

Management Information

Chairperson's Message **8** Managing Director's Review of Operations
14 Board of Directors **20** Corporate Management **26** Senior
Management **30** Management Discussion & Analysis **32** Customer
Centre Network **86** Main Correspondents Worldwide **88**

Corporate Governance

Risk Management at HNB **90** Your Boardroom Governance Report
116 Directors' Statement on Internal Control **151** Independent
Assurance Report **153**

Sustainability Report

The Journey Towards Sustainability **155** Integrating Sustainability
156 Sustainability Strategy **156** Sustainability Commitment for
the Short and Medium Term **157** The National Vision **158** Key
Impacts, Risks, Opportunities **159** Report Scope and Boundary
164 Sustainability Stewardship **165** Stakeholder Engagement
169 Economic Wealth Creation **178** Social Performance **184**
Environmental Citizenship **204** Independent Assurance Report
213 GRI Statement **214** GRI Indicators **215**
Financial Calendar **232**

Financial Reports

Annual Report of the Board of Directors on the Affairs of the
Company **234** Directors' Interest in Contracts with the Bank **244**
The Human Resources and Remuneration Committee Report **246**
Nomination Committee Report **247** The Board Integrated Risk
Management Committee Report **248** Audit Committee Report **249**
CEO's and CFO's Responsibility Statement **251** Directors'
Responsibility for Financial Reporting **252** Independent Auditors'
Report **253** Income Statement **254** Statement of Comprehensive
Income **255** Statement of Financial Position **256** Statement of
Changes in Equity **257** Statement of Cash Flows **260** Notes to the
Financial Statements **262** Compliance with Other Disclosure
Requirements **370**

Supplementary Information

Income Statement in US Dollars **374** Statement of Comprehensive
Income in US Dollars **375** Statement of Financial Position in US
Dollars **376** Analysis of Deposits **377** Analysis of Loans and
Receivables **378** Province-wise Analysis of Deposits and Advances
379 Sources and Utilisation of Income **380** Value Added
Statement **381** Ten Year Statistical Summary **382** Quarterly
Statistics **383** Segmental Analysis **384** Investor Relations **385**
Glossary of Financial / Banking Terms **393** Notice of Meeting **398**
Form of Proxy – Voting **399** Form of Proxy – Non Voting **401**

Change
creates
opportunity.

HIGHLIGHTS
BUILDING HEALTHY
ECONOMIES
STRENGTHENING OUR
FUNDAMENTALS
INVESTING IN TECHNOLOGY

Annual Report **2013**

Vision

To be the acknowledged leader and chosen partner in providing financial solutions through inspired people

Mission

Combining entrepreneurial spirit with empowered people and leading edge technology to constantly exceed stakeholder expectations

OUR VALUES

- Treasure professional and personal integrity at all times
- Demonstrate mutual respect in all our interactions
- Passionate about everything we do
- Committed to being customer centric
- Courage to change, challenge and be different
- Demonstrate unity in diversity

Change creates opportunity.

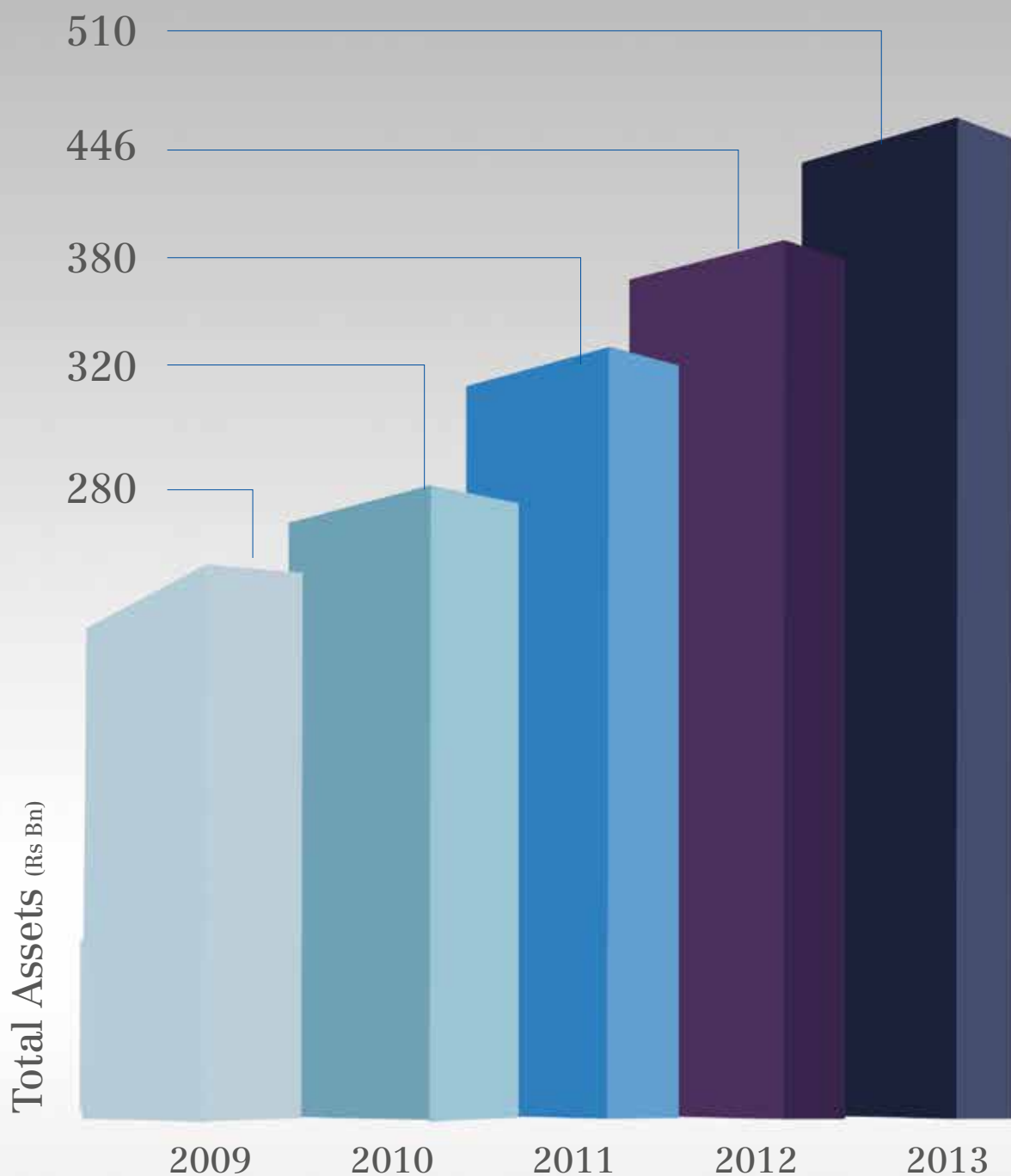
Change
creates
opportunity.

At HNB we believe that to be successful in the long term we must continually reassess our business model, in order to respond to and even thrive upon the challenges the financial industry faces today. As a benchmarked industry leader, we believe that we can inspire and engage others even as we reinvent and re-orient ourselves, using the myriad opportunities of change to create an environment where innovation will flourish and creativity is encouraged; to shape our future and serve our customers and stakeholders better with each passing year.

This report takes an in-depth look at how we have embraced the journey of change and the strategies we plan to implement in the years ahead in order to reach our goals. You will note how, over a period of time, we have been investing strategically into technology and systems, improving our multi-channel delivery network, using tools such as, social media, mobile apps, customer data and predictive analytics to deliver a holistically enriched service offering, advanced in security, precision and speed. These initiatives will also strengthen our already stringent governance processes, further enhancing our reputation as a bank that is solid, safe and sound.

Hatton National Bank. Thriving on the opportunities of change.

Financial Highlights



ASSETS

Rs **510** Bn

LOANS & RECEIVABLES (GROSS)

Rs **363** Bn
17% Growth

PBT

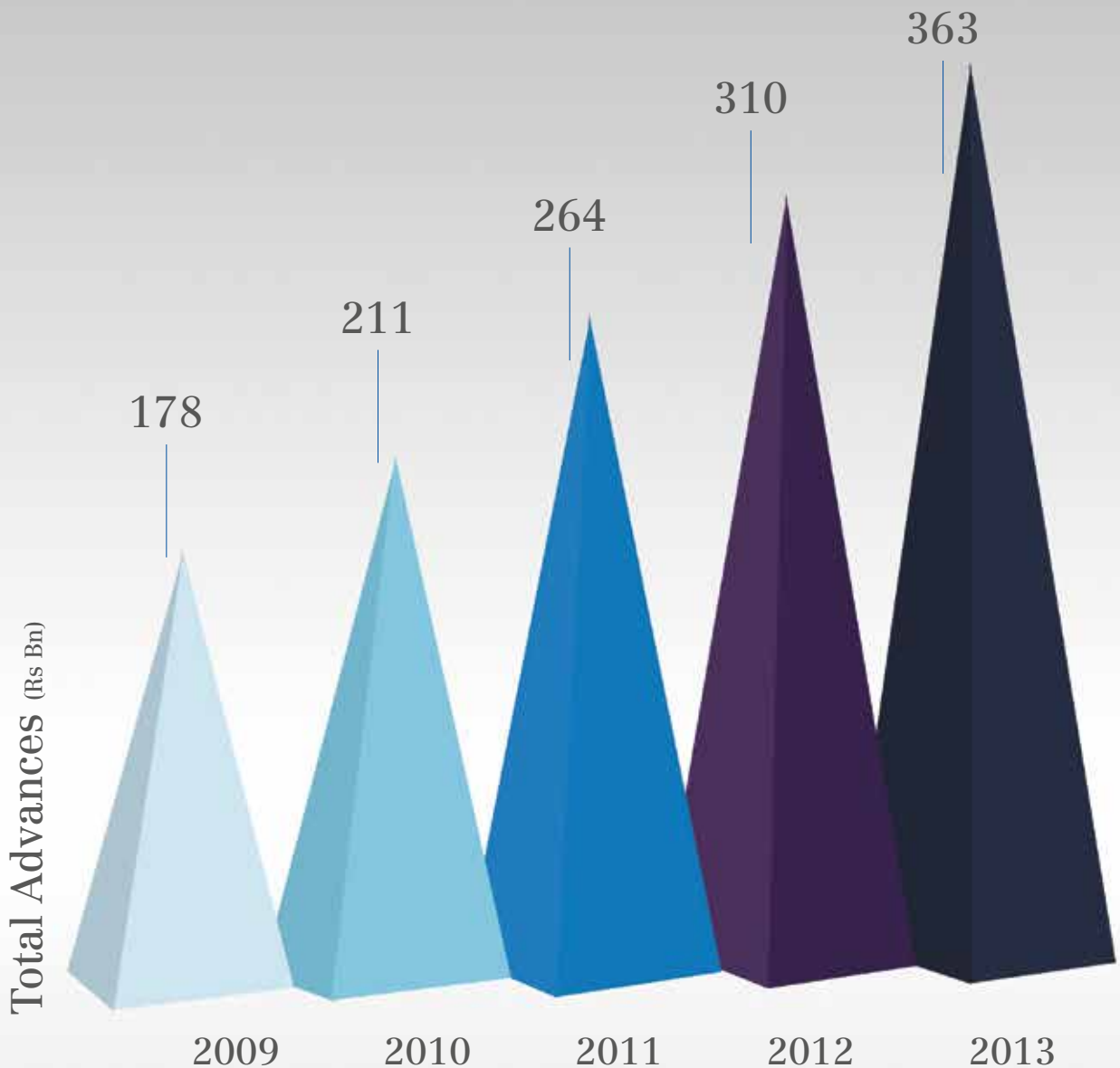
Rs **10** Bn

COST TO INCOME

47.8%

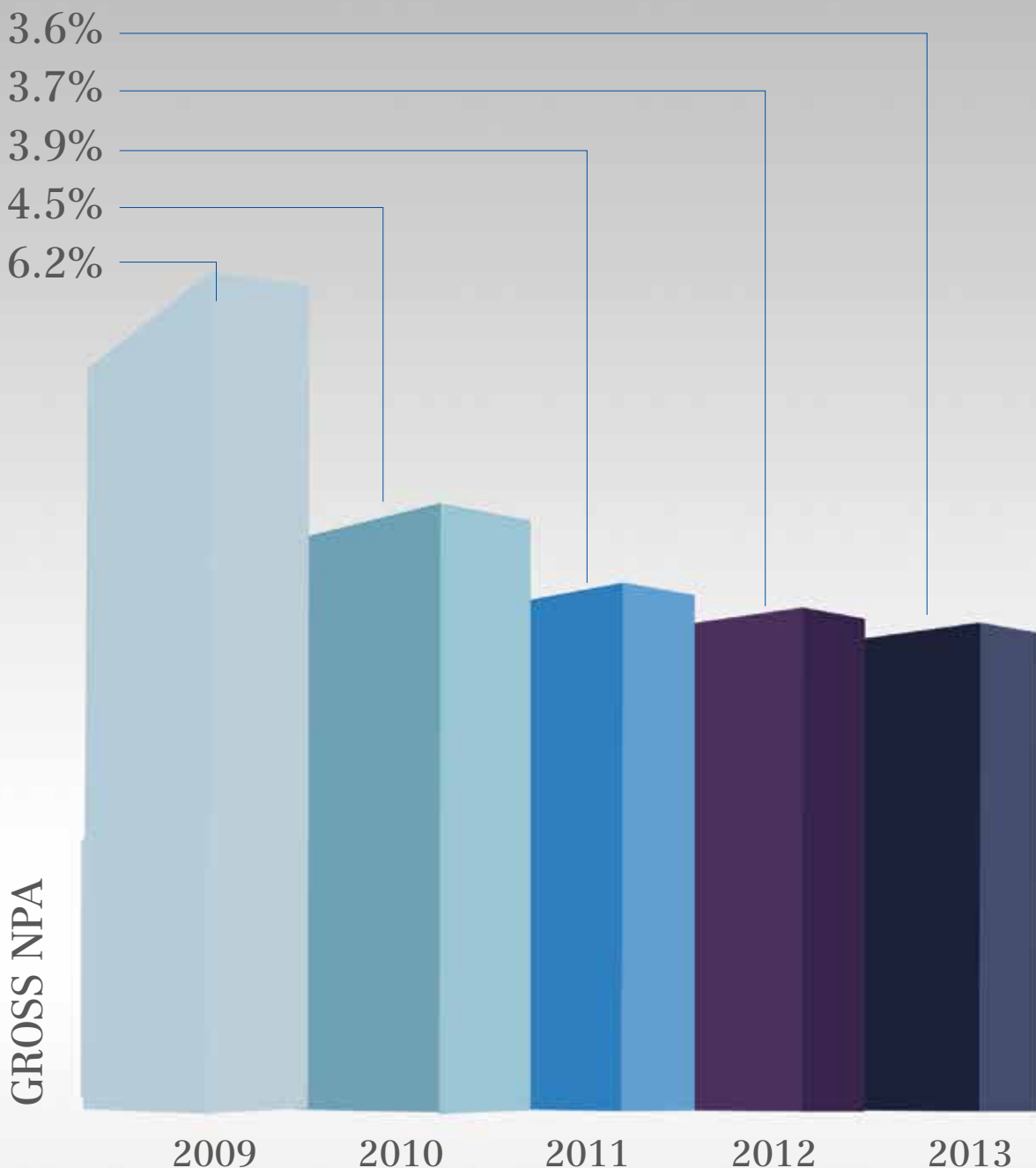
NPA (GROSS)

3.6%



Financial Highlights & Financial Goals / Performance

Our customer -focused approach and exceptional service differentiate us from the competition.



	2013	Bank		2013	Group	
	Rs Mn	2012	%	Rs Mn	2012	%
		Rs Mn	Change		Rs Mn	Change
Results For the Year						
Income	60,074	51,539	+	16.6	64,638	55,212 + 17.1
Net profit before income tax	10,008	9,876	+	1.3	10,916	10,523 + 3.7
Income tax on profits	2,998	2,342	+	28.0	3,103	2,421 + 28.2
Net profit after taxation	7,010	7,534	-	7.0	7,812	8,102 - 3.6
Gross Dividends	3,399	3,379	+	0.6	3,399	3,379 + 0.6
Profit available after appropriation	3,611	4,155	-	13.1	4,413	4,723 - 6.6

At the Year End

Shareholders' funds (Capital and Reserves)	51,454	46,899	+	9.7	57,562	52,048 + 10.6
Deposits from customers	385,361	341,424	+	12.9	385,001	340,848 + 13.0
Loans and receivables to customers (Gross)	362,591	310,365	+	16.8	363,460	310,874 + 16.9
Total Assets	510,310	446,358	+	14.3	525,395	459,453 + 14.4

Information per Ordinary Share

Earnings (Rs)	17.59	18.94	-	7.1	19.20	20.75 - 7.5
Dividends (Rs)	8.50	8.50	-	-	-	-
Dividend Yield (%) - Voting	5.78	5.74	+	0.7	-	-
Net asset value (Rs)	128.78	118.06	+	9.1	144.06	131.02 + 10.0
Market value (Rs) - Voting	147.00	148.00	-	0.7	-	-
Market value (Rs) - Non voting	119.00	112.50	+	5.8	-	-

Ratios

Return on average shareholders' funds (%)	14.26	17.75			13.96	16.97
Price earning (Times) - Voting	8.36	7.81			7.66	7.13
Dividend cover (Times)	2.06	2.23			2.30	2.40

Capital Adequacy Ratios

Tier 1 (%) (Statutory minimum ratio required is 5%)	12.95	13.85			13.33	14.10
Total Capital (%) (Statutory minimum ratio required is 10%)	16.52	16.63			16.86	16.94

Information is based on LKASs / SLFRs

	2009	2010	2011	2012	2013	Medium Term Goals	
Key Performance Indicators							
Return on Average Assets (%)		1.6	1.5	1.8	1.8	1.5	Over 1.8
Return on Average Shareholders' Funds (%)		19.6	17.4	18.2	17.8	14.3	Over 20.0
Cost / Net Income Ratio (Excl Financial VAT) (%)		52.7	54.9	55.3	53.0	47.8	Below 50.0
Dividend per Share (Rs)		6.50	7.00	7.50	8.50	8.50	Payout of 30%
Capital Adequacy							
Tier 1 Capital Ratio (%) (Statutory Minimum Ratio Required is 5%)		11.1	11.0	12.8	13.9	13.0	11.0
Total Capital Ratio (%) (Statutory Minimum Ratio Required is 10%)		13.2	12.6	14.5	16.6	16.5	13.5

Key Pages

Chairperson's Message 8

The results speak for themselves in testifying to the resilience of your Bank and the collective strength in responding to change and remaining focused.

Managing Director's Review of Operations 14

Year 2013 brought us together as a team united in purpose, by the realisation that we embark on a journey towards being the best in class service provider. We placed cutting edge technology at the forefront of our operations, enhanced reach and service delivery through electronic channels, and commenced a Business Process Re-engineering initiative to drive sales by optimising the business operating model.

Management Discussion & Analysis 32

We will continue to focus on our existing five pillar strategy bringing in more depth and breadth over the medium term in driving to optimise on the investments made in our people, systems, network, channels and products

Risk Management at HNB 90

The changing nature of today's business environment is increasing both the scope and potential impact of the risks we face in our day-to-day operations. Managing risk therefore constantly requires innovation and reinvention.

Sustainability Report 155

We have aligned our business strategy with the national development goals in keeping with our approach towards a business model that is sustainable in the longer term.

Exploring the opportunities of change.



Because we understand the need to constantly reinvent ourselves we have developed the art of managing change.

Management Information:

Chairperson's Message

I welcome you all to the forty fifth Annual General Meeting of Hatton National Bank PLC, having concluded a challenging year in which your Bank displayed tenacity and agility in surmounting the many challenges. We have continued to deliver consistent value for our stakeholders as HNB records another year of growth and profitability. It gives me great satisfaction and pleasure to place before you the Audited Financial Statements for the financial year ending December 2013 and the Annual Report of the Bank.

Challenging times

The reporting period has been one in which our sustainable business model and the collective skills of our team have been put to test on many fronts. The results speak for themselves in testifying to the resilience of your Bank and the collective strength in responding to change and remaining focused. Indeed, this is a noteworthy performance that will reinforce your commitment to making Hatton National Bank an undisputed leader in the industry and a worthy investment for yourselves.

Once again in 2013, for the second consecutive year, we were adjudged 'Sri Lanka's Best Bank' by the prestigious 'The Banker' Magazine of the UK. We are undoubtedly proud to be the recipient of this coveted accolade, and are humbled by the recognition we have received for being committed to our customers' progress, for contributing to national development and being an innovative and responsible bank.

Our lending portfolio recorded a growth of over 17% over the previous year with our asset base crossing the Rs 500 Bn mark. Consolidated gross income grew by 17% and Net Interest Income by 12% reflecting the steady growth of the balance sheet. In 2013, Group Post – tax profits declined by 3.6% to Rs 7.8 Bn. The NPA ratio of the Bank

was marginally reduced from 3.66% last year to 3.64% in 2013 reflecting the improved quality of our portfolio.

I am delighted to announce the proposed final dividend of Rs 7.00 per share for both voting and non-voting shares, in addition to the interim dividend of Rs 1.50 per share which was paid in December 2013, resulting in a total dividend of Rs 8.50 per share.

A new Managing Director and Chief Executive Officer

The Board welcomes Mr. Jonathan Alles as our new Managing Director/ Chief Executive Officer effective from July 2013. Mr Alles succeeds Mr Rajendra Theagarajah following the latter's retirement.

Jonathan was invited to join HNB in 2010 as our Chief Operating Officer and in September 2011, he was appointed Deputy Chief Executive Officer and in July 2013, as Managing Director and Chief Executive Officer. The Board is confident that Jonathan's leadership qualities, combined with his strategic thinking and extensive experience locally and overseas in the financial services industry, make him the right person to drive HNB to success over the coming years. I am confident that his approach and track record of delivering results with his innovative business drive and openness will be valued by shareholders and employees alike.

The Global Influence

The gradual withdrawal of Quantitative Easing (QE) and the decline in the gold price took centre stage in 2013 as the global economy rebalances. The US Federal Reserve's announcement of the withdrawal of QE measures has adversely affected markets in developing and emerging countries, firstly by leading to withdrawal of short term funds from markets and bringing pressure on the



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Chairperson's Message

exchange rate and secondly, by reducing trading as investors sat on the side lines avoiding losses.

Although these external disturbances were temporarily confined to only a few bad weeks in the 3rd quarter of 2013, the markets and financial services industry need to exercise prudence and prepare for the inevitable withdrawal of QE by the USA as the Federal Reserve has started a phased tapering off of the bond buying programme.

The announcement of the gradual withdrawal of the QE undoubtedly contributed to the reversal of capital flows, but much of the turmoil in emerging markets in June 2013 also came from investors' closer scrutiny of economic fundamentals in individual countries.

The price of gold declined by 28% in 2013 ending a 12 year bullish market for the precious metal affecting adversely the gold backed pawning portfolios of banks in South Asia. Although many Sri Lankan banks managed to scale down the portfolio through promoting redemption, losses incurred on the auctioning process remained a significant challenge to banks with large pawning portfolios.

Sri Lanka's resilient economic performance

Sri Lanka's economic growth rebounded in the second half of 2013 with the USD 67 Bn economy forecast to grow at over 7% in 2014. Once again, the economy has demonstrated resilience to global and domestic challenges and adjusted with agility to the policy measures enacted by the Government and the Central Bank of Sri Lanka.

The first half of 2013 witnessed a low appetite for credit, due to policy measures enacted in 2012 towards macroeconomic stabilisation of which high interest rates was the key. The domestic economy rebounded in the second half of the year, responding positively to policy measures and due to protracted recovery of the global economy. Strong performance was noted in all of the macroeconomic indicators in 2013. Inflation has declined reaching benign single digit levels with headline inflation reducing to 4.7% at the year end.

Export earnings crossed the USD 1 Bn mark for two consecutive months commencing October 2013 helped by the moderate recovery of the US and marginally higher demand from European markets.

Once again, the economy has demonstrated resilience to global and domestic challenges and adjusted with agility to the policy measures enacted by the Government and the Central Bank of Sri Lanka...

The Balance of Payments reported a surplus of USD 991Mn due to strong worker remittances, improved performance of exports and increase of foreign capital inflows into the country, based on provisional estimates released by the CBSL. The Gross Official Reserves increased to USD 7.1 Bn, the equivalent of 4.5 months of imports by end 2013, reflecting an improved external sector performance. Overall, Sri Lanka posted the fastest growth rates in South Asia in recent times and remains poised for stable and sustainable growth as the growth forecasts edge over 7%.

These developments have contributed to improving business and international investor confidence while attracting investments into the capital market. It was encouraging to note the interest and response of both corporate and retail investors in subscribing to the numerous debenture issues throughout 2013, leading to the development of the capital market for listed debt, with a few issues taking on fairly long tenures over 10 years. During this year, HNB's issues of both subordinated and senior debentures were oversubscribed by three times on the day of opening.

Challenging times for Banking and Financial Services Industry

The banking industry in Sri Lanka has shown a remarkable resilience to a number of passing crises that affected developed as well as emerging economies globally. Among others, HNB portrayed its marked resilience and robustness in terms of capital, liquidity and leverage ratios, while growing its assets at a higher rate during 2013.

The proposed initiative of the Central Bank towards consolidation of the banking and non-banking financial institutions is expected to bring about more resilience in the financial system. However, the institutions/entities would be required to deal with the issue of securing necessary finances for the purpose, in addition to the operational challenges involved in the process.

The reduced interest margins in a low interest environment would force banking institutions to look for alternative sources of income generating activities. Given the intense competition, the success of this search would depend on the effectiveness of the business strategies adopted by banks.

While technological advances would pave way for future business growth, challenges involved in the use of technology cannot be ignored. This calls for a collective industry-wide approach to deal with technology based risks, especially cyber crimes.

The calibration of capital to cover risks will become increasingly important as the industry moves towards implementing BASEL III. Banks will be required to hold capital buffers to absorb external shocks and mitigate against a wide range of risks that go beyond the existing credit, market and operational risk profile of the industry.

HNB has formalised the Internal Capital Adequacy Assessment Process (ICAAP) required under BASEL II in 2013. Key risk indicators have been defined to identify and bring risk within tolerance of the risk appetite in a timely manner. This in its own right would pose a challenge as the estimation of capital adequacy would require a considerable amount of judgement to be exercised due to the use of internal risk rating models determining the accuracy of the quantum of capital to be held.

A tested business model focusing on technology

The advancement in technology and the proposed consolidation of the industry offer opportunities to use shared platforms and systems to increase productivity and optimise on cost in view of the declining trend noted in net interest margins. The use of smart technology by HNB has made banking services speedier, more secure and smarter, with digital convergence changing the face of conventional banking.

Year 2013 has been no different in dealing with numerous challenges and we have leap frogged on existing technology to deliver some of the best in class products, platforms and electronic channels to our customers in finding new ways to do business. The Bank has continued to spread expertise throughout its core banking activities, with a number of measures being taken to augment the intuitive thinking of our clients and customers. It is our focus to drive more transparency in our operations and decision making while engaging with our stakeholders through multi-channel banking and financial services. Our unwavering commitment to our customers, shareholders and other stakeholders has led us to invest in technology and this has helped in part, to respond to the uncertainty and volatility in the external environment. We have continued to cater to all customer segments effectively and provide our services to different age groups using newer technology.

The Bank has had the privilege of supporting some of the country's largest infrastructure initiatives. These initiatives undoubtedly promote a stable economy enabling sustainable development and fostering financial inclusion. We have continued with our focus on serving the SME and micro finance segments to promote financial inclusion.

HNB's purpose has remained the same for well over 125 years, and we have partnered with our customers and communities across all provinces for generations. Our primary focus has been to stand by our customers while finding new ways to promote access to finance. Importantly, we have achieved this goal through prudent strategic discipline by focusing on the basics of safe and secure banking. The adoption of newer technology ensuring user friendliness has enabled the Bank to reach the goal of inclusive business.

Chairperson's Message

Sound Governance as part of our brand identity

We believe strong governance is crucial to our long-term success. A diversified business model such as that of HNB is dependent on stable and responsible governance and compliance principles, robust management processes and effective risk management and control.

We have established processes and structures to meet with the requirements of accepted best practice and governance in upholding our reputation as a safe and sound bank. We have diligently followed the mandatory corporate governance framework as well as enterprise governance. We have invested in technology that will assist in managing our assets and liabilities more efficiently and combating financial crime. Conformance and performance criteria are not viewed as 'policing' tools but as a framework that supports better business decisions and opportunities to work and yield better.

While displaying a higher degree of accountability and transparency in our conduct we comply with the requisite board structures and roles, and requirements on executive remuneration and performance assessment of corporate management. We continue to report to CBSL and other regulatory authorities on all aspects covered under regulatory reporting and have adopted the IFRS framework in preparing and presenting our Financial Statements since 2012.

The Bank as a Promoter of Sustainability and Social Responsibility

HNB is not just a bank; we have a stake in the wellbeing of our employees, customers, suppliers, community and our environment, a responsibility to exercise good stewardship as individuals and as an institution. We positively encourage investments in renewable energy and environmental conservation through our credit evaluation and funding processes. We lead by example and have reduced our carbon footprint, by constructing green buildings and committing to a green pledge.

As an employer of choice, the Bank provides our employees with a safe place to work, offering ethical work practices and opportunities for life-long learning and development.

Strategic focus

As we remain focused on our core banking activities, our strategic priorities under the five core areas will remain

unchanged over the medium term. However, we will add more depth and breadth to each of the strategies in growing towards a larger asset base and becoming a stronger bank over the medium term. We will continue to focus on a strong sales culture and profitable balance sheet growth, and to provide more transparent, compliant and socially responsible operations along with service excellence and cost optimisation. Today service excellence entails professional management of the business, its network of relationships, product knowledge, ability to provide advisory services and customised solutions. It calls for having the right products and channels in place, secure and efficient processes and providing comfort and convenience to our clients to do their banking with us. We remain committed to making progress in all these areas having laid a firm foundation on each of these fronts over the past few years.

Business Outlook

Despite the economy rebounding in Q3 of 2013 with a lower interest rate structure already in place, and private sector lending showing signs of takeoff, we see year 2014 as another challenging year. In a low interest rate era, we need to improve on our fee generating capabilities and look for new revenue streams due to pressure on margins. The proposed new taxes and increased regulatory costs would bring in significant impacts on the profitability of the Bank. We will look to technology as an enabler; since we believe that understanding our client's needs and finding a combination of technological solutions has worked well for the Bank. As a systemically important bank we are forward looking and are committed to thinking beyond today. We will make all endeavours to provide a world class service to our valued customers through re-engineered business processes supported by a robust and effective governance and risk management framework.

Appreciations

I take this opportunity to thank my Board members for their unstinted support and cooperation extended to me throughout the year, for their skills and expertise which proved to be invaluable in guiding the Bank towards greater success in a very challenging year. Our togetherness helps HNB to strategise its business model to suit emerging situations. I also wish to thank Mr. R Theagarajah, Mrs. P C Cooray and Mr. N G Wickremeratne who retired / resigned from the Board for their contributions over the years.

HNB is not just a bank; we have a stake in the wellbeing of our employees, customers, suppliers, community and our environment, a responsibility to exercise good stewardship as individuals and as an institution...

I extend my deep appreciation to the Management and staff for their resilience during a tumultuous year, their relentless pursuit towards success and for their commitment to working together as a winning team. I express my grateful thanks to the staff of HNB's subsidiary companies for their commitment and cooperation and all our shareholders and customers with whom we have deep and long relationships. Without your trust we cannot lay claim to being adjudged the 'Best Bank' in Sri Lanka.

I place on record my grateful thanks to His Excellency the President and Minister of Finance Mahinda Rajapaksa, the Secretary to the Ministry of Finance and Economic Development, Dr. P B Jayasundera, the Governor of the Central Bank of Sri Lanka, Mr. Ajith Nivard Cabraal and his officials for their guidance and continued support during the year. The Government and policy makers deserve a word of thanks for creating a conducive macro-economic environment that enabled the financial services industry to do good business.

We stay committed to serving and safeguarding the rights of our stakeholders, by upholding the tenets of good governance and accepted best practice. We as the Board of Directors will execute prudence in raising HNB to the top while contributing to Sri Lanka's journey of progress.



Ranee Jayamaha
Chairperson

Colombo
21st February 2014

Managing Director's Review of Operations

Year 2013 brought us together as a team united in purpose, by the realisation that we embark on a journey towards being the best in class service provider. We placed cutting edge technology at the forefront of our operations, enhanced reach and service delivery through electronic channels, and commenced a Business Process Re-engineering initiative to drive sales by optimising the business operating model.

This was a year in which we recognised the power of team spirit, the importance of building teams and succession planning towards sustainable future growth.

We added another chapter into the annals of our rich heritage by continuing with the efforts and commitment of the great minds that led this institution before our time, in moving forward on our journey of exploring new opportunities and frontiers with foresight.

Having come out stronger for having made it through a tumultuous year fraught with challenge and change, it is satisfying and motivating to report on the resilient performance achieved by your Bank, and the efforts of an equally resilient and committed team of inspired people.

Your Bank is the proud recipient of the award for having been adjudged as Sri Lanka's 'Best Bank' by the prestigious "The Banker" Magazine of the UK for the second consecutive year, and the 'Best Retail Bank' by the Asian Banker Magazine for the sixth consecutive year.

In reviewing the performance of your Bank, it is pertinent that we reflect on the global and domestic economic conditions, which set the stage for all economic activity that took place during the year.

The Global Economy


There was a high degree of volatility and uncertainty in the global economy with downward revisions being made to the growth forecast of the developed and emerging markets from the protracted recovery from the 2008/09 global economic crisis, and from external shocks such as the Federal Reserves' QE tapering. It is expected that the world economy would report a growth of 3% for 2013 which is likely improve to 3.7 % in 2014.

The highlights for the year would be: the US Fed's QE, the moderation of China's economic growth down to 7.7%, Europe's recovery and slower growth reported by India at 4.4%.

The Sri Lankan Economy

The year 2013 was one of volatility with the first half witnessing sluggish economic performance from a high interest rate regime, leading to a low appetite for private sector credit, liquidity constraints from delayed settlement by principals, decline in export volumes and an increase in Government debt due to the post war infrastructure revival and borrowings of State-owned Enterprise.

Despite a significant reduction in private sector lending, the second half in 2013 looked more optimistic from stronger than expected growth. Monetary easing, softer inflation and a more stable exchange rate put the country on a firmer footing for more robust economic growth. A stronger performance from exports helped narrow the trade gap, improving the external sector performance. GDP growth is expected to be at 7.2% for full year 2013 and is forecast at 7.8 % for 2014.



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Managing Director's Review of Operations

The year under review

In looking back on the year that was, the performance of your Bank has exceeded expectations amidst changes and challenges in the operating environment. It bears testament to the agility and dexterity displayed by the team in their focused approach in surmounting the challenges. It is said that it is not the situation but your reaction to the situation which determines success.

A focused and target driven sales initiative resulted in moderating the low demand for credit witnessed in 1H 2013. The appetite for credit picked up in the third quarter, helped by an easing in interest rates. We grew our loan book due to the dynamic and focused approach adopted by the team in responding to the volatility and uncertainty in market conditions. We have outperformed our peers and performed better than the industry.

High interest rates drove depositors towards high yielding fixed deposits and subordinated debt issues that offered tax waivers and liquidity. Notwithstanding this, the Bank was able to grow the savings base by 14% through focused market communication and a series of regional activities in the savings space. These initiatives were reinforced by the brand promise that is associated with being safe and sound.

We were successful in containing our NPA ratio to 3.64% against an industry average of 5.6 % from continuous and concerted efforts through aggressive recoveries, active monitoring and prudent lending. In fact the performance this year is a marginal improvement over last year and is noteworthy, given the impact arising from the decline in bullion prices and its implications on the pawning portfolio. We applied a three pronged approach to mitigate the impact which encompassed reduction in our 'Loan to Value', adoption of an aggressive provisioning policy and intensified auctioning in the absence of ancillary cash flows which cushioned the impact from the decline in the price of gold. This strategy enabled us to contain our NPAs well below the industry levels.

The Bank made a strategic decision to grow our fee income from remittances by leveraging on our existing relationships and expanding through partnerships and agents as opposed to an ownership model. Accordingly, we initiated the process to divest our investments in both Majan and Delma exchange houses. However, the efforts

were protracted due to stringent procedural requirements and took longer than expected to reach finalisation.

Financial performance

Our core banking results have been moderated by a combination of factors. However, they still remain satisfactory in the wider context of industry performance and the economic environment that prevailed in 2013. It has also put the Bank on a stronger footing and boosted our confidence in approaching 2014.

The growth of our loan book by 17% is a positive outcome despite a significant reduction in private sector lending witnessed during the year. We could have improved on the growth trajectory of the previous year had the environment been more conducive. We have done well to record increases in net interest income by 11% and fee income by 16% over the prior period. The launch of our new product MOMO, the mobile POS, HNB One NFC card, our best in class mobile banking solution and new ATM Switch as per our multi-channel strategy have given us a strong operating platform to support future growth in CASA, payment services and fee income.

We have contained the increase in the operating cost base through our strategic initiative to drive a more cost conscious culture across the Bank. Other operating expenses have increased by 14.5% to Rs 8.2 Bn largely due to our significant investments in technology, electronic delivery channels and new product development. The cost to income ratio is reported at 47.8%. We continue to pursue with productivity enhancement measures over the medium term and consider any cost which does not produce value to our customers as excessive.

The prudence in our provisioning is reflected in the performance of our profitability. This underlines the importance we place in remaining the 'safe and sound' systemic bank we are known to be, and in safeguarding the interests of our stakeholders by focusing on sustainable bottom line.

We have reported PBT of Rs 10 Bn against an industry performance that has witnessed an erosion of profitability and given way to a negative performance. Post-tax profits are reported at Rs 7 Bn for the financial year ending 2013.

We have reported PBT of Rs 10 Bn...

In 2013 we crossed the Rs 500 Bn mark in total assets, with the assets growing by 14.3% over the prior year...

In 2013 we crossed the Rs 500 Bn mark in total assets, with the assets growing by 14.3% over the prior year and deposits recording a growth of 12.9%.

Operational performance

The best companies have stimulating workplaces where their staff feels motivated and valued. We have focused on identifying talent with the potential to take up future leadership positions through our structured succession planning initiatives. We have identified our top 100 leaders who will be coached and given the necessary exposure to develop as the future leaders of your Bank.

Over the past three years we increased our footprint by adding 60 customer centres to our existing network. In 2013 we added only three additional customer centres taking a strategic view to consolidate our existing footprint. Leveraging more from our existing investment in our network will remain a priority. The focus of our multi-channel distribution strategy is on increasing our reach through electronic delivery channels that deliver increased customer convenience and greater choice.

We dedicated 2013 to implementing new technology and enhancing the functionalities of existing technology. The investments will assist us in successfully crossing the technology chasm which is the next frontier in the evolution of the banking eco system. Technology and digital convergence will transform our business model by the shift to digital channels, opening up new opportunities for engaging and interacting with customers to build relationships and grow new revenue streams. We have set out a clear digital vision on identifying the changes taking

place in the eco system of banking towards securing customer relationship primacy and sustainability.

The ground work has been laid in 2013 for a complete overhaul of our processes. In 2014 we will work towards redesigning and reengineering existing processes making them more robust and effective in facilitating speed, efficiency and productivity across the Bank. Our objective is twofold, the first being to drive unparalleled customer satisfaction and convenience through service excellence, with the second being to work towards a target operating model which will lead to better and more efficient ways of optimising our existing cost structures. Leveraging our cost base to 'do more' becomes imperative in driving scale and facing up to the challenges of shrinking margins, new taxes and more investment in governance and oversight.

Strengthening the capital base of the Bank

Strengthening the capital base and maintaining adequate liquidity in tandem with our growth has always remained a priority. During the year we raised USD 49 Mn on very attractive terms from China Development Bank towards longer term project financing. The Bank issued Rs 4 Bn worth of unsecured subordinated redeemable debentures to fund its projected lending activities and strengthen the Bank's regulatory Tier II capital base. Our capital position continued to be strong with Tier I capital adequacy ratio at 12.95% and total capital adequacy at 16.52%.

The Internal Capital Adequacy Assessment (ICAAP) process has been formalised in 2013 in keeping with the requirements of adopting BASEL II. The Bank will progress towards a principal based framework for assessing capital adequacy from the existing rule based methodology. We remain committed to maximising shareholder value within the defined risk appetite of the Bank. The risk management strategy of the Bank is well balanced between risk and return, whilst aiming to maintain adequate liquidity and capital positions along with asset quality.

As we have continuously done in the past, we drive our governance frameworks towards greater transparency and accountability. The need to continuously reinforce our compliance efforts has received the highest priority in keeping abreast with the continuous changes taking place

Managing Director's Review of Operations

in the various regulatory and compliance frameworks which continue to evolve.

A sustainable business model contributing to national development

Having alignment between our business strategy and the national development goals is in keeping with our approach towards a business model that is sustainable in the longer term. Hatton National Bank continues to play an integral role in the development of Sri Lanka and will continue to support the development drive of the nation towards reaching upper middle income status.

The Bank has contributed to national growth, economic development and prosperity through our funding initiatives to the SME and micro finance sectors. As a pioneer in micro finance, we reach a significant milestone in 2014, as we count 25 years in uplifting livelihoods and promoting economic self-sufficiency of rural Sri Lanka through capacity development and access to funding.

In 2013 Sri Lanka were co-hosts with Uganda the second 'Global Agriculture Financing Forum' titled 'Investing in Agriculture Profitably'. The conference was managed by the World Bank through AgriFin and supported by the Bill and Melinda Gates Foundation with Hatton National Bank as the local host. Hatton National Bank partnering with AgriFin, has helped further expand its outreach to rural areas while building capacity to improve access to finance for the SMEs involved in agriculture. The products developed and the lessons learnt in Sri Lanka will in turn be shared as best practices among global communities of learning. 125 banking professionals from 31 countries participated in this conference.

The Bank has facilitated more opportunities in the area of trade finance by taking trade expertise and improving awareness on trade related activity by setting up regional trade cells across the country thereby improving trade income by 11%. We have also played a lead role in attracting worker remittances back to the country through our pioneering efforts to develop an international network of relationships that channel remittances through the banking system.

We have also contributed towards modernising and developing the banking infrastructure to make banking

Hatton National Bank continues to play an integral role in the development of Sri Lanka and will continue to support the development drive of the nation towards reaching upper middle income status.

more accessible and to reach the unbanked through our investments in electronic delivery channels and e-products. The Bank has funded a sizeable number of construction and infrastructure development projects in the corporate sector during the year. We have actively participated in the funding of tourism and renewable energy. The positive impact of our actions is evident when we make capital available to companies involved in green construction, clean technology, renewable energy or other low-carbon sectors while having a sizeable presence in all sectors of the economy.

Good environmentalism is good economics. The existing environmental risk assessment process for credit evaluation of environment sensitive projects will be expanded to include the whole portfolio. This mirrors our thought leadership on minimising the negative impacts to eco systems and surrounding communities from funding the initiatives of our clients and our commitment to do no harm.

We have weathered the storm in 2013 and come out stronger and better for having faced the test, becoming a more resilient team that has the agility to respond to the volatility and uncertainty that is the current day dynamic of doing business. And even after 125 years we do not hesitate to chase after the challenges and tread the unknown in going beyond the realms of conventional

banking. Our spirits are strengthened by our rich heritage and strong brand promise that has been long associated with safety, stability and progress. We are known for building and nurturing strong relationships by caring for our customers and employees and for investing in the lives of all Sri Lankans. Caring is a powerful business advantage.

We are also known for being a trusted systemic bank, partnering for progress in delivering value to our stakeholders and contributing to national development. We commit to continuing with our sustainable focus.

We will leverage on the investments made in 2013 towards making the operating platform best in class to drive growth and profitability in the medium term. Our strategic focus will remain unchanged but take on more breadth and depth. We aim to make step changes in enhancing service quality, service delivery and operational efficiency during the period 2014 - 16 to provide unparalleled service to our customers, while we aspire to continue as the best bank in Sri Lanka. We remain optimistic and positive to the proposed changes that will take place in the industry.

Appreciation

Our journey of continued success would not be possible without the loyalty of our customers who have continued to build stronger relationships and patronize our products and services for generations. Thank you for continuing to select HNB as your banking partner; your trust has sustained HNB's continuous success, and you have been our source of learning. To our investors for the trust that they have placed in the Bank and in the leadership team, we are very grateful.

I extend my appreciation to the Governor of the Central Bank of Sri Lanka and his team of officials for the guidance and support extended to the Bank during the financial year.

On behalf of the Bank we express our appreciation to all our colleagues who have retired or made career changes during the course of the year for their contribution to the Bank.

My grateful thanks to the Chairperson and fellow Directors of the Board, for their encouragement, guidance and oversight. For being a strong support through the challenges, and sharing their knowledge and expertise through active engagement.

I also sincerely appreciate the support extended and contribution made by my leadership team and the Hatna Family for your dedication and commitment. I thank you all for your team spirit and resilience in embracing change towards the betterment of HNB and all its stakeholders.

Embracing change is an opportunity to be progressive.



Jonathan Alles
Managing Director/CEO

Colombo, Sri Lanka
21st February 2014.

Board of Directors

Mr Jonathan Alles
Managing Director/
Chief Executive Officer

Dr Ranee Jayamaha
Chairperson



Mr L U D Fernando
Director

Miss D S C Jayawardena
Director

Dr Willie W Gamage
Director

Ms M A R C Cooray
Director



Mr R S Captain
Director



Mrs K A L Thushari Ranaweera
Company Secretary



Mr D T S H Mudalige
Director

Dr L R Karunaratne
Director

Board of Directors

DR RANEE JAYAMAHA

CHAIRPERSON

(Non-Executive Director)   





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

Appointed Director and the Chairperson on 31st March 2011. She is the Chairperson of HNB Assurance PLC and Sithma Development (Pvt) Ltd. Dr Jayamaha had been the Deputy Governor in charge of Financial System Stability of the Central Bank of Sri Lanka from 2004 up to her retirement at end of May 2009. She has over 40 years of extensive experience in the fields of economics, banking, finance, regulation and administration, having held a number of positions in the Central Bank and outside. She is currently an Advisor to His Excellency the President.

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

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

In 2012, the University of Stirling bestowed Dr Jayamaha with the Degree of Doctor of the University (Duniv) in recognition of her distinguished career as one of the University's first Master's Graduates in Economics and as a person of great distinction in the fields of learning the arts and public affairs.

-  Member of HR & Remuneration Committee
-  Member of Nomination Committee
-  Member Board Integrated Risk Management Committee
-  A Member of Audit Committee

MR JONATHAN ALLES

MANAGING DIRECTOR/CHIEF EXECUTIVE OFFICER
(Executive Director) 

M.B.A. Finance (Stirling), A.I.B. Sri Lanka

He was appointed an Executive Director on 1st May 2013 and Managing Director/Chief Executive Officer on 1st July 2013.

Mr Alles holds a MBA from the University of Stirling, U.K. and is an Associate Member of the Institute of Bankers, Sri Lanka. He counts 25 years of banking experience having served International Banks and HSBC, Sri Lanka and also at Hatton National Bank during the period September 2002 to June 2005. Having returned to Sri Lanka from the UAE in September 2010, Mr Alles re-joined Hatton National Bank in the capacity of Chief Operating Officer.

He also serves as a Director of HNB Assurance PLC, Sithma Development (Pvt) Ltd, Acuity Partners (Pvt) Ltd, Acuity Stockbrokers (Pvt) Ltd, Lanka Ventures PLC and Lanka Financial Services Bureau Ltd.

MS M A R C COORAY

DIRECTOR

(Non-Executive Director)   

B.A. (Hons) (University of Ceylon, Peradeniya, Sri Lanka), M.Sc (Strathclyde University, U.K.), (Non-Executive Director)

Appointed Director in February 2010 and designated as the Senior Director with effect from 17th May 2013. She is a retired Deputy Governor of the Central Bank of Sri Lanka where she served for over 35 years. She is a Director of Ceylon Guardian Investment Trust PLC and Ceylon Investment PLC.

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

She has functioned as the Vice Chairperson of the Institute of Bankers of Sri Lanka for 5 years and has served on a number of Committees at national level covering a variety of subjects representing the Ministry of Finance and the Central Bank. She has also represented the Central Bank and the Ministry of Finance at various international meetings/seminars.

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

DR WILLIE W GAMAGE

DIRECTOR

(Non-Executive Director)  

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

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

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

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

Board of Directors

DR L R KARUNARATNE

DIRECTOR

(Non-Executive Director) (N) (R) (A)

B.E (India), T.Eng (CEI), MIE (Lon), MBA (U.K.), Ph.D (U.K.), FIIM (HK), FCIQB

Appointed Director in October 2011. Dr Rohan Karunaratne, a Consultant Engineer, is the incumbent President of the Ceylon Institute of Builders (CIOB), engaged in developing the construction industry and construction builders in Sri Lanka. He is the Managing Director of A.K.K. Engineers (Pvt) Ltd, an Engineering Company specialized in building construction, civil engineering, water supply and waste water, construction of swimming pools and now in road construction, the Chairman of Associated Motor Finance Co Ltd and is also the Deputy Chairman of the International Institute of Management.

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

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

MR L U D FERNANDO

DIRECTOR

(Non-Executive Director) (H)

MBA (Sri J), FCMA (U.K.)

Appointed Director in April 2012. Mr Fernando was the former Executive Director of Sri Lanka Insurance Corporation Limited and of The Lanka Hospitals Corporation PLC. He also had served in the Boards of Distilleries Company of Sri Lanka PLC, Pelwatte Sugar Industries PLC, Melstacorp Limited, Lanka Bell Limited, National Asset Management Limited, Continental Insurance Lanka Limited and in the Boards of several other Companies in the DCSL Group.

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

He is a Fellow of Chartered Institute of Management Accountants of United Kingdom. He has been awarded a Master's degree in Business Administration by the Postgraduate institute of Management of University of Sri Jayawardenepura.

MR D T S H MUDALIGE

DIRECTOR

(Non-Executive Director) (A) (H)

FCA (Sri Lanka), FCMA (UK), FCCA (UK), FCPA (Australia)

Appointed Director in April 2012. Mr Mudalige is a past President of the Institute of Chartered Accountants of Sri Lanka (CA – Sri Lanka) and is the Chairman of the Sri Lanka Accounting Standards Committee. Mr Mudalige has more than 25 years of experience in public accounting practice and in industry. He was a Member of the Securities and Exchange Commission of Sri Lanka (SEC) and chaired its audit committee. He is a Board Member of the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) and is a Member of the Financial Systems Stability Consultative Committee (FSSCC) of the Central Bank of Sri Lanka.

Mr Mudalige is the President of the Confederation of Asian and Pacific Accountants (CAPA), the largest regional body of accountants. The confederation includes the professional accountancy bodies of Asian and Pacific nations.

He is a Fellow of the Institute of Chartered Accountants of Sri Lanka (CA-SL), Fellow of the Chartered Institute of Management Accountants (CIMA-UK), Fellow of the Association of Chartered Certified Accountants (ACCA -UK) and Fellow of the Certified Public Accountants (CPA- Australia).

MISS D S C JAYAWARDENA

DIRECTOR

(Non-Executive Director) (A) (R)

B.A. Monash University, Australia, Certified Auditor (DNV-Norway), CIM – London, MCIM (U.K) Chartered Marketer

Appointed Director in April 2012. Miss D S C Jayawardena is a Director of Lanka Milk Foods (CWE) Plc., Lanka Dairies (Pvt) Ltd, Ambewela Livestock Company Ltd, Pattipola Livestock Company Ltd, Ambewela Products (Pvt) Ltd and Indo Lanka Exports (Pvt) Ltd, since 2009. She has worked as an Intern for the Clinton Foundation in 2008.

Miss Jayawardena holds a B.A. (Commercial Law, Criminology, Sociology) from the Monash University, Australia, Professional Certificate in Marketing (CIM), Diploma in Marketing (CIM) and a Professional Postgraduate Diploma in Marketing (CIM). She is also a Certified Auditor (DNV-Norway), a Member of the Chartered Institute of Marketing (UK) (MCIM) and a Chartered Marketer.

MR R S CAPTAIN

DIRECTOR

(Non-Executive Director) (A)

University of Miami, Florida

Appointed Director in April 2012. Mr R S Captain is the Managing Director of Austin Gloves (Ceylon) Ltd, CEI Plastics Ltd, Propertex Development Ltd, Paints & General Industries Ltd, Paints & General Industries (Exports) Ltd, Polypak Secco Ltd and Ranweli Ltd. He is also a Director of Agriland Ltd, CIC Holdings PLC, Forest Creek Park Ltd, Body Bar Ltd, H. Senid Software Ltd, Horahena Investments Ltd, Palmland Ltd, Parkland Ltd, Polytex Garments Ltd and Randiya Farms Ltd.

Mr Captain has had his Primary education at the Royal College and Secondary education (O/L & A/L) at Millfield, U.K. and the University of Miami, Florida.

MRS K A L THUSHARI RANAWEERA

COMPANY SECRETARY

Attorney at Law, Master's Degree in Law (LLM) - University of Cambridge, United Kingdom. Diploma in International Affairs - Bandaranaike Centre for International Studies, Sri Lanka

Appointed Company Secretary on 2nd January 2012. She is also the Assistant General Manager - Legal of the Bank. Mrs Ranaweera joined the Bank on 7th October 2010 and counts over 20 years of experience in the field of Banking. She holds a Master's of Law Degree from the University of Cambridge, U.K.

Corporate Management



- 1 **A J Alles**
M.B.A. - Finance (Stirling) A.I.B. (Sri Lanka)
Managing Director/Chief Executive Officer
- 2 **D P N Rodrigo**
M.B.A. (Cranfield), F.C.M.A.(UK), F.C.C.A. (UK)
Chief Operating Officer
- 3 **Ms I R D Thenabadu**
F.C.I.B. (London), F.C.M.A.(UK)
Deputy General Manager - Corporate & Wholesale Banking
- 4 **P D Hennayake**
M.B.A. (A.I.T) Thailand, P.G. Dip. (Eng.), B.Sc. Eng. (Hons) Moratuwa , C.Eng., M.I.E. (Sri Lanka)
Deputy General Manager - Services



- 5 **A P L Fernando**
M.B.A. (Colombo), F.I.B. (Sri Lanka), Dip. in Bank Mgmt.
Deputy General Manager - Recoveries & Credit Quality Management
- 6 **A Ratnasabapathy**
FP.M.A.
Assistant General Manager - Corporate Banking
- 7 **M Asokan**
F.C.A. (Sri Lanka), A.C.M.A.(UK), C.I.S.A. (USA), C.I.A. (USA)
Asst General Manager - Internal Audit
- 8 **N U Jumat**
F.I.B. (Sri Lanka)
Assistant General Manager - Trade & International

Corporate Management



- 9 R J Thambirajah
Assistant General Manager - Network Management
- 10 R M P Dayawansa
M.B.A. (Sri J.), F.I.B. (Sri Lanka), F.C.I.M. (UK), F.S.L.I.M.
Assistant General Manager - Personal Financial Services
- 11 Ms S Gnanapragasam
BSc. (Hons), F.C.M.A.(UK), C.G.M.A.
Assistant General Manager - Risk
- 12 Ms L C Cooray
M.B.A. (Wales), Dip. in HR (IPMSL), I.P.M.A. - CP (USA)
Assistant General Manager - Human Resources



- 13 Ms K A L T Ranaweera**
Attorney at Law, LL.M. (Cambridge), Dip. in Int'l Affairs (BCIS)
Assistant General Manager - Legal/Company Secretary
- 14 S N Wijeratne**
M.B.A. (Sri J.), B.Sc. (IT) – UK
Chief Information Officer / Assistant General Manager – IT
- 15 R D Manatunga**
F.C.M.A.(UK), C.G.M.A., A.C.A. (Sri Lanka)
Chief Strategy Officer / Assistant General Manager - Strategy

Senior Management

- 1 **K L Wijesooriya**
LL.B (Sri Lanka)
Chief Manager - Inward Remittances & Exchange Houses
- 2 **V Vijayakumar**
M.Sc. (I.T) UK, A.I.B. (Sri Lanka), M.I.M.I.S. (Lond.), A.M.I.A.P. (Lond.), M.A.A.T. (Sri Lanka), M.B.C.S.
Chief Manager - IT Operations
- 3 **A Goonesekere**
M.B.A. (Sri J.), F.C.A. (Sri Lanka), F.C.M.A. (Sri Lanka)
Chief Accountant
- 4 **R B Warnakulasuriya**
M.B.A. (Sri J.), B.Com. (Special) Kelaniya, M.A.A.T., A.I.C.M.
Chief Manager - Greater Colombo Region
- 5 **V Ratnasabapathy**
A.C.I.B. (Lond.), A.C.S.I. (UK)
Chief Manager - Risk
- 6 **U N I Elapata**
B.A. (Hons) - Uni. of Texas (Austin)
Chief Manager - Financial Institutions
- 7 **Ms R Prabhakaran**
A.I.B. (Sri Lanka)
Chief Manager - Treasury Operations
- 8 **Ms N M C P Wettasinha**
Attorney-at-Law & Notary Public
Chief Manager - Legal
- 9 **W J T Fernando**
M.B.A. (Sri J), A.I.B. (Sri Lanka)
Chief Manager - North Western Region
- 10 **A R Uduwela**
M.B.A. (Sri J.), B.Sc. Special (Pera.)
Chief Manager - Operations
- 11 **D S L Ferdinando**
A.D.C.M. (IBSL)
Chief Manager - Corporate Account Relationship
- 12 **Ms K Balasubramaniam**
LL.B (Sri Lanka)
Chief Manager - Human Resource Management
- 13 **A V Abeygunasekara**
M.B.A. (Colombo), B.Sc. (Colombo), A.C.M.A. (UK), A.C.I.
Chief Manager - Treasury & Markets
- 14 **M P Wickramasinghe**
M.B.A. (IT) Moratuwa, MSc. (Colombo)
Head of Card Centre & Electronic Delivery Channels
- 15 **S Udayakumar**
D.B.A (UK), B.Sc. (AM), F.C.M.I. (Lond.), M.S.L.I.M., Dip. in Busi. Mgmt. & Admin. (UK), M.C.P.M.(Sri Lanka), Dip. in Sales Mgmt. & Marketing (UK), A.I.T.D. (Sri Lanka)
Senior Manager - Audit (Branch Operations)
- 16 **Ms M K Rambukwella**
M.B.A. (Sri J.), M. Sc. (Pera.), B.A. (Hons) - (Pera.), A.C.I.M. (UK), M.S.L.I.M., A.M.I.T.D.(Sri Lanka)
Senior Manager - Learning & Development
- 17 **H J A Ferdinando**
Senior Manager - Centralized Operations
- 18 **L S C L R Fernando**
A.I.B. (Sri Lanka)
Senior Manager - SME
- 19 **N M Kulatunga**
M.B.A. (Sri J.), A.I.B. (Sri Lanka)
Senior Manager - Credit Administration
- 20 **W M C O Panditharatne**
Senior Manager - Procurement & Logistics
- 21 **R L Maheswaran**
Senior Manager - Cinnamon Gardens
- 22 **Ms G Arjuna**
F.C.M.A. (UK), F.C.P.A. (Australia), C.G.M.A.
Senior Manager - Personal Financial Services
- 23 **N Y Liyanage**
N.D.T. (Civil Eng.) - Moratuwa, P.G. Dip. in Project Mgmt. (Moratuwa), A.M.I.E. (Sri Lanka), M.S.S.E.(Sri Lanka)
Senior Manager - Premises & Engineering

- 24 **P Paranathan**
P.G. Exe.Dip. in Bank Mgmt. (IBSL)
Senior Manager - Pawning
- 25 **Ms A F M Fernando**
Senior Manager - Corporate Account Relationship
- 26 **Ms A C De Silva Gallage**
M.B.A. (Sri J.), B.B.A. (Special) - Colombo, A.C.M.A. (UK), C.G.M.A., C.P.A. (Australia), Dip. in Commerce (Uni of PNG), I.C.A. - Licentiate
Senior Manager - Finance
- 27 **N R Somasiri**
M.B.A. (Sri J.), B.Sc. (Colombo)
Senior Manager - Credit Supervision & Recoveries
- 28 **B V F Mendis**
Senior Manager - City Office
- 29 **M K N S Perera**
M.B.A. (Manipal), Dip. in Marketing (L.B.S.) SL
Regional Head - Colombo Region
- 30 **J N Rupasinghe**
Senior Manager - Systems Implementation
- 31 **C S Weerasinghe**
M.B.A. (Sri J), M.C.I.M. (UK)
Senior Manager - Marketing & Communications
- 32 **J C Ilangantileke**
M.B.A (Manipal), B.A. (Hons) - Northumbria(UK), A.I.B. (SL)
Senior Manager - Trade Services
- 33 **A G R Dissanayake**
B.B.A. (Colombo), A.C.M.A.(UK), C.F.A. (USA)
Senior Manager - Strategic Planning
- 34 **P D H Muthukumarana**
M.B.A. (Sri J), P.G. Dip. in IT(SLIT), M.B.C.S. (UK), M.I.E.T. (UK), M.I.E.E.E.(USA)
Senior Manager - Enterprise Software
- 35 **H L J P Bastiansz**
M.B.C.S. (UK), C.I.T.P.
Senior Manager - IT Strategic Projects
- 36 **D Dissanayake**
Regional Head -South Western Region
- 37 **R D R Amarasekara**
Dip in Bank Mgmt (IBSL)
Senior Manager - Customer Relations & Business Dev. (Subsidiaries)
- 38 **F Mohamed**
MSc. (IT), (Uni. of Keele) - UK
Senior Manager - System Support
- 39 **L A M Hisham**
Head of Islamic Banking
- 40 **J Epasinghe**
M.B.A. (Australia), A.I.B. (SL), P.M.P.
Head of Process Improvement & Change Management

Management Discussion & Analysis

Economic Review

Global Economy

The fragile recovery of the global economic system continues to put pressure on emerging Asia's growth plans, calling for greater monetary and fiscal discipline at the regional and national levels. Asia's economy which recorded strong growth immediately after the sub-prime crisis has slowed down in the past few years, amid a weak demand from the West and a deceleration in the economies of the two regional giants China and India. Growth in developing Asia slowed down from approximately 9% in 2010 to around 6% in 2013 with a marginal increase to 6.2% expected in 2014 (Source: ADB).

The consensus is that global economic activity will gradually pick up pace in 2014, with signs of recovery in the Eurozone reflecting a more comfortable position than one year ago and the US Federal Reserve's announcement in December 2013 that it would begin to taper its QE program from January 2014 as a result of the positive economic data seen in 2013. The Japanese economy also showed signs of recovery during the past two years with GDP stabilizing at 2% after a Quantitative Easing policy pursued by the new government.

The recovery of the global economy and increase in output in the developed economies bodes well for Sri Lanka in respect to improving our external sector performance, as our exports are significantly impacted by the economic performance of both the US and the Eurozone. For Sri Lanka, as well as the other emerging markets, the costs of borrowing abroad will be higher

with the inevitable rise in US bonds. The extent of the risk premium demanded by international capital markets will depend on the strength of the country's macroeconomic fundamentals, particularly the current account and budget deficits.

The Sri Lankan Economy

GDP Growth

Economy rebounds from stronger than expected second half performance in 2013

Economic activity rebounded with the end of the war and the IMF Standby Agreement, resulting in two straight years of 8% growth in 2010-11 with growth moderating to 6.4% in 2012. Economic growth remained low in the first half of 2013 with a low appetite for credit from the private sector arising from a high interest rate regime and dampened business sentiment. However with the lowering of interest rates and recovery of the global economy, the domestic economy showed signs of recovery commencing Q3 2013 and is most likely to grow at over 7% for 2013. Industry and services sectors contributed positively towards growth while the agriculture sector contracted. Sri Lanka's current USD 67 Bn economy is estimated to grow by 7.8% in 2014.

Key economic indicators

Economic Indicators	2009	2010	2011	2012	2013 (Provisional)
GDP Growth %	3.5	8	8.2	6.4	7.2
Head line Inflation %	5.0	6.8	4.9	9.2	4.7
364 day Treasury Bill Rate (year end) %	9.3	7.6	9.3	11.7	8.3
Annual Average Exchange Rates	114.94	113.06	110.57	127.6	129.1
Per-capita Income (USD)	2,057	2,400	2,836	2,923	3,282
Exports (USD Mn)	7,085	8,626	10,559	9,774	10,386
Imports (USD Mn)	10,207	13,451	20,269	19,183	17,999
Worker Remittances (USD Mn)	3,330	4,116	5,145	5,985	6,763
Gross Official Reserves (USD Mn)	5,097	6,610	5,958	6,878	7,100
Trade Balance (USD Mn)	-3,122	-4,825	-9,710	-9,417	-7,613
Balance of Payments (USD Mn)	2,725	921	-1,061	151	991

Source: CBSL

Inflation

Sri Lanka's YoY inflation decelerated to 4.7% in December 2013, from a high of 9.8 % at the commencement of the year

Inflation decelerated significantly to reach 'benign' mid-single digit levels of 4.7% in December 2013, from 9.2% reported for December 2012, and a high of 9.8% in January 2013, having been contained within single digit levels for nearly five years. This has been the longest period during which inflation has remained at single digit levels post liberalization of the economy.

Inflation target for 2014 is forecasted to hover around 4 - 6 % based on Central Bank forecast.

Interest Rates

Government 1 Year Treasury Bill rate reached a 26 month low level of 8.3% by year end 2013 while the Average Prime Lending Rate (AWPLR) witnessed a steep decline of 452 basis points over the last 12 months. The low interest rate regime is expected to continue during major part of this year.

Exchange Rates

The Rupee witnessed reasonable stability against the US Dollar during 1H 2013 but depreciated with the uncertainty caused by the initiative to taper QE.

The Rupee depreciated approximately 2.8% against the US Dollar (11.6% in 2012) and appreciated 8.7% against the Indian Rupee.

The Rupee stabilised against the Dollar at Rs 132 towards year end from an all-time low reported in August 2013. Stabilization of the Rupee was driven by increase in exports towards the latter part of 2013. Earnings from exports reached USD 10.4 Bn for the year 2013 which is a 6.3% growth over 2012. During the year gross official

reserves were maintained at an equivalent of 4.5 months of imports which is well above the internationally accepted norm of 3 months.

Equity Markets

The stock market reports a rise for the first time in 2 years with benchmark of the Colombo Stock Exchange ASPI gaining by 4.8% during the year surpassing growth in several regional markets. Foreign participation was strong in the market contributing approximately 36% to market turnover compared to 25% in 2012.

Industry Review

The industry globally as well as locally is going through an unprecedented increase in regulation, continuing cost pressures compounded by the persistent trend in margin compression and alarming market volatility.

At end-2013, there were 33 licensed banks comprising 24 Licensed Commercial Banks (LCB) and 9 Licensed Specialised Banks (LSB). Half of the LCBs were foreign bank branches.

The Sri Lankan banking sector remains concentrated. At present, only 5 domestic banks have asset bases over Rs 500 Bn with a market share of 66.3%. The 12 foreign banks account for only 10% of the market share.

Customer reach is still largely through the traditional "brick and mortar" model, while most banks have started introducing electronic channels at different levels.

The geographical dispersion of branches indicates a concentration in the Western Province. After the cessation of the civil war, most banks have also expanded their presence in the Northern and Eastern Provinces, which was earlier under banked.

Key performance indicators and trends

	2009	2010	2011	2012	2013
Number of Banks	36	31	33	33	33
Number of Branches	5,678	5,921	6,184	6,374	6,457
Number of ATMs	1,876	2,020	2,237	2,390	2,496

Source: Roadmap 2014

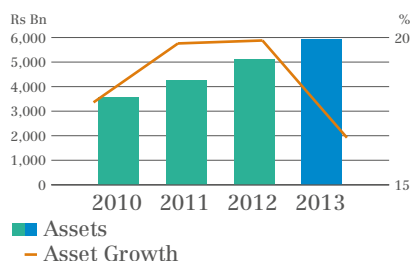
Management Discussion & Analysis

Growth in Assets

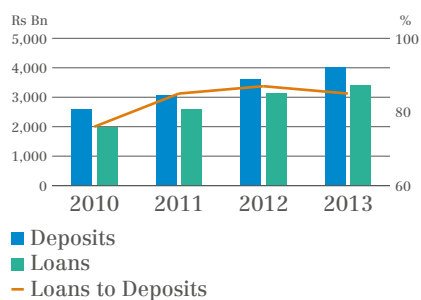
The banking sector accounts for approximately 57% of the assets of the financial services system, and expanded to Rs 5,943 Bn as at December 2013, with a focused strategy of reaching Rs 10 Trillion by 2016 through consolidation of the banking and finance industry.

The banking sector expanded by Rs 844 Bn with asset growth declining to 16.6%.

Industry Asset Growth

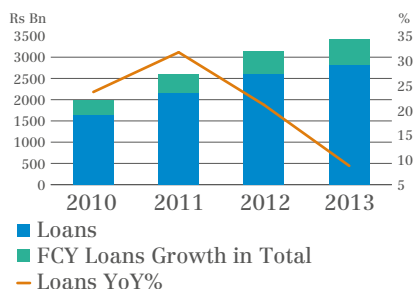


Industry Loan and Deposit Growth



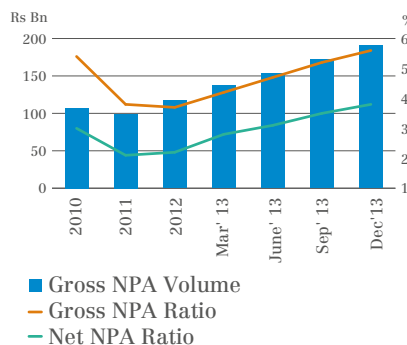
The sector recorded an overall credit growth of 8.8 % for 2013.

Credit Growth

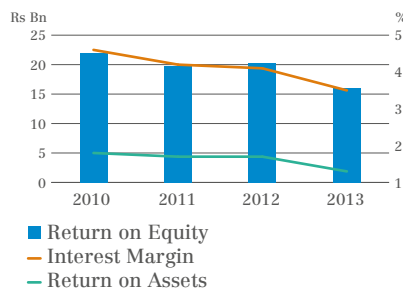


Industry NPA's have been on an increasing trend during the year with gross NPA ratio reaching 5.6% as at end of 2013.

Industry Trend in NPA

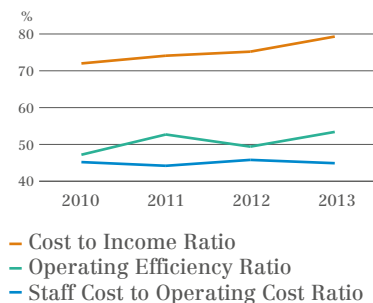


Profitability



Profitability of the industry has been impacted in 2013 due to decline in net interest income and operating profits.

Efficiency



The proposed new regulatory framework will continue to be in line with international best practices

Adopt standardized approach for calculating capital charge for operational risk under Pillar 1 in compliance with Basel II Capital Adequacy Requirement

Amend the Banking Act to take into account the new developments in domestic and international financial markets	<ul style="list-style-type: none"> • Supervision of bank dominated financial groups to be strengthened • Provisions to facilitate mergers and acquisition of banks to be introduced • Bank resolution measures to be strengthened
Develop new regulations	<ul style="list-style-type: none"> • Liquidity risk management • Framework for valuation of immovable property of Licensed Banks
Require banks to further strengthen	<ul style="list-style-type: none"> • The quantity and quality of capital to improve their loss absorbency capabilities • Increase in minimum capital requirement <ul style="list-style-type: none"> – Licensed Commercial Banks - minimum Rs 10 Bn – Licensed Specialized Banks - minimum Rs 5 Bn • The systems and processes to migrate to advanced approaches on the Basel II capital framework • The management of banking risks in an integrated manner • The governance, fitness and propriety of directors and senior management to establish operational accountability

Source: CBSL Website

Regulatory Oversight

Regulatory directives, initiatives and plans in gearing Sri Lanka towards Upper Middle income status

Focusing on the local operating landscape, the master plan of the Central Bank to consolidate Sri Lanka’s over expanded banking and financial service sector will be the key focus of the industry over the next two years as the larger Banks prepare to consolidate by acquiring or absorbing smaller peers. The consolidation of the financial services sector is to avoid the possible ‘Middle income Trap’ on Sri Lanka reaching “Upper Middle Income” status by 2016 in targeting to achieve a per capita income of over USD 4,000 levels and ensure financial stability of the system.

Through this initiative it is envisaged that the CBSL will trim down the number of smaller banks and Non-Banking Financial Institutions (NBFIs) in the industry. 58 NBFIs are to be consolidated into 20 larger institutions through mergers and absorptions. To ensure financial system stability, the expected outcome in consolidation is to result in a banking sector where at least 5 Sri Lankan banks will have assets of Rs 1 Trillion or more, with a strong regional presence.

The Impact of Budget 2013

Nation Building Tax (NBT) of 2% was made applicable on the banking industry with effect from January 2014.

The impact of technology on the banking industry

Traditional banking is facing its steepest challenge in over a generation, with the tipping point being reached with technology as its fulcrum.

Electronic channels are most likely to dominate the transaction banking space with customers in the retail and SME sectors using branch banking for advisory services.

Customer relationship primacy is likely to be the new source of value in banking

Prior to the financial crisis banks relied heavily on financial leverage to create shareholder value. Today, the economic climate, increased regulatory intervention and competitive challenges are forcing banks to deleverage and look for other sources of value. A new value model is required, based upon securing customer relationship primacy (the position of being the preferred and main bank for a customer), through efforts to build trust and customer engagement.

Despite challenges posed by the advent of technology and digital convergence, banks remain the most trusted providers of banking services. In growing markets where the under banked population is sizeable, digital technologies would play a key role in accessing the un-banked.

Management Discussion & Analysis

Business Performance Review

Overview

HNB over the years has shown resilience and outperformed the industry in most of the KPIs despite challenges and volatile operating environment. The year 2013 was no exception with significant changes and challenges that affected the financial industry such as global uncertainty, low credit appetite and volatile interest rates. In successfully facing these challenges the Bank deployed a combination of strategies and tactical initiatives on the product, channel, funding, operational, marketing, and HR fronts with information technology being the enabler of achieving our key priority for 2013.

Strategic Direction of the Bank

We will continue to focus on our existing five pillar strategy bringing in more depth and breadth over the medium term in driving to optimise on the investments made in our people, systems, network, channels and products during the years 2011 – 2013. We have worked systematically at designing a best in class operating platform secured by a strong risk management and

governance framework, in laying a strong foundation to support the future growth momentum of a stronger balance sheet.

Just as we prioritized technological advancement as a key focus area for 2013, we have ear marked 2014 for the achievement of service excellence, and 2014 – 2016 towards overall operational excellence. The strategic direction of the Bank will focus on Processes, People and Technology.

Our strategic intent is to be best Bank in Sri Lanka, to be the unrivalled and undisputed leader in the industry.

Key Strategic Priorities in 2013

Crafting Strategy

The sustainable strategic focus of the Bank is an outcome of the annual strategic planning process and from the insight gained from our continuous engagement with our stakeholders. The strategic plan formulates the short medium and long term plans for the execution of strategy and monitoring of performance.

CORE STRATEGIC DRIVERS	STRATEGIC OBJECTIVES 2013	FOCUS
Focus on strong sales culture and profitable balance sheet growth	<ul style="list-style-type: none"> Growth of 17% in loan book Launch new products Efficient use of capital 	Growth, Profitability and Sustainability
Focus on governance; transparency compliance and social responsibility	<ul style="list-style-type: none"> Complying with regulatory requirements Maintaining a high level of transparency in engagements with stakeholder 	Sustainability
Focus on operational service excellence and cost optimisation	<ul style="list-style-type: none"> Focus on convenience for customers through electronic delivery channels Re-engineer branch processes Adopt latest technology to support business growth, governance, employee engagement and risk management 	Growth, Profitability and Service Quality
Enhance Fee Income	<ul style="list-style-type: none"> Implement new fee generating initiatives Automate collection of fee income 	Growth, Profitability and Service Quality
Build a component, engaged and motivated team	<ul style="list-style-type: none"> Strengthening the HNB Brand as an employer of choice Superior rewards and recognition for superior performance Succession planning 	Sustainability

The business strategies flow from the overarching sustainability strategy which includes social performance and environmental citizenship in addition to economic wealth creation. Both the sustainability strategy and business strategy are aligned to the national vision and development goals of the country in partnering the nation and her people in progress.

Key Strategic Priorities of the Bank

Focus on a Strong Sales Culture and Profitable Balance Sheet Growth

Objectives:	Status
17% growth in loan book	16.8%
The efficient use of capital through prudent lending resulting in a sustainable and stable business model	✓
Support BASEL II transition strategy of the Bank by strengthening capital base	✓

Achievements

	2011	2012	2013
Loan growth	24.9	17.6	16.8
Deposit growth	21.9	17.2	12.9
ROE	18.2	17.8	14.3
NPA % (Gross)	3.92	3.66	3.64

1. Deposit growth of 12.9% YoY with savings base growing by 14%
2. Debt capital was raised through senior debt, subordinated debt and foreign funding at attractive rates during the year to support lending growth
 - Raised Rs 4 Bn through an unsecured redeemable subordinated debenture issue which further strengthened Tier II capital base
 - Senior Debenture issue of Rs 2Bn (face value)
 - Senior loan of USD 49 Mn from China Development Bank at very attractive interest rates
- 3 Capital position remains strong
 - Tier I ratio at 12.95% and Total CAR at 16.52%

An aggressive sales culture drives sales

Despite the significant decline in private sector borrowing, a low appetite for credit and shocks to the system from the decline in gold prices that led to a reduction in the pawning portfolio, we have achieved a profitable growth of 16.8% in the lending portfolio over the previous year driven mainly by the growth in Corporate Banking and SME segments. Despite being marginally lower than the target of 17% it remains a noteworthy achievement given the industry growth of 8.8% for the period.

Our focused approach to sales, prudent underwriting, increasing our sales to operational staff mix, increasing our bench strength in sales, designing of incentive schemes and structures to recognise sales performance and driving towards an aggressive sales culture have materialised in the growth achieved in very challenging market conditions.

The bench strength in sales has been reinforced in driving a more aggressive sales culture through the redeployment of staff involved in operations in branches, to sales and distribution. 700 staff members were selected and underwent training in selling techniques through structured workshops and external training programmes.

Low cost deposits contribute to sustainable growth

The Bank has continued to leverage its competitive advantage of mobilizing sustainable low cost deposits by leveraging its extensive branch network, and brand strength of being a safe and secure Bank a reputation, that has been built up over the years. The deep knowledge and strong relationships built with the communities we engage, in providing access to our products and services have given the Bank a comparative advantage in attracting and retaining deposits, staving off stiff competition from within the banking sector and from non- banking institutions. The growth in savings deposits by 14% during 2013 and thereby maintaining CASA ratio at 38.5 %, amplifies this fact.

Capital position strengthened

We have supplemented the deposit growth with other sources of funding to support the aggressive growth in the loan book. The issue of Rs 4 Bn unsecured subordinated redeemable debentures was oversubscribed in June 2013 with the issue closing on the opening day. The Rs 4 Bn raised through this debenture further supplemented the Tier II capital base thereby strengthening the Bank's capital adequacy position giving ample room for future

Management Discussion & Analysis

growth. In addition we also raised funds through a senior debenture issue with a face value of Rs 2 Bn to support the asset growth. A further USD 49 Mn was raised by way of a long term loan from China Development Bank (CDB) for the second consecutive year to fund longer term projects underpinning the confidence international banks have placed in the strength and stability of the Bank.

Focus on Operational Excellence and Cost Optimisation

Objectives:	Status
Focus on more convenience for customers through electronic delivery channels	✓
Initiate re-engineering of branch processes to improve service quality	✓
Adopt latest technology to support business growth, governance, employee engagement and risk management	✓

Achievements

Financial KPI	2011	2012	2013
Cost to Income ratio %	55.3	52.3	47.8

A multi-channel distribution strategy to cater to varying customer needs and offer more convenience.

The Bank has implemented a multi-channel distribution strategy with electronic channels complimenting the existing foot print of customer centres. By adopting a multi-channel strategy for distribution the Bank provides access by catering to the varied spectrum of needs of conventional, hybrid (using both branch banking as well as electronic channels) and cyber customers.

As a Bank we have understood the changes that technology is driving in the banking eco system which explains our aggressive pursuit in driving electronic channels as a cost effective and significantly more convenient solution for accessing our products and services.

e-products and electronic delivery channels afford more choice and convenience

The e-product suite, electronic channels and a dedicated contact / call centre set up in 2013 have afforded customers more choice and convenience in accessing the products and services of the Bank.

Debit card with Near Field Communication (NFC) technology launched as a first in the industry and being currently tested in the Southern province as means for paying for travel in buses. The NFC technology will

facilitate faster check out in super markets and drive through fast food outlets, facilitating more convenience in a cost effective manner.

The new ATM switch, will gear the operating platform towards significantly improving operational performance by processing increasing transaction volumes. Fraud prevention, monitoring, cash management, chargebacks and reconciliation are some of the other functional capabilities of the new switch. These capabilities will lead to a more productive and efficient back office operation. It will also significantly improve our card and e-product development capability.

The Bank outsourced its Contact / Call Centre to a world-class industry leader WNS. Our outsourced service has the capability to handle all incoming and specific outgoing calls delivering the same service level to every caller in any of the three languages.

Consolidation of our foot print driving scale and profitability

After an aggressive growth in 2010 and 2011 where the network was expanded by approximately 25% with opportunities presented with the cessation of the war, the strategy over the last two years has changed to that of consolidation and driving business in newly opened branches. Accordingly only 3 new customer centres were opened in 2013 as opposed to 10 centres in the previous year. Subjecting branch performance to close scrutiny and evaluating profitability will further leverage the benefits from our existing foot print of customer centres in driving scale and profitability.

The profitability from this initiative will accrue over a period of time in tandem with the growth of the portfolio and the deposit base.

Engaging with our customers to assess service quality

During the year a "mystery shopper" exercise was carried out in 53 customer centres with a further 50 customer centres being identified for a similar exercise in 2014. The Bank conducted a survey on Service Quality involving all ten regions. Over 12,000 questionnaires were sent out to customers selected at random. The feedback received will contribute to improving the service quality of the Bank which is a key priority during in 2014.

Processes redesigned and re-engineered towards operational excellence and efficiency

The credit origination system is a result of ground work that has been laid towards re-engineering the mega processes of the Bank in aligning the processes and procedures with the current day needs of customers, regulators and governance frameworks. The credit origination system is a common evaluation and rating system implemented across the Bank replacing existing individual systems used for corporate and retail banking. It has expedited the credit evaluation process by providing more visibility on bottle necks through email alerts to approvers at various levels. It has resulted in standardized credit evaluation with embedded system controls and work flows, ensuring the necessary checks are carried out throughout the approval process in a systematic and standardized manner.

Some of the branch operations have been centralised, releasing branch personnel to focus on customer relationship management and sales by adopting a hub and spoke model for operations.

The foundation for carrying out business process re-engineering and redesign of processes based on current business operations and regulatory landscape has been laid in 2013 with the changes being made to existing operating structure incorporating functional responsibility for business process re-engineering. The position was resourced during the year and the work in this area is now under way and would be prioritized for action during the next two years.

Technology has enabled efficiency and productivity across the Bank

The ALM/ FTP system has improved the Bank’s Management Information System (MIS) capability by leaps and bounds by not only allowing it to analyse profitability in different dimensions such as customer, product, business segment and channels, it has also enabled the Bank to forecast its net interest income for future periods on various dimensions. HNB is one of the first Sri Lankan banks to invest in such sophisticated analytical capabilities. As such, through better MIS the Bank is in a position to drive its sales strategy more aggressively based on more profitable segments, products and customers.

Enhance Fee Income

Objectives:	Status
Implement new fee generating initiatives	✓
Automate collection of fee income	✓

Financial KPI	2011	2012	2013
Growth in fee income %	29	38	16

Achievements

- Launch of mobile banking
- Launch of mobile POS - MOMO
- New ATM SWITCH offers multi institutional support functions and sophisticated product development capability
- EDI for service fulfilment
- HNB One

With the pressure on margins which is evidenced across the industry, generating fee income to augment net interest income has become a priority for the Bank. Issuance of credit cards, commissions from trade products such as Letters of Credit and Guarantees, loan administration fees were the key drivers of fee income during the year. The increase in fee income from credit cards was volume driven based on a successful set of co-branded initiatives that targeted customer needs in the areas of leisure, shopping and retail. Commission income from trade products improved by 11% during the year, despite slowdown in international trade during 2013.

The significant growth in fee income witnessed in 2012 was due to concerted efforts made by the Bank in that year to focus on automating fee recovery processes, reviewing fee structures and introducing new fee lines. These efforts have continued in 2013 and have resulted in maintaining a healthy growth in fees and commission income.

New revenue streams for fee income have been identified through our strategic planning process and IT will be an enabler in facilitating these initiatives in 2014 through pull data strategies with large private and public sector organizations.

The new ATM switch offers features such as multi institutional support to industries such as insurance where reimbursement of accident claims could be obtained through our ATM network eliminating the entire process surrounding payments using cheques. The same principle could be applied to salary disbursements for

Management Discussion & Analysis

large corporates and industries such as the apparel sector. The switch offers non HNB customers the option of making utility payments through a generic payment portal.

The Electronic Data Interchange solution offered by corporate banking is one such initiative that binds corporates through push strategies, through the solution offered to wholesalers and distributors in the SME segment for supplier payments. This solution is being offered to large corporates and MNCs currently and found to be most effective in supply chains with manufacturers/distributors releasing stocks on receipt of settlement.

Build a Competent, Engaged and Motivated Team

Objectives:	Status
Strengthening the HNB brand as an employer of choice	✓
Succession planning	✓
Superior rewards and recognition for superior performance and accelerated leadership development	✓

Achievements

130 structured external and internal training programs conducted to covering core technical skills
 Leadership Top 100 identified for capacity building and skill development
 Rebranding of the HR function as a business partner

The Bank provided employment to 4604 employees during the year 2013. Focus on increasing staff productivity helped achieve a leaner organisation despite the branch network increasing to 250.

The investment into staff skills development recorded a significant level of Rs 22.4 Mn. HNB's L&D centre delivered 130 in house programmes covering 182 training days. On the virtual classroom frontier over 1985 employees across the island took proficiency tests online, real time through the e-learning system on their desktops. The business impact was evidenced through a remarkable reduction in operational lapses and reduction in supervisory and audit concerns in core business areas.

Core HR strategies to support the business strategy of the Bank involved capacity building within the leadership team through accelerated leadership development

programmes such as "Aspire" for high potentials, launching Unleash, an innovation ideation programme for the Gen Y employees to augment the HNB brand as an employer of choice and HR road shows in central, north central and southern regions covering 67 branches and nearly 900 employees strengthening employee engagement in the branch network.

HNB won the Overall Award for Best Results Based Training" at the 4th CMO Asia Awards in Singapore conferred by the World HRD Congress, Stars of Industry Group partnered by CMO Asia and endorsed by Asian Confederation of Business. This was the highest award in the category.

Key execution challenges for 2013

The challenges tabulated below were the key execution challenges addressed in achieving the business plan for 2013.

Execution Challenges in 2013	Mitigating Actions
Low demand for credit	Sales drive focusing on quality lending Outcome: HNB has outperformed the industry credit growth
Pressure on margins	Focus on improving CASA Outcome: HNB maintains one of the highest margins in the industry; 12% growth in CASA deposits
Increasing NPA	Aggressive recovery of overdue loans, continuous monitoring of facilities, prudent lending Outcome: Better than industry -asset quality
Decline in gold prices	Increasing lending margin to cushion further drop in prices, monitoring exposure, recovery of overdue through auctions Outcome: Relatively low exposure and NPAs compared to the industry
Retaining and managing talent	Effectively managing the aspirations of a diverse and multi generational work force. Outcome: Attrition (excluding natural attrition) 2.3%

Business vertical	Corporate Banking																
Strategic focus	Grow the corporate banking portfolio and maintain quality by leveraging on the strong brand promise of 'partnering for progress', backed by skillful relationship management and multiple delivery channels.																
Business scope	Large corporate customers and midmarket customers																
Strategic objectives 2013	<ul style="list-style-type: none"> • Penetrate the market to acquire profitable corporate relationships that meet with the defined risk appetite and risk profile of the Bank • Maintain portfolio quality • Upgrade Large SMEs to Corporates. • Focus on capturing the growth of the country through alignment to the national vision • Focus on growing trade lines. 																
Key markets and products	<p>Corporate Banking offers customized funding solutions for working capital, trade finance and term finance in the construction, retail, agriculture, fisheries, manufacturing and services sectors.</p> <p>Further products such as internet banking and Electronic Data Interchange which offers a convenient electronic solution to wholesalers and retailers for managing the supply chain, form part of our corporate banking product portfolio.</p>																
Key indicators	<div style="display: flex; justify-content: space-around;"> <div style="text-align: center;"> <p>Corporate Banking - Loans and Advances</p> <table border="1"> <caption>Corporate Banking - Loans and Advances (Rs Bn)</caption> <thead> <tr> <th>Year</th> <th>Loans and Advances (Rs Bn)</th> </tr> </thead> <tbody> <tr> <td>2011</td> <td>100</td> </tr> <tr> <td>2012</td> <td>115</td> </tr> <tr> <td>2013</td> <td>155</td> </tr> </tbody> </table> </div> <div style="text-align: center;"> <p>Corporate Banking NPA %</p> <table border="1"> <caption>Corporate Banking NPA %</caption> <thead> <tr> <th>Year</th> <th>NPA %</th> </tr> </thead> <tbody> <tr> <td>2011</td> <td>4.5</td> </tr> <tr> <td>2012</td> <td>3.2</td> </tr> <tr> <td>2013</td> <td>2.8</td> </tr> </tbody> </table> </div> </div>	Year	Loans and Advances (Rs Bn)	2011	100	2012	115	2013	155	Year	NPA %	2011	4.5	2012	3.2	2013	2.8
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Key developments during the year	<p>Corporate Banking wins big ticket deals from the corporate sector</p> <p>During the year the Corporate Banking division was successful in marking its presence as a leader in corporate banking by capturing a larger portion of the growth mainly in the areas of leisure and infrastructure development. Despite the slowdown in private sector credit growth, the segment recorded significant growth.</p> <p>Portfolio quality maintained despite decreasing credit quality across the industry</p> <p>A risk based analysis of each industry was applied in assessing specific industry risks at both global and local level. This approach has further improved the credit assessment process and underwriting quality. It resulted in the selection of target industries that fell within the risk appetite of the Bank and conversely reduced the exposure to high risk industries. Proactive recovery efforts by timely watch listing were other initiatives, and high quality management information received on a timely basis led to the unit reporting an improved performance in its NPA ratio of 2.82 % for 2013 which is significantly better than the performance in the previous year as well as the industry performance.</p> <p>The management information and analytics have contributed to better decisions and identification of any likely risks of default in a timely manner.</p>																

Management Discussion & Analysis

Business vertical	Corporate Banking
Actions that led to success	Strategic execution
	<p>Records 33% growth YoY by leveraging in depth knowledge and strong customer relationships</p>
	<p>Despite the poor appetite for credit and contraction in private sector lending arising from the volatile market conditions, the business vertical has achieved a commendable growth of 33 % and reported an increase of Rs 39 Bn for loans and advances over the corresponding period in 2012. It has contributed to the balance sheet growth of the Bank while maintaining the quality of the portfolio. The team has leveraged on the core competency of relationship management and deep rooted knowledge of the customer base in addressing the economic challenges and delivering profitable growth. Drivers of growth are discussed below.</p>
	<p>The Bank was involved in project financing of a number of infrastructure development projects in the areas of road development, food management, agri /dairy, tourism, and water and sanitation. The Bank also extended project funding to selected corporate clients for property development with a value proposition to both the developer and borrower by way of entering into a tripartite agreement which is a first for the industry, while capitalizing on an opportunity to cross sell.</p>
	<p>Funding alternate sources of energy and infrastructure development (approx. Rs 3.5 Bn.) continued in 2013 and aligned the strategic focus of the Bank with national development goals, and the priorities of the accelerated development plan of the Government of Sri Lanka in fostering economic development and driving the GDP growth of the country. It is also an extension of the sustainability strategy, supporting the sustainability needs of the Bank's customers and driving the commitment of the Bank towards green banking. The Bank is identified as a dominant niche player in this segment with significant potential for growth due to the existing high cost of electricity and the ever increasing demand for green energy, created by global debate and greater awareness towards environmental conservation and protection.</p>
	<p>The corporate banking team worked closely with the various investment and trade bodies in generating fresh leads for business development in their pursuit to penetrate the market further and maintain the growth momentum despite the contraction of the market.</p>
	<p>e-Products such as EDI lock in customer relationships in the supply chain</p>
	<p>Corporate internet banking and Electronic Data Interchange (EDI) platforms have significantly improved customer reach and convenience and helped lock in corporate and midmarket relationships along the supply chain.</p>
	<p>The upgrading of middle market SMEs to corporate status, focus on growing trade lines, spreading the growth targets across the entire portfolio and minimizing non-performing loans and advances in the face of economic slowdown and temporary liquidity issues were key priorities of the corporate banking unit during the year under review.</p>
Key impactors	<p>Decreases in the appetite for credit, with customers adopting a wait and see approach, in making investment decisions, due to the uncertainty and volatility in interest and exchange rates made worse by uncertainty and shocks arising from the Fed's QE tapering strategy.</p>
	<p>The temporary liquidity issues from delayed settlements by principals had a cascading impact down the supply chain. This posed a challenge to profitability and involved considerable time and effort in managing the credit administration across the portfolio. Nevertheless HNB was successful in managing this impact as indicated by the improved NPA ratios.</p>

Business vertical	Corporate Banking
Focus for 2014	<ul style="list-style-type: none"> • Grow fee income exponentially by focusing on trade, forex and fee generating credit products and services. • Further strengthen risk awareness and risk based decision making. • Participate in larger financing deals. • Increase wallet share by leveraging on the deep knowledge, strong relationships built over time and offering a complete suite of banking products and services including technologically advanced e-products and electronic delivery platforms.
Outlook	<p>It is envisaged that the results of the easing of interest rates in 4Q 2013 will result in a resurgence of the growth momentum from a greater appetite for credit. However it is likely that there would be pressure on margins.</p>
Business vertical	SME
Strategic focus	<p>Partnering the rise of Sri Lankan Entrepreneurs Align with the national goals and objectives in harnessing the potential of the SME sector by being an 'enterprise development partner'.</p>
Business scope	<p>Customers/enterprises with an annual turnover of less than Rs 600 Mn and exposure of less than Rs 200 Mn.</p>
Strategic objectives 2013	<p>Aggressive profitable balance sheet growth in harnessing the potential of the SME sector. Through a value proposition that offers a wide range of benefits and comprehensive financial solutions in addressing the critical success factors for start- up ventures and business expansion in the SME sector.</p> <p>Focus on promoting internet and mobile banking The electronic channels such as internet banking and mobile banking not only offer a more cost effective solution to the cost conscious entrepreneur but also frees up time for the branch personnel to offer advisory services and tailor made solutions in addressing the multiple needs and wants of this segment.</p> <p>Cross selling as a means of providing a one stop solution in meeting the diverse and multiple needs of the customer The inquiring mindset of the branch personnel has resulted in many opportunities to cross sell due to deeper involvement and engagement with the customer.</p> <p>Enhance the effectiveness of the SME cells and build capacity. SME Cells enabled the Bank to leverage on the levels of expertise available and directly contributed towards the improvement of the product offering.</p>
Customer needs and target industries	<p>Customer needs The SME customers have diverse financial requirements in meeting their business needs, including working capital, investment in capital expenditure, letters of guarantee for traders when acquiring distributorship and agencies. Furthermore, contractors bid and performance bonds, advance payment guarantees, leasing facilities, pledge facilities, revolving facilities for seasonal requirements, Import and Export facilities make up the gamut of their requirements.</p>

Management Discussion & Analysis

Business vertical SME

Target Industries

Agro, animal husbandry, horticulture, food processing, fisheries, wood based products, construction, wholesale and retail trading, transport, tourism industry and service providers.

SME Sector wise exposure



Channel Offered across the branch foot print in 250 customer centres and via electronic banking channels such as internet and mobile banking platforms.

Actions that led to success in 2013 The performance for the year improved over the prior year and the following are the key highlights contributing towards improved performance, despite the challenges posed by volatile market conditions and the high interest rates witnessed in 1H 2013.

Regional SME cells and the branch network drive profitable portfolio growth of 23 % exceeding planned target of 16 % for the year

The branch network played a proactive role in understanding entrepreneur needs and tailoring solutions. The structural inclusion of SME cells at regional level delivered value in the form of expertise and technical support to branches actively involved in generating new leads, screening and evaluating the customer requests.

The sector had a comparatively higher credit appetite despite sluggish market conditions. Lowering of interest rates from August 2013 impacted the growth trajectory positively with momentum picking up.

Focused recovery efforts improve NPA ratio over prior year despite deteriorating industry trend

The NPA ratio was reported at 5.4 % for the year ending 2013 improving from 6.7 % reported in 2012.

Focused leadership across the Bank on recovery efforts, team work, timely and qualitative management information and watch listing initiative were the key drivers leading to higher recovery levels noted during the year.

Key impactors/risks and mitigation. **Lack of adequate business awareness of best practices**

The lack of procedures, controls and audited financial statements towards assessing financial standing and past performance of business ventures, pose a significant risk when coupled with the diversity of this segment.

Management has developed structured training programs for introducing best practices, basic principles of management and techniques including basic book keeping towards creating and improving awareness on the value of best practices and business frameworks. Eight training programs and workshops were carried out during the year. This has led to new opportunities in attracting new leads from word of mouth and improved performance within the business ventures and related NPA ratios.

Business vertical	SME
	<p>Overtrading</p> <p>At a minimum, annual reviews of the portfolio are carried out with more frequent reviews on a bi annual or quarterly basis as the case may warrant in reviewing enterprise performance and assessing trends pertaining to sales, working capital utilization, debtors and payment cycles. Customer awareness is increased through constructive feedback from industry and portfolio reviews, with resultant efforts being made to either restrict further lending or restructure existing facilities as deemed necessary.</p> <p>Extended credit</p> <p>Close scrutiny of debtor outstanding days and working capital cycles have assisted in minimizing the need for extended credit.</p> <p>Impact from climate change</p> <p>Conditions for obtaining insurance are included as part of the banking arrangements which include comprehensive cover for stocks and business assets, crop insurance and policies that insure against weather conditions such as floods.</p>
Focus for 2014	<ul style="list-style-type: none"> • Improve quality of the portfolio • Capture a larger portion of the market opportunities • Convert customers to use internet and mobile banking
Outlook	<p>Highly competitive environment as industry players compete to harness the potential of the SME sector and align with national development goals</p> <p>The SME sector is poised for growth and will remain a key focus area of the Bank given the opportunities arising from the significant untapped potential of this segment, and the high level of importance attached to developing the sector as part of the national goals. The Bank remains optimistic in attracting a larger share of business generated from the SME sector in achieving the objective of profitable balance sheet growth.</p> <p>Pricing will remain a key driver in attracting new business and retaining existing relationships. However the Bank will leverage on service quality and excellence in service delivery as a differentiator in a highly competitive space and leverage on the skills of the branch network and strong brand identity of ‘partnering for progress’ which is firmly ingrained in the minds of the community.</p>
Business vertical	Islamic Banking
Strategic focus	<p>Launch Islamic Banking and Finance as an alternative form of Banking in line with the Bank’s sustainability strategy of engaging with customers with diverse needs and expectations.</p>
Business scope	<p>Islamic Banking and Finance offered to the Corporate and SME segments.</p>
Strategic priorities 2013	<ul style="list-style-type: none"> • Retention of existing customers of the Bank • Enhance product range with new and innovative product suite • Enhance awareness and visibility • Maintain a quality and profitable lending portfolio • Leverage on network of customer centres to reach target customer base • Recruit and train key management personnel and staff in customer centres and operations

Management Discussion & Analysis

Business vertical	Islamic Banking																																																				
Key markets and products	Niche market targeting customers requiring Shariah compliant Banking and Finance. Key products and services include deposit products, trade related services, home financing, working capital financing and personal financial services.																																																				
Channels	Offered across the foot print of 250 customer centres Personal selling																																																				
Key indicators	<p>The deposit book grew by Rs 1.6 Bn, an increase of a multiple of 1.9X over the 12 month period from December 2012, and reported Rs 2.5 Bn as at year end 2013.</p> <p>CASA ratio above 60%.</p> <p>Loans and advances increased by Rs 823 Mn, an increase of a multiple of 1.7X to Rs 1.29 Bn over the 12 months in 2013.</p> <p>Average advances to deposit ratio maintained above 52 % throughout the period.</p> <p>Funded income grew by multiples of 3X to Rs 169 Mn since December 2012, due to growth in advances.</p> <p>Non funded income grew by multiples 2X to reach Rs 7.6 Mn as at year end 2013. Trade finance business witnessed a substantial increase from December 2012, which brought in the non-funded income, as well as new facilities disbursements.</p> <p>HNB Islamic Banking paid out some of the highest profits in 2013 in comparison to peers resulting in significant inflow of deposits driving both the number of accounts and the increase in deposit size.</p> <p>There are no non-performing loans reported for the period under review.</p> <p>A diversified portfolio of customers in sectors such as wholesale trading, construction, manufacturing, energy, agriculture, aviation, banking and financial services, gems and jewellery.</p>																																																				
<p>Key trending for 12 months in 2013</p> <div style="display: flex; justify-content: space-around;"> <div style="text-align: center;"> <p>Growth in Deposits</p> <table border="1"> <caption>Growth in Deposits (Rs Mn)</caption> <thead> <tr><th>Month</th><th>Value</th></tr> </thead> <tbody> <tr><td>Jan</td><td>1,000</td></tr> <tr><td>Feb</td><td>1,000</td></tr> <tr><td>Mar</td><td>1,000</td></tr> <tr><td>Apr</td><td>1,000</td></tr> <tr><td>May</td><td>1,000</td></tr> <tr><td>Jun</td><td>1,100</td></tr> <tr><td>Jul</td><td>1,200</td></tr> <tr><td>Aug</td><td>1,300</td></tr> <tr><td>Sep</td><td>1,400</td></tr> <tr><td>Oct</td><td>2,000</td></tr> <tr><td>Nov</td><td>2,200</td></tr> <tr><td>Dec</td><td>2,500</td></tr> </tbody> </table> </div> <div style="text-align: center;"> <p>Loans and Advances</p> <table border="1"> <caption>Loans and Advances (Rs Mn)</caption> <thead> <tr><th>Month</th><th>Value</th></tr> </thead> <tbody> <tr><td>Jan</td><td>500</td></tr> <tr><td>Feb</td><td>600</td></tr> <tr><td>Mar</td><td>700</td></tr> <tr><td>Apr</td><td>800</td></tr> <tr><td>May</td><td>850</td></tr> <tr><td>Jun</td><td>800</td></tr> <tr><td>Jul</td><td>850</td></tr> <tr><td>Aug</td><td>900</td></tr> <tr><td>Sep</td><td>1,000</td></tr> <tr><td>Oct</td><td>1,100</td></tr> <tr><td>Nov</td><td>1,150</td></tr> <tr><td>Dec</td><td>1,200</td></tr> </tbody> </table> </div> </div>		Month	Value	Jan	1,000	Feb	1,000	Mar	1,000	Apr	1,000	May	1,000	Jun	1,100	Jul	1,200	Aug	1,300	Sep	1,400	Oct	2,000	Nov	2,200	Dec	2,500	Month	Value	Jan	500	Feb	600	Mar	700	Apr	800	May	850	Jun	800	Jul	850	Aug	900	Sep	1,000	Oct	1,100	Nov	1,150	Dec	1,200
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Actions that led to success in 2013	<p>Recruitment of experienced and competent team conversant in Shariah Standards operating as a centralized unit and integrating seamlessly with the core banking network</p> <p>Branch-wise awareness programs initiated to educate and enhance the knowledge of staff at customer centres and regional units to better equip them to handle customer queries on Islamic Banking at HNB</p>																																																				

Business vertical	Islamic Banking
Key developments	<p>Expansion of market share in geographical locations with high density of Muslim communities.</p> <p>Deployment of new investment products in order to increase deposit base.</p> <p>Approval of Wakala facility.</p> <p>Awarded the Silver Award for Emerging Islamic Finance Entity of the Year at the SLIBFI Awards Night held in October 2013.</p>
Key impactors/challenges	<p>Training key individuals and customer service front lines to up skill in the area of Islamic Banking and developing the ability to respond to customer queries and clarifications is a challenge, that will be addressed through structured training programs conducted in 2014.</p> <p>Identifying possible new markets in regions to setup regional offices to better cater to the growing customer base.</p>
Focus for 2014	<p>Carry out research to identify customer needs and expectations to develop need based products.</p> <p>Islamic Banking cells to be incorporated into selected customer centres</p> <p>Create more visibility to the HNB AL-NAJAH brand through marketing campaigns and advertising.</p>
Outlook	<p>The external environment</p> <p>There are 5 LCBs offering Islamic Banking currently, whilst a number of financial and leasing institutions also provide these facilities. The total deposit base is estimated at Rs 35 Bn whilst the loan book is estimated at Rs 25 Bn. The number of players are likely to increase in the foreseeable future.</p> <p>As one of the fastest growing industries in the world, there is significant room for further development in the Sri Lankan market, by way of new products, increased liquidity, and integrating with the country's development needs. Opportunities for existing Islamic Banking operations to raise funding from international markets via Shariah compliant instruments make the outlook positive.</p> <p>The industry will look to regulators to provide an equal playing field with necessary regulatory changes being effected to facilitate the smooth growth of the Industry in a planned, transparent and strategic manner.</p> <p>Management's response</p> <p>HNB will look to maximizing its first mover advantage to stay ahead of new entrants whilst focusing on gaining market leadership.</p> <p>Growth potential to be harnessed by developing a value proposition that is need based and addressed through customized product and service offerings. The extensive network of HNB in comparison to peers offering Islamic Banking would serve as a competitive advantage in reaching potential customers and accessing new markets.</p> <p>Key risks, and mitigating actions</p> <p>All products and services of the Islamic Banking unit are compliant with the guidelines and determinations issued by the Central Bank of Sri Lanka and conform to Shariah Principals.</p> <p>A Shariah audit is conducted on a quarterly basis to ensure compliance and strict credit risk evaluation carried out to ensure that quality of the lending portfolio is maintained.</p>

Management Discussion & Analysis

A 'Multi Channel banking strategy' offering the customer choice and convenience.

In executing this farsighted vision into strategic focus, management commenced implementing a 'multi channel banking strategy' for distribution, thus providing customers with choice and convenience. Electronic delivery channels will compliment and augment the traditional brick and mortar branch network in addressing the needs and providing solutions to the traditional, cyber (use only internet banking) and the hybrid customer (uses both traditional branch banking facilities as well as internet banking).

The management has worked on a multi channel strategy in 2013 delivering the wide spectrum of products and services to our customer network spread across many geographical locations both locally and internationally and includes customers from the generation of baby boomers, tech savvy Generation Y to the newest Generation Z.

The multi channel distribution strategy reaches the customer through

1. The wide network of branches spread geographically across the island
2. Electronic channels that offer multiple choices
3. Exchange houses located overseas – discussed under International Remittances
4. Strategic tie ups with Dialog Axiata and Airtel

Customer centre foot print

An over view of the network foot print is detailed below.

Network foot print The Bank has a foot print of 250 customer centres across the Island and is operative in all provinces of the country.

Three new customer centres were opened in Veyangoda, Yakkalamulla and Walasmulla during the year 2013.

HNB Customer Centres

As at year end	2012	2013
Customer Centres	247	250
HNB Student Banking Centre	166	168
No of ATMs	400	415
Village Based Gami Pubuduwa Units	6	3
Branch Based Gami Pubuduwa Units	114	118
Micro Banking Units	9	9
HNB Mobile Banking Service Units	2	-
Overseas Representative Offices	Chennai India	Chennai India

Customer Center Categorization

Premier Grade Branches	5
Super Grade Branches	11
A Grade Branches	26
B Grade Branches	44
C & D Grade Branches	124
Extension Offices	32
Pay Offices	8
	250

The Bank operates 1 Priority banking centre and 4 Crystal Banking centres within the network to serve high networth individuals. In addition to the services offered through the network the micro enterprises are served through 9 dedicated micro branches and the SME segment is supported through SME cells in all 10 Regions.

The table below provides an overview on the ATM coverage and usage.

ATM Coverage

On Site	Off Site	With Sampath Bank	Total Points	Average no of transactions per day
340	75	270	685	42,000

The ATM network serves the customers of the Bank as well as all holders of VISA and Master Cards issued by other banks.

The Bank operates three ‘drive through’ ATMs in response to the customer need for fast and easy access on the move.

The ATMs provide a full suite of transaction types beyond cash withdrawal and includes fund transfers, utility payments, credit card settlements, cheque book requisitions and current account statements

Delivery Channels

Brick and Mortar Channels

Management focused their skills and capabilities in coming up with new contours for the branch network by focusing on process re-engineering and redesign to drive efficiency improvements and shift focus to sales and advisory from providing mere customer service at branches. These initiatives have been driven in the back drop of consolidation efforts that commenced in the previous year.

Strategic focus 2013

There was shift in the strategic focus of branch capacity building towards sales and advisory in supporting a ‘Multi Channel banking strategy’ offering the customer choice and convenience.

Business Scope

Driving business development, profitability and overseeing the operations of the Branch network

Strategic objectives in 2013

The Branch network continues to remain important and relevant, even in the face of the digital age. Re- engineering and re design initiatives were commenced in 2013 in driving cost optimisation and consolidation of the network

- Shift focus of customer centres towards sales and provision of advisory services.
- Redeploy and retrain the staff to support the shift in focus at branch level.
- Improve efficiency of network by reducing processing time.
- Improve efficiency by reduction in queuing time.

Actions that led to success in 2013

Strategic execution

The implementation of e-Space, a system for credit approval and processing

‘e Space’ is an outcome of redesigning and re-engineering the process surrounding the credit origination, evaluation and approval across the Bank.

The system is a single platform with integrated score cards for the banking business. It is a fully automated loans capturing/ appraisal / approval system in order to create a paperless environment, reduce documentation formalities and most importantly to provide faster delivery to the segment clients.

Management Discussion & Analysis

The system has created visibility across the entire process, facilitated faster processing times and eliminated bottle necks and delays, as a result of faster follow up action. Email alerts have sped up the entire approval process and resulted in significantly reducing the processing time of loan applications to four days from a previous average of two weeks.

The automated workflows with inbuilt bench marks and time targets for processing turnaround time, provide important feedback for performance evaluation and continuous improvement.

Carrying out “Mystery Shopping” exercises to assess service quality

Mystery Shopping exercise was carried out to assess service quality standards and customer satisfaction levels with great success in 53 branches of the network. The Bank conducted a survey on Service Quality involving all ten regions. Over 12,000 questionnaires were sent out to customers picked at random. The feedback received from these initiatives will improve service standards still further.

Key impactors Engaging with customers and providing transparency

The fixing of centrally updated digital screens at customer centres which disseminate information pertaining to interest rates, exchange rates, product information etc and localized to suit the community have proved to be very effective in improving transparency and communication with customers.

Cost escalation and impact to the cost income ratio

Containing costs pertaining to administration overheads, rising energy costs, ground rent and related facilities costs are key to managing the cost income ratio of the Bank. Increasing scale to optimize on capital and running costs are critical in improving branch profitability over time. The focus on improved management information to monitor branch profitability has provided insight into opportunities for further cost optimization and improved profitability.

Focus for 2014 Focus will remain on revenue generation by cross-selling and integrating business intelligence gathered at branches to provide customized solutions and improve overall profitability of the network.

Improve customer interactions and engagement through more effective communication, drive efficiency gains through process upgrades and training.

Outlook Branches would leverage virtual technology to access pools of SME customers from multiple locations. The emerging class of digitally-savvy bank customers, including SMEs, will use the bank branches increasingly for more sophisticated financial advice and less for conventional transactions such as encashing pay cheques and making cash deposits.

We are of the view that the branch network would continue to remain the key touch point in attracting low cost deposits and capturing of new customers.

Electronic Channels – ‘Focus on innovation for tomorrow’s customer’

Just as HNB revolutionised retail banking in setting up one of the largest branch networks which made banking accessible to all provinces of the country in partnering for progress; the focus of the management on innovating for tomorrow’s customer, will position HNB as the leading ‘Tech Bank’ in an era of digital technological advancement and convergence.

Strategic focus 2013 A 'Multi Channel banking strategy' offering the customer choice and convenience.

The Bank has focused on 'innovation for tomorrow's customer, which is the next stage of evolution in the life cycle of HNB, which has kept reinventing the way it does business and has been the underlying driver in achieving sustainable leadership over the last 125 years in the banking arena of Sri Lanka.

Electronic delivery channels will serve and cater to the diverse digital and internet based needs of the entire customer base of the Bank, comprising retail, corporate, SME, development banking and micro banking segments. The Bank has taken the lead in pioneering the next generation banking in Sri Lanka.

Recent research indicated that online and mobile are preferred channels, particularly by generation Y customers.

Strategic objectives in 2013

- Provide a better choice to customers in electronic delivery.
- Brand and position the Bank as the 'Leading Tech Bank'.
- Further enhance service excellence, quality and consistency across all channels.

Actions that led to success in 2013

Strategic execution

Providing customers with preference of choice and convenience

The Bank successfully launched the following electronic banking channels in 2013.

The launch of MOMO – an electronic mobile POS

We successfully launched the mobile POS branded as MOMO, in September 2013 which is a mobile point of sale device which is used in the payment card acquisition space.

International brands such as Pizza Hut, Allianz Lanka, AIA Insurance and local companies such as HNB Assurance and Kangaroo Cabs have been early adopters of this revolutionary POS technology which facilitates the use of credit and debit cards on the move with a feature to trigger a SMS back to the customer confirming sales transaction, point of sale and transaction value.

We will also leverage on the technology of the mobile POS – MOMO to create greater synergies with payment cards (both credit and debit cards) in accessing the retail merchants, having successfully acquired the business volumes of all major corporate merchants previously in augmenting our leadership position.

The launch of mobile banking platform – another first in the industry

HNB being the only bank in the country to offer 4 separate flavours of mobile banking (SMS, USSD, SmartApp and Browser) provides the customer a range of applications to engage in phone banking using either smart phones or basic mobile phones.

The launch of Social Media banking

During the year 2013, the Bank initiated the process to introduce another first to the Sri Lankan market through the launch of 'Face Book banking', which provides yet another electronic delivery channel in the area of social media networks in aligning the product and service offering to the users of social media who predominantly comprise of generation Y users.

Management Discussion & Analysis

In addition the following electronic delivery channels also comprise the electronic delivery suite.

- Internet Banking for the individual and e corporate banking to the discerning corporate customer
- 415 ATM machines spread across the country
- EDI offering B2B integration to large corporates and SME customers

Rebranding as a 'leading Tech Bank'

The Bank invested in core infrastructure and a state-of-the-art ATM switch enabling the Bank the flexibility to offer personalized services in the electronic space. The investment in this platform has given the bank a high degree of agility to reduce the time to market and compete beyond the banking and financial services sector in taking on competition from the telco and retail industries that have entered retail financial services space that was hitherto owned by the banking industry.

Enhance service excellence and quality

The challenges technological solutions pose are service failure, minimizing customer dissatisfaction during this time frame and frequency of the occurrence of down time. In addressing this key challenge the management has built in service standards of 99.9% of 'up time' and a window of less than 30 minutes for down time. The service teams and system administrators are trained in proactive trouble shooting techniques in addressing system down time and associated glitches. Our Disaster Recovery Plan and process for Business Continuity is tested using live data on a periodic basis for effectiveness.

Key developments Increase in eBanking usage

eBanking usage has reported an increase of over 300 % with the implementation of the new e-Banking products and electronic channels

The Launch of the New ATM Switch

A secure banking concept was initiated with enhanced user experience. The Launch of a new ATM switch in November will give financial inclusion a whole new meaning by facilitating branchless banking through a range of value added services.

Key impactors The threat of replication and being able to leap frog on technology

Electronic mediums are easy to replicate and often done cheaper than the initial product from leap frogging up the learning curve.

In identifying the risk we have addressed this challenge by creating and offering the customer a value proposition which includes de commoditising a commodity product through service excellence and quality. The value proposition is further augmented by a broad spectrum of feature rich delivery channels which are convenient to reach and delivered through a concept of personalized mass customization. A competitive advantage that is hard to beat.

Focus for 2014 Using Technology as a means to reach the unbanked

The Bank will leverage on its investments made in 2013 to reach the unbanked, driving inclusivity through its new e-products MOMO, Mobile Banking and HNB One which use near field technology, and focus on taking a leadership role in product innovation, providing greater convenience to customers

Business Vertical	Personal Financial Services
Strategic focus 2013	Drive a more aggressive sales culture, focus on electronic channels for delivery and differentiate through service excellence in contributing to profitable balance sheet growth, operational excellence and cost optimization through an engaged and motivated team.
Strategic objectives 2013	<p>Aggressive sales culture, high quality platform and service excellence</p> <p><i>Driving a more aggressive sales culture through recognition and reward</i></p> <p>Introduction of new incentive structures and schemes to drive business development and leverage on cross selling opportunities, by incentivising agents, staff referral initiatives and strategic partners, in driving innovation, motivation and engagement and rewarding staff through incentives for outperformance in achieving sales targets and profitability.</p> <p><i>Creation of sales teams to support the sales drive</i></p> <p>700 staff members retrained and moved into sales from operations across the branch foot print. Recognition of the sales person of the month, introduction of a sales score card to monitor targets and evaluate performance and improve the quality of management information used to track and support analysis, were success factors in carrying out this initiative. This initiative was carried out on the conclusive evidence of a work study that reflected an 80:20 mix between operations and sales staff.</p> <p><i>Introduction of centres for excellence</i></p> <p>The credit card support function was outsourced to WNS during the year, freeing up time for sales and better relationship management through more active engagement with customers</p> <p><i>Moving towards electronic banking in leading the way in being a tech savvy bank by focusing on innovation for tomorrow's customer</i></p> <p>Offering the customer a preference of choice and convenience from a wide variety of products and services that use an electronic platform in carrying out transactions. Products such as mobile banking accessible by basic mobile and smart phones, mobile POS solutions through MOMO, the flagship product of the electronic medium, were launched during the year.</p> <p>Electronic Banking is viewed as a more cost effective solution in driving down the Cost to Income ratio and focusing on cost optimization.</p> <p><i>Service excellence as a differentiator in delivering products and services to customers</i></p> <p>Adopting a hub and spoke model at branch level resulted in freeing up time to focus on service quality. Centralising operations improved efficiencies by eliminating rework.</p> <p>Attained process efficiency by the reduction of queuing time</p> <p>Carrying out 'Mystery Shopper' exercises to assess service excellence and customer satisfaction levels, with feedback being tied to the branch manager's performance.</p> <p>Monthly meetings conducted to review the effectiveness of advertising campaigns to assess the ROI pertaining to advertising campaigns.</p>

Management Discussion & Analysis

Business Vertical Personal Financial Services

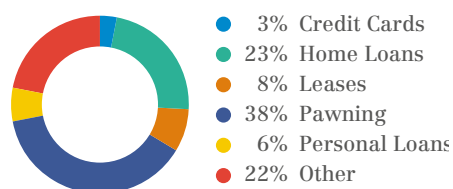
Key markets and products

Product and service offerings comprise the following:

Lending products that include leasing, pawning, housing loans, personal loans and credit card services, Investment products such as bancassurance, savings, fixed deposits and current accounts targeting the child, student, adult and senior citizens space and along with Priority banking services for high net worth individuals. In addition to catering to customers through the island wide branch network, the Bank also mobilises deposits through overseas markets such as the Middle East & Italy.

Key indicators

Retail Advances Mix



Actions that led to success in 2013

Inward remittances out performed Industry growth

Aligned marketing with operations and adopted aggressive business development strategies to grow market share.

Successful launch of e-Space credit origination system

The Bank successfully implemented a single platform loan originating system e-Space with integrated Retail Score Cards for the retail banking business.

Implementation of a new leasing system 'Lease Wave' with enhanced features

The system enabled a centralized processing solution freeing up time of the branch staff to focus on sales and service delivery.

Achieved expectations on CASA, asset quality and Sales volumes.

Exceeded expectations on Personal Loans.

Key impactors

The sharp decline in the price of gold resulted in reducing exposure to pawning from 16% to 13% by year end 2013.

Demand for vehicle financing decline in 1H 2013, picked up post 3Q 2013 helping to accelerate performance.

A declining trend in the demand for housing loans due to reduction in disposable income.

Maintaining a healthy CASA ratio continued to remain a challenge in the face of high interest rate regime that prevailed until 3 Q 2013.

Sluggish market demand for credit in the face of high interest rates, and volatility in interest rate movement and exchange rates in 1H 2013 and moderated by monetary easing 2 H 2013.

Business Vertical Personal Financial Services

Focus for 2014 Design and develop new revenue generating models in response to the challenges posed by the external environment and volatility in the macro environment.

Centralization of credit administration in keeping with a hub and spoke model.

Continue with business process re-engineering initiatives in simplifying how we do business and deliver value.

Outlook Poised for growth with a high quality platform in place.

The Bank remains optimistic in the area of retail banking, having taken steps to develop a high quality operating platform, taking the lead in developing the electronic and digital channels, and having a well thought through strategy in place to develop an aggressive sales culture to increase wallet share from the anticipated increases in per capita income of USD 4000 by 2016. A creative take on the need to challenge and change towards sustainability and stay ahead as leaders has gathered momentum.

Product Deposit Mobilization

Sub brands Pathum Vimana the key driver of savings incentivising savings on a regular basis.

Singithi Kiriketiyu, Singithi Lama and HNB Teen target minor savings.

Yawanaabimanya target youth above 18 years of age.

Capital savings targeting interest sensitive savers with HNB Adhistana targeting savings of migrant works.

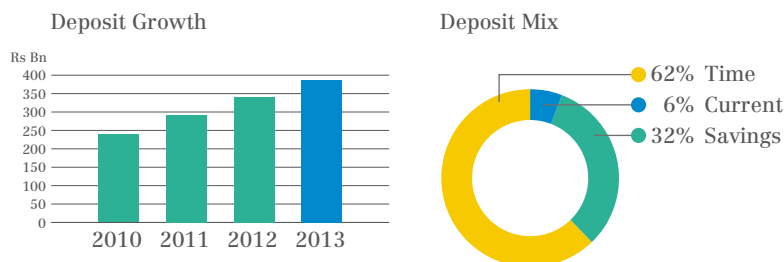
Product features Product suite comprises of saving, call and term deposits covering the full customer life cycle.

Customer segmentation Toddlers, children, teens, students, youth, adults and senior citizens. Expats Sri Lankan communities in overseas markets, professionals and High Net Worth individuals comprise of the main segments in the savings space.

Customer need Investment, savings, income and liquidity needs of individuals over their life cycle, from birth to retirement.

Channel Deposits are mobilized throughout the 250 customer centres Island wide, through school banking units, and exchange houses overseas.

Key indicators Retail deposit breakdown by product.



Management Discussion & Analysis

Product Deposit Mobilization

Operational overview

The external environment

Deposits continued to remain the main source of funding for the Bank. The high interest rate regime witnessed in IH 2013, eased during the later part of the year.

The financial services sector also witnessed many debenture issues of subordinated listed debt which had attractive interest rates from exemptions from income tax and WHT on interest income that generated interest from retail investors. Competition for attracting deposits was intense within the banking sector, from Licensed Finance Companies and from the insurance sector.

Management's response

HNB was successful in growing its deposit base by 13% to Rs 385 Bn over the previous year. HNB's flagship savings brand, Pathum Vimana was a key driver of low cost savings and attracted a larger share of the savings pool despite the lucrative rewards offered by competition.

The personal selling efforts of the staff, effective marketing communications and branch level activities such as town storming were other contributors to growth. World children's day commemorated in October was dedicated to child savings and augmented deposit mobilization efforts. The extensive branch network was leveraged to attract low cost deposits with the brand promise of being a safe and secure bank acting as a comparative advantage in responding to market challenges.

Risk and opportunities

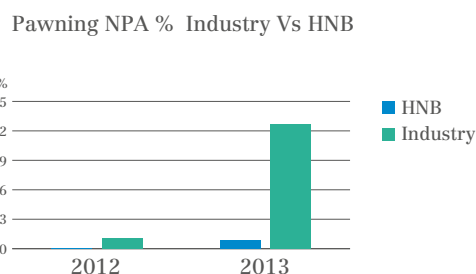
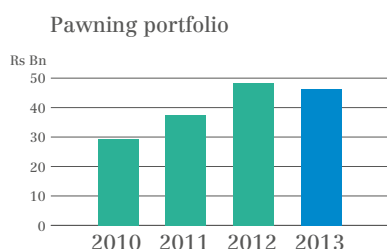
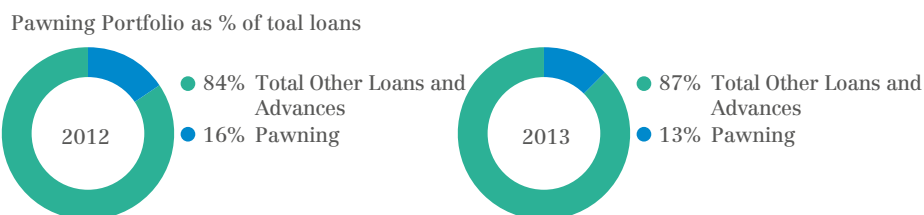
Interest rates are expected to reduce further impacting customer segments that depend on interest savings to fund living expenses. Banks are less likely to attract savings with depositors moving away from the banking industry in pursuit of higher yields. This will have a significant impact on mobilizing low cost deposits.

The Bank will rely on the strong relationships developed over time to retain and attract savings, while relying on our Brand promise of being a safe and secure brand; safeguarding not only the trust of customers but also their deposits which will compensate for likely reductions in interest rates.

Outlook and focus for 2014

The Bank will continue to focus on mobilizing low cost savings. Product offerings will be revamped in line with customer expectations and intense competition anticipated from peers. Investment in new technology and platforms to offer new products is expected to improve CASA.

Product	Pawning
Under the umbrella of HNB	HNB Pawning is identified with providing utility value in funding a broad spectrum of needs and as a fast and easy route to accessing bridging finance from a market leader in commercial banking.
Customer segmentation	Retail and large scale Pawnees. Granted only to individuals.
Customer need	The perception of the product offering has witnessed a change from personal financing to encompassing a wider range of needs that include working capital/bridging finance for funding business operations, short term funding of agrarian projects, construction, education, and consumption.
Channel	Offered at 235 customer centres Island wide.
Key indicators	Accounted for 13 % of the total loan book and reported at Rs 46.2 Bn as at year end 2013. This is considered as being low in exposure in comparison to peers.



Source: CBSL presentation Banking Sector Developments December 2013

Operational overview

The external environment

Sri Lanka witnessed a surge in pawning advances in 2012, as a popular method of borrowing against the metal, and commercial banks' exposure grew by 20% year-on-year to around Rs 339.4 Bn (\$2.59 Bn) in 2012, amounting to circa 14.4% of the year's total loans, as per Central Bank data. The sharp decline in the price of gold was observed throughout the year 2013. The trend is likely to continue in the foreseeable future with gold prices falling by as much as 28% internationally and by 20% locally.

Management's response

This has resulted in focused actions to reduce exposure to pawning with the portfolio being scaled down to 13% from a previous exposure of 16% at the beginning of 2013. An increase in NPA levels from 0.1% to 1.1% was witnessed in tandem with the decline in gold prices. However the NPA ratio for pawning is significantly better than the NPA ratio of the industry which is reported at 12.7% for 2013.

Management Discussion & Analysis

Product Pawning

Risk identification and mitigation

The frequent review of gold prices and subjecting the pawning portfolio to stress testing mitigated against significant material losses being suffered by the Bank.

Timely action from early warning signs led to accelerated recovery of advances, part payment of outstanding balances and auctioning of pawned items on advances on which interest had not been paid, to minimize losses.

Outlook and focus in 2014

Focus on recoveries and subjecting the portfolio to constant review and stress testing will continue as movement in the price of gold remain volatile. The Government announcement of the import duty reduction from 10 % to 7.5 % in November 2013 in addition to scrapping the customs surcharge on gold imports to aid the local jewellery industry is unlikely to impact the banking industry.

Product Leasing

Under the umbrella of HNB

HNB Leasing

Identified with customised solutions and value for money. A key driver of brand equity in the commercial leasing space.

Customer segmentation

Individual, SME and Corporate Customer segment (Brand New/Reconditioned and Registered Vehicle Customer)

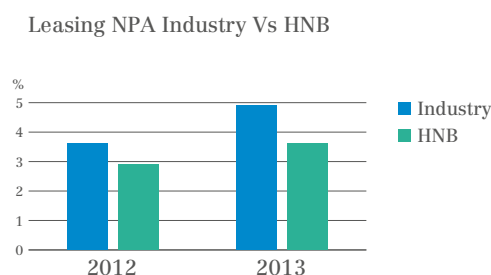
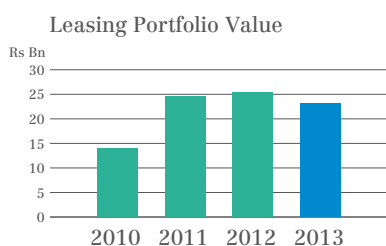
Customer need

Private motor vehicle leases and commercial/machinery leases at attractive interest rates and instalment plans for personal and commercial use.

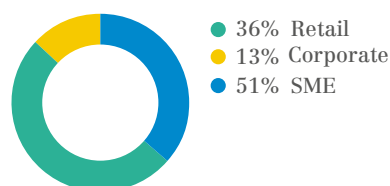
Channel

Offered at 250 customer centres Island wide, through agents and selected vehicle suppliers.

Key indicators



Leasing Portfolio - segmentwise breakdown



Source: CBSL presentation Banking Sector Developments December 2013

Product Leasing

Operational overview **The external environment**

The deceleration of the leasing industry was witnessed in 1H 2013, as credit growth slowed down from a drop in demand for vehicle financing loans as import duties spiked, with lending rates and inflation remaining high, eroding disposable income levels. However vehicle imports increased from June 2013 and recorded a year on year increase of 109% in August 2013. The sharp depreciation of several currencies including the Indian Rupee and the Japanese yen against the US dollar was a co contributory factor driving demand.

Management’s response

Management was responsive to the opportunities from the expansion of the agrarian projects, construction and infrastructure development, and leveraged on the strong brand name and leadership in the leasing space to enter new market segments.

The branch network carried out co- branded leasing promotions with leading automotive dealers, importers at supplier locations to capture new business through customized leasing plans. Tactical promotional activities were carried out to achieve sales targets with focused marketing communication campaigns to achieve the required degree of product awareness and hype in the market.

Risk and controls

Despite the macro-economic challenges, focused efforts resulted in maintaining the quality of the leasing portfolio through effective monitoring and detailed credit evaluations and the application of prudence. This is witnessed in the NPA levels being maintained below 4% despite non performing advances rising rapidly across the industry.

Outlook and focus for 2014

The easing of interest rates, lower inflation and removal of cash margin are expected to result in a gradual increase in demand for credit with vehicle financing expected to play the dominant role. We have also launched a Higher Purchase scheme to cater to the buyers of registered vehicles and leverage on our strong supplier relationships.

Product Housing Loans

Sub Brand HNB “Shanthi”, the flag ship product of the Bank

Customer segmentation Sri Lankans employed in Sri Lanka and abroad attached to public/private sector institutions, businessman and individuals with adequate repayment capacity.

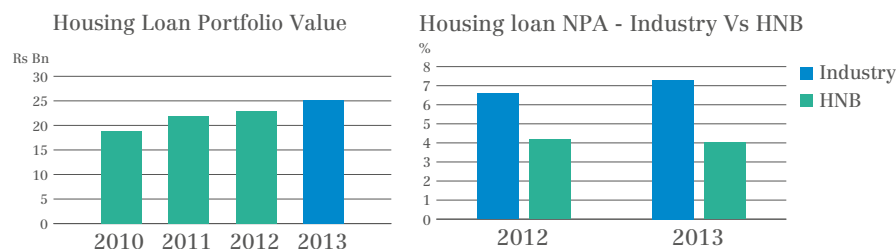
Customer need Purchase of a residential house and property, construction/completion /renovation of a residential house, purchase of land for housing and purchase of condominium apartments

Channel Offered at 250 customer centres island wide and through strategic tie-ups entered into with reputed property developers.

Management Discussion & Analysis

Product Housing Loans

Key Indicators



Source: CBSL presentation Banking Sector Developments December 2013

Operational overview

The external environment

The high cost of living and reduction in disposable income curtailed the demand for housing loans in the domestic market.

Management’s response

The Bank has created value in the hands of customers through a unique value proposition by entering into strategic tie-ups with selected large scale property developers and prospective individual condominium owners, under Tripartite Agreements. This tactical move leverages on opportunities for financing high rise apartments patronized by High Net Worth Individuals. Management attention was also focused on overseas markets with a high density of expat Sri Lankan communities such as the Middle East in attracting foreign currency advances for housing to mitigate against the fall in demand. This initiative was supported by focused advertising and marketing campaigns.

Risk identification and mitigation

The credit origination system e-Space was implemented with integrated Retail Score Cards for retail banking business. The system led to standardizing and improving the quality of the appraisal note, incorporation of scientifically developed internal risk ratings for retail loans and the requisite infrastructure for BASEL advance approaches ahead of the regulatory deadlines.

Outlook and Focus for 2014

We will continue to consolidate and leverage on tactical strategies adopted in 2013 in exploring new opportunities with reputed condominium developers and expand the customer offering through our representative offices overseas particularly in the Middle East and Europe, by targeting white collar workers.

Introduction of the Central Credit Processing Unit for approval and disbursement of loans in order to expedite the delivery and productivity enhancement.

Product Personal Loans

Under the umbrella Brand HNB

Well established brand name in the Auto Loan market “Dream Drive”
 “HNB Personal Loan Scheme” is tailor made to suit the needs of Professionals/ Business Executives.

HNB Education Loan scheme “FUTUR+”

Customer segmentation

Medical Practitioners, Accountants, IT professional, Pilots, Aeronautics Engineers, Nurses and Business Executives in senior management and High Net Worth Individuals.

Customer need Funding for education, vehicles, residential, and Life style associated needs such as wedding expenses, travel abroad etc.

Channel Offered at 250 customer centres island wide along with strategic tie-ups entered into with Professional / Education Institutes.

Key indicators



Operational overview **External environment**

The removal of the restriction on the transfer of ownership on vehicles imported under Government permits issued to state sector employees created an opportunity for auto loans. The country moving to middle income status, the rise in per capita income and dual family income have been key drivers of life style changes and the greater need for and focus on education in the emerging middle class leading to unmet needs in various customer segments.

Management's response

Need based market segmentation was carried out for unmet or partially met life style needs. Business executives and professionals with demanding lifestyles identified as segments with potential were targeted to tailor value propositions. This included a range of life style loans catering to diverse needs.

The education loan scheme under the brand name "FUTUR+" was revamped and repositioned to harness the potential for financing education programs and courses both locally and overseas. The product and service offering 'Dream Drive' auto loans targeted vehicle importers who had access to vehicle permits.

Risk identification and mitigation

Management demonstrated agility in responding to the opportunities arising from diverse customer needs and changes in demographic and social trends in creating new market space and tailoring value propositions in response to these changes. This has led to mitigating possible adverse impacts of regulatory changes and shifts in consumer demand for conventional product and service offerings that may have progressed towards maturity in the product life cycle.

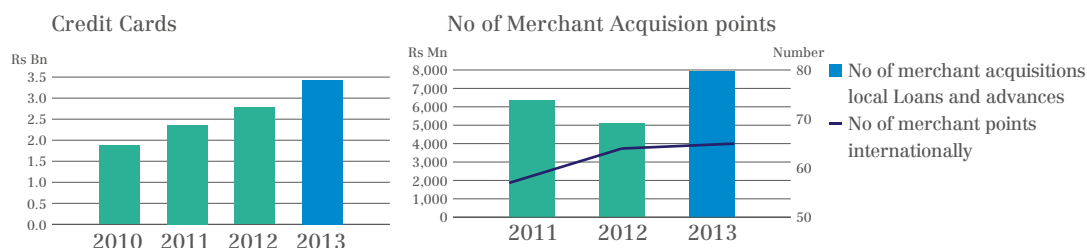
Outlook and focus for 2014

Branch network to aggressively target customer segments with potential to obtain high value personal loans and explore opportunities to cross sell by leveraging on existing corporate relationships. Product awareness to be improved through training programmes conducted at customer centres.

Management Discussion & Analysis

Product	Credit card services
Under the umbrella Brand HNB	Rebranding and re positioning initiatives were carried out for credit cards issued by the Bank during the year 2013.
Market leadership	HNB is the market leader in card acquisitions with market share in excess of 40% and placed fourth for card issuance in order of market rankings.
Product features	<p>Card - Issuance</p> <p>HNB VISA infinite, Signature, Platinum, Gold, and Classic branded cards with EMV chip technology and MasterCard Gold and Standard cards catering to all income segments.</p> <p>HNB 1 debit card with Near Field Communication (NFC) technology, a first in the industry.</p> <p>Card acquisitions</p> <p>As the market leader in Card Acquisitions the Bank provides multiple acceptance devices including standard POS machines, GPRS/IP connectivity, mobile POS through “HNB MOMO”, Internet Payment Gateway services, Mail Order and Easy Payment Plans to merchant customers.</p>
Customer segmentation	<p>For issuance: Professionals, business executives, high net worth individuals, corporate clientele.</p> <p>For acquisition: Corporate and retail market segments</p>
Customer need	Funding of health, education, holidays, travel, purchase of electronics and household appliances and other life style associated needs
Channels	<p>Leverage on Island wide network of the Bank’s customer centers for card issuance and acquisition.</p> <p>The mobile POS – ‘MOMO’ will be the main vehicle used to penetrate corporate and retail space of the acquisition business.</p>

Key indicators



Operational overview

The external environment

Commoditisation remains a key challenge in this space and is highly competitive, with many of the local banks obtaining the franchise rights for VISA, MASTER and American Express cards. Additionally the local Banks compete with Multinational Banks such as HSBC and Standard Chartered Bank who have significantly larger network of merchant points globally.

Product Credit card services

Management's response

The services of research and creative agencies were engaged to carry out market research on card user behaviour, wants and needs to refine the market segmentation. The value proposition will be repositioned based on the findings of the surveys and research.

Strategic tie ups with merchants for acquisitions in the retail and hotel space, attractive discounts on holidays with leading hotel chains, the launch of 'MOMO' the mobile POS, e-commerce acquiring, and the completion of all regulatory requirements in end-to-end Terminal Line Encryption and EMV Acquiring on POS platforms led to increasing the market share of the acquisition business by a further 5% and card usage by 16% over the previous year.

Risk identification and mitigation

Fraud prevention, skimming of cards and unauthorized usage remain inherent risks associated with this product. The risks have been addressed through fraud monitoring and analytics using the "Fraud Guard" Case management tool. The experienced risk management team focused on training, preventive measures and investigations improving awareness levels.

The Bank was awarded the status of the 'Best Acquirer and Risk Mitigator' in South Asia in 2013 from VISA international, beating advanced markets such as India. This bears testimony to the robust risk identification process and mitigatory measures adopted by the Bank.

Outlook and focus for 2014

The rebranding initiative for credit cards will combine the sub brand attributes of agility, advanced technology and innovation with the attributes of strength, security and sustainability of the corporate brand, in redefining the brand proposition. The brand promise will offer enhanced value to the customer in 'partnering for progress.'

Niche strategies, access to the ever increasing international merchant networks and technological advancement and digitization will be game changes in this space. We are well positioned to address these trends having completed the market research for more focused segmentation to differentiate within a commoditised market and through the ongoing initiatives towards technological advancement and digitization.

Services Priority Banking

Priority Banking is the service offering tailored to meet the discerning needs of High Net Worth Customers through 'The Club' and the 'Crystal Circle', providing customized solutions and premium financial advisory services, with dedicated relationship Managers assigned to provide a more customer centric personalized service. The green path centre has been revamped and refurbished to provide priority banking customers with a plush and comfortable ambience.

During 2013 the Priority Banking loan book expanded by nearly 150%, while the deposits grew by 15%.

Bancassurance

Given the low insurance penetration for both Life and General insurance there is significant potential for growth in the insurance industry with a greater focus on Life insurance. Given the aging population of the country and no social security framework offered to retirees, Life insurance products such as pensions and annuities have been identified as products that have significant growth potential.

Bancassurance services are available at 161 customer centres with plans for extending to 185 customer centres by end 2014.

This product is offered in association with HNB Assurance PLC, with a view to offering a complete suite of financial solutions for our retail customers.

Management Discussion & Analysis

Business Vertical	Development Banking
Strategic focus	Creating opportunities through financial inclusion for the rural and agricultural sectors by making financial services available, accessible, affordable and attractive.
Business scope	<p>The Bank's Development Banking Division was instituted with the intention of becoming the leading Development Banking unit among commercial banks. HNB remains the only commercial banking institution to have downscaled their operations to meet the needs of the micro finance market, under the brand "Gami Pubuduwa".</p> <p>Existing customer base comprises 37,000 customers for development banking including 20,000 customers for micro finance.</p>
Strategic objectives 2013	<p>Leveraging on the trickle down effects of the development focus of the country</p> <p>Expand outreach using technology such as mobile banking for transaction banking needs.</p> <p>Increase outreach through bulk lending to smaller Micro Finance Institutions (MFIs) for onward lending to smaller localized communities operating within specific geographical areas.</p>
Product and service offering	<p>During the last two decades, the Bank opened its doors to more people for income generating activities particularly in rural Sri Lanka, providing access to Micro-savings, Micro-lending, Money transfer services and Micro-insurance.</p> <p>The value proposition in this space offers a comprehensive package of services to the rural community, which includes technical know-how, marketing arrangements and financial management in addition to financial assistance. The full suite of value additions in the offering act as enablers, contributing significantly towards the development of the rural economy.</p>
Customer need	<p>Access to affordable funding towards income generation activities</p> <p>For basic transaction processing such as deposits, fund transfers and ATM access for withdrawals.</p> <p>Bank as a supportive partner in their progress in providing</p> <ul style="list-style-type: none"> • Structured programs for developing basic financial awareness and management concepts, • Creating linkages with the supply chains, to ensure commercial viability and sustainability of their income generating activities • Entrepreneur development and social development programmes • Financial literature to improve financial literacy
Customer segmentation	Small and micro level entrepreneurs who engage in income generating activities including agriculture farming, fisheries and dairy and a wide array of manufacturing activities and services activities at medium, small and Micro level.
Channels and foot print	<p>121 microfinance units dedicated for microfinance spread across the customer network</p> <p>149 dedicated field staff including 47 agricultural officers to handle agro related facilities</p> <p>10 regional offices to evaluate larger loans</p>
Actions that led to success in 2013	<p>Active participation in donor sponsored credit lines</p> <p>Funding offered on concessionary terms through the following loan schemes among many other schemes, Prosperity, SMILE III (Revolving), Commercial Scale Dairy Development Loan Scheme (CSDDL), New Comprehensive Rural Credit Scheme (NCRCS), Coconut Cultivation Development Credit scheme (CCDCS).</p>

Business Vertical Development Banking	
	<p>HNB was the Co Host for the Agriculture Finance Support Facility (AgriFin) Conference held in Colombo in August 2013</p> <p>The very first conference was held in Uganda and followed up with a second conference held in Sri Lanka. The Bank was able to network with international donor organizations and who could end up as future partners. We have arranged an exposure visit to India for field Staff with the assistance of the World Bank Agrifin project.</p>
Key developments	<p>e learning tool developed for financial education and entrepreneurship development.</p> <p>Bulk loans for income generating and housing purpose.</p>
Key impactors/ risks and mitigation.	<p>Climatic Change</p> <p>Natural calamities such as drought and flood have adverse impacts on the income streams of the rural farming communities. Rescheduling of loans for up to 6 seasons, or granting fresh loans to tide over liquidity issues and resume of short term cultivation after drought or floods is common. The rate of recovery is very high as farmers are able to continue their cultivation with the granting of the fresh loans which are invariably recovered over cultivating season.</p> <p>Competition from new entrants</p> <p>Competition has also intensified with more institutions increasing their scope of activity in further penetrating the space of development banking and micro finance. Being pioneers in this area of specialization the Bank continues to provide leadership backed by the strong brand promise of partnering for progress.</p> <p>The network of relationships built over time with the field officers have given the Bank a comparative edge over competition in managing non-performing loans and advancers, attracting new customers and retention of existing customers.</p>
Focus for 2014	Enhance the financial outcome of development banking efforts through the development of a strategic plan for the medium term while improving the reach of development banking efforts.
Outlook	The development banking sector is poised for growth and the Bank remains committed to contributing towards the capability of the nation through capacity enhancement and development of the micro and agro sectors into commercially viable opportunities.

Business Vertical International Remittances	
Strategic focus	<p>Partnering expatriate Sri Lankan communities to contribute towards the livelihood and economic development of family, community and country</p> <p>Align with the national goals and objectives by attracting foreign exchange earnings back into the country by tapping the worker remittance pools of the expat Sri Lankan communities residing across the globe and creating awareness of the availability of accepted and secure electronic channels for inward remittances.</p>
Business scope	Channelling all inward worker remittances through strategic alliances, international banks and Exchange Houses.
Strategic objectives 2013	<p>Grow fee income by tapping into remittance pools in new markets</p> <p>Engaging with the Sri Lankan expatriate community to enhance brand presence and awareness on the availability of secure and legitimate channels for inward remittances. The Bank has underlined its commitment to serving communities and facilitating cross border solutions as part of the overarching strategy on sustainability which is no longer confined within the country.</p>

Management Discussion & Analysis

Business Vertical International Remittances

Appoint HNB representatives across the globe to strengthen market presence

HNB representatives were appointed in the Gulf states, in Europe and East Asian markets. This was not only to ensure that service standards and delivery will be enhanced but also address all regulatory compliance requirements relating to inward remittances and mitigates against the risk of fraud and default. This initiative also augments existing strategic tie ups in overseas markets.

Product and service offering, customer segments, customer needs

Product and service offering

Agency arrangements and correspondent relationships with reputed banks have been established to offer effective and secured financial solutions

Customer segments

Targeting all expatriate Sri Lankans employed and/or residing overseas

Customer needs

Secure and speedy repatriation of funds across the Island.

Channel

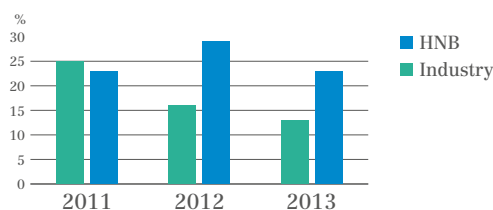
Cash payouts facilities offered across the branch foot print in 250 customer centres and via electronic banking channels such as Internet.

75 well established tie ups with Exchange Houses in the Gulf, European Union and Asia Pacific regions. 5 main strategic alliances for inward remittances across the globe.

Super-Agent for MoneyGram International authorised to appoint sub agents. Money Gram International has a global presence through over 296,000 agents in 197 countries facilitating remittances. Asia Asset Finance was appointed as a sub agent in 2013, taking the total count of paying locations to 324.

Key indicators

Worker Remittances to the Country Vs HNB



Actions that led to success in 2013

Automation and system upgrades to improve service quality in addressing the customer need for secure and speedy repatriation of funds.

Systems connecting exchange houses and strategic business partners were upgraded to provide online real time updating facilities for fund transfers, providing beneficiaries with peace of mind and speedy confirmation on the repatriation and receipt of funds.

Key developments

Divestiture of shareholding in Majan Exchange LLC in Oman

The Bank entered into a sale and purchase agreement to divest its holding of 40% during the year. This has been concluded successfully.

Business Vertical International Remittances

Key impactors/ risks and mitigation. Fraud and Money Laundering

The risk of fraud, default and money laundering are the key risks identified in this space. The risk factors are addressed through the anti-money laundering system implemented by the Bank in 2013 and by stationing HNB representatives in the overseas locations. The HNB representatives who have been selected through an extensive selection process from existing staff are trained for the required skills and carry the core values of the Bank in carrying out their tasks. These reps vet all documentation and origin of funds in line with KYC principals to ensure regulatory compliance.

Financial standing of new remitting agents selected at overseas locations

Management carry out a rigorous reference check on all overseas agents prior to appointment, including obtaining a background check and status report from the agent's bankers in assessing their suitability and financial standing as an agent of the Bank. Having the HNB representative on-site has added significant value in obtaining market information and carrying out the required follow up actions in terms of completion of the compliance check list etc.

Focus for 2014 Further strengthen existing relationship with strategic partners and exchange houses, through market visits and stationing of HNB representatives in key markets

3 year strategic plan is in place for the regions of Gulf, European Union and Asia Pacific.

Outlook Increasing trend for worker remittances, crosses USD 6.7 Bn mark in 2013

Based on available market information Sri Lankan migrant worker remittances surpassed USD 6.7Bn in 2013, an increase of nearly USD 700 Mn over the previous year. It is projected that remittances will reach USD 10 Bn by 2020. As per current market information, over 1.7 Mn Sri Lankans work overseas with migrant workers constituting 17% of Sri Lanka's working population. Worker remittances will continue to reflect an upward trajectory from increased migration of skilled manpower earning higher salaries and perks, compared to unskilled female domestic workers.

Management is of the view that the current focus on electronic channels across the Bank addresses the customer need of convenience, choice of access and same day straight through processing (STP). The Bank is geared to cater to the anticipated increase in transaction volumes through electronic data interchange platforms and mobile banking with SMS service confirmations which address the above customer expectations of STP.

Business Vertical Trade Services

Strategic focus 2013 Focus on facilitating exports aligning with National priorities in 'Partnering for Progress'

The Bank has continued to actively participate in facilitating exports, focusing mainly on the SME sector as majority of the exporters belong to the SME segment and in the rapid infrastructure development program of the country.

Strategic objectives 2013 Aggressive growth from fee based income

Augment growth in income by increasing the contribution from fee based income from Trade products over the previous year.

Management Discussion & Analysis

Business Vertical	Trade Services
<p>Actions that led to success in 2013</p>	<p>Issuance of Letters of credit, diversified Guarantees and handling of Exports Bills propelled growth of fee based income over the previous year.</p> <p>Fee and commission income for 2013 increased by 11% over the previous year. The above performance is despite Trade volumes of the country in 2013 showing a decline in comparison to that of the year 2012. Sustained growth was achieved through service excellence and specialized knowledge in trade products and services.</p> <p>Service excellence and quality differentiate the Bank from peers and stamped with ISO certification and benchmarked against global best practices.</p> <p>The ISO certification awarded for trade operations in 2004 has laid the foundation for service excellence and high standards being attained in the provision of trade solutions and is the main differentiator, leading to undisputed excellence which has underlined our identity, as a leader in the industry, in providing trade solutions.</p> <p>This certification is renewed every three years and in April this year the ISO certification was renewed for a further period of 3 years after a stringent audit of the operational processes and procedures pertaining to trade operations by Bureau Veritas. It has reinforced the credibility and reputation of the Bank at both local and international levels.</p> <p>Continuous emphasis to enhance the technical knowledge of the trade team and the branch staff</p> <p>The skill and competency of the trade team have been a key catalyst in delivering the high standards demanded by the ISO certification consistently over time. The centrally located trade team is supported by the growing base of Certified Documentary Credit Specialists (CDCS) who cascade their expertise across the branch network.</p> <p>Internal and external training programs and the continuous emphasis to enhance the technical knowledge of the Trade Team and the Branch staff have resulted in a competent and well experienced team, who are well versed in trade practices and international best practice.</p> <p>Trade Units located throughout the Island attracted new business in the regions through greater customer interaction and creating awareness at branch level on trade products and services</p> <p>The 27 Trade Units which have been strategically located throughout the Island are linked to a centralized unit carrying out core trade operations based on a hub and spoke model. These units have facilitated greater interaction and engagement with trade customers and proved to be a value generator. This is consistent with the sustainability policy of the Bank which focuses on greater engagement with customers and is a key touch point of customer centricity. It has also resulted in customized solutions being offered due to the proximity to the customer and insights gained from meeting the customers on a one to one basis.</p>
<p>Key impactors</p>	<p>Multiplier effects on trade activity arising from global challenges.</p> <p>The Euro crisis of 2012 continued into 2013 due to the economic crisis situations in Greece, Cyprus, and Spain. The crisis in the Middle East continued to affect the political stability in the region and with sanctions imposed restricted the free flow of goods to key markets. The economic uncertainties of the US continued to impact local exporters further compounding the issue. The political and economic uncertainty across key international markets had multiplier effects on both the import and export sectors of the country.</p>

Business Vertical Trade Services

Focus for 2014 Customized solutions, electronic delivery to extend reach and further improve service quality, garner new business from international markets through stronger correspondent relationships in the APAC region.

Outlook Develop export potential in SME space

The Bank would continue to develop the export potential in Sri Lanka mainly focusing on the SME sector, and is exploring avenues to facilitate accommodation to this sector, which is constrained by the ability to provide collateral to obtain facilities for their operations.

Business Vertical Treasury Operations

Strategic focus 2013 Managing market risk within the risk appetite of the Bank

The focus has been on managing currency risk, interest rate risk, asset and liability management, sourcing of funds towards capital adequacy and maintaining adequate liquidity positions for the Bank in compliance with regulatory requirements.

Strategic objectives 2013 Maintain Net Interest Income margins.

Interest margins maintained on par with prior year.

Raising Tier II capital.

Achieved by way of the debenture issue and deep discounted bond issue

Maintain desired liquidity levels.

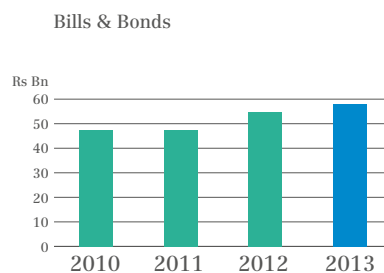
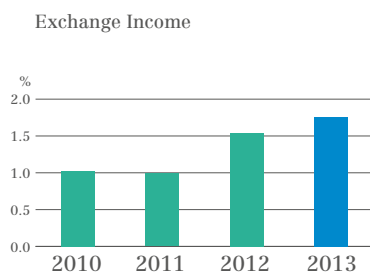
Liquidity was managed above regulatory levels, making a maximum contribution to the Bank's bottomline.

Process improvements driving efficiency and effectiveness.

Ongoing objective of process improvements to drive efficiency and effectiveness in improving service quality of internal and external customers. The state of the art technology solution has enabled 250 branches to connect to the treasury for on line rates in delivering timely and faster responses to customers across the network.

Products and key markets Serves the retail, SME and corporate clientele of the Bank.

Product portfolio comprises foreign currency/ interest rate swaps, foreign currency/interest rate hedging, foreign currency dealing, forward exchange contracts, interest rate caps/floors and collars, money market products, trading in fixed income securities, repurchase and reverse repurchase transactions.



Management Discussion & Analysis

Business Vertical	Treasury Operations
<p>Actions that led to success in 2013</p>	<p>ALM operations further strengthened through the Asset Liability Management system in securing better margins and adhering to regulatory compliance</p> <p>Net interest income (NII) margins maintained on par with the previous year despite challenging and volatile market conditions that prevailed throughout 2013.</p> <p>Significant benefits were derived from the Asset and Liability Management system introduced in the latter part of 2012 as part of the focus on technology in the effective management of assets and liabilities as well as liquidity movement, and in maximizing the NII margins of the Bank. The treasury is one of the key users of this system and it has improved the quality of the management information generated to the Assets and Liability Committee (ALCO) and facilitated better management of assets and liabilities of the Bank while complying with regulatory requirements.</p>
	<p>Issuance of debentures amounting to Rs 4 Bn towards improving Tier II capital, which were rated 'A+(lka)', one notch lower than its National Long-Term Rating of the Bank</p> <p>The Bank issued Rs 4 Bn worth of unsecured subordinated redeemable debentures to fund its projected lending activities and strengthen the Bank's regulatory Tier II capital base in June 2013. The issue was oversubscribed by 3 times on the opening day.</p> <p>Raised Rs 1.35 Bn through a Deep Discounted Bond Issue</p> <p>The Bank raised Rs 1.35 Bn through a deep discounted Bond Issue (Rating of AA-)</p> <p>The Bank issued 20Mn senior, listed, unsecured redeemable 10 year debentures in August 2013 at an issue price of Rs 67.715. The issue was oversubscribed on the day of the opening by over 3 times.</p> <p>Long term loan of USD 49 Mn raised through China Development Bank (CDB).</p> <p>The loan was obtained to fund trade related long term project financing of the Bank. This was a second loan granted to the Bank and demonstrates the confidence international banks have placed in the strength and stability of the Bank.</p>
<p>Key impactors</p>	<p>Increased volatility in global interest rates increases currency risk in the domestic market</p> <p>The currency fluctuation and volatility in global markets compounded by liquidity issues results in the volatility in the exchange rate for the Lankan Rupee.</p> <p>Due to the US Federal Reserve's announcement in May 2013 indicating tapering of quantity easing the bench mark US 10 year Bond rates moved from 1.6 % p.a. to 3.03 % p.a. by December 2013 creating uncertainty about liquidity in the market for the US Dollar.</p> <p>Interest rate reduction in May and October 2013</p> <p>CBSL announced 50 basis points reduction in repo and reverse repo rates in May 2013 and October 2013. This has resulted in the domestic market interest rates moving downwards making borrowing more attractive. In June 2013 CBSL reduced the statutory reserve requirement of the banks from 8 % to 6 %. This resulted in having excess liquidity in the interbank market and yields of treasury bills and bonds moving down. If rates continue to stay low, reinvestment in treasury bills and bonds will be at a low level resulting in low interest income.</p>
<p>Focus for 2014</p>	<p>Enhanced value through customer specific solutions backed by improved service quality and efficiency from technological advancement.</p>

Business Vertical Treasury Operations

Outlook Growth to be driven mainly by advanced economies; emerging markets weaker than expected.

Globally, the advanced economies are gradually strengthening while growth in emerging market economies is slowing down. This confluence is leading to tensions, with emerging market economies facing the dual challenges of slowing growth and tighter global financial conditions.

Towards a sustainable business model with technology and digitization as an enabler

Strategic focus We have identified technology and digital convergence as enablers in achieving our business strategy and in ensuring that our business model remains viable in keeping with our approach towards sustainable performance.

Functional scope Technology as a function in the Bank aligns itself to provide strategic customer edge, facilitate operational excellence and help adhere and comply to Bank's policies, procedures and guidelines.

Strategic objectives 2013 We have understood the importance of technological advancement and digitization towards our own survival as a Bank, in addressing the needs and safeguarding the rights of our stakeholders. It has prioritized the need to focus and invest in various technologies and systems over the medium term commencing 2011.

Key actions that led to success in 2013 The 'Go Live' timelines were achieved for 10 Business IT projects in 2013 and (19 projects over 2012/13)
73% of these projects have a direct influence to customer service

Key challenges Quantifying the ROI on investment made to date and ensuring that the business implements all initiatives to leverage full value of the investment in IT projects
Manage possible cost overruns from delay in go live dates, revisions to original scope and change requests

Focus for 2014 With the completion of projects under taken in 2012/2013 the Bank's focus will shift from productivity improvement to systems that innovate with the business by

- Enabling revenue generation
- Offering low cost services
- Analysing customer insight and behaviours, locking in corporate relationships and
- Facilitating quick decision making for product positioning

Operational review

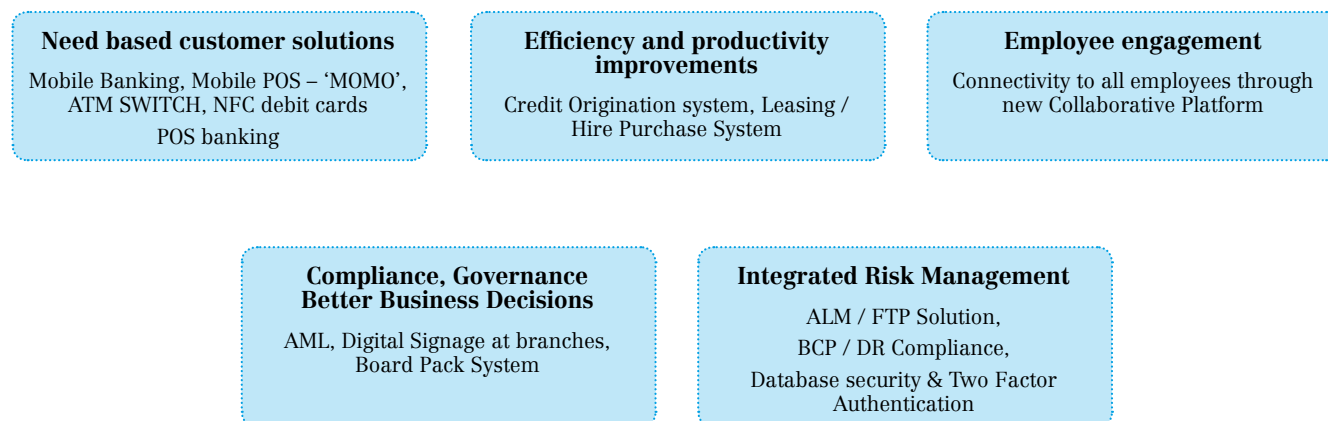
Modern day customer life styles and behavioural patterns are being revolutionized by the advances of technology and digitization, with the expectations for banking services being changed and influenced by other online service providers in other industries.

Our focus on technological advancement has gone beyond redesigning our customer offering and delivery channels and includes equally vital aspects such as governance and oversight, monitoring and compliance, ensuring accuracy of reporting and improving efficiency and productivity across the business.

The ensuing figure and table summarize and outlines how technology was used as an enabler in achieving the overarching business strategy of the Bank in 2013 and in continuing with a sustainable business model for the future.

Management Discussion & Analysis

The value release to the business for major projects implemented in 2013 and the latter part of 2012 are tabulated below.



Qualitative benefits	Quantitative benefits	Strategic Focus
ATM Switch		
Online cash deposits, card-less transactions, gift/top-up cards, online bill payments, additional transaction volume handling, multi institutional support, fraud prevention, monitoring, cash management, chargebacks and reconciliation.	Stop current revenue leakages Ability to set fees and charges	Profitable Balance Sheet Growth Higher fee income to augment Net interest income Operational excellence and cost optimization Governance and transparency
Mobile Banking		
Advance Mobile Solution Solution for all phones and all customer segments Only bank offering 4 connectivity channels (SMS, USSD, Smart App and Browser based) operations.	Increase in customer acquisitions Accessing the unbanked in the micro finance space Increase in existing customer utilization Fees and charges	Profitable Balance Sheet Growth Operational excellence and cost optimization Higher fee income to augment Net interest income
ALM FTP System		
A solution to address the needs of Asset and Liability Management and Fund Transfer Pricing.	Information supports the ALCO to manage risk Branch profitability and transfer pricing Reports for interest rate sensitivity and maturity profiles of assets and liabilities as per CBSL directives	Profitable growth Operational excellence Governance and transparency

Leasing & Hire Purchase System		
New leasing solution to replace the troubled ProLease solution eliminating down time.	Growth in revenue from existing and new business	Profitable growth
Hassel free month-end closure	Recovery of penal interest, fees and charges	Operational excellence and cost optimization
Centralized recovery action	Release of staff for other duties	Higher fee income to augment Net interest income
New leasing solution to replace the troubled ProLease solution eliminating down time.	Growth in revenue from existing and new business	Profitable growth
Hassel free month-end closure	Recovery of penal interest, fees and charges	Operational excellence and cost optimization
Centralized recovery action	Release of staff for other duties	Higher fee income to augment Net interest income
Anti-Money Laundering solution		
Anti-Money Laundering solution that interacts with all systems	Analyse patterns of customer transactions, behavioural aspects, Maps customers against the published global blacklist /sanction databases to generate alerts.	Governance and transparency Regulatory compliance
Automated information to the Board		
Automation of the distribution of Board Packs and enhanced confidentiality of documents.	Speed of delivery Reduction in printing cost	Governance Confidentiality
E Space credit origination solution – 4 Q 2012		
New credit evaluation and rating system to replace existing individual systems used for corporate and retail.	The solution standardizes the credit rating and evaluation process and also facilitate the implementation of BASEL II.	Operational excellence Governance and transparency
Digital dissemination of information at customer centres – 3Q 2012		
Digital Displays deployed in all customer locations. The system is controlled centrally and customizes information based on language to suite ethnicity of various geographical locations.	Displays interest rates, bank's promotions and Customer Charter requirements. Minimizes customer grievances and complaints with regard to transparency of information	Operational excellence Governance and transparency
The collaborative platform – 4 Q 2012		
Facilitating online interaction between management and staff and productive use of limited time	Cost effective solution in eliminating costs incurred on phone calls, , group meetings, printing, travel cost and time in attending meetings	Cost optimization Operational excellence Motivated and engaged team

Management Discussion & Analysis

Managing and mitigating risks

One of the key challenges of automation is the risk of data protection, customer confidentiality and business continuity. The bank has invested significantly in 2013 on the Core Business Continuity Plan (BCP), Disaster Recovery (DR) system in addressing the key risks by acquiring the latest standards in data security and confidentiality and having a tried and tested process for disaster recovery and business continuity. DR drills are conducted quarterly, switching operations to the Banks DR site and operating business as usual for all regular banking operations with all connected systems over the entire branch network from remote locations.

The enhanced Security offering through Two Factor Authentication (2FA) and Personal Assurance Message (PAM) make HNB the only bank in the country to offer 4 distinctive form factors to ensure customer authentication on eBanking. The solution offers different customer segments, a more appropriate mechanism depending on their behaviour patterns. For example, frequent travellers can use “hardware token” while the standard home and office users can use the “seamless Id” binding the client PC and the host computer. Alternatively, for more tech-savvy smart phone users can generate a “soft token” on their phone while a primitive user can depend on a SMS message delivering a one-time password (OTP).

In delaying the initial investment in technology the Bank has now been successful in being able to leap frog ahead of competition with its current technical and operational capability to offer many superior products to the market as elaborated in this review and under each of the ensuing discussions under products and electronic channels.

Outlook

The need to reach more customers faster, offering more choice and convenience in a more cost effective manner, spawning new revenue streams through a value proposition of e-products, e-services, electronic channels, platforms and devices will be key to the survival of the Banking industry.

Gaining customer centricity through technology and digitization would draw a clear distinction between the winners and losers. Banks who continue with more traditional and conventional thinking are eventually most likely to lose out to Banks who have been early adopters of the digital wave driving social media and social networks driving customer centricity.

Marketing

Strategic focus 2013 Redefining the value proposition offered to customers

In the face of technological advancement and demand for convenience the marketing strategy has addressed customer needs and perception, redefining the value proposition of the Bank in selected segments, using the actionable intelligence originating from market research and market surveys carried out during the year under review.

- Customer Solution
- Cost to customer
- Customer Convenience
- Communication

- Product
- Price
- Process
- Promotion
- Place
- People

The marketing strategy deployed by the Bank has lent support to the core business strategy of,

- Achieving balance sheet growth through attracting low cost funding and profitable selective lending in challenging times and intense competition over the corresponding year. Strong sub brands such as Pathum Vimana and Singithi have been drivers of deposit mobilization and improving the CASA mix with sub brands such as HNB Leasing and Shanthy driving the leasing and housing loans market space, consolidating performance despite a decline in private sector lending.
- Launching of several e-Products such as the mobile POS –‘MOMO’, Mobile Banking and HNB One Debit card using Near Field Technology in addition to revamping internet banking.
- Promoting a strong sales culture through focused target driven incentive schemes in the personal banking segment.
- Addressing the need for wider reach, access and convenience with low cost electronic channels and multi- channel strategy.
- Using socially responsible, focused marketing campaigns and communication using digital mediums throughout the foot print.
- Repositioning HR as a business partner in driving engagement and motivation

The marketing strategy has not focused only on the financial score card but also evaluated the marketing score card to interpret changes taking place in the market share, by addressing critical success factors such as customer attrition, customer satisfaction, product quality, access and convenience relative to competition in the chosen segments.

By analysing the findings and insight obtained from the various research initiatives, market surveys, focus groups, mystery shopping exercises and actionable intelligence gathered from analytics, the Bank has focused on understanding the market opportunities, demographics, behaviour patterns, attitudes and perceptions of customers and identified customer needs that have been met, partially met or unmet.

Strategic objectives in 2013

Research initiatives in the retail space and savings segment

The savings segment based research revalidated the strength the Bank has in this sphere with very strong brands like Pathum Vimana and Singithi covering general savings and children’s savings. In the retail segment key savings and advances products were tracked with competition in order to improve on the marketing mix to maintain lead position in the respective category.

Reinforcing the corporate brand promise

Your partner in progress

The Bank continues with a successful umbrella strategy for managing the brand with strong sub brands complementing and reinforcing the corporate brand promise of being ‘ your partner in progress’.

Strong relationship management, safety and stability through fair banking practices, responsible leadership, good governance, integrity and financial inclusion across a broad spectrum of customers operating in the key segments of corporate, personal banking, SME, development banking and micro finance, are some of the key attributes of the brand that have been and continue to be associated with the brand name HNB. The brand will increasingly be associated with technology based products and drive through its e-based product offerings driving alternate channels for banking at greater convenience.

Management Discussion & Analysis

Brand management has gone beyond the traditional approach of advertising to build brand value by focusing on the need to provide customer solutions to traditional, cyber (use only internet banking) and the hybrid customer who uses both traditional branch banking facilities as well as internet banking.

The numerous technological advancements to the operating platform and initiatives from process reengineering leading to simplified, efficient and robust automated processes driving convenience and the use of multiple electronic mediums for delivery that are not constrained by a single fixed location in 2013 (discussed in detail under the various business verticals) will associate the brand with fast and efficient delivery, and greater choice of access on 24/7 basis and service excellence that will endeavour to exceed customer expectations, and further strengthen the brand promise and create greater value in the hands of the customer.

This value proposition of superior products, service excellence and choice of convenient electronic access will not only meet the growing need for easier, convenient online real time access of the existing customer, but also position the Bank as a leader in meeting the needs of a growing tech savvy generation.

Actions towards success in 2013 The Bank engaged AC Neilson during the year under review to carry out the following research initiatives and market surveys

- Assess the strength and attributes and recall of the corporate brand and sub brands
- A national level market research initiative aimed at the savings space and which included the Northern and Eastern provinces in gathering greater insight into the demographics, saving patterns and attitude of customers
- Tracking study to ascertain the position of the Bank Vis a Vis competition in the retail space based on product features, service quality, competitiveness and communication strategy across key personal banking products/brands.

Marketing score card and ROI Above the line communication and marcom strategy of the Bank, lead the Bank to achieve leadership in the following product and service segments.

Growth rate of loans and receivables of 17% better industry average of 8.8%.

Growth in Fee income of 16.3% despite industry reporting a decline.

An overall growth of 5% pre VAT and tax profit achieved over the corresponding prior period in an extremely challenging external environment that had significant changes in economic and monetary policy and volatility in macroeconomic indicators in both the global and domestic market.

Key developments The research based approach the Bank took to marketing in 2013 strongly directs to a strong corporate brand focused marketing approach. While acknowledging changing life styles and generational experiences connecting to a rapidly changing media landscape and understanding that the modern customer needs a new approach that maximises their limited time and attention the Bank invested in emerging mediums and the digital space. With this insight advertising was action driven and targeted.

Key impactors The investment on digital advertising was successful in connecting advertising spend to ROI. In 2014 an estimated 10% of the marcom budget will be in the area of digital based advertising.

The research findings from the research indicated that people like to be rewarded for savings apart from the interest they earn. Hence the Bank will place more emphasis on sales and service driven culture with rewards to staff.

Focus 2014 Build on the strong corporate brand while positioning the Bank as a safe and stable Bank.

Drive the marketing budget, striking a good balance between marcom, rewards and digital in driving the corporate brand and key product brands.

Continue the research based approach to marketing and product decisions in driving customer value.

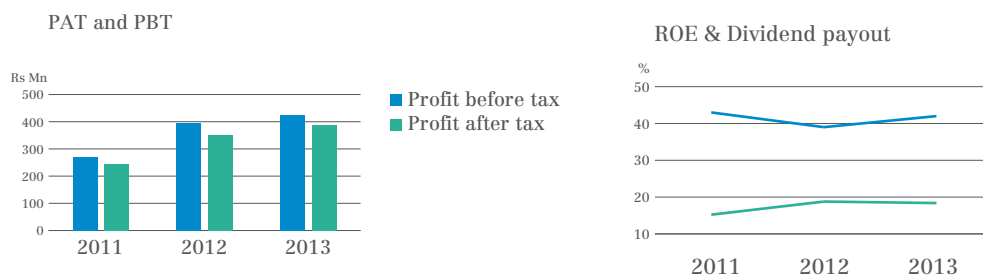
More marketing focus on youth.

Subsidiary HNB Assurance PLC

Vision To be Sri Lanka's most admired and trusted partner in meeting insurance needs professionally with a spirit of caring

Business scope Composite insurer offering both Life and Non-Life Insurance 52:48 (December 2013)

Key Indicators



Key highlights of operational performance reported over the corresponding period in 2012

- Revenue growth of 21 %
- GWP reports a significant growth of 34% for Life
- Overall growth in GWP reported at 21% out paces industry growth of 9%
- PAT reported at Rs 389 Mn being an increase of 11% YoY
- Funds under management increase to Rs 6,660 Mn
- Dividends declared for the year Rs 162.5 Mn
- Market share increases to 4%

Key developments during the year Obtaining certification to carry out Takaful business for both Life and Non-Life Insurance businesses.

Greater collaboration with the Bank in signing up a memorandum of understanding for the use of 'MOMO', the mobile POS to be used by the agents, and tripartite promotions involving the Bank, vehicle dealers and the insurance company in securing more Non-Life motor business

Strategic tie ups with financial institutions

The successful launch of Single premium investment products in the Life space that was a key driver of growth in excess of 34%

Key internal and external variables impacting the business **Non-Life**

Achieving growth in a market that was slowing down and was competing on soft rates.

Deceleration of growth in premium income from a decline in motor vehicle imports due to higher import duties, tariffs and a 100 % margin requirement on the import of passenger vehicles being imposed. This also impacted the leasing industry. Maintaining the growth momentum of prior periods posed a significant challenge as the market continued to slow down having reported an annual growth of 15% during the previous reporting period.

Management Discussion & Analysis

Subsidiary HNB Assurance PLC

Life

Attracting the right skill sets in agent recruitment posed a significant challenge in the face of increased demand for Life insurance agents in the industry.

Focus for 2014 Aggressively pursue strategic tie ups within the financial services sector for growth opportunities in Non-Life insurance space.

Collaborating with the Bank in offering retirement products to expatriate Sri Lankan communities overseas.

Exploring opportunities for inorganic growth through Mergers and Acquisitions.

Outlook The regulatory amendments to the RII Act and significant enactments requiring the segregation of composite business into Life and Non-life along with a requirement to list and the likelihood of increasing the capital required per class of business to Rs 500 Mn from existing Rs 100 Mn would call for changes in the existing business models and pricing strategies adopted especially in the area of Non-Life insurance to ensure that the operations meet with the additional capital requirements

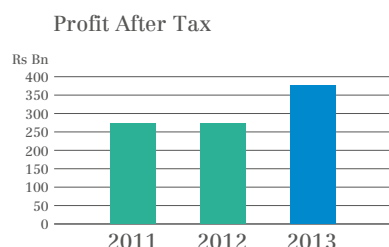
Subsidiary Sithma Development Ltd.

Vision To provide premium office space with a corporate ambiance focusing on a green environment, energy conservation, security, health and safety

Business scope Rental of premium office space and allied building and facilities management

Key Indicators

Rs'000	2011	2012	2013
Rental income	795,519	800,567	830,856
Total Operating expenses	284,443	304,156	293,894
Finance cost	242,148	239,543	152,741
Profit after tax	276,068	272,706	374,038
ROE	5.51%	4.46%	5.77%
ROCE	4.34%	3.83%	5.35%
Dividend declared	NIL	NIL	5,000

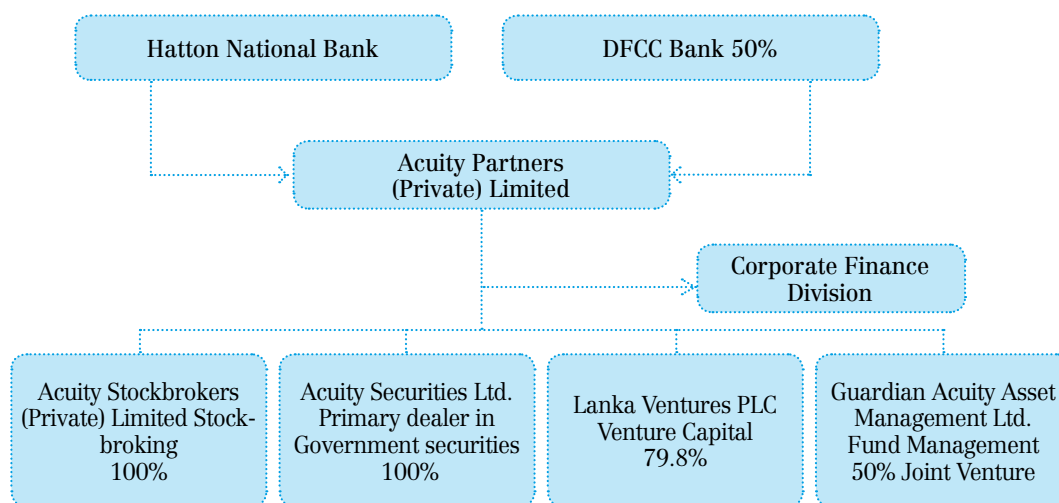


Key developments during the year It was a smooth year of operation after the completion and sale of the Spathodea apartment complex in November 2012. Management brainstormed with regard to envisioning the strategy for the next 3 – 5 years and working towards obtaining ISO certification for HNB Towers.

Subsidiary	Sithma Development Ltd.
Key internal and external variables impacting the business	The company was able to charge a premium from being able to satisfy the requirements in providing solutions to tenants in addressing the exponential demand growth for grade “A” office space in the city of Colombo. The downward trend in interest rates impacted finance costs positively and resulted in an upward boost to the bottom line with minimum impacts from external shocks.
Focus for 2014	HNB Towers has been maintained in excellent condition over the past 10 years. Operational excellence and service standards to be increased by a further notch by achieving ISO certification in 2014.
Outlook	The demand for grade “A” office space in Colombo is growing exponentially with rates increasing in tandem with demand. Demand is likely to be driven by the number of overseas BPO operations relocating their operations in Sri Lanka who require A grade office space with a green ambiance and compliance with health and safety regulations.

Joint Venture	Acuity Partners (Pvt) Ltd
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Business scope Acuity Partners (Pvt) Ltd is a joint venture between HNB and DFCC Bank with each partner owning 50% of the company.



Acuity Partners is an integrated, one stop full service Investment Banking Firm providing the following services:

- Stock Broking
- Fixed income servicing
- Corporate Finance
- Asset Management
- Venture Capital

Strategic Focus 2013 Value addition through superior service

Increase market share and bottom line by focusing on continuous improvement to service quality, as ‘the product’ for both the stock broking and the primary dealers is largely homogeneous.

Focused marketing strategy to increase market share

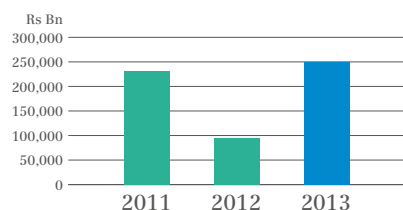
Deploying a focused marketing strategy to increase assets under management and breakeven.

Management Discussion & Analysis

Joint Venture Acuity Partners (Pvt) Ltd

Key Indicators	2011	2012	2013
Rs'000			
Income	766,982	448,481	538,912
Total Operating expenses	469,854	343,976	391,169
Profit before tax	288,306	118,177	316,336
Profit after tax	231,240	95,662	250,590
AUM	1,853,814	2,064,630	2,319,197
ROE	12.4	4.6	10.8
ROA	3.8	1.4	3.2
Dividend declared	32,750	-	42,051

Profit after tax



Operational overview of the Group

The power sector, fixed income servicing and stock brokering activity were key drivers of profitability for Acuity Partners who have made a strong come back in posting a post-tax profit of Rs 250Mn for the year 2013 being an increase of 161.9% over the prior period.

Lanka Ventures PLC

Strategic focus is in the areas of energy and healthcare.

Energy comprises of investments in renewable and thermal energy. Renewable energy projects include Hydro and Wind Power.

Investments as at year ended 31st December 2013

- Energy Portfolio Rs 1.5Bn
- Health care Rs 111Mn
- Installed capacity of renewable energy projects 29 MW
- Installed capacity of Thermal power projects in Bangladesh 52 MW

Favourable weather conditions propelled a higher share of earning for Lanka Ventures PLC from their investments in the power sector. The company reported a post-tax profit of Rs 204 Mn for the year under review.

Managing and mitigating risks

Energy portfolio is spread across different energy sources and geographic locations to diversify risk from varying weather patterns.

Venturing overseas has mitigated the risk of being exposed to a single buyer in Sri Lanka. Further the thermal power projects off set the impacts of seasonality of income generation patterns from the renewable energy projects.

Joint Venture Acuity Partners (Pvt) Ltd	
	<p>Focus for 2014</p> <p>Funding of wind power projects as part of the strategic focus and expertise gained in funding renewable energy projects.</p>
	<p>Acuity Stock Brokers (Pvt) Ltd</p> <p>Strategic focus:</p> <p>The brokering arm targets both the retail and High Net worth Individuals (HNIs) for investments in equity. Despite adverse market conditions in the first 3 quarters of the year, Acuity Stockbrokers (Pvt) Ltd was successful in maintaining its market share and maintains its position within the top 5 brokers, reporting a post-tax profit of Rs 24.4 Mn for the year ending 31 December 2013.</p> <p>The scale and depth of Acuity Stock Brokers from the combined strength of DFCC stock brokers and HNB Brokers has helped mitigate the risk of volatile market conditions. Being able to leverage on the strong retail presence of HNB to distribute shares through the branch network and leverage on the HNI network of DFCC has also given the company a comparative advantage.</p>
	<p>Acuity Securities Ltd</p> <p>Acuity Securities Ltd., the Primary Dealer arm of the group, performed well under challenging conditions during the year. Whilst the reduction in monetary policy stance by the CBSL during the year resulted in a decrease of around 200 bps across the GSEC yield curve, leading to better trading opportunities, the gap between GSEC interest rates and alternate investment products such as Fixed Deposits, led to erosion in client business volumes.</p> <p>The company posted a Profit After Tax of Rs 73 Mn approximately for 2013, which was a 55% increase over the previous year.</p>
Key internal and external variables impacting the business	<ul style="list-style-type: none"> • Skilled and experienced staff and significant scale and depth in operations are positive internal impacts. • Seasonality of weather patterns that impact revenue generation in the power sector. • Performance of the market indices that impact the stock brokering activity. • Movement in interest rates impacting demand for fixed income securities. • New 10 point action plan of CSC and road shows avail an opportunity to attract more interest in the Colombo Stock Exchange. • New listing rules pertaining to 20% listing in increasing the public float will have created opportunities for growth.
Key achievements during the year	<p>Issuer of the HNB debenture issue which was oversubscribed by over Rs 2Bn raising subordinated debt of Rs 4 Bn.</p>
Focus for 2014	<p>Continue to develop existing suite of products.</p> <p>Enter debt market for issue subordinated debt by leveraging on the capital strength of the JV partners.</p> <p>Developing a branch foot print for setting up strategically located branches as current presence is limited to Colombo.</p> <p>MOU with a leading firm to pursue opportunities in investment banking.</p>

Management Discussion & Analysis

FINANCIAL REVIEW

Industry Overview

The financial year 2013 was one of the most challenging years faced by the financial services industry and by HNB. The high interest rates which prevailed during the early part of the year, rising non-performing loans, low demand for credit and declining gold prices affecting the lucrative pawning business saw most financial institutions perform below par. In addition to the local macro environment, internationally the environment remained challenging. Sluggish performance in the Euro zone affected exports from the Country during most part of the year. The announcement of tapering of QE by the US Fed in mid 2013 posed challenges to most emerging markets with investments flowing out and risk premiums widening. Though Sri Lanka was not as affected by the tapering as its giant neighbour India, the rates at which the government and financial institutions could borrow from international markets increased significantly during 2013.

Financial Performance

Income

Interest income which is by far the biggest contributor to the Bank's total revenue grew by 17.8% to Rs. 55.7 Bn as a result of aggressive growth of over 16.8% achieved by the Bank in advances, despite overall credit demand being sluggish in the Country with industry credit growth limiting to 8.8% during the year 2013. High interest rates witnessed during major part of 2013 also contributed

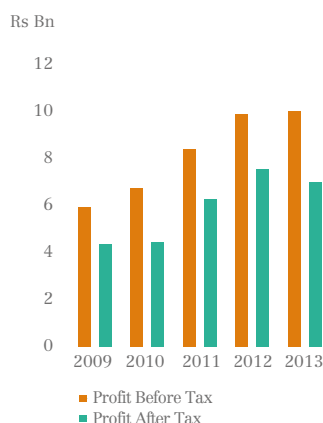
towards the growth in interest income. However the interest write-offs from pawning advances have negatively contributed towards the growth in interest income during the year. Interest expenses increased at a faster pace of 23.9% during the year thereby compressing margins. Growth in deposits coupled with higher interest rates resulted in the surge in interest cost during the year. Despite the drop in margins the Bank managed to post a 10.8% growth in net interest income to achieve Rs 24.3 Bn as a result of the strong balance sheet growth.

Fee and commission income which is the main contributor towards non funded income witnessed a 16.4% year on year growth driven by higher growth in fees from card acquisitions, remittances, guarantees and trade income despite overall slowdown in international trade during the year. In addition several initiatives were made in electronic and mobile banking space which will play a key role in driving Bank's fee income in the medium term.

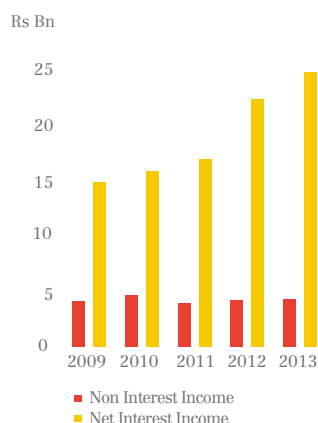
The revaluation loss on swaps that were obtained to hedge exchange risk created due to foreign borrowings is shown as a net loss from trading. During 2013, the Bank recorded a loss of Rs 1.8 Bn which is a 11.2% increase from the previous year. This is a reflection of higher swap cost during 2013 compared to 2012.

Net gain from financial investments of the Bank increased by Rs 159.1 Mn mainly due to higher dividends received during the year from its equity investments in the available for sale category.

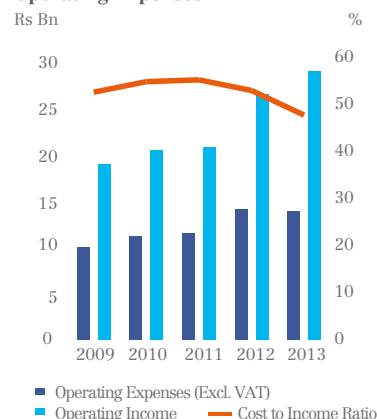
Profit



Income



Operating Income & Operating Expenses



Other income of the Bank mainly reflects exchange gains from customer transactions and revaluation of on balance sheet open positions. In 2012 the rupee depreciated by 12% which resulted in the on balance sheet open position showing a sizable gain. The low volatility in the currency in 2013 resulted in lower revaluation gain which in turn reduced other income by 24% compared to 2012.

The total operating income of the Bank stood at Rs 28.6 Bn for 2013, which is a growth of 9.4% over 2012.

Asset Quality

High interest rates, tight cash flows in the economy and drop in gold prices had significant implications on the asset quality of the banking industry during 2013. In line with the industry, HNB too witnessed a significant deterioration in its asset quality in the first few quarters with gross NPA peaking at 4.65% in the third quarter. However due to aggressive recovery efforts the ratio was significantly reduced to 3.64% by the year end which is a marginal improvement compared to the NPA ratio of 3.66% for 2012. This was achieved on the backdrop of industry NPA ratio deteriorating from 3.7% in 2012 to 5.6% by end of 2013. Provisioning for the year increased significantly to Rs 3.2 Bn with fall in gold prices being a main contributor for the rise. The higher provisioning during the year has resulted in maintaining a healthy provisioning cover of 62.5%. Accordingly the net NPA for 2013 improved to 1.37% compared to 1.82% in the previous year. The above NPA ratios and provision cover

calculations are based on time based provisioning method as specified by the Central Bank of Sri Lanka.

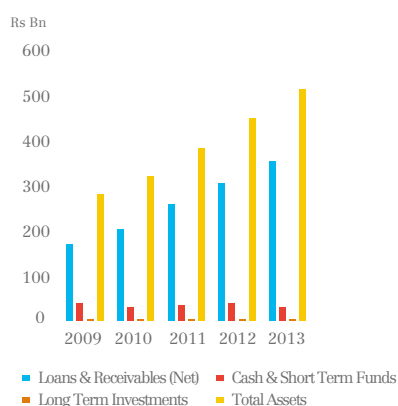
Operating expenses

The overall operating expenses reflected a drop of 1.4% mainly due to a 18.5% reduction in personnel expenses. As per the SLFRS requirements all Employee Share Benefit Trust (ESBT) and Employee Share Option Plan (ESOP) given to employees have to be revalued and the benefit accruing to the employee from same has to be accounted as a cost to the Bank under personnel expenses. With the Bank taking the decision to unwind the ESBT during 2013, the value of same which was taken as a cost in previous years was reversed during 2013. The net reduction in personnel cost due to winding up of the ESBT and the new ESOP granted amounted to Rs 1.3 Bn for 2013.

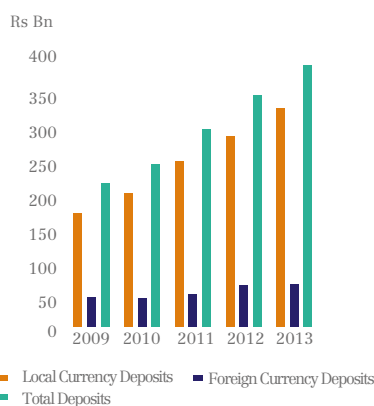
Other expenses increased by 14.5% during the year, largely due to increase in advertising costs, higher investments made to upgrade technology, payments on account of higher credit card transactions and due to an operational loss on account of card operations.

Overall the cost to income ratio for 2013 improved to 47.8% compared to 53.0% in the previous year. The ratio adjusted for ESBT and ESOP was at 52.2% for 2013.

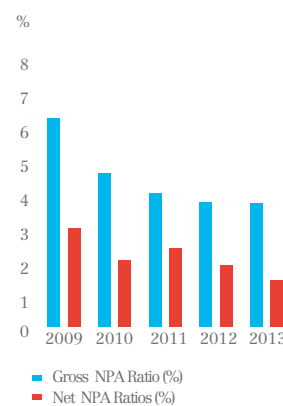
Assets



Deposits



Non Performing Assets Ratio



Management Discussion & Analysis

Taxation for the year

The financial VAT increased by 33.0% to Rs 1.7 Bn in 2013 whereas the corporate tax expense increased by 28.0% to Rs 3.0 Bn. Accordingly the effective rate for VAT & corporate tax increased to 40% from 32% in 2012. The Bank had a substantial amount of tax reversals which resulted in the effective tax rate been substantially low in 2012 compared to 2013.

Profitability

The Bank's profit before VAT and tax grew by 4.9% to Rs 11.7 Bn while the Group managed a 5.9% growth in the same line.

The net profit after tax for the Bank recorded a decline of 7.0% to stand at Rs 7 Bn mainly as a result of higher provisions and tax expenses.

The ROA for 2013 stood at 1.5% while the ROE was at 14.3%.

Group Companies

Other group companies including HNB Assurance PLC, Acuity Partners and Sithma Development Ltd performed well during the year with profit growth of 11.0%, 161.9% and 37.2% respectively. Accordingly the Group posted a net profit of Rs 7.8 Bn which is a drop of 3.6%, lower than the decline in profits witnessed by the Bank. With Insurance and capital markets still in early stage of development, we believe these investments will contribute

a larger share of the Group profitability going forward. HNB Assurance witnessed a 21% growth in gross written premium during the year compared to 2012. Despite capital markets been fairly dull during 2013, Acuity Partners posted a significant growth in profits with main contribution coming from Lanka Ventures Ltd, which is the venture capital arm of the Group. Overall the HNB Group managed a ROA of 1.6% and an ROE of 13.9%.

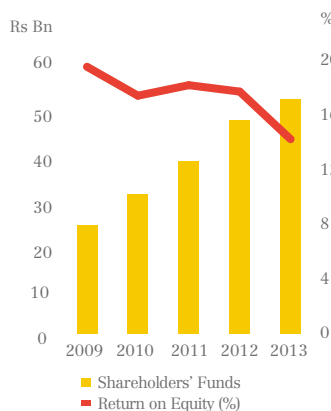
Statement of Financial Position

With interest rates being high during major part of 2013, the industry witnessed a slowdown in credit growth specially during the early part of the year. Despite lower appetite for credit HNB managed to increase the loan book by 16.8% which is commendable. The growth in credit was driven mainly by corporate banking while the SME segment also contributed towards the growth.

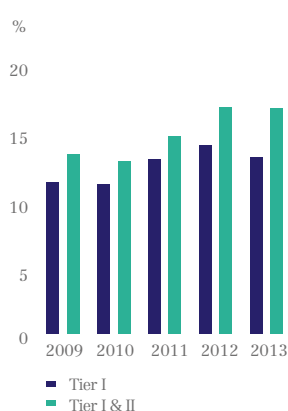
The Bank's balance sheet grew by 14.3% in 2013, with the growth in assets predominantly being funded by deposits, which grew by a healthy 12.9%. During the year the Bank increased its borrowings by 36% through raising over Rs 5 Bn from senior and subordinated debentures as well the as by raising US\$ 49 Mn in long term borrowings from China Development Bank.

Compared to a negative growth in savings accounts in 2012, the Bank was successful in increasing its savings deposit balance by 14% in 2013 resulting in a CASA ratio of 38.5%. Growth in CASA accounts helped the Bank to minimize the impact on margins despite a significant

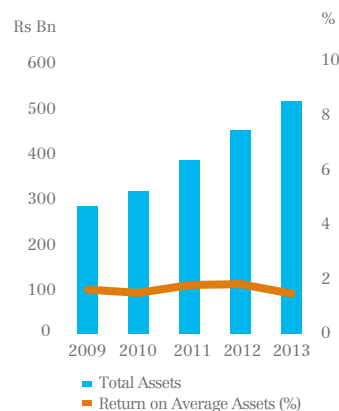
Shareholders' Funds



Capital Adequacy Ratio



Return on Average Assets



drop in rates during the latter part of the year and the negative growth in the high yielding pawning portfolio.

Shareholders' Funds

The shareholders' funds (for the Group) witnessed a growth of 10.7% with the retained profits for the year thereby increasing net book value of a share from Rs 131.02 to Rs 144.06 in 2013.

The Bank proposes a final cash dividend of Rs 7.00 per share in addition to the interim dividend of Rs 1.50 per share declared in December 2013 resulting in a total cash dividend of Rs 8.50 per share for the year amounting to a gross dividend payment of approximately Rs 3.40 Bn.

Capital Adequacy

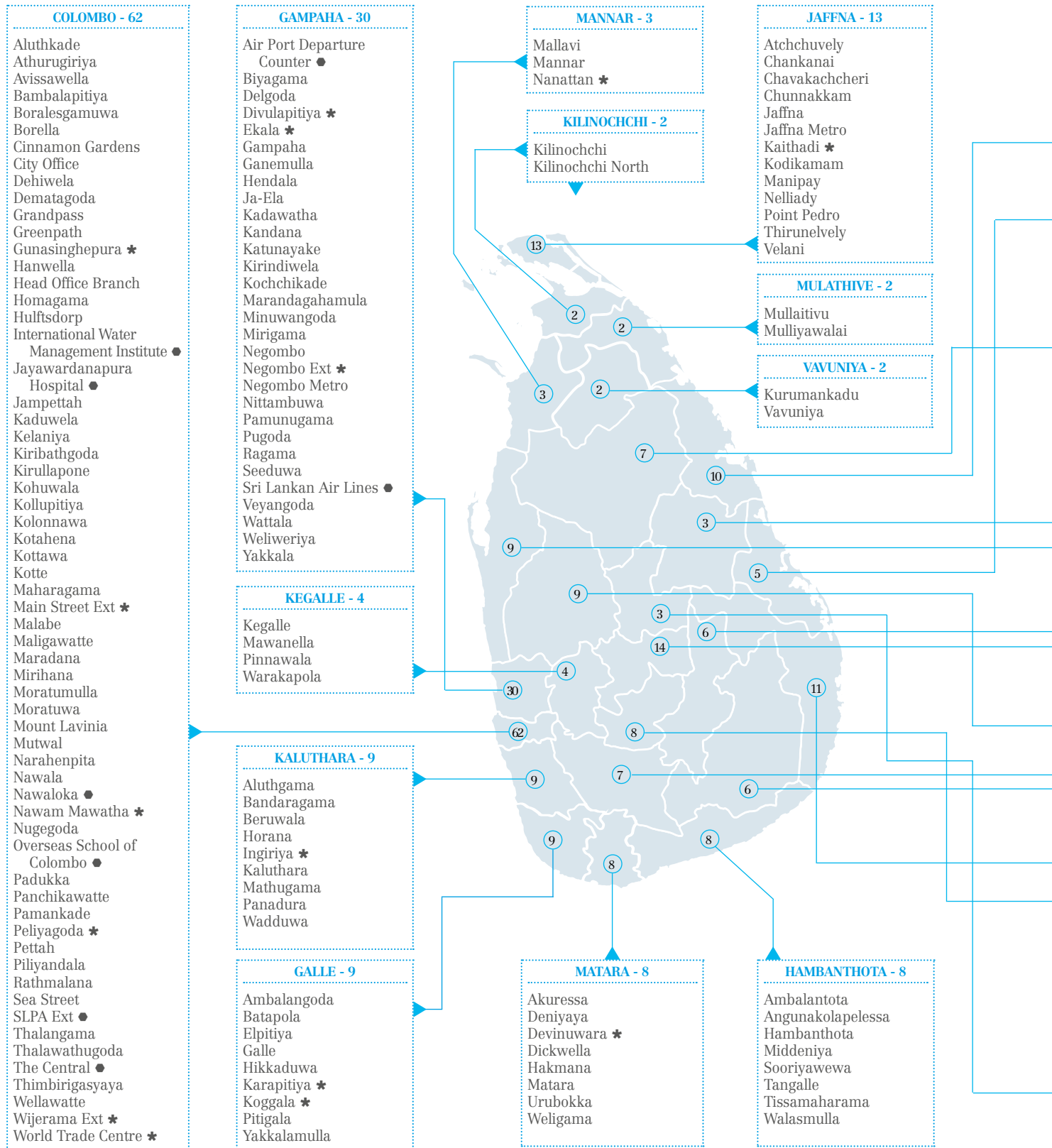
Capital adequacy position of the Bank remained strong with Tier I capital ratio maintained at 12.95% compared to 13.85% for 2012 through internal generation of funds. The total capital adequacy ratio was maintained at 16.52% compared to 16.63% for 2012 with supplementary capital strengthened through the subordinated debenture issue.

Future outlook

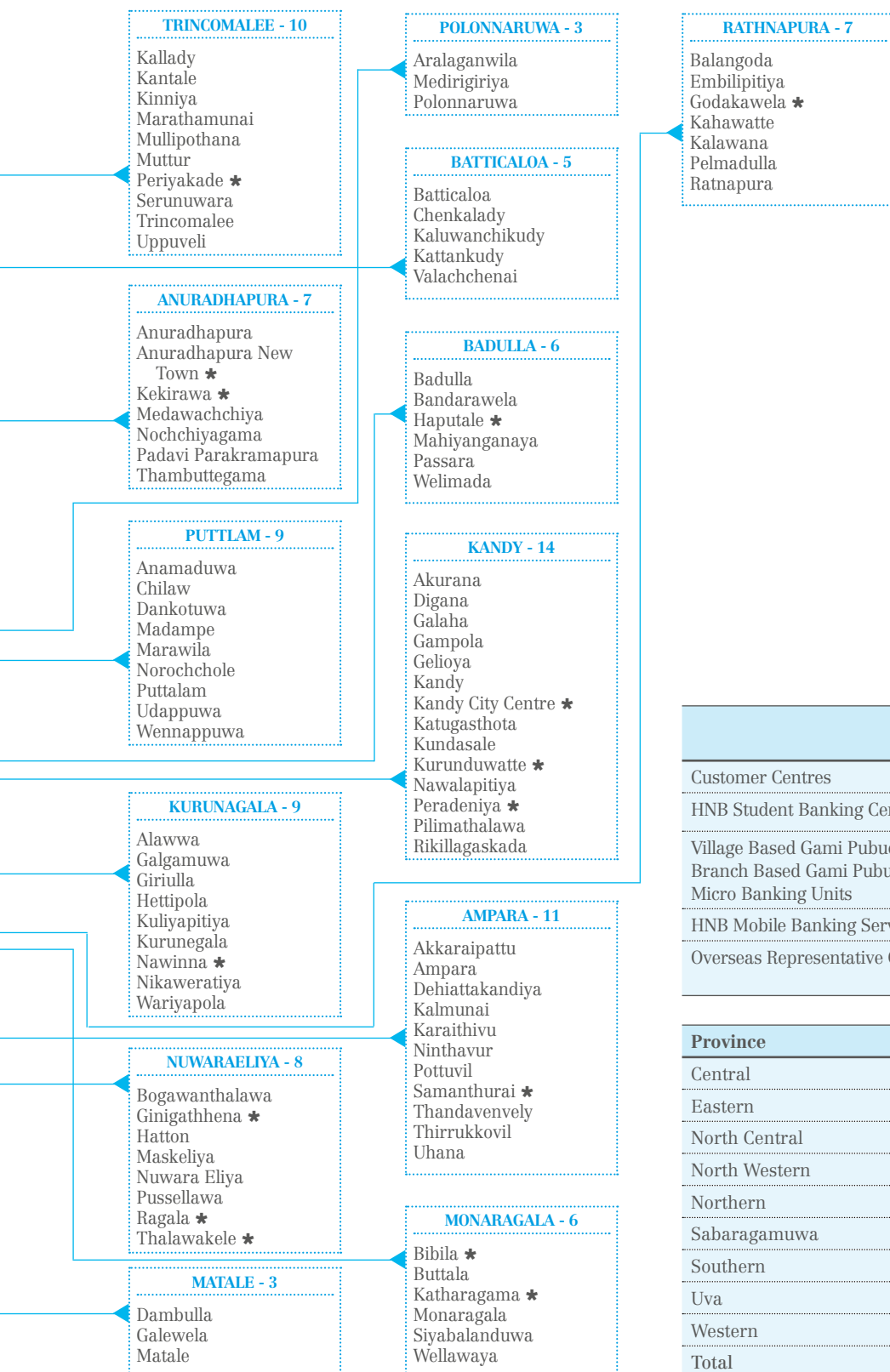
Year 2014 remains even more challenging with volatility in interest rates affecting banking sector margins and gold prices continuing to remain sluggish. On a positive note, the low interest rates are expected to drive loan growth while improving asset quality.

The Central Bank road map to consolidate the financial industry will also pose new challenges and opportunities for banks during the next 12 months. At HNB we see these as opportunities and will drive our strategies toward leveraging on same, while at the same time improve efficiency and driving fee income to face the challenges of operating in a low margin environment.

Customer Centre Network



* Extension Offices ● Pay Offices



	as at end of 2012	as at end of 2013
Customer Centres	247	250
HNB Student Banking Centres	166	168
Village Based Gami Pubuduwa Units	6	3
Branch Based Gami Pubuduwa Units	114	121
Micro Banking Units	9	9
HNB Mobile Banking Service Units	2	-
Overseas Representative Offices:	Chennai - India	Chennai - India

Province	Customer Centres	ATMs
Central	25	35
Eastern	26	33
North Central	10	13
North Western	18	25
Northern	22	31
Sabaragamuwa	11	15
Southern	26	31
Uva	11	16
Western	101	216
Total	250	415

Main Correspondents Worldwide

EUROPE

Austria	Liechtenstein
Belgium	Luxembourg
Bulgaria	Macedonia
Channel Islands	Monaco
Cyprus	Netherlands
Czech Republic	Norway
Denmark	Poland
Finland	Portugal
France	Romania
Germany	Slovakia
Greece	Slovenia
Hungary	Spain
Ireland	Sweden
Isle of Man	Switzerland
Italy	Turkey
Kosova (Republic of)	Ukraine
Latvia	United Kingdom

ASIA

Bahrain	Maldiv Islands
Bangladesh	Nepal
China	Oman
Hong Kong	Pakistan
Georgia	Philippines
India	Qatar
Indonesia	Russian Federation
Israel	Saudi Arabia
Japan	Singapore
Jordan	Taiwan
Korea (Republic of)	Thailand
Kuwait	United Arab Emirates
Lebanon	Vietnam
Malaysia	

NORTH AMERICA

Canada
Mexico
United States of America

SOUTH AMERICA

Argentina
Bolivia
Brazil
Chile
Colombia
Ecuador
Peru

AFRICA

Botswana
Egypt
Ethiopia
Ghana
Kenya
Mauritius
Morocco
Seychelles
South Africa
Swaziland
Uganda
Zambia

AUSTRALIA

Australia
New Zealand



Continuity
establishes roots;
change give us
new leaves.



We will build upon
our rich heritage by
evolving to succeed
in the changing
world of tomorrow.

Corporate Governance:

Risk Management at HNB

The changing nature of today’s business environment is increasing both the scope and potential impact of the risks we face in our day-to-day operations. Managing risk therefore constantly requires innovation and reinvention.

Formulated and refined under the Integrated Risk Management Direction (2011) of the Central Bank of Sri Lanka (CBSL), HNB’s risk management framework is focused on supporting the day to day business activities of the Bank by building and strengthening its risk management processes at all levels of the organisation.

While HNB remains committed to maximising shareholder value by growing its business in line with a Board determined risk appetite, the Bank is mindful of achieving this objective in the best interest of all stakeholders. The Bank’s risk management strategy is to achieve a sound balance between risk and return to the business, whilst maintaining strong liquidity and

adequate capital positions at all times combined with a robust asset quality.

The development of new technologies has impacted the Bank in many ways, allowing for innovation and effectiveness in the delivery of banking products and services to our customers. As the popularity of new communication channels increases, so do the risks associated with such technology, calling for increased due diligence and sound banking practices.

Over the past three years, HNB has invested significantly in risk and capital management resources and infrastructure to support the Bank’s growing credit portfolio. The implemented programmes have helped us to streamline our business processes, contributed towards improving our risk monitoring capabilities to meet a more demanding regulatory environment and supported the decision making process by providing faster access to critical information.

Key Initiatives in 2013

Development of requisite Basel II infrastructure in Credit Risk system	Testing of Basel II IRB infrastructure completed for corporate credit portfolio.
Implementation of Anti-Money Laundering (AML) System	Implementation of an AML system to better address financial crime and detect patterns of cash inflows and outflows across customer accounts.
Enhancement of the Asset & Liability Management (ALM) processes	Comprehensive ALM policy in place. System driven stress testing developed to enhance the Bank’s liquidity and interest rate risk monitoring capabilities and also for better management and allocation of capital.
Formalisation of the Bank’s Internal Capital Adequacy Assessment Process (ICAAP)	Assessment and documentation of the Bank’s ICAAP aimed at improving the risk and capital management processes of the Bank.

Priorities for 2014

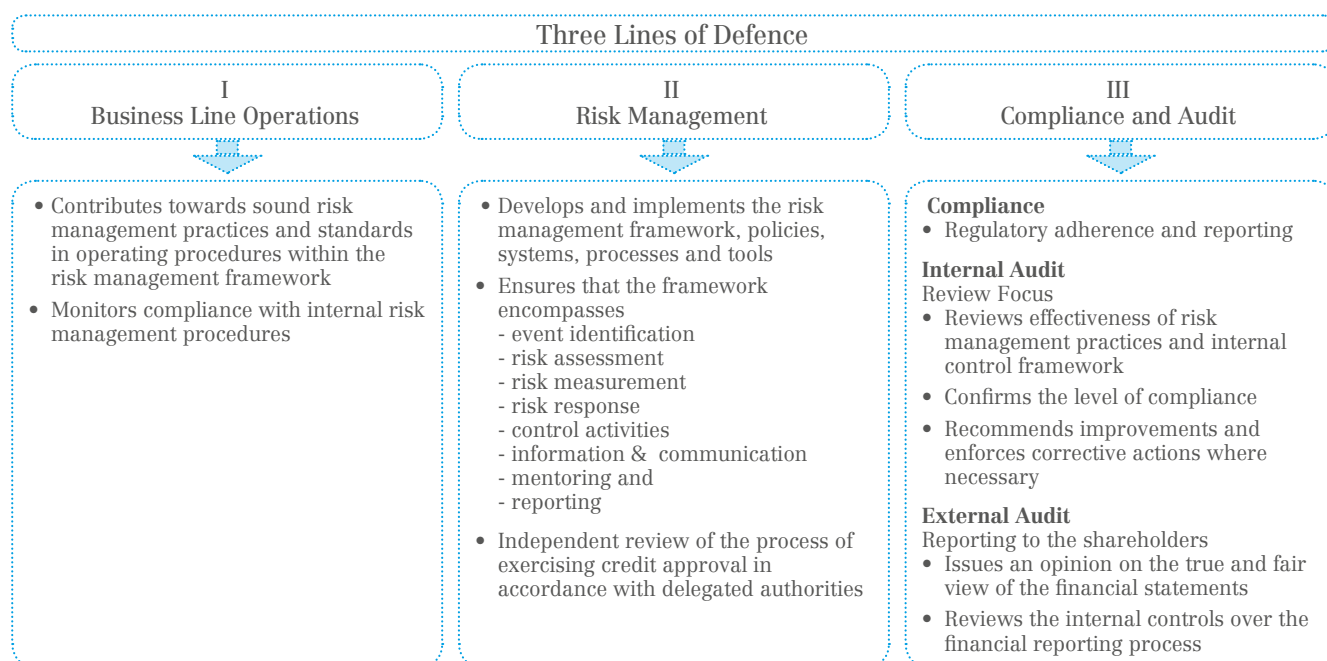
Implementation of the Basel II Standardised / Alternative Standardised Approach for the measurement of Operational Risk	Infrastructure been developed to compute capital requirements for operational risk under the Standardised / Alternative Standardised Approach (TSA/ASA) in order to move away from the Basic Indicator Approach.
Enhance the Bank’s Internal Capital Adequacy Assessment Process (ICAAP) based on Pillar 2 of the Basel II Framework	Assess and quantify where appropriate the capital requirements for the additional risks covered under the CBSL Banking Act Direction no. 5 from 2013 on the Supervisory Review Process. Enhance the Bank’s stress testing framework.
Refine internal risk rating based pricing model for credit products	Integration of the internal risk rating based pricing methodology in the Bank’s credit tariffs and enhancement of PD, LGD and EAD methodology.*
Development of key risk indicators for Asset and Liability Management	Development of Value at Risk (VAR) / Earnings at Risk (EAR) methodology for Asset and Liability Management in ALM system.

* Probability of Default (PD), Loss given Default (LGD) and Exposure at Default (EAD)

Corporate Governance

HNB's capacity to identify, assess, prioritise and mitigate the risks it faces has enabled the Bank to develop and grow over the years, ultimately reflecting the Bank's strong corporate governance and prudent risk management stance.

The Bank's corporate governance framework is based on three lines of defence promoting accountability, transparency and independent verification.



Risk Governance

The Board of Directors and Board Sub-Committees work together with Senior Management to combine the specialised knowledge of its risk professionals with the experience of the corporate oversight functions. HNB's Board has the ultimate responsibility for risk management and sets the tone at the top for an effective management of risk through defining its strategic goals and high-level objectives.

HNB's Board operates through two key Committees:

- **The Board Integrated Risk Management Committee (BIRMC)** which ensures that risk management strategies, policies and processes are in place to manage events that could impact the Bank's earnings performance, reputation and capital. The approach involves active monitoring of the level of risk exposure against the Bank's risk appetite.
- **The Board Audit Committee (BAC)** which provides its assessment on the effectiveness of internal audit and external disclosure in line with accounting policies and financial reporting to the Board.

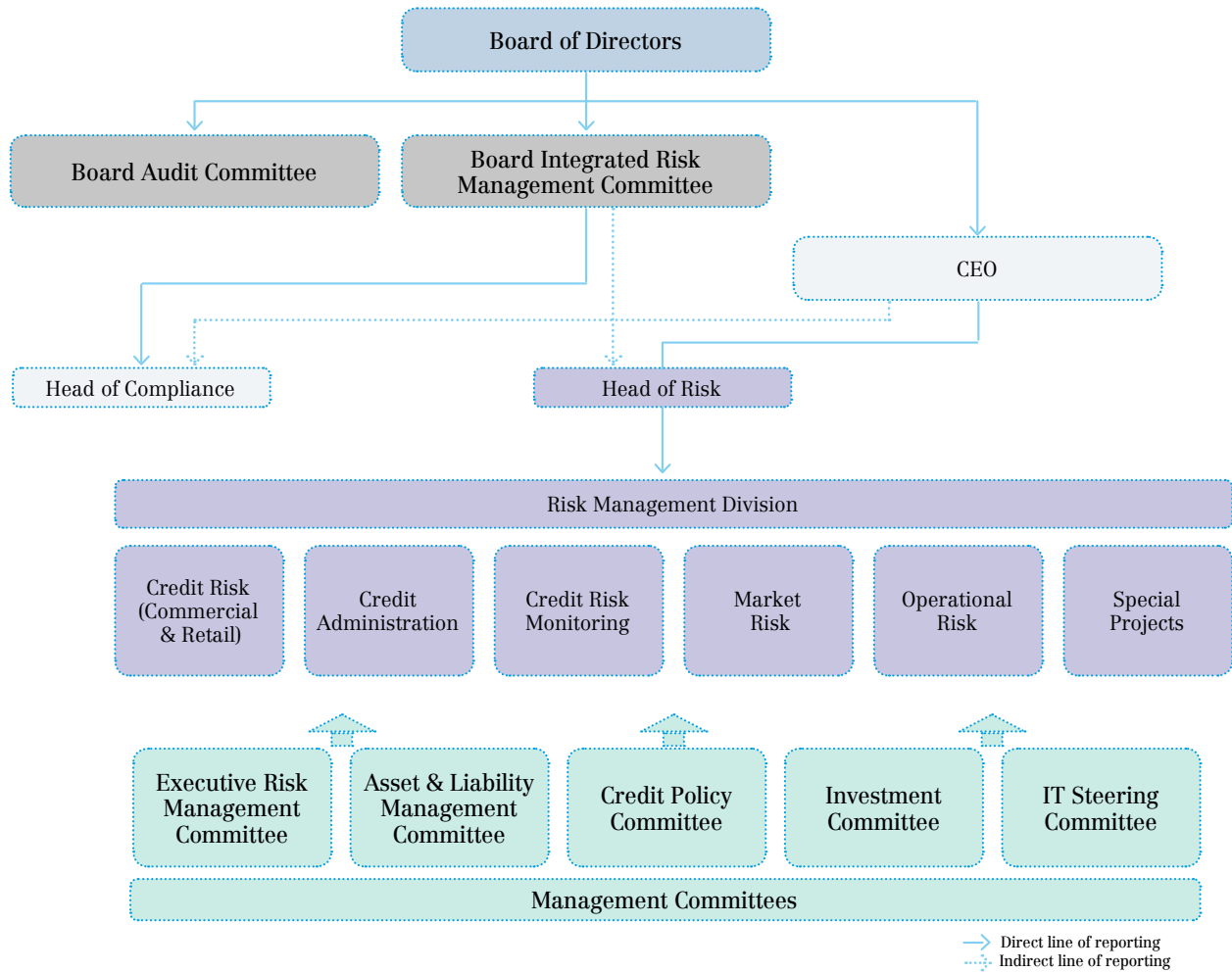
The various Executive Management Committees, each with specialised focus, support the BIRMC and are responsible for implementation of approved policy, oversight and co-ordination of risk matters for the business areas.

Established in 2003, HNB's Risk Management Division consists today of 38 individuals dedicated to the management of risk. The risk function is independent of the business units it monitors. It plays a central role in monitoring the Bank's risk appetite and risk strategy, and partners with the business lines to ensure that risk management is truly engrained in HNB's corporate culture.

A separate Recoveries and Credit Quality Management Division reporting directly to the Chief Executive Officer, is responsible for ensuring the accuracy of classifications on non-performing loans and provisioning per regulatory requirements. The team also manages problem credits and drives recovery efforts across the Bank.

Risk Management at HNB

Risk Governance Structure



Risk Appetite

HNB’s risk appetite can be expressed as the amount of risk the Bank is willing to accept in pursuit of its return objectives. The risk appetite framework is overseen by HNB’s Board and adherence is monitored and controlled by the Risk Management function. Key performance and risk measures are tracked and reported regularly to the Board, the responsible Committees and Corporate Management with escalation at each level depending on the severity of the breach.

The Bank’s risk appetite is monitored quantitatively through risk measures such as prudent risk limits, capital adequacy requirements and stress testing. Qualitatively, monitoring takes place through sound policies, procedures and controls meant to limit risk. The defined risk tolerance limits provide a basis for controlling the

Bank’s business activities. It sets boundaries aligning the Bank’s business strategy with stakeholder expectations.

Managing our Risks

HNB’s risk management philosophy is about focusing on “risk” that matters. The Bank has identified credit, market and operational as its main risk areas. The Bank also monitors liquidity risk on a regular basis. Other risk areas identified and monitored are compliance risk, group risk and business/strategy risk.

Risk Management Processes

HNB’s Risk Management Processes are based on a clear understanding of the various risks the Bank faces, and disciplined assessment, measurement and continuous monitoring in the form of risk dashboards against the predetermined risk appetite approved by its Board.



Credit Risk Management

Credit risk can be defined as the risk of a potential loss to the Bank when a borrower or counterparty is either unable or unwilling to meet its financial obligations.

Granting loans and advances is the core business of HNB and as such credit risk is its most material risk. The credit risk that we face arises primarily from Corporate Banking, SMEs and Retail loans and advances. Given the scale and materiality of the Bank’s loan book, managing the credit quality of the lending portfolio is a key focus area with the objective of minimising probable losses and maintaining credit risk exposure within acceptable parameters. The Bank’s credit portfolio remains well diversified by customer, business segment and sector.

Credit Risk Policy

HNB’s Credit Policy approved by the Bank’s Board of Directors plays a central and strategic role in managing daily business activities. The policy defines the principles encompassing client selection, due diligence, early alert reporting, tolerable levels of concentration risk and

portfolio monitoring, in line with the Bank’s risk appetite. The approach is to avoid large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralisation where feasible.

The policy is reviewed regularly by the Board of Directors and updated throughout the year to ensure consistency with the Bank’s business strategy. A monthly Credit Policy Committee meeting chaired by the Chief Executive Officer drives policy decisions and implementation plans.

Credit System

The Bank’s credit system provides the foundation for an efficient, automated credit appraisal process that allows easy access to details about a given facility. The system is used for Corporate, SME and Retail customer segments across the network. The credit system ensures that a basis for decision making, including case comments, current credit exposure and financial statements are created and stored. Credit exposure is based on real-time information, and a credit file is automatically routed to the appropriate manager or committee level.

Risk Management at HNB

Credit Processes

The Bank's credit processes can be summarised as follows:	
Loan Origination and Risk Appraisal	Screening and appraisal where the evaluation focuses on the borrower's ability to meet its obligations in a timely manner with collateral and guarantees forming an important part of the credit risk mitigation process.
Credit Approval and Sanction	Guidelines for loan approvals / renewals by adopting a committee based approval structure, where all approving signatories carry equal responsibility for credit risk.
Credit Administration and Disbursement	HNB's Corporate Banking loan portfolio is administered through a centralised Credit Administration Division which ensures efficient and effective post sanction customer support including disbursement, settlements, processing renewal notices and advising customers on interest rate amendments.
Credit Risk Measurement Monitoring and Reporting	<p>The Credit Risk Management Division measures and tracks the status of the credit portfolio, undertakes impact studies and detects early warning signals pointing to a deterioration in the financial health of a borrower.</p> <p>A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assess performance against internal limits (board risk appetite) and regulatory requirements.</p> <p>An internally developed Business Intelligence System ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional and bank level.</p> <p>Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.</p>
Recoveries	<p>Problem credits and Non Performing Advances are managed by the Recoveries and Credit Quality Division. The team is responsible for all aspects of an overdue facility, follow up of rescheduled facilities, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalised.</p> <p>This division's activities are seamlessly integrated with Credit Administration and Credit Risk Management to ensure effective follow up.</p> <p>Back Office recovery functions representing non performing advances classification, rescheduling, provisioning and valuation of collateral on delinquent assets centralised to ensure standardisation and accuracy.</p>

Approval Structure

The delegated credit approval structure (seven Committee levels including the Board of Directors) and the associated processes ensure the efficient administration and control of the lending limits given to the Bank's managers and credit officers.

Credit Rating Models

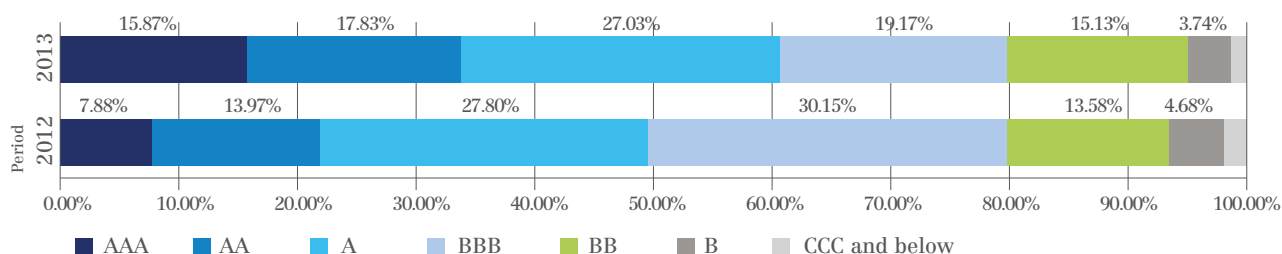
Corporate and SME Rating Models

The Bank uses three credit rating models for large corporates, middle markets and financial and leasing institutions to rate corporate clients and SMEs, focusing on aspects of operating risks, financial risks and account/facility conduct.

For corporates nine rating grades from AAA to C have been defined and for SMEs ten rating grades on a scale of one to ten. A corporate rating of 'AA' implies for example a very high credit worthiness and very low expectation of credit risk. It indicates a very strong capacity for timely payment of financial commitments and is not significantly vulnerable to foreseeable adverse industry and economic conditions. The rating further denotes a high level of professionalism in management and growing financial position.

The quality of the Bank's corporate loan book improved in the investment grade rating categories (AAA to BBB) in 2013. A main area of focus has been the high risk accounts (internally risk rated B and below) which are reviewed by Risk Managers at least quarterly.

Corporate Banking Portfolio based on Internal Risk Rating



Retail Rating Model

Unlike the rating models for Corporate and SME, scoring models for the retail segment were developed using the Bank’s internal portfolio characteristics and the account behaviour observed therein. Some of the significant variables derived for instance for the retail segment home loan model are age, gender, civil status, number of dependents, net worth (assets minus liabilities) and income.

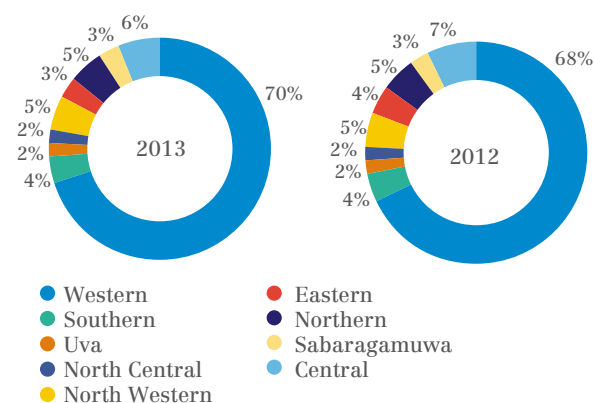
Credit Concentration Risk

Credit concentration risk is the risk of a loss to the Bank as a result of excessive build-up of exposure to a single counterparty or counterparty segment, industry, product or geographical location. This concentration typically exists where a number of counterparties are engaged in similar activities and have similar characteristics, which could result in their inability to meet contractual obligations being similarly affected by changes in economic or environmental conditions. The monitoring of credit concentration is an integral part of the credit risk monitoring process. Methodology based on indexing techniques such as the Herfindahl-Hirschman Index (HHI), analysis of key ratios, internally developed limit models and stress tests are applied to measure and monitor credit concentration in the Bank’s loan portfolio.

To manage industry concentration in its loan portfolio, the Bank has developed a credit model to define limits for the key industries where exposure is high and/or industries where the Bank sees potential for high growth. The model is based on factors involving industry as a percentage of core capital, top 20 customer exposure, industry risk rating and industry exposure relative to country GDP. Regulatory limits for single borrower and selective industry types add another dimension to measuring and monitoring credit concentration risk. The individual industry limits are monitored and reported in the credit risk dashboard.

Furthermore sensitivity analysis on the likelihood of the Bank’s top 20 customers going into default and the impact of these events on the Bank’s capital adequacy ratio (CAR) are assessed and results monitored on a regular basis.

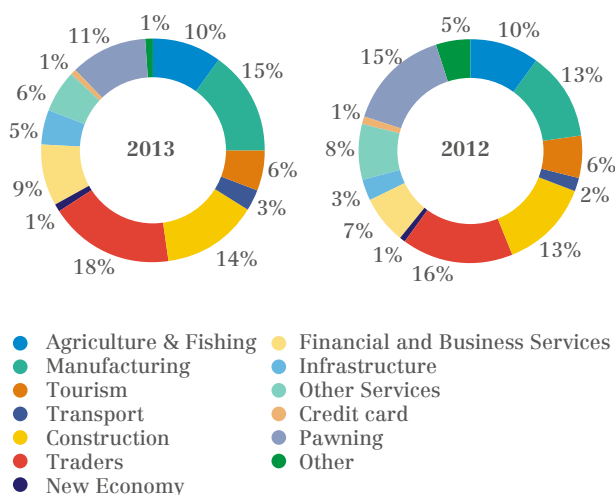
Geographical Concentration



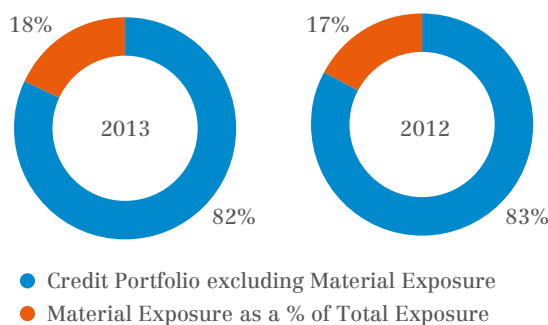
Growth of the credit portfolio in 2013 continued across all provinces broadly in line with 2012, with the highest distribution in the Western Province due mainly to project accounts being booked in Head Office.

Risk Management at HNB

Industry Concentration

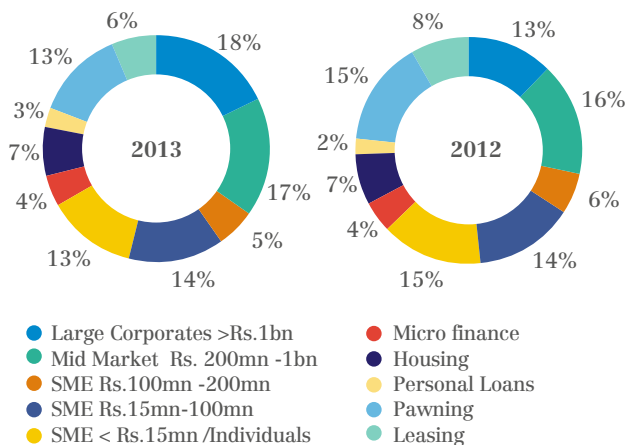


Material Exposure



The material exposure of the loan book increased marginally by 1% in 2013 as compared to 2012.

Exposure by Counterparty



The large Corporates and Mid-Market customer bases have grown in 2013. Pawning and Leasing have seen slight decreases in volumes due to more cautious lending practices and to increases in NPA in these areas.

Credit Risk Mitigation

The Bank uses a range of strategies to actively mitigate credit risk such as netting and set-off, use of collateral and guarantees and risk transfer through insurance. Detailed policies and processes are in place to ensure that credit risk mitigation is appropriately applied and recorded.

Collateral

Collateral is a key factor used by the Bank to mitigate credit risk when granting loans. Collateral can be seen as security provided by borrowers in the form of an asset or third party obligation which helps the Bank to mitigate a possible credit loss in the event of a default. It also ensures a satisfactory degree of protection for depositors' funds which are used for lending activities. While collateral can be an alternative source of repayment, the Bank is aware that accepting security from creditors does not replace the necessity for high quality standards in its credit granting process.

The Bank as a policy calls for collateral/security when granting credit facilities. The amount and type of security taken by the Bank generally depends on the customer's credit risk assessment.

Determination of security is based on the following factors:

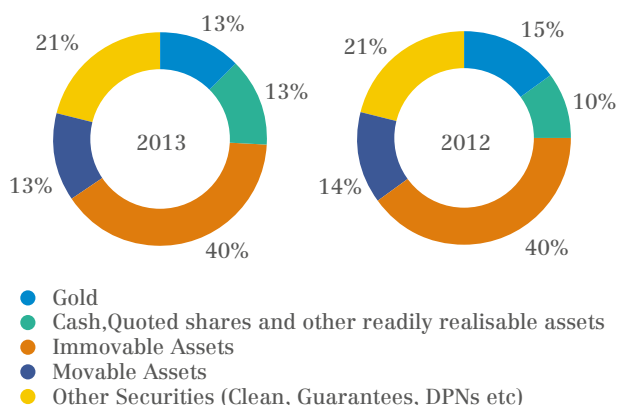
- The ownership and title to the security must be good and mortgageable wherever applicable and should be free of any defects, disputes and other encumbrances.
- Such security must always have a stable minimum value with the required margin of security in favour

of the Bank to support the borrowing during its repayment period.

- The Bank should be in a position to realise such security in the event of default in the manner applicable, without difficulty.

The margin retained on valuation when accepting security will vary according to types of assets taken as security, i.e. for cash deposits held with the Bank it will be 10%, whilst a mortgage over immovable property will be around 35% to 40%. Furthermore guarantees are often required particularly in support of credit facilities granted to a group of companies and weaker counterparties. Creditworthiness is established for the guarantor as part of the credit approval process.

Main Types of Collateral



In 2013, collateral in the form of readily realisable assets increased to 13% as compared to 10% in 2012, reflecting awareness of the long recovery process involved in liquidating certain types of assets. The decrease in gold as collateral to 13% in 2013 from 15% during the previous year can be attributed to a large extent to the steep fall in gold prices during 2013, resulting in a loss in the value of the pawning portfolio where gold acts as collateral.

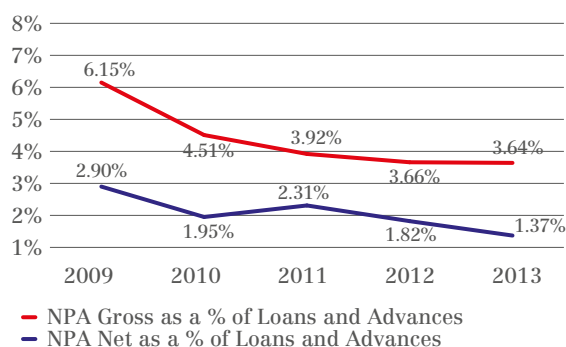
Non Performing Advances (NPA)

Non-performing advances (NPAs) were on the increase in 2013, indicating the existence of vulnerabilities across the domestic financial and banking sector. The steep fall in gold prices during 2013 for example, took many financial institutions by surprise and thus ended the reign of pawning long perceived as a risk-free business model. Credit risk in pawning has as a result come under increased scrutiny and banks have begun to enhance

their internal credit pricing models and risk mitigation processes to deal with the lessons learned.

The increase in NPAs was also felt by HNB, where NPAs increased from Rs.13 Bn in 2012 to Rs.15.4 Bn at the end of 2013. However as a result of the continuous reviewing and monitoring activities undertaken by the BIRMC, a sound credit approval mechanism, measures taken to limit the Bank's exposure to certain areas of business, a proactive watch-listing and good recovery efforts throughout the network, the Bank was able to control NPAs during 2013.

Non Performing Advances 2009 - 2013



Over the past five years, the Bank's gross NPA as a percentage of Loans and Advances has steadily declined from 6.15% in 2009 to a low of 3.64% in 2013. The low NPA ratio was partly due to the growth of the Bank's credit portfolio in 2013, a strengthened risk governance and credit process and also as a result of the strong recovery efforts during the year.

All that glitters is not gold

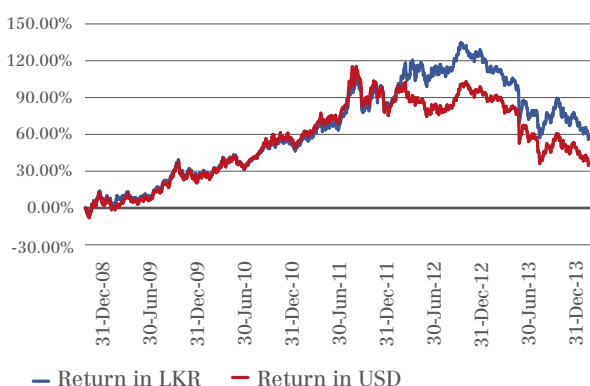
With the steady increase in gold prices, pawning loans in Sri Lanka have grown significantly over the last five years and banks have taken advantage of the zero risk weight (considered near cash) on pawning advances in the calculation of their regulatory capital ratios. HNB's pawning business also experienced steady growth over the past five years with pawning advances growing significantly from Rs.21.92 Bn in 2009 to Rs.45.9 Bn in 2012 and decreasing to Rs.41.56 Bn at the end of 2013.

Banks face several risks when the price of gold falls significantly below the amount at which customers borrowed. When gold prices decline sharply, customers will be less likely to repay their loans and collect their pawned articles whose value may have reduced

Risk Management at HNB

substantially in monetary terms. Banks have to take the risk of a decline in the value of their pawning portfolio and potential increase in non-performing advances (NPAs).

Performance of Gold 2009 - 2013



Since October 2012, the price of gold has been in a downward spiral. The bear market for gold intensified in April 2013, when the price of the yellow metal tumbled by more than 9% in one day, with the year ending on a negative note and the value of gold declining by -28% in USD and -26% in LKR terms, the biggest annual loss in 32 years.

Some of the key factors which were seen to influence gold prices in 2013 were the rise in equity markets (higher returns), an improving macro-economic environment, strengthening of the USD, implementation of the US Federal Reserve's restrictive quantitative easing (QE) programme and the weaker than expected growth rates in China and India.

The constant increase in gold prices over the years until October 2012 highlights the complacency which had set in industry-wide, with many banks underestimating the volatility of gold prices and driven by the necessity to keep up with competition when setting scales for pawning advances.

Following the dramatic fall in international gold prices during the first half of 2013 and estimated 47% year-on-year increase in gold imports to June 2013, the Government of Sri Lanka imposed a higher duty and a customs surcharge on gold imports in June 2013. These measures were adopted to partly stabilize the significant exposure to gold-related lending assumed by the local banking industry. The customs surcharge was subsequently removed and the import duty reduced to 7.5% from 10% towards the end of 2013.

Risk Mitigation

The Bank has a number of prudential risk mitigating measures in place to control the gold price risk. The BIRMC recognising the importance of sound risk management practices, even in good times.

Prudential Measures adopted by the Bank:

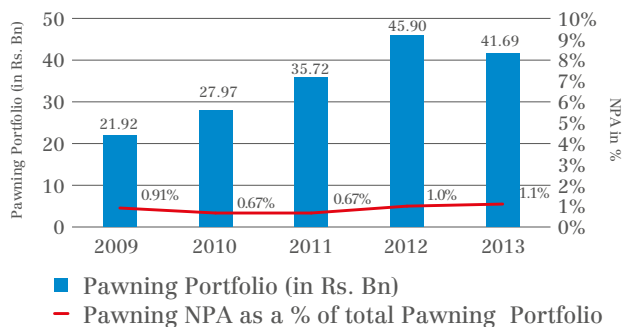
- A finance-to-value limit of maximum 85% of the local average gold value for the preceding three months, allowing for a margin of 15% to compensate for a decline in gold prices and cover other costs. This margin was consequently increased to 30% following the steep fall in gold prices.
- Setting a favourable margin on interest rates charged for pawning advances thereby reducing the impact of falling gold prices to some extent.
- Lending based on a preceding three month average when gold prices were increasing to cushion the impact of volatile price movements and applying the day's price or weekly average price in determining the lending rates when gold prices were on the decline.
- A cap on pawning advances as a percentage of the Bank's total credit portfolio, set at 17.5% in 2012.
- Stress tests carried out to assess the impact of a significant decline in gold prices on the Bank's pawning portfolio.

These measures were further intensified in May 2013. The cap on pawning advances was set lower, re-set to 15% in mid-2013 and a year-end target of 12.5%. Steps were also taken to reduce the scales for pawning significantly to reflect the drop in gold prices and auctioning of gold articles increased. Furthermore key branches were requested to collect data on customer behaviour i.e. redemptions, renewals and NPAs and the monitoring of large individual positions was also recommended in order to avoid significant speculative trades which could go bad.

Impact on HNB's Pawning Portfolio

Due to the risk monitoring and risk mitigating techniques adopted by the Bank, the impact of the significant decline in gold prices to the pawning portfolio during 2013 was under control. With a pawning portfolio valued at Rs. 41.56 Bn as of December 2013, non-performing advances (NPA over 90 days) were 1.1% of total pawning advances.

Pawning Portfolio 2009 -2013



Market Risk Management

Market Risk is the risk that changes in equity, bond and commodity prices, as well as movements in foreign exchange rates and interest rates may adversely affect the Bank’s trading and banking books.

HNB’s Board approves the market risk appetite and related limits for both the banking and the trading portfolios. Treasury Middle Office (TMO) which is part of the independent Risk Management Division reports on market risk and is instrumental in ensuring that the market risk limits are in line with the level of risk acceptable to the Board. TMO keeps track of price movements and other developments in the market that affect the Bank’s risk profile and monitors primarily exchange rate, interest rate and equity price risks. Presently exposure to the Bank’s trading book is only 2% of its banking book given the capital market restrictions and minimal opportunities in the market.

The Bank does not deal in commodities and therefore has no direct commodity risk. However through loans to the Bank’s Corporate and SME customers who may be involved in businesses where commodities such as grain, metal and oil play an important role, the Bank may face counterparty credit risk. Some of the problems these businesses may encounter could be as a result of a significant rise in commodity prices leading to higher costs, the volatility of exchange rates, businesses speculating on movements in commodity prices and political risk.

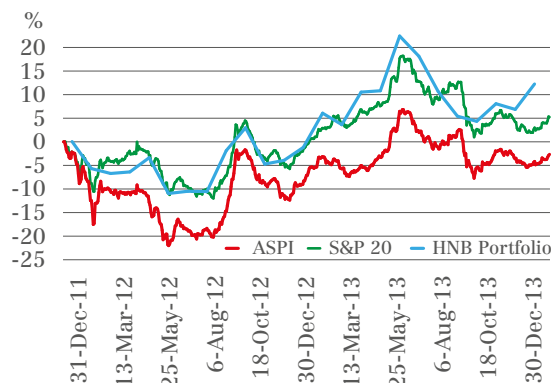
The Bank’s market risk on long term investments is managed in accordance with the purpose and strategic benefits of such investments, rather than purely on mark to-market considerations. Reviews and assessments on the performance of the investments are undertaken regularly by the Bank’s Investment Committee. A Market

Risk Dashboard indicates performance against risk appetite for currency, bond and equity positions of the trading and investment portfolios. Most approved products that can be independently priced and properly processed are permitted to be traded. All limits require prior approval from the ALCO.

Some of the market risk mitigating measures applied by the Bank include, hedging using permissible financial instruments, limiting concentration of exposures, applying stop loss, maximum tenor and dealer limits. The Bank also has a comprehensive Board approved Treasury Policy in place to reflect regulatory and market developments. TMO also independently reviews activities of the Treasury Front Office and adherence to regulatory / internal policy guidelines.

The following graph shows the performance of the Bank’s equity portfolio during the past two years.

Performance of HNB Equity Portfolio and Stock Markets 2012 to 2013



The Bank’s equity portfolio outperformed the equity markets over the last two years (2012 -2013) with a return of 12.51% as compared to the S&P 20 with a performance of 5.24% and the ASPI which recorded a negative return of -2.66% for the same period.

The market risk of both individual financial instruments and portfolios of instruments can be a function of one or several factors and, in many cases, can be significantly complex. Hence the Bank’s decision to implement an ALM system in 2012 to introduce more sophisticated techniques to measure, monitor and control the market risks involved in its trading and banking book activities

With the ALM system, the Bank is able to monitor its foreign exchange position in more detail.

Risk Management at HNB

Foreign Exchange Position as of 31 December 2013

Currency	Spot	Forward		Net Open Position	Net Open Position in Other Exchange Contracts	Overall Exposure in Respective Foreign Currency	Overall Exposure in Rs. '000
	Net	Assets	Liabilities				
USD	(65,624)	219,580	(146,752)	72,828	7,204	-	942,118
GBP	(18,730)	18,850	(75)	18,775	45	-	9,777
EUR	(28,255)	38,453	(10,178)	28,275	20	-	3,543
JPY	(73,084)	121,000	(59,385)	61,615	(11,468)	-	14,284
AUD	(35,451)	35,550	(100)	35,450	(1)	-	63
CAD	73	-	-	-	73	-	8,946
Other Currencies in USD	(1,781)	2,134	(150)	1,984	203	-	27,063
Total Exposure							1,005,794
Total Capital Funds as per the latest Audited Financial Statements (capital base as at 31 December 2013)							53,274,391
Total Exposure as a % of total Capital Funds as per the latest Audited Financial Statements							1.89%

Value-at-Risk Approach

The Bank uses the historical Value-at-Risk (VaR) approach to derive quantitative measures for market risk under normal conditions. VaR measures the expected loss of a financial position over a given holding period for a specific confidence level. Market risk exposures for the Bank's overnight foreign exchange positions and equity portfolio are monitored using VaR methodology. HNB uses a one day, 99% VaR for overnight foreign exchange positions to reflect the 99% probability that the daily loss will not exceed the reported VaR. For equity positions the Bank uses a ten day, 99% VaR measure.

Value at Risk (VaR) Position	Dec-13 Rs.	Dec-12 Rs.
Foreign Currency Risk* (USD net open position)	1,573,561	4,269,048
Equity Risk	15,777,600	39,864,000

* Over 90% of the Bank's foreign currency risk is to the USD.

Although VaR is a valuable guide to risk, the Bank is aware of its limitations such as the use of historical data as a proxy for estimating future events, which may not encompass all potential events, particularly those which are extreme in nature, the assumption that all positions can be liquidated in one or ten days and the use of a 99% confidence level which does not take into account losses that might occur beyond this level of confidence.

Internal Model Approach (IMA)

Capital computations for market risk under Pillar I of the Basel II Accord define two broad approaches, the standardised or internal models approach (IMA). Currently the CBSL has directed banks to adopt the "Standardised Measurement Method" approach for the computation of required capital for market risk. However a roadmap for implementation of the IT infrastructure to enable banks to move to the advance approach (IMA) has also been provided.

The Internal Models Approach (IMA) has several incremental qualitative and quantitative requirements. In order for banks to qualify to use IMA, they will need to develop the market risk charge based on daily value at risk (VaR).

To analyse the position of HNB in the event of adopting IMA, the Bank computed the capital charge for market risk in 2013. Due to the size of the trading portfolio (2% of banking book) and the resulting minimal impact on CAR when using IMA, the Bank will continue to use the standardised approach in computing the market risk charge weighing the consequences of added value and cost effectiveness in implementing IMA.

Market Risk charge under IMA (Trading Book)

Product	IMA Approach Rs. Mn	Current Approach Rs. Mn	Difference Rs. Mn
Foreign Exchange & Gold	106.40	99.17	-7.23
Equity	81.45	32.17	-49.27
Interest Rate Products	32.69	0.10	-32.59
Total	220.53	131.45	-89.09
Capital	53,274	53,274	
Risk Weighted Assets	322,569	322,480	
Capital Adequacy Ratio	16.52%	16.52%	0.005%

Interest Rate Risk (Banking Book)

Interest rate risk in the banking book arises from the structural interest rate risk caused by the differing re-pricing characteristics of banking assets and liabilities.

The Bank is exposed to interest rate risk arising from a fixed rate liability book where re-pricing is slower than the majority of the loan portfolio which is on fixed rates. However, almost the entire deposit base contractually or otherwise can be re-priced within a year which is an additional strength, which serves to reduce our vulnerability to interest rate risks.

Interest rate risk is monitored through regular review of net interest yields by product to ensure interest rate margins and spreads are maintained and also by a revisiting asset and liability pricing to ensure that this is in line with our expectations.

The Bank generates through its ALM system a report which shows the gap between its interest rate sensitive assets (RSA) and interest rate sensitive liabilities (RSL) for the different maturity buckets. This allows the Bank to determine the change in interest income due to a change in interest rates.

While gap analysis is a useful one, the Bank does recognize its limitations for instance option features of deposit instruments and loans are not readily available, interest rate on assets and liabilities do not always move in the same magnitude and speed, re-pricing of investments or funds may roll off at rates significantly different to current rates.

The Bank manages its structural interest rate risks by setting advisory limits for PV01. PV01 is the present value of the impact of a one basis point movement in interest rates for a given risk positions. Considering the interest rate movement patterns in the local market the Bank monitors an interest rate change of 50 basis points (PV50) in both directions.

Treasury Middle Office (TMO) recommends the PV50 limits which are approved by the Bank's Asset & Liability Management Committee (ALCO). These advisory limits are allocated to the Central Funding Unit (CFU) for the risk management of the ALCO Book. ALCO will advise an appropriate risk management decision if this limit is exceeded.

Risk Management at HNB

Interest Rate Sensitivity Analysis for Local and Foreign Currency denominated Assets & Liabilities
as at 31 December 2013 (in Rs. Mn)

	Upto 1 Month	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years	Over 5 Years	Non -Sensitive	Total (Rs.Mn)
Assets and Off Balance Sheet Exposures									
Balances due from Head Office, Affiliates and Own Branches	-	-	-	-	-	-	-	3,012	3,012
Bills of Exchange	1,038	403	139	-	-	-	-	-	1,580
Cash on hand	-	-	-	-	-	-	-	10,835	10,835
Deposits with Central Bank	-	-	-	-	-	-	-	16,366	16,366
Investments (Net of provisions)	16,749	17,395	36,648	18,246	1,669	633	971	-	92,311
Loans and Advances	107,200	32,617	20,255	35,333	46,476	18,776	11,618	-	272,275
Non-Performing Loans	-	-	-	-	2,171	2,875	1,222	9,081	15,348
Net Inter-Branch Transactions	-	-	-	-	-	-	-	3	3
Other Assets	-	-	-	-	-	-	-	10,789	10,789
Overdrafts	20,921	5,239	3,976	29,088	-	-	-	-	59,224
Accrued Interest	-	-	-	-	-	-	-	5,162	5,162
Balances due from Other Banks	1,246	-	-	-	-	-	-	-	1,246
Fixed Assets	-	-	-	-	-	-	-	10,863	10,863
Reverse Repo	6,280	-	-	-	-	-	-	-	6,280
Total	153,436	55,654	61,018	82,666	50,316	22,284	13,811	66,113	505,297
Liabilities and Off Balance Sheet Exposures									
Balances due to Other Banks	7,672	5,264	5,148	4,753	7,193	5,754	287	-	36,071
Bills Payable	1,403	-	-	-	-	-	-	-	1,403
Demand Deposits	-	-	-	-	-	-	-	23,224	23,224
Interest Payable	-	-	-	-	-	-	-	10,995	10,995
Other Liabilities	-	-	-	-	-	-	-	11,785	11,785
Savings Deposits	124,490	-	-	-	-	-	-	-	124,490
Time Deposits	38,506	68,838	40,951	66,414	5,888	4,395	429	3,210	228,631
Bonds Issued	-	300	-	-	-	4,500	4,764	-	9,564
Borrowings	55	237	272	600	2,105	1,652	762	-	5,682
Capital	-	-	-	-	-	-	-	12,830	12,830
Certificates of Deposits	370	855	618	222	191	279	-	-	2,535
Repo	3,452	438	146	74	-	-	-	-	4,110
Reserves	-	-	-	-	-	-	-	33,977	33,977
Total	175,947	75,932	47,136	72,062	15,376	16,580	6,243	96,020	505,297
Period Gap	(22,512)	(20,278)	13,883	10,604	34,939	5,704	7,568		
Cumulative Gap	(22,512)	(42,790)	(28,907)	(18,303)	16,636	22,340	29,908		
RSA/RSL	0.87	0.73	1.29	1.15	3.27	1.34	2.21		

Notes:

- 1) The above figures have been prepared as per SLAS and may differ from SLFRS figures given in the Statement of Financial Position
- 2) Prepared as per requirement given in the Banking Act Direction No 7 of 2011 on "Integrated Risk Management Framework".

Liquidity Risk Management

Liquidity risk arises when the Bank cannot maintain or generate sufficient funds to meet its payment obligations as they fall due or can only do so at a material loss. This can arise when counterparties who provide funding to the Bank withdraw or do not roll over a line of funding or as a result of a general disruption in financial markets which lead to normal liquid assets becoming illiquid.

The main sources of the Bank's funding are capital, core deposits from retail and commercial clients, wholesale deposits and access to borrowed funds from the interbank money market. The Bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position.

HNB manages liquidity risk in accordance with regulatory guidelines and international best practices. A Board approved Liquidity Policy to manage liquidity on a day-to-day basis and a Contingency Funding Plan to deal with crisis situations are in place. Contractual maturity of assets and liabilities, liquidity ratios to include adherence

to regulatory requirements and monthly liquidity forecasts generated from the ALM system are reviewed at ALCO meetings. Furthermore liquidity stress tests are carried out to assess the impact of extreme events.

The Treasury Middle Office (TMO) under the purview of the Head of Risk Management monitors the asset-liability position with oversight and supervision from the ALCO. A monthly liquidity gap is computed for each currency together with the overall gap position. Liquidity gap is based on the expected realisation of the assets and liabilities, which are determined based on contractual maturities as well as behavioural assumptions. The net liquidity position reported for the month is monitored against the pre-set limits which have been approved by the ALCO.

The following table shows the liquidity gap analysis (contractual) for the Bank's foreign currency assets and liabilities.

Liquidity Gap Analysis for Foreign Currency Denominated Assets and Liabilities as at 31 December 2013 (in Mn)

	Upto 1 Month	1-3 Months	3-6 Months	6-12 Months	1-3 Years	3-5 Years	Over 5 Years	Total
Total Assets	21,975	9,807	21,209	10,940	36,510	14,035	4,682	119,158
Total Liabilities	33,954	18,848	16,468	13,545	8,431	16,574	9,542	117,362
Net Liquidity Gap	(11,979)	(9,041)	4,741	(2,605)	28,079	(2,539)	(4,859)	
Cumulative Gap	(11,979)	(21,021)	(16,279)	(18,884)	9,195	6,656	1,796	

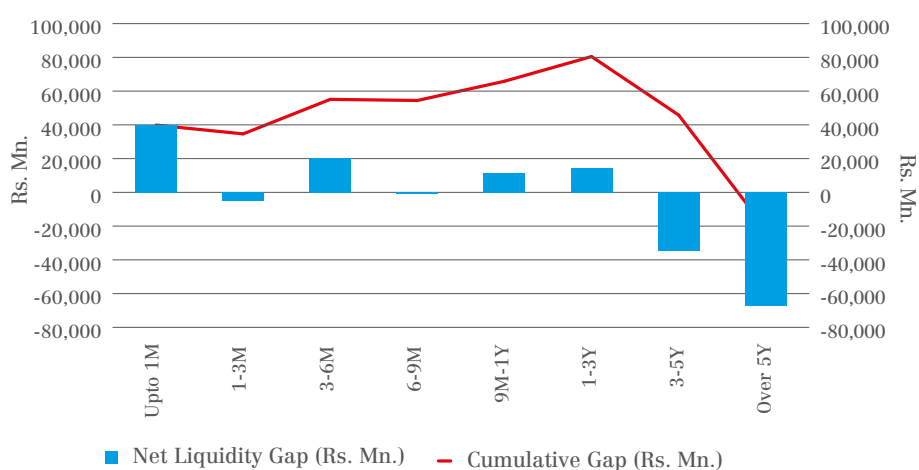
The Bank's loan book is comfortably financed by retail deposits, hence reliance on wholesale deposits and interbank market is low. This is a significant strength as these sources can be availed of during periods of short term liquidity stress. The lack of long term borrowing instruments at affordable cost results in some maturity mismatch in the asset book (borrow short and lend long).

The graph on the following page is based on the behavioural analysis of the Bank's assets and liabilities with the following assumptions:

- Behaviour of fixed deposit rollovers based on historical rollover patterns
- Unutilised overdrafts are assumed to be utilised on straight line basis over a year
- Undisbursed loans to be disbursed 75% within the year and 25% (1-3 years)
- 40% of the pawning advances will be rolled over

Risk Management at HNB

Liquidity Gap based on behavioural analysis



The consolidated liquidity gap for the Bank as at 31st December 2013 based on behavioural analysis shows no significant gap in the short term (up to 1 year). However a maturity mismatch exists in the asset book in the 3-5 Year and over 5 Year maturity brackets.

Liquidity Ratios

The following table includes some of ratios of liquidity risk that the Bank monitors. Limits are applied in order to monitor the liquidity movements in the Bank's assets and liabilities.

Ratios	Limits		Position as of	
			Dec-13	Dec-12
Net Loans/ Total Assets	max	75%	68.61%	67.60%
Gross Loans/ Customer Deposits*	max	90%	96.02%	93.10%
Large Deposits/ Earning Assets	max	10%	7.87%	8.10%
Liquid Assets/ Short Term Liabilities	max	50%	57.11%	59.80%
Purchase funds / Total Assets	max	10%	7.93%	6.30%
Commitments / Total Loans	max	75%	49.93%	54.60%
Statutory Liquid Asset Ratio (LAR)	min	20%	23.32%	22.40%

* The Gross Loans to Customer Deposits ratio is slightly above the set limit. The Bank has covered the loan book by interbank borrowing.

Operational Risk Management

Operational Risk is the risk of losses incurring due to human errors, inadequate or failed internal processes or systems or external events including legal risk. Legal risk arises when the Bank's business is not conducted in accordance with applicable laws, when the Bank may be liable for damages to third parties or when contractual obligations may be enforced against the Bank resulting from legal proceedings.

The objective of the Operational Risk Management (ORM) division is to establish sound control practices to increase the effectiveness of the Bank's resources and minimise financial losses. Operational risk is monitored on a regular basis and the operational risk management policy framework is embedded in the daily activities of all employees.

Working in conjunction with business unit managers, the ORM division has developed tools to assist in identifying, measuring, monitoring and reporting operational risk.

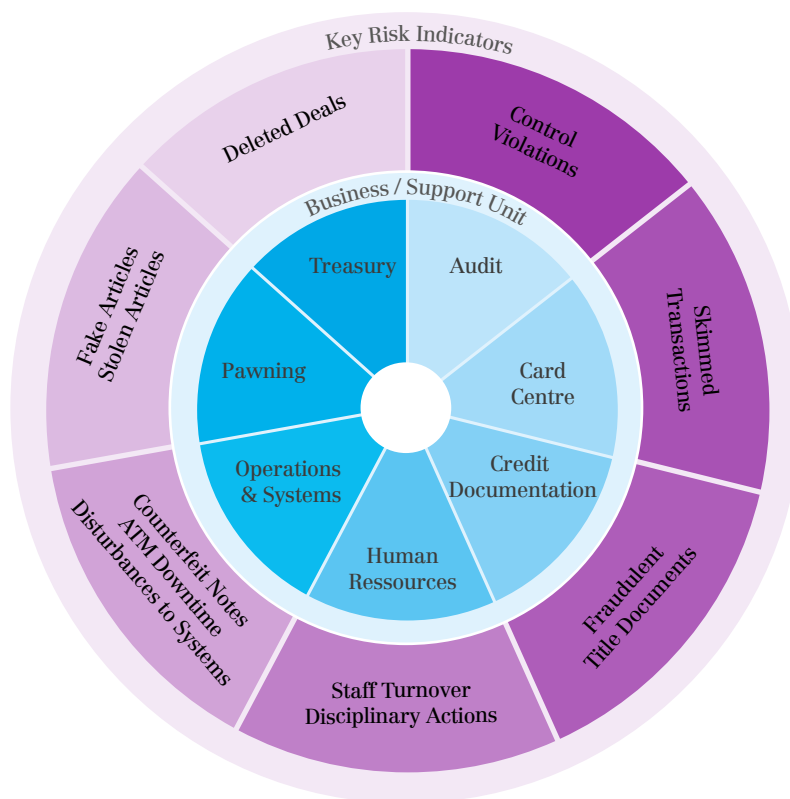
Risk identification techniques include highlights of audit reports, discussions with network management, branch visits and operational risk review meetings conducted across branches.

Key Risk Indicators

HNB has identified a number of Key Risk Indicators (KRIs) for the different business units in order to increase transparency of operations and identify possible sources of risk to the Bank. The information derived from these KRIs act as an early warning signal to identify a potential event that may harm our daily business activities and consequently have an impact on the whole Bank.

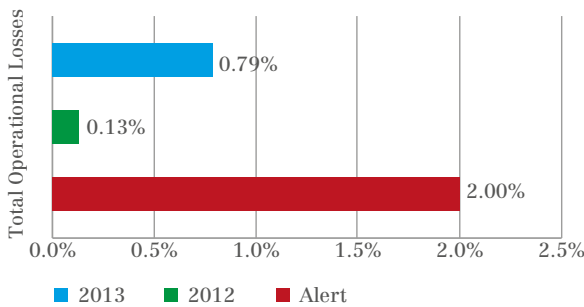
A high level operational risk dashboard is prepared monthly for monitoring purposes and for circulation to Senior Management and the Board. All branch and head office losses over a pre-defined Rupee threshold are reported. Furthermore tolerance limits for operational losses and key risk indicators (KRIs) covering lapses in credit and general operations, cash and pawning, legal, card centre and information systems are monitored.

The KRIs (some of which are given below) contribute to an assessment of the operational risk profile of the Bank. The main purpose is to assist management by providing an early-warning indicator of potential risk exposures and/or a potential breakdown of controls.



Risk Management at HNB

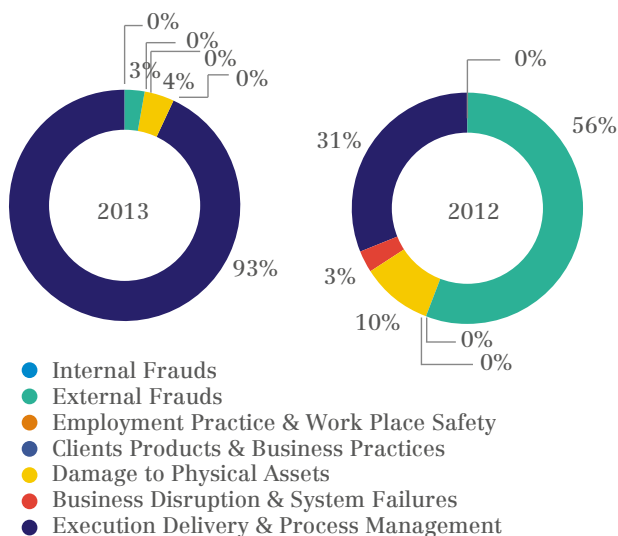
Operational Losses Alert Levels



Performance against internal alert level is tracked monthly. The internal alert level has been defined as 2% of turnover for total losses. Comparison of total losses with the internal alert level over the past two years, show a low level of losses (0.79% in 2013 and 0.13% in 2012) in comparison to actual turnover.

The Bank uses the Basel II defined event types for loss classification and a comprehensive loss tracking database is in place containing over five years of information, analysed by business function and loss incident matrix. Significant loss incidents (above Rs.500,000) are analysed for root causes and lessons learnt. This process includes information on external events occurring in the banking industry to ensure similar incidents do not happen to HNB.

Operational Losses as per Basel II Loss Classification

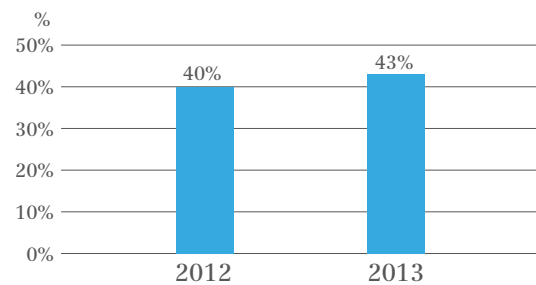


In 2013, 93% of operational losses were attributed to the loss event type “Execution Delivery and Process Management” as compared to 31% in this category in 2012.

Insurance

Insurance continues to be the key risk mitigation tool for Operational Risk. The adequacy and effectiveness of insurance coverage is independently reviewed by the ORM division at least annually. Particular attention is given to low frequency high severity events for example earthquakes and other natural disasters and also to high frequency low impact events such as counterfeit notes, fake and stolen pawning articles. The Bank has also retained market expertise in order to assess and improve the insurance coverage of its risks.

Recoveries through Insurance as a % of Insurance Premiums paid



Collections show a steady improvement as a result of monitoring insurance claims, settlements, rejections and withdrawals on a regular basis. The Bank was able to recover 43% of losses through insurance or other means in 2013.

Risk Mitigation Action

- Review of the Operational Risk Policy during the year and updating it in line with regulatory developments and internal decisions
- Regular meetings with regional management and support functions to ensure effectiveness of Operational Risk Review Meetings across the network and adequate follow up of issues identified for implementation
- Periodic review of information security to ensure data availability, confidentiality and integrity
- System disruptions reviewed during the year through operational KRIs

- Due diligence continued on Mobile Banking where HNB acts as custodian bank to a leading telecommunications company
- Review of insurance adequacy and effectiveness
- Monitoring of legal cases and recovery process

Business Continuity

The Bank has a Business Continuity Plan in order to protect the business functions, assets and employees. Contingency plans for core services, key systems and priority business processes have been developed and are revisited as part of existing management processes to ensure that continuity plans remain relevant. These plans provide each business unit with the necessary guidelines and procedures in case of an emergency.

To address local disaster events, the Bank has established business continuity centres which are capable of carrying out the Bank's major operational activities. Core systems have been tested and at least one test is conducted annually using live data to ensure that the guidelines and procedures are effective. Continuous updates of these plans are performed annually, to ensure that they are kept up to date with changes in systems and business units.

Outsourcing

HNB has a comprehensive Outsourcing Policy and outsourced activities are managed centrally by the Compliance Division.

The Bank carries out a due diligence on potential service providers before entering into a new service agreement or renewing an existing contract. The due diligence process covers the material factors that could impact the potential service provider's ability to perform the business activity and includes assessing expertise and experience, financial and technical abilities, reputation in the industry and if the service provider is an existing one, what has the experience of the Bank been to date.

Other important factors the Bank considers are the service provider's internal control framework, performance standards, technology in place and whether the service provider has an adequate Business Continuity Plan.

Some of the business activities outsourced include archival of documents, ATM cash management and cash transport and selected recovery functions. Details of the activities that have been outsourced, the service providers

contracted and the basis for payment for such services are submitted to the regulator periodically.

Compliance Risk

Compliance risk is the risk of regulatory sanctions, financial loss or loss to reputation that the Bank may suffer as a result of its failure to comply with laws, regulations, code of conduct and standards of good practice applicable to its financial services activities.

HNB conducts its business in accordance with the Bank's code of conduct, laws and regulations imposed by the regulatory authorities with zero tolerance for failure to identify and remedy any breaches of such obligations. Further to the establishment of an independent Compliance Division in 2010 and development of policies and processes, the compliance policy was revisited in 2013 with a broad vision of establishing a better corporate governance and risk mitigating culture within the Bank. An initiative taken during the year to strengthen corporate governance was the establishment of a direct line of communication, with the Bank's Compliance Officer reporting directly to the BIRMC and with a dotted line reporting to MD/CEO on administrative matters.

The Compliance Division continues to support the business in complying with current and emerging regulatory developments, including money laundering and terrorist financing control. One of the key achievements of the Compliance Division during the year was the completion of the project to implement a Anti-Money Laundering (AML) system. Implementation of the AML system facilitates carrying out customer due diligence in a more effective manner, keeping in line with the provision of Financial Transaction Reporting Act No: 6 of 2006.

Risk Management at HNB

Key Initiatives in 2013

Formulation of policies on “Related Party Transactions” and “Politically Exposed Persons (PEP)” and revision of the AML and Compliance policies.

Effective follow up on the supervisory concerns of CBSL audit report and the concerns highlighted in the reports submitted by the Financial Intelligence Unit and Securities Exchange Commission and coordinating with the relevant business units/ process owners to ensure proper and timely remedial action.

Training provided to enhance staff awareness on compliance related areas, with specific focus on Anti-Money Laundering / Combating the Financing of Terrorism concepts / regulations and on application of the AML software.

Proactive on site compliance checks carried out in 24 branches.

Screening of new products for compliance risk prior to approval by the Product Development Committee

Conformity to regulations introduced in 2013

Date issued/ Department	Regulations/Directions/Determinations/Guidelines	Status
01.01.2013 Exchange Control	Securities Investment Account (SIA)	Compliant
01.01.2013 Exchange Control	Foreign Exchange Earners' Account (FEEA)	Compliant
01.01.2013 Exchange Control	External Commercial Borrowing Account (ECBA)	Circular withdrawn by CBSL on 24.01.2013
02.01.2013 International Operations	Limits on Daily Foreign Exchange Position(NOP)	Compliant
02.01.2013 Exchange Control	Forward Sales and Purchases of Foreign Exchange	Compliant
02.01.2013 Exchange Control	Non-resident Foreign Currency Accounts (NRFC)	Compliant
02.01.2013 Exchange Control	Special Foreign Investment Deposit Account (SFIDA)	Compliant
02.01.2013 Exchange Control	Resident Non National Foreign Currency Account (RNNFC)	Compliant
02.01.2013 Exchange Control	Non Resident Non National Foreign Currency Account (NRNFA)	Compliant
23.01.2013 Exchange Control	Inward Investment Account (IIA)	Compliant
24.01.2013 Exchange Control	External Commercial Borrowing Account (ECBA)	Compliant
24.01.2013 Exchange Control	Foreign Exchange Earners' Account (FEEA)	Compliant
28.01.2013 Exchange Control	Commencement of Live Operations of the New Web-Based OIA monitoring system	Compliant
31.01.2013 Exchange Control	Investment in Unit Trusts by Investors Resident outside Sri Lanka	Compliant
11.02.2013 Bank Supervision	Preparation, presentation and publication of Annual Audited Accounts of banks	Compliant
14.02.2013 Public Debt	Appointment of Licensed Commercial Banks as Primary Dealers	Noted
21.02.2013 Exchange Control	Foreign Exchange Earners' Account (FEEA)	Compliant
04.04.2013 Bank Supervision	Banking Act Direction 1 of 2013 on Exposure to Stock Market by Licensed Commercial Banks and Licensed Specialised Banks	Compliant
05.04.2013 Bank Supervision	Definition of liquid assets under section 86 of the Banking act no.30 of 1988, as amended	Compliant

**Conformity to regulations
introduced in 2013**

Date issued/ Department	Regulations/Directions/Determinations/Guidelines	Status
10.04.2013 Public Debt	Guidelines/Procedures to participating Agents on the purchase and sale of treasury bills and treasury bonds issued by the Government of Sri Lanka to foreign investors and non-resident Sri Lankans	Compliant
12.04.2013 Bank Supervision	Banking Act Direction 3 of 2013 Amendments to Directions on Corporate Governance issued to Licensed Commercial Banks in Sri Lanka	Compliant
17.04.2013 Bank Supervision	Exempting Foreign Borrowings of Licensed Commercial Banks from Regulatory Limits	Compliant
22.04.2013 Domestic Operations	Reserve Requirements - Minimum Daily Deposit	Compliant
24.04.2013 Bank Supervision	Amendments to guidelines on the operations of the Investment Fund Account	Compliant
29.04.2013 Exchange Control	Entrepot Trade	Compliant
30.04.2013 Bank Supervision	Mandatory Lending to the Agriculture Sector	Compliant
21.05.2013 Domestic Operations	Use of Repo standing facility when the CBSL offers Reverse Repo Auction	Compliant
04.06.2013 Payment and Settlement	General Direction No.01 of 2013-Operation of Common ATM Switch	Noted
07.06.2013 Bank Supervision	Interest rates on Credit Cards and other loans and advances	Compliant
12.06.2013 Exchange Control	Resident Foreign Currency (RFC) Accounts	Compliant
12.06.2013 Exchange Control	Opening and maintaining of Nostro Accounts by Authorised Dealers	Compliant
12.06.2013 Exchange Control	Issuance of Foreign Currency Notes to Sri Lankans Travelling Abroad	Compliant
12.06.2013 Exchange Control	Non-resident Foreign Currency Accounts (NRFC)	Compliant
12.06.2013 Exchange Control	Sale of Foreign Exchange to Emigrants	Compliant
12.06.2013 Exchange Control	Securities Investment Accounts (SIA)	Compliant
12.06.2013 Exchange Control	Repatriation of sale proceeds of immovable property held by non- residents	Compliant
12.06.2013 Exchange Control	Accommodation to holders of Foreign Exchange Earners Accounts (FEEA)	Compliant
26.06.2013 Domestic Operation	Reserve Requirements	Compliant
03.07.2013 Payment and Settlement	General Direction No.02 of 2013-Fees Chargeable on the transactions effected through the common ATM switch	Noted
24.07.2013 Domestic Operations	Operating Instructions on Open Market Operations of the CBSL in scripless Government Securities	Compliant
26.07.2013 Bank Supervision	Cap on Penal Interest Rates charged by Licensed Banks on Loans and Advances	Compliant
31.07.2013 Bank Supervision	Banking Act Direction No.5 of 2013 on Supervisory Review Process (Pillar 2 of Basel II) for Licensed Commercial Banks and Licensed Specialised Banks	Requirements noted. Work in progress
28.08.2013 Exchange Control	Purchase of Sri Lanka Sovereign Bonds in the secondary market by Licensed Commercial banks appointed as authorised dealers	Compliant
30.08.2013 Domestic Operations	Margin requirements against Letters of Credit for importation of Motor Vehicles	Compliant

Risk Management at HNB

Conformity to regulations introduced in 2013

Date issued/ Department	Regulations/Directions/Determinations/Guidelines	Status
02.09.2013 Public Debt	Direction of the Monetary Board on funds remaining unclaimed in the customer accounts maintained by the Dealer Direct Participants	Compliant
13.09.2013 Currency	Guidelines for Settlement of Discrepancies in currency deposits with CBSL	Compliant
17.09.2013 Bank Supervision	Publication of Financial Statements and other Disclosures on the Websites	Compliant
24.09.2013 Domestic Operations	Margin requirements against Letters of Credit for importation of Motor Vehicles	Compliant
25.09.2013 Payment & Settlement	Transaction through Asian clearing union mechanism	Compliant
21.10.2013 Exchange Control Dept	Re-designation of the Foreign Currency Account maintained by a Foreign Shipping Line/Airline agent as the Foreign Currency Account for an agent of foreign shipping line/airline (FCAASA)	Compliant
21.10.2013 Domestic Operations Dept	Margin requirements against Letters of Credit for importation of Motor Vehicles	Compliant
29.10.2013 Financial Intelligence Unit	Prevention and suppression of terrorism and terrorist financing obligation of reporting institutions	Significantly compliant
08.11.2013 Bank Supervision Dept	Misleading and Unethical Advertisements	Compliant
22.11.2013 Bank Supervision Dept	Introducing of new returns under the web based off-site surveillance system	Compliant
04.12.2013 Bank Supervision Dept	Permitting licensed commercial banks to invest in International Sovereign Bonds issued by the Government of Sri Lanka	Noted
04.12.2013 Bank Supervision Dept	Definition of liquid assets under section 86 of the Banking act no. 30 of 1988	Compliant

Previous Regulations issued which are being followed up towards necessary compliance

Guidelines on Mobile phone based payment system – Bank led mobile payment guideline and custodian based mobile payment services	CDD and identification of suspicious transactions need to be improved / intensified further by Dialog Axiata PLC. We have requested Dialog to improve their due diligence processes to track suspicious transactions more effectively.
Currency Division - Guidelines for detection of counterfeit currency notes	Machines have been ordered and supplied to 191 branches. Action is underway to provide the relevant machines to other branches as well.

Group Risk

Group risk from HNB's perspective can be viewed as the risk of a loss (financial or non-financial) incurred by the Bank through one of its subsidiaries or group entities. Group risks are reviewed by HNB's Board through risk management reports submitted by the Group entities with their representatives making presentations to the Bank's BIRMC at least once a year.

HNB's Group Structure as at 31. Dec. 2013

Company	Group Entity	Country	Holding % of HNB PLC
HNB Assurance PLC	Subsidiary	Sri Lanka	60%
Sithma Development (Pvt) Ltd	Subsidiary	Sri Lanka	100%
Acuity Partners (Pvt) Ltd	Joint Venture	Sri Lanka	50%

- The Bank has a 60% shareholding in HNB Assurance PLC which specialises in Life and General Insurance.
- Sithma Development (Pvt) Ltd, a fully owned Subsidiary of Hatton National Bank PLC was incorporated as a Special Purpose Vehicle (SPV) to put up the landmark HNB Tower building, commissioned in 2003. While being the facilities provider to the HNB tower, Sithma diversified in to condominium development in 2006.
- HNB also has a holding of 50% in the joint venture company Acuity Partners (Pvt) Ltd., which operates as an investment company and provides financial services.

Mitigation of Group Risk

Aggregating the risks of the Group companies remains a challenge due to their diverse business models and risk profiles – real estate/property development, insurance, and investment banking. However the Bank believes group risk is mitigated to a large extent by the following:

- HNB's capital at risk is limited to the amount invested in these companies in the form of equity, at the time the companies were incorporated.
- HNB Assurance PLC, the largest subsidiary by size, is listed, thereby regulated by the SEC and the IBSL as well.
- HNB's Directors / Key Management Personnel are represented on the Board of Directors / Board Audit Committee / Board Risk Committees of its subsidiaries, thereby ensuring full and sufficient knowledge of subsidiaries' operations and risk profiles.
- HNB Assurance PLC's Board Risk Committee is chaired by the Banks' COO.
- All inter-company transactions are at arms-length and full disclosure of such transactions is made.
- The Bank is the holding company and owns the largest balance sheet i.e. over 90% of total assets and liabilities of the Group.

Business/Strategy Risk

Business/Strategy risk can be seen as the impact on a company's earnings or capital, due to poor business policy decisions, improper implementation of business strategies or lack of responsiveness to industry changes. This type of risk is a function of the compatibility of a bank's strategic objectives, business decisions developed to achieve these goals, resources deployed and the quality of implementation.

In pursuing its strategic goals and business objectives, HNB has established clear communication channels at all levels of the organisation, allocated resources for operating systems and delivery networks and increased managerial capacities and capabilities.

A formal framework was introduced to assess strategic risks arising from market trends / developments in competition, product, channel, process, human resources and technology. Specific risks are identified, impact on HNB's business plans assessed and mitigating actions reviewed periodically. A business/strategic risk template was developed for this purpose and is part of the input in the strategic management process.

Risk Management at HNB

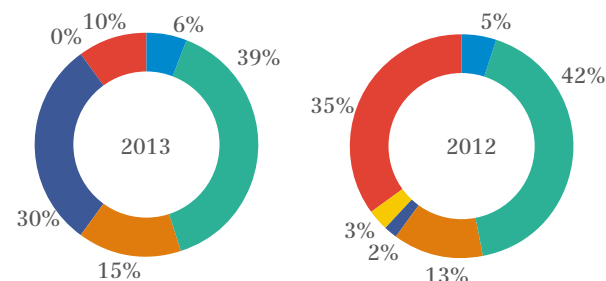
Reputational Risk

Reputational risk results from damage to the Bank’s image among stakeholders due to negative publicity regarding the Bank’s business practices or management, and whether true or false, it can result in a loss of revenue or decline in shareholder confidence. The reputation of a company can be perceived as an intangible asset similar to goodwill.

HNB considers reputational risk as a consequence of a failure to manage its key risks. The Bank is therefore committed to managing reputational risk by promoting strong corporate governance and risk management practices at all levels of the organisation, by understanding how different aspects of its business activities affect stakeholders’ perception of the organisation, through effective communication in the form of timely and accurate financial reports and news bulletins, by maintaining strong media presence, valuable client service and investor relationships and by complying effectively with current laws and regulations.

The Bank also recognises the importance of making a positive contribution to society by promoting corporate social responsibility (CSR) through ethical banking practices, environmental awareness and a commitment to the local community.

In 2013, the Bank’s Corporate Social Responsibility (CSR) budget allocation was concentrated in the areas of Assistance to Cancer Patients (39%) and Health & Related Assistance (30%).



- National Trust – Sri Lanka
- Assistance to Cancer Patients
- Climate Change
- Health & Related Assistance
- Safe Drinking Water & Sanitation
- School Libraries and Computer Centres

Stress Testing

Formulated under the Integrated Risk Management (IRM) framework and supported by the implementation of the Internal Capital Adequacy Assessment Process (ICAAP), HNB’s stress testing framework has continuously evolved in depth and coverage. The focus being to assess how the Bank’s portfolios would react if business conditions deteriorated significantly and the consequent impact of these risk scenarios on our capital base. Stress testing may reveal a reduction in surplus capital or a shortfall in capital under specific scenarios. This may then serve as a leading indicator to the Bank to follow different avenues such as raise additional capital, reduce capital outflows/ increase capital inflows or adjust the Bank’s risk appetite.

With its stress testing initiatives, the Bank hopes to support a number of value-added business processes such as the assessment of potential changes in the risk profile of the Bank, capital planning and management, and strengthening communication with internal and external stakeholders. The Bank’s Stress Testing Policy is updated regularly and reviewed at least annually by the BIRMC. The appropriateness of the stress scenarios and the severity of the relevant scenarios are also reviewed and recommendations made by the BIRMC for appropriate follow-up action.

Stress Testing Methodology and Results

The Bank uses a number of sensitivity tests to measure the impact on the value of its portfolios due to extreme market movements, applying low, moderate and high impact shocks on hypothetical scenarios. Management reviews the outcomes of the stress tests and where necessary, determines appropriate mitigating actions such as limiting exposures or reviewing and changing risk limits in order to manage the risks induced by potential stresses. Stress tests scenarios are recommended by TMO and approved by ALCO.

The Bank has implemented stress tests to measure the resilience of its lending and pawning portfolios to adverse movements in NPAs.

Credit Risk Scenarios

	Magnitude of shock	50%	80%	100%
	Original CAR	CAR after Change		
1) A negative shift in NPA categories on the Bank's credit portfolio *	16.52%	16.27%	16.12%	16.02%
	Magnitude of shock	5%	10%	20%
	Original CAR	CAR after Change		
2) Increase in NPAs in the loan book	16.52%	16.32%	16.12%	15.72%
3) Increase in NPAs in the pawning portfolio**		16.36%	16.14%	15.59%
4) Top 20 Customer default scenario***		15.27%	13.99%	11.30%
	Magnitude of shock	10%	20%	40%
	Original CAR	CAR after Change		
5) Negative shift in NPAs due to fall in FSV of mortgaged collateral in credit portfolio	16.52%	16.33%	16.14%	15.75%

Notes for Credit Risk:

* Composition of NPA categories: Special Mention 14%, Substandard 19%, Doubtful 8% and Loss 59%.

** Impact of a reduction in gold prices and increase in NPAs on pawning portfolio

*** Impact of top 20 customers falling into NPA (based on outstandings)

Losses arising from operational risks are stressed to assess the impact on internal loss tolerance limits.

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

Market Risk Scenarios

Foreign Currency Risk	Magnitude of shock	5%	10%	15%
	Original CAR	CAR after Change		
1) All foreign currencies	16.52%	16.52%	16.52%	16.51%
2) USD/LKR		16.52%	16.52%	16.51%
Equity Risk	Magnitude of shock	10%	20%	40%
	Original CAR	CAR after Change		
1) Equity Prices	16.52%	16.52%	16.51%	16.50%
Fixed Income Risk	Magnitude of shock	1%	2%	5%
	Original CAR	CAR after Change		
1) Fixed Income Total Portfolio	16.52%	16.28%	16.04%	15.31%
2) Fixed Income Trading Portfolio		16.52%	16.52%	16.52%

The Bank also applies stress tests on interest rates to determine the impact of interest rate changes on net interest income.

Interest Rate Risk	Interest Rate shock	-1%	-2%	1%	2%
		Net interest income change			
1) Effect on Net Interest income (1 year horizon)		-2.61%	-5.22%	-2.61%	-5.23%

Risk Management at HNB

Stress tests are also carried out to measure the resilience of the Bank’s portfolios to a drop in liquidity. This also involved a liquidity stress simulation over a period of three consecutive days to assess the tolerance level of the Bank to a liquidity crisis.

The Bank believes that such a severe liquidity crisis event could be triggered off by any one or more of the following events taking place.

- Loss of reputation due to rumours of a large loss, fraud, management misdemeanour etc.
- Severe rating downgrade (3-4 notches or to below investment grade)
- News/Speculation of an impending takeover / merger.
- Large regulatory penalty / qualification of accounts by Auditors/ other compliance related loss of reputation.

As per the Bank’s Contingency Funding Plan (CFP), trigger points of impending liquidity stress scenarios will be monitored by Treasury Middle Office with relevant Business Units and Management will be immediately alerted to activate the CFP.

Staying ahead of the Risk Curve

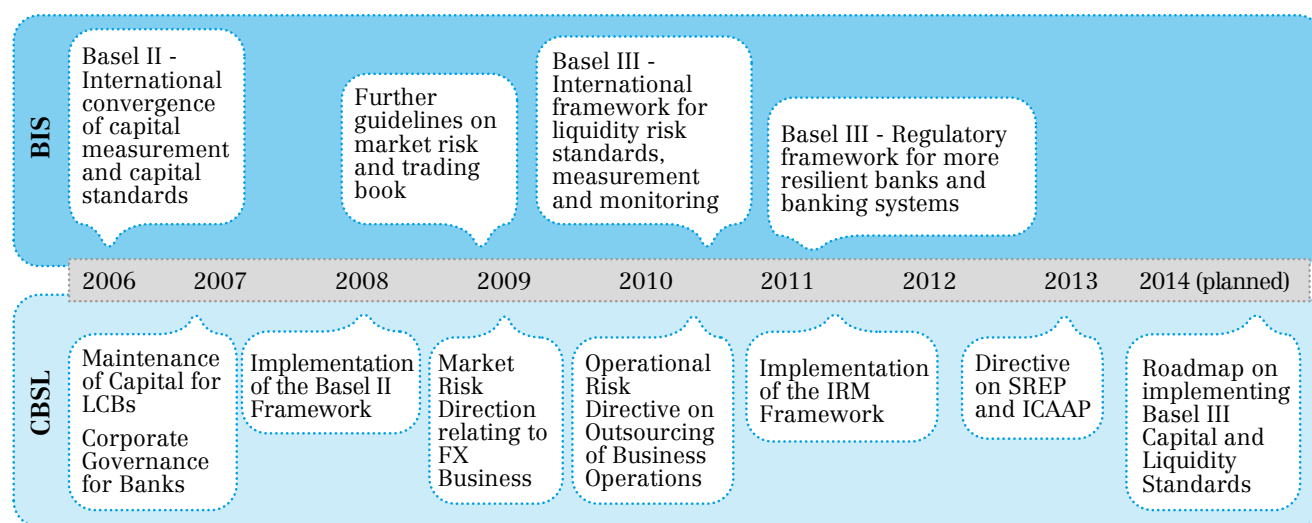
The Central Bank of Sri Lanka (CBSL) has always regarded a sound risk management framework as

fundamental to the prudential management of its Banks and since 2008 the Basel II framework has been embedded in its supervisory and prudential guidelines and standards.

Prudential standards have become more and more comprehensive, calling for banks in 2011 to have an Integrated Risk Management (IRM) framework. This was followed by the formalisation of Pillar 2 of the Basel II framework in 2013, which covers the Supervisory Review Process (SREP) and the Internal Capital Adequacy Assessment Process (ICAAP) which requires banks to link their risk management processes to the management of capital.

Further regulatory developments in the pipeline are the development of a stress testing framework, standards to regulate the exposure of the banking system to asset markets and other potential economic shocks and concentrations and also the implementation of the Basel III framework which will require banks to not only maintain additional capital buffers as a precautionary measure but also to ensure minimum liquidity standards aimed at promoting a better management of their short term and long term liquidity.

Basel Standards internationally and in Sri Lanka



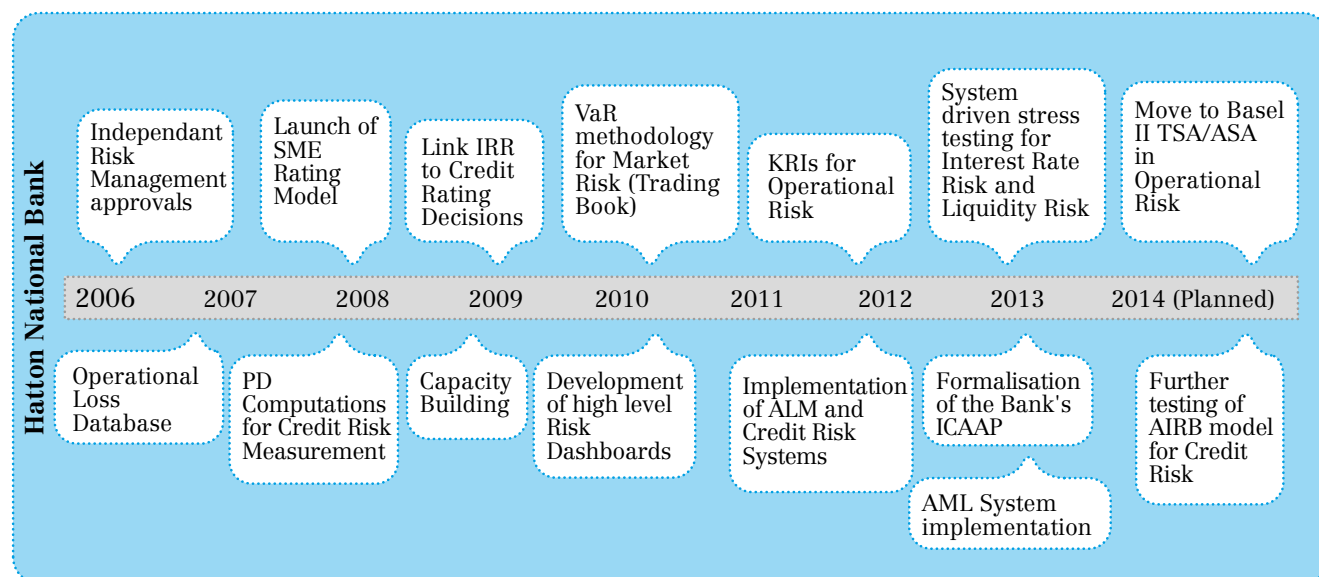
(Timeline reported from 2006 onwards)

FX: Foreign Exchange ICAAP: Internal Capital Adequacy Assessment Process IRM: Integrated Risk Management LCB: Licensed Commercial Banks SREP: Supervisory Review and Evaluation Process

HNB is confident that it is able to identify, measure and monitor its material risks. Progress has been made on a number of fronts in respect of assessing the Pillar 2 risks (Basel II), such as developing a risk template for strategic/business risk, increased awareness of reputational risk, surveillance of the Bank's group entities to assess group risk, system-driven maturity gap analysis and stress testing for liquidity risk and interest rate risk, development of a risk matrix and implementation of an anti-money laundering system to better address compliance risk.

Planned activities for the coming year in operational risk are the development of thresholds for key risk indicators (KRIs) and computation of an operational value at risk (OpVaR). An Internal Risk Rating based pricing model is currently being developed for the Bank's credit portfolio in order to capture factors such as tenor of loan, probability of default (PD) and loss given default (LGD). Scenario analysis for all risk categories will also be intensified in 2014.

Key steps taken by HNB to meet Regulatory Developments



(Timeline reported from 2006 onwards)

AIRB: Advanced Internal Rating Based ALM: Asset & Liability Management AML: Anti Money Laundering ICAAP: Internal Capital Adequacy Assessment Process IRR: Internal Risk Ratings KRI: Key Risk Indicator PD: Probability of Default SME: Small & Medium Enterprises TSA/ASA: The Standardised Approach / Alternative Standardised Approach

All figures in the risk management section have been prepared as per SLAS unless otherwise stated and may differ from SLFRS figures. For more details on Risk Management please refer to the Financial Risk Management section on pages 285 to 300.

Your Board Room Governance Report...

Chairperson's Statement

Corporate Governance is a strategic priority at Hatton National Bank and is integrated into the business process. Good governance is part of our business philosophy and is voluntarily adhered across the management hierarchy & drives sustainability, and provides a framework that is conducive to carrying out business based on the highest professional standards and ethics.

The Board of Directors delegates authority to the Corporate Management personnel through MD / CEO and codified in the policies and procedures that outline the business process. These policies and procedures aid management in providing oversight and ensuring compliance and are subject to review on a periodic basis.

The Governance framework brings in transparency and accountability not only to satisfy relevant regulatory requirements but also to show openness of the Bank to our stakeholders and the public. We at HNB, consider it as an investment in ensuring that our business model is made safe and secure driving stability over the long term. Within this framework we uphold honesty and integrity at all times because our relationships and value propositions have been built and designed on trust. We have earned unbroken trust of generations and that indicates the importance we place on Governance and ethical conduct.

The Governance framework of the Bank is holistic in its approach in ensuring that our strategies are aligned and within our core values throughout the execution process. It ensures that the business process is supported by effective and robust controls that drive the business in a systematic manner to deliver value and is also applied to how performance is measured, evaluated and rewarded.

The report below demonstrates how the Bank has embraced and complied with the Corporate Governance regulations issued under the Banking Act Direction No 11 of 2007 and subsequent amendments thereto for Licensed Commercial Banks in Sri Lanka by the Central Bank of Sri Lanka, and the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) in 2013 (the Code).

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

It is imperative that Shareholders exercise their rights with a duty of care in order that the embedded value of the Governance frameworks is derived when governing structures are adhered to on a consistent basis and applied prudently. I trust that this report will provide you with the required insight to understand better, how Corporate Governance is effected and complied with at Hatton National Bank PLC.



Ranee Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2014

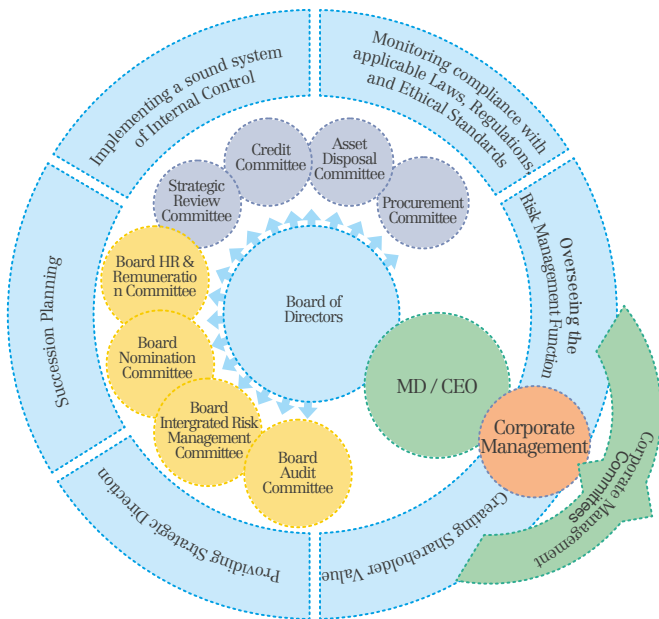
Corporate Governance Initiatives During 2013 at a Glance

January	<ul style="list-style-type: none"> Changes were made to the Corporate Management structure and reporting lines in pursuance of the Bank's Strategic Plan.
April	<ul style="list-style-type: none"> Mr N G Wickremeratne was appointed as the Senior Director.
May	<ul style="list-style-type: none"> Appointment of Mr Jonathan Alles as the Acting Chief Executive Officer and an Executive Director Appointment of Mr D P N Rodrigo as the Chief Operating Officer Appointment of Ms M A R C Cooray as the Senior Director following the resignation of Mr N G Wickremeratne from the Board. Re composition of Board Sub committees to optimise contribution from Directors. Review of the Audit Committee Charter and approval of amendments.
July	<ul style="list-style-type: none"> Mr Jonathan Alles assumed responsibilities as the Chief Executive Officer / Managing Director following the resignation of Mr Rajendra Theagarajah, upon reaching the age of retirement. A Remuneration Policy for the Board of Directors was approved by the Board. A formal procedure to appoint MD / CEO , KMPs and Directors of HNB was approved by the Board.
September	<ul style="list-style-type: none"> A formal terms of reference for the Senior Director was approved by the Board.

Corporate Governance Framework

Good Corporate Governance practices are not just a matter for the Board but are at the heart of everything that we do within the Bank.

The Bank operates within an integrated Governance framework formulated after taking into consideration the Corporate Governance regulation issued by the Central Bank and Corporate Governance best practice issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), which is outlined in the diagram below and set out in the report that follows;



Corporate Governance

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

values and rewards exemplary ethical standards, personal and corporate integrity and mutual respect.

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

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

HNB has incorporated in its Governance Framework and the guidelines prescribed in the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka and the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

The extent of compliance by HNB for the year ended 31st December 2013 with the above rules, directive principles and best practices are given in the following sections:

The Compliance with CSE listing rules on Corporate Governance, has not been disclosed as Listed Banks are exempted from complying with the said rules from 2010 onwards. This is because such a requirement has been adequately covered in the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka.

Your Board Room Governance Report...

SECTION ONE

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

Statement of Compliance

The disclosures below reflect HNB's level of conformance with the above Code which comprises of seven (7) fundamental principles. These are namely:

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

The structures in place, the conformance with the requirement and expectations of the said Code are tabulated below under the said seven fundamental principles.

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
A. DIRECTORS			
A.1. The Board			
The Bank should be headed by a Board, which should direct, lead and control the Bank			
<i>All Directors with the exception of the MD / CEO serve the Bank in a Non Executive capacity. The Board consists of professionals in the fields of Banking, Accounting, Management, Law, Economics, Engineering, Marketing and Business. All Directors possess the skills, experience and knowledge complemented with a high sense of integrity and independent judgment. The Board gives leadership in setting the strategic direction and establishing a sound control framework for the successful functioning of the Bank. The Board's composition reflects sound balance of independence and anchors shareholder commitment.</i>			
1. Board Meetings	A.1.1	Adopted	<p>The Board usually meets on monthly intervals, but meets more frequently whenever it is necessary.</p> <p>The Board met seventeen (17) times during the year. Scheduled Board and Committee meetings were arranged well in advance and all Directors were expected to attend each Board meeting. Any instance of non-attendance at Board meetings were generally related to prior business, personal commitments or illness.</p> <p>The attendance at Board meetings held in 2013 is set out on page 149.</p>

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013																																							
			<p>Attendance at Board meetings during 2013</p> <table border="1"> <caption>Attendance at Board meetings during 2013</caption> <thead> <tr> <th>Meeting No.</th> <th>Meetings attended</th> <th>Meetings not attended</th> </tr> </thead> <tbody> <tr><td>1</td><td>17</td><td>0</td></tr> <tr><td>2</td><td>8</td><td>4</td></tr> <tr><td>3</td><td>8</td><td>1</td></tr> <tr><td>4</td><td>5</td><td>0</td></tr> <tr><td>5</td><td>9</td><td>0</td></tr> <tr><td>6</td><td>13</td><td>4</td></tr> <tr><td>7</td><td>12</td><td>5</td></tr> <tr><td>8</td><td>17</td><td>0</td></tr> <tr><td>9</td><td>15</td><td>2</td></tr> <tr><td>10</td><td>17</td><td>0</td></tr> <tr><td>11</td><td>15</td><td>2</td></tr> <tr><td>12</td><td>13</td><td>4</td></tr> </tbody> </table> <p>Note: Ms Pamela C. Cooray resigned from the Board w.e.f. 31st March 2013, having served the Board for nine (9) years. Mr N G Wickremeratne resigned from the Board w.e.f. 16th May 2013. Mr Rajendra Theagarajah resigned from the Board w.e.f. 30th June 2013, upon reaching the age of retirement. Mr Jonathan Alles was appointed to the Board w.e.f. 01st May 2013.</p>	Meeting No.	Meetings attended	Meetings not attended	1	17	0	2	8	4	3	8	1	4	5	0	5	9	0	6	13	4	7	12	5	8	17	0	9	15	2	10	17	0	11	15	2	12	13	4
Meeting No.	Meetings attended	Meetings not attended																																								
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2. Board Responsibilities	A.1.2	Adopted	<p>The Board Charter sets out the responsibility of the Board.</p> <p>The Board is responsible to the shareholders for creating and delivering long term sustainable shareholder value through the oversight of business.</p> <p>The Board has provided strategic direction to the development of short, medium and long term strategy which is aimed at promoting the long term success of the Bank. The business strategy is reviewed at least on a quarterly basis by the Board with updates at each Board meeting on execution of the agreed strategy by the management.</p> <p>The Board has put in place a Corporate Management team led by the MD / CEO with the required skills, experience and knowledge necessary to implement the business strategy of the Bank. The names and the qualifications of the Corporate Management team are provided on pages 26 to 29. The Board has also implemented a structured approach towards succession planning of the Corporate Management and Senior Management team during the past couple of years, the most significant being the appointment of the Chief Operating Officer in May 2013. During the early part of 2013, changes were made to the Corporate and Senior Management structure and reporting lines as part of Banks' strategy on succession planning.</p> <p>The Board recognises its' responsibility for the Bank's system of internal control and for reviewing its effectiveness on a continuous basis. These systems manage the risk of the Bank's business and ensure that the financial information on which business decisions are made and published is reliable. It also ensures that the Bank's assets are safeguarded against unauthorised use or disposition.</p> <p>The Board is satisfied with the integrity of financial information and the robustness of the financial controls and systems of risk management of the Bank.</p>																																							

Your Board Room

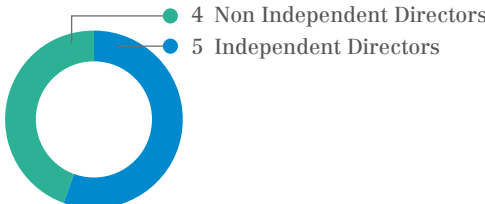
Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
3. Compliance with laws and access to independent professional advice	A.1.3	Adopted	<p>The Board collectively as well the Directors individually, recognize their duty to comply with laws of the country which are applicable to the Bank. The Board of Directors ensures that procedures and processes are in place to ensure that the Bank complies with all applicable laws and regulations.</p> <p>A procedure has been put in place for Directors to seek independent professional advice, in furtherance of their duties, at the Bank's expense. This will be coordinated through the Board Secretary, as and when it is requested.</p>
4. Board Secretary	A.1.4	Adopted	<p>All Directors have access to the Board Secretary, who is an Attorney-at-Law by profession.</p> <p>Her services were available to all Directors, particularly the Non Executive Directors who needed additional support to ensure they receive timely and accurate information to fulfil their duties. The Board secretary had provided the Board with support and advice relating to corporate governance matters, Board procedures and applicable rules and regulations during the year. Further, she assisted the Chairperson and MD / CEO in determining the annual Board plan.</p>
5. Independent judgment	A. 1.5	Adopted	<p>Non Executive Directors are responsible for bringing independent and objective judgment, and scrutinizing the recommendations/ proposals made by the Corporate Management led by the MD / CEO, on issues of strategy, performance, resources utilisation and business conduct. The Board promotes an environment whereby challenging contribution from the Non Executive Directors is welcomed and encouraged, combined with full support for and empowerment of the MD / CEO in implementing decisions.</p>
6. Dedication of adequate time and effort by the Board and Board Committees	A.1.6	Adopted	<p>The Chairperson and members of the Board have dedicated adequate time for the fulfilment of their duties as Directors of the Bank. In addition to attending Board meetings, they have attended Sub-committee meetings and also have contributed to decision making via circular resolution where necessary. The Board Sub-committees include:</p> <ul style="list-style-type: none"> - Audit Committee - Board Integrated Risk Management Committee - Human Resources & Remuneration Committee - Nomination Committee - Credit Committee - Procurement Committee - Asset Disposal Committee - Strategic Review Committee <p>Further, as and when it was required the Board appointed special Sub-committees to look into specific matters.</p>
7. Training for Directors	A.1.7	Adopted	<p>The Board of Directors recognises the need for continuous training and expansion of knowledge and undertakes such professional development as they consider necessary in assisting them to carry out their duties as Directors.</p>

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013												
			<p>The Directors have attended the following programmes during the year.</p> <table border="1" data-bbox="703 607 1474 936"> <thead> <tr> <th data-bbox="703 607 1070 645">Programme</th> <th data-bbox="1075 607 1474 645">Conducted by</th> </tr> </thead> <tbody> <tr> <td data-bbox="703 651 1070 719">Company law Obligations of Directors in a Listed Company</td> <td data-bbox="1075 651 1474 719">Securities and Exchange Commission of Sri Lanka</td> </tr> <tr> <td data-bbox="703 725 1070 757">Technical Session</td> <td data-bbox="1075 725 1474 757">Central Bank of Sri Lanka</td> </tr> <tr> <td data-bbox="703 763 1070 824">Developing a new Governance Culture</td> <td data-bbox="1075 763 1474 824">Sri Lanka Institute of Directors</td> </tr> <tr> <td data-bbox="703 831 1070 898">Presentation on "Directors & Officers' Liability Policy"</td> <td data-bbox="1075 831 1474 898">Finlay Insurance Brokers (Pvt) Ltd</td> </tr> <tr> <td data-bbox="703 904 1070 936">The Bank Directors' Symposium</td> <td data-bbox="1075 904 1474 936">Central Bank of Sri Lanka</td> </tr> </tbody> </table>	Programme	Conducted by	Company law Obligations of Directors in a Listed Company	Securities and Exchange Commission of Sri Lanka	Technical Session	Central Bank of Sri Lanka	Developing a new Governance Culture	Sri Lanka Institute of Directors	Presentation on "Directors & Officers' Liability Policy"	Finlay Insurance Brokers (Pvt) Ltd	The Bank Directors' Symposium	Central Bank of Sri Lanka
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Presentation on "Directors & Officers' Liability Policy"	Finlay Insurance Brokers (Pvt) Ltd														
The Bank Directors' Symposium	Central Bank of Sri Lanka														
A.2. Chairperson and Chief Executive Officer															
<p>There should be a clear division of responsibilities between the Chairperson and Chief Executive to ensure a balance of power and authority, in such a way that any individual has no unfettered powers of decisions.</p>															
<p><i>The roles of the Chairperson and Chief Executive Officer are segregated at HNB. The Chairperson's main responsibility is to lead, direct and manage the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. MD / CEO is responsible for the day-to-day operations of the Bank.</i></p>															
8. Division of responsibilities of the Chairperson and MD / CEO	A.2.1	Adopted	<p>The roles of the Chairperson and Chief Executive are separate. The role of the Chief Executive is to manage the day-to-day running of the Bank. The Board has delegated this responsibility to the Chief Executive and he then leads the Corporate Management team in making and executing operational decisions. The Chief Executive is also responsible for recommending strategy to the Board.</p>												
A.3. Chairperson's Role															
<p>The Chairperson should lead and manage the Board, ensuring that it discharges its legal and regulatory responsibilities effectively and fully and preserves order and facilitates the effective discharge of the Board function.</p>															
<p><i>The profile of the Chairperson is given on page 22.</i></p>															
9. Role of the Chairperson	A.3.1	Adopted	<p>The Chairperson is responsible for leadership of the Board and ensuring effectiveness in all aspects of its role. The Chairperson of HNB is a Non Executive Director, elected by the Board. The Chairperson's role encompasses:</p> <ul style="list-style-type: none"> - Ensuring that the new Board members are given appropriate induction, covering terms of appointment, duties and responsibilities. - Leading the Board and managing the business of the Board while taking full account of the issues and concerns of the Board. - Approving the agenda for each meeting prepared by the Board Secretary. - Ensuring that the Board members receive accurate, timely and clear information, in particular about the Bank's performance to enable the Board to take sound decisions, monitor efficiently and provide advice to promote success of the Bank. - Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate include the individual and collective views of the Directors. 												

Your Board Room Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
			<ul style="list-style-type: none"> - Facilitates and encourages discussions amongst all Directors where decisions are needed on matters of risk and strategy. - Encouraging effective participation of all Directors in the decision making process to optimise contribution. - Representing the views of the Board to the public. - Initiates the process for self assessment of the Board from its members and uses the meaningful feedback to further improve the effectiveness of the Board.
A.4. Financial Acumen			
<p>The Board should ensure the availability within it of those with sufficient financial acumen and knowledge to offer guidance on matters of finance.</p> <p><i>The Board is equipped with members having sufficient financial acumen and knowledge.</i></p>			
10. Availability of sufficient financial acumen and knowledge	A.4	Adopted	<p>All Directors possess financial acumen and knowledge through the experience gained from leading large private and public enterprises coupled with their academic and professional background.</p> <p>The details of their qualifications and experience have been set out on pages 20 to 25.</p>
A.5. Board Balance			
<p>There should be balance of Executive and Non Executive Directors so that no individual or small group of individuals can dominate the Board's decision-taking.</p> <p><i>All Directors are Non Executive Directors except for the MD / CEO. Each of them bring to the Board, wide experience and the ability to exercise independence and judgment when taking informed decisions.</i></p>			
11. Presence of Non Executive Directors	A.5.1	Adopted	<p>All Directors are Non Executive Directors except for the MD / CEO.</p> <p>The requirement as per the Code has been complied with throughout 2013.</p> <p>Executive Vs Non Executive Directors</p> <p>● 1 Executive Director ● 8 Non Executive Directors</p>

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
12. Independent Directors	A.5.2	Adopted	<p>Five (5) Non Executive Directors are independent as defined by the Code.</p> <p>Independent Vs Non Independent Directors</p>  <p>The requirement as per the Code has been complied with throughout 2013.</p>
13. Criteria to evaluate Independence of Non Executive Directors	A.5.3	Adopted	<p>Please refer Section A.5.5 below.</p> <p>The Board considers Non Executive Director's independence on an annual basis, as part of each Director's performance evaluation. The Board reviewed the independence of each Non Executive Director in 2013 and concluded that each of them continues to demonstrate these essential behaviours.</p>
14. Signed declaration of independence by the Non Executive Directors	A.5.4	Adopted	<p>All Non Executive Directors of the Bank have made written submissions as to their independence against the specified criteria set out by the Bank, which is in line with the requirements of Schedule J of the Code.</p>
15. Determination of independence of the Directors by the Board	A.5.5	Adopted	<p>The Board has determined that the submission of declaration/s by the Non Executive Directors, as to their independence, as fair representation and will continue to evaluate their submission annually. Circumstances have not arisen for the determination of independence by the Board, beyond the criteria set out in the Code. The following Directors are Independent as at 31st December 2013;</p> <p>Ms M A R C Cooray Dr W W Gamage Dr L R Karunaratne Mr L U D Fernando Mr Sujeewa Mudalige</p>
16. Alternate Director	A.5.6	Adopted	<p>The requirement as per the Code has been met at the time of appointing of Alternate Directors during 2013</p>
17. Senior independent Director	A.5.7	N/A	<p>Although the requirement to appoint a Senior Independent Director does not arise under this Code, the following Directors functioned as Senior Independent Director during 2013, to meet the requirement under Rule 3(5) (ii) of the CBSL Direction on Corporate Governance.</p> <p>Ms Pamela C. Cooray (resigned w.e.f. 31st March 2013, having served the Board for nine (9) years) Mr N G Wickremeratne (appointed w.e.f. 01st April 2013 for the period up to 16th May 2013) Ms M A R C Cooray (appointed w.e.f. 17th May 2013)</p>

Your Board Room Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
18. Confidential discussion with the Senior Independent Director	A.5.8	N/A	Please refer above comment.
19. Meeting of Non Executive Directors	A.5.9	Adopted	Chairperson meets with the Non Executive Directors without the presence of the Executive Director, on a need basis. The Non Executive Directors met two (02) times without the presence of the Executive Director during 2013.
20. Recording of concerns in Board Minutes	A.5.10	Adopted	All concerns raised and wished to be recoded have been documented in sufficient detail.
A.6. Supply of Information			
Management should provide time bound information in a form and of quality appropriate to enable the Board to discharge its duties.			
<i>Financial and non-financial information are analysed and presented to the Board to make informed and accurate decisions.</i>			
21. Information to the Board by the Management	A.6.1	Adopted	The Board was provided with timely and appropriate information by the management by way of Board papers and proposals. The Board sought additional information as and when necessary. Members of the Corporate and Senior Management team made presentations to Directors on important issues relating to strategy, risk management, recoveries endeavours and audit. The Chairperson ensured that all Directors were briefed on issues arising at Board meetings. The Directors have free and open contact with the Corporate and Senior Management of the Bank.
22. Adequate time for effective Board meetings	A.6.2	Adopted	The Board papers are sent to the Directors at least a week before the respective Board meetings giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the respective meetings.
A.7. Appointments to the Board			
A formal and transparent procedure should be followed for the appointment of new Directors to the Board.			
<i>The Nomination Committee assesses the suitability of the prospective nominees to the Board and recommends persons found to be "fit and proper" for consideration of the entire Board. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to the appointment.</i>			
<i>Mr Jonathan Alles who had been serving as the Deputy Chief Executive Officer was appointed as the Acting Chief Executive Officer and an Executive Director w.e.f. 01st May 2013. Mr Alles assumed responsibilities as the Chief Executive Officer / Managing Director w.e.f. 01st July 2013, following the resignation of Mr Rajendra Theagarajah, upon reaching the age of retirement.</i>			
The profile of Mr Jonathan Alles is given on page 23.			
23. Nomination Committee	A.7.1	Adopted	The Nomination Committee made recommendations to the Board on all new appointments. The Terms of Reference for the members of the Nomination Committee are similar to the one set out in Schedule A to the Code. The following Directors served on the Nomination Committee during 2013. MD / CEO attends these meetings by invitation.

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
			<p>Dr L R Karunaratne Dr W W Gamage Dr Rane Jayamaha Ms M A R C Cooray</p> <p>Dr W W Gamage served as the Chairman of the above Committee up to 15th January 2013. Dr L R Karunaratne was appointed the Chairman of the Nomination Committee w.e.f. 15th January 2013.</p> <p>A formal procedure to appoint MD / CEO, KMPs and Directors was approved by the Board in July 2013.</p> <p>The Nomination Committee report is given on page 247.</p>
24. Assessment of Board Composition by the Nomination Committee	A.7.2	Adopted	<p>The Nomination Committee carries out continuous review of the structure, size and composition (including the skills, knowledge, experience and independence required of Directors) of the Board to address and challenge adequately key risks and decisions that confront, or may confront, the Board and makes recommendations to the Board with regard to any changes.</p> <p>Currently, more than 50% of Board members are Independent Non Executive Directors.</p>
25. Disclosure of details of new Directors to shareholders	A.7.3	Adopted	<p>Details of new Directors are disclosed to the shareholders at the time of their appointment by way of public announcements as well as in the Annual Report. Prior approval for appointment of new Directors is obtained from the Director of Bank Supervision of CBSL and notification is sent to Colombo Stock Exchange. All new appointments as well as continuing Directorships are reviewed by the Nomination Committee. The Directors are required to report any substantial changes in their professional responsibilities and business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.</p>
A.8. Re - election			
All Directors should submit themselves for re-election at regular intervals and at least once in every three years, and all Non Executive Directors should be appointed for a specific term and subject to re-election.			
26. Appointment of Non Executive Directors	A.8.1	Adopted	<p>Articles of Association of the Bank require each Director other than the MD / CEO and any nominee Director, to retire by rotation once in every three years and they are required to stand for re-election by the shareholders at the Annual General Meeting. The proposed re-election of Directors is subject to prior review by the full Board.</p> <p>Ms M A R C Cooray, Mr L U D Fernando and Mr Sujeewa Mudalige will retire by rotation at the AGM under the Articles of Association of the Bank. Ms M A R C Cooray, Mr L U D Fernando and Mr Sujeewa Mudalige have offered themselves for re-election, with the unanimous support of the Board.</p>
27. Election of Directors by the shareholders	A.8.2	Adopted	Please refer to comments above.

Your Board Room

Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
A.9. Appraisal of Board Performance			
The Board should periodically appraise its own performance against the pre set targets in order to ensure that the Board responsibilities are satisfactorily discharged.			
28. Appraisal of Board performance	A.9.1	Adopted	<p>Goals and targets of the Board of Directors have been clearly set out and evaluated at the end of the year by the members.</p> <p>Further each member of the Board carried out a self assessment of his / her own effectiveness as an individual as well as effectiveness of the Board as a team for the year 2013. The outcome of the assessment were tabled at a meeting of the Board in February 2014. The Sub-committees, except for the Audit Committee, carries out a self assessment process annually, in accordance with the pre-set criteria, to ensure they function effectively and efficiently with the objective of facilitating continuous improvement individually and collectively in the performance of the Board.</p> <p>The Audit Committee evaluation was conducted by the Non Executive Chairperson, with individual assessments from the members of the Audit Committee, MD / CEO, COO, AGM-Internal Audit, the Chief Accountant and the External Auditor, in accordance with international best practices.</p>
29. Annual self evaluation of the Board and its Committees	A.9.2	Adopted	Refer to comments given for Section A.9.1
30. Disclosure of the method of Appraisal of Board and Board Sub Committee performance	A.9.3	Adopted	Refer to comments given for Section A.9.1
A.10. Disclosure of Information in respect of Directors			
Details in respect of each Director should be disclosed in the Annual Report for the benefit of the shareholders.			
31. Details in respect of Directors	A.10.1	Adopted	<p>Details of the Directors are given on pages 20 to 25 Directors' attendance at the Board and Board Sub-committee meetings are given on page 149.</p> <p>The total number of Board seats (excluding directorship in HNB) held by each director can be summarized as follows;</p>

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013					
			Name of Director	Directorship Status	No of Board seats held in listed companies		No of Board seats held in unlisted companies	
					Executive Capacity	Non Executive Capacity	Executive Capacity	Non Executive Capacity
			Dr Ranee Jayamaha	Non Executive Chairperson		2		2
			Mr Jonathan Alles	Managing Director / CEO		2		4
			Ms M A R C Cooray	Senior Independent Non Executive Director		2		
			Dr W W Gamage	Independent Non Executive Director				1
			Dr L R Karunaratne	Independent Non Executive Director			1	1
			Mr L U D Fernando	Independent Non Executive Director				
			Mr Sujeewa Mudalige	Independent Non Executive Director				
			Ms D S C Jayawardena	Non Executive Director		1		5
			Mr Rusi S. Captain	Non Executive Director		1	15	

A.11. Appraisal of the CEO

The Board of Director should at least annually assess the performance of the Chief Executive Officer.

32. Targets for MD / CEO	A.11.1	Adopted	MD / CEO's performance objectives are aligned with business sustainability of the Bank. The performance targets for the MD / CEO are set at the commencement of every year by the full Board which are in line with the short, medium and long term objectives of the Bank.
33. Evaluation of the performance of the MD / CEO	A.11.2	Adopted	There is an ongoing process to evaluate the performance of MD / CEO against the financial and non financial targets set as described above, which is followed by a formal annual review by the Board at the end of each financial year.

Your Board Room

Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
B. DIRECTORS' REMUNERATION			
B.1. Remuneration Procedures			
The Bank should have a formal and transparent procedure for developing policy on executive remuneration and fixing the remuneration packages of individual Directors. No Director should be involved in deciding his / her remuneration in order to avoid the self review threat.			
34. HR & Remuneration Committee	B.1.1	Adopted	<p>The HR & Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for the Executive Director and the Corporate Management.</p> <p>The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD / CEO. The MD / CEO participates at meetings when deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management team.</p>
35. Composition of the HR & Remuneration Committee	B.1.2 B.1.3	Adopted Adopted	<p>The following Non Executive Directors served on the HR & Remuneration Committee during 2013.</p> <p>Dr W W Gamage Ms Pamela C. Cooray (resigned w.e.f. 31st March 2013, having served the Board nine (9) years) Dr Ranee Jayamaha Mr N G Wickremeratne (resigned w.e.f. 16th May 2013) Mr L U D Fernando (appointed w.e.f. 15th January 2013) Mr Sujeewa Mudalige (appointed w.e.f. 15th January 2013)</p> <p>Ms Pamela C. Cooray served as the Chairperson of the above Committee up to 31st March 2013. Dr W W Gamage was appointed the Chairman of the HR & Remuneration Committee w.e.f. 01st April 2013.</p> <p>The Terms of Reference of the Committee was formally approved by the Board in 2012.</p> <p>A Remuneration Policy for the Board of Directors was approved by the Board in July 2013.</p> <p>The HR & Remuneration Committee report is given on page 246.</p>
36. Remuneration of the Non Executive Directors	B.1.4	Adopted	<p>The Board as a whole decides the remuneration of the Non Executive Directors. The Non Executive Directors receive a fee for being a Director of the Board and additional fee for being a member of a Committee. They do not receive any performance related / incentive payments.</p>
37. Consultation of the Chairperson and access to professional advice	B.1.5	Adopted	<p>Input of the Chairperson is obtained by her involvement as a member of the said Sub - committee. External professional advice is sought by the HR & Remuneration Committee, on a need basis through the Board Secretary.</p>

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
B.2. Level and make up of Remuneration			
The level of remuneration of both Executive and Non Executive Directors should be sufficient to attract and retain the Directors needed to run the Bank successfully. A Proportion of Executive Directors remuneration should be structured to link rewards to the corporate and individual performance.			
38. Level and make up of the remuneration of MD / CEO	B.2.1	Adopted	<p>The Board is mindful of the fact that the remuneration of Executive and the Non Executive Directors should reflect the market expectations and is sufficient enough to attract and retain the quality of Directors needed to run the Bank. The remuneration package of the MD / CEO is structured to link rewards to corporate and individual performance.</p> <p>The Bank's remuneration framework for the CEO is designed to create and enhance value for all HNB's stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank.</p>
39. Comparison of remuneration with other companies	B.2.2	Adopted	The HR & Remuneration Committee in deciding the remuneration of the Directors (including the compensation package of the MD / CEO) takes into consideration the level of remuneration paid by the other comparable companies, performance and risk factors entailed in his job.
40. Comparison of remuneration with other companies in the Group	B.2.3	N/A	The size and scale of the Bank is not comparable with any other Group companies.
41. Performance related payment to MD / CEO	B.2.4	Adopted	Please refer to Section B.2.1.
42. Executive share options	B.2.5	Adopted	Share options have been offered to the Executive Director as part of the scheme offered to Senior and Corporate Management which was approved by the shareholders of the Bank. The details of which are given in note No 59 (b) of the Financial Statements on page 351.
43. Deciding the Executive Directors remuneration	B.2.6	Adopted	In deciding the remuneration of the MD / CEO the Bank takes note of the provisions set out in Schedule E.
44. Early termination of Directors	B.2.7	N/A	Not applicable to the Board except for the MD / CEO who is an employee of the Bank and his terms of employment is governed by the contract of service.
45. Early termination not included in the initial contract	B.2.8	N/A	Refer to comments above.
46. Remuneration of the Non Executive Directors	B.2.9	Adopted	Non Executive Directors receive a fee in line with the market practices. Non Executive Directors do not participate in the current share option plans of the Bank and / or other performance related incentive schemes.

Your Board Room

Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
B.3. Disclosure of Remuneration			
The Bank should disclose the remuneration policy and the details of remuneration of the Board as a whole.			
47. Disclosure of remuneration	B.3.1	Adopted	Please refer to Section B.1.2 on page 128 for the details on the composition of the HR & Remunerations Committee. The Committee's report setting out the policy of the Committee is given on page 246. The remuneration paid to the Board of Directors is disclosed in aggregate in note No 18 to the Financial Statements on page 307.
C. RELATIONS WITH SHAREHOLDERS			
C.1. Constructive use of the Annual General Meeting and Conduct of General Meetings			
The Board should use the Annual General Meetings to communicate with shareholders and encourage their active participation.			
48. Use of proxy votes	C.1.1	Adopted	The Bank has a mechanism to record all proxy votes and proxy votes lodged for each resolution prior to the General meeting.
49. Separate resolution for all separate issues	C.1.2	Adopted	The Board, remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain it's value framework in all shareholder dealings and communications. HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each such issue, separately.
50. Availability of all Board Sub-committee Chairmen at the AGM	C.1.3	Adopted	The Board, which includes the Chairpersons of the Audit, HR & Remuneration, Board Integrated Risk Management and Nomination Committees, was present at the 2013 AGM to answer any questions.
51. Adequate notice of the AGM	C. 1.4	Adopted	The Annual Report including financial statements and the notice of the meeting are sent to shareholders at least 15 working days prior to the date of the AGM. All shareholders irrespective of their voting status are encouraged to attend the AGM.
52. Procedures of voting at General Meetings	C.1.5	Adopted	Voting procedures at General Meetings are circulated to the shareholders.
C.2. Communication with Shareholders			
The Board should implement effective communication with shareholders			
53. Channel to reach all shareholders of the company	C.2.1	Adopted	The primary modes of communication between HNB and the shareholders are the Annual Report and AGM. Information is provided to the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of HNB, either verbally or in writing prior to the AGM. The Bank will post on its website (www.hnb.net) copies of annual reports, interim reports, stock information, stock exchange announcements etc. These will be posted on the website as soon as practicable after they have been released to the stock exchange.

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
54. Policy and methodology for communication with shareholders	C.2.2	Adopted	The Bank will focus on open communication and fair disclosure, with emphasis on the integrity, timeliness and relevance of the information provided. The Bank will ensure information is communicated accurately and in such a way as to avoid the creation or continuation of a false market.
55. Implementation of the Policy and methodology for communication with shareholders	C.2.3	Adopted	Shareholders are consulted on their preference to receive the Annual Report from the Bank either by means of a CD or in hardcopy form. Shareholders may at any time elect to receive Annual Report from the Bank in printed form. Printed copies will be provided without charge.
56. Contact Person in relation to shareholders' matters.	C.2.4 C.2.6	Adopted	Shareholders may, at any time, direct questions, request for publicly available information and provide comments and suggestions to Directors or management of the Bank. Such questions, requests and comments should be addressed to the Company Secretary.
57. Process to make all Directors aware of major issues and concerns of shareholders	C.2.5	Adopted	The Company Secretary shall maintain a record of all correspondence received and will deliver as soon as practicable such correspondence to the Board or individual director/s as applicable. The Board or individual director/s, as applicable, will generate an appropriate response to all validly received shareholder correspondence and will direct the Company Secretary to send the response to the particular shareholder.
58. The process responding to shareholder matters	C.2.7	Adopted	Refer to comments given for Section C.2.5
C.3. Major and Material transactions			
Directors should disclose to shareholders all proposed material transactions which would materially alter the net asset position of the Bank, if entered into.			
59. Major transactions	C.3.1	Adopted	During 2013, The Bank had not engaged in or committed to any 'Major related party transaction which materially affected HNB's net asset base.
D. ACCOUNTABILITY AND AUDIT			
D.1. Financial Reporting			
The Board should present a balanced and understandable assessment of the company's financial position, performance and prospects.			
60. Statutory and Regulatory reporting	D.1.1	Adopted	HNB has reported a true and fair view of its financial position and performance for the year ended 31st December 2013 and at the end of each quarter of 2013. In the preparation of quarterly and annual financial statements, HNB had complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. HNB has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank of Sri Lanka, the Colombo Stock Exchange and the Securities and Exchange Commission.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
61. Directors' report in the Annual Report	D.1.2	Adopted	The "Annual Report of the Board of Directors on the Affairs of the Company" which is given on pages 234 to 243 covers all areas of this Section.
62. Statement of Directors', and Auditor's responsibility for the Financial Statements.	D.1.3	Adopted	The statement of "Directors' Responsibility for Financial Reporting" is given on page 252. Auditor's reporting responsibility is given in their report on the Financial Statements on page 253. The Directors' Statement on Internal Control is given on pages 151 and 152.
63. Management Discussions and Analysis	D.1.4	Adopted	The Management Discussion and Analysis is given on pages 32 to 85.
64 Declaration by the Board that the business as a going Concern	D.1.5	Adopted	This is given in the "Annual Report of the Board of Directors on the Affairs of the Company" on pages 234 to 243.
65. Summoning an EGM to notify serious loss of capital	D.1.6	N/A	Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.
66. Related Party Transactions	D.1.7	Adopted	<p>The Directors have instituted an effective and comprehensive system of Internal Controls for identifying, recording and disclosure of related party transactions.</p> <p>Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties. Further, the Board ensures that no related party benefits from favourable treatment. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with that what is applied to transactions between the Bank and its unrelated customers.</p> <p>All related party transactions as defined in Sri Lanka Accounting Standard - 24 (LKAS 24) on "Related Party Transactions" is disclosed in note No 59 to the Financial Statements on page 351.</p>
D.2. Internal Control			
The Board should have a sound system of internal controls to safeguard shareholders' investments and the Bank's assets.			
67. Annual evaluation of the risks facing the bank and the effectiveness of the system of internal controls	D.2.1	Adopted	The Board is responsible for establishing a sound framework of risk management & internal controls and monitoring its effectiveness on a continuous basis. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published is reliable, and also ensures that the Bank's assets are safeguarded against unauthorised use or disposition.
68. Internal audit function	D.2.2	Adopted	Bank has its in-house Internal Audit function.

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
69. Review of the process and effectiveness of risk management and internal controls	D.2.3	Adopted	<p>The Internal Audit Division of the Bank carries out regular reviews on the risk management function and internal control system including internal control over financial reporting.</p> <p>The Audit Committee monitors, reviews and evaluates the effectiveness of internal control system including the internal controls over financial reporting.</p> <p>In the year 2013, the Board of Directors was satisfied with the effectiveness of the system of internal controls of the Bank. Refer the Directors' Statement on Internal Control on pages 151 and 152 for details.</p> <p>The External Auditors of the Bank have independently reviewed the report of the Directors referred to above and have issued a report which is given on page 153.</p>
70. Responsibilities of Directors in maintain a sound system of internal Control	D.2.4	Adopted	<p>The Directors' responsibility for maintaining a sound system of internal control is given in the Directors' Statement on Internal Control on pages 151 and 152.</p>
D.3. Audit Committee			
The Board should have a formal and transparent arrangements in selecting and applying the accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the Bank's External Auditor.			
71. Composition of the Audit Committee	D.3.1	Adopted	<p>The following Directors served on the Audit Committee during 2013.</p> <p>Mr Sujeewa Mudalige - Chairman</p> <p>Mr N G Wickremeratne (resigned w.e.f. 16th May 2013)</p> <p>Ms Pamela C. Cooray (resigned w.e.f. 31st March 2013 having served the Board for nine (9) years)</p> <p>Ms M A R C Cooray</p> <p>Mr Rusi S. Captain (appointed w.e.f. 15th January 2013)</p> <p>Ms D S C Jayawardena (appointed w.e.f. 30th May 2013)</p> <p>Dr L R Karunaratne (appointed w.e.f. 30th May 2013)</p> <p>The said Committee met nine (9) times during the year.</p> <p>The Board Secretary functions as the Secretary to the Audit Committee. The Directors, CEO, COO, AGM - Risk, AGM - Internal Audit, Chief Accountant, Compliance Officer and the External Auditor attend meetings on invitation.</p>

Your Board Room Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
72. Review of Objectivity of the External Auditor	D.3.2	Adopted	<p>The Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements.</p> <p>The Committee sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account :</p> <ul style="list-style-type: none"> (a) Relevant regulations with regard to the provision of non-audit services and the guidelines issued by the Central Bank of Sri Lanka on "Prohibited Services". (b) The External Auditor's skills and experience for providing the particular non-audit service. (c) The Nature of non-audit services, the related fee levels individually and in aggregate relative to the audit firm. <p>A formal policy document for the engagement of the external auditor to provide non audit services was approved by the Board in 2012.</p> <p>The Audit Committee has the primary responsibility for making recommendations on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.</p>
73. Terms of reference of the Audit Committee	D.3.3	Adopted	<p>The Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was reviewed in 2013. The Board also considered the Code of Best Practice on Audit Committees of CA Sri Lanka in defining the terms of reference for the Audit Committee.</p> <p>Duties of the committee encompasses:</p> <ul style="list-style-type: none"> - Assisting the Board in the preparation and presentation of Financial Statements - Bank's compliance with applicable regulations - Assess the processes to ensure internal controls are adequate, specially in relation to financial reporting - Assess the Bank's ability to continue as a going concern <p>The Audit Committee monitors and reviews the effectiveness of HNB's Internal Audit function. The AGM - Internal Audit reports to the Audit Committee. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It ensures that the Internal Audit plan adequately covers the significant risks of the Bank, reviews the important Internal Audit findings and follow-up procedures.</p> <p>The Audit Committee is authorized to obtain external professional advice and to invite outsiders with relevant experience to attend if necessary. The Committee also has full access to information in order to investigate into matters relating to any matter within its terms of reference.</p>

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
74. Disclosures of the Audit Committee	D.3.4	Adopted	<p>The names of the members of the Audit Committee are given in the Audit Committee Report on pages 249 and 250.</p> <p>The External Auditor, has provided an Independence confirmation in compliance with the "Guidelines for Appointment of Auditors of Listed Companies" issued by SEC.</p> <p>In order to safeguard the objectivity and independence of the External Auditor, the Audit Committee reviewed the nature and scope taking account of the regulations guidelines stated in Section D.3.2 on page 134.</p> <p>The Board has decided to rotate the External Auditor in keeping with the principles of good Corporate Governance.</p>
D.4. Code of Business Conduct and Ethics			
The Bank should develop a Code of Business Conduct and Ethics for Directors and members of the Senior Management team.			
75. Code of Business Conduct and Ethics	D.4.1	Adopted	<p>The Bank has developed a Code of Business Conduct and Ethics for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the Bank's assets, compliance with applicable laws and regulations and encouraging the reporting of any illegal or unethical behaviour, financial integrity, insider trading, accurate accounting and record keeping, receiving gifts and entertainment etc. The code of business conduct and ethics for Directors is embodied in the Board Charter.</p> <p>The Board is not aware of any material violations of any of the provisions of the Code of business conduct and ethics by any Director or Corporate Management member of the Bank.</p>
76. Affirmation by the Chairperson that there is no violation of the code of conduct & ethics	D.4.2	Adopted	Please refer to Chairperson's statement on page 116 for details.
D.5. Corporate Governance Disclosures			
The Bank should disclose the extent of adoption of best practice in Corporate Governance.			
77. Disclosure of Corporate Governance	D.5.1	Adopted	This requirement is met through the presentation of this report.
E. INSTITUTIONAL INVESTORS			
E.1. Shareholders voting			
Institutional shareholders are required to make considered use of their votes and encouraged to ensure their voting intentions are translated into practice.			
78. Institutional shareholders	E.1.1	Adopted	Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and concern to the general membership. The Investor Relations team headed by the MD / CEO has regular discussions with key institutional shareholders to share highlights of the Bank's performance and also with the view to obtaining constructive feedback. The feedback obtained from institutional shareholders are communicated to the entire Board by the MD / CEO.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & CA Sri Lanka Code Reference	Adoption Status	HNB's Extent of Compliance in 2013
E.2. Evaluation of Corporate Governance initiatives			
Institutional investors are encouraged to give due weight to all relevant factors in Board structure and composition.			
F. OTHER INVESTORS			
F.1. Investing / Divesting decision			
79. Individual Shareholders	F.1	Adopted	Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on their investing, holding or divesting decisions.
F.2. Shareholder Voting			
80. Individual shareholders voting	F.2	Adopted	Individual shareholders are encouraged to participate at Annual General Meetings and exercise their voting rights.
G. SUSTAINABILITY REPORTING			
G.1. Principles of Sustainability Reporting			
Sustainability is a business approach that creates long term stakeholder value by embracing opportunities and managing risks derived from economic, environmental and social developments and their potential implications and impacts on the business activities of the entity.			
<i>Sustainability reporting is the practice of recognising, measuring, disclosing and being accountable to internal and external stakeholders for organisational performance towards the goals of sustainable development in the context of the overall business activities and strategy of the entity and directed to the target stakeholders, usually shareholders, employees customers, society and government.</i>			
81. Economic Sustainability	G.1.1	Adopted	Please refer to the Sustainability Report on pages 154 to 231 for details
82. The Environment	G.1.2	Adopted	
83. Labour Practice	G.1.3	Adopted	
84. Society	G.1.4	Adopted	
85. Product & Service Responsibility	G.1.5	Adopted	
86. Stakeholder identification , engagement & effective communication	G.1.6	Adopted	
87. Sustainable Reporting and Disclosure	G.1.7	Adopted	

SECTION TWO

Statement of Compliance

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

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

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

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
3 (1) The Responsibilities of the Board			
1. Strengthening the safety and soundness of the Bank	Rule 3 (1) (i)	Compliant	<p>The Board Charter sets out the responsibility of the Board.</p> <p>The Board is responsible for formulating strategy, ensuring the adequacy of the risk management processes, review of the internal control system and defining the responsibility of the Corporate Management. Please refer Section A.1.2 of the SEC & CA Sri Lanka Code table on page 119 for further details.</p> <p>The Board has strengthened the safety and soundness of the Bank through the implementation of the following :</p> <p>(a) Strategic Objectives and Corporate Values</p> <p>The Bank's strategic objectives and corporate values which are derived from our vision and mission statement have been communicated to all staff members throughout the Bank. Further, as explained in Section D.4.1. of the SEC & CA Sri Lanka Code table on page 135, the Bank has developed a Code of Business Conduct and Ethics for all employees, which is in line with our strategic objectives and corporate values. This Code was communicated to all staff members throughout the Bank.</p> <p>(b) Overall Business Strategy</p> <p>The Board has provided direction in the development of short, medium and long term strategy of the Bank with the objective of promoting sustainability and profitable growth of the Bank.</p> <p>The strategic plan covering the period 2014-16 was approved in November 2013. The business strategy is reviewed usually on a quarterly basis by the Board with updates at Board meetings on execution of the agreed strategy. The Board approves and monitors the annual budget which is derived from Bank's strategic plan.</p>

Your Board Room Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
			<p>Further, the overall risk management policy, procedures and mechanisms with time bound implementation milestones was approved and monitored by the Board Integrated Risk Management Committee on a regular basis.</p> <p>(c) Risk Management</p> <p>The Board takes responsibility for the overall risk framework of the Bank. The Board Integrated Risk Management Committee ensures that the risks taken in Credit, Operational, Market, Strategic and other areas are within the approved risk appetite set out by the Board.</p> <p>(d) Communication with Stakeholders</p> <p>The Board is responsible for ensuring timely and effective communication with shareholders and other stakeholders. The Bank substantially implemented the provisions of Banking Act Direction No 8 of 2011 “Customer Charter of Licensed Banks” which became effective in 2012. This Charter sets key standards of fair banking practices envisaged by customers when they undertake transactions with the Bank and provides guidelines to adopt a “Code of Conduct” on customer protection. The Charter also includes a set of customer obligations towards the Bank in the interest of stable relationship.</p> <p>The Bank is in the process of developing a formal Corporate Communication Policy with a view to build up global trust in HNB’s Corporate Brand.</p> <p>Please refer Section E.1.1 of the SEC & CA Sri Lanka Code table on page 135 for further details.</p> <p>(e) Bank’s Internal Control System and Management Information System</p> <p>Please refer Section D.2.1 of the SEC & CA Sri Lanka Code table on page 132.</p> <p>(f) Key Management Personnel (KMP)</p> <p>According to Sri Lanka Financial Reporting Standard (LKAS 24) “Related Party Disclosures”, Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity.</p> <p>Accordingly, the Directors of the Bank (including executive and non-executive Directors), members of the corporate management, Chief Accountant, Chief Manager - Operations, Chief Manager - Treasury, Senior Manager - Compliance and their immediate family members have been classified as KMP of the Bank.</p> <p>Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective Director for more than 50% of his / her financial needs.</p>

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
			<p>(g) Authority and Responsibility of Key Management Personnel Duties and responsibilities of the Board of Directors are included in the Board Charter. The Duties and responsibilities of Bank's Corporate Management is formally documented through the Corporate Management Charter and their respective job descriptions.</p> <p>(h) Oversight of the affairs of the Bank by Key Management Personnel The Board of Directors formulates policies and exercises oversight of the affairs of the Bank through the MD / CEO.</p> <p>(i) Board's own Governance Practices The effectiveness of the Board's own governance practices, including the process for selection, nomination and election of Directors (which is explained in detail in Section A.7.1 and A.7.2 of the SEC & CA Sri Lanka Code table on pages 124 and 125 respectively) and the process for management of conflict of interest (which is explained in detail under Rule 3 (1) (xii) are reviewed by Board on a periodic basis. Further, the review of the effectiveness of the Board's own Governance practices are embodied in the Board and Sub-committee self-assessment process which is explained in detail under Rule 3 (1) (xvii) and Section A.9.1 of the SEC and CA Sri Lanka Code table on page 126.</p> <p>(j) Succession Plan for Key Management Personnel In May 2013, a comprehensive review of the bank's talent pool was undertaken and as a consequence thereto a paper was presented to the Human Resources/ Remuneration Committee providing succession to the top management team. This paper was presented with an update on 18th November 2013 to a subsequent Human Resources/ Remuneration Committee held on 3rd December 2013, and it supported by 3 comprehensive career development training programmes namely the "Catalyst", the "Acumen" and the "Aspire" which have already been commenced.</p> <p>(k) Regular Meetings with Key Management Personnel As explained in Section A.6.1 of the SEC & CA Sri Lanka Code table on page 124, the Directors have free and open contact with the Corporate and Senior Management of the Bank. Further Non Executive Directors have the option to attend important management meetings at the invitation of MD / CEO.</p> <p>(l) Regulatory Environment Please refer Section A.1.3 of the SEC & CA Sri Lanka Code table on page 120 for details.</p>

Your Board Room

Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
			<p>(m) Review of Objectivity of the External Auditor</p> <p>Please refer Section D.3.2 of the SEC & CA Sri Lanka Code table on page 134.</p> <p>A formal policy document for the engagement of the external auditor to provide non audit services was approved by the Board in 2012.</p>
2. Chairperson and CEO	Rule 3 (1) (ii)	Compliant	The Board has appointed the Chairperson and the Chief Executive. The roles of the Chairperson and the Chief Executive are separate. Please refer Section A.2 and A.3 of the SEC & CA Sri Lanka Code table on page 121 for details.
3. Board Meetings	Rule 3 (1) (iii)	Compliant	Please refer Section A.1.1 of the SEC & CA Sri Lanka Code table on page 118.
4. Inclusion of proposals by all Directors in the agenda	Rule 3 (1) (iv)	Compliant	Proposals from all Directors on promotion of business and management of risk and other areas relevant to the progress of the Bank are included where relevant in the agenda for regular meetings.
5. Notice of Meetings	Rule 3 (1) (v)	Compliant	Directors are given adequate time and usually at least 7 days of notice is given for regular Board meetings. For all other meetings a reasonable notice period is given.
6. Non attendance of Directors	Rule 3 (1) (vi)	Compliant	All Directors have attended at least two thirds (2/3) of the meetings held during 2013. Further no Director has been absent from three consecutive regular Board meetings during 2013.
7. Board Secretary	Rule 3 (1) (vii) Rule 3 (1) (viii)	Compliant	Please refer Section A.1.4 of the SEC & CA Sri Lanka Code table on page 120 for details.
8. Minutes of the Meetings	Rule 3 (1) (ix) Rule 3 (1) (x)	Compliant	Minutes of the Board meetings are maintained in sufficient detail by the Board Secretary, and is open for inspection by any Director.
9. Independent professional advice	Rule 3 (1) (xi)	Compliant	Please refer Section A.1.3 of the SEC & CA Sri Lanka Code table on page 120.
10. Conflicts of Interest	Rule 3 (1) (xii)	Compliant	The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board, declares his / her interest and unless the Board resolves otherwise, he / she does not participate in discussions or vote on that specific matter.
11. Formal schedule of matters	Rule 3(1) (xiii)	Compliant	The Board reserves for itself a formal schedule of matters on which it takes the ultimate decision.
12. Situation of Insolvency	Rule 3(1) (xiv)	N/A	This situation has not arisen during the year.
13. Capital adequacy	Rule 3 (1) (xv)	Compliant	The Bank has been fully compliant with the capital adequacy requirements of the Monetary Board during 2013.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
14. Corporate Governance Report	Rule 3 (1) (xvi)	Compliant	This requirement is met through the presentation of this report.
15. Annual self assessment by the Directors	Rule 3 (1) (xvii)	Compliant	<p>Individual Directors carried out an annual self-assessment of their own performance and the effectiveness of the Board as a whole. The summary findings together with areas for future improvement has been tabled at the Board meeting for discussion and endorsement by the full Board.</p> <p>Each director carries out an assessment of “fitness and propriety” to serve as a Director of the Bank. These declarations are tabled at the Board meeting prior to onward transmission to the Director Bank Supervision of the Central Bank of Sri Lanka.</p> <p>Please refer Section A.9.1 of the SEC & CA Sri Lanka Code table on page 126 for details of the evaluation of the Board and the Sub-committees.</p>
3 (2) The Board's Composition			
16. Number of Directors	Rule 3 (2) (i)	Compliant	The Board comprised of nine (9) Directors as 31st December 2013 (eleven (11) directors as at 31st December 2012).
17. Period of service of a Director	Rule 3 (2) (ii)	Compliant	The total period of service of all Non Executive Directors does not exceed nine (9) years.
18. Appointment of an employee as a Director	Rule 3 (2) (iii)	Compliant	<p>Mr Jonathan Alles (MD / CEO) is the only employee appointed to the Board as at date, as such the number of Executive Directors does not exceed one third (1/3) of the number of Directors of the Board.</p> <p>The requirement as per the Direction has been complied with throughout 2013.</p>
19. Independent Non Executive Director	Rule 3 (2) (iv)	Compliant	The Board includes Five (5) Independent Non Executive Directors as per the definition of this Direction, which is more than one third (1/3) of the Board. The Board considers Non Executive Directors' independence on an annual basis, based on the self declaration and as part of each Director's self assessment.
20. Alternative Director	Rule 3 (2) (v)	Compliant	During the year all alternate directors appointed to represent Independent Non Executive directors were independent.
21. Credibility, skills and experience of Non Executive Directors	Rule 3 (2) (vi)	Compliant	Please refer pages 20 to 25 for the profiles of the Non Executive Directors.
22. Presence of Non Executive Directors in Board Meetings	Rule 3 (2) (vii)	Compliant	At all Board meetings convened during the year, more than one half (1/2) of the Directors present were Non Executive Directors.
23. Details of Directors	Rule 3 (2) (viii)	Compliant	Please refer page 149 for the details of the Directors and their categories.
24. Appointment of new Directors	Rule 3 (2) (ix)	Compliant	Please refer Section A.7 of the SEC & CA Sri Lanka Code table on page 124 for details.
25. Appointment to fill a casual vacancy	Rule 3 (2) (x)	N/A	This situation has not arisen during the year.

Your Board Room Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
26. Resignation / removal of a Director	Rule 3 (2) (xi)	Compliant	<p>The following directors retired / resigned from the Board during the year.</p> <p>Ms Pamela C. Cooray (resigned w.e.f. 31st March 2013, having served the Board for nine (9) years)</p> <p>Mr N G Wickremeratne (resigned w.e.f. 16th May 2013)</p> <p>Mr Rajendra Theagarajah (resigned w.e.f. 30th June 2013, upon reaching the age of retirement)</p> <p>Ms Pamela C. Cooray who had completed 9 years as a Director of the Bank, resigned from the Board to comply with Rule 3(2)(ii) of the CBSL Direction on Corporate Governance.</p> <p>The announcements of the above changes in Board have been made to Colombo Stock Exchange and the Director of Bank supervision of CBSL within the specified time period.</p>
27. Appointments to other Banks	Rule 3 (2) (xii)	Compliant	None of the Directors are either employees or Directors of other Banks.
3 (3) Criteria to assess the fitness and propriety of Directors.			
28. Directors over 70 Years of age	Rule 3 (3) (i)	Compliant	All Directors are below the age of Seventy (70) years as at 31st December 2013.
29. Holding of office in more than 20 companies	Rule 3 (3) (ii)	Compliant	No Director holds office as a Director in more than 20 companies.
3 (4) The Management function delegated by the Board			
30. Delegation of work to the management	Rule 3 (4) (i)	Compliant	<p>The Board annually evaluates the delegated authority process to ensure that the delegation of work does not materially affect the ability of the Board as a whole in discharging its' functions.</p> <p>The Financial authority manual and the credit delegation authority are reviewed annually by the Board as part of its delegation of authority to the Management through the MD / CEO.</p>
31. Extent of Delegation	Rule 3 (4) (ii)	Compliant	Please refer comments above.
32. Evaluation of the delegated process	Rule 3 (4) (iii)	Compliant	Please refer comments on rule 3(4)(i) above.
3(5) The Chairperson and Chief Executive Officer			
33. Division of Responsibilities of the Chairperson and MD / CEO	Rule 3 (5) (i)	Compliant	The roles of the Chairperson and Chief Executive Officer are separate. Please refer Section A.2 and A.3 of the SEC & CA Sri Lanka Code table on page 121 for details.
34. Chairperson preferably be an Independent Director and if not designate a Senior Director	Rule 3 (5) (ii)	Compliant	<p>Dr Ranee Jayamaha is considered non independent as she holds office as the Chairperson of two (2) subsidiary companies of the Bank. However, her non independent status was countered by the existence of a Senior Director designated by the Board.</p> <p>A formal terms of reference for the Senior Director was approved by the Board in September 2013.</p>

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
35. Relationship between Chairperson and CEO and other Directors	Rule 3 (5) (iii)	Compliant	There are no material relationship between the Chairperson / CEO and / or other members of the Board which will impair their respective roles.
36. Role of the Chairperson and CEO	Rule 3 (5) (iv) to Rule 3 (5)(xi)	Compliant	Please refer Section A.2 and A.3 of the SEC & CA Sri Lanka Code table on page 121 for detailed information.
3(6) Board appointed Committees			
37. Board appointed four Sub - committees	Rule 3 (6) (i)	Compliant	There are eight (8) Board appointed Sub-committees including the four (4) Committees prescribed by the CBSL Direction. Please refer section A.1.6 of the SEC & CA Sri Lanka Code table on page 120 above for the names of the Board Sub-committees.
38. Audit Committee			
38.01 Chairman of the Audit Committee	Rule 3 (6) (ii) (a)	Compliant	Mr Sujeewa Mudalige (Independent Non Executive Director) is the Chairman of the Audit Committee. Mr Mudalige is a fellow member of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), the Chartered Institute of Management Accountants (CIMA - UK), Fellow of the Association of Chartered Certified Accountants (ACCA - UK) and Fellow of the Certified Public Accountants (CPA - Australia) He is a past president of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).
38.02 Composition of the Audit Committee	Rule 3 (6) (ii) (b)	Compliant	Majority of the members of the Audit Committee are Independent Non Executive Directors.
38.03 External Auditors	Rule 3 (6) (ii) (c), (d) and (e)	Compliant	Please refer Section D.3.2 and D.3.4 of the SEC & CA Sri Lanka Code table on pages 134 and 135 respectively.
38.04 Nature and Scope of External Audit	Rule 3 (6) (ii) (f)	Compliant	The Committee met with the External Auditor during the year to discuss their audit approach and procedures including matters relating to the scope of the audit and auditor's independence.
38.05 Review of Financial Information of the Bank	Rule 3 (6) (ii) (g)	Compliant	The Audit Committee has reviewed the Bank's Annual Report and quarterly Financial Statements before the submission to the Board for approval.
38.06 Meeting with External Auditors	Rule 3 (6) (ii) (h) and (l)	Compliant	The Committee met the External Auditor two (2) times without the presence of the Executive Director and Corporate Management.
38.07 External Auditor's Management Letter	Rule 3 (6) (ii) (i)	Compliant	During the year, the Audit Committee reviewed the year end Management Letter for 2012, and the responses thereto with the External Auditor and the Corporate Management team.

Your Board Room

Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
38.08 Internal Audit	Rule 3 (6) (ii) (j) and (k)	Compliant	<p>During the year, the Audit Committee reviewed the independence, objectivity and performance of the internal audit function. The findings of the internal audits completed during the year and the internal audit department's evaluation of the Bank's internal controls were reviewed by the Committee.</p> <p>The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning. The Committee reviewed the performance appraisal of AGM - Internal Audit and the senior staff members of the internal audit department.</p>
38.09 Terms of Reference	Rule 3 (6) (ii) (m)	Compliant	Please refer Section D.3.3. of the SEC & CA Sri Lanka Code table on page 134 for details.
38.10 Meetings	Rule 3 (6) (ii) (n) and (o)	Compliant	The Committee met nine (9) times for 2013. The attendance at Audit Committee meetings held in 2013 is set out on page 149.
38.11 Secretary	Rule 3 (6) (ii) (p)	Compliant	The Company Secretary also acts as secretary to the Audit Committee.
38.12 Process by which employees raise concerns in confidence	Rule 3 (6) (ii) (q)	As at 31.12.2013 Partially Compliant As at 21.02.2014 Compliant	<p>The effectiveness of the whistle blowing policy which was approved by the Board in 2013, was reviewed by the Audit Committee during the year and certain amendments to the policy was suggested by the Audit Committee. The revised policy was approved by the Board in January 2014. The revised whistle blowing policy and the mechanism had been communicated to staff members in 2014.</p> <p>The Audit Committee reviews issues relating to breach of ethics if any and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place.</p> <p>The Board Charter addresses the Boards responsibility to encourage any communication regarding non compliances and unethical behaviour within the Bank.</p>
39. Human resources / Remuneration Committee	Rule 3 (6) (iii)	Compliant	<p>Please refer Section B.1.1 and A.1.1 of the SEC & CA Sri Lanka Code table on pages 128 and 118 respectively for details.</p> <p>The Human Resources & Remuneration Committee is chaired by an Independent Non-Executive Director and has three other Non-Executive Directors as its members, two of whom are also Independent.</p> <p>The Committee met fourteen (14) times during the year.</p> <p>The Committee reviews all significant human resource policies and initiatives, salary structures, promotions and terms and conditions relating to staff at senior management level with information and recommendations from the MD/CEO and AGM – HR. The remuneration packages, annual increments and bonuses of the MD / CEO, COO, members of the Corporate Management and senior management staff are deliberated upon and recommended to the Board of Directors for ratification.</p>

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
			A Remuneration Policy for the Board of Directors was approved by the Board in July 2013.
40. Nomination Committee	Rule 3 (6) (iv)	Compliant	<p>Please refer Section A.7.1 and A.7.2 of the SEC & CA Sri Lanka Code table on pages 124 and 125 respectively for details for the composition of the Committee.</p> <p>The Nominations Committee is chaired by an Independent Non Executive Director.</p> <p>The Committee considers and recommends the re-election of the Directors to the Board. The Committee also set criteria of the succession of the CEO.</p> <p>During the period under reference, the Nomination Committee reviewed the additional/ new expertise and succession arrangements for the Senior Management Cadre and specific recommendations were made to the Board to fill the gaps with a time bound plan.</p> <p>The Terms of Reference of the Committee which was adopted by the Board of Directors in 2013 was reviewed by the members at its meeting held on 16th January 2014 and suitable amendments were introduced.</p> <p>A formal procedure to appoint MD / CEO, KMPs and Directors was approved by the Board in July 2013.</p>
41. Integrated Risk Management Committee	Rule 3 (6) (v)	Compliant	<p>The following personnel served on the Board Integrated Risk Management Committee during 2013.</p> <p>Ms M A R C Cooray - Independent Non Executive Director</p> <p>Dr Rane Jayamaha - Non Executive Director</p> <p>Mr Rajendra Theagarajah - Managing Director / CEO (resigned w.e.f. 26th June 2013, upon reaching the age of retirement)</p> <p>Mr Jonathan Alles - Managing Director / CEO</p> <p>Dr L R Karunaratne - Independent Non Executive Director</p> <p>Ms D S C Jayawardena - Non Executive Director (appointed w.e.f. 30th May 2013)</p> <p>Mr J R P M Paiva -DGM - Strategy & Compliance (resigned w.e.f. 3rd October 2013)</p> <p>Mr D P N Rodrigo - COO</p> <p>Mr D A de Vas Gunasekara - CFO (resigned w.e.f. 16th July 2013)</p> <p>Mr A P L Fernando - DGM -Recoveries & Credit Quality Management - (appointed w.e.f. 30th May 2013)</p> <p>Ms S Gnanapragasam - A G M- Risk</p> <p>Mr Ashok Goonasekera - Chief Accountant (appointed w.e.f. 29th August 2013)</p> <p>Mr C B Wijayarathne - Senior Manager - Compliance (appointed w.e.f. 29th August 2013)</p> <p>Mr Sujeewa Mudalige was invited to participate at BIRMC meetings as an observer.</p> <p>Ms M A R C Cooray serves as the Chairperson of the above Committee.</p>

Your Board Room Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
			<p>The Committee met eight (8) times during 2013. The Sub-committee had kept the Board informed of their risk assessment of the Bank continuously during the year.</p> <p>The Committee assesses, reviews and takes action to mitigate the effects of the specific identified risks in credit, market, liquidity, strategic and operational areas. The Committee also oversees the compliance function. The designated Compliance officer also reports to the Committee.</p> <p>During the year, the Committee also reviewed the effectiveness of the Bank's Business Continuity Plan in place through Disaster Recovery drills carried out, particularly in Core Banking and related Banking product modules such as Pawning.</p> <p>The Board Integrated Risk Management Committee report is given on page 248.</p>
3(7) Related Party Transactions			
42. Avoiding conflicts of interest in related party transaction and favourable treatment	Rule 3 (7) (i) Rule 3 (7) (ii) Rule 3 (7) (iii)	Compliant	<p>Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties as per the definition of this Direction and Sri Lanka Accounting Standard - 24 (LKAS 24) on "Related Party Transactions". Further, the Board ensures that no related party benefits from favourable treatment. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with that what is applied to transactions between the Bank and its unrelated customers.</p> <p>The net accommodation granted to each category of related parties as a percentage of the Bank's regulatory capital is given under Rule 3 (8) (ii) (e).</p>
43. Accommodation to Directors and / or their close relatives	Rule 3 (7) (iv)	Compliant	<p>All accommodations to Directors and / or their close relatives are approved by all Directors who are available in the country at the time the said accommodation is considered, other than the Director concerned. All accommodations to Directors and / or their close relatives are secured by security which is prescribed by the Monetary Board.</p>
44. Appointment of Director subsequent to approval of facilities to him / her	Rule 3 (7) (v)	Compliant	<p>The Bank is compliant with this rule for 2013.</p>
45. Accommodation to employees	Rule 3 (7) (vi) Rule 3 (7) (vii)	Compliant	<p>Accommodation has not been given to employees on a favourable basis other than the general schemes applicable to all employees of the Bank.</p>
3(8) Disclosures			
46. Financial reporting, statutory and regulatory reporting	Rule 3 (8) (i)	Compliant	<p>The Financial Statements for the year ended 31st December 2013, are in conformity with all rules and regulatory requirements and for the quarters then ended have been published in the newspapers in all three languages.</p>

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013															
47. Minimum disclosure in the Annual Report	Rule 3 (8) (ii)	Compliant	<p>(a) Compliance with applicable accounting standards and regulatory requirements has been reported under the “Directors’ Responsibility for Financial Reporting” on page 252, the “CEO’s and CFO’s Responsibility Statement” on page 251 and note No 2.1 (Statement of Compliance) to the Financial Statements on page 262.</p> <p>(b) Directors’ report on the effectiveness of the internal control system over financial reporting is given under the Directors’ Statement on Internal Control on pages 151 and 152.</p> <p>(c) The Assurance Report issued by the External Auditor on the Internal Control over Financial Reporting based on “SLSAE 3050 – Assurance Reports for Banks on Directors’ Statement on Internal Controls” issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is given on page 153. The recommendations made by the Auditors where relevant, will be dealt with, in 2014.</p> <p>(d) Details of the Directors are given on pages 20 to 25 Directors’ transactions with the Bank have been disclosed in note No 59 to the Financial Statements on pages 351 to 362. The remuneration paid to the Board of Directors is disclosed in aggregate in note No. 18 to the Financial Statements on page 307.</p> <p>(e) The net accommodation granted to each category of related parties is given below as a percentage of the Bank’s regulatory capital.</p> <table border="1"> <thead> <tr> <th>Category of Related Party Transactions</th> <th>(Rs Mn)</th> <th>%</th> </tr> </thead> <tbody> <tr> <td>- Key Management Personnel</td> <td>318</td> <td>0.60</td> </tr> <tr> <td>- Subsidiaries</td> <td>953</td> <td>1.79</td> </tr> <tr> <td>- Joint Venture</td> <td>150</td> <td>0.28</td> </tr> <tr> <td>- Other Related Parties</td> <td>3,514</td> <td>6.60</td> </tr> </tbody> </table> <p>(f) The aggregate amount of remuneration paid to Key Management Personnel and the transaction with Key Management Personnel have been disclosed in note No 59 (b) to the Financial Statements on pages 351 to 354.</p> <p>(g) The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4750 issued by the Institute of Chartered Accountants of Sri Lanka (SLSRS 4750), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report dated 21st February 2014 addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board. The recommendations made by the Auditors where relevant will be dealt with, in 2014.</p>	Category of Related Party Transactions	(Rs Mn)	%	- Key Management Personnel	318	0.60	- Subsidiaries	953	1.79	- Joint Venture	150	0.28	- Other Related Parties	3,514	6.60
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Your Board Room Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2013
			(h) There were no material non compliance to prudential requirements, regulations, laws and internal controls affecting the Bank. (i) There were no supervisory concerns on lapses in the Bank's risk management system or non compliance with this Direction that have been pointed out by the Director of the Bank Supervision Department of the CBSL and requiring disclosure to the public.
48. Transitional and other general provisions	Rule 3 (9)	Compliant	The Bank has complied with the transitional and other general provisions.

Report from External Auditors

The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4750 issued by the Institute of Chartered Accountants of Sri Lanka (SLSRS 4750), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report dated 21st February 2014 addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board.



Jonathan Alles
Managing Director / Chief Executive Officer



Raneer Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2014

Board and the Committee Attendance

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

Names	Directorship Status	Board	Audit Committee	Nomination Committee	HR & Remuneration Committee	Board Integrated Risk Management Committee	Strategic Review Committee	Credit Committee
Total No. Meetings		17	9	3	14	8	4	8
Dr Ranee Jayamaha	Non Executive Chairperson	17/17	5 ^a	3/3	14/14	8/8	4/4	8/8
Mr Rajendra Theagarajah (resigned w.e.f. 30th June 2013, upon reaching the age of retirement)	Managing Director / CEO	8/12	2 ^a	1 ^a	2 ^a	2/2	1/1	2/4
Mr Jonathan Alles (appointed an Executive Director w.e.f. 01st May 2013 and appointed as MD / CEO w.e.f. 01st July 2013)	Managing Director / CEO	8/9	7 ^a		7 ^a	5/8	3/3	4/7
Ms Pamela C. Cooray (resigned w.e.f. 31st March 2013, having served the Board for nine (9) years)	Senior Independent Non Executive Director	5/5	2/2		3/3			2/2
Mr N G Wickremeratne (resigned w.e.f. 16th May 2013)	Senior Independent Non Executive Director	9/9	3/3		3/5		1/1	1/2
Ms M A R C Cooray	Senior Independent Non Executive Director	*13/17	8/9	*** 2/3		8/8	3/4	7/8
Dr W W Gamage	Independent Non Executive Director	** 12/17		3/3	13/14			3/8
Dr L R Karunaratne	Independent Non Executive Director	17/17	3/6	3/3		5/8	3/4	8/8
Mr L U D Fernando	Independent Non Executive Director	15/17			11/13		2/3	0/5
Mr Sujeewa Mudalige	Independent Non Executive Director	17/17	9/9		11/13	7 ^a	3 ^a	5/7 1 ^a
Ms D S C Jayawardena	Non Executive Director	15/17	6/6 2 ^a			3/6 2 ^a	3 ^a	5/7 1 ^a
Mr Rusi S. Captain	Non Executive Director	13/17	7/9				1/3 1 ^a	0/5

Your Board Room

Governance Report...

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

Names	Total No of papers approved in 2013		
	Credit	Asset Disposal	Procurement
Total No of papers approved in 2013	363	05	15
Dr Raneer Jayamaha	361	05	15
Mr Rajendra Theagarajah (resigned w.e.f. 30th June 2013, upon reaching the age of retirement)	86		03
Mr. Jonathan Alles (appointed an Executive Director w.e.f. 01st May 2013 and appointed as MD / CEO w.e.f. 01st July 2013)	214	05	12
Ms Pamela C. Cooray (resigned w.e.f. 31st March 2013, having served the Board for nine (9) years)	36		02
Mr N G Wickremeratne (resigned w.e.f. 16th May 2013)	46		
Ms M A R C Cooray	200		01
Dr W W Gamage	203		01
Dr L R Karunaratne	104	05	15
Mr L U D Fernando	30	05	01
Mr Sujeewa Mudalige	190		01
Ms D S C Jayawardena	26	05	15
Mr Rusi S. Captain	28		01

Key

* In addition 4 meetings were attended by alternate Director

** In addition 2 meetings were attended by alternate Director

*** In addition 1 meeting was attended by alternate Director

a meetings attended by invitation

■ Chairman / Chairperson of the Board / respective sub- committee as at 31.12.2013

Directors' Statement on Internal Control

Responsibility

As per Section 3 (8) (ii) (b) of Banking Act Direction No: 11 of 2007, the Board of Directors present this report on internal control mechanisms of the Bank.

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

The Board has established an on-going process for identifying, evaluating and managing the significant risks faced by the Bank and this process includes enhancing the system of internal controls as and when there are changes to business environment or regulatory guidelines.

The process is regularly reviewed by the Board in accordance with the guidance for Directors of Banks on the Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). As per the said guidance, significant processes affecting significant accounts of the Bank were assessed along with the key risk areas of the Bank.

The management assists the Board in the implementation of the Board's policies and procedures on risk and control by identifying and assessing the risks faced by Bank, and in the design, operation and monitoring of suitable internal controls to mitigate and control these risks.

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

Key Internal Control Processes

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

- The Board Sub Committees are established to assist the Board in ensuring:
 - the effectiveness of the Bank's daily operations.
 - that the Bank's operations are in accordance with the corporate objectives and strategies.
 - that the operations of the Bank are in line with the annual budget as well as the policies and business directions that have been approved by the Board.
- The Internal Audit Division of the Bank checks for compliance with policies and procedures and the effectiveness of the internal control systems and highlights significant findings in respect of any non-compliance. Audits are carried out on majority of units and branches, the frequency of which is determined by the level of risk assessed by the internal audit, to provide an independent and objective report on operational and management activities of these units and branches. The annual audit plan is reviewed and approved by the Audit Committee and the findings of the audits are submitted to the Audit Committee for review at their periodic meetings.
- The Audit Committee of the Bank reviews internal control issues identified by the Internal Audit Division, the external auditors, regulatory authorities and management; and evaluates the adequacy and effectiveness of the risk management and internal control systems. They also review the internal audit function with particular emphasis on the scope of audits and quality of the same. The minutes of the Audit Committee meetings are tabled for the information of the Board on a periodic basis. Further details of the activities undertaken by the Audit Committee of the Bank are set out in the Audit Committee Report on pages 249 to 250.
- The Board Integrated Risk Management Committee (BIRMC) is established to assist the Board to oversee the overall management of principal areas of risk of the Bank. The Management Risk Committee which includes representation from all key business and operating units of the Bank, assists the Board with the implementation of policies advocated at the Board Integrated Risk Management Committee (BIRMC).

Directors' Statement on Internal Control

- Operational committees have also been established with appropriate empowerment to ensure effective management and supervision of the Bank's core areas of business operations. These committees include the Human Resource Management Committee, the Credit Policy Committee, Investment Committee, the Information Technology Steering Committee and the Executive Risk Management Committee.

In assessing the internal control system, the relevant officers of the Bank collated all procedures and controls that are connected with significant accounts and disclosures of the financial statements of the Bank. These in turn were observed and checked by the Internal Audit Division for suitability of design and effectiveness on an on-going basis. The Bank adopted the new Sri Lanka Accounting Standards comprising LKAS and SLFRS in 2012. The initially laid down processes relating to the adoption of such standards were further strengthened during the current year based on the feedback received from Board Audit Committee, external and internal auditors and the regulators. They recognised the need to introduce an automated financial reporting process to more effectively comply with the requirements of recognition, measurement, classification and disclosures of financial instruments. The assessment covered only the process applied by the Bank and did not include the processes carried out by its subsidiaries.

The recommendations made by the external auditors in connection with the internal control system in previous years were reviewed during the year and appropriate steps have been taken to rectify them. The recommendations made by the external auditors in 2013 in connection with the internal control system is being addressed at present.

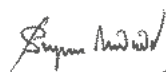
Confirmation

Based on the above processes, the Board confirms that the financial reporting system of the Bank has been designed to provide a reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes has been done in accordance with Sri Lanka Accounting Standards and regulatory requirements of the Central Bank of Sri Lanka.

Review of the Statement by External Auditors

The external auditor, Messrs KPMG, have reviewed the above Directors' Statement on Internal Control for the year ended 31st December 2013 and reported to the Board that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control system of the Bank. Their Report on the Statement of Internal Control is given on page 153 of this Annual Report.

By order of the Board



Sujeewa Mudalige
Chairman - Audit Committee



Jonathan Alles
*Managing Director /
Chief Executive Officer*



Raneer Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2014

Independent Assurance Report



KPMG
(Chartered Accountants)
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P. O. Box 186,
Colombo 00300,
Sri Lanka.

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To the Board of Directors of Hatton National Bank PLC

We were engaged by the Board of Directors of Hatton National Bank PLC ("Bank") to provide assurance on the Directors' Statement on Internal Control ("Statement") included in the annual report for the year ended 31st December 2013.

Management's responsibility for the Statement on Internal Control

Management is responsible for the preparation and presentation of the Statement in accordance with the "Guidance for Directors of Banks on the Directors' Statement on Internal Control" issued in compliance with the section 3(8)(ii)(b) of the Banking Act Direction No. 11 of 2007, by the Institute of Chartered Accountants of Sri Lanka.

Scope of the engagement in compliance with SLSAE 3050

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

Summary of work performed

Our engagement has been conducted to assess whether the Statement is both supported by the documentation prepared by or for directors and appropriately reflects the process the directors have adopted in reviewing the system of internal control for the Bank.

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

- Enquired the directors to obtain an understanding of the process defined by the Board of Directors for their review of the design and effectiveness of internal control and compared their understanding to the Statement made by the directors in the annual report.
- Reviewed the documentation prepared by the directors to support their Statement made.

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

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

Our conclusion

Based on the procedures performed, nothing has come to our attention that causes us to believe that the Statement included in the annual report on pages 151 and 152 is inconsistent with our understanding of the process the Board of Directors have adopted in the review of the design and effectiveness of internal control system over the financial reporting of the Bank.

Chartered Accountants
Colombo
21st February 2014

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

M.R. Mihular FCA P.Y.S. Perera FCA C.P. Jayatilake FCA
T.J.S. Rajakarier FCA W.W.J.C. Perera FCA Ms. S. Joseph FCA
Ms. S.M.B. Jayasekara ACA W.K.D.C. Abeyrathne ACA S.T.D.L. Perera FCA
G.A.U. Karunaratne ACA R.M.D.B. Rajapakse ACA Ms. B.K.D.T.N Rodrigo ACA
Principals - S.R.I. Perera ACMA, LLB, Attorney-at-Law, H.S. Goonewardene ACA

We innovate.

We adapt.

We grow &

We deliver.

We use the challenge of change to reinforce our position and serve our customers and stakeholders better with each passing year.

Sustainability Report:



Sustainability Report



Jonathan Alles
Managing Director/CEO
Refer Managing Director's review
pages 14-19

We have aligned our business strategy with the national development goals in keeping with our approach towards a business model that is sustainable in the longer term. Hatton National Bank continues to play an integral role in the development of Sri Lanka and will continue to support the national development drive of reaching upper middle income status.

Our thought leadership focuses on minimising the negative impacts to the eco systems and we commit to do no harm.

The journey towards sustainability

From its inception as Hatton Bank in 1888, the Bank has adopted a business model based on principles of sustainability. It began its operation in Hatton, a hill station reputed today for its tea production. The beginnings were modest, with the main objective of catering to the needs of the tea industry that was still at a very nascent stage and yet today, the main export crop of the nation. The new Bank made it convenient for tea planters to collect labourers' wages and pay for transportation. Very soon the Bank earned a reputation amongst small time savers and planters alike as a stable financial institution serving their needs.

125 years later we claim to be one of the largest systemically important commercial banks in the country with a competitive market presence and a sustainable footprint of 250 customer centres, employing 4,604 people and nurturing thousands of customer relationships. We are present in all sectors of the economy, reaching out to all customer segments, improving living standards, developing entrepreneurs and contributing to national infrastructure development. We have made banking accessible to the unbanked through our pioneering development banking and micro finance initiatives. Today, HNB can proudly acclaim that it has been a true partner in progress to the Sri Lankan economy in its journey toward success.



41,696
classroom
training hours
Training
investment
Rs 22.4 Mn



9 SME & 132
Micro finance
customer
training
programmes



25,000
trees
planted



2 new Green
buildings

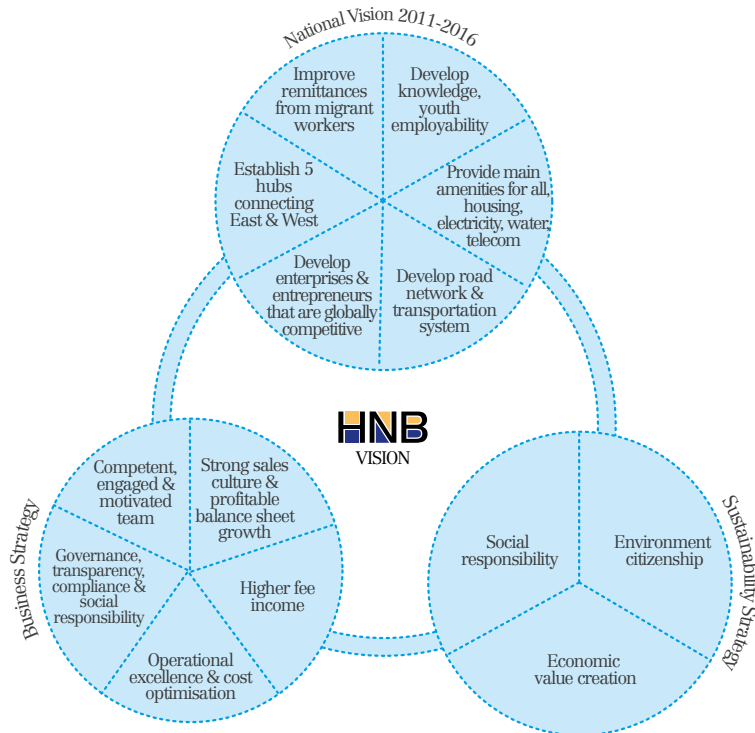


Established
200th school
library



Surgical ICU at
Cancer Hospital
partnering with
Colours of
Courage Trust

Sustainability Report



Integrating sustainability

We have aligned our business goals to the national vision on a strong foundation of sustainability.

The Bank's sustainability strategy is crafted from the inputs gathered from continuous stakeholder engagement and inclusion within the context of our corporate vision, mission and values.

We have used the yardsticks of 'entrepreneurial spirit' and 'empowered people' embedded in our mission to identify investors, customers, employees, suppliers, communities and the environment as our key stakeholders.

Sustainability strategy

The sustainability strategy of the Bank addresses sustainable performance based on economic wealth creation, social performance and environmental citizenship. The Bank adopts a systematic strategic review as part of its annual planning process. Periodic assessment of socio economic trends, environmental issues, risks and opportunities which may impact sustainability from an economic, social and environmental perspective is an integral part of this process.

We:

- continuously scan the internal and external environment and monitor issues, risks and opportunities on a global and national scale to identify emerging socio economic trends, advancements and convergence of technology, changes in legal, regulatory and statutory reporting frameworks and to evaluate the response and behaviour of direct and indirect competition to the dynamics within and across industry
- identify needs or unmet needs of emerging stakeholders that may impact sustainability in the future vis-a-vis the vision, mission, values and strategic intent of the Bank
- engage with existing and most likely stakeholders of the future in building relationships to create an inclusive business model with a view to finding more sustainable solutions
- embed a culture of sustainability throughout the Bank that addresses the short, medium and long term expectations of our stakeholders, by making risk adjusted business decisions, by addressing the importance of social and environmental dimensions in addition to economic implications of business decisions
- translate and integrate our sustainability approach across all business processes to achieve a sustainable competitive advantage through the short, medium and long term strategic focus of the Bank

Sustainability commitments for the short and medium term

<p>Entrench a drive for value creation and wealth</p>	<ul style="list-style-type: none"> • Develop the business model to deliver sustainable economic value and wealth to stakeholders
<p>Entrench social performance</p>	<ul style="list-style-type: none"> • Entrench risk, governance and compliance <ul style="list-style-type: none"> – Identification and mitigation of risks – Well governed and compliant culture through adoption of accepted codes of conduct and governance frameworks – Implementation of a wide range of sophisticated technological tools for business continuity, data security and disaster recovery • Entrench customer centricity and excellence <ul style="list-style-type: none"> – Implement continuous assessment of customers’ reasonable expectations in terms of products, service and responsibility – Carry out audits to determine lapses – Institute new processes to improve satisfaction and customer experience through value proposition, products and service delivery – Ease of access through cost effective channels and platforms – Create awareness and improve financial literacy • Entrench talent of employees <ul style="list-style-type: none"> – Enhance talent and innovation through a culture of learning – Foster creativity and an inspired work place that is conducive to decent work practices and human rights – Embed best practice and accepted codes of conduct towards being an employer of choice • Invest in community development <ul style="list-style-type: none"> – Education, health and access to safe drinking water – Financial literacy programmes
<p>Environmental citizenship</p>	<ul style="list-style-type: none"> • Green banking <ul style="list-style-type: none"> – Influencing conservation and protection through our loan disbursement process – Actively promoting projects that invest in renewable energy and alternate sources of energy – Green buildings • Green procurement <ul style="list-style-type: none"> – Select suppliers with an entrenched sustainability focus – Ensure sustainability principles and concepts are integrated into supplier contracts • Green pledge <ul style="list-style-type: none"> – Embed conservation of energy and reduction of the carbon footprint in the Bank’s culture

Sustainability Report

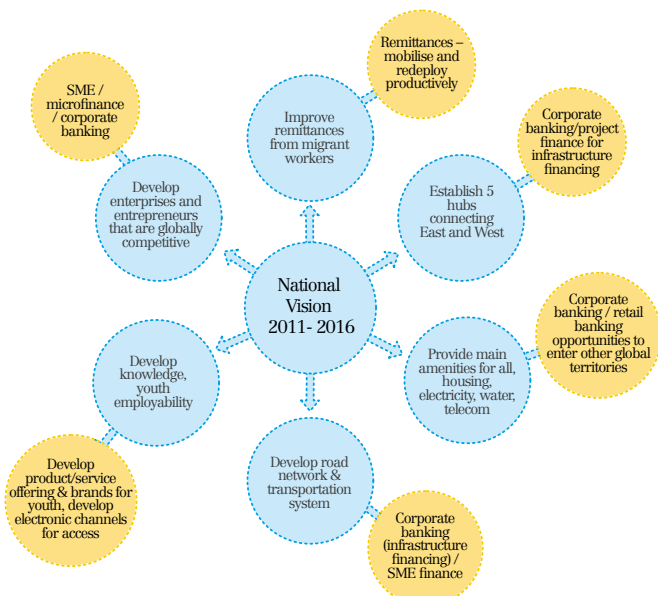
The National Vision 2011 - 2016

The national vision 2011 – 2016 outlines focus areas for sustainable development for resurgent Sri Lanka, as the country moves toward middle income status, a per capita income of USD 3,282 forecast GDP growth in the range of 7 – 7.8% (2014) and a potential for growth at 8% thereafter. Inflation is forecast to be in the range of 4-6% with a balance of payment surplus and trending towards a marginal currency appreciation. Possible fiscal consolidation and lower policy rates to offset headwinds from the US Federal Reserve’s QE tapering. The country has weathered the effects of the QE tapering relatively well, with a resulting lower capital outflow and less pressure on currency than regional peers.

The vision is built around working towards being a plentiful nation through self-sufficiency in agriculture, fisheries and aquatic resources, dairy, water and development of plantations, infrastructure development of roads and transport system, world class enterprises providing the main amenities, communication technology and strategically focused state owned entities and globally competitive industries, modern education and knowledge systems, a healthy nation with improved comforts and convenience towards an improved life style.

The figure below depicts how the Bank has aligned its business strategy with the national vision. The initiatives under corporate banking, development banking, SME, international remittances and initiatives on developing

Aligning our sustainability strategy with the national vision



multi channels discussed under the Management Discussion and Analysis provides more details on the type of banking activity and strategic initiatives taking place to support the national agenda.

Our involvement and development efforts through Gami Puduwa - Village Reawakening in the areas of development banking and micro finance have also won international recognition from institutions such as the World Bank. Our efforts in the area of technology and digital convergence through initiatives such as the launching of a mobile POS - MoMo, debit card with near field technology and mobile banking have contributed to developing the digital platforms and infrastructure in the industry in addition to catering to the needs of the Generation ‘Y’ customers. They will also facilitate access to the unbanked by leveraging on the 100% penetration of mobile telephony.

Our lending in the corporate banking sector has supported road development, housing, tourism and investments in alternate and renewable energy.

The Bank has also been a strong proponent of developing awareness and improving the financial literacy of the nation and its customer base over time, through many initiatives in SME, development banking and microfinance segments through structured training programmes and workshops.

Being present across all sectors and serving all customer segments remain part of our sustainability strategy for the Bank and cascade into our business strategy and strategic focus for the period 2014 – 2016.

Business strategy

The strategic focus areas for 2013 and the period 2014 – 2016 have been prioritised based on the emerging trends, risks and opportunities in the industry. We have summed up our strategic focus into 5 core areas in achieving our short term aspirations as detailed below. The cascading of these business strategies into strategic focus areas across the business is discussed under the Management Discussion and Analysis on pages 32-85 under various initiatives across the business.

Key impacts, risks and opportunities

Impacts of sustainability trends, risks and opportunities in the short/medium term

Economic

Impacts	Risk and Opportunities
<ul style="list-style-type: none"> • Risk adjusted sustainable return to investors of capital from a compelling investment and wealth creation • Making banking and finance solutions accessible across the country to all customer segments in all sectors • Contributing to national development goals by lending to the corporate, development banking, SME and micro finance sectors to fund infrastructure, agriculture, farming, service related projects and trade related activity • Lending to individuals through the various lifestyle based value propositions funding housing, education, vehicles, travel and leisure needs of individuals • Attracting much needed foreign currency through inward remittances • Community development, poverty alleviation, self-sufficiency and capacity enhancement in rural sectors • Providing employment and decent work practices to 4,604 people by being an employer of choice • Contributing to national income by way of taxes • Investment in developing the electronic banking infrastructure providing global access through electronic channels 	<p>Risk</p> <ul style="list-style-type: none"> • Volatility in credit appetite from volatile movements in interest rates. High interest rate regimes (1H 2013) decelerated credit growth significantly, with the economy overheating from exponential growth arising low interest rates (during 2009-2011) • Significant downward pressure on margins eroding profitability, declining CASA ratio, imposition of NBT on Banking sector, thinner spreads, competition within the sector • Liquidity constraints leading to trend of non-performing assets and credit risk • Significant fall in gold prices leading to increased provisioning in the area of pawning • Volatility in global markets and developed economies impacting export related growth from decelerating demand (1 H 2013) and impacting trade related activity • Consolidation of the banking industry which may lead to asset stripping or non-performing assets being acquired, additional capital infusion and dilution of focus from sorting legacy issues inherited in the case of M&A activity • Implementation of BASEL II and III leading to a risk based approach to capital adequacy and the need to have access to low cost funding at short notice to maintain capital adequacy at all times <p>Opportunities</p> <ul style="list-style-type: none"> • Economy poised for growth. Forecasted GDP growth of 7 – 7.8% for 2014 and potential of 8% beyond 2014 • Lowering of interest rates commencing 2H 2013 resulted in credit appetite picking up from 3Q 2013 onwards • Consolidation in the banking industry would create stronger balance sheets and opportunities for inorganic growth • Further penetration through low cost electronic channels such as mobile banking from 100% density of the mobile industry • Significant growth potential in the SME and micro finance space • Advisory services and investment banking as potential avenues to increase fee income • Opportunities to leapfrog on technology developed by Telcos in moving to electronic platforms and channels and using digital convergence • Strategic B2B tie ups in accessing new customer pools (leasing, condominium developers, franchise houses)

Sustainability Report

Social

Impacts	Risk and Opportunities
<ul style="list-style-type: none"> • Developing self-sufficient sustainable communities through poverty alleviation from micro finance initiatives and lending to the rural poor and creating linkages for supply chains • Treating customers fairly, committing to customer responsibility by adopting the customer charter, implementing a procedure for dealing with complaints, embedded ethics and code of conduct, combating financial crime through anti money laundering policy and fraud prevention, and responsible media publicity and communication • Respecting human rights, subscribing to core ILO standards in providing decent work • Enhancing the skill inventory of employees leading to opportunities for sustainable lifelong employment • Creating financial awareness, increasing financial literacy of customers and the public through structured programmes, workshops and media campaigns • Improving life styles of the emerging middle class and spawning the entrepreneurial spirit of the nation • The HNB Sustainability Foundation, a separate trust to carry out community development and continuity of projects • Making basic human rights such as the right to education, health and clean drinking water accessible to the marginalised and various initiatives promoting education, IT literacy through the school libraries and computer centre programmes • Active membership of the Sri Lanka Business Coalition for HIV/AIDS and a proponent of HIV/AIDS awareness at the workplace • Establishing a trust fund providing financial assistance to the Counselling Centre at the National Cancer Institute, for trauma counselling for patients/families 	<p>Risks</p> <ul style="list-style-type: none"> • The threat of reputational risk from irresponsible communication using social networks which reach millions of people • Potential increase in fraud and money laundering activity through collusion with internal staff • Cyber-attacks, data protection and safe guarding customer confidentiality. Risk of losing confidential information gathered through KYC initiatives and customer data bases to competition • Stickiness of customers on the decline due to customers being multi banked and having access to numerous banks <p>Opportunities</p> <ul style="list-style-type: none"> • Social impact is a clear opportunity for the Bank to become involved in the community. Over 50% of the population is still not part of the financial system in Sri Lanka. Through our schemes we try to reach out to such segments of people to create awareness and promote inclusion • The use of social network to conduct research with generations Y and Z and gather big data to predict preferences

Environment

Impacts	Risk and Opportunities
<ul style="list-style-type: none"> • Incorporating environmental policies into lending, customer and supplier assessment and commitment to finance renewable and clean technology projects • Implementation of the “Green Pledge” and 3R concept towards reducing our carbon footprint whereby all employees have taken a pledge to support this cause • Energy efficient buildings and construction of “Green Buildings” • Tree planting initiatives in a bid to reverse our impact as measured against the amount of paper consumed • Significant investment over a period of time in reclaiming the Bundala National Park from invasive species that threaten the bio diversity of the area 	<p>Risks</p> <ul style="list-style-type: none"> • Although the nature of our business is such that we are not directly influenced by environmental considerations in our day-to-day activities or through the scope of our business, the fact that we interact with millions on a daily basis enables us to act as a conduit in changing societal behaviour and perceptions • Our role therefore is to be a good environmental citizen and a role model for the Sri Lankan public. As such we take it upon ourselves to lead from the front in creating awareness about environmental considerations and incorporate it in our daily activities as far as possible. Furthermore by implementing a supplier screening system and rigorous loan covenants, we are able to influence our business suppliers and customers to adopt eco friendly practices

Prioritising our challenges and our approach towards mitigation and impacts on stakeholders

In promulgating sustainability the Bank has to continuously create growth strategies and sustainable wealth creation over time in addressing the rights and reasonable expectations of its stakeholders. Economic wealth generation by the business to remain financially viable is the core to sustaining our social and environmental commitments.

Key challenges

Narrowing net interest margins, low appetite for credit from volatile interest rates, increasing non performing advances due to illiquidity, decline in gold prices, imposition of Nation Building Tax (NBT) for the banking sector from 2014 onwards, retaining and managing talent in the back drop of intense competition within the banking and non-banking financial services sector were the key impactors of wealth creation during the year under review.

Our strategic focus on growing our balance sheet by acquiring profitable business, by aggressively pursuing opportunities to grow fee based income and our focus on cost optimisation would address some of the challenges discussed above. We continued to attract low cost deposits by leveraging on our relationships with the community

through our 250 customer centres across the country and multi channel banking.

Our strategic priority for 2013 was investing in technology and digital convergence. We have invested in a credit origination system across all product verticals, implemented an anti-money laundering system and successfully launched a mobile POS - MoMo, mobile banking, a debit card using near field technology, and revamped our internet banking platforms in 2013. These initiatives are aimed at improving efficiency and productivity across the business and providing qualitative and timely information towards making better business decisions.

The investments in technology and digital convergence have also afforded us the means to access the unbanked in a more cost effective and user friendly manner.

We have retained and attracted talent by being recognised as an employer of choice. We have invested in the development of our people and their career progression through periodic review to assess individual performance and achievements against corporate targets, and by way of investing in structured learning and development initiatives.

Sustainability Report

The ground work was laid this year to focus on operational excellence through business process re-engineering and developing a service culture towards excellence as core priorities for 2014. We believe that the strategies crafted would moderate and minimise the negative impacts on sustainable growth and profitability.

The rights of stakeholders

The enhanced governance frameworks such as the focus on anti-money laundering activity, the customer charter being rolled out by the Regulator and already in place at the Bank, will safe guard the rights of customers, deposit holders and investors. The implementation of BASEL II and III would result in a risk based approach to capital adequacy. The Internal Capital Adequacy Assessment Process (ICAAP) would quantify the capital required to be held based on the risk profile and risk appetite of the bank. Currently, the Bank is well above the defined thresholds for capital adequacy and as such the risk to investors and deposit holders would be categorised as low.

Processes in place to address performance and manage risks

We place a great deal of importance on governance and adopt internationally accepted best practice, such as anti-money laundering policies and systems and a risk based approach to business. We comply with human rights and health and safety standards, international conventions outlined by the ILO on decent work practices and maintain good employee relations. We have implemented the ICAAP based on the requirements of BASEL II in terms of maintaining adequate funds for both Tiers I and II capital adequacy ratios.

We consider the cost incurred on governance, ethics and compliance with accepted codes of conduct and best practice as an investment in our approach towards safe guarding the rights of our stakeholders. We have invested in our communities and environment to remain an economically viable business model through community development and environmental preservation and conservation.

We have taken a long term view on growth and profitability and safeguarding our stakeholders by being a positive influence on fostering economic development, through our efforts to build capacity, build lives and develop communities through entrepreneurial thinking, by partnering for progress and encouraging green finance, green procurement and taking the green pledge to recycle, reuse and reduce consumption of our limited resources.



Awards and recognition

- “Bank of the year 2013” in Sri Lanka, (for the 2nd consecutive year) awarded by the prestigious UK based “The Banker” Magazine
- “Best Retail Bank in Sri Lanka - 2012” presented by “The Asian Banker” in The Asian Banker Excellence in Retail Financial Services Awards 2013, for the 6th consecutive year
- “Best Managed Bank in Sri Lanka” at the Asian Banker Summit 2013
- Global Brand Leadership Award For Excellence in Banking and Financial Services at the Global Brand Excellence Awards organised by the World Brand Congress and endorsed by the CMO Council Asia, Asian Confederation of Businesses and the World Federation of Marketing Professionals.
- HNB Al-Najah Islamic Banking Unit won the Silver Award for Emerging Islamic Finance Entity of the Year at the SLIBFI Awards Night
- Top award for “The Best Acquiring Institution across India & South Asia” at the Leader Awards ceremony at the VISA Security Summit
- MoneyGram Award for “Special achievement in Brand building ICC T20 World Cup 2012”
- HNB Adhishtana saving accounts emerged winner of the IFAD Award for Best Practice at the Global Forum on Remittances 2013 jointly organised by the International Fund for Agricultural Development (IFAD) and the World Bank and co-sponsored by the European Union, CGAP, IDB and UNCDF
- Annual Report Awards 2013 of the Institute of Chartered Accountants in Sri Lanka
 - Bronze Award for the best presentation in Corporate Governance
 - Bronze Award for the best presented Annual Report in Banking Sector
 - Bronze Award for the best presented Annual Report in Corporate Social Responsibility (CSR)
- South Asian Federation of Accountants (SAFA) Best Presented Annual Report Awards and SAARC Anniversary Awards for Corporate Governance Disclosures 2011 - 1st Runner up for Private Sector Banks (including Co-Operative Banks)
- Overall Award for Best Results Based Training” at the 4th CMO Asia Awards in Singapore at the “Asia’s Training & Excellence Awards 2013” conferred by the World HRD Congress
- Rated as the sixth most valuable brand in Sri Lanka by the Brand Finance Lanka (Affiliated to Brand Finance UK) for 2013
- Business Today Top 25 2012-2013 (5th)
- Corporate Accountability Index – 13th



Sustainability Report

Report scope and boundary

Defining the report content

This year, as in the past six years, we report our sustainability strategy and initiatives against the Global Reporting Initiative Reporting Framework (GRI). As in the previous financial year, we continue to report against the requirements of GRI Application Level A+, and this report has undergone a GRI Application Level Check (refer GRI application level check on page 215).

This report gives an update on the Bank's performance against the defined core sustainability focus areas namely Economic Value Creation, Community Development / People Progress and Environmental Conservation and also on the sustainability pillars of Health, Education, Entrepreneurship and Environment. It contains data and information on different aspects of our business and operations. The alignment of business vision against national vision is reflected in this report.

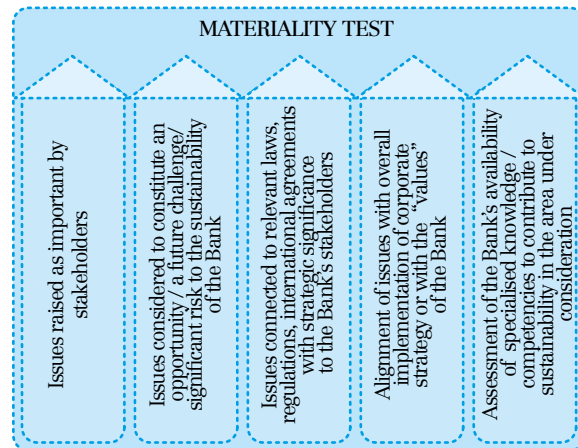
The reporting principles defining the report content

Materiality

The Bank is cognizant of the importance of materiality in reporting. The Sustainability Report therefore, focuses on topics and indicators that reflect the Bank's significant economic, environmental and social impacts, and information that would influence the assessment and decisions of its stakeholders. A combination of internal and external factors and related indicators has been taken into account in determining materiality.

The materiality assessment in this report allows us to take a considered look at the issues that are of concern to our stakeholders and that potentially affect our ability to execute our business strategy. We identify and prioritise these areas of focus based on the results of our engagement with stakeholders, formal/informal, direct/indirect feedback obtained through our network of 250 customer centres, the review of ratings and rankings surveys, investor questionnaires and studies, and through internal consultations with senior executives and colleagues throughout the year.

The following process is used to determine the materiality of issues that may have significant economic, social and environmental impacts.



The following issues have been rated as being material in respect of the economic, social and environmental impact to business and considered important by stakeholders during the year under review.

- Service quality
- Product range and access
- Business expansion / growth
- Recruitment and retention of the best talent
- Improved internal processes
- Compliance with regulatory requirements
- Financial inclusion and community empowerment
- Environmental citizenship
- Human rights
- Diversity and inclusion
- Ethics and governance

This report endeavours to prioritise the above-mentioned material topics and performance indicators where applicable.

Sustainability context

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

Defining the report quality

This report endeavours to present an unbiased presentation of the Bank's performance by having a balanced approach to reporting where the positive and negative aspects of performance are discussed with information being presented on basis of comparability. As far as possible, the Report provides accurate information in a manner that is understandable and accessible to its readers.

Defining the report boundary

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

Audience

This report aims to service the information needs of our stakeholders. It is specifically based on expectations that were identified as important to our customers, employees, investors and those with an advanced understanding of sustainability issues, in particular sustainability rating agencies and analysts.

Scope and definitions of reported data

In order to obtain the relevant data for this report, information has been gathered from the customers centres and departments within the Bank.

Data validation

The information reported is validated by the respective departments and follows the standard reporting protocol for processing management information within the Bank.

Stakeholder inclusivity and engagement

Sustainability reporting evaluates performance in a wider context by including social and environmental dimensions to economic value creation. This leads to identifying key stakeholders who impact performance and necessitates inclusivity through ongoing engagement. The Bank has identified investors, customers, employees, suppliers, the community and environment as key stakeholders.

Given the diverse stakeholder needs and differing expectations of various stakeholders, we prioritise the multiple demands based on reasonable expectations and interest. This is based on the materiality of potential impact on our business in terms of accountability and the significance to our stakeholders in the short, medium and long term.

We endeavour to strike an equitable balance between diverse and differing expectations through dialogue and greater engagement with stakeholders.

The approach defining stakeholder engagement, and the impact on sustainability is described in more detail on pages 169-177 of this report.

Assurance

Independent Assurance is a widely accepted norm within the process of Sustainability Reporting. The Bank

recognises that independent assurance enhances the transparency and credibility of its Sustainability Reporting process which outlines the economic, social and environmental performance of the Bank and its' management approach in executing sustainable strategies to create value and conserve the environment to users of this report and stakeholder groups.

M/s KPMG Sri Lanka has provided an Independent Assurance Report on Hatton National Bank's Sustainability Report. The Auditors review engagement was carried out in accordance with the Sri Lanka Standard on Assurance Engagements (SLSAE 3000).

Sustainability stewardship

The Sustainability Committee

The Sustainability Committee is headed by the Managing Director/CEO of the Bank and includes all the key functional heads. Board representation is through the Managing Director/CEO, as depicted on page 166.

The Sustainability Committee has 3 subcommittees responsible for customer service and investor relations, employee liaison and a group to advise on the environment and community.

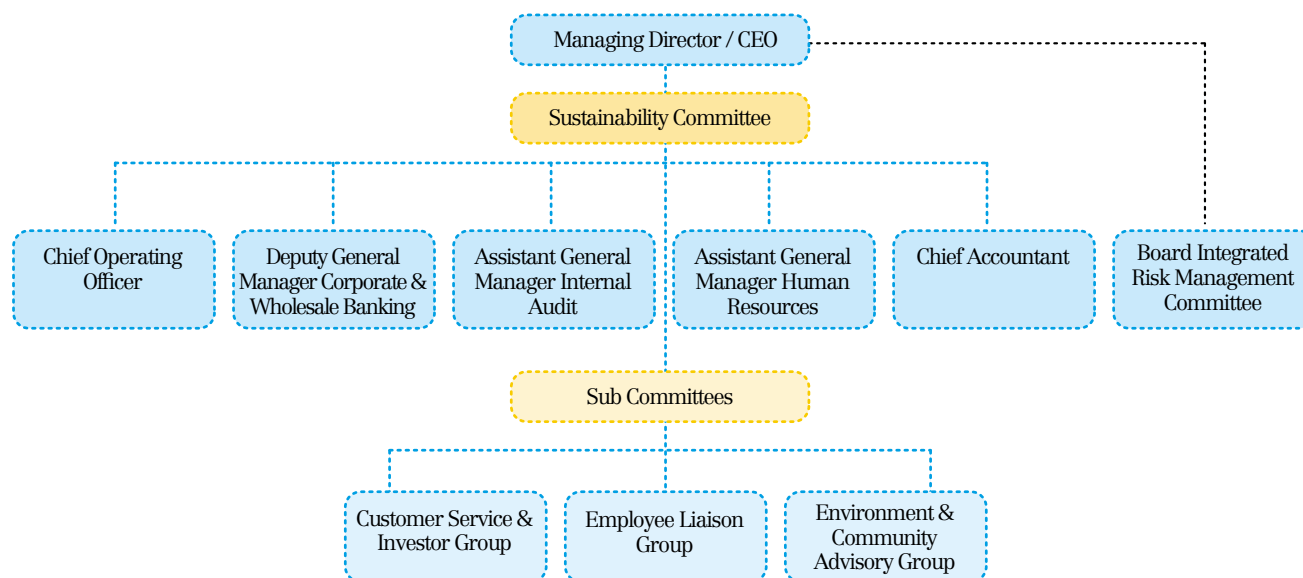
The HNB Sustainability Foundation provides oversight over the environment and community advisory group.

The Bank's Board Integrated Risk Management Committee provides oversight to the sustainability strategy formulation and implementation.

The Sustainability Committee is tasked with the following responsibilities

- a. Acting as the think tank in formulating the sustainability agenda
- b. Ensuring conformance with all sustainability guidelines and best practice
- c. identifying areas of noncompliance within the sustainability principles
- d. Proactively evaluating decisions that impact on the reputation, ethics, and values of the Bank
- e. Overseeing progress across the four strategic CSR pillars
- f. Setting standards and procedures for meeting sustainability principles.

Sustainability Report



The HNB Sustainability Foundation

The HNB Sustainability Foundation was launched in 2009 and is responsible for the social responsibility agenda and strategy formulation for community development. The Foundation independently drives the CSR strategy and acts as the base for social/community initiatives irrespective of adverse external environments. The Foundation formulates policy and strategy with implementation delegated to the Bank’s employees.

The Foundation’s Trustees comprise of 2 members of the Board of Directors including the Managing Director/CEO and 5 members of the Bank’s Management team. The presence of 2 Board Directors facilitates representation of shareholder interest.

Commitments to external initiatives

Precautionary approach

We believe sustainability management is an important precautionary approach to economic, social and environmental risk management. We are committed to serve all strata of society and through careful customer segmentation provide financial access and services across the continuum of socio-demographic groups. Sustainability is at the very core of the Bank’s corporate strategy. By integrating social responsibility into core business processes and stakeholder management, the Bank recognises its ability to achieve the ultimate goal of creating both social and corporate value.

Sustainability Precepts

1. Commitment to sustainability

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

2. Commitment to 'Do No Harm'

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

3. Commitment to responsibility

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

4. Commitment to accountability

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

5. Commitment to transparency

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

6. Commitment to sustainable markets and governance

The Bank ensures that markets are more capable of fostering sustainability by actively supporting public policy, regulatory and/or market mechanisms that facilitate sustainability.

Sustainability Report

Policies and frameworks implemented by the Bank towards sustainable business

Human Rights	Human Rights are upheld in every aspect of the Bank's operations. The Human Rights policy reflects the Bank's commitment to conduct business in a manner consistent with the principles of the policy. The Bank protects human rights within areas of influence. The Bank does not employ workers under the legal minimum age, prohibits the use of all forms of forced labour, respects employees rights to join, form or not join a labour union, respects the principles of collective bargaining, provides health & safety at work, is non-discriminatory to age, race, religion or sex, prohibits sexual harassment, limits work to standard accepted hours and condemns the use of corporal punishment.
Code of Conduct and Compliance and Integrity Programme	The Bank's Code of Conduct and Compliance and Integrity Programme is at the heart of its management approach to sustainable business. The Code is applicable to all employees and calls for honest and ethical conduct, outlines conflict of interests, misuse of corporate opportunities specifically information security, defines gifts and entertainment, calls for financial integrity in disclosure to investors and regulators, calls for compliance with laws, regulations and rules, and commits every employee to report concerns where the code has been breached.
Whistle Blowing policy	The Whistle Blowing Policy is intended to make it easier for members of staff to be able to report irregularities in good faith, without having to fear that their action may have adverse consequences. It is a key element for safeguarding the Bank's integrity. It is aimed at enhancing the Bank's transparency and underpinning its system for combating practices that might damage its activities and reputation.
Equity & Diversity policy	Equity and Diversity is promoted at the Bank through policies in place to eradicate discrimination. The Bank actively ensures that its workforce reflects diverse communities and intends to create a place where employees hold common values about respect for others, and respecting differences between people. The principles of the Equity & Diversity policy ensure that the Bank adopts a non-discriminatory approach to employment, career development, training, and all other recognition and reward.
Health & Safety policy	The Bank is committed to achieving high standards of health and safety (H&S) at the workplace and promotes an accident free occupational environment. The H&S policy is one that is holistic and inclusive, and is a priority consideration for all business operations. By complying with the above standards which supersede the minimum H&S regulations laid out by the relevant authorities, the Bank creates a secure environment for employees, customers and other stakeholders.
Work-life Balance policy	The Bank recognises that work-life balance is imperative for the wellbeing of employees, and therefore supports and promotes a balance between work and life for all employees. The Bank fully endorses the maintenance of a sound balance in work and life and acknowledges that this enhances the overall productivity of employees, increases staff retention, reduces absenteeism and raises employee morale. The scope of the work-life balance policy is organisation-wide and is applicable to all employees. It specifically covers provisions for employee leave, career breaks, financial assistance towards achieving personal objectives, integration of family in sports and social activities, access to health related information and guidance, as well as employees' access to counselling where necessary.
Grievance Handling policy	The Bank's Grievance Handling policy ensures that its employees have the opportunity to make representations to the Management for redress. This is aimed at improving employee-employer relations and thereby instituting sound industrial relations. The grievance handling procedure is a three-step approach that allows the grievance to be escalated to the highest level of authority within the organisation, ensuring fairness and transparency of the process.
The Green Pledge	The Green Pledge commits every employee to act with environmental consciousness. Every employee at the Bank is committed to the pledge and not only limits his or her behaviour to the precepts of the pledge but also commits to cascade the awareness to his or her family and peers.

Membership in associations

The bank is a member and/or represented at the following membership forums with the objective of having access to new insights, trends and research on various business related topics pertaining to the management of economic, social and environmental impacts, continuous learning and development and to influence sustainable business practices

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

Stakeholder engagement for inclusivity and partnering for progress

Our mission is to constantly exceed stakeholder expectations by combining entrepreneurial spirit with empowered people and leading edge technology.

Demonstrating mutual respect and unity in diversity, customer centricity, the courage to change, challenge and be different are among our core values.

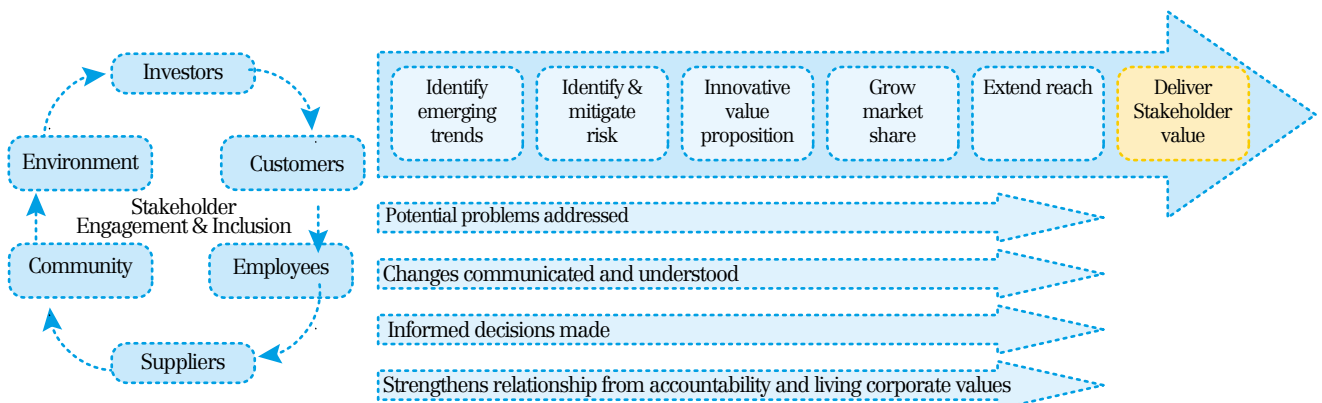
As such the need to engage stakeholders towards inclusivity is not an outcome of a reporting requirement

or based on a new management concept. It is at the core of our reason for existing as a bank which has adopted a sustainable business model from its very inception, 125 years ago.

The importance of stakeholder engagement and inclusivity has been recognised and reaffirmed over the years as part of our strategic thinking and planning process and is reflected in our performance as we lay claim to being one of the largest commercial banks in the country. It has been our belief that our stakeholders can have their say, and we as a bank are willing to listen and be challenged, as we have the courage to change and be different. Today, HNB continues to listen and work with its stakeholders through inclusivity, just as it has done over the past 125 years. We have regular honest conversations with our stakeholders, and what they say and do continues to influence how the Bank thinks and strategises. Our focus on technological advancement in 2013 is one of the outcomes of engagement and inclusivity.

Across all our activities we seek to engage with stakeholders to help us reach our ‘Sustainable Plan’, innovate, identify emerging trends, grow our market share and extend our reach. Working in partnership is crucial in developing and delivering on our major commitments, because we work on the premise of being a “partner in progress”.

We have identified investors, customers, employees, suppliers, community and environment as our key stakeholders for reporting purposes.



Sustainability Report

Stakeholder engagement process

Investors

Stakeholder	Investors
Rationale for selection	Being the contributors of capital and entrepreneurship
Sustainable Business Objectives	<ul style="list-style-type: none"> • Strike a balance between profitability in the short term and long term sustainable profitable growth • Reinvest earnings in the operating platform, in talent development, in community development and the environment to support future growth momentum • Strengthen governance, risk assessment and mitigation to support sustained growth and profitability • Deliver short term and long term risk adjusted returns on investment
Engagement Objectives	<ul style="list-style-type: none"> • Discuss and review business performance against targets, revised forecasts, projections and industry bench marks • Identify drivers of positive and negative performance, industry trends, opportunities, risks and actions taken to mitigate risks and realign with business plans • To review shareholder return vis a vis the economic performance of the Bank • Provide assurance on all regulatory and statutory compliance requirements
Method of engagement and frequency	<ul style="list-style-type: none"> • The Annual General Meeting held annually, with question and answer session to review and clarify on performance, • Provision of investor feedback form facilitating written responses annually • Conducting investor forums to discuss published results and performance of quarterly results published in the press, hosted on the corporate web site and released to the Colombo Stock Exchange • Corporate communications and press release notifications on performance, launch of new products, services and banking access • Access to management via email and telecommunication
Key topics, concerns and issues	<ul style="list-style-type: none"> • Improved profitability, increasing shareholder return • Greater interaction to gain insight into understanding the drivers of performance and reasons for positive and negative variances • More simplified information addressing quantitative and qualitative content
Our response	<ul style="list-style-type: none"> • Announcing a dividend declaration of Rs 3,399.4 Mn for the year 2013 • Debenture issues of listed subordinated debt amounting to Rs 4 Bn which were oversubscribed • Improving the corporate web site to be more interactive and informative • Dedicated investor relations team • Developing an aggressive sales and cost conscious culture across the Bank • Investing in technology, process re-engineering and redesign, revamping the MI generation to generate better quality information for decision support in developing a best in class operating platform • Anti money laundering system to fight financial crime

Customers

Stakeholder	Customers
Rationale for selection	Core value of the Bank to be customer centric. Further deposit holders contribute capital and deposits still remain the largest source of funding. Deposit holders treated as customers and not investors due to inherent feature and nature of banking model.
Sustainable Business Objectives	<ul style="list-style-type: none"> • Treating customers fairly and safe guarding the interests and rights of deposit holders • Meeting with reasonable customer expectations with regard to investment return, access and reach, service quality, financial stability and risk rating as communicated by the Bank in the public domain • Comply and conform to all regulatory and statutory requirements by maintaining prescribed ratios and capital adequacy as prescribed by the Central Bank • Adhering to good governance and having a robust control framework tested frequently for effectiveness of embedded controls. • To make capital accessible to those who lack access to capital due to socio-economic, demographic and geographic limitations • To promote financial literacy proactively in improving customer awareness across all customer segments
Engagement Objectives	<ul style="list-style-type: none"> • To understand customer needs and expectations, behavioural patterns, identifying partially met or unmet needs of the customer segments served by the Bank. • To obtain customer feedback based on reasonable expectations on product suite, service quality, investment returns, reach and brand perception • Engage to develop mutually beneficial stronger relationships • Ascertain specific customer information towards completing KYC requirements • To foster better understanding and awareness of product and service features and terms and conditions of contract, dissemination of technical expertise • Communicate changes to the existing regulatory environment and changes made to standard operating procedures
Method of engagement and frequency	<ul style="list-style-type: none"> • Customer meetings and customer visits • Site visits by field officers to review progress of projects and other funding initiatives in the area of micro finance under the Gami Puduwa programme. This has proved an invaluable source of information in providing micro finance, where no formal procedures, processes and documentation exist for credit evaluation. These visits are frequent during the time of granting facilities and bi annual thereafter. • Annual site visits to factories, project sites and corporate establishments by relationship managers who monitor progress and obtain input for conducting annual reviews of the portfolio and assess individual customer performance and project progress against milestones. • Visits to overseas markets to attract inward remittances to the country by identifying customer needs, regulatory requirements and country specific information. Creating customer awareness of product and service features in order to attract inward remittances through legitimate channels. Product specialists visited Italy, Qatar, and countries in the Gulf region and Far East during 2013 to strengthen relationships with exchange houses and bonding with the Sri Lankan expatriate communities domiciled in these countries. ‘Sri Parakum’ a premier Sinhalese Movie was staged 7 times in Italy attracting over 3000 expatriate Sri Lankans • Service delivery a major touch point with daily interaction banking at 250 customer centers located in all 9 provinces

Sustainability Report

Stakeholder	Customers
	<ul style="list-style-type: none"> • Actively involving the customer in assessing satisfaction levels pertaining to service delivery and service quality through the use of happy and sad faces at branches to assess service quality levels and standards. Initiated in 2013 at 3 head office branches • Mystery shopping exercises carried out at selected branches in 2013. Outcomes tagged to Branch managers' performance • Customer surveys and focus groups conducted in 2012 and 2013 to understand customer behaviour, attitude and brand perception from an entity perspective. Firms such as Saatchi and Saatchi and BBDO engaged to carry our surveys and research to obtain insights in branding HNB credit cards in 2013 • Training and structured workshops to improve financial awareness and provide technical expertise by engaging with communities and customer segments • Gami Puduwa Programme - agricultural officers provide technical expertise, knowhow and basic management techniques to farmers • Trade practices, trade products and export procedures, management and book keeping techniques for SME customers • Treasury services for corporate clients • Direct and mass media communication to promote awareness on products and services, provide updates and specific customer information • Reaching individuals and corporate customers through direct mailers, email notifications and through the corporate web site • Personalised SMS notifications (a first in the country), status updates, and informing customers of various offers available on use of credit cards at merchant outlets • Multimedia advertising campaigns • Press releases and press conferences to launch and announce new products and initiatives • Customer get-togethers organised for launch of new products and services • Industry reviews and technical workshops on specific topics. Workshops conducted for development banking sector with the collaboration of the World Bank. • Promoting fellowship and amity during religious festivals, fostering inclusion and diversity among communities and ethnicities, several times during the year • Through the recovery process on rescheduling of loans as necessitated
<p>Key topics, concerns and issues</p>	<ul style="list-style-type: none"> • Access and reach – more choice in channels for accessing the products and services of the Bank. Serving all customer segments in multiple industries, consideration of differently abled customers • More customer convenience –service delivery and access on a 24/7 basis, enhance banking facilities at extension offices on par with fully fledged customer centres, assistance to senior citizens • Products and service offering - requirement for enhanced service excellence, service quality and customised solutions tailor made to need, increased range of services for SME customers • Investment returns and cost of borrowing - obtain investment returns that are commensurate with the risk profile of the bank and competitive with industry benchmarks, competitive interest rates on lending and investment • Relationship management - account reviews and exit of customers who do not fit the risk profile of the bank • Compliance - completing KYC documentation and dealing with information gaps, anti money laundering screening

Stakeholder	Customers
	<ul style="list-style-type: none"> • Treating customers fairly • Formalised and Board approved customer charter detailing the rights and entitlements of customers and the roles and responsibilities of the Bank in serving customers • Assessing and evaluating customer risk profiles and funding requirements. • Safeguarding the rights of the customer by not extending credit facilities over and above the requirement and customer's capacity to repay • Improved MI to monitor non performing loans and advances, early warning signals through watch lists leading to proactive action to prevent default • Access and reach • Multi channel distribution strategy. Ease of access through multiple delivery channels, branch banking, electronic platforms, ATM facilities and internet and mobile banking access. • 250 Customer centres spread throughout the country and present in all 9 provinces • Systematic upgrading of extension offices to customers centres to provide better service • Introduction of mobile POS to reach tier II and III merchants • Separate access, specially designed restrooms, low level counters being systematically introduced for disabled customers • More customer convenience • Electronic channels and platforms that support mobile banking, internet banking and mobile POS – MoMo supporting Tier II and III merchants • Holiday banking in 59 customer centres • Products and service offering • To avail of advisory services and financial guidance in making investment decisions and entering into borrowing relationships • Free medical insurance to senior citizens • Free life and accidental life cover, concessionary rates on issuance of cheque books and legal and documentation fees to SME customer segment • Investment returns and cost of borrowing • Preferential rates to customers with strong credit profiles granted to SME customers • A special senior citizen scheme with higher interest rates • Governance and Compliance • Launched Anti Money laundering system to monitor, trace and track financial crime • Strong focus on good governance, with Board oversight and approval of transactions over and above delegated limits of authority granted to management and control framework with robust and effective controls • Automated credit automation system and process which was redesigned based on current regulatory requirement and market conditions with standardised process for credit evaluation and approval • Risk based lending

Sustainability Report

Employees

Stakeholder	Employees
Rationale for selection	Custodians of customer wealth & guardians of stakeholder interests
Sustainable Business Objectives	<ul style="list-style-type: none"> • To foster a diverse talent pool of inspired people • Engage to deliver sustainable performance through consistent achievement of targets and goals of the organisation • Ensuring workforce productivity adhering to corporate values and effective worklife balance
Engagement Objectives	<ul style="list-style-type: none"> • Create two-way relationships that inculcate team spirit within the Hatna Family concept • Consciously enhancing the tangible and intangible skill inventory and competencies of employees, through training and inspired leadership • Preserving the psychological contract that exists within an employer employee partnership
Method of engagement and frequency	<ul style="list-style-type: none"> • Open door policy for communication throughout the organisation • Ongoing employee relations, engagement and communication • Monthly Town Hall meetings at HNB Towers for the head office leadership team and joined by regional heads and senior managers via video conferencing • HR roadshows conducted with the active participation of the HR leadership team in Central, North Central and Southern regions taking HR to the people as a business partner. All branches were visited in the selected regions and a fellowship evening was conducted in each region for the branch management teams to communicate the HR strategy of the Bank • CEO's annual audio visual presentation outlining the strategic focus of the Bank disseminated via digital panels at all customer centres and broadcast to all head office staff at the HNB Towers Auditorium • Monthly corporate management meetings, weekly divisional heads meeting and quarterly strategic plan review meetings to discuss progress against plan and refocus initiatives • 'Unleash' - the innovative think tank spawning innovation and continuous improvement targets the under 25 years category including new recruits, sharing ideas and continuing conversations on product, process and system improvements and customer service. Ideations reach the Board room via the Unleash committee mentors and buddies • All cross functional committees complete a self-assessment form and review the Committee Terms of Reference (TOR) annually for efficiency and effectiveness in management decision making • Conferences for customer centre managers (annual) and regional conferences (quarterly) to share the Bank's strategic plan and review at regional level for further acclimatisation of the strategic plan • Direct one on one communication with senior leadership of the Bank and equal opportunity to reach out and access leaders • "From the CEO's Desk" - CEO's monthly email to all staff, commenting on performance, communicating changes, realigning focus with objectives and recognising achievements • In-house magazine – 'Hatna Mag' a quarterly publication distributed among all employees carrying informative articles as well as literary contribution from staff • Circulars (weekly) creating awareness on operational standards, new product launches, interest rate changes etc

Stakeholder	Employees
	<ul style="list-style-type: none"> • Email notifications (daily / weekly) • Management Snippets from the Learning & Development Centre sharing best practices with employees • Exit interviews creating a positive off-boarding experience for resigning staff and strengthening the employee brand • Talent evaluation and management through a formal training need analysis, talent audits, salary surveys, culture and engagement surveys • Assessing performance against key performance indicators (monthly) – KPI dashboard • Performance reviews (quarterly, bi- annually, annually) based on management by objective and competency based hybrid methods and balanced score card • Ongoing structured performance feedback system for performance development • Equal opportunity for learning and development via virtual classroom, external and overseas learning and development exposure, exchange programmes and study tours • Intranet (daily) access • E Learning system (daily) access • Online discussion forums (daily) • Online training systems (daily) via the Learning Management System • External training on leadership, performance enhancement and other technical subjects • Grievance Handling procedure – daily exercise carried out between superior and subordinate and HR throughout the organisation, through oral and written communication and one to one discussions.
<p>Key topics, concerns and issues</p>	<ul style="list-style-type: none"> • Recruitment and retention of the best talent through talent evaluation and management • Ensuring compliance with governance policies, codes of best practice and conduct • Consistently outperforming the industry in terms of building and managing talent through HNB's unique grow talent philosophy • Create more direct access to staff and increase face time with employees working across all regions managing the diverse aspirations of a multigenerational workforce
<p>Our response</p>	<ul style="list-style-type: none"> • Positioning HNB as an Employer of Choice amongst all generational typologies where each and every employee feels valued • Ensuring value alignment and building a compliant workforce of professional bankers • Future ready and tech savvy service providers through up-skilling and multiskilling • Transforming HR from an administrative service provider to a business partner and setting the foundation to convert HR to a centre of service excellence • Virtual learning and online training and learning content delivery to employees' computer terminals located at branches and their homes

Suppliers

Stakeholder	Suppliers
<p>Rationale for selection</p>	<p>Reduce direct and indirect social and environmental impacts through our supply chain</p>
<p>Sustainable Business Objectives</p>	<ul style="list-style-type: none"> • Social, Ethical and Environmental considerations will become an integral part of how we evaluate and select our suppliers. • To balance cost considerations with sustainable procurement practices
<p>Engagement Objectives</p>	<ul style="list-style-type: none"> • Focus on mutually beneficial ethical relationships that are built on trust and embody the values of transparency and accountability

Sustainability Report

Stakeholder	Suppliers
Method of engagement and frequency	<ul style="list-style-type: none"> • Registration of suppliers (annually) • Supplier reviews for assessing quality of goods supplied and quality of service delivered and accompanying pricing (bi-annually) • Feedback evaluations (annually) • Procurement committee meetings (monthly) • Green audit (annually)
Key topics, concerns and issues	<ul style="list-style-type: none"> • System for handling appeals and other grievances • Support micro and SME suppliers • Support and guidance to become sustainable businesses
Our response	<ul style="list-style-type: none"> • Appointment of 2 committees to address supplier issues • Over 60% of the Bank's suppliers are from the SME and micro category of suppliers • Workshops on sustainable business practices and guidance on implementation

Community

Stakeholder	Community
Rationale for selection	Social capital that provides a social license to operate
Sustainable Business objective	<ul style="list-style-type: none"> • To engage with the community at every level towards community development • To act as a catalyst for positive change and betterment through action in healthcare, education and entrepreneurship
Engagement Objectives	<ul style="list-style-type: none"> • Create sustainable self sufficient communities through education, micro financing , entrepreneurial assistance and health
Method of engagement and frequency	<ul style="list-style-type: none"> • Visits by field officers to fishing and farmer communities (on need basis) • Visits to markets and weekly fairs (Pola) of the village community • Visits to the Village schools and temples and places of religious worship • Employee involvement in local community projects (on need basis) • Continuous dialogue through network of customer centres (daily)
Key topics, concerns and issues	<ul style="list-style-type: none"> • A lack of financial awareness • Lack of funding • Links and connections to major supply chains for distribution • Lack of access to IT facilities, books and literature to develop and enhance knowledge. • Lack of basic infrastructure such as health care, access roads and schools
Our response	<ul style="list-style-type: none"> • Introducing the Gami Pubuduwa micro finance scheme as a method of assisting young entrepreneurs after the youth insurrection in 1988/89 • Provision of agricultural expertise in the areas of dairy produce, farming and fisheries through 50 graduates in agriculture • Training provided on basic book keeping techniques, financial management and related management techniques ensure the sustainability of the entrepreneurial efforts and projects • Connecting entrepreneurs with the demand chain, by linking up with MNC's such as Fonterra for purchasing milk supplies, Cargills for dairy and agri produce and reputed millers to purchase paddy harvest.

Stakeholder	Community
	<ul style="list-style-type: none"> • Setting up a separate Trust to carry out community development programmes – the HNB Sustainability Foundation to ensure continuity of the Bank’s community projects • Establishment of school libraries • Computer centres in schools to develop awareness and skills on information communication technology • Counselling centre at the National Cancer Institute • Providing financial assistance to cancer patients • Community development through investment in remote rural areas

Environment

Stakeholder	Environment
Rationale for selection	Natural capital for sustenance and existence
Sustainable Business Objectives	<p>To promote environmental conservation at the work place through the green pledge, integrating environmentally friendly practices into daily operations whilst also giving due consideration to</p> <ul style="list-style-type: none"> • Responsible lending practices through green banking • Green procurement • Implement an environmental management system (EMS) • National asset restoration
Engagement Objectives	<ul style="list-style-type: none"> • Ensure a sustainable planet through conservation and preservation of the environment by introducing best practices
Method of engagement and frequency	<ul style="list-style-type: none"> • Creating and reinforcing awareness on a continuous basis through the conduct of efficiency meetings (monthly) • Site visits • Annual reviews of facilities • Registration of suppliers annually • Consultancy audits (ad hoc)
Key topics, concerns and issues	<ul style="list-style-type: none"> • Climate change • Energy conservation • Reduction of carbon foot print
Our response	<ul style="list-style-type: none"> • Green building and eco-friendly practices in Nittambuwa, Jaffna and Kalmunai • Funding to rid the Bundala National Park of invasive species • Green banking • Green procurement • E-waste programmes • The green pledge • Tree planting initiatives

Sustainability Report

Economic Wealth Creation

Economic Wealth Creation

We believe in aligning our sustainable strategies with the national goals and targets. By being present across a wide range of industries and serving all income segments we contribute to the economic and social development of the country. Our initiatives in funding the retail and SME sectors have boosted the entrepreneurial spirit of post conflict Sri Lanka while our efforts with development banking have resulted in community development and improving the financial awareness, entrepreneurial agility and living conditions of rural Sri Lanka.

The investments in information communication technology and digital convergence have contributed to developing high end electronic channels (mobile and internet banking, ATM access through 700 locations),

making finance more accessible to all citizens across different walks of life and geographical locations. Our pioneering effort in attracting worker remittances from expatriate Sri Lankan communities has brought in valuable foreign exchange through the banking network into the country.

We have funded infrastructure development for tourism, housing, road construction, renewable sources of energy and agricultural development, demonstrating our commitment to national development goals and priorities.

By working towards achieving our own corporate strategies, goals and targets we have created wealth for the nation, through our stakeholder engagement and inclusivity we have created wealth for our investors, customers, employees, suppliers and communities, while safe guarding and conserving the environment.

Our management approach to economic wealth creation

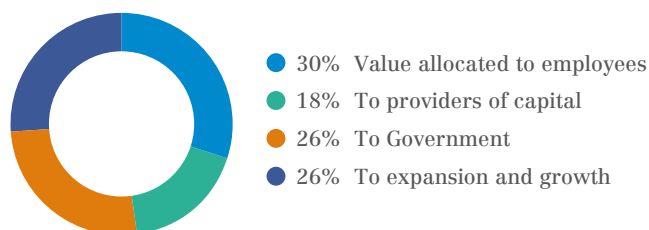
A distinctive investment, delivering sustainable performance, creation of wealth and value over time

It is our objective to provide equal opportunity and access to banking and finance by being present across all sectors through an array of products and services differentiated through service quality and relationship management. We reach our customer through 250 customer centres spread throughout the country and through electronic channels such as mobile and internet banking and 415 ATMs located around the country. Over the past two years we have focused on the following strategies in driving sustainable performance and investment returns.

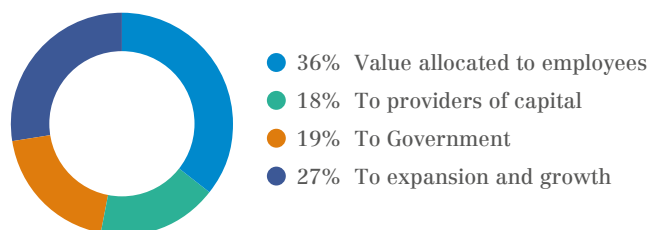
- Capital adequacy: Higher quantity and quality of capital to strengthen resilience to absorb shocks from financial and economic stress
- Driving an aggressive sales culture towards profitable balance sheet growth
- Growth in fee income
- Operational excellence and cost optimisation
- Focus on governance, transparency, compliance and responsible reporting
- Building a competent engaged and motivated team

We have fostered entrepreneurship and engaged with our stakeholders in an ethical transparent manner. We have reinvested in the business in revamping systems and driving digital convergence in a bid to provide more choice of access and convenience to our customers. We have invested in our people to evaluate and develop talent and train the workforce towards being multi skilled. We have invested in the communities we operate and created value for our investors.

Analysis of Value Addition 2013



Analysis of Value Addition 2012



Wealth creation for investors

The Bank enhances shareholder value by focusing on growth in sustainable earnings and recording above average returns on equity.

Despite short term fluctuations in share price the Bank has succeeded in providing attractive returns to its shareholders over the long run.

This section should be read in conjunction with the Financial Review detailed on page 82 of this report.

Customer value creation

Value creation not limited to mere funding.

As a Bank we remain committed to serving customers in all segments and strata of socio economic groups in all geographic locations. We cater to the wide and varied needs and expectations of our customer base, that comprises of large and medium scale corporates, retail customers, SME and micro segments.

We offer value to our customers in their pursuit of wealth creation. Our value proposition to our customers offers more than funding and access to capital in addressing their expectations and needs. We offer customised and tailor made solutions using our wide range of products and services, speed and efficient service, choice and convenience in accessing our products and services. We also provide peace of mind and partner in their progress using one of our core competencies of relationship management. Our customers are beneficiaries of the vast amount of knowledge and experience we have gained in

serving and partnering Sri Lanka for 125 years in her journey of progress.

Our products have been subject to stringent testing and continue to evolve based on changing needs and wants of our customers and comply with the regulatory standards prescribed. We have selected a multiple distribution strategy for accessing our products and services. Our investment in electronic channels such as mobile and internet banking, electronic data exchange facilities, near field touch cards for payment facilities and smart ATMs complement our branch foot print of over 250 customer centres island wide, providing our customers speed, choice and convenience in accessing our products and services in pursuit of their own wealth creation.

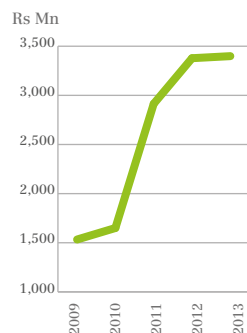
Our access to several correspondent banking relationships across the globe and strong relationships with exchange houses have facilitated global access and reach in supporting export development, trade related activity and inward foreign currency remittances into the country. We have added value by having the requisite infrastructure and trade services in place to support the national efforts of narrowing the trade gap, driving exports and providing our customers with access to international trade corridors and markets.

	2009	2010	2011	2012	2013
Earnings per Share (Adjusted) (Rs) *	10.9	11.2	15.7	18.9	17.6
Dividend Yield (%) - Voting	3.8	1.8	5.0	5.7	5.8
Dividend Yield (%) - Non Voting	6.2	3.3	9.0	7.6	7.1
Assets Growth (YOY) (%)	9.2	12.0	19.0	17.3	14.3
Holding Period Return - Voting (%)	153.4	139.0	(42.7)	3.4	5.1
Holding Period Return - Non Voting (%)	247.7	111.6	(39.6)	45.4	13.3
Operating Cost - Efficiency Ratio (%)	52.7	54.9	55.3	53.0	47.8
Share Price - Voting (Rs)	170.3	399.9	151.3	148.0	147.0
Share Price - Non Voting (Rs)	104.8	214.6	83.2	112.5	119.0
Gross Dividends (Rs Mn)	1,533.2	1,649.5	2,914.5	3,378.7	3,399.4

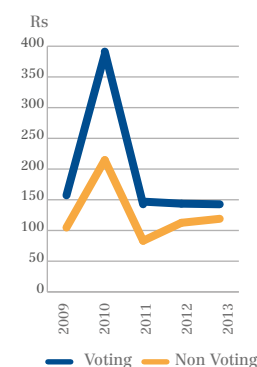
* Earnings per share has been adjusted for weighted average number of shares during the current year.

Sustainability Report

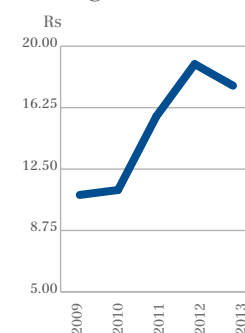
Gross Dividends



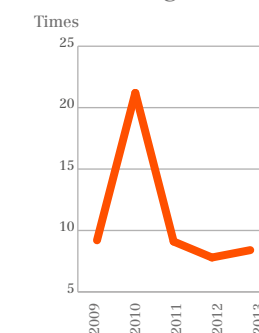
Share Price



Earnings Per Share



Price Earnings Ratio



Value proposition to the SME and micro segments

a. The Small and medium enterprises (SME) and small and medium industries (SMI)

The SME and micro customer base remains critical to the Bank from a strategic perspective. The introduction of SME cells into the regional customer centres has facilitated the transfer of technical expertise, building the required awareness on trade services, export and import procedure and offering tailor made solutions to the growing wants and needs of the SME and SMI segment. Structured workshops conducted by the well experienced Trade Services team for both staff and customers at various regional locations have addressed the critical need for financial awareness and literacy in developing and building capacity in this sector. This sector also affords opportunity to the Bank to cross sell its products such as leasing facilities, housing loans, personal loans and credit card services arising from the diverse needs and wants of this sector.

Our financial literacy and knowledge sharing programmes for SMEs and SMIs have fostered commercial viability over the years, and helped graduate these industries and enterprises to more complex and sophisticated commercial entities that continue to remain loyal customers of the Bank. The Bank’s financial literacy programme has followed a planned approach over the last few years, and we have effectively collaborated with other corporates and Chambers of Commerce to establish linkages and share know-how, to facilitate SMEs and SMIs to develop their potential and follow a realistic roadmap towards sustainable business practices and capacity enhancement.

Training programmes have been conducted in areas such as Ratnapura, Gampola, Embilipitiya, Matale,

Trincomalee, Buttala, Medawachchiya, Jaffna and Kilinochchi by renowned consultants in all three languages with regard to these issues and capacity building and Environmental Friendly entrepreneurship. Additionally, the bank has trained 90 Branch Managers, Executives, Junior Executives selected from all regions of the country to provide the services to SMEs.

b. Gami Puduwa (Village Reawakening) programme

(This section must be read in conjunction with information contained on pages 64-65 contained under the management discussion analysis.)

We have pioneered the introduction of financial services to persons considered otherwise as “non-bankable”. The HNB Gami Puduwa (Village Reawakening) micro finance programme emphasises harnessing the skills of rural entrepreneurs towards achievement of self sufficiency.

We recognise that one of our most critical roles is to support the growth of the economy, effectively fostering wealth creation and facilitating capacity development in the area of development banking. Please refer to the review on Development banking on pages 64-65 for detailed information.

We employ 40 graduates with training in agricultural expertise to impart technical knowledge and expertise in the areas of farming, fisheries and dairy production. They are graduates with well-established links to the Department of Agriculture, Coconut Cultivation Board, Animal procedure and health and the Gannoruwa In-service Agriculture Training centre. We stay connected through our deep rooted network comprising of over 110 field officers who work and live within the village, and 10 regional offices and 110 dedicated micro finance units

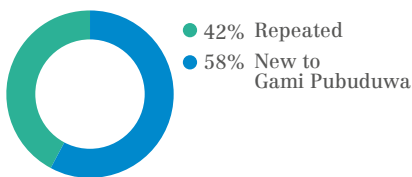
that support the work of the 'bare foot bankers'. These field officers play a critical role in assessing the financial needs and viability and potential of entrepreneurial endeavours and projects, as information and documentation to assess financial standing and credit worthiness is almost non-existent.

The Bank also facilitates engagement with demand chains by connecting these rural farming and fishing communities with large local and multinational corporates operating in the FMCG space through market linkages to purchase produce. Paddy farmers are linked up with large scale millers for further value addition and storage of produce. These initiatives have provided these communities with access to markets, minimising financial

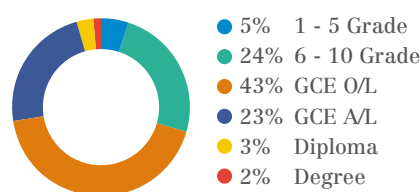
losses through crop failure and inability to sell produce due to lack of storage capacities during harvest. Additional loans granted on concessionary terms have helped these communities sustain their livelihoods during times of drought and floods, despite the adverse impacts of climatic change.

As done in the SME sector, the Bank provides input and training in the areas of financial management, book keeping and basic governance principles. The overall need for governance is reinforced and developed over time through such structured training programmes and contributes to the overall improvement and enhancement of best practice and corporate governance at a national level.

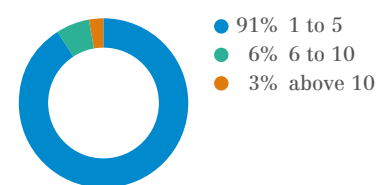
Banking Relationship



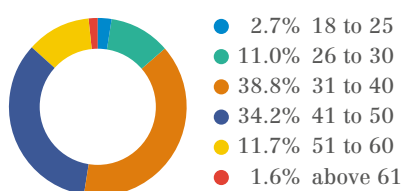
Level of Education



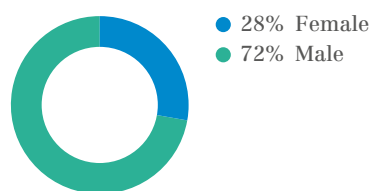
No. of Employees (including promoter)



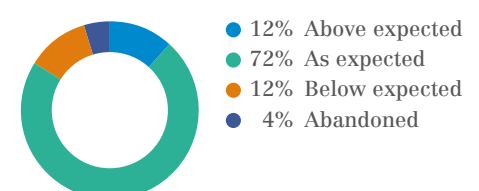
Age (main promoter)



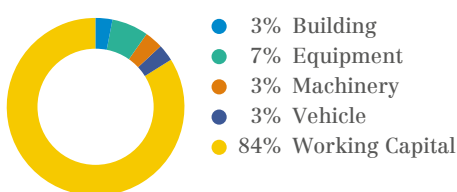
Gender (main promoter)



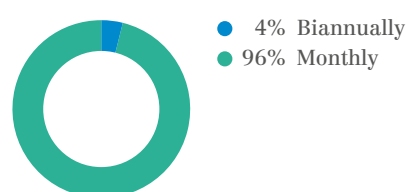
Present Status of the Project



Purpose of Loan (Main)



Repayment Frequency



Sector



Sustainability Report

Value creation for migrant workers

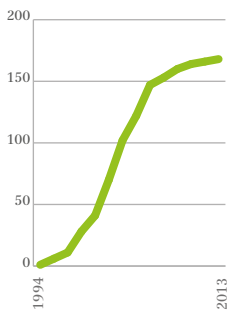
Assistance to the migrant workers who are Sri Lanka's highest forex income earner remains a core pillar of our business strategy. But the Bank does not limit itself to merely facilitating inward remittances. Instead, over the years, we have been increasing our focus on inculcating the savings habit, promoting RFC savings whilst offering and cross-selling a range of domestic currency financial instruments and services such as agricultural loans. Thus, capacity building through savings and capture of capital has enabled the Bank to effectively sustain the livelihoods of its client base whilst also meeting national objectives towards the augmentation of foreign exchange reserves.

Central Bank of Sri Lanka, the Bank has progressively approached schools, assisting them in infrastructure development and capacity building. To complement the national curriculum the Bank established Student Savings Units within the premises of these schools and has effectively inculcated the savings habit amongst today's youth whilst also imparting the basics of financial education, responsibility and accountability.

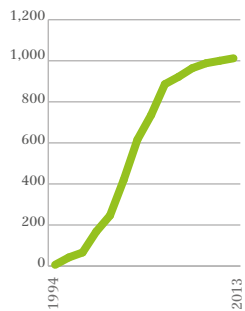
Student Bankers

Most importantly, we have been leading a move to inculcate the savings habit amongst children, the future of our nation. Through the HNB Student Managers Programme, which was established in 1994, the Bank has been engaging and empowering youth. Over the years, with the consent of the Ministry of Education and the

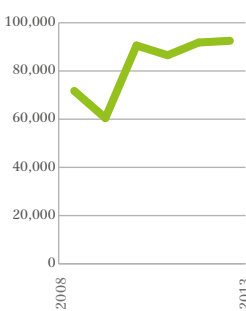
No. of student savings units



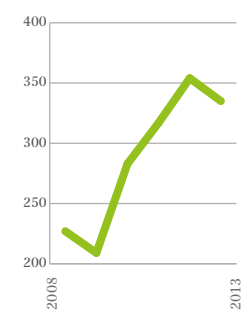
No. of student managers



No. of student savings accounts



Cumulative value of student savings (Rs Mn)



Value creation for employees

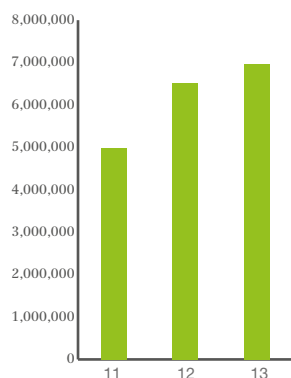
2013 - Number of recruitments made permanent category

Year	No. of Employees
2011	133
2012	205
2013	104

2013 - Number of employees promoted

Year	No. of Employees
2011	271
2012	188
2013	131

Salaries & other benefits to employees



***Personnel expenses for 2013 after adjusting for the one-off reversal on ESBT provisioning of Rs 1.5 Bn*

Value creation for suppliers

Suppliers have a bearing on our sustainability as stakeholders influencing the supply chain excluding depositors. In this light it is appropriate that the boundaries are defined for sustainable practice. Our strategic sourcing strategy promotes sustainable procurement by taking into consideration environmental, ethical and social factors when making sourcing decisions. We view supplier relations as an opportunity to promote greater economic activity especially in the area of micro-enterprise.

The procurement policy of the Bank is based on equitable wealth creation and providing equal opportunities to suppliers through a transparent procurement process. The procurement policy specifies that the procurement of goods and services must be at fair prices, is accommodative of credit periods for suppliers that require financial assistance, and comprises of a review process for supplier complaints. Stringent review process for suspension of supplier services enhances transparency as does the tender process. Late delivery penalties are imposed on suppliers with suppliers having to adhere to the terms and conditions of the Bank's Green procurement policy.



Sustainability Report

Social Performance

Our approach to sustainability on the social dimension is concerned with our impacts as a Bank on the social systems within which we operate. It addresses the key performance aspects surrounding our people policy and management approach with regard to our employees, human rights, our corporate social responsibility to society and product responsibility.

Customer & product responsibility

Our Bank provides access to a range of financial services and products in response to diverse financial needs of our existing and potential customers and is present in all sectors of the economy, serving customers of all ages and walks of life and belonging to all income categories.

Our core focus in product responsibility is to aim for simplicity and transparency across the service delivery process and in the product offering. We aim to achieve the following.

- Ensuring that product features and pricing is explained to and understood by our customers

- Creating awareness and understanding surrounding the terms and conditions of contract/products and services
- The provision of factual information on our value propositions, products and services being made available to the customer through product literature and brochures in all 3 languages
- Communicating responsibly through individual and mass communication in any form of media and promotional material in all 3 languages to ensure that our marketing communication material does not contain any information that could mislead the public.
- Not lending beyond what is actually required by customers by assessing their financial needs and capabilities to repay, based on their future cash flows and the viability and financial feasibility of income generation.
- Endeavouring to speedily address customer complaints

We are governed by the Banking Act No 30 of 1988 and comply with the conditions outlined in the customer charter issued by the Central Bank of Sri Lanka.

Customer Service Highlights 2013

- The Banker Magazine - “Bank of the Year”
- Excellence in Retail Financial Services Awards 2012 “Best Retail Bank in Sri Lanka”
- Business Today Top 25
- 3 new customer centres
- 8 new and revised products and services
- Launch of the new ATM Switch
- Launch of e-Space credit origination system and a new leasing system ‘Lease Wave’ with enhanced features
- 9 financial literacy and capacity development programmes for SMEs
- Extensive mystery shopper exercises in 53 customer centres and customer surveys covering over 12,000 customers



Management approach to customer responsibility

We treat our customers fairly

We ensure that we safe guard the capital lent to us by depositors based on trust, by maintaining capital adequacy above regulatory specified thresholds, by defining our risk appetite for credit, and other identified risks and lending within the risk appetite of the Bank. We provide our customers with a return that is adjusted for risk and commensurate with the risk profile of the Bank. We make every effort to ensure that our customers understand the implications of investing their capital with us, that they are made aware of the inherent features of our products and services. We assess their credit profiles and financial requirements and repayment capacity and capability when we tailor solutions, by understanding their needs using our entrepreneurial capabilities and deep knowledge. We treasure personal and professional integrity at all times, a core value that leads us to believe in long term relationships, commitment and assistance in times of need. We ensure that we invest and coexist in harmony with our communities and environment, and refrain from practices and avoid transactions that undermine sustainability and are detrimental to our own long term survival and conversely endorse Green banking.

Management approach actioned

Responsible lending practices comply with regulatory guidelines and determinations of the Central Bank of Sri Lanka; uphold human rights and environmental conservation standards issued by the Central Environmental Authority and any other regulators. For us, behaving responsibly does not only mean avoiding products, advice and services that might have a negative impact. Above all, it also means creating value and generating benefits for society. Our positive impact is especially evident when we make capital available to companies involved in clean technology, renewable energy or other low-carbon sectors.

Products and services are governed by the customer charter which is available on the Bank's web site.

Key Facts Document is prepared and shared with customers on request, and is available in all 3 languages.

Detailed description of products, financial and other benefits to customers including any incentives and promotions, fees, charges, commissions levied from customers, procedures to be followed to obtain products and services, major terms and conditions, and the common procedure for addressing complaints

Digital screens and video walls are used to publish the following at all our customer centres in all 3 languages. This would be the equivalent to product labelling carried out as part of health and safety conditions in the FMCG category

- Current interest rates on all deposits and loan products
- Buy and sell rate of foreign currencies
- Credit rating of the Bank with underlying specifications
- Banking hours and holiday notices

Regulatory requirements are also displayed on digital screens in 3 languages at all customer centres ensuring transparency. This is centrally controlled to avoid any opportunity for manipulation.

We observe an ethical and responsible advertising code in compliance with guidelines specified by the Central Bank of Sri Lanka as contained in the customer charter, the 4 A's advertising standards (industry body for Advertising) for media communication and by our brand values.

Mass media communications are made in all 3 languages and customised to each region.

We advertise only on reputed web sites.

The Code of Conduct and Code of Ethics enhance focus on Anti-Corruption Practices, Compliance and Transparency. Customer confidentiality is safe guarded and maintained.

Periodic statements capturing transactions, balances of deposits and loans, minimum balances to be paid on credit card transactions and interest amount charged are sent to customers in electronic or printed form to their permanent residential address or as specified by them.

We have in place a whistleblowing policy for corruption and malpractice.

A product development committee chaired by Chief Operating Officer has functional representation including the Compliance Officer who certifies compliance with regulatory requirements. The Committee TOR includes fair pricing, positioning and accurate and reliable communication.

Access to products and services facilitated through 250 customer centres, 685 ATMs, (includes 415 owned by HNB and shared ATM's) Internet and mobile banking with 80,000 + registrations, 7,300+ Master Card mobile electronic POS machines and debit cards using near field technology.

Multi-channel access facilitated customer convenience, choice and access on a 24/7 basis. Electronic channels compliment the extensive branch foot print.

Sustainability Report

Customer engagement and inclusivity are given priority working towards new and improved customer solutions and stronger relationships.

The installation of a new electronic payment SWITCH, significantly improved service standard of ATMs.

Research studies conducted on savings behaviour in Sri Lanka, tracking brands of the bank on 5 key factors of, awareness of the product brand reason for consideration, impact, association, and emotive loyalty to recommend as favourable brand in order to compute the brand equity index.

Surveys were carried out to assess service quality and delivery through 83 mystery shopping exercises at selected branches, and through focus groups. 12,000 questionnaires were circulated in all 10 regions.

A formalised customer complaint system and complaint management process was implemented

An independent compliance function was established for AML, KYC under the Compliance policy

A data security and fraud management strategy implemented during the year

Your partner in progress

Identifying and serving the interests of customers is driven by our core value of customer centricity. The Bank focused on 6 areas to serve customer interests

- New product development
- Embracing the next generation of customers
- Access to banking services
- Protecting customer interests
- Listening and engaging with our customers
- Financial literacy to build lives

Designing and developing customer value propositions.

Market needs assessment, customer feedback, regulatory requirements, emerging technological and social trends such as the advancement of social networks and digital convergence have been key inputs to product design and development. We have evaluated the needs of Generation Y customers who are technologically savvy and connected to multiple social networks, and catered to their need in developing Apps and mobile banking, in launching Face Book banking.

Each new product is fully tested and evaluated for suitability and undergoes a rigorous assessment for compliance in addition to being often put through compliance testing and validation to the regulator, the Central Bank of Sri Lanka. The product development committee plays a key role in evaluating how well new products/services and value propositions are aligned with customer needs and the degree of compliance with regulatory requirements to ensure that customers' are treated fairly and their rights are protected.

The customer charter is the guiding framework and glue that safeguards the rights of depositors, borrowers and the Bank. Our product fact sheet for each product/service provides a comprehensive overview of the costs, additional charges and outlines implications of the product. The Bank undertakes awareness creation on new products giving customers a holistic understanding of the product, service or value proposition, and supplements these with consistent product communication such as video walls at branches to bring greater transparency and create awareness in all 3 languages.

Our Customer Intents



2013 New / Revised Products & Services

Product/Service	Brand	Description and Target Customer Groups
Electronic banking services (Mobile Phone Banking)	HNB Mobile Banking	Banking anytime and anywhere in the island, conveniently via your mobile phone. The solution is available on any phone type – from the basic to the most advanced and can be used on different platforms. Services include; balance inquiry, mini statement, bill payments, self-fund transfer, any HNB fund transfer, chequebook request, cheque status inquiry etc
Mobile POS solution	HNB MOMO	HNB MOMO can be used by any business including micro level businesses such as three wheelers, boutique shops up to any large scale business such as home delivery, supermarket chains, clothing stores, luxury cab services etc who may not have large sum transactions and also give greater scale of mobility and more convenience to customers. Simply the unit can be plugged to a smart phone and the vendor will obtain the capability of accepting debit and credit card transactions.
Senior Citizens Account	HNB Senior Citizens Account	Senior citizens scheme was re-launched adding more value to the senior citizens. A gift voucher scheme and free confirmation of hospital deposit was introduced for senior citizens savings accounts and current accounts in addition to the various benefits offered for the account holders such as hospitalisation cover, discounts at renowned organisations etc.
Current Accounts	HNB Privilege Current Account	Product was modified with value additions for professionals & executives earning a monthly net income of Rs 50,000 and above
Current Accounts	Shareline Current Accounts	Shareline current accounts was re-launched in June 2013 for HNB shareholders. The minimum share requirement has been increased to 10,000.
Electronic Banking Services	HNB Internet Banking	The interface of the product was modified to make it more user friendly.
Internet Based Payment Systems	HNB PayFast	The product was modified to initiate transactions from any location of preference. It facilitates all business and personal payment transactions such as supplier payments, salary payments and fund transfers. Businesses that sign up for PayFast can also automate their ETF and EPF payments reducing a bulk of tasks.
Educational Loans	“HNB GRADUATESHIP” Loan Scheme re-launched as “HNB FUTUR+” Higher Educational loan Scheme	The existing product was modified to finance education loans for professional courses and degree programmes conducted locally and abroad to cover registration, tuition and exam fees and including hostel / living expenses for courses conducted overseas.

Sustainability Report

Access to Banking Services

The Bank is committed to serve all strata of society through effective product segmentation and provides financial access and services across the continuum of socio-demographic groups.

2013 Multi-Point Distribution Network

	2011	2012	2013
Customer Centres	240	247	250
HNB Student Banking Centres	164	166	168
No. of branches with dedicated micro banking officers	119	129	129
Micro Banking Units	9	9	9
Crystal Circles – Personalised Banking Services	3	3	4
Priority Banking Services	1	1	1
On-site ATMS	335	339	340
Off-site ATMS	65	71	75
Total ATM penetration points including strategic collaborations	400	672	685
SMS Banking	✓	✓	✓
Electronic Banking	✓	✓	✓

Protecting Customer Interests

Our relationships with our customers depend upon trust. To retain this trust we must set our customers' interests first while ensuring that all our customers are treated fairly according to the highest standards of service, transparency and responsible banking practices. We conduct our business in an ethical way, guided by our core values of mutual respect, continuity, professionalism and commitment.

The Bank is extremely conscious of the need to safeguard the interests of its depositors. Through many measures of governance and risk management, the Bank has earned a reputation as a stable financial institution. The deposit product line is vast and extends across the lifecycle continuum with products available for newborns to senior citizens.

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

Ensuring that our customers can afford to manage their credit is a key component of responsible lending. This is

why our credit decisions are always based on the customer's individual situation and repayment abilities.

Our approach entails fair and ethical marketing, and we consciously avoid products that may pose risk of debt over-exposure to our customers whilst ensuring that our depositors stay safe.

Fraud prevention has been a priority for the Bank in recent years, including the launch of a new fraud prevention strategy. We are strengthening our focus on proactive measures, by reviewing fraud issues earlier in the business processes. Our core fraud combating units are Security, Compliance, Internal Audit, Information Security, Human Resources and Risk Control. They work together to strengthen fraud prevention management. This includes assisting business and support functions in building and maintaining "fraud proof" banking processes.

Security and Safety Initiatives:

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

Initiative	Description	End Objective
AML Risk profiling of all customers	Action taken towards implementing on-line collation of data to better profile customers based on risk	To meet regulatory requirements and combat financial crime in upholding our core values and commitment to good governance and codes of best practice
Obtaining KYC data from customers	An ongoing process to track vital information of customers in a central data repository	Carry out customer due diligence, customer profiling for product development and design of value propositions. To facilitate greater engagement, understand the financial needs and expectations of customers in providing solutions
Key risk indicators, risk dash boards, risk profiling and identification. Stress Testing and calibration of risks	Stress Testing enables the Bank to determine the impact on portfolios if risks were to materialise, and how much additional capital they would need to hold.	Monitor exposure and sensitivity to various risk profiles, determine capital adequacy, maintain stability and sustainability
Implementation of Risk Management Systems	To enhance and automate the Bank's risk monitoring processes	Detect early warning signs, improve information on experience studies and manage risks proactively
Disaster Recovery Systems and processes	In the event of a natural or manmade disaster the ability to restore systems and resume operations within a short space of time	Business continuity and data security is ensured through continues disaster recovery and business continuity planning (BCP) drills by enhancing preparedness
Business Intelligence & Analytics tool	Enables better management of big data, access to timely customised business intelligence and MI due to automation and drill down facilities	Enhance and improve decision making, through better business decisions made on a timely basis
Data security enhancements	Adoption of better encryption methodologies for internet banking, mobile banking and credit cards	Enhance security of transactions, customer confidentiality and security
Multifactor authentication	Adoption of multi-layer authentication for online banking	Enhances security of data and transaction
3D security implementation	Payment gateway security enhancement	Ensures transaction points are secure
Stable operating platform	Ensuring accuracy of transaction processing and information capture and computations	Responsible accurate reporting of all financial information and transaction
A strong control environment	Automated processes with embedded controls, good governance, accepted best practices and compliance with all regulatory and statutory requirements	Sustainability and business continuity

Sustainability Report

Listening and engaging our customers

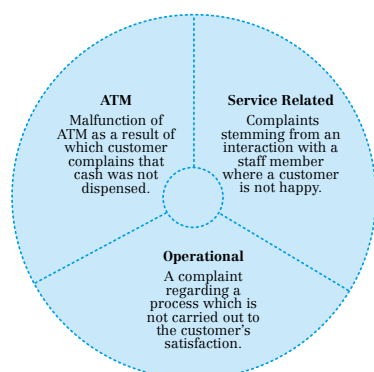
Our core competency of relationship management and deep rooted knowledge gained over a century and more leads to positive engagement and inclusivity at all customer touch points. We engage with our customers as means to continuously improve our service delivery and service quality, to continuously develop and position our product and service offering based on customer expectations and perception. We also engage with our customers to provide financial advisory services keeping their best interest at heart, to improve their financial awareness and literacy and empower towards greater financial progress and prosperity, to provide them with peace of mind and keep them aware and abreast of regulatory changes and emerging trends.

How we deal with complaints

To improve customer satisfaction, the fundamental principle is to always process complaints fairly, effectively, and without delay. Our customer centre staff and complaints management team are responsible for handling customer complaints and recommending suitable solutions.

Our complaints management process helps staff record customer complaints in the complaints management system, which ensures continuity in the resolution process and provides a holistic view of the complaints to top management. In this way, we can identify recurring complaints and faults in product and service processes at an early stage. We also track the efficiency of the resolution process and review unresolved complaints. We protect the customers' interests and improve customer satisfaction sustainably with the aid of our values, our principles and our internal processes.

Areas of frequent complaints



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We promote a blame free culture and work towards a culture of learning and knowledge sharing. In sharing common, recurring or specific customer complaints among our team at customer touch points we preempt reoccurrence and create greater awareness and understanding about customer sensitivities, behavioural trends and expectations. We become more conscious and receptive to what is expected from us, on our service delivery, product features and processes, in short the whole customer experience, as perceived by the customer.

During the year, 9 training programmes were held on managing customer complaints with 364 staff members being trained in this area.

	2011	2012	2013
No. of customer centres	240	247	250
No. of direct complaints	289*	510*	729*
No. of complaints to the Financial Ombudsman	11	12	15

** excluding complaints received at the Central Monitoring Unit

Sharing our knowledge with customers

We have actively engaged to improve the financial literacy of our existing and potential customers and the public and society at large from our deep knowledge of the banking industry. Our entrepreneurial experiences across all sectors and customer segments have given us a comparative edge and advocacy. Being a systemic bank we recognise the importance of our role and involvement in creating awareness on the latest trends sweeping across the banking and financial service sector.

We have developed a variety of programmes and initiatives to help different customer segments to better understand financial matters and improve their knowledge of banking and finance. Our commitment to building capacity on basic business skills, financial capabilities and providing access to business networks is apparent from the many initiatives that we direct to a spectrum of sectors and customers as outlined below.

Project	Description
Student banking: Financial literacy to the youth	The Student Banking Programme was established in 1994 to involve rural youth, provide them access to resources and to allow them to interact with the rest of the nation. The Bank established Student Savings Units within school premises with a view to not only inculcate the savings habit but also to impart financial education, responsibility and accountability to Student Bankers
Financial literacy to rural, micro entrepreneurs and youth empowerment programmes	The “Divi Saviya” Programme has been in existence for over two decades and creates financial inclusion for rural micro entrepreneurs. During the year 132 programmes were held for 32,571 participants
Financial Management Education	Programmes aimed at creating a greater understanding of financial management amongst Small and Medium Enterprises. Seminars and workshops on Marketing Management and Improving Business Skills for Entrepreneurs were organised by the Bank with the financial assistance of the SMEDeF credit line and conducted by International Finance Corporation authorised trainers. During the year programmes were held in 9 districts
Programme on International Trade	Seminars and awareness programmes for our customers on international trade. During the year one such programme was held.

Sustainability Report



Chiranthi Cooray
*Assistant General Manager
 Human Resources*

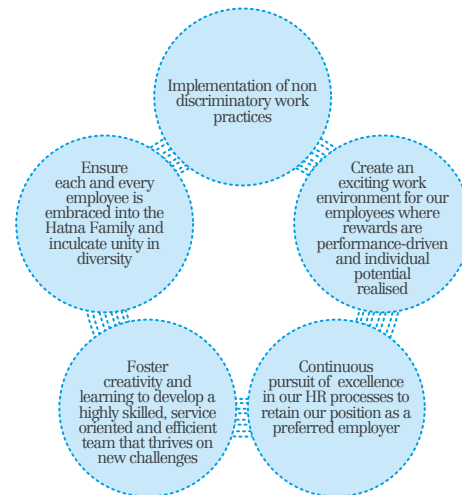
We employ 4,604 people, from different age groups and diverse professional and social backgrounds. We are an equal opportunity employer. Our brand identity has made us an employer of choice and given us the equity to attract the best talent from within the country and Sri Lankans working in overseas markets.

Labour practices and decent work

Employee of Choice

Our human resource philosophy is recognised by the many awards and accolades we have won locally and internationally, as an employer of choice. It has led to our relentless pursuit of greater excellence in developing the potential of our people who in turn contribute to the national goals of resurgent Sri Lanka. We stay committed to our values and ideals that have been handed down over 125 years to face the challenges of our times, in sharing our knowledge and experience with our people and the banking and finance industry in Sri Lanka. We consciously and actively drive the dignity of labour concept in our day to day dealings, which creates a conducive and equal opportunity work environment.

Our employee intents



Awards, recognition and progress highlights 2013

- Overall Award for “Best Results Based Training” at the 4th CMO Asia Awards in Singapore. This was the highest award in the category “Asia’s Training & Excellence Awards 2013” conferred by the World HRD Congress, Stars of Industry Group partnered by CMO Asia and endorsed by Asian Confederation of Business
- “Unleash” – a programme to encourage innovation and ideation amongst the young HNBers
- “Aspire” – for high potential managers
- “HNB Future Leaders” – a 2 year cutting edge programme for management trainees
- HR Roadshows – taking HR to the employees

Our management approach to employee excellence and development

Creating talent pools of inspired people in a common bond - Hatna Family

Our promise is to offer our employees and potential recruits equal opportunities for career development and progression, regardless of gender, ethnicity, age or religion. We provide our employees with the resources, opportunities, skills and forum to develop the courage to change, challenge and be different in creating a pool of inspired people. Our responsibility is to evaluate and manage talent through a performance based culture, inculcating a strong work ethic that is based on living our values. We have created a work environment that is conducive to developing the individual and is a secure and safe work place. We commit to respecting rights of individuals and groups.

Our employment benefits, remuneration schemes, rewards and recognition systems have paved the way for our people towards economic freedom to pursue their individual aspirations and dreams.

By focusing on a sustainable strategy and performance based culture, we provide opportunity for career development through diverse and structured mediums of learning and career progression. We cater to personal development objectives by way of constructive, continuous feedback from appraisals and development initiatives. Learning and development is part of our culture, the catalyst for ideation, innovation, creativity, personal excellence, team work and collaboration. We invest in our people to lay the foundation for a workplace that challenges, stimulates creativity and pushes our teams to innovate.

As a Bank we have demonstrated the importance of integrity, accountability and ethical work practices as part of our approach to sustainability and inculcated accepted codes of best practice and governance into our work ethic. In addition our work ethic is based on the principles of equality, meritocracy and a participatory approach. We encourage individual pursuance of excellence, teamwork and entrepreneurial spirit within the risk tolerance of the Bank, accepted codes of best practice and governance and within the frameworks of regulatory and statutory compliance.

From a professional stand point we endeavour to provide an environment that is conducive to development in a range of technical competencies with a focus on creating leaders in banking and finance. By employing 4,604 people and supporting their progress in

a banking career we have contributed immensely to the national goal of retaining our talent. We have contributed to the requirements of the industry by attracting, developing and nurturing the skill and competencies required by the industry in an era of global migration and brain drain.

Management approach actioned

99.56% of our staff is in permanent employment with the Bank.

Our gender mix is 63:37 male:female.

Our employee turnover for the bank is reported at 4% for 2013 (3% for 2012) and is skewed towards male employees.

45% of our staff is within the age category of 18 – 35 years out of which 37% is between the ages of 18 to 25 years of age. 40% of our team has rendered a service between 15 – 30 years with 23 % being in employment with us for between 15 – 20 years. 20% of the talent pool has worked with us for less than 2 years indicating that there is a good mix between tacit knowledge and fresh blood that has been infused over time.

Employee management relations

Our management approach to employee relations: We demonstrate mutual respect in all our interactions

Our employees have the freedom of expression and are treated with respect and trust. In living our values we demonstrate mutual respect in all our interactions.

We promote an environment that is ethical, embraces diversity, equality and inclusivity. We work together in partnership and collaboration towards a common goal to achieve a better work life balance. We are always conscious of the psychological contract that we share with our employees and safeguard and strengthen it with each member of staff throughout their working career, by way of open and honest discussion.

Grievance handling procedure

Any employee is entitled to address their grievances with their superiors and/or with the HR department through verbal or written communication or through representations made through the unions. Our open door policy further underlines our commitment to open communication channels and facilitates employee relations, giving access to employees to have dialogue with the Bank's top management including the CEO by writing to ceo@hnb.lk. Through this process we have

Sustainability Report

received suggestions and ideas as well as addressed several grievances during the year under review.

The Bank's Grievance Handling policy ensures that its employees have the opportunity to make representations to the management for redress. This is aimed at improving employee-employer relations and thereby instituting sound industrial relations. The grievance handling procedure is a three-step approach that allows the grievance to be escalated to the highest level of authority within the organisation if not satisfactorily addressed by the immediate superior and HR department, ensuring fairness and transparency of the process.

The Grievance Handling policy is hosted on the Bank's intranet and is accessible to all employees.

Management approach actioned

Re branding HR as a trusted business partner, 'partner in progress'

Road shows were conducted with the active participation of the HR leadership team in Central, North Central and Southern regions taking HR to the people as a business partner. The objective was to increase face time, engage in two way communication and share the HR strategy, listen and provide on the spot solutions for grievances. All branches were visited in the selected regions and a fellowship evening was conducted in each region for the branch management teams to facilitate greater engagement.

Employee Relationship Manager

We have appointed an Employee Relationship Manager who is the first point of contact for all work place related grievances and issues.

The role of the Manager – Employee Relations is primarily that of a counsellor/guide/confidante who assists employees to find solutions to workplace related problems; improves work relationships; and guides employees in the development of skills and strategies to handle problems in order to enjoy a healthier work-life balance. The role and function involves visiting branches and departments and making recommendations to improve working conditions. The Employee Relationship Manager would also ensure the Bank's Grievance Handling procedure is adhered to by all concerned.

Transfer committee

Provides greater transparency and governance to the inter-customer centre transfer process. This was given priority as the highest number of employee grievances arise from discontent due to transfers. The formation of this Committee allows employees to independently appeal and have access to a second hearing. The committee met 31 times during the year and reviewed 63 appeals received, being 5.8% of the total transfers of 1,075 effected during the year. 27 appeals were favourably addressed with remainder not warranting change as all jobs are transferable based on the employment contract and conditions of employment. The statistics are indicative of the transparency and fairness of the transfer process and flexibility afforded to employees with genuine grievances.

Healthy relationships with Unions

We adhere stringently to International Labour Organisation (ILO) labour practices and standards as well as other relevant regulations applicable to Sri Lanka. We give importance to industrial harmony. Our learning, applying, growing and winning fundamentals have been implemented into the very ethos of our industrial relations, ensuring that the Bank has on going dialogue with employees representatives. Open door discussions, transparent and accountable processes have all added up to an environment of complete industrial harmony. 77% of the employees numbering 3,551 are covered by collective agreements for remuneration and benefits as well as dispute resolution.

Communication with the highest level of the organisation

"From the CEO's Desk" is the CEO's monthly email to all staff, commenting on performance, communicating changes, realigning focus with objectives and recognising achievements. Employees too can communicate via ceo@hnb.lk there by creating a direct link between the CEO and the employee.

Occupational Health and Safety

Our management approach to employee health and safety conditions

Safe and sound workplace

We have always been passionate about taking care of our employees providing them with a safe and sound place to work, an ambiance that stimulates thought, ideation, physical comfort, recreation and physical wellbeing.

The Bank recognises that work-life balance is imperative for the wellbeing of employees and therefore supports

and promotes a balance between work and life for all employees. The Bank acknowledges that this enhances the overall productivity of employees, increases staff retention, reduces absenteeism and raises employee morale.

The scope of the work-life balance policy is organisation-wide and is applicable to all employees. It specifically covers provisions for employee leave, career breaks, financial assistance towards achieving personal objectives, integration of family in sports and social activities, access to health related information and guidance, as well as employees' access to counselling where necessary.

The policy on Work Life Balance is hosted on the Bank's intranet and is accessible to all employees.

The Bank promotes high standards of health and safety (H&S) at the workplace and an accident free occupational environment. The H&S policy is one that is holistic and inclusive, and is a priority consideration for all business operations. By complying with the above standards which supersede the minimum H&S regulations laid out by the relevant authorities, the Bank creates a safe environment for employees, customers and other stakeholders.

The Health and Safety policy hosted on the Bank's intranet is accessible to all employees.

Management approach actioned

By way of access to medical care, the Bank provides medical reimbursements for hospitalisation and outpatient treatment for employees and their dependents.

Programmes conducted on health and well being

On Stress and Lifestyle Management conducted by Dr. Manoj Fernando on 8th March 2013 for Head Office Staff which was attended by 170 staff.

On Mindfulness conducted by Prof. Nandani De Silva held on 16th May 2013, with approximately 130 staff members were present.

A Health programme conducted by Dr. Prasad Katulanda on 6th June 2013 was attended by 120 staff members.

Provision of quarters for staff especially in rural areas ensuring their safety and security and comfortable accommodation at no extra cost.

Provision of indoor gymnasium facilities at head office, with all the branches arranging recreational activity through their sports clubs.

Organisation sponsored athletics, leagues and sport teams.

Access to in house cafeteria facilities run by a reputed caterer offering subsidised meals.

Payment of professional membership fees, leave pay and leave encashment

Sports club and welfare associations conduct several sports and welfare activities throughout the year

State of the art buildings including 3 green buildings which provide a great ambiance and comfort, in addition to being environmentally friendly.

Learning and Development (L&D)

Our management approach to learning and development

“Helping our people to grow, enabling individuals to make a difference and teams to win.”

Strategic focus is imperative for the development of competencies for business growth, cost management, productivity, compliance and regulatory requirements. The Bank's learning and development philosophy gives emphasis to these core themes. The L&D process supports needs such as building and retaining lasting customer relationships, service quality, customer service excellence, the importance of self-management in aligning with and achieving individual and corporate objectives, development of managerial competencies and multi-skills to support succession planning and job rotation.

The learning and development agenda is aligned to the strategic vision and objectives of the Bank and takes into account the training needs based on skill and competency gaps that have been identified through the performance evaluation and appraisal process. The training plan also considers the Bank's mission for the long-term sustenance of the business in identifying skills and competencies required based on changing trends in socio economic indicators, customer needs, behaviour, changes driven by regulatory and statutory requirements, the advancement and convergence of technology and greater awareness for environmental protection and conservation.

Comparatively new developments in the Sri Lankan banking industry such as e-Banking, mobile banking and Islamic banking have created the need to source new skills. Internal talent pools have been strengthened with exposure to technical training and overseas exposure in these areas. External talent has been acquired to head some of these initiatives. Since these are new

Sustainability Report

developments in the banking industry, continual learning investment is internalised.

Succession planning in the Bank is a top down process, with the engagement and support of the Board of Directors, MD/CEO and the Corporate Management. Performance evaluations based on Balanced Score Card provide the framework for assessment. One to one interactions, cross functional team exposure, leadership skills and achievements help assess the performance of potential candidates. Critical talent leadership is identified and given visibility and exposure to all stakeholders. All employees are encouraged to develop skills that further their personal and professional development.

Management approach actioned

Continuous Professional Development (CPD) programmes are structured and delivered throughout the year.

A three-tiered structured curriculum for Banking Assistants to enhance their knowledge through continuous learning, Efficiency Bar (E Bar) examinations held periodically to provide opportunities to update and test technical know-how. The examinations assist in the acquisition of CPD Points, which are linked to career progression and professional requirements towards gaining membership with the various professional bodies.

Investment in externally developed, specialised training courses to develop specialised skills such as the global OMEGA credit skills programme, risk management programmes, certified documentary credit specialists (CDCS) and Treasury management courses continue to occur.

The Bank also has a fully equipped library with an online books requisitioning system, which facilitates borrowing and returning of books, CDs and DVDs from any of the Bank's branches. Staff members can order books online and delivery takes place at the Bank's expense. A tranquil and spacious area which serves as a study area is open on Saturdays 1/2 day and during banking exams 7 days for a period of 7-8 weeks. The library was proactive in taking steps to stock up on books for the new syllabus for banking exams in 2013, to cater to the syllabus change end 2014/15.

Several Management Development Programmes (MDPs) were conducted during 2013 upskilling the leadership. Each programme consists of 11 modules spread over 4 months. This resulted in effective management decision-making and the ROI is visible in the financial results delivered by the participants in their new roles as branch managers and assistant managers. Many were motivated to pursue post graduate studies.

The Bank's e-learning tool is an integrated, role based e-learning platform with a user-friendly interface and has been well adopted by the Bank's employees, disseminating a wealth of knowledge with convenient 24/7 access.

The succession plans of the Bank for the period 2013-2015 have been documented, key successors identified, formally communicated, and progressive handover/understudy already underway.

Mentoring and coaching played a key role in employee development. The programme focuses on developing of soft and hard skills for future leadership roles. A coaching programme termed "Hatna PAL" was introduced to familiarise young new recruits with the Bank's operations,

A snapshot of the L&D delivery

Programme Type	No. of Programmes	No: of Programme Days	Total No. of Participants
Leadership & Management Development	10	32.5	385
Sales & Customer Service Excellence	30	28.5	1,286
Banking Operations & Competency Tests	17	11	2,323
Credit Evaluation & Administration	20	43.5	911
Trade Finance & International	15	20	456
Compliance & Assurance	9	8	419
Electronic Banking	2	1.5	421
IT	5	5	199
Communication Skills	3	19	147

policies and processes, to ensure that they were fully integrated into the Bank's culture and work ethic.

Our approach to Human Rights

Human Rights are upheld in every aspect of the Bank's operations. The Human Rights policy reflects the Bank's commitment to conduct business in a manner consistent with the principles of the policy. The Bank protects human rights within its areas of influence. The bank does not employ workers under the legal minimum age, prohibits the use of all forms of forced labour, respects employees rights to join, form or not join a labour union, respects the principles of collective bargaining, provides health and safety at work, is non-discriminatory to age, race, religion or sex, prohibits sexual harassment, limits work to standard accepted hours and condemns the use of corporal punishment.

Staff Strength, Gender Analysis

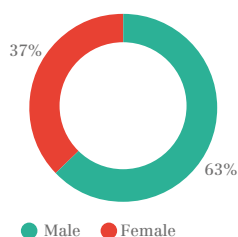
Category	2011			2012			2013		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Corporate Management	19	6	25	15	5	20	11	4	15
Senior Management	29	7	36	30	7	37	31	7	38
Managers & Executives	470	131	601	495	141	636	487	147	634
Officers	756	343	1,099	784	356	1,140	795	369	1,164
Banking Assistants	903	655	1,558	898	666	1,564	1,053	748	1,801
Trainees	372	190	562	403	210	613	215	115	330
Secretaries, Stenographers, Typists	9	358	367	9	343	352	8	322	330
Support Staff	297	-	297	282	-	282	270	0	270
Contract Staff	29	10	39	22	13	35	17	5	22
Total	2,884	1,700	4,584	2,938	1,741	4,679	2,887	1,717	4,604

Staff distribution by province

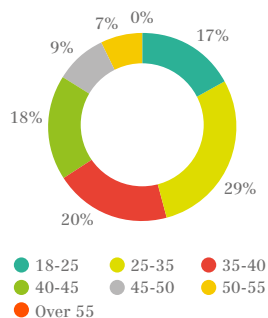
As at 31st December	2011		2012		2013	
	No	%	No	%	No	%
Central	316	6.9%	331	7.1%	333	7.2%
Eastern	222	4.8%	230	4.9%	222	4.9%
North Central	129	2.8%	142	3.0%	127	2.7%
North Western	266	5.8%	219	4.7%	216	4.7%
Northern	170	3.7%	216	4.6%	235	5.1%
Sabaragamuwa	135	2.9%	149	3.2%	138	3.0%
Southern	208	4.5%	267	5.7%	272	5.9%
Uva	122	2.7%	125	2.7%	118	2.6%
Western (including Head office, Colombo & Greater Colombo Regions)	2,997	65.4%	2,987	63.8%	2,932	63.7%
Overseas	19	0.4%	13	0.3%	11	0.2%
Total	4,584	100.0%	4,679	100.0%	4,604	100.0%

Sustainability Report

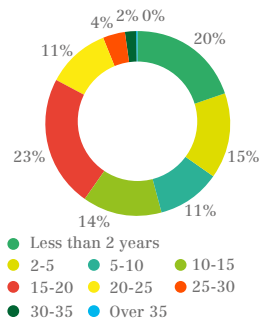
Genderwise Analysis of Employees



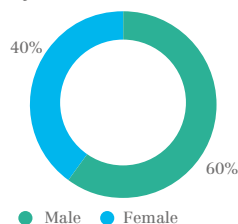
Agewise Analysis of Employees



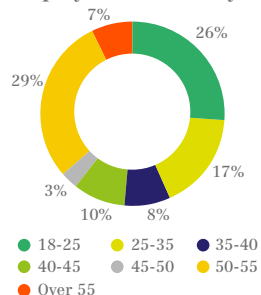
Servicewise Analysis of Employees



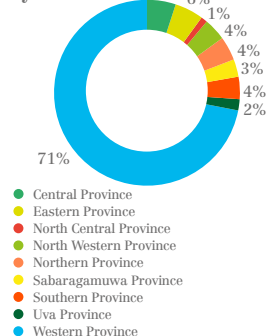
Employee Turnover by Gender



Employee Turnover by Age



Employee Turnover by Province



Employee Training - 2013

Employee Category	No. of programmes		Average no. of hours
	Overseas	In-house	
Corporate Management	10	3	6
Senior Management /Management	18	6	7
Executives	12	25	34
Non Executives	2	96	12

Employees covered by Collective Agreements

Year	No of Employees	%
2011	3,259	71
2012	3,358	71
2013	3,551	77

Permanent vs Contract Staff

Employment Type	No of Employees	%
Permanent	4,584	99.56
Contract	20	0.44
Total	4,604	100.00



Sports Achievements 2013



Cricket

Mercantile A division six a side Cricket Tournament - Champions
Mercantile A division T 20 Cricket Tournament - Runners up
APB cricket carnival organised by Association of Professional Bankers - Champions



Netball

Runner up - National Netball Championship
Runner up - Mercantile League Netball



National Players 2013

Ms. Dharshika Abeywickrema
Ms Somitha De Alwis appointed as national coach for the Nations Cup tournament held in Singapore



Badminton

Mercantile novices championship veteran doubles - Winner
Mercantile doubles championship grand slam - Winner
Mercantile open championship - Overall champions
Mercantile open championship men's doubles - Winner
Mercantile open championship men's veteran doubles - Winner
Mercantile open championship men's veteran singles - Runner up
Mercantile open championship men's single - Runner-up
Mercantile team championship men's A division Runner-up
Mercantile team championship women's A division Runner-up



Chess

2nd Mercantile & Govt services Chess championship - Winner

Internationally rated players

M J Eksith I Fernando
R Priyantha
C K D Fonseka



Basketball - Men

Mercantile league tournament 2013 - Semi Final

Basketball - Women

Mercantile league tournament - Champions
Super league tournament - Champions
Mercantile knockout tournament - Champions



Hockey

Mercantile "A" division sevens tournament - Champions
Mercantile "A" division league tournament - Joint champions
Mercantile "A" division knock out tournament - Champions

National Players 2013

Mr M M D M Bandara
Mr D U Fernando



Soccer

Mercantile "B" division league tournament - Champions
Mercantile "A" division knockout tournament - Runners up
Mercantile 7-a-side tournament plate - Champions
HNB Soccer Team participated in the International Soccer Tournament conducted by the Singapore Soccer Club



Athletics

34th Masters National Athletic Meet Tour of India

Medal Winners

Kumarine Silva -2 Silver
Nadeera Kuruppu -1 Gold & 1 Silver
Sashika Samarasinghe - 3 Gold
K.Sundararajah
Indika Silva

Achievements of the HNB Toastmasters Club

- Achieved President's Distinguished Club status
- Winner of the Golden Gavel

- Roshantha Jayatunge Manager HNB Card Centre emerged the Champion Speaker at the Table Topics (Impromptu) Speech Contest at "Ovation 2013", in Chennai, the biggest annual conference of Toastmasters in District 82, which comprises of members from South India and Sri Lanka.

Sustainability Report

Social responsibility

We commit to working proactively with our host communities in a responsible manner in order to maximise sustainable benefits and opportunities for the community and environment as well as for our investors. We recognise that community development and self-serving stable communities are vital to our sustainability as a Bank.

Our management approach to social responsibility

We are trusted as partners for progress and dedicated to making a difference in the communities within which we operate

We provide more than banking access to the remote and under privileged communities within which we operate and serve. In providing these underserved and under privileged communities with basic access to education, health, clean water and sanitation we underline our commitment to adding a social and environmental dimension to our philosophy of sustainable performance and overarching commitment to ensuring the rights of children and safeguarding human rights. We change lives and partner for progress in return for obtaining a social license to operate.

Management approach actioned

HNB Sustainability Foundation set up to address the social and environmental needs and articulate strategy with the assistance of the sustainability committee on 3 core areas: economic contribution, environmental conservation and community development

Definitive strategy for investment in the community by subscribing to the United Nations Millennium Development Goals for education and healthcare, and national development goals for empowered rural communities.

- Employee volunteerism encouraged
- Education as an extension of the Bank's focus on financial literacy
- Healthcare, Water and Sanitation to ensure basic human rights
- Entrepreneurship as a tool for social empowerment

Investment in our communities

Education

We subscribe to the United Nations Millennium Development Goal Target 2 "Achieve Universal Primary Education"

Nena Pubuduwa

Investment commitments to date – Rs 55 Mn

A project aimed at providing, basic resources and infrastructure to support education and learning to students in rural communities. The project initiated in 2005 had a target of assisting 100 schools lacking in facilities and financial resources. It has now expanded to assisting over 200 schools. It involves setting up of libraries in rural schools by donating books, furniture, and renovating buildings with a commitment to donate additional books in the future.

The project has progressively enhanced the literacy skills of over 50,000 children across Sri Lanka with 201 libraries in operation.

Number of libraries by province

Province	2011	2012	2013
Central	33	33	33
Eastern	15	16	17
North Central	16	18	18
North Western	9	11	11
Northern	11	15	15
Sabragamuwa	14	15	15
Southern	24	26	26
Uva	15	18	18
Western	48	48	48
Total	185	200	201

Project activities in 2013

- Official opening of the 200th Library – Kopai Nawalar Vidyalayam in Jaffna
- Distribution of Year-5 scholarship examination model question and answer booklets
- Acquired books from Asia Foundation and purchase of books for donation to schools as per book list provided
- Routine maintenance of libraries

Computer project for schools

Investment commitments to date – Rs 15.6 Mn

This project was initiated in 2009 as the second step in our objective to establish “Model Schools”. Currently 21 Computer Centres have been established under this project.

The Bank has been setting up computer centres with a view to facilitating computer literacy and awareness on information communication technology, as an enabler. In breaking down boundaries and promoting international and inter cultural understanding and awareness. It also provided access to knowledge and information and improves and expands the knowledge of English, creating opportunities for higher education and employment.

21 centres have been established under this project benefiting over 5,000 children annually.

Project activities in 2013

- The Bank partnered the Rotary Club to set up a computer lab at the Chundikuli Girls School, Jaffna

Partnering Don Bosco to set up English language teaching facility

Investment commitments to date – Rs 4.6 Mn

The HNB Sustainability Foundation assisted the Reverend Brothers of Don Bosco Sri Lanka to set up an online English language training centre in Kilinochchi. The beneficiaries are school children and young adults who are interested in education and keen on moving forward in the aftermath of the civil war.

Supporting this project would create an IT enabling environment for students who would otherwise not have the opportunities to improve their English literacy, for higher education and employment, which in turn leads to increased and sustainable income for the community.

The teaching of English will be conducted through the use of computer software namely “DynEd English language teaching programme”. The DynEd Solution is a blended language learning system that combines the best features of traditional learning and contemporary multimedia technology.

The principal patron of the National Trust of Sri Lanka

Investment commitments to date – Rs 5.2 Mn

The National Trust for Cultural and Natural Heritage commonly referred to as “The National Trust – Sri Lanka” was founded in May 2005, to operate as a national body for protecting and safe guarding the tangible and intangible heritage of Sri Lanka. This includes sites, monuments, sculptures, paintings, artifacts, music, dance, the fauna and flora which are not protected or safeguarded by any institution of the Government of Sri Lanka.

An MOU was signed in 2010 to assist as principal patron by donating a sum of Rs 1.5 Mn per annum.

Health

Maintenance of the counselling centre at the National Cancer Institute Maharagama and Jaffna

Investment commitments to date – Rs 20 Mn

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

The Bank also supported to set up a similar unit at the Teaching Hospital in Jaffna in 2011.

HNB Sustainability Foundation took over the entire maintenance costs of the Counselling Centre commencing 2009. Approximately 3,000 people have been counselled to date with an average of between 10-15 patients per day.

During the year 2013 the following initiatives were pursued:

- Provision for expenses related to routine maintenance
- Provision for purchase of recording equipment to facilitate recording counselling sessions for review
- Explore possibility to set up counselling facilities at the Teaching Hospital, Anuradhapura

Sustainability Report

Financial assistance to cancer patients

Funded from the proceeds of an Investment of – Rs 15 Mn

Implementation of the mechanism of providing financial assistance to cancer patients was a significant milestone for the HNB Sustainability Foundation. An agreement to this effect was entered into with the Patients Advise and Liaison Services Unit at the National Cancer Institute, Maharagama in November 2009.

83 families were selected and were each granted a donation of Rs 5,000 per month, since December 2009 for a period of 6 months each.

A fund of Rs 15 Mn has been set aside for this purpose and the interest from the proceeds has been utilised for this purpose.

Surgical Intensive Care Unit - Rs 10 Mn

The Bank partnered the Colours of Courage Trust towards building a surgical intensive care unit at the National Cancer Institute.

Renovation of the Radiotherapy - Rs 0.9 Mn

The Bank supported the National Cancer Institute by renovating the patients waiting area during the year.

Renovations to the National Cancer Institute Maharagama

Investment commitments to date – Rs 3.5 Mn

The Bank continued to maintain the Male Surgical Ward at the National Cancer Institute, Maharagama and assisted towards the renovation of the ward.

Creating HIV/ AIDS Awareness

As a member of the Lanka Business Coalition for HIV & AIDS (LBCHA), HNB is expected to undertake various activities to combat HIV & Aids epidemic as well as payment of annual subscription.

Description of Activity	
2009	Commemoration of World AIDS Day by all employees and training of 20 HIV Champions
2010	Commemoration of World AIDS Day by all employees and training of HIV Champions and new recruits under 25
2011	Commemoration of World AIDS Day by all employees and training of HIV Champions and new recruits under 25
2012	Training 5 HIV Champions , Branch wise awareness programmes in the Greater Colombo Region, North Western Region and Southern Region, awareness programmes for 35 HNB Student Managers
2013	Supported the “HIV & AIDS Pledge” organised to increase awareness about HIV. Staff members from HNB Towers participated in the programme on February 8, 2013 and pledged to create awareness about HIV & AIDS and to support victims. Commemoration of World Aids Day by all employees and partnering the LBCHA on their initiatives

Safe drinking water and sanitation programme

Investment commitments to date – Rs 14.75 Mn

The high incidence of bowel and dental disease and thalassaemic conditions caused by unsafe drinking water and poor sanitation is a critical health issue in the country. In line with the UN Millennium Development goals of providing safe drinking water, this scheme was launched in 2007.

9 projects have been completed in addition to the donation of 50 water tanks and 100 toilets to the internally displaced. It is estimated that around 1,000 people have benefited from this programme in addition to the large number of pilgrims who use the facilities at Kataragama and Ragama Basilica.

Province - wise distribution of projects

Province	No. of projects
North Central	1
North Western	2
Northern	2*
Eastern	1*
Southern	1
Uva	1
Western	1
Total	9

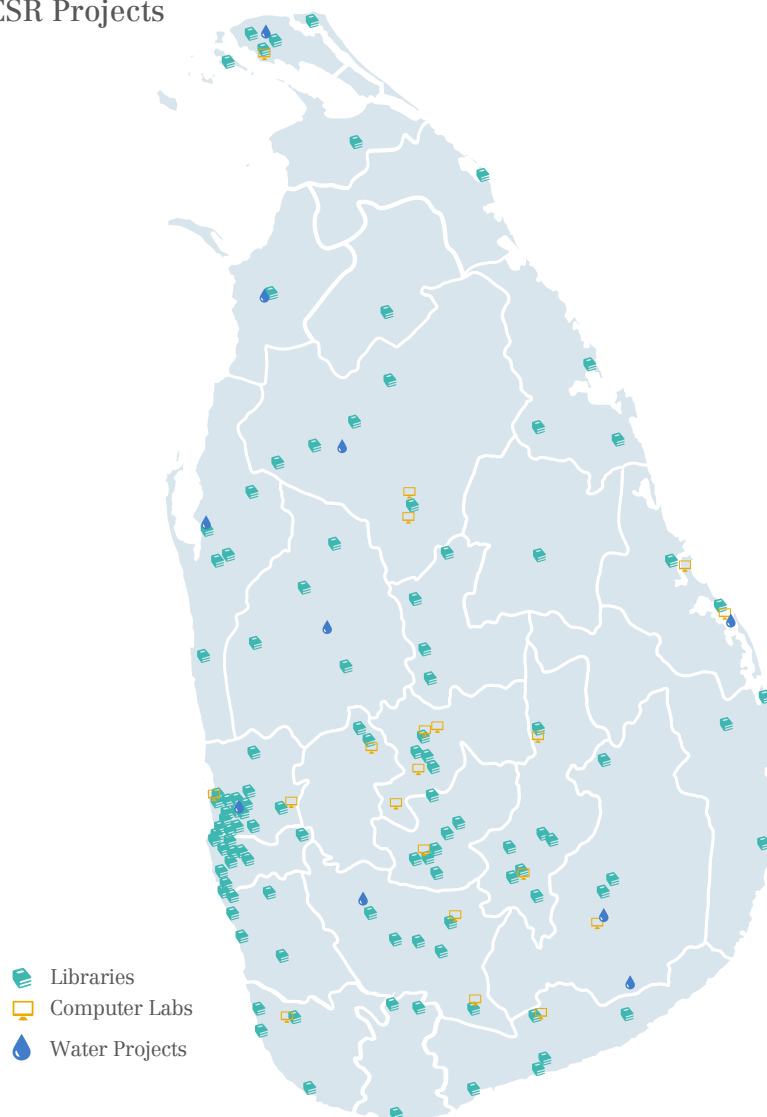
* including assistance to IDP

Project activities in 2013

During the current year the following activities were undertaken:

- Renovating a rest place and providing proper safe drinking water facilities at Adams Peak, Sri Lanka.
- Provision to assist schools to renovate and develop drinking water and sanitary facilities – Aspire team projects – 2 schools

HNB CSR Projects



Sustainability Report

Environmental Citizenship

Our framework for dealing with risks to the environment and society systematically integrates ecological and social factors into the approval processes. It plays a paramount role for business transactions sensitive to any potentially negative impact on the environment or society. Over the years we have also positively encouraged the investment in renewable energy and increased our exposure over time. Turning every business into an environment friendly enterprise involves the application of new principles. During the year we have endeavoured to apply these principles into our work ethic and in living our lives.

Environment Policy

The Environment Policy of Hatton National Bank PLC serves as the framework, within which we ensure that all our activities are environmentally viable and compliant with the regulatory environmental standards as applicable or likely to be in force in the future.

We aspire to pursue best practices in environmental management (including energy and resource efficiency, waste reduction and recycling) in our internal operations. We seek to work with customers and suppliers who follow high environmental standards and will take into account sustainability issues for the procurement of internal goods and services.

Our management approach

Coexist with our environment and commit to do no harm

Being a bank our business model does not have a direct impact on the environment, however we influence our customers, suppliers and employees through active stakeholder engagement to commit no harm to the environment based on the principles of green finance, green procurement, green buildings and the green pledge taken by our employees.

Our business operations affect our carbon footprint on many levels, through energy and water consumption in our offices, business trips by our staff and use of paper. We have committed to minimise the negative impact of our business operations on the planet as much as possible. Therefore, we have adopted the 3R policy of Recycle, Reuse and Reduce the use of natural resources in carrying out our business.

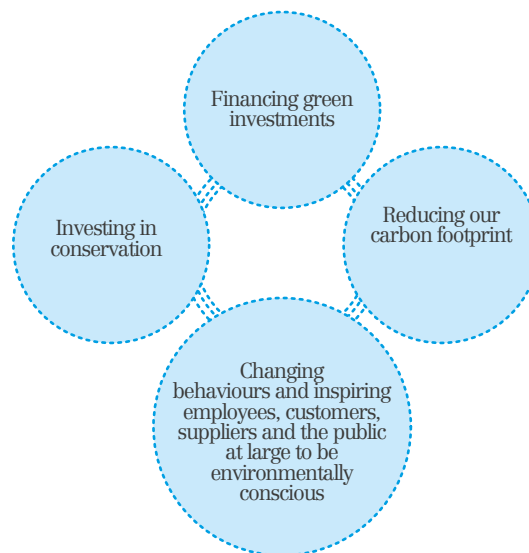
We support local environmental preservation initiatives that have far reaching sustainability consequences in the future preservation of the country's natural assets and actively seek to support projects that target biodiversity enrichment.

Management Approach Actioned

- Scorecards and rating systems to assess environmental and social impact of lending activity
- Covenants placed in offer letters and agreements regularly monitored and inspected
- Environmental Management System (EMS) under testing with training having commenced
- Measurement of environmental sustainability criteria against key performance indicators reducing carbon foot print, energy and water consumption, reduction in CFC emissions and waste disposal
- Initiatives to enhance the environmental credibility by minimising carbon footprint.
- Green Buildings constructed at Nittambuwa, Kalmunai and Jaffna

Natural asset restoration in key wilderness projects in Buttala and Udawalawe Nature Reserves

Our Green Intents



Key highlights 2013

- Financing of renewable energy projects as at end 2013 - Rs 3.8 Bn
- Sri Lanka National Energy Efficiency Award for the second consecutive year for “Green Branch”
- Completion of 2 Green Buildings in Kalmunai and Jaffna
- Significant reduction in energy and water consumption
- More than 25,000 trees planted

Engaging for sustainable business practice

Economic dynamism can be combined with environmental and social responsibility. Financial returns can go hand in hand with respect for human rights, and the preservation of natural resources. The Bank endeavours to achieve a balance of social and environmental considerations in business and is aware of the role of and the need for stakeholder inclusiveness as a core driver of sustainable business practice. Shaping behaviours is deemed critical to the long-term effectiveness of the Bank’s sustainability strategy. Every economic threat also represents an inspiring challenge to those who are both courageous and creative. Investment in the technologies and products and the new energy infrastructure will shape the low carbon future. There lies huge opportunity for businesses large and small around the world. Towards this end, the Bank continues to

progressively initiate programmes that instil the values of environmental and social responsibility.

We make every endeavour to achieve the benchmarks against the key performance indicators and continue to commit to do no harm to both the environment and the community by reducing our carbon foot print and consumption of natural resources. We also take responsibility to ensure that we address all sensitive environmental and societal concerns prior to funding the numerous initiatives of our clients.

In order to manage the Bank’s environmental impact systematically and efficiently, the Bank made a decision in 2012 to implement an Environmental Management System (EMS). The system will ensure that the Bank continually improves its environmental behaviour and regularly reports on environmental conditions internally as well as externally. During the year 2013 we have moved towards automating this system and have commenced training the various user groups who would update and use this system.

Green Finance

We are committed to granting loans to finance renewable energy projects, energy efficiency and clean technologies. We provide funding for energy-efficient construction and sustainable energy projects.

Portfolio

- 14 Mini Hydro projects
- 6 Wind Power projects

Portfolio Value as at year end 2013

- Rs 3.8 Bn

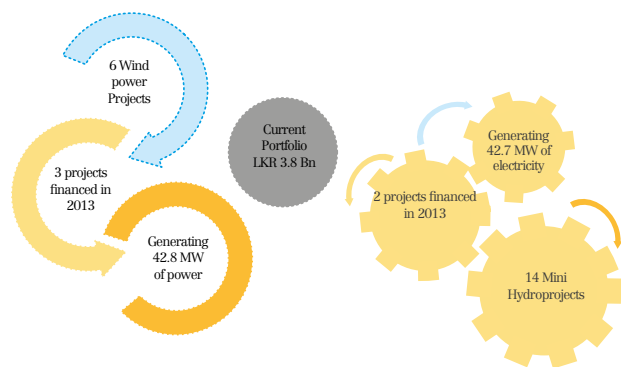
- Total capacity of 85.5 MW of renewable energy

Sustainability Report

Sustainable credit: Funding for green projects

‘Commitment to responsibility’ is one of our sustainability precepts. The Bank bears full responsibility for the environmental and social impacts of its transactions and the social and environmental cost that are borne by the communities. Our commitment to responsibility is not limited to avoiding products, advice and services that might have a negative impact on the environment and communities. It takes a wider responsibility of creating value and generating benefits for society. The positive impact of our actions is evident when we make capital available to companies involved in clean technology, renewable energy or other low-carbon sectors. As a policy the Bank aims to balance financial gain with sustainable practices.

Our current portfolio comprises of 14 mini hydro power projects and 6 wind power projects with a total capacity of 85.5 MW.



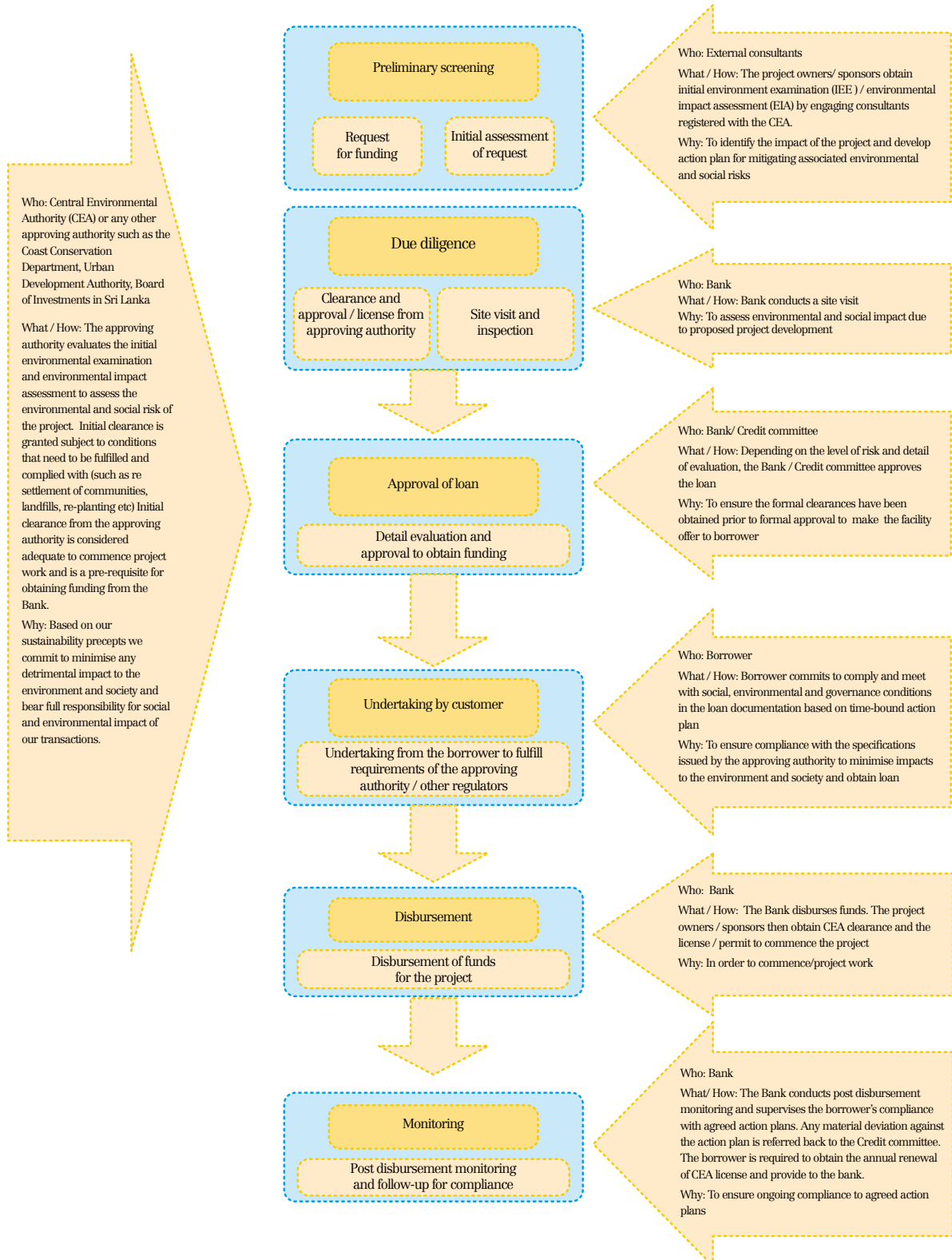
A green credit origination process

We are revamping our credit origination process by enlarging the scope of the existing environmental and social aspects evaluated in advancing credit and it will be extended across the whole portfolio. The ground work was laid in 2013.

Currently we review the Environmental Impact Assessments (EIA) and Initial Environmental Examination (IEE) reports carried out by external consultants on the respective companies requesting for funding from the Bank for large projects valued at Rs 100 Mn and above. They must also demonstrate the approval granted by the Project Approving Authority such as the Central Environmental Authority (CEA), Coast Conservation Department (CCD), Urban Development Authority (UDA) or the Board of Investment (BOI). Covenants are placed in the offer letters and agreements and are monitored for compliance against the various conditions stipulated by the respective approving authority. e.g. obtaining a bird migratory report, report on noise levels to ensure that the noise levels of the machinery are within the permitted range, and monitoring measures taken to prevent soil erosion. Obtaining the Environmental Protection License is a pre-requisite for SME facilities.

Green finance process

Environmental risk assessment process for credit evaluation of environment sensitive projects



Sustainability Report

Green Pledge in practice

We work hard to reduce our own impact on the environment and have laid considerable emphasis on the achievement and the measurement of this impact. The Bank's Green Pledge serves as the fundamental base for impact reduction and is the catalyst shaping behaviour within and outside of the organisation. It aims to educate employees as well as to seek commitment towards adopting the 12 actions of the Green Pledge towards energy conservation and environment sustainability in achieving the overarching objective of a greener work place.

During the year the Bank broadened its scope on the implementation of the "Green Pledge". Key focus areas included

- Waste management
- Resource efficiency



Waste Management

Waste Management Systems

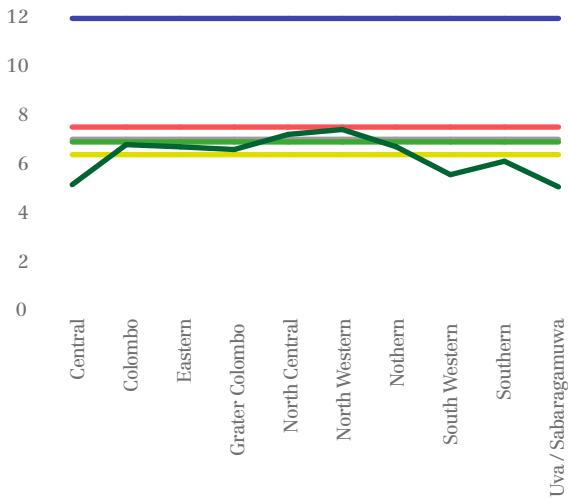
Programme Type	2011	2012	2013
Disposal of sanitary waste	230 customer centres	247 customer centres	248 customer centres and Head Office
Anaerobic waste treatment systems	5 customer centres	6 customer centres	7 customer centres
Waste disposal system	Head Office	Head Office and 247 customer centres	Head Office and 247 customer centres

Resource Efficiency

Water Efficiency

Programme Type	2011	2012	2013
Rainwater harvesting	2. customer centre	5. customer centres	5 customer centres
Anaerobic waste treatment systems	5 customer centres	6 customer centres	7 customer centres

Comparison of Regionwise Power Consumption for 1,000 sqft per Working hour During the year - 2013



- Actual Power Consumption for HNB Branch network (1000 sqft / working hour)
- Average Power consumption for HNB Branch Network (1000 sqft for working hour)
- "Base line Power Consumption for 1000 sqft for working hour for conventional type buildings (Base line Given by Sri Lanka Sustainable Energy Authority)"
- "Base line Power consumption for 1000 sqft Per working Hour for bank premises (Base line given by Chartered Institution of Building Services Engineers)"
- Base line Power consumption for 1000 sqft Per working Hour for bank premises

Resource Management

Measures introduced to reduce resource utilisation over time	Driver		Impact Assessment of reduction measures introduced				Total direct and indirect greenhouse gas emissions by weight			Direct and indirect energy consumption by source				
			Saving				Driver		Metric Tons of CO ₂		Driver		Consumption	
			LKR Mn	Units (kWh)		2012	2013	2012	2013	2012	2013	2012	2013	
Annual Power consumption kWh for 1,000 sqft for working hour	6.32	5.80	-	-	-	1,284,800								
Energy efficient lighting systems	14 Customer Centers	17 Customer Centers	2.28	4.3	108,000	174,000								
Energy efficient signages	62 Nos	31 Nos	3.3	3.45	157,000	164,000								
Inverter type Air conditioners	175 Nos	148 Nos	5.7	9.97	272,000	383,000								
Reduction from other measures		250 Customer Centres	-	14.6	-	563,800								
Reduction of diesel consumption due to reduction of electrical power consumption at customer centres	247 Customer Centres (217,526 Ltr)	250 Customer Centres (121,000 Ltr)	1.152	11.58	9,600 Liters	96,526 Liters								
Total				43.9				9263.94						
Other measures introduced to reduce consumption Installation of Solar Photovoltaic power systems Maximise use of natural daylight Maintain optimal temperature settings in air conditioning systems Maintain optimal indoor air quality Green Branch competition Continuous awareness creation to reduce/minimise consumption Introduce Energy Efficient lights for 17 nos. of customer centres and annual saving 174 Mwh amounting to Rs. 4.3 Mn Introduce 31 Nos. energy efficient Signages 164 Mwh amount to Rs. 3.45 Mn Introduce 148 nos. of Energy Efficient Inverter type Air Conditioners 383,822 kWh Rs. 9.97 Mn Reduce diesel consumption by 96,526 Ltrs due to the reduction of electricity consumption							Assumptions and bases for computation * 1Ltr of Diesel = 2.572 x10 ⁻³ metric tons of CO ₂ ** Complete combustion of 1Ltr of Diesel generates 0.03586 GJ of heat *** 1kWh = 4.278 x 10 ⁻⁴ metric tons of CO ₂			Reference www.carbonfootprint.com www.wikipedia.org www.carbonfootprint.com				

Sustainability Report

Resource Management

Engagement programmes for efficiency management 2013

- Workshop on oversized Air-Conditioning Systems and overcooled building in hot and humid climates conducted by ASHRAE Sri Lankan Chapter
- Seminar on Energy efficient Turboacor Compressors and Magnetic Bearings air conditioners by Access Alum Australia Pty Ltd
- 4 day training programme on urban rainwater harvesting and decentralised wastewater treatment and reuse
- Workshop on energy efficient vertical inline pumps
- Staff training at Kalmunai Branch with regard to energy efficient buildings.
- International conference on “Transition to Efficient Lighting”
- Green Buildings and LEEDS rating system training conducted by ASHRAE Sri Lankan Chapter

Green Buildings – creating eco-friendly work space

In 2013, the Bank continued its investment in construction of buildings which are designed on the principles of green construction, targeting energy savings and improved energy efficiency. We have helped create new benchmarks in corporate real estate through our green buildings that have created innovative ecofriendly work spaces. We commenced with HNB Towers and have continued constructing green buildings in Nittambuwa, Kalmunai and in the Jaffna peninsula which is the latest addition to our green building portfolio..

A green landmark in Jaffna

HNB’s latest addition to the green building portfolio bore fruition when the Jaffna Metro Branch and the Northern Regional Office in the Jaffna Peninsula was opened in 2013. Architecturally, the building sets precedence in post war regional architecture with the traditional architectural style synonymous with Jaffna’s cultural heritage, which is characterised by domes, pinnacles and column capitols. This building sets a new trend in conserving and combining the spatial and progressional characteristics of cultural heritage architecture, adorned with local art-forms with contemporary ultra-modern design, on par with buildings in the western world. It comprises of a 250 seat auditorium and an elevated garden.

This landmark building has the following unique features.

Intelligent building with a Building Management System (BMS)	<ul style="list-style-type: none"> • The BMS integrates with air-conditioning and energy sub systems • Monitors and controls vital points on a real time status basis • Notifies building alarms, history logs and optimises energy control through algorithms
Chill water central air conditioning system with air side consisting pressure independent variable air volume (VAV) terminal boxes	<ul style="list-style-type: none"> • High efficiency chiller connected with variable temperature and variable water flow • Chill water piping system
Automated louvre system reducing heat gain and glare; use of natural day light to reduce operating cost of building	<ul style="list-style-type: none"> • Controllable solar shading systems enable the building to “react” to changes in the weather and the sun’s position optimising the flow of heat and light through the façade.
Solar photovoltaic system with net metering facility	<ul style="list-style-type: none"> • 15kVA roof mounted solar PV system • Capacity to generate 1,800 kWh of electricity reducing electricity consumption by 15% due to same day timing.

Reducing our carbon emissions through eco-efficient operations not only makes sense for the environment but is also good business practice in engaging with our environment and improving the surroundings of our communities

Awards and recognition of our green eco space

<ul style="list-style-type: none"> • Leed Gold certificate 2011 - Awarded by the US Green council • Sri Lanka National Energy Efficiency Award – Silver Flame 2012 - Sri Lanka Sustainable Energy Authority • National Awards for Green Construction Excellence 2013-Institute of Construction Training and Development 	Nittambuwa Branch	<ul style="list-style-type: none"> • Platinum Certificate for Green Buildings, awarded in 2013 by the Green Building Council Sri Lanka • Sri Lanka National Energy Efficiency Award - Silver Flame - 2013 awarded by the Sri Lanka Sustainable Energy Authority 	Kalmumai Branch	<ul style="list-style-type: none"> • Sri Lanka National Energy Efficiency Award – Silver Flame 2011 - Sri Lanka Sustainable Energy Authority 	HNB Towers
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Green Procurement

We consider it important that we apply standards of environmental, social and ethical criteria to procurement and ensure that suppliers meet our sustainability requirements at the same standards we set for ourselves. Therefore social and environmental criteria play a decisive role in our sourcing as our clients and investors increasingly expect that.

Our Green procurement policy establishes a sustainability framework to be used when sourcing a wide range of goods and services. It stipulates that our suppliers have to meet certain eco-efficiency requirements as specified below

Green procurement process

We assess compliance at the time of supplier registration. This ensures sustainability of our supply chain.

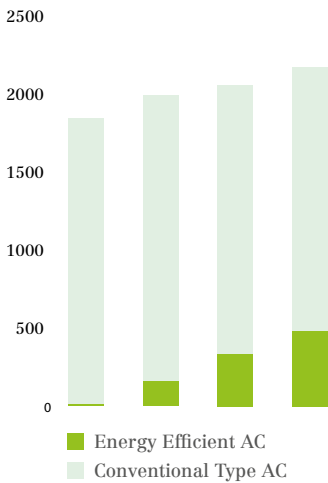
- 1 Pre-evaluation of suppliers' business processes
- 2 Pre-evaluation of suppliers' stand on human rights, labour, health & safety and ethics
- 3 Tender process ensures transparency of expectations
- 4 Selection process beyond the financial benefits to sustainability criteria
- 5 Micro/ SME suppliers assisted through accommodative processes on selective basis
- 6 Inspection of suppliers' premises and business practices on an ongoing need basis
- 7 Supplier appeal scheme and whistle blowing mechanism
- 8 Credit accommodation for suppliers and advance payment bonds
- 9 Late delivery penalties and fair review prior to suspension
- 10 Panel of auctioneers appointed for the disposal of environmentally friendly fixed assets
- 11 Procurement of goods and services at financially viable prices



Sustainability Report

The 3 R Policy

The Bank also adopts a 3R policy – Recycle, Reuse, Reduce - towards all tangible resources including furniture, paper and CFC emitting air conditioners amongst others.



Replace R22 (HCFC) conventional type air conditioners with CFC free R410A (HFC) inverter type air conditioners

No of air conditioners consisting of R22 refrigerant 1,694


No of air conditioners replaced with CFC free R 410A refrigerant 483

This is an ongoing process towards converting all AC units to CFC free AC units

Natural Asset Conservation


Nation wide tree planting – 2010 to date

- Tree planting campaigns led by employees, customers & school children to protect our environment
- The significance of this campaign would be that each sapling planted would have an owner who has pledged to nourish and protect it until it grows into a mature tree.
- 2013 Investment Rs 3.5 Mn - 25,000 trees
- Impact - 67,000 Trees planted to date




Recycle

Paper Recycling: 167,306 Kg of paper equivalent to 2,844 trees, 5,316,985 litres of water 669,224 kWh of electricity, 293,622 litres of oil, 502 cubic Meter of land fill, Reduced Green House Gas Emission by 167,306 Kg of Carbon Equivalent.




Re-Use

Reconditioning and re-use of office furniture, prolonging lifetime and thereby reducing the waste generated through routine replacement.



Reduce

Total weight of office paper purchased (A4, B5, Legal, Computer Paper, Letterheads) 148 tonnes
No. of customer centres 250



3R POLICY

Independent Assurance Report



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Independent Assurance Report to Hatton National Bank PLC On the Sustainability Report for the year ended 31 December 2013

Introduction

We were engaged by the Board of Directors of Hatton National PLC ("Bank") to provide assurance on the following elements of the Sustainability Report for the year ended December 31, 2013 of Hatton National Bank PLC ("the Report") for the year ended 31st December 2013.

- Reasonable assurance on the data on financial performance, as reported on pages 179 to 180 of the Report 2013;
- Limited assurance on Performance Indicators and other information presented in the Report.

Managements' responsibility and the criteria applied

Management is responsible for the preparation and presentation of the Report in accordance with the Sustainability Reporting Guidelines (G3) of the Global Reporting Initiative as described in the Report, and the information and assertions contained within it; for determining the Bank's objectives in respect of sustainable development performance and reporting, including the identification of stakeholders and material issues; and for establishing and maintaining appropriate performance management and internal control systems from which the reported performance information is derived.

Our responsibilities and compliance with SLSAE 3000

Our responsibility is to carry out a reasonable assurance and limited assurance engagement and to express a conclusion based on the work performed. We conducted our engagement in accordance with Sri Lanka Standard on Assurance Engagements 3000: Assurance Engagements other than Audits or Reviews of Historical Financial Information, issued by the Institute of Chartered Accountants of Sri Lanka.

This Standard requires that we comply with applicable ethical requirements, including independence requirements, and plan and perform the engagement to obtain reasonable and limited assurance about whether the Report is free from material misstatement.

Summary of work performed

Financial data

A reasonable assurance engagement on financial performance involves verification that they were properly derived from the audited financial statements of the Bank for the year ended 31 December 2013.

Performance Indicators and the other information

A limited assurance engagement on Performance Indicators and other information in the Report consists of making inquiries, primarily of persons responsible for the preparation of information presented in the Report, and applying analytical and other evidence gathering procedures, as appropriate. These procedures included:

- Inquiries of management to gain an understanding of the Bank's processes for determining the material issues for the Bank's key stakeholder groups.
- Interviews with senior management and relevant staff at group level and selected business unit level concerning sustainability strategy and policies for material issues, and the implementation of these across the business.
- Interviews with relevant staff at corporate and business unit level responsible for providing the information in the Report.
- Inquiries about the design and implementation of the systems and methods used to collect and process the information reported, including the aggregation of data into information as presented in the Report.
- Comparing the information presented in the Report to corresponding information in the relevant underlying sources to determine whether all the relevant information contained in such underlying sources has been included in the Report.
- Reading the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, the sustainability performance of the Bank

Our conclusion

Based on the procedures performed, as described above, we conclude that

- The data on financial performance, as reported on pages 179 to 180 of the Report 2013 are properly derived from the financial statements of the Bank for the year ended 31 December 2013.
- Nothing has come to our attention that causes us to believe that the Performance Indicators and other information presented in the Report are not fairly presented, in all material respects, in accordance with the GRI Sustainability Reporting Guidelines (G3).

Our assurance report is made solely to Hatton National Bank in accordance with the terms of our engagement. Our work has been undertaken so that we might state to Hatton National Bank those matters we have been engaged to state in this assurance report and for no other purpose. We do not accept or assume responsibility to anyone other than Hatton National Bank for our work, for this assurance report, or for the conclusions we have reached.

CHARTERED ACCOUNTANTS

Colombo
21st February 2014

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

M.R. Mihular FCA P.Y.S. Perera FCA C.P. Jayatilake FCA
T.J.S. Rajakarier FCA W.W.J.C. Perera FCA Ms. S. Joseph FCA
Ms. S.M.B. Jayasekara ACA W.K.D.C. Abeyrathne ACA S.T.D.L. Perera FCA
G.A.U. Karunaratne ACA R.M.D.B. Rajapakse ACA Ms. B.K.D.T.N. Rodrigo ACA
Principals - S.R.I. Perera ACMA, LLB, Attorney-at-Law, H.S. Goonewardene ACA

GRI Statement



Statement GRI Application Level Check

GRI hereby states that **Hatton National Bank PLC** has presented its report “<Sustainability Report - Change Creates Opportunity” to GRI’s Report Services which have concluded that the report fulfills the requirement of Application Level A+.

GRI Application Levels communicate the extent to which the content of the G3 Guidelines has been used in the submitted sustainability reporting. The Check confirms that the required set and number of disclosures for that Application Level have been addressed in the reporting and that the GRI Content Index demonstrates a valid representation of the required disclosures, as described in the GRI G3 Guidelines. For methodology, see www.globalreporting.org/SiteCollectionDocuments/ALC-Methodology.pdf

Application Levels do not provide an opinion on the sustainability performance of the reporter nor the quality of the information in the report.

Amsterdam, 21 February 2014

A handwritten signature in blue ink, appearing to read "Nelmara Arbex", is written over a faint, large watermark of the GRI logo in the background.

Nelmara Arbex
Deputy Chief Executive
Global Reporting Initiative



The “+” has been added to this Application Level because Hatton National Bank PLC has submitted (part of) this report for external assurance. GRI accepts the reporter’s own criteria for choosing the relevant assurance

The Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the world’s most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. The GRI Guidelines set out the principles and indicators that organizations can use to measure and report their economic, environmental, and social performance. www.globalreporting.org

Disclaimer: Where the relevant sustainability reporting includes external links, including to audio visual material, this statement only concerns material submitted to GRI at the time of the Check on 13 February 2014. GRI explicitly excludes the statement being applied to any later changes to such material.

GRI Indicators

G3 Content Index - Financial Services Sector Supplement				Assured by KPMG		
Application Level		A+	GRI-checked			
STANDARD DISCLOSURES PART I: Profile Disclosures						
Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
1. Strategy and Analysis						
1.1	Statement from the most senior decision-maker of the organization.	Fully	Pages 8-13, 14-19			
1.2	Description of key impacts, risks, and opportunities.	Fully	Pages 8-13, 14-19, 90-115, 159-161			
2. Organizational Profile						
2.1	Name of the organization.	Fully	Haiton National Bank PLC.(HNB)			
2.2	Primary brands, products, and/or services.	Fully	Pages 32-85			
2.3	Operational structure of the organization, including main divisions, operating companies, subsidiaries, and joint ventures.	Fully	Pages 32-85			
2.4	Location of organization's headquarters.	Fully	No. 479, T B Jayah Mawatha (Darley Road), P O Box 837, Colombo 10, Sri Lanka			
2.5	Number of countries where the organization operates, and names of countries with either major operations or that are specifically relevant to the sustainability issues covered in the report.	Fully	The Company primarily operates in Sri Lanka. The business dealings between the Company and its business partners given on pages 77-81			
2.6	Nature of ownership and legal form.	Fully	Public Limited Company registered under the Companies Act.No.7 of 2007, Sri Lanka			
2.7	Markets served (including geographic breakdown, sectors served, and types of customers/beneficiaries).	Fully	Pages 77-81			
2.8	Scale of the reporting organization.	Fully	Number of employees 4604, Income statement page 254, 10 year summary page 382, 20 largest shareholders page 389, breakdowns of operating income & expenses pages 306-307			
2.9	Significant changes during the reporting period regarding size, structure, or ownership.	Fully	No significant changes happened during the year			
2.10	Awards received in the reporting period.	Fully	Page 163			
3. Report Parameters						
3.1	Reporting period (e.g. fiscal/calendar year) for information provided.	Fully	1 January 2013 to 31 December 2013			
3.2	Date of most recent previous report (if any).	Fully	31 December 2012			
3.3	Reporting cycle (annual, biennial, etc.).	Fully	Annual			
3.4	Contact point for questions regarding the report or its contents.	Fully	Assistant General Manager - Human Resources			
3.5	Process for defining report content.	Fully	Page 164			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
3.6	Boundary of the report (e.g. countries, divisions, subsidiaries, leased facilities, joint ventures, suppliers). See GRI Boundary Protocol for further guidance. State any specific limitations on the scope or boundary of the report (see completeness principle for explanation of scope).	Fully	Page 164			
3.7	Basis for reporting on joint ventures, subsidiaries, leased facilities, outsourced operations, and other entities that can significantly affect comparability from period to period and/or between organizations.	Fully	Pages 164-165			
3.8	Data measurement techniques and the bases of calculations, including assumptions and techniques underlying estimations applied to the compilation of the Indicators and other information in the report. Explain any decisions not to apply, or to substantially diverge from, the GRI Indicator Protocols.	Fully	Focuses on indicators that reflect the Bank's significant economic, environmental and social impacts or that would influence the assessment and decisions of its stakeholders Pages 164-165			
3.9	Explanation of the effect of any re-statements of information provided in earlier reports, and the reasons for such re-statement (e.g. mergers/acquisitions, change of base years/periods, nature of business measurement methods).	Fully	No such requirements arose during the year			
3.10	Significant changes from previous reporting periods in the scope, boundary, or measurement methods applied in the report.	Fully	No significant changes from the previous reporting year			
3.11	Table identifying the location of the Standard Disclosures in the report.	Fully	This GRI Table			
3.12	Policy and current practice with regard to seeking external assurance for the	Fully	Page 165			
3.13						

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
4. Governance, Commitments, and Engagement						
4.1	Governance structure of the organization, including committees under the highest governance body responsible for specific tasks, such as setting strategy or organizational oversight.	Fully	Pages 117, 165-166			
4.2	Indicate whether the Chair of the highest governance body is also an executive officer.	Fully	Dr Raneer Jayamaha is Chairperson and non-executive director of HNB's Board of Directors. Mr Jonathan Alles is Managing Director and Chief Executive Officer.			
4.3	For organizations that have a unitary board structure, state the number of members of the highest governance body that are independent and/or non-executive members.	Fully	Pages 117, 122-124			
4.4	Mechanisms for shareholders and employees to provide recommendations or direction to the highest governance body.	Fully	The Bank recognises the critical role of stakeholder feedback in further enhancing its sustainability reporting frameworks. To facilitate better engagement and formal feedback, an Investor/Stakeholder Feedback Form is attached to this Report.			
4.5	Linkage between compensation for members of the highest governance body, senior managers, and executives (including departure arrangements), and the organization's performance (including social and environmental performance).	Fully	Pages 126-127			
4.6	Processes in place for the highest governance body to ensure conflicts of interest are avoided.	Fully	Page 140			
4.7	Process for determining the qualifications and expertise of the members of the highest governance body for guiding the organization's strategy on economic, environmental, and social topics.	Fully	Pages 122, 141-142			
4.8	Internally developed statements of mission or values, codes of conduct, and principles relevant to economic, environmental, and social performance and the status of their implementation.	Fully	Inner front cover			
4.9	Procedures of the highest governance body for overseeing the organization's identification and management of economic, environmental, and social performance, including relevant risks and opportunities, and adherence or compliance with internationally agreed standards, codes of conduct, and principles.	Fully	Pages 135-140			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
4.10	Processes for evaluating the highest governance body's own performance, particularly with respect to economic, environmental, and social performance.	Fully	Page 126			
4.11	Explanation of whether and how the precautionary approach or principle is addressed by the organization.	Fully	Page 166			
4.12	Externally developed economic, environmental, and social charters, principles, or other initiatives to which the organization subscribes or endorses.	Fully	The GRI Framework			
4.13	Memberships in associations (such as industry associations) and/or national/international advocacy organizations in which the organization: * Has positions in governance bodies; * Participates in projects or committees; * Provides substantive funding beyond routine membership dues; or * Views membership as strategic.	Fully	Page 169			
4.14	List of stakeholder groups engaged by the organization.	Fully	Pages 170-177			
4.15	Basis for identification and selection of stakeholders with whom to engage.	Fully	Page 169			
4.16	Approaches to stakeholder engagement, including frequency of engagement by type and by stakeholder group.	Fully	Pages 170-177			
4.17	Key topics and concerns that have been raised through stakeholder engagement, and how the organization has responded to those key topics and concerns, including through its reporting.	Fully	Pages 170-177			
STANDARD DISCLOSURES PART II: Disclosures on Management Approach (DMAs)						
FSSS DMAs	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	To be reported in
DMA FS Aspects	Disclosure on Management Approach FS Product Portfolio	Fully	Pages 32-85			
FS1	Policies with specific environmental and social components applied to business lines.	Fully	Pages 204-211			
FS2	Procedures for assessing and screening environmental and social risks in business lines.	Fully	Pages 204-211			
FS3	Processes for monitoring clients' implementation of and compliance with environmental and social requirements included in agreements or transactions.	Fully	Pages 93-95, 204-211			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
FS4	Process(es) for improving staff competency to implement the environmental and social policies and procedures as applied to business lines.	Fully	Pages 204-211			
FS5	Interactions with clients/investees/business partners regarding environmental and social risks and opportunities.	Fully	Pages 170-177			
	Audits	Fully	Pages 133-135			
	Active Ownership	Fully	Pages 77-81			
DMA_EC Aspects	Disclosure on Management Approach EC	Fully	Pages 32-85			
	Economic Performance COMM	Fully	Pages 32-85			
	Market presence	Fully	Pages 32-85			
	Indirect economic impacts	Fully	Pages 32-85			
DMA_EN Aspects	Disclosure on Management Approach EN	Fully	Zero impact operations and resource efficiency are inherent objectives of our sustainability strategy. As a financial service organisation we have identified paper as the most significant material consumed in our daily operations and reporting. We are in the process of automating electronically our processes in order to reduce paper usage and have successfully implemented several online approval mechanisms within the Bank ranging from credit approvals to processing of leave for employees.			
	Energy	Fully	Energy Minimum impact operations and resource efficiency are inherent objectives of our sustainability strategy.			
	Water	Fully	Water Minimum impact operations and resource efficiency are inherent objectives of our sustainability strategy.			
	Biodiversity	Fully	The Bank addresses environmental impacts in its lending policies.			
	Emissions, effluents and waste	Fully	The Bank minimises its carbon footprint and adopts a strategy of resource reduction/optimisation. However, it is presently not material to our type of operations to further breakdown our emissions and waste indicators.			
	Products and services	Fully	The Bank's product and service portfolio is continuously screened for environmental impact under the green banking policies.			
	Compliance	Fully	General stance towards compliance covers this aspect fully and therefore detailed reporting is not considered material.			
	Transport	Fully	Our objectives towards reducing our carbon footprint includes business related travel and transport.			
	Overall	Fully	Minimum impact and efficient use of energy and resources are inherent objectives of our sustainability strategy.			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation	
DMA LA Aspects	Disclosure on Management Approach LA						
	Employment	Fully	Pages 192-197				
	Labour/management relations	Fully	Pages 192-197				
	Occupational health and safety/COMM	Fully	Pages 192-197				
	Training and education	Fully	Pages 192-197				
	Diversity and equal opportunity	Fully	Pages 192-197				
	DMA HR Aspects	Disclosure on Management Approach HR					
		Investment and procurement practices	Fully	Pages 175-176, 183			
		Non-discrimination	Fully	Pages 192-197			
		Freedom of association and collective bargaining	Fully	Pages 192-197			
DMA SO Aspects	Child labour	Fully	Pages 192-197				
	Forced and compulsory labour	Fully	Pages 192-197				
	Security practices	Fully	Pages 192-197				
	Indigenous rights	Fully	Pages 192-197				
	Disclosure on Management Approach SO						
	Community	Fully	Pages 200-203				
	Corruption	Fully	One of the Bank's core values is "Treasure Professional and personal integrity at all times. All employees are bound by the Code of Ethics, Compliance & Integrity Programme, Whistle Blowing Policy and Customer Charter. The Code of Business Conduct and Ethics for all employees addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the Bank's assets, compliance with applicable laws and regulations and encouraging the reporting of any illegal or unethical behaviour."				
	Public policy	Fully	Pages 184-186				
	Anti-competitive behaviour	Fully	Pages 184-186				
	Compliance	Fully	Pages 184-186				
DMA PR Aspects	Disclosure on Management Approach PR						
	Customer health and safety	Fully	Pages 184-186				
FS15	Product and service labelling	Fully	Pages 184-186				
	Policies for the fair design and sale of financial products and services	Fully	Pages 184-186				
	Marketing communications	Fully	Pages 184-186				
STANDARD DISCLOSURES PART III: Performance Indicators Product and Service Impact Product portfolio	Customer privacy	Fully	Pages 184-186				
	Compliance	Fully	Pages 184-186				
	STANDARD DISCLOSURES PART III: Performance Indicators Product and Service Impact Product portfolio						

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
FS6	Percentage of the portfolio for business lines by specific region, size (e.g. micro/SME/large) and by sector.	Fully	Pages 95-96			
FS7	Monetary value of products and services designed to deliver a specific social benefit for each business line broken down by purpose.	Fully	Pages 32-85			
FS8	Monetary value of products and services designed to deliver a specific environmental benefit for each business line broken down by purpose.	Fully	Pages 32-85			
Audit FS9	Coverage and frequency of audits to assess implementation of environmental and social policies and risk assessment procedures.	Fully	Pages 143-144			
Active ownership FS10	Percentage and number of companies held in the institution's portfolio with which the reporting organization has interacted on environmental or social issues.	Fully	Pages 354-362			
FS11	Percentage of assets subject to positive and negative environmental or social screening.	Fully	Pages 95-96, 204-207			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
FS12	Voting policies) applied to environmental or social issues for shares over which the reporting organization holds the right to vote shares or advises on voting.	Not			Not applicable	HNB only exercises significant voting rights on its subsidiaries and associates. There have not been instances where HNB had to vote on environmental and social issues upto date. Whilst currently the Bank does not have a specific voting policy applied to environmental or social issues for shares it is intended that this aspect would be addressed during the implementation of the proposed EMS by 2016.
Economic performance						
EC1COMM	Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.	Fully	Pages 178, 381			
EC2	Financial implications and other risks and opportunities for the organization's activities due to climate change.	Fully	Pages 8-13, 14-19, 45, 204-211			
EC3	Coverage of the organization's defined benefit plan obligations.	Fully	Pages 344-345			
EC4	Significant financial assistance received from government.	Not			Not applicable	The Bank does not receive significant financial assistance.
Market presence						

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
EC5	Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation.	Fully	As defined in the Collective Agreements.			
EC6	Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation.	Partially	As a policy procurement of imported goods is resorted to only when such goods are not locally manufactured.	The proportion of spending on locally based suppliers has not been disclosed in this report	Not material	At HNB 'locally based suppliers' is defined as manufacturers using locally available material in their production process. The Bank only deals with suppliers who have registered their services with HNB. Prior to approving the registration of the supplier an inspection is carried out by the Bank to ascertain the supplier's business, social and environmental practices. Selection of suppliers for a particular procurement decision would be based on number of factors including price, quality and ability to supply a large order in an ethical manner.
EC7	Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation.	Fully	All hiring is done locally at significant locations of operation			
EC8	Indirect economic impacts. Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement.	Fully	Pages 200-203			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
EC9	Understanding and describing significant indirect economic impacts, including the extent of impacts.	Fully	HNB is the largest private commercial bank in the country with an extensive branch network spanning the entire country. HNB works on the premise "Partner in progress" and focuses on sustainable business through the supply chain. The Bank works to ensure that our customers have access to fair and affordable banking. HNB is one of the leading private banks in micro finance and project finance. With over 4,604 employees the Bank invest heavily in the development of staff.			
Environmental Performance Indicator	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for Omission	Explanation To be reported in
Materials						
EN1	Materials used by weight or volume.	Fully	Page 212			
EN2	Percentage of materials used that are recycled input materials.	Not		Not material	Our business processes are not material intensive.	
Energy						
EN3	Direct energy consumption by primary energy source.	Fully	Page 209			
EN4	Indirect energy consumption by primary source.	Fully	Page 209			
EN5	Energy saved due to conservation and efficiency improvements.	Fully	Page 209			
EN6	Initiatives to provide energy-efficient or renewable energy based products and services, and reductions in energy requirements as a result of these initiatives.	Fully	Pages 209, 212			
EN7	Initiatives to reduce indirect energy consumption and reductions achieved.	Fully	Pages 209, 212			
Water						
EN8	Total water withdrawal by source.	Not		Not material	Our core business processes do not utilise water.	
EN9	Water sources significantly affected by withdrawal of water.	Not		Not material	Our core business processes do not utilise water.	
EN10	Percentage and total volume of water recycled and reused.	Fully	Page 208			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
Biodiversity EN11	Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas.	Not		Not applicable	Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.	
EN12	Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas.	Not		Not applicable	Not applicable to our business as our operations have no direct impact on biodiversity rich habitats. However the Bank addresses environmental impacts in its lending policies - given on pages 206- 207 of this Report	
EN13	Habitats protected or restored	Fully	Page 212			
EN14	Strategies, current actions, and future plans for managing impacts on biodiversity.	Not		Not applicable	Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.	
EN15	Number of IUCN Red List species and national conservation list species with habitats in areas affected by operations, by level of extinction risk.	Not		Not applicable	Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.	

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
Emissions, effluents and waste EN16COMM	Total direct and indirect greenhouse gas emissions by weight.	Not			Not material	not relevant or applicable to type of operations
EN17	Other relevant indirect greenhouse gas emissions by weight.	Not			Not material	not relevant or applicable to type of operations
EN18	Initiatives to reduce greenhouse gas emissions and reductions achieved.	Not			Not material	not relevant or applicable to type of operations
EN19	Emissions of ozone-depleting substances by weight.	Not			Not applicable	not relevant or applicable to type of operations
EN20	NOx, SOx, and other significant air emissions by type and weight.	Not			Not applicable	not relevant or applicable to type of operations
EN21	Total water discharge by quality and destination.	Not			Not material	not material to our industry or operations
EN22COMM	Total weight of waste by type and disposal method.	Not			Not material	the cost of implementing additional data breakdowns do not outweigh the benefits, since such breakdowns are not deemed material, neither business wise nor volume wise.
EN23	Total number and volume of significant spills.	Not			Not applicable	not relevant or applicable to type of operations
EN24	Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I, II, III, and VIII, and percentage of transported waste shipped internationally.	Not			Not applicable	not relevant or applicable to type of operations
EN25	Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organization's discharges of water and runoff.	Not			Not applicable	not relevant or applicable to type of operations
Products and services EN26	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	Fully	Being a commercial bank our products and services do not typically impact directly on the environment. There may however be an indirect impact through the activities of customers to whom we lend. HNB has endeavours to address this issue by lending guidelines and conditions. Further information on environmental credit risk assessment is given on pages 206-207 of this Report.			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
EN27	Percentage of products sold and their packaging materials that are reclaimed by category.	Not			Not material	not relevant or applicable to the type of products & services in our industry
Compliance						
EN28	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.	Fully	During the year under review so far as we are aware HNB did not incur any significant fines, penalties or non-monetary sanctions for non-compliance with any environmental laws and regulations.			
EN29	Significant environmental impacts of transporting products and other goods and materials used for the organization's operations, and transporting members of the workforce.	Fully	Page 209			
Overall						
EN30	Total environmental protection expenditures and investments by type.	Fully	Page 212			
Social, Labour Practices and Decent Work						
Performance Indicator	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for Omission	To be reported in
Employment						
LA1	Total workforce by employment type, employment contract, and region.	Fully	Pages 197-198			
LA2	Total number and rate of employee turnover by age group, gender, and region.	Fully	Page 198			
LA3	Benefits provided to full-time employees that are not provided to temporary or part-time employees, by major operations.	Fully	As defined in the Collective Agreements. Permanent employees are eligible to a range of benefits including loans at subsidised rates, medical reimbursements, other allowances.			
Labour/management relations						
LA4	Percentage of employees covered by collective bargaining agreements.	Fully	Page 198			
LA5	Minimum notice period(s) regarding significant operational changes, including whether it is specified in collective agreements.	Fully	The Bank endeavours to give a minimum of 1 month notice regarding significant operational changes. It is not defined in collective agreements except for notice regarding resignations.			
Occupational health and safety						
LA6	Percentage of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programs.	Fully	As defined in the Collective Agreements			
LA7	Rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region.	Not			Not applicable	not relevant or applicable to type of operations

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
LA8	Education, training, counselling, prevention, and risk-control programs in place to assist workforce members, their families, or community members regarding serious diseases.	Fully	Pages 195, 202			
LA9	Health and safety topics covered in formal agreements with trade unions.	Fully	Medical leave, medical insurance, annual health check up and reimbursement of medical expenses including hospitalisation as benefits while Unions commit to abide by the Bank's Health and Safety Policies at all times.			
LA10	Training and education	Fully	Page 198			
LA11	Average hours of training per year per employee by employee category. Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings.	Fully	Pages 195-196			
LA12	Percentage of employees receiving regular performance and career development reviews.	Fully	100%			
LA13	Diversity and equal opportunity	Fully	Pages 197-198			
LA14	Composition of governance bodies and breakdown of employees per category according to gender, age group, minority group membership, and other indicators of diversity. Ratio of basic salary of men to women by employee category.	Fully	The Bank is an equal opportunity employer and does not discriminate on gender. Basic salary of both men and women is equal in every employee category.			
HR1	Social, Human Rights Investment and procurement practices	Fully	All credit audits comprise of HR screening as a part of the overall business screening. If brought to the Bank's attention, it influences to change the HR position in creditors' business environment or terminates where change is not foreseeable.			
HR2	Percentage of significant suppliers and contractors that have undergone screening on human rights and actions taken.	Fully	100%			
HR3	Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained.	Fully	Policies and procedures concerning aspects of human rights are covered in Induction training for all employees. Total number of training hours for 2013 for new recruits - 188 hours			
HR4	Non-discrimination	Fully	None reported during the year under review			
	Total number of incidents of discrimination and actions taken.	Fully	None reported during the year under review			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
HR5	Freedom of association and collective bargaining. Operations identified in which the right to exercise freedom of association and collective bargaining may be at significant risk, and actions taken to support these rights.	Fully	Collective Agreements are adhered to			
HR6	Child labor. Operations identified as having significant risk for incidents of child labour, and measures taken to contribute to the elimination of child labour.	Fully	HNB employs only adult workforce			
HR7	Forced and compulsory labour. Operations identified as having significant risk for incidents of forced or compulsory labour, and measures to contribute to the elimination of forced or compulsory labour.	Fully	HNB does not have operations at risk of forced or compulsory labour			
HR8	Security practices. Percentage of security personnel trained in the organization's policies or procedures concerning aspects of human rights that are relevant to operations.	Fully	Security Coordinators are employed to monitor the security functions which are outsourced			
HR9	Indigenous rights. Total number of incidents of violations involving rights of indigenous people and actions taken.	Fully	Our operations are centred on urban, semi urban and rural areas that have a significant population density. As far as we are aware no incidents of violations involving rights of indigenous people were reported during the year under review.			
S01	Social, Society Performance Indicator. Description Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting economically disadvantaged areas by type.	Reported	Cross-reference/Direct answer Pages 155-158, 200-203	if applicable, indicate the part not reported	Reason for Omission	Explanation To be reported in
FS13	Initiatives to improve access to financial services for disadvantaged people.	Fully	Pages 180-182			
S02	Corruption. Percentage and total number of business units analysed for risks related to corruption.	Fully	100%. HNB has extensive risk management policies and processes in place to reduce the risk of corruption. All employees are trained on a Code of Conduct and a Compliance and Integrity programme.			
S03	Percentage of employees trained in organization's anti-corruption policies and procedures.	Fully	100%. All employees are inducted on the Code of Ethics and Code of Conduct			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
SO4	Actions taken in response to incidents of corruption.	Fully	None reported during the year under review			
Public policy						
SO5	Public policy positions and participation in public policy development and lobbying.	Fully	The policy is to not donate to or sponsor political activities			
SO6	Total value of financial and in-kind contributions to political parties, politicians, and related institutions by country.	Fully	The policy is to not donate to or sponsor political activities			
Anti-competitive behaviour						
SO7	Total number of legal actions for anti-competitive behaviour, anti-trust, and monopoly practices and their outcomes.	Fully	None reported during the year under review			
Compliance						
SO8	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations.	Fully	None reported during the year under review			
Social: Product Responsibility						
Customer health and safety						
PR1	Life cycle stages in which health and safety impacts of products and services are assessed for improvement, and percentage of significant products and services categories subject to such procedures.	Fully	Given the nature of our business, product assessment and redesign is not dependent on health and safety aspects.			
PR2	Total number of incidents of non-compliance with regulations and voluntary codes concerning health and safety impacts of products and services during their life cycle, by type of outcomes.	Fully	None reported during the year under review			
Product and service labelling						
PR3	Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements.	Fully	All credit based products are accompanied by contractual agreements which outline the nature of the product, their terms of credit and repayment conditions. All deposit based products are accompanied with information on deposit type, terms of deposit and withdrawal conditions. Our website too includes information about the various products and services.			

Profile Disclosure	Description	Reported	Cross-reference/Direct answer	If applicable, indicate the part not reported	Reason for omission	Explanation
PR4	Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labelling, by type of outcomes.	Fully	All complaints from customers are addressed through the Bank's complaints resolution process. If a customer is not satisfied by the outcome of the internal complaints resolution process, the customer can refer the matter to the Financial Ombudsman. During the year under review there were no such events reported in relation to non-compliance with regulations and voluntary codes concerning product and service information and labelling. Pages 184-191			
PR5	Practices related to customer satisfaction, Fully including results of surveys measuring customer satisfaction.	Fully	Page 191			
FS16	Initiatives to enhance financial literacy by type of beneficiary.	Fully	Page 191			
Marketing communications						
PR6	Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship.	Fully	HNB complies with laws and regulations relating to the disclosure of information about the products and services we provide.			
PR7	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes.	Fully	All complaints from customers are addressed through the Bank's complaints resolution process. If a customer is not satisfied by the outcome of the internal complaints resolution process, the customer can refer the matter to the Financial Ombudsman. During the year under review there were no such events reported in relation to non-compliance with regulations and voluntary codes concerning marketing communications.			
Customer privacy						
PR8	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.	Fully	At HNB any occurrence involving inappropriate disclosure that may cause the privacy of our customers to be impacted is taken into serious consideration and we focus on identification and investigation of all such events. During the year under review there were no such events reported.			
Compliance						
PR9	Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services.	Fully	No significant fine was levied against the Bank for the current reporting period.			

Financial Calendar - 2013

44th Annual General Meeting held on	28th March 2013
Rs 7.00 per share Final Dividend for 2012 paid on	4th April 2013
Rs 1.50 per share Interim Dividend for 2013 paid on	13th December 2013
Audited Financial Statements signed on	21st February 2014
45th Annual General Meeting to be held on	28th March 2014
Rs 7.00 per share Final Dividend for 2013 payable in	*April 2014

Interim Financial Statements published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:

1st Quarter Interim Results released on	13th May 2013
2nd Quarter Interim Results released on	12th August 2013
3rd Quarter Interim Results released on	13th November 2013

Proposed Financial Calendar - 2014

Interim Dividend for 2014 to be payable in **	December 2014
46th Annual General Meeting to be held in	March 2015
Final Dividend for 2014 to be payable in ***	April 2015

Interim Financial Statements to be published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:

1st Quarter Interim Results to be released in	May 2014
2nd Quarter Interim Results to be released in	August 2014
3rd Quarter Interim Results to be released in	November 2014

* *Subject to confirmation by Shareholders*

** *Subject to confirmation by Directors*

*** *Subject to confirmation by Directors and Shareholders*

Thriving on transformation.



We shall continually reassess our business model in order to respond to and even thrive upon the challenges our industry faces today.

Financial Reports:

Annual Report of the Board of Directors on the Affairs of the Company

1. GENERAL

The Board of Directors of Hatton National Bank PLC has pleasure in presenting its Annual Report to the shareholders for the financial year ended 31st December 2013, together with the audited financial statements of the Bank, consolidated financial statements of the Group for that year and the Auditor's Report on those financial statements, conforming to the requirements of the Companies Act No 7 of 2007 and the Banking Act No 30 of 1988. The financial statements were reviewed and approved by the Board of Directors on 21st February 2014.

This Report includes the information as required by the Companies Act No 7 of 2007, Banking Act Direction No 11 of 2007 on Corporate Governance for Licensed Commercial Banks and subsequent amendments thereto, Listing Rules of the Colombo Stock Exchange (CSE). The Report is also guided by the recommended best practices on Corporate Governance.

Hatton National Bank PLC ("the Bank") is a Licensed Commercial Bank registered under the Banking Act No 30 of

1988 and was incorporated as a public limited liability company in Sri Lanka on 5th March 1970 under the Companies Ordinance No 51 of 1938. The Bank was re-registered as required under the provisions of the Companies Act No 7 of 2007 on 27th September 2007. The re-registration number of the Bank is PQ 82.

The ordinary shares (both voting and non-voting) and unsecured subordinated/senior redeemable debentures of the Bank are listed on the main board of the Colombo Stock Exchange in Sri Lanka.

The Bank has been assigned a National Long Term Rating of AA-(lka) with a Stable Outlook by Fitch Ratings Lanka Ltd and a foreign currency issuer rating of B1 by Moody's which is on par with the sovereign rating of B1 of Sri Lanka. This is the first ever international rating obtained by a Sri Lankan Bank.

The registered office as well as the Head Office of the Bank is at No 479, T B Jayah Mawatha, Colombo 10, Sri Lanka.

Section 168 of the Companies Act No. 07 of 2007, requires the following information to be published in the Annual Report prepared for the year under review.

Information required to be disclosed as per the Companies Act No. 07 of 2007	Reference to the Companies Act	Level of compliance by the Bank
The nature of the business of the Bank and the Group	Section 168 (1) (a)	Refer section 3 on page 235
Signed financial statements of the Bank and the Group for the accounting period completed	Section 168 (1) (b)	Refer section 7 on page 235
Auditor's Report on financial statements of the Bank and the Group	Section 168 (1) (c)	Refer section 9 on page 235
Changes in accounting policies made during the accounting period	Section 168 (1) (d)	Refer section 10 on page 235
Particulars of entries in the interests register made during the accounting period	Section 168 (1) (e)	Refer section 35 on page 240
Remuneration and other benefits paid to the Directors during the accounting period	Section 168 (1) (f)	Refer section 39 on page 241
Total amount of donations made by the Bank during the accounting period	Section 168 (1) (g)	Refer section 15 on page 237
Information on Directorate of the Bank and its subsidiaries/joint ventures during and at the end of the accounting period	Section 168 (1) (h)	Refer section 28 on page 238 and 32 on page 239
Amounts payable to the auditor as audit fees and fees for other services rendered during the accounting period as a separate disclosure	Section 168 (1) (i)	Refer section 48 on page 243
Auditor's relationship or any interest with the Bank and its subsidiaries	Section 168 (1) (j)	Refer section 48 on page 243
Annual Report of the Board signed on behalf of the Board by two Directors and the Company Secretary	Section 168 (1) (k)	Refer section 50 on page 243

2. VISION, MISSION AND CORPORATE CONDUCT

The Bank's Vision and Mission statements are given in inner front cover of the Report. The business activities of the Bank are conducted in keeping with the highest level of ethical standards in achieving its Vision and Mission. Bank's Code of Ethics reflects our commitment to high standards of business conduct and ethics.

3. PRINCIPAL ACTIVITIES

The principal activities of the Bank and the Group during the year were general banking, development banking, offshore banking, mortgage financing, lease and hire purchase financing, corporate banking, dealing in government securities and listed equities, pawn broking, e - banking facilities, Islamic banking, custodian banking for mobile banking, stock broking, providing life and general insurance services, other financial services and property development. There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

The names of the Bank's subsidiaries and their nature of principle activities are given in Note 1.1.2 to the financial statements and are found on page 262.

4. CHANGES TO THE GROUP STRUCTURE

During the year, the Bank disposed its investment (Rs 56.12 Mn) in Majan Exchange LLC, 40% owned subsidiary company to a local investor in Oman and recorded a loss of Rs 0.16 Mn. Bank also decided to close its liaison office in Chennai, India subject to the Indian regulatory approval.

The Bank liquidated the Employee Share Benefit Trust (ESBT) during the year ended 31st December 2013 after informing CSE and Securities and Exchange Commission (SEC). Accordingly the Bank discontinued its treatment of the ESBT as a special purpose entity in the consolidated financial statements as explained in section 41 of this Report.

5. REVIEW OF OPERATIONS

A review of the operations of the Bank during the financial year 2013 and results of its operations are contained in the Chairperson's Message (pages 8 to 13) the Managing Director's Review (pages 14 to 19) and the Management Discussion & Analysis (pages 32 to 85). These reports form an integral part of the Annual Report of the Board of Directors.

6. FUTURE DEVELOPMENTS

An overview of the future developments of the Bank is given in the Chairperson's Message (pages 8 to 13), the Managing Director's Review (pages 14 to 19) and the Management Discussion & Analysis (pages 32 to 85).

7. FINANCIAL STATEMENTS

The financial statements of the Bank and the Group have been prepared in accordance with Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and they comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988.

The financial statements of the Bank and the Group for the year ended 31st December 2013 duly signed by the Chief Accountant, two of the Directors of the Bank and the Company Secretary are given in pages 254 to 369, which form an integral part of the Annual Report of the Board of Directors.

8. DIRECTORS' RESPONSIBILITY FOR FINANCIAL REPORTING

The Directors are responsible for the preparation of the financial statements of the Bank to present a true and fair view of its state of affairs. The Directors are of the view that these financial statements have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards, (SLFRSs and LKASs) Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto and the Listing Rules of the CSE. The Statement of Directors' Responsibility for Financial Reporting is given on page 252 and forms an integral part of the Annual Report of the Board of Directors.

9. AUDITORS' REPORT

Bank's auditors, Messrs KPMG, carried out the audit on the financial statements of the Bank and the consolidated financial statements of the Group for the year ended 31st December 2013 and their report on those financial statements is given on page 253 of this Annual Report.

10. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the financial statements are given on pages 264 to 285.

11. GOING CONCERN

The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, we continue to adopt the "going concern" basis in preparing these financial statements.

12. INCOME

The income of the Group for 2013 was Rs 64,637,504,000/- (2012: Rs 55,211,622,000/-) while the Bank's income was Rs 60,073,685,000/- (2012: Rs 51,538,779,000/-). An analysis of the income is given in Note 10 to the financial statements.

Annual Report of the Board of Directors on the Affairs of the Company

13. FINANCIAL RESULTS AND APPROPRIATIONS

The Bank has recorded a growth in profit before tax of 1.3% and a drop in profit after tax of 7% in 2013. The Group's profit before tax recorded a growth of 3.72% and a drop in profit after tax of 3.57% over 2012.

The Bank's total comprehensive income for the year is Rs 7,446,457,000/- (2012: Rs 10,282,689,000/-) while the Group has recorded a total comprehensive income of Rs 8,268,303,000/- for the year (2012: Rs 11,798,500,000/-).

	2013 Rs 000	2012 Rs 000
The Group profit for the year ended 31st December after payment of all operating expenses and provision for depreciation and contingencies	10,915,647	10,523,380
Less : taxation	(3,103,199)	(2,421,431)
Group net profit after taxation	7,812,448	8,101,949
Other comprehensive income net of income tax		
Gains and losses arising from translating the financial statements of foreign operations	1,764	13,843
Gains and losses on re-measuring available-for-sale financial assets		
Net change in fair value on available-for-sale financial assets	1,306,774	475,771
Transfer to life policy holder reserve fund	2,991	(21,335)
Net amount transferred to profit or loss (available-for-sale financial assets)	-	76,765
Actuarial gains and losses on defined benefit plans	(855,674)	756,710
Changes in revaluation surplus	-	2,394,797
Total Group comprehensive income for the year	8,268,303	11,798,500
Non - controlling interests	(168,992)	(170,622)
	8,099,311	11,627,878
Other comprehensive income net of tax relating to:		
Capital reserve	-	(2,394,797)
Available for sale reserve	(1,304,688)	(529,475)
Exchange equalisation reserve	(706)	(5,142)
	6,793,917	8,698,464
Unappropriated profit brought forward from previous year	5,321,846	3,504,132
Balance available before appropriation / adjustments	12,115,763	12,202,596
Write off of subsidiary	-	(3,665)
Disposal of subsidiary	9,250	-
Disposal of associate	-	52,052
Deemed disposal gain	40,189	76,873
Effect of winding up of special purpose entity	(41,931)	-
	12,123,271	12,327,856
Appropriations		
Transfer to general reserve	(1,300,000)	(2,400,000)
Transfer to reserve fund	(430,000)	(430,000)
Transfer to investment fund account	(1,800,643)	(1,322,225)
Transfer of revaluation reserve on disposal of PPE	-	5,689
Dividends		
Final dividend paid (Cash) 2011	-	(1,120,823)
Final dividend paid (Scrip) 2011	-	(1,166,032)
Interim dividend paid (Cash) 2012	-	(572,619)
Final dividend paid (Cash) 2012	(2,782,814)	-
Interim dividend paid (Cash) 2013	(599,332)	-
Balance carried forward as at 31st December	5,210,483	5,321,846

14. RESERVES

The Group reserves consist of:

	31.12.2013 Rs 000	31.12.2012 Rs 000
Capital reserve	8,792,657	8,792,657
Statutory reserve fund	2,660,000	2,230,000
Investment fund account	4,101,205	2,300,562
Available for sale reserve	4,454,989	3,150,301
Exchange equalisation reserve	-	8,544
Life policy holder reserve fund	(4,182)	(1,191)
Treasury shares	-	(310,938)
ESOP reserve	416,216	176,515
Revenue reserve	24,310,483	23,121,846
	44,731,368	39,468,296

The movement in these reserves is shown in the Statement of Changes in Equity on pages 258 and 259 of the Annual Report.

As per the Central Bank's Guidelines, the Directors propose to transfer Rs 1,800,643,000/- (2012: Rs 1,322,225,000/-) to the investment fund account.

Further, the Directors propose to transfer Rs 430,000,000/- (2012: Rs 430,000,000/-) to the statutory reserve fund, and Rs 1,300,000,000/- (2012: Rs 2,400,000,000/-) to the general reserve account.

15. CORPORATE DONATIONS

During the year the Bank made donations amounting to Rs. 23,900,712/- (2012: Rs 32,579,000/-) in terms of the resolution passed at the last Annual General Meeting. Donations made by the Group during the year amounted to Rs 24,265,000/- (2012: Rs 32,879,000/-). The donations made by the Bank to Government approved charities from the above sum amounted to Rs 2,000,000/- (2012: Rs 2,000,000/-).

16. TAXATION

The income tax rate applicable on the Bank's domestic operations and FCBU on-shore & off-shore banking operations is 28% (2012: 28%).

It is the Bank's policy to provide for deferred taxation on all known temporary differences under the liability method.

The Bank is also liable for Financial Services VAT at 12% (2012: 12%).

With effect from 1st April 2013, the Bank is liable to pay Crop Insurance Levy on a quarterly basis at 1% on after tax profit to the Insurance Trust Fund Board.

17. STATUTORY PAYMENTS

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to the Government and the employees have been made up to date.

18. DIVIDENDS ON ORDINARY SHARES

An interim dividend of Rs 1.50 per share (2012: Rs 1.50) was paid on 13th December 2013 to the holders of the ordinary shares (both voting and non-voting) for the financial year 2013. A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the Bank and will therefore be free of income tax in the hands of the shareholders. On this basis 43.9% of the interim dividend paid for 2013 is subject to income tax.

The Directors recommend that a final cash dividend of Rs 7.00 per share (2012: Rs 7.00 per share) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2013.

The Board of Directors was satisfied that the Bank would meet the solvency test immediately after the interim dividend was paid on 13th December 2013 and the final dividend proposed which will be paid in April 2014 in terms of the provisions of the Companies Act No 7 of 2007 and Listing Rules of the CSE. The Board provided the Statements of Solvency to the auditors and obtained Certificates of Solvency from the auditors in respect of each dividend payment conforming to the statutory provision.

19. CAPITAL EXPENDITURE

The total capital expenditure on acquisition of investment property, property, plant and equipment and intangible assets of the Bank and the Group amounted to Rs 1,626,501,000/- and Rs 1,703,513,000/- respectively (2012 Bank: Rs 1,059,463,000/- and Group: Rs 1,134,293,000/-). Details are given in Notes and to the financial statements. The capital expenditure approved and contracted for, after the year end is given in Note 58 (a) to the financial statements.

20. PROPERTY, PLANT AND EQUIPMENT (PPE)

Details of property, plant and equipment are given in Note 38 to the financial statements.

21. NET BOOK VALUE OF FREEHOLD PROPERTIES

The net book values of freehold properties owned by the Bank and the Group as at 31st December 2013 are included in the accounts at Rs 7,168,211,000/- and Rs 13,698,738,000/- respectively (2012 Bank: Rs 6,843,071,000/- and Group: Rs 13,444,282,000/-).

A panel of Chartered Valuers / Licensed Surveyors carried out a revaluation of the Bank's freehold properties in 2012. The details of freehold properties owned by the Bank are given in Note 38 (a) to the financial statements.

Annual Report of the Board of Directors on the Affairs of the Company

22. OUTSTANDING LITIGATION

In the opinion of the Directors and the Bank's Lawyers, pending litigation against the Bank disclosed in Note 58 (e) of the financial statements will not have a material impact on the financial position of the Bank or its future operations.

23. EVENTS AFTER THE REPORTING DATE

No circumstances have arisen since the Statement of Financial Position date which would require adjustments to, or disclosure in, the accounts, except those disclosed in Note 63 to the financial statements.

24. STATED CAPITAL AND DEBENTURES

The stated capital of the Bank as at 31st December 2013 was Rs. 12,830,268,000/- consisting of 399,555,201 ordinary shares, consisting of 319,353,829 (voting) and 80,201,372 (non-voting). (2012: Rs 12,579,479,000/-consisting of 397,246,449 ordinary shares, 317,650,102 - voting and 79,596,347 - non-voting.)

The Bank issued 2,308,752 ordinary shares during the year, 1,703,727 shares (voting) at a consideration of Rs 205,685,000/- and 605,025 shares (non-voting) at a consideration of Rs 45,104,000/- under the approved Employee Share Option Plan (ESOP). Therefore the Stated Capital increase of the Bank due to employees exercising their options under ESOP amounted to Rs 250,789,000/- (2012: Rs 78,599,000/-). The total increase in the stated capital during the year is Rs 250,789,000/- (2012: Rs 1,128,028,000/-).

The Bank had issued unsecured, subordinated, redeemable debentures to the value of Rs 8,607,558,000/- as at 31st December 2013. (2012: Rs 4,585,568,000/-). The Bank issued a five year debenture amounting to Rs 4,000,000,000/- in 2013. The details of unsecured, subordinated, redeemable debentures issued and redeemed during the year 2013 and those outstanding as at 31st December 2013 are given in Note 51 (a) to the financial statements. Further, in August 2013, the Bank issued 20,000,000 senior listed unsecured redeemable 10 year debentures at a price of Rs. 67.715 and accordingly raised Rs 1,354,300,000/-. The details of this debenture are given in Note 46 to the financial statements.

25. SHARE INFORMATION

Information relating to earnings, dividend, net assets and market price per share is given on page 5 of the Annual Report. Information on share trading is given on page 386 of the Annual Report.

26. SHAREHOLDINGS

As at 31st December 2013 there were 4,401 and 11,107 registered voting and non-voting shareholders respectively (2012: voting 4,389 and non-voting 11,360). Information on the distribution of shareholding and the respective percentages is indicated on pages 385 and 386 of the Annual Report. The twenty largest voting and non-voting shareholders of the Bank as at 31st December 2013, together with an analysis are given on pages 389 and 390 of the Annual Report.

27. EQUITABLE TREATMENT TO SHAREHOLDERS

The Bank has at all times ensured that all shareholders (both voting and non-voting) are treated equitably except for the right to vote.

28. THE BOARD OF DIRECTORS

The Board of Directors of the Bank consists of nine (2012: eleven) Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the Statement of Financial Position date and their brief profiles appear on pages 22 to 25 of the Annual Report.

Name of the Director	Status
Dr Raneer Jayamaha - Chairperson	NIND / NED
Ms M A R C Cooray	IND / NED - Appointed as Senior Director w.e.f. 17.5.2013
Dr W W Gamage	IND / NED
Dr L R Karunaratne	IND / NED
Mr L U D Fernando	IND / NED*
Mr Sujeewa Mudalige	IND / NED
Ms D S C Jayawardena	NIND / NED
Mr Rusi S Captain	NIND / NED
Mr Jonathan Alles (MD/CEO)	ED - Appointed as ED w.e.f. 1.5.2013 and as MD/CEO w.e.f. 1.7.2013

(IND - Independent Director; NIND - Non Independent Director; NED - Non Executive Director and ED - Executive Director)

*Director Mr L U D Fernando has declared that with effect from 1st January 2014, he shall be a Non-Independent / Non Executive Director.

29. RETIREMENT / RESIGNATION OF DIRECTORS

Three Directors resigned/retired during the year 2013. Mrs Pamela C Cooray (Senior Director) resigned from the Board w.e.f. 31st March 2013 having served the Board for nine (09) years. Mr N G Wickramaratne resigned w.e.f. 16th May 2013. Mr Rajendra Theagarajah resigned from the Board w.e.f. 30th June 2013 and also resigned from Board statutory and non statutory sub-committees w.e.f. 26th June 2013 upon reaching the age of retirement.

30. APPOINTMENT OF DIRECTORS

Mr Jonathan Alles was appointed to the Board on 1st May 2013 initially as an Executive Director and with effect from 1st July 2013 as the Managing Director/Chief Executive Officer.

31. RETIREMENT BY ROTATION AND RE-ELECTION / RE-APPOINTMENT OF DIRECTORS

Ms M A R C Cooray, Mr L U D Fernando, Mr Sujeewa Mudalige will retire at the Annual General Meeting in terms of Article 34 of the Articles of Association of the Bank and will offer themselves for re-election under the said Article .

32. LIST OF DIRECTORS OF SUBSIDIARIES AND JOINT VENTURES OF THE BANK

Subsidiaries

HNB Assurance PLC

Dr Ranee Jayamaha - Chairperson
Mr M H de Silva - Managing Director
Mr M U de Silva
Mr J E P A de Silva
Mr S C Ratwatte
Mr Jonathan Alles
Mr J A P M Jayasekera
Mr K Balasundaram
Mr D P N Rodrigo (Appointed w.e.f. 01.07.2013)
Mrs S N Wickramasinghe (Appointed w.e.f. 02.10.2013)
Mr Rajendra Theagarajah (Resigned w.e.f. 01.05.2013)

Sithma Development (Pvt) Ltd

Dr Ranee Jayamaha - Chairperson
Mr P D Hennayake - Director/CEO
Mr Jonathan Alles
Mr A P L Fernando (Appointed w.e.f. 17.05.2013)
Mr Rajendra Theagarajah (Resigned w.e.f. 01.05.2013)
Mr D A de Vas Gunasekara (Resigned w.e.f. 02.05.2013)

Joint Ventures

Acuity Partners (Pvt) Ltd

Mr A R Fernando - Chairman (Appointed w.e.f. 03.05.2013)
Mr M R Abeywardena - CEO
Mr Jonathan Alles
Mr T W de Silva
Mr D A B Ellepola
Ms C M M S Gunawardena
Ms I R D Thenabadu (Appointed w.e.f. 09.05.2013)
Mr D P N Rodrigo (Appointed w.e.f. 16.07.2013)
Mr J R P M Paiva (Resigned w.e.f. 16.07.2013)
Mr Rajendra Theagarajah (Resigned w.e.f. 01.05.2013)
Mr A N Fonseka (Resigned w.e.f. 03.05.2013)

33. BOARD SUB-COMMITTEES

The Board while assuming the overall responsibility and accountability for the management oversight of the Bank has also appointed Board Sub-Committees to ensure oversight and control over certain affairs of the Bank, conforming to the Banking Act Direction No 11 of 2007 issued by the Monetary

Board of the Central Bank of Sri Lanka, on “Corporate Governance for Licensed Commercial Banks of Sri Lanka”. Accordingly, the following mandatory Sub-Committees have been constituted by the Board:

Audit Committee : Mr Sujeewa Mudalige - Chairman
comprises Ms M A R C Cooray (Senior Director)
Dr L R Karunaratne
Ms D S C Jayawardena
Mr Rusi S Captain

Mr N G Wickramaratne who was appointed as a Senior Director on 1st April 2013 resigned from the Board w.e.f. 16th May 2013 and Ms Pamela C Cooray (Senior Director) resigned from the Board w.e.f. 31st March 2013 having served the Board for nine (09) years. Mr Rusi S Captain was appointed to the Committee w.e.f. 15th January 2013 whilst Ms D S C Jayawardena and Dr L R Karunaratne were appointed w.e.f. 30th May 2013.

The Report of the Audit Committee is given on page 249 to 250 and forms part of the Annual Report of the Board of Directors.

Nomination : Dr L R Karunaratne - Chairman
Committee (appointed Chairman w.e.f. 15.1.2013)
comprises Dr W W Gamage
Dr Ranee Jayamaha
Ms M A R C Cooray

The Report of the Nomination Committee is given on page 247 and forms part of the Annual Report of the Board of Directors.

Human : Dr W W Gamage - Chairman
Resources & (appointed Chairman w.e.f. 30.5.2013)
Remuneration Dr Ranee Jayamaha
Committee Mr L U D Fernando
comprises Mr Sujeewa Mudalige

The Report of the Human Resources & Remuneration Committee is given on page 246 and forms part of the Annual Report of the Board of Directors.

Board : Ms M A R C Cooray - Chairperson
Integrated Risk Dr Ranee Jayamaha
Management Dr L R Karunaratne
Committee Mr Sujeewa Mudalige (Observer)
comprises Ms D S C Jayawardena
Mr Jonathan Alles - MD/CEO
Mr D P N Rodrigo - Chief Operating Officer
Mr A P L Fernando - Deputy General
Manager (Risk & Credit Quality
Management)
Ms Shanti Gnanapragasam -
Assistant General Manager (Risk)
Mr Ashok Goonesekere - Chief Accountant
Mr C B Wijayarathne - Senior Manager
(Compliance)

Annual Report of the Board of Directors on the Affairs of the Company

The Report of the Integrated Risk Management Committee is given on page 248 and forms part of the Annual Report of the Board of Directors.

Mr Jonathan Alles - MD/CEO, Mr D P N Rodrigo - Chief Operating Officer, Mr A P L Fernando - Deputy General Manager (Risk & Credit Quality Management), Ms Shanti Gnanapragasam - Assistant General Manager (Risk), Mr Ashok Goonesekere - Chief Accountant, Mr C B Wijayarathne - Senior Manager (Compliance) represented the Management on the Committee.

Apart from the mandatory Board Sub-Committees, the Board has appointed four other non-mandatory Sub-Committees namely the Board Credit/Assets & Liability Committee, Strategic & Investment Review Committee, Procurement Committee and Committee for Disposal of Assets/Investment Properties to effective discharge of its duties. The composition of these Committees was as follows:-

Credit/Assets & Liability Committee : Dr L R Karunaratne - Chairman
Dr Rane Jayamaha
Ms M A R C Cooray
Dr W W Gamage
Mr L U D Fernando
Mr Sujewa Mudalige
Ms D S C Jayawardena
Mr Rusi S Captain (as an invitee)

Management Officers

Mr Jonathan Alles - MD/CEO
Mr D P N Rodrigo - Chief Operating Officer
Ms I R D Thenabadu - Deputy General Manager (Corporate & Wholesale Banking)
Mr Arjuna Ratnasabapathy - Assistant General Manager (Corporate Banking)
Ms Shanti Gnanapragasam - Assistant General Manager (Risk)

Strategic & Investment Review Committee : Dr Rane Jayamaha - Chairperson
Ms M A R C Cooray
Dr L R Karunaratne
Mr Rusi S Captain
Mr L U D Fernando

Management Officers

Mr Jonathan Alles - MD/CEO
Mr D P N Rodrigo - Chief Operating Officer
Mr Rajive Dissanayake - Senior Manager (Strategic Planning)

Procurement Committee : Dr Rane Jayamaha - Chairperson
Mr Jonathan Alles - MD/CEO
Ms D S C Jayawardena
Dr L R Karunaratne

Management Officer

Mr Piyal Hennayake - Deputy General Manager (Services)

Committee for Disposal of Assets/Investment Properties : **Up to Rs. 10.0 Mn**
Dr Rane Jayamaha - Chairperson
Mr Jonathan Alles - MD/CEO

Over Rs. 10.0 Mn

(Any two of the following)
Dr L R Karunaratne
Mr L U D Fernando
Ms D S C Jayawardena

34. DIRECTORS' MEETINGS

The details of the Directors' meetings which comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Human Resource & Remuneration Committee meetings and Board Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 149 of the Annual Report. Furthermore, the Directors contributed towards policy advocacy and direction by participating in the deliberations of the Board appointed Sub-Committees on Strategic & Investment Review, Credit/Assets & Liability, Disposal of Assets/Investment Properties and Procurement. In furtherance of the deliberations of the Board, special Committees consisting of Board members were constituted from time to time to attend to specific tasks.

35. DIRECTORS' INTERESTS REGISTER

The Bank maintains Directors' interests register conforming to the provisions of the Companies Act No 7 of 2007. The Directors of the Bank have disclosed their interests in other companies to the Board and those interests are recorded in the interests register conforming to the provisions of the Companies Act. The particulars of those entries are set out on pages 244 to 245 of the Annual Report and form an integral part of the Annual Report of the Board of Directors.

36. DIRECTORS' INTERESTS IN THE ORDINARY SHARES (VOTING AND NON-VOTING)

The shareholdings of Directors were as follows:

	As at 31st December 2013 No of Shares	As at 31st December 2012 No of Shares
Dr Rane Jayamaha	101	101
Mr Jonathan Alles	2,000	-
Mr Rajendra Theagarajah (resigned w.e.f. 30.06.2013 upon reaching the age of retirement)	-	36,788
Ms Pamela C. Cooray (resigned w.e.f. 31.03.2013 having served the Board for nine years)	-	78,473
Mr N G Wickremeratne (resigned w.e.f. 16.05.2013)	-	8,451

	As at 31st December 2013 No of Shares	As at 31st December 2012 No of Shares
Ms M A R C Cooray	5,312	5,312
Dr W W Gamage	101	101
Dr L R Karunaratne	1,018	1,018
Mr L U D Fernando	2,667	2,667
Mr Sujeewa Mudalige	-	-
Ms D S C Jayawardena	500	500
Mr Rusi S Captain	6,007	6,007

There has been no change in their interests in shares between 31st December 2013 and 21st February 2014, being the date of this Report. There are no arrangements enabling the Non Executive Directors of the Bank to acquire shares of the Bank other than via the market.

37. DIRECTORS' INTEREST IN DEBENTURES

There were no debentures registered in the name of any Director as at the beginning and at the end of the year.

38. RELATED PARTY TRANSACTIONS

The Directors have also disclosed transactions if any, that could be classified as related party transactions in terms of LKAS 24 "Related Party Disclosures" which is adopted in the preparation of the financial statements. Those transactions disclosed by the Directors are given in Note 59 to the financial statements forming part of the Annual Report of the Board of Directors.

39. DIRECTORS' REMUNERATION

Details of Directors' emoluments and other benefits paid in respect of the Group and the Bank during the financial year ended 31st December 2013 are given in Note 59 (b) to the financial statements.

40. HUMAN RESOURCES

The employment strategies of the Bank are framed to employ, train, develop and retain the best talent available. Towards this end, employment policies are reviewed periodically to be aligned with organisational needs.

Specific measures taken in this regard are detailed in the Sustainability Report on pages 154 to 212.

41. EMPLOYEE SHARE BENEFIT TRUST (ESBT)

The Bank established an Employee Share Benefit Trust in the year 2005 with the approval of the shareholders for the benefit of the staff members in the grade of Executive and above.

The scheme was formulated to pass certain benefits (dividends, bonus shares etc.) on the ordinary shares (non-voting) of the Bank to the staff without transferring the ownership. For this purpose, the Bank created a Trust and the Trustees were entrusted to acquire ordinary shares (non-voting) of the Bank in the secondary market or otherwise and to allocate the shares to the staff on a basis determined by the Board.

The Trustees were granted an overdraft facility to acquire the shares. The benefit from the sale of shares was given to the staff members during their employment. On cessation of employment, they were paid the market value of the shares allocated. Any part of the overdraft outstanding, interest and statutory payments were recovered prior to transferring the benefits.

According to Rule 5.6.10 issued by the CSE all share benefit schemes which had been introduced by the companies listed in the CSE have to be wound up prior to 01st March 2015. Complying with the said rule, Board of Directors resolved to wind up the ESBT and to give beneficiaries the option to get shares transferred in their name or to get the proceeds after the sale of shares in the market. Accordingly, 2,859,684 shares were transferred with regulatory approval and the balance 12,640,247 shares were sold in the market and the proceeds were distributed according to their entitlement. Outstanding loans, accrued interest, taxes and stamp duty relating thereto were recovered.

From inception up to the date of winding up 284 staff members have received benefits from this scheme. The amount released to the employees who left services of the Bank during 2013 up to the date of winding up was Rs 90,149,083/- (2012 : Rs 92,326,000/-).

42. EMPLOYEE SHARE OPTION PLAN (ESOP)

In the year 2008 with the approval of the shareholders, the Bank formulated an Employee Share Option Plan for the staff in the management grades, recognising and rewarding them for their contribution. The scheme was aimed at further motivating the management staff. This gives an option to the management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It is operative for 5 years and the management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit of 1.25% of the shares issued and up to a maximum of 5% of the total shares issued.

Based on the performance achieved for the year 2007, first option to purchase shares, has been offered to 175 management officers. The option to purchase shares was exercisable up to 1st October 2013. As at date of expiry, 154 management officers have exercised the option (some fully and others partially) and purchased shares.

Based on the performance achieved for the year 2009, second option to purchase shares has been offered to 182 management officers. The option to purchase shares is exercisable up to 1st April 2015. As at 31st December 2013, 140 management officers have exercised the option (some fully and others partially) and purchased shares.

Based on the performance achieved for the year 2011, third option to purchase shares has been offered to 196 management officers.

Annual Report of the Board of Directors on the Affairs of the Company

The option to purchase shares is exercisable up to 29th March 2017. As at 31st December 2013, 44 management officers have exercised the option (some fully and others partially) and purchased shares.

Based on the performance achieved for the year 2012, fourth option to purchase shares has been offered to 192 management officers. The option to purchase shares is exercisable up to 4th June 2018. As at 31st December 2013, 5 management officers have exercised the option (some fully and others partially) and purchased shares.

SLFRS 2, Share Based Payments, requires the Bank to fair value the employee share options granted during the year. The total fair value of these options amounting to Rs 239.7 Mn has been charged to the Income Statement for the year ended 31st December 2013 crediting the "ESOP Reserve".

The details of the options offered to the employees under ESOP as at 31st December 2013 are as follows:

	2008 Allocation		2010 Allocation		2012 Allocation		2013 Allocation	
	Voting	Non voting	Voting	Non voting	Voting	Non voting	Voting	Non voting
No of options brought forward	84,222	15,769	2,877,970	675,023	3,792,336	896,018	-	-
No of options granted in 2013	-	-	-	-	-	-	3,970,506	994,902
No of options exercised during the year	-	-	(1,220,048)	(354,588)	(268,156)	(200,585)	(215,523)	(49,852)
No of options expired during the year	(84,222)	(15,769)	(18,877)	(4,952)	(255,988)	(28,656)	(215,518)	(58,156)
No of options remaining	-	-	1,639,045	315,483	3,268,192	666,777	3,539,465	886,894
Allotment price (Rs)	77.33	35.07	111.43	65.67	145.79	81.43	142.17	110.04
Funding granted to employees	None	None	None	None	None	None	None	None

43. ENVIRONMENTAL PROTECTION

To the best of knowledge of the Board, the Bank has complied with the relevant environmental laws and regulations. The Bank has not engaged in any activity that is harmful or hazardous to the environment. Specific measures taken to protect the environment are given on pages 204 to 212.

44. RISK AND INTERNAL CONTROL

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an on going process for identifying, recording, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Board Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and financial statements.

45. DIRECTORS' STATEMENT ON INTERNAL CONTROL

The Board has issued a report on the internal control mechanism of the Bank as per Section 3 (8) (ii) (b) of Banking Act Direction No 11 of 2007 on Corporate Governance. The Board has confirmed that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements. The above report, which forms an integral part of the Annual Report of the Board of Directors, is given on page 151 to 152.

The Board has obtained an assurance report from the external auditors on Directors' Statement on Internal Control which is given on page 153 of the Annual Report.

46. CORPORATE GOVERNANCE

In the management of the Bank, the Directors have placed emphasis on conforming to the best corporate governance practices and procedures. Accordingly, systems and structures have been introduced / improved from time to time to enhance risk management measures and to improve accountability and transparency. A separate report on Corporate Governance is given on pages 116 to 150.

47. COMPLIANCE WITH LAWS AND REGULATIONS

The Bank has at all times ensured that it complied with the applicable laws and regulations including the Listing Rules of the CSE as a listed company. Senior Manager - Compliance who reports to Board Integrated Risk Management Committee, tables a report on compliance at the quarterly meetings of the Board Audit Committee.

48. AUDITORS

The Bank's auditors during the period under review were Messrs KPMG, Chartered Accountants. Audit fees and reimbursement of expenses paid to KPMG during the year under review by the Bank and the Group amounted to Rs 8,036,000/- (2012: Rs 7,678,000/-) and Rs 11,232,000/- (2012: Rs 11,055,000/-) respectively. Further Rs 6,530,000 (2012: Rs 8,592,000/-) and Rs 7,788,000/- (2012: Rs 11,057,000/-) were paid by the Bank and the Group respectively for audit related and non-audit services including reimbursement of expenses.

Based on the declaration provided by Messrs KPMG, and as far as the Directors are aware, the auditors do not have any relationship or interest with the Bank that in our judgment, may reasonably be thought to have a bearing on their independence within the meaning of the Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), applicable on the date of this Report. Bank has taken a decision to rotate the auditors for good governance and transparency purposes. This was informed to the shareholders of the Bank at its last general meeting held on 28th March 2013.

As such, the Board of Directors has proposed that Messrs Ernst & Young (Chartered Accountants) which was selected pursuant to the selection process deployed in 2012, will be appointed to take over the external audit functions of the Bank subject to the approval of the shareholders' to be obtained at the next Annual General Meeting to be held on 28th March 2014.

A resolution relating to appointment of new auditors and authorising the Directors to fix their remuneration, will be proposed at the forthcoming Annual General Meeting.

49. NOTICE OF MEETING

The 45th Annual General Meeting of the Bank is convened on Friday 28th March 2014, at 10.00 in the forenoon, at the Auditorium on Level 22 of "HNB Towers" (Registered Office), No 479, T B Jayah Mawatha, Colombo 10. The Notice of the 45th Annual General Meeting is enclosed.

50. ACKNOWLEDGEMENT OF THE CONTENTS OF THE REPORT

As required by Section 168 (1) (k) of the Companies Act No. 07 of 2007, the Board of Directors hereby acknowledges the contents of this Annual Report.

For and on behalf of the Board of Directors.



Jonathan Alles
Managing Director /
Chief Executive Officer



Raneer Jayamaha
Chairperson



K A L Thushari Ranaweera
Assistant General Manager
(Legal) / Company Secretary

Colombo, Sri Lanka
21st February 2014

1. Lending Transactions with the Bank (Contd.)

Company	Name of the Director/ Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2013		As at 31st December 2012		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Harcros Chemicals (Pvt) Ltd	Subsidiary of Capital Maharajah (Pvt) Ltd	Letters of Credit	100.00	10.80	100.00	5.78	Stock in trade
		Import Loan	*(100.00)	43.37	*(100.00)	12.32	Corporate guarantee
		Overdraft	35.00	28.33	35.00	4.59	
		Letters of Guarantee	1.50	-	1.50	-	
		Total	136.50	82.50	136.50	22.69	
S-Lon Lanka (Pvt) Ltd	Subsidiary of Capital Maharajah (Pvt) Ltd	Overdraft	110.00	9.36	65.00	39.62	Stock in trade
		Letters of Guarantee	25.00	9.54	-	-	Corporate guarantee
		Letters of Credit	150.00	7.08	-	-	
		Import Loan	*(150.00)	145.70	-	-	
		Total	285.00	171.68	65.00	39.62	
Tuffline Ltd	Subsidiary of Capital Maharajah (Pvt) Ltd	Letters of Credit	50.00	33.54	100.00	18.52	Trade receivables
		Import Loan	*(50.00)	19.09	*(100.00)	19.05	Mortgage over
		Overdraft	55.00	53.97	41.34	41.34	machinery
		Letters of Guarantee	1.00	-	1.00	-	
		Local Trading Loan	5.00	4.23	5.00	4.83	
		Term Loan	5.37	5.37	11.85	11.85	
		Total	116.37	116.20	159.19	95.59	

* Figures in brackets indicate sublimits granted to respective entities

2. Other Business Transactions with the Bank

Company	Name of the Director / Relationship	Nature of Transaction	Amount (Rs Mn)	
			2013	2012
Colombo Stock Exchange	Mr Rajendra Theagarajah* (Director)	Professional fees	1.16	0.01
Lanka Clear (Pvt) Ltd	Mr Rajendra Theagarajah* (Director)	Clearing and other charges	18.95	41.99
Lanka Financial Services Bureau Ltd	Mr Jonathan Alles (Director)	Subscription and other charges	2.59	0.77
Ceylon Guardian Investment Trust PLC	Ms M A R C Cooray (Director)	Repurchase agreements	-	42.11
Ceylon Investments PLC	Ms M A R C Cooray (Director)	Interest on repurchase agreements	0.42	0.31
		Repurchase agreements	-	34.28
Mobitel (Pvt) Ltd	Dr W W Gamage (Director)	Interest on repurchase agreements	0.34	0.83
		Interest on repurchase agreements	0.75	1.79
		Merchant commission	4.07	2.05
		Other charges	0.04	0.03

The above entities also held customer deposits with the Bank totalling to Rs 159.794 Mn as at 31st December 2013.

KMP includes Board of Directors, members of Corporate Management, Chief Accountant, Chief Manager - Operations, Chief Manager - Treasury, Senior Manager - Compliance and their immediate family members.

* resigned w.e.f. 30th June 2013 upon reaching the age of retirement.

The Human Resources & Remuneration Committee Report

Composition of the Committee

The Human Resources & Remuneration Committee ("the Committee"), appointed by and responsible to the Board of Directors comprises four Non-Executive Directors of whom three including the Chairman are Independent Directors. One member is Non-Independent. The following Directors serve on the HR & Remuneration Committee:

Dr W W Gamage (IND / NED) - Chairman

Dr Ranee Jayamaha (NIND / NED)

Mr L U D Fernando (IND / NED)

Mr Sujeewa Mudalige (IND / NED)

(IND - Independent Director, NIND - Non-Independent Director and NED - Non Executive Director)

Brief profiles of the Directors are given on pages 22 to 25 of the Annual Report.

The Managing Director / Chief Executive Officer (MD / CEO) who is responsible for the overall management of the Bank, attends meetings and participates in the deliberations by invitation. The MD / CEO took part in all deliberations except when his own interest, performance and compensation were discussed.

The Board Secretary functions as the Secretary to the Committee.

Policy

The Bank's remuneration policy aims to attract, motivate and retain management in a competitive environment with the appropriate professional, managerial and operational expertise necessary to achieve the objectives of the Bank.

It is the focus of the Committee to ensure that the total remuneration package is sufficiently competitive to attract the best available talent to the Bank.

The remuneration of the MD / CEO, COO and corporate management is designed to create and enhance value for all stakeholders of the Bank and to ensure alignment between the short and long term interests of the Bank and its management.

Scope

The Committee is vested with power to examine, evaluate and recommend to the Board of Directors on any matter that may affect the Human Resources Management of the Bank within its Terms of Reference (TOR) and any other matters as may be referred to it by the Board.

The Committee sets targets and goals for the Directors, MD/CEO and the Key Management Personnel annually. It reviews all significant Human Resource policies and initiatives, salary structures and terms and conditions relating to staff at senior management level. In this process, necessary information and recommendations are obtained from the MD/CEO and AGM (Human Resources). The Committee deliberates upon and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, COO, members of the

corporate management and senior management staff, having evaluated their performance against the set goals and targets.

The organisational structure is also reviewed periodically and adjustments are made according to the focus of the strategic plan. An ongoing priority is to ensure proper succession for key posts. In doing so, the aspirations for career progression of management are taken into account.

Recruitments and promotions of staff at management level are also considered and approved based on proposals submitted by the MD/CEO and AGM (Human Resources) following a formal process of evaluation and thereafter recommended to the Board for ratification. When necessary, interviews are held to assess the core competencies of applicants for key posts.

Reports of meetings of the Committee with its recommendations are referred to the Board for discussion and ratified or otherwise acted upon by the Board of Directors.

During the year under review, Terms of Reference for this Committee together with certain other HR policies were formalised and ratified by the Board on presentation.

Meetings

The Committee met fourteen (14) times during 2013. Other Board Members may attend meetings on invitation.

Attendance at the meetings is given in table on page 149 of the Annual Report.

Fees


All Non-Executive Directors receive a monthly fee for participation in the deliberations of the Board including attendance at meetings. They may also receive fees for attending Sub-Committee meetings, and/or meetings of subsidiary boards. They do not receive any performance or incentive payments.

Professional Advice

The Committee has the authority to seek external professional advice on matters within its purview.

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2013, which was conducted by the Chairman and Committee members and was deemed to be satisfactory.



W W Gamage
Chairman
Human Resources & Remuneration Committee

Colombo, Sri Lanka
21st February 2014

Nomination Committee Report

Composition of the Committee

The Nomination Committee (“the Committee”) comprises of four Non-Executive Directors appointed by the Board of Directors of the Bank. The following Directors serve on the Nomination Committee:

Dr L R Karunaratne (IND / NED) - Chairman
(w.e.f. 15th January 2013)

Dr W W Gamage (IND / NED)

Dr Raneer Jayamaha (NIND / NED)

Ms M A R C Cooray (IND / NED)

(IND - Independent Director, NIND - Non Independent Director and NED - Non Executive Director)

Brief profiles of the members of the Committee are given on pages 22 to 25 of the Annual Report.

The Board Secretary functioned as the Secretary to the Nomination Committee.

The Terms of Reference (TOR) and the Primary Responsibilities of the Nomination Committee

The scope of the Nomination Committee includes the following:

- i. To ensure the implementation of the approved procedure in selecting/appointing Directors/CEO and the Key Management Personnel;
- ii. Taking into account the performance and contribution made by Directors towards the overall discharge of responsibilities of the Board and to make a recommendation on the re-election of current Directors to the Board of Directors;
- iii. To set the criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post of Managing Director/CEO and the Key Management positions;
- iv. To ensure Directors, Managing Director/CEO and the Key Management Personnel are fit and proper persons to hold office as required by the Banking Act and other applicable statutes;
- v. To consider and recommend from time to time the requirements of additional/new expertise and the succession arrangements for retiring Directors and Key Management Personnel;
- vi. To provide advice and recommendations to the Board or the Chairman (as the case may be) on any such appointment; and
- vii. To regularly review the structure, size, composition and competencies (including the skills, knowledge and experience) of the Board and make recommendations to the Board with regard to any changes;

The TOR of the Nomination Committee which was adopted by the Board of Directors in 2013 was reviewed by the members at its meeting held on 16th January 2014 and suitable amendments were introduced.

Meetings

The Nomination Committee met three (03) times during the year under review, mainly (1) to adopt the Procedure on the Appointment of Managing Director/Chief Executive Officer, the Key Management Personnel and the members of the Board, (2) to consider and recommend the appointment of the new Managing Director/Chief Executive Officer and to assess the fitness and propriety of the Directors holding office in terms of the provisions of the Banking Act and the Directions of the Monetary Board relating to Corporate Governance and (3) to consider strengthening the corporate management structure. Attendance by the Committee members at the meetings is given in the table on page 149 of the Annual Report. The Chief Executive Officer also attended one (01) meeting, by invitation.

Re-election / Re-appointment of Directors at the 45th Annual General Meeting

Since three members of the Committee namely Mrs M A R C Cooray - Senior Director, Directors - Mr Sujeewa Mudalige and Mr L U D Fernando should be re-elected/re-appointed at the 45th Annual General Meeting to be held on 28th March 2014, the Committee decided to recommend that this matter be discussed at and approved by the full Board. Accordingly, the Board at its meetings held on 16th January 2014, decided that Mrs M A R C Cooray - Senior Director, Directors - Mr Sujeewa Mudalige and Mr L U D Fernando should be re-elected/re-appointed at the next Annual General Meeting recognising their contribution in discharging their responsibilities.

Committee Evaluation

The Committee completed the evaluation process with self-assessment on 16th January 2014, which was conducted by the Chairman and Committee members and was deemed to be satisfactory.



L R Karunaratne
Chairman
Nomination Committee

Colombo, Sri Lanka
21st February 2014

The Board Integrated Risk Management Committee

At the end of 2013, the Board Integrated Risk Management Committee (BIRMC) comprised of ten members, of which four members were Non-Executive Directors.

Ms M A R C Cooray (IND / NED) - Chairperson

Dr Raneer Jayamaha (NIND / NED)

Dr L R Karunaratne (IND / NED)

Ms D S C Jayawardena (NIND / NED)

Appointed w.e.f. 30th May 2013

Mr Jonathan Alles, Managing Director / CEO

Appointed MD / CEO w.e.f. 1st July 2013

Mr D P N Rodrigo, Chief Operating Officer

Mr A P L Fernando, Deputy General Manager - Recoveries and Credit Quality Management

Appointed w.e.f. 30th May 2013

Ms S Gnanapragasam, Assistant General Manager - Risk

Mr Ashok Goonesekere, Chief Accountant

Appointed w.e.f. 29th August 2013

Mr C B Wijayarathne, Senior Manager - Compliance

Appointed w.e.f. 29th August 2013

Mr Sujeewa Mudalige (IND / NED) was invited to participate at the meetings as an observer.

Members who resigned during 2013

Mr Rajendra Theagarajah, Managing Director / CEO

Resigned w.e.f. 26th June 2013 upon reaching the age of retirement

Mr J R P M Paiva, Deputy General Manager

- Strategy & Compliance

Resigned w.e.f. 3rd October 2013

Mr D A De Vas Gunasekara, Chief Financial Officer

Resigned w.e.f. 16th July 2013

(IND - Independent Director, NIND - Non Independent Director and NED - Non Executive Director)

The BIRMC was established as a Committee of the Board, in compliance with Section 3 (6) of the Banking Act Direction No. 11 of 2007, on "Corporate Governance for Licensed Commercial Banks in Sri Lanka". The composition and the scope of work of the Committee are in conformity with the provisions of the aforementioned Direction.

Brief profiles of the Directors representing the Committee are given on pages 22 to 25 of the Annual Report.

The Primary Responsibilities of the Committee

The Terms of Reference set out by the Board of Directors, includes the following:

1. To ensure that the Bank has a comprehensive risk management framework, appropriate compliance policies and systems in place.
2. To assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic/reputational risks to the Bank through appropriate risk indicators and management information.

3. To ensure risk decisions are taken in accordance with established delegated authorities and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the Committee, on the basis of Bank's policies and regulatory and supervisory requirements.
4. To monitor and assess the effectiveness of the Bank's Risk Management System and the robustness of the risk management function.
5. Periodically assess performance against internally defined risk appetite.
6. To review the Bank's compliance report on money laundering and action taken in relation to report.
7. Review issues raised by Internal Audit that impact upon the risk management framework.
8. To review progress on Basel II Roadmap implementation.

Meetings

Eight (08) meetings were held and at least one (01) in each quarter. Attendances at the meetings are given in table on page 149 of the Annual Report. The discussions and conclusions reached at the meeting are recorded in minutes and circulated to the Board of Directors for information and advice. The Chairman of the Committee also briefs the Board of Directors on the main findings of the Committee at each Board meeting.

Professional Advice

The Committee has the authority to seek external professional advice on matters within its purview.

Appreciation

The Committee wishes to thank retiring CEO/Managing Director, Mr Rajendra Theagarajah, retiring DGM-Strategy & Compliance, Mr J R P M Paiva and former CFO Mr D A De Vas Gunasekera for their valuable contribution to the Committee over the years.

Compliance

The Bank has adopted an Integrated Risk Management (IRM) framework in compliance with the Central Bank of Sri Lanka Banking Act Direction No. 7 of 2011.

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2013 which was deemed to be satisfactory.



M A R C Cooray
Chairperson
Integrated Risk Management Committee

Colombo, Sri Lanka
21st February 2014

Audit Committee Report

Composition of the Committee

The Audit Committee ("the Committee"), appointed by and responsible to the Board of Directors comprises of five Non Executive Directors with three of them are Independent and two Non Independent Directors. Mr N G Wickremeratne stepped down from the committee with his resignation from the Board w.e.f. 16th May 2013. Ms Pamela Cooray - member of the Committee, stepped down from the Committee with her resignation from the Board w.e.f. 31st March 2013 having served the Board for nine (09) years.

The following members serve / served on the Audit Committee:

Mr Sujeewa Mudalige (IND / NED) - Chairman

Ms M A R C Cooray (IND / NED)

Mr Rusi S Captain (NIND / NED)

Appointed w.e.f. 15th January 2013

Ms D S C Jayawardena (NIND / NED)

Appointed w.e.f. 30th May 2013

Dr L R Karunarathne (IND / NED)

Appointed w.e.f. 30th May 2013

(IND - Independent Director, NIND - Non Independent Director and NED - Non Executive Director)

Brief profiles of the members are given on pages 22 to 25 of the Annual Report.

The Board Secretary functions as the Secretary to the Audit Committee.

Audit Committee Meetings

The Audit Committee met nine (09) times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 149 of the Annual Report. The Managing Director / Chief Executive Officer, Head of Internal Audit and other relevant senior management team members also attended these meetings by invitation. On the invitation of the Committee, the Engagement Partner of the Bank's external auditors, Messrs KPMG attended three (03) Committee meetings during the year. The Audit Committee continued to closely monitor the implementation of new Sri Lanka Accounting Standards (SLFRSs & LKASs) which became effective from 1st January 2012. The Committee continued guiding the management with the selection of the new Accounting Policies which is required under the aforesaid new Accounting Standards and implementing same.

Financial Reporting

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the management, the annual and the quarterly financial statements prior to their release. The review included the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30 of 1988 and amendments thereto. The Committee also reviews the effectiveness of the Financial Reporting Systems in place to ensure reliability of the information provided and the accounting policies to determine the most appropriate accounting policies after considering all choices available. Matters of special interest in the

current environment and the processes that support certifications of the financial statements by the Bank's Chief Executive Officer and Chief Financial Officer were also brought up for discussion.

Risks and Internal Controls

Additionally, the Committee also assessed the effectiveness of the Bank's internal control over financial reporting as of 31st December 2013, as required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Subsection 3(8)(ii) (b), based on the "Guidance for Directors of Banks on the Directors' Statement on Internal Control" issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). The result of the assessment is given on pages 151 and 152, "Directors' Statement on Internal Control" in the Annual Report.

The external auditors have issued an Assurance Report on Directors' Statement on Internal Controls. The report is given on page 153 of the Annual Report.

The Committee has reviewed the processes for identification, recording, evaluation and management of all significant risks throughout the Bank and other Group entities.

Corporate Governance Report

As required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Annual Corporate Governance Report for 2013 is provided on pages 116 to 150. The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4750 (SLSRS 4750) issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report dated 21st February 2014, addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported by the Board on pages 116 to 150.

External Audit

The Audit Committee undertook the annual evaluation of the independence and objectivity of the external auditor and the effectiveness of the audit process.

The Committee met with the external auditor three (03) times during the year to discuss their audit approach and procedures, including matters relating to the scope of the audit and auditor's independence. Messrs KPMG rotated the Lead Audit Partner in 2012, as the Audit Partner is required to be rotated every five years, in order to ensure the independence of the auditor and to comply with the requirements of the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka. In the meantime, members of the Audit Committee at its meetings held on 26th September 2012 and 18th December 2012, have taken a decision to rotate the existing external auditor for good governance and transparency purposes. This fact was informed to the shareholders of the Bank at its last general meeting held on 28th March 2013. Having gone through a transparent procedure, the Audit Committee recommended to the Board that Messrs Ernst & Young - Chartered Accountants be appointed as the external auditors of the Bank subject to the approval of the

Audit Committee Report

shareholders at the forthcoming Annual General Meeting. Statutory Notice in respect of the change of auditors have been duly given to the existing external auditors.

The Committee reviewed the audited financial statements with the external auditor who is responsible for expressing an opinion on its conformity with the Sri Lanka Accounting Standards.

The Committee reviewed the Interim Management Letters issued by the external auditor together with the management responses thereto.

The Committee met the external auditors twice during the year without the presence of MD / CEO and the corporate management to ensure that there was no limitation of scope in relation to the audit and to allow for full disclosure of any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there was no cause for concern.

The Audit Committee reviewed and approved the non-audit services provided by the external auditor and was of the view that such services were not within the category of services identified as prohibited under:

1. The guidelines issued by the Central Bank of Sri Lanka, for external auditors, relating to their statutory duties in terms of Section 39 of Banking Act No 30 of 1988 and amendments thereto.
2. The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the external auditor by the Board and Letter of Independence Confirmation issued by the external auditor were tabled at the Audit Committee Meeting.

Internal Audit

During the year, the Audit Committee reviewed the independence, objectivity & performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control including internal control systems. The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Internal Audit Department's resource requirements including succession planning.

Regulatory Compliance

The Committee reviewed the procedures established by management for compliance with the requirements of regulatory authorities. Senior Deputy General Manager – Strategy & Compliance and subsequently the Senior Manager - Compliance of the Bank who has oversight of the compliance function, submitted quarterly reports to the Audit Committee on the extent to which the Bank was in compliance with the regulatory requirements.

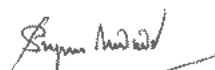
The Committee also reviewed the Statutory Examination Report issued by the Central Bank of Sri Lanka together with the management responses thereto during the year.

Professional Advice

The Committee has the authority to seek external professional advice on matters within its purview.

Committee Evaluation

The annual evaluation of the Committee was conducted by the Non-Executive Chairperson, with contributions from the individual assessments by the members of the Audit Committee, Managing Director / CEO, Chief Operating Officer, Chief Accountant, Head of Internal Audit and the external auditor in accordance with international best practices and was deemed to be satisfactory.



Sujeewa Mudalige
Chairman
Audit Committee

Colombo, Sri Lanka
21st February 2014

Chief Executive Officer's and Chief Financial Officer's Responsibility Statement

The financial statements of Hatton National Bank PLC ("the Bank") and the consolidated financial statements of the Bank and its subsidiaries as at 31st December 2013 are prepared and presented in compliance with the requirements of the following:

- Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka),
- Companies Act No 7 of 2007,
- Sri Lanka Accounting and Auditing Standards Act No 15 of 1995,
- Banking Act No 30 of 1988 (as amended),
- Listing Rules of the Colombo Stock Exchange and
- Code of Best Practice on Corporate Governance issued jointly by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and the Securities and Exchange Commission of Sri Lanka

The formats used in the preparation of the financial statements and disclosures made comply with the formats prescribed by the Central Bank of Sri Lanka.

The Accounting Policies used in the preparation of the financial statements are appropriate and are consistently applied by the Group. There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

The significant accounting policies and estimates that involved a high degree of judgment and complexity were discussed with the Audit Committee and external auditors.

The Board of Directors and the management of the Bank accept responsibility for the integrity and objectivity of these financial statements. The estimates and judgments relating to the financial statements were made on a prudent and reasonable basis; in order that the financial statements reflect in a true and fair manner, the form and substance of transactions and that the Bank's state of affairs is reasonably presented. To ensure this, the Bank has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets and for preventing and detecting frauds as well as other irregularities, which is reviewed, evaluated and updated on an on going basis. It is confirmed that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, the Bank will continue to adopt the 'going concern' basis in preparing these financial statements.

Our internal auditor has conducted periodic audits to provide reasonable assurance that the established policies and procedures of the Bank were consistently followed. However, there are inherent limitations that should be recognised in weighing the assurances provided by any system of internal controls and accounting. Further your Board assessed the effectiveness of the Bank's internal controls over financial reporting during the year ended 31st December 2013, as required by the Banking Act Direction No 11 of 2007, result of which is given on page 151 to 152 in the Annual Report, the "Directors' Statement on Internal Control". External auditor's

Assurance Report on the "Directors' Statement on Internal Control" is given on page 153 of the Annual Report.

The financial statements of the Group were audited by Messrs KPMG, Chartered Accountants, the independent external auditors. Their report is given on page 253 of the Annual Report.

The Audit Committee of the Bank meets periodically with the internal audit team and the independent external auditor to review their audit plans, assess the manner in which these auditors are performing their responsibilities and to discuss their reports on internal controls and financial reporting issues. To ensure complete independence, the external auditor and the internal auditor have full and free access to the members of the Audit Committee to discuss any matter of substance. The details of which are given in the 'Audit Committee Report' on pages 249 to 250.

The Audit Committee approves the audit and non audit services provided by external auditor, Messrs KPMG, in order to ensure that the provision of such services does not impair KPMG's independence.

We confirm that,

- the Bank and its subsidiaries have complied with all applicable laws, regulations and prudential requirements;
- there are no material non compliances ; and
- there are no material litigations that are pending against the Group other than those disclosed in the Note 58 (e) to the financial statements in this Annual Report.



Jonathan Alles
Managing Director / Chief Executive Officer



Ashok Goonesekere
Chief Accountant

Colombo, Sri Lanka
21st February 2014

Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the financial statements of the Bank and its subsidiaries prepared in accordance with the provisions of the Companies Act No 7 of 2007 is set out in the following statement.

The responsibilities of the external auditor in relation to the financial statements are set out in the Report of the auditors given on page 253 of the Annual Report.

As per the provisions of the sections 150 (1), 151, 152 and 153 (1) & (2) of the Companies Act No 7 of 2007, the Directors are required to prepare financial statements for each financial year and place them before a General Meeting. The financial statements comprise the Statement of Financial Position as at 31st December 2013, and the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended and notes thereto.

The financial statements of the Bank and its subsidiaries give a true and fair view of:

1. the state of affairs of the Bank and its subsidiaries as at 31st December 2013; and
2. the profit or loss of the Bank and its subsidiaries for the financial year then ended.

In preparing these financial statements, the Directors are required to ensure that:

1. appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
2. judgments and estimates have been made which are reasonable and prudent; and
3. all applicable Accounting Standards, as relevant, have been complied with;

The Directors are also required to ensure that the Bank and its subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these financial statements.

Further, the Directors have a responsibility to ensure that the Companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its subsidiaries.

Financial statements prepared and presented in this Report have been prepared based on new Sri Lanka Accounting Standards (SLFRS) which came to effect from January 01, 2012 and are consistent with the underlying books of account and are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standard Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto, the Listing Rules of the Colombo Stock Exchange and the Code of Best Practice on Corporate Governance issued jointly by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and the Securities and Exchange Commission of Sri Lanka (SEC).

In addition, these financial statements comply with the prescribed format issued by the Central Bank of Sri Lanka for the preparation of annual financial statements of Licensed Commercial Banks.

The Directors have also instituted effective and comprehensive systems of internal control for identifying, recording, evaluating and managing the significant risks faced by the Bank throughout the year and it is being under regular review of the Board of Directors. This comprises

internal reviews, internal audit and the whole system of financial and other controls required to carry on the business of banking in an orderly manner, safeguard its assets, prevent and detect frauds and other irregularities and secure as far as practicable the accuracy and reliability of the records. The results of such reviews carried out during the year ended 31st December 2013 are given on pages 151 to 152 of the Annual Report, "Directors' Statement on Internal Control". External Auditor's Assurance Report on the "Directors' Statement on Internal Control" is given on page 153 of the Annual Report.

The Directors have taken appropriate steps to ensure that the Bank and Group maintain proper books of account and review the financial reporting system directly by them at their regular meetings and also through the Board Audit Committee, the Report of the said Committee is given on pages 249 to 250. The Board of Directors also approves the interim financial statements prior to their release following a review and recommendation by the Board Audit Committee.

The Board of Directors accepts responsibility for the integrity and objectivity of the financial statements presented in this Annual Report.

Directors are required to prepare the financial statements and to provide the Bank's external auditor, Messrs KPMG, with every opportunity to carry out whatever reviews and sample checks on the system of internal control they may consider appropriate and necessary for expressing their independent audit opinion on the financial statements.

The financial statements of the Bank and the Group have been certified by the Bank's Chief Accountant, the officer responsible for their preparation, as required by the Sections 150 (1) (b) and 152 (1) (b) of the Companies Act. Also the financial statements of the Bank and the Group have been signed by two Directors and the Company Secretary of the Bank on February 21st, 2014 as required by Sections 150 (1) (c) and 152 (1) (c) of the Companies Act.

Further, as required by Section 56 (2) of the Companies Act No 7 of 2007, the Directors have confirmed that the Bank, based on the information available, satisfies the solvency test immediately after the distribution of dividends, in accordance with Section 57 of the Companies Act No 7 of 2007, and has obtained a certificate from the auditors, prior to declaring a final dividend of Rs 7.00 per share for this year to be paid in April 2014.

The Directors to the best of their knowledge and belief, are satisfied that all statutory payments in relation to all relevant regulatory and statutory authorities which were due and payable by the Bank and its subsidiaries as at the Statement of Financial Position date have been paid or where relevant provided for.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By order of the Board



K A L Thushari Ranaweera
Assistant General Manager (Legal) / Company Secretary
Colombo, Sri Lanka

21st February 2014

Independent Auditors' Report



KPMG
(Chartered Accountants)
32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300,
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TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

Report on the Financial Statements

We have audited the accompanying financial statements of Hatton National Bank PLC ("the Company") and the consolidated financial statements of the Company and its subsidiaries ("the Group"), which comprise the statements of financial position as at December 31, 2013, the statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information set out on pages 254 to 369 of the annual report.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion - Company

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended December 31, 2013 and the financial statements give a true and fair view of the financial position of the Company as at December 31, 2013, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Opinion - Group

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Company and its subsidiaries dealt with thereby as at December 31, 2013, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

These financial statements also comply with the requirements of Sections 153(2) to 153(7) of the Companies Act No. 07 of 2007 and present the information required by the Banking Act No. 30 of 1988.

CHARTERED ACCOUNTANTS

21st February 2014
Colombo, Sri Lanka.

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

M.R. Mihular FCA P.Y.S. Perera FCA C.P. Jayatilake FCA
T.J.S. Rajakarier FCA W.W.J.C. Perera FCA Ms. S. Joseph FCA
Ms. S.M.B. Jayasekara ACA W.K.D.C. Abeyrathne ACA S.T.D.L. Perera FCA
G.A.U. Karunaratne ACA R.M.D.B. Rajapakse ACA Ms. B.K.D.T.N Rodrigo ACA
Principals - S.R.I. Perera ACMA, LLB, Attorney-at-Law, H.S. Goonewardene ACA

Income Statement

For the year ended 31st December	Note	Bank		Group	
		2013 Rs 000	2012 Rs 000 Restated	2013 Rs 000	2012 Rs 000 Restated
Income	10	60,073,685	51,538,779	64,637,504	55,211,622
Interest income		55,749,193	47,326,377	56,626,984	47,919,387
Less: Interest expenses		31,423,945	25,368,432	31,576,786	25,495,541
Net interest income	11	24,325,248	21,957,945	25,050,198	22,423,846
Fee and commission income		4,351,992	3,740,497	4,500,180	3,905,052
Less: Fee and commission expenses		82,082	53,407	470,456	411,943
Net fee and commission income	12	4,269,910	3,687,090	4,029,724	3,493,109
Net interest, fee and commission income		28,595,158	25,645,035	29,079,922	25,916,955
Net gain/(loss) from trading	13	(1,815,061)	(1,632,528)	(1,755,536)	(1,624,049)
Net gain/(loss) from financial investments	14	246,591	87,446	309,493	116,463
Other operating income	15	1,540,970	2,016,987	4,956,383	4,894,769
Total Operating income		28,567,658	26,116,940	32,590,262	29,304,138
Less: Impairment charge for loans and other losses	16	3,249,166	1,142,110	3,305,287	1,142,110
Net operating income		25,318,492	24,974,830	29,284,975	28,162,028
Personnel expenses	17	5,453,778	6,689,864	6,061,024	7,272,980
Other expenses	18	8,197,298	7,160,603	10,776,364	9,134,427
		13,651,076	13,850,467	16,837,388	16,407,407
Operating profit before value added tax (VAT)		11,667,416	11,124,363	12,447,587	11,754,621
Less: Value added tax (VAT) on financial services		1,659,755	1,247,873	1,659,755	1,247,873
Operating profit after value added tax (VAT)		10,007,661	9,876,490	10,787,832	10,506,748
Share of profit of Associates (net of income tax)	19	-	-	127,815	16,632
PROFIT BEFORE INCOME TAX		10,007,661	9,876,490	10,915,647	10,523,380
Less: Income tax expense	20	2,997,555	2,342,335	3,103,199	2,421,431
PROFIT FOR THE YEAR		7,010,106	7,534,155	7,812,448	8,101,949
Profit attributable to:					
Equity holders of the Bank		7,010,106	7,534,155	7,650,461	7,941,754
Non-controlling interests		-	-	161,987	160,195
PROFIT FOR THE YEAR		7,010,106	7,534,155	7,812,448	8,101,949
Earnings per share on profit	21				
Basic earnings per ordinary share (Rs)		17.59	18.94	19.20	20.75
Diluted earnings per ordinary share (Rs)		17.55	18.91	19.15	20.72
Dividend per Share (Rs)		*8.50	8.50	*8.50	8.50

The Notes to the Financial Statements from pages 262 to 369 form an integral part of these Financial Statements.

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

Statement of Comprehensive Income

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000 Restated	2013 Rs 000	2012 Rs 000 Restated
PROFIT FOR THE YEAR	7,010,106	7,534,155	7,812,448	8,101,949
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAX				
Gains and losses arising from translating the financial statements of foreign operations	-	-	1,764	13,843
Gains and losses on re-measuring available-for-sale financial assets				-
Net change in fair value on available-for-sale financial assets	1,294,197	453,801	1,306,774	475,771
Transfer to life policy holder reserve fund	-	-	2,991	(21,335)
Net amount transferred to profit or loss (available-for-sale financial assets)	-	75,402	-	76,765
Actuarial gains and losses on defined benefit plans	(857,846)	756,710	(855,674)	756,710
Changes in revaluation surplus	-	1,462,621	-	2,394,797
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	436,351	2,748,534	455,855	3,696,551
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	7,446,457	10,282,689	8,268,303	11,798,500
Total comprehensive income attributable to:				
Equity holders of the Bank	7,446,457	10,282,689	8,099,312	11,627,878
Non-controlling interests	-	-	168,991	170,622
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	7,446,457	10,282,689	8,268,303	11,798,500

The Notes to the Financial Statements from pages 262 to 369 form an integral part of these Financial Statements.

Statement of Financial Position

As at 31st December	Note	Bank		Group	
		2013 Rs 000	2012 Rs 000 Restated	2013 Rs 000	2012 Rs 000 Restated
ASSETS					
Cash and cash equivalents	23	11,624,645	8,769,206	11,588,264	8,848,466
Balances with central banks	24	16,366,368	19,933,463	16,366,565	19,950,321
Placements with banks	25	1,246,611	10,321,832	3,083,584	11,667,417
Derivative financial instruments	26	174,573	344,552	174,573	344,552
Other financial assets held for trading	27	652,312	474,083	2,568,136	1,078,124
Non-current assets held for sale	28	-	-	-	2,875
Loans and receivables to banks	29	6,267,809	-	6,680,288	651,480
Loans and receivables to other customers	30	351,976,401	302,760,980	352,845,678	303,270,612
Financial investments - Available-for-sale	31	63,391,086	58,295,356	64,270,094	59,355,106
Financial investments - Held-to-maturity	32	-	-	1,004,501	1,643,852
Financial investments - Loans and receivables	33	33,104,536	20,030,669	35,103,762	20,904,172
Investments in Associates	34	-	-	582,115	386,172
Investment in Joint Venture	35	655,000	655,000	-	-
Investments in Subsidiaries	36	2,357,285	2,357,285	-	-
Investment properties	37	346,478	349,708	160,864	164,598
Property, plant and equipment	38	9,521,496	9,417,915	17,791,159	17,815,411
Intangible assets	39	994,677	556,171	1,121,005	689,501
Deferred tax assets	49	767,826	-	656,191	-
Other assets	40	10,863,333	12,092,199	11,398,073	12,679,956
Total Assets		510,310,436	446,358,419	525,394,852	459,452,615
LIABILITIES					
Due to banks	41	34,934,217	23,852,647	35,360,925	24,443,058
Derivative financial instruments	42	748,962	1,436,443	748,962	1,436,443
Due to other customers	43	385,360,970	341,423,986	385,000,600	340,847,606
Dividends payable	44	426,347	221,455	428,143	223,251
Other borrowings	45	8,663,102	8,332,545	10,253,539	9,538,743
Debt securities issued	46	1,418,775	-	1,530,295	150,000
Current tax liabilities		3,040,107	1,755,428	3,134,407	1,839,714
Insurance provision - Life	47	-	-	4,348,491	3,626,239
Insurance provision - Non-Life	48	-	-	1,011,101	969,441
Deferred tax liabilities	49	-	1,111,111	-	1,186,615
Other provisions		2,919,320	4,240,497	2,966,730	4,400,091
Other liabilities	50	9,488,222	9,333,364	10,164,227	10,044,868
Subordinated term debts	51	11,856,560	7,751,890	11,781,703	7,729,333
Total Liabilities		458,856,582	399,459,366	466,729,123	406,435,402
EQUITY					
Stated capital	53	12,830,268	12,579,479	12,830,268	12,579,479
Statutory reserves	54	6,761,205	4,530,562	6,761,205	4,530,562
Retained earnings	55	3,465,419	4,225,948	5,210,483	5,321,846
Other reserves	56	28,396,962	25,563,064	32,759,680	29,615,888
Total equity attributable to equity holders of the Bank		51,453,854	46,899,053	57,561,636	52,047,775
Non-controlling interests	57	-	-	1,104,093	969,438
Total Equity		51,453,854	46,899,053	58,665,729	53,017,213
Total Liabilities and Equity		510,310,436	446,358,419	525,394,852	459,452,615
Contingent liabilities and commitments	58	174,070,970	164,367,012	174,070,970	164,367,012

The Notes to the Financial Statements from pages 262 to 369 form an integral part of these Financial Statements.

I certify that these Financial Statements are in compliance with the requirements of Companies Act No 7 of 2007.



Ashok Goonesekere
Chief Accountant

For and on behalf of the Board




Jonathan Alles
Managing Director /
Chief Executive Officer

21st February 2014
Colombo



Raneey Jayamaha
Chairperson



K A L Thushari Ranaweera
Assistant General Manager (Legal) /
Company Secretary

Statement of Changes in Equity

	Stated Capital		Statutory Reserves		Other Reserves			Retained earnings	Total
	Voting Shares Rs 000	Non-Voting Shares Rs 000	Statutory Reserve Rs 000	Investment Fund Account Rs 000	Capital Reserve Rs 000	Available for sale reserve Rs 000	General Reserve Rs 000		
Balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	3,009,986	2,334,403	15,400,000	-	37,983,730
Prior year adjustment [Note 64 (c)]	-	-	-	-	-	256,025	-	-	256,025
Restated balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	3,009,986	2,590,428	15,400,000	-	38,239,755
Total comprehensive income for the year									
Net profit for the year 2012	-	-	-	-	-	-	-	-	7,534,155
Other comprehensive income, net of tax	-	-	-	-	1,462,621	529,203	-	-	756,710
Total comprehensive income for the year	-	-	-	-	1,462,621	529,203	-	-	8,290,865
Transactions with equity holders, recognised directly in equity									
Contributions by and distributions to equity holders									
Final dividend for 2011 - Cash (Note 44)	-	-	-	-	-	-	-	-	(1,166,032)
Final dividend for 2011 - Scrip (Note 44)	840,958	208,471	-	-	-	-	-	-	(1,166,032)
Interim dividend for 2012 - Cash (Note 44)	-	-	-	-	-	-	-	-	(595,870)
ESOP allocation 2012	-	-	-	-	-	-	-	176,515	-
Shares issued under ESOP	64,975	13,624	-	-	-	-	-	-	78,599
Total contributions by and distributions to equity holders	905,933	222,095	-	-	-	-	-	176,515	(1,623,391)
Transfer of revaluation reserve for disposal of property, plant and equipment	-	-	-	-	(5,689)	-	-	-	5,689
Transfers during the year 2012	-	-	430,000	1,322,225	-	-	2,400,000	-	(4,152,225)
Balance as at 31st December 2012	10,049,259	2,530,220	2,230,000	2,300,562	4,466,918	3,119,631	17,800,000	176,515	46,899,053
Total comprehensive income for the year									
Net profit for the year 2013	-	-	-	-	-	-	-	-	7,010,106
Other comprehensive income, net of tax	-	-	-	-	-	1,294,197	-	-	(857,846)
Total comprehensive income for the year	-	-	-	-	-	1,294,197	-	-	6,152,260
Transactions with equity holders, recognised directly in equity									
Contributions by and distributions to equity holders									
Final dividend for 2012 - Cash (Note 44)	-	-	-	-	-	-	-	-	(2,782,814)
Interim dividend for 2013 - Cash (Note 44)	-	-	-	-	-	-	-	-	(599,332)
ESOP allocation 2013	-	-	-	-	-	-	-	239,701	-
Shares issued under ESOP	205,685	45,104	-	-	-	-	-	-	250,789
Total contributions by and distributions to equity holders	205,685	45,104	-	-	-	-	-	239,701	(2,891,656)
Transfers during the year 2013	-	-	430,000	1,800,643	-	-	1,300,000	-	(3,530,643)
Balance as at 31st December 2013	10,254,944	2,575,324	2,660,000	4,101,205	4,466,918	4,413,828	19,100,000	416,216	51,453,854

Statement of Changes in Equity

	Attributable to Equity Holders of the Bank											Total Rs 000		
	Stated Capital		Statutory Reserves		Other Reserves				Retained Earnings		Non Controlling Interest Rs 000			
	Voting Shares Rs 000	Non-Voting Shares Rs 000	Statutory Reserve Fund Rs 000	Investment Fund Account Rs 000	Capital Reserve Rs 000	Available for sale reserve Rs 000	Treasury shares Rs 000	General Reserve Rs 000	Exchange Equalisation Reserve Rs 000	Life policy holder reserve Fund Rs 000			ESOP Reserve Rs 000	
Balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	6,403,549	2,364,801	(310,938)	15,400,000	5,733	(22,526)	-	3,504,132	782,224	42,356,763
Prior year adjustment [Note 64 (c)]	-	-	-	-	-	256,025	-	-	-	-	-	-	-	256,025
Restated balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	6,403,549	2,620,826	(310,938)	15,400,000	5,733	(22,526)	-	3,504,132	782,224	42,612,788
Total comprehensive income for the year	-	-	-	-	-	-	-	-	-	-	-	7,941,754	160,195	8,101,949
Net profit for the year 2012	-	-	-	-	-	-	-	-	-	-	-	7,941,754	160,195	8,101,949
Other comprehensive income, net of tax	-	-	-	-	2,394,797	529,475	-	-	5,142	-	-	756,710	10,427	3,696,551
Total comprehensive income for the year	-	-	-	-	2,394,797	529,475	-	-	5,142	-	-	8,698,464	170,622	11,798,500
Transactions with equity holders, recognised directly in equity Contributions by and distributions to equity holders														
Final dividend for 2011 - Cash (Note 44)	-	-	-	-	-	-	-	-	-	-	-	(1,120,823)	(51,046)	(1,171,869)
Final dividend for 2011 - Scrip (Note 44)	840,958	208,471	-	-	-	-	-	-	-	-	-	(1,166,032)	-	(116,603)
Interim dividend for 2012 - Cash (Note 44)	-	-	-	-	-	-	-	-	-	-	-	(572,619)	-	(572,619)
ESOP allocation 2012	-	-	-	-	-	-	-	-	-	-	176,515	-	-	176,515
Shares issued under ESOP	64,975	13,624	-	-	-	-	-	-	-	-	-	-	-	78,599
Total contributions by and distributions to equity holders	905,933	222,095	-	-	-	-	-	-	-	-	176,515	(2,859,474)	(51,046)	(1,605,977)
Transfer to life policy holder reserve fund	-	-	-	-	-	-	-	-	-	21,335	-	-	-	21,335
Write off of subsidiary investment	-	-	-	-	-	-	-	-	3,665	-	-	(3,665)	-	-
Disposal of associate company	-	-	-	-	-	-	-	-	(5,996)	-	-	52,052	-	46,056
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	-	-	-	76,873	67,638	144,511
Transfer of revaluation reserve	-	-	-	-	(5,689)	-	-	-	-	-	-	-	-	-
for disposal of property, plant and equipment	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Transfers during the year 2012	-	-	430,000	1,322,225	-	-	-	2,400,000	-	-	-	(4,152,225)	-	-
Balance as at 31st December 2012	10,049,259	2,530,220	2,230,000	2,300,562	8,792,657	3,150,301	(310,938)	17,800,000	8,544	(1,191)	176,515	5,321,846	969,438	53,017,213
Total comprehensive income for the year														
Net profit for the year 2013	-	-	-	-	-	-	-	-	-	-	-	7,650,461	161,987	7,812,448
Other comprehensive income, net of tax	-	-	-	-	-	1,304,688	-	-	706	-	-	(856,543)	7,004	455,855
Total comprehensive income for the year	-	-	-	-	-	1,304,688	-	-	706	-	-	6,793,918	168,991	8,268,303

Group
For the year ended 31st December 2013

	Attributable to Equity Holders of the Bank													
	Stated Capital		Statutory Reserves			Other Reserves						Total		
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Investment Fund Account	Capital Reserve	Available for sale reserve	Treasury shares	General Reserve	Exchange Equalisation Reserve	Life policy holder reserve fund	ESOP Reserve		Retained Earnings	Non Controlling Interest
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Transactions with equity holders, recognised directly in equity														
Contributions by and distributions to equity holders														
Final dividend for 2012 - Cash (Note 44)	-	-	-	-	-	-	-	-	-	-	-	(2,782,814)	(70,439)	(2,853,253)
Interim dividend for 2013 - Cash (Note 44)	-	-	-	-	-	-	-	-	-	-	-	(599,332)	-	(599,332)
ESOP allocation 2013	-	-	-	-	-	-	-	-	-	-	239,701	-	-	239,701
Effect of winding up of Special Purpose Entity	-	-	-	-	-	-	310,938	-	-	-	-	(41,931)	-	269,007
Shares issued under ESOP	205,685	45,104	-	-	-	-	-	-	-	-	-	-	-	250,789
Total contributions by and distributions to equity holders	205,685	45,104	-	-	-	-	310,938	-	-	-	-	239,701	(70,439)	(2,693,088)
Transfer to life policy holder reserve fund	-	-	-	-	-	-	-	-	-	(2,991)	-	-	-	(2,991)
Disposal of subsidiary company	-	-	-	-	-	-	-	-	(9,250)	-	-	9,250	(29,209)	(29,209)
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	-	-	-	40,189	65,312	105,501
Transfers during the year 2013	-	-	430,000	1,800,643	-	-	-	1,300,000	-	-	-	(3,530,643)	-	-
Balance as at 31st December 2013	10,254,944	2,575,324	2,660,000	4,101,205	8,792,657	4,454,989	-	19,100,000	-	(4,182)	416,216	5,210,483	1,104,093	58,665,729

The Notes to the Financial Statements from page 262 to 369 form an integral part of these Financial Statements.

Statutory Reserve Fund represents the statutory requirement in terms of Section 20 (1) and (2) of the Banking Act No 30 of 1988.

Capital Reserve relates to revaluation of freehold land and buildings carried out in 1989, 1993, 2007 and 2012 and includes the surplus on revaluation of those assets.

General Reserve comprises the amounts appropriated by the Board of Directors as a general banking reserve.

Exchange equalisation reserve consists of foreign exchange differences resulting from translation of foreign Subsidiary and Associate financial statements to functional currency of the Group (Sri Lankan Rupees).

Investment Fund Account consists of 8% of the profits calculated for the payment of Value Added Tax and 5% of the Profit Before Tax calculated for payment of Income Tax purposes during the year.

ESOP reserve consists of the liability recognised on account of the ESOP allocations during 2012 and 2013 [Note 4.15.3 (b)]

Statement of Cash Flows

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Cash Flows from Operating Activities				
Interest and commission receipts	55,729,913	47,901,062	56,192,778	47,916,971
Interest payments	(31,938,047)	(24,728,933)	(32,090,888)	(24,856,302)
Receipts from other operating activities	1,848,831	1,638,755	5,283,495	4,598,787
Cash payments to employees	(6,947,716)	(6,385,313)	(7,426,385)	(6,896,173)
Recovery of loans written off in prior years	8,295	11,192	8,295	11,192
Cash payments to other operating activities	(9,659,378)	(9,176,304)	(11,349,125)	(10,327,090)
Operating Profit before Changes in Operating Assets and Liabilities [Note (a)]	9,041,898	9,260,459	10,618,170	10,447,385
(Increase) / Decrease in Operating Assets				
Deposits held for regulatory or monetary control purpose	3,567,095	(1,250,058)	3,567,179	(1,249,869)
Loans and receivables to other customers	(56,940,880)	(44,961,367)	(56,782,186)	(45,863,570)
Other short term assets	763,228	(902,569)	637,244	(981,135)
	(52,610,557)	(47,113,994)	(52,577,763)	(48,094,574)
Increase / (Decrease) in Operating Liabilities				
Deposits from customers	42,745,044	48,819,348	42,961,054	48,687,988
Other liabilities	999,210	(568,538)	990,616	(316,089)
	43,744,254	48,250,810	43,951,670	48,371,899
Net Cash Generated from Operating Activities before Income Tax	175,595	10,397,275	1,992,077	10,724,710
Income taxes paid	(2,889,690)	(929,178)	(2,949,187)	(966,030)
Net Cash Generated from / (Used in) Operating Activities	(2,714,095)	9,468,097	(957,110)	9,758,680
Cash Flows from Investing Activities				
Dividend income	362,509	248,990	297,112	223,433
Dividend income received from associates	-	-	53,148	-
Net proceeds from sale, maturity and purchase of financial investments	(15,854,115)	(10,687,368)	(17,171,637)	(10,741,492)
Purchase of property, plant & equipment	(952,411)	(872,396)	(1,021,075)	(925,940)
Purchase of intangible assets	(671,888)	(181,982)	(681,445)	(208,214)
Improvements to investment properties	(2,202)	(5,085)	(993)	(139)
Investment in Associate company	-	-	(121,275)	(20,000)
Net proceeds from sale of Associate company	-	58,815	-	58,815
Net proceeds from sale of Subsidiary company	56,158	-	-	-
Net proceeds from sale of non current assets held for sale	-	-	2,485	-
Proceeds from sale of property, plant and equipment	18,398	36,038	22,421	37,237
Proceeds from deemed disposal of Subsidiary company by Joint Venture	-	-	105,500	144,511
Net cash effect on disposal of Subsidiary [Note (b)]	-	-	9,920	-
Net Cash Flows used in Investing Activities	(17,043,551)	(11,402,988)	(18,505,839)	(11,431,789)
Cash Flows from Financing Activities				
Increase in debentures	5,090,472	2,815,526	4,999,692	2,827,525
Increase in borrowings	11,396,199	5,199,665	11,638,468	5,129,078
Dividends paid	(3,177,254)	(1,825,130)	(3,247,693)	(1,807,716)
Proceeds from issue of shares under ESOP	250,789	78,599	250,789	78,599
Share issue expenses	-	(5,649)	-	(8,247)
Debenture issue expenses	(22,342)	-	(22,342)	-
Issue of preference shares	-	-	-	150,000
Net Cash Generated from Financing Activities	13,537,864	6,263,011	13,618,914	6,369,239
Net Increase / (Decrease) in Cash and Cash Equivalents	(6,219,782)	4,328,120	(5,844,035)	4,696,130
Cash and Cash Equivalents at the Beginning of the year	19,091,038	14,762,918	20,515,883	15,819,753
Cash and Cash Equivalents at the End of the year [Note (c)]	12,871,256	19,091,038	14,671,848	20,515,883

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Note (a) Reconciliation of operating profit before changes in operating assets and liabilities				
Profit before income tax	10,007,661	9,876,490	10,915,647	10,523,380
Dividend income	(362,509)	(230,842)	(297,112)	(205,285)
Profit from sale of property, plant and equipment	(15,010)	(14,816)	(18,356)	(14,986)
Depreciation of investment properties	5,432	4,751	4,727	4,569
Depreciation of property, plant and equipment	720,170	657,326	904,104	822,570
Amortisation of intangible assets	233,382	175,314	249,941	189,099
Amortisation of leasehold property	125,272	138,309	127,652	143,060
Impairment charge for loans and other losses	3,249,166	1,142,110	3,305,287	1,142,110
Net gain on marked to market valuation of financial investments	(57,594)	(71,868)	(77,715)	(54,138)
Net capital loss from sale of financial investments	45,798	217,220	(20,835)	193,727
Gain / (loss) from sale of Subsidiary company	161	-	(36,488)	-
Gain on disposal of Associate company	-	(38,393)	-	(38,393)
Loss on FCBU revaluation	1,567	19,291	1,567	19,291
Notional tax credit and WHT credit	(702,122)	(564,615)	(742,141)	(605,321)
Debenture issue expenses	22,342	-	22,342	-
Share issue expenses	-	5,649	-	8,247
Increase in insurance contract liabilities - Life	-	-	722,252	604,908
Share of profit of Associates	-	-	(127,815)	(16,632)
Net income from sale of apartments	-	-	(17,770)	(91,133)
Accrual for interest receivables	(3,749,382)	(2,592,945)	(3,842,444)	(2,816,458)
Accrual for other receivables	(3,540)	(66,065)	10,356	(59,927)
Accrual for other payables	(898,410)	(1,605,152)	(907,923)	(1,501,581)
Accrual for interest payable	1,823,129	2,058,757	1,823,127	2,058,497
Accrual for personnel expenses	(1,643,316)	(60,601)	(1,620,324)	(68,758)
Loss on sale of non current assets held for sale	-	-	390	-
Fair value of equity settled share based payment transactions	239,701	176,515	239,701	176,515
Net loss arising on derecognition of financial assets measured at amortised cost	-	34,024	-	34,024
	9,041,898	9,260,459	10,618,170	10,447,385

	Group 2013 Rs 000
Note (b) Net cash effect on disposal of Subsidiary company	
Cash and cash equivalents	46,238
Statutory deposit with central bank	23,700
Property, plant and equipment	9,742
Other assets	16,999
Borrowings	(6,572)
Other liabilities	(41,425)
Non-controlling interest	(29,209)
Net identifiable assets and liabilities	19,473
Consideration received in cash	56,158
Cash and cash equivalents disposed	(46,238)
Net cash inflow	9,920

Note (c) Cash and cash equivalents at the end of the year

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Cash and cash equivalents (Note 23)	11,624,645	8,769,206	11,588,264	8,848,466
Placements with banks (Note 25)	1,246,611	10,321,832	3,083,584	11,667,417
	12,871,256	19,091,038	14,671,848	20,515,883

The Notes to the Financial Statements from pages 262 to 369 form an integral part of these Financial Statements.

Notes to the Financial Statements

1. REPORTING ENTITY

Hatton National Bank PLC (“Bank”/“HNB”) is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. It is a Licensed Commercial Bank regulated under the Banking Act No. 30 of 1988 and amendments thereto. The Company was re-registered under the Companies Act No. 07 of 2007. The registered office of the Bank is situated at No 479, T B Jayah Mawatha, Colombo 10. The shares of the Bank have a primary listing on the Colombo Stock Exchange. The staff strength of the Bank as at 31st December 2013 is 4,604 (2012- 4,679).

The Consolidated Financial Statements of the Bank as at and for the year ended 31st December 2013 include the Bank and its Subsidiaries (together referred to as the “Group” and individually as “Group entities”) and the Group’s interest in its Joint Venture. The Financial Statements of all companies in the Group have a common financial year which ends on December 31st except for Lanka Ventures PLC, a subsidiary of Acuity Partners (Pvt) Limited, the joint venture, with a financial year ending March 31st.

The Bank does not have an identifiable parent of its own.

There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

1.1 Principal Activities

1.1.1 Bank

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities, leasing, islamic banking etc.

1.1.2 Subsidiaries

Name of Subsidiary	Principal Activities
HNB Assurance PLC	Insurance services
Sithma Development (Pvt) Ltd	Property development
Majan Exchange LLC	Provision of remittances and foreign currency related services

Majan Exchange LLC, a subsidiary of the Bank was disposed during the year and consequently the provision made against the investment in the said company was reversed to the Income Statement.

1.1.3 Joint Venture

Name of Joint Venture	Principal Activities
Acuity Partners (Pvt) Ltd	Operating as an Investment Company and providing financial services

1.1.4 Special Purpose Entity

Name of Special Purpose Entity	Principal Activities
Employee Share Benefit Trust (ESBT)	Administering the employee share benefit scheme

The Bank liquidated the ESBT during the year ended 31st December 2013. Accordingly, the Bank discontinued its treatment of the ESBT as a special purpose entity in the Consolidated Financial Statements.

2. BASIS OF PREPARATION

2.1 Statement of Compliance

The Consolidated Financial Statements of the Group and the Financial Statements of the Bank which comprise the Statement of Financial Position, Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity, Statement of Cash Flows and Notes thereto have been prepared in accordance with Sri Lanka Accounting Standards (SLFRSs and LKASs) laid down by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), and comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988 and amendments thereto and provide appropriate disclosures as required by the Listing Rules of the Colombo Stock Exchange.

2.2 Responsibility for Financial Statements

The Board of Directors is responsible for the preparation and presentation of the Financial Statements of the Group and the Bank as per the provisions of the Companies Act No 07 of 2007 and the Sri Lanka Accounting Standards.

2.3 Approval of Financial Statements by Directors

The Consolidated and Bank’s Financial Statements were authorised for issue by the Board of Directors in accordance with the resolution of the Directors on 21st February 2014.

2.4 Basis of Measurement

The Financial Statements have been prepared on the historical cost basis and applied consistently with no adjustments being made for inflationary factors affecting the Financial Statements, except for the following:

- Derivative financial instruments are measured at fair value
- Financial instruments classified as fair value through profit and loss are measured at fair value

- Available-for-sale financial assets are measured at fair value
- Freehold land and buildings are measured at cost at the time of acquisition and subsequently at revalued amounts (except investment properties), which are the fair values at the date of revaluation
- Non-current assets held for sale are measured at lower of its carrying amount and fair value less costs to sell
- Liability for defined benefit obligations is recognised as the present value of the defined benefit obligation less the fair value of the plan assets.

2.5 Functional and Presentation Currency

The Financial Statements are presented in Sri Lankan Rupees, which is the Bank's functional currency. Financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand unless indicated otherwise.

Each entity in the Group determines its own functional currency and items included in the Financial Statements of each individual entity are measured using that functional currency. There was no change in the Group's presentation and functional currency during the year under review.

2.6 Presentation of Financial Statements

The assets and liabilities of the Group presented in its Statement of Financial Position are grouped by nature and listed in an order that reflects their liquidity and maturity pattern. The maturity profile of the Bank's and the Group's assets and liabilities are given in Note 60 to the financial statements.

Assets and liabilities are offset and the net amount is reported in the Statement of Financial Position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the Statement of Comprehensive Income unless required or permitted by an Accounting Standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

2.7 Significant Accounting Judgements, Estimates and Assumptions

The preparation of Financial Statements in conformity with Sri Lanka Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are

recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the Financial Statements are described in the relevant notes as follows.

- Recognition, classification and measurement of financial instruments (refer Note 4.5.1 and 4.5.2)
- Identification, measurement and assessment of impairment of financial assets (refer Note 4.5.8)
- Classification of Investment Property (Refer Note 4.11)
- Impairment of Non-financial assets (Refer Note 4.13)
- Employee Retirement Benefits (Refer Note 4.15)

An analysis of financial instruments measured at fair value as at the end of the reporting period, by the level of the fair value hierarchy is given in Note 8.

2.8 Changes in Accounting Policy

2.8.1 Defined Benefit plans

The Group adopted Sri Lanka Accounting Standard (LKAS 19) "Employee Benefits" (2013) with effect from 1st January 2013 as part of its mandatory application and changed its basis for determining the income or expense related to defined benefit plan.

As a result of the change, the Bank now determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability (asset) at the beginning of the annual period. The net interest on the net defined benefit liability (asset) comprises:

- Interest cost on the defined benefit obligation; and
- Interest income on plan assets

Previously, the Group determined interest income on plan assets based on their long term rate of expected return.

Impact of change in Accounting Policy

The change in accounting policy has been applied retrospectively as per Sri Lanka Accounting Standard (LKAS 8) "Accounting Policies, Changes in Accounting Estimates and Errors". It increased the defined benefit expense recognised in profit or loss and correspondingly increased the defined benefit plan's re-measurement gain recognised in other comprehensive income by Rs 169.22 Mn for the year ended 31st December 2012. The following table summarises the financial effects on the Income Statement and the Statement of Comprehensive Income on implementation of the new accounting policy:

Notes to the Financial Statements

For the year ended 31st December	Note	2012 Rs 000
Increase in provision charge for employee benefits	17 (a)	169,216
Increase in actuarial gains / (losses) on defined benefit plans		169,216

The change in accounting policy had no impact on net assets as at 31st December 2012 and had an immaterial impact on income taxes for the year ended 31st December 2012.

3. MATERIALITY AND AGGREGATION

Each material class of similar items is presented separately in the Financial Statements. Items of dissimilar nature or function are presented separately unless they are immaterial.

4. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements, unless otherwise indicated. The accounting policies of the Bank have been consistently applied by the Group entities where applicable and deviations if any, have been disclosed accordingly.

4.1 Basis of Consolidation

4.1.1 Business Combinations

The Group measures goodwill as the fair value of the consideration transferred including the recognised amount of any Non-controlling Interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

The group elects on a transaction by transaction basis whether to measure Non-controlling Interest at its fair value, or at its proportionate share of the recognised amount of the identifiable net assets, at the acquisition date.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Non-controlling Interest

Non-controlling Interests represent the portion of profit or loss and net assets of the Subsidiaries not owned, directly or indirectly, by the Bank. The Non-controlling Interest is presented in the Consolidated Statement of Financial

Position within equity, separately from the equity attributable to the Equity Holders of the Bank.

Non-controlling Interest in the profit or loss of the Group is disclosed separately in the Consolidated Statement of Comprehensive Income.

Any losses applicable to the Non-controlling Interests are allocated against the interests of the Non-controlling Interest even if this results in a deficit balance.

The details of Non-controlling Interests are given in Note 57.

4.1.2 Subsidiaries

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

Where Subsidiaries have been sold or acquired during the year, their operating results have been included to the date of disposal or from the date of acquisition.

There are no significant restrictions on the ability of the Subsidiaries to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

All Subsidiaries of the Bank as at the reporting date have been incorporated in Sri Lanka.

A list of Subsidiaries within the Group is provided in Note 36.

Loss of Control

Upon the loss of control, the Group derecognises the assets and liabilities of the Subsidiary, any Non-controlling Interests and the other components of equity related to the Subsidiary. Any surplus or deficit arising on the loss of control is recognised in the Statement of Changes in Equity. If the Group retains any interest in the previous Subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently, it is accounted for as an equity-accounted investee or in accordance with the Group's accounting policy for financial instruments depending on the level of influence retained.

4.1.3 Special Purpose Entity (SPE)

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well defined objective. A SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE.

The Bank operated an Employee Share Ownership Plan covering specific employees who after having served for a minimum service period are allotted a specific number of shares of the Bank. HNB had set up a trust (Employee Share Benefit Trust (ESBT / Trust) to administer the plan

and has given an overdraft to the Trust at concessional rate of interest. The Trust had purchased equity shares (non-voting) of HNB from open market for meeting the obligations under the Plan. Accordingly, the ESBT had been treated as a SPE and included in the Consolidated Financial Statements up to 31st March 2013.

As per the Colombo Stock Exchange (CSE) Rule 5.6.10 all share benefits schemes which had been introduced by the companies listed in the CSE had to be wound up prior to 01st March 2015. Complying with the said rule, Board of Directors approved to transfer the shares in the trust to eligible employees upon settling the outstanding loan, accrued interest and taxes relating thereto. The said decision was communicated to all the eligible employees. Accordingly, the Bank discontinued its treatment of the ESBT as a special purpose entity in the Consolidated Financial Statements with effect from June 2013.

4.1.4 Associates

Associate is an entity in which the Group has significant influence, but no control over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity.

Investments in associates are accounted for using the equity method and are recognised initially at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The Consolidated Financial Statements include the Group's share of the income and expenses and equity movements of the Associate, after adjustments being made to align the accounting policies with those of the Group from the date that significant influence effectively commences.

When the Group's share of losses exceeds its interest in the Associate, the carrying amount of that interest, including any long term investments, is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the Associate. If the Associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The Group discontinues the use of the equity method from the date that it ceases to have significant influence over an Associate and accounts for the investment in accordance with the Group's accounting policy for financial instruments.

There are no significant restrictions on the ability of the Associate to transfer funds to the Group in the form of cash dividends or repayment of loans and advances.

Details of the Associates within the Group are provided in Note 34.

4.1.5 Joint Venture

Joint Venture is an entity over whose activities the Group has joint control, established by contractual arrangement and requiring unanimous consent for strategic, financial and operating decisions. The Group recognises its interest in the Joint Venture using the line by line reporting format for proportionate consolidation method and is recognised initially at cost.

The Group combines its share of each of the assets, liabilities, income and expenses of the Joint Venture with similar items, line by line in the Consolidated Financial Statements from the date that joint control commences, until the date joint control ceases.

There are no significant restrictions on the ability of the Joint Venture to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

Details of the Joint Venture are provided in Note 35.

4.1.6 Transactions Eliminated on Consolidation

Intra-group balances, and income and expenses arising from intra-group transactions are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with equity accounted investees are eliminated to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

4.1.7 Material Gains or Losses, Provisional Values or Error Corrections

There were no material gains or losses, provisional values or error corrections recognised during the year in respect of business combinations that took place in previous periods.

4.2 Foreign Currency

4.2.1 Foreign Currency Transactions

Transactions in foreign currencies are translated to Sri Lankan Rupees at the middle rate of exchange ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to Sri Lankan Rupees at the exchange rates ruling at the date that the fair value was determined.

Notes to the Financial Statements

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognised in Other Comprehensive Income. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

4.2.2 Foreign Operations

The Financial Statements of foreign entities within the Group, whose functional currency is different to presentation currency, are translated to Sri Lankan Rupees as follows:

- Assets (including goodwill and fair value adjustment arising on acquisition) and liabilities are translated at the middle rate of exchange at the reporting date.
- Income and expenses are translated at the average exchange rate ruling during the period under consideration.
- All resulting foreign exchange differences are recognised in Other Comprehensive Income.

When a foreign operation is disposed of, the relevant amount in the exchange equalisation reserve is transferred to Retained Earnings.

ASSETS AND LIABILITIES AND BASIS OF MEASUREMENT

4.3 Cash and Cash Equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances with Central Banks, balances with banks, placements with banks, money at call and short notice with less than three months maturity from the date of acquisition. Cash and cash equivalents are carried at amortised cost in the Statement of Financial Position.

Details of cash and cash equivalents are given in Note 23 to the financial statements.

4.4 Statutory Deposit with Central Banks

The Monetary Law Act requires that all Commercial Banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lankan Rupees. The details of reserve requirements are given in Note 24 to the financial statements.

4.5 Financial Assets and Financial Liabilities

4.5.1 Recognition and Initial Measurement

The Group initially recognises all financial assets and liabilities on the date they are originated.

However for financial assets/liabilities held at fair value through profit and loss any changes in fair value from the trade date to settlement date is accounted in the Statement of Comprehensive Income while for available-for-sale financial assets any changes in fair value from the trade date to settlement date is accounted in the Statement of Other Comprehensive Income.

A financial asset or a financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

Transaction costs in relation to financial assets and financial liabilities at fair value through profit or loss are dealt with through profit or loss.

4.5.2 Classification and Subsequent Measurement

Financial assets

At inception a financial asset is classified in one of the following categories:

- fair value through profit or loss (either as held for trading or designated at fair value through profit or loss)
- loans and receivables
- held to maturity financial assets
- available-for-sale financial assets

Financial liabilities

The Group initially recognises all financial liabilities on the date that they are originated and classifies its financial liabilities as measured at amortised cost or fair value through profit or loss (either as held for trading or designated at fair value through profit or loss).

4.5.2 (a) Financial assets and financial liabilities at fair value through profit or loss

A financial asset or a financial liability is classified as fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition.

Financial assets or financial liabilities designated at fair value through profit or loss;

Financial assets and financial liabilities are designated as fair value through profit or loss when;

- The designation eliminates or significantly reduces measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis

- A group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis
- The assets or liabilities include embedded derivatives and such derivatives are required to be recognised separately

The Group has not designated any financial asset/liability upon initial recognition at fair value through profit or loss as at the reporting date.

Financial Assets/Liabilities Held for Trading

Financial assets and liabilities are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of a portfolio that is managed together for short term profit or position taking. This category also includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships. The Group evaluates its financial assets/liabilities held for trading, other than derivatives, to determine whether the intention to sell them in the near term is still appropriate. When the Group is unable to trade these financial assets due to inactive markets and management's intention to sell them in the foreseeable future significantly changes, the Group may elect to reclassify these financial assets in rare circumstances.

Financial Assets held for Trading include instruments such as government securities, equity instruments etc. that have been acquired principally for the purpose of selling in the near term and derivatives.

The Group has not classified any financial liabilities at fair value through profit or loss except derivatives as at the reporting date.

Upon initial recognition, attributable transaction costs of the financial assets and liabilities at fair value through profit or loss are recognised in profit or loss as incurred.

Financial assets and financial liabilities at fair value through profit or loss are measured at fair value and changes therein are recognised in profit or loss under Net Gain/(Loss) from Trading (Note 13) to the financial statements. Interest and dividend income are also recorded in Net Gain/(Loss) from Trading according to the terms of the contract or when the right to receive the payment has been established.

Details of Other Financial Assets Held for Trading are given in Note 27 to the financial statements.

4.5.2 (b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments, that are not quoted in an active market that the Group does not intend to sell immediately or in the near term, upon initial recognition not designated as available for sale and those for which the

Group may recover substantially all of its initial investment through contractual cash flows other than because of credit deterioration. Loans and receivables are subsequently carried at amortised cost using the effective interest rate method less allowance for impairment except when the Group recognises loans and receivables at fair value through profit or loss.

Loans and advances to customers, bills of exchange, commercial papers, lease receivables and other financial investments such as investments in Sri Lanka Development bonds and unquoted debt instruments are classified as loans and receivables.

4.5.2 (c) Held-to-maturity financial assets (HTM)

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity and which were not designated as at fair value through profit or loss or as Available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method. A sale or reclassification of a more than insignificant amount of Held-to-maturity investments would result in the reclassification of all Held-to-maturity investments as Available-for-sale, and would prevent the Group from classifying investment securities as Held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- sales or reclassifications after the Group has collected substantially all of the asset's original principal; and
- sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.

Details of Financial Investments - Held-to-maturity are given in Note 32 to the financial statements.

4.5.2 (d) Available-for-sale financial assets (AFS)

Available-for-sale investments are non-derivative investments that were designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments are carried at fair value after initial recognition.

Interest income on Available-for-sale financial assets is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Group becomes entitled to the dividend. Foreign exchange gains or losses on Available-for-sale debt security investments are recognised in profit or loss.

Notes to the Financial Statements

Other fair value changes are recognised directly in equity through Other Comprehensive Income in the Available-for-sale Reserve until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in Other Comprehensive Income are reclassified to profit or loss as a reclassification adjustment. The losses arising from impairment of such investments are recognised in profit or loss and removed from the Available-for-sale Reserve.

Details of Financial Investments - Available-for-sale are given in Note 31.

4.5.2 (e) Financial liabilities measured at amortised cost

Financial liabilities not classified as fair value through profit or loss is classified as amortised cost instruments. Dues to banks, dues to customers, other borrowings, debt securities issued, and subordinated debentures etc. are classified as Financial Liabilities measured at Amortised Cost.

4.5.3 Amortised Cost Measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

4.5.4 Fair Value Measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument (Level 01 Valuation). A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, then the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analysis and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group calibrates valuation techniques and tests them

for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument, i.e. without modification or repackaging, or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data (Level 02 Valuation) or the transaction is closed out.

Any difference between the fair value at initial recognition and the amount that would be determined at that date using a valuation technique in a situation in which the valuation is dependent on unobservable parameters (Level 03 Valuation) is not recognised in profit or loss immediately but is recognised over the life of the instrument on an appropriate basis or when the instrument is redeemed, transferred or sold, or the fair value becomes observable.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties; to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

4.5.5 Reclassifications

Reclassifications of financial assets, other than as set out below, or of financial liabilities between measurement categories are not permitted following initial recognition.

A non derivative financial asset Held for Trading that would have met the definition of Loans and Receivables (if the financial asset had not been required to be classified as held for trading at initial recognition) may be reclassified out of the Fair Value through Profit or Loss category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

Financial assets are transferred out of the Available-for-sale category to the Loan and Receivables category where they would have met the definition of a Loan and Receivable at the date of reclassification and the Group has

the intent and ability to hold the assets for the foreseeable future or until maturity.

Held-to-maturity assets are reclassified to the Available-for-sale category if the portfolio becomes tainted following the sale of other than an insignificant amount of Held-to-maturity assets prior to their maturity.

Financial assets are reclassified at their fair value on the date of reclassification. For financial assets reclassified out of the Available-for-sale category into Loans and Receivables, any gain or loss on those assets recognised in Shareholders' Equity prior to the date of reclassification is amortised to profit or loss over the remaining life of the financial asset, using the effective interest method.

4.5.6 Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expires, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or it has transferred its right to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass through arrangement' or in which the Group neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability in the Statement of Financial Position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognised in Other Comprehensive Income is recognised in profit or loss.

When the Group has transferred its right to receive cash flows from an asset or has entered in to pass through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expired.

Where an existing financial liability is replaced by another from the same lender on substantially different terms or the terms of an existing liability are substantially modified such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid, including any non cash assets transferred or liabilities assumed is recognised in profit or loss.

4.5.7 Offsetting

Financial assets and liabilities are offset and the net amount presented in the Statement of Financial Position when, and only when, the Group has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under Sri Lanka Accounting Standards, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

4.5.8 Identification, Measurement and Assessment of Impairment of Financial Assets

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Impairment of financial assets carried at amortised cost

The Group considers evidence of impairment for loans and advances and Held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and Held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and Held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified.

Notes to the Financial Statements

Assets that are individually assessed for impairment and for which an impairment loss is recognised are not included in a collective assessment of impairment. Loans and advances and Held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and Held-to-maturity investment securities with similar risk characteristics.

In assessing collective impairment, the Group uses the net flow rate method. Under this methodology, the movement in the outstanding balance of customers over the periods are used to estimate the amount of loans that will eventually be written off as a result of the events occurring before the reporting date which the Group is not able to identify on an individual loan basis, and that can be reliably estimated.

In assessing collective impairment, the Group uses historical trends of the probability of default, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than as suggested by historical data. Current economic conditions and portfolio risk factors are also evaluated when calculating the appropriate level of allowance required for covering the inherent loss.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If the loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Group has reclassified trading assets to loans and receivables, the discount rate for measuring any impairment loss is the new effective interest rate determined at the date of reclassification.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from the foreclosure less costs of obtaining and selling the collateral, whether or not foreclosure is probable. The methodology and the assumptions used for estimating future cash flows are reviewed regularly to reduce any difference between loss estimates and actual loss experience.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on impaired assets continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on Available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in Other Comprehensive Income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from Other

Comprehensive Income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired Available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired Available-for-sale equity security is recognised in Other Comprehensive Income.

The Group writes off certain loans and advances and investment securities when they are determined to be uncollectible.

4.5.8.1 Collateral Valuation

The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, gold, securities, letters of credit/guarantees, real estate, receivables, inventories, other non financial assets and credit enhancements such as netting arrangements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Bank's annual reporting schedule.

Non financial collateral such as real estate is valued by an external, independent valuation company, having appropriate recognised professional qualifications and recent experience in the location and category of property being valued. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of the valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably.

In the absence of current prices in an active market, the valuations are prepared by considering the estimated rental value of the property. A market yield is applied to the estimated rental value to arrive at the gross property valuation. When actual rents differ significantly from the estimated rental value, adjustments are made to reflect actual rents.

4.5.9 Rescheduled Loans

Loans whose original terms have been modified including those subject to forbearance strategies are considered rescheduled loans. If the renegotiations are on terms that are not consistent with those readily available on the market, this provides objective evidence of impairment. Once terms have been renegotiated, any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan/

advance is no longer considered past due. Management continually reviews renegotiated loans and advances to ensure that all criteria are met and the future payments are likely to occur.

4.6 Sale and Repurchase Agreements

Securities sold subject to repurchase agreements (repos) remain on the Statement of Financial Position; the counterparty liability is included under borrowings. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

4.7 Derivative Financial Instruments

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as trading unless they are designated as hedging instruments. Bank uses derivatives such as forward exchange contracts and swaps. Bank has not designated any derivatives as hedging instruments and has not followed hedge accounting as at the reporting date.

All derivatives are initially recognised and subsequently measured at fair value, with all revaluation gains or losses recognised in profit and loss under Net Gain/(Loss) from Trading (Note 13). All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Fair value is determined using the forward market rates ruling on the reporting date.

Details of Derivative Financial Instruments are given in Note 26 and Note 42.

4.8 Non-current Assets Held for Sale and Disposal Groups

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "Held-for-sale". These are assets which are available for immediate sale in their present condition, subject to only the terms that are usual and customary for sale of such assets. Their sale is highly probable and the management has committed to the sale and the sale is expected to have been completed within one year from the date of classification.

Non-current Assets Held for Sale are presented separately on the face of the Statement of Financial Position at the lower of its carrying amount and fair value less costs to sell. Thereafter, the Group assesses at each reporting date or more frequently if events or changes in circumstances indicate that the investment is impaired. The Group recognises an impairment loss for any initial or subsequent write down of the assets to fair value less cost to sell and also recognises a gain for any subsequent increase in fair value less cost to sell of an asset, only to the extent of the

cumulative impairment losses that have been recognised previously. Impairment losses on initial classification as held for sale and subsequent gains and losses on re-measurement are recognised in profit or loss.

Assets classified as Non-current Assets Held for Sale are neither amortised nor depreciated.

In the Income Statement of the reporting period, and of the comparable period of the previous reporting period, income and expenses from discontinued operations if any are reported separately from income and expenses from continued operations, down to the level of profit after taxes, even when the Group retains a non controlling interest in the subsidiary after the sale. The resulting profit or loss (after taxes) is reported separately in the Income Statement.

Details of Non-current Assets Held for Sale are given in Note 28.

4.9 Finance Leases

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Leasing balances are stated in the Statement of Financial Position after deduction of unearned lease income and the impairment for rentals doubtful of recovery. Amounts receivable under finance leases are classified as Lease Receivables and presented within loans and receivables to other customers in the Statement of Financial Position.

4.9.1 Identification and Measurement of Impairment for Lease Receivables

Lease receivables are collectively assessed for impairment as stated above in Note 4.5.8.

4.10 Intangible Assets

An intangible asset is an identifiable non monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.

Details of Intangible Assets are given in Note 39.

4.10.1 Basis of Recognition

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the assets can be measured reliably. An intangible asset is initially measured at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition.

Notes to the Financial Statements

4.10.1 (a) Goodwill

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. Goodwill is measured at initial recognition in accordance with Note 4.1.1.

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment, and an impairment loss in such investment is not allocated to any asset, including goodwill, that forms part of the carrying amount of the equity accounted investee.

Any gain on bargain purchase is recognised immediately in profit or loss.

4.10.1(b) Software

All computer software costs incurred, licensed for use by the Group, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it's probable that they will lead to future economic benefits, are included in the Statement of Financial Position under the category Intangible Assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

4.10.2 Subsequent Expenditure

Expenditure incurred on software is capitalised only when it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. All other expenditure is expensed as incurred.

4.10.3 Amortisation

Intangible assets, except for goodwill, are amortised on a straight line basis in profit or loss from the date when the asset is available for use, over the best estimate of its useful economic life based on a pattern in which the asset's economic benefits are consumed by the Bank. The estimated useful life of software is six years. Expenditure on an intangible item that was initially recognised as an expense by the Bank in previous Annual Financial Statements or Interim Financial Statements are not recognised as part of the cost of an intangible asset at a later date. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

4.10.4 Retirement and Disposal

An intangible asset is derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal. Gains or losses arising from

derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in profit or loss.

4.11 Investment Properties

Investment properties are properties held either to earn rental income or for capital appreciation or both but not for sale in the ordinary course of business, used in the production or supply of goods or services or for administrative purposes.

Details of Investment Properties are given in Note 37.

4.11.1 Basis of Recognition

Investment property is recognised if it is probable that future economic benefits that are associated with the investment property will flow to the Group and cost of the investment property can be reliably measured.

When a portion of the property is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes the Group accounts for the portions separately if these portions could be sold separately (or leased out separately under a finance lease). If the portions could not be sold separately, the property is treated as investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Where the Group provides ancillary services to the occupants of a property it holds, the Group treats such a property as investment property if the services are insignificant to the arrangement as a whole.

4.11.2 Measurement

An investment property is measured initially at its cost. The cost of a purchased investment property comprises of its purchase price and any directly attributable expenditure. The cost of a self constructed investment property is its cost at the date when the construction or development is complete.

The Group applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard (LKAS 40) - "Investment Property". Accordingly, land classified as investment properties are stated at cost less any accumulated impairment losses and buildings classified as investment properties are stated at cost less any accumulated depreciation and any accumulated impairment losses.

Group determines the fair value of its investment properties annually for disclosure purposes by using

independent valuers who are not connected with the Bank and such fair values have been disclosed under Note 37 to the financial statements as required by Sri Lanka Accounting Standard (LKAS 40) - "Investment Property".

4.11.3 Depreciation

Depreciation is provided on a straight line basis over the estimated life of the class of asset from the date of purchase up to the date of disposal.

Hatton National Bank PLC	
Freehold buildings	2.5% per annum
[Refer Note 37 (a)]	

Sithma Development (Pvt) Ltd*	
Freehold buildings	2.5% per annum
[Refer Note 37 (b)]	

Plant, machinery and equipment integral to freehold buildings referred to above	20% per annum
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* Sithma Development (Pvt) Ltd

The HNB towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. However, the ancillary services provided by Sithma Development (Pvt) Ltd to the occupants of HNB towers, is a significant component of the arrangement as a whole. Therefore, HNB towers is not classified as investment property in the financial statements of Sithma, but has been classified under property, plant and equipment in accordance with Sri Lanka Accounting Standard (LKAS 40) - "Investment Property".

4.11.4 Derecognition

Investment properties are derecognised when disposed of, or permanently withdrawn from use because no future economic benefits are expected. Gains or losses arising from derecognition of an investment property are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in profit or loss.

Transfers are made to and from investment properties only when there is a change in use.

4.11.5 Investment Property Leased within the Group

Any property leased out to parent or subsidiary is considered as owner-occupied from the perspective of the group and adjustments are made for consolidation purposes and changes are disclosed in Note 37 (b) to the Financial Statements.

4.12 Property, Plant and Equipment

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or

services, for rental to others or for administrative purposes and are expected to be used during more than one period.

Details of property, plant and equipment are given in Note 38.

4.12.1 Basis of Recognition

Property, plant and equipment are recognised if it is probable that future economic benefits associated with the assets will flow to the Group and cost of the asset can be reliably measured.

4.12.2 Measurement

An item of property, plant and equipment that qualifies for recognition as an asset is initially measured at its cost. Cost includes expenditure that is directly attributable to the acquisition of the asset and cost incurred subsequently to add to, replace part of, or service it. The cost of self constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of computer equipment.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate Items (major components) of property, plant and equipment.

4.12.3 Cost Model

The Group applies cost model to property, plant and equipment except for freehold land and buildings and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

4.12.4 Revaluation Model

The Group applies the revaluation model to the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Freehold land and buildings of the Group are revalued every five years on a roll over basis to ensure that the carrying amounts do not differ materially from the fair values at the reporting date. On revaluation of an asset, any increase in the carrying amount is recognised in Other Comprehensive Income and accumulated in equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to profit or loss. Statement of Comprehensive Income. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the Income Statement or debited in the Other Comprehensive Income to the extent of any credit balance existing in the capital reserve in

Notes to the Financial Statements

respect of that asset. The decrease recognised in Other Comprehensive Income reduces the amount accumulated in equity under capital reserves. Any balance remaining in the revaluation reserve in respect of an asset is transferred directly to Retained Earnings on retirement or disposal of the asset.

4.12.5 Reclassification to Investment Property

When the use of property changes from owner-occupied to investment property, the property is re-measured to fair value and reclassified as investment property. Any gain arising on re-measurement is recognised in profit or loss to the extent that it reverses a previous impairment loss on the specific property, with any remaining gain recognised in Other Comprehensive Income and presented in revaluation reserve in equity. Any loss is recognised immediately in profit or loss.

4.12.6 Subsequent Costs

The subsequent cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Group and its cost can be reliably measured. The costs of day to day servicing of property, plant and equipment are charged to profit or loss as incurred. Costs incurred in using or redeploying an item is not included under carrying amount of an item.

4.12.7 Derecognition

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the de-recognition of an item of property, plant and equipment which is calculated as the difference between the carrying amount and the net disposal proceeds is included in profit or loss when the item is derecognised.

When replacement costs are recognised in the carrying amount of an item of property, plant and equipment, the remaining carrying amount of the replaced part is derecognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is derecognised.

4.12.8 Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal, at the following rates on a straight line basis over the periods appropriate to the estimated useful lives based on the pattern in which the asset's future economic benefits are expected to be consumed by the Group of the different types of assets, except for which are disclosed separately. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale or the date that the asset is derecognised. Depreciation does not cease

when the assets become idle or is retired from active use unless the asset is fully depreciated.

Hatton National Bank PLC and its Subsidiary Companies (except for Sithma Development (Pvt) Ltd)

	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	16.7
Office equipment	20
Furniture and fittings	10
Fixtures	10
Civil works (Majan Exchange LLC*)	10
Improvements to leasehold buildings	over the lease period

Depreciation is not provided for freehold land.

*Bank disposed its stake on Majan exchange LLC during the year.

Sithma Development (Pvt) Ltd

	% per annum
Freehold buildings - Sithma building	1
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Furniture and fittings	10

Change in estimates

During the year ended 31st December 2012 the Group conducted an operational efficiency review and there were changes in the expected usage of the chillers and building management system used by Sithma Development (Pvt) Ltd. These items had a previous expected useful life of 25 years which are now expected to be used for 20 and 14 years respectively from the date of purchase. As a result the expected useful lives of these assets decreased. The effect of this change on depreciation expense is as follows.

Rs Mn	2012	2013	2014	2015	2016
Increase in depreciation expense	3.6	10.8	10.8	10.8	10.8

Depreciation methods, useful lives and residual values are reassessed at each reporting date and adjusted if appropriate.

4.12.9 Capital Work-in-Progress

These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation. Capital work-in-progress would be transferred to the relevant asset when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Capital work-in-progress is stated at cost less any accumulated impairment losses.

4.12.10 Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset have been capitalised as part of the cost of the asset in accordance with Sri Lanka Accounting Standard (LKAS 23) - "Borrowing Costs". A qualifying asset is an asset which takes substantial period of time to get ready for its intended use or sale. Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Other borrowing costs are recognised in the profit or loss in the period in which they incur.

4.13 Impairment of Non-financial Assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. An impairment loss is recognised if the carrying amount of an asset or its Cash Generating Unit (CGU) exceeds its estimated recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Impairment losses are recognised in profit or loss, except for property previously revalued where the gain or loss on revaluation was taken to Equity. In this case, the impairment is also recognised in Equity up to the extent of any previously recognised revaluation gains. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs) and then to reduce the carrying amount of the other assets in the CGU (group of CGUs) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Liabilities and provisions

4.14 Dividends Payable

Provision for final dividends is recognised at the time the dividend recommended and declared by the Board of Directors, is approved by the shareholders. Interim dividends payable is recognised when the Board approves such dividend in accordance with the Companies Act No. 7 of 2007.

Details of dividend payable are given in Note 44.

4.15 Employee Retirement Benefits

4.15.1 Defined Benefit Plan

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

4.15.1 (a) Pension Fund

The Bank operates an approved Pension Fund to facilitate the following payments for permanent staff of the Bank:

- a) Pensions to retiring staff
- b) Benefits to staff who opted for the optional scheme for pension introduced in 2005
- c) Gratuity

The gratuity would be the payments to staff who satisfy the criteria as per the Gratuity Act at the time of leaving the

Notes to the Financial Statements

services of the Bank without pension rights. The requirement under the Payment of Gratuity Act No 12 of 1983, payment of gratuities to employees who have completed more than five years of service is covered through the Bank's own non-contributory pension scheme which is in force.

The Bank's obligation in respect of defined benefit pension plan is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods and discounting that benefit to determine its present value, then deducting the fair value of any plan assets to determine the net amount to be shown in the Statement of Financial Position. The value of any defined benefit asset is restricted to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to any plan in the Bank. An economic benefit is available to the Bank if it is realisable during the life of the plan, or on settlement of the plan liabilities.

The Bank determines the net interest expense (income) on the net defined benefit liability (asset) by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability (asset) at the beginning of the annual period.

The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligations. The calculation is performed by a qualified actuary using the Projected Unit Credit method.

The Bank recognises the total actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan in Other Comprehensive Income during the period in which it occurs.

The demographic assumptions underlying the valuation are retirement age (55 yrs), early withdrawals from service and retirement on medical grounds, death before and after retirement etc.

The Subsidiaries do not operate pension funds.

Details of pension fund are given in Note 52 (a).

4.15.1 (b) Other Long-term Employee Benefits

The Bank's net obligation in respect of long-term employee benefits other than pension fund is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligation. The calculation is performed using the

projected unit credit method. Any actuarial gains and losses are recognised in profit or loss in the period in which they arise. The Bank's liability towards the portion of the accumulated leave which is expected to be utilised beyond one year from the end of the reporting period is treated as other long term employee benefits.

4.15.1 (c) Widows', Widowers' and Orphans' Pension Fund

The Bank operates a separate Widows', Widowers' and Orphans' Pension Scheme (WW & OP) which was established with effect from 1st September 1995. The contributions are from employees only and the Bank does not have any legal or constructive obligation towards the above scheme.

Details of Widows', Widowers' and Orphans' Pension Fund are given in Note 52 (b).

4.15.1 (d) Majan Exchange LLC

The Company's obligation in respect of non-Omani terminal benefits which is an unfunded defined benefit retirement plan, is made in accordance with Omani Labour Laws and is calculated by estimating the amount of future benefit that such employees have earned in return for their service in the current and prior periods. The obligation is calculated using the Projected Unit Credit method and is discounted to its present value. The Bank sold its stake on Majan Exchange LLC during the year.

4.15.1 (e) Employees' Provident Fund - Bank

Employees' Provident Fund is an approved private provident fund which has been set up to meet the provident fund liabilities of the Bank to which the Bank and employees contribute 12% and 8% respectively on the salary of each employee. Staff members who are members of the fund are entitled to receive a minimum interest rate which is the higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi annual basis. Accordingly this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation of the same.

4.15.2 Defined Contribution Plans

A defined contribution plan is a post employment plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay a further amount. Obligations for contributions to defined contribution plans are recognised as expense in profit or loss as and when they are due.

4.15.2 (a) Employees' Provident Fund – Group Companies

The Group entities and their employees contribute 12% and 8% respectively on the salary of each employee to Employees' Provident Fund [except for the Bank as explained in note 4.15.1 (e)].

4.15.2 (b) Employees' Trust Fund

The Bank / Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

4.15.2 (c) Majan Exchange LLC

In respect of Majan Exchange LLC, contributions to a defined contribution retirement plan for Omani employees in accordance with the Omani Social Insurance Scheme are recognised as an expense in profit or loss as and when they are due. The Bank sold its stake on Majan Exchange LLC during the year.

4.15.3 Share Based Payment Transactions

4.15.3 (a) Cash Settled Share Based Payment Transactions

The Employee Share Benefit Trust (ESBT) was treated as a cash settled share based payment scheme. It was introduced in 2005 and offered shares to executive and high rank officers of the Bank. The shares allotted to the respective employee under the plan would remain within the plan while the beneficial interest will be with the employee. At the time the employee leaves the Bank the difference between the issue price and the market price is paid to the employee. Therefore the said Employee Share Benefit Trust has no potential dilutive effect on the earnings per share of the Bank. The fair value of the amount payable to employees in respect of share appreciation rights settled in cash is recognised as an expense with a corresponding increase in liabilities. The liability was re-measured at each reporting date. Any changes in the fair value of the liability were recognised as personnel expenses in profit or loss. The trust was treated as a Subsidiary and the shares held by the trust were treated as treasury shares which were eliminated against reserves in the Consolidated Statement of Financial Position.

The Bank obtained clearance from Colombo Stock Exchange and Securities and Exchange Commission to liquidate the ESBT during the year ended 31st December 2013. Accordingly the Bank discontinued its treatment of the ESBT as a special purpose entity in the Consolidated Financial Statements. Further the liability created for the increase in share appreciation rights up to the date of winding up of the Trust was extinguished through profit or loss during the year under Personnel Expenses.

4.15.3 (b) Equity Settled Share Based Payment Transactions

The grant date fair value of equity-settled share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance

conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for difference between expected and actual outcomes.

At the Annual General Meeting held on 28th March 2008 a resolution was passed to formulate an Employee Share Option Plan (ESOP) apart from the Employee Share Benefit Trust enabling the staff in the management rank and above of the Bank to take part in the voting and non-voting ordinary shares of the Bank. The total number of share options available to the eligible employees per year will be 1.25% of shares issued by the Bank up to a maximum limit of 5% of the shares issued (both voting and non-voting) by the Bank in 4 years. The benefits under ESOP will accrue to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

An eligible employee will qualify to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options to be granted to each qualified eligible employee will depend on his / her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings per share of the Bank.

Details of share options are given in Note 53 (c) i.

4.16 Other Short Term Employee Benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

4.17 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. The amount recognised is the best estimate of the consideration required to settle the present obligation at the reporting date, taking in to account the risks and uncertainties surrounding the obligation at that date. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is determined based on the present value of those cash flows.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of

Notes to the Financial Statements

continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

4.18 Operational Risk Events

Provisions for operational risk events are recognised for losses incurred by the Group which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation as at the reporting date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

4.19 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a Subsidiary, Associate or Joint Venture for which the Bank is also liable severally or otherwise are also included with appropriate disclosures.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured.

To meet the financial needs of customers, the Bank enters into various irrevocable commitments and contingent liabilities. These consist of financial guarantees, letters of credit and other undrawn commitments to lend. Letters of credit and guarantees commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Guarantees and standby letters of credit carry a similar credit risk to loans. Operating lease commitments of the Bank (as a lessor and as a lessee) and pending legal claims against the Bank too form part of commitments of the Bank. Contingent liabilities are not recognised in the Statement of Financial Position but are disclosed unless they are remote. But these contingent liabilities do contain credit risk and are therefore form part of the overall risk of the Bank.

Details of commitments and contingencies are given in Note 58.

4.19.1 Financial Guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are recognised initially at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The

financial guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment when a payment under the guarantee has become probable. Financial guarantees are included within other liabilities.

4.19.2 Legal Claims

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. There were no pending litigations against the Bank as at 31st December 2013 which would have a material impact on the financial statements other than those disclosed under Note 58 (e).

4.20 Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all transaction costs and fees that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in profit or loss include interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;

Fair value changes on other derivatives held for risk management purposes and all other financial assets and liabilities carried at fair value through profit or loss, are presented in Net Gain/(Loss) from Trading (Note 13).

Interest income on Available-for-sale investment securities calculated on an effective interest basis is also included in interest income.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

4.21 Dividend Income

Dividend income is recognised in profit or loss on an accrual basis when the Bank's right to receive the dividend is established.

This is usually on the ex-dividend date for equity securities. Dividends are presented in Net Gain / (Loss) from Trading (Note 13), Net Gain / (Loss) from Financial Investments (Note 14) or Other Operating Income (Note 15) based on the underlying classification of the equity investment.

4.22 Lease Income

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month in which the lease is executed in proportion to the declining receivable balance (i.e in a manner that reflects a constant periodic rate of return on capital outstanding).

4.23 Discounts on Bills of Exchange

Income on discounting bills of exchange is recognised proportionately over the period of the instrument.

4.24 Fee and Commission

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees are recognised as the related services are performed. Fees and commission earned for the provision of services over a period of time are accrued over that period.

Other fees and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received. Fee and commission expenses are recognised on an accrual basis.

4.25 Profit / Loss from Sale of Property, Plant and Equipment

Profit / loss from sale of property, plant and equipment is recognised in the period in which the sale occurs and is classified as Other Operating Income.

4.26 Profit / Loss from Sale of Investment Properties

Any profits or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

4.27 Rental Income

Rental income is recognised on an accrual basis.

4.28 Revenue Recognition on Sale of Apartments – Residential Apartment Complex

Revenue from sale of apartments is recognised in profit or loss when significant risks and rewards of ownership transfer to the buyer.

4.29 Lease Payments

4.29.1 Operating Leases

Operating leases are those leasing arrangements that do not transfer to the Bank, substantially all the risks and rewards incidental to ownership of the leased items.

Total payments to be made under each operating lease agreement are recognised in profit or loss on a straight line basis over the term of the lease.

The future monthly commitments on operating leases are shown in Note 58 (b).

4.29.2 Finance Leases

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

4.30 Income Tax Expense

Income tax expense comprises of current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in Other Comprehensive Income.

4.30.1 Current Tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted on the reporting date, and any adjustment to tax payable in respect of previous years.

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and the amendments thereto at the rates specified in Note 20.

Provision for taxation on overseas Subsidiaries / Associates is made on the basis of the profit for the year as adjusted for taxation purposes in accordance with the provisions of the relevant statutes in those countries.

Notes to the Financial Statements

4.30.2 Deferred Tax

Deferred taxation is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax base of assets and liabilities, which is the amount attributed to those assets and liabilities for tax purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates that are expected to be applied to the temporary differences when they reverse based on the laws that have been enacted or substantively enacted as at the reporting date.

Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future; and
- temporary differences arising on the initial recognition of goodwill.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Details of the deferred tax assets and liabilities as at the reporting date are given in Note 49.

4.30.3 Offsetting

Current and deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority, there is a legal right and intentions to settle on a net basis and it is allowed under the tax law of the relevant jurisdiction.

4.30.4 Withholding Tax on Dividends (WHT)

Dividend distributed out of taxable profit of the local subsidiaries attracts a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the subsidiaries in the Financial Statements as a consolidation adjustment.

Withholding tax that arises from the distribution of dividends by the Bank is recognised at the same time as the liability to pay the related dividend is recognised.

4.30.5 Value Added Tax on Financial Services (VAT)

The base for the computation of Value Added Tax on Financial Services is the profit from operations before income tax expenses as per SLFRSs adjusted for emoluments of employees and the economic depreciation computed on prescribed rates.

4.30.6 Economic Service Charges (ESC)

As per provisions of the Economic Service Charge (ESC) Act No 13 of 2006, ESC was payable at 1% on Bank's liable turnover and was deductible from income tax payable (maximum tax payable is Rs. 30 Mn). With effect from 1st April 2012 as per the ESC amendment Act No 11 of 2012 ESC is payable only on exempt turnover of the Bank and is deductible from income tax payable. ESC is not payable on turnover on which income tax is payable.

4.31 Earnings per Share (EPS)

The Group presents Basic and Diluted Earnings per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to the ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

Details of earnings per share are given in Note 21.

4.32 Segment Reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the chief operating decision maker to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

Group's activities have been segregated into five different segments (banking, leasing, dealing, property and insurance) based on the business activities that each unit is engaged in for purpose of reviewing the operating results of the Group as well as to make decisions about resource allocation. Dealing involves activities such as stock broking, securities dealing, remittances, investment banking, venture capital businesses and foreign currency related services. Property and insurance represents the operating results and financial position of the subsidiaries, Sithma Development (Pvt) Ltd and HNB Assurance PLC respectively. Financial results of the Joint venture, Acuity Partners (Pvt) Ltd has been reported under the operating segment "Dealing".

Inter segment transactions are accounted for at fair market prices charged to inter-bank counterparts for similar services on an arm's length basis. Such transfers are eliminated on consolidation.

Income taxes are managed on a group basis and are not allocated to operating segments. Other expenses which cannot be directly identified against a particular business segment have been treated as consolidation adjustments.

No revenue from transactions with a single external customer or counter party amounted to 10% or more of the Bank's total revenue in 2013 or in 2012.

Details of segment reporting are given in Note 61.

4.33 Cash Flow Statement

The Cash Flow Statement has been prepared using the direct method of preparing Cash Flows in accordance with the Sri Lanka Accounting Standard (LKAS 7) - "Statement of Cash Flows". Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalent include cash in hand, balances with banks, placements with banks, money at call and short notice.

4.34 Regulatory Provisions

4.34 (a) Deposit Insurance Scheme

In terms of the Banking Act Direction No 5 of 2010 "Insurance of Deposit Liabilities" issued on 27th September 2010 and subsequent amendments there to all Licensed Commercial Banks are required to insure their deposit liabilities in the Deposit Insurance Scheme operated by the Monetary Board in terms of Sri Lanka Deposit Insurance Scheme Regulations No 1 of 2010 issued under Sections 32A to 32E of the Monetary Law Act with effect from 1st October 2010. The said scheme was renamed as the "Sri Lanka Deposit Insurance and Liquidity Support Scheme" as per the Sri Lanka Deposit Insurance and Liquidity Support Scheme Regulation No 1 of 2013. Deposits to be insured include demand, time and savings deposit liabilities and exclude the following:

- deposit liabilities to member institutions
- deposit liabilities to Government of Sri Lanka
- deposit liabilities to Directors, key management personnel and other related parties as defined in Banking Act Direction No 11 of 2007 on Corporate Governance of Licensed Commercial Banks
- deposit liabilities held as collateral against any accommodation granted
- deposit liabilities falling within the meaning of abandoned property in terms of the Banking Act and dormant deposits in terms of the Finance Companies Act funds of which have been transferred to Central Bank of Sri Lanka

Licensed Commercial Banks are required to pay a premium of 0.10% on eligible deposit liabilities if the Bank maintains a capital adequacy ratio of 14% or above as at the end of the immediately preceding financial year and a premium of 0.125% on eligible deposit liabilities for all other Licensed Commercial Banks calculated on the total amount of eligible deposits as at the end of the quarter within a period of 15 days from the end of the quarter.

4.34 (b) Investment Fund Account

As proposed in the budget proposals of 2011 every person or partnership who is in the business of banking or financial services is required to establish and operate an Investment Fund Account.

As and when taxes are paid after 1st January 2011 Licensed Commercial Banks are required to transfer the following funds to the Investment Fund Account and build a permanent fund in the bank.

- 8% of the profits calculated for the payment of Value Added Tax (VAT) on Financial Services on dates as specified in the VAT Act for payment of VAT
- 5% of the profit before tax calculated for payment of income tax purposes on dates specified in Section 113 of the Inland Revenue Act for the self-assessment payments of tax

Licensed Commercial Banks shall utilise the funds in the Investment Fund Account in the following manner.

- Invest in long term government securities and/or bonds with maturities not less than seven years
- Lend on maturities not less than five years at interest rates not exceeding 5 year treasury bond rates plus 2%
- Lend only for the following purposes:
 - i. Long term loans for cultivation of plantation crops / agriculture crops including fruits, vegetables, cocoa and spices and for livestock and fisheries
 - ii. Factory / mills modernisation / establishment / expansion
 - iii. Small and medium enterprises Loans up to Rs 200 Mn to enterprises with annual turnover less than Rs 600 Mn
 - iv. Information technology related activities and business process outsourcing
 - v. Infrastructure development
 - vi. Education – vocational training and tertiary education
 - vii. Housing up to Rs 2 Mn per customer for construction of a house for residential purposes
 - viii. Housing development: construction of low cost houses for residential purposes
 - ix. Construction of hotels and for related purposes
 - x. Investment in / purchase of sustainable energy sources including solar power up to Rs 10 Mn

Notes to the Financial Statements

- xi. Women entrepreneurship venture capital projects up to Rs 10 Mn
- xii. Restructuring of loans extended for the above purposes

Details of investment fund account are given in Note 30 (g).

4.34 (C) Crop Insurance Levy

In terms Section 15 of the Finance Act No 12 of 2013 all institutions under the purview of Banking Act No 30 of 1988, Finance Companies Act No 78 of 1988 and Regulation of Insurance Industry Act No 43 of 2000 are required to pay 1% of the profit after tax as Crop Insurance Levy to the National Insurance Trust Fund Board effective from 01st April 2013.

4.35 Offsetting Income and Expenses

Income and expenses are not offset unless required or permitted by accounting standards.

4.36 Events Occurring after the Reporting Period

Events after the reporting period are those events, favourable and unfavourable, that occur between the reporting date and the date the Financial Statements are authorised for issue.

All material and important events that occurred after the reporting date, including the final dividend declared on Ordinary Shares have been considered and appropriate disclosures are made in Note 63 to the Financial Statements.

5 SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY – HNBA ASSURANCE PLC (HNBA)

As permitted by Sri Lanka Accounting Standard (SLFRS 4) - "Insurance Contracts", HNBA continues to apply the existing accounting policies for Insurance Contracts that were applied prior to the adoption of SLFRS.

5.1 Product Classification

SLFRS 4 requires contracts written by insurers to be classified as either "insurance contracts" or "investment contracts" depending on the level of insurance risk transferred.

Insurance contracts are those contracts where the entity (the insurer) has accepted significant insurance risk from another party (the policyholders) by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, HNBA determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk.

Investment contracts are those contracts that transfer significant financial risk and no significant insurance risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of price or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts can, however, be reclassified as insurance contracts after inception if insurance risk becomes significant.

All the products sold by HNBA are insurance contracts and therefore classified as Insurance contracts under the SLFRS 4 - Insurance Contracts. Thus, HNBA does not have any investment contracts within its product portfolio as at the date of the Statement of Financial Position.

5.2 Deferred Acquisition Costs (DAC)

Those direct and indirect costs incurred during the financial period arising from the writing or renewing of insurance contracts are deferred and amortised over the period in which the related revenues are earned. All other acquisition costs are recognised as an expense when incurred.

The DAC is applicable only to General Insurance Contracts. No DAC is calculated for Life Insurance Contracts as the acquisition costs are incurred in line with the revenues earned.

In line with the available regulatory guidelines from the Insurance Board of Sri Lanka (IBSL), the DAC is calculated based on the 1/24th basis.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the income statement. No such indication of impairment was experienced during the year.

DAC is derecognised when the related contracts are either settled or disposed of.

5.3 Reinsurance

The Subsidiary cedes insurance risk in the normal course of business to recognised reinsurers through formal reinsurance arrangements.

Reinsurance assets include the balances due from reinsurance companies for paid and unpaid losses and loss adjustment expenses. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsurer's policies and are in accordance with the related reinsurance contract.

Reinsurance is recorded gross in the Statement of Financial Position unless a right to offset exists.

Reinsurance assets are reviewed for impairment at each reporting date, or more frequently, when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the entity may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the entity will receive from the reinsurer. The impairment loss, if any is recorded in the Statement of Financial Position.

Ceded reinsurance arrangements do not relieve the entity from its obligations to policyholders.

Reinsurance assets or liabilities are derecognised when the contractual rights are extinguished or expired or when the contract is transferred to another party.

5.4 Premium Receivable

Insurance receivables from Non-Life Insurance are recognised when due and measured on initial recognition at the fair value of the consideration receivable. Collectability of premiums is reviewed on an ongoing basis.

According to the Premium Payment Warranty (PPW) directive issued by the Insurance Board of Sri Lanka (IBSL), all Non-Life insurance policies are issued subject to PPW and are cancelled upon the expiry of 60 days if not settled.

Due Life Insurance premiums (only the premiums due in the 30 day grace period) are recognised at each reporting date and will be reversed if the premiums are not settled during the subsequent month, and thus the policies will be lapsed as per the entity policy.

5.5 Insurance Contract Liabilities

5.5.1 Insurance Provision – Life Insurance

Life insurance liabilities are recognised when contracts are entered into and premiums are charged. These liabilities are measured by using the net premium method as

specified by the Insurance Board of Sri Lanka (IBSL) based on the recommendation of the Independent Consultant Actuary. The liability is determined as the sum of the discounted value of the expected future benefits, less the discounted value of the expected future premiums that would be required to meet the future cash outflows based on the valuation assumptions used. The liability is computed based on IBSL specified guidelines and current assumptions which vary based on the contract type.

Furthermore, adjustments are performed to capture the likely liabilities that may arise due to currently lapsed contracts getting reviving in the future.

As required by the SLFRS 4- Insurance Contracts, the entity performed a Liability Adequacy Test (LAT) in respect of Life Insurance contract liabilities with the assistance of an external actuary. In performing the LAT, current best estimates of future contractual cash flows, including related cash flows such as claims handling and policy administration expenses, policyholder options and guarantees, as well as investment income from assets backing such liabilities, are used.

5.5.2 Insurance Provision – Non-Life Insurance

Non-Life Insurance contract liabilities include the outstanding claims provision including IBNR and IBNER, the provision for unearned premium and the provision for premium deficiency.

The outstanding claims provision is based on the estimated ultimate cost of all claims incurred but not settled at the reporting date, whether reported or not, together with related claims handling costs and reduction for the expected value of salvage and other recoveries. Delays can be experienced in the notification and settlement of certain types of claims, therefore, the ultimate cost of these cannot be known with certainty at the reporting date.

The valuation of Unearned Premium Reserves are measured in accordance with guidelines of the Regulation of Insurance Industry Act, No. 43 of 2000 (i.e. based on the 1/24th basis).

The Incurred But Not Reported (IBNR) and Incurred But Not Enough Reported (IBNER) claims reserve are actuarially computed.

The liability is not discounted for the time value of money. No provision for equalisation or catastrophe reserves is recognised. The liabilities are derecognised when the obligation to pay a claim expires, is discharged or is cancelled.

As required by the SLFRS 4- Insurance Contracts, the entity performed a Liability Adequacy Test (LAT) in respect of General Insurance contract liabilities with the assistance of the external actuary.

Notes to the Financial Statements

5.6 Title Insurance Reserve

Title insurance reserve is maintained by the entity to pay potential claims arising from the title insurance policies. Title insurance policies are normally issued for a long period such as 5 years or more. Thus, no profit is recognised in the first year of the policy given the higher probability of claims occurring in the first two years. From the 2nd year onwards, profit is recognised by amortising the premium received and will be distributed throughout the remaining period of the policy using the straight line method. Profit in the first year will be recognised in the 2nd year and therefore it is periodically recognised.

If the corresponding loan of the Title Insurance Policy issued is settled before the maturity, full premium of such policies remaining as at the date of settlement of such loan is recognised in profits upon confirmation of the same by the respective Bank.

5.7 Revenue Recognition

5.7.1 Insurance Premiums

Life Insurance Business

Gross recurring premiums on life insurance contracts are recognised as revenue when payable by the policyholder (policies within the 30 day grace period are considered as due). Premiums received in advance is not recorded as revenue and recorded as liability until the premium is due unless otherwise the relevant policy conditions require such premiums to be recognised as income. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

For single premium business, revenue is recognised on the date on which the policy is effective.

Non-Life Insurance Business

Gross non-life insurance written premiums comprise the total premiums received /receivable for the whole period of cover provided by contracts entered into during the accounting period. Gross Written Premium is generally recognised is written upon inception of the policy. Upon inception of the contract, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage.

Rebates that form part of the premium rate, such as no-claim rebates, are deducted from the gross premium.

Unearned premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned premiums are calculated on 1/24th basis in accordance with the Regulation of Insurance Industry Act, No. 43 of 2000. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are earned over the period of risk in proportion to the amount of insurance protection provided. The proportion

attributable to subsequent periods is deferred as a provision for unearned premiums which is included under liabilities.

5.7.2 Reinsurance Premiums

Gross reinsurance premiums on insurance contracts are recognised as an expense on the earlier of the date when premiums are payable or when the policy becomes effective. Reinsurance premiums are decided based on rates agreed with reinsurers.

Unearned reinsurance premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts (using 1/24th basis in accordance with the Regulation of Insurance Industry Act, No 43 of 2000).

5.7.3 Fees and Commission Income

Insurance and investment contract policyholders are charged for policy administration services and other contract fees. These fees are recognised as revenue upon receipt or becoming due.

5.8 Benefits, Claims and Expenses

5.8.1 Gross Benefits and Claims

Life Insurance Business

Claims by death and maturity are charged against revenue on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

Expenses on Life Insurance relates to the acquisition expenses and expenses for maintenance of Life Insurance business, investment related expenses not treated as a part of the capital cost of investment, etc which are accounted on accrual basis.

Non-life Insurance Business

Non-life insurance claims include all claims occurring during the year, whether reported or not together with claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of settling claims.

The provision in respect of Claims Incurred But Not Reported (IBNR) and Claims Incurred But Not Enough Reported (IBNER) is actuarially valued to ensure a more realistic estimation of the future liability based on the past experience and trends. Actuarial valuations are performed on a semi-annual basis.

Whilst the Directors of HNBA consider that the provisions for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the Financial Statements for that period.

The methods used to estimate claims and the estimates made are reviewed regularly.

5.8.2 Reinsurance Claims

Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

5.8.3 Net Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and are directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned.

Reinsurance commission is also treated in the same manner within deferred acquisition costs.

5.9 Actuarial Valuation of Life Insurance Fund

The Directors of HNBA agree to the long term insurance provision for the entity at the year-end on the recommendations of the Independent Consultant Actuary following his annual investigation of the Life Insurance business. The actuarial valuation takes into account all liabilities and is based on assumptions recommended by the Independent Consultant Actuary.

5.10 Premium Income (GWP) and Other Sundry Sales Related Taxes

Revenues, expenses and assets are recognised net of the amount of sales taxes and premium taxes except where the premium or sales tax incurred on the purchase of assets or services is not recoverable from the taxation authority, in which case, the sales tax is recognised as a part of the cost of acquisition of the asset or as a part of the expense item, as applicable.

Outstanding net amounts of sales or premium tax recoverable from, or payable to, the taxation authority are included as a part of receivables or payables in the Statement of Financial Position.

6. COMPARATIVE INFORMATION

The comparative information is re-classified wherever necessary to conform with the current year's classification in order to provide a better presentation. The details of such re-classifications have been provided in Note 64.

7 FINANCIAL RISK MANAGEMENT

7.1 Introduction and Overview

The Group has exposure to the following risks from financial instruments:

- Credit Risk
- Liquidity Risk
- Market Risk
- Operational Risk

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital. Since the Bank (ultimate parent) accounts for more than 90% of the total assets, liabilities, income and expenses of the Group, only the Bank's exposure has been discussed under this note.

7.2 Risk Management Framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. In discharging its governance responsibility it operates through two key committees, the Board Integrated Risk Management Committee (BIRMC) and the Audit Committee.

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

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

- Executive Risk Management Committee
- Asset and Liability Committee
- Credit Policy Committee
- Investment Committee
- IT Steering Committee

The Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

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

Notes to the Financial Statements

Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

7.3 Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks and investment in debt/equity securities. For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, industry risk and geographical risk etc.).

For risk management purposes, credit risk arising on trading assets is managed independently and information thereon is disclosed below.

Management of Credit Risk

The Credit Risk Policy plays a central role in managing daily business activities. The Bank has developed a policy which defines the principles encompassing client selection, due diligence, early alert reporting, tolerable levels of concentration risk and portfolio monitoring in line with Bank's risk appetite. The approach is to avoid large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralisation where feasible. The policy is reviewed at least annually and approved by the Board of Directors ensuring consistency with the Bank's business strategy. A monthly Credit Policy Meeting chaired by the Chief Executive Officer, drives policy decisions and implementation plans.

Bank manages credit risk by focusing on following stages.

Loan Origination and Risk Appraisal

The loan origination process comprises initial screening and credit appraisal. The evaluation focuses on the borrower's ability to meet its obligations in a timely manner. Efforts are made to ensure consistent standards are maintained in credit approval. Collateral and guarantees form an important part of the credit risk mitigation process and internal policy dictates margins in Bank's favour by type of security offered, standards for periodic valuations and assessment of realisable value of collateral.

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

Loan Approval and Sanction

The Bank has established clear guidelines for loan approvals / renewals by adopting a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a minimum threshold require an independent risk signatory with no revenue targets in respective committees (process ensures over 85% of loans, excluding cash and gold backed facilities, are approved in this manner).

Credit Administration and Disbursement

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

Credit Measurement and Monitoring

To safeguard the Bank against possible losses, problem loans need to be identified early. The Credit Risk Management Division measures and tracks the status of the credit portfolio, undertakes impact studies and detects early warning signals pointing to deterioration in the financial health of a borrower.

A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assess performance against internal limits (board risk appetite) and regulatory requirements. An internally developed Business Intelligence system ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and bank level. Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.

Recoveries

Problem loans are managed by the Recoveries and Credit Quality Division. This unit is responsible for all aspects of an overdue facility, restructuring of the credit, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalised. This division's activities are seamlessly integrated with Credit Administration and Credit Risk Management to ensure effective follow up and learning transfer.

Back Office recovery functions representing problem loans classification, rescheduling, provisioning and valuation of collateral on delinquent assets is centralised to ensure standardisation and accuracy. The Bank strictly conforms to regulatory requirements in problem loan classification and management.

Regular audits of business units are undertaken by Internal Audit in order to ensure smooth functioning of each of these stages.

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

7.3.1 Loans and Receivables to Other Customers

The Bank classifies loans and receivables to other customers in to individually significant exposures and other loans in to homogenous portfolios by segment / product as required by the Sri Lanka Accounting Standards (LKAS 39) - "Financial Instruments Recognition and Measurement".

As at 31st December	Note	2013 Rs 000	2012 Rs 000
Carrying amount at amortised cost	30	351,976,401	302,760,980
Individually significant impaired loans		8,598,976	5,745,226
Allowance for impairment as at 31st December		(2,027,843)	(1,788,262)
Carrying amount as at 31st December		6,571,133	3,956,964

The above loans are subject to individual credit appraisal and impairment testing. The general creditworthiness of significant customers tends to be the most relevant indicator of credit quality of a loan extended to those parties. However, collateral provides additional security and the Bank generally requests large borrowers to provide same. The Bank may take collateral in the form of a first charge over real estate, floating charges over all corporate assets and other liens and guarantees. As Bank's focus on corporate customers is mainly based on their credit worthiness, business standing and reputation, Bank does not insist on updated valuation of collateral from corporate clients. Such valuations will only be called for from corporate clients only if there is a foreseeable deterioration in credit standing or evidence of possible credit risk. Accordingly, the Bank does not routinely update the valuation of collateral held against all loans to significant customers. For impaired loans, the Bank usually obtains the current market value of the collateral, since it may be an input to the impairment measurement.

As at 31st December	2013 Rs 000	2012 Rs 000
Collateral wise analysis of individually significant impaired loans		
Secured by movable assets	613,262	-
Secured by immovable assets	6,301,561	4,737,306
Secured by cash/shares	387,156	105,922
Other securities	1,228,618	666,778
Clean	68,379	235,220
	8,598,976	5,745,226
Individually significant unimpaired loans		
Watch listed	10,065,509	8,649,790
Others	154,497,725	113,856,075
	164,563,234	122,505,865
Allowance for impairment as at 31st December	(848,937)	(571,281)
Carrying amount as at 31st December	163,714,297	121,934,584
Collateral wise analysis of individually significant unimpaired loans		
Secured by movable assets	12,880,407	1,830,919
Secured by immovable assets	62,283,101	48,240,516
Secured by cash/shares	11,755,343	2,656,310
Other securities	41,302,455	35,625,972
Clean	36,341,928	34,152,148
	164,563,234	122,505,865

The Bank's policy is to pursue timely realisation of the collateral in an orderly manner. The Bank generally does not use non-cash collateral for its own operations.

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

7.3.1 Loans and Receivables to Other Customers (Contd.)

Analysis of Individually significant unimpaired loans based on the number of overdue days is given below.

As at 31st December	2013 Rs 000	2012 Rs 000
Not Past Due	138,778,366	102,638,561
Past Due But Not Impaired		
1-30 days	23,021,293	15,386,099
31-60 days	2,108,926	3,857,878
61-90 days	616,361	592,899
91-120 days	38,288	4
121-150 days	-	29,663
151-180 days	-	761
Above 180 days	-	-
	164,563,234	122,505,865
Other Loans		
Gross carrying amount as at 31st December	189,428,373	182,113,462
Allowance for impairment as at 31st December	(7,737,402)	(5,244,030)
Carrying amount as at 31st December	181,690,971	176,869,432

Analysis of other loans based on the number of overdue days is given below.

As at 31st December	Gross Loans Rs 000	2013 Impairment provision Rs 000	Gross Loans Rs 000	2012 Impairment provision Rs 000
Not Past Due	140,732,370	148,092	142,725,471	125,652
Past Due But Not Impaired				
1-30 days	28,412,423	110,762	25,662,250	94,251
31-60 days	7,519,420	107,804	6,771,650	96,236
61-90 days	4,924,764	783,279	968,162	66,835
91-120 days	431,325	79,468	531,907	91,447
121-150 days	420,165	205,809	397,392	158,801
151-180 days	779,593	144,262	527,119	81,297
Past Due and Impaired				
Above 180 days	6,208,313	6,157,926	4,529,511	4,529,511
	189,428,373	7,737,402	182,113,462	5,244,030

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

7.3.1 Loans and Receivables to Other Customers (Contd.)

Allowances for Impairment

The Bank established an allowance for impairment losses on assets carried at amortised cost/available for sale that represents its estimate of incurred losses in its loan and investment debt/equity security portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures and for assets measured at amortised cost, a collective loan loss allowance established for groups of homogeneous assets as well as for individually significant exposures that were subject to individual assessment for impairment but not found to be individually impaired. Assets carried at fair value through profit or loss are not subject to impairment testing as the measure of fair value reflects the credit quality of each asset.

The Bank regards a loan and advance or a debt security (individually significant) as impaired where there is objective evidence that a loss event has occurred since initial recognition and such loss event has an impact on future estimated cash flows from the asset. In addition, other loans are considered impaired if they are overdue for 180 days or more.

Movement of the impairment provision during the year is given in Note 30 (e) and 30 (f) to the financial statements.

Past Due but Not Impaired Loans

Past due but not impaired loans are those for which contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Bank.

Rescheduled Loans

Rescheduled loans are loans that have been restructured due to deterioration in the borrower's financial position, where the Bank has made concessions by agreeing to terms and conditions that are more favourable for the borrower than the Bank has provided initially. The Bank implements forbearance policy in order to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis in situation where the debtor is currently in default on its debt, or where there is a high risk of default, there is evidence that the debtor made all the reasonable effort to pay under the original contractual terms and it is expected to be able to meet the revised terms. The revised terms usually include extending maturity, changing timing of interest payments and amendments to the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring. At the time of restructuring the loan, the Bank determines the fair value of the loan and carrying value is brought down to reflect the fair value charging the difference, if any to the Income Statement under Impairment for Loans and Other Losses.

During the year ended 31st December 2013, the Bank restructured loans and advances with a carrying value of Rs 1,184.674 Mn (2012 - Rs 1,162.835 Mn) and recognised an impairment of Rs 82.001 Mn (2012 - Rs 46.199 Mn) in the Income Statement.

The Board Audit Committee regularly reviews reports on forbearance activities.

Write-off Policy

The Bank writes off a loan or an investment in debt / equity security balance and any related allowances for impairment losses, when it determines that the loan or security is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's/issuer's financial position such that the borrower / issuer can no longer pay the obligation or that proceeds from collateral will not be sufficient to pay back the entire exposure. For standardised loans with smaller balances, write-off decisions generally are based on a product-specific past due status.

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

7.3.1 Loans and Receivables to Other Customers (Contd.)

Concentrations of Credit Risk

The Bank monitors concentration of credit risk by sector and by geographic location. An analysis of concentration of credit risk from loans and advances as at the reporting date is shown below.

As at 31st December	2013		2012	
	Rs 000	%	Rs 000	%
Concentration by sector				
Agriculture and fishing*	31,534,965	8.70	31,306,579	10.09
Manufacturing	54,303,345	14.98	38,851,459	12.51
Tourism	21,388,931	5.90	18,731,165	6.04
Transport	10,016,784	2.76	5,034,068	1.61
Construction	51,732,475	14.27	40,234,886	12.96
Traders	66,970,995	18.47	49,636,247	15.99
New economy	4,476,372	1.23	4,675,435	1.51
Financial and business services	32,519,017	8.97	23,051,027	7.43
Infrastructure	16,737,440	4.62	8,923,369	2.88
Other services	20,278,085	5.58	23,469,029	7.56
Credit card	3,428,037	0.95	2,778,069	0.90
Pawning	46,234,919	12.75	48,447,062	15.61
Other	2,969,218	0.82	15,226,158	4.91
	362,590,583	100.00	310,364,553	100.00

*Agriculture and fishing for 2012 includes pawning advances amounting to Rs 813.208 Mn.

The Bank's total exposure to pawning advances amounted to Rs 46.235 Bn as at 31st December 2013 (2012 : Rs 49.260 Bn) and the Bank had recognised an impairment provision of Rs 878.207 Mn considering the decline in gold prices. Sensitivity of the impairment provision to the possible fluctuations in gold price is given below.

Gold Price	Impairment Provision (Rs 000)
Actual as at 31st December 2013	878,207
10 % decline	1,210,200
15% decline	1,398,625
20% decline	1,672,875

Consequent to the decline in gold prices in 2013, the Bank took a strategic decision to cut down the amounts advanced against gold with effect from the second quarter of 2013. Since then, significant amount of pawning advances which had been granted at higher scales were shifted to lower scales by way of part settlement of capital and interest, thus reducing the credit risk faced by the Bank.

As at 31st December	2013		2012	
	Rs 000	%	Rs 000	%
Concentration by location				
Western	228,213,578	62.94	184,309,968	59.38
Southern	17,887,161	4.93	15,682,399	5.05
Uva	6,920,048	1.91	5,914,993	1.91
North Central	20,877,513	5.76	19,480,894	6.28
North Western	29,113,603	8.03	26,432,272	8.51
Eastern	10,325,024	2.85	9,888,377	3.19
Northern	15,380,716	4.24	15,353,576	4.95
Sabaragamuwa	7,384,986	2.04	6,793,832	2.19
Central	22,186,182	6.12	21,019,248	6.77
Overseas	4,301,772	1.18	5,488,994	1.77
	362,590,583	100.00	310,364,553	100.00

Concentration by location for loans and advances is measured based on the location of the customer centre granted that facility, which has a high correlation with the location of the borrower except for loans granted by the Foreign Currency Banking Unit (FCBU).

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

7.3.1 Loans and Receivables to Other Customers (Contd.)

Exposure to Maldives

Bank has granted Rs 4.023 Bn to Maldives based projects as at 31st December 2013 (2012 : 5.093 Bn) . All these loans have been considered as significant loans and analysed individually. When the Bank has identified objective evidence of impairment of these loans, future cash flows have been estimated giving due consideration for specific industry, country risk factors etc. and availability of collateral. Analysis of the gross and net carrying values of the loans granted to Maldivian projects is given below.

As at 31st December	2013 Rs 000	2012 Rs 000
Gross carrying value as at 31st December	4,023,274	5,092,950
Provision for impairment	(173,480)	(475,712)
Net carrying value as at 31st December	3,849,794	4,617,238

Total unutilised overdrafts approved to above customers as at 31st December 2013 amounts to Rs 784.650 Mn (2012 : Rs 765.900 Mn).

As at 31st December	Note	2013 Rs 000	2012 Rs 000
7.3.2 Loans and Receivables to Banks	29		
Reverse repurchase agreements		6,267,809	-
		6,267,809	-

Loans and receivables to banks represent reverse repurchase agreements outstanding as at 31st December 2013 with the Central Bank of Sri Lanka amounting to Rs 5,901.054 Mn , Pan Asia Banking Corporation PLC amounting to Rs 175.032 Mn and Nations Trust Bank amounting to Rs 191.723 Mn.

As at 31st December	Note	2013 Rs 000	2012 Rs 000
7.3.3 Financial Investments	31 & 33	96,495,622	78,326,025
Investment in debt securities at amortised cost			
AA-		526,358	926,932
A+		-	18,000
A		570,347	389,778
A-		922,602	686,000
BBB+		99,089	-
BBB		29,271	-
Unrated		489,000	489,000
		2,636,667	2,509,710
Investment in local/foreign government securities at amortised cost			
Sri Lanka Development Bonds [Note 33 (a)]		30,467,869	17,520,959
		30,467,869	17,520,959
Investments in equity securities at Available for Sale			
Local			
AA		-	4,251,708
AA -		4,882,593	-
Unrated		241,455	225,456
International			
A +		611,773	406,488
A -		33,664	19,322
		5,769,485	4,902,974
Investments in government securities - Available-for-Sale			
Government of Sri Lanka Treasury Bills [Note 31 (e)]		39,016,018	47,804,967
Government of Sri Lanka Treasury Bonds [Note 31 (d)]		18,605,583	5,587,415
		57,621,601	53,392,382

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

As at 31st December		Note	2013 Rs 000	2012 Rs 000
7.3.4 Other Financial Assets Held for Trading		27		
Equity securities			303,992	452,847
Government securities			348,320	21,236
			652,312	474,083

Analysis of equity securities held for trading based on external risk ratings is given below.

As at 31st December	Cost	2013 Market Value	%	Cost	2012 Market Value	%
	Rs 000	Rs 000		Rs 000	Rs 000	
AAA	19,815	20,492	7	146,247	147,643	32
AA	-	-	-	104,496	76,833	17
AA-	132,486	107,397	35	62,084	49,508	11
A+	-	-	-	17,494	16,701	4
A	19,833	21,571	7	34,754	25,654	6
BBB+	13,807	11,700	4	7,060	6,531	1
Unrated	169,278	142,832	47	187,875	129,977	29
	355,219	303,992	100	560,010	452,847	100

Risk ratings are based on the external ratings as published by the Fitch Ratings Lanka Ltd and RAM Ratings Lanka (Pvt) Limited.

Sector wise analysis of the equity securities held for trading is given below.

As at 31st December	Cost	2013 Market Value	%	Cost	2012 Market Value	%
	Rs 000	Rs 000		Rs 000	Rs 000	
Banks, Finance and Insurance	152,447	142,829	47	132,300	116,502	26
Beverage, Food and Tobacco	18,714	19,304	6	63,805	50,572	11
Diversified Holdings	103,410	74,982	25	208,659	183,714	40
Hotels and Travels	31,666	28,747	9	-	-	-
Manufacturing	-	-	-	79,938	55,427	12
Motors	26,825	26,539	9	-	-	-
Oil and Palms	-	-	-	39,755	25,789	6
Power and Energy	22,157	11,591	4	35,553	20,843	5
	355,219	303,992	100	560,010	452,847	100

Total investment in securities issued by Government of Sri Lanka

As at 31st December	2013 Rs 000	2012 Rs 000
Loans and receivables (at amortised cost)	30,467,869	17,520,959
Fair value through profit or loss	348,320	21,236
Available-for-sale	57,621,601	53,392,382
	88,437,790	70,934,577
Government securities as a % of total trading assets and financial investments	91.0	90.0

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.3 Credit Risk (Contd.)

7.3.5 Derivative Assets / Liabilities Held for Risk Management

The Bank holds derivative assets / liabilities (Forward exchange contracts and Swaps) for risk management purposes. An analysis of the credit quality of such derivative assets / liabilities, based on rating agency's ratings where applicable, is as follows:

As at 31st December	Note	2013 Rs 000	2012 Rs 000
Derivative assets held for risk management purposes	26	174,573	344,552
Derivative liabilities held for risk management purposes	42	(748,962)	(1,436,443)
		(574,389)	(1,091,891)
Analysis of derivative assets/liabilities based on external risk ratings of the counterparts			
AAA		(118,338)	(676,018)
AA+		-	4,317
AA		(30,285)	(512,398)
AA-		(50,626)	1,202
A+		19,982	(21)
A		1,550	66,272
A-		-	26,985
BBB+		(641)	4,620
BBB-		21,642	40,000
BB+		2,747	(25)
unrated *		(420,420)	(46,825)
		(574,389)	(1,091,891)

*Unrated includes derivatives with the Central Bank of Sri Lanka, unrated international banks / financial institutions, unrated local banks, individuals and corporates.

Analysis of derivative assets/liabilities by counterparts / products is given below:

As at 31st December	2013 Rs 000	2012 Rs 000
Banks and financial institutions		
Local		
Forward Exchange Contracts	27,287	6,642
Swaps	(627,091)	(1,201,834)
International		
Forward Exchange Contracts	1,964	44
Swaps	29,675	112,239
Others (Individuals and corporates)	(6,224)	(8,982)
	(574,389)	(1,091,891)

7.3.6 Cash and Cash Equivalents / Placements with Banks

The Bank held cash and cash equivalents / placements with banks amounting to Rs 12.871 Bn as at 31 December 2013 (2012 : Rs 19.091 Bn) which represents its maximum credit exposure on these assets. The cash and cash equivalents consisted of cash on hand amounting to Rs 10.835 Bn (2012 : Rs 8.368 Bn), placements with banks and financial institutions which are rated AA- to AAA based on rating agency's ratings amounting to Rs 1.316 Bn (Rs 10.184 Bn) and placements with other local / foreign banks and financial institutions amounting to Rs 0.720 Bn (2012 : Rs 0.539 Bn)

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.4 Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its debt obligations associated with its financial liabilities due to lack of funds or having to meet these obligations at excessive cost.

7.4.1 Management of Liquidity Risk

The Bank manages liquidity risk in accordance with regulatory guidelines and international best practices. The objective of the Bank's liquidity and funding framework is to ensure that funding commitments and deposit withdrawals can be met when due and that market access remains cost effective. A Board approved liquidity policy to manage liquidity on a day-to-day basis and a contingency funding plan to deal with crisis situations are in place. Contractual maturity of assets and liabilities, key liquidity ratios and monthly liquidity forecasts and gaps are reviewed at ALCO meetings. The main sources of the Bank's funding are capital, core deposits from retail and commercial clients, wholesale deposits and access to borrowed funds from the interbank money market. The Bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position. Bank's lending portfolio is financed to a great extent by retail deposits and reliance on wholesale deposits and interbank market is low. Liquidity risk exposure is managed by Treasury with limits and triggers set to ensure that sufficient liquidity surplus and reserves are available to meet daily business requirements and also to deal with a sudden liquidity shock. Treasury reports the Bank's overall liquidity position to management on a daily basis.

Exposure to Liquidity Risk

The Bank monitors the following liquidity ratios to assess funding requirements.

	2013 %	2012 %
Net loans / Total assets	68.97	67.83
Gross Loans / Customer deposits	94.09	90.90
Liquid Asset Ratio (LAR)		
As at 31st December	23.32	22.38
Average for the year	23.30	21.90
Maximum for the year	24.70	23.28
Minimum for the year	21.80	20.79

Components of the Bank's liquid assets portfolio used for the purpose of Statutory Liquid Asset Ratio calculation as at 31st December 2013 (Average balance for the month of December) is given below.

As at 31st December	2013 Rs 000	2012 Rs 000
Cash	9,093,209	7,395,013
Balances with licensed commercial banks	1,239,207	5,411,084
Money at call in Sri Lanka	1,300,806	3,759,129
Treasury bills and securities issued or guaranteed by the Government of Sri Lanka which have a maturity not exceeding one year	85,963,162	66,852,073
Import bills	174,486	316,716
Export bills	920,976	527,145
Cash items in the process of collection	606,006	509,522
Balances with the banks abroad	1,201,810	1,271,500
Total average liquid assets for the month of December	100,499,662	86,042,182

Monthly liquidity gap is reported to ALCO by Treasury for each currency together with the overall gap position. Liquidity gap is based on the expected realisation of the assets and liabilities which have been determined based on historical behaviour. Net liquidity position reported for the month is monitored against the pre set limits which have been approved by the ALCO.

The Bank also monitors the maturity profile of its assets and liabilities based on contractual maturities. Maturity analysis of assets and liabilities which is based on the remaining period as at the reporting date to the respective contractual maturity date is given in Note 60 to the financial statements.

The Bank also holds debt / equity securities which are not considered as liquid assets but for which there is an active and liquid market. These assets can be readily sold to meet any unexpected liquidity requirements. Detailed analysis of the debt / equity securities held by the Bank as at 31st December 2013 is presented under credit risk. No assets have been pledged as collateral for borrowings other than treasury bills / bonds which are pledged against repurchase transactions. Details of treasury bills and bonds pledged as collateral against repurchase transactions are disclosed under Note 31 (k) to the financial statements.

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.5 Market Risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of the Bank's market risk management is to manage and control market risk exposures within acceptable parameters in order to ensure the Bank's solvency while optimising the return on risk.

7.5.1 Management of Market Risk

The Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolio includes financial assets and liabilities that are managed on a fair value basis. All foreign exchange positions within the Bank are treated as part of the Bank's trading portfolios for risk management purposes. Non trading portfolio is managed in accordance with the purpose and strategic benefits of such investments, rather than purely on fair value basis.

The Bank has a Board approved market risk management policy. Treasury Middle Office monitors the Bank's compliance with the above policy and ensures that the Bank's market risk limits are in line with the level of risk acceptable to the Board. The Bank employs a range of tools to monitor and limit market risk exposures which are discussed below.

7.5.2 Exposure to Market Risk

The principal tool used to measure and control market risk exposure within the Bank is value at risk (VaR). The VaR of a portfolio is the estimated loss that will arise on the portfolio over a specified period of time (holding period) from an adverse market movement with a specified probability (confidence level). The VaR model used by the Bank is based upon a 99 percent confidence level and assumes a 10-day holding period. The VaR model used is based mainly on historical simulation. Taking account of market data from the previous two years, and observed relationships between different markets and prices, the model generates a wide range of plausible future scenarios for market price movements.

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based give rise to some limitations, including the following:

- A 10-day holding period assumes that it is possible to hedge or dispose of positions within that period. This may not be the case for illiquid assets or in situations in which there is severe general market illiquidity.
- A 99 percent confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a one percent probability that losses could exceed the VaR.
- VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the trading day.
- The use of historical data as a basis for determining the possible range of future outcomes may not always cover all possible scenarios, especially those of an exceptional nature.
- The VaR measure is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position reduces if market price volatility declines and vice versa.

The Bank uses VaR limits for foreign exchange and equity risks. The overall structure of VaR limits is subject to review and approval by ALCO. VaR limits are allocated to portfolios. VaR is measured at least monthly and reported to ALCO.

The Bank's VaR models are subject to regular validation by TMO to ensure that they continue to perform as expected, and that assumptions used in model development are still appropriate.

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.5 Market Risk (Contd.)

7.5.2 Exposure to Market Risk (Contd.)

A summary of the VaR position of the Bank as at 31 December and during the period is as follows:

	As at 31st December Rs 000	Average Rs 000	Maximum Rs 000	Minimum Rs 000
2013				
Foreign currency risk (USD NOP)*	1,574	3,378	5,449	207
Equity Risk	15,778	26,799	39,275	15,778
2012				
Foreign currency risk (USD NOP)*	4,269	6,748	18,399	458
Equity Risk	39,864	30,451	39,864	17,450

* Only USD exposure has been considered as it represents over 90% of the foreign currency transactions.

The limitations of the VaR methodology are recognised by supplementing VaR limits with other risk measures. The Bank uses a wide range of stress tests to model the financial impact of a variety of exceptional market scenarios such as changes in exchange rates, interest rates and prices of financial instruments such as equities and bonds. The results of the stress tests are reviewed by ALCO.

7.5.3 Exposure to Interest Rate Risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. The Bank manages the interest rate risk against interest rate gap limits which is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various rate scenarios. Net interest yields are also calculated for each product to ensure adequate margins are kept.

The Bank holds treasury bills and bonds with shorter maturities, thus the impact of interest rate changes on treasury bill/bond prices are very minimal. Modified duration of both the trading and non trading portfolios as at 31st December 2013 is given below.

As at 31st December	2013	2012
Trading	0.7825	0.6509
Non Trading	0.9793	0.7317

Modified duration follows the concept that the interest rates and bond prices move in opposite directions. This determines the effect that a 100 basis point (1%) change in interest rates will have on the price of a bond.

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates assuming a constant financial position (as at 31st December 2013) is as follows:

	Decrease of 100 bps Rs 000	Decrease of 200 bps Rs 000	Increase of 100 bps Rs 000	Increase of 200 bps Rs 000
Effect on Net Interest Income for the year ended 31st December 2014 based on the portfolio as at 31st December 2013	(414,801)	(829,590)	415,121	830,250

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.6 Operational Risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's involvement with financial instruments, including processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Bank's standards for the management of operational risk in the following areas:

- Requirements for appropriate segregation of duties including the independent authorisation of transactions
- Requirements for the reconciliation and monitoring of transactions
- Compliance with regulatory and other legal requirements
- Documentation of controls and procedures
- Requirements for the periodic assessment of operational risks faced and the adequacy of controls and procedures to address the risks identified
- Requirements for the reporting of operational losses and proposed remedial action
- Development of contingency plans
- Training and professional development
- Ethical and business standards and
- Risk mitigation including insurance where this is effective

Compliance with Bank's standards is supported by a program of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank.

Provisions made by the Bank for operational losses for the last five years are given below along with the subsequent recoveries made out of such provisions.

For the year ended 31st December	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000	2013 Rs 000
Provisions made for operational losses	60,083	43,169	10,973	8,777	243,214
Operational losses recovered	-	7,024	18,360	4,006	15,271

7.7 Capital Management

The Bank's capital management objectives can be summarised as follows:

- Maintain sufficient capital to meet minimum regulatory capital requirements
- Hold sufficient capital to support the Bank's risk appetite
- Allocate capital to businesses to support the Bank's strategic objectives
- Ensure that the Bank maintains capital in order to achieve debt rating objectives and to withstand the impact of potential stress events

Regulatory Capital

The Bank manages its capital considering regulatory capital requirements. The Central Bank of Sri Lanka (CBSL) sets and monitors capital requirements for licensed banks in Sri Lanka based on the Basel Framework. Thus the Bank's operations are directly supervised by the CBSL and the Bank is required to comply with the provisions of the Basel II framework in respect of regulatory capital. Commercial banks in Sri Lanka need to maintain a minimum Capital Adequacy Ratio (CAR) of 10% and a Core Capital Ratio (Tier 1) of at least 5% .

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.7 Capital Management (Contd.)

7.7.1 Capital Adequacy

The primary objective of the Capital Adequacy Ratio (CAR) defined under Basel II is to protect a bank's depositors, whilst maintaining confidence and giving stability to the world banking system. The regulators attempt to accomplish this by setting the minimum capital reserves a bank needs to hold in relation to the risk the bank exposes itself through its business activities. Keeping in line with international standards, the Central Bank of Sri Lanka has supported these regulatory reforms by enhancing them in accordance with local funding and liquidity requirements.

The Bank computes CAR as a ratio of its capital to its risk weighted assets. Calculations of the risk weightings defined under credit risk and market risk are based on the standardized approach whereas operational risk is computed by using the basic indicator approach. As the Basel II guidelines are phased in and more sophisticated risk measurement systems and models are implemented, banks will be in a position to move from the standardized methods to the more refined and robust requirements of the advanced approaches.

As of 31st December 2013, the Bank reported a Tier 1 ratio of 12.95% and a total CAR of 16.52% which remain comfortably above the CBSL's capital requirements.

In arriving at the above ratios, the Bank has used profits as per SLFRSs for the purpose of Tier 1 Capital and gross income as per SLFRSs for the purpose of computing operational risk. However all other balances are as per the accounting standards existed prior to 1st January 2012 (Previous GAAP - SLAS) including the risk weighted assets.

The Bank's policy is to maintain a strong capital base so as to ensure investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank manages its capital structure and adjusts it accordingly in line with changes in global and local economic and market conditions and its overall risk appetite. In order to maintain or increase capital, the Bank may issue Tier 1 or Tier 2 securities, change the dividend payment to shareholders or obtain international funding. Accordingly the Bank in 2013 issued Rs 4 Bn debentures.

As at 31st December	2013 Rs Mn	2012 Rs Mn
CAPITAL BASE		
TIER 1		
Voting ordinary shares	10,255	10,049
Non-Voting ordinary shares	2,575	2,530
Statutory reserve fund	2,660	2,230
Published retained earnings (Note 1)	5,174	5,077
General and other reserves	23,201	20,101
Less: Deductions from Tier 1 capital (Note 2)	(2,094)	(2,322)
Eligible Tier 1 Capital	41,771	37,665
TIER II		
50% of approved asset revaluation reserves (Note 3)	1,029	1,029
General provision for loan losses	1,440	1,169
Approved subordinated term debt	11,128	7,208
Tier II Capital	13,597	9,406
Less: Deductions from Tier II capital (Note 2)	(2,094)	(1,846)
Eligible Tier II capital	11,503	7,560
Capital Base	53,274	45,225
Risk Adjusted capital ratios		
Tier 1 (Eligible Tier 1 capital / Total risk adjusted balance) *	12.95	13.85
Total (Capital base / Total risk adjusted balance) **	16.52	16.63

* Statutory minimum 5%

** Statutory minimum 10%

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.7 Capital Management (Contd)

7.7.1 Capital Adequacy (Contd.)

Risk adjusted on - Balance Sheet Exposure

As at 31st December	Balance		Risk Weights %	Risk Adjusted Balance	
	2013 Rs Mn	2012 Rs Mn		2013 Rs Mn	2012 Rs Mn
Exposures					
- To Central Government and CBSL	123,065	95,015	0	-	-
- To banks / foreign sovereigns	2,209	11,064	20 - 150	548	2,511
- To financial institutions	8,498	9,760	20 - 150	4,450	5,513
- To corporates	101,667	79,796	20 - 150	89,916	72,318
- To retail sector (excluding claims secured by residential properties)	124,051	106,175	75 - 100	96,818	81,131
- Secured on residential property mortgages	27,782	25,491	50 - 100	18,093	17,329
- Non performing advances	7,089	6,775	50 - 150	7,560	7,246
- Other exposures	552	1,130	20 - 150	552	1,130
- Cash and cash items in the process of collection	13,097	11,523	0 - 20	592	631
- Other assets	22,228	20,406	100	22,228	20,406
Asset base for risk weight	430,238	367,135		240,757	208,215

Risk adjusted off - Balance Sheet Exposure

As at 31st December	Amount of Off-Balance Sheet Items 2013 Rs Mn	Credit Conversion Factor %	Credit Equivalent Amount 2013 Rs Mn	Risk Weights %	Risk Adjusted Balance	
					2013 Rs Mn	2012 Rs Mn
Financial guarantees, bank acceptances and other guarantees	21,330	100	21,330	0 -100	16,875	13,319
Performance related guarantees and warranties and stand by LCs related to particular transactions	25,485	50	12,742	0 -100	11,849	9,334
Shipping guarantees, documentary letter of credit and trade related acceptances	22,415	20	4,483	0 -100	4,438	4,422
Other commitments with an original maturity of < 1 year	50,212	0 - 20	-	0 -100	-	-
> 1 year	15,421	50	7,711	0 -100	7,711	-
Foreign exchange contracts	97,297	2	1,946	0 -100	1,946	2,089
Total off-balance sheet exposures	232,160		48,212		42,819	29,164

Notes to the Financial Statements

7 FINANCIAL RISK MANAGEMENT (CONTD.)

7.7 Capital Management (Contd)

7.7.2 Capital Adequacy (Contd.)

Capital Charge for Market Risk

As at 31st December	Capital charge		Risk Adjusted Balance	
	2013 Rs Mn	2012 Rs Mn	2013 Rs Mn	2012 Rs Mn
Interest rate	0.1	0.3	1	3
Equity	32.1	61.2	321	612
Foreign exchange and gold	99.2	40.7	992	407
Total risk adjusted balance for market risk	131.4	102.2	1,314	1,022

Capital Charge for Operational Risk

As at 31st December	Capital charge	
	2013 Rs Mn	2012 Rs Mn
Average gross income (Note 4)	25,060.6	22,376.4
15% of average gross income	3,759.1	3,356.5
Total capital charge for operational risk	3,759.1	3,356.5

As at 31st December	2013 Rs Mn	2012 Rs Mn
Total risk adjusted balance for operational risk	37,591	33,565
Total risk adjusted balances (credit risk, market risk, operational risk)	322,481	271,966

NOTES:

- In computing the CAR for 2013, profits for the year was computed based on SLFRS.
- Deductions

As at 31st December	Tier I		Tier II	
	2013 Rs Mn	2012 Rs Mn	2013 Rs Mn	2012 Rs Mn
Additional investment in Sithma Development (Pvt) Ltd.	450	450	450	450
Employee share option plan	-	476	-	-
Others	1,644	1,396	1,644	1,396
Total deductions	2,094	2,322	2,094	1,846

- Revaluation reserves approved by CBSL is Rs 2,058 Mn.
- In computing the CAR for 2013, capital charge for operational risk was computed based on SLFRS.

8 USE OF ESTIMATES AND JUDGEMENTS

8.1 Fair Value Measurement

The determination of fair value for financial assets and financial liabilities for which there is no observable market price requires the use of valuation techniques as described in Note 4.5.4. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. The Group's accounting policy on fair value measurements is discussed in Note 4.5.4. The Group 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 identical instrument.

Level 2: Valuation techniques based on observable inputs, either directly (i.e. 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 than 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.

The Group uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like government securities, interest rate and currency swaps that use mostly 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, government securities and simple over the counter derivatives like forward exchange contracts and interest rate swaps. 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.

Management judgements and estimations 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.

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level of the fair value hierarchy.

	Note	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Rs 000
31st December 2013					
Financial Assets					
Derivative financial instruments	26				
Currency swaps		-	39,058	-	39,058
Forward foreign exchange contracts		-	135,515	-	135,515
			174,573		174,573
Other financial assets held for trading	27				
Quoted shares		303,992	-	-	303,992
Government of Sri Lanka treasury bills and bonds		-	348,320	-	348,320
		303,992	348,320	-	652,312
Financial Investments available for sale	31				
Quoted shares and units		5,727,530	-	-	5,727,530
Unquoted shares		-	-	41,955	41,955
Government of Sri Lanka treasury bills and bonds		-	57,621,600	-	57,621,600
		5,727,530	57,621,600	41,955	63,391,086
Financial Liabilities					
Derivative financial instruments	42				
Currency swaps		-	636,475	-	636,475
Forward foreign exchange contracts		-	112,487	-	112,487
			748,962		748,962

Notes to the Financial Statements

8 USE OF ESTIMATES AND JUDGEMENTS (CONTD.)

	Note	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Rs 000
31st December 2012					
Financial Assets					
Derivative financial instruments	26	-	151,188	-	151,188
Currency swaps		-	193,364	-	193,364
Forward foreign exchange contracts		-	344,552	-	344,552
Other financial assets held for trading	27				
Quoted shares		452,847	-	-	452,847
Government of Sri Lanka treasury bills and bonds		-	21,236	-	21,236
		452,847	21,236	-	474,083
Financial investments available for sale	31				
Quoted shares and units		4,875,518	-	-	4,875,518
Unquoted shares		-	-	27,456	27,456
Government of Sri Lanka treasury bills and bonds		-	53,392,382	-	53,392,382
		4,875,518	53,392,382	27,456	58,295,356
Financial Liabilities					
Derivative financial instruments	42	-	1,240,783	-	1,240,783
Currency swaps		-	195,660	-	195,660
Forward foreign exchange contracts		-	1,436,443	-	1,436,443

There were no transfers between Level 1, Level 2 and Level 3 during 2013 and 2012.

Movement of the financial assets Available-for-sale, classified as "Level 3" in the fair value hierarchy

	2013 Rs 000	2012 Rs 000
Balance as at 01st January	27,456	207,456
Investments made during the year	16,550	-
Redemptions during the year	-	(180,000)
Impairment charge for the year	(2,051)	-
Balance as at 31st December	41,955	27,456

Investments made during the year ended 31st December 2013 include the investment in unquoted shares of Ram Ratings Lanka Ltd.

Investments made in rated cumulative redeemable preference shares of Dialog Axiata PLC were redeemed during the year ended 31st December 2012.

Directors carried out an impairment assessment of the unquoted share investments held by the Bank and concluded that an impairment provision of Rs 2.501 Mn be made against the investment in S.W.I.F.T.

8.2 Fair Value of Financial Instruments Carried at Amortised Cost

The following table summarises the carrying amounts and the Bank's estimate of fair values of those financial assets and liabilities not presented on the Bank's Statement of Financial Position at fair value. The fair values in the table below may be different from the actual amounts that will be received / paid on the settlement or maturity of the financial instrument. For certain instruments, the fair value may be determined using assumptions which are not observable in the market.

As at 31st December	2013	
	Carrying amount Rs 000	Fair value Rs 000
Assets		
Cash and cash equivalents	11,624,645	11,624,645
Balances with central banks	16,366,368	16,366,368
Placements with banks	1,246,611	1,246,611
Loans and receivables to banks	6,267,809	6,267,809
Loans and receivables to other customers	351,976,401	351,928,856
Financial Investments - Loans and receivables	33,104,536	33,104,536

8 USE OF ESTIMATES AND JUDGEMENTS (CONTD.)

8.2 Fair Value of Financial Instruments Carried at Amortised Cost (Contd.)

As at 31st December	2013	
	Carrying amount Rs 000	Fair value Rs 000
Liabilities		
Due to banks	34,934,217	34,934,217
Due to other customers	385,360,970	385,360,970
Other borrowings	8,663,102	8,663,102
Debt securities issued	1,418,775	1,418,775
Subordinated term debts	11,856,560	12,346,979

Given below is the basis adopted by the Bank in order to establish the fair values of the financial instruments which are shown above.

Cash and cash equivalents, balances with central banks and placements with banks

The carrying amounts of cash and cash equivalents, balances with central banks and placements with banks approximate their fair value as those are short term in nature. These balances have a remaining maturity of less than three months from the reporting date.

Loans and receivables to banks

Loans and receivables to banks represent reverse repurchase agreements with other banks. These are short term reverse repurchase contracts which will be matured within three months from the reporting date and thus the carrying amounts of such contracts approximate to their fair values.

Loans and receivables to other customers

Approximately 50% of the total portfolio of loans and receivables to other customers have a remaining contractual maturity of less than one year.

The fair value of loans and receivables to other customers with a residual maturity of less than one year generally approximates the carrying value, subject to any significant movement in credit spreads.

The estimated fair value of loans and receivables with a residual maturity of more than one year is the present value of future cash flows expected to be received from such loans and receivables calculated based on interest rates at the reporting date for similar types of loans and receivables. Such loans include both fixed and floating rate loans. Majority of the floating rate loans can be re priced either quarterly or semi annually while for fixed rate loans, the loan contract allows the Bank to change the contracted rate if there is a material difference between the contracted rate and the market interest rate.

The Bank calculated the fair value of the housing loan portfolio with a fixed interest rate and that will have a maturity of more than 12 months from the reporting date. Fair value of such loans as at 31st December 2013 was Rs 18.064 Bn as against its carrying value which amounted to Rs 18.112 Bn.

Based on the results of the housing loan portfolio, it is assumed that fair value of the other loans with a maturity of more than one year is not materially different to its carrying value as at the reporting date.

Financial investments - Loans and receivables

Financial investments - Loans and receivables include investments in Sri Lanka Development Bonds, unquoted debentures and securitised notes.

Sri Lanka Development Bonds are variable rate instruments issued by the Government where repricing happens semi annually. Thus the carrying value of these bonds approximate to their fair value as at the reporting date.

The Bank estimates the fair value for unlisted debentures and notes by using other valuation techniques that are commonly used by market participants.

Due to banks

Approximately 50% of the amounts due to other banks as at the reporting date have a remaining contractual maturity of less than one year. Majority of the balance amount comprised of floating rate instruments where interest is reset either quarterly or semi annually. Therefore, fair value of amounts due to banks approximate to the carrying value as at the reporting date.

Notes to the Financial Statements

8 USE OF ESTIMATES AND JUDGEMENTS (CONTD.)

8.2 Fair Value of Financial Instruments Carried at Amortised Cost (Contd.)

Due to other customers

More than 95% of the customer deposits are either repayable on demand or have a remaining contractual maturity of less than one year. Customer deposits with a contractual maturity of more than one year are subject to pre mature upliftment. Amounts paid to customers in the event of pre mature upliftment would not be materially different to its carrying value as at date. Therefore fair value of customer deposits approximates to their carrying value as at the reporting date.

Other borrowings

Other borrowings mainly consist of securities sold under repurchase agreements which have a remaining contractual maturity of less than three months. The balance consists of floating rate loans where interest repricing happens semi annually. Accordingly, carrying value of these borrowings would not be materially different to their fair values as at the reporting date.

Debt securities issued

Debt securities issued represent the senior listed unsecured redeemable 10 year debenture issued by the Bank on 30th August 2013. This is a fixed rate instrument and contracted rate at the time of issuing the debenture is not materially different to the market interest rate as at 31st December 2013. Thus the carrying value of this security is a close approximation of the fair value as at the reporting date.

Subordinated term debts

Subordinated term debts include fixed and variable rate debentures and a subordinated loan obtained from German Development Financial Institution (DEG)

Carrying value of the variable rate debentures and the loan obtained from DEG approximate to their fair values as at the reporting date.

In respect of fixed rate subordinated debentures, fair value has been determined by discounting the future cash flows by the interest rates prevailing as at the reporting date for similar instruments. Accordingly, the fixed rate subordinated debentures had a fair value of Rs 8.798 Bn as at 31st December 2013 as against its carrying value which amounted to Rs 8.308 Bn. Market interest rates as at 31st December 2013 has been determined with reference to Government Treasury Bond rates with adjustments for maturity mismatches and credit risk factors since there is no active market for quoted debentures.

9 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE

The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) has issued the following new Sri Lanka Accounting Standards which will become applicable for financial periods beginning on or after 1st January 2014.

Accordingly, these Standards have not been applied in preparing these financial statements.

SLFRS 9 - Financial Instruments: Classification and Measurement

SLFRS 9, as issued, reflects the first phase of work on replacement of Sri Lanka Accounting Standards (LKAS 39) - "Financial Instruments Recognition and Measurements" and applies to classification and measurement of financial assets and liabilities.

The mandatory application date of this standard is yet to be announced by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

SLFRS 10 - Consolidated Financial Statements

The objective of this SLFRS is to establish principles for the presentation and preparation of Consolidated Financial Statements when an entity controls one or more other entities.

SLFRS 10 will become effective from 1st January 2014 for the Group with early adoption permitted. This SLFRS will supersede the requirements relating to Consolidated Financial Statements in Sri Lanka Accounting Standards (LKAS 27) - "Consolidated and Separate Financial Statements".

SLFRS 11 Joint Arrangements

SLFRS 11 will become effective from 1st January 2014 for the Group with early adoption permitted.

SLFRS 12 - Disclosure of Interests in Other Entities

SLFRS 12 will become effective from 1st January 2014 for the Group with early adoption permitted.

SLFRS 13 - Fair Value Measurement

SLFRS 13 establishes a single source of guidance under SLFRS for all fair value measurements. SLFRS 13 will be effective for financial periods beginning on or after 1st January 2014.

The extent of the impact of the above standards to the Financial Statements has not been determined as at 31st December 2013. None of these is expected to have a significant effect on the Consolidated Financial Statements of the Group.

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000 Restated	2013 Rs 000	2012 Rs 000 Restated
10 INCOME				
Interest income [Note 11 (a)]	55,749,193	47,326,377	56,626,984	47,919,387
Fee and commission income	4,351,992	3,740,497	4,500,180	3,905,052
Net gain / (loss) from trading (Note 13)	(1,815,061)	(1,632,528)	(1,755,536)	(1,624,049)
Net gain / (loss) from financial investments (Note 14)	246,591	87,446	309,493	116,463
Other operating income (Note 15)	1,540,970	2,016,987	4,956,383	4,894,769
	60,073,685	51,538,779	64,637,504	55,211,622
11 NET INTEREST INCOME				
11 (a) Interest income				
Cash and cash equivalents	299,382	225,074	299,382	225,074
Placements with banks	47,500	281,816	259,205	408,455
Loans and receivables to other customers	46,478,896	39,731,889	46,550,681	39,715,822
Unwinding of interest income on impaired assets	229,791	258,258	229,791	258,258
Other financial assets - Held for trading	96,214	96,421	191,246	137,396
Financial investments - Held to maturity	-	-	146,845	250,477
Financial investments - Available for sale	6,984,540	5,572,802	7,116,390	5,649,263
Financial investments - Loans and receivables	1,477,584	1,087,336	1,672,426	1,201,108
Other interest income	135,286	72,781	161,018	73,534
Total interest income	55,749,193	47,326,377	56,626,984	47,919,387

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
11 (b) Interest expenses				
Due to banks	1,623,215	1,356,755	1,649,817	1,373,531
Deposits from customers (due to other customers)	27,671,327	22,336,872	27,649,826	22,305,703
Other borrowings	992,474	939,758	1,121,224	1,080,592
Debt securities issued	64,475	-	83,253	-
Subordinated term debts	1,009,300	703,745	1,008,744	702,955
Other interest expenses	63,154	31,302	63,922	32,760
Total interest expenses	31,423,945	25,368,432	31,576,786	25,495,541
Net interest income	24,325,248	21,957,945	25,050,198	22,423,846

Notional Tax Credit for Withholding Tax on Government Securities on Secondary Market Transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in Government securities be entitled to a notional tax credit (being one ninth of the net interest income) provided such interest income forms part of the statutory income of the company for that year of assessment.

Accordingly, net income earned from secondary market transactions in Government securities for the year by the Bank / Group has been grossed up in the Financial Statements and the resulting notional tax credit amounted to Rs 672 Mn (2012 : Rs 534 Mn) for the Bank and Rs 712 Mn (2012 : Rs 574 Mn) for the Group.

11 (c) Net Interest Income from Sri Lanka Government Securities

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Interest income	8,291,626	6,268,929	8,653,841	6,907,671
Less : Interest expenses	408,695	445,771	558,806	595,455
Net interest income from Sri Lanka government securities	7,882,931	5,823,158	8,095,035	6,312,216

Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
12 NET FEE AND COMMISSION INCOME				
Fee and commission income	4,351,992	3,740,497	4,500,180	3,905,052
Less: Fee and commission expenses	82,082	53,407	470,456	411,943
Net fee and commission income	4,269,910	3,687,090	4,029,724	3,493,109
Comprising				
Loans	539,747	488,061	539,747	488,061
Cards	1,251,097	974,609	1,251,097	974,609
Trade and remittances	983,016	865,230	983,016	865,230
Deposits	296,536	327,996	295,662	327,351
Guarantees	510,655	403,210	510,655	403,210
Currency	436,619	392,862	446,988	428,402
Others	252,240	235,122	2,559	6,246
Net fee and commission income	4,269,910	3,687,090	4,029,724	3,493,109
13 NET GAIN / (LOSS) FROM TRADING				
Fixed income				
Net marked to market gain	1,670	2,466	14,560	7,681
Net capital gain	5,470	1,108	19,625	6,402
Equities				
Net marked to market gain	55,924	69,402	63,155	46,457
Net capital loss	(51,268)	(180,069)	(44,628)	(172,358)
Dividend income	14,846	13,822	33,456	27,027
Foreign exchange loss	(1,841,703)	(1,539,257)	(1,841,704)	(1,539,258)
	(1,815,061)	(1,632,528)	(1,755,536)	(1,624,049)
14 NET GAIN / (LOSS) FROM FINANCIAL INVESTMENTS				
Assets available for sale				
Debt securities	-	(38,259)	-	(38,259)
Equities	246,591	159,729	263,655	185,828
Government Securities	-	-	45,838	2,918
Net loss arising from derecognition of financial assets measured at amortised cost	-	(34,024)	-	(34,024)
	246,591	87,446	309,493	116,463
15 OTHER OPERATING INCOME				
Rent received	6,049	4,543	147,857	132,306
Rent received from investment properties	63,405	54,255	54,240	46,279
Dividend income from subsidiaries and joint venture	101,072	57,291	-	-
Auditorium hire income	4,751	4,195	4,751	4,195
Profit from sale of property, plant and equipment	15,010	14,816	18,356	14,986
Profit from sale of gold	1,433	1,524	1,433	1,524
Recovery of loans written off in prior years	8,295	11,192	8,295	11,192
Recovery of operational losses provided for in prior year	15,271	4,006	15,271	4,006
Insurance premium income	-	-	3,234,502	2,630,385
Net income from sale of apartments	-	-	17,770	91,133
Gain on disposal of Associate company	-	38,393	-	38,393
Foreign exchange gain	1,311,398	1,812,186	1,334,267	1,832,784
Gain / (loss) from sale of Subsidiary company [Note 36 (b)]	(161)	-	36,488	-
Loss from sale of non current assets held for sale [Note 28 (a)]	-	-	(390)	-
Miscellaneous	14,447	14,586	83,543	87,586
	1,540,970	2,016,987	4,956,383	4,894,769

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000 Restated	2013 Rs 000	2012 Rs 000 Restated
16 IMPAIRMENT CHARGE / (REVERSAL) FOR LOANS AND OTHER LOSSES				
Loans and receivables to other customers				
Charge / (reversal) from individual impairment	239,581	(269,588)	239,581	(269,588)
Charge from collective impairment	2,867,781	1,317,503	2,867,781	1,317,503
Direct write offs	149,902	-	149,902	-
Others	42,266	(29,249)	42,266	(29,249)
Financial investments - Available-for-sale	2,051	-	2,051	-
Financial investments - Loans and receivables	3,706	53,032	3,706	53,032
Property, plant and equipment	-	70,412	-	70,412
Investment in Subsidiary company [Note 36 (c)]	(56,121)	-	-	-
	3,249,166	1,142,110	3,305,287	1,142,110
17 PERSONNEL EXPENSES				
Salaries and bonus	5,437,466	5,020,892	5,970,218	5,548,689
Contribution to Employees' Provident Fund	459,245	400,480	500,487	434,134
Contribution to Employees' Trust Fund	112,065	100,281	122,325	108,708
Provision charge for employee benefits [Note 17 (a)]	467,227	473,160	490,219	486,398
Equity-settled share-based payment transactions	239,701	176,515	239,701	176,515
Cash-settled share-based payment charge / (reversal)	(1,503,655)	292,116	(1,503,655)	292,116
Increase in liability for EPF interest guarantee	16,585	2,814	16,585	2,814
Increase / (decrease) in liability for accumulated leave	18,264	(1,427)	18,264	(1,427)
Others	206,880	225,033	206,880	225,033
	5,453,778	6,689,864	6,061,024	7,272,980
17 (a) Provision Charge for Employee Benefits				
Current service cost	529,628	402,934	529,628	402,934
Interest on obligation	994,318	884,931	994,318	884,931
Expected return on plan assets	(1,056,719)	(814,705)	(1,056,719)	(814,705)
Provision made for gratuities	-	-	22,992	13,238
	467,227	473,160	490,219	486,398
For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
18 OTHER EXPENSES				
Directors' emoluments	68,096	95,360	68,451	95,520
Auditors' remuneration [Note 18 (a)]	14,566	16,270	19,020	22,112
Legal expenses and professional fees	80,083	161,088	85,671	168,702
Depreciation of investment property (Note 37)	5,432	4,751	4,727	4,569
Depreciation of property, plant and equipment	720,170	657,326	904,104	822,570
Amortisation of intangible assets (Note 39)	233,382	175,314	249,941	189,099
Amortisation of leasehold property	125,272	138,309	127,652	143,060
Provision for operational risk event losses	243,214	8,777	243,214	8,777
Advertising and related expenses	350,151	294,231	399,577	335,341
Donations	23,907	32,579	24,265	32,879
Debenture issue expenses	22,342	-	22,342	-
Direct operating expenses on investment property	4,312	1,726	11,616	3,101
Share issue expenses	-	5,649	-	8,247
Deposit insurance premium	335,730	301,176	335,730	301,176
Crop Insurance Levy	56,628	-	60,437	-
Net claims incurred	-	-	1,568,210	1,154,520
Change in contract liabilities Life Fund	-	-	724,829	555,909
Office administration and establishment expenses	5,007,952	4,477,105	4,773,098	4,205,213
Other overhead expenses	906,061	790,942	1,153,480	1,083,632
	8,197,298	7,160,603	10,776,364	9,134,427

Notes to the Financial Statements

18 OTHER EXPENSES (CONTD.)

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
18 (a) Auditors' Remuneration				
Audit fees and expenses	8,036	7,678	11,232	11,055
Audit related fee and expenses	5,214	3,580	6,378	5,504
Non-audit services	1,316	5,012	1,410	5,553
	14,566	16,270	19,020	22,112
19 SHARE OF PROFIT OF ASSOCIATES (NET OF INCOME TAX)				
Share of profit of Associates before income tax	-	-	130,414	23,810
Income tax on share of operating results of Associates	-	-	(2,599)	(7,178)
Share of profit of Associates after income tax (Note 34)	-	-	127,815	16,632
20 INCOME TAX EXPENSE				
Recognised in the Income Statement				
20 (a) Current Tax Expense				
Current tax on profits for the year	4,763,601	2,918,036	4,829,825	2,971,349
Over provision as per the taxes finalised for the Y/As 2008/09 and 2010/11	-	(690,434)	-	(694,778)
Under provision in previous years	112,891	-	116,179	-
	4,876,492	2,227,602	4,946,004	2,276,571
20 (b) Deferred Tax Expense				
Charge to deferred tax liability [Note 49 (a) i & 49 (a) ii]	155,512	170,674	192,440	198,158
Recognition of deferred tax asset [Note 49 (b)]	(2,034,449)	(55,941)	(2,035,245)	(53,298)
	(1,878,937)	114,733	(1,842,805)	144,860
Total income tax expense [Note 20 (e)]	2,997,555	2,342,335	3,103,199	2,421,431
For the year ended 31st December			Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
20 (c) Current Tax on Profits of Subsidiaries				
HNB Assurance PLC			35,141	42,692
20 (d) Current Tax on Profits of Joint Venture				
Acuity Partners (Pvt) Ltd and Subsidiaries			31,083	10,621
Total			66,224	53,313

20 INCOME TAX EXPENSE (CONTD.)

20 (e) Reconciliation of effective tax rate

For the year ended 31st December	Bank				Group			
	2013 %	2013 Rs 000	2012 %	2012 Rs 000	2013 %	2013 Rs 000	2012 %	2012 Rs 000
Profit before income tax		10,007,661		9,876,490		10,915,647		10,523,380
Tax using the corporate tax rate	28.00	2,802,145	28.00	2,765,417	28.00	3,056,381	28.00	2,946,546
Effect of change in tax rates in								
Joint Venture	-	-	-	-	-	22	(0.13)	(13,379)
Disallowable expenses	33.21	3,323,081	10.47	1,033,693	30.75	3,356,989	10.44	1,098,306
Allowable expenses	(29.32)	(2,934,415)	(26.79)	(2,645,462)	(27.05)	(2,952,559)	(25.32)	(2,665,028)
Tax exempt income	(9.82)	(982,491)	(4.92)	(486,072)	(10.79)	(1,178,194)	(6.18)	(650,435)
Adjustments for leasing	25.53	2,555,281	22.79	2,250,460	23.41	2,555,282	21.39	2,250,459
Tax loss utilised	-	-	-	-	(0.19)	(21,108)	(0.03)	(2,790)
Tax loss incurred during the year	-	-	-	-	0.12	13,012	0.09	9,627
Adjustments	-	-	-	-	-	-	(0.02)	(1,957)
Current tax on profits								
for the year [Note 20 (a)]	47.60	4,763,601	29.55	2,918,036	44.25	4,829,825	28.24	2,971,349
(Over) / under provision in prior years	1.13	112,891	(6.99)	(690,434)	1.06	116,179	(6.6)	(694,778)
Current tax on profits for the year	48.73	4,876,492	22.55	2,227,602	45.31	4,946,004	21.63	2,276,571
Charge to deferred tax liability								
on temporary differences	1.55	155,512	1.73	170,674	1.76	192,440	1.88	198,158
Recognition of deferred tax asset								
on temporary differences	(20.33)	(2,034,449)	(0.57)	(55,941)	(18.65)	(2,035,245)	(0.51)	(53,298)
Total income tax expense [Note 20 (b)]	29.95	2,997,555	23.72	2,342,335	28.43	3,103,199	23.01	2,421,431

For the year ended 31st December	Group	
	2013 Rs 000	2012 Rs 000
20 (f) Tax Losses Brought Forward and Utilised during the Year		
Tax losses brought forward	213,972	245,201
Adjustments for brought forward tax losses	(7,179)	19,747
Loss incurred during the year	46,473	42,820
Tax losses utilised during the year	(75,383)	(93,796)
Tax losses not utilised and carried forward	177,883	213,972

20 (g) Hatton National Bank PLC

The Bank is liable for taxation on its income from banking operations at the rate of 28% (2012: 28%) for the year.

20 (h) HNB Assurance PLC

HNB Assurance PLC is liable for income tax at the rate of 28% (2012 : 28%) on its taxable income.

Notes to the Financial Statements

20 INCOME TAX EXPENSE (CONTD.)

20 (i) Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 18th June 1999, the profits and income of Sithma Development (Pvt) Ltd are exempt from Income Tax until 24th January 2018. After the expiration of the said tax exemption period, the provisions of the Inland Revenue Regulations for the time being in force shall apply to the company.

Accordingly deferred tax liability has been created for temporary difference which will reverse after the expiry of the tax holiday period.

20 (j) Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is liable for income tax at the rate of 28% (2012 : 28%) on its taxable income. Provision has been made in the Financial Statements accordingly. Subsidiaries of Acuity Partners (Pvt) Ltd other than Lanka Ventures PLC (2013 : 12%, 2012 : 12%) are liable for income tax at the rate of 28% (2012 : 28%).

21 EARNINGS PER SHARE ON PROFIT

21 (a) Basic Earnings per Share

Basic Earnings per Share (Basic EPS) has been calculated by dividing the profit for the year attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding (both voting and non-voting) during the year, as per the requirements of the Sri Lanka Accounting Standard (LKAS 33) "Earnings per Share".

21 (b) Diluted Earnings per Share

The calculation of Diluted Earnings per Share (Diluted EPS) as at the reporting date was based on the profit attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year, after adjusting for the effects of all potentially dilutive weighted average number of ordinary shares that would be issued on the conversion of all the dilutive ESOPs into ordinary shares.

The details of the options granted, exercised and expired under Employee Share Option Plan during the year are given in Note 53 (c) i.

For the year ended 31st December	Bank		Group	
	2013	2012 Restated	2013	2012 Restated
Profit attributable to equity holders of the Bank (Rs 000)	7,010,106	7,534,155	7,650,461	7,941,754
Weighted average number of ordinary shares outstanding during the year used as the denominator for Basic EPS ('000)	398,450	397,811	398,450	382,699
Basic Earnings Per Share (Rs)	17.59	18.94	19.20	20.75
Profit attributable to equity holders of the Bank (Rs 000)	7,010,106	7,534,155	7,650,461	7,941,754
Weighted average number of ordinary shares outstanding during the year used as the denominator for Basic EPS ('000)	398,450	397,811	398,450	382,699
Weighted average number of shares under option ('000)	9,736	7,717	9,736	7,717
Weighted average number of ordinary shares that would have been issued at average market price ('000)	(8,649)	(7,179)	(8,649)	(7,179)
Weighted average number of ordinary shares outstanding during the year used as the denominator for Diluted EPS ('000)	399,537	398,349	399,537	383,237
Diluted Earnings Per Share (Rs)	17.55	18.91	19.15	20.72

22 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

22 (a) Bank - 2013

	Held for trading	Loans and receivables/ deposits at amortised cost	Available for sale	Total carrying amount
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Cash and cash equivalents	-	11,624,645	-	11,624,645
Balances with central banks	-	16,366,368	-	16,366,368
Placements with banks	-	1,246,611	-	1,246,611
Other financial assets held for trading	652,312	-	-	652,312
Derivative financial instruments	174,573	-	-	174,573
Loans and receivables to banks	-	6,267,809	-	6,267,809
Loans and receivables to other customers	-	351,976,401	-	351,976,401
Financial investments	-	33,104,536	63,391,086	96,495,622
Total financial assets	826,885	420,586,370	63,391,086	484,804,341
Liabilities				
Due to banks	-	34,934,217	-	34,934,217
Derivative financial instruments	748,962	-	-	748,962
Due to other customers	-	385,360,970	-	385,360,970
Other borrowings	-	8,663,102	-	8,663,102
Debt securities issued	-	1,418,775	-	1,418,775
Subordinated term debts	-	11,856,560	-	11,856,560
Total financial liabilities	748,962	442,233,624	-	442,982,586

22 (b) Bank - 2012

	Held for trading	Loans and receivables/ deposits at amortised cost	Available for sale	Total carrying amount
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Cash and cash equivalents	-	8,769,206	-	8,769,206
Balances with central banks	-	19,933,463	-	19,933,463
Placements with banks	-	10,321,832	-	10,321,832
Other financial assets held for trading	474,083	-	-	474,083
Derivative financial instruments	344,552	-	-	344,552
Loans and receivables to other customers	-	302,760,980	-	302,760,980
Financial investments	-	20,030,669	58,295,356	78,326,025
Total financial assets	818,635	361,816,150	58,295,356	420,930,141
Liabilities				
Due to banks	-	23,852,647	-	23,852,647
Derivative financial instruments	1,436,443	-	-	1,436,443
Due to other customers	-	341,423,986	-	341,423,986
Other borrowings	-	8,332,545	-	8,332,545
Subordinated term debts	-	7,751,890	-	7,751,890
Total financial liabilities	1,436,443	381,361,068	-	382,797,511

Notes to the Financial Statements

22 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (CONTD.)

22 (c) Group - 2013

	Held for trading	Held to maturity	Loans and receivables/ deposits at amortised cost	Available for sale	Total carrying amount
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets					
Cash and cash equivalents	-	-	11,588,264	-	11,588,264
Balances with central banks	-	-	16,366,565	-	16,366,565
Placements with banks	-	-	3,083,584	-	3,083,584
Other financial assets held for trading	2,568,136	-	-	-	2,568,136
Derivative financial instruments	174,573	-	-	-	174,573
Loans and receivables to other customers	-	-	352,845,678	-	352,845,678
Financial investments	-	1,004,501	35,103,762	64,270,094	100,378,357
Total financial assets	2,742,709	1,004,501	418,987,853	64,270,094	487,005,157
Liabilities					
Due to banks	-	-	35,360,925	-	35,360,925
Derivative financial instruments	748,962	-	-	-	748,962
Due to other customers	-	-	385,000,600	-	385,000,600
Other borrowings	-	-	10,253,539	-	10,253,539
Debt securities issued	-	-	1,530,295	-	1,530,295
Subordinated debentures	-	-	11,781,703	-	11,781,703
Total financial liabilities	748,962	-	443,927,062	-	444,676,024

22 (d) Group - 2012

	Held for trading	Held to maturity	Loans and receivables/ deposits at amortised cost	Available for sale	Total carrying amount
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets					
Cash and cash equivalents	-	-	8,848,466	-	8,848,466
Balances with central banks	-	-	19,950,321	-	19,950,321
Placements with banks	-	-	11,667,417	-	11,667,417
Other financial assets held for trading	1,078,124	-	-	-	1,078,124
Derivative financial instruments	344,552	-	-	-	344,552
Loans and receivables to other customers	-	-	303,270,612	-	303,270,612
Financial investments	-	1,643,852	20,904,172	59,355,106	81,903,130
Total financial assets	1,422,676	1,643,852	364,640,988	59,355,106	427,062,622
Liabilities					
Due to banks	-	-	24,443,058	-	24,443,058
Derivative financial instruments	1,436,443	-	-	-	1,436,443
Due to other customers	-	-	340,847,606	-	340,847,606
Other borrowings	-	-	9,538,743	-	9,538,743
Debt securities issued	-	-	150,000	-	150,000
Subordinated debentures	-	-	7,729,333	-	7,729,333
Total financial liabilities	1,436,443	-	382,708,740	-	384,145,183

23 CASH AND CASH EQUIVALENTS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Local currency in hand	10,136,171	7,766,981	10,137,225	7,768,030
Foreign currency in hand	698,795	601,274	698,795	610,628
Balances with banks	789,679	400,951	752,244	469,808
	11,624,645	8,769,206	11,588,264	8,848,466

All cash and cash equivalent balances held by the Group entities were available for use by the Group.

24 BALANCES WITH CENTRAL BANKS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Statutory balances with central banks				
Central Bank of Sri Lanka	16,366,368	19,933,463	16,366,368	19,933,463
Central Bank of Oman	-	-	-	16,577
Non-statutory balances with central banks				
Central Bank of Sri Lanka	-	-	197	281
	16,366,368	19,933,463	16,366,565	19,950,321

As required by the provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka as explained in Note 4.4. The minimum cash reserve requirement on Rupee deposit liabilities was 6% as at 31st December 2013 (2012 : 8%).

There are no reserve requirements for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

Majan Exchange LLC is required to maintain a deposit of Omani Riyal 50,000 with the Central Bank of Oman (CB Oman) in accordance with its licensing regulations for exchange houses issued by the CB Oman. Interest is earned at the rate of 2% per annum. This is not available for use in the ordinary course of business. Bank disposed its investment in Majan Exchange LLC during the year.

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
25 PLACEMENTS WITH BANKS				
Local currency	1,000,000	4,265,843	2,805,741	5,555,510
Foreign currency	246,611	6,055,989	277,843	6,111,907
	1,246,611	10,321,832	3,083,584	11,667,417
26 DERIVATIVE FINANCIAL INSTRUMENTS				
Foreign currency derivatives				
Currency swaps	39,058	151,188	39,058	151,188
Forward foreign exchange contracts	135,515	193,364	135,515	193,364
	174,573	344,552	174,573	344,552

Notes to the Financial Statements

27 OTHER FINANCIAL ASSETS HELD FOR TRADING

As at 31st December	2013 Market Value Rs 000	2012 Market Value Rs 000
Quoted shares - Bank [Note 27 (a)]	303,992	452,847
Government of Sri Lanka treasury bills - Bank [Note 27 (b)]	346,739	19,790
Government of Sri Lanka treasury bonds - Bank [Note 27 (c)]	1,581	1,446
Total Other financial assets held for trading - Bank	652,312	474,083
Quoted shares - Subsidiaries [Note 27 (d)]	195,143	215,668
Government of Sri Lanka treasury bills - Joint Venture [Note 27 (e)]*	1,192,826	186,015
Government of Sri Lanka treasury bonds - Subsidiaries and Joint Venture [Note 27 (f)]*	388,918	54,968
Quoted Units in Unit Trusts - Subsidiaries [Note 27 (g)]	7,608	7,550
Unquoted Units in Unit Trusts - Subsidiaries [Note 27 (h)]	131,329	139,840
Total Other financial assets held for trading - Subsidiaries and Joint Venture	1,915,824	604,041
Total Other financial assets held for trading - Group	2,568,136	1,078,124

* Other financial assets held for trading through the Joint Venture reported above represent only 50% of the total other financial assets held for trading of the Joint Venture, being the shareholding of the Bank on the same.

27 (a) Quoted Shares Held by the Bank

As at 31st December	2013				2012		
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Banks, Finance and Insurance							
Central Finance Company PLC	-	-	-	-	102,899	17,494	16,701
Ceylinco Insurance PLC	15,600	10,128	2.85	20,904	15,600	10,128	13,352
National Development Bank PLC	270,000	48,934	13.78	43,335	270,000	48,934	37,233
Nations Trust Bank PLC	346,800	19,833	5.58	21,571	296,800	16,787	16,620
Sampath Bank PLC	263,634	59,745	16.82	45,319	130,000	31,897	26,065
Singer Finance (Lanka) PLC	1,000,004	13,807	3.89	11,700	476,704	7,060	6,531
Beverage, Food and Tobacco							
Cargils (Ceylon) PLC	-	-	-	-	100,000	23,204	14,550
Distilleries Company of Sri Lanka PLC	100,019	18,714	5.27	19,304	217,000	40,601	36,022
Diversified Holdings							
Aitken Spence PLC	348,000	57,764	16.26	35,600	330,000	55,562	39,600
Hayleys PLC	63,969	23,807	6.70	18,743	77,395	30,189	23,443
John Keells Holdings PLC	5,230	1,102	0.31	1,189	507,600	105,646	111,621
Vallibel One PLC	-	-	-	-	500,000	17,262	9,050
Sunshine Holdings PLC	694,661	20,737	5.84	19,450	-	-	-
Hotels & Travels							
Aitken Spence Hotel Holdings PLC	225,301	16,952	4.77	15,748	-	-	-
Asian Hotels & Properties PLC	202,476	14,714	4.14	12,999	-	-	-
Manufacturing							
Chevron Lubricants Lanka PLC	-	-	-	-	82,500	14,053	16,665
Lanka Floortiles PLC	-	-	-	-	121,700	15,576	7,910
Lanka Walltiles PLC	-	-	-	-	114,423	8,078	6,957
Royal Ceramics Lanka PLC	-	-	-	-	150,100	24,266	14,860
Tokyo Cement Company (Lanka) PLC	-	-	-	-	315,900	17,965	9,035
Motors							
United Motors PLC	233,409	26,825	7.55	26,539	-	-	-
Oil & Palms							
Bukit Darah PLC	-	-	-	-	37,000	39,755	25,789
Power & Energy							
Vallibel Power Erathna PLC	1,998,409	22,157	6.24	11,591	3,206,655	35,553	20,843
Total		355,219	100.00	303,992		560,010	452,847
Loss from marked to market valuation		(51,227)				(107,163)	
Total Quoted Shares - Bank		303,992		303,992		452,847	452,847

27 OTHER FINANCIAL ASSETS HELD FOR TRADING (CONTD.)

27 (b) Government of Sri Lanka Treasury Bills Held by the Bank

As at 31st December			2013		2012	
Face Value	Year of Maturity	Carrying Value (Rs 000)	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Rs 352 Mn	2014	346,739	345,047	346,739	19,714	19,790
Gain from marked to market valuation			1,692		76	
Total Government of Sri Lanka Treasury Bills - Bank			346,739	346,739	19,790	19,790

27 (c) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December			2013		2012	
Face Value	Year of Maturity	Carrying Value (Rs 000)	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Rs 2 Mn	2015	1,581	1,492	1,581	1,395	1,446
Gain from marked to market valuation			89		51	
Total Government of Sri Lanka Treasury Bonds - Bank			1,581	1,581	1,446	1,446

27 (d) Quoted Shares Held by the Subsidiaries

As at 31st December	2013							2012		
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000			
Commercial Bank of Ceylon PLC	34,627	4,132	1.72	4,169	147,164	17,921	15,158			
Hemas Holdings PLC	321,000	14,106	5.86	10,914	321,000	14,106	8,667			
John Keells Holdings PLC	91,794	18,335	7.62	20,865	87,556	17,827	19,254			
John Keells Holdings PLC - Warrants 2015	4,078	-	-	326	-	-	-			
John Keells Holdings PLC - Warrants 2016	4,078	-	-	385	-	-	-			
Dialog Axiata PLC	-	-	-	-	217,500	5,243	1,805			
National Development Bank PLC	78,200	9,519	3.96	12,551	78,200	9,519	10,784			
John Keells Hotels PLC	92,700	1,564	0.65	1,159	92,700	1,564	1,279			
Royal Ceramic Lanka PLC	183,000	26,095	10.84	15,482	183,000	26,095	18,117			
ACL Cables PLC	50,000	3,555	1.48	3,245	50,000	3,555	3,370			
Dipped Products PLC	19,500	1,829	0.76	1,755	19,500	1,829	2,145			
Peoples Leasing & Finance PLC	932,800	16,790	6.98	12,500	1,162,800	20,930	15,349			
DFCC Bank	30,000	3,436	1.43	3,870	43,000	5,390	4,855			
Seylan Bank PLC - (Non Voting)	410,283	15,445	6.42	12,719	399,999	15,445	14,040			
Palm Garden Hotels PLC	23,000	4,537	1.89	1,440	23,000	4,537	3,220			
The Lighthouse Hotel PLC	21,400	1,433	0.60	942	21,400	1,433	1,136			
Sampath Bank PLC	78,422	17,088	7.10	13,481	76,125	17,088	15,263			
Nations Trust Bank PLC	275,000	18,229	7.57	17,105	275,000	18,229	15,400			
Richard Pieris and Company PLC	1,375,000	17,228	7.16	8,663	1,375,000	17,228	10,725			
CIC Holdings PLC	95,000	9,603	3.99	4,551	95,000	9,603	6,109			
Distilleries Company of Sri Lanka PLC	60,000	10,650	4.42	11,580	60,000	10,648	9,960			
Haycarb PLC	20,500	3,547	1.47	3,891	20,500	3,547	3,508			
Chevron Lubricants Lanka PLC	12,599	1,899	0.79	3,374	24,000	3,619	4,848			

Notes to the Financial Statements

27 OTHER FINANCIAL ASSETS HELD FOR TRADING (CONTD.)

27 (d) Quoted Shares Held by the Subsidiaries (Contd.)

As at 31st December	2013				2012		
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Tokyo Cement Company (Lanka) PLC	443,202	19,402	8.06	12,631	402,912	19,402	11,523
Kelani Cables PLC	44,300	5,035	2.09	3,279	44,300	5,035	3,105
Laugfs Gas PLC - (Voting Shares)	135,000	6,114	2.54	3,834	175,000	7,927	4,480
PC House PLC	-	-	-	-	82,820	911	447
Renuka Holdings PLC	50,877	2,121	0.88	1,557	50,877	2,121	1,837
Textured Jersey Lanka PLC	-	-	-	-	428,500	6,428	3,814
Dolphin Hotels PLC	59,900	2,196	0.91	2,690	149,900	5,505	5,470
Vallibel One PLC	375,000	6,764	2.81	6,185	-	-	-
Total Quoted Shares - Subsidiaries		240,652	100.00	195,143		272,685	215,668
Loss from marked to market valuation		(45,509)				(57,017)	
Total Quoted Shares - Subsidiaries		195,143		195,143		215,668	215,668

27 (e) Government of Sri Lanka Treasury Bills held through Joint Venture

As at 31st December	Face Value	Year of Maturity	Carrying Value (Rs 000)	2013		2012	
				Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
	Rs 1,234 Mn	2014	1,192,826	1,144,964	1,192,826	185,178	186,015
	Gain from marked to market valuation			47,862		837	
	Total Government of Sri Lanka Treasury Bills - Joint Venture			1,192,826	1,192,826	186,015	186,015

27 (f) Government of Sri Lanka Treasury Bonds held by Subsidiaries and through Joint Venture

As at 31st December	Face Value	Year of Maturity	Carrying Value (Rs 000)	2013		2012	
				Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
	Rs 16.5 Mn	2014	16,954				
	Rs 148 Mn	2015	152,704				
	Rs 25 Mn	2017	25,317				
	Rs 200 Mn	2018	193,943				
	Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Venture			373,206		54,871	54,968
	Gain from marked to market valuation			15,712		97	
	Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Venture			388,918	388,918	54,968	54,968

27 OTHER FINANCIAL ASSETS HELD FOR TRADING (CONTD.)**27 (g) Quoted Units in Unit Trusts Held by Subsidiaries**

As at 31st December	2013			2012		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	No of Units	Cost of Investment Rs 000	Market Value Rs 000
Namal Acuity Value Fund	114,400	7,203	7,608	114,400	7,203	7,550
Gain from marked to market valuation		405			347	
Total Quoted Units - Subsidiaries		7,608	7,608		7,550	7,550

27 (h) Unquoted Units in Unit Trusts Held by Subsidiaries

As at 31st December	2013			2012		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	No of Units	Cost of Investment Rs 000	Market Value Rs 000
Namal IPO Fund	-	-	-	1,000,000	9,750	10,270
Cey Bank	1,800,000	18,000	19,164	1,800,000	18,000	19,602
Ceylon Asset Management	-	-	-	664,622	6,500	4,333
FC Wealth Fund	3,851	4,000	4,420	3,851	4,000	4,349
Ceylon Income Fund	2,686,703	35,000	35,464	2,686,703	35,000	34,470
Guardian Acuity Fixed Income Fund	1,998,002	20,000	23,317	1,998,002	20,000	22,018
Comtrust Money Market Fund	383,877	4,000	4,123	383,877	4,000	4,131
Eagle Income Fund	969,932	10,000	10,436	969,932	10,000	10,417
Namal High Yield Fund	2,686,567	27,000	34,405	2,686,567	27,000	30,250
Gain from marked to market valuation		13,329			5,590	
Total Unquoted Units in Unit Trusts - Subsidiaries		131,329	131,329		139,840	139,840

28 NON CURRENT ASSETS HELD FOR SALE

As at 31st December	Bank		Group	
	2013 Carrying Amount Rs 000	2012 Carrying Amount Rs 000	2013 Carrying Amount Rs 000	2012 Carrying Amount Rs 000
Non current assets held for sale	-	-	-	2,875
	-	-	-	2,875

28 (a) Freehold Land*

As at 31st December	2013		2012	
	Extent (perches)	Cost of Land Rs 000	Extent (perches)	Cost of Land Rs 000
Lot - X, Survey plan - 6448, off Edirisinghe Rd, Mirihana*	-	-	10	2,875
Total - Group				2,875

* Value of the above land (10 perches) amounted to Rs 5.75 Mn as at 31st January 2011 based on the valuation carried out by Messrs K C B Condegama AIV (Sri Lanka). As this land is held by Acuity Partners (Pvt) Ltd, the Joint Venture, only 50% of the value had been taken to the Consolidated Financial Statements.

The said property was disposed during 2013 and the resultant loss of Rs. 0.39 Mn is disclosed in Note 15 - Other Operating Income.

Notes to the Financial Statements

29 LOANS AND RECEIVABLES TO BANKS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Gross loans and receivables	6,267,809	-	6,680,288	651,480
Less: Individual impairment	-	-	-	-
Collective impairment	-	-	-	-
Net loans and receivables	6,267,809	-	6,680,288	651,480
29 (a) Product wise analysis of loans and receivables to banks				
Overdrafts	-	-	-	-
Short-term loans	-	-	-	-
Long-term loans	-	-	-	-
Reverse repo agreements	6,267,809	-	6,680,288	651,480
	6,267,809	-	6,680,288	651,480
29 (b) Currency wise analysis of loans and receivables to banks				
Sri Lankan Rupee	6,267,809	-	6,680,288	651,480
	6,267,809	-	6,680,288	651,480
30 LOANS AND RECEIVABLES TO OTHER CUSTOMERS				
Gross loans and receivables	362,590,583	310,364,553	363,459,860	310,874,185
Less: Individual impairment [Note 30 (e)]	2,027,843	1,788,262	2,027,843	1,788,262
Collective impairment [Note 30 (f)]	8,586,339	5,815,311	8,586,339	5,815,311
Net loans and receivables	351,976,401	302,760,980	352,845,678	303,270,612
30 (a) Product wise analysis of loans and receivables to other customers				
Overdrafts	62,458,953	61,160,391	62,429,757	61,022,596
Bills of exchange	1,856,997	1,272,694	1,856,997	1,272,694
Commercial papers	-	527,779	60,372	681,526
Securities purchased under resale agreements	11,022	51,050	1,038,391	1,594,291
Short term loans	39,628,925	16,756,644	39,628,925	16,756,644
Trust receipts	13,820,842	13,059,931	13,820,842	13,059,931
Packing credit loans	5,770,743	3,277,487	5,770,743	3,277,487
Staff loans	7,159,143	6,196,877	7,419,200	6,386,355
Term loans	137,411,719	110,531,099	136,962,394	109,292,060
Lease receivable [Note 30 (d)]	23,152,822	25,280,078	23,152,822	25,280,078
Housing loans	25,084,498	22,990,253	25,084,497	22,990,253
Pawning advances	46,234,919	49,260,270	46,234,920	49,260,270
	362,590,583	310,364,553	363,459,860	310,874,185

30 LOANS AND RECEIVABLES TO OTHER CUSTOMERS (CONTD.)**30 (b) Currency wise analysis of loans and receivables**

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Sri Lankan Rupee	321,899,418	278,597,183	322,768,695	279,106,815
United States Dollar	39,376,576	30,243,653	39,376,576	30,243,653
Great Britain Pound	205,199	197,086	205,199	197,086
Euro currency	1,047,542	1,274,088	1,047,542	1,274,088
Other currencies	61,848	52,543	61,848	52,543
	362,590,583	310,364,553	363,459,860	310,874,185

30 (c) Industry wise analysis of loans and receivables

Agriculture and fishing	31,534,965	31,306,579	31,534,965	31,306,579
Manufacturing	54,303,345	38,851,459	54,303,345	38,851,459
Tourism	21,388,931	18,731,165	21,388,931	18,731,165
Transport	10,016,784	5,034,068	10,016,784	5,034,068
Construction	51,732,475	40,234,886	51,200,298	39,102,119
Traders	66,970,995	49,636,247	66,970,995	49,636,247
New economy	4,476,372	4,675,435	4,476,372	4,675,435
Financial and business services	32,519,017	23,051,027	32,519,017	23,046,159
Infrastructure	16,737,440	8,923,369	16,737,440	8,923,369
Other services	20,278,085	23,469,029	20,278,085	23,469,029
Credit card	3,428,037	2,778,069	3,428,037	2,778,069
Pawning	46,234,919	48,447,062	46,234,919	48,447,062
Other	2,969,218	15,226,158	4,370,672	16,873,425
	362,590,583	310,364,553	363,459,860	310,874,185

30 (d) Lease receivable

Total lease rentals receivable	28,003,223	30,837,997	28,003,223	30,837,997
Unearned lease income	(4,850,401)	(5,557,919)	(4,850,401)	(5,557,919)
Gross lease receivable	23,152,822	25,280,078	23,152,822	25,280,078
Impairment allowance for lease receivable - Collective [Note 30 (d) (iv)]	(546,730)	(302,133)	(546,730)	(302,133)
Net lease receivable	22,606,092	24,977,945	22,606,092	24,977,945
Gross lease receivables within one year [Note 30 (d) (i)]	8,525,674	8,783,462	8,525,674	8,783,462
Gross lease receivables from one to five years [Note 30 (d) (ii)]	14,074,577	16,194,483	14,074,577	16,194,483
Gross lease receivables after five years [Note 30 (d) (iii)]	5,841	-	5,841	-
	22,606,092	24,977,945	22,606,092	24,977,945

30 (d) i Gross lease Receivables within One Year

Total lease rentals receivable within one year from reporting date	11,317,939	11,823,506	11,317,939	11,823,506
Unearned lease income	(2,586,071)	(2,933,799)	(2,586,071)	(2,933,799)
Impairment allowance for lease receivable	(206,194)	(106,245)	(206,194)	(106,245)
	8,525,674	8,783,462	8,525,674	8,783,462

30 (d) ii Gross lease Receivables from One to Five years

Total lease rentals receivables from one to five years from reporting date	16,678,797	19,014,491	16,678,797	19,014,491
Unearned lease income	(2,263,825)	(2,624,120)	(2,263,825)	(2,624,120)
Impairment allowance for lease receivables	(340,395)	(195,888)	(340,395)	(195,888)
	14,074,577	16,194,483	14,074,577	16,194,483

Notes to the Financial Statements

30 LOANS AND RECEIVABLES TO OTHER CUSTOMERS (CONTD.)

30 (d) iii Gross lease Receivables after Five Years

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Total lease rentals receivable after five years from reporting date	6,487	-	6,487	-
Unearned lease income	(505)	-	(505)	-
Impairment allowance for lease receivable	(141)	-	(141)	-
	5,841	-	5,841	-

30 (d) iv Movement in Collective Impairment Allowance for Lease Receivable - Bank / Group

	2013 Rs 000	2012 Rs 000
Balance as at 1st January	302,133	217,385
Net impairment charge for the year	253,346	84,748
Write off against the provision	(8,749)	-
Balance as at 31st December	546,730	302,133

30 (e) Movement in Individual Impairment Allowance for Loans and Advances - Bank / Group

	2013 Rs 000	2012 Rs 000
Balance as at 1st January	1,788,262	2,057,850
Net impairment charge/(reversal) for the year	171,439	(249,467)
Interest unwinding	68,142	(20,121)
Balance as at 31st December	2,027,843	1,788,262

30 (f) Movement in Collective Impairment Allowance for Loans and Advances - Bank / Group

	2013 Rs 000	2012 Rs 000
Balance as at 1st January	5,815,311	4,607,058
Net impairment charge for the year	2,867,781	1,317,503
Write-off during the year	(96,753)	(109,250)
Balance as at 31st December	8,586,339	5,815,311

30 (g) Loans Granted from Investment Fund Account

The details of loans granted from Investment Fund Account, which were outstanding as at 31st December 2013 are as follows.

	Number of loans	Total amount outstanding Rs 000	Interest rate	Tenure
Agriculture	1	98,950	10.2% (LKR)	5 Years
Infrastructure development	9	3,823,064	6.04% - 6.34% (USD) & 9.2% - 11.85% (LKR)	8-10 Years
Construction of hotels and related purposes	4	2,345,384	4.99% - 5.33% (USD) & 9.26% (LKR)	6-10 Years
		6,267,398		

Investment Fund Account was Rs 4,101.20 Mn as at 31st December 2013. This balance had been fully allocated against the loans granted. Further loans of Rs 2,166.20 Mn had been granted for this purpose which is in excess of the balance in the Investment Fund Account as at the reporting date.

31 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE

As at 31st December	Market Value/ Fair Value 2013 Rs 000	Market Value/ Fair Value 2012 Rs 000 Restated
Quoted shares - Bank [Note 31 (a)]	5,528,030	4,677,518
Quoted units - Bank [Note 31 (b)]	199,500	198,000
Unquoted shares - Bank [Note 31 (c)]	41,955	27,456
Government of Sri Lanka treasury bonds - Bank [Note 31 (d)]	18,605,583	5,587,415
Government of Sri Lanka treasury bills - Bank [Note 31 (e)]	39,016,018	47,804,967
Total financial investments - Available-for-sale - Bank	63,391,086	58,295,356
Quoted shares - Joint Venture [Note 31 (f)] *	3,899	3,644
Unquoted shares - Joint Venture [Note 31 (g)] *	204,706	58,332
Unquoted units in Unit Trust - Joint Venture [Note 31 (h)]	25,514	24,094
Government of Sri Lanka treasury bonds - Subsidiaries [Note 31 (i)]	480,353	767,221
Government of Sri Lanka treasury bills - Subsidiaries [Note 31 (j)]	164,536	206,459
Total financial investments - Available-for-sale - Subsidiaries and Joint Venture	879,008	1,059,750
Total financial investments - Available-for-sale - Group	64,270,094	59,355,106

* Financial investments - Available for sale through the Joint Venture reported above represent only 50% of the total investment securities of the Joint Venture, being the shareholding of the Bank on the same.

31 (a) Quoted Shares Held by the Bank

As at 31st December	No of Ordinary Shares	2013 Cost of Investment Rs 000	Market Value Rs 000	No of Ordinary Shares	2012 Cost of Investment Rs 000 Restated	Market Value Rs 000 Restated
DFCC Bank	32,396,140	942,651	4,195,300	32,396,140	942,651	3,660,764
National Development Bank PLC	4,282,200	694,519	687,293	4,282,200	694,519	590,944
Visa Inc.	21,008	-	611,773	21,008	-	406,488
Mastercard Inc.	3,081	-	33,664	3,081	-	19,322
Total Quoted Shares - Bank		1,637,170	5,528,030		1,637,170	4,677,518

31 (b) Quoted Units in Unit Trusts Held by the Bank

held by the Bank						
Namal Acuity Value Fund	3,000,000	150,000	199,500	3,000,000	150,000	198,000
Total Quoted Units in Unit Trusts - Bank		150,000	199,500		150,000	198,000

31 (c) Unquoted Shares Held by the Bank

As at 31st December	No of Shares	2013 Cost of Investment Rs 000	Fair Value Rs 000	No of Shares	2012 Cost of Investment Rs 000	Fair Value Rs 000
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530
Fitch Ratings Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	225,000	2,250	2,250
S.W.I.F.T*	21	2,051	-	21	2,051	2,051
Ram Ratings Lanka Ltd	1,379,182	16,550	16,550			
Magpek Exports Ltd**	359,000	14,360	-	359,000	14,360	-
Impairment provision		(16,411)	-	-	(14,360)	-
Total Unquoted Shares - Bank		41,955	41,955		27,456	27,456

* Directors carried out an impairment assessment of the unquoted share investments held by the Bank and concluded that an impairment provision of Rs. 2.501 Mn be made against the investment in S.W.I.F.T.

** As shares of Magpek Exports Ltd has been de-listed, the market value is shown as nil. Impairment provision of Rs 14.36 Mn has been made in the Financial Statements.

Notes to the Financial Statements

31 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE (CONTD.)

31 (d) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December Face Value	Year of Maturity	Carrying Value Rs 000	2013 Cost of Investment Rs 000	2013 Market Value Rs 000	2012 Cost of Investment Rs 000	2012 Market Value Rs 000
Rs 17,640 Mn	2014	18,385,984				
Total Government of Sri Lanka Treasury Bonds - Bank			18,385,984	18,605,583	5,679,886	5,587,415

31 (e) Government of Sri Lanka Treasury Bills Held by the Bank

Face Value	Year of Maturity	Carrying Value Rs 000	2013 Cost of Investment Rs 000	2013 Market Value Rs 000	2012 Cost of Investment Rs 000	2012 Market Value Rs 000
Rs 40,035 Mn	2014	38,762,150				
Total Government of Sri Lanka Treasury Bills - Bank			38,762,150	39,016,018	47,681,212	47,804,967

31 (f) Quoted Shares Held through Joint Venture

As at 31st December	No of Shares	2013 Cost of Investment Rs 000	2013 Market Value Rs 000	No of Shares	2012 Cost of Investment Rs 000	2012 Market Value Rs 000
Hayleys PLC	7,491	558	2,195	7,491	558	2,269
John Keells Holdings PLC	7,230	22	1,643	6,240	22	1,372
Central Finance PLC	16	-	3	16	-	3
John Keells Holdings Warrants	660	-	58	-	-	-
Total Quoted Shares - Joint Venture		580	3,899		580	3,644

31 (g) Unquoted Shares Held through Joint Venture

As at 31st December	No of Shares	2013 Cost of Investment Rs 000	2013 Fair Value Rs 000	No of Shares	2012 Cost of Investment Rs 000	2012 Fair Value Rs 000
Durdans Medical and Surgical Centre (Pvt) Ltd	1,061,225	13,357	12,562	1,061,225	13,357	13,357
Raj Lanka Power Company Ltd	7,860,000	127,700	127,700	-	-	-
Nividhu (Pvt) Ltd	1,640,000	16,490	64,444	1,640,000	16,490	44,975
Total unquoted Shares - Joint Venture		157,547	204,706		29,847	58,332

31 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE (CONTD.)**31 (h) Unquoted Units in Unit Trusts Held through Joint Venture**

As at 31st December	No of Units	2013 Cost of Investment Rs 000	Market Value Rs 000	No of Units	2012 Cost of Investment Rs 000	Market Value Rs 000
Guardian Acuity Fixed Income Fund	2,250,000	22,500	25,514	2,250,000	22,500	24,094
Total Unquoted Units - Joint Venture		22,500	25,514		22,500	24,094

31 (i) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December Face Value	Year of Maturity	Carrying Value Rs 000	2013 Cost of Investment Rs 000	Market Value Rs 000	2012 Cost of Investment Rs 000	Market Value Rs 000
Rs 130Mn	2014	133,359				
Rs 50Mn	2015	53,738				
Rs 150Mn	2016	147,452				
Rs 147Mn	2018	145,804				
Total Government of Sri Lanka Treasury Bonds - Subsidiaries			464,080	480,353	742,269	767,221

31 (j) Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December Face Value	Year of Maturity	Carrying Value Rs 000	2013 Cost of Investment Rs 000	Market Value Rs 000	2012 Cost of Investment Rs 000	Market Value Rs 000
Rs 170Mn	2014	164,536	164,541	164,536	205,170	206,459
Total Government of Sri Lanka Treasury Bills - Subsidiaries			164,541	164,536	205,170	206,459

31 (k) Assets Pledged as Security

The following amount of Financial Investments - Available-for-sale is pledged as security for re-purchase agreements entered into by the Bank / Group.

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Treasury bills	4,016,567	4,027,950	5,194,883	5,860,845
Treasury bonds	116,034	543,333	490,438	705,810
	4,132,601	4,571,283	5,685,321	6,566,655

31 (l) Investment in government securities on behalf of Investment Fund Account

There were no investments in government securities on behalf of Investment Fund Account as at 31st December 2013.

32 FINANCIAL INVESTMENTS - HELD-TO-MATURITY

As at 31st December	2013 Cost of Investment Rs 000	2012 Cost of Investment Rs 000
Government of Sri Lanka treasury bills - Subsidiaries [Note 32 (a)]	-	34,902
Government of Sri Lanka treasury bonds - Subsidiaries [Note 32 (b)]	931,681	1,533,066
Unquoted debentures - Joint Venture [Note 32 (c)] *	68,612	71,593
Quoted debentures - Joint Venture [Note 32 (d)] *	4,208	4,291
Total Financial Investments - Held-to-maturity - Group	1,004,501	1,643,852

* Financial investment - Held to maturity through the Joint Venture reported above represent only 50% of the total financial investments - Held to maturity of the Joint Venture, being the shareholding of the Bank on the same.

Notes to the Financial Statements

32 FINANCIAL INVESTMENTS - HELD TO MATURITY (CONTD.)

32 (a) Government of Sri Lanka Treasury Bills held by Subsidiaries

As at 31st December		2013		2012	
		Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
		-	-	34,902	34,897
Total Government of Sri Lanka Treasury Bills - Subsidiaries		-	-	34,902	34,897

32 (b) Government of Sri Lanka Treasury Bonds held by Subsidiaries

As at 31st December			2013		2012	
Face Value	Year of Maturity	Carrying Value (Rs 000)	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Rs 150 Mn	2014	155,303				
Rs 310 Mn	2015	324,470				
Rs 300 Mn	2016	293,191				
Rs 175 Mn	2018	158,717				
Total Government of Sri Lanka Treasury Bonds - Subsidiaries			931,681	948,081	1,533,066	1,498,605

32 (c) Unquoted Debentures held by Subsidiaries and through Joint Venture

As at 31st December		2013		2012	
		No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
Ceylon Hospitals PLC (Rs 10/- each)		4,312,500	43,125	5,000,000	50,000
Neluwa Cascade Hydro Power (Private) Limited		2,000,000	25,487	2,000,000	21,593
Total Unquoted Debentures - Subsidiaries and Joint Venture		6,312,500	68,612	7,000,000	71,593

32 (d) Quoted Debentures held through Joint Venture

As at 31st December		2013		2012	
		No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
Bank of Ceylon (Rs 100/- each)		40,000	4,208	40,000	4,291
Total Quoted Debentures - Joint Venture		40,000	4,208	40,000	4,291

33 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES

As at 31st December	Cost of Investment 2013 Rs 000	Cost of Investment 2012 Rs 000
Sri Lanka Development bonds and Sovereign bonds - Bank [Note 33 (a)]	30,467,869	17,520,959
Foreign government bonds - Bank [Note 33 (b)]	-	-
Other long term investments - Bank [Note 33 (c)]	2,636,667	2,509,710
Total financial investments - loans and receivables - Bank	33,104,536	20,030,669
Quoted debentures - Subsidiaries [Note 33 (d)]	1,741,067	533,443
Unquoted debentures - Subsidiaries [Note 33 (e)]	258,159	340,060
Total financial investments measured as loans and receivables - Subsidiaries	1,999,226	873,503
Total financial investments measured as loans and receivables - Group	35,103,762	20,904,172

33 (a) Sri Lanka Development Bonds and Sovereign Bonds Held by the Bank

As at 31st December			2013 Cost of Investment Rs 000	2012 Cost of Investment Rs 000
Face Value	Year of Maturity	Carrying Value Rs 000		
Rs 2,616 Mn	2014	2,616,372		
Rs 15,039 Mn	2015	15,314,252		
Rs 5,885 Mn	2016	5,979,698		
Rs 6,408 Mn	2018	6,557,547		
Total Sri Lanka Development Bonds and Sovereign Bonds - Bank			30,467,869	17,520,959

33 (b) Foreign Government Bonds Held by the Bank

As at 31st December			2013 Cost of Investment Rs 000	2012 Cost of Investment Rs 000
Face Value	Year of Maturity	Carrying Value Rs 000		
Rs 57 Mn	2042	56,739		
Impairment loss investments		(56,739)		
Total Foreign Government Bonds - Bank			-	-

These bonds are issued by the Government of Greece and the investment is fully provided for.

33 (c) Other Long Term Investments Held by the Bank

As at 31st December	2013		2012	
	Cost	Fair Value	Cost	Fair Value
	Rs 000	Rs 000	Rs 000	Rs 000
Long term non-negotiable bonds maturing on 14th November 2016	489,000	489,000	489,000	489,000
Central Finance PLC - securitised notes	-	-	18,000	18,000
LB Finance PLC - securitised notes trust 19*	476,500	476,500	686,000	686,000
People's Leasing Co. Ltd. - securitised notes trust 71*	307,558	307,558	581,232	581,232
People's Leasing Co. Ltd. - securitised notes trust 65*	218,800	218,800	345,700	345,700
Singer (Sri Lanka) PLC Debentures	377,713	377,713	389,778	389,778
Singer Finance Debentures	99,089	99,089	-	-
HDFC Bank Debentures	29,271	29,271	-	-
Nawaloka Hospitals Debentures	192,634	192,634	-	-
LB Finance Debentures	446,102	446,102	-	-
Total Other Long Term Investments - Bank	2,636,667	2,636,667	2,509,710	2,509,710

*Rs 609 Mn out of these investments will be redeemed in 2014.

Notes to the Financial Statements

33 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (CONTD.)

33 (d) Quoted debentures held by Subsidiaries

As at 31st December	2013		2012	
	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
DFCC Bank (Rs 1000/- each)	5,000	5,697	5,000	5,698
Lanka Orix Leasing Company PLC	750,000	79,475	750,000	79,475
Merchant Bank of Sri Lanka PLC	1,384,700	145,800	675,000	71,515
Sampath Bank PLC (Rs 100/- each)	1,160,800	121,611	283,100	29,334
Singer (Sri Lanka) PLC (Rs 100/- each)	752,170	77,121	302,170	30,217
Bank of Ceylon (Rs 100/- each)	1,600,000	163,655	1,800,000	183,039
Nations Trust Bank PLC (Rs 1000/- each)	581,500	58,399	17,000	18,764
Urban Development Authority (Rs 100/- each)	1,124,200	115,401	1,124,200	115,401
LB Finance PLC	851,000	86,219	-	-
Lion Brewery (Ceylon) PLC	96,000	99,333	-	-
National Development Bank PLC	498,000	50,021	-	-
Nawaloka Hospitals PLC	550,000	56,962	-	-
People's Leasing and Finance Company PLC	500,000	55,578	-	-
Seylan Bank PLC	1,200,000	135,899	-	-
Softlogic Holdings PLC	920,000	95,613	-	-
HDFC Bank of Sri Lanka	798,900	82,178	-	-
Hayleys PLC	110,000	113,951	-	-
Central Finance Company PLC	55,500	57,549	-	-
Abans (Pvt) Limited	1,400,000	140,605	-	-
Total Quoted Debentures - Subsidiaries		1,741,067		533,443

33 (e) Unquoted Debentures Held by Subsidiaries

As at 31st December	2013		2012	
	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
Abans (Pvt) Ltd	25,000	25,927	100,000	101,068
People's Leasing Co. Ltd	750,000	79,424	750,000	75,000
National Development Bank PLC	40,000	40,100	40,000	41,234
Singer (Sri Lanka) PLC	490,000	50,269	490,000	50,248
Sampath Leasing and Factoring Limited	377,500	62,439	385,000	72,510
Total Unquoted Debentures - Subsidiaries		258,159		340,060

34 INVESTMENTS IN ASSOCIATES

As at 31st December	Group	
	2013 Rs 000	2012 Rs 000
Investment in Associate companies (at cost)	328,281	391,955
Additional investment in Associate company held through Joint Venture	121,275	20,000
Negative goodwill on acquisition recognised in Income Statement in 2008 and 2011	5,629	5,629
Group share of Associate company as at 1st January	52,263	(16,422)
Current year's share of profits / (loss) after tax (Note 19)	127,815	16,632
Dividend received during the year	(53,148)	-
Exchange effect on revaluation of investment	-	5,996
Disposal of Associate company	-	(37,618)
Group Investment in Associate companies (equity basis)	582,115	386,172

Splendor Media (Pvt) Ltd (Splendor Media)

The Bank's fully owned Subsidiary Sithma Development (Pvt) Ltd (Sithma) increased its holding in Splendor Media from 25% as at 31st December 2010 to 49.99% during 2011. Accordingly Splendor Media continues to be accounted for as an Associate of Sithma.

Associates through the Joint Venture reported above represent only 50% of the total investment in Associate, being the shareholding of the Bank on the same.

The Board of Directors carried out an internal assessment of impairment as at 31st December 2013 and concluded that there was no indication of impairment of these investments.

34 (a) Summarised Financial Information of Associates**34 (a) i Associates Held by the Bank**

For the year ended 31st December	Delma Exchange	
	2013 Rs 000	2012 Rs 000
Revenue	-	83,964
Expenses	-	(138,993)
Tax	-	-
Loss after tax	-	(55,029)
As at 31st December	2013 Rs 000	2012 Rs 000
Current assets	-	-
Non-current assets	-	-
Total assets	-	-
Current liabilities	-	-
Non-current liabilities	-	-
Total liabilities	-	-

*This associate was disposed on 17th December 2012.

Notes to the Financial Statements

34 INVESTMENTS IN ASSOCIATES (CONTD.)

34 (a) Summarised Financial Information of Associates (Contd.)

34 (a) ii Associate Held by Subsidiary - Sithma Development (Pvt) Ltd

For the year ended 31st December	Splendor Media (Pvt) Ltd	
	2013 Rs 000	2012 Rs 000
Revenue	119,123	144,964
Expenses	(105,614)	(142,198)
Tax	(2,841)	(1,145)
Profit after tax	10,668	1,621
As at 31st December	2013 Rs 000	2012 Rs 000
Current assets	100,494	111,480
Non-current assets	2,218	3,526
Total assets	102,712	115,006
Current liabilities	43,562	65,925
Non-current liabilities	1,422	1,397
Total liabilities	44,984	67,322

34 (a) iii Associates Held through Joint Venture - Acuity Partners (Pvt) Ltd

For the year ended 31st December	Unit Energy Lanka (Pvt) Ltd		Hayleys Hydro Energy (Pvt) Ltd		Pavan Danavi (Pvt) Ltd		Nala Danavi (Pvt) Ltd
	2013	2012	2013	2012	2013	2012	2013
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Revenue	57,166	87,085	71,772	68,508	845,674	104,996	194,917
Expenses	(72,009)	(71,963)	(50,912)	(53,318)	(367,983)	(21,377)	(103,706)
Tax	(4,882)	(4,883)	2,353	(6,929)	-	-	(2,492)
Profit / (loss) after tax	(19,725)	10,239	23,213	8,261	477,691	83,619	88,719
As at 31st December	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000	2013 Rs 000
Current assets	59,124	29,485	39,357	34,812	230,089	140,618	143,566
Non-current assets	435,821	451,792	328,280	475,335	2,630,881	2,650,748	1,415,599
Total assets	494,945	481,277	367,637	510,147	2,860,970	2,791,366	1,559,165
Current liabilities	114,857	91,037	93,007	65,729	359,185	310,268	103,469
Non-current liabilities	144,825	137,082	110,000	229,308	1,151,422	1,320,670	871,976
Total liabilities	259,682	228,119	203,007	295,037	1,510,607	1,630,938	975,445

The above companies are Associates of Lanka Ventures PLC which is a Subsidiary of Acuity Partners (Pvt) Ltd.

35 INVESTMENT IN JOINT VENTURE

Bank		2013		2012			
As at 31st December		Cost of	Directors'	Cost of	Directors'		
Principal	%	Investment	Valuation	Investment	Valuation		
Activity	Holding	Rs 000	Rs 000	Rs 000	Rs 000		
Unquoted							
Acuity Partners (Pvt) Ltd	Investment banking	50	655,000	655,000	50	655,000	655,000
Total for the Bank			655,000	655,000		655,000	655,000

Bank's interest in Acuity Partners (Pvt) Ltd include:

	2013 Rs 000	2012 Rs 000
Assets	3,815,615	3,353,510
Liabilities	2,362,882	2,118,402
Income	222,812	200,473
Expenses	184,891	163,646
Tax	32,873	11,258

36 INVESTMENTS IN SUBSIDIARIES

36 (a) Quoted

As at 31st December			2013	Market		2012	Market
Principal Activity	% Holding	Investment Rs 000	Value Rs 000	% Holding	Investment Rs 000	Value Rs 000	
HNB Assurance PLC (29,993,000 shares)	Insurance	60	384,285	1,574,633	60	384,285	1,469,657
Total Quoted Subsidiaries			384,285			384,285	

36 (b) Unquoted

As at 31st December			2013	Directors'		2012	Directors'
Principal Activity	% Holding	Investment Rs 000	Valuation Rs 000	% Holding	Investment Rs 000	Valuation Rs 000	
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	Property development	100	1,973,000	1,973,000	100	1,973,000	1,973,000
Majan Exchange LLC (200,000 shares)	Dealing in foreign exchange	-	-	-	40	56,121	-
Impairment provision		-	-			(56,121)	
Total Unquoted Subsidiaries			1,973,000			1,973,000	
Total for the Bank [36 (a) and 36 (b)]			2,357,285			2,357,285	

Bank together with 40% shareholding in Majan Exchange LLC and management control over its activities could govern the financial and operating policies of the company. Accordingly the investment in Majan Exchange LLC had been classified as investment in Subsidiary.

The Bank's investment in Majan Exchange LLC of Rs 56.121 Mn was fully provided for in 2011 in view of the continuous losses incurred by the subsidiary.

Bank disposed its investment in Majan Exchange LLC during the year and the said provision was reversed. The resultant loss of Rs 0.161 Mn is disclosed in Note 15 Other Operating Income.

36 (c) Movement in impairment during the year

	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Balance as at 1st January	56,121	66,184	-	-
Reversed to income statement (Note 16)	(56,121)	-	-	-
Written off against the investment	-	(10,063)	-	-
Balance as at 31st December	-	56,121	-	-

Bank's investment in Commercial Interlink Services Inc. (o/a of Delma Exchange Canada) was written off against the provision in 2012.

37 INVESTMENT PROPERTIES

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Cost				
Opening Balance	382,230	377,145	248,885	248,746
Disposal	-	-	(215)	-
Improvements	2,202	5,085	993	139
Closing Balance	384,432	382,230	249,663	248,885
Accumulated depreciation				
Opening Balance	32,522	27,771	84,287	79,718
Disposal	-	-	(215)	-
Charge for the year	5,432	4,751	4,727	4,569
Closing Balance	37,954	32,522	88,799	84,287
Net book value as at 31st December	346,478	349,708	160,864	164,598

Notes to the Financial Statements

37 INVESTMENT PROPERTIES (CONTD.)

37 (a) Valuation of Investment Properties - Bank

As at 31st December 2013	Building sq.ft	Extent Perches	Cost / Carrying Amount Building			Fair Value		
			Land (Cost) Rs 000	(Net Book Value) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7	10,645	105.10	37,081	39,396	76,477	625,000	50,000	675,000
479 T B Jayah Mawatha, Colombo 10 *	Land	112.96	75,783	-	75,782	82,699	-	82,699
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 *	Land	26.62	34,889	-	34,889	79,860	180,092	259,952
10, Sri Uttarananda Mawatha, Colombo 03 **	57,917	40	72,000	87,330	159,330	240,000	254,834	494,834
			219,753	126,726	346,478	1,027,559	484,926	1,512,485

37 (b) Valuation of Investment Properties - Group

As at 31st December 2013	Building sq.ft	Extent Perches	Cost / Carrying Amount Building			Fair Value		
			Land (Cost) Rs 000	(Net Book Value) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7	10,645	105.10	37,081	39,396	76,477	625,000	50,000	675,000
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1	41,688	-	-	84,387	84,387	-	180,092	180,092
			37,081	123,783	160,864	625,000	230,092	855,092

The Bank carries investment properties at cost. Market valuations of the above investment properties were carried out as at 31st December 2012 by Messrs J M J Fernando, FIV, DIV (Sri Lanka) and K T D Tissera, FIV,FRICS (Eng), who are independent valuers not connected with the Bank.

The Directors carried out an internal valuation based on the market conditions of similar properties situated within close proximity and by obtaining endorsements from the valuers who had previously carried out valuation of such properties. No significant changes in the fair values of investment properties were observed as at 31st December 2013 when compared with the previous year other than the property situated in No 23 & 23 1/1, Independence Avenue, Colombo 07 in which case a fresh valuation report was obtained as at 31st December 2013.

Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded that there was no impairment in investment properties.

* Land situated at No 479, T B Jayah Mw, Colombo 10 on which HNB Towers is built, and No 21, 21A, 23 and 25 Janadhipathi Mawatha, Colombo 01 are leased to Sithma Development (Pvt) Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as investment property in the Statement of Financial Position of the Bank. However, according to Sri Lanka Accounting Standard (LKAS 40) "Investment Property", the said lands are treated as property, plant and equipment in the Consolidated Statement of Financial Position, since these are leased to a Group entity.

** Building situated at No 10, Sri Uttarananda Mw, Colombo 03 is leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. Accordingly this building is classified as investment property in the Statement of Financial Position of the Bank. However, according to Sri Lanka Accounting Standard (LKAS 40) "Investment Property", the said building is treated as property, plant and equipment in the Consolidated Statement of Financial Position, since Group uses a significant portion of the building for use in the production or supply of goods and services.

38 PROPERTY, PLANT AND EQUIPMENT

Bank	Leasehold Buildings Note 38 (b) Rs 000	Freehold Land and Buildings Note 38 (a) Rs 000	Computer Equipment Rs 000	Equipment Furniture and Fixtures Rs 000	Motor Vehicles Rs 000	Capital Work-in Progress Rs 000	2013 Total Rs 000	2012 Total Rs 000
Cost / valuation								
as at 1st January	1,417,594	6,847,749	2,584,078	3,514,591	240,415	217,179	14,821,606	12,893,143
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	(267,947)
Revaluation surplus	-	-	-	-	-	-	-	1,597,923
Net impairment charge	-	-	-	-	-	-	-	(70,411)
Additions and improvements	41,880	168,055	239,561	287,300	27,448	188,167	952,411	872,396
Disposals during the year	(23,190)	-	(28,313)	(52,075)	(28,387)	-	(131,965)	(203,498)
Transferred from capital work-in-progress	25,868	241,397	-	102,146	-	(369,411)	-	-
Cost / valuation								
as at 31st December	1,462,152	7,257,201	2,795,326	3,851,962	239,476	35,935	15,642,052	14,821,606
Accumulated depreciation								
as at 1st January	948,048	4,678	1,871,616	2,411,288	168,061	-	5,403,691	5,058,279
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	(267,947)
Charge for the year	125,272	84,312	269,214	336,020	30,624	-	845,442	795,635
Disposals during the year	(22,510)	-	(28,294)	(49,386)	(28,387)	-	(128,577)	(182,276)
Accumulated depreciation								
as at 31st December	1,050,810	88,990	2,112,536	2,697,922	170,298	-	6,120,556	5,403,691
Net book value								
as at 31st December 2013	411,342	7,168,211	682,790	1,154,040	69,178	35,935	9,521,496	
Net book value								
as at 31st December 2012	469,546	6,843,071	712,462	1,103,303	72,354	217,179		9,417,915

There were no capitalised borrowing costs relating to the acquisition of property, plant and equipment during the year.

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

Group	Leasehold Buildings	Freehold Land and	Computer Equipment Buildings	Equipment Furniture	Civil Works and Fixtures	Motor Vehicles	Capital Work-in Progress	2013 Total	2012 Total
	Note 38 (b) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation as at 1st January without exchange effect	1,437,837	13,500,954	2,752,340	5,649,271	6,610	261,749	217,502	23,826,263	21,362,602
Effect of movements in exchange rates	-	-	1,381	620	910	-	-	2,911	195
Cost / Valuation as at 1st January	1,437,837	13,500,954	2,753,721	5,649,891	7,520	261,749	217,502	23,829,174	21,362,797
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	-	(597,385)
Revaluation surplus	-	-	-	-	-	-	-	-	2,530,099
Net impairment charge	-	-	-	-	-	-	-	-	(70,411)
Adjustment on accumulated Depreciation for change in remaining useful life	-	-	-	-	-	-	-	-	(110,309)
Effect of movements in exchange rates	-	-	290	123	160	-	-	573	2,716
Additions and improvements	41,880	170,764	256,337	320,410	-	43,519	188,165	1,021,075	925,940
Disposal of Subsidiaries	-	-	(14,138)	(5,912)	(7,680)	-	-	(27,730)	-
Disposals during the year	(23,190)	-	(30,681)	(61,151)	-	(40,537)	-	(155,559)	(213,370)
Written off during the year	-	-	-	-	-	-	-	-	(903)
Transferred from capital work-in-progress	25,868	241,397	-	102,146	-	-	(369,411)	-	-
Cost / Valuation as at 31st December	1,482,395	13,913,115	2,965,529	6,005,507	-	264,731	36,256	24,667,533	23,829,174
Accumulated depreciation as at 1st January without exchange effect	964,724	56,672	1,969,953	2,836,596	2,369	182,466	-	6,012,780	5,947,083
Effect of movements in exchange rates	-	-	524	242	213	-	-	979	79
Accumulated depreciation as at 1st January	964,724	56,672	1,970,477	2,836,838	2,582	182,466	-	6,013,759	5,947,162
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	-	(597,385)
Adjustment on accumulated Depreciation for change in remaining useful life	-	-	-	-	-	-	-	-	(110,309)
Disposal of Subsidiaries	-	-	(9,782)	(4,448)	(3,756)	-	-	(17,986)	-
Charge for the year	127,652	157,705	291,198	418,511	1,103	35,587	-	1,031,756	965,630
Disposals during the year	(22,510)	-	(30,610)	(57,837)	-	(40,537)	-	(151,494)	(191,335)
Written off during the year	-	-	-	-	-	-	-	-	(903)
Effect of movements in exchange rates	-	-	184	84	71	-	-	339	903
Accumulated Depreciation as at 31st December	1,069,866	214,377	2,221,467	3,193,148	-	177,516	-	6,876,374	6,013,759
Net book value as at 31st December 2013	412,529	13,698,738	744,062	2,812,359	-	87,215	36,256	17,791,159	-
Net book value as at 31st December 2012	473,113	13,444,282	783,244	2,813,053	4,938	79,283	217,502	-	17,815,411

As set out in Note 4.12.4, the Bank / Group revalued its freehold land and buildings as at 1st December 2012, by professionally qualified independent valuers. The revaluation was carried out by taking into account the observable prices in active market or recent market transactions on arm's length term. The revaluation surplus, amounting to Rs 1,597.9 Mn / Rs 2,530.1 Mn had been credited to the revaluation reserve account in respect of Bank / Group respectively in 2012. Net impairment loss of Rs 70.4 Mn was accounted for in 2012 in respect of freehold land and buildings based on revaluation of such properties.

Based on the assessment of potential impairment on property, plant and equipment carried out internally by the Board of Directors as at 31st December 2013, no provision was required to be made in the Financial Statements as at reporting date other than those disclosed above.

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)**38 (a) Freehold Land and Buildings - Bank**

As at 31st December 2013	Buildings Sq.ft.	Extent (perches)	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2013 Rs 000	Net Book Value 2012 Rs 000
14, Main Street, Akkaraipattu.	9,097	17.00	23,000	25,000	48,000	740	47,260	47,975
94/1, New Galle Road, Ambalangoda.	5,081	29.90	65,000	15,000	80,000	501	79,499	79,983
30, Maithripala Senanayake Mawatha, Anuradhapura.	9,505	58.99	65,114	29,405	94,519	982	93,537	89,967
15, 15 1/1, Udayaraja Mawatha, Badulla.	5,680	27.75	35,000	12,101	47,101	463	46,638	46,684
24, Maharagama Road, Boralesgamuwa.	5,107	30.34	60,600	32,311	92,911	944	91,967	89,968
16, Janadhipathi Mawatha, Colombo 1.	44,807	84.00	168,000	131,634	299,634	5,446	294,188	294,236
285, Galle Road, Colombo 04.	16,170	20.00	150,000	75,625	225,625	3,106	222,519	219,909
100 & 102, Galle Road, Colombo 06.	16,082	36.05	180,250	110,398	290,648	3,727	286,921	290,395
53/1, D S Senanayake Mawatha, Colombo 08.	10,102	28.00	119,000	89,000	208,000	2,791	205,209	207,905
90, Vinayalankara Mawatha, Colombo 10.	10,250	249.00	996,000	37,584	1,033,584	1,108	1,032,476	1,033,550
168, Panchikawatta Road, Colombo 10.	16,366	22.55	78,900	83,700	162,600	2,422	160,178	162,516
60, Sea Street Colombo 11.	9,608	6.93	55,440	42,429	97,869	1,623	96,246	97,424
88, Main Street, Colombo 11.	3,708	-	-	53,192	53,192	1,569	51,623	52,947
149-151, Main Street, Colombo 11.	11,460	13.03	130,000	71,208	201,208	2,878	198,330	199,909
11, Mohandiram's Road, Colombo 12.	7,377	42.57	96,800	23,663	120,463	914	119,549	120,369
182, St Joseph Street, Colombo 14.	11,221	24.00	66,000	71,000	137,000	2,300	134,700	136,922
700/B, Anuradhapura Road, Dambulla.	7,456	94.50	80,325	20,492	100,817	636	100,181	100,578
3, Wakwella Road, Galle.	7,035	13.80	41,000	19,000	60,000	729	59,271	59,975
148, Colombo Road, Gampaha.	16,779	25.00	50,000	158,200	208,200	4,730	203,470	207,994
12, Kandy Road, Gampola.	6,190	11.88	21,384	12,728	34,112	467	33,645	30,987
142, Kandy Road, Gampola.	12,130	17.05	34,000	93,323	127,323	2,819	124,504	111,239
Bank House -No 295/6, Dimbula Road, Hatton.	4,113	53.80	16,140	6,311	22,451	184	22,267	21,992
Cottage-78, Dimbulla Road, Hatton.	2,114	42.20	13,752	2,747	16,499	106	16,393	16,496
No 88,90 & 90A, Dimbula Road, Hatton.	6,028	15.68	28,208	9,792	38,000	376	37,624	37,988
16, Mount Road Hatton.	5,088	160.00	24,000	6,000	30,000	230	29,770	29,992
73, Old Negombo Road, Kanuwana Ja-Ela.	5,017	19.00	33,200	21,953	55,153	804	54,349	54,977
212.214 Hospital Road Jaffna.	30,776	62.36	276,000	256,268	532,268	3,294	528,974	276,000
772 A, Main Street, Kahawatte.	10,554	16.14	16,000	25,852	41,852	734	41,118	41,718

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

38 (a) Freehold Land and Buildings - Bank (Contd.)

As at 31st December 2013	Buildings Sq.ft.	Extent (perches)	Cost /	Cost /	Total Value	Accumulated Depreciation	Net Book Value 2013	Net Book Value 2012
			Valuation of Land	Valuation of Buildings				
			Rs 000	Rs 000				
30A, Batticaloa Road Kalmunai.	7,000	25.10	19,800	55,528	75,328	1,945	73,383	65,892
1, Dalada Veediya, Kandy.	29,196	57.65	490,025	147,975	638,000	5,682	632,318	637,809
451, Kandy Road Kegalle.	Bare Land	58.70	27,793	-	27,793	-	27,793	27,500
225, Main Street, Kuliyapitiya.	3,815	32.80	37,440	10,560	48,000	405	47,595	47,987
6, St. Anne's Street, Kurunegala.	17,970	36.25	119,063	84,937	204,000	3,261	200,739	203,890
68, Main Street, Mannar.	5,680	23.00	20,300	17,960	38,260	532	37,728	38,243
534, Colombo Road, Marawila.	7,286	43.80	32,850	27,250	60,100	1,046	59,054	60,065
7/11, New Town, Maskeliya.	7,382	20.32	6,072	21,928	28,000	837	27,163	26,474
58D, Esplanade Road, Matara.	9,580	26.00	39,000	31,179	70,179	1,194	68,985	69,960
41, Samarakkody Road Minuwangoda.	3,452	20.51	25,637	14,212	39,849	410	39,439	39,785
No 67/11, Kumaradola Road, Monaragala.	Bare Land	20.00	1,600	-	1,600	-	1,600	1,600
605, Galle Road, Mount Lavinia.	11,350	22.66	62,300	58,600	120,900	2,250	118,650	120,825
18, Rajapakse Broadway, Negombo.	4,845	8.88	22,000	9,197	31,197	334	30,863	29,990
201, Colombo Road Negombo.	25,770	51.98	103,900	206,183	310,083	6,164	303,919	309,733
22, Kandy Road, Nittambuwa.	10,411	44.90	67,000	162,169	229,169	6,391	222,778	227,954
10, Puttalam Road, * Nochchiyagama.	8,265	-	-	24,000	24,000	922	23,078	23,969
181, High Level Road, Nugegoda.	11,096	15.71	74,000	61,000	135,000	2,342	132,658	134,921
190, 190/1, Highlevel Road, Nugegoda.	Bare Land	39.65	99,709	-	99,709	-	99,709	-
42, Queen Elizabeth Drive, Nuwara Eliya.	14,145	149.03	89,418	38,995	128,413	1,540	126,873	128,321
467, Main Street, Kaduruwela * Polonnaruwa.	9,882	-	-	48,055	48,055	1,389	46,666	47,953
510, Nuwaraeliya Road, Pussellawa.	6,163	15.95	10,840	14,319	25,159	402	24,757	24,986
9 Senanayake Mw Ratnapura.	8,236	43.40	64,800	20,210	85,010	782	84,228	84,974
59, Ehamparam Road, Trincomalee.	9,156	31.75	47,625	32,375	80,000	958	79,042	79,968
43, Inner Circular Road, * Vavuniya.	8,340	-	-	28,816	28,816	1,266	27,550	28,541
270, 270/1, Negombo Road, Wattala.	8,579	53.00	119,200	46,800	166,000	1,618	164,382	165,946
35, Nuwara Eliya Road, Welimada.	3,450	14.37	19,500	5,500	25,000	163	24,837	24,995
70, Kumaradasa Mawatha, Wellawaya.	6,560	30.00	12,109	18,443	30,552	534	30,018	30,195
Total freehold land and buildings			4,535,094	2,722,107	7,257,201	88,990	7,168,211	6,843,071

*Building constructed on state lands given on lease.

38 PROPERTY, PLANT AND EQUIPMENT (CONTD.)**38 (b) Leasehold Buildings**

As at 31st December	Bank				Group			
	Cost of Buildings Rs 000	2013 Accumulated Depreciation Rs 000	Net Book Value Rs 000	2012 Net Book Value Rs 000	Cost of Buildings Rs 000	2013 Accumulated Depreciation Rs 000	Net Book Value Rs 000	2012 Net Book Value Rs 000
01 - 05 years	567,064	526,517	40,547	81,309	587,307	545,572	41,735	84,877
05 - 10 years	824,487	476,335	348,152	366,306	824,487	476,335	348,152	366,306
10 - 15 years	56,690	37,684	19,006	17,832	56,690	37,684	19,006	17,832
15 - 20 years	13,911	10,274	3,637	4,099	13,911	10,275	3,636	4,098
Total	1,462,152	1,050,810	411,342	469,546	1,482,395	1,069,866	412,529	473,113

38 (c) Fully Depreciated Property, Plant and Equipment - Bank

The initial cost of fully depreciated property, plant and equipment, which are still in use as at reporting date is as follows.

As at 31st December	2013 Rs 000	2012 Rs 000
Motor vehicles	100,336	101,645
Leasehold building	416,323	353,105
Computer equipment	1,207,843	1,012,534
Equipment, furniture and fixtures	1,713,312	1,365,611
Intangible assets	620,091	624,313

38 (d) Temporarily Idle Property, Plant and Equipment - Bank

Two lands worth of Rs 29.39 Mn were idle as at 31st December 2013 (2012 : Rs 29.10 Mn) as these lands were not identified as available for immediate use.

The Bank has identified plans to develop and sell these lands in the near future.

38 (e) Property, Plant and Equipment Retired from Active Use - Bank

The carrying amount of property, plant and equipment which are retired from active use and not classified as held for sale as at 31st December 2013 is Rs 0.449 Mn (2012 - Rs 0.282 Mn).

38 (f) Title Restriction on Property, Plant and Equipment - Bank / Group

There were no restrictions on the title of property, plant and equipments as at 31st December 2013.

38 (g) Property, Plant and Equipment Pledged as Security for Liabilities - Bank / Group

There were no items of property, plant and equipments pledged as securities for liabilities.

38 (h) Compensation from Third Parties for Property, Plant and Equipment - Bank

Rs 6.13 Mn (2012 : Rs 5.9 Mn) was received as compensation from third parties for items of property, plant and equipment that were impaired, lost or given up.

Notes to the Financial Statements

39 INTANGIBLE ASSETS

	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Cost				
Balance as at 1st January	1,796,959	1,614,977	2,005,378	1,798,083
Additions and improvements during the year	671,888	181,982	681,445	126,532
Transferred from capital work in progress	-	-	-	81,682
Disposals / write offs during the year	-	-	-	(919)
Balance as at 31st December	2,468,847	1,796,959	2,686,823	2,005,378
Accumulated amortisation				
Balance as at 1st January	1,240,788	1,065,474	1,315,877	1,127,309
Amortisation for the year	233,382	175,314	249,941	189,099
Disposals / write offs during the year	-	-	-	(531)
Balance as at 31st December	1,474,170	1,240,788	1,565,818	1,315,877
Net book value as at 31st December	994,677	556,171	1,121,005	689,501
39 (a) Analysis of Intangible Assets				
Computer Software	994,677	556,171	1,050,817	619,313
Goodwill *	-	-	70,188	70,188
	994,677	556,171	1,121,005	689,501

As stated in Note 4.10.1 (b), all computer software costs incurred by the Bank / Group which are not integrally related to associated hardware have been classified as intangible assets.

There were no restrictions on the title of the intangible assets as at the reporting date. Further there were no items pledged as securities for liabilities.

* 50% of the goodwill recognised in 2010 in respect of acquisition of Lanka Ventures PLC by the Joint Venture Acuity Partners (Pvt) Ltd.

40 OTHER ASSETS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Deposits and prepayments	5,894,567	5,611,526	5,515,547	5,187,829
Items in transit	2,989,721	3,237,945	2,989,721	3,237,945
VAT recoverable	913,884	1,379,435	913,884	1,379,456
Related party receivable - exchange houses *	-	-	-	-
Items held for use	44,813	52,152	44,813	52,152
Inventory - residential apartment complex **	-	-	20,989	162,990
Receivable from pension fund	107,127	513,748	107,127	513,748
Other debtors	913,221	1,297,393	1,805,992	2,145,836
	10,863,333	12,092,199	11,398,073	12,679,956

* Rs 13.896 Mn included under related party receivable from Majan Exchange LLC has been fully provided in 2011. During the year the said provision was reversed and included under recovery of operational losses provided for in prior years in Note 15 - Other Operating Income.

** Rs 7.728 Mn has been charged as a provision in the Consolidated Financial Statements for impairment of inventory - residential apartment complex held by the Subsidiary, Sithma Development (Pvt) Ltd in 2012.

41 DUE TO BANKS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Call and time deposits	4,558,609	530,000	4,558,609	530,000
Refinance borrowings	5,312,578	6,085,541	5,312,578	6,085,541
Securities sold under repurchase agreements	-	896,216	426,708	1,486,627
Foreign bank borrowings	19,145,680	11,845,824	19,145,680	11,845,824
Borrowings from local banks	5,917,350	4,495,066	5,917,350	4,495,066
	34,934,217	23,852,647	35,360,925	24,443,058

42 DERIVATIVE FINANCIAL INSTRUMENTS

Foreign exchange derivatives				
Currency swaps	636,475	1,240,783	636,475	1,240,783
Forward foreign exchange contracts	112,487	195,660	112,487	195,660
	748,962	1,436,443	748,962	1,436,443

43 DUE TO OTHER CUSTOMERS

Local currency deposits	322,166,629	280,644,472	321,910,075	280,191,284
Foreign currency deposits	63,194,341	60,779,514	63,090,525	60,656,322
	385,360,970	341,423,986	385,000,600	340,847,606

43 (a) Product wise analysis of due to other customers

Current account deposits	23,837,932	23,390,690	23,610,872	23,073,949
Savings deposits	124,510,241	109,176,640	124,503,574	109,169,526
Time deposits	233,084,721	200,801,761	232,958,078	200,549,236
Certificates of deposit	3,928,076	8,054,895	3,928,076	8,054,895
	385,360,970	341,423,986	385,000,600	340,847,606

43 (b) Currency wise analysis of due to other customers

Sri Lankan rupee	322,166,629	280,644,471	321,910,075	280,191,287
United State Dollar	47,627,819	45,632,264	47,524,003	45,509,071
Great Britain Pound	4,279,913	4,313,126	4,279,913	4,313,126
Euro currency	6,382,379	5,815,462	6,382,379	5,815,462
Australian Dollar	4,259,666	4,254,395	4,259,666	4,254,393
Other currencies	644,564	764,267	644,564	764,267
	385,360,970	341,423,986	385,000,600	340,847,606

Notes to the Financial Statements

44 DIVIDENDS PAYABLE

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Balance as at 1st January	221,455	168,080	223,251	169,876
Final cash dividends declared in the prior year	2,782,814	1,166,032	2,853,253	1,217,078
Final scrip dividends declared in the prior year	-	116,603	-	116,603
Interim dividends declared during the year	599,332	595,870	599,332	595,870
Dividends paid	(3,177,254)	(1,825,130)	(3,247,693)	(1,876,176)
Balance as at 31st December	426,347	221,455	428,143	223,251

44 (a) Proposed Final Dividend

The Directors recommend that a final cash dividend of Rs 7.00 per share (2012 : Rs 7.00 per share) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2013.

Further this dividend is to be approved at the Annual General Meeting to be held on 28th March 2014. In accordance with Sri Lanka Accounting Standard (LKAS 10), "Events after the reporting period", this proposed final dividend has not been recognised as a liability as at 31st December 2013. Under the Inland Revenue Act No 10 of 2006, a withholding tax of 10% has been imposed on dividends declared. An interim dividend of Rs 1.50 per share (2012 : Rs 1.50) was paid to the shareholders on 13th December 2013. Final dividends proposed for the year 2013 amounts to Rs 2,800.11 Mn (2012 : Rs 2,782.81 Mn).

44 (b) Compliance with Section 56 and 57 of Companies Act No 7 of 2007

As required by Section 56 of the Companies Act No 07 of 2007, the Board of Directors of the Bank satisfied the solvency test in accordance with the section 57, prior to recommending the final dividend. A statement of solvency completed and duly signed by the directors on 21st February 2014 has been audited by Messrs KPMG.

45 OTHER BORROWINGS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Securities sold under repurchase agreements	4,132,603	3,705,268	5,625,961	4,796,439
Refinance borrowings	301,961	343,025	301,961	343,025
Others	4,228,538	4,284,252	4,325,617	4,399,279
	8,663,102	8,332,545	10,253,539	9,538,743

46 DEBT SECURITIES ISSUED

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Issued by the bank [Note 46 (a)]	1,418,775	-	1,399,184	-
Issued through joint venture [Note 46 (b)]	-	-	131,111	150,000
	1,418,775	-	1,530,295	150,000

46 (a) Debt securities issued by the bank*

Colombo Stock Exchange Listing	Interest payment frequency	Face value Rs 000	Interest rate	Repayment terms	Issue date	Maturity date	Bank		Group	
							As at 31.12.2013 Rs 000	As at 31.12.2012 Rs 000	As at 31.12.2013 Rs 000	As at 31.12.2012 Rs 000
(i) Year of issuance 2013 Listed	Annually	2,000,000	8%	10 Years	30th Aug 2013	29th Aug 2023	1,418,775	-	1,399,184	-
Total debt securities issued - Bank							1,418,775	-	1,399,184	-
Due within one year							-	-	-	-
Due after one year							1,418,775	-	1,399,184	-
Total							1,418,775	-	1,399,184	-

46 (b) Debt securities issued through joint venture**

Colombo Stock Exchange Listing	Face value Rs 000	Interest rate	Repayment terms	Issue date	Maturity date	Bank		Group	
						As at 31.12.2013 Rs 000	As at 31.12.2012 Rs 000	As at 31.12.2013 Rs 000	As at 31.12.2012 Rs 000
(i) Year of issuance 2012 Unlisted	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2013	-	-	-	30,000
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2014	-	-	41,111	30,000
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2015	-	-	30,000	30,000
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2016	-	-	30,000	30,000
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2017	-	-	30,000	30,000
Total debt securities issued through joint venture						-	-	131,111	150,000
Due within one year						-	-	41,111	30,000
Due after one year						-	-	90,000	120,000
Total						-	-	131,111	150,000

* Senior listed unsecured redeemable 10 year debentures issued by the Bank. HNB Assurance PLC, a subsidiary of the Bank holds Rs 19.6 Mn of the debt securities issued by the Bank

** Redeemable preference shares issued by Lanka Ventures PLC, a subsidiary of joint venture, Acuity Partners (Pvt) Ltd. Only 50% of the value is accounted for in the Consolidated Financial Statements.

47 INSURANCE PROVISION-LIFE

The insurance provision - life balance represents the life fund of the Subsidiary HNB Assurance PLC, which is carrying out life and general insurance business.

This balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the insurance provision - life as at 31st December 2013 was made by Mr M Poopalanathan, AIA, of Messrs Actuarial and Management Consultants (Pvt) Ltd for and on behalf of HNB Assurance PLC.

The life fund stands at Rs 4,348.5 Mn as at 31st December 2013 (2012 : Rs 3,626.2 Mn) and in the opinion of the Actuary this amount is adequate to cover the liabilities pertaining to the long term insurance business of HNB Assurance PLC, as per the actuary's report dated 3rd February 2014.

Notes to the Financial Statements

48 INSURANCE PROVISION - NON-LIFE

Insurance provision - non-life represents the following which are included in the financial statements of HNB Assurance PLC, Subsidiary of the Bank, as required by the Statement of Recommended Practice of the Institute of Chartered Accountants of Sri Lanka and in accordance with the regulation of Insurance Industry Act No 43 of 2000.

As at 31st December	Group		Group	
	2013 Rs 000	2013 Rs 000	2012 Rs 000	2012 Rs 000
Unearned premium				
Gross		936,283		845,279
Reinsurance		(183,046)		(169,636)
Net		753,237		675,643
Deferred acquisition expenses		-		20,446
Unexpired risk reserve		22,370		80
		775,607		696,169
Claims outstanding - Gross	182,147		240,349	
Claims incurred but not reported - Gross	53,347	235,494	32,923	273,272
Total		1,011,101		969,441

49 DEFERRED TAX (ASSETS) / LIABILITIES

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Deferred tax liabilities [Note 49 (a)]	1,636,349	1,480,837	1,751,247	1,558,808
Deferred tax assets [Note 49 (b)]	(2,404,175)	(369,726)	(2,407,438)	(372,193)
	(767,826)	1,111,111	(656,191)	1,186,615

49 (a) Deferred Tax Liabilities

49 (a) i Deferred Tax Liabilities on other Temporary Differences

As at 31st December	Bank				Group			
	2013 Temporary Difference Rs 000	2013 Tax Effect Rs 000	2012 Temporary Difference Rs 000	2012 Tax Effect Rs 000	2013 Temporary Difference Rs 000	2013 Tax Effect Rs 000	2012 Temporary Difference Rs 000	2012 Tax Effect Rs 000
Balance as at 1st January	5,288,704	1,480,837	4,195,932	1,174,861	5,298,400	1,483,551	4,197,156	1,175,203
Deferred tax liability attributable to revaluation surplus charged to equity	-	-	483,221	135,302	-	-	483,221	135,302
Originating during the year	555,400	155,512	609,550	170,674	600,163	168,046	618,020	173,046
Balance as at 31st December	5,844,104	1,636,349	5,288,703	1,480,837	5,898,563	1,651,597	5,298,397	1,483,551

49 (a) ii Deferred Tax Liabilities on Undistributed Profits of Subsidiaries

As at 31st December	Bank				Group			
	2013 Temporary Difference Rs 000	2013 Tax Effect Rs 000	2012 Temporary Difference Rs 000	2012 Tax Effect Rs 000	2013 Temporary Difference Rs 000	2013 Tax Effect Rs 000	2012 Temporary Difference Rs 000	2012 Tax Effect Rs 000
Balance as at 1st January	-	-	-	-	752,580	75,258	501,450	50,145
Deferred tax liability attributable to undistributed profits of Subsidiaries	-	-	-	-	243,940	24,392	251,130	25,112
Balance as at 31st December	-	-	-	-	996,520	99,650	752,580	75,257
Total deferred tax liabilities	5,844,104	1,636,349	5,288,703	1,480,837	6,895,083	1,751,247	6,050,977	1,558,808

Deferred Tax Liability Charged Directly to Equity

According to Sri Lanka Accounting Standard (LKAS 12) "Income Taxes", deferred tax shall be charged or credited to equity through other comprehensive income if the tax relates to items that are credited or charged, in the same or in a different period, directly to equity.

Accordingly, the deferred tax liability arising on revaluation of property, plant and equipment of Rs 135.302 Mn was charged to revaluation reserve through Other Comprehensive Income during 2012.

49 DEFERRED TAX (ASSETS)/LIABILITIES (CONTD.)**49 (b) Deferred Tax Assets**

As at 31st December	Bank				Group			
	2013 Temporary Difference Rs 000	2013 Tax Effect Rs 000	2012 Temporary Difference Rs 000	2012 Tax Effect Rs 000	2013 Temporary Difference Rs 000	2013 Tax Effect Rs 000	2012 Temporary Difference Rs 000	2012 Tax Effect Rs 000
Balance as at 1st January	1,320,451	369,726	1,120,660	313,785	1,329,263	372,193	1,138,911	318,895
Deferred tax asset recognised / (reversed) on deductible temporary differences	7,265,889	2,034,449	199,791	55,941	7,268,729	2,035,245	190,352	53,298
Balance as at 31st December	8,586,340	2,404,175	1,320,451	369,726	8,597,992	2,407,438	1,329,263	372,193

49 (c) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following

	Bank						Group					
	2013			2012			2013			2012		
	Assets	Liabilities	Net	Assets	Liabilities	Net	Assets	Liabilities	Net	Assets	Liabilities	Net
Property, plant and equipment	-	(446,972)	(446,972)	-	(396,996)	(396,996)	-	(461,894)	(461,894)	-	(399,432)	(399,432)
Intangible assets	-	(101,757)	(101,757)	-	(92,220)	(92,220)	-	(102,080)	(102,080)	-	(92,498)	(92,498)
Assets on lease business	-	(896,313)	(896,313)	-	(800,314)	(800,314)	-	(896,313)	(896,313)	-	(800,314)	(800,314)
Revaluation on free hold buildings	-	(191,307)	(191,307)	-	(191,307)	(191,307)	-	(191,308)	(191,308)	-	(191,307)	(191,307)
Undistributed profits of subsidiaries	-	-	-	-	-	-	-	(99,652)	(99,652)	-	(75,257)	(75,257)
Temporary difference on provisions	2,404,175	-	2,404,175	369,726	-	369,726	2,407,438	-	2,407,438	372,193	-	372,193
	2,404,175	(1,636,349)	767,826	369,726	(1,480,837)	(1,111,111)	2,407,438	(1,751,247)	656,191	372,193	(1,558,808)	(1,186,615)

50 OTHER LIABILITIES

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Cheques sent on clearing	3,091,688	3,215,781	3,091,688	3,215,781
Bills payable	1,758,922	1,430,578	1,758,922	1,430,578
Items in transit	47,153	123,225	47,153	123,225
Margins	1,797,422	1,219,804	1,797,422	1,219,804
Refundable deposits and advances*	-	-	80,676	138,236
Balance held o/a of Pension Fund	289,305	237,474	289,305	237,474
Balance held o/a of Widows', Widowers' and Orphans' Pension Fund (WW&OP)	54,627	16,878	54,627	16,878
Balance held o/a of Employees' Provident Fund (EPF)	79,035	105,143	79,035	105,143
Liability for EPF interest rate guarantee [Note 50 (a)]	34,281	17,696	34,281	17,696
Liability for accumulated leave [Note 50 (b)]	127,438	109,174	127,438	109,174
Liability for cash settled share based payment [Note 50 (c)]	-	1,320,451	-	1,320,451
Provision for retiring benefits	-	-	74,559	56,119
Payable to vendors for lease equipments	288,011	144,605	288,011	144,605
Other creditors	1,920,340	1,392,555	2,441,110	1,909,704
	9,488,222	9,333,364	10,164,227	10,044,868

*Refundable deposits and advances include the advances taken from customers on account of the apartments in the Residential Apartments Complex which is developed by Sithma Development (Pvt) Ltd.

Notes to the Financial Statements

50 OTHER LIABILITIES (CONTD.)

50 (a) Employee Provident Fund (EPF) Interest Rate Guarantee - Bank

EPF is an approved provident fund which has been set up to meet the provident fund liabilities of the Bank. Staff members who are members of the fund are entitled to receive a minimum interest rate higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi annual basis. Accordingly this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation of the same with the following actuarial assumptions.

As at 31st December	2013	2012
Discount rate	10.00%	11.00%
Future salary increase	9.69%	9.75%

50 (b) Liability for accumulated leave - Bank

Employees are entitled to accumulate annual leave upto a maximum of ninety days and such accumulated leave to be utilised prior to their retirement. This has been treated as an other long term benefit in terms of LKAS 19 "Employee benefits" and an actuarial valuation has been conducted on the same with the following assumptions.

As at 31st December	2013	2012
Discount rate	10.00%	11.00%
Future salary increase	9.69%	9.75%

50 (c) Liability for cash settled share based payments

In 2005 the Bank had set up an Employee Share Benefit Trust for the benefit of the executive employees that entitled those employees to a cash payment. The amount of cash payment was determined based on the increase in the share price of the Bank between grant date and vesting date adjusted for interest and the related charges.

The Employee Share Benefit Trust was wound up during the year and the beneficiaries were given the option to get the shares transferred in their name or to get the proceeds after the sale of shares in the market. Accordingly, no liability is recognised in respect of the cash settled share based payment scheme as at 31st December 2013 and the total liability recognised as at the date of winding up was reversed to the Income Statement as disclosed in Note 17 Personnel Expenses.

As at 31st December	2013 Rs. 000	2012 Rs. 000
Total carrying amount of liabilities for cash-settled arrangements	-	1,320,451

51 SUBORDINATED TERM DEBTS

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Subordinated debentures [Note 51 (a)]	8,607,558	4,585,568	8,532,701	4,563,011
Subordinated loan [Note 51 (b)]	3,249,002	3,166,322	3,249,002	3,166,322
	11,856,560	7,751,890	11,781,703	7,729,333

51 (a) Subordinated debentures

	Colombo Stock Exchange Listing	Interest payment frequency	Face value Rs 000	Repayment Interest rate	terms	Issue date	Maturity date	Bank		Group	
								As at 31.12.2013 Rs 000	As at 31.12.2012 Rs 000	As at 31.12.2013 Rs 000	As at 31.12.2012 Rs 000
Issued by the Bank											
(i) Year of issuance 2006	Listed	Semi Annually	250,000	6 months net TB + 2.25%	7 Year	1st Apr 2006	31st Mar 2013	-	250,000		250,000
		Semi Annually	300,000	6 months net TB + 2.25%	8 Year	1st Apr 2006	31st Mar 2014	300,000	312,254	300,000	312,254
		At maturity	241,600	11.00%	15 Year	1st Apr 2006	31st Mar 2021	241,600	217,658	224,735	202,463
		At maturity	457,416	11.25%	18 Year	1st Apr 2006	31st Mar 2024	457,416	411,159	457,416	411,159
(ii) Year of issuance 2007	Listed	Annually	500,000	16.00%	10 Year	1st Aug 2007	31st Jul 2017	540,000	540,000	540,000	540,000
		Annually	700,000	16.75%	15 Year	1st Aug 2007	31st Jul 2022	758,625	758,625	758,625	758,625
(iv) Year of issuance 2008	Not listed	Annually	89,704	1 year net TB + 1.00%	5 Year	5th Jun 2008	4th Jun 2013	-	95,872	-	88,510
(v) Year of issuance 2011	Listed	Semi Annually	2,000,000	11.50%	10 Year	5th Sep 2011	4th Sep 2021	2,000,000	2,000,000	2,000,000	2,000,000
(vi) Year of issuance 2013	Listed	Annually	4,000,000	14.00%	5 Year	13th June 2013	12th June 2018	4,309,917	-	4,251,925	
Total								8,607,558	4,585,568	8,532,701	4,563,011
Due within one year								300,000	250,000	300,000	250,000
Due after one year								8,307,558	4,335,568	8,232,701	4,313,011
Total								8,607,558	4,585,568	8,532,701	4,563,011

HNB Assurance PLC, a Subsidiary of the Bank holds debentures amounting to Rs 74.9 Mn.

51 (b) Subordinated loan

Subordinated loan represents eight year subordinated loan of USD 25 Mn from German Development Financial Institution (DEG).

Notes to the Financial Statements

52 EMPLOYEE BENEFITS

52 (a) Pension Fund - Bank

An actuarial valuation of the Pension Fund was carried out as at 31st December 2013 by Mr M Poopalanathan, AIA, Messrs Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuaries to value the Fund is the "Projected Unit Credit Method", the method recommended by the Sri Lanka Accounting Standard (LKAS 19) "Employee Benefits".

Accordingly, the Bank contributes on the following basis for the employees to the Pension Fund:

Pensionable Employees - 24.34%

Employees who opted for the Optional Scheme - 23%

The assets of the Fund, which are independently administered by the Trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No additional provision has been made in the Financial Statements of the Bank for gratuities to employees who have completed five or more years of service, payable under the payment of Gratuity Act No 12 of 1983 as the Bank contributes for all permanent employees to its own non-contributory pension scheme, which is in force.

52 (a) i Amounts Recognised in the Statement of Financial Position are as follows

As at 31st December	2013 Rs 000	2012 Rs 000
Present value of unfunded obligation	-	-
Present value of funded obligation	11,272,452	9,469,694
Total present value of obligations	11,272,452	9,469,694
Fair value of plan assets	(11,390,292)	(10,063,990)
Present value of net obligations/(surplus)	(117,840)	(594,296)
Less: Unrecognised actuarial losses	-	-
Recognised liability/(asset) for defined benefit obligations	(117,840)	(594,296)

The Bank is expecting to recover the above surplus by way of reduced future contributions to the pension fund and accordingly the Bank recognised a net receivable of Rs 107.127 Mn (2012 : Rs 513.748 Mn) from the pension fund as the present value of the reduction in future contributions which is disclosed under Note 40 "Other Assets".

52 (a) ii Plan Assets Consist of the Following

As at 31st December	2013 Rs 000	2012 Rs 000
Equity securities and debentures	564,534	825,211
Government bond	2,106,867	1,866,908
Balance with Hatton National Bank PLC	289,305	237,474
Fixed deposits	7,827,588	6,773,001
Others	601,998	361,396
	11,390,292	10,063,990

52 (a) iii Movement in the Present Value of Defined Benefit Obligations

Liability for defined benefit obligations as at 1st January	9,469,694	9,315,060
Actuarial (gains)/losses	962,102	(575,840)
Benefits paid by the plan	(683,290)	(557,391)
Current service cost and interest cost	1,523,946	1,287,865
Liability for defined benefit obligations as at 31st December	11,272,452	9,469,694

As at 31st December	2013 Rs 000	2012 Rs 000 Restated
52 (a) iv Movement in Plan Assets		
Fair value of plan assets as at 1st January	10,063,990	8,575,838
Contributions paid into plan	848,617	1,049,968
Benefits paid by the plan	(683,290)	(557,391)
Actuarial gains	104,256	180,870
Expected return on plan assets	1,056,719	814,705
Fair value of plan assets as at 31st December	11,390,292	10,063,990

52 EMPLOYEE BENEFITS (CONTD.)

52 (a) v Actuarial Assumptions

As at 31st December	2013 %	2012 %
Discount rate	10.00	10.50
Expected return on plan assets as at 1st January	10.50	9.50
Future salary increases	9.69	9.75
Future pension increases	Nil	Nil
Increase in cost of living allowance	10.00	10.00

The overall expected long term rate of return on assets is 10.50%.

The demographic assumptions underlying the valuation are retirement age (55 years), early withdrawals from service and retirement on medical grounds, death before and after retirement, etc.

Discount rate has a significant effect on the amounts recognised in Income Statement. A 0.50% change in discount rate would have the following effects.

	0.50% increase Rs 000	0.50% decrease Rs 000
Increase / (decrease) current service and interest cost	(39,343)	44,065
Increase / (decrease) defined benefit obligation	(536,662)	594,220

52 (a) vi Historical Information

As at 31st December	2012 Rs 000	2011 Rs 000	2010 Rs 000	2009 Rs 000	2008 Rs 000
Present value of the defined benefit obligation	9,469,694	9,315,060	8,415,678	6,927,747	6,496,902
Fair value of plan assets	(10,063,990)	(8,575,838)	(7,358,111)	(5,977,832)	(4,338,509)
(Surplus)/Deficit in the plan	(594,296)	739,222	1,057,567	949,915	2,158,393

52 (b) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Fund indicates that the actuarial present value of the promised benefit is Rs 473.54 Mn and that the fair value of the fund assets is Rs 894.63 Mn resulting in a past service surplus of Rs 421.09 Mn (2012 : Rs 452.11 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2013.

No contribution is made by the Bank and the members' contribution during the period amounted to Rs 61 Mn.

53 STATED CAPITAL

In accordance with Section 58 of Companies Act No 7 of 2007, which became effective from 3rd May 2007, share capital and share premium have been classified as stated capital.

53 (a) Stated Capital - Bank / Group

	2013 Rs 000	2012 Rs 000
Voting ordinary shares		
Balance as at 1st January	10,049,259	9,143,326
Issue of shares under ESOP	205,685	64,975
Scrip dividend*	-	840,958
Balance as at 31st December	10,254,944	10,049,259
Non-voting ordinary shares		
Balance as at 1st January	2,530,220	2,308,125
Issue of shares under ESOP	45,104	13,624
Scrip dividend*	-	208,471
Balance as at 31st December	2,575,324	2,530,220
Stated Capital as at 31st December	12,830,268	12,579,479

Notes to the Financial Statements

53 STATED CAPITAL (CONTD.)

53 (b) Reconciliation of Number of Shares

	2013	2012
Voting ordinary shares		
Balance as at 1st January	317,650,102	311,406,247
Issue of shares under ESOP	1,703,727	561,707
Scrip dividend*	-	5,682,148
Balance as at 31st December	319,353,829	317,650,102
Non-voting ordinary shares		
Balance as at 1st January	79,596,347	77,190,596
Issue of shares under ESOP	605,025	197,371
Scrip dividend*	-	2,208,380
Balance as at 31st December	80,201,372	79,596,347

The non-voting shares rank pari passu in respect of all rights with the ordinary shares of the Bank except voting rights on resolutions passed at general meetings.

If the Bank fails to pay dividends for three consecutive years, these shares will automatically be converted into voting ordinary shares.

*Pursuant to a resolution adopted by the shareholders of the Bank at the Annual General Meeting held on 30th March 2012 a scrip dividend was approved according to which a total of 7,890,528 new ordinary shares (comprising of 5,682,148 voting shares and 2,208,380 non-voting shares) were issued on 30th March 2012.

53 (c) Share-based payment transactions

On 28th March 2008 the Bank established an Employee Share Option Scheme that entitles employees in the rank of management and above to purchase shares in the Bank. Holders of vested options are entitled to purchase shares at the given exercise prices.

The recognition and measurement principles in SLFRS 2 "Share Based Payment" standard have not been applied to the grants made in 2008 and 2010 based on the transitional provisions available in SLFRS 2. The standard is applied for share options granted after 1st January 2012 and have not yet vested on the effective date of SLFRS 2.

The Bank made two further grants under the Employee Share Option Scheme on 30th March 2012 and 05th June 2013, which are recognised and measured in terms of SLFRS 2.

All options are to be settled by physical delivery of shares.

53 STATED CAPITAL (CONTD.)**53 (c) i Employee Share Option Plan (Equity-settled share based payment scheme)**

The number and the weighted average exercise price of share options are as follows:

	2013		2012	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
Outstanding as at 1st January	119.64	8,341,338	101.71	4,365,075
Granted during the year	135.73	4,965,408	133.01	4,818,863
Exercised during the year	108.63	(2,308,752)	100.66	(926,656)
Expired during the year	126.35	(682,138)	-	-
Additional options due to scrip dividend	-	-	98.09	84,056
Outstanding as at 31st December	129.40	10,315,856	119.64	8,341,338
Exercisable as at 31st December	124.65	5,889,497	101.93	3,717,400

The options outstanding as at 31st December 2013 have an exercise price in the range of Rs 65.67 to Rs 142.17 (2012: Rs 35.07 to Rs 145.79) and a weighted average contractual life of 5.93 years (2012 : 3.36 years)

The weighted average share price at the date of exercise, for share options exercised during the year ended 31st December 2013 was Rs 158.81 for voting shares and Rs 118.41 for non voting shares (2012: Rs 154.36 voting and Rs 104.45 non voting).

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using a binomial lattice model, with the following inputs:

	Allocation 2013	Allocation 2012
Fair value of share options and assumptions		
Fair value at measurement date (Rs. 000)	239,701	176,515
Share price	Voting - Rs 168.80 Non voting - Rs 126.00	Voting - Rs 153.00 Non voting - Rs 94.50
Exercise price	Voting - Rs 142.17 Non voting - Rs 110.04	Voting - Rs 145.79 Non voting - Rs 81.43
Expected volatility*	Voting - 33%, Non voting - 33%	Voting - 26%, Non voting - 30%
Option life (expected weighted average life)	5 Years	5 Years
Expected dividends*	30%	30%
Risk free interest rate (based on government bonds)	11.00%	11.80%

* Annual rates

54 STATUTORY RESERVES**54 (a) Statutory Reserve Fund**

	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Balance as at 1st January	2,230,000	1,800,000	2,230,000	1,800,000
Transfers during the year	430,000	430,000	430,000	430,000
Balance as at 31st December	2,660,000	2,230,000	2,660,000	2,230,000

54 (b) Investment Fund Account

Balance as at 1st January	2,300,562	978,337	2,300,562	978,337
Transfers during the year	1,800,643	1,322,225	1,800,643	1,322,225
Balance as at 31st December	4,101,205	2,300,562	4,101,205	2,300,562
Total statutory reserves as at 31st December	6,761,205	4,530,562	6,761,205	4,530,562

Notes to the Financial Statements

55 RETAINED EARNINGS

	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Balance as at 1st January	4,225,948	3,009,553	5,321,846	3,504,132
Profit for the year	7,010,106	7,534,155	7,650,461	7,941,754
Other comprehensive income for the year	(857,846)	756,710	(856,543)	756,710
Transfer of revaluation reserve for disposal of property, plant and equipment	-	5,689	-	5,689
Transfer to other reserves	(3,530,643)	(4,152,225)	(3,530,643)	(4,152,225)
Dividends	(3,382,146)	(2,927,934)	(3,382,146)	(2,859,474)
Write-off of subsidiary investment	-	-	-	(3,665)
Disposal of associate company	-	-	-	52,052
Deemed disposal gain through joint venture	-	-	40,189	76,873
Disposal of subsidiary company	-	-	9,250	-
Effect of winding up of special purpose entity	-	-	(41,931)	-
Balance as at 31st December	3,465,419	4,225,948	5,210,483	5,321,846

56 OTHER RESERVES

56 (a) 2013

	Bank			Group		
	Opening balance Rs 000	Movement/ transfers Rs 000	Closing balance Rs 000	Opening balance Rs 000	Movement/ transfers Rs 000	Closing balance Rs 000
Capital reserve	4,466,918	-	4,466,918	8,792,657	-	8,792,657
Available for sale reserve	3,119,631	1,294,197	4,413,828	3,150,301	1,304,688	4,454,989
General reserve	17,800,000	1,300,000	19,100,000	17,800,000	1,300,000	19,100,000
ESOP reserve	176,515	239,701	416,216	176,515	239,701	416,216
Exchange equilisation reserve	-	-	-	8,544	(8,544)	-
Treasury shares	-	-	-	(310,938)	310,938	-
Life policy holder reserve fund	-	-	-	(1,191)	(2,991)	(4,182)
	25,563,064	2,833,898	28,396,962	29,615,888	3,143,792	32,759,680

56 (b) 2012

	Bank			Group		
	Opening balance Rs 000	Movement/ transfers Rs 000	Closing balance Rs 000	Opening balance Rs 000	Movement/ transfers Rs 000	Closing balance Rs 000
Capital reserve	3,009,986	1,456,932	4,466,918	6,403,549	2,398,108	8,792,657
Available for sale reserve	2,590,428	529,203	3,119,631	2,620,826	529,475	3,150,301
General reserve	15,400,000	2,400,000	17,800,000	15,400,000	2,400,000	17,800,000
ESOP reserve	-	176,515	176,515	-	176,515	176,515
Exchange equilisation reserve	-	-	-	5,733	2,811	8,544
Treasury shares	-	-	-	(310,938)	-	(310,938)
Life policy holder reserve fund	-	-	-	(22,526)	21,335	(1,191)
	21,000,414	4,562,650	25,563,064	24,096,644	5,528,244	29,615,888

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
56 (c) Capital Reserve				
Balance as at 1st January	4,466,918	3,009,986	8,792,657	6,403,549
Surplus on revaluation of freehold land and buildings	-	1,597,923	-	2,530,099
Revaluation surplus transferred to retained earnings on disposal of land and buildings	-	(5,689)	-	(5,689)
Deferred tax effect on revaluation surplus	-	(135,302)	-	(135,302)
Balance as at 31st December	4,466,918	4,466,918	8,792,657	8,792,657

56 OTHER RESERVES (CONTD.)

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000 Restated	2013 Rs 000	2012 Rs 000 Restated
56 (d) Available-for-sale Reserve				
Balance as at 1st January	3,119,631	2,590,428	3,150,301	2,620,826
Net change in fair value on available-for-sale financial assets	1,294,197	453,801	1,304,688	454,073
Net amount transferred to profit or loss on disposal of available for sale financial assets	-	75,402	-	75,402
Balance as at 31st December	4,413,828	3,119,631	4,454,989	3,150,301
56 (e) General Reserve				
Balance as at 1st January	17,800,000	15,400,000	17,800,000	15,400,000
Transfer during the year	1,300,000	2,400,000	1,300,000	2,400,000
Balance as at 31st December	19,100,000	17,800,000	19,100,000	17,800,000
56 (f) ESOP Reserve				
Balance as at 1st January	176,515	-	176,515	-
Allocations during the year	239,701	176,515	239,701	176,515
Balance as at 31st December	416,216	176,515	416,216	176,515
56 (g) Exchange Equivalisation Reserve				
Balance as at 1st January	-	-	8,544	5,733
Net unrealised gains / (losses) from the translation of financial statements of foreign operations	-	-	706	5,142
Write off of subsidiary investment	-	-	-	3,665
Disposal of associate company	-	-	-	(5,996)
Disposal of subsidiary company	-	-	(9,250)	-
Balance as at 31st December	-	-	-	8,544
56 (h) Treasury Shares				
Balance as at 1st January	-	-	(310,938)	(310,938)
Effect of winding up of ESBT	-	-	310,938	-
Balance as at 31st December	-	-	-	(310,938)
56 (i) Life Policy Holder Reserve Fund				
Balance as at 1st January	-	-	(1,191)	(22,526)
Transfer to life policy holder reserve fund	-	-	(2,991)	21,335
Balance as at 31st December	-	-	(4,182)	(1,191)
57 NON-CONTROLLING INTEREST				
Subsidiaries				
HNB Assurance PLC			809,771	719,380
Majan Exchange LLC			-	46,660
Through the Joint Venture				
Lanka Ventures PLC			294,322	203,398
Total			1,104,093	969,438

Notes to the Financial Statements

58 CONTINGENT LIABILITIES AND COMMITMENTS

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers and would be party to litigation due to its operations. No material losses are anticipated as a result of these transactions.

58 (a) Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amounts to approximately Rs 157 Mn.

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Approved and contracted for	90,129	357,263	90,129	357,263
Approved and not contracted for	66,580	119,893	66,580	119,893
	156,709	477,156	156,709	477,156

58 (b) Future Monthly Commitments on Operating Leases

As at 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
0-1 year	5,853	1,576	5,853	29,131
1-5 years	67,388	75,765	67,388	112,287
6-10 years	11,879	11,957	11,879	13,093
11-15 years	414	799	414	799
16-20 years	15	15	15	15
	85,549	90,112	85,549	155,325

58 (c) Irrevocable Commitments - Bank

Commitments as at reporting date that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs 62.59 Mn (2012 : Rs 46.53 Mn).

58 (d) Contingent Liabilities - Bank / Group

As at 31st December	2013 Rs 000	2012 Rs 000
Acceptances	7,714,530	7,568,098
Documentary credit	11,189,689	11,243,091
Guarantees	51,404,604	35,284,487
Bills for collection	6,465,027	5,800,704
Forward exchange contracts	97,297,120	104,470,632
Total - Bank / Group	174,070,970	164,367,012

Contingent liabilities of Joint Venture as at 31st December 2013 was nil.

58 (e) Litigation against the Bank

The Bank confirms that there is no case (including the LT cases) filed against the Bank which is not disclosed which would have a material impact on the financial position of the Bank.

58 (f) Tax Assessments against the Bank

The following tax assessments are outstanding, against which the Bank has duly appealed,

- VAT on financial services for 2003 and 2004, taxes amounting to Rs 207 Mn, on Assessment Nos. VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05. (Pursuant to the determination made by the Board of Review on the appeal made for VAT on Financial Services, the Bank filed a case in the Court of Appeal - CA No.01/2010 – BRA/VAT- 06)
- PAYE taxes amounting to Rs 407 Mn on Assessments Nos.8018210, 8202714 and 8364152 for the years 2003, 2004 and 2005 respectively.
- Income tax for the Year of Assessment 2010/11 Assessment No ITR 13291100066V2. As per the Assessment , Notional tax credit Rs 434.17 Mn and withholding tax credit on interest Rs 8.6 Mn has been disallowed.

The Bank is of the view that the above assessments will not have any material impact on the Financial Statements.

59 RELATED PARTY DISCLOSURES

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in the Sri Lanka Accounting Standard LKAS 24, "Related Party Disclosures", the details of which are reported below. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with what is applied to transactions between the Bank and its unrelated customers.

59 (a) Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

59 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard LKAS 24 "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity.

59 (b) i Key Management Personnel (KMP) of the Bank

Directors of the Bank (including executive and non-executive Directors), members of the Corporate Management, Chief Accountant, Chief Manager - Operations, Chief Manager - Treasury, Senior Manager - Compliance and their immediate family members have been classified as KMP of the Bank as at 31st December 2013.

59 (b) ii Key Management Personnel (KMP) of the Group

Bank is the ultimate parent of its Subsidiaries listed out in Note 36. Thus the KMP of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group and have been identified as KMP of the Group as well.

Therefore, officers who are only Directors of the Subsidiaries and not of the Bank have been classified as KMP of that respective Subsidiary only.

Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective KMP for more than 50% of his / her financial needs.

59 (b) iii Changes in Key Management Personnel (KMP) During the Year

Following changes took place during the year due to retirements, resignations, new recruitments, re-designations and reporting line changes.

Name of the KMP	Position	Date of Resignation/Retirement	Date of Designation as KMP
Mr Rajendra Theagarajah*	Executive Director (MD/CEO)	w.e.f 30th June 2013	
Ms Pamela C. Cooray**	Non Executive Director	w.e.f 31st March 2013	
Mr N G Wickremeratne	Non Executive Director	w.e.f 16th May 2013	
Mr C P Abeywickrema	DGM - Development Banking	w.e.f 11th April 2013	
Mr J R P M Paiva	DGM - Strategy and Compliance	w.e.f 03rd October 2013	
Ms L L C C Thambiah	DGM - Network Management	w.e.f 29th April 2013	
Mr P Sridharan	AGM - Premier and Electronic Banking	w.e.f 22nd February 2013	
Mr D A de Vas Gunasekara	Chief Financial Officer	w.e.f 16th July 2013	
Mr Ruwan Manatunga	Chief Strategy Officer		w.e.f 14th November 2013
Mr A V Abeygunasekara	Chief Manager - Treasury		w.e.f. 31st May 2013
Mr C B Wijayaratne	Senior Manager - Compliance		w.e.f 01st August 2013

* Resigned w.e.f 30th June 2013 upon reaching the age of retirement.

** Resigned w.e.f 31st March 2013 having served the Board for nine years.

Notes to the Financial Statements

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (b) Transactions with Key Management Personnel (KMP) (Contd.)

59 (b) iv Compensation to KMP

For the year ended 31st December	Bank		Group	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Short term employment benefits				
Board of Directors (including MD/CEO)*	61,206	85,920	61,561	86,080
Other KMP**	214,316	240,086	214,476	240,128
Post employment benefits				
Board of Directors (including MD/CEO)*	6,890	9,440	6,890	9,440
Other KMP**	28,794	36,199	28,794	36,199
	311,206	371,645	311,721	371,847

* Includes the remuneration paid to Mr Rajendra Theagarajah (Ex - MD/CEO) up to 30th June 2013.

** Other KMP includes members of the Corporate Management, Chief Accountant, Chief Manager - Operations, Chief Manager -Treasury and the Senior Manager - Compliance.

All employees including Other KMP are eligible for prior to retirement paid leave up to a maximum of 90 days provided such employees have unutilised accumulated leave at the time of retirement. As per LKAS 19, "Employee Benefits", the Bank fair valued the above benefit and a total liability of Rs 127.438 Mn (2012 -Rs 109.174 Mn) is accounted as provision for other long term benefits [Other Liabilities (Note 50)] being the total fair value of unutilised leave of all employees as at 31st December 2013.

In addition to their salaries / fees, the Bank provides non cash benefits to KMP. The Bank also contributes to a post employment defined benefit plan on behalf of KMP excluding non executive Directors who also participate in the Employee Share Option Plan.

Benefits offered to KMP under Employee Share Option Plan

	Bank		Group	
	2013	2012	2013	2012
MD / CEO				
Mr Rajendra Theagarajah				
Voting (No of shares) - Exercised	173,018	-	173,018	-
- Remaining	-	114,992	-	114,992
Non-voting (No of shares) - Exercised	42,958	-	42,958	-
- Remaining	-	28,418	-	28,418
Mr Jonathan Alles				
Voting (No of shares) - Exercised	-	-	-	-
- Remaining	79,987	-	79,987	-
Non-voting (No of shares) - Exercised	-	-	-	-
- Remaining	19,939	-	19,939	-

Mr Jonathan Alles was appointed as the Managing Director/Chief Executive Officer of the Bank with effect from 01st July 2013. Accordingly number of options held by him as at 31st December 2012 is disclosed with Other KMP in 2012.

	Bank		Group	
	2013	2012	2013	2012
Other KMP				
Voting (No of shares) - Exercised	83,471	254,958	83,471	254,958
- Remaining	1,568,287	1,426,804	1,568,287	1,426,804
Non-voting (No of shares) - Exercised	38,444	91,344	38,444	91,344
- Remaining	372,076	347,994	372,076	347,994

Share options exercised during the year includes new share options granted in 2013.

Bank has fair valued the options granted in 2013 and the total fair value of the options granted to all employees above management grade including MD/CEO and Other KMP was charged to the Income Statement under Personnel Expenses (Note 17) "Equity settled share based payment transactions".

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (b) Transactions with Key Management Personnel (KMP) (Contd.)

59 (b) iv Compensation to KMP (Contd.)

Benefits offered to KMP under Employee Share Benefit Trust (ESBT)

	Bank		Group	
	2013	2012	2013	2012
Non-voting (No of shares)				
MD / CEO	-	97,383	-	97,383
Other KMP	-	1,482,947	-	1,482,947

Bank wound up the ESBT during the year ended 31st December 2013. The net cash benefit paid to KMP including MD/CEO consequent to the winding up of the Trust amounted to Rs 79.820 Mn.

Further 316,818 shares were transferred to other KMP who elected to purchase the shares after settling the loan outstanding which amounted to Rs 5.996 Mn.

In addition to above, the Trust has paid Rs 56.478 Mn (2012: Rs 22.584 Mn) to Other KMP who retired during the year ended 31st December 2013, (prior to the winding up of the Trust) as termination benefits under Employee Share Benefit Trust.

59 (b) v Credit Card Facilities to KMP

As at 31st December	2013		2012	
	Limit	Outstanding Balance	Limit	Outstanding Balance
	Rs 000	Rs 000	Rs 000	Rs 000
Board of Directors (including MD / CEO)	5,240	918	6,150	906
Other KMP	29,180	1,608	44,805	5,089
	34,420	2,526	50,955	5,995

From the total outstanding of Rs 2.526 Mn as at 31st December 2013 (2012 - Rs 5.995 Mn), Rs 0.324 Mn (2012 : Rs 0.552 Mn) is secured by cash as at that date.

59 (b) vi Lending Facilities Granted to KMP

As at 31st December	2013		2012		Security
	Aggregate Limit	Amount of Accommodation Outstanding	Aggregate Limit	Amount of Accommodation Outstanding	
	Rs 000	Rs 000	Rs 000	Rs 000	
Board of Directors (including MD / CEO)	43,975	7,667	21,000	15,000	Immovable property, Cash EPF Balance, Immovable Property, Movable Property, Lien over Deposits
Other KMP	402,851	344,272	434,572	375,405	
	446,826	351,939	455,572	390,405	

No losses have been recorded against loan balances outstanding with KMP during the period and no provisions have been made for impairment losses against balances with KMP and their immediate family members as at the reporting date.

Notes to the Financial Statements

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (b) Transactions with Key Management Personnel (KMP) (Contd.)

59 (b) vii Deposits held by KMP with the Bank

The aggregate deposits (including Repos) held by the KMP with the Bank are as follows:

As at 31st December	2013	2012
Board of Directors (including MD/CEO)		
SLRs '000	62,064	346,201
USD '000	318	220
GBP '000	-	97
EUR '000	-	147
Other KMP		
SLRs '000	179,666	212,591
USD '000	212	287
GBP '000	20	13
EUR '000	-	13
AUD '000	330	329
CAD '000	-	1
SGD '000	-	2

59 (b) viii Other Business Transactions by KMP with the Group

For the year ended 31st December	2013 Rs 000	2012 Rs 000
Transactions with HNB Assurance PLC		
Board of Directors (including MD / CEO)		
Insurance Premium - General	73	101
Insurance Premium - Life	275	297
Claims - General	-	13
Other KMP		
Insurance Premium - General	240	1,396
Insurance Premium - Life	1,566	1,224
Claims - General	327	116

59 (c) Transactions with / between Subsidiaries

Details of the Subsidiaries are given in Note 36.

59 (c) i HNB Assurance PLC

HNB Assurance PLC ("Assurance"), is a 60% owned Subsidiary of the Bank.

The details of the transactions with the Bank are as follows:

- (a) Assurance held deposits and current accounts with the Bank amounting to Rs 274.180 Mn as at 31st December 2013. (2012 : Rs 250.785 Mn)

The Company also held debentures of the Bank amounting to Rs 80.073 Mn as at 31st December 2013 (2012 : Rs 7.5 Mn).

- (b) A summary of transactions of Assurance with the Group are given below:

For the year ended 31st December	2013		2012	
	HNB Rs 000	Sithma Rs 000	HNB Rs 000	Sithma Rs 000
Premium received	33,197	975	63,979	1,118
Claims incurred	7,587	-	6,573	570
Interest received	20,969	-	22,941	-
Office rent and electricity paid	47,769	-	47,853	-
Reimbursement of other administrative expenses	135,603	-	132,192	-
Dividend paid	82,481	-	62,985	-

59 RELATED PARTY DISCLOSURES (CONTD.)**59 (c) Transactions with / between Subsidiaries (Contd.)****59 (c) ii Sithma Development (Pvt) Ltd**

Sithma Development (Pvt) Ltd (“Sithma”) is a wholly owned Subsidiary of the Bank.

(a) The details of its borrowing transactions with the Bank are as follows:

Type of Facility	Rate of Interest	As at 31st December 2013		As at 31st December 2012		Security
		Limit	Outstanding	Limit	Outstanding	
		Rs 000	Rs 000	Rs 000	Rs 000	
Overdraft	AWPLR To be reviewed monthly	450,000	29,196	750,000	125,300	Registered primary floating mortgage for Rs 3,000 Mn over the leasehold rights of the land and building at No 479, T B Jayah Mw, Colombo 10.
Term Loan	6 month treasury bill rate (gross) + 1.5% To be reviewed every 6 months	2,000,000	502,982	2,000,000	1,007,467	Same as for the overdraft

(b) A summary of other transactions of Sithma with the Group are given below:

For the year ended 31st December	2013		2012	
	HNB Rs 000	HNB Assurance Rs 000	HNB Rs 000	HNB Assurance Rs 000
Lease rental received	678,746	-	660,764	-
Refundable deposit received	374,295	-	478,365	-
Advance payment received - rent	122,305	-	18,941	-
Interest expense on refundable deposit	42,695	-	48,181	-
Insurance premium paid	-	975	-	1,118
Claims received	-	-	-	570
Overdraft interest paid	7,250	-	42,550	-
Term loan interest paid	102,796	-	148,806	-
Ground rent paid	3,829	-	3,829	-
Dividend paid	5,000	-	-	-

59 (c) iii Majan Exchange LLC

Majan Exchange LLC (Majan) was a 40% owned Subsidiary of the Bank.

Bank had made a full provision against the investment of Rs 56.121 Mn and the advance payment of Rs 13.896 Mn as at 31st December 2012.

The Bank sold its stake in Majan Exchange LLC during the year ended 31st December 2013 and recognised a net loss of Rs 0.161 Mn after reversing the above provisions to the Income Statement.

Net loss on disposal of Majan Exchange LLC is disclosed under Note 15 “Other Operating Income” to the financial statements.

Notes to the Financial Statements

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (d) Transactions with Associates

Details of the Associates are given in Note 34.

59 (d) i Delma Exchange

Delma Exchange was a 20% owned Associate of the Bank.

Bank sold its stake in Delma Exchange during the year ended 31st December 2012.

50% of the sales proceeds have already been received by the Bank and the balance amount (Rs 64.800 Mn) is to be received on deferred terms as per the sales and purchase agreement entered into with the buyer.

Full provision has been made in the financial statements as at 31st December 2013 considering the delay in recovery of the balance sales proceeds.

59 (d) ii Splendor Media (Pvt) Ltd

Splendor Media (Pvt) Ltd is a 49.99% owned Associate of Sithma, a fully owned Subsidiary of the Bank.

Summary of transactions of Splendor Media (Pvt) Ltd with the Bank and the Group are given below:

Transaction Type	HNB	2013	HNB	HNB	2012	HNB
	Rs 000	Sithma Rs 000	Assurance Rs 000	Rs 000	Sithma Rs 000	Assurance Rs 000
Advertising commission	56,027	-	3,102	51,164	239	1,140
Interest income	5,823	-	-	3,903	-	-
Rebate paid	21,106	253	-	7,223	42	-
Deposits including current accounts	55,974	-	-	48,412	-	-
Dividend paid	-	163	-	-	230	-

59 (e) Transactions with Joint Venture - Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is the Joint Venture between DFCC Bank and HNB. Bank holds a 50% stake in Acuity Partners (Pvt) Ltd as at 31st December 2013.

Summary of transactions of the Bank with Acuity Partners (Pvt) Ltd are given below:

Transaction Type	2013	2012
	Rs 000	Rs 000
Deposits including current accounts	8,201	2,107
Overdraft	-	9,736
Corporate finance fees paid	9,735	-
Interest and bank charges received	1,692	3,528
Interest paid	115	208

59 (f) Transactions with the Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka

The Government of Sri Lanka indirectly holds more than 25% of the voting rights of the Bank as at 31st December 2013 through Sri Lanka Insurance Corporation Ltd, Employee Provident Fund, National Savings Bank and Employee Trust Fund. The Bank has considered the Government of Sri Lanka and other entities which are controlled, jointly controlled or significantly influenced by the Government of Sri Lanka (government related entities) as Related Parties according to LKAS 24 "Related Party Disclosures".

During the year ended 31st December 2013, the Bank has carried out transactions with the Government of Sri Lanka and other Government related entities in the ordinary course of its business, the details of which are given below. The pricing applicable to such transactions was based on the assessment of risk and pricing model of the Bank and was comparable with what was applied to transactions between the Bank and its unrelated customers.

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (f) i Transactions which are Individually Significant

Bank uses an internal threshold of 5% of total equity of the Bank in order to identify individually significant transactions with the Government and Government related entities. Accordingly, the said threshold was Rs 2,572.693 Mn as at 31st December 2013. All transactions with the Government of Sri Lanka and Government related entities that exceeded the above threshold has been reported below.

Name of the Government Entity	Relationship with the Bank	Nature of the Transactions	2013 Rs 000	2012 Rs 000
Government of Sri Lanka	Shareholder with significant influence	Government of Sri Lanka Treasury Bills [Note 27 (b)]	346,739	19,790
		Government of Sri Lanka Treasury Bonds [Note 27 (c)]	1,581	1,446
		Sri Lanka Development Bonds [Note 33 (a)]	30,467,869	17,520,959
		Government of Sri Lanka Treasury Bonds [Note 31 (d)]	18,605,583	5,587,415
		Government of Sri Lanka Treasury Bills [Note 31 (e)]	39,016,018	47,804,967
Interest income recognised during the year from the above investments is disclosed under Interest Income [Note 11 (a)] to the financial statements.				
Central Bank of Sri Lanka	Government related entity	Statutory deposit (Note 24)	16,366,368	19,933,463
		Reverse repurchase agreement	5,901,054	-
Interest income recognised during the year from the reverse repurchase agreements is disclosed under Interest Income [Note 11 (a)] to the financial statements.				
Bank of Ceylon	Government related entity	Short term borrowings	2,750,000	-
Interest expense recognised during the year from the above borrowings is included under Interest Expense [Note 11 (b)] to the financial statements.				
NSB Fund Management Company Ltd	Government related entity	Long term borrowings	4,000,000	4,000,000
Interest expense recognised during the year on borrowings from NSB Fund Management Ltd (Wholly owned Subsidiary of the National Savings Bank) is included under Interest Expense [Note 11 (b)] to the financial statements.				
DFCC Bank	Government related entity	Investment in ordinary shares [Note 31 (a)]	4,195,300	3,660,764
Dividend income recognised during the year from the above investment is included under Net Gain/(Loss) from Financial Investments (Note 14) to the financial statements.				
DFCC Bank	Government related entity	Refinance Borrowings	3,797,812	4,351,302
Interest expense recognised during the year from the above borrowings is included under Interest Expense [Note 11 (b)] to the financial statements.				
Department of Inland Revenue	Government related entity	Provision for current taxation [Note 20 (a)]	4,876,492	2,227,602
		Current tax payable	3,040,107	1,755,428

Notes to the Financial Statements

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (f) Transactions with the Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka (Contd.)

59 (f) i Transactions which are Individually Significant (Contd.)

Name of the Government Entity	Relationship with the Bank	Nature of the Transactions	2013	2012
			Rs 000	Rs 000
Road Development Authority	Government related entity	Loans and advances	3,746,629	309,120
Ministry of Finance	Government related entity	Loans and advances	6,254,350	3,339,672
Interest income recognised during the year from the above advances is included under Interest Income [Note 11 (a)] to the financial statements.				
Central Bank of Sri Lanka	Government related entity	Derivative contracts (Swaps)	15,039,125	12,765,000
		Derivative contracts (Forward Exchange Contracts)	1,307,750	-

Net unrealised foreign exchange loss to the Bank from the above derivatives amounted to Rs 417.784 Mn as at 31st December 2013 (2012 - Rs 360.258 Mn).

59 (f) ii Transactions which are not Individually Significant

Apart from the transactions listed above, the Bank / Group has carried out transactions with the Government of Sri Lanka and other Government related entities in the form of loans and advances, deposits, short term and long term borrowings, payment of taxes, payment of utility bills etc. during the year ended 31st December 2013. Such transactions were carried out on an arms length basis and on comparable terms which are applied to transactions between the Bank and its unrelated customers.

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (g) Transactions with Other Related Entities

59 (g) i Lending Transactions with Other Related Entities by the Bank

Company	Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2013		As at 31st December 2012		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of the Joint Venture "Acuity"	Overdraft	130.00	-	130.00	-	
		Total	130.00	-	130.00	-	
Acuity Securities Limited	Subsidiary of the Joint Venture "Acuity"	Overdraft	1,100.00	-	1,100.00	-	
		Total	1,100.00	-	1,100.00	-	
CIC Holdings PLC	Mr R S Captain (Director having control over the company)	Letters of Credit	-	-	250.00	-	
		Overdraft	-	-	*(150.00)	148.02	
		Money Market Loan	-	-	*(150.00)	-	
		Total	-	-	250.00	148.02	
Paints & General Industries (Pvt) Ltd	Mr R S Captain (Director having control over the company)	Overdraft	3,240.00	175.53	2,208.00	2,046.02	Quoted company shares
		Letters of Credit	*(100.00)	22.93	200.00	30.39	
		Total	3,240.00	198.46	2,408.00	2,076.41	
A K K Engineers (Pvt) Ltd	Dr L R Karunaratne (Director having control over the company)	Term Loan	0.50	0.50	3.50	3.50	Immovable property Cash deposits
		Overdraft	30.90	12.64	30.00	9.99	
		Letters of Guarantee	47.50	43.79	44.00	30.20	
		Total	78.90	56.93	77.50	43.69	
Chemanex PLC	Subsidiary of CIC Holdings PLC	Letters of Credit	50.00	-	50.00	-	Indemnity Demand promissory note Accepted usance drafts
		Money Market Loan / Short Term Loan/	-	-	-	-	
		Overdraft	100.00	52.68	100.00	98.09	
		Letters of Guarantee	5.00	-	5.00	-	
		Total	155.00	52.68	155.00	98.09	
CIC Agri Businesses (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Letters of Credit	97.45	97.45	700.00	515.53	Negative pledge over stocks Demand promissory note
		Overdraft	-	-	*(200.00)	166.66	
		Money Market Loan	-	-	*(200.00)	-	
		Money Market Loan	-	-	300.00	300.00	
		Short Term Loan	-	-	350.00	350.00	
		Total	97.45	97.45	1,350.00	1,332.19	
Link Natural Products (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Letters of Credit	20.00	-	20.00	-	Immovable property Primary mortgage over motor vehicle Demand promissory note
		Import Loan	*(20.00)	-	*(20.00)	-	
		Packing Credit	20.00	13.53	20.00	18.11	
		Term Loan	4.75	4.75	8.31	8.31	
		Total	44.75	18.28	48.31	26.42	

* Figures in brackets indicate sub limits granted to the respective entities.

Notes to the Financial Statements

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (g) Transactions with Other Related Entities (Contd.)

59 (g) i Lending Transactions with Other Related Entities by the Bank (Contd.)

Company	Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2013		As at 31st December 2012		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	
CIC Cropguard (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Letters of Credit	-	-	100.00	-	
		Overdraft / Money Market Loan	-	-	30.00	28.85	
		Total	-	-	130.00	28.85	
CIC Seeds (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Term Loan	16.66	16.66	-	-	
		Overdraft	-	-	30.00	4.90	
		Total	16.66	16.66	30.00	4.90	
CIC Agri Biotech (Pvt) Ltd	Subsidiary of CIC Agri Businesses (Pvt) Ltd	Overdraft	-	-	20.00	20.24	
		Total	-	-	20.00	20.24	
N Chandraratne Decorators (Pvt) Ltd	Subsidiary of CIC Agri Businesses (Pvt) Ltd	Letters of Credit	5.00	-	5.00	-	Accepted usance
		Import Loan	*(5.00)	-	*(5.00)	-	drafts
		Letters of Guarantee	15.00	5.77	15.00	10.56	Immovable
		Overdraft	6.00	2.34	6.00	-	property
		Lease	5.58	5.58	6.88	6.88	Leased motor
		Total	31.58	13.69	32.88	17.44	vehicles
Kelani Valley Canneries Ltd	Subsidiary of CIC Holdings PLC	Overdraft	5.00	4.54	5.00	-	Cash
		Total	5.00	4.54	5.00	-	

No losses have been recorded against loan balances outstanding during the period with the above entities and no provisions have been made for impairment losses as at the reporting date.

* Figures in brackets indicate sub limits granted to the respective entities.

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (g) Transactions with Other Related Entities (Contd.)

59 (g) II Other Business Transactions with Other Related Entities by the Bank

Company	Relationship	Nature of Transaction	Amount (Rs Mn)	
			2013	2012
Hatton National Bank Retirement Pension Fund	Post employment benefit plan	Investment in term deposits	7,827.59	6,637.57
		Investment in HNB debentures	79.77	8.86
		Balance held by the Bank on behalf of the fund	289.31	237.47
		Interest paid	974.80	564.23
		Contributions made	467.23	473.16
		Receivable from pension fund	107.13	513.75
Hatton National Bank Employee Provident Fund	Post employment benefit plan	Investment in term deposits	5,801.33	2,957.00
		Balance held by the Bank on behalf of the fund	79.04	105.14
		Investment in HNB shares - Voting	18.18	18.30
		- Non-voting	68.39	64.66
		Contribution made	459.24	400.48
		Interest paid	218.59	425.93
Widows', Widowers' and Orphans' Pension Fund	Post employment benefit plan	Dividends paid	5.40	2.84
		Balance held by the Bank on behalf of the fund	54.63	16.88
		Time deposits	772.04	706.66
Acuity Securities Limited	Subsidiary of the Joint Venture "Acuity"	Interest paid	104.78	71.07
		Commission and other charges received	5.41	1.39
		Current account balance as at year end	62.43	8.45
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of the Joint Venture "Acuity"	Interest and bank charges	0.20	0.12
		Current account balance as at year end	26.38	30.61
Guardian Acuity Asset Management Ltd	Joint Venture of "Acuity"	Repurchase agreements	5.02	9.39
		Interest on repurchase agreements	0.56	2.38
		Bank and other charges	0.97	0.78
		Deposits including current accounts	0.51	0.54
Lanka Ventures PLC	Subsidiary of the Joint Venture "Acuity"	Interest paid	2.20	17.20
		Bank charges and overdraft interest received	0.08	1.20
		Deposits including current accounts	34.78	533.09
		Debentures	-	13.50
Employee Share Benefit Trust (ESBT)	Post employment benefit plan	Overdraft	-	292.26
		Interest paid	19.36	29.27
		Dividends paid	131.76	68.46
		Benefits paid to employees by the Trust*	90.15	92.32

* Amount paid to employees retired/resigned prior to the winding up of the Trust.

Bank wound up the ESBT during the year ended 31st December 2013. The net cash benefit paid to employees consequent to the winding up of the Trust amounted to Rs 1,268.972 Mn.

Further 2,859,684 shares were transferred to employees who elected to purchase the shares after settling the loan outstanding as at the date of winding up of the Trust.

Notes to the Financial Statements

59 RELATED PARTY DISCLOSURES (CONTD.)

59 (g) Transactions with Other Related Entities (Contd.)

59 (g) II Other Business Transactions with Other Related Entities by the Bank (Contd.)

Company	Relationship	Nature of Transaction	Amount (Rs Mn)	
			2013	2012
A K K Engineers (Pvt) Ltd	Dr L R Karunaratne (Director having control over the company)	Customer Deposits	21.43	20.81
CIC Agri Businesses (Private) Ltd	Subsidiary of CIC Holdings PLC	Customer Deposits	0.43	-
Polypack Secco Ltd	Mr R S Captain (Director having control over the company)	Customer Deposits	0.01	0.01
507 Holdings (Pvt) Ltd	Other KMP of the Bank having control over the company	Customer Deposits	2.06	1.36
CIC Cropguard (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Customer Deposits	0.84	-
CIC Agri Biotech (Pvt) Ltd	Subsidiary of CIC Agri Businesses (Pvt) Ltd	Customer Deposits	2.81	0.32
CIC Seeds (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Customer Deposits	0.51	-

59 (g) III Other Business Transactions with Other Related Entities by the Group

Company	Relationship	Nature of Transaction	Amount (Rs Mn)	
			2013	2012
HNB Assurance PLC				
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of "Acuity"	Insurance premium received	0.31	1.12
		Claims paid	0.46	1.07
		Brokerage fees	0.41	0.20
Acuity Securities Limited	Subsidiary of "Acuity"	Insurance premium received	0.10	0.53
		Claims paid	0.05	0.69
		Interest received	16.31	12.52
Acuity Partners (Pvt) Ltd	Joint venture of the Bank	Investments (Repo)	147.37	128.07
		Insurance premium received	0.35	0.88
		Claims paid	0.23	0.69

60 MATURITY ANALYSIS

60 (a) Maturity Analysis - Bank

	Upto 3 Months Rs. 000	3-12 Months Rs. 000	1-3 years Rs. 000	3-5 Years Rs. 000	More than 5 years Rs. 000	Total Rs. 000
Interest earning assets						
Cash and cash equivalents	570,792	-	-	-	-	570,792
Placements with banks	1,246,611	-	-	-	-	1,246,611
Other financial assets held for trading	348,320	-	-	-	-	348,320
Loans and receivables to banks	6,267,809	-	-	-	-	6,267,809
Loans and receivables to other customers	161,895,148	15,862,543	85,103,125	37,880,880	51,234,705	351,976,401
Financial investments - Available-for-sale	14,218,888	43,402,713	-	-	-	57,621,601
Financial investments - Held-to-maturity	-	-	-	-	-	-
Financial investments - Loans and receivables	175,542	3,068,472	22,676,115	7,184,407	-	33,104,536
	184,723,110	62,333,728	107,779,240	45,065,287	51,234,705	451,136,070
Non interest earning assets						
Cash and cash equivalents	11,053,853	-	-	-	-	11,053,853
Balances with Central Banks	16,366,368	-	-	-	-	16,366,368
Derivative financial instruments	113,767	60,806	-	-	-	174,573
Other financial assets held for trading	303,992	-	-	-	-	303,992
Financial investments - Available-for-sale	-	-	-	-	5,769,485	5,769,485
Investment in Joint Venture	-	-	-	-	655,000	655,000
Investments in Subsidiaries	-	-	-	-	2,357,285	2,357,285
Investment properties	-	-	-	-	346,478	346,478
Property, plant and equipment	-	-	-	-	9,521,496	9,521,496
Intangible assets	-	-	-	-	994,677	994,677
Deferred tax assets	-	-	-	767,826	-	767,826
Other assets	3,661,842	564,354	1,322,618	-	5,314,519	10,863,333
	31,499,822	625,160	1,322,618	767,826	24,958,940	59,174,366
Total assets	216,222,932	62,958,888	109,101,858	45,833,113	76,193,645	510,310,436
Percentage - 31st December 2013	42.37	12.34	21.38	8.98	14.93	100
Percentage - 31st December 2012	38.71	17.96	22.11	8.50	12.72	100
Interest bearing liabilities						
Due to banks	14,648,220	3,089,160	2,239,410	14,221,607	735,820	34,934,217
Due to other customers	242,414,207	108,062,980	7,261,634	3,497,872	286,375	361,523,068
Other borrowings	4,442,949	220,153	4,000,000	-	-	8,663,102
Debt securities issued	-	-	-	-	1,418,775	1,418,775
Subordinated debentures	300,000	408,543	-	4,500,000	6,648,017	11,856,560
	261,805,376	111,780,836	13,501,044	22,219,479	9,088,987	418,395,722
Non- interest bearing liabilities						
Derivative financial instruments	631,944	117,018	-	-	-	748,962
Due to other customers	23,837,902	-	-	-	-	23,837,902
Dividends payable	426,347	-	-	-	-	426,347
Current tax liabilities	-	3,040,107	-	-	-	3,040,107
Other provisions	1,553,034	-	1,366,286	-	-	2,919,320
Other liabilities	9,326,503	-	-	-	161,719	9,488,222
Shareholders' funds	-	-	-	-	51,453,854	51,453,854
	35,775,730	3,157,125	1,366,286	-	51,615,573	91,914,714
Total Liabilities and shareholders' funds	297,581,106	114,937,961	14,867,330	22,219,479	60,704,560	510,310,436
Percentage - 31st December 2013	58.32	22.52	2.91	4.35	11.90	100
Percentage - 31st December 2012	61.61	19.40	4.04	2.14	12.81	100

* Upto 3 months deposits include the Bank's savings deposit base of Rs 124.510 Bn (2012 - Rs 109.177 Bn)

Notes to the Financial Statements

60 MATURITY ANALYSIS (CONTD.)

60 (b) Maturity Analysis - Group

	Upto 3 Months Rs. 000	3-12 Months Rs. 000	1-3 years Rs. 000	3-5 Years Rs. 000	More than 5 years Rs. 000	Total Rs. 000
Interest earning assets						
Cash and cash equivalents	534,411	-	-	-	-	534,411
Placements with banks	1,928,657	1,041,301	10,127	103,499	-	3,083,584
Other financial assets held for trading	1,212,155	680,025	152,704	219,260	-	2,264,144
Loans and receivables to banks	6,266,554	413,734	-	-	-	6,680,288
Loans and receivables to other customers	162,942,903	15,882,787	84,980,362	37,799,435	51,240,191	352,845,678
Financial investments - Available-for-sale	14,321,078	43,621,554	201,190	145,805	210,982	58,500,609
Financial investments - Held to maturity	76,557	51,070	675,032	158,717	43,125	1,004,501
Financial investments - Loans and receivables	175,542	3,068,472	23,596,839	8,248,224	14,685	35,103,762
	187,457,857	64,758,943	109,616,254	46,674,940	51,508,983	460,016,977
Non interest earning assets						
Cash and cash equivalents	11,053,853	-	-	-	-	11,053,853
Balances with Central Banks	16,366,565	-	-	-	-	16,366,565
Derivative financial instruments	113,767	60,806	-	-	-	174,573
Other financial assets held for trading	303,992	-	-	-	-	303,992
Financial investments - Available-for-sale	-	-	-	-	5,769,485	5,769,485
Investments in Associates	-	-	-	-	582,115	582,115
Investment properties	-	-	-	-	160,864	160,864
Property, plant and equipment	-	-	-	-	17,791,159	17,791,159
Intangible assets	-	-	-	-	1,121,005	1,121,005
Deferred tax assets	-	-	-	656,191	-	656,191
Other assets	4,290,386	901,022	1,270,619	44,790	4,891,256	11,398,073
	32,128,563	961,828	1,270,619	700,981	30,315,884	65,377,875
Total assets	219,586,420	65,720,771	110,886,873	47,375,921	81,824,867	525,394,852
Percentage - 31st December 2013	41.79	12.51	21.11	9.02	15.57	100
Percentage - 31st December 2012	38.50	17.86	21.72	8.42	13.50	100
Interest bearing liabilities						
Due to banks	15,074,928	3,089,160	2,239,410	14,221,607	735,820	35,360,925
Due to other customers	242,181,065	107,935,752	7,261,634	3,497,872	286,375	361,162,698
Other borrowings	5,943,336	235,953	4,039,600	34,650	-	10,253,539
Debt securities issued	-	41,111	60,000	30,000	1,399,184	1,530,295
Subordinated debentures	300,000	408,543	-	4,446,159	6,627,001	11,781,703
	263,499,329	111,710,519	13,600,644	22,230,288	9,048,380	420,089,160
Non- interest bearing liabilities						
Derivative financial instruments	631,944	117,018	-	-	-	748,962
Due to other customers	23,837,902	-	-	-	-	23,837,902
Dividends payable	428,143	-	-	-	-	428,143
Current tax liabilities	-	3,134,407	-	-	-	3,134,407
Insurance provisions - Life	-	-	-	-	4,348,491	4,348,491
Insurance provisions - Non-Life	-	1,011,101	-	-	-	1,011,101
Deferred tax liabilities	-	-	-	-	-	-
Other provisions	1,578,409	22,035	1,366,286	-	-	2,966,730
Other liabilities	9,710,511	193,312	9,624	5,184	245,596	10,164,227
Shareholders' funds	-	-	-	-	58,665,729	58,665,729
	36,186,909	4,477,873	1,375,910	5,184	63,259,816	105,305,692
Total Liabilities and shareholders' funds	299,686,238	116,188,392	14,976,554	22,235,472	72,308,199	525,394,852
Percentage - 31st December 2013	57.04	22.11	2.85	4.23	13.76	100
Percentage - 31st December 2012	60.21	19.13	3.93	2.11	14.62	100

* Upto 3 months deposits include the Bank's savings deposit base of Rs. 124.510 Bn (2012 - Rs. 109.177 Bn)

61 SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments. The business segments are determined based on the Group's management and internal reporting structure.

Business segments - Group

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2013 Rs.000	2012 Rs.000	2013 Rs.000	2012 Rs.000	2013 Rs.000	2012 Rs.000	2013 Rs.000	2012 Rs.000	2013 Rs.000	2012 Rs.000	2013 Rs.000	2012 Rs.000	2013 Rs.000	2012 Rs.000
Revenue from external customers :														
Interest	51,928,969	43,356,014	3,666,692	3,728,480	293,880	251,985	-	-	737,443	612,183	-	(29,275)	56,626,984	47,919,387
Fee and commission	4,349,138	3,739,489	-	-	78,141	93,889	-	-	72,901	71,674	-	-	4,500,180	3,905,052
Net gain/loss from trading	(1,815,061)	(1,632,528)	-	-	27,045	5,294	-	-	32,481	3,185	-	-	(1,755,536)	(1,624,049)
Net gain/loss from financial investments	246,591	87,446	-	-	17,064	26,099	-	-	45,838	2,918	-	-	309,493	116,463
Other operating income	1,513,223	1,990,465	-	-	10,218	79,885	145,397	163,366	3,259,788	2,648,036	27,757	13,017	4,956,383	4,894,769
Total revenue from external customers	56,222,860	47,540,886	3,666,692	3,728,480	426,348	457,152	145,397	163,366	4,148,450	3,337,996	27,757	(16,258)	64,637,504	55,211,622
Inter-segment revenue	184,133	269,413	-	-	6,155	9,711	678,746	660,770	63,806	95,840	(932,840)	(1,035,734)	-	-
Total revenue	56,406,993	47,810,299	3,666,692	3,728,480	432,503	466,863	824,143	824,136	4,212,256	3,433,836	(905,083)	(1,051,992)	64,637,504	55,211,622
Segment result	8,792,420	8,317,346	2,299,498	2,534,844	36,331	76,253	517,848	389,478	477,928	447,194	(49,769)	(99,069)	12,074,256	11,666,046
Unallocated expenses													(1,286,424)	(1,159,298)
Profit from operations													10,787,832	10,506,748
Income from associates													127,815	16,632
Income tax expense													(3,103,199)	(2,421,431)
Profit for the year													7,812,448	8,101,949
Minority interests													(161,987)	(160,195)
Profit attributable to the Equity Holders of the Bank													7,650,461	7,941,754
Other comprehensive income ,net of tax	436,351	2,748,534	-	-	20,350	(4,210)	-	828,962	(2,610)	6,208	1,764	117,057	455,855	3,696,551
Total Comprehensive income													8,268,303	11,798,500
Non controlling interests													(168,991)	(170,622)
Profit attributable to the Equity Holders of the Bank													8,099,312	11,627,878

Notes to the
Financial Statements
61 SEGMENT REPORTING (CONTD.)

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Segment assets	462,198,251	395,952,196	22,606,090	24,977,945	3,815,615	3,974,365	7,626,706	7,917,607	8,059,665	7,034,877	(1,405,285)	(2,820,368)	502,901,042	437,036,622
Investment in associates													582,115	386,172
Unallocated assets													21,911,695	22,029,821
Total Assets													525,394,852	459,452,615
Segment liabilities	422,135,418	359,250,144	22,606,090	24,977,945	2,362,882	2,655,322	1,146,995	1,806,298	5,946,553	5,167,788	(1,583,891)	(2,653,372)	452,614,047	391,204,124
Unallocated liabilities													14,115,076	15,231,278
Total liabilities													466,729,123	406,435,402
Cash flows from operating activities	(4,841,351)	10,179,396	2,127,256	(711,299)	30,875	(85,887)	611,961	689,745	271,266	287,670	842,883	(600,945)	(957,110)	9,758,680
Cash flows from investing activities	(17,043,551)	(11,402,988)	-	-	(200,571)	81,681	(10,856)	(3,076)	(198,970)	(163,732)	(1,051,891)	56,326	(18,505,839)	(11,431,789)
Cash flows from financing activities	13,537,864	6,263,011	-	-	(2,025)	223,024	(505,001)	(356,411)	(137,500)	(105,000)	725,576	344,615	13,618,914	6,369,239
Capital Expenditure	1,528,975	1,059,256	97,526	207	1,346	6,751	10,856	3,076	64,812	63,174	-	1,829	1,703,515	1,134,293
Depreciation	848,141	797,261	2,733	3,125	9,539	12,080	131,335	116,688	36,808	40,154	7,927	891	1,036,483	970,199
Amortization	223,994	175,258	9,388	56	464	534	68	79	16,027	13,172	-	-	249,941	189,099

**Stock Broking, Securities Dealings, remittances, investment banking, venture capital business and foreign currency related services

As at 31st December	Bank		Group	
	2013	2012	2013	2012
62 NET ASSETS VALUE PER ORDINARY SHARE				
Amount used as the numerator:				
Shareholders' funds (Rs 000)	51,453,854	46,899,053	57,561,636	52,047,775
Number of ordinary shares used as the denominator:				
Total number of shares	399,555,201	397,246,449	399,555,201	397,246,449
Net assets value per share (Rs)	128.78	118.06	144.06	131.02

63 EVENTS OCCURRING AFTER THE REPORTING PERIOD

There are no events occurring after the reporting date which require adjustments to or disclosure in the Financial Statements, other than those disclosed below:

63 (a) Proposed Dividends

Refer Note No 44 (a)

64 COMPARATIVE INFORMATION

The following comparative figures have been reclassified in the 2013 Financial Statements to maintain comparability of financial statements in order to provide a better presentation.

64 (a)

Note	Bank			Group			
	As disclosed Rs 000	Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Reclassified Rs 000	Adjustment Rs 000	
Income Statement							
Income	64 (a) i	51,558,900	51,538,779	20,121	55,160,069	55,211,622	51,553
Interest income	64 (a) i	47,346,498	47,326,377	20,121	47,939,508	47,919,387	20,121
Net gain/(loss) from							
financial investments	64 (a) ii	142,479	87,446	55,033	114,412	116,463	2,051
Other operating income	64 (a) ii	1,961,954	2,016,987	55,033	4,896,820	4,894,769	2,051
Fee and commission income	64 (a) iii	3,740,497	3,740,497	-	3,833,378	3,905,052	71,674
Impairment charge/(reversal)							
for loans and other losses	64 (a) i	1,162,231	1,142,110	20,121	1,162,231	1,142,110	20,121
Fee and commission expenses	64 (a) v	53,407	53,407	-	64,032	411,943	347,911
Premises, equipment and							
establishment expenses	64 (a) iv	3,575,606	-	3,575,606	3,481,168	-	3,481,168
Other expenses	64 (a) iii,iv,v	3,584,997	7,160,603	3,575,606	5,929,498	9,134,427	3,204,929

64 (a) i Recognition of unwinding effect of interest income on impaired assets of Rs 20.12 Mn.

64 (a) ii Reclassification of dividend income from subsidiaries and joint ventures of Rs 57.29 Mn included in Net gain/(loss) from financial investments as Other operating income and reclassification of dividend income from Visa Inc and Mastercard Inc of Rs 2.26 Mn included in other operating income as net gain/(loss) from financial investments.

64 (a) iii Reclassification of brokerage income of Rs 71.67 Mn netted off against other expenses as fee and commission.

64 (a) iv Reclassification of premises, equipment and establishment expenses as other expenses.

64 (a) v Reclassification of Rs 347.91 Mn included in other expenses as fee and commission expenses.

Notes to the Financial Statements

64 COMPARATIVE INFORMATION (CONTD.)

64 (b)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Income Statement							
Personnel expenses	64 (b) i	6,520,648	6,689,864	169,216	7,103,764	7,272,980	169,216
Statement of Comprehensive Income							
Actuarial gains and losses on defined benefit plans	64 (b) i	587,494	756,710	169,216	587,494	756,710	169,216

64 (b) i Impact from change in accounting policy on recognition of interest income on pension fund plan assets based on long term rate of expected rerun to the discount rate used to measure the defined benefit obligation at the beginning of the annual period.

64 (c)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Statement of Comprehensive Income							
Net change in fair value on available-for-sale financial assets	64 (c) i	284,016	453,801	169,785	305,986	475,771	169,785
Statement of Financial Position							
Available-for-sale reserve		2,693,821	3,119,631	425,810	2,724,492	3,150,301	425,809
Financial investments - Available-for-sale		57,869,546	58,295,356	425,810	58,929,296	59,355,106	425,810

64 (c) i Bank holds shares in Visa Inc and Mastercard Inc. These shares were carried at zero cost. These investments were recognised as Financial Instruments - Available-for-sale and the net change in fair value of these shares as at 31st December 2011 of Rs 256.02 Mn and at 31st December 2012 of Rs 169.78 Mn were recognised as prior year adjustments.

64 (d)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Statement of Comprehensive Income							
Changes in revaluation surplus	64 (d) ii	1,465,117	1,462,621	2,496	2,397,293	2,394,797	2,496
Statement of Financial Position							
Capital reserve	64 (d) ii	4,469,414	4,466,918	2,496	8,795,153	8,792,657	2,496
Deferred tax assets	64 (d) i, ii	369,726	-	369,726	372,193	-	372,193
Deferred tax liabilities		1,478,341	1,111,110	367,231	1,556,312	1,186,615	369,697

64 (d) i Deferred tax assets and liabilities presented separately has been netted off.

64 (d) ii Reversal of deferred tax liabilities reversed back to revaluation reserve of Rs 2.50Mn.

64 COMPARATIVE INFORMATION (CONTD.)

64 (e)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Statement of Financial Position							
Cash and cash equivalents	64 (e) i	8,769,206	8,769,206	-	8,848,746	8,848,466	280
Balances with central banks	64 (e) i	19,933,463	19,933,463	-	19,950,041	19,950,321	280

64 (e) i Reclassification of Rs 0.28 Mn included in cash and cash equivalents as non statutory balances with central banks.

64 (f)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Statement of Financial Position							
Loans and receivables to banks	64 (f) i	-	-	-	-	651,480	651,480
Loans and receivables to other customers	64 (f) i	302,760,980	302,760,980	-	303,922,092	303,270,612	651,480

64 (f) i Reclassification of Rs 651.48 Mn of securities purchased under resale agreements with banks included in loans and receivables to other customers as loans and receivables to banks

64 (g)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Statement of Financial Position							
Due to banks	64 (g) i,ii,iii	30,400,980	23,852,647	6,548,333	30,400,980	24,443,058	5,957,922
Other borrowings	64 (g) i,ii	4,950,535	8,332,545	3,382,010	6,747,144	9,538,743	2,791,599
Subordinated term debts	64 (g) iii	4,585,568	7,751,890	3,166,322	4,563,011	7,729,333	3,166,322

64 (g) i Securities sold under repurchase agreements with Banks of Rs 896 Mn included under other borrowings has been reclassified as due to banks (Group Rs 1,486 Mn)

64 (g) ii Reclassification of Rs 4,278.22 Mn included under due to banks as other borrowings.

64 (g) iii Subordinated loan of Rs 3,166.32 Mn included in due to banks has been reclassified as subordinated term debts.

64 (h)

	Note	As disclosed Rs 000	Bank Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Group Reclassified Rs 000	Adjustment Rs 000
Statement of Financial Position							
Bills payable	64 (h) i	1,430,578	-	1,430,578	1,430,578	-	1,430,578
Other liabilities	64 (h) i	7,902,786	9,333,364	1,430,578	8,614,290	10,044,868	1,430,587

64 (h) i Reclassification of bills payable of Rs 1,430.58 Mn as other liabilities

65 DIRECTORS' RESPONSIBILITY STATEMENT

The Board of Directors of the Bank is responsible for the preparation and presentation of these Financial Statements.

Please refer to page 252 for the statement of the Directors' Responsibility for Financial Reporting.

Compliance with Other Disclosure Requirements

Bank's level of compliance with the other disclosure requirements given in the specified format for the preparation of Annual Financial Statements of Licensed Commercial Banks issued by the Central Bank of Sri Lanka is detailed below.

1.	INFORMATION ABOUT THE SIGNIFICANCE OF FINANCIAL INSTRUMENTS FOR FINANCIAL POSITION AND PERFORMANCE	
1.1	Statement of Financial Position	
1.1.1	Disclosures on categories of financial assets and financial liabilities	Note 22 to the Financial Statements
1.1.2	Other disclosures	
	(i) Special disclosures about financial assets and financial liabilities designated to be measured at fair value through profit or loss, including disclosures about credit risk and market risk, changes in fair values attributable to these risks and the methods of measurement	Note 4.5.2 (c) to the Financial Statements
	(ii) Reclassifications of financial instruments from one category to another	N/A
	(iii) Information about financial assets pledged as collateral and about financial or non-financial assets held as collateral	Note 31 (k) to the Financial Statements
	(iv) Reconciliation of the allowance account for credit losses by class of financial assets	Note 30 (a) and 30 (e) to the Financial Statements
	(v) Information about compound financial instruments with multiple embedded derivatives	N/A
	(vi) Breaches of terms of loan agreements	N/A
1.2	Statement of Comprehensive Income	
1.2.1	Disclosures on items of income, expense, gains and losses	Note 11, 12,13, 14, 15, 16, 17 and 18 to the Financial Statements
1.2.2	Other disclosures	
	(i) Total interest income and total interest expense for those financial instruments that are not measured at fair value through profit and loss	Note 11 to the Financial Statements
	(ii) Fee income and expense	Note 12 to the Financial Statements
	(iii) Amount of impairment losses by class of financial assets	Note 16 to the Financial Statements
	(iv) Interest income on impaired financial assets	Note 11 (a) to the Financial Statements
1.3	Other disclosures	
1.3.1	Accounting policies for financial instruments	Note 4.5 and 4.7 to the Financial Statements
1.3.2	Information on hedge accounting	N/A
1.3.3	Information about the fair values of each class of financial asset and financial liability, along with:	Note 8, 27, 31, 26 and 42 to the Financial Statements
	(i) Comparable carrying amounts	Note 4.5.4 and 8 to the Financial Statements
	(ii) Description of how fair value was determined	Note 4.5.4 and 8 to the Financial Statements
	(iii) The level of inputs used in determining fair value	N/A
	(iv) Reconciliations of movements between levels of fair value measurement hierarchy, additional disclosures for financial instruments that fair value is determined using level 3 inputs	Note 8 to the Financial Statements
	(v) Information if fair value cannot be reliably measured	N/A
2.	INFORMATION ABOUT THE NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS	
2.1	Qualitative disclosures	
2.1.1	Risk exposures for each type of financial instrument	Note 7 to the Financial Statements and "Risk Management at HNB" section
2.1.2	Management's objectives, policies, and processes for managing those risks	Note 7 to the Financial Statements and "Risk Management at HNB" section
2.1.3	Changes from the prior period	"Risk Management at HNB" section
2.2	Quantitative disclosures	
2.2.1	Summary of quantitative data about exposure to each risk at the reporting date	Note 7 to the Financial Statements
2.2.2	Disclosures about credit risk, liquidity risk, market risk, operational risk, interest rate risk and how these risks are managed	
	(i) Credit Risk	
	(a) Maximum amount of exposure (before deducting the value of collateral), description of collateral, information about credit quality of financial assets that are neither past due nor impaired and information about credit quality of financial assets	Note 7.3 to the Financial Statements and "Risk Management at HNB" section

(b) For financial assets that are past due or impaired, disclosures on age, factors considered in determining as impaired and the description of collateral on each class of financial asset	Note 7.3 to the Financial Statements
(c) Information about collateral or other credit enhancements obtained or called	Note 7.3 to the Financial Statements and “Risk Management at HNB” section
(d) For other disclosures, refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 7.3 to the Financial Statements and “Risk Management at HNB” section
(ii) Liquidity Risk	
(a) A maturity analysis of financial liabilities	Note 60 to the Financial Statements
(b) Description of approach to risk management	Note 7.4 to the Financial Statements and “Risk Management at HNB” section
(c) For other disclosures, refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 7.5 to the Financial Statements and “Risk Management at HNB” section
(iii) Market Risk	
(a) A sensitivity analysis of each type of market risk to which the entity is exposed	Note 7.5 to the Financial Statements and “Risk Management at HNB” section
(b) Additional information, if the sensitivity analysis is not representative of the entity’s risk exposure	Note 7.5 to the Financial Statements and “Risk Management at HNB” section
(c) For other disclosures, refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 7.5 to the Financial Statements and “Risk Management at HNB” section
(iv) Operational Risk	
Refer Banking Act Direction No. 7 of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)	Note 7.6 to the Financial Statements and “Risk Management at HNB” section
(v) Equity risk in the banking book	Note 7.5 to the Financial Statements and “Risk Management at HNB” section
(a) Qualitative disclosures	
*Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons.	Note 4.5.2 (c) and Note 4.5.2 (d) to the Financial Statements
*Discussion of important policies covering the valuation and accounting of equity holdings in the banking book.	Note 4.5.2 (c) and Note 4.5.2 (d) to the Financial Statements
(b) Quantitative disclosures	
*Value disclosed in the statement of financial position of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value.	Note 27, 31 and 32 to the Financial Statements
*The types and nature of investments.	Note 27, 31 and 32 to the Financial Statements
* The cumulative realised gains/(losses) arising from sales and liquidations in the reporting period.	Note 14 and 15 to the Financial Statements
(vi) Interest rate risk in the banking book	Note 7.5.3 to the Financial Statements and “Risk Management at HNB” section
(a) Qualitative disclosures	
Nature of interest rate risk in the banking book (IRRBB) and key assumptions	Note 7.5.3 to the Financial Statements and “Risk Management at HNB” section
(b) Quantitative disclosures	
The increase/(decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management’s method for measuring IRRBB, broken down by currency (as relevant).	“Risk Management at HNB” section
2.2.3 Information on concentrations of risk	“Risk Management at HNB” section

Compliance with Other Disclosure Requirements

3. OTHER DISCLOSURES	
3.1 Capital	
3.1.1 Capital structure	
(i) Qualitative disclosures	
Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.	Note 7.7 to the Financial Statements
(ii) Quantitative disclosures	
(a) The amount of Tier 1 capital, with separate disclosure of:	
*Paid-up share capital / common stock	
*Reserves	
*Non-controlling interests in the equity of subsidiaries	
*Innovative instruments	Note 7.7 to the Financial Statements
*Other capital instruments	
*Deductions from Tier 1 capital	
(b) The total amount of Tier 2 and Tier 3 capital	
(c) Other deductions from capital	
(d) Total eligible capital	
3.1.2 Capital adequacy	
(i) Qualitative disclosures	Note 7.7 to the Financial Statements
A summary discussion of the bank's approach to assessing the adequacy of its capital to support current and future activities.	
(ii) Quantitative disclosures	
(a) Capital requirements for credit risk, market risk and operational risk	Note 7.7 to the Financial Statements
(b) Total and Tier 1 capital ratio	Note 7.7 to the Financial Statements

Challenges
are also
opportunities.



We will use our
broad experience
and industry
expertise to
transform challenges
into opportunities
for growth.

Supplementary Information:

Income Statement

in US Dollars

For the year ended 31st December	BANK		GROUP	
	2013 US \$ 000	2012 US \$ 000 Restated	2013 US \$ 000	2012 US \$ 000 Restated
Income	459,367	403,751	494,266	432,523
Interest income	426,299	370,751	433,011	375,397
Less: Interest expenses	240,290	198,734	241,459	199,730
Net interest income	186,009	172,017	191,552	175,667
Fee and commission income	33,278	29,303	34,412	30,592
Less: Fee and commission expenses	628	418	3,597	3,227
Net fee and commission income	32,650	28,885	30,815	27,365
Net interest, fee and commission income	218,659	200,902	222,367	203,032
Net gain/(loss) from trading	(13,879)	(12,789)	(13,424)	(12,723)
Net gain/(loss) from financial investments	1,886	685	2,367	912
Other operating income	11,783	15,801	37,900	38,345
Total Operating income	218,449	204,599	249,210	229,566
Less: Impairment charge for loans and other losses	24,845	8,947	25,275	8,947
Net operating income	193,604	195,652	223,935	220,619
Personnel expenses	41,704	52,408	46,347	56,976
Other expenses	62,682	56,096	82,404	71,558
	104,386	108,504	128,751	128,534
Operating profit before value added tax (VAT)	89,218	87,148	95,184	92,085
Less: Value added tax (VAT) on financial services	12,692	9,776	12,692	9,776
Operating profit after value added tax (VAT)	76,526	77,372	82,492	82,309
Share of profit of Associates (net of income tax)	-	-	977	130
PROFIT BEFORE INCOME TAX	76,526	77,372	83,469	82,439
Less: Income tax expense	22,921	18,350	23,729	18,969
PROFIT FOR THE YEAR	53,605	59,022	59,740	63,470
Profit attributable to:				
Equity holders of the Bank	53,605	59,022	58,501	62,215
Non-controlling interests	-	-	1,239	1,255
PROFIT FOR THE YEAR	53,605	59,022	59,740	63,470
Earnings per share on profit				
Basic earnings per ordinary share	0.13	0.15	0.15	0.16
Diluted earnings per ordinary share	0.13	0.15	0.15	0.16
Dividend per share (Rs)	0.06	0.07	0.06	0.07

Exchange rate of US\$ 1 was Rs 130.775 as at 31st December 2013 (Rs 127.65 as at 31st December 2012).

The income statement given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

Statement of Comprehensive Income in US Dollars

For the year ended 31st December	BANK		GROUP	
	2013 US \$ 000	2012 US \$ 000 Restated	2013 US \$ 000	2012 US \$ 000 Restated
PROFIT FOR THE YEAR	53,605	59,022	59,740	63,470
OTHER COMPREHENSIVE INCOME , NET OF INCOME TAX				
Gains and losses arising from translating the financial statements of foreign operations	-	-	13	108
Gains and losses on re-measuring available-for-sale financial assets				
Net change in fair value on				
available-for-sale financial assets	9,896	3,555	9,992	3,727
Transfer to life policy holder reserve fund	-	-	23	(167)
Net amount transferred to profit or loss (available-for-sale financial assets)	-	591	-	601
Actuarial gains and losses on defined benefit plans	(6,560)	5,928	(6,543)	5,928
Changes in revaluation surplus	-	11,458	-	18,761
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	3,336	21,532	3,485	28,958
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	56,941	80,554	63,225	92,428
Total comprehensive income attributable to:				
Equity holders of the Bank	56,941	80,554	61,933	91,092
Non-controlling interests	-	-	1,292	1,336
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	56,941	80,554	63,225	92,428

Exchange rate of US\$ 1 was Rs 130.775 as at 31st December 2013 (Rs 127.65 as at 31st December 2012).

The statement of comprehensive income given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

Statement of Financial Position

in US Dollars

As at 31st December	BANK		GROUP	
	2013 US\$ 000	2012 US\$ 000 Restated	2013 US\$ 000	2012 US\$ 000 Restated
ASSETS				
Cash and cash equivalents	88,890	68,697	88,612	69,318
Balances with Central Banks	125,149	156,157	125,151	156,289
Placements with banks	9,532	80,860	23,579	91,402
Derivative financial instruments	1,335	2,699	1,335	2,699
Other financial assets held for trading	4,988	3,714	19,638	8,446
Non-current assets held for sale	-	-	-	23
Loans and receivables to banks	47,928	-	51,082	5,104
Loans and receivables to other customers	2,691,466	2,371,806	2,698,113	2,375,798
Financial investments - Available-for-sale	484,734	456,681	491,456	464,983
Financial investments - Held-to-maturity	-	-	7,681	12,878
Financial investments - Loans and receivables	253,141	156,919	268,429	163,762
Investments in Associates	-	-	4,451	3,025
Investment in Joint Venture	5,009	5,131	-	-
Investments in Subsidiaries	18,026	18,467	-	-
Investment properties	2,649	2,740	1,230	1,289
Property, plant and equipment	72,808	73,779	136,044	139,565
Intangible assets	7,606	4,357	8,572	5,401
Deferred tax assets	5,871	-	5,018	-
Other assets	83,069	94,730	87,157	99,336
Total Assets	3,902,201	3,496,737	4,017,548	3,599,318
LIABILITIES				
Due to banks	267,132	186,860	270,395	191,485
Derivative financial instruments	5,727	11,253	5,727	11,253
Due to other customers	2,946,748	2,674,688	2,943,992	2,670,173
Dividends payable	3,260	1,735	3,274	1,749
Other borrowings	66,244	65,276	78,406	74,726
Debt securities issued	10,849	-	11,702	1,175
Current tax liabilities	23,247	13,752	23,968	14,412
Insurance provision - Life	-	-	33,252	28,408
Insurance provision - Non-Life	-	-	7,732	7,595
Deferred tax liabilities	-	8,704	-	9,296
Other provisions	22,323	33,220	22,686	34,470
Other liabilities	72,554	73,117	77,723	78,691
Subordinated term debts	90,664	60,728	90,091	60,551
Total Liabilities	3,508,748	3,129,333	3,568,948	3,183,984
EQUITY				
Stated capital	98,109	98,547	98,109	98,547
Statutory reserves	51,701	35,492	51,701	35,492
Retained earnings	26,499	33,106	39,843	41,691
Other reserves	217,144	200,259	250,504	232,009
Total equity attributable to equity holders of the Bank	393,453	367,404	440,157	407,739
Non-controlling interests	-	-	8,443	7,595
Total Equity	393,453	367,404	448,600	415,334
Total Liabilities and Equity	3,902,201	3,496,737	4,017,548	3,599,318
Contingent liabilities and commitments	1,331,072	1,287,638	1,331,072	1,287,638

Exchange rate of US\$ 1 was Rs 130.775 as at 31st December 2013 (Rs 127.65 as at 31st December 2012).

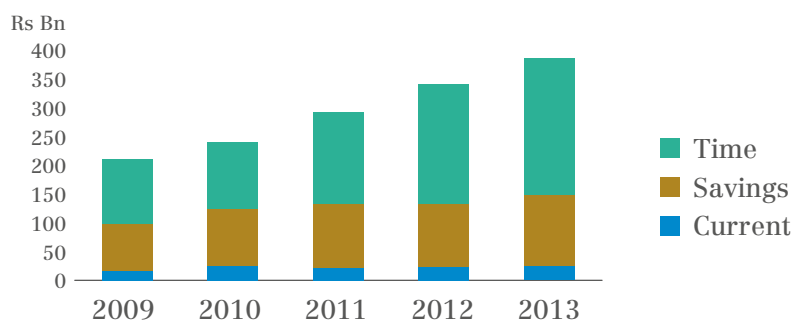
The statement of financial position given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

Analysis of Deposits

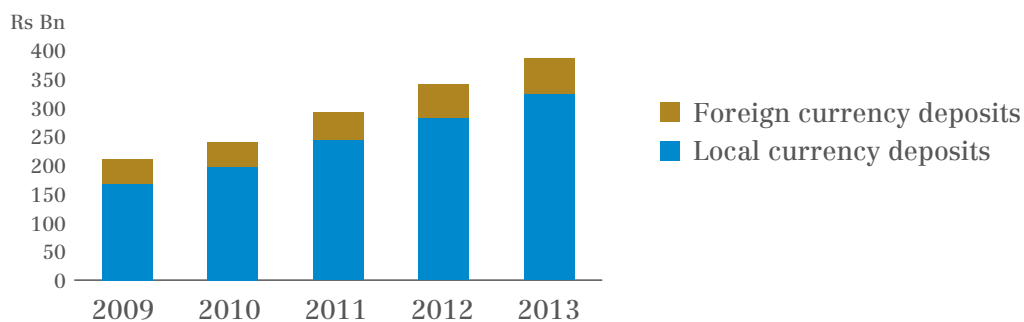
	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000	2013 Rs 000
Analysis of Total Deposits					
Local currency deposits	167,182,907	196,671,010	243,138,771	280,644,471	322,166,629
Foreign currency deposits	43,323,898	42,362,773	48,217,807	60,779,515	63,194,341
	210,506,805	239,033,783	291,356,578	341,423,986	385,360,970
Product wise analysis of Deposits					
Current	16,282,068	25,008,108	21,771,048	23,390,690	23,837,932
Savings	80,795,773	99,020,314	111,121,508	109,176,640	124,510,241
Time	113,428,964	115,005,361	158,464,022	208,856,656	237,012,797
	210,506,805	239,033,783	291,356,578	341,423,986	385,360,970

2009 figures are based on SLAS (previous GAAP) and 2010 - 2013 are based on LKASs/SLFRSs.

Analysis of Product-wise Deposits



Analysis of Total Deposits

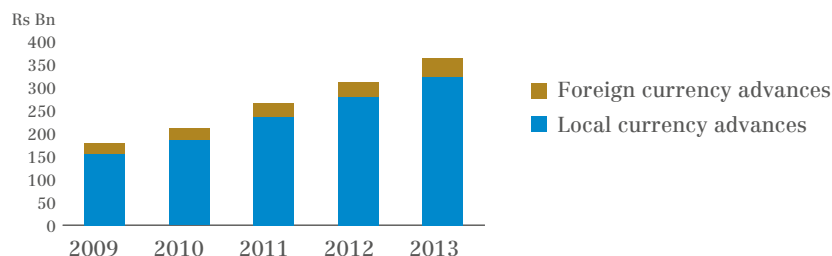


Analysis of Loans and Receivables

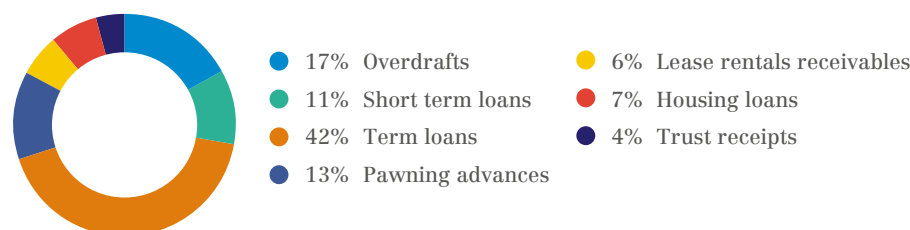
	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000	2013 Rs 000
Analysis of Loans and Receivables to customers (Gross)					
Local currency advances	154,357,736	182,561,153	234,850,162	278,597,183	321,899,418
Foreign currency advances	23,371,444	27,404,539	29,013,089	31,767,370	40,691,165
Total advances (Gross)	177,729,180	209,965,692	263,863,251	310,364,553	362,590,583
Product wise analysis of loans and receivables to customers (Gross)					
Overdrafts	33,723,102	43,179,410	48,088,165	61,160,391	62,458,953
Short term loans	10,297,431	13,754,239	13,254,457	16,756,644	39,628,925
Trust receipts	8,826,074	8,414,353	11,152,041	13,059,931	13,820,842
Term loans	75,405,923	82,595,924	107,510,467	121,856,986	152,209,624
Lease rentals receivables	9,398,642	13,919,320	24,568,780	25,280,078	23,152,822
Housing loans	18,163,102	18,821,074	21,800,114	22,990,253	25,084,498
Pawning advances	21,914,906	29,281,372	37,489,227	49,260,270	46,234,919
	177,729,180	209,965,692	263,863,251	310,364,553	362,590,583

2009 figures are based on SLAS (previous GAAP) and 2010 - 2013 are based on LKASs/SLFRSs.

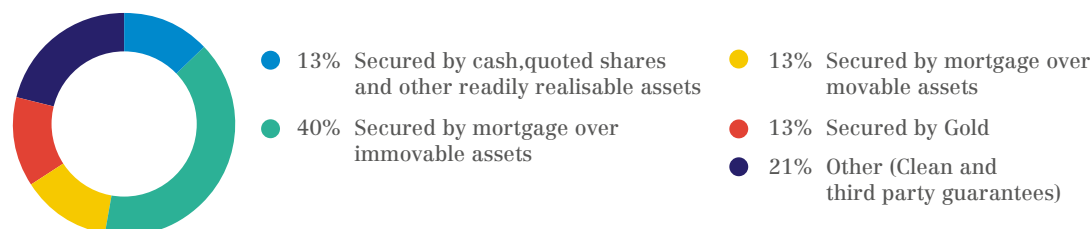
Analysis of Total Advances



Product-wise Analysis of Loans and Receivables



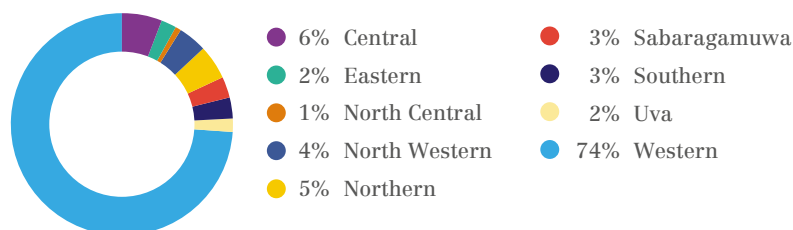
Analysis of Total Advances by Security



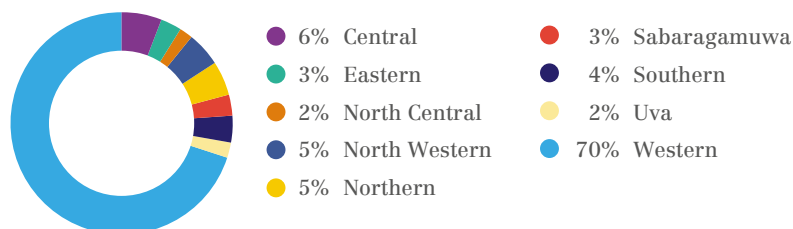
Province-wise Analysis of Deposits and Advances

As at 31st December 2013						
PROVINCE	No of Branches	Deposits (Rs Mn)	%	Advances including Leasing (Rs Mn)	%	Deposit Utilisation %
CENTRAL	25	24,577	6	23,294	6	95
EASTERN	26	9,395	2	12,386	3	132
NORTH CENTRAL	10	4,904	1	7,460	2	152
NORTH WESTERN	18	16,233	4	16,949	5	104
NORTHERN	22	18,541	5	16,409	5	89
SABARAGAMUWA	11	10,544	3	9,878	3	94
SOUTHERN	26	13,420	3	16,051	4	120
UVA	11	6,295	2	6,839	2	109
WESTERN	101	281,452	74	253,325	70	90
Total	250	385,361	100	362,591	100	94

Province-wise Deposits



Province-wise Advances

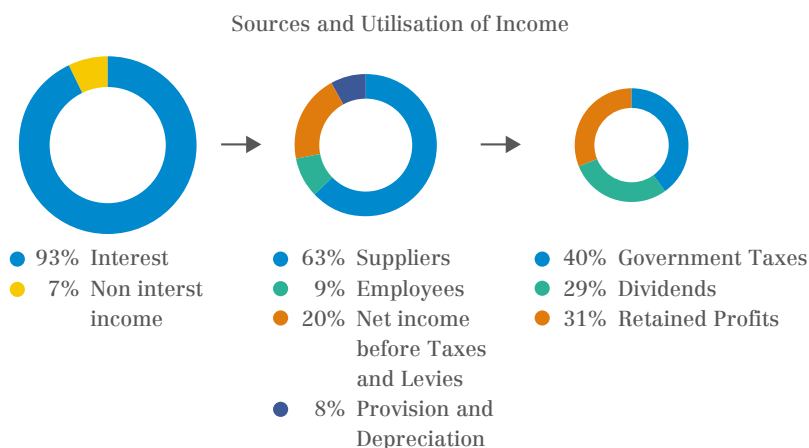


Sources and Utilisation of Income

	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000	2013 Rs 000
Sources of Income					
Interest	34,620,276	30,249,230	33,175,928	47,326,377	55,749,193
Non interest income	4,190,823	4,621,188	3,890,373	4,212,402	4,324,492
Total	38,811,099	34,870,418	37,066,301	51,538,779	60,073,085
Utilisation of Income					
Employees					
Salaries and other payment to Staff	4,909,419	5,507,101	4,987,287	6,689,864	5,453,778
Suppliers					
Interest Paid	20,039,646	14,703,256	16,530,253	25,368,432	31,423,945
Other expenses	4,082,875	4,622,349	5,512,544	6,214,551	6,860,219
	24,122,521	19,325,605	22,042,797	31,582,983	38,284,164
Provisions and depreciation					
Depreciation and amortisation	751,009	830,565	915,126	975,700	1,084,256
Impairment for loans and other losses	768,310	524,478	(434,400)	1,150,887	3,492,380
	1,519,319	1,355,043	480,726	2,126,587	4,576,636
Net Income before Government Taxes and Levies	8,259,840	8,682,669	9,555,491	11,139,345	11,759,107
Government					
Income Tax, VAT, Crop Insurance, Debit Tax (Incl. Deferred Tax)	3,770,452	4,188,491	3,364,886	3,605,190	4,749,001
Shareholders					
Dividends	1,533,222	1,649,547	2,914,624	3,378,684	3,399,438
Retained Profits	2,956,166	2,844,631	3,275,981	4,155,471	3,610,668
Total	38,811,099	34,870,418	37,066,301	51,538,779	60,073,685

2009 and 2010 figures are based on SLAS (previous GAAP) and 2011 - 2013 are based on LKASs/SLFRSs.

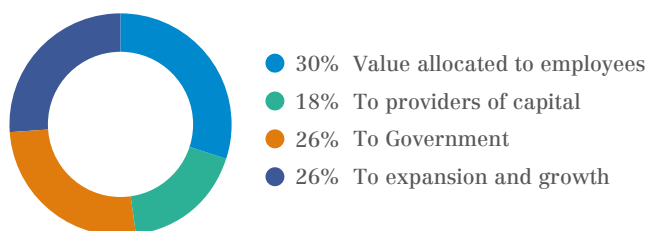
Debit tax discontinued from 1st April 2011



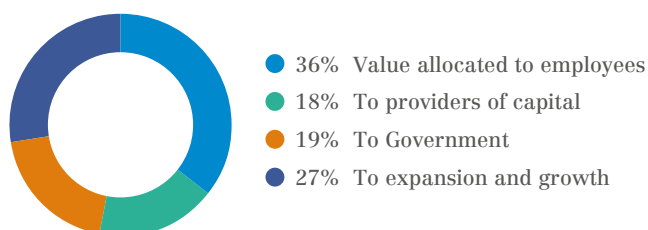
Value Added Statement

	2013 Rs 000	%	2012 Rs 000	%		
Value Added						
Income earned by providing banking services	61,420,878		52,890,252			
Cost of services	38,525,715		31,590,822			
Value added by banking services	22,895,163		21,299,430			
Non-banking income	221,277		193,609			
Net Gain/(loss) from trading and financial investment	(1,568,470)		(1,545,082)			
Impairment for loans and other losses	(3,249,166)		(1,142,110)			
	18,298,804		18,805,847			
Value allocated to employees						
Salaries,wages & other benefits	5,453,778	29.80	6,689,864	35.56		
To providers of capital						
Dividends to shareholders	3,399,437	18.58	3,378,684	17.97		
To Government						
Value added tax	1,659,755		1,247,873			
Income tax	2,997,555		2,342,335			
Crop insurance levy	56,628		-			
Local taxes	1,663		938			
Stamp duty	35,063	4,750,664	25.96	14,982	3,606,128	19.18
To expansion and growth						
Retained income	3,610,669	19.73	4,155,471	22.10		
Depreciation and amortization	1,084,256	5.93	975,700	5.19		
	18,298,804	100.00	18,805,847	100.0		

Analysis of Value Addition 2013



Analysis of Value Addition 2012



Ten Year Statistical Summary

Year ended 31st December (Rs Mn)	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
OPERATING RESULTS										
Income	13,829	16,674	21,168	29,565	36,615	38,811	34,870	37,066	51,539	60,074
Interest Income	11,469	14,130	18,452	26,250	32,431	34,620	30,249	33,176	47,326	55,749
Interest Expense	5,962	7,281	9,797	15,190	19,752	20,040	14,703	16,530	25,368	31,424
Non Interest Income	2,360	2,544	2,716	3,315	4,184	4,191	4,621	3,890	4,213	4,325
Operating Expenses (Incl. Financial VAT)	6,917	7,543	8,352	10,040	12,078	12,853	13,436	12,148	16,295	18,642
Profit before Income Tax	950	1,850	3,019	4,335	4,785	5,918	6,731	8,388	9,876	10,008
Income Tax on Profit	(26)	195	799	1,313	1,566	1,566	2,267	2,123	2,342	2,998
Profit after Taxation	976	1,655	2,220	3,022	3,219	4,352	4,464	6,265	7,534	7,010
LIABILITIES AND SHAREHOLDERS' FUNDS										
Customer Deposits	118,524	128,284	147,557	175,660	186,770	210,507	239,034	291,357	341,424	385,361
Refinance Borrowings	2,066	2,712	3,583	5,750	6,424	6,169	6,436	7,045	6,429	5,615
Other Liabilities	22,788	23,463	31,687	32,472	42,064	38,774	42,572	42,923	50,495	67,880
Deferred Tax Liabilities	350	314	314	606	872	939	891	1,175	1,111	-
Shareholders' funds	9,052	11,239	12,930	18,419	20,581	23,900	30,775	37,984	46,899	51,454
Total	152,780	166,012	196,071	232,907	256,711	280,289	319,708	380,484	446,358	510,310
ASSETS										
Loans and Receivables to Customers (Net)	97,510	112,500	133,460	160,343	174,808	169,639	202,253	257,198	302,761	351,976
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	25,013	24,400	30,200	32,565	35,149	38,216	30,600	33,446	39,024	29,238
Property, Plant and Equipment	3,387	3,059	2,908	6,083	6,866	7,180	7,428	7,835	9,418	9,521
Deferred Tax Assets	-	-	-	-	-	-	506	315	-	768
Other Assets	26,870	26,053	29,503	33,916	39,888	65,254	78,921	81,690	95,155	118,807
Total	152,780	166,012	196,071	232,907	256,711	280,289	319,708	380,484	446,358	510,310
RATIOS										
Return on Average Shareholders Funds (%)	12	16	18	19	17	20	16	18	18	14
Income Growth (%)	(6)	21	27	40	24	6	(10)	6	39	17
Return on Average Assets (%)	0.7	1.0	1.2	1.4	1.3	1.6	1.5	1.8	1.8	1.5
Dividend Cover (Times)	2.8	3.5	3.8	3.7	3.4	2.8	2.7	2.1	2.2	2.1
Property, Plant and Equipment to Shareholders' Funds (%)	37	27	22	33	33	30	24	21	20	19
Total Assets to Shareholders' Funds (Times)	17	15	15	13	12	12	10	10	10	10
Liquid Assets to Liabilities (%)	25	24	22	22	22	29	24	22	22	23
SHARE INFORMATION										
Market Value per Share (Rs)										
-Voting	57.00	112.50	155.75	122.50	69.75	170.25	399.90	151.30	148.00	147.00
-Non Voting	32.75	41.50	70.00	53.25	32.00	104.75	214.60	83.20	112.50	119.00
Earnings per Share (Rs)	9.75	14.05	18.86	12.83	13.67	18.47	18.84	16.60	18.94	17.59
Earnings per Share (Adjusted) (Rs) *	2.45	4.15	5.57	7.59	8.08	10.92	11.20	15.72	18.91	17.59
Price Earnings Ratio	5.84	8.01	8.26	9.55	5.10	9.22	21.23	9.11	7.81	8.36
Net Assets per Share (Adjusted) (Rs) **	22.65	28.13	32.36	46.10	51.51	59.82	77.02	95.07	117.38	128.78
Dividend per share (Rs)	3.50	4.00	5.00	3.50	4.00	6.50	7.00	7.50	8.50	8.50
Gross Dividends (Rs Mn)	350	471	589	824	942	1,533	1,650	2,915	3,379	3,399
OTHER INFORMATION										
No of Employees	4,180	4,259	4,287	4,334	4,395	4,302	4,352	4,584	4,679	4,604
No of Customer Centres	142	148	151	167	177	186	205	240	247	250
No of Student Banking Centres	152	152	152	152	152	153	159	164	166	168
No of Other Financial Centres	110	113	113	114	114	115	121	123	132	134

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

** Net Assets per share has been computed for the current number of shares issued as at 31st December 2013

Highlighted information is based on LKASs/SLFRSs.

Quarterly Statistics

For the three months ended	* 2013				* 2012			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
Statement of financial position (Rs. Million)								
Total assets	510,310	486,862	481,921	451,745	446,358	428,821	417,972	411,554
Loans and receivables to banks and other customers	358,244	335,303	324,715	306,533	302,761	293,583	285,751	283,625
Due to other customers	385,361	364,159	351,534	348,176	341,424	328,661	319,723	313,928
Shareholders' funds	51,454	50,407	48,782	46,141	46,899	42,417	39,800	38,366
Average assets	498,586	484,392	466,833	449,052	437,590	423,397	414,763	395,990
Income statement data (Rs 000)								
Net interest income	5,770,377	6,037,403	6,419,307	6,098,161	6,045,390	5,618,582	5,446,073	4,847,900
Net fee and commission income	1,130,937	1,136,375	984,833	1,017,765	968,818	887,656	907,078	923,538
Net gain/(loss) from trading	(826,752)	26,821	7,069	(1,022,199)	(983,116)	(1,293,861)	(160,658)	805,107
Net gain/(loss) from financial investments	22,353	19,361	185,277	19,600	(69,198)	16,305	119,546	20,793
Other operating income	610,141	171,609	(145,356)	904,576	699,827	1,425,745	214,568	(323,153)
Total operating income	6,707,056	7,391,569	7,451,130	7,017,903	6,661,721	6,654,427	6,526,607	6,274,185
Less :Impairment (charge)/reversal for loans and other losses	(423,192)	(166,003)	(1,640,866)	(1,019,105)	35,273	(107,570)	(480,807)	(589,006)
Net operating income	6,283,864	7,225,566	5,810,264	5,998,798	6,696,994	6,546,857	6,045,800	5,685,179
Operating expenses	(3,431,479)	(3,982,248)	(2,354,233)	(3,883,116)	(3,343,426)	(3,535,375)	(3,492,120)	(3,479,546)
VAT on financial services	(312,584)	(471,837)	(449,602)	(425,732)	(121,961)	(436,270)	(306,318)	(383,324)
Provision for income tax	(869,032)	(574,061)	(1,022,466)	(531,996)	(325,596)	(746,865)	(681,810)	(588,064)
Profit for the year	1,670,769	2,197,420	1,983,963	1,157,954	2,906,011	1,828,347	1,565,552	1,234,245
Other comprehensive income for the year	(76,251)	(632,887)	303,232	842,257	2,150,714	754,768	(146,083)	(10,865)
Total comprehensive income for the year	1,594,518	1,564,533	2,287,195	2,000,211	5,056,725	2,583,115	1,419,469	1,223,380
Ordinary share information								
Market price per share (Rs)								
	V	NV	V	NV	V	NV	V	NV
High	176.00	132.50	164.80	118.00	176.00	131.00	169.00	132.50
Low	140.00	108.20	145.00	108.20	140.00	116.20	142.50	111.00
Closing	147.00	119.00	150.00	110.30	161.10	118.10	167.30	131.80
V- Voting NV - Non Voting								
Book value per ordinary share	128.78		126.31		122.40		116.06	
Financial measures								
Profitability								
Return on average shareholders' equity (annualised) (%)	14.25		14.63		13.13		9.96	
Productivity								
Non interest expenses to total revenue (%)	51.16		53.88		31.60		55.33	
Capital								
Risk weighted capital ratios								
Tier 1 (%)	12.95		12.58		11.75		12.38	
Total (Tier 1+2) (%)	16.52		16.37		15.61		14.96	
Asset quality								
Gross NPA ratio (%) **	3.64		4.65		4.55		4.86	
Net NPA ratio (%) **	1.36		2.51		2.51		3.04	

Note

* Quarterly information has been amended based on classification changes made in 2013.

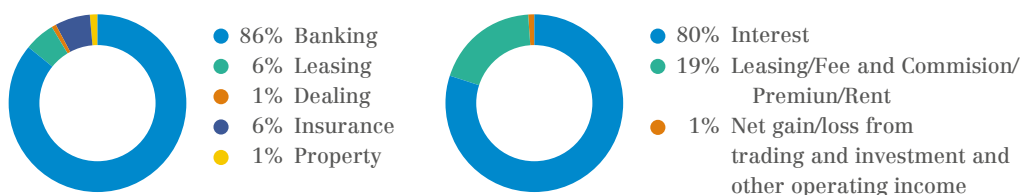
** This information has been compiled in accordance with the instructions issued by the Central Bank of Sri Lanka for interim publication which may differ from information in other disclosures.

Segmental Analysis

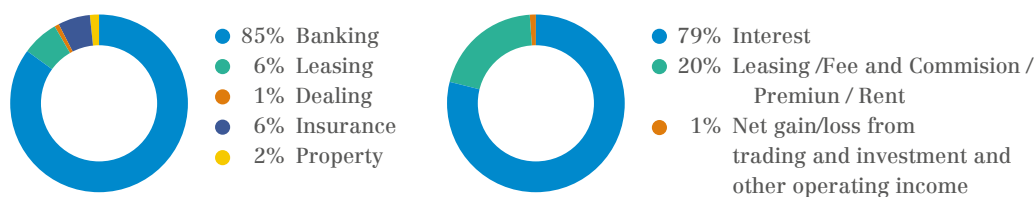
Business Segments	Banking		Leasing		Dealings *		Property		Insurance		Total	
	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000	2013 Rs 000	2012 Rs 000
Interest	52,082,501	43,597,897	-	-	295,167	261,598	-	-	766,569	641,384	53,144,059	44,500,879
Leasing /fee and commission / premium / rent	4,426,197	3,803,490	3,666,692	3,728,480	91,310	100,498	830,856	800,569	3,342,083	2,768,698	12,357,316	11,201,735
Net gain/(loss) from trading, financial investment and the operating income	(101,705)	408,912	-	-	46,026	104,767	(6,713)	23,567	103,604	23,754	41,212	561,000
Total revenue	56,406,993	47,810,299	3,666,692	3,728,480	432,503	466,863	824,143	824,136	4,212,256	3,433,836	65,542,587	56,263,614

* Stock broking, securities dealings, remittances, investment banking, venture capital business and Foreign currency related services

Segmental Analysis 2013



Segmental Analysis 2012



Investor Relations

1 STOCK EXCHANGE LISTING

The issued ordinary shares of Hatton National Bank PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st December 2013 and the audited Balance Sheet of the Bank as at date have been submitted to the Colombo Stock Exchange within three months of the Balance Sheet date.

Stock Exchange code for Hatton National Bank PLC shares is "HNB". Reuter code of Hatton National Bank PLC is "HNBL"

2 ORDINARY SHAREHOLDERS

SHARE INFORMATION - VOTING

There were 4,401 registered Voting Shareholders as at 31st December 2013 (2012 - 4,389) distributed as follows.

	Resident			Non-Resident			Total		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1 - 1,000	2,543	726,293	0.32	33	12,733	0.02	2,576	739,026	0.25
1,001 - 10,000	1,209	3,815,966	1.67	36	139,689	0.19	1,245	3,955,655	1.32
10,001 - 100,000	456	12,937,065	5.66	18	532,208	0.74	474	13,469,273	4.48
100,001 - 1,000,000	69	17,397,760	7.61	11	3,177,906	4.41	80	20,575,666	6.84
Over 1,000,000	12	193,700,115	84.74	14	68,229,930	94.64	26	261,930,045	87.12
	4,289	228,577,199	100.00	112	72,092,466	100.00	4,401	* 300,669,665	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2013			31st December 2012		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	4,289	228,577,199	76.02	4,262	225,810,239	75.53
Non-Resident	112	72,092,466	23.98	127	73,155,699	24.47
Total	4,401	* 300,669,665	100.00	4,389	* 298,965,938	100.00

Individuals / Institutions

	31st December 2013			31st December 2012		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	4,106	54,100,147	17.99	4,088	46,978,110	15.71
Institutions	295	246,569,518	82.01	301	251,987,828	84.29
Total	4,401	* 300,669,665	100.00	4,389	* 298,965,938	100.00

As at 31/12/2013 the average size of holding of ordinary shareholding was 68,318 voting shares. (31/12/2012 - 68,117 voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2013 was 67% approximately.

*18,684,164 number of unregistered shares in respect of an entity whose name has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)© of the Banking Act, are not included herein.

Investor Relations

SHARE INFORMATION - NON VOTING

There were 11,107 registered Non Voting Shareholders as at 31st December 2013 (2012 - 11,360) distributed as follows.

	Resident			Non-Resident			Total		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1 - 1,000	6,585	2,323,360	4.87	51	18,063	0.06	6,636	2,341,423	2.92
1,001 - 10,000	3,723	11,375,740	23.85	63	223,474	0.69	3,786	11,599,214	14.46
10,001 - 100,000	595	15,356,050	32.19	15	448,877	1.38	610	15,804,927	19.71
100,001 - 1,000,000	55	13,878,486	29.10	7	1,795,488	5.52	62	15,673,974	19.54
Over 1,000,000	3	4,766,658	9.99	10	30,015,176	92.35	13	34,781,834	43.37
	10,961	47,700,294	100.00	146	32,501,078	100.00	11,107	80,201,372	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2013			31st December 2012		
	No of Shareholders	No of Shares	%	No of Share holders	No of Shares	%
Resident	10,961	47,700,294	59.48	11,194	62,705,114	78.78
Non-Resident	146	32,501,078	40.52	166	16,891,233	21.22
Total	11,107	80,201,372	100.00	11,360	79,596,347	100.00

Individuals / Institutions

	31st December 2013			31st December 2012		
	No of Shareholders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	10,824	33,912,490	42.28	11,047	32,973,278	41.43
Institutions	283	46,288,882	57.72	313	46,623,069	58.57
Total	11,107	80,201,372	100.00	11,360	79,596,347	100.00

As at 31/12/2013 the average size of holding of ordinary shareholding was 7,221 non-voting shares. (31/12/2012 - 7,007 non-voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2013 was 99% approximately.

3 SHARE TRADING

	2013	2012
VOTING		
Number of transactions	5,487	3,113
Number of shares traded (Mn)	68	12
Rank (As per CSE)	37	108
Value of shares traded (Rs Mn)	10,303	1,811
Rank (As per CSE)	3	21
NON VOTING		
Number of transactions	7,328	6,374
Number of shares traded (Mn)	24	15
Value of shares traded (Rs Mn)	2,839	1,444

4 **DIVIDENDS**

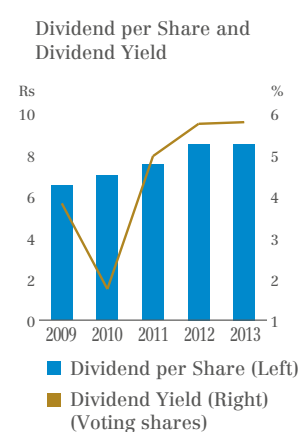
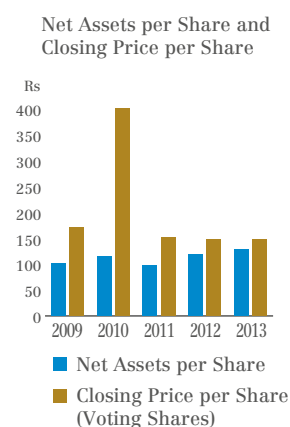
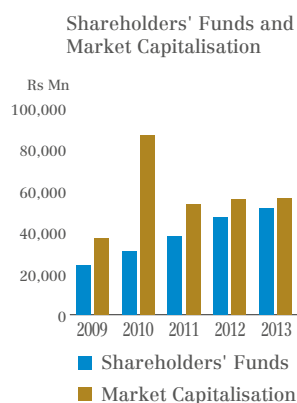
	2013		2012	
Interim (Rs)	1.50	Paid in December 2013	1.50	Paid in December 2012
Final (Rs) - Cash Dividend	7.00	Propose to be paid in April 2014	7.00	Paid in April 2013
Dividend payout ratio (%)	48.49		44.84	

5 **EARNINGS**

	2013	2012
Earnings per share (Rs)	17.59	18.94
Price earnings ratio (Times) - Voting Shares	8.36	7.81

6 **MARKET VALUE**

	Highest Rs	Lowest Rs	Year End Rs
2009 - Voting	175.00	68.00	170.25
- Non Voting	107.00	32.00	104.75
2010 - Voting	445.00	168.00	399.90
- Non Voting	260.00	105.00	214.60
2011 - Voting	410.00	120.00	151.30
- Non Voting	228.00	79.00	83.20
2012 - Voting	170.00	130.00	148.00
- Non Voting	121.70	77.50	112.50
2013 - Voting	176.00	140.00	147.00
- Non Voting	132.50	108.20	119.00



7 **MARKET CAPITALISATION (AS AT 31ST DECEMBER)**

	Capital & Reserves Rs Mn	HNB Market Capitalization* Rs Mn	CSE Market Capitalization Rs Mn	HNB Market Capitalization as a % of CSE Market Capitalization	Market Capitalization Ranking
2009	23,900	32,266	1,092,138	2.95	8
2010	27,274	76,491	2,210,452	3.46	7
2011	37,984	47,116	2,213,873	2.13	10
2012	46,899	47,012	2,167,134	2.17	11
2013	51,454	46,945	2,459,897	1.91	11

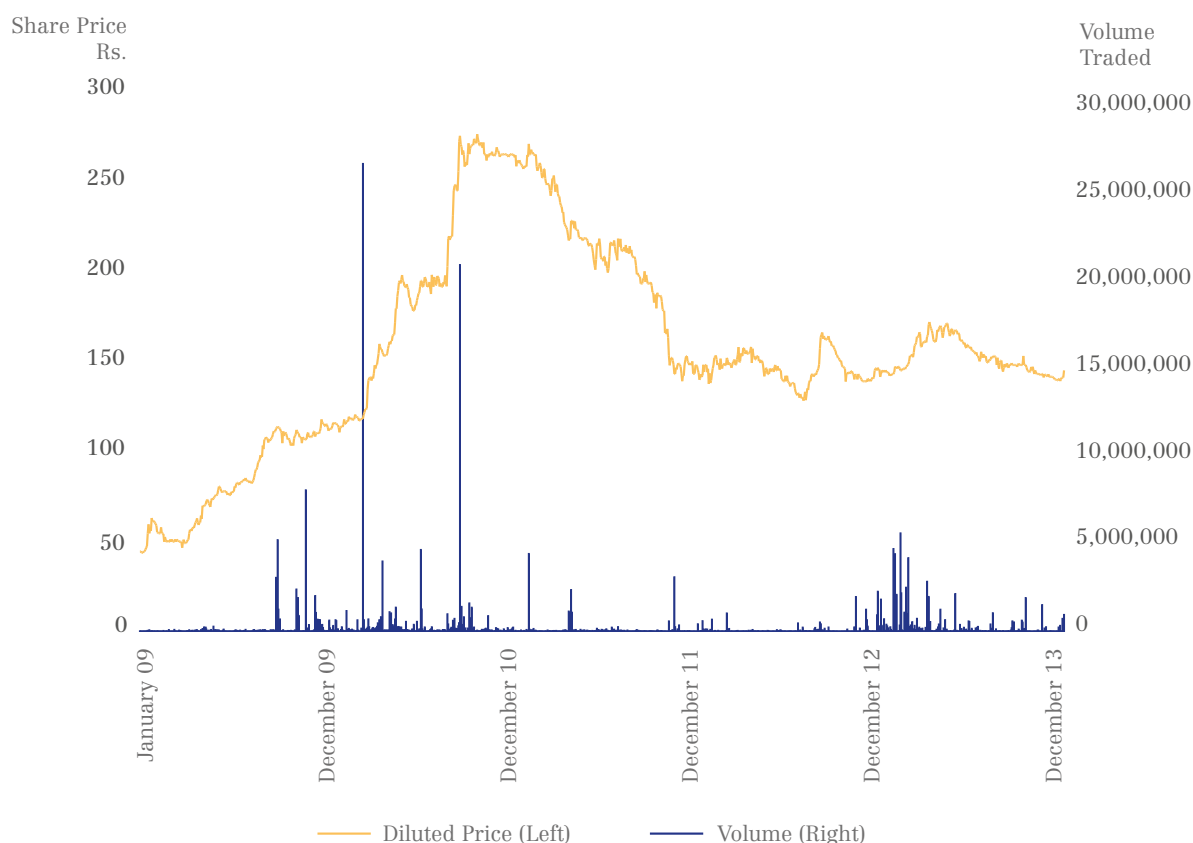
*HNB Market Capitalization includes only Voting shares

Investor Relations

8 INFORMATION ON MOVEMENT IN SHARE CAPITAL

Year	Issue	Basis	No of Shares
	Prior to public issue		50,000
1971	Public issue		220,000
1977	Rights issue (@ Rs 10/-)	42:50	230,000
1980	Rights issue (@ Rs 10/-)	1:1	500,000
1982	Bonus	1:1	1,000,000
1988	Bonus	1:1	2,000,000
1990	Bonus	1:2	2,000,000
1993	Bonus	1:1	6,000,000
1996	Bonus	2:3	8,000,000
1998	Bonus	1:2	10,000,000
1999	Bonus	2:3	20,000,000
1999	Rights (non voting @ Rs 70/-)	3:10	15,000,000
2002	Bonus	1:10	6,500,000
2004	Rights (voting @ Rs 55.00 and non voting @ Rs 33.00)	2:5	28,600,000
2005	Issue of underlying shares for GDR		17,664,700
2007	Bonus	1:1	117,764,700
2009	Shares issued under ESOP		240,747
2010	Shares issued under ESOP		2,198,875
2011	Sub division of shares	1:2	119,179,782
2011	Rights (voting @ Rs 219.50 and non voting @ Rs 119.50)	1:10	21,858,851
2011	Private placement of unsubscribed rights		8,975,700
2011	Shares issued under ESOP		613,488
2012	Scrip Dividend		7,890,528
2012	Shares issued under ESOP		759,078
2013	Shares issued under ESOP		2,308,752
	Total		399,555,201

9 PRICE VOLUME CHART



MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2013

	Name	% on total capital	% on total voting capital	No. of Shares 2013	No. of Shares 2012
1.	Sri Lanka Insurance Corporation Ltd.	11.92	14.92	47,635,487	47,635,487
2.	Employees Provident Fund	7.97	9.97	31,836,612	30,436,612
3.	Milford Exports (Ceylon) Limited	6.46	**8.09	25,828,280	25,828,280
4.	Mr.Sohli Edelji Captain	5.93	7.42	23,705,220	18,723,547
5.	Stassen Exports Ltd	5.60	**7.01	22,387,096	22,387,096
6.	Sonetto Holdings Limited	3.68	4.60	14,697,921	14,697,921
7.	HSBC Int'l Nominees Ltd-JPMLU-Franklin Templeton Investment	3.47	4.35	13,876,398	974,080
8.	Brown & Company PLC	3.42	4.27	13,647,856	22,186,122
9.	Distilleries Company of Sri Lanka PLC	2.51	**3.14	10,016,272	10,016,272
10.	National Savings Bank	2.35	2.93	9,371,940	9,371,940
11.	Citi Group Global Markets Ltd Agency Trading Prop. Sec.	1.90	2.37	7,582,044	1,200,000
12.	Standard Chartered Bank Singapore S/A HL Bank Singapore	1.58	1.98	6,320,188	6,235,188
13.	The Bank of New York Mellon SA/NV-CF Ruffer Total return Fund	1.29	1.61	5,138,289	5,138,289
14.	The Bank of New York Mellon SA/NV-CF Ruffer Absolute Return Fund	0.86	1.08	3,448,972	3,448,972
15.	Employees Trust Fund Board	0.84	1.05	3,346,644	2,020,976
16.	HSBC INTL Nom Ltd-UBS AG Zurich	0.79	0.99	3,154,940	-
17.	Ms.Leesha Anne Captain	0.72	0.90	2,870,020	2,870,020
18.	BNY-CF Ruffer Investment Funds : CF Ruffer Pacific Fund	0.66	0.82	2,628,518	2,628,518
19.	HSBC Int'l Nom Ltd-JPMCB-Investerings Foreningen Bank Invest, AF	0.65	0.81	2,590,000	-
20.	HSBC Int'l Nom Ltd-BBH-Pioneer Multi-Asset Real Return Fund	0.60	0.75	2,409,956	-
	Sub total	63.19	79.06	252,492,653	225,799,320
	* Unregistered Shares	4.68	5.85	18,684,164	18,684,164
	Balance held by 4,381 voting shareholders	12.06	15.09	48,177,012	73,166,618
	(Total voting shareholders- 4,401)				
	Total voting shares	79.93	100.00	319,353,829	317,650,102
	Shares held by 11,107 Non-voting shareholders	20.07		80,201,372	79,596,347
	Total No. of Ordinary shares	100.00		399,555,201	397,246,449

* An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

**Pursuant to the provisions of the Banking Act Directions No. 1 of 2007, the total collective voting rights in the Bank, of Milford Exports (Ceylon) Limited, Stassen Exports Limited and Distilleries Company of Sri Lanka (who collectively hold 18.24% of the voting shares of the Bank) are limited to 10% of the total voting rights of the Bank with effect from 15th March 2012 as the voting rights in excess of such percentage is deemed invalid from that date.

Investor Relations

20 MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2013

Name	% on total capital	% on total non-voting capital	No. of Shares 2013	No. of Shares 2012
1. HSBC Intl nominees Ltd-JPMLU-Franklin Templeton Invest	1.91	9.51	7,625,980	4,525,980
2. Mellon-Frontaura Global Frontier Fund LLC	1.84	9.15	7,334,507	-
3. HSBC Int'l Nom Ltd-UBS AG Zurich	1.11	5.53	4,437,534	-
4. The Bank of New York Mellon SA/NV-CF Ruffer Total Return Fund	0.64	3.19	2,557,103	2,557,103
5. Employees Trust Fund Board	0.56	2.77	2,220,644	2,633,690
6. The Bank of New York Mellon SA/NV-CF Ruffer Absolute Return	0.43	2.12	1,703,364	1,703,364
7. CITI Bank NY S/A Forward International Dividend Fund	0.37	1.82	1,461,149	746,894
8. Northern Trust Company S/A Polar Capital Funds PLC	0.36	1.80	1,447,181	-
9. Mr. Sohli Edelji Captain	0.36	1.80	1,442,839	1,442,839
10. HINL-JPMCB-Butterfield Trust (Bermuda) LTD	0.32	1.60	1,285,885	1,985,885
11. Pershing LLC S/A Averbach Grauson & Co.	0.29	1.44	1,151,358	1,190,438
12. National Savings Bank	0.28	1.38	1,103,175	1,103,175
13. BNY-CF Ruffer Investment Funds:CF Ruffer Pacific Fund	0.25	1.26	1,011,115	1,011,115
14. Akbar Brothers Pvt Ltd A/c No.1	0.23	1.13	906,807	791,122
15. Mr. Jayampathi Divale Bandaranayake	0.18	0.87	700,997	558,189
16. DFCC Bank A/c No. 01	0.16	0.79	632,900	715,947
17. Waldock Mackenzie Ltd/Mr. H M S Abdulhussein	0.16	0.78	623,487	641,487
18. Bank of Ceylon A/c Ceybank Century Growth Fund	0.15	0.76	612,575	625,799
19. Hatton National Bank PLC A/c No. 2	0.14	0.72	574,733	574,733
20. Union Assurance PLC No. 1 A/c	0.13	0.65	521,346	521,346
Sub total	9.85	49.07	39,354,679	23,329,106
Balance held by 11,087 Non-voting shareholders (Total Non-voting shareholders-11,107)	10.22	50.93	40,846,693	56,267,241
Total Non-voting shares	20.07	100.00	80,201,372	79,596,347
Shares held by 4,401 voting shareholders	75.25		300,669,665	298,965,938
* Unregistered voting Shares	4.68		18,684,164	18,684,164
Total voting shares	79.93		319,353,829	317,650,102
Total No. of Ordinary shares	100.00		399,555,201	397,246,449

* An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

12 RELATED PARTY TRANSACTIONS EXCEEDING 10% OF THE EQUITY OR 5% OF THE TOTAL ASSETS OF THE BANK

The Bank carried out transactions in the ordinary course of business with the following parties and the aggregate monetary value of these transactions exceeded 10% of the share holders' equity of the Bank as at 31st December 2013.

Government of Sri Lanka and other government related entities

Hatton National Bank Retirement Pension Fund

Hatton National Bank Employee Provident Fund

The details of these transactions are given in [Note 59 (f)] 'Transactions with the Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka' and [Note 59 (g) (ii)] 'Other Business Transactions with Other Related Entities by the Bank' respectively.

13. DEBENTURE INFORMATION

HNB DEBENTURES 2006

i) Market Value

12 months ended 31st December 2013

These debentures have not traded during the year ended 31st December 2013

ii) Interest Rate

12 months ended 31st December	2013			2012		
	Coupon Rate%	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
8 year Floating Rate (6 months TB + 2.25% p.a.) *	10.54	11.60	8.72	13.93	14.78	12.58
15 year Fixed Rate (11.00% p.a.)	0	11.00	11.39	0	11.00	13.53
18 year Fixed Rate (11.25% p.a.)	0	11.25	11.94	0	11.25	13.75

* The floating rate debentures have a cap of 16.00% p.a. and a floor of 8.00% p.a.

HNB DEBENTURES 2007

i) Market Value

12 months ended 31st December 2013

These debentures have not traded during the year ended 31st December 2013

ii) Interest Rate

12 months ended 31st December	2013			2012		
	Coupon Rate%	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
10 year Fixed Rate (16.00% p.a.)	16.00	16.00	10.22	16.00	16.00	13.14
15 year Fixed Rate (16.75% p.a.)	16.75	16.75	11.64	16.75	16.75	13.52

Investor Relations

HNB DEBENTURES 2011

i) Market Value

12 months ended 31st December 2013

These debentures have not traded during the year ended 31st December 2013

ii) Interest Rate

12 months ended 31st December	2013			2012		
	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
10 year Fixed Rate (11.50% p.a.)	11.50	11.83	11.39	11.50	11.83	13.52

HNB DEBENTURES 2013

i) Market Value

12 months ended 31st December 2013

	Highest Rs	Lowest Rs	Last Traded Rs	Trade Yield %
	100.00	100.00	100.00	13.99

ii) Interest Rate

12 months ended 31st December	2013			2012		
	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
5 year Fixed Rate (14.00% p.a.)	14.00	14.00	10.87	-	-	-

Note: HNB Debenture information is listed under Subordinated Term Debts, Note 51 of the Financial Position.

HNB SENIOR DEBENTURES 2013

i) Market Value

12 months ended 31st December 2013

These debentures have not traded during the year ended 31st December 2013

ii) Interest Rate

12 months ended 31st December	2013			2012		
	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
10 year Fixed Rate	8.00	14.25	11.84	-	-	-

Note: HNB Senior Debenture information is listed under Debt Securities issued, Note 46 of the Financial Position.

Ratios	2013	2012
Listed Debentures to Equity ratio (%)	19.49	9.78
Listed Debentures Interest Cover (Times)	11.88	1746
Liquidity Asset Ratio (LAR)	23.32	22.38

Note: Equivalent Govt. Security rates are Grossed up for withholding tax

Glossary of Financial / Banking Terms

A ACCEPTANCES

The signature on a Bill of Exchange indicates that the person on whom it is drawn accepts the conditions of the Bill. In other words a Bill of Exchange that has been accepted.

ACCOUNTING POLICIES

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

ACCRUAL BASIS

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

AMORTISATION

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

AMORTISED COST

Amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and minus any reduction for impairment or uncollectability.

ASSOCIATE

An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

AVAILABLE FOR SALE FINANCIAL ASSETS

Available for sale financial assets are those non derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss.

B BILLS SENT FOR COLLECTION

A Bill of Exchange drawn by an exporter usually at a term, on an importer overseas and brought by the exporter to his Bank with a request to collect the proceeds.

BONUS ISSUE

The issue of new shares to existing shareholders in proportion to their shareholdings. It is a process for converting a company's reserves (in whole or part) in to issued capital and hence does not involve an infusion of cash.

C CAPITAL ADEQUACY RATIO

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

CAPITAL RESERVE

Capital reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank.

CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

COLLECTIVELY ASSESSED LOAN IMPAIRMENT PROVISIONS

Also known as portfolio impairment provisions. Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses that has been incurred but has not yet been identified at the reporting date. Typically assets within the consumer banking business are assessed on a portfolio basis.

COMMERCIAL PAPER

An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. The debt is usually issued at a discount, reflecting prevailing market interest rates.

COMMITMENT TO EXTEND CREDIT

Credit facilities available to clients either in the form of loans, bankers' acceptances and other on-balance sheet financing or through off-balance sheet products such as guarantees and letters of credit.

CONTINGENCIES

Conditions or situations at the reporting date, the financial effect of which are to be determined by the future events which may or may not occur.

CONTRACTUAL MATURITY

Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.

CORPORATE GOVERNANCE

The process by which corporate entities are governed. It is concerned with the way in which power is exercised over the management and direction of entity, the supervision of executive actions and accountability to owners and others.

CORRESPONDENT BANK

A Bank in a foreign country that offers banking facilities to the customers of a Bank in another country.

COST INCOME RATIO

Operating expenses excluding loan loss provision as a percentage of total operating income.

Glossary of Financial / Banking Terms

COST METHOD

Cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

COST-PUSH INFLATION

A continuous increase in average price levels due to an increase in production costs.

CREDIT RATINGS

An evaluation of a corporate's ability to repay its obligations or likelihood of not defaulting, carried out by an independent rating agency.

CREDIT RISK

Credit risk is the risk of financial loss to the Bank if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the loans and advances to customers and other banks and investment in debt/ equity securities.

CURRENCY RISK

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

CURRENCY SWAPS

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of same currency for forward settlement.

D DEBT RESTRUCTURING / RESCHEDULING

This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.

DEFERRED TAX

Sum set aside in the financial statements for taxation that may become payable in a financial year other than the current financial year.

DELINQUENCY

A debt or other financial obligation is considered to be in a state of delinquency when payments are overdue. Loans and advances are considered to be delinquent when consecutive payments are missed. Also known as 'Arrears'.

DERECOGNITION

Removal of a previously recognised financial asset or financial liability from an entity's Statement of Financial Position.

DERIVATIVES

A derivative is a financial instrument or other contract, the value of which changes in response to some underlying variable (eg. an interest rate), that has an initial net investment smaller than would be required for other instruments that have a similar response to the variable, and that will be settled at a future date.

DEPRECIATION

The systematic allocation of the depreciable amount of an asset over its useful life.

DIVIDEND COVER

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

DIVIDEND YIELD

Dividend earned per share as a percentage of its market value.

DOCUMENTARY LETTERS OF CREDIT (L/Cs)

Written undertakings by a Bank on behalf of its customers, authorising a third party to draw on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

E EARNINGS PER SHARE (EPS)

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

EFFECTIVE INTEREST RATE

Rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or when appropriate a shorter period to the net carrying amount of the financial asset or financial liability.

EFFECTIVE TAX RATE

Income tax expense for the year divided by the profit before tax.

EQUITY INSTRUMENT

Equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

EQUITY METHOD

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition changes in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

ESOP (EMPLOYEE SHARE OPTION PLAN)

A method of giving employees shares in the business for which they work.

ECONOMIC VALUE ADDED (EVA)

A measure of productivity which takes into consideration cost of total invested equity.

F FAIR VALUE

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

FINANCE LEASE

A lease in which the lessee acquires all the financial benefits and risks attaching to ownership of the asset under lease.

FINANCIAL ASSET OR FINANCIAL LIABILITY AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial asset or financial liability that is held for trading or upon initial recognition designated by the entity as 'at fair value through profit or loss'.

FINANCIAL INSTRUMENT

Financial Instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

FOREIGN EXCHANGE INCOME

The gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the reporting date at prevailing rates which differ from those rates in force at inception or on the previous reporting date. Foreign exchange income also arises from trading in foreign currencies.

FORWARD EXCHANGE CONTRACT

Agreement between two parties to exchange one currency for another at a future date at a rate agreed upon today.

G GROSS DIVIDENDS

The portion of profit inclusive of tax withheld distributed to shareholders.

GROUP

A group is a parent and all its subsidiaries.

GUARANTEES

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his / her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

H HEDGING

A strategy under which transactions are effected with the aim of providing cover against the risk of unfavourable price movements (interest rate, foreign exchange rate, commodity prices, etc.).

HELD TO MATURITY INVESTMENTS

Non derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity.

I IMPAIRED LOANS

Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.

IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

IMPAIRMENT ALLOWANCES

Impairment allowances are provisions held on the Statement of Financial Position as a result of the raising of a charge against profit for the incurred loss. An impairment allowance may either be identified or unidentified and individual (specific) or collective (portfolio) respectively.

INCREMENTAL COST

Costs that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

INDIVIDUALLY SIGNIFICANT LOAN IMPAIRMENT PROVISIONS

Also known as specific impairment provisions. Impairment is measured individually for assets that are individually significant to the Group. Typically assets within the corporate banking business of the Group are assessed individually.

INTANGIBLE ASSET

An identifiable non-monetary asset without physical substance held for use in the production / supply of goods / services or for rental to others or for administrative purposes.

INTEREST MARGIN

Net interest income as a percentage of average interest earning assets.

INTEREST RATE SWAP

An agreement between two parties (known as counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount.

INTEREST RATE RISK

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

INTEREST SPREAD

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

INVESTMENT PROPERTIES

Investment property is property (land or a building - or part of a building - or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use or sale.

Glossary of Financial / Banking Terms

INTEREST COVER

A ratio showing the number of times interest charges is covered by earnings before interest and tax.

J JOINT CONTROL

Joint control is the contractually agreed sharing of the control over an economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

JOINT VENTURE

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

K KEY MANAGEMENT PERSONNEL

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.

L LETTER OF CREDIT (L/C)

Written undertakings by a Bank on behalf of its customer (typically an importer), authorising a third party (e.g. an exporter) to draw drafts on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

LIQUID ASSETS

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other Banks, Bills of Exchange and Treasury Bills.

LIQUIDITY RISK

The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

LOANS AND RECEIVABLES

Non derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those intended to sell immediately or in the near term and designated as fair value through profit or loss or available for sale on initial recognition.

LOSS GIVEN DEFAULT (LGD)

LGD is the percentage of an exposure that a lender expects to lose in the event of obligor default.

M MARKET CAPITALISATION

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

MARKET RISK

This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.

MATERIALITY

The relative significance of a transaction or an event, the omission or misstatement of which could influence the decisions of users of financial statements.

N NET ASSET VALUE PER SHARE

Shareholders' funds divided by the number of ordinary shares in issue.

NET-INTEREST INCOME

The difference between what a Bank earns on assets such as loans and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

NON CONTROLLING INTEREST

Equity in a subsidiary not attributable, directly or indirectly to a parent.

O OFF BALANCE SHEET TRANSACTIONS

Transactions that are not recognised as assets or liabilities in the Statement of Financial Position, but which give rise to contingencies and commitments.

OPERATIONAL RISK

This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

P PARENT

A parent is an entity that has one or more subsidiaries.

PAST DUE

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

PRICE EARNINGS RATIO (P/E RATIO)

Market price of an ordinary share divided by earnings per share (EPS).

PROBABILITY OF DEFAULT (PD)

PD is an internal estimate for each borrower grade of the likelihood that an obligor will default on an obligation.

PRUDENCE

Inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

R REPURCHASE AGREEMENT

This is a contract to sell and subsequently repurchase government securities at a given price on a specified future date.

RETURN ON AVERAGE ASSETS (ROAA)

Profit after tax expressed as a percentage of average total assets, used along with ROE, as a measure of profitability and as a basis of intra-industry performance comparison.

RETURN ON AVERAGE EQUITY (ROAE)

Profit after tax less preferred share dividends if any, expressed as a percentage of average ordinary shareholders' equity.

REVENUE RESERVE

Reserves set aside for future distribution and investment.

REVERSE REPURCHASE AGREEMENT

Transaction involving the purchase of government securities by a Bank or dealer and resale back to the seller at a given price on a specific future date.

RIGHTS ISSUE

Issue of shares to the existing shareholders at an agreed price, generally lower than market price.

RISK-WEIGHTED ASSETS

Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off-balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.

S SEGMENT REPORTING

Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking and securities dealings, property and insurance.

SHAREHOLDERS' FUNDS

Shareholders' funds consist of stated capital, statutory reserves, capital and revenue reserves.

SPECIFIC IMPAIRMENT PROVISIONS

Impairment is measured individually for loans that are individually significant to the Bank.

STATUTORY RESERVE FUND

Reserve created as per the provisions of the Banking Act No. 30 of 1988.

SUBSIDIARY

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

SUBSTANCE OVER FORM

The consideration that the accounting treatment and the presentation in financial statements of transactions and events should be governed by their substance and financial reality and not merely by legal form.

T TIER I CAPITAL

Consists of the sum total of paid up ordinary shares, non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained profits, general and other reserves, less goodwill.

TIER II CAPITAL

Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

TOTAL CAPITAL

Total capital is the sum of Tier I capital and Tier II capital.

TRANSACTION COSTS

Incremental costs that is directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

U UNIT TRUST

An undertaking formed to invest in securities under the terms of a trust deed.

V VALUE ADDED

Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth.

Y YIELD TO MATURITY

Discount rate which the present value of future cash flows would equal the security's current price.

Notice of Meeting

Notice is hereby given that the Forty Fifth (45th) Annual General Meeting of Hatton National Bank PLC (the "Bank") is convened on Friday, the Twenty Eighth (28th) day of March 2014 at the Auditorium on Level 22 of "HNB Towers" at No. 479, T.B. Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following business will be transacted:

- i. To receive and consider the Annual Report of the Board of Directors along with the Financial Statements of the Bank for the year ended 31st December 2013, the Auditors' Report thereon.
- ii. To declare a final dividend of Rs. 7.00 per share for the year 2013 to the shareholders as recommended by the Directors and thereafter to consider and if thought fit, to pass the following resolution:

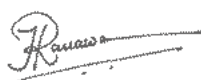
Ordinary Resolution

"IT IS HEREBY RESOLVED THAT a final dividend of Rs. 7.00 per share, on both voting and non-voting shares of the Bank, for the financial year ended 31.12.2013, shall be declared".

- iii. To re-elect Mrs M A R C Cooray, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- iv. To re-elect Mr L U D Fernando, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- v. To re-elect Mr D T S H Mudalige, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- vi. (a) To appoint Messrs Ernst & Young (Chartered Accountants) as recommended by the Board of Directors, as the auditor to the Bank for the ensuing year;

(b) To authorise the Board of Directors to determine the remuneration of the auditor for the ensuing year.
- vii. To authorise the Directors to determine payments for the year 2014 for charitable and other purposes.

By Order of the Board of Hatton National Bank PLC



K A L Thushari Ranaweera
Assistant General Manager (Legal)/Board Secretary

Colombo, Sri Lanka.
21st February 2014

Notes :

1. A member who is entitled to attend or attend and vote at the meeting, is entitled to appoint a proxy to attend or attend and vote as the case may be, in his stead.
2. A proxy need not be a member of the Bank. The Form of Proxy is enclosed.
3. The completed Form of Proxy should be deposited with the Board Secretary at the Registered Office of the Bank at No. 479, T.B. Jayah Mawatha, Colombo 10 (at "HNB Towers", Level 18), not less than 48 hours before the time appointed for holding the meeting.

Form of Proxy - Voting

I/We of being *a member/members of the Hatton National Bank PLC, hereby appoint of or failing him/her Ranee Jayamaha or failing her, Antonio Jonathan Alles or failing him, Mirihana Arachchige Rose Chandralatha Cooray or failing her, William Wijesinghe Gamage or failing him, Lokuwithanage Rohan Karunaratne or failing him, Lintotage Udaya Damien Fernando or failing him, Don Tiburtius Sujeewa Handapangoda Mudalige or failing him, Don Sanjivani Clarinda Jayawardena or failing her, Rusi Sohli Captain, as *my/our proxy, to represent *me/us at the Forty Fifth (45th) Annual General Meeting of the Bank to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10, on the Twenty Eighth (28th) day of March, 2014 at 10.00 in the forenoon and at any adjournment thereof :

(i) To declare the recommended dividend of Rs. 7.00 per share as the final dividend for 2013 and to adopt the relevant Resolution set out in Notice of Meeting	In favour	
	Against	
(ii) To re-elect Mrs M A R C Cooray as a Director of the Bank	In favour	
	Against	
(iii) To re-elect Mr L U D Fernando as a Director of the Bank	In favour	
	Against	
(iv) To re-elect Mr D T S H Mudalige as a Director of the Bank	In favour	
	Against	
(v) To appoint Messrs Ernst & Young as the auditor for the ensuing year/authorise the Directors to fix their remuneration	In favour	
	Against	
(vi) To authorise the Directors to determine payments for charitable and other purposes.	In favour	
	Against	

Mark your preference with " ✓ "

Signed thisday 2014.

Signature/s

.....

Please provide the following details:	
Shareholder's NIC No / Company Registration No. :
Number of Shares held. :
Proxy holder's NIC No (if not a Director) :

Note - See reverse hereof for instructions to complete the proxy

* Delete inappropriate words

INSTRUCTIONS TO COMPLETE PROXY

1. The full name and the registered address of the shareholder appointing the proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Bank at No. 479, T B Jayah Mawatha, Colombo 10 ("HNB Towers", Level 18), not less than 48 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
 - (a) in the case of an individual, be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Bank.
 - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Bank may, but shall not be bound to, require evidence of the authority of any such attorney or officer.
 - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder, signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

Form of Proxy - Non Voting

I/We..... of
..... being *a
member/members of the Hatton National Bank PLC, hereby appoint
..... of.....
..... or failing him/her Ranee Jayamaha or failing her, Antonio Jonathan Alles or failing
him, Mirihana Arachchige Rose Chandralatha Cooray or failing her, William Wijesinghe Gamage or failing him, Lokuwithanage Rohan
Karunaratne or failing him, Lintotage Udaya Damien Fernando or failing him, Don Tiburtius Sujeewa Handapangoda Mudalige or failing him,
Don Sanjivani Clarinda Jayawardena or failing her, Rusi Sohli Captain, as *my/our proxy, to represent *me/us at the Forty Fifth (45th) Annual
General Meeting of the Bank to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10, on the
Twenty Eighth (28th) day of March, 2014 at 10.00 in the forenoon and at any adjournment thereof.

Signed thisday 2014.

Signature/s

.....

Please provide the following details:

Shareholder's NIC No / Company Registration No. :

Number of Shares held. :

Proxy holder's NIC No (if not a Director) :

Note - See reverse hereof for instructions to complete the proxy

* Delete inappropriate words

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 - (a) in the case of an individual, be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Bank.
 - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Bank may, but shall not be bound to, require evidence of the authority of any such attorney or officer.
 - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder, signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

Corporate information

NAME OF COMPANY

HATTON NATIONAL BANK PLC

LEGAL FORM

A Public Limited Company incorporated on 5th March 1970 under the Laws of the Republic of Sri Lanka. The Company was re-registered under the Companies Act No 7 of 2007 on 27th September 2007. It is a Licensed Commercial Bank under the Banking Act.

COMPANY REGISTRATION NUMBER

PQ 82 (previous PBS 613)

ACCOUNTING YEAR END

31st December

STOCK EXCHANGE LISTING

The ordinary shares and the unsecured subordinated/senior redeemable debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka.

REGISTERED OFFICE

“HNB Towers”
No 479, T B Jayah Mawatha (Darley Road),
P O Box 837, Colombo 10, Sri Lanka

HEAD OFFICE

“HNB Towers”
No 479, T B Jayah Mawatha (Darley Road),
P O Box 837, Colombo 10, Sri Lanka

Cable Address : HATNABANK
Telephone Nos : +94 11 2664664
 +94 11 2662772
 +94 11 4764764
Fax : +94 11 2662832

International
Division : +94 11 2661859
Swift : Bic Code – HBLILKLX
E-mail : moreinfo@hnb.net
Web : www.hnb.net

CREDIT RATINGS

The Bank has been assigned a national long term rating of AA- (lka) by Fitch Ratings Lanka Limited and a Foreign currency issuer rating of B1 by Moody's Investors Service.

BOARD OF DIRECTORS

Dr Ranee Jayamaha (Chairperson)
Mr Jonathan Alles
(Managing Director / CEO)
Ms M A R C Cooray (Senior Director)
Dr W W Gamage
Dr L R Karunaratne
Mr L U D Fernando
Mr Sujeewa Mudalige
Ms D S C Jayawardena
Mr Rusi S Captain

BOARD SECRETARY

Ms K A L Thushari Ranaweera
Attorney-at-Law, LL.M. (Cambridge), Dip in
Int'l Affairs (BCIS)

AUDIT COMMITTEE

Mr Sujeewa Mudalige (Chairman)
Ms M A R C Cooray
Dr L R Karunaratne
Ms D S C Jayawardena
Mr Rusi S Captain

NOMINATION COMMITTEE

Dr L R Karunaratne (Chairman)
Dr W W Gamage
Dr Ranee Jayamaha
Ms M A R C Cooray

HR & REMUNERATION COMMITTEE

Dr W W Gamage (Chairman)
Dr Ranee Jayamaha
Mr L U D Fernando
Mr Sujeewa Mudalige

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Ms M A R C Cooray (Chairperson)*
Dr Ranee Jayamaha*
Dr L R Karunaratne*
Mr Sujeewa Mudalige*
(Observer)
Ms D S C Jayawardena*
Mr Jonathan Alles**
(Managing Director / CEO)
Mr D P N Rodrigo***
(Chief Operating Officer)
Mr A P L Fernando***
(DGM - Risk and Credit Quality Management)
Ms Shanti Gnanapragasam***
(AGM-Risk)
Mr Ashok Goonesekere***
(Chief Accountant)
Mr C B Wijayaratne***
(Senior Manager - Compliance)

* Representatives of the Board
** Representatives of the Board & the Management
*** Representatives of the Management

JOINT VENTURE COMPANIES

Acuity Partners (Pvt) Ltd 50.00%
Financial Services

SUBSIDIARY COMPANIES

HNB Assurance PLC 60.00%
Insurance Services
Sithma Development (Pvt) Ltd 100.00%
Property Development

AUDITORS

KPMG
Chartered Accountants
No 32A, Sir Mohamed Macan Markar
Mawatha,
Colombo 3,
Sri Lanka

INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Chief Strategy Officer at:
“HNB Towers”, Level 16,
No 479, T B Jayah Mawatha (Darley Road),
Colombo 10, Sri Lanka

Telephone : +94 11 2664001
Fax : +94 11 2662815
E-mail : ruwan.manatunga@hnb.lk

