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**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

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RISK APPETITE STATEMENT

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RISK APPETITE STATEMENT

1. Purpose and Governance

- 1.1 The Risk Appetite Statement (“this Statement”) provides a comprehensive summary of Risk Appetite parameters guiding the operations of the Bank. Its main purpose is to facilitate concise presentation and informed periodic review of the amount of risk the Bank is prepared to take in its key activities. It reflects market practice, enhances the quality of internal decision-making, and helps build Bank-wide risk awareness culture. It will assist the Bank in communication with stakeholders, including investors, donors and rating agencies, supporting continued access to funding and ability to pursue the Bank’s objectives.
- 1.2 The document provides a consolidated overview of how various types of risk are governed at the Bank. It sets out the overall risk governance architecture of the Bank and summarises its business profile and approach to risk mitigation. It then goes on to define the Risk Capacity of the Bank which is linked to a target of best in class among IFIs (currently triple-A) credit rating, as well as its Risk Appetite in terms of liquidity and reputation risks. Lastly, the paper sets out Financial Loss Tolerance Thresholds, expressed in terms of annual net earnings (losses) and changes in capital utilisation, which the Bank wishes to remain within, to avoid undue capital depletion in the normal course of business.
- 1.3 Most of the parameters described in this Statement have been adopted by Management and the Board of Directors (“the Board”) through dedicated policy instruments. These are referenced throughout the paper. This Statement will be updated annually to reflect changes in such underlying policies.
- 1.4 The Financial Loss Tolerance Thresholds are approved by Management and disclosed to the Board as part of the Strategy Implementation Plan (“SIP”). They are informed by the broader business planning conversation, financial performance of the Bank, as well as forward looking assessment of risks to profitability included in regular reports of the Bank. Financial Loss Tolerance Thresholds facilitate early quantification of the approaching threats and, provide time to implement risk mitigating actions, if appropriate. They are tested and calibrated against the results of the annual Bank-wide stress test.
- 1.5 Specifically, an increase in any of the Financial Loss Tolerance Thresholds implied by the business plan set out in SIP will prompt Management either (i) to accept the increased potential losses and consequent changes of the relevant parameters of this Statement or (ii) to adjust the business plan to keep the Bank’s risk profile back within previously agreed parameters.

- 1.6 The document is prepared and updated periodically by the Vice President Risk & Compliance Chief Risk Officer (“CRO”) in consultations with the Vice President, Chief Financial Officer (“CFO”) and others as appropriate.

2. Key Principles

- 2.1 The Bank recognises that it achieves its strategic objectives by assuming risk. Without appropriate limitation, these risks have the potential to threaten its key resources and therefore undermine the trust and confidence our stakeholders, including shareholding government, clients, civil society organisations and other relevant bodies, have in the Bank, its Management, and its strategy. At the extreme, these risks could necessitate request for callable capital or even threaten the existence of the Bank.
- 2.2 To ensure that the risk profile of the Bank does not facilitate such undesirable outcomes, based on Management’s recommendation, the Board adopts a set of Risk Appetite parameters articulated in this Statement and other policy documents as appropriate. These parameters guide both strategic planning and day-to-day tactical decision making, thereby avoiding excessive risk taking and encouraging the development of robust controls to protect the key resources of the Bank.
- 2.3 The key resources that facilitate the achievement of the Bank’s objectives and simultaneously maintain confidence in the Bank’s resilience in the face of adverse events include: net earnings, capital, liquidity and reputation. In aggregate, these key resources underpin the triple-A (best in class among IFIs) rating that is considered to be a vital component of the operating model of the EBRD. The Risk Appetite parameters have been calibrated to ensure the continuation of this rating.
- 2.4 Management is required to establish and maintain an infrastructure (including risk measurement, limits, rules, guidelines, independent decision-making, controls, monitoring, testing and reporting) to ensure that this Risk Appetite is complied with and to provide reports in the form of annual Bank-wide stress tests and quarterly risk reporting to evidence compliance.

3. Risk Governance Architecture

- 3.1. The overall Risk Governance of the Bank is anchored in the Agreement Establishing the Bank (“the AEB”). In accordance with Article 1 of the AEB, the Bank puts its capital at risk in pursuit of its mandate to promote transition towards market oriented economic systems in its countries of operations.

- 3.2. The Bank seeks to protect and build up its capital in order to support an enhanced range of activities and enable the Bank to withstand negative impact to its capital due to financial losses resulting from credit, market or other financial risks. Consistent with Article 13(i) of the AEB, the Bank complies with sound banking principles to all its operations, which implies alignment with market practice in terms of assessing, measuring and managing the risks faced by the Bank.
- 3.3. The Bank interprets market practice by reference to common standards of corporate governance, banking regulation and market practice in the banking industry. Additional reinforcement comes from the wider objectives of the Bank, whereby the Bank wishes to deploy capital appropriately, to achieve adequate overall return on the risks borne, to support its financial sustainability, and to mitigate against potential excessive losses that would deplete its medium term operational capacity.
- 3.4. To achieve this, the Bank puts in place checks and balances to ensure that:
- Investment decisions are not unduly influenced by business targets and that risks are fully considered to ensure that there is a good prospect of avoiding losses.
 - The build-up of any material correlated risks is identified, reviewed and where appropriate acted upon.
 - Controls are adequately designed around all material risks, robustly implemented and rigorously tested, to ensure Management is agile to act on evolving risk profiles.
- 3.5. Within the context of the Bank's overall governance structure, the Vice President, Risk & Compliance CRO is responsible for ensuring independent risk management of the Banking and Treasury exposures including corporate recovery matters, operational risk and information security, and for ensuring the review and compliance of the Bank's activities with environmental policies and procurement policies, and implementing related policy initiatives. The responsibility of the Vice President, Risk & Compliance CRO for financial controls carried out in connection with operational risks is shared with the Vice President, CFO.
- The Vice President, Risk & Compliance CRO is a member of the Executive Committee and reports to the President. Furthermore, the Audit Committee of the Board of Directors regularly meets with the Vice President, Risk & Compliance CRO without other members of management being present, on matters concerning the risk management function.
- 3.6. The Bank's overall framework for identification and management of risks is underpinned by:

- Shared responsibility by all staff members to identify and manage risks they incur in the course of fulfilling their responsibilities (“first line of defence”).
 - Independent, empowered and appropriately resourced “second line of defence” functions with control responsibilities for matters falling into their areas of competence, including Risk Management in respect of credit, market and operational risks, the Office of the Chief Compliance Officer in respect of conduct and reputational risks, the Environmental and Social Department in respect of environmental and social impact risks, the Procurement Policy and Advisory Department in respect of procurement related issues, and the Finance Vice Presidency in respect of liquidity, funding and capital management risks.
 - Internal Audit Department, which acts as “third line of defence”, and independently assesses the effectiveness of the processes within the first and second lines of defence.
- 3.7. In discharging the duties of the role, the Vice President, Risk & Compliance CRO is supported by the Risk Management department. Risk Management (i) provides an independent assessment of risks associated with individual investments undertaken by the Bank, (ii) performs an ongoing review of the portfolio to monitor the risk presented by investments from inception to repayment or exit, (iii) assesses and proposes ways to manage risks arising from correlations and concentrations within the portfolio, and (iv) ensures that adequate systems and controls are put in place for identification and management of operational risks across the Bank. Working together with other departments and units, Risk Management develops and maintains relevant policies for Banking and Treasury operations and promotes risk awareness across the Bank.
- 3.8. In exercising its responsibilities, Risk Management aims to:
- Provide assurance that risk taking decision making in the Bank is balanced and within the agreed appetite, and that control processes are rigorously designed and applied; and
 - Support the Bank’s business strategy and its execution, including the maximisation of transition impact through provision of efficient and effective delivery of risk management advice, challenge and decision-making.
- 3.9. In accordance with its terms of reference, the Audit Committee of the Board of Directors periodically reviews and evaluates the functions performed by the Internal Audit Department, Office of the Chief Compliance Officer, Evaluation Department and Risk Management Department. The Audit Committee regularly meets with the heads of all these functions, without other members of management being present.

4. Business Profile and Risk Mitigation Techniques

- 4.1. The principal risks the Bank faces – both financial and non-financial - in carrying out its mandate are contained in Risk Taxonomy summarised in Annex 2 which broadly serves as a basis for the Bank’s risk appetite statement.
- 4.2. As part of its Banking activities, the Bank invests in debt, equity, guarantee and other products with international and local clients in the Countries of Operations (“CoO”). As part of its Treasury mandate, the Bank invests world-wide in high quality liquid assets. In doing so, the Bank incurs credit, market and reputational risk on transaction and portfolio level.
- 4.3. The Bank protects itself from idiosyncratic (transaction specific) credit risk related to Banking transactions by carefully selecting and structuring individual investments, including by taking security over movable and immovable assets, by accepting guarantees from companies and individuals, and by requiring a set of financial and operational covenants, as well as by imposing associated reporting obligations.
- 4.4. The Bank protects itself from systemic (correlated) credit risk by adopting portfolio limits, including country limits, to reduce the impact of adverse external events on its capital. The Bank's prudential limits covering country and single obligor Banking exposures are articulated in the Capital Adequacy Policy approved by the Board.
- 4.5. These prudential limits are supplemented by Management-level operational limits as appropriate, to contain and manage concentration risk at the level of country and single obligor.
- 4.6. Generally, the limits described in sections 4.4 and 4.5 are managed in such a way that if they are close to being breached, discussions are held at Management-level so that either a business case is made for a change in limits (temporarily or permanently) or the Bank’s business plan is adjusted to accommodate the exposure against the threshold.
- 4.7. To identify emerging risk and enable appropriate risk mitigating actions, the Bank also conducts regular stress testing exercises and comprehensive reviews of its investment portfolios. The Bank recognises that any resulting risk mitigation is constrained by the limited geographical space within which the Bank operates.
- 4.8. Idiosyncratic and systemic credit risks related to Treasury operations are managed through a comprehensive set of limits articulated in the Treasury Authority and Liquidity Procedures, as updated by Management from time to time.
- 4.9. The Bank's business planning process, encapsulated in the annual Strategy Implementation Plan, sets balanced objectives in terms of geographical, sector and

product distribution of Banking activities, taking into account the level of available capital and the desired risk profile of the Bank set out in this Statement.

- 4.10. The Bank seeks to maintain very low market risk related to its Banking loan and guarantee transactions by hedging foreign exchange and interest rate risks. The limits setting out the maximum amount of market risk accepted in this context are set out in the Treasury Authority and Liquidity Policy approved by the Board.
- 4.11. The Bank accepts market risk related to its Banking equity investments. The Bank does not in principle directly hedge currency risk or local equity market movements. As such, these risks are a significant contributor to annual volatility in the Bank's financial results. Hybrid investments (i.e., quasi debt / quasi equity) are hedged on a case by case basis, as determined by Treasury.
- 4.12. The Bank's Treasury operations aim at (i) the provision and preservation of liquidity to support the Bank's business plan and operations; (ii) the management of the capital of the Bank, retained earnings and borrowed funds; and (iii) local capital market development and provision of local currency funding in the Bank's Countries of Operations. The Bank's Treasury Department seeks to satisfy minimum liquidity criteria, while maintaining appropriately low credit risk and capital consumption associated with liquid asset portfolio.
- 4.13. The Bank's risk profile benefits from the Bank's special status as an international financial institution and under the AEB. In particular, the Bank's preferred creditor status may provide protection against sovereign default and currency convertibility risks. Nevertheless, the Bank is exposed to reputational risk and the consequences of risk taking activities.

5. Risk Capacity and Target Credit Rating

- 5.1 Risk Capacity is the maximum level of risk the Bank can assume given its level of resources before breaching constraints determined by its capital, liquidity, operational environment, operating capabilities and obligations towards stakeholders. The Bank's Risk Appetite, set out in this document, is intended to remain within the Risk Capacity across all dimensions of risk.
- 5.2 The Bank's Financial Risk Capacity is the maximum level of risk it can assume given its capital resources. The Bank's Capital Adequacy Policy sets out the capital requirements for each type of exposure consistent with the Bank being able to honour all payments to its creditors and customers without recourse to callable capital even in the event of a catastrophic shock (1:10,000 event). This approach is consistent with the requirements of triple-A (best in class among IFIs) rating set out by the three main rating agencies.

- 5.3 The Bank manages its capital utilisation against a 90% utilisation threshold as one of the control parameters in the Strategic and Capital Framework.

6. Liquidity Risk Appetite

- 6.1. The minimum amount of liquidity to be held by the Bank is set out in the Treasury Authority and Liquidity Policy.
- 6.2. Given that the Bank does not have access to funding sources such as deposits or central banks, it must be able to meet its commitments in both normal and disrupted/closed financial markets for an agreed survivability period. In addition, the Bank needs to retain sufficient high-quality liquidity, so that under the rating agencies' methodologies liquidity should always be considered a strong/positive factor within the overall rating.
- 6.3. The key parameters set out in the Treasury Authority and Liquidity Policy are summarised below for ease of reference:
- The Bank is able to meet its obligations for at least *12 months under an Extreme Stress scenario*, defined as a 1 in 100 year event under the Bank's stress test methodology, without access to funding markets.
 - The Bank's liquidity position is *perceived as robust by rating agencies and investors*. In particular, the Bank should ensure that at least 75% of the next two years' net cash flow requirements can be met, without recourse to accessing funding markets.
 - The Bank should maintain additional liquidity, to be able to step out of unfavourable markets *for at least three months* and still be in compliance with the long term liquidity requirements set out above. This gives the Bank the ability to opt out of a potentially expensive borrowing market and avoid having to sell long dated securities at a potential loss, without putting at risk its long-term liquidity position.

7. Operational Risk Appetite

- 7.1 The Bank's Operational Risk Appetite aims to articulate the aggregate level and types of operational risk that, for a given point in time, the Bank is willing to accept in its business activities in order to achieve its business objectives.
- 7.2 Operational Risk Appetite is embedded through using the Operational Risk Management Policy, Operational Risk Management Framework, Operational Risk Appetite

Framework, through the definition of key indicators, policies and risk limits, and our procedures and controls which guide day-to-day operations.

- 7.3 All business functions consider a balanced approach to their risks and controls, employ sound risk management principles, transparent decision-making, and effective communication to prioritise risk. In case a residual risk is assessed to be outside our risk appetite, where appropriate, further risk reducing actions are undertaken including further remediating risks. Where the Bank has discretion, the Bank is willing to assume more risk to remain agile in meeting the challenges of an evolving business, political and banking landscape.

8. Reputational Risk Appetite

- 8.1 The Bank's Reputational Risk Appetite is informed by a number of policies, notably including Integrity Risks Policy and Terms of Reference for the Office of the Chief Compliance Officer, Procurement Policies and Rules, Environmental and Social Policy, Operational Risk Management Policy, as well as Codes of Conduct for EBRD Personnel and for Officials of the Board of Directors.
- 8.2 The Bank strives to prevent excessive exposure to the loss of Reputation, thereby avoiding the circumstances that could substantially weaken stakeholder confidence in its Board or Management and undermine the ongoing primary mission as set out in the AEB.
- 8.3 The Bank's status as an international financial institution does not protect its reputation. The Bank's reputation provides a robust moral and professional platform that is critical to its ability to engage in policy dialogue and the raising of governance standards in countries of operation. However, this reputation is vulnerable to a wide range of incidents that can have a relatively high probability occurrence and despite many risks being small scale they could potentially erode confidence. Faced with this high risk the Bank sets its Risk Appetite for losing its reputation as very low and therefore requires the following.
- 8.4 The Board must, based on Management's recommendation:
- Adopt appropriate international standards of corporate governance and transparency.
 - Appoint a suitably qualified and respected external auditor and provide them with an appropriate remit to supply an external independent opinion of the financial soundness and robustness of the control environment.
- 8.5 In addition, Management must:

- Articulate the values and behaviours that are expected by employees, consultants, clients and suppliers to protect the EBRD reputation.
- Establish appropriate standards for: (i) client suitability; (ii) product appropriateness; (iii) environmental, social and ethical responsibility; (iv) procurement and; (v) compliance with international standards derived, as deemed appropriate by Management and the Board, from law and regulation (despite the Bank's status), that would serve to protect the organisation's reputation.
- Strive to maintain professional business conduct across the Bank, including reputation for reliability, efficiency of delivery and absence of undue politicisation. This includes, in particular, identification and appropriate mitigation of operational risks across the Bank, as well as responsible exercise of fiduciary duties in respect of donor funds entrusted with the Bank.
- Commit to the delivery of training of both technical competence and also the development of strong supervisory skills, to drive the culture that delivers the required values and behaviours.
- Maintain and enable an adequately resourced, suitably skilled and appropriately independent set of control functions.
- Establish performance measurement and balanced incentives that: (i) reward good outcomes (behaviour and achievement of results); (ii) reinforce accountability; and (iii) encourage pro-active transparency and escalation of problems and mistakes.

9 Financial Loss Tolerance Thresholds

- 9.1 Notwithstanding its strong capitalisation and the resulting resilience to withstand extreme level of losses consistent with triple-A (best in class among IFIs) rating, the Bank also wishes to manage its business to avoid excessive losses and depletion of capital in less extreme circumstances. In particular, the Bank wishes to retain its triple-A rating with high degree of probability and does not wish to be forced to substantially revise its business plan due a routine cyclical downturn.
- 9.2 This section sets out key warning indicators that the Bank wishes to heed, to avoid undue loss of capital and to be able to adjust its business plan and strategy well before its Financial Risk Capacity comes under challenge. These thresholds do not represent new constraints but merely highlight that the risk taking is approaching the boundaries set out in the Bank's policies. Such warning signals facilitate early discussion of the approaching threats and, if appropriate, provide time to implement risk mitigating actions. They form a part of the broader business planning conversation, which is already informed by financial performance of the Bank and forward looking assessment of risks to

profitability included in regular reports of the Bank. They facilitate a comprehensive discussion of the Bank's business plan and consideration of the associated risks.

- 9.3 The assessment of the Bank's risk profile against the parameters set out in this section is made through the Annual Bank-wide Stress Test. The test is based on statistical forward-looking analysis of the properties of the Bank's Balance Sheet and not against actually observed financial performance in any given year.
- 9.4 An increase in any of the thresholds implied by the business plan set out in SIP will prompt Management either (i) to accept the increased potential losses and consequent changes of the relevant parameters of this Statement or (ii) to adjust the business plan to keep the Bank's risk profile back within previously agreed parameters. This decision must be made by Management in the context of the annual approval of the Bank's SIP and disclosed to the Board as part of the process.
- 9.5 The levels of the Financial Loss Tolerance Thresholds are expected to evolve based on (i) advances in modelling techniques and understanding of risks, (ii) changes to external environment, including volatility of financial markets, (iii) changes in the size and structure of the Bank's balance sheet, including e.g. size of the Equity Portfolio, (iv) changes in business plan and priorities and other relevant factors.
- 9.6 The remaining paragraphs set out the Financial Loss Tolerance Thresholds for the two generic scenarios used in the Bank-wide stress test.
- 9.7 The Bank strives to avoid excessive exposure to losses arising from poorly performing investment assets and/or the failure of controls, under the stress of the worst year in a typical *Cyclical Downturn (once every 7 years)*. This worst year is likely to correspond to an economic slowdown or mild recession. In abstract terms, the Bank has a 1:7 probability of such a loss level occurring any year of its business plan and therefore sets at this probability level the following Risk Appetite:
- In stress scenario designed to replicate a cyclical downturn, Net Earnings must not be negative by more than €2.0 billion in any single year. Additionally, the reduction in Available Capital must not be greater than €2.0 billion, while the corresponding increase in capital utilisation (as defined by the Capital Adequacy Policy) must not exceed 7%.
 - The cumulative negative Net Earnings over a three year cyclical downturn stress scenario and reduction in Available Capital must not be greater than €1.1 billion, while the corresponding increase in capital utilisation must not exceed 9%.
- 9.8 The Bank strives to avoid excessive exposure to losses arising from poorly performing investment assets and/or failure of controls under *Severe Stress event* that whilst being non systemic has the scale that is likely to occur *once every 25 years*. This is likely to

be a deep recession induced by an international financial or political event. In abstract terms, the Bank has a 1:25 probability of such a loss level occurring any year of its business plan and therefore sets at this probability level the following Risk Appetite:

- In stress scenario designed to replicate a material once in a generation downturn, Net Earnings in a single year (taking into account Institutional Action taken by Management in response to the stress) must not be negative by more than €3.7 billion. Additionally, the reduction in Available Capital must not exceed €3.7 billion, while the corresponding increase in capital utilisation (as defined by the Capital Adequacy Policy) must not exceed 9%.
- The cumulative negative Net Earnings over the three year stress scenario event period and reduction in Available Capital must not be greater than €3.0 billion, while the corresponding increase in capital utilisation must not exceed 12%.

This loss tolerance is equivalent to a drop in terms of S&P RAC ratio that should in principle allow the Bank to ***retain its triple-A rating*** if other factors, such as perceived shareholder support, business profile and liquidity, remain positive.

Annex 1: Glossary of Terms

Bank-wide Stress Test: Statistical top-down stress test covering all elements of the Bank's balance sheet and activity. It is based on statistical models of the Bank's assets and liabilities and informed by historical trends and patterns in the underlying data, including default experience and market movements.

Capital: Members' equity attributable to equity holders as defined by the International Financial Reporting Standards and reported in the Balance Sheet of the Bank. Capital consists of paid-in capital, reserves and retained earnings.

Catastrophic Shock: A hypothetical adverse scenario of a systemic worldwide meltdown, with the degree of severity implying exceptionally low likelihood. In statistical terms, it is likely to occur in any year with a likelihood of 1:10,000. It is used as a benchmark to establish capital requirements for a triple-A institution.

Cyclical Downturn: A hypothetical adverse stress test scenario equivalent to the worst year in a typical 7 year business cycle. In statistical terms, it is likely to occur in any year with a likelihood of 1:7.

Extreme Stress: A hypothetical adverse stress test scenario equivalent to a substantial widespread global depression. In statistical terms, it is likely to occur in any year with a likelihood of 1:100.

Financial Loss Tolerance Threshold: The maximum amount of losses, as measured by net earning under IFRS accounting standards, and the maximum increase in capital utilisation, as measured by the Capital Adequacy Policy, that the organisation is willing to tolerate under a given Bank-wide Stress Test scenario.

Financial Risk Capacity: The maximum level of risk it can assume given its capital resources.

Net Earnings: Net loss or profit for the year arising from continuing operations as defined by the International Financial Reporting Standards and reported in the Income Statement of the Bank. Net Earnings are measured before any income transfers approved by the Board of Governors.

Risk Appetite: The aggregate level and types of risk that an institution is willing to accept, or to avoid, in order to achieve its business objectives. It normally covers liquidity and reputation risks, as well as risks to capital and profitability.

Risk Appetite Statement: The articulation in written form of Risk Appetite. It normally includes qualitative statements and quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures as appropriate.

Risk Capacity: The maximum level of risk the Bank can assume given its level of resources before breaching constraints determined by its capital, liquidity, operational environment, operating capabilities and obligations towards stakeholders.

Severe Stress: A hypothetical adverse stress test scenario equivalent to a material non-systemic crisis. In statistical terms, it is likely to occur in any year with a likelihood of 1:25.

Annex 2: Risk Taxonomy

Risk Type	Definition
Credit risk <ul style="list-style-type: none"> - Idiosyncratic risk - Systemic / concentration risk 	The potential loss to a portfolio that could result from either the default of a counterparty or the deterioration of its creditworthiness.
Market risk <ul style="list-style-type: none"> - Interest rate risk - FX risk - Credit spread risk - Equity price risk - Commodity price risk 	The potential loss that could result from adverse market movements.
Operational risk <ul style="list-style-type: none"> - Conduct risk - People risk - Process risk - Change management / project risk - Cyber crime - Business resilience risk - Technology risk - Third-party service provider risk 	The risk of financial and/or non-financial loss resulting from inadequate or failed internal processes, people and systems or from external events.
Liquidity risk	The risk of not having sufficient financial resources available to enable the Bank to meet its payment obligations as they fall due, or the Bank can only access these resources at excessive costs.
Reputational risk	Potential for damage to franchise, resulting in loss of earnings following a negative view of the Bank, its actions or inactions by stakeholders.
Pension risk	Risk of having to meet an actuarially assessed shortfall in the Bank's defined benefit pension plan.
Business / strategic risk	The possible source of loss (or lost opportunity) that may arise from the pursuit of an unsuccessful business plan.