



LOMBARD ODIER
LOMBARD ODIER DARIER HENTSCH

Lombard Odier Group Pillar 3 Disclosures at 31 December 2017

Contents

Introduction	5
Consolidation scope	5
Composition of capital	9
Risk-weighted assets and minimum capital requirements	11
General information about risk management	11
Organisation	11
Governance	12
Internal Capital Adequacy Assessment Process and risk appetite	12
Risk reporting and stress testing	13
Risk culture	13
Risk systems	13
Credit Risk	13
Credit risk mitigation	15
Use of external ratings	16
Counterparty Credit Risk	16
Default risk	16
Market Risks	17
Operational Risks	18
Leverage Ratio	19
Liquidity Coverage Ratio	21

Introduction

Lombard Odier Group is subject for the first time to the full disclosure requirements for capital adequacy according to the conditions defined in FINMA Circular 2016/1 'Disclosure – banks' as at 31 December 2017. As approved by the Swiss Financial Market Supervisory Authority (FINMA) on 12 April 2018, Lombard Odier Group has early adopted the liquidity disclosure requirements under Article 14, para 2 of FINMA Circular 2016/1 entering into force on 1 January 2019, and has limited the disclosures included in the report to the quantitative and qualitative information considered to be pertinent.

This document aims to provide our counterparties, external analysts, rating agencies, control bodies and our clients with detailed information relating to Lombard Odier Group risk management. All financial and risk figures in this report are as of 31 December 2017.

It must be noted that the figures presented were individually rounded to the closest value depending on the scale chosen. They have not been adapted to match the totals, themselves also rounded to the closest value.

Key metrics

In thousands CHF	31.12.2017	31.12.2016
Available capital		
Common Equity Tier 1 (CET1)	1,039,249	1,035,689
Tier 1	1,043,661	1,038,520
Total capital	1,043,661	1,038,520
Risk weighted assets		
Total risk-weighted assets (RWA)	3,916,525	3,534,763
Risk-based capital ratios as a percentage of RWA		
Common Equity Tier 1 ratio (%)	26.5%	29.3%
Tier 1 ratio (%)	26.6%	29.4%
Total capital ratio (%)	26.6%	29.4%
Basel III leverage ratio		
Leverage ratio exposures	18,123,899	17,259,018
Basel III leverage ratio (%)	5.8%	6.0%
Liquidity coverage ratio		
Three-month average for the 4th quarter for high-quality liquid assets	9,047,734	9,936,045
Three-month average for the 4th quarter for net cash outflow	4,930,198	4,831,090
Short-term liquidity coverage ratio (LCR) for the 4th quarter (%)	183.5%	205.7%

Consolidation scope

The Lombard Odier Group's consolidated financial statements comprise the financial statements of the companies which are directly or indirectly controlled by the Group, or over which it exercises a controlling influence. Those companies are fully consolidated.

In Note 1.7 of the 2017 Lombard Odier Group Financial Report there is a list of all subsidiaries of the Group as at 31 December 2017.

The scope of consolidation for calculating capital adequacy is identical to that used in preparing the group financial statements.

Table 1 - Reconciliation of financial statements and regulatory exposure

Consolidated balance sheet

(FINMA Circular 2016/1 - annex 2 / table 1)

In thousands CHF	31.12.2017	31.12.2016	
	According to the financial statements	According to the financial statements	Reference ¹
Assets			
Liquid assets	7,367,976	7,338,546	
Amounts due from banks	1,054,671	562,859	
Amounts due from securities financing transactions	48,724	203,997	
Amounts due from customers	4,102,262	3,156,188	
Trading portfolio assets	981	1,362	
Positive replacement values of derivative financial instruments	306,935	500,418	
Other financial instruments at fair value	469,268	480,511	
Financial investments	2,942,616	3,661,430	
Accrued income and prepaid expenses	170,385	139,080	
Non-consolidated participations	2,047	1,877	
Tangible fixed assets	244,044	173,656	
Other assets	160,497	163,948	
Total assets	16,870,406	16,383,872	
Liabilities			
Amounts due to banks	1,283,437	540,793	
Amounts due in respect of customer deposits	13,194,275	13,230,214	
Negative replacement values of derivative financial instruments	277,976	489,976	
Liabilities from other financial instruments at fair value	504,024	534,858	
Accrued expenses and deferred income	330,398	303,769	
Other liabilities	113,922	104,841	
Provisions	127,125	134,228	
<i>of which deferred tax relating to the reserves for general banking risks</i>	<i>75,084</i>	<i>73,644</i>	
<i>of which deferred tax relating to employer contribution reserves</i>	<i>24,611</i>	<i>24,611</i>	
<i>of which deferred tax relating to unrealized gains</i>	<i>6,404</i>	<i>6,152</i>	
Total liabilities	15,831,157	15,338,679	
<i>of which subordinated liabilities eligible as Tier 2 capital (T2)</i>	<i>-</i>	<i>-</i>	
<i>of which subordinated liabilities eligible as additional Tier 1 capital (AT1) ²</i>	<i>4,412</i>	<i>2,831</i>	a
Shareholders' equity			
Reserves for general banking risks	237,766	233,206	
Capital	73,710	98,010	b
<i>of which recognized as CET1</i>	<i>73,710</i>	<i>98,010</i>	
<i>of which recognized as AT1</i>	<i>-</i>	<i>-</i>	
Retained earnings reserve	596,445	608,021	
Foreign currency translation reserve	(14,767)	(18,548)	c
Consolidated profit	146,095	124,504	
Total shareholders' equity	1,039,249	1,045,193	

¹ For the reconciliation of individual balance sheet amounts, the listed reference numbers in this table set a link to a corresponding reference number in table 4 "Composition of regulatory capital".

² The amount of the subordinated liabilities is totaling CHF 5.9 million as at 31 December 2017, to which a haircut of 25% was applied in the regulatory capital calculation.

Table 2 - Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories

(LII / FINMA Circular 2016/1 - annex 2 / table 5)

	a According to the financial statements	c				d	f	g
		Carrying values of items:						
		Subject to credit risk framework	Subject to counterparty credit risk framework	Subject to market risk framework	Not subject to capital requirements or subject to deduction from capital			
	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF			
Assets								
Liquid assets	7,367,976	7,367,976						
Amounts due from banks	1,054,671	1,019,372	35,299					
Amounts due from securities financing transactions	48,724		48,724					
Amounts due from customers	4,102,262	4,098,934	3,329					
Trading portfolio assets	981			981				
Positive replacement values of derivative financial instruments	306,935		306,935	306,935				
Other financial instruments at fair value	469,268			469,268				
Financial investments	2,942,616	2,942,616						
Accrued income and prepaid expenses	170,385	170,385						
Non-consolidated participations	2,047	2,047						
Tangible fixed assets	244,044	244,044						
Other assets	160,497	160,497						
Total assets	16,870,406	16,005,871	394,287	777,184		-		
Liabilities								
Amounts due to banks	1,283,437		36,925			1,246,512		
Amounts due in respect of customer deposits	13,194,275					13,194,275		
Negative replacement values of derivative financial instruments	277,976		116,545	277,976		163,594		
Liabilities from other financial instruments at fair value	504,024			504,024				
Accrued expenses and deferred income	330,398					330,398		
Other liabilities	113,922					113,922		
Provisions	127,125					127,125		
Total liabilities	15,831,157	-	153,470	782,000		15,175,826		

There are no differences between accounting and regulatory scopes of consolidation. For this reason, column “b” is omitted.

The amounts shown in the column “According to the financial statements” do not equal the sum of the amounts shown in the remaining columns of this table for line items “Positive replacement values of derivative financial instruments”, as some of the assets included in these items are subject to regulatory capital charges for both credit counterparty risk (CCR) and market risk.

Table 3 - Main sources of differences between regulatory exposure amounts and carrying values in financial statements

(LI2 / FINMA Circular 2016/1 - annex 2 / table 6)

	a	b	d	e
	Total	Positions subject to:		
		Credit risk framework	Counterparty credit risk framework	Market risk framework
	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF
1 Asset carrying value amount under regulatory scope of consolidation (as per Table 2)	16,870,406	16,005,871	394,287	777,184
2 Liabilities carrying value amount under regulatory scope of consolidation (as per Table 2)	935,470	-	153,470	782,000
3 Total net amount under regulatory scope of consolidation	15,934,936	16,005,871	240,817	(4,816)
4 Off-balance-sheet amounts	1,105,435	685,245		
5 Potential future exposure on derivative positions and forward contracts	460,424		460,424	
6 Differences due to booking date and value date	(1,321,444)	(1,321,444)		
7 Cash held in the certificates issued	39,559			39,559
8 Exposure amounts considered for regulatory purposes	16,179,351	15,369,672	701,240	34,743

Explanations of differences between accounting and regulatory exposure amounts

Off-balance sheet amounts

Off-balance sheet amounts subject to credit risk include undrawn portions of committed facilities and guarantees, by applying a credit conversion factor ("CCF") to these items.

Differences due to booking date and value date

According to the Group's accounting policies, all transactions are recorded on a trade-date basis. As at year-end 2017, large forward foreign exchange transactions were concluded for the account of customers with a value date in 2018 but were accounted for booking date in 2017. These transactions do not expose the Group to credit risk.

Cash held in the certificates issued

"Liabilities from other financial instruments at fair value" presented in the balance sheet, correspond to the value of the certificates issued by Bank Lombard Odier & Co Ltd. The certificates are booked on the liability side of the balance sheet. They are covered by positions booked on the asset side of the balance sheet. Those positions are bonds and securities, classified in "Other financial instruments at fair value", fair values of derivative instruments presented under "Positive/negative replacement values of derivative financial instruments", and cash.

Composition of capital

Table 4 – Composition of regulatory capital

(FINMA Circular 2016/1 - annex 2 / table 2)

In thousands CHF

Common equity (CET1)		31.12.2017	31.12.2016	Reference ¹
1	Issued and paid-in capital, fully eligible	73,710	98,010	b
2	Retained earnings reserves, including reserves for general banking risks, profit carry forward and profit for the period	980,306	956,227	
3	Capital reserves and foreign currency translation reserve (+/-)	(14,767)	(18,548)	c
6	Common Equity Tier 1 capital before regulatory adjustments	1,039,249	1,035,689	
CET1 regulatory adjustments				
28	Total regulatory adjustments to CET1	-	-	
29	Common Equity Tier 1 capital (net CET1)	1,039,249	1,035,689	
Additional Tier 1 capital (AT1)				
30	Issued and paid in instruments, fully eligible	4,412	2,831	a
32	<i>of which: classified as liabilities</i>	<i>4,412</i>	<i>2,831</i>	
36	Additional Tier 1 capital before regulatory adjustments	4,412	2,831	
Additional Tier 1 capital regulatory adjustments				
43	Total regulatory adjustments to AT1	-	-	
44	Additional Tier 1 capital (net AT1)	4,412	2,831	
45	Tier 1 capital (net Tier 1)	1,043,661	1,038,520	
Tier 2 capital (T2)				
46	Issued and paid in instruments, fully eligible	-	-	
51	Tier 2 capital before regulatory adjustments	-	-	
Tier 2 capital regulatory adjustments				
57	Total regulatory adjustments to T2	-	-	
58	Tier 2 capital (net T2)	-	-	
59	Total regulatory capital (net T1 & T2)	1,043,661	1,038,520	
60	Total risk-weighted assets (RWA)	3,916,525	3,534,763	
Capital ratios				
61	CET1 ratio (item 29, as a % of RWA)	26.5%	29.3%	
62	T1 ratio (item 45, as a % of RWA)	26.6%	29.4%	
63	Regulatory capital ratio (item 59, as a % of RWA)	26.6%	29.4%	
64	CET1 requirements in accordance with the Basel minimum standards (minimum requirements plus capital buffer plus counter-cyclical buffer and the capital buffer for systemically important banks) (as a % of RWA)	5.8%	5.8%	
65	<i>of which, capital buffer in accordance with Basel minimum standards (as a % of RWA)</i>	<i>1.3%</i>	<i>1.3%</i>	
66	<i>of which, countercyclical buffer¹⁸ in accordance with the Basel minimum standards (as a % of RWA)</i>	<i>0.0%</i>	<i>0.0%</i>	
67	<i>of which, capital buffer for systemically important institutions in accordance with the Basel minimum standards (as a % of RWA)</i>	<i>0.0%</i>	<i>0.0%</i>	
68	CET1 available to meet minimum and buffer requirements as per the Basel minimum standards, after deduction of the AT1 and T2 requirements met by CET1 (as a % of RWA)	23.1%	25.9%	
68a	CET1 total requirement target in accordance with Annex 8 of the CAO plus the countercyclical buffer (as a % of RWA)	7.8%	7.8%	
68b	CET1 available (as a % of RWA)	26.5%	29.3%	
68c	T1 total requirement in accordance with Annex 8 of the CAO plus the countercyclical buffer (as a % of RWA)	9.6%	9.6%	
68d	T1 available (as a % of RWA)	26.6%	29.4%	
68e	Total requirement for regulatory capital as per Annex 8 of the CAO plus the countercyclical buffer (as a % of RWA)	12.0%	12.0%	
68f	Regulatory capital available (as a % of RWA)	26.6%	29.4%	

¹Reference is made to items reconciling to the balance sheet as disclosed in table 1 "Reconciliation of financial statements and regulatory exposure"

Lombard Odier Group regulatory capital is almost entirely Common Equity Tier 1 – CET1 – and for a minor amount Additional Tier 1 Capital -AT1-. The Common Equity Tier 1 is comprised only of disclosed reserves and share capital.

In 2017, the capital decreased by CHF 24.3 million following the acquisition by LO Holding SA of a share in the capital of Compagnie Immobilière Lombard odier SCmA, which was previously 90% directly held by the Managing Partners and 10% by LO Holding SA.

Table 5 – Main features of regulatory capital instruments

(FINMA Circular 2016/1 - annex 2 / table 45)

1	Issuer	Compagnie Lombard Odier SCmA
3	Governing law of the instrument	Swiss Law
Regulatory treatment		
4	Transitional Basel III rules	Common Equity Tier 1
6	Eligible at single-entity, group/single-entity and group levels	Group
7	Equity securities/debt securities/hybrid instruments/other instruments	Equity
8	Amount recognised in regulatory capital (as per most recent capital adequacy report)	CHF 73,710,000
9	Par value of instrument	7,360,000 shares A at a par value of CHF 10 and 100,100 shares B at a par value of CHF 1
10	Accounting classification	Capital
11	Original date of issuance	32865
12	Perpetual or dated	Perpetual
13	Original maturity date	No maturity date
14	Issuer call (subject to prior approval from supervisory authority)	No
Coupons/dividends		
17	Fixed or variable coupon or dividend	Variable
20	Fully discretionary, partially discretionary or mandatory	Class A shares : fully discretionary Class B shares : partially discretionary, preferred stocks with respect to a dividend of 50% of the par value.
21	Existence of step up or other incentive to redeem	No
22	Non-cumulative or cumulative	Non-cumulative
23	Convertible or non-convertible	Non-convertible
30	Write-down feature	No
36	Features that prevent full recognition under Basel III	No

Lombard Odier Group has not issued any convertible bonds or options that could affect its capital structure and it does not have supplementary capital (Tier 2).

As long as the local regulatory requirements are met, there are no restrictions that could prevent the transfer of money or capital within the Group.

Risk-weighted assets and minimum capital requirements

Table 6 – Overview of risk-weighted assets

(OV1 / FINMA Circular 2016/1 - annex 2 / table 4)

In thousands CHF

	Risk Weighted Assets 31.12.2017	Risk Weighted Assets 31.12.2016	Minimal Capital requirements 31.12.2017
1 Credit risk (excluding CCR – counterparty credit risk)	1,702,148	1,400,589	136,172
2 <i>of which standardised approach (SA)</i>	1,458,104	1,226,934	116,648
<i>of which non-counterparty related risk</i>	244,044	173,656	19,524
4 Counterparty credit risk	138,868	127,527	11,109
<i>of which current exposure method (CEM)</i>	101,333	93,896	8,107
<i>of which credit value adjustment (CVA)</i>	37,535	33,631	3,003
11 Settlement risk	-	-	-
16 Market risk	67,622	56,407	5,410
17 <i>of which standardised approach</i>	67,622	56,407	5,410
19 Operational risk	2,007,887	1,950,243	160,631
20 <i>of which basic indicator approach</i>	2,007,887	1,950,243	160,631
23 Amounts below the thresholds for deduction (subject to 250% risk weight)	-	-	-
24 Floor adjustment	-	-	-
25 Total (1+4+11+16+19+23)	3,916,525	3,534,766	313,322

Lombard Odier Group Risk Weighted Assets (RWA) mostly result from its Operational risks (“Basis indicator approach”) representing about CHF 2,008 million or 51% of its total RWA, while Credit risk accounts for about CHF 1,702 million or 43%. Market risks (“Standardised approach”) only contribute CHF 67.6 million or 2% and Counterparty credit risk CHF 138.9 million or 4%. The total minimum regulatory capital requirement is CHF 313 million, compared with the regulatory capital of CHF 1,044 million.

The RWA for credit risk increased by CHF 231.2 million compared to 2016 and is linked to growth of the credit activity in line with the Group strategy. The RWA for non-counterparty rose by CHF 70.4 million mainly due to investments made as part of the planned construction of a new headquarters in Geneva.

General information about risk management

Organisation

Lombard Odier internal control system is organized around the three lines of defense model. The first line of defense includes the businesses and functions involved in risk taking and risk control. To support them with their risk management responsibilities, these businesses and functions have dedicated Business Risk Managers that report to the Unit Head. The second line of defense is composed of risk specialists. It includes Risk Management, Compliance, Human Resources, Finance and Legal, among others. These functions are independent from the business and are responsible for providing oversight, advice and challenge to the first line of defense. The third line of defense is the Group Internal Audit function.

Governance

Lombard Odier Group's governance and main responsibilities with regard to risk management are:

- The Supervisory Board (*Organe de Contrôle* – OC) acts in corpore as the Risk Committee. The OC is notified by the Administration¹ of the risk profile of the Group and its entities, the state of the Group's equity capital, and of any major event that may alter the Group's risk profile, on a quarterly basis.
- The Administration is responsible for defining the principles and architecture of the Group's internal control system (ICS), supervising its implementation and monitoring its efficiency. They define the general risk policy framework and regularly check its suitability. They approve the overall limits for liquidity, market risk, credit risk and counterparty risk on an individual and consolidated basis.
- The Finance, Risk & Due Diligence Committee has decision-making powers and is responsible for establishing the Group's risk policy and proposing it to the Partners. It monitors the Group's risk profile to ensure that it is consistent with the defined policy and oversees the good governance of its internal control system. The Committee ensures that appropriate measures are taken and implemented when the risk profile deviates from the fixed framework. The Committee immediately informs the Partners and the Supervisory Board of any major event that could alter the Group's risk profile.
- The Chief Risk Officer (CRO) implements the Administration's decisions on managing and controlling the risks. More specifically, the CRO establishes a suitable organisation for risk management. He or she proposes to the relevant governing bodies all measures necessary for consistent management of the Group's risks and monitors the changes in those risks. He or she sets up the management tools and methodologies necessary to manage the Group's risks. The CRO immediately informs the Partners of any event that might alter the Group's risk profile.
- The Risk Management unit, under the supervision of the CRO, reports regularly to management and to the governing bodies the level of risk compared to applicable limits. The Risk Management unit is part of the 2nd line of defense.
- The Compliance Unit is tasked with ensuring that business is carried out in a manner that is compliant with our regulatory environment, is fair and equitable, and is in the overriding interests of clients and in compliance with market conduct rules. As a second line of defence function, the Compliance Unit helps to ensure that the Group has a proper internal control system in place which adequately measures and manages the risks of non-compliance that it faces. Under the supervision of the Group Chief Compliance Officer, the primary responsibilities of the Unit are: the supervision of financial crime risks (including Anti-Money Laundering, compliance with international financial sanctions, measures against internal and external frauds, etc), compliance with the requirements of corporate governance, segregation of duties and the prevention of conflicts of interest, monitoring of trading activities and the adaptation of the internal organisation based on new requirements identified thanks to regulatory monitoring. The Group Chief Compliance Officer regularly reports to governing bodies in charge of management risk and compliance and draws their attention to any situation of non-compliance while proposing areas for improvement.
- The Group Internal Audit reports directly to the Supervisory Board. It acts entirely independently and in compliance with regulatory requirements. It coordinates its activities according to the annual audit schedule approved by the Supervisory Board. It reports on a quarterly basis to the Supervisory Board to which it presents new audit reports, the coordination with external auditors and gives an update on attention points and recommendations priorities. The Group Internal Audit is the 3rd line of defense.

Internal Capital Adequacy Assessment Process and risk appetite

On a yearly basis, the Group issues an Internal Capital Adequacy Assessment Process (ICAAP). The main purpose of the Group ICAAP report is to determine the adequate level of capital to support the residual risks that the Group faces while implementing its business strategy, as well as to demonstrate, based on a three-year capital plan, how the Group can meet its regulatory capital adequacy requirements, taking into account the event of an economic downturn. The ICAAP not only considers the risks required to be covered by capital for regulatory purposes (i.e. credit, market and operational risk) but also considers other risk types to which the Group is exposed, in particular business risk and interest rate risk in the banking books.

As part of its Enterprise Risk Management framework the Group has a common risk taxonomy for each category of risk and sets risk appetite statements and risk appetite measures for each risk. Risk appetites are then cascaded to entities within the Group.

¹ The Administration is the Group Management (Konzernleitung), made up only of partners with unlimited liability of Compagnie Lombard Odier SCmA, together forming the Partners (Collège des Associés).

Risk reporting and stress testing

Risk reporting is in place from the Risk Management unit to the different governing bodies of the Lombard Odier Group and to the internal audit. Its objective is to provide a synthetic update and to identify changes in the Group risk profile. The responsibility for this reporting lies within the Risk Management unit, under the supervision of the Chief Risk Officer.

The risk reporting provides key indicators on financial risks (liquidity, market, investment, counterparty and credit) and operational risks. Current and historical risk indicators are compared to Group risk appetite. Key insights are given on different components of the risks, including top counterparties or credit exposures and top operational events. The risk appetite section of the reporting includes key risk metrics for individual risk types which form a dedicated part of the regular risk reporting communicated to a variety of stakeholders.

The Group performs stress testing as part of its capital planning to gauge the effect on the medium-term capital plan and key financials. These stress tests focus on the key risk areas of the Group, including business risk, operational risk and credit risk as well as interest rate risk. The Group also separately undertakes regularly stress tests on liquidity, interest rate risk and AUM (including inferred revenues impacts).

In addition, the Risk Management unit also performs ad-hoc analysis and stress tests were relevant (eg. Brexit, French elections).

Risk culture

Risk management is the responsibility of all staff within Lombard Odier Group. This is made clear through the onboarding process, staff handbook and code of conduct.

The risk culture is further reinforced through the risk management framework and governance, learning and development initiatives, internal communication and collaboration, appraisal process, consequence management and the constant effort to bring Risk Management closer to the Business with the objective of making it a value-adding factor in strategic decision-making.

Risk systems

Financial risks are monitored in the first place by front-office employees who form part of the first line of defence (relationship managers, traders and treasurers mainly) thanks to their operating systems. The risk management function, acting as the second line of defence, uses in-house risk management tools and systems to calculate risk exposures and to compare them to the limits. They are based on independent extractions from the front-office tools, accounting systems, global repository system and operation systems. Risk Management provides to the first line of defence regular reporting to reconcile with their risk views.

A dedicated in-house system, used for data gathering and depository, is in place to manage operational incidents. Users feed it directly and it has a group-wide scope. The data is consolidated and it sources the operational risk Key Risk Indicators. The respective risk type owners ensure consistency of reporting within the business lines. The second line of defense ensures a global monitoring.

Strong interactions between the different departments, including business, operations and finance, and a New Business Initiative process, ensure that all stakeholders are involved in new business developments and that systems keep up with them.

Credit Risk

Lombard Odier Group faces credit risk against its clients ('Client credit risk') and against its financial counterparties ('Counterparty credit risk'). Lombard Odier also faces credit risk through its investment portfolio on the issuers. Dedicated group guidelines cover all credit risks.

Credit risk and counterparty credit risk account for CHF 147.3 million of regulatory capital, equivalent to Risk Weighted Assets of CHF 1,841 million. Regulatory capital consumption represents approximately 14.1% of Group regulatory capital.

In line with FINMA's regulations, RWA attached to counterparty credit risk only includes exposures linked to derivatives and exposure of securities financing transactions (SFT). All other credit exposures are reported in the Credit risk section. These rules have been applied to prepare the table 6 'Overview of risk-weighted assets'.

From a Lombard Odier Group risk perspective, the definition of credit risk linked to client activities, and counterparty credit risk linked to market activities, is different and detailed below.

Client credit risk

The Group's client credit risk is generated through two forms of activity both secured by a pledge of high-quality, negotiable securities:

1. Lending, which is essentially limited to cash credit (loans and overdrafts) granted to clients (also known as "Lombard Credit").
2. Other credit exposures, which may include credit commitments (bank guarantees and subscriptions on behalf of clients to Private Equity or other investment vehicles employing capital calls) and trading positions that require a margin such as derivatives and any other financial instruments.

Pledged portfolios are analysed in depth by the Credit Risk Department, and a conservative lending value is assigned to each pledged position based on relevant indicators of credit risk, market risk, as well as liquidity and country risk of the investment. Currency risk, as well as concentration risk by issuer and by country, are systematically taken into consideration with regard to each collateral portfolio.

The credit exposure amount, market value and lending value of the pledged assets are valued and monitored on a daily basis using a standard suite of haircuts specified in the credit-risk policy of Lombard Odier Group. Where coverage is insufficient or a limit is exceeded, margin calls are made, and the Group may sell the pledged assets if needed to repay loans or cover other credit exposures.

Loans are classified as past due when the client has failed to make a payment when contractually due. The exposure is not considered impaired as the Group believes that on the basis of the collateral available it is still covered.

It is not the Group's policy to grant mortgages or commercial loans.

Counterparty credit risk

Counterparty risk is defined as the potential loss for the Group should its financial counterparties (banks or counterparties to transactions in its course of business) fail to meet their payment obligations.

The Group's risk policy restricts the choice of institutional counterparties in line with a cautious approach, long-term vision and the objective of providing clients with a high-quality service. Institutions that play a major – or even systemic – economic role in their country or internationally are preferred.

OTC derivatives are traded exclusively on a collateralised basis. Reverse repos and repos are used for liquidity management purposes, and all derivatives transactions in which the Group is principal are governed by standard collateralisation agreements with strict parameters for margin calls and eligible collateral.

All new counterparties are investigated thoroughly, analysed and approved independently by the Risk Management Unit. The eligibility, financial health and limits of counterparties are reassessed at least once a year.

Counterparty risk is managed through a combination of limits that cover the various instrument types arising from the Group's activities. Limits are set where the Group acts as principal towards counterparties (direct risk) but also where it acts as agent on its clients' behalf (indirect risk).

The Group applies a maximum financial risk for each counterparty, which limits the total amount of acceptable exposure across all of its activities. The limits per activity and the maximum total amount authorised vary according to the counterparty's creditworthiness.

The Risk Management unit monitors the change in the quality of service of counterparties, their financial soundness and the macroeconomic situation. It proposes changes to the limits wherever necessary. Counterparty limits are monitored daily, by both the 1st line (traders and treasurers) and the 2nd line of defence (Risk Management unit).

Governance

The Administration defines the global business strategy and in particular the credit strategy for the Group. The Finance, Risk & Diligence Committee monitors the credit risk and proposes potential changes to the credit risk management approach including credit calculation methodologies. The committee takes credit decisions within its authority.

Limit approval and credit delegations are in place, depending, in the case of counterparty credit risk, on criteria such as the maximum exposure to defaults per rating and counterparty type. Additional factors, for example country or sector classification, are also taken into account for the investment portfolio. Regarding client credit risk, credit delegation authorities are in place for credit facilities depending on the type of credit (standard / non-standard).

Monitoring reports are provided on a regular basis to the competent bodies (Finance, Risk & Diligence Committee, Administration and Supervisory Board). The reports are also communicated to the Group Internal Audit. A dedicated team, part of the Risk Management unit (2nd line of defence), is responsible for daily monitoring of the situation and the preparation of reports. Client credit-risk reporting includes the evaluation of the credit book by business unit, exposure type and type of collateral. It also presents the top clients with

credit exposures and the term-loans maturity profile. The counterparty risk monitoring section includes breakdowns of indirect and direct exposures, as well as settlement risk top exposures. The section dedicated to the investment portfolio presents information such as creditworthiness, sectoral concentrations and top issuers.

Credit risk mitigation

The client lending activity is essentially limited to loans and advances to clients secured by the pledging of first-rate negotiable securities (Lombard loans). Pledge agreements are put in place with clients which allow netting across all on- and off-balance sheet items the client held.

The regulation regarding eligible collaterals excludes some pledged assets, such as most funds and life insurance, which may be considered eligible within Lombard Odier credit policy.

Mitigation in place for counterparty credit risk includes the exchange of collateral when market practices allow it. For example it is the case for listed derivatives, cleared OTC derivatives and OTC derivatives for which an ISDA master netting agreement/CSA is in place (e.g. OTC derivatives are traded exclusively on a collateral basis). The settlement execution risk is managed, when possible, by the systematic usage of delivery versus payment (DvP) or payment versus payment (PvP) settlements. A dedicated team, attached to Treasury, is responsible for the daily management of collateral received by and given to market counterparts. The Finance, Risk & Diligence Committee is responsible for defining the types of collateral acceptable.

Lombard Odier does not use derivatives to cover its credit risk (CDS).

Table 7 – Credit risk mitigation techniques – overview

(CR3 / FINMA Circular 2016/1 - annex 2 / table 13)

	a	b	c	d	e	f	g
	Exposures unsecured / carrying amount	Exposures secured by collateral	Exposures secured by collateral, of which: secured amount	Exposures secured by financial guarantees	Exposures secured by financial guarantees, of which: secured amount	Exposures secured by credit derivatives	Exposures secured by credit derivatives, of which: secured amount
	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF	In thousands CHF
1 Loans (excluding debt securities)	569,626	3,230,567	2,760,724				
2 Debt securities	2,941,849						
3 Total	3,511,475	3,230,567	2,760,724	-	-	-	-
<i>of which defaulted</i>	-	-	-	-	-	-	-

The carrying amount of unsecured loans considered for regulatory purpose consists of Amounts due from banks totaling CHF 308.5 million and from customers for CHF 261.6 million. A large portion of unsecured Amounts due from banks includes delivery versus payment transactions and booking date and value date differences. Unsecured Amounts due from customers are mainly due to the non-eligibility, according to Basel III rules, of some mutual funds and the life insurance products received in collateral.

Use of external ratings

Lombard Odier Group consistently uses the main three rating agencies: Fitch, Standard & Poor's and Moody's. Credit ratings are used to monitor counterparty credit risk resulting from direct exposure (mainly cash and investment portfolio) and to rate the collateral deposited or received from clients or market counterparts. For internal risk-monitoring purposes, and when no more complex models apply, it is the worst of the ratings available that is used.

Risk Weighted Assets relating to credit risk are impacted by changes in external credit ratings as the Group applies the AS-BRI approach. Indeed, the capital requirements for credit risks in the banking sector (FINMA Circular 2008/19 "Credit Risks – Banks") and the Capital Adequacy Ordinance (CAO) make use of external credit ratings. They impact respectively the weighting applicable for exposure towards financial counterparties, and the pledge value of the clients' pledged assets, indirectly impacting the Group client-credit RWA.

Counterparty Credit Risk

Counterparty credit risk is limited to a net exposure for regulatory purposes of CHF 701.2 million (cf. Table 3 "Main sources of differences between regulatory exposure amounts and carrying values in financial statements"). Positive and negative replacement values of derivative financial instruments are the main contributor to this risk, which is collateralized on a daily basis (see Credit-risk mitigation section above). The associated risk weighted assets are CHF 138.9 million generating a minimal capital requirement of CHF 11.1 million representing 1.1% of the regulatory capital. Most of the replacement values exposure is generated by back-to-back activities as the bank faces its client on one-side and market counterparts on the other.

Lombard Odier is not a direct Central Counterparty Clearing house (CCP) member. It accesses this type of services through prime brokers.

A credit-rating downgrade would not have direct consequences on the quality or amount of collateral to be exchanged with our counterparties. A wrong-way-risk detailed analysis was conducted internally that lead us to conclude it was not material for Lombard Odier Group.

Default risk

At the end of 2017 Lombard Odier Group had no credit provisions and no loans to clients were considered doubtful.

In the unlikely event that a borrower is not able to meet its obligations, the Administration and/or the Finance, Risk & Diligence Committee decides whether a specific provision should be recognised, taking into account the detailed analysis of the pledged assets. The loan would be then considered doubtful.

Market Risks

Market risk is the risk of loss due to value fluctuation of a position resulting from a change in the factors that determine its price, such as exchange rates, interest rates, equity prices, etc. It impacts the Group's results mainly through the balance sheet positions of derivatives contracts. The framework for risk management is defined in the market risk policy of the Lombard Odier Group.

Table 8 – Market risk under standardised approach

(MR1 / FINMA Circular 2016/1 - annex 2 / table 39)

In thousands CHF

	Risk-weighted assets (RWA)	
	31.12.2017	31.12.2016
Outright products *		
1 Interest-rate risk (general and specific)	13,612	19,638
2 Equity risk (general and specific)	1,767	2,000
3 Foreign-exchange risk	39,388	27,463
4 Commodity risk	10,587	5,625
Options		
6 Delta-plus method	2,268	1,688
9 Total	67,622	56,413

*Outright refers to products that are not optional

All assets (bonds, stocks, funds, ETFs, for example) have their prices sourced from market providers. Mark-to-model is used only in the case of unlisted derivatives, for example forex forwards. Standard pricing models are used in conjunction with end-of-day market data (interest rates, exchange rates, etc.) retrieved from market providers. Daily pricing reconciliation with our market counterparties are in place. A dedicated team in Operations is in charge of this reconciliation and investigates mismatches. In addition, centralized value systems generate alerts when daily variations above a certain threshold are detected. Another dedicated team in charge of the centralized valuation system investigates such alerts. The bank does not hold assets whose fair value is not determined by using observable inputs or measures ('Level 3 assets').

Currency risks are centralised in the Swiss bank entity of the Group whilst only minimal positions are allowed for the foreign entities.

Limits are defined for the banking book and the trading book at a global level; they are reviewed at least annually. For the latter, sub-limits are defined for each trading activity. Market risk associated with trading activities is managed and controlled by the bearer of the risk (trading desks as 1st line of defense), and then independently controlled by the Risk Management unit through daily and intraday controls.

The risk report transmitted to the different governing bodies of the Group (GRC, Administration and OC) includes a dedicated market risk section.

The strategy of Lombard Odier is to execute clients' orders and not to take proprietary trading positions. Trading limits are therefore limited. The certificates issued by Lombard Odier are fully covered by assets with little market risk remaining, mainly due to trading size limitations. The gross amount of certificates issued are reported in the assets whilst their hedges are on the liabilities. Both are netted to calculate the regulatory capital requirement of this activity.

The Group minimum regulatory capital consumed is CHF 5.4 million, equivalent to Risk Weighted Assets of CHF 67.6 million. Regulatory capital consumption represents approximately 0.5% of Group regulatory capital.

Table 9 – Interest rate risk in the banking book

(FINMA Circular 2016/1 - annex 2 / table 44)

In thousands CHF

Increase (+) / decrease (-) in interest rate	CHF	EUR	USD	Autres	Total
+100 basis point - 31.12.2017	21,190	867	(23,353)	6,543	5,248
+100 basis point - 31.12.2016	24,407	(2,946)	(52,551)	4,021	(27,069)

Within the banking book, interest rate risks (i.e. potential risks relating to net interest income and variations in the economic value of own capital due to interest rate fluctuations) are managed in a centralised manner in the Swiss bank entity of the Group whilst only minimal positions are allowed for foreign entities.

Table 9 presents the interest rate risk as the Economic Value Capital sensitivity to a parallel shift of +100 basis points. It is equal to CHF 5.2 million. This limited exposure is explained by the duration of assets being close to that of liabilities. No assumptions are taken on fixed-term loans (no rollover assumed), while the investment portfolio and balance sheet are considered constant. Assumptions are taken on cash deposits based on non-maturing historical analysis and back tested regularly. In particular, a replicating model is used for non-maturing deposits whereas 80% are considered overnights. Such models are described in the market and risk group guidelines.

The interest-rate risk is calculated on a quarterly basis. Its key drivers, including long-term loans, investment portfolio and cash deposits, are followed daily.

Operational Risks

Operational risk is defined as the risk of loss arising from inadequacy or failure on the part of internal processes, people or systems, or following external events due to intentional, accidental or natural causes. It includes legal, fiscal, regulatory and compliance risks.

Operational risk is inherent in the business activities of the Group. Operational risk may take various forms and have many causes, ranging from unintentional human error to fraudulent acts and external events.

The Group is prepared to accept operational risks on the strict condition that they are in line with the implementation of its strategy and business policy, and that compliance with the regulations and laws of the markets in which it operates is ensured at all times. The Group has issued a statement regarding operational risk appetite that enables the Partners to supervise and manage the operational risk profile at any time.

The Group believes that operational risk management is the responsibility of all employees and that it requires the commitment of managers at all levels, as well as a strong operational risk prevention culture within the Group.

In practice, this means that each business unit must take ownership of its operational risks as a first line of defence with respect to the identification, evaluation and management of these risks, and the proactive implementation of improvement measures.

The second line of defence, represented in particular by Risk Management and Compliance, is responsible for the supervision and monitoring of operational risk. They also offer specialist training and support to the units with regard to the implementation of the Group's risk management framework and the management of specific types of risk. Legal risks associated with potential litigation are assessed individually by the Legal department and the Administration, with the assistance of external expert lawyers if necessary.

The Group has defined principles and processes for the identification and evaluation of prevalent operational risks, their management and mitigation, the surveillance and reporting of operational risks within the Group, and the promotion of a strong operational risk culture.

The Group's operational risk management framework complies with the standards defined by the Basel Committee and adopted by FINMA.

An independent assessment of the internal control system for back-office and IT activities is conducted annually on the basis of an external audit in order to obtain a Type II assurance opinion based on ISAE 3402 (SSAE 16) and ISAE 3000 standards.

Operational incidents trigger notifications that undergo a validation and escalation process. Such incidents are reported and analysed to ensure that suitable corrective and preventive measures can be taken to reduce the frequency and gravity of potential risk events in the future.

With regard to its business continuity plan, the Group believes that, in the event of an accident or major disaster, its ability to maintain and rapidly recover its critical activities is crucial to minimising the impact of such events on its operations. The Business Continuity Manager is responsible for the methodology and the setup of a Crisis Management team to handle matters if such an event were to occur.

The Group also tests its business continuity plan at least once a year to ensure that it is suitable, especially as regards its sensitive activities (technological infrastructure, information system, access to markets, and executing and booking of orders). The Group abides by the Swiss Bankers Association's Recommendations for Business Continuity Management and applies the self-regulation recognised as a minimum standard by FINMA (FINMA Circular 2008/10 "Self-regulation as a minimum standard").

Finally, with respect to cyber security, the Group has set up the cyber risk management framework according to FINMA's requirements and in line with the NIST cyber security framework. Processes and controls are implemented within the organization to ensure the identification of potential threats, the protection of the technology infrastructure, the timely detection of security incidents based on systematic monitoring and the reaction and quick recover of normal activities in case of events. The Chief Information Security Officer is responsible for the operational security. Risk management is responsible for the supervision and monitoring of the cyber risk profile.

The minimum regulatory capital consumed by this risk is CHF 160.6 million, equivalent to Risk Weighted Assets of CHF 2,008 million. Regulatory capital consumption represents approximately 15.4% of Group regulatory capital. The basic indicator approach is used to measure RWA on operational risk.

Leverage Ratio

Table 10 – Summary comparison of accounting assets vs leverage ratio exposure measure

(FINMA Circular 2016/1 - annex 2 / table 46)

In thousands CHF

Object	31.12.2017	31.12.2016
1 Total consolidated assets as per published financial statements	16,870,406	16,383,872
2 Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	-	-
3 Adjustment for fiduciary assets recognised on the balance sheet for accounting purposes, but excluded from the leverage ratio exposure measure	-	-
4 Adjustment for derivative financial instruments	395,877	197,245
5 Adjustment for securities financing transactions (SFTs)	-	-
6 Adjustment for off-balance-sheet items (i.e. conversion to credit equivalent amounts of off-balance-sheet exposures)	857,616	677,901
7 Other adjustments	-	-
8 Leverage ratio exposure	18,123,899	17,259,018

Table 11 – Leverage ratio common disclosure

(FINMA Circular 2016/1 - annex 2 / table 47)

In thousands CHF

	31.12.2017	31.12.2016
On-balance-sheet exposures		
1 On-balance sheet items (excluding derivatives and SFTs, but including collateral)	16,514,747	15,679,457
2 (Assets that must be deducted in determining the eligible Tier 1 capital)	-	-
3 Total on-balance sheet exposures within the leverage ratio framework, excluding derivatives and SFTs	16,514,747	15,679,457
Derivatives		
4 Replacement costs associated with all derivatives transactions, including those with CCPs (net of eligible cash variation margin and/or with bilateral netting)	178,199	332,013
5 Add-on amounts for PFE associated with all derivatives transactions	563,240	603,524
7 (Deduction of receivables assets for cash variation margin provided in derivatives transactions)	(38,627)	(237,874)
11 Total derivative exposures	702,812	697,663
Securities financing transaction exposures		
12 Gross SFT assets with no recognition of netting, including sale accounting transactions, less the items spec-	48,724	203,997
16 Total securities financing transaction exposures	48,724	203,997
Other off-balance-sheet exposures		
17 Off-balance-sheet exposure at gross national amounts before application of credit conversion factors	2,829,086	2,254,125
18 (Adjustments for conversion to credit equivalent amounts)	(1,971,470)	(1,576,224)
19 Total off-balance-sheet items	857,616	677,901
Eligible capital and total exposures		
20 Tier 1 capital	1,043,661	1,038,520
21 Total exposure	18,123,899	17,259,018
Leverage ratio		
22 Leverage ratio	5.8%	6.0%

Liquidity Coverage Ratio

Table 12 – Information on the liquidity coverage ratio (LCR)

(FINMA Circular 2016/1 - annex 2 / table 48)

In thousands CHF

	Q4 2017		Q3 2017		Q2 2017		Q1 2017	
	3-month average		3-month average		3-month average		3-month average	
	unweighted values	weighted values	unweighted values	weighted values	unweighted values	weighted values	unweighted values	weighted values
High-quality liquid assets (HQLA)								
1 Total high-quality liquid assets (HQLA)		9,047,734		8,937,958		9,744,838		10,010,039
Cash outflows								
2 Retail deposits	6,373,422	916,596	6,517,112	932,238	6,718,353	970,894	6,799,873	994,433
3 <i>of which, stable deposits</i>	-	-	-	-	-	-	-	-
4 <i>of which, less stable deposits</i>	6,373,422	916,596	6,517,112	932,238	6,718,353	970,894	6,799,873	994,433
5 Unsecured wholesale funding	8,126,909	5,535,396	7,486,127	5,024,633	7,360,177	4,747,013	7,454,284	4,753,270
6 <i>of which, operational deposits (all counterparties) and deposits in networks of cooperative banks</i>	-	-	-	-	-	-	-	-
7 <i>of which, non-operational deposits (all counterparties)</i>	7,332,869	5,455,989	6,660,704	4,942,090	6,478,237	4,658,819	6,556,929	4,663,534
8 <i>of which, unsecured debt</i>	-	-	-	-	-	-	-	-
9 Secured wholesale funding and collateral swaps		-		-		-		-
10 Other outflows	1,145,698	496,132	986,468	457,985	970,679	485,120	953,388	504,281
11 <i>of which, outflows related to derivative exposures and other transactions</i>	412,680	270,891	343,382	257,544	327,319	279,495	302,317	291,287
12 <i>of which, outflows related to loss of funding on asset-backed securities, covered bonds and other structured financing instruments, asset-backed commercial papers, conduits, securities investment vehicles and other such financing facilities</i>	-	-	-	-	-	-	-	-
13 <i>of which, outflows related to committed credit and liquidity facilities</i>	733,018	225,241	643,086	200,441	643,360	205,625	651,071	212,994
14 Other contractual funding obligations	-	-	-	-	-	-	-	-
15 Other contingent funding obligations	2,036,822	16,795	1,816,772	15,000	1,718,722	14,327	1,609,858	14,521
16 Total cash outflows		6,964,919		6,429,856		6,217,353		6,266,504
Cash inflows								
17 Secured lending (e.g. reverse repos)	49,575	-	24,230	-	37,691	-	84,453	-
18 Inflows from fully performing exposures	2,163,937	1,639,844	2,067,725	1,566,115	1,357,863	980,601	1,861,876	1,433,651
19 Other cash inflows	394,877	394,877	334,222	334,222	318,497	318,497	65,316	65,316
20 Total cash inflows	2,608,388	2,034,721	2,426,177	1,900,336	1,714,051	1,299,098	2,011,645	1,498,967
		Adjusted values		Adjusted values		Adjusted values		Adjusted values
21 Total high-quality liquid assets (HQLA)		9,047,734		8,937,958		9,744,838		10,010,039
22 Total net cash outflows		4,930,198		4,529,519		4,918,255		4,767,537
23 Liquidity coverage ratio (in %)		183.5%		197.3%		198.1%		210.0%

Composition of High Quality Liquid Assets (“HQLA”)

Lombard Odier Group holds a pool of unencumbered HQLA that are readily available to meet cash-flow obligations under stress scenarios, as defined in the LCR rules. The liquid assets mainly include Level 1 HQLA, which comprises cash deposited to the Swiss National Bank, highly rated bonds issued by governments and supranational entities, and mortgage bonds.

Derivative exposure and potential collateral calls

Derivative exposures are mainly from, but not limited to foreign-exchange forwards and swaps and interest rate swaps. All derivative positions are marked-to-market daily, affecting the collateral amounts posted to and received from interbank counterparties and/or exchanges. Cash flows resulting from potential changes in collateral amounts posted/received are incorporated into LCR net cash outflows.

Concentration of funding sources

In addition to capital, client deposits represent the main funding source. They are diversified across the clients base. More than 60% of deposits are held into accounts with balances below CHF 5 million which represent more than 90% of the client accounts.

Liquidity management across Lombard Odier Group

The Group has adopted a centralised approach to cash and balance-sheet management, which falls within the remit of the Treasury/ALM Department. Accordingly, uninvested client assets are placed conservatively, in line with clearly established constraints. The liquidity consumption of the loan book is monitored against the stable funding capacity from clients’ deposits. The Risk Management unit carries out independent analysis. The liquidity approach is outlined in the Group’s liquidity investment policy.

This document is published in English.
It is also available in PDF format for download from our website, www.lombardodier.com.

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