 2010 consisted of 350 locations. As at the end of the financial year under review, the Bank's ATM network included 38 on-site (at customer centre premises), and 12 off-site ATMs spread across the island and includes three drive-thru ATMs located at the Bank's Head Office, "HNB Towers" and Nittambuwa, and at its Priority Banking Centre. During the year, the Bank also collaborated with Sampath Bank to collectively enhance ATM accessibility to both

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MANAGEMENT DISCUSSION & ANALYSIS

continued

Customer centres: New

Location	Commencement
1. Kinniya	21/03/2011
2. Siyabalanduwa	28/03/2011
3. Udappuwa	04/04/2011
4. Nanattan (Ext Mannar)	08/06/2011
5. Ginigathhena (Ext Nawalapitiya)	17/06/2011
6. Uppuveli	23/06/2011
7. Anamaduwa	30/06/2011
8. Kaithady (Ext Chavakachcheri)	04/07/2011
9. Peliyagoda (Ext Wattala)	11/07/2011
10. Dickwella	15/07/2011
11. Uhana	29/07/2011
12. Ingiriya (Ext Horana)	05/08/2011
13. Devinuwara (Ext Matara)	11/08/2011
14. Karaitheevu	18/08/2011
15. Medirigiriya	09/09/2011
16. Serunuwara	15/09/2011
17. Mullaitivu	22/09/2011
18. Padaviparakramapura	29/09/2011
19. Kundasale	03/10/2011
20. Achchuveli	10/10/2011
21. Kodikamam	10/10/2011
22. Mullipothana	18/10/2011
23. Muttur	18/10/2011
24. Maruthamunai	24/10/2011
25. Kallady	24/10/2011
26. Aralaganwila	27/10/2011
27. Kolonnawa	18/11/2011
28. Kilinochchi 2nd	28/11/2011
29. Dehiattakandiya	05/12/2011
30. Galaha	16/12/2011
31. Hakmana	20/12/2011
32. Urubokka	20/12/2011
33. Kalawana	23/12/2011
34. Hikkaduwa	28/12/2011
35. Bandaragama	28/12/2011

Micro Banking Unit

Location	Commencement
1. Siyabalanduwa	28/03/2011
2. Udappuwa	04/04/2011
3. Uhana	29/07/2011
4. Serunuwara	15/09/2011
5. Mullipothana	18/10/2011
6. Aralaganwila	27/10/2011
7. Hakmana	20/12/2011
8. Urubokka	20/12/2011

banks' customer bases, significantly increasing accessibility to over 655 ATM points. In addition to settlement of HNB Credit Cards, the Bank furthered its facilities for utility bill payments with the addition of a number of new utility payment services.

E-Banking gathers momentum as an alternate channel

The Bank's Internet Banking Service, "Virtual Branch" continued to garner increased traffic and transactions during the year. The integration of the Virtual Branch to Finacle Internet Banking served as a secure platform for increased transaction processing and the Bank witnessed a 300% increase in transactions and a 55% increase in the number of users.

Dual factor authentication was introduced during the year as a security enhancement measure in addition to account related transaction security. The Bank also introduced an array of payees for online utility payments to further convenience the e-banking customer base.

The usage of SMS and Mobile Banking evidenced a growth of 70% during the year with over 1200 transactions carried out monthly on average at a total transaction value of Rs 190 Mn.

Deposit Mobilisation

Whilst deposits are fundamental cornerstones of banking, a sound deposit mix determines the extent to which financial institutions can leverage resources towards a range of services. The low interest rates that prevailed in 2011, posed challenges for deposit mobilisation. However, through prudent mobilisation strategies, the Bank recorded commendable growth across the entire range of deposit products. The Bank recorded a 23% growth in total Rupee deposits that stood at Rs 236.3 Bn at the end of the year under review whilst total Rupee savings grew by a commendable 15% to Rs 96.2 Bn.

The Bank optimised the use of low cost deposit mobilisation strategies during the year and continued to maintain growth of the deposit base despite interest sensitivities. Low cost savings witnessed a growth of 12% at the close of the financial year.

HNB Pathum Vimana, the Bank's flagship deposit mobilisation tool for the past 19 years, played a critical role in garnering a greater share of the savings deposits during the year. Targeted at the Bank's entire customer base across the spectrum of geo-demographics, Pathum Vimana effectively attracted a significant flow of funds into the Bank through low interest cost savings accounts.

Capital Savings posted a 27% growth in the deposit base to Rs 17.6 Bn. With a greater affinity towards urban markets, Capital Savings, though beneficial to the customer are less cost effective to the Bank due to high cost of funds incurred by high interest rates.

Rupee Term Deposits too registered a sound growth trend of 45% in 2011. A senior citizens scheme supported both savings and term mobilisation serving to provide better returns to this customer segment.

Minor savings products - Singithi Kirikatiyo and Singithi Lama - aimed at inculcating the habit of thrift amongst children, effectively drew in over Rs 1.2 Bn during the year, recording an increase of 17% in the minor savings deposit base. The Student Banking Units continued to play a critical role in this regard. These units have successfully instilled a strong savings habit amongst children and have served as a source of inspiration to countless children across the nation who have in turn preached the benefits of a savings culture to their peers and parents, thus shaping beliefs and changing behaviours.

Foreign Currency deposits witnessed 13% growth during the year despite the instability in the global economy. NRFC and RFC accounts pulled new savings deposits by virtue of the success of the HNB World promotional drive.

Pawning

Pawning as a product has emerged as a focal line of business in the retail sector. It is a significant contributor to the profitability of the Bank whereby its influence on the bottom-line has consistently grown sharper over the past years. The change in perception of the product amongst consumers - with greater acceptance as a financial tool - and the changes in usage have placed pawning as a viable financial tool for many consumers.

In 2011, research indicated that of the Bank's pawning customer base, over 70% used the product as a source of short term finance for business, whilst 10% of individuals engaged in agriculture used the product to procure working capital, and 20% for consumption.

The popularity of the product, therefore served to accelerate the industry growth over 60% during the year. Hatton National Bank's portfolio growth mirrored the industry growth momentum during the year, with the pawning portfolio growing by 28% as at the end of the financial year. The Bank's pawning portfolio is characterised by its quality. Whilst aggressively marketed, the Bank is conscious of the need for ethical lending and concertedly follows a series of quality evaluations prior to lending. This lack of compromise on the quality of the portfolio is evident in that the Bank enjoys below industry Non Performing Advance (NPA) levels of approximately 0.11%. As a result low capital losses have firmly established pawning as a core in the retail product line.

Internal processes were revisited and improved during the year to ensure that speedy facilitation of customer requests and service levels is further enhanced with Saturday pawning introduced across a greater number of branches and customer centres across the branch network.

Leasing

In 2011, the leasing industry grew sharply, largely due to a growth in the motor vehicle market, consequent to revisions to import taxation. This market growth affected the entirety of the leasing industry which recorded around 60% growth during the financial year. The Bank recorded above market growth with the leasing product posting over

76% growth during the year and continued to retain its position of market leadership in the Banking sector in 2011.

The above market growth was precipitated by the Bank's extensive network and the offer of leasing as a service across almost all branches. Value additions such as offers for professionals, and duty permit holders further facilitated growth. Expansion of product offers in the North and East also supported the growth momentum.

The Bank maintained the quality of the leasing portfolio wherein effective monitoring and credit evaluations rendered low NPA levels with a consistent focus on portfolio quality and recoveries.

Enhanced customer relations and a series of tactical promotions worked hand in hand to strengthen the brand and to consolidate the business. The Bank conducted unique promotions across Sri Lanka in association with vehicle dealers.

Housing Loans

In the area of housing loans, the Bank's flagship product "Shanthi" continued to maintain leadership position amongst housing loan products offered by private sector banks. The financial year under review remained one of the best years in terms of profitability. During the year, new loans disbursed exceeded by 61% and stood at Rs 21.6 Bn.

The base for new business generation laid in strategic tie-ups with reputed property developers through tripartite agreements. Improved service delivery was facilitated through the branch network and legal aspects of the loan disbursements were dealt with greater agility to ensure shorter turnaround times. Step up housing loans were introduced during the year as a new product development enabling a loan to be procured by a parent in conjunction with a son or a daughter who has the capability to contribute to the loan repayment.

The priority for the year, as in previous years, remained in the maintenance of the portfolio quality with many control measures undertaken to contain the NPA levels.

Personal Loans

In 2010, Hatton National Bank re-positioned the "Dream Drive" loan scheme targeting professionals. As a result of the demand arising from import tax revision in 2010 and 2011, the scheme was commendably accepted by customers, leading to loan growth in excess of 100%. The scheme was tailor-made to suit the requirements and convenience of professionals with the aim of providing a total package.

During the year, through prudent credit evaluation the Bank was successful in reducing its NPA on Personal Loans to 4.5%. A focused strategy in providing a diversity of personal loan products enabled the Bank to balance its portfolio risk. Very competitive rates together with different interest rate options from floating to fixed and flexible repayment tenors enabled the Bank to differentiate from the rest of the industry.

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MANAGEMENT DISCUSSION & ANALYSIS

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Credit Card Services

The Bank continued to hold the number one position in merchant acquisition and expanded the card base by 15% during the financial year. The back end systems were upgraded in 2011 to Prime III with a view to enhance security aspects and to be compliant with EMV (CHIP) Acquiring security requirements of Europay, Master and Visa specifications. In addition, fraud monitoring tools were enhanced in line with the Bank's strategy to continually develop security measures and the Bank, successfully implemented end-to-end Terminal Line Encryption, to safeguard payment card transactions through POS terminal network.

Periodic promotions to augment card usage led to an overall increase in the card usage by 28% from that of the previous financial year. In the Maldives, the Bank's credit card operation continued to record growth and was evident in the increase of turnover by 19.6%. The Visa Debit Card base grew by almost 111% during the financial year with a significant increase in card usage, both at Point of Sale and ATM.

Bancassurance

In 2011, together with HNB Assurance, the Bank took the Bancassurance product to new heights by rolling out the product across 120 branches. As a result of this expansion drive, Bancassurance recorded a commendable growth of 34% in policy numbers and 68% in policy values. Bancassurance continued to occupy the position of industry leadership during the year.

Priority Banking

The Bank continued to cater to the High Net Worth segment through its Private Banking arm "The Club HNB", at its Greenpath Branch. However, in 2011 the Bank recognised that there remained another segment, which needed Priority level service. This level of service was needed not only in Colombo and its environs but also in cities outside of the greater Colombo area. Thus, a Priority Banking arm was created under the brand "Crystal Circle" to serve High Networth customers throughout the island. As a result of this in 2011, Hatton National Bank launched the first Crystal Circle unit at its modern and luxurious premises at the Negombo Metro branch. The unit was staffed by the crème de la crème of financial advisors of the Bank. These officers are able to serve premier clients at service levels, which exceed the expectations of the clients. The concept of Crystal Circle is centered on customers to personalise their banking needs. From the Priority Banking centre with reserved parking, to on call financial advisory specialists, HNB Crystal Circle seeks to save customers' time and go the extra mile to serve their clients. Later in the year, two more Crystal Circle units were opened in Kandy and Wellawatte. Through Crystal Circle, the Bank intends to extend Priority Banking experiences to clients across the country. With the launch of these units, the Bank rolled out its vision in providing unique banking services to the entirety of Sri Lanka.

Objective for 2012:

To maintain momentum of growth across all personal financial services and products.

DEVELOPMENT BANKING

Did you Know?

Hatton National Bank assisted over 20,000 micro/ rural entrepreneurs in 2011 by disbursing Rs 6.2 Bn in micro/ agri credit. Accessibility to the Bank's development banking products was increased with the opening of an additional 21 customer centres in rural towns and 8 dedicated micro-banking branches in rural pockets, island wide.

Focus for 2011:

To expand business through geographic penetration and new product development

As a premier private sector commercial bank in Sri Lanka, Hatton National Bank has been actively involved in rural development during the last four decades. The Bank has been at the forefront by providing financial services to the rural community. The Bank promotes a number of rural sector refinance and non-refinance credit lines and provides a comprehensive package of financial services for the development of the rural economy. The Bank's wide network of customer centres especially in the outstations has disbursed over Rs 20 Bn in agri rural sector loans. To reinforce its commitment, the Bank has currently deployed more than 140 field officers including microfinance / agricultural experts to assist the rural sector banking operations.

In 2011, the Bank followed a concerted strategy of expansion in the area of development banking, twinning enhanced accessibility / financial literacy with new product development. These initiatives enabled the Bank in 2011 to achieve a 43% growth in volumes. With a sectoral importance on agriculture, the Bank lay emphasis on growth in agri-based businesses and continued to partner the progress of entrepreneurial spirit in the Northern and Eastern provinces.

Entrepreneur Development

Over the years, the Bank has gained wide exposure in serving the rural community and has gone beyond the normal engagement of providing financial assistance by finding markets for the products that are produced through the rural sector. To facilitate this process in 2011, the Bank organised and conducted a number of trade fairs in the rural hamlets of Sri Lanka and was the main sponsor of "AgriBiz" exhibition held in the Eastern province. In addition, 27 farmer awareness and entrepreneur development programmes to assist smallholder farmers and micro entrepreneurs were held during the financial year.

The Bank is of the view that the Sri Lankan Farmers can graduate from traditional cultivation practices to become commercially viable agriculture entrepreneurs only through the creation of greater linkages and partnerships. It is with this objective in mind that the Bank has fostered and sustained its tripartite partnerships with corporates who have the commercial muscle to assist and engage with smallholder farmers. In 2011, the Bank further strengthened its partnerships with CIC and Hayleys making greater inroads into the creation of opportunities for the farming community to market their produce, and

procure investment in significant capacity building initiatives to drive sustainable revenue generation. In this area, the Bank will look to develop this network of partnerships across the value chain in the future.

During the year, 19 agri-graduates and 20 Microfinance Field Officers were recruited into the Bank's Development Banking efforts with a view to enhance its level of engagement with existing and potential micro banking customers. They are located around rural communities and act as conduits between the Bank and the rural community. However, as technically proficient agricultural experts, they assist farmer communities to develop their farming know-how whilst also facilitating them with their financial development.

Financial Inclusion: Micro Banking

Twenty-two years ago, Hatton National Bank's world-renowned Microfinance programme, "Gami Pubuduwa" embarked on a journey to create greater access to financial services to the people at the bottom of the economic pyramid. One of the very first Gami Pubuduwa efforts was initiated in the hamlet of Siyambalanduwa with the opening of a small microfinance unit located in the Siyambalanduwa town with a Microfinance field officer to identify and support the farming community of the area and to also create greater access to financial services. During the past twenty-two years the Bank has carried out diverse initiatives to support Micro Entrepreneur creation and to take the smallholder beyond farming to become small scale Entrepreneurs. In 2011, after 22 years of commitment, engagement and involvement with the people of Siyambalanduwa, the Bank opened a fully-fledged customer centre with all banking facilities to the people of Siyambalanduwa, as a testament to the economic progression of the village and its people.

To create greater accessibility to the Bank's development banking products, 8 dedicated micro-banking customer centres were opened in rural pockets of Sri Lanka in 2011.

Ran Govi Saviya

Analysis of the Bank's Pawning customer portfolio indicated that approximately 20-25% of the pawning portfolio comprised of farmers seeking to obtain additional working capital. As a part of its innovative initiatives to develop the farming community in Sri Lanka, the Bank in 2011 launched the loan scheme "Ran Govi Saviya" targeting the agricultural sector of the nation.

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MANAGEMENT DISCUSSION & ANALYSIS

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The primary objective of “Ran Govi Saviya” is to provide the farming community with a sense of security and to ease the financial burden of high finance costs. Through “Ran Govi Saviya” finance is provided to the farmer by way of a loan at a low interest rate in exchange for their Gold. Through this initiative, the Bank looks to facilitate the development of Sri Lanka’s rural agricultural economy and empower the Sri Lankan Farmer to harness his latent potential.

Adhishtana

The Bank’s strategy towards financial inclusion has been a strategy of development-focused inclusion for Youth and Women. In 2011, the Bank partnered with International Fund for Agricultural Development (IFAD) to develop financial services products for vulnerable women dependent on migrant remittances. “Adhishtana” is a unique savings offering that avails the sender and receiver a host of benefits and services including micro credit, micro housing finance and micro insurance. The product aims to include those who are outside of the banking network to become integrated into the banking process and thereafter move across the continuum of entrepreneurial development. The product is viewed primarily as a tool for inclusion and empowerment of women who are otherwise dependent on remittances from their spouses working abroad. Launched as a pilot project in July 2011, Adhishtana was rolled out to the entire network in November 2011.

Yauwanabhimana

Yauwanabhimana is an innovative programme of the Bank, that aims to empower Youth economically. Developed in partnership with The Small Enterprise Education and Promotion Network (SEEP network) and the Mastercard Foundation US, it comprises of four components - financial education, a savings product that aims to kindle a relationship with the Bank, and youth focused loan products which facilitates credit for education, entrepreneurial efforts, housing, vehicle and personal needs as well as a tailor-made insurance product at a lower premium. The programme is enriched by the eight corporate partners sharing industry best practices and emphasising on becoming an employable youth than focusing solely on paper based qualifications. The programme presents an opportunity for youth to have one to one contact with the personnel of the top management and directors of the corporate partners (CIC, Hayleys, Dialog, Holcim, DIMO, The British Council, World University Studies Canada (WUSC) and the University of Colombo) in a bid to shape and develop the participants to become more economically and commercially viable. In addition, the Bank developed a dedicated youth web site www.ya.lk and also continues to conduct island wide youth development programmes with the participation of the corporate partners.

These initiatives focused on capacity building programmes, micro entrepreneur skills development, financial education and providing the technical knowledge, best practices and creation of market linkages to the youth, women and micro entrepreneurs. The Bank is of the belief that it is only through greater inclusion and empowerment of the bottom tier, that it can successfully catalyse development and thereby enrich the national wealth.

Objective for 2012:

To further strengthen the strategy for financial inclusion

The Bank’s strategy for Development Banking and Financial Inclusion is long term. It acknowledges that the process of inclusion to entrepreneurial development is in itself a step-wise development process requiring significant investment in terms of time, resources and capital. In light of the above, the focus continued to be on the inclusion of the small holder farmers and small scale entrepreneurs through the effective dissemination of technical know-how and financial literacy, thereby assisting them to become more commercially viable as agri entrepreneurs transposing from traditional cultivation practitioners. As such, the future objective will be to continue to strengthen and widen its efforts to enhance inclusion of a greater population of people from the bottom of the economic pyramid. Given national priorities for economic development, the Bank views its development banking efforts as critical to the long-term prosperity of the nation.

INTERNATIONAL OPERATIONS

Did you Know?

Hatton National Bank supported more than 461,000 inward remittance transactions in 2011 from Sri Lankans abroad and these transactions were totally valued at USD 853 Mn from a network of 80 inward remittance partners in 18 countries.

Focus for 2011:

To establish strategic remittance relationships in new and unsaturated markets where potential has not been fully harnessed and in new markets that have potential

Inward worker remittances demonstrate strong growth

Sri Lanka recorded a USD 4.12 Bn inflow of worker remittances in 2010 and the forecast for 2011 was to exceed USD 5 Bn. Inward remittances mainly from the Middle East supported the growth in 2011 and according to the Central Bank of Sri Lanka increased numbers in skilled labour migration spurred the momentum of remittance growth in 2011. Government's strategy is focused to achieve a commendable increase of approximately 25% to USD 6.5 Bn in 2012.

The trend in Hatton National Bank's inward worker remittances, mirrored the National inward remittances growth curve with the Bank recording 23% growth in worker remittance inflow in 2011 over that of the previous year. In absolute terms a total of USD 853 Mn was received by the Bank compared to USD 679 Mn in 2010 and the Bank successfully defended its position as the holder of the 2nd largest foreign currency base in the Sri Lankan banking sector for yet another year.

Hatton National Bank's strategy in 2011 was to review markets in which the true potential had not been tapped and to identify new markets to harness inward remittance inflows. Thus in the year under review, the Bank deployed a dual strategy of revamping existing remittance relationships and establishing new relationships, whilst concurrently seeking to place its own representatives in these key markets.

Deployment of the Bank's online remittance processing system "HNB Cash Xpress" which is proprietary to the Bank, across a greater number of remittance relationships played a key role in the enhancement of the delivery process which in turn contributed to the growth in inward worker remittances. Continuous upgrading of this remittance system is ongoing in order to ensure value addition to the remittance partners and the eventual beneficiaries of these remittances.

The Middle Eastern market continues to be vital for migrant workers from Sri Lanka. Despite indications of saturation and increased competition, Hatton National Bank pursued a strategy to utilise its Exchange Houses in Oman and UAE to garner a greater share of inward worker remittance business. Majan Exchange in Oman has 02 outlets in central localities, while Delma Exchange United Arab Emirates operates

from 05 outlets located in close proximity to industrial zones and strategic city center locations.

Hatton National Bank has operated as the Super Agent for MoneyGram since 2008 and has 02 sub representatives under this Super Agency which enhances customer access points by a further 73 outlets over and above the network of the Bank.

From an overall perspective, initiatives towards strategic alliance with remittance partners is expected to strengthen and enhance the coverage from remittance originating countries to fortify Hatton National Bank's position as an inward remittance handler.

Objective for 2012:

To enhance worker remittance volume growth by capturing opportunities in markets with potential

In order to match national objectives, Hatton National Bank will continue to support worker remittances into Sri Lanka through medium term strategies with a focus on establishing new remittance relationships and growing existing remittance relationships to meet the change in composition of the migrant worker population.

International Services

As in previous years, the services for letters of guarantee relating to new infrastructure projects in the country have been sought after and our longstanding relationships with Correspondent Banks overseas have supported the cause in sectors such as Water Management, Health Care facilities, Sewerage and Power Generation.

This trend is expected to continue in 2012 in view of the National Strategy giving prominence to infrastructure development around the island.

Trade Services

In the financial year under review, strong economic fundamentals spurred demand for trade services. International Trade operations in 2011 continued to demonstrate an upward trend thereby increasing the Bank's Non Fund Income from Trade by an approximate 30% from that earned in the previous financial year.

Demand for trade finance also demonstrated growth led largely by infrastructure development, expansion of imports due to prevalence of higher disposable income and a perceptible growth in the tourism and

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hospitality industries. However, despite a volume appreciation of trade finance business, a scenario of low interest rates constrained the returns on fund income in value terms.

The Bank's Trade Service operations in 2011 remained in conformity with ISO 9001: 2008 with certification secured from Bureau Veritas (India). The certification has been a critical foundation upon which the reputation and credibility of the Bank's Trade Services have been built upon, and remains key to its future successes. In addition, the Bank's team of highly qualified and experienced professionals who have the expertise and know-how in trade services has placed the Bank in the realm of one of the best trade services teams in the industry. This has been further leveraged by the fact that the team includes Certified Documentary Credit Specialists (CDCS).

In the medium term, the economic expectations for the nation will be a key factor in enhancing the demand for Trade services, and as such it is expected that the Bank will benefit from the forecast growth in sector specific economic activity over the next five years. This potential will also be largely enhanced by the viability of bilateral trade, including the

exploitation of Free Trade Agreements between India and Pakistan which will further the opportunities for the Bank's International Trade Operations. The presence of an experienced team across representative offices in India and Pakistan will serve to facilitate this initiative. The Bank is also mindful of the huge growth potential in intra-Asian trade expected during the next decade and is developing a strong network of correspondent relationships in this region.

From an operational perspective, the Division looks to continue its focus on employee quality with emphasis on further enhancing the number of Certified Documentary Credit Specialists (CDCS) employed to handle Trade operations. In the upcoming financial year precedence will also be given to customer education in the regions, in an effort to develop SME customers to productively utilise a greater number of Trade Service Products. As such, focused and well-structured seminars and workshops will continue to remain a key strategy for business development.

Further enhancements to the Trade module in the newly introduced Finacle system with a view to provide a more efficient service is a key objective for 2012.

TREASURY

Did you Know?

Hatton National Bank's treasury operations saw client volumes increase by 21% in 2011.

Focus for 2011:

To maintain interest income across all indices/sectors through prudent asset & liability management

In 2010, the world economy, led by emerging markets, staged a remarkable rebound from the deepest global recession since the 1930s. Growth moderated in 2011, however, as the global economy showed signs of instability. With economic activity gradually picking up in the United States, the European crisis - which is pushing Europe into a shallow recession, and possibly much worse - has reclaimed the spotlight. In response the Treasury prudently reduced investment and proprietary positioning exposure to the euro zone during the latter half of 2011. Though the expectations are that the world economy will continue to grow in 2012, its pace will slow further and the downside risks will be significant. With little economic space and even less political will for more expansionary policies, policy makers are called upon to focus on preventing a catastrophe in Europe. Arguably the most critical challenge this scenario will bring would be in the sphere of financing/funding, where established Western sources of financing may be more difficult to access. As Sri Lanka's growth far outpaces available domestic resources, the Bank has embarked on the mission to source other, non-traditional avenues of financing and capital augmentation, which should bear fruit in 2012.

During 2011, the Treasury's focus was primarily on Asset and Liability Management, as robust loan growth across the Industry and at the Bank rapidly used up surplus liquidity. The year began with banks holding high levels of liquidity and seeing low growth in advances. Borrowing customers of good credit standing enjoyed strong bargaining power, and as a result, margins narrowed with banks actively soliciting loan volumes at the expense of spreads. The Bank's view that a dearth of liquidity in the latter part of the year would pressure interest rates upwards was proved valid. Advances grew 26%, at a much faster pace than deposits which grew by 21% during the year. Market liquidity declined sharply from Rs 113 billion at the beginning of 2011 to a deficit of Rs 5 billion by its end. Competition for deposits as a means to liquidity and loanable funds heated up in the final quarter, driving up important market indicators such as the AWPLR, AWDR and government securities rates. In response, the Bank embarked on many

funding initiatives, and their effect is seen in interest margins that have managed to hold their own despite aggressive competition driving margins down across the industry. The Treasury set up large treasury funding lines with its offshore counterparties in order to reinforce funding of the Bank's balance sheet. The average maturity of rupee borrowings was lengthened through term financing. Deposit and asset re-pricing occurred with greater frequency, with focus shifting in the later stages of the year to selective lending and asset quality vis a vis loan pricing. The second half of 2011 saw the Bank raising equity capital through a rights issue and debt capital via a listed debenture, both of which boosted the Bank's leveraging capabilities and liquidity.

In 2011, Hatton National Bank's treasury saw stable foreign exchange earnings in an environment of stable exchange rates. Customer transaction volumes grew on the back of a more favourable international trade framework with reduced import tariffs boosting imports. Interest income increased as renewed economic optimism accelerated loan growth. Thus, for the best part of the financial year most indicators led well. However, towards the end of the financial year under review, credit aggression tapered due to the drying up of liquidity and rising cost of funding at banks. Despite the overall brisk and positive trends in 2011, a scenario of intense competition in the banking and financial services sector led to narrowing interest margins, while rates on government securities remained stable for much of the year offering limited trading opportunities. The final weeks of 2011 however, saw a sharp increase in interbank and bond yields across the yield curve, sharply impacting interest income and capital gains. The Bank through 2011 consciously reduced the duration of its fixed income portfolio so as to mitigate the impact of rising interest rates.

Objective for 2012:

To overcome the challenges resulting from global recessionary pressures.

There are encouraging signs for the world's largest economy as 2011 comes to an end, with exports rising, consumers spending more, the housing market improving and employers shedding fewer jobs.

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MANAGEMENT DISCUSSION & ANALYSIS

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But downside risks remain; the unresolved debt crisis in Europe, the slowdown in China, the world's fastest growing economy and U.S. stimulus spending cuts pose a serious challenge for policy makers as 2012 begins.

If as many fear, Europe slips back into another recession, export growth in countries such as Sri Lanka that are heavily dependent on those countries, will reduce. Forecasts indicate that Europe will enter a recession, the United States will continue to register below average growth and emerging economies will witness a dimming of economic prospects leading to world growth falling below the 2.5% recession threshold.

In sharp contrast, Sri Lanka is expected to maintain its growth momentum to achieve 8% growth in 2012.

In such a scenario, the Bank's treasury operation foresees the need to overcome the effects of the global crisis; especially when income from trade transactions may fall. However, on the positive side, historically

low yields in developed markets and currencies will provide the Bank with new routes of access to foreign funding, enabling the Bank to secure funding at a reasonable cost. On the market side, greater competitive behaviour by market participants will continue to pressure margins and constrain earnings.

The proposed reduction in credit growth would also be a challenge given the rising demand for funds for long term projects. The Bank is committed to strike a delicate and prudent balance in prioritising credit disbursements during the year.

The Bank expects 2012 to be a challenging year with the critical need emerging for Treasury to support the Bank especially in the areas of international financing and sourcing of scarce local funds.

INFORMATION TECHNOLOGY

Did you Know?

Through the implementation of strategic IT initiatives, Hatton National Bank leveraged its operations to better deliver value across the product/service portfolio whilst approving investments over Rs 500 Mn on IT systems for implementation during 2011/12.

Focus for 2011:

To implement strategic initiatives which will further strengthen the IT infrastructure and be responsive to expanding business needs

In 2011, the Bank conceived an all encompassing IT strategy leveraging on the recently completed core banking implementation, to support and sustain the Bank's momentum for future growth. In the year under review, vital components of this strategy were put into implementation with initiatives in the areas related to customer insight, risk and regularity support and enhancing system scalability.

The systems revamp will ensure effectiveness in the area of customer interaction and is expected to deliver better management of customer information. Similarly, enhanced business intelligence systems will enable the Bank to make more objective decisions with regard to its strategic direction as well as assisting towards meeting more short-term operational decisions with greater precision. However, real benefits of the system enhancements are expected to be realised in the 3rd and final quarter of the upcoming financial year.

In the areas of risk and regularity, IT deployments during the year further strengthened internal controls. Compliance measures were fortified through enhancements to the regulatory frameworks, internal processes augmented through robust IT governance and by meeting all licensing requirements. Security specific system deployments have enabled the Bank to further improve the safety and security of its customers and their transactions. The various security measures introduced assure the Bank's customers of better security through electronic channel delivery. Investments approved during 2011 included

- a) Replacement of the existing Leasing software;
- b) Replacement of the current Credit System with a comprehensive Credit Rating, Loan Origination / BASEL II system;
- c) A comprehensive Asset Liability Management (ALM)/Funds Transfer Pricing (FTP) system;
- d) Anti Money Laundering (AML) software;
- e) A Margin Trading system supporting equities related margin based lending; and
- f) Mobile Banking Application software.

In 2011, technical upgrades to the Bank's IT infrastructure were carried out with a view to attain a robust, scalable architecture. The main onus of the system change process was to achieve internal responsiveness to changing business needs, and thereby to have in place an IT platform that is able to support systems expansion with agility and speed. The changes included enhanced scalability in the areas of electronic channel delivery, business continuity and disaster recovery, functionality on straight through processing, and technology to explore and deliver in mobile applications space.

Objective for 2012:

Proactive IT enhancements to ensure future scalability of IT to drive business growth

The role of Information Technology at Hatton National Bank is strategic and progressive. Given the criticality of the function to the overall business of the Bank, the focus for the future will lie predominantly in the implementation of a range of strategic initiatives to drive business growth. These strategies will broadly address areas related to customer service, delivery channels, customer profiling and analytics, compliance reporting and data quality and workplace productivity.

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MARKETING

Did you Know?

Hatton National Bank rewarded customers with over Rs 250 Mn worth of cash and promotional giveaways during the year 2011, in response to customer loyalty.

Focus for 2011:

To strengthen/reinforce Hatton National Bank's position as the best retail bank in Sri Lanka

In 2011 the Bank's marketing and communications strategy strived to develop and strengthen the HNB brand with a view to position the Bank as the best retail bank in Sri Lanka. Building on the Bank's heritage, financial stability and wide range of asset and liability driven solutions, the Bank deployed an overall market positioning strategy that weighed heavily on the balance of horizontal and vertical business dimensions. Thus, by pursuing geo-expansion and product expansion, the Bank effectively reached out to a larger target audience.

The thrust of the Bank's brand communications in 2011, therefore lay in successfully positioning itself as a mainstay banking and financial services brand in the new geographic locations by creating the right perceptual image as a national bank with a commitment to sustain national wealth creation. Whilst for the past two financial years the Bank had invested into integrated brand communications as a tool for image building, in 2011 the Bank sought to utilise its island wide presence as an effective tool to establish the brand footprint. Therefore, during the year, concerted efforts were made to ensure that the brand experience at each point of contact - be it customer centres, micro banking centres or Crystal Circle priority banking centres - lived up to and projected HNB's brand values.

As in the past, the Bank sought to form association with events of repute. In 2011, the focus for sponsorships lay primarily in accomplishing the task of enhancing the brand reputation as a leader in retail banking. In view of this objective, the Bank affirmed its commitment to Asian Bankers Association's General Meeting & Conference held in October 2011 to act as the host bank for the event. Some 200 of the leading bankers and bank regulators from around the Asia-Pacific region gathered in Colombo for the 28th General Meeting and Conference of the Asian Bankers Association (ABA) to confer under the theme of "Asia Taking The Lead In The Global Economy: A Bankers' Perspective." The Bank took on the role of local host bank given the opportunity to share with ABA members the renewed optimism and enthusiasm of the people of Sri Lanka on the future of the country whilst establishing itself as a frontrunner in the financial services industry.

As in previous years, the Bank unveiled a series of integrated marketing efforts to activate specific sub-brands. All these sub brands were carefully nurtured to support individual product leadership whilst also taking shelter under the overall HNB brand which represented Trust and Integrity of the institution in today's volatile financial services landscape.

HNB Pathum Vimana

The HNB Pathum Vimana draw was held for the nineteenth consecutive year in 2011. The promotional tool holds the distinction of being the biggest deposit draw in the financial services and banking industry in Sri Lanka, and incentivises customers to save on a regular basis to build substantial savings accounts. The scheme, which is multi-pronged, provides customers with multiple chances to win. In 2011, the draw was immensely successful in increasing the low cost savings base, and over 31,569 winners collected in excess of Rs 119,200,000 in prizes.

HNB World

HNB World continued to achieve its prime objective of creating greater awareness amongst the Sri Lankan diaspora on the benefits of NRFC / RFC savings. The Bank's foreign currency deposit draw was promoted extensively in key cities across the world and with the relaunch in the previous financial year has witnessed a greater affinity amongst Sri Lanka expatriates. In 2011, the draw offered approximately USD 10,000 as prize money on a monthly basis to clearly differentiate the offer to foreign currency savers with the Bank.

HNB Singithi

The Bank's minor savings scheme was successfully marketed by way of two product offerings namely Singithi Lama and Singithi Kirikatiyo. As a cohesive product offering the Singithi product progressively caters to various stages across the childhood of a minor from newborn to toddler to child.

In 2011, promotion-wise the Bank carried out a series of activations at hospitals and further strengthened its promotional activity targeting children at school unit level and at hospitals targeting the parents and grand-parents of newborns.

HNB Shanthy

In 2011 a new multimedia communications campaign including TV, Radio and Print media was launched to improve the brand recall and

awareness for Shanthi Home Loans. The main thrust of the communications and promotions for Shanthi Home Loans revolved around the existing Shanthi Home Loan offer and the launch of the joint housing loan sub-product. Practical and effective communication platforms were utilised on the back of customer insights.

HNB Leasing

The Bank conducted a number of joint promotions with leading automotive dealers and importers with a view to promote the Bank's leasing product with customised attractive leasing offers. Through the year tailor-made lease options were promoted jointly for vehicles for personal use, commercial purposes and construction etc with reputed Automotive Dealers.

HNB Pawning

The HNB Pawning brand was active throughout the year with a promotional drive to maintain high brand visibility and brand recall. Gift promotions were utilised to differentiate the product offer whilst rate leadership served to create a competitive advantage for HNB Pawning.

HNB Credit cards

In 2011 a number of credit card promotions were initiated in collaboration with leading partner outlets mainly targeting attractive offers on leisure and lifestyle. The promotional drive aimed at increasing card usage and building loyalty.

Customer network expansion

The Bank's network expansion efforts were duly communicated under the theme of "HNB team" giving recognition to the teams at each customer centre whilst also creating an aura of service excellence to the customer.

HNB Crystal Circle

The Bank unveiled HNB Crystal Circle as a second tier private banking solution in 2011. Communications were focused on the launch of the different location specific openings whilst creating an aura of privileged and customised banking. A customised communication strategy was devised to cater to this niche segment with strong branding at site while redefining the banking experience in Crystal Circle Centres opened in Negombo, Wellawatte and Kandy.

HNB Small & Medium Enterprise Development Partner

The Bank re-launched its offer to the small and medium sector with a new branded product offer. This was in line with the focus and importance the bank places in this sector. The launch was supported by an integrated marketing communications campaign with a view to creating awareness among the SME sector.

HNB Adhishtana

The Bank launched a new remittance linked savings product targeting men and women working overseas who are active in the remittance market. The communication strategy developed looked at creating awareness among both senders and receivers of remittances with savings and empowerment as key initiatives.

HNB Yauwanabhimana

A new youth empowerment programme targeting youth in the age group 18 to 30 years was launched with the objective of improving employability, creating dignity of labour, harnessing entrepreneurship, financial literacy and financial inclusion among Sri Lankan youth. The Yauwanabhimana product was developed after a comprehensive market research conducted among the segment. The communication strategy was key in reaching out to the segment which included a dedicated trilingual interactive website coupled with popular media highly accessed by the target segment.

HNB Ran Govi Saviya

The year 2011 saw the launch of an innovative gold backed financing product structured with an essence of creativity for financing cultivation activities. The product promotion was supported by both media and grass root level communication. This is yet another milestone for HNB as a Bank that had touched the lives of the rural masses.

Objective for 2012:

To maintain the HNB brand at top of the mind with high brand recall and positive brand association

Increasing competition and fragmentation of the marketplace will call for greater focus on marketing in the years ahead. Whilst maintenance of loyalty and consolidation of existing customer bases will remain critical for the Bank, consumer relevant advertising and shaping of promotional activity will lead the approach towards customer retention. To this end, the Bank will continue to gear itself for precision in marketing whilst continuing to do what it has done best in the years past; that is, building and retaining relationships with the critical mass of Sri Lanka and the future generations of customers, through financial inclusion of the rural and student customers. The rapid advent of social media in to the communication sphere has unveiled a new gamut of opportunities in advertising and brand visibility. The increased usage of social media especially among the youth segment will drive the Bank to mark its presence in such media through more focused and targeted communication in popular social media platforms such as Facebook, Twitter and YouTube.

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HNB ASSURANCE PLC

Did you Know?

HNB Assurance issued over 49,000 policies in 2011 across the nation, in addition to 156,000 existing policies in force.

Focus for 2011:

Product development as a means to market development

During the financial year 2011, HNB Assurance recorded an excellent growth in turnover, with a noted 27% growth in General and 19% growth in Life business. In addition, during the year, the Company enhanced its capital base through a capitalisation of reserves followed by a Rights Issue effectively enlarging the capital from Rs 375 Mn to Rs 1.17 Bn. This in turn, set HNB Assurance on a comfortable stance to meet the new capital requirement of Rs 500 Mn each, for Life and General businesses, as proposed by the Insurance Board of Sri Lanka. During the year, Fitch Ratings Lanka Limited affirmed HNB Assurance PLC's National Long-Term rating and its National Insurer Financial Strength rating at 'A(Ika)' with stable outlooks. The Company continued to hold the second highest rating amongst companies in the insurance sector.

In the area of General Insurance, HNB Assurance witnessed a significant growth contribution from Motor and Miscellaneous, with both sectors driven by a combination of volume and rate increases. Growth in motor insurance was assisted largely by the relaxation of import duties and permits, and further aided by the more profuse availability of leasing facilities.

Life Insurance also demonstrated strong growth across its sub-classes. Mortgage reducing policies tied to housing loans pushed growth in this segment while mainstream endowment policies also stimulated the growth momentum.

The Hatton National Bank customer centre network served as the catalyst for growth of Bancassurance business in 2011, stimulating a 43% contribution to General business. The 120 Bancassurance points across the country garnered a growth rate in Life insurance business of 69%, growing at a much faster rate than all other traditional channels.

As a cumulative outcome of sound commercial performance throughout the year in all areas of business, the Company achieved a turnover growth of 24% and a profit growth of 14% recording a pre-tax profit of Rs 300 Mn and a post tax profit of Rs 275 Mn by year-end 2011.

Product development played a key role in the Company's ability to perpetuate market development in 2011. Innovative products and policies developed to cater to varied market segments enabled the Company to fortify its position in the marketplace whilst enhancing its customer base. Entry into the retirement income segment - undoubtedly one of the segments in Life business that has

demonstrated strong growth - enabled HNB Assurance to enlarge its target customer base during the year.

The launch of My Fund - a retirement fund building plan for those in the ages of 30-45, with the ability to build up a fund through small savings - demonstrated a high demand with over 5500 policies being issued during the financial year generating a premium income of Rs 94 Mn. As a result, My Fund had achieved the distinction of being recognised as the most successful new product launched by the Company in recent times. 2011 also saw the launch of My Freedom, a product designed for retirees who have a lump sum in hand to invest with the expectation of a guaranteed monthly income for a period of 15 years. The product was jointly developed with the Hatton National Bank, wherein monies invested are re-invested in the Bank.

The Company also worked in close association with Hatton National Bank during the financial year to develop insurance products to supplement the Bank's products, thereby offering a value enhancement to certain customer segments such as SMEs, migrant workers and youth sector accounts.

Objective for 2012:

Profitable growth through value creation

In moving forward, HNB Assurance will aggressively look for growth opportunities whilst balancing the need for profitable growth. Therefore, the Company will carry out a strategy of selectively targeting profitable segments, whilst also promoting products that are value creating. Bancassurance will also be further explored, in close association with the Bank, to garner greater returns for both institutions.

SITHMA DEVELOPMENT (PVT) LTD

Did you Know?

“HNB Towers”, the flagship project of Sithma Development (Pvt) Ltd is one of the most energy efficient buildings in Sri Lanka.

Focus for 2011:

Achieve 100% occupancy in both commercial and residential properties

Sithma Development completed yet another year of commendable performance in 2011, recording a profitability in excess of Rs 274 Mn, an increase of 60% from 2010. The Company's two stellar projects - HNB Towers and Spathodea Residencies - demonstrated sound financial returns whilst also earning public recognition as buildings of repute in the areas of sustainability and design.

The growing demand for commercial property coupled with HNB Towers' reputation as one of the best commercial buildings in Sri Lanka placed it high on the list of desirable commercial spaces in 2011. The building achieved 100% occupancy during the financial year.

“HNB Towers” in 2011 received the accolade of being one of the most energy efficient buildings in Sri Lanka and was awarded the Silver Award in the large scale Category for Commercial Sector Buildings at the “Sri Lanka National Energy Efficiency Award - 2011” organised by Sri Lanka Sustainable Energy Authority. The award is all the more significant and evocative in the fact that there was no Gold awarded for Large Scale Commercial Sector buildings.

Spathodea Residencies, Sithma Developments' condominium development project achieved another milestone in its journey towards full completion. With over 70% occupancy through outright sale, the Company established a Condominium Management Corporation to overlook the operational management of the building, thereby delegating much of the day to day condominium management functions to the Corporation. Despite having fallen short of the occupancy target in 2011, Sithma Developments is confident of achieving 100% occupancy of Spathodea Residencies in 2012, especially in light of the growing economic relevance of Colombo as a commercial and residential hub.

Objective for 2012:

To seek and secure opportunities in facilities management and commercial property development

The Company will look to explore opportunities in the areas of facilities management and commercial property development in the year ahead. The favourability of the commercial real estate market poses great opportunities for Sithma Development in the area of commercial property development and will enable the Company to further its expertise in sustainable design and construction. However, in 2012, Sithma developments will also face considerable challenges to maintain HNB Towers at its current high standard whilst developing the processes and systems to meet future demands.

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EXCHANGE HOUSES

Did you Know?

In 2011 over 167,000 remittances were made from Hatton National Bank exchange houses in Oman and UAE of which over 66,000 valued at LKR 3.77 Bn were to Sri Lanka while the balance were to six other countries.

Focus for 2011:

Operational efficiency coupled with growing volumes to ensure early break-even

Majan Exchange LLC (Oman)

Majan Exchange completed its third year of operations in 2011. Though initial expectations were to break-even during the financial year under review, further challenges arose and the momentum of growth in the market was constrained due to new regulations by the Government of Oman on the appointment of agents by exchange houses. In line with this, the target for break-even was revised to 2012.

Majan Exchange facilitates remittances to Sri Lanka whilst catering to other corridors such as India, Pakistan, Nepal, Bangladesh, and the Philippines. As an agent for MoneyGram, XpressMoney and EzRemit, Majan Exchange also caters to many other corridors. It operates two outlets in Oman with one in Ruwi and the other which commenced operations in 2011 in Ghala.

Delma Exchange (UAE)

Established in January 2009, Delma Exchange UAE has been operational just short of three years. Based in close proximity to industrial zones and strategic city centres Delma Exchange is a remittance house catering to the city's expatriate community. It facilitates remittances to Sri Lanka, India, Pakistan, Bangladesh, Nepal, Malaysia and the Philippines. Access to other countries is through an agency from Western Union.

In the financial year under review, Delma Exchange posted a commendable performance in terms of transaction volume. However, the extremely high costs of operation - which is characteristic of the local market context - continued to pose pressure on the break-even targets, necessitating the operations' break-even targets to be re-evaluated. Forecasts reveal breakeven during the latter part of 2012. Delma currently operates five outlets of which two were commissioned for operation in 2011 one in Karama, Dubai and the other in Hamdan Street, Abu Dhabi.

Objective for 2012:

To expand volumes in existing markets and new areas

In the forthcoming financial year focus will be in market expansion in terms of volumes both within the existing market space as well as in new areas.

ACUITY PARTNERS (PVT) LTD

Did you Know?

Acuity Partners raised in excess of Rs 12 Bn in 2011 through a variety of capital market instruments while acting as the financial advisor and manager to some of the largest Private Placements and IPOs on the CSE.

Focus for 2011:

To retain key position in the industry as a full serviced investment banking firm through consolidation and growth

By the end of the financial year 2011, Acuity Partners continued to retain its leadership in the industry as one of the leading full serviced investment banking firms in Sri Lanka. Despite the rather tumultuous year for Sri Lanka from the perspective of the capital and equity markets, Acuity accrued a commendable year-end turnover and profitability, largely as a result of its reputation as a technically competent and versatile investment-banking firm coupled with astute investment strategies. As a result, at the end the financial year, Acuity Partners posted a pre-tax profit of Rs 288 Mn and post tax profit of Rs 231 Mn, which however is a decline of 23% when compared to the post tax profit of year end 2010, which remains as the best year for the Capital Markets industry.

The year 2011 was a year of stagnation and decline for the Colombo Stock Exchange, predominantly due to the imposition of a range of new regulations that gave rise to market liquidity issues. By the end of the year 2011, the CSE had slipped from being the world's best performing market in 2010 to the sixth best performer in 2011. Yet despite the market's subdued nature, industry rivalry competition intensified with the issuance of seven new Broker Licenses during the financial year. Nevertheless, irrespective of the challenges, Acuity Stockbrokers recorded a commendable performance during the year.

During the year, the Corporate Finance division enabled Acuity to be at the forefront of the financial services industry, leading and managing a number of key placements / IPOs. As the sole financial advisor and manager of 2011's inaugural IPO for HVA Foods Ltd., worth Rs 319 Mn, Acuity Corporate Finance successfully secured an oversubscription of the IPO of 23 times with applications received to a value of Rs 7.5 Bn. Additionally, Acuity managed and was a broker to the largest Private Placement in Sri Lanka of Rs 4.9 Bn by Vallibel One which attracted applications over Rs 7.5 Bn. The ensuing IPO valued at Rs 533 Mn was oversubscribed by 11.65 times. Acuity also partnered with NDB to jointly manage the Union Bank IPO that attracted the highest over subscription of an IPO in the history of the Sri Lankan market of over 350 times and partnered with CT Capital to manage the IPO of Textured Jersey for Rs 1.2 Bn.

In 2011, Acuity widened its business outlook by exploring new frontiers for business expansion. As a result, it ventured into margin trading by securing a license to provide margin trading services whilst also securing a license to undertake underwriting and to act as an asset management service provider. Furthermore, Acuity formed a joint venture with Ceylon Guardian Investment Trust PLC to explore growth opportunities in the asset management business. The new venture, Guardian Acuity Asset Management Limited, commenced business with the intention of launching a series of unit trusts catering to the local and international market whilst continuing to explore other opportunities to collaborate in the asset management business over time. In November 2011, two unit trusts licenses were obtained from the Securities & Exchange Commission of Sri Lanka and will be launched in early 2012. Guardian Acuity Asset Management is in the process of finalising the legal requirements to launch an international fund by partnering Key Note Capitals, a respected and reputed brokerage firm in India, which is listed on the Bombay Stock Exchange.

Acuity's venture capital arm consolidated its growth and effectively leveraged on the strengths of the Acuity Group's full range of financial services to productively enhance its scope of operations and to enlarge focal areas of business.

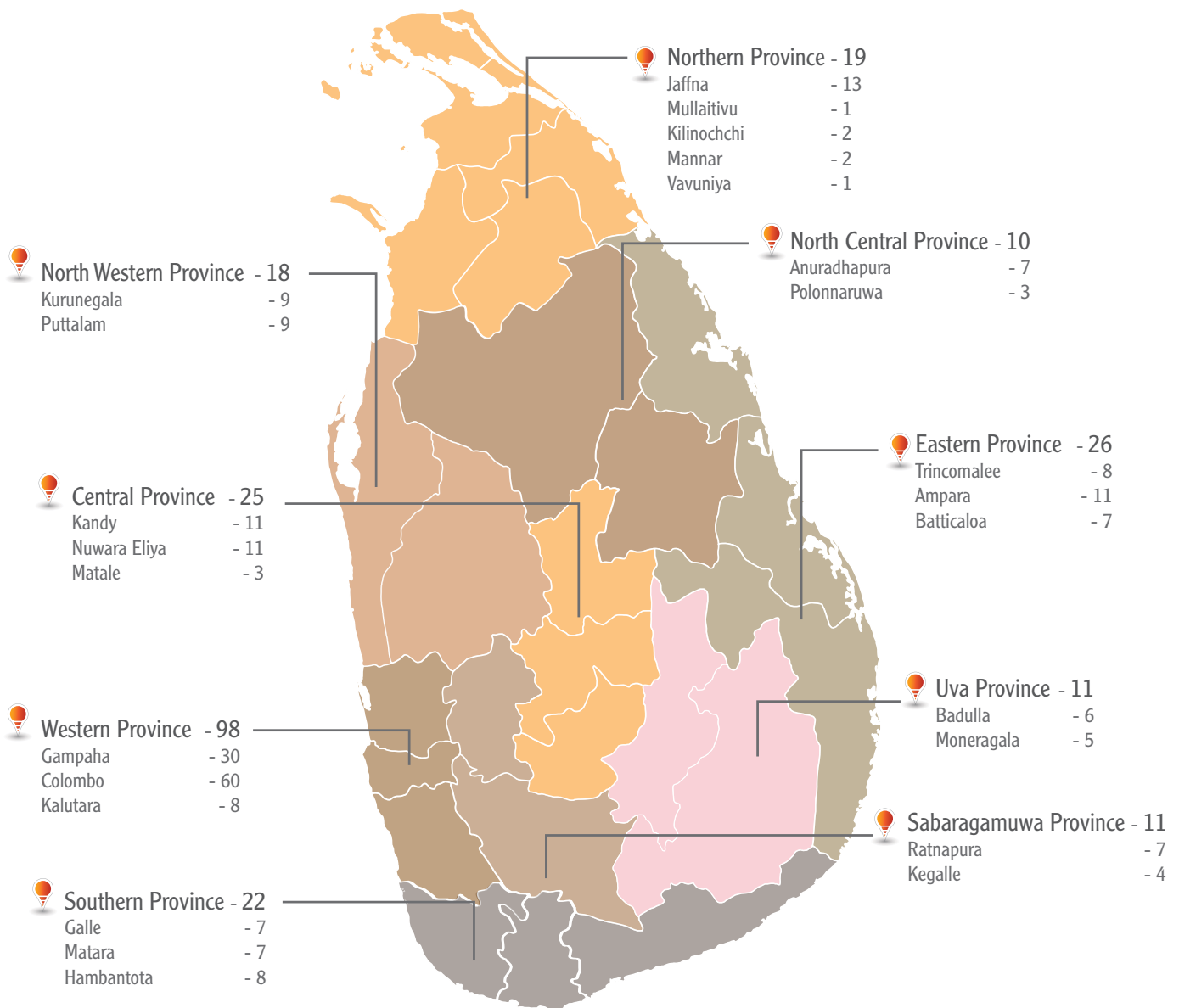
Objective for 2012:

To maintain growth momentum to secure medium term growth targets

Acuity has continued to benefit from the convergence of expertise from both DFCC and Hatton National Bank and has harnessed the resources of both entities to its advantage. As a result, Acuity remains on target to meet budgeted revenues for the medium term and ROI in 2012 remains positive and achievable.



CUSTOMER CENTRE NETWORK



HNB Customer Centre to be opened during the 1st quarter of 2012:

* Wadduwa

	as at end of 2010	as at end of 2011
Customer Centres	205	240
HNB Student Banking Centres	159	164
HNB Gami Pubuduwa Banking Centres	117	119
Village Based Units	8	6
Branch Based Units	108	104
Micro Banking Units	1	9
HNB Mobile Banking Service Units	Kandalama Heritage Hotel Amaya Lake Hotel (Dambulla)	Kandalama Heritage Hotel Amaya Lake Hotel (Dambulla)
Overseas Representative Offices:	Chennai – India Karachi – Pakistan	Chennai – India Karachi – Pakistan

Customer Centre Network - as at 31.12.2011

Province	Customer Centres	ATMs
Central	25	35
Eastern	26	33
North Central	10	13
North Western	18	25
Northern	19	28
Sabaragamuwa	11	15
Southern	22	26
Uva	11	16
Western	98	209
Total	240	400

Western Province – 98

- Airport Office
- Aluthgama
- Aluthkade
- Athurugiriya
- Avissawella
- Bambalapitiya
- Bandaragama
- Beruwela
- Biyagama
- Boralesgamuwa
- Borella
- Cinnamon Gardens
- City Office
- Dehiwela
- Delgoda
- Dematagoda
- Divulapitiya
- Ekala
- Gampaha
- Ganemulla
- Grandpass
- Green Path
- Gunasinghepura
- Hanwella
- Head Office Branch
- Hendala
- Homagama
- Horana
- Hulftsdorp
- Ingiriya
- IWMI – Pelawatta
- Ja-ela
- Jampettah Street
- Kadawatha
- Kaduwela
- Kalutara
- Kandana
- Katunayake
- Kelaniya
- Kiribathgoda
- Kirindiwela
- Kirullapone
- Kochchikade
- Kohuwala
- Kolonnawa
- Kollupitiya
- Kotahena
- Kottawa
- Kotte
- Maharagama
- Malabe

- Maligawatte
- Maradana
- Marandagahamula
- Mathugama
- Minuwangoda
- Mirigama
- Mirihana
- Moratumulla
- Moratuwa
- Mt. Lavinia
- Mutwal
- Narahenpita
- Nawala
- Nawaloka Hospital
- Nawam Mawatha
- Negombo
- Negombo Extension Office
- Negombo Metro
- Nittambuwa
- Nugegoda
- Overseas School of Colombo
- Padukka
- Panadura
- Panchikawatte
- Pettah
- Pettah – 2nd Office
- Peliyagoda
- Piliyandala
- Ports Authority
- Pugoda
- Ragama
- Ratmalana
- Sea Street
- Seeduwa
- Sri Jayawardenapura Hospital
- Sri Lankan Airlines Admin Complex
- Talangama
- Thalawathugoda
- The Cental Hospital
- Thimbrigasyaya
- Wattala
- Weliveriya
- Wellawatte
- Wellawatte Extension Office
- Wijerama
- World Trade Centre
- Yakkala

North Western Province – 18

- Alawwa
- Anamadua
- Chilaw
- Dankotuwa
- Galgamuwa
- Giriulla
- Hettipola
- Kuliyapitiya
- Kurunegala
- Marawila
- Madampe
- Nikaweratiya
- Norochchola
- Nawinne - Kurunegala
- Puttalam
- Udappuwa
- Wennappuwa
- Wariyapola

Northern Province – 19

- Achchuweli
- Chankanai
- Chavakachcheri
- Chunnakam
- Jaffna
- Jaffna – 2nd Office
- Kaithady
- Kiliinochchi South
- Kiliinochchi North
- Kodikamam
- Mannar
- Manipay
- Mullaitivu
- Nanattan
- Nelliady
- Point Pedro
- Thirunelvely
- Vavuniya
- Velanai

North Central Province – 10

- Anuradhapura
- Anuradhapura Ext. Office
- Aralaganwila
- Kekirawa
- Madawachchiya
- Medirigiriya
- Nochchiyagama
- Padaviparakramapura

- Polonnaruwa
- Thambuttegama

Eastern Province – 26

- Akkaraipattu
- Ampara
- Batticaloa
- Dehiattakandiya
- Eravur
- Kaluwanchikudy
- Kalmunai
- Kallady
- Kantalai
- Karaitheevu
- Kattankudy
- Kinniya
- Maruthamunai
- Mullipothana
- Muttur
- Ninthavur
- Pottuvil
- Sammanthurai
- Serunuwara
- Thandavenveli
- Trincomalee
- Trincomalee – Courts Road
- Thirukkivil
- Uhana
- Uppuveli
- Valachchenai

Central Province – 25

- Akurana
- Bogawantalawa
- Dambulla
- Digana
- Gampola
- Galewela
- Galaha
- GeliOya
- Ginigathhena
- Hatton
- Kandy
- Kandy City Centre
- Katugastota
- Kundasale
- Kurunduwatte
- Maskeliya
- Matale
- Nawalapitiya
- NuwaraEliya
- Peradeniya

- Pilimathalawa
- Pussellawa
- Ragala
- Rikillagaskada
- Thalawakelle

Sabaragamuwa Province – 11

- Balangoda
- Embilipitiya
- Godakawela
- Kahawatte
- Kalawana
- Kegalle
- Mawanella
- Pelmadulla
- Pinnawela
- Ratnapura
- Warakapola

Southern Province – 22

- Agunakolapelassa
- Akuressa
- Ambalangoda
- Ambalantota
- Deniyaya
- Dickwella
- Devinuwara
- Elpitiya
- Galle
- Hakmana
- Hikkaduwa
- Karapitiya
- Kataragama
- Hambantota
- Koggala
- Matara
- Middeniya
- Pitigala
- Suriyawewa
- Tangalle
- Tissamaharama
- Urubokka

Uva Province – 11

- Badulla
- Bandarawela
- Bibile
- Buttala
- Haputale
- Mahiyangana
- Moneragala
- Passara
- Siyabalanduwa
- Welimada
- Wellawaya



MAIN CORRESPONDENTS WORLDWIDE



- | | | | |
|--------------------|------------------------|-----------------------|-----------------------------|
| 1 Argentina | 23 Finland | 45 Libya | 67 Saudi Arabia |
| 2 Australia | 24 France | 46 Liechtenstein | 68 Serbia & Montenegro |
| 3 Austria | 25 Georgia | 47 Luxembourg | 69 Singapore |
| 4 Bahrain | 26 Germany | 48 Malaysia | 70 Slovakia |
| 5 Bangladesh | 27 Ghana | 49 Maldives | 71 Slovenia |
| 6 Belgium | 28 Gibraltar | 50 Mauritius | 72 South Africa |
| 7 Bermuda | 29 Greece | 51 Mexico | 73 Spain |
| 8 Bolivia | 30 Hong Kong | 52 Monaco | 74 Swaziland |
| 9 Botswana | 31 Hungary | 53 Morocco | 75 Sweden |
| 10 Brazil | 32 India | 54 Nepal | 76 Switzerland |
| 11 Bulgaria | 33 Indonesia | 55 Netherlands | 77 Taiwan |
| 12 Canada | 34 Ireland | 56 New Zealand | 78 Thailand |
| 13 Channel Islands | 35 Isle of Man | 57 Norway | 79 Turkey |
| 14 Chile | 36 Israel | 58 Oman | 80 Uganda |
| 15 China | 37 Italy | 59 Pakistan | 81 United Arab Emirates |
| 16 Colombia | 38 Japan | 60 Peru | 82 United Kingdom |
| 17 Cyprus | 39 Jordan | 61 Philippines | 83 United States of America |
| 18 Czech Republic | 40 Kenya | 62 Poland | 84 Vietnam |
| 19 Denmark | 41 Korea (Republic of) | 63 Portugal | 85 Zambia |
| 20 Ecuador | 42 Kuwait | 64 Qatar | |
| 21 Egypt | 43 Latvia | 65 Romania | |
| 22 Ethiopia | 44 Lebanon | 66 Russian Federation | |

FINANCIAL REVIEW

Industry overview

The financial year 2011 presented a set of new challenges for the Banking sector, different from those it witnessed during the previous two years. In 2011 the Banking sector experienced an unprecedented growth in demand for credit recording a 25.8% growth in loans and advances compared to 18.5% in 2010. The bigger challenge for the Banking sector, however, was to manage its liquidity as the deposits witnessed only a 21.4% growth during the year. In addition, the healthy margins enjoyed by the industry in the past came under persistent pressure with interest rates remaining close to single digit for the major part of 2011.

The financial year 2011 was also a year of capacity building for the industry as most banks increased their customer centre franchises by entering into new areas that were fast developing as a consequence of the peace dividend. The nation's economic growth remained robust during 2011, despite pressure from the external front due to the aggravation of the European crisis. However, economic variables which remained stable for the most part of the year showed signs of volatility towards the latter part of 2011.

Financial Performance

Income

The interest income which witnessed a negative growth in 2010, showed a 9.6% growth during the year under review due to rapid growth in loans and advances. However growth in interest income did not keep pace with the increase in loans and advances, demonstrating a drop in yields compared to 2010. Interest cost in 2011 increased by 13.9% during the same period, despite deposits growing at a slower pace than advances. Hence the Bank's net interest margin narrowed in 2011. This was an industry-wide phenomenon witnessed during the financial year. Accordingly, the net interest income of the Bank grew by 5.5% in 2011 compared to 2010.

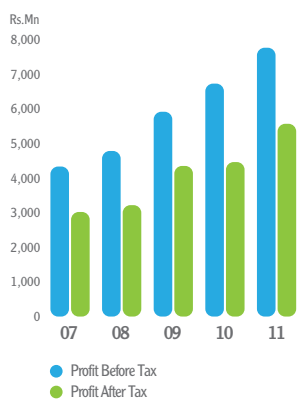
The Bank was successful in growing its commission income base by more than 32% during the year with trade income and card commissions leading the way. However exchange income witnessed a setback during 2011 due to relatively stable exchange rates for the most part of the year. A significant drop was noted in other income due to a couple of reasons. In 2010, the Bank disposed its investments in Commercial Bank of Ceylon PLC, Distilleries Company of Sri Lanka PLC, Acuity Securities (Pvt) Ltd and Lanka Ventures PLC thereby realising a capital gain of approximately Rs 646.4Mn, the latter two being sold to its joint venture investment banking company Acuity Partners Ltd. In addition, the Bank recorded mark to market gains from its stock market investments amounting to Rs 90.0 Mn in the previous year. The absence of any such exceptional gains through sale of investments, resulted in other income falling by 49.9% in 2011 compared to the previous year. Dividend income increased by Rs 200 Mn as a result of higher dividend declared by DFCC.

Accordingly, the net income of the Bank for 2011 stood at Rs 21.2 Bn, which is a 5.2% growth from the previous year.

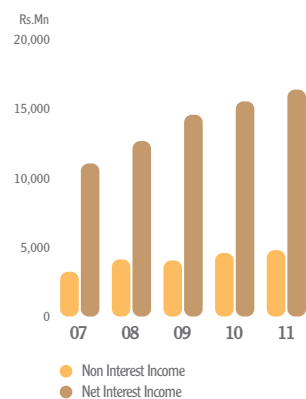
Operating expenses

The rationalisation of cost continued to be a priority during 2011, although 35 new customer centres were added to the network; by far the most aggressive network expansion by the Bank during the past decade. Despite the said expansion, the Bank managed to maintain the increase in staff emoluments at a modest 5% while other expenses increased by 10.1% during the year. However, the increased contribution towards the deposit insurance scheme introduced in late 2010 and marked to market losses of the equity portfolio included under other expenses further contributed towards increasing the cost base compared to the previous year. This, coupled with the lower growth in net income has caused the cost to income ratio to deteriorate to 57.7% compared to 54.9% last year.

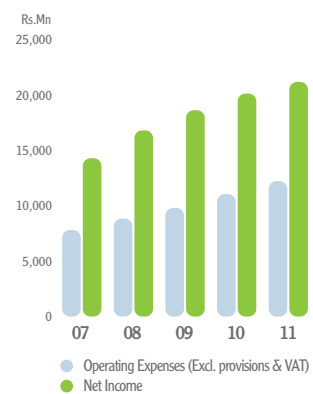
Profit



Income



Operating Income & Operating Expenses



FINANCIAL REVIEW

continued

The Bank continued its recovery efforts to bring the gross NPA ratio below 4% in 2011. Accordingly, the NPA ratio stood at 3.9% compared to 4.5% last year. However, the net NPA witnessed a marginal increase to 2.3% from 1.95% in 2010 mainly due to the 0.5% reversal of the general provision as per Central Bank guidelines as a precursor to the introduction of fair value accounting in 2012.

Taxation

The Industry witnessed the benefit of a lower tax regime in 2011, as the Government budget proposals in 2010 announced significant reductions in corporate tax rates applicable for banks. Accordingly, the corporate tax charge for HNB dropped by 3.1% reflecting an effective tax rate of 28.3% compared to 33.7% in 2010.

Group Companies

The Group Companies recorded commendable contributions during the year 2011, with HNB Assurance PLC, the insurance subsidiary posting a 23.6% growth in gross written premium and 13.6% growth in post-tax profits to reach Rs 275 Mn. Sithma Development Limited, the property development subsidiary recorded outstanding performance in 2011 recording a growth of 60% in post-tax profits to reach Rs 274 Mn as at end of 2011 backed by favourable economic conditions. Acuity Partners (Pvt) Ltd, the joint venture investment bank, posted a group profit of Rs 231 Mn despite sluggish market conditions that prevailed during most part of the year. The Acuity Group further consolidated its position as the full service investment bank in the country through the asset management arm that was set up during the year, in collaboration with Ceylon Guardian Investments PLC.

Majan Exchange established its presence further during the year with the opening of a branch office in the busy neighbourhood of Ghala, Muscat. Despite projections to breakeven during the year, Majan Exchange continued to make losses in 2011. Considering this as an

indication of impairment, the Bank provided fully against the investment made in Majan Exchange LLC during the year.

Profitability

The Bank managed to grow its pre-tax profits by 15.4% to Rs 7.8 Bn compared to the previous year, while the Group posted a pre-tax profit of Rs 8.5 Bn recording a growth of 17%.

The net profit after tax for the Bank stood at Rs 5.6 Bn recording a growth of 24.8 % in 2011 despite pressure on margins and significant reduction in investment income as explained above. The Group net profit for 2011 amounted to Rs 6.2 Bn which represents a year on year growth of 27.6%.

The Bank's return on average assets stood at 1.6% compared to 1.5% in the previous year and return on average equity was maintained at 17.3% in 2011 despite the equity infusion.

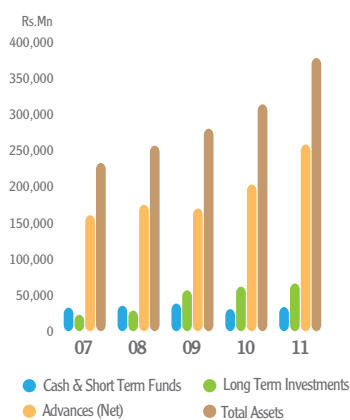
Balance sheet

During 2011, the Bank strengthened its balance sheet further as a planned measure to capture opportunities available in a growing economy as well as to prepare the Bank for better management of a possible global liquidity shortage which could affect the financial services industry.

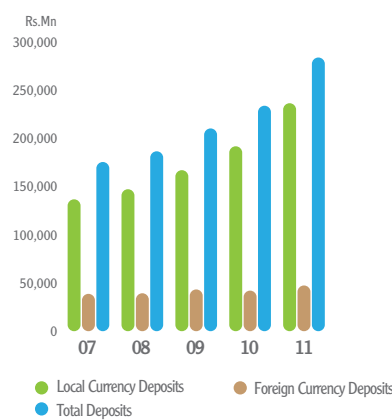
Asset growth

In 2011, the Bank's asset base grew by a significant 20.4% funded by an infusion of capital as well as a steady growth of its deposit base. Contrary to the previous two years, the loan book of the Bank grew by a staggering 25.8% to Rs 264.3 Bn. While almost all types of advances witnessed a healthy growth during the year, leasing portfolio showed the highest percentage growth of 76.5%, whilst pawning grew by

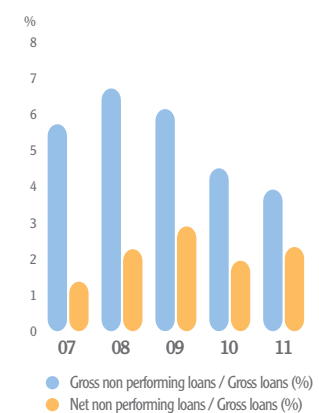
Assets



Deposits



NPA Ratio



27.7%. The Bank's leasing portfolio benefitted from the reduced import duty for vehicles as it dominated the leasing market among private sector banks. The Bank also benefited from the increase in gold prices as its pawning portfolio showed a robust growth, although the Bank exercised cautious aggression in its approach to pawning advances due to the market risk associated with the product. The Bank's SME portfolio too witnessed significant growth during the year aided by the Bank's customer centre network spread across the Country. The network expansion during the year, especially in the previous war torn regions too contributed towards this end.

Liability growth

Though the Bank witnessed a robust growth in deposits of 21.4%, it did not keep pace with loans and advances. Accordingly, the Advances to Deposit ratio for the Bank increased from 89.7% to 93.0% in 2011. The current account base for the Bank showed a drop from the previous year, mainly due to the withdrawal of a large deposit which came in for a short period of time during the last week of 2010. The savings deposit base witnessed a healthy growth during the year despite increasing interest rates towards the latter part of the year adding pressure on low cost deposits. The rupee fixed deposits during the year witnessed a sizable growth of 44.9% to Rs 113.3 Bn in 2011. Accordingly, the Current Account and Savings Account (CASA) ratio dropped from 56.4% in 2010 to 49.5% in 2011.

Shareholders' funds

In order to meet the rising credit demand and to take advantage of the growth opportunities, the Bank raised Rs 6.1Bn by way of a rights issue during the year, which together with the retained earnings, led to a 36% growth in shareholders' funds from Rs 27.3 Bn in 2010 to Rs 37.1 Bn in 2011.

The Bank declared an interim dividend of Rs 1.50 per share for 2011 in November, which amounted to Rs 582.6 Mn and proposes a final dividend of Rs 6.00 per share. The final dividend consists of cash dividend of Rs 3.00 per share and a scrip dividend of Rs. 3.00 per share. The gross dividend of Rs 2,914 Mn on account of the total dividend payment of Rs 7.50 per share records an increase of 76.7% against the total gross dividend payment for 2010.

Capital adequacy

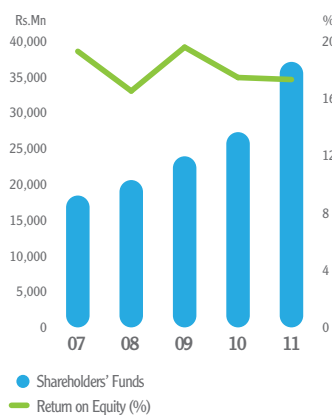
In addition to the infusion of equity through the rights issue, tier II capital of the Bank was strengthened through a subordinated debt issue of Rs 2 Bn during the year. As a result, the capital adequacy ratios remained healthy with the core capital ratio at 12.76% and the total capital adequacy ratio at 14.51% as at the end of December 2011.

Future Outlook

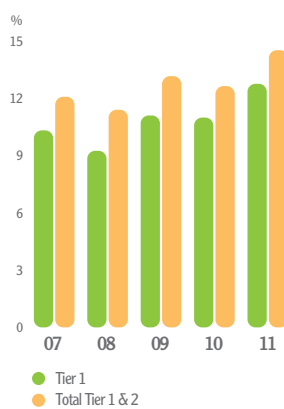
As witnessed in 2011, in line with the national vision, the expansion in credit is expected to drive business growth. Considering the pressures on margins due to the competitive environment, the focus of the Bank would be on profitable balance sheet growth. Given the opportunities in the market, the sector would be faced with the challenge of sourcing medium to long term capital funding in addition to traditional sources of deposits to support this growth. As such, the Bank will endeavour to mobilise low cost funding and will leverage on enhanced delivery channels to reach customers in all parts of the country.

As in the past, the Bank will continue to focus on its strategic priorities towards sustainable growth.

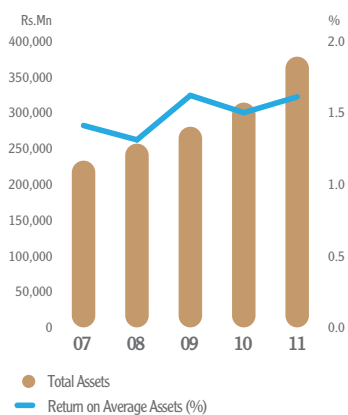
Shareholders' Funds



Capital Adequacy Ratio

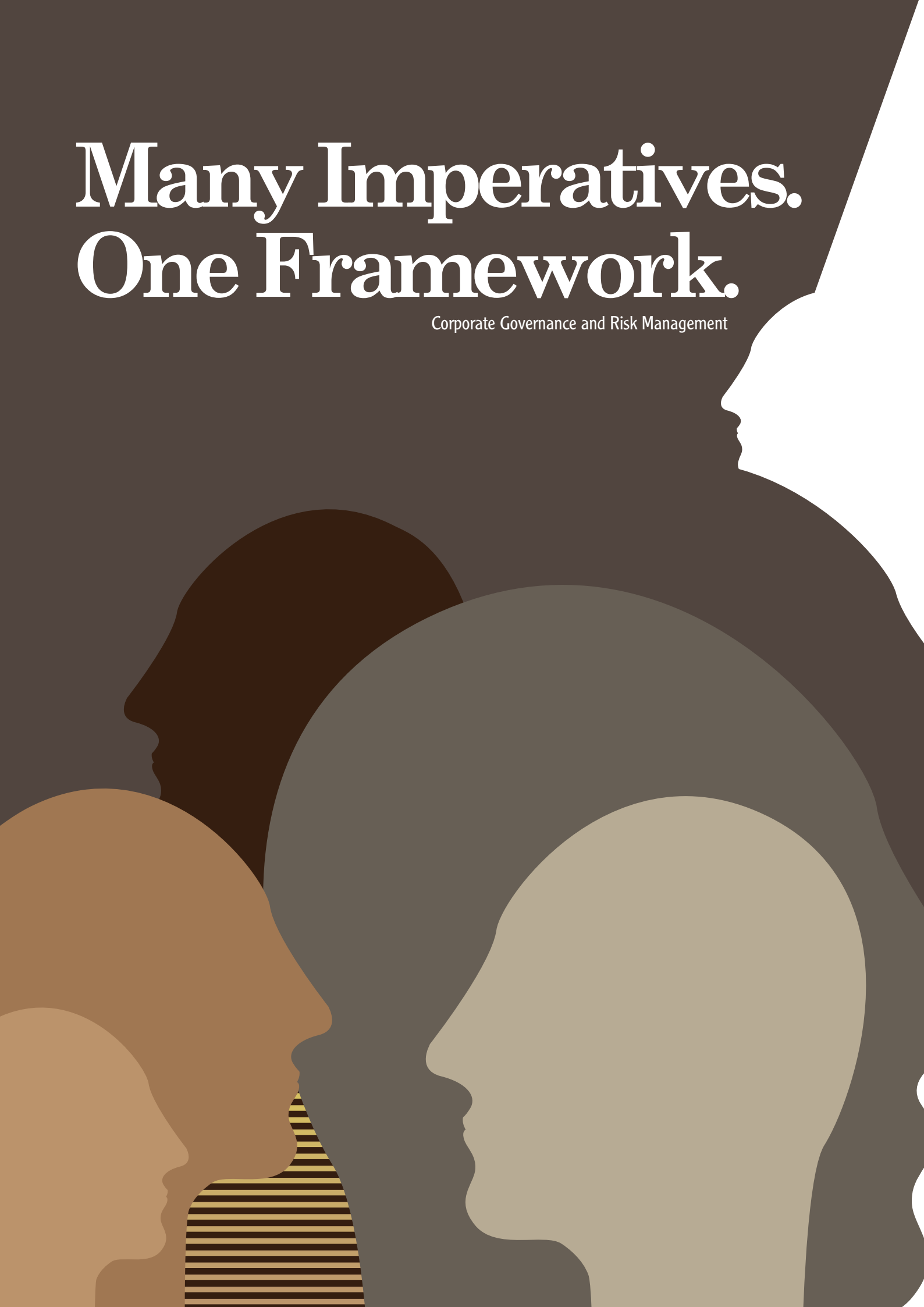


Return on Average Assets



Many Imperatives. One Framework.

Corporate Governance and Risk Management



RISK MANAGEMENT

Risk Philosophy

Managing risk is central to an organization’s business strategy and fundamental to long term profitability and stability. We believe that risk management should provide insight in to the business decision making process, enhance management effectiveness and ultimately reflect the corporate culture of the bank. The vision of Risk Management is to proactively assist the business in delivering superior shareholder value by ensuring an optimal trade-off between risk and return. HNB’s Risk Management Strategy is based on a clear understanding of various risks, disciplined assessment, measurement and continuous monitoring in the form of risk dashboards against the predetermined risk appetite approved by the Board.

Since setting up an independent Risk Management Division in 2003, the approach has been to embrace best practices in Risk Management. Following a diagnostic review in 2007 with the assistance of external consultants, a 5 year roadmap was developed for implementation. This resulted in a revisiting of internal standards, organization structure, meeting schedules, analytics and systems to improve risk return performance across the organization.

Risk Organization and Board Governance

HNB’s Risk Management Division independently reports to Board Integrated Risk Management Committee (BIRMC) and Chief Executive Officer and co-ordinates across all functions to ensure Risk Management is seamlessly ingrained in HNB’s culture.

The role of the Board in Risk Management has evolved significantly from pure oversight to active participation in defining risk appetite and

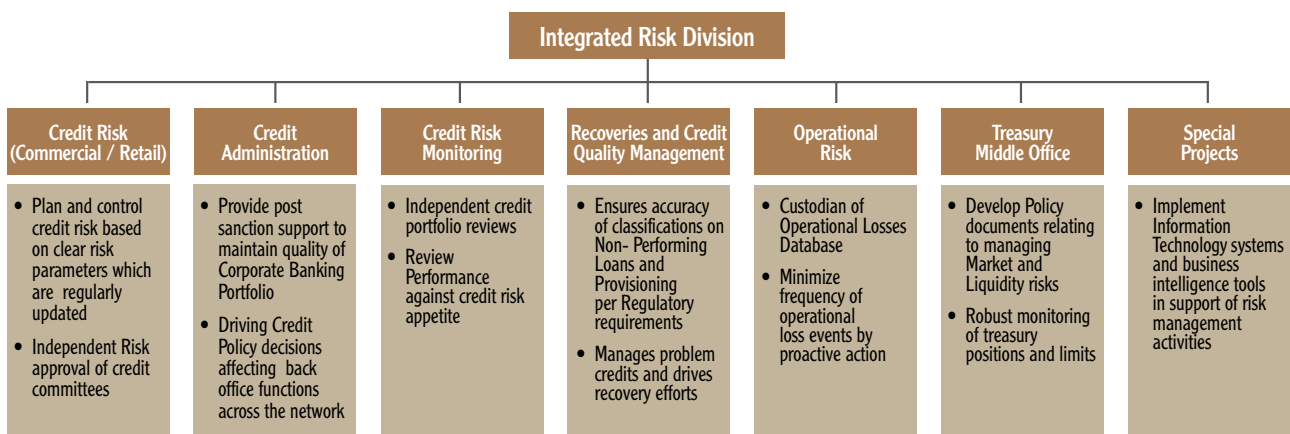
approving the broad risk parameters for the enterprise. HNB’s Board has ultimate responsibility for Risk Management. In discharging its governance responsibility it operates through two key committees the Board Integrated Risk Management Committee and the Audit Committee.

The BIRMC provides the Board the assurance that risk management strategies, policies and processes are in place to manage events / outcomes that have the potential to impact significantly on earnings performance, reputation and capital. The approach entails active monitoring of the level of risk exposure against the parameters set in the risk appetite. The BIRMC also assists the Board by assessing and approving significant credit and other transactions beyond the discretion of executive management.

The Audit Committee provides its assessment on the effectiveness of internal audit and external disclosure of accounting policies and financial reporting to the Board.

The following Executive Management Sub - Committees, each with specialized focus, support the BIRMC and are responsible for the co-ordination of risk matters for each of the areas of risk management:

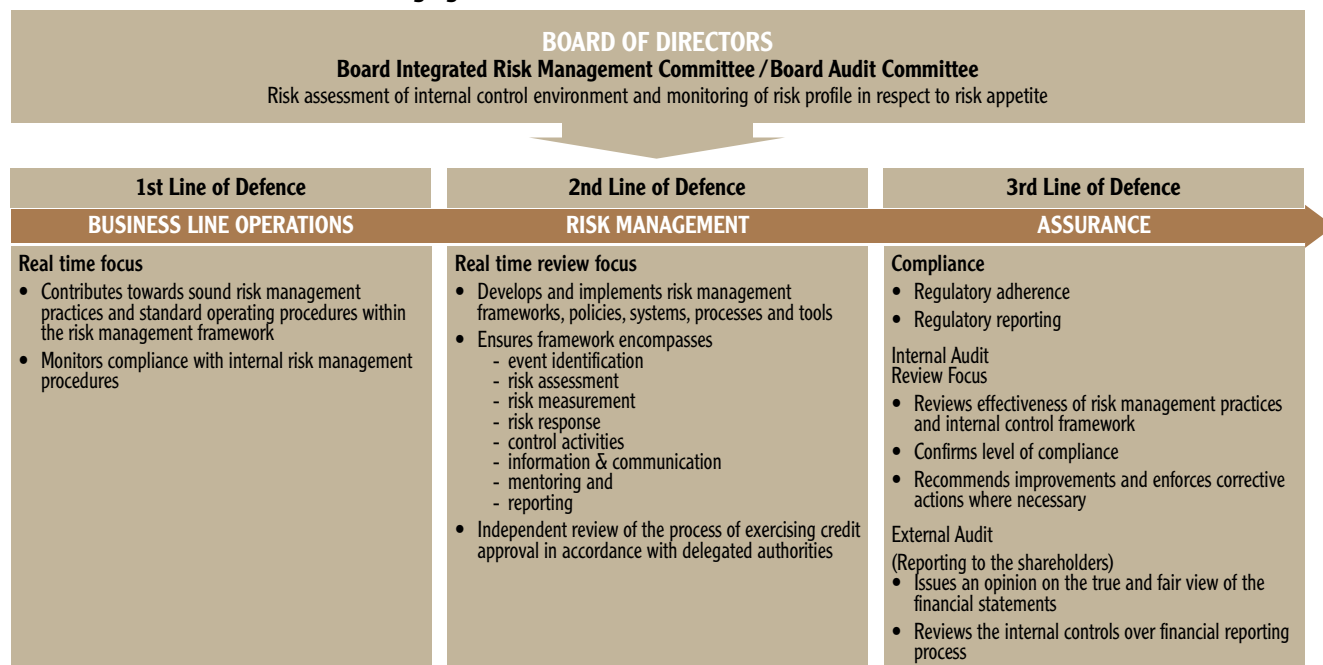
- Executive Risk Management Committee
- Asset and Liability Committee (ALCO)
- Credit Policy Committee
- Investment Committee
- IT Steering Committee
- Sustainability Committee
- Staff Committee



RISK MANAGEMENT

continued

HNB's three Lines of Defence in managing Risk



Risk Management Priorities in the context of a volatile Global Environment

The global environment continues to remain volatile as ever with the crises in Europe further eroding recovery prospects and much needed confidence. Whilst the Sri Lankan economy continues to record significant post war economic growth largely driven by leisure, property construction, infrastructure and consumption sectors, a prolonged global economic crisis is likely to have reverberations in our economy. Most notably due to increased unpredictability in commodity prices and strain on balance of payments (uncertainty in export earnings, slowing foreign direct investment and remittance flows).

HNB continues to be proactive in its Risk Management initiatives by strengthening focus on liquidity risk management, raising capital levels and rebalancing credit portfolios. Whilst commodities (tea, rubber, coconut, steel, crude oil, dhal, wheat and gold) play a significant role in

the Sri Lankan economy, price trends and risk management approaches are consistently disseminated across the network to better equip decision making. Bank placements and counterparty limits with foreign correspondent banks are constantly reviewed.

HNB's balance sheet comprises over 2/3rd of its assets in the form of loans and advances. Consequently, credit risk continues to remain the key risk. The credit portfolio remains well diversified by customer, business segment and sector with no exposure to subprime or global hedge funds. A large portion of the remaining 1/3rd comprises investments in bonds and treasury bills with the Sri Lanka Government for statutory reserve and liquidity requirements. On the liability side, given the strong and stable local and foreign currency retail deposit base built up over the years its reliance on the interbank market is low, which holds the bank in good stead in the future.

Risk Event in 2011	Period	Impact on HNB	Risk Mitigation
Eurozone Sovereign Crisis	Jan 11 - Dec 11	Low	No new exposure to Eurozone during the year. Greek Bond for Euro 1mio. expiring in March 2012 for which full provision has been made as a precautionary measure. On-going analysis of foreign currency positions and limits in market risk dashboard.
Crisis in the Maldives	Jan 11 - Dec 11	Medium	Regular country risk reviews and analysis of large exposures. No new facilities booked during the year.
Uprise in the Middle East	Feb 11 - Mar 11	Low	Close monitoring of tea industry exposure and material export customers.
Earthquake and Tsunami Disaster in Japan	Mar 11	Low	Due to production and export disruptions caused by disaster, our customers representing key trading partners to Japan reviewed.
Floods in Thailand	May 11 - Jun 11	Low	Sri Lanka is largely self sufficient in rice consequently little or no impact on local market.
Capital Adequacy Stress Tests carried out on EU Banks	Jul 11	Low	We had no exposure to banks that failed stress tests.
US Rating Downgrade to AA+ by S&P	Aug 11	Low	The Bank has no exposure to US sovereign bonds. Foreign exchange exposure monitored through regulatory / internal limits.

Approach to managing Key Risks

Credit Risk

Given the scale and materiality of relative exposure of our loan book managing credit quality of the portfolio is a key focus area of the Bank. The credit risk that the Bank faces mainly arises from corporate banking, SME and retail loans and advances.

Credit Risk Policy

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 alert reporting, tolerable levels of concentration risk and portfolio monitoring in line with Bank's risk appetite. The approach is to avoid large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralization where feasible. The policy is reviewed at least annually and approved by the Board of Directors ensuring consistency with the Bank's business strategy. A monthly Credit Policy Meeting chaired by the Chief Executive Officer, drives policy decisions and implementation plans.

Credit Risk Management Process

HNB manages credit risk by focusing on the following stages:

Stage 1 – Loan Origination and Risk Appraisal

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 our favour by type of security offered, standards for periodic valuations and assessment of realizable value of collateral.

A suite of internal risk rating models (scientifically developed with the assistance of external consultants) is in place for corporate and retail customer segments. The internal risk rating is an important part of the risk assessment of customers and incorporated in the credit decision process. Significant strides have been made in internalizing this approach with a view to giving due prominence to lending based on cash flow repayment ability as distinct from collateral based lending.

Stage 2 – Loan Approval and Sanction

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 (process ensures over 85% of loans, excluding cash and gold backed facilities, are approved in this manner).

Stage 3 – Credit Administration and Disbursement

HNB's Corporate Banking loan portfolio is administered through a centralized Credit Administration Division which ensures efficient and effective post sanction customer support including disbursement, settlements, processing renewal notices and advising customers on interest rate amendments. This division independently reports to the Risk Management Unit to ensure clear segregation of duties from business origination and disbursements only after stipulated conditions have been met and relevant security documents obtained.

Stage 4 – Credit Measurement and Monitoring

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 pointing to a deterioration in the financial health of a borrower.

A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assess performance against internal limits (board risk appetite) and regulatory requirements.

An internally developed Business Intelligence system ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and bank level. Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.

Stage 5 - Recoveries

Problem credits and Non Performing Advances are managed by the Recoveries and Credit Quality 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 finalized. 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 Non Performing Advances classification, rescheduling, provisioning and valuation of collateral on delinquent assets was centralized during the year to ensure standardization and accuracy.

The Bank strictly conforms to regulatory requirements in problem loan classification and management. The transition to fair value based accounting (LKAS 32 and 39) requires the present age wise classification to be gradually replaced with a cash flow based approach. The Bank retained the services of independent consultants to assist in this project. The approach adopted was to classify loans in to individually significant exposures and other loans in to homogenous portfolios by segment / product for necessary computations as appropriate.



RISK MANAGEMENT

continued

Credit Risk Console

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
Credit Risk			
Risk of a potential loss to the Bank when a borrower is either unable or unwilling to meet its financial obligations			
<p>Effectiveness of Credit Policy</p> <p>Risk arises where credit policy amendments do not keep pace with changes in local and global environment</p>	Low / Low	<p>Review adequacy and effectiveness of credit policies in monthly meetings.</p> <p>Review of Credit Approval Structure based on feedback from Regional Management / Network.</p> <p>Risk analysis of Islamic banking products and processes.</p> <p>Development of internal credit limits encompassing portfolio concentration, country limits, credit quality and prudential ratios.</p> <p>Reports developed for policy amendments as necessary. Examples include Impact of floods on lending portfolio, Industry Risk Reviews, Top 20 reviews, Impact of Stress Tests on European Banks.</p>	<p>Credit policy and discretionary lending limits updated regularly.</p> <p>Risk evaluation of new products prior to launch.</p> <p>Performance against internally defined risk appetite and regulatory directions reviewed monthly in credit risk dashboards.</p> <p>Reports circulated among relevant Business Units, Credit Committees and Board as necessary.</p>
<p>Adequacy of Portfolio monitoring</p> <p>Risk arises where systems and controls are not in place to regularly assess the health of the credit portfolio</p>	Low / Low	<p>Use of internal MIS “KPI Wizard” to track risk performance across business units with greater focus on key risk ratios, improved sharing of best practices through performance benchmarking and improved accountability at all levels.</p> <p>Credit Quality Based on Internal Risk Ratings The improved country rating for 2011 also reflected in corporate portfolio.</p> <p>Corporate Banking Portfolio Based On Internal Risk Rating</p> <p>2011</p> <p>2010</p> <p>0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%</p> <p>AAA AA A BBB BB B CCC CC C</p>	<p>Risk Managers independently review Branch/Regional performance and provide monthly feedback highlighting areas for improvement to line management.</p> <p>Focus on high risk accounts (internally risk rated B and below) reviewed by Risk Managers at least quarterly.</p>
<p>Credit Concentration Risk</p> <p>Risk arises where Credit Portfolio is not sufficiently diversified</p>	Moderate / Low	<p>Industry Concentration</p> <p>Increase in exposure to agriculture, leisure, trading, logistics and construction industries observed in line with country prospects during the year.</p> <p>Industrywise Exposure</p> <p>2011</p> <p>2010</p> <p>● Agriculture & Fishing ● Transport ● New Economy ● Other Services ● Pawning ● Manufacturing ● Construction ● Financial and Business Services ● Credit card ● Other ● Tourism ● Traders ● Infrastructure</p>	<p>Industry Limits updated for key industries with a view to communicating risk appetite and monitoring actual exposure on a periodic basis.</p> <p>Strategies developed to improve penetration of low risk industries and conversely reduce exposure to high risk industries.</p>

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
	High / High	<p>Geographical Concentration</p> <p>A tighter concentration on the Western Province was observed in 2011, mainly due to project accounts booked in head office although economic benefits accrue to areas of presence across the country. Notwithstanding this growth in Central, Northern and Eastern regions was significant during the year.</p> <p>Geographical Distribution</p> <p> ● Western ● North Central ● Northern ● Overseas ● Southern ● North Western ● Sabaragamuwa ● Uva ● Eastern ● Central </p>	<p>Medium Term Credit Strategy influences increased lending to SME's outside the Western Province. HNB is well placed with its extensive, expanding branch network to leverage on emerging opportunities.</p>
	Low / Low	<p>Exposure by Counterparties</p> <p>Growth in Leasing segment was significant during the year.</p> <p>Exposure by Counterparties</p> <p> ● Corporates >1Bn ● Corporates 35mn -100mn ● Micro finance ● Personal Loans ● Corporates 100mn -1bn ● SME 35mn -10mn ● Housing ● Leasing </p>	<p>HNB has a well-diversified portfolio comprising Corporate, SME, Retail and Microfinance segments.</p>
	Moderate / Moderate	<p>Top 20 Customer Exposure</p> <p>A decrease in Top 20 customer exposure as a % of total customer exposure in 2011 points to less concentration risk.</p> <p>Material Exposures</p> <p> ● Top 20 Exposure as a % of Total Exposure ● Credit Portfolio excluding Top 20 Exposure </p>	<p>A Comprehensive Risk Review of Top 20 Customers is conducted annually and account strategies updated.</p>



RISK MANAGEMENT
continued

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
<p>Adequacy of Recoveries Process</p> <p>Risk arises where systems and controls are not in place to monitor recoveries and adequate bad debt provisioning</p>	Low / Moderate	<p>NPA Classification</p> <p>An analysis of NPA by category shows significant shifts in portfolio composition evident following successful recovery strategies during the year for “loss accounts”.</p> <p>NPA Summary</p> <p>A consistently improving trend evident in NPA.</p> <p>Non - Performing Advances 2005 - 2011</p>	<p>Recoveries Dashboard introduced to track delinquency and customers in early stages of NPA by business segment and product.</p> <p>Causes of new additions to Non Performing Advances (NPA) by segment and region.</p> <p>Shared accountability with line management for asset quality targets supported by a business intelligence system with progressively more depth and granularity.</p>

Liquidity and Interest Rate Risks

Policy and Approach

The management of liquidity is entering a new era as regulators set more stringent capital and liquidity requirements for banks. Liquidity risk cannot be viewed in isolation and tends to compound other risks. Contractual maturity of assets and liabilities, key liquidity ratios and monthly liquidity forecasts are reviewed at ALCO meetings. HNB has a Board approved Liquidity Policy and Contingency Funding Plan in place to deal with liquidity issues.

Interest rate risk is reviewed through regular review of net interest yields by product to ensure interest rate margins and spreads are maintained and revisiting asset and liability pricing in line with our expectations on the interest yield curve.

The Bank is committed to improving its liquidity and interest rate risk management infrastructure through the procurement of an Asset and Liability Management System for implementation in 2012. This system will have the capability to assess behavioural and contractual maturity profiles of assets and liabilities with advanced stress testing capabilities.

Risk Assessment

At a portfolio level the Bank’s loan book is comfortably financed by retail deposits, hence reliance on wholesale deposits and interbank

market is minimal. This is a significant strength as these sources can be availed of during periods of short term liquidity stress. The lack of long term borrowing instruments at affordable cost results in some maturity mismatch in the asset book (borrow short and lend long). A challenge faced this year was that the Rupee loan book significantly outstripped Rupee deposit growth which resulted in undue reliance on the local interbank borrowings for short periods of time. This position was rectified with successful capital augmentation efforts and slowing loan book during the latter part of the year. Overall Loans to Deposits ratio remains at 90%, with a large and growing retail deposit base accounting for over 90% of deposits ensuring a comfortable liquidity position.

The Bank is exposed to interest rate risk arising from a fixed rate liability book where re-pricing is slower than the majority of loan portfolio on fixed rates (notable exceptions being the entire corporate banking portfolio and some midmarket exposures on floating rates) particularly in a reducing interest rate scenario we experienced during the year, exerting significant pressure on margins. However, almost the entire deposit base contractually or otherwise can be re-priced within a year (over 4/5th within 3 months) which is an additional strength, which serves to reduce our vulnerability to interest rate risks.

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Liquidity and Interest Rate Risk Console

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011													
		Risk Analysis	Risk Mitigating Strategies												
Liquidity Risk															
Risk arising when an institution is unable to meet its debt obligations without incurring large losses															
Risk arising from inability to raise capital in a liquidity crisis	Moderate / Moderate	Liquidity policy and contingency plan in place to address strategy in a liquidity crisis and procedures for meeting cash flow shortfalls in emergency situations.	Updated liquidity risk policy and contingency plan.												
Risk arising from inability to meet maturing deposit liabilities as they fall due	Moderate / Moderate	<p>Regular review of Asset and Liability Yield Analysis by ALCO.</p> <p>Monitoring of key remittances from overseas.</p> <p>Foreign currency deposits of HNB exceed foreign currency lending by over 100%. The reliance on interbank borrowing is therefore low, which is a considerable strength.</p> <p>Bank maintains a Loan to Deposit Ratio of 90% and is generally a net lender in the call money market.</p> <p>Monitoring of liquidity ratios to assess funding requirements.</p> <table border="1"> <thead> <tr> <th>Ratio</th> <th>December 2011</th> <th>December 2010</th> </tr> </thead> <tbody> <tr> <td>Net Loans/Total Assets</td> <td>64.29%</td> <td>60.45%</td> </tr> <tr> <td>Loans/ Customer Deposits</td> <td>90.31%</td> <td>85.86%</td> </tr> <tr> <td>Liquid Assets/ Short Term Liabilities</td> <td>54.25%</td> <td>48.28%</td> </tr> </tbody> </table> <p>Liquid assets include cash and short term funds, bills purchased and short term investments. Short term liabilities include savings deposits, call and repo borrowings and current taxation.</p>	Ratio	December 2011	December 2010	Net Loans/Total Assets	64.29%	60.45%	Loans/ Customer Deposits	90.31%	85.86%	Liquid Assets/ Short Term Liabilities	54.25%	48.28%	<p>Ensures optimal Net Interest Margins.</p> <p>Improved liquidity forecasting capabilities.</p> <p>Improved monitoring of liquidity ratios.</p>
Ratio	December 2011	December 2010													
Net Loans/Total Assets	64.29%	60.45%													
Loans/ Customer Deposits	90.31%	85.86%													
Liquid Assets/ Short Term Liabilities	54.25%	48.28%													
Interest Rate Risk															
Risk to which the Bank is exposed to due to uncertain and adverse movements in future interest rates															
Risk rising from adverse movements in interest rates	Low / Low	Impact of interest rates on portfolios minimal due to Bank holding to a great extent treasury bills and bonds with short maturities. The duration of the trading and investment portfolios are both less than 1 year.	The performance of the bond portfolio is monitored using the concept of Modified Duration to assess sensitivity of bond prices to interest rate changes.												
Risk arising from maturity mismatch	Moderate / Moderate	Contractual maturity mismatch of Rupee and FCY earning Assets and Liabilities reviewed and implications identified. The absence of a long term yield curve, results in having to borrow short to lend long for both Rupee and FC exposures.	<p>Long-term lending on floating rate basis and regular re-pricing of fixed priced loans ensured.</p> <p>Investment in an ALM system made for 2012.</p>												



RISK MANAGEMENT

continued

Operational Risk

Policy and Approach

HNB has a comprehensive Operational Risk Policy in place comprising risk identification and assessment, implementation of controls for improving management and monitoring process and mitigation tools for operational risks. A lot of progress has been made on standardizing and quantifying operational risk, this is reflected in an improving preventative culture and insurance effectiveness.

Risk Assessment

Risk identification techniques include highlights of audit reports, discussions with network management, branch visits and operational risk review meetings conducted across branches. A comprehensive loss tracking database is in place containing over 5 years of information,

analysed by business function and loss incident matrix. Significant loss incidents (above Rs 500,000/-) are analysed for root causes and learnings. This process includes information on external events occurring in the banking industry to ensure similar incidents do not happen to us. A high level operational risk dashboard is prepared for monthly circulation and monitoring purposes.

The Bank has an Outsourcing Policy and outsourced activities are managed centrally by the Compliance Department.

Insurance continues to be the key risk mitigant for operational risk and adequacy and effectiveness of insurance is independently reviewed by the Operational Risk Unit, at least annually.

Operational Risk Console

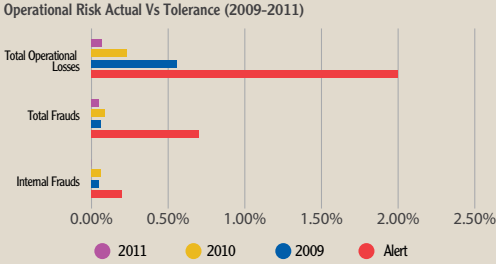
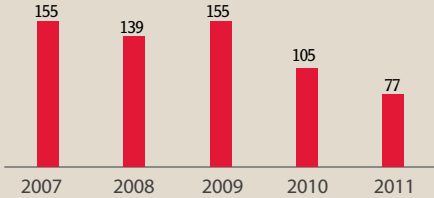
Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011																			
		Risk Analysis	Risk Mitigating Strategies																		
Operational Risk																					
Risk of losses incurred by a company due to human factors, inadequate internal processes or systems and external events																					
Effectiveness of Operational Risk Policy	Low / Low	Operational Risk Policies reviewed during the year.	Updated policies in line with regulatory developments and internal decisions.																		
Risks arising from a poor Control Environment	Low / Low	<p>Trend in Operational Losses</p> <p>A significant improvement in net operational losses indicated over the years.</p> <p>Analysis of last 5 years operational losses indicate steady decline of losses of which around 18% were recovered through insurance or other means in 2011. The increase of losses in the period 2007 to a peak in 2009 could be a result of an improving loss reporting culture and quantifying operational losses in the Bank.</p> <div style="text-align: center;"> <table border="1"> <caption>Trend in Operational Losses Reported</caption> <thead> <tr> <th>Year</th> <th>Total Recoveries as a % of Total Operational Loss incidents</th> <th>Total Loss Incidents (Amounts Rs.) (Mn)</th> </tr> </thead> <tbody> <tr> <td>2007</td> <td>66%</td> <td>55</td> </tr> <tr> <td>2008</td> <td>33%</td> <td>136</td> </tr> <tr> <td>2009</td> <td>20%</td> <td>222</td> </tr> <tr> <td>2010</td> <td>30%</td> <td>82</td> </tr> <tr> <td>2011</td> <td>18%</td> <td>28</td> </tr> </tbody> </table> </div> <p>While total losses in absolute terms are much lower in 2011 (as indicated in the graph above) the largest contributor represents external fraud o/a card skimming transactions and an advance granted against faulty documentation.</p>	Year	Total Recoveries as a % of Total Operational Loss incidents	Total Loss Incidents (Amounts Rs.) (Mn)	2007	66%	55	2008	33%	136	2009	20%	222	2010	30%	82	2011	18%	28	<p>Material losses regularly analysed by cause. Action taken to improve systems and controls to prevent recurrence.</p> <p>Regular meetings with regional management and support functions to ensure effectiveness of Operational Risk Review Meetings across the network and adequate follow up of issues identified for implementation.</p>
Year	Total Recoveries as a % of Total Operational Loss incidents	Total Loss Incidents (Amounts Rs.) (Mn)																			
2007	66%	55																			
2008	33%	136																			
2009	20%	222																			
2010	30%	82																			
2011	18%	28																			



Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
		<p>Operational Losses according to Incident Type</p> <p>Legend: ● Internal Frauds ● External Frauds ● Clients Products & Business Practices ● Damage to Physical Assets ● Execution Delivery & Process Management ● Employment Practice & Work Place Safety ● Business Disruption & System Failures</p>	<p>A comprehensive Operational Loss database is in place to track losses by incident type and business line as per BASEL II guidelines.</p>
Technology Risk			
Risk arising from system breakdowns and disruptions	<u>Moderate</u> / Moderate	Access control to core banking system reviewed during the year.	<p>Access control reviews and effectiveness of interest and other computations through specialized audit software was conducted by internal audit during the year.</p> <p>An automated performance monitoring system in place.</p>
Risk arising from not keeping ahead of latest technology and delivery channels in banking	<u>Moderate</u> / Moderate	New cost efficient alternative delivery channels (ie. Internet, mobile banking) were analysed.	The Bank is committed to aggressively penetrate market share in alternative delivery channels and is making the necessary investments in people, structure and systems to ensure competitive advantage.
High Impact Unforeseen Events			
Risk arising from lack of preparedness to Natural Disasters and Terrorism	<u>Moderate</u> / Moderate	Risk Assessment and Contingency Plans reviewed across the organization, including IT Disaster Recovery Plan. A time bound action plan is in place to ensure live run from BCP site covering all branches carried out per agreed dates.	Documents tabled at Board Risk Committee and subject to ongoing review.
Risk arising from inadequate risk mitigation strategies	<u>Low</u> / Moderate	<p>Insurance Recovery Progress</p> <p>Collections show a steady improvement as a result of monitoring claims, settlements, rejections and withdrawals on a regular basis.</p> <p>Recoveries as a % of Insurance Premiums Paid</p>	<p>Insurance is the key mitigating factor for operational risk and consequently a strong interaction between the risk and insurance departments takes place to ensure adequacy and effectiveness of insurance coverage in key areas.</p> <p>A culture where operational risk reviews / challenges effectiveness of insurance in place.</p>



RISK MANAGEMENT
continued

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
Risk arising from inadequate risk mitigation strategies (continued)	Low / Moderate	<p>Operational Losses against Internal Alert Level</p> <p>Internal alert level for total losses set at 2% of annual turnover. Limits of 0.2% for internal frauds and 0.7% for total frauds have also been defined.</p> <p>Actual losses experienced in the last three years remain comfortably within internal alert levels.</p> <p>Operational Risk Actual Vs Tolerance (2009-2011)</p> 	Performance against internal alert levels tracked monthly.
<p>People Risk</p> <p>Risk arising from inability to attract and retain skilled staff at middle to senior management levels</p>	Low / Moderate	<p>The Bank is experiencing a reversal of the brain drain from overseas although competition for talent locally is intensifying within local banks and the non-bank financial sector.</p>	<p>Talent development, retention of top performers and succession planning for all departments are key focus areas.</p> <p>Performance related share options in place for management grade staff and upwards.</p>
<p>Legal Risk</p> <p>Risk arising from litigation against the bank or faulty legal documentation</p>	Low / Low	<p>Review of Legal Charter</p> <p>Litigation Action</p> <p>Types of legal action include Money Recovery Actions, Mortgage Bond Actions, Debt Recovery Actions, Liquidation Actions, Special Case Actions.</p> <p>In 2010, there were many money actions but with the introduction of the new requirement that all defaults up to Rs 250,000/- should be first referred to mediation, the number of cases filed under this sector came down.</p> <p>With the change that took place relating to the law on execution of parate rights of the Bank, the number of Mortgage and Debt Recovery Actions filed in 2011 increased.</p> <p>Litigations during the last 5 years</p> 	<p>Review of legal charter supported by an executive committee.</p> <p>Monitoring of legal cases and recovery process.</p>



Market Risk

Market Risk is managed by the Treasury Middle Office. The team keeps track of price movements and other developments in the market that affect the risk profile of the Bank. Treasury Middle Office monitors primarily exchange rate, interest rate and equity risks. Presently exposure to trading book is only 2% of the banking book given the capital market restrictions and minimal opportunities in the market.

A comprehensive Board approved Treasury Policy is in place to reflect regulatory and market developments. The Treasury Middle Office

monitors the asset-liability position under the supervision of the ALCO. It also independently reviews activities of the Treasury Front Office and adherence to regulatory / internal policy guidelines.

Market Risk Management practices were strengthened during the year with establishment of country limits, duration and value at risk (VAR) based limits for currencies, bond and equity portfolios. A Market Risk Dashboard is in place to indicate performance against risk appetite and continues to be refined in line with best practices.

Market Risk Console

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
Market Risk			
Risks arising from fluctuations in interest rates, foreign exchange positions and prices of commodity and equity investments			
General appetite for Market Risk based on Treasury activity	Low / Low	Review and amendment of Treasury Policy to reflect regulatory developments and internal decision-making. Developing internal procedure manuals for Front, Back and Middle office.	Treasury Management focus is on covering Corporate Banking Positions with minimal trading on own account under the guidance of ALCO and Treasury Committee. The Bank's trading book accounts for just 2% of the banking book.
Equity Risk Risk rising from adverse movements in stock markets	Low / Low	Equity portfolio performance A negative return of minus 30% was registered for the portfolio in 2011 also reflected in the negative stock market returns during this period. The return on the equity portfolio over a 2 year period was however 52%. Performance of Equity Portfolio and Stock Markets 2010 to 2011 	Return of equity portfolio and benchmark indices closely monitored and recommendations made in Investment Committee and ALCO meetings. Value at Risk based measurement for equity portfolios developed.
Foreign Exchange Risk Risk arising from unhedged foreign exchange positions and poor treasury controls.	Low / Low	Risk / Return Profile of major currencies The most volatile currencies (over 10%) during 2011 were the Yen, Canadian and Australian Dollars, Euro and Swiss Franc. The Chinese Renminbi was the best performer with a return above 9% and volatility of 5%. Currency Risk / Return Profile 	Risk profile of major currencies tracked against LKR. Very little exposure to unhedged positions given internal policy and strengthened supervision by the regulators on minimizing open foreign currency positions. Monthly tabling of market risk dashboard at ALCO. Value at Risk limits to monitor overnight foreign currency positions which is mainly to the USD.



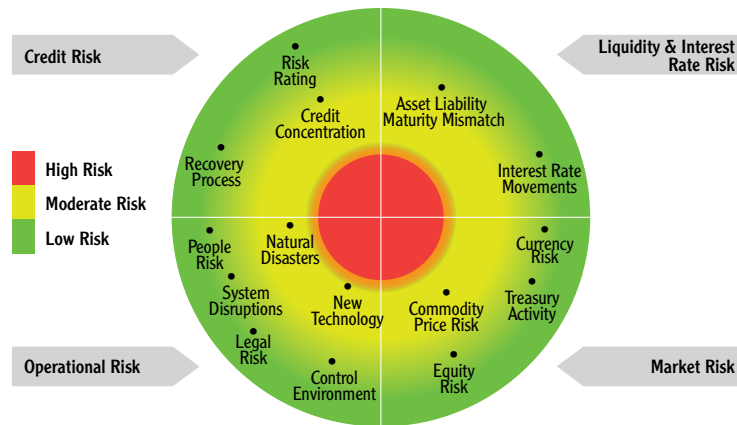
RISK MANAGEMENT
continued

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
<p>Commodity Risk</p> <p>Risk arising from adverse movements in global commodity prices</p>	<p>Moderate / Moderate</p>	<p>Commodity Performance in 2011</p> <p>Grains and other Crops</p> <p>Paddy prices which are subject to dramatic seasonal changes, decreased sharply during January 2011. However due to recurring floods in many parts of Sri Lanka and floods arising in key rice exporting nations such as Thailand, paddy prices increased sharply during the latter part of the year to close back near 2010 year-end prices.</p> <p>In 2011, Tea, Sugar, Palm Oil and Rubber all recorded a negative performance with Rubber prices falling even further in the final quarter of 2011.</p> <p>Metals - Steel and Gold</p> <p>As a result of the global economic crisis, the demand for steel declined dramatically in 2009. In 2010 and 2011, however prices recovered and stabilized as demand from the industry's major markets bounced back.</p> <p>In 2011, the gold price hit a record of over \$1,900 per ounce and oscillated between this high and a low slightly above \$1,300 an ounce with a yearly return just over 10%. The weakening global economy could drive more funds to safe-haven investments such as gold in the coming year.</p>	<p>Quarterly review of commodity price trends for circulation to network to ensure minimal speculative financing.</p> <p>Monthly review of gold prices and stress tests to assess impact on pawning portfolio.</p>

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Risk Radar



Compliance Risk

The Board expects HNB’s business to be conducted in accordance with the Bank’s code of conduct, laws and regulations imposed by the authorities / regulations with zero tolerance for failure to identify and remedy any breaches of such obligations, if any, on the part of the Bank.

Consequent to the establishment of an independent Compliance Division, HNB formulated a Compliance Policy with a broad vision of establishing a fully compliant “Corporate Governance” and a “Risk Mitigating” culture within the Bank. Accordingly the Bank is working towards establishing and maintaining internal procedures and systems to adhere to the highest standards of ethical and professional behavior

in the conduct of Bank’s business which comply fully with all applicable laws, regulations, rules and directions that govern the Bank’s business.

The new initiatives taken by the Compliance Division during the year includes submission of regular reports to the Board Integrated Risk Management Committee on matters of concern with suggested remedial action, responsibility undertaken to put in place a mechanism to further enhance data integrity of regulatory statements submitted to CBSL by various process owners etc. The Compliance Division also ensures that the Bank complies with AML / CFT regulations and is in the process of establishing an AML Software in the Bank. This system is scheduled to be completed during 2012.

Conformity to New Regulations introduced during 2011

Date issued	Mandatory Regulations/Directions/Determinations	Bank’s status
6/1/2011	Approval for service exporters to borrow foreign exchange from domestic banks to meet their working capital and fixed capital requirements	Compliant. Int’l Div. Circular No:2011/07 issued on 20.01.2011 covering the stipulations.
21/01/2011	Outward Investment Account (OIA) - Instructions on opening and operating the account	Compliant. Int’l Div. Circular No:2011/12 issued on 15.02.2011 covering the stipulations.
1/2/2011	General Direction No:01/2011 on SLIP system	Significantly compliant. Initiatives are underway to be fully compliant by 1st quarter of 2012.
21/02/2011	Banking Act Determination on Assessment of fitness and propriety of Directors and officers performing executive functions	Compliant. Declarations submitted.
28/03/2011	Financial Transactions Reporting Act No.6 of 2006 - Modified rules on obtaining customer identification data and information for the purpose of KYC and CDD	Significantly compliant. An Internal Gap Analysis is in place with plans to bridge the identified gaps.
17/06/2011	Display of Interest Rates, Exchange Rates, Service Charges Fees and Commissions	Significantly Compliant. Action is under way to have a Centrally controlled rate display mechanism in Branches
28/07/2011	Register any pledge, mortgage or obligation on movable assets as collateral with Secured Transaction Registry at the CRIB.	Compliant
8/8/2011	Assessment of fitness and propriety of CEO’s of Licensed Commercial Banks -A declaration called for the assessment	Compliant



RISK MANAGEMENT

continued

Date issued	Mandatory Regulations/Directions/Determinations	Bank's status
18/08/2011	Direction: Amendment to Opening of Non-Resident Blocked Accounts (NRBA)	Compliant. Int'l Div. Circular No:2011/66 issued on 11.11.2011 covering the stipulations.
18/08/2011	Direction : Repayment of loans obtained by Sri Lankan who have proceeded overseas for educational purposes, from banks universities or financial institutions of foreign countries	Compliant. International Div. circular No:2011/62 issued on 01.11.2011 covering the stipulations
18/08/2011	Direction : Resident Non Nationals' Foreign Currency Account - Amendment to operation of the account	Compliant. Int'l Div Circular No:2011/46 issued on 29.08.2011 covering the stipulations.
26/08/2011	Banking Act Direction 5 of 2011 on Exposure to Stock Market	Noted for necessary compliance. Exposure to Stock Market Policy amended to accommodate changes.
29/09/2011	Banking Act Determination No:2 of 2011 - Annual Licensed Fee of Licensed Commercial Banks (2012 to 2014)	Noted for necessary compliance.
5/10/2011	Banking Act Direction No:7 of 2011 - Integrated Risk Management Framework for Licensed Banks. (To be fully compliant by 05.04.2012)	An Internal Gap Analysis is in place with plans and timelines to bridge the identified gaps.
5/10/2011	Banking Act Direction No:8 of 2011- Customer Charter for Licensed Banks. (To be fully compliant by 05.04.2012)	An Internal Gap Analysis is in place with plans and timelines to bridge the identified gaps.
27/10/2011	Designated Foreign Currencies - Chinese Renminbi has been specified as a designated foreign currency for transactions in both DBU & FCBU units	Compliant. Int'l Div. Circular No:2011/40 dated 06/07/2011 issued covering the stipulations.
31/10/2011	Banking Act Direction No:9 of 2011 - Amendment to Direction on Maintenance of Capital Adequacy Ratio	Noted for necessary compliance.
8/11/2011	Banking Act Order No:2 of 2011 - Banking (Off shore Banking Business Scheme) order - Amendment to Banking Order, 2000 of 7th April 2000.	Compliant. International Div Circular No:2011/75 issued on 07.12.2011 covering the stipulations
6/12/2012	Securities Investment Accounts (SIA) - Amendment to direction number 06/04/01/2010	Noted for necessary compliance.
16/12/2012	Banking Act Direction No:11 of 2011- Amendment to direction No:5 of 2011 on exposure to stock market for LCB's in Sri Lanka.	Noted for necessary compliance.

Date issued	Guidelines	Bank's Status
7/3/2011	Guidelines for handling counterfeit / suspect currency notes of Sri Lanka.	Compliant. Operations Div Circular No:OP/CL/04/2011 issued covering guidelines
14/03/2011	Guidelines on Mobile phone based payment system - Bank -led mobile payment guideline and Custodian based mobile payment services	Existing Bank mobile payment system is compliant with the guidelines. (New proposal to commence the service of custodian based mobile payment service with Dialog Axiata PLC has been submitted to CBSL for clearance/ approval.)
29/04/2011	Guidelines on the operations of the Investment Fund Account	Noted for necessary compliance.
31/10/2011	Amendment to Guideline on the Operations of the Investment Fund Account - section 3.1 of the prevailing Guideline dated 29/04/2011 has been amended	Noted for necessary compliance.

Previous Regulations Issued which are being followed up towards necessary compliance

Obtaining KYC Data from customers (August 2008)	
* New Customers	Complying
* Existing	Data collection in process. Progress being monitored monthly.
Direction on Outsourcing (October 2010)	Significantly Compliant, Identified gaps will be bridged with next renewal /reassignment
Adoption of LKAS 32 and 39 by January 2012	The Bank will be fully compliant with the standards with effect from 2012.
Anti-Money Laundering - Risk profiling of all customers (May 2007)	AML system implementation will be a pre-requisite. Will be implemented upon procurement of AML software in 2012.

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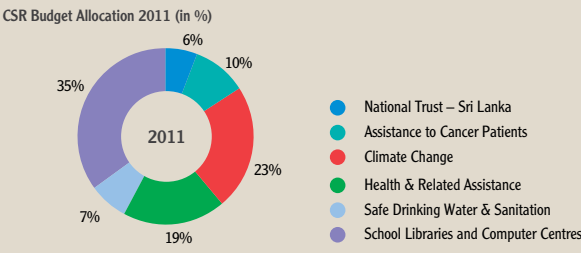


Strategic / Reputational Risk

A formal framework was introduced to assess Strategic Risks arising from market trends / developments in competition, product, channel,

process, human resources, technology etc. Specific risks are identified, impact on HNB's business plans assessed and mitigating actions reviewed on a quarterly basis.

Strategic / Reputational Risk Console

Risk Category	Risk Rating 2011/2010	Mitigating Actions Implemented in 2011	
		Risk Analysis	Risk Mitigating Strategies
Strategic/Reputational Risk			
Risk arising from an event or behaviour that could adversely impact market perception of the Bank thereby affecting its going concern.			
Risk arising from poor external and internal surveillance to identify strategic risks in a timely manner	Moderate / Moderate	Corporate Management meets at least annually at offsite strategy meetings, to develop/review medium term goals and strategic priorities in the context of the environment.	Specific action plans with accountabilities and timelines developed to address each strategic goal / risk area identified.
Risk to brand / reputation arising from lack of inadequate Corporate Social Responsibility practices	Low / Low	An active Sustainability Committee is in place with cross-functional representation to oversee implementation of CSR Projects. 	Key Performance Indicators developed to conceptualize goals and assess progress on CSR initiatives.

Stress Testing

Stress testing is an integral part of the new generation of risk management tools and assists in creating a culture of preparedness in the face of an increasingly volatile and unpredictable business environment. HNB's Stress Testing approaches have continuously evolved in depth and coverage. The focus being to assess how portfolios would react if business conditions deteriorated significantly and the consequent impact on our capital base under various risk scenarios. A Stress Testing Policy is in place and Senior Management regularly reviews the results of the stress tests for action as appropriate. All stress tests results based on information as per 31st December 2011.

Credit Risk

The Bank has implemented stress tests to measure the resilience of its lending and pawning portfolios to negative NPA movements.

The stress testing scenarios include assessing the impact of:

- A. A negative shift in NPA categories on credit portfolio
- B. An increase in the level of NPA on credit portfolio
- C. A reduction in gold prices and resulting increase in the level of NPA of pawning portfolio due to non-redemption of pawning articles
- D. Risk of Top 20 Customers defaulting

Credit Risk		Scenario 1	Scenario 2	Scenario 3
Magnitude of shock		50%	80%	100%
Negative Shift in NPA Categories	Original CAR	Revised CAR		
A. Credit Portfolio	14.51%	14.22%	14.05%	13.93%

Composition of NPA categories: Special Mention 21%, Substandard 20%, Doubtful 8% and Loss 51%.

A negative shift in the NPA categories has a minor effect on the Bank's CAR due to well-diversified portfolio at industry and counterparty level.



RISK MANAGEMENT

continued

Credit Risk		Scenario 1	Scenario 2	Scenario 3
Magnitude of shock		5%	10%	20%
Increase in Non Performing Advances	Original CAR	Revised CAR		
B. Credit Portfolio	14.51%	14.28%	14.05%	13.58%
C. Pawning Portfolio*		11.48%	11.23%	10.58%
D. Top 20 Customer Scenario**		13.67%	12.80%	11.02%

* Impact of a reduction in gold prices on pawning portfolio ** Impact of top 20 customers falling into NPA (based on outstandings)

All three scenarios show comfortable CARs above the regulatory requirement of 10%, even in the extreme scenario of a 20% NPA shock to the Bank's top 20 customers and in the 20% gold decrease scenario on the pawning portfolio where we expect NPA to increase due to non-redemptions.

Market Risk

Market risk stress tests assess the impact of adverse changes in exchange rates, interest rates and prices of financial instruments such as equities and bonds which could affect the assets of the Bank's trading and investment portfolios as well as its profits and capital base.

Foreign Currency Risk	Original CAR	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock		5%	10%	15%
All foreign currencies	14.51%	14.50%	14.48%	14.46%
USD/LKR	14.51%	14.50%	14.48%	14.47%

95% of the Bank's foreign currency exposure is to the USD and it is hedged to a large extent, hence minimal change to CAR.

Equity Risk	Original CAR	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock		10%	20%	40%
Equity Price	14.51%	14.50%	14.48%	14.44%

The Bank holds a very small market equity portfolio therefore impact on CAR is minimal even at 40% shock.

Fixed Income Risk	Original CAR	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock		1%	2%	5%
Fixed Income Total Portfolio	14.51%	14.31%	14.11%	13.50%
Fixed Income Trading Portfolio	14.51%	14.51%	14.51%	14.51%

The Bank has invested to a large extent in government treasury bills and bonds with a duration of approximately 1 year, therefore impact on CAR minimal with the exception of the 5% shock on the total bond portfolio which still gives a comfortable CAR of 13.50%.

Our Roadmap towards implementing Best Practices in Risk Management

History has taught us that economic and financial turmoil provides opportunity for change and progress. Market stress has intensified over the past few months due to increasing uncertainty in the property, equity and bond markets of the western economies, we are mindful that a prolonged crisis in western markets can cause significant reverberations in emerging economies such as ours. In this environment HNB remains committed in its endeavour to continue its efforts in strengthening the risk management infrastructure to pursue the aggressive growth plans envisaged for the future.

We continue to revisit our policy framework and improve our risk dashboards – Credit, Operations, Market and Recovery as a means to

communicate our risk appetite and galvanize actions across the network to address these risks.

Capacity Building for the future

As a systemically important bank in Sri Lanka, HNB has made significant strides to put in place BASEL II (IRB) infrastructure ahead of the regulatory deadline and is largely on track on the roadmap developed for implementation. The key focus areas for 2012 would be to ensure rationalizing of credit infrastructure, strengthening credit appraisal and analytics and introducing best practices in liquidity and interest rate risk management. There would be increased focus on embracing new technology for analytics, business intelligence, data rationalization with a view to supporting risk management more effectively.

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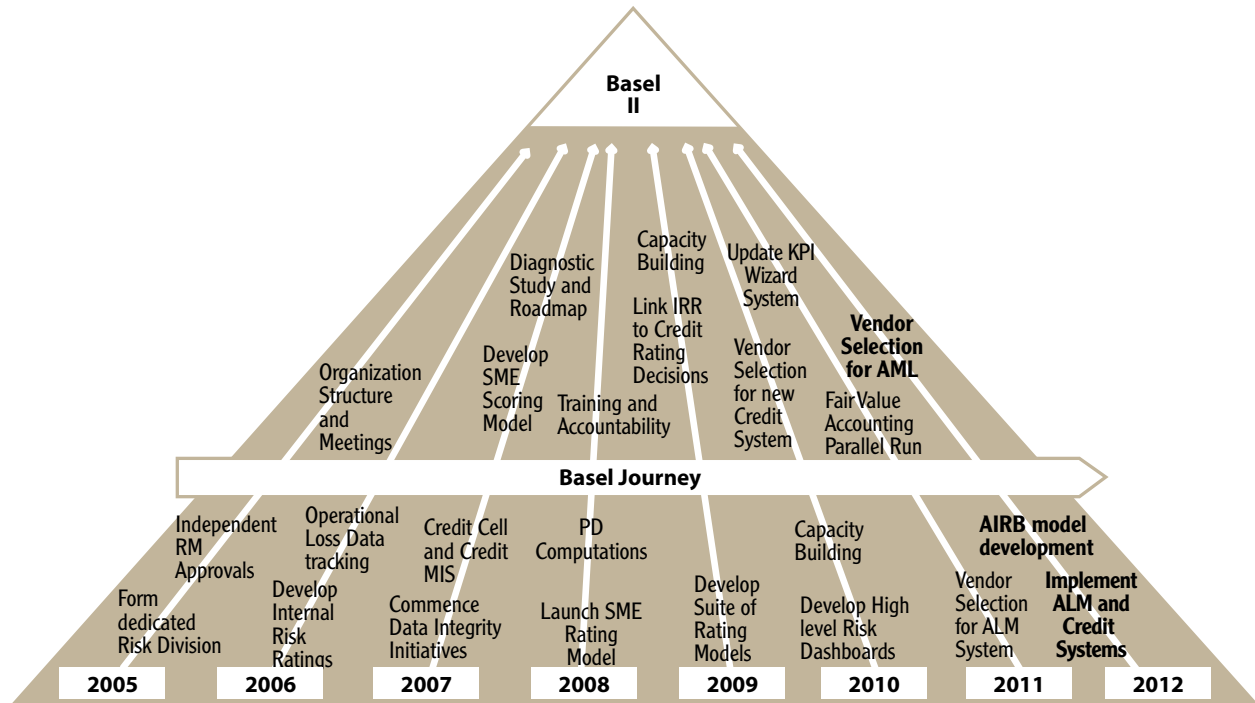
Key Risk Management Initiatives in 2011

Specification of Business Requirements for new Credit System	Implementation underway for new loan origination and rating system with requisite BASEL II infrastructure. Initiative driven by a cross functional project team and steering committee with the assistance of an External Project Manager.
Improving Risk Analytics	Refinement of existing Risk Dashboards - Credit, Operational and Market and developing a Recoveries Dashboard to communicate performance against risk appetite, enable comprehensive data analysis and facilitate accountability.
Capacity Building – Talent and Systems	A comprehensive training program on best practices in Asset and Liability Management and Fund Transfer Pricing was conducted for members of ALCO by a team of foreign experts. The program identified gaps between best practices and our approaches with recommendations on how to close these gaps effectively.
Implementation of LKAS 32 and 39	HNB completed preparation for parallel computations on Fair Value Accounting for Financial Year 2012. HNB engaged the assistance of an external consultancy firm to assist in implementation efforts.

Priorities for 2012

Implementation of ALM System	Assist in implementation of an Asset and Liability Management system with a view to developing the necessary infrastructure to manage liquidity and interest rate risks more effectively.
Implementation of Loan Origination and Rating System	Effective implementation of new credit appraisal system with BASEL advanced approaches infrastructure. Ensure alignment of existing forms, procedures, policies and MIS to ensure expectations met.
Preparation for BASEL Standardized / Advanced Approaches in Operational Risk	Commence development of requisite risk infrastructure – revenue identification by segment, identifying key risk indicators and strengthen loss reporting.

Our Road Map towards Basel II Compliance



KPI: Key Performance Indicator EL: Expected Loss PD: Probability of Default IRR: Internal Risk Ratings RM: Risk Management
 SME: Small and Medium Customers MIS: Management Information System ALM: Asset and Liability Management AML: Anti Money Laundering



YOUR BOARD ROOM GOVERNANCE REPORT...

Chairperson's Statement

When I took over the role of Non Executive Chairperson of HNB on 31st March 2011, I was conscious that my foremost duty was to give leadership and direction to Board of Directors to ensure a sustainable and a long-term value creation for shareholders in a consistent manner that strengthens the confidence of all key stakeholders.

It is an essential part of my role to ensure that appropriate and timely information is available to the Board in a readily understandable format, and that there is a conducive environment in the Boardroom that promotes and supports constructive dialogue on issues requiring decisions and direction from the Board.

Several initiatives were made to strengthen the Corporate Governance Framework of the Bank during the year of which the most significant being the focus to continuously strengthen the Board to successfully meet the challenges in facing the new developments in the banking sector and the economy as a whole.

Two new independent Non Executive Directors were invited to join the Board during the year in order to sustain the balance and composition of the Board and the subcommittees.

The report below demonstrates how the Bank has embraced and complied with the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka in 2008

(the Code) and the Banking Act Direction No 11 of 2007 and subsequent amendments thereto on Corporate Governance for Licensed Commercial Banks in Sri Lanka issued by the Central Bank of Sri Lanka.

As required by the above Code, I hereby confirm that, I am not aware of any material violations of any of the provisions of the Code of Business Conduct and Ethics (as embodied in the Charter of the Board of Directors or the Code of Business Conduct and Ethics as the case may be) by any Director or Corporate Management member of Hatton National Bank PLC.

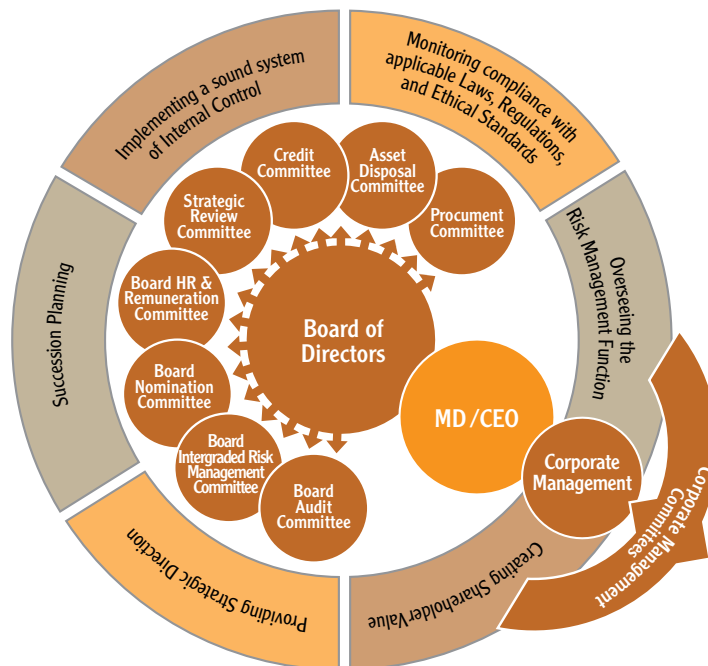
Whilst emphasizing the fact that for Corporate Governance structures to work effectively, active and prudent use of rights by the shareholders is imperative. I hope that this report will assist you to gain a better understanding on how Corporate Governance works at Hatton National Bank PLC.

Dr Rane Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2012

Corporate Governance Framework

Good Corporate Governance practices are not just a matter for the Board but are at the heart of everything that we do within the Bank. The Bank operates within a comprehensive Governance framework, which is outlined in the diagram below and set out in the report that follows;



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Corporate Governance

Corporate Governance is the system by which a Company is directed, controlled and managed. At Hatton National Bank, the Corporate Governance Framework guides our organization and drives towards progress by way of developing and implementing appropriate corporate strategies. The approach to governance is predicated on the belief that there is a link between high-quality governance and the creation of long-term stakeholder value. In pursuing the Corporate Objectives, we have committed to the highest level of governance and strive to foster a culture that values and rewards exemplary ethical standards, personal and corporate integrity and mutual respect.

The Board of Directors, led by the Chairperson, is responsible for the governance of the Bank, and developing effective Governance Framework to meet challenges, both in the short and long term. The Board is committed to reviewing and improving our systems to provide transparency and accountability, and initiate transformational changes whenever necessary to ensure best practices are maintained and enhanced according to the principles of Corporate Governance.

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

HNB has incorporated in its Governance Framework the guidelines prescribed in the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (the Code), Banking Act

Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka.

The extent of compliance by HNB for the year ended 31st December 2011 with the above rule and directive principles and best practices are given in the following sections:



SECTION ONE

covers the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka.



SECTION TWO

covers HNB's level of compliance with the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka issued by the Central Bank of Sri Lanka.

However the compliance with CSE listing rules on Corporate Governance, have not been disclosed as Listed Banks are exempted from complying with the said rules from the year 2010 onwards.



CORPORATE GOVERNANCE INITIATIVES DURING 2011 AT A GLANCE

JANUARY - Board Approval of the Corporate Management Charter.

MARCH - Appointment of the new Non Executive Chairperson and an Independent Non Executive Director following the resignation of two Non Executive Directors in March 2011.

APRIL - Re composition of Board Sub-committees.

JUNE - Strengthening the process of identification, recording and disclosure of Related Party Transactions.

JULY - Further refining the Directors self-assessment process.

OCTOBER - Commenced implementing the provisions of Banking Act Direction on Customer Charter.

- Further strengthening the composition of the Board with the appointment of another Independent Non Executive Director (INED) to bring the total number of INEDs to five (5).

NOVEMBER- Appointment of a Deputy Chief Executive Officer as part of formalization of key management succession and to enable the MD/CEO to enhance focus on strategic initiatives.



YOUR BOARD ROOM GOVERNANCE REPORT...

continued

SECTION ONE

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



SECTION ONE

covers the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka.

Statement of Compliance

The disclosures below reflect HNB's level of conformance to the above Code which comprises of six (6) fundamental principles.

These are namely:

- A. Directors
- B. Directors' Remuneration
- C. Relations with Shareholders
- D. Accountability and Audit
- E. Institutional Investors and
- F. Other Investors

The structures in place and the conformance to the requirement and expectations are tabulated below under the said six fundamental principles.

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
A. DIRECTORS			
A.1. The Board			
The Bank should be headed by a Board, which should direct, lead and control the Bank			
All Directors with the exception of the MD / CEO serves the Bank in a Non Executive capacity. The Board consists of professionals in the fields of Banking, Accounting, Management, Law, Economics, Engineering and Business Leaders. All Directors possess the skills and experience and knowledge complemented with a high sense of integrity and independent judgment. The Board gives leadership in setting the strategic direction and establishing a sound control framework for the successful functioning of the Bank. The Board's composition reflects sound balance of independence and anchors shareholder commitment.			
1. Board Meetings	A.1.1	Adopted	<p>The Board usually meets in monthly intervals, but meets more frequently whenever it is needed.</p> <p>The Board met eighteen (18) times during the year. Scheduled Board and Committee meetings were arranged well in advance, and all Directors were expected to attend each meeting. Any instance of non-attendance at Board meetings were generally related to prior business, personal commitments or illness.</p> <p>The attendance at Board meetings held in 2011 is set out on page 89.</p>
2. Board Responsibilities	A.1.2	Adopted	<p>The Board is responsible to the shareholders for creating and delivering sustainable shareholder value through the management of business.</p> <p>The Board has provided strategic direction in the development of short, medium and long term strategy which is aimed at promoting the long term success of the Bank. The business strategy is reviewed at least on a quarterly basis by the Board with updates at each Board meeting on execution of the agreed strategy by the management.</p> <p>The Board has put in place a Corporate Management team led by the MD / CEO with the required skills, experience and knowledge necessary to implement the business strategy of the Bank. The names and the qualifications of the Corporate Management team are provided on pages 14 to 17. The Board has also implemented a structured approach towards succession planning of the Corporate Management team during the past couple of years, the most significant being the appointment of the Deputy Chief Executive Officer in the latter part of 2011.</p> <p>The Board recognizes it's responsibility for the Bank's system of internal control and for reviewing its effectiveness on a continuous basis. These systems manage the risk of the Bank's business and ensure that the financial information on which business decisions are made and published is reliable. It also ensures that the Bank's assets are safeguarded against unauthorised use or disposition.</p>

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Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
			<p>The Board is satisfied with the integrity of financial information and the robustness of the financial controls and systems of risk management of the Bank. The Bank had complied with all applicable laws and, regulations during the year, while demonstrating a high degree of ethical standards set by the Bank.</p> <p>The updated Charter of the Board of Directors (the Board Charter) was approved in December 2011.</p>
3. Compliance with laws and access to independent professional advice	A.1.3	Adopted	<p>The Board collectively as well the Directors individually, recognize their duty to comply with laws of the country which are applicable to the Bank. The Bank had complied with all applicable laws and regulations during the year.</p> <p>A procedure has been put in place for Directors to seek independent professional advice, in furtherance of their duties, at the Bank's expense. This will be coordinated through the Board Secretary, as and when it is requested.</p>
4. Board Secretary	A.1.4	Adopted	<p>All Directors have access to the Board Secretary, who is an Attorney-at-Law by profession.</p> <p>Her services were available to all Directors, particularly the Non Executive Directors who needed additional support to ensure they receive timely and accurate information to fulfill their duties. Further, she had provided the Board with support and advice relating to corporate governance matters, Board procedures and applicable rules and regulations.</p>
5. Independent judgment	A. 1.5	Adopted	<p>Non Executive Directors are responsible for bringing independent and objective judgment, and scrutinizing the decisions taken by the Corporate Management led by the MD / CEO, on issues of strategy, performance, resources utilisation and business conduct. The Board promotes an environment whereby challenging contribution from the Non Executive Directors is welcomed and encouraged, combined with full support for and empowerment of the MD / CEO in implementing decisions.</p>
6. Dedication of adequate time and effort by the Board and Board Committees	A.1.6	Adopted	<p>The Chairperson and members of the Board have dedicated adequate time for the fulfillment of their duties as Directors of the Bank. In addition to attending Board meetings, they have attended Sub-committee meetings and also have made decisions via circular resolution where necessary. The Board Sub-committees include:</p> <ul style="list-style-type: none"> - Audit Committee - Board Integrated Risk Management Committee - Human Resources & Remuneration Committee - Nomination Committee - Credit Committee - Procurement Committee - Asset Disposal Committee - Strategic Review Committee
7. Training for new Directors	A.1.7	Adopted	<p>The Board of Directors recognize the need for continuous training and expansion of knowledge and undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors.</p> <p>During the year, presentations were made to the Board / Board Sub - committees by the Corporate Management of HNB from time to time on industry specific matters and regulatory updates.</p> <p>The new Directors have attended a number of meetings with the Corporate Management team to familiarize themselves with the Bank's strategy, risk appetite, operations and internal controls.</p>



YOUR BOARD ROOM GOVERNANCE REPORT...

continued

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
A.2. Chairperson and Chief Executive Officer			
<p>There should be a clear division of responsibilities between the Chairperson and Chief Executive to ensure a balance of power and authority, in such a way that any individual has no unfettered powers of decisions.</p> <p>The roles of the Chairperson and Chief Executive Officer are functioning separately at HNB. The Chairperson's main responsibility is to lead, direct and manage the work of the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. MD / CEO is responsible for the day-to-day operations of the Bank.</p>			
8. Division of responsibilities of the Chairperson and MD / CEO	A.2.1	Adopted	The roles of the Chairperson and Chief Executive are separate. The role of the Chief Executive is to manage the day-to-day running of the Bank. The Board has delegated this responsibility to the Chief Executive and he then leads the Corporate Management team in making and executing operational decisions. The Chief Executive is also responsible for recommending strategy to the Board.
A.3. Chairperson's Role			
<p>The Chairperson should lead and manage the Board, ensuring that it discharges its legal and regulatory responsibilities effectively and fully and preserves order and facilitates the effective discharge of the Board function.</p> <p>With effect from 31st March 2011, Dr Ranee Jayamaha was appointed as Chairperson. Her profile is given on page 12.</p>			
9. Role of the Chairperson	A.3.1	Adopted	<p>The Chairperson is responsible for leadership of the Board and ensuring effectiveness in all aspects of its role. The Chairperson of HNB is a Non Executive Director, elected by the Board. The Chairperson's role encompasses:</p> <ul style="list-style-type: none"> - Ensuring that the new Board members are given appropriate induction, covering terms of appointment, duties and responsibilities. - Leading the Board and managing the business of the Board while taking full account of the issues and concerns of the Board. - Approving the agenda prepared by the Board Secretary. - Ensuring that the Board members receive accurate, timely and clear information, in particular about the Bank's performance to enable the Board to take sound decisions, monitor efficiently and provide advice to promote success of the Bank. - Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate included the individual and collective views of the Directors. - Facilitates and encourages discussions amongst all Directors where decisions are needed on matters of risk and strategy. - Encouraging effective participation of all Directors in the decision making process to optimise contribution. - Representing the views of the Board to the public. - Initiates the process for self assessment of the Board from its members and uses the meaningful feedback to further improve the effectiveness of the Board.
A.4. Financial Acumen			
<p>The Board should ensure the availability within it of those with sufficient financial acumen and knowledge to offer guidance on matters of finance.</p> <p>The Board is equipped with members having sufficient financial acumen and knowledge.</p>			
10. Availability of sufficient financial acumen and knowledge	A.4	Adopted	<p>The Chairperson has more than 40 years of experience as a banking sector policy maker / regulator, during which she has acquired hands on experience of implementing monetary policy and financial systems stability initiatives at national level.</p> <p>The MD / CEO is a Fellow member of the Institute of Chartered Accountants of Sri Lanka and the Chartered Institute of Management Accountants – UK. He is also a member of the Sri Lanka Accounting & Auditing Standards Monitoring Board and the Chartered Institute of Management Accountants Governing Board, Sri Lanka.</p> <p>The Directors have experience in the banking and financial sector coupled with their academic background and also possesses financial acumen and knowledge. In addition, they have significant business acumen leading private and public enterprises. The details of their qualifications have been set out on pages 12 and 13.</p>

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Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
A.5. Board Balance			
There should be balance of Executive and Non Executive Directors so that no individual or small group of individuals can dominate the Board's decision-taking.			
All Directors are Non Executive Directors except for the MD / CEO. Each of them bring to the Board, wide experience and the ability to exercise independence and judgment when taking informed decisions.			
11. Presence of Non Executive Directors	A.5.1	Adopted	All Directors are Non Executive Directors except for the MD / CEO. The requirement as per the Code has been complied throughout 2011.
12. Independent Directors	A.5.2	Adopted	Five (5) Non Executive Directors are independent as defined by the Code. The requirement as per the Code has been complied throughout 2011.
13. Criteria to evaluate Independence of Non Executive Directors	A.5.3	Adopted	Please refer Section A 5.5 below. The Board considers Non Executive Director's independence on an annual basis, as part of each Director's performance evaluation. The Board reviewed the independence of each Non Executive Director in 2011 and concluded that each of them continues to demonstrate these essential behaviours.
14. Signed declaration of independence by the Non Executive Directors	A.5.4	Adopted	All Non Executive Directors of the Bank have made written submissions as to their independence against the specified criteria set out by the Bank, which is in line with the requirements of Schedule H of the Code.
15. Determination of independence of the Directors by the Board	A.5.5	Adopted	The Board has determined that the submission of declaration/s by the Non Executive Directors, as to the independence of them, as fair representation and will continue to evaluate their submission annually. Circumstances have not arisen for the determination of independence by the Board, beyond the criteria set out in the Code. The following Directors are deemed to be Independent Directors; Ms Pamela C. Cooray Mr N G Wickremeratne Ms M A R C Cooray Dr W W Gamage Dr L R Karunaratne
16. Senior independent Director	A.5.6	N/A	Although the requirement to appoint a Senior Independent Director does not arise under this Code, the Bank designated Ms Pamela C. Cooray as the Senior Independent Director in 2010, to meet the requirement under Rule 3(5) (ii) of the CBSL Direction on Corporate Governance.
17. Confidential discussion with the Senior Independent Director	A.5.7	N/A	Please refer above comment.
18. Meeting of Non Executive Directors	A.5.8	Adopted	Chairperson meets with the Non Executive Directors without the presence of MD / CEO, on a need basis. The Board has met once (1) without the presence of the CEO during 2011.
19. Recording of concerns in Board Minutes	A.5.9	N/A	There were no concerns raised by the Directors during the year, which needed to be recorded in the Board meeting minutes.
A.6. Supply of Information			
Management should provide time bound information in a form and of quality appropriate to enable the Board to discharge its duties.			
Financial and non-financial information are analysed and presented to the Board to make informed and accurate decisions.			
20. Information to the Board by the Management	A.6.1	Adopted	The Board was provided with timely and appropriate information by the management by way of Board papers and proposals. The Board sought additional information as and when necessary. Members of the Corporate Management made presentations on issues of importance. The Chairperson ensured that all Directors were briefed on issues arising at Board meetings. The Directors have free and open contact with the Corporate and Senior Management of the Bank.



YOUR BOARD ROOM GOVERNANCE REPORT...

continued

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
21. Adequate time for effective Board meetings	A.6.2	Adopted	The Board papers were sent to the Directors at least a week before the respective Board meetings giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the meeting.
A.7. Appointments to the Board			
A formal and transparent procedure should be followed for the appointment of new Directors to the Board.			
<p>The Nomination Committee assess the suitability of the prospective nominees to the Board and recommends persons found to be “fit and proper” for consideration of the entire Board. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a “fit and proper” person, prior to the appointment. The following Non Executive Directors were appointed to the Board during the year.</p> <p>Dr Ranee Jayamaha Dr WW Gamage Dr L R Karunaratne</p> <p>The profiles of the above Directors are given on pages 12 and 13.</p>			
22. Nomination Committee	A.7.1	Adopted	<p>The Nomination Committee made recommendations to the Board on all new appointments. The Terms of Reference for the members of the Nomination Committee are similar to the one set out in Schedule A to the Code. The Terms of Reference of the Committee was formally approved by the Board in 2012. The following Directors served on the Nomination Committee during 2011. MD / CEO attends these meetings by invitation.</p> <p>Mr Rienzie T. Wijetilleke (resigned w.e.f 31st March 2011) Mr MV Theagarajah (resigned w.e.f. 31st March 2011) Dr Ranee Jayamaha (appointed w.e.f. 31st March 2011) Dr WW Gamage (appointed w.e.f. 31st March 2011) Mr R K Obeyesekere (resigned w.e.f. 30th December 2011) Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)</p> <p>Mr Rienzie T. Wijetilleke was the Chairman of the Nominations Committee up to 31st March 2011. Dr Ranee Jayamaha was appointed as the Chairperson of this Committee from 31st March 2011 to 15th December 2011. Dr WW Gamage was appointed as the Chairman of this committee w.e.f. 15th December 2011 in order to comply with Governance Regulations.</p>
23. Assessment of Board Composition by the Nomination Committee	A.7.2	Adopted	<p>The Nomination Committee carried out continuous review of the structure, size and composition (including the skills, knowledge, experience and independence required of Directors) of the Board to address and challenge adequately key risks and decisions that confront, or may confront, the Board and makes recommendations to the Board with regard to any changes.</p> <p>New appointments were made to strengthen the Board composition to respond to the challenges and take advantage of the opportunities in the Banking sector. Currently, more than 50% of Board members are Independent Non Executive Directors.</p>
24. Disclosure of details of new Directors to shareholders	A.7.3	Adopted	<p>Details of new Directors were disclosed to the shareholders on their appointment by way of public announcements as well as in the Annual Report. Prior approval for appointment of new Directors was obtained from the Director of Bank Supervision of CBSL and notification was sent to Colombo Stock Exchange. All new appointments as well as continuing Directorships are reviewed by the Nomination Committee. The Directors are required to report any substantial change in their professional responsibilities and business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.</p>

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Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
A.8. Re - election			
All Directors should submit themselves for re-election at regular intervals and at least once in every three years. And all Non Executive Directors should be appointed for a specific terms and subject to re-election.			
25. Appointment of Non Executive Directors	A.8.1	Adopted	<p>Articles of Association of the Bank requires, each Director other than the MD / CEO and any nominee Director, to retire by rotation once in every three years and is required to stand for re-election by the shareholders at the Annual General Meeting. The proposed re-election of Directors is subject to prior review by the full Board.</p> <p>Ms M A R C Cooray and Mr N G Wickremeratne retire by rotation at the AGM under the Articles of Association of the Bank. Ms M A R C Cooray and Mr N G Wickremeratne offer themselves for re-election, with the unanimous support of the Board.</p> <p>Dr Raneey Jayamaha, Dr W W Gamage and Dr L R Karunaratne were appointed during the year to fill in casual vacancies which arose due to resignations of Mr Rienzie T. Wijetilleke, Mr M V Theagarajah and Mr R Seevaratnam.</p> <p>All Directors appointed to fill casual vacancies during the year will be subject to election by shareholders at the 2012 Annual General Meeting.</p>
26. Election of Directors by the shareholders	A.8.2	Adopted	Please refer to comments above.
A.9. Appraisal of Board Performance			
The Board should periodically appraise its own performance against the pre set targets in order to ensure that the Board responsibilities are satisfactorily discharged.			
27. Appraisal of Board performance	A.9.1	Adopted	<p>Each member of the Board carried out a self assessment of his / her own effectiveness as an individual as well as effectiveness of the Board as a team for the year 2011. The outcome of the assessment were tabled at a meeting of the Board in February 2012. The Sub committees, except for the Audit Committee, carries out a self assessment process annually, in accordance with the preset criteria, to ensure they function effectively and efficiently with the objective of facilitating continuous improvement in conformance and performance related areas.</p> <p>The Audit Committee evaluation is conducted by the Non Executive Chairperson, with the assessments from the Committee members, CEO, Deputy CEO, SDGM - Strategy and Compliance, CFO, Head of Internal Audit and the External Auditor, in accordance with international best practices.</p>
28. Annual self evaluation of the Board and its Committees	A.9.2	Adopted	Refer to comments given for Section A.9.1
29. Disclosure of the method of Appraisal of Board and Board Sub Committee performance	A.9.3	Adopted	Refer to comments given for Section A.9.1
A.10. Disclosure of Information in respect of Directors			
Details in respect of each Director should be disclosed in the Annual Report for the benefit of the shareholders.			
30. Details in respect of Directors	A.10.1	Adopted	Details of the Directors are given on pages 10 to 13. Directors attendance at the Board and Board Sub Committee meetings are given on page 89.
A.11. Appraisal of the CEO			
The Board of Director should at least annually assess the performance of the Chief Executive Officer.			
31. Targets for MD / CEO	A.11.1	Adopted	MD / CEO's performance objectives are aligned with business sustainability of the Bank. The performance targets for the MD / CEO are set at the commencement of every year by the full Board which are in line with the short, medium and long term objectives of the Bank.



YOUR BOARD ROOM GOVERNANCE REPORT...

continued

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
32. Evaluation of the performance of the MD / CEO	A.11.2	Adopted	There is an ongoing process to evaluate the performance of MD / CEO against the financial and non financial targets set as described above, which is followed by a formal annual review by the Board at the end of each financial year.
B. DIRECTORS' REMUNERATION			
B.1. Remuneration Procedures			
The Bank should have a formal and transparent procedure for developing policy on executive remuneration and fixing the remuneration packages of individual Directors. No Director should be involved in deciding his/her remuneration in order to avoid the self review threat.			
33. HR & Remuneration Committee	B.1.1	Adopted	<p>The HR & Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for the Executive Director and the Corporate Management, and for making all relevant disclosures.</p> <p>The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD / CEO. The MD / CEO participates at meetings when deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management team.</p>
34. Composition of the HR & Remuneration Committee	B.1.2 B.1.3	Adopted Adopted	<p>The following Non Executive Directors served on the HR & Remuneration Committee during 2011.</p> <p>Ms Pamela C. Cooray Mr N G Wickremeratne Mr Rienzie T. Wijetilleke (resigned w.e.f. 31st March 2011) Dr Raneey Jayamaha (appointed w.e.f. 31st March 2011) Mr R K Obeyesekere (resigned w.e.f. 30th December 2011) Dr W W Gamage (appointed w.e.f. 13th September 2011) Ms Pamela C. Cooray serves as the Chairperson of the above Committee.</p> <p>The Terms of Reference of the Committee was formally approved by the Board in 2012.</p>
35. Remuneration of the Non Executive Directors	B.1.4	Adopted	The Board as a whole decides the remuneration of the Non Executive Directors. The Non Executive Directors receive a fee for being a Director of the Board and additional fee for either chairing or being a member of a Committee, working on special Committees and / or serving on Subsidiary Boards. They do not receive any performance related / incentive payments.
36. Consultation of the Chairperson and access to professional advice	B.1.5	Adopted	Input of the Chairperson is obtained by her involvement as a member of the said Sub - committee. External professional advice is sought by the HR & Remuneration Committee, on a need basis through the Board Secretary.
B.2. Level and make up of Remuneration			
The level of remuneration of both Executive and Non Executive Directors should be sufficient to attract and retain the Directors needed to run the Bank successfully. A Proportion of Executive Directors remuneration should be structured to link rewards to the corporate and individual performance.			
37. Level and make up of the remuneration of MD / CEO	B.2.1	Adopted	<p>The Board is mindful of the fact that the remuneration of Executive and the Non Executive Directors should reflect the market expectations and is sufficient enough to attract and retain the quality of Directors needed to run the Bank. The remuneration package of the MD / CEO is structured to link rewards to corporate and individual performance.</p> <p>The Bank's remuneration framework for the CEO is designed to create and enhance value for all HNB's stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank.</p>
38. Comparison of remuneration with other companies	B.2.2	Adopted	The HR & Remuneration Committee in deciding the remuneration of the Directors (including the compensation package of the MD / CEO) takes into consideration the level of remuneration paid by the other comparable companies, performance and risks entailed in his job.
39. Comparison of remuneration with other companies in the Group	B.2.3	N/A	The size and scale of the Bank is not comparable with any other Group companies.

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Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
40. Performance related payment to MD / CEO	B.2.4	Adopted	Please refer to Section B.2.1 on page 76.
41. Executive share options	B.2.5	Adopted	Share options have been offered to the Executive Director as part of the scheme offered to Senior and Corporate Management which was approved by the shareholders of the Bank. The details of which are given in note No 46 (d) of the Financial Statements on page 244.
42. Deciding the Executive Directors remuneration	B.2.6	Adopted	In deciding the remuneration of the MD / CEO the Bank took note of the provisions set out in Schedule D.
43. Early termination of Directors	B.2.7	N/A	Not applicable to the Board except for the MD / CEO who is an employee of the Bank and his terms of employment is governed by the contract of service.
44. Early termination not included in the initial contract	B.2.8	N/A	Refer to comments above.
45. Remuneration of the Non Executive Directors	B.2.9	Adopted	Non Executive Directors received a nominal fee in line with the market practices. Non Executive Directors do not participate in the current share option plans of the Bank and / or other performance related incentive schemes.

B.3. Disclosure of Remuneration

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

46. Disclosure of remuneration	B.3.1	Adopted	Please refer to Section B.1.2 on page 76 for the details on the composition of the HR & Remunerations Committee. The Committee's report setting out the policy of the Committee is given on page 164. The Compensation paid to the Board of Directors is disclosed in aggregate in note No 15 to the Financial Statements on page 199.
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C. RELATIONS WITH SHAREHOLDERS

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

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

47. Use of proxy votes	C.1.1	Adopted	The Bank has a mechanism to record all proxy votes and proxy votes lodged for each resolution prior to the General meeting.
48. Separate resolution for all separate issues	C.1.2	Adopted	The Board, remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain its value framework in all shareholder dealings and communications. HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each such issue, separately.
49. Availability of all Board Sub Committee Chairmen at the AGM	C.1.3	Adopted	The Board, which includes the Chairpersons of the HR & Remuneration, Nomination and Board Integrated Risk Management Committees, was present at the AGM to answer any questions. The Chairman of the Audit Committee was not present at the 2010 AGM held in March 2011 due to a prior personal commitment, however all the other members of the Audit Committee were present at the AGM, to answer any questions raised by the shareholders.
50. Adequate notice of the AGM	C.1.4	Adopted	The primary modes of communication between HNB and the shareholders are the Annual Report and AGM. Information is provided to the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of HNB, either verbally or in writing prior to the AGM. All shareholders irrespective of their voting status are encouraged to attend the AGM. The Annual Report including financial statements and the notice of the meeting are sent to shareholders at least 15 working days prior to the date of the AGM.
51. Procedures of voting at General Meetings	C.1.5	Adopted	Voting procedures at General Meetings are circulated to the shareholders.



YOUR BOARD ROOM GOVERNANCE REPORT..

continued

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
C.2. Major transactions			
Directors should disclose to shareholders all proposed material transactions which would materially alter the net asset position of the Bank, if entered into.			
52. Major transactions	C.2.1	Adopted	During 2011 there were no major transactions as defined by Section 185 of the Companies Act No 07 of 2007 which materially affected HNB's net asset base. Transactions, if any, which materially affect the net assets base of HNB, will be disclosed in the quarterly / annual financial statements.
D. ACCOUNTABILITY AND AUDIT			
D.1. Financial Reporting			
The Board should present a balanced and understandable assessment of the company's financial position, performance and prospects.			
53. Statutory and Regulatory reporting	D.1.1	Adopted	HNB has reported a true and fair view of its position and performance for the year ended 31st December 2011 and at the end of each quarter of 2011. In the preparation of quarterly and annual financial statements, HNB had strictly complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. HNB has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank of Sri Lanka, the Colombo Stock Exchange and the Securities and Exchange Commission.
54. Directors' report in the Annual Report	D.1.2	Adopted	The "Annual Report of the Board of Directors on the Affairs of the Company" which is given on pages 155 to 161 covers all areas of this Section.
55. Statement of Directors' and Auditor's responsibility for the Financial Statements	D.1.3	Adopted	The statement of "Directors' Responsibility for Financial Reporting" is given on page 170. Auditor's reporting responsibility is given in their report on the Financial Statements on page 171.
56. Management Discussions and Analysis	D.1.4	Adopted	The Management Discussion and Analysis is given on pages 22 to 43.
57. Declaration by the Board that the business as a going Concern	D.1.5	Adopted	This is given in the "Annual Report of the Board of Directors on the Affairs of the Company" on pages 155 to 161.
58. Summoning an EGM to notify serious loss of capital	D.1.6	Adopted	Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.
D.2. Internal Control			
The Board should have a sound system of internal controls to safeguard shareholders' investments and the Bank's assets.			
59. Annual evaluation of the internal controls system	D.2.1	Adopted	The Board is responsible for establishing a sound framework of internal controls and monitoring its effectiveness on a continuous basis. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published is reliable, and also ensures that the Bank's assets are safeguarded against unauthorised use or disposition. The Internal Audit Division of the Bank carries out regular reviews on the internal control system including internal control over financial reporting. The Audit Committee monitors, reviews and evaluates the effectiveness of internal control system including the internal controls over financial reporting. In the year 2011, the Board of Directors was satisfied with the effectiveness of the system of internal controls of the Bank. The report by the Board of Directors on the Internal Control over Financial Reporting is given on pages 90 and 91. The External Auditors of the Bank have independently reviewed the report of the Directors referred to above and have issued a report which is given on page 92.
60. Need for internal audit function	D.2.2	N/A	The Bank's internal audit function is managed by capacity which has been developed in house.

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Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
D.3. Audit Committee			
The Board should have a formal and transparent arrangements in selecting and applying the accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the Bank's External Auditor.			
61. Composition of the Audit Committee	D.3.1	Adopted	<p>The following Directors served on the Audit Committee during 2011.</p> <p>Mr N G Wickremeratne Ms Pamela C. Cooray Mr R Seevaratnam (resigned w.e.f. 31st March 2011) Ms M A R C Cooray (appointed w.e.f. 9th March 2011) Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)</p> <p>Mr N G Wickremeratne was appointed Chairman of the Audit Committee with effect from 31st March 2011, on resignation of Mr R Seevaratnam, former Chairman of the Committee.</p> <p>The said Committee met nine (9) times during the year. In May 2011 the Committee co-opted Mr H M A Jayasinghe, Partner - Messers Ernst & Young Sri Lanka, as a consultant.</p> <p>Mr Jayasinghe is a Fellow member of the Institute of Chartered Accounts of Sri Lanka and the Chartered Institute of Management Accountants-UK. The Board Secretary functions as the Secretary to the Audit Committee. The CEO, Deputy CEO, SDGM - Strategy & Compliance, DGM - Risk & Credit Quality, Head of Internal Audit, CFO and External Auditor attend meetings on invitation.</p>
62. Review of Objectivity of the External Auditor	D.3.2	Adopted	<p>The Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.</p> <p>The Committee sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account :</p> <p>(a) Relevant regulations with regard to the provision of non-audit services and the guidelines issued by the Central Bank of Sri Lanka on "Prohibited Services".</p> <p>(b) The External Auditor's skills and experience for providing the particular non-audit service.</p> <p>(c) The Nature of non-audit services, the related fee levels individually and in aggregate relative to the audit firm.</p> <p>The Audit Committee has the primary responsibility for making recommendations on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.</p>
63. Terms of reference of the Audit Committee	D.3.3	Adopted	<p>The Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was last reviewed in 2010. The Board also considered the Code of Best Practice on Audit Committees of the ICASL in defining the terms of reference for the Audit Committee.</p> <p>Duties of the committee encompasses:</p> <ul style="list-style-type: none"> - Assisting the Board in the preparation and presentation of Financial Statements - Bank's compliance with applicable regulations - Assess the processes to ensure internal controls are adequate, specially in relation to financial reporting - Assess the Bank's ability to continue as a going concern <p>The Audit Committee monitors and reviews the effectiveness of HNB's Internal Audit function. The Head of Internal Audit reports to the Audit Committee. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It ensures that the Internal Audit plan adequately covers the significant risks of the Bank, reviews the important Internal Audit findings and follow-up procedures.</p>



YOUR BOARD ROOM GOVERNANCE REPORT...

continued

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2011
			The Audit Committee is authorized to obtain external professional advice and to invite outsiders with relevant experience to attend if necessary. The Committee also has full access to information in order to investigate into matters relating to any matter within its terms of reference.
64. Disclosures of the Audit Committee	D.3.4	Adopted	<p>The names of the members of the Audit Committee are given in the Audit Committee Report on pages 167 and 168.</p> <p>The Committee ensures that the rotation of External Audit Engagement Partner, once in every 5 years, is met. The External Auditor, has provided an Independence confirmation in compliance with the "Guidelines for Appointment of Auditors of Listed Companies" issued by SEC.</p> <p>In order to safeguard the objectivity and independence of the External Auditor, the Audit Committee reviewed the nature and scope taking account of the regulations guidelines stated in Section D.3.2 on page 79.</p>
D.4. Code of Business Conduct and Ethics			
The Bank should develop a Code of Business Conduct and Ethics for Directors and members of the Senior Management team.			
65. Code of Business Conduct and Ethics	D.4.1	Adopted	<p>The Bank has developed a Code of Business Conduct and Ethics for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the Bank's assets, compliance with applicable laws and regulations and encouraging the reporting of any illegal or unethical behaviour etc. The code of business conduct and ethics for Directors is embodied in the Board Charter.</p> <p>The Board is not aware of any material violations of any of the provisions of the Code of business conduct and ethics by any Director or Corporate Management member of the Bank.</p>
66. Affirmation by the Chairperson that there is no violation of the code of conduct & ethics	D.4.2	Adopted	Please refer to Chairperson's statement on page 68 for details.
D.5. Corporate Governance Disclosures			
The Bank should disclose the extent of adoption of best practice in Corporate Governance.			
67. Disclosure of Corporate Governance	D.5.1	Adopted	This requirement is met through the presentation of this report.
E. INSTITUTIONAL INVESTORS			
E.1. Shareholders voting			
Institutional shareholders are required to make considered use of their votes and encouraged to ensure their voting intentions are translated into practice.			
68. Institutional shareholders	E.1.1	Adopted	Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and concern to the general membership. The Investor Relations team headed by the MD / CEO has regular discussions with key institutional shareholders to share highlights of the Bank's performance and also with the view to obtaining constructive feedback. The feedback obtained from institutional shareholders are communicated to the entire Board by the MD / CEO.
E.2. Evaluation of Corporate Governance initiatives			
Institutional investors are encouraged to give due weight to all relevant factors in Board structure and composition.			
F. OTHER INVESTORS			
F.1. Investing / Divesting decision			
69. Individual Shareholders	F.1	Adopted	Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on their investing, holding or divesting decisions.
F.2. Shareholder Voting			
70. Individual shareholders voting	F.2	Adopted	Individual shareholders are encouraged to participate at Annual General Meetings and exercise their voting rights.

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SECTION TWO

Statement of Compliance

Central Bank of Sri Lanka issued the Direction on Corporate Governance (Banking Act Direction No 11 of 2007 and subsequent amendments thereto), in order to improve and sustain the Corporate Governance processes and practices of the Licensed Commercial Banks in Sri Lanka. The disclosures below reflect HNB's level of conformance to the above Direction which comprises of eight (8) fundamental principles, namely:

- 1 The responsibilities of the Board
- 2 The Board's composition
- 3 Criteria for the assessment of the fitness and propriety of Directors
- 4 Management functions delegated by the Board
- 5 The Chairperson and Chief Executive Officer
- 6 Board appointed Sub Committees
- 7 Related Party Transactions and
- 8 Disclosures



SECTION TWO
covers HNB's level of compliance with the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka issued by the Central Bank of Sri Lanka.

The structures in place and the conformance to the requirement and expectations are tabulated below under the said eight fundamental principles.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
3 (1) The Responsibilities of the Board			
1. Strengthening the safety and soundness of the Bank	Rule 3 (1) (i)	Compliant	<p>The updated Board Charter which was formally approved by the Board in December 2011, sets out the responsibility of the Board.</p> <p>The Board is responsible for formulating strategy, ensuring the adequacy of the risk management processes, review of the internal control system and defining the responsibility of the Corporate Management. Please refer Section A.1.2 of the SEC & ICASL Code table on page 70 for further details.</p> <p>The Board has strengthened the safety and soundness of the Bank through the implementation of the following :</p> <p>(a) Strategic Objectives and Corporate Values The Bank's strategic objectives and corporate values which are derived from our vision and mission statement have been communicated to all staff members throughout the Bank. Further, as explained in Section D.4.1. of the SEC & ICASL Code table on page 80, the Bank has developed a Code of Business Conduct and Ethics for all employees, which is in line with our strategic objectives and corporate values. This Code was communicated to all staff members throughout the Bank.</p> <p>(b) Overall Business Strategy The Board has provided direction in the development of short, medium and long term strategy of the Bank with the objective of promoting sustainability and profitable growth of the Bank.</p> <p>During the year, the Board approved a strategic plan for the next 03 years covering 2012- 14. The business strategy is reviewed at least on a quarterly basis by the Board with updates at Board meetings on execution of the agreed strategy. The Board approves and monitors the annual budget which is derived from Bank's strategic plan.</p> <p>Further, the overall risk management policy, procedures and mechanisms with time bound implementation milestones was approved and monitored by the Board Integrated Risk Management Committee on a regular basis.</p> <p>(c) Risk Management The Board takes responsibility for the overall risk framework of the Bank. The Board Integrated Risk Management Committee ensures risks taken in Credit, Operational, Market, Strategic and other areas are within the approved risk appetite set out by the Board.</p>



YOUR BOARD ROOM GOVERNANCE REPORT...

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
			<p>(d) Communication with Stakeholders The Board is responsible for ensuring timely and effective communication with shareholders and other stakeholders. The Bank is in the process of implementing the provisions of Banking Act Direction No 8 of 2011 “Customer Charter of Licensed Banks” which became effective in 2012. This Charter sets key standards of fair banking practices envisaged by customers when they undertake transactions with the Bank and provides guidelines to adopt a “Code of Conduct” on customer protection. The Charter also includes a set of customer obligations towards the Bank in the interest of stable relationship.</p> <p>Please refer Section E.1.1 of the SEC & ICASL Code table on page 80 for further details.</p> <p>(e) Bank’s Internal Control System and Management Information System Please refer Section D.2.1 of the SEC & ICASL Code table on page 78.</p> <p>(f) Key Management Personnel According to Sri Lanka Accounting Standard 30 (Revised 2005) “Related Party Disclosures”, Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, the Directors (including Executive and Non Executive Directors), and their immediate family members have been classified as KMP of the Bank.</p> <p>Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective Director for more than 50% of his / her financial needs.</p> <p>(g) Authority and Responsibility of Key Management Personnel Duties and responsibilities of the Board of Directors are included in the Board Charter.</p> <p>(h) Oversight of the affairs of the Bank by Key Management Personnel The Board of Directors formulates policies and exercises oversight of the affairs of the Bank through the MD / CEO.</p> <p>(i) Board’s own Governance Practices The effectiveness of the Board’s own governance practices, including the process for selection, nomination and election of Directors (which is explained in detail in Section A.7.1 and A.7.2 of the SEC & ICASL Code table on page 74) and the process for management of conflict of interest (which is explained in detail under Rule 3 (1) (xii)) are reviewed by Board on a periodic basis. Further, the review of the effectiveness of the Board’s own Governance practices are embodied in the Board and Sub Committee self-assessment process which is explained in detail under Rule 3 (1) (xvii) and Section A.9.1 of the SEC and ICASL Code table on page 75.</p> <p>(j) Succession Plan for Corporate Management Personnel Please refer Section A.1.2 of the SEC & ICASL Code table on page 70 for details on succession planning for Corporate Management Personnel.</p> <p>(k) Regular Meetings with Corporate Management Personnel As explained in Section A.6.1 of the SEC & ICASL Code table on page 73, the Directors have free and open contact with the Corporate and Senior management of the Bank. Further Non Executive Directors have the option to attend important management meetings at the invitation of MD / CEO.</p> <p>(l) Regulatory Environment Please refer Section A.1.3 of the SEC & ICASL Code table on page 71 for details.</p> <p>(m) Review of Objectivity of the External Auditor Please refer Section D.3.2 of the SEC & ICASL Code table on page 79.</p>
2. Chairperson and CEO	Rule 3 (1)(ii)	Compliant	The Board has appointed the Chairperson and the Chief Executive. The roles of the Chairperson and the Chief Executive are separate. Please refer Section A.2 and A.3 of the SEC & ICASL Code table on page 72 for details.
3. Board Meetings	Rule 3 (1)(iii)	Compliant	Please refer Section A.1.1 of the SEC & ICASL Code table on page 70.

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
4. Inclusion of proposals by all Directors in the agenda	Rule 3 (1)(iv)	Compliant	Proposals from all Directors on promotion of business and management of risk and other areas relevant to the progress of the Bank are included where relevant in the agenda for regular meetings.
5. Notice of Meetings	Rule 3 (1)(v)	Compliant	Directors are given adequate time and usually at least 7 days of notice is given for regular Board meetings. For all other meetings a reasonable notice period is given.
6. Non attendance of Directors	Rule 3 (1)(vi)	Compliant	All Directors have attended at least two thirds (2/3) of the meetings held during 2011. Further no Director has been absent from three consecutive regular Board meetings during 2011.
7. Board Secretary	Rule 3 (1)(vii) Rule 3 (1)(viii)	Compliant	Please refer Section A.1.4 of the SEC & ICASL Code table on page 71 for details.
8. Minutes of the Meetings	Rule 3 (1)(ix) Rule 3 (1)(x)	Compliant	Minutes of the Board meetings are maintained in sufficient detail by the Board Secretary, and is open for inspection by any Director.
9. Independent professional advice	Rule 3 (1)(xi)	Compliant	Please refer Section A.1.3 of the SEC & ICASL Code table on page 71.
10. Conflicts of Interest	Rule3 (1)(xii)	Compliant	<p>The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board, declares his / her interest and unless the Board resolves otherwise, he / she does not participate in discussions or vote on that specific matter.</p> <p>During the year, the Bank has also taken steps to strengthen the process for identification, recording and disclosure of related party transactions. The Bank will continue to strengthen this process.</p>
11. Formal schedule of matters	Rule 3(1)(xiii)	Compliant	<p>The Board reserves for itself a formal schedule of matters on which it takes the ultimate decision.</p> <p>The Board has approved the Terms of Reference of the Corporate Management during 2011.</p>
12. Situation of Insolvency	Rule 3(1)(xiv)	N/A	This situation has not arisen during the year.
13. Capital adequacy	Rule3 (1)(xv)	Compliant	The Bank has been fully compliant with the capital adequacy requirements of the Monetary Board during 2011.
14. Corporate Governance Report	Rule 3 (1)(xvi)	Compliant	This requirement is met through the presentation of this report.
15. Annual self assessment by the Directors	Rule3 (1)(xvii)	Compliant	<p>Until 2010, the annual self assessment of the Board was performed by the Chairman with input from other Directors. In 2011, this process has been further refined by individual Directors performing an annual self-assessment of their own performance and the effectiveness of the Board as a whole. The summary findings together with areas for future improvement has been tabled at the Board meeting for discussion and endorsement by the full Board.</p> <p>Each director carries out an assessment of "fitness and propriety" to serve as a Director of the Bank. These declarations are tabled at the Board meeting prior to onward transmission to the Director Bank Supervision of the Central Bank of Sri Lanka.</p> <p>Please refer Section A.9.1 of the SEC & ICASL Code table on page 75 for details of the evaluation of the Board and the Sub-committees.</p>
3 (2) The Board's Composition			
16. Number of Directors	Rule 3 (2)(i)	Compliant	During the year the Board comprised of nine (9) Directors and as at balance sheet date the number was reduced to seven (7).
17. Period of service of a Director	Rule 3 (2)(ii)	Compliant	The compliance of this section of the rule is mandatory with effect from 01st January 2012. Mr R K Obeyesekere resigned from the Board w.e.f. 30th December 2011 and Mr D H S Jayawardena had ceased to be a director w.e.f. 31st December 2011, in complying with this Section.



YOUR BOARD ROOM GOVERNANCE REPORT..

continued

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
18. Appointment of an employee as a Director	Rule 3 (2)(iii)	Compliant	Mr Rajendra Theagarajah (MD/CEO) is the only employee appointed to the Board as at date, as such the number of Executive Directors does not exceed one third (1/3) of the number of Directors of the Board.
19. Independent Non Executive Director	Rule 3 (2)(iv)	Compliant	The Board includes five (5) Independent Non Executive Directors as per the definition of this Direction, which is more than one third (1/3) of the Board. The Board considers Non Executive Directors' independence on an annual basis, based on the self declaration and as part of each Director's self assessment.
20. Alternative Director	Rule 3 (2)(v)	Compliant	This situation has not arisen.
21. Credibility, skills and experience of Non Executive Directors	Rule 3 (2)(vi)	Compliant	Please refer pages 10 to 13 for the profiles of the Non Executive Directors.
22. Presence of Non Executive Directors in Board Meetings	Rule 3 (2)(vii)	Compliant	At all Board meetings convened during the year, more than one half (1/2) of the Directors present were Non Executive Directors.
23. Details of Directors	Rule 3 (2)(viii)	Compliant	Please refer page 89 for the details of the Directors and their categories.
24. Appointment of new Directors	Rule 3 (2)(ix)	Compliant	Please refer Section A.7 of the SEC & ICASL Code table on page 74 for details.
25. Appointment to fill a casual vacancy	Rule 3 (2)(x)	Compliant	Dr Raneer Jayamaha, Dr W W Gamage and Dr L R Karunaratne were appointed during the year to fill in casual vacancies which arose due to resignations of Mr Rienzie T. Wijetilleke, Mr MV Theagarajah and Mr R Seevaratnam. All Directors appointed to fill casual vacancies during the year will be subject to election by shareholders at the 2012 Annual General Meeting.
26. Resignation / removal of a Director	Rule 3 (2)(xi)	Compliant	The following directors resigned from the Board Mr Rienzie T. Wijetilleke (w.e.f. 31st March 2011) Mr MV Theagarajah (w.e.f. 31st March 2011) Mr R Seevaratnam (w.e.f. 31st March 2011) Mr R K Obeyesekera (w.e.f. 30th December 2011) Mr D H S Jayawardena (ceased to be a Director of the Bank w.e.f. 31st December 2011) Mr Rienzie T. Wijetilleke and Mr MV Theagarajah resigned in order to comply with Rule 3 (3)(i) of the Direction on Corporate Governance, the compliance of which regulation, is mandatory with effect from 01st January 2012. Mr R K Obeyesekere and Mr D H S Jayawardena had resigned from the Board/ceased to be a Director, in order to comply with Rule 3 (2) (ii) of the direction on Corporate Governance, the compliance of which regulation, is mandatory with effect from 01st January 2012. The announcements of the above changes in Board have been made to Colombo Stock Exchange and the Director of Bank Supervision of CBSL, within the specified time period.
27. Appointments to other Banks	Rule 3 (2)(xii)	Compliant	None of the Directors are either employees or Directors of other Banks.
3 (3) Criteria to assess the fitness and propriety of Directors.			
28. Directors over 70 Years of age	Rule 3 (3)(i)	Compliant	The compliance of this section of the rule is mandatory with effect from 01st January 2012. However, during the year Mr Rienzie T. Wijetilleke and Mr MV Theagarajah resigned w.e.f. 31st March 2011, in advance of the applicable deadline to make way for orderly succession in the Board of Directors.
29. Holding of office in more than 20 companies	Rule 3 (3)(ii)	N/A	The compliance of this Section of the rule is mandatory with effect from 01st January 2012.

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
3 (4) The Management function delegated by the Board			
30. Delegation of work to the management	Rule 3 (4)(i)	Compliant	The Board annually evaluates the delegated authority process to ensure that the delegation of work does not materially affect the ability of the Board as a whole in discharging its' functions. The Financial authority manual and the credit delegation authority are reviewed annually by the Board as part of its delegation of authority to the Management through the MD / CEO.
31. Extent of Delegation	Rule 3 (4)(ii)	Compliant	Please refer comments above.
32. Evaluation of the delegated process	Rule 3 (4)(iii)	Compliant	Please refer comments on rule 3(4)(i) above.
3(5) The Chairperson and Chief Executive Officer			
33. Division of Responsibilities of the Chairperson and MD / CEO	Rule 3 (5)(i)	Compliant	The roles of the Chairperson and Chief Executive Officer are separate. Please refer Section A.2 and A.3 of the SEC & ICASL Code table on page 72 for details.
34. Chairperson preferably be an Independent Director and if not designate a Senior Director	Rule 3 (5)(ii)	Compliant	The Chairperson of HNB when appointed to the Board was considered to be an Independent Director as per the definition set out in the Direction on Corporate Governance for Licensed Commercial Banks issued by the CBSL. During the year Dr Raneer Jayamaha was deemed to have lost her independence status on account of assuming Chairmanship of a subsidiary company. However, this change in status was countered by the existence of a Senior Director already designated by the Board.
35. Relationship between Chairperson and CEO and other Directors	Rule 3 (5)(iii)	Compliant	There are no material relationship between the Chairperson / CEO and / or other members of the Board which will impair their respective roles.
36. Role of the Chairperson and CEO	Rule 3 (5)(iv) to Rule 3 (5)(xi)	Compliant	Please refer Section A.2 and A.3 of the SEC & ICASL Code table on page 72 for detailed information.
3(6) Board appointed Committees			
37. Board appointed four Sub - committees	Rule 3 (6)(i)	Compliant	There are eight (8) Board appointed Sub-committees including the four (4) Committees prescribed by the CBSL Direction. Please refer section A.1.6 of the SEC & ICASL Code table on page 71 above for the names of the Board Sub-committees.
38. Audit Committee			
38.01 Chairman of the Audit Committee	Rule 3 (6)(ii) (a)	Non-Compliant	With effect from 31st March 2011, the Audit Committee had been Chaired by an Independent Non Executive Director who does not possess any formal qualification and experience in accountancy or audit. The Bank had obtained approval from CBSL to rectify the above non compliance by 31st March 2012 In May 2011, the Committee co-opted Mr H M A Jayasinghe, Partner - Messers Ernst & Young Sri Lanka, as a consultant with the approval of Central Bank of Sri Lanka as an interim measure. Mr Jayasinghe is a Fellow member of the Institute of Chartered Accounts of Sri Lanka and the Chartered Institute of Management Accountants-UK.
38.02 Composition of the Audit Committee	Rule 3 (6)(ii) (b)	Compliant	All members of the Audit Committee are Non Executive Directors. As at balance sheet date all members were independent, Non Executive Directors.
38.03 External Auditors	Rule 3 (6)(ii) (c), (d) and (e)	Compliant	Please refer Section D.3.2 and D.3.4 of the SEC & ICASL Code table on pages 79 and 80 respectively.
38.04 Nature and Scope of External Audit	Rule 3 (6)(ii) (f)	Compliant	The Committee met with the External Auditor during the year to discuss their audit approach and procedures including matters relating to the scope of the audit and auditor's independence.
38.05 Review of Financial Information of the Bank	Rule 3 (6)(ii) (g)	Compliant	The Audit Committee has reviewed the Bank's Annual Report and quarterly Financial Statements before the submission to the Board for approval.
38.06 Meeting with External Auditors	Rule 3 (6)(ii) (h) and (l)	Compliant	The Committee met the External Auditor twice (2) without the presence of the Executive Director and Corporate Management.



YOUR BOARD ROOM GOVERNANCE REPORT..

continued

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
38.07 External Auditor's Management Letter	Rule 3 (6) (ii) (i)	Compliant	During the year, the Audit Committee reviewed the year end Management Letter for 2010, and Interim Management letter for 2011, and the responses thereto with the External Auditor and the Corporate Management team.
38.08 Internal Audit	Rule 3 (6) (ii) (j) and (k)	Compliant	<p>During the year, the Audit Committee reviewed the independence, objectivity and performance of the internal audit function. The findings of the internal audits completed during the year and the internal audit department's evaluation of the Bank's internal controls were reviewed by the Committee.</p> <p>The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning. The Committee reviewed the performance appraisal of the head of internal audit and the senior staff members of the internal audit department.</p>
38.09 Terms of Reference	Rule 3 (6) (ii) (m)	Compliant	Please refer Section D.3.3. of the SEC & ICASL Code table on page 79 for details.
38.10 Meetings	Rule 3 (6) (ii) (n) and (o)	Compliant	The Committee met nine (9) times for 2011. The attendance at Audit Committee meetings held in 2011 is set out on page 89.
38.11 Secretary	Rule 3 (6) (ii) (p)	Compliant	The company secretary also act as secretary to the Audit Committee.
38.12 Process by which employees raise concerns in confidence	Rule 3 (6) (ii) (q)	Non-Compliant	<p>The Bank does not have a formal whistle blowing policy in place. However arrangements have been made to develop a suitable policy during 2012.</p> <p>The Audit Committee reviews issues relating to breach of ethics if any and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place.</p> <p>The Board Charter which was formally approved by the Board in December 2011, addresses the Boards responsibility to encourage any communication regarding non compliances and unethical behaviour within the Bank. A formal process will be developed in the future.</p>
39. Human resources / Remuneration Committee	Rule 3 (6) (iii)	Compliant	Please refer Section B.1.1 and A.1.1 of the SEC & ICASL Code table on pages 76 and 70 respectively for details.
40. Nomination Committee	Rule 3 (6) (iv)	Compliant as at year end	<p>Please refer Section A.7.1 and A.7.2 of the SEC & ICASL Code table on page 74 for details for the composition of the Committee.</p> <p>Up to 15th December 2011, the Nominations Committee was chaired by a Non Independent Director, from the 15th December 2011, an Independent Director has been appointed as Chairman of the said committee to rectify this non compliance.</p> <p>The Committee considers and recommends the re-election of the Directors to the Board. The Committee also set criteria of the succession of the CEO.</p> <p>The Terms of Reference of the Committee was formally approved by the Board in 2012.</p>
41. Integrated Risk Management Committee	Rule 3 (6) (v)	Compliant	<p>The following personnel served on the Board Integrated Risk Management Committee during 2011.</p> <p>Ms M A R C Cooray Mr Rajendra Theagarajah - Managing Director / CEO Mr M V Theagarajah - Independent Non Executive Director (resigned w.e.f. 31st March 2011) Mr Rienzie T. Wijetilleke - Non Executive Director (resigned w.e.f. 31st March 2011) Dr Raneey Jayamaha - Non Executive Director (appointed w.e.f. 31st March 2011) Dr W W Gamage - Independent Non Executive Director (appointed w.e.f. 31st March 2011) Dr L R Karunaratne - Independent Non Executive Director (appointed w.e.f. 7th October 2011) Mr A J Alles - Deputy CEO (appointed w.e.f. 1st July 2011) Mr J D N Kekulawala - Senior DGM - Strategy & Compliance Mr D P N Rodrigo - DGM - Risk and Credit Quality Mr D A de Vas Gunasekara - CFO</p>

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Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011
			<p>The Committee met six (6) times for 2011. The Sub - committee had kept the Board informed of their risk assessment of the Bank periodically.</p> <p>The Committee assesses, reviews and takes action to mitigate the effects of the specific identified risks in credit, market, liquidity, strategic and operational areas. The Committee also oversees the compliance function. The designated Compliance officer also reports to the Committee.</p> <p>The Committee also reviewed the adequacy and effectiveness of the Credit Committee and the Asset and Liability Committee for 2011.</p> <p>During the year, the Committee reviewed the Bank's Business Continuity Plan and Disaster Recovery Plan.</p>
3(7) Related Party Transactions			
42. Avoiding conflicts of interest in related party transaction and favourable treatment	Rule 3 (7)(i) Rule 3 (7)(ii) Rule 3 (7)(iii)	Compliant	<p>Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties as per the definition of this Direction and Sri Lanka Accounting Standard - 30 on "Related Party Transactions". Further, the Board ensures that no related party benefits from favourable treatment. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with that what is applied to transactions between the Bank and its unrelated customers.</p> <p>The process to identify the related parties and collate all relevant details of transactions with related parties was further strengthened during 2011, and the Bank will continue to strengthen the process.</p>
43. Accommodation to Directors and / or their close relatives	Rule 3 (7)(iv)	Compliant	All accommodations to Directors and / or their close relatives are approved by all Directors who are available in the country at the time the said accommodation is considered, other than the Director concerned.
44. Appointment of Director subsequent to approval of facilities to him / her	Rule 3 (7)(v)	Compliant	<p>During the year, three (3) new Directors were appointed to the Board. Of these, two did not have any facilities or accommodation with HNB at the time of appointment. The third Director has been informed in writing by the management of the requirements under the Banking Act for providing approved security to secure such accommodation .</p> <p>As at balance sheet date, accommodations extended to the said Director were within the exemption period of one year specified by CBSL.</p>
45. Accommodation to employees	Rule 3 (7)(vi) Rule 3 (7)(vii)	Compliant	Accommodation has not been given to employees on a favourable basis other than the general schemes applicable to all employees of the Bank.
3(8) Disclosures			
46. Financial reporting, statutory and regulatory reporting	Rule 3 (8) (i)	Compliant	The Financial Statements for the year ended 31st December 2011, are in conformity with all rules and regulatory requirements and for the quarters then ended have been published in all three languages.
47. Minimum disclosure in the Annual Report	Rule 3 (8) (ii)	Compliant	<p>(a) Compliance with applicable accounting standards and regulatory requirements has been reported under the "Directors' Responsibility for Financial Reporting" on page 170 and, the "CEO's and CFO's Responsibility Statement" on page 169.</p> <p>(b) Directors' report on the effectiveness of the internal control system over financial reporting is given under the "Statement of Internal Control" on pages 90 and 91.</p> <p>(c) The Assurance Report issued by the External Auditor on the Internal Control over Financial Reporting based on the auditing framework issued by ICASL for this engagement is given on page 92. The recommendations made by the Auditors where relevant, will be dealt with, in 2012.</p> <p>(d) Details of the Directors are given on pages 10 to 13 Directors transactions with the Bank and their remunerations have been disclosed in note No 48 to the Financial Statements on pages 246 to 260.</p>



YOUR BOARD ROOM GOVERNANCE REPORT...

continued

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2011																		
			<p>(e) Accommodation granted to the Related Parties is given in note No 48 to the Financial Statements on pages 246 to 255. The net accommodation granted to each category of related parties is given below as a percentage of the Bank's regulatory capital.</p> <p>CATEGORY OF RELATED PARTY TRANSACTIONS</p> <table border="1"> <thead> <tr> <th></th> <th>(Amount in Rs Mn)</th> <th>%</th> </tr> </thead> <tbody> <tr> <td>- Key Management Personnel</td> <td>4.80</td> <td>0.01</td> </tr> <tr> <td>- Subsidiaries</td> <td>2,105.05</td> <td>5.81</td> </tr> <tr> <td>- Associate</td> <td>86.83</td> <td>0.24</td> </tr> <tr> <td>- Joint Venture</td> <td>150.00</td> <td>0.41</td> </tr> <tr> <td>- Other Related Parties</td> <td>4,388.60</td> <td>12.12</td> </tr> </tbody> </table>		(Amount in Rs Mn)	%	- Key Management Personnel	4.80	0.01	- Subsidiaries	2,105.05	5.81	- Associate	86.83	0.24	- Joint Venture	150.00	0.41	- Other Related Parties	4,388.60	12.12
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- Other Related Parties	4,388.60	12.12																			
			<p>(f) Please refer (d) and (e) above.</p> <p>(g) The Bank has obtained a Factual Findings Report from the Auditors on annual Corporate Governance Report, based on the auditing framework issued by ICASL for this engagement. The recommendations made by the Auditors where relevant will be dealt with, in 2012.</p> <p>(h) There were no material non compliance to prudential requirements, regulations, laws and internal controls affecting the Bank.</p> <p>(i) There were no supervisory concerns on lapses in the Bank's risk management system or non compliance with this Direction that have been pointed out by the Director of the Bank Supervision Department of the CBSL and requiring disclose to the public.</p>																		
48. Transitional and other general provisions	Rule 3 (9)	Compliant	The Bank has complied with the transitional provisions.																		

Report from External Auditors

The external auditors have performed procedures set out in Sri Lanka Related Services Practice Statement 4750 issued by the Institute of Chartered Accountants of Sri Lanka (SLRSPS 4750), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report dated 21st February 2012 addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board.



J D N Kekulawala
Senior DGM - Strategy & Compliance

Colombo, Sri Lanka
21st February 2012



Dr Ranee Jayamaha
Chairman

Colombo, Sri Lanka
21st February 2012

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Board and the Committee Attendance

The number of meetings of the Board, Board appointed Sub - committees and individual attendance by members is shown below.

Names	Directorship Status	Board	Audit Committee	Nomination Committee	HR & Remuneration Committee	Board Integrated Risk Management Committee	Strategic Review Committee
Total No. Meetings		18	9	3	6	6	2
Mr Rienzie T. Wijetilleke (resigned w.e.f. 31st March 2011)	Non Executive Chairman	04/04		1/1	3/4	1/1	
Dr Raneey Jayamaha (appointed w.e.f. 31st March 2011)	Non Executive Chairperson	14/14		2/2	2/2	5/5	2/2
Mr Rajendra Theagarajah	Managing Director / CEO	18/18	09 ^a	03 ^a	04 ^a	6/6	1/2
Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)	Non Executive Director	14/18	2/9	2/3			0/2
Mr MVTheagarajah ^b (resigned w.e.f. 31st March 2011)	Independent Non Executive Director	03/04		0/1		1/1	
Mr R K Obeyesekere (resigned w.e.f. 30th December 2011)	Non Executive Director	17/18		3/3	6/6		
Ms Pamela C. Cooray	Senior/Independent Non Executive Director	18/18	9/9		6/6		01 ^c
Mr R Seevaratnam (resigned w.e.f. 31st March 2011)	Independent Non Executive Director	03/04	2/2				
Mr N G Wickremeratne	Independent Non Executive Director	14/18	8/9		5/6		1/2
Ms M A R C Cooray	Independent Non Executive Director	16/18	5/7			6/6	2/2
Dr WW Gamage (appointed w.e.f. 31st March 2011)	Independent Non Executive Director	11/14		2/2	1/1	1/5	
Dr L R Karunaratne (appointed w.e.f. 6th October 2011)	Independent Non Executive Director	03/04				1/2	

The papers relating to Credit, Asset Disposal and Procurement are circulated to the members of the respective Board appointed Sub - committees set out below. If a Director has an interest in the relevant subject matter under consideration, he / she declares his / her interest to the respective Committee and withdraws from the approval process.

Names	Credit	Asset Disposal	Procurement
Total No of papers approved in 2011	362	3	21
Mr Rienzie T. Wijetilleke (resigned w.e.f. 31st March 2011)	97	1	2
Dr Raneey Jayamaha (appointed w.e.f. 31st March 2011)	222	2	19
Mr Rajendra Theagarajah	324 ^d	3	18
Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)	119		
Mr MVTheagarajah (resigned w.e.f. 31st March 2011)	74		2
Mr R K Obeyesekere (resigned w.e.f. 30th December 2011)	193	2	7
Ms Pamela C. Cooray	236	3	19
Mr R Seevaratnam (resigned w.e.f. 31st March 2011)	61		
Mr N G Wickremeratne	163	2	14
Ms M A R C Cooray	197	1	1
Dr WW Gamage (appointed w.e.f. 31st March 2011)	137		
Dr L R Karunaratne (appointed w.e.f. 6th October 2011)	28		

Key

^a Mr Rajendra Theagarajah attended nine (9) Audit Committee (by invitation), three (3) Nomination Committee (by invitation) and four (4) HR & Remuneration Committee meetings.

^b The above table gives Directorship Status as per the CBSL Direction on Corporate Governance, and Mr MVTheagarajah was considered as an Independent Director under the said Direction. As per the ICASL & SEC Code Mr MVTheagarajah was not considered as an Independent Director.

^c Ms Pamela C. Cooray Attended one (1) Strategic Review Committee meeting by invitation.

^d A further 34 credit papers were approved by Mr Rajendra Theagarajah's alternate when he was overseas.

■ Chairman / Chairperson of the Board / respective Sub - committee as at 31.12.2011.



STATEMENT OF INTERNAL CONTROL

RESPONSIBILITY

The Board of Directors ("Board") is responsible for the adequacy and effectiveness of the Hatton National Bank PLC ("the Bank") system of internal controls. However, such a system is designed to manage the Bank's key areas of risk within an acceptable risk profile, rather than eliminate the risk of failure to achieve the policies and business objectives of the Bank. Accordingly, the system of internal controls can only provide reasonable but not absolute assurance against material misstatement of management and financial information and records or against financial losses or fraud.

The Board has established an ongoing 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 of Internal Control issued by the Institute of Chartered Accountants of 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 Bank, and in the design, operation and monitoring of suitable internal controls to mitigate and control these risks.

The Board is of the view that the system of internal controls in place is sound and adequate to provide reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes and is in accordance with relevant accounting principles and regulatory requirements.

KEY INTERNAL CONTROL PROCESSES

The key processes that have been established in reviewing the adequacy and integrity of the system of internal controls include the following:

- The Board Sub Committees are established to assist the Board in ensuring:
 - the effectiveness of the Bank's daily operations.
 - that the Bank's operations are in accordance with the corporate objectives and strategies.
 - that the operations of the Bank are in line with the annual budget as well as the policies and business directions that have been approved by the Board.
- The Internal Audit division of the Bank checks for compliance with policies and procedures and the effectiveness of the internal control systems and highlights significant findings in respect of any non-compliance. Audits are carried out on majority of units and branches, the frequency of which is determined by the level of risk assessed by the Internal Audit, to provide an independent and objective report on operational and management activities of these units and branches. The annual audit plan is reviewed and approved by the Audit Committee and the findings of the audits are submitted to the Audit Committee for review at their periodic meetings.
- The Audit Committee of the Bank reviews internal control issues identified by the Internal Audit Division, the external auditors, regulatory authorities and management; and evaluates the adequacy and effectiveness of the risk management and internal control systems. They also review the internal audit function with particular emphasis on the scope of audits and quality of the same. The minutes of the Audit Committee meetings are tabled for the information of the Board on a periodic basis. Further details of the activities undertaken by the Audit Committee of the Bank are set out in the Audit Committee Report on pages 167 to 168.
- 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 Management Risk Committee which includes representation from all key business and operating units of the Bank, assists the Board with the implementation of policies advocated at the 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 Committee, the Credit Committee, the Investment Committee, and the Information Technology Steering Committee.

In assessing the internal control system, the relevant 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 division for suitability of design and effectiveness on an ongoing basis.

The assessment covered only the process applied by the Bank and did not include the processes carried out by its subsidiaries.

The comments made by the external auditors in connection with internal control system in 2010 were reviewed during the year and appropriate steps have been taken to rectify them. The recommendations made by the external auditors in 2011 in connection with the internal control system will be dealt with in the future.

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CONFIRMATION

Based on the above processes, the Board confirms that the financial reporting system of the Bank has been designed to provide 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 auditors, Messrs KPMG Ford, Rhodes, Thornton & Co., have reviewed the above Directors Statement on Internal Control for the year ended 31st December 2011 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 on Internal Control is given on page 92 of this Annual Report.

By order of the Board



N G Wickramaratne
Chairman - Audit Committee



Rajendra Theagarajah
Managing Director /Chief Executive Officer



Raneer Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2012



INDEPENDENT ASSURANCE REPORT



KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)
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Colombo 00300,
Sri Lanka.

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Fax : + 94 - 11 244 5872
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+ 94 - 11 254 1249
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Internet : www.lk.kpmg.com

To the Board of Directors of Hatton National Bank PLC

We were engaged by the Board of Directors of Hatton National Bank PLC ("Bank") to provide assurance on the Directors' Statement on Internal Control ("Statement") for the year ended 31st December 2011, as set out on pages 90 to 91 of this Annual Report.

Management's responsibility for the Statement on Internal Control

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 the section 3(8)(ii)(b) of the Banking Act Direction No. 11 of 2007, by the Institute of Chartered Accountants of Sri Lanka.

Scope of the engagement in compliance with SLSAE 3050

Our responsibility is to issue a report to the Board on the Statement based on the work performed. We conducted our engagement in accordance with Sri Lanka Standard on Assurance Engagements SLSAE 3050 – Assurance Report for Banks on Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka.

Summary of work performed

Our engagement has been conducted 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 system of internal control for the Bank.

To achieve this objective, appropriate evidence has been obtained by performing the following procedures:

- Enquired the directors to obtain an understanding of the process defined by the Board of Directors for their review of the design and effectiveness of internal control and compared their understanding to the Statement made by the directors in the annual report.
- Reviewed the documentation prepared by the directors to support their Statement made.
- Related the Statement made by the directors to our knowledge of the Bank obtained during the audit of the financial statements.

- Reviewed the minutes of the meetings of the Board of Directors and of relevant Board Committees.
- Attended meetings of the audit committee at which the annual report, including the Statement on Internal Control is considered and approved for submission to the Board of Directors.
- Considered whether the Director's Statement on Internal Control covers the year under review and that adequate processes are in place to identify any significant matters arising.
- Obtained written representations from directors on matters material to the Statement on Internal Control where other sufficient appropriate audit evidence cannot reasonably be expected to exist.

SLSAE 3050 does not require us to consider whether the Statement covers all risks and controls, or to form an opinion on the effectiveness of the Bank's risk and control procedures. SLSAE 3050 also does not require us to consider whether the processes described to deal with material internal control aspects of any significant problems disclosed in the annual report will, in fact, remedy the problems.

Our conclusion

Based on the procedures performed, nothing has come to our attention that causes us to believe that the Statement included in this Annual Report on pages 90 to 91 is inconsistent with our understanding of the process the Board of Directors have adopted in the review of the design and effectiveness of internal control system over the financial reporting of the Bank.

Ford Rhodes Thornton & Co.

Chartered Accountants

21st February 2012
Colombo, Sri Lanka

KPMG Ford, Rhodes, Thornton & Co., a Sri Lankan Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International cooperative ("KPMG International"), a Swiss entity.

A.N. Fernando FCA	M.R. Mihular FCA	Ms. M. P. Perera FCA
P.Y.S. Perera FCA	C.P. Jayatilake FCA	T.J.S. Rajakarier FCA
W.W.J.C. Perera FCA	Ms. S. Joseph FCA	Ms. S.M.B. Jayasekara ACA
W.K.D.C. Abeyrathne ACA	S.T.D.L. Perera FCA	G.A.U. Karunaratne ACA

Principals - S.R.I. Perera ACMA, LLB, Attorney-at-Law, H.S. Goonewardene ACA



Many Generations. One Future.

Sustainability Report



Our Bank has a clear vision for sustainable development that considers the interest and welfare of all our shareholders and stakeholders

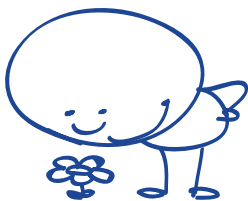
Ours is a sustainable business, where focus remains not only on wealth creation for ourselves but for everyone connected to us

CHIEF EXECUTIVE OFFICER'S STATEMENT



Sustainability at the core of how we do business

At Hatton National Bank, sustainability is an integral component of our business model. Ours is a sustainable business, where focus remains not only on wealth creation for ourselves but for all our stakeholders. This is not something that we have started to adopt recently; in fact, it has been the way we have done business for over a century. While sustainability has become a focus across organisations the world over in recent times, it is truly humbling to think that a local, fledgling bank in the 1880s conceived a business model around the concept of sustainable business and sustainable development.



This ethos of sustainability has now grown to encompass every component of our business and has evolved into a concerted strategy that defines and determines how we do business. HNB's business and sustainability goals are inextricably interlinked and work hand in hand to deliver business returns which are sustainable to our stakeholders and Mother Nature.

In 2011, our sustainability strategy was intensified in the areas of financial literacy, access to finance and enterprise development. We also intensified our outlook on green banking by taking ground-breaking measures to redefine our operational model, thereby reducing our impact on the environment. Our "Green Customer centre" in Nittambuwa is a first in the financial services industry and is a prime example of how we continue to lead in the area of sustainability. We continued to mirror our business strategy and sustainability strategy alongside the nation's development strategy and undertook perceptive actions to further propagate the banking concept to rural, under-privileged communities. Our enterprise development programmes reached out to extend expertise amongst the farming and fishing communities, assisting them to grow through technical know-how and financial assistance. We continued to make an impact on community development by investing into our long-standing projects that have now become case studies in health, education and entrepreneurship development.

We believe that sustainability reporting demonstrates our commitment to sustainability and that it underlies our responsiveness to those who want to know us better, our customers and suppliers, our shareholders and the community, and our present and future employees. In 2011, as in the past six years we continued to report on our sustainability agendas and actions. You will find that this year, our sustainability report has been presented to focus on six core areas - fair banking, supporting enterprise, safety and security, environmental sustainability, community, and employee responsibility. We have enhanced our reporting focus on safety and security to open a bigger window of comprehension to our shareholders and stakeholders on the measures that we are taking towards safeguarding the interests of our customers, investors, employees and society.

We remain committed to a range of wider goals; particularly the United Nations Millennium Development Goals, which we embrace as the

foundation of our commitment towards community development especially in the areas of health, education and poverty alleviation through youth and women empowerment. We are also staying committed to being a fair and ethical workplace through dedication to global covenants and standards on labour and human rights as laid out by the International Labour Organisation.

This financial year for the second consecutive year, we have further validated the authenticity and the transparency of our sustainability reporting efforts by submitting this report to the Global Reporting Initiative (GRI) for formal checking with self assessed "A+" rating, (2010: "B+" rating) as a show of commitment towards the sustainability reporting process. Also for the second consecutive year, we seek to demonstrate our commitment to the environment by making this year's Annual Report and Sustainability Report, a carbon neutral publication. We believe this to be a defining step towards giving authenticity to the HNB Green Pledge.

As we move forward, our Bank has a vision for sustainable development that considers the interests and welfare of all our shareholders and stakeholders. We look to be a conduit for national wealth creation and an icon of responsible behaviour. As we journey towards this, I ask our shareholders and stakeholders to actively engage with us and become partners in furthering this vision. As a first step, your response to the feedback form attached to this Report will greatly assist us towards enhancing our sustainability approach and reporting approach in the years ahead.



Rajendra Theagarajah
Managing Director/CEO

Colombo, Sri Lanka
21st February 2012



REPORT PARAMETERS



For the fifth consecutive year, our Sustainability Report has been developed based on the GRI Reporting Framework (GRI), which serves as a universally recognised framework for reporting on an organisation’s economic, environmental and social performance.

Global Reporting Guidelines (GRI G3) provide specific ‘Reporting Principles’ and ‘Reporting Guidance’ to assist companies through the decision making processes associated with the preparation of a sustainability report. This Sustainability Report defines the content, the quality of the Report and set out its boundaries as outlined by the GRI Reporting Principles.

In 2011, we have enhanced our reporting to meet requirements of GRI Application Level A, and this report has been submitted for compliance check against these predetermined requirements (refer page 143).

In addition, in 2011, we commenced the re-evaluation and design of the Bank’s processes against the criteria and requirements laid out by the International Standard 26000 for Guidance on Social Responsibility. Whilst we touch on the processes that have been earmarked for evaluation, we look to fully report on their completion and resulting effects /improvements arising from same in the sustainability report for the forthcoming financial year.

We have also expanded our Report to be more conclusive through a broader projection of Key Performance Indicators whilst issues material to our operations are discussed in greater detail under the Management Approach Section of this Report.

Defining the Report Content:

(A) Issue of Materiality

In the preparation and compilation of this Sustainability Report, materiality proved to be a challenge. To develop an approach that provides relevant data and information expected by a cross-section of stakeholders coupled with the need to identify and understand the sustainability related aspects and issues that define the success of the Sustainability Report proved to be a dilemma.

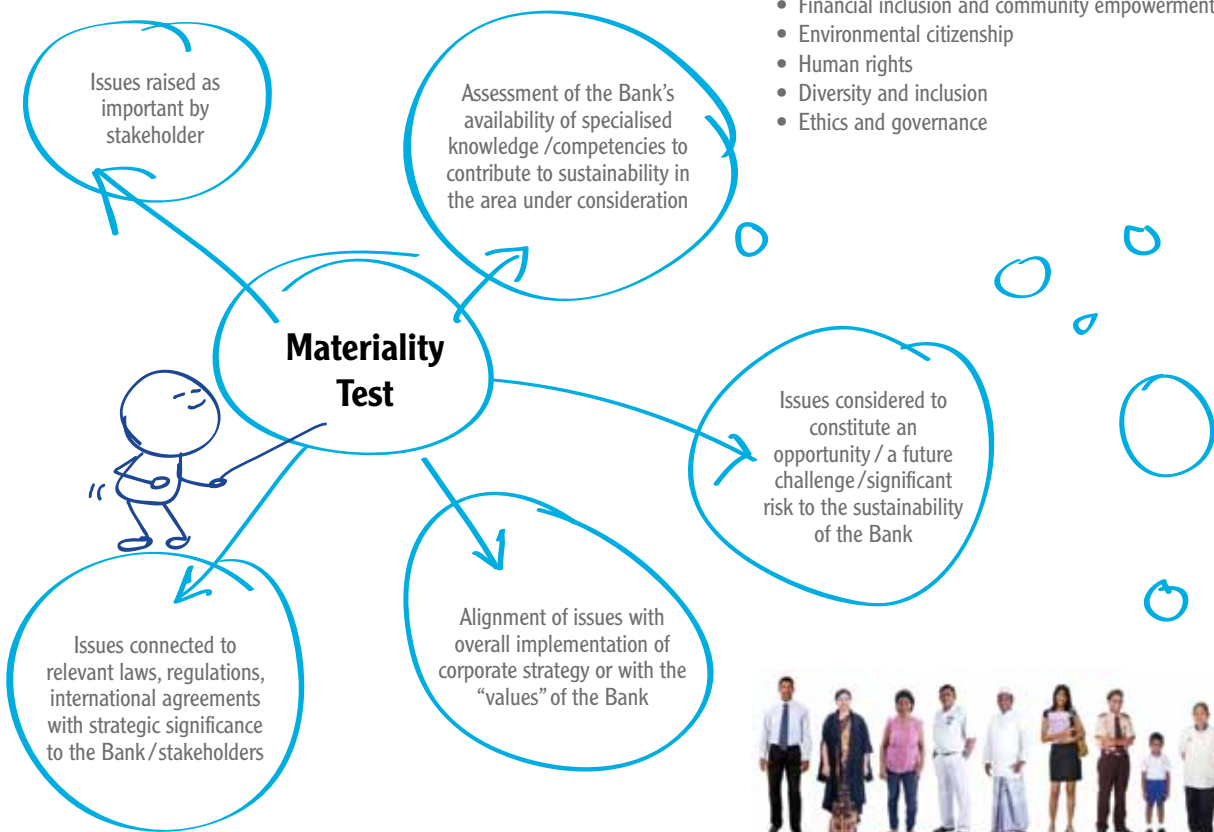
As outlined in the GRI guidelines, the Bank recognises and accepts the importance of materiality. Thus, in this light this Sustainability Report covers topics and indicators that reflect the Bank’s significant economic, environmental and social impacts or that would substantively influence the assessment and decisions of its stakeholders.

The Bank follows a systematic process to determine materiality of issues to be reported on as depicted below.

Thus, by assessing each of the Bank’s actions during the year against the five components of criteria, key actions and initiatives that are considered as material to each of the stakeholder groups have been reported on, in this Sustainability Report.

Material issues largely remained the same in 2011 as in previous years. Core focus areas were:

- Customer service
- Product range and access
- Business expansion /growth
- Recruitment and retention of the best talent
- Improved internal processes and development of the new core banking system
- Compliance with regulatory requirements
- Financial inclusion and community empowerment
- Environmental citizenship
- Human rights
- Diversity and inclusion
- Ethics and governance



(B) Stakeholder Inclusiveness and Engagement

Sustainability Reporting affords the Bank a means to communicate and engage with its stakeholders. Given the disparate nature (and interests) of various stakeholders, the Bank is compelled to strategically define its key stakeholder audience to ensure materiality in engagement and reporting. Thus, the Bank defines its key Stakeholders as investors, customers, employees, suppliers, communities and environment. Through stakeholder inclusiveness and strategic engagement, the Bank objectively aims to achieve conclusive and positive outcomes for each of the identified stakeholders.

(C) Sustainability Content

This Report presents the Bank’s performance in the wider context of sustainability, providing an insight into the Bank’s contribution towards the enhancement of economic, environmental and social conditions within which it operates.

Defining the Report Quality

(A) Balance, Accuracy and Clarity

This Report endeavours to present an unbiased reflection of the Bank’s performance by reporting positive and negative aspects of the Bank’s performance to enable a reasonable assessment of overall performance.

As far as possible, the Report provides accurate information in a manner that is understandable and accessible to its readers.

(B) Defining Report Boundary

This Report covers only the sustainable performance of the Bank and has not been extended to cover its subsidiaries.

Standard Disclosures in the Report

(A) Strategy and Profile

In this Section we provide a high level strategic view of the Bank’s relationship to sustainability in order to provide context for understanding the Bank’s performance, such as its strategy, profile and governance.

(B) Management Approach & Performance Indicators

The Performance Indicators are organised by Economic, Environmental and Social categories as set out in the GRI Table. However, the report is subdivided into six sections - Fair Banking; Enterprise Governance, Security and Safety; Supporting Enterprise; Transforming Communities; Employee Excellence and Environmental Citizenship. For each of the sub-sections, the Management Approach is specified and Performance Indicators outlined.

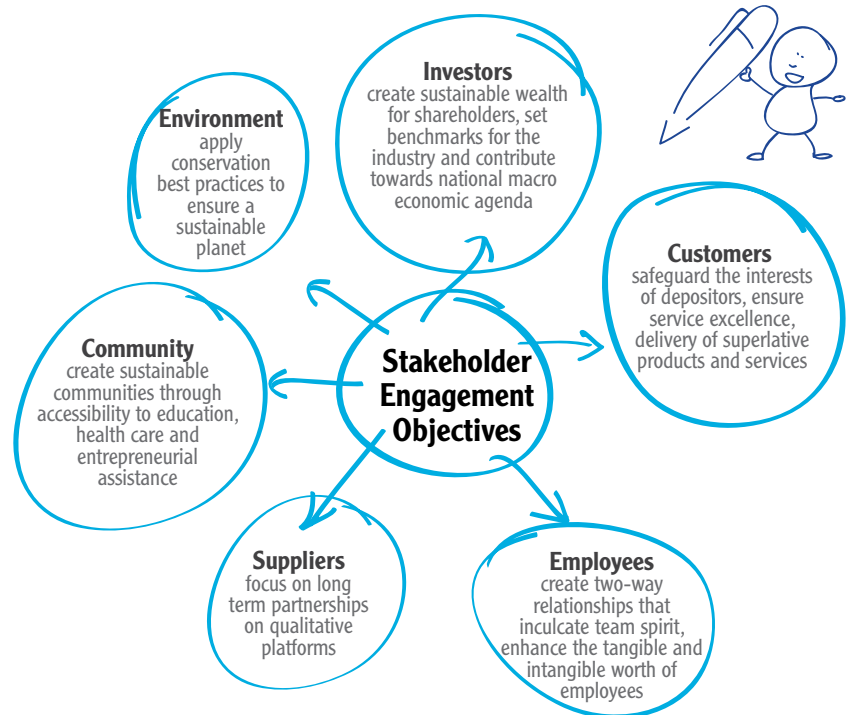
Independent Assurance

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

M/s KPMG Ford Rhodes Thornton & Company has provided an Independent Assurance Report on Hatton National Bank’s Sustainability Report. The Auditors’ review engagement was carried out in accordance with Sri Lanka Standard on Assurance Engagements 3000: Assurance Engagements other than Audits or Reviews of historical financial information, issued by the Institute of Chartered Accountants of Sri Lanka.

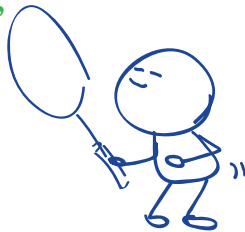
Stakeholder Feedback

The Bank considers stakeholder feedback as a critical criterion for future enhancement of its Sustainability Reporting initiatives. As such an Investor /Stakeholder Feedback Form is attached to this Report and serves as a formal feedback mechanism in addition to the continuous stakeholder engagement process.



STRATEGY & SUSTAINABILITY

“For over one hundred and twenty years, one institution has reached out and touched the lives of thousands, assisting them to rise above their challenges, making way for prosperity and sustainable development for the nation...one bank, many people...that is the crux of Hatton National Bank’s existence.”



Vision for a Sustainable Business

Our corporate vision “to be the acknowledged leader and chosen partner in providing financial solutions through inspired people” is the very foundation of our sustainability vision. As a Bank, we exist beyond the commercial reason, striving in every conceivable manner to not only do well but also do good. Our performance is not judged solely by financial means but mostly by how well we support sustainable development of lives and the national economy. Our sustainability is based on enduring relationships and ensuring that all our stakeholders succeed. “One Bank, Many people” sums up our raison d’être, and validates our role as “your partner in progress”.

Sustainability has been and continues to be at the very core of the Bank’s corporate DNA and is an element that transcends from mere philanthropy to be a holistic and cohesive component of the long-term corporate strategy, which in turn is reflective of the broader national and social priorities. It is this same vision to provide financial solutions through inspired people that was the crux of Hatton National Bank’s beginning over a century ago.

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking. To be a responsible lender by judging whether a customer’s aspiration to borrow is affordable and meets the Bank’s assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.



Enduring Sustainability

Because sustainability is fully integrated and intrinsically aligned to the Bank's corporate objectives, sustainable business practices ensure that Hatton National Bank maintains its sustainability focus at all times. Sustainable development is an ongoing and continuous area of concern in strategic discussions, and is given full consideration when objectives, goals and targets are set, and is integrated with governance and accountability arrangements and risk management. The Bank ensures that sustainable development is featured at a strategic level, supported by leadership and envisioning, whilst also integrated into strategic priorities and all parts of the operational plan.

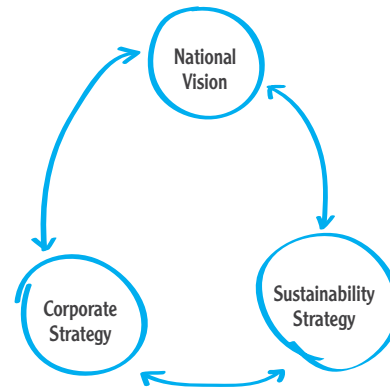
The Bank adopts a continuous and organic strategy review process which seeks to ensure that the Bank remains open to potential developments and windows of opportunity. As a result, we constantly strive to define our approach to sustainability and how it is managed across the Bank in a more explicit and lucid manner. Our approach now formally acknowledges that 'sustainability' is not a static agenda. Instead, both the materiality of sustainability issues and our response to them will evolve over time, as new issues emerge and priorities change. This evolution is all the more evident when we reflect on sustainability milestones over the years, and fully endorses the fluid and strategic nature of our sustainability actions.

Strategy for today: Our strategy is defined and shaped by the economic and socio-economic changes that are evident in Sri Lanka today. But as in the past, our present and future concerns lie predominantly in how we manage and support the economic and financial needs of Sri Lanka's population. Through perceptive business practice we continue to map ourselves against the national vision, serving to partner the progress of the national economy. By uplifting the lives, and supporting entrepreneurs at the very bottom of the economic scale, we have infused the national economy and strengthened its capacity for productive gain. Today, as Sri Lanka stands on the verge of becoming an economy of reckoning, Hatton National Bank takes the onus of empowering the rural community by providing them with financial know-how and access to finance. We speak of these initiatives in the areas of fair banking, supporting enterprise, enterprise governance, security and safety, transforming communities, employee excellence, and environmental citizenship from pages 104 to 141.

Moulding the business landscape of tomorrow:

In continuing to remain committed to sustainable business, we acknowledge the need to be open and receptive to issues that will become material in the future. Our vision also commits us to take a long-term view on the issues that will impact future prosperity. Our strategic focus is therefore to anticipate and shape the most pressing emerging societal issues of the future, where we have the skills and experience to make a meaningful difference. By identifying future needs, and harnessing our resources and capacities well, we are confident of our ability to sustain commerce as well as livelihood support and economic value generation for the nation.

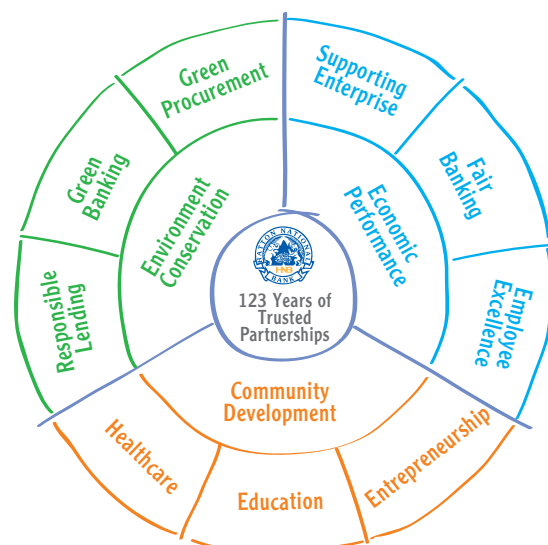
Sustainability Focus



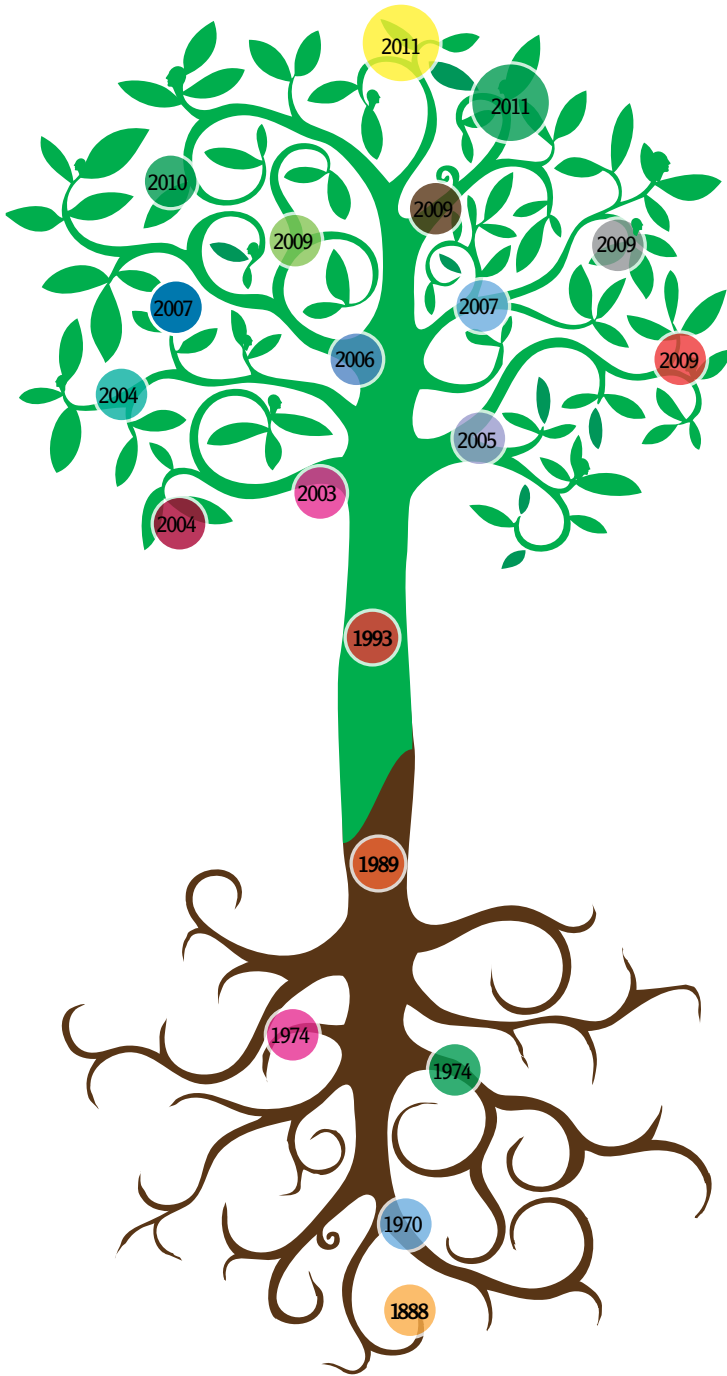
Our first focus area is the national economy. By supporting and energising commercial and entrepreneurial bases, we look to enlarge the national growth. Sustainable performance, partnering wider segment of people and businesses, and igniting the capacities of microfinance through financial inclusion are viewed as the cornerstones for sustainable growth and sustainable wealth creation for the nation.

The second focus area is to meet and overcome conservation and environmental challenges. We are focused on making a positive imprint on the environment by lessening our dependency and adverse impact. Through responsible lending, green practices and green procurement, we look to employ innovative business solutions to cascade green sustainability.

Our third focus area lies in community development. We firmly believe that by developing future leaders, infusing learning and innovation across the nation especially amongst youth communities, and by assisting communities to have access to basic health and education will pave the way for better livelihoods. These fundamental changes are expected to act as the medium in developing balanced communities.



STRATEGY & SUSTAINABILITY
continued



Sustainability Milestones

- **1888 Hatton Bank**
Hatton Bank founded, seed of sustainable banking sowed
- **1970 Hatton National Bank**
Birth of a new era in Banking
- **1974 Appointment of Agriculture Officers**
Partners in Progress of farming communities, pioneers deployment of specialist agriculture officers
- **1974 Assisting rural food production**
Access to finance for farming communities through rural customer centre expansion
- **1989 Gami Pubuduwa, micro finance scheme**
In the aftermath of social unrest, Gami Pubuduwa awakens new aspirations
- **1993 Pathum Vimana, savings scheme**
The creator of many millionaires in the years to come
- **2003 HNB Towers**
Icon in resource efficiency sets the standard for green building design
- **2005 First CSR Report**
Sustainability given authenticity through reporting and disclosure
- **2004 HNB Museum**
Legacy of Sri Lanka's banking preserved for posterity
- **2004 Listing in the Luxembourg Stock Exchange**
Global recognition as a creator of wealth
- **2006 Nena Pubuduwa, school library programme**
Empowering future generations through access to knowledge
- **2007 GRI Report**
Reporting of sustainability efforts against universally accepted criteria
- **2007 Cancer Counseling Centre**
Transforming lives through trauma counseling
- **2009 HNB Sustainability Foundation**
Dedicated resources and focus on CSR initiatives
- **2009 First dedicated Micro Finance Customer centre**
Grass root entrepreneurship given precedence as the generator of future wealth
- **2009 Green Pledge**
Bank-wide commitment to reduce impact on the environment
- **2009 Financial assistance to cancer patients**
Extending a hand to restore livelihoods of cancer afflicted families
- **2010 Opening of the 200th customer centre**
Access to finance furthered
- **2011 Green customer centre**
Pioneers concept of green banking
- **2011 Appointment of Manager – Employee Relations**
Dedication to employee engagement demonstrated



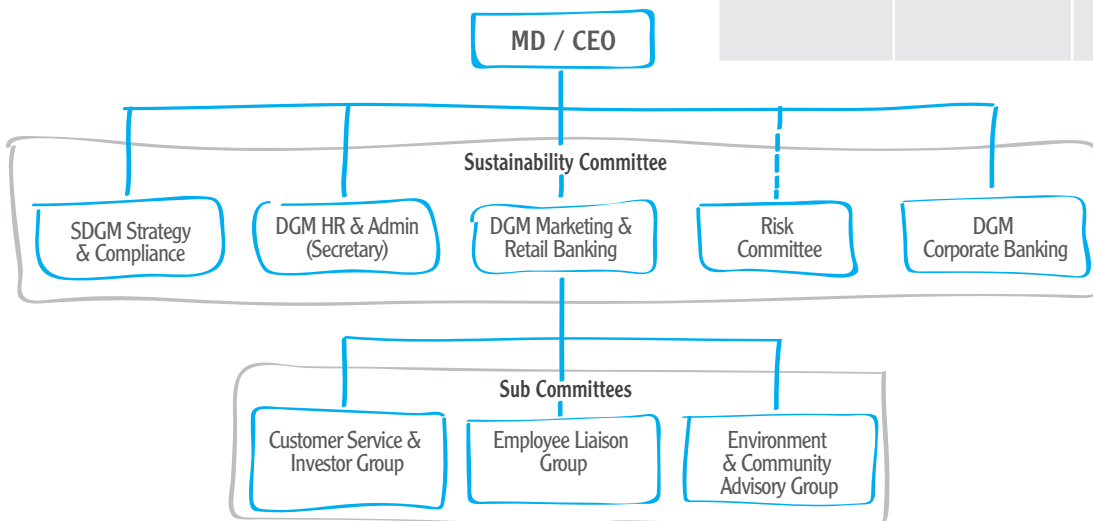
Sustainability Structure & Stewardship

Whilst the corporate vision acts as the foundation for the sustainability objectives, which evolve with respect to the Bank’s evaluation of the key areas of sustainability focus, a top-down approach defines the sustainability stewardship of the Bank. Under the direct leadership of the Managing Director / Chief Executive Officer, sustainability is driven in parallel with sustainable business objectives as well as guided by the Bank’s Sustainability Committee.

In essence, the Bank’s overall strategy for sustainability stems from the Board Level and is strategically aligned to corporate strategic priorities, and managed by the Sustainability Committee and its respective sub-committees.

In 2009, the Bank formed a Sustainability Foundation to facilitate and better manage the Bank’s Corporate Social Responsibility (CSR) efforts that fall under the third area of sustainability focus – community development. The HNB Sustainability Foundation, therefore, is endowed with the responsibility to oversee progress of initiatives falling within the purview of community development and further propels the CSR strategy of the Bank. Whilst the Foundation independently drives the CSR strategy and acts as the base for policy and strategy formulation specific to its area, it continues to be monitored under close scrutiny of the Bank’s top management with 2 Board Members, MD/CEO and 7 members of the Bank’s Management Team serving as Trustees.

Sustainability Focus	Responsibility	Tasks
Focus Area 1: Economic Contribution to the nation Focus Area 2: Environment Conservation	Sustainability Committee	<ul style="list-style-type: none"> Oversees progress across economic, business, employee and environmental projects Acts as the think tank in developing the sustainability agenda Ensures conformance with all sustainability guidelines Proactively evaluates decisions that impact on the reputation, ethics, and values of the Bank Identifies and manages areas of non-compliance with the sustainability principles Sets standards for policies & procedures in meeting sustainability principles
	Risk Committee	<ul style="list-style-type: none"> Oversees the CSR activities carried out by the Bank
Focus Area 3: Community Development	Sustainability Foundation	<ul style="list-style-type: none"> Formulates CSR policy and strategy Evaluates investment viability Oversees implementation & progress in community projects Binds employee interaction with projects



STRATEGY & SUSTAINABILITY

continued

Our Sustainability Precepts

1. Commitment to Sustainability:

To fully integrate the consideration of ecological limits, social equity and economic justice into corporate strategies and core business areas, to put sustainability objectives on an equal footing to shareholder value creation and client satisfaction, and to actively strive to finance transactions that promote sustainability.

2. Commitment to 'Do No Harm':

Commit to do no harm by preventing and minimising the environmentally and/or socially detrimental impacts of the Bank's portfolios and operations by creating policies, procedures and standards based on the Precautionary Principle to minimise environmental and social harm, improve social and environmental conditions where the Bank operates, and avoid involvement in transactions that undermine sustainability.

3. Commitment to Responsibility:

The Bank bears responsibility for the environmental and social impacts of its transactions including financial risks, as well as social and environmental costs that are borne by communities.

4. Commitment to Accountability:

The Bank is accountable to its stakeholders. Accountability means that stakeholders have an influential voice in financial decisions that affect the quality of their environments and their lives - both through ensuring that stakeholders' rights are protected by law, and through practices and procedures adopted by the Bank itself.

5. Commitment to Transparency:

The Bank is at all times transparent to its stakeholders, not only through robust, regular and standardised disclosure, but also by being responsive to stakeholder needs for specialised information on the Banks' policies, procedures and transactions.

6. Commitment to Sustainable Markets and Governance:

The Bank bears responsibility for the environmental and social impacts of its transactions including financial risks, as well as social and environmental impact on communities.

Our Membership Commitments

- ACCA Sri Lanka Branch
- American Chamber of Commerce (Amcham)
- Asian Bankers Association
- Association of Professional Bankers, Sri Lanka
- Banking with the Poor Network, Singapore
- Employers Federation of Ceylon
- International Chamber of Commerce, Sri Lanka
- Sri Lanka Forex Association
- The Ceylon Chamber of Commerce
- The Chartered Institute of Management Accountants (UK) - Sri Lanka Division
- The Institute of Bankers of Sri Lanka
- The Institute of Chartered Accountants of Sri Lanka
- Trade Finance Association of Bankers



KEY IMPACTS, RISKS AND OPPORTUNITIES

The Bank's scope of sustainability responsibility is consistently widening - from environmental protection to social inclusion of underprivileged groups and consideration of other social issues, such as labour practices, to preservation of cultural and natural heritage.

As such, the Bank views this continued emphasis on sustainable development as a process of continual improvement whereby it strives to determine its key impacts, risks and opportunities as a means to have a coherent view of the external and internal sustainability issues. This awareness and acceptance of impacts, risks and opportunities allows the Bank to integrate better standards as well as expand the view of what generates long-term value across all of its stakeholders. Furthermore, it negates contingency risk avoidance and builds in a more proactive approach to optimise the business opportunities offered by sustainable development.

Key impacts on sustainability: Economic

- Wide array of products fosters and stimulates entrepreneurship creating a viable base for sustainable growth and progression.
- Offers attractive savings products ranging from new born infants to senior citizens, in a bid to further inculcate the savings habit.
- Facilitates entrepreneurship through micro finance, enhancing productive output of the national economy.
- Facilitates financial empowerment and inclusion through the pioneering programme "Gami Pubuduwa" (Village Awakening) Micro Finance Scheme by drawing those classified as unbankable into mainstream banking.
- Continues to develop products that meet the financial needs of rural communities by understanding their requirements, which leads to the creation of flexible loan schemes which are secured through non-conventional means.
- Provides technical assistance and marketing opportunities for micro entrepreneurs, farmers through collaborations with some of the largest corporate organisations in Sri Lanka.
- Deploys 140 agriculture-specialists as field officers.
- Supports the growth of the SME sector through a host of loan and lease products that have been designed for the specific needs of the nation's growing SME sector.
- Continues to be the partner in progress to the nation's corporate sector through customised solutions.

Key impacts on sustainability: Social

- A pioneer in the front of poverty alleviation by assisting and encouraging individuals to take measured risk towards entrepreneurship.
- "HNB Sustainability Foundation" spurs a variety of progressive sustainability initiatives in the areas of health, education and sanitation.
- The School Library programme has assisted more than 45,000 children in 185 of the most under-privileged, rural schools in Sri Lanka.
- Donation of computers to schools and the setting up of computer centers in under-privileged schools have served to improve IT literacy in the rural communities.
- Is an active member of the Sri Lanka Business Coalition for HIV & AIDS and strives to create awareness and educate through concerted programmes.
- Has set up a Cancer Counseling Centre at the National Cancer Institute to fulfill the need for trauma counseling.

- Financially empowers cancer patients and their families, assisting them to retain their livelihoods.
- Has in place a concerted programme to train and develop youth from the previously conflicted afflicted Jaffna peninsula in a bid to enhance the human resources of the area.

Key impacts on sustainability: Environmental

- Operations have a minimum impact on the environment.
- Continues to be cognisant of environmental issues and engages for collective responses from employees, suppliers, customers and the community at large.
- Engages in a 3R policy and action and strives to Reduce, Recycle and Reuse in a bid to minimise resource utilisation.
- Credit policies ensure credit approval is dependent on the project meeting the standards set by the Central Environmental Authority.
- Strives to engage suppliers to conform with the Bank's standard environmental obligations as stated in its green procurement policy.
- Makes a significant investment towards bio-diversity conservation.
- Pioneered the concept of "Green Banking" in Sri Lanka.
- Operations are governed by a "Green Pledge" across every aspect of the business.
- Adopts a green lending stance, demonstrating a commitment to finance renewable and clean technology projects.

Risks /challenges or opportunities: Economic

- Challenges will arise in terms of reaching potential customers with the cost of network development posing challenges to the brick and mortar model.
- The lack of education, literacy and poverty limits the Bank's efforts to provide banking facilities to rural communities.
- Preconceived beliefs about credit and the risks associated with same, will require engagement with customers to create attitudinal shifts to banking.
- Implementation of rigorous screening processes on lending to minimise risk of wilful default.

Risks /challenges or opportunities: Social

- Opportunity to further explore role in social mobilisation and wealth creation as in excess of 50% of Sri Lanka's population still remains outside of the mainstream banking system.
- The possibility to reach out and act as a catalyst to change by the promotion of inclusion through existing and well entrenched programmes for financial inclusion and literacy such as Gami Pubuduwa and Divi Saviya, Adhishtana, and Yauwanabhimana will define the future of the Bank's business viability.

Risks /challenges or opportunities: Environmental

- Remains a conduit for behavioural and attitudinal change as the Bank interacts with millions of customers on a daily basis.
- As an opinion leader the Bank has the opportunity to give stewardship to environmental and sustainability issues.
- By implementing supplier screening systems and rigorous loan covenants we are able to influence suppliers and customers towards eco-friendly practice.



STRATEGY IN ACTION FAIR BANKING



Fair banking means getting it right for our customers. This area covers the focus and relationship we have with our customers, including:

- Depositor responsibility
- Responsible lending practices and products
- Customer Service
- Access to financial services
- Financial literacy & education

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking. To be a responsible lender by judging whether a customer's aspiration to borrow is affordable and meets the Bank's assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.



Strategic Priorities for Fair-Banking

- Continue to enhance access to finance through greater geographic and socio-economic penetration
- Enhance product and service portfolio in line with market needs
- Assist in building capacity and financial literacy across the nation
- Further enhance depositor interests
- Further enhance initiatives towards responsible lending
- Adopt 360° approach to customer service

2011 Highlights

- Customer centre network expanded by 35 new customer centres
- Product portfolio expanded through the introduction of 4 new products and 1 revised product
- 27 financial literacy and capacity development programmes conducted for micro entrepreneurs
- Depositor interests furthered through ongoing enhancement of risk frameworks and efforts to achieve enhanced financial stability
- Responsible lending practices re-assessed and fine-tuned
- Continuous customer service development initiatives adopted

Going Forward

Continue to develop capacities in all areas relevant to fair-banking, with a view to establishing the Bank as one of the most perceptive and emphatic sustainable businesses in Sri Lanka



Defining the management approach to Fair Banking:



C P Abeywickrema
Deputy General Manager
– Marketing & Retail Banking

“Hatton National Bank has been built on a foundation of heritage and trust over a period of 120 years and continues its journey on the precepts of fair banking. Ours has truly been a journey of striving to be and living up to the adage of ‘Your Partner in Progress’. As a bank we have touched the lives of many and contributed towards changing the economic course of the nation. Our fair banking practices have been founded on the principles of customer responsibility, access to financial services, financial literacy and responsible lending.

In the area of customer responsibility, we strive at all times to minimise risk to the customer and to ensure that customers are aware of the full impact of the products and services they seek on their own long-term financial standing. Ensuring that we have available and affordable credit is a key service that we provide. We are responsible and ensure

that credit is affordable so that we have a sustainable business with a sustainable customer base. We strive to be accountable for our actions and to instil this sense of accountability amongst our customers. Through interactive engagement we aim to provide the full impact of the financial product on offer to customers and often this enhanced level of interaction enables us to tailor-make products to meet specific needs of customers. We are also a partner that holds hands with customers on their journey of development. We believe in graduating customers along the development continuum, assisting them to achieve their vision and objectives in life. This involved and highly interactive role that we undertake as a partner as opposed to a mere financial services provider enables us to be on top of customer expectations and to minimise customers complaints and dissonance.

Under ‘Divi Saviya’ our longstanding financial literacy programme, we undertook 27 programmes in 2011, across all provinces. The programmes were designed in consideration of the industrial sectors whilst being sensitive to the customers’ cultural and economic backgrounds. In addition, during the year, our Bank demonstrated its commitment to the nation as a responsible corporate partner by conceptualising and launching “Yauwanabhimana”, a programme aimed at enhancing the employability of youth across the nation. The Bank has pledged the full backing of its considerable resources to this initiative and has additionally sought and obtained the willing support and cooperation of some of the most recognised and respected organisations in the country. By securing the broad based support of corporate Sri Lanka we are now able to provide the youth of this nation with linkages to top corporate bodies, access to different markets, information about prospective career opportunities, access to industry best practices and knowledge sharing, financial education programmes for better income and asset management, personal development programmes and English language training, which is a requirement sought by virtually every employer in the country.

We believe that access to financial services is dependent on two key variables: availability and affordability. The Bank is of the view that customer centre availability alone is inadequate unless entry points to accessibility have been made affordable. Our 240 network points operate on diverse models with resources aligned to the location and their specific needs. For example; in the remote yet prosperous farming area of Padaviya, a field officer with over 15 years of agri experience manages the centre and is able to relate to the specific needs and aspirations of this agricultural community to optimally assist them to enhance product and service delivery. The Bank’s expansion drive in rural communities has been primarily focused on ensuring that financial inclusion becomes a meaningful reality.

Responsible lending practices are also dependent on harmonising with economic objectives and cultural/social sensitivities. The Bank always ensures that in the product and service delivery, human rights are upheld, malpractices minimised and that entry to or catering of industries in malpractice are avoided.



STRATEGY IN ACTION: FAIR BANKING continued

In view of the need to address and acknowledge the growing need to incentivise green finance, the Bank has been consciously creating and offering a range of green financial services.

In working towards wealth creation for the nation, our efforts towards enhancing the productivity of the nation have been well-acknowledged, particularly in the area of youth inclusion. By partnering governmental and non governmental organisations we have strived to achieve social and environmental balance.

The Bank's size and scale entail freedom of operations from the smallest to the largest financial need. As a partner in large-scale infrastructure development, the Bank has demonstrated its ability to service the financial needs across the chain of sub-contractors. From a business strategy perspective this has enabled the Bank to capture cash flows, thus enhancing its resource-base, whilst providing services across the product and service continuum of the Bank, thereby facilitating small time operators to participate on an equal footing to that of large and medium scale operators through financial inclusion.

Similarly, the Bank's role in serving the migrant workers of Sri Lanka has been a mainstay of the business strategy for many decades. Through its inward remittance services, the Bank provides a cost effective, secure and speedy service to Sri Lankan migrant labour placed across the globe. Moreover, the Bank has played a vital role in minimising the unnecessary consumption of foreign exchange by inculcating a savings habit amongst its client base. Having identified the particular needs of the segment, the Bank introduced the one and only comprehensive product offering for migrant workers aptly named Adhishatana – Striving for progress. In turn, the Bank has effectively cross-sold a range of financial instruments and services such as agricultural loans whilst retaining foreign exchange savings. Thus, capacity building through savings and recycling and capture of capital has enabled the Bank to effectively sustain the livelihoods of its client base whilst also meeting national objectives towards the augmentation of foreign exchange reserves.

Our communication of the Bank's products and services has always been based on principles of ethical and responsible advertising, steering clear of overselling. In product design, a robust design process takes place under the scrutiny of the product committee which analyses the mechanics, determines fair pricing and fair positioning in line with the stakeholder interests (regulator, customer, employees, investors) in addition to the Bank's own interests."



L L C Thambiah
Deputy General Manager
- Network Management

"In 2011, the Bank accelerated the expansion of customer centres as well as ATM locations. A study during the year revealed that the Northern and Eastern provinces of Sri Lanka were recording the fastest rate of development. However, despite this the penetration of banks, financial services remained disproportionate as in the case in rural Sri Lanka, which continues to have a penetration rate of approximately 10 banks for every 100,000 individuals. In 2011, our network strategy has been in line with overcoming these shortcomings, and we introduced 35 customer locations across Sri Lanka, and increased the ATM network to 400 with a keen focus on enhancing the reach to rural communities.

Fair enterprise continues to be at the helm of our operations. In 2011, our Bank demonstrated an interest yield of 13% and has been flexible and conscious of the need to maintain interest levels where both the Bank and the customer equally benefit. People orientation has been one of Hatton National Bank's strengths since its inception and has created a firm standing for the Bank over the years. In consequence, confidence and loyalty of customers has enabled the Bank to become a sustainable business, humane aspects superseding mere commercial benefits.

Customer engagement is a critical component of our retention strategy with diverse engagement processes at work. Within this framework, customer development and training takes on critical significance. Customers have access to and can approach management across the hierarchy of the Bank. Engagement processes involve interaction with every customer segment from personal, micro, SME to corporate with equal emphasis.

Customer centre-wise evaluation of service levels is conducted periodically. Feedback from this evaluation is utilised to enhance the service scenario. Over the years, enhanced services such as Saturday-banking, Sunday-banking, evening-banking, 365-day banking, priority banking, accessibility at the Bandaranayake International Airport have all evolved to increase our service standards.

In support of economic value addition, the Bank provides adequate assistance to exporters and funds their warehousing and storage facilities. In essence we take pride in being their committed and true partner in progress."



Engagement for Fair Banking:

The Bank’s engagement with customers is largely divided into three core areas that aim towards deriving customer insight, driving customer relations and delivering greater customer experiences.

1. Deriving customer insight

Continuous and ongoing qualitative and quantitative research being deployed both through in-house as well as outsourced research houses. Results are analysed and internal processes, products and services adjusted to meet customer needs and deliver value to translate the customer insight into a substantial service outcome from product development to enhanced access to finance.

2. Driving customer relations

Face to face interaction with customers facilitated at specific forums organised and managed by the Bank to enable customers to interact and to facilitate open dialogue on issues that are critical to them. These issues are then vetted and responses and solutions afforded wherever possible including the determination of the need for and the degree of financial literacy requirements.

3. Delivering customer experiences

Conducts programmes to assess customer service and customer experiences at each of the Bank’s key customer touch points. “Secret-shopper” programmes and third party assessments of the Bank’s customer service are analysed to determine service gaps.

Customer Engagement in 2011

Description of Programmes undertaken in 2011	Issues Raised/Addressed	Responsive Goal for 2012
Customer awareness programmes, Corporate Seminars & Divi Saviya programmes (at Micro level, SME, Card Services, Internet Banking, Treasury, Share Trading etc.)	Ease of access to banking	Further enhancement of the Bank’s customer centre network to better reach rural communities whilst also facilitating access to banking through non-traditional means through the evolution of the e-banking solution
	Expansion of banking facilities at Extension Offices to match those available in a fully fledged customer centre office	Continue the systematic upgrading of extension offices to customer centres
	Consideration of differently-abled customers when designing customer centre and service points	Separate access, specially designed restrooms, low level counters to be systematically introduced across the Customer centre Network
	Enhancement of services for SME customers	Enlargement of the SME unit and its scope of operations to reach and service a larger population of SME customers across Sri Lanka
	Greater considerations for entrepreneurs and business start-ups in terms of facilitating their business through technical and marketing assistance	Further the concept of “Yauwanabhimana” to empower youth towards economic productivity whilst also supporting Micro and SMEs to build market connections. The Bank will continue to enhance know-how via knowledge and best practice sharing, conduct financial education and spearhead personal development and English language training.
Student Manager Conferences: Total of 9 conferences comprising of 975 students, 172 schools, 178 teachers	Priority to be given to Student Managers when the Bank is recruiting	Bank will assess the viability of recruitment on a case by case basis with preference given to Student Managers who fulfill the minimum criteria
	Increase the frequency of the Bank’s interaction with Student Managers whilst also exploring the possibility of providing individual school based specific training	Explore the possibility of establishing KPIs for staff managing the school units
Customer get-togethers / celebration of religious events / parties	Individual customer centre organised several events for their respective customers to mark religious and calendar events such as Vesak, Christmas, New year, Eid, Ramazan, Navarathri, customer centre anniversaries and other festivities to enhance customer relationships	Individual customer issues raised at these functions have been noted by the respective customer centre and responsive actions outlined to resolve these on an on-going basis
Commemorating World Environment Day	Every branch donated saplings to selected customers to further propagate the Bank’s Green Policy	



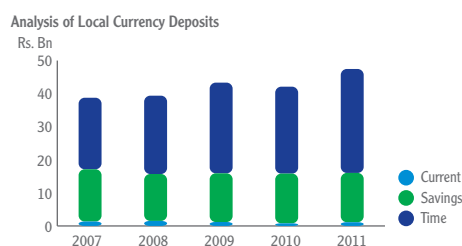
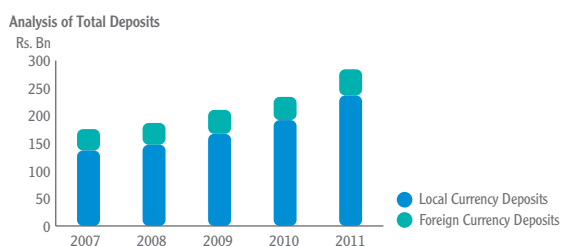
STRATEGY IN ACTION: FAIR BANKING continued

Fair Banking Initiatives and Indicators:

1. Safeguarding depositor interests

The Bank is extremely conscious of the need to safeguard the interests of its depositors. Through many measures of governance and risk management, the Bank has earned a reputation as a stable financial institution. Depositors are afforded a high interest yield whilst at the same time ensuring that depositors have the capability to withdraw their deposits, as and when they wish. The deposit product line is vast

and extends across the lifecycle continuum with products available for newborns to senior citizens. Deposit products offer a variety of value-additions and are tailored to suit the needs of the target markets. The Bank's extensive customer centre network ensures easy access to depositors' monies and the many safety and security measures adopted by the Bank in addition to risk management and compliance efforts adds to the physical security of the deposits.



2. Customer service development

The Bank undertook quantitative and qualitative research to determine customer service gaps in a bid to better design products and services that meet the changing needs of the customer base.

Initiative	Description	Period of Implementation
Market Research Survey –Youth	Youth based research was continued in 2011 with a view to garner greater insight into youth behaviour especially in line with their spending patterns, aspirations and financial aptitude. The survey is expected to assist towards shaping future products and services to match the needs of both rural and urban youth.	2010-2011
Market Research Survey - Remittances	Remittance based research to determine the way in which remittances are consumed, savings habit and disposable incomes of remittance receivers. Research carried out in collaboration with International Fund for Agricultural Development (IFAD) and Womens World Bank (WWB). Continued research conducted to facilitate further fine-tuning of new products and the introduction of further products.	2010-2011
Continuous Product / Service Quality Improvement Schemes	An array of product and service improvement measures are undertaken on an ongoing basis. These initiatives assist towards the creation of a culture of continuous service development and are ongoing programmes of action that continue irrespective of timelines with the objective of reaching excellence in customer satisfaction.	Ongoing
Corporate Customer Audit	Quarterly audits carried out to determine levels of customer satisfaction and to proactively mitigate issues.	Ongoing



3. Product and service development

The Bank recognises that a sustainable customer orientation extends beyond merely the services offered by the Bank, and that in fact products and services need to be renewed and revived keeping in line with the external environment and the changing socio-economic context.

Prior to making the products or services available to the customer, each product undergoes a rigorous assessment for compliance. Each product is fully tested and evaluated for suitability. Most often products are put forward for compliance testing and verification to third parties such as the authorisation of the Central Bank of Sri Lanka.

In 2011, the Product Development Committee worked towards assessing market needs based on research and customer suggestions. As a consequence, the Committee effected changes to existing products and designed new products and services in an effort to better cater to customer needs.

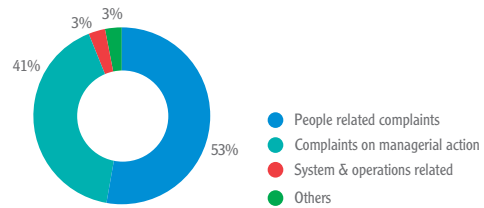
New/ Revised Product	Description
HNB Small & Medium Enterprise Development Partner	Re launch of branded product offer for SME sector.
HNB Crystal Circle	Second tier private banking solutions with privileged and customised banking.
HNB Adhishtana	Remittance linked savings product with financing and insurance options targeting Sri Lankans working overseas.
HNB Yauwanabhimana	Youth empowerment programme targeting youth in the age group of 18-30 years, aimed at developing entrepreneurship skills, financial literacy and financial inclusion.
HNB Ran Govi Saviya	A gold backed financing product targeting the farmer community.

4. Listening to customers

Receiving feedback from a client is very valuable to us as it helps us to align ourselves with customer expectations. The Bank in fact takes complaints very seriously and ensures that no complaint or grievance goes unattended. The customer however reserves the privilege to also seek relief from the Financial Ombudsman.

	Complaints received Direct	Complaints received through the Financial Ombudsman	Total
2007	81	10	91
2008	83	6	89
2009	81	11	92
2010	86	16	102
2011	289	11	300
Complaints pending resolution as at 31 December 2011			4

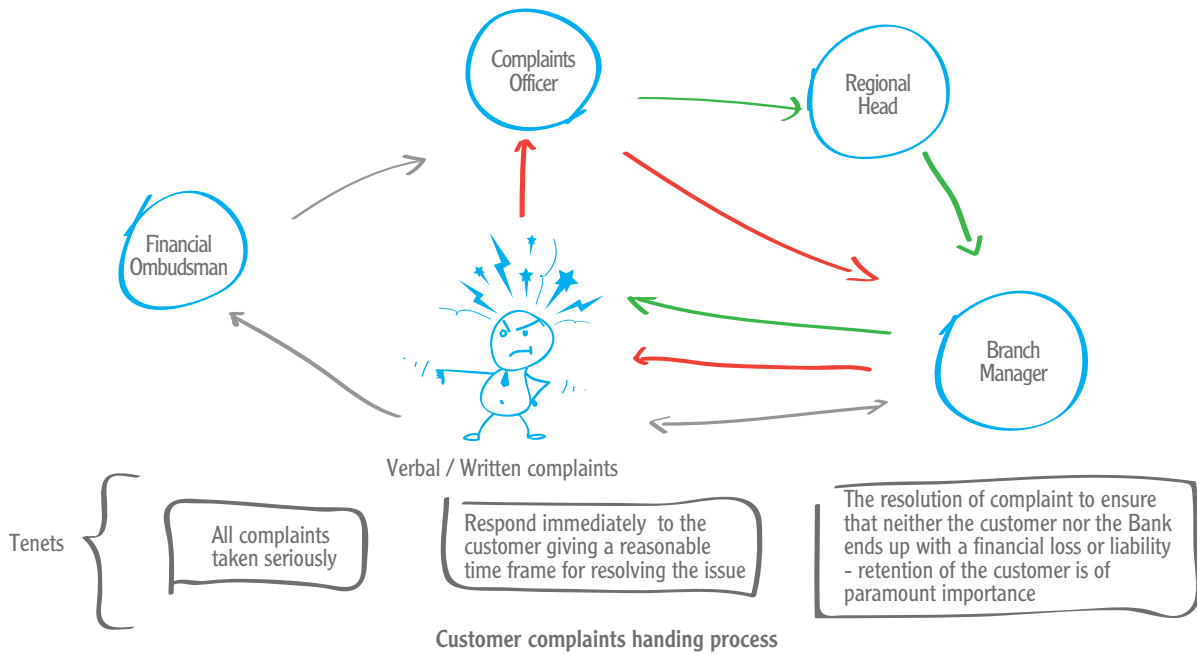
Analysis of Complaints received - 2011



Complaints and issues raised are taken into the service development agenda for the year and looked at constructively when designing and updating customer service standards and in product development.



STRATEGY IN ACTION: FAIR BANKING continued

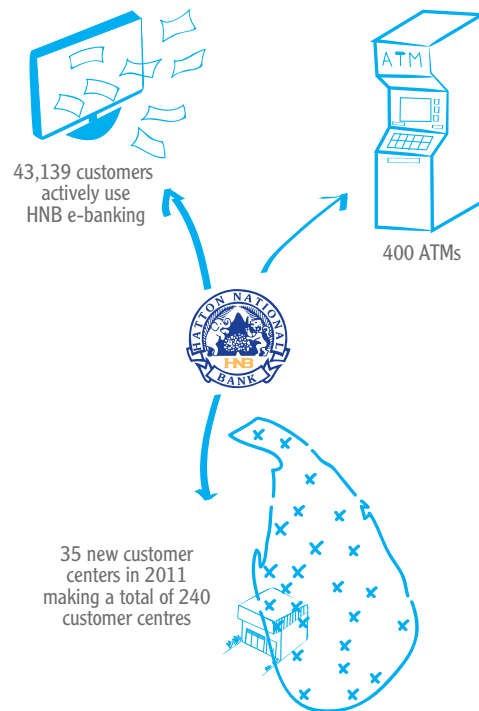


5. Enhancing customer accessibility

The Bank employs a multi-point distribution strategy with a view to increase the penetration of its service offer, the strategy being to reach even the most rural of customers. As such, the Bank operates fully fledged customer centre and extension offices, micro customer centre that cater to the specific needs of micro-enterprises and doorstep customer centre which offer the most basic of banking services in deep rural pockets where communities have little or no access to financial services.

In 2011, the Bank looked to greatly enhance its penetration and presence in rural communities and as such commissioned a total of 35 customer centres during the year. By year end, the Bank reached a milestone of 240 Customer Centres and continues to maintain the largest and widest network of customer centres among private commercial banks operating in the country.


In addition, with a view to target and grow high-net worth clients in the suburbs and in the outstation markets, the Bank launched 3 Crystal Circle centres in Negombo, Kandy and Wellawatte. The concept of Crystal Circle is centered on partnering with customers to personalise banking services. From the private banking centre with reserved parking, to on-call financial specialists, HNB Crystal Circle plans to save customers time and go the additional mile to assist them achieve their financial needs. In 2011, the Bank's Automated Teller Machine network expanded to 400. During the year, the Bank also partnered with Sampath Bank to provide dual accessibility to both Bank customer bases. This strategic collaborative effectively enhanced accessibility by doubling ATM access to over 1,400 locations placing the Bank at the forefront of ATM penetration in the country.



6. Engaging the next generation

Financial Literacy to Youth: Through the Student Bankers Programme, which was established in 1990, the Bank has been engaging and empowering the rural youth, providing them with access to resources and giving them the necessary resources to interact with the rest of the nation.

Over the years, with the consent of the Central Bank of Sri Lanka, the Bank has established Student Banking Units within the premises of schools and has effectively inculcated the savings habit amongst today's youth whilst also imparting the basics of financial education, responsibility and accountability. In the long term, the Bank is confident that its interaction with the students would enable them to procure employability with ease.

-  Approximately 22,000 Student Bankers trained over a period of 22 years
- No. of Student Savings units – 164

Yauwanabhimana: The Bank together with a number of premier corporate enterprises in Sri Lanka, initiated a programme in 2011 aimed at overcoming a growing concern for youth – the lack of skills for employability. The programme offers young people throughout the island the opportunity to improve both themselves and their skills through a groundbreaking initiative termed Yauwanabhimana meaning 'The Pride of Youth'. Focused on empowering youth between the ages of 18 to 30 years, Yauwanabhimana aims to provide young people with the resources, skills and tools required to become 'employable' either with the ability to obtain employment in the corporate sector or successfully manage self-employment endeavours of their own.

-  No. of participants in 2011 - 140
- Expected No. of participants in 2012 - 10,000

7. Financial Literacy to build lives

The Bank's financial literacy programme now popularly known as "Divi Saviya" is a large - scale and systematic engagement process. Divi Saviya aims to create financial inclusion for rural micro-entrepreneurs. The programme has facilitated over 100,000 micro-entrepreneurs over a period of two decades and works in tandem with the Bank's Micro-financing programme "Gami-Pubuduwa" or "Village-reawakening". Financial Literacy efforts are further augmented by provisioning greater accessibility to financial services and opportunities for livelihood development to rural youth. To enhance the impact of the Divi Saviya programme, the Bank has effectively collaborated with corporate partners, thereby going beyond the normal engagement of provisioning financial services to one of establishing market linkages. This collaborative effort has enabled customers to enhance the marketability of their produce through quality enhancement efforts and market development initiatives. The Bank's collaborative programme has therefore enabled customers to develop their businesses through access to linkages and resources, enabling them to meet sustainability opportunities and risks with greater confidence.

-  No. of events in 2011 - 27
- No. of Participants in 2011 - 35,915

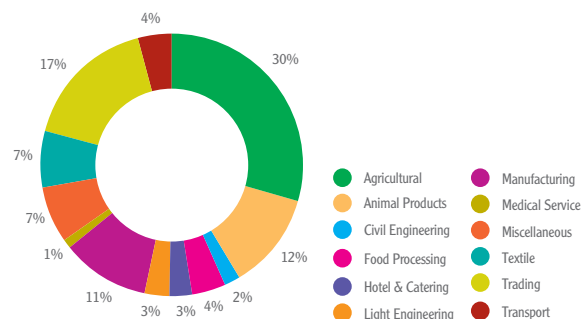


"Adhishtana" empowering women for sustainable livelihoods

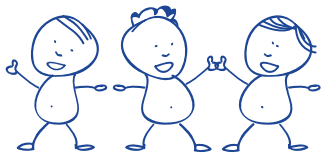
The Bank introduced a first of its kind savings account for migrant workers which in turn enables the account holders to make use of a series of concessionary products and benefits. The new product offering launched under the brand name "Adhishtana" is a savings account option with access to financing and insurance for remittance senders and receivers. Keeping in line with the aspirations of a majority who seek foreign employment to fulfill the dream of a home of their own, the "Adhishtana" account paves the way for special housing loans from Rs.50,000/- to Rs.1,000,000/- and loans ranging from Rs.25,000/- to Rs.1,000,000/- to start small business enterprises together with business guidance and advice provided by the Bank. Moreover, all "Adhishtana" account holders are offered the choice of 5 life insurance plans ranging from Rs 100,000/- to Rs 1,000,000/-. The Bank bears 50% of the insurance premium for the Rs 100,000/- plan in the first year of the policy. The Bank has also developed a "financial education booklet" in 3 languages which is distributed free of charge amongst the community as well as a "financial education documentary" addressing real life situations faced by migrant workers and their dependants which is used at awareness programmes

Gami Pubuduwa Review - Sectorwise distribution of Loans 2011

Sector	Amount	No. of Loans
Agricultural	906,751,481	6,241
Animal products	284,490,290	2,442
Civil Engineering	91,012,786	324
Food processing	164,641,802	762
Hotel & Catering	141,665,004	573
Light Engineering	186,580,453	713
Manufacturing	515,798,500	2,219
Medical service	34,892,403	124
Miscellaneous	336,479,031	1,553
Textile	240,244,130	1,421
Trading	738,803,912	3,499
Transport	177,237,915	895
Total	3,818,597,707	20,766



STRATEGY IN ACTION ENTERPRISE GOVERNANCE, SECURITY & SAFETY



Ensuring the safety and security of our customers' and investors' money and information is a key responsibility of Hatton National Bank. This area covers issues and areas such as:

- **Protecting customers & investors through safer banking**
- **Anti-corruption**
- **Know your customer, anti-money laundering & combating financing of terrorism**
- **Data security & fraud prevention**
- **Physical security at customer centre & ATM**

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking To be a responsible lender by judging whether a customer's aspiration to borrow is affordable and meets the Bank's assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.





Strategic Priorities for Enterprise Governance, Security & Safety

- Strengthen enterprise governance frameworks, processes
- Full implementation of BASEL 2 requirements
- Part implementation of BASEL 3 roadmap
- Implementation of a robust, scalable IT system
- Enhanced physical security at customer centre-level

2011 Highlights

- Enterprise governance framework further developed
- Progressed on BASEL 2 roadmap
- Compliance systems and processes for BASEL 3 implementation commenced
- Invested Rs. 358.9 Mn into IT infrastructure development
- Invested Rs. 292.2 Mn into enhanced physical security at customer centre level

Going Forward

Enterprise Governance, Security & Safety will continue to be a core area of focus for the Bank in fostering confidence, financial stability and sustainability of the Bank's business

HNB's Board and Management is committed to ensuring business is conducted without compromising ethics and values and continually refines its risk appetite in line with best practices and regulatory directions."



J D N Kekulawala
Senior Deputy General Manager
– Strategy & Compliance

"In the preceding financial year, the Bank diverged its compliance function from Risk Management in a bid to give greater focus and independence to the function. The Bank's compliance includes regulatory conformance. Critical areas such as Anti Money Laundering (AML) / Know Your Customer (KYC) and their respective responsibilities are set out in the Bank's AML Policy Document.

The implementation of the Customer Charter as per the Banking Act Direction No 11 of 2008 during the course of this financial year has served to enlarge the window of information for our customers pertaining to products, services and transactions. We view the Customer Charter as means to further enhance not only our standards of fair banking practice but also the safety of customer interests through customer protection. The introduction of the Bank's Code of Conduct for all employees, in addition to the Code of Ethics, has served to enhance the Bank's focus on Customer Protection, Compliance and Transparency. In outsourcing business operations which relate to provision of financial services, our policy on outsourcing provides direction and guidance to ensure that risks in outsourcing are managed effectively, avoiding conflicts in internal control systems or situations that may result in reputation of the Bank being compromised."

(Refer Pages 51-67 for further insight into Risk Management and pages 68-91 for Governance procedures).

Defining the management approach to Governance, Security & Safety:



D P N Rodrigo
Deputy General Manager
– Risk & Credit Quality

"The Bank's Risk and Governance Structures are fundamental in creating a conducive platform for security and safety across every function of the bank whilst safeguarding the interests of its stakeholders. Risk Management is firmly embedded in business activities through periodically updated policies and practices.

The Bank's operational risk policy comprises risk identification, implementation of controls for measurement, monitoring and mitigation of operational risks. The operational risk unit facilitates a 'loss prevention culture' through operational risk guidelines and operational risk meetings conducted across the network. A 5 year database of operational losses analysed by root causes assists in developing a learning culture. The Bank is in the process of developing organization wide Key Risk Indicators to further strengthen its approach to managing operational risk.



S N Wijeratne
Chief Information Officer
/ Head of IT

"In the areas of data security and fraud prevention, the Bank has invested in numerous technology initiatives to overcome the growing external threats, and in keeping with global best practices. The prevention of fraud is a strategic priority for the Bank and we have been consistently seeking means by which to improve controls through technology in a bid to reduce the risk of fraud.



STRATEGY IN ACTION: ENTERPRISE GOVERNANCE, SECURITY & SAFETY continued

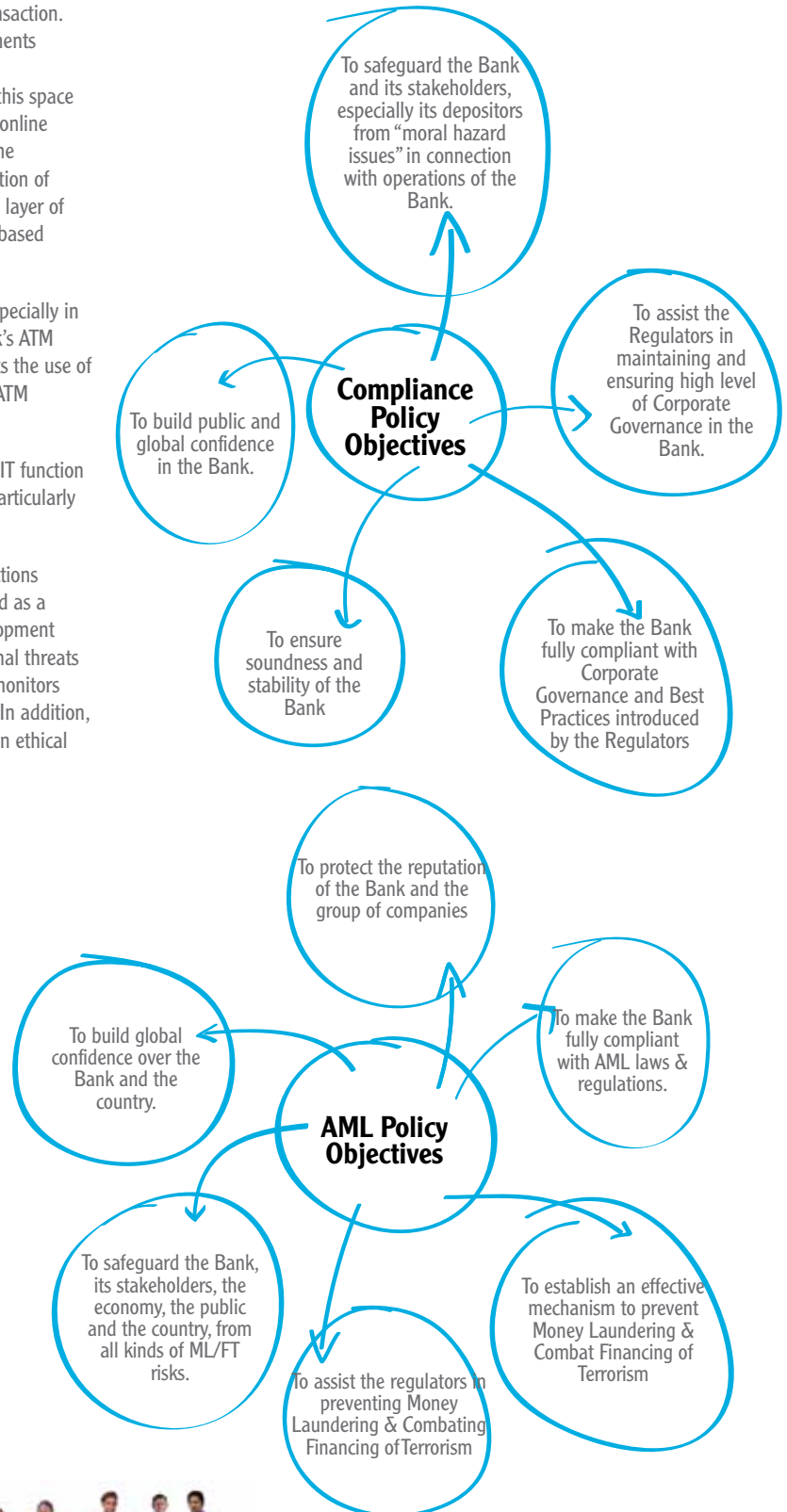
In 2011 as in previous years we continued to invest in new systems and controls. Focus of attention in this regard was largely placed on ensuring safety of transactions and data protection, post transaction. The transaction end was further secured for credit card payments through the implementation of advanced data encryption methodologies. Further introductions have been initiated in this space to acquire and issue chip based cards and also extending to online verification. In the same manner, online payments through the electronic banking channel will benefit from the implementation of multifactor authentication that effectively adds an additional layer of security. The Bank continues to adopt numerous technology-based strategies to ensure transaction points are secure.

The Bank takes stringent measures to adopt ATM security especially in light of the growing concerns regarding ATM fraud. The Bank's ATM network is fraud-proofed from its very design, which prevents the use of skimming devices and potential threat. In addition physical ATM security is in place by way of cameras and fraud guards.

From a technology support perspective, in 2011, the Bank's IT function deployed numerous systems to facilitate risk management particularly in the area of KYC.

Other fundamental systems such as firewalls, intruder protections systems and back-end transaction monitoring were enhanced as a component of the on-going security maintenance and development measures. The Bank is well aware and informed of the external threats to its network. A dedicated IT Security Team maintains and monitors vulnerabilities and activities across the network, proactively. In addition, in circumstances that require reactive measures we engage in ethical hacking to reduce our exposure to fraud."

Policies & Processes at work:



Engagement for Security & Safety:

The Bank adopts pervasive and persistent engagement with its employees to perpetuate the relevance and importance of compliance with critical policies and processes that deliver value in enhancing the area of safety and security. New employees undergo a series of orientation and initiation programmes that outline the Bank's core risk management and governance efforts as well as imparting sound knowledge on specific compliance requirements. Existing employees are periodically re-orientated with changes in risk management and compliance requirements at the Bank's in-house training centre. In addition, all employees are encouraged to utilise the e-learning tool to develop their knowledge in the area of risk management, governance and compliance. Online competency tests allow employees to test their understanding of the subjects and the specific processes.

Specific training programmes are also held for niche areas of speciality such as AML/CFT/KYC training. Likewise, with the Bank journeying towards BASEL 2 implementation by 2012, employees are being trained in the requirements for change and compliance to meet areas under the purview of BASEL 2 implementation. Regulatory changes by CBSL have also necessitated greater engagement of the Bank with its employees in creating awareness of regulatory changes and the subsequent compliance requirements.

The Bank's stance on Anti-corruption is communicated and impressed upon all employees through the Code of Conduct, a binding document that requires individual employee acceptance and is signed by each new employee.

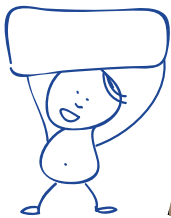
Security & Safety Initiatives:

Following are a few of the initiatives undertaken by the Bank to augment security and safety of the Bank's operations and its customers and other stakeholders:

Initiative	Description	End Objective
AML Risk profiling of all customers	Collation of data to better profile customers based on risk	To meet regulatory requirements
Obtaining KYC data from customers	An ongoing process to enhance the Bank's database on customers	To carry out Customer Due Diligence more effectively
Stress Testing	Stress Testing enables the Bank to determine how its portfolios will react if business conditions become more challenging	Enhance the risk picture and possible outcomes of a deteriorating external environment.
Development of Risk Dashboards	Demonstrate the Bank's performance against Board Approved Risk Appetite	Serve as business intelligence tools in assessing risk performance
Business Intelligence & Analytics tool	Enables the business performance to be with greater depth and drill down capabilities	Enhances the top-level perspective of the business and shortcomings
Data security enhancements	Adoption of better encryption methodologies for credit cards	Enhance security of transactions
Multifactor authentication	Adoption of multi-layer authentication for online banking	Enhances security of data and transaction
3D security implementation	Payment gateway security enhancement	Ensures transaction points are secure



STRATEGY IN ACTION
EMPLOYEE EXCELLENCE



We aim to support, engage, listen and develop our employees. At Hatton National Bank we realise that the foundation of our business lies on our employees who are the key drivers of our business strategy. We continually involve and engage our “Hatna family” by striving for/to:

- **Diversity & inclusion**
- **Employee development**
- **Employee and community engagement through volunteerism**
- **Listen to employees**

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking. To be a responsible lender by judging whether a customer’s aspiration to borrow is affordable and meets the Bank’s assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.





Strategic Priorities for Employee Excellence

- To increase the diversification of our employee base with greater emphasis on recruitment from semi-urban and rural sectors
- To formulate training and development based on future needs
- To engage employees beyond their work role through community volunteerism
- To create more open and transparent channels of employee communication and engagement

2011 Highlights

- 58% of recruitment at entry level from semi-urban and rural sectors
- 36 Junior Executives underwent a Management Development Programme.
- Engagement in Cancer Counseling, Fire Safety awareness Championing, HIV & AIDS awareness Championing
- Appointment of a dedicated Employee Relationship Officer

Going Forward

Continue to develop the capacities of employees to meet the Bank's and the industry's future needs whilst furthering the Hatna family concept

Defining the management approach to Employee Responsibility:



J R P M Paiva
Deputy General Manager
– Human Resources &
Administration

“The success of Hatton National Bank over the years has been its people. From its inception in 1888, the Bank has nurtured financial and banking specialists who in turn have contributed towards the development of Sri Lanka's banking industry.

The Bank is a firm believer in leading its **employees towards excellence** in every aspect of financial management and banking. Sharing knowledge across the talent pool irrespective of job function, proactively and on an on-going continuous basis, has enabled the Bank to create a culture of learning. Foreseeing change and adapting proactively to acquire new skills and competencies to the talent pool has allowed the Bank to develop sustainable business. The Bank's **employee development programmes** is focused on instilling the pursuit of excellence amongst employees and future employees. It does not believe in merely developing an individual in his current capacity or job function but focuses on developing an individual who is inspired, motivated and professional and has the depth and capacity to impact not only on value creation for the Bank but also for the industry, and the nation at large.

We encourage an **open and transparent culture** and engage with our employees directly. In 2011, we took specific steps to further the HR

dimension to a new level of employee relations with the appointment of a dedicated Employee Relationship Officer, thereby giving direct access to a person whose sole responsibility is to engage and facilitate employee dialogue. An open door policy further facilitates employee relations, giving access to employees to have dialogue with the Bank's top management including the CEO. Several employee-focused events throughout the year also aid this interaction process and serve as a sound platform for strengthening of employee relations. The Bank's "Upward Mobility" HRIS also serves as a tool for interaction, with online capabilities for employee suggestions.

We support our employees as our business evolves. The Bank actively strives towards the creation of a **culture of learning**, one that is built on a firm foundation of knowledge, skills and attitude and which effectively utilises Training and Development as a tool towards the creation of high levels of functional as well emotional aptitude.

The Bank's Training Plan mirrors the strategic vision, objectives and the overall strategic intent for the Bank. Thus, the need to train, develop and the eventual Training Plan for the year are in direct alignment with the Bank's mission for the long-term sustenance of the business. In the belief that strategic focus is imperative for the development of competencies for business growth, cost management, productivity, compliance and regulatory requirements, the Bank's training and development gives primary emphasis to these core themes. Support needs such as building and retaining lasting customer relationships, service quality, customer service excellence, understanding the importance of self management in realising individual and bank objectives, the need to develop managerial competencies and pursuit of multi-skills to support succession planning and job rotations are also encapsulated in the overall training and development process. The Bank's **e-learning** tool plays a critical role in empowering employees through knowledge. The tool gives employees the freedom to develop themselves in every conceivable area of interest within the sphere of the Bank's operations. This limitless access (even from home) to a wealth of knowledge and know-how has fostered a culture of constant learning where employees understand that opportunities are limitless for those who take the initiative to develop themselves.

Diversity and inclusion is a key focus for us. We have always laid heavy emphasis on recruiting from semi-urban and rural communities. One in five of our employees therefore originate from semi-urban towns and rural villages across Sri Lanka. We have a fair representation of employees from every province and are consciously maintaining a sound balance of employment from all provinces and ethnic communities. We are firm believers that inclusion and integration cultivates a culture of harmony and aids in the cross-fertilisation of knowledge.

To achieve our Strategic Plan we need to attract, retain and motivate our employees. Remuneration is one key element to achieving this - we must reward our employees' efforts fairly and competitively.

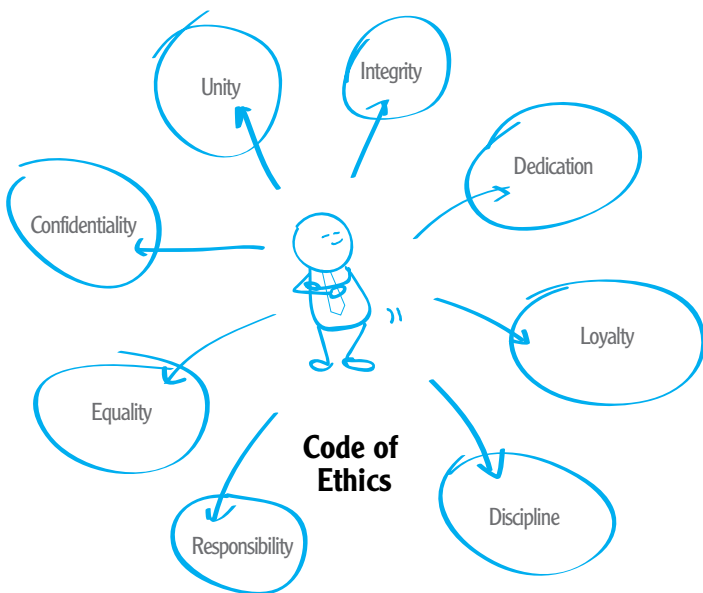
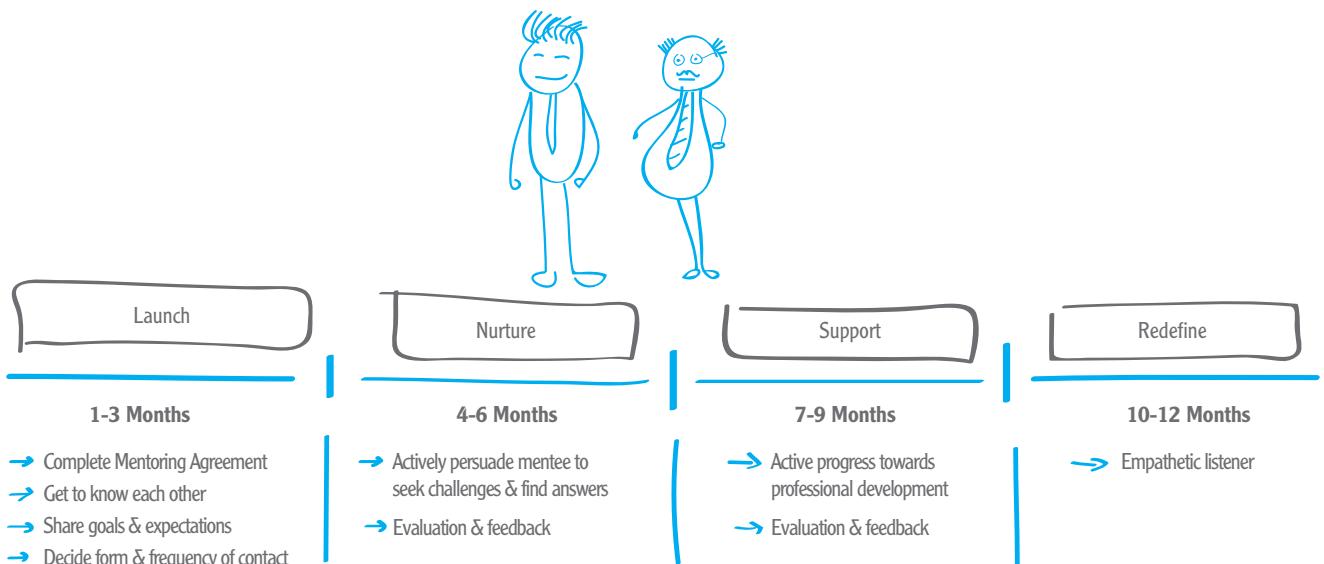
The Bank encourages employee volunteerism for community engagement. We believe that this fosters a sound balance of work and social commitment and actively promotes the concept of employee volunteerism as an avenue to nurture our employees to be selfless and dedicated beyond just the business. Over the years we have seen our emphasis on volunteerism pay dividends and the best example of this dedication is by far the Cancer Counseling Centre and the role that our employees play in cancer counseling.”

STRATEGY IN ACTION: EMPLOYEE EXCELLENCE

continued

Policies & Processes at work:

Mentoring Process for Management Trainees



Engagement for Employee Responsibility:

1. Driving exceptional employee relations

The Bank's employee relations strategy is multi-pronged and multi-tiered. With engagement activities conducted across all levels from welfare activities, annual designated engagement activities, interaction with Relationship Officers, customer centre to head office interaction, HRIS and an open door policy, the Bank follows a concerted strategy towards maintaining exceptional employee relations.

2. Creating a culture of learning

The Bank actively strives towards the creation of a culture of learning, one that is built on a firm foundation of knowledge, skills and attitude. In nurturing people Hatton National Bank effectively utilises Training and Development as a tool towards the creation of high levels of functional as well emotional aptitude. Development and developmental activities such as training programmes, mentoring, e learning, Toastmasters Club, inter customer centre quiz competitions, best speaker competitions allow for greater intellectual vitality.

3. Rewarding employee volunteerism

The Bank opens up possibilities for employee volunteerism in areas that are directly aligned to the Bank's sustainability strategy. Through volunteerism, the Bank is able to pass ownership of its sustainability projects to its employees, and thereafter to a wider community.



4. Promoting work-life balance

The Bank promotes work-life balance through its Work Life Balance Policy which dictates the need for harmonious balance between employees work and personal responsibilities. Encouragement to actively pursue a variety of sports, regional level sports day, annual trips and parties, Vesak bakthi gee, Christmas carols, talent shows are some of the events organised by the bank for the staff towards achieving work-life balance.

5. Shaping behaviour

Changing behaviours is of critical importance to the long-term effectiveness of the Bank's sustainability strategy. Towards this end the Bank conducts programmes that instill the values of social responsibility leading towards the achievement of social reform. The Bank espouses the values of its "Green Pledge" to all employees and encourages staff to abide by and live the commandments of the pledge in their day-to-day activities. In addition the Code of Conduct for all employees together with the Code of Ethics lay out the expectations of the Bank with regard to Anti-corruption practice, Compliance and Transparency.

Employee Responsibility Initiatives and Indicators:

1. Human resource development for industry growth

Post conflict the Bank proactively sought to develop the youth of the Jaffna peninsula. Since 2009 the Bank has been conducting a Certificate Course in Elementary Banking and Finance in the peninsula with the intention of exposing secondary school educated youth to the fundamentals of Banking and Finance. The initiative was the direct outcome of a post conflict boom in commercial activity in Jaffna precipitated by the establishment of the financial services industry. Due to the lack of qualified recruits, the Bank initiated the training programme that serves as a primer for those entering the Banking and Financial Services industry. The project has proven to be a success and in 2011, the Bank graduated the 6th batch of participants to the industry.

2. HRIM/IS

The Bank's HR Information System (HRIS) enables Strategic Human Resource intelligence tools to be utilised for planning and decision-making and this has proven to improve business performance. The system enables the Bank to cater to personalised HR needs of employees and acts as a sound base for organisational development. In 2011, the system was further upgraded and currently facilitates the total automation of the HR recruitment function from online application to selection. For Training and Development, the system enables the calling of nominations online, and allows modular proficiency tests to be carried out on the system online in real-time across differing geographic locations. The system also allows for performance management to be fully automated and facilitates employee engagement through the online suggestion process. With routine HR processes also online, HRIS has served to decrease paper generation. In

the future, the HRIS is expected to facilitate our journey towards a paperless office.

3. Driving diversity & inclusion

Employees are recruited with the objective of maintaining the Bank's 1 to 5 ratio (one in five employees will be from the semi-urban, rural communities outside of the Western province). However, in doing so, the Bank is conscious of the need to match potential employees with the employee profile requirements of the Bank. In 2011, two sets of recruitments were conducted from the Northern province in a bid to re-integrate the communities in the previously conflict affected area. In the upcoming year recruitment from the Eastern province and the North Central Province are planned. The Bank also strives at every opportunity to recruit from the communities within which it operates, to drive the Bank's inclusion strategy forward.

The Bank is an equal-opportunities employer and is a member of the Employer Network on Disability.

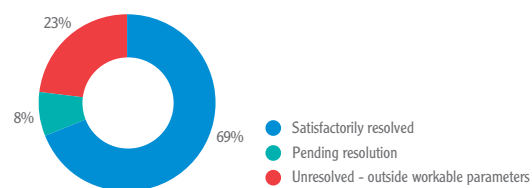
The Bank is also a member of the Lanka Business Coalition on HIV/AIDS and works actively to raise the awareness on HIV and AIDS in the workplace. Through its awareness programmes, the Bank has propagated acceptance amongst employees allowing the shedding of biased opinions, discrimination and prejudice.

4. Employee empathy & communication

Spark is an employee suggestion scheme launched in 2007, which aims to give a voice to employees on the activities of the Bank and on new initiatives. The scheme epitomises the Bank's attitude towards employee inclusiveness in the quest for strategic and operational excellence. Focused on innovation, Spark calls for fresh thinking and has over past years proven to be a catalyst in pushing employee creativity to new heights. Employee suggestions through Spark are reviewed by a cross-functional team and ideas and suggestions picked for implementation based on their applicability and relevance to business issues.

In 2011, the Bank introduced an Employee Relations Officer in a bid to establish one point of contact for employee grievances. In addition, the Bank appointed a Transfer Committee to provide greater transparency and equality to inter-customer centre transfers. This was given priority in the financial year, as the highest number of employee grievances arise from discontent due to transfers. The appointment of this Committee allows employees to independently appeal and have access to a second hearing.

Employees grievances recorded by Manager - Employee Relations



STRATEGY IN ACTION: EMPLOYEE EXCELLENCE continued

5. Employee development

The Bank's Training Plan is designed in accordance with its training needs analysis based on information gathered from performance appraisals, questionnaires and recommendations from Heads of Departments. The annual **Training Needs Analysis** and **Annual Training Plan** form the basis of continuous development of the workforce in terms of technical, managerial and specialised areas of knowledge and skills development.

Continuous Professional Development (CPD) programmes are an inherent component of the Bank's quest for knowledge enhancement. A three-tiered structured curriculum is available for Banking Assistants to enhance their knowledge through continuous learning. Efficiency Bar examinations are held periodically to provide opportunities to update and test their technical know-how. The examinations assist employees to acquire CPD Points, which are linked to career progression.

The Bank also conducts a Management Development Programme (MDP) that is defined by its unique curriculum. The programme is considered one of the most critical determinants for future organisational success.

The Bank's e-learning tool is an integrated, role based e-learning platform with a user-friendly interface and has been well adopted by the Bank's employees. It has proved to be an effective teaching and knowledge enhancement mechanism.

Mentoring and coaching continued to be at the core of employee development in 2011. In addition to the existing mentoring programme for executives – which is focused on the development of soft and hard skills for future leadership roles – a coaching programme termed "PAL" was introduced to familiarise young recruits with the Bank's operations, policies and processes and to ensure that they are fully integrated into the Bank's culture.

6. Industrial relations & human rights

We are committed to respecting and upholding human rights in all areas of our operations and within our sphere of influence, as expressed in the Universal Declaration of Human Rights. The Bank also adheres strictly to the International Labour Organisations (ILO) labour practices and standards as well as labour laws and regulations as stipulated by the local authorities. The Bank has an ongoing engagement process with Labour Unions and integrates them and gives them ownership of business objectives and strategy.

7. Succession planning

In anticipation of future growth, the Bank implemented a series of strategic HR initiatives towards succession planning. The most significant of these initiatives have been the steps taken towards the fortification of the Management team through infusion of greater expertise. Succession planning in 2011 was largely based on identifying the future skills and roles of key positions and developmental efforts taken towards nurturing identified persons to enhance their capacities and know-how.

8. The Hatna family concept

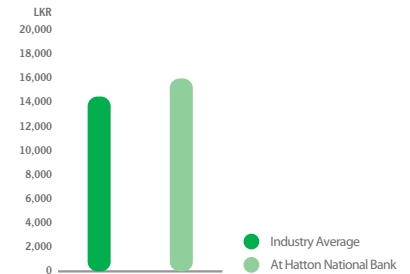
The Hatna Family Concept has been the key differentiator of the Bank's strategy towards employee relations. It is a culture that has its unique attributes based on trust, mutual respect and acceptance. Over the years the Hatna Family Concept has defined the Bank's own identity, and the core values emanating from this culture have shaped the Bank's service orientation and perspective on business. In 2011, the Hatna Family Concept continued to be key to employee relations. The Bank continued to assist employees for critical needs such as medical assistance. The Bank also continued to offer scholarships for the children of employees who excelled in their studies, lending them a hand to further excel.



Staff Strength, Gender Analysis

As at 31st December	2009			2010			2011		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Corporate Management	17	4	21	19	7	26	19	6	25
Senior Management	30	4	34	25	5	30	29	7	36
Managers & Executives	447	123	570	459	128	587	470	131	601
Officers	657	323	980	687	324	1011	756	343	1099
Banking Assistants	1019	581	1600	1036	690	1726	903	655	1558
Trainees	152	165	317	155	92	247	372	190	562
Secretaries, Stenographers, Typists	11	389	400	9	367	376	9	358	367
Support Staff	341	0	341	314	0	314	297	0	297
Contract Staff	28	11	39	30	5	35	29	10	39
Total	2702	1600	4302	2734	1618	4352	2884	1700	4584

Comparison of salaries at entry level



Staff distribution by Province

Province	2009		2010		2011	
	No	%	No	%	No	%
Central	303	7.0	305	7.0	316	6.9
Eastern	144	3.3	171	3.9	222	4.8
North Central	88	2.0	133	3.1	129	2.8
North Western	234	5.4	217	5.0	266	5.8
Northern	139	3.2	155	3.6	170	3.7
Sabaragamuwa	140	3.3	143	3.3	135	2.9
Southern	232	5.4	233	5.4	208	4.5
Uva	117	2.7	117	2.7	122	2.7
Western	2892	67.2	2863	65.8	2997	65.4
Overseas	13	0.3	15	0.3	19	0.4
Total	4302	100	4352	100	4584	100

Permanent staff vs. Contract staff

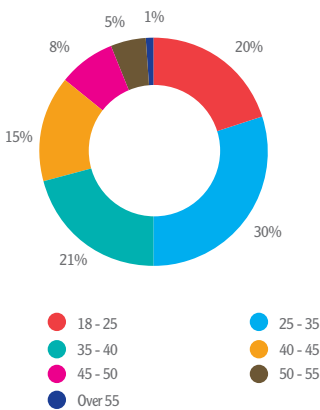
Employment Type	No.	%
Permanent	4545	99.15
Contract	39	0.85
Total	4584	100.00

*Full time vs Part time staff - All Staff including contract staff work a full day

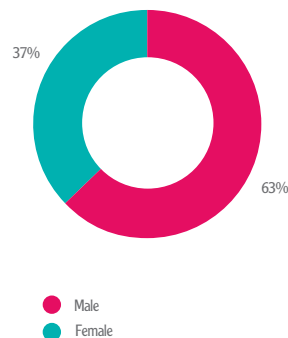
Percentage of staff covered by Collective Agreements

Year	2009	2010	2011
No. of employees covered by Collective Agreements	3152	3267	3259
Percentage	73%	75%	71%

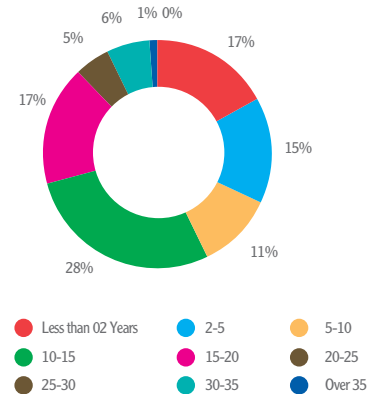
Age-wise Analysis of Employees



Gender-wise Analysis of Employees

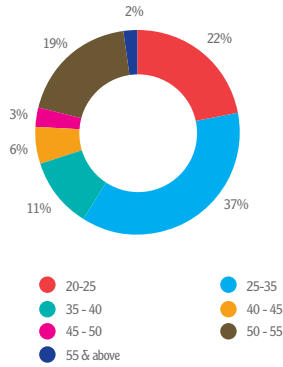


Servicewise Analysis of Employees

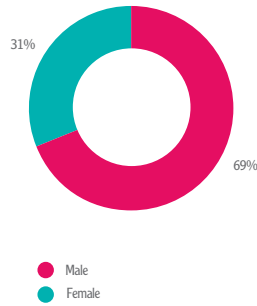


STRATEGY IN ACTION: EMPLOYEE EXCELLENCE continued

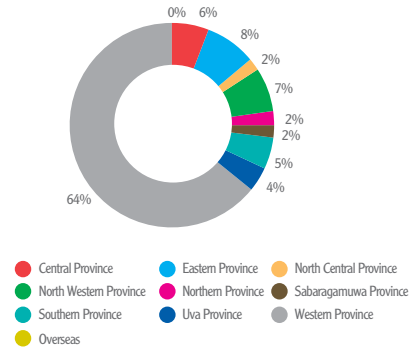
Staff Turnover by Age



Staff Turnover by Gender



Staff Turnover by Region



Achievements in Sports 2011

Cricket

- Champions - Mercantile 'G' Division Cricket Tournament
- Champions - Mercantile Over-40 Tournament
- Champions - Indoor Cricket Games 'A' Division
- 3rd Place - Mercantile 'A' division 20-20 Tournament
- Semi-finals - Mercantile 'A' division limited-over Tournament

Soccer

- Mercantile 'A' Division League Champions

Hockey

- Champions Mercantile Knockout Tournament
- Runner-up Mercantile League Tournament
- Runner-up Mercantile Seven a Side Tournament

Basketball

- Winner - Mercantile Knockout Tournament (women)
- Winner - Mercantile League Tournament (women)
- Winner - Mercantile Semi-league Tournament (women)
- Semifinals - Delmege Super League 'A' Division (men)
- Semifinals - Mercantile Knockout 'A' Division (men)
- Semifinals - Superleague 'A' Division (men)

Bowling

- Amcham Bowling Tournament - 4th place

Netball

- Winners - Open Club Tournament
- Runner up - Mercantile Tournament
- Runner up - Nationals

Badminton

- Overall Champions - Mercantile Badminton Overall Championship
- Winners - Mercantile Open & Mercantile Team Championships
- Winners - Mercantile Double Team Championship

Athletics

- Mercantile Athletic Meet
Gold - 7, Silver - 13, Bronze - 19

HNBers representing Sri Lanka in 2011

Badminton

Mr. Dinuka Karunaratne
Ms. Nadeesha Gayanathi

Basketball (Men)

Mr. Roshan Fernando

Basketball (Women)

Ms. Kumarine Silva
Ms. Anjalie Ekanayake

Cricket

Mr. Kosala Kulasekera
Mr. Sajeewa Weerakoon

Hockey

Mr. Thilina Perera
Mr. M M Gazzali

Netball

Ms. Shashika Samarasinghe
Ms. Gayathri Lankatilleke
Ms. Kumarine Silva

Achievements of the HNB Toastmasters Club

- Expansion of activities to the hill country by chartering a separate club for the benefit of staff in the Central province.
- The HNB Best Speaker Contest an initiative of the HNB Toastmasters club to develop leadership and communication skills amongst all staff was successfully conducted for the 3rd successive year.
- Speech Competitions
TM Roshantha Jayatunga (President HNB Toastmasters Club) - Runner up at the District 82 Humorous & Evaluation Speech Contest held in Managalore, India.
- Successfully coordinated and conducted 4 speech crafter's programmes at Ceylon Pencil Company (Pvt) Ltd (2 batches), Inforamtics (Pvt) Ltd and Sanasa Development Bank thus aiding the development of communication skills beyond the Bank.
- Elections to Council - The Division Governor for Division J and 2 Area Governors for Division Council were elected from the HNB Toastmasters Club during this period.





The triumphant HNB Badminton team



A section of the choristers at the annual Christmas Carols



Rewarding loyal employees for 25 years of dedicated service



Creating awareness about HIV AIDS



Enjoying a spot of fancy dress at the Annual Childrens Party



At the annual sports fiesta



STRATEGY IN ACTION
SUPPORTING ENTERPRISE



Hatton National Bank recognises that one of its most critical roles is to support the growth of the economy, effectively fostering wealth creation and facilitating capacity development in key economic sectors and segments. As a partner in progress, we support enterprise by empowering and enriching. We do this in a number of ways:

- SME/SMI Development
- Working towards national wealth creation
- Investor returns
- Responsible sourcing

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking. To be a responsible lender by judging whether a customer's aspiration to borrow is affordable and meets the Bank's assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.





Strategic Priorities for Supporting-Enterprise

- Proactive and planned approach to SME/SMI Development
- Capacity building for thrust sectors in line with national economic priorities
- Investor wealth creation
- Strategic Sourcing to promote micro and SME suppliers

2011 Highlights

- Participated in a World Bank sponsored SME Development Fund Credit Line
- 3 products and services developed to enlarge SME/ Micro sectors
- P/E Ratio at 10x, EPS at Rs 15.08, Gross Dividend of 2.9 Bn
- Supplier base comprised of 97.5% SME/ Micro suppliers who account for 23% of total value of supplies for the year

Going Forward

Continue to support-enterprise with a view to catalysing change in rural economies whilst enhancing investor returns

Defining the management approach to Supporting Enterprise:



I R D Thenabadu
Deputy General Manager
– Corporate Banking

“Supporting enterprise has always been on the Bank’s agenda. If you look back, over 120 years ago, Hatton National Bank was formed for the purpose of supporting enterprise. Our very origins hark back to a legacy of partnering with grass root industry, assisting them grow and create wealth. Over a century later, our business philosophy is still built on the principle of supporting enterprise.

We are more than just a bank to our customers. We are an interactive lender in that we contribute in advising and guiding our customers. We are always cognisant of the need to manage the customers credit and take responsibility in managing their exposure. Through fair pricing, we assist enterprises to leverage returns. By always offering the best rates based on market movements, the Bank supports enterprises to grow.

Our financial literacy and knowledge sharing programmes for Small and Medium Enterprises (SMEs) and Small and Medium Industries (SMI) has fostered commercial vivacity over the years, and helped graduate these industries and enterprises to become more complex and

sophisticated commercial entities. The Bank’s financial literacy programme has followed a planned approach over the last three years, and we have effectively collaborated with other corporates and Chambers of Commerce to establish linkages and share know-how, to facilitate SMEs and SMIs to build their capacities and follow a realistic roadmap for sustainable business.

The Bank’s business strategy is aligned to the national strategy and this has meant that we are strategically focusing on economic sectors of national importance. Agriculture, Tea, Fisheries, Dairy, Construction and Tourism continue to be key sectors of focus, and the Bank has actively facilitated capital investment into these sectors in view of their strategic importance to the nation. The Bank is also positioned as the SME development partner having proactively developed financial solutions that meet the full range of financial needs of SMEs. Thus, Hatton National Bank’s progressive focus on the SMI and SME sectors have largely assisted towards meeting national economic objectives and the Bank is seen as a channel of national wealth creation.”



J D N Kekulawala
Senior Deputy General Manager
– Strategy & Compliance

“The Bank has a stable and sustainable business model for shareholder wealth creation. Our continued focus on investor returns and relations has enabled the Bank to deliver consistent value to shareholders over the years. We believe that our coherent approach to balancing risk and reward has enabled us to focus on creating consistent value. This has been furthered by the symbiosis of the Bank’s overall strategy towards sustainable business and its strategy towards investor relations.

The Bank follows a concerted strategy of interactions and good relations with investors, where continuous dialogue of the Bank’s strategy and future plans with investors has enabled the incorporation of investor opinion and feedback in shaping our future strategies. Therefore, investor relations is an on-going and inherent process in determining not only the returns to shareholders but also in shaping how we do business.”

Corporate Governance plays a critical role in determining the continuity of sustainable returns and therefore is a fundamental component in the structure for value creation. Our continued focus on good governance has enabled the Bank to create an environment where in the assurance of sustainable returns are balanced on a sound governance structure that evolves with changes in both the internal and external environments.”



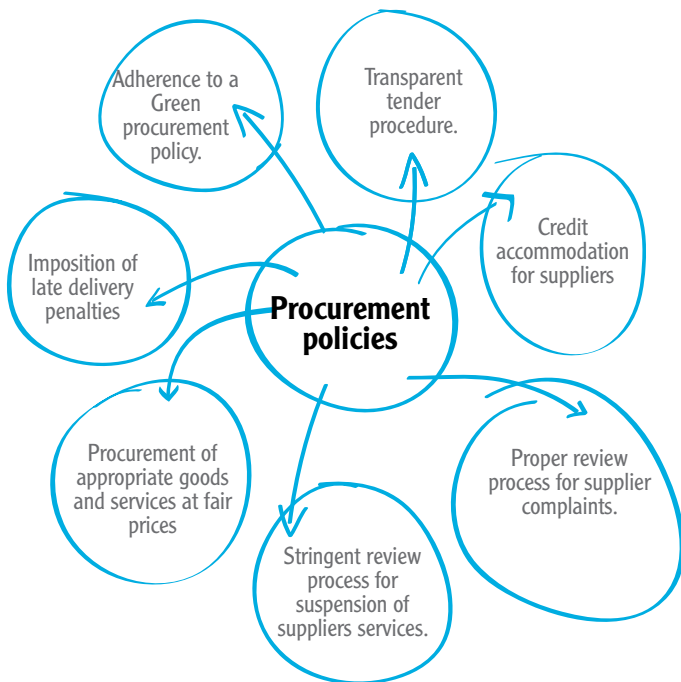
STRATEGY IN ACTION: SUPPORTING ENTERPRISE continued



P D Hennayake
Deputy General Manager
- Services

“Responsible Sourcing is a fundamental base in the Bank’s overall approach to supporting enterprise. Suppliers play a key role in the Banks’ microenvironment. As an essential component of the overall business function, suppliers are regarded as partners. The Bank is conscious of the role of suppliers in the achievement of strategic objectives and therefore views supplier relations as critical to long-term viability. It also recognises that its relationship with suppliers and organisations is built on a solid foundation of value and trust. The Bank adopts a management approach that balances cost considerations with responsible and sustainable procurement practices. The Bank’s strategic sourcing strategy promotes sustainable procurement by taking into consideration environmental, ethical and social factors when making sourcing decisions. As an organisation that is focused on the broader prospect of national development, the Bank views supplier relations as an opportunity to promote and catalyse greater economic activity especially in the area of micro-enterprise”.

Policies & Processes at work:



Objective	Process
Sustainable practice at supplier level	<ul style="list-style-type: none"> • Pre-evaluation of suppliers’ business processes. • Inspection of supplier’s premises and business practices on an ongoing basis. • Procurement of goods and services at fair price.
Selection of suppliers	<ul style="list-style-type: none"> • The selection process goes beyond the financial benefits to take into account other factors such as level of compliance with criteria laid out by the green procurement policy. • Tender process ensures transparency. • Complete and impartial review of supplier complaints with an appeal scheme allowing supplier to directly raise issues or whistle-blow to Deputy General Manager Services and thereafter to Managing Director/Chief Executive Office. • Credit accommodation for suppliers. • Imposition of late delivery penalties and stringent yet fair review prior to suspension of suppliers. • Micro/SME suppliers assisted through accommodative processes such as processing invoices within a week instead of a month, tenders invited for amounts as low as Rs. 25,000 to allow for capability to compete with larger suppliers.
Creating greater awareness of the “green” aspects of business	<ul style="list-style-type: none"> • Engagement with suppliers that have a turnover in excess of Rs. 1 million through a comprehensive engagement process.
Determining one supplier over another	<ul style="list-style-type: none"> • Through a rating process based on criteria laid out in the green procurement policy and through the adoption of a transparent tender procedure.
Policy of non-discrimination	<ul style="list-style-type: none"> • Encourage SME and micro enterprises to enter into partnership with the Bank.
Upholding of Human Rights and containment of social risks	<ul style="list-style-type: none"> • During the pre-evaluation of the supplier’s business process prior to rating the supplier, the Bank investigates practices such as child labour, forced labour, Environment, Health and Safety issues.



The Banks' Microfinance and Development Banking strategy continues to provide access to finance for under-served communities. Hatton National Bank prides itself on being the premier private sector commercial bank in Sri Lanka to have been actively involved in rural development during the last four decades. The Bank commenced its development banking activities almost at inception. By 1972, the Bank recognised the need for focused resource allocation to further develop the services to the rural community and thereafter established the Development Banking Division with a vision to be the foremost development banking unit among commercial banks whilst positively contributing towards the economic development of the nation by providing credit and other social banking services. Since then, the Bank has and continues to make significant inroads in benefiting the rural population of the country.

Engagement in Support of Enterprise:

1 Driving enterprise based education

The Bank conducts specialist programmes for Micro/SME customers who are engaged in sectors such as agriculture, fisheries, dairy, paddy and cash crop cultivation as well as tourism and other income generating micro enterprises. The programmes are held periodically with the intention of enhancing customer know-how and to impart best practices relevant to each of the specific programmes. The Bank understands the critical need for knowledge based capacity building as a means for economic expansion.

2. Dialogue with financial investors

Channels of communication with investors are maintained for honest and open dialogue. The Annual General Meeting is an effective dialogue process on matters that are of concern to the general membership. Institutional / International shareholder engagement is carried out frequently with the Bank's Investor Relations team and the Bank's MD/CEO sharing and discussing the Bank's current performance and future outlook. These meetings serve as a two-way dialogue that is considered a critical source of feedback. The Bank's website also serves as an effective tool for engagement.

The Bank participated in international investor forums organised by Credit Lyonnais Securities Asia in Hong Kong, Credit Suisse in Hong Kong, IIFL in India and a the Sri Lanka Day Investor Forum organised by the Colombo Stock Exchange held in Singapore and Malaysia, during the year with a view to attract foreign investment into Sri Lanka's capital market as well as to position itself credibly in the international capital market scenario.

3. Establishing linkages

The Bank collaborates with corporate partners through partnering agreements to assist customers to form market linkages and also to create more opportunities to enhance their businesses in a more commercially viable manner. By conducting trade fairs to actively promote products and enhancing the quality focus through technical expertise from the corporate partners and specified quality standards, the Bank serves as the livewire in strengthening the entrepreneurs' finances.

4. Building strong relationships

The Bank engages with its micro and development banking customers by successfully establishing closer linkages with the rural community to whom financial services had hitherto been inaccessible. To achieve this strong bond between the rural micro customer and the Bank, it deploys in excess of 140 field officers including microfinance /agricultural experts to assist the rural sector banking operations. These field officers have knowledge in financial services as well as the specific economic sector they serve. For example, agri-based customers have the privilege of receiving support from a field officer who has expertise in the area of agriculture.

5. Setting standards

In accordance with the Banks' Sustainability Strategy and Corporate Procurement Strategy it strives to incorporate environmental and social considerations into the procurement process, thus ensuring that suppliers meet the guidelines of the Bank's Sustainable Procurement Policy. The Bank recognises its responsibility to encourage suppliers to minimise negative environmental and social effects associated with the products and services they provide and engages regularly to impart the basics of the Bank's Green Policy.

The Bank's Sustainable Procurement Policy serves as the foundation for interaction with suppliers and business partners in engaging for change. With a robust system in place to educate and create awareness about the requirements of the Sustainable Procurement Policy, the Bank regularly engages with suppliers to promote the principles of sustainable business including the environmental impact of business partner operations and social risks and opportunities. To this end, the Bank encourages the adoption of its Green Policy by business partners wherever feasible.

6. Financial management education

In addition to its Financial Literacy programme, the Bank conducts a dedicated programme aimed at enhancing the understanding of financial management principles and targets Micro/SMEs. The Bank also engages with corporate customers through financial management seminars conducted by global and local financial service experts.

Supporting Enterprise Initiatives and Indicators:

1. Financial management education

Following the success of the seminar on financial management for SMI/SME in the Southern region held in collaboration with International Finance Corporation (IFC), during 2010, the Bank continued to focus on developing the lower to middle tier entrepreneurs. The Bank also established linkages with the Chamber of Commerce of Sri Lanka to conduct a series of programmes for its membership in the year 2012. It is intended to commence the financial management education programmes for 2012 from Uva, Sabragamuwa, Northern and Eastern provinces.



STRATEGY IN ACTION: SUPPORTING ENTERPRISE continued

2. Corporate seminars

The Bank held 3 seminars for corporate customers during the year. The seminars focused on specialist areas of Banking and Financial Management. The programmes also served as platforms for corporate customers to interact with financial services experts.

3. Developing industry specific know-how

27 programmes were held in 2011 dedicated to sharing know-how with customers engaging in farming, fisheries and related areas. The programmes facilitated knowledge sharing and served to enhance the customers' capabilities in terms of best practices, technological advancements, quality improvement, marketing and packaging techniques, and market development. In the pursuit of making smallholder farmers commercially viable, Hatton National Bank also organised two farmer forums for Nilaveli and Thampalagama farmer communities in the Eastern province during that year.

4. Collaborative programme to build market linkages for customers

In 2011, the tripartite partnerships between the Bank and corporate partners sought to identifying prospective farmers and entrepreneurs who are eligible to be linked with each of the participating company's out grower networks in sectors such as paddy, livestock, fisheries, fruit and vegetables supply. Customers chosen for the programme benefit through agri input and advisory services, assistance in agro technologies and the implementation of buy back agreements to purchase their produce. Meanwhile, the Bank continued to drive the approach of building financial literacy, technical know-how among the rural farmer community through its customer centre managers, agricultural officers and micro finance officers serving in the rural areas whilst also providing financial assistance through credit based products. In 2011, the Bank assisted over 20,700 customers through this programme.

5. Enhancing stakeholder wealth creation

The Bank has been strategically focused on creating and enhancing shareholder value through robust long term financial performance. This is evident by the continuous growth in Earnings Per Share (EPS) over the last five years. The growth in earnings has increased by as much as 84% from 2007 to 2011. The strong financial performance has in turn positively contributed towards the Bank's share price movement, as it has outperformed the movement of the All Share Price Index (ASPI) over the last five years.

A subdivision of shares took place on 5th April 2011, on the basis of one ordinary voting share for every existing two ordinary voting shares and one ordinary non-voting share for every existing two ordinary non-voting shares. The Bank also offered rights on the basis of 1 ordinary share for every existing 10 ordinary shares (for both voting and non-voting) at Rs. 219.50 and Rs. 119.50 respectively in June 2011. The Bank proposes to declare a total dividend of Rs 7.50 per share for 2011 including the interim dividend of Rs 1.50 per share paid in December 2011. The final dividend would consist of a cash dividend of Rs 3.00 per share and a scrip dividend of Rs 3.00 per share.

6. Sustainable procurement

Suppliers with an annual turnover in excess of Rs. 1 million have been requested to comply with the Bank's Green policy in as many areas as possible. Over 55% are partially compliant.

Of the Bank's supplier portfolio 97.5% is classified as SME/Micro suppliers where the classification is defined as vendors with an annual turnover less than Rs. 600 million. The value of procurement from SME/Micro suppliers is estimated at 23% of total procurements.

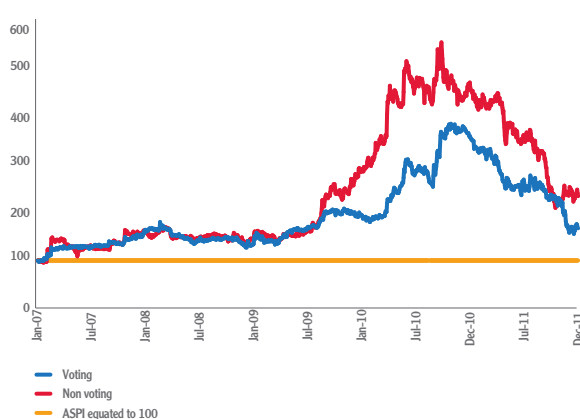
160 meetings were held with representatives of major suppliers to address issues pertaining to responsible business practice.

All suppliers including micro-suppliers are granted supplier credit, depending on their financial and credit records.

	2007	2008	2009	2010	2011
Earnings Per Share (Adjusted) (Rs)*	8.18	8.71	11.78	12.08	15.08
Dividend Yield (%) - Voting	2.86	5.73	3.82	1.75	4.96
Dividend Yield (%) - Non Voting	6.57	12.50	6.21	3.26	9.01
Assets Growth (YOY) (%)	18.79	10.22	9.18	12.03	20.43
Holding Period Return - Voting (%)	61.80	(39.80)	153.41	139.00	(60.29)
Holding Period Return - Non Voting (%)	62.14	(32.39)	247.66	111.55	(57.74)
Operating Cost - Efficiency Ratio (%)	54.65	52.61	52.66	54.91	57.73
Share Price - Voting (Rs)	122.50	69.75	170.25	399.90	151.30
Share Price - Non Voting (Rs)	53.25	32.00	104.75	214.60	83.20
Gross Dividends (Rs Mn)	824.35	942.12	1,533.22	1,649.55	2,914.48

* Earnings per share has been adjusted for weighted Average number of shares during the current year.

HNB share price performance against ASPI



7. Conveying best practices to business partners

The Bank ensures that sustainability criteria are included in specifications to suppliers and that sustainability criteria are met in the award of contracts by ensuring that suppliers’ environmental credentials are considered in the supplier appraisal process. Towards this end the Bank continued to communicate and educated suppliers on the Bank’s Green policy and the need for the implementation of ethical manufacturing processes for the long-term sustainability of their own businesses. Under the Green Policy, the Bank, in the long term intends to work proactively with existing and potential suppliers to investigate and introduce environmentally friendly processes and products.

8. Host Bank to Asian Bankers Association General Meeting & Conference

Some 200 of the leading bankers and bank regulators from around the Asia-Pacific region gathered in Colombo, Sri Lanka on October 3-4, 2011 for the 28th General Meeting and Conference of the Asian Bankers Association (ABA). The Bank acted as the host bank for the event and took a lead role in promoting Sri Lanka’s Banking and Financial Services industry to the region. The theme for the year’s Conference was “ASIATAKING THE LEAD IN THE GLOBAL ECONOMY: A Bankers’ Perspective.” The key objectives of the Conference were to:

- a. Explore and understand what the responsibilities of Asia are in the global economy and how Asia will have to play a leading role in the future;
- b. Exchange ideas covering the challenges and opportunities facing Asian banks in their emergence as global market players;
- c. Provide a forum for Asian banks to discuss international regulatory standards and the way forward.

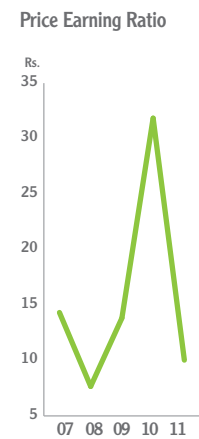
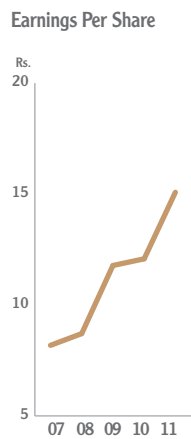
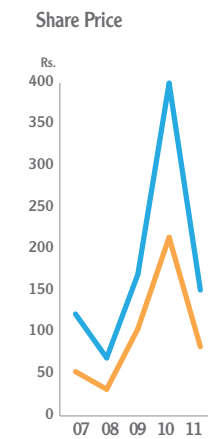
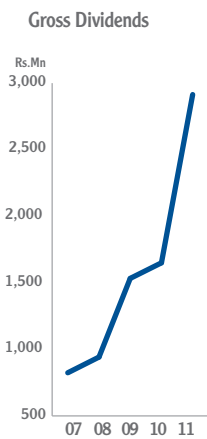
Experts from the banking sector, the academe and government were invited to talk on three timely and relevant topics, namely:

- (a) Fundamentals of Asian Banking;
- (b) The China-India Equation; and
- (c) Asia’s Contribution to Sustainable Banking.

In addition, a CEO Forum was also held as part of the Conference at which a panel of CEOs, both from the banking and non-banking sectors, elaborated on their perspectives on issues of current interest to the banking and finance sector and the business community as a whole.

9. “Ran Govi Saviya” empowering the farming communities

As a part of the Bank’s innovative initiatives to develop the farming community in Sri Lanka, the Bank in 2011 launched a new loan scheme “Ran Govi Saviya” targeting the agricultural sector of the nation. The primary objective of “Ran Govi Saviya” is to help today’s insecure farmer get a firm footing with a sense of security and ease the financial burden of high finance cost. Under this scheme, finance is provided to farmers by way of a loan at a low interest in exchange of gold. This product has a great potential to contribute towards developing Sri Lanka’s rural agricultural economy.



STRATEGY IN ACTION TRANSFORMING COMMUNITIES

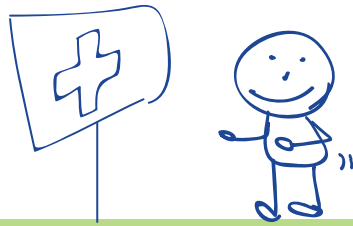


We recognise the need to play a positive role in the communities in which we operate. With a legacy that originated deep in the hill town of Hatton, the Bank has been consciously and concertedlly creating a change momentum for communities across Sri Lanka. The Bank's Community Responsibility Strategy focuses on three pillars:

- Healthcare
- Education
- Entrepreneurship

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking. To be a responsible lender by judging whether a customer's aspiration to borrow is affordable and meets the Bank's assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.





Strategic Priorities in Transforming Communities

- To provide opportunities for less privileged children to better meet their educational needs
- To make an appreciable impact on healthcare, water and sanitation which could improve the lives of communities across Sri Lanka
- To empower communities through entrepreneur development

2011 Highlights

- Established 17 school libraries and 4 computer labs in 2011
- Invested Rs. 3.9 Mn into Counseling and providing financial assistance, to needy Cancer patients and supporting renovations to the Male Surgical Ward at Maharagama Cancer Hospital
- Conducted 27 programmes on entrepreneur development and capacity building

Going Forward

To continue interacting and engaging with the communities at large in a planned manner to achieve key objectives over the medium term

many patients and their families continued to be psychologically scarred by the effects of the disease on their lives and relationships. On the Banks’ part, we feel that the most telling of our focus on community relations, however, has been the voluntary involvement of our staff members in the cancer counseling process. The Bank has invested towards training volunteers and supported them to invest time into counseling at the Cancer Counseling Centre.

Our safe drinking water and sanitation project is also a critical contributor to community development. We have grown this project over the last few years to touch the lives of over 1000 families and 50,000 pilgrims and have assisted towards reducing the high incidence of bowel disease that was otherwise prevalent across rural Sri Lanka. Dengue prevention, flood relief and HIV awareness remain high on our agenda for proactive change.

Education remains an area of immense interest for the Bank and we view the development of the quality of education as critical to the future development of the nation and national progress. The Bank considers education as the most potent change agent, one that is fundamental in the creation of a younger generation that is more empathic to not only future economic progress but is also towards the conservation of national culture and heritage. Through a number of flagship projects such as “Nana Pubuduwa” we have been catalysing change, assisting rural students to have access to the most modern in technology and knowledge.

Our efforts to foster entrepreneurship are interwoven into every aspect of our corporate being. We have promoted entrepreneurship from the day our Bank started operations over 120 years ago, and continue to foster and stimulate local communities to make paradigm shifts in their livelihoods through entrepreneur development. We have changed attitudes and perceptions by taking families from below the poverty lines to gradual wealth creation, stimulating and nourishing the idea that positive change through conviction and hard work is a possibility.”

Defining the management approach to Community Development:



J R P M Paiva
Deputy General Manager
– Human Resources & Administration

“Over many decades, Hatton National Bank has been in the forefront of creating opportunities. Catalysing change in many ways, the Bank has been the epitome of responsible stewardship, and has been the means of social inclusiveness for many thousands of rural communities.

As an organisation whose beginnings stem from an intuitive understanding of the people and their aspirations, the Bank has worked strategically to enhance the lives of communities across Sri Lanka.

Our focus on healthcare has seen the Bank invest into Cancer counseling and care of both patients and their families, through financial assistance and simply being there for people at times of financial and emotional need. Sri Lanka as a nation grapples with an affliction rate of approximately 10,000 per annum and has commendable infrastructure in place for preventive screening, radiotherapy and treatment through the National Cancer Control Programme, the National Cancer Institute and the National Cancer Hospital. However, despite the availability of medical infrastructure,

Aligning to wider global and national goals:

Healthcare

United Nations Millennium Development Goal Target 7 “ Providing safe drinking water and sanitation facilities”

Education

United Nations Millennium Development Goal Target 2 “Achieve universal primary education”

Entrepreneurship

National Vision for an empowered rural community



STRATEGY IN ACTION: TRANSFORMING COMMUNITIES

continued

Engagement for Community Responsibility:

From a national business perspective, the Bank has been championing behavioural change to create a more conducive social and economic focus in view of the future national objectives and the need for greater productivity of Sri Lanka's human resources. Community development through engagement of the corporate sector therefore remains critical to the end objective, and this has been one of the key drivers for greater engagement between the Bank and the community at large.

Over the past five years, the Bank has cascaded its flagship projects under the pillars of healthcare, education and entrepreneurship – cancer counseling centre, safe drinking water and sanitation projects, Nena Pubuduwa school libraries and computer centres and entrepreneurship development through Gami Pubuduwa – in a number of ways effectively engaged rural communities to embrace new ideas and given them the tools to empower themselves. In addition, the Bank also supports short-term projects that fall within its strategic focus areas through one-off contributions.

Community Responsibility Initiatives and Indicators:

1. Cancer Counseling Centres – Maharagama & Jaffna

Investment allocated during the year – Rs 2 Mn
Investment to date – Rs 10 Mn

Inaugurated in 2007, the Cancer Counselling Centre was the first and only facility of its nature in Sri Lanka. Established in association with Maharagama National Cancer Hospital with support from Arbeiter Samariter Bund (ASB) Germany, the counselling centre caters to both the patients as well as their families in overcoming the psychological trauma associated with the diagnosis of cancer.

The availability of a professional Counselling Centre dedicated to those afflicted by the disease has enhanced the mental wellbeing of those concerned through the cumulative effects of guidance, support and reassurance.

In 2011 too, four of the Bank's employees volunteered at the cancer-counseling centre dividing their time between their professional duties and their sustainability leadership efforts based on a roster system. Having undergone a professional counseling programme the volunteers have now been involved in the counseling process for the past three years.

During the financial year, the Bank further invested into this area by establishing a counselling centre in Jaffna where the prevalence of cancer is very high as an outcome of high agri-chemical usage coupled with the habit of chewing betel. The Bank perceives its role in the area of cancer prevention based primarily on education and awareness on the causes of cancer. The Cancer Counselling Centre therefore will play a dual role in not only counselling those families that are afflicted by the disease but also those who face high risk of affliction in the future.

2. Financial assistance to cancer patients

Investment to date – from the proceeds of Rs 15 Mn Investment Fund

The Bank assists patients and their families to overcome the financial burden of daily expenses especially in cases where the earning capacity of

the breadwinner is afflicted. The Bank's cancer benefit upto 2011 has sustained 50 families for a period of six months in the most trying of circumstances. Upon the completion of the initial six-month period, the benefit was extended to those that were perceived to be worthy of an extension based on an evaluation process. In the year ahead, the Bank will be looking to expand the project to enlarge the scale, with a view to benefiting a larger number of families.

3. Renovations to the National Cancer Institute, Maharagama

Investment allocated during the year – Rs 1 Mn
Investment to date – Rs 3 Mn

The Bank continued to undertake renovations of the Male Surgical Ward at the National Cancer Institute, Maharagama in 2011 and completed the renovation of Ward 12 and continued to assist towards the maintenance of the ward.

4. HIV/AIDS Awareness

Investment allocated during the year – Rs 0.3 Mn
Investment to date – Rs 0.5 Mn

The Hatton National Bank continues to be a member of the Lanka Business Coalition on HIV/AIDS and actively raises awareness on HIV and AIDS in the workplace. The Lanka Business Community on HIV and AIDS (LBCH) was established after the 8th International Congress on AIDS in Asia and the Pacific (ICCAP) was held in Sri Lanka in August 2007. LBCH is modelled on the Global Business Coalition on HIV and AIDS and is a member of the Asia Pacific Business Coalition on AIDS.

5. Flood Relief - Rs 1.0 Mn

In 2011, the Bank's employees collectively acted to assist communities affected by floods across the nation. Flood relief efforts included the provision of fresh drinking water, clothes, medicines and food.

6. Water and Sanitation Projects

Investment allocated during the year – Rs 1.75 Mn
Investment to date – Rs 13.75 Mn

Providing communities with safe drinking water and sanitation has been a priority for the Bank over the last five years. A United Nations Millennium Development Goal, access to safe drinking water and sanitation, though a bare necessity, is one that is lacking in many rural communities in Sri Lanka.

In 2011, the Bank completed its 8th safe drinking water and sanitation project at the Ragama Basilica, a place of fervent worship, where several thousands visit annually.

7. Nena Pubuduwa - School libraries and computer centres

Investment allocated during the year – Rs 8.7 Mn
Investment to date – Rs 60 Mn

The Bank's Nena Pubuduwa project was an ambitious project aimed at enhancing the educational resources of students in rural communities specifically those whose resources are low due to lack of infrastructure at school-level. In inception the project aimed to provide a hundred libraries to schools lacking in facilities and financial resources. The project has progressively enhanced the literacy skills of over 45,000 children across Sri Lanka. However, by 2011 the project had a total of 185 libraries in place. The investment towards books during the financial year alone stands at Rs 4 Mn with 17 new libraries set up in the year under review.



The project has given the opportunity for children to be stimulated and to derive the simple pleasure of exploring the world through books, enhancing not only their knowledge but also their psychological skills, enabling little minds to empathise as well as to be empirically astute.

Coinciding and working in tandem with this project, the Bank has been setting up computer centres in schools already supported by the Bank in a bid to enlarge the scope of the project to include computer literacy. In 2011, the Bank set up 4 computer centres in schools. Overall the number of computer centres stands at 15.

The Bank has also assisted schools by way of renovation to buildings and the provision of furniture and fittings.

8. Skills Development for youth

8.1 Certificate Course in Elementary Banking and Finance

Investment during the year – Rs 0.25 Mn
Investment to date – Rs 1.5 Mn

Introduced as a post conflict livelihood rehabilitation project, the Bank initiated a “Certificate Course in Elementary Banking and Finance” to develop the skills of the youth in the Jaffna Peninsula. A notable feature in delivering course content was the availability of on site technical resources ably supported by distance learning tools using webinars. The project has been of great success and has benefited over 160 youth from the provinces that hereto had lacked the specific skills for employability despite the growing demand for financial services skills as a consequence to the entry of an array of financial service providers to the area. The programme has been instrumental in not only benefiting the community but also the financial service industry in the area. In 2011, the fourth batch of participants graduated from the programme and the total number of trainees stands at 162 several of whom are now employed at this Bank as well as competitor banks.

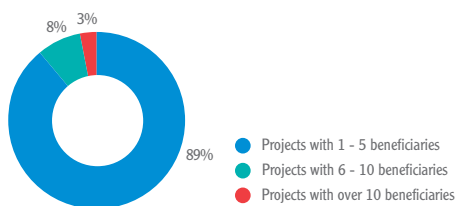
8.2 Yauwanabhimana - Empowering the youth of Sri Lanka

Investment during the year – Rs 14.5 Mn

The Bank also set the wheels in motion to offer young people throughout the island the opportunity to improve both themselves and their skills through its unique programme “Yauwanabhimana”. Focused on empowering youth between the ages of 18 to 30 years, Yauwanabhimana aims to provide young people with the resources, skills and tools they need to become more ‘employable’ individuals – i.e – individuals with the ability to obtain employment in the corporate sector or successfully manage self-employment endeavours of their own.

The project scope also includes island-wide youth development programmes organised by a range of “Yauwanabhimana” corporate partners, with exposure to the fields of corporate business, construction, telecommunication, motor mechanical engineering, agriculture and vocational studies. In 2011,

Reach of Gami Pubuduwa



the first batch of youth comprising of 140 individuals participated in the programme.

9. National Trust of Sri Lanka

Investment allocated during the year – Rs 1.5 Mn
Investment to date – Rs 3 Mn

The National Trust for Cultural and Natural Heritage was founded in May 2005 to operate as a national body for protecting and safe guarding the tangible and intangible heritage of Sri Lanka. The services rendered by the organisation are focused towards protecting and preserving the cultural heritage of the country. The Bank partners with the National Trust of Sri Lanka and sponsors the monthly lectures focussing on important heritage landmarks in Sri Lanka with a view to partner a programme worthy of national importance.

10. Gami Pubuduwa

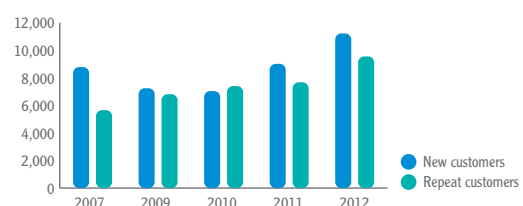
For over two decades, Hatton National Bank’s world-renowned Microfinance programme, “Gami Pubuduwa” created greater access to financial services to people at the bottom of the socio-economic scale and classified as “less-bankable”. In the year 1989, “Gami Pubuduwa” was conceived and implemented with a Microfinance field officer placed in the hamlet of Pubbowa, Kurunegala to identify and support the micro entrepreneurs and the farming community and also to create greater access to financial services. This initiative focused primarily on capacity building programmes, Micro Entrepreneur skills development, and financial education and providing the technical knowledge and best practices of agriculture to the farming communities in rural Sri Lanka. During the past twenty two years the Bank has carried out diverse initiatives to support Micro Entrepreneur creation and to take the small holders beyond farming to become small scale Entrepreneurs.

In 2011, the Bank furthered the concept of “Gami Pubuduwa” placing additional Barefoot Bankers across the country. As a sustainability tool that precipitates financial awareness and inclusion, the programme has been a global case study in sustainable business.

11. Financial Literacy to Indigenous communities

The Bank has promoted financial literacy and the savings habit amongst the indigenous “aadiwasii” Veddah community for many years in an initiative to assisting this community to integrate with society in a more sustainable manner.

Gami Pubuduwa Banking Relationships



STRATEGY IN ACTION: TRANSFORMING COMMUNITIES continued

“Aside from the strategic sustainability initiatives, our staff at every customer centre across the nation catalyses and leads a multitude of CSR projects that touch many people in many ways”.



At the cancer hospital where the HNB team initiated a bakthi Gee programme to mark Posen



HNB sets up Information Technology Centre and Savings Unit at Visakha Nursery School



Ice cream dhansala organised by the HNB Mathugama team - one of many such events throughout the country to mark Vesak

“Our employees go beyond their call of duty to touch lives and do good”.



HNB's Launches Ran Govi Saviya loan scheme to Benefit the Farming Communities





The management and staff of Hatton National Bank contributed generously to provide relief items to those affected by floods. 2 lorry load worth of dry rations, milk food, mineral water, mats, mosquito coils etc were donated amongst the affected families in the Eastern Province



Donation of books to the HNB school Libraries



Mr RTheagarajah, Managing Director/CEO participating at the Tree Planting Programme Held At The HNB Towers Premises To Commemorate The World Environment Day.



Judges at the staff green poster competition



HNB and LFSUS partner with Kahawatte Plantations (PLC) to Construct 25 Houses for Estate Sector Employees in Nawalapitiya



Aiding the community at every opportunity



STRATEGY IN ACTION
ENVIRONMENTAL CITIZENSHIP



Environmental sustainability is a key responsibility agenda at Hatton National Bank. We are one of the few financial services companies in Sri Lanka to take significant steps towards reducing the impact of our operations on planet earth. Focus areas include:

- **Financing green investments**
- **Reducing our operational footprint**
- **Changing behaviours**
- **Investing in conservation**

Stakeholder Group	Sustainability Vision & Sustainable Business Objectives
Investors	To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings. To maintain internal processes and policies as tools to combat financial crime and poor quality lending.
Customers	To safeguard the interests of depositors through responsible banking. To be a responsible lender by judging whether a customer's aspiration to borrow is affordable and meets the Bank's assessment of risk and pricing. To always serve customers with passion and dedication. To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations. To promote financial literacy proactively for capacity development.
Employees	To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Suppliers	To balance cost considerations with sustainable procurement practices.
Community	To engage with the community at every level. To act as a catalyst for positive change through action in healthcare, education and entrepreneurship.
Environment	To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending.





Strategic Priorities for Environmental Citizenship

- Place emphasis on the propagation of environmentally friendly commerce
- Calculate our carbon footprint and work towards diminishing it over time
- Inspire employees, customers, suppliers and the public at large to be environmentally conscious
- Place emphasis on the preservation of cultural and natural assets

2011 Highlights

- Financing of renewable energy projects comprise 12% of the loan (project) book
- 6% reduction in energy consumption for the entire Bank; 50% reduction in water consumption in 5 customer centre
- 18,300 trees planted as part of the Green Pledge
- Re-invested into the National Trust and the Bundala National Park conservation project – total of Rs. 4.75 million

Going Forward

Lead from the front in cascading the cause for environmental citizenship across Sri Lanka

Defining the management approach to Environmental Responsibility:

On the commercial side, the Bank has been actively supportive of sustainable energy finance and has continued to increase its visibility and exposure to the sector. Prospects for business from alternative and sustainable energy sector remain positive, especially given the strong growth expectations for Sri Lanka. In line with these expectations the Bank has actively sought to enlarge its portfolio of green investments. The Bank's Corporate Banking Unit together with its Venture Capital arm actively seeks and support projects that require green financing. The Bank also participates in financing projects that focus on hazardous waste reduction and pollution control under the Bank's E-Friends Loan scheme.

During the process of credit evaluation of all potential projects, the Bank engages in a systematic assessment of environmental risk to determine the project's environmental, social and ethical risks. The Bank adopts processes to assess the environmental and social risks and opportunities arising from its client's business activities and manages the Bank's exposure to them. The sustainability system ensures that sustainability considerations play a core role in the Bank's decision-making process for credit assessment and portfolio analysis. This system enables the Bank to consider environmental and socio-economic issues comprehensively and move beyond merely conforming to regulation, thereby taking advantage of sustainability opportunities. The Bank uses scorecards and rating systems to assess credit risks. Covenants placed in offer letters and agreements are followed by regular monitoring and inspections.

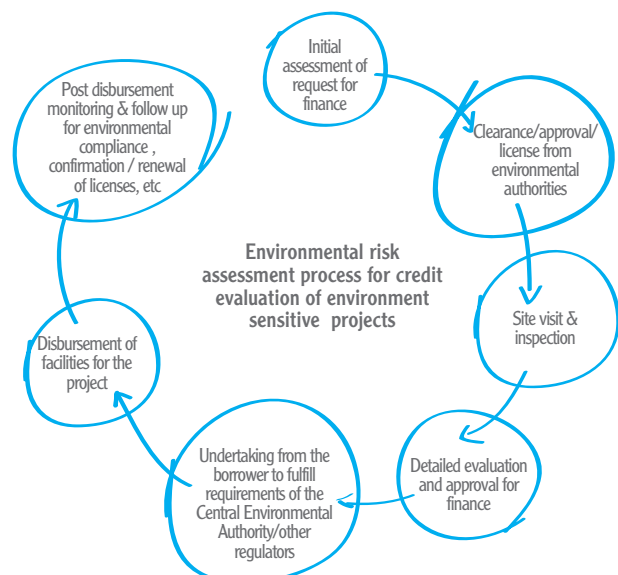
From an operational perspective, Hatton National Bank is driven by the desire to reduce its own impact on the environment and has laid

considerable emphasis on not only achievement but also on the measurement of this impact. Performance evaluation and measurement of sustainability criteria within the function of the Bank are carried out through a range of energy efficiency, waste improvement and environmental performance criteria. The Bank meets benchmarks against Key Performance Indicators and undertakes initiatives to enhance the environmental credibility of the organisation whilst minimising its carbon footprint.

The Bank's Green Pledge serves as the fundamental base for impact reduction and is the catalysis for behavioural change both within and outside of the organisation. The basic principles of the Green Pledge have been communicated to each employee, as well as customers, suppliers and the wider social circles within which the Bank operates. With the tone set from the top, the Bank has integrated every facet of the Green Pledge to strategic and operational targets. As an extension of this strategy of minimal environmental impact, the Bank has invested into numerous green technologies that have been employed in specific Green Buildings, especially at its customer centre in Nittambuwa, which qualifies as a green building under the LEEDS criteria for environmentally friendly buildings. The Bank considers the green building concept as a strategic differentiator and competence for the future success of the business.

Over the years, the Bank has identified and selected a number of focal environmental preservation initiatives that have far reaching sustainability consequences. Whilst third party institutions that have the expertise and linkages on ecological, conservation and environmental sustainability direct most, the Bank serves the role of primary investor in making these projects a reality. The Bank deems these investments as critical to the future preservation of Sri Lanka's natural assets and actively seeks to support projects that will support biodiversity enrichment.

Policies & Processes at work:



STRATEGY IN ACTION: ENVIRONMENTAL CITIZENSHIP

continued

Engagement for Environmental Responsibility:

1. Green Pledge

In the belief that cohesion and consistency are the pillars of a successful strategic approach to environmental responsibility, the Bank steers a two-pronged environmental responsibility ethics programme termed the Green Pledge. The programme is designed to educate the employees of the Bank as well as to garner commitment towards the cause.

Commitment to environmental sustainability is demonstrated by each employee who undertakes to adopt 12 actions that will facilitate the Bank's objective for a greener workplace. The tenets of the pledge are further cascaded to families of the employees, customers and suppliers through a range of awareness creating initiatives that bind these external audiences and engage them to make a change.

2. Eco-conscious purchase

The Bank aims to adopt a green procurement policy in a bid to inculcate green business practices amongst the supplier base. The procurement policy allows for preference to suppliers who manufacture or follow principles that minimise their impact on Mother Earth.

3. Optimising efficiencies

Resource efficiency optimisation has been high on the Bank's environmental sustainability agenda over the past three years. The Bank has effectively deployed resource efficiency policies across the organisation cascading from the head office to customer centre offices. This implementation has included the effective implementation of a range of energy efficiency and water efficiency measures. The Bank's employees are fully aware of the measures to be undertaken, and are kept abreast of efficiency targets and monthly efficiency achievements. This ongoing and robust internal dialogue assists towards optimisation of resources utilised by the Bank as all employees remain committed towards the cause. The Bank also invests and engages in a combined effort towards instilling the 5S practice organisationwide. The Bank has implemented 5S across its entire Customer centre Network and attributes the adoption of the housekeeping system to its high levels of efficiency.

4. Green banking

Hatton National Bank pioneered the construction of green buildings in the financial services sector. The HNB Tower sets the precedent as an energy efficient high-rise building and is one of the few buildings in Sri Lanka that utilises revolutionary green technology. The Bank also invested into and completed its first green customer centre in 2011 in Nittambuwa and has plans to open a series of new green customer centre in the medium term. These green buildings serve as engagement tools for employees, customers, suppliers, the community and all other stakeholders including the financial service industry, as they inspire the public to look beyond the conventional in banking operations.

5. 3R concept

The Bank adopts a 3R policy – Recycle, Reuse, Reduce – towards all tangible resources including furniture, paper, printer cartridges and paint, amongst others. The 3R policy has been embraced by the Bank's employees and their families and has had considerable impact on behaviour towards resource utilisation.

6. Preservation of natural assets

The Bank engages with like-minded conservationists and experts in the areas of bio-diversity conservation. Investments towards externally driven large scale projects have been made based on a thorough examination of the projects, their impact on reversing negative environmental impacts and the benefit in communicating and engaging the public. As such, the Bank, over the years has invested in a few critical projects on a long-term basis. Additionally, the Bank engages the community, employees and customers in projects that will have a long-term impact on the environment whilst also creating greater awareness on the need for preservation and conservation of the earth's natural habitat.

Environmental Responsibility Initiatives and Indicators:

1. Energy efficiency

In 2011, Hatton National Bank continued to further improve on its commitment to energy efficiency. The measures adopted in previous years were supplemented with new initiatives to further reduce its impact on the national power grid. In 2011, energy consumption for airconditioning was significantly reduced through the conversion or replacement of airconditioners to inverter technology. Inverter airconditioners are capable of continuously regulating their thermal transfer flow by altering the speed of the compressor in response to cooling demand. Retrofitting of airconditioners to be 100% CFC-Free continued to be on target, with expected completion in 2017. Previous efficiency measures such as the introduction of energy efficient lighting, the introduction of electronic ballasts to corporate signage and the use of biogas for customer centre usage continued to yield positive efficiency improvements.

As a cumulative outcome of these efficiency measures and the further improvement in implementation of measures yielded an annual savings of 853,356 kWh. As a direct result, the Bank's emission of Green House Gases reduced by 426,795 Kg for the financial year.



Measures taken to reduce resource usage presently and in the future:

- Introducing energy efficient lights
- Introducing energy efficient corporate signages
- Introducing energy efficient inverter type air conditioners
- Introducing 30 kVA generators instead of 45 kVA by reducing energy requirement of customer centres
- Introducing natural lighting systems into the buildings

Measures that have reduced environmental damage during the year

- Introduction of energy efficient lights for 43 nos. of customer centres: savings = 326,000 kWh – Rs. 6,846,000.00
- Introduction of energy efficient corporate signages: Savings = 190,350 kWh – Rs. 4,000,000.00
- Introduction of 207 nos. of energy efficient inverter type air conditioners Savings = 318,506 kWh – Rs. 6,688,630.00
- Fuel savings through introduction of 24 nos of 30 kVA generators: Savings = 24,000 Ltr – Rs. 1,680,000.00 (assuming that generators are in operation for minimum of 250 hours per year)
- Energy savings by introduction of natural lights at Nittambuwa Green building: Savings = 18,500 kWh – Rs. 388,000.00

Total direct and indirect greenhouse gas emissions by weight:

- Direct green greenhouse gas emissions from diesel generators and transportation = 2,030 metric tons of Co₂ (Assuming 1 Ltr of Diesel = 2.572 x10⁻³ metric tons of Co₂ ref:www.carbonfootprint.com)
- Indirect green greenhouse gas emissions from Electricity consumption = 8,193 metric tons of Co₂ (Assuming 1 kWh = 4.278 x 10⁻⁴ metric tons of Co₂ ref:www.carbonfootprint.com)
- Annual Fuel savings from 24 customer centres by reducing capacity requirement from 45 kVA to 30 kVA = 61.73 metric tons of Co₂
- Annual Power Savings = 365 metric tons of Co₂

Over the next 3-5 years the Bank will be exploring the possibility of replacing R22 (HCFC) conventional type air conditioners with CFC free R410A (HFC) inverter type air conditioners.

Presently, the Bank's air conditioning system comprises of 1,839 air conditioners with R22 refrigerant and the number of air conditioners replaced with CFC free R 410A refrigerant was 207.

2. Water efficiency

Hatton National Bank's pilot project on water harvesting demonstrated encouraging results in 2011. The project, initiated in the Bank's Buttala customer centre saved approximately 20% of water, avoiding consumption from the national water supply. The Customer centre utilises harvested water for its operations during the rainy seasons and has initiated a model project within its premises to create greater awareness of the concept amongst customers. As the Customer centre is located in an area where people are sensitive to the scarcity of water, and given that over 85% of the population engages in farming activities, the model has become a point of interest. The project has been received by the Bank as successful and is under review for replication in geographic areas where water scarcity is high. During 2011, the first replication project was initiated at the Green Customer centre in Nittambuwa.

Anaerobic wastewater treatment systems installed in five key customer centres in the previous financial year continued to deliver favourable results in terms of wastewater discharge. The five customer centres discharged to the environment an approximate 60,000 litres per month during the year of treated wastewater whilst treated water was also used for gardening purposes.

On the whole, the Bank saved 2,400,000 litres of water in 2011.

3. 3R concept at work

Recycle

- Paper Recycling: 145,758 Kg of paper equivalent to 2,477 trees 4,632,189 liters of water, 583,032 kWh of electricity, 255,805 litres of oil.
- Drop in usage of paper over the last five years – 8%

Re-use

- Reconditioning and re-use of office furniture, prolonging lifetime and thereby reducing the waste generated through routine replacement.
- Reconditioning of printer cartridges – 54% reduction in use of new cartridges.

Reduce

Paper consumption (most relevant material used by the Bank)

	2009	2010	2011
Total weight of office paper purchased (A4, B5, Legal, Computer Paper, Letterheads) tonnes	140	148	142
No. of customer centres	186	205	240
Total office paper purchased per customer centre (kg)	750	720	590

Effective drop in 2011 compared to 2009 can be attributed to;

- Increase in awareness at customer centres in usage of paper
- Use of both sides of paper where possible
- Request for papers from customer centres being subject to careful scrutiny by the Head office centralised stationery stores
- General reduction in the use of paper due to systematic automation of processes



STRATEGY IN ACTION: ENVIRONMENTAL CITIZENSHIP

continued

4. Engagement programmes for efficiency management

Employees were engaged to bring greater awareness of the Bank's efficiency programmes during 2011. Programmes were conducted on:

- Introduction of waste management systems
- Introduction of eco friendly gas generators
- Introduction of solar power air conditioning systems
- Integration of solar power with the national grid to optimise the required demand
- Introduction of natural light systems
- Training in Green Rating Systems of commercial buildings conducted by Green Building Council of Sri Lanka
- Training in environmental friendly material usage for bank interiors conducted by Dura International

5. Green Pledge in practice

During the year, the Bank broadened its scope on the implementation of the Green Pledge to ensure 100% commitment and engagement by its employees as well as other stakeholders. As such in 2011, the Bank invested in a large-scale tree planting activity to mark the World Environment Day. The project was put into action in view of the escalation of deforestation in Sri Lanka. The nation's forest has reportedly decreased from an estimated 84 percent of land area in 1886 to 23% (1.48 Mn ha) in 1992. The United Nations Environment Programme (UNEP) has reported that the earth's net forest loss per day is 20,000 hectares which adds up to 7.3 Mn hectares per year.

In consideration of the fact that in one year, an average tree inhales 12 kilograms of carbon dioxide and exhales enough oxygen for a family of four for a year, Hatton National Bank invested into the planting of approximately 18,300 trees throughout the country during the year.

The programme engaged employees, customers and school children from diverse geographic locations. The Bank donated a sapling to each staff, selected customers and 10 saplings each to 330 schools where the Bank had existing well-established relations.

The benefits of the programme were two-fold. Whilst on the one hand the Bank strived to utilise the programme as a means to diminish its carbon footprint, the programme was intended to create awareness on the overall benefits of home gardening, such as reduced pressure on the natural supply of resources and enhanced food security. Moreover, the programme mechanics ensure that each planted tree has a rightful owner, and therefore will be nourished and protected till the tree reaches maturity.



6. Green champions

The Bank initiated a Bank-wide poster design competition in 2011 to stimulate employees to think outside of the box in relation to sustainability actions. The poster competition served as the first step in an internal communication campaign. The campaign involved the use of winning posters selected from the competition. The initiative was largely to inspire people to think beyond the obvious and to create further awareness on the need for environmental responsibility at the workplace.

7. Green customer centre awards

During the year, the Bank held its very first Green Customer centre Awards in a bid to further stimulate and motivate employees to implement the Bank's Green Pledge concepts into daily practice. Through the competition's set criteria of evaluation, the best customer centre was chosen from each region. The winners in 2011 were Balangoda, Kandy, Mutwal, Batticaloa, Kohuwela, Jaffna, Kurunegala, Ganemulla and Mathugama.

8. Green buildings

In 2011, HNB Towers was nationally recognised as one of the most energy efficient building in Sri Lanka and was awarded the SILVER Award in the large scale Category for Commercial Sector Buildings at the "Sri Lanka National Energy Efficiency Awards - 2011" organised by Sri Lanka Sustainable Energy Authority.

The Sri Lanka National Energy Efficiency Award competition is an annual event conducted by the Sri Lanka Sustainable Energy Authority for public and private sector institutions with the aim of recognising their contribution towards Energy Secure Sri Lanka.

As a result of various energy efficient features incorporated at HNB Towers it has been found to achieve following benchmark values:

- The electrical power consumption for the Air Conditioning system at HNB Towers is less than 50% of the total electrical power consumption of the building. In a conventional building this figure is normally greater than 60%
- The After Diversity Maximum Demand (ADMD) in HNB Towers is in the neighbourhood of 50 VA/m². In a conventional building this figure is in the range of 70~100 VA/m².

The Bank's continuous quest to incorporate energy efficient systems and practices led to the opening of Sri Lanka's first green bank customer centre in Nittambuwa. This building was rated GOLD under Leadership in Energy and Environmental Design (LEED) Certification by the US Green Building Council during the year.

The building has a structure that is environmentally responsible and resource efficient and its sustainability stance is characterised by the fact that :

- 90% of construction waste has been diverted to a land-fill
- 40% of material used for construction is from the location itself
- 70% of water saved from baseline



- Annual energy savings up to 30%
- CO₂ sensor regulates intake of fresh air
- Rainwater harvesting systems provide 34,000 gallons of water
- Special meters monitor energy savings
- Separate, dedicated waste sorting and disposal facility on site
- Solar tubes, glass panels and large windows provide the building with natural light
- Low flush closets and urinals
- Non-toxic materials used for surfaces
- Intelligent lighting systems – motion sensors switch off lights when there is no human presence.

Construction of new Green buildings in Jaffna and Kalmunai are currently under design and construction.

9. Conservation of Bundala National Park

The Bank reinvested into the conservation of the Bundala National Park during the year in review re-affirming its commitment towards the protection of Sri Lanka's natural and biodiversity resources. The Bundala National Park is considered a critical wintering ground for migratory birds and is internationally recognised as a haven for 197 species of birds including the magnificent Greater Flamingo that migrates in flocks to the water bodies of the National Park. Bundala was Sri Lanka's first wetland to be declared as a RAMSAR site under the Convention on Wetlands of International Importance, thus recognising the ecological importance of the Park as a habitat for water birds.

However, over the past 30 years the increasing presence of two invasive plants - Cacti, Andara - have led to the contamination of water bodies, and threaten the existence of wildlife. With Cacti covering the ground and the Andara scrub plant growing above, sunlight is cut off for the undergrowth and mid-height plants. With the density of the Cacti increasing profusely, growth of feeding plants for deer and elephants have been restricted. Hatton National Bank was party to a project aimed at the eradication of these two invasive plant species. Responsible corporate citizens including the Hatton National Bank supported the project, an initiative of renowned nature photographer Sarinda Unamboowe, the Department of Wildlife Conservation and International Conservation Union (IUCN).

Over the past 5 years, the Bank has invested Rs 8.3 Mn into the clearing of approximately 30 hectares of which 5 hectares were cleared in 2011. The Bank is also actively engaged in a re-forestation initiative for the cleared areas working within the strategic intent of the project to re-introduce endemic flora and vegetation to the Bundala National Park. Visible results of the success of the project are evident from the increase in the presence of migrant birds in Bundala National Park during the last two years.

10. Honoured at Taiki Akimoto 5S awards

Hatton National Bank was honoured with several accolades at the Taiki Akimoto 5S Awards 2010. The Bank's Kurunegala customer centre won the Overall Award in the Banking Sector category, a first for the Banking Sector in Sri Lanka. Customer centres in Grandpass and Nawalapitiya received Merit awards whilst customer centres in Mahiyanganaya and Pettah were awarded with Certificates of Commendation.

The Taiki Akimoto 5S awards are conducted annually by the Japan Sri Lanka Technical & Cultural Association and has a 15 year history in Sri Lanka. In this particular year a record number of 95 institutions participated in the competition representing various sectors.

11. Disposal of sanitary waste

Sanitact Bins were used across 230 customer centres to dispose of sanitary waste. This initiative reduces the impact of environmental pollution as the modern hydro-clave technology that is used to dispose of the sanitary waste ensures the conversion of waste to a powder which is then utilised for land-fills. The technology and the initiative is approved by the Central Environmental Authority.

Plans are in place to introduce a comprehensive waste management system across the entirety of the customer centre network in association with the Central Environment Authority. The system is expected to be implemented within the 2nd quarter of the following year.



INDEPENDENT ASSURANCE REPORT



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INDEPENDENT ASSURANCE REPORT TO HATTON NATIONAL BANK PLC

Introduction

We were engaged by the Board of Directors Hatton National Bank PLC ("Bank") to provide assurance on the following elements of the Sustainability Report 2011 ("Report") for the year ended 31 December 2011:

- Reasonable assurance on the data on financial performance, as reported on pages 128 to 129 of the Report 2011;
- Limited assurance on Performance Indicators and other information presented in the Report.

Managements' responsibilities and the criteria applied

Management is responsible for the preparation and presentation of the Report in accordance with the GRI Sustainability Reporting Guidelines as described in pages 96 to 97 of the Report and the information and assertions contained within it: for determining the Bank's objectives in respect of sustainable development performance and reporting, including the identification of stakeholder and material issues, and for establishing and maintaining appropriate performance management and internal control systems from which the reported performance information is derived.

Our responsibilities and compliance with SLSAE 3000

Our responsibility is to carry out a reasonable & limited assurance engagement and to express a conclusion based on the work performed. We conducted our engagement in accordance with the Sri Lanka Standard on Assurance Engagements 3000: Assurance Engagements Other Than Audits or Reviews of Historical Financial Information, issued by the Institute of Chartered Accountants of Sri Lanka.

This Standard requires amongst others that we comply with applicable ethical requirements, including independence requirements, and plan and perform the engagement to obtain reasonable & limited assurance about whether the Report is free of material misstatement.

Summary of work performed

Financial data

A reasonable assurance engagement on financial performance reported on pages 128 to 129 of the Report involves verification that they were properly derived from the audited financial statements of the Bank for the year ended 31 December 2011.

Performance Indicators and the other information

A limited assurance engagement on Performance Indicators and other information in the Report consists of making inquiries, primarily of persons responsible for the preparation of information presented in the

Report, and applying analytical and other evidence gathering procedures, as appropriate. These procedures included:

- Inquiries of management to gain an understanding of the Bank's processes for determining the material issues for the Bank's key stakeholder groups.
- Interviews with senior management and relevant staff at group level and selected business unit level concerning sustainability strategy and policies for material issues, and the implementation of these across the business.
- Interviews with relevant staff at corporate and business unit level responsible for providing the information in the Report.
- Inquiries about the design and implementation of the systems and methods used to collect and process the information reported, including the aggregation of data into information as presented in the Report.
- Comparing the information presented in the Report to corresponding information in the relevant underlying sources to determine whether all the relevant information contained in such underlying sources has been included in the Report.
- Reading the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, the sustainability performance of the Bank
- Visits to selected project sites and branches to review systems and data.

Our conclusion

Based on the procedures performed, as described above, we conclude that

- The data on financial performance, as reported on pages 128 to 129 of the Report 2011 are properly derived from the financial statements of the Bank for the year ended 31 December 2011 for which the independent auditors have issued an unqualified audit opinion dated 21st February, 2012 on page 171 of this Annual Report;
- Nothing has come to our attention that causes us to believe that the Performance Indicators and other information presented in the Report are not fairly presented, in all material respects, in accordance with the GRI Sustainability Reporting Guidelines as described in pages 96 to 97 of the Report.

Ford Rhodes Thornton & Co.

Chartered Accountants

21st February 2012
Colombo, Sri Lanka

KPMG Ford, Rhodes, Thornton & Co., a Sri Lankan Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International cooperative ("KPMG International"), a Swiss entity.

A.N. Fernando FCA
P.Y.S. Perera FCA
W.W.J.C. Perera FCA
W.K.D.C. Abeyrathne ACA

M.R. Mihular FCA
C.P. Jayatilake FCA
Ms. S. Joseph FCA
S.T.D.L. Perera FCA

Ms. M. P. Perera FCA
T.J.S. Rajakarier FCA
Ms. S.M.B. Jayasekara ACA
G.A.U. Karunaratne ACA

Principals - S.R.I. Perera ACMA, LLB, Attorney-at-Law, H.S. Goonewardene ACA

GRI STATEMENT



Statement GRI Application Level Check

GRI hereby states that **Hatton National Bank PLC** has presented its report "Sustainability Report - Many Generations One Future" (2011) to GRI's Report Services which have concluded that the report fulfills the requirement of Application Level A+.

GRI Application Levels communicate the extent to which the content of the G3.1 Guidelines has been used in the submitted sustainability reporting. The Check confirms that the required set and number of disclosures for that Application Level have been addressed in the reporting and that the GRI Content Index demonstrates a valid representation of the required disclosures, as described in the GRI G3.1 Guidelines.

Application Levels do not provide an opinion on the sustainability performance of the reporter nor the quality of the information in the report.

Amsterdam, February 21st 2012

A handwritten signature in blue ink, appearing to read "Nelmara Arbex", is written over a faint background watermark of a globe.

Nelmara Arbex
Deputy Chief Executive
Global Reporting Initiative



The "+" has been added to this Application Level because **Hatton National Bank PLC** has submitted (part of) this report for external assurance. GRI accepts the reporter's own criteria for choosing the relevant assurance provider.

The Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. The GRI Guidelines set out the principles and indicators that organizations can use to measure and report their economic, environmental, and social performance. www.globalreporting.org

Disclaimer: Where the relevant sustainability reporting includes external links, including to audio visual material, this statement only concerns material submitted to GRI at the time of the Check on February 14th 2012. GRI explicitly excludes the statement being applied to any later changes to such material.

GRI INDICATORS

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
1. Strategy and Analysis				
1.1	Statement from the most senior decision- maker of the organisation.	●	94-95	
1.2	Description of key impacts, risks, and opportunities.	●	53-63, 103	
2. Organisational Profile				
2.1	Name of the organisation.	●	Hatton National Bank PLC	
2.2	Primary brands, products, and/or services.	●	27 - 30	
2.3	Operational structure of the organisation, including main divisions, operating companies, subsidiaries, and joint ventures.	●	69, 31 -43,68	
2.4	Location of organisation's headquarters.	●	Colombo, Sri Lanka	
2.5	Number of countries where the organisation operates, and names of countries with either major operations or that are specifically relevant to the sustainability issues covered in the report.	●	The Company primarily operates in Sri Lanka. The operating locations within Sri Lanka are given in 44-45. The business dealings between the Company and its business partners are shown in 31-43	
2.6	Nature of ownership and legal form.	●	Public Limited Company registered under the Companies Act No. 7 of 2007, Sri Lanka (Refer inner back cover)	
2.7	Markets served (including geographic breakdown, sectors served, and types of customers/beneficiaries).	●	25-41, 27-30, 44-45, 54-55	
2.8	Scale of the reporting organisation.	●	Number of employees 4584, (Income statement, 10 year summary, 20 largest shareholders, breakdowns of operating income & expenses	
2.9	Significant changes during the reporting period regarding size, structure, or ownership.	●	No significant changes happened during the year	
2.10	Awards received in the reporting period.	●	23-24	
3. Report Parameters				
3.1	Reporting period (e.g., fiscal/calendar year) for information provided.	●	1 January 2011 to 31 December 2011	
3.2	Date of most recent previous report (if any).	●	31st December 2010	
3.3	Reporting cycle (annual, biennial, etc.)	●	Annual	
3.4	Contact point for questions regarding the report or its contents.	●	Senior DGM (Strategy & Compliance)	
3.5	Process for defining report content.	●	96-97	
3.6	Boundary of the report (e.g., countries, divisions, subsidiaries, leased facilities, joint ventures, suppliers).	●	97	
3.7	State any specific limitations on the scope or boundary of the report	●	97	
3.8	Basis for reporting on joint ventures, subsidiaries, leased facilities, outsourced operations, and other entities that can significantly affect comparability from period to period and/or between organisations.	●	97	
3.9	Data measurement techniques and the bases of calculations, including assumptions and techniques underlying estimations applied to the compilation of the Indicators and other information in the report.	●	96-97	
3.10	Explanation of the effect of any re-statements of information provided in earlier reports, and the reasons for such re-statement (e.g., mergers/acquisitions, change of base years/periods, nature of business, measurement methods).	●	No such requirements arose during the year	
3.11	Significant changes from previous reporting periods in the scope, boundary, or measurement methods applied in the report.	●	No significant changes from the previous reporting year	
3.12	Table identifying the location of the Standard Disclosures in the report.	●	This GRITable	
3.13	Policy and current practice with regard to seeking external assurance for the report.	●	97	

● Fully reported ● Partially reported ○ Not reported

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
4. Governance, Commitments, and Engagement				
4.1	Governance structure of the organisation, including committees under the highest governance body responsible for specific tasks, such as setting strategy or organisational oversight.	●	68	
4.2	Indicate whether the Chair of the highest governance body is also an executive officer.	●	68	
4.3	State the number of members of the highest governance body that are independent and/or non-executive members.	●	68	
4.4	Mechanisms for shareholders and employees to provide recommendations or direction to the highest governance body.	●	97	
4.5	Linkage between compensation for members of the highest governance body, senior managers, and executives (including departure arrangements), and the organisation's performance (including social and environmental performance).	●	76-77, 117	
4.6	Processes in place for the highest governance body to ensure conflicts of interest are avoided.	●	83	
4.7	Process for determining the qualifications and expertise of the members of the highest governance body for guiding the organisation's strategy on economic, environmental, and social topics.	●	70	
4.8	Internally developed statements of mission or values, codes of conduct, and principles relevant to economic, environmental, and social performance and the status of their implementation.	●	Inner front cover	
4.9	Procedures of the highest governance body for overseeing the organisation's identification and management of economic, environmental, and social performance, including relevant risks and opportunities, and adherence or compliance with internationally agreed standards, codes of conduct, and principles.	●	80-87	
4.10	Processes for evaluating the highest governance body's own performance, particularly with respect to economic, environmental, and social performance.	●	75-76	
4.11	Explanation of whether and how the precautionary approach or principle is addressed by the organisation.	●	98-103	
4.12	Externally developed economic, environmental, and social charters, principles, or other initiatives to which the organisation subscribes or endorses.	●	96-97	
4.13	Memberships in associations (such as industry associations) and/or national/international advocacy organisations in which the organisation: * Has positions in governance bodies; * Participates in projects or committees; * Provides substantive funding beyond routine membership dues; or * Views membership as strategic.	●	102	
4.14	List of stakeholder groups engaged by the organisation.	●	97	
4.15	Basis for identification and selection of stakeholders with whom to engage.	●	97	
4.16	Approaches to stakeholder engagement, including frequency of engagement by type and by stakeholder group.	●	97,105,107,111,115,118-119,127,132,138	
4.17	Key topics and concerns that have been raised through stakeholder engagement, and how the organisation has responded to those key topics and concerns, including through its reporting.	●	105,107,111,115,118-119,127,132,138	

● Fully reported ● Partially reported ○ Not reported

GRI INDICATORS

continued

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
Disclosure of Management Approach (DMA) & Performance Indicators				
Economic Performance Indicators				
DMA	Economic performance	●	98-99,105-106	
	Market presence	●	25-30	
	Indirect economic impacts	●	98-99	
EC1	Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.	●	274	
EC2	Financial implications and other risks and opportunities for the organisation's activities due to climate change.	●	103,137141	
EC3	Coverage of the organisation's defined benefit plan obligations.	●	241-242	
EC4	Significant financial assistance received from government.	○	Not applicable. The Bank does not receive significant financial assistance	
EC5	Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation.	●	As defined in the Collective Agreements. Refer 121	
EC6	Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation.	◐	As a policy procurement of imported goods is resorted too only when such goods are not locally manufactured.	Not material
EC7	Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation.	●	All hiring is done locally at significant locations of operation	
EC8	Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement.	●	131-135	
EC9	Understanding and describing significant indirect economic impacts, including the extent of impacts.	●	131-135	
Environmental Performance Indicators				
DMA	Materials	●	Zero impact operations and resource efficiency are inherent objectives of our sustainability strategy.	
	Energy	●	Minimum impact operations and resource efficiency are inherent objectives of our sustainability strategy.	
	Water	●	Minimum impact operations and resource efficiency are inherent objectives of our sustainability strategy.	
	Biodiversity	●	The Bank addresses environmental impacts in its lending policies	
	Emissions, effluents and waste	●	The Bank strives to minimise its carbon footprint and adopts a strategy of resource reduction/optimisation. However, it is presently not material to our type of operations to further breakdown our emissions and waste indicators.	
	Products & Services	●	The Bank's product and service portfolio is continuously screened for environmental impact under the green banking policies.	
	Compliance	●	General stance towards compliance covers this aspect fully and therefore detailed reporting is not considered material.	
	Transport	●	Our objectives towards reducing our carbon footprint includes business related travel and transport.	
	Overall	●	Minimum impact and efficient use of energy and resources are inherent objectives of our sustainability strategy.	
EN1	Total amount of paper consumption (most relevant material used by the Bank) by weight or volume	●	139	
EN2	Percentage of materials used that are recycled input materials.	○		Not material. Our business processes are not material intensive.
EN3	Direct energy consumption by primary energy source.	●	138-140	
EN4	Indirect energy consumption by primary source.	●	138-140	

● Fully reported ◐ Partially reported ○ Not reported

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
EN5	Energy saved due to conservation and efficiency improvements.	●	138-140	
EN6	Initiatives to provide energy-efficient or renewable energy based products and services, and reductions in energy requirements as a result of these initiatives.	●	138-140	
EN7	Initiatives to reduce indirect energy consumption and reductions achieved.	●	138-140	
EN8	Total water withdrawal by source.	○		Not material. Our core business processes do not utilise water.
EN9	Water sources significantly affected by withdrawal of water.	○		Not material. Our core business processes do not utilise water.
EN10	Percentage and total volume of water recycled and reused.	●	139-140	
EN11	Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas.	○		Not applicable. Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.
EN12	Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas.	○		Not applicable. The Bank addresses environmental impacts in its lending policies - Refer CSR page 137-138
EN13	Habitats protected or restored.	●	141	
EN14	Strategies, current actions, and future plans for managing impacts on biodiversity.	○		Not applicable. Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.
EN15	Number of IUCN Red List species and national conservation list species with habitats in areas affected by operations, by level of extinction risk.	○		Not applicable. Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.
EN16	Total direct and indirect greenhouse gas emissions by weight.	○		Not material. Not relevant or applicable to type of operations
EN17	Other relevant indirect greenhouse gas emissions by weight.	○		Not material. Not relevant or applicable to type of operations
EN18	Initiatives to reduce greenhouse gas emissions and reductions achieved.	○		Not material. Not relevant or applicable to type of operations
EN19	Emissions of ozone-depleting substances by weight.	○		Not relevant or applicable to type of operations
EN20	NO _x , SO _x , and other significant air emissions by type and weight.	○		Not relevant or applicable to type of operations
EN21	Total water discharge by quality and destination.	○		Not material to our industry or operations
EN22	Total weight of waste by type and disposal method.	○		Not material. The cost of implementing additional data breakdowns do not outweigh the benefits, since such breakdowns are not deemed material, neither business wise nor volume wise
EN23	Total number and volume of significant spills.	○		Not relevant or applicable to type of operations
EN24	Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the BASEL Convention Annex I, II, III, and VIII, and percentage of transported waste shipped internationally.	○		Not relevant or applicable to type of operations

● Fully reported ○ Partially reported ○ Not reported

GRI INDICATORS

continued

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
EN25	Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organisation's discharges of water and runoff.	○		Not relevant or applicable to type of operations
EN26	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	●	137-140	
EN27	Percentage of products sold and their packaging materials that are reclaimed by category.	○		Not material. Not relevant or applicable to the type of products & services in our industry
EN28	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.	○		Not applicable. None reported during the year under review
EN29	Significant environmental impacts of transporting products and other goods and materials used for the organisation's operations, and transporting members of the workforce.	◐	In 2011, the total mileage relating to official business travel and transport stands at 1,470,223 km. Process in design for wider and more conclusive data coverage in 2012.	
EN30	Total environmental protection expenditures and investments by type.	●	141	
Social performance indicators: Labour practices and decent work				
DMA	Employment	●	117	
	Labour/management relations	●	117	
	Occupational health and safety	●	117	
	Training and education	●	117	
	Diversity and equal opportunity	●	117,119	
LA1	Total workforce by employment type, employment contract, and region.	●	121	
LA2	Total number and rate of employee turnover by age group, gender, and region.	●	122	
LA3	Benefits provided to full-time employees that are not provided to temporary or part-time employees, by major operations.	●	As defined in the Collective Agreements. Permanent employees are eligible to a range of benefits including loans at subsidised rates, medical reimbursements, allowances etc.	
LA4	Percentage of employees covered by collective bargaining agreements.	●	121	
LA5	Minimum notice period(s) regarding significant operational changes, including whether it is specified in collective agreements.	●	The Bank endeavours to give a minimum of 1 month notice regarding significant operational changes. It is not defined in collective agreements except for notice regarding resignations	
LA6	Percentage of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programs.	●	As defined in the Collective Agreements	
LA7	Rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region.	○		Not applicable
LA8	Education, training, counseling, prevention, and risk-control programs in place to assist workforce members, their families, or community members regarding serious diseases.	●	132	
LA9	Health and safety topics covered in formal agreements with trade unions.	●	Medical leave, medical insurance, annual health check up & reimbursement of medical expenses including hospitalisation as benefits while Unions commit to abide by the Bank's Health & Safety Policies at all times.	
LA10	Average hours of training per year per employee by employee category.	●	120	
LA11	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings.	●	120	
LA12	Percentage of employees receiving regular performance and career development reviews.	●	100%	
LA13	Composition of governance bodies and breakdown of employees per category according to gender, age group, minority group membership, and other indicators of diversity.	●	121	

● Fully reported ◐ Partially reported ○ Not reported

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
LA14	Ratio of basic salary of men to women by employee category.	●	The Bank is an equal opportunity employer	
Social Performance Indicators: Human Rights				
DMA	Investment and Procurement Practices	●	125-126	
	Non-discrimination	●	125-126	
	Freedom of association and collective bargaining	●	117,125-126	
	Child labour	●	117,125-126	
	Forced and compulsory labour	●	117,125-126	
	Security practices	●	117,125-126	
	Indigenous rights	●	117,125-126	
HR1	Percentage and total number of significant investment agreements that include human rights clauses or that have undergone human rights screening.	●	133. All credit audits comprise of HR screening as a part of the overall business screening. If brought to the Bank's attention, it influences to change the HR position in creditors' business environment or terminates where change is not foreseeable.	
HR2	Percentage of significant suppliers and contractors that have undergone screening on human rights and actions taken.	●	100%	
HR3	Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained.	●	Policies and procedures concerning aspects of human rights are covered in Induction training. Total number of training hours for 2011 - 832	
HR4	Total number of incidents of discrimination and actions taken.	●	None reported during the year	
HR5	Operations identified in which the right to exercise freedom of association and collective bargaining may be at significant risk, and actions taken to support these rights.	●	Collective Agreements are adhered to	
HR6	Operations identified as having significant risk for incidents of child labor, and measures taken to contribute to the elimination of child labor.	○		Not applicable
HR7	Operations identified as having significant risk for incidents of forced or compulsory labour, and measures to contribute to the elimination of forced or compulsory labour.	○		Not applicable
HR8	Percentage of security personnel trained in the organisation's policies or procedures concerning aspects of human rights that are relevant to operations.	●	Security Coordinators are employed to monitor the security functions which are outsourced.	
HR9	Total number of incidents of violations involving rights of indigenous people and actions taken.	○		Not applicable
Social Performance Indicators: Society				
DMA	Community	●	98-99,131	
	Corruption	●	113-115,119	
	Public policy	●	113-115	
	Anti-competitive behaviour	●	113-115	
	Compliance	●	113-115	
SO1	Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting.	●	98-99,101	
SO2	Percentage and total number of business units analysed for risks related to corruption.	●	100%	
SO3	Percentage of employees trained in organisation's anti-corruption policies and procedures.	●	100%, At induction stage	
SO4	Actions taken in response to incidents of corruption.	●	None reported during the year	
SO5	Public policy positions and participation in public policy development and lobbying.	●	The policy is to not donate to or sponsor political activities	
SO6	Total value of financial and in-kind contributions to political parties, politicians, and related institutions by country.	●	The policy is to not donate to or sponsor political activities	

● Fully reported ○ Partially reported ○ Not reported

GRI INDICATORS

continued

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
S07	Total number of legal actions for anti-competitive behaviour, anti-trust, and monopoly practices and their outcomes.	●	None reported during the year	
S08	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations.	●	None reported during the year	
Social Performance Indicators: Product Responsibility				
DMA	Customer health and safety	●	105-106	
	Product and service labelling	●	105-106	
	Marketing communications	●	105-106	
	Customer privacy	●	105-106	
	Compliance	●	113-114	
PR1	Life cycle stages in which health and safety impacts of products and services are assessed for improvement, and percentage of significant products and services categories subject to such procedures.	●	Given the nature of our business product assessment and redesign is not dependent on health & safety aspects. Further information on product & service development is given in page 109	
PR2	Total number of incidents of non-compliance with regulations and voluntary codes concerning health and safety impacts of products and services during their life cycle, by type of outcomes.	●	None reported during the year	
PR3	Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements.	●	All credit based products are accompanied by contractual agreements which outline the nature of the product, their terms of credit and repayment conditions. All deposit based products are accompanied with information on deposit type, terms of deposit and withdrawal conditions.	
PR4	Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labelling, by type of outcomes.	●	None reported during the year	
PR5	Practices related to customer satisfaction, including results of surveys measuring customer satisfaction.	●	108	
PR6	Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship.	●	113-115	
PR7	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes.	●	None reported during the year	
PR8	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.	●	None reported during the year	
PR9	Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services.	●	None reported during the year	
Financial Services Sector Supplement (FSSS)				
FSSS Performance Indicators				
FS1	Policies with specific environmental and social components applied to business lines.	●	137-138	
FS2	Procedures for assessing and screening environmental and social risks in business lines.	●	137-138	
FS3	Processes for monitoring clients' implementation of and compliance with environmental and social requirements included in agreements or transactions.	●	137-138	
FS4	Process(es) for improving staff competency to implement the environmental and social policies and procedures as applied to business lines.	●	137-138	
FS5	Interactions with clients/investees/business partners regarding environmental and social risks and opportunities.	●	127-129	
FS6	Percentage of the portfolio for business lines by specific region, size (e.g. micro/SME/large) and by sector.	●	54-55	

● Fully reported ● Partially reported ○ Not reported

		Reported	Cross-reference - HNB Annual Report 2011 Page No. / Direct answer	Explanation of non or partial reporting / Notes
FS7	Monetary value of products and services designed to deliver a specific social benefit for each business line broken down by purpose.	●	25-39	
FS8	Monetary value of products and services designed to deliver a specific environmental benefit for each business line broken down by purpose.	●	25-39	
FS9	Coverage and frequency of audits to assess implementation of environmental and social policies and risk assessment procedures.	●	78-80	
FS10	Percentage and number of companies held in the institution's portfolio with which the reporting organisation has interacted on environmental or social issues.	●	246-260	
FS11	Percentage of assets subject to positive and negative environmental or social screening.	●	53-62,105,113-115,137-138	
FS12	Voting polic(ies) applied to environmental or social issues for shares over which the reporting organisation holds the right to vote shares or advises on voting.	○		Not applicable
FS13	Access points in low-populated or economically disadvantaged areas by type.	●	44-45	
FS14	Initiatives to improve access to financial services for disadvantaged people.	●	111,127,129,133	
FS15	Policies for the fair design and sale of financial products and services.	●	108-109	
FS16	Initiatives to enhance financial literacy by type of beneficiary.	●	111	

● Fully reported ○ Partially reported ○ Not reported



Financial Calendar – 2011

Rs 5.50 per share Final Dividend for 2010 paid on	11th April 2011
Rs 1.50 per share Interim Dividend for 2011 paid on	12th December 2011
Audited Financial Statements signed on	21st February 2012
43rd Annual General Meeting to be held on	30th March 2012
Rs 6.00 per share Final Dividend for 2011 payable in*	April 2012
(Cash Dividend Rs 3.00 per share and Scrip Dividend Rs 3.00 per share)	

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	12th May 2011
2nd Quarter Interim Results released on	12th August 2011
3rd Quarter Interim Results released on	9th November 2011

Many Ideas. One Goal.

Financial Information



Proposed Financial Calendar – 2012

Interim Dividend for 2012 to be payable in **	December 2012
44th Annual General Meeting to be held in	March 2013
Final Dividend for 2012 to be payable in ***	April 2013

Interim Financial Statements to be published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:

1st Quarter Interim Results to be released in	May 2012
2nd Quarter Interim Results to be released in	August 2012
3rd Quarter Interim Results to be released in	November 2012

* Subject to confirmation by Shareholders

** Subject to confirmation by Directors

*** Subject to confirmation by Directors and Shareholders



ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY



The Board of Directors of Hatton National Bank PLC (HNB) has pleasure in presenting their Annual Report to the members for the financial year ended 31st December 2011, together with the audited Financial Statements of the Bank, Consolidated Financial Statements of the Group for that year and the Auditors' Report on those Financial Statements, conforming to the requirements of the Companies Act. The Financial Statements were reviewed and approved by the Board of Directors on 21st February 2012. The Report also includes certain disclosures required to be made under the Banking Act Direction No 11 of 2007 on Corporate Governance, Listing Rules of the Colombo Stock Exchange and is guided by the recommended best practices on Corporate Governance.

Hatton National Bank PLC (Bank) is a Public Limited Company incorporated in Sri Lanka in March 1970 under the Companies Ordinance. The Bank was re-registered as required under the provisions of the Companies Act No 7 of 2007, on 27th September 2007.

The ordinary shares and the majority of the unsecured subordinated redeemable debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka. Global Depository Receipts (GDR) of the Bank were listed on the Luxembourg Stock Exchange up to 1st December 2011. The final batch of GDRs held by Deutsche Bank Trust Company Americas in trust for the GDR holders, have been transferred to investors who have opted to convert them into the underlying shares and the GDRs which represented those shares had been cancelled in December 2011.

The Bank's National Long Term Rating and Subordinated Debt Rating have been assigned AA-(lka) and A+(lka) respectively by Fitch Ratings Lanka Ltd.

Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, offshore banking, mortgage financing, lease financing, corporate banking, dealing in government securities and listed equities, pawn broking, credit card facilities, stock broking, providing life and general insurance services, other financial services and property development. There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

Changes to the Group Structure

The Bank made a full provision as at Balance Sheet date amounting to Rs 70 Mn against investment in its 40% owned Subsidiary, Majan Exchange LLC, in view of the continuous losses that the company had made.

During the year the Bank wrote off its investment (Rs 20.6 Mn) in Browns Engineering (Pvt) Ltd, 32.63% owned Associate Company, against the provision brought forward.

Review of Operations

A review of the operations of the Bank during the financial year 2011 and results of its operations are contained in the Chairperson's Message (pages 3 to 6), the Chief Executive Officer's Review (pages 7 to 9) and Management Discussion & Analysis (pages 22 to 49). These reports form an integral part of the Annual Report of the Board of Directors.

Future Developments

An overview of the future developments of the Bank is given in the Chairperson's Message (pages 3 to 6), the Chief Executive Officer's Review (pages 7 to 9) and Management Discussion & Analysis (pages 22 to 49).

Financial Statements

The Financial Statements of the Bank and the Group for the year ended 31st December 2011 duly signed by the Chief Financial Officer, two of the Directors of the Bank and the Board Secretary are given on pages 172 to 264 which form an integral part of the Annual Report of the Board of Directors.

Significant Accounting Policies

The significant accounting policies adopted in the preparation of the Financial Statements and the potential impact of the new / revised Sri Lanka Accounting Standards which have become effective from 1st January 2012 are given on pages 179 to 197.

Going Concern

The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, we continue to adopt the "going concern" basis in preparing these Financial Statements.

Auditors' Report

Bank's Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company carried out the audit on the Financial Statements of the Bank and the Consolidated Financial Statements of the Group for the year ended 31st December 2011 and their report on those Financial Statements is given on page 171 of this Annual Report.

Income

The Income of the Group for 2011 was Rs 41,168,444,000/- (2010 : Rs 37,393,462,000/-) while the Bank's income was Rs 37,968,762,000/- (2010 : Rs 34,870,418,000/-). An analysis of the income is given in Note 9 to the Financial Statements.

Financial Results and Appropriations

The Bank has recorded a profit before tax and profit after tax growth of 15.4% and 24.8% respectively in 2011. The Group's profit before tax and profit after tax for the year too recorded a growth of 16.9% and 27.6% respectively over 2010.

ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY

continued

	2011 Rs 000	2010 Rs 000
The Group profit for the year ended 31st December 2011 after payment of all operating expenses and provision for depreciation and contingencies	8,482,813	7,251,667
Less: Taxation	(2,248,615)	(2,364,839)
Group net profit after taxation	6,234,198	4,886,828
Minority Interest	(85,357)	(100,058)
	6,148,841	4,786,770
Unappropriated profit brought forward from previous year	4,355,024	3,550,268
Balance available before appropriation / adjustments	10,503,865	8,337,038
Transfer to General Reserve	(2,400,000)	(2,300,000)
Transfer to Reserve Fund	(290,000)	(250,000)
Transfer to Investment Fund	(978,337)	-
Final dividend paid	(1,310,975)	(1,179,807)
Interim dividend paid	(582,560)	(338,570)
Dividend reversal	-	175,712
Transfer of Revaluation Reserve on disposal of PPE	19,374	-
Reduction in reserves from disposal of Associate company and long term investment to Joint Venture	-	(88,637)
Acquisition of minority interest in Subsidiary by Group	-	(712)
Balance carried forward as at 31st December	4,961,367	4,355,024

Reserves

The Group Reserves consist of:

	2011 Rs 000	2010 Rs 000
Capital Reserve	5,776,808	5,791,791
Statutory Reserve Fund	1,800,000	1,510,000
Investment Fund Account	978,337	-
Exchange Equalisation Reserve	5,733	2,744
Revenue Reserve	20,361,367	17,355,024
Total	28,922,245	24,659,559

The movement in these reserves is shown in the Statement of Changes in Equity on page 175 of the Annual Report.

As per the Central Bank's Guidelines on the Operations of the Investment Fund Account, the Directors propose to transfer Rs 978,337,000/- (2010 : nil) to the Investment Fund Account.

The Directors propose to transfer Rs 290,000,000/- (2010 : Rs 250,000,000/-) to the Statutory Reserve Fund, and Rs 2,400,000,000/- (2010 : Rs 2,300,000,000 /-) to the General Reserve Account.

Corporate Donations

During the year the Bank made donations amounting to Rs 53,945,000/- (2010 : Rs 20,303,000/-) in terms of the resolution passed at the last Annual General Meeting. Donations made by the Group during the year amounted to Rs 54,370,000/- (2010 : Rs 20,661,000/-).

The donations made by the Bank to Government approved charities from the above sum amounted to Rs 28,500,000/- (2010 : Rs 400,000/-).

Taxation

The income tax rate applicable on the Bank's domestic operations and FCBU on-shore banking operations is 28% (2010 : 35%). The off-shore operations of the FCBU are taxed at 28% (2010 : 20%).

It is the Bank's policy to provide for deferred taxation on all known temporary differences under the liability method.

The Bank is also liable for Financial Services VAT at 12% (2010 : 20%).

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.

Dividends

An interim dividend of Rs 1.50 per share (2010 : Rs 1.50) was paid on 12th December 2011 to the holders of the ordinary shares (both voting and non-voting) for the financial year 2011. A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the Bank and will therefore be free of income tax in the hands of the shareholders. On this basis 32.4% of the interim dividend paid for 2011 is subject to income tax.

The Directors recommend that final dividend of Rs 6.00 per share which will consist of Rs 3.00 per share in cash and Rs 3.00 per share in the form of a scrip dividend, (2010 : Rs 5.50 per share in cash) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2011.

The following table reflects the number of shares to be issued, the proportion and consideration in which shares are to be issued and the amount of the retained earnings to be set aside for scrip dividends based on the number of issued shares as at 21st February 2012.

	Voting	Non-Voting
Existing ordinary shares as at 21st February 2012	311, 446, 495	77,207,304
The number of shares to be issued (this is on the basis of Rs 3.00 per existing share after providing for 10% withholding tax)	5,681,795	2,208,260
Amount to be capitalized (net of withholding tax) (Rs)	840,905,537	208,459,721
Value of a share as at 17th February 2012 - last trading day prior to the Board Meeting (Rs)	148.00	94.40
The proportion with which the shares are to be issued	1 for 54.815	1 for 34.963

However, the above-said number of voting and non-voting shares will be varied since it is required to accommodate new shares to be allotted under ESOPs in progress from 21st February 2012 to effective ex-dividend date to be notified.

The scrip dividend is subject to the Colombo Stock Exchange approving in principle the issue and listing of shares and obtaining shareholder approval in terms of the Bank's Articles of Association.

The Board of Directors was satisfied that the Bank would meet the solvency test immediately after the interim dividend was paid in December 2011 and the final dividend proposed which will be paid in April 2012 in terms of the provisions of the Companies Act No 7 of 2007. The Board provided the Statements of Solvency to the Auditors and obtained Certificates of Solvency from the Auditors in respect of each dividend payment conforming to the statutory provision.

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 1,322,651,000/- and Rs 1,382,040,000/- respectively (2010 Bank : Rs 1,052,876,000/- and Group : Rs 1,139,281,000/-) details of which are given in Notes 33, 34 and 35 to the Financial Statements. The capital expenditure approved and contracted for, after the year end is given in Note 47 (a) to the Financial Statements.

Property, Plant and Equipment (PPE)

Details of property, plant and equipment are given in Note 34 to the Financial Statements.

Market Value of Freehold Properties

The net book value of freehold properties owned by the Bank and the Group as at 31st December 2011 is included in the accounts at Rs 5,189,255,000/- and Rs 10,282,027,000/- respectively (2010 Bank : Rs 5,058,275,000/- and Group : Rs 10,207,154,000/-).

A panel of Chartered Valuers / Licensed Surveyors carried out a revaluation of the Bank's freehold properties in 2007. The details of freehold properties owned by the Bank are given in Note 34 (a) to the Financial Statements.

Outstanding Litigation

In the opinion of the Directors and the Bank's Lawyers, pending litigation against the Bank disclosed in Note 47 (e) of the Financial Statements will not have a material impact on the financial position of the Bank or its future operations.

Events after the Balance Sheet Date

No circumstances have arisen since the Balance Sheet date which would require adjustments to, or disclosure in, the accounts, except those disclosed in Note 52 to the Financial Statements.

Stated Capital and Debentures

The stated capital of the Bank as at 31st December 2011 was Rs 11,451,451,000/-, consisting of 388,596,843 ordinary shares, 311,406,247 (voting) and 77,190,596 (non-voting), (2010 : Rs 5,318,550,000/- consisting of 237,969,022 ordinary shares, 191,275,606 (voting) and 46,693,416 (non-voting)).

Sub-Division of Shares

The Bank sub-divided its shares on the basis of one ordinary voting share for every existing two ordinary voting shares and one ordinary non-voting share for every existing two ordinary non-voting shares without making any changes to the Bank's Stated Capital on 5th April 2011. As a result of this share split the number of shares of the Bank was increased by 119,179,782 (95,800,065 voting & 23,379,717 non-voting).

Rights Issue

The Board of Directors recommended the issue of 35,753,936 new ordinary shares comprising 28,740,020 shares (voting) and 7,013,916 shares (non-voting) by way of a rights issue on the basis of one ordinary voting share for every existing ten ordinary voting shares (1:10) and one ordinary non-voting share for every existing ten ordinary non-voting shares (1:10). The new shares were priced at Rs 219.50 per voting share and Rs 119.50 per non-voting share. Based on shareholders' response, the Bank issued 21,858,851 shares on 1st August 2011 comprising of 19,020,702 shares (voting) and 2,838,149 shares (non-voting). Further 8,975,700 shares were issued on 7th September 2011 by way of a private placement comprising of 4,800,000 shares (voting) and 4,175,700 shares (non-voting) at Rs 219.50 and Rs 119.50 respectively. The Bank raised Rs 6,066,799,000/- worth of new capital from above noted share issues (Rs 5,228,644,000/- from voting & Rs 838,155,000/- from non-voting).

Further the Bank issued 613,488 ordinary shares during the year, 509,874 shares (voting) at a consideration of Rs 59,702,000/- and 103,614 shares (non-voting) at a consideration of Rs 6,400,000/- under the approved Employee Share Option Plan (ESOP). Therefore the Stated Capital increase of the Bank due to employees exercising their options under ESOP amounted to Rs 66,102,000/- (2010 : Rs 234,466,000/-).

The total increase in the stated capital during the year is Rs 6,132,901,000/- (2010 : Rs 234,466,000/-).

Purpose of the Rights Issue

The purpose of the rights issue discussed above, was to strengthen the balance sheet to support the growing demand for credit, improve the

ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY continued

capital base of the Bank to be compliant with any stringent capital adequacy requirements that might be introduced with the proposed Basel III code and capitalise on opportunities available in the market with the accelerated growth in the economy.

The Bank has utilised the money raised through the rights issue for the above purposes and has not deviated from the said purpose.

Share Information

Information relating to earnings, dividend, net assets and market price per share is given in the Financial Highlights on page 2 of the Annual Report. Information on share trading is given on page 281 of the Annual Report.

Shareholdings

As at 31st December 2011 there were 4,430 and 11,828 registered voting and non-voting shareholders respectively. The distribution is indicated on pages 280 and 281 of the Annual Report. The twenty largest voting and non-voting shareholders of the Bank as at 31st December 2011, together with an analysis are given on pages 284 and 285 of the Annual Report.

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.

The Board of Directors

The Board of Directors of the Bank consists of nine (2010: nine) Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the Balance Sheet date and their brief profiles appear on pages 10 to 13 of the Annual Report.

Name of the Director	Status
Dr Raneey Jayamaha - Chairperson (appointed w.e.f. 31st March 2011)	NED
Mr Rajendra Theagarajah (MD / CEO)	ED
Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)	NED
Mr R K Obeyesekere (resigned w.e.f. 30th December 2011)	NED
Ms Pamela C. Cooray - Senior Director	IND / NED
Mr N G Wickremeratne	IND / NED
Ms M A R C Cooray	IND / NED
Dr W W Gamage (appointed w.e.f. 31st March 2011)	IND / NED
Dr L R Karunaratne (appointed w.e.f. 6th October 2011)	IND / NED

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

Resignation of Directors

Mr Rienzie T. Wijetilleke and Mr M V Theagarajah, Directors, having attained the age of 70 years resigned from the Board with effect from

31st March 2011. Mr Ranjeevan Seevaratnam, Director, too resigned from the Board with effect from 31st March 2011.

Mr D H S Jayawardena ceased to be a Director of HNB with effect from 31st December 2011 as per the provisions of Monetary Board Direction No 11 of 2007 as amended by Direction No 5 of 2008 issued under the Banking Act. Mr R K Obeyesekere too has resigned from the Board of HNB with effect from 30th December 2011 after completing his term of office as per the provisions in the above said Directions.

Appointment of Directors

Dr Raneey Jayamaha was appointed to the Board in terms of Article 93 of Articles of Association as a Non Executive Director with effect from 31st March 2011. Dr W W Gamage and Dr L R Karunaratne were appointed to the Board as Independent and Non Executive Directors with effect from 31st March 2011 and 6th October 2011 respectively by the Board in terms of Article 93 of Articles of Association.

Retirement and re-election / re-appointment of Directors

Dr Raneey Jayamaha, Dr W W Gamage and Dr L R Karunaratne retire at the AGM under Article 93 of the Articles of Association of the Bank and offer themselves for re-election under the said Article.

Mr N G Wickremeratne and Ms M A R C Cooray retire by rotation at the AGM and offer themselves for re-election under the Article 87 of the Articles of Association of the Bank.

Board Committees

The Board while assuming the overall responsibility and accountability for the management oversight of the Bank has also appointed Board Committees to ensure oversight, control over certain affairs of the Bank, conforming to corporate governance standards of the Monetary Board of the Central Bank of Sri Lanka, and adopting the best practices. Accordingly, the following Committees have been constituted by the Board:

Audit Committee	- Comprises	-	• Mr N G Wickremeratne (Chairman)
			• Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)
			• Ms Pamela C. Cooray (Senior Director)
			• Ms M A R C Cooray (appointed w.e.f. 9th May 2011)
			• Mr H M A Jayasinghe (Consultant appointed w.e.f. 1st May 2011)

The Report of the Audit Committee is given on page 167 to 168 which forms part of the Annual Report of the Board.

- Nomination Committee - Comprises -
- Dr W W Gamage (Chairman)* (appointed w.e.f. 31st March 2011)
 - Dr Ranee Jayamaha (appointed w.e.f. 31st March 2011)
 - Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)
 - Mr R K Obeyesekere (resigned w.e.f. 30th December 2011)

*(Note: Dr Ranee Jayamaha was the Chairperson of this Committee till 15th December 2011 and Dr W W Gamage was appointed as the Chairman w.e.f. 15th December 2011 in order to comply with Governance Regulations).

The Report of the Nomination Committee is given on page 165 which forms part of the Annual Report of the Board of Directors.

- Human Resources & Remuneration Committee - Comprises -
- Ms Pamela C. Cooray (Chairperson)
 - Dr Ranee Jayamaha (appointed w.e.f. 31st March 2011)
 - Mr R K Obeyesekere (resigned w.e.f. 30th December 2011)
 - Mr N G Wickremeratne
 - Dr W W Gamage (appointed w.e.f. 13th September 2011)

The Report of the Human Resources & Remuneration Committee is given on page 164 which forms part of the Annual Report of the Board.

- The Board Integrated Risk Management Committee - Comprises -
- Ms M A R C Cooray (Chairperson) (appointed w.e.f. 31st March 2011)
 - Dr Ranee Jayamaha (appointed w.e.f. 31st March 2011)
 - Dr W W Gamage (appointed w.e.f. 31st March 2011)
 - Dr L R Karunaratne (appointed w.e.f. 7th October 2011)
 - Mr Rajendra Theagarajah (MD / CEO)
 - Mr A J Alles (Deputy CEO) (appointed w.e.f. 1st July 2011)

- Mr J D N Kekulawala (Senior DGM - Strategy & Compliance)
- Mr D P N Rodrigo (DGM - Risk & Credit Quality)
- Mr D A de Vas Gunasekara (CFO) (appointed w.e.f. 1st January 2011)

The Report of the Integrated Risk Management Committee is given on page 166 which forms part of the Annual Report of the Board.

Mr Rajendra Theagarajah, Mr A J Alles, Mr J D N Kekulawala, Mr D P N Rodrigo and Mr D A de Vas Gunasekara represent the Management on the Committee.

Directors' Meetings

The number of Directors' meetings comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Human Resource & Remuneration Committee meetings and Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 89 of the Annual Report. Furthermore, the Directors contributed towards policy advocacy and direction by participating in the deliberations of the Board appointed sub committees on Strategic Review, Procurement and Disposal of Assets.

Directors' Responsibility for Financial Reporting

The Directors are responsible for the preparation of the Financial Statements of the Bank to present a true and fair view of the state of its affairs. The Directors are of the view that these Financial Statements have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange. The Statement of Directors' Responsibility for Financial Reporting is given on page 170 which forms an integral part of the Annual Report of the Board of Directors.

Convergence with SLFRS / LKAS

Sri Lanka has taken a decision to converge fully with International Financial Reporting Standards (IFRSs) with effect from 1st January 2012. The Bank commenced working towards this goal during 2010 with the help of an external consultant. The Bank will publish its 2012 first quarter results in accordance with these new / revised Sri Lanka Accounting Standards.

Directors' Interest Register

The Bank maintains Directors' Interest Register conforming to the provisions of the Companies Act. The Directors of the Bank have disclosed their interests in other companies to the Board and those interests are recorded in the Interest Register conforming to the provisions of the Companies Act. The particulars of those entries are set out on pages 162 to 163 of the Annual Report which form an integral part of the Annual Report of the Board of Directors.

ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY

continued

Directors' Interests in the Ordinary Shares

The shareholdings of Directors were as follows:

	As at 31st December 2011 No of Shares	As at 31st December 2010 No of Shares
Dr Raneer Jayamaha (appointed w.e.f. 31st March 2011)	100	-
Mr Rajendra Theagarajah	36,001	21,820
Mr D H S Jayawardena (ceased to be a Director w.e.f. 31st December 2011)	16,516	10,010
Mr R K Obeyesekere (resigned w.e.f. 30th December 2011)	16,516	10,010
Ms Pamela C. Cooray	76,886	46,599
Mr N G Wickremaratne	8,300	2,000
Ms M A R C Cooray	5,165	-
Dr W W Gamage (appointed w.e.f. 31st March 2011)	-	-
Dr L R Karunaratne (appointed w.e.f. 6th October 2011)	1,000	-

There has been no change in their interests in shares between 31st December 2011 and 21st February 2012, being the date of this Report.

Related Party Transactions

The Directors have also disclosed the transactions if any, that could be classified as related party transactions in terms of Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures" which is adopted in the preparation of the Financial Statements. Those transactions disclosed by the Directors are given in Note 48 to the Financial Statements forming part of the Annual Report of the Board of Directors.

Directors' Remuneration

Details of Directors' emoluments paid during the year are given in Note 48 to the Financial Statements.

Human Resources

The employment strategies of the Bank are framed to employ, train, develop and retain the best talent available. Towards this end, employment policies are reviewed periodically to be aligned with organisational needs.

Employee Share Benefit Trust

The Bank established an Employee Share Benefit Trust in the year 2005 for the benefit of the staff members in the grade of Executive and above with the approval of the shareholders.

The scheme was formulated to pass certain benefits (dividends, bonus shares etc) on the ordinary shares (non-voting) of the Bank to the staff without transferring the ownership. For this purpose, the Bank created a Trust and the Trustees were entrusted to acquire ordinary shares (non-voting) of the Bank in the secondary market or otherwise and to allocate the shares to the staff on a basis determined by the Board.

The Trustees were granted an overdraft facility to acquire the shares. The benefits from the shares are given to the staff members during their employment. On cessation of employment, they are paid the market value of the shares allocated. Any part of the overdraft outstanding, interest and statutory payments are recovered prior to transferring the benefits. From inception up to 31st December 2011, 235 staff members have received benefits from this scheme.

The overdraft outstanding as at 31st December 2011 was Rs 399,074,000/- (2010 : Rs 197,284,000/-). The amount released to the employees who left the services of the Bank during 2011 was Rs 86,184,000/- (2010 : Rs 105,782,000/-).

Employee Share Option Plan

In the year 2008 with the approval of the shareholders, the Bank formulated an Employee Share Option Plan for the staff in the Management grades, recognising and rewarding them for their contribution. The Scheme was aimed at further motivating the Management staff. This gives an option to the Management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It is operative for 5 years and the Management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit of 1.25% of the shares issued up to a maximum of 5% of the shares issued. Based on the performance achieved for the year 2007, first option to purchase shares, has been offered to 175 Management Officers. The option to purchase shares is exercisable up to 1st October 2013. As at 31st December 2011, 154 Management Officers have exercised the option (some fully, some partially) and purchased shares.

Based on the performance achieved for the year 2009, second option to purchase shares has been offered to 182 Management Officers. The option to purchase shares is exercisable up to 31st March 2015. As at 31st December 2011, 160 Management Officers have exercised the option (some fully, some partially) and purchased shares.

The details of the options offered to the employees as at 31st December 2011 are as follows:

	2008 Allocation		2010 Allocation	
	Voting	Non voting	Voting	Non voting
No of options brought forward	343,139	65,183	2,231,526	544,443
No of options exercised before the share split & rights issue	(283,008)	(55,890)	(41,516)	(10,128)
No of options immediately before the share split & rights issue	60,131	9,293	2,190,010	534,315
No of additional options due to share split & rights issue	39,082	6,038	1,406,175	342,977
No of options immediately after the share split & rights issue	99,213	15,331	3,596,185	877,292

No of options exercised after the share split & rights issue	(16,500)	-	(168,850)	(37,596)
No of options granted in 2011	-	-	-	-
No of options expired during the year	-	-	-	-
No of options remaining	82,713	15,331	3,427,335	839,696
Allotment price before share split (Rs)	115.54	52.51	166.51	98.31
Allotment price after share split & rights issue (Rs)	77.33	35.07	111.43	65.67
Funding granted to employees	None	None	None	None

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.

Risk and Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, recording, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and Financial Statements.

Directors' Statement on Internal Control

The Board has issued a report on the internal control mechanism of the Bank as per Section 3 (8) (ii) (b) of Banking Act Direction No 11 of 2007 on Corporate Governance. The Board has confirmed that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements. The above report, which forms an integral part of the Annual Report of the Board of Directors, is given on page 90 to 91. The Board has obtained an assurance report from the External Auditors on Directors' Statement on Internal Control which is given on page 92 of the Annual Report.

Corporate Governance

In the management of the Bank, the Directors have placed emphasis on conforming to the best corporate governance practices and procedures. Accordingly, systems and structures have been introduced / improved from time to time to enhance risk management measures and to

improve accountability and transparency. A separate report on Corporate Governance is given on pages 68 to 89.

Compliance with Laws and Regulations

The Bank has at all times ensured that it complied with the applicable laws and regulations including the listing rules of the Colombo Stock Exchange as a listed company. Senior Deputy General Manager – Strategy & Compliance tables a report on compliance at the quarterly meetings of the Board Audit Committee.

Auditors

The Bank's Auditors during the period under review were Messrs KPMG Ford, Rhodes, Thornton & Company (KPMG), Chartered Accountants. Audit fees and reimbursement of expenses paid to KPMG during the year under review by the Bank and the Group amounted to Rs 11,322,000/- (2010 : Rs 8,666,000/-) and Rs 15,205,000/- (2010 : Rs 12,017,000/-) respectively. Further Rs 4,088,000/- (2010 : Rs 3,294,000/-) and Rs 4,768,000/- (2010 : Rs 3,294,000/-) were paid by the Bank and the Group respectively for Audit related and non-audit services including reimbursement of expenses.

Based on the declaration provided by Messrs KPMG Ford, Rhodes, Thornton & Company (KPMG), and as far as the Directors are aware, the Auditors do not have any relationship with or interest with the Bank that in our judgment, may reasonably be thought to have a bearing on their independence within the meaning of the Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka, applicable on the date of this Report.

The retiring Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company, have expressed their willingness to continue in office. A resolution relating to their re-appointment and authorising the Directors to fix their remuneration, will be proposed at the forthcoming Annual General Meeting.

Notice of Meeting

The 43rd Annual General Meeting of the Bank is convened on Friday the 30th March 2012, at 10.00 in the forenoon, at the Auditorium on Level 22 of "HNB Towers" (Registered Office), No 479, T B Jayah Mawatha, Colombo 10. The Notice of the 43rd Annual General Meeting is on page 290 of the Annual Report.

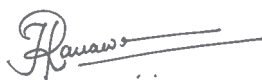
For and on behalf of the Board of Directors.



Rajendra Theagarajah
Managing Director /
Chief Executive Officer



Raneey Jayamaha
Chairperson



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

Colombo, Sri Lanka
21st February 2012

DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

Directors' Interest in Contracts with the Bank

"The Bank carries out transactions in the ordinary course of business at commercial rates with entities in which a Director of the Bank is the Chairman or a Director of such entities. The transactions with entities where a Director of the Bank either has control or exercises significant influence, have been classified as related party transactions and disclosed in Note 48 to the Financial Statements.

The transactions with entities where Directors of the Bank neither have control nor exercise significant influence, but only hold directorships are disclosed below:

1. Lending Transactions with the Bank

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			as at 31st December 2011		as at 31st December 2010		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Finlays Colombo PLC	Mr N G Wickremeratne (Director)	Short Term Loan	75.00	-	75.00	-	-
		Export Bill Discounting	(50.00)	-	(50.00)	-	-
		Total	75.00	-	75.00	-	-
Finlays Cold Storage (Pvt) Ltd	Subsidiary of Finlays Colombo PLC at which Mr N G Wickremeratne is a Director	Finance Lease	6.23	6.23	7.87	7.87	Vehicles leased
		Total	6.23	6.23	7.87	7.87	
Ceylon Guardian Investment Trust PLC	Ms M A R C Cooray (Director)	Overdraft / Revolving Short	300.00*	-	300.00	266.31	-
		Total	300.00	-	300.00	266.31	*Interchangeable limit
Ceylon Investment PLC	Ms M A R C Cooray (Director)	Overdraft / Revolving Short	(300.00)*	-	(300.00)	30.11	-
		Total	-	-	-	30.11	*Interchangeable limit
Mobitel (Pvt) Ltd	Dr W W Gamage** (Director)	Term Loan	528.13	528.13	-	-	Corporate
		Overdraft	500.00	-	-	-	guarantee
		Total	1,028.13	528.13	-	-	

No losses have been recorded against loan balances outstanding during the period with the above entities and no specific provisions have been made for loan losses as at the Balance Sheet date.

** Appointed with effect from 31st March 2011

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

2. Trading Transactions with the Bank

Company	Name of Director / Relationship	Nature of Transaction	2011 Amount (Rs Mn)	2010 Amount (Rs Mn)
Diesel and Motor Engineering PLC	Mr Ranjeevan Seevaratnam* (Director)	Repairs and maintenance of vehicles	2.01	0.41
		Purchase of motor vehicles	18.00	-
Finlay Rentokil Ceylon (Pvt) Ltd	Subsidiary of Finlays Colombo PLC at which Mr N G Wickremeratne is a Director	Pest control services	-	0.14
		Janitorial services	0.73	0.81
Mobitel (Pvt) Ltd	Dr W W Gamage ** (Director)	Interest on repurchase agreements	2.33	-
		Merchant commission	0.23	-
Ceylon Guardian Investment Trust PLC	Ms M A R C Cooray (Director)	Interest on repurchase agreements	13.66	-
Ceylon Investment PLC	Ms M A R C Cooray (Director)	Interest on repurchase agreements	10.93	-

* Resigned with effect from 31st March 2011.

** Appointed with effect from 31st March 2011

Mr Rienzie T. Wijetilleke, Mr MV Theagarajah and Mr Ranjeevan Seevaratnam had no interest in the Bank's contracts after their resignation from the Board with effect from 31st March 2011. Accordingly balances/transactions with other entities in which they continued to hold Directorships after their resignation from the Bank had not been reported under Directors' Interest in Contracts with the Bank.

Dr Raneer Jayamaha, Dr W W Gamage (with effect from 31st March 2011) and Dr L R Karunaratne (with effect from 6th October 2011) were appointed to the Board during the year to replace the outgoing Directors.

New Directors appointed during the year had no interest in the Bank's contracts before their appointment to the Board. Therefore transactions with other entities in which such Director is the Chairman or a Director (without having control or significant influence) has been reported from the date of appointment to the Bank's Board.

HUMAN RESOURCES & REMUNERATION COMMITTEE REPORT

The HR & Remuneration Committee (“the Committee”), appointed by and responsible to the Board of Directors comprises four Non Executive Directors, three of whom, including the Chairperson, are also Independent Directors and the Managing Director / Chief Executive Officer (MD / CEO). The following Directors serve / served on the HR & Remuneration Committee:

Ms Pamela C. Cooray - Chairperson (IND / NED)

Mr Rienzie T. Wijetilleke (NED)
resigned w.e.f. 31st March 2011

Dr Raneer Jayamaha (NED)
appointed w.e.f. 31st March 2011

Mr R K Obeyesekere (NED)
resigned w.e.f. 30th December 2011

Mr N G Wickremeratne (IND / NED)

Dr W W Gamage (IND / NED)
appointed w.e.f. 13th September 2011

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

Brief profiles of the Directors are given on pages 10 to 13 of the Annual Report.

Policy

The Bank's remuneration policy aims to attract, motivate and retain management in a competitive environment with the appropriate professional, managerial and operational expertise necessary to achieve the objectives of the Bank.

It is the focus of the Committee to ensure that the total remuneration package is sufficiently competitive to attract the best available talent to the Bank.

The Bank's remuneration of the MD / CEO and Corporate Management is designed to create and enhance value for all stakeholders of the Bank and to ensure alignment between the short and long term interests of the Bank and its Management.

Scope

The Committee reviews all significant Human Resource policies and initiatives, salary structures and terms and conditions relating to staff at Senior Management level. In this process, necessary information and recommendations are obtained from the MD / CEO and DGM - Human Resources and Administration. The Committee deliberates and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD / CEO, Deputy CEO, other members of the Corporate Management and senior staff.

The organisational structure is also reviewed annually and adjusted according to the focus of the Strategic Plan. Proper succession for key posts is an on-going priority.

The MD / CEO who is responsible for the overall management of the Bank attends meetings and participates in the deliberations except when his own interest, performance and compensation are discussed.

Recruitment and promotions of staff at Management level are also considered and approved based on the proposals submitted by the MD / CEO and DGM – Human Resources and Administration following a formal process of evaluation and thereafter recommended to the

Board for ratification. When necessary, interviews are held to assess the core competencies of applicants for key posts.

The Committee also undertakes deliberation and resolution of other HR related matters such as complaints, compensation, retirements etc. at the request of the Board.

During the course of 2011, the Committee tasked two of its members to have informal meetings with members of the Corporate Management to ascertain their views on their effectiveness in the organisation. The overall findings of this engagement were submitted to the Board for information and action where necessary.

Meetings

The Committee met six times during 2011. The reports of the Committee are circulated and thereafter discussed and acted upon by the Board of Directors.

Attendance at the meetings is given in table on page 89 of the Annual Report.

Fees

All Non Executive Directors receive a monthly fee for participation in the deliberations of the Board including attendance at meetings. They may also receive fees for attending sub-committee meetings, and / or meetings of subsidiary boards. They do not receive any performance or incentive payments.

Professional Advice


The Committee has the authority to seek external professional advice on matters within its purview.

Appreciation

I wish to record with appreciation the immense contribution of the former Chairman, Mr Rienzie T. Wijetilleke and of Mr R K Obeyesekere, whose knowledge and insights were invaluable in the deliberations of the Committee.

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2011, which was conducted by the Chairperson and Committee Members and was deemed to be satisfactory.



Pamela C. Cooray
Chairperson
Human Resources & Remuneration Committee

Colombo, Sri Lanka
21st February 2012

NOMINATION COMMITTEE REPORT

Composition of the Nomination Committee

The Nomination Committee comprises four Non-Executive Directors appointed by the Board of Directors of the Bank. The Committee was chaired by Dr Rane Jayamaha from 31st March 2011 (on Mr Rienzie T. Wijetilleke, former Chairman, resigning from the Board) to 15th December 2011. Dr W W Gamage who served as a member of this Committee from 31st March 2011 was appointed as Chairman of the Nominations Committee with effect from 15th December 2011, on Dr Rane Jayamaha stepping down from the position of Committee Chair. She continues to serve on the said Committee as a member. Further Dr L R Karunaratne (IND / NED) was also appointed to serve as a member of this Committee from 12th January 2012. The following Directors serve / served on the Nomination Committee:

Mr Rienzie T. Wijetilleke (NED)
Chairman up to 31st March 2011
resigned w.e.f. 31st March 2011

Dr Rane Jayamaha (NED)
Chairperson of the Committee till 15th December 2011
appointed w.e.f. 31st March 2011

Dr W W Gamage (IND / NED)
Chairman w.e.f. 15th December 2011
appointed to the Committee w.e.f. 31st March 2011

Mr D H S Jayawardena (NED)
ceased to be a Director w.e.f. 31st December 2011

Mr M V Theagarajah (IND / NED)
resigned w.e.f. 31st March 2011

Mr R K Obeyesekere (NED)
resigned w.e.f. 30th December 2011

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

Brief profiles of the members of the Committee are given on pages 10 to 13 of the Annual Report.

The Primary Responsibilities of the Nomination Committee

The mandate of the Nomination Committee includes the following:

1. To establish a procedure to select / appoint new Directors.
2. To consider and recommend (or not recommend) the re-election of current Directors, taking into account the performance and contribution made by the Director concerned.
3. To assess at the time of appointment and annually thereafter whether a Director is fit and proper to hold office.
4. To recommend from time to time, the requirements of additional / new expertise and the succession arrangements for retiring Directors taking into consideration the demands from the medium term strategic plan of the Bank.
5. To look into and make recommendations to any other matters referred to it by the Board of Directors.

Nomination Committee Meeting

The Nomination Committee met three times during the year under review to consider and recommend the appointment of three additional Non-Executive Directors including two Independent Directors to the Board and to assess the fitness and propriety of each 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. Attendance by the Committee members at the meeting is given in the table on page 89 of the Annual Report. The Chief Executive Officer also attended all meetings by invitation.

Re-election / Re-appointment of Directors at the 43rd Annual General Meeting

Since both Dr Rane Jayamaha and Dr W W Gamage should be re-elected / re-appointed at the 43rd Annual General Meeting to be held on 30th March 2012, the Committee decided to recommend that this matter be discussed at and approved by the full Board.

Appreciation

I wish to record with appreciation the immense contribution of the former Chairman, Mr Rienzie T. Wijetilleke, Mr D H S Jayawardena, Mr M V Theagarajah and of Mr R K Obeyesekere, whose knowledge and insights were invaluable in the deliberations of the Committee.

Committee Evaluation

The Committee completed the evaluation process with self assessment in 2011, which was conducted by the Chairperson and Committee Members and was deemed to be satisfactory.



W W Gamage
Chairman
Nomination Committee

Colombo, Sri Lanka
21st February 2012

THE BOARD INTEGRATED RISK MANAGEMENT COMMITTEE REPORT

The Board Integrated Risk Management Committee (BIRMC) comprises nine members of which four members are Non-Executive Directors.

Ms M A R C Cooray (IND / NED)

Chairperson

appointed Chairperson w.e.f. 31st March 2011

Mr M V Theagarajah (IND / NED)

Chairman

resigned from Committee w.e.f. 31st March 2011

Dr Raneey Jayamaha (NED)

appointed w.e.f. 31st March 2011

Mr Rienzie T. Wijetilleke (NED)

resigned from Committee w.e.f. 31st March 2011

Dr W W Gamage (IND / NED)

appointed w.e.f. 31st March 2011

Dr L R Karunaratne (IND / NED)

appointed to the Committee w.e.f. 7th October 2011

Mr Rajendra Theagarajah

MD / CEO

Mr A J Alles

Deputy CEO

appointed w.e.f. 1st July 2011

Mr J D N Kekulawala

Senior DGM - Strategy & Compliance

Mr D A de Vas Gunasekara

CFO

appointed w.e.f. 1st January 2011

Mr D P N Rodrigo

DGM - Risk & Credit Quality

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

Brief profiles of the Directors representing the Committee are given on pages 10 to 13 of the Annual Report.

Terms of Reference [Charter]

The Terms of Reference set out by the Board of Directors, include the following:

1. to ensure that the Bank has a comprehensive risk management framework, appropriate compliance policies and systems in place.
2. to assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic/reputational risks to the Bank through appropriate risk indicators and management information.
3. to ensure risk decisions are taken in accordance with established delegated authorities and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the Committee, on the basis of Bank's policies and regulatory and supervisory requirements.
4. to monitor and assess the effectiveness of the Bank's Risk Management System and the robustness of the risk management function.
5. to periodically assess performance against internally defined risk appetite.

6. to review the Bank's compliance report and action taken in relation to report
7. to review issues raised by Internal Audit that impact upon the Risk Management framework
8. to review progress on Basel II Roadmap implementation

We draw your attention to the Risk Management Section of the report (pages 51 to 67) which extensively covers level of adherence against the terms of reference, achievements during the year and actions taken to mitigate key risks.

Meetings

Six meetings were held during the year and at least one each quarter.

Attendances at the meetings are given in table on page 89 of the Annual Report.

The discussions and conclusions reached at the meeting are recorded in minutes and circulated to the Board of Directors for information and advice.

Appreciation

The Committee wishes to convey its heartfelt gratitude to retiring Directors Mr MVTheagarajah, Mr Rienzie T. Wijetilleke and Mr R K Obeyesekere for their valuable contribution to the Committee over the years.

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2011, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.



M A R C Cooray

Chairperson - Integrated Risk Management Committee

Colombo, Sri Lanka

21st February 2012

AUDIT COMMITTEE REPORT

Committee Composition

The Audit Committee comprises of four Non Executive Directors, a majority of whom are independent including the Chairman. The Committee is chaired by Mr N G Wickremeratne who was appointed as the Chairman of the Audit Committee with effect from 31st March 2011, on the resignation of Mr Ranjeevan Seevaratnam from the Board.

The following Directors serve / served on the Audit Committee:

Mr Ranjeevan Seevaratnam (IND / NED)

Chairman up to 31st March 2011
resigned w.e.f. 31st March 2011

Mr N G Wickremeratne (IND / NED)

Chairman w.e.f. 31st March 2011

Mr D H S Jayawardena (NED)

ceased to be a Director w.e.f. 31st December 2011

Ms Pamela C. Cooray (IND / NED)

Senior Director

Ms M A R C Cooray (IND / NED)

appointed w.e.f. 9th May 2011

Mr H M A Jayasinghe

Consultant
appointed w.e.f. 1st May 2011

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

Mr H M A Jayasinghe (FCA, FCMA), serves as the Consultant to the Audit Committee since 1st May 2011. He is a Partner of Messrs Ernst & Young Sri Lanka, Firm of Chartered Accountants.

Brief profiles of the members are given on pages 10 to 13 of the Annual Report.

The Board Secretary functions as the Secretary to the Audit Committee.

Meetings

The Audit Committee met nine times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 89 of the Annual Report. The Managing Director / Chief Executive Officer, Deputy CEO, Senior DGM Strategy & Compliance, DGM Risk and Credit Quality, Chief Financial Officer and Head of Internal Audit also attended these meetings by invitation. On the invitation of the Committee, the Engagement Partner of the Bank's External Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company attended two Committee meetings during the year. The Audit Committee met the External Auditors, without the presence of CEO and the Corporate Management, to ensure that there was no limitation of scope in relation to the Audit and to allow for full disclosure of any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there were no cause for concern. The Audit Committee also met the external consultants who have been engaged to guide the Management with the implementation of new Sri Lanka Accounting Standards which became effective from 1st January 2012.

Financial Reporting

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the Management, the annual and the quarterly Financial Statements prior to their release. The review included the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30 of 1988 and amendments thereto. Matters of special interest in the current environment and the processes that support certifications of the Financial Statements by the Bank's Chief Executive Officer and Chief Financial Officer were also brought up for discussion.

Risks and Internal Controls

During the year, the Committee reviewed the effectiveness of the Bank's internal control system and has reviewed quarterly reports on losses resulting from frauds and / or operational failures. Additionally, the Committee also assessed the effectiveness of the Bank's internal control over financial reporting as of 31st December 2011, 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. The result of the assessment is given on page 90 to 91, "Directors' Statement on Internal Control" in the Annual Report. The External Auditors have issued an Assurance Report on Directors' Statement on Internal Controls. The report is given on page 92 of the Annual Report.

The Committee has reviewed the processes for identification, recording, evaluation and management of all significant risks throughout the Bank and other Group entities.

External Audit

The Audit Committee undertook the annual evaluation of the independence and objectivity of the External Auditor and the effectiveness of the audit process.

The Committee met with the External Auditor during the year to discuss their audit approach and procedures, including matters relating to the scope of the audit and Auditor's independence. The Lead Audit Partner is required to be rotated every five years, in order to ensure the independence of the Auditor and to comply with the requirements of the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka.

The Committee reviewed the audited Financial Statement with the External Auditor who is responsible for expressing an opinion on its conformity with the Sri Lanka Accounting Standards.

The Committee reviewed the Interim Management Letter issued by the External Auditor together with the management responses thereto.

The Committee met the External Auditors three times during the year without the presence of the executive management to ensure that there was no limitation of scope in relation to the Audit and to allow for full disclosure of any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there was no cause for concern.

AUDIT COMMITTEE REPORT

continued

The Audit Committee reviewed the Non-Audit Services provided by the External Auditor and was of the view that such services were not within the category of services identified as prohibited under;

1. The guidelines issued by the Central Bank of Sri Lanka, for External Auditors, relating to their statutory duties in terms of Section 39 of Banking Act No 30 of 1988 and amendments thereto.
2. The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the External Auditor by the Board and Letter of Independence Confirmation issued by the External Auditor were tabled at the Audit Committee Meeting.

The Audit Committee has recommended to the Board of Directors that Messrs KPMG Ford, Rhodes, Thornton & Company, Firm of Chartered Accountants, be re-appointed for the financial year ending 31st December 2012 subject to the approval of shareholders at the next Annual General Meeting.

Internal Audit

During the year, the Audit Committee reviewed the independence, objectivity & performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control including internal control systems. The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Internal Audit Department's resource requirements including succession planning.

Regulatory Compliance

The Committee reviewed the procedures established by Management for compliance with the requirements of regulatory authorities. Senior Deputy General Manager – Strategy & Compliance who has oversight of the Compliance function, submitted quarterly reports to the Audit Committee on the extent to which the Bank was in compliance with the regulatory requirements.

Professional Advice

The Committee has the authority to seek external professional advice on matters within its purview.

Appreciation

I wish to record with appreciation the immense contribution of Mr Ranjeevan Seevaratnam and of Mr D H S Jayawardena whose knowledge and insights were invaluable in the deliberations of the Committee.

Committee Evaluation

The annual evaluation of the Committee was conducted by the Non Executive Chairman, with the contribution from the Managing Director / CEO, the Deputy CEO, the Senior DGM Strategy and Compliance, the Chief Financial Officer, the Head of Internal Audit and the External Auditor in accordance with international best practices and was deemed to be satisfactory.



N G Wickremeratne
Chairman
Audit Committee

Colombo, Sri Lanka
21st February 2012

CHIEF EXECUTIVE OFFICER'S AND CHIEF FINANCIAL OFFICER'S RESPONSIBILITY STATEMENT

The Financial Statements of Hatton National Bank PLC (Bank) and the Consolidated Financial Statements of the Bank and its Subsidiaries as at 31st December 2011 are prepared in compliance with the Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, the Banking Act No 30 of 1988 and amendments thereto, and the Listing Rules of the Colombo Stock Exchange. The Accounting Policies used in the preparation of the Financial Statements are appropriate and are consistently applied by the Group. There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

The significant accounting policies and estimates that involved a high degree of judgment and complexity were discussed with the Audit Committee and External Auditors.

The Board of Directors and the Management of the Bank accept responsibility for the integrity and objectivity of these Financial Statements. The estimates and judgments relating to the Financial Statements were made on a prudent and reasonable basis; in order that the Financial Statements reflect in a true and fair manner, the form and substance of transactions and that the Bank's state of affairs is 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 is reviewed, evaluated and updated on an ongoing basis. 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 2011, as required by the Banking Act Direction No 11 of 2007, result of which is given on page 90 to 91 in the Annual Report, the "Directors Statement on Internal Control". External Auditors' Assurance Report on the "Directors Statement on Internal Control" is given on page 92 of the Annual Report.

The Financial Statements of the Group were audited by Messrs KPMG Ford, Rhodes, Thornton & Company ("KPMG"), Chartered Accountants, the independent External Auditors. Their report is given on page 171 of the Annual Report.

The Audit Committee of the Bank meets periodically with the Internal Audit team and the independent External Auditor to review their audit plans, assess the manner in which these auditors are performing their responsibilities and to discuss their reports on internal controls and financial reporting issues. To ensure complete independence, the External Auditor and the Internal Auditor have full and free access to the members of the Audit Committee to discuss any matter of substance.

The Audit Committee approves the audit and non audit services provided by External Auditor, KPMG, in order to ensure that the provision of such services does not impair KPMG'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 47 (e) to the Financial Statements in this Annual Report.



Rajendra Theagarajah
Managing Director / Chief Executive Officer



Ajantha de Vas Gunasekara
Chief Financial Officer

Colombo, Sri Lanka
21st February 2012

DIRECTORS' RESPONSIBILITY FOR FINANCIAL REPORTING

The responsibility of the Directors in relation to the Financial Statements of the Bank and its Subsidiaries prepared in accordance with the provisions of the Companies Act No 7 of 2007 is set out in the following statement. The responsibilities of the External Auditor in relation to the Financial Statements are set out in the Report of the Auditors given on page 171 of the Annual Report.

As per the provisions of the Companies Act No 7 of 2007 the Directors are required to prepare Financial Statements for each financial year and place them before a General Meeting. The Financial Statements comprise the Balance Sheet as at 31st December 2011, and the Income Statement, Statement of Changes in Equity and Cash Flow 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 2011; 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. the appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
2. judgments and estimates have been made which are reasonable and prudent; and
3. all applicable Accounting Standards, as relevant, have been complied with.

The Directors are also required to ensure that the Bank and its Subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these Financial Statements.

Further, the Directors have a responsibility to ensure that the Companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its Subsidiaries.

Financial Statements prepared and presented in this Report are consistent with the underlying books of account 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. 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 2011 is given on page 90 to 91 of the Annual Report, "Directors Statement on Internal Control". External Auditors' Assurance Report on the "Directors Statement on Internal Control" is given on page 92 of the Annual Report.

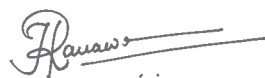
Directors are required to prepare the Financial Statements and to provide the Bank's External Auditor, Messrs KPMG Ford, Rhodes, Thornton & Company, with every opportunity to carry out whatever reviews and sample checks on the system of internal control they may consider appropriate and necessary for expressing their independent audit opinion on the Financial Statements.

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 6.00 per share for this year, which will consist of Rs 3.00 per share in cash and Rs 3.00 per share in the form of a scrip dividend.

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 Balance Sheet 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
Assistant General Manager (Legal) / Company Secretary

Colombo, Sri Lanka
21st February 2012

INDEPENDENT AUDITORS' REPORT



KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)
32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300,
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TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

Report on the Financial Statements

We have audited the accompanying financial statements of Hatton National Bank PLC ("Company"), and the consolidated financial statements of the Company and its subsidiaries as at 31st December 2011, which comprise the balance sheet as at that date, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 172 to 264 of this Annual Report.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended 31st December 2011 and the financial statements give a true and fair view of the Company's state of affairs as at 31st December 2011 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at 31st December 2011 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

Report on Other Legal and Regulatory Requirements

1. These financial statements also comply with the requirements of Section 153(2) to 153(7) of the Companies Act No. 07 of 2007.
2. These financial statements present the information required by the Banking Act, No 30 of 1988.

Ford Rhodes Thornton & Co.

CHARTERED ACCOUNTANTS

21st February 2012
Colombo, Sri Lanka.

KPMG Ford, Rhodes, Thornton & Co., a Sri Lankan Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International cooperative ("KPMG International"), a Swiss entity.

A.N. Fernando FCA
P.Y.S. Perera FCA
W.W.J.C. Perera FCA
W.K.D.C. Abeyrathne ACA

M.R. Mihular FCA
C.P. Jayatilake FCA
Ms. S. Joseph FCA
S.T.D.L. Perera FCA

Ms. M. P. Perera FCA
T.J.S. Rajakarier FCA
Ms. S.M.B. Jayasekara ACA
G.A.U. Karunaratne ACA

Principals - S.R.I. Perera ACMA, LLB, Attorney-at-Law, H.S. Goonewardene ACA

INCOME STATEMENT

For the year ended 31st December	Note	BANK		GROUP	
		2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
INCOME	9	37,968,762	34,870,418	41,168,444	37,393,462
Interest income	10	33,141,598	30,249,230	33,569,716	30,563,795
Less: Interest expenses	11	16,745,453	14,703,256	16,842,036	14,777,155
Net interest income		16,396,145	15,545,974	16,727,680	15,786,640
Fee and commission income	12	2,779,700	2,098,127	3,055,558	2,404,240
Less: Fee and commission expenses		34,520	30,211	53,518	30,955
Net fee and commission income		2,745,180	2,067,916	3,002,040	2,373,285
Net interest, fee and commission income		19,141,325	17,613,890	19,729,720	18,159,925
Foreign exchange profit		988,231	1,015,987	995,580	1,014,208
Dividend income	13	409,440	209,762	407,506	199,012
Other income	14	649,793	1,297,312	3,140,084	3,212,207
Operating income		21,188,789	20,136,951	24,272,890	22,585,352
Less:					
OPERATING EXPENSES	15				
Personnel expenses	16	4,891,183	4,624,286	5,418,038	5,090,220
Premises, equipment and establishment expenses		3,191,644	2,978,363	3,091,520	2,821,552
Provision charge for employee benefits	17	893,507	882,815	907,939	894,118
Provision charge / (release) for loan losses	18	(164,562)	481,309	(164,562)	481,309
Diminution in value of investment securities / Subsidiary		202,031	8,025	145,910	1,088
Loans written off		2,005	274	2,005	274
Other expenses		4,405,379	4,430,428	6,373,498	6,042,695
		13,421,187	13,405,500	15,774,348	15,331,256
PROFIT FROM OPERATIONS		7,767,602	6,731,451	8,498,542	7,254,096
Share of loss of Associates (net of income tax)	19	-	-	(15,729)	(2,429)
PROFIT BEFORE INCOME TAX		7,767,602	6,731,451	8,482,813	7,251,667
Less: Income tax expense	20	2,197,263	2,267,484	2,248,615	2,364,839
PROFIT FOR THE YEAR		5,570,339	4,463,967	6,234,198	4,886,828
Attributable to:					
Equity holders of the Bank		5,570,339	4,463,967	6,148,841	4,786,770
Minority interest		-	-	85,357	100,058
PROFIT FOR THE YEAR		5,570,339	4,463,967	6,234,198	4,886,828
BASIC EARNINGS PER SHARE (Rs)	21	15.08	12.56	16.64	13.47
DILUTED EARNINGS PER SHARE (Rs)	21	14.97	12.50	16.53	13.41
DIVIDEND PER SHARE (Rs)		*7.50	7.00	*7.50	7.00

The Notes to the Financial Statements from pages 179 to 264 form an integral part of these Financial Statements.

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

BALANCE SHEET

As at 31st December	Note	BANK		GROUP	
		2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
ASSETS					
Cash and cash equivalents	22	14,741,947	18,005,640	15,661,521	18,506,511
Statutory deposit with Central Banks	23	18,683,405	12,491,644	18,698,197	12,506,052
Government treasury bills		-	-	544,821	976,447
Dealing securities	24	1,142,064	1,457,502	1,867,368	2,504,283
Securities purchased under re-sale agreements		781,193	1,185,831	2,929,866	2,713,591
Non-current assets held for sale	25	-	-	2,875	2,875
Bills of exchange	26	959,012	1,401,130	959,012	1,401,130
Commercial papers		24,986	158,963	87,537	212,045
Lease receivable within one year	27	7,138,715	4,630,492	7,138,715	4,630,492
Lease receivable after one year	27	16,785,652	8,816,761	16,785,652	8,816,761
Loans and advances	28	233,521,000	188,033,851	231,851,155	185,982,734
Investment securities	29	62,942,501	58,704,102	65,397,612	60,250,684
Investments in Associates	30	83,674	83,651	384,319	196,009
Investment in Joint Venture	31	655,000	655,000	-	-
Investments in Subsidiaries	32	2,357,285	2,179,086	-	-
Investment properties	33	349,374	353,563	169,028	173,595
Property, plant and equipment	34	7,847,808	7,473,947	14,802,569	14,535,778
Intangible assets	35	549,503	577,015	670,774	702,930
Other assets	36	9,587,469	7,786,083	10,634,841	9,226,858
Total Assets		378,150,588	313,994,261	388,585,862	323,338,775
LIABILITIES					
Deposits from customers	37	284,145,962	234,073,977	283,712,115	233,883,446
Dividends payable	38	168,080	49,558	169,876	51,121
Securities sold under re-purchase agreements		6,559,088	11,951,727	8,311,440	13,523,113
Borrowings	39	19,998,527	10,810,554	20,101,312	10,803,498
Current tax liabilities		1,679,787	3,127,622	1,750,987	3,258,984
Bills payable		1,404,158	1,305,161	1,404,158	1,305,161
Subordinated debentures	40	4,781,098	2,724,293	4,754,348	2,697,543
Insurance provision - Life	41	-	-	2,990,998	2,385,246
Insurance provision - General	42	-	-	924,262	730,658
Deferred tax liabilities	43	1,168,800	735,884	1,164,032	734,376
Other liabilities	44	21,157,225	21,941,718	22,136,341	23,398,928
Total Liabilities		341,062,725	286,720,494	347,419,869	292,772,074
EQUITY					
Stated capital	46	11,451,451	5,318,550	11,451,451	5,318,550
Statutory reserves		2,778,337	1,510,000	2,778,337	1,510,000
Retained earnings		4,448,089	4,420,248	4,961,367	4,355,024
Other reserves		18,409,986	16,024,969	21,182,541	18,794,535
Total equity attributable to equity holders of the Bank		37,087,863	27,273,767	40,373,696	29,978,109
Minority interest		-	-	792,297	588,592
Total Equity		37,087,863	27,273,767	41,165,993	30,566,701
Total Liabilities and Equity		378,150,588	313,994,261	388,585,862	323,338,775
Commitments and contingencies	47	152,589,043	124,170,550	152,589,043	124,170,550

The Notes to the Financial Statements from pages 179 to 264 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 and give a true and fair view of the state of affairs of Hatton National Bank PLC and the Group as at 31st December 2011 and the profits for the year then ended.



Ajantha de Vas Gunasekara
Chief Financial Officer

For and on behalf of the Board



Rajendra Theagarajah
Managing Director /
Chief Executive Officer

Colombo, Sri Lanka
21st February 2012



Ranee Jayamaha
Chairperson



Thushari Ranaweera
Assistant General Manager (Legal) /
Company Secretary

STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2011
BANK

	Stated Capital		Statutory Reserves		Other Reserves		Retained Earnings	Total
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Investment Fund Account	Capital Reserve	General Reserve		
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 31st December 2009	3,645,330	1,438,754	1,260,000	-	3,007,060	10,700,000	3,848,946	23,900,090
Final dividend for 2009	-	-	-	-	-	-	(1,179,807)	(1,179,807)
Deferred tax liability for revaluation reserve (Note 43 (a))	-	-	-	-	2,248	-	-	2,248
Impact on rate change (Note 43 (a))	-	-	-	-	15,661	-	-	15,661
Net profit for the year 2010	-	-	-	-	-	-	4,463,967	4,463,967
Interim dividend for 2010	-	-	-	-	-	-	(338,570)	(338,570)
Shares issued under ESOP	209,650	24,816	-	-	-	-	-	234,466
Dividend reversal (Note 38 (c))	-	-	-	-	-	-	175,712	175,712
Transfers during the year 2010	-	-	250,000	-	-	2,300,000	(2,550,000)	-
Balance as at 31st December 2010	3,854,980	1,463,570	1,510,000	-	3,024,969	13,000,000	4,420,248	27,273,767
Final dividend for 2010 (Note 38)	-	-	-	-	-	-	(1,310,975)	(1,310,975)
Deferred tax liability for revaluation reserve (Note 43 (a))	-	-	-	-	4,391	-	-	4,391
Net profit for the year 2011	-	-	-	-	-	-	5,570,339	5,570,339
Interim dividend for 2011 (Note 38)	-	-	-	-	-	-	(582,560)	(582,560)
Shares issued under ESOP	59,702	6,400	-	-	-	-	-	66,102
Rights issue and private placement	5,228,644	838,155	-	-	-	-	-	6,066,799
Transfers of revaluation reserve for disposal of PPE (Note 34 (a))	-	-	-	-	(19,374)	-	19,374	-
Transfers during the year 2011	-	-	290,000	978,337	-	2,400,000	(3,668,337)	-
Balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	3,009,986	15,400,000	4,448,089	37,087,863

GROUP

	Attributable to Equity Holders of the Bank									
	Stated Capital		Statutory Reserves		Other Reserves			Retained Earnings	Minority Interest	Total
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Investment Fund Account	Capital Reserve	General Reserve	Exchange Equalisation Reserve			
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 31st December 2009	3,645,330	1,438,754	1,260,000	-	5,773,882	10,700,000	5,505	3,550,268	399,869	26,773,608
Final dividend for 2009	-	-	-	-	-	-	-	(1,179,807)	(30,158)	(1,209,965)
Deferred tax liability for revaluation reserve [Note 43 (a)]	-	-	-	-	2,248	-	-	-	-	2,248
Impact on rate change [Note 43 (a)]	-	-	-	-	15,661	-	-	-	-	15,661
Exchange loss on translation of Financial Statements of foreign operations	-	-	-	-	-	-	(2,761)	-	(1,905)	(4,666)
Minority interest on additional investment in Subsidiaries through Joint Venture	-	-	-	-	-	-	-	-	22,974	22,974
Reduction in reserves from disposal of Associate company and long term investment to Joint Venture	-	-	-	-	-	-	-	(88,637)	-	(88,637)
Acquisition of minority interest in Subsidiary by Bank	-	-	-	-	-	-	-	(712)	712	-
Minority interest as at the date of acquisition of Subsidiary through Joint Venture	-	-	-	-	-	-	-	-	97,042	97,042
Net profit for the year 2010	-	-	-	-	-	-	-	4,786,770	100,058	4,886,828
Interim dividend for 2010	-	-	-	-	-	-	-	(338,570)	-	(338,570)
Shares issued under ESOP	209,650	24,816	-	-	-	-	-	-	-	234,466
Dividend reversal [Note 38 (c)]	-	-	-	-	-	-	-	175,712	-	175,712
Transfers during the year 2010	-	-	250,000	-	-	2,300,000	-	(2,550,000)	-	-
Balance as at 31st December 2010	3,854,980	1,463,570	1,510,000	-	5,791,791	13,000,000	2,744	4,355,024	588,592	30,566,701
Final dividend for 2010	-	-	-	-	-	-	-	(1,310,975)	(39,205)	(1,350,180)
Deferred tax liability for revaluation reserve [Note 43 (a)]	-	-	-	-	4,391	-	-	-	-	4,391
Exchange gain on translation of Financial Statements of foreign operations	-	-	-	-	-	-	2,989	-	1,303	4,292
Net profit for the year 2011	-	-	-	-	-	-	-	6,148,841	85,357	6,234,198
Interim dividend for 2011	-	-	-	-	-	-	-	(582,560)	-	(582,560)
Shares issued under ESOP	59,702	6,400	-	-	-	-	-	-	-	66,102
Rights issue and private placement	5,228,644	838,155	-	-	-	-	-	-	156,250	6,223,049
Transfer of revaluation reserve for disposal of PPE [Note 34 (a)]	-	-	-	-	(19,374)	-	-	19,374	-	-
Transfers during the year 2011	-	-	290,000	978,337	-	2,400,000	-	(3,668,337)	-	-
Balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	5,776,808	15,400,000	5,733	4,961,367	792,297	41,165,993

The Notes to the Financial Statements from page 179 to 264 form an integral part of these Financial Statements.

In accordance with Section 58 of Companies Act No 7 of 2007, Share Capital and Share Premium have been classified as Stated Capital.

Statutory Reserve Fund represents the statutory requirement in terms of Section 20 (1) and (2) of the Banking Act No 30 of 1988.

Capital Reserve relates to revaluation of freehold land and buildings carried out in 1989, 1993 and 2007 and includes the surplus on revaluation of those assets.

General Reserve comprises the amounts appropriated by the Board of Directors as a general banking reserve.

Exchange equalisation reserve consists of foreign exchange differences resulting from translation of foreign Subsidiary and Associate financial statements to functional currency of the Group (Sri Lankan Rupees).

Investment Fund Account consist of 8% of the profits calculated for the payment of Value Added Tax and 5% of the Profit Before Tax calculated for payment of Income Tax purposes during the year.

Voting and Non-voting shares included under stated capital include share premium on shares issued of Rs 1,730 Mn and Rs 974 Mn respectively.

CASH FLOW STATEMENT

For the year ended 31st December	BANK		GROUP	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Cash Flows from Operating Activities				
Interest and commission receipts	32,159,829	28,640,224	32,631,563	29,102,540
Interest payments	(14,224,011)	(15,894,274)	(14,315,333)	(15,967,635)
Cash receipts from other operating activities	1,085,225	1,080,673	3,538,505	3,000,822
Cash payments to employees	(5,755,443)	(5,569,257)	(6,281,655)	(5,999,849)
Cash payments to suppliers	(2,308,727)	(2,155,209)	(2,027,410)	(1,840,568)
Recovery of loans written off in prior years	4,071	6,549	4,071	6,549
Cash payments to other operating activities	(6,869,825)	(3,166,029)	(7,980,888)	(4,130,923)
Operating Profit before Changes in Operating Assets and Liabilities [Note (a)]	4,091,119	2,942,677	5,568,853	4,170,936
Increase in Operating Assets				
Commercial papers and reverse repos	538,615	(635,696)	(42,062)	(1,354,410)
Deposits held for regulatory or monetary control purpose	(6,191,761)	(1,427,696)	(6,191,761)	(1,427,696)
Loans and advances	(54,828,705)	(33,303,019)	(55,209,976)	(33,936,494)
Other short term assets	(1,334,423)	(1,257,812)	(1,286,384)	(1,397,764)
	(61,816,274)	(36,624,223)	(62,730,183)	(38,116,364)
Increase in Operating Liabilities				
Deposits from customers	49,541,869	23,430,674	49,298,553	23,383,803
Negotiable certificates of deposits	530,116	136,498	530,116	136,498
Other liabilities	(507,767)	1,332,947	(697,363)	1,700,720
	49,564,218	24,900,119	49,131,306	25,221,021
Net Cash Used in Operating Activities before Income Tax	(8,160,937)	(8,781,427)	(8,030,024)	(8,724,407)
Income taxes paid	(2,645,086)	(1,807,700)	(2,725,564)	(1,814,307)
Net Cash Used in Operating Activities	(10,806,023)	(10,589,127)	(10,755,588)	(10,538,714)
Cash Flows from Investing Activities				
Dividend receipts	399,486	216,556	397,552	205,806
Net (purchase) / sale of dealing securities	169,479	(640,338)	509,214	(216,052)
Net purchase of investment securities	(1,661,402)	(1,352,171)	(2,015,516)	(1,431,652)
Improvements to investment properties	(395)	(7,247)	-	(5,496)
Purchase of property, plant and equipment	(1,231,520)	(977,446)	(1,281,298)	(1,033,680)
Purchase of intangible assets	(90,736)	(68,183)	(100,742)	(100,105)
Investment in Associate company	-	-	(199,661)	(48,500)
Investment in Subsidiary company	(234,320)	-	-	-
Net proceeds from sale of Associate company	-	179,907	-	89,954
Investment in Joint Venture company	-	(405,000)	-	-
Net cash effect on investment / increase percentage held in Subsidiary company by Joint Venture [Note (b) i and (b) ii]	-	-	-	(416,086)
Proceeds from sale of property, plant and equipment	84,388	6,077	90,044	7,835
Net Cash Used in Investing Activities	(2,565,020)	(3,047,845)	(2,600,407)	(2,947,976)
Cash Flows from Financing Activities				
Increase in debentures	2,000,000	-	2,000,000	-
Net increase of other borrowings	3,795,333	5,767,154	4,086,139	5,677,415
Dividends paid	(1,775,013)	(1,508,714)	(1,813,985)	(1,537,309)
Proceeds from rights issue and private placement	6,066,799	-	6,066,799	-
Proceeds from issue of shares under ESOP	66,102	234,466	66,102	234,466
Share issue expenses	(45,871)	(2,542)	(50,300)	(2,542)
Proceeds from issue of shares to minority share holders	-	-	156,250	22,974
Net Cash Generated from Financing Activities	10,107,350	4,490,364	10,511,005	4,395,004
Net decrease in cash and cash equivalents	(3,263,693)	(9,146,608)	(2,844,990)	(9,091,686)
Cash and cash equivalents at the beginning of the year	18,005,640	27,152,248	18,506,511	27,598,197
Cash and Cash Equivalents at the end of the Year (Note 22)	14,741,947	18,005,640	15,661,521	18,506,511

For the year ended 31st December	BANK		GROUP	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Note (a) Reconciliation of Operating Profit				
Profit before taxation	7,767,602	6,731,451	8,482,813	7,251,667
Dividend income	(409,440)	(209,762)	(407,506)	(199,012)
Profit on sale of property, plant and equipment	(19,062)	(4,674)	(17,309)	(5,691)
Bad debts recovered	(528,879)	(421,433)	(528,879)	(421,433)
Depreciation of investment properties	4,584	4,444	4,567	4,456
Depreciation of property, plant and equipment	737,630	657,360	889,494	806,143
Amortisation of intangible assets	172,914	168,761	185,624	179,997
Loans written off	2,005	274	2,005	274
Provision charge / (released) for loan losses	(164,562)	481,309	(164,562)	481,309
Diminution in value of investment securities / Subsidiary	202,031	8,025	145,910	1,088
(Gain) / loss from dealing securities	185,069	(114,604)	194,803	(184,654)
Capital gain from sale of investment securities	(444)	(101,710)	(1,482)	(63,186)
Capital gain from sale of Associate company	-	(47,581)	-	(23,791)
Capital gain from sale of investment securities transferred to dealing securities	-	(497,114)	-	(497,114)
(Profit) / Loss on FCBU revaluation	18,234	(29,902)	18,234	(29,902)
Property, plant and equipment written off	-	20,717	-	20,775
Share issue expenses	45,871	2,542	50,300	2,542
Discount accrual on government securities	(2,763,420)	(3,454,466)	(2,911,664)	(3,540,277)
Share of loss of Associates (net of income tax)	-	-	15,729	2,429
Non life insurance reserve fund	-	-	799,356	663,027
Notional tax and withholding tax credit	(325,101)	(438,856)	(359,397)	(476,242)
Accrual for interest receivable	(624,310)	201,261	(674,399)	164,847
Accrual for other receivable	(58,851)	(19,388)	(61,987)	(791)
Accrual for interest payable	2,521,442	(1,191,018)	2,526,704	(1,190,479)
Accrual for other payable	(2,672,194)	1,197,041	(2,546,530)	1,232,234
Negative goodwill recognised on investment in Subsidiaries	-	-	(2,213)	(7,280)
Net income from sale of apartments	-	-	(70,758)	-
Operating Profit before Changes in Operating Assets and Liabilities	4,091,119	2,942,677	5,568,853	4,170,936
				2010 Rs 000
Note (b) Net Cash Effect on Investment in Subsidiaries by Joint Venture Company				
Note (b) i Investment in Lanka Ventures PLC				
Property, plant and equipment				247
Reverse re-purchase agreements				5,043
Investment securities				139,890
Investment in Associates				47,645
Cash and cash equivalents				31,504
Commercial papers				10,961
Government securities				61,716
Other receivable				13,363
Other liabilities				(2,260)
Retirement benefit obligations				(571)
Minority interest				(18,128)
Net identifiable assets and liabilities				289,410
Goodwill on acquisition				70,187
Consideration paid in cash				(359,597)
Cash acquired				31,504
Net cash outflow				(328,093)

CASH FLOW STATEMENT

continued

	2010 Rs 000
Note (b) ii Increase in Percentage held in Acuity Securities Limited	
Property, plant and equipment	1,124
Intangible assets	266
Reverse re-purchase agreements	288,748
Cash and cash equivalents	355
Government securities	739,981
Loans and advances	2,246
Other receivable	14,842
Re-purchase agreements	(922,344)
Current tax liability	(21,308)
Deferred tax liability	(71)
Other liabilities	(8,211)
Net identifiable assets and liabilities	95,628
Negative goodwill on acquisition	(7,280)
Consideration paid in cash	(88,348)
Cash acquired	355
Net cash outflow	(87,993)

Comparative information in the Cash Flow Statement has been amended based on the reclassified figures.

The Notes to the Financial Statements from pages 179 to 264 form an integral part of these Financial Statements.

NOTES TO THE FINANCIAL STATEMENTS

1 REPORTING ENTITY

Hatton National Bank PLC ("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 regulated under the Banking Act No. 30 of 1988 and amendments thereto. The Company 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 Global Depository Receipts (GDRs) issued by the Bank had a primary listing on the Luxemburg Stock Exchange up to 1st December 2011. These GDR holders had opted to convert them into underlying shares and the GDRs which represented those shares had been cancelled in December 2011.

The staff strength of the Bank as at 31st December 2011 was 4,584 (2010 : 4,352).

The Consolidated Financial Statements of the Bank for the year ended 31st December 2011 comprise the Bank and its Subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its Associate and Joint Venture. The Financial Statements of all companies in the Group have a common financial year which ends on December 31.

The Bank does not have an identifiable parent of its own.

There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

1.1 Principal Activities

1.1.1 Bank

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities etc.

1.1.2 Subsidiaries

Name of Subsidiary	Principal Activities
HNB Assurance PLC	Insurance services
Sithma Development (Pvt) Ltd	Property development
Majan Exchange LLC	Money transfer and foreign currency related services

The commercial activities of Commercial Interlink Services Inc were ceased on 1st October 2010.

1.1.3 Associate

Name of Associate	Principal Activities
Delma Exchange	Money transfer and foreign currency related services

1.1.4 Joint Venture

Name of Joint venture	Principal Activities
Acuity Partners (Pvt) Ltd	Operating as an investment company and providing financial services.

2 BASIS OF PREPARATION

2.1 Statement of Compliance

The Consolidated Financial Statements of the Group and the Separate Financial Statements of the Bank which comprise the Balance Sheet, Income Statement, Statement of Changes in Equity, Cash Flow Statement and Notes thereto have been prepared in accordance with the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka, and comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988 and amendments thereto.

2.2 Approval of Financial Statements by Directors

The Financial Statements were authorised for issue by the Board of Directors in accordance with the resolution of the directors on 21st February 2012.

2.3 Basis of Measurement

The Financial Statements have been prepared on the historical cost basis and applied consistently with no adjustments being made for inflationary factors affecting the Financial Statements, except for the following;

- Land and buildings are measured at cost at the time of acquisition and subsequently at revalued amounts, which are the fair values at the date of revaluation less accumulated depreciation and impairment losses, if any.
- Dealing securities are measured at market value.
- Non-current assets held for sale are measured at lower of its carrying amount and fair value less costs to sell.
- Liability for defined benefit obligations is recognised as the present value of the defined benefit obligation less the net total of the plan assets, plus unrecognised actuarial gains, less unrecognised past service cost and unrecognised actuarial losses.

NOTES TO THE FINANCIAL STATEMENTS

continued

2.4 Functional and Presentation Currency

The Financial Statements are presented in Sri Lankan Rupees, which is the Bank'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.

2.5 Use of Estimates and Judgements

The preparation of Financial Statements in conformity with Sri Lanka Accounting Standards requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant 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 are described in Notes 2.5.1 to 2.5.5.

2.5.1 Provision for Loan Losses

In addition to the specific provisions for possible loan losses made on the basis of continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23 "Revenue Recognition and Disclosures in the Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka, the Bank evaluates the need for additional provisions for loans and advances based upon Management's best estimate of recoverability. In estimating the recoverability the Management makes judgments about the borrower's financial situation, the workout strategy and the net realisable value of any underlying collateral.

The general provisions cover loan losses inherent in portfolios with similar credit risk characteristics (portfolios of pawning, lease receivables and Shanthy Housing loans). In assessing the need for general provision for loan losses, Management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required provisions, assumptions are made to define the way inherent losses are determined based on historical experience.

2.5.2 Classification of Dealing (Trading) and Investment Securities

In classifying securities as "Dealing" (Trading), the Bank has determined that it meets the description set out in Note 4.6.1.

In classifying securities as "Investment", the Bank has determined that it has both the positive intention and ability to hold the securities until their maturity date as described in Note 4.6.2.

2.5.3 Assessment of Impairment

The Bank assesses at each Balance Sheet date whether there is objective evidence that an asset or portfolio of assets is impaired. The recoverable amount of an asset or Cash Generating Unit (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 present value using appropriate discount rates that reflects the current market assessments of the time value of money and risks specific to the asset.

The carrying value of goodwill is reviewed at each Balance Sheet date and is written down to the extent that it is no longer supported by probable future benefits. Goodwill is allocated to the respective CGU for the purpose of impairment testing.

2.5.4 Employee Retirement Benefits

The liability in respect of employee retirement benefits of the Bank's Pension Fund which is a separate entity, as at Balance Sheet date was actuarially valued based on the assumptions set out in Note 45 (a) v. Bank makes contributions to the Pension Fund based on the actuarial valuation and the unfunded pension fund liability as at the Balance Sheet date as set out in Note 45 (a) i.

2.5.5 Classification of Investment Properties

Classification of Investment Properties is based on the description set out in Note 4.11.

3 MATERIALITY AND AGGREGATION

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.

4 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements. The accounting policies of the Bank have been consistently applied by the Group entities where applicable and deviations if any, have been disclosed accordingly.

4.1 Basis of Consolidation

4.1.1 Subsidiaries

Subsidiaries are entities that are controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights presently exercisable are taken into account. The Financial Statements of Subsidiaries are included in the Consolidated Financial Statements from the date that control effectively commences until the date that control effectively ceases.

The Minority Interest is presented in the Consolidated Balance Sheet within equity, separately from the equity attributable to the Equity Holders of the Bank. Minority Interest in the profit or loss of the Group is disclosed separately in the Consolidated Income Statement.

The Consolidated Financial Statements are prepared to common financial year end of 31st December. The accounting policies of Subsidiaries have been changed when ever necessary to align them with the policies adopted by the Bank.

Where Subsidiaries have been sold or acquired during the year, their operating results have been included to the date of disposal or from the date of acquisition.

Upon the loss of control, the Group derecognises the assets 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 Income Statement. If the Group retains any interest in the previous subsidiary, then carrying amount of the investment at the date that control is lost, would be regarded as the cost on initial measurement of a financial asset in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

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 have been incorporated in Sri Lanka except for Majan Exchange LLC in Oman.

A list of Subsidiaries within the Group is provided in Note 32.

4.1.2 Associate

Associate is an entity on which the Bank has significant influence, but no control over the financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. The Associate is accounted for using the

Equity method and is recognised initially at cost. The Bank's investments include goodwill identified on acquisition, net of any accumulated impairment losses. The Consolidated Financial Statements include the Bank's share of the income and expenses and equity movements of the Associate, after adjustments being made to align the accounting policies with those of the Group from the date that significant influence effectively commences until the date that significant influence effectively ceases.

When the Bank's share of losses exceeds its interest in the Associate, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that Bank has an obligation or made payments on behalf of the Associate. If the Associate subsequently reports profits, the Bank resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The Bank discontinues the use of the Equity method from the date that it ceases to have significant influence over an Associate and accounts for the investment in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

There are no significant restrictions on the ability of the Associate to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

Details of the Associate within the Group are provided in Note 30.

4.1.3 Joint Venture

Joint Venture is an entity over whose activities the Bank has joint control, established by contractual arrangement and requiring unanimous consent for strategic, financial and operating decisions. The Bank recognises its interest in the Joint Venture using the line by line reporting format for Proportionate Consolidation method and is recognised initially at cost.

The Bank combines its share of each of the assets, liabilities, income and expenses of the Joint Venture with similar items, line by line in the Consolidated Financial Statements from the date that joint control commences, until the date joint control ceases.

There are no significant restrictions on the ability of the Joint Venture to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

Details of the Joint Venture are provided in Note 31.

4.1.4 Transactions Eliminated on Consolidation

Intra-group balances and transactions, income, expenses and any unrealised gains arising from intra-group transactions and transactions with Joint Venture are eliminated in preparing the Consolidated Financial Statements.

NOTES TO THE FINANCIAL STATEMENTS

continued

Unrealised gains arising from transactions with Associates are eliminated to the extent of the Group's interest in the Associates against the investment in the Associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

4.1.5 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.

4.2 Foreign Currency Translation

4.2.1 Foreign Currency Transactions

Transactions in foreign currencies are translated to Sri Lankan Rupees at the middle rate of exchange ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. Foreign exchange differences arising on the settlement or resulting due to unrealised gains or losses from revaluation of the Bank's monetary items at rates different from those at which they were initially recognised in the financial statements, are recognised in the Income Statement in the period in which they arise.

Non-monetary assets and liabilities denominated in foreign currency that are stated at historical cost at the Balance Sheet date are translated to Sri Lankan Rupees at the foreign exchange rates ruling at the date of the initial transaction. Non-monetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value was determined.

4.2.2 Foreign Operations

The Financial Statements of foreign entities within the Group whose functional currency is different to presentation currency, (Sri Lankan Rupees) are translated to Sri Lankan Rupees as follows:

- Assets (including goodwill) and liabilities are translated at the middle rate of exchange at the date of Balance Sheet.
- Income and expenses are translated at the average exchange rate ruling during the period under consideration.
- All resulting foreign exchange differences are recognised directly in equity.

When a foreign operation is disposed of, the cumulative relevant exchange differences recognised in equity is transferred to Income Statement as part of the gain or loss on disposal.

4.2.3 Foreign Currency Banking Unit

The Income Statement and the Balance Sheet of the Foreign Currency Banking Unit is translated to Sri Lankan Rupees at the middle rate of exchange ruling at the Balance Sheet date.

4.2.4 Forward Exchange Contracts

Forward exchange contracts are valued at the forward market rates ruling on the date of the Balance Sheet. Resulting net unrealised gains and losses are dealt with through the Income Statement.

ASSETS AND BASES OF THEIR VALUATION

4.3 Cash and Cash Equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances with Central Banks, balances with banks, placements with banks, money at call and short notice. They are brought to account at the face value or the gross value where appropriate.

4.4 Statutory Deposit with Central Banks

The Monetary Law Act requires that all Commercial Banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lankan Rupees. The licensing regulations for Exchange Houses issued by the Central Bank of Oman require that all Exchange Houses maintain a deposit with the Central Bank of Oman.

The details of reserve requirements are given in Note 23.

4.5 Government of Sri Lanka Treasury Bills and Bonds

4.5.1 Investment in Treasury Bills and Treasury Bonds Held for Dealing

Investments in treasury bills and treasury bonds in dealing portfolio are those investments that the Group acquires or incurs principally for the purpose of selling, or holds as part of a portfolio that is managed for short term profit. These investments are initially recognised and subsequently measured at market value in the Balance Sheet. Gains and losses on marked to market valuation are dealt with through the Income Statement.

4.5.2 Securities Purchased under Re-sale Agreements

Securities purchased under re-sale agreements are recorded separately in the Financial Statements at cost. The difference between the purchase and re-sale price represents interest income and is recognised in the Income Statement over the period of the resale agreement.

4.6 Investments

An investment is an asset held by the Bank / Group for the accretion of wealth through distribution (such as interest, royalties, dividends and rentals (other than leases)) for capital appreciation or for other benefits to the Bank / Group such as those obtained through trading relationships.

4.6.1 Dealing (Trading) Securities

Dealing (trading) securities are those investments that are acquired or incurred principally for the purpose of selling or holding as part of a portfolio that is managed for short term profit. These investments are initially recognised at cost and subsequently measured at market value. Gains and losses on marked to market valuations are dealt with through the Income Statement.

The Bank's Subsidiary HNB Assurance PLC measures dealing securities at cost or market value whichever is lower.

4.6.2 Investment Securities

These are securities which are acquired and held for yield or capital growth in the medium / long term with the positive intent and ability to hold until maturity. Such securities are recorded at cost. Interest and dividend income are accrued. Changes in market values of these securities are not taken into account, unless there is considered to be a diminution in value which is other than temporary.

Investments in treasury bills / bonds in the investment portfolio are initially measured at market value of bills / bonds at the date of purchase and the discount / premium accrued thereon.

On disposal of an investment the difference between net disposal proceeds and the carrying amount is recognised as income or expense.

Sale of more than insignificant amount of investment securities would result in reclassification of all such securities as "Trading Securities". However, sales and reclassification in any of the following circumstances would not trigger a reclassification:

- Sale or reclassification that are so close to maturity that changes in the market rate of interest would not have a significant effect on the securities' market value
- Sale or reclassification after the Bank has collected substantially all of the securities' original principal
- Sale or reclassification attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

4.6.3 Investments in Subsidiaries

Investments in Subsidiaries are stated at cost in the Bank's Financial Statements.

4.6.4 Investment in Associate

Investment in Associate is accounted for at cost in the Bank's Financial Statements and under the Equity method in the Consolidated Financial Statements.

Under the Equity method, the investment in Associate is initially accounted for at cost and the carrying amount is adjusted for post acquisition changes in the Bank's share of net assets of the Associate, less any impairment in the Bank's net investment in Associate.

4.6.5 Investment in Joint Venture

Investment in Joint Venture is accounted for at cost in the Bank's Financial Statements and under the Proportionate Consolidation method in the Consolidated Financial Statements.

4.7 Non-current Assets Held for Sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "Held for Sale" once identified that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. These are assets which are available for immediate sale in their present condition, subject to only the terms that are usual and customary for sale of such assets and their sale is highly probable.

"Non-Current Assets Held for Sale" are presented separately on the face of the Balance Sheet at the lower of its carrying amount and fair value less costs to sell.

Assets classified as "Non-Current Assets Held for Sale" are neither amortised nor depreciated.

Impairment losses on initial classification as held for sale and subsequent gains and losses on re-measurement are recognised in the Income Statement.

4.8 Loans and Advances to Customers

Loans and advances to customers are stated in the Balance Sheet at the recoverable amount represented by the gross value of the outstanding balance adjusted for provision of loan losses and interest in suspense (interest which is not accrued to revenue).

4.8.1 Non Performing Loans and Advances

The loans and advances are classified as Non Performing Advances (NPA) based on the criteria set out in Direction No 3 of 2008 dated 8th May 2008, as amended by the

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direction No 6 of 2009, issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning". Details of the criteria referred to above are given in Note 28 (c)

Provision for possible loan losses are made on the basis of a continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial Statements of the Banks" and the Directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank.

4.8.2 Foreclosed Properties

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances up to 2001 and are yet to be disposed. From 2001 onwards this practice was discontinued whereby loans and advances in satisfaction of which properties are acquired, continue to be classified as non-performing loans and advances. These are accounted for at the lower of cost or forced sale value on an individual property basis. The shortfall between the prevailing forced sale value of the property and the related loan outstanding is recognised as a provision for loan losses in the Income Statement during the year of acquiring the said property in satisfaction of the loan. Any shortfall between the carrying amount of these properties and their respective forced sale values identified subsequently is charged as a provision for loan losses in the Income Statement. Subsequent recoveries on the disposal of the said properties are treated as provisions written back and any shortfall between capital outstanding and amount recovered if not provided is charged to the Income Statement. These properties are recorded under loans and advances until those are disposed off. Any subsequent expenditure on these properties are capitalised and provisions are made for such subsequent additions.

4.8.3 Provision for Loan Losses

4.8.3 (a) Specific Provisions for Loan Losses are Made as Follows:

In accordance with the Direction No 3 of 2008 dated 8th May 2008 issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning" specific provisions on NPA are made as follows.

Category of NPA Credit Facilities	Minimum Specific Provision Requirement
Substandard	
Credit Cards	25%
Other Advances	20%
Doubtful	50%
Loss	100%

The criteria for categorisation of advances within non performing lending portfolio is given in Note 28 (c) ii.

The provision made relates to all categories of loans and advances including pawning and leasing identified as substandard, doubtful and loss.

Where necessary, specific provisions have been made over and above the minimum percentages stipulated above, on a case by case basis.

4.8.3 (b) General Provision

The amount of potential losses not specifically identified but which experience indicates are present in the portfolio of pawning, lease receivables and Shanthi housing loans are recognised as a general provision in the Income Statement. Accordingly, a general provision of 0.1% of the total portfolio of pawning facilities, 2% of the lease receivables (net of specific provision) and 0.2% of the total portfolio of Shanthi housing loans are made in the Income Statement.

Based on the Direction issued on 8th May 2008 by the Monetary Board of Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning" all Licensed Commercial Banks maintained a general provision of 1% of the total on balance sheet performing loans and advances and on balance sheet overdue loans and advances net of interest in suspense and credit facilities secured by cash deposits, gold or government securities with the same bank till 30th September 2010.

This requirement was amended by the Direction No 3 of 2010 issued by the Monetary Board of the Central Bank of Sri Lanka on 27th September 2010 in terms of Section 46(1) and 46A of the Banking Act No 30 of 1988, as amended, by "Amendments to Directions on Classification of Loans and Advances, Income Recognition and Provisioning for Licensed Commercial Banks in Sri Lanka". The above Direction requires all Licensed Commercial Banks to maintain general provision at 0.5% of the total outstanding of on balance sheet performing loans and advances and on balance sheet overdue loans and advances net of interest in suspense and credit facilities secured by cash deposits, gold or government securities with the same bank commencing from 1st January 2012. For this purpose banks reduced the general provision requirement of 1% to 0.5% at a rate of 0.1% per quarter during the five quarters commencing 1st October 2010.

Accordingly, general provision was maintained at 0.5% as at 31st December 2011.

4.8.4 Revenue Recognition on Non-Performing Loans

When an advance is classified as non performing, based on criteria set out in Direction No 3 of 2008 dated 8th May 2008, as amended by Direction No 6 of 2009 issued by the Central Bank of Sri Lanka on "Classification of Loans and

Advances, Income Recognition and Provisioning” as explained in Note 28 (c), interest ceases to be accrued and is taken to income thereafter on cash basis.

4.8.5 Write-Off Policy

The Bank writes off a loan (net of any related loan loss provisions), when it determines that the loan is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower’s financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

4.9 Finance Leases

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 included under “Lease Receivable”. Leasing balances are stated in the Balance Sheet after deduction of initial rentals received, unearned lease income and the provisions for rentals doubtful of recovery.

4.9.1 Provision for Lease Receivables

Specific provision has been made in relation to identified non performing leases as stated above in Note 4.8.3 (a). In addition, a general provision has been made as stated above in Note 4.8.3 (b).

4.10 Intangible Assets

An intangible asset is an identifiable non monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.

4.10.1 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 entity and the cost of the assets can be measured reliably. An intangible asset is initially measured at cost.

4.10.1 (a) Goodwill

Goodwill arising on the acquisition represents the excess of the cost of acquisition over the Group’s interest in the net fair value of the acquiree’s identifiable assets, liabilities and contingent liabilities at the date of acquisition. Goodwill is not amortised, instead it is tested for impairment annually and assessed for any indication of impairment at each reporting date to ensure that its carrying amount does not exceed its recoverable amount.

If an impairment loss is identified, it will be recognised immediately in the Income Statement.

The negative goodwill is recognised immediately in the Income Statement.

4.10.1 (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 they will lead to future economic benefits, are included in the Balance Sheet under the category intangible assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

4.10.2 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.

4.10.3 Amortisation

Intangible assets, except for goodwill, are amortised on a straight line basis in the Income Statement from the date when the asset is available for use, over the best estimate of its useful economic life based on a pattern in which the asset’s economic benefits are consumed by the Bank. The estimated useful life of software is six years. Expenditure on an intangible item that was initially recognised as an expense by the Bank in previous Annual Financial Statements or Interim Financial Reports are not recognised as part of the cost of an intangible asset at a later date.

4.10.4 Retirement and Disposal

An intangible asset is derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal.

4.11 Investment Properties

Investment properties are properties held either to earn rental income or for capital appreciation or both but not for sale in the ordinary course of business, used in the production or supply of goods or services or for administrative purposes.

4.11.1 Basis of Recognition

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.

4.11.2 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 complete.

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The Group applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard 40 (Revised 2005) "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 losses.

4.11.3 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.

Hatton National Bank PLC

Freehold buildings

(Refer Note 33 (a)) 2.5% per annum

Sithma Development (Pvt) Ltd*

Freehold buildings (Smart building)

(Refer Note 33 (b)) 2.5% per annum

Plant, machinery and equipment

integral to freehold buildings

referred to above 20% per annum

* Sithma Development (Pvt) Ltd

The HNB towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. However, the ancillary services provided by Sithma Development (Pvt) Ltd to the occupants of HNB towers is a significant component of the arrangement as a whole. Therefore, HNB towers is not classified as investment property in the financial statements of Sithma, but has been classified under property, plant and equipment in accordance with Sri Lanka Accounting Standard 40 (Revised 2005) "Investment Property".

4.11.4 Derecognition

Investment properties are derecognised when disposed of, or permanently withdrawn from use because no future economic benefits are expected. Transfers are made to and from investment properties only when there is a change in use.

4.12 Property, Plant and Equipment

Property, plant and equipment are tangible items that are held for servicing, or for administrative purposes and are expected to be used during more than one period.

4.12.1 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.

4.12.2 Measurement

An item of property, plant and equipment that qualifies for recognition as an asset is initially measured at its cost. Cost includes expenditure that is directly attributable to the acquisition of the asset and cost incurred subsequently to add to, replace part of, or service it. The cost of self constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of computer equipment.

4.12.3 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.

4.12.4 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 losses. Freehold land and buildings of the Group are revalued every five to seven years to ensure that the carrying amounts do not differ materially from the fair values at the Balance Sheet date. On revaluation of an asset, any increase in the carrying amount is credited directly to equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to the Income Statement. 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 Income Statement or debited directly to equity under revaluation reserve to the extent of any credit balance existing in the capital reserve in respect of that asset. 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.

4.12.5 Reclassification to investment property

When the use of property changes from owner-occupied to investment property, the property is remeasured to fair value and reclassified as investment property. Any gain arising on remeasurement is recognised in 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 Income Statement.

4.12.6 Subsequent Costs

The cost of replacing part 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 Income Statement as incurred. Costs incurred in using or redeploying an item are not included under carrying amount of an item.

4.12.7 Derecognition

The carrying amount of an item of property, plant and equipment is derecognised 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 is included in Income Statement when the item is derecognised.

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 derecognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is derecognised.

4.12.8 Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal, 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 Bank of the different types of assets, except for which are 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 derecognised. 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)

	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	16.7
Office equipment	20
Furniture and fittings	10
Fixtures	10
Civil works (Majan Exchange LLC)	10
Improvements to	
leasehold buildings	lower of asset life or over the lease period

Depreciation is not provided for freehold land.

Sithma Development (Pvt) Ltd

	% per annum
Freehold buildings - Sithma building	1
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

4.12.9 Capital Work-in-Progress

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation. Capital work-in-progress would be transferred to the relevant asset when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Capital work-in-progress is stated at cost less any accumulated impairment losses.

4.13 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 20 "Borrowing Costs". Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

4.14 Impairment

4.14.1 Financial Assets

The Group assesses at each Balance Sheet date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred if and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the Balance Sheet date ("a loss event"), and that loss event or events have had an impact on the estimated realisable value of the asset.

The Group first assesses whether objective evidence of impairment exists for financial assets that are significant (except for loans and advance explained below).

For loans and advances, impairment loss is measured individually and collectively as explained in Note 4.8.3. When a loan is uncollectible, it is written off against the related

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provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of the amounts previously written off are included under "Other Income" in the Income Statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the impairment provision account. The amount of the reversal is recognised in the Income Statement.

4.14.2 Non Financial Assets

Tangible and intangible assets (excluding deferred tax assets which are explained in Note 4.28.2) are written down to recoverable amount where their carrying value exceeds recoverable amounts.

The carrying values of property, plant and equipment are reviewed for impairment annually or when events or changes in circumstances indicate that the carrying value may not be recoverable. If such indications exist and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. Impairment losses are recognised in the Income Statement unless it reverses a previous revaluation surplus for the same asset.

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. Any decrease in the carrying value is recognised as an expense in the Income Statement in the reporting period in which the impairment loss occurs.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to establish cash generating units. Each of these cash generating units is represented by an individual primary reporting segment, or a subdivision of a primary segment.

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 balance sheet 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 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.

LIABILITIES AND PROVISIONS

4.15 Deposits from Customers

Deposits include non interest bearing deposits, savings deposits, term deposits, deposits redeemable at call and certificates of deposit. They are brought to account at the gross value of the outstanding balance. Interest paid is charged to the Income Statement.

4.16 Deposit Insurance Scheme

In terms of the Banking Act Direction No 5 of 2010 "Insurance of Deposit Liabilities" issued on 27th September 2010 and subsequent amendments thereto all Licensed Commercial Banks are required to insure their deposit liabilities with the Deposit Insurance Scheme operated by the Monetary Board in terms of Sri Lanka Deposit Insurance Scheme Regulations No 1 of 2010 issued under Sections 32A to 32E of the Monetary Law Act with effect from 1st October 2010. Deposits to be insured include demand, time and savings deposit liabilities and exclude the following.

- deposit liabilities to member institutions
- deposit liabilities to Government of Sri Lanka
- deposit liabilities to directors, key management personnel and other related parties as defined in Banking Act Direction No 11 of 2007 on Corporate Governance of Licensed Commercial Banks
- deposit liabilities held as collateral against any accommodation granted
- deposit liabilities falling within the meaning of abandoned property in terms of the Banking Act and dormant deposits in terms of the Finance Companies Act funds of which have been transferred to Central Bank of Sri Lanka

Banks are required to pay a premium of 0.10% on eligible deposit liabilities if the bank maintains a capital adequacy ratio of 14% or above as at the end of the immediately preceding financial year and a premium of 0.125% on eligible deposit liabilities for all other Licensed Commercial Banks calculated on the total amount of eligible deposits as at the end of the quarter within a period of 15 days from the end of the quarter.

4.17 Dividends Payable

Provision for dividends is recognised at the time the dividend recommended and declared by the Board of Directors is approved by the Shareholders.

4.18 Borrowings

Borrowings include refinance borrowings, call and time deposits, vostro balances and borrowings from financial institutions. They are brought to account at the gross value of the outstanding balance.

4.19 Securities Sold under Re-purchase Agreement

Securities sold under agreements to re-purchase are recorded separately in the Financial Statements. The difference between the sale and the re-purchase price represents interest expense, which is recognised in the Income Statement over the period of the re-purchase agreement.

4.20 Bills Payable and Other Liabilities

Bills payable and other liabilities include all financial liabilities, interest, fees, expenses payable and securities purchased but not delivered. These liabilities are recorded at the cash value to be realised when settled.

4.21 Employee Benefits

4.21.1 Defined Benefit Plan

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

4.21.1 (a) Pension Fund

The Bank operates an approved Pension Fund to facilitate the following payments for permanent staff of the Bank:

- a) Pensions to retiring staff
- b) Benefits to staff who opted for the optional scheme for pension introduced in 2005
- c) Gratuity
The gratuity would be the payments to staff who satisfy the criteria as per the Gratuity Act at the time of leaving the services of the Bank without pension rights

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 and past service cost not yet recognised. The value of any defined benefit asset is restricted to the sum of any past service cost not yet recognised and 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. 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 which is the method recommended by Sri Lanka Accounting Standard 16 (Revised 2006) "Employee Benefits" (SLAS 16).

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in the Income Statement on a straight line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in Income Statement.

To determine the net amount in the statement of financial position, any actuarial gains and losses that have not been recognised because of application of the 'corridor' approach described below are added or deducted as appropriate and unrecognised past service costs are deducted.

The Bank recognises a portion of actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan in the Income Statement over the expected average remaining working lives of the employees participating in the plan. The portion is determined as the extent to which any cumulative unrecognised actuarial gain or loss at the end of the previous reporting period exceeds 10 percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets (the corridor). Otherwise, the actuarial gains and losses are not recognised.

Monthly provision is made by the Bank to the Pension Fund, based on a percentage of the gross salary of employees. The percentage of contributions are determined by the same actuary and retirement benefits are provided to all permanent staff. The Bank carries out an actuarial valuation of the Pension Fund in December each year to ascertain the full liability of the fund. The valuation method used by the actuary to value the fund is the Projected Unit Credit method, the method recommended by SLAS 16.

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 Subsidiaries do not operate pension funds.

Transitional provisions applied on first time adopting of Sri Lanka Accounting Standard 16 - (Revised 2006) "Employee Benefits" on 1st January 2008

On first adopting the standard, the Bank determined its transitional liability for defined benefit plans as at 1st January 2008. As the transitional liability was more than the liability that would have been recognised on 1st January 2008 under the entity's previous accounting policy, the Bank made an irrevocable choice to recognise that increase in its defined benefit liability, as an expense on a straight line basis over a period of five years from 1st January 2008.

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4.21.1 (b) 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.

The actuarial valuation of the Widows', Widowers' and Orphans' Pension Scheme is carried out by the same actuary who carried out the actuarial valuation of the Pension Fund using the same method and same assumptions detailed in Note 4.21.1 (a) above.

4.21.1 (c) Majan Exchange LLC

The Company's obligation in respect of non-Omani terminal benefits which is an unfunded defined benefit retirement plan, is made in accordance with Omani Labour Laws and is calculated by estimating the amount of future benefit that such employees have earned in return for their service in the current and prior periods. The obligation is calculated using the Projected Unit Credit method and is discounted to its present value.

4.21.2 Defined Contribution Plans

A defined contribution plan is a post employment plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay a further amount. Obligations for contributions to defined contribution plans are recognised as expense in the Income Statement as and when they are due.

4.21.2 (a) Employees' Provident Fund

The Bank and employees contribute 12% and 8% respectively on the salary of each employee to the approved private Provident Fund while the Group entities and their employees contribute the same percentages to Employees' Provident Fund.

4.21.2 (b) Employees' Trust Fund

The Bank / Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

4.21.2 (c) Majan Exchange LLC

In respect of Majan Exchange LLC, contributions to a defined contribution retirement plan for Omani employees in accordance with the Omani Social Insurance Scheme are recognised as expense in the Income Statement as and when they are due.

4.21.3 Gratuities

No 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

gratuity of all permanent employees through its own non-contributory pension scheme which is in force.

Based on the Sri Lanka Accounting Standard 16 (Revised 2006) - "Employee Benefits" which became effective from financial years commencing after 1st July 2007, the Subsidiaries other than HNB Assurance PLC have adopted the Gratuity Formula method while HNB Assurance PLC continues to apply the Actuarial Valuation method. Accordingly provisions have been made based on the above methods.

The gratuity liabilities are not externally funded.

4.21.4 Employee Share Benefit Trust

The Employee Share Benefit Trust introduced in 2005 offered shares to executive and high rank officers of the Bank. The shares allotted to the respective employee under the plan would remain within the plan while the beneficial interest will be with the employee. At the time the employee leaves the Bank the difference between the issue price and the market price is paid to the employee. Therefore the said Employee Share Benefit Trust has no potential dilutive effect on the earnings per share of the Bank.

4.21.5 Employee Share Option Plan

At the Annual General Meeting held on 28th March 2008 a resolution was passed to formulate an Employee Share Option Plan (ESOP) apart from the Employee Share Benefit Trust enabling the staff in the management rank and above of the Bank to take part in the voting and non-voting ordinary shares of the Bank. The total number of share options available to the eligible employees per year will be 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 will accrue to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

An eligible employee will qualify to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options to be granted to each qualified eligible employee will depend on his / her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings per share of the Bank.

Details of share options are given in Note 46 (c) and (d).

4.22 Investment Fund Account

As proposed in the budget proposals of 2011 every person or partnership who is in the business of banking or financial services is required to establish and operate an Investment Fund Account.

As and when taxes are paid after 1st January 2011 Licensed Commercial Banks are required to transfer the funds to the Investment Fund Account and build a permanent fund in the bank as explained below.

- 8% of the profits calculated for the payment of Value Added Tax (VAT) on financial services on dates as specified in the VAT Act for payment of VAT
- 5% of the profit before tax calculated for payment of income tax purposes on dates specified in Section 113 of the Inland Revenue Act for the self-assessment payments of tax

Licensed Commercial Banks shall utilise the funds in the Investment Fund Account in the following manner.

- Invest in long term government securities and/or bonds with maturities not less than seven years
- Lend on maturities not less than five years at interest rates not exceeding 5 year treasury bond rates plus 2%
- Lend for the following purposes:
 - I. Long term loans for cultivation of plantation crops/ agriculture crops including fruits, vegetables, cocoa and spices and for livestock and fisheries
 - II. Factory/mills modernisation/establishment/expansion
 - III. Small and medium enterprises
Loans up to Rs 200 Mn to enterprises with annual turnover less than Rs 600 Mn
 - IV. Information technology related activities and business process outsourcing
 - V. Infrastructure development
 - VI. Education – vocational training and tertiary education
 - VII. Housing up to Rs 2 Mn per customer for construction of a house for residential purposes
 - VIII. Construction of hotels and for related purposes
 - IX. Restructuring of loans extended for the above purposes

4.23 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

Provisions for non performing loans and advances are made as set out in Note 4.8.3

4.24 Operational Risk Events

Provisions for operational risk events are recognised for losses incurred by the Bank which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation as at the Balance Sheet date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

4.25 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a Subsidiary, Associate or Joint Venture for which the Bank is also liable severally or otherwise are also included with appropriate disclosures.

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 Balance Sheet but are disclosed unless they are remote.

4.26 Income Recognition

4.26.1 Interest

Interest receivable is recognised on an accrual basis. Interest from loans and advances ceases to be accrued when they are classified as non-performing as explained in Note 4.8.4. Interest on non-performing loans and advances is accounted for on a cash basis. Interest on non-performing loans and advances is credited to the "Interest in Suspense Account" which is netted in the Balance Sheet against the relevant loans and advances.

Interest income from investments is recognised on an accrual basis.

4.26.2 Dividend Income

Dividend income is recognised in the Income Statement on an accrual basis when the Bank's right to receive the dividend is established.

4.26.3 Lease Income

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month in which the lease is executed in proportion to the declining receivable balance.

NOTES TO THE FINANCIAL STATEMENTS

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Gross earnings under finance leases in respect of lease rentals due, cease to be taken to revenue when they are classified as non-performing as explained in Note 28 (c) ii. Thereafter, such income is recognised on a cash basis.

4.26.4 Discount on Bills of Exchange

Income on discounting bills of exchange is recognised proportionately over the period of the instrument.

4.26.5 Trading Income

Gains or losses arising from the sale of investment securities, dealing securities, shares and units are accounted for on the date of transaction in the Income Statement.

4.26.6 Fee and Commission Income

Fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees are recognised as the related services are performed.

4.26.7 Profit / Loss from Sale of Property, Plant and Equipment

Profit / loss from sale of property, plant and equipment is recognised in the period in which the sale occurs and is classified as other income.

4.26.8 Profit / Loss from Sale of Investment Properties

Any gains or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

4.26.9 Rental Income

Rental income is recognised on an accrual basis.

4.27 Expenses

4.27.1 Interest Expenses and Other Expenses

Interest payable and other expenses are recognised on an accrual basis.

4.27.2 Lease Payments

Payments made under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease.

The future monthly commitments on operating leases are shown in Note 47 (b).

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

4.27.3 Fee and Commission Expenses

Fee and commission expenses are recognised on an accrual basis.

4.28 Income Tax Expense

Income tax expense comprises of current and deferred tax. Income tax expense is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

4.28.1 Current Tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted on the Balance Sheet date, and any adjustment to tax payable in respect of previous years.

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and the amendments thereto at the rates specified in Note 20 (g).

Provision for taxation on overseas Subsidiaries / Associates is made on the basis of the profit for the year as adjusted for taxation purposes in accordance with the provisions of the relevant statutes in those countries.

4.28.2 Deferred Tax

Deferred taxation is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax base of assets and liabilities, which is the amount attributed to those assets and liabilities for tax purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted by the reporting date.

Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future; and
- temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available

against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Details of the deferred tax assets and liabilities as at the Balance Sheet date are given in Note 43.

4.28.3 Offsetting

Current and deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority, there is a legal right and intentions to settle on a net basis and it is allowed under the tax law of the relevant jurisdiction.

4.28.4 Withholding Tax on Dividends

Dividend distributed out of taxable profit of the local Subsidiaries attracts a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the Subsidiaries in the Consolidated Financial Statements as a consolidation adjustment.

Withholding tax that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

4.28.5 Value Added Tax on Financial Services

The base for the computation of Value Added Tax on Financial Services is the accounting profit before income tax adjusted for the economic depreciation and emoluments of employees computed on prescribed rate.

4.28.6 Social Responsibility Levy (SRL)

As per the Provisions of the Finance Act No 5 of 2005, and amendments thereto, the SRL was introduced with effect from January 01, 2005. The SRL was payable at the rate of 1.5% on the corporate tax liability. This was abolished from April 01, 2011.

4.28.7 Economic Service Charges (ESC)

As per the provisions of the Finance Act No 11 of 2004, and amendments thereto, the ESC was introduced with effect from April 01, 2004. Currently the ESC is payable at 1% on Liabile 'Turnover' (subject to a maximum of Rs 30 Mn per quarter) and is deductible from the income tax payments. Unclaimed ESC, if any can be carried forward and set off against the income tax payable in the five subsequent years.

4.29 Earnings per Share

The Group presents Basic and Diluted Earnings per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. 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.

4.30 Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products and services within a particular economic environment (geographical segment), which is subject to risks and returns different from those of other business segments. For the purposes of segment reporting disclosures, the information is presented in respect of the Group's business segments, which is based on the Group's management and internal reporting structure (Note 51). The Group comprises the following major business segments; banking, leasing, dealing, property and insurance.

Inter-segment pricing is determined on an arms length basis.

Measurement of segment assets, liabilities, segment revenue and results is based on the accounting policies set out above. Segment revenue results, assets and liabilities include items directly attributable to segments as well as those that can be allocated on a reasonable basis.

4.31 Cash Flow Statement

The Cash Flow Statement has been prepared using the "Direct Method" of preparing Cash Flows in accordance with the Sri Lanka Accounting Standard 9 "Cash Flow Statements". Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice.

PRESENTATION

Assets and liabilities are grouped by nature and listed in an order that reflects their relative liquidity and maturity pattern. Where appropriate, the significant accounting policies are disclosed in the succeeding Notes.

4.32 Offsetting Income and Expenses

Income and expenses are not offset unless required or permitted by accounting standards.

4.33 Offsetting Assets and Liabilities

Assets and liabilities are offset and the net amount reported in the Balance Sheet only where there is :

- a current enforceable legal right to offset the asset and liability; and
- an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

NOTES TO THE FINANCIAL STATEMENTS

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4.34 Events Occurring after the Balance Sheet Date

Events after the Balance Sheet date are those events, favourable and unfavourable, that occur between the Balance Sheet date and the date the Financial Statements are authorised for issue.

All material and important events that occurred after the Balance Sheet date, including the final dividend declared on Ordinary Shares have been considered and appropriate disclosures are made in Note 52 to the Financial Statements.

5 SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY – HNB ASSURANCE PLC

5.1 General Insurance Business

5.1.1 Gross Written Premium

Gross written premium is generally recognised as written upon inception of the policy. Upon inception of the contract, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are earned over the period of risk in proportion to the amount of insurance protection provided.

5.1.2 Reinsurance Premium

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance services received. Reinsurance premiums are decided based on rates agreed with reinsurers.

5.1.3 Unearned Premium

The unearned premium reserve represents the portion of the premiums net of outward reinsurance premiums written in the current year in respect of risks related to subsequent periods. Unearned premiums are calculated on the 1/24th basis in accordance with the Regulation of Insurance Industry Act No 43 of 2000.

5.1.4 Unexpired Risk

Provision is made where appropriate for the estimated amount required over and above unearned premiums to meet future claims and related expenses on the business in force as at end of the year.

5.1.5 Title Insurance Reserve

Title insurance reserve is maintained by the Company 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 first two years of the policy given the higher probability for claims occurring in the first two years. From the 3rd year onwards,

profit is recognised by amortising the premium received and will be distributed throughout the remaining period of the policy using the straight line method. Profit up to the 2nd year will be recognised in the 3rd year. Balance premiums are transferred to the Title Insurance Premium. If the corresponding loan of the Title Insurance Policy issued is settled before the maturity, full premium of such policies remaining as at the date of settlement of such loan is recognised in profits upon confirmation of the same by the respective Bank.

5.1.6 Net Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned. Reinsurance commission is also treated in the same manner within deferred acquisition costs.

5.1.7 Claims

Claims include provisions for the estimated cost of claims and related handling expenses in respect of Incidents up to the year end, including those which have not been notified, net of salvage, anticipated reinsurance and other recoveries. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of settling claims.

The provision in respect of Claims Incurred But Not Reported (IBNR) and Claims Incurred But Not Enough Reported (IBNER) is actuarially valued to ensure a more realistic estimation of the future liability based on the past experience and trends. Actuarial valuations are performed on a semi-annual basis.

Whilst the directors consider that the provision for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the Financial Statements for that period. The methods used and the estimates made are reviewed regularly.

5.2 Life Insurance Business

5.2.1 Gross Written Premium

Premium from traditional life insurance contracts, including participating contracts and annuity policies with life contingencies, are recognised as revenue when cash is received from the policy holder. However, any premiums received in advance is not recorded as revenue and recorded as liability until the premium is due. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

5.2.2 Reinsurance Premium

Outward reinsurance premiums are recognised when payable. Reinsurance recoveries are credited to match the relevant gross claims.

5.2.3 Acquisition Costs

Commission expense is charged to the period in which it is incurred.

5.2.4 Benefits, Losses and Expenses

Claims by death and maturity are charged against revenue on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

Expenses on the Life Insurance relates to the acquisition expenses and expenses for maintenance of Life Insurance business, investment related expenses not treated as a part of the capital cost of investment, etc which are accounted on accrual basis.

5.2.5 Actuarial Valuation for Long Term Insurance Provision

The directors agree to the long term insurance provision for the Company at the year end on the recommendations of the Independent Consultant Actuary following his annual investigation of the Life Insurance business. The actuarial valuation takes into account all liabilities and is based on assumptions recommended by the Independent Consultant Actuary.

6 SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY - SITHMA DEVELOPMENT (PVT) LTD**6.1 Revenue Recognition**

Revenue from sale of apartments has been recognised at the point of the execution of transfer deed.

6.2 Inventories - Residential Apartment Complex

Sithma Development (Pvt) Ltd commenced a project to develop a residential apartment complex. The expenses relating to this project were accounted for as work-in-progress until the completion of the project.

On completion, the value of apartments was transferred to inventories - residential apartment complex. Inventories are shown under other assets in the Balance Sheet.

7 COMPARATIVE INFORMATION

The comparative information is re-classified wherever necessary to conform with the current year's classification in order to provide a better presentation. The details of such re-classifications have been provided in Note 50.

8 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT BALANCE SHEET DATE

The Institute of Chartered Accountants of Sri Lanka has issued a new volume of Sri Lanka Accounting Standards which have become applicable for financial periods beginning on or after 1st January 2012.

Accordingly, these Standards have not been applied in preparing these Financial Statements as they were not effective for the year ended 31st December 2011. These Sri Lanka Accounting Standards comprise of Accounting Standards prefixed both SLFRS (corresponding to IFRS) and LKAS (corresponding to IAS). Application of Sri Lanka Accounting Standards prefixed SLFRS and LKAS for the first time shall be deemed to be an adoption of SLFRS's.

The said new / revised standards have become applicable to the Bank from 1st January 2012 and accordingly the reporting framework for the year ending 31st December 2012 will be LKAS / SLFRS. Given the complexities and technical expertise required in the process of convergence, the Bank carried out an initial impact analysis with the assistance of an external consultant based on the 2010 balances. Using the same methodology the Bank has extended its impact analysis to 2011 to approximately assess the potential impact on the financial statements had these said standards been applied for the year ended 31st December 2011. As this is only a preliminary assessment of the potential effects of these Standards, it is based on a few assumptions and approximation.

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The Table below sets out the key impact areas for the Bank in 2012 with the adoption of LKAS/SLFRS.

Accounting Standard	Key requirement in the Standards	Preliminary assessment of potential impact for HNB
LKAS 32 - "Financial Instruments Presentation", LKAS 39 - "Financial Instruments: Recognition and Measurement" SLFRS 7 - "Financial Instruments: Disclosures"	<p>The Financial assets classified as Loans and Advances and Held to maturity will be initially recognised at fair value. Subsequent measurement of Loans and Advances and Held to Maturity assets will be at amortised cost using effective interest rates.</p> <p>Impairment of these financial assets will be determined using incurred loss model based on objective evidence of impairment.</p> <p>Individually significantly loans will be tested for impairment separately while loans which are not individually significant are collectively assessed for impairment (portfolio based impairment) based on credit risk characteristics.</p>	<p>Impairment provision for loans and advances.</p> <p>The current practice of classifying and providing for Non performing Loans and advances as per the rules prescribed by the Central Bank of Sri Lanka based on the age of the Loans and advances will not be applicable.</p> <p>Based on our preliminary assessment of potential impact, the additional provision required for impairment on loans and advances when compared with the existing provisions (specific and general) and interest in suspense in accordance with CBSL guidelines for bills of exchange, loans and advances and lease receivables as at Balance Sheet date was approximately Rs 800 Mn.</p> <p>Accordingly the equity as at 31st December 2011 would have been reduced by Rs 800 Mn.</p> <p>The above quantification has been based on few initial assumptions and the Bank is in the process of refining the same to arrive at more accurate results.</p>
	<p>For the purpose of measuring a financial asset LKAS 39 requires the financial assets to be classified into the following four categories ;</p> <ul style="list-style-type: none"> - fair value through profit and loss - measured at fair value with changes in fair value taken to Income Statement - available-for-sale investments - measured at fair value with changes in fair value taken to Statement of Changes in Equity - held to maturity investments measured at amortised cost; and - originated loans and receivables measured at amortised cost using effective interest method 	<p>Impact from categorisation / measurement of investments</p> <p>The categorisation of investments in the Bank will determine whether and where the re-measurement will be recognised in the Bank's Financial Statements.</p> <p>Based on our initial assessment of potential impact, the gain was Rs 2.4 Bn.</p> <p>This gain results from the investments that need to be classified as Available for Sale securities based on LKAS 39 which are currently classified as investment securities and the gain would have resulted in an increase in the equity.</p>
	<p>Financial liabilities are measured at amortised cost except certain financial liabilities which are presented at fair value.</p>	<p>Impact from measurement of deposits</p> <p>The Bank is in the process of quantifying the potential impact</p>
	<p>Fair value of derivatives should be determined based on present value .The fair value of assets and liabilities are required to be presented gross on the balance sheet.</p>	<p>Forward contracts / currency swaps are currently recognised at their fair values at each period end and the net amount is presented in the Balance Sheet. However, the Bank does not use discounting to determine the fair values at present.</p> <p>The Bank is in the process of quantifying the potential impact</p>

Accounting Standard	Key requirement in the Standards	Preliminary assessment of potential impact for HNB
SLFRS 2 - "Share based payments"	This standards introduces the requirement for the Bank to recognise an expense / liability in respect of all share-based payment transactions (including expenses associated with transactions in which share options are granted to employees) determined with reference to the fair value of the share appreciation rights, by applying an option pricing model.	<p>The Bank does not recognize any expense / liability in relation to benefit offered to the employees in respect of the Employee Share Ownership Plan and Employee Share Option Plan.</p> <p>The Bank is in the process of quantifying the potential impact</p> <p>The Employee Share Benefit Trust set up by the Bank shall be treated as a special purpose entity and will be required to be consolidated with the Bank and /or consolidated financial statements.</p>
SLFRS 1 – "First time adoption of International Financial reporting Standards"	This Standard applied to the Bank when it first applied SLFRS / LKAS. The opening SLFRS statements of financial position at the date of transition to SLFRSs need to be prepared. The same accounting policies should be used in its opening SLFRS Statements of financial position and throughout all periods presented in its first SLFRs financial statements .	The Bank is in the process of preparing the financial statements under SLFRS and will provide an explanation how the transition from SLAS to SLFRSs affected its reported financial position, financial performance and cashflows.

In addition to the above, there may be some impact with the adoption of other new / revised accounting standards which have become effective from 1st January 2012, and the Bank does not expect any material impact.

The Bank will also experience changes in presentation and disclosure requirements under the new / revised accounting standards from the year ending 31st December 2012 onwards.

NOTES TO THE FINANCIAL STATEMENTS

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For the year ended 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
9 INCOME				
Interest income (Note 10)	33,141,598	30,249,230	33,569,716	30,563,795
Foreign exchange profit	988,231	1,015,987	995,580	1,014,208
Fee and commission income (Note 12)	2,779,700	2,098,127	3,055,558	2,404,240
Dividend income (Note 13)	409,440	209,762	407,506	199,012
Other income (Note 14)	649,793	1,297,312	3,140,084	3,212,207
	37,968,762	34,870,418	41,168,444	37,393,462
10 INTEREST INCOME				
Loans and advances to customers	27,708,066	23,535,452	27,509,049	23,267,708
Government securities	4,475,698	5,605,876	4,924,932	6,062,711
Placements with banks	183,350	606,409	185,242	663,081
Other interest income	774,484	501,493	950,493	570,295
	33,141,598	30,249,230	33,569,716	30,563,795

Notional Credit for Withholding Tax on Government Securities on Secondary Market Transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in Government securities be entitled to a notional tax credit (being one ninth of the net interest income) provided such interest income forms part of the statutory income of the company for that year of assessment.

Accordingly, net income earned from secondary market transactions in Government securities for the year by the Bank / Group has been grossed up in the Financial Statements and the resulting notional tax credit amounted to Rs 306 Mn (2010 : Rs 434.17 Mn) for the Bank and Rs 340.70 Mn (2010 : Rs 471.56 Mn) for the Group.

For the year ended 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
11 INTEREST EXPENSES				
Deposits from customers	13,947,156	12,776,807	13,935,176	12,770,089
Short term borrowings	1,380,694	878,574	1,490,624	962,370
Long term borrowings	162,289	-	164,007	-
Refinance borrowings	377,302	457,899	377,302	457,899
Subordinated debentures	435,545	361,959	432,385	358,815
Other interest expenses	442,467	228,017	442,542	227,982
	16,745,453	14,703,256	16,842,036	14,777,155
12 FEE AND COMMISSION INCOME				
Fee income	13,768	5,907	40,939	14,998
Commission income	2,765,932	2,092,220	3,014,619	2,389,242
	2,779,700	2,098,127	3,055,558	2,404,240
13 DIVIDEND INCOME				
Dealing securities	10,948	1,208	16,042	3,600
Investment securities - quoted	356,606	145,634	347,834	140,595
Investment securities - unquoted	41,886	62,920	43,630	54,817
	409,440	209,762	407,506	199,012

For the year ended 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
14 OTHER INCOME				
Gain from dealing securities	-	114,604	-	184,654
Capital gain from sale of investment securities (disposal through dealing securities) [Note 29 (b)]	-	497,114	-	497,114
Capital gain from sale of Associate company	-	47,581	-	23,791
Capital gain from sale of investment securities [Note 29 (d)]	444	101,710	1,482	63,186
Rent received	4,426	8,439	125,170	91,237
Rent received from investment properties	48,424	41,951	46,698	40,079
Auditorium hire income	3,149	3,420	3,149	3,420
Profit from sale of property, plant and equipment	19,062	4,674	17,309	5,691
Profit from sale of gold	4,987	24,351	4,987	24,351
Recovery of bad debts [Note 26 (a), 27 (c) and 28 (a)]	528,879	421,433	528,879	421,433
Recovery of loans written off in prior years	4,071	6,549	4,071	6,549
Recovery of operational losses provided for in prior year	18,360	7,024	18,360	7,024
Insurance premium income	-	-	2,292,245	1,813,089
Net income from sale of apartments	-	-	70,758	-
Miscellaneous	17,991	18,462	26,976	30,589
	649,793	1,297,312	3,140,084	3,212,207

15 OPERATING EXPENSES

Operating expenses, among others, include the following:

Legal expenses and professional fees	130,824	81,061	136,289	86,884
Depreciation of investment property (Note 33)	4,584	4,444	4,567	4,456
Depreciation of property, plant and equipment (Note 34)	737,630	657,360	889,494	806,143
Amortisation of intangible assets (Note 35)	172,914	168,761	185,624	179,997
Provision for operational risk event losses	10,973	43,169	60,998	43,189
Provision for related party receivable - Exchange houses	18,663	18,885	-	-
Property, plant and equipment written off (Note 34)	-	20,717	-	20,775
Directors' emoluments	116,979	81,979	137,506	98,087
Auditors' remuneration [Note 15 (a)]	15,410	11,960	20,144	15,775
Advertising and related expenses	301,897	256,904	335,184	308,287
Donations	53,945	20,303	54,370	20,661
Direct operating expenses on investment property	2,738	4,363	2,575	1,556
Share issue expenses [Note 46 (b)]	45,871	2,542	50,300	2,542
Deposit insurance premium	312,464	66,621	312,464	66,621
Net loss from dealing securities*	185,069	-	194,803	-
Impairment loss on inventory - residential apartment complex (Note 36)	-	-	-	8,367

* Net loss from dealing securities consist of the capital gains / (losses) and marked to market gain / (losses) on dealing securities.

15 (a) Auditors' Remuneration

Audit fees and expenses	7,476	6,605	10,562	9,308
Audit related fee and expenses	3,846	2,061	4,643	2,709
Non-audit services	4,088	3,294	4,768	3,294
Audit fee and expenses - other auditors	-	-	171	464
	15,410	11,960	20,144	15,775

16 PERSONNEL EXPENSES

In addition to salaries, personnel expenses include the following :

Contribution to Employees' Provident Fund	358,177	339,475	387,318	364,266
Contribution to Employees' Trust Fund	89,547	84,869	96,195	90,960

Provision for employee retirement benefits is shown separately in Note 17.

NOTES TO THE FINANCIAL STATEMENTS

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For the year ended 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
17 PROVISION CHARGE FOR EMPLOYEE BENEFITS				
Current service cost	427,275	392,326	427,275	392,326
Interest on obligation	820,529	727,413	820,529	727,413
Expected return on plan assets	(637,772)	(520,399)	(637,772)	(520,399)
Amortisation of actuarial losses and transitional liability	283,475	283,475	283,475	283,475
Provision made for gratuities	-	-	14,432	11,303
	893,507	882,815	907,939	894,118

On first time adoption of Sri Lanka Accounting Standard 16 (Revised 2006) "Employee Benefits" (SLAS 16), the transitional liability of the Bank as at 1st January 2008 was Rs 1,417.37 Mn. According to the transitional provisions provided in SLAS 16, the said deficit is being amortised on a straight line basis over a period of 5 years, beginning from 2008. The annual charge is Rs 283.47 Mn. The unamortised transitional liability as at the balance sheet date was Rs 283.47 Mn.

The Subsidiaries did not have transitional liabilities as at 1st January 2008.

For the year ended 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
18 PROVISION CHARGE / (RELEASE) FOR LOAN LOSSES				
Specific provision for loans and advances*	217,199	296,308	217,199	296,308
General provision for pawning advances	7,751	6,050	7,751	6,050
General provision for housing advances	6,065	1,146	6,065	1,146
Additional general provision charge / (release) for performing and overdue / special mention loans and advances to fulfill statutory requirement [Note 28 (b)]	(635,353)	41,313	(635,353)	41,313
Total provision charge / (release) for loans and advances [Note 28 (a)]	(404,338)	344,817	(404,338)	344,817
Specific provision for bills of exchange [Note 26 (a)]	9,514	-	9,514	-
General provision reversal for bills of exchange [Note 26 (a)]	(7,763)	(1,784)	(7,763)	(1,784)
Specific provision for leases [Note 27 (c)]	24,188	46,376	24,188	46,376
General provision for leases [Note 27 (c)]	213,837	91,900	213,837	91,900
Total provision made / (release) during the year	(164,562)	481,309	(164,562)	481,309

*Specific provisions against pawning and housing advances are also included in specific provision for loans and advances.

19 SHARE OF LOSS OF ASSOCIATES (NET OF INCOME TAX)

Share of profit / (loss) of Associates before income tax		(14,100)	1,959
Income tax expense on share of operating results of Associates		(1,629)	(4,388)
Share of loss of Associates after income tax		(15,729)	(2,429)

20 INCOME TAX EXPENSE

Recognised in the Income Statement

20 (a) Current Tax Expense

Current tax on profits for the year [Note 20 (e)]	2,198,508	2,555,321	2,259,136	2,660,366
Over provision as per the taxes finalised for the Y/As 2008/09 and 2009/10 (2010 :Y/A 2007/08)	(438,552)	(102,377)	(444,568)	(109,388)
	1,759,956	2,452,944	1,814,568	2,550,978

20 (b) Deferred Tax Expense

Adjustment to opening balance [Note 43 (b)]	-	-	-	156
Adjustment to opening deferred tax asset / liability resulting from change in tax rate [Note 43 (a), (b) and (c)]	-	(172,191)	-	(172,045)
Deferred tax asset recognised / (reversed) during the year [Note 43 (b)]	148,656	(132,037)	145,363	(132,908)
Charge to deferred tax liability [Note 43 (a)]	288,651	118,768	288,684	118,658
	437,307	(185,460)	434,047	(186,139)
Total income tax expense	2,197,263	2,267,484	2,248,615	2,364,839

20 INCOME TAX EXPENSE (Contd.)

For the year ended 31st December	Group	
	2011 Rs 000	2010 Rs 000
20 (c) Current Tax on Profits of Subsidiaries		
HNB Assurance PLC	26,012	28,208
20 (d) Current Tax on Profits of Joint Venture		
Acuity Partners (Pvt) Ltd and Subsidiaries	34,616	76,837
Total	60,628	105,045

For the year ended 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
20 (e) Reconciliation of Accounting Profit and Taxable Income				
Profit before taxation	7,767,602	6,731,451	8,482,813	7,251,667
Disallowable expenses	2,818,790	4,325,379	2,930,812	4,495,043
Allowable expenses	(8,504,698)	(5,927,023)	(8,565,521)	(5,971,227)
Tax exempt income	(1,084,525)	(2,414,337)	(1,602,035)	(2,730,913)
Adjustments for leasing	6,854,643	4,696,906	6,854,643	4,696,906
Tax losses utilised [Note 20 (f)]	-	-	(50,383)	(43,638)
Tax loss incurred during the year	-	-	21,725	19,920
Taxable income	7,851,812	7,412,376	8,072,054	7,717,758
Of which,				
Taxable income at 35%	-	6,887,877	10	7,170,775
Taxable income at 20%	-	524,499	1,500	546,983
Taxable income at 28%	7,851,812	-	8,064,760	-
Taxable income at 12%	-	-	5,784	-
	7,851,812	7,412,376	8,072,054	7,717,758
Income tax provision for the year is made up of the following:				
Income tax at 35%	-	2,410,757	4	2,509,771
Income tax at 20%	-	104,900	300	109,397
Income tax at 28%	2,198,508	-	2,258,134	-
Income tax at 12%	-	-	694	-
	2,198,508	2,515,657	2,259,132	2,619,168
Social Responsibility Levy at 1.5% on income tax liability	-	37,735	4	39,269
Social Responsibility Levy on dividend paid during the year	-	1,929	-	1,929
Current tax on profits for the year	2,198,508	2,555,321	2,259,136	2,660,366
Effective tax rate	28.30%	37.96%	26.63%	36.69%
Effective tax rate of current tax expense [Note 20 (a)]	22.66%	36.44%	21.39%	35.18%
Effective tax rate of total income tax expense	28.29%	33.68%	26.51%	32.61%

20 (f) Tax Losses Brought Forward and Utilised during the Year

Tax losses brought forward	-	-	273,859	292,923
Adjustments for brought forward tax losses	-	-	-	4,654
Loss incurred during the year	-	-	21,725	19,920
Tax losses utilised during the year [Note 20 (e)]	-	-	(50,383)	(43,638)
Tax losses not utilised and carried forward	-	-	245,201	273,859

20 (g) Hatton National Bank PLC

The Bank is liable for taxation on its income from banking operations at the rate of 28% for the year. In 2010 taxable income of the Bank's Domestic Banking Unit (DBU) and the taxable income of on shore operations of the Foreign Currency Banking Unit (FCBU) were liable for taxation at the rate of 35%. The taxable income from off shore operations of FCBU in 2010 was liable for taxation at the rate of 20%.

NOTES TO THE FINANCIAL STATEMENTS

continued

20 INCOME TAX EXPENSE (Contd.)**20 (h) HNB Assurance PLC**

HNB Assurance PLC is liable for income tax at the rate of 28% (2010 : 35%) on its taxable income. Provision has been made in the Financial Statements accordingly.

20 (i) Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 28th December 1994, the profits and income of Sithma Development (Pvt) Ltd are exempt from taxation until Year of Assessment 2014 / 15. After the expiration of the said tax exempt period, the following options are available for the company for another 15 years;

(a) Income tax payable for the Year of Assessment shall be computed at 2% of the turnover of the Company, or

(b) The provisions of the Inland Revenue laws for the time being in force shall apply to the Company.

In the event the company elects option (a), no deferred tax liability will arise even after the expiration of the tax exempt period. The company needs to make the election only 90 days prior to the expiration of the said tax exemption period, after evaluating all tax implications prevailing at that time. Therefore, no provision has been made in the Financial Statements by the company for deferred tax liability which could arise after the tax exempt period in the event the company elects option (b).

20 (j) Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is liable for income tax at the rate of 28% (2010 : 35%) on its taxable income. Provision has been made in the Financial Statements accordingly. Subsidiaries of Acuity Partners (Pvt) Ltd other than Lanka Ventures PLC (2011 : 12%, 2010 : 20%) are liable for income tax at the rate of 28% (2010 : 35%).

21 EARNINGS PER SHARE**21 (a) Basic Earnings per Share**

Basic Earnings per Share has been calculated by dividing the profit for the year attributable to equity holders of the Bank by the weighted average number of ordinary shares on issue (both voting and non-voting) during the year, as per the requirements of the Sri Lanka Accounting Standard 34 - "Earnings per Share".

21 (b) Diluted Earnings per Share

The calculation of Diluted Earnings per Share as at Balance Sheet date was based on the profit attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year, after adjusting for the effects of all potentially dilutive weighted average number of ordinary shares that would be issued on the conversion of all the dilutive ESOPs into ordinary shares.

The details of the options exercised and expired under Employee Share Option Plan during the year are given in Note 46 (d).

For the year ended 31st December	Bank		Group	
	2011	2010	2011	2010
Profit attributable to equity holders of the Bank (Rs 000)	5,570,339	4,463,967	6,148,841	4,786,770
Weighted average number of ordinary shares during the year used as the denominator ('000) for Basic EPS	369,411	355,428	369,411	355,428
Basic Earnings Per Share (Rs)	15.08	12.56	16.64	13.47
Profit attributable to equity holders of the Bank (Rs 000)	5,570,339	4,463,967	6,148,841	4,786,770
Weighted average number of ordinary shares during the year used as the denominator ('000) for Basic EPS	369,411	355,428	369,411	355,428
Weighted average number of shares under option ('000)	4,645	3,309	4,645	3,309
Weighted average number of ordinary shares that would have been issued at average market price ('000)	(1,992)	(1,727)	(1,992)	(1,727)
Weighted average number of ordinary shares during the year used as the denominator ('000) for Diluted EPS	372,064	357,010	372,064	357,010
Diluted Earnings Per Share (Rs)	14.97	12.50	16.53	13.41

The Basic and the Diluted Earnings Per Share of Bank / Group for 2010 have been adjusted for the effect of sub division of shares which took place on 5th April 2011.

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
22 CASH AND CASH EQUIVALENTS				
Local currency in hand	6,447,510	5,541,469	6,448,527	5,567,435
Foreign currency in hand	472,408	299,083	505,463	299,083
Balances with local banks	17,116	80,295	20,363	81,407
Fixed deposits with other banks in local currency	-	2,000,000	840,391	2,382,943
Balances / placements with banks in foreign currency	7,406,605	7,571,480	7,448,469	7,662,330
Money at call and short notice	350,000	2,000,000	350,000	2,000,000
Placements with banks by FCBU	48,308	513,313	48,308	513,313
	14,741,947	18,005,640	15,661,521	18,506,511

All cash and cash equivalent balances held by the Group entities were available for use by the Group.

23 STATUTORY DEPOSIT WITH CENTRAL BANKS				
Statutory deposit with Central Bank of Sri Lanka	18,683,405	12,491,644	18,683,405	12,491,644
Statutory deposit with Central Bank of Oman	-	-	14,792	14,408
	18,683,405	12,491,644	18,698,197	12,506,052

As required by the provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka as explained in Note 4.4. The minimum cash reserve requirement on Rupee deposit liabilities was 8% as at 31st December 2011 (2010 : 7%).

There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

Majan Exchange LLC is required to maintain a deposit of Omani Riyal 50,000 with the Central Bank of Oman (CB Oman) in accordance with its licensing regulations for exchange houses issued by the CB Oman. Interest is earned at the rate of 2% per annum. This is not available for use in the ordinary course of business.

24 DEALING SECURITIES

24 (a) Dealing Securities - Summary

As at 31st December	2011 Cost / Market Value Rs 000	2010 Cost / Market Value Rs 000
Quoted shares - Bank (Note 24 (b))	723,316	576,280
Government of Sri Lanka treasury bills - Bank (Note 24 (c))	17,723	877,998
Government of Sri Lanka treasury bonds - Bank (Note 24 (d))	401,025	3,224
Dealing Securities - Bank	1,142,064	1,457,502
Quoted shares - Subsidiaries (Note 24 (e))*	256,004	174,136
Government of Sri Lanka treasury bills - Joint Venture (Note 24 (f))	125,587	567,210
Government of Sri Lanka treasury bonds - Joint Venture (Note 24 (g))	343,713	305,435
Dealing securities - Bank	1,142,064	1,457,502
Dealing Securities - Group	1,867,368	2,504,283

*HNB Assurance PLC (HNBA) carries its dealing securities at cost or market value whichever is lower as explained in Note 4.6.1.

These investments are held by the life fund, therefore any gains relating to these investments can not be taken to the Income Statement. Accordingly a marked to market loss of Rs 35.54 Mn had been accounted for in the Consolidated Financial Statements in 2011 while, gain of Rs 34 Mn arising from adjustment required to the accounting policy of HNBA to be consistent with that of the Bank, had not been accounted for in the Consolidated Financial Statements in 2010.

Dealing securities through the Joint Venture reported above represent only 50% of the total dealing securities of the Joint Venture, being the shareholding of the Bank on the same.

NOTES TO THE FINANCIAL STATEMENTS

continued

24 DEALING SECURITIES (Contd.)**24 (b) Quoted Shares Held by the Bank**

As at 31st December	2011				2010		
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Banks, Finance and Insurance							
Ceylinco Insurance PLC (Non-voting)	15,600	10,128	1.13	11,648	4,000	700	1,080
Lanka Orix Leasing Company PLC	212,900	27,715	3.08	17,735	225,000	29,322	28,755
National Development Bank PLC	270,000	48,934	5.44	37,287	100,000	36,253	34,950
Sampath Bank PLC	407,317	102,261	11.36	79,427	201,738	40,053	54,853
Seylan Bank PLC	-	-	-	-	533,400	40,230	52,167
Beverage, Food and Tobacco							
Cargils (Ceylon) PLC	163,000	37,822	4.20	33,089	-	-	-
Distilleries Company of Sri Lanka PLC	413,000	77,273	8.59	60,752	-	-	-
Lion Brewery Ceylon PLC	340,000	56,960	6.33	64,600	450,000	74,215	83,295
Diversified Holdings							
Aitken Spence PLC	450,000	75,766	8.42	54,180	450,000	75,766	76,455
Expo Lanka Holdings PLC	750,500	9,699	1.08	6,754	-	-	-
Hayleys PLC	55,500	22,317	2.48	20,812	-	-	-
John Keells Holdings PLC	357,600	74,855	8.32	60,863	282,900	77,644	84,417
Softlogic Holdings PLC	416,000	12,064	1.34	7,488	-	-	-
Vallible One PLC	1,400,000	48,335	5.37	33,320	-	-	-
Health Care							
Lanka Hospitals PLC	-	-	-	-	298,742	7,513	9,471
Nawaloka Hospitals PLC	-	-	-	-	7,673,300	29,792	28,391
Manufacturing							
ACL Cables PLC	224,400	20,307	2.26	16,606	-	-	-
Ceylon Grain Elevators PLC	-	-	-	-	352,800	18,062	26,354
Lanka Tiles PLC	301,700	38,614	4.29	24,226	-	-	-
Royal Ceramics Lanka PLC	175,100	28,308	3.15	24,777	-	-	-
Tokyo Cement PLC	648,900	36,902	4.10	28,552	377,500	20,014	20,763
Motors							
Diesel & Motor Engineering PLC	18,870	29,104	3.23	24,571	-	-	-
United Motors PLC	180,800	31,572	3.51	26,397	-	-	-
Oil & Palms							
Bukit Darah PLC	40,000	42,979	4.78	41,200	-	-	-
Power & Energy							
Vallible Power Erathna PLC	6,129,100	67,954	7.54	49,032	-	-	-
Trading							
Browns & Co PLC	-	-	-	-	305,100	52,778	75,329
Odd lots and delisted shares	-	123	-	-	-	135	-
Total		899,992	100.00	723,316		502,477	576,280
Gain / (loss) from marked to market valuation		(176,676)				73,803	-
Total Quoted Shares - Bank		723,316		723,316		576,280	576,280

24 (c) Government of Sri Lanka Treasury Bills Held by the Bank

As at 31st December	Face Value	Year of Maturity	Carrying Value (Rs 000)	2011		2010	
				Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
	Rs 18 Mn	2012	17,791	17,791	17,723	874,589	877,998
	Gain / (loss) from marked to market valuation			(68)		3,409	
	Total Government of Sri Lanka Treasury Bills - Bank			17,723	17,723	877,998	877,998

24 DEALING SECURITIES (Contd.)**24 (d) Government of Sri Lanka Treasury Bonds Held by the Bank**

As at 31st December

Face Value	Year of Maturity	Carrying Value (Rs 000)	2011		2010	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Rs 400 Mn	2012	399,852				
Rs 4 Mn	2015	3,362	403,214	401,025	3,298	3,224
Loss from marked to market valuation			(2,189)		(74)	
Total Government of Sri Lanka Treasury Bonds - Bank			401,025	401,025	3,224	3,224

24 (e) Quoted Shares Held by the Subsidiaries

As at 31st December

	No of Ordinary Shares	2011			2010		
		Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Commercial Bank of Ceylon PLC	144,598	17,921	6.15	14,460	67,050	17,046	17,426
Hemas Holdings PLC	321,000	14,106	4.84	10,593	321,000	14,106	14,285
John Keells Holdings PLC	108,256	20,472	7.02	18,425	81,193	20,472	24,228
Dialog Axiata PLC	217,500	5,243	1.80	1,697	217,500	5,243	2,567
Asian Hotels & Properties PLC	-	-	-	-	5,000	167	970
National Development Bank PLC	78,200	9,519	3.27	10,799	17,100	2,646	5,976
John Keells Hotels PLC	92,700	1,564	0.54	1,251	-	-	-
Expo Lanka Holdings PLC	221,700	3,104	1.06	1,995	-	-	-
Softlogic Holdings PLC	170,600	4,947	1.70	3,071	-	-	-
Browns Investments PLC	142,200	711	0.24	597	-	-	-
Royal Ceramics Lanka PLC	183,000	26,095	8.95	25,895	12,000	633	3,659
Chemical Industries (Colombo) PLC	95,000	9,603	3.29	10,593	116,500	10,905	16,392
ACL Cables PLC	50,000	3,555	1.22	3,700	25,000	1,414	2,128
Dipped Products PLC	19,500	1,829	0.63	2,077	19,500	1,829	2,334
Peoples' Leasing Company PLC	1,162,800	20,930	7.18	18,605	-	-	-
Renuka Agri Foods PLC	-	-	-	-	309,100	815	2,071
Aitken Spence Hotels Holdings PLC	75	3	0.00	5	23,375	820	2,471
DFCC Bank	43,000	5,390	1.85	4,855	43,000	5,390	8,609
Seylan Bank PLC - Non Voting	399,999	15,445	5.30	12,320	-	-	-
Riverina Hotels PLC	46,000	4,537	1.56	4,830	52,000	5,060	5,476
The Lighthouse Hotel PLC	21,400	1,433	0.49	1,145	21,400	1,433	1,348
Sampath Bank PLC	74,399	17,088	5.86	14,508	92,724	19,945	25,212
Nations Trust Bank PLC	275,000	18,229	6.25	15,675	180,000	11,767	15,012
Singer Finance (Lanka) PLC	-	-	-	-	4,400	66	66
Richard Pieris and Company PLC	1,375,000	17,228	5.91	12,375	325,000	2,449	3,413
Distilleries Company of Sri Lanka PLC	60,000	10,648	3.65	8,826	-	-	-
Hayleys PLC	-	-	-	-	22,000	7,258	7,590
Haycarb PLC	20,500	3,547	1.22	3,178	20,500	3,547	3,454
Chevron Lubricants Lanka PLC	24,000	3,619	1.24	4,080	24,000	3,619	3,828
Tokyo Cement Company (Lanka) PLC	402,912	19,402	6.65	17,728	304,512	12,764	16,748
Kelani Cables PLC	44,300	5,035	1.73	3,557	44,300	5,035	4,652
ACL Plastics PLC	3,600	372	0.13	450	3,600	372	586
Laugfs Gas PLC - (Voting Shares)	175,000	7,927	2.72	6,650	26,700	614	692
Laugfs Gas PLC - (Non Voting Shares)	-	-	-	-	19,200	288	355
PC House PLC	178,800	1,967	0.67	2,485	178,800	1,967	2,020
Renuka Holdings PLC	50,877	2,121	0.73	2,742	70,000	2,970	4,333
Textured Jersey Lanka PLC	428,500	6,428	2.20	4,371	-	-	-
Asiri Hospital Holdings PLC	700,000	6,021	2.07	6,020	928,200	7,990	8,168
Dolphin Hotels PLC	149,900	5,506	1.88	6,446	149,900	5,506	9,174
Total		291,545	100.00	256,004		174,136	215,243
Loss from marked to market valuation		(35,541)				-	
Total quoted shares - Subsidiaries		256,004		256,004		174,136	215,243

NOTES TO THE FINANCIAL STATEMENTS

continued

24 DEALING SECURITIES (Contd.)**24 (f) Government of Sri Lanka Treasury Bills held through Joint Venture**

As at 31st December

			2011		2010	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)				
Rs 131 Mn	2012	126,062	126,062			
Loss from marked to market valuation			(475)			
Total Government of Sri Lanka Treasury Bills - Joint Venture			125,587	125,587	567,210	567,834

24 (g) Government of Sri Lanka Treasury Bonds held through Joint Venture

As at 31st December

			2011		2010	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)				
Rs 152 Mn	2012	151,422				
Rs 0.9 Mn	2013	911				
Rs 9 Mn	2014	8,883				
Rs 75 Mn	2015	74,856				
Rs 125 Mn	2016	108,881	344,953			
Loss from marked to market valuation			(1,240)			
Total Government of Sri Lanka Treasury Bonds - Joint Venture			343,713	343,713	305,435	305,435

25 NON CURRENT ASSETS HELD FOR SALE

As at 31st December

	Bank		Group	
	2011 Carrying Amount Rs 000	2010 Carrying Amount Rs 000	2011 Carrying Amount Rs 000	2010 Carrying Amount Rs 000
Non current assets held for sale	-	-	2,875	2,875

25 (a) Freehold Land*

	2011		2010	
	Extent (perches)	Cost of Land Rs 000	Extent (perches)	Cost of Land Rs 000
Lot - X, Survey plan - 6448, off Edirisinghe Rd, Mirihana*	10	2,875	10	2,875
Total - Group		2,875		2,875

*Value of the above land (10 perches) amounted to Rs 5.75 Mn as at 31st January 2011 based on the valuation carried out by Messrs K C B Condegama AIV (Sri Lanka). As this land is held by Acuity Partners (Pvt) Ltd, the Joint Venture, only 50% of the value is taken to the Consolidated Financial Statements.

26 BILLS OF EXCHANGE

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Inland bills	609,480	567,857	609,480	567,857
Import bills	210,812	300,652	210,812	300,652
Export bills	242,537	628,810	242,537	628,810
Gross bills of exchange	1,062,829	1,497,319	1,062,829	1,497,319
Provision for bills of exchange				
Specific provision [Note 26 (a)]	(86,704)	(74,458)	(86,704)	(74,458)
General provision [Note 26 (a)]	(4,808)	(12,571)	(4,808)	(12,571)
Total provision for bills of exchange	(91,512)	(87,029)	(91,512)	(87,029)
Bills of exchange after provision	971,317	1,410,290	971,317	1,410,290
Less : Interest in suspense [Note 26 (b)]	12,305	9,160	12,305	9,160
Net bills of exchange	959,012	1,401,130	959,012	1,401,130

26 (a) Movement in Provision for Bills of Exchange - Bank / Group

As at 31st December	2011	2010	2011	2010
	Rs 000 Specific	Rs 000 Specific	Rs 000 General	Rs 000 General
Balance as at 1st January	74,458	305,249	12,571	14,355
Exchange rate variance on foreign currency provision	1,747	(2,042)	-	-
Additional provision made / (reversed) during the year (Note 18)	9,514	-	(7,763)	(1,784)
Recoveries made during the year	-	(385)	-	-
Transfer from loan loss provision [Note 28 (a)]*	985	-	-	-
Bills written off against provision	-	(228,364)	-	-
Balance as at 31st December	86,704	74,458	4,808	12,571

*Specific provisions in respect of bills which were in loan loss provision were transferred to provision for bills of exchange during the year.

26 (b) Movement in Interest in Suspense for Bills of Exchange - Bank / Group

As at 31st December	2011	2010
	Rs 000	Rs 000
Balance as at 1st January	9,160	14,199
Interest suspended during the year	6,783	2,356
Exchange rate variance on interest in suspense for foreign currency bills of exchange	109	-
Interest recovered	(5,647)	(4,773)
Interest written off	-	(2,622)
Transfer from interest in suspense for loans [Note 28 (f)]*	1,900	-
Balance as at 31st December [Note 28 (g)]	12,305	9,160

*Interest in suspense in respect of bills which were in interest in suspense for loans were transferred to interest in suspense for bills of exchange during the year.

NOTES TO THE FINANCIAL STATEMENTS

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27 LEASE RECEIVABLES

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Gross lease rentals receivable	49,386,549	33,736,872	49,386,549	33,736,872
Initial rentals received	(102,215)	(85,923)	(102,215)	(85,923)
Lease rentals received	(19,121,395)	(16,357,491)	(19,121,395)	(16,357,491)
Total lease rentals receivable	30,162,939	17,293,458	30,162,939	17,293,458
Unearned lease income	(5,594,160)	(3,374,141)	(5,594,160)	(3,374,141)
Gross lease receivable	24,568,779	13,919,317	24,568,779	13,919,317
Provisions for lease receivable				
Specific [Note 27 (c)]	(156,142)	(197,631)	(156,142)	(197,631)
General [Note 27 (c)]	(488,270)	(274,433)	(488,270)	(274,433)
Net lease receivable	23,924,367	13,447,253	23,924,367	13,447,253
Lease receivable within one year [Note 27 (a)]	7,138,715	4,630,492	7,138,715	4,630,492
Lease receivable after one year [Note 27 (b)]	16,785,652	8,816,761	16,785,652	8,816,761
	23,924,367	13,447,253	23,924,367	13,447,253

27 (a) Lease Receivable within One Year

Total lease rentals receivable within one year from				
Balance Sheet date	10,164,813	6,637,506	10,164,813	6,637,506
Unearned lease income	(2,724,250)	(1,714,883)	(2,724,250)	(1,714,883)
Provision for lease receivable				
Specific [Note 27 (c)]	(156,142)	(197,631)	(156,142)	(197,631)
General	(145,706)	(94,500)	(145,706)	(94,500)
Balance as at 31st December	7,138,715	4,630,492	7,138,715	4,630,492

27 (b) Lease Receivable after One Year

Total lease rentals receivable after one year from				
Balance Sheet date	19,998,126	10,655,952	19,998,126	10,655,952
Unearned lease income	(2,869,910)	(1,659,258)	(2,869,910)	(1,659,258)
Provision for lease receivable - General	(342,564)	(179,933)	(342,564)	(179,933)
Balance as at 31st December	16,785,652	8,816,761	16,785,652	8,816,761

There were no lease receivables beyond five years.

27 (c) Movement in Provision for Lease Receivable - Bank / Group

As at 31st December	Bank		Group	
	2011 Rs 000 Specific	2010 Rs 000 Specific	2011 Rs 000 General	2010 Rs 000 General
Balance as at 1st January	197,631	271,867	274,433	182,533
Exchange rate variance on foreign currency provision	6	(7)	-	-
Additional provision during the year (Note 18)	24,188	46,376	213,837	91,900
Recoveries made during the year	(53,347)	(69,265)	-	-
Fully provided leases written off	(12,336)	(51,340)	-	-
Balance as at 31st December	156,142	197,631	488,270	274,433

28 LOANS AND ADVANCES

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Sri Lanka Rupee loans and advances				
Overdrafts	46,234,887	40,871,128	45,712,019	40,461,566
Short term loans	13,198,213	13,101,182	13,243,711	13,101,182
Trust receipts	9,856,547	7,461,863	9,856,547	7,461,863
Packing credit loans	134,384	211,285	134,384	211,285
Staff loans	9,464,606	8,594,691	9,622,052	8,728,096
Term loans	74,845,785	52,015,664	73,495,864	50,240,704
Housing loans	20,885,882	18,005,579	20,885,882	18,005,579
Pawning advances	35,715,818	27,965,219	35,715,818	27,965,219
Foreclosed properties [Note 28 (h)]	25,378	25,378	25,378	25,378
	210,361,500	168,251,989	208,691,655	166,200,872
Foreign currency loans and advances				
Overdrafts	1,886,639	2,273,268	1,886,639	2,273,268
Short term loans	17,608	571,715	17,608	571,715
Trust receipts	1,211,004	920,755	1,211,004	920,755
Packing credit loans	4,623,680	5,755,495	4,623,680	5,755,495
Term loans	19,293,475	15,584,006	19,293,475	15,584,006
Housing loans	785,327	697,183	785,327	697,183
Foreclosed properties [Note 28 (h)]	450,878	437,905	450,878	437,905
	28,268,611	26,240,327	28,268,611	26,240,327
Sri Lanka Rupee and foreign currency loans and advances	238,630,111	194,492,316	236,960,266	192,441,199
Less:				
Specific provision for loans and advances [Note 28 (b) i]	2,442,585	3,157,152	2,442,585	3,157,152
Specific provision for foreclosed properties [Note 28 (b) i]	461,398	448,778	461,398	448,778
General provision for pawning advances	35,716	27,965	35,716	27,965
General provision for housing loans	43,048	36,984	43,048	36,984
Additional general provision for performing and overdue / special mention loans and advances to fulfill statutory requirement [Note 28 (b) ii]	468,653	1,099,004	468,653	1,099,004
Total provision for loan losses [Note 28 (a)]	3,451,400	4,769,883	3,451,400	4,769,883
Loans and advances after provision	235,178,711	189,722,433	233,508,866	187,671,316
Less: Interest in suspense [Note 28 (f)]	1,657,711	1,688,582	1,657,711	1,688,582
Net loans and advances	233,521,000	188,033,851	231,851,155	185,982,734
28 (a) Movement in Provision for Loan Losses				
Balance as at 1st January	4,769,883	4,930,860	4,769,883	4,930,860
Exchange rate variance on foreign currency provision	40,678	(47,215)	40,678	(47,215)
Provision made / (reversal) during the year (Note 18)	(404,338)	344,817	(404,338)	344,817
Fully provided loans written off	(478,306)	(106,796)	(478,306)	(106,796)
Recoveries made during the year	(475,532)	(351,783)	(475,532)	(351,783)
Transfer to bills of exchange provision [Note 26 (a)]	(985)	-	(985)	-
Balance as at 31st December	3,451,400	4,769,883	3,451,400	4,769,883

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28 LOANS AND ADVANCES (Contd.)

As at 31st December

	2011		2010	
	Rs 000	Rs 000	Rs 000	Rs 000
28 (b) Total Provision for Loan Losses - Bank / Group				
28 (b) i Specific Provision				
Bills of exchange [Note 26 (a)]	86,704		74,458	
Lease receivable within one year [Note 27 (c)]	156,142		197,631	
Loans and advances (Note 28)	2,442,585		3,157,152	
Foreclosed properties [Note 28 (i)]	461,398	3,146,829	448,778	3,878,019
28 (b) ii General Provision				
Bills of exchange [Note 26(a)]	4,808		12,571	
Lease receivable within one year [Note 27 (a)]	145,706		94,500	
Lease receivable after one year [Note 27 (b)]	342,564		179,933	
Loans and advances (pawning and housing loans)	78,764		64,949	
Additional general provision for performing and overdue / special mention loans and advances to fulfill statutory requirement	468,653	1,040,495	1,099,004	1,450,957
Total provision [Note 26 (a), 27 (c) and 28 (a)]		4,187,324		5,328,976

As explained in Note 4.8.3 (b), the Bank makes general provision for potential losses not specifically identified but which experience indicates are present in the portfolio of pawning, lease receivable and Shanthi Housing Loans. A reversal of general provision of Rs 635.35 Mn was made during the year resulting from reduction of regulatory requirement for general provision from 0.9% in 2010 to 0.5% in 2011 while a provision of Rs 41.3 Mn was made in 2010 to meet the regulatory requirement. The total general provision of Rs 1,040.5 Mn (2010 : Rs 1,451.0 Mn) was 0.5% (2010 : 0.9%) of the total performing and overdue loans and advances, net of interest in suspense as at the Balance Sheet date and was equal to the regulatory requirement (0.5%) as at 31st December 2011 (2010 : 0.9%).

28 (c) Non-performing Lending Portfolio

Loans, advances, bills of exchange and finance leases are classified as non-performing as explained in Note 4.8.1. The criteria used for the classification of lending portfolio of the Bank as non performing is set out below. This is in accordance with the direction issued by the Central Bank of Sri Lanka on 8th May 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning".

In accordance with Section 4(7)(l) of Banking Act Direction No. 3 of 2008, Banks shall reclassify Non Performing Loans and Advances (NPA) as Performing Loans and Advances (PLA) if interest and principal in arrears are paid in full by the borrower.

In accordance with section 1 of Banking Act Direction No. 6 of 2009, with effect from 1st January 2011 all credit facilities extended to a borrower are classified as NPA when one or more of the credit facilities has / have been classified as NPA and if the aggregate amount of the outstanding of such NPA (excluding interest in suspense) exceeds 30% of the total credit facilities extended to such borrower (excluding interest in suspense).

28 (c) i CBSL Classification of Advances into Non-performing Lending Portfolio

Type of facility	Point of classification
Overdrafts	Outstanding balance in excess of sanctioned limit continuously for a period of 90 days or more
Credit facilities repayable in monthly installments	Three consecutive installments, principal and / or interest have not been paid
Credit facilities payable in quarterly / half yearly installments	An installment is not paid within 90 days from the due date
Credit facilities repayable in one installment	Payment is not made within 90 days from the end of the agreed period or the due date. (bullet payments)
Credit cards	Minimum payment is in arrears for 90 days from the due date

28 LOANS AND ADVANCES (Contd.)**28 (c) Non Performing Lending Portfolio (Contd.)****28 (c) ii Categorisation of Advances within Non Performing Lending Portfolio**

Type of facility	Determinant	Categorisation of NPA			
		Overdue / special mention	Substandard	Doubtful	Loss
Overdrafts	Period that the outstanding is in excess of the sanctioned limit continuously	Equal to or more than 90 days but less than 180 days	Equal to 180 days or more but less than 360 days	Equal to or more than 360 days but less than 540 days	Equal to 540 days or more
Credit facilities repayable in monthly installments	No of installments, principal and / or interest due and unpaid	3 installments or more but less than 6 installments	6 installments or more but less than 12 installments	12 installments or more but less than 18 installments	Equal to 18 installments or more
Credit cards	No of days minimum payment is in arrears for from due date	90 days or more but less than 120 days	120 days or more but less than 180 days	180 days or more but less than 240 days	Equal to 240 days or more
Other credit facilities	No of days payments are in arrears from the due date	90 days or more but less than 180 days	180 days or more but less than 360 days	360 days or more but less than 540 days	Equal to 540 days or more

Provision for possible loan losses are made on the basis of a continuous review of all advances to customers, in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank, after considering the values of the collateral obtained against the respective non performing loans and advances.

Valuation of collateral is performed based on the direction issued by the Central Bank of Sri Lanka as explained in Note 28 (c) iii.

28 (c) iii Valuation of Securities for Provisioning Purposes

As per Direction No 3 of 2008 dated 8th May 2008 issued by the Central Bank of Sri Lanka on Classification of Loans and Advances, Income recognition and provisioning, the initial and progressive discounts that need to be applied to the Forced Sale Value (FSV) of immovable property held as collateral are as follows:

Category	% of FSV of immovable property that can be considered as the value of security	
	Freehold Property	Leasehold Property
At the first time of provisioning	75	60
Period in the loss section		
Less than 12 months	75	60
More than 12 but less than 24 months	60	50
More than 24 but less than 36 months	50	40
More than 36 but less than 48 months	40	30
More than 48 months	Property should be reviewed on a regular basis and discounted further at the discretion of the bank's management	
		Nil

NOTES TO THE FINANCIAL STATEMENTS

continued

28 LOANS AND ADVANCES (Contd.)**28 (d) Asset Quality - Non Performing Lending Portfolio - Bank / Group**

As at 31st December	2011		2010	
	Rs 000		Rs 000	
Bills of exchange	106,026		100,559	
Loans and advances	10,847,525		9,927,769	
Foreclosed properties	476,256		463,283	
Lease receivable	536,893		595,641	
Gross non-performing lending portfolio	11,966,700		11,087,252	
Less: Specific provisions				
Bills of exchange [Note 26 (a)]	86,704		74,458	
Lease receivable [Note 27 (c)]	156,142		197,631	
Loans and advances (Note 28)	2,442,585		3,157,152	
Foreclosed properties [Note 28 (i)]	461,398	3,146,829	448,778	3,878,019
		8,819,871		7,209,233
Less: Interest in suspense [Note 28 (g)]		1,670,016		1,697,742
Net non-performing lending portfolio		7,149,855		5,511,491
NPA ratio		3.92%		4.51%

Net non-performing lending portfolio of Rs 7,149.9 Mn (2010 : Rs 5,511.5 Mn) is secured by immovable assets, movable assets and other registered securities, approved by the Central Bank of Sri Lanka for provisioning purposes. The values of the immovable properties are discounted for provisioning purposes as explained in Note 28 (c) iii.

28 (e) Credit Risk**28 (e) i Collateral Wise Analysis of Gross Non-performing Lending Portfolio**

The Bank holds collateral against its lending portfolio in the form of mortgage interest over property, other registered securities and assets. Estimation of fair values / realisable values are based on the value of collateral assessed at the time of lending and generally are not updated except when a loan is individually assessed as non-performing.

As at 31st December	2011		2010	
	Rs 000	%	Rs 000	%
Secured by immovable assets	9,754,482	81	7,111,325	64
Secured by movable assets	552,281	5	697,181	6
Secured by cash / shares	144,979	1	110,691	1
Other securities	1,043,440	9	1,729,624	16
Clean	434,878	4	1,413,599	13
Pawning	36,640	-	24,832	-
	11,966,700	100	11,087,252	100

28 LOANS AND ADVANCES (Contd.)**28 (e) Credit Risk (Contd.)****28 (e) ii Sector / Product Wise Analysis of Gross Lending Portfolio - Bank 2011**

The Bank monitors concentration of credit risk by sectors. An analysis of concentration of credit risk as at the Balance Sheet date is shown below:

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	%
Agriculture and fishing	7,178,438	215,063	12,205,869	3,414,303	-	2,796,590	25,810,263	9.81
Manufacturing	7,821,235	916,004	13,019,064	5,383,137	-	2,756,875	29,896,315	11.36
Tourism	767,344	17,286	6,215,095	7,808,259	-	1,570,513	16,378,497	6.22
Transport	649,740	21,884	1,744,617	1,277,759	-	6,516,733	10,210,733	3.88
Construction	3,678,214	140,953	8,226,196	26,525,213	-	-	38,570,576	14.65
Traders	13,063,537	288,367	21,328,430	6,193,301	-	-	40,873,635	15.53
New economy	446,342	13,617	2,051,427	913,320	-	-	3,424,706	1.30
Financial and business services	3,391,043	80,415	14,875,531	3,158,543	-	-	21,505,532	8.17
Infrastructure	1,430,695	136,997	2,229,215	3,276,081	-	-	7,072,988	2.69
Other services	7,596,037	114,871	3,043,385	2,277,137	-	-	13,031,430	4.95
Other customers	2,098,901	2,347,294	3,628,618	1,705,516	35,715,818	10,928,068	56,424,215	21.44
Total	48,121,526	4,292,751	88,567,447	61,932,569	35,715,818	24,568,779	263,198,890	100.00
Gross loans and advances (Note 28)							238,630,111	90.67
Gross lease receivable (Note 27)							24,568,779	9.33
							263,198,890	100.00
The "other customers" category comprises the following advances:								
Credit card	-	2,238,201	-	-	-	-	2,238,201	3.97
Pawning*	-	-	-	-	35,715,818	-	35,715,818	63.30
Others	2,098,901	109,093	3,628,618	1,705,516	-	10,928,068	18,470,196	32.73
Total	2,098,901	2,347,294	3,628,618	1,705,516	35,715,818	10,928,068	56,424,215	100.00

* Pawning includes facilities extended to agriculture and fishing sectors amounting to Rs 3.16 Bn.

NOTES TO THE FINANCIAL STATEMENTS

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28 LOANS AND ADVANCES (Contd.)**28 (e) Credit risk (Contd.)****28 (e) iii Sector / Product Wise Analysis of Gross Lending Portfolio - Bank 2010**

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	%
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	
Agriculture and fishing	4,341,287	7,469,118	6,117,361	571,954	-	780,835	19,280,555	9.30
Manufacturing	5,399,197	9,668,639	8,143,561	1,079,785	-	-	24,291,182	11.23
Tourism	720,931	852,611	6,189,300	4,426,970	-	-	12,189,812	5.88
Transport	656,604	639,381	2,769,542	346,124	-	7,580,480	11,992,131	5.78
Construction	2,565,157	2,198,428	5,921,233	20,238,811	-	2,856,613	33,780,242	16.29
Traders	12,391,709	9,684,827	8,385,630	2,243,420	-	163,070	32,868,656	15.85
New economy	451,803	261,615	961,572	141,912	-	807,093	2,623,995	1.27
Financial and business services	3,754,775	2,727,599	8,046,167	1,053,103	-	-	15,581,644	7.51
Infrastructure	1,447,533	518,119	1,094,962	2,539,863	-	-	5,600,477	2.70
Other services	8,545,519	1,982,822	1,209,366	529,386	-	1,508,725	13,775,818	6.64
Other customers	2,869,881	2,260,439	938,256	2,170,825	27,965,219	222,501	36,427,121	17.55
Total	43,144,396	38,263,598	49,776,950	35,342,153	27,965,219	13,919,317	208,411,633	100.00
Gross loans and advances (Note 28)							194,492,316	93.32
Gross lease receivable (Note 27)							13,919,317	6.68
							208,411,633	100.00

The "other customers" category comprises the following advances:

Credit card	-	1,877,220	-	-	-	-	1,877,220	5.15
Pawning*	-	-	-	-	27,965,219	-	27,965,219	76.77
Others	2,869,881	383,219	938,256	2,170,825	-	222,501	6,584,682	18.08
Total	2,869,881	2,260,439	938,256	2,170,825	27,965,219	222,501	36,427,121	100.00

* Pawning includes facilities extended to agriculture and fishing sectors amounting to Rs 6.057 Bn.

28 LOANS AND ADVANCES (Contd.)**28 (e) Credit Risk (Contd.)****28 (e) iv Sector / Product Wise Analysis of Gross Lending Portfolio - Group 2011**

Sector / Type of Loan	Overdrafts Rs 000	Short Term Loans Rs 000	Medium Term Loans Rs 000	Long Term Loans Rs 000	Pawning Rs 000	Leasing Rs 000	Total Rs 000	%
Agriculture and Fishing	7,178,438	215,063	12,205,869	3,414,303	-	2,796,590	25,810,263	9.87
Manufacturing	7,821,235	916,004	13,019,064	5,383,137	-	2,756,875	29,896,315	11.43
Tourism	767,344	17,286	6,215,095	7,808,259	-	1,570,513	16,378,497	6.26
Transport	649,740	21,884	1,744,617	1,277,759	-	6,516,733	10,210,733	3.90
Construction	3,222,656	140,953	8,226,196	25,175,293	-	-	36,765,098	14.06
Traders	13,063,537	288,367	21,328,430	6,193,301	-	-	40,873,635	15.63
New Economy Financial and	446,342	13,617	2,051,427	913,320	-	-	3,424,706	1.31
Business Services	3,369,230	80,415	14,875,531	3,158,543	-	-	21,483,719	8.21
Infrastructure	1,430,695	136,997	2,229,215	3,276,081	-	-	7,072,988	2.70
Other Services	7,596,037	114,871	3,043,385	2,277,137	-	-	13,031,430	4.98
Other Customers	2,098,901	2,347,294	3,786,064	1,705,516	35,715,818	10,928,068	56,581,661	21.65
Total	47,644,155	4,292,751	88,724,893	60,582,649	35,715,818	24,568,779	261,529,045	100.00
Gross loans and advances (Note 28)							236,960,266	90.61
Gross lease receivable (Note 27)							24,568,779	9.39
							261,529,045	100.00
Credit card	-	2,238,201	-	-	-	-	2,238,201	3.96
Pawning	-	-	-	-	35,715,818	-	35,715,818	63.12
Other	2,098,901	109,093	3,786,064	1,705,516	-	10,928,068	18,627,642	32.92
Total	2,098,901	2,347,294	3,786,064	1,705,516	35,715,818	10,928,068	56,581,661	100.00

* Pawning includes facilities extended to agriculture and fishing sectors amounting to Rs 3.16 Bn.

NOTES TO THE FINANCIAL STATEMENTS

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28 LOANS AND ADVANCES (Contd.)**28 (e) Credit Risk (Contd.)****28 (e) v Sector / Product Wise Analysis of Gross Lending Portfolio - Group 2010**

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	%
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	
Agriculture and Fishing	4,341,287	7,469,118	6,117,361	571,954	-	780,835	19,280,555	9.39
Manufacturing	5,399,197	9,668,639	8,143,561	1,079,785	-	-	24,291,182	11.34
Tourism	720,931	852,611	6,189,300	4,426,970	-	-	12,189,812	5.94
Transport	656,604	639,381	2,769,542	346,124	-	7,580,480	11,992,131	5.84
Construction	2,155,596	2,198,428	5,921,233	18,463,851	-	2,856,613	31,595,721	15.39
Traders	12,391,709	9,684,827	8,385,630	2,243,420	-	163,070	32,868,656	16.01
New Economy	451,803	261,615	961,572	141,912	-	807,092	2,623,994	1.28
Financial and Business Services	3,754,775	2,727,599	8,046,167	1,053,103	-	-	15,581,644	7.59
Infrastructure	1,447,533	518,119	1,094,962	2,539,863	-	-	5,600,477	2.72
Other Services	8,545,519	1,982,822	1,209,366	529,386	-	1,508,725	13,775,818	6.70
Other Customers	2,869,881	2,260,439	1,071,661	2,170,825	27,965,219	222,501	36,560,526	17.80
Total	42,734,835	38,263,598	49,910,355	33,567,193	27,965,219	13,919,316	206,360,516	100.00
Gross loans and advances (Note 28)							192,441,199	93.25
Gross lease receivable (Note 27)							13,919,317	6.75
							206,360,516	100.00
Credit card	-	1,877,220	-	-	-	-	1,877,220	5.13
Pawning	-	-	-	-	27,965,219	-	27,965,219	76.49
Other	2,869,881	383,219	1,071,661	2,170,825	-	222,501	6,718,087	18.38
Total	2,869,881	2,260,439	1,071,661	2,170,825	27,965,219	222,501	36,560,526	100.00

* Pawning includes facilities extended to agriculture and fishing sectors amounting to Rs 6.057 Bn.

28 LOANS AND ADVANCES (Contd.)

As at 31st December

	2011	2010
	Rs 000	Rs 000

28 (f) Movement in Interest in Suspense for Loans - Bank / Group

Balance as at 1st January	1,688,582	1,661,926
Interest suspended	1,330,147	1,962,086
Exchange translation	5,663	-
Interest recovered	(1,352,219)	(1,924,285)
Interest written off	(12,562)	(11,145)
Transfer to interest in suspense for bills of exchange [Note 26 (b)]	(1,900)	-
Balance as at 31st December [Note 28 (g)]	1,657,711	1,688,582

28 (g) Total Interest in Suspense - Bank / Group

Bills of exchange [Note 26 (b)]	12,305	9,160
Loans and advances [Note 28 (f)]	1,657,711	1,688,582
Total interest in suspense	1,670,016	1,697,742

As a policy, the Bank seals off interest on non-performing loans and advances after one year of classification into the loss category. However, at the time of recovery, further interest on such advances is calculated from the date on which interest was sealed off.

28 (h) Movement in Foreclosed Properties - Bank / Group

As at 31st December

	2011	2010
	Rs 000	Rs 000

Balance as at 1st January	14,505	14,958
Disposals during the year	-	(721)
Exchange translation	1,719	436
Provision during the year	(1,366)	(889)
Provision reversed during the year	-	721
Balance as at 31st December	14,858	14,505

The total of foreclosed properties and related provisions have been classified under loans and advances

Sri Lanka Rupee loans and advances	25,378	25,378
Foreign currency loans and advances	450,878	437,905
Specific provision for foreclosed properties [Note 28 (i)]	(461,398)	(448,778)
	14,858	14,505

28 (i) Movement in Provision for Foreclosed Properties - Bank / Group

Balance as at 1st January	448,778	461,768
Exchange rate variance in foreign currency provision	11,254	(13,158)
Provision during the year	1,366	889
Recoveries made during the year	-	(721)
Balance as at 31st December [Note 28 (b) i]	461,398	448,778

28 (j) Loans granted from Investment Fund Account

The details of loans granted from Investment Fund Account which were outstanding as at 31st December 2011 are as follows.

	Number of loans	Total amount outstanding Rs 000	Interest rate	Tenure
Agriculture	1	164,150	10.33% (LKR)	5 Years
Infrastructure development	2	247,940	9.49% (LKR) & 9.83% (LKR)	8 Years
Construction of hotels and related purposes	2	1,517,260	5.32% (US\$) & 9.24% (LKR)	6-7 Years
		1,929,350		

Investment Fund Account was Rs 978.337 Mn as at the Balance Sheet date. This balance had been fully allocated against the loans granted. Further loans of Rs 951.013 Mn had been granted for this purpose which is in excess of the balance in the Investment Fund Account as at the Balance Sheet date.

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29 INVESTMENT SECURITIES**29 (a) Investment Securities Summary**

As at 31st December	2011 Cost of Investment Rs 000	2010 Cost of Investment Rs 000
Quoted shares - Bank [Note 29 (b)]	1,605,918	911,399
Quoted units in unit trusts - Bank [Note 29 (c)]	150,000	150,000
Unquoted shares - Bank [Note 29 (d)]	207,456	387,956
Sri Lanka Development bonds and Sovereign bonds - Bank [Note 29 (e)]	12,062,741	10,183,798
Government of Sri Lanka treasury bonds - Bank [Note 29 (f)]	10,316,759	8,297,895
Government of Sri Lanka treasury bills and CBSL securities - Bank [Note 29 (g)]	36,073,227	37,508,009
Foreign government bonds - Bank [Note 29 (h)]	-	140,645
Other long term investments - Bank [Note 29 (i)]	2,526,400	1,124,400
Investment Securities - Bank	62,942,501	58,704,102
Quoted shares - Joint Venture [Note 29 (j)]	580	580
Unquoted shares - Joint Venture [Note 29 (k)]	44,603	46,303
Quoted units in unit trusts - Subsidiaries and Joint Venture [Note 29 (l)]	7,203	7,203
Unquoted units in unit trusts - Subsidiaries [Note 29 (m)]	113,250	81,500
Quoted debentures - Subsidiaries and Joint Venture [Note 29 (n)]	429,920	257,420
Unquoted debentures - Subsidiaries and Joint Venture [Note 29 (o)]	296,500	150,500
Government of Sri Lanka treasury bonds - Subsidiaries and Joint Venture [Note 29 (p)]	1,563,055	1,003,076
Investment securities - Bank	62,942,501	58,704,102
Investment Securities - Group	65,397,612	60,250,684

Based on the internal assessment carried out by the Board of Directors as at 31st December 2011, there was no indication of impairment other than those disclosed in Note 29 (d) and Note 29 (h) which required provision for other than temporary decline in value of investment securities of the Bank.

Investment securities through the Joint Venture reported above represent only 50% of the total investment securities of the Joint Venture, being the shareholding of the Bank on the same.

29 (b) Quoted Shares Held by the Bank

As at 31st December	2011			2010		
	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
DFCC Bank	32,109,140	911,399	3,625,122	32,109,140	911,399	6,428,250
National Development Bank PLC	4,282,200	694,519	599,508	-	-	-
Total Quoted Shares - Bank		1,605,918	4,224,630		911,399	6,428,250

During 2010, the Bank's investments in Ceylinco Insurance PLC, Commercial Bank of Ceylon PLC and Distilleries Company of Sri Lanka PLC were transferred to dealing securities and were subsequently disposed in that year itself. The resultant gain of Rs 497.114 Mn was reported under "Capital gain from sale of investment securities (disposed through dealing securities)" in Note 14 - Other Income.

29 INVESTMENT SECURITIES (Contd.)**29 (c) Quoted Units in Unit Trusts held by the Bank**

As at 31st December

	No of Units	2011	Market Value Rs 000	No of Units	2010	Market Value Rs 000
		Cost of Investment Rs 000			Cost of Investment Rs 000	
Namal Acuity Value Fund	3,000,000	150,000	203,700	3,000,000	150,000	270,000
Total Quoted Units in Unit Trusts - Bank		150,000	203,700		150,000	270,000

29 (d) Unquoted Shares Held by the Bank

As at 31st December

	No of Shares	2011	Directors' Valuation Rs 000	No of Shares	2010	Directors' Valuation Rs 000
		Cost of Investment Rs 000			Cost of Investment Rs 000	
Browns' Group Motels Ltd *	-	-	-	50,000	500	500
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530
Fitch Rating Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	225,000	2,250	2,250
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
Dialog Axiata PLC						
Rated cumulative redeemable preference shares	180,000,000	180,000	180,000	360,000,000	360,000	360,000
Magpek Exports Ltd	359,000	14,360	-	359,000	14,360	-
Metal Recyclers Colombo Ltd	-	-	-	69	3	-
Provision for diminution in market value **		(14,360)			(14,363)	
Total Unquoted Shares - Bank		207,456	207,456		387,956	387,956

* During the year the investment in Browns' Group Motels Ltd was disposed and the resultant gain of Rs 0.444 Mn has been reported under "Capital gain from sale of investment securities" in Note 14 - Other Income. Gain of Rs 101.71 Mn reported as "Capital gain from sale of investment securities" in 2010, represent the gain from disposal of investment of 49.99% in Acuity Securities Limited with a cost of Rs 74.985 Mn to Acuity Partners (Pvt) Ltd, a Joint Venture between the Bank and DFCC Bank during 2010.

** As shares of Magpek Exports Ltd has been de-listed, the market value is shown as nil. Provision of Rs 14.36 Mn for diminution in market value has been made in the Financial Statements. The investment in Metal Recyclers Colombo Ltd was written off against the provision during the year.

29 (e) Sri Lanka Development Bonds and Sovereign Bonds Held by the Bank

As at 31st December

Face Value	Year of Maturity	Carrying Value (Rs 000)	2011	2010
			Cost of Investment Rs 000	Cost of Investment Rs 000
Rs 7,517 Mn	2012	7,506,741		
Rs 2,278 Mn	2014	2,278,000		
Rs 2,278 Mn	2015	2,278,000		
Total Sri Lanka Development Bonds and Sovereign Bonds - Bank			12,062,741	10,183,798

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29 INVESTMENT SECURITIES (Contd.)

29 (f) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December				2011		2010	
Face Value	Year of Maturity	Carrying Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Market Value Rs 000
Rs 6,399 Mn	2012	6,412,647					
Rs 1,701 Mn	2013	1,727,672					
Rs 2,150 Mn	2014	2,176,440					
Total Government of Sri Lanka Treasury Bonds - Bank			10,316,759	10,195,236	8,297,895	8,314,671	

29 (g) Government of Sri Lanka Treasury Bills and CBSL Securities Held by the Bank

Face Value	Year of Maturity	Carrying Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Market Value Rs 000
Rs 36,701 Mn	2012	36,073,227			
Total Government of Sri Lanka Treasury Bills and CBSL Securities - Bank			36,073,227	35,950,659	37,508,009

29 (h) Foreign Government Bonds Held by the Bank

Face Value	Year of Maturity	Carrying Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Market Value Rs 000
Rs 147 Mn	2012	145,910	145,910		
Provision for diminution in value			(145,910)		
Total Foreign Government Bonds - Bank			-	-	140,645

These bonds are issued by the Government of Greece and the investment is fully provided for.

29 (i) Other Long Term Investments Held by the Bank

As at 31st December		2011		2010	
		Cost Rs 000	Directors' Valuation Rs 000	Cost Rs 000	Directors' Valuation Rs 000
Long term non-negotiable bonds					
maturing on 14th November 2016					
		489,000	489,000	489,000	489,000
Central Finance PLC - securitised notes*					
		92,000	92,000	-	-
LB Finance PLC - securitised notes trust 19*					
		700,000	700,000	-	-
People's Leasing Co. Ltd. - securitised notes trust 71*					
		730,000	730,000	-	-
People's Leasing Co. Ltd. - securitised notes trust 65*					
		365,400	365,400	365,400	365,400
Singer Sri Lanka PLC Debentures*					
		150,000	150,000	270,000	270,000
Total Other Long Term Investments - Bank		2,526,400	2,526,400	1,124,400	1,124,400

*Rs 411 Mn out of these investments will be redeemed in 2012.

29 (j) Quoted Shares Held through Joint Venture

As at 31st December		2011		2010	
No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
John Keells Holdings PLC	6,240	22	796	4,680	22
Hayleys PLC	7,491	558	2,809	7,491	558
Central Finance PLC	15	-	-	3	-
Vallible One PLC	35,000	-	836	-	-
Total Quoted Shares - Joint Venture		580	4,441	580	3,982

29 INVESTMENT SECURITIES (Contd.)**29 (k) Unquoted Shares Held through Joint Venture**

As at 31st December

	2011		2010	
	No of Shares	Cost of Investment Rs 000	No of Shares	Cost of Investment Rs 000
Durdans Heart Surgical Centre (Private) Ltd	750,000	7,313	750,000	7,313
Durdans Medical & Surgical Centre (Private) Ltd	1,000,000	12,500	1,000,000	12,500
Vibhavi Hydro Generation (Pvt) Ltd	50	1,629	-	-
Pupulaketiya Hydro Power (Pvt) Ltd	51	1,141	-	-
KankiriyaThamabiliya Mini Hydro Power Project	2	5,530	-	-
E Services Lanka Limited (Preference Shares)	1,250,000	12,500	1,250,000	12,500
Tudawe Brothers Limited (Preference Shares)	-	-	100,000	10,000
Nividhu (Private) Limited (Preference Shares)	1,640,000	16,490	1,640,000	16,490
		57,103		58,803
Provision for diminution in value		(12,500)		(12,500)
Total Unquoted Shares - Joint Venture		44,603		46,303

29 (l) Quoted Units in Unit Trusts Held by Subsidiaries and through Joint Venture

As at 31st December

	2011			2010		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	No of Units	Cost of Investment Rs 000	Market Value Rs 000
Namal AcuityValue Fund	114,400	7,203	7,767	114,400	7,203	10,296
Total Quoted Units - Subsidiaries and Joint Venture		7,203	7,767		7,203	10,296

29 (m) Unquoted Units in Unit Trusts Held by Subsidiaries

As at 31st December

	2011		2010	
	No of Units	Cost of Investment Rs 000	No of Units	Cost of Investment Rs 000
Namal Giltedge Funds	1,000,000	10,000	1,000,000	10,000
Namal IPO Fund	1,000,000	9,750	-	-
Cey Bank	3,300,000	33,000	4,000,000	40,000
Ceylon Asset Management	664,622	6,500	664,622	6,500
FCWealth Fund	3,851	4,000	-	-
Ceylon Income Fund	1,896,813	25,000	-	-
Namal Income Fund	2,436,870	25,000	2,436,870	25,000
Total Unquoted Units in Unit Trusts - Subsidiaries		113,250		81,500

As at 31st December

	2011		2010	
	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000

29 (n) Quoted Debentures Held by Subsidiaries and through Joint Venture

DFCC Bank (Rs 1000/- each)	5,000	5,000	10,000	10,000
Lanka Orix Leasing Company PLC	750,000	75,000	-	-
Merchant Bank of Ceylon	225,000	22,500	-	-
Merchant Bank of Sri Lanka PLC	450,000	45,000	-	-
National Development Bank PLC	20,000	20,000	-	-
Seylan Bank PLC (Rs 100/- each)	100,000	10,000	100,000	10,000
Sampath Bank PLC (Rs 100/- each)	250,000	25,000	240,000	24,000
Singer (Sri Lanka) PLC (Rs 100/- each)	240,000	24,000	250,000	25,000
Bank of Ceylon (Rs 100/- each)	740,000	74,000	590,000	59,000
NationsTrust Bank PLC (Rs 1000/- each)	17,000	17,000	17,000	17,000
Urban Development Authority (Rs 100/- each)	1,124,200	112,420	1,124,200	112,420
Total Quoted Debentures - Subsidiaries and Joint Venture		429,920		257,420

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29 INVESTMENT SECURITIES (Contd.)**29 (o) Unquoted Debentures Held by Subsidiaries and through Joint Venture**

As at 31st December	2011		2010	
	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
Abans (Pvt) Ltd	75,000	75,000	-	-
People's Leasing Co. Ltd	750,000	75,000	-	-
National Development Bank PLC	20,000	20,000	-	-
Seylan Bank PLC (Rs 100/- each)	-	-	150,000	15,000
Senkadagala Finance Co. Ltd (Rs 1000/-each)	40,000	40,000	40,000	40,000
DSI Holdings Ltd (Rs 1000/-each)	25,500	16,500	30,000	25,500
Ceylon Hospital PLC (Rs 10/- each)	5,000,000	50,000	5,000,000	50,000
Neluwa Cascade Hydro Power (Private) Limited	2,000,000	20,000	2,000,000	20,000
Total Unquoted Debentures - Subsidiaries and Joint Venture		296,500		150,500

As at 31st December	2011		2010	
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000

29 (p) Government of Sri Lanka Treasury Bonds Held by Subsidiaries and through Joint Venture

Face Value	Year of Maturity	Carrying Value (Rs 000)		
Rs 218 Mn	2012	214,366		
Rs 608 Mn	2013	556,040		
Rs 150 Mn	2014	150,499		
Rs 310 Mn	2015	320,295		
Rs 350 Mn	2016	321,855		
Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Venture			1,563,055	1,630,649

29 (q) Assets Pledged as Security

Out of the treasury bills and bonds classified as dealing and investment securities, the following amount is pledged as security for re-purchase agreements entered into by the Bank / Group.

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Treasury bills	5,867,639	10,926,033	7,289,424	11,989,447
Treasury bonds	691,449	1,025,694	1,396,260	1,631,688
	6,559,088	11,951,727	8,685,684	13,621,135

29 (r) Investment in government securities on behalf of Investment Fund Account

There were no investments in government securities on behalf of Investment Fund Account as at 31st December 2011.

30 INVESTMENTS IN ASSOCIATES**30 (a) Bank**

As at 31st December			2011 Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	2010 Cost of Investment Rs 000	Directors' Valuation Rs 000
	Principal Activity	% Holding					
Unquoted							
Browns Engineering (Pvt) Ltd (2,056,000 ordinary shares)	Engineering	-	-	-	32.63%	20,560	-
Delma Exchange (simple limited partnership)	Dealing in foreign exchange	20.00%	83,674	83,674	20.00%	83,651 (20,560)	83,651
Provision for diminution in value			-				
Total for the Bank			83,674			83,651	

Browns Engineering (Pvt) Ltd

Investment in Browns Engineering (Pvt) Ltd was written off against the provision during the year.

Delma Exchange

Delma Exchange is a limited liability partnership incorporated in Abu Dhabi and the Bank holds 20% of this partnership. Increase in the investment in Delma Exchange of Rs 0.023 Mn is as a result of the exchange rate movement between the date of investment and the date of settlement.

As at 31st December	Quoted Investments*		Unquoted Investments		Total	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
30 (b) Group						
Investment in Associate companies (at cost)	-	132,326	192,271	71,730	192,271	204,056
Investment in Associate company through Joint Venture	-	-	-	59,870	-	59,870
Additional investment in Associate company by the Bank	-	-	23	12,171	23	12,171
Additional investment in Associate company held by Subsidiary	-	-	7,661	-	7,661	-
Additional investment in Associate company held through Joint Venture	-	-	192,000	48,500	192,000	48,500
Negative goodwill on acquisition recognised in Income Statement	-	5,830	5,629	3,416	5,629	9,246
Group share of Associate company retained profits balance as at 1st January	-	14,206	(693)	(4,648)	(693)	9,558
Current year's share of profits / (loss) after tax	-	(6,384)	(15,729)	3,955	(15,729)	(2,429)
Exchange effect on revaluation of investment	-	-	3,157	1,015	3,157	1,015
Disposal of Associate company	-	(145,978)	-	-	-	(145,978)
Group Investment in Associate companies (equity basis)	-	-	384,319	196,009	384,319	196,009

***Lanka Ventures PLC**

In 2010, Bank's investment in Lanka Ventures PLC was sold to Acuity Partners (Pvt) Ltd, a Joint Venture investment banking company of DFCC Bank and HNB. Accordingly the company ceased to be an Associate of the Bank from 18th January 2010. The gain from sale of this investment of Rs 47.581 Mn is disclosed in Note 14 - Other Income. Accordingly 2011 balances have not been reported above.

Splendor Media (Pvt) Ltd (Splendor Media)

The Bank's fully owned Subsidiary Sithma Development (Pvt) Ltd (Sithma) increased its holding in Splendor Media from 25% as at 31st December 2010 to 49.99% during 2011. Accordingly Splendor Media continues to be accounted for as an Associate of Sithma.

Associate through the Joint Venture reported above represent only 50% of the total investment in Associate, being the shareholding of the Bank on the same.

The Board of Directors carried out an internal assessment of impairment as at 31st December 2011 and concluded that there was no indication of impairment of this investment.

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30 INVESTMENTS IN ASSOCIATES (Contd.)**30 (c) Summarised Financial Information of Associates****30 (c) i Associates Held by the Bank**

As at 31st December	Delma Exchange (Pvt) Ltd	
	2011 Rs 000	2010 Rs 000
Revenue	50,014	17,670
Expenses	(147,771)	(97,057)
Tax	-	-
Loss after tax	(97,757)	(79,387)
Current assets	224,644	257,615
Non-current assets	47,422	45,568
Total assets	272,066	303,183
Current liabilities	60,204	2,683
Non-current liabilities	4,187	2,993
Total liabilities	64,391	5,676

30 (c) ii Associate Held by Subsidiary - Sithma

As at 31st December	Splendor Media (Pvt) Ltd	
	2011 Rs 000	2010 Rs 000
Revenue	90,778	81,525
Expenses	(83,520)	(68,767)
Tax	(1,072)	(7,472)
Profit after tax	6,186	5,286
Current assets	102,924	115,195
Non-current assets	4,344	1,728
Total assets	107,268	116,923
Current liabilities	59,648	75,851
Non-current liabilities	1,096	483
Total liabilities	60,744	76,334

30 (c) iii Associates Held through Joint Venture - Acuity

As at 31st December	Unit Energy Lanka (Pvt) Ltd		Hayles Hydro Energy (Pvt) Ltd		Neluwa Cascade Hydropower	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Revenue	101,462	160,867	-	-	68,508	72,542
Expenses	(76,256)	(96,645)	(393)	(93)	(52,925)	(60,595)
Tax	(4,663)	(4,257)	-	-	(6,929)	(6,840)
Profit / (loss) after tax	20,543	59,965	(393)	(93)	8,654	5,107
Current assets	28,232	76,336	-	26	34,812	18,567
Non-current assets	469,744	487,697	119,100	119,100	356,235	349,553
Total assets	497,976	564,033	119,100	119,126	391,047	368,120
Current liabilities	20,807	32,886	1,212	844	64,517	87,625
Non-current liabilities	234,250	284,553	-	-	229,308	185,085
Total liabilities	255,057	317,439	1,212	844	293,825	272,710

The above companies are Associates of Lanka Ventures PLC which is a Subsidiary of Acuity Partners (Pvt) Ltd.

31 INVESTMENT IN JOINT VENTURE

Bank

As at 31st December

	Principal Activity	% Holding	2011 Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	2010 Cost of Investment Rs 000	Directors' Valuation Rs 000
Unquoted							
Acuity Partners (Pvt) Ltd	Investment banking	50%	655,000	655,000	50%	655,000	655,000
Total for the Bank			655,000	655,000		655,000	655,000

Bank's interest in Acuity Partners (Pvt) Ltd include:

	2011 Rs 000	2010 Rs 000
Assets	3,283,755	2,985,433
Liabilities	2,263,262	2,051,891
Income	448,206	484,785
Expenses	259,850	225,641
Tax	25,580	69,569

Acuity Partners (Pvt) Ltd, the Joint Venture of the Bank entered into a Joint Venture "Guardian Acuity Asset Management Ltd" on 17th June 2011.

32 INVESTMENTS IN SUBSIDIARIES**32 (a) Quoted**

As at 31st December

	Principal Activity	% Holding	2011 Cost of Investment Rs 000	Market Value Rs 000	% Holding	2010 Cost of Investment Rs 000	Market Value Rs 000
HNB Assurance PLC (29,993,000 shares) *	Insurance	60%	384,285	1,709,601	60%	149,965	1,754,591
Total Quoted			384,285			149,965	

* Bank subscribed to the rights issue of HNB Assurance PLC during the year. As a result, the number of shares held by the Bank in HNB Assurance PLC increased from 22,494,750 to 29,993,000.

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32 INVESTMENTS IN SUBSIDIARIES (Contd.)**32 (b) Unquoted**

As at 31st December			2011	Directors'		2010	Directors'
	Principal Activity	% Holding	Cost of Investment Rs 000	Valuation Rs 000	% Holding	Cost of Investment Rs 000	Valuation Rs 000
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	Property development	100%	1,973,000	1,973,000	100%	1,973,000	1,973,000
Majan Exchange LLC (200,000 shares)	Dealing in foreign exchange	40%	56,121	-	40%	56,121	56,121
Commercial Interlink Services Inc (o/a Delma Exchange Canada) (100,001 shares)	Dealing in foreign exchange	100%	10,063	-	100%	10,063	-
	Provision for diminution in value		(66,184)			(10,063)	
Total Unquoted			1,973,000			2,029,121	
Total for the Bank [32 (a) and 32 (b)]			2,357,285			2,179,086	

Bank together with 40% shareholding in Majan Exchange LLC and management control over the activities of the company can govern the financial and operating policies of the company. Accordingly the investment in Majan Exchange LLC has been classified as investment in Subsidiary.

During the year the Bank made a full provision against the investment in Majan Exchange LLC of Rs 56.121 Mn and Rs 13.896 Mn (Note 36) against the receivable from the said Subsidiary in view of the continuous losses incurred by the Subsidiary.

As directed by the Director Bank Supervision of the Central Bank of Sri Lanka, the Bank has taken steps to liquidate Commercial Interlink Services Inc (o/a of Delma Exchange Canada) and the commercial operation of the same has been ceased since 1st October 2010. The said entity has been treated as a Subsidiary up to the Balance Sheet date and the results of the same have been consolidated. The Bank has made full provision of Rs 10.063 Mn against the investment and Rs 18.885 Mn (Note 36) against the receivable from the said Subsidiary during 2010, while a further provision of Rs 4.767 Mn was made against the receivable from the said subsidiary in 2011.

33 INVESTMENT PROPERTIES

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Cost				
Balance as at 1st January	376,750	369,503	248,746	243,250
Improvements	395	7,247	-	5,496
Balance as at 31st December	377,145	376,750	248,746	248,746
Accumulated depreciation				
Balance as at 1st January	23,187	18,743	75,151	70,695
Charge for the year	4,584	4,444	4,567	4,456
Balance as at 31st December	27,771	23,187	79,718	75,151
Net book value as at 31st December	349,374	353,563	169,028	173,595

33 (a) Valuation of Investment Properties - Bank

	Building	Extent	Cost / Carrying Amount		Total	Land	Fair Value Building	Total
			Land (Cost)	Building (Net Book Value)				
As at 31st December 2011	sq.ft	Perches	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7	10,800	105	37,081	42,092	79,173	393,750	43,200	436,950
479T B Jayah Mawatha, Colombo 10 *	Land	112.96	75,782	-	75,782	519,616	-	519,616
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 *	Land	26.62	34,889	-	34,889	39,930	-	39,930
10, Sri Uttarananda Mawatha, Colombo 03 **	49,500	40	72,000	87,530	159,530	200,000	147,697	347,697
			219,752	129,622	349,374	1,153,296	190,897	1,344,193

33 (b) Valuation of Investment Properties - Group

	Building	Extent	Cost / Carrying Amount		Total	Land	Fair Value Building	Total
			Land (Cost)	Building (Net Book Value)				
As at 31st December 2011	sq.ft	Perches	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7	10,800	105	37,081	42,092	79,173	393,750	43,200	436,950
Smart building, 21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1	41,688	-	-	89,855	89,855	-	145,908	145,908
			37,081	131,947	169,028	393,750	189,108	582,858

The Bank carries investment properties at cost. Market valuations of the above investment properties were carried out as at 31st December 2009 by Messrs J M J Fernando, FIV, DIV (Sri Lanka), K C B Condegama, AIV (Sri Lanka), members of the Institute of Valuers of Sri Lanka, who are independent valuers not connected with the Bank.

The Directors have carried out an internal valuation as disclosed above as at 31st December 2011 based on the market conditions of similar properties situated within close proximity. Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded there was no impairment in investment properties.

* Land situated at No 479, T B Jayah Mw, Colombo 10 on which HNB Towers is built, and No 21, 21A, 23 and 25 Janadhipathi Mawatha, Colombo 01 are leased to Sithma Development (Pvt) Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as investment property in the Balance Sheet of the Bank. However, according to Sri Lanka Accounting Standard 40 "Investment Property" (SLAS 40), the said lands are treated as property, plant and equipment in the Consolidated Balance Sheet, since these are leased to a Group entity. Accordingly, the revaluation impact of such property has not been adjusted in the Group since the classification is a consolidation adjustment.

** Building situated at No 10, Sri Uttarananda Mw, Colombo 03 is leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. Accordingly this building is classified as investment property in the Balance Sheet of the Bank. However, according to SLAS 40, the said building is treated as property, plant and equipment in the Group Balance Sheet, since Group uses a significant portion of the building for use in the production or supply of goods and services.

NOTES TO THE FINANCIAL STATEMENTS

continued

34 PROPERTY, PLANT AND EQUIPMENT

Bank	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in- Progress	2011 Total	2010 Total
	Note 34 (b) Rs 000	Note 34 (a) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation								
as at 1st January	1,194,882	5,217,723	2,238,264	2,905,763	229,168	159,495	11,945,295	11,097,766
Additions and improvements	66,382	116,857	213,598	291,734	86,219	456,730	1,231,520	977,446
Disposals during the year	(8,734)	(44,355)	(4,463)	(76,379)	(82,131)	-	(216,062)	(105,679)
Sub category transfers during the year	8,840	(8,840)	-	-	-	-	-	-
Transferred from capital work-in-progress	137,535	121,478	-	149,146	-	(408,159)	-	-
Written off during the year*	-	-	-	-	-	-	-	(20,717)
Transferred to debtors	-	-	-	-	-	-	-	(1,200)
Transferred to intangible assets	-	-	-	-	-	(54,666)	(54,666)	(2,321)
Cost / valuation as at 31st December	1,398,905	5,402,863	2,447,399	3,270,264	233,256	153,400	12,906,087	11,945,295
Accumulated depreciation								
as at 1st January	706,697	159,448	1,431,562	2,004,923	168,753	-	4,471,383	3,918,264
Charge for the year	132,967	57,072	249,461	260,973	37,157	-	737,630	657,360
Sub category transfers during the Year	371	(371)	-	-	-	-	-	-
Disposals during the year	(6,220)	(2,541)	(4,463)	(75,181)	(62,329)	-	(150,734)	(104,276)
Accumulated depreciation as at 31st December	833,815	213,608	1,676,560	2,190,715	143,581	-	5,058,279	4,471,348
Net book value as at 31st December 2011	565,090	5,189,255	770,839	1,079,549	89,675	153,400	7,847,808	-
Net book value as at 31st December 2010	488,183	5,058,275	806,735	900,845	60,414	159,495	-	7,473,947

* Based on the internal assesment, Capital Work-in-progress (WIP) relating to system development of Rs 20.7 Mn was written off to the Income Statement during 2010 as it was concluded that the said WIP will not generate any future economic benefits to the Bank.

34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

Group	Leasehold Buildings Note 34 (b) Rs 000	Freehold Land and Buildings Rs 000	Computer Equipment Rs 000	Equipment Furniture and Fixtures Rs 000	Civil Works Rs 000	Motor Vehicles Rs 000	Capital Work-in- Progress Rs 000	2011 Total Rs 000	2010 Total Rs 000
Cost / valuation as at 1st January without exchange effect	1,215,651	10,630,576	2,373,554	5,122,039	3,527	247,989	159,752	19,753,088	18,846,686
Effect of movements in exchange rates	111	-	(30)	96	(87)	-	65	155	528
Cost /Valuation as at 1st January	1,215,762	10,630,576	2,373,524	5,122,135	3,440	247,989	159,817	19,753,243	18,847,214
Acquisitions of Subsidiaries	-	-	-	-	-	-	-	-	7,354
Additions and improvements	66,435	117,512	236,411	304,870	3,091	96,249	456,730	1,281,298	1,033,680
Disposals during the year	(9,621)	(44,355)	(9,230)	(80,537)	-	(87,786)	-	(231,529)	(109,409)
Written off during the year	-	-	-	-	-	-	-	-	(21,702)
Sub category transfers during the year	8,840	(8,840)	-	-	-	-	-	-	-
Transferred from capital work-in-progress	137,535	121,478	-	149,146	-	-	(408,159)	-	-
Transferred to debtors	-	-	-	-	-	-	-	-	(1,200)
Transferred to intangible assets	-	-	-	-	-	-	(54,666)	(54,666)	(2,321)
Effect of movements in exchange rates	8	-	329	137	179	-	-	653	(373)
Cost /Valuation as at 31st December	1,418,959	10,816,371	2,601,034	5,495,751	6,710	256,452	153,722	20,748,999	19,753,243
Accumulated depreciation as at 1st January without exchange effect	714,216	423,422	1,498,745	2,400,770	724	179,609	-	5,217,486	4,514,233
Effect of movements in exchange rates	16	-	(15)	(3)	(19)	-	-	(21)	52
Accumulated depreciation as at 1st January	714,232	423,422	1,498,730	2,400,767	705	179,609	-	5,217,465	4,514,285
Adjustment to opening balance	-	-	-	-	-	-	-	-	(620)
Acquisitions of Subsidiaries	-	-	-	-	-	-	-	-	5,922
Charge for the year	137,563	113,834	267,660	327,897	862	41,678	-	889,494	806,143
Disposals during the year	(6,428)	(2,541)	(6,347)	(77,486)	-	(67,984)	-	(160,786)	(107,265)
Written off during the year	-	-	-	-	-	-	-	-	(927)
Sub category transfers during the year	371	(371)	-	-	-	-	-	-	-
Effect of movements in exchange rates	2	-	157	55	43	-	-	257	(73)
Accumulated Depreciation as at 31st December	845,740	534,344	1,760,200	2,651,233	1,610	153,303	-	5,946,430	5,217,465
Net book value as at 31st December 2011	573,219	10,282,027	840,834	2,844,518	5,100	103,149	153,722	14,802,569	-
Net book value as at 31st December 2010	501,530	10,207,154	874,794	2,721,368	2,735	68,380	159,817	-	14,535,778

As set out in Note 4.12.4, the Bank / Group had revalued its freehold land and buildings as at 1st January 2007, by professionally qualified independent valuers. The revaluation was carried out by taking into account the observable prices in active market or recent market transactions on arm's length term. The revaluation surplus, amounting to Rs 2,778.7 Mn / Rs 5,545.5 Mn had been credited to the revaluation reserve account in respect of Bank / Group respectively in 2007. An impairment loss of Rs 87.76 Mn was recognised in that year in respect of freehold land and buildings based on revaluation of such properties.

Based on the assessment of potential impairment carried out internally by the Board of Directors as at 31st December 2011, no provision was required to be made in the Financial Statements as at Balance Sheet date other than those disclosed above.

NOTES TO THE FINANCIAL STATEMENTS

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34 PROPERTY, PLANT AND EQUIPMENT (Contd.)**34 (a) Freehold Land and Buildings - Bank**

As at 31st December 2011	Buildings Sq.ft.	Extent (perches)	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2011 Rs 000	Net Book Value 2010 Rs 000
Within Colombo City Limits								
Bambalapitiya Branch 285, Galle Road, Colombo 4.	12,590	20.00	80,000	107,938	187,938	16,022	171,916	174,788
Borella Branch 53/1, D S Senanayake Mawatha, Borella.	8,565	28.00	98,493	52,979	151,472	6,858	144,614	145,252
Centralised Operations Building 90, Vinayalankara Mawatha, Colombo 10.	10,250	249.00	996,000	38,985	1,034,985	4,573	1,030,412	1,028,446
City Office 16, Janadhipathi Mawatha, Colombo 1.	49,911	84.00	252,000	84,065	336,065	11,157	324,908	316,760
Grandpass Branch 182, St Joseph Street, Colombo 14.	9,325	24.00	36,000	23,712	59,712	3,177	56,535	57,176
Gunasinghepura Pay Office and Stores 11, Mohandiram's Road, Colombo 12.	6,990	37.53	112,600	17,764	130,364	5,353	125,011	128,368
Panchikawatta Branch 168, Panchikawatta Road, Colombo 10.	10,211	23.67	101,538	30,863	132,401	2,060	130,341	129,491
Pettah Branch 149-151, Main Street, Colombo 11.	9,732	13.03	85,000	47,058	132,058	7,206	124,852	125,530
Pettah Extension Office 88, Main Street, Colombo 11.	5,644	6.29	47,100	18,903	66,003	2,273	63,730	63,511
Sea Street Branch 60, Sea Street, Colombo 11.	7,946	6.93	48,500	25,858	74,358	3,572	70,786	70,607
Wellawatte Branch 102, Galle Road, Wellawatte.	18,040	36.05	140,000	61,566	201,566	6,926	194,640	186,622
Total freehold land and buildings within Colombo City Limits			1,997,231	509,691	2,506,922	69,177	2,437,745	2,426,551

34 PROPERTY, PLANT AND EQUIPMENT (Contd.)**34 (a) Freehold Land and Buildings - Bank (Contd.)**

As at 31st December 2011	Buildings Sq.ft.	Extent (perches)	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2011 Rs 000	Net Book Value 2010 Rs 000
Outside Colombo City Limits								
Akkaraipattu Branch 1, Main Street, Akkaraipattu.	8,635	17.00	20,400	17,129	37,529	2,047	35,482	35,916
Ambalangoda Branch 94/1, New Galle Road, Ambalangoda.	4,950	32.56	31,000	13,893	44,893	1,711	43,182	42,389
Anuradhapura Branch 30, Maithripala Senanayake Mawatha, Anuradhapura.	8,968	59.00	48,083	14,706	62,789	2,138	60,651	61,111
Badulla Branch 15, 15 1/1, Udayaraja Mawatha, Badulla.	4,084	27.75	26,200	13,521	39,721	1,786	37,935	38,357
Boralesgamuwa Branch 24, Maharagama Road, Boralesgamuwa.	4,650	30.34	33,375	15,736	49,111	2,049	47,062	47,461
Dambulla Branch 622, Anuradhapura Road, Dambulla.	5,636	94.50	42,525	16,479	59,004	2,035	56,969	57,398
Galle Branch 3, Wakwella Road, Galle.	9,142	13.80	41,000	22,691	63,691	3,319	60,372	61,067
Gampaha Branch 150, Colombo Road, Gampaha.	16,685	25.00	24,959	115,387	140,346	5,905	134,441	137,219
Gampola Branch 12, Kandy Road, Gampola.	5,114	11.88	14,920	11,736	26,656	1,826	24,830	25,198
Gampola Bare Land 142,144,146, Kandy Road, Gampola.	Under Construction	17.05	28,028	-	28,028	-	28,028	28,028
Hatton Branch 78, Dambulla Road, Hatton.	10,141	69.48	35,179	14,518	49,697	2,058	47,639	48,076
Mount Bungalow 16, Mount Road Hatton	5,088	160.00	16,000	8,044	24,044	1,053	22,991	23,232
Ja-Ela Branch 73, Old Negombo Road Ja-Ela	4,300	19.00	11,400	13,354	24,754	1,902	22,852	22,990
Jaffna Branch 181/5C, Ponnambalam Road Jaffna.	Under Construction	62.36	48,839	34	48,873	10	48,863	48,863

NOTES TO THE FINANCIAL STATEMENTS

continued

34 PROPERTY, PLANT AND EQUIPMENT (Contd.)**34 (a) Freehold Land and Buildings - Bank (Contd.)**

As at 31st December 2011	Buildings Sq.ft.	Extent (perches)	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2011 Rs 000	Net Book Value 2010 Rs 000
Kandy Branch 1, Dalada Veediya, Kandy.	26,391	57.65	432,375	246,863	679,238	21,668	657,570	655,504
Kalmunai Branch 30A, Batticaloa Road Kalmunai.	Under Construction	136.50	19,779	-	19,779	-	19,779	19,779
Kahawatte Branch 77 2A, Main Street, Kahawatte.	14,652	16.14	12,100	42,765	54,865	4,215	50,650	51,719
Kegalle Branch Main Street, Kegalle.	Bare Land	48.70	15,600	-	15,600	-	15,600	15,600
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya.	3,795	31.80	15,150	20,314	35,464	2,279	33,185	33,468
Kurunegala Branch 6, St. Anne's Street, Kurunegala.	16,155	36.25	32,375	83,746	116,121	8,251	107,870	109,218
Mannar Branch 68, Main Street, Mannar.	5,466	23.00	619	17,234	17,853	2,289	15,564	15,975
Marawila Branch 534, Chilaw Road, Marawila.	4,755	43.80	19,545	17,370	36,915	2,370	34,545	35,067
Maskeliya Branch 9, New Town, Maskeliya.	4,757	20.32	4,100	33,369	37,469	2,780	34,689	34,419
Matale Branch* 660, Trincomalee Road, Matale.	-	-	-	-	-	-	-	39,101
Matara Branch 29, Anagarika Dharmapala Mw., Matara.	9,370	26.00	22,000	35,506	57,506	4,574	52,932	53,307
Mount Lavinia Branch 100, Galle Road, Mount Lavinia.	12,674	22.66	34,000	34,432	68,432	5,182	63,250	64,328
Minuwangoda Branch 115A, Minuwangoda Road, Ekala.	3,240	20.51	20,044	6,754	26,798	467	26,331	26,500
Monaragala Branch No 67/11, Kumaradola Road, Monaragala.	Bare Land	20.00	1,455	-	1,455	-	1,455	1,455

*Matale Branch property was disposed in 2011 and the sales proceeds amounted to Rs 27.497 Mn. The resultant loss of Rs 2.8 Mn is netted off in "Profit on sale of property plant and equipment" included in Note 14 - Other Income. The revaluation surplus of this property amounting to Rs 19.374 Mn which was included in capital reserve was transferred to retained earnings subsequent to this sale.

34 PROPERTY, PLANT AND EQUIPMENT (Contd.)**34 (a) Freehold Land and Buildings - Bank (Contd)**

As at 31st December 2011	Buildings Sq.ft.	Extent (perches)	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2011 Rs 000	Net Book Value 2010 Rs 000
Nawalapitiya Branch 92, Gampola Road, Nawalapitiya.	4,600	7.00	6,400	6,959	13,359	1,075	12,284	12,501
Negombo Branch 18, Rajapakse Broadway, Negombo.	4,529	8.88	11,100	50,472	61,572	3,440	58,132	28,884
Negombo Metro Building 190, Colombo Road Negombo.	24,416	51.98	25,479	189,544	215,023	6,830	208,193	202,103
Nittambuwa Branch 22, Kandy Road, Nittambuwa.	9,600	40.05	50,623	155,495	206,118	4,069	202,049	58,471
Nochchiyagama Branch 10, Puttalam Road, Nochchiyagama.	4,025	40.00	10,000	16,298	26,298	2,366	23,932	24,442
Nugegoda Branch 181, High Level Road, Nugegoda.	11,638	15.71	47,130	71,752	118,882	11,274	107,608	121,224
Nuwara Eliya Branch / Bungalow 42, Queen Elizabeth Drive, Nuwara Eliya.	13,507	149.03	41,700	31,350	73,050	3,743	69,307	67,732
Polonnaruwa Branch* 467, Main Street, Kaduruwela Polonnaruwa.	7,740	18.43	-	39,772	39,772	5,588	34,184	32,817
Pussellawa Branch 409/9A, Pussellawa Road, Pussellawa.	8,090	15.90	10,599	22,870	33,469	1,316	32,153	29,370
Ratnapura Branch 21 & 23, Senanayake Mawatha, Ratnapura.	8,166	27.70	24,879	13,459	38,338	1,313	37,025	37,094
Trincomalee Branch 59, Ahambaram Road, Trincomalee.	6,802	33.91	24,137	25,022	49,159	5,938	43,221	43,799
Welimada Branch 35, Nuwara Eliya Road, Welimada.	4,415	14.37	20,747	12,798	33,545	4,230	29,315	28,637
Wellawaya Branch 70, Kumaradasa Mawatha Wellawaya.	3,500	30.00	2,835	21,299	24,134	4,877	19,257	19,583
Wattala Branch 270, 270/1, Negombo Road, Wattala.	7,204	53.00	60,605	35,986	96,591	6,458	90,133	92,322
Total freehold land and buildings outside Colombo City Limits			1,387,284	1,508,657	2,895,941	144,431	2,751,510	2,631,724
Total freehold land and buildings			3,384,515	2,018,348	5,402,863	213,608	5,189,255	5,058,275

*99 year leasehold property.

NOTES TO THE FINANCIAL STATEMENTS

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34 PROPERTY, PLANT AND EQUIPMENT (Contd.)**34 (b) Leasehold Buildings**

As at 31st December	Bank 2011			Group 2011			Bank 2010	Group 2010
	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000	Net Book Value Rs 000
01 - 05 years	436,798	337,007	99,791	456,849	348,932	107,917	97,975	111,322
05 - 10 years	318,538	230,304	88,234	318,538	230,304	88,234	360,533	360,533
10 - 15 years	541,734	217,052	324,682	541,734	217,052	324,682	23,443	23,443
15 - 20 years	38,483	24,494	13,989	38,486	24,494	13,992	6,232	6,232
20 - 30 years	63,352	24,958	38,394	63,352	24,958	38,394	-	-
	1,398,905	833,815	565,090	1,418,959	845,740	573,219	488,183	501,530

34 (c) Fully Depreciated Property, Plant and Equipment - Bank

The initial cost of fully depreciated property, plant and equipment as at 31st December 2011, which are still in use as at Balance Sheet date is as follows.

As at 31st December	2011 Rs 000	2010 Rs 000
Motor vehicles	86,469	70,697
Leasehold building	286,834	192,658
Computer equipment	956,702	682,961
Equipment, furniture and fixtures	1,291,100	1,165,032
Intangible assets	609,964	419,647

34 (d) Temporarily Idle Property, Plant and Equipment - Bank

Two lands worth of Rs 17.055 Mn were idle as at 31st December 2011 (2010 : Rs 17.055) as these lands were not identified as available for immediate use. The Bank has identified plans to develop and sell these lands in the near future.

34 (e) Property, Plant and Equipment Retired from Active Use - Bank

The carrying amount of property, plant and equipment which are retired from active use and not classified as held for sale as at 31st December 2011 is nil.

34 (f) Title Restriction on Property, Plant and Equipment - Bank / Group

There were no restrictions on the title of property, plant and equipments as at 31st December 2011.

34 (g) Property, Plant and Equipment Pledged as Security for Liabilities - Bank / Group

There were no items of property, plant and equipments pledged as securities for liabilities.

34 (h) Compensation from Third Parties for Items of Property, Plant and Equipment - Bank

Rs 3.1 Mn (2010 : Rs. 5.3 Mn) was received as compensation from third parties for items of property, plant and equipment that were impaired, lost or given up.

35 INTANGIBLE ASSETS

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Cost				
Balance as at 1st January without exchange effect	1,469,575	1,399,071	1,645,230	1,470,140
Effect of movement in exchange rates	-	-	354	301
Balance as at 1st January	1,469,575	1,399,071	1,645,584	1,470,441
Additions and improvements during the year	90,736	68,183	100,742	100,105
Acquisitions of Subsidiaries by Joint Venture	-	-	-	2,475
Goodwill on acquisition through Joint Venture [Note 35 (b)]	-	-	-	70,188
Transferred from capital work-in-progress	54,666	2,321	54,666	2,321
Effect of movement in exchange rates	-	-	57	54
Disposals / write offs during the year	-	-	(2,966)	-
Balance as at 31st December	1,614,977	1,469,575	1,798,083	1,645,584
Accumulated amortisation				
Balance as at 1st January without exchange effect	892,560	723,799	942,590	760,385
Effect of movement in exchange rates	-	-	64	47
Balance as at 1st January	892,560	723,799	942,654	760,432
Amortisation for the year	172,914	168,761	185,624	179,997
Acquisition of Subsidiaries by Joint Venture	-	-	-	2,209
Effect of movement in exchange rates	-	-	6	16
Disposals / write offs during the year	-	-	(975)	-
Balance as at 31st December	1,065,474	892,560	1,127,309	942,654
Net book value as at 31st December	549,503	577,015	670,774	702,930

35 (a) Analysis of Intangible Assets

Computer Software	549,503	577,015	600,586	632,742
Goodwill [Note 35 (b)]	-	-	70,188	70,188
	549,503	577,015	670,774	702,930

As stated in Note 4.10.1 (b), all computer software costs incurred by the Bank / Group which are not integrally related to associated hardware have been classified as intangible assets.

There were no restrictions on the title of the intangible assets as at the Balance Sheet date. Further there were no items pledged as securities for liabilities.

35 (b) Goodwill

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Balance as at 1st January	-	-	70,188	-
Goodwill recognised during the year	-	-	-	70,188
Balance as at 31st December	-	-	70,188	70,188

Goodwill was recognised during 2010 in respect of acquisition of Lanka Ventures PLC by the Joint Venture Acuity Partners (Pvt) Ltd. 50% of the goodwill created through this transaction has been recognised in Consolidated Financial Statements being the shareholding of the Bank in the Joint Venture.

NOTES TO THE FINANCIAL STATEMENTS

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36 OTHER ASSETS

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Deposits, prepayments and interest receivable	4,376,715	3,560,104	4,163,478	3,317,668
Items in transit	3,037,183	2,540,450	3,037,183	2,540,450
Claims receivable	-	-	3,441	71,759
VAT recoverable	1,598,932	1,109,223	1,601,378	1,114,337
Related party receivable - exchange houses *	-	11,937	2,982	-
Items held for use	137,709	141,023	138,505	142,090
Inventory - residential apartment complex **	-	-	557,710	941,055
Other debtors	436,930	423,346	1,130,164	1,099,499
	9,587,469	7,786,083	10,634,841	9,226,858

* Rs 18.885 Mn included under related party receivable from Commercial Interlink Services Inc (o/a Delma Exchange Canada) has been fully provided in 2010 while a further provision of Rs 4.767 Mn was made against the receivable from the said Subsidiary in 2011 which are reported in Note 15 - Operating Expenses.

Rs 13.896 Mn included under related party receivable from Majan Exchange LLC has been fully provided in 2011 and the provision has been reported in Note 15 - Operating Expenses.

** Rs 8.367 Mn has been charged as provision in the Consolidated Financial Statements for impairment of inventory - residential apartment complex held by the Subsidiary, Sithma Development (Pvt) Ltd in 2010.

37 DEPOSITS FROM CUSTOMERS

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Local Currency Deposits				
Current account deposits	20,644,899	24,214,105	20,522,559	24,134,386
Savings deposits	96,215,937	83,981,743	96,215,001	83,980,788
Time deposits	113,308,379	78,201,845	113,103,630	78,174,595
Certificates of deposit	6,106,431	5,576,315	6,106,431	5,576,315
	236,275,646	191,974,008	235,947,621	191,866,084
Foreign Currency Deposits				
Current account deposits	1,126,136	794,003	1,126,136	794,003
Savings deposits	14,901,117	15,033,471	14,895,305	15,019,677
Time deposits	31,843,063	26,272,495	31,743,053	26,203,682
	47,870,316	42,099,969	47,764,494	42,017,362
Total Deposits	284,145,962	234,073,977	283,712,115	233,883,446
Deposits from non-bank customers	284,102,214	234,029,142	283,668,367	233,838,611
Deposits from banks	33,183	29,238	33,183	29,238
Deposits from finance companies	10,565	15,597	10,565	15,597
	284,145,962	234,073,977	283,712,115	233,883,446

38 DIVIDENDS PAYABLE

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Balance as at 1st January	49,558	215,607	51,121	214,045
Final dividends declared in the prior year	1,310,975	1,179,807	1,350,180	1,209,965
Interim dividends declared during the year	582,560	338,570	582,560	338,570
Reversal of dividend declared in prior years [Note 38 (c)]	-	(175,712)	-	(175,712)
Dividends paid	(1,775,013)	(1,508,714)	(1,813,985)	(1,537,309)
Unclaimed balance of Subsidiary acquired by Joint Venture	-	-	-	1,562
Balance as at 31st December	168,080	49,558	169,876	51,121

38 DIVIDENDS PAYABLE (Contd.)**38 (a) Proposed Final Dividend**

The Directors recommend that a final dividend of Rs 6.00 per share which will consist of Rs 3.00 per share in cash and Rs 3.00 in the form of a scrip dividend, (2010 : Rs 5.50 per share) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2011. The scrip dividend is subject to the Colombo Stock Exchange approving in principle the issue and listing of shares and obtaining shareholder approval in terms of the Bank's Articles of Association.

Further this dividend is to be approved at the Annual General Meeting to be held on 30th March 2012. In accordance with Sri Lanka Accounting Standard No 12 (Revised 2005), "Events after the Balance Sheet Date", this proposed final dividend has not been recognised as a liability as at 31st December 2011. Under the Inland Revenue Act No 10 of 2006, a withholding tax of 10% has been imposed on dividends declared. An interim dividend of Rs 1.50 per share (2010 : Rs 1.50) was paid for the shareholders on 12th December 2011. Final dividends proposed for the year 2011 amounts to Rs 2,331.922 Mn (2010 : Rs 1,310.975 Mn).

38 (b) Compliance with Section 56 and 57 of Companies Act No 7 of 2007

As required by Section 56 of the Companies Act No 07 of 2007, the Board of Directors of the Bank satisfied the solvency test in accordance with the section 57, prior to recommending the final dividend. A statement of solvency completed and duly signed by the directors on 21st February 2012 has been audited by Messrs KPMG Ford, Rhodes, Thornton & Co.

38 (c) Reversal of Dividend Declared in Previous Years

The persons who invested in the ordinary shares (voting) of the Bank's capital, but not recognised and registered as shareholders of the Bank in the share register are not entitled to such shares. Title to any share/s will vest on a person only when such person's name is entered in the register as a holder of shares in the Bank. Thus no dividends were paid to unregistered investors as such investors had no right to receive any dividends. In the event such investors are recognised as shareholders at any stage, then their shareholdings will be dated back to the date of the first investment and they will become entitled to all past dividends. However, the investors who disposed their shares while they were not registered as investors are therefore no longer entitled to any past dividends on such shares. Accordingly dividends accrued against such investors of Rs 175.712 Mn has been credited to retained earnings during 2010 and presented in the Statement of Changes in Equity.

39 BORROWINGS

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Refinance borrowings	6,944,535	6,314,639	6,944,535	6,314,639
Borrowings from foreign banks	8,142,792	4,494,901	8,135,222	4,474,029
Other borrowings	4,911,200	1,014	5,021,555	14,830
	19,998,527	10,810,554	20,101,312	10,803,498

40 SUBORDINATED DEBENTURES

Balance as at 1st January	2,724,293	2,673,192	2,697,543	2,653,192
Debentures issued *	2,000,000	-	2,000,000	-
Interest capitalised **	56,805	51,101	56,805	51,101
Debentures of the Bank held by Subsidiary acquired through Joint Venture***	-	-	-	(6,750)
Balance as at 31st December	4,781,098	2,724,293	4,754,348	2,697,543

* Rs 2 Bn worth of debentures were issued on 5th September 2011

** Interest payable on zero coupon debentures have been added to the debenture value.

*** Lanka Ventures PLC, a Subsidiary of Acuity Partners (Pvt) Ltd the Joint Venture holds Rs 13.5 Mn debentures of the Bank. 50% of this is recognised being the shareholding of the Bank in the Joint Venture.

HNB Assurance PLC, a Subsidiary of the Bank holds 200,000 debentures amounting to Rs 20 Mn.

40 (a) Terms and Conditions of Unsecured, Subordinated, Redeemable Debentures issued are as follows

40 (a) i Year of Issuance	2002
Number of debentures of Rs 100 each	1,132,240
Six types of debentures were included in the above issue, with fixed or floating interest rate options as follows.	
Redemption period	10 Years
Fixed p.a.	14.20%
Effective annual yield p.a.	14.70%
Floating p.a.	6 months netTB+1.25%
Redeemable on	10th September 2012
Amount (Rs 000)	113,224

The floating rate is based on the six month treasury bill net rate with a cap of 17% p.a. and a floor of 12% p.a. These debentures are listed on the Colombo Stock Exchange.

NOTES TO THE FINANCIAL STATEMENTS

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40 SUBORDINATED DEBENTURES (Contd.)**40 (a) ii Year of Issuance 2006**

Number of debentures of Rs 100 each 11,200,000

Five types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

Redemption Period	6 Year	7 Year	8 Year	15 Year	18 Year
Fixed p.a.	-	-	-	11.00%	11.25%
Effective annual yield p.a.				11.00%	11.00%
Floating p.a.	6 months netTB + 2.25%	6 months netTB + 2.25%	6 months netTB + 2.25%	-	-
Redeemable on Amount (Rs 000)	31st March 2012 262,500	31st March 2013 250,000	31st March 2014 300,000	31st March 2021 196,088	31st March 2024 369,582

The above floating rate is based on the six month treasury bill net rate with a cap of 16% p.a. and a floor of 8% p.a. These debentures are listed on the Colombo Stock Exchange.

40 (a) iii Year of Issuance 2007

Number of debentures of Rs 100 each 12,000,000

Two types of debentures were included in the above issue with fixed rates.

Redemption Period	10 years	15 years
Fixed p.a.	16.00%	16.75%
Effective annual yield p.a.	16.00%	16.75%
Redeemable on Amount (Rs 000)	31st July 2017 500,000	31st July 2022 700,000

These debentures are listed on the Colombo Stock Exchange.

40 (a) iv Year of Issuance 2008

Number of debentures of Rs 100 each 897,045

Five types of debentures were included in the above issue with fixed or floating interest rate options. However only the 5 year debentures were issued with the following characteristics.

Redemption period	5 year
Floating p.a.	1 year netTB + 1.00%
Redeemable on Amount (Rs 000)	4th June 2013 89,705

These debentures are pending listing on the Colombo Stock Exchange.

40 (a) v Year of Issuance 2011

Number of debentures of Rs 100 each 20,000,000

Following are the characteristics of the above debentures

Redemption period	10 year
Fixed p.a.	11.50%
Effective annual yield p.a.	11.83%
Redeemable on Amount (Rs 000)	4th September 2021 2,000,000

These debentures are listed on the Colombo Stock Exchange.

40 (a) vi The above debentures will, in the event of the winding up of the Bank, be subordinated to the claims of depositors and all other creditors of the Bank. The Bank has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2011 and 2010.

41 INSURANCE PROVISION-LIFE

The insurance provision - life balance represents the life fund of the Subsidiary HNB Assurance PLC, which is carrying out life and general insurance business. This balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the insurance provision - life as at 31st December 2011 was made by Mr M Poopalanathan, AIA, of Messrs Actuarial and Management Consultants (Pvt) Ltd for and on behalf of HNB Assurance PLC. The life fund stands at Rs 2,991 Mn as at 31st December 2011 (2010 : Rs 2,385.2 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 30th January 2012.

42 INSURANCE PROVISION - GENERAL

Insurance provision general represents the following which are included in the financial statements of HNB Assurance PLC, Subsidiary of the Bank, as required by the Statement of Recommended Practice of the Institute of Chartered Accountants of Sri Lanka and in accordance with the regulation of Insurance Industry Act No 43 of 2000.

As at 31st December	Group		Group	
	2011 Rs 000	2011 Rs 000	2010 Rs 000	2010 Rs 000
Unearned premium				
Gross		897,426		748,856
Reinsurance		(212,097)		(196,675)
Net		685,329		552,181
Deferred acquisition expenses		(20,059)		(12,392)
Unexpired risk reserve		20,209		12,641
		685,479		552,430
Claims outstanding - Gross	211,523		154,176	
Claims incurred but not reported - Gross	27,260	238,783	24,052	178,228
Total		924,262		730,658

43 DEFERRED TAX LIABILITIES

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Deferred tax liabilities [Note 43 (a)]	1,174,862	890,602	1,175,823	891,530
Deferred tax assets [Note 43 (b)]	(6,062)	(154,718)	(11,791)	(157,154)
	1,168,800	735,884	1,164,032	734,376

43 (a) Deferred Tax Liabilities

	Bank				Group			
	2011		2010		2011		2010	
	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	3,180,727	890,602	2,764,583	967,604	3,184,752	891,530	2,768,345	968,494
Opening balance adjustment	-	-	-	-	(716)	-	-	-
Impact on rate change reversed to Income Statement [Note 43 (c)]	-	-	-	(177,861)	-	-	-	(177,898)
Impact on rate change to equity	-	-	-	(15,661)	-	-	-	(15,661)
Reversal of deferred tax liabilities attributable to revaluation surplus charged to equity	(15,682)	(4,391)	(8,029)	(2,248)	(15,682)	(4,391)	(8,029)	(2,248)
Adjustment to deferred tax liability on additional investment in Subsidiary through the Joint Venture	-	-	-	-	-	-	657	185
Originating during the year	1,030,896	288,651	424,173	118,768	1,031,014	288,684	423,779	118,658
	4,195,941	1,174,862	3,180,727	890,602	4,199,368	1,175,823	3,184,752	891,530

Deferred Tax Liability Charged Directly to Equity

According to Sri Lanka Accounting Standard No 14 (Revised 2005) "Income Taxes", deferred tax shall be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or in a different period, directly to equity.

Accordingly, the deferred tax liability arising on revaluation of property, plant and equipment of Rs 17,547 Mn was charged directly to revaluation reserve in the Statement of Changes in Equity in 2007. Reversals of Rs 4.391 Mn per annum (2010 : Rs 2.248 Mn) have been credited to the revaluation reserve in the Statement of Changes in Equity from deferred tax liability. The reversal of deferred tax liability credited to revaluation reserve results from the excess depreciation resulting from the revaluation of property, plant and equipment that took place in 2007.

No deferred tax liability has been recognised for Sithma Development (Pvt) Ltd, in view of the tax holiday enjoyed by the company. The details have been given in Note 20 (i).

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43 DEFERRED TAX LIABILITIES (Contd.)**43 (b) Deferred Tax Asset**

	Bank				Group			
	2011		2010		2011		2010	
	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	552,563	154,718	81,003	28,351	560,756	157,154	86,078	30,128
Opening balance adjustment	-	-	-	-	504	-	(446)	(156)
Impact on rate change reversed to Income Statement (Note 43 (c))	-	-	-	(5,670)	-	-	-	(5,853)
Deferred tax asset recognised / (reversed) on general provisions (Note 43 (d))	(530,914)	(148,656)	471,560	132,037	(530,914)	(148,656)	471,560	132,037
Adjustment to deferred tax asset on additional investment in Subsidiary through the Joint Venture	-	-	-	-	-	-	454	127
Deferred tax asset recognised / (reversed) on deductible temporary differences other than general provision	-	-	-	-	11,763	3,293	3,110	871
	21,649	6,062	552,563	154,718	42,109	11,791	560,756	157,154

43 (c) Impact Due to Corporate Income Tax Rate Change - 2010

The corporate income tax rate was reduced to 28% commencing from year of assessment 2011/12 as per the amendment made by the Inland Revenue (Amendment) Act No 22 of 2011 which was enacted in Parliament on 31st March 2011. Accordingly, in 2010 deferred tax asset and liability was computed based on 28% and Rs 172.191 Mn in the Bank and Rs 172.045 Mn in the Group had been reversed to Income Statement as disclosed in Note 20 (b) - Deferred Tax Expense.

43 (d) Deductible Temporary Difference - General Provision - Bank

During the year 2010 Central Bank of Sri Lanka issued amended guidelines on general provision requirement for performing and overdue / special mention loans and advances as explained in Note 4.8.3 (b) which required the banks to maintain general provision at 0.5% commencing from 1st January 2012. Accordingly, banks reduced the general provision requirement of 1% to 0.5% at a rate of 0.1% per quarter commencing from 1st October 2010.

The general provision requirement as at 31st December 2010 was 0.9%. Accordingly, 0.4% of the general provision was reversed during 2011. In 2010 the Bank had recognised a deferred tax asset amounting to Rs 146.444 Mn arising due to the said reversal.

In management's view the Bank's NPA ratio as at Balance Sheet date is an indicator of deferred tax asset which could be recovered in the future periods in respect of the deductible temporary difference arising from the general provision of 0.5%. Recognition of deferred tax asset relating to temporary differences arising from general provision of 0.5% as at Balance Sheet date was limited to Bank's NPA ratio of 3.92% (2010 : 4.51%). In 2011 deferred tax asset of Rs 148.656 Mn was reversed, which consisted of the reversal of deferred tax asset recognised in 2010 in view of the reduction in general provision requirement and the reversal due to reduction in the NPA ratio as at Balance Sheet date.

44 OTHER LIABILITIES

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Cheques sent on clearing	2,865,652	2,191,687	2,865,652	2,191,687
Accrued expenditure and interest	14,269,734	14,451,827	14,348,886	14,571,759
Items in transit	5,332	5,782	5,332	5,782
Margins	1,377,110	1,162,309	1,377,110	1,162,309
Refundable deposits and advances*	-	-	304,033	489,442
Balance held o/a of Pension Fund	1,245,519	2,207,605	1,245,519	2,207,605
Balance held o/a of Widows' / Widowers' and Orphans' Pension Fund (WW&OP)	20,792	41,047	20,792	41,047
Balance held o/a of Employees' Provident Fund (EPF)	43,235	110,365	43,235	110,365
Provision for retiring benefits	-	-	46,434	33,776
Payable to vendors for lease equipments	414,884	640,469	414,884	640,469
Other creditors	914,967	1,130,627	1,464,464	1,944,687
	21,157,225	21,941,718	22,136,341	23,398,928

*Refundable deposits and advances include the advances taken from customers on account of the apartments in the Residential Apartments Complex which is developed by Sithma Development (Pvt) Ltd.

45 EMPLOYEE BENEFITS**45 (a) Pension Fund - Bank**

An actuarial valuation of the Pension Fund was carried out as at 31st December 2011 by Mr M Poopalanathan, AIA, Messrs Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuaries to value the Fund is the "Projected Unit Credit Method", the method recommended by the Sri Lanka Accounting Standard No 16 (Revised 2006) "Employee Benefits".

Accordingly, the Bank contributes on the following basis for the employees to the Pension Fund:

Pensionable Employees - 24.34%

Employees who opted for the Optional Scheme - 23%

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.

45 (a) i Amounts Recognised in the Balance Sheet are as follows

As at 31st December	2011 Rs 000	2010 Rs 000
Present value of unfunded obligation	-	-
Present value of funded obligation	9,315,060	8,415,678
Total present value of obligations	9,315,060	8,415,678
Fair value of plan assets	(8,575,838)	(7,358,111)
Present value of net obligations	739,222	1,057,567
Less: Unrecognised net obligations	(739,222)	(1,057,567)
Recognised liability for defined benefit obligations	-	-

The transitional liability to be recognised amounts to Rs 283.47 Mn (2010 : Rs 566.94 Mn).

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45 (a) ii Plan Assets Consist of the Following

As at 31st December	2011 Rs 000	2010 Rs 000
Equity securities and debentures	322,549	402,302
Government bond	3,358,777	4,347,510
Balance with Hatton National Bank PLC	1,245,519	2,207,605
Fixed deposits	3,417,413	255,936
Interest receivable	236,199	148,770
Tax payable	(4,619)	(4,012)
	8,575,838	7,358,111

45 (a) iii Movement in the Present Value of Defined Benefit Obligations

As at 31st December	2011 Rs 000	2010 Rs 000
Liability for defined benefit obligations as at 1st January	8,415,678	6,927,747
Actuarial losses	45,996	741,662
Benefits paid by the plan	(394,418)	(373,470)
Current service cost and interest cost	1,247,804	1,119,739
Liability for defined benefit obligations as at 31st December	9,315,060	8,415,678

45 (a) iv Movement in Plan Assets

Fair value of plan assets brought forward	7,358,111	5,977,832
Contributions paid into plan	893,507	825,160
Benefits paid by the plan	(394,418)	(373,470)
Actuarial gains	80,866	408,190
Expected return on plan assets	637,772	520,399
Fair value of plan assets as at 31st December	8,575,838	7,358,111

45 (a) v Actuarial Assumptions

	2011	2010
Discount rate as at 31st December	9.50%	9.75%
Expected return on plan assets as at 1st January	8.33%	8.38%
Future salary increases	9.99%	9.77%
Future pension increases	Nil	Nil
Increase in cost of living allowance	5%	10%

Assumptions regarding future mortality are based on 1967 - 70 mortality table and a (90) annuitants table (males and females) issued by the Institute of Actuaries.

The overall expected long term rate of return on assets is 8.33%.

The demographic assumptions underlying the valuation are retirement age (55 years), early withdrawals from service and retirement on medical grounds, death before and after retirement, etc.

45 (a) vi Historical Information

As at 31st December	2010 Rs 000	2009 Rs 000	2008 Rs 000	2007 Rs 000
Present value of the defined benefit obligation	8,415,678	6,927,747	6,496,902	5,275,079
Fair value of plan assets	(7,358,111)	(5,977,832)	(4,338,509)	(3,857,705)
Deficit in the plan	1,057,567	949,915	2,158,393	1,417,374

45 (b) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Fund indicates that the actuarial present value of the promised benefit is Rs 317.5 Mn and that the fair value of the fund assets is Rs 634.7 Mn resulting in a past service surplus of Rs 317.2 Mn (2010 : Rs 294.1 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2011.

No contribution is made by the Bank and the members contribution during the period amounted to Rs 47 Mn.

46 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.

46 (a) Stated Capital

As at 31st December	2011		2010	
	Rs 000	Rs 000	Rs 000	Rs 000
Voting ordinary shares				
As at 1st January	3,854,980		3,645,330	
Issue of shares under ESOP	59,702		209,650	
Rights issue**	4,175,044		-	
Private placement***	1,053,600		-	
As at 31st December		9,143,326		3,854,980
Non-voting ordinary shares				
As at 1st January	1,463,570		1,438,754	
Issue of shares under ESOP	6,400		24,816	
Rights issue**	339,159		-	
Private placement***	498,996		-	
As at 31st December		2,308,125		1,463,570
Stated Capital as at 31st December		11,451,451		5,318,550

46 (b) Reconciliation of Number of Shares

	2011	2010
	Rs 000	Rs 000
Voting ordinary shares		
As at 1st January	191,275,606	189,520,615
Issue of shares under ESOP	509,874	1,754,991
Sub division of shares*	95,800,065	-
Rights issue**	19,020,702	-
Private placement***	4,800,000	-
As at 31st December	311,406,247	191,275,606
Non-voting ordinary shares		
As at 1st January	46,693,416	46,249,532
Issue of shares under ESOP	103,614	443,884
Sub division of shares*	23,379,717	-
Rights issue**	2,838,149	-
Private placement***	4,175,700	-
As at 31st December	77,190,596	46,693,416

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.

*Based on the resolution approved by the shareholders on the Annual General Meeting held on 31st March 2011 a sub division of shares took place on 5th April 2011 on the basis of one ordinary voting share for every existing two ordinary voting shares and one ordinary non-voting share for every existing two ordinary non-voting shares without making any changes to the Bank's Stated Capital.

**A resolution was approved by the shareholders at the Extra Ordinary General Meeting held on 1st July 2011 to issue 35,753,936 new ordinary shares comprising 28,740,020 shares (voting) and 7,013,916 shares (non-voting) by way of a rights issue on the basis of one ordinary voting share for every existing ten ordinary voting shares and one ordinary non-voting share for every existing ten ordinary non-voting shares (1:10) priced at Rs 219.50 per voting share and Rs 119.50 per non voting share. Based on shareholders' response, the Bank had issued 21,858,851 shares on 1st August 2011 comprising of 19,020,702 shares (voting) and 2,838,149 shares (non-voting).

***Further 8,975,700 shares were issued on 7th September 2011 by way of a private placement comprising of 4,800,000 shares (voting) and 4,175,700 shares (non-voting).

Voting and non-voting shares included under stated capital consist of share premium on shares issued of Rs 1,730 Mn and Rs 974 Mn respectively. Share premium of Rs 741.85 Mn relating to voting ordinary shares included in non-voting ordinary shares was reclassified to voting ordinary shares and presented accordingly in Statement of Changes in Equity by adjusting 31st December 2009 balances.

Expenses relating to the above share issue amounting to Rs 45.871 Mn (2010 : Rs 2.542 Mn) of the Bank has been charged to Income Statement as disclosed in Note 15 - Operating Expenses in the Bank. During the year Bank's subsidiary HNB Assurance PLC (HNBA) had incurred Rs 4.379 Mn for share issue expenses. HNBA had set off this expense against Retained Earnings. This had been charged to the Income Statement in the Consolidated Financial Statements.

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46 (c) Employee Share Benefit Trust - Bank

Employee Share Benefit Trust was introduced in 2005 where shares were offered to the executive employees of the Bank.

No shares were purchased by the Employee Share Benefit Trust during the year other than those subscribed through rights issue of the Bank. The overdraft outstanding as at 31st December 2011 amounts to Rs 399.074 Mn (2010 : Rs 197.284 Mn). The amount released to the employees who left the service in 2011 is Rs 86.18 Mn (2010 : Rs 105.78 Mn).

46 (d) Employee Share Option Plan - Bank

	Allocation 2008*		Allocation 2010**	
	Voting	Non voting	Voting	Non voting
Number of options brought forward	343,139	65,183	2,231,526	544,443
Number of options exercised prior to share split and rights issue	(283,008)	(55,890)	(41,516)	(10,128)
Number of options expired prior to share split and rights issue	-	-	-	-
Number of options increased from share split and rights issue	39,082	6,038	1,406,175	342,977
Number of options exercised after share split and rights issue	(16,500)	-	(168,850)	(37,596)
Number of options expired after share split and rights issue	-	-	-	-
Number of options remaining	82,713	15,331	3,427,335	839,696

*These options were allocated on 28th March 2008 and the retention period ended on 27th March 2009.

The remaining contractual life of the above share options is 1 year and 2 months as at the Balance Sheet date.

**These options were allocated on 20th April 2010 and the retention period ended on 19th April 2011.

The remaining contractual life of the above share options is 3 years and 3 months as at the Balance Sheet date.

No financial assistance is granted to the employees in order to purchase shares.

The share options received at a particular grant can be exercised only after one year from the grant date. However if an employee retires during the year in which he or she has been granted the options, may exercise the options prior to retirement.

The outstanding options can be exercised within four years from the end of retention period or at retirement, resignation or death whichever occurs first.

47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers and would be party to litigation due to its operations. No material losses are anticipated as a result of these transactions.

47 (a) Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amounts to approximately Rs 746 Mn.

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Approved and contracted for	641,514	297,780	669,014	495,780
Approved and not contracted for	104,427	49,163	104,427	49,163
	745,941	346,943	773,441	544,943

Share of capital commitments of Joint Venture amounted to Rs 198 Mn as at 31st December 2010.

47 (b) Future Monthly Commitments on Operating Leases

As at 31st December	Bank		Group	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
0 - 1 year	1,959	-	28,381	17,721
1 - 5 years	63,114	61,631	89,707	71,982
6 - 10 years	10,507	7,233	11,124	7,233
11 - 15 years	828	304	828	304
16 - 20 years	15	15	15	15
	76,423	69,183	130,055	97,255

47 (c) Irrevocable Commitments - Bank

Commitments as at Balance Sheet date that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs 48.46 Mn (2010 : Rs 42.51 Mn).

47 (d) Contingent Liabilities

As at 31st December	2011 Rs 000	2010 Rs 000
Acceptances	6,715,619	6,487,793
Documentary credits	17,939,376	14,290,864
Guarantees	30,521,320	28,220,189
Bills for collection	7,140,247	5,842,576
Interest rate swap	105	394
	62,316,667	54,841,816
Forward exchange contracts	90,272,376	69,328,734
Total - Bank / Group	152,589,043	124,170,550

Unrecognised pension fund deficit of the Bank amounted to Rs 739.22 Mn as at 31st December 2011 (2010 : Rs 1,057.57).

Contingent liabilities of Joint Venture as at 31st December 2011 was nil.

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47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP (Contd.)

47 (e) Litigation against the Bank

The Bank confirms that there is no case (including the LT cases) filed against the Bank which is not disclosed which would have a material impact on the financial position of the Bank.

47 (f) Tax assessments against the Bank

The following tax assessments are outstanding, against which the Bank has duly appealed.

- i VAT on financial services for 2003 and 2004, taxes amounting to Rs 207 Mn, on Assessment Nos. VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05. (Pursuant to the determination made by the Board of Review on the appeal made for VAT on financial services, the Bank filed a case in the Court of Appeal - CA No. 01/2010 – BRA/VAT- 06)
- ii PAYE taxes amounting to Rs 407 Mn on Assessments Nos.8018210, 8202714, & 8364152 for the years 2003, 2004 & 2005 respectively.
- iii VAT on financial services for 2006, the balance taxes payable subsequent to the determination made by the Commissioner General of Inland Revenue amounting to Rs 177.7 Mn on Charge Nos VATFS/BFSU/2009/110 to VATFS/BFSU/2009/113. Pursuant to the determination made by the Commissioner General of Inland Revenue on the appeals made for VAT on financial services on the above mentioned Charge Nos. the Bank has made a petition of appeal to the Tax Appeals Commission.
- iv VAT for the year 2009 taxes amounting to Rs 11.8 Mn on Assessment No.8882823
- v VAT on financial services for 2009 taxes amounting to Rs 2,192.3 Mn, on Charge Nos VATFS/BFSU/2011/302 to VATFS/BFSU/2011/313

The Bank is of the view that the above assessments will not have any material impact on Financial Statements.

48 RELATED PARTY DISCLOSURES

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", the details of which 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.

48 (a) Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

48 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, the Directors of the Bank (including executive and non-executive Directors) and their immediate family members have been classified as KMP of the Bank.

As the Bank is the ultimate parent of its Subsidiaries listed out in Note 32, and the Board of Directors of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group, the Directors of the Bank and their immediate family members have been identified as the KMP of the Group.

Therefore, officers who are only Directors of the Subsidiaries and not of the Bank have been classified as KMP of that respective Subsidiary only.

Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective Director for more than 50% of his / her financial needs.

Mr Rienzie T. Wijetilleke, Mr MV Theagarajah and Mr Ranjeevan Seevaratnam resigned from the Board with effect from 31st March 2011. Therefore only those transactions that occurred up to the date of resignation had been reported under Note 48 (b) "Transactions with Key Management Personnel (KMP)". Accordingly the balances (credit cards, loans and deposits) held by them with the Bank as at 31st December 2011 had not been reported under Note 48 (b) since they were not considered as KMP as at the Balance Sheet date.

Mr D H S Jayawardena ceased to be a Director with effect from 31st December 2011 and Mr R K Obeyesekere resigned from the Board with effect from 30th December 2011. Accordingly they have been considered as KMP as at the Balance Sheet date.

Dr Rane Jayamaha, Dr WW Gamage (with effect from 31st March 2011) and Dr L R Karunaratne (with effect from 6th October 2011) were appointed to the Board during the year to replace the outgoing Directors. Accordingly transactions with the Bank from the date of their appointment as Directors have been reported under Note 48 (b).

48 RELATED PARTY DISCLOSURES (Contd.)**48 (b) i Compensation to KMP**

	Bank		Group	
	2011	2010	2011	2010
Short term employment benefits (Rs 000)	83,393	74,544	83,553	74,774
Post employment benefits (Rs 000)	8,586	7,435	8,586	7,435
Termination benefits (Rs 000)	25,000	-	25,000	-
	116,979	81,979	117,139	82,209

In addition to their salaries / fees, the Bank provides non cash benefits to KMP. The Bank also contributes to a post employment defined benefit plan on behalf of the Executive Director who also participates in the Employee Share Option Plan and the Employee Share Ownership Plan.

Benefits offered to the Executive Director under Employee Share Option Plan

Voting (No of shares)	- Exercised	-	38,083	-	38,083
	- Remaining*	59,942	36,329	59,942	36,329
Non-voting (No of shares)	- Exercised	-	9,293	-	9,293
	- Remaining*	14,626	8,865	14,626	8,865

Benefits offered to the Executive Director under Employee Share Ownership Plan

Non-voting (No of shares)	94,675	53,179	94,675	53,179
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* Shares allotted in 2010 based on the results achieved for the year 2009. Increase in the remaining number of shares is due to the share split and the subsequent right issue [Note 46 (b)] which was approved by the shareholders on 01st July 2011.

Further, the Bank has made a special payment of Rs 25 Mn and provided non cash benefit to Mr Rienzie T. Wijetilleke (Ex-chairman) on his retirement on 31st March 2011. The said amount has been included under termination benefits.

48 (b) ii Credit Card Facilities to KMP

As at 31st December

	2011		2010	
	Limit	Outstanding Balance	Limit	Outstanding Balance
	Rs 000	Rs 000	Rs 000	Rs 000
Dr Raneey Jayamaha (Chairperson) (appointed w.e.f 31st March 2011)	500	8	-	-
Mr Rajendra Theagarajah (Managing Director / CEO)	500	90	500	308
Mr D H S Jayawardena *	10,000	486	10,500	189
Mr R K Obeyesekere**	500	15	500	29
Ms Pamela C. Cooray	500	81	500	1
Mr N G Wickremeratne***	900	479	900	269
Ms M A R C Cooray	500	85	500	-
Mr Rienzie T. Wijetilleke ****	-	-	500	152
Mr MV Theagarajah****	-	-	500	12
Mr Ranjeevan Seevaratnam****	-	-	350	-

Bank has earned Rs 12,986/- during the year ended 31st December 2011 as interest and other charges from the above credit card facilities granted to KMP.

* Cash cover available for the total limit. Ceased to be a Director with effect from 31st December 2011.

** Resigned from the Board with effect from 30th December 2011.

*** Cash cover available for the total limit.

**** Resigned from the Board with effect from 31st March 2011.

NOTES TO THE FINANCIAL STATEMENTS

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48 RELATED PARTY DISCLOSURES (Contd.)**48 (b) Transactions with Key Management Personnel (KMP) (Contd.)****48 (b) iii Facilities Granted to KMP**

Name of Director	As at 31st December 2011		As at 31st December 2010		Security
	Aggregate Limit Rs 000	Amount of Accommodation Outstanding Rs 000	Aggregate Limit Rs 000	Amount of Accommodation Outstanding Rs 000	
Mr Rajendra Theagarajah (Managing Director / CEO)	20,000	19,000	-	-	EPF balance
Ms Pamela C. Cooray	-	-	6,000	-	-
Mr N G Wickremeratne	-	-	180	-	Shares and cash deposit
Mr Rienzie T. Wijetilleke*	-	-	2,380	2,038	Cash deposit
Mr MV Theagarajah*	-	-	4,600	-	Cash deposit
Mr Ranjeevan Seevaratnam*	-	-	1,500	-	-

*Resigned from the Board with effect from 31st March 2011.

Bank has earned Rs 396,712/- as interest income during the year from the above facilities granted to KMP.

No losses have been recorded against loan balances outstanding during the period with KMP and no specific provisions have been made for loan losses on balances with KMP and their immediate family members as at the Balance Sheet date.

48 (b) iv Deposits held by KMP with the Bank

The aggregate deposits (including Treasury Bills and Repos) held by the KMP with the Bank are as follows:

As at 31st December	2011	2010
SLRs '000	516,390	173,028
USD '000	238	203
GBP '000	97	18
EUR '000	-	1
AUD '000	-	28
CAD '000	-	13

48 (b) v Other Business Transactions by KMP with the Group

Transactions with HNB Assurance PLC	2011 Rs 000	2010 Rs 000
Insurance Premium - General	541	538
Insurance Premium - Life	23	-
Claims Paid - General	331	617

48 (c) Transactions with / between Subsidiaries

Details of the Subsidiaries are given in Note 32.

48 (c) i HNB Assurance PLC

HNB Assurance PLC ("Assurance"), is a 60% owned Subsidiary of the Bank.

The details of the transactions with the Bank are as follows:

(a) Assurance held deposits and current accounts with the Bank amounting to Rs 328.24 Mn as at 31st December 2011 (2010 : Rs 155.16 Mn). The Company also held debentures of the Bank amounting to Rs 20.0 Mn as at 31st December 2011 (2010 : Rs 20.0 Mn).

(b) A summary of transactions of Assurance with the Group are given below:

For the year ended 31st December Transaction Type	2011		2010	
	HNB Rs 000	SITHMA Rs 000	HNB Rs 000	SITHMA Rs 000
Premium received	52,025	3,994	23,462	5,853
Claims incurred	8,156	43	7,099	4,464
Interest received	12,863	-	9,244	-
Office rent paid	16,409	-	16,756	-
Reimbursement of other administrative expenses	95,722	-	69,074	-
Dividend paid	40,491	-	33,742	-

48 RELATED PARTY DISCLOSURES (Contd.)**48 (c) Transactions with / between Subsidiaries (Contd.)****48 (c) ii Sithma Development (Pvt) Ltd**

Sithma Development (Pvt) Ltd ("Sithma") is a wholly owned Subsidiary of the Bank.

(a) The details of its borrowing transactions with the Bank are as follows:

Type of Facility	Rate of Interest	As at 31st December 2011		As at 31st December 2010		Security
		Limit Rs 000	Outstanding Rs 000	Limit Rs 000	Outstanding Rs 000	
Overdraft	2% above the one year treasury bill rate (net). To be reviewed every 6 months.	750,000	455,558	900,000	409,562	Registered primary floating mortgage for Rs 3,000 Mn over the leasehold rights of the land and building at No 479, T B Jayah Mw, Colombo 10.
Term Loan	1.5% above the 6 month treasury bill rate (gross). To be reviewed every 6 months	2,000,000	1,349,920	2,000,000	1,774,960	Same as for the overdraft
	Interest payable		6,331		10,687	

(b) A summary of other transactions of Sithma with the Group are given below:

Transaction Type	2011		2010	
	HNB Rs 000	HNB ASSURANCE Rs 000	HNB Rs 000	HNB ASSURANCE Rs 000
Lease rental received	614,884	-	617,917	-
Refundable deposit received	500,000	-	500,000	-
Insurance premium paid	-	3,994	-	5,853
Claims received	-	43	-	4,464
Overdraft interest paid	47,961	-	62,592	-
Term loan interest paid	150,859	-	218,308	-
Ground rent paid	3,830	-	3,811	-

48 (c) iii Majan Exchange LLC

Majan Exchange LLC (Majan) is a 40% owned Subsidiary of the Bank.

The details of the transactions with the Bank are as follows:

Transaction Type	2011 Rs 000	2010 Rs 000
Deposits including current accounts	7,533	20,835
Guarantees issued	5,126	4,993
Advance payment made	13,896	11,937
Interest received	39	15
Interest paid	301	158

Bank has made a full provision against the investment of Rs 56.121 Mn and the advance payment of Rs 13.896 Mn as at 31st December 2011.

48 (c) iv Commercial Interlink Services Inc (o/a of Delma Exchange Canada)

Commercial Interlink Services Inc (o/a of Delma Exchange Canada) is a wholly owned Subsidiary of the Bank.

The company has ceased its commercial operations on 1st October 2010.

Accordingly Bank has made a full provision of Rs 33.715 Mn (2010 : Rs 28.948 Mn) against its investment and the amount due from the company as at 31st December 2011.

The company maintains a current account with the Bank and the balance as at 31st December 2011 amounted to Rs 36,972/- (2010 : Rs 36,709/-).

NOTES TO THE FINANCIAL STATEMENTS

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48 RELATED PARTY DISCLOSURES (Contd.)**48 (d) Transactions with Associates**

Details of the Associates are given in Note 30.

48 (d) i Delma Exchange

Delma Exchange is a 20% owned Associate of the Bank.

The details of the transactions with the Bank are as follows:

Transaction Type	2011 Rs 000	2010 Rs 000
Deposits including current accounts	21,108	35,375
Guarantees issued	86,826	78,537
Interest received	6	10
Interest paid	512	243

48 (d) ii Splendor Media (Pvt) Ltd

Splendor Media (Pvt) Ltd is a 49.99% owned Associate of Sithma, a fully owned Subsidiary of the Bank.

Sithma increased its investment in Splendor Media (Pvt) Ltd by investing Rs 7.7 Mn during the year. Consequently Sithma's stake in Splendor Media (Pvt) Ltd increased from 25% to 49.99%.

Summary of transactions of Splendor Media (Pvt) Ltd with the Bank and the Group are given below:

Transaction Type	2011			2010		
	HNB Rs 000	Sithma Rs 000	HNB Assurance Rs 000	HNB Rs 000	Sithma Rs 000	HNB Assurance Rs 000
Advertising commission	65,016	745	-	41,028	698	-
Interest income	3,639	-	-	1,317	-	-
Rebate paid	6,839	111	-	-	-	-
Deposits including current accounts	45,458	-	-	51,287	-	-
Dividend paid	-	563	-	-	-	-
Insurance premium paid	-	-	122	-	-	-
Claims received	-	-	443	-	-	-

48 (e) Transactions with Joint Venture - Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is the Joint Venture between DFCC Bank and HNB. Bank holds a 50% stake in Acuity Partners (Pvt) Ltd as at 31st December 2011.

Summary of transactions of the Bank with Acuity Partners (Pvt) Ltd are given below:

Transaction Type	2011 Rs 000	2010 Rs 000
Capital contribution made	-	405,000
Deposits including current accounts	7,293	14,295
Overdraft	75,399	-
Interest and bank charges received	5,101	22,245
Capital gains earned*	-	149,291

* Bank sold its equity stakes in Lanka Ventures PLC (20.07%) and Acuity Securities Limited (49.99%) to Acuity Partners (Pvt) Ltd on 18th January 2010 and 30th September 2010 respectively. Total profit earned by the Bank from these transactions amounted to Rs 149.29 Mn which is disclosed in Note 14 - Other Income under "Capital gain from sale of Associate company" and "Capital gain from sale of investment securities".

48 (f) Transactions with Other Related Entities

Other Related Entities are those which are controlled or significantly influenced, directly or indirectly by KMP of the Bank. Significant influence is presumed to be established if a KMP of the Bank has more than 20% shareholding in an entity, unless otherwise rebutted by the respective KMP. Further, significant influence is also established if in the view of a KMP, he / she has the ability to influence the operating and financial policies of an entity even in the absence of 20% shareholding.

As explained in Note 48 (b), with the resignation of Mr Rienzie T. Wijetilleke, Mr MV Theagarajah and Mr Ranjeevan Seevaratnam from the Board, certain entities became no longer related to the Bank. Therefore transactions/balances held by such entities with the Bank after the date of resignation of the said Directors had not been reported under 48 (f) "Transactions with Other Related Entities".

Transactions with those entities that deemed to be related to the Bank with the appointment of new Directors (Note 48 (b)) had been reported from the date of appointment of the Director. Accordingly balances held by such entities with the bank as at 31st December 2010 were not reported under Note 48 (f) since they were not considered as other related entities as at that date.

The transactions of the Bank / Group with other related entities are disclosed in Note 48 (f) i, ii and iii.

48 Related Party Transactions (Contd.)**48 (f) i Lending Transactions with Other Related Entities by the Bank**

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			as at 31st December 2011		as at 31st December 2010		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Stassen Exports (Pvt) Ltd	Mr D H S Jayawardena (Chairman / Shareholder) Mr R K Obeyesekere (Director)	Overdraft	3,048.50	262.82	3,248.50	399.64	Quoted company shares
		Letters of Credit	265.00	47.64	265.00	35.19	Corporate guarantee
		Letters of Guarantee	100.00	43.05	100.00	47.95	Corporate guarantee
		Forex Forward Contracts	172.50	19.78	172.50	33.30	
		Negotiation of Documentary Bills	500.00	1.48	500.00	25.01	
		Total	4,086.00	374.77	4,286.00	541.09	
Stassen International (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Overdraft	300.00	32.65	100.00	-	Quoted company shares
		Letters of Credit	150.00	34.86	150.00	63.38	Corporate guarantee
		Letters of Guarantee	125.00	61.11	125.00	61.11	Corporate guarantee
		Negotiation of Documentary Bills	500.00	15.77	500.00	76.78	
		Total	1,075.00	144.39	875.00	201.27	
Milford Exports (Ceylon) (Pvt) Ltd	Mr D H S Jayawardena (Managing Director / Shareholder) Mr R K Obeyesekere (Director)	Overdraft	10.00	-	10.00	-	Quoted company shares
		Letters of Credit	50.00	-	50.00	-	
		Letters of Guarantee	40.00	-	40.00	10.00	
		Negotiation of Documentary Bills	200.00	-	200.00	-	
		Total	300.00	-	300.00	10.00	
Madulsima Plantations PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	153.00	106.04	153.00	37.30	Immovable property (leasehold),
		Letters of Guarantee	2.25	-	2.25	1.25	Quoted company shares,
		Term Loan	-	-	16.00	16.00	Stock in trade
		Letters of Credit	0.53	0.53	-	-	Cash deposit
		Total	155.78	106.57	171.25	54.55	
Ceylon Garden Coir (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Letters of Credit	10.00	0.28	10.00	-	Quoted company shares
		Total	10.00	0.28	10.00	-	Corporate guarantee
Stassen Natural Foods (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Letters of Credit	50.00	0.56	50.00	0.65	Quoted company shares
		Letter of Guarantee	15.00	15.00	15.00	15.00	Corporate guarantee
		Negotiation of Documentary Bills	200.00	5.75	200.00	10.18	
		Overdraft	10.00	-	10.00	-	
		Total	275.00	21.31	275.00	25.83	
Browns Beach Hotels PLC	Mr D H S Jayawardena (Chairman)	Letters of Guarantee	-	-	0.25	0.25	Cash deposits
		Total	-	-	0.25	0.25	
Lanka Milk Foods (CWE) PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	300.00	11.15	900.00	133.52	Quoted company shares
		Letters of Credit	600.00	-	(900.00)	-	
		Letters of Guarantee I	(70.00)	81.65	(70.00)	96.65	
		Letter of Guarantee II	30.00		30.00		
		Total	930.00	92.80	930.00	230.17	

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

NOTES TO THE FINANCIAL STATEMENTS

continued

48 Related Party Transactions (Contd.)

48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			as at 31st December 2011		as at 31st December 2010		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Lanka Dairies (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	200.00	4.22	200.00	152.77	Quoted company shares Corporate guarantee
		Letter of Credit	100.00	13.41	100.00	17.02	
		Letters of Guarantee	25.00	-	-	-	
		Total	325.00	17.63	300.00	169.79	
Ambewela Products (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	10.00	8.60	10.00	9.87	Quoted company shares Corporate guarantee
		Letters of Credit	50.00	0.17	50.00	13.03	
		Letters of Guarantee	-	-	-	-	
		Total	60.00	8.77	60.00	22.90	
Ambewela Livestock Company Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	50.00	11.82	50.00	4.91	Quoted company shares Corporate guarantee
		Letters of Credit	10.00	-	10.00	-	
		Letters of Guarantee	-	-	-	-	
		Total	60.00	11.82	60.00	4.91	
Pattipola Livestock Company Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	50.00	6.45	50.00	8.22	Quoted company shares Corporate guarantee
		Letters of Credit	10.00	-	10.00	-	
		Letters of Guarantee	-	-	-	-	
		Total	60.00	6.45	60.00	8.22	
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman)	Overdraft	560.00	446.88	1,220.00	1,202.64	Quoted company shares Cash margins
		Letters of Credit	375.00	332.69	400.00	233.07	
		Letters of Guarantee	3.12	3.37	3.12	3.12	
		Total	938.12	782.94	1,623.12	1,438.83	
Periceyl (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Letters of Credit	25.00	11.40	25.00	-	Quoted company shares Cash margins Corporate guarantee
		Standby Overdraft	(25.00)	-	(25.00)	11.92	
		Letters of Guarantee	3.65	3.65	1.80	1.80	
		Total	28.65	15.05	26.80	13.72	
Balangoda Plantations PLC	Mr D H S Jayawardena (Chairman)	Overdraft	45.00	49.95	45.00	-	Immovable property (leasehold) Cash deposit *Excess since regularised
		Letters of Credit	-	-	-	-	
		Letters of Guarantee	-	-	-	-	
		Total	45.00	49.95*	45.00	-	
Texpro Industries Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	21.53	19.83	21.53	20.92	Cash deposit Immovable property Machinery
		Bank Guarantee	0.22	0.22	0.22	0.22	
		Total	21.75	20.05	21.75	21.14	
		Overdraft US\$ Mn	0.15	0.13	0.15	0.13	
		Letter of Credit US\$ Mn	1.60	0.44	1.60	0.83	
		Export Loans US\$ Mn	(1.60)	0.33	(1.60)	0.54	
		Bill Purchase US\$ Mn	0.30	0.27	(0.30)	0.22	
		Term Loans US\$ Mn	-	-	0.03	0.03	
		Total US\$ Mn	2.05	1.17	1.78	1.75	
		Total	700.00	700.00	100.00	100.00	
Aitken Spence PLC	Mr D H S Jayawardena (Chairman)	Term Loan	700.00	700.00	100.00	100.00	Negative pledge

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

48 Related Party Transactions (Contd.)**48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)**

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			as at 31st December 2011		as at 31st December 2010		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Elpitiya Plantations PLC	Subsidiary of Aitken Spence Plantation Management Ltd	Overdraft / Short Term Loan	50.00	50.00	50.00	32.52	Immovable property (leased hold) Stock in trade Cash margins Corporate guarantee Equipments leased
		Money Market Loan / Overdraft	85.00	75.00	75.00	75.00	
		Revolving Loan / Overdraft	-	-	10.00	-	
		Term Loan	8.20	8.20	28.84	28.84	
		Bank Guarantee	-	-	5.50	-	
		E-friends Loan	2.83	2.83	4.53	4.53	
		Overdraft	64.00	12.56	39.00	-	
		Lease	23.22	23.22	6.97	6.97	
		Letters of Credit	2.81	2.81	-	-	
		Total	236.06	174.62	219.84	147.86	
Aitken Spence Hotel Holdings PLC	Mr D H S Jayawardena (Chairman)	Term Loan	608.44	460.44	460.44	460.44	Corporate guarantee
		Overdraft	20.00	-	20.00	-	
		Total	628.44	460.44	480.44	460.44	
Aitken Spence Resources (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Letters of Guarantee	0.75	0.75	0.75	0.75	Corporate guarantee Indemnity
		Total	0.75	0.75	0.75	0.75	
Aitken Spence Hotel Management (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	10.00	-	10.00	-	Corporate guarantee
		Total	10.00	-	10.00	-	
Aitken Spence Travels (Pvt) Ltd	Joint Venture of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	10.00	-	-	-	
		Total	10.00	-	-	-	
Neptune Ayurvedic Village (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	10.00	-	10.00	-	Corporate guarantee
		Total	10.00	-	10.00	-	
Hethersett Hotels Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	15.00	-	15.00	-	Corporate guarantee
		Total	15.00	-	15.00	-	

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

NOTES TO THE FINANCIAL STATEMENTS

continued

48 Related Party Transactions (Contd.)

48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			as at 31st December 2011		as at 31st December 2010		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Ace Containers (Pvt) Ltd	Subsidiaries of Aitken Spence PLC in which	Overdraft / Money Market loan *	150.00	33.03	100.00	63.25	Corporate guarantee
Ace Distriparks (Pvt) Ltd	Mr D H S Jayawardena is the Chairman	Letters of Credit *	(150.00)	3.94	(100.00)	5.20	Indemnity
Ace Container Repair (Pvt) Ltd		Letters of Guarantee *	(150.00)	16.74	(100.00)	19.36	* Interchangeable limit within 7 companies
Ace Freight Management (Pvt) Ltd		Total	150.00	53.71	100.00	87.81	
Ace Haulage (Pvt) Ltd							
Ace Container Terminal (Pvt) Ltd							
Logilink (Pvt) Ltd							
Aitken Spence Garments Ltd	Joint Venture of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Letters of Credit US\$ Mn Short Term	1.50	0.10	1.50	0.29	Stock and book debts /
		Export Loan US \$ Mn	(1.50)	0.04	(1.50)	0.46	corporate guarantee,
		Overdrafts US\$ Mn	0.25	-	0.25	0.02	mortgage over immovable
		Total US\$ Mn	1.75	0.14	1.75	0.77	property /
		Overdraft	(25.00)	-	(25.00)	-	movable
		Letters of Guarantee	2.00	0.01	2.00	0.70	machinery
		Forex Forward					Indemnity
		Contracts	56.50	26.84	-	-	
		Total	58.50	26.85	2.00	0.70	
Cowrie Investments (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Term Loan US\$ Mn	3.20	3.20	4.47	4.47	Leashold rights to the Island of Meedhapparu
		Overdraft US\$ Mn	2.00	-	2.00	0.14	
		Total US\$ Mn	5.20	3.20	6.47	4.61	

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

48 Related Party Transactions (Contd.)**48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)**

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			as at 31st December 2011		as at 31st December 2010		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Ace Power Embilipitiya (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	-	-	200.00	0.05	Leasehold land, building & fixtures book debts & stock shares of the company
		Syndicated Overdraft	(350.00)	-	(350.00)	-	
		Total	-	-	200.00	0.05	
		Overdraft US\$ Mn	3.24	3.23	3.25	3.75	
		Letter of Credit US \$	-	-	0.50	-	
Elpitiya Lifestyle Solutions (Pvt) Ltd	Joint Venture of Elpitiya Plantations PLC	Term Loan US\$ Mn	2.12	2.12	3.57	3.57	Corporate guarantee Leasehold land Factory, building & machinery
		Total US\$ Mn	5.36	5.35	7.32	7.32	
		Overdraft	5.00	4.89	4.00	3.88	
		Total	5.00	4.89	4.00	3.88	
ADS Resorts (Pvt) Ltd	Subsidiary of Aitken Spence Hotel International Ltd	Term Loan US\$ Mn	1.36	1.36	1.94	1.94	Immovable property
Total US\$ Mn			1.36	1.36	1.94	1.94	
Unique Resorts (Pvt) Ltd	Subsidiary of Aitken Spence Hotel International Ltd	Term Loan US\$ Mn	14.31	14.31	16.76	16.76	Immovable property
Total US\$ Mn			14.31	14.31	16.76	16.76	
Kandalama Hotels Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	20.00	-	20.00	-	Corporate guarantee
		Letters of Credit	75.00	75.00	-	-	
		Total	95.00	75.00	20.00	-	
Golden Sun Resorts (Pvt) Ltd (Ramada Resort)	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	10.00	11.29*	10.00	-	Corporate guarantee Immovable property Cash deposit *Excess since regularised
		Term Loan	166.22	164.88	18.31	18.31	
		Letters of Guarantee	0.16	-	-	-	
		Letters of Credit	75.00	22.51	-	-	
		Total	251.38	198.68	28.31	18.31	
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of the Joint Venture "Acuity"	Overdraft	130.00	-	130.00	-	-
Total			130.00	-	130.00	-	
Acuity Securities Limited	Subsidiary of the Joint Venture "Acuity"	Overdraft	1,100.00	-	100.00	-	-
Total			1,100.00	-	100.00	-	
A K K Engineers (Pvt) Ltd	Dr L R Karunaratne (Managing Director)	Term Loan	6.50	6.50	-	-	Immovable property Cash deposits
		Overdraft	30.00	2.99	-	-	
		Letters of Guarantee	44.00	21.47	-	-	
		Total	80.50	30.96	-	-	

No losses have been recorded against loan balances outstanding during the period with the above entities and no specific provisions have been made for loan losses as at the Balance Sheet date.

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

NOTES TO THE FINANCIAL STATEMENTS

continued

48 Related Party Transactions (Contd.)**48 (f) ii Other Business Transactions with Other Related Entities by the Bank**

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2011	2010
Madulsima Plantation PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Lease of holiday bungalow at Bogawantalawa	4.24	2.28
Lanka Bell (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Telecommunication charges Merchant commission	29.06 0.02	25.26 0.08
Aitken Spence PLC	Mr D H S Jayawardena (Chairman)	Interest on repurchase agreements Air tickets	0.06 -	0.01 0.01
Aitken Spence Hotel Management (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Merchant commission	0.04	0.02
Aitken Spence Travels (Pvt) Ltd	Joint Venture of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Air tickets Merchant commission	0.14 0.55	0.09 0.67
Aitken Spence Garments Ltd	Joint Venture of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Repurchase agreements Interest on repurchase agreements	3.00 0.23	- 0.17
Aitken Spence Hotel Holdings PLC	Mr D H S Jayawardena (Chairman)	Repurchase agreements Interest on repurchase agreements Merchant commission	38.00 7.49 2.72	107.00 11.73 2.62
Ace Power Embilipitiya (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Loan syndication fee	0.20	0.20
Balangoda Plantations PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Repurchase agreements Interest on repurchase agreements	- 8.68	194.40 6.34

48 Related Party Transactions (Contd.)**48 (f) ii Other Business Transactions with Other Related Entities by the Bank (Contd.)**

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2011	2010
BellVantage (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Payment for telephone systems	0.23	0.01
Browns Beach Hotels PLC	Mr D H S Jayawardena (Chairman)	Repurchase agreements	227.00	68.00
		Interest on repurchase agreements	10.76	2.96
		Merchant commission	0.25	0.85
Stassen Exports (Pvt) Ltd	Mr D H S Jayawardena (Chairman / Shareholder) Mr R K Obeyesekere (Director)	Forward contract	-	336.80
		Interest on repurchase agreements	7.48	0.49
Stassen International (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Interest on repurchase agreements	0.42	0.98
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Interest on repurchase agreements	112.02	-
		Sponsorship	-	0.03
Periceyl (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Interest on repurchase agreements	0.21	-
Sri Lanka Insurance Corporation Ltd	Significant shareholder of the Bank (according to CBSL direction)	Repayment of excess insurance claims received	-	3.19
		Insurance premium paid	0.47	4.83
		Claims lodged	-	0.52
		Merchant commission	1.70	1.30
Lanka Financial Services Bureau Ltd	Mr Rajendra Theagarajah (Director)	Subscription paid	3.17	3.98
Colour of Courage Trust Guarantee Ltd	Mr Rajendra Theagarajah (Director)	Repurchase agreements	131.00	-
		Interest on repurchase agreements	1.06	-
		Sponsorships	0.25	-
Hatton National Bank Retirement Pension Fund	Mr Rajendra Theagarajah (Trustee)	Investment in term deposits	3,417.41	255.94
		Investment in HNB debentures	36.15	53.65
		Interest received on HNB debentures	3.71	4.04
		Balance held by the Bank on behalf of the fund	1,245.52	2,207.61
		Interest paid	146.36	164.24
		Contributions made	893.51	882.82

NOTES TO THE FINANCIAL STATEMENTS

continued

48 Related Party Transactions (Contd.)**48 (f) ii Other Business Transactions with Other Related Entities by the Bank (Contd.)**

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2011	2010
Hatton National Bank Employee Provident Fund	Mr Rajendra Theagarajah (Trustee)	Investment in term deposits	4,285.09	1,811.44
		Investment in Repos	704.00	2,177.59
		Balance held by the Bank on behalf of the fund	43.24	110.37
		Investment in HNB shares		
		- Voting	4.51	2.08
		- Non-voting	14.80	8.73
		Contribution made	358.18	339.48
		Interest paid	13.07	3.78
		Dividends paid	3.03	2.45
Widows', Widowers' and Orphans' Pension Fund	Mr Rajendra Theagarajah (Trustee)	Balance held by the Bank on behalf of the fund	20.79	41.05
		Interest paid	7.09	7.21
Acuity Securities Limited	Subsidiary of the Joint Venture "Acuity"	Interest received	0.06	0.10
		Commission received	1.20	0.60
		Interest paid	0.59	-
		Current account balance as at year end	70.01	12.29
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of the Joint Venture "Acuity"	Bank charges	0.09	0.07
		Interest received	1.04	3.35
		Commission paid	18.46	26.80
		Current account balance as at year end	5.38	39.94
Guardian Acuity Asset Management Ltd	Joint Venture of the "Acuity"	Repurchase agreements	35.24	-
		Interest on repurchase agreements	1.21	-
		Deposits including current accounts	0.05	-
Lanka Ventures PLC	Subsidiary of the Joint Venture "Acuity"	Interest paid	3.95	1.24
		Bank charges and overdraft interest received	0.59	0.05
		Overdraft	58.40	-
		Deposits including current accounts	127.89	4.21
		Debentures	13.50	13.50
Namal Acuity Value Fund	A fund managed by National Asset Management Ltd (NAMAL*) *Was a Subsidiary of Milford Holdings (Pvt) Ltd up to February 2011	Investment in units	150.00	150.00
American Chamber of Commerce in Sri Lanka	Mr Rajendra Theagarajah (Board Member)	Corporate membership	0.02	-
Ceylon Chamber of Commerce	Mr Rajendra Theagarajah (EXCO member)	Participation/subscription and other charges	0.27	-
		Merchant commission	0.01	-
Continental Insurance Lanka Ltd	Mr D H S Jayawardena (Chairman)	Merchant commission	0.34	-
Chartered Institute of Management Accountants	Mr Rajendra Theagarajah (Vice Chairman)	Corporate partnership and contribution	0.04	-

48 Related Party Transactions (Contd.)**48 (f) ii Other Business Transactions with Other Related Entities by the Bank (Contd.)**

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2011	2010
Employers' Federation of Ceylon	Mr Rajendra Theagarajah (Council Member)	Fees and subscription	0.92	-
Lanka Clear (Pvt) Ltd	Mr Rajendra Theagarajah (Board Member)	Clearing and other charges	40.63	-
Golden Sun Resorts (Pvt) Ltd (Ramada Resort)	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Merchant commission	0.08	0.18
Hethersett Hotels Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Merchant commission	1.37	0.88
Kandalama Hotels Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman	Merchant commission	4.08	3.37

48 (f) iii Business Transactions with Other Related Entities by the Group

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2011	2010
Sithma Development (Pvt) Ltd				
Lanka Bell (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Telecommunication charges	0.05	0.06
		Lease rentals received	0.57	-
HNB Assurance PLC				
Acuity Stockbrokers (Pvt) Ltd	Mr Rajendra Theagarajah (Chairman)	Insurance premium received	1.84	1.31
		Claims paid	0.37	0.27
Acuity Securities Limited	Mr Rajendra Theagarajah (Chairman)	Insurance premium received	0.30	0.35
		Claims paid	0.25	0.36
		Interest received	15.53	13.54
		Investments (Repo)	242.16	145.38
Acuity Partners (Pvt) Ltd	Mr Rajendra Theagarajah (Chairman)	Insurance premium received	1.66	0.98
		Claims paid	0.16	-
Sri Lanka Insurance Corporation Ltd	Significant shareholder of the Bank (according to CBSL direction)	Co insurance premium	0.24	0.69
		Co insurance claims	0.10	-
Stassen Exports (Pvt) Ltd	Mr D H S Jayawardena (Chairman / Shareholder) Mr R K Obeyesekere (Director)	Insurance premium received	16.30	11.92
		Claims paid	8.17	9.77
Stassen International (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Insurance premium received	0.55	1.32
		Claims paid	0.25	-

NOTES TO THE FINANCIAL STATEMENTS

continued

48 Related Party Transactions (Contd.)**48 (f) iii Business Transactions with Other Related Entities by the Group (Contd.)**

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2011	2010
Stassen Natural Foods (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Insurance premium received	0.20	0.21
Ceylon Garden Coir (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Insurance premium received	0.07	0.07
Milford Exports (Ceylon) (Pvt) Ltd	Mr D H S Jayawardena (Managing Director / Shareholder) Mr R K Obeyesekere (Director)	Insurance premium received	0.04	0.04
Milford Developers (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Insurance premium received	0.51	0.46
Aitken Spence Garments Ltd	Joint Venture of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Insurance premium received Claims paid	0.41 0.03	0.36 -
Aitken Spence Cargo (Pvt)Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Insurance premium received	0.17	0.22
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Insurance premium received Claims paid	0.01 -	0.21 2.76
Texpro Industries Ltd	Mr D H S Jayawardena (Chairman)	Insurance premium received Claims paid	0.86 0.14	0.61 -
Lanka Diaries (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr. R K Obeyesekere (Director)	Insurance premium received	0.02	0.01

49 MATURITY ANALYSIS

Analysis of the total assets and liabilities of the Bank / Group as at 31st December, based on the remaining period at the Balance Sheet date to the respective contractual maturity dates, are given below:

49 (a) Bank

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2011 Rs 000
Interest earning assets						
Cash and Short Term Funds	7,804,913	-	-	-	-	7,804,913
Securities purchased under resale agreements	781,193	-	-	-	-	781,193
Commercial Papers	24,986	-	-	-	-	24,986
Dealing Securities - Bills and Bonds	418,748	-	-	-	-	418,748
Investment Securities - Bills, Bonds and Debentures	29,834,186	20,569,979	7,416,712	3,158,250	-	60,979,127
Bills of Exchange	959,012	-	-	-	-	959,012
Loans and Advances	85,330,074	37,997,263	44,450,643	33,697,066	32,045,954	233,521,000
Lease Rentals Receivable	2,004,384	5,134,331	12,451,060	4,334,592	-	23,924,367
	127,157,496	63,701,573	64,318,415	41,189,908	32,045,954	328,413,346
Non-interest Earning Assets						
Cash and Short Term Funds	6,937,034	-	-	-	-	6,937,034
Statutory Deposit with CBSL	18,683,405	-	-	-	-	18,683,405
Dealing Securities - Shares	723,316	-	-	-	-	723,316
Investments - Quoted	-	-	-	-	1,755,918	1,755,918
Investments - Unquoted	-	180,000	-	-	27,456	207,456
Investment in Associate Companies	-	-	-	-	83,674	83,674
Investments in Joint Venture Companies	-	-	-	-	655,000	655,000
Investment in Subsidiary Companies	-	-	-	-	2,357,285	2,357,285
Intangible Assets	-	-	-	-	549,503	549,503
Investment Properties	-	-	-	-	349,374	349,374
Property, Plant and Equipment	-	-	-	-	7,847,808	7,847,808
Other Assets	7,057,502	391,059	1,638,908	-	500,000	9,587,469
	33,401,257	571,059	1,638,908	-	14,126,018	49,737,242
Total Assets	160,558,753	64,272,632	65,957,323	41,189,908	46,171,972	378,150,588
Percentage - 31st December 2011	42.46	17.00	17.44	10.89	12.21	100
Percentage - 31st December 2010	46.27	17.51	11.35	10.74	14.13	100
Interest Bearing Liabilities						
Deposits from Customers	184,970,619	66,275,641	9,009,914	633,486	1,485,267	262,374,927
Borrowings	6,142,784	4,011,985	2,027,911	5,627,128	2,188,719	19,998,527
Repo Agreements	6,107,836	451,252	-	-	-	6,559,088
Subordinated Debentures	262,500	113,224	639,705	-	3,765,669	4,781,098
	197,483,739	70,852,102	11,677,530	6,260,614	7,439,655	293,713,640
Non-interest Bearing Liabilities						
Deposits from Customers	21,771,035	-	-	-	-	21,771,035
Dividend Payable	168,080	-	-	-	-	168,080
Bills Payable	1,404,158	-	-	-	-	1,404,158
Current Tax Liability	-	1,679,787	-	-	-	1,679,787
Deferred Tax Liability	-	-	-	-	1,168,800	1,168,800
Other Liabilities	16,336,263	-	4,820,962	-	-	21,157,225
Shareholders' Funds	-	-	-	-	37,087,863	37,087,863
	39,679,536	1,679,787	4,820,962	-	38,256,663	84,436,948
Total Liabilities and Shareholders' Funds	237,163,275	72,531,889	16,498,492	6,260,614	45,696,318	378,150,588
Percentage - 31st December 2011	62.72	19.18	4.36	1.66	12.08	100
Percentage - 31st December 2010	64.36	17.00	4.22	4.07	10.35	100

* Upto 3 months deposits include the Bank's Savings Deposit Base of Rs 111.117 Bn (2010 - Rs 99.0 Bn)

NOTES TO THE FINANCIAL STATEMENTS

continued

49 MATURITY ANALYSIS (Contd.)**49 (b) Group**

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2011 Rs 000
Interest earning assets						
Cash and Short Term Funds	8,026,304	416,600	281,092	-	-	8,723,996
Securities purchased under resale agreements	2,829,866	100,000	-	-	-	2,929,866
Dealing Securities - Bills and Bonds	695,530	544,671	83,912	108,756	-	1,432,869
Commercial Papers	39,986	47,551	-	-	-	87,537
Investment Securities - Bills						
Bonds and Debentures	29,874,625	20,803,906	8,212,251	4,172,110	230,710	63,293,602
Bills of Exchange	959,012	-	-	-	-	959,012
Loans and Advances	85,181,290	37,474,332	43,965,945	33,249,998	31,979,590	231,851,155
Lease Rentals Receivable	2,004,384	5,134,331	12,451,060	4,334,592	-	23,924,367
	129,610,997	64,521,391	64,994,260	41,865,456	32,210,300	333,202,404
Non-interest Earning Assets						
Cash and Short Term Funds	6,937,525	-	-	-	-	6,937,525
Statutory Deposit with CBSL	18,698,197	-	-	-	-	18,698,197
Dealing Securities - Shares	979,320	-	-	-	-	979,320
Investments - Quoted	7,203	-	-	-	1,756,498	1,763,701
Investments - Unquoted	25,000	180,000	19,813	-	115,496	340,309
Investment in Associate Companies	-	-	-	-	384,319	384,319
Intangible Assets	-	-	-	-	670,774	670,774
Investment Properties	-	-	-	-	169,028	169,028
Property, Plant and Equipment	-	-	-	-	14,802,569	14,802,569
Non-current Assets held for Sale	-	-	-	-	2,875	2,875
Other Assets	7,561,693	1,255,678	1,775,176	-	42,294	10,634,841
	34,208,938	1,435,678	1,794,989	-	17,943,853	55,383,458
Total Assets	163,819,935	65,957,069	66,789,249	41,865,456	50,154,153	388,585,862
Percentage - 31st December 2011	42.16	16.97	17.19	10.77	12.91	100
Percentage - 31st December 2010	45.92	17.63	11.26	10.43	14.76	100
Interest Bearing Liabilities						
Deposits from Customers	184,883,227	66,083,273	8,984,914	633,486	1,485,267	262,070,167
Borrowings	6,145,569	4,011,985	2,027,911	5,627,128	2,288,719	20,101,312
Repo Agreements	7,815,849	495,591	-	-	-	8,311,440
Subordinated Debentures	250,000	106,474	639,705	-	3,758,169	4,754,348
	199,094,645	70,697,323	11,652,530	6,260,614	7,532,155	295,237,267
Non-interest Bearing Liabilities						
Deposits from Customers	21,641,948	-	-	-	-	21,641,948
Dividend Payable	169,876	-	-	-	-	169,876
Bills Payable	1,404,158	-	-	-	-	1,404,158
Insurance Provisions - Life	-	-	-	-	2,990,998	2,990,998
Insurance Provisions - General	-	924,262	-	-	-	924,262
Current Tax Liability	-	1,750,987	-	-	-	1,750,987
Deferred Tax Liability	-	-	-	-	1,164,032	1,164,032
Other Liabilities	16,823,135	275,057	4,934,718	-	103,431	22,136,341
Shareholders' Funds	-	-	-	-	41,165,993	41,165,993
	40,039,117	2,950,306	4,934,718	-	45,424,454	93,348,595
Total Liabilities and Shareholders' Funds	239,133,762	73,647,629	16,587,248	6,260,614	53,956,609	388,585,862
Percentage - 31st December 2011	61.54	18.95	4.27	1.61	13.63	100
Percentage - 31st December 2010	63.16	16.98	4.09	3.95	11.82	100

50 COMPARATIVE INFORMATION

The following comparative figures have been reclassified in the 2011 Financial Statements to maintain comparability of financial statements in order to provide a better presentation.

50 (a)

	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Income	35,581,621	34,870,418	711,203	38,104,665	37,393,462	711,203
Fee and commission income	2,809,330	2,098,127	711,203	3,115,443	2,404,240	711,203
Fee and commission expenses	134,572	30,211	104,361	135,314	30,955	104,359
Other expenses	5,037,270	4,430,428	606,842	6,649,915	6,042,695	607,220
Provision charge for employee benefits	-	-	-	893,742	894,118	(376)

50 (a) i Expenses relating to the generation of fee and commission income of Rs 711.23 Mn included under other expenses have been reclassified.

50 (a) ii Other expenses of Rs 104.359 Mn included under fee and commission expenses have been reclassified.

50 (a) iii Provision charge for employee benefits included under other expenses of Rs 0.37 Mn in the Group has been reclassified.

50 (b)

	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Other assets	7,705,316	7,786,083	(80,767)	9,146,091	9,226,858	(80,767)
Deposits from customers	234,071,085	234,073,977	(2,892)	233,880,554	233,883,446	(2,892)
Other liabilities	21,863,843	21,941,718	(77,875)	23,321,053	23,398,928	(77,875)

50 (b) i Other assets of Rs 80.767 Mn included under other liabilities have been reclassified.

50 (b) ii Deposits of customers of Rs 2.892 Mn included under other liabilities have been reclassified.

Comparative information in the Cash Flow Statement has been amended based on the reclassified figures as disclosed above.

NOTES TO THE FINANCIAL STATEMENTS

continued

51 SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments.

The business segments are determined based on the Group's management and internal reporting structure.

Business segments - Group	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Revenue from external customers :														
Interest	30,034,241	28,091,408	-	-	193,740	147,290	-	-	436,584	435,045	2,905,152	1,890,052	33,569,717	30,563,795
Exchange/Premium	988,231	1,015,987	-	-	4,327	3,711	-	-	2,298,997	1,868,746	-	-	3,291,555	2,888,444
Lease/Brokerage	-	-	2,905,152	1,890,052	259,113	304,404	-	-	-	-	(2,905,152)	(1,890,052)	259,113	304,404
Fee/Commissions/Rent	2,808,007	2,122,656	14,149	12,164	27,140	15,407	141,810	97,495	-	-	-	-	2,991,106	2,247,722
Other	986,144	1,436,117	-	-	94,104	124,468	507	-	10,065	8,689	(33,867)	(180,177)	1,056,953	1,389,097
Total revenue from external customers	34,816,623	32,666,168	2,919,301	1,902,216	578,424	595,280	142,317	97,495	2,745,646	2,312,480	(33,867)	(180,177)	41,168,444	37,393,462
Inter-segment revenue	232,838	302,034	-	-	17,552	11,585	614,884	618,037	78,006	44,968	-	-	943,280	976,624
Total revenue	35,049,461	32,968,202	2,919,301	1,902,216	595,976	606,865	757,201	715,532	2,823,652	2,357,448	(33,867)	(180,177)	42,111,724	38,370,086
Segment result	6,823,807	6,273,812	1,858,955	1,288,204	133,904	246,544	384,632	281,242	345,460	309,864	31,468	(154,974)	9,578,226	8,244,692
Unallocated expenses													(1,079,684)	(990,596)
Profit from operations													8,498,542	7,254,096
Income from Associates													(15,729)	(2,429)
Income tax expense													(2,248,615)	(2,364,839)
Profit for the period													6,234,198	4,886,828
Minority interests													(85,357)	(100,058)
Profit for the Equity Holders of the Bank													6,148,841	4,786,770
Segment assets	332,796,108	281,438,663	23,924,367	13,447,253	3,407,137	3,134,815	7,660,289	8,209,036	6,035,904	4,548,029	(2,846,542)	(2,663,832)	370,977,263	308,113,964
Investment in Associates													384,319	196,009
Unallocated assets													17,224,280	15,028,800
Total Assets													388,585,862	323,338,773
Segment liabilities	292,964,466	247,418,459	23,924,367	13,447,253	2,374,574	2,122,282	2,656,700	3,479,387	4,426,188	3,531,689	(2,519,017)	(2,537,209)	323,827,278	267,461,861
Unallocated liabilities													23,592,590	25,310,211
Total liabilities													347,419,868	292,772,072
Cash flows from														
operating activities	(156,560)	(6,068,451)	(10,649,463)	(4,520,676)	(113,831)	127,038	389,694	592,170	1,111,405	789,197	(1,336,833)	(1,457,992)	(10,755,588)	(10,538,714)
Cash flows from investing activities														
	(2,565,020)	(3,047,845)	-	-	(100,808)	(403,112)	(10,690)	(451)	(1,317,532)	(745,694)	1,393,643	1,249,126	(2,600,407)	(2,947,976)
Cash flows from financing activities														
	10,107,350	4,490,364	-	-	60,515	348,004	(425,000)	(225,040)	318,746	(56,250)	449,394	(162,074)	10,511,005	4,395,004
Capital Expenditure	1,322,384	1,052,403	267	474	23,156	10,319	3,029	451	33,110	44,944	93	30,690	1,382,039	1,139,281
Depreciation	741,134	660,701	1,080	1,103	13,861	13,975	110,612	110,485	33,219	30,355	(5,845)	(6,020)	894,061	810,599
Amortisation	172,691	168,711	223	50	759	1,394	80	79	11,839	9,983	32	(220)	185,624	179,997

**Stock broking and Securities dealing, Money transfer and Foreign currency related services

52 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There are no events occurring after the Balance Sheet date which require adjustments to or disclosure in the Financial Statements, other than those disclosed below:

52 (a) Proposed Dividends

Refer Note No 38 (a)

53 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 170 for the statement of the Directors' Responsibility for Financial Reporting.

CAPITAL ADEQUACY

Capital adequacy is a measure of a bank's financial strength and its ability to withstand liquidity shocks during the course of its business activities. The financial crisis in 2008 clearly revealed the need for regulators and banks alike to review existing capital and liquidity requirements and to assess a bank's capability of absorbing losses in its daily course of business and during economic and market stress situations.

RISK ASSESSMENT UNDER BASEL II

The primary objective of the Capital Adequacy Ratio (CAR) defined under Basel II is to protect a bank's depositors, whilst maintaining confidence and giving stability to the world banking system. The regulators attempt to accomplish this by setting the capital reserves a bank needs to hold in relation to the risk the bank exposes itself to through its business activities. Keeping in line with international standards, the Central Bank of Sri Lanka has supported these regulatory reforms by enhancing them in accordance with local funding and liquidity requirements. The capital adequacy of local banks is monitored by CBSL on a regular basis.

The Bank computes CAR as a ratio of its capital to its risk weighted assets. Calculations of the risk weightings defined under credit risk and market risk are based on the standardised approach whereas operational risk is computed by using the basic indicator approach. As the Basel II guidelines are phased in and more sophisticated risk measurement systems and models are implemented, banks will be in a position to move from the standardised methods to the more refined and robust requirements of the advanced approaches.

HNB's capital ratios of 12.76% and 14.51% remain comfortably above CBSL's current capital requirements of Tier 1 and Total Capital Ratios of 5% and 10% respectively.

CHANGES AND IMPLICATIONS OF BASEL III

The latest package of reforms defined under Basel III contains several important changes for banks' capital structures. Recently endorsed at the G-20 Summit held in November 2010 in Seoul, the new standards were finalized in mid-December 2010.

Summary of changes proposed under Basel III

- Increase in capital requirements

The minimum requirement for Tier 1 capital is to be raised from 4% to 6%, the focus shifting from Tier 1 capital to "Core Tier 1" capital, the concentration being on common equity where tougher minimum standards have been set.
- Introduction of a capital conservation buffer

Banks will be required to maintain additional capital up to 2.5% that can be used to absorb losses during periods of financial and economic stress. Although banks are permitted to draw on the buffer during periods of stress, the closer their regulatory capital ratios approach the minimum requirement, the greater the constraints on the distribution of earnings.
- Implementation of a countercyclical framework

Capital between 0% - 2.5% of common equity or other fully loss absorbing capital to be introduced at the discretion of national regulators. The aim of the countercyclical buffer is to force banks to start building up an extra reserve when the economy is in boom and when supervisors see excessive credit in the system that could reverse in the form of loan losses during a slump.
- New liquidity and funding standards

The liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) are to be introduced to ensure that banks have sufficient high-quality liquid assets to withstand a stressed funding scenario.
- Introduction of a leverage ratio

The objective of this ratio is to put a floor on the build-up of leverage in the banking sector and to put additional safeguards in place by supplementing risk-based measures with a more straightforward absolute measure.
- Revised framework for credit risk

Revised measures have been introduced to better address counterparty credit worthiness.

In view of Basel III, it is imperative that banks begin to measure their readiness on the new measures of liquidity and leverage. HNB has reviewed the impact of this initiative and will continue to monitor regulatory developments in this area.

CAPITAL ADEQUACY - BANK

continued

CAPITAL BASE

As at 31st December	2011 Rs Mn	2010 Rs Mn
TIER 1		
Voting ordinary shares	9,143	3,855
Non-Voting ordinary shares	2,308	1,464
Statutory reserve fund	1,800	1,510
Published retained earnings	4,448	4,420
General and other reserves	16,379	13,000
Less: Deductions from Tier 1 capital (Note 1)	(2,245)	(1,591)
Eligible Tier 1 Capital	31,833	22,658
TIER II		
50% of approved asset revaluation reserves (Note 2)	1,032	1,042
General provision for loan losses	1,041	1,451
Approved subordinated term debt	4,157	2,303
Tier II Capital	6,230	4,796
Less: Deductions from Tier II capital (Note 1)	(1,846)	(1,394)
Eligible Tier II capital	4,384	3,402
Capital Base	36,217	26,060
Risk Adjusted capital ratios		
Tier 1 (Eligible Tier 1 capital / Total risk adjusted balance) *	12.76	10.99
Total (Capital base / Total risk adjusted balance) **	14.51	12.64

* Statutory minimum 5% ** Statutory minimum 10%

RISK ADJUSTED ON - BALANCE SHEET EXPOSURE

As at 31st December	Balance		Risk Weights %	Risk Adjusted Balance	
	2011 Rs Mn	2010 Rs Mn		2011 Rs Mn	2010 Rs Mn
Exposures					
- To Central Government and CBSL	81,519	73,122	0	-	-
- To banks / foreign sovereigns	8,060	12,539	20 - 150	1,779	2,871
- To financial institutions	7,994	3,297	20 - 150	3,997	1,663
- To corporates	76,793	68,908	20 - 150	74,394	66,456
- To retail sector (excluding claims secured by residential properties)	90,210	56,033	75 - 100	69,191	45,384
- Secured on residential property mortgages	24,063	21,202	50 - 100	16,391	13,215
- Non performing advances	7,150	5,511	50 - 150	7,769	5,810
- Other Exposures	1,805	3,861	20 - 150	1,805	3,861
- Cash and cash items in the process of collection	9,693	7,911	0 - 20	555	414
- Other Assets	15,556	14,025	100	15,556	14,025
Total Assets	322,843	266,409		191,437	153,699

RISK ADJUSTED OFF - BALANCE SHEET EXPOSURE

As At 31st December	Amount of	Credit	Credit	Risk	Risk Adjusted	
	Off-Balance Sheet Items 2011 Rs Mn	Conversion Factor %	Equivalent Amount 2011 Rs Mn	Weights %	2011 Rs Mn	2010 Rs Mn
Financial guarantees, bank acceptances and other guarantees	8,707	100	8,707	0-100	8,707	8,553
Performance related guarantees and warranties and stand by LCs related to particular transactions	24,039	50	12,019	0-100	11,790	8,633
Shipping guarantees, documentary letter of credit and trade related acceptances	19,666	20	3,933	0-100	3,933	3,792
Other commitments with an original maturity of < 1year	37,998	0 - 20	6	0-100	6	16
> 1year	-	50	-	0-100	-	14
Foreign exchange contracts	90,272	2	1,805	0-100	1,805	1,386
Interest rate contracts	63	7	4	0-100	4	15
Total off-balance sheet exposures	180,745		26,474		26,245	22,409

CAPITAL CHARGE FOR MARKET RISK

As at 31st December	Capital charge		Risk Adjusted Balance	
	2011 Rs Mn	2010 Rs Mn	2011 Rs Mn	2010 Rs Mn
Interest rate	5.8	1.1	58	11
Equity	109.4	72.0	1,094	720
Foreign exchange and gold	100.2	96.0	1,002	960
Total risk adjusted balance for market risk	215.4	169.1	2,154	1,692

CAPITAL CHARGE FOR OPERATIONAL RISK

As At 31st December	Capital charge		Risk Adjusted Balance	
	2011 Rs Mn	2010 Rs Mn	2011 Rs Mn	2010 Rs Mn
Average gross income	19,786.5	18,922.6		
15% of average gross income	2,967.9	2,838.4		
Total risk adjusted balance for operational risk	2,967.9	2,838.4	29,679	28,384
Total risk adjusted balances (credit risk, market risk, operational risk)			249,515	206,184

NOTES:**(1) Deductions**

	Tier I		Tier II	
	2011 Rs Mn	2010 Rs Mn	2011 Rs Mn	2010 Rs Mn
Additional investment in Sithma Development (Pvt) Ltd.	450	450	450	450
Employee share option plan	399	197	-	-
Others	1,396	944	1,396	944
Total deductions	2,245	1,591	1,846	1,394

(2) Revenue Reserves approved by CBSL is Rs 2,064 Mn.

INCOME STATEMENT IN US DOLLARS

For the year ended 31st December	BANK		GROUP	
	2011 US\$ 000	2010 US\$ 000	2011 US\$ 000	2010 US\$ 000
INCOME	333,352	314,303	361,444	337,046
Interest income	290,971	272,651	294,730	275,486
Less: Interest expenses	147,019	132,527	147,867	133,194
Net interest income	143,952	140,124	146,863	142,292
Fee and commission income	24,405	18,911	26,827	21,671
Less: Fee and commission expenses	303	272	470	279
Net fee and commission income	24,102	18,639	26,357	21,392
Net interest, fee & commission income	168,054	158,763	173,220	163,684
Foreign exchange profit	8,676	9,158	8,741	9,142
Dividend income	3,595	1,891	3,578	1,794
Other income	5,705	11,692	27,568	28,953
Operating Income	186,030	181,504	213,107	203,573
Less:				
OPERATING EXPENSES				
Personnel expenses	42,943	41,681	47,568	45,881
Premises, equipment and establishment expenses	28,021	26,846	27,143	25,432
Provision charge for employee benefits	7,845	7,957	7,971	8,059
Provision charge / (released) for loan losses	(1,445)	4,338	(1,445)	4,338
Diminution in value of investment securities / Subsidiary	1,774	72	1,281	10
Loans written off	18	2	18	2
Other expenses	38,677	39,934	55,957	54,466
	117,833	120,830	138,493	138,188
PROFIT FROM OPERATIONS	68,197	60,674	74,614	65,385
Share of loss of associates (net of income tax)	-	-	(138)	(22)
PROFIT BEFORE INCOME TAX	68,197	60,674	74,476	65,363
Less: Income tax expense	19,291	20,438	19,742	21,316
PROFIT FOR THE YEAR	48,906	40,236	54,734	44,047
Attributable to:				
Equity holders of the Bank	48,906	40,236	53,985	43,145
Minority interest	-	-	749	902
PROFIT FOR THE YEAR	48,906	40,236	54,734	44,047
BASIC EARNINGS PER SHARE (US\$)	0.13	0.11	0.15	0.12
DILUTED EARNINGS PER SHARE (US\$)	0.13	0.11	0.15	0.12
DIVIDEND PER SHARE (US\$)	*0.07	0.06	*0.07	0.06

Exchange rate of US\$ 1 was Rs 113.90 as at 31st December 2011 (Rs 110.945 as at 31st December 2010)

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

The Income Statement given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.

BALANCE SHEET IN US DOLLARS

As at 31st December	BANK		GROUP	
	2011 US\$ 000	2010 US\$ 000	2011 US\$ 000	2010 US\$ 000
ASSETS				
Cash and cash equivalents	129,429	162,293	137,502	166,808
Statutory deposit with Central Banks	164,033	112,593	164,163	112,723
Government treasury bills	-	-	4,783	8,801
Dealing securities	10,027	13,137	16,395	22,572
Securities purchased under re-sale agreements	6,859	10,688	25,723	24,459
Non-current assets held for sale	-	-	25	26
Bills of exchange	8,420	12,629	8,420	12,629
Commercial papers	219	1,433	769	1,911
Lease receivable within one year	62,675	41,737	62,675	41,737
Lease receivable after one year	147,372	79,470	147,372	79,470
Loans and advances	2,050,228	1,694,838	2,035,568	1,676,351
Investment securities	552,612	529,128	574,167	543,068
Investments in Associates	735	754	3,374	1,767
Investment in Joint Venture	5,751	5,904	-	-
Investments in Subsidiaries	20,696	19,641	-	-
Investment properties	3,067	3,187	1,484	1,565
Property, plant and equipment	68,901	67,366	129,961	131,018
Intangible assets	4,824	5,201	5,889	6,336
Other assets	84,175	70,181	93,370	83,165
Total Assets	3,320,023	2,830,180	3,411,640	2,914,406
LIABILITIES				
Deposits from customers	2,494,697	2,109,820	2,490,888	2,108,103
Dividends payable	1,476	447	1,491	461
Securities sold under re-purchase agreements	57,586	107,727	72,971	121,890
Borrowings	175,580	97,441	176,482	97,377
Current tax liabilities	14,748	28,191	15,373	29,375
Bills payable	12,328	11,764	12,328	11,764
Subordinated debentures	41,976	24,555	41,741	24,314
Insurance provision - Life	-	-	26,260	21,499
Insurance provision - General	-	-	8,115	6,586
Deferred tax liabilities	10,262	6,633	10,220	6,619
Other liabilities	185,752	197,770	194,349	210,906
Total Liabilities	2,994,405	2,584,348	3,050,218	2,638,894
EQUITY				
Stated capital	100,540	47,939	100,540	47,939
Statutory reserves	24,393	13,610	24,393	13,610
Retained earnings	39,053	39,842	43,559	39,254
Other reserves	161,632	144,441	185,974	169,404
Total equity attributable to equity holders of the Bank	325,618	245,832	354,466	270,207
Minority interest	-	-	6,956	5,305
Total Equity	325,618	245,832	361,422	275,512
Total Liabilities and Equity	3,320,023	2,830,180	3,411,640	2,914,406
Commitments and contingencies	1,339,676	1,119,208	1,339,676	1,119,208

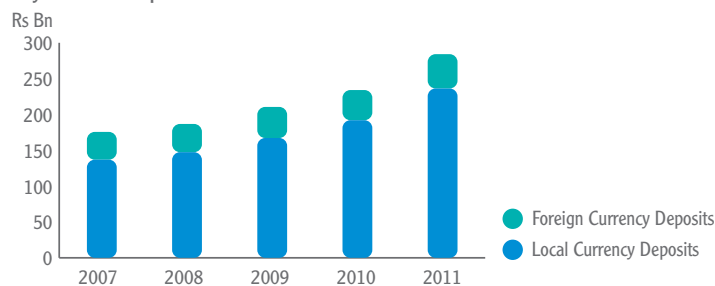
Exchange rate of US\$ 1 was Rs 113.90 as at 31st December 2011 (Rs 110.945 as at 31st December 2010)

The Balance Sheet given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.

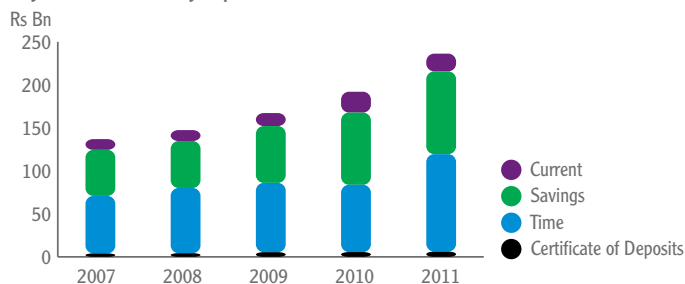
ANALYSIS OF DEPOSITS

	2007 Rs 000	2008 Rs 000	2009 Rs 000	2010 Rs 000	2011 Rs 000
Local Currency Deposits					
Current	12,482,701	12,748,863	15,090,759	24,214,105	20,644,899
Savings	53,565,590	54,544,453	66,080,330	83,981,743	96,215,937
Time	66,836,282	75,828,902	80,572,001	78,201,845	113,308,379
Certificate of Deposit	4,021,045	4,269,993	5,439,817	5,576,315	6,106,431
	136,905,618	147,392,211	167,182,907	191,974,008	236,275,646
Foreign Currency Deposits					
Current	1,348,573	1,522,500	1,191,309	794,003	1,126,136
Savings	15,784,655	14,178,854	14,715,443	15,033,471	14,901,117
Time	21,620,727	23,676,297	27,417,146	26,272,495	31,843,063
	38,753,955	39,377,651	43,323,898	42,099,969	47,870,316
Total Deposits	175,659,573	186,769,862	210,506,805	234,073,977	284,145,962
Refinance	5,749,624	6,424,054	6,169,445	6,314,639	6,944,535
Total Deposits and Refinance	181,409,197	193,193,916	216,676,250	240,388,616	291,090,497

Analysis of Total Deposits



Analysis of Local Currency Deposits



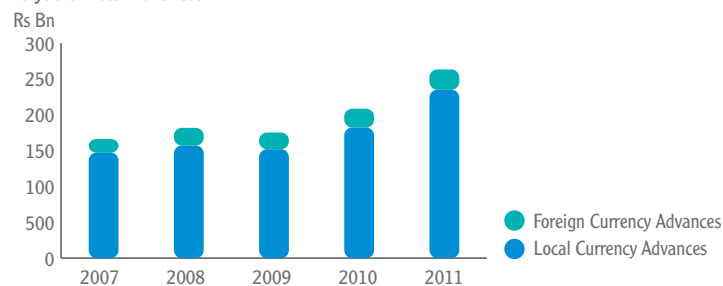
Analysis of Foreign Currency Deposits



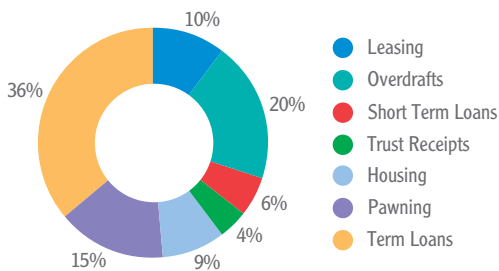
ANALYSIS OF ADVANCES

	2007 Rs 000	2008 Rs 000	2009 Rs 000	2010 Rs 000	2011 Rs 000
Local Currency Advances (Gross)					
Overdrafts	33,776,672	35,393,588	32,264,297	40,871,128	46,234,887
Short term loans	5,129,706	7,074,630	9,704,995	13,101,182	13,198,213
Trust receipts	7,097,272	7,642,331	6,347,877	7,461,863	9,856,547
Housing loans	16,062,341	18,084,738	17,551,280	18,005,579	20,885,882
Pawning advances	16,783,984	21,129,938	21,914,906	27,965,219	35,715,818
Term loans	54,609,297	55,654,181	54,685,347	60,847,018	84,470,153
	133,459,272	144,979,406	142,468,702	168,251,989	210,361,500
Lease facilities	13,772,361	12,038,851	9,398,642	13,919,317	24,568,779
Total local currency advances	147,231,633	157,018,257	151,867,344	182,171,306	234,930,279
Foreign Currency Advances (Gross)	18,988,347	24,696,099	23,371,444	26,240,327	28,268,611
Total Advances	166,219,980	181,714,356	175,238,788	208,411,633	263,198,890

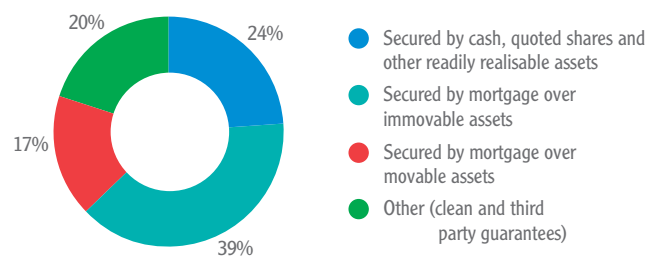
Analysis of Total Advances



Analysis of Local Currency Advances by Type



Analysis of Total Advances by Security

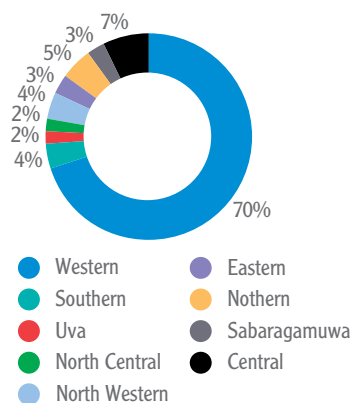


PROVINCEWISE ANALYSIS OF DEPOSITS AND ADVANCES

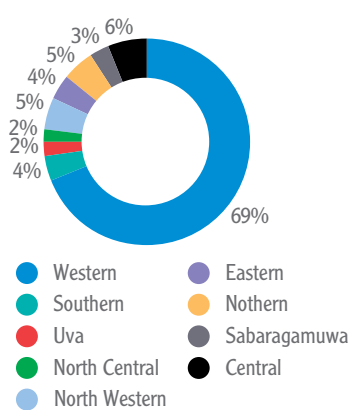
As at 31st December 2011

Province	No of Branches	Deposits (Rs Mn)	%	Advances Including Leasing (Rs Mn)	%	Deposit Utilisation %
Western	98	201,708	70	181,294	69	90
Southern	22	10,359	4	11,329	4	109
Uva	11	5,633	2	5,278	2	94
North Central	10	4,469	2	5,471	2	122
North Western	18	12,773	4	14,054	5	110
Eastern	26	8,283	3	9,137	4	110
Northern	19	13,569	5	12,341	5	91
Sabaragamuwa	11	8,335	3	7,561	3	91
Central	25	19,018	7	16,734	6	88
Total	240	284,146	100	263,199	100	93

Province-wise Deposits



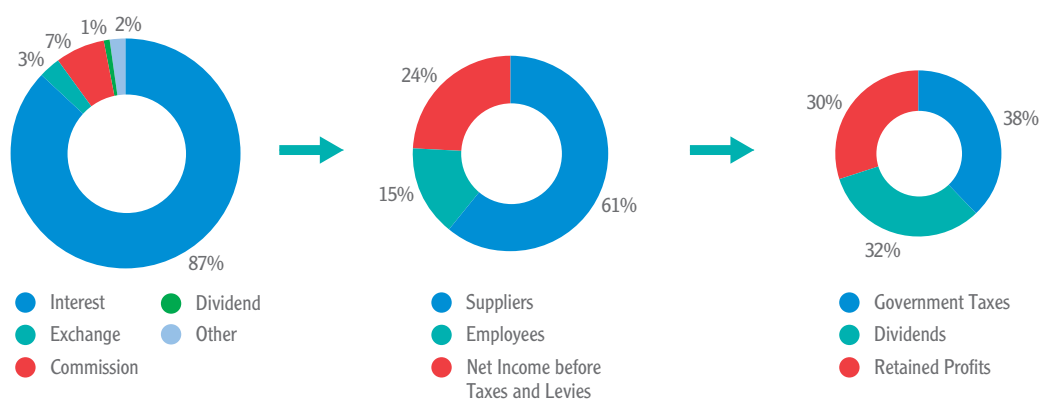
Province-wise Advances



SOURCES AND UTILISATION OF INCOME

	2007 Rs 000	2008 Rs 000	2009 Rs 000	2010 Rs 000	2011 Rs 000
SOURCES OF INCOME					
Interest	26,250,038	32,431,158	34,620,276	30,249,230	33,141,598
Exchange	1,114,313	1,166,979	903,210	1,015,987	988,231
Commission	1,652,064	1,828,504	1,784,514	2,098,127	2,779,700
Dividend	125,142	538,321	217,353	209,762	409,440
Other	423,656	650,194	1,285,746	1,297,312	649,793
Total	29,565,213	36,615,156	38,811,099	34,870,418	37,968,762
UTILISATION OF INCOME					
Employees					
Salaries and other payment to Staff	3,657,112	4,348,690	4,909,419	5,507,101	5,784,690
Suppliers					
Interest Paid	15,189,698	19,751,667	20,039,646	14,703,256	16,745,453
Other expenses	5,036,460	5,899,282	5,602,193	5,977,392	6,468,874
	20,226,158	25,650,949	25,641,839	20,680,648	23,214,327
Net Income before Government Taxes and Levies	5,681,943	6,615,517	8,259,841	8,682,669	8,969,745
Government					
Income Tax, VAT, Debit Tax, SRL (Incl. Deferred Tax)	2,581,275	3,343,547	3,770,452	4,188,491	3,364,886
Shareholders					
Dividends	824,353	942,118	1,533,222	1,649,547	2,914,484
Retained Profits	2,276,315	2,329,852	2,956,166	2,844,631	2,690,375
Total	29,565,213	36,615,156	38,811,099	34,870,418	37,968,762

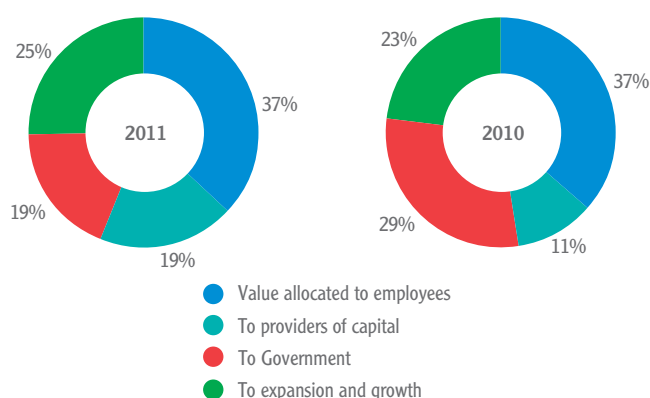
Sources and Utilisation of Income



VALUE ADDED STATEMENT

	2011 Rs 000	%		2010 Rs 000	%
Value Added					
Income earned by providing banking services	37,442,479			33,791,326	
Cost of services	22,296,218			19,390,960	
Value added by banking services	15,146,261			14,400,366	
Non-banking income	526,283			1,079,092	
Provision for fall in value of investments	(202,031)			(8,025)	
Provision (charge) / released for bad debts	164,562			(481,309)	
	15,635,075			14,990,124	
Value allocated to employees					
Salaries, wages and other benefits	5,784,690	37.00		5,507,101	36.74
To providers of capital					
Dividends to shareholders	2,914,484	18.64		1,649,545	11.00
To Government					
Value Added Tax	1,149,711		1,859,676		
Income tax	1,759,956		2,452,944		
Debit tax	2,964		11,156		
Stamp duty	14,948		50,175		
	2,927,579	18.72	4,373,951		29.18
To expansion and growth					
Retained income	2,655,855	16.99		2,814,422	18.78
Depreciation and Amortisation	915,160	5.85		830,565	5.54
Deferred taxation	437,307	2.80		(185,460)	(1.24)
	15,635,075	100.00		14,990,124	100.0

Analysis of Value Addition



QUARTERLY STATISTICS

For the three months ended	2011				* 2010											
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st								
Balance Sheet Date																
(Rs Mn)																
Total Assets	378,150	369,074	345,974	329,823	313,994	295,535	285,971	281,652								
Loans, leases and bills (Gross) **	263,677	259,075	248,476	222,288	209,500	190,867	180,245	174,595								
Deposits **	288,029	272,042	259,369	248,864	240,206	222,867	217,828	216,981								
Shareholders' funds	37,088	35,739	28,393	27,140	27,274	25,689	24,642	23,393								
Average assets	373,612	357,524	337,899	321,909	304,765	290,753	283,812	280,971								
Income Statement Data																
(Rs 000)																
Net interest income	4,366,900	4,196,472	3,872,987	3,959,786	4,244,428	3,866,343	3,816,891	3,618,312								
Foreign exchange profit	220,457	241,125	250,205	276,444	273,851	319,516	239,412	183,208								
Other income	873,386	766,416	953,763	677,898	604,792	885,351	1,077,673	579,192								
Total Revenue	5,460,743	5,204,013	5,076,955	4,914,128	5,123,071	5,071,210	5,133,976	4,380,712								
Provision (charge) / released for loan losses (Net of recovery)	289,587	253,366	73,256	79,298	42,394	(36,574)	(10,041)	(49,380)								
Non-interest expenses	(3,376,792)	(3,506,162)	(3,405,279)	(3,295,511)	(2,848,965)	(3,510,430)	(3,426,144)	(3,138,378)								
Provision for income tax	(397,673)	(672,697)	(562,236)	(564,657)	(596,777)	(572,259)	(558,271)	(540,177)								
Net Profit after Tax	1,975,865	1,278,520	1,182,696	1,133,258	1,719,723	951,947	1,139,520	652,777								
Ordinary Share Information																
Market Price Per Share (Rs)	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV		
High	202.00	94.00	223.00	120.50	360.00	147.00	410.00	228.00	445.00	260.00	390.00	250.00	300.00	207.00	189.50	145.00
Low	138.00	79.00	120.00	90.00	200.40	115.60	365.00	202.00	380.00	190.70	270.00	173.60	185.00	132.25	168.00	105.00
Closing	151.30	83.20	201.90	92.80	205.30	115.80	380.00	213.30	399.90	214.60	386.10	239.90	281.00	190.25	188.25	140.00
V - Voting NV - Non-voting																
Book value per Ordinary Share ***	95.44	92.02	79.41	75.91	76.41	72.00	69.32	66.09								
Financial Measures																
Profitability																
Return on average Shareholders' equity (annualised) (%) **	17.84	16.28	16.67	16.44	17.92	14.99	14.96	10.92								
Productivity																
Non interest expenses to total revenue (%)	61.84	67.37	67.07	67.06	55.61	69.22	66.73	71.64								
Capital																
Risk weighted capital ratios																
Tier 1 (%)	12.76	11.82	9.13	9.77	10.99	10.49	10.40	10.50								
Total (Tier 1+2) (%)	14.51	13.65	10.30	11.17	12.64	12.25	12.31	12.47								
Asset Quality																
Gross NPA ratio (%) **	3.93	4.37	4.74	5.00	4.52	5.94	6.48	7.40								
Net NPA ratio (%) **	2.33	2.49	2.68	2.63	1.96	3.09	3.30	4.11								

* Comparative information has been amended based on reclassified figures.

** This information has been compiled in accordance with the instructions issued by the Central Bank of Sri Lanka for interim publication which may differ from information in other disclosures.

*** Comparative figures have been adjusted for the effect of sub division of shares which took place on 5th April 2011.

TEN YEAR STATISTICAL SUMMARY

Year ended 31st December (Rs Mn)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
OPERATING RESULTS										
Income	11,659	14,655	13,829	16,674	21,168	29,565	36,615	38,811	34,870	37,969
Interest Income	9,399	11,537	11,469	14,130	18,452	26,250	32,431	34,620	30,249	33,142
Interest Expense	6,258	6,909	5,962	7,281	9,797	15,190	19,752	20,040	14,703	16,745
Exchange Income	382	506	662	646	773	1,114	1,167	903	1,016	988
Other Income	1,878	2,612	1,697	1,897	1,943	2,201	3,017	3,288	3,605	3,839
Operating Expenses	4,732	6,654	6,794	7,426	8,249	9,963	12,026	12,716	13,406	13,421
Profit before Income Tax	669	1,092	950	1,850	3,019	4,335	4,785	5,918	6,731	7,768
Income Tax on Profit	80	83	(26)	195	799	1,312	1,566	1,566	2,267	2,197
Profit after Taxation	589	1,008	976	1,655	2,220	3,022	3,219	4,352	4,464	5,570
LIABILITIES AND SHAREHOLDERS' FUNDS										
Customer Deposits	87,884	101,026	118,524	128,284	147,557	175,660	186,770	210,507	234,074	284,146
Refinance Borrowings	1,659	1,764	2,066	2,712	3,583	5,750	6,424	6,169	6,315	6,945
Other Liabilities	19,354	23,161	22,787	23,464	31,687	32,472	42,064	38,773	45,596	48,803
Deferred Taxation	304	387	350	314	314	606	872	939	736	1,169
Shareholders' funds	6,235	6,993	9,052	11,239	12,930	18,419	20,581	23,900	27,274	37,088
Total	115,436	133,331	152,780	166,012	196,070	232,906	256,711	280,289	313,994	378,151
ASSETS										
Bills of Exchange	2,690	2,412	2,077	2,027	1,911	2,069	2,187	1,447	1,401	959
Loans and Advances (Net)	62,152	75,326	88,594	101,609	119,997	144,985	161,073	159,247	188,034	233,521
Lease Rentals Receivable (Net)	4,032	5,085	6,838	8,864	11,552	13,289	11,547	8,944	13,447	23,924
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	21,479	21,119	25,013	24,400	30,200	32,565	35,149	38,216	30,497	33,425
Property, Plant and Equipment	2,781	3,414	3,387	3,059	2,908	6,083	6,866	7,180	7,474	7,848
Other Assets	22,302	25,975	26,870	26,053	29,502	33,915	39,888	65,254	73,141	78,473
Total	115,436	133,331	152,780	166,012	196,070	232,906	256,711	280,289	313,994	378,151
RATIOS										
Return on Average Shareholders Funds (%)	10	15	12	16	18	19	17	20	17	17
Income Growth (%)	1	26	(6)	21	27	40	24	6	(10)	9
Return on Average Assets (%)	0.6	0.8	0.7	1.0	1.2	1.4	1.3	1.6	1.5	1.6
Dividend Cover (times)	2.8	3.5	2.8	3.5	3.8	3.7	3.4	2.8	2.7	1.9
Advance to Deposits and Refinance (%)	78	81	81	86	88	88	90	78	84	89
Property, Plant and Equipment to Shareholders Funds (%)	45	49	37	27	22	33	33	30	27	21
Total Assets to Shareholders Funds (Times) (As specified in the Banking Act No. 30 of 1988)	19	19	17	15	15	13	12	12	12	10
Capital Funds to Liabilities including Contingent Liabilities (%)	1.2	1.0	1.0	1.0	1.0	1.3	1.2	1.1	1.1	2.2
Liquid Assets to Liabilities (%)	32	27	25	24	22	22	22	29	24	22
SHARE INFORMATION										
Market Value per Share (Rs)										
- Voting	79.00	69.00	57.00	112.50	155.75	122.50	69.75	170.25	399.90	151.30
- Non Voting	47.00	36.75	32.75	41.50	70.00	53.25	32.00	104.75	214.60	83.20
Earnings per Share (Rs)	8.24	14.10	9.75	14.05	18.86	12.83	13.67	18.47	18.84	15.08
Earnings per Share (Adjusted) (Rs) *	1.59	2.73	2.64	4.48	6.01	8.18	8.71	11.78	12.08	15.08
Price Earnings Ratio	9.59	4.89	8.77	12.01	12.39	14.32	7.66	13.82	31.84	10.03
Net Assets per Share (Adjusted) (Rs) **	16.04	18.00	23.29	28.92	33.27	47.40	52.96	61.50	70.19	95.44
Dividend per share (Rs) ***	3.00	4.00	3.50	4.00	5.00	3.50	4.00	6.50	7.00	7.50
Gross Dividends (Rs Mn)	215	286	350	471	589	824	942	1,533	1,650	2,914
OTHER INFORMATION										
No. of Employees	4,280	4,203	4,180	4,259	4,287	4,334	4,395	4,302	4,352	4,584
No. of Customer Centres	137	138	142	148	151	167	177	186	205	240
No. of Student Banking Centres	144	151	152	152	152	152	152	153	159	164
No. of other Financial Centres	110	110	110	113	113	114	114	115	121	123

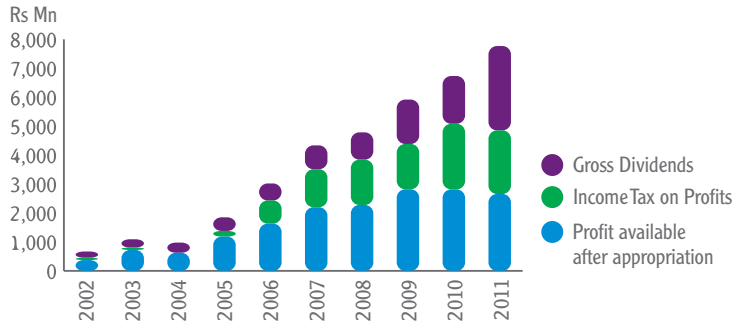
* Earnings per share has been adjusted for weighted Average number of shares outstanding during the current year.

** Net Assets per share has been computed for the current number of shares issued as at 31st December 2011.

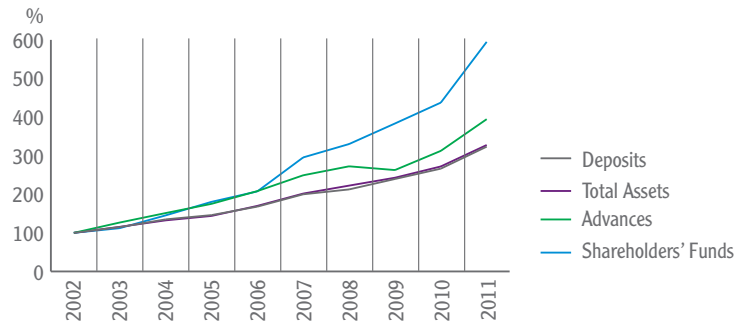
*** 2011 final dividend consist of a cash dividend of Rs 3.00 per share and a scrip dividend of Rs 3.00 per share.

TEN YEAR GRAPHICAL REVIEW

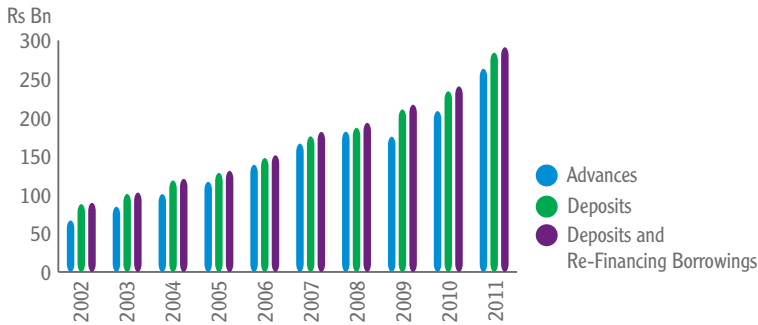
Distribution of Profits



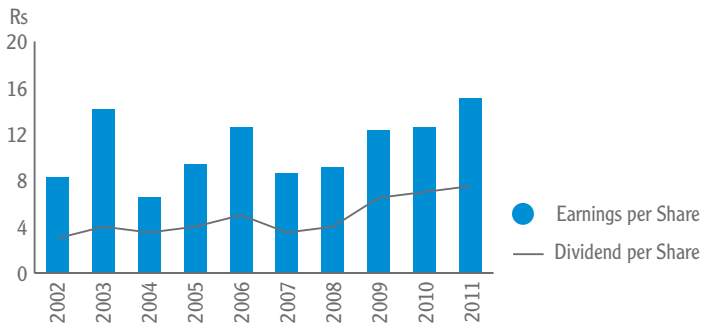
Balance Sheet Growth (Base year 2002)



Advances, Deposits and Re-Finance Borrowings



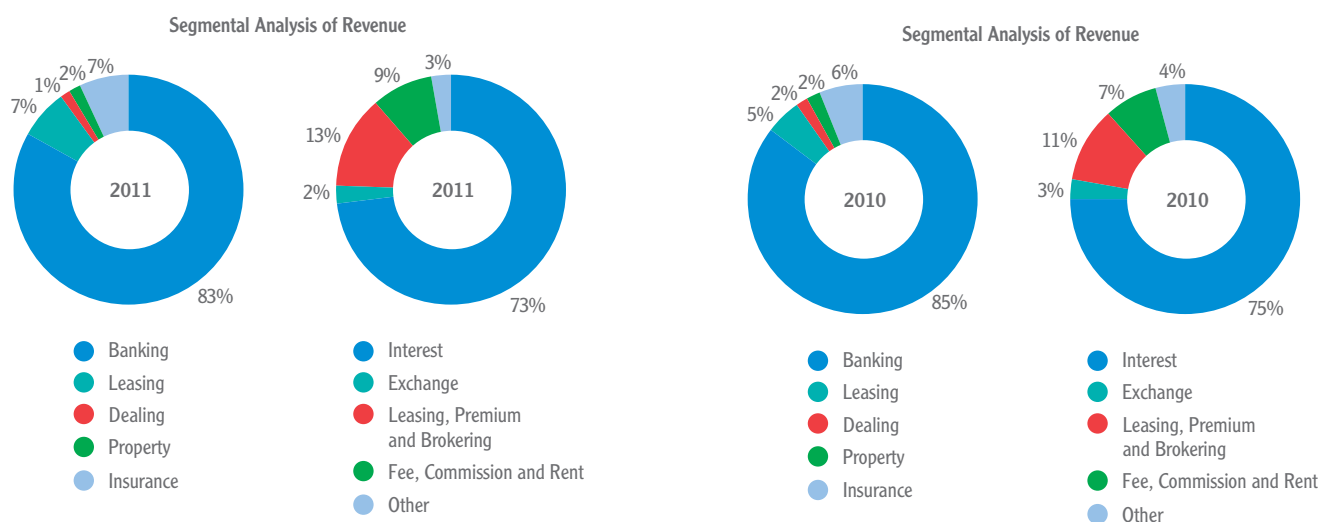
Earnings per Share and Dividends per Share



SEGMENTAL ANALYSIS

Business Segments	Banking		Leasing		Dealing*		Property		Insurance		Total	
	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000	2011 Rs 000	2010 Rs 000
Interest	30,236,446	28,359,178	-	-	201,238	150,040	-	-	457,214	448,742	30,894,898	28,957,960
Exchange	988,231	1,015,987	-	-	4,327	3,711	-	-	3,022	(5,489)	995,580	1,014,209
Leasing, Premium and Brokering	-	-	2,905,152	1,890,052	260,644	306,003	-	-	2,353,351	1,905,506	5,519,147	4,101,561
Fee, Commission and Rent	2,818,401	2,136,353	14,149	12,164	27,140	15,407	756,694	715,532	-	-	3,616,384	2,879,456
Other	1,006,383	1,456,684	-	-	102,627	131,704	507	-	10,065	8,689	1,119,582	1,597,077
Total Revenue	35,049,461	32,968,202	2,919,301	1,902,216	595,976	606,865	757,201	715,532	2,823,652	2,357,448	42,145,591	38,550,263

*Stock Broking, Securities dealing, Money transfer and Foreign currency related services



INVESTOR RELATIONS

Listing Rule No 7.6, Contents of the Annual Report, at a glance

Rule No	Disclosure Requirement	Section Reference	Page Reference
7.6 (i)	Names of persons who held the positions of Directors during the financial year	Annual Report of the Board of Directors on the Affairs of the Company	158
7.6 (ii)	Principal activities of the Entity and its Subsidiaries during the year and any changes therein	Notes to the Financial Statements (Note 1.1) Annual Report of the Board of Directors on the Affairs of the Company	179 155
7.6 (iii)	The names and the number of shares held by the 20 largest holders of voting and non-voting shares and the percentage of such shares held	Investor Relations (Sections 10 and 11)	284 to 285
7.6 (iv)	The Public Holding percentage	Investor Relations (Section 2)	280 to 281
7.6 (v)	The statement of each Director's holding and Chief Executive Officer's holding in shares of the Entity at end of financial year	Annual Report of the Board of Directors on the Affairs of the Company	160
7.6 (vi)	Information pertaining to material foreseeable risk factors of the Entity	Risk Management	51 to 67
7.6 (vii)	Details of material issues pertaining to employees and industrial relations of the Entity	Not applicable for the year as the Bank did not encounter any situation of this nature which require disclosure	-
7.6 (viii)	Extents, locations, valuations and the number of buildings of the Entity's land holdings and investment properties	Notes to the Financial Statements (Note 33 and 34)	226 to 234
7.6 (ix)	Number of shares representing the Entity's stated capital	Notes to the Financial Statements [Note 46 (b)] Investor Relations (Section 2)	243 280 to 281
7.6 (x)	A distribution schedule of the number of holders in each class of equity securities, and the percentage of their total holdings	Investor Relations (Section 2)	280 to 281
7.6 (xi)	Equity Ratios Market Value Debenture Information	Investor Relations (Sections 4 and 5) Investor Relations (Section 6) Investor Relations (Section 13)	282 282 286 to 287
7.6 (xii)	Significant changes in the Entity's or its subsidiaries' fixed assets and the market value of land, if the value differs substantially from the book value	Notes to the Financial Statements (Note 34)	228 to 234
7.6 (xiii)	Details of funds raised through Public Issues, Rights Issues and Private Placements during the year	Investor Relations (Section 8)	283
7.6 (xiv)	Information in respect of Employee Share Option Plan and Employee Share Ownership Plan	Notes to the Financial Statements (Note 46) Annual Report of the Board of Directors on the Affairs of the Company	243 to 244 160 to 161
7.6 (xv)	Disclosures pertaining to Corporate Governance practices in terms of Rules 7.10.3, 7.10.5 c. and 7.10.6 c. of Section 7 of the Rules	Corporate Governance Report	68 to 89
7.6 (xvi)	Disclosure on Related Party Transactions exceeding 10% of the Equity or 5% of the total assets of the Entity as per Audited Financial Statements, whichever is lower	Investor Relations (Section 12)	285

INVESTOR RELATIONS

continued

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 2011 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 4,430 registered Voting Shareholders as at 31st December 2011 (2010 : 4,380) distributed as follows.

SHARE INFORMATION - VOTING

	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	2,479	771,353	0.33	35	15,231	0.02	2,514	786,584	0.25
1,001 - 10,000	1,290	4,120,037	1.75	35	122,877	0.16	1,325	4,242,914	1.36
10,001 - 100,000	462	12,590,399	5.34	26	732,244	0.97	488	13,322,643	4.28
100,001 - 1,000,000	63	14,119,848	5.98	16	4,679,785	6.19	79	18,799,633	6.04
Over 1,000,000	13	204,248,805	86.60	11	70,005,668	92.66	24	274,254,473	88.07
	4,307	235,850,442	100.00	123	75,555,805	100.00	4,430	311,406,247	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2011			31st December 2010		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	4,307	235,850,442	75.74	4,252	137,411,162	76.75
Non-Resident	123	75,555,805	24.26	128	41,631,502	23.25
Total	4,430	311,406,247	100.00	4,380	179,042,664	100.00

Individuals / Institutions

	31st December 2011			31st December 2010		
	No Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	4,126	41,589,266	13.36	4,086	27,304,716	15.25
Institutions	304	269,816,981	86.64	294	151,737,948	84.75
Total	4,430	311,406,247	100.00	4,380	179,042,664	100.00

As at 31st December 2011 the average size of holding of ordinary shareholding was 70,295 voting shares. (31st December 2010 : 40,877 voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2011 was 68% approximately.

SHARE INFORMATION - NON-VOTING

There were 11,828 registered Non voting Shareholders as at 31st December 2011 (2010 : 11,536) 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	7,085	2,852,262	4.42	52	23,230	0.18	7,137	2,875,492	3.73
1,001 - 10,000	3,979	13,043,658	20.23	68	258,786	2.04	4,047	13,302,444	17.23
10,001 - 100,000	545	14,570,265	22.60	27	884,106	6.95	572	15,454,371	20.02
100,001 - 1,000,000	53	13,883,943	21.53	10	2,792,806	21.97	63	16,676,749	21.60
Over 1,000,000	5	20,128,775	31.22	4	8,752,765	68.86	9	28,881,540	37.42
	11,667	64,478,903	100.00	161	12,711,693	100.00	11,828	77,190,596	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2011			31st December 2010		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	11,667	64,478,903	83.53	11,405	40,520,812	86.78
Non-Resident	161	12,711,693	16.47	131	6,172,604	13.22
Total	11,828	77,190,596	100.00	11,536	46,693,416	100.00

Individuals / Institutions

	31st December 2011			31st December 2010		
	No Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	11,487	33,792,014	43.78	11,249	21,385,974	45.80
Institutions	341	43,398,582	56.22	287	25,307,442	54.20
Total	11,828	77,190,596	100.00	11,536	46,693,416	100.00

As at 31st December 2011 the average size of holding of ordinary shareholding was 6,526 non voting shares. (31st December 2010 : 4,048 non voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2011 was 96% approximately.

3 SHARE TRADING

	2011	2010
VOTING		
Number of transactions	4,317	8,997
Number of shares traded (Mn)	19	96
Rank (As per CSE)	119	41
Value of shares traded (Rs Mn)	5,011	27,131
Rank (As per CSE)	27	2
NONVOTING		
Number of transactions	8,547	11,745
Number of shares traded (Mn)	15	19
Value of shares traded (Rs Mn)	2,046	3,538

INVESTOR RELATIONS

continued

4 DIVIDENDS

	2011		2010	
Interim (Rs)	1.50	Paid in December 2011	1.50	Paid in November 2010
Final (Rs) - Cash Dividend	3.00	Proposed to be paid in April 2012	5.50	Paid in April 2011
- Scrip Dividend	3.00			
Dividend payout ratio (%)	52.32		36.95	

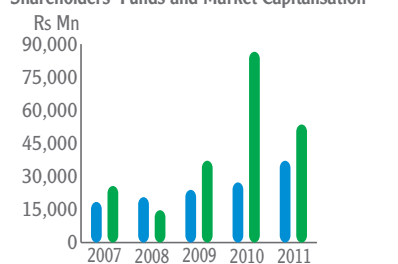
5 EARNINGS

	2011	2010
Earnings per share (Rs)	15.08	12.08
Price earnings ratio (Times)	10.03	31.84

6 MARKET VALUE

	Highest Rs.	Lowest Rs.	Year End Rs.
2006 - Voting	161.00	100.00	155.75
- Non Voting	74.25	39.00	70.00
2007 - Voting	225.00	90.00	122.50
- Non Voting	120.00	35.00	53.25
2008 - Voting	135.00	65.00	69.75
- Non Voting	57.50	31.00	32.00
2009 - Voting	175.00	68.00	170.25
- Non Voting	107.00	32.00	104.75
2010 - Voting	445.00	168.00	399.90
- Non Voting	260.00	105.00	214.60
2011 - Voting	410.00	120.00	151.30
- Non Voting	228.00	79.00	83.20

Shareholders' Funds and Market Capitalisation



● Shareholders' Funds ● Market Capitalisation

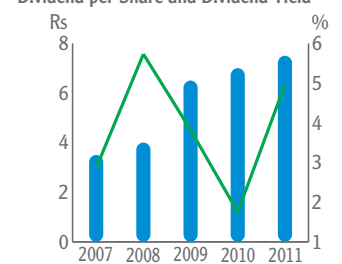
*HNB Market Capitalisation includes both Voting and Non voting shares

Net Assets per Share and Closing Price per Share



● Net Asset per Share ● Closing Price per Share (Voting Shares)

Dividend per Share and Dividend Yield



● Dividend per Share ● Dividend Yield (Voting Share)

7 MARKET CAPITALISATION (as at 31st December)

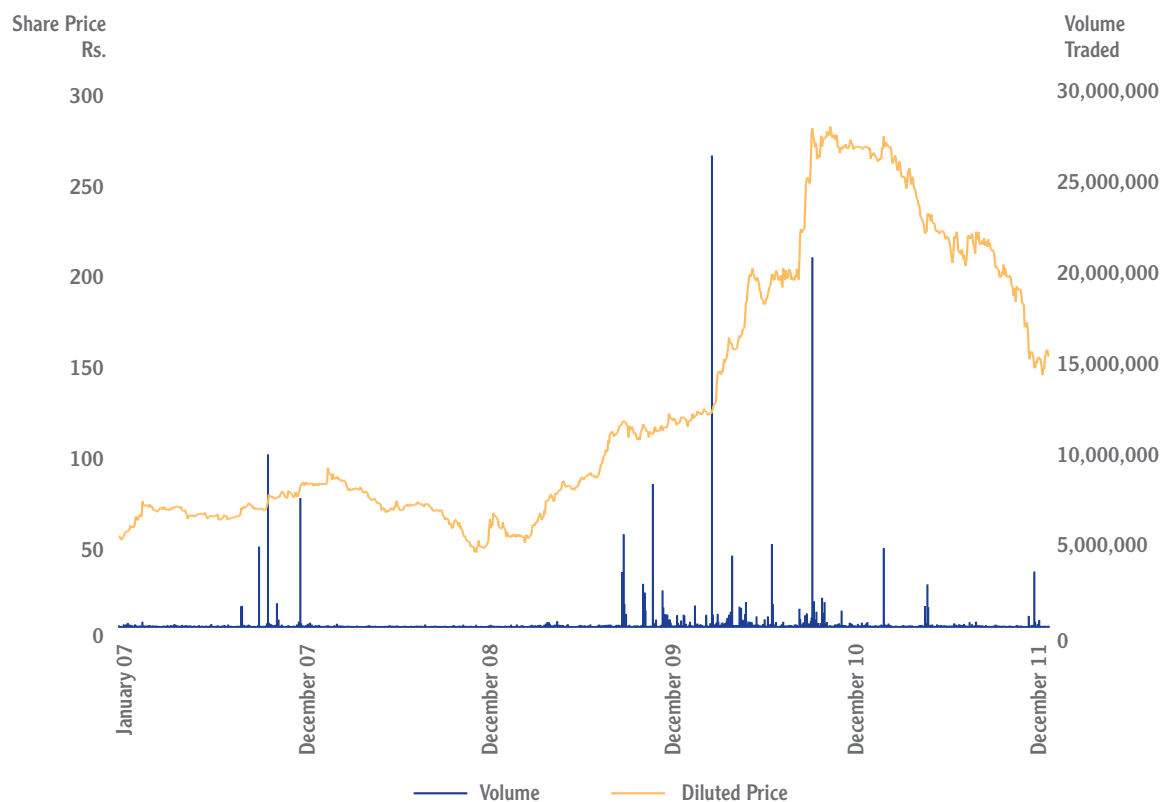
	Capital & Reserves Rs Mn	HNB Market Capitalisation* Rs Mn	CSE Market Capitalisation Rs Mn	HNB Market Capitalisation as a % of CSE Market Capitalization	Market Capitalisation Ranking
2006	12,930	16,361	834,763	1.95	10
2007	18,419	25,653	820,652	3.13	6
2008	20,581	14,684	488,813	3.00	7
2009	23,900	32,266	1,092,138	2.95	8
2010	27,274	76,491	2,210,452	3.46	7
2011	37,088	47,116	2,213,873	2.13	10

* HNB Market Capitalization includes only Voting shares

8 INFORMATION ON MOVEMENT IN SHARE CAPITAL

Year	Issue	Basis	No of Shares
	Prior to public issue		50,000
1971	Public issue		220,000
1977	Rights issue (@ Rs.10/-)	42:50	230,000
1980	Rights issue (@ Rs.10/-)	1:1	500,000
1982	Bonus	1:1	1,000,000
1988	Bonus	1:1	2,000,000
1990	Bonus	1:2	2,000,000
1993	Bonus	1:1	6,000,000
1996	Bonus	2:3	8,000,000
1998	Bonus	1:2	10,000,000
1999	Bonus	2:3	20,000,000
1999	Rights (non voting @ Rs.70/-)	3:10	15,000,000
2002	Bonus	1:10	6,500,000
2004	Rights (voting @ Rs 55.00 and non voting @ Rs 33.00)	2:5	28,600,000
2005	Issue of underlying shares for GDR		17,664,700
2007	Bonus	1:1	117,764,700
2009	Shares issued under ESOP		240,747
2010	Shares issued under ESOP		2,198,875
2011	Sub division of shares	1:2	119,179,782
2011	Rights (voting @ Rs 219.50 and non voting @ Rs 119.50)	1:10	21,858,851
2011	Private placement of unsubscribed rights		8,975,700
2011	Shares issued under ESOP		613,488
	Total		388,596,843

9 PRICE VOLUME CHART



INVESTOR RELATIONS

continued

10 TWENTY MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2011

Name	% on total capital	% on total voting capital	No of Shares 2011	No of Shares 2010
1. Sri Lanka Insurance Corporation Ltd	12.08	15.07	46,940,572	28,448,832
2. Employees Provident Fund	7.69	9.60	29,891,300	18,042,000
3. Milford Exports (Ceylon) Ltd	6.53	8.15	25,365,532	15,373,050
4. Stassen Exports Ltd	5.66	7.06	21,986,002	13,324,850
5. Brown & Company PLC	5.61	7.00	21,788,629	13,205,230
6. Mr.Sohli Edelji Captain	4.06	5.06	15,765,390	9,589,060
7. Sonetto Holdings Ltd	3.71	4.64	14,434,589	8,445,206
8. HSBC Intl Nom.Ltd - SSBT - Janus Overseas Fund	3.66	4.56	14,210,400	9,473,600
9. Distilleries Co. of Sri Lanka Ltd	2.53	3.16	9,836,818	5,961,708
10. National Savings Bank	2.37	2.96	9,204,030	5,578,200
11. HSBC Intl Nom Ltd.- Janus Aspen Series Overseas Port Fol.	1.66	2.07	6,438,600	4,292,400
12. Standard Chartered Bank Singapore S/A HL Bank Singapore Branch	1.57	1.96	6,099,640	4,013,800
13. SBIVen Holdings Pte Ltd	1.48	1.84	5,739,600	-
14. HSBC International Nominees Ltd - BBH - Gmoemerging Markets Fund	1.47	1.84	5,731,554	3,266,130
15. The Bank of NewYork Mellon SA/NV - CF RufferTotal Return Fund	1.30	1.62	5,046,230	-
16. FI-CIBLUX S/A Battery March Global Emerging Market Fund	1.12	1.40	4,369,200	2,648,000
17. The Bank of NewYork Mellon SA/NV - CF Ruffer Absolute Return Fund	0.87	1.09	3,387,180	-
18. BNY-CF Ruffer Investment Funds: CF Ruffer Pacific Fund	0.66	0.83	2,581,425	1,564,500
19. Ms. L A Captain	0.62	0.78	2,418,600	-
20. HSBC Intl Nom Ltd. - BBH - GMO Emerging Illiquid Fund	0.51	0.63	1,967,250	-
Sub Total	65.16	81.31	253,202,541	
* Unregistered Shares	4.72	5.89	18,349,413	12,232,942
Balance held by 4,410 voting shareholders (Total voting shareholders - 4,430)	10.26	12.80	39,854,293	
Total voting shares	80.14	100.00	311,406,247	191,275,606
Shares held by 11,828 Non-voting shareholders	19.86		77,190,596	46,693,416
Total No. of Ordinary Shares	100.00		388,596,843	237,969,022

* An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

11 TWENTY MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2011

Name	% on total capital	% on total Non-voting capital	No of Shares 2011	No of Shares 2010
1. Legalinc Trustee Services (Pvt) Ltd	3.88	19.52	15,069,901	9,133,274
2. Pershing LLC S/A Averbach Grauson & Co.	0.69	3.47	2,680,100	1,873,100
3. The Bank of New York Mellon SA/NV-CF Ruffer Total Return Fund	0.64	3.22	2,486,000	-
4. HINL-JPMCB-Butterfield Trust (Bermuda) Ltd	0.50	2.50	1,930,665	1,170,100
5. The Bank of New York Mellon SA/NV-CF Ruffer Absolute Return Fund	0.43	2.15	1,656,000	-
6. Employees Trust Fund Board	0.42	2.12	1,639,795	826,130
7. Bank of Ceylon No. 1 Account	0.31	1.54	1,187,550	439,900
8. Mr. Yonmerenne Simon Hewage Indrakumara Silva	0.30	1.50	1,159,029	88,242
9. National Savings Bank	0.28	1.39	1,072,500	650,000
10. BNY-CF Ruffer Investment Funds : CF Ruffer Pacific Fund	0.25	1.27	983,000	-
11. Bank of Ceylon A/c Ceybank Century Growth Fund	0.18	0.92	713,800	408,700
12. DFCC Bank A/c 1	0.18	0.90	696,040	797,600
13. Waldock Mackenzie Ltd/Mr. H M S Abdulhussein	0.16	0.81	623,650	290,200
14. Deutsche Bank AG-National Equity Fund	0.15	0.78	600,000	442,400
15. Hatton National Bank A/c No.2	0.14	0.72	558,752	338,638
16. Union Assurance Plc No. 1 A/c	0.13	0.66	506,850	297,900
17. Akbar Brothers Pvt Ltd A/c No. 1	0.12	0.60	466,550	94,500
18. Mr. Dickowita Kankanamge Weeratunga & Mr. Dickowita Kankanamge Athula Kithsiri Weeratunga	0.12	0.58	450,090	237,760
19. Deutsche Bank AG as Trustee for Namal Acuity Value Fund	0.12	0.58	450,000	413,300
20. Mr. Dueleep Fairlie George Dalpethado	0.11	0.57	442,301	-
Sub Total	9.11	45.82	35,372,573	
Balance held by 11,808 Non-voting shareholders	10.75	54.18	41,818,023	
(Total Non-voting shareholders-11,828)				
Total Non-voting shares	19.86	100.00	77,190,596	46,693,416
Shares held by 4,430 voting shareholders	75.42		293,056,834	179,042,664
* Unregistered Voting Shares	4.72		18,349,413	12,232,942
Total Voting Shares	80.14		311,406,247	191,275,606
Total No. of Ordinary Shares	100.00		388,596,843	237,969,022

* An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

12. RELATED PARTY TRANSACTIONS EXCEEDING 10% OF THE EQUITY OR 5% OF THE TOTAL ASSETS OF THE BANK

The Bank carried out transactions in the ordinary course of business with the following parties and the aggregate monetary value of these transactions exceeded 10% of the share holders' equity of the Bank as at 31st December 2011.

Sithma Development (Pvt) Ltd

Stassen Exports (Pvt) Ltd*

Hatton National Bank Retirement Pension Fund

Hatton National Bank Employee Provident Fund

The details of these transactions are given in Note 48 (c) ii (page 249), 48 (f) I (page 251) and 48 (f) ii (pages 257 and 258) respectively.

* For the above computation, the credit limit granted to this company by the Bank of Rs 4,086 Mn was considered, although the outstanding as at the Balance Sheet date was Rs 374.77 Mn.

INVESTOR RELATIONS

continued

13 DEBENTURE INFORMATION**HNB DEBENTURES 2002****i) Market Value**

12 months ended 31st December 2011

These debentures have not traded during the year ended 31st December 2011

ii) Interest Rate

12 months ended 31st December

	2011		2010	
	Interest Rate	Interest Rate of comparable Govt. Security	Interest Rate	Interest Rate of comparable Govt. Security
10 year Fixed Rate (14.20% p.a.)	14.20	8.87	14.20	7.75
10 year Floating Rate (6 monthsTB +1.25% p.a.)*	12.00	8.71	12.00	7.35

*The floating rate debentures have a cap of 17.00% p.a. and a floor of 12.00% p.a.

HNB DEBENTURES 2006**i) Market Value**

12 months ended 31st December 2011

These debentures have not traded during the year ended 31st December 2011

ii) Interest Rate

12 months ended 31st December

	2011		2010	
	Interest Rate	Interest Rate of comparable Govt. Security	Interest Rate	Interest Rate of comparable Govt. Security
6 year Floating Rate (6 monthsTB + 2.25% p.a.) *	10.74	8.71	9.63	7.35
7 year Floating Rate (6 monthsTB + 2.25% p.a.) *	10.74	8.71	9.63	7.35
8 year Floating Rate (6 monthsTB + 2.25% p.a.) *	10.74	8.71	9.63	7.35
15 year Fixed Rate (11.00% p.a.)	11.00	N/Q	11.00	N/Q
18 year Fixed Rate (11.25% p.a.)	11.25	10.04	11.25	9.49

*The floating rate debentures have a cap of 16.00% p.a. and a floor of 8.00% p.a.

N/Q – Not quoted for the period ended 31st December

HNB DEBENTURES 2007**i) Market Value**

12 months ended 31st December 2011

These debentures have not traded during the year ended 31st December 2011

ii) Interest Rate

12 months ended 31st December

	2011		2010	
	Interest Rate	Interest Rate of comparable Govt. Security	Interest Rate	Interest Rate of comparable Govt. Security
10 year Fixed Rate (16.00% p.a.)	16.00	N/Q	16.00	N/Q
15 year Fixed Rate (16.75% p.a.)	16.75	N/Q	16.75	N/Q

N/Q – Not quoted for the period ended 31st December

HNB DEBENTURES 2008**i) Market Value**

12 months ended 31st December 2011

These debentures were not listed as at 31st December 2011

ii) Interest Rate

12 months ended 31st December

	Interest Rate	2011 Interest Rate of comparable Govt. Security	Interest Rate	2010 Interest Rate of comparable Govt. Security
5 year Floating Rate (1 year TB + 1.00% p.a.)	8.35	8.68	10.27	7.24

HNB DEBENTURES 2011**i) Market Value**

12 months ended 31st December 2011

These debentures have not traded during the year ended 31st December 2011

ii) Interest Rate

12 months ended 31st December

	Interest Rate	2011 Interest Rate of comparable Govt. Security	Interest Rate	2010 Interest Rate of comparable Govt. Security
10 year Fixed Rate (11.50% p.a.)	11.50	N/Q	-	-

N/Q – Not quoted for the period ended 31st December

Ratios

	2011	2010
Debenture to Equity Ratio (%)	12.89	9.99
Debenture Interest Cover (times)	18.83	19.60
Liquid Asset Ratio (LAR)	21.96	23.55

GLOSSARY OF FINANCIAL / BANKING TERMS

A ACCOUNTING POLICIES

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting Financial Statements.

ACCURAL BASIS

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

AMORTISATION

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

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.

B 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 and Reserve Fund set aside for specific purposes defined under the Banking Act, No 30 of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

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.

COMMITMENT TO EXTEND CREDIT

Credit facilities available to clients either in the form of loans, bankers' acceptances and other on-balance sheet financing or through off-balance sheet products such as guarantees and letters of credit.

CONTINGENCIES

Conditions or situations at the balance sheet date, the financial effect of which are to be determined by the future events which may or may not occur.

CORPORATE GOVERNANCE

The process by which corporate entities are governed. It is concerned with the way in which power is exercised over the management and direction of entity, the supervision of executive actions and accountability to owners and others.

CORRESPONDENT BANK

A bank in a foreign country that offers banking facilities to the customers of a bank in another country.

COST INCOME RATIO

Operating expenses as a percentage of net income.

COST METHOD

Cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognizes 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 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 securities.

CREDIT RATINGS

An evaluation of a corporate ability to repay its obligations or likelihood of not defaulting, carried out by an independent rating agency.

D DEALING SECURITIES

These are marketable securities acquired and held with the intention to resale over a short period of time.

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.

DERIVATIVES

A derivative is a financial instrument or other contract, the value of which changes in response to some underlying variable (eg, an interest rate), that has an initial net investment smaller than would be required for other instruments that have a similar response to the variable, and that will be settled at a future date.

DEPRECIATION

The systematic allocation of the depreciable amount of an asset over its useful life.

DIVIDEND COVER

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

DIVIDEND YIELD

Dividend earned per share as a percentage of its market value.

DOCUMENTARY LETTERS OF CREDIT (L/Cs)

Written undertakings by a bank on behalf of its customers, authorising a third party to draw on the bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

E EARNINGS PER SHARE (EPS)

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

EFFECTIVE TAX RATE

Provision for taxation excluding deferred taxation divided by the profit before tax.

EQUITY METHOD

The equity method is a method of accounting whereby the investment is initially recognized 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.

F FAIR VALUE

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

FINANCE LEASE

A lease in which the lessee acquires all the financial benefits and risks attaching to ownership of the asset under lease.

FOREIGN EXCHANGE CONTRACT

Agreement between two parties to exchange one currency for another at a future date at a rate agreed upon today.

FOREIGN EXCHANGE INCOME

The realised gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the balance sheet date at prevailing rates which differ from those rates in force at inception or on the previous balance sheet date. Foreign exchange income also arises from trading in foreign currencies.

G GENERAL PROVISIONS

General provisions are established for leasing transactions, housing loans, pawing advances and others for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

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 unfavorable price movements (Interest Rate, Foreign exchange rate, commodity prices, etc).

I IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

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 SPREAD

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

INTEREST IN SUSPENSE

Interest suspended on non-performing loans and advances.

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.

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.

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 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.

LOAN LOSS PROVISION

Please refer Provision for Bad and Doubtful Debts below.

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-PERFORMING ADVANCES

A loan or an advance placed on cash basis (i.e. Interest income is only recognised when cash is received) because, in the opinion of management, there is reasonable doubt regarding the collectability of principal or interest.

NON-PERFORMING ADVANCES COVER (NPA COVER)

Cumulative loan provision as a percentage of total non-performing advances (net of interest in suspense).

NPA RATIO

Total non-performing advances (net of interest in suspense) divided by total advances portfolio (net of interest in suspense).

O OFF BALANCE SHEET TRANSACTIONS

Transactions that are not recognised as assets or liabilities in the Balance Sheet, but which give rise to contingencies and commitments.

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.

PRICE EARNINGS RATIO (P/E RATIO)

Market price of an ordinary share divided by earnings per share (EPS).

PROVISION FOR BAD AND DOUBTFUL DEBTS

A charge to income which is added to the allowance for loan losses. Specific provisions are established to reduce the book value of specific assets (primarily loans) to estimated realizable values.

R RELATED PARTIES

Parties where one party has ability to control the other party or exercise significant influence over the other party in making financial and operating decisions, directly or indirectly.

RETURN ON AVERAGE ASSETS (ROA)

Net income 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 (ROE)

Net income, 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.

REPURCHASE AGREEMENT

This is a contract to sell and subsequently repurchase government securities at a given price on a specified future date.

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.

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.

RIGHTS ISSUE

Issue of shares to the existing shareholders at an agreed price, generally lower than market price.

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.

SHARE PREMIUM

Amount paid by a shareholder, over and above the par value of a share.

SHAREHOLDERS' FUNDS

Shareholders' funds consist of stated capital plus capital and revenue reserves.

STATUTORY RESERVE FUND

A capital 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).

SWAPS (CURRENCY)

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement. Alternatively a simultaneous spot sale and forward purchase of a currency.

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.

U 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.

NOTICE OF MEETING

Notice is hereby given that the Forty Third (43rd) Annual General Meeting of Hatton National Bank PLC (the "Bank") is convened on Friday, the Thirtieth (30th) day of March 2012 at the Auditorium on Level 22 of "HNB Towers" at No. 479, T.B. Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following business will be transacted:

- i. To receive and consider the Annual Report of the Board of Directors along with the Financial Statements of the Bank for the year ended 31st December 2011 and the Auditors' Report thereon.
- ii. To declare a final dividend of Rs 6.00 per share for the year 2011 to the shareholders as recommended by the Directors and therefore to consider and if thought fit, to pass the following resolutions:

Ordinary Resolution - 1

"IT IS HEREBY RESOLVED THAT a final dividend of Rs 6.00 per share which shall consist of Rs 3.00 per share in cash and Rs 3.00 per share in the form of a scrip dividend on both voting and non-voting shares of the Bank shall be declared for the financial year ended 31st December 2011."

Ordinary Resolution - 2

For voting shares:

"IT IS HEREBY FURTHER RESOLVED THAT a sum of rupees Nine Hundred and Thirty Four Million Three Hundred and Ninety Seven Thousand Six Hundred and Seven (Rs 934,397,607/=) subject to a withholding of tax at the rate of 10%, be declared for the financial year 2011 as a scrip dividend at the said rate of rupees Three (Rs 3.00) subject to a withholding of tax at the rate of 10%, per voting share and such shares be issued at the valuation of rupees one hundred and forty eight (Rs 148/-) per share, which will result in one (01) voting share being issued for each existing fifty four decimal eight one five (54.815) shares, held by the VOTING shareholders of the Bank as at the end of trading on the date of the Annual General Meeting. The number of voting shares to be so issued as a scrip dividend shall be Five Million Six Hundred and Eighty Two Thousand One Hundred and Forty Eight (5,682,148). The total number of issued voting shares of the Bank following the scrip dividend shall then be Three Hundred and Seventeen Million One Hundred and Forty Eight Thousand and Seventeen (317,148,017)."

Ordinary Resolution - 3

For non-voting shares:

"IT IS HEREBY FURTHER RESOLVED THAT a sum of rupees Two Hundred and Thirty One Million Six Hundred and Thirty Four Thousand Four Hundred and Forty Three (Rs 231,634,443/=) subject to a withholding of tax at the rate of 10%, be declared for the financial year 2011 as a scrip dividend at the said rate of rupees Three (Rs 3.00) subject to a withholding of tax at the rate of 10%, per non-voting share and such shares be issued at the valuation of rupees ninety four and forty cents (Rs 94.40) per share, which will result in one (01) non-voting share being issued for each existing thirty four decimal nine six three (34.963) shares, held by the NON-VOTING shareholders of the Bank as at the end of trading on the date of the Annual General Meeting. The number of non-voting shares to be so issued as a scrip dividend shall be Two Million Two Hundred and Eight Thousand Three Hundred and Eighty (2,208,380). The total number of issued non-voting shares of the Bank following the scrip dividend shall then be Seventy Nine Million Four Hundred and Nineteen Thousand Eight Hundred and Sixty One (79,419,861)."

Ordinary Resolution - 4

- a. "IT IS FURTHER RESOLVED THAT the voting and non-voting shares issued for the scrip dividend be listed on the Colombo Stock Exchange".
- b. "IT IS FURTHER RESOLVED THAT the shares arising from the aggregation of the residual fractions consequent to the scrip dividend be disposed of in the market by a trustee to be nominated by the Board of Directors and the sale proceeds to be distributed to a charity approved by the Board of Directors of the Bank".

- iii. To re-elect Dr Rane Jayamaha, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 93 of the Articles of Association of the Bank.
- iv. To re-elect Dr W W Gamage, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 93 of the Articles of Association of the Bank.
- v. To re-elect Dr L Rohan Karunaratne, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 93 of the Articles of Association of the Bank.
- vi. To re-elect Mr N G Wickremeratne, who retires by rotation at the Annual General Meeting, as a Director of the Bank in terms of Article 87 of the Articles of Association of the Bank.
- vii. To re-elect Ms M A R C Cooray, who retires by rotation at the Annual General Meeting, as a Director of the Bank in terms of Article 87 of the Articles of Association of the Bank.
- viii. To re-appoint the Auditors for the ensuing year and to authorise the Directors to fix their remuneration.
- ix. To authorise the Directors to determine payments for the year 2012 for charitable and other purposes.
- x. To consider and amend Article 74 of the Articles of Association (if thought fit) by adopting the special resolution as given below for the purpose of increasing the maximum number of Directors of the Bank from 10 to 12:

Special Resolution

IT IS HEREBY RESOLVED THAT, subject to obtaining the approval of the Monetary Board of the Central Bank of Sri Lanka, Article 74 of the Articles of Association of the Bank be amended by replacing same with the following Article:

"74. The Directors of the Company shall not be less than 5 nor more than 12 in number and for this purpose no alternate Director and no alternate for a nominee director (as referred to in Article 106) shall be counted".

By Order of the Board of Hatton National Bank PLC,



Ms Thushari Ranaweera

Assistant General Manager (Legal) / Board Secretary

Colombo, Sri Lanka.
23rd February 2012

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 "HNB Towers", Level 18, No. 479, T.B. Jayah Mawatha, Colombo 10, not less than 48 hours before the time appointed for holding the meeting.

FORM OF PROXY [VOTING]

I/We.....
of
being *a member/members of the Hatton National Bank PLC, hereby appoint
.....of
..... or failing him/her Rane Jayamaha or failing her
Rajendra Theagarajah or failing him Pamela Christine Cooray, or failing her Nirmala Gihan Wickremeratne, or failing him Mirihana Arachchige Rose
Chandralatha Cooray or failing her William Wijesinghe Gamage, or failing him Lokuwithanage Rohan Karunaratne, as *my/our proxy, to represent *me/
us at the FortyThird (43rd) 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 30th day of March, 2012 at 10.00 in the forenoon and at any adjournment thereof :

(i) To declare the recommended dividend of Rs 6.00 per share as the final dividend for 2011 and adopt the relevant Resolution/s set out in the Notice of Meeting	In favour	
	Against	
(ii) To re-elect Dr Rane Jayamaha, as a Director of the Bank	In favour	
	Against	
(iii) To re-elect Dr WW Gamage, as a Director of the Bank	In favour	
	Against	
(iv) To re-elect Dr L Rohan Karunaratne, as a Director of the Bank	In favour	
	Against	
(v) To appoint Mr N G Wickremeratne, as a Director of the Bank	In favour	
	Against	
(vi) To appoint Ms M A R C Cooray, as a Director of the Bank	In favour	
	Against	
(vii) To re-appoint the Auditors for the ensuing year/authorise the Directors to fix their remuneration	In favour	
	Against	
(viii) To authorise the Directors to determine payments for charitable and other purposes	In favour	
	Against	
(ix) To amend Article 74 of the Articles of Association of the Bank by adopting the special resolution set out in the Notice of Meeting	In favour	
	Against	

Mark your preference with "√"

Signed this day 2012.

Signature/s

.....

Please provide the 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 “HNB Towers”, Level 18, No: 479, T B Jayah Mawatha, Colombo 10, not less than 48 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 Rane Jayamaha or failing her
Rajendra Theagarajah or failing him Pamela Christine Cooray, or failing her Nirmala Gihan Wickremeratne, or failing him Mirihana Arachchige Rose
Chandralatha Cooray or failing her William Wijesinghe Gamage, or failing him Lokuwithanage Rohan Karunaratne, as *my/our proxy, to represent *me/
us at the FortyThird (43rd) 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 30th day of March, 2012 at 10.00 in the forenoon and at any adjournment thereof :

Signed this day 2012.

Signature/s
.....

Please provide the details:

Shareholder's NIC No / Company Registration No

Folio No / Number of Shares held

Proxy holder's NIC No (if not a Director)

Note - See reverse hereof for instructions to complete the proxy

* Delete inappropriate words

INSTRUCTIONS TO COMPLETE PROXY

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 - (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.

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.

Global Depository Receipts of the Bank which were listed on the Luxembourg Stock Exchange have been fully cancelled as at 1st December 2011.

REGISTERED OFFICE

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 11 2662772
+94 11 4764764
Fax Nos : +94 11 2662814
+94 11 2662832
International Dept. +94 11 2446523
Swift : Bic Code – HBLILK LX
e-mail : moreinfo@hnb.net
Web : www.hnb.net

CREDIT RATINGS

The Bank has been assigned AA-(lka) national credit rating for implied long term unsecured senior debt by Fitch Ratings Lanka Limited

BOARD OF DIRECTORS

Dr Raneey Jayamaha (Chairperson)
Mr Rajendra Theagarajah (Managing Director / CEO)
Mr D H S Jayawardena
- Ceased to be a Director w.e.f. 31st December 2011
Mr R K Obeyesekere
- Resigned w.e.f. 30th December 2011
Ms Pamela C. Cooray (Senior Director)
Mr N G Wickremeratne
Ms M A R C Cooray
Dr W W Gamage
Dr L R Karunaratne

BOARD SECRETARY

Ms Indrani Goonesekera
Attorney-at-Law & Notary Public

AUDIT COMMITTEE

Mr N G Wickremeratne (Chairman)
Mr D H S Jayawardena
Ms Pamela C. Cooray
Ms M A R C Cooray
Mr H M A Jayasinghe (Consultant)

NOMINATION COMMITTEE

Dr W W Gamage (Chairman)
Dr Raneey Jayamaha
Mr D H S Jayawardena
Mr R K Obeyesekere

HR & REMUNERATION COMMITTEE

Ms Pamela C. Cooray (Chairperson)
Dr Raneey Jayamaha
Mr R K Obeyesekere
Mr N G Wickremeratne
Dr W W Gamage

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Ms M A R C Cooray (Chairperson)*
Dr Raneey Jayamaha*
Dr W W Gamage*
Dr L R Karunaratne*
Mr Rajendra Theagarajah (Managing Director / CEO)**
Mr A J Alles (Deputy CEO)***
Mr J D N Kekulawala (Senior DGM - Strategy & Compliance)***
Mr D P N Rodrigo (DGM - Risk & Credit Quality)***
Mr D A de Vas Gunasekara (CFO)***

* Representatives of the Board
** Represents the Board & the Management
*** Representatives of the Management

ASSOCIATE COMPANIES

Delma Exchange (UAE) 20.00%
Money transfers and Foreign Currency Related Services

JOINT VENTURE COMPANIES

Acuity Partners (Pvt) Ltd 50.00%
Financial Services

SUBSIDIARY COMPANIES

HNB Assurance PLC 60.00%
Insurance Services
Sithma Development (Pvt) Ltd 100.00%
Property Development

Majan Exchange LLC (Oman) 40.00%
Money transfers and Foreign Currency Related Services

Commercial Interlink Services Inc (Canada) 100.00%
*(O/A of Delma Exchange Canada)
Ceased operations from 1st October 2010*

AUDITORS

KPMG Ford, Rhodes, Thornton & Co,
Chartered Accountants
No 32A,
Sir Mohamed Macan Markar Mawatha,
Colombo 3,
Sri Lanka.

INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Senior DGM - Strategy & Compliance at:
"HNB Towers", Level 16,
No 479, T B Jayah Mawatha (Darley Road), Colombo 10, Sri Lanka.
Telephone : +94 11 2662705,
+94 11 2664705
Fax : +94 11 2662815
e-mail : nihhalke@hnb.lk

Many
People
One
Bank

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