Triodos Bank

Annual Report 2020

1.7 Risk and compliance

Risk management

Managing risk is a fundamental part of banking. Triodos Bank manages risk as part of a long-term strategy of resilience.

Risk management is embedded throughout the organisation. While business managers are primarily responsible for a sound business and risk approach, they are supported by risk managers with local business knowledge to identify, assess and manage risk. At Group level the risk appetite process allows Triodos Bank's risk profile to be managed within the defined risk tolerance levels in pursuit of the achievement of Triodos Bank's strategic objectives.

Periodically each business unit performs a strategic risk assessment to identify and manage potential risks that could impede the realisation of its business objectives. The results of these assessments are consolidated and used as input for the Executive Board's own risk assessment. They are also part of the business plan cycle.

Three important external developments may influence the strategy of the bank and therefore pose a strategic risk: the impact of the COVID-19 epidemic, the continuing low interest rate environment and new (additional) regulatory requirements. The first has fundamentally changed the way of working within Triodos Bank and will probably adversely impact certain sectors within the economy to which part of Triodos Bank's assets are exposed. The second has led to a decreased margin and consequently lower profitability than anticipated and may – depending on the development – continue to do so. The third has led and will lead to an extra effort of co-workers, system adaptation and processes in order to implement these new regulatory requirements, as well as increasing contributions to the Deposit Guarantee Scheme and resolution costs.

The strategic risk environment forms one of the starting points for determining the corporate strategy, the assessment of the capital and liquidity requirements in relation to the risk appetite and the recovery plan. In addition, business units are assessed on their sensitivity to risks, to determine the input for scenarios used to stress-test Triodos Bank's solvency, liquidity and profitability.

Given the selected scenarios, Triodos Bank is sensitive to a continuing, low interest environment scenario. It shows that, with projected business volumes and fee income, profitability will be under pressure in the coming years. This risk will be mitigated by a focus on cost efficiency and by diversification of income.

The impact of the scenarios was calculated and assessed in relation to profitability, capital ratios and liquidity. The results indicated that Triodos Bank has a strong capital base to absorb unexpected losses.

In addition to the regular stress scenarios, the regulator requires a specific scenario dedicated to climate risk. Climate risk contains two elements:
- The risk that relates to the transition of 'old' sources of energy to sustainable ones (transition risk), which can result in stranded assets. Power plants using coal that have to close earlier than expected, are an example.
- The risk that relates to the changes of the climate itself causing physical damage (physical risk). The rise of sea levels as a result of extreme weather conditions is an example.

Given that sustainability considerations are a starting point within Triodos Bank's lending processes, transition risks are minimal in its loan portfolio. Triodos Bank's lending is already focused on financing enterprises contributing to a low-carbon future.

Triodos Bank's portfolio could be impacted by the physical risks of climate change. Regarding physical risk, the changes in climate leading to storms, floods and droughts may have an impact on its assets. In the longer term, impact on weather conditions (such as wind and solar resources) may affect renewable energy generation.

Triodos Bank carries out annual climate stress tests which take extreme but plausible situations into account. As part of determining the scenarios, it evaluates whether extreme weather situations could impact the bank's resilience with a time horizon of three years. Currently, the conclusions of this work are that it is very unlikely to have material impact within this time horizon.

Finally, Triodos Bank believes that since these climate risks will have a profound impact on society as a whole over the longer term, society and the banking sector should create structures to drastically decrease and minimise the financing of unsustainable assets.

Triodos Bank is sensitive to reputational risk events. To prevent events that may trigger reputational risk, it is essential to clearly communicate the bank's purpose, mission and act accordingly, as well as to prevent compliance issues and related press coverage.

A fully integrated risk management report presents Triodos Bank's risk profile in relation to its risk appetite. The report is an important risk monitoring tool for Triodos Bank, which also contains analyses on specific risk types and themes. This report is distributed quarterly and discussed with the Supervisory Board's Audit and Risk Committee.

Several risk committees are in place at group level. Each is dedicated to cover and manage specific types of risk. The monthly Asset and Liability Committee is concerned with managing liquidity risk, interest rate risk, foreign exchange risk and capital management in general. The monthly Non-Financial Risk Committee monitors and manages the development of non-financial risks (i.e. operational risk and compliance risk). The Anti-Money Laundering and Counter-terrorist Financing Risk Committee monitors and manages the regulatory and associated topics regarding anti-money laundering and counter-terrorist financing risk.

The Enterprise Risk Committee of Triodos Bank is the body delegated by the Executive Board to propose the risk appetite, monitor the actual risk profile against the risk appetite and in particular discuss and decide on topics pertaining to the enterprise risks of Triodos Bank (e.g. strategic and reputational risks).

The Credit Risk Committee plays an important role in assessing the risk of new loans and monitoring the credit risk of the entire loan portfolio. The assessment of credit risk of individual loans is primarily the responsibility of local banking business units, who are responsible for the day-to-day operations. The Group risk function sets norms, approves large loans and monitors the credit risk and concentration risk of Triodos Bank's entire loan book.

The Risk Management section of Triodos Bank's annual accounts provides a description of the main risks related to the strategy of the bank. It also includes a description of the design and effectiveness of the internal risk management and control systems for the main risks during the financial year. The Group's growth over the past years in combination with new legislation and regulatory demands, requires the bank to continuously review, assess and adapt its internal organisation and governance structure.

Capital and liquidity requirements

Regulators are demanding a more resilient banking sector by strengthening the solvency of the banks and introducing strict liquidity requirements, such as those developed by the Basel Committee on Banking Supervision. Triodos Bank complies with the capital and liquidity requirements based on the Capital Requirements Regulation.

Triodos Bank's capital strategy is to be strongly capitalised. Triodos Bank aims for a common equity tier-1 (CET1) ratio of at least 15%, well above its own internal economic capital adequacy models to guarantee a healthy and safe risk profile. The quality of capital as well as the solvency rate are important. Currently, nearly all of Triodos Bank's capital is qualified as common equity. Economic capital is the amount of risk capital held to enable the organisation to survive any difficulties, such as market or credit risks. Economic capital is calculated periodically and supports Triodos Bank's own view of capital adequacy for the purpose of the yearly Internal Capital Adequacy Assessment Process (ICAAP), which is reviewed by De Nederlandsche Bank.

In 2020 Triodos Bank raised only a small amount of additional capital (EUR 5.4 million) by issuing additional Depository Receipts as the trading of DR was suspended for a prolonged time during 2020. In October trading in DRs resumed based on an updated prospectus and a changed set of trading principles, however trading was suspended again in January 2021. Nevertheless, the CET1 ratio increased by 0.8% from 17.9% at the year-end 2019 to 18.7% at the year-end 2020. This was mainly as a result of changes to capital regulation in 2020, referred to as the EU risk reduction package. This capital ratio is well above the regulatory requirement.

The liquidity buffer mainly consists of liquid assets with central banks (nearly two-thirds at the end of 2020) and liquid investments in bonds (close to 30% of total liquidity). There is a small amount of liquidity at sight with commercial banks, mainly for payment services, and some investments (around 6% of total liquidity) are made in cash loans (<1-year maturity) with Dutch and German municipalities. Around 27% of the bond investments are in central government bonds and 61% is invested in regional government and agency bonds. The other bond investments were made in green bonds of corporates and banks for diversification and to optimise risk-return. Due to market circumstances in the past years (dominated by the downward impact of central bank asset purchases on bond yields), the opportunities to re-invest maturing bonds are limited. Consequently, the percentage of liquidity at the current account at central banks has increased from about 40% in early 2018 to slightly more than 60% at the end of 2020.

The liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) are both well above the minimum limits of Basel III. More detailed information about Triodos Bank's approach to risk is included in the Annual Accounts section on Risk management (see page 206).

In-control statement

The Executive Board is responsible for designing, implementing and maintaining an adequate system for internal control over financial reporting. Financial reporting is the product of a structured process carried out by various functions and banking entities under the direction and supervision of the financial management of Triodos Bank.

The Executive Board is responsible for the risk management function and compliance function. The risk management function works together with management to develop and execute risk policies and procedures involving identification, measurement, assessment, mitigation and monitoring of the financial and non-financial risks. The compliance function plays a key role in monitoring Triodos Bank's adherence to external rules and regulation and internal policies. The adequate functioning of the risk management and compliance function as part of the internal control system is frequently discussed in the Audit and Risk Committee. It is further supported by Triodos Bank's risk culture as a key element of the bank's risk management framework.

Triodos Bank's Internal Audit function provides independent and objective assurance of Triodos Bank's corporate governance, internal controls, compliance and risk management systems. The Executive Board, under the supervision of the Supervisory Board and its Audit and Risk Committee, is responsible for determining the overall internal audit work and for monitoring the integrity of these systems.

The risk management framework is an important cornerstone in the in-control statement process (see also Risk management (see page 206). Triodos Bank is working in a continuously changing environment, which requires regular upgrades of its control framework.

The risk management and control systems provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation and fair presentation of its financial statements.

Compliance and integrity

Triodos Bank has internal policies, rules and procedures to ensure management complies with relevant laws and regulations regarding customers and business partners. In addition, the Compliance department independently monitors the extent to which Triodos Bank complies with its rules and procedures. The external aspects of the Compliance department's role primarily concern accepting new customers, monitoring financial transactions and preventing money laundering. Internal aspects primarily concern checking private transactions by co-workers, preventing and, where necessary, transparently managing, conflicts of interest and safeguarding confidential information. In addition, it is concerned with raising and maintaining awareness of, for example, financial regulations, compliance procedures and fraud and anti-corruption measures.

Triodos Bank has a European compliance team which is led by the Group Director Compliance, who is also the Group data protection officer. Compliance officers and data protection officers are appointed in every banking entity with a functional line to the central compliance department. The Director of Compliance reports to the Chief Risk Officer and has an escalation line to the Chair of the Audit and Risk Committee, that supports the independence of the Compliance function.

Triodos Bank aims to serve the interests of all stakeholders, including society, by actively fulfilling its role as a gatekeeper in the financial system and countering money laundering and terrorism financing. The bank applies various procedures and measures in this respect.

In 2018, De Nederlandsche Bank (DNB) conducted a thematic, sector-wide survey among Dutch banks, focusing on the measures that the banks have taken to prevent money laundering and terrorism financing. Following this survey, DNB concluded that Triodos Bank is required to implement enhanced measures concerning customer due diligence and monitoring of customer transactions. On 6 March 2019, DNB imposed on Triodos Bank N.V. a formal instruction (aanwijzing) to remedy shortcomings in the compliance with provisions of the anti-money laundering and counter-terrorist financing laws and the financial supervision laws. Triodos Bank accepted this instruction and is implementing mitigating measures, which are on track. Following the formal instruction Triodos Bank received an administrative penalty on 14 December 2020 that was paid without delay.

Triodos Bank was not involved in any other material legal proceedings or any other further sanctions associated with non-compliance with legislation or regulations in terms of financial supervision, corruption, advertisements, competition, data protection or product liability.

Sustainability policy

Sustainability considerations are shared at all levels of Triodos Bank and are an integral part of its management, including how it evaluates risk. Social and environmental aspects are taken into account in all day-to-day business decisions. Therefore, Triodos Bank does not have a separate department that continuously focuses on sustainability or corporate social responsibility.

Triodos Bank employs specific criteria to ensure the sustainability of products and services. It employs both positive criteria to ensure it is actively doing good and negative criteria for exclusion, to ensure it doesn’t do any harm. The negative criteria exclude loans and investments in sectors or activities that are damaging to society. The positive criteria identify leading businesses and encourage their contributions to a sustainable society. Twice a year, these criteria are tested and adjusted if necessary. Triodos Bank has also defined sustainability principles for its internal organisation. These are included in its Business Principles. All sustainability criteria referred to can be found on our website.