Disclosure on Risk Based Capital Requirement Under Pillar-3 of Basel II

for the year ended 31 December, 2011

"The aim of introducing Market Discipline in the revised capital framework is to establish more transparent and more disciplined financial market 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"

Overview

The Basel Committee on Banking Supervision published a framework for international convergence of capital measurement and capital standards commonly termed as Basel II which replaced the original 1988 Basel I accord. In Bangladesh, Risk Based Capital Adequacy for Banks' (Revised regulatory capital framework in line with Basel II) came into force fully from January 2010 Following the BRPD circular # 20 on December 29, 2009 after parallel existence with Basel I during the year 2009.

Mercantile Bank has implemented Basel II effectively and efficiently. Because it believes that Basel II is not merely a reporting system but a principle on which overall banking business runs.With a view to facilitating the way of implementation, the Bank has formed a high powered committee under the heading of Basel II implementation Unit. This committee forecast the future; follow up the overall implementation status and way out the probable solution to cope with the international best practices and to make the bank's capital more risk sensitive as well as more shock resilient. The Bank has also formed a Supervisory Review Process (SRP) team to participate the dialogue with the Supervisory Review Evaluation Process (SREP) team of BB for measuring the adequate capital requirement.

The Basel II principle stands on the following three pillars:

Pillar-I: Minimum Capital Requirement

Banks must hold minimum regulatory capital against Credit, Market and Operational Risk inherent with Banking Business.

Pillar-II: Supervisory Review Process (SRP)

SRP basically deals with other risks faced by a bank not covered in pillar-1. The key principle of SRP is that banks have a process for assessing overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital at an adequate level. The assessment of adequate capital would be the outcome of the dialogue to be held between the bank's SRP and Bangladesh Bank's SREP team.

Pillar-III: Market Discipline

The purpose of Market Discipline in the Revised Capital Adequacy Framework is to complement the minimum capital requirement and the supervisory review process. The aim of introducing Market Discipline in the revised capital framework is to establish more transparent and more disciplined financial market 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.

Basel II Principle: 3 Pillars

Pillar One
Minimum Capital Requirements

Minimum Capital Requirement for-

Credit Risk
- Standardized approach
- Foundation IRB Approach
- Advanced IRB Approach

Market Risk
- Standardized Approach
- Internal VAR Models

Operational Risk
- Basic Indicator Approach
- Standardized Approach (Alternative) .

Pillar Two
Supervisory Committee

- Process for assessing overall capital adequacy in relation to risk profile.
- Strategy for maintaining capital at an adequate level.
- Formation of Supervisory Review Process (SRP) Team.
- Process document i.e. Internal Capital Adequacy Assessment Process (ICAAP) for assessing overall risk profile and a strategy for maintaining adequate capital.
- Agree an internal assessment process with the regulator through active dialogue between Bank's SRP and BB's SREP team.

Pillar Three
Market Discipline

- To complement the minimum capital requirement and the supervisory review process.
- Disclosure of key information relevant to a wider scope of risks managed by the Bank
- Establish more transparent and more disciplined financial market
- Encompasses the Bank's management of capital.

Disclosure Framework

The following detailed qualitative and quantitative disclosures of the Bank are furnished to provide our stakeholders with consistent and understandable disclosure framework to evaluate the Bank's performance as on December 31, 2011 in accordance with BRPD circular # 35 on December 29, 2010.

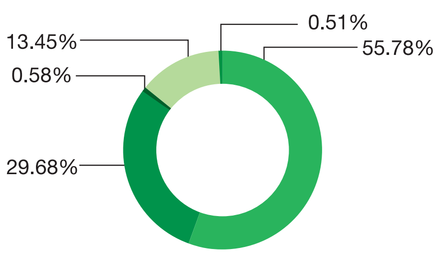
a) Scope of application

Qualitative Disclosures	(a)	The name of the corporate entity in the group to which the guidelines applies. • Mercantile Bank Limited (MBL)
	(b)	An outline of difference in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities with in 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 investment is risk-weighted). • MBL, the leading third generation private commercial bank incorporated on May 20, 1999 and commenced business on June 02, 1999. It was listed in DSE and CSE on February 16, 2004 and February 26, 2004 respectively. MBL has 75 branches at on reporting date i.e. December 31, 2011. The Bank has two subsidiaries namely Mercantile Bank Securities Ltd and Mercantile Exchange House (UK) Limited and a Off-shore Banking Unit to pace up the international trade especially in Export Processing Zone. **Mercantile Bank Securities Ltd** Mercantile Bank Securities Ltd (MBSL), a subsidiary company of MBL had been formed on 27 June 2010 to deal with stock dealing and broking. MBSL has started its commercial operation seperately from 14 September 2011 through obtaining stock dealer and broker license from the Securities and Exchange Commission. The main operation of the subsidiary is to buy and sell off securities listed with Dhaka and Chittagong Stock Exchange or approved by Securities and Exechange Commission for its customer and equity loan is extended to the customers against their equity for investment in the listed companies. **Mercantile Exchange House (UK) Limited** Mercantile Exchange House (UK) Limited, a fully owned subsidiary company of MBL incorporated as private limited company with companies for England and Wales under registration no. 07456837 on December 01, 2010. The company commenced its business operation at Birmingham in UK on December 06, 2011. Mercantile Exchange House is committed to provide faster, easier and safer remittance services to the Bangladeshi expatriate living and working in UK. It also ensures reliable and secured remittance services at the door step of their near and dear ones living in Bangladesh. **Off-shore Banking Unit (OBU)** MBL obtained the Off-shore Banking Unit permission vide letter no. BRPD (P-3) 744 (114)/2010-1743 dated May 04, 2010. The commencement of operation of this unit is from March 20, 2011. Presently, the Bank has 2 (two) units in operation in Bangladesh. The Off-shore Unit is governed under the rules and guidelines of Bangladesh Bank. The principle activities of the OBU are to provide all kinds of commercial banking services to its customers through its branches in Bangladesh.
	(c)	Any restriction, 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

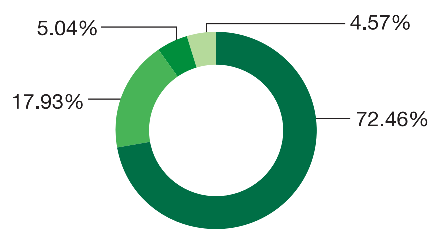
Qualitative Disclosures	(a)	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of capital instruments eligible for inclusion in Tier 1 or in Tier 2. • **Conditions for calculating the Tier 1 capital, Tier 2 capital and Tier 3 capital set by BB is as under:** a) The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 Capital. b) 50% of revaluation reserves for fixed assets and securities eligible for Tier 2 Capital. c) 10% of revaluation reserves for equity instruments eligible for Tier 2 Capital. d) Subordinated debt shall be limited to a maximum of 30% of the amount of Tier 1 Capital. e) Limitation of Tier 3: A minimum of about 28.50% 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. • **In order to obtain the eligible regulatory capital for the purpose of calculating Capital Adequacy Ratio (CAR), the following deductions are required from bank's Tier 1 capital:** a) Value of Intangible Assets i.e. Goodwill shown as assets. b) Shortfall in provisions required against classified assets. c) Shortfall in provisions required against investment in shares. d) Remaining deficit on account of revaluation of investments in securities after netting off any other surplus on the securities. e) Reciprocal/Crossholding of bank's capital/subordinated debt. f) Unauthorized amount of share holding. g) Investments in subsidiaries which are not consolidated.	
Quantitative Disclosures	(b)	The amount of Consolidated Tier 1 capital, with separate disclosure of:	**(BDT in Cr.)**
		Paid Up Capital	496.81
		Non-repayable Share Premium account	-
		Statutory Reserve	264.34
		General Reserve	-
		Retained Earning	119.76
		Minority Interest in Subsidiaries	5.17
		Non-Cumulative Irredeemable Preferences Shares	-
		Dividend Equalization Account	4.57
		Others (If any item approved by Bangladesh Bank)	-
	(c)	Total amount of Consolidated Tier 2 and Tier 3 capital	179.44
	(d)	Other deductions from capital	-
	(e)	Consolidated Total Eligible Capital	1,070.09

Tier 1 Capital



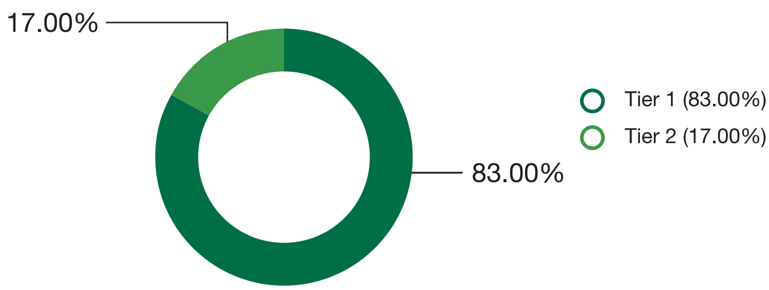
Paid-up Capital (55.78%)
Retained Earning (13.45%)
Statutory Reserve (29.68%)
Dividend Equilization Account (0.51%)
Minority Interest In Subsidiaries (0.58%)

Tier 2 Capital



General Provision (Unclassified loan + SMA + off Balance Sheet exposure) (72.46%)
Assets Revaluation Reserves up to 50% (17.93%)
Revaluation Reserve for securities up to 50%* (5.04%)
Revaluation Reserve for equity instrument up to 10% (4.57%)

Total Consolidated Capital Fund as on December, 2011



c) Capital Adequacy

<table>
<tr><td rowspan="1">Qualitative Disclosures</td><td>(a)</td><td colspan="2">A summary discussion of the Bank's approach to assessing the adequacy of its capital to support current and future activities.

RWA & CAR

MBL has adopted Standardized Approach for computation of Capital Charge for Credit Risk and Market Risk while Basic Indicator Approach for Operational Risk. Total Risk Weighted Assets (RWA) of the Bank is determined by multiplying the capital charge for market risk and operational risk by the reciprocal of the minimum capital adequacy ratio i.e. 10% as on December 2011 and adding the resulting figures to the sum of risk weighted assets for credit risk. Total RWA is then used as denominator while total Eligible Regulatory Capital as on numerator to derive Capital Adequacy Ratio i.e.

$$CAR = \frac{\text{Eligible Regulatory Capital x 100}}{\text{RWA}}$$
Strategy to achieve the required Capital Adequacy

The Bank's policy is to manage and maintain its capital with the objective of ensuring strong capital adequacy ratio in line with Basel-II. For the said purpose, MBL has already taken numerous steps including revaluation of its fixed assets, and issuance of Subordinated Debt (Bond) worth to BDT 100 crore is likely to be accomplished very soon. Besides, MBL has emphasized on the credit rating of its corporate customers in order to reduce the RWA and thereby achieve adequate capital adequacy ratio. Corporate customers of the Bank are continuously encouraged to conduct their credit rating only by any of the Bangladesh Bank approved External Credit Assessment Institutions (ECAIs) i.e. CRISL, CRAB, ECRL, NCRL and ACRSL. As on December 2011, a significant number of corporate party has conducted their credit rating by BB Approved ECAIs</td></tr>
<tr><td rowspan="4">Quantitative Disclosures</td><td>(b)</td><td>Capital Requirement for Credit Risk</td><td>(BDT in Cr.)
874.88</td></tr>
<tr><td>(c)</td><td>Capital Requirement for Market Risk</td><td>61.32</td></tr>
<tr><td>(d)</td><td>Capital Requirement for Operational Risk</td><td>73.32</td></tr>
<tr><td>(e)</td><td>Total and Tier 1 capital ratio
• For the consolidated group
Total
Tier 1
• For stand alone
Total
Tier 1</td><td>

10.60%
8.82%

10.52%
8.74%</td></tr>
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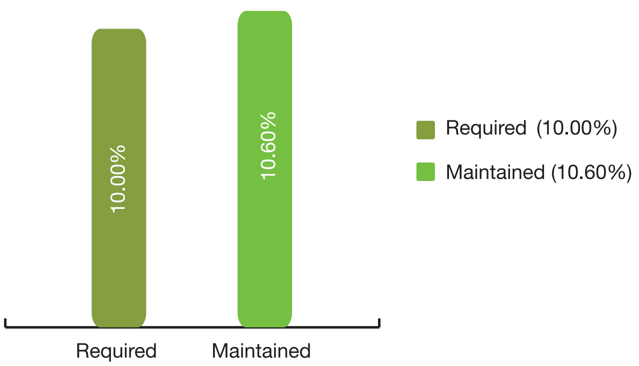
Consulidated CAR as on December, 2011



d) Credit Risk

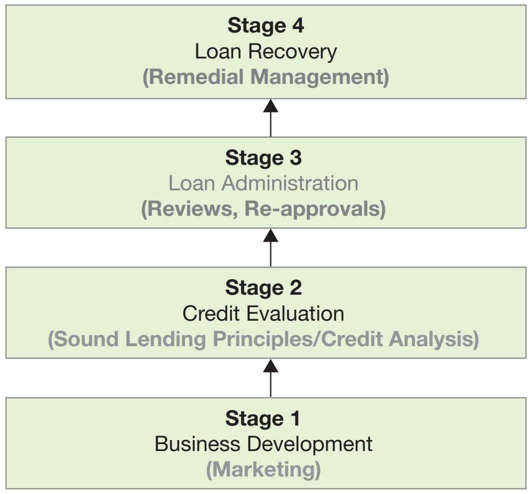
Qualitative Disclosures	(a)	**The general qualitative disclosure requirement with respect to credit risk, including:** Definition of past due and impaired (for accounting purposes); • As per guideline of Bangladesh Bank, All Loans and Advances are grouped into 4 (four) categories namely Continuous Loan, Demand Loan, Fixed Term Loan and short term Agricultural Credit for the purpose of Loan Classification. As per relevant BB guideline, depending on the type, the entire loan/amount of unpaid installments will be treated as overdue from the following date/after six month of the expiry day. Any continuous credit, Demand loans or a Term Loan which remain overdue for a period of 3 months or more, will be treated as **Special Mentioned Account**. If the past due loans/defaulted installment/irregular loans remains for 6/12 months or more it will be termed as **Sub-standard**. Again, if the past due loans/defaulted installment/irregular loans remains for 9/12/18/36 months or more it will be treated as **Doubtful** and for 12/18/24/60 months will be treated as **Bad/Loss**. Description of approaches followed for specific and general allowances and statistical methods; • Specific and General provisions are maintained according to the relevant BB guideline. For Example, 1% or 2% or 5% provision is maintained against good loans, 5% against SMA loans, 20% against sub-standard, 50% against doubtful and 100% against bad/loss loans after deducting the amount of interest expenses and value of eligible securities from the outstanding balance of classified accounts. Discussion of the Bank's credit risk management policy; **The Bank manages its credit risk in the following manner:** **Creating Credit Risk Awareness Culture** Strong emphasis is given to create credit risk awareness among all lending employees within the Bank. Awareness programs have been conducting regularly to create a risk-conscious culture and empower them with the capability to identify, control and manage Credit Risks more effectively.

Qualitative Disclosures		**Approved Credit Policy by the Board of Directors** The Board of Directors has approved the Credit Policy for the Bank where major policy guidelines, growth strategy, exposure limits (for particular sector, product, individual company and group) and risk management strategies have been described/stated in detail. Credit Policy is regularly updated to cope up with the changing global, environmental and domestic economic scenarios. **Separated Credit Risk Management Division (CRMD)** CRMD has been segregated from Credit Administration Division in line with Central Bank's Guidelines. CRMD assess credit risks and suggest mitigations before recommendation of every credit proposal while Credit Administration confirms that adequate security documents are in place before disbursement. **Formation of Law and Recovery Team** A strong Law and Recovery Team has been formed to monitor the performance of the loans & advances, identify early signs of delinquencies in portfolio, and take corrective measures to mitigate risks, improve loan quality and to ensure recovery of loans in a timely manner including legal actions. **Independent Internal Audit and Direct Access to Board /Audit Committee** Internal Control and Compliance Division (ICCD) independently verifies and ensures, at least once in a year, compliance with approved lending guidelines, Bangladesh Bank guidelines, operational procedures, adequacy of internal control and documentation procedures. ICCD directly reports to the Board/Audit Committee the overall quality, performance, recovery status, risks status, adequacy of provision of loan portfolio for information, overall observation and guidance. **Large Loan limit and Credit Facility on business Consideration** Central Bank's instructions are strictly followed in determining Single Borrower/ Large Loan limit. The Bank watchfully avoids name lending. Credit facility is allowed absolutely on business consideration after observing due diligence. In all cases, viability of business, credit requirements, and security offered, cash flow and risks level are meticulously and professionally analyzed. **Credit Quality and Portfolio Diversification** 5Cs principles of Credit i.e. Character, Capacity, Capital, Conditions and Collateral are followed professionally in the credit evaluation stage. Evaluation of repayment ability, characteristics of financial discipline, financial health of the borrowers and other qualitative and quantitative information are gathered and credit facilities are allowed in a manner so that Bank's optimum asset quality is ensured. Significant concentration of credit is carefully avoided to minimize risk. Credit Lines are segregated focusing on regulatory guidelines. **Early Warning System** Performance of loans is regularly monitored to trigger early warning system to address the loans and advances whose performance show any deteriorating trend. It enables the Bank to grow its credit portfolio with ultimate objective to protect the interest of depositors and shareholders. **Provision & Suspension of Interest** If any loan is classified as 'Sub-standard' and 'Doubtful', interests accrued on such loan are credited to Interest Suspense Account, instead of crediting the same to Income Account. In case of rescheduled loans the unrealized interest, if any, are credited to Interest Suspense Account, instead of crediting the same to Income Account. As soon as any loan or advance is classified as 'Bad/Loss' neither any interest is calculated nor any interest is credited against those accounts.

Qualitative Disclosures

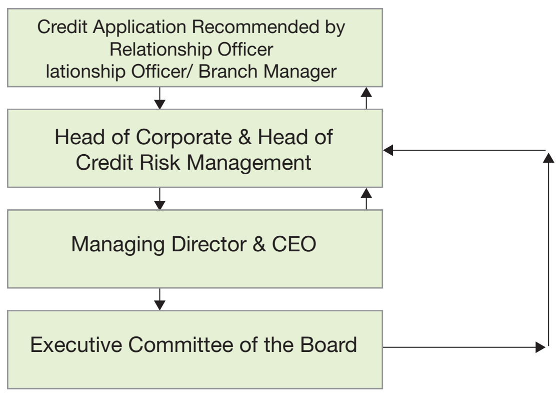
Lending Process in MBL

Lending Process of the Bank followed by the credit officials starting from stage-1 to stage-4 as mentioned in the Bank's approved lending guidelines are shown below:



Credit Approval Process

Credit approval process encompasses pre-approval evaluation, approval and post approval evaluation. All significant loans are approved at Head Office level by the Credit Committee while experienced Senior Officers at Branches are given authority to approve loans with lower risk exposure. Flow Chart of Credit Approval Process of the Bank has been demonstrated below:



Risk Assets Portfolio

To mitigate the Credit Risk, the Bank diversifies its loan exposure to different sectors confirming the Central Bank's requirements. Retail, SME, Consumer, Trading and Agricultural Loan get the priority for lending diversifications.

Qualitative Disclosures		**Counterparty Credit Rating** Proper initiatives have been taken to rate the borrowers' of the Bank. As per Central Bank's guidelines, Corporate Clients have been requested to be rated immediately by BB Approved (ECAIs) duly recognized by the Central Bank. A significant number of corporate clients have already conducted their credit rating by ECAIs following the persuasion of the Bank and we are sanguine of getting almost 70% of our corporate customers to be rated by the end of the year 2012. **NPL Management** The Bank measures its loan portfolio in terms of payment arrears. The impairment levels on the loans and advances are monitored regularly. Loans and Advances are written off to the extent that (i) Five years have been passed since termed as Bad/Loss and 100% provision has also been kept against this loan (ii) there is no realistic prospect of recovery and (iii) against which legal cases are pending as per Central Bank's guidelines. Detail records for all such write off accounts are meticulously maintained and followed up. **Methods used to measure Credit Risk** As per the directives of Bangladesh Bank, 'The Standardized approach' is applied by the Bank to measure its Credit Risk.
Quantitative Disclosures	(b)	Total gross credit risk exposures broken down by major types of credit exposure. • **Total Gross Credit Risk exposures broken down by major types of credit exposure as on December, 2011 is as under:**
	(c)	Geographical distribution of exposure, broken down in significant areas by major types of credit exposure. • **Geographical Distribution of total exposure as on December, 2011 is as under:**

Table (b):

Particulars	(BDT in Cr.) (	% of Total)
Claim on Corporate	4,630.49	58.08
Claim on SME	980.93	12.30
Past Due Claim	220.91	2.77
Claim on CRM	576.82	7.23
Staff Loan	87.25	1.09
Claim on Retail	68.00	0.85
Claim on HBLRES	83.32	1.05
Claim on HBLCOM	167.20	2.10
Claim on Consumer	126.70	1.59
Claim on Bank & NBFI	665.96	8.35
Margin Loan	365.23	4.58
Total	**7,972.80**	**100.00**

Table (c):

Division	(BDT in Cr.)	(% of Total)
Dhaka	5,762.90	72.28
Chittagong	1,577.97	19.79
Rajshahi	402.01	5.04
Sylhet	84 .65	1.06
Khulna	46.37	0.58
Barisal	39.83	0 50
Rangpur	59.07	0.74
Total	**7,972.80**	**100.00**

Quantitative disclosure

(d) Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.

- **Industry type Distribution of total exposure as on December, 2011 is as under:**

Industry	(BDT in Cr.)	(% of Total)
Textile	225.59	2.83
Agriculture	67.98	0.85
SME	383.36	4.81
Pharmaceuticals	164.28	2.06
Information Technology	79.24	0.99
Telecommunication	22.65	0.28
Garments	1,233.89	15.48
Trading and Others	5,795.81	72.69
Total	**7,972.80**	**100.00**

(e) Residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposure.

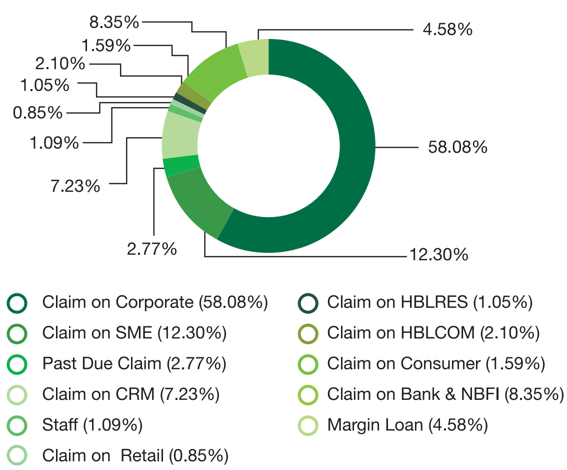
- **Residual contractual maturity breakdown of total exposure as on December, 2011 is as under:**

Particulars	(BDT in Cr.)	(% of Total)
UP to 1 Month	1,524.22	19.12
Over 1 Month Up to 3 Month	1,129.81	14.17
Over 3 Month Up to 12 Month	2,542.07	31.88
Over 1 year Up to 5 Years	1,987.88	24.93
Over 5 Years	788.83	9.89
Total	**7,972.80**	**100.00**

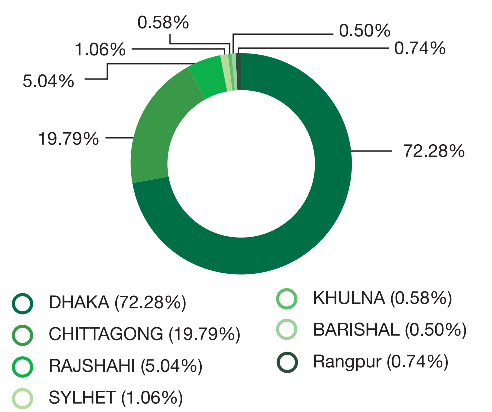
(f)

By major industry and counter party type:	**(BDT in Cr.)**
Amount of impaired loans and if available, past due loans provided separately.	-
Specific and general provisions;	173.54
Charges for specific allowances and charge-offs during the periods	-

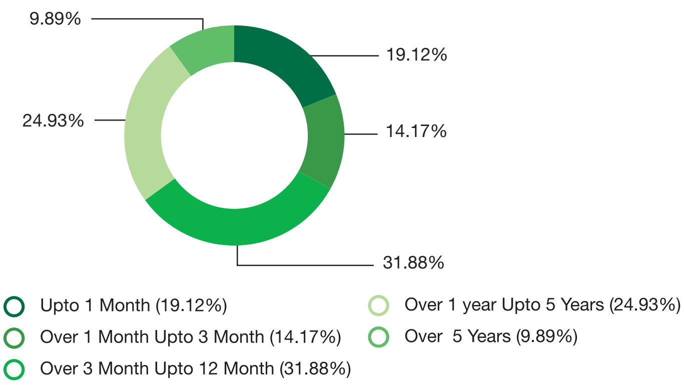
Total Risk Exposure broken down by major types of credit exposures



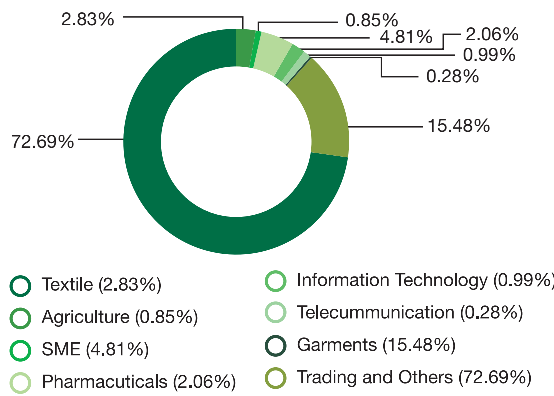
Geographical Distribution of total Exposure



Residual Contractual maturity breakdown of whole portfolio



Industry wise distribution of Total Exposure



Quantitative disclosure	(g)		**(BDT in Cr.)**
		Gross non-performing assets (NPAs):	208.46
		Non-performing Assets (NPAs) to Outstanding Loans & Advances	2.61%
		Movement of Non Performing Assets	
		Opening balance	227.72
		Additions	63.40
		Reductions	82.66
		Closing balance	208.46
		Movement of specific provisions for NPAs	
		Opening balance	77.45
		Recoveries of amount from pre-written off	0.23
		Provisions made during the period	9.23
		Write-off	15.67
		Write-back of excess provisions	-
		Closing balance	71.24

e) Equities: Disclosure for Banking Book Positions

Qualitative Disclosure	(a)	The general qualitative disclosure 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. • MBL's total equity share holding comprises of two purposes i.e. capital gain and other strategic reason like equity participation and investment diversification. MBL is the director of IDLC finances Ltd and sole purpose of such investment is not capital gain, rather maintain relationship as well as diversify its investment portfolio. 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 the practices. • Quoted shares are recorded at cost prices and after every quarter end if the total cost of entire portfolio is higher than the market value, provision is maintained to the extent of differential amount of cost and market value of the portfolio as per terms and condition of regulatory authority. On the other hand, unquoted share is valued at cost price or book value as per latest audited accounts.

Quantitative Disclosure	(b)	Value disclosed in the balance sheet of investment, 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. **(BDT in Cr.)** • Quoted shares 59.03 • Unquoted shares 61.87
	(c)	The cumulative realized gain (losses) arising from sales and liquidations in the reporting periods.
	(d)	**(BDT in Cr.)** • Realized gain (losses) from equity investments • Total unrealized gains (losses) 82.02 • Total latent revaluation gains (losses) - • Any amount of the above included in tier 2 Capital. 8.20
	(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 regulating capital requirements. • **Specific Risk**- Market value of investment in equities is BDT 141.05 cr. Capital Requirement is 10% of the said value which stand to BDT 14.11 cr. • **General Risk**- Market value of investment in equities is BDT 141.05 cr. Capital Requirement is 10% of the said value which stand to BDT 14.11 cr.

f) : Interest Rate Risk in the 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 in the banking book arises from mismatches between the future yield of an assets and their funding cost. Assets Liability Committee (ALCO) monitors the interest rate movement on a regular basis. MBL measure the Interest Rate Risk by calculation Duration Gap i.e. a positive Duration Gap affect bank's profitability adversely with the increment of interest rate and a negative Duration Gap increase the bank's profitability with the reduction of interest rate.
Quantitative Disclosure	(b)	The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring IRRBB, broken down by currency (as relevant) • **Interest Risk-Increase in Interest Rate (As on December 31, 2011): (BDT in million) Where applicable.**

	Minor Shock	Moderate Shock	Major Shock
Magnitude of Shock	**1.00%**	**2.00%**	**3.00%**
Duration Gap (Years)	0.28	0.28	0.28
Total Regulatory Capital	1,070.09	1,070.09	1,070.09
Risk Weighted Assets	10,095.27	10,095.27	10,095.27
CAR	10.60%	10.60%	10.60%
Revised Capital (After Shock)	1,041.34	1,012.60	983.85
Revised RWA	9,970.95	9,970.95	9,970.95
Revised CAR (%)	**10.44%**	**10.16%**	**9.87%**

g) : Market Risk

Qualitative Disclosure	(a)	**Views of BOD on trading/investment activities** • All the Market Risk related policies/guidelines are duly approved by BOD. The BOD sets limit and review and update the compliance on regular basis aiming to mitigate the Market risk. **Methods used to measure Market risk** • Market Risk is the probability of losing assets in balance sheet and off-balance sheet position arising out of volatility in market variables i.e. interest rate, exchange rate and prices of securities. In order to calculate the market risk for trading book purposes the Bank uses Standardized (rule based) Approach where capital charge for interest rate risk, price and foreign exchange risk is determined separately. **Market Risk Management System** A Policy for managing Market Risk has been set out by the Board of Directors of the Bank where clear instructions has been given on Loan Deposit Ratio, Whole Sale Borrowing Guidelines, Medium Term Funding, Maximum Cumulative Outflow, Liquidity Contingency Plan, Local Regulatory Compliance, Recommendation / Action Plan etc. Treasury Division and International Division mainly manage the Market Risk with the help of Asset Liability Committee (ALCO) and Asset Liability Management (ALM) Desk in the following fashion: • **Interest Rate Risk Management** Treasury Division reviews the risks of changes in income of the Bank as a result of movements in market interest rates. In the normal course of business, the Bank tries to minimize the mismatches between the duration of interest rate sensitive assets and liabilities. Effective Interest Rate Risk Management is done as under: • **Market Analysis** Market analysis over interest rate movements are reviewed by the Treasury Division of the Bank. The type and level of mismatch interest rate risk of the Bank is managed and monitored from two perspectives, being an economic value perspective and an earning perspective. • **Gap Analysis** ALCO has established guidelines in line with central Bank's policy for the management of assets and liabilities, monitoring and minimizing interest rate risks at an acceptable level. ALCO in its regular monthly meeting analyzes Interest Rate Sensitivity by computing GAP i.e. the difference between Rate Sensitive Assets and Rate Sensitive Liability and take decision of enhancing or reducing the GAP according to prevailing market situation aiming to mitigate interest rate risk. • **Foreign Exchange Risk Management** Risk arising from potential change in earnings resulted from exchange rate fluctuations, adverse exchange positioning or change in the market prices are considered as Foreign Exchange Risk. Treasury and International Division manage this risk in the following fashion: • **Continuous Supervision** Bank's Treasury Division manages and controls day-to-day trading activities under the supervision of ALCO that ensures continuous monitoring of the level of assumed risks. Treasury Division monitors the foreign exchange price changes and Back Office of the Treasury Division verifies the deals and passes the entries in the books of account.

- **Treasury Back Office separated from Treasury Front Office**

Treasury Back Office is conducting its operation in separate locations apart from the Treasury Front Office. Treasury Back Office is responsible for currency transactions, deal verification, limit monitoring and settlement of transactions independently. Treasury Back Office gathers the market rates from an independent source other than dealers of the same organization, which helps to avoid any conflict of interest.

- **Mark-to-Market Method for Approved Securities and Foreign Exchange Revaluation**

All foreign exchange reserves and balances along with approved securities are revalued at Mark-to-Market method according to Bangladesh Bank's guidelines. Such valuation are made after specific time interval as prescribed by Bangladesh Bank.

Nostro Accounts

Nostro accounts are maintained by the Bank with various currencies and countries. These Accounts are operated by the International Division of the Bank. All Nostro accounts are reconciled on monthly basis. The management reviews outstanding entry beyond 30 days for settlement purpose. The Management sets limits for handling Nostro accounts transactions including time limits for settlements of transactions and time and amount limits for items which are investigated after receipt of the account statements. Nostro accounts are verified by the external auditors twice in a year (half yearly basis) and reports are to be submitted to Bangladesh Bank.

- **Equity Risk Management**

Equity Risk is the risk of loss due to adverse change in market price of equities held by the Bank. Equity Risk is managed by the following fashion:

Investment Portfolio Valuation

Mark-to-Market valuations of the share investment portfolio is followed in measuring and identifying risk. Mark-to-Market valuation is done against a predetermined cut loss limit.

Diversified Investment to minimize Equity Risk

MBL minimizes the Equity Risks by Portfolio diversification as per investment policy of the Bank. A high powered committee has been formed headed by Deputy Managing Director of the Bank to reduce the risk by taking prudent decision while involved in Equity Investment.

Margin Accounts are monitored very closely

Where Margin loan is allowed, security of investment, liquidity of securities, reliability of earnings and risk factors are considered and handled professionally.

Quantitative Disclosure	(b)	**The capital requirements for;**	**(BDT in Cr.)**
		Interest rate risk;	20.10
		Equity position risk;	28.21
		Foreign Exchange risk	13.02
		Commodity risk.	-

g) : Operational Risk

<table>
<tr><td rowspan="1">Qualitative Disclosure</td><td>(a)</td><td>

Views of BOD on System to Reduce Operational Risk

- All the policies/guidelines including Internal Control and Compliances and Board audit are duly approved by BOD. Audit Committee of the Board directly oversees the activities of internal control and compliances aiming to check all types of lapses and irregularities inherent with operational activities of the Bank and thereby may create a notable downfall risk for the Bank.

Performance Gap of Executives and Staffs

- The BOD of the Bank is always keen to provide a competitive, attractive and handsome remuneration package for its employees. Apart from the aforesaid, the recruitment policy of the Bank is always bestow to sort out fresh graduate from the reputed universities and nurture them until transformation to a 'Human Capital' of highest quality. Besides, the Bank's name and fame as top tier Bank of the country acts as moral boosting factor for the employees. An accommodating, welcoming, co-operative and congenial work atmosphere motivates its employees to act as a family towards achievement of goal. As such, there exists no performance gap in the Bank.

Potential External Events

- No potential external events have been detected yet at the time of reporting of the capital accord.

Policies and Processes for Mitigating Operational Risk

- Operational Risks results from inadequate or failed internal process, people and systems or from external events. Within the Bank, Operational Risk may arise from negligence and dishonesty of the employees, lack of management supervision, inadequate operational control, lack of physical security, poor technology, lack of automation, non- compliance of regulatory requirements, internal and external fraud etc. Operational Risk Management Framework has been designed to provide a sound and well-controlled operational environment and thereby mitigate the degree of operational risk.

Approach for calculating capital charge for operational risk

- Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and system or from external events. The Bank use Basic Indicator Approach for calculating capital charge against operational risk i.e. 15% of average positive annual gross income of the Bank over the last three years.

</td></tr>
<tr><td>Quantitative Disclosure</td><td>(b)</td><td>

The capital requirements for	**(BDT in Cr.)**
Operational risk	73.32

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