Basel II (Pillar 3) Disclosures

1. Scope of Application

Pillar 3 disclosures apply to Kotak Mahindra Bank Limited (KMBL) and its consolidated entities for regulatory purposes, wherein KMBL is the controlling entity in the group.

Basis of Consolidation for capital adequacy

The consolidated capital adequacy is based on consolidated financial statements of Kotak Mahindra Bank and its subsidiaries, prepared in accordance with guidelines for consolidated accounting and other quantitative methods vide circular DBOD.No.BP.BC.72/ 21.04.018/2001-02 dated 25th February, 2003 issued by Reserve Bank of India (RBI). The capital charge is computed as per RBI guidelines for implementation of the New Capital Adequacy Framework (Basel II) released in April 2007.

In accordance with the guidelines issued by RBI, the insurance subsidiary has been excluded from consolidation for the purpose of capital adequacy. The entities which carry on activities of financial nature are considered for consolidation for capital adequacy purpose as stated in the scope for preparing consolidated prudential reports laid down in RBI guidelines. The Bank consolidates all subsidiaries as defined in Accounting Standard - 21 (AS - 21) *Consolidated Financial Statements* on a line by line basis by adding together like items of assets, liabilities, income and expenses. Further, Bank's investments in Associates are consolidated using the equity method of accounting as defined by Accounting Standard – 23 (AS - 23) *Accounting for Investments in Associates in Consolidated Financial Statements*. KMBL and its subsidiaries which have been consolidated, constitute the "Group". The list of subsidiaries/ associates consolidated as per AS - 21 alongwith their treatment in consolidated capital adequacy computation is as under:

Name of the Subsidiary	Country of Origin	Activity	Status of consolidation
Kotak Mahindra Prime Limited	India	Non Banking Finance Company	Fully consolidated
Kotak Securities Limited	India	Securities Broking	Fully consolidated
Kotak Mahindra Capital Company Limited	India	Investment Banking	Fully consolidated
Kotak Mahindra Old Mutual Life Insurance Limited	India	Life Insurance	Fully consolidated for financial reporting but not for capital adequacy. Investment deducted from regulatory capital for capital adequacy
Kotak Mahindra Investments Limited	India	Non Banking Finance Company	Fully consolidated
Kotak Mahindra Asset Management Company Limited	India	Asset Management Company – Mutual Funds	Fully consolidated
Kotak Mahindra Trustee Company Limited	India	Trustee of mutual funds	Fully consolidated
Kotak Mahindra (International) Limited	Mauritius	Brokerage and advisory services	Fully consolidated
Kotak Mahindra (UK) Limited	U.K	Brokerage and advisory services	Fully consolidated
Kotak Mahindra, Inc.	USA	Brokerage and advisory services	Fully consolidated
Global Investments Opportunities Fund Limited (GIOFL)*	Mauritius	Investment company	Fully consolidated
Kotak Investment Advisors Limited	India	Asset manager of venture capital, private equity and similar funds	Fully consolidated
Kotak Mahindra Trusteeship Services Limited	India	Trustee of venture capital, private equity and similar funds	Fully consolidated
Kotak Forex Brokerage Limited	India	Foreign exchange brokerage services	Fully consolidated

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Name of the Subsidiary	Country of Origin	Activity	Status of consolidation
Kotak Mahindra Pension Fund Limited	India	Pension fund management	Fully consolidated
Kotak Mahindra Financial Services Limited	Dubai	Advising on financial products	Fully consolidated for Middle East
Infina Finance Private Limited	India	Non Banking Finance Company	Consolidated by equity method
Phoenix ARC Private Limited	India	Securitisation and asset Reconstruction	Consolidated by equity method
ACE Derivatives and Commodity Exchange Limited	India	Commodity Exchange	Consolidated by equity method
Matrix Business Services India Private Limited	India	Business service provider	Consolidated by equity method for financial reporting but not for capital adequacy purpose
Add Albatross Properties Private Limited**	India	Real estate developer	Consolidated by equity method for financial reporting but not for capital adequacy purpose

**GIOFL is a collective investment scheme set up as a fund in Mauritius with the status of a limited company under the Mauritius Companies Act. In terms of constitution and private placement memorandum, GIOFL has classes of redeemable participating shares. Each class of participating shares has its own Balance Sheet and Profit and Loss account. The Profit / Loss of each such class belongs to the participating shareholders of that class. KMBL owns 100% of the management share and management shareholder is not entitled to any beneficial interest in the profit / loss of various classes nor is required to make good any shortfall. In substance there are no direct or indirect economic benefits received by the management shareholders. The substance over form must prevail. Accordingly, the Group consolidates management shares of the entity having regard to substance over form of the entity.*

*** Effective 28th November, 2011 KMBL acquired 29.99% stake in Add Albatross Properties Private Limited as a part of consideration in settlement of acquired non-performing assets.*

a. Capital Deficiencies

As at 31st March 2012 there is no deficiency of capital in any of the subsidiaries of the Bank. The Bank maintains an oversight over its subsidiaries through its representation on their respective Boards and the Management Committee of the Bank is regularly updated.

b. Investment in Insurance subsidiary

The Group's investment in Insurance subsidiary as at 31st March 2012 is deducted from regulatory capital for capital adequacy purpose under Basel II as give below:

₹ in crore

Name of the Entity	% shareholding of the Group	Investment value
Kotak Mahindra Old Mutual Life Insurance Limited	74%	377.62

The quantitative impact on regulatory capital of using risk weights investments versus using the deduction method is given below:

₹ in crore

Method	Quantitative Impact
Deduction method	377.62
Capital at 10% based on risk weighted assets	37.76

2. Capital Structure

The capital adequacy norms issued by RBI classify capital funds into Tier-1 and Tier-2 capital. Tier-1 capital includes paid-up equity capital, statutory reserves, other disclosed free reserves, capital reserves and elements of Tier-2 capital include investment reserve, general provision and loss reserve, eligible upper Tier-2 instruments and subordinate debt instruments (lower Tier-2 bonds). Group has issued debt instruments that form part of Tier-2 capital. The terms and conditions that are applicable for these instruments comply with the stipulated regulatory requirements.

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Equity capital

KMBL has authorized share capital of ₹ 400 cr comprising 800,000,000 equity shares of ₹ 5 each. As on 31st March 2012, KMBL has issued, subscribed and paid-up equity capital of ₹ 370.34 crore, constituting 740,689,510 number of equity shares of ₹ 5 each. KMBL shares are listed on the National Stock Exchange and the Bombay Stock Exchange. The GDRs issued by KMBL are listed on Luxembourg Stock Exchange. During the year KMBL has also allotted equity shares to employees under its Employee Stock Option Plan. The provisions of the Companies Act, 1956 and other applicable laws and regulations govern the rights and obligations of the equity share capital of KMBL.

Details of Upper Tier 2 and Lower Tier 2 Capital

Group has issued debt instruments that form a part of Tier-2 capital. The terms and conditions that are applicable for these instruments comply with the stipulated regulatory requirements. The upper Tier-2 bonds are cumulative and have an original maturity of 15 years with call option after 10 years. The interest on upper Tier-2 bonds is payable either annually or semi-annually. Some of the upper Tier-2 debt instruments have a step-up clause on interest payment ranging up to 50 bps. The lower Tier-2 Subordinated bonds issued by Bank are cumulative and have an original maturity between 5 to 15 years. The lower Tier-2 Subordinated bonds issued by a subsidiary have an original maturity between 6 to 10 years and interest on these lower Tier-2 capital instruments is payable annually.

a. Amount of Tier I and Tier II Capital

₹ in crore

	Amount
(a) Tier I Capital	
Paid-up share capital	370.34
Reserves and Surplus excluding translation and investment reserve	12,374.55
Deductions:	
Investment in paid-up capital of subsidiaries/ associates (50%)	190.64
Intangible assets other than Goodwill	268.41
Goodwill	3.42
Net Tier I Capital	**12,282.42**
(b) Total eligible Tier II Capital	973.16
(c) Debt instruments eligible for inclusion in Upper Tier II Capital	
Total amount outstanding	364.94
Of which raised during the current financial year	—
Amount eligible to be reckoned as capital	364.94
(d) Subordinated debt eligible for inclusion in Tier II capital	
Total amount outstanding	777.40
Of which raised during the current financial year	150.00
Amount eligible to be reckoned as capital	608.22
(e) General Provisions and loss reserves	214.66
(f) Investment reserve	30.58
Deductions:	
Investment in paid-up capital of subsidiaries/ associates (50%)	190.64
Net Tier II Capital	**1,027.76**

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b. Total eligible capital as at 31st March 2012

₹ in crore

	Amount
Tier I Capital	12,282.42
Tier II Capital	1,027.76
Total eligible Capital	**13,310.18**

3. Capital Adequacy

The Group has made considerable progress in capturing data and implementing systems with regards to computing capital adequacy as per the standardised approach of Basel II for credit risk. Efforts are on to automate the process of capital computation as per Basel II and application system is being implemented to that effect.

In accordance with the guidelines of the Reserve Bank of India, the Group has adopted standardised approach for credit risk, basic indicator approach for operational risk and standardised duration approach for market risk for computing capital adequacy.

The legal minimum as per license conditions stipulates that the capital base of the Bank (Tier I + Tier II) must correspond to at least 10 percent of its risk-weighted assets.

The Bank supplements the Capital Adequacy computation by performing stress tests, based on Scenarios approved by its Risk Management Committee, to assess how its businesses perform under Stress Conditions. These tests help the Bank to design appropriate risk response to meet stressed conditions.

Approach to Capital Adequacy Assessment to support business activities

The diversified business activities require the Group to identify, measure, aggregate and manage risks effectively and to allocate capital among its businesses appropriately. The risk management framework lays emphasis on the Group's risk philosophy, proper organisational structure, risk and reward balance and is supported by dedicated monitoring and risk measuring mechanism. The Key risks the Group is exposed to are Credit Risk, Market Risk, Interest Rate Risk, Liquidity Risk and Operational risk.

Basic principles and risk and capital management

The Bank undertakes sound risk management in achieving its purpose, objectives and strategies. The Board of Directors approves risk appetite for the Bank. The approved risk appetite sets the boundaries for risk taking and translates into business management limits and policies. Performance against approved Risk Appetite is reviewed periodically by the Risk Management Committee and the Board. Development of the risk strategy and risk appetite is an ongoing process and is based on past experience and future plans. The risk strategy is consistent with the Board's overall risk tolerance, management's expertise in each business unit and the total financial amount that the Bank is prepared to place at risk of loss (capital at risk).

The Management Committee provides overall risk management supervision for the consolidated Group as a whole. Various risk committees, namely Risk Management Committee, Asset Liability Management Committee (ALCO), Credit Committee, First Tier Audit Committee, Information Security Committee etc, review specific risk areas and supervise the activities of enterprise wide risk management.

Other capital adequacy assessment aspects:

- Capital adequacy ratio (CAR) of the Bank is maintained at levels well over the 10% required in accordance with the license conditions.
- The Bank has put in place the ICAAP Policy and the same is being reviewed on a yearly basis which enables the Bank to review and assess its capital for Pillar II risks.

CAR has been worked out based on Basel-I and Basel-II guidelines (parallel run) and CAR is above the regulatory minimum level of 10%.

Capital requirements for various risk categories as at 31st March 2012 ₹ in crore

Items	**Amount**
(a) Capital requirements for credit risk	
Portfolios subject to standardised approach	6,099.95
Securitisation exposures	1.51
(b) Capital requirements for market risk	
Using standardised duration approach	
Interest rate risk	237.30
Foreign exchange risk (including gold)	20.00
Equity position risk	341.94
(c) Capital requirements for operational risk	
Measured using basic indicator approach	727.24
Total capital required at 10%	7,427.93
Total capital funds of the Group	13,310.18
Total risk weighted assets	74,279.29
Capital adequacy ratio	**17.92%**

Computed as per Basel II guidelines

4. Credit Risk

Credit Risk is defined as the possibility of losses associated with borrowers or counterparties failing to fulfil their contractual obligations to the Bank or diminution in their credit quality. In a bank's portfolio, losses stem from outright default due to inability or unwillingness of a customer or counterparty to meet commitments in relation to lending, trading, settlement and other financial transactions. Credit risk is managed in the Bank through committees that approve credit and an enterprise wide risk management framework which sets out policies and procedures covering the measurement and management of credit risk.

The Bank's credit policies and process notes articulate the credit risk strategy of the Bank and thereby the approach for credit origination, approval and maintenance. These policies define the Bank's overall credit sanction criteria, including the general terms and conditions. The policies / processes generally address such areas as target markets / customer segmentation, qualitative-quantitative assessment parameters, portfolio mix, prudential exposure ceilings, concentration limits, structure of limits, approval authorities, exception reporting system, prudential accounting and provisioning norms, etc. They take cognisance of prudent and prevalent banking practices, relevant regulatory requirements, nature and complexity of the Bank's activities, market dynamics, etc.

The Bank's credit exposure is primarily categorised into retail and wholesale borrowers. Retail exposure is mostly term loans and asset backed loans other than personal loans. Wholesale borrowers are internally categorized into corporate, mid-markets and financial institutional group. While retail credit lending is largely based on predefined parameters and is mostly decentralised, credit appraisal is undertaken by an independent dedicated credit risk team for wholesale exposure.

Credit risk management processes

Credit risk management is an integral part of the management and governance process within the Bank. The Bank focuses on ensuring that credit risk taking is in line within approved policies, while meeting risk-reward objectives. The Bank expects to achieve its earnings objectives and to satisfy its customers' needs while maintaining a sound portfolio. Credit exposures are managed through target market identification, appropriate credit approval processes, post-disbursement monitoring and remedial management procedures. Proactive managing of risks on its portfolio has helped the Bank foresee and restrict the impact of the global turmoil on its credit operations. Periodic portfolio review, clear identification of early warning signals and prompt action on the legal and recovery front ensure a healthy credit portfolio. Timely and in-depth research on industries and sectors ensure that funds are directed to positive outlook sectors. Adverse developments in sectors are tracked to facilitate timely decisions to exit Companies in negative outlook sectors. The Bank also constantly reviews its concentration across borrowers, groups, portfolio segments, geography, maturity, sectors and ratings. This helps the Bank maintain a well diversified portfolio. The Bank has also put in place a rating based approval matrix for sanctioning wholesale bank loans.

Nature of reporting and measurement systems

Integral to the lending decision is the credit rating of borrowers. The Bank has an internal rating model which is capable of rating large and emerging corporates, traders, brokers, NBFCs and services. Ratings are supported by financial analysis and combined with Credit Head's judgment to arrive at the final rating for a borrower / counterparty. The Bank uses an 18 point scale to grade borrowers.

Each internal rating, translates into a Probability of Default (PD) for the borrower. The PD captures the risk of a borrower defaulting over a one-year horizon. The rating model is being further enhanced to give required inputs to estimate Probability of Default (PDs) and Loss Given Default (LGDs) based on the Bank's own experience.

The Bank has strong governance on the rating models and framework for changes to the model or enhancements. Performance of the internal rating model is reviewed periodically.

On the retail side, the bank has processes for risk assessment of retail loan exposures. Application scorecards for major businesses in retail loans are ready. The parameters used for these scorecards and their individual weight-ages have been decided based on past experience of the bank. These parameters are both qualitative and quantitative in nature. Credit rating frameworks using these application scorecards are at different stages of implementation in different businesses in retail loans. The final output of the rating will help the bank to assess the expected probable loss number attached to each rating category. The internal rating systems are being further developed and validated as part of the Bank's endeavor to move towards advanced approaches of Basel II.

The Bank has an approved stress testing framework, covering Corporate as well as Retail portfolio. The Bank also uses scenario analysis for stress testing. Loss analysis and expected loss forecasting on a static pool basis is continuously being refined to meet the demand of the current volatile market. Results of these stress tests are placed to the RMC & Board.

The Bank complies with the norms on exposure stipulated by RBI for both single borrower as well as borrower group at the consolidated level. Limits have been set as a percentage of the Bank's consolidated capital funds and are regularly monitored.

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- The Bank monitors the level of credit risk (Low/Moderate/High) and direction of change in credit risk (increasing /decreasing/ stable) at the portfolio level on a regular basis.

  During the year, the Bank maintained a well diversified portfolio.

  As part of the ICAAP, the Bank periodically reports the ICAAP outcomes in terms of the risk appetite statements and assessment of credit concentration risk and underestimation of credit risk under the standardized approach to the Board. During the year, the Bank also had its ICAAP validated by an External agency.

Credit Risk Management Principles

The Bank measures and manages its credit risk based on the following principles:

- The extension and renewal of any credit facility to a particular borrower requires credit approval at the appropriate authority level. The approval authorities policy indicates the sanctioning authorities and the rating tool helps the authorities in such decisions.
- The approval of all limits to counterparties should be in line with the corporate credit policy and credit risk mitigation policy of the bank. Such approval should generally be within the Bank's portfolio guidelines and credit strategies.
- The credit worthiness of borrowers is regularly reviewed and monitored. Customers with emerging credit problems are identified early and classified accordingly. Remedial action is initiated promptly to minimize the potential loss to the bank

Definition and classification of non-performing assets (NPA)

The Bank classifies its advances into performing and non-performing advances in accordance with extant RBI guidelines.

A NPA is defined as a loan or an advance where;

- interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan;
- the account remains 'out of order' – in respect of an overdraft/ cash credit (OD/ CC); and
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

Out of Order

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/ drawing power for a continuous period of 90 days. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/ drawing power, but there are no credits continuously for 90 days as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Overdue

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Further, NPAs are classified into sub-standard, doubtful and loss assets based on the criteria stipulated by RBI. A sub-standard asset is one, which has remained NPA for a period less than or equal to 12 months. An asset is classified as doubtful if it has remained in the sub-standard category for a period exceeding 12 months. A loss asset is one where loss has been identified by the Bank or internal or external auditors or during RBI inspection but the amount has not been written off fully.

The loans of subsidiaries have been classified as non-performing in accordance with the guidelines prescribed by their respective regulators.

Total credit risk exposures as at 31st March 2012

₹ in crore

Overall credit exposure	Fund based	Non-fund based	Total
Total gross credit exposures	53,561.97	9,883.34	63,445.31

Includes all entities considered for Basel II capital adequacy computation

Credit exposure include term loans, working capital facilities (i.e. funded facilities like cash credit, demand loans, temporary limits and non-funded facilities like letter of credits, acceptances and guarantees).

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Geographic distribution of exposures as at 31st March 2012

₹ in crore

Exposures	Fund based	Non-fund based	Total
Domestic	53,561.97	9,875.22	63,437.19
Overseas	-	8.12	8.12
Total	53,561.97	9,883.34	63,445.31

Includes all entities considered for Basel II capital adequacy computation

Industry-wise distribution of exposures

₹ in crore

Industry	Fund based	Non-fund based	Total
Auto loans	17,946.60	-	17,946.60
Personal loans	2,413.33	-	2,413.33
Home loans/ Loan against property	8,369.92	-	8,369.92
Credit cards	256.36	-	256.36
Other retails loans	7,472.18	-	7,472.18
Iron and steel	100.14	414.47	514.61
Engineering	723.19	1,060.95	1,784.14
Chemical, dyes, paints etc	1,189.14	1,030.74	2,219.88
Construction	2,773.21	345.23	3,118.44
Automobiles	1,305.38	1,031.49	2,336.87
Infrastructure	2,724.00	3,005.74	5,729.74
NBFC's	455.57	664.47	1,120.04
Other industries (i)	7,832.95	2,330.25	10,163.20
Total	**53,561.97**	**9,883.34**	**63,445.31**

Includes all entities considered for Basel II capital adequacy computation

i) Other industries include entities from sectors such as cotton textiles, sugar, food processing, vegetable oils and vanaspati, paper and paper products, rubber and rubber products, cement, IT-related, gems and jewellery, capital markets, media publication etc.

Residual contractual maturity break-down of assets as at 31st March 2012

₹ in crore

Maturity Pattern	Cash and balances with monetary authority	Balances with other banks	Investments	Advances	Fixed Assets	Other Assets
0 to 14 days	667.24	580.63	9,185.35	3,626.94	-	435.68
15 to 28 days	104.14	-	805.99	1,816.30	-	139.07
29 days to 3 months	253.33	-	1,898.91	5,165.36	-	123.49
Over 3 months & upto 6 months	188.45	-	1,857.27	5,061.37	-	132.98
Over 6 months & upto 1 year	231.35	-	2,671.83	8,077.08	-	-
Over 1 year & upto 3 years	460.74	2.59	3,825.48	19,070.40	-	19.71
Over 3 year & upto 5 years	65.54	-	704.47	4,151.41	-	135.85
Over 5 years	47.75	0.09	1,186.50	5,907.77	478.28	1290.17
Total	**2,018.54**	**583.31**	**22,135.80**	**52,876.63**	**478.28**	**2,276.95**

Consolidated figures for Kotak Mahindra Bank Limited, Kotak Mahindra Prime Limited and Kotak Mahindra Investments Limited

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Amount of non-performing loans as at 31st March 2012 including NPAs acquired from other banks and NBFCs

₹ in crore

Items	Amount	
	Gross NPA	**Net NPA**
Substandard	309.97	214.28
Doubtful 1	146.58	34.94
Doubtful 2	150.95	24.21
Doubtful 3	47.86	-
Loss	44.38	-
Total	**699.74**	273.43
NPA Ratio (%)	1.31%	0.51%
Movement of NPAs		
Opening balance as at 1st April 2011	711.98	242.67
Additions	353.55	160.15
Reductions	(365.79)	(129.39)
Closing balance as at 31st March 2012	699.74	273.43

Includes all entities considered for Basel II capital adequacy computation
Gross NPA ratio is computed as a ratio of gross non-performing loans to gross advances
Net NPA ratio is computed as a ratio of net non-performing loans to net advances

Movement of provisions for NPAs

₹ in crore

	Amount
Opening balance as at 1st April 2011	469.31
Provisions made during the year	193.40
Write-off/ Write back of excess provisions	(236.40)
Closing balance as at 31st March 2012	426.31

Amount of non-performing loans as at 31st March 2012 excluding NPAs acquired from other banks and NBFCs

₹ in crore

Items	Amount	
	Gross NPA	**Net NPA**
Substandard	309.25	214.28
Doubtful 1	130.25	37.18
Doubtful 2	76.81	8.92
Doubtful 3	1.16	-
Loss	43.35	-
Total	**560.82**	**260.38**
NPA Ratio (%)	1.05%	0.49%
Movement of NPAs (gross)		
Opening balance as at 1st April 2011	468.60	177.56
Additions	343.35	189.26
Reductions	(251.13)	(106.44)
Closing balance as at 31st March 2012	560.82	260.38

Gross NPA ratio is computed as a ratio of gross non-performing loans to gross advances
Net NPA ratio is computed as a ratio of net non-performing loans to net advances

Movement of provisions for NPAs

₹ in crore

	Amount
Opening balance as at 1st April 2011	291.04
Provisions made during the year	153.20
Write-off/ write back of excess provisions	(143.80)
Closing balance as at 31st March 2012	300.44

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Amount of Non-performing investments (NPI)

₹ in crore

	Amount
Gross NPI as at 31st March 2012	21.71
Amount of provisions held for NPI	16.11
Net NPI as at 31st March 2012	5.60

Movement of provisions for depreciation on investments

₹ in crore

	Amount
Opening balance as at 1st April 2011	3.68
Write off /Write back of provisions during the year*	12.43
Closing balance as at 31st March 2012	16.11

*After considering appreciation in investments

5. Credit risk - portfolios subject to the standardised approach

External Ratings

In accordance with RBI Basel II guidelines, the Bank has identified the following External Credit Assessment Agencies (ECAI's) as approved rating agencies:

a. Domestic credit rating agencies: CRISIL, ICRA, CARE and FITCH India

b. International rating agencies: S&P, FITCH and Moody's

The Bank uses the external credit ratings to risk weights exposures on corporates. The issue/ issuer ratings of the ECAI's are considered for the borrowers and the risk weights are then derived on a case by case basis based on a variety of factors (Seniority, Maturity of rating etc) based on RBI's New Capital Adequacy Framework.

Credit exposures by risk weights

₹ in crore

Exposure category	Fund based	Non-fund based	Total
Below 100% risk weight	19,860.70	4,877.01	24,737.71
100% risk weight	18,306.17	4,056.33	22,362.50
More than 100% risk weight	15,092.41	381.50	15,473.91
TOTAL	**53,259.28**	**9,314.84**	**62,574.12**

Includes all entities considered for Basel II capital adequacy computation

6. Credit Risk Mitigation

The Bank has a credit risk mitigation policy that lists possible credit risk mitigation techniques and associated haircuts as envisaged in RBI guidelines. The objective of this Policy is to enable classification and valuation of credit risk mitigants in a manner that allows regulatory capital adjustment to reflect them. The Policy adopts the Comprehensive Approach, which allows full offset of collateral (after appropriate haircuts), wherever applicable against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. The bank has taken ₹ 871.19 crore of collateral benefit in the capital computation as of 31st March 2012.

7. Securitisation

a. Securitisation objectives and policies

Securitisation of assets is undertaken with the following objectives:

- **Meeting credit needs of borrowers** - Due to various constraints such as single party and group exposure norms, paucity of capital, internal sectoral exposure norms, etc, at times the Bank is unable to meet the entire credit requirements of the borrowers. Securitisation helps the Bank to overcome such constraints and meet customer's credit needs.
- **Assistance in management of asset-liability mismatches** - With traditional on balance sheet borrowing and lending, the maturity of assets tends be much longer than that of the liabilities. Securitisation effectively makes Bank's assets more liquid providing scope to more flexibly manage maturity mismatches.

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- **Reduction of credit risk, interest rate and liquidity risk** - Through Securitisation, the Bank can transfer credit, interest rate and liquidity risks to third parties.
- **Freeing up of capital and Improvement in return on capital** - Securitisation removes assets from the Bank's balance sheet and hence frees up capital for other uses. It also improves return on capital.
- **Contingency plan** - Securitisation of retail asset portfolio is considered as an important element of the contingency funding plan of the Bank.

Role played by the Group in the securitisation process:

- **Structurer:** The Bank scans the market to identify potential investors and structures the transaction to meet their requirements in compliance with the extant guidelines.
- **Collection and paying agent:** The SPV may appoint the concerned entity in the Bank as the collection and paying Agent. In such cases, the Bank collects the amounts due from the underlying obligors on the due dates and remits the same into the account of the SPV.

b. Summary of Bank's accounting policies for securitisation activities

In terms of RBI guidelines Bank sells assets to SPV only on cash basis and the sale consideration is received not later than the transfer of the asset to the SPV. Any loss arising on account of the sale is accounted immediately and reflected in the profit and loss account for the period during which the sale is effected and any profit/ premium arising on account of sale is amortised over the life of the securities issued or to be issued by the SPV.

i) In case the securitised assets qualify for derecognition from the books of the Bank, the entire expenses incurred on the transaction e.g. legal fees, etc., is expensed at the time of the transaction and is not deferred.

ii) Where the securitised assets do not qualify for derecognition the sale consideration received is treated as a secured borrowing.

c. Rating of the securitisation transactions:

The Bank uses the ratings provided by external credit rating agencies viz. CRISIL, FITCH (India), ICRA and CARE for the securitization of corporate loans and retail pools.

d. Breakup of the exposure securitised by the Group during the year and subject to securitization framework:

A. Banking Book

₹ in crore

S No.	Exposure type	Amount
1	Total amount of exposures securitised	
	Corporate Loans	3,500.00
	Auto Loans (Car and commercial vehicles)	–
	Mortgage Loans	–
	Total	3,500.00
2	Loss recognized during the period on securitisation	–
3	Amount of assets intended to be securitised within a year	–
	Of which	
	- Amount of assets originated within a year before securitisation	-
4	Unrecognised gain on securitisation	
	Corporate Loans	2.23
	Auto Loans (Car and commercial vehicles)	-
	Mortgage Loans	-

Includes all entities considered for Basel II capital adequacy computation

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Aggregate amount of securitisation exposures retained or purchased and outstanding as on 31st March 2012 is given below:

₹ in crore

S No.	Exposure type	On Balance Sheet Amount	Off Balance Sheet Amount
1	Total amount of exposures retained	–	–
2	Securities purchased	–	–
3	Liquidity facility	–	–
4	Credit commitments (cash collateral)	–	–
5	Other commitments	–	–

Risk-weight wise and bucket wise details of the securitization exposures on the basis of book value

₹ in crore

Exposure type	Amount	Capital charge
Below 100% risk weight	–	–
100% risk weight	–	–
More than 100% risk weight	–	–
Deductions		
– Entirely from Tier I capital	–	–
– Credit enhancing I/Os deducted from total capital	–	–
– Credit enhancement (cash collateral)	–	–

B. Trading Book

Breakup of the exposure securitised by the Bank during the year and subject to securitization framework:

₹ in crore

Sr. No.	Type of Securitisation	Amount
1.	Aggregate amount of exposures securitized by the Bank for which the Bank has retained some exposures and which is subject to the market risk approach	NIL

Aggregate amount of securitisation exposures retained or purchased and outstanding as on 31st March, 2012 is given below:

₹ in crore

S No.	Exposure type	On Balance Sheet Amount	Off Balance Sheet Amount
1.	Total amount of exposures retained	–	–
2.	Securities purchased		
	Auto Loans (Commercial vehicles and construction equipments)	126.26	–
3.	Liquidity facility	–	–
4.	Credit commitments (cash collateral)	–	–
5.	Other commitments	–	–

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Risk-weight wise and bucket wise details of the securitization exposures on the basis of book value

₹ in crore

Exposure type	Amount	Capital charge
Below 100% risk weight	126.26	1.51
100% risk weight	-	
More than 100% risk weight	-	-
Deductions		
- Entirely from Tire I capital	-	-
- Credit enhancing I/Os deducted from total capital	-	-
- Credit enhancement (cash collateral)	-	-

Includes all entities considered for Basel II capital adequacy computation

8. Market Risk in Trading Book

a. Market risk management policy

Market risk is defined as the risk to earnings arising from the movement in market risk factors, namely interest rates, foreign exchange rates, credit spreads or equity prices. For regulatory capital purposes, the Bank calculates its market risk capital requirements according to the Standardised methodology.

The objective of the risk management function is risk identification, measurement and reporting them to the management. The Bank has designed and implemented policies and procedures to ensure that market risk exposures are managed within the approved risk management framework. Embedded within these is a framework of management responsibilities. The Board oversees the market risk management process.

The capital market risk management policies and procedures are based on the product traded.

The Bank's risks are managed through a framework that related the Bank's integrated risk management policy and structure of risk management to the Bank's strategy and objectives. The risk management framework lays emphasis on the groups risk philosophy, proper organizational structure, risk and reward balance and is supported by dedicated monitoring and risk measurement mechanism. This framework for market risk management ensures that appropriate controls, policies and senior management oversight form the basis of the Bank's approach to market risk management.

The market risk for the Bank and each of its major subsidiaries is managed in accordance with the investment policy, which is approved by the respective Boards. These policies ensure that transactions in capital and foreign exchange markets and derivatives are conducted in accordance with sound and acceptable business practices and are as per the extant regulatory guidelines, laws governing transactions in financial markets and the financial environment.

The policies are reviewed regularly to incorporate changes in regulatory guidelines and business and economic environment.

Risk management objectives

The Bank manages its risk with the objectives listed below:

- Achieving risk return balance
- Managing and optimizing interest rate risk in banking and trading book
- Ensuring that mismatches between rate sensitive assets and liabilities is kept within limits
- Managing and optimizing currency and liquidity risk
- Proper recognition, classification, measurement and accounting of investments
- Compliance with regulatory guidelines
- Oversight over the operation and execution of market transactions

Structure and organization of the market risk management function

The Bank's risk management architecture is overseen by the Board of Directors and appropriate policies to manage risks are approved by the Board. The Board is involved in defining risk appetite and capital at risk for the Bank, at an integrated level, covering all activities of the Bank. The Board has also delegated to the Group Head - Risk, the responsibility for middle office and risk management. Risk Management department is entirely independent of Treasury Department.

Development of the risk strategy and risk appetite is an ongoing process and is based on past experience and future plans. The risk strategy is consistent with the Board's overall risk tolerance, management's expertise in each business unit and the total financial amount that the Bank is prepared to place at risk of loss (Capital at risk).

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The Bank uses a comprehensive range of quantitative tools and metrics for monitoring and managing risks. Some of these tools are common to a number of risk categories whereas the others are tailored to address the particular features of specific risk categories. Both with a view to bringing in risk sensitivity through policies and to duly meet the regulatory requirements, the Bank continually assesses the appropriateness and the reliability of the quantitative tools and metrics in the light of the changing risk environment.

Value at Risk

The Bank is computing the market risk capital charge for the trading book as per the standardized approach as per the regulator's guidelines. To complement this, Bank also calculates value at risk on its portfolio. Value at risk is computed for each type of market risk i.e. interest rate, foreign currency, equity etc taking into effect the various correlations between the risk factors. The Bank performs stress tests on its portfolio and assesses its impact on the overall capital. The VaR model is also back tested to ensure its accuracy. The Bank has also recently got the VaR model validated by an external consultant. The Risk Management Committee is apprised of the capital that would have to be maintained under the Internal Models Approach.

Stress Testing

Losses beyond the set confidence level are not captured by the value at risk calculation. The Bank periodically stresses the portfolio to highlight the potential risks that may arise due to events that are rare but plausible. The Bank conducts various tests like the impact of shock to one risk factor, extreme events that may change various risk factors simultaneously and worst case scenario that captures the potential damaging shift in various market risk factors. During the year, the Bank participated in the stress testing programme conducted jointly by the RBI and IMF, as part of the Financial Sector Assessment Programme (FSAP). The Bank was within the internal and regulatory capital ratios after applying the stress scenarios. The stress test results and the subsequent capital requirements are placed before the Board for their perusal.

Liquidity Risk

Effective Liquidity Risk Management ensures the Bank's ability to meet all payment obligations when they become due in both normal and stressed environments.

The Bank's Board defines the Liquidity Risk Management Strategy of the Bank. The Asset Liability Management Committee (ALCO) is entrusted with the responsibility of setting tolerances for and closely overseeing the management of liquidity risk. The Balance Sheet Management Unit (BMU) in Treasury is responsible for the management of Liquidity Risk in accordance with the overall strategy and tolerances.

Funding mismatches are a natural outcome of the Liquidity Transformation function of the Bank. The Bank has a framework for accurately projecting cash flows from on and off Balance sheet items over different time horizons - to ensure that funding mismatches are within acceptable tolerances. The Bank monitors the immediate short term (3 month) liquidity mismatches using the Statement of Short Term Dynamic Liquidity Statement and the long-term structural mismatches using the Structural Liquidity Statement. The ALM team carries out comprehensive analysis of its asset and liability portfolios to track the non-contractual behavior of customers. These Behavioral Analyses are integral to planning for the Bank's future funding requirements.

The Bank has in place a comprehensive set of Early Warning Indicators (EWIs) designed to forewarn of impending liquidity stresses. These EWIs are defined in the Bank's Board Approved Contingency Liquidity Plan (CLP). The overall Liquidity Risk level of the Bank is determined through the levels of the various individual EWIs. The CLP also sets out alternative actions to be taken at levels of increased Liquidity Risk. Special teams, which would potentially be activated in times of heightened liquidity stress, have been defined.

In order to strengthen the liquidity risk management, RBI also issued draft guidelines on "Liquidity Risk Management and Basel III Framework on Liquidity Standards" in February 2012. The proposed two minimum global regulatory standards viz., LCR and NSFR as set out in the Basel III rules will become binding for banks in India from January 2015 and January 2018, respectively. Bank is proactively assessing these ratios and has incorporated these as part of risk appetite and monitors these on regular basis.

Active management of intraday liquidity is another key element in the Bank's Liquidity Risk Management structure.

The Bank also conducts Liquidity Stress Testing on a periodic basis using different Bank-specific and Market-wide stress scenarios. These stress tests are conducted on a quarterly basis and the results are reviewed by top management.

Hedging and risk mitigation

The Bank has defined limits on the positions that can be taken and all the business groups are required to adhere to the same. The hedging transactions are periodically assessed for hedged effectiveness in accordance with the applicable guidelines.

Market risk capital charge

₹ in crore

Risk category	**Capital charge**
Interest rate risk	237.30
Equity position risk	341.94
Foreign exchange risk	20.00
Total capital required	599.24

Includes all entities considered for Basel II capital adequacy computation

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9. Operational Risk Management (ORM)

The Bank and the subsidiaries have well defined operational risk management objectives, strategies and governance structures. The Bank has a comprehensive ORM Framework that covers all activities and governance structure that helps manage operational risk effectively. Through implementation of the Operational Risk Framework and related policies, businesses are able to adopt a structured approach to identify, assess and monitor Operational Risk exposures, design appropriate mitigation strategies, and provide timely and effective reporting to Risk Committee & the Board. The Operational risk framework is supported by policies and processes that help business manage operational risk within approved tolerances, on behalf of its stakeholders.

On the basis of the Enterprise wide Risk Management policy, operational risk policies are prepared for the Bank. These policies outline the ORM governance structure, key risk assessment, risk monitoring and risk mitigating activities. The policy applies to all business lines within the Bank.

Most Group entities, including the Bank, have Risk Management Committees to manage operational risks. Separate sub committees also exist in a few entities to screen all potential new mandates for profitability and to ensure that compliance, legal and reputational issues are addressed before accepting any mandate. Hence, depending upon the size of the group entity, the operational risk governance structure is adequate to manage material operational risks.

Senior Management in all group entities is actively involved in the management of operational risk and implementation of the respective ORM Frameworks / policies. Some group entities have separate operational risk management department. Remaining entities manage operational risk through internal control departments that vary in sophistication depending upon the business needs.

The internal control framework ensures that process related operational risks are minimized by way of regular monitoring and audits. The Group internal audit team, following RBI's risk based audit methodology, and the group compliance department provide sound platform for operational risk management along with risk management unit.

The following are some of the key techniques applied by bank and / or group companies to manage operational risks -

- The Bank has built into its operational process segregation of duties, clear reporting structures, well defined processes, operating manuals, staff training., verification of high value transactions and strong audit trails to control and mitigate operational risks
- New Product & activity notes prepared by business units are reviewed by all concerned departments including compliance, risk management and legal. All concerned departments coordinate and discuss key operational risk issues involving people, process, technology, external factors, etc. so as to minimize them or ensure adequate controls over them. In subsidiaries, internal controls unit reviews the product notes in consultation with the respective departments, including compliance and legal.
- The Operational risk team performs detailed risk analysis and root cause analyses on operational risk events, reported by business units, to identify inherent areas of risk and suggest suitable risk mitigating actions which are monitored for resolution. The Bank wide unusual event reporting and capture system forms the basis for this analysis. The Operational risk team also proactively scans information on external events occurring in the industry to ensure that the bank can respond suitably to similar incidents.
- Bank has in place a 'Risks and Controls Self Assessment' programme for formally assessing operational risks and related controls to mitigate these risks. The self assessments are performed by individual business units and functions. As part of the annual Risks and Controls Self Assessment ("RCSA") process, areas with high risk potential are highlighted and business unit / function either proposes mitigating measures to resolve the issue or provides a rationale for why the risk is acceptable.
- The Bank continuously takes various steps to increase the overall level of operational risk awareness amongst staff at all levels using various tools like trainings, workshops, risk assessment exercise and process related compliance certification / testing, etc. Operational risk profile reports for business divisions are reviewed and discussed with the department's senior management. This enables the Bank to detect changes to the units risk profile at an early stage and take necessary corrective actions The Bank believes that this process helps build a strong risk management culture and increased level of risk awareness amongst work force.
- The Group level IT Security Committee provides direction for mitigating the operational risk in IT security. There is group wide IT security programme (ARISTI) to ensure complete data security and integrity.
- Disaster recovery and Business Continuity Plans (BCP) have been established for significant businesses to ensure continuity of operations and minimal disruption to customer services. These plans are periodically tested and reviewed to ensure their effectiveness to mitigate unforeseen risks arising out of disruptions.
- In the larger group entities, Risk Containment Unit has been setup within Business Units, which identifies and monitors risk on an ongoing basis including sample checks and control testing..
- Risk transfer via insurance is a key strategy to mitigate operational risk exposure at the Bank. The Operational Risk team helps assess the quantum of insurance cover required and aligns it to the Bank's current and projected operational risk exposures.

Approaches for computation of operational risk capital

In accordance with the guidelines issued by RBI, the Bank has adopted the "Basic Indicator Approach" for calculation of operational risk capital for capital adequacy purposes.

As per these guidelines, the capital for operational risk is based on a single indicator: income. The Capital charge associated with operational risk is calculated as 15% of average positive annual gross income of the previous three years.The Bank's operational risk capital charge using basic indicator approach is ₹ 727.24 crore as at 31st March 2012.

At an appropriate time, the Bank also plans to adopt the AMA approach for maintaining operational risk capital. Under this approach, operational risk capital is computed on a VaR methodology by evaluating risks on the basis of their likelihood (probability) and the financial consequence (severity) of such an event.

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10. Interest Rate Risk in the Banking Book (IRRBB)

The exposure of the Bank's financial condition to adverse movements in interest rates is referred to as interest rate risk. The impact of market risk (including Interest Rate Risk) on the Bank's trading book is actively measured through a variety of risk metrics like PV01, option greeks and VaR. The Bank's tolerance with respect to its exposure to market risk in the trading book is articulated through various risk limits and monitored through different MIS reports. The Bank also provides for capital for exposure to market risk in the trading book.

In the context of banking book, interest rate risk is interpreted as the current or prospective risk to both the earnings and capital of the Bank arising from adverse movements in interest rates, which affect the Bank's banking book. Changes in interest rates affect a Bank's earnings by altering interest-sensitive income and expenses, and the underlying value of a Bank's assets, liabilities and off-balance sheet instruments because the present value of future cash flows changes when interest rates change. Although, the very nature of the financial intermediation business makes the Bank susceptible to interest rate risk, excessive risk could potentially pose a significant threat to the Bank's earnings and capital.

The main bodies in charge of management of interest rate risk in the banking book in the Bank are the Asset Liability Management Committee (ALCO) and the Balance Sheet Management Unit (BMU). BMU is part of the Bank's treasury.

The Bank's ALCO is broadly responsible for the financial management of the Balance Sheet. The ALCO sets the overall policy and limit framework within which the BMU operates. The responsibility of controlling of Interest Rate Risk in the banking book is vested with the BMU.

Various asset and liability divisions in the Bank disburse assets and mobilize liabilities of varying types, tenors and rates. These divisions may be net users of fund or net providers of fund to the Bank. Individually and together, they lead to the creation of Interest rate risk in the Banking Book. Through the Funds Transfer Pricing (FTP) mechanism, the management of interest rate risk is taken out of the hands of individual asset and liability divisions and entrusted to a competent interest rate risk management body i.e. the BMU. The BMU analyses the risks inherent in the Balance Sheet, determines appropriate hedging strategies in consultation with the ALCO and executes these strategies. FTP rates are reviewed by the ALCO in its meetings periodically and are calibrated to encourage the mobilization of desirable deposits and the disbursement of favorable assets.

If the directional movement or volatility of interest rate is determined to be potentially adverse, the BMU may decide to hedge the risk using derivative products like IRS/CIRS. A properly constructed hedge would insulate the Economic Value of Equity (EVE) from dissipating to a great extent.

The Bank views Interest Rate Risk from two different but complementary perspectives, namely the Earnings Perspective and the Economic Value Perspective.

- The Bank uses gap analysis to determine the interest rate risk on the banking book from the earnings perspective.
- The duration gap approach is used by the Bank to determine the sensitivity of the Economic Value of Equity (EVE) of the Bank to changes in interest rates. Modified duration is computed on an account-wise basis for the interest rate sensitive assets and liabilities of the Bank. A 100 bps shock is applied on the Leveraged MDuration Gap to arrive at the EVE impact due to on-balance sheet items. The impact of 100 bps shock on off-balance sheet items in also incorporated. Through constant monitoring, risk limits, FTP and hedging management has constantly strived to keep the level of IRR in the Bank within acceptable levels.
- Details of increase/ (decline) in earnings and economic value for upward and downward rate shocks based on Balance Sheet as at 31st March 2012 are given below:
  - o Earnings Perspective
    Impact on earnings of 100 bps parallel shift in yield curve ₹ 64.26 crore
  - o Economic Value of Equity

Impact on MVE of 100 bps adverse parallel shift in yield curve	₹ 129.25 crore
Impact as a percentage of Tier1 Capital	1.05%

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