PILLAR III DISCLOSURES UNDER THE NEW CAPITAL ADEQUACY FRAMEWORK (BASEL II)

1. SCOPE OF APPLICATION

Development Credit Bank Limited is a scheduled commercial bank which was incorporated on May 31, 1995. The Bank has no subsidiaries.

As on March 31, 2012, the Bank does not have investment in any insurance entity.

2. CAPITAL STRUCTURE

Capital funds are classified into Tier I and Tier II capital under the capital adequacy framework.

Tier-I Capital:
The Bank's Tier I capital includes paid-up equity capital, statutory reserves, other disclosed free reserves, capital reserves as mandated by RBI.

Equity Capital
The Bank has authorized share capital of Rs. 500 crores comprising 500,000,000 equity shares of Rs.10/- each. As on March 31, 2012 the Bank has issued subscribed and paid-up capital of Rs. 240.67 crores, constituting 240,665,457 shares of Rs.10/- each. The provisions of the Companies Act, 1956 and other applicable laws and regulations govern the rights and obligations of the equity share capital of the Bank.

Tier II Capital:
The Bank's Tier II capital include revaluation reserve, general provision for standard assets and subordinated debt instruments (lower Tier II bonds) eligible for inclusion in Tier II capital.

Subordinated Debt (Lower Tier II bonds)
As on March 31, 2012, the Bank had an outstanding subordinated debt (Unsecured Redeemable Non-convertible Bonds) aggregating Rs. 75 crores, the details of which are stated below:

(Rs. crores)

Issue Series	Deemed Date of Allotment	Coupon Rate (% p.a.)	Tenure (in months)	Equivalent Amount as on March 31, 2012
III (Option II)	March 31, 2004	7.15	99	10.00
IV	August 31, 2009	11.25	68	65.00
Total				**75.00**

Composition of Capital – Tier I and Tier II :

(Rs. crores)

Particulars	As on March 31, 2012
1. Tier I capital	
1.1 Paid-up share capital	240.67
1.2 Reserves	559.55
1.3 Gross Tier I capital (1.1 + 1.2)	800.22
1.4 Deductions	0.49
1.5 Total Tier I capital (1.3 - 1.4)	**799.73**
2. Tier II capital	
2.1 Subordinated Debt (Lower Tier II bonds)	39.00
2.2 General Provisions/IRA and Revaluation Reserves	53.34
2.3 Gross Tier II capital (2.1 + 2.2)	92.34
2.4 Deductions	-
2.5 Total Tier II capital (2.3 - 2.4)	**92.34**
3. Debt capital instruments eligible for inclusion in Upper Tier II capital	
3.1 Total amount outstanding	-
3.2 Of which amount raised during the current year	-
3.3 Amount eligible to be reckoned as capital funds	-
4. Subordinated debt eligible for inclusion in Lower Tier II capital	
4.1 Total amount outstanding	75.00
4.2 Of which amount raised during the current year	-
4.3 Amount eligible to be reckoned as capital funds	39.00
5. Other deductions from capital	
5.1 Other deductions from capital	-
6. Total eligible capital	
6.1 Total eligible capital (1.5 + 2.5)	**892.07**

3. CAPITAL ADEQUACY

The Bank has a process for assessing its overall capital adequacy in relation to the Bank's risk profile and a strategy for maintaining its capital levels. The process ensures that the Bank has adequate capital to support all the material risks and an appropriate capital cushion. The Bank identifies, assesses and manages comprehensively all risks that it is exposed to through robust risk management framework, control mechanism and an elaborate process for capital calculation and planning. The Bank has implemented a Board approved comprehensive Internal Capital Adequacy Assessment Process (ICAAP).

The Bank has a structured process for the identification and evaluation of all risks that the Bank faces, which may have an adverse material impact on its financial position. The Bank considers the following risks as material risks it is exposed to in the normal course of its business and therefore, factors these while assessing / planning capital:

- Credit Risk
- Concentration Risk
- Market Risk
- Operational Risk
- Liquidity Risk
- Strategy Risk
- Reputational Risk
- Residual Risk

The Bank has also implemented a Board approved Stress Testing policy. Stress Testing involves the use of various techniques to assess the Bank's potential vulnerability to extreme but plausible ("stressed") business conditions. Typically, this relates, among other things, to the impact on the Bank's profitability and capital adequacy. Stress Tests are conducted on a half yearly basis on the Bank's on and off balance sheet exposures to test the impact of Credit, Liquidity risk and Interest Rate Risk in the Banking book (IRRBB). The stress test results are put up to the Risk Management Committee (RMC) of the Board on a half yearly basis, for their review and guidance. The Bank periodically assesses and refines its stress tests in an effort to ensure that the stress scenarios capture material risks as well as reflect possible extreme market moves that could arise as a result of market conditions. The stress tests are used in conjunction with the Bank's business plans for the purpose of capital planning in the ICAAP.

In line with the RBI guidelines for implementing the New Capital Adequacy Framework under Basel II, the Bank has successfully migrated to the framework from March 31, 2009. The Bank has continued parallel run of Basel II framework continuously tracking the exposures and studied the impact on Bank's Capital to Risk weighted Assets Ratio (CRAR) on a monthly basis. In accordance with the RBI's requirement, the Bank has continued to adopt Standardised Approach (SA) for Credit Risk and Basic Indicator Approach (BIA) for Operational Risk to compute capital as on March 31, 2012. Besides this, the Bank continues to apply the Standardised Duration Approach (SDA) for computing capital requirement for Market Risk. RBI has prescribed banks to maintain a minimum CRAR of 9% with regard to credit risk, market risk and operational risk on an ongoing basis. The total Capital to Risk weighted Assets Ratio (CRAR) as per Basel II guidelines works to 15.41% as on March 31, 2012 (as against minimum regulatory requirement of 9%). The Tier I CRAR stands at 13.81% as against RBI's prescription of 6.00%. The Bank has followed the RBI guidelines in force, to arrive at the eligible capital, risk weighted assets and CRAR.

Capital requirements for Credit Risk, Market Risk and Operational Risk:

(Rs. crores)

Particulars	As on March 31, 2012
1. Capital requirement for Credit Risk	**473.88**
• Portfolio subject to Standardised Approach	473.88
• Securitization Exposures	Nil
2. Capital requirement for Market Risk	**5.45**
• Standardised Duration Approach	
o Interest Rate Risk	2.23
o Foreign Exchange Risk (Including gold)	3.15
o Equity Risk	0.07
3. Capital requirement for Operational Risk	**41.83**
• Basic Indicator Approach	41.83
Total capital requirements at 9% (1 + 2 + 3)	**521.16**
Total capital	**892.07**
CRAR %	**15.41%**
Tier-I CRAR %	**13.81%**

4. RISK MANAGEMENT FRAMEWORK

The Bank is exposed to various types of risk such as Credit, Market, Operation, Liquidity, Interest Rate, Reputational, Legal and Strategic risk. The Bank has separate and independent Risk Management Department in place which oversees all types of risks in an integrated fashion.

The objective of risk management is to have optimum balance between risk and return. It entails the identification, measurement and management of risks across the various businesses of the Bank. Risk is managed through framework defined in policies approved by the Board of Directors and supported by an independent risk management function which monitors and takes corrective action so that the Bank operates within its risk appetite. The risk management function attempts to anticipate vulnerabilities through quantitative or qualitative examination of the embedded risks in various activities. The Bank continues to focus on refining and improving its risk measurement systems. In addition to ensuring compliance with regulatory requirements, the Bank has developed robust internal systems for assessing capital requirements keeping in view the business objectives.

The Board of Directors (BOD) approves the strategies and policies for Risk Management, based on recommendations of the Risk Management Committee (RMC) of the Board set up to focus upon risk management issues. The RMC reviews various aspects of risk arising from the businesses undertaken by the Bank. Operating level risk committees comprising of senior management viz. Asset Liability Management Committee (ALCO), the Operational Risk Management Committee (ORCO) and the Credit Risk Management Committee (CRMC) oversee specific risk areas. These committees in turn provide inputs for review by the Risk Management Committee (RMC).

Risk Management Committee (RMC) of the Board:

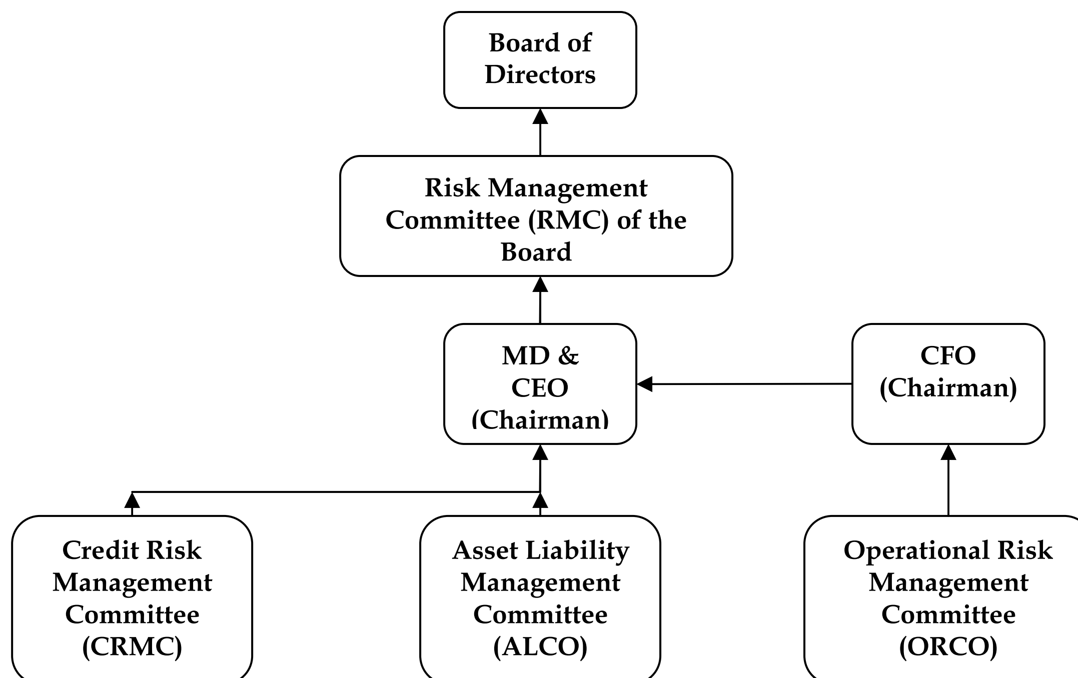
The Risk Management Committee of the Board is the primary tier to oversee implementation of Board approved strategies and policies, recommend setting up of tolerance limits wherever required, monitor implementation of strategies and policies, as well as adherence to prescribed tolerance limits etc. The RMC oversees the functioning of Executive level Committees for risk management. For this purpose, the minutes of the meetings of the Executive Level Committees are placed before RMC regularly. Matters relating to Credit risk are routed through the Credit Committee of Board (CCB) which also approves individual credit exposure in excess of executive delegated lending authority.

Executive Level Committees:

At Executive Management level, the organizational responsibilities for implementing and monitoring Board approved strategies and policies and adhering to prescribed tolerance limits etc are as under:

Sr. No.	Executive Level Committee	Focus Area	Chairman
1	Asset Liability Management Committee (ALCO)	All aspects of Market Risk management, monitoring & control	Managing Director & Chief Executive Officer (MD & CEO)
2	Credit Risk Management Committee (CRMC)	All aspects of Credit Risk management, monitoring & control	Managing Director & Chief Executive Officer (MD & CEO)
3	Operational Risk Management Committee (ORCO)	All aspects of Operational Risk management, monitoring & control	Chief Financial Officer (CFO)

All the Executive Level Committees meet at least once in a month. ALCO however meets more frequently depending upon market conditions.



5. CREDIT RISK

The Bank adopts the definition of 'past due' and 'impaired credits' (for accounting purposes) as defined by Reserve Bank of India under Income Recognition, Asset Classification and Provisioning (IRAC) norms (vide RBI Master Circular dated July 1, 2011).

Credit Risk Management:

Credit Risk Management Committee (CRMC) headed by MD & CEO is the top level functional committee for managing credit risk. The committee is responsible for implementation of Credit Risk Management policy approved by the Bank's Board. The committee considers and takes decision necessary to manage and control credit risk within the overall quantitative prudential limits approved by the Bank's Board. The committee is entrusted with the responsibilities to formulate standards for presentation of credit proposals, financial covenant, rating standards and benchmarks. The committee also oversees compliance with Pillar II requirements under Basel II such as ICAAP and Stress Test.

The Bank has successfully implemented RAM rating model of CRISIL which is being used to assess the credit rating of all business loans exceeding Rs. 1 crore. The rating serves as a single point indicator of the diverse counterparty risk for taking credit decision. The rating migration is monitored on regular interval.

The Bank has a well developed credit monitoring system to monitor the health of the loan accounts and to detect the delinquencies at the initial stage. A separate department independent

of the business units is monitoring the transactions in all the Corporate, Agri and Inclusive Banking (AIB), SME and MSME exposures with credit limits exceeding Rs. 1 crore with a view to detect any early warning signals.

The Bank adopts an integrated approach to credit risk management, which encompasses:

- Establishment and articulation of corporate priorities
- Institution and inculcation of an appropriate credit culture
- Determination of specific credit risk strategy and profile
- Implementation of appropriate credit risk controls
- Monitoring the effectiveness of credit risk controls

Though the Bank has implemented the Standardized approach for regulatory capital measurement for credit risk, the necessary steps for implementing Internal Rating Based Approach have been initiated.

Credit Strategy and Risk Profile:

The Bank adopts a credit risk strategy and risk appetite, which is in line with its risk taking ability to ensure conservation and growth of shareholder funds, with a proper balance between risk and reward. Financial resources are allocated to best optimize the risk reward ratio.

There is a clearly articulated definition of acceptable credit risk, based upon:

- Identification of target markets/segments
- Establishing of characteristics of desirable customers within the target market
- Assessing whether adequate resources are available to support the business
- Ensuring that all economic and regulatory requirements are complied with
- Ensuring that the portfolio is consistent with the Bank's strategy and objectives especially in relation to risk concentration, maturity profile and liquidity management

Credit Risk Controls:

Credit risk controls focus on identification, measuring, monitoring and managing the assumed risks and include:

- A documented credit policy and credit risk management policy
- Approval process with delegated authorities
- Asset quality and risk rating system and its verification
- Effective loan administration to ensure past-due management and bad loan detection
- A loan review mechanism
- Portfolio management tools to manage portfolio risks

Management of credit risk is at three levels:

- Strategic or Portfolio level, so as to ensure that no single event can have a significant adverse impact
- Established credit policy to have a minimum standard for assuming risk
- Reliance on the competence of trained staff to make sound credit decisions

There is a clear separation in functional responsibilities between:

- Origination and sales
- Credit assessment and approvals
- Post- sanction loan administration and
- Credit Risk Management

The Bank relies upon formal and conventional risk assessment, viz.:

- The ability and willingness of borrowers to repay
- Dependence primarily on cash flows for repayment with security taken to provide a secondary source of repayment
- Quality of data and analysis thereof forms the basis of assessment and not external reputation or unsubstantiated beliefs
- Rational assessment of probability of default and assessment of 'Worst Case Scenario'
- Transparency and communication of all relevant facts (negative as well as positive) necessary for making an informed credit decision
- Documentation of all assessment, rationale and decisions

Know Your Customers 'KYC' forms the bedrock of initiating and sustaining any relationship.

The Bank's selection of personnel and systems of rewarding performance is aligned to meet the Bank's stated key priorities. There is a commitment to training and upgrading of staff skills. Strong 'ownership' of exposures is encouraged, through rewards as well as strong accountability. The Bank encourages use of contemporary and appropriate technology to measure, monitor and manage risks and to remain abreast of technological advancements in the industry.

i) Total gross credit risk exposure as on March 31, 2012:

(Rs. crores)

Category	Exposure
Fund based [1]	6,045.63
Non fund based [2]	1,009.17
Total	**7,054.80**

Note:

1. Fund based credit exposure excludes SLR investments, cash in hand, balance with RBI and Fixed and Other assets.
2. Non-Fund based exposure includes outstanding Letter of Credit, Acceptances and Bank Guarantee exposures.

ii) Geographical distribution of exposures as on March 31, 2012:

(Rs. crores)

Category	Domestic	Overseas
Fund based	6,045.63	-
Non fund based	1,009.17	-
Total	**7,054.80**	**-**

iii) Industry type distribution of exposures as on March 31, 2012:

(Rs. crores)

Industry	Fund based	Non-fund based
Mining	**3.83**	**0.02**
Iron & Steel	**163.22**	**10.95**
Other Metal & Metal Products	**55.24**	**9.33**
Engineering	**225.17**	**60.24**
Electricity	**25.24**	**3.43**
Textiles	**110.70**	**0.66**
Tea	**61.39**	**7.44**
Food Processing	**159.19**	**0.14**
Vegetable Oils	**23.04**	**13.86**
Paper & Paper products	**18.38**	**0.04**
Rubber	**6.98**	**-**
Chemicals	**267.61**	**73.24**
Cement	**5.32**	**0.24**
Leather & Leather products	**23.13**	**-**
Gems & Jewellery	**17.55**	**8.15**
Constructions	**207.21**	**158.57**
Automobiles, incl. Trucks	**18.97**	**7.01**
Infrastructure	**-**	**122.93**
Other Manufacturing	**28.68**	**14.00**
NBFCs	**139.75**	**0.83**
Trade	**605.59**	**211.86**
Agriculture	**608.93**	**10.62**
Personal Loans	**120.82**	**-**
Retail Business Loans	**382.74**	**-**
Real Estate	**813.07**	**22.37**
Capital Market	**1.19**	**41.60**
Finance (Others)	**30.34**	**16.75**
Other Services	**544.40**	**110.38**
Residual	**1,377.95**	**104.51**
- Exposure on PSEs	422.51	-
- Exposure to banks	125.87	-
- Others	829.57	104.51
Total	**6,045.63**	**1,009.17**

Note:

1. Other Services includes Travel & Tourism, Logistics, IT & related services, Renting of Equipments.
2. Exposure on PSEs includes RIDF, NABARD and SIDBI deposits.

The Bank's exposure exceeds 5% marginally only in the case of one industry i.e. Construction with exposure at 5.18%.

iv) Residual contractual maturity breakdown of assets as on March 31, 2012:

(Rs. crores)

Assets	Next Day	2-7 Days	8-14 Days	15-28 Days	29 Days -3 Months	3 Months - 6 Months	6 Months - 1 Year	1-3 Years	3-5 Years	Above 5 Years	Total
Cash	85.68	-	-	-	-	-	-	-	-	-	**85.68**
Balance with RBI	119.62	6.04	7.92	4.28	26.94	24.85	34.19	92.57	4.79	0.61	**321.83**
Balances with Other Banks	48.27	-	-	-	0.35	-	0.10	0.33	-	-	**49.05**
Investments	-	64.92	-	-	207.03	123.04	78.36	202.05	798.26	1,044.10	**2,517.76**
Advances (Excl. NPA provn.)	78.75	91.70	97.46	117.77	367.89	240.84	314.37	2,405.82	401.45	1,168.38	**5,284.42**
Fixed Assets	-	-	-	-	-	-	-	-	-	184.64	**184.64**
Other Assets (Net)	44.94	3.72	8.54	4.56	14.90	18.12	3.31	99.28	29.39	6.70	**233.47**
Total	**377.26**	**166.39**	**113.92**	**126.61**	**617.10**	**406.86**	**430.34**	**2,800.05**	**1,233.88**	**2,404.44**	**8,676.84**

v) Advances and Provisions:

(Rs. crores)

Particulars	As on March 31, 2012
Amount of NPAs (Gross)	
a. Substandard	38.60
b. Doubtful 1	24.96
c. Doubtful 2	55.44
d. Doubtful 3	1.78
e. Loss	121.02
NPA Ratios	
a. Gross NPAs to gross advances (%)	4.40%
b. Net NPAs to Net Advances (%)	0.57%
Movement of NPAs(Gross)	
a. Opening balance	263.57
b. Additions during the year	68.17
c. Reductions during the year	89.94
d. Closing balance	241.80
Movement of Net NPAs	
a. Opening balance	41.23
b. Additions during the year	15.81
c. Reductions during the year	26.80
d. Closing balance	30.24
Movement of provisions for NPAs (excluding provision on Standard Assets)	
a. Opening balance	218.63
b. Provision made during the year	50.86
c. Write-off/ write-back of excess provisions	63.09
d. Closing balance	206.40
Movement of depreciation on investments	
a. Opening balance	0.05
b. Add: Provision made during the year	0.87
c. Less: Write-off/ write-back of excess provision during the year (including depreciation utilized on the sale of securities)	0.20
d. Closing balance	0.72

6. CREDIT RISK: Disclosures for portfolio subject to the Standardised Approach

The Bank has used the ratings of the following domestic external credit rating agencies for the purpose of risk weighting their claims on the domestic entities for capital adequacy purpose:

i. CRISIL Ltd
ii. FITCH Ratings
iii. Credit Analysis and Research Limited
iv. ICRA Limited

International Credit rating agencies: Standard and Poor, Moody's, Fitch

The Bank has used the solicited ratings assigned by the above credit rating agencies for credit facilities provided to its customers.

A description of the process used to transfer public issue ratings onto comparable assets in the banking book:

- Bank has used short term ratings for assets with maturity upto one year and long-term ratings for assets maturing after one year as accorded by the approved external credit rating agencies.
- Bank has not cherry picked ratings. Bank has not used one rating of a CRA (Credit Rating Agency) for one exposure and another CRA's rating for another exposure on the same counterparty unless only one rating is available for a given exposure.
- Notwithstanding the repayable on demand condition, cash credit exposures have been subjected to Long-term rating.
- If an issuer has a long term external credit rating that warrants RW (Risk Weight) of 150%, all unrated exposures on the same issuer whether long or short is assigned the same 150% RW unless mitigated by recognized Credit Risk Mitigation (CRM) techniques.
- Bank has used only solicited rating from the recognized CRAs. In case the issuer has multiple ratings from CRAs, the Bank has a policy of choosing (if there are two ratings) lower rating.
- Where RW associated with the rating by a CRA for a specific investment instrument is lower than one corresponding to unrated exposure, but the Bank's exposure is not in that instrument but some other debt, the RW for the rated exposure has been applied to Bank's unrated exposure provided the latter ranks pari-passu or senior to the specific rated exposure and the maturity of Bank's claim is not later than the rated exposure.
- If either the issuer or a single issue has been rated warranting RW equal or higher than unrated claim, a claim on the same issuer which is unrated but ranks pari-passu or junior to the rated exposure has been assigned the same RW as the rated exposure.
- No recognition of CRM technique has been taken into account in respect of a rated exposure if that has already been factored by the CRA while carrying out the rating.

For exposure amounts after risk mitigation subject to the standardised approach, amount of a Bank's outstanding (rated and unrated) in the following three major risk buckets as well as those that are deducted as on March 31, 2012 are as follows:

(Rs. crores)

Particulars	Fund based	Non fund based
Below 100% risk weight	3,224.36	433.63
100% risk weight	2,551.50	533.94
More than 100% risk weight	269.77	41.60
Deducted	-	-
Total	**6,045.63**	**1,009.17**

7. CREDIT RISK MITIGATION: Disclosures for Standardised Approach

The Bank has adopted Credit Risk Mitigation (CRM) Techniques and Collateral Management (CM) guidelines issued by RBI under Master circular – Prudential guidelines on capital Adequacy and Market Discipline – New Capital Adequacy Framework (NCAF) (vide RBI Master Circular dated July 1, 2011)

Bank has utilized credit risk mitigation in the case of Bank's own deposits, Kisan Vikas Patra, LIC policies, National Saving Certificate and Gold, wherever the Collateral is identifiable, marketable and enforceable and complies with RBI requirements. Sovereign exposures and Sovereign guaranteed exposures are risk weighted as per RBI directives.

The general principles applicable for use of credit risk mitigation techniques are as under:

i. No transaction in which Credit Risk Mitigation (CRM) techniques are used has been assigned higher capital requirement than as otherwise identical transaction where such techniques are not used.
ii. The Bank has taken care to see that effects of CRM are not double counted. To ensure this no additional supervisory recognition of CRM for regulatory capital purposes are made available on claims for which an issue-specific rating is used that already reflects that CRM.
iii. Principal-only ratings will not be allowed within the CRM framework. The rating should cover principal and interest.

Bank has therefore put in place robust procedures and processes to control these risks, including strategy, consideration of the underlying credit, valuation, policies and procedures systems, control of roll-off risks, and management of concentration risk arising from the use of CRM techniques and its interaction with the Bank's overall credit risk profile.

Eligible Financial Collateral:

The following eligible collateral instruments are used for recognition in the comprehensive approach:

i. Cash or deposits with the Bank itself
ii. Gold: Gold would include both bullion and jewellery
iii. Securities issued by Central and State Governments
iv. Kisan Vikas Patra and National Savings Certificates provided no lock-in period is operational and if they can be encashed within the holding period
v. Life insurance policies with a declared surrender value of an insurance company which is regulated by an insurance sector regulator.
vi. Debt securities rated by a chosen Credit Rating Agency in respect of which the banks should be sufficiently confident about the market liquidity where these are either:
    a. Attracting 100 per cent or lesser risk weight i.e. rated at least BBB (-), when issued by public sector entities and other entities (including banks and Primary Dealers); or
    b. Attracting 100 per cent or lesser risk weight i.e. rated at least PR3/ P3/F3/A3 for short-term debt instruments.
vii. Debt securities not rated by a chosen Credit Rating Agency in respect of which the banks should be sufficiently confident about the market liquidity where these are:
    a. Issued by a bank
    b. Listed on a recognised exchange
    c. Classified as senior debt
    d. All rated issues of the same seniority by the issuing bank are rated at least

e. BBB (-) or PR3/P3/F3/A3 by a chosen Credit Rating Agency
f. The bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB(-) or PR3/P3/F3/A3 (as applicable)
g. Banks should be sufficiently confident about the market liquidity of the security

(Rs. crores)

Particular	As on March 31, 2012
Total exposure covered by eligible financial collateral after application of applicable haircuts	806.12
Total exposure covered by guarantees/credit derivatives	-

8. SECURITIZATION EXPOSURES

The Bank has not undertaken any securitization deals in Financial Year 2011-12.

9. MARKET RISK IN TRADING BOOK

Market risk refers to the uncertainty of future earnings resulting from changes in interest rates, foreign exchange rates, market prices and volatilities. The Bank assumes market risk in its lending and deposit taking businesses and in its investment activities, including position taking and trading. The market risk is managed in accordance with the investment policies, which are approved by the Board. These policies ensure that operations in securities, foreign exchange and derivatives are conducted in accordance with sound and acceptable business practices and are as per the extant regulatory guidelines, laws governing transactions in financial securities and the financial environment. Market Risk in Trading Book is assessed as per the Standardised Duration approach. The capital charge for Held for Trading (HFT) and Available for Sale (AFS) portfolios is computed as per Reserve Bank of India prudential guidelines.

Market risk management objectives:

The objectives of market risk management are as follows:

- Management of liquidity
- Management of interest rate risk and exchange rate risk.
- Proper classification and valuation of investment portfolio
- Adequate and proper reporting of investments and derivative products
- Compliance with regulatory requirements

Structure and organization of the market risk management function:

The Board, through Risk Management Committee, approves the policies with regard to identification, measurement and control of market risks (Interest Rate Risk and Foreign Exchange Risk) and Liquidity Risk. Market Risk department is an independent function. The Market Risk Department exercises independent control over the process of market risk management and recommends changes in processes and methodologies for measuring Market Risk.

Strategies and processes:

To comply with the regulatory guidelines and to have independent control groups there is clear functional separation of:

- Trading (Front office)
- Monitoring & control (Middle office) and
- Settlements (Back office)

The strategy/guidelines for controlling market risk include:

- Direct involvement of experienced line management
- Stringent controls and limits
- Strict segregation of front, middle and back office duties
- Comprehensive periodical reporting of positions
- Regular independent reviews of all controls and limits
- Rigorous testing and auditing of all pricing, trading and risk management

The scope and nature of risk reporting and measurement systems:

Reporting - The Bank periodically reports on the various investments and their related risk measures to the senior management and the committees of the Board. The Bank also periodically reports to its regulator in compliance with regulatory requirements.

Measurement - The Bank has devised various risk metrics for measuring market risk. These are reported to Asset Liability Management Committee by Market Risk Management Department. Some of the risk metrics adopted by the Bank for monitoring its risks are Value-at-Risk, Earnings at Risk, Modified Duration, Stop Loss limits amongst others.

Capital requirements for market risk

(Rs. crores)

Particulars	As on March 31, 2012
• Interest Rate Risk	2.23
• Foreign Exchange Risk (Including gold)	3.15
• Equity Risk	0.07
Capital requirement for Market Risk	**5.45**

10. OPERATIONAL RISK

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk but excludes strategic and reputation risks.

The Bank has put in place a Board approved Operational Risk Management Policy which outlines overall framework for management of Operational Risk. The Bank has identified Key Operational Risk Indicators (KORIs) across various units, which are measured, monitored regularly and reported to Operational Risk Management Committee (ORCO) on monthly basis. The Bank has a robust system of reporting Operational Risk events across various units through identified Operational Risk Officers, who are given adequate training to identify and report such events as and when they occur. The Bank has a very effective system of recording and reporting operational losses booked. The Bank also collects qualitative data on self assessment of operational risk faced by various units through Risk Control Self Assessment (RCSA) exercise.

The Bank has implemented Periodic Risk Identification and Controls Evaluation (PRICE) system with a view to develop policy framework for identification and documented plan to mitigate various risks in the Bank. The PRICE system is expected to provide a robust overview of various risks being identified proactively that remain un-mitigated. The PRICE system is pivotal in

continuous assessment of our risk and control environment and prioritize our remedial efforts based on risk/impact.

The Bank manages Operational Risk by way of adopting best practices in processes as well as products. All the new and existing process are subjected to rigorous review by Management Committee for Approval of Process (MCAP), which comprises of senior management personnel with diversified experience in banking. Utmost importance is given on communication and understanding of processes at transactional level and compliance to same are monitored through effective internal audits.

The Bank understands the criticality of business continuity in event of any undesirable event and has put in place an exhaustive Business Continuity Plan (BCP) in place which is subject to periodic drills. The Bank has robust Information Technology with Disaster Recovery site (DR) for critical functions and backups, further there is a strict adherence to Information Security Policy across the Bank.

As per the mandate from RBI, the Bank is following the Basic Indicator Approach (BIA) for assessment of Operational Risk Capital. The Bank has taken quantitative and qualitative steps in view of moving towards advanced approaches as prescribed by RBI.

Capital requirement for operational risk as per Basic Indicator Approach (BIA) as on March 31, 2012 is Rs. 41.83 crore.

11. INTEREST RATE RISK IN BANKING BOOK

Interest Rate Risk in the Banking Book (IRRBB):

Interest rate risk is the potential change in Net Interest Income or Economic Value of Equity (Balance Sheet impact), caused by unexpected changes in market interest rates. Since NII or NIM of Bank is dependent on the movements of interest rates, any mismatches or gaps in the cash-flows on re-pricing dates exposes Bank's NII or NIM to interest rate risk. Interest Rate Risk in Banking Book results from an unavoidable position or gap arising from Bank's normal day to day business by holding assets and liabilities in different maturities and different re-pricing dates.

Risk management framework and monitoring:

The Board of the Bank, through Risk Management Committee (RMC), has overall responsibility for management of risks and it set limits and policies for management of liquidity risk, market risk including foreign exchange, interest rate and equity risk. The Asset Liability Management Committee (ALCO), a strategic decision making body constituted by Board, headed by Managing Director and comprising of senior executives of the Bank is responsible for deciding the mix and maturity profile of the assets and liabilities, recommendation of risk policies, setting up of prudential limits to manage the risks and ensuring compliance with the limits set by the Board. The ALM policy of the Bank includes the prudential limits on interest rate risk, liquidity risk, foreign exchange risk and equity risk.

Market Risk Management Department is responsible for monitoring the limits laid down in the ALM Policy through various reports. These reports are prepared at regular intervals and exceptions/deviations are reported to the ALCO/RMC, as may be required by the ALM policy.

Risk measurement and reporting framework:

As a part of its regular activities, ALCO manages the impact of the interest rate risk in banking book, through various limits, reports and tools such as interest rate sensitive gaps, Earnings at risk analysis, duration gap analysis, stress testing, etc. detailed as follows:

Interest rate sensitivity gap:

The interest rate gap risk, at any given date, is the risk arising from the mismatches in the assets & liabilities over the different time intervals. These mismatches or gaps are arrived at after matching rate sensitive assets & rate sensitive liabilities in the particular time bucket taking into account all assets and liabilities (including off Balance Sheet exposure). The rate sensitive assets & liabilities are grouped in the buckets as per the residual maturity or re-pricing date, whichever is earlier and is reported on monthly basis. The gap indicates whether net interest income is positively or negatively impacted by a change in interest rates and the magnitude of the gap approximates the change in net interest income for any given interest rate shift. Limits are fixed on individual gaps.

Earnings at Risk Analysis (EAR):

The gaps in the report indicates whether the Bank is in a position to benefit from rising interest rates by having a positive gap (RSA > RSL) or whether it is in a position to benefit from declining interest rates by a negative gap (RSL >RSA). The Bank monitors the Earnings at Risk on NII for 1% change in interest rates on the open periodic gaps.

Stress testing:

The Bank measures the impact on Net Interest Margin (NIM)/ EaR after taking into account various possible movement in interest rates across tenor and impact on the earnings is calculated for each of these scenarios. These reports are prepared on a quarterly basis for measurement of interest rate risk.

Duration gap analysis:

Movement in the interest rates also have a long-term impact on the market value of equity of the Bank, as the economic value of the Bank's assets, liabilities and off-Balance Sheet positions get affected. Duration is a measure of interest rate sensitivity of assets, liabilities and also equity. It may be defined as the percentage change in the market value of an asset or liability (or equity) for a given change in interest rates. Thus Duration Gap Analysis measures by how much the market value of equity of a firm would change for the possible change in the interest rates.

The following tables show the impact on NII and economic value of equity for a given change in the interest rates. The impact is calculated assuming parallel shifts in the yield curve across all time buckets.

i) Impact on NII:

(Rs. crores)

Currency	Change in interest rates (in bps)			
	(100)	**(50)**	**50**	**100**
INR	(0.92)	(0.46)	0.46	0.92
USD	0.94	0.47	(0.47)	(0.94)
JPY	0.00	0.00	0.00	0.00

Currency	Change in interest rates (in bps)			
	(100)	**(50)**	**50**	**100**
GBP	0.01	0.00	(0.00)	(0.01)
EUR	(0.00)	(0.00)	0.00	0.00
Total	**0.03**	**0.02**	**(0.02)**	**(0.03)**

ii) Impact on economic value of equity:

(Rs. crores)

	Changes in interest rates (in bps)			
Currency	**(100)**	**(50)**	**50**	**100**
INR	44.01	22.00	(22.00)	(44.01)
** No major exposure in foreign currencies*				