ML UK Capital Holdings Limited

Including Merrill Lynch International

# Pillar 3 Disclosure

As at 31 December 2016

Bank of America Merrill Lynch

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# Glossary

| | |
|---|---|
| ABS | Asset-Backed securities |
| AT1 | Additional Tier 1 capital |
| BAC | Bank of America Corporation / the Enterprise |
| BAMLI | Bank of America Merrill Lynch International Limited |
| BANA | Bank of America, National Association |
| BRC | Board Risk Committee |
| CCR | Counterparty and Credit Risk |
| CCYB | Countercyclical Capital Buffer |
| CET1 | Common Equity Tier 1 |
| CMR | Contingent Market Risk |
| COR | Corporate Operational Risk team |
| CQS | Credit Quality Steps |
| CRD IV | Capital Requirements Directive IV |
| CRM | Comprehensive Risk Measure |
| CRO | Chief Risk Officer |
| CRR | Capital Requirements Regulation |
| CSA | Credit Support Annex |
| CVA | Credit Valuation Adjustment |
| EBA | European Banking Authority |
| ECAIs | External Credit Assessment Institutions |
| EEA | European Economic Area |
| EMEA | Europe, Middle East and Africa |
| EU | European Union |
| EWI | Early Warning Indicator |
| FCA | Financial Conduct Authority |
| Fitch | Fitch Ratings, Inc. |
| FPC | Financial Policy Committee |
| FRS 101 | Financial Reporting Standard 101 ‘ Reduced Disclosure Framework’ |
| GMRAs | Global Master Repurchase Agreements |
| HQLA | High Quality Liquid Assets |
| ICAAP | Internal Capital Adequacy Assessment Process |
| IFRS | International Financial Reporting Standards |
| IRC | Incremental Risk Charge |
| ISDA | International Swaps and Derivative Association |
| LCR | Liquidity Coverage Ratio |
| LOB | Line of Business |
| MLI | Merrill Lynch International / the Company |
| MLUKCH | ML UK Capital Holdings Limited |
| Moody’s | Moody’s Investors Service, Inc. |
| PRA | Prudential Regulation Authority |
| PRR | Market Position Risk Requirement |
| P&L | Profit or Loss |
| RAS | Risk Appetite Statement |
| RNiV | Risk Not in VaR |
| RMC | Risk Management Committee |
| RRC | Reputational Risk Committee |
| RSA | Risk Self-Assessment |
| RWA | Risk Weighted Assets |
| SPE | Special Purpose Entities |
| SREP | Supervisory Review and Evaluation Process |
| SVaR | Stressed Value at Risk |
| S&P | Standard & Poor’s |
| VaR | Value at Risk |
| VVOP | Voluntary Variation of Permission |

# 1. Introduction

# 1.1 Overview and Purpose of Document

This document contains the Pillar 3 disclosure as at 31 December 2016 in respect of the capital and risk management of ML UK Capital Holdings Limited ("MLUKCH"), its sole operating subsidiary, Merrill Lynch International ("MLI" or "the Company") and its other non-operating subsidiaries (together "the Group" or "the MLUKCH Group"). All defined terms are found in the glossary.

Capital Requirements Directive IV ("CRD IV"), the European Union ("EU") legislation implementing Basel III, came in to effect on 1st January 2014, mandating the quality and quantity of capital that firms are required to hold, introducing an EU wide liquidity regime and establishing leverage requirements. This legislation consists of three Pillars. Pillar 1 is defined as "Minimum Capital Requirement", Pillar 2 "Supervisory Review Process" and Pillar 3 "Market Discipline". The aim of Pillar 3 is to encourage market discipline by allowing market participants to access key pieces of information regarding the capital adequacy of institutions through a prescribed set of disclosure requirements.

MLUKCH's ultimate parent company is Bank of America Corporation ("BAC" or "the Enterprise") and it acts predominantly as the holding company for MLI.  In accordance with the Capital Requirements Regulation ("CRR"), the MLUKCH Group complies with the Pillar 3 requirements on a consolidated basis. As its sole operating subsidiary, the information set out in this document predominately relates to MLI.

This document provides detail on the Group's and MLI's available capital resources ("Capital Resources") and regulatory defined Pillar 1 minimum capital requirement ("Minimum Capital Requirement"). It demonstrates that the Group and MLI have Capital Resources in excess of this requirement and maintains robust risk management and controls primarily in respect of the activities of MLI.

To further increase transparency, this document also includes information on the Group's and the Company's capital requirements in respect of the Countercyclical Capital Buffer ("CCYB").

### 1.1.1 ML UK Capital Holdings Limited

The MLUKCH Group is supervised on a consolidated basis in the UK by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"). The principal activity of MLUKCH is to act as a holding company for MLI. MLUKCH also acts as a holding company for a small number of non-operating subsidiaries.

MLUKCH is not itself a risk taking entity and the risk is booked in its operating subsidiary MLI, where the business is managed.

As MLUKCH is a holding company, the qualitative disclosures regarding risk management and governance are relevant to the subsidiaries where the activity is conducted and recorded. In this respect, unless otherwise stated, discussion herein relates primarily to MLI. For the purpose of this document, quantitative disclosures for the MLUKCH Group are presented on a consolidated basis unless stated otherwise.

For a full BAC organisation chart, please refer to the investor relations website at http://investor.bankofamerica.com

### 1.1.2 Merrill Lynch International

MLI is a UK Investment Firm and BAC's largest operating subsidiary outside of the US. MLI is authorised and regulated by the PRA and the FCA.

MLI serves the core financial needs of global corporations and institutional investors. MLI's head office is in the United Kingdom with branches in Stockholm, Dubai and Qatar as well as a representative office in Zurich. MLI has the ability to trade throughout the European Economic Area ("EEA") and conduct business with international clients.

MLI has a key role within the wider BAC group, by providing non-US market access for Global Banking and Global Markets clients. MLI is BAC's primary non-bank Global Markets trading entity in Europe, Middle East and Africa ("EMEA").

The principal activities of the entity are to provide a wide range of financial services globally for business originated in EMEA, Asia Pacific and the Americas, to act as a broker and dealer in financial instruments and to provide corporate finance advisory services. The entity also provides a number of post trade related services including settlement and clearing services to third party clients.

As at 31 December 2016, MLI was rated by Fitch Ratings, Inc ("Fitch") (A / F1) and Standard & Poor's ("S&P") (A+ / A-1).

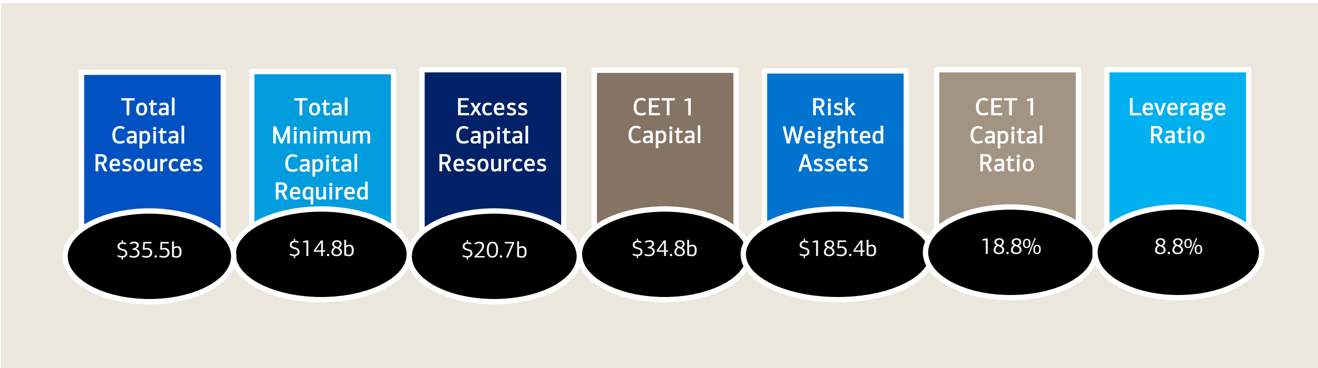
### 1.1.3 Other Entities

Other entities, although consolidated into the Group, are not separately disclosed in this document on the grounds of materiality.

### 1.1.4 MLI's Capital Position at 31 December 2016

Figure 1 illustrates MLI's key capital metrics. MLI's Capital Resources consist predominately of Common Equity Tier 1 ("CET1") capital and MLI continues to maintain capital ratios and resources significantly in excess of its minimum requirement.

Figure 1. Summary of MLI's Key Metrics as at 31 December 2016




Note: All of MLI's Tier 1 capital is CET1, therefore CET1 Capital Ratio and Tier 1 Capital ratio are the same.

## 1.2 Basis of Preparation

The information contained in these Pillar 3 disclosures has been prepared in accordance with the Basel III rule framework, for the purpose of explaining the basis on which the Group and MLI have prepared and disclosed certain information about the management of risks and application of regulatory capital adequacy rules and concepts. It therefore does not constitute any form of financial statement on MLUKCH or its subsidiaries, or of the wider Enterprise, and as such, is not required to be prepared in accordance with International Financial Reporting Standards ("IFRS") or Financial Reporting Standard 101 'Reduced Disclosure Framework' ("FRS 101"). Therefore the information is not directly comparable with annual financial statements and the disclosure is not required to be audited by external auditors.

In addition, the report does not constitute any form of contemporary or forward looking record or opinion on the Group, the Company or the Enterprise. Although the Pillar 3 disclosure is intended to provide transparent information on a common basis, the information contained in this document may not be directly comparable with the information provided by other banks.

The basis of consolidation for the Group used for prudential purposes is the same as the consolidation used for accounting purposes. Figures for the Group are presented on a consolidated basis. Figures for MLI are presented on a solo basis. Certain comparatives have been re-presented to be consistent with current year disclosures.

This Pillar 3 disclosure is published on BAC's corporate website: http://investor.bankofamerica.com

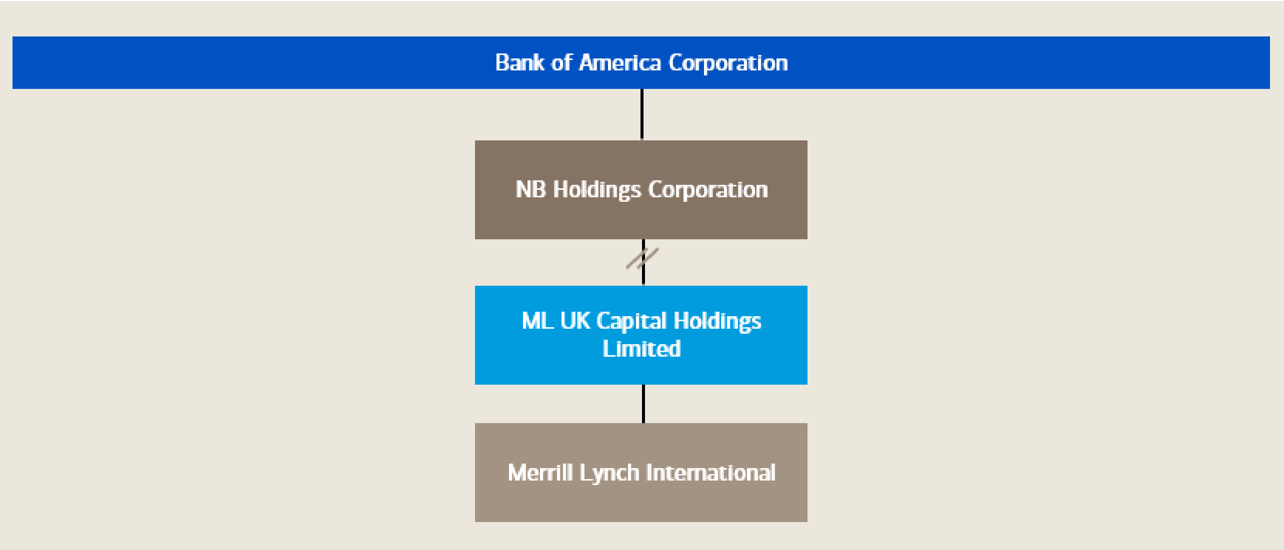
## 1.3 Operation, Structure and Organisation

MLI has a key role within the wider BAC group, by providing non-US market access for Global Banking and Global Markets clients. MLI is BAC's primary non-bank Global Markets trading entity in Europe, Middle East and Africa ("EMEA").

The principal activities of the entity are to provide a wide range of financial services globally for business originated in EMEA, Asia Pacific and the Americas, to act as a broker and dealer in financial instruments and to provide corporate finance advisory services. The entity also provides a number of post trade related services including settlement and clearing services to third party clients.

For a full BAC organisation chart, please refer to the investor relations website at http://investor.bankofamerica.com

Figure 2. High Level Ownership Chart




// represents indirect ownership relationship

# 2. Capital Resources and Minimum Capital Requirement

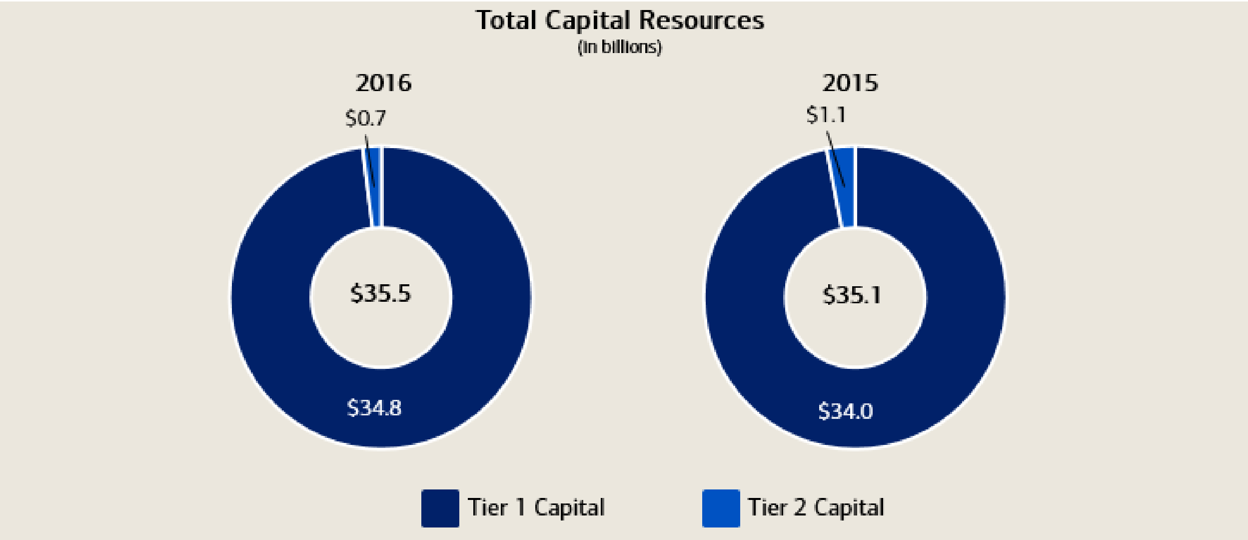
## 2.1 Capital Resources

### 2.1.1 Summary of 2016 Capital Resources

Capital resources represent the amount of regulatory capital available to an entity in order to cover all risks. Defined under CRD IV, capital resources are designated into two tiers, Tier 1 and Tier 2. Tier 1 capital consists of CET1 and Additional Tier 1 ("AT1"). CET1 is the highest quality of capital and typically represents equity and audited reserves; AT1 usually represents contingent convertible bonds; Tier 2 capital typically consists of subordinated debt and hybrid debt capital instruments.

Tier 1 capital is the primary component of MLI and the Group's Capital Resources. All of MLI and the Group's Tier 1 capital is made up of CET1.

Figure 3. Summary of MLI's Capital Resources



### 2.1.2 Key Movements in 2016

MLI's Capital Resources increased year-on-year from $35.1bn in 2015 to $35.5bn in 2016.

The increase was primarily due to an increase in Tier 1 capital due to the inclusion of current year audited earnings offset by the reduction in Tier 2 Capital driven by amortisation and foreign exchange movements. Additionally, Tier 1 Capital of the Group was also impacted by the recognition of a non-controlling interest following a change in the ownership structure of MLI. Following this change, all controlling interests in MLI continue to be owned entirely within the BAC group.

Table 1 shows a breakdown of the capital resources of MLI and the Group.

Table 1. Capital Resources

| | MLI | | MLUKCH Group | |
|---|---|---|---|---|
| *(Dollars in Millions)* | 2016 | 2015 | 2016 | 2015 |
| Ordinary Share Capital | **7,933** | 7,933 | **2,926** | 2,926 |
| Share Premium | **4,499** | 4,499 | **-** | - |
| Capital Contribution | **9,193** | 9,193 | **745** | 745 |
| Profit and Loss Account [1] [2] | **13,917** | 13,096 | **30,226** | 29,811 |
| Non-Controlling Interest | **-** | - | **243** | - |
| Total Tier 1 Capital Before Deductions | **35,542** | 34,721 | **34,140** | 33,482 |
| Deferred Tax Asset | **(448)** | (351) | **(448)** | (351) |
| Defined Benefit Pension Fund Asset (net of associated deferred tax liability) | **(315)** | (358) | **(315)** | (358) |
| **Tier 1 Capital** | **34,779** | 34,012 | **33,377** | 32,773 |
| Total Tier 2 Capital Before Deductions | **703** | 1,070 | **1,743** | 2,233 |
| **Tier 2 Capital** | **703** | 1,070 | **1,743** | 2,233 |
| **Total Capital Resources (net of deductions)** | **35,482** | 35,082 | **35,120** | 35,006 |

[1] Profit and loss account is shown here on a regulatory basis. See table 24 for a reconciliation to accounting balance sheet.
[2] Profit and loss account reflects the inclusion of 2016 audited retained earnings.

### 2.1.3 Transferability of Capital within the Group

Capital Resources are satisfied by sourcing capital either directly from BAC or from other affiliates. There are no material, current or foreseen, practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities, subject to applicable regulatory requirements.

## 2.2 Minimum Total Capital Requirement

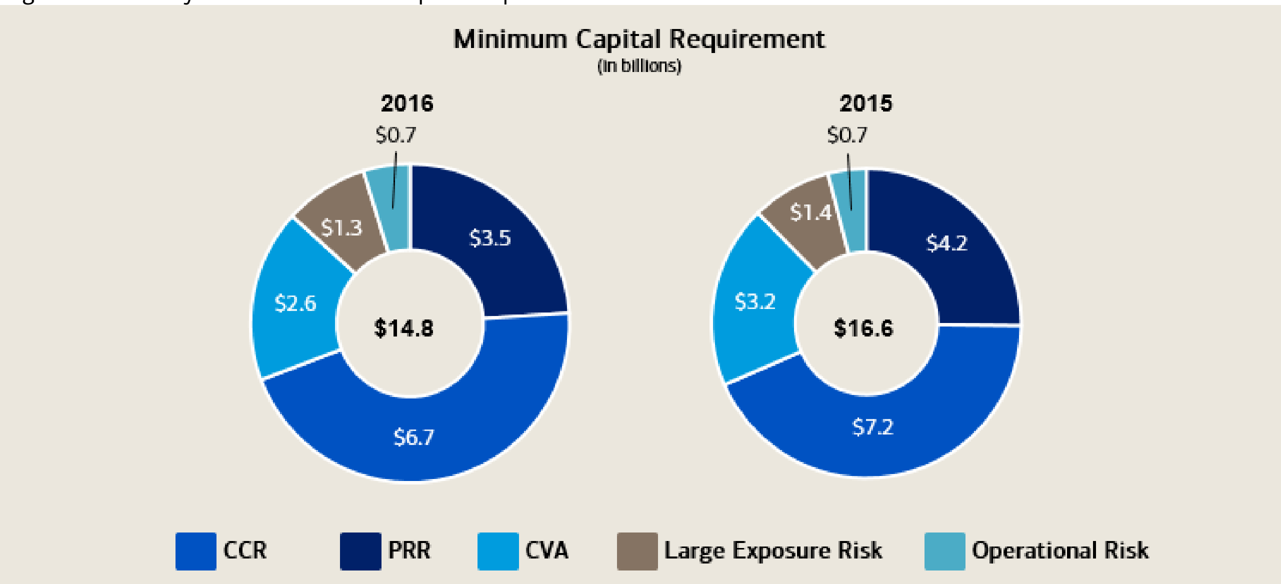
### 2.2.1 Summary of 2016 Capital Requirement

The Minimum Capital Requirement is the amount of Pillar 1 capital that the CRR requires the Company and the Group to hold at all times. Both the Company and the Group's total Capital Resources must be greater than the Minimum Capital Requirement, allowing for a capital excess to cover any additional obligations, for example, Pillar 2 capital requirements.

The Minimum Capital Requirement comprises of Counterparty and Credit Risk ("CCR"), Market Position Risk Requirement ("PRR"), Large Exposure Risk, Operational Risk and Credit Valuation Adjustment ("CVA") requirements.

MLI has a Minimum Capital Requirement of $14.8bn (2015: $16.6bn) comprising of the risk requirements outlined in Figure 4.

Figure 4. Summary of MLI's Minimum Capital Requirement



### 2.2.2 Key Movements in 2016

MLI's minimum capital requirement decreased year-on-year from $16.6bn to $14.8bn.

The decrease was primarily driven by reductions in the CCR and CVA capital requirements mainly due to a significant reduction in the volume of inter-affiliate trades booked in MLI over the course of the year. PRR internal model based capital requirement also decreased in the year due to a reduction in stressed VaR capital requirement.

Table 2 shows a breakdown of the Minimum Capital Requirement of MLI and the Group.

Table 2. Minimum Capital Requirement

| | MLI | | MLUKCH Group | |
|---|---|---|---|---|
| *(Dollars in Millions)* | 2016 | 2015 | 2016 | 2015 |
| VaR | 362 | 365 | 362 | 365 |
| Stressed VaR | 911 | 1,419 | 911 | 1,419 |
| Incremental risk charge | 427 | 435 | 427 | 435 |
| Comprehensive risk measure | 317 | 238 | 317 | 238 |
| **PRR: Internal Model Based Capital Requirement** | **2,017** | 2,457 | **2,017** | 2,457 |
| PRR on Traded Debt Instruments [1] | 906 | 928 | 913 | 934 |
| Equity PRR | 246 | 188 | 292 | 229 |
| Commodity PRR | 197 | 477 | 197 | 477 |
| Foreign Exchange PRR | 125 | 112 | 120 | 106 |
| **PRR: Capital Requirement under Standardised Approaches** | **1,474** | 1,705 | **1,522** | 1,746 |
| **Total Market Risk (PRR)** | **3,491** | 4,162 | **3,539** | 4,203 |
| Counterparty Risk | **6,018** | 6,736 | **6,019** | 6,737 |
| Credit Risk | **664** | 483 | **663** | 537 |
| **Counterparty and Credit Risk (CCR)** | **6,682** | 7,219 | **6,682** | 7,274 |
| **Credit Valuation Adjustment (CVA)** | **2,587** | 3,186 | **2,587** | 3,186 |
| **Large Exposure Risk** | **1,289** | 1,365 | **1,256** | 1,391 |
| **Operational Risk** | **782** | 666 | **782** | 666 |
| **Total Minimum Capital Requirement** | **14,831** | 16,598 | **14,846** | 16,720 |

[1] PRR on traded debt instruments includes $227m of securitisation exposures.

### 2.2.3 Minimum Capital Requirement Approach

Within the Group, MLI has adopted the standardised approach for calculating Counterparty Risk, Credit Risk and Operational Risk Capital Requirements. In order to adhere to the standardised rules in CRD IV, MLI uses external ratings from External Credit Assessment Institutions ("ECAIs") based on a combination of Moody's Investors Service, Inc. ("Moody's"), Standard and Poors ("S&P") and Fitch Ratings, Inc ("Fitch").

MLI's approach for Market Risk is a combination of models approved by the PRA, including Value at Risk ("VaR") and the standardised approach. The Group applies the standardised approach to all other exposures.

## 2.3 Capital Resources vs. Minimum Capital Requirement and Tier 1 Capital Ratio

### 2.3.1 Capital Resources vs. Minimum Capital Requirement

Table 3 outlines that MLI and the Group's Total Capital Resources are significantly in excess of the Pillar 1 Total Minimum Capital Requirement.

MLI's capital resources in excess of its minimum capital requirements have increased from $18.5bn to $20.7bn.

The Group's capital resources in excess of its minimum capital requirements are $20.3bn as at 31 December 2016.

Capital Resources and Minimum Capital Requirement for MLI are monitored and analysed on a daily basis. Both MLI and the Group continuously maintain a surplus over the Minimum Capital Requirement.

### 2.3.2 Tier 1 ratio

An entity's Tier 1 ratio is the ratio of Tier 1 Capital to Risk Weighted Assets ("RWA"). RWA has decreased in 2016, primarily driven by reductions in the CCR and CVA capital requirements mainly due to a significant reduction in the volume of inter-affiliate trades booked in MLI over the course of the year. As well as a reduction in RWA, Tier 1 capital increased during the year due to the inclusion of current year audited earnings.

Following on from the changes outlined above MLI's Tier 1 ratio has increased year-on-year from 16.4% to 18.8%.

The Group's Tier 1 ratio is 18.0% as at 31 December 2016.

Table 3. Capital Surplus over Minimum Capital Requirement and Tier 1 Ratio

| | MLI | | MLUKCH Group | |
|---|---|---|---|---|
| *(Dollars in Millions)* | 2016 | 2015 | 2016 | 2015 |
| Total Capital Resources | **35,482** | 35,082 | **35,121** | 35,006 |
| Total Minimum Capital Requirement | **14,831** | 16,598 | **14,846** | 16,720 |
| **Surplus over Requirement** | **20,651** | 18,484 | **20,275** | 18,287 |
| Tier 1 Capital Resources | **34,779** | 34,012 | **33,378** | 32,773 |
| Risk Weighted Assets | **185,366** | 207,486 | **185,562** | 208,994 |
| **Tier 1 Capital Ratio** | **18.8%** | 16.4% | **18.0%** | 15.7% |

## 2.4. Leverage Ratio

### 2.4.1 Summary

The leverage ratio is a measure of Tier 1 capital as a percentage of exposure as defined under the CRR rules.

The requirement for the calculation and reporting of leverage ratios was introduced as part of CRD IV in 2014, and amended by the European Commission Delegated Act (EU) 2015/62 in 2015.

CRD IV legislation allows for the calculation of a transitional leverage ratio, permitting various adjustments to Tier 1 capital in the years leading to 2018. However the PRA, as local regulator, require transitional Tier 1 capital to be calculated on a fully phased-in basis. Therefore, the transitional and fully phased-in leverage ratios are computed in the same manner.

CRD IV does not currently include a minimum Leverage Ratio requirement. In November 2016 the European Commission published a legislative proposal to amend various elements of CRD IV, which included a binding minimum Leverage Ratio requirement of 3%, as well as a number of changes to the calculation of the exposure measure. Based on the draft text of the proposal, it is currently expected that these amendments will become effective on 1 January 2021. MLI and the Group's leverage ratios are in excess of the proposed minimum at 8.8% and 8.6% respectively.

Table 4. Transitional and Fully Phased-In Leverage Ratio

| | MLI | | MLUKCH Group | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Transitional and Fully Phased-In Leverage Ratio | 8.8% | 8.6% | 8.6% | 8.3% |

### 2.4.2 Key Movements in 2016

The Company and the Group's leverage ratios both increased during the year, primarily due to the increase in Tier 1 capital following the inclusion of current year audited earnings.

# 3. Liquidity Position and Encumbered and Unencumbered Assets

## 3.1 Liquidity Position

### 3.1.1 Regulatory Requirement

The MLUKCH Group is subject to Basel III liquidity reporting requirements legislated by CRD IV and the CRR.

The MLUKCH Group is subject to the Liquidity Coverage Ratio ("LCR"), which requires the Group to hold a sufficient buffer of eligible High Quality Liquid Assets ("HQLA") to cover potential cash outflows during the first 30 days of a liquidity stress event.

### 3.1.2 Liquidity Position

As of 31 December 2016, MLI, as MLUKCH's sole operating subsidiary, was in compliance with its regulatory and internal liquidity requirements.

### 3.1.3 Funding Profile

MLUKCH does not issue debt to parties external to BAC and is not licensed to take deposits. The Group primarily funds its balance sheet through wholesale secured funding, capital and intercompany unsecured debt.

These funding sources are used to support the Group's trading and capital market activities and maintain sufficient excess liquidity.

## 3.2 Encumbered and Unencumbered Assets

An asset shall be treated as encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn.

Within the MLUKCH Group, encumbered assets primarily comprise of on/off balance sheet assets that are pledged as collateral against secured funding transactions; these include repurchase agreements, stock lending and collateral swaps. In addition, the Group's encumbered assets includes collateral posted against derivative contracts and securities covering shorts. Asset encumbrance is an integral part of the Group's secured funding and collateral management process. Corporate Treasury monitors the funding requirement / surplus and models the liquidity impact relating to these activities on an ongoing basis.

The business model of MLI, as the sole operating subsidiary in the Group and primary driver of asset encumbrance, has remained relatively stable over time with types of encumbered assets remaining consistent.

This asset encumbrance disclosure is prepared in accordance with both European Banking Authority ("EBA") guidelines and PRA disclosure guidelines. It is based on accounting information prepared in accordance with international accounting standards.

MLI, as the primary driver of asset encumbrance in the Group, primarily adopts standard collateral agreements and collateralises at appropriate levels based on industry standard contractual agreements (mostly Credit Support Annexes ("CSA") and Global Master Repurchase Agreements ("GMRAs")).

Table 5 outlines the carrying and fair value of certain assets of the Company and the Group split between those encumbered and unencumbered.

Table 5. Analysis of Assets [(1)]

| MLI | 2016 | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Carrying Amount of Encumbered Assets | Fair Value of Encumbered Assets | Carrying Amount of Unencumbered Assets | Fair Value of Unencumbered Assets |
| **Assets of the Company** [(2)] | **65,729** | | **446,266** | |
| Equity Instruments | 24,646 | 24,646 | 7,695 | 7,695 |
| Debt Securities | 14,464 | 14,464 | 10,880 | 10,880 |
| Other Assets [(3)] | - | | 325,389 | |

| | 2015 | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Carrying Amount of Encumbered Assets | Fair Value of Encumbered Assets | Carrying Amount of Unencumbered Assets | Fair Value of Unencumbered Assets |
| **Assets of the Company** [(2)] | **63,312** | | **490,428** | |
| Equity Instruments | 17,156 | 17,156 | 19,668 | 19,668 |
| Debt Securities | 14,575 | 14,575 | 14,443 | 14,443 |
| Other Assets [(3)] | - | | 345,150 | |

| MLUKCH Group | 2016 | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Carrying Amount of Encumbered Assets | Fair Value of Encumbered Assets | Carrying Amount of Unencumbered Assets | Fair Value of Unencumbered Assets |
| **Assets of the Group** [(2)] | **65,729** | | **442,107** | |
| Equity Instruments | 24,646 | 24,646 | 7,695 | 7,695 |
| Debt Securities | 14,464 | 14,464 | 10,880 | 10,880 |
| Other Assets [(3)] | - | | 325,489 | |

| | 2015 | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Carrying Amount of Encumbered Assets | Fair Value of Encumbered Assets | Carrying Amount of Unencumbered Assets | Fair Value of Unencumbered Assets |
| **Assets of the Group** [(2)] | **64,254** | | **393,114** | |
| Equity Instruments | 27,567 | 27,567 | 9,907 | 9,907 |
| Debt Securities | 11,968 | 11,968 | 11,126 | 11,126 |
| Other Assets [(3)] | - | | 281,871 | |

[(1)] Greyed out cell format stems from EBA asset encumbrance template, indicating not applicable disclosures. As a result of the Group's broker-dealer activity, fair value equals carrying value for securities.
[(2)] Equity Instruments, Debt Securities and Other Assets are a subset of Assets of the Company / Group and may not be equal to the total on the "Assets of the Company / Group" lines. Remaining assets primarily relate to cash pledges on derivative contracts and loans & advances.
[(3)] The majority of unencumbered Other Assets relates to derivative assets not available for encumbrance.

Table 6 provides detail on both the fair value of encumbered collateral received and collateral received that is available for encumbrance. As defined by the EBA, no "Other Collateral" or "Own Debt Securities other than own Covered Bonds or Asset-Backed Securities ("ABS")" have been received as collateral.

Table 6. Analysis of Collateral Received

| | MLI | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| *(Dollars in Millions)* | Fair Value of Encumbered Collateral Received or Own Debt Securities Issued | Fair Value of Collateral Received or Own Debt Securities Issued Available for Encumbrance | Fair Value of Encumbered Collateral Received or Own Debt Securities Issued | Fair Value of Collateral Received or Own Debt Securities Issued Available for Encumbrance |
| **Collateral Received by the Company [(1)]** | **178,455** | **56,139** | **161,162** | **55,581** |
| Equity Instruments | 50,999 | 10,167 | 30,189 | 5,236 |
| Debt Securities | 126,120 | 14,485 | 126,721 | 20,935 |

| | MLUKCH Group | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| *(Dollars in Millions)* | Fair Value of Encumbered Collateral Received or Own Debt Securities Issued | Fair Value of Collateral Received or Own Debt Securities Issued Available for Encumbrance | Fair Value of Encumbered Collateral Received or Own Debt Securities Issued | Fair Value of Collateral Received or Own Debt Securities Issued Available for Encumbrance |
| **Collateral Received by the Group [(1)]** | **178,455** | **56,139** | **161,435** | **50,886** |
| Equity Instruments | 50,999 | 10,167 | 32,184 | 1,711 |
| Debt Securities | 126,120 | 14,485 | 129,251 | 19,399 |

[(1)] Equity Instruments and Debt Securities are a subset of Collateral Received by the Company / Group and may not be equal to the total on the "Collateral Received by the Company / Group" line.

Table 7 outlines the value of liabilities against which assets have been encumbered and the respective asset values.

Table 7. Encumbered Assets / Collateral Received and Associated Liabilities

| | MLI | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| *(Dollars in Millions)* | Matching Liabilities, Contingent Liabilities or Securities Lent | Assets, Collateral Received and Own Debt Securities Issued other than Covered Bonds and ABSs Encumbered | Matching Liabilities, Contingent Liabilities or Securities Lent | Assets, Collateral Received and Own Debt Securities Issued other than Covered Bonds and ABSs Encumbered |
| **Carrying Amount** | **147,884** | **150,133** | **135,833** | **144,230** |

| | MLUKCH Group | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| *(Dollars in Millions)* | Matching Liabilities, Contingent Liabilities or Securities Lent | Assets, Collateral Received and Own Debt Securities Issued other than Covered Bonds and ABSs Encumbered | Matching Liabilities, Contingent Liabilities or Securities Lent | Assets, Collateral Received and Own Debt Securities Issued other than Covered Bonds and ABSs Encumbered |
| **Carrying Amount** | **147,884** | **150,133** | **132,822** | **142,116** |

# 4. Risk Management, Objectives and Policy

## 4.1 BAC Risk Framework

BAC has established a risk governance framework (the "Risk Framework") which serves as the foundation for consistent and effective management of risks facing BAC and its subsidiaries. BAC adopted the 2017 Risk Framework in December 2016. The key enhancements from the 2016 Risk Framework include the incorporation of the responsible growth strategy and updates to various definitions, and organisation and governance structures.

The MLUKCH Group, including the sole operating subsidiary MLI, is integrated into and adheres to the global management structure including risk management and oversight, as adapted to reflect local business, legal and regulatory requirements. The Board of MLI adopted the BAC 2017 Risk Framework in February 2017.

The following section lays out the risk management approach and key risk types for the MLUKCH Group.

## 4.2 Risk Management Approach

Risk is inherent in all business activities. Managing risk well is the responsibility of every employee. Sound risk management enables the Group to serve the customers and deliver for the BAC shareholders. If not managed well, risks can result in financial loss, regulatory sanctions and penalties, and damage to the Group's reputation, each of which may adversely impact the Group's ability to execute its business strategies. Managing risk well is fundamental to delivering on the Enterprise's strategy for responsible growth.

The Risk Framework applies to all employees. It provides an understanding of the Group's approach to risk management and each employee's responsibilities for managing risk. All employees must take ownership for managing risk well and are accountable for identifying, escalating and debating risks facing the Group. The Risk Framework sets forth roles and responsibilities for the management of risk by front line units, independent risk management, other control functions and Corporate Audit. The following are the five components of the Group's risk management approach:

- Culture of managing risk well
- Risk appetite and risk limits
- Risk management processes
- Risk data management, aggregation and reporting
- Risk governance

Focusing on these five components allows effective management of risks across the seven key risk types faced by the Group's businesses, namely: Strategic, Credit, Market, Liquidity, Operational, Compliance and Reputational risks.

### 4.2.1 Culture of Managing Risk Well

A culture of managing risk well is fundamental to the Group's core values and operating principles. It requires focus on risk in all activities and encourages the necessary mindset and behaviour to enable effective risk management and promote sound risk-taking within the Group's risk appetite. Sustaining a culture of managing risk well throughout the organisation is critical to the success of the Group and is a clear expectation of the Group's executive management team and its Board of Directors.

The following principles form the foundation of the Group's culture of managing risk well:

1. Managing risk well protects the Group and its reputation and enables the Group to deliver on its purpose and strategy.
2. The Group treats customers fairly and acts with integrity to support the long-term interests of its employees, customers and shareholders. The Group understands that improper conduct, behaviour or practices by the Group, its employees or representatives could harm the Group, the shareholders or customers, or damage the integrity of the financial markets.
3. Individual accountability and an ownership mindset are the cornerstones of the Enterprise Code of Conduct and are at the heart of the Group's culture
4. All employees are responsible for proactively managing risk as part of their day-to-day activities through prompt identification, escalation and debate of risks
5. While the Group employs models and methods to assess risk and better inform the Group's decisions, proactive debate and a thorough challenge process lead to the best outcomes
6. Lines of business and other front line units are first and foremost responsible for managing all aspects of their businesses, including all types of risk
7. Independent risk management provides independent oversight and effective challenge, while Corporate Audit provides independent assessment and validation
8. The Group strives to be best-in-class by continually working to improve risk management practices and capabilities

### 4.2.2 Risk Profile and Appetite

**Risk Profile:**

MLI, MLUKCH's sole operating subsidiary, is BAC's largest operating subsidiary outside the US and serves the core financial needs of global corporations and institutional investors.

The MLUKCH Group's risk profile reflects the principal activities of MLI which are to provide a wide range of financial services globally for business originated in EMEA, Asia Pacific and the Americas, to act as a broker and dealer in financial instruments and to provide corporate finance advisory services. The entity also provides a number of post trade related services including settlement and clearing services to third party clients.

As at 31 December 2016, the Group's total assets prepared in accordance with FRS 101 totalled $412bn, and for MLI standalone $417bn, and comprised principally of derivative assets, equities, fixed income securities and sale and repurchase transaction positions. 26% of balances are with affiliated companies (MLI: 27%). As at 31 December 2016 the Group has $35.1bn of regulatory Capital Resources (MLI: $35.5bn), mainly consisting of CET1 capital $33.4bn (MLI: $34.8bn). The Group has a Tier 1 capital ratio of 18% (MLI: 18.8%).

Consistent with the business strategy, the Group's and the Company's largest Counterparty and Credit Risk industry sectors based on regulatory capital exposures are banks 30%, clearing houses 17% and broker-dealers 17%. 59% of the Group's Counterparty and Credit Risk requirement is based on exposures within the EMEA region and 64% of Counterparty and Credit Risk related exposures mature in less than 1 year. The Group has over 45% of exposures with counterparties externally rated between AAA and A-. Although generally assessed internally as being of high quality, 48% of exposure in the Group is to counterparties not rated by external rating agencies. Credit risk is assessed as outlined at section 4.3.

Market risk for the Group is generated by the activities in the interest rate, foreign exchange, credit, equity and commodities markets. In addition, the values of asset and liabilities could change due to market liquidity, correlations across markets and expectations of market volatility. Average regulatory VaR for MLI during 2016 was $54m.

MLI maintains excess liquidity in order to meet day to day funding requirements, withstand a range of liquidity shocks, safeguard against potential stress events, and meet internal and regulatory requirements.

**Risk Appetite:**

The Risk Appetite Statement ("RAS"), established for MLI as the sole operating subsidiary, collectively defines the aggregate level and types of risk MLI is willing to accept in order to achieve its business objectives. It is designed with the objective of ensuring that it is comprehensive for all key risks, relevant to the MLI business and aligned with the risk management practices of the Group. The RAS is reviewed and approved by the MLI Board at least annually.

MLI's risk appetite is designed to be consistent with the aggregate risk appetite at the BAC level and includes the following key elements:

1. Comprehensive RAS with both quantitative limits and qualitative statements
2. Integrated with capital, strategic and risk planning
3. Limits baseline and stressed operating conditions
4. Effective controls and robust governance with risk review and approval

The RAS covers the seven key risk types as defined in the Risk Framework. There are detailed qualitative statements for all of the key risk types within the Risk Framework including a suite of metrics for the following risks:

- Credit Risk: Forward looking stress and baseline metrics in addition to concentration limits aligned to credit quality using internal risk rating, geography and industry
- Market Risk: Metrics relating to trading VaR and stress loss
- Operational Risk: Metrics covering losses incurred and an aggregate assessment as described in the Risk Self-Assessment ("RSA")
- Liquidity Risk: Metrics relating to key liquidity coverage ratios

Additionally, there is also a capital trigger in the MLI RAS which complements the metrics detailed above. Collectively, they ensure that MLI and therefore the Group maintains an acceptable risk profile that is aligned with its capital resources and strategic plan.

The performance against the MLI risk appetite is reviewed on a monthly basis by the MLI Risk Management Committee ("RMC"). Limits are monitored by front line units and risk management on a more frequent basis. Performance is also reported to the MLI Board Risk Committee ("BRC") and provided to the MLI Board on a quarterly basis.

### 4.2.3 Risk Management Processes

The Risk Framework requires that strong risk management practices are integrated in key strategic, capital and financial planning processes and day-to-day business processes across the Group, thereby ensuring risks are appropriately considered, evaluated and responded to in a timely manner.

The Group's approach to Risk Management Processes:

- All employees are responsible for proactively managing risk
- Risk considerations are part of all daily activities and decision-making
- The Group encourages a thorough challenge process and maintains processes to identify, escalate and debate risks
- The Group utilizes timely and effective escalation mechanisms for risk limit breaches

The front line units have primary responsibility for managing risks inherent in their businesses. The Group employs an effective risk management process, referred to as Identify, Measure, Monitor and Control (IMMC) as part of its daily activities.

### 4.2.4 Risk Data Management, Aggregation and Reporting

Effective risk data management, aggregation and reporting is critical to provide a clear understanding of current and emerging risks and enables the Group to proactively and effectively manage risk.

Risk Data Management, and Reporting Principles:

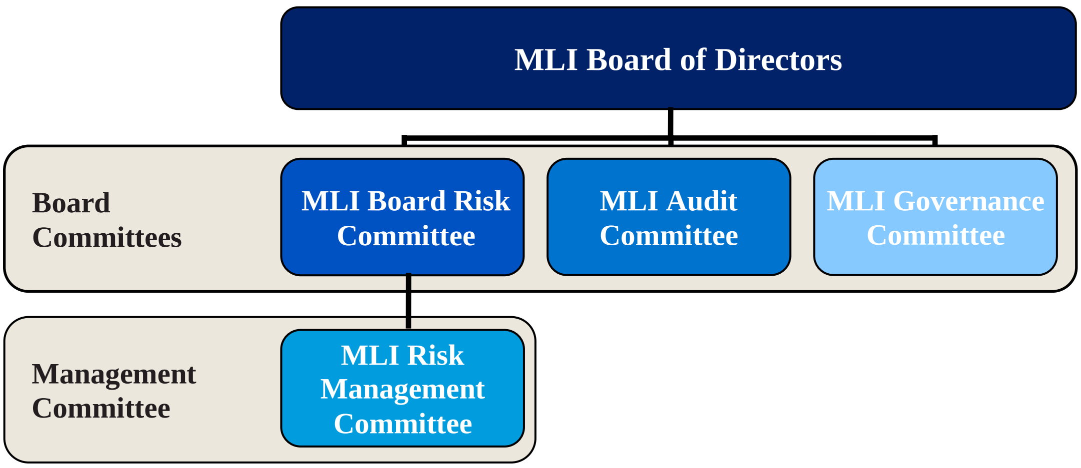
- Complete, accurate, reliable and timely data
- Clear and uniform language to articulate risks consistently across the Group
- Robust risk quantification methods
- Timely, accurate and comprehensive view of all material risks, including appropriate levels of disaggregation

### 4.2.5 Risk Governance

The MLUKCH Board is responsible for oversight of adequate risk management and controls for the Group. The principal activity of MLUKCH is to act as a holding company for MLI, the sole operating subsidiary in the Group. MLUKCH is not itself a risk taking entity and the risk in the Group is booked in MLI, where the business is managed. As a result, the majority of the risk governance for the Group is conducted at MLI, where that risk is incurred.

The MLI Board ensures suitable risk management and controls through the BRC, the MLI Audit Committee, the MLI Governance Committee and the RMC.

Figure 5. MLI Risk Governance Structure






Section 4: Risk Management, Objectives and Policy

The MLI BRC assists the MLI Board in fulfilling its oversight responsibility relating to senior management's responsibilities regarding the identification of, management of, and planning for market risk, credit risk, liquidity risk, operational risk and reputational risk. The MLI BRC met five times during 2016.

The MLI RMC reports to the MLI BRC and is responsible for providing management oversight and approval of (or reviewing and recommending to the MLI BRC, the MLI Board or other committees, as appropriate) market risk, credit risk, operational risk, balance sheet, capital, liquidity management and stress testing activities. The MLI RMC met fourteen times during 2016.

The MLI Audit Committee assists the MLI Board in fulfilling its oversight responsibilities relating to MLI's internal financial controls, the preparation and integrity of MLI's financial statements, MLI's relationship with its external auditor, and the performance and independence of MLI's Internal Audit and Compliance functions. The MLI Audit Committee met six times during 2016.

**MLI Director Selection and Diversity Policy**

The Governance Committee of the MLI Board (the "Governance Committee") assists the MLI Board in fulfilling its oversight of compliance with remuneration policies and regulatory requirements and nominates for the MLI Board's approval candidates to fill Board vacancies. The MLI Governance Committee acts as the nomination committee and the remuneration committee of the MLI Board. The MLI Governance Committee met 6 times during 2016.

Before any appointment is made by the MLI Board, the MLI Governance Committee is responsible for evaluating the balance of skills, knowledge, experience and diversity on the Board, and, in light of this evaluation, preparing a description of the role and capabilities required for a particular appointment. Pursuant to the terms of the charter for the MLI Governance Committee, in identifying suitable candidates the MLI Governance Committee shall consider candidates from a wide range of backgrounds and consider candidates on merit and against objective criteria and with due regard for the benefits of diversity on the MLI Board, including gender representation, taking care that appointees have sufficient time available to devote to the position.

In addition, pursuant to the terms of its charter, the MLI Governance Committee is responsible for deciding on a target for the representation of the underrepresented gender on the MLI Board and how to meet it (as required).

**MLUKCH Director Selection and Diversity Policy**

Members of the MLUKCH Board, along with representatives from HR, Subsidiary Corporate Governance and Legal, are responsible for identifying and approving Board candidates to fill its Board vacancies as and when they arise.

The MLUKCH Board considers candidates from a wide range of backgrounds and considers candidates on merit and against objective criteria and with due regard for the benefits of diversity on the Board, including gender representation, taking care that appointees have sufficient time available to devote to the position.

**General**

All appointments to both the MLI Board and the MLUKCH Board are made in compliance with Bank of America's Background Check Policy and are subject to successful completion of the following background checks: Identification, Credit, Criminal, Global Sanctions, Media, Directorship, Employment and Education checks, as required. In addition, executive directors and board and committee chairs appointed to the MLI Board require regulatory pre-approval in line with the PRA and FCA's requirements under the Senior Managers Regime.

Board member experience is detailed within individual director biographies (Appendix I).

The independent risk management functions within the EMEA region led by the EMEA Chief Risk Officer ("EMEA CRO") have operational responsibility for risk management of MLI and ensuring appropriate reporting and escalation to the MLI Board.

The MLUKCH Board confirms that the risk management arrangements of the Group outlined are adequate to facilitate the management of risk in the context of the Group's profile and strategy.

## 4.3 Key Risk Types

The risk management processes outlined above allow the Group, through the sole operating subsidiary, MLI, to manage risks across the seven key risk types: Strategic, Credit, Market, Liquidity, Operational, Compliance and Reputational. Details of how risk is managed within MLI are given below:

### Strategic Risk

#### Definition

Strategic Risk is the risk resulting from incorrect assumptions about external and/or internal factors, inappropriate business plans (e.g. too aggressive, wrong focus, ambiguous), ineffective business strategy execution, or failure to respond in a timely manner to changes in the regulatory, macroeconomic or competitive environments, in the geographic locations in which MLI operates (such as competitor actions, changing customer preferences, product obsolescence, and technology developments).

#### Strategic Risk Management

Strategic Risk is managed through the assessment of effective delivery of strategy. Strategic Risk is monitored continuously by the executive management team through a number of existing processes ranging from monitoring of financial and operating performance, through to the management of recovery and resolution plans and also with the regular assessment of earnings and risk profile throughout the year. The executive management team provides the BAC Board with reports on progress in meeting the strategic plan, as well as whether timelines and objectives are being met and if additional or alternative actions need to be implemented.

Regional and MLI strategy execution and risk management are aligned to the overall BAC strategic plans through a formal planning and approval process. The strategic plans are set within the context of overall risk appetite and the strategic planning process includes an evaluation of the internal and external environment and BAC's strengths, weaknesses, opportunities and threats. During the planning process, the BAC Board provides credible challenge to management's assumptions and recommendations, and approves the strategic plans after a comprehensive assessment of the risks.

Management routines play an important role in developing strategic recommendations for committees, regional and executive management. Specific thematic focused presentations are made to the BAC Board as necessary to address any developments or additional considerations as it relates to strategic planning or the strategic plan itself.

Strategic Risk is embedded in every business and, to some extent, is part of the other major risk types (Credit, Market, Liquidity, Operational, Compliance and Reputational Risk).

#### Strategic Risk Governance

The BAC Board is responsible for overseeing the strategic planning process and management's implementation of the resulting strategic plan. BAC's strategic plan is reviewed and approved annually by the BAC Board in consideration of the capital plan, financial operating plan, liquidity requirements and risk appetite. Significant strategic actions, such as capital actions, material acquisitions or divestitures, and recovery and resolution plans are reviewed and approved by the BAC board as required. Strategic planning at BAC level is representative of more detailed planning undertaken at the business unit, regional and MLI level.

At the business unit, regional and MLI level, strategic planning processes are consistent with each other and their output is incorporated as part of the BAC planning process. The MLI strategy is reviewed and signed-off by the MLI Board on an annual basis. Strategic decisions relating to MLI are presented and discussed at the BRC and Board. Routines exist to discuss the Strategic Risk implications of new, expanded, or modified businesses, products or services and other strategic initiatives, and to provide formal review and approval where appropriate. Independent risk management, Corporate Audit and other control functions provide input, challenge and oversight to front line unit and regional level strategic plans and initiatives. Corporate Audit reviews the strategic plan and provides feedback to regional management, the MLI Board and the BAC Board as necessary regarding the impact to the control environment.

## Strategic Risk (continued)

### Strategic Risk Reporting

Individual business units provide regular updates to both global and regional management on their business performance and management of strategic risk. Updates take into account analyses of performance relative to the strategic plan and risk appetite and performance relative to peers, the strength of capital and liquidity positions and stress tests, which address potential macroeconomic events, changing regulatory requirements and various market growth rate assumptions.

Focused regional performance updates are provided to executive leadership and the BAC board on a periodic basis. Entity performance updates are provided to the MLI Board.

## Credit Risk

### Definition

Credit risk is the risk of loss arising from the inability or failure of a borrower or counterparty to meet its obligations. MLI defines credit exposure to a borrower or counterparty as the loss potential arising from loans, leases, derivatives and other extensions of credit.

Credit risk is created when MLI commits to, or enters into, an agreement with a borrower or counterparty.

### Credit Risk Management

MLI manages credit risk to a borrower or counterparty based on its risk profile, which includes assessing repayment sources, underlying collateral (if any), and the expected effects of the current and forward-looking economic environment on the borrowers or counterparties. Underwriting, credit management and credit risk limits are proactively reassessed as a borrower's or counterparty's risk profile changes.

MLI uses a number of actions to mitigate losses, including increased frequency and intensity of portfolio monitoring for moderate to weak risk profiles, hedging, and transferring management of deteriorated commercial exposures to special asset officers.

Credit Risk management includes the following processes:

- Credit origination
- Portfolio management
- Loss mitigation activities

These processes create a comprehensive and consolidated view of the company's credit risks, thus providing executive management with the information required to guide or redirect front line units.

#### *Credit Origination*

As BAC's main investment firm outside of the US, MLI's credit strategy and origination is focused on its trading, securities and derivatives activities which account for the majority of its credit exposure.

Borrowers' credit risk profiles are assessed through risk modeling, underwriting and asset analysis, while considering current and forward-looking views on economic, industry and borrower outlooks to ensure portfolio asset quality within front line units remains within approved credit risk limits. New products and credit terms and conditions are differentiated based on risk, within the limits of risk appetite.

Credit Risk in MLI arises from its derivative and other trading activities and varies by type of transaction. The principal exposure measure for a traded product is potential exposure, which is the maximum amount of exposure on a derivative contract at a future date given a particular confidence level. Portfolio concentrations are monitored so decisions on credit risk appetite reflect the most accurate and timely understanding of the credit portfolio.

**Credit Risk (continued)**

***Portfolio Management***

Once credit has been extended, processes are in place to monitor credit risk exposure at both the individual borrower and portfolio levels. Key credit risk exposures are assessed under both normal and stress scenarios and credit risk is managed primarily through establishing and monitoring limits. Credit risk may be hedged to mitigate exposure and remain within credit risk appetite and return expectations.

Regular portfolio monitoring and reporting and business-specific governance routines, including periodic testing and examinations by Credit Review, which is part of Corporate Audit, enable detection of deteriorating credit trends, development of mitigation strategies and measurement of the effectiveness of actions taken. At the borrower and counterparty level, the risks inherent in ongoing financial performance are reviewed. At the portfolio level, aggregate losses, credit performance and concentrations in baseline and potential stress scenarios are assessed.

As part of the portfolio management process, loss experience is evaluated compared to expected losses against established credit risk metrics for the entire credit portfolio, including obligor and facility rating distributions for the commercial portfolio. In addition, targeted and portfolio stress testing and scenario analysis are performed and reviewed.

***Loss Mitigation Activities***

When borrowers and counterparties do not fulfill their obligations steps are taken to mitigate and manage losses. Teams and stringent processes are in place to appropriately manage defaults.

Under Enterprise policy, MLI accepts collateral that it is permitted by documentation such as repurchase agreements or a Credit Support Annex ("CSA") to an International Swap Dealers Association Master Agreement ("ISDA"). For derivatives, required collateral levels may vary depending on the credit quality of the party posting collateral. Generally, collateral is accepted in the form of cash and high grade government securities. MLI nets collateral against the applicable derivative fair value where legally enforceable netting agreements are recognised. Daily valuations are carried out on market trading activities such as collateralized OTC derivatives and structured finance trades in support of margining requirements. All requests for non-standard collateral are approved through a committee process. Collateral Management report and escalate all fails to receive and deliver collateral to the appropriate persons.

Derivatives exposure will increasingly be routed through Central Counterparties in response to regulation changes being phased-in globally. Clearing of new eligible trades became mandatory under US Regulation in September 2016 with European Regulation to follow.

The taking of third party guarantees represents a further form of credit risk mitigation. Guarantees are reviewed by the legal department and must conform to certain standards in order to be recognised as mitigation for Credit Risk management purposes. The main types of provider of guarantees are banks, other financial institutions and corporates, the latter typically in support of subsidiaries of their company group.

**Credit Risk Governance**

MLI Credit Risk is integrated into the BAC and MLI governance structure as described earlier in the document. The Credit Risk governance structure enables a system of risk escalation, which includes the hierarchy and process to be followed for approvals, limit excesses, policy variances, and internally identified issues and emerging risks.

Independent risk management oversees credit risk management processes and governance in accordance with requirements and authority levels.

## Credit Risk (continued)

### Credit Risk Reporting

Transparency of Credit Risk is critical to effective risk management. To ensure appropriate transparency and escalation to BAC and MLI Boards and senior management, comprehensive and actionable credit risk reporting containing the required granularity of content for each level of seniority is produced.

Reporting includes monitoring of credit exposure against approved risk appetite limits, as well as more detailed credit information covering total outstanding volumes, key counterparty exposures, credit quality trends and concentration analyses.

## Market Risk

### Definition

Market risk is the risk that changes in market conditions may adversely impact the values of assets and or liabilities or otherwise negatively impact earnings.

Market risk is composed of price risk and interest rate risk:

Price risk: Trading positions within MLI are subject to various changes in market based risk factors. The majority of this risk is generated by the activities in interest rate, foreign exchange, equities, commodities and credit markets. In addition, the values of asset and liabilities could change due to market liquidity, correlations across markets and expectations of market volatility.

Interest rate risk: The risk to current or projected financial condition and resilience arising from movements in interest rates. Interest rate risk results from differences between the timing of rate changes and the timing of cash flows (re-pricing risk), from changing rate relationships among different yield curves affecting bank activities (basis risk), from changing rate relationships across the spectrum of maturities (yield curve risk), and from interest-related options embedded in bank products (options risk).

### Market Risk Management

At the asset and liability level, market risk is assessed by evaluating the impact of individual risk factors on individual exposures. At the legal entity level, price risk is assessed primarily through risk models, including VaR models. MLI's aggregate potential economic exposure, as well as earnings and capital sensitivity, to interest rate risk in the banking book is also assessed.

MLI has been granted permission by the PRA to use the Internal Model Approach ("IMA") for the following models in the calculation of own funds requirements for market risk: Value at Risk, Stressed VaR, Incremental Risk Charge and Comprehensive Risk Measure.

- VaR is a statistical measure specified according to a particular time horizon and confidence level. A single model is used consistently across the trading portfolios. VaR for regulatory capital calculations ("Regulatory VaR") is equivalent to a 99% confidence level, has a ten-day time horizon and uses 3 years of historic data.
- Stressed VaR ("Stressed VaR") for regulatory capital calculations is equivalent to a 99% confidence interval, has a ten-day overlapping holding period and uses a historical window that is calibrated to a continuous 12-month period that maximises the resulting VaR calculation for MLI. A scalar is applied to correct for autocorrelation introduced by the use of overlapping holding periods.
- VaR is also used for management reporting purposes ("Trading VaR"). Two measures are calculated: a version using 3-years of historic data and a version using a 1-year period. Both are equivalent to a 99% confidence level and a 1-day holding period.
- Although both Regulatory VaR and Trading VaR utilize the same process and methodology as well as the same historical data, they differ in population. Regulatory standards require that Regulatory VaR only include the in-scope trading book positions, while Trading VaR also includes out of scope trading book positions. The IMA Permission defines which products are included in the Regulatory VaR calculation for Equities, Rates, FX, Credit and Commodity businesses.

**Market Risk (continued)**

Incremental Risk Change ("IRC") and Comprehensive Risk Measures (CRM") are components of the regulatory calculation for Market Risk for Credit products.

- IRC estimates the potential losses, at a 99.9% confidence level, that non-securitised credit products in the trading portfolio might experience over a one-year period of financial stress from defaults, ratings migration and significant basis risk factors. To calculate the potential losses at the required 99.9 percent confidence level, the model utilizes a Monte-Carlo simulation calibrated using relevant, available historical data for each risk factor in order to sample potential market scenarios. The model reflects the impact of concentrated risks, including issuer, sector, region and product basis risks, and assigns a higher potential loss to a concentrated portfolio than a more diversified portfolio with a similar credit profile. The model framework also captures the broad relationships between the different risk factors and is flexible enough to allow additional dependencies or risk factors to be incorporated in the future. The IRC model assumes a constant position and a liquidity horizon of one year.
- CRM estimates the potential losses, at a 99.9% confidence level, that the correlation trading portfolio (primarily tranches on credit index and bespoke credit portfolios, with their corresponding hedges) might experience over a one-year period of financial stress. CRM is a model consistent with IRC, albeit with the inclusion of additional risk factors e.g. credit spread volatility, volatility of implied correlations, correlation basis. CRM is comprised of a modelled component and a surcharge for the eligible positions in the correlation trading portfolio, primarily tranches on index and bespoke portfolios, and their corresponding hedges. The modelled component of the CRM takes into account all of the risk factors that materially impact the value of the positions within the correlation trading portfolio. The model captures the complexity of these positions including the non-linear nature of the trade valuations, particularly during periods of market stress, and the impact of the joint evolution of the risk factors. The modelled component of the CRM utilizes the same Monte-Carlo simulation framework as the IRC model with the additional risk factors required for the correlation products in order to calculate the potential losses at the required 99.9 percent confidence level. The modelled component of the CRM, like the IRC model, assumes a constant position and a liquidity horizon of one year.

MLI identifies and assesses any risks that are not adequately captured by its models on at least a quarterly basis and holds additional own funds against those risks.

For positions with insufficient historical data for the VaR calculation, the process for establishing an appropriate proxy is based on fundamental and statistical analysis of the new product or less liquid position. This analysis identifies reasonable alternatives that replicate both the expected volatility and correlation to other market risk factors that the missing data would be expected to experience.

Interest rate risk arises in MLI's non-trading book from differences in re-pricing, rate and maturity characteristics between its assets and liabilities. Interest rate risk is measured as the potential change in net interest income or economic value of equity caused by movements in market interest rates.

MLI adheres to the Global Markets Market Risk Policy and the Global Markets Market Risk Limits Policy. The MLI Market Risk Policy Supplement specifies any additional local corporate governance, legal or regulatory requirements beyond those stated in the global policies and is approved by the Market Risk Management Committee.

MLI manages and monitors its market risk exposures in a way that reflects MLI's Risk Framework and aggregate risk tolerance. Assessing key exposures and setting and monitoring limits to ensure that MLI operates within the approved risk appetite are at the core of MLI's approach to managing market risk. Key market risk exposures at the aggregate and at the specific asset and liability level are assessed, both in normal and stressed scenarios.

**Market Risk (continued)**

Robust monitoring and reporting processes for limits are in place, with limit breaches triggering appropriate notification and escalation based on the severity of the breach as defined by magnitude or frequency. The RMC and BRC review and recommend RAS limits for approval to the MLI Board. MLI uses a variety of VaR, stress and sensitivity limits set at both a granular level – to ensure extensive coverage of risks – as well at business and legal entity level – to account for correlations among risk factors.

The effectiveness of the VaR methodology is evaluated and monitored through backtesting, which compares the daily VaR results, utilising a one-day holding period, against comparable trading revenue. A backtesting overshooting occurs when a trading loss exceeds the VaR for the corresponding day. These overshoots are evaluated to understand the positions and market moves that produced the trading loss in order to ensure that the VaR methodology accurately represents those losses. Exceptions at the legal-entity or business level, are documented and reported to the PRA, as appropriate, as part of regulatory reporting processes.

Stress testing and scenario analysis are performed to capture potential risk that may arise in severe but plausible events. These stress tests may be hypothetical or historical, and applied to individual instruments or the aggregate MLI portfolio. Markets Risk Management identifies points of weakness and concentrations in the MLI portfolio or where the entity holds positions that are illiquid or which could be exposed to particular extreme tail events. Stress scenarios may be specifically designed to target potential vulnerabilities that are not always easy to capture or model using VaR, or where there may be difficulty in hedging or exiting positions in a timely fashion - or at a reasonable price - in an extreme event.

### Market Risk Governance

MLI has established a market risk governance structure through which oversight from the MLI Board and its committees flows downward, while vital market risk insight and transparency flows upward.

All personnel involved in risk related activities are an active part of the risk management process. Front Line Units are accountable for appropriately assessing and effectively managing the risks associated with their activities. They are required to take an active role in ensuring they are fully apprised of the approved risk parameters and permitted activities in MLI. Market risk is identified, analysed, monitored, and controlled by an independent control function. The MLI Markets Risk Executive reports functionally to the Head of Global Market Risk, but also has a reporting line to the EMEA CRO. On an annual basis, the EMEA CRO provides written attestation to the PRA that the internal approaches for which the firm has received permission comply with regulatory requirements.

Market Risk Management responsibilities include ownership of market risk policy, calculating aggregated risk measures, establishing and monitoring position limits consistent with risk appetite, conducting daily reviews and analysis of trading inventory, approving material risk exposures and new trades and fulfilling regulatory requirements.

The VaR model is continually reviewed, evaluated and enhanced so that it reflects the material risks in the trading portfolio. Changes to the VaR model are reviewed and approved prior to implementation and any material changes are reported to management as well as regulators through the appropriate management committees, as well as to the PRA – where relevant.

### Market Risk Reporting

Transparency of market risks is critical to effective risk management. MLI produces reports on exposure, including VaR, Stress, and Risk Factor sensitivities. MLI also reports on risks such as yield curve shifts and twists, changes to implied volatility, correlations between market variables, and credit spreads.

Market risk reports are distributed to senior management within Markets Risk Management and, where appropriate, to relevant stakeholders – such as Front Line Units. Markets Risk Management also contributes to governance committee reports.

Non-trading book interest rate risk position reporting is provided on a daily basis, with monthly reporting to the MLI RMC, to help ensure non-trading book risk is within MLI’s risk appetite.

## Liquidity Risk

### Definition

Liquidity risk is the potential inability to meet expected or unexpected cash flow and collateral needs while continuing to support the businesses and customers, under a range of economic conditions.

### Liquidity Risk Management

The fundamental objective of liquidity risk management within MLI is to ensure MLI can meet expected and unexpected cash flow and collateral needs while continuing to support the businesses and customers with the appropriate funding sources, under a range of economic conditions

The approach to managing MLI's Liquidity Risk has been established by the MLI Board, aligned to BAC processes, and tailored to meet MLI's business mix, strategy, activity profile, risk appetite, and regulatory requirements. Key components include:

- The MLI Liquidity Risk Policy, which is approved annually by the MLI Board and formally articulates the principles for managing liquidity risk within MLI, including requirements for internal stress testing, limits and early warning indicators (EWIs), reporting and monitoring, roles and accountabilities, and regulatory requirements
- The MLI liquidity risk appetite, established by the MLI Board, requires MLI to maintain sufficient excess liquidity resources to meet net modelled outflows under an internally-developed combined stress scenario and to comply with regulatory requirements
- A robust framework of limits and EWIs that are monitored and reported daily to ensure ongoing compliance with internal and regulatory requirements
- The MLI contingency funding plan, which is approved annually by the MLI Board and details senior management's strategy to address potential liquidity shortfalls during periods of stress

MLI is subject to the following regulatory liquidity requirements:

- LCR: requires MLI to hold a sufficient buffer of eligible HQLA to cover:
    - Potential cash outflows during the first month of a liquidity stress event ("LCR Pillar 1")
    - A series of prescribed add-ons specific to MLI ("LCR Pillar 2")
- Voluntary Variation of Permission ("VVOP"): MLI is also required to hold eligible liquidity resources under a VVOP

As at 31 December 2016, MLI was in compliance with its regulatory and internal liquidity requirements.

[1] Effective from 1 October 2015, MLI is required to comply with a minimum 80% LCR Pillar 1, rising to 100% by 1 January 2018.

**Liquidity Risk (continued)**

### Liquidity Risk Governance

MLI Liquidity Risk is integrated into the BAC and MLI governance structure described earlier in the document.

Effective liquidity risk management requires coordination and transparency across front line units, independent risk management and other control functions. To achieve this, the Company has established a liquidity risk governance structure that provides oversight from the Boards and its committees to the individual front line units. Front line units actively identify, escalate and debate liquidity risks related to their activities both internally and to independent risk management.

### Liquidity Risk Reporting

Timely, transparent and relevant liquidity reporting provides front line unit management with actionable information essential for making sound decisions to manage MLI's cash, liquidity exposures and funding needs in real time, as necessary, across market cycles. MLI's liquidity risk reporting supports liquidity risk exposure monitoring, including emerging trends and EWIs, and performance against established limits within and across significant legal entities, currencies, and LOBs as well as cash flow projections over short and long-term time horizons. Dedicated personnel within Corporate Treasury monitor liquidity and provide regular reporting of MLI's liquidity position and metrics to Senior Management. Independent risk management routinely monitors and reports on liquidity risk trends and limits to various risk governance committees, executive management and the Board, in accordance with the BAC's subsidiary governance requirements and enterprise policies. Additionally, liquidity risk monitoring and reporting enable appropriate risk escalation, which includes defined protocols for limit breaches, and emerging risks and issues, to ensure transparency at the appropriate level of granularity for each audience.

**Operational Risk**

### Definition

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

Operational Risks are associated with the following seven operational loss event categories: internal fraud; external fraud; employment practices and workplace safety; clients, products and business practices; damage to physical assets; business disruption and systems failures; and execution, delivery and process management.

### Operational Risk Management

Operational Risk exists in all business activities conducted by MLI and is an unavoidable consequence of doing business. Consistent Operational Risk management across all legal entities within BAC globally is supported through the implementation of the Operational Risk policy and the supporting Standards.

The Operational Risk management function is independent of front line unit / control function management, and consists of the Corporate Operational Risk ("COR") and front line unit / control function Operational Risk teams ("Operational Risk Teams").

COR defines the requirements within the policy and the standards and is responsible for designing the program and overseeing its implementation and execution in accordance with the Operational Risk policy and its supporting Standards. Front line units / control functions and Operational Risk Teams establish and implement procedures to embed Operational Risk management practices in support of these requirements. Operational Risk Teams are also responsible for objectively assessing, challenging and advising the front line units / control functions on Operational Risk. Front line units / control functions may have business oversight or control teams that support business leaders in the implementation of the program.

| | |
|---|---|
| Operational Risk (continued) | A key element of the program is the MLI RSA which captures the operational exposures faced by MLI, and entails: ongoing identification, measurement, mitigation, monitoring, reporting and escalation of applicable current and emerging Operational Risk and causes. In addition to the RSA process, MLI performs other Operational Risk management processes including internal and operational loss data monitoring and the execution of scenario analysis. Scenario analyses are targeted to identify plausible, low-frequency, high-severity operational loss events. Risk reduction and mitigation activities are developed and enacted when potential Operational Risk losses are assessed or control gaps identified.<br><br>**Operational Risk Governance**<br><br>MLI Operational Risk is integrated into the BAC and MLI governance structure described earlier in the document. The BAC Operational Risk management framework incorporates and documents the overarching processes for identifying, measuring, mitigating, controlling, monitoring, testing, reviewing and reporting Operational Risk information to senior management and governance bodies.<br><br>**Operational Risk Reporting**<br><br>Transparency of Operational Risks is critical to effective risk management. To achieve transparency, MLI reports on the Operational Risk exposures, including operational loss events and RSA results. A consolidated report on Operational Risk is reviewed, discussed and debated with both the management and MLI BRC. |

| | |
|---|---|
| Compliance Risk | **Definition**<br><br>Compliance risk is the risk of legal or regulatory sanctions, material financial loss or damage to the reputation of MLI arising from the failure of MLI to comply with requirements of applicable laws, rules and regulations and related self-regulatory organizations’ standards and codes of conduct.<br><br>**Compliance Risk Management**<br><br>Front line units are responsible for the proactive identification, management and escalation of compliance risks across MLI. Global Compliance is responsible for setting BAC-wide policies and standards and provides independent challenge and oversight to the front line units. BAC’s approach to the management of compliance risk is further described in the Global Compliance Policy, which outlines the requirements of BAC’s global compliance risk management program and defines roles and responsibilities related to the implementation, execution and management of the global compliance risk management program by Global Compliance.<br><br>**Compliance Risk Governance**<br><br>Global Compliance is a separate function with governance routines and executive reporting distinct from those of the front line units and other control functions. Global Compliance also collaborates with other control functions to provide additional support for specific remediation efforts and shares responsibility with the front line units, Global Risk Management and other control functions for mitigating reputational risk.<br><br>**Compliance Risk Reporting**<br><br>The Global Compliance Executive leads the Global Compliance organisation, which together with the front line units, also has responsibility for the aggregated identification, management and escalation of compliance risks and compliance-related matters across the Company, including financial crimes compliance risks. Compliance Risk issues are reported to the MLI Board and the MLI Audit Committee. |

**Reputational Risk**

### Definition

Reputational Risk is the potential risk that negative perceptions of MLI's conduct or business practices will adversely affect its profitability or operations through an inability to establish or maintain existing customer / client relationships.

Reputational Risk can stem from many of MLI's activities, including those related to the management of strategic, operational or other risks, as well as the overall financial position. As a result, MLI evaluates the potential impact to its reputation within all of the risk categories and throughout the risk management process.

### Reputational Risk Management

BAC manages reputational risk through established policies and controls in the business and risk management processes to mitigate reputational risks in a timely manner and through proactive monitoring and identification of potential reputational risk events.

At the Enterprise level, Reputational Risk is reviewed by the Enterprise Risk Committee and the Management Risk Committee, which provide primary oversight of Reputational Risk. Additionally, top reputational risks are reviewed by the Global Risk Management Leadership team and the BAC Board.

For the EMEA region there is a specialist committee, the EMEA Reputational Risk Committee, whose charter includes consideration of Reputational Risk issues and to provide guidance and approvals for activities that represent specific Reputational Risks which have been referred for discussion by other current control frameworks or LOB. Reputational Risk items relating to MLI are considered as part of the EMEA Reputational Risk Committee.

Activities will be escalated to the EMEA Reputational Risk Committee for review and approval where elevated levels of Reputational Risk are present.

Examples of such activities include:

- Business activities that present significant legal, regulatory or headline risk
- Violations of, or deviations from, MLI policies
- Concerns about customer/client identity or integrity, money laundering, potential criminal activity or potential violations of economic sanctions requirements, such as direct or indirect terrorist financing or operation of an account for or on behalf of a sanctioned country, company or person
- Business activities that have a particular accounting, finance or tax treatment as a material objective
- Business activities that raise the possibility that MLI might have an undisclosed or significant conflict of interest
- Business activities from which MLI expects to receive disproportionate compensation compared with the services provided, investments made and/or risks assumed
- Business activities which, due to their nature or due to the current or historic reputation of any of the parties involved, might reflect adversely on the Enterprise's reputation or suggest the need for close scrutiny
- Business activities that present the risk of creating information or security breaches or consumer privacy issues, including public disclosure of information
- Business activities that may present environmental or social risks due to actions by the Enterprise or any of the parties involved
- Business activities or practices that may follow longstanding industry practice where there is the potential for a shift in public sentiment such that the business activity or practice might now or in the future be perceived as unfair, improper or unethical
- Business activities that are similar to other activities in the Enterprise or another firm that have caused reputational harm

**Reputational Risk (continued)**

- Any potential reputational risk associated with the introduction, modification or discontinuation of products, services, lines of business or delivery channels
- Any reputational risk concerns that are specific to the business, region or the markets in which the business operates

Ultimately, to ensure that Reputational Risk is mitigated through regular business activity, awareness of Reputational Risk is integrated into the overall governance process, as well as incorporated into the roles and responsibilities for employees.

Given the nature of Reputational Risk, BAC does not set quantitative limits for the level of acceptable risk. Through proactive risk management, BAC seeks to minimise both the frequency and impact of reputational events.

### Reputational Risk Governance

BAC has an appropriate organisational and governance structure in place to ensure strong oversight at both the Enterprise and business levels.

The EMEA Reputational Risk Committee membership consists of executive representation from Markets, Global Corporate and Investment Banking and control functions (General Counsel, Compliance and Risk). During the year to 31 December 2016, the committee was chaired by either the regional President, Chief Operating Officer or Chief Risk Officer for EMEA. The EMEA Reputational Risk Committee charter requires that a majority of members must be present, including a co-chair and all control functions, in order for meetings to proceed.

The EMEA Reputational Risk Committee is a sub-committee of both the EMEA Regional Risk Committee and the Global Reputational Risk Committee and is applicable to all key legal operating entities in the region.

Items requiring increased attention may be escalated from the EMEA Reputational Risk Committee to the EMEA Regional Risk Committee and/or the Global Reputational Risk Committee as appropriate. The MLI BRC is informed of such matters.

### Reputational Risk Reporting

The reporting of reputational risk issues is captured as part of the management routines for the EMEA Reputational Risk Committee. Issues that are identified and presented for discussion as part of the meeting are included in reporting. Tracking of items presented to EMEA Reputational Risk Committee is maintained through reporting which provides detail such as description of the reputational risk issue, geographical jurisdiction of the issue, reason for escalation and decision reached by EMEA Reputational Risk Committee and which legal entity the issue relates to. Summary reporting of the EMEA Reputational Risk Committee issues is provided to the EMEA Regional Risk Committee on a quarterly basis as part of the control function support papers. In addition, the EMEA Reputational Risk Committee provides updates to the MLI BRC on a quarterly basis.

## 4.4 Other Risk Considerations

The risk management approach outlined in section 4.2 also allows the Group, through its sole operating subsidiary MLI, to manage the other risk considerations set out below.

### Wrong-way Risk

Wrong-way risk exists when there is adverse correlation between the counterparty's probability of default and the market value of the underlying transaction and /or the collateral. Examples of wrong-way risk include, but are not limited to, situations that involve a counterparty that is a resident and/or incorporated in an emerging market entering into a transaction to sell non-domestic currency in exchange for its local currency; a trade involving the purchase of an equity put option from a counterparty whose shares are the subject of the option; or the purchase of credit protection from a counterparty who is closely associated with the credit default swap reference entity.

MLI uses a range of policies and reporting to identify and monitor wrong-way risk across the portfolio. Forums have been established to review potential situations of wrong-way risk, and depending on the nature of the wrong way risk, Risk Management may require pre-trade approval or apply various portfolio limits. In keeping with the Risk Framework, several processes exist to control and monitor wrong-way risk including reviews at the BAC Global Markets Risk Committee and the BAC Credit Risk Committee.

### Contingent Market Risk

Contingent Market Risk ("CMR") arises from concentrated positions with a single counterparty or a subset of counterparties. Traditional exposure metrics, like potential exposure and CVA trend towards zero with the rise of overcollateralization and central clearing, while tail risk remains. This risk is captured by measuring concentrated positions while remaining agnostic to specific market scenarios and counterparty worthiness.

MLI is subject to various Enterprise-level CMR limits by asset class and risk factor, based on appropriate measures and levels, taking into account market liquidity, risk appetite stress scenarios and business rationale. Limits are reviewed and monitored by Counterparty Credit Risk Portfolio Management. Permanent limits are approved at the BAC Global Markets Risk Committee.

### Pegged Currency Risk

A pegged exchange rate is a type of exchange rate regime where a currency's value is managed against either the value of another single currency, to a basket of other currencies, or to another measure of value. Pegged Currency Risk arises when the peg "breaks", such as that which occurred in January 2015 when the Swiss National Bank announced it would no longer be pegging its currency, the Swiss Franc, to the Euro.

MLI is subject to various Enterprise Pegged Currency limits for each pegged currency, across different ratings buckets and at the single name and portfolio level. Limits are reviewed and monitored by Counterparty Credit Risk Portfolio Management. Permanent limits are approved at the BAC Global Markets Risk Committee.

### Exposures to Interest Rate Risk in the Non-Trading Book

No detailed disclosures are made in respect of exposures to interest rate risk in the non-trading book as the information provided by such disclosure is not regarded as material.

### Equities Exposures in the Non-Trading Book

No detailed disclosures are made in respect of equity exposures in the non-trading book as the information provided by such disclosures is not regarded as material.

## Impact of a Credit Rating Downgrade on OTC Collateral

The full impact of a BAC credit rating downgrade on MLI depends on numerous factors, including (1) the type and severity of any downgrade; and (2) the reaction of counterparties, customers, and investors who face MLI.

Based on the terms of various over-the-counter derivatives contracts and other trading agreements, a BAC credit rating downgrade may result in MLI posting additional collateral to counterparties or counterparties choosing to unwind or terminate specific transactions. In either case, MLI could experience liquidity outflows or the loss of funding sources. The materiality of such events will depend on whether the downgrade affects long-term or short-term credit ratings, as well as whether credit ratings drop by one or more levels.

The potential impact of a BAC credit rating downgrade on collateral is monitored continuously and factored into MLI's internal liquidity stress testing and regulatory liquidity requirements. As of 31 December 2016, MLI was in excess of both internal and regulatory liquidity requirements.

For more information on the impact of a credit downgrade on collateral posted for the Enterprise see pg. 139 of the BAC 10K filing for 2016. http://investor.bankofamerica.com

## Internal Capital Adequacy Assessment Process ("ICAAP")

As the sole operating subsidiary of the MLUKCH Group, the ICAAP is completed at least annually for MLI in compliance with CRD IV and the PRA Rulebook with all conclusions also deemed applicable to the Group. The ICAAP assesses the capital adequacy of MLI in relation to current and future activities and ensures that MLI maintains an appropriate amount of capital relative to the risks to which it is exposed. The ICAAP forms a key part of the governance framework and covers MLI's risk appetite; strategy and financial plans; capital and risk management; and stress testing.

## Securitisation Risk Governance and Reporting

Securitisation products traded in MLI can vary from notes backed by fairly standardised collateral to less standard, more bespoke assets. Positions that are deemed to be concentrated or illiquid are assessed through a prudential valuation process and a quarterly concentration/point of weakness risk analysis. Risk reporting is provided daily with weekly and monthly reporting looking at larger trends.

MLI is active in all classes of securitisation issuances, trading senior, mezzanine and residual tranches to facilitate client activity. To control against the increase in default risk for bonds with weaker credit enhancement, Market Risk management has tighter limits on more junior and weaker rated bonds as well as on less standard, more bespoke assets. Although asset-backed securities ("ABS") are the dominant driver of the capital requirement for securitisation positions, MLI is also active in all classes of collateralised loan obligation issuance and also has certain derivative positions collateralised by ABS.

Monitoring and controls are in place via VaR based modelling, stress testing and market value limits. Monitoring processes for re-securitisation positions also include prudential valuation assessment, concentration/point of weakness analysis and market risk limits.

# 5. Further Detail on Capital Requirement, Capital Resources, Leverage, Securitisation and Capital Buffers

## 5.1 Minimum Capital Requirement Summary

MLI and the Group's Minimum Capital Requirement primarily arises from CCR and PRR. Figures 6 and 7 illustrate MLI's CCR exposure by industry and PRR Capital Requirement by type, respectively.

The majority of MLI's CCR exposure is against banks, broker-dealers and clearing houses. Total exposure reduced year on year mainly due to a significant reduction in the volume of inter-affiliate trades booked in MLI over the course of the year.

MLI's Market Risk Capital Requirement is principally driven by MLI's internal model based capital requirement and a standard rules charge on traded debt instruments. Further detail on Market Risk can be found in Section 5.2.

Figure 6. Minimum Capital Requirement Detail: Counterparty and Credit Risk Exposure

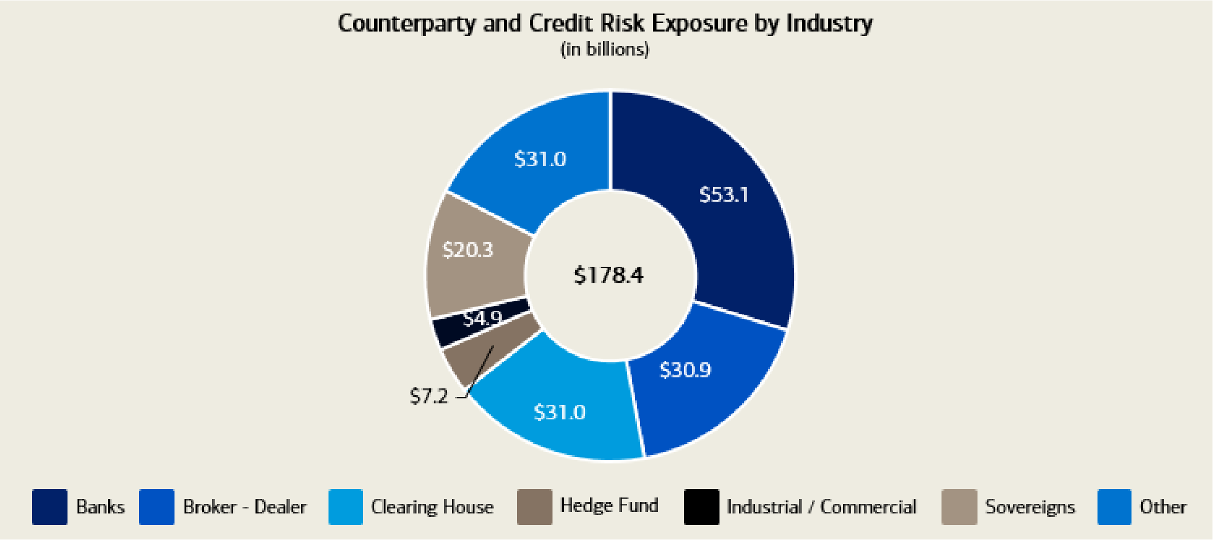
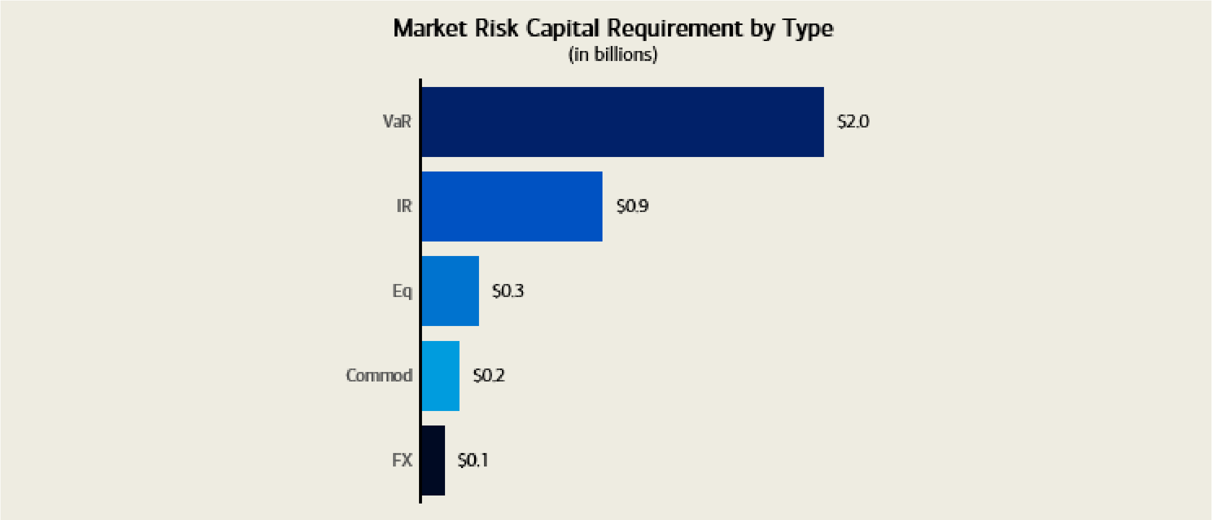



Figure 7. Minimum Capital Requirement Detail: Market Risk Capital Requirement



# 5.2 Market Position Risk Requirement (PRR)

## Summary

Market risk is the risk that changes in market conditions may adversely impact the value of assets or liabilities or otherwise negatively impact earnings.

Table 8 presents a breakdown of MLI and the Group's PRR. Further detail on the components follows the table.

Table 8. Market Position Risk Requirement (PRR)

| | MLI | MLUKCH Group |
|---|---|---|
| *(Dollars in Millions)* | 2016 | 2016 |
| VaR | 362 | 362 |
| Stressed VaR | 911 | 911 |
| Incremental risk charge | 427 | 427 |
| Comprehensive risk measure | 317 | 317 |
| **PRR: Internal Model Based Capital Requirement** | 2,017 | 2,017 |
| PRR on Traded Debt Instruments [1] | 906 | 913 |
| Equity PRR | 246 | 292 |
| Commodity PRR | 197 | 197 |
| Foreign Exchange PRR | 125 | 120 |
| **PRR: Capital Requirement under Standardised Approaches** | 1,474 | 1,522 |
| **Total Market Risk (PRR)** | 3,491 | 3,539 |

[1] PRR on traded debt instruments includes $227m (2015: $287m) of securitisation exposures.

### 5.2.1 Internal Model Based Capital Requirement

Within the MLUKCH Group, the model based regulatory capital requirement in MLI is calculated based on the internal model (VaR) approved by the PRA. MLI, as the sole operating subsidiary in the Group, has established trading book guidelines which set out the policies and procedures for the overall management of the trading book in accordance with the requirements of CRD IV.

#### VaR

VaR is a common statistic used to measure market risk as it allows the aggregation of market risk factors, including the effects of portfolio diversification. Our primary VaR statistic is equivalent to a 99 percent confidence level. This means that for a VaR with a one-day holding period, there should not be losses in excess of VaR, on average, 99 out of 100 trading days.

For further details on VaR and how MLI uses VaR as a risk management tool, please refer to the Market Risk key risk type in section 4.3.

#### *Regulatory VaR*

Regulatory VaR is a variation of VaR in which a ten-day holding period is used with rolling actual ten-day returns generated from three years of historical market data.

### *Backtesting*

The VaR methodology is evaluated through a daily backtesting process, which compares the daily VaR results, utilizing a one-day holding period, against a comparable subset of trading profit or loss (“P&L”).

As required by the CRR, backtesting uses the ‘Hypothetical’ and ‘Actual’ definitions of the P&L. Hypothetical P&L is the P&L from the move in the value of the portfolio on the current day assuming unchanged positions from the end of the previous day. Actual P&L and Hypothetical P&L exclude fees, commissions and net interest income.

A backtesting overshooting occurs when a trading loss on day N exceeds the VaR value of the portfolio on day N-1. These overshoots are evaluated to understand the positions and market moves that produced the trading loss and to ensure that the VaR methodology accurately represents those losses.

The number of backtesting overshootings observed can differ from the statistically expected number of overshootings for a number of reasons. When this occurs, analysis is done to assess the model’s performance.

Backtesting overshootings for MLI’s total Regulatory VaR results in the year to 31 December 2016 were analysed and reported to the PRA as required. The overshootings that occurred in the year were as a result of market volatility.

### *Trading Portfolio Stress Testing*

Given the very nature of a VaR model, results can exceed the model’s estimates and it is dependent on a limited historical window. As such, our portfolio is also stress tested using scenario analysis. This analysis estimates the change in value of the trading portfolio that may result from abnormal market movements.

For further details on how MLI performs stress testing to the trading portfolio, please refer to the Market Risk key risk type in section 4.3.

### *Stressed VaR*

Stressed VaR is a variation of VaR in which the historical window is not the previous three years but is calibrated to a continuous 12-month window that reflects a period of significant stress appropriate to MLI. Stressed VaR is calculated based on 99% confidence level, a 10-day holding period and the same population of exposures as the regulatory VaR.

### *Risk Not in VaR (“RNiV”) Framework*

The RNIV framework aims to capture and capitalise material market risks that are not adequately covered in the VaR model.

## Incremental Risk Charge

The IRC model is one component of the regulatory capital calculation for market risk. The model is intended to capture the potential losses that non-securitised credit products in the trading portfolio might experience over a one-year period of financial stress from defaults, ratings migration and significant basis risk factors. To calculate potential losses at the required 99.9 percent confidence level, the Company utilises a Monte-Carlo simulation calibrated using relevant, available historical data for each risk factor in order to sample potential market scenarios.

The model reflects the impact of concentrated risks, including issuer, sector, region and product basis risks, and assigns a higher potential loss to a concentrated portfolio than a more diversified portfolio with a similar credit profile. The model framework also captures the broad relationships between the different risk factors and is flexible enough to allow additional dependencies or risk factors to be incorporated in the future. The IRC model assumes a constant position and a liquidity horizon of one year.

## Comprehensive Risk Measure

The Company’s CRM is the modelled component of the All Price Risks regulatory capital requirement for market risk for positions which are eligible to be included in the correlation trading portfolio, primarily tranches on indices and bespoke portfolios and their corresponding hedges. The CRM takes into account all of the risk factors that materially impact the value of the positions within the correlation trading portfolio.

The model captures the complexity of these positions including the non-linear nature of the trade valuations, particularly during periods of market stress, and the impact of the joint evolution of the risk factors. The CRM utilises the same Monte-Carlo simulation framework as our IRC model with the additional risk factors required for the correlation products in order to calculate the potential losses at the required 99.9 percent confidence level. The modelled component of the CRM, like the IRC model, assumes a constant position and a liquidity horizon of one year.

For the All Price Risk regulatory capital requirement purposes, the point in time modelled CRM value is compared to its 12 week average and to the correlation trading portfolio floor calculated under the standardised approach for market risk per the CRR. The highest of these three numbers will be the All Price Risk regulatory capital requirement used for the correlation trading portfolio.

Table 9 shows MLI's high, low, average and year-end values for regulatory VaR and Stressed VaR, and risk numbers for the IRC and CRM models for 2016. Both VaR and Stressed VaR include a price volatility cross risk add-on.

Table 9. VaR, SVaR, IRC & CRM

| | 2016 | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | VaR | SVaR | IRC | CRM |
| Highest | 109 | 222 | 481 | 347 |
| Lowest | 29 | 51 | 238 | 168 |
| Mean | 54 | 97 | 366 | 264 |
| Measure at Year End | 77 | 92 | 427 | 285 |

### 5.2.2 Capital Requirement under Standardised Approaches

#### PRR on Traded Debt Instruments

Within the MLUKCH Group, PRR on Traded Debt Instruments is the regulatory capital requirement calculated on traded debt instruments that are not part of the scope of the internal models permission granted by the PRA to MLI. The requirement is split into two components: general market risk and specific risk:

- General market risk is based on a currency portfolio basis. Positions are grouped into maturity bands ranging from <1 month to >20 years, with a different weighting applied to each maturity band.
- Specific risk looks at each security in terms of type of issuer (e.g. corporate / government), credit quality and maturity.

#### Equity PRR

Within the Group, Equity PRR is the regulatory capital requirement calculated on equity positions that are out of scope of the internal models permission granted by the PRA to MLI.

#### Commodity PRR

Within the Group, Commodity PRR is the regulatory capital requirement calculated on the global commodities index product business in MLI. The positions are grouped by maturity with a different weighting applied to each maturity band.

#### Foreign Exchange PRR

Within the Group, Foreign Exchange PRR is the regulatory capital requirement calculated on the open net foreign currency exposure of the balance sheet.

#### Option PRR

Within the Group, Option PRR is the regulatory capital requirement calculated on options which are not in scope of the internal models permission granted by the PRA to MLI, and attract a delta equivalent treatment, with additional regulatory capital requirement calculated for convexity risk (gamma risk) and volatility risk (vega risk).

## 5.3 Counterparty and Credit Risk (CCR)

CCR is the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. CCR capital requirements are derived from risk-weighted exposures, determined using the standardised approach. MLI has CCR exposure as a result of derivative trades, securities financing transactions and other trading book exposures. Both MLI and the Group also have non-trading book exposures.

Within the MLUKCH Group, MLI measures CCR exposure on derivatives using mark-to-market method, defined as mark-to-market plus a notional add-on.

A financial asset is past due when the counterparty has failed to make a payment when contractually due. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The Group did not have any impairments for credit losses in the year.

The following section provides detailed information on MLI and the MLUKCH Group's regulatory CCR exposures using the above mentioned approach. All exposures, unless stated otherwise, are post Credit Risk Mitigation and the application of Credit Conversion Factors.

### 5.3.1 Counterparty and Credit Risk by Type

Tables 10 and 11 set out MLI and the Group's RWA, CCR capital requirement and exposure by industry distribution. The majority of exposures of MLI and the Group are against corporates and institutions. The ratings of counterparties are derived by referring to external credit ratings provided by Moody's, Fitch and S&P for all exposure classes.

Counterparty and Credit Risk are combined for reporting purposes.

Table 10. Counterparty and Credit Risk Minimum Capital Requirement and RWA

| | 2016 | | | |
|---|---|---|---|---|
| | MLI | | MLUKCH Group | |
| *(Dollars in Millions)* | RWA | Capital Requirement | RWA | Capital Requirement |
| Central Governments or Central Banks | 1,850 | 148 | 1,850 | 148 |
| Corporates | 48,913 | 3,913 | 48,904 | 3,912 |
| Institutions | 26,439 | 2,115 | 26,529 | 2,122 |
| Other [1] | 6,332 | 506 | 6,245 | 500 |
| **Total** | 83,534 | 6,682 | 83,528 | 6,682 |

[1] Other comprises of exposures to international organisations, multilateral development banks, public sector entities, regional governments or local authorities, claims on institutions and corporates with a short-term credit assessment, exposures secured by mortgages on immovable property, exposures in default, equity exposures, items associated with particularly high risk, items representing securitisation positions and other items.

Table 11. Counterparty and Credit Risk Exposure by Industry Distribution

| | 2016 | |
|---|---|---|
| *(Dollars in Millions)* | MLI | MLUKCH Group |
| Bank | 53,057 | 53,444 |
| Broker Dealer | 30,885 | 30,878 |
| Clearing House/Exchange | 31,040 | 31,040 |
| Industrial and Commercial Companies | 4,913 | 4,913 |
| Energy and Commodities | 1,299 | 1,299 |
| Hedge Fund | 7,171 | 7,171 |
| Insurance | 4,657 | 4,657 |
| Sovereign & Government Related | 20,301 | 20,301 |
| Other Financial | 25,076 | 25,033 |
| **Total Exposure Value** | 178,399 | 178,736 |

### 5.3.2 Counterparty and Credit Exposure Geographic Distribution and Maturity Profile Detail

Further analysis for MLI and the Group showing the geographical distribution of the exposure value is shown in Table 12.

The geographical distribution is reported by analysing where the counterparty is based and is further analysed to show the breakdown by exposure class. The majority of MLI and the Group's exposure sits within EMEA and Americas, reflecting its global business activities.

Table 12. Counterparty and Credit Risk Exposure by Geographical Distribution

| | 2016 MLI | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Asia | Americas | EMEA | Total |
| Central Governments or Central Banks | 3,447 | 174 | 12,979 | 16,600 |
| Corporates | 6,056 | 25,916 | 50,354 | 82,326 |
| Institutions | 10,919 | 21,663 | 38,077 | 70,659 |
| Other [1] | 1,197 | 3,275 | 4,342 | 8,814 |
| **Total Exposures** | 21,619 | 51,028 | 105,752 | 178,399 |

| | 2016 MLUKCH Group | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Asia | Americas | EMEA | Total |
| Central Governments or Central Banks | 3,447 | 174 | 12,979 | 16,600 |
| Corporates | 6,056 | 25,859 | 50,404 | 82,319 |
| Institutions | 10,919 | 21,817 | 38,080 | 70,816 |
| Other [1] | 1,197 | 3,232 | 4,572 | 9,001 |
| **Total Exposures** | 21,619 | 51,082 | 106,035 | 178,736 |

[1] Other comprises of exposures to international organisations, multilateral development banks, public sector entities, regional governments or local authorities, claims on institutions and corporates with a short-term credit assessment, exposures secured by mortgages on immovable property, exposures in default, equity exposures, items associated with particularly high risk, items representing securitisation positions and other items.

Table 13 splits MLI and the Group's Counterparty and Credit Risk exposure values at the end of the year by residual maturity and exposure class. The total average value of the exposures for the year is also provided.

Table 13. Counterparty and Credit Risk Exposure by Residual Maturity and Average Value

| | As at end of 2016 MLI | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Under 1 Year | One - Five Years | Over Five Years | Total |
| Central Governments or Central Banks | 15,402 | 350 | 848 | 16,600 |
| Corporates | 52,575 | 15,678 | 14,073 | 82,326 |
| Institutions | 38,029 | 24,627 | 8,003 | 70,659 |
| Other [1] | 7,826 | 498 | 490 | 8,814 |
| **Total Exposure Value** | 113,832 | 41,153 | 23,414 | 178,399 |

Table 13. (cont'd) Counterparty and Credit Risk Exposure by Residual Maturity and Average Value

| | As at end of 2016 MLUKCH Group | | | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Under 1 Year | One - Five Years | Over Five Years | Total |
| Central Governments or Central Banks | 15,402 | 350 | 848 | 16,600 |
| Corporates | 52,583 | 15,665 | 14,071 | 82,319 |
| Institutions | 38,186 | 24,627 | 8,003 | 70,816 |
| Other [1] | 8,013 | 498 | 490 | 9,001 |
| **Total Exposure Value** | **114,184** | **41,140** | **23,412** | **178,736** |

| | 2016 Average Exposure | | | |
|---|---|---|---|---|
| | MLI | | MLUKCH Group | |
| *(Dollars in Millions)* | Pre-Credit Risk Mitigation [2] | Post-Credit Risk Mitigation | Pre-Credit Risk Mitigation [2] | Post-Credit Risk Mitigation |
| Central Governments or Central Banks | 20,371 | 19,719 | 20,371 | 19,719 |
| Corporates | 109,101 | 91,239 | 108,127 | 91,619 |
| Institutions | 101,586 | 74,757 | 101,631 | 74,802 |
| Other [1] | 7,142 | 6,401 | 7,556 | 6,816 |
| **Total Exposure Value** | **238,200** | **192,116** | **237,685** | **192,956** |

[1] Other comprises of exposures to international organisations, multilateral development banks, public sector entities, regional governments or local authorities, claims on institutions and corporates with a short-term credit assessment, exposures secured by mortgages on immovable property, exposures in default, equity exposures, items associated with particularly high risk, items representing securitisation positions and other items.

### 5.3.3 Counterparty and Credit Exposure by Credit Quality Step

Table 14 analyses exposure values by exposure class and Credit Quality Step ("CQS"), showing the position Pre and Post Credit Risk Mitigation. For MLI and the Group, Credit Risk Mitigation comprises of collateral only.

A CQS is a credit quality assessment scale as set out in CRD IV. This mapping table is provided by the FCA and can be accessed through the following link:

http://www.fca.org.uk/static/documents/fsa-ecais-standardised.pdf

The CQS is derived by referring to ECAIs including Moody's, Fitch and S&P, where available.

The Group and MLI both have over 45% of exposures with counterparties externally rated between AAA and A-. Although generally assessed internally as being of high quality, 48% of exposure in the Group and MLI is to counterparties not rated by external rating agencies. Credit risk is assessed as outlined at section 4.3.

Table 14. Counterparty and Credit Risk Exposure by Credit Quality Step

| | 2016 | | | |
|---|---|---|---|---|
| | MLI | | MLUKCH Group | |
| *(Dollars in Millions)* | Pre-Credit Risk Mitigation [2] | Post-Credit Risk Mitigation | Pre-Credit Risk Mitigation [2] | Post-Credit Risk Mitigation |
| **Central and Regional Governments or Central Banks** | | | | |
| Credit Quality Step | | | | |
| 1 | 13,040 | 10,118 | 13,039 | 10,118 |
| 2 | 5,419 | 5,768 | 5,418 | 5,768 |
| 3 | 334 | 335 | 334 | 335 |
| 4 | 55 | 55 | 55 | 55 |
| 5 | 158 | 160 | 158 | 160 |
| 6 | 173 | 173 | 173 | 173 |
| NR-Non Rated | 208 | 191 | 208 | 191 |
| **Total Exposure Value** | 19,387 | 16,800 | 19,385 | 16,800 |
| **Corporates** | | | | |
| Credit Quality Step | | | | |
| 1 | 5,593 | 4,817 | 5,593 | 4,817 |
| 2 | 3,992 | 3,741 | 3,992 | 3,741 |
| 3 | 2,662 | 2,473 | 2,662 | 2,473 |
| 4 | 1,078 | 513 | 1,078 | 513 |
| 5 | 77 | 77 | 77 | 77 |
| 6 | 5 | 5 | 0 | 0 |
| NR-Non Rated | 92,387 | 70,700 | 87,286 | 70,698 |
| **Total Exposure Value** | 105,794 | 82,326 | 100,688 | 82,319 |
| **Institutions** | | | | |
| Credit Quality Step | | | | |
| 1 | 12,279 | 8,906 | 12,279 | 8,906 |
| 2 | 52,074 | 41,957 | 52,096 | 41,978 |
| 3 | 14,162 | 8,569 | 14,162 | 8,569 |
| 4 | 372 | 130 | 372 | 130 |
| 5 | 24 | 5 | 24 | 5 |
| 6 | 331 | 4 | 331 | 4 |
| NR-Non Rated | 14,611 | 11,088 | 14,748 | 11,224 |
| **Total Exposure Value** | 93,853 | 70,659 | 94,012 | 70,816 |

Table 14 (cont'd). Counterparty and Credit Risk Exposure by Credit Quality Step

| | 2016 | | | |
|---|---|---|---|---|
| | MLI | | MLUKCH Group | |
| *(Dollars in Millions)* | Pre-Credit Risk Mitigation [(2)] | Post-Credit Risk Mitigation | Pre-Credit Risk Mitigation [(2)] | Post-Credit Risk Mitigation |
| **Other** [(1)] | | | | |
| Credit Quality Step | | | | |
| 1 | 1,872 | 910 | 2,103 | 1,140 |
| 2 | 3,559 | 3,480 | 3,560 | 3,480 |
| 3 | 98 | 98 | 98 | 98 |
| 4 | 71 | 71 | 71 | 71 |
| 5 | 20 | 20 | 20 | 20 |
| 6 | 168 | 121 | 168 | 121 |
| NR-Non Rated | 6,156 | 3,914 | 6,112 | 3,871 |
| **Total Exposure Value** | 11,944 | 8,614 | 12,132 | 8,801 |
| **Combined Total Exposure Value** | 230,978 | 178,399 | 226,217 | 178,736 |

[(1)] Other comprises of exposures to International Organisations, Multilateral Development Banks, Public Sector Entities, Short-term Claims on Institutions and Corporates, Exposures Secured by Mortgages on Immovable Property, Exposures in Default, Equity Exposures, Items Associated with Particularly High Risk, Other Items and Items Representing Securitisation Positions.
[(2)] Exposure Pre CRM includes the effect of funded credit protection in the form of master netting agreements for Securities Financing Transactions

Table 15 analyses exposure value Pre and Post Credit Risk Mitigation.

Table 15 Counterparty and Credit Risk Exposure Pre and Post Credit Mitigation by exposure class

| | 2016 | |
|---|---|---|
| | MLI | |
| *(Dollars in Millions)* | Pre-Credit Risk Mitigation[(2)] | Post-Credit Risk Mitigation |
| Central Governments or Central Banks | 19,130 | 16,600 |
| Corporates | 105,794 | 82,326 |
| Institutions | 93,855 | 70,659 |
| Other [(1)] | 12,199 | 8,814 |
| **Total Exposure Value** | **230,978** | **178,399** |

| | 2016 | |
|---|---|---|
| | MLUKCH Group | |
| *(Dollars in Millions)* | Pre-Credit Risk Mitigation[(2)] | Post-Credit Risk Mitigation |
| Central Governments or Central Banks | 19,131 | 16,600 |
| Corporates | 100,688 | 82,319 |
| Institutions | 94,012 | 70,816 |
| Other [(1)] | 12,386 | 9,001 |
| **Total Exposure Value** | **226,217** | **178,736** |

[(1)] Other comprises of exposures to International Organisations, Multilateral Development Banks, Public Sector Entities, Regional Governments or Local Authorities, Short-term Claims on Institutions and Corporates, Exposures Secured by Mortgages on Immovable Property, Exposures in Default, Equity Exposures, Items Associated with Particularly High Risk, Other Items and Items Representing Securitisation Positions.

[(2)] Exposure Pre CRM includes the effect of funded credit protection in the form of master netting agreements for Securities Financing Transactions

### 5.3.4 Counterparty and Credit Risk Exposure by Product

Measures for exposure value under Counterparty Credit Risk for MLI and the Group are calculated using the mark-to-market method. Table 16 analyses this risk by product and before and after credit risk mitigation.

Table 16. Counterparty and Credit Risk Exposure by Product

| | 2016 | |
|---|---|---|
| *(Dollars in Millions)* | MLI | MLUKCH Group |
| **OTC Derivatives Counterparty Credit Risk** | | |
| Gross Positive Fair Value of Contracts | 329,750 | 329,795 |
| Gross Potential Future Credit Exposure | 221,428 | 221,416 |
| **Gross Exposure Value** | **551,178** | **551,211** |
| Netting Benefits | (399,398) | (399,398) |
| Collateral Held | (37,236) | (37,236) |
| **Net Current Credit Exposure** | **114,544** | **114,577** |
| **Distribution of Credit Exposure** | | |
| Central Governments or Central Banks | 3,607 | 3,607 |
| Corporates | 55,584 | 55,520 |
| Institutions | 55,054 | 55,151 |
| Other [1] | 299 | 299 |
| **Total** | **114,544** | **114,577** |

[1] Other comprises of exposures to International Organisations, Multilateral Development Banks, Public Sector Entities, Regional Governments or Local Authorities, Short-term Claims on Institutions and Corporates, Exposures Secured by Mortgages on Immovable Property, Exposures in Default, Equity Exposures, Items Associated with Particularly High Risk, Other Items and Items Representing Securitisation Positions.

### 5.3.5 Counterparty and Credit Risk – Credit Derivatives

Table 17 analyses the notional value of MLI and The Group's credit derivative portfolio. This is additionally categorised between MLI and the Group's own credit portfolio and products used for intermediation.

Table 17. Counterparty and Credit Risk Exposure – Credit Derivatives

| | 2016 | | | |
|---|---|---|---|---|
| | MLI | | MLUKCH Group | |
| *(Dollars in Millions)* | Protection Bought | Protection Sold | Protection Bought | Protection Sold |
| **Credit Derivative Products used for Intermediation** | | | | |
| Credit Default Swaps | 140,291 | 140,291 | 140,291 | 140,291 |
| Total Return Swaps | 54 | 54 | 54 | 54 |
| **Total Notional Value** | **140,345** | **140,345** | **140,345** | **140,345** |
| **Credit Derivative Products used for Own Credit Portfolio** | | | | |
| Credit Default Swaps | 63,212 | 60,705 | 63,212 | 60,705 |
| Total Return Swaps | 191 | 1,438 | 191 | 1,438 |
| **Total Notional Value** | **63,403** | **62,143** | **63,403** | **62,143** |

## 5.4 Securitisation

### 5.4.1 Securitisation Activities

Within the Group, MLI acts as sponsor[(1)] and investor[(2)] in securitisations. MLI has also historically acted as originator of securitisations.

MLI's main involvement in relation to securitisation activity is to act as a secondary market maker. MLI has engaged in securitisation activities related to commercial and residential mortgage loans, corporate loans, and other types of financial instruments. Where MLI acts as derivative counterparty to a securitisation, the derivatives are typically interest rate swaps.

In its role as sponsor, MLI facilitates the use of Special Purpose Entities ("SPE") to securitise customer loans and advances owned by the originating entities for on-sale to third party investors. In such cases the loans and advances are transferred by the originator of the securitisation to the SPEs for cash and the SPEs issue debt securities to these investors to fund the cash purchases. MLI facilitates this process and markets the notes to investors on behalf of the originator, typically purchasing a portion of the notes issued by the SPEs in order to facilitate market making activity and provide market liquidity for the notes.

MLI acted as sponsor for two new securitisations in 2016. Both were originated by Bank of America Merrill Lynch International Limited ("BAMLI"), a UK regulated bank and affiliate of MLI.

MLI did not originate any securitisations in 2016.

### 5.4.2 Regulatory Capital Treatment

MLI uses the Standardised Approach to calculate the capital requirements on its securitisation positions that are not held in the correlation trading portfolio, in accordance with Part Three, Title II, Chapter 5 and Article 337 of the CRR. This approach uses rating agency credit ratings to determine risk weights. MLI uses ratings from three ECAIs, Moody's, S&P and Fitch.

The approach used for the calculation of capital requirements for the correlation trading portfolio is discussed in section 5.2.

### 5.4.3 Accounting Treatment

MLI accounts for its interests in SPEs in accordance with IFRS 10: *Consolidated Financial Statements*, which establishes the criteria for when it is deemed to control another entity. IFRS 10 defines control as follows: "an investor controls an investee when it is exposed, or has the rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee". In assessing control all relevant factors are considered including qualitative and quantitative aspects.

The consolidation analysis is reassessed whenever there is a change in the substance of the relationship between MLI and an SPE, for example, when the nature of the MLI's involvement or the governing rules, contractual arrangements or capital structure of the SPE change. Further, the full population is reassessed every quarter-end. The review process includes all stakeholders, including front line units.

Whether the transfer of assets to an SPE in a securitisation transaction is treated as a sale or financing depends on whether the derecognition requirements of IAS 39 - *Financial Instruments: recognition and measurement* are met.

The 'derecognition' criteria are satisfied if:

a) substantially all the risks and rewards associated with the assets have been transferred, in which case, they are derecognised in full; or
b) MLI neither transfers nor retains substantially all the risks and rewards of ownership, and has not retained control, in which case the assets are derecognised in their entirety and the Group, through MLI recognises separately as assets or liabilities any rights and obligations created or retained in the transfer, otherwise if MLI has retained control, the assets continue to be recognised to the extent of the MLI's continuing involvement.

(1) Sponsor is defined by CRR Article 4(14) as "an institution other than an originator institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third-party entities".
(2) Investor is not defined in the CRR, however the scope of the rule is inferred from the guidance therein. Investor is deemed to include activity as derivative counterparty to, and investor in securitisation vehicle.
(3) Sponsor is defined by CRR Article 4(13) as "an entity which: (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or (b) purchases a third party's exposures for its own account and then securitises them"

Transactions where derecognition of the assets transferred to a SPE has occurred are treated as sales or partial sales of those assets. The difference between the carrying amount of the assets transferred and the consideration received is recorded in current period net operating income.

Assets that have been transferred to an unconsolidated SPE which fail the ‘derecognition’ requirements in IAS 39 are treated as financing arrangements and will remain on MLI’s balance sheet, with a corresponding liability recognised for the proceeds received. These assets are classified as trading assets and the corresponding liabilities are classified as Creditors: Amounts falling due after one year. The assets are measured at fair value through profit or loss and the liabilities at amortised cost or fair value through profit or loss under a fair value option election.

Synthetic securitisations arise where the underlying assets are not sold to the SPE, instead credit derivatives are used to transfer the economic risk of the underlying assets. The Group, through MLI may or may not hold the underlying assets and may or may not transfer other high quality liquid assets to the SPE as security for the principal of the notes issued. Synthetic securitisations are accounted for under the same accounting policies to those summarised above, with the associated credit derivatives accounted for at fair value through profit or loss in accordance with the requirements of IAS 39.

MLI’s retained interests in securitisation transactions are valued in accordance with the Accounting Policies, as set out in MLI’s Annual Financial Statements. These interests comprise loans and securities, which are classified as trading assets and measured at fair value through profit or loss. These will accordingly be included within the fair value disclosures in Note 26 in the MLI Annual Financial Statements. Other interests include for example, agreement between MLI to receive the fee payable by the SPE over several years (at an increased rate) and off-balance sheet liquidity facilities (e.g. in a credit-linked note structure) provided to the SPE. Neither MLUKCH nor MLI provide financial support to its SPEs.

### 5.4.4 Securitisation Risk Governance and Reporting

Please refer to section 4 for securitisation risk governance and reporting process.

### 5.4.5 Securitisation Exposures

The following table provide a summary of the outstanding exposures securitised by the Group to which the Group continues to have exposure as at 31 December 2016 and the aggregate amount of such securitisation exposure in the trading book and non-trading book.

Table 18 - Outstanding Exposures Securitised and Current Exposure by Exposure Type to Securitisations (Originator / Sponsor)

| | Outstanding Exposures Securitised | Current Exposure | | | |
|---|---|---|---|---|---|
| | | Trading Book | | Non-trading Book | |
| *(Dollars in Millions)* | | Originator | Sponsor | Originator | Sponsor |
| **Traditional Securitisations** | | | | | |
| Residential Mortgages | 2,963 | - | 27 | - | 12 |
| Commercial Mortgages | 2,091 | - | 13 | - | 20 |
| Loans to Corporates or SMEs | 555 | 1 | - | 7 | - |
| Other Assets | 3,000 | - | - | 94 | - |
| **Traditional Total** | 8,609 | 1 | 40 | 101 | 32 |
| **Synthetic Securitisations** | | | | | |
| Residential Mortgages | - | - | - | - | - |
| Commercial Mortgages | - | - | - | - | - |
| Loans to Corporates or SMEs | - | - | - | - | - |
| Other Assets | 5,315 | - | - | 17 | - |
| **Synthetic Total** | 5,315 | - | - | 17 | - |

Table 19 - Securitisation Exposures (Investor)

| *(Dollars in Millions)* | Trading Book Exposure | Non-trading Book Exposure |
|---|---|---|
| Residential Mortgages | 446 | 36 |
| Commercial Mortgages | 43 | 0 |
| Loans to Corporates or SMEs | 135 | 265 |
| Other Assets | 17 | 369 |
| **Total** | **641** | **670** |

The Group does not have any exposures to securitisations which are subject to the early amortisation treatment.

Table 20 – Securitisation Positions Risk Weighted at 1,250%

| *(Dollars in Millions)* | Trading Book Exposure | Non-trading Book Exposure |
|---|---|---|
| Residential Mortgages | 154 | 12 |
| Commercial Mortgages | 24 | 4 |
| Loans to Corporates or SMEs | 10 | 58 |
| Other Assets | 5 | 188 |
| **Total** | **193** | **262** |

Table 21 –Securitisation Exposures and Capital Requirements by Credit Quality

| | Trading | | Non-Trading | |
|---|---|---|---|---|
| *(Dollars in Millions)* | Exposure | Capital | Exposure | Capital |
| **Securitisations** | | | | |
| 1 | 232 | 4 | 70 | 1 |
| 2 | 37 | 1 | 274 | 11 |
| 3 | 43 | 3 | 36 | 3 |
| 4 | 59 | 17 | 71 | 20 |
| All Other CQS | 194 | 194 | 189 | 189 |
| **Securitisations Total** | **565** | **219** | **640** | **224** |
| **Re-securitisations** | | | | |
| 1 | 117 | 8 | 108 | 3 |
| 2 | - | - | - | - |
| 3 | - | - | - | - |
| 4 | - | - | - | - |
| All Other CQS | - | - | 72 | 72 |
| **Re-Securitisations Total** | **117** (1) | **8** | **180** (2) | **75** |

(1) The Group has gross exposure of $620m to re-securitisations in the trading book before hedges are taken into account. After hedges, the Group has net exposure of $117m to re-securitisations in the trading book as shown in the above table.
(2) The exposure to non-trading book re-securitisations in the above table is shown net of credit risk mitigation, which reduced the exposure by $41m.

## 5.5 Capital Buffers

The CCYB was introduced through CRD IV and is defined as the amount of CET1 capital MLI and the Group must calculate in accordance with CRD IV as implemented by the PRA. The CCYB is equal to MLI and the Group's total risk exposure amount multiplied by the weighted average of the CCYB rates that apply to exposures in the jurisdictions where MLI and the Group's relevant credit exposures are located.

The aim of the CCYB is to achieve the broader macro-prudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk. The CCYB requirements may also help to limit the build-up of credit in jurisdictions in the first place, by raising the cost of credit and dampening its demand. Thus jurisdictions will be required to monitor credit growth in relation to measures such as GDP and assess whether growth is excessive and leading to the build-up of system-wide risk. Based on this assessment a countercyclical buffer requirement, ranging from 0% to 2.5% of risk weighted assets, may be put in place for specified jurisdictions.

Under CRD IV, MLI and the Group should face the same CCYB rates as domestic institutions on its cross-border exposures under the international reciprocation process. On 30 November 2016, the Financial Policy Committee ("FPC") maintained a UK CCYB rate of 0%. In terms of other jurisdictions for 2016, the FPC decided to recognise the CCYB rates of Hong Kong, Norway and Sweden on exposures of UK institutions of 0.625%, 1.5% and 1.5% respectively which were implemented in January 2016, on 30 June 2016 and on 27 June 2016 respectively, and were applicable as at 31 December 2016.

Table 22 outlines the components of relevant credit exposures used in the calculation of CCYB by country.

Table 22: MLI Countercyclical Capital Buffer

| | MLI | | | |
|---|---|---|---|---|
| | General Credit Exposures | Trading Book Exposures | | Securitisation Exposures |
| *(Dollars in Millions)* | Exposure value for Standardised Approach | Sum of long and short positions of trading book exposures for Standardised Approach | Value of trading book exposures for internal models | Exposure value for Standardised Approach |
| Norway | 66 | - | 4 | - |
| Sweden | 462 | 26 | 26 | - |
| Hong Kong | 347 | 20 | 63 | - |
| United Kingdom | 25,190 | 767 | 237 | 514 |
| United States Of America | 20,088 | 190 | 57 | 29 |
| Other (own funds requirement individually less than $500m) | 40,344 | 1,249 | 2,123 | 277 |
| Total | 86,497 | 2,251 | 2,510 | 820 |

| | MLI | | | | | |
|---|---|---|---|---|---|---|
| | Own Funds Requirements | | | | Own funds requirements weights | Countercyclical Capital Buffer rate |
| *(Dollars in Millions)* | of which: General credit exposures | of which: Trading book exposures | of which: Securitisation exposures | Total | | |
| Norway | 2 | 2 | - | 4 | 0.001 | 1.500% |
| Sweden | 20 | 27 | - | 47 | 0.008 | 1.500% |
| Hong Kong | 19 | 29 | - | 48 | 0.008 | 0.625% |
| United Kingdom | 699 | 242 | 262 | 1,203 | 0.213 | 0.000% |
| United States Of America | 889 | 88 | 24 | 1,001 | 0.177 | 0.000% |
| Other (own funds requirement individually less than $500m) | 2,390 | 938 | 14 | 3,342 | 0.593 | 0.000% |
| Total | 4,019 | 1,326 | 300 | 5,645 | 1.000 | |

| Amount of institution-specific countercyclical capital buffer | |
|---|---|
| *(Dollars in Millions)* | |
| Total risk exposure amount | 185,366 |
| Institution specific countercyclical capital buffer rate | 0.019% |
| Institution specific countercyclical capital buffer requirement | 35 |

Table 23: MLUKCH Group Countercyclical Capital Buffer

| | MLUKCH Group | | | |
|---|---|---|---|---|
| | General Credit Exposures | Trading Book Exposures | | Securitisation Exposures |
| *(Dollars in Millions)* | Exposure value for Standardised Approach | Sum of long and short positions of trading book exposures for Standardised Approach | Value of trading book exposures for internal models | Exposure value for Standardised Approach |
| Norway | 66 | - | 4 | - |
| Sweden | 462 | 26 | 26 | - |
| Hong Kong | 347 | 20 | 63 | - |
| United Kingdom | 25,271 | 838 | 237 | 514 |
| United States Of America | 20,049 | 190 | 57 | 29 |
| Other (own funds requirement individually less than $500m) | 40,484 | 1,248 | 2,123 | 277 |
| Total | 86,679 | 2,322 | 2,510 | 820 |

| | MLUKCH Group | | | | | |
|---|---|---|---|---|---|---|
| | Own Funds Requirements | | | | Own funds requirements weights | Countercyclical Capital Buffer rate |
| *(Dollars in Millions)* | of which: General credit exposures | of which: Trading book exposures | of which: Securitisation exposures | Total | | |
| Norway | 2 | 2 | - | 4 | 0.001 | 1.500% |
| Sweden | 20 | 27 | - | 47 | 0.008 | 1.500% |
| Hong Kong | 19 | 29 | - | 48 | 0.008 | 0.625% |
| United Kingdom | 690 | 248 | 262 | 1,200 | 0.213 | 0.000% |
| United States Of America | 885 | 88 | 24 | 997 | 0.177 | 0.000% |
| Other (own funds requirement individually less than $500m) | 2,395 | 938 | 14 | 3,347 | 0.593 | 0.000% |
| Total | 4,011 | 1,332 | 300 | 5,643 | 1.000 | |

| Amount of institution-specific countercyclical capital buffer | |
|---|---|
| *(Dollars in Millions)* | |
| Total risk exposure amount | 185,562 |
| Institution specific countercyclical capital buffer rate | 0.019% |
| Institution specific countercyclical capital buffer requirement | 35 |

## 5.6 Capital Resources

The below table shows a reconciliation between the accounting balance sheet values and the regulatory capital values of the items included in MLI and the Group's Capital Resources. Further details on the composition of MLI and the Group's capital resources are shown in tables 24, 25 and 26.

Table 24. Regulatory Capital Resources Reconciliation to Accounting Balance Sheet

| | 2016 | |
|---|---|---|
| *(Dollars in Millions)* | MLI | MLUKCH Group |
| Ordinary Share Capital | 7,933 | 2,926 |
| Share Premium | 4,499 | - |
| Capital Contribution | 9,193 | 745 |
| Profit and Loss Account | 13,917 | 30,226 |
| *Profit and Loss Account (Accounting Balance Sheet Value)* | *14,768* | *31,078* |
| *Debit Valuation Adjustment* | *(335)* | *(335)* |
| *Prudential Valuation Adjustment* | *(516)* | *(516)* |
| Non-Controlling Interest | - | *243* |
| *Non-Controlling Interest (Accounting Balance Sheet Value)* | - | *364* |
| *Surplus non-controlling interest disallowed in Tier 1* | - | *(121)* |
| Tier 1 Capital Before Deductions | 35,542 | 34,140 |
| *Deferred Tax Asset* | (448) | (448) |
| *Defined Benefit Pension Fund Asset (net of associated deferred tax liability)* | (315) | (315) |
| **Tier 1 Capital** | 34,779 | 33,377 |
| Subordinated Liabilities (After Regulatory Adjustments) | 703 | 1,743 |
| *Subordinated Liabilities (Accounting Balance Sheet Value)* | *1,421* | *2,591* |
| *Amortisation and Other Adjustments* | *(718)* | *(848)* |
| **Tier 2 Capital** | 703 | 1,743 |
| **Total Capital Resources (net of deductions)** | 35,482 | 35,120 |

Following the implementation of CRD IV on 1 January 2014, a new requirement was introduced requiring a prudential valuation adjustment to be deducted from MLI and the Group's Tier 1 Capital Resources. There is an established valuation control policy and prudent valuation guidelines which set out the policies and procedures for the determination of price verification and prudent valuation in accordance with the requirements of CRD IV and related interpretive guidance.

Table 25. MLUKCH Group Capital Instrument Features

| | | MLUKCH Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Capital Instruments Main Features** | | **CET1** | **AT1** | **T2** | **T2** | **T2** | **T2** | **T2** | **T2** |
| 1 | Issuer | ML UK Capital Holdings | N/a | Merrill Lynch International | ML UK Capital Holdings | ML UK Capital Holdings | Merrill Lynch International | Merrill Lynch International | ML UK Capital Holdings |
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | Private Placement | N/a | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement |
| 3 | Governing law(s) of the instrument | English | N/a | English | English | English | English | English | English |
| **Regulatory Treatment** | | | | | | | | | |
| 4 | Transitional CRR rules | CET1 | N/a | T2 | T2 | T2 | T2 | T2 | T2 |
| 5 | Post-transitional CRR rules | CET1 | N/a | T2 | T2 | T2 | T2 | T2 | T2 |
| 6 | Eligible at solo/(sub-)consolidated/ solo & (sub-)consolidated | Consolidated | N/a | Solo and Consolidated | Consolidated | Consolidated | Solo and Consolidated | Solo and Consolidated | Consolidated |
| 7 | Instrument type (types to be specified by each jurisdiction) | Ordinary shares with full voting rights | N/a | Subordinated Loan | Subordinated Loan | Subordinated Loan | Subordinated Loan | Subordinated Loan | Subordinated Loan |
| 8 | Amount recognised in regulatory capital (currency in million, as of most recent reporting date) | $2,926m comprising nominal and premium | N/a | USD 223m | USD 549m | USD 171m | USD 0m | USD 0m | USD 800m |
| 9 | Nominal amount of instrument | $1.00 | N/a | USD 619m | USD 1,000m | USD 171m | USD 1m | USD 1m | USD 800m |
| 9a | Issue price | $1.00 30 Dec 2015 | N/a | USD 619m | USD 1,000m | USD 171m | USD 1m | USD 1m | USD 800m |
| 9b | Redemption price | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 10 | Accounting classification | Shareholders equity | N/a | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost |
| 11 | Original date of issuance | 30-Dec-15 | N/a | 21-Jun-13 | 28-Sep-09 | 31-Mar-11 | 31-Jan-13 | 31-Mar-11 | 27-Nov-15 |
| 12 | Perpetual or dated | Perpetual | N/a | Dated | Dated | Dated | Dated | Dated | Dated |
| 13 | Original maturity date | No maturity | N/a | 21-Jun-19 | 28-Sep-19 | 21-Dec-30 | 31-Jan-19 | 31-Aug-18 | 27-Nov-26 |
| 14 | Issuer call subject to prior supervisory approval | No | N/a | No | No | No | No | No | No |
| 15 | Optional call date, contingent call dates and redemption amount | N/a | N/a | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. |
| 16 | Subsequent call dates, if applicable | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| **Coupons / Dividends** | | | | | | | | | |
| 17 | Fixed or floating dividend/coupon | N/a | N/a | Floating | Floating | Floating | Floating | Floating | Floating |
| 18 | Coupon rate and any related index | N/a | N/a | 3month GBP LIBOR plus 213 bps per annum | 1month USD LIBOR plus 331 bps per annum | 1month USD LIBOR plus 337 bps per annum | 1month USD LIBOR plus 187 bps per annum | 1month USD LIBOR plus 328 bps per annum | 1month USD LIBOR plus 227 bps per annum |
| 19 | Existence of a dividend stopper | No | N/a | No | No | No | No | No | No |
| 20a | Fully discretionary, partially discretionary or mandatory (in terms of timing) | Fully discretionary | N/a | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory |
| 20b | Fully discretionary, partially discretionary or mandatory (in terms of amount) | Fully discretionary | N/a | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory |
| 21 | Existence of step up or other incentive to redeem | No | N/a | No | No | No | No | No | No |
| 22 | Noncumulative or cumulative | Non-cumulative | N/a | Cumulative | Cumulative | Cumulative | Cumulative | Cumulative | Cumulative |
| 23 | Convertible or non-convertible | Non-convertible | N/a | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible |
| 24 | If convertible, conversion trigger(s) | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 25 | If convertible, fully or partially | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 26 | If convertible, conversion rate | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 27 | If convertible, mandatory or optional conversion | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 28 | If convertible, specify instrument type convertible into | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 29 | If convertible, specify issuer of instrument it converts into | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 30 | Write-down features | No | N/a | No | No | No | No | No | No |
| 31 | If write-down, write-down trigger(s) | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 32 | If write-down, full or partial | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 33 | If write-down, permanent or temporary | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 34 | If temporary write-down, description of write-up mechanism | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | All subordinated liabilities - Columns 3-8 | N/a | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities |
| 36 | Non-compliant transitioned features | No | N/a | No | No | No | No | No | No |
| 37 | If yes, specify non-compliant features | N/a | N/a | N/a | N/a | N/a | N/a | N/a | N/a |

(') Insert 'N/A' if the question is not applicable

Table 26. MLI Capital Instrument Features

| | | MLI | | | | | |
|---|---|---|---|---|---|---|---|
| | Capital Instruments Main Features | CET1 | AT1 | T2 | T2 | T2 | T2 |
| 1 | Issuer | Merrill Lynch International | N/a | Merrill Lynch International | Merrill Lynch International | Merrill Lynch International | Merrill Lynch International |
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | Private Placement | N/a | Private Placement | Private Placement | Private Placement | Private Placement |
| 3 | Governing law(s) of the instrument | English | N/a | English | English | English | English |
| **Regulatory Treatment** | | | | | | | |
| 4 | Transitional CRR rules | CET1 | N/a | T2 | T2 | T2 | T2 |
| 5 | Post-transitional CRR rules | CET1 | N/a | T2 | T2 | T2 | T2 |
| 6 | Eligible at solo/(sub-)consolidated/ solo & (sub-)consolidated | Solo | N/a | Solo | Solo | Solo | Solo |
| 7 | Instrument type (types to be specified by each jurisdiction) | Ordinary shares with full voting rights | N/a | Subordinated Loan | Subordinated Loan | Subordinated Loan | Subordinated Loan |
| 8 | Amount recognised in regulatory capital (currency in million, as of most recent reporting date) | $12,432m comprising nominal and premium | N/a | USD 307m | USD 396m | USD 0m | USD 0m |
| 9 | Nominal amount of instrument | $1.00 | N/a | USD 619m | USD 800m | USD 1m | USD 1m |
| 9a | Issue price | $1.00 19 Dec 2012<br>$4.76 18 Nov 2014 | N/a | USD 619m | USD 800m | USD 1m | USD 1m |
| 9b | Redemption price | N/a | N/a | N/a | N/a | N/a | N/a |
| 10 | Accounting classification | Shareholders equity | N/a | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost |
| 11 | Original date of issuance | $6,735m 19 Dec 2012<br>$1,198m 18 Nov 2014 | N/a | 21-Jun-13 | 21-Jun-13 | 31-Jan-13 | 31-Mar-11 |
| 12 | Perpetual or dated | Perpetual | N/a | Dated | Dated | Dated | Dated |
| 13 | Original maturity date | No maturity | N/a | 21-Jun-19 | 21-Jun-19 | 31-Jan-19 | 31-Aug-18 |
| 14 | Issuer call subject to prior supervisory approval | No | N/a | No | No | No | No |
| 15 | Optional call date, contingent call dates and redemption amount | N/a | N/a | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. | No issuer call date. However, may repay in whole or in part at par on any date if a Regulatory Event or Tax Event occurs, subject to prior supervisory approval. |
| 16 | Subsequent call dates, if applicable | N/a | N/a | N/a | N/a | N/a | N/a |
| **Coupons / Dividends** | | | | | | | |
| 17 | Fixed or floating dividend/coupon | N/a | N/a | Floating | Floating | Floating | Floating |
| 18 | Coupon rate and any related index | N/a | N/a | 3month GBP LIBOR plus 213 bps per annum | 3month USD LIBOR plus 221 bps per annum | 1month USD LIBOR plus 187 bps per annum | 1month USD LIBOR plus 328 bps per annum |
| 19 | Existence of a dividend stopper | No | N/a | No | No | No | No |
| 20a | Fully discretionary, partially discretionary or mandatory (in terms of timing) | Fully discretionary | N/a | Mandatory | Mandatory | Mandatory | Mandatory |
| 20b | Fully discretionary, partially discretionary or mandatory (in terms of amount) | Fully discretionary | N/a | Mandatory | Mandatory | Mandatory | Mandatory |
| 21 | Existence of step up or other incentive to redeem | No | N/a | No | No | No | No |
| 22 | Noncumulative or cumulative | Non-cumulative | N/a | Cumulative | Cumulative | Cumulative | Cumulative |
| 23 | Convertible or non-convertible | Non-convertible | N/a | Non-convertible | Non-convertible | Non-convertible | Non-convertible |
| 24 | If convertible, conversion trigger(s) | N/a | N/a | N/a | N/a | N/a | N/a |
| 25 | If convertible, fully or partially | N/a | N/a | N/a | N/a | N/a | N/a |
| 26 | If convertible, conversion rate | N/a | N/a | N/a | N/a | N/a | N/a |
| 27 | If convertible, mandatory or optional conversion | N/a | N/a | N/a | N/a | N/a | N/a |
| 28 | If convertible, specify instrument type convertible into | N/a | N/a | N/a | N/a | N/a | N/a |
| 29 | If convertible, specify issuer of instrument it converts into | N/a | N/a | N/a | N/a | N/a | N/a |
| 30 | Write-down features | No | N/a | No | No | No | No |
| 31 | If write-down, write-down trigger(s) | N/a | N/a | N/a | N/a | N/a | N/a |
| 32 | If write-down, full or partial | N/a | N/a | N/a | N/a | N/a | N/a |
| 33 | If write-down, permanent or temporary | N/a | N/a | N/a | N/a | N/a | N/a |
| 34 | If temporary write-down, description of write-up mechanism | N/a | N/a | N/a | N/a | N/a | N/a |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | All subordinated liabilities - Columns 3-6 | N/a | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities |
| 36 | Non-compliant transitioned features | No | N/a | No | No | No | No |
| 37 | If yes, specify non-compliant features | N/a | N/a | N/a | N/a | N/a | N/a |

(') Insert 'N/A' if the question is not applicable

Table 27. Own Funds Disclosure Template [1]

| Transitional Own Funds Disclosure Template (Dollars in millions) | | Amount at Disclosure Date | |
|---|---|---|---|
| | | MLI | MLUKCH Group |
| 1 | Capital instruments and the related share premium accounts | 12,432 | 2,926 |
| | of which: Ordinary shares with full voting rights | 12,432 | 2,926 |
| 2 | Retained earnings | 14,768 | 31,077 |
| 3 | Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards) | 9,193 | 745 |
| 5 | Minority Interests (amount allowed in consolidated CET1) | - | 243 |
| 6 | Common Equity Tier 1 (CET1) capital before regulatory adjustments | 36,393 | 34,991 |
| **Common Equity Tier 1 (CET1) Capital: Regulatory Adjustments** | | | |
| 7 | Additional value adjustments (negative amount) | (516) | (516) |
| 10 | Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount) | (225) | (225) |
| 14 | Gains or losses on liabilities valued at fair value resulting from changes in own credit standing | (335) | (335) |
| 15 | Defined-benefit pension fund assets (negative amount) | (315) | (315) |
| 25 | Deferred tax assets arising from temporary differences | (223) | (223) |
| 28 | **Total Regulatory Adjustments to Common Equity Tier 1 (CET1)** | (1,614) | (1,614) |
| 29 | **Common Equity Tier 1 (CET1) Capital** | 34,779 | 33,377 |
| **Additional Tier 1 (AT1) capital: Instruments** | | | |
| 45 | **Tier 1 Capital (T1 = CET1 + AT1)** | 34,779 | 33,377 |
| **Tier 2 (T2) Capital: Instruments and Provisions** | | | |
| 46 | Capital instruments and the related share premium accounts | 703 | 1,519 |
| 48 | Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties | - | 223 |
| 51 | Tier 2 (T2) capital before regulatory adjustments | 703 | 1,743 |
| **Tier 2 (T2) Capital: Regulatory Adjustments** | | | |
| 57 | **Total Regulatory Adjustments to Tier 2 (T2) Capital** | - | - |
| 58 | **Tier 2 (T2) Capital** | 703 | 1,743 |
| 59 | **Total Capital (TC = T1 + T2)** | 35,482 | 35,120 |
| 60 | **Total Risk Weighted Assets** | 185,366 | 185,562 |
| **Capital Ratios and Buffers** | | | |
| 61 | **Common Equity Tier 1** (as a percentage of risk exposure amount) | 18.8% | 18.0% |
| 62 | Tier 1 (as a percentage of risk exposure amount) | 18.8% | 18.0% |
| 63 | Total Capital (as a percentage of risk exposure amount) | 19.1% | 18.9% |
| 64 | Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount) | 5.1% | 5.1% |
| 65 | of which: capital conservation buffer requirement | 0.6% | 0.6% |
| 66 | of which: countercyclical buffer requirement | 0.0% | 0.0% |
| 68 | **Common Equity Tier 1** available to meet buffers (as a percentage of risk exposure amount) | 11.1% | 10.9% |
| **Amounts below the thresholds for deduction (before risk weighting)** | | | |
| 72 | Direct, indirect and synthetic holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10 % threshold and net of eligible short positions) | 2,823 | 2,823 |
| 73 | Direct, indirect and synthetic holdings by the institution of the CET 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10 %threshold and net of eligible short positions) | 58 | - |
| **Applicable caps on the Inclusion of provisions In Tier 2** | | | |
| 76 | Credit risk adjustments included in T2 in respect of exposures subject to standardized approach (prior to the application of the cap) | - | - |
| 77 | Cap on inclusion of credit risk adjustments in T2 under standardised approach | 79,118 | 79,114 |

[1] There are no own funds items or adjustments that are subject to pre-regulation (EU) No 575 / 2013 treatment or prescribed residual amount of regulation (EU) No 575 / 2013 in MLI or the Group.

## 5.7 Leverage

### 5.7.1 Leverage Approach

The leverage ratio for a quarter end is calculated using regulatory capital and on / off balance sheet figures at a point in time. The measure of Tier 1 capital used in the computation of the Group's ratio is the same under both transitional and fully phased in definitions of Tier 1 capital per CRD IV.

The leverage ratio is monitored in line with regulatory requirements. Exposure is typically managed through a combination of mechanisms including risk appetite limits, collateralisation and netting arrangements.

### 5.7.2 Additional Detail on Leverage Ratio

Table 28. Summary Reconciliation of Accounting Assets and Leverage Ratio Exposures [1]

| *(Dollars in Millions)* | MLI |
|---|---|
| Total Assets as per Balance Sheet | 416,791 |
| Adjustments for Derivative Financial Instruments | (44,346) |
| Adjustments for Securities Financing Transactions | 29,100 |
| Adjustment for Off-Balance Sheet Items (ie conversion to credit equivalent amounts of off-balance sheet exposures) | 1,660 |
| Other Adjustments | (8,498) |
| **Leverage Ratio Exposure** | **394,707** |

[1] In accordance with article 4(2) of Regulation (EU) 2016/200 on the disclosure of leverage ratio, this table is not disclosed for the Group as the Group does not publish financial statements at the consolidated level.

Table 29. Leverage Ratio Common Disclosure

| *(Dollars in Millions)* | MLI | MLUKCH Group |
|---|---|---|
| **On-Balance Sheet Exposures (excluding derivatives and SFTs)** | | |
| On-balance Sheet Items (excluding Derivatives, SFTs and fiduciary assets, but including Collateral) | 108,139 | 103,399 |
| Asset Amounts Deducted in Determining Tier 1 Capital | (1,614) | (1,614) |
| **Total On-Balance Sheet Exposures (excluding derivatives, SFTs and fiduciary assets)** | **106,525** | **101,785** |
| **Derivative Exposures** | | |
| Replacement Cost Associated with Derivatives Transactions (net of Eligible Cash Variation Margin) | 29,732 | 29,743 |
| Add-on Amounts for PFE Associated with Derivatives Transactions (Mark-to-Market method) | 109,020 | 109,031 |
| Gross-up for Derivatives Collateral provided where deducted from the Balance Sheet Assets pursuant to the Applicable Accounting Framework | 816 | 816 |
| (Deductions of Receivables Assets for Cash Variation Margin provided in Derivatives Transactions) | (7,157) | (7,157) |
| (Exempted CCP leg of Client-Cleared Trade Exposures) | (7,482) | (7,482) |
| Adjusted Effective Notional Amount of Written Credit Derivatives | 202,487 | 202,257 |
| (Adjusted Effective Notional Offsets and Add-On Deductions for Written Credit Derivatives) | (155,340) | (155,338) |
| **Total Derivative Exposure** | **172,076** | **171,870** |
| **Securities Financing Transaction Exposures** | | |
| Gross SFT Assets (With No Recognition of Netting), after Adjusting for Sales Accounting Transactions | 162,139 | 162,139 |
| (Netted Amounts of Cash Payables and Cash Receivables of Gross SFT Assets) | (72,747) | (72,747) |
| Counterparty Credit Risk Exposure for SFT Assets | 25,055 | 25,094 |
| **Total Securities Financing Transaction Exposures** | **114,447** | **114,486** |
| **Off-Balance Sheet Exposures** | | |
| Off-balance Sheet Exposures at Gross Notional Amount | 8,495 | 8,406 |
| Adjustments for Conversion to Credit Equivalent Amounts | (6,835) | (6,755) |
| **Total Off-Balance Sheet Exposures** | **1,660** | **1,651** |
| **Exempted Exposures** | | |
| **Capital and Total Exposures** | | |
| Tier 1 Capital | 34,779 | 33,377 |
| **Total Leverage Ratio Exposures** | **394,707** | **389,792** |
| **Leverage Ratio** | | |
| Leverage Ratio | 8.8% | 8.6% |
| **Choice on Transional Arrangements and Amount of Derecognised Fiduciary Items** | | |
| Choice on Transitional Arrangements for the Definition of the Capital Measure | Fully phased-in | Fully phased-in |

Table 30. Split of On-Balance Sheet Exposures (excluding derivatives and SFTs)

| *(Dollars in Millions)* | MLI | MLUKCH Group |
|---|---|---|
| **Total On-Balance Sheet Exposures (excluding derivatives and SFTs), of which:** | **108,139** | **103,400** |
| Trading Book Exposures | 92,285 | 92,289 |
| Banking Book Exposures, of which: | 15,854 | 11,111 |
| Exposures treated as Sovereigns | 3,987 | 3,987 |
| Institutions | 216 | 237 |
| Secured by Mortgages of Immovable Properties | 2 | 2 |
| Corporate | 6,975 | 2,024 |
| Exposures in Default | 31 | 31 |
| Other Exposures (Eg Equity, Securitisations, and other Non-Credit Obligation Assets) | 4,643 | 4,830 |

# 6. Additional Information on Remuneration Disclosure

## 6.1 Remuneration Disclosure

Remuneration disclosures are reported at a UK level in respect of the Remuneration Code and as required under CRD IV. These remuneration policies include the breakdown of remuneration of staff by business collectively for all BAC entities operating in the UK and are not specific to the Group or its subsidiaries.

These remuneration disclosures are separately published on BAC's corporate website (http://investor.bankofamerica.com) and should be deemed part of the Pillar 3 Disclosure for the Group.

# 7. Appendix

## Appendix I – MLUKCH Directors Board Membership and Experience

| | |
|---|---|
| **Martin Butler**<br>EMEA CFO<br>Directorships: 1 | Joined the organisation in 1988, becoming CFO for European Debt in 1997. Further senior management roles followed, including head of Global Equity ISS and head of European Business Finance. CFO EMEA since the Bank of America - Merrill Lynch merger in 2009, assuming the additional role of International Treasury Executive in 2012. A member of the EMEA Executive Committee. Additional internal board memberships include BAMLI, MLI and Merrill Lynch International Bank Designated Activity Company ("MLIB"). |
| **Bernard Mensah**<br>Co-Head of FICC Trading<br>Directorships: 1 | Joined the organisation in 2011 to lead the Emerging Markets Global FICC Trading group, prior to becoming Head of EMEA FICC Trading in 2012. Was then appointed as Global Co-Head of FICC Trading in January 2015. Before joining the organisation, he was a Partner and Global Head of Bank Loans and Distressed Debt at Goldman Sachs. Also a member of the EMEA Executive Committee. Additional internal board memberships include BAMLI and MLI. |
| **Jennifer Taylor**<br>Head of EMEA Compliance and EMEA Operational Risk<br>Directorships: 1 | Joined the organisation in 1997, responsible for the legal coverage of structured finance transactions. Held various General Counsel roles across Asia Pacific (APAC) before assuming the role of General Counsel for all Merrill Lynch businesses in the APAC region. Assumed the role of Chief Administration Officer for Asia in 2006, later being appointed COO of the region before returning to the UK to act as COO in EMEA. Also a member of the EMEA Executive Committee. Additional internal board memberships include BAMLI, MLI and MLIB. |
| **Alex Wilmot-Sitwell**<br>EMEA President<br>Directorships: 1 | Joined the organisation in 2012 as the president for EMEA. Responsible for the execution and development of the bank's business activities and support functions in the EMEA region. Based at the bank's European headquarters in London, he chairs the bank's EMEA Executive Committee and is a member of the Global Banking, and Markets Committee. Additional internal board memberships include BAMLI, MLI and MLIB. |
| **Jan Przewozniak**<br>EMEA Chief Risk Officer<br>Directorships: 1 | Joined the organisation in 2013, being appointed EMEA Deputy CRO in January 2014, prior to becoming EMEA CRO in September 2014. Over 30 years of banking and risk management experience, focussed on Emerging Markets, Financial Institutions and Corporate Credit Risk. Also a member of the EMEA Executive Committee. |

Note: The table outlines the directors that served at March 2017. For the purpose of disclosing the number of directorships held by each board member, directorships held within the same group of companies are counted as a single directorship. Directorships in organisations which do not pursue predominantly commercial objectives are not included.

### Additional Directors Serving on the MLI Board

With the exception of Jan Przewozniak, the above directors of MLUKCH also serve on the MLI Board. In addition, the following directors also serve on the MLI Board:

| | |
|---|---|
| **Malcolm Basing**<br>Non Executive Director<br>Directorships: 2 | Over thirty years of senior management experience in investment banking and financial markets, including COO of UBS Americas. Previously, Chairman of Plus Markets Group PLC, Chairman of Newedge UK Financial Ltd, Chairman of the International Swaps and Derivatives Association and Chairman of Primus Guaranty (UK) Ltd. |
| **Susan Bies**<br>Chair / Non Executive Director<br>Directorships: 2 | Current board member of BAC and BANA and a member of the Risk and Governance Committees. Board member of Zurich Insurance Group, chair of Risk Committee and member of Audit Committee. Member of Oliver Wyman advisory board. Member of Federal Reserve Board of Governors 2001-2006. Executive officer First Tennessee National Corporation, including CFO, CRO, auditor, chair of asset/liability committee, 1979-2001. |
| **John Gollan**<br>Non Executive Director<br>Directorships: 2 | A chartered accountant with international experience across banking, investment management, financial markets and management consultancy. Holds or has held non-executive director of various financial services organisations including Euronext, LIFFE, healthcare companies and higher education institutions. Board experience as an executive comprises four roles as CFO, two as CEO and one as Chairman. Additional internal board memberships include BAMLI. |
| **Claire Ighodaro CBE**<br>Non Executive Director<br>Directorships: 3 | Non-Executive Director and Audit Committee Chair of Flood RE and Lloyd's of London. Past President of the Chartered Institute of Management Accountants and current member of the IFAC International Ethics Standards Board for Accountants and the FCO Diplomatic Excellence External Panel. |
| **Julien Bahurel**<br>Head of Equities<br>Directorships: 1 | Joined the organisation in 2013, becoming Head of Equities in 2014. He was formerly Global Head of Equity Derivatives Sales and Head of European Equity Distribution. Also a member of the Global Equities Senior Leadership Team, EMEA Executive Committee, EMEA Conduct Risk Council, EMEA Reputational Risk Committee, MLI Risk Management Committee and EMEA Regional Risk Committee. |
| **Sanaz Zaimi**<br>Head of FICC Sales<br>Directorships: 1 | Joined the organisation in 2010 to build the FICC franchise and is currently Global Head of FICC Sales. Over two decades of experience in financial markets, focused on globally diverse organizations. Also a member of the EMEA Executive Committee, the Global Banking and Markets Leadership Team, the Global Reputation Risk Committee and a member of the Bank of America Foundation Advisory Board. |

Note: The table outlines the directors that served at March 2017. For the purpose of disclosing the number of directorships held by each board member, directorships held within the same group of companies are counted as a single directorship. Directorships in organisations which do not pursue predominantly commercial objectives are not included.

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