Pillar 3 Disclosures

As at 31st December 2016

Registered number 4152338

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1. The Bank's Activities

Melli Bank plc ("the Bank") is a UK incorporated commercial bank with its Head Office in London. It is authorised by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority ("FCA") and the PRA under the Financial Services and Markets Act 2000. The Bank's registered address is 98a Kensington High Street, London, W8 4SG.

The Bank is a wholly owned subsidiary of Bank Melli Iran ("BMI"), the largest commercial and retail bank in Iran, which has had a presence in London since 1967.

The Bank has one branch in Hong Kong which is regulated by the Hong Kong Monetary Authority ("HKMA").

The principal activity of the company is the provision of banking services.

2016 was an eventful year for the Bank. On 14 July 2015 the E3/EU+3 (China, France, Germany, the Russian Federation, the United Kingdom and the United States, with the High Representative of the European Union for Foreign Affairs and Security Policy) and the Islamic Republic of Iran agreed a Joint Comprehensive Plan of Action (JCPOA). On the implementation of the JCPOA on 16th January 2016, the EU sanctions imposed on the Bank and a number of other Iranian institutions (including Bank Melli Iran and the Central Bank of Iran) were lifted. SWIFT was also permitted to reconnect its network to Iranian banks that were no longer under sanction. Further to the signing of the JCPOA, the Bank, in anticipation of the imminent lifting of the sections, started a business re-launch programme to achieve readiness for the resumption of the banking activities. As part of this process the Bank sought the PRA's guidance on the steps it needed to take to ensure the PRA did not object to the resumption of the activities. In satisfaction of these steps and in keeping with the regulatory requirements, the Bank submitted a revised business plan, ICAAP and ILAAP and a project plan explaining how and when the Bank would establish appropriate governance and risk management arrangements. The PRA, having reviewed these documents, informed the Bank on 18 January 2016 that it does not object to the Bank resuming normal banking activities.

The restrictions on the activities of the Bank's Hong Kong branch which were imposed by the Hong Kong Monetary Authority as a result of the imposition of the EU sanctions were lifted on 24 June 2016. However, prior to undertaking any banking transactions, the Hong Kong branch is reviewing and enhancing its systems and controls to levels which are sufficient and effective for the purpose of the resumption of normal banking activities.

During 2016 the Bank was engaged in putting in place the services required to enable it to implement its business plan. The Bank's business model relies on the provision of banking services to the customers or potential customers involved in the chain of trade transactions between Iran and the EU and the Asia Pacific countries. It is crucial for the Bank to be able to pay and receive funds in Euro, which is its functional currency, as well as Sterling and the Hong Kong Dollar which are the currencies of the locations where the Bank has a physical presence. The Bank has become a direct participant of TARGET2, the Euro clearing system, and the Hong Kong branch has access to HKD CHATS, the Hong Kong Dollar clearing system. The efforts to establish Pound Sterling clearing in the UK are ongoing. At the same time the Bank has been devoting a great deal of time, effort and resources to customer due diligence with the aim of on boarding its key customers which are made up of government owned Iranian banks and institutions. Solid progress was made in 2016 and as a result the Bank is ready to provide banking services to its core customer base.

The Bank, prior to the imposition of sanctions, held a prominent position in the provision of banking services to the importers, exporters and the banking counterparties involved in the international trading transactions between Iran and other countries. The lifting of the EU sanctions has enabled the Bank to resume the strategy of offering these products and services.

2. Pillar 3 disclosures

The European Union Capital Requirements Directive ("CRD") came into effect on 1 January 2007. It introduced capital adequacy standards (and an associated supervisory framework) in the EU based on the Basel II rules.

The Basel Framework is structured around three pillars:

- **Pillar 1** establishes a bank's minimum capital requirements in respect of credit, market and operational risk exposures.
- **Pillar 2** requires banks to identify any specific risks that may result in additional capital being held (along with a supervisory review of the same).
- **Pillar 3** defines the disclosure requirements that allow market participants to assess a bank's risk profile.

These requirements have been enhanced over time and the latest CRD (implementing Basel III and known as CRD IV) came into effect on 1 January 2014.

This document represents Melli Bank plc's annual Pillar 3 disclosure for the financial year ended 31 December2016.

3. Risk Management Overview

The aim of risk management is to minimise risk and maximise opportunities in all of the Bank's activities. An effective risk management framework ensures that the Board of Directors ("the Board") and senior management run the Bank prudently and allows the Bank to carry out its operations with adequate resilience against failure.

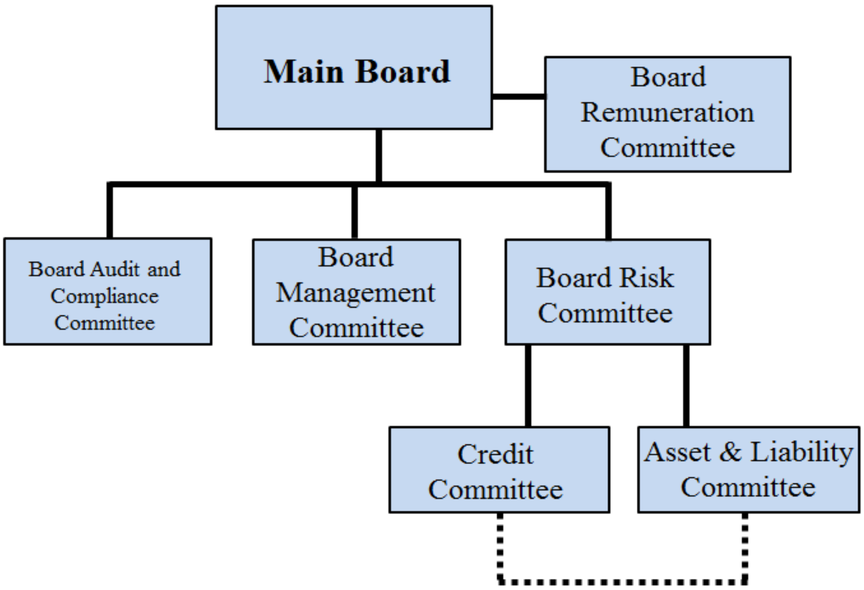
The Bank's Risk Management Framework Policy formalises the Bank's risk management framework and establishes the process for the management of risks faced by the Bank. The policy is reviewed on an annual basis.

It is the responsibility of all Board members, senior management and staff to identify, analyse, evaluate, respond, monitor and communicate risks associated with any activity, function or process within their scope of responsibility and authority.

3.1 Risk Control Environment

The size and structure of Melli Bank enables the direct involvement of the most senior managers in the day to day activities of the Bank and provides short and effective channels of communication that readily identify and address both threats and opportunities.

In parallel to routine operational controls, the Bank operates a committee structure to formally review activities.



3.1.1 The Board of Directors

The Board is primarily responsible for approving and overseeing the implementation of the Bank's strategic objectives, risk strategy, corporate governance and corporate values. Furthermore, the Board is also accountable for monitoring and overseeing the performance of senior management as the latter manages the day-to-day affairs of the Bank.

The Board comprises of four non-executive directors (two of whom are UK based independent non-executive directors and one is the Chairman of the Bank who is also the Chairman and Managing Director of BMI), the Managing Director, the Director of Risk Management & Finance and the Director of Corporate Affairs.

In accordance with the Bank's Articles of Association, the members of the Board are appointed by the majority shareholder, Bank Melli Iran.

Appointments to the Board are made so as to ensure that its members have collectively the appropriate skills and expertise to manage the current operations of the Bank and to successfully execute the business plan.

The Bank recognises the value of diversity. The Board comprises a mix of nationalities, ethnic backgrounds and religious beliefs.

The members of the Board hold a further 9 directorships between them.

3.1.2 The Board Audit and Compliance Committee

The Board Audit and Compliance Committee provides independent oversight of the activities of the management and plays a significant role in ensuring that the controls as implemented by the management are effective. It assists the Board in the appointment of the external and internal auditors and the review of their findings.

The Board Audit and Compliance Committee comprises two independent non-executive UK resident directors. There is a requirement that at least one of these directors must be a member of the Board Risk Committee and at least one of these directors must have recent and relevant financial experience.

3.1.3 The Board Risk Committee

The Board Risk Committee, in liaison with the executive management, provides oversight over the arrangements for the management of risk. It assesses the Bank's capability to identify and manage new risk types, and oversees and advises the Board on the current risk exposures and future risk strategy including the strategy for capital and liquidity management. Its advice to the Board includes advice on the Bank's overall risk appetite and the related risk limits and risk tolerances.

Membership of the Board Risk Committee comprises of two independent non-executive UK resident directors (one of whom is the Chairman), the Managing Director and the Director for Risk Management and Finance. The activities of the Board Risk Committee involve participation by the Chairman of the Board Audit and Compliance Committee.

3.1.4 The Board Remuneration Committee

The Board Remuneration Committee is responsible for ensuring that the members of the executive management of the Bank are provided with appropriate remuneration and incentives to encourage enhanced performance in a fair and responsible manner (in line with the Bank's risk appetite and risk culture).

The Remuneration Committee comprises of two independent non-executive UK resident directors and the Chairman of the Board who chairs the Committee. When appropriate, the Remuneration Committee may invite the Executive Directors or other members of staff or advisors of the Bank to attend its meetings.

3.1.5 The Board Management Committee

The Board Management Committee is responsible for supporting the Board in setting strategic objectives, and business and operational strategies. It reviews the Bank's policies for submission to the Board for approval and it is responsible for the review and approval of operational procedures.

The Board Management Committee is chaired by the Managing Director and in addition consists of the Director for Risk Management and Finance, the Director for Corporate Affairs, Assistant to Managing Director – Banking Operations, Manager of Risk Department, Financial Controller, Head of Compliance, Credit Administration and Settlements Manager, Customer Services Manager, Treasury Manager and IT Manager.

3.1.6 The Credit Committee

The Credit Committee is an executive committee which assesses proposed credit exposure transactions and, if within the Board mandated limits, either approves them or rejects them. If the proposed exposures are outside the Committee's authority, it recommends them to the Board for approval in accordance with the provisions of the Credit Policy Statement.

The Credit Committee comprises the Managing Director (as Chairman), the Director of Risk Management and Finance, Director of Corporate Affairs, the Manager of Risk Department and the Assistant to Managing Director - Banking Operations. The Credit Analyst attends the meetings for presenting the proposals to the committee.

3.1.7 The Assets & Liabilities Committee

The Assets & Liabilities Committee is an executive committee which supports and advises the Managing Director on the management of the Bank's assets and liabilities. It also provides oversight of liquidity and market risk in accordance with the provisions of the Liquidity and Market Risk policies.

The Assets & Liabilities Committee comprises of the Managing Director, Director of Risk Management and Finance, Director Corporate Affairs, Assistant to Managing Director – Banking Operations, Manager of Risk Department, Manager of Treasury Department and the Financial Controller.

3.2 The Executive Directors

The Executive Directors are responsible for the day-to-day management of risks within their lines of responsibility and report to the Board on risk matters.

Managing Director

The Managing Director is responsible for the formulation of strategies that are aligned with the Bank's Risk Appetite and to ensure they are executed in keeping with the Risk Management Framework.

Director for Corporate Affairs

The Director for Corporate Affairs ("DCA") is responsible for bank-wide coordination of the oversight of legal and compliance matters, human resourcing and staff training. The DCA also has overall responsibility for the Bank's Treasury function.

Director for Risk Management and Finance

The Director for Risk Management and Finance ("DRMF) is responsible for coordinating the risk management activities of the Bank. The DRMF also has overall responsibility for the Bank's Finance function.

3.3 Risk Responsibilities

The Bank has defined a hierarchical structure to define risk responsibilities adopting the "three lines of defence" model:

- **First line of defence**: line management is responsible for ensuring that a risk and control environment is established as part of the day-to-day operations.
- **Second line of defence**: oversight functions (i.e. the Director of Risk Management and Finance and the Director of Corporate Affairs) are responsible for designing policies, setting direction and ensuring compliance.
- **Third line of defence**: assurance is provided by independent internal auditors reporting to the Board Audit and Compliance Committee.

3.4 Risk Management Framework ("RMF")

The Bank's risks are managed through an RMF to ensure consistency and transparency in risk management across the Bank and in its various locations (London, Hong Kong and Tehran).

The Bank's RMF and internal control systems are commensurate to the nature, size and complexity of its operations and are based upon what the Board considers to be appropriate having regard to the materiality of strategic, business, financial and operational risks inherent in the execution of the Bank's business plan. The framework has not been defined to eliminate the risk of loss but to provide reasonable assurance against material loss.

The Bank operates an integrated risk framework whose main elements are the following:

- Identification of the risks that could significantly impact business objectives;
- Definition of the risk appetite given the business objectives, risk capacity and existing risks;
- Assessment and measurement of the risks and definition of mitigation activities to ensure consistency between risk-taking and the risk appetite;
- Performing stress tests to assess the Bank's resilience in case of severe economic scenarios; and
- Monitoring the risks and ensuring a comprehensive, meaningful and timely risk reporting to anticipate problems and provide forward looking risk assessments;
- Considering the information emerging from the process in the strategic planning process and in setting business objectives.

3.4.1 Risk Identification

There are a wide variety of internal and external risks that could affect the performance of the Bank and undermine the achievement of its objectives. Risk identification is the critical first step of the risk management process. In the absence of an effective risk identification process the Bank could fail in establishing monitoring activities and controls leaving the Bank vulnerable to internal and external threats.

3.4.1.1 Core Risks

The Bank's core risks are:

- Credit Risk
- Concentration Risk (in particular the risk attached to the Bank's large credit exposure in Iran)
- Operational Risk
- Business and Strategic Risk
- Liquidity Risk

Other risks include:

- Interest Rate Risk
- Market Risk
- Group Risk
- Reputational Risk
- Pension Obligations Risk

Credit Risk

Credit risk arises mainly from sovereign exposures (mainly Iran and any High Quality Liquid Assets sovereign exposures) and bank counterparty credit exposures (currently, mainly Iranian/non-Iranian nostros and placements. Iranian trade finance related bank exposures are expected to become significant in the future).

There is a requirement to clearly identify credit risk and to manage it not only individually, but also at a sector/industry level and at an overall portfolio level. By closely monitoring its portfolio, the Bank is able to gauge the quality of credit risk taken on its books and is able to gauge the movement of the portfolio over time.

The Bank emphasises a policy of adequate asset quality, as reflected in its Credit Policy Statement. Asset quality is determined on the basis of the size, trend, and mix of the Bank's portfolio of financial assets, as well as the associated credit risk. The Bank's consistently strong asset base is the direct result of credit decisions that have been and will continue to be driven by principles outlined in its Credit Policy Statement.

Iran has been the Bank's niche market where it has historically had a large concentration, mainly as a result of its expert knowledge in understanding, analysing and managing the unique risks associated with investment opportunities in the Iranian market. However, strict standards in maintaining a high-quality asset base have led to the adoption of a conservative approach even with the Iranian business and thus the Bank's products (including bank placements) have generally been offered to a select class of high-quality and reputable customers known to the Bank. To assess risk, the Bank has carefully combined a judgmental approach, taking account of management quality, industry, and operating environment, with a discriminant analysis approach addressing liquidity, leverage, profitability, debt-service coverage, and volatility among other factors.

The Bank monitors the credit portfolio identifying individual portfolio segments and movements in the portfolio over time. Customer, issuer and industry risk are reviewed on inception of each particular transaction, and regularly thereafter. In instances of concern, a more frequent review schedule is applied.

The Bank would usually look to take security in support of corporate loan facilities with the type and level of security being determined on a case by case basis but normally taking the form of one or more of the following:

- A pledge of shares in listed companies
- A mortgage of property
- Bank, corporate or personal guarantees
- Cash

The security would typically cover a sum in excess of the credit exposure.

Inter-bank limits are reviewed annually with the assistance of a matrix approved by the Board. The matrix is driven by the level of the External Credit Assessment Institution ("ECAI") short and long term ratings and the net worth of each bank. Any adverse change in the rating of a bank could require the limit to be reduced. Occasionally, the Bank will take a view that it would be appropriate to mark a limit above the matrix driven limit or mark a limit for a bank which is not rated by an ECAI, in which case an individual credit risk analysis is performed.

Country risk is analysed using a matrix based upon the level of the ECAI short and long term rating for each country. The matrix is approved by the Board, and a presentation to Credit Committee is made annually. As is the case with banks, any adverse change in the rating of a country during the year could require the limit to be reduced.

Exposures against overall limits (both regulatory and internal) are checked on a daily basis, and any excesses are reported to senior management, the Credit Committee and the Board Risk Committee.

As the sanctions prevented the Bank from undertaking new business the Bank's loan book largely ran-off, and it has no material off-balance sheet exposures. The Bank now intends to re-build its loan portfolio to enhance profitability.

The Bank makes impairment provisions only where there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that event (or events) has an impact on the estimated future cash flows from the asset that can be reliably estimated. No change to the provision charge was made in 2016.

Concentration Risk

Concentration risk arises when a number of counterparties are engaged in similar activities or similar geographic locations so that they have economic characteristics that would cause their ability to meet their obligations to be similarly affected by changes in economic or other circumstances. Concentration risk can also arise from a large exposure to a single counterparty. Before the imposition of the sanctions the major area of sector concentration was the Iranian banking sector whilst geographic concentration arose from the Bank's exposure to Iran: this area receives particular attention in the identification of the amount of capital to be set aside to meet the risks inherent in the Bank's business model. During the sanctions certain single name bank concentrations developed due to the inability to move funds across the Bank's correspondent bank (nostro) accounts. Following the lifting of the sanctions the Bank has successfully reduced single name bank concentration. Once correspondent banking relationships in the UK have been established single name concentration will be further reduced. The Bank intends to implement the same business model as it successfully pursued prior to the imposition of the sanctions and hence similar sector and country concentrations are projected.

The Bank's business plan includes the take up of exposure to Iranian state-owned banks. Its experience of lending to Iranian state owned banks and businesses has been good, with no losses recorded from such business during more than 14 years of Melli Bank's operation. Furthermore, the Bank has not recorded any losses from such business even whilst operating as a branch of Bank Melli Iran, in total more than forty years of experience without loss. The Iranian state banks have an established track record of meeting all obligations, including any interest cost of delayed payments.

The Bank also lends to privately-owned Iranian banks. Again, the Bank's experience has been good with no recorded losses, but the history is shorter and the customers are inherently less secure. However, given the regulatory environment and the structure of the Iranian banking sector, the Bank considers that capital losses will not arise.

Before the sanctions the Bank had some funding concentration risk as almost all of its deposits were from its parent and the Central Bank of Iran. The Bank intends to diversify its deposit and funding base as the loan book is re-built.

<u>Operational Risk</u>

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It can arise in a wide range of areas. The Bank's current focus is on governance, processing of banking transactions (Operations), compliance with regulations, conduct, and cybercrime

The Bank's policy is to monitor Operational Risk through the assessment of losses or events that could have resulted in a significant loss, the review of new procedures and reporting to the Risk Committee. The Bank has identified no material losses since implementation of this policy, and any process failures identified as near losses have been addressed. The Bank has a full Business Continuity Plan in place which is tested to ensure operational effectiveness. The procedures include a fully functional back up site with necessary IT systems and communication capabilities.

<u>Business and Strategic Risk</u>

Business and Strategic Risk is any risk to the Bank arising from changes in its business, including the acute risk to earnings posed by falling or volatile income and the broader risk of a Bank's business model or strategy proving inappropriate due to macroeconomic, geopolitical, industry, regulatory or other factors. It also arises from the Bank's remuneration policy. It can also arise from significant investments for which there is a high uncertainty about success and profitability, and from a change in the Bank's strategy.

The main business risks faced by the Bank are: (i) Iran is deemed to have breached the JCPOA and the sanctions 'snap-back' (ii) letters of credit are no longer used as the preferred choice for trade flows between Iran and the rest of the world (iii) competition reduces Iranian lending margins (iv) Iranian banks and large corporates no longer choose, or are unable to maintain large balances overseas, in particular in Europe.

Liquidity Risk

The Treasury Department is responsible for carrying out the day-to-day management of liquidity risk. Special attention is paid to the inflows and outflows in the eight-day and one month time bands. Other time bands are also monitored. The Bank runs a flat to positive mismatch up to one month. The Assets and Liabilities Committee ensures that liquidity risk remains within the Bank's risk appetite. The Board Risk Committee oversees and advises the Board on the current liquidity risk exposure.

Policies in respect to liquidity management are set forth in the Bank's Liquidity Policy Statement, based on which the Bank maintains a suitable liquid position that ensures it is able to meet obligations as they become due and manages potential fluctuations in depositors' demands. The Liquidity Policy Statement specifies, among other things, the Bank's business activities and associated maturities, the structure of the deposit base and borrowing capacity, and the implementation and monitoring of liquidity.

Prior to the sanctions, the general liquidity strategy was based on funding by sustainable deposits and capital base and lending mainly in short, upto one year, assets (including a sizable portfolio of highly liquid debt securities) as this enabled the retention of adequate levels of liquidity at all times.

During the sanctions, the Bank built up large balances with banks in short term placements funded mainly by the Bank's capital. These funds were well in excess of the Bank's liquidity needs. However the sanctions prevented the Bank from managing its High Quality Liquid Assets requirements. Following the lifting of the sanctions the Bank can now manage its High Quality Liquid Assets and comfortably meets its Liquidity Coverage Ratio ("LCR") requirements.

The Bank's Internal Liquidity Adequacy Assessment Process (ILAAP) assesses liquidity risk. It assesses the prudent level of liquidity resources required to comply with the regulatory liquidity requirements and the Bank's liquidity risk appetite. It also addresses the strategies, policies and processes that enable the Bank to identify, measure, manage and monitor liquidity risk. The Bank's ILAAP concludes the Bank is in a strong liquidity position and is expected to have ample liquidity resources available over the twelve month assessment period.

3.4.1.2 Other Risks

Other risks that could affect the performance of the Bank and undermine the achievement of its objectives include:

Interest Rate Risk

The Bank is exposed to interest rate risk in the banking book as most of its receivables (from loans and placements) and customer deposit costs are interest rate driven. The Bank intends to match assets and liabilities tenors to ensure that the maturities and repricing is as close as possible.

The interest rate risk is managed and monitored by means of daily interest rate gap reports. Reports are circulated to the Assets & Liabilities Committee and the report distribution system enables drill down of any reported item to product or account level.

Under the Interest Rate Risk in the Banking Book ("IRRBB") calculations, the net present value ("NPV") sensitivity to a +2% shift in interest rates is estimated to be -€803,000, the sensitivity to a -2% shift is estimated to be +€825,000.

The analysis of Interest Rate Risk is shown as the time period until interest rates are repriced or the fixed interest investments mature. No material interest rate gap in excess of one year is carried.

The Bank makes no adjustment to the re-pricing dates of deposits or assets, all are assumed at the contracted date in the management of interest exposure.

Market Risk

The Treasury Department is responsible for carrying out the day-to-day management of foreign exchange risk. The Assets and Liabilities Committee ensures that foreign exchange risk remains within the Bank's risk appetite and related risk limits. The Board Risk Committee oversees and advises the Board on the current foreign exchange risk and future market risk strategy. It also reviews the efficiency of the processes for the identification and management of market risk and advises the Board on the Bank's risk appetite and related risk limits and risk tolerances for market risk.

The open positions are monitored daily.

Before the sanctions, the Bank's foreign exchange activity was principally driven by the requirement to cover exposure related to client operations. The limit on any open position is set by the Board on an annual basis.

During the sanctions the regulations did not permit the squaring of the Bank's positions, however, the extent of the exposure was relatively small and did not pose a large threat to the Bank's profitability.

Following the lifting of the sanctions, the Bank set about reducing open positions and now, in line with the Bank's policy, no material open positions are held.

Prior to the sanctions, market risk was primarily incurred through the Bank's limited trading activities. The Bank's post sanctions Business Plan does not envisage trading activities.

Group Risk

Transactions referred by the Group will play a large part in the Bank's ongoing viability. The Bank's main Group Risk is that its parent makes a strategic decision to route a significant portion of its trade finance transactions, which would normally be expected to come to the Bank, to other members of the group.

Reputational Risk

The risk of loss caused by a negative impact on the Bank's good name. Risks in this area could arise from operational failures, or a perceived loss of competitiveness in the market.

Pension Obligations Risk

The risk that the Bank will be required to fund its pension scheme. The Bank closed its defined benefit pension scheme in 2004 but remains liable for residual obligations. The deficits under previous valuations have been fully funded.

3.4.2 Risk Appetite

The risk appetite describes the aggregate level and types of risk that the Bank is willing to assume within its risk capacity to achieve its strategic objectives and business plan. It is considered a relevant element of the Bank's strategy and the foundation of its RMF. The Risk Appetite Framework ("RAF") includes policies, processes, controls, and systems through which the risk appetite is established, communicated, and monitored. The RAF is formalised in the Risk Appetite Statement ("RAS") approved by the Board and reviewed at least on annual basis.

The Bank classifies its risk appetite into four groups: Averse (avoidance of risk or preference for ultra-safe options that are low risk and only have a potential for limited reward), Cautious (preference for safe options that have a low degree of risk and may only have limited potential for reward), Ambitious (willing to consider all potential options and choose the one most likely to be successful, while also providing an acceptable level of reward and value for money) and Aggressive (eager to be innovative and to choose options offering potentially higher business rewards, despite greater inherent risk).

3.4.3 Risk assessment, measurements and mitigation

The Bank's risk assessment process provides the Board with information on whether risk management measures are effective, and helps the Board and the senior management to compare actual level of risks the Bank is taking with the risk appetites set. The objective of the risk assessment process is also to quantify and prioritise the most significant risks to support risk management decisions.

The Bank follows Key Risk Indicators ("KRIs") to assess the adherence to the risk appetite through triggers and limits; The Bank sets triggers and limits to avoid unknowingly exceeding its risk appetite and risk capacity. The Bank maintains a Risk Register containing information about the most relevant risks for the Bank; and a Risk Dashboard which summarises current risks.

3.4.3.1 Risk mitigation and hedging

When business is undertaken by the Bank, the amount and type of collateral taken, if any, depends on an assessment of the credit risk of the counterparty. The types of collateral considered include cash, guarantees from banks, quoted shares and property. The market value of any collateral is monitored regularly.

The Bank would expect to utilise derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies and credit risks.

3.4.3.2 Use of ECAIs and resulting outcomes

Interbank risk limits are determined using major ECAI (External Credit Assessment Institution) ratings, usually Fitch, where such ratings exist or by using the Bank's own risk assessment methodology. The assessment takes into account the transaction type and the collateral if any.

All limits are reviewed at least on an annual basis and exposures monitored daily.

3.4.3.3 Stress tests

Stress tests examine the potential impact of hypothetical adverse scenarios on the health of the Bank and provide information on the Bank's resilience to a range of adverse shocks.

The Bank performs stress tests when reviewing its Internal Capital Adequacy Assessment Process ("ICAAP") and Internal Liquidity Adequacy Assessment Process ("ILAAP") documents.

ICAAP

The Bank's ICAAP assesses projected risks and identifies how much capital is required by the Bank. This document is forward looking and reviewed at least annually. The ICAAP concludes that the Bank has more than adequate capital to satisfy not just current regulatory capital requirements but also to meet the additional capital requirements resulting from its business plans over a 5 years period.

Before the sanctions, the Bank's capital resources supported its activities. During the sanctions, the Bank's activities reduced significantly and it carried substantial excess capital which it could not utilise efficiently as it was prevented from undertaking new business. Shareholder's funds were successfully preserved during sanctions by avoiding operational losses.

The strong capital position remains. At 31 December 2016, the Bank's capital resources amounted to €280,654,000 (2015: €278,147,000) all of which was Common Equity Tier One ("CET1") capital (2015: 75% amounting to €209,264,000).The increase in the proportion of capital resources represented by CET1 was due to the repayment of a subordinated loan and simultaneous issue of new share capital. This compared with the requirements under the Bank's Individual Capital Guidance of €61,133,000 (2015: €68,545,000). These figures have been sourced from the Bank's audited annual accounts.

The Bank aims to utilise its capital more efficiently by expanding its balance sheet position and enhancing profitability within the regulatory and internal capital risk limits.

ILAAP

The ILAAP assesses the prudent level of liquidity resources required to comply with both regulatory liquidity requirements and the Bank's liquidity risk appetite. It also addresses the strategies, policies and processes that enable the Bank to identify, measure, manage and monitor liquidity risk. The Bank's ILAAP concludes the Bank is in a strong liquidity position and is expected to have ample liquidity resources available over the twelve month assessment period.

The Bank built up large balances with banks whilst under sanctions as the pre-sanctions loan book converted into cash and no new transactions were permitted. As a result the Bank emerged from the sanctions in a strong liquidity position. The Bank now intends to rebuild its loan book. The Bank will, however, have considerable flexibility to scale back on loan take-up to meet any unexpected liquidity stresses.

3.4.4 Risk Reporting

The Bank has developed a comprehensive set of Management Information ("MI") reports that must be produced in a timely manner and provide meaningful information to the Board and senior management in order to allow them to make informed business decisions.

The reports developed by the Bank include both qualitative risk assessments and quantitative analysis.

3.4.5 Strategic Planning

A full financial planning exercise is undertaken by the Bank every year covering financial budgets, target markets, projected income and expenditure and capital expenditure. This exercise is coordinated by the Director for Risk Management and Finance and his line. The exercise involves discussion and debate of the early drafts of projections by the key executives and committees of the Bank to ensure that there is broad agreement on the underlying assumptions. On an on-going basis management information is compared to budget and variances are analysed.

Development of the strategy of the Bank is the responsibility of the Board of Directors. The implementation of strategic plans is the responsibility of the Managing Director acting through line management.

3.5 Risk Culture

Risk culture is the set of norms and behaviours that determine the way in which individuals and groups identify, understand, discuss and act on the risks that the Bank faces and takes. It is an overarching element of the RMF and is essential to roll out the RMF across the organisation. A sound risk culture not only encourages responsible risk-taking, but also ensures that current or emerging risks are recognised and addressed in a timely manner.

To develop and maintain a sound risk culture, the Bank focuses on:

- Tone from the top and in the middle
- Accountability
- Effective challenge

3.6 Pillar 1 Risk Measurement

The Bank calculates its Pillar 1 Capital Resources Requirement (“CRR”) using the:

- Standardised Approach (“SA”) for credit risk
- Position Risk Requirement (“PRR”) for market risk, and
- Basic Indicator Approach (“BIA”) for operational risk

3.7 Declaration of Adequacy of Risk Management Processes

The Board considers the risk management processes which are in place to be appropriate and effective for the Bank’s current operations. They will also provide a good foundation for any necessary upgrades in risk management which may become necessary in the future.

4. Eligible Regulatory Capital

The Bank calculates and maintains regulatory capital based on its solo balance sheet as it has no subsidiary companies.

At 31 December 2016 and throughout the year the Bank complied with all capital requirements as set out by the PRA.

The Bank’s eligible capital at 31 December 2016 was Euro 280 million as detailed below:

Capital Resources

As at 31 December 2016	EUR ('000)
CET 1 Capital	
Share Capital	264,412
Retained Surplus	16,242
Total CET 1 Capital	**280,654**
Total Capital Resources	**280,654**

Until 19 December 2016 the Bank's Regulatory Capital comprised the Subordinated Loan Capital and Shareholder's Equity. On 19 December 2016 the Bank issued 71,626,396 Euro denominated shares at EUR1 per share allocated to Bank Melli Iran, which paid for the entire issue in cash. These shares qualified as Common Equity Tier 1 (CET1) capital. On the same day the Bank redeemed, and repaid in cash, all of the US$75 Million Subordinated Loan Notes (Subordinated Loan Capital) which had qualified as tier 2 capital. This effectively converted the tier 2 capital into CET1 capital, significantly strengthening the core CET1 capital ratio, which is now equal to the Total Capital Ratio.

5. Capital Adequacy

5.1 Capital Requirement

In the first instance, the Bank assesses the adequacy of its capital resources as part of its annual Budget and Business Planning process, where it looks at projected earnings, balance sheet growth and capital usage. This capital requirement assessment is supplemented by the Bank's ICAAP. The ICAAP assesses the Bank's internal capital requirement for all relevant risks.

The Bank calculates its Pillar 1 minimum capital requirement as described in Section 3.6. The ICAAP represents the Bank's views on the necessary Pillar 2a add-ons (i.e. the Bank's capital requirements which are not fully reflected in Pillar 1 minimum capital requirement) and compares Pillar 1 and Pillar 2a with any regulatory capital guidance. The ICAAP also considers the capital buffer requirements (including the Combined Buffer and the PRA Buffer).

The ICAAP involves assessing the impact of stresses to the business. The Bank was under continual and severe stress as a result of the imposition of the sanctions so additional stress scenarios are limited. However, in view of the lifting of the sanctions, the Bank has performed stress tests based on its business plan using three scenarios (idiosyncratic, system-wide and combined). In all of the scenarios the stress test results showed that the Bank maintains a healthy capital surplus.

The Board has the ownership of the ICAAP. This involves ensuring that the risk structures, capital allocation techniques and executive governance subscribe to both ICAAP principles and the Bank's risk appetite. The ICAAP document has been developed by the Director for Risk Management and Finance in conjunction with business heads and senior management. It is based on the internal risk management tools used to assist with the proper management of the business. The Board Risk Committee is responsible for reviewing the ICAAP's adequacy and make recommendations to the Board accordingly.

5.2 Pillar 1 (minimum capital requirement)

5.2.1 Credit Risk Component

Each class of exposure is weighted by the stipulated regulatory risk weighting under the standardised approach to produce a risk weighted exposure, against which the Bank is required to hold capital of at least 8%, producing a minimum credit risk capital figure. There is no separate assessment of counterparty risk as the Bank had no trading activity and did not undertake hedging via derivatives.

Exposure Class 31 December 2016	Minimum Capital Requirement EUR ('000)
Central governments or Central banks	7,439
Institutions	18,460
Exposures in default	2,691
Other items	659
Total	**29,249**

5.2.2 Market Risk

The Bank does not have a trading book.

The foreign exchange P&L result for 2016 was a profit of €1,457k.

The Bank does not allocate capital for market risk as the net foreign exchange position is less than 2% of total own funds.

5.2.3 Operational Risk

Operational risk is the risk of loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks.

The Bank calculates its Pillar 1 capital for operational risk using the Basic Indicator Approach which produced a requirement of Euro 1,134k as at 31 December 2016.

5.2.3.1 Pillar 1 Capital Requirement

The amounts calculated for the Pillar 1 capital requirement as at 31 December2016 are:

Risk Category	Pillar 1 Capital Requirement EUR ('000)
Credit risk	29,249
Market risk	-
Operational risk	1,134
Total	**30,383**

5.3 PRA Buffer

The PRA sets a PRA buffer only if it judges that the CRD IV buffers are inadequate for a particular firm given its vulnerability in a stress scenario, or where the PRA has identified risk management and governance failings, which the CRD IV buffers are not intended to address.

The PRA determines how much capital a firm needs to achieve the purpose of the PRA buffer and will then assess the extent to which the CRD buffers already address the risks identified in the PRA buffer assessment, and will decide whether additional capital is required.

5.4 CRD IV Capital Buffer Requirements

The European Union's Capital Requirements Directive (CRD) creates a combined capital buffer that all firms will be expected to meet in addition to their Pillar 1 and Pillar 2 capital requirements (separately, the PRA may also impose a firm-specific buffer, the PRA buffer). The combined buffer must be met with Common Equity Tier 1 (CET1) capital and will include the Capital Conservation Buffer ("CCB") and the Countercyclical Capital Buffer ("CCyB"), each of which is described in the sections below.

5.4.1 Countercyclical Capital Buffer

The CCyB requires firms to build up capital when aggregate growth in credit is judged to be associated with a build-up of system-wide risk. The buffer can then be drawn down to absorb losses during stressed periods. Firms are required to calculate their firm-specific CCyB rate as a weighted average of the buffer rates that are being applied in jurisdictions to which they have a relevant credit exposure, subject to a maximum total of 2.5% of risk-weighted exposures.

The geographical distribution of the Bank's credit exposures relevant for the calculation of its countercyclical capital buffer is provided in Section 9 - Additional Disclosures. Currently the only jurisdiction to which the Bank has exposure which has set a non-zero CCyB is Hong Kong.

5.4.2 Capital Conservation Buffer

Within their combined buffer, all firms will be subject to a maximum capital conservation buffer of 2.5% of risk-weighted assets (RWAs) at both group and solo level. The purpose of this buffer is to enable firms to absorb losses in stressed periods. This buffer became effective from 1 January 2016, in line with the transition timetable set out in the CRD (i.e. 0.625% in 2016, 1.25% in 2017, 1.875% in 2018 and 2.5% in 2019).

From 1 January 2016 the Bank was therefore required to hold a capital conservation buffer of common equity tier 1 capital equivalent to 0.625% of its total RWA. This increased to 1.25% from 1 January 2017.

5.5 Capital Management

Before the sanctions, the Bank's capital resources supported its significant business activities. No erosion of capital took place during the sanction period as the Bank managed to maintain a modest level of profitability. Hence, the Bank maintains a strong capital position which will support its future business plans.

At 31 December 2016, the Bank's capital resources amounted to Euro 280m all of which was CET1 capital (2015: Euro 276m of which 75% was CET1 capital).

Until 19 December 2016 the Bank's Regulatory Capital comprised the Subordinated Loan Capital and Shareholder's Equity. On 19 December 2016 the Bank issued 71,626,396 Euro denominated shares at EUR1 per share which were entirely allocated to Bank Melli Iran, which paid for the entire issue in cash. These shares qualified as Common Equity Tier 1 (CET1) capital. On the same day the Bank redeemed, and repaid in cash, all of the

US$75 Million Subordinated Loan Notes (Subordinated Loan Capital) which had qualified as tier 2 capital. This effectively converted the tier 2 capital into CET1 capital, significantly strengthening the core CET1 Capital Ratio, which is now equal to the Total Capital Ratio.

5.6 Capital Reporting

The Bank reports its capital adequacy to the PRA on a quarterly basis through COREP returns.

For internal management purposes, the Bank is able to calculate capital adequacy daily.

The Board reviews financial and business performance indicators, including capital adequacy, on a regular basis.

6. Credit Risk Adjustments

The preparation of the Bank's financial statements requires management to make estimates and judgments. This is particularly so in the development of provisions against non-performing loans and in assessing impairment of debt securities. Making reliable estimates of the ability of customers and other counterparties to repay is often difficult even in periods of economic stability and becomes more difficult in periods of economic volatility. Therefore, there can be no assurance that the provisions for bad and doubtful debts or other impairment provisions will prove adequate for all losses ultimately realised.

Impairment provisions are made where there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that a loss event (or events) has an impact on the estimated future cash flows from the asset that can be reliably estimated.

If there is objective evidence that an impairment loss on loans and advances has been incurred, the amount of loss is measured as the difference between the assets' carrying amounts and the present value of the future cash flows (excluding future credit losses that have not been incurred). The carrying amounts of the assets are reduced either directly or through use of an allowance account. The amount of the loss is recognised in profit and loss.

7. Leverage

The Bank's year-end 2016 Leverage Ratio under Basel III is 75% (versus a minimum regulatory requirement of 3%). Detailed statistics will not become relevant until there is a substantial pick up in business and significant balance sheet expansion takes place. In the meantime the leverage position is monitored and reported in regular COREP returns.

8. Liquidity

During the sanctions, the Bank built up large balances in short term placements funded mainly by the Bank's capital. These funds were well in excess of the Bank's liquidity needs. The Bank continues to hold large balances in short term placements, some of which will be utilised for new lending.

The Bank's year-end 2016 Liquidity Coverage Ratio was 119.16% (versus a minimum regulatory requirement of 80%).

In addition to the Liquidity Coverage Ratio, the Bank also uses the Liquidity Maintenance Ratio (for the Hong Kong Branch) and the Net Stable Funding Ratio to manage its liquidity and funding risk. Special attention is also paid to the inflows and outflows in the eight day and one month time bands.

9. Additional Disclosures

Analysis of financial liabilities by remaining maturities

As at 31 December 2016 EUR ('000)	Not more than 3 months	More than 3 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Total
Financial Liabilities	90,252	3,192	-	-	93,444
Total	**90,252**	**3,192**	**-**	**-**	**93,444**

Credit Exposure (pre-provisions) by Class and Maturity

As at 31 December 2016 EUR ('000)	<12 mths	<24 mths	<60 mths	>5yrs	Past due	Total
Central governments or Central banks	78,104	-	-	-	-	78,104
Institutions	264,768	-	-	-	-	264,768
Retail	7	-	-	-	-	7
Exposures in default	-	-	-	-	42,389	42,389
Other items	10,785	-	-	-	-	10,785
Total	**353,664**	**-**	**-**	**-**	**42,389**	**396,053**

Exposure (pre-provisions) by Economic Sector & Geographic Region

As at 31 December 2016 EUR ('000)	UK	Europe	Iran	Asia	Other Middle East	Africa	Total
Central governments/central banks	-	15,500	61,995	609	-	-	78,104
Institutions	141,888	40,508	67,264	9,576	5,438	94	264,768
Exposures in default	9,600	-	7,124	7,972	17,693	-	42,389
Other items	10,785	-	-	-	-	-	10,785
Retail	7	-	-	-	-	-	7
Total	**162,280**	**56,008**	**136,383**	**18,157**	**23,131**	**94**	**396,053**

Average exposure (pre-provisions) over last four quarters by economic activity

2016	Average EUR ('000)
Central governments/central banks	92,284
Institutions	226,390
Exposures in default	40,143
Other items	8,666
Retail	5
Total	**367,488**

Credit Exposure (pre-provisions) by Rating Band

As at 31 December 2016	EUR ('000)
AAA+ TO AA-	1,116
A+ TO A-	640
BBB+ TO BBB-	142,765
BB+ TO BB-	166
Unrated	251,366
Total	**396,053**

Risk concentration against individual counterparties

As at 31 December 2016	EUR ('000)
Largest exposure to individual Bank before collateral	118,028
Largest exposure to individual Bank after collateral	118,028
Largest exposure to individual customer before collateral	6,222
Largest exposure to individual customer after collateral	6,222

Maximum exposure (pre-provisions) to credit risk without taking into account collateral and other credit enhancements

As at 31 December 2016	EUR ('000)
Due from banks (inc Central Banks)	342,813
Loans and advances to customers	42,396
Other	10,785
Total – On Balance Sheet	**395,994**
Guarantees	59
Commitments	-
Total – Off Balance Sheet	59
Total	**396,053**

Impairment of Credit Risks

As at 31 December 2016	EUR ('000)
Past due not impaired	13,259
Exposures considered impaired (gross)	29,130
Exposures considered impaired (net impair.)	9,169
Impairment provision in year	-

Credit Exposure (pre-provisions) by Maturity as at 31 December 2016

EUR (m)	<12 mths	<24 mths	<60 mths	>5yrs	Past due	Total
Banks and Institutions	342,878	-	-	-	-	342,878
Customers and Other	10,786	-	-	-	42,389	53,175
Total	**353,664**	**-**	**-**	**-**	**42,389**	**396,053**

10. Disclosures Statement

The Board of Directors of the Bank, having taken into account the size and complexity of the Bank's operations, believe that these disclosures comprehensively convey the risk profile of the Bank. The disclosures have not been subjected to external audit.

These disclosures are available on the Bank's website: http://www.mellibank.com