DISCLOSURE UNDER PILLAR III OF BASEL III ACCORD

1. SCOPE OF APPLICATION

The Karnataka Bank Limited, a premier private sector Bank, was incorporated on February 18th 1924 in Mangalore. The Bank does not have any subsidiary/Associate companies under its Management.

The Bank presently is not involved in insurance business. However, Bank has entered in to a Joint venture agreement and holds equity investments to the extent of 15 per cent in M/s Universal Sompo General Insurance Company Limited. The financials of the joint venture company are not consolidated with the balance sheet of the Bank. The investment in the joint venture is not deducted from the capital funds of the Bank but is assigned risk weights as an investment.

2. CAPITAL STRUCTURE

(Rs in crore)

	Particulars	No of equity Shares	Face value per share	Amount
1	Authorized Capital	300000000	10	300.00
2	Issued Capital	188466932	10	188.47
3	Subscribed Capital	188460854	10	188.46
4	Called up/Paid up Capital	188444304	10	*188.45

*inclusive of forfeited shares

The Bank's shares are listed on the National Stock exchange of India Ltd and Bombay Stock Exchange Ltd.

During the quarter ended Dec 31, 2014 the Bank has allotted 5330 equity shares under equity shares to employees under its Employee Stock Option Plan and release of entitlements kept in abeyance during earlier right issue. Apart from the above, Bank has not raised any capital by IPO, Rights or by Public offer during the quarter ended Dec 31, 2014.

Breakup of Capital Funds

The Tier I Capital of the Bank comprises of

(Rs in crore)

1	Paid up Capital (Including forfeited shares)	188.45
2	Reserves	2863.89
	Total	3052.34

The Tier II Capital of the Bank comprises of

(Rs in crore)

1	Undisclosed reserves	15.95
2	General Provisions and Loss Reserves	204.30
3	Subordinated debts eligible for inclusion in Lower Tier 2 Capital	435.90
	Total	656.15

The Total capital comprises of

(Rs in crore)

1	Tier I Capital	3052.34
2	Tier II Capital	656.15
	Total	3708.49

Details of the aggregate amounts of the bank's total interests in insurance entities, which are risk-weighted :

(Rs. in crores)

Name of the insurance entities / country of incorporation	Principle activity of the entity	Total balance sheet equity (as stated in the accounting balance sheet of the legal entity)	% of bank's holding in the total equity / proportion of voting power	Quantitative impact on regulatory capital of using risk weighting method versus using the full deduction method
Universal Sompo General insurance Co Ltd / India	General Insurance	350	15%	CRAR is reduced by 0.08%

Assessment of Capital Adequacy

An assessment of the capital requirement of the Bank is carried out through comprehensive projections of future business that takes cognizance of the strategic intent of the Bank, profitability of particular business and opportunities for growth. The proper mapping of credit, operational and market risks to this projected business growth enables assignment of capital that not only adequately covers the minimum regulatory capital requirements but also provides headroom for growth. The calibration of risk to business is enabled by a strong risk culture in the Bank aided by effective, technology based risk management systems.

A summary of the Bank’s Capital requirement under Basel III for credit, market and operational risk and the capital adequacy ratio is detailed below.

(Rs in crore)

b	**Capital requirement for Credit Risk**	
	-Portfolios subject to Standardized approach	2444.14
	-Securitization exposures	-
c	**Capital requirement for Market Risk**	
	Standardized duration approach	146.78
	-Interest rate Risk	92.92
	-Foreign exchange risk	1.35
	-Equity Risk	52.51
d	**Capital requirement for Operational Risk**	
	-Basic Indicator approach	196.90
e	Total Capital requirement	2787.82
f	Total eligible Capital Funds of the Bank as per Basel III	3652.01
g	Total Risk Weighted Assets	30975.90
h	Common Equity Tier I ratio (CET1) (%)	9.84%
i	Tier I CRAR (%)	9.84%
j	Tier II CRAR (%)	1.95%
k	Total CRAR (%)	11.79%

3. RISK MANAGEMENT: OBJECTIVES AND ORGANIZATION STRUCTURE

The various risks taken by the Bank during the course of the business development are identified, assessed, measured, controlled, monitored, mitigated and reported effectively. The key components of the Bank's risk management rely on the risk governance architecture, comprehensive processes and internal control mechanism. The Bank's risk governance architecture focuses attention on key areas of risk such as credit, market and operational risk and quantification of these risks wherever possible for effective and continuous monitoring.

a. Objectives and Policies

The Bank's risk management processes are guided by well-defined policies appropriate for various risk categories, independent risk oversight and periodic monitoring through the sub-committees of the Board of Directors. The Bank has a well documented Board approved 'Risk

Management Policy' in place. The Board sets the overall risk appetite and philosophy for the Bank. The Board of Directors, the Integrated Risk Management Committee and the Audit Committee of the Board review various aspects of risk arising from the businesses of the Bank.

b. Structure and Organization

The Bank has a risk management system that is centralized with a three track committee approach. The committees are- Credit Policy Committee (CPC), Asset Liability Management Committee (ALCO) and Operational Risk Management Committee (ORMC). An Integrated Risk Management Committee (IRMC) evaluates the overall risk factors faced by the bank and directly reports to the Board of directors.

CPC deals with credit policies and procedures, ALCO deals with Asset Liability Management (ALM) and Investment Policy of the Bank and ORMC formulates policies and procedures for managing operational risk.

4. CREDIT RISK MANAGEMENT

Bank has developed online comprehensive credit risk rating system for all borrower accounts. Risk rating of borrowers intended to help banks in quantifying and aggregating the credit risk across various exposures. The bank has validated its existing rating models and refined/revised the corporate models, besides introduction of Specialized lending rating models, Retail score card models [Pool based approach] and Facility rating. Accordingly, bank is rating its credit portfolio as per the criteria laid down for rating in the Loan Policy of the Bank. The rating serves as a single point indicator of diverse risk factors of counter-party and for taking credit decisions. The risk rating system is drawn up in a structured manner, incorporating different factors such as borrower and industry specific characteristics. The Bank also undertakes periodic validation exercise of its rating models and also conducts migration and default rate analysis to test robustness of its rating models.

The Bank has formulated a comprehensive Loan Policy by incorporating various parameters and prudential limits to manage and control default, transaction and intrinsic/concentration risk. The credit exposures are taken after subjecting the proposals to analysis of various risk factors such as financial risk, industry risk, management risk, business risk, transaction risk etc.

The Bank analyses the migration of borrowers in various risk rating categories to gauge the quality of the loan portfolio. The Bank also conducts periodical review of the loan assets to ascertain conduct of the accounts. The Bank conducts periodical Credit Audit and Stock Audit of large credit exposures to limit the magnitude of credit risk and interest rate risk.

Credit sanction and related processes

Know Your Customer is a leading principle for all business activities. The other components of the credit processes are:

1. Sound credit approval process with well laid credit sanctioning criteria .
2. The acceptability of credit exposure, primarily based on the sustainability and adequacy of borrower's normal business operations and not based solely on the availability of security.
3. Portfolio level risk analysis and reporting to ensure optimal spread of risk across various rating classes to prevent undue risk concentration across any particular industry segments and monitor credit risk migration.
4. Sector specific studies at periodic intervals to highlight risks and opportunities in those

sectors.
5. Adoption of rating linked exposure norms .
6. Industry-wise exposure ceilings based on the industry performance, prospects and the competitiveness of the sector.
7. Separate risk limits for credit portfolios like advances to NBFC and unsecured loans that require special monitoring.

Review and Monitoring

1. All credit exposures, once approved, are monitored and reviewed periodically against the approved limits. Borrowers with lower credit rating are subject to more frequent reviews.
2. Credit monitoring involves independent review of credit risk assessment, compliance with internal policies of the Bank and with the regulatory framework, compliance with the sanction terms and conditions and effectiveness of loan administration.
3. Customers with emerging credit problems are identified early and classified accordingly. Remedial action is initiated promptly to minimize the potential loss to the Bank.

Concentration Risk

The Bank controls concentration risk by means of appropriate sectoral limits and borrowers limits based on creditworthiness.The Bank also captures the Concentration risk by monitoring the geographical exposure.

Large exposures to individual clients or group

The Bank has individual borrower-wise exposure ceilings based on the internal rating of the borrower as well as group-wise borrowing limits. The Bank monitors the level of credit risk (Low/Moderate/High/Very High) and direction of change in credit risk (increasing /decreasing/ stable) at the portfolio level.

Definition of Non-Performing Assets

Bank has adopted the definition of the past due and impaired assets (for accounting purposes) as defined by the regulator for income recognition and asset classification norms.

Exposures

A. Total gross credit exposure including geographic distribution of exposure

(Rs in crore)

	Domestic	**Overseas**	**Total**
Fund Based	35284.76	-	35284.76
Non Fund based	5415.46	-	5415.46
Total	**40700.22**	**-**	**40700.22**

Geographic distribution of credit exposure

(Rs in crore)

S No.	State Name	Fund Based	Non Fund Based	Total Exposure
1	Andhra Pradesh	1204.38	123.97	1328.35
2	Assam	67.31	47.92	115.23
3	Bihar	8.01	110.00	118.01
4	Chandigarh	48.22	3.04	51.26
5	Chhattisgarh	330.10	31.35	361.44
6	Delhi	3895.54	464.08	4359.62
7	Goa	172.00	37.02	209.02
8	Gujarat	328.50	73.23	401.73
9	Haryana	1035.36	340.46	1375.82
10	Jharkhand	48.49	1.95	50.44
11	Karnataka	13970.84	1763.48	15734.32
12	Kerala	355.76	11.07	366.83
13	Madhya Pradesh	269.00	17.73	286.73
14	Maharashtra	5264.69	847.18	6111.86
15	Orissa	448.26	43.33	491.59
16	Pondicherry	34.23	2.17	36.41
17	Punjab	439.68	118.18	557.86
18	Rajasthan	732.01	52.58	784.59
19	Tamil Nadu	3268.08	366.30	3634.38
20	Telangana	1656.11	605.37	2261.47
21	Uttar Pradesh	554.28	190.85	745.13
22	Uttarakhand	66.97	2.86	69.83
23	West Bengal	1086.94	161.35	1248.29
	Total Exposure	**35284.76**	**5415.46**	**40700.22**

While determining level and direction of credit risk, parameters like percentage of low- risk credit (investment grade and above) to credit risk exposure and migration from investment to non-investment grade (quantum as percentage of credit risk exposure) are also considered. The Bank monitors the rating-wise distribution of its borrowers also.

Exposure to Industries

Industry analysis plays an important part in assessing the concentration risk within the loan portfolio. Particular attention is given to industry sectors where the Bank believes that there is a high degree of risk or potential for volatility in the future. The Bank has fixed internal limits for aggregate commitments to different sectors so that the exposures are evenly spread over various sectors.

The credit policy deals with short term as well as long term approach to credit risk management. The policy of the Bank embodies in itself the areas of risk identification, risk measurement, risk grading techniques, reporting and risk control systems /mitigation techniques, documentation practice and the system for management of problematic loans.

B. Distribution of Credit Exposure by Industry sector (Rs in Crore)

S No.	State Name	Fund Based	Non Fund Based	Total Exposure
1	Andhra Pradesh	1204.38	123.97	1328.35
2	Assam	67.31	47.92	115.23
3	Bihar	8.01	110.00	118.01
4	Chandigarh	48.22	3.04	51.26
5	Chhattisgarh	330.10	31.35	361.44
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8	Gujarat	328.50	73.23	401.73
9	Haryana	1035.36	340.46	1375.82
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22	Uttarakhand	66.97	2.86	69.83
23	West Bengal	1086.94	161.35	1248.29
	Total Exposure	**35284.76**	**5415.46**	**40700.22**

The details of the Industry wherein the bank’s exposure in the related Industry has exceeded the 5 per cent of total gross credit exposure is furnished below.

Sl No	Industry / sectors classification	Percentage of the total credit exposure
1	Infrastructure advances	7.58 %

C. Residual Contractual Maturity of Advances and Investments (Rs in crore)

Maturity Bucket	Advances	Investments
1day	1205.39	406.05
2 to 7 days	140.60	396.76
8 to 14 days	267.95	99.80
15 to 28 days	282.08	268.34

29 days and upto 3 months	1758.95	1200.17
Over 3 months and upto 6 months	1755.82	406.69
Over 6 months and upto 1 year(s)	3097.33	582.25
Over 1 year(s) and upto 3 year(s)	13674.63	2415.80
Over 3 year(s) and upto 5 year(s)	3371.60	2956.37
Over 5 year(s)	4783.40	8167.88
Total	**30337.75**	**16900.11**

D. Classification of Non Performing Advances (Rs in Crore)

		31.12.2014
A	Amount of NPA's (Gross)	1054.17
	-Substandard	519.75
	-Doubtful 1	241.34
	-Doubtful 2	169.41
	-Doubtful 3	23.74
	-Loss	99.92
B	Net NPAs	727.09
	Gross NPAs to Gross Advances ratio (%)	3.44
	Net NPAs to Net Advances ratio (%)	2.41

Movement of NPAs (Gross) (Rs in crores)

	31.12.2014
1. Opening Balance as on 01.04.2014	835.93
2. Additions	778.92
3. Reductions	560.68
4. Closing Balance as on 30.06.2014	1054.17

Movement of Provisions for NPAs

(Rs. in crores)

	31.12.2014
1. Opening Balance	271.53
2. Provision made during the period	211.87
3. Write off	172.64
4. Write back of excess provisions	0.00
5. Closing balance	310.76

E. Non Performing Investments and movement of provision for depreciation on Investments

(Rs in Crore)

		31.12.2014
A	Amount of Non performing Investments	19.49
B	Amount of Provision held for Non performing Investments	19.49
C	Movement of provisions for depreciation on Investments	
	a)Opening balance	97.01
	b) Add: Provisions made during the year	0.00
	c) Less: Write off/write back of excess provisions	42.10
	d) Closing balance	54.91

Disclosure for portfolios subject to the standardized approach

Large corporate borrowers and Public Sector Enterprises are being encouraged to solicit ratings from approved external rating agencies and wherever such ratings are available the Bank uses the same in assigning risk weights. Bank has approved 6 domestic credit rating agencies identified by RBI i.e. CRISIL, CARE, India Ratings and Research Private Limited (earlier FITCH India), ICRA, Brickwork and SMERA Ratings Limited. The ratings available in public domain are mapped according to risk profile and specific risk characteristics of each rating grade of respective agencies as envisaged in RBI guidelines.

The credit exposure [fund based & non fund based] after risk mitigation (subject to the standardized Approach) in different risk buckets are as under:

(Rs in Crore)

Sl No	Risk weight	Exposure Outstanding
1	Below 100%	11029.66
2	100%	12133.70
3	More than 100%	4449.94
	Total	27613.30

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