# DISCLOSURE UNDER PILLAR III OF BASEL III ACCORD
# [Position as on 31.12.2013]

## 1. SCOPE OF APPLICATION

The Karnataka Bank Limited is a premier private sector bank which was incorporated on February 18th 1924 at 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% 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

| | Particulars | No of equity Shares | Face value per share | Amount (Rs.) |
|---|---|---|---|---|
| 1 | Authorized Capital | 300000000 | 10 | 3000000000 |
| 2 | Issued Capital | 188434884 | 10 | 1884348840 |
| 3 | Subscribed Capital | 188426486 | 10 | 1884264860 |
| 4 | Called up/Paid up Capital | 188409936 | 10 | 1884099360 |

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

During the quarter ended 31st December, 2013, the Bank has allotted 2734 equity shares to employees under its Employee Stock Option Plan. Apart from the above, Bank has not raised any capital by IPO, Rights or by Public offer during the said quarter.

**Breakup of Capital Funds**

The Tier I Capital of the Bank comprises of

(Rs in crore)

| | | |
|---|---|---|
| 1 | Paid up Capital ( Including forfeited shares) | 188.42 |
| 2 | Reserves | 2630.48 |
| | **Total** | 2818.90 |

The Tier II Capital of the Bank comprises of

(Rs in crore)

| | | |
|---|---|---|
| 1 | Undisclosed reserves | 14.95 |
| 2 | General Provisions and Loss Reserves | 183.86 |
| 3 | Subordinated debts eligible for inclusion in Lower Tier 2 Capital | 505.90 |
| | **Total** | 704.71 |

**The Total capital comprises of**

(Rs in crore)

| | | |
|---|---|---|
| 1 | Tier I Capital | 2818.90 |
| 2 | Tier II Capital | 704.71 |
| | **Total** | 3523.61 |

The aggregate amounts (e.g. current book value) 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 | General Insurance | 350 | 15% | CRAR will be reduced by 0.04% |
| | | | | |

## Assessment of Capital Adequacy

a] 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 as detailed below.

(Rs in crore)

| | | |
|---|---|---|
| b | Capital requirement for Credit Risk | |
| | -Portfolios subject to Standardized approach | 2129.26 |
| | -Securitization exposures | - |
| c | Capital requirement for Market Risk | |
| | Standardized duration approach | 147.92 |
| | -Interest rate Risk | 105.29 |
| | -Foreign exchange risk | 1.80 |
| | -Equity Risk | 40.83 |
| d | Capital requirement for Operational Risk | |
| | -Basic Indicator approach | 164.08 |
| e | Total Capital requirement | 2441.26 |
| f | Total eligible Capital Funds of the Bank as per Basel III | 3487.53 |
| g | Total Risk Weighted Assets | 27125.24 |
| h | Common Equity Tier I ratio (CET1) (%) | 10.26% |
| i | Tier I CRAR (%) | 10.26% |
| j | Tier II CRAR (%) | 2.60% |
| k | Total CRAR (%) | 12.86% |

### 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 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.

Credit Policy Committee deals with credit policies and procedures, Asset Liability Management Committee deals with Asset Liability Management (ALM) and Investment Policy of the Bank and Operational Risk Management Committee 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 specific characteristics, industry specific characteristics etc. Bank is also undertaking periodic validation exercise of its rating models and also conducting 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. In addition to the above, 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 activities. The other components of the credit process are:

1. Sound credit approval process with well laid credit sanctioning criteria is in place.
2. The acceptability of credit exposure is 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 are periodically undertaken to highlight risk and opportunities in those sectors.
5. Rating linked exposure norms have been adopted by the Bank.
6. Industry-wise exposure ceilings are based on the industry performance, prospects and the competitiveness of the sector.
7. Separate risk limits are set out 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 of 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.

**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. The bank captures the Concentration risk by monitoring the geographical exposure.

**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 | 31549.45 | - | 31549.45 |
| Non Fund based | 4449.48 | - | 4449.48 |
| **Total** | **35998.93** | **-** | **35998.93** |

**Geographic Concentration** (Rs in crore)

| S.No. | State / Union Territory | Funded Exposure | Non Funded Exposure |
|---|---|---|---|
| 1 | ANDHRA PRADESH | 2628.73 | 672.39 |
| 2 | ASSAM | 48.43 | 33.75 |
| 3 | BIHAR | 10.23 | 0.00 |
| 4 | CHHATTISGARH | 310.01 | 33.62 |
| 5 | CHANDIGARH | 54.15 | 9.48 |
| 6 | DELHI | 3439.96 | 363.77 |
| 7 | GUJARAT | 292.36 | 54.03 |
| 8 | GOA | 157.75 | 36.02 |
| 9 | HARYANA | 835.32 | 298.05 |
| 10 | JHARKHAND | 39.98 | 2.00 |
| 11 | KARNATAKA | 12029.88 | 1298.61 |
| 12 | KERALA | 326.42 | 10.23 |
| 13 | MAHARASHTRA | 5090.87 | 886.57 |
| 14 | MADHYA PRADESH | 241.39 | 11.07 |
| 15 | ORISSA | 473.29 | 34.91 |
| 16 | PONDICHERRY | 37.03 | 1.45 |
| 17 | PUNJAB | 371.02 | 65.01 |
| 18 | RAJASTHAN | 625.63 | 47.42 |
| 19 | TAMIL NADU | 2991.96 | 318.98 |
| 20 | UTTARAKHAND | 58.21 | 2.97 |
| 21 | UTTAR PRADESH | 530.13 | 143.37 |
| 22 | WEST BENGAL | 956.70 | 125.78 |
| | **Total Exposure** | **31549.45** | **4449.48** |

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 also monitors the rating-wise distribution of its borrowers.

**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**

(Rs in Crore)

| Sl. No. | INDUSTRY | FUNDBASED | NON FUNDBASED |
|---|---|---|---|
| 1 | Coal and Mining | 96.19 | 1.50 |
| 2 | Iron and Steel | 783.00 | 92.02 |
| 3 | Metal and Metal Products | 339.86 | 129.47 |
| 4 | Other Engineering | 562.10 | 285.41 |
| 5 | Wood Based Industries | 91.07 | 152.98 |
| 6 | Electronics | 25.21 | 3.80 |
| 7 | Cotton Textile | 742.87 | 95.94 |
| 8 | Jute Textile | 15.30 | 3.63 |
| 9 | Other Textiles | 822.47 | 95.71 |
| 10 | Tea Industry | 39.92 | 0.31 |
| 11 | Kandasari and Sugar | 34.31 | 2.11 |
| 12 | Vegetable Oil | 18.25 | 0.00 |
| 13 | Tobbaco and Tobbaco Products | 1.12 | 0.00 |
| 14 | Paper and Paper Products | 251.39 | 34.75 |
| 15 | Rubber and Rubber Products | 14.17 | 4.05 |
| 16 | Plastic and Plastic Products | 216.36 | 76.74 |
| 17 | Chemicals, Dyes | 84.12 | 20.03 |
| 18 | Drugs and Pharmaceuticals | 109.73 | 53.35 |
| 19 | Cement and Cement Products | 419.95 | 21.93 |
| 20 | Leather and Leather Products | 38.89 | 21.24 |
| 21 | Petroleum Products | 252.51 | 1.53 |
| 22 | Distilleries, Brewaries including soft drinks | 22.79 | 0.82 |

| | | | |
|---|---|---|---|
| 23 | Cashewnut Processing | 20.29 | 0.00 |
| 24 | Rice, Flour, Dhal Mills | 271.86 | 10.39 |
| 25 | Marine Products/Processing | 0.03 | 0.00 |
| 26 | Food and Food Products | 232.06 | 5.81 |
| 27 | Gems and Jewellery | 655.93 | 40.29 |
| 28 | Automobiles | 435.33 | 11.64 |
| 29 | Computer Software and Computer Hardware | 21.64 | 22.75 |
| 30 | Infrastructure advances | 2974.22 | 172.47 |
| 31 | All Other Industries | 690.12 | 201.51 |
| | TOTAL INDUSTRIAL EXPOSURE | 10283.05 | 1562.18 |

The details of the Industry wherein the bank's exposure in the related Industry has exceeded the 5% of total gross credit exposure will be furnished as detailed here below.

| **Sl No** | **Industry / sectors classification** | **Percentage of the total credit exposure** |
|---|---|---|
| 1 | Infrastructure advances | 8.74 % |

C. Residual Contractual Maturity of Advances and Investments

(Rs in crore)

| Sl No | Maturity Buckets | Advances | Investments |
|---|---|---|---|
| 1 | 1 day | 1127.53 | 358.37 |
| 2 | 2 to 7 days | 263.45 | 163.25 |
| 3 | 8 to 14 days | 305.19 | 0.83 |
| 4 | 15-28 Days | 308.79 | 104.71 |
| 5 | 29 Days to 3 Months | 1602.77 | 441.9 |
| 6 | Over 3 Months to 6 Months | 2059.76 | 260.67 |
| 7 | Over 6 Months to 12 Months | 2983.41 | 727.91 |
| 8 | Over 1 Year to 3 years | 11856.74 | 2603.63 |
| 9 | Over 3 Years to 5 Years | 2679.62 | 2568.58 |
| 10 | Over 5 Years | 3817.85 | 7904.32 |
| | Total | 27005.11 | 15134.17 |

**D. Classification of Non Performing Advances**

(Rs in Crore)

| | | 31.12.2013 |
|---|---|---|
| A | Amount of NPA's ( Gross) | 996.81 |
| | -Substandard | 484.08 |
| | -Doubtful 1 | 292.63 |
| | -Doubtful 2 | 137.44 |
| | -Doubtful 3 | 18.77 |
| | -Loss | 63.89 |
| B | Net NPAs | 599.44 |
| | Gross NPAs to Gross Advances ratio (%) | 3.65 |
| | Net NPAs to Net Advances ratio (%) | 2.23 |

**Movement of NPAs (Gross)** (Rs in crores)

| | 31.12.2013 |
|---|---|
| 1. Opening Balance as on 01.04.2013 | 638.86 |
| 2. Additions | 569.01 |
| 3. Reductions | 211.06 |
| 4. Closing Balance as on 31.12.2013 | 996.81 |

**Movement of Provisions for NPAs**

(Rs. in crores)

| | 31.12.2013 |
|---|---|
| 1. Opening Balance | 198.81 |
| 2. Provision made during the period | 170.95 |
| 3. Write off | 45.46 |
| 4. Write back of excess provisions | |
| 5. Closing balance | 324.30 |

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

(Rs in Crore)

| | | 31.12.2013 |
|---|---|---|
| A | Amount of Non performing Investments | 13.80 |
| B | Amount of Provision held for Non performing Investments | 13.80 |
| C | Movement of provisions for depreciation on Investments | |
| | a)Opening balance | 87.92 |
| | b) Add: Provisions made during the year | 19.62 |
| | c) Less: Write off/write back of excess provisions | 1.13 |
| | d) Closing balance | 106.41 |

**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. 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% | 9995.22 |
| 2 | 100% | 11088.25 |
| 3 | More than 100% | 4201.88 |
| | **Total** | **25285.35** |

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