Finance and risk management

Assuming risk goes hand in hand with the business of banking. Sustainable and methodical finance and risk management is required to ensure that the risks remain calculable. For this reason, we use an integrated approach.

Integrated approach

Sustainable finance management and anticipatory risk management: we attach very great importance to these at all levels of the organisation. To avoid conflicts of interest, we have established effective and organisationally independent controlling bodies and processes. The Group CFO Division is responsible for the different areas of finance and risk management at the LLB Group.

Financial management

The aim of our financial management is to create transparency at all levels of management in order that costs and income can be managed in line with corporate strategy and in an efficient and timely manner. The key instruments we use for this are medium-term planning, the annual budgeting process, the Group Management Information System (MIS) and capital management.

Financial management includes the preparation of the financial statements in accordance with local laws and International Financial Reporting Standards (IFRS) as well as regulatory reporting. The Group-wide treasury manages the risks in the banking book that arise from banking activities, specifically liquidity, interest rate and foreign currency risks.

Risk management

It is essential for the protection of the reputation, the maintenance of the excellent financial strength and the securing of the sustainable profitability of the LLB Group that risks are dealt with prudently. Risk management is based on risk policy and encompasses the systematic identification and assessment, reporting, management and monitoring of credit risks, market risks, liquidity risks and operational risks as well as asset liability management (ALM). The LLB Group applies an appropriate organisational and methodological framework for assessing and managing risk (see chapter “Risk Management”, pages 192 – 213).

Internal control system

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

Liquidity management

The LLB Group has in place robust strategies, policies, processes and systems that enable it to identify, measure, manage and monitor liquidity risk. The internal liquidity adequacy assessment process (ILAAP) is set down in the internal regulations and guidelines and is reviewed and revised annually.

Within the framework of the ILAAP, the liquidity coverage ratio (LCR), as a binding regulatory liquidity reference figure, represents a material indicator both for liquidity risk assessment as well as liquidity risk management. At the end of 2018, a regulatory lower limit of 100 per cent was applicable for the LLB Group. The minimum requirement ensures that credit institutions can cover their liquidity requirements in the case of a liquidity stress scenario within 30 calendar days. With an LCR of 148 per cent (2017: 126 %), the LLB Group’s ratio was substantially higher than that required under the regulations.

Capital management

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

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

Solid equity base

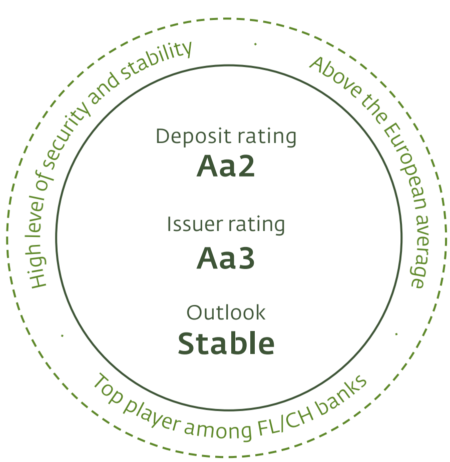
LLB is considered to be of systemic importance to the Liechtenstein economy and subject to a regulatory minimum capital adequacy ratio of 13 per cent. We are targeting a Tier 1 ratio of over 14 per cent as a strategic objective.

As at the end of 2018, the LLB Group had CHF 2.0 billion in equity capital (31.12.2017: CHF 1.9 billion). At 19.0 per cent (31.12.2017: 21.6 %), LLB's Tier 1 ratio is well above the regulatory requirement.

The LLB Group continues to enjoy a high level of financial stability and security on account of its solid equity base, which consists entirely of hard core capital. The comfortable capital situation gives it leeway to make acquisitions (see chapter "Strategy and organisation", page 14).

Rating confirms financial strength

Rating agency Moody's assigned a deposit rating of Aa2 to Liechtensteinische Landesbank once again in April 2018, and its rating is proof of our prudent finance and risk management. The rating underlines LLB's stability and financial strength. LLB is among the top range of Liechtenstein and Swiss banks and ranks well above the average of European financial institutions.



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

Credit management

The LLB Group pursues a conservative credit risk policy. It includes the individual and differentiated evaluation of loan applications, the conservative assessment of collateral values, the individual calculation of affordability as well as compliance with standard equity requirements. The differentiated control processes help us to reliably fulfil our performance mandate (see chapter "Responsibilities for society and the environment", page 57) and to take appropriate account of risks.

We accompany private individuals, companies, small businesses and public institutions to finance their plans for the future. At CHF 11.1 billion, the majority of the loans, namely 86 per cent (2017: 87 %), comprised credits secured by mortgages. The volume of loans has grown continually over the past few years. At the end of 2016, we booked CHF 11.5 billion in loans; by the end of 2017, this figure had already risen to CHF 12.1 billion. At the end of 2018, the volume of loans had increased to CHF 12.9 billion. The LLB Group extends mortgages primarily within the market regions of Liechtenstein, north-eastern Switzerland and the region of Zurich.

Standardised control mechanisms

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

We have developed a Group-wide uniform methodology for determining the collateral value of our Lombard loans. Credits against non-diversified securities or single asset lending may only form an insignificant portion of a Lombard loan portfolio.

Independent credit management

Within the LLB Group, credit competences are assigned according to the knowledge and experience of the decision-makers and the appropriate level and credit type. The authority to grant credit has been given to Group Credit Management and the Credit Committees, with the exception of standard business transactions. Credit decisions are thus made independently of market pressures and market targets. In this way, we are able to avoid conflicts of interest and objectively and independently assess risk in individual cases.

Legal and compliance risks

Within the LLB Group, combating money laundering and its predicate offences as well as the financing of terrorist or criminal activities is assigned the highest priority. Monitoring is performed by an IT system. In addition to the systematic monitoring of transactions, employees receive ongoing training on regulatory changes. They are also sensitised to the indications of possible money laundering activities. LLB has a legal department, Group Legal, and three specialised compliance departments:

- Group Financial Crimes Compliance is responsible for fulfilling legal anti-money laundering requirements.
- Group Tax Compliance is responsible, inter alia, for implementing a tax compliance strategy as well as AEOI and FATCA (see chapter "Regulatory framework and developments", pages 46 and 47).
- Group Regulatory Compliance is focused on compliance with supervisory requirements, inter alia, in the areas of MiFID and cross-border, and monitors employee transactions.

Cross-border banking

The LLB Group does its utmost to minimize the regulatory risks that exist in cross-border financial services. We restrict our international activities to selected strategically and economically significant markets. Our focus is on the onshore markets of Liechtenstein, Switzerland and Austria, on the traditional cross-border markets in Germany and the rest of Western Europe, and on the growth markets of Central and Eastern Europe as well as the Middle East.

The LLB Group's internal rulings ensure that employees know and comply with the regulations of the respective target country when engaging in cross-border activities. Again in 2018, training courses were conducted for client advisers in the particular markets relevant to them.

Cyber risks

As a company, we have a responsibility towards clients to handle their assets and information carefully. Through the progressive digitalisation of the banking business, the risks and necessary protective measures are also changing. Protection against cyber attacks has top priority and can only be guaranteed through state-of-the-art IT systems and trained and aware employees.

The Group Information Security Department formulates, implements and maintains our information security programme. The principles and guidelines on which this is based are specified in directives that are binding throughout the Group.

The assets and information entrusted to us are protected by coordinated processes and systems. Specialists continually analyse the latest risks arising from cyber threats and implement appropriate counter measures. The LLB Group's virtual Cyber Security Incident Response Team (vCSIRT), which has been operational since 2017, provides 24 / 7 cyber incident detection and initiates defensive measures. In July 2018, the Group Information Security Department became part of the Group CFO Division. This facilitates cooperation with those responsible for risk management and risk reporting, and allows us to use synergies in these areas.

Fraud detection system

Working in cooperation with a technology partner, we have developed a self-learning fraud detection system for payment systems. Once the data for a mobile or online payment order has been entered, the system checks against various criteria as to whether it could be a fraudulent payment. If the system detects any risks, then different security levels are activated or payments are blocked.

Raising awareness among employees

Handling client data and information responsibly is an integral part of LLB's corporate culture. Training courses for employees have been held regularly since 2014.

LLB uses a learning game with the innovative gamification approach to raise employees' awareness of cyber security issues. Through mandatory IT security training, employees who have less affinity with technology are taught how to deal with phishing, distributed denial-of-service (DDoS) attacks, social engineering and the like in a fun way.

Rules of conduct

We expect our corporate bodies and employees to comply with the applicable laws, regulations and guidelines, professional standards and our rules of conduct. These stipulate which transactions in financial instruments are not permitted for employees and corporate bodies. They also set out the general principles for employee transactions. How business relationships are supported by employees and corporate bodies is also clearly regulated, as is the acceptance of inducements and the exercise of secondary employment.