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.

2: CAPITAL STRUCTURE

Equity Capital:

The Bank has authorized share capital of Rs. 500 Crore comprising 500,000,000 equity share of Rs. 10/- each. As on March 31, 2011, the Bank has issued, subscribed and paid-up capital of Rs. 200.17 Crore, constituting 200,171,209 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.

Lower Tier II Capital:

Subordinated Debt

As on March 31, 2011, the Bank had an outstanding subordinated debt (Unsecured Redeemable Non-convertible Bonds) aggregating Rs. 101 Crore the details of which are stated below:

(Rs. in Crores)

Issue Series	Deemed Date of Allotment	Coupon Rate (% p.a.)	Tenure (in months)	Equivalent Amount as on March 31, 2011
II (Option II)	September 30, 2003	7.30	92	26.00
III (Option II)	March 3, 2004	7.15	99	10.00
IV	August 31, 2009	11.25	68	65.00
TOTAL				**101.00**

Composition of Capital – Tier I and Tier II as on March 31, 2011

(Rs. in Crores)

Tier I Capital	
Paid up Share Capital	200.17
Reserves	359.03
Gross Tier I Capital	**559.20**
Deductions	-
Amounts deducted from Tier I capital	1.67
Net Tier I Capital	**557.53**
Tier II Capital	
Lower Tier II Bonds	-
Subordinated debts	54.00
General Provisions/IRA and Revaluation Reserves	53.90
Gross Tier II Capital	**107.90**
Deductions	-
Net Tier II Capital	107.90
Total eligible capital	**665.43**

Debt Capital instruments eligible for inclusion in Upper Tier II Capital	-
Total amount outstanding	-
Of which amount raised during the current year	-
Amount eligible to be reckoned as Capital funds	-
Subordinated debt eligible for inclusion in Lower Tier II Capital	-
Total amount outstanding	101.00
Of which amount raised during the current year	-
Amount eligible to be reckoned as Capital funds	54.00
Tier I Capital Funds	**557.53**
Tier II Capital Funds	**107.90**
Total Eligible Capital Funds	**665.43**

3: CAPITAL ADEQUACY

In line with the RBI guidelines for implementing the New Capital Adequacy Framework, the Bank has successfully migrated to the revised 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, 2011. Besides this, the Bank continues to apply the Standardised Duration Approach (SDA) for computing capital requirement for Market Risk. Reserve Bank of India 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 13.25% as on March 31, 2011 (as against regulatory requirement of 9%). The Tier I CRAR stands at 11.10% 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 Requirement for Credit Risk, Market Risk and Operational Risk as on March 31, 2011

(Rs. in Crores)

Risk Type	Amount
A) Capital requirements for Credit Risk	**405.81**
▪ Portfolio subject to Standardised approach	405.81
▪ Securitization Exposures	Nil
B) Capital requirements for Market Risk	**5.37**
▪ Standardised duration approach	
o Interest Rate Risk	2.22
o Foreign Exchange Risk (Including gold)	3.15
o Equity Risk	0.00
C) Capital requirements for Operational Risk	**40.78**
▪ Basic indicator approach	40.78
Total Capital requirements at 9%	**451.96**
Total Capital Funds	**665.43**
CRAR	**13.25%**
Tier-I CRAR	**11.10%**

4 : RISK MANAGEMENT FRAMEWORK

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

The overall objectives of the Risk Management function are:

- To integrate the sound principles of Risk Management system and practices into the overall functioning and set up of the Bank
- To facilitate a long term view of risks and its management from a long term perspective
- To provide the necessary base for the Board to convey its overall Risk Philosophy and Risk Appetite which will facilitate the executive management to fix the contours of risk
- To provide a framework for the linkage between different types of risks across products and processes

The Board of Directors (BOD) approves the strategies and policies for Risk Management, based on recommendations of the Committee of Directors on Risk Management (RMC) set up to focus upon risk management issues. BOD decides/revises the composition of RMC, frequency and quorum for meetings of RMC etc. from time to time. BOD oversees the functioning of RMC. BOD's oversight of implementation of approved strategies and policies is the primary tool of ensuring compliance to BOD approved strategies and policies.

Committee of Directors on Risk Management (RMC)

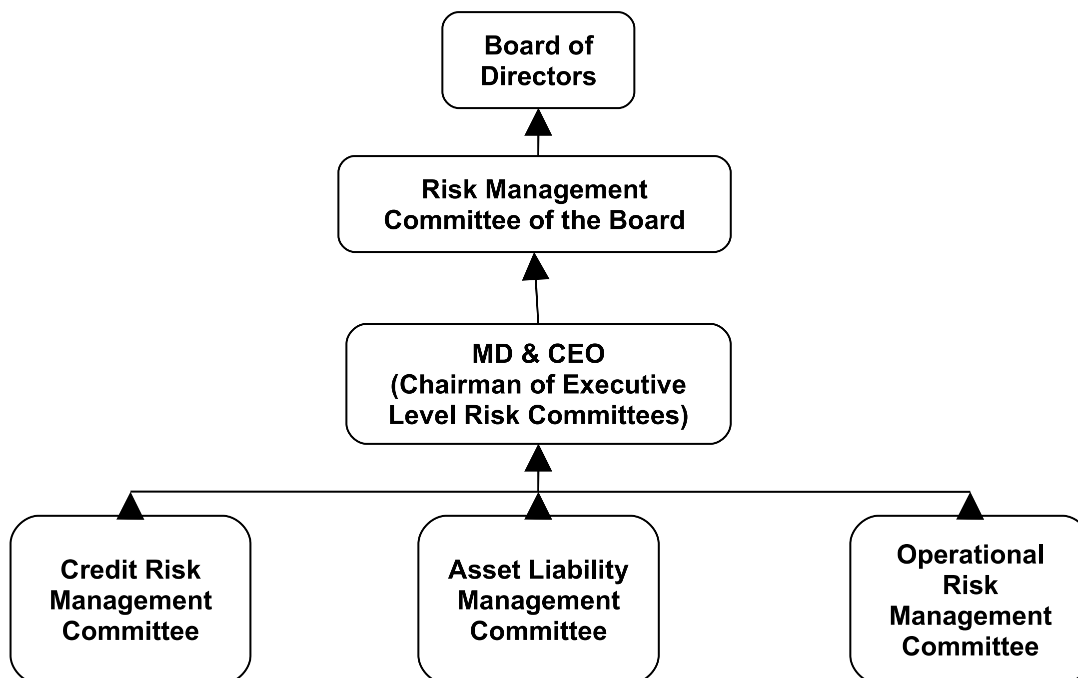
The Committee of Directors on Risk Management (RMC) is the primary tier to oversee implementation of BOD approved strategies and policies, recommend setting up of tolerance limits wherever required, monitoring of implementation of strategies and policies as well as adherence to prescribed tolerance limits 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 BOD approved strategies and policies and adhering to prescribed tolerance limits etc are as under

1	Asset Liability Committee (ALCO)	All aspects of Market Risk management, monitoring & control
2	Credit Risk Management Committee (CRMC)	All aspects of Credit Risk management, monitoring & control
3	Operational Risk Management Committee (ORMC)	All aspects of Operational Risk management, monitoring & control

All the Executive level committees meet at least once in a month. ALCO however meets more frequently depending upon market conditions. Managing Director is the Chairman of these committees.



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 01, 2010)

Credit Risk Management:

Credit Risk Management Committee headed by MD & CEO is the top level functional committee for managing credit risk. 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 etc.

The Bank has procured RAM rating model from CRISIL which is being used to assess the credit rating of all business loans exceeding Rs. One 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, SME and MSME exposures with credit limits exceeding Rs. One 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 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 loan 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 and
- Post- sanction loan administration

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

- The capacity 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 up gradation 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 exposures:

(Rs. in Crores)

Type	Amount
Fund based [1]	5,135.70
Non fund based [2]	1,026.77
Total	**6,162.47**

Note:

1. Fund based exposure includes Gross advances, Investments other than Government securities and other assets excluding deposits with banks. Exposures to Government/ RBI have been excluded from Fund based exposures.

2. Non Fund Based exposure includes outstanding Letter of Credit, Acceptances and Bank Guarantee exposures

ii) Geographical distribution of exposures:

(Rs. in Crores)

Type	Domestic	Overseas
Fund based	5,135.70	-
Non fund based	1,026.77	-
Total	**6,162.47**	**-**

iii) Industry type distribution of exposures:

(Rs. in Crores)

Industry	Fund based (Outstandings)	Non fund based (Outstandings)
Mining	35.98	0.02
Iron & Steel	37.38	1.74
Other Metal & Metal Products	20.40	145.80
Engineering	120.39	46.65
Electricity	26.35	0.96
Textiles	81.91	0.46
Tea	16.50	0.00
Food Processing	147.38	0.63
Vegetable Oils	25.18	33.95
Paper & Paper products	5.11	0.30
Rubber	2.01	0.00
Chemicals	207.85	41.96
Cement	1.06	0.02
Leather & Leather products	17.28	0.00
Gems & Jewellery	37.79	24.00
Constructions	376.62	175.07
Automobiles, incl. Trucks	10.91	9.89
Infrastructure	1.22	89.94
Other Manufacturing	16.10	21.96
NBFCs	267.78	3.65

Trade	398.72	211.27
Agriculture	583.21	13.15
Personal Loans & consumer loans	686.76	2.80
Real Estate	653.93	21.17
Capital Market	9.51	35.95
Finance (Others)	5.00	8.25
Other Services	359.16	65.02
Residual*	984.21	72.19
Total	**5,135.70**	**1,026.77**

** Residual assets also include deposits with NABARD under RIDF.*

The Bank's exposure exceeds 5% only in the case of one industry i.e. Construction with exposure at 8.95%

iv) Residual contractual maturity breakdown of assets:

(Rs. in 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	63.86	-	-	-	-	-	-	-	-	-	**63.86**
Balance with RBI	100.66	7.62	9.46	7.13	23.07	24.56	49.79	102.07	4.91	11.39	**340.65**
Balances with Other Banks	45.95	33.45	0.73	0.06	-	1.70	0.40	0.31	0.02	-	**82.60**
Investments	-	-	-	25.17	241.84	26.92	129.91	195.77	537.63	1,137.81	**2,295.04**
Advances (Excl NPA provn)	100.26	185.14	101.60	60.36	305.21	362.56	227.58	1,827.37	296.66	804.70	**4,271.45**
Fixed Assets	-	-	-	-	-	-	-	-	-	127.50	**127.50**
Other Assets (net)	9.92	7.65	4.85	4.19	12.90	9.57	4.59	107.36	24.12	6.08	**191.23**
Total	**320.64**	**233.86**	**116.63**	**96.91**	**583.02**	**425.31**	**412.26**	**2,232.88**	**863.34**	**2,087.48**	**7,372.34**

v) Advances and Provisions:

(Rs. in Crores)

Particulars	As on March 31, 2011
Amount of NPAs(Gross)	
a. Substandard	27.64
b. Doubtful 1	50.23
c. Doubtful 2	55.26
d. Doubtful 3	5.77
e. Loss	124.67
NPA Ratios	
a. Gross NPAs to gross advances (%)	5.86%
b. Net NPAs to Net Advances (%)	0.97%
Movement of NPAs(Gross)	
a. Opening balance	319.18
b. Additions during the year	50.71
c. Reductions during the year	106.32
d. Closing balance	263.57
Movement of Net NPAs	
a. Opening balance	107.62
b. Additions during the year	-31.16
c. Reductions during the year	35.23
d. Closing balance	41.23
Movement of provisions for NPAs (excluding provision on Standard Assets)	
a. Opening balance	211.51
b. Provision made during the year	78.17
c. Write-off/ write-back of excess provisions	71.05
d. Closing balance	218.63
Movement of provision on depreciation on investments	
a. Opening balance	0.04
b. Add: Provision made during the year	0.25
c. Less: Write-off/ write-back of excess provision during the year (including depreciation utilized on the sale of securities)	0.24
d. Closing balance	0.05

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:

1. CRISIL Ltd
2. FITCH Ratings
3. Credit Analysis and Research Limited
4. 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 to 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 then 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 outstandings (rated and unrated) in the following three major risk buckets as well as those that are deducted are as follows :

(Rs. in Crores)

Below 100% risk weight	3,003.88
100% risk weight	2,905.11
More than 100% risk weight	253.48
Deducted	-
Total	**6,162.47**

7: CREDIT RISK MITIGATION: Disclosures for Standardised Approach

The Bank has adopted Credit Risk Mitigation (CRM) Techniques and Collateral Management (CM) guidelines issued by Reserve Bank of India under Master circular –Prudential guidelines on capital Adequacy and Market Discipline – New Capital Adequacy Framework (NCAF) (vide RBI Master Circular dated July 01, 2010)

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:

a) 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.
b) 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.
c) 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 BBB (-) or PR3/P3/F3/A3 by a chosen Credit Rating Agency
    e) 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)
    f) Banks should be sufficiently confident about the market liquidity of the security

Quantitative Disclosure

(Rs. in Crores)

Particular	Fund Based
Exposure before applying eligible financial collateral	5,135.70
Exposure after applying eligible financial collateral	4,705.30

8: SECURITIZATION EXPOSURES: Disclosure for Standardised Approach

The Bank has not undertaken any securitization deals to acquire home loan portfolio in 2010-11 and does not have any exposure to such assets as on March 31, 2011.

The Bank has no exposure to securitization deals to transfer loans to other entities.

9: MARKET RISK IN TRADING BOOK

a. Market risk management policy

Risk management policies:

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 Availiable For Sale (AFS) portfolios is computed as per Reserve Bank of India prudential guidelines.

Risk management objectives:

The objectives of market risk management are as follows:
(i) Proper management of liquidity
(ii) Management of interest rate risk and exchange risk.
(iii) Proper classification and valuation of investment portfolio
(iv) Adequate and proper reporting of investments and derivative products
(v) 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:
(i) Trading (Front office)
(ii) Monitoring & control (Middle office) and
(iii) Settlements (Back office)

The strategy/guidelines for controlling market risk include:

(i) Direct involvement of experienced line management
(ii) Stringent controls and limits
(iii) Strict segregation of front, middle and back office duties
(iv) Comprehensive periodical reporting of positions
(v) Regular independent reviews of all controls and limits
(vi) 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.

b. Capital requirements for market risk

(Rs. in Crores)

Capital requirements for Market Risk as on March 31, 2011	**5.37**
▪ Interest Rate Risk	2.22
▪ Foreign Exchange Risk (Including gold)	3.15
▪ Equity Risk	0.00

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 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 Process Development Committee (PDC) and Process Approval Committee (PAC), which comprise 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 Audit.

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, 2011 is Rs. 40.78 Crores.

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 & liabilities in different maturities and different re-pricing dates.

Risk management framework & 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 & maturity profile of the assets & 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 & 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 monthly 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 & 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.

a. Impact on NII

(Rs. in Crores)

Currency	Changes in int rates (in bps)			
	(100.00)	**(50.00)**	**50.00**	**100.00**
INR	(0.66)	(0.33)	0.33	0.66
USD	0.22	0.11	(0.11)	(0.22)
JPY	0.00	0.00	0.00	0.00
GBP	0.00	0.00	(0.00)	(0.00)
EUR	0.00	0.00	(0.00)	(0.00)
Total	**(0.44)**	**(0.22)**	**0.22**	**0.44**

b. Impact on economic value of equity

(Rs. in Crores)

	Changes in interest rates (in bps)			
Currency	**(100)**	**(50)**	**50**	**100**
INR	45.17	22.58	(22.58)	(45.17)
** No major exposure in foreign currencies*				