SMBC BANK INTERNATIONAL

SMBC Group

SMBC Bank International plc

A trusted partner for the long term

Annual report and financial statements
Year ended 31 March 2021

Company information

Registration

Registered as a public limited company in England and Wales under company number 04684034.

Registered office

99 Queen Victoria Street, London, EC4V 4EH, United Kingdom.

Regulated status

Authorised by the Prudential Regulation Authority and regulated by the Prudential Regulation Authority and the Financial Conduct Authority. Our Financial Services Register number is 223304.

Auditor

KPMG LLP
15 Canada Square
London
E14 5GL

Website

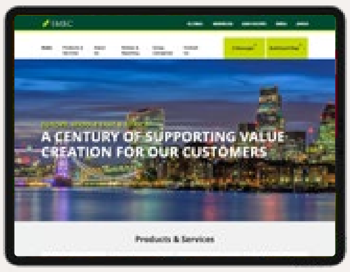
The Bank's website is:
www.smbcgroup.com/emea/group-companies/smbc-bank-international-plc/

Pillar 3 document

The Bank's Pillar 3 disclosures can be found at:
www.smbcgroup.com/emea/notices-and-reporting/corporate-disclosures/

Use of terms in the annual report and financial statements

In this document the terms 'SMBC BI', 'Bank', 'we', 'us' or 'our' refer to SMBC Bank International plc. Our parent company is Sumitomo Mitsui Banking Corporation, which is shown as 'SMBC'. 'SMBC Group' refers to the corporate group of companies of Sumitomo Mitsui Financial Group, shown as 'SMFG', of which we are a part. The term 'EMEA' refers to Europe, Middle East and Africa.



Find out more online
smbcgroup.com/emea

In this report

Understanding SMBC BI
Who we are

The Directors present the Strategic Report of **SMBC Bank International plc** for the year ended 31 March 2021.

Our purpose

A trusted partner for the long term.
We believe this reflects the long-term relationship-based approach we adopt in carrying out our business for the benefit of our customers and all our stakeholders.

About us

We are a wholesale bank incorporated in England and Wales with offices in London and a branch in Paris.

We are a wholly owned subsidiary of SMBC, a Japanese bank, which is a core member and a wholly owned subsidiary of SMFG, a company that is also incorporated in Japan.

On 30 September 2020, we re-registered as a public limited company and changed our name from Sumitomo Mitsui Banking Corporation Europe Limited to SMBC Bank International plc.

Our business

We offer a wide range of wholesale banking products, including bilateral loans, guarantees, syndicated loans, project, real estate, aviation, maritime, trade, leveraged, and other specialised structured finance, cash management, money markets, foreign exchange, deposit taking and derivatives.

Our customers are typically sovereigns, financial institutions and corporates, either domiciled in EMEA, or regional subsidiaries of global multinational corporates, many of which are headquartered in Japan and Asia.

We also act as the EMEA headquarters for SMBC Group and are responsible for providing services to various SMBC Group subsidiary companies, branches and representative offices in EMEA in support of their own activities.

Our business model

Our business model is to provide corporate finance in a way that supports the achievement of our long-term sustainable growth, ensuring that we are well funded, well controlled and that there is a sensible balance between risk and reward.

Our stakeholders

We recognise that the success of our business is dependent on our stakeholders and that our business activities impact our stakeholders in different ways. Our stakeholders are listed below.

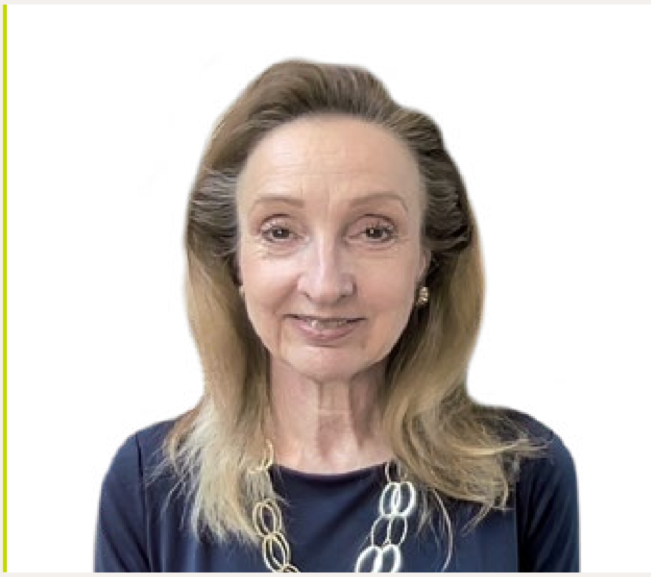
+ Read more about our business model **on page 6**

+ Read more about our stakeholders **on pages 22 to 26**

Our stakeholders

- Our customers
- Our workforce
- Our environment and society
- The markets and our regulators
- Our suppliers
- SMBC Group

Chair's statement
A message from our Chair



Resilience has been a key theme for us in 2020. The arrival of COVID-19 caused us to rapidly consider how we best maintain our levels of service and support to our customers – particularly those who would be severely impacted by the suspension of normal operations and access to liquidity – while ensuring the health and wellbeing of our colleagues.

As has now been universally observed, the year 2020 brought an unprecedented range of health, social and other challenges throughout the world that all of us have had to cope with, individually and collectively. The shadow of COVID-19 grew rapidly to touch every corner of our lives, from how we buy our bread to how we manage our work and relationships. We have benefited from global efforts to attack the virus through astonishingly rapid developments of highly effective vaccines, but we have also had to say goodbye too soon to thousands of loved ones before that happened. The toll in human lives, lost years and economic impact is unprecedented in most of our lifetimes.

Beyond the pandemic, it has been a year of learning. The Black Lives Matter movement has caused the world to reflect on its behaviours and move towards greater commitment to fairness and inclusion. Extraordinary weather events and increasing weather volatility have highlighted beyond question that our approach to climate change must advance. Political tensions have erupted in various geographies – some remote, some closer to home; all with consequences in some form for how the world works. But our collective resilience keeps us moving forward.

Resilience has been a key theme for us in 2020. The arrival of COVID-19 caused us to rapidly consider how we best maintain our levels of service and support to our customers – particularly those who would be severely impacted by the suspension of normal operations and access to liquidity – while ensuring the health and wellbeing of our colleagues. Our rapid deployment of 'work from home' technological solutions enabled us to move the activities of the vast majority of employees from our offices to their homes without any material disruption of activities or creation of unmanageable risk. My thanks go out to the teams who made this possible, to those colleagues who continued to come into our offices in spite of the personal risk and also to those who had to often find quite creative solutions to remote working, combining home study and childcare requirements in home settings that were not intended to be daycare, schools and workplaces combined.

We have learned a great deal about how we can work and, importantly, how our customers and our teams want to work. We have seen that digital solutions can provide opportunities for more frequent and time-efficient interactions, but also highlight the situations in which in-person contact genuinely matters. Armed with these insights, we will look to develop new models of supporting our customers as they wish to work with us and will utilise technology to enable deeper connections and offer more value. For our own people, we have developed a blueprint for future hybrid working that is informed by what we have learned from a year of working remotely and that supports a range of approaches.

This past year has also been important for us in progressing changes to how we operate as a Group to best serve the needs of our customers. We have enhanced our range of products, which will allow us to further tailor solutions to each of our customers' specific needs. This has been supported by efficiency improvements within our operations, as well as rethinking our operating structure to better integrate our Group-wide capabilities and serve our clients in a more seamless way.

We have also made important progress this year in how our business considers sustainability, which includes developing our climate change business and management capability, but also the wider spectrum of environmental, social and governance (ESG) concerns. We recognise the role we can play in partnership with our stakeholders to move forward the global ESG agenda constructively; this has been a clear focus for both our management and our Board, who recognise our responsibility to ensure close attention to our progress on these important issues. Within our own business, we have also paid particular attention to the importance of diversity and inclusion and working with our teams to support the best possible environment and opportunities for historically disadvantaged groups.

While 2020 has indeed been 'a year like no other', as often described in the press, it has nonetheless been a year in which the Board and I take great pride in seeing how our creative and committed teams have not only coped with extraordinary challenges, but also have moved the business forward. We look forward to 2021 as an opportunity to consolidate the learnings of this past year, but also as a year to grow and build with our customers, our people, our communities and others for a brighter future.

Laurel Powers-Freeling
Chair
5 July 2021

+ Read more about our response to the COVID-19 pandemic **on pages 8 and 9**

+ Read more about our diversity and inclusion initiatives **on page 12**

+ Read more about our our approach to climate change **on pages 14 to 20**

Business model, objectives and strategy

An overview of our business

Our business model is to provide corporate finance in a way that supports the achievement of our long-term sustainable growth, ensuring that we are well funded, well controlled and that there is a sensible balance between risk and reward.

Our strategy is built around four corporate objectives:

Serving customers

To be the bank of choice for our EMEA customers through the provision of high quality value-added services in cooperation with SMBC Group companies.

Sustainable growth

To run our business in a way that is appropriately balanced and sustainable; to develop an efficient and effective infrastructure to support sound business growth; and to provide services to SMBC EMEA branches and SMBC EU AG (an SMBC Group company) through service level agreements.

'Edges' as SMBC BI

To establish and develop our competitive 'edges'. These are areas where we feel we have a particularly strong position in customer relationships, product capabilities and global reach (with Japanese/Asian origin).

Team SMBC Group

To share and help realise SMBC Group's Mission and Vision. SMBC Group's Mission is: "We grow and prosper together with our customers by providing services of greater value to them; we aim to maximise our shareholders' value through the continuous growth of our business; we create a work environment that encourages and rewards diligent and highly motivated employees; and we contribute to a sustainable society by addressing environmental and social issues." SMBC Group's Vision is: "A trusted global solution provider committed to the growth of our customers and advancement of society."

Review of the year

While GDP growth in 2020 was lower than our original assumptions, the COVID-19 pandemic has resulted in minimal impact to our corporate strategy. This is also reflected in an increase in our net profit in the year from USD 152.9 million to USD 240.9 million. We believe this good performance reflects our focus on lending to top-tier borrowers and on ensuring we have a well-diversified credit portfolio. As a result, we have been able to continue lending to customers in all our business sectors in the year. We took the decision early in the year to support as many of our core customers as possible in managing their liquidity and capital needs. We believe such actions typify our purpose statement, which emphasises the value of long-term customer relationships.

While our overall strategy has remained unchanged, at the request of the Board management has put in place action plans setting out our approach to lending in each of our credit portfolio segments based on assumptions of market and economic conditions. We have also taken steps to enhance our management of credit costs, including through the implementation of individual borrower and sectoral reviews. Further information on this can be found in the Risk Review on pages 57 to 65.

The UK's departure from the EU (Brexit) has meant that our ability to offer our products and services to our customers in the European Economic Area (EEA) has become restricted. The loss of our EEA 'passporting' rights was, however, anticipated and in previous years SMBC Group took structural actions to ensure that we could continue to provide our customers with sustained and reliable banking services after Brexit. This was achieved primarily through SMBC Group establishing banking and capital markets subsidiaries in Frankfurt.

The loss of our EEA passporting rights has meant that, within the EEA, we are now unable to market our products and services beyond the UK and France, where our Paris Branch has been converted to a branch of a third country bank. Our commitment to providing services to our customers in the UK and in non-EEA countries across EMEA is unaffected by Brexit. We also continue to provide non-marketing-related services to SMBC Group's banking subsidiary in Frankfurt to support its offering of products and services to its EEA customers.

Future developments

Our strategy for the year ahead remains consistent with that pursued in the year. This means that over the coming 12 months we will continue to focus on delivering a full suite of corporate finance solutions to our customers in close collaboration with SMBC Group companies. We will also further develop our governance and risk management frameworks to ensure these remain commensurate with the size and complexity of our business.

Other significant areas of focus in the year will include responding to the consequences arising from the COVID-19 pandemic and the development of our sustainability capabilities and business. Further information on these matters can be found in the relevant sections of the Strategic Report.

We are also considering the future risks that Brexit may give rise to. These key risks include the impact of regulatory divergence between the UK and EU and further restrictions on cross-border marketing. Should these risks materialise they could have a significant impact on our operations, but not on our overall strategy and business model. It is also possible that the EU and the UK reach an agreement on financial services in due course which could restore some of the lost EEA marketing rights.

Operating and business environment
Response to COVID-19

Our people

In responding to the COVID-19 pandemic, the health and wellbeing of our people has been and remains our main priority.

The vast majority of our people have continued to work from home, and we recognise the potential psychological and emotional stress associated with this prolonged period of isolation and remote working. We have sought to support our people through the introduction of agile working practices and the provision of resources to assist with their physical and mental wellbeing. In April 2020, we launched the Thriving Through Change and Uncertainty Programme to help maintain business continuity and workforce productivity through the pandemic by providing employees with the training, tools and resources needed to work in a virtual environment and to manage personal wellbeing.

Our offices have remained open throughout the pandemic, largely for those employees undertaking key worker roles, but when permitted we have also invited those employees suffering from the impact of isolation and poor mental health to work from the office. For those coming into one of our offices, we have taken steps to protect them and to prevent the spread of the virus, including bringing all our UK offices up to the government's 'COVID-secure' standards; similar steps were also taken in our Paris office.

During the year, we have undertaken surveys to understand how our people were feeling, where they needed additional help and the impact of the pandemic on our culture. The results of these surveys were generally consistent and positive, and indicated that many of our people enjoy working from home, recognising good team spirit and strong support and clarity of messages from senior leaders. The adoption and acceptance of new agile working practices was also recognised.

The surveys also indicated that our people remained concerned about catching the virus, the ongoing uncertainty surrounding the pandemic and the risk of isolation and loneliness, compounded by the lack of direct social interaction. Balancing family care and home schooling with work commitments was also a consistent concern. Our people felt that our culture was being adversely impacted due to the lack of social connectivity with a resulting influence on employee wellbeing. In response to feedback regarding remote working practices, we introduced new, and enhanced existing, digital collaboration tools and helped our people to enhance their home-working environments.

+ Further information on the wider culture survey undertaken in the year can be found on **page 23**

> In response to feedback regarding remote working practices, we introduced new, and enhanced existing, digital collaboration tools and helped our people to enhance their home-working environments.

Future developments

Over the coming year, and subject to official guidance, we anticipate the gradual and phased return of our people to working in our offices. The focus will, however, remain on ensuring the health and wellbeing of our people. We will also introduce a new hybrid working model setting out the principles to allow our teams to work in the way that is best suited to them and the business.

Risk environment

While the pandemic has impacted all our principal risk types (liquidity, credit, market and operational), our strong risk framework and balance sheet have allowed us to navigate the stressed environment. We have also proved our resilience in undertaking our operations and our ability to continue to support the needs of our customers and other stakeholders.

In respect of credit risk, there has been an increase in the non-performing loan ratio in the year from 0.4% to 2.0%, which reflects credit deterioration in certain customer and product segments we operate in.

We have undertaken an in-depth credit and impairment analysis, albeit this was against an uncertain external environment with several event risks. We have been managing this credit stress through a credit taskforce that can mobilise single credit reviews and actions, coupled by a top-down approach typified by credit stress testing. Despite the increase in the non-performing loan ratio in the year, the portfolio is currently showing resilience and, as a result of the increased provisions put in place last year to reflect the expected economic impact posed by COVID-19, our total impairment provisions charge in the year decreased by USD 191.7 million compared with last year (2021 charge of USD 8.6 million; 2020 charge of USD 200.3 million). The total impairment provision has decreased in the year to USD 219.9 million from USD 276.4 million in 2020. Further information on how we manage our credit risk can be found in the Risk Review on page 62 and in note 4 to the financial statements on pages 84 to 102.

The current and potential future impact of the pandemic has been incorporated into our capital and liquidity adequacy assessments and into our recovery and resolution planning. During the year, our capital ratio has remained stable and we have operated above our capital requirements, under both base and stress scenarios. We have, however, established capital contingency plans should these be required in the future. At 31 March 2021, our tier 1 capital ratio was 16.7%, as compared to 15.8% at the previous year-end.

We recognise that with the significant increase in remote working our cyber security risk has increased over the last year. We have taken measures to improve our anti-phishing protection with the implementation of an enhanced email security product and trained our people in best practice for keeping their home environments secure.

Future developments

There remains a high degree of uncertainty in the economic outlook despite recent improvements in economic forecasts. Given this uncertainty, we will continue to give a high level of focus to our overall credit risk. We recognise that an improvement or growth phase in some economies may lead to increased credit concerns and defaults amongst some corporate customers. We also recognise that a financial recovery in certain sectors may take a significant period of time and that financial stresses may occur over the coming years. We will continue to monitor and manage individual credit exposures where we identify signs of credit deterioration. We will also continue to manage our capital and liquidity positions to ensure that we are well positioned to navigate the current business environment.

Overview of performance
Key performance indicators

Performance

We use a broad range of financial and non-financial measures to help us understand how we are performing. In particular, key performance indicators (KPIs) are widely used by the Board and its Committees and across the Bank more generally.

Set out in this section are our main financial KPIs. Information on the key non-financial measures used can be found in the following sections:

+ Read more about our diversity and inclusion measures on **page 12**

+ Read our Streamlined Energy and Carbon Reporting on **page 20**

+ Read more about our Supplier Payment Periods on **page 25**

Performance commentary

- Operating income was largely unchanged year on year from USD 843.3 million to USD 841.0 million.
- Net interest income once again increased in the year, up 7.1% to USD 340.6 million, despite the challenging market conditions.
- Profit before income tax in the year increased from USD 219.6 million to USD 333.1 million. Of this number, USD 315.6 million was derived from our UK operations and USD 17.5 million from France.
- Net fee and commission income also increased in the year by 17.4% to USD 436.1 million. There was good fee flow in the year, boosted by strong business in the Group, with increasing fees received from Group companies through Service Level Agreement arrangements. This is as a result of changes made to the Group's structure in recent years in preparation for Brexit, leading to an increased level of fees from Group companies for our contribution on deals booked elsewhere in the Group.
- Trading Income is down in the year to USD 64.3 million from USD 154.1 million. This business is subject to fluctuations and last year's result was a historic high.
- Other non-operating income of USD 4.9 million relates to the profit made on the sale of the Transportation business of the Paris Branch to SMBC Bank EU AG during the year.
- Net operating expenses are down in the year from USD 632.4 million to USD 512.8 million. The main contributor to this reduction has been net impairments where a substantial charge was booked last year; the current year result is a charge of USD 8.6 million. Overall, there has been an improvement in the levels of impairment, reflecting an improved economic outlook, in part due to the positive impact across economies of government intervention and support. Although USD 70.0 million of losses on sales were booked on impaired customers during the year, this has been offset by reductions in post model adjustments and underlying model results.
- In Other Comprehensive Income, there was a net charge of USD 27.4 million on the Bank's defined-benefits pension scheme. The charge was primarily due to a reduction in asset values and year on year changes in the discounting rate on the scheme's liabilities.
- Balance sheet footings have decreased from USD 60.4 billion at 31 March 2020 to USD 53.6 billion. This reduction was in line with our expectations as a number of one-off transactions in the previous year unwound, with Balance Sheet footings expected to remain at the reduced levels.

The full year results for the year are set out in the Statement of Comprehensive Income on page 72. The Directors do not recommend the payment of a dividend in respect of the year ended 31 March 2021.

Key financial KPIs

Return on equity
Profit after tax of USD 240.9 million (2020: USD 152.9 million) divided by the average monthly equity in the year of USD 4,689.6 million (2020: USD 4,548.4 million)

5.1%

2020: 3.4%
2019: 6.4%

Tier 1 capital ratio
Tier 1 capital of USD 4,787.9 million divided by total risk weighted assets of USD 28,662.1 million

16.7%

2020: 15.8%
2019: 18.5%

Cost income ratio
Net operating expenses (excluding impairment losses) of USD 512.8 million divided by operating income of USD 841.0 million

61.0%

2020: 51.2%
2019: 51.6%

Non-performing loan ratio
Gross exposure non-performing loans of USD 529.4 million divided by on balance sheet gross exposure total loans of USD 26,591.7 million

2.0%

2020: 0.4%
2019: 0.5%

Leverage ratio
Regulatory Tier 1 capital of USD 4,787.9 million divided by Capital Requirements Regulation (CRR) leverage exposure of USD 62,531 million

7.7%

2020: 6.8%
2019: 7.6%

Net profit
Profit for the year attributed to equity holders of the parent

USD 240.9m

2020: USD 152.9m
2019: USD 275.3m

Gross income
Operating income

USD 841.0m

2020: USD 843.3m
2019: USD 830.8m

Total assets

USD 53,568.5m

2020: USD 60,391.3m
2019: USD 48,009.3m

Our people
Committed to developing a diverse and highly skilled workforce

Workforce

Our people are our key resource and we are committed to developing a diverse and highly skilled workforce. Our workforce comprises locally hired employees, expatriate colleagues from SMBC Group and colleagues typically engaged for specific projects or activities.

Equal opportunities

We are an equal opportunities employer and committed to providing a safe and tolerant workplace. It is our intention that no potential or current employee is subject to discrimination on account of age, race, nationality, colour, disability, ethnic background, gender, gender expression or gender identity, sexual orientation, pregnancy or maternity leave, marital status, or religion or belief. All employees have personal responsibility for the practical application of our equal opportunities policy, which extends to the treatment of employees, customers and suppliers. Special responsibility for the practical application of our equal opportunities policy falls upon managers and supervisors involved in the recruitment, selection, promotion and development of employees.

During the year we updated our equal opportunities policies by: introducing a Transgender Policy, which sets out the support and guidance available to employees who are transitioning; enhancing our maternity and adoption policies to include fostering and surrogacy; and introducing a parental bereavement leave policy to support parents who suffer the loss of a child under 18 years of age. We also partnered with an external company to raise awareness and develop understanding amongst our employees of the experiences and needs of colleagues with disability; and we took that opportunity to streamline our process for requesting workplace adjustments.

Diversity and inclusion

We are committed to diversity and inclusion, and recognise that diversity of our people, opinions and perspectives is vital for the sustainable growth of our organisation and is to the benefit of our stakeholders. Our aim is to build an inclusive work environment where everyone feels able to be their authentic self.

Our diversity and inclusion strategy is led by the Diversity and Inclusion Steering Committee, which is chaired by Stanislas Roger, an executive Director. The Steering Committee works closely with DRIVE (an acronym of diversity, respect, inclusion, value and equality), which is the umbrella for our employee-led diversity networks. These networks provide a community for employees to come together to share their experiences, raise awareness and celebrate our diversity. DRIVE comprises various networks, each focused on a key aspect of diversity and inclusion, namely Balance (gender), Niji EMEA (LGBT+) and Collaborate (inclusion). This year saw the launch of our Black Employees & Allies Network under the DRIVE umbrella and the establishment of a Disability Confident working group.

SMBC Group is a proud signatory of the Women in Finance Charter. In 2020, to reflect organisational changes and our desire to maintain ambitious targets with respect to gender diversity progression, we moved our seniority target up to a higher level. Our aim is to have 30% of all senior roles (now defined at a higher level) filled by female leaders by 2023. At the year-end, 30.3% of these roles were held by females, compared with 24.4% last year. Stanislas Roger is responsible for making regular progress updates on these targets to the Executive Committee and Board.

Performance, learning and development

We have a continuous performance management system in place to drive employee performance and professional development involving regular and meaningful conversations between employees and their managers.

We encourage our employees to be proactive and to drive their own development using agreed frameworks to identify and work towards their longer-term career goals. We provide our employees with a range of learning and development opportunities, which include provision of digital training, workshops and study support for professional qualifications.

Wellbeing

We are committed to supporting the wellbeing of our workforce and have a Wellbeing Strategy in place to promote this. We provide a range of fixed and optional benefits, collaboration with external providers and internal training and awareness raising to ensure our people have access to the support they need. We have trained a team of employees who are registered as Mental Health First Aiders and equipped to offer initial support through non-judgemental listening and guidance and to signpost colleagues to other services and support available. During the COVID-19 pandemic we amplified our focus on supporting employees with their mental wellbeing and further information on this can be found on page 8.

Employee communication and consultation

We value our employees and their views and endeavour to ensure they are properly consulted on matters affecting them. The means of communication varies depending on the situation, but includes emails, employee meetings, working groups, townhall meetings and formal consultation.

To support our involvement in societal and community initiatives, we provide up to six days' paid leave for employees volunteering to support charitable or community initiatives.

Our communities

To support our involvement in societal and community initiatives, we provide up to six days' paid leave for employees volunteering to support charitable or community initiatives. We have also established a Corporate Giving Fund from which donations are made to carefully selected community organisations and charities that have long-term volunteering relationships with our employees. In addition, we match employee contributions and funds raised by employees from charitable fund-raising events, subject to eligibility criteria.

In response to the COVID-19 pandemic, we launched a fundraising campaign in the summer of 2020 in partnership with other SMBC Group entities in the UK. This campaign was established to support three charitable organisations directly involved in the response to the pandemic: a homeless charity, a medical research organisation and an ambulance service charity.

During the year, including the matching of employee donations and fund raising, we made total charitable donations of USD 34,803 (2020: USD 17,818).

Climate change
Our approach

We recognise that addressing climate change is one of the foremost global issues of the 21st century.

SMBC Group supports the Task Force on Climate-related Financial Disclosures (TCFD) and has published on its website the Group's 2020 TCFD Report and related documents, which includes the Group Statement on Sustainability and the Group Environmental Policy.

In April 2020, SMBC Group updated its Mission to add "We contribute to a sustainable society by addressing environmental and social issues" and also announced a Sustainability Statement, which defines sustainability as "creating a society in which today's generation can enjoy economic prosperity and wellbeing, and pass it on to future generations". At the same time, SMBC Group established 'GREEN×GLOBE 2030', a 10-year plan that focuses on three key areas: sustainability initiatives that are directed towards our customers/society; internal initiatives that contribute to sustainability management; and enhanced engagement with investors. We fully support these initiatives and continue to liaise with our colleagues in the Group to further the Group's sustainability and environmental objectives.

Climate change is identified as one of our top risks and is a topic of considerable Board and management focus. In this section we set out our approach to managing the risks and opportunities arising from climate change. This is structured on the basis of the recommendations put forward by the TCFD to disclose: governance, strategy, risk management, and metrics and targets.

Status of measures to address the TCFD recommendations

Item	Recommended disclosure	Status of initiatives
1 Governance	Governance around climate-related risks and opportunities	– We have clearly defined and documented the roles and responsibilities of the Board and management in the oversight and management of climate-related risks. – We are carrying out our activities based on these roles and responsibilities. – We have appointed Hideo Kawafune, an executive Director and Chief Operating Officer, to oversee our response to climate change. – Sustainability is discussed at all Board meetings.
2 Strategy	Impacts of climate-related risks and opportunities on businesses, strategy and financial planning	– We have developed a Sustainability Strategy, which has been approved by the Board.
3 Risk management	How climate-related risks are identified, assessed and managed	– A holistic risk management approach has been developed to ensure climate risks are considered in key risk processes.
4 Metrics and targets	Metrics and targets used to assess and manage climate-related risks and opportunities	– Initial identification of metrics implemented, including targets such as for new business and our net zero ambition. – We expect further enhancement and evolution of metrics over time.

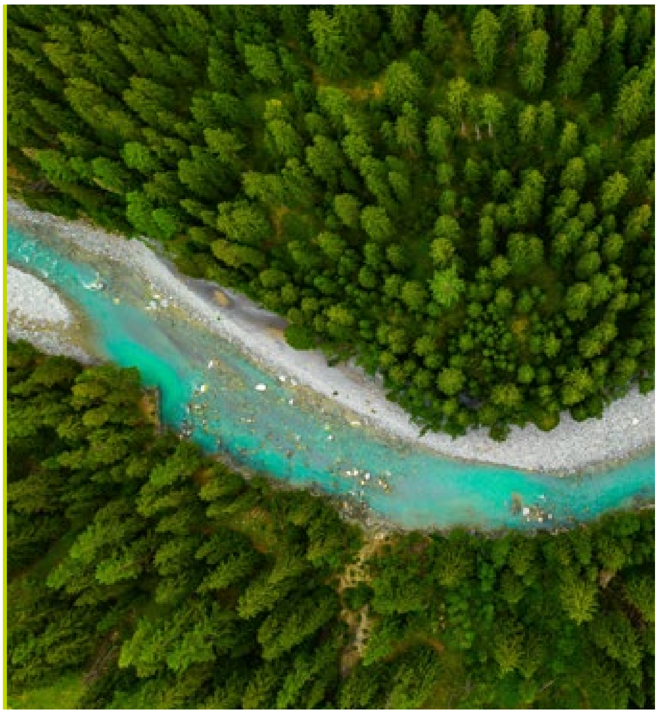
❶ Governance

Oversight

The Board is responsible for setting and monitoring our sustainability strategy and for overseeing our overall response to the risks and opportunities posed by climate change. The Board receives quarterly reports on the development of this strategy and on our broader sustainability initiatives and provides appropriate challenge as needed.

The Board is supported by the Audit Committee, which is responsible for considering climate and sustainability disclosures, and the Risk Committee, which is responsible for considering the risk impact of climate change and the development of climate stress testing.

Key activities undertaken by the Board and its Committees in the year in respect of climate change were as follows.



Board

- Receiving regular reports on the activities of the EMEA Sustainability Programme.
- Considering the main areas of focus for our Sustainability Strategy and the related stakeholder interests. The Sustainability Strategy was approved after the year-end.
- Considering a gap analysis of our climate arrangements against our regulators' expectations.
- Expanding the Board's considerations of climate change to a wider range of environmental, social and governance (ESG) matters.
- Considering the key priorities for activity in 2021 and an overview of areas of focus until 2030.
- Considering developments in SMBC Group's sustainability strategy.
- Undertaking a deep dive into the business activities of our ESG and Green Finance and Energy Sector Initiative teams.

Audit Committee

- Considering our climate disclosure obligations and developments more generally on climate reporting.
- Considering the disclosure obligations under the Streamlined Energy and Carbon Reporting regulations and our approach to meeting those obligations. Particular focus was given on the extent to which we are able to make voluntary disclosures under Scope 3.

Risk Committee

- Considering the progress made to develop climate stress testing and approving our approach through review and approval of the Internal Capital Adequacy Assessment Process (ICAAP) document.

+ Read more about the activities of the Board in the year on **pages 27 and 28**

+ Read more about the activities of the Board Committees on **pages 46 to 51**

Our approach to climate change continued

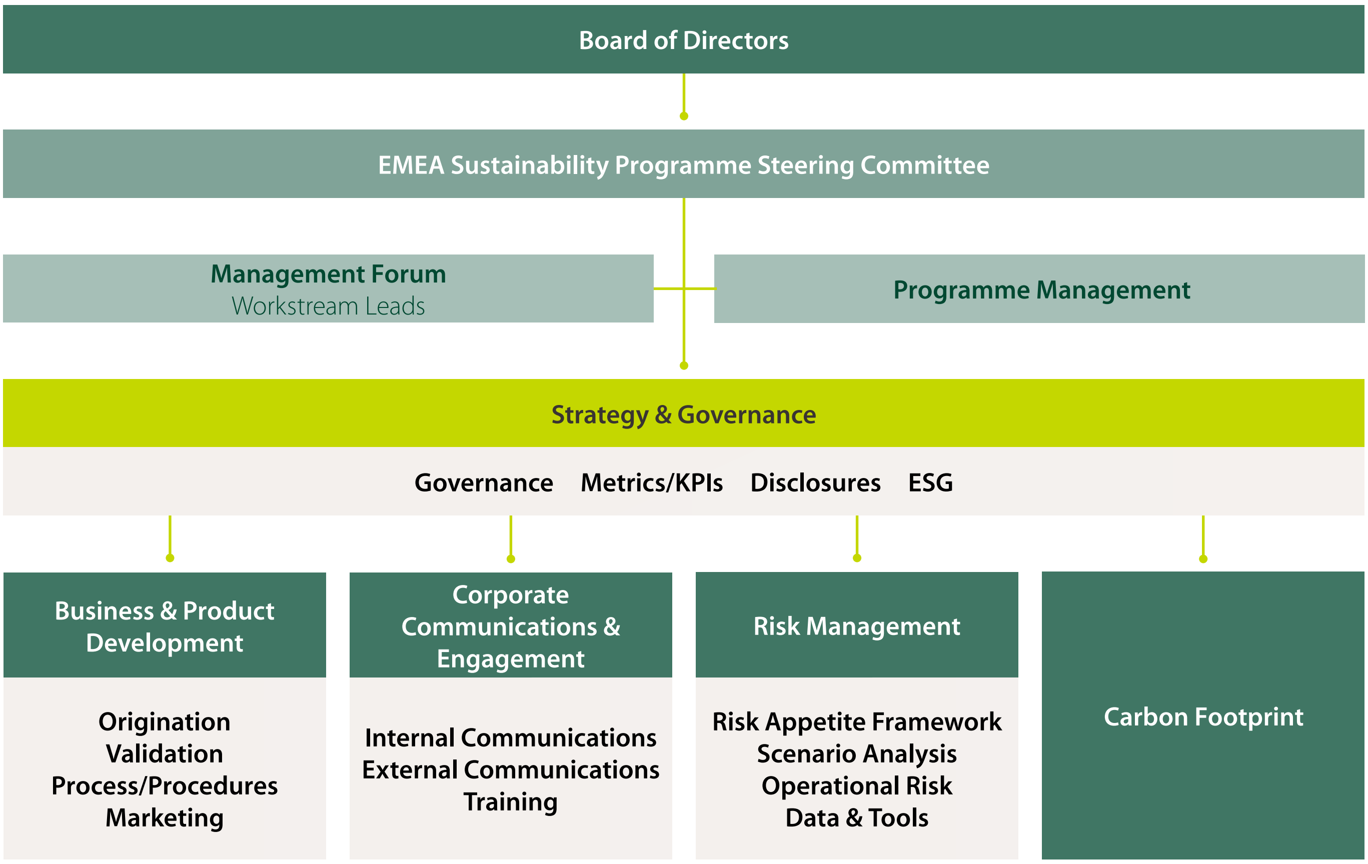
Board skills

The Board is mindful of the need to ensure that it has the skills required to lead the Bank's climate strategy and that it is familiar with emerging best practice. Reflecting this, for the first time this year, an assessment of the Directors' individual experience in climate change management and green finance was included in the Board's skills assessment. As a developing area of expertise, the Board recognises the need to benefit from external perspectives and, during the year, received a briefing from an adviser on the regulatory expectations placed on banks in responding to climate change and leading practices in this area. The Board expects that briefings on climate matters will remain an important element of its ongoing training and education. The Board also benefits from the perspectives of its non-executive Directors. The Board's discussions are Chaired by Laurel Powers-Freeling, who is also a non-executive Director of Chapter Zero, the UK Chapter of the World Economic Forum's Climate Governance Initiative.

Execution

The Board has appointed Hideo Kawafune, an executive Director and Chief Operating Officer, to oversee our response to climate change. His responsibilities include: developing our Sustainability Strategy and incorporating this within our overall corporate strategy, escalating significant business and strategic developments to the Board and developing our overall climate governance. Hideo works closely with the Chief Risk Officer to develop our overall climate risk appetite statement and framework.

Hideo is supported in this work by the EMEA Sustainability Programme (ESP), the key components of which are a Steering Committee, a Management Forum and four workstreams established to consider specific areas of our climate activities. Together, these meetings have responsibility for considering all aspects of our climate response. Set out below is further information on the ESP:



Steering Committee

Chaired by the Head of Sustainability Strategy (who reports to the General Counsel and was hired in February 2021), with membership including: the executive Directors Hideo Kawafune, Stanislas Roger and Katsufumi Uchida, Chief Risk Officer, General Counsel, Chief Compliance Officer, the Co-General Manager of Loan Capital Markets Department and senior executives from other SMBC Group companies. The Committee sets our sustainability strategy and has overall ownership of the ESP's business plan. Specific responsibilities include: considering our competitive position, driving strategic progress and ensuring alignment with stakeholder requirements, and resource and priority planning. The Committee meets monthly, and additionally as required, and has delegated day-to-day responsibility for delivering the ESP to the Management Forum. Significant discussions held at the Committee are reported to the Board, as relevant, by Hideo Kawafune, the Head of Sustainability Strategy and the Chief Risk Officer.

Management Forum

Chaired by the Head of Sustainability Strategy, the Forum brings together the workstream leads to discuss delivery of the ESP's objectives and to ensure business and regulatory requirements are met. Specific responsibilities include: project planning and monitoring of progress, early identification and management of issues and risks and assessing operating model impacts. The Forum meets monthly, and additionally as required, and reports to the Steering Committee.

Workstreams

The four workstreams are led by functional specialists, who are responsible for progressing the ESP in their areas of expertise. The workstream leads report to the Management Forum, with the oversight of the Head of Sustainability Strategy, who also specifically considers the strategic and governance aspects of these activities.

❷ Strategy

The Board has approved, and oversees, our Sustainability Strategy, which is based on four strategic ambitions:

- Our clients: Supporting our clients in their journey to sustainability.
- Our solutions: Recognised as a leading provider of green and sustainable finance solutions.
- Our business: Embed sustainability management and culture in all aspects of our business operations.
- Our operations: Proactively pursue in-house greenhouse gas emission reductions with an aim to be net zero by 2030 or sooner (Scope 1 and 2)

We recognise that this Strategy will need to be developed as we grow our capabilities and knowledge and in response to external developments. For instance, over the next year, we expect to expand our existing product offering beyond our already marketed range of green and sustainability linked loans to include other ESG factors, such as social loans.

We believe that the training of our people will be central to our efforts to embed sustainability management and culture in our business. During the year, we held our first Green Week, which comprised a number of webinars and other forms of communication through which we provided information to our people on climate change issues, risks and opportunities and the initiatives we are taking, internally and with clients, to create a more sustainable future. We have also trained our front office teams on use of our Climate Change Ratings Assessment (CCRA) tool through which we collate the data needed to evaluate our customers' exposure to physical and transition risk. Further information on the CCRA is shown on page 19.

Our approach to climate change continued

❸ Risk management

We have implemented, and continue to develop, a holistic risk management approach to identify, assess, monitor, measure, report and escalate climate change risks. This approach is illustrated and explained more fully below:

Risk Register

This is our internal taxonomy of key risks and controls, which we use to inform the ongoing identification of risks. We have recognised that climate change risks are inherent across the spectrum of our risk categories and no longer regard them as a standalone risk. This has allowed us to consider how climate change risk impacts each of our risk drivers and the control environment in place to manage them.

Top 10 risks

Climate Change risk features in our Top 10 emerging risks framework. This is considered monthly by the Executive Committee and quarterly by the Risk Committee.

Climate Change Ratings Assessment tool

Through the CCRA tool we have assigned a climate change score, reflecting the transition and physical risk profile, to the vast majority of our obligors. Transition risk represents the financial risks/losses that arise from the process of adjusting towards a low carbon economy. This includes changes in technology, social preferences and policy. Physical risk represents the financial risks or losses that arise as a result of climate and weather-related events, such as heatwaves, floods, droughts and sea level rises. The combination of the CCRA and broader consideration of ESG risks in transactions will enable us to understand our clients' energy transition plans. This information is included in our transaction origination documentation and is assessed by the Credit Department as part of our credit approval process.

Stress testing

We use stress testing and scenario analysis to determine the physical and transition climate change impact on our credit portfolio over a 25–30-year period.

Our scenario analysis approach is broadly aligned with the Bank of England's Climate Biennial Exploratory Scenario (announced in November 2020) and through it we analyse the stress impact on our portfolio of three scenarios: No additional policy (>4°C temperature change), Early Policy Action (<2°C) and Late Policy Action (<2°C). Risk adjusted portfolios are created to calculate the Climate Risk Value at Risk (VaR) impact of each scenario. The stress scenarios inform the potential credit impact of climate change in the existing portfolio over the long term, and the results are included within the ICAAP document.

Key risk and key performance indicators

We have established quantitative measures to monitor the four pillars of our Sustainability Strategy. These metrics will be developed as we enhance our understanding of the climate change risks facing our clients and their ability to manage or mitigate them.

Risk assessment results

Through our risk identification and assessment process, we have determined that transition risk and, to a lesser extent, physical risk are two important risk elements in our credit portfolio. We have started monitoring higher-risk obligors with a focus on high-transition risk sectors, including energy and automotive. We are also seeking to differentiate between clients in higher-risk sectors but with well-developed transition plans and those with less well-developed plans. We will use this information to manage our risks and opportunities.

We have also completed an assessment of the physical risks of our own operations based on the location of our offices and SMBC Group data centres in North America, the UK and Japan. For all regions where a data centre is located, we have in place primary and secondary sites, so any disruption to a primary data centre is mitigated by having a secondary data centre in place. Amongst our sites, Japan has the highest risk of physical climate change, while North America has a relatively moderate risk and the UK a relatively low risk. Based on this assessment we consider the overall physical risk of our operation to be low.

How we monitor and mitigate risk

As a global financial group, SMBC Group is working to strengthen its structure for managing environmental and social risks. The Group has established loan policies for sectors that are likely to have a significant impact on the environment and society. These policies have also been implemented in SMBC Group companies, which include our Bank. These policies are publicly available on SMFG's Management of Environmental Risks website. The following policy topics are considered most likely to have an impact on climate change: coal-fired power generation; oil and gas; coal mining; palm oil plantations; and deforestation. SMBC Group has internal procedures and training to support the implementation of these policies.

SMBC Group has also adopted the Equator Principles, a set of principles for determining, assessing and managing social and environmental risks in finance to large-scale development projects. SMBC Group has established the Environment & Social Analysis Department (ESAD) to assess the social and environmental risks in accordance with the Principles. Our marketing departments liaise closely with ESAD on relevant transactions.

Our approach to climate change continued

Through the initiative of the SMBC Group EMEA Division, of which the Bank is a part, SMBC Group is also a signatory to the Poseidon Principles. As a signatory to these Principles, the Group commits to measuring the carbon emissions of our lending portfolio of financed ships and, starting from December 2022 at the latest, disclose the alignment of its portfolio with the trajectory to achieve a 50% reduction in emissions by 2050 vs 2008 (the United Nations – International Maritime Organization target).

Informed by our ongoing assessment of our customers' climate change risks, over the coming year we intend to develop our suite of management information so that we better understand the climate change risk across our lending portfolio. For instance, analysis is underway to understand our exposure to TCFD-identified sectors in order to facilitate management monitoring. We anticipate providing more information on this in future reports.

4 Metrics and targets

This is our first TCFD disclosure and we are taking steps to develop our climate metrics and targets and expect to disclose these more fully in next year's report. We have started monitoring a proportion of high climate change risk obligors in our portfolio on a country, sector, obligor, departmental and Bank-wide basis. Thresholds are being established to trigger escalation to management in the event of an adverse risk movement in the risk profile. In order to ensure that green and sustainable finance business is a growing part of our portfolio, lending targets are being set for such facilities. Information on our greenhouse gas emissions in the year are shown in the Streamlined Energy and Carbon Report.

Streamlined Energy and Carbon Reporting

The UK Government's Streamlined Energy and Carbon Reporting (SECR) policy was implemented on 1 April 2019, when the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 came into force. We meet the SECR qualification criteria in the UK.

We have opted to use the Operational Control boundary definition to define our carbon footprint boundary. The reporting period for compliance is 1 April 2020 to 31 March 2021. Included within that boundary are Scope 1 and 2 emissions, as well as Scope 3 emissions from gas, electricity, company fleet, grey fleet and waste disposal in the UK. The GHG Protocol Corporate Accounting & Reporting Standard and the UK Government's GHG Conversion Factors for Company Reporting have been used as part of carbon emissions calculation.

The results show that our total energy use and total gross greenhouse gas (GHG) emissions amounted to 8,157,789 kWh and 1,166 tonnes of CO_2 equivalent (CO_2e), respectively, in the 2020/21 financial year in the UK. We have chosen 'Tonnes of CO_2e per full time employee (FTE)' as an intensity metric as this is an appropriate metric for the business. As a result, the intensity metric for the financial year was 0.8 tCO_2e per FTE.

The comparison with the previous financial year is as follows:

	2020/21	2019/20
Total energy use	8,157,789 kWh	9,799,460 kWh
Total net GHG emissions	1,166 tonnes of CO_2e	1,823* tonnes of CO_2e
Tonnes of CO_2e per FTE	0.8 tonnes	1.45* tonnes

* We had reported 2,909 tonnes of CO_2e and 2.31 tonnes, respectively, in the previous financial year's report. These figures have since been updated following an external review which revealed that a large proportion of the Bank's electricity use was procured from renewable sources.

We have invested over many years to reduce carbon emissions on our properties. Within the 2020/21 financial year, we implemented changes in several locations as follows:

- Operating times on air conditioning units have been adjusted.
- Office floors were shut down during extended periods of low attendance due to the COVID-19 pandemic.
- The number of vending machines has been reduced, and vending machines and hot/cold water dispensers have been replaced with more energy efficient models.

Section 172(1) Statement

The Directors recognise the significance of the Bank being a public interest entity and the need to ensure that our business is run for the benefit of all our stakeholders.

The Directors are aware of their duty under section 172(1) of the Companies Act 2006 to act in the way in which they consider, in good faith, would be most likely to promote the Bank's success for the benefit of our members as a whole and, in so doing, to have regard (amongst other matters) to:

(a) the likely consequences of any decision in the long term;
(b) the interests of our employees;
(c) the need to foster our business relationships with suppliers, customers and others;
(d) the impact of our operations on the community and the environment;
(e) the desirability of us maintaining a reputation for high standards of business conduct; and
(f) the need to act fairly as between members.

This section describes how the Directors have had regard to the above matters when performing their duty under section 172(1). As we are a wholly owned subsidiary of SMBC, fairness between members is less relevant to the Directors' discussions than the other section 172(1) matters.

Our stakeholders
Engaging with our stakeholders

Our stakeholders

In addition to the section 172(1) matters, the Board considers the views and interests of a wider set of stakeholders. Our key stakeholders, which were unchanged during the year, are those that most materially impact our strategy or are impacted by it. They are: our customers, our workforce, our environment and society, the markets and our regulators, our suppliers and SMBC Group.

The Board delegates to management the authority to run the business on a day-to-day basis and to execute the strategy approved by the Board. Interactions with stakeholders therefore take place with the Board and Directors and with employees in the context of the strategies and policies set by the Board and its Committees. As necessary, significant interactions with our employees and our other stakeholders are reported to the Board and Committees.

Reflecting the working environment in the year, the Board's and management's engagement with stakeholders was primarily through virtual means. Although the Board recognises the importance of face-to-face interaction, it was nonetheless able to use virtual meetings to interact directly with stakeholders. In certain cases, virtual meetings have proved to be more effective than physical meetings, such as in townhall meetings where more of our people were able to attend than would have been possible in an office environment.

> 'Customer First' is a core value of our Bank and we seek to build our brand by being a reliable and trusted partner to our customers.

Our customers

'Customer First' is a core value of our Bank and we seek to build our brand by being a reliable and trusted partner to our customers. Senior management visit customers regularly in order to enhance our relationships with them and to understand their views and needs. Having surveyed many of our key customer relationships in 2019, we understand that our customers value our long-term approach, flexibility, responsiveness and the concept of us working in partnership with them. Our customers also told us that they would like us to focus on more strategic solutions and being more coordinated across SMBC Group globally. The Board has recognised this feedback and, in response, has enhanced the strategy setting process by including representatives from the boards of SMBC Group's other principal subsidiary companies in EMEA in the Board's annual strategy discussion meeting. The purpose of this change was to facilitate a common understanding of the strategy amongst those boards and to focus on how SMBC Group companies can work together more effectively for the benefit of our customers.

The outcomes from the customer survey also directly informed the creation and adoption of our Purpose Statement, 'to be a trusted partner for the long term', as we felt it reflected the voice of our customers and offered an authentic view of us as a firm overall, and how we approach our business.

The Board, Risk Committee and Executive Committee have continued to focus on the ways in which we have conducted our business. These meetings receive key risk and performance indicators setting out adherence to internal policies and procedures related to our conduct. These include customer outcomes, the quality of our marketing materials and customer expressions of dissatisfaction.

Our workforce

The Board recognises that our colleagues are central to us achieving our sustainable growth objective and we regard our people as our key resource.

The Board has considered the three methods for workforce engagement set out in the UK Corporate Governance Code and has decided to adopt alternative arrangements to understand the views of our workforce. Engagement with our workforce is achieved through a number of means, including regular consideration by the Board and Remuneration and Human Resources Committee of matters impacting our workforce, including our diversity and inclusion initiatives, Remuneration Policy and significant human resources initiatives. During the year, there has been regular senior management engagement with our people through surveys, regular emails sent by the Chief Executive Officer on matters such as our business strategy and performance, and townhall meetings with members of the Board.

The independent non-executive Directors also engage directly with our people through various means. Examples in the year included: a virtual townhall meeting with the employees of our Paris Branch at which our employees were invited to ask questions on all aspects of our activities, a panel discussion to mark International Women's Day, an event to mark the third anniversary of Niji (our employee-led LGBT+ network) in partnership with our newly formed Black Employees & Allies Network and receiving presentations from participants on our leadership programmes.

+ Read more about how we supported and engaged with our employees over the last year in response to the COVID-19 pandemic **on page 8**

Examples of engagement

Culture survey

During the year, the Board considered the results of a repeat survey of our workforce undertaken by an independent third party on our culture. Encouraging progress was noted in all areas, with corresponding improvements in the recorded levels of employee commitment and engagement. Our workforce also expressed more positive sentiments towards the Bank in relation to the work we have done with respect to diversity and inclusion.

The Board has considered the results of this survey and has identified that, given the positive momentum at an organisational level, further action is now required to evolve culture at the departmental and local level. Our broader cultural development work will continue to focus on implementing new ways of working, both in response to the COVID-19 pandemic and returning to the office, in preparation for occupancy at our new regional headquarters in 2022.

Black Employees & Allies Network

In November, the Board met members of the Black Employees & Allies Network, which has been established to advocate and support a more inclusive and representative workplace for Black people throughout SMBC Group. As part of the Network's reverse mentoring initiative, the Board heard from a number of Black employees about their personal and often moving experiences both inside and outside the workplace. On the same day, the Board held a discussion with an advisory firm setting out race and ethnicity diversity and inclusion best practices for boards and companies. During the year, we also conducted a series of anonymous listening groups, inviting colleagues from different racial and ethnic backgrounds to provide insight and feedback on their experience of inclusion at the Bank.

As a result of these engagements, we have asked a group of employees, reporting to our Diversity and Inclusion Steering Committee, to consider race and ethnicity issues within the Bank. The Board will oversee this work through its quarterly review of diversity and inclusion matters.

Our stakeholders continued

Our environment and society

The Board recognises our role in society and the importance of contributing positively to the societies in which we operate.

The Board receives regular updates on the activities of the EMEA Sustainability Programme, through which we are coordinating our response to the business impact arising from climate change and on aspects of our ESG work.

Our UK tax affairs are managed in a manner that is consistent with SMBC Group's philosophy on corporate social responsibility. SMBC Group recognises its duty to shareholders to minimise business tax inefficiency, but also its social responsibility to pay all applicable taxes in the countries in which it does business. During the year, the Audit Committee and Board reviewed and approved our UK Tax Strategy, which can be found on our website.

+ Read more about our response to climate change **on pages 14 to 20**

The markets and our regulators

We are required to comply with our regulators' rules and to ensure the integrity of the financial markets in which we operate. We recognise that failure to comply with these requirements will impact our ability to carry out our business and serve our customers.

The Board recognises the importance of open and proactive dialogue with our regulators. During the year, the Bank's supervisors from the Prudential Regulation Authority attended a Board meeting to present their annual Periodic Summary Meeting feedback letter. Individual Directors and members of senior management engage regularly with our regulators at the Prudential Regulation Authority and Financial Conduct Authority through continuous assessment and other meetings.

In addition to this formal engagement, during the year the Directors received regular updates on financial services regulation and participated in training on developments in global financial sanctions and cyber risk.

+ Read more about how we conduct our activities on **pages 29 to 33**

Our suppliers

We rely upon external suppliers to provide certain products or services that assist us in the running of our business. Suppliers are engaged for a variety of reasons, including the provision of expertise or resource that we may or may not possess ourselves.

When we engage suppliers, we seek assurances from them that they will comply with applicable laws and regulations as well as our own policies. We apply a rigorous due diligence process when onboarding new suppliers and regularly monitor their activities.

Our suppliers expect the timely payment of invoices and that we will manage our relationships with them with due care and attention. We have processes in place to ensure that invoices are paid promptly and the Board and Executive Committee receive periodic reports on our supplier payment periods. In addition, during the year, the Board considered a report on the steps being taken to develop our procurement function, which we believe will enhance the way in which we engage with our suppliers.

Our UK supplier payment statistics in the year, with prior year comparatives, are as follows:

	Average days to pay	Paid in 30 days	Paid in 60 days	Paid later than 60 days
April 2020 to March 2021	27	77%	15%	8%
April 2019 to March 2020	30	75%	16%	9%

During the year, and through the implementation of streamlined invoice approval processes, we were able to improve our ‘average days to pay’ and ‘paid in 30 days’ in the year. There was also a reduction in the year in the total number of invoices received, primarily due to the impact of the COVID-19 pandemic.

SMBC Group

As part of SMBC Group, we share and contribute to the realisation of the Group’s Mission and Vision. We also seek to assist SMBC Group to expand and consolidate its global franchise. A Service Level Agreement framework for the provision and receipt of services between the Bank and SMBC Group is in place.

The Board comprises senior representatives of SMBC Group, including Hirofumi Otsuka, the Head of SMBC’s Planning Department, Global Banking Unit, who sits on the Board as a non-executive Director.

The intention is that our independent non-executive Directors visit SMBC’s Head Office in Tokyo annually in order to meet the SMBC board and senior management representatives. Due to the travel restrictions in place during the year, this was not possible in 2020. However, Hirofumi Otsuka regularly updated the Board on significant matters impacting SMBC Group, and his participation in the Board’s decision-making ensures that Board decisions are consistent with the needs and expectations of our shareholder.

Our stakeholders continued

The Board and culture

Our business is based on trust and integrity, and the Board recognises that in order to earn the trust of our stakeholders and achieve our objective of long-term sustainable growth, we must exercise the highest standards of business conduct. This objective is underpinned by our Board approved Culture and Purpose Statements and aligned to the global SMBC Group Mission, Vision and Sustainability Statement.

Our Culture and Purpose Statements, underpinned by our core values, provide a framework of expected behaviours for our employees, which in turn drives appropriate conduct to deliver the best outcomes for all our stakeholders. At its quarterly meetings the Board considers metrics assessing overall behaviours across the Bank against the five components of the Culture Statement and other metrics relating to staff conduct.

Our Culture Statement has five components:

1. Provide an excellent service to customers and colleagues through collaboration, teamwork and a sense of shared purpose.
2. Build our brand by being a reliable and trusted partner to our customers and contribute positively to the societies in which we operate.
3. Protect our customers and markets by conducting our business in a transparent, prudent and compliant manner.
4. Treat each other with respect and integrity and embrace diversity in all its forms.
5. Be focused, creative and proactive in evolving our business to meet new challenges.

This Statement is aligned with the corporate values established by SMBC Group globally, which also guide our behaviours. These are:

1. Integrity – as a professional, always act with sincerity and a high ethical standard.
2. Customer first – always look at it from the customer's point of view, and provide value based on their individual needs.
3. Proactive and innovative – embrace new ideas and perspectives, don't be deterred by failure.
4. Speed and quality – differentiate ourselves through the speed and quality of our decision-making and service delivery.
5. Team 'SMBC Group' – respect and leverage the knowledge and diverse talent of our global organisation, as a team.

Board decision-making

The Board and decision-making

Board meeting agendas are set by the Chair in consultation with the Company Secretary. Agendas are structured to allow the Board sufficient time to discuss all matters, with a particular focus on those items requiring approval or strategic consideration. The Chair and Company Secretary also work together to ensure that all items requested by the Board in its discussions are duly addressed by management. At the start of each year the Board puts in place a forward planner which is designed to assist the drafting of meeting agendas.

When members of management present proposals to the Board and its Committees for decision, they are required to state in the supporting documentation the factors and stakeholder groups relevant to the matter.

On an ongoing basis, the Board and Committees consider a range of management information that enables them to understand matters relevant to our stakeholders. This information includes key performance indicators on targets set by the Board, such as on diversity and financial performance, key risk indicators and metrics related to the conduct of our activities.

The Board has defined a principal decision as one that is of strategic importance to the Bank, or which could materially impact any of our stakeholders. The following case studies provide some examples of how stakeholder interests have been considered in principal decision-making.

Transfer of a business line

During the year, the Board approved the transfer of the operations in the maritime finance sector of our Paris Branch's Transportation Department to the Paris Branch of SMBC EU AG. This decision was taken in order to ensure that SMBC Group could continue to serve this Department's customers without disruption following the UK's departure from the EU.

In approving this transfer, the Board recognised that the Department's employees would remain employed by SMBC Group. The Board then had to consider whether the proposed transfer price reflected the fair value of the Department's operations and that the Bank paid the correct amount of tax arising on the transfer. We appointed an independent third party to assist the Board in determining the valuation of this business and to ensure that the Board correctly understood the tax implications of the transfer.

Transfer of people

During the year, the Board agreed that we would develop integrated control and support functions with our affiliated company, SMBC Nikko Capital Markets. This involved the transfer to us of 189 people from SMBC Nikko in various control and support functions, who in many cases now provide services to SMBC Nikko. Of the 189 colleagues who transferred to the Bank, 140 did so on 1 April 2021 and 49 on 1 July 2020.

In making this decision, the Board considered the impact on the individuals to be transferred, the regulatory implications and the views of our shareholder. The Board also received confirmation that no significant concerns had been raised by the affected employees through the employee consultation process. The Board gave particular focus to the impact of the transfer on our risk management and control environment and the extent to which we had sufficient resources to oversee the additional employees.

The Board concluded that the transfer was consistent with the shareholder's expectations and in line with our strategy. The Board has continued to be kept apprised of matters related to this transfer.

Board decision-making continued

The other key matters considered by the Board in the year are set out below.

Strategy and business

- Approving the Purpose Statement.
- Approving the Corporate and Sustainability Strategies.
- Deep dive reviews of areas of strategic business focus.
- An ongoing focus on the way in which we were responding to the COVID-19 pandemic, considering in particular the working arrangements of our people.
- Reviewing the status of significant project activity.
- Approving an updated Financial Crime Risk Appetite Statement.
- Approving an updated Slavery and Human Trafficking Statement.

People

- Approving, on the recommendation of the Nomination Committee, the appointment of Katsufumi Uchida and Hirofumi Otsuka as Directors.
- Approving, on the recommendation of the Remuneration and Human Resources Committee, the Remuneration Policy and Gender Pay Report.
- Reviewing the results of an employee culture survey performed by a third party and ongoing consideration of culture and conduct metrics.
- Reviewing the Diversity and Inclusion Strategy and our ongoing initiatives.
- Reviewing the Human Resources Strategy.

Risk management, recovery and resolution

- Considering the annual Periodic Summary Meeting feedback letter from the Prudential Regulation Authority.
- Approving, based on recommendations from the Risk and Audit Committees, the capital and liquidity adequacy documents and the recovery and resolution documents.

Financial and accounting

- Approving, based on a recommendation from the Audit Committee, the annual report and financial statements, Pillar 3 disclosures and UK Tax Strategy.

Governance

- Considering the results of the internally facilitated Board effectiveness review.
- Approving our change of name and conversion to a public limited company.
- Approving revised terms of reference of the Board and Board Committees.

Non-Financial Information Statement

This section is our Non-Financial Information Statement as required by sections 414CA and 414CB of the Companies Act 2006. We have a number of policies and processes which govern the way in which we carry out our business. Information on the principal policies is shown below. Any breaches to these policies may be self-reported or identified through ongoing review activity, including those performed by the Compliance Monitoring Function or Audit Department. Breaches are taken seriously and depending on the nature of the breach may result in an assessment for disciplinary action.

Description of policies	Review processes	Outcome	Further information
Environmental matters			
Our main **environmental policies** are described in the 'Our approach to climate change' section of the Strategic Report.			Pages 14 to 20
Employees			
Through the **Whistleblowing 'Speak Up' Policy** we encourage our people to escalate concerns about breaches of our policies or legal and regulatory requirements, including bullying and harassment. Amongst the various internal and external channels available to raise concerns, staff are also able to report concerns, in confidence, to an independent firm working in partnership with us.	The Audit Committee receives an annual report from the Whistleblowers' Champion on the independence, autonomy and effectiveness of our whistleblowing procedures. The Policy is reviewed annually by the Chief Compliance Officer.	The nature of whistleblowing reports received is reviewed quarterly by the Audit Committee, together with the time taken to resolve reports. Relevant information on whistleblowing systems and controls is also considered. All employees have access to the 'Speak Up' Policy and receive regular training on it.	–
The **Employee Handbook**, which all employees are required to sign up to, contains our terms and conditions of employment and includes our requirements for employees to comply with all regulatory and legal requirements. This includes our Codes of Practice on matters such as **equal opportunities**, **working with respect** and **work-life balance**.	The Handbook is updated regularly to reflect changes in our internal policies and external legal and regulatory requirements and market developments.	Following a review of market practice, during the year we updated the Handbook to include a Transgender Policy, which includes how we support employees who are transitioning, and extended our Maternity and Adoption Policies to include surrogacy arrangements. During the year, we have published an agile working toolkit to assist our employees during the extended period of remote working.	Page 12

Non-Financial Information Statement continued

Description of policies	Review processes	Outcome	Further information
Employees			
The **Health and Safety Policy** sets out how we comply with relevant health and safety legislation and ensure that our offices are safe places to work or visit.	This Policy is reviewed at least annually and where there has been a significant change in the workplace.	The Board receives an annual report of health and safety incidents, with regular reporting through the year to the Operational and General Risk Committee. As required, we commission a third party to review our health and safety arrangements to ensure we are following all necessary health and safety requirements.	–
Human rights			
The **SMBC EMEA Anti-Slavery Policy** and our **Slavery and Human Trafficking Statement** set out the ways in which we seek reasonable assurance that none of our customers, business partners, suppliers and other third parties are involved in the commission or facilitation of slavery and/or human trafficking.	The Anti-Slavery Policy is owned by the Head of Financial Crime and this is reviewed annually. The Board reviews and approves the Statement yearly.	The Statement was enhanced in the year to better articulate the due diligence processes we follow to prevent modern slavery in all aspects of our business, including in our own supply chain.	–
Within our Data Governance Privacy Framework a number of policies, including our **Personal Data Protection Policy**, set out the roles and responsibilities that ensure we handle personal data correctly and in line with legal obligations. The framework is supported by comprehensive information security policies including those associated to cyber threats.	The data governance policies are owned by the Head of our Data Governance Team, who reviews them annually. We have a process in place, including a requirement for contractual obligations, that ensures that other firms who process data on our behalf do so in line with our requirements.	All employees are required to undertake annual mandatory training on data privacy matters.	–

Description of policies	Review processes	Outcome	Further information
Social matters			
The **Credit Policy** states that we will not extend any credit that may damage our reputation. Through the Policy we seek to employ best practice and avoid carrying out business that may breach acceptable social standards, including any laws or regulations.	The Chief Risk Officer owns this Policy. The Policy is subject to annual review.	With a few limited exceptions, all transactions must be approved by our Credit Department, which ensures that the requirements of the Credit Policy are adhered to. As necessary, customer transactions and/or relationships are reviewed by the Financial Crime and Reputational Risk Committee.	Page 62
The **Pre-Sales**, **Sales** and **Post-Sales** Policies set out the process through which we ensure adherence to regulatory requirements when dealing with our customers, ensuring they are treated fairly.	These Policies are owned by the Chief Compliance Officer and are reviewed regularly.	These policies and the overall framework of compliance policies are regularly reviewed in line with both regulatory change and the growth and development of our business. All relevant individuals are trained on the content of the Policies.	Page 65
The **Customer Voice Policy** documents how we seek to identify, record, investigate, respond to and escalate expressions of dissatisfaction. Where errors are a consequence of our actions, we will seek to ensure that our customers do not suffer any detriment.	This Policy is owned by the Chief Compliance Officer and is reviewed annually.	The Executive Committee and Risk Committee receive information on customer complaints. During the year, the level of complaints was very low and all were managed in line with our Policy to the satisfaction of our customers. Our people are trained on the content of these policies to ensure they know how to respond should a customer express dissatisfaction.	Page 22

Non-Financial Information Statement continued

Description of policies	Review processes	Outcome	Further information
Social matters			
Our policy is that all new or potentially **new products or services are subject to a risk assessment and monitoring process**. This process is intended to ensure that we can offer that product or service in a way that complies with all regulatory and legal requirements and meets our customers' expectations.	The Product Approval Committee meets regularly to consider all new product and services applications. This Committee is attended by functional specialists from around the Bank.	A record is maintained of all matters relevant to the approval of products and services. All products and services are reviewed periodically to ensure they remain appropriate for the purpose originally intended, with the highest-risk products and services reviewed annually.	Pages 59 and 65
The **Market Abuse Policy** describes our arrangements for complying with market abuse regulatory requirements, setting out the rules and standards of conduct to which all staff must adhere.	The Chief Compliance Officer owns this Policy and it is reviewed regularly. Any significant changes to the Policy must be approved by the Chief Executive Officer.	The Board, Risk Committee and Executive Committee receive regular reports on employee adherence to the Policy. Our people are trained on the content of the Policies and frequent reminders on conduct are issued.	Page 65
The **SMBC EMEA Anti-Money Laundering and Combating Terrorist Financing Policy** provides the framework of controls and customer due diligence processes to prevent money laundering and fraud and to combat the financing of terrorism. This is supported by other policies, such as the SMBC EMEA Sanctions Policy, which documents the processes through which we seek to comply with all applicable sanctions regimes.	The Chief Compliance Officer and Money Laundering Reporting Officer owns these policies. They are subject to a minimum annual review and more frequent reviews are undertaken to ensure compliance with changing legislation.	All employees complete mandatory anti-money laundering training annually. The Money Laundering Reporting Officer reports to the Risk Committee annually on the operation and effectiveness of the arrangements we have in place to counter the risk of the Bank being used to further financial crime.	Pages 59 and 65

Description of policies	Review processes	Outcome	Further information
Anti-corruption and anti-bribery			
The **SMBC EMEA Anti-Bribery and Corruption Policy** sets out our requirements and principles through which seek to prevent bribery and corruption.	The Policy is owned by the Head of Financial Crime and is reviewed annually.	All employees complete mandatory training on anti-bribery and corruption matters.	Page 65
Principal risks			Page 35
Business model			Page 6
Explanation of amounts in the financial statements			Pages 9 and 10
Non-financial performance indicators			Pages 12, 20 and 25

Risk management and controls

Risk strategy and risk appetite

Our risk strategy is designed to support the corporate strategy and the achievement of sustainable growth over the long term. The risk strategy comprises four pillars, being the foundations upon which we seek to achieve our strategic objectives: business model (sustainable growth), maintaining solvency and liquidity, conducting business (in accordance with all regulatory requirements) and maintaining operational resilience.

We use risk appetite to define the broad-based level of risk we are able and willing to take in carrying out our business. Our risk appetite is arranged according to the four strategic pillars and ensures formal management identification and consensus about the strategic level risks we are facing and, as such, is a key tool for managing the business.

Risk management framework

We adopt a three lines of defence model in order to communicate clear accountabilities and to achieve and assure overall effective risk governance, management and assurance, which reflects and reinforces our internal control framework. Further details on the three lines of defence model are set out in the Risk Review starting on page 57 and this information is incorporated by reference into this Report.

Risk profile

At the year-end, our risk profile was within the overall tolerance established by the Board. The risk profile relative to risk appetite is reported monthly at the Executive Committee and quarterly at the Risk Committee.
Our appetite for market risk, conduct risk, operational risk and other non-financial risks is low. As a consequence, the main risks we proactively acquire are credit risk and liquidity risk.

Principal risks and uncertainties

We are exposed to certain risks and uncertainties in conducting our business, and our principal risk categories are classified as on the next page.

Principal risks		
Type	**Description**	**How risks are managed**
Credit	The risk of any losses we may incur due to reduction or loss of the value of assets (including off-balance sheet assets) arising from any credit events, such as the deterioration of a borrower's financial standing.	Credit risk is identified, managed and monitored individually and in aggregate. A number of approaches are used such as limits, indicators and stress testing. Example key indicators include earnings volatility, obligor, sector and country concentration limits and credit quality metrics.
Liquidity	The risk that we cannot meet our liabilities, unwind or settle our positions as they become due.	Liquidity risk is identified, managed and monitored using a number of approaches such as limits, indicators and stress testing. Example key indicators include liquidity coverage ratio, net stable funding ratio and survivability period metrics under stress scenarios.
Market	The risk that movements in interest rates, foreign exchange rates or stock prices will change the market value of financial products, leading to a loss.	We use Value at Risk (VaR) to a 99% confidence interval and a one-day time horizon to measure and control market risk alongside other relevant metrics.
Conduct	The risk of our actions, inactions or behaviours resulting in poor outcomes for our customers and stakeholders, damaging the integrity of the financial markets or undermining effective competition.	We assess our conduct and culture against our Culture Statement using a suite of targeted metrics.
Operational	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risks.	Operational risk is managed with a view to maximising resilience and continuity whilst maintaining acceptable levels of residual risk. Example key indicators used to monitor, measure and report operational risk include operational risk losses and an operational risk profile score underpinned by diverse operational risk indicators.
Model	The potential loss resulting from errors in the development, implementation or use of internal models.	Model risk is managed through the model risk management framework, which comprises four key components: model governance & control, model management, model development and independent model validation.
Other non-financial	As a result of our activities we assume other potential risk impacts such as reputational, conduct and others which we manage within the overall policy framework.	A number of appropriate approaches are used to manage other non-financial risks. Further details are contained in the Risk Review.

Risk management and controls continued

Specific risks to our business, reviewed through our top emerging risk process on a monthly basis, include: deterioration in the macroeconomic environment, cyber risk, IBOR transition, climate change, sanctions and anti-money laundering and conduct risks.

The mitigating actions for these risks are diverse and include stress testing, capital and liquidity impact analyses, monitoring of key management information and metrics and staff training.

+ Read more about the risks arising from Brexit **on page 7**

+ Read more about the risks arising from COVID-19 **on page 9**

+ Read more about climate risks **on pages 18 to 20**

Benchmark interest rate reforms

We continue to run an extensive IBOR transition programme to prepare for the discontinuation of certain reference rates, such as the London Interbank Offered Rate (LIBOR), and the adoption of alternative risk-free reference rates (RFRs). The adoption of RFRs will affect a broad range of transactions that use LIBOR to determine the amount of interest payable, such as in loans, deposits, bonds or derivative products. We are taking the necessary preparations to be able to offer RFR products in line with regulatory and market expectations and to transition existing LIBOR based transactions to an RFR alternative.

The implementation of RFRs also introduces a number of risks, any of which could have an adverse impact on our business and financial position. Further information on these risks is shown over the page.

Conduct risk

The lack of client engagement and disclosures, if not adequate, could impact existing and new business. There is the risk that we receive a higher than normal number of complaints or disputes from dissatisfied clients as a result of actions we are taking to prepare for the discontinuation of LIBOR and implementation of RFRs.

Regulatory risk

There is a risk that our regulators are unsatisfied with our level of preparedness for a smooth transition to RFRs.

Reputational risk

Our reputation may be damaged if we fail to adequately prepare and transition from LIBOR to RFRs in an effective, smooth and timely manner.

Operational risk

In preparation for the implementation of RFRs, we are required to update a number of our IT systems, some of which are reliant upon the development support of external vendors. In addition, we are required to update a number of our operational processes and to ensure that payments are made on the basis of RFRs. Furthermore, we will be required to ensure that all relevant contractual documentation contains relevant provisions for RFRs. If not undertaken correctly, we could be exposed to litigation risk.

Financial risk

There is the risk that RFRs create a change in the value of existing transactions and that we will be required to hold additional capital against those assets. Basis risk (the spread between LIBOR and RFR) may have a cost impact. We will centrally manage the incremental market risk that the transition to RFRs may give rise to and this may include the use of hedging.

Legal risk

There is the potential for basis risk to arise between linked products due to different operational conventions in the loan and derivative markets. If products cannot be effectively aligned we may be exposed to litigation risk for our role in the transition process or more generally for mis-selling or unfair treatment of customers.

+ Read more on the impact of the benchmark reforms in **Note 13 of the financial statements**

Approved by the Board of Directors

Keiichiro Nakamura
Chief Executive Officer
5 July 2021

Board of Directors
The right skills and experience

The Directors who were in office during the year and up to the date of signing the financial statements were:

Laurel Powers-Freeling

Chair and independent non-executive Director
Appointed to the Board:
1 July 2015

Laurel has extensive experience in the financial services sector gained from a number of senior executive roles, including Director of Corporate Strategy & Planning at Prudential plc, Group Finance Director of Lloyds Abbey Life, Managing Director of Lloyds Bank's Wealth Management Division, Chief Executive of Marks & Spencer's financial services business and Executive Director of American Express Europe. She has served as a non-executive director of the Bank of England, a number of financial services companies and of the Royal Academy of Music and the National Joint Registry. Laurel's other current board appointments are: Uber UK (Chair), Cambridge University Health Partners (Chair), Chapter Zero, Majid Al Futtaim Global Solutions (Chair) and Majid Al Futtaim Leisure, Entertainment & Cinemas.

Keiichiro Nakamura

Executive Director and Chief Executive Officer
Appointed to the Board:
1 May 2020 (as Chief Executive Officer)

Prior to his current role, Keiichiro served on the Board as a non-executive Director from 25 July 2018 to 1 May 2020 and as an executive Director from 2 April 2012 to 3 April 2018. Alongside his role as Chief Executive Officer, he is also Managing Executive Officer and Head of EMEA Division of SMFG and SMBC. Keiichiro is a non-executive director of The Japanese School Limited, Shimano Europe B.V. and of the following SMBC Group companies: SMBC Nikko Capital Markets Limited, SMBC Capital Markets GmbH, SMBC Bank EU AG and JSC Sumitomo Mitsui Rus Bank.

Alan Keir

Independent non-executive Director
Appointed to the Board:
12 October 2016

In his executive career, Alan held a number of senior positions at HSBC, including Group Managing Director of HSBC Holdings plc from 2011 until his retirement in 2016. He is a former board member of the British Bankers' Association, the UAE-UK Business Council and the University of Bradford School of Management Advisory Board. Alan's other current board appointments are HSBC UK Bank plc and Majid Al Futtaim Holdings.

Hideo Kawafune

Executive Director and Chief Operating Officer

Appointed to the Board:
3 April 2018

Hideo has responsibility for corporate planning, human resources and financial reporting matters. He is an Executive Officer of SMBC and serves as a non-executive Director of the following SMBC Group companies: SMBC Nikko Capital Markets Limited, SMBC Bank EU AG, JSC Sumitomo Mitsui Rus Bank, JRI Europe Limited and SMBC Advisory Services Saudi Arabia.

Charlotte Morgan

Independent non-executive Director

Appointed to the Board:
1 September 2017

Charlotte is a Chartered Accountant and Corporate Treasurer. Her executive career included Standard Chartered Group, where she was Head of Corporate Treasury and Tax, and finance roles in a range of banking and financial services businesses. Charlotte has been a non-executive director of FCE Bank PLC and Vice-President of the Association of Corporate Treasurers, where she is currently a member of the Policy and Technical Panel. She is a director of the classical music charities London Sinfonietta and Second Movement.

Hirofumi Otsuka

Non-executive Director

Appointed to the Board:
2 December 2020

Hirofumi is a Managing Executive Officer of SMFG and SMBC and General Manager of SMFG's Planning Department, Global Business Unit and of SMBC's Planning Department, Global Banking Unit. He holds no other appointments.

Board of Directors continued

Stanislas Roger

Executive Director and Deputy Chief Executive Officer

Appointed to the Board:
29 April 2015

Stanislas is a Deputy Chief Executive Officer and Country Head of France and has responsibility for coordinating our asset finance and Western European businesses. He is an Executive Officer of SMBC and is Deputy Head of EMEA Division of SMBC. Stanislas is a non-executive Director of the SMBC Group company SMBC Leasing (UK) Limited.

Katsufumi Uchida

Executive Director and Deputy Chief Executive Officer

Appointed to the Board:
4 February 2021

Katsufumi is a Deputy Chief Executive Officer and has responsibility for coordinating our business in emerging markets and in certain products, including project finance, trade finance and transaction banking. He is also a Managing Executive Officer of SMBC, Deputy Head of EMEA Division of SMBC, Deputy Head of Financial Solutions Division, Wholesale Banking Unit of SMBC, and a Supervisory Board Director of the SMBC Group company JSC Sumitomo Mitsui Rus Bank.

Changes to the Board in the year

Tetsuro Imaeda resigned from the Board on 1 May 2020 and Keiichiro Nakamura was appointed Chief Executive Officer on the same day. Masaki Kambayashi resigned from the Board on 18 May 2020. Hirofumi Otsuka and Katsufumi Uchida were, respectively, appointed to the Board on 2 December 2020 and 4 February 2021.

Board and Committee membership

The Directors' Board and Committee responsibilities at 31 March 2021 were as follows:

Name	Board of Directors	Committees				
		Audit	Nomination	Remuneration*	Risk	Executive
Non-executive Directors						
Laurel Powers-Freeling	C	M	C	C	M	–
Alan Keir	M	M	M	M	C	–
Charlotte Morgan	M	C	M	M	M	–
Hirofumi Otsuka	M	M	–	M	M	–
Executive Directors						
Keiichiro Nakamura	M	–	M	–	–	C
Hideo Kawafune	M	–	M	–	–	M
Stanislas Roger	M	–	M	–	–	M
Katsufumi Uchida	M	–	–	–	–	M

C Chair of Board or Committee

M Member of Board or Committee

* The full name is Remuneration and Human Resources Committee.

On the invitation of the respective Chairs, members of the Board and management team also attend meetings. Further details on this are shown on pages 46 to 51.

The Wates Principles

The Board is committed to maintaining a high standard of corporate governance within the Bank.

For the year ended 31 March 2021, the Board has applied the Wates Corporate Governance Principles for Large Private Companies. Included within this section is a description of how, in practice, the Board has applied the Wates Principles and information on the activities of the Board Committees. Where reference is made to disclosures made elsewhere in this document, these are incorporated by reference.

Principle 1
Purpose and leadership

"An effective board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose."

How we apply this Principle

The Board is responsible for our leadership, direction and control and for ensuring that we comply with our legal and regulatory requirements. Matters reserved for the Board's approval include key appointments, strategy, budgeting, capital and liquidity adequacy, recovery and resolution planning and the financial statements.

The Board has approved a Corporate Purpose Statement, which is for us to be "a trusted partner for the long term". The Board believes that this Statement reflects the relationship-based approach we adopt in carrying out our business for the benefit of our customers and all our stakeholders.

The Board approves a corporate strategy annually. This process involves consideration of high level strategic principles, including those of SMBC Group, a strategy discussion meeting, and review and challenge of the draft and final versions of the strategy document. Our strategy is underpinned by our corporate objectives and culture. Business developments and progress against the strategy are considered by the Board quarterly and by the Executive Committee monthly.

Our corporate strategy and developments in the business are communicated to employees in a variety of ways including regular update emails from the Chief Executive Officer to all employees and through the Bank's intranet.

+ Further information on the Bank's strategy, business model and culture can be found in the Strategic Report **on pages 6 and 26**

Principle 2
Board composition

"Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company."

How we apply this Principle

The Board comprises eight Directors, four of whom are executive and four of whom are non-executive. Three of the non-executive Directors are deemed to be independent. The Board has appointed a separate non-executive Chair and Chief Executive to ensure there is clear division of responsibilities between the leadership of the Board and the executive leadership of the business. The Board believes that its overall size and composition is appropriate, but regularly keeps this under review.

Appointments to the Board are made on the basis of the candidate's fitness and propriety for the role, which includes an assessment of their competencies, skills, experience and values.

During the year, the Company Secretary facilitated a review of the skills and experience of the Board, the results of which were considered by the Nomination Committee. All Directors possess international banking experience and have other individual areas of expertise, including in tax, accounting, strategic development, regulatory compliance, human resources management and risk management. The Nomination Committee concluded that while the current composition of the Board, including its skills and experience profile, was appropriate for the nature, size and complexity of our business, this should continue to be kept under review.

The Board's Senior Management Appointment and Diversity Policy sets out the approach for the selection and appointment of individuals to Board Director and senior executive management positions. This Policy states a target that at least 25% of the Board will be made up of women, while also ensuring an appropriate mix of skills, experiences and competencies on the Board. The Board currently meets this target. During the year, the Board revised this Policy to document that it commits to taking positive action to source applications from Asian, Black and other minority ethnic candidates for Director vacancies.

We put in place a bespoke training and development programme for all new members of the Board and senior management. The purpose of such programmes is to give those individuals the information they need for them to become as effective as possible in their new role within the shortest practicable time. In addition, ongoing training is provided to the Directors on significant topics.

During the year, the Board and its Committees undertook a review of their own effectiveness, facilitated by the Chair and Company Secretary. The Board review was structured on the Wates Principles and included an assessment of effectiveness against aspects relevant to each of those Principles. The overall effectiveness review identified many elements where the Board and Committees are effective in carrying out their work, but highlighted that they had the potential to become more effective through development of the Directors' training programme, enhancing the quality and scope of management reporting and improvements in interactions with the management team. The Board has discussed these findings and will put in place measures to address them. A follow-up review will be undertaken in 2021.

The Wates Principles continued

Principle 3
Director responsibilities

"The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge."

How we apply this Principle

All Directors have in place a role description and have individual regulatory responsibilities in accordance with the Senior Managers Regime. These responsibilities are documented within the individuals' Statement of Responsibilities and the Management Responsibilities Map.

The Board meets quarterly, and additionally when necessary. Between these meetings there is regular contact between the executive and non-executive Directors. The Board has delegated certain responsibilities to its Committees as documented in their terms of reference. The Board and the Audit, Risk, Nomination and Remuneration and Human Resources Committees are each Chaired by an independent non-executive Director.

The Board has delegated to the Chief Executive Officer responsibility for the management and day-to-day running of the Bank. The Chief Operating Officer assists the Chief Executive Officer in this role by participating in and overseeing all key decision-making in the Bank.

All Directors have access to the advice of the Company Secretary and have the right to seek independent professional advice at the Bank's expense in the furtherance of their duties.

All Directors are required annually to complete a questionnaire through which any potential conflicts of interest are identified. In addition, the independent non-executive Directors are required to seek the approval of the Bank and SMBC in advance of them being appointed to the board of any other company in order to ensure that any potential conflicts of interest with the Bank can be identified and, as necessary, managed.

The Audit Committee has responsibility for managing the Bank's relationship with our external auditor, ensuring that at least every 10 years the external audit will be considered for re-tender. The Audit Committee has also established a policy to ensure that we comply with the Financial Reporting Council requirements related to the involvement of our auditor on non-audit engagements.

Principle 4
Opportunity and risk

"A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks."

How we apply this Principle

Opportunity

Medium- and long-term strategic opportunities are identified through the annual corporate strategy development process. Any expansion of the business into new areas is considered in conjunction with our risk appetite. Short-term strategic opportunities are considered by the executive management team and reported to the Board on a regular basis.

Risk

The Risk Management and Controls section of the Strategic Report on pages 34 to 37 sets out the key risks to which we are exposed. Our key risks are considered by the Risk Committee and the Executive Committee.

Principle 5
Remuneration

"A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company."

How we apply this Principle

Our approach to remuneration is set out in a Remuneration Policy, which is approved annually by the Remuneration and Human Resources Committee and the Board. With some limited exceptions, this Policy does not apply to employees of SMBC seconded to the Bank, the remuneration of whom is governed by rules established by SMBC in Japan.

It is our intention that remuneration will support our long-term aims and that it will seek to encourage and support long-term stability and sustainability, particularly of our capital base, and promote steady growth and keen risk awareness. All employees are eligible to participate in the annual performance-related bonus scheme with variable pay outcomes determined by the performance of the Bank, Departments and the individual. In order to encourage a culture of collaboration, we operate a team-based bonus award scheme, a key objective of which is to emphasise the shared purpose of all colleagues across SMBC Group in EMEA, including the Bank.

The Remuneration and Human Resources Committee has the authority to adjust the bonus pool and individual bonus payments at any stage in the annual pay review process, from the calculation and determination of the fund itself to the final distribution.

We have uploaded our UK Gender Pay Report to the Government's Gender Pay Gap Service portal. For a second year, we have also published Gender Pay Reporting in France in line with legislation. The results of both Reports have been distributed to all employees, who were also invited to join a panel session with senior leaders to discuss the findings of this year's report and ask any questions. We remain committed to improving our gender pay gap.

Principle 6
Stakeholder relationships and engagement

"Directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions."

How we apply this Principle

Information on the way in which the Board considers stakeholders' interests is set out in the Section 172(1) statement in the Strategic Report on pages 21 to 26.

Board Committees

The Board has terms of reference, which contains a schedule of matters reserved for its attention. These terms of reference, together with those for its Committees, were reviewed and updated in the year. Where expedient to do so, the Board and its Committees hold combined meetings.

During the year, the Board met 10 times and the principal activities undertaken are set out on pages 27 and 28.

Board Committees

The Board has established the Committees shown in this section to provide oversight and make recommendations on the matters delegated to them by the Board. Details of the roles and responsibilities of the Board Committees and their respective memberships and activities are also shown. These are detailed more fully in terms of reference, which are reviewed regularly and updated as required. The Chair of each Board Committee provides a report on the Committee's activities at each Board meeting, including any matters being recommended by the Committee for Board approval.

Audit Committee

The Audit Committee comprises the non-executive Directors.

On the invitation of the Chair, meetings are also attended by members of management, including Keiichiro Nakamura and Hideo Kawafune, the Co-Heads of the Audit Department and the Head of Finance and Control. A representative of our external auditor, KPMG, also attends meetings.

The Audit Committee is responsible for considering matters related to the preparation and audit of the annual report and accounts, internal financial controls, engagement with the external auditor and taxation matters. It is also responsible for safeguarding the independence and overseeing the performance of the Audit Department, considering the results of Internal Audit and Credit Review activity and for the appointment and dismissal of the Co-General Managers of the Audit Department. The Committee is also responsible for assessing the effectiveness of the Bank's whistleblowing arrangements.

During the year, the Audit Committee met nine times and its principal activities were as follows:

- Reviewing the annual report and accounts and recommending these to the Board for approval.
- Assessing the appropriateness of key management judgements and estimates, including the assumptions underlying the IFRS 9 model and post model adjustments.
- Considering significant developments in financial and non-financial reporting.
- Considering various climate disclosure matters as set out on page 14 to 20.
- Overseeing the external auditor's independence and objectivity.
- Approving a revised Policy on Auditor Independence to reflect revised Financial Reporting Council Ethical Standards.
- Considering the effectiveness of the internal controls and risk management arrangements in relation to financial reporting and the ongoing work to strengthen those arrangements.
- Reviewing our regulatory reporting arrangements and the associated assurance processes.
- Approving, for recommendation to the Board, the UK Tax Strategy.
- Considering the tax aspects related to the transfer of one of our business lines to another SMBC Group company.
- Approving the annual work plans of the Audit Department's Internal Audit and Credit Review Groups and monitoring their resourcing arrangements.
- Reviewing the work undertaken by Internal Audit and Credit Review to assess the effectiveness of the Bank's internal control environment and credit risk management arrangements.
- Reviewing the assurance arrangements adopted in preparation of the Bank's Pillar 3, ICAAP and Internal Liquidity Adequacy Assessment (ILAA) documents.
- Reviewing the integrity, independence and effectiveness of the whistleblowing systems and controls.

Board Committees continued

Executive Committee

The Executive Committee is Chaired by Keiichiro Nakamura, with the other members being Hideo Kawafune, Stanislas Roger, Katsufumi Uchida and members of the Bank's senior management team.

The Executive Committee is responsible for the supervision and management of our daily operations.

The Executive Committee meets monthly and reports to the Board of Directors. The non-executive Directors receive a copy of the papers and minutes of all Executive Committee meetings.

During the year, the Executive Committee met 12 times and its principal activities were as follows:

- Receiving reports from senior management on major business activities.
- Considering the status of significant project work, including the IBOR transition programme and preparations for a future office move.
- Reviewing business performance and drivers of overall financial performance.
- Reviewing the status of risk.
- Considering major information technology projects and cyber security matters.
- Considering our diversity and inclusion and culture initiatives.

Nomination Committee

The Nomination Committee comprises the independent non-executive Directors, Keiichiro Nakamura, Hideo Kawafune and Stanislas Roger.

On the invitation of the Chair, meetings are also attended by the Head of Human Resources.

The Nomination Committee is responsible for assessing and recommending candidates to the Board to fill Board, Senior Manager Function and certain other senior executive management level vacancies. The Committee is also responsible for matters related to Board composition, performance and skills and for reviewing Board and senior management succession plans.

During the year, the Nomination Committee met three times and its principal activities were as follows:

- Approving, for recommendation to the Board, the appointment of a new non-executive Director, Hirofumi Otsuka, and a new executive Director, Katsufumi Uchida.
- Considering the adequacy of succession plans for key roles in the Bank, encompassing all Director, Senior Manager Function, Department Heads and other senior positions.
- Considering the Senior Management Appointment and Diversity Policy and the composition of the Board.
- Considering the results of a Board skills assessment.

Remuneration and Human Resources Committee

The Remuneration and Human Resources Committee comprises the non-executive Directors.

On the invitation of the Chair, meetings are also attended by members of management, including Keiichiro Nakamura, Hideo Kawafune, the Head of Human Resources and, as necessary, the Chief Risk Officer.

The Remuneration and Human Resources Committee is responsible for overseeing the development and implementation of our remuneration policies and practices, which includes specific responsibility for recommending the Remuneration Policy to the Board for approval. The Committee also considers other significant remuneration and human resources matters, such as approval of remuneration for Material Risk Takers and the bonus fund cap calculation.

During the year, the Remuneration and Human Resources Committee met five times and its principal activities were as follows:

- Reviewing and approving, for recommendation to the Board, the Remuneration Policy, Pillar 3 remuneration disclosures and Gender Pay Report.
- Reviewing and approving key remuneration policies, including the Cash and Phantom Share Scheme Rules and Bonus Cap Calculation Methodology, and the approach to the identification of Material Risk Takers.
- Reviewing and approving the Remuneration Strategy.
- Reviewing and approving the Bank’s remuneration response in light of the COVID-19 pandemic.
- Reviewing and approving the results of the remuneration review for Material Risk Takers, including the timing of deferred bonus payments.
- Reviewing and approving the annual remuneration returns to the regulators.
- Considering regulatory changes impacting remuneration.

Board Committees continued

Risk Committee

The Risk Committee comprises the non-executive Directors.

On the invitation of the Chair, meetings are also attended by members of management, including Keiichiro Nakamura and Hideo Kawafune, the Chief Risk Officer, the Chief Compliance Officer, the General Counsel and the Co-Heads of the Audit Department.

The Risk Committee is principally responsible for considering the Bank's risk management structure and systems, the main areas of risk faced by the Bank, the ICAAP document, the ILAA document, the Recovery and Resolution Plan, and regulatory engagement and compliance.

During the year, the Risk Committee met seven times and its principal activities were as follows:

- Considering the impact of the COVID-19 pandemic on our credit, capital and liquidity positions and on operational risk and resilience.
- Considering the stress testing scenarios to be used for the IFRS 9 impairment and ICAAP capital calculations.
- Reviewing risks relative to the Board approved risk appetite.
- Reviewing our capital and liquidity positions.
- Reviewing our credit risk, including the level of provisions, significant transactions undertaken and the market environment.
- Reviewing, for recommendation to the Board, the Bank's ICAAP, ILAA, and Recovery and Resolution Plan documentation.
- Reviewing the risks, and associated mitigation plans, arising from Brexit.
- Reviewing and approving the annual report from the Money Laundering Reporting Officer.
- Reviewing the financial crime prevention systems and controls, the Bank's Financial Crime Risk Appetite Statement and the culture of financial crime compliance.
- Reviewing matters related to the management of conduct risk, including adherence by employees to internal policies and procedures and regulatory developments.
- Considering the results of the annual review of risk management systems and internal controls.
- Assessing the risk adjustments to our variable compensation arrangements.
- Reviewing our cyber security arrangements.

Annual review of internal controls

The Directors, through the Risk Committee, consider annually the adequacy and appropriateness of our risk management framework. Based on the annual review undertaken in respect of the year ended 31 March 2021, the Directors have formed the view that our risk management framework is adequate.

In addition, through the Risk Committee, the Directors undertake an annual review of the effectiveness of our system of internal controls. At its June 2021 meeting, the Risk Committee received confirmation from the Bank's Risk Management Department that management has taken or is taking the necessary actions to remedy any weaknesses identified through the operation of the Bank's framework of controls. This review considers the results of an attestation process under which the key risks facing the Bank, along with related key controls, are assessed and recorded by the heads of business units and functions.

In addition to this review, at its June 2021 meeting the Audit Committee received the results of a review undertaken by management of the effectiveness of the internal controls and risk management arrangements in relation to financial reporting.

On the basis of these assessments, the Board considers our system of internal controls to be appropriate. Our system of internal controls is designed to identify, evaluate and manage, rather than eliminate, our risks. Key components of the framework that we have in place to provide assurance to the Board on the effectiveness of internal controls are set out in the Risk Review starting on page 57.

Approved by the Board of Directors and signed by order of the Board

Keiichiro Nakamura

Chief Executive Officer
5 July 2021

The Directors' Report

The Directors present their Report and the audited financial statements for the year ended 31 March 2021.

Details of other information that is relevant to the Directors' Report is shown below where applicable. This information is incorporated into the Directors' Report by reference.

An indication of likely future developments is included in the Strategic Report. No important events requiring disclosure have occurred since the year-end.

Company name and status

On 30 September 2020, we re-registered as a public limited company and changed our name from Sumitomo Mitsui Banking Corporation Europe Limited to SMBC Bank International plc.

Issue of shares

To facilitate our re-registration as a public limited company, we issued 50,000 shares of £1 each on 31 July 2020 to SMBC.

Directors

The Directors at the date of signing this Report and the changes to the Board in the year are set out in the Governance Report on pages 38 to 40.

Statement of corporate governance arrangements

The statement of corporate governance arrangements is on pages 42 to 45.

Directors' indemnities and insurance

During the financial year, the independent non-executive Directors, Laurel Powers-Freeling, Charlotte Morgan and Alan Keir, benefited from qualifying third party indemnity provisions. These provisions remain in place at the date of this Report. In addition, we have directors' and officers' liability insurance in place in respect of certain losses or liabilities to which our officers may be exposed in the discharge of their duties.

Financial instruments

We use financial instruments extensively as an integral part of our normal business activity. These instruments expose us to a number of financial risks, including credit, market and liquidity risk. We have in place well-defined policies and procedures to mitigate, identify, measure and control these risks in line with our risk management objectives.

As part of the management of these risks we use derivatives to hedge interest and foreign exchange exposures on non-trading positions (primarily on fixed rate loans). Further information on financial instruments can be found in the following notes to the accounts: note 3(e): Significant accounting policies, financial instruments – initial recognition and subsequent measurement; note 4: financial risk management; note 5: fair value of financial instruments; and note 13: derivative financial instruments and hedge accounting.

Dividends

No dividends have been declared or paid in the financial year ended 31 March 2021 and no final dividend is recommended by the Board.

Overseas offices

At the date of signing this Report, we had one operational Branch which is established in Paris.

Charitable and political donations

Details of the Bank's charitable donations and activities are set out in the accompanying Strategic Report on page 13. The Bank made no political donations or contributions during the year (2020: nil).

Employee matters

Information on the way in which the Directors have engaged with employees is set out in the Strategic Report in the Our People section starting on page 12 and in the Section 172(1) Statement on page 23.

Information on our policies in respect of the employment, training, career development and promotion of disabled persons is also set out in the Our People section of the Strategic Report.

Engagement with suppliers, customers and other stakeholders

Details of the way in which we have engaged with our suppliers, customers and stakeholders is set out in the Section 172(1) Statement of the Strategic Report on pages 21 to 26.

Streamlined Energy and Carbon Report

The Streamlined Energy and Carbon Report is set out on page 20.

Research and development

Our marketing departments develop new products and services in the ordinary course of their business. Our policy is that any new or potentially new product or service is subject to a risk assessment and monitoring process.

The Directors' Report continued

Going concern

The Directors believe that the Bank has adequate financial resources and is well placed to manage its business risks successfully despite the current uncertain outlook for the global economy and the banking sector, especially in light of the current and potential future impact of the COVID-19 pandemic. In addition, the Directors believe the Bank will be able to continue in operation and meet its liabilities, taking into account its current position and the principal risks faced, over a period of at least 12 months.

In making this assessment, the Directors have considered a wide range of detailed information relating to present and future conditions, including projections of profitability, liquidity and capital requirements and resources. They determined that the principal risks the Bank currently faces are those arising from the COVID-19 pandemic and post-Brexit complications, although other risks are also considered.

This belief is based on consideration of a wide range of information including the following:

- The results of the Bank's three-year liquidity planning assessment. This includes consideration of the COVID-19 pandemic and post-Brexit complications along with other significant risks.
- The results of the Bank's three-year capital planning assessment. This includes consideration of the COVID-19 pandemic and post-Brexit complications along with other significant risks.
- The results of the Bank's capital and liquidity stress testing, including consideration of the impact of the COVID-19 pandemic and post-Brexit complications as key risks.

  The economic scenarios for the capital stress included:
  - UK and EU recession: post-Brexit complications which hamper recovery and significantly increase non-performing loans when government COVID-19 supporting measures are phased out.
  - global recession: global unrest due to shortage of and access to COVID-19 vaccines.
  - Japan recession: the Olympic Games are cancelled, and failure of a robust fiscal consolidation plan leads to a downgrade of Japanese Government Bonds and SMFG.

  The economic scenarios for the liquidity stress included:
  - UK/EU Market Wide: financial market disruption occurs throughout the UK and the European financial sector.
  - Japanese Market Wide: Japan recession resulting in downgrades of Japanese Government Bonds, impacting the Bank's credit worthiness.
  - SMBC Group Idiosyncratic: severe stress affecting SMBC Group resulting in SMBC withdrawing from overseas business.
  - Combined Scenario: EU/UK or Japan Recession combined with an SMBC Group idiosyncratic event.
  - Reverse stress test: reverse stress testing measures the sensitivity of the combined scenario to quantify what is our liquid asset buffer capacity.

  These stress scenarios result in a significant increase in credit impairments, but the Bank remains above overall minimum capital and liquidity requirements throughout the stress period.
- Details of the Bank's three-year business strategy (profit and loss and balance sheet) forecasts.
- Details of the Bank's approach to managing risks.
- Consideration of a number of other related factors including consideration of a Keep Well Deed under which the Bank and SMBC agree to certain financial arrangements, including the obligation of SMBC to maintain tangible net worth in the Bank at all times sufficient to cover the Bank's obligations arising through any of its business activities.

Based on the foregoing, the Directors conclude that the Bank has adequate resources to continue operations for a period of at least 12 months from the date of these financial statements, and therefore it is appropriate to continue to adopt the going concern basis.

Disclosure of information to auditor

Each person who is a Director of the Bank as at the date of approval of this Report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Bank's auditor is unaware; and
- the Director has taken all the steps that he or she ought to have taken as a Director in order to make him/herself aware of any relevant audit information and to establish that the Bank's auditor is are aware of that information.

Auditor

Pursuant to section 485 of the Companies Act 2006, we appointed our existing auditor, KPMG LLP, as our auditor for the fiscal year beginning 1 April 2019. This appointment was made following completion of an audit tender process, which was undertaken in line with the requirements of Statutory Auditors and Third Country Auditors Regulations 2016. KPMG LLP have indicated their willingness to continue in office. A resolution to reappoint KPMG LLP as the Bank's auditor will therefore be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors and signed by order of the Board

Mark Bradley
Company Secretary
5 July 2021

Statement of Directors' responsibilities in respect of the Strategic Report, the Directors' Report and the financial statements

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of its profit or loss for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report and a Directors' Report that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Chair of the Board

Laurel Powers-Freeling

Executive Directors

Keiichiro Nakamura
Hideo Kawafune
Stanislas Roger
Katsufumi Uchida

Non-executive Directors

Alan Keir
Charlotte Morgan
Hirofumi Otsuka

Risk review

Risk strategy and risk appetite

Our risk strategy is designed to support the corporate strategy and the achievement of sustainable growth over the long term. The risk strategy comprises four pillars, being the foundations upon which we seek to achieve our strategic objectives: business model (sustainable growth), maintaining solvency and liquidity, conducting business (in accordance with all regulatory requirements) and maintaining operational resilience.

Pillar 1: Business model (sustainable growth)

- We generate revenue as a direct result of taking credit risk through our lending portfolio. We have an active appetite for well-controlled credit risk and a limited appetite for market risk.
- We ensure that our pricing for risk is appropriate for maintaining a sustainable business.
- We seek to limit the volatility of our earnings to ensure that under a moderate (1 in 10 years) stress we will not make a loss.
- We intend to grow our sustainable finance business and help customers to transition to a low carbon economy. We will manage the material sustainability and climate change risks within our portfolio and own operations.

Pillar 2: Maintaining solvency and liquidity

- We aim to ensure that we are robust from a capital and liquidity perspective, in excess of regulatory minimum and risk appetite levels.
- In addition to controlling earnings volatility, we need to manage more extreme stresses (1 in 1,000 years), to ensure we are capitalised in line with regulatory expectations.
- We maintain sufficient cash and liquid assets to cover plausible but extreme stresses. We will consider the key liquidity risks and ensure that the balance sheet is robust to cover the resulting stresses.
- Resolvability is demonstrated through the maintenance of a liquidity structure that can plausibly support the Solvent Wind Down Plan.

Pillar 3: Conducting business

- Through the strong management of our business, we will ensure that we do not, through action or inaction, cause an adverse outcome for customers, suppliers, regulators and/or our wider stakeholder group and that we do not adversely impact our reputation.
- We seek to manage our business at all times with the aim of meeting the applicable financial crime regulatory requirements of all bodies and countries within which we operate.
- We will seek to emphasise our 'Customer First' value through fair and transparent dealings with our customers. We aim to minimise regulatory/compliance risk by meeting both the spirit and letter of all applicable regulation.
- Our people and culture are key strengths in achieving sustainable growth, guided by our five values.
- We wish to maintain a balance between the emphasis on team rather than individual, and individual accountability. We want to maintain a 'Customer First' focus, whilst ensuring that there is a strong and embedded risk sensitivity and conservatism.

Pillar 4: Maintaining operational resilience

- Our systems, processes and infrastructure should have strong market standard defences and be able to withstand plausible operational risk scenarios such as cyber attacks, supplier failure, natural disasters, pandemics and terrorist activity.
- This will include actionable recovery plans such as Business Continuity Plans, Disaster Recovery Plans and incident management that minimise recovery times and limit disruption. We should ensure that critical services can be maintained during resolution.

Risk review continued

Risk management objectives

Our risk management objectives are:

- to ensure our risk appetite, as articulated in strategic statements and quantitative risk appetite measures, is observed and maintained in the pursuance of our strategic objectives;
- to maintain a risk appetite that maximises risk/return whilst ensuring that we maintain adequate capital at all times;
- to ensure that we have prudent levels of liquidity in place to fund our operations even under stressed conditions;
- to maintain fair and ethical relationships with all our customers and stakeholders;
- to manage and minimise risk that we assume as a consequence of our business strategy, for instance, operational risk and conduct risk;
- to maintain an adequate and effective control environment; and
- to ensure adherence to the letter and spirit of laws and regulations governing our business.

Segregation of duties: Roles and responsibilities in the management of risk

Three lines of defence

We have adopted the three lines of defence model. This approach separates the ownership and management of risk from the functions that oversee risk and the function that provides independent assurance:

First line of defence –
Functions that own and manage risk

Second line of defence –
Functions that oversee risk

Third line of defence –
Functions that provide independent assurance

First line

Senior management in the first line of defence are ultimately responsible for the risks and controls that fall within their area of responsibility and are required to establish their own risk appetite measures at departmental level. Each department proposes individual business unit risk tolerance statements and thresholds in the context of its own strategy, taking into account our overall risk management framework and corporate strategy. This approach is designed to ensure that risk appetite is cascaded down to those areas where risk is taken.

Second line

The Risk Management Department, Compliance Department and Credit Department are collectively our second line of defence. These departments are independent from the business areas that generate risk and operate within a governance framework that allows them to exercise professional judgement and make recommendations in an effective and impartial manner.

Third line

The third line of defence comprises the Internal Audit function, which provides independent assurance through: (a) the review of the activities and results of the first and second lines of defence; and (b) ensuring that the arrangements and structures of the first and second lines of defence are appropriate and that those involved are discharging their roles and responsibilities effectively.

Audit Department comprises an Internal Audit Group and a Credit Review Group. The objective of Internal Audit is to provide reasonable assurance to the Board, management and other stakeholders that an effective internal control environment has been established to protect the assets, reputation and sustainability of the Bank. In order to achieve this objective, the Internal Audit Group conducts audits and provides related services using a risk-based approach and through meeting the Chartered Institute of Internal Auditors (CIIA) Standards and following the Guidance on Effective Internal Audit in the Financial Services Sector issued by the CIIA.

Additional assurance is provided by Credit Review Group, which is responsible for reviewing the credit grading process. Audit Department acts independently of our business units. The two Co-General Managers of Audit Department report to the Audit Committee at its quarterly meetings.

Executive level risk and control committees

The risk and control committees are executive level committees that have been established to consider certain areas of risk. They are as follows:

Asset and Liability Management Committee

This Committee is primarily responsible for considering market and liquidity risk management issues, and asset and liability management issues, discussing operations and funding policy (including the long-term funding strategy) and reporting on risk appetite and associated risk tolerances, monitoring limits, guidelines and compliance with regulatory requirements.

Credit Risk Committee

This Committee is primarily responsible for discussing a range of credit issues including consideration of credit risk key risk indicators, portfolio analysis, sector analysis and asset allocation, as well as credit risk appetite and associated risk tolerances. It also reviews matters such as our business origination guidelines and issues arising from the ongoing credit review activity performed by the Audit Department Credit Review Group.

Cyber Resilience Committee

This Committee is primarily responsible for driving actions to ensure we meet the expectations set out by our regulators and SMBC Group in the area of cyber and technical resilience. This Committee, the Security Committee and the IT Steering Committee all contribute to our cyber and technical resilience.

Financial Crime and Reputational Risk Committee

This Committee is responsible for overseeing the embedding of our Financial Crime Risk Provisions and Policies, as detailed in the Financial Crime Risk Appetite Statement, and for overseeing the embedding of the approach to reputation risk. The Committee is independent of other Committees but reports to the Executive Committee and Risk Committee on any significant matters that require the attention of those Committees.

Operational and General Risk Committee

This Committee is primarily responsible for examining and discussing matters related to general risk management issues. The subjects discussed include risk issues arising in relation to the overall risk management framework, the risks arising from the implementation of new products and services, and the operational risk management framework and elements thereof, such as information systems issues, information security matters, compliance and regulatory matters and Internal Audit findings.

The Operational and General Risk Committee has established the following sub-committees:

- IT Steering Committee – responsible for examining and discussing IT initiatives and policy and for considering any impacts on our operations in the EMEA region.
- Product Approval Committee – responsible for considering applications for the introduction of new products and services.
- Security Committee – responsible for supporting actions to deliver our Security Strategy to achieve the right balance between keeping ourselves secure and doing customer-focused business at speed.

Risk review continued

Prudential Regulatory Committee

This Committee is primarily responsible for considering a number of prudential risk issues, including examining the governance processes, assumptions and results related to: the Internal Capital Adequacy Assessment Process, recovery and resolution planning, wind down analysis, Internal Liquidity Adequacy Assessment Process, credit risk management models and non-credit risk related models (such as the operational risk model).

Finance Committee

This Committee is responsible for providing control, governance, transparency and challenge around finance matters. Key matters the Committee oversees and considers are: financial reporting, external audit, taxation, regulatory reporting and internal financial control.

Key elements of risk management framework

Shown below are key elements of our approach to risk management.

Risk identification and assessment

The key principles used for risk identification and assessment are:

- to identify the major risks that could impact our 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.

Risk management and monitoring

The key principles for risk measurement and monitoring are to:

- measure risk exposure by loss modelling, enterprise level key risk indicators (KRIs) and scenarios;
- provide an operational risk capital methodology and implementation;
- facilitate senior management understanding of the severity of the risk;
- maintain a record of accepted risk;
- measure risk exposure by loss modelling, enterprise level KRIs and scenarios; and
- ensure appropriate reporting to Board, Risk Committee and Executive Committee of inherent and post-mitigation risk via KRIs to facilitate any mitigation and/or changes to the risk appetite.

Model risk management framework

We have developed a comprehensive model risk management framework which comprises four key components: model governance and control, model management, model development and independent model validation.

Model risk governance and control is based on the framework that clearly outlines roles and responsibilities in accordance with the three lines of defence approach. This allows the alignment of responsibility and authority as well as identifying potential conflict of interests.

Model stakeholders including model users, owners and developers are the first line of defence in the model risk management framework. The Model Validation team acts as the second line providing independent challenge. The third line of defence is Internal Audit, which reviews and provides assurance of the overall effectiveness of the framework.

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 we can adequately understand and quantify risks not only as they currently exist, but as they might develop in times of stress.

Reverse stress testing

We use reverse stress testing to identify and monitor the factors and the stress levels that have the potential to cause our business model to become unviable. Reverse stress testing is an important part of the overall risk management framework and assists management in understanding potential business model vulnerabilities.

Risk appetite setting

Our risk appetite defines the broad-based level of risk that we are able and willing to undertake in pursuit of our objectives.

The key principles of the risk appetite framework are:

- appropriate governance at Board, Risk Committee and Executive Committee level. The risk appetite is set by the Board on an annual basis as part of the strategic planning process and monitored throughout the year;
- risk appetite is driven by both top-down Board leadership and bottom-up involvement of business units;
- to facilitate embedding of risk appetite into the Bank and its culture;
- to evaluate opportunities for appropriate risk taking and act as a defence against excessive risk taking;
- to promote robust discussions;
- to be adaptive to changes in business and market conditions;
- to cover all our activities;
- that Board level appetite changes should drive real changes in risk taking at the business level;
- that risk taking is calibrated to our long-term sustainability; and
- that risk appetite setting is an integral part of our strategy.

The risk appetite framework comprises: risk strategy, risk appetite measures and control measures. Risk appetite is linked to overall business strategy, including assessment of new business opportunities, liquidity, funding and capital planning.

Risk review continued

Risk control and mitigation

We seek to control and mitigate inherent risk as far as possible to ensure that it remains within the risk appetite. Risks are monitored on an inherent (pre-control/mitigation) and residual (post-control/mitigation) basis to assess our risk profile.

The risk control and mitigation we undertake 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 are articulated in the policy framework for the main risk types. Controls that implement the policies are contained in the relevant procedure manuals for our operational processes.

Acceptance List

Certain risks may not be capable of being fully mitigated or in certain circumstances the cost or practicality may be excessive for the size of the inherent risk; these risks are formally accepted by the Bank. To ensure appropriate monitoring and good governance, all outstanding risk acceptances are recorded on an Acceptance List.

Principal risk management

Credit risk (audited)

Credit risk is the risk of any losses we may incur due to a reduction or loss of the value of assets (including off-balance sheet assets) arising from any credit events, such as the deterioration of a borrower's financial standing.

The framework

The Board is ultimately responsible for ensuring that the level of credit risk we take is in line with our 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, who 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.
- The implementation of the Bank's risk appetite framework.
- Ensuring understanding of vulnerabilities through stress testing and reverse stress testing.
- Ensuring our model governance framework is robust.
- Having strong rating systems to measure the risk of individual transactions.
- Regular reviews conducted by Audit Department Credit Review Group to ensure compliance with policies, procedures and market best practice.
- 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 analysis of industrial trends such as the competitiveness of a borrower's products, services and management calibre.

Market risk (audited)

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

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

We use a variety of matrices to measure and control market risk. One such tool is the use of Value at Risk (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 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. We therefore conduct a programme of stress testing using scenarios relevant to the current portfolio composition. The scenarios involve historical stress events such as Black Monday, the Exchange Rate Mechanism crisis and the Lehman crisis in order to assess potential losses.

Interest rate risk on the Banking book is assessed according to regulatory requirements and utilising the SMBC BI Banking Group net basis point value position for the major currencies being EUR, GBP and USD (we do not carry any significant positions in other currencies except JPY). The assessment is based on several market shift scenarios, such as curve steepening, curve flattening and parallel shift, as per the European Banking Authority prescribed scenarios.

Liquidity risk (audited)

Liquidity risk is the risk that we cannot meet our liabilities, unwind or settle our positions as they become due.

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

- The establishment of a clear, consistent risk appetite framework, and its underpinning quantitative risk metrics, early warning indicators and key risk indicators, that is understood across the Bank.
- 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 we are operating within risk appetite, along with other select metrics.
- Regular senior management training.
- Within the governance framework outlined above, we have established a liquidity risk management approach as a core component of the risk management process. The purpose of the framework is to ensure that we successfully follow our strategy while operating within the bounds outlined by the liquidity risk appetite statement.
- We use a variety of internal and regulatory matrices to measure and control liquidity risk.

Risk review continued

Operational and other risks

Operational risk

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 our day-to-day operations and is relevant to every aspect of the business. Operational risk management is embedded through regular engagement with the business, challenge where required, operational risk reporting and training. This is further supported by the execution of the following processes to ensure the operational risk profile is understood and managed: operational risk appetite definition and calibration; operational risk identification, assessment and measurement; control and mitigation; and reporting and escalation.

The ongoing management of operational risk is supported by diverse processes and tools, which include: operational risk event reporting; scenario analysis; a Risk Register; risk acceptance; product approval framework; risk indicators; operational risk capital assessment; third party risk management/outsourcing; and IT and cyber risk oversight.

Operational resilience concerns our ability to prevent, adapt, respond to, recover and learn from operational disruptions.

Operational disruptions to the products and services offered by firms have the potential to cause harm to consumers, market participants and the financial system as a whole. Our main business concerns generating revenue as a direct result of taking credit risk through our lending portfolio, and operational resilience is an important factor in helping us achieve our business plan. This entails preventing, as far as possible, a major operational disruption from occurring. Operational resilience also places a large emphasis on the assumption that a disruption of the business has occurred and our ability to continue, respond and minimise impact to customers and the market. In addition, operational resilience is focused on being able to recover to normal operations. There is also the requirement to demonstrate our resilience to the Board and our regulators.

The operational resilience framework is being developed, enhanced and implemented in accordance with regulatory expectations. Key components include key and important business services and operational resilience assessments. These components complement the operational risk processes, which are largely focused on the prevention of disruption, to introduce the operational resilience concepts of response and recovery to normal operations.

Conduct risk

The risk of our actions, inactions or behaviours resulting in poor outcomes for our customers and stakeholders, damaging the integrity of the financial markets or undermining effective competition.

Conduct risk management is integrated with our wider risk management framework. We identify and assess current and emerging conduct risks across our business lines, ensuring controls are effectively mitigating these risks for all our stakeholders. These conduct risk mitigants include:

- a comprehensive policy and procedure framework providing guidance and setting requirements for various conduct-related risk areas such as, for example, management of conflict of interests, inside information, competition, financial crime prevention and personal account dealing;
- monitoring, reporting and oversight of our adherence to the above policy and procedure framework and regulatory expectations;
- providing advice, communications and training so that our people are familiar with our policy and procedure framework as well as potential or emerging conduct risks and ensuring that an understanding is embedded in all our employees of their individual responsibilities and expected behaviours in relation to conduct risk including the conduct rules;
- promoting a culture of accountability through senior management communication to our people of our Values, Purpose and Culture Statements;
- stringent product and services approval processes and customer complaints analysis; and
- a remuneration and appraisal structure that ensures an individual's remuneration and promotion are at risk if expected levels of conduct are not met.

We are continually challenging the information shared in relation to conduct risk so that senior management can make effective decisions taking conduct risk fully into account.

KPMG

Independent auditor's report

to the members of SMBC Bank International plc

1. Our opinion is unmodified

We have audited the financial statements of SMBC Bank International plc ("the Bank") for the year ended 31 March 2021 which comprise the Statement of comprehensive income, Statement of financial position, Statement of changes in equity, Statement of cash flows, and the related notes, including the accounting policies in note 3.

In our opinion the financial statements:

— give a true and fair view of the state of Bank's affairs as at 31 March 2021 and of its profit for the year then ended;

— have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and

— have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the shareholders on 10 July 2009 (and then reappointed on 31 January 2021). The period of total uninterrupted engagement is for the twelve financial years ended 31 March 2021. We have fulfilled our ethical responsibilities under, and we remain independent of the Bank in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality	$13.5m (31 March 2020:$17m) 4.3% (31 March 2020: 5.6%) of average Profit Before Tax of the last three years	
Key audit matters		**vs 2020**
Recurring risks	Going concern	▼
	Impairment of loans and advances	◄►

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters (unchanged from 2020), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
Going concern *Refer to page 54 (Report of the Directors) and Note 2(a) (basis of measurement).*	**Disclosure quality:** The financial statements explain how the Board has formed a judgment that it is appropriate to adopt the going concern basis of preparation for the Bank. That judgment is based on an evaluation of the inherent risks to the Bank's business model that might affect the Bank's financial resources or ability to continue operations over a period of at least 12 months from the date of approval of the financial statements. The risk most likely to adversely affect the Bank's available financial resources over this period is the impact of the COVID-19 pandemic and in particular, how significant the effects of the impairment of loans and advances could be. The risk for our audit was whether or not the risk of the COVID-19 pandemic is such that it amounted to a material uncertainty that may have cast significant doubt about the ability to continue as a going concern. Had this been the case, then that fact would have been required to be disclosed. The Directors have determined that, as at the reporting date, a material uncertainty does not exist in respect of going concern. We consider that this risk decreased given that COVID-19 is no longer a 'late-breaking' event which was the case in the prior year.	We considered whether these risks could plausibly affect the capital or liquidity position of the Bank in the going concern period by assessing the directors' sensitivities over the level of available financial resources indicated by the Bank's financial forecasts taking account of severe, but plausible, adverse effects that could arise from these risks individually and collectively. Our procedures also included: — **Our COVID-19 knowledge:** We considered the Directors' assessment of COVID-19 related sources of risk for the Bank's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. — **Our sector experience:** We critically assessed the Bank's financial forecasts and capital projections by comparing the Bank's stress scenarios to severe but plausible downside scenarios to external published guidance and our own understanding of the Bank's risk profile. — **Assessing transparency:** Assessing the completeness and accuracy of the matters covered in the going concern disclosure, including those in the report of the Directors, by comparing the overall picture against our understanding of the risks. **Our results** — We found the going concern disclosure without any material uncertainty to be acceptable (2020: acceptable).
Impairment of loans and advances at amortised cost, including off-balance sheet elements Charge: $8.6m (2020: £200.3m) Provision: $219.9m (2020: £276.4m) *Refer to Note 4 (a) (accounting policy and credit risk disclosures).*	**Subjective estimate:** The estimation of expected credit losses ("ECL") on financial instruments involves significant judgement and estimates. The key areas where we identified greater levels of management judgement and therefore increased levels of audit focus in the Bank's determination of ECL are:	Our procedures included: — **Control testing:** We tested the design and implementation and operating effectiveness of the key control over the approval of credit grade assessments which is used as a key input into the PD models. — **Our financial risk modelling expertise:** We involved our own financial risk modelling specialists to assist us in evaluating the appropriateness of the Bank's impairment methodology (including the staging criteria). Our specialists also evaluated the model output by inspecting the corresponding model functionality and independently implementing the model by rebuilding the model code.

	The risk	Our response
	- Model estimations – Inherently judgemental modelling is used to estimate ECLs which involves determining Probabilities of Default ("PD"), Loss Given Default ("LGD"), and Exposures at Default ("EAD"). The ECL global corporates portfolio models (which cover 93% of the total loans and advances to customers), in particular the PD model, and the criteria selected to identify a significant increase in credit risk are the key drivers of the expected credit loss calculation (including staging of assets) and are therefore the most significant judgemental aspects of the Bank's ECL modelling approach. - Economic scenarios – IFRS 9 requires the Bank to measure ECLs on an unbiased forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determining the economic scenarios used and the probability weightings applied, particularly given the continued economic uncertainty as a result of the COVID-19 pandemic. - Lifetime expected credit losses on customer exposures in Stage 3 – The identification and measurement of Stage 3 assets is an inherently judgmental area within the financial statements. These are individually determined based on certain assumptions about the recovery of the asset using various key inputs including the expected future cash flows, discount rates, and expected recoveries from guarantees. - Qualitative adjustments ('PMAs') – Adjustments to the model-driven ECL results were raised by the Bank primarily to address the COVID-19 pandemic impact. Such adjustments are inherently uncertain given the current economic situation and significant management judgement is involved in estimating these amounts. - Disclosure quality – The disclosures regarding the Bank's application of IFRS 9 ECL are key to understanding the key judgements and material inputs to the ECL results. The effect of these matters is that, as part of our risk assessment, we determined that the expected credit loss provisions on loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 4) disclose the sensitivity estimated by the Bank.	— **Our economic scenario expertise:** We engaged our own economic specialists to assess and challenge the appropriateness of the economic scenarios (including macro-economic variables selection) and the probability weights assigned to them. We also assessed the overall reasonableness of the economic forecasts by comparing the Bank's forecasts to our own modelled forecasts, with a particular focus on the UK unemployment rate and EU GDP. We also assessed the reasonableness of the Bank's considerations of the ECL impact resulting from the continuing economic uncertainty due to COVID-19. — **Assessing individual exposures:** For the full population of Stage 3 exposures, we understood the latest developments with each borrower and the basis for classifying and measuring the exposure as Stage 3 and considered whether key judgements were appropriate given the borrower's circumstances. We also re-performed the lifetime expected credit loss calculation, testing key inputs or assumptions including the expected future cash flows, discount rates and expected recoveries arising from guarantees. — **Testing management overlay:** With the assistance of both our financial risk modelling specialists and our economists, we challenged the Bank's approach to recognising PMAs and whether it was appropriate to do so. For the adjustments recognised, we assessed whether the key assumptions used were reasonable by comparing them to other reasonable possible alternatives. We also independently recalculated the PMAs and for a sample of data, agreed it back to source data. — **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining ECL. As part of this, we assessed whether the disclosures of the key judgements and assumptions were made sufficiently clear. **Our results** — We found the ECL charge, provision recognised and related disclosures to be acceptable (2020: acceptable).

3. Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at $13.5m (2020: $17m), determined with reference to a benchmark of average profit before tax (PBT) over the past three years, of which it represents 4.3% (2020: 5.6%).

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole. Performance materiality was set at 75% (2020: 65%) of materiality for the financial statements as a whole, which equates to $10m (2020: $11m). We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

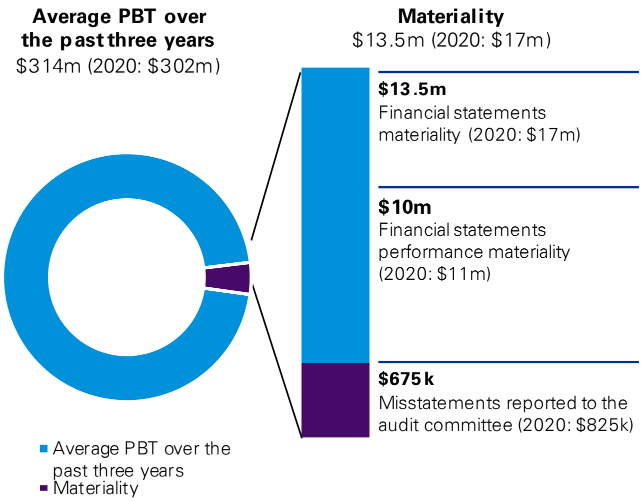
We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding $675k (2020: $825k), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit was undertaken to the materiality and performance materiality levels specified above and was performed by a single audit team.

Certain processes and controls operate at the Bank's Parent locations in Tokyo and New York. We instructed the participating audit teams in Tokyo and New York to perform specific risk-focused audit procedures as follows:

- Control and test of details over credit impairment model inputs; and
- Certain IT general and application controls on systems hosted by the Parent.

We evaluated the work which the participating audit teams performed in these areas. In the conditions of travel restrictions due to the COVID-19 pandemic, we also organised a remote review of the work carried out by the participating audit teams which was in addition to the regular video conference meetings held throughout the year.



4. Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Bank or to cease its operations, and as they have concluded that the Bank's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

An explanation of how we evaluated management's assessment of going concern is set out in the related key audit matter in section 2 of this report.

Our conclusions based on this work:

— we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and

— we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Bank's ability to continue as a going concern for the going concern period.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Bank will continue in operation.

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5. Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. In this risk assessment we considered the following:

- Our meetings throughout the year with the Bank's Chief Risk Officer, General Counsel and Chief Compliance Officer and review of the Bank's compliance reporting summaries;
- Enquiries of operational managers, internal audit and the Board Audit Committee, including obtaining and reviewing supporting documentation concerning the Bank's policies and procedures relating to:
  - detecting and responding to the risk of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks related to fraud.
- The Bank's remuneration policies, key drivers for remuneration and bonus levels;
- Discussions among the engagement team regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. The engagement team includes senior individuals and staff who have extensive experience of working with banks, and this experience was relevant to the discussion about where fraud risks may arise.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, we perform procedures to address the risk of management override of controls and the risk of fraudulent revenue recognition, which we isolate to revenue from upfront loan fees and the risk that management may be in a position to make inappropriate accounting entries.

We did not identify any additional fraud risks.

Our audit procedures included evaluating the design and implementation and operating effectiveness of relevant internal controls, assessing significant accounting estimates for bias as well as substantive procedures to address the fraud risks. These procedures also included identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements. For this risk assessment, matters considered included the following:

- our general commercial and sector experience;
- discussion with the Directors and other management (as required by auditing standards);
- inspection of the Bank's regulatory and legal correspondence;
- inspection of the policies and procedures regarding compliance with laws and regulations;
- relevant discussions with the Bank's external legal counsel; and
- relevant discussions with the Bank's key regulatory supervisors including the Prudential Regulation Authority and Financial Conduct Authority.

As the Bank operates in a highly regulated environment, our assessment of risks of material misstatement also considered the control environment, including the Bank's higher level procedures for complying with regulatory requirements. Our assessment included inspection of key policies in place, understanding the role of the compliance function in establishing these and monitoring compliance and inspection of whistleblowing and complaints reports.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Bank is subject to laws and regulations that directly impact the financial statements including:

- financial reporting legislation (including related companies' legislation);
- distributable profits legislation; and
- taxation legislation (direct and indirect).

We assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Bank is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Bank's licence to operate. We identified the following areas as those most likely to have such an effect:

- Specific aspects of regulatory capital and liquidity;
- Customer conduct rules
- Money laundering
- Sanctions list and financial crime
- Certain aspects of company legislation recognising the financial and regulated nature of the Bank's activities.

Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. If a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

In relation to the legal matters disclosed in note 19 we performed audit procedures which included making enquiries of the Bank's General Counsel. We also made enquiries of external counsel and obtained legal confirmations from the Bank's external counsel.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6. We have nothing to report on the strategic report and the directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

— we have not identified material misstatements in those reports;

— in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and

— in our opinion those reports have been prepared in accordance with the Companies Act 2006.

7. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

— adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or

— the financial statements are not in agreement with the accounting records and returns; or

— certain disclosures of directors' remuneration specified by law are not made; or

— we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

8. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 56, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

9. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Richard Smith (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
6 July 2021

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Statement of comprehensive income For the year ended 31 March 2021

	Notes	2021 USDm	2020 USDm
Interest income[1,2]		**578.6**	878.5
Interest expense		**(238.0)**	(560.6)
Net interest income		**340.6**	317.9
Fees and commissions income		**482.2**	443.4
Fees and commissions expense		**(46.1)**	(72.1)
Net fee and commissions income		**436.1**	371.3
Net trading income		**64.3**	154.1
Operating Income		**841.0**	843.3
Net impairment loss on financial assets	4	**(8.6)**	(200.3)
Personnel expenses	6	**(339.2)**	(270.7)
Depreciation and amortisation	15,16	**(40.8)**	(33.6)
Bank levy		**(0.6)**	(7.0)
Other expenses	6	**(123.6)**	(120.8)
Net operating expenses		**(512.8)**	(632.4)
Other Income		**4.9**	8.7
Profit before income tax		**333.1**	219.6
Income tax charge	10	**(92.2)**	(66.7)
Profit for the year attributed to equity holders of the parent		**240.9**	152.9
Other comprehensive income net of tax:			
Items that will never be reclassified to profit and loss			
Actuarial (losses)/gains on defined benefit scheme		**(27.4)**	13.0
Items that will be reclassified to profit and loss			
Movement in cash flow hedge reserve		**(2.8)**	3.9
Movement in fair value hedge reserve		**0.5**	(0.6)
Other comprehensive income net of income tax		**(29.7)**	16.3
Total comprehensive income for the year		**211.2**	**169.2**

1 All interest income was calculated using the effective interest rate method.

2 Interest income mainly relates to interest recognised on financial assets measured at amortised cost.

The notes on pages 76 to 141 are an integral part of these financial statements.

Statement of financial position
As at 31 March 2021

	Notes	2021[1] USDm	2020[1] USDm
Assets			
Cash and balances at central banks		**24,550.4**	24,726.5
Settlement balances		**39.2**	4,216.8
Loans and advances to banks	11	**3,795.4**	3,802.5
Loans and advances to customers	11	**20,845.5**	22,722.7
Reverse repurchase agreements		**1,732.7**	1,502.5
Investment securities	12	**496.5**	624.9
Derivative assets	13	**1,255.7**	1,776.3
Other assets	14	**540.6**	836.4
Intangible assets and goodwill	15	**39.9**	38.3
Property and equipment	16	**219.1**	45.1
Current tax asset	10	**–**	30.6
Deferred tax asset	10	**20.4**	6.5
Pensions surplus	9	**33.1**	62.2
Total assets		**53,568.5**	**60,391.3**
Liabilities			
Deposits by banks		**23,826.3**	25,681.1
Customer accounts		**22,319.2**	27,648.9
Debt securities in issue	17	**853.6**	–
Derivative liabilities	13	**1,228.8**	1,625.9
Other liabilities	18	**499.3**	826.2
Other provisions		**21.2**	9.6
Current tax liability		**18.3**	–
Deferred tax liability	10	**13.2**	22.3
Total liabilities		**48,779.9**	**55,814.0**
Shareholders' equity			
Called up share capital	20	**3,200.1**	3,200.0
Other reserves		**100.9**	103.2
Retained earnings		**1,487.6**	1,274.1
Total equity		**4,788.6**	**4,577.3**
Total liabilities and equity		**53,568.5**	**60,391.3**

These financial statements were approved by the Board of Directors and signed on its behalf by:

Hideo Kawafune, Director

5 July 2021

1 The risk management policy disclosures on credit, market and liquidity risk described on pages 62 and 63 and marked 'audited' are incorporated into these financial statements by reference.

The notes on pages 76 to 141 are an integral part of these financial statements.

Company registration number 4684034

Statement of changes in equity
For the year ended 31 March 2021

	Share capital USDm	Retained earnings USDm	Capital redemption USDm	Hedge reserve USDm	Fair value reserve USDm	Total USDm
At 1 April 2020	**3,200.0**	**1,274.1**	**100.0**	**3.9**	**(0.7)**	**4,577.3**
Total comprehensive income for the year						
Net profit for the period	**–**	**240.9**	**–**	**–**	**–**	**240.9**
Other comprehensive income, net of tax						
Net gains/(losses) transferred to net profit	**–**	**–**	**–**	**(3.9)**	**–**	**(3.9)**
Actuarial gain/(loss) on defined benefits scheme	**–**	**(27.4)**	**–**	**–**	**–**	**(27.4)**
Change in fair value of assets classified as FVOCI	**–**	**–**	**–**	**–**	**0.5**	**0.5**
Effective portion of changes in fair value	**–**	**–**	**–**	**1.1**	**–**	**1.1**
Total comprehensive income	**3,200.0**	**1,487.6**	**100.0**	**1.1**	**(0.2)**	**4,788.5**
Transactions with owners, recorded directly in equity	**–**	**–**	**–**	**–**	**–**	**–**
Issue of new shares	**0.1**	**–**	**–**	**–**	**–**	**0.1**
At 31 March 2021	**3,200.1**	**1,487.6**	**100.0**	**1.1**	**(0.2)**	**4,788.6**
At 1 April 2019	3,200.0	1,108.2	100.0	–	(0.1)	4,408.1
Total comprehensive income for the year						
Net profit for the period	–	152.9	–	–	–	152.9
Other comprehensive income, net of tax						–
Net gains/(losses) transferred to net profit	–		–	–	–	–
Actuarial gain/(loss) on defined benefits scheme	–	13.0	–	–	–	13.0
Change in fair value of assets classified as FVOCI	–	–	–	3.9	(0.6)	3.3
Total comprehensive income	**3,200.0**	**1,274.1**	**100.0**	**3.9**	**(0.7)**	**4,577.3**
Transactions with owners, recorded directly in equity						
Issue of new shares	–	–	–	–	–	–
At 31 March 2020	**3,200.0**	**1,274.1**	**100.0**	**3.9**	**(0.7)**	**4,577.3**

The notes on pages 76 to 141 are an integral part of these financial statements.

Statement of cash flows For the year ended 31 March 2021

	2021 USDm	2020 USDm
Reconciliation of profit before tax to net cash flows from operating activities:		
Profit for the year before tax	**333.1**	219.6
Adjustments for non-cash items:		
Net impairment loss on financial assets	**8.6**	200.3
Unrealised exchange movements on non operating assets and liabilities	**1,698.8**	(696.9)
Depreciation and amortisation	**40.8**	33.6
Changes in operating assets and liabilities:		
Changes in loans and advances to banks	**8.9**	(891.4)
Changes in reverse repurchase agreements	**(230.2)**	290.9
Changes in derivative financial instruments	**123.5**	(25.2)
Changes in loans and advances to customers	**1,943.4**	(1,404.4)
Changes in other assets	**341.6**	(402.6)
Changes in deposits by banks	**(1,854.8)**	1,468.5
Changes in customer accounts	**(5,329.7)**	9,455.9
Changes in other liabilities	**(324.4)**	601.1
	(3,240.4)	8,849.4
Taxes paid	**(50.5)**	(150.3)
Net cash from operating activites	**(3,290.9)**	**8,699.1**
Purchase of investment securities	**(1,137.0)**	(1,136.1)
Proceeds from sale or redemption of investment securities	**1,269.1**	922.1
Purchase of intangible assets	**(20.9)**	(23.8)
Proceeds from sale of intangible assets	**0.2**	1.4
Purchase of property and equipment	**(199.1)**	(4.1)
Proceeds from sale of property and equipment	**15.1**	6.0
Net cash from investing activities	**(72.6)**	**(234.5)**
Cash flow from financing activities		
Payment of lease liabilities	**(19.0)**	(10.6)
Proceeds from issue of debt securities	**853.6**	–
Repayment of debt securities	**–**	(13.1)
Net cash from financing activities	**834.6**	**(23.7)**
Net (decrease)/increase in cash and cash equivalents	**(2,528.9)**	**8,440.9**
Cash and cash equivalents at start of the year	**28,943.3**	**19,801.1**
Exchange differences in respect of cash and cash equivalents	**(1,824.8)**	701.3
Cash and cash equivalents at 31 March	**24,589.6**	**28,943.3**
Cash and cash equivalents comprise:		
Cash and balances at central banks	**24,550.4**	24,726.5
Settlement balances	**39.2**	4,216.8
	24,589.6	**28,943.3**

Interest received was USD 774.2m (2020: USD 270.4m) and interest paid was USD 885.5m (2020: USD 577.1m).

The notes on pages 76 to 141 are an integral part of these financial statements.

Notes to the financial statements For the year ended 31 March 2021

1. Reporting entity

The Bank is a company domiciled in the United Kingdom. The Bank offers a wide range of wholesale banking products, including: bilateral loans, guarantees, syndicated loans, project finance, aircraft finance, shipping finance, other specialised structured finance, trade finance, leveraged finance, cash management, money markets, foreign exchange, deposit taking and derivatives. The registered office is 99 Queen Victoria Street, London, EC4V 4EH.

During the year, the Bank re-registered from an English private limited company to an English public limited company and changed its name to SMBC Bank International plc under the relevant provisions of the Companies Act 2006. Following completion of the required regulatory and corporate procedures, this was effective on 5 October 2020.

2. Basis of preparation

(a) Statement of compliance

The Bank's financial statements have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006.

(b) Basis of measurement

The Bank's financial statements are prepared on a going concern basis and under the historical cost convention as modified by the revaluation of investments, derivatives and other financial instruments, in accordance with applicable accounting standards and the Companies Act 2006.

The Directors believe that the Bank has adequate financial resources and is well placed to manage its business risks successfully despite the current uncertain outlook for the global economy and the banking sector, especially in light of the uncertainty arising from the COVID-19 pandemic. In addition, the Directors believe the Bank will be able to continue in operation and meet its liabilities, taking into account its current position and the principal risks faced, over a period of at least 12 months from the date of approval of these financial statements.

In making this assessment, the Directors have considered a wide range of detailed information relating to present and future conditions, including projections of profitability, liquidity and capital requirements and resources. They determined that the principal risks the Bank currently faces are those arising from the the COVID-19 pandemic and post-Brexit complications, although other risks are also considered.

This belief is based on consideration of a wide range of information including:

- the results of the Bank's three-year liquidity planning assessment. This includes consideration of the COVID-19 pandemic and post-Brexit complications along with other significant risks.
- the results of the Bank's three-year capital planning assessment. This includes consideration of the COVID-19 pandemic and post-Brexit complications along with other significant risks.
- the results of the Bank's capital and liquidity stress testing, including consideration of the impact of the COVID-19 pandemic and post-Brexit complications as key risks.

  The economic scenarios for the capital stress included:
  - UK and EU recession: post-Brexit complications which hamper recovery and significantly increase non-performing loans when the COVID-19 pandemic government supporting measures are phased out;
  - global recession: global unrest due to shortage of and access to the COVID-19 pandemic vaccines; and
  - Japan recession: the Olympic Games are cancelled and failure of robust fiscal consolidation planning leads to downgrade of the Japanese Government Bonds and SMFG;

The economic scenarios for the liquidity stress included:

- UK and EU market wide: financial market disruption occurs throughout the UK and European financial sector;
- Japanese market wide: Japan recession resulting in downgrade of Japanese Government Bonds impacting SMBC BI's credit worthiness;
- SMBC Group idiosyncratic: severe stress affecting SMBC Group resulting in SMBC withdrawing from overseas business;
- Combined scenario: EU/UK or Japan recession combined with SMBC Group idiosyncratic event;
- Reverse stress test: reverse stress testing measures the sensitivity of the combined scenario to quantify what is our LAB capacity.
- These stress scenarios result in a significant increase in credit impairments, but the bank remains above overall and minimum capital and liquidity requirements throughout the stress period.

- details of the Bank's three-year business strategy (profit and loss and balance sheet) forecasts;
- details of the Bank's approach to managing risks; and
- consideration of a number of other related factors including consideration of a Keep Well Deed under which the Bank and SMBC agree to certain financial arrangements, including the obligation of SMBC to maintain tangible net worth in the Bank at all times sufficient to cover the Bank's obligations arising through any of its business activities.

Based on the above, the Directors conclude that the Bank has adequate resources to continue operations for a period of at least 12 months from the date of these financial statements, and therefore it is appropriate to adopt the going concern basis.

(c) Functional and presentation currency

These financial statements are presented in US Dollars, which is also the Bank's functional currency. US Dollars is the Bank's functional currency as it is the dominant operating currency of the Bank's business. All financial information has been rounded to the nearest one million US Dollars.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(d) Adoption of IFRS

i) New and amended standards and interpretations

Except for the Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7, the Bank has no transactions that are affected by the newly effective standards.

IFRS 9, IAS 39 and IFRS 7 – Phase 2 Amendments relating to Interest Rate Benchmark Reform

The requirements of "Interest Rate Benchmark Reform – Phase 2 – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16" (IBOR Reform Phase 2) is effective for annual periods beginning on or after 1 January 2021 with early adoption permitted. The Bank has elected to early adopt the amendments, which has resulted in additional disclosures. In accordance with exceptions provided in the Phase 2 amendments, the Bank has elected not to restate the prior period to reflect the application of these amendments, including not providing additional disclosures for 31 March 2020.

IBOR Reform Phase 2 provides practical relief from certain requirements in the standards. The relief applies upon transition of a financial instrument from an IBOR to a risk-free rate (RFR).

The Phase 2 amendments provide a practical expedient to update the effective interest rate of a financial instrument before applying the existing requirements in the standards when the basis for determining the contractual cash flows of a financial instrument is changed as a direct consequence of interest rate benchmark reform and is made on an economically equivalent basis. The amendments also provide an exception to use a revised discount rate that reflects the change in interest rate when remeasuring a lease liability because of a lease modification that is required by the interest rate benchmark reform.

Notes to the financial statements For the year ended 31 March 2021 continued

2. Basis of preparation continued

Finally, IBOR Reform Phase 2 provides temporary reliefs that allow the Bank's hedging relationships to continue without any interruption upon the replacement of an existing interest rate benchmark with an RFR. Further details are provided in Note 13.

ii) Future accounting standards

There are no new standards or amendments to standards which will become applicable in the future that are expected to have a significant impact on the Bank.

(e) Significant accounting judgements and estimates

The preparation of the Bank's financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. The most significant areas where judgements and estimates have been used, and the notes where information on these is disclosed, are as follows:

Impairment losses on loans and advances and undrawn loan commitments (note 4)

IFRS 9 impairment involves several areas of judgement as follows:

- Establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining the methodology for incorporating forward-looking information into the measurement of expected credit loss (ECL) and selection and approval of models used to estimate ECL.
- Determination of inputs into ECL measurement model, including key assumptions used in estimating recoverable cash flows and incorporation of forward-looking information.
- Considerations taken into account and calculation of impairment allowances for individually significant assets in Stage 3.

The Bank reviews its problem assets held at amortised cost at each reporting date to assess whether an allowance for credit impairment should be recorded in profit and loss. In determining the expected credit loss, management is required to exercise judgement in defining what is considered to be a significant increase in credit risk and in making assumptions and estimates to incorporate relevant information about past events, current conditions and forecasts of economic conditions. The exercise of judgement in making estimations requires the use of assumptions that are highly subjective and sensitive to the risk factors. Further information and sensitivity analyses of ECL to different economic scenarios is provided in Note 4.

In addition to specific allowances against defaulted loans and advances (Stage 3), the Bank also makes provisions on performing assets based on 12-months expected credit losses (Stage 1) and on assets subject to a significant increase in credit risk based on lifetime expected credit losses (Stage 2).

Pensions (note 9)

The cost of the defined benefit pension scheme is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of the scheme, such estimates are subject to significant uncertainty.

Fair value of financial instruments (note 5)

Where the prices of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from markets where valuations are actively quoted, they are determined using a variety of valuation techniques that include use of mathematical models. The input to these models is taken from observable market data where possible, but where this is not feasible a degree of judgement is required in establishing fair values.

3. Significant accounting policies

This section describes the Bank's significant accounting policies that relate to the financial statements and the notes as a whole. If an accounting policy relates to a particular note, the accounting policy is contained within the relevant note.

(a) Basis of consolidation

Subsidiaries are investees controlled by the Bank. The Bank 'controls' an investee if it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Bank reassesses whether it has control if there are changes to one or more of the elements of control. In the normal course of business the Bank lends to structured entities in a number of different industries. The assessment undertaken by the Bank includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Bank having power over the investee. The financial statements of any subsidiaries would be included in the consolidated financial statements from the date control commences until the date control ceases. At 31 March 2021 the Bank did not control any investees.

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are generally measured at their fair values at the date of acquisition. Goodwill is measured as the excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of the Bank's previously held equity interest, if any, over the net of the amounts of the identifiable assets acquired and the liabilities assumed.

(b) Interest and similar income and expense

Interest income and expense are recognised in the income statement for all financial assets and financial liabilities at amortised cost using the effective interest method. The effective interest method is a method of calculating the cost of a financial asset or liability and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period if appropriate. The application of the method has the effect of recognising income receivable on the instrument in proportion to the amount outstanding over the period to maturity or repayment. In calculating effective interest, the Bank estimates cash flows considering all contractual terms of the financial instrument but, for financial assets, excluding future credit losses. Where it is not possible to otherwise estimate reliably the cash flows or the expected life of the financial instrument, effective interest is calculated by reference to the payments or receipts specified in the contract, and the full contractual term.

(c) Fee and commission income and expense

Fee income relating to loans and advances held at amortised cost is recognised in profit and loss as either an adjustment to the effective interest rate or on an accruals basis as the service is provided. Where a fee is considered to be an adjustment to the effective interest rate, it is recognised as such over the original life of the advance or expected life if this is reliably estimated to be shorter. Where loans and advances are purchased in the secondary market and there is observable evidence that the fair value is higher than the purchase price, then the differential is recognised as profit within fees.

Fees and commissions receivable in respect of all other services provided are recognised in profit and loss when the related services are performed and when consideration is considered receivable. The performance obligations, as well as the timing of when they have been met, are identified, and determined, at the inception of the contract. The Bank's revenue contracts do not include multiple performance obligations. When the Bank provides a service to its customers, consideration is generally due immediately upon satisfaction of a service provided at a point in time or at the end of the contract period for a service provided over time.

Fee and commission expense relates mainly to transaction and service fees, which are expensed as the service is received.

Notes to the financial statements For the year ended 31 March 2021 continued

3. Significant accounting policies continued

(d) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

(e) Financial instruments – initial recognition and subsequent measurement

Financial assets

These include loans and advances to banks and customers and investment securities.

i) Classification, initial recognition and subsequent measurement

Financial assets are classified into the following measurement categories:

- those to be measured at fair value (either through other comprehensive income (FVOCI), or through profit or loss (FVTPL)); or
- those to be measured at amortised cost.

The classification depends on the business model for managing financial assets and the contractual terms of the financial assets' cash flows.

Business model assessment

The Bank makes an assessment of the objective of the business model in which a financial asset is held based on the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related liabilities or expected cash outflows or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity.

The Bank's corporate banking business comprises primarily loans to customers that are held for collecting contractual cash flows. Sales of loans from these portfolios are very rare. The exception to this is the syndications portfolio where the assets are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

Investment securities are largely held for collecting contractual cash flows and selling financial assets with the exception of a small number of debt securities which are held only for collecting contractual cash flows and where sales of such assets would be infrequent.

Contractual terms of financial assets' cash flows

For financial assets to be held at amortised cost, the contractual terms of the financial asset must give rise to cash flows on specified dates that represent solely payments of principal and interest on the principal amount outstanding.

For the purposes of this assessment, principal is defined as the fair value of the financial assets on initial recognition and interest is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Bank considers:

- contingent events that would change the amount or timing of cash flows;
- terms that may adjust the contractual coupon rate, including variable rate features;
- prepayment and extension features; and
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse features).

A prepayment feature is consistent with the solely payments of principal and interest criterion if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for early termination of the contract. Additionally, for a financial asset acquired at a discount or premium to its contractual par amount, a feature that permits or requires prepayment at an amount that substantially represents the contractual par amount plus accrued contractual interest (which may include reasonable additional compensation for early termination) is treated as consistent with this criterion if the fair value of the prepayment feature is insignificant at initial recognition.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial assets are initially recognised at their fair value plus, in the case of financial assets not at fair value through profit and loss, any transaction costs that are incremental and directly attributable to the acquisition of the financial asset.

Fair value for financial instruments traded in an active market is based on quoted market prices or dealer price quotations (bid price for long and offer price for short positions). For other financial instruments, the fair value is determined by using appropriate valuation techniques including present-value techniques or comparison to similar instruments.

Notes to the financial statements For the year ended 31 March 2021 continued

3. Significant accounting policies continued

Financial liabilities

These include deposits, debt securities issued and subordinated debts which are the Bank's source of debt funding. Financial liabilities are classified as non-trading, held for trading or designated as held at fair value through profit and loss. Financial liabilities are initially recognised at their fair value minus, in the case of financial liabilities not at fair value through profit and loss, any transaction costs that are incremental and directly attributable to the issue of the financial liability. Subsequent to initial recognition, non-trading liabilities are recorded at amortised cost. Subsequent to initial recognition, liabilities held for trading or liabilities designated as held at fair value through profit and loss are accounted for as indicated in the accounting policy for financial liabilities at fair value through the profit and loss.

ii) Derecognition of financial assets and liabilities

The Bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or when it transfers the financial assets in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. On derecognition of a financial asset, the difference between the carrying amount of the asset and the sum of i) the consideration received including any new asset obtained less any new liability assumed and ii) any cumulative gain or loss that has been recognised in other comprehensive income is recognised in profit and loss. Any cumulative gain or loss recognised in other comprehensive income in respect of equity investments designated as at fair value through other comprehensive income is not recognised in profit or loss on derecognition.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

iii) Modifications of financial assets and liabilities

Financial assets

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this instance, the original financial asset is derecognised and a new financial asset is recognised at fair value.

If the cash flows of a modified financial asset carried at amortised cost or FVOCI are not substantially different, then the modification does not result in the derecognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

Financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and the new financial liability with modified terms is recognised in profit or loss.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss.

Interest rate benchmark reform (policy applied from 1 April 2020)

If the basis for determining the contractual cash flows of a financial asset or financial liability measured at amortised cost or at fair value through other comprehensive income changes as a result of the interest rate benchmark reform, then the Bank updates the effective interest rate of the financial asset or financial liability to reflect the change that is required by the reform. A change in the basis for determining the contractual cash flows is required by interest rate benchmark reform if the following conditions are met:

- The change is necessary as a direct consequence of the reform; and
- The new basis for determining the contractual cash flows is economically equivalent to the previous basis.

If changes are made to a financial asset or financial liability in addition to changes to the basis for determining the contractual cash flows required by interest rate benchmark reform, then the Bank first updates the effective interest rate of the financial asset or financial liability to reflect the change that is required by interest rate benchmark reform. After that, the Bank applies the policies on accounting for modifications set out above to the additional changes.

(f) Foreign currencies

The financial statements are presented in US Dollars, which is the Bank's functional and reporting currency. Items included in the financial statements of each of the Bank's operations are measured using their functional currency, being the currency of the primary economic environment in which they operate.

Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the period end. Foreign exchange gains and losses resulting from the translation and settlement of these items are recognised in the income statement except for qualifying cash flow hedges.

Non-monetary items that are measured in terms of historicalal cost in a foreign currency are translated using the exchange rate at the date of the transaction. Translation differences on equities classified as at fair value through profit or loss are reported as part of the fair value gain or loss in the income statement.

(g) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprises balances with original maturities of up to three months including cash and cash equivalents with central banks and loans and advances to banks. These comprise highly liquid investments that are readily convertible into cash with an insignificant risk of changes in value.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management

The risks relating to financial instruments and the way in which the Bank manages these are described below.

(a) Credit risk

Credit risk is the risk of any losses the Bank may incur due to a reduction or loss of the value of assets (including off-balance sheet assets) arising from any credit events, such as the deterioration of a borrower's financial standing.

Credit assessment

The Bank assesses and manages the credit risk of individual loans and credit portfolios on a consistent quantitative basis utilising 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 categories are set out in the table below, and are used for the purposes of determining the Bank's credit quality of obligors.

G grade*	J grade*	
Code	Code	Borrower's category
G1	J1	Normal borrowers
G2	J2	Normal borrowers
G3	J3	Normal borrowers
G4	J4	Normal borrowers
G5	J5	Normal borrowers
G6	J6	Normal borrowers
G7	J7	Borrowers requiring caution
G7R	J7R	Substandard borrowers
G8	J8	Potentially bankrupt borrowers
G9	J9	Virtually bankrupt borrowers
G10	J10	Bankrupt borrowers

* G grade – non-Japanese borrowers, J Grade – Japanese borrowers.

The internal ratings G7R and J7R through to G10 and J10 are recognised as 'Default' in terms of EU Capital Requirements Directive IV and in line with regulatory default definition.

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

- annual monitoring following financial results disclosures; and
- ad-hoc monitoring should credit conditions deteriorate.

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 minimise 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 Credit Risk Control Unit (CRCU) performs validation of the grading models at least annually to ensure heir appropriateness 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 events such as the COVID-19 pandemic.

Expected credit losses
Accounting for impairment provisions
Impairment provisions are accounted for in line with IFRS 9 "Financial Instruments Classification and Measurement". The Bank applies a three-stage approach to measuring ECL for the following categories of financial instruments that are not measured at fair value through profit and loss:

- Loans and advances to banks and customers measured at amortised cost.
- Debt instruments measured at amortised cost and fair value through other comprehensive income.
- Loan commitments.
- Financial guarantee contracts.

The Bank has grouped its financial instruments into Stage 1, Stage 2 and Stage 3, based on the implied impairment methodology, as described below:

Stage 1: 12-months ECL – For performing financial instruments where there has not been a significant deterioration in their credit quality since initial recognition, the Bank recognises an allowance for the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months.

Stage 2: Lifetime ECL – For financial instruments where there has been a significant increase in credit risk since initial recognition but are not credit-impaired, the Bank recognises an allowance for the lifetime ECL.

Stage 3: Credit-Impaired – Financial instrument exposures are assessed as credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the instrument have occurred. For financial instruments that have been assessed as credit-impaired, the Bank recognises an allowance for the lifetime ECLs.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

Determining the stage for impairment

At each balance sheet date, for loans carried at amortised cost, loan commitments, financial guarantee contracts and debt securities carried at fair value through other comprehensive income, the Bank assesses whether there has been significant increase in credit risk for exposures since initial recognition by comparing the risk of default between the balance sheet date and the date of initial recognition. Credit risk is assessed either individually to financial assets, or collectively to a portfolio of similar, homogenous assets.

Significant increase in credit risk (SICR)

In order to determine whether a significant increase in credit risk of a financial instrument has taken place since its initial recognition, the Bank considers reasonable and verifiable information that is relevant and accessible without excessive cost or effort. The Bank assesses significant increase in credit risk using both quantitative and qualitative information.

Determining whether SICR takes place

The Bank uses the quantitative factor of a change in the probability of default (PD) based on grading as well as additional factors such as 30 days past due and whether a customer is on the Credit Alarm System (Watch List) in order to determine whether a significant increase in the credit risk of a financial instrument has taken place.

The Bank applies a grading based review of each exposure from origination to current reporting date. The Bank uses relative PD thresholds based on grading as a quantitative criterion for significant increases in credit risk. Thresholds of relative increase in PD were assessed based on reviews of the historicalal data.

The Bank uses additional criteria for determining whether a SICR takes place – 30 days past due. The number of days overdue is determined by counting the number of days starting from the first day when the payment was not received in full. Payment dates are determined without taking into account the grace period that can be provided to the borrower. In addition, for customers graded G/J 5 and G/J 6, inclusion in the Watch List is an indicator of SICR. This is for customers categorised as 'Normal' but determined as requiring additional monitoring due to credit deterioration.

Recognition of financial assets as impaired (Stage 3)

A financial asset is recognised as impaired, if default has occurred since initial recognition.

Default definition

The definition of default for the purpose of determining ECLs has been aligned to the Capital Requirements Regulation (CRR) Article 178 definition of default, to maintain a consistent approach with IFRS 9 and associated regulatory guidance. The following events generally provide objective evidence of a default situation:

- The management bodies of the borrower/group of borrowers decide to reorganise or liquidate the borrower and/or any bankruptcy proceedings or involuntary liquidation in respect to the borrower is initiated (either by the borrower itself or by any third parties) and/or an external manager, provisional manager, liquidator or commissioner is appointed.
- Delinquency exceeds three months. Delinquency is considered to be caused by the deterioration of business conditions or constrained cash flow (and including cases in which only interest is not paid, but there is no delay in repayment of the principal).
- The loan is restructured towards the more favourable conditions for a borrower, in the absence of which the borrower could not fulfil the obligations towards the Bank properly.
- Breach of financial covenants, which, in the reasonable opinion of the Bank, may result in improper fulfilment of obligations by the borrower.

- Any other event happened in relation to the borrower/group of borrowers that, in the Bank's opinion, can cause improper fulfilment of obligations by the borrower.

An exposure will migrate through the ECL stages as asset quality deteriorates. If, in a subsequent period, asset quality improves and also reverses any previously assessed significant increase in credit risk since origination, the impairment provision reverts from lifetime ECL to 12-months ECL.

The Bank recognises write-offs when the Bank assesses there is no prospect of further recoveries, typically on liquidation of the counterparty. In practice, write-offs on liquidation are infrequent.

Improvement of credit quality

If a financial asset classified in Stage 2 shows an improvement in credit quality, then this asset can be classified in Stage 1. No probation period is applied as the latest grading will reflect the customer's current financial credit worthiness with consideration of any near-term factors which could impact the customer grade already taken into account.

Movement from Stage 3 to Stage 2 or 1 is dependent on individual assessment. All relevant factors in relation to the credit worthiness of the customer will be taken into account before a customer is upgraded and moved out of Stage 3. The Stage 3 exposures with forbearance measures in place have to go through, in addition to the above requirements, minimum cure period of two years as a normal borrower before they can be moved out of Stage 3. There have been no such movements during the year.

Grades (credit ratings)

The Bank assigns appropriate grades to each exposure based on data that is used to predict the risk of default and by applying expert judgement on credit quality. Ratings are determined based on qualitative and quantitative factors, indicators of the risk of default. These factors vary depending on the type of the borrower and exposure itself.

Grades are determined in a way that the risk of default increases significantly as credit quality deteriorates. For example, the difference between 1 and 2 grades is less than the difference between 2 and 3 grades.

Each exposure is assigned with a particular grade at the date of the initial recognition based on the information available. These exposures are subject to continuous monitoring. So, the grade assigned to the exposure could change since the date of the initial recognition.

Monitoring usually includes the analysis of the following data:

- Information obtained as a result of analysis of the borrowers on a periodic basis: audited financial statements, management accounts, budgets, forecasts and plans.
- Credit rating agencies' data, publications, and information on changes in external credit ratings.
- Bond and credit default swap quotes, if such information is available.
- Actual and expected significant changes in political, regulatory and technological environments that could influence the borrower's business.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

Creation of provisions

The calculation of ECLs is based on the following metrics:

- Probability of default (PD).
- Loss given default (LGD).
- Exposure at default (EAD).

The LGD model is a linear model that allows the Bank to predict LGD depending on the dynamics of GDP and the type of asset.

EAD is defined on the basis of the models that take into account the current and forecast utilisation of financial assets. The projected utilisation rate for revolving facilities is determined using forecasts of GDP dynamics and change in yield of US corporate bonds. For single facilities the Bank uses an amortisation model.

The credit conversion factor (CCF) is used to adjust drawn and undrawn parts (applied only to committed facilities) of facilities.

The value of CCF that applies to undrawn parts of financial instruments is determined annually at SMBC Group level and is calculated as historicalal average.

CCF for drawn parts is different for on-balance and off-balance sheet items. For on-balance sheet items CCF is 100%. The value of CCF for off-balance sheet items depends on risk type of financial instrument and is determined at SMBC Group level.

In order to calculate ECL for loans provided to corporate clients and banks, the Bank adjusts the annual value of PD in proportion to the term of the financial instrument.

Probability of default

The probability of default (PD) is modelled using credit ratings transition matrices that were created based on internal and external statistics. The transition matrix shows the expected migration of a customer at a specific grade to alternative grades over a period of time. The bank uses two sets of transition matrices to forecast PD, including transition matrices for borrowers whose parent companies are located in Japan and transition matrices for borrowers whose parent companies are residents of other countries. The value of PD is determined based on macroeconomic forecasts, including the dynamics of unemployment rates for the UK model and GDP for the EU model (2020: GDP for the UK and EU model and equity price for the UK model).

Grades are the main inputs that are used for creation of the PD for positions exposed to credit risk. The bank collects information on the debt service quality and default level of exposures, analysed depending on jurisdiction or region, type of product and borrower, and also depending on rating of credit risk.

The Bank uses statistical models to analyse the collected data and to obtain estimates of the PD for the remaining period for positions exposed to credit risk and expectations of their changes in the future.

This analysis includes the estimation and calibration of correlation between changes in default levels and changes in key macroeconomic factors. The Bank uses dynamics of GDP of the EU and Japan, and unemployment rates of the UK as key macroeconomic factors to determine the PD of positions exposed to credit risk.

The Bank uses these forecasts to adjust PD estimates.

Macroeconomic forecasts

The Bank defines EU GDP and UK unemployment rates (2020: EU and UK GDP and equity prices) as key macroeconomic factors in the models of PD, LGD and EAD.

For each key macroeconomic factor the Bank estimates four scenarios: a base, optimistic, pessimistic (moderate) and pessimistic (severe) scenario (2020: three scenarios: base, optimistic and pessimistic). The base scenario is based on third party subject matter expert forecasts and is parameterised internally to give the optimistic and pessimistic scenarios. Weightings for each scenario are applied based on the 7th, 15th, 20th and 58th percentile (severe pessimistic, moderate pessimistic, base and optimistic).

Measurement of expected credit losses

ECLs are derived from probability-weighted estimates of expected loss, and are measured as follows:

- *Financial assets that are not credit-impaired at the balance sheet date:* as the present value of all cash shortfalls over the next 12 months of the financial asset discounted by the effective interest rate for assets classified as Stage 1 and as the present value of all cash shortfalls over the expected life of the financial asset discounted by the effective interest rate for assets classified as Stage 2. The cash shortfall is the difference between the cash flows due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive.
- *Financial assets that are credit-impaired at the balance sheet date:* as the difference between the gross carrying amount and the present value of estimated future cash flows discounted by the effective interest rate.
- *Undrawn loan commitments:* as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.
- *Financial guarantee contracts:* the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Movement in ECLs is recognised as impairment loss in the income statement and for financial assets measured at amortised cost as a deduction from the gross carrying amount of the assets. In the case of debt securities measured at FVOCI no loss allowance is recognised in the statement of financial position because the carrying amount of the assets is their fair value. However, on derecognition, the Bank recognises the impairment charge in the income statement with the corresponding amount recognised in the fair value reserve in other comprehensive income. For undrawn loan commitments and financial guarantee contracts that are recognised off balance sheet, the Bank recognises the impairment charge in the income statement with the corresponding amount recognised in other provisions on the balance sheet.

Methods of estimation and creation of provision for credit losses

The Bank estimates provisions for credit losses at the transaction level for all financial instruments.

Expected life

For term loans, the expected life of the transactions are based on contractual maturity.

For revolving credit facilities a model linked to the macroeconomic variables is used to predict utilisation rates.

Use of exemptions permitted under IFRS 9

The Bank has not applied the low credit risk exemption permitted under IFRS 9.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

Purchased or originated credit-impaired

Financial assets that are purchased or originated at a deep discount that reflects the incurred credit losses are considered to be purchased or originated credit-impaired (POCI). This includes the recognition of a new financial asset following a renegotiation where concessions have been granted for economic or contractual reasons relating to the borrower's financial difficulty that otherwise would not have been considered. Any changes in lifetime ECLs since initial recognition of POCI assets are recognised in profit or loss until the POCI is derecognised, even if the lifetime ECLs are less than the amount of ECLs included in the estimated cash flows on initial recognition.

As at 31 March 2021, the Bank did not hold any financial assets that are purchased or originated credit-impaired (2020: None).

Governance

The ECL models are all subject to the Bank's model governance framework.

The macroeconomic factors for the base and pessimistic scenarios are sourced from external subject matter experts whilst the optimistic is derived internally. These are reviewed and challenged by internal subject matter experts. The macroeconomic factors are presented for review and approval to the Prudential Regulatory Committee which reports into Risk Committee. These are subsequently presented for review and final approval to the Audit Committee. The Audit Committee also reviews and considers the weightings applied to each scenario.

The COVID-19 pandemic

The 31 March 2020 year end coincided with one of the most globally far reaching, severe and one-off events experienced in living memory. The COVID-19 pandemic has continued to impact the global economy throughout the year to 31 March 2021. In this respect the Bank has taken action throughout the pandemic to effectively manage its credit risk.

With the pandemic continuing to adversely affect economies globally, consideration has been taken to ensure that the Bank's impairment provisions sufficiently cover this increased risk. The unique nature of the pandemic means the ECL models do not fully reflect this. As a result, the Bank has applied a number of post model adjustments (PMAs) in the year to 31 March 2021 and 31 March 2020. With changing circumstances, the Bank's view is that some of the PMAs recognised at 31 March 2020 are no longer appropriate, whilst others need to evolve to reflect the current view of the risks impacting the portfolio.

Post Model Adjustments 31 March 2021

In advance of the year end, the Bank undertook a review of its PMAs. The conclusion of this review was that the two PMAs applied in the previous year were no longer required.

Customers grades now reflect the impact from COVID-19 and therefore there is no requirement for a grading review PMA. With regards to the high risk portfolio and sector review PMA, a number of the customers identified did deteriorate to Stage 3 in the year. Taking into consideration the evolving impact from COVID-19 this PMA has been replaced with the sector PMA and uncertainty PMA.

As at 31 March 2021, the Bank has applied three PMAs. One covers sectors, one is focused on individual customers which, whilst not yet defaulted, are considered to be at high risk of defaulting within one year and the third covers the scenario weightings applied to the ECL model calculation.

- Sectors PMA – A review of sectors has been undertaken and linked to the Bank's Internal Capital Adequacy Assessment Process. The COVID-19 pandemic has caused asymmetric performance by sectors across the economy with clear winners and losers. High risk sectors were identified by using analysis based on revenue movements of European listed companies as a result of the pandemic. This analysis reflects the asymmetric performance or 'K-shaped' recovery observed. Depending on the severity of impact on each high risk sector, customers in these sectors have been downgraded by one or two notches. In addition a number of outperforming sectors were subject to a 1 notch upgrade. A PMA of USD 8.7m has been applied.
- Uncertainty PMA – This PMA considers customers in the portfolio which are 'Normal Borrowers' but are at high risk of default. From a review of their credit worthiness they are not expected to default to Stage 3 within a one-year time horizon but are expected to be downgraded to 7B. However, due to the subjective nature of grading an asset, this overlay captures the risk that the Bank's assessment could be wrong and some of this population may default and be graded 7R or below within a one-year horizon. As the current economic climate remains challenging and uncertain, the balance of probability is weighted towards a more pessimistic view such that we may expect some level of default in this population. An uncertainty PMA of USD 25.0m has been included in the ECL as of 31 March 2021.
- Weightings PMA – Whilst latest macroeconomic forecasts indicate a bounce back in the coming years, the outlook remains uncertain. The Bank has agreed acceptable ranges for the weighting of the four model scenarios and due to the ongoing uncertain environment has applied scenario weightings at the maximum pessimistic weightings within the range deemed acceptable by internal and external economists. The revised weightings, which have also been applied to the sector PMA, have resulted in a PMA of 7.2m.

Post Model Adjustments 31 March 2020

For the year ended 31 March 2020, a number of steps were taken in response to the pandemic as follows:

- Grading review – A grading review was undertaken to compensate for time lags which arose in the credit monitoring process and to ensure grades appropriately reflected the impact from the pandemic. This led to a number of customers being downgraded resulting in an increase in Stage 2 exposures and an increase in ECL of USD 59.1m.
- High risk portfolio and customer review – a review was undertaken of high risk portfolios and customers with particular focus on the Bank's Leveraged Buy Out Loan portfolio which holds a significant number of the Bank's lower credit quality customers and by its nature is higher risk and more sensitive to changes in macroeconomic factors. This review identified 17 customers with a total exposure of USD 592.8m that were deemed higher risk. A PMA of USD 73.6m was applied to these customers based on historicalal losses on similar assets and a range of possible outcomes.

The result is that a post model adjustment of USD 40.9m has been included in the ECL as of 31 March 2021 (2020: USD 73.6m).

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

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.

	2021 USDm	2020 USDm
Cash and balances at central banks	**24,550.4**	24,726.5
Settlement balances	**39.2**	4,216.8
Loans and advances to banks	**3,795.4**	3,802.5
Loans and advances to customers	**20,845.5**	22,722.7
Reverse repurchase agreements	**1,732.7**	1,502.5
Investment securities	**496.5**	624.9
Derivative assets	**1,255.7**	1,776.3
	52,715.4	**59,372.2**
Guarantees and letters of credit	**3,136.2**	2,945.3
Commitments	**12,469.6**	11,217.5
	15,605.8	**14,162.8**
Total	**68,321.2**	**73,535.0**

Cash and balances with central banks comprises current and short-term deposits with the Bank of England of USD 11,440.4m (2020: USD 14,683.5m) and the Banque de France of USD 13,110.0m (2020: USD 10,453.0m).

Collateral held

Whilst the Bank's corporate lending is at times secured by fixed and floating charges on the assets of borrowers, the only collateral which is valued on a continuous basis is collateral in the form of cash and bonds. The value of this collateral held by the Bank, including collateral held against reverse repurchase agreements and against inter-group positions for large exposure purposes, was USD 6,205.8m (2020: USD 7,739.0m). This collateral is held against loans and advances to banks and customers, and reverse repurchase agreements of USD 5,839.0m (2020: 6,947.4m) and derivative assets of USD 366.8m (2020: 791.6m). There are no restrictions on re-pledging the collateral held against reverse repurchase agreements .

Estimates of the fair value of the collateral held are 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 dependent on the types of asset and the jurisdiction of the borrowers as well as the ability to dispose of the collateral.

The Bank's estimate of the fair value of different types of collateral and other credit enhancements held as security against loans to customers that are individually impaired is USD 400.7m (2020: USD 30.6m).

Credit quality and stage per class of financial asset

The following tables show the gross exposure and related impairments allowance by stage and grading as of 31 March 2021 and 31 March 2020.

		Gross exposure				ECL				
As at 31 March 2021	Internal grading	Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm	Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm	Net exposure USDm
Cash and balances at central banks at amortised cost										
Normal borrowers	1-6	24,550.4	–	–	24,550.4	–	–	–	–	24,550.4
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**24,550.4**	**–**	**–**	**24,550.4**	**–**	**–**	**–**	**–**	**24,550.4**
Settlement balances										
Normal borrowers	1-6	39.2	–	–	39.2	–	–	–	–	39.2
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**39.2**	**–**	**–**	**39.2**	**–**	**–**	**–**	**–**	**39.2**
Loans and advances to banks at amortised cost										
Normal borrowers	1-6	3,065.3	732.9	–	3,798.2	1.4	1.4	–	2.8	3,795.4
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**3,065.3**	**732.9**	**–**	**3,798.2**	**1.4**	**1.4**	**–**	**2.8**	**3,795.4**
Loans and advances to customers at amortised cost										
Normal borrowers	1-6	18,150.1	1,678.2	–	19,828.3	33.1	51.4	–	84.5	19,743.8
Borrowers requiring caution	7A, 7B	–	686.7	–	686.7	–	55.2	–	55.2	631.5
Substandard borrowers and below	7R, 8-10	–	–	526.4	526.4	–	–	56.2	56.2	470.2
Total		**18,150.1**	**2,364.9**	**526.4**	**21,041.4**	**33.1**	**106.6**	**56.2**	**195.9**	**20,845.5**
Investment securities at amortised cost										
Normal borrowers	1-6	130.1	–	–	130.1	–	–	–	–	130.1
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**130.1**	**–**	**–**	**130.1**	**–**	**–**	**–**	**–**	**130.1**
Investment securities at FVOCI										
Normal borrowers	1-6	353.6	–	0.1	353.7	–	–	–	–	353.7
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**353.6**	**–**	**0.1**	**353.7**	**–**	**–**	**–**	**–**	**353.7**
Off-balance sheet loans and commitments and financial guarantee contracts										
Normal borrowers	1-6	14,611.5	763.1	–	15,374.6	11.8	7.8	–	19.6	15,355.0
Borrowers requiring caution	7A, 7B	–	134.8	–	134.8	–	1.3	–	1.3	133.5
Substandard borrowers and below	7R, 8-10	–	–	96.4	96.4	–	–	0.3	0.3	96.1
Total		**14,611.5**	**897.9**	**96.4**	**15,605.8**	**11.8**	**9.1**	**0.3**	**21.2**	**15,584.6**

In addition to the ECL disclosed above, there is USD 0.3m of ECL in relation to other financial assets.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

As at 31 March 2020	Internal grading	Gross exposure Stage 1 USDm	Gross exposure Stage 2 USDm	Gross exposure Stage 3 USDm	Gross exposure Total USDm	ECL Stage 1 USDm	ECL Stage 2 USDm	ECL Stage 3 USDm	ECL Total USDm	Net exposure USDm
Cash and balances at central banks at amortised cost										
Normal borrowers	1-6	24,726.5	–	–	24,726.5	–	–	–	–	24,726.5
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**24,726.5**	**–**	**–**	**24,726.5**	**–**	**–**	**–**	**–**	**24,726.5**
Settlement balances										
Normal borrowers	1-6	4,216.8	–	–	4,216.8	–	–	–	–	4,216.8
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**4,216.8**	**–**	**–**	**4,216.8**	**–**	**–**	**–**	**–**	**4,216.8**
Loans and advances to banks at amortised cost										
Normal borrowers	1-6	3,795.3	11.3	–	3,806.6	4.5	0.1	–	4.6	3,802.0
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**3,795.3**	**11.3**	**–**	**3,806.6**	**4.5**	**0.1**	**–**	**4.6**	**3,802.0**
Loans and advances to customers at amortised cost										
Normal borrowers	1-6	20,731.7	1,724.5	–	22,456.2	41.5	83.4	–	124.9	22,331.3
Borrowers requiring caution	7A, 7B	–	398.6	–	398.6	–	81.2	–	81.2	317.4
Substandard borrowers and below	7R, 8-10	–	–	124.6	124.6	–	–	56.1	56.1	68.5
Total		**20,731.7**	**2,123.1**	**124.6**	**22,979.4**	**41.5**	**164.6**	**56.1**	**262.2**	**22,717.2**
Investment securities at amortised cost										
Normal borrowers	1-6	186.2	–	–	186.2	–	–	–	–	186.2
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**186.2**	**–**	**–**	**186.2**	**–**	**–**	**–**	**–**	**186.2**
Investment securities at FVOCI										
Normal borrowers	1-6	430.7	1.2	0.3	432.2	–	–	–	–	432.2
Borrowers requiring caution	7A, 7B	–	–	–	–	–	–	–	–	–
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**430.7**	**1.2**	**0.3**	**432.2**	**–**	**–**	**–**	**–**	**432.2**
Off-balance sheet loans and commitments and financial guarantee contracts										
Normal borrowers	1-6	13,818.9	290.3	–	14,109.2	6.4	2.5	–	8.9	14,100.3
Borrowers requiring caution	7A, 7B	–	53.6	–	53.6	–	0.7	–	0.7	52.9
Substandard borrowers and below	7R, 8-10	–	–	–	–	–	–	–	–	–
Total		**13,818.9**	**343.9**	**–**	**14,162.8**	**6.4**	**3.2**	**–**	**9.6**	**14,153.2**

In addition to the ECL disclosed above, there is USD 0.8m of ECL in relation to other financial assets.

Movement in impairment provisions

The following tables present a reconciliation of the opening to closing balance of the exposure and impairment allowance for financial assets at amortised cost. Transfers between stages in the tables have been reflected as if they had taken place at the beginning of the year. The movements are measured over a 12-month period.

Financial assets at amortised cost

At 31 March 2021	Gross exposure Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	54,100.1	2,122.8	124.8	56,347.7
Transfers from Stage 1 to 2	(1,445.7)	1,445.7	–	–
Transfers from Stage 2 to 1	595.2	(595.2)	–	–
Transfers to Stage 3	(280.3)	(146.4)	426.7	–
Transfers from Stage 3	–	–	–	–
Net drawdowns, repayments and movements due to exposure and risk parameter changes	7,751.9	422.5	193.3	8,367.7
Financial assets derecognised	(14,432.5)	(151.6)	(218.3)	(14,802.4)
Write-offs	–	–	–	–
Balance at end of year	46,288.7	3,097.8	526.5	49,913.0

	Impairment allowance Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	46.1	165.0	56.5	267.6
Transfers from Stage 1 to 2	(7.2)	7.2	–	–
Transfers from Stage 2 to 1	19.0	(19.0)	–	–
Transfers to Stage 3	(0.3)	(21.4)	21.7	–
Transfers from Stage 3	–	–		–
Net drawdowns, repayments and movements due to exposure and risk parameter changes	(17.2)	(20.1)	5.2	(32.1)
Financial assets derecognised	(5.8)	(3.5)	(27.2)	(36.5)
Write-offs	–	–	–	–
Balance at end of year	34.6	108.2	56.2	199.0

The above provisions and movements thereon mainly relate to loans and advances to banks and customers. Out of the USD 199.0m (2020: USD 267.6m) year-end balance, USD 189.7m (2020: USD 266.8m) relates to loans and advances to banks and customers.

The movement in gross exposure between the beginning and the end of the period relates to origination and derecognition in the normal course of business with no major movements arising as a result of modification.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

	Gross exposure			
At 31 March 2020	Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	45,343.9	1,037.4	135.5	46,516.8
Transfers from Stage 1 to 2	(1,412.2)	1,412.2	–	–
Transfers from Stage 2 to 1	306.9	(306.9)	–	–
Transfers to Stage 3	–	(47.6)	47.6	–
Transfers from Stage 3	–	–	–	–
Net drawdowns, repayments and movements due to exposure and risk parameter changes	15,294.4	68.0	(6.8)	15,355.6
Financial assets derecognised	(5,432.9)	(40.3)	(47.0)	(5,520.2)
Write-offs	–	–	(4.5)	(4.5)
Balance at end of year	**54,100.1**	**2,122.8**	**124.8**	**56,347.7**

	Impairment allowance			
	Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	21.3	18.9	57.4	97.6
Transfers from Stage 1 to 2	(3.5)	3.5	–	–
Transfers from Stage 2 to 1	5.7	(5.7)	–	–
Transfers to Stage 3	–	(3.1)	3.1	–
Transfers from Stage 3	–	–	–	–
Net drawdowns, repayments and movements due to exposure and risk parameter changes	26.8	152.7	1.8	181.3
Financial assets derecognised	(4.2)	(1.3)	(1.3)	(6.8)
Write-offs	–	–	(4.5)	(4.5)
Balance at end of year	**46.1**	**165.0**	**56.5**	**267.6**

The following tables present a reconciliation of the opening to closing balance of the exposure and impairment allowance for loan commitments and financial guarantees.

Loan commitments and financial guarantees

	Gross exposure			
At 31 March 2021	**Stage 1 USDm**	**Stage 2 USDm**	**Stage 3 USDm**	**Total USDm**
Balance at beginning of year	**13,818.9**	**343.9**	**–**	**14,162.8**
Transfers from Stage 1 to Stage 2	**(922.2)**	**922.2**	**–**	**–**
Transfers from Stage 2 to Stage 1	**163.3**	**(163.3)**	**–**	**–**
Transfers to Stage 3	**(18.1)**	**(60.3)**	**78.4**	**–**
Transfers from Stage 3	**–**	**–**	**–**	**–**
New drawdowns, repayments, net remeasurement and movements due to exposure and risk parameter changes	**1,569.6**	**(144.6)**	**18.0**	**1443.0**
Balance at end of year	**14,611.5**	**897.9**	**96.4**	**15,605.8**

At 31 March 2021	Impairment allowance Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	**6.4**	**3.2**	**–**	**9.6**
Transfers from Stage 1 to Stage 2	**(5.7)**	**5.7**	**–**	**–**
Transfers from Stage 2 to Stage 1	**2.6**	**(2.6)**	**–**	**–**
Transfers to Stage 3	**–**	**(2.0)**	**2.0**	**–**
Transfers from Stage 3	**–**	**–**		**–**
New drawdowns, repayments, net remeasurement and movements due to exposure and risk parameter changes	**8.5**	**4.8**	**(1.7)**	**11.6**
Balance at end of year	**11.8**	**9.1**	**0.3**	**21.2**

At 31 March 2020	Gross exposure Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	15,673.8	383.2	–	16,057.0
Transfers from Stage 1 to Stage 2	(131.8)	131.8	–	–
Transfers from Stage 2 to Stage 1	72.4	(72.4)	–	–
Transfers to Stage 3	–	–	–	–
Transfers from Stage 3	–	–	–	–
New drawdowns, repayments, net remeasurement and movements due to exposure and risk parameter changes	(1,795.5)	(98.7)	–	(1,894.2)
Balance at end of year	**13,818.9**	**343.9**	**–**	**14,162.8**

At 31 March 2020	Impairment allowance Stage 1 USDm	Stage 2 USDm	Stage 3 USDm	Total USDm
Balance at beginning of year	3.2	2.3	–	5.5
Transfers from Stage 1 to Stage 2	(0.1)	0.1	–	–
Transfers from Stage 2 to Stage 1	–	–	–	–
Transfers to Stage 3	–	–	–	–
Transfers from Stage 3	–	–	–	–
New drawdowns, repayments, net remeasurement and movements due to exposure and risk parameter changes	3.3	0.8	–	4.1
Balance at end of year	**6.4**	**3.2**	**–**	**9.6**

Reconciliation of ECL movement to impairment charge for the period

	2021 USDm	2020 USDm
ECL movements since beginning of the period	**(3.1)**	174.1
Effect of disposals and write-offs	**(58.3)**	5.8
(Gain)/loss on disposal of impaired assets	**70.1**	19.3
Foreign exchange and other movements	**(0.1)**	1.1
Impairment charge for the period	**8.6**	**200.3**

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

Coverage ratios

The tables below show the coverage ratio as of 31 March 2020 and 31 March 2021.

As at 31 March 2021	Stage 1 %	Stage 2 %	Stage 3 %	Total %
Loans and advances to banks at amortised cost	**0.05**	**0.19**	**–**	**0.07**
Loans and advances to customers at amortised cost	**0.18**	**4.51**	**10.68**	**0.93**
Off-balance sheet loan commitments and financial guarantee contracts	**0.07**	**0.89**	**0.31**	**0.12**
Total	**0.13**	**2.93**	**9.07**	**0.54**

As at 31 March 2020	Stage 1 %	Stage 2 %	Stage 3 %	Total %
Loans and advances to banks at amortised cost	0.12	0.88	–	0.12
Loans and advances to customers at amortised cost	0.20	7.75	45.06	1.14
Off-balance sheet loan commitments and financial guarantee contracts	0.05	0.93	–	0.07
Total	**0.14**	**6.77**	**45.06**	**0.67**

The coverage ratio has decreased in the year. This is largely due to the value of collateral and credit risk mitigation on a number of new Stage 3 loans. In addition, a number of impaired assets were sold in the year reducing the total provision levels held at year end.

Macroeconomic variables and scenario weightings

Macroeconomic scenarios

The Bank has used a four-scenario model to calculate ECL at year-end. The base case forecast has been sourced externally and two downside scenarios and one upside scenario have been derived. An overview of the four scenarios used at the year-end is as follows:

Optimistic scenario – produced internally using in an in-house scenario generator. Assumes a rapid recovery for UK, EU and Japan economies.

Base scenario – sourced externally. Forecasts a strong post COVID-19 pandemic bounce back for the UK, EU and Japan.

Moderate pessimistic scenario – produced internally. Follows a similar basis as the base scenario but with a much slower rebound than the base case and is somewhere in between the base and severe pessimistic scenarios.

Severe pessimistic scenario – produced internally. The forecast for this scenario is in line with the Bank's ICAAP stress test and its severity has been benchmarked to the Bank of England's concurrent stress testing. Assumes extended lockdowns in the UK and EU, post-Brexit complications and weakening of the EU economy.

Scenario weightings

The Bank's ECL scenario weighting methodology is based on statistical modelling taking into consideration the average value of the three-year forecasts. To determine the weights for alternative scenarios the Bank computes a three-year forecast average for each macroeconomic parameter, compares it to its historical values and identifies the percentile that it is closest to. The final scenario percentile is the average percentile across all parameters for each scenario. The base weight is 100% less the sum of alternative weights. Whilst economic forecasts indicate a bounce back in the coming years, the outlook remains uncertain. Due to COVID-19 related uncertainty in the year ended 31 March 2021, the Bank applied scenario weightings within the range deemed acceptable by the Bank's economists. These resulted in revised probability weightings.

The tables below show the probability weightings applied to each scenario and the key macroeconomic variables by scenario used in the ECL calculation.

	Scenario probability weighting			
	Severe pessimistic %	**Moderate pessimistic %**	**Base %**	**Optimistic %**
Revised scenario probabilty weightings after taking into account the COVID-19 pandemic as at 31 March 2021	**10**	**20**	**55**	**15**
Original scenario probability weightings as at 31 March 2021	*7*	*15*	*58*	*20*

	Scenario probability weighting		
	Pessimistic %	Base %	Optimistic %
Revised scenario probabilty weightings after taking into account the COVID-19 pandemic as at 31 March 2020	20	60	20
Original scenario probability weightings as at 31 March 2020	*7.6*	*84.8*	*7.6*

		Key macroeconomic variables			
As at 31 March 2021		**Severe pessimistic %**	**Moderate pessimistic %**	**Base %**	**Optimistic %**
EMU CPI[1]	2021	**-0.2**	**-0.2**	**0.2**	**0.1**
	2022	**0.2**	**0.0**	**-0.1**	**0.0**
	2023	**0.0**	**0.2**	**0.0**	**0.0**
EMU nominal GDP[2]	2021	**-0.4**	**0.8**	**2.5**	**0.6**
	2022	**2.3**	**1.3**	**-0.5**	**1.9**
	2023	**-0.3**	**-0.3**	**-0.1**	**0.2**
EMU interest rate, short term[3]	2021	**-0.1**	**0.0**	**0.0**	**0.1**
	2022	**0.2**	**0.0**	**0.0**	**0.1**
	2023	**0.0**	**0.0**	**0.0**	**0.0**
UK unemployment rate[4]	2021	**0.7**	**-0.1**	**-0.4**	**-0.4**
	2022	**-1.7**	**-0.6**	**0.0**	**-0.1**
	2023	**-0.1**	**0.1**	**-0.2**	**-0.2**
UK interest rate, short term[5]	2021	**0.1**	**0.1**	**0.2**	**0.2**
	2022	**0.1**	**0.0**	**0.0**	**0.1**
	2023	**0.0**	**0.0**	**0.0**	**0.0**
Japan GDP nominal FY YoY growth[6]	2021	**3.3**	**3.3**	**4.2**	**5.4**
	2022	**0.8**	**0.8**	**1.2**	**2.3**
	2023	**1.6**	**1.6**	**1.9**	**2.9**

1 Year over year percentage change, forecast quarter on quarter.
2 Year over year percentage change, forecast quarter on quarter.
3 Year over year change, forecast quarter on quarter.
4 Year over year change, forecast quarter on quarter lagged by one quarter.
5 Year over year change, forecast quarter on quarter.
6 Four quarter average GBP level year on year percentage change.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

As at 31 March 2020		Key macroeconomic variables Pessimistic	Base	Optimistic
Revised scenario inputs after taking into account the COVID-19 pandemic				
EU GDP growth	2020	-10.0	-9.3	-4.5
	2021	3.0	6.7	3.7
	2022	0.0	1.5	2.4
UK GDP growth	2020	-14.3	-13.3	-4.3
	2021	7.0	10.3	3.4
	2022	0.1	1.4	2.5
UK equity price change	2020	-25.0	-9.7	-1.6
	2021	-31.1	8.4	15.6
	2022	-4.8	16.0	30.0
Original scenario inputs				
EU GDP growth	*2020*	*-6.0*	*-5.3*	*-4.5*
	2021	*-1.0*	*2.7*	*3.7*
	2022	*0.0*	*1.5*	*2.4*
UK GDP growth	*2020*	*-6.3*	*-5.3*	*-4.3*
	2021	*-1.0*	*2.3*	*3.4*
	2022	*0.1*	*1.4*	*2.5*
UK equity price change	*2020*	*-25.0*	*-9.7*	*-1.6*
	2021	*-31.1*	*8.4*	*15.6*
	2022	*-4.8*	*16.0*	*30.0*

The table above shows the standard scenario inputs and revised inputs in response to the COVID-19 pandemic used for 31 March 2020. The unique nature of the pandemic in 2020 led to increased economic uncertainty with pessimistic views of the future. The Bank reviewed the macroeconomic inputs derived from its standard process. The conclusion from this review was to reflect the increased uncertainty and the negative outlook, by revising downwards the macroeconomic inputs in respect of EU and UK GDP.

The impact of the revised macroeconomic inputs which took into account COVID-19 was to increase ECLs by USD 7.0m in the year ended 31 March 2020.

ECL sensitivity analysis

The measurement of ECL involves increased complexity and judgement, including estimation of probability of default (PD), loss given default (LGD), range of unbiased future economic scenarios, estimation of expected lives, estimation of exposure at default (EAD) and assessing significant increases in credit risk.

The table below shows the ECL assuming each scenario has been 100% weighted to show the impact of alternative scenarios.

	Severe pessimistic	**Moderate pessimistic**	**Base**	**Optimistic**
At 31 March 2021	**USD 251.5m**	**USD 211.8m**	**USD 188.3m**	**USD 171.2m**

	Pessimistic	Base	Optimistic
At 31 March 2020	USD 195.7m	USD 129.4m	USD 116.6m

The above results do not include the impact of the post model adjustments.

Credit risk by sector

The exposure by major industrial sectors can be analysed as follows:

31 March 2021 USDm	**Finance and insurance**	**Government and local authorities**	**Manufacturing**	**Wholesale and services**	**Other corporate exposures**	**Transport**	**Energy and infrastructure**	**Total**
Cash and balances at central banks	**24,550.4**	–	–	–	–	–	–	**24,550.4**
Settlement balances	**39.2**	–	–	–	–	–	–	**39.2**
Loans and advances to banks	**3,795.4**	–	–	–	–	–	–	**3,795.4**
Loans and advances to customers	**2,446.6**	**1,467.9**	**952.2**	**1,212.6**	**10,967.2**	**1,181.3**	**2,617.7**	**20,845.5**
Reverse repurchase agreements	**1,732.7**	–	–	–	–	–	–	**1,732.7**
Investment securities	**142.9**	**353.6**	–	–	–	–	–	**496.5**
Derivative assets	**1,037.7**	**1.6**	**76.1**	**11.5**	**84.0**	**44.8**	–	**1,255.7**
Total on-balance sheet	**33,744.9**	**1,823.1**	**1,028.3**	**1,224.1**	**11,051.2**	**1,226.1**	**2,617.7**	**52,715.4**
Commitments and guarantees	**1,198.3**	**126.3**	**2,924.0**	**505.8**	**10,851.4**	–	–	**15,605.8**
Total	**34,943.2**	**1,949.4**	**3,952.3**	**1,729.9**	**21,902.6**	**1,226.1**	**2,617.7**	**68,321.2**

31 March 2020 USDm	Finance and insurance	Government and local authorities	Manufacturing	Wholesale and services	Other corporate exposures	Transport	Energy and infrastructure	Total
Cash and balances at central banks	24,726.5	–	–	–	–	–	–	24,726.5
Settlement balances	4,216.8	–	–	–	–	–	–	4,216.8
Loans and advances to banks	3,802.5	–	–	–	–	–	–	3,802.5
Loans and advances to customers	3,505.1	1,168.1	2,897.3	1,039.8	10,456.2	1,139.0	2,517.2	22,722.7
Reverse repurchase agreements	1,502.5	–	–	–	–	–	–	1,502.5
Investment securities	192.5	432.0	–	–	0.4	–	–	624.9
Derivative assets	1,237.7	8.1	201.7	8.2	317.8	2.8	–	1,776.3
Total on-balance sheet	**39,183.6**	**1,608.2**	**3,099.0**	**1,048.0**	**10,774.4**	**1,141.8**	**2,517.2**	**59,372.2**
Commitments and guarantees	997.1	316.2	2,714.2	909.3	9,226.0	–	–	14,162.8
Total	**40,180.7**	**1,924.4**	**5,813.2**	**1,957.3**	**20,000.4**	**1,141.8**	**2,517.2**	**73,535.0**

The industry exposure classifications shown above follow the same categories as used in the Bank's Pillar 3 disclosures. Finance and insurance exposure includes USD 11,440.4m to the Bank of England (2020: USD 14,683.5m) and USD 13,110.0m to the Banque de France (2020: USD 10,043.0m).

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

Credit risk by location

The table below analyses the geographical spread of financial assets based on country of residence of the counterparty.

31 March 2021 USDm	United Kingdom	France	Italy	Other Europe	Eastern Europe	Japan	Middle East & Africa	Other countries	Total
Cash and balances at central banks	11,440.4	13,110.0	–	–	–	–	–	–	24,550.4
Settlement balances	–	–	–	9.7	7.3	2.7	1.6	17.9	39.2
Loans and advances to banks	589.4	2.2	–	568.7	136.5	1,003.6	1,365.6	129.4	3,795.4
Loans and advances to customers	5,513.5	3,929.1	31.5	4,243.4	634.3	91.1	4,796.0	1,606.6	20,845.5
Reverse repurchase agreements	1,333.3	–	–	–	–	399.4	–	–	1,732.7
Investment securities	20.7	–	–	463.1	1.2	–	–	11.5	496.5
Derivative assets	707.7	59.1	–	478.0	–	–	–	10.9	1,255.7
Total on-balance sheet	**19,605.0**	**17,100.4**	**31.5**	**5,762.9**	**779.3**	**1,496.8**	**6,163.2**	**1,776.3**	**52,715.4**
Commitments and guarantees	4,537.5	7,328.2	9.5	1,435.6	248.8	272.3	1,133.7	640.2	15,605.8
Total	**24,142.5**	**24,428.6**	**41.0**	**7,198.5**	**1,028.1**	**1,769.1**	**7,296.9**	**2,416.5**	**68,321.2**

31 March 2020 USDm	United Kingdom	France	Italy	Other Europe	Eastern Europe	Japan	Middle East & Africa	Other countries	Total
Cash and balances at central banks	14,683.5	10,043.0	–	–	–	–	–	–	24,726.5
Settlement balances	4,169.5	6.2	–	15.0	3.9	7.9	1.1	13.2	4,216.8
Loans and advances to banks	310.7	–	308.3	626.6	153.3	1,140.5	1,179.3	83.8	3,802.5
Loans and advances to customers	5,443.8	4,099.3	1,157.0	4,995.0	877.8	17.5	5,814.5	317.8	22,722.7
Reverse repurchase agreements	984.6	–	–	–	–	517.9	–	–	1,502.5
Investment securities	3.2	–	–	615.3	1.2	–	–	5.2	624.9
Derivative assets	933.1	21.0	–	780.5	–	4.6	–	37.1	1,776.3
Total on-balance sheet	**26,528.4**	**14,169.5**	**1,465.3**	**7,032.4**	**1,036.2**	**1,688.4**	**6,994.9**	**457.1**	**59,372.2**
Commitments and guarantees	3,826.3	6,718.8	97.4	1,383.8	207.1	307.9	913.2	708.3	14,162.8
Total on-balance sheet	**30,354.7**	**20,888.3**	**1,562.7**	**8,416.2**	**1,243.3**	**1,996.3**	**7,908.1**	**1,165.4**	**73,535.0**

The geographical exposure classifications shown above follow the same categories as used in the Bank's Pillar 3 disclosures. The above disclosures are based on country of residence, whilst the Bank's Pillar 3 disclosures use country of risk. The figures reported include balances with the Bank of England and Banque de France as disclosed above.

(b) Market risk

Market risk is the risk that movements 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 its 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 Value at Risk (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 historicalal simulation which is updated monthly to generate the VaR result using data from a four-year observation period. The Bank uses VaR to control market risk both on the Trading and Banking accounts on both a standalone and a 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 programme 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 per the Prudential Sourcebook for Banks, Building Societies and Investment Firms, section 2.3.8) as part of the ICAAP submission. Stress tests are also carried out on foreign exchange positions (assuming 17% appreciation and depreciation of each 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 during the year were:

	To 31 March 2021				To 31 March 2020			
	Maximum USDm	**Minimum USDm**	**Average USDm**	**31 March USDm**	Maximum USDm	Minimum USDm	Average USDm	31 March USDm
Trading	**0.3**	**–**	**0.1**	**–**	0.2	–	0.1	–
Banking	**3.5**	**1.4**	**2.4**	**3.1**	2.5	1.7	2.1	2.1
Total	**4.0**	**1.7**	**2.8**	**3.4**	2.5	1.7	2.2	2.1

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

Income sensitivity with respect to changes in interest rates:

	Banking book		**Trading book**	
	31 March 2021 USDm	31 March 2020 USDm	**31 March 2021 USDm**	31 March 2020 USDm
Profit and loss impact	**3.6**	1.9	**2.1**	4.2

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

(c) Liquidity risk

Liquidity risk is the risk that the Bank cannot meet its liabilities, unwind or settle its positions as they become due.

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 financial assets and financial liabilities. Impairment provisions on loans and advances to banks and customers are included in the Up to 3 months column.

At 31 March 2021 USDm	Up to 3 months USDm	3 to 12 months USDm	1 to 5 years USDm	Over 5 years USDm	Total USDm
Assets					
Cash and balances at central banks	24,550.4	–	–	–	24,550.4
Settlement balances	39.2	–	–	–	39.2
Loans and advances to banks	2,407.9	478.6	838.4	70.5	3,795.4
Reverse repurchase agreements	1,732.7	–	–	–	1,732.7
Derivative assets	406.8	371.1	347.0	130.8	1,255.7
Loans and advances to customers	4,524.9	997.7	9,975.5	5,347.4	20,845.5
Investment securities	363.9	132.6	–	–	496.5
Total financial assets	**34,025.8**	**1,980.0**	**11,160.9**	**5,548.7**	**52,715.4**
Liabilities					
Deposits by banks	11,324.1	222.2	10,759.0	1,521.0	23,826.3
Customer accounts	21,340.3	978.9	–	–	22,319.2
Derivative liabilities	380.2	388.1	335.3	125.2	1,228.8
Debt securities in issue	812.3	41.3	–	–	853.6
Total financial liabilities	**33,856.9**	**1,630.5**	**11,094.3**	**1,646.2**	**48,227.9**
Cumulative gap financial assets less financial liabilities	**168.9**	**518.4**	**585.0**	**4,487.5**	**4,487.5**

At 31 March 2020 USDm	Up to 3 months USDm	3 to 12 months USDm	1 to 5 years USDm	Over 5 years USDm	Total USDm
Assets					
Cash and balances at central banks	24,726.5	–	–	–	24,726.5
Settlement balances	4,216.8	–	–	–	4,216.8
Loans and advances to banks	2,457.7	531.3	741.3	72.2	3,802.5
Reverse repurchase agreements	1,502.5	–	–	–	1,502.5
Derivative assets	714.8	452.3	591.4	17.8	1,776.3
Loans and advances to customers	5,318.1	2,494.2	9,026.4	5,884.0	22,722.7
Investment securities	497.4	127.5	–	–	624.9
Total financial assets	**39,433.8**	**3,605.3**	**10,359.1**	**5,974.0**	**59,372.2**
Liabilities					
Deposits by banks	14,677.8	1,485.6	8,049.7	1,468.0	25,681.1
Customer accounts	26,630.6	922.3	96.0	–	27,648.9
Derivative liabilities	720.5	409.8	481.4	14.2	1,625.9
Debt securities in issue	–	–	–	–	–
Total financial liabilities	**42,028.9**	**2,817.7**	**8,627.1**	**1,482.2**	**54,955.9**
Cumulative gap financial assets less financial liabilities	**(2,595.1)**	**(1,807.5)**	**(75.5)**	**4,416.3**	**4,416.3**

The table below shows the contractual maturity analysis of interest and principal balances for liabilities, issued financial guarantee contracts and unrecognised loan commitments.

Maturity of liabilities as at 31 March 2021	**Up to 3 months USDm**	**3 to 12 months USDm**	**1 to 5 years USDm**	**Over 5 years USDm**	**Total USDm**
Deposits by banks	**11,341.6**	**271.7**	**10,926.0**	**1,525.0**	**24,064.3**
Customer accounts	**21,346.6**	**835.5**	**145.2**	**–**	**22,327.3**
Debt securities in issue	**791.8**	**62.0**	**–**	**–**	**853.8**
Issued financial guarantee contracts	**658.7**	**1,713.8**	**760.8**	**3.1**	**3,136.4**
Unrecognised loan commitments	**259.9**	**1,342.6**	**8,877.8**	**1,428.2**	**11,908.5**
	34,398.6	**4,225.6**	**20,709.8**	**2,956.3**	**62,290.3**
Derivative liabilities	**405.4**	**371.9**	**312.7**	**138.8**	**1,228.8**
Total liabilities, issued guarantees and commitments	**34,804.0**	**4,597.5**	**21,022.5**	**3,095.1**	**63,519.1**

Maturity of liabilities as at 31 March 2020	Up to 3 months USDm	3 to 12 months USDm	1 to 5 years USDm	Over 5 years USDm	Total USDm
Deposits by banks	14,723.3	1,576.8	8,309.6	1,503.9	26,113.6
Customer accounts	26,648.5	930.4	97.1	–	27,676.0
Debt securities in issue	–	–	–	–	–
Issued financial guarantee contracts	777.7	1,137.3	1,026.1	4.2	2,945.3
Unrecognised loan commitments	235.3	829.0	8,252.1	1,367.3	10,683.7
	42,384.8	**4,473.5**	**17,684.9**	**2,875.4**	**67,418.6**
Derivative liabilities	724.1	409.2	451.8	40.8	1,625.9
Total liabilities, issued guarantees and commitments	**43,108.9**	**4,882.7**	**18,136.7**	**2,916.2**	**69,044.5**

(d) Interest Rate Benchmark Reform

There have been no changes to the Bank's risk management strategies following the IBOR reform.

Following the financial crisis, the reform and replacement of benchmark interest rates such as IBOR has become a priority for global regulators. The Bank has significant exposure to IBORs on its financial instruments that will be reformed as part of this market-wide initiative. It is expected that most reforms affecting the Bank will be completed by the end of 2021 although some LIBORs may continue to be published beyond that date. The Bank is in the process of amending or preparing to amend contractual terms in response to IBOR reform. There remains uncertainty over the timing and the methods of transition as the views of the market and borrowers continue to evolve.

The main risks to which the Bank is exposed as a result of IBOR reform are operational –for example, the renegotiation of loan contracts through bilateral negotiation with customers, updating of contractual terms, updating of systems that use IBOR curves and revision of operational controls related to the reform. Financial risk is predominantly limited to interest rate risk. The Bank continues to have loans referencing LIBOR which could become unrepresented; this will continually be monitored as part of the IBOR project but the liquidity risk arising from this is considered low.

Notes to the financial statements For the year ended 31 March 2021 continued

4. Financial risk management continued

Non-derivative financial assets and loan commitments

The Bank's exposures on loans and advances to customers include GBP, USD, EUR and JPY LIBOR.

The alternative reference rate for Sterling LIBOR is the Sterling Overnight Index Average (SONIA) and for US Dollar LIBOR is the Secured Overnight Financing Rate (SOFR). Changes to the contractual terms of financial assets referenced to LIBOR to incorporate new benchmark rates were not yet complete as at 31 March 2021. There are some contracts, known as 'tough legacy contracts', that may be difficult to transition from LIBORs to SONIA or SOFR. These tough legacy contracts are often part of more complex or structured transactions or arrangements. In response, in March 2020, the Alternative Reference Rates Committee, which is the working group for the US Dollar LIBOR transition to SOFR, proposed changes in law to minimise legal uncertainty and adverse economic impacts associated with these tough legacy contracts. In addition, the UK Government has proposed that the Financial Conduct Authority (FCA) be granted the power under UK law to direct a change in the methodology of LIBOR and extend its publication for a limited time period in certain circumstances. In November 2020, the ICE Benchmark Administration (IBA), the FCA-regulated and authorised administrator of LIBOR, announced that it had started to consult on its intention to cease the publication of certain USD LIBORs after June 2023 and other LIBORs after December 2021. It is unclear whether GBP LIBOR or USD LIBOR will continue to be published after the end of 2021 for these tough legacy contracts and, therefore, the Bank continues to communicate with counterparties to include a fallback clause or replace those LIBORs with SONIA or SOFR.

The Bank has begun to amend existing loans and advances, including loan commitments, to corporate customers throughout the year. The amendments made are to incorporate a fallback provision stating that the existing GBP LIBOR and USD LIBOR benchmark rate will be replaced by SONIA and SOFR, respectively, when LIBOR ceases to exist.

The Bank monitors the progress of transition from IBORs to new benchmark rates by reviewing the total amounts of contracts that have yet to transition to an alternative benchmark rate and the amounts of such contracts that include a fallback clause. The Bank considers that a contract is not yet transitioned to an alternative benchmark rate when interest under the contract is referenced to a benchmark rate that is still subject to IBOR reform, even if it includes a fallback clause that deals with the cessation of the existing IBOR (referred to as an 'unreformed contract'). The Bank has in place detailed plans, processes and procedures to continue to transition contracts to alternative benchmark rates which will be completed in line with official sector expectations and milestones.

Derivatives and hedge accounting

The Bank uses derivatives for trading and risk management purposes (see note 13). Some of the derivatives held for risk management purposes are designated in hedging relationships. The interest rate swaps have floating rates that reference various IBORs. The Bank's derivative instruments are governed by International Swaps and Derivatives Association (ISDA) definitions.

ISDA has reviewed its definitions in light of IBOR reform and issued an IBOR fallbacks supplement on 23 October 2020. This sets out how the amendments to new alternative benchmark rates (e.g. SOFR, SONIA) in the ISDA definitions will be accomplished. The effect of the supplement is to create fallback provisions in derivatives that describe what floating rates will apply on the permanent discontinuation of certain key IBORs or on ISDA declaring a non-representative determination of an IBOR. The supplement is effective from 25 January 2021 and from that date, all new derivatives that reference the ISDA definitions will also include the fallbacks. Further information on the impact of IBOR reform on the Bank's hedge accounting is given in note 13.

The following table shows the Bank's exposure at the year-end to significant IBORs subject to reform that have yet to transition to risk-free rates.

At 31 March 2021	Non-derivative financial assets at carrying value USDm	Non-derivative financial liabilities at carrying value USDm	Undrawn commitments USDm	Derivatives notional amount USDm
GBP LIBOR	**3,985.4**	**–**	**1,616.6**	**615.4**
USD LIBOR	**9,278.1**	**4,371.5**	**2,107.2**	**863.3**
JPY LIBOR	**427.4**	**–**	**138.5**	**144.4**

The Bank's exposure risk management also includes the use of the Euro Interbank Offered Rate (EURIBOR). In July 2019, the Belgian Financial Services and Markets Authority granted authorisation with respect to EURIBOR under the European Union Benchmarks Regulation. This allows market participants to continue to use EURIBOR after 1 January 2020 for both existing and new contracts. The Bank expects that EURIBOR will continue to exist as a benchmark rate for the foreseeable future. The Bank does not anticipate changing the hedged risk to a different benchmark. For these reasons, the Bank does not consider its fair value or cash flow hedges of the EURIBOR benchmark interest rate to be directly affected by interest rate benchmark reform at 31 March 2021.

Notes to the financial statements For the year ended 31 March 2021 continued

5. Fair value of financial instruments

The Bank's accounting policy on fair value measurements is disclosed in accounting policy 3(e) Financial Instruments – initial recognition and subsequent measurement.

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an individual instrument.
- Level 2: Valuation techniques based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques.

Valuation techniques include net present value and discounted value models, comparison to similar instruments for which observable market prices exist, Black-Scholes and polynomial option pricing models and binomial valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. All observable data is taken directly from Bloomberg or Reuters screens. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, which would have been determined by market participants acting at arm's length.

The Bank uses widely recognised models for determining the fair value of common and more simple financial instruments, such as interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange-traded derivatives and simple over the counter derivatives. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For some financial instruments at fair value through other comprehensive income the Bank uses discounted cash flow models created internally and discounted cash flow models provided by external independent parties which are assessed internally to be acceptable for the purpose of valuation. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

Fair value of financial instruments carried at fair value

The following table shows the Bank's financial assets and liabilities that are held at fair value by the level in the fair value hierarchy into which the fair value measurement is categorised:

At 31 March 2021 USDm	**Level 1**	**Level 2**	**Level 3**	**Total fair value**
Financial assets				
Loans and advances to banks	–	–	–	–
Loans and advances to customers	–	–	–	–
Derivative assets	–	**1,255.7**	–	**1,255.7**
Investment securities	–	**353.6**	**12.8**	**366.4**
Total assets	–	**1,609.3**	**12.8**	**1,622.1**
Financial liabilities				
Derivative liabilities	–	**1,228.8**	–	**1,228.8**
Total liabilities	–	**1,228.8**	–	**1,228.8**

There are no significant movements between Level 1, Level 2 or Level 3.

At 31 March 2020 USDm	Level 1	Level 2	Level 3	Total fair value
Financial assets				
Loans and advances to banks	–	0.5	–	0.5
Loans and advances to customers	–	5.5	–	5.5
Derivative assets	–	1,776.3	–	1,776.3
Investment securities	–	432.2	6.5	438.7
Total assets	–	2,214.5	6.5	2,221.0
Financial liabilities				
Derivative liabilities	–	1,625.9	–	1,625.9
Total liabilities	–	1,625.9	–	1,625.9

Of the total movement in Level 3 assets during the year of USD 6.3m (2020: USD 3.2m), USD 1.0m (2020: USD 1.3m) relate to losses through other comprehensive income and USD 5.3m (2020: 4.5m) relate to purchases.

For assets and liabilities which are accounted at fair value under Level 3, the valuations are primarily based on Fund Manager valuations and are based on reasonable estimates. Applying reasonable alternative valuations would not lead to a significantly different valuation.

Notes to the financial statements For the year ended 31 March 2021 continued

5. Fair value of financial instruments continued

Fair value of financial instruments carried at amortised cost

The following table summarises the fair value of financial assets and liabilities measured at amortised cost, by the level in the fair value hierarchy into which the fair value measurement is categorised:

31 March 2021 USDm	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and balances at central banks	–	**24,550.4**	–	**24,550.4**	**24,550.4**
Settlement balances	–	**39.2**	–	**39.2**	**39.2**
Loans and advances to banks	–	–	**3,801.4**	**3,801.4**	**3,795.4**
Loans and advances to customers	–	–	**21,082.3**	**21,082.3**	**20,845.5**
Reverse repurchase agreements	–	**1,732.7**	–	**1,732.7**	**1,732.7**
Investment securities	–	**130.1**	–	**130.1**	**130.1**
Liabilities					
Deposits by banks	–	**23,799.5**	–	**23,799.5**	**23,826.3**
Customer accounts	–	**22,320.1**	–	**22,320.1**	**22,319.2**
Debt securities in issue	–	**853.6**	–	**853.6**	**853.6**

31 March 2020 USDm	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets					
Cash and balances at central banks	–	24,726.5	–	24,726.5	24,726.5
Settlement balances	–	4,216.8	–	4,216.8	4,216.8
Loans and advances to banks	–	–	3,802.7	3,802.7	3,802.0
Loans and advances to customers	–	–	22,717.3	22,717.3	22,717.2
Reverse repurchase agreements	–	1,502.5	–	1,502.5	1,502.5
Investment securities	–	186.2	–	186.2	186.2
Liabilities					
Deposits by banks	–	25,668.8	–	25,668.8	25,681.1
Customer accounts	–	27,649.8	–	27,649.8	27,648.9
Debt securities in issue	–	–	–	–	–

There were no positions classified on inception as designated at fair value through profit and loss during the year.

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or have a short-term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity, and variable rate financial instruments.

Fixed rate financial instruments

The fair values of fixed rate financial assets and liabilities carried at amortised cost not hedged through fair value hedges are estimated by comparing market interest rates on initial recognition with current market rates offered for similar financial instruments including any effect of changes in market credit spreads, where material. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. The fair values of quoted debt instruments issued are calculated based on quoted market prices.

6. Personnel and other expenses

	2021 USDm	2020 USDm
Salaries and bonuses	**242.6**	183.9
Compulsory social security obligations	**57.0**	49.3
Pension costs – contribution plans	**17.1**	14.5
Pension costs – defined benefit plans	**3.3**	2.6
Other staff costs	**19.2**	20.4
Total personnel costs	**339.2**	**270.7**
Operating lease payments	**6.1**	5.8
Other operating expenses	**117.5**	115.0
Total personnel and other costs	**462.8**	**391.5**
	No.	No.
Average number of front office department employees	**498**	464
Average number of support department employees	**748**	672
Average number of employees	**1,246**	**1,136**

Deferred shares bonus scheme

The Bank has in place a deferred bonus scheme for certain employees. Such employees receive part of their annual bonus as a deferred award comprising 50% in cash and 50% in a scheme pegged to the SMFG share price. Any deferred awards are dependent on future service and are awarded over periods up to eight years. As at the year-end total deferred bonuses were USD 17.6m (2020: USD 13.7m).

7. Auditor's remuneration

	2021 USDm	2020 USDm
Fees payable to the Bank's auditor for the audit of Bank's annual accounts	**1.5**	1.0
Audit-related assurance services	**0.7**	0.4
Other assurance services	**–**	–
	2.2	**1.4**

Audit-related assurance services includes worked performed in relation to the Group audit and interim review work of SMFG and various regulatory assurance services. Fees amounting to USD 0.6m (2020: USD 0.5m) were paid by SMBC and SMFG.

Notes to the financial statements For the year ended 31 March 2021 continued

8. Directors' emoluments

	2021 USDm	2020 USDm
Directors' fees	**0.6**	0.5
Directors' emoluments (excluding fees)	**3.0**	2.0
Post-employment benefits	**0.1**	0.1
	3.7	**2.6**

The highest paid Director received emoluments of USD 886,117 (2020: USD 881,487).

One Director belonged to the Bank's defined contribution pension scheme with the Bank paying contributions of USD 83,835 (2020: one Director with contributions of USD 90,745) in the year. These amounts are included within the Directors' emoluments figures above. Four Directors received a bonus (2020: One Director) and part of this was subject to a deferral period.

Three employees of the parent company were Directors during the year and received remuneration from the Bank as they were subject to secondment agreements.

9. Pension costs

Accounting for pension and other post-retirement benefits

The Bank operates, for the majority of staff, a defined contribution scheme. Contributions are charged to profit and loss as they become payable in accordance with the rules of the scheme.

A defined benefit scheme, the Sumitomo Mitsui Banking Corporation Europe Limited Pension Scheme, is provided to a small number of staff. The assets of the scheme are held separately from the assets of the Bank and are administered by trustees. This scheme is closed to new members.

The cost of providing benefits under the defined benefit scheme is determined using the projected-unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised in profit or loss as operating expenses.

The interest element of the defined benefit cost represents the change in present value of scheme obligations arising from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment, made at the beginning of the year, of long-term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year. The differences between the expected return on plan assets and the interest costs are recognised in profit and loss as other finance income or expense.

Actuarial gains and losses are recognised in full in other comprehensive income in the period in which they occur.

The defined benefit pension asset or liability in the statement of financial position comprises the total for the plan of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds that have been rated at AA or equivalent status), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value of the assets held is based on quoted prices or observable inputs for the underlying investments. The value of any net pension asset recognised is limited to the amount that may be recovered either through reduced contributions or agreed refunds from the scheme.

A triennial funding valuation of the defined benefit scheme was undertaken with an effective date of 31 December 2017 and was completed in March 2019. A triennial valuation of the fund as at 31 December 2020 is currently being undertaken but as the results are not yet available, an update of the funding position has been prepared to 31 March 2021 by a qualified independent actuary. The scheme is funded and, per the triennial valuation, there was no deficit in the pension plan.

The principal actuarial assumptions as at 31 March (expressed as weighted averages) were as follows:

	2021	2020
Discount rate	**2.0%**	2.3%
Future salary increase (weighted average)	**4.4%**	3.8%
Future pension increase	**3.3%**	2.8%
Inflation assumption (CPI)	**2.9%**	1.8%

As at 31 March 2020, an assumption for CPI inflation of 1.0% per annum below the RPI assumption was used. As a result of the announcement by the Chancellor of the Exchequer in November 2020 that RPI will be aligned with CPIH from 2030, a CPI assumption of 0.5% per annum less than RPI has been used as at 31 March 2021.

The underlying mortality assumption is based upon the standard table known as S3PA Light on year of birth usage with CMI 2020 future improvement factors with a long-term annual rate of future improvement of 1.0% (31 March 2020: same except CMI 2018). This results in the following life expectancies:

– Male age 65 now has a life expectancy of 23.0 years from retirement (previously 23.0 years).

– Female age 65 now has a life expectancy of 24.5 years from retirement (previously 24.4 years).

Cash flow data is used to estimate the amount which the scheme needs to reimburse the Bank at the end of the year. This reimbursement is in respect of benefit payments which the Bank has paid on behalf of the scheme since 31 December 2018 (the scheme has refunded the Bank for benefits payments up until 31 December 2018). The weighted average duration of the defined benefit obligation is about 20 years.

Notes to the financial statements For the year ended 31 March 2021 continued

9. Pension costs continued

The following table shows a reconciliation from the opening balances to the closing balances for the net defined benefit liability (asset) and its components:

	Defined benefit obligations		Fair value of plan assets		Net defined benefit (liability)/asset	
	2021 USDm	2020 USDm	2021 USDm	2020 USDm	2021 USDm	2020 USDm
Balance at beginning of year	**182.0**	196.2	**244.2**	241.8	**62.2**	45.6
Included in profit or loss						
Current service cost	**1.8**	1.7	**–**	–	**(1.8)**	(1.7)
Past service cost	**0.7**	–	**–**	–	**(0.7)**	–
Interest expense	**4.6**	4.4	**–**	–	**(4.6)**	(4.4)
Interest income	**–**	–	**6.2**	5.5	**6.2**	5.5
Effect of movements in exchange rates	**20.0**	(9.9)	**27.0**	(12.5)	**7.0**	(2.6)
	27.1	**(3.8)**	**33.2**	**(7.0)**	**6.1**	**(3.2)**
Included in other comprehensive income						
Actuarial gain/(loss) arising from:						
Financials	**21.5**	(4.5)	**–**	–	**(21.5)**	4.5
Demographic	**0.6**	–	**–**	–	**(0.6)**	–
Experience	**0.5**	0.3	**–**	–	**(0.5)**	(0.3)
Return on plan assets excluding interest income	**–**	–	**(14.9)**	13.6	**(14.9)**	13.6
	22.6	**(4.2)**	**(14.9)**	**13.6**	**(37.5)**	**17.8**
Other						
Contributions paid by employer	**–**	–	**2.3**	2.0	**2.3**	2.0
Benefits paid by fund	**(4.5)**	(6.2)	**(4.5)**	(6.2)	**–**	–
	(4.5)	**(6.2)**	**(2.2)**	**(4.2)**	**2.3**	**2.0**
Balance at end of year	**227.2**	**182.0**	**260.3**	**244.2**	**33.1**	**62.2**

The agreed contributions of pensionable salaries in respect of the future service accrual to be paid by the Bank for the year ended 31 March 2021 were 63.3% of pensionable earnings. In addition, the Bank is currently paying contributions to cover the cost of pension payments, cash lump sums on retirement, trivial commutation payments and transfer values.

The scheme is run by the Trustees of the scheme who ensure compliance with the Trust Deed and Rules of the scheme. The Trustees are required by law to fund the scheme on prudent funding assumptions under the Trust Deed and Rules of the scheme. The contributions payable by the Bank to fund the scheme are set by the Trustees after consultation with the Bank.

The Trustees use the attained age funding method which is suitable for funding a scheme open for future accruals but is closed to new entrants.

IFRIC 14 is an interpretation of existing paragraph IAS 19.65, which deals with the level of net pension asset recognisable on a company's balance sheet. IFRIC 14 also requires consideration of minimum funding requirements a company has made to its pension scheme and whether this gives rise to an additional balance sheet liability. Under the scheme's Trust Deed, the Bank has an unconditional right to a refund of surplus from the scheme in the context of IFRIC 14 paragraphs 11(b) and 12. As at 31 March 2021, there was no additional balance sheet liability arising in respect of any funding commitment the Bank has to the scheme.

The employer pays all the costs of administering the scheme and any levies required by the Pensions Protection Fund and the Pensions Regulator. The expected employer contribution to the scheme for the year ending 31 March 2022 in respect of future accrual contributions is USD 2.27m.

The following list is not exhaustive but covers the main funding risks for the Scheme:

- Investment return risk: If the assets underperform the returns assumed in setting the funding target, additional contributions may be required at subsequent valuations.
- Investment matching risk: The scheme remains partially invested in equity type assets, whereas the solvency target is closely related to return on bonds. If equity assets fall in value relative to the matching assets of bonds, additional funding may be required.
- Longevity risk: If future improvements in mortality exceed the assumptions made then additional contributions may be required.
- Legislative risk: The Government, or the Courts, may introduce overriding legislation leading to an increase in the value of scheme benefits.
- Solvency risk: As the funding target is not a solvency target, and the investment strategy does not exactly follow that required for a solvency target, the assets of the scheme may not be sufficient to provide all members with the full value of their benefits on a scheme wind-up. The Bank would then be required to pay the funding shortfall.

The Bank expects to pay USD 5.6m in contributions to defined benefit plans in the coming financial year to 31 March 2022.

Scheme assets were made up of the following:

	2021 USDm	2020 USDm
Equity securities	**29.8**	19.1
Government bonds	**230.2**	225.3
Cash	**0.3**	–
	260.3	**244.4**

Sensitivity analysis

The approximate impact on the defined benefit obligation of changes in the significant assumptions is shown below:

Assumption varied	**2021 % change in defined benefit obligation**	2020 % change in defined benefit obligation
Discount rate 1% p.a. lower (2020: 0.5% p.a. lower)	**20%**	10%
Salary increase rate 1% p.a. lower	**(-2%)**	(-2%)
Pension increase (in payment and in deferment) rate 1% p.a. lower (2020 0.5% p.a. lower)	**(-8%)**	(-4%)
Minimum rate of improvement of mortality 0.5% p.a. lower	**(-2%)**	(-2%)

The figures assume that each assumption is changed independently of others. Therefore, the disclosures are only a guide because the effect of changing more than one assumption is not cumulative. The sensitivity analysis was calculated by re-running the figures as at the last formal valuation as at 31 December 2017 adjusted approximately for changes in the membership up to 31 March 2021. Therefore, the analysis is only approximate as at 31 March 2021.

Notes to the financial statements For the year ended 31 March 2021 continued

10. Income taxes

Accounting for income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in profit and loss except to the extent that they relate to items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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 substantially 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 benefits will be realised.

Income tax expense

Recognised in the income statement:

Recognised in the income statement	**2021 USDm**	2020 USDm
Current tax charge		
Current year	**83.2**	54.8
Overseas tax	**9.7**	12.2
Adjustment for prior years	**10.8**	2.2
	103.7	**69.2**
Deferred tax charge		
Origination and reversal of temporary differences	**0.6**	(1.2)
Adjustment for prior years	**(12.1)**	(1.8)
Deferred tax change in rate	**–**	0.5
	(11.5)	**(2.5)**
Total income tax expense	**92.2**	**66.7**

Reconciliation of effective rate of tax	**USDm**	USDm
Profit before income tax	**333.1**	219.6
Income tax using the domestic corporation tax rate of 27%[1] (2020: 27%)	**89.9**	59.3
Adjustment for prior years	**(1.3)**	0.6
Deferred tax change in rate	**–**	0.5
Expenses not deductible for tax purposes	**3.4**	3.2
Banking surcharge allowance	**(1.8)**	(1.7)
Overseas tax	**2.0**	4.8
	92.2	**66.7**

1 UK corporation tax rate of 19% plus bank surcharge rate of 8%.

In the Budget on 3 March 2021, the Chancellor of the Exchequer announced an increase in the headline rate of corporation tax from 19% to 25% from 1 April 2023. In addition to this, it was announced in the Budget that the bank surcharge rate of 8% applicable to profits of banking companies under the Finance (No.2) Act 2015 is being reviewed by the Government, indicating a possible reduction from 1 April 2023. A consultation on this will take place later on this year.

Deferred tax assets and liabilities are required to be valued using the tax rate which will be in force at the time when the temporary difference is expected to unwind. In line with the requirements of IAS12, the impact of the change in the headline rate of corporation tax has not been reflected in the deferred tax balances at 31 March 2021 and will be recognised once it has been substantively enacted by the UK Parliament. The estimated impact of the change in the headline corporation tax rate would be an increase in the deferred tax liability of circa USD 1.1m. The deferred tax liability has been calculated at 27% as at 31 March 2020 and 2021.

Income tax recognised in other comprehensive income:

Income tax recognised in other comprehensive income	**Before tax 2021 USDm**	**Tax (expense) /benefit 2021 USDm**	**Net of tax 2021 USDm**	Before tax 2020 USDm	Tax (expense)/ benefit 2020 USDm	Tax rate change 2020 USDm	Net of tax 2020 USDm
Actuarial gains/(losses) on defined benefit scheme	**37.5**	**(10.1)**	**27.4**	17.8	(4.8)	–	13.0
FVOCI	**(0.4)**	**0.1**	**(0.3)**	(0.5)	0.1	–	(0.4)
Cash flow hedges	**3.8**	**(1.0)**	**2.8**	5.3	(1.4)	0.1	4.0
IFRS 9 transitional adjustments	**–**	**–**	**–**	(0.1)	–	0.4	0.3
	40.9	**(11.0)**	**29.9**	**22.5**	**(6.1)**	**0.5**	**16.9**

Deferred tax

The components of deferred taxes disclosed on the balance sheet are as follows:

	USDm 2021	USDm 2020
Deferred tax liability	**(13.2)**	(22.3)
Deferred tax asset	**20.4**	6.5
Net deferred tax asset/(liability)	**7.2**	**(15.8)**

Movements on deferred tax assets and liabilities were as follows:

	Fixed asset temporary differences USDm	**Bonus accrual USDm**	**Pensions and other retirement benefits USDm**	**Cash flow hedge/ FVOCI/AFS USDm**	**IFRS 9 transitional adj USDm**	**Paris branch, IFRS 9 and upfront fees USDm**	**Total USDm**
Asset/(liability) at 1 April 2020	4.5	2.0	(16.6)	(1.3)	(4.4)	–	(15.8)
Adjustments relating to prior years	0.2	1.8	–	–	–	10.1	12.1
Movement through the P&L account	(0.2)	(0.1)	(2.3)	–	–	2.0	(0.6)
Movement through other comprehensive income	–	–	10.1	0.9	0.6	–	11.6
Exchange rate changes	–	–	(0.1)	–	–	–	(0.1)
At 31 March 2021	**4.5**	**3.7**	**(8.9)**	**(0.4)**	**(3.8)**	**12.1**	**7.2**
Asset/(liability) at 1 April 2019	4.2	2.3	(13.9)	(0.1)	(4.7)	–	(12.2)
Adjustments relating to prior years	(0.3)	(0.5)	2.5	–	–	–	1.7
Movement through the P&L account	0.6	0.2	(0.6)	–	0.6	–	0.8
Movement through other comprehensive income	–	–	(4.8)	(1.2)	(0.3)	–	(6.3)
Exchange rate changes	–	–	0.2	–	–	–	0.2
At 31 March 2020	**4.5**	**2.0**	**(16.6)**	**(1.3)**	**(4.4)**	**–**	**(15.8)**

The amount of deferred tax asset expected to be recovered after more than 12 months is USD 15.0m (2020: USD 5.9m).

The deferred tax asset at 31 March 2021 has been calculated based on the rate of 27%.

Notes to the financial statements For the year ended 31 March 2021 continued

11. Loans and advances to banks and customers

Accounting for loans and advances to banks and customers

Loans and advances at amortised cost

Loans and advances at amortised cost are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and exclude those that are classified as held for trading and those that are designated as at fair value through profit and loss. Subsequent to initial recognition, loans and advances are measured at amortised cost less impairment losses where:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise to cash flows on specified dates, that represent solely payments of principal and interest on the principal amount outstanding.

Where exposures are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only (note 13).

Loans and advances at fair value through other comprehensive income

Loans and advances are classified as at fair value through other comprehensive income where:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount.

Loans and advances at fair value through other comprehensive income are measured at fair value on the statement of financial position. Unrealised gains and losses are recognised in other comprehensive income and only when disposed of is the cumulative gain or loss, previously recognised in other comprehensive income, recognised in profit and loss.

The Bank does not hold any loans and advances at fair value through other comprehensive income.

Loans and advances at fair value through profit and loss

Loans and advances held at fair value through profit and loss include all loans and advances classified as held for trading, those irrevocably designated as held at fair value through profit and loss on initial recognition and those with contractual terms that do not represent solely payments of principal and interest on the principal amount outstanding.

Loans and advances classified at fair value through profit and loss are recorded at fair value on the statement of financial position with changes in fair value recognised in profit and loss. Financial instruments are classified as held for trading when they are held with the intention of generating short-term profits.

Finance leases

Leases in terms of which the Bank assumes substantially all risks and rewards of ownership are classified as finance leases. Upon initial recognition the lease asset receivable is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Lease income is recognised in interest income over the term of the lease using the net investment method (before tax) which reflects a constant periodic rate of return.

	2021 USDm			2020 USDm		
	Loans to banks	**Loans to customers**	**Total**	Loans to banks	Loans to customers	Total
Gross loans and advances at amortised cost	**3,798.2**	**21,041.4**	**24,839.6**	3,806.6	22,979.4	26,786.0
Less: impairment provisions (note 4)	**(2.8)**	**(195.9)**	**(198.7)**	(4.6)	(262.2)	(266.8)
Loans and advances at amortised cost	**3,795.4**	**20,845.5**	**24,640.9**	**3,802.0**	**22,717.2**	**26,519.2**
Loans and advances at fair value through profit and loss	**–**	**–**	**–**	0.5	5.5	6.0
Total loans and advances	**3,795.4**	**20,845.5**	**24,640.9**	**3,802.5**	**22,722.7**	**26,525.2**

	2021 USDm	2020 USDm
Amount included within loans and advances to customers expected to be recovered more than 12 months after the reporting date	**15,328.0**	14,913.0
Included in loans and advances to customers are the following amounts relating to leases:		
Gross investment in finance leases		
– Less than one year	**120.5**	4.8
– One to two years	**–**	112.9
– Two to three years	**–**	–
– Three to four years	**–**	–
– Four to five years	**–**	–
	120.5	**117.7**
Less: Unearned finance income	**(1.3)**	(2.5)
	119.2	**115.2**
Net investment in finance leases		
– Less than one year	**119.2**	3.5
– One to two years	**–**	111.7
– Two to three years	**–**	–
– Three to four years	**–**	–
– Four to five years	**–**	–
	119.2	**115.2**

The ECL on the lease receivables is immaterial.

Finance lease income is included within net interest income. The amount recognised in the income statement during the year all related to finance income from net investment in leases and was USD 1.3m (2020: USD 3.0m). There have been no finance leases entered into during the period and no leases have ended.

Notes to the financial statements For the year ended 31 March 2021 continued

12. Investment securities

Accounting for investment securities

Debt securities at amortised cost

Debt securities at amortised cost are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and exclude those that are classified as held for trading and those that are designated as at fair value through profit and loss. Subsequent to initial recognition, debt securities are measured at amortised cost less impairment losses where:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise to cash flows on specified dates, that represent solely payments of principal and interest on the principal amount outstanding.

Investment securities at fair value through other comprehensive income

Debt instruments

Investments in debt instruments that are classified as at fair value through other comprehensive income are those where:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount.

Debt instruments at fair value through other comprehensive income generally comprise securities. The assets are measured at fair value on the statement of financial position. Unrealised gains and losses are recognised in other comprehensive income and only when disposed of is the cumulative gain or loss, previously recognised in other comprehensive income, recognised in profit and loss.

Equity instruments

Investments in equity instruments that are not held for trading are measured at fair value through other comprehensive income where an irrevocable election has been made on initial recognition by management. Amounts presented in other comprehensive income are not subsequently transferred to profit or loss.

Investment securities at fair value through profit and loss

Investment securities held at fair value through profit and loss include all instruments classified as held for trading, those instruments irrevocably designated as held at fair value through profit and loss on initial recognition and debt instruments with contractual terms that do not represent solely payments of principal and interest on the principal amount outstanding.

Investment securities classified at fair value through profit and loss are recorded at fair value on the statement of financial position with changes in fair value recognised in profit and loss. Financial instruments are classified as held for trading when they are held with the intention of generating short-term profits.

	2021 USDm	2020 USDm
Investment securities held at amortised cost	**130.1**	186.2
Investment securities at fair value through other comprehensive income	**354.9**	433.4
Investment securities at fair value through profit and loss	**11.5**	5.3
Total investment securities	**496.5**	**624.9**

	USDm	USDm
Debt securities held at amortised cost	**130.1**	186.2
Debt securities held at fair value through other comprehensive income	**353.7**	432.2
Equities held at fair value through other comprehensive income	**1.2**	1.2
Equities held at fair value through profit and loss	**11.5**	5.3
	496.5	**624.9**

At start of year	**624.9**	426.5
Exchange rate adjustments	**3.6**	(15.9)
Acquisitions & transfers	**1,137.0**	1,136.4
Fair value movement recognised in other comprehensive income	**0.3**	(0.3)
Disposals and maturities	**(1,269.1)**	(922.1)
Amortisation of discounts and premiums	**(0.2)**	0.3
At end of year	**496.5**	**624.9**

13. Derivative financial instruments and hedge accounting

Accounting for derivatives

Derivatives include interest rate swaps and futures, cross currency swaps, credit default swaps, forward foreign exchange contracts and options on interest rates and foreign currencies. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Derivative instruments that do not meet the criteria to be designated as a hedge are deemed to be held for trading and are measured at fair value with the resultant profits and losses included in net trading income.

The fair value of exchange-traded derivatives is determined by reference to the quoted market price.

The fair value of over the counter derivatives is determined by calculating the expected cash flows under the terms of each specific contract, and then discounting these to their net present value. The expected cash flows for each contract are determined either directly by reference to actual cash flows implicit in observable market prices, or through modelling cash flows using appropriate pricing models. The effect of discounting expected cash flows back to present value is achieved by constructing discount curves derived from the market price of the most appropriate observable interest rate products such as deposits, interest rate futures and swaps.

The impact of changes in a counterparty's credit spreads (known as credit valuation adjustments) is considered when measuring the fair value of derivative assets and the impact of changes in the Group's own credit spreads (known as debit valuation adjustments) is considered when measuring the fair value of its derivative liabilities.

Notes to the financial statements For the year ended 31 March 2021 continued

13. Derivative financial instruments and hedge accounting continued

Hedge accounting

The Bank continues to apply the requirements of IAS 39 “Financial Instruments: Recognition and Measurement” for hedge accounting purposes and consequently there have been no changes to the hedge accounting policies and practices following the adoption of IFRS 9.

Derivative financial instruments are used to hedge interest rate risk on fixed rate assets and liabilities and foreign exchange movement risk on highly probable forecast transactions. Instruments used for hedging purposes include interest rate derivatives, cross currency interest rate derivatives and foreign exchange forwards.

The criteria required for a derivative instrument to be classified as a hedge are as follows:

- At inception of the hedge the Bank formally documents the hedge relationship between hedged item and the hedging instrument. This will also include the aim and objective of the risk management and the method that will be used to assess the effectiveness of the hedging relationship.
- The hedge is expected to be highly effective.
- For cash flow hedges, any forecast transactions included must be highly probable and must present an exposure to variations in cash flows that could affect the profit and loss.
- The effectiveness of the hedge (hedged item and hedging instrument) can be reliably measured.
- The hedge effectiveness is assessed on an ongoing basis and determined to have been highly effective throughout the financial reporting periods for which the hedge is designated.

The Bank applies either fair value or cash flow hedge accounting when the transaction meets the above criteria. Hedge accounting is discontinued when it is determined that the derivative ceases to be highly effective as a hedge. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%. A hedge will also cease to be effective if the derivative or asset is sold, terminated, expires or matures, or when a forecast transaction is no longer deemed probable.

Interest rate benchmark reform (policy applied from 1 April 2020)

i) Phase 1 amendments

The Bank applies the IBOR reform Phase 1 reliefs to hedging relationships directly affected by IBOR reform during the period before the replacement of an existing interest rate benchmark with an alternative risk-free rate (RFR). A hedging relationship is affected if IBOR reform gives rise to the following uncertainties:

- the timing and or amount of interest rate benchmark-based cash flows of the hedged item or the hedging instrument; and/or
- an interest rate benchmark subject to the reform is designated as the hedged risk, regardless of whether the rate is contractually specified.

The reliefs require that for the purpose of determining whether a forecast transaction is highly probable, it is assumed that the IBOR on which the hedged cash flows are based is not altered as a result of the IBOR reform.

IBOR reform Phase 1 requires that for hedging relationships affected by IBOR reform, the Bank must assume for the purpose of assessing expected future hedge effectiveness, the interest rate is not altered as a result of IBOR reform. Also, the Bank is not required to discontinue the hedging relationship if the results of the assessment of retrospective hedge effectiveness fall outside the range of 80% to 125%, although any hedge ineffectiveness must be recognised in profit or loss, as normal.

The reliefs cease to apply once certain conditions are met. These include when the uncertainty arising from IBOR reform is no longer present with respect to the timing and amount of the benchmark-based cash flows of the hedged item, if the hedging relationship is discontinued or once amounts in the cash flow hedge reserve have been released.

ii) Phase 2 amendments (policy applied from 1 April 2020)

The Bank has elected to early adopt "interest Rate Benchmark Reform – Phase 2 – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16" issued in August 2020 and has retrospectively applied the amendments from 1 April 2020.

When the basis for determining the contractual cash flows of the hedged item or hedging instrument changes as a result of IBOR reform and therefore there is no longer uncertainty arising about the cash flows of the hedged item or the hedging instrument, the Bank amends the hedge documentation of that hedging relationship to reflect the change(s) required by IBOR reform. For this purpose, the hedge designation is amended only to make one or more of the following changes:

- designating an alternative benchmark rate as the hedged risk;
- updating the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged;
- updating the description of the hedging instrument; or
- updating the description of how the entity will assess hedge effectiveness.

The Bank amends the description of the hedging instrument only if the following conditions are met:

- it makes a change required by IBOR reform by changing the basis for determining the contractual cash flows of the hedging instrument or using another approach that is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument; and
- the original hedging instrument is not derecognised.

The Bank amends the formal hedge documentation by the end of the reporting period during which a change required by IBOR reform is made to the hedged risk, hedged item or hedging instrument. These amendments in the formal hedge documentation do not constitute the discontinuation of the hedging relationship or the designation of a new hedging relationship. If changes are made in addition to those changes required by IBOR reform described above, then the Bank first considers whether those additional changes result in the discontinuation of the hedge accounting relationship. If the additional changes do not result in the discontinuation of the hedge accounting relationship, then the Bank amends the formal hedge documentation for changes required by IBOR reform as mentioned above.

Notes to the financial statements For the year ended 31 March 2021 continued

13. Derivative financial instruments and hedge accounting continued

Cash flow hedges

The Bank does not have any cash flow hedges that are based on IBOR.

Fair value hedge accounting

For qualifying fair value hedges, the changes in fair value in respect of the hedged risk of both the hedged item and hedging derivative are recognised in profit and loss. Any ineffective portion of the hedge is immediately recognised in profit and loss under interest income.

If hedge relationships no longer meet the criteria for hedge accounting or the hedging derivative is sold, terminated, expires or matures, hedge accounting is discontinued. For fair value hedges of interest rate risk, the fair value adjustment to the hedged item is amortised over the remaining period to maturity of the previously designated hedge relationship using the effective interest rate method. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in profit or loss.

Cash flow hedge accounting

For qualifying cash flow hedges in respect of financial assets and liabilities, the effective portion of the change in the fair value of the hedging derivative is initially recognised in other comprehensive income and is released to profit and loss in the same periods during which the hedged item affects profit and loss. Any ineffective portion of the hedge is immediately recognised in profit and loss under net trading income.

Analysis of derivatives

The following tables show the notional amounts and fair values of the Bank's derivatives at 31 March 2021 and 31 March 2020.

	2021 Notional contract amount USDm	2021 Fair value derivative assets USDm	2021 Fair value derivative liabilities USDm	2020 Notional contract amount USDm	2020 Fair value derivative assets USDm	2020 Fair value derivative liabilities USDm
Trading derivatives						
Foreign exchange derivatives						
Forward foreign exchange	**175,305.7**	**1,216.1**	**(1,169.1)**	178,180.6	1,600.3	(1,561.5)
Currency swaps	**1,006.5**	**6.1**	**(6.1)**	2,080.0	13.3	(13.8)
Total trading derivatives	**176,312.2**	**1,222.2**	**(1,175.2)**	**180,260.6**	**1,613.6**	**(1,575.3)**
Derivatives held for risk management						
Foreign exchange derivatives						
Currency swaps – Fair value hedges	**683.3**	**33.2**	**(17.2)**	1,613.6	162.6	–
Total foreign exchange derivatives	**683.3**	**33.2**	**(17.2)**	**1,613.6**	**162.6**	**–**
Interest rate derivatives						
Interest rate swaps – Fair value hedges	**1,882.9**	**0.3**	**(36.4)**	1,491.7	0.1	(50.6)
Total interest rate derivatives	**1,882.9**	**0.3**	**(36.4)**	**1,491.7**	**0.1**	**(50.6)**
Total derivatives held for risk management	**2,566.2**	**33.5**	**(53.6)**	**3,105.3**	**162.7**	**(50.6)**
Total derivatives	**178,878.4**	**1,255.7**	**(1,228.8)**	**183,365.9**	**1,776.3**	**(1,625.9)**

Offsetting of financial assets and financial liabilities

In accordance with IAS 32 "Financial Instruments: Presentation" the bank does not offset any financial assets and liabilities. It does however receive or give collateral against certain derivative transactions and reverse repurchase agreements with such collateral subject to standard industry terms including the ISDA Credit Support Annex.

In addition, the Bank also enters into ISDA and similar master netting agreements which only allow offsetting on certain events, such as following an event of default. These do not meet the criteria for offsetting in the statement of financial position.

The disclosures set out below include derivative assets, derivative liabilities and reverse repurchase agreements that are subject to enforceable master netting arrangements or similar agreements.

		Related amounts not offset				
	Gross amounts recognised in the statement of financial position USDm	Financial instruments USDm	Cash collateral USDm	Net amount USDm	Amounts not subject to enforceable netting arrangements USDm	Total USDm
At 31 March 2021						
Derivative assets	1,098.2	(920.7)	(63.2)	114.3	157.5	1,255.7
Reverse repurchase agreements	1,732.7	(1,732.7)	–	–	–	1,732.7
	2,830.9	**(2,653.4)**	**(63.2)**	**114.3**	**157.5**	**2,988.4**
Derivatives liabilities	**1,128.4**	**(920.7)**	**(143.0)**	**64.7**	**100.4**	**1,228.8**
At 31 March 2020						
Derivative assets	1,362.2	(781.4)	(183.5)	397.3	414.1	1,776.3
Reverse repurchase agreements	1,502.5	(1,502.5)	–	–	–	1,502.5
	2,864.7	**(2,283.9)**	**(183.5)**	**397.3**	**414.1**	**3,278.8**
Derivatives liabilities	**1,301.2**	**(781.4)**	**(386.5)**	**133.3**	**324.9**	**1,626.1**

Hedge accounting

As part of its asset and liability management, the Bank uses derivatives as fair value hedges to protect it against changes in the fair value of financial assets and financial liabilities due to movements in exchange rates and interest. Derivatives often involve at their inception only a mutual exchange of promises with little or no transfer of consideration. These instruments frequently involve a high degree of leverage and can be volatile. Due to this, the Bank maintains very tight control over their use and whenever a derivative hedge is used it is imperative that the critical terms of the hedging instrument and the hedged item are closely aligned.

The Bank applies hedge accounting to manage interest rate and foreign exchange risk. Further details of how these risks arise and how they are managed by the Bank are discussed in note 4(b).

In order to hedge the risks to which the Bank is exposed, the hedging instruments employed are interest rate and cross currency interest rate swaps. Swaps are contractual agreements between two parties to exchange streams of payments over time based on specified notional amounts, in relation to movements in specified underlying indices such as an interest rate or foreign currency rate.

Notes to the financial statements For the year ended 31 March 2021 continued

13. Derivative financial instruments and hedge accounting continued

Interest rate swaps relate to contracts taken out by the Bank with other financial institutions in which the Bank either receives or pays a floating rate of interest in return for paying or receiving, respectively, a fixed or alternative floating rate of interest. The payment flows are usually netted against each other, with the difference being paid by one party to the other.

In a cross currency interest rate swap, the Bank pays the principal amount in one currency and receives the principal amount in the other currency at the start of the deal with the reverse at the maturity of the deal. Interim cash flows of interest are then exchanged on the same basis as an interest rate swap in that the Bank either receives or pays a floating rate of interest in one currency, in return for paying or receiving, respectively, a fixed rate of interest in the other currency.

The hedging instruments share the same risk exposure as the hedged items, being interest rate and currency risk. Before fair value hedge accounting is applied, the Bank determines whether an economic relationship exists between the hedged item and the hedging instrument based on an evaluation of the qualitative characteristics of these items and the hedged risk and considers whether the critical terms of the hedged item and hedging instrument are closely aligned.

Hedge effectiveness is determined with reference to changes in the fair value of the hedged item compared with the fair value of the hedge on a cumulative basis. The hedge is considered effective if the results are in the range of 80% to 125%.

Sources of hedge ineffectiveness may arise from the following:

- mismatches between the contractual terms of the hedged item and hedging instrument, including differences in maturities or basis differences between the hedged item and the hedging instrument; or
- changes in credit risk of the hedging instrument.

Interest rate benchmark reform

Following the financial crisis, the reform and replacement of benchmark interest rates such as IBOR has become a priority for global regulators. Since the changes are market driven, there is currently some uncertainty around the timing and precise nature of these changes.

The Bank's risk exposure is directly affected by interest rate benchmark reform, across its fair value hedge accounting activities where IBOR-linked derivatives are designated as a fair value hedge of fixed interest rate assets.

The Bank's risk exposure is predominantly to GBP, USD, EUR and JPY LIBOR.

Fair value hedges

The financial instruments hedged for interest rate risk include fixed rate loans and bonds. The Bank uses interest rate swaps to hedge interest rate risk (including currency swaps) and to hedge against specifically identified currency risks. Interest rate risk arises as the Bank holds a portfolio of medium and long-term fixed rate customer loans whose fair value fluctuates due to movements in market interest rates. In such cases changes in the fair values in respect of the hedged risk of both the hedging instrument and the hedged item are recognised in profit and loss.

The Bank hedges interest rate risk only to the extent of benchmark interest rates because the changes in fair value of fixed rate loans or bonds are significantly influenced by changes in the benchmark interest rate.

The following table shows the hedging instruments which are carried on the Bank's balance sheet within derivative assets and liabilities:

Hedge type	Risk category	Notional amount USDm	Carrying amount derivative assets USDm	Carrying amount derivative liabilities USDm	Change in fair value used as a basis to determine ineffectiveness USDm	Notional amount directly impacted by IBOR reform USDm
As at 31 March 2021						
Fair value	Interest rate risk	1,882.9	0.3	36.4	36.1	1,623.1
		1,882.9	**0.3**	**36.4**	**36.1**	**1,623.1**
As at 31 March 2020						
Fair value	Interest rate risk	1,491.7	0.1	50.6	56.0	n/a
		1,491.7	**0.1**	**50.6**	**56.0**	**n/a**

The following table summarises the significant hedge accounting exposures impacted by the IBOR reform as at 31 March 2021:

Current benchmark rate	Expected convergence to RFR	Notional amount of hedged items directly impacted by IBOR reform USDm	Notional amount of hedging instruments directly impacted by IBOR reform USDm
GBP London Interbank Offered Rate (LIBOR)	Reformed Sterling Overnight Index Average (SONIA)	615.4	615.4
USD LIBOR	Secured Overnight Financing Rate (SOFR)	863.3	863.3
JPY LIBOR	Tokyo Overnight Average (TONA)	144.4	144.4

Notes to the financial statements For the year ended 31 March 2021 continued

13. Derivative financial instruments and hedge accounting continued

The following table profiles the expected notional values of current hedging instruments:

	Maturity 31 March 2021			Maturity 31 March 2020		
Interest rate risk **Hedge of loans and advances to customers**	**Less than 1 year**	**1 to 5 years**	**More than 5 years**	Less than 1 year	1 to 5 years	More than 5 years
Notional amount (USDm)	**241.2**	**1,357.2**	**284.5**	204.4	994.1	293.2
Average fixed interest rate %	**0.3%**	**0.4%**	**1.9%**	1.1%	0.9%	2.6%

The following table shows the hedged items in fair value hedge accounting relationships:

At 31 March 2021 **Hedged risk**	**Hedged item statement of financial position classification**	**Carrying amount USDm**	**Accumulated fair value hedge adjustments included in carrying amount USDm**	**Change in fair value used as a basis to determine ineffectiveness USDm**	**Hedge ineffectiveness recognised in the income statement USDm**
Interest rate risk	Loans and advances to customers	1,882.9	39.1	39.1	–
		1,882.9	**39.1**	**39.1**	**–**

At 31 March 2020 Hedged risk	Hedged item statement of financial position classification	Carrying amount USDm	Accumulated fair value hedge adjustments included in carrying amount USDm	Change in fair value used as a basis to determine ineffectiveness USDm	Hedge ineffectiveness recognised in the income statement USDm
Interest rate risk	Loans and advances to customers	2,250.7	54.2	54.2	–
		2,250.7	**54.2**	**54.2**	**–**

Cash flow hedges

The Bank does not, in its normal customer business, transact cash flow hedges. The main use of cash flow hedges is to reduce the foreign exchange risk on the cash flows arising from the Bank's forecast Sterling expenses for each financial year. The Bank enters into US Dollar/Sterling foreign exchange forward contracts to manage variability in the Bank's highly probable cash outflows in relation to Sterling expenses for each month of the financial year.

The following table shows the hedged items in cash flow hedge accounting relationships:

Hedge type	**Risk category**	**Change in fair value used as a basis to determine ineffectiveness USDm**	**Balance in cash flow hedging reserve for assets USDm**	**Hedging gains or losses recognised in other comprehensive income USDm**	**Hedge ineffectiveness recognised in income statement USDm**
As at 31 March 2021					
Cash flow hedge	Foreign exchange risk	1.5	1.5	1.5	–
		1.5	**1.5**	**1.5**	**–**
As at 31 March 2020					
Cash flow hedge	Foreign exchange risk	5.3	5.3	5.3	–
		5.3	**5.3**	**5.3**	**–**

The amount recycled from other comprehensive income due to hedged items affecting the income statement for cash flow hedges of foreign exchange rate was USD (3.9)m (2020: nil).

The following table shows the movements of the cash flow hedging reserve:

	Cash flow hedging reserve USDm
At 1 April 2020	**3.9**
Hedging gains for the year	**1.5**
Amounts reclassified in relation to cash flows affecting profit or loss	**(3.9)**
Tax	**(0.4)**
At 31 March 2021	**1.1**

	Cash flow hedging reserve USDm
At 1 April 2019	–
Hedging gains for the year	5.3
Amounts reclassified in relation to cash flows affecting profit or loss	–
Tax	(1.4)
At 31 March 2020	**3.9**

14. Other assets

	2021 USDm	2020 USDm
Accrued income	**350.2**	291.3
Prepayments and other receivables	**40.0**	40.7
Cash collateral received under Credit Support Annex	**150.4**	504.4
	540.6	**836.4**

Notes to the financial statements For the year ended 31 March 2021 continued

15. Intangible assets and goodwill

Accounting for intangible assets

Intangible assets are stated at capitalised cost less accumulated amortisation and accumulated impairment losses. The carrying values of intangible assets are reviewed for impairment at each reporting date and when events or changes in circumstances indicate that the carrying value may not be recoverable. Expenditure on internally developed software is recognised as an asset when the Bank is able to demonstrate its intention and ability to complete the development and use the software in a manner which will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and are amortised over its useful life.

Intangible assets are amortised on a straight-line basis over their estimated useful lives as follows:

Computer software	3 years

Accounting for goodwill

The carrying value of goodwill is determined in accordance with IFRS 3 "Business Combinations" and IAS 36 "Impairment of Assets".

Goodwill arising on the acquisition of subsidiaries represents the excess of the fair value of the purchase consideration over the fair value of the Bank's share of the asset acquired and the liabilities and contingent liabilities assumed on the date of acquisition.

Goodwill is reviewed annually for impairment, or more frequently when there are indications that impairment may have incurred. The test involves comparing the carrying value of the cash generating unit (CGU) including goodwill with the present value of the pre-tax cash flows, discounted at a rate of interest that reflects the inherent risks of the CGU to which the goodwill relates, or the CGU's fair value if this is higher.

Goodwill

Goodwill acquired in a business combination is allocated, at acquisition, to the CGU that is expected to benefit from that business combination. The carrying amount of goodwill, which is immaterial, is USD 1.9m (2020: USD 1.9m).

Software

The carrying amount of software is as follows:

	Internally generated software USDm	Other software USDm	Total USDm
At 1 April 2020	12.4	94.1	106.5
Additions	3.4	17.5	20.9
Disposals	(0.1)	(0.1)	(0.2)
At 31 March 2021	**15.7**	**111.5**	**127.2**
Accumulated amortisation			
At 1 April 2020	6.9	63.2	70.1
Charge for the year	3.1	16.1	19.2
Disposals	(0.1)	–	(0.1)
At 31 March 2021	**9.9**	**79.3**	**89.2**
Net book value at 31 March 2021	**5.8**	**32.2**	**38.0**
At 1 April 2019	9.7	74.3	84.0
Additions	3.0	20.9	23.9
Disposals	(0.3)	(1.1)	(1.4)
At 31 March 2020	**12.4**	**94.1**	**106.5**
Accumulated amortisation			
At 1 April 2019	4.3	51.6	55.9
Charge for the year	2.9	12.7	15.6
Disposals	(0.3)	(1.1)	(1.4)
At 31 March 2020	**6.9**	**63.2**	**70.1**
Net book value at 31 March 2020	**5.5**	**30.9**	**36.4**

The gross carrying amount of fully depreciated software still in use is USD 61.4m (2020: USD 48.3m).

Notes to the financial statements For the year ended 31 March 2021 continued

16. Property and equipment

Accounting for property and equipment

Fixed tangible assets are stated at capitalised cost less accumulated depreciation and accumulated impairment losses. The carrying values of fixed tangible assets are reviewed for impairment at each reporting date and when events or changes in circumstances indicate that the carrying value may not be recoverable.

Property and equipment are depreciated on a straight-line basis over their estimated useful lives as follows:

Leasehold improvements	10 years or over the remaining life of the lease, whichever is the shorter
Computer hardware	3 years
Motor vehicles	5 years
Equipment, fixtures and fittings	5 years

Accounting for leases

At inception of a contract, the Bank assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Bank uses the definition of a lease in IFRS 16.

Bank acting as a lessee

At commencement or on modification of a contract that contains a lease component, the Bank allocates consideration in the contract to each lease component on the basis of its relative standalone price.

The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease, or if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate.

The Bank determines its incremental borrowing rate by analysing its borrowings from various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Lease payments included in the measurement of the lease liability comprise the following:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee; and
- the exercise price under a purchase option that the Bank is reasonably certain to exercise, lease payments in an optional renewal period if the Bank is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Bank is reasonably certain not to terminate early.

The lease liability is measured at amortised cost using the effective interest rate method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Bank's estimate of the amount expected to be payable under a residual value guarantee, if the Bank changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Bank presents right-of-use assets in property and equipment and lease liabilities in "other liabilities" in the statement of financial position.

The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low value assets and short-term leases, including leases of IT equipment. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term (note 6). The total recognised in the income statement for the year ended 31 March 2021 was USD 6.1m (2020: 5.8m).

Notes to the financial statements For the year ended 31 March 2021 continued

16. Property and equipment continued

	Right-of-use assets Land and buildings USDm	Leasehold improvements USDm	Equipment USDm	Total USDm
Cost				
At 1 April 2020	30.5	55.1	47.4	133.0
Additions	178.7	8.3	12.1	199.1
Disposals	(15.0)	(0.1)	–	(15.1)
At 31 March 2021	**194.2**	**63.3**	**59.5**	**317.0**
Accumulated depreciation				
At 1 April 2020	8.7	40.7	38.5	87.9
Charge for the year	13.8	1.9	5.9	21.6
Disposals	(11.5)	(0.1)	–	(11.6)
At 31 March 2021	**11.0**	**42.5**	**44.4**	**97.9**
Net book value at 31 March 2021	**183.2**	**20.8**	**15.1**	**219.1**
Cost				
At 1 April 2019	–	55.4	49.0	104.4
Recognition of right-of-use asset on initial application of IFRS 16	30.5	–	–	30.5
Adjusted balance at 1 April 2019	**30.5**	**55.4**	**49.0**	**134.9**
Additions	–	2.6	1.5	4.1
Disposals	–	(2.9)	(3.1)	(6.0)
At 31 March 2020	30.5	55.1	47.4	133.0
Accumulated depreciation				
At 1 April 2019	–	39.7	34.4	74.1
Recognition of right-of-use asset on initial application of IFRS 16	–	–	–	–
Adjusted balance at 1 April 2019	**–**	**39.7**	**34.4**	**74.1**
Charge for the year	8.7	2.7	6.6	18.0
Disposals	–	(1.7)	(2.5)	(4.2)
At 31 March 2020	**8.7**	**40.7**	**38.5**	**87.9**
Net book value at 31 March 2020	**21.8**	**14.4**	**8.9**	**45.1**

The gross carrying amount of fully depreciated property plant and equipment still in use is USD 71.3m (2020: USD 56.6m).

The ROU assets additions of USD 178.7m relate to recognition of new lease of 100 Liverpool Street and extension of existing leases of 99 Queen Victoria Street and 30 Gresham Street.

17. Debt securities in issue

	2021 USDm	2020 USDm
Certificates of deposit – held at amortised cost	**853.6**	–

All debt securities are expected to be settled no more than 12 months after the reporting date.

18. Other liabilities

	2021 USDm	2020 USDm
Lease liabilites	**192.0**	20.9
Accruals and deferred income	**181.7**	127.9
Accounts payable to parent	**6.3**	16.8
Cash collateral received under Credit Support Annex	**69.0**	205.8
Other liabilities	**50.3**	454.8
	499.3	**826.2**

Lease liabilities

The Bank leases various offices under non-cancellable lease arrangements to meet its operational business requirements. The Bank does not have any material subleasing arrangements. Right-of-use assets relate to property leases only: refer to note 16 for a breakdown of the carrying amount of right-of-use assets.

The total expenses recognised during the year for short-term and low value leases were USD 5.7m (2020: USD 5.6m) and USD 0.4m (2020 USD 0.2m), respectively. The portfolio of short-term and low value leases to which the Bank is exposed at the end of the year is not dissimilar to the expenses recognised during the year.

	USDm
As at 31 March 2019	–
Effects of changes in accounting policy	31.3
As at 1 April 2019	**31.3**
Interest expense	0.2
New leases	–
Disposals	–
Cash payments	(10.6)
As at 31 March 2020	**20.9**
Interest expense	0.9
New leases	189.2
Disposals	–
Cash payments	(19.0)
As at 31 March 2021	**192.0**

Notes to the financial statements For the year ended 31 March 2021 continued

18. Other liabilities continued

The undiscounted maturity analysis of lease liabilities at 31 March 2020 is as follows:

	Up to 3 months USDm	3 to 12 months USDm	1 to 2 years USDm	2 to 3 years USDm	3 to 4 years USDm	4 to 5 years USDm	Over 5 years USDm	Total USDm
31 March 2021								
Lease payments	2.5	7.5	5.6	7.7	16.8	16.8	151.3	208.2
Finance charges	(0.5)	(1.5)	(1.9)	(1.9)	(1.7)	(1.6)	(7.1)	(16.2)
Net present values	**2**	**6**	**3.7**	**5.8**	**15.1**	**15.2**	**144.2**	**192.0**
31 March 2020								
Lease payments	2.3	6.6	3.9	2.6	2.3	0.9	2.6	21.2
Finance charges	–	(0.1)	(0.1)	(0.1)	–	–	–	(0.3)
Net present values	**2.3**	**6.5**	**3.8**	**2.5**	**2.3**	**0.9**	**2.6**	**20.9**

The Bank is not exposed to any additional cash flows in respect of variable lease payments or extension and termination options. Additionally, the Bank does not have any significant sale and lease back transactions and does not have any restrictions or covenants imposed by the lessor on its property leases which restrict its business.

In October 2020, the Bank completed the lease signing of the new office building property at 100 Liverpool Street and recognised the lease liability of USD 158.3m payable in the next 15 years. The move from the existing buildings to the new building is expected to take place in the year to 31 March 2022.

19. Contingent liabilities

Accounting for contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised but are disclosed unless they are remote.

The Bank is a defendant in certain LIBOR-related legal cases alleging certain of our practices and actions were improper. Management believes that the Bank will be successful in resolving these matters to the extent that we are able to assess them. At the reporting date the amount at risk is not reasonably estimable. This is an area of significant judgement and the potential liability could be material to the results at the point they are recognised in future periods.

20. Called up share capital

	USDm
Issued, alloted and fully paid share capital (Ordinary shares of USD 1,000)	
At 31 March 2020	3,200.0
Additions	0.1
At 31 March 2021	**3,200.1**

The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the Prudential Regulation Authority in supervising banks.

The Bank's capital is managed to ensure the Bank complies with external requirements and, in order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payments to shareholders, return capital or issue capital securities. There were no changes to the objectives, policies or process for the management of capital in the year. During the year there were no breaches of the Bank's capital adequacy requirement which required reporting to the Prudential Regulation Authority.

The Bank's available regulatory capital as at year-end was USD 4,787.9m (2020: USD 4,583.3m) calculated as total equity per financial statements less regulatory adjustments as per the requirements laid down in the Capital Requirements Regulation (CRR).

The following table provides a reconciliation of the Bank's balance sheet position to the Bank's regulatory capital position.

	2021 USDm	2020 USDm
Shareholders' equity per financial statements	**4,788.6**	4,577.3
Reserves not included in Tier 1 capital	**(1.1)**	(3.9)
Cash flow hedge	**(1.1)**	(3.9)
Deductions and other adjustments	**0.4**	9.9
Tier 1 capital after deductions	**4,787.9**	**4,583.3**

21. Guarantees and commitments

Accounting for guarantees

In the course of its business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are initially recognised in the financial statements at fair value being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium or the provision in line with the policy in note 4. The premium receivable is recognised in profit and loss in fees and commissions income using the effective interest rate method over the life of the guarantee. Any increase in the liability relating to financial guarantees is taken to profit and loss.

	2021 Contract amount USDm	2020 Contract amount USDm
Guarantees and letters of credit	**3,136.2**	2,945.3
Undrawn formal standby facilities, credit lines and other commitments to lend	**12,469.6**	11,217.5

Guarantees and letters of credit commit the Bank to make payments on behalf of customers upon the occurrence of an event, generally related to the import or export of goods.

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Guarantees, letters of credit and commitments carry the same credit risk as loans and are subject to the expected credit loss requirements of IFRS 9: for further details please refer to note 4.

Notes to the financial statements For the year ended 31 March 2021 continued

22. Assets pledged

Assets are pledged as collateral to secure liabilities or as security deposits on derivatives. The following table summarises the nature and carrying amount of assets pledged against liabilities held.

	2021 USDm	2020 USDm
Loans and advances to customers	**264.0**	441.6
Other assets	**150.4**	504.4
	414.4	**946.0**

The loan and advance to customers were pledged to the Banque de France. These assets allow the Bank to draw additional liquidity as of the year-end of USD 262.8m (2020: USD 434.3m). The other assets have been pledged as security deposits on derivatives.

23. Related parties

Two or more parties are considered to be related when one party has direct or indirect control over the other party; or the parties are subject to common control from the same source; or one party has influence over the financial and operating policies of the other party to the extent that that other party might be inhibited from pursuing at all times its own separate interests.

Key management personnel are the Directors of the Company. There were no loans or deposits with or to key management personnel (and their connected persons) of the Bank. Key management personnel compensation is as follows:

	2021 USDm	2020 USDm
Short-term employee benefits	**3.0**	2.0
Post-employment benefits	**0.1**	0.1
	3.1	**2.1**

The Bank has entered into a Keep Well Deed under which the Bank and SMBC agree to certain financial arrangements, including the obligation of the parent to maintain tangible net worth in the Bank at all times sufficient to cover the Bank's obligations arising through any of its business activities.

Amounts receivable from related parties of the Bank are as follows:

	2021		2020	
	Loans and advances USDm	Other assets USDm	Loans and advances USDm	Other assets USDm
Amounts due from parent company	**1,708.7**	**646.4**	1,989.6	756.2
Amounts due from other related parties	**333.3**	**94.1**	313.5	230.9
Total	**2,042.0**	**740.5**	**2,303.1**	**987.1**

Loans and advances are made in the ordinary course of business and on the same terms as comparable transactions with third parties. Other assets predominantly include derivative assets and other receivables.

Amounts payable to related parties of the Bank are as follows:

	2021		2020	
	Deposits USDm	**Other liabilities USDm**	Deposits USDm	Other liabilities USDm
Amounts due to parent company	**20,752.0**	**355.1**	22,798.9	212.6
Amounts due to other related parties	**471.1**	**58.8**	756.8	68.6
Total	**21,223.1**	**413.9**	**23,555.7**	**281.2**

The Bank receives collateral consisting of cash (part of amounts due to parent company) of USD 4,392.3m (2020: USD 6,002.4m), from SMBC, to mitigate large exposures on intra-group positions. Deposits are taken in the ordinary course of business and on the same terms as comparable transactions with third parties.

Guarantees received from related parties of the Bank are as follows:

	2021 USDm	2020 USDm
Guarantees received on customer accounts	**2,830.9**	3,764.8
Guarantees received on the Bank's liabilities	**3,062.9**	2,467.8

Amounts recognised in the statement of comprehensive income in respect of related party transactions are as follows:

2021	**Parent companies USDm**	**Other related parties USDm**	**Total USDm**
Interest income	**1.5**	**11.2**	**12.7**
Interest payable	**(97.0)**	**(35.4)**	**(132.4)**
Fees and commissions receivable	**385.5**	**20.4**	**405.9**
Fees and commissions payable	**(1.1)**	**(1.2)**	**(2.3)**
Net trading	**–**	**(0.3)**	**(0.3)**
Other expenses	**(16.3)**	**(3.1)**	**(19.4)**
Total	**272.6**	**(8.4)**	**264.2**

2020	Parent companies USDm	Other related parties USDm	Total USDm
Interest income	3.7	24.0	27.7
Interest payable	(197.2)	(82.5)	(279.7)
Fees and commissions receivable	367.7	8.9	376.6
Fees and commissions payable	(2.2)	(1.1)	(3.3)
Net trading	–	(0.3)	(0.3)
Other expenses	(21.2)	(5.4)	(26.6)
Total	**150.8**	**(56.4)**	**94.4**

Notes to the financial statements For the year ended 31 March 2021 continued

24. Country-by-country report

The Capital Requirements (Country-by-country Reporting) Regulations 2013 came into effect on 1 January 2014. The requirements impose certain reporting obligations on credit institutions and investments firms within the UK and within the scope of EU Capital Requirements Directive IV. The Bank's Country-by-country report is presented below.

Country-by-country disclosure (USDm)

2021

Type	Activity	Geographical location	Turnover	Profit or loss before income tax	Cash tax	Average headcount
Branch	Corporate banking	UK	**735.3**	**315.6**	**35.7**	**1,165**
Branch	Corporate banking	France	**113.2**	**17.5**	**14.8**	**81**
Intra-group adjustments			**(7.5)**			
Total			**841.0**	**333.1**	**50.5**	**1,246**

2020

Type	Activity	Geographical location	Turnover	Profit or loss before income tax	Cash tax	Average headcount
Branch	Corporate banking	UK	770.3	175.6	132.9	1,059
Branch	Corporate banking	France	80.4	35.8	17.4	77
Branch	Corporate banking	Italy[1]	–	–	2.1	n/a
Branch	Marketing activities	Netherlands[2]	–	2.7	0.7	n/a
Branch	Marketing activities	Ireland[2]	–	2.3	–	n/a
Branch	Marketing activities	Spain[2]	–	0.9	–	n/a
Branch	Marketing activities	Czechia[2]	–	2.3	0.2	n/a
Intra-group adjustments			(7.4)	–	–	–
Total			**843.3**	**219.6**	**153.3**	**1,136**

1 On 18 March 2019, the assets and liabilities of Milan Branch were transferred to SMBC Bank EU AG and the Branch ceased its operations as part of the Bank on that date.

2 On 1 April 2019 the assets and liabilities of the Amsterdam, Ireland, Madrid and Prague Branches were transferred to SMBC Bank EU AG and the Branches ceased their operations as part of the Bank on that date. The profit for each of the Branches above relates to the profit arising on sale.

Basis of preparation

1. Activities:

   Corporate banking – refers to the activities mentioned on page 3.
   Marketing activities – refers to customer facing activities undertaken on behalf of other Bank branches.

2. Geographical location – the country where the branch is established.

3. Turnover includes interest income, interest expense, fees and commissions income, fees and commissions expense and net trading (loss)/income. This is in line with the financial statements.

4. Cash tax – refers to cash amount of all corporation tax paid in each location during the period 1 April to 31 March each year including Group relief.

5. Public subsidies – refers to direct support by the Government. The Bank does not receive any public subsidies.

25. Parent companies

The Bank's immediate parent is Sumitomo Mitsui Banking Corporation, a company incorporated in Japan. It has included the Bank in its Group financial statements, copies of which are available from its registered office 1-1-2, Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan.

The Bank's ultimate parent company is Sumitomo Mitsui Financial Group Inc. which is incorporated in Japan. SMFG's consolidated financial statements can be obtained from its registered office at 1-1-2, Marunouchi , Chiyoda-ku, Tokyo 100-0005, Japan.

SMBC