disclosures on risk based capital (Basel II)

Background: These disclosures under Pillar III of Basel II are made following revised 'Guidelines on Risk Based Capital Adequacy (RBCA)' for banks issued by Bangladesh Bank (Central Bank of Bangladesh) in December 2010. These quantitative and qualitative disclosures are intended to complement the Minimum Capital Requirement (MCR) under Pillar I and Supervisory Review Process (SRP) under Pillar II of Basel II.

The purpose of these disclosures is to present relevant information on adequacy of capital in relation to overall risk exposures of the Bank so that the market participants can assess the position and direction of the Bank in making economic decisions.

Consistency and Validation: The quantitative disclosures are made on the basis of consolidated audited financial statements of EBL and its Subsidiaries as at and for the year ended 31 December 2013 prepared under relevant international accounting and financial reporting standards as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) and related circulars/instructions issued by Bangladesh Bank from time to time. The assets, liabilities, revenues and expenses of the subsidiaries are combined with those of the parent company (EBL), eliminating inter-company transactions. Assets of the subsidiaries were risk weighted and equities of subsidiaries were crossed out with the investment of EBL while consolidating.

So, information presented in the 'Quantitative Disclosures' section can easily be verified and validated with corresponding information presented in the consolidated and separate audited financial statements 2013 of EBL (Group and the Bank) available on the website of the Bank (www.ebl.com.bd).

Scope of Application

Applicable top corporate entity: The Risk Based Capital Adequacy framework applies to **Eastern Bank Limited (EBL)** on **'Consolidated Basis**' as there were three operational subsidiaries of the Bank as on the reporting date i.e. 31 December 2013. However, **'Solo Basis'** information has been presented beside those of 'Consolidated Basis' to facilitate comparison.

Entities within the group: The Bank had four subsidiaries, all of them were fully owned, as on the reporting date i.e. 31 December 2013.

EBL Securities Limited: Having acquired rest 40% shares of a brokerage house namely 'EBL Securities Ltd.', EBL completed full acquisition of the same in 2012. It has membership of both DSE & CSE and holds both broker & dealer license for buying, selling and settlement of securities on behalf of investors and for buying & selling of securities in its own portfolio.

EBL Investments Ltd.: A private limited company established to do merchant banking operations, obtained approval from BSEC for Merchant Banking License in January 2013. It is running business in full scale.

EBL Finance (HK) Limited: The first foreign subsidiary of EBL was incorporated on 28 November 2011 with Hong Kong (HK) authority to act as a routing and discounting intermediary of LCs issued by EBL and to advise other local and foreign banks' LCs. EBL obtained all the required licenses from Bangladesh and HK authority. It is now in full operation.

EBL Asset Management Ltd.: A private limited company formed to grab the potential business opportunity in managing mutual funds and institutional wealth. EBL has already obtained permission from Bangladesh Bank and is under process of applying for the license to BSEC.

Restriction on movements of funds: The rules and regulations of BRPD of Bangladesh Bank that govern 'Single Borrower Exposure Limit' for the customers are equally applicable for the Bank in financing its own subsidiaries. Bank is following latest Bangladesh Bank circular in determining maximum amount of finance to the subsidiaries of the Bank. As on year end 2013, EBL had a credit line to 'EBL Securities Ltd.'of BDT 950 million and a Guarantee of BDT 150 million (against clearing settlements with DSE).

Aggregate amount of capital deficiencies: As on the reporting date there was no such deficiency.

Capital Structure

Summary information on the terms and conditions of tier I & II capital instruments: Regulatory capital, as stipulated in the revised RBCA guidelines by BB, is categorized into three tiers according to the order of quality of capital (Tier I, II & III). Tier I or Core Capital comprises the highest quality capital components, Tier II or Supplementary Capital comprises capital elements that fall short of some of the characteristics of core capital but contribute to overall strength of the Bank and Tier III or Additional Supplementary Capital comprises short term subordinated debt with maturity of two to five years. As on year end 2013, there was no tier III component of capital at EBL. Component wise details are presented in the quantitative disclosure part that follows:

Conditions for maintaining regulatory capital (solo basis): The Bank complied with all the required conditions for maintaining regulatory capital as stipulated in the revised RBCA guidelines by Bangladesh Bank as per following details:

- The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 capital:
  - **Status of Compliance:** Complied.
- 50% of revaluation reserves for fixed assets and securities eligible for Tier 2 capital:
  - **Status of Compliance:** Complied.

- 10% of revaluation reserves for equity instruments eligible for Tier 2 capital:
  - **Status of Compliance:** There was no unrealized gain from quoted equities as on the reporting date.
- Subordinated debt shall be limited to a maximum of 30% of the amount of Tier 1 capital:
  - **Status of Compliance:** As on the reporting date there was no subordinated debt in the capital structure of EBL.
- Limitation of Tier 3: A minimum of about 28.5% of market risk needs to be supported by Tier-1 capital. Supporting of Market Risk from Tier 3 capital shall be limited up to maximum of 250% of a bank's Tier-1 capital that is available after meeting credit risk capital requirement.
  - **Status of compliance:** Complied. Excess Tier-1 capital maintained after meeting credit risk was BDT 1,878.5 million (BDT 13,245.16 - BDT 11,366.66). Whereas capital required for meeting 28.5% of market risks was BDT 352.25 million (BDT 1,235.95 X 28.5%) as on the reporting date.

There are certain deductions from tier i capital which are noted with the status of compliance in the respective table presented below.

Quantitative Disclosures: As on the reporting date (31 December 2013), the Bank had a consolidated capital of BDT 16,871.67 million comprising Tier-1 capital of BDT 13,352.60 million and Tier-2 capital of BDT 3,519.07 million. Following table presents component wise details of capital (Tier-1&2) as on reporting date i.e. 31 December 2013:

(Figures are in million BDT)

A	Tier – 1 (Core Capital)	Consolidated	Solo (Bank)
1	Fully Paid-up Capital	6,111.80	6,111.80
2	Statutory Reserve	5,362.42	5,362.42
3	Non- repayable Share premium account	-	-
4	General Reserve	130.00	130.00
5	Retained Earnings	1,392.34	1,284.90
6	Minority interest in Subsidiaries	-	-
7	Non- Cumulative irredeemable Preference shares	-	-
8	Dividend Equalization Account	356.04	356.04
9	Other (if any item approved by Bangladesh Bank)	-	-
10	Sub-Total: (1 to 9)	**13,352.60**	**13,245.16**
B	Tier -2 (Supplementary Capital)		
1	General Provision (Unclassified loans + SMA+ off balance sheet exposure)	1,644.33	1,644.33
2	Assets Revaluation Reserves up to 50%	1,844.75	1,844.75
3	Revaluation Reserve for Securities up to 50%	29.99	29.99
4	Revaluation Reserve for equity instruments up to 10%	-	-
5	All other preferences shares	-	-
6	Subordinated debt	-	-
7	Other (if any item approved by Bangladesh Bank)	-	-
8	**Sub total (1 to 7)**	**3,519.07**	**3,519.07**
9	Deductions from tier i and ii capital (if any)	-	-
C	**Total Eligible Capital (A+B)**	**16,871.66**	**16,764.23**

Capital Adequacy

Assessment of the adequacy of capital: Assessing regulatory capital in relation to overall risk exposures of a bank is an integrated and comprehensive process. EBL follows the 'asset based' rather than 'capital based' approach in assessing the adequacy of capital to support current and projected business activities.

The Bank focuses on strengthening risk management and control environment rather than increasing capital to cover up weak risk management and control practices. EBL has been generating most of its incremental capital from retained profit (stock dividend and statutory reserve transfer etc.) and occasional issue of right shares to support incremental growth of Risk Weighted Assets (RWA). Besides meeting regulatory capital requirement, the Bank maintains adequate capital to absorb material risks foreseen. Therefore, the Bank's Capital Adequacy Ratio (CAR) remains consistently within the comfort zone since the parallel run from 1 January 2009. During the year 2013, the CAR ranges from 11.36% to 12.01% on consolidated basis and from 11.30% to 11.95 % on solo basis against minimum requirement of 10% of RWA.

Risk Management Unit (RMU) under guidance of the SRP team/BRMC (Bank Risk Management Committee), is taking active measures to identify, quantify, manage and monitor all risks to which the Bank is exposed to.

Quantitative Disclosures: Following table shows component wise allocation of capital to meet three risks and an amount of additional capital maintained over MCR i.e. 10% of RWA. As on the reporting date i.e. 31 December 2013, EBL maintained a Capital Adequacy Ratio (CAR) of 12.01% on 'Consolidated Basis' and 11.95% on 'Solo Basis' against required minimum of 10%. We had an excess capital of BDT 2,823.56 million (Consolidated) after meeting all three risks as on the reporting date as shown in the following table:

(Figures are in million BDT)

Capital Adequacy	Consolidated	Solo (Bank)
Capital requirement for Credit Risk	11,350.90	11,366.66
Capital requirement for Market Risk	1,255.94	1,235.95
Capital requirement for Operational Risk	1,441.26	1,425.27
Minimum capital requirement (MCR)	**14,048.10**	**14,027.88**
Additional capital maintained over MCR	2,823.56	2,736.35
Total capital maintained	**16,871.66**	**16,764.23**
Risk weighted assets	**140,480.99**	**140,278.79**
Total capital ratio (CAR)	12.01%	11.95%
Tier I capital ratio	9.50%	9.44%

Credit Risk

Qualitative Disclosures:

Definition of Credit Risk: Credit risk is the risk of loss that may occur from the failure of any counterparty to make required payments in accordance with agreed terms and conditions and/or deterioration of creditworthiness. Credit risk may arise from both the banking book and trading book and is managed through a framework set by policies and procedures established by the Board of Directors. The responsibility is clearly segregated between originator of business transaction and approver in the risk function.

Credit approval: Board of Directors of EBL has the sole authority to approve any credit exposure and to sub delegate such authority to the Managing Director & CEO with or without authority for further sub delegation. We have adopted individual authority based approval structure to ensure better accountability. Currently, MD & CEO's lending authority is further sub delegated to Head of Credit Risk Management Division and Departmental Heads.

Credit policies and procedures: The Credit Policy Manual contains the core principles for identifying, measuring, approving, and managing credit risk in the bank. These policies are established by the Board of Directors, and are designed to meet the organizational requirements that exist today, and to provide flexibility for future. These policies represent the minimum standards for credit extension by the bank, and are not a substitute for experience and good judgment.

There is a comprehensive credit appraisal procedure that covers industry/business risk, management risk, financial risk, facility structure risk, security risk, environmental risk, reputational risk, and account performance risk. Credit risk management function is independent of business originating functions to establish better control and check, and to reduce conflict of interest. The Head of Credit Risk Management (HoCRM) has clear responsibility for management of credit risk.

Credit risk grading and measurement: Risk measurement along with judgment and experience play a central role in informed risk taking decisions, and portfolio management. For the purpose of risk measurement we use a numerical grading system 'Credit Risk Grading Matrix' (CRGM) associated with a borrower. This CRGM is not a lending decision making tool but used as a general indicator to compare one set of customers with another set, and its weighted average value indicate movement of portfolio risk.

CRGM analyzes a borrower against a range of quantitative and qualitative measures. Quantitative measurements scale has numeric grades from 1 to 11; lower numbers are indicative of lower likelihood of default while 9 to 11 grades are assigned to default borrowers. However, we are yet to assign Probability of Default (PD) corresponding to each grade and to cap exposure both at borrower and portfolio level against each risk grade. No score card or rating model for retail and SME (small) borrowers are currently in practice; rather borrowers are assessed against some pre-approved criteria outlined in Product Program Guidelines (PPG), which are approved by the Board of Directors.

Credit risk mitigation: Potential credit losses from any given account, customer or portfolio are mitigated using a range of tools such as collateral, netting agreements, credit insurance, and other guarantees. The reliance that can be placed on these mitigants is carefully assessed in light of issues such as legal certainty and enforceability, market valuation, and counterparty risk of the guarantor. Collateral types which are eligible for risk mitigation include: cash; residential, commercial and industrial property; fixed assets such as motor vehicles, aircraft, plant and machinery; marketable securities; commodities; bank guarantees; and letters of credit. Collateral is valued by independent third party surveyor in accordance with our credit policy and procedures.

Credit monitoring: Credit exposures and portfolio performance are monitored at least quarterly at EBL. Corporate and medium enterprise accounts are continuously monitored under a clearly set out 'Early Alert' policy. Sign of deteriorations are well defined and broad guidelines are given in the credit policy to be followed by business origination units. Early Alerts are raised for financial deterioration, management weakness, irregular repayments, breach of covenants, eroding position in the industry, etc. If early alerts are raised, account plans are then reevaluated; remedial actions are agreed and monitored. Remedial actions include but not limited to exposure reduction, security enhancement, exiting the relationship or immediate movement to our Special Asset Management Division (SAMD) – the dedicated loan recovery unit of the Bank.

Definitions of past due and impaired credit: To define past due and impairment through classification and provisioning, the bank follows Bangladesh Bank Circulars and Guidelines. The summary of some objective criteria for loan classification and provisioning requirement as stipulated by the central bank BRPD circular no. 14 dated 23 September 2012 are as below:

Type of Facility	Loans Classification					
	Sub Standard		Doubtful		Bad & Loss	
	Overdue Period	Provision (%)	Overdue Period	Provision (%)	Overdue Period	Provision (%)
Continuous Loan	3 months or more but less than 6 months	20%	6 months or more but less than 9 months	50%	9 months or more	100%
Demand Loan	3 months or more but less than 6 months	20%	6 months or more but less than 9 months	50%	9 months or more	100%
Fixed Term Loan more than Tk. 10 lac	3 months or more but less than 6 months	20%	6 months or more but less than 9 months	50%	9 months or more	100%
Fixed Term Loan up to Tk. 10 lac	6 months or more but less than 9 months	20%	9 months or more but less than 12 months	50%	12 months or more	100%
Short Term Agricultural & Micro Credit	12 months or more but less than 36 months	5%	36 months or more but less than 60 months	5%	60 months or more	100%

Specific provision for classified loans and general provisions for unclassified loans and advances and contingent assets are measured following BB prescribed provisioning rates as mentioned below:

General provision on: (for both Standard and Special Mention Account)	Rate
Unclassified general loans and advances	1%
Unclassified small and medium enterprise	0.25%
Loans to BHs/MBs/SDs against shares etc.	2%
Unclassified loans for housing finance and on loans for professionals	2%
Unclassified consumer financing other than housing financing and loans for professionals	5%
Short term agri credit and micro credit	5%
Off balance sheet exposures	1%
Specific provision on:	
Substandard loans and advances other than short term agri credit and micro credit	20%
Doubtful loans and advances other than short term agri credit and micro credit	50%
Bad/loss loans and advances	100%
Substandard short term agri credit and micro credit	5%
Doubtful short term agri credit and micro credit	5%

Problem Credit Management: The Bank has a Special Asset Management Division (SAMD), dedicated for management, settlement and recovery of problem credits. Major responsibility of this department is to formulate strategy and action plans for minimization of risk, prevention of loss, maximization of recoveries, and restructuring, direct recovery, and/or pursuing legal actions.

Quantitative Disclosures:

Total gross credit risk exposures by major types: Bangladesh Bank guidelines on Basel II, stipulated to segregate bank's asset portfolio into different categories, and the below table shows our gross exposure in each asset category.

(Figures are in million BDT)

SL.	Exposure type	Exposures	
		Consolidated	Solo (Bank)
a)	Cash	1,752.69	1,752.66
b)	Claims on Bangladesh Government (Other than PSEs) and BB (denominated in domestic and foreign currency)	6,430.87	6,430.87
	Different Risk Weights	350.85	350.85
	Unrated	41.00	41.00

SL.	Exposure type	Exposures Consolidated	Exposures Solo (Bank)
c)	Claims on Banks and NBFIs (denominated in domestic as well as foreign currency)		
	i) Original maturity over 3 months:	-	-
	Different Risk Weights	1,220.00	1,220.00
	Unrated	250.00	250.00
	ii) Original maturity less than 3 months	11,014.97	10,569.60
d)	Claims on Corporate (excluding equity exposures):	-	-
	Different Risk Weights	35,166.10	35,166.10
	Unrated	34,447.75	34,447.75
e)	Claims under Credit Risk Mitigation (Corporate)	50.00	50.00
f)	Claims categorized as retail portfolio & Small Enterprise (excluding consumer finance and staff loans)	5,794.56	5,794.56
g)	Consumer finance	6,870.08	6,870.08
h)	Claims fully secured by residential property (excluding staff loan)	937.70	937.70
i)	1. Past Due Claims (Risk weights are to be assigned net of specific provision):		
	Where specific provisions are less than 20 per cent of the outstanding amount of the past due claim	984.27	984.27
	Where specific provisions are no less than 20 per cent of the outstanding amount of the past due claim	378.02	378.02
	Where specific provisions are more than 50 per cent of the outstanding amount of the past due claim	417.52	417.52
	2. Claims fully secured against residential property that are past due for more than 90 days and/or impaired and specific provision held there-against is less than 20% of outstanding amount.	5.40	5.40
j)	Capital market exposures	1,064.67	939.40
k)	Unlisted equity investments and regulatory capital instruments issued by other banks (other than those deducted from capital) held in banking book.	1,243.06	1,243.06
l)	Investments in premises, plant and equipment and all other fixed assets	6,528.29	6,517.49
m)	All other assets:		
	i) Claims on GoB & BB (e.g. Coupon Receivable from Govt. T Bonds & reimbursable from BB on PSP, Shadharan shanchaypatra, etc.)	627.98	627.98
	ii) Staff loan/investment	1,236.54	1,236.54
	v) Other assets (net of specific provision, if any)	1,593.72	2,007.72
	Total:	**118,406.02**	**118,238.56**

Geographical distribution of exposures: Our business is concentrated in two major cities – Dhaka and Chittagong as country's business activities are concentrated in these two locations. Below table shows our credit exposure as at year end 2013 in different divisions:

(Figures are in million BDT)

Division	CORP	SME	CNB (incld. Staff)	Total
Dhaka Division	51,033.81	10,275.02	8,812.40	70,121.24
Chittagong Division	22,577.04	4,454.36	2,872.89	29,904.29
Sylhet Division	-	302.23	196.08	498.31
Rajshahi Division	308.48	584.54	198.50	1,091.52
Khulna Division	-	920.20	239.81	1,160.01
Rangpur Division	-	104.07	30.78	134.85
Total	**73,919.33**	**16,640.42**	**12,350.47**	**102,910.22**

Industry wise distribution of exposures: Major industry wise credit exposure of the bank (not group) as on 31 December 2013 was as below, and the numbers remained within the appetite of the bank as approved by the Board of Directors.

(Figures are in million BDT)

Industry/sector	31-12-2013	Mix %	31-12-2012	Mix %
Commercial and Trading	18,768.87	18.2%	16,752.93	17.3%
Construction	1,606.80	1.6%	1,141.40	1.2%
Sugar & Edible Oil Refinery	2,997.69	2.9%	4,497.19	4.6%
Crops, fisheries & live stocks	1,593.56	1.5%	2,062.27	2.1%
Electronics & Electrical Goods	2,951.15	2.9%	3,590.71	3.7%
Individuals	12,344.81	12.0%	11,634.71	12.0%
Pharmaceuticals Industries	4,034.23	3.9%	3,102.20	3.2%
Readymade Garments Industry	10,700.66	10.4%	11,055.38	11.4%
Ship Breaking Industry	3,196.89	3.1%	5,508.78	5.7%
Metal & Steel Products	7,867.56	7.6%	7,116.32	7.4%
Transport & E-communication	6,015.25	5.8%	7,089.52	7.3%
Textile Mills	9,771.75	9.5%	8,361.72	8.6%
Power Sector	2,539.08	2.5%	2,747.14	2.8%
Others	18,521.91	18.0%	12,059.47	12.5%
Total	**102,910.22**	**100.0%**	**96,719.74**	**100.0%**

Residual contractual maturity of credit exposure: Residual maturity of credit exposure in our major business (counterparty type) as on 31 December 2013 was as below:

(Figures are in million BDT)

Business Segment	below 90 days	3-6 months	6-12 months	1-5 years	More than 5 years	Total (with OBU) as on 31.12.2013
Consumer	4,569.59	451.86	1,037.59	4,199.19	853.94	11,112.18
Corporate	37,337.71	18,406.53	4,090.84	12,924.35	1,159.89	73,919.33
SME (small)	399.00	525.65	1,126.35	6,352.40	-	8,403.39
SME (medium)	4,571.75	1,555.96	1,314.13	795.18	-	8,237.03
Staff	1.81	1.49	6.89	192.34	1,035.77	1,238.29
Total	**46,879.86**	**20,941.49**	**7,575.81**	**24,463.46**	**3,049.60**	**102,910.22**

Business segment wise impaired loans: as on 31 December 2013:

(Figures are in million BDT)

Business type	SMA	SS	DF	BL	Total Classified Loans and SMA
Corp	214.97	201.71	-	2,221.05	2,637.72
SME (small)	261.99	85.44	75.25	301.48	724.15
SME (medium)	84.10	0.24	1.47	108.03	193.84
Consumer	561.06	287.38	76.71	2,630.55	3,555.71
Total	**1,122.12**	**574.77**	**153.43**	**5,261.11**	**7,111.42**

Gross Non Performing Assets (NPAs): As on the reporting date i.e. 31 December 2013, NPA ratio was 3.59%.

Movement of NPAs: Movement of classified loans during the year is presented in the following table:

(Figures are in million BDT)

Particulars	2013	2012
Opening Balance as on 01 January	3,070.77	1,560.59
Additions during the year	3,998.58	2,255.63
Reductions during the year	3,372.13	745.45
Closing Balance as on 31 December	**3,697.23**	**3,070.77**

Movement of Specific Provisions for NPAs (provisions for classified loans) is presented in following table:

(Figures are in million BDT))

Particulars	2013	2012
Opening balance of provision held	1387.32	866.44
New provisions during the year	817.40	845.88
Provisions no longer required (written off loans)	274.78	(325.00)
Closing balance of provision held	**1,929.94**	**1,387.32**

Equities: Disclosures for Banking Book Positions

Nature and purpose of Equity investment: Investment of EBL in equity securities is broadly categorized into two parts: securities (Ordinary shares, Mutual Fund) that are traded in the secondary market (trading book assets) and Un-quoted securities (including preference share and subscription for private placement). Unquoted securities are categorized as banking book equity exposures which are further subdivided into two groups: unquoted securities which are invested without any expectation that these will be quoted in near future (i.e. held to maturity) and securities that are acquired under private placement or IPO and are going to be traded in the secondary market after completing required formalities. Usually these securities are held for trading or investment for making capital gains.

Policies for valuation and accounting of equity holdings: For valuation of Unquoted HTM and quoted HFT equity securities, relevant BFRS and Bangladesh Bank circulars are followed respectively. Unquoted HTM securities are recorded at purchase price including transactions costs, if any and are impairment tested whereas quoted HFT securities are marked to market quarterly. Revaluation loss (if any) is booked accordingly calculated on portfolio basis (gain net off). No unrealized gain is booked against HFT equity securities as per Bank policy. Dividends received from these securities are accounted for as and when received.

Quantitative Disclosures: As EBL Securities Limited maintains an insignificant portfolio of proprietary equity investment, comparison between consolidated and solo (bank) positions showed almost identical balance as on the reporting date i.e. 31 December 2013. For unquoted equities (including private placement), market value has been assumed identical to cost in the following table only to facilitate calculation of unrealized losses.

(Figures are in million BDT)

	Cost		Market Value	
	Consolidated	Solo (Bank)	Consolidated	Solo (Bank)
Quoted shares and Mutual Funds	3,542.35	3,428.14	2,672.34	2,572.43
Unquoted shares and Mutual Funds:	60.90	60.90	60.90	60.90
Unquoted (HTM)	29.60	29.60	29.60	29.60
Private placement	31.30	31.30	31.30	31.30
Total	**3,603.25**	**3,489.04**	**2,733.24**	**2,633.33**

Other information related to equity investments including capital requirement for the year has been presented as follows:

(Figures are in million BDT)

	Consolidated	Solo (Bank)
Cumulative realized gains (losses) arising from sales	54.95	54.95
Total unrealized gains (losses)	(870.01)	(855.72)
Total latent revaluation gains (losses)	-	-
Any amount of the above included in Tier 2 capital	-	-
Capital required for quoted securities:	534.47	514.49
Specific risk	267.23	257.24
General market risk	267.23	257.24

Interest Rate Risk In The Banking Book

Interest rate risk is the risk that a bank will experience deterioration in its financial position as interest rates move over time. Interest rate risk is typically divided into two parts:

- Traded interest rate risk
- Non-traded interest rate risk (balance sheet)

Interest rate risk in the banking book (IRRBB) arises from a bank's core banking activities. It arises from differences between the timing of rate changes and the timing of cash flows (re-pricing risk); from changing rate relationships among yield curves that affect bank activities (basis risk); from changing rate relationships across the range of maturities (yield curve risk); and from interest-rate-related options embedded in bank products (option risk).

The process of interest rate risk management by the bank involves determination of the business objectives, expectation about future macro-economic variables and understanding the money markets and debt market in which it operates. Interest rate risk management also includes quantifying the appetite for market risk to which bank is comfortable.

The Bank uses the following approach to manage interest rate risks inherent in the Balance sheet:

Simple Gap Analysis: Traditional Gap analysis of on-balance sheet Asset Liability Management (ALM) involves careful allocations of assets and liabilities according to repricing/maturity buckets. This approach quantifies the potential change in net interest income using a specified shift in interest rates, e.g. 100 or 200 basis points, or a simulated future path of interest rates.

Assumptions: For Gap analysis, bank considers the following:

- For fixed-rate contract, remaining maturity is considered.
- For contracts with provision of re-pricing, time remaining for next re-pricing is considered.
- For assets and liabilities which lack definitive re-pricing interval or for which there is no stated maturity, bank determines the core and volatile portion. For asset, volatile portion is bucketed till 3 months using historical repayment behavior and stable portion is bucketed in 6-12 months bucket. For liabilities, volatile portion is bucketed till 1 year using historical withdrawal behavior and stable portion is bucketed in over 1 year segment.

Also, following assumptions are met:

- The main assumption of gap analysis is that interest rate moves on parallel fashion. In reality however, interest rate does not move upward.
- Contractual repayment schedule are met.
- Re-pricing of assets and liabilities takes place in the mid-point of time bucket.
- The expectation that loan payment will occur in schedule.
- Optionality embedded in different products is not considered.

Quantitative Disclosure: Result of **Gap analysis** as on December 31, 2013:

Particulars	3 month	6 Months
For 100 basis point increase/decrease in Interest rate, Impact on NII	+-48.1 million	+-49.1 million
For 200 basis point increase/decrease in Interest rate, Impact on NII	+-96.2 million	+-98.2 million

Duration Analysis: The focus of the Duration Analysis is to measure the level of a bank's exposure to interest rate risk in terms of sensitivity of Market Value of its Equity (MVE) to interest rate movements. Duration Gap can be used to evaluate the impact on the Market Value of Equity of the bank under different interest rate scenarios. ALCO monitors the Leveraged Liability Duration and duration gap of the total bank balance sheet on a quarterly basis to assess the impact of parallel shift of the assumed yield curve.

	Dec-31-2012	Jun-30-2013	Dec-31-2013
Duration of Asset	0.88	0.92	1.04
Duration of Liabilities	0.34	0.41	0.41
Leveraged Liability Duration	0.30	0.67	0.67
Duration Gap	0.58	0.35	0.37

Market Risk

Qualitative Disclosures:

Market Risk: Market Risk is defined as the possibility of loss due to changes in the market variables. It is the risk that the value of on/off-balance sheet positions will be adversely affected by movements in equity price, interest rate and currency exchange rates. The objective of our market risk policies and processes is to obtain the best balance of risk and return whilst meeting customers' requirements. The primary categories of market risk for the bank are:

Interest rate risk: arising from changes in yield curves, credit spreads and implied volatilities on interest rate options.

Currency exchange rate risk: arising from changes in exchange rates and implied volatilities on foreign exchange options.

Equity price risk: arising from changes in the prices of equities, equity indices, equity baskets and implied volatilities on related options.

Bank has comprehensive Treasury Trading Policy, Asset-Liability Management Policy, Investment Policy approved by Board of

Directors to assess, monitor and manage all the above market risks. Bank has defined various internal limits to monitor market risk and is computing the capital requirement as per standardized approach of Basel II.

Methods used to measure Market Risk: Bank applies maturity method in measuring interest rate risk in respect of securities in trading book. The capital charge for entire market risk exposure is computed under the standardized approach using the maturity method and in accordance with the guideline issued by Bangladesh Bank.

Market Risk Management System: To manage the interest rate risk, ALCO regularly monitors various ratios and parameters. Among the ratios, the key ratios that ALCO regularly monitors are Liquid asset to total assets, Volatile liability dependency ratio, medium term funding ratio, Snap liquidity ratio and Short term borrowing to Liquid assets ratio. ALCO also regularly monitors the interest rate sensitive gap and duration gap of total portfolio.

To manage foreign exchange risk of the bank, the Bank has adopted the limit by central bank to monitor foreign exchange open positions. Foreign exchange risk is computed on the sum of net short positions or net long positions, whichever is higher of the foreign currency positions held by the Bank.

Bank is using Value at Risk (VaR) analysis based on historical method to assess the minimum level of loss on foreign currency holding that is likely to be exceeded at certain level of probability (5% probability) in 1 day. Also, based on VaR, bank has set Management Trigger Point at BDT 10.00 million for aggregate currency exposure, based on 1 day VaR at 95% level of confidence.

Value-at-Risk estimates (Loss in domestic currency) presented below:

	Time Horizon				
Confidence level	1 day	2 days	3 days	4 days	5 days
90%	1,458,612	1,936,841	2,221,913	2,989,821	3,001,321
95%	1,921,877	2,826,103	3,171,631	3,859,277	4,282,481
99%	3,694,004	5,469,763	5,478,434	5,384,724	7,033,220

The Bank has been active in secondary market during the year with 2.17% assets invested in equity securities as on the reporting date. To manage equity risk, the Investment Committee of the bank ensures taking prudent investment decisions complying sectoral preference as per investment policy of the bank and capital market exposure limit set by BB.

Quantitative Disclosures: Capital required for market risk as on the reporting date follows:

(Figures are in million BDT)

a	Interest rate risk	667.37
b	Equities	534.47
c	Foreign exchange risk	54.10
d	Commodity risk	
	Total	**1,255.94**

Operational Risk

Qualitative Disclosures:

Operational Risk: Operational risk is the risk of direct or indirect loss due to an event or action resulting from the failure of internal processes, people and systems, or from external events. We seek to minimize exposure to operational risk, subject to cost benefit trade-offs.

The bank captures some pre identified risk events associated with all functional departments of the bank through standard reporting format. Bank's Operational Risk Committee (BORC) sits every month with all these reports and decides action plans to resolve risk issues by specific individual and/or group within an agreed timeline. The committee also escalates 'high level risk' issues to MANCOM (Management Committee) and BRMC (Bank Risk Management Committee) based on importance and urgency of taking effective decisions. BORC is responsible for setting and maintaining standards for operational risk management and measurement, which is separate from the business functions.

Performance gap of executives and staffs: EBL is an equal opportunity employer. At EBL we recognize the importance of having the right people at right positions to achieve organizational goals. Our recruitment and selection is governed by the philosophies of fairness, transparency and diversity. Understanding what is working well and what requires further support is essential to our performance management system. The performance management process aims to clarify what is expected from employees as well as how it is to be achieved.

At the beginning of a year we adequately communicate to our direct reports what are expected from him/her during ensuing period. A half yearly and yearly performance appraisal practices are in place to review achievements based on which rewards and recognition decisions are made. Internal control & compliance (ICC) is continuously monitoring to minimize any potential brand damaging performance gap by employees especially fraud-forgery, misuse of power of attorney, weak customer services, weak internal and regulatory compliance etc.

However, our learning and development strategy puts special focus on continuous professional development to strengthen individual's skill level by removing the weakness to perform the assigned job with perfection. We have a wide range of internal & external training programs to enhance capabilities to minimize performance gap and to contribute more to bottom line.

The reward and recognition policy of the bank is designed to motivate our people to perform better be it business or supporting business. Our strategy of reinforcing people's positive behaviors is based on following premises:

- Is rooted in an understanding of what really motivates our people.
- Encourage teamwork by creating a culture where individual and team success is recognized.
- Regular benchmarking to compare our reward and recognition strategy with similar organizations.

Potential external events: We understand that business operates in an umbrella of inter connected socio-economic and political environment. Few externalities affect business performance directly such as macro-economic conditions, regulatory changes, change in demand, status of infrastructure whereas few factors affect operations of the business directly or indirectly such as force shut down due to political instability, threat of vandalism to the bank's sophisticated physical outlets including IT equipments etc.

Policies and processes for mitigating operational risk: As there is no upside of this risk, the objective of the management of operational risk is to minimize the risk in cost effective manner, if elimination is not possible.

Currently bank is not using any model or tool to capture operational loss data for historical analysis rather it is a self-assessment process. Bank has a separate Operational Risk Management Unit responsible for risk identification, measurement, monitoring, control, and reporting of operational risk.

Operational risks are analyzed through review of Departmental Control Function Check List (DCFCL). This is a self-assessment process for detecting HIGH risk areas and finding mitigation of those risks. These DCFCLs are then discussed in monthly meeting of Bank's Operational Risk Committee (BORC). The committee analyzes HIGH and MODERATE risk indicators and set responsibility for suitable personnel to resolve the issue. If anything remains unresolved or marked HIGH, it is referred to MANCOM.

Approach for calculating capital charge for operational risk: The bank applies 'Basic Indicator Approach' of Basel II as prescribed by BB in revised RBCA guidelines. Under this approach, banks have to calculate average annual gross income (GI) of last three years and multiply the result by 15% to determine required capital charge. Gross Income is the sum of 'Net Interest Income' and 'Net non-interest income' of a year or it is 'Total Operating Income' of the bank with some adjustments as noted below. GI shall:

- Be gross of any provision (e.g. for unpaid interest),
- Be gross of operating expenses, including fees paid to outsourcing service providers,
- Exclude realized profits/losses from sale of securities held to maturity in the banking book,
- Exclude extraordinary or irregular items,
- Exclude income derived from insurance and
- Include lost interest i.e. interest suspense on SMA and classified loans.

Quantitative Disclosures: The capital requirement for operational risk is as follows:

(Figures are in million BDT)

Particulars	Consolidated	Solo (Bank)
Last three year's average Gross Income (adjusted)	9,608.39	9,501.79
Capital charge required (15% of GI)	1,441.26	1,425.27