SMBC
SUMITOMO MITSUI BANKING CORPORATION
EUROPE LIMITED

Pillar 3 Disclosures

(As of 31st March 2014)

Contents

Document disclaimer

- The purpose of the Pillar 3 disclosures as contained within this Disclosure Document is solely to explain the basis according to which Sumitomo Mitsui Banking Corporation Europe Limited ("SMBCE" or "the Bank") complies with certain capital related requirements and to provide information about the management of risks relating to those requirements.

- This Disclosure Document does not constitute any form of financial statement on behalf of the Bank and should be read in conjunction with the Bank's Annual Report & Financial Statements.

- This Disclosure Document reflects, where appropriate, information which is contained within the Bank's Annual Report & Financial Statements.

- The Information has been subject to internal review, but has not been audited by the Bank's external auditors.

- Although Pillar 3 disclosures are designed to provide transparent capital disclosure by banks on a common basis, the information contained in this particular Disclosure Document may not be directly comparable with that made available by other banks. This may be due to a number of factors such as:

    - The mix of approaches allowed under the Capital Requirements Directive ("CRD"),
    - The mix of corporate exposure types between banks,
    - The different risk appetites and profiles of banks,
    - The different waivers applied for and allowed by the Prudential Regulation Authority ("PRA") .

- Pillar 2 capital requirements are excluded from this Disclosure Document, but nevertheless play a major role in determining both the total capital requirements of the Bank and any surplus capital available.

1. Overview

1.1 Background

The ongoing capital requirements for international banks are governed on an overall basis by a capital accord formulated by the Basel Committee on Banking Supervision, commonly referred to as Basel 3. The framework involves a three-pillar approach, with each individual Pillar being an important and mutually reinforcing element in determining the overall capital which an institution needs to have in place:

- Pillar 1 is Minimum & Enhanced Capital Requirement (quantification of credit risk, market risk and operational risk).
- Pillar 2 is Supervisory Review (involving Individual Capital Guidance & Assessment by the regulator based on consideration of Risk and Business & Control Risk Factors. This enables capture of other wider general risks).
- Pillar 3 is Market Discipline (requires disclosure to allow market participants to understand the Bank's risk profile)

The formal legislative framework to be reflected in the detailed rules and requirements are imposed by each local regulator. The Bank is regulated by the PRA and the Financial Conduct Authority ("FCA").

The relevant requirements are contained in the Capital Requirements Regulation ("CRR"). The CRR Part 8 lays out the disclosure requirements applicable to banks and building societies, in accordance with Pillar 3. These requirements are designed to promote market discipline by providing market participants with key information on a firm's risk exposures, risk management processes, and capital adequacy. Improved public disclosures of such information is intended to ensure increased transparency and hence more effective market discipline.

The PRA granted the Bank permission to use an Internal Ratings Based ("IRB") approach to credit risk and capital management, alongside the Standardised approach for certain assets (as outlined in more detail in subsequent sections of this document) in December 2007. The Bank has therefore been subject to the relevant BIPRU and GENPRU requirements since January 2008 until December 2013 and subject to the relevant CRD IV requirements since January 2014.

After due consideration of the size and complexity of operations, the Bank determined that it would make the necessary Pillar 3 disclosures within a Disclosure Document to be issued on an annual basis. The first Pillar 3 Disclosures were made as of 31st March 2009 (covering the first full financial year for which the requirements existed).

1.2 Disclosure overview

In accordance with the CRR Part 8, the Bank has prepared this Disclosure Document as at 31st March 2014.

The Disclosure Document contains both qualitative and quantitative information, concerning the following areas:

- **Governance** (section 2);
- **Risk Management;** both in relation to overall risk management issues and specific risk categories (sections 3 – 7);
- **Capital structure and adequacy** (sections 8 – 9)

In addition section 10 provides a more detailed analysis of the Bank's credit portfolio and associated capital requirements in relation thereto.

1.3 Basis and Frequency of Disclosures

These disclosures are based on 31st March 2014 year end data.

After due consideration of the size and complexity of operations, the Bank has determined that the Disclosure Document will be formally updated on an annual basis, to reflect the situation as at the end of each financial year. However, any material change in the approaches or permissions used to calculate capital requirements will be disclosed as it arises.

1.4 Consolidation basis

The Bank is authorised by the PRA and is regulated by the FCA and PRA.

The Bank is required by the PRA to produce consolidated regulated reports, including its branches in France, Italy, the Netherlands, the Republic of Ireland and the Czech Republic in order to assess its capital resources and capital requirements.

This Disclosure Document therefore relates to the SMBCE group.

1.5 Location and verification

This Disclosure Document has been reviewed by the Bank's senior management but has not been subject to external audit. However, where data is equivalent to that included in the Bank's Annual Report and Financial Statements, then such data has been subject to external audit during the formal review and verification process.

The Disclosure Document is published on the Bank's corporate website, which is felt to be the most appropriate medium as per CRR Article 434.
This can be found at https://www.smbcgroup.com/emea/info/smbce

2. Governance

2.1 Overview

The Directors are committed to maintaining a high standard of corporate governance within the Bank. While it is not mandatory to do so, the Directors have regard to the provisions of The UK Corporate Governance Code to the extent those provisions are suitable and relevant for a wholly owned subsidiary of a multinational company.

The Bank's corporate governance systems and structures enable the clear allocation of responsibilities for the management of risk. Key elements of these risk management responsibilities are as follows:

The SMBCE Board is responsible for the leadership, direction and control of the Bank and for ensuring that the Bank complies with its legal and regulatory requirements.

The Executive Committee is responsible for the supervision and management of the Bank's daily operations and for overseeing the work of the Risk Committees. As part of this responsibility, the Executive Committee reviews and monitors the most significant risk issues. The Executive Committee meets monthly and reports to the Board of Directors.

The Audit, Risk and Compliance Committee is principally responsible for considering the Bank's risk management structure and systems, the main areas of risk faced by the Bank, conduct risk and regulatory issues, key matters arising in the Risk Committee meetings, annual financial statements, external audit arrangements, Internal Audit and Credit Review oversight, monitoring the Bank's risk management and internal control systems, and the appointment and dismissal of the senior management members of the Audit Department. The Audit, Risk and Compliance Committee meets quarterly and reports to the Board of Directors.

The EMEA Nomination Committee is responsible for assessing and recommending candidates to the Board to fill Board and certain other senior-level vacancies as and when they arise. The Committee is also responsible for: (i) considering the composition of the Board, which includes matters of diversity and the Board's policy for the selection and appointment of Directors and senior management; (ii) assessing at least annually the knowledge, skills and experience of the Directors individually and the Board collectively; (iii) assessing annually the size, composition and performance of the Board; and (iv) taking into account the need to ensure that the Board's decision-making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interest of the Bank as a whole.

The Remuneration and Human Resources Committee is responsible for assessing the appropriateness of and approving the remuneration of the Bank's Directors and certain other members of management. It also has responsibility for other Board level remuneration and human resource matters, such as approving the Bank's remuneration policy and considering the level of staff turnover. The Remuneration and Human Resources Committee meets quarterly and reports to the Board of Directors.

Risk Committees - The Bank has established the following Risk Committees, which report to the Executive Committee and the Audit, Risk and Compliance Committee. These Committees have responsibility for considering the risks to which the Bank is exposed, as follows:

- Financial crime and related reputational risks are considered by the **Financial Crime Committee**;

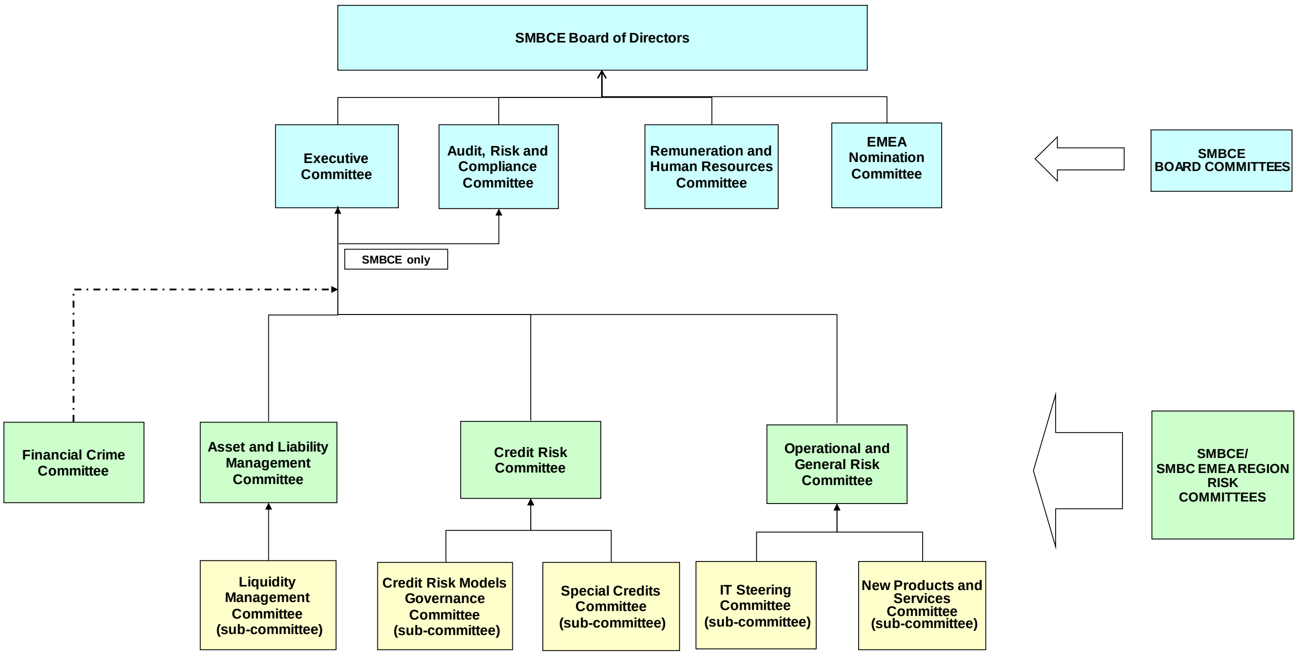
- Market and Liquidity Risk issues are monitored at the **Asset and Liability Management Committee;**
- Credit Risk issues are monitored at the **Credit Risk Committee** ; and
- Operational Risks are monitored at the **Operational and General Risk Committee** ("OGRC").

In addition, the OGRC has responsibility for examining the risks associated with new products and major project and business change activity. This Committee also examines a number of other risk areas, including: IT, the business continuity plan, human resources, legal, regulatory compliance and reputational risk.

The following Sub-Committees have also been established:

- **Liquidity Management Committee** (Sub-Committee of Asset and Liability Management Committee), which is responsible for considering issues relating to liquidity risk management, including analysis of the funding market, stress testing results, impact of business strategy on assets and deposits and funding strategy;
- **Special Credits Committee** (Sub-Committee of Credit Risk Committee), which is responsible for considering issues relating to, and the status of, Special Credit borrowers;
- **Credit Risk Models Governance Committee** (Sub-Committee of Credit Risk Committee), which is responsible for considering issues relating to credit risk models;
- **IT Steering Committee** (Sub-Committee of OGRC), which is primarily responsible for examining IT projects and IT policies and strategies including global initiatives and how these apply to the Bank, and
- **New Products and Services Committee** (Sub-Committee of OGRC), which is responsible for examining risks arising from the implementation of new products and services in order to support the risk analysis of the relevant departments. The Committee can also recommend that new products or services undergo the final approval process before their implementation.

The Committee structure is represented in the diagram below:



2.2 Relationship with Parent

As a 100% subsidiary of Sumitomo Mitsui Banking Corporation ("SMBC"), SMBCE will in general seek to ensure alignment of strategy in important areas and to ensure cost-effective and consistent approaches across the group, where appropriate.

The Bank therefore follows overall SMBC group policy in assessing and managing risks and uncertainties.

However, the Bank's management will at all times ensure local relevance in order to support achievement of local objectives.

3. Risk Management Framework

Principal risks and uncertainties

The Bank is exposed to certain risks and uncertainties in conducting its business. The principal risk and uncertainties are shown below:

- **Credit Risk** – the risk that a borrower or counterparty will fail to meet its obligations in accordance with the agreed terms. The Bank's total credit exposure as at 31 March 2014 was USD 31.1 billion (2013:USD 30.3 billion)
- **Liquidity Risk** – the risk that the Bank, although solvent, either does not have available sufficient resources to enable it to meet its obligations as they fall due, or can only secure such resources at excessive cost.
- **Market Risk** – the risk that fluctuations in interest rates, foreign exchange rates, or stock prices will change the market value of financial products, leading to a loss. The Bank uses Value at Risk ("VaR") to a 99% confidence interval to measure market risk alongside other relevant metrics. During the financial year ending 31 Mar 14, the average VaR was $0.3m.
- **Conduct Risk** is the risk of the Bank's behaviour resulting in poor customer outcome and/or damage to the integrity of the financial markets. Any significant failure in this area could lead to regulatory censure and/or reputational damage.
- **Operational Risk** – the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risks. Historically, losses in this risk category have been low.
- **Other non financial risks** – as a result of its activities the Bank assumes other potential risk impacts such as reputational and others which it manages with in the overall policy framework. Historically, losses in this risk category have been low.

Strategic Risk and Risk Governance

The Bank's risk framework is represented below illustrating the key management and governance processes employed in managing risk.

Corporate Culture

Key to ensuring the long term sustainability of the Bank is maintaining a culture that is conducive to effective risk management. The tone from the top set by senior management includes:-

- Maintaining valued customer relationships upon which the Bank's business model is based,
- Achieving sustainable growth over the long term by ensuring business is run in an appropriately balanced way where all risks are correctly identified and managed,
- Having in place strong governance and risk management to capture and expand our business in the knowledge that we are able to assess, measure and control the risks associated with it,
- Conducting business in the context of the Bank's risk appetite,
- Ensuring the Bank is appropriately rewarded for the risks it incurs in undertaking business,
- Ensuring that management and staff are appropriately trained,
- Ensuring the appropriateness of remuneration,
- Having a balanced set of objectives to ensure there is no conflict between the strategic and risk management objectives of the Bank,
- Conducting its business to ensure fair customer outcomes and market integrity, and
- Conducting its business with a view to maintaining a strong and positive reputation.

Risk management objectives

The Bank's business model is designed to ensure that the Bank remains a well-funded, well-controlled, risk adverse corporate banking institution focusing resources on carefully selected sectors and regional customer partnerships in order to achieve sustainable and balanced growth. Supporting the senior management strategy of sustainable growth the Bank is committed to maintaining a robust risk management framework, including effective controls, to manage and mitigate its key risks.

The Bank's risk management objectives are as follows:-

- To ensure the Bank's risk appetite is observed and maintained in pursuance of the Bank's strategic objectives,
- To maintain a risk appetite that maximises risk/return whilst ensuring that the Bank maintains adequate capital at all times,
- To ensure that prudent levels of liquidity are in place to fund the Bank even under stressed conditions,
- To maintain fair and ethical relationships with all our customers,
- To manage and minimise risk that we assume as a consequence of our business strategy e.g. Operational Risk, Conduct risk
- To maintain an adequate and effective control environment, and
- To ensure that the Bank adhere to the rules and spirit of laws and regulations governing our business.

Enterprise Risk Management

The Bank utilises the industry-wide standard 3 Lines Of Defence ("3 LOD") model to manage its risk. The model is used as a means to achieve and assure overall effective risk governance, management and assurance, reflecting and reinforcing the Bank's internal control framework.

The Bank's 3 LOD approach separates the ownership/management of risk from the functions that oversee risks and the functions that provide independent assurance:

LOD 1 – Functions that own and manage risk,

LOD 2 – Functions that independently oversee risk,

LOD 3 – Functions that provide independent assurance.

The model is illustrated in the diagram below:

1) Risk Identification and Assessment;

The key principles used in the Bank for risk identification and assessment are:

- To identify the major risks that could impact the Bank's long term sustainability,
- To assess the likelihood and impact of the risks materialising, and
- To assess the robustness of the controls that mitigate the risks

2) Risk Management and Monitoring;

The key principles used for risk measurement and monitoring are:

- To measure risk exposure by loss modelling, enterprise level Key Risk Indicators ("KRIs") and scenarios,
- To maintain a record of risks, both accepted and being addressed,
- To ensure appropriate reporting to the Board of inherent and residual risk via KRIs to facilitate any mitigation and/or changes to the risk appetite, and,
- To facilitate senior management understanding of the severity of the risk.

Stress Testing and Scenario Analysis

Stress testing is a key forward looking tool to calculate the impact of several scenarios over differing timeframes. Stress testing and scenario analysis are used across the principal risks to ensure that the Bank can adequately understand and quantify not only risks as they currently exist, but as they might develop in times of stress.

Reverse Stress Testing

Reverse Stress Testing is used by the Bank to help identify and monitor the factors and the stress levels that have the potential to cause the Bank's business model to become unviable. Reverse stress testing is an important part of the overall risk management framework of the Bank, in helping to understand vulnerabilities.

3) Risk Appetite Setting

The Bank's risk appetite defines the broad-based level of risk that the entity is able and willing to undertake in pursuit of its objectives.

The key principles of the Risk Appetite Framework are that:

- The Risk Appetite of the Bank is set by the Board of Directors as part of the annual strategic planning process,
- The Risk Appetite is driven by both top-down Board level strategic objectives and bottom-up participation of business units,
- The risk appetite is embedded into the Bank and its culture,
- The framework is adaptive to changes in business and market conditions,
- The framework covers all activities at the Bank, and
- The risk appetite is calibrated to the Bank's long term sustainability.

The Risk Appetite framework consists of three levels: Risk Preferences, Risk Tolerances and 'Targets and Limits'. Risk Appetite is linked to overall business strategy, including assessment of new business opportunities, liquidity, funding and capital planning.

4) Risk Control and Mitigation

The Bank seeks to mitigate its inherent risk as far as possible to ensure that it remains within the risk appetite. This takes the form of tangible mitigation such as collateral, credit default swaps, and in the form of policies, processes and controls. Both the inherent risks and the residual risks are monitored to analyse the Bank's risk profile.

The risk control and mitigation that the Bank undertakes is in the form of:-

- Tangible security,
- Financial collateral,
- Credit default swaps and guarantees,
- Risk governance, policy and procedures,
- Individual and collective controls, and
- Other mitigation and control actions.

The control and mitigation is articulated in the policy framework for the main risk types. Controls that implement the policies are contained in the relevant procedure manuals for the Bank's operational processes.

4. Credit Risk Management

Credit risk is the risk that a borrower or counterparty will fail to meet its obligations in accordance with the agreed terms.

The Framework

The Bank's Board is ultimately responsible for ensuring that the level of credit risk taken by the Bank is in line with its risk appetite and business model. It achieves this through the following key measures:

- Having a credit risk management framework that consists of appropriate controls and senior management governance and oversight,
- The establishment of well-defined policies and procedures for the identification, measurement and control of credit risk,
- A centralised credit risk control function under the responsibility of the Chief Risk Officer (CRO). The CRO has a right of veto on credit and underwriting transactions,
- Having thorough risk analysis and reporting functions, conducted by a credit management team with the capabilities and resources to evaluate and monitor the exposures and limits,
- By the implementation of the Bank's risk appetite framework,
- Ensuring understanding of vulnerabilities through stress testing and reverse stress testing,
- Having strong rating systems to measure the risk on individual transactions,
- By regular reviews conducted by Audit Department – Credit Review Group to ensure compliance with policies, procedures and market best practice.

There have been no significant changes in FY2013 in the objectives and policies for the management of credit risk.

Credit Assessment

The Bank assesses and manages credit risk of individual loans and credit portfolios on a consistent quantitative basis utilizing an internal rating system.

The rating system consists of two indicators namely:

- The obligor grading, which indicates the credit worthiness of the borrower, and
- The facility grading, which indicates the probability of repayment of each facility. Facility grades are assigned based on the borrower's obligor grading and transaction terms such as guarantee, maturity and collateral.

The Bank's internal grading, and borrower's categories are set out in the below table and are used for the purposes of determining the Bank's credit quality of obligors.

G grade Code	J grade Code	Borrower's Category
G1	J1	Normal Borrowers
G2	J2	
G3	J3	
G4	J4	
G5	J5	
G6	J6	
G7	J7	Borrowers Requiring Caution
G7R	J7R	Substandard Borrowers
G8	J8	Potentially Bankrupt Borrowers
G9	J9	Virtually Bankrupt Borrowers
G10	J10	Bankrupt Borrowers

The internal ratings, G7R and J7R or lower are recognised as "Default" in terms of CRD IV and in line with the regulatory default definition.

In addition to the above internal rating assessment, to ensure a fully comprehensive credit assessment further analysis is undertaken including:

- Analysis of a variety of financial measures (e.g. cash flow), and
- Quantitative analyses of industrial trends such as the competitiveness of a borrower's products, services and management calibre.

Credit Monitoring

Credit monitoring is carried out through an ongoing reassessment of obligor grades involving:

- Periodic monitoring following financial results disclosures,
- Continuous monitoring should credit conditions deteriorate, and
- Should a customer be downgraded or considered a likely candidate for future downgrade(s) to below 'normal borrower' category, the customer is added to the Special Credit borrower List and reported to Management.

To minimize the potential loss that may arise from any model failure and/or inadequate usage of the models and systems, the Bank has appropriate policies in place to manage its models and grading systems. The Bank's Independent Credit Risk Control Unit (ICRCU) performs validation of the grading models at least annually to ensure the appropriateness and conservatism of the grading models.

The Bank regularly monitors the credit risks associated with wider aspects of its business, such as specific country exposure, products, industries etc. on a portfolio basis. The Bank also undertakes regular stress tests on its portfolio to ensure adequate capital is kept at all times to cover potential losses incurred during extreme but plausible events.

Industry Exposures

The exposure by major industrial sectors of cash and balances to central banks, balances and loans to banks and customers, and debt securities can be analysed as follows:

	2014 USD m	2013 USD m
Finance and insurance	18,304.1	18,271.0
Government and local authorities	1,074.5	479.5
Manufacturing	1,752.6	1,648.9
Wholesale	342.7	364.0
Services	162.0	28.6
Other corporate exposures	4,110.1	4,070.7
Transport	1,112.4	1,641.7
Energy	1,420.0	1,285.2
Infrastructure	2,301.5	1,997.1
Co-Investment	75.5	83.1
	30,655.4	29,869.8

Geographical Exposures

The table below analyses the geographical spread of cash and balances to central banks, balances and loans to banks and customers and debt securities. This is based on country of domicile of the counterparty.

	2014	2013
	USDm	USDm
United Kingdom	13,495.9	13,185.6
France	7,133.1	8,403.2
Italy	430.5	425.3
Other Europe	2,789.7	2,954.1
Eastern Europe	1,675.2	1,442.7
Japan	761.0	590.9
Other Asia	600.6	315.7
Africa	684.4	602.5
Latin America	-	-
Middle East	647.1	582.5
North America	2,251.3	1,154.0
Oceania	186.6	213.3
	30,655.4	29,869.8

Maximum exposure to credit risk

The table below shows the maximum exposure to credit risk for the components of the statement of financial position, including derivatives. The maximum exposure is shown gross and does not take into account collateral or other credit enhancements.

	2014	2013
	USDm	USDm
Cash and balances at central banks	13,775.6	15,425.1
Loans and advances to banks	4,526.6	2,945.9
Loans and advances to customers	11,351.5	11,022.7
Derivative Assets	468.7	483.0
Investment Securities	1,001.7	476.1
Total	31,124.1	30,352.8
Guarantees and Letters of Credit	3,063.0	2,678.4
Commitments	8,739.7	7,512.5
Total	11,802.7	10,190.9

Collateral Held

The Bank's corporate lending is often secured by fixed and floating charges on the assets of borrowers. However , unless the asset is impaired the only collateral which is valued is on a continued basis are cash and Government Bonds. The value of this collateral held by the Bank, including collateral held against inter-group positions for large exposure purposes, was USD 6,178.1m (2013: USD 8,524.1m). This collateral is held against loans and advances to banks and customers and derivative assets.(USD:5,871.9m(2013: 8,364.4m) and derivative assets (USD 306.2m(2013: 159.7m).

Estimates of the fair value of the collateral held is made when a loan is individually assessed for impairment. Collateral takes various forms and the value of this security will vary over time and is dependant on the types of asset and the jurisdiction of the borrowers as well as the ability to dispose of the collateral.

The table below gives the Bank's estimate of the fair value of different types of collateral held as security against loans to customers that are individually impaired and past due but not impaired.

	Past due but not impaired 2014 USDm	Individually impaired 2014 USDm	Past due but not impaired 2013 USDm	Individually impaired 2013 USDm
Guarantees	-	24.1	-	25.3
Ships	-	4.1	-	3.8
Project assets	-	-	-	15.9
Total	-	28.2	-	45.0
Amounts of loans collateralised	-	67.9	-	70.3

Credit quality of counterparty per class of financial assets

USDm	Internal grading	2014 Loans and receivables	2014 Available-for- sale	2014 Total**	2013 Loans and receivables	2013 Available-for- sale	2013 Total**
Cash and balances at central banks	1-6	13,775.6	-	13,775.6	15,425.1	-	15,425.1
Loans and advances to banks							
Normal borrowers	1-6	4,525.5	-	4,525.5	2,940.2	-	2,940.2
Borrowers requiring caution	7A	1.1	-	1.1	-	-	-
Borrowers requiring caution	7B*	-	-	-	-	-	-
Substandard borrowers and below	7R, 8-10	-	-	-	5.7	-	5.7
Total		4,526.6	-	4,526.6	2,945.9	-	2,945.9
Loans and advances to customers							
Normal borrowers	1-6	11,035.2	-	11,035.2	10,708.1	-	10,708.1
Borrowers requiring caution	7A	170.5	-	170.5	126.5	-	126.5
Borrowers requiring caution	7B*	114.9	-	114.9	123.4	-	123.4
Substandard borrowers and below	7R, 8-10	30.9	-	30.9	64.7	-	64.7
Total		11,351.5	-	11,351.5	11,022.7	-	11,022.7
Investment securities							
Normal borrowers	1-6	-	983.7	983.7	-	444.5	444.5
Borrowers requiring caution	7A	18.0	-	18.0	23.1	-	23.1
Borrowers requiring caution	7B*	-	-	-	-	-	-
Substandard borrowers and below	7R, 8-10	-	-	-	8.5	-	8.5
Total		18.0	983.7	1,001.7	31.6	444.5	476.1

*There were no customer balances which were past due but not impaired (2013: USD nil).

**There were no customers who would have been classified as past due or impaired if they had not renegotiated terms in the year (2013: USD nil).

5. Market Risk Management

Market Risk Management

Market Risk is the risk that fluctuations in interest rates, foreign exchange rates, or stock prices will change the market value of financial products, leading to a loss.

The Bank's Board is ultimately responsible for ensuring that the level of market risk run by the Bank is in line with their risk appetite and business model.

The Bank uses a variety of matrices to measure and control market risk. One such tool is the use of VAR. . VaR is a measure of the maximum expected loss in a portfolio to a given degree of confidence over a specified period. The Bank uses a 99% confidence interval and a one-day time horizon. The Bank currently uses a historical simulation to generate the VaR result using data from a four year observation period and which is updated monthly. The Bank uses VaR to control market risk both on the Trading and Banking accounts on both a standalone and consolidated basis. The Bank has in place an ongoing programme of back-testing and analysis for the VaR model. However, VaR is not a perfect tool for risk management and cannot provide an indication of the potential losses that may occur. The Bank therefore conducts a program of stress-testing using scenarios relevant to the current portfolio composition.

Interest rate risk on the Banking book is stressed by taking the Basis Point Value (BPV) positions and stressing them by an average of 100 basis points (bp). In addition to this a further 200 bp parallel shift stress test is carried out as part of the ICAAP submission. Stress tests are also carried out on FX positions (assuming 17% appreciation and depreciation of currency vs. USD).
Risk management for each category is augmented by employing suitable sensitivity limits such as BPV limits which measure the potential change in portfolio fair value for an instantaneous 0.01% shift in interest rates. Using the BPV, the Bank can examine the effects to income of movements in yields applied to the Banking and Trading portfolios.

The Bank's VaR exposures were:

	To 31 March 2014				To 31 March 2013			
	Maximum	Minimum	Average	31 March	Maximum	Minimum	Average	31 March
	USDm	USDm	USDm	USDm	USDm	USDm	USDm	USDm
Trading	0.7	0.1	0.2	0.4	0.9	0.1	0.3	0.1
Banking	0.3	0.1	0.2	0.2	0.4	0.1	0.2	0.1
Consolidated	0.7	0.1	0.3	0.5	1.0	0.1	0.4	0.1

The Income sensitivity table below reports the worst case of six possible yield curve shift scenarios averaging 100bp, including “Steepening”, “Flattening” and “Parallel” shifts, which comprises of the Market Risk Stress Test.

Note: Impact to future income is based on an adverse 100bp move in interest rates.

Fair value of derivative assets and liabilities

The following tables show the Bank’s fair value disclosures at 31 March 2014 and 31 March 2013

Derivatives held for risk management				
Foreign exchange derivatives				
Forward foreign exchange - Cash flow hedges	2.0	-	-	(7.7)
Currency swaps - Fair value hedges	35.6	(3.0)	6.3	(31.2)
Total	37.6	(3.0)	6.3	(38.9)
Interest rate derivatives				
Interest rate swaps - Fair value hedges	1.4	(45.1)	-	(72.8)
Total	1.4	(45.1)	-	(72.8)
Total derivatives	39.0	(48.1)	6.3	(111.7)
Effect of netting	-	-	-	-
Total fair value	39.0	(48.1)	6.3	(111.7)
Total fair value of derivatives	468.7	(451.5)	483.0	(415.1)

	2014 USDm Positive fair value	2014 USDm Negative fair value	2013 USDm Positive fair value	2013 USDm Negative fair value
Trading derivatives				
Foreign exchange derivatives				
Forward foreign exchange	670.3	(644.2)	884.8	(712.3)
Currency swaps	-	-	-	-
OTC options bought and sold	5.6	(5.8)	4.4	(4.6)
Total	675.9	(650.0)	889.2	(716.9)
Interest rate derivatives				
Interest rate swaps	0.4	-	1.0	-
Total	0.4	-	1.0	-
Total derivatives	676.3	(650.0)	890.2	(716.9)
Effect of netting	(246.6)	246.6	(413.5)	413.5
Total fair value	429.7	(403.4)	476.7	(303.4)

Where master netting agreements are in place and there is intention and ability to settle on a net basis, the net balance has been shown on the face of the statement of financial position. Exchange traded futures are valued based by reference to published price quotations in an active market. All other derivatives are valued using a valuation technique with market observable inputs.

6. Liquidity Risk Management

Liquidity risk is the risk that the Bank, although solvent, either does not have available sufficient resources to enable it to meet its obligations as they fall due, or can only secure such resources at excessive cost.

The SMBCE Board is ultimately responsible for ensuring that the level of liquidity risk run by the Bank is in line with their risk appetite and business model. It achieves this through the following main measures:

- The establishment of a clear, consistent Risk Appetite that is understood across the organisation. This is composed of a qualitative risk preference statement, and quantitative risk tolerances supplemented by 'targets and limits'

- Defining clear roles and responsibilities for the management of liquidity under normal and stressed circumstances.

- The implementation of a robust committee framework to manage liquidity risk issues, with clear terms of reference and standard agendas.

- Regular management information to demonstrate that the Bank is operating within risk appetite, along with other select metrics.

- Regular senior management training.

Within the governance framework outlined above, the Bank has established a liquidity risk management approach as a core component of the enterprise risk management process. The purpose of the framework is to ensure that the Bank successfully follows its strategy while operating within the bounds outlined by the liquidity risk appetite statement.

In developing the framework, the Bank considered the following factors:

- Development of proactive and practical risk management policies to adopt market best practice.
- Accurate quantification and communication of risk.
- Adequate control of the relevant risk limits.
- Ensuring the transparency of risk management.
- Ensuring the validity of reports through appropriate checks and comparisons.
- Accurate and timely risk measurement.

To supplement the current limit framework the Bank also holds a portfolio of highly liquid unencumbered assets including UK Gilts, Swiss Government bonds, U.S. Treasury Bills and cash held at Bank of England and European Central Bank reserve accounts. The quantity of this buffer of liquid assets is purposefully maintained such that the Bank comfortably exceeds its individual liquidity guidance, as prescribed by the regulators in November 2013.

The Bank is monitoring its estimated positions under the incoming CRD IV liquidity requirements and expects to exceed the minimum liquidity coverage ratio and net stable funding ratio metrics when implemented.

Analysis of Liquidity Risk

Contractual maturity of financial assets and liabilities form an important source of information used by management for the management of liquidity risk. The table below provides details on the contractual maturity of assets and liabilities. Impairment provisions on loans and advance to banks and customers are included in the up to 3 months column. Liquidity risk on these items is not managed on the basis of contractual maturity since they are not held for settlement according to such maturity.

At 31 March 2014 USDm	Up to 3 months USDm	3 to 12 months USDm	1 to 5 years USDm	Over 5 years USDm	Netting effect USDm	Total USDm
ASSETS						
Cash and balances at central banks	13,775.6	-	-	-	-	13,775.6
Loans and advances to banks	3,396.5	666.5	326.5	137.1	-	4,526.6
Derivative assets	715.3	-	-	-	(246.6)	468.7
Loans and advances to customers	2,308.7	635.6	2,764.4	5,642.8	-	11,351.5
Investment securities	283.6	59.4	658.7	-	-	1,001.7
Total financial assets	20,479.7	1,361.5	3,749.6	5,779.9	(246.6)	31,124.1
Other assets						265.6
Total assets						31,389.7
LIABILITIES						
Deposits by banks	15,560.1	1,169.2	123.7	226.8	-	17,079.8
Customer accounts	7,441.1	281.4	-	102.8	-	7,825.3
Derivative liabilities	698.1	-	-	-	(246.6)	451.5
Debt securities in issue	2,331.9	43.8	-	-	-	2,375.7
Subordinated liabilities	-	-	-	-	-	-
Total financial liabilities	26,031.2	1,494.4	123.7	329.6	(246.6)	27,732.3
Other liabilities						131.8
Total liabilities						27,864.1
Cumulative gap	(5,551.5)	(5,684.4)	(2,058.5)	3,391.8	-	3,391.8

At 31 March 2013 USDm	Up to 3 months USDm	3 to 12 months USDm	1 to 5 years USDm	Over 5 years USDm	Netting effect USDm	Total USDm
ASSETS						
Cash and balances at central banks	15,425.1	-	-	-	-	15,425.1
Loans and advances to banks	2,008.2	209.2	540.0	188.5	-	2,945.9
Derivative assets	896.5	-	-	-	(413.5)	483.0
Loans and advances to customers	2,409.8	626.7	2,644.5	5,341.7	-	11,022.7
Investment securities	26.6	378.5	62.4	8.6	-	476.1
Total financial assets	20,766.2	1,214.4	3,246.9	5,538.8	(413.5)	30,352.8
Other assets						220.9
Total assets						30,573.7
LIABILITIES						
Deposits by banks	17,563.5	615.4	946.6	151.9	-	19,277.4
Customer accounts	4,837.8	278.5	-	-	-	5,116.3
Derivative liabilities	828.6	-	-	-	(413.5)	415.1
Debt securities in issue	2,140.8	99.2	-	-	-	2,240.0
Subordinated liabilities	-	-	-	800.0	-	800.0
Total financial liabilities	25,370.7	993.1	946.6	951.9	(413.5)	27,848.8
Other liabilities						100.4
Total liabilities						27,949.2
Cumulative gap	(4,604.5)	(4,383.2)	(2,082.9)	2,504.0	-	2,504.0

7. Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events including legal risks. Operational risk arises due to the Bank's day to day operations and is relevant to every aspect of the business.

The Bank's Board is ultimately responsible for ensuring that the level of operational risk taken by the Bank is in line with their risk appetite and business model. The Bank have, in place, an operational risk management framework to effectively manage operational risk and minimize the occurrence and impact of operational risk events.

This framework consists of the following key elements:

- Internal loss data, used to assess the Bank's exposure to operational risk and the effectiveness of internal controls,
- External loss data, used to explore possible weaknesses in the control environment or consider previously unidentified risk exposures,
- Business Environment & Internal Control Factors (BEICFs), factors that affect operational risk, including changes to laws/regulations, internal rules and procedures and new products,
- Risk & Control Assessments (RCA), the Bank's methodology to assess operational risk.

The RCA methodology has been developed to evaluate and manage the level of residual operational risk within the Bank and to reflect changes in risk profile and control environment in each business unit. A set of 24 predefined scenarios that are relevant to our business are used. Each scenario is mapped to one of the seven Event Types according to CRD IV.

Risk & Control Assessments are conducted on a semi-annual basis in March and September. During these exercises all business units are required to review and reassess their existing scenarios and update risk and control scores and maximum potential losses as required.

The Bank's operational risk management framework also includes processes for capital calculations and stress testing. The Bank applies the Standardised Approach for calculating its regulatory operational risk capital. For each business line, the Bank calculates a capital requirement for operational risk as a certain percentage of the three year average of the Bank's net income. Stress testing is utilized to calculate any additional capital requirement deemed necessary under stressed conditions.

Conduct Risk

Conduct risk is the risk of the Bank's behavior resulting in poor customer outcomes and/or damage to the integrity of the financial markets.

Since its establishment in April 2013 the **FCA** has been developing and expanding its requirements in respect of the conduct of financial institutions. SMBCE's work on conduct includes assessing key risks across the business, identifying controls and ensuring that management receives the right information to enable it to identify and deal with conduct related issues.

Conduct risks are mitigated through a robust risk framework and include:

- Strong governance and culture, and
- Good product design and sales processes, and
- Appropriate market behaviour and conflict of interest management.

The Bank's Conduct Risk initiative is in progress and is set to continue for the coming year and will aim to build on our existing controls framework.

8. Capital Structure

8.1 Overview

All figures in USD millions

	31 March 2014	31 March 2013
Tier 1 core capital		
Permanent share capital	3,200.0	2,400.0
Profit & Loss and other reserves	326.0	231.4
Intangible assets	(6.2)	(2.9)
Qualified tier 2 capital		
Subordinated debt	-	800.0
Deductions from Tier 1 and Tier 2 capital	(2.6)	(2.8)
Total capital after deductions	3,517.2	3,425.7

On 28 May 2013, the Bank repaid and cancelled the USD 800 million Subordinated Loan Note that had been issued to SMBC in May 2008. On the same date, the Bank issued to SMBC 800,000 new Ordinary shares of USD 1,000 each at par value.

8.2 Reconciliation of Total capital to Shareholders Equity

Figures in USD millions

	31 March 2014	31 March 2013
Shareholders Equity per Financial Statements	**3,525.6**	**2,624.5**
Reserves not included in Tier 1 capital		
Cash flow Hedge	(1.6)	5.9
Available for Sale reserve	2.0	1.0
Deductions from Tier 1 capital	(8.8)	(5.7)
Subordinated Loan	-	800.0
Total Capital	**3,517.2**	**3,425.7**

8.3 Securitisation first losses

As per CRR Article 264, SMBCE has elected to include any first loss positions arising from securitisation transactions as additions to Credit Risk rather than deduct the exposure value from capital resources.

8.4 Expected loss excesses

SMBCE's provisions exceed the Expected Losses on its IRB assets. Therefore, there is no requirement or opportunity to deduct 50% of excesses from capital.

9. Capital Adequacy

9.1 Capital requirements for Credit Risk

All figures in this section USD 000's

	31 March 2014	31 March 2013
Standardised Approach		
Corporate exposures	620,493	593,808
Internal Ratings Based Approach - Foundation		
Central governments and central banks	21,364	5,162
Banks	114,467	42,630
Corporate exposures – excluding specialised lending	77,628	89,792
Corporate exposures – specialised lending	285,919	243,127
Non credit obligations	4,800	-
Credit Valuation Adjustment	16,077	-
Total IRB	520,255	380,710
Total Credit Risk Capital Requirement	1,140,748	974,518

Notes:

1. *The Standardised Approach is used for non-Japanese corporate customer exposures and is calculated as credit risk-weighted asset amount x 8%.*
2. *Foundation IRB Approach is used for all other asset classes, including Specialised Lending via the Supervisory Slotting Criteria. It is calculated as per PRA guidelines using Bank estimates of Probability of Default (PD). The credit risk-weighted asset amount x 8% is then multiplied by a scaling factor of 1.06.*
3. *Figures include securitisation first losses, as additions to Credit Risk rather than deductions from capital resources.*

9.2 Capital requirements for Market Risk

	31 March 2014	31 March 2013
Standardised Method		
Interest rate risk	12,350	21,300
Options transactions	100	700
Foreign Exchange risk	4,420	1,800
	16,870	23,800

9.3 Capital requirements for Operational Risk

	31 March 2014	31 March 2013
The Standardised Approach	61,472	54,127
	61,472	54,127

9.4 Capital Adequacy ratio, Tier 1 capital adequacy ratio and total capital requirement

	31 March 2014	31 March 2013
Total capital adequacy ratio	22.9%	25.4%
Tier 1 capital adequacy ratio	22.9%	19.4%
Total capital requirements	1,202,190	1,072,901
8% of credit risk-weighted assets	1,123,848	994,974
Capital requirements for Market Risk	16,870	23,800
Capital requirement for Operational Risk	61,472	54,127

9.5 Leverage Ratio

As per CRR article 499(3) the leverage ratio is calculated as the arithmetic mean of the monthly leverage ratios over a quarter

	31 Jan 2014	28 Feb 2014	31 Mar 2014
Tier 1 Capital	**3,424,900**	**3,474,800**	**3,472,463**
Total Exposure Measure:			
On Balance Sheet Assets	32,714,000	29,931,000	31,389,700
Derivatives including regulatory add-on	993,390	977,227	984,114
Undrawn credit facilities which may be cancelled unconditionally without notice	904,439	952,700	973,860
Medium/low risk traded related off balance sheet items	97,743	101,180	97,749
Medium risk traded related off balance sheet items	553,769	600,275	627,609
Other Off balance sheet items	9,424,771	9,479,829	9,520,981
Total Exposure Measure	**44,688,112**	**42,042,211**	**43,594,013**
Monthly Leverage ratio	**7.7%**	**8.3%**	**8.0%**

Arithmetic monthly mean Leverage Ratio: 8.0%

Note: Total Exposure Measure disclosed as total exposure values after appropriate weightings applied in accordance with CRR Part 7.

10. Credit Risk Exposures

10.1 By approach

All figures in this section in USD 000's

	Exposure At Default "EAD"	
	31 March 2014	31 March 2013
Standardised	8,698,583	8,408,800
FIRB	26,275,393	25,283,494
FIRB – Specialised Lending	5,368,461	4,738,484
	40,342,437	38,430,778

10.2 By exposure type

Exposure type	EAD	Specific provisions	EAD	Specific provisions
	31 March 2014		31 March 2013	
Finance and insurance	20,245,429	25,000	19,762,774	33,264
Govt. & local authorities	1,213,930	0	560,343	0
Manufacturing	2,873,999	24,859	2,745,135	22,986
Wholesale	475,302	0	599,578	0
Services	278,165	0	32,049	0
Other corporate exposures	9,506,269	36,854	9,432,271	138,318
Transport	1,521,044	0	1,667,892	0
Energy	1,323,681	0	1,103,965	0
Infrastructure	2,820,203	0	2,451,751	0
Co-Investment	84,415	0	75,020	0
	40,342,437	86,713	38,430,778	194,568

10.3 By residual maturity

Maturity band	EAD	
	31 March 2014	31 March 2013
To 1 year	23,260,100	22,501,438
More than 1 year to 3 years	4,211,176	3,821,953
More than 3 years to 5 years	5,360,687	4,703,272
More than 5 years to 7 years	1,421,179	1,678,813
More than 7 years	6,089,295	5,725,302
	40,342,437	38,430,778

10.4 By geographic area

Country region	EAD	Specific provisions	EAD	Specific provisions
	31 March 2014		31 March 2013	
United Kingdom	15,240,299	0	15,092,475	41,090
France	11,391,803	1,261	11,666,291	63,342
Italy	1,116,935	7,084	1,120,194	7,109
Other Europe	3,898,712	27,608	4,426,223	28,885
Eastern Europe	2,001,387	24,859	1,756,400	26,184
Japan	3,239,579	0	1,315,528	0
Other Asia	219,594	0	394,351	0
Africa	884,980	0	688,094	0
Latin America	387	25,000	7,356	0
Middle East	771,865	901	646,269	27,958
North America	1,384,319	0	1,053,016	0
Oceania	192,577	0	264,581	0
	40,342,437	86,713	38,430,778	194,568

10.5 Exposures subject to IRB approach – Corporate exposures

31 March 2014

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
J1 - J2	416,332	73,884	490,217	9.7%
J3 - J4	1,034,247	479,440	1,513,687	31.1%
J5 - J6	7,879	0	7,879	113.1%
J7A - 7B	0	2,479	2,479	175.4%
Others	0	173,833	173,833	0%
J7R - J10	0	0	0	
	1,458,458	729,636	2,188,095	

31 March 2013

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
J1 - J2	396,401	52,887	449,288	13.1%
J3 - J4	930,863	467,338	1,398,201	33.2%
J5 - J6	7,923	30,561	38,484	111.7%
J7A - 7B	0	1,523	1,523	139.5%
Others	0	73,235	73,235	18.0%
J7R - J10	0	0	0	
	1,335,187	625,544	1,960,731	

10.6 Exposures subject to IRB approach – Sovereign exposures

31 March 2014

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
G1 - G2	14,710,197	140,444	14,850,641	0.0%
G3 - G4	0	6,908	6,908	86.3%
G5 - G6	125,000	31	125,031	163.5%
G7A - 7B	0	0	0	0.0%
Others	0	110	110	107.7%
G7R - G10	0	0	0	
	14,835,197	147,493	14,982,690	

31 March 2013

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
G1 - G2	15,846,106	0	15,846,106	0.0%
G3 - G4	36,308	0	36,308	70.2%
G5 - G6	30,000	0	30,000	107.4%
G7A - 7B	0	0	0	0.0%
Others	0	0	0	0.0%
G7R - G10	0	0	0	
	15,912,414	0	15,912,414	

10.7 Exposures subject to IRB approach – Bank exposures ("J-series")

31 March 2014

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
J1 - J2	986,978	22,149	1,009,126	11.1%
J3 - J4	672	8,497	9,169	23.0%
J5 - J6	0	0	0	0.0%
J7A - 7B	0	0	0	0.0%
Others	0	222,777	222,777	0%
J7R - J10	0	0	0	
	987,650	253,423	1,241,073	

31 March 2013

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
J1 - J2	491,467	77,789	569,256	4.8%
J3 - J4	15,000	37,911	52,911	26.2%
J5 - J6	0	0	0	0.0%
J7A - 7B	0	0	0	0.0%
Others	0	146,124	146,124	27.4%
J7R - J10	0	0	0	
	506,467	261,824	768,291	

10.7 Exposures subject to IRB approach – Bank exposures – cont. (“G-series)

31 March 2014

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
G1 - G2	3,171,872	962,913	4,134,785	13.8%
G3 - G4	140,283	81,330	221,613	70.9%
G5 - G6	89,489	14,474	103,963	100.3%
G7A - 7B	0	0	0	0.0%
Others	0	106	106	118.5%
G7R - G10	0	0	0	
	3,401,644	1,058,823	4,460,467	

31 March 2013

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
G1 - G2	1,585,212	651,350	2,236,562	14.6%
G3 - G4	259,954	35,856	259,810	56.0%
G5 - G6	59,716	29,918	89,635	42.0%
G7A - 7B	0	0	0	0.0%
Others	0	0	0	
G7R - G10	0	0	0	
	1,904,882	717,124	2,622,006	

10.8 Exposures subject to IRB approach – All exposures

31 March 2014

("J-series")

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
J1 - J2	1,403,310	96,033	1,499,343	10.6%
J3 - J4	1,034,919	487,937	1,522,856	31.1%
J5 - J6	7,879	0	7,879	113.1%
J7A - 7B	0	2,479	2,479	175.4%
Others	0	396,610	396,610	0.0%
J7R - J10	0	0	0	
	2,446,108	983,059	3,429,167	

("G-series")

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
G1 - G2	19,672,912	2,154,898	21,827,810	3.5%
G3 - G4	313,072	396,140	709,212	54.8%
G5 - G6	249,780	14,157	263,937	134.0%
G7A - 7B	0	0	0	0
Others	18,906	420	19,326	246.2%
G7R - G10	25,804	0	25,804	100.1%
Total	20,280,474	2,565,615	22,846,089	

10.8 Exposures subject to IRB approach – All exposures – cont.

31 March 2013

("J-series")

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
J1 - J2	887,868	130,676	1,018,544	8.5%
J3 - J4	945,863	505,249	1,451,112	32.9%
J5 - J6	7,923	30,561	38,484	111.7%
J7A - 7B	0	1,523	1,523	139.5%
Others	0	232,108	232,108	24.2%
J7R - J10	0	0	0	
	1,841,654	900,117	2,741,771	

("G-series")

	EAD			
Grade	On balance sheet	Off balance sheet	Total	Average risk-weight
G1 - G2	19,514,919	2,021,149	21,536,068	2.5%
G3 - G4	424,607	231,605	656,212	46.9%
G5 - G6	196,242	30,310	226,552	80.1%
G7A - 7B	47,282	0	47,282	248.9%
Others	0	0	0	0.0%
G7R - G10	63,828	0	63,828	100.1%
	20,246,878	2,283,004	22,529,942	

Total	20,246,878	2,283,004	22,529,942

10.9 Specialised lending by exposure and weighting

Slotting Criteria	Risk-weight	EAD	
		31 March 2014	31 March 2013
Strong	**50%** **70%**	4,579,325	4,105,721
Good	**70%** **90%**	518,307	350,468
Satisfactory	**115%**	137,530	121,546
Weak	**250%**	256,657	111,367
		5,491,819	4,689,102

Other assets under EL methodology

	31 March 2014	31 March 2013
Co-investment transactions	0	49,382
Total EL method	5,491,820	4,738,484

10.10 Standardised Approach by risk weighting

CQS	S&P ratings	Weight	EAD	
			31 March 2014	31 March 2013
1	AAA to AA-	20.0%	185,375	65,791
2	A+ to A-	50.0%	1,054,217	953,234
3	BBB+ to BBB-	100.0%	1,337,587	1,395,693
4	BB+ to BB-	100.0%	464,283	84,010
5	B+ to B-	150.0%	36,311	55,228
6	CCC+ and below	150.0%	0	0
No ECAI grade [1]		20.0%	0	0
		50.0%	24,839	36,012
		100.0%	5,595,971	5,706,521
LFG [2]		150.0%	0	112,311
			8,698,583	8,408,800

[1] *Default weight depends on exposure class for all transactions without an external grade from an approved ECAI. All SMBCE Standardised Approach assets are corporates.*

[2] *Leveraged Finance Group (LFG) assets default to 100% but an internal adjustment is made to assume that CQS5 @ 150% would be applied if external grade were found.*