Finance and risk management

Assuming risk goes hand in hand with the business of banking. A conscious and prudent approach to dealing with risk is of paramount importance to the LLB Group. Finance and risk management is based on a sustainable approach.

Risk management

We are convinced that sustainable, profitable growth is only possible with a prudent risk culture. Consciously accepting and profitably managing risks is one of the LLB Group's core competences. We attach great importance to a prudent approach to dealing with risk at all levels of the organisation.

To avoid conflicts of interest, we have established effective and organisationally independent controlling bodies and processes. We address the issue of risk in a constructive and solution-oriented dialogue and manage it appropriately.

Risk assessment

It is essential for the protection of the reputation, the maintenance of the excellent financial strength and the securing of the sustainable profitability of the LLB Group that risks are dealt with prudently (see chapter "Risk management", pages 178 – 196). The LLB Group applies an appropriate organisational and methodological framework for assessing and managing risk.

For equity capital and liquidity, which are important reference figures for a bank, we use the internal capital adequacy assessment process (ICAAP) and the internal liquidity adequacy assessment process (ILAAP).

Integrated approach

The Group Chief Financial Officer (CFO) is responsible for finance and risk management at the LLB Group. He is a member of the Group Executive Board and head of the Group CFO Division. The latter encompasses the following tasks and key areas in finance and risk management:

- **Overall bank management:** It ensures transparency at all management levels in order that costs and income can be managed in line with corporate strategy and in an efficient and timely manner. This includes medium-term planning, the annual budgeting process, the Group Management Information System (MIS) and capital management.
- **Financial management:** It includes the preparation of the financial statements in accordance with both local laws and International Financial Reporting Standards (IFRS) as well as regulatory reporting and group-wide treasury management.
- **Risk management**: It is based on risk policy and encompasses the systematic identification and assessment, reporting, management and monitoring of credit risks, market risks, liquidity risks and operational risks as well as asset liability management (ALM).
- **Credit management:** It implements efficient and effective credit processes as well as timely credit decisions according to valid directives and instructions in a risk-oriented and profit-oriented manner.
- **Legal & Compliance:** Systematic monitoring encompasses legal and regulatory changes, providing support for their implementation and carrying out subsequent controls to avoid operational, financial and reputational risk. It deals not only with legal risk, but also compliance risk, such as money laundering and market abuse, and risk related to tax issues (see chapter "Regulatory framework and developments", pages 62 – 65).

Conservative credit risk policy

The LLB Group accompanies private persons, companies, small businesses and public institutions to finance their plans for the future. The majority of the loans in 2017, i.e. 87.0 percent (2016: 86.4 %), comprised credits secured by mortgages.

The LLB Group primarily extends mortgages within the market regions of Liechtenstein, north-eastern Switzerland and the region of Zurich.

Differentiated control processes

We pursue a conservative credit risk policy. It includes the individual and differentiated evaluation of loan applications, the conservative assessment of collateral values, the individual calculation of affordability as well as compliance with standard equity requirements. The differentiated control processes help us to reliably fulfil our performance mandate (see chapter "Responsibilities for society and the environment", page 68) and to take appropriate account of risks.

For real estate financing, we observe the Ordinance on Banks and Investment Firms (FL-BankV), which governs risk management in accordance with Art. 7a and Art. 21c. ff of the Liechtenstein Banking Act. For financing in Switzerland, we observe the minimum requirements for mortgage financing drawn up by the Swiss Bankers Association (SBA) and approved by the Swiss Financial Market Supervisory Authority (FINMA). We also apply the EU guidelines on assessing, evaluating and processing mortgage secured loans.

We have developed a group-wide uniform methodology for determining the collateral value of our Lombard loans.

Independent Credit & Risk Management

Within the LLB Group, credit competences are assigned in relation to the current expertise of key employees and their experience according to different levels and credit types. The authority to grant credit has been given to Group Credit & Risk Management and the Credit Committees, with the exception of standard business transactions. Credit decisions are thus made independently of market pressures and market targets. In this way, we are able to avoid conflicts of interest and objectively and independently assess risk in individual cases.

Internal control system

The LLB Group applies standards that are customary in the banking industry for the internal control system (ICS), a sub-system of corporate risk management. The ICS contributes to increasing risk transparency within the company as an integral part of our group-wide risk management by monitoring the risks in the relevant business processes through effective control processes.

Equity strategy

A good equity base not only protects its reputation, but is also part of the financial management and credibility of a bank. Having a sufficiently high-quality equity base at its disposal is part of the LLB Group's identity. The LLB Group's financial strength shall remain, as far as possible, unaffected by fluctuations in the capital markets.

We simulate external influences and analyse how these affect our capital base using scenario analyses and stress tests and, where necessary, we take measures to limit risks.

Solid equity base

LLB is considered to be of systemic importance to the Liechtenstein economy and subject to a regulatory minimum capital adequacy ratio of 13 percent. We are targeting a Tier 1 ratio of over 14 percent as a strategic objective.

As at the end of 2017, the LLB Group had CHF 1.9 billion in equity capital (31.12.2016: CHF 1.8 billion). At 22.2 percent (31.12.2016: 21.0 %), LLB's Tier 1 ratio is well above the regulatory requirement.

The LLB Group continues to enjoy a high level of financial stability and security on account of its solid equity base, which consists entirely of hard core capital. The comfortable capital situation gives the LLB Group leeway to make acquisitions (see chapter "Strategy and organisation", page 27).

Regulatory standards

Basel III

The comprehensive reform package of the Basel Committee on Banking Supervision (Basel III) has been in effect in the EU since 1 January 2014. The regulations commit banks to larger capital buffers and set requirements for liquidity coverage. The reforms aim to improve the regulation, the supervision and the risk management of banks and, as a result, to increase the resilience of both individual banks and the banking system as a whole.

Liechtenstein, as a member of the EEA, implemented the Basel III standard with the enactment of the Capital Requirements Regulation (CRR) and the accompanying Capital Requirements Directive (CRD IV) on 1 February 2015.

Bank Recovery and Resolution Directive

The Recovery and Resolution Act (RRA) and the Recovery and Resolution Ordinance (RRO) have been in force in Liechtenstein since 1 January 2017. The EEA country has thereby transposed the Directive 2014 / 59 / EU on the recovery and resolution of financial institutions (the Bank Recovery and Resolution Directive (BRRD)) into national law. Through the RRA, among other things, Liechtenstein has provided a framework for solving the "too-big-to-fail" issue and strengthening the stability of the Liechtenstein financial system.

The RRA requires LLB, as a systemically important bank in Liechtenstein, to submit a recovery plan to the Liechtenstein Financial Market Authority (FMA). The recovery plan contains an analysis of measures determined as part of an overall bank stress test that can be taken to restore its financial position under various crisis scenarios.

Internal capital adequacy assessment process

The Liechtenstein Banking Act (FL-BankG) requires the banks to have in place sound, effective and complete strategies and processes to assess and maintain on an ongoing basis adequate equity capital. The internal capital adequacy assessment process (ICAAP) is an important risk management instrument for the LLB Group. The ICAAP is documented in the internal regulations and guidelines and is reviewed and revised annually, taking into account overall bank stress tests.

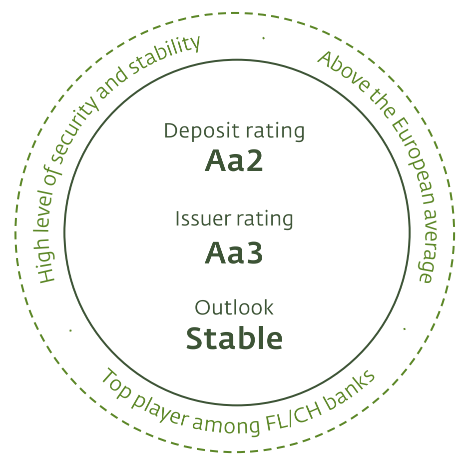
Internal liquidity adequacy assessment process

The Banking Ordinance (FL-BankV) requires the banks to have in place robust strategies, policies, processes and systems that enable them to identify, measure, manage and monitor liquidity risk. The internal liquidity adequacy assessment process (ILAAP) is set down in the internal regulations and guidelines and is reviewed and revised annually.

Within the framework of the ILAAP, the liquidity coverage ratio (LCR), as a binding regulatory liquidity reference figure, represents an important indicator both for liquidity risk assessment as well as liquidity risk management. At the end of 2017, a regulatory lower limit of 80 percent was applicable for the LLB Group. The minimum requirement ensures that credit institutions maintain a reasonable level of liquidity in order to cover their liquidity requirements in the case of a liquidity stress scenario within 30 calendar days. With an LCR of 126 percent (2016: 115 %), the LLB Group's ratio was substantially higher than that required under the regulations.

Rating confirms financial strength

Moody's, the rating agency, assigned a deposit rating of Aa2 to Liechtensteinische Landesbank in April 2016 and reaffirmed the rating in the spring of 2017. This underlines LLB's stability and financial strength. LLB is among the top range of Liechtenstein and Swiss banks and ranks well above the average of European financial institutions.



Moody's acknowledged the solid financial fundamentals, in particular the good capital base as well as the good liquidity and refinancing situation. Moody's rating provides investors and market participants with additional transparency.