South Bangla Agriculture and Commerce Bank Ltd.

Disclosures under Risk Based Capital (Basel II)
For the year ended 31 December 2013

Background: These disclosures under Pillar III of Basel II are made according to 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 the Supervisory Review Process (SRP) under Pillar II of Basel II.

The purpose of market discipline in the Revised Capital Adequacy Framework is to disclose relevant information on capital adequacy in relation to various risks of the bank so that stakeholders can assess the position of a bank regarding holding of assets and to identify the risks relating to the assets and capital adequacy to meet probable loss of assets as well as can make the economic decision. The disclosures under Pillar-III of Basel II framework of the bank as on 31 December 2013 are as under:

A) Scope of Application
B) Capital Structure
C) Capital Adequacy
D) Credit Risk
E) Equities: Disclosures for Banking Book Positions
F) Interest Rate Risk in Banking Book (IRRBB)
G) Market Risk
H) Operational risk

A) Scope of Application

Qualitative Disclosures:		
a)	The name of the top corporate entity in the group to which this guidelines applies.	**South Bangla Agriculture and Commerce Bank Ltd. (the Bank)**

b)	An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities within the group (a) that are fully consolidated; (b) that are given a deduction treatment; and (c) that are neither consolidated nor deducted (e.g. where the credit is risk-weighted).	The Risk Based Capital Adequacy framework applies to South Bangla Agriculture and Commerce Bank Limited on "Solo Basis" as there are no subsidiaries of the bank on reporting date.
c)	Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group.	Not applicable
Quantitative Disclosures:		
d)	The aggregate amount of capital deficiencies in all subsidiaries not included in the consolidation that are deducted and the name(s) of such subsidiaries	Not applicable

B) Capital Structure

Qualitative Disclosures:		
a)	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of capital instruments eligible for inclusion in Tier 1 or Tier 2.	Regulatory capital, as stipulated by the revised RBCA guidelines by Bangladesh Bank, is categorized into three tiers according to the order of quality of capital (Tier I, II & III). i) **Tier-I capital** called 'Core Capital' comprises of highest quality of capital elements that consists of paid up capital, statutory reserves, general reserve eligible for inclusion in Tier-I capital that comply with requirement specified by Bangladesh Bank. ii) **Tier-II capital** called 'Supplementary Capital' represents other elements, which fall short of some of the characteristics of the core capital but contribute to the overall strength of a bank and consists of revaluation reserve, general provision etc. **iii) Tier-III capital** called 'Additional Supplementary Capital', consists of short-term subordinated debt, which would be solely for the purpose of meeting a proportion of the capital requirements for market risk. 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: 1) **Requirements:** The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 capital. **Status of Compliance:** Complied 2) **Requirements:** 50% of revaluation reserves for fixed assets and securities eligible for Tier 2 capital. **Status of Compliance:** Complied 3) **Requirements:** 10% of revaluation reserves for equity instruments eligible for Tier 2 capital. **Status of Compliance:** There was no revaluation reserve from quoted equities as on the reporting date. 4) **Requirements:** Subordinated debt shall be limited to a maximum of 30% of the amount of Tier-I capital. **Compliance Status :** As on the reporting date there was no subordinated debt in the capital structure of South Bangla Agriculture and Commerce Bank Ltd.

		5) **Requirements:** Limitation of Tier 3: A minimum of about 28.5% of market risk needs to be supported by Tier-I capital. Supporting of Market Risk from Tier 3 capital shall be limited up to maximum of 250% of a bank's Tier-I capital that is available after meeting credit risk capital requirement. **Compliance Status :** As on the reporting date there was no subordinated debt in the capital structure of South Bangla Agriculture and Commerce Bank Ltd.

Quantitative Disclosures: As on the reporting date, the Bank had a total capital of BDT 416.93 Crore comprising Tier-I capital of BDT 413.59 Crore and Tier-II capital of BDT 3.34 Crore (South Bangla Agriculture and Commerce Bank had no Tier III element in its capital structure). Following table presents component wise details of capital as on reporting date i.e. 31 December 2013:

Amount in crore Tk.

Sl No.	Particulars	Solo
1	**Elements of Tier-I Capital**	
2	Paid up capital	408.96
3	Statutory Reserve	2.11
4	Non-repayable Share premium account	-
5	General Reserve	-
6	Retained Earnings	2.52
7	Minority interest in Subsidiaries	-
8	Non-Cumulative Irredeemable Preferences shares	-
9	Dividend Equalization Account	-
10	Other (if any item approved by Bangladesh Bank)	-
11	**Sub Total(2+3+----------+10)**	**413.59**
12	**Deductions from Tier-1 Capital**	-
13	**Total eligible Tier -1 Capital (Core Capital) (11-12)**	**413.59**
14	**Total amount of Tier-II Capital**	3.34
15	**Total amount of Tier-III Capital**	-
16	**Other deductions from Capital**	-
17	**Total Eligible Capital (13+14+15-16)**	**416.93**

C) Capital Adequacy

Qualitative Disclosures:		
a)	A summary discussion of the bank's approach to assess the adequacy of its capital to support current and future activities.	In terms of RBCA guidelines on Basel-II framework issued by Bangladesh Bank, the bank has adopted the standardized approach for credit risk, standardized (rule based) approach for market risk and basic indicator approach for operational risk. As per capital adequacy guidelines, the bank is required to maintain a minimum CAR of 10.00% with regards to Risk Weighted Assets. South Bangla Agriculture and Commerce Bank Ltd. focuses on strengthening and enhancing its risk management culture and internal control processes rather than increasing capital to cover up weak risk management and control practices. The bank is able to maintain capital adequacy ratio (CAR) at 61.98% on solo basis against the regulatory minimum level of 10.00%. The Bank's policy is to manage and maintain its capital with the objective of maintaining strong capital ratio and high rating. The Bank also ensures that the capital levels comply with regulatory requirements and satisfy the external rating agencies and other stakeholders including depositors. The whole objective of the capital management process in the Bank is to ensure that the Bank remains adequately capitalized at all times.

b. Quantitative Disclosures:

Amount in crore Tk

Sl No.	Particulars	Solo
1	Capital Requirement for Credit Risk	612.68
2	Capital Requirement for Market Risk	10.23
3	Capital Requirement for Operational Risk	49.79
4	Total Risk Weighted Assets (RWA)	672.70
5	Minimum Capital Requirement	400.00
6	Total CAR	61.98 %
7	Tier-I CAR	61.48 %
8	Tier-II CAR	0.50 %
9	Total and Tier 1 Capital Ratio:	99.20 %

D) Credit Risk

Qualitative Disclosures:		
a)	**The general qualitative disclosures:**	
	Definitions of past due and impaired:	A loan payment that has not been made as of its due date is called past due/overdue. Failure to repay any credit on time could have negative implications for the customer's credit worthiness. In case of past due loan, the bank may charge compensation which does not come under bank's income rather the charges are used for benevolent purpose. A loan is impaired when it is not likely the bank will collect the full value of the loan because the creditworthiness of a customer has fallen. The bank will pursue either restructuring or foreclosure as a result of the impaired status of the credit. Further, the bank must report the loan as impaired on any of its financial statements and CIB of Bangladesh bank. With a view to strengthening loan discipline and bring classification and provisioning regulation in the line with international standard, a phase wise program for classification and provisioning was undertaken by the Bank as per Bangladesh Bank circulars issued from time to time. In this regard, all the loans are grouped into four categories for the purpose of classification, namely (i) Continuous Loan, (ii) Demand Loan, (iii) Fixed Term Loan and (iv) Short-term Agricultural and Micro Credit. The above loans are classified as follows: **Continuous & Demand Credit are classified as under:** • Sub-standard- if it is past due/overdue for 3 months or beyond but less than 6 months • Doubtful- if it is past due/overdue for 6 months or beyond but less Than 9 months • Bad/Loss- if it is past due/overdue for 9 months or beyond **Fixed Term Loan (More than BDT 10.00 Lac) is classified as** • Sub-standard- if the defaulted installment is equal to or more than the amount of installment (s) due within 3 (three) months, the entire loans are classified as "Sub-standard" • Doubtful- if the defaulted installment is equal to or more than the amount of installment (s) due within 6 (six) months, the entire loans are classified as "Doubtful. • Bad/Loss- if the defaulted installment is equal to or more than the amount of

installment (s) due within 9 (nine) months, the entire loans are classified as "Bad/Loss".

Fixed Term Loan (Up to BDT 10.00 Lac) is classified as

- Sub-standard- if the defaulted installment is equal to or more than the amount of installment (s) due within 6 (six) months, the entire loans are classified as "Sub-standard".
- Doubtful- if the defaulted installment is equal to or more than the amount of installment (s) due within 9 (nine) months, the entire loans are classified as "Doubtful
- Bad/Loss- if the defaulted installment is equal to or more than the amount of installment (s) due within 12 (twelve) months, the entire loans are classified as "Bad/Loss".

Short-term Agricultural and Micro Loan are classified as

- Sub-standard- if the irregular status continue after a period of 12 (twelve) months, the loans are classified as "Sub-standard"
- Doubtful- if the irregular status continue after a period of 36 (thirty six) months, the loan are classified as "Doubtful"
- Bad/Loss- if the irregular status continue after a period of 60 (sixty) months, the loan are classified as "Bad/Loss".

** A Continuous loan, Demand loan or Term Loan which will remain overdue for a period of 60 days or more, are treated as "Special Mention Account (SMA)"

Past due for more than 90 days excluding term loan upto Tk. 10.00 lac have been considered for the purpose of calculation of risk weighted asset as per guidelines of Bangladesh Bank.

We follow the following approach for specific and general allowances and statistical method:

Description of approaches followed for specific and general allowances and statistical methods:

Particulars		Short Term Agriculture credit and micro credit	Consumer Financing			Small Enterprise Financing	Credits to BHs/MBS/ SDs	All other credit
			Other than HF & LP	HF	LP			
Unclassified	Standard	5%	5%	2%	2%	0.25%	2%	1%
	SMA	n/a	5%	2%	2%	0.25%	2%	1%
Classified	SS	5%	20%	20%	20%	20%	20%	20%
	DF	5%	50%	50%	50%	50%	50%	50%
	B/L	100%	100%	100%	100%	100%	100%	100%

		*** Base for provision = Outstanding- (eligible security+ interest suspense) or 15% outstanding whichever is higher.
	Discussion of the bank's credit risk management policy.	Risk is inherent in all aspects of a commercial operation; however for Banks and financial institutions, credit risk is an essential factor that needs to be managed. Credit risk is the possibility that a borrower or counter party will fail to meet its obligations in accordance with agreed terms. Credit risk, therefore, arises from the bank's dealings with or lending to corporate, individuals, and other banks or financial institutions. To manage credit risk South Bangla Agriculture and Commerce Bank Ltd follows "Bangladesh bank's Circulated CREDIT RISK MANAGEMENT guidelines".
b)	**Quantitative Disclosures:**	
	Total gross credit risk exposures broken down by major types of credit exposures	Major types of credit exposure as per disclosures in the audited financial statements as of 31 December 2013
	Geographical distribution of exposures, broken down in significant areas by major types of credit exposure	Geographical distribution of credit exposures as per the disclosures in the audited financial statements as of 31 December 2013 are as follows:

Major types of credit exposure as per disclosures in the audited financial statements as of 31 December 2013

Amount in Crore Tk.

Sl.	Mode-wise Credit	Exposure	Mix (%)
1	Overdrafts	69.47	23.10%
2	General loans	0. 76	0.25%
3	Cash credit	142.55	47.41%
4	Loan against trust receipt	37.73	12.55%
5	Consumer credit	1.07	0.36%
6	Lease finance	0.20	0.07%
7	Staff loan	6.61	2.20%
8	Inland bills purchased	42.29	14.06%
	Total	300.68	100.00%

Geographical distribution of credit exposures as per the disclosures in the audited financial statements as of 31 December 2013 are as follows:

Amount in Crore Tk

Sl.	Division-wise Loan	Exposure	Mix (%)
1	Dhaka	281.23	93.53%
2	Chittagong	8.75	2.91%
3	Khulna	10.70	3.56%
	Total	**300.68**	**100.00%**

Industry or counterparty type distribution of exposures, broken down by major types of credit exposures.

Industry or counterparty type distribution of exposures, broken down by major types of credit exposures as per the disclosures in the audited financial statements as of 31 December 2013 are as follows:

Amount in Crore Tk

Sl.	Industry-wise Loans	Exposure	Mix (%)
1	Loan to small cottage industries	3.72	1.24%
2	Loan to large & medium industries	5.20	1.73%
3	Import credit	37.74	12.55%
4	Export credit	42.29	14.06%
5	Trade finance	186.69	62.09%
6	Consumer credit	1.21	0.40%
7	Others	23.83	7.93%
	Total	300.68	100.00%

Residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposures

Residual contractual maturity of exposures as per the disclosures furnished in the audited financial statements as of 31 December 2013 are as follows:

Amount in Crore Tk

Sl.	**Item**	**Exposure**	**Mix (%)**
1	On demand	-	-
2	Not more than 3 months	115.47	38.40%
3	More than 3 months but less than 1 year	175.17	58.26%
4	More than 1year but less than 5 years	5.36	1.78%
5	More than 5 years	4.68	1.56%
	Total	**300.68**	**100.00%**

By major industry or counterparty type:

No past dues against impaired Loans.

	Specific and general provisions	**Amount in Crore Tk** Provision required: - Unclassified Loans 2.74 Special mention accounts (SMA) - Agriculture (Short Term Agri) - Sub total 2.74 Substandard - Doubtful - Bad/Loss - Sub total - Total 2.74 ***Provision for off-balance sheet item- BDT 0.50 crore

Amount in Crore Tk

Provision required:	-
Unclassified Loans	2.74
Special mention accounts (SMA)	-
Agriculture (Short Term Agri)	-
Sub total	2.74
Substandard	-
Doubtful	-
Bad/Loss	-
Sub total	-
Total	2.74

***Provision for off-balance sheet item- BDT 0.50 crore

E) Equities: Disclosures for Banking Book Positions

a)	**Qualitative Disclosures:**	
	The general qualitative disclosures requirement with respect to equity risk, including	
	Differentiation between Holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons;	Not applicable
	Discussion of important policies covering the valuation and accounting of equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices	Quoted and unquoted shares are valued at cost. Provisions are made for any loss arising from diminution in value of investment.

Quantitative Disclosures:

b)	Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value.	Not applicable
c)	The cumulative realized gains (losses) arising from sales and liquidations in the reporting (31 December 2013) period.	-
d)	• Total unrealized gains (losses)	-
	• Total latent revaluation gains (losses)	-
	• Any amounts of the above included in Tier 2 capital.	-
e)	Capital requirements broken down by appropriate equity groupings, consistent with the bank's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory provisions regarding regulatory capital requirements	Capital charge on banking book equities has been BDT 6.25 crore, calculated by giving 125% risk weight

F) Interest Rate Risk in Banking Book (IRRBB)

Qualitative Disclosure:		
a)	The general qualitative disclosure requirement including the nature of IRRBB and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of IRRBB measurement.	Interest rate risk is the exposure of a bank's financial condition to adverse movements in interest rates. The process of interest rate risk management by the bank involves determination of the business objectives, expectation about future macro variables and understanding the money markets and debt market in which it operates. Interest rate risk is the risk, which affects the Bank's financial condition due to changes in the market interest rates. Changes in interest rates affect both the current earnings (earnings perspective, traditional approach to interest rate risk assessment taken by many banks) as well as the net worth of the Bank (economic value perspective). The risk from earnings perspective measured as impact on the Net Interest Income (NII). Similarly, the risk from economic value perspective which affect the underlying value of the bank's assets, liabilities, and off- balance-sheet (OBS) instruments because the present value of future cash flows (and in some cases, the cash flows themselves) change when interest rates change can be measured in the Economic Value of Equity (EVE). Accordingly, an effective risk management process that maintains interest rate risk within prudent levels is essential to the safety and soundness of banks. The Bank adopted traditional (earnings perspective) Duration Gap Analysis for assessing the impact on the Economic Value of Equity (Economic Value Perspective) by applying a notional Interest rate shock up from 100 bps to 300 bps under stress test practice at the bank.

Quantitative Disclosures:

The risk from earnings perspective can be measured as impact in the Net Interest Income (NII) due to changes in Interest rate.

CAR before-shock (%) 61.98

Amount in crore Tk.

Interest Rate Stress	**Minor**	**Moderate**	**Major**
Assumed change in Interest Rate	1%	2%	3%
Net interest income impact			
<12 months	4.18	8.36	12.55
Capital after-shock	421.11	425.29	429.48
CAR after-shock (%)	**62.60**	**63.22**	**63.84**
Change in CAR after-shock (%)	**0.62**	**1.24**	**1.87**

Impact of fluctuation in the interest rates on economic value of a financial institution is tested in the stress test. Economic value is affected both by changes in future cash flows and discount rate used for determining present value. To determine the impact of increase in interest rate risk 3 scenarios are tested, in minor level of shock of 1% increase in interest rate cause CAR to 62.60% from 61.98% and 2% increase in interest rate cause CAR to 63.22%, finally a major shock of 3% increase in interest rate cause CAR to 63.84%.

Amount in Crore Tk

Interest Rate Risk- Increase in Interest Rate	Minor Level of Shock	Moderate Level of Shock	Major Level of Shock
Magnitude of Shock	1%	2%	3%
Duration GAP (year)	0.25	0.25	0.25
Fall in MVE (on-balance sheet)	1.93	3.86	5.80
Revised Capital	415.00	413.07	411.13
Revised RWA	672.25	672.25	672.25
Revised CAR (%)	61.73	61.455	61.16
Net Investment Income Impact (<12 Month)	4.18	8.36	12.55

*The stress testing was conducted considering CAR of 61.98% before finalizing the Financial Statement 2013.

G) Market Risk

a) Qualitative Disclosures:	
Views of Board of Directors on trading/ investment activities:	The Board approves all policies related to market risk, set limits and reviews compliance on a regular basis. The objective is to provide cost effective funding to finance assets growth and trade related transactions. The market risk covers the followings risks of the Bank's balance sheet: i) Interest rate risk; ii) Equity price risk; iii) Foreign exchange risk; and iv) Commodity price risk
Methods used to measure Market risk:	Methods used to measure Market risk as per relevant Bangladesh Bank guidelines, Standardize approach has been used to measure the Market risk. The total capital requirement in respect of market risk is the aggregate capital requirement calculated for each of the risk sub-categories. For each risk category minimum capital requirement is measured in terms of two separately calculate capital charges for "specific risk" and "general market risk".
Market Risk Management system:	The Treasury Division of the Bank manages market risk covering liquidity, interest rate and foreign exchange risks with oversight from Assets-Liability Management Committee (ALCO) comprising senior executives of the Bank. ALCO is chaired by the Managing Director. ALCO meet at least once in a month.
Policies and processes for mitigating market risk	There are approved limits for credit deposit ratio, liquid assets to total assets ratio, maturity mismatch, commitments for both on-balance sheet and off-balance sheet items and borrowing from money market and foreign exchange position. The limits are monitored and enforced on a regular basis to protect against market risks. The exchange rate committee of the bank meets on a daily basis to review the prevailing market condition, exchange rate, foreign exchange position, and transactions to mitigate foreign exchange risks

b) Quantitative Disclosures:

Amount in crore Tk

	Total Capital Charge
Interest Rate Related Instruments	
Equities a) Specific Risk - Market value of investment in equities BDT 50.28 Crore. Capital Charge at 10% of market value amounting BDT 5.02 Crore . b) General Market Risk -Market value of investment in equities BDT 50.28 Crore. Capital Charge at 10% of market value amounting BDT 5.02 Crore .	0.80
Foreign Exchange Position	0.22
Commodities	-
Total	**1.02**

H) Operational Risk

a) QualitativeDisclosures		
i)	**Views of Board of Directors (BOD) on system to reduce Operational Risk**	The policy for operational risks including internal control and compliance risk is approved by the Board taking into account relevant guidelines of Bangladesh Bank. Audit Committee of the Board directly oversees the activities of Internal Control and Compliance Division (IC&CD) to protect against all operational risk.
ii)	**Performance gap of executives and staffs**	The Bank has a policy to provide competitive package and best working environment to attract and retain the most talented people available in the industry. The Bank's strong brand image plays an important role in employee motivation. As a result, there is no significant performance gap.
iii)	**Potential external events**	No potential external events is expected to expose the Bank to significant operational risk.
iv)	**Policies and processes for mitigating operational risk**	No potential external events is expected to expose the Bank to significant operational risk. The policy for operational risks including internal control and compliance risk is approved by the Board taking into account relevant guidelines of Bangladesh Bank. Policy guidelines on Risk Based Internal Audit (RBIA) System is in operation. As per RBIA, branches are rated according to their risk status and branches scoring more on risk status are subjected to more frequent audit by Internal Control and Compliance Division (IC&CD). IC&CD directly report to Audit Committee of the Board. In addition there is a Vigilance Cell established in 2013 to reinforce operational risk management of the Bank. Bank's Anti-Money laundering activities are headed by CAMLCO and their activities are devoted to protect against all money laundering and terrorist finance related activities. Apart from that, there is adequate check and balance at every stage of operation, authorities are properly segregated and there is at least dual control on every transaction to protect against operational risk.

v)	**Approaches for calculating capital charge for operational risk**	The Bank follows the Basic Indicator Approach (BIA) in terms of BRPD Circular No. 35 dated 29 December2010 [Guidelines on 'Risk Based Capital Adequacy for Banks' (Revised regulatory capital framework in line with Basel II)]. The BIA stipulates the capital charge for operational risk is a fixed percentage, denoted by α (alpha) of average positive annual gross income of the Bank over the past three years. It also states that if the annual gross income for any year is negative or zero, that should be excluded from both the numerator and denominator when calculating the average gross income. The capital charge for operational risk is enumerated by applying the following formula: $K = [(GI\ 1 + GI2 + GI3)\ \alpha]/n$ Where: K = the capital charge under the Basic Indicator Approach GI = only positive annual gross income over the previous three years (i.e., negative or zero gross income if any shall be excluded) α = 15 percent n = number of the previous three years for which gross income is positive. Besides, Gross Income (GI) is calculated as "Net Interest Income" plus "Net non-Interest Income". The GI is also the net result of : i) Gross of any provisions; ii) Gross of operating expenses, including fees paid to outsourcing service providers; iii) Excluding realized profits/losses from the sale of securities held to maturity in the banking book; iv) Excluding extraordinary or irregular items; v) Excluding income derived from insurance.

b) **Quantitative Disclosures:**

Amount in Crore Tk

The capital requirements for operational risk	49.79

<u>Capital Charge for Operational Risk- Basic Indicator Approach</u>

Amount in Crore Tk

Year	Gross Income (GI)	Average Gross Income (AGI)	Capital Charge = 15% of AGI
2013	33.19	33.19	4.98