

## 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 18<sup>th</sup> 1924 in Mangaluru. 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 into 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)

Sl. No	Particulars	No of equity Shares	Face value per share	Amount
1.	Authorized Capital	500000000	10	500.00
2.	Issued Capital	282727150	10	282.73
3.	Subscribed Capital	282624236	10	282.62
4.	Called up/Paid up Capital	282607686	10	*282.62

\*inclusive of forfeiture shares.

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

During the quarter ended June'18, Bank has not raised any capital by IPO, Rights or by Public offer.

#### a. Breakup of Capital Funds

The Tier I Capital of the Bank comprises of

(Rs in crore)

1.	Paid up Capital ( Including forfeited shares)	282.62
2.	Reserves	4708.06
	<b>Total</b>	<b>4990.68</b>

The Tier II Capital of the Bank comprises of

(Rs in crore)

1	Undisclosed reserves	17.95
2	General Provisions and Loss Reserves	230.18
3	Subordinated debts eligible for inclusion in Lower Tier 2 Capital	100.00
	<b>Total</b>	<b>348.13</b>

The Total capital comprises of:

		(Rs in crore)
1	Tier I Capital	4990.68
2	Tier II Capital	348.13
	<b>Total</b>	<b>5338.81</b>

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

(Rs in crore)				
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 0.16%

#### b. 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)		
A	Capital requirement for Credit Risk	
	- Portfolios subject to Standardized approach	3554.54
	- Securitization exposures	-
B	Capital requirement for Market Risk	
	Standardized duration approach	216.86
	- Interest rate Risk	95.07
	- Foreign exchange risk	1.01
	- Equity Risk	120.78
C	Capital requirement for Operational Risk	
	- Basic Indicator approach	371.35
D	Total Capital requirement (**)	4142.75
E	Total eligible Capital Funds of the Bank as per Basel III	5338.81
F	Total Risk Weighted Assets	46030.47
G	Common Equity Tier I ratio (CET1) (%)	10.84%

H	Tier I CRAR (%)	10.84%
I	Tier II CRAR (%)	0.76%
J	<b>Total CRAR (%)</b>	<b>11.60%</b>

\*\* Excluding CCB

### 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 an online comprehensive credit risk rating system for all borrower accounts. Risk rating of borrowers is 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

### Total gross credit exposure including geographic distribution of exposure

(Rs in crore)

Category	Domestic	Overseas	Total
Fund Based	52534.30	0	52534.30
Non Fund based	6609.14	0	6609.14
<b>Total</b>	<b>59143.44</b>	<b>0</b>	<b>59143.44</b>

### Geographic distribution of credit exposure

(Rs in crore)

Sl. No.	State / Union Territory	Funded Exposure	Non Funded Exposure	Total Exposure
1.	Andhra Pradesh	2259.33	353.94	2613.27
2.	Arunachal Pradesh	0.19	0.00	0.19
3.	Assam	81.99	94.99	176.98
4.	Bihar	4.93	0.10	5.03
5.	Chandigarh	70.50	46.41	116.91
6.	Chhattisgarh	591.77	70.46	662.23
7.	Delhi	3641.09	390.40	4031.49
8.	Goa	221.91	24.80	246.71
9.	Gujarat	740.60	78.77	819.37
10.	Haryana	1148.63	284.29	1432.92
11.	Himachal Pradesh	9.04	1.00	10.04
12.	Jammu and Kashmir	0.08	0.00	0.08
13.	Jharkhand	132.09	2.39	134.48
14.	Karnataka	22070.12	2498.53	24568.65
15.	Kerala	766.47	23.75	790.22

(Rs in crore)

Sl. No.	State / Union Territory	Funded Exposure	Non Funded Exposure	Total Exposure
16.	Madhya Pradesh	399.30	10.91	410.21
17.	Maharashtra	9768.56	824.74	10593.3
18.	Orissa	550.57	85.26	635.83
19.	Pondicherry	35.11	1.78	36.89
20.	Punjab	914.99	86.72	1001.71
21.	Rajasthan	541.95	99.67	641.62
22.	Tamil Nadu	4508.60	390.22	4898.82
23.	Telangana	1645.47	769.38	2414.85
24.	Uttar Pradesh	820.16	87.68	907.84
25.	Uttarakhand	128.00	7.90	135.90
26.	West Bengal	1471.03	375.00	1846.03
27.	Dadra and Nagar Haveli	4.87	0.01	4.88
28.	Manipur	0.00	0.03	0.03
29.	Sikkim	6.65	0.00	6.65
30.	Tripura	0.30	0.01	0.31
	Total	<b>52534.30</b>	<b>6609.14</b>	<b>59143.44</b>

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.

## Distribution of Credit Exposure by Industry sector

(Rs in crore)

Sl. No.	Industry	Fund based	Non Fund based	Total
1.	Infrastructure advances	3905.88	258.00	4163.88
2.	Other Textiles	1164.54	114.00	1278.54
3.	Other Engineering	792.46	308.20	1100.66
4.	Cement and Cement Products	1040.66	17.10	1057.76
5.	Cotton Textile	651.09	60.03	711.12
6.	Metal and Metal Products	324.43	142.24	466.67
7.	Iron and Steel	408.09	30.27	438.36
8.	Automobiles	355.43	42.07	397.50
9.	Plastic and Plastic Products	288.43	47.17	335.60
10.	Rice, Flour, Dhal Mills	302.63	12.61	315.24
11.	Gems and Jewellery	226.38	61.58	287.96
12.	Drugs and Pharmaceuticals	213.98	65.28	279.26
13.	Food and Food Products	120.00	115.61	235.61
14.	Coal and Mining	186.07	4.60	190.67
15.	Petroleum Products	153.75	1.07	154.82
16.	Paper and Paper Products	129.68	13.12	142.80
17.	Chemicals, Dyes	113.28	22.77	136.05
18.	Kandasari and Sugar	81.44	1.00	82.44
19.	Distilleries, Breweries including soft drinks	51.37	3.05	54.42
20.	Tea Industry	50.35	0.81	51.16
21.	Rubber and Rubber Products	20.23	5.50	25.73
22.	Electronics	14.12	3.23	17.35
23.	Leather and Leather Products	10.88	5.75	16.63
24.	Wood Based Industries	7.37	0.09	7.46
25.	Computer Software and Computer Hardware	0.72	0.84	1.56
26.	Cashewnut Processing	1.03	0.00	1.03
27.	Vegetable Oil	0.65	0.00	0.65
28.	Jute Textile	0.45	0.00	0.45
29.	Marine Products/Processing	0.02	0.00	0.02
30.	Tobacco and Tobacco Products	0.01	0.00	0.01
31.	All Other Industries	1236.29	326.49	1562.78
	<b>TOTAL EXPOSURE TO INDUSTRY SECTOR</b>	<b>11851.71</b>	<b>1662.48</b>	<b>13514.19</b>

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	7.04%

## Residual Contractual Maturity of Advances and Investments

(Rs in crore)

SL No	Maturity Buckets	Investments	Advances
1.	1day	263.69	1418.08
2.	2 to 7 days	21.68	138.71
3.	8 to 14 days	0.00	399.96
4.	15 to 30 days	54.63	321.42
5.	31 days to 2 Months	149.02	1240.74
6.	2 Months to 3 Months	17.14	2033.99
7.	Over 3 Months to 6 months	159.45	4009.77
8.	Over 6 months to 1 year	210.53	3989.18
9.	Over 1 year to 3 years	1084.85	19943.50
10.	Over 3 years to 5 years	2990.49	5193.06
11.	5 year to 7 Years	1990.22	2516.20
12.	7 Year to 10 years	5201.60	2124.79
13.	10 Year to 15 Years	2661.58	2752.89
14.	Over 15 Years	1056.44	1648.94
	<b>Total</b>	<b>15861.32</b>	<b>47731.23</b>

## Classification of Non Performing Advances

(Rs in crore)

		30.06.2018
<b>A</b>	<b>Amount of NPA's ( Gross)</b>	<b>2296.53</b>
	Substandard	592.89
	Doubtful 1	762.12
	Doubtful 2	891.05
	Doubtful 3	23.00
	Loss	27.47
<b>B</b>	<b>Net NPAs</b>	
	Amount of Net NPA	1395.97
<b>C</b>	<b>NPA Ratios</b>	
	Gross NPAs to Gross Advances ratio (%)	4.72
	Net NPAs to Net Advances ratio (%)	2.92

## Movement of NPAs (Gross)

(Rs in crore)

	30.06.2018
1. Opening Balance as on 01.04.2018	2376.07
2. Additions	269.82
3. Reductions	349.36
<b>4. Closing Balance as on 30.06.2018</b>	<b>2296.53</b>

### Movement of Provisions for NPAs

(Rs in crore)

	30.06.2018
1. Opening Balance	946.26
2. Provision made during the period	193.78
3. Write off	269.18
4. Write back of excess provisions	0
<b>5. Closing balance</b>	<b>870.86</b>

(Rs in crore)

Particulars	Amount
Write offs booked directly to income statement	0
Recoveries booked directly to income statement	8.64

### Non Performing Investments and movement of provision for depreciation on Investments

(Rs in crore)

	30.06.2018
A Amount of Non performing Investments	42.53
B Amount of Provision held for Non performing Investments	18.61
C Movement of provisions for depreciation on Investments	
a) Opening balance	137.03
b) Add: Provisions made during the year	58.83
c) Less: Write off/write back of excess provisions	0.00
d) Closing balance	195.86

### Major Industry break up of NPA

(Rs in crore)

Industry	Gross NPA	Specific Provision
NPA in Top 5 Industries	563.43	224.12

### Geography wise Distribution of NPA and Provision

(Rs in crore)

Geography	Gross NPA	Specific Provision	General Provision
Domestic	2296.53	870.86	15.74
Overseas	0.00	0.00	0.00
<b>Total</b>	<b>2296.53</b>	<b>870.86</b>	<b>15.74</b>

### 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 7 domestic credit rating agencies identified by RBI i.e. CRISIL, CARE, India Ratings and Research Private Limited (earlier FITCH India), ICRA, Brickwork, Acuite Ratings & Research Ltd (Earlier SMERA Ratings Limited) and INFOMERICS Valuation and Rating Pvt Ltd (INFOMERICS). 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)

SI No	Risk weight	Exposure Outstanding
1.	Below 100%	23669.16
2.	100%	15939.42
3.	More than 100%	5790.11
	<b>Total</b>	<b>45398.69</b>

### **Credit Risk Mitigation: Disclosures for Standardized Approach**

As stipulated by the RBI guidelines, the Bank uses the comprehensive approach for collateral risk mitigation. Under this approach, the Bank reduces its credit exposure to counterparty when calculating its capital requirements to the extent of risk mitigation provided by the eligible financial collateral as specified in the Basel guidelines.

#### **Types of eligible financial collateral / Guarantors:**

The Bank recognizes only specified types of financial collateral and guarantees (counter-guarantors) for providing capital relief in line with Basel II guidelines on credit risk mitigation.

This includes cash, Bank own deposits, gold (including bullion and jewellery, subject to collateralized jewellery being notionally converted/benchmarked to 99.99 per cent purity), securities issued by the Central and State Governments, Kisan Vikas Patra, National Savings certificates, life insurance policies with a declared surrender value which is regulated by IRDA, certain debt securities rated by a recognized credit rating agency, certain debt securities not rated but issued by Banks and listed on a recognized exchange and are classified as senior debt, certain mutual fund units where daily Net Assets Value (NAV) is available in public domain.

#### **Eligible Guarantors (counter-guarantors):**

Credit protection given by the following entities is recognized:

- i. Sovereigns, sovereign entities (including BIS, IMF, European Central Bank and European Community as well as permitted MDBs, ECGC, CRGFTLIH and CGTMSE), banks and primary dealers with a lower risk weight than the counterparty;
- ii. Other entities that are externally rated except when credit protection is provided to a securitization exposure. This would include credit protection provided by parent,

subsidiary and affiliate companies when they have a lower risk weight than the obligor.

- iii. When credit protection is provided to a securitization exposure, other entities that currently are externally rated BBB- or better and that were externally rated A- or better at the time the credit protection was provided. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

The extent of total credit exposure (under the standardized approach) covered by eligible financial collaterals after application of haircuts are furnished below:

(Rs in crore)	
Eligible financial collaterals after haircuts	4132.39
Eligible guarantees	830.29

## 5. MARKET RISK & LIQUIDITY RISK

The Bank has put in place Board approved Integrated Treasury Policy and Asset Liability Management (ALM) policy for effective management of market risk in the Bank. The objective of Integrated Treasury Policy is to assess and minimize risks associated with treasury operations by extensive use of various risk management tools. Broadly, it encompasses Policy prescriptions for managing systemic risk, credit risk, market risk, operational risk and liquidity risk in treasury operations.

For market risk arising out of various products in treasury and its business activities, the Bank has set regulatory / internal limits and ensures the adherence thereof. Migration of ratings is tracked regularly. Limits for exposures to counter-parties, industries and countries are monitored and the risks are controlled through Stop Loss Limits, Overnight limit, Daylight limit, Aggregate Gap limit, Individual gap limit, Value at Risk (VaR) limit for Forex, Inter-Bank dealing and various investment limits. For the Market Risk Management the Bank has a Mid Office. The functions of Mid Office are handled by Integrated Risk Management Department.

The Board, IRMC & ALCO are overseeing the market risk management of the Bank, procedures thereof, implementing risk management guidelines issued by regulator, best risk management practices followed globally and ensures that internal parameters, procedures, practices/policies and risk management prudential limits are adhered to.

The policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigates are discussed in ALCO and based on views taken by / mandates of ALCO, hedge deals are undertaken.

Liquidity risk of the Bank is assessed through daily gap analysis for maturity mismatch

based on residual maturity in different time buckets as well as various liquidity ratios and management of the same is done within the prudential limits fixed thereon. Advance techniques such as Stress testing, simulation, sensitivity analysis etc. are conducted on regular intervals to draw the contingency funding plan under different liquidity scenarios.

### Market Risk in Trading Book

Bank has adopted the Standardized Duration Approach as prescribed by RBI for computation of capital charge for market risk and is fully compliant with such RBI guidelines. Bank is now preparing itself for the Advanced Approach based on a Value at Risk (VaR) model, which is under implementation.

The capital requirements for market risk are detailed below:

(Rs in crore)

Sl No	Risk Category	Capital Charge
I	Interest Rate	95.07
II	Equity	120.78
III	Foreign Exchange , Gold and Derivatives	1.01
IV	Total Capital Charge for market Risk ( I+II+III)	216.86

### 6. INTEREST RATE RISK IN THE BANKING BOOK (IRRBB)

The interest rate risk is viewed from two perspectives i.e. 'Earnings Perspective' and 'Economic Value Perspective'. Generally, the former is measured using Earnings-at-Risk (EaR) under Traditional Gap Analysis (TGA) and the latter is measured through changes in the Market value of Equity (MVE) under Duration Gap Analysis (DGA).

➤ **Earnings-at-Risk (EaR):**

All the Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) maturing/ re-pricing up to 1 year are bucketed as per Traditional Gap Analysis (TGA) and EaR analysis is conducted by applying various shocks on product-wise weighted average interest rates in each time band. EaR is quantified by changes in the NII and NIM in comparison with the previous financial year end.

➤ **Impact on Market Value of Equity (MVE):**

Impact on Market Value of Equity (MVE) is analyzed through Duration Gap Analysis (DGA) which involves bucketing of market value of all Rate Sensitive Assets and Rate Sensitive Liabilities as per residual maturity/ re-pricing in various time bands and computing Modified Duration Gap. Accurate method is adopted for computing the market value by discounting each cash flow of all Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) with various discount curves as suggested by RBI. Notional interest rate shocks are applied on the resultant Modified Duration Gap to arrive at the changes in the Market Value of Equity (MVE).

- Prudential limits have been fixed for changes in NIM and MVE for 200bps shock in the interest rates and monitored on a monthly basis.
- Earning at Risk for 200 bps interest rate shock is estimated at Rs.34.90 crore and change in the Market value of Equity for 200 bps interest rate shocks is 16.57%.

## **7. OPERATIONAL RISK**

**Strategies and Processes:** Bank has initiated several measures to manage operational risk through identification, assessment and monitoring of inherent risks in all its business processes. A framework has been laid to capture loss data which can be mapped to operational risk events to measure the impact quantitatively. Bank has put in place a hierarchical structure to effectively manage operational risk through the formation of internal committee viz., Operational Risk Management Committee (ORMC).

### **Scope and Nature of Operational Risk Reporting and Measurement Systems**

A systematic process for reporting risk events, loss events, “near misses” and non-compliance issues relating to operational risks have been developed and implemented. The information gathered will be used to develop triggers to initiate corrective actions to improve controls. All critical risks and potential loss events are reported to the senior Management/ORMC/IRMC as appropriate for their directions and suggestions.

An Operational Risk Management Policy approved by the Risk Management Committee of the Board details the framework for hedging and/or mitigating operational risk in the Bank. As per the policy, all new products are vetted by the New Product Approval Committee to identify and assess potential operational risks involved and suggest control measures to mitigate the risks.

### **Approach for Operational Risk Capital Assessment**

As per the RBI guidelines, the Bank has adopted Basic Indicator Approach for computing capital charge for Operational Risk. Steps have been initiated to migrate to the Advanced Measurement Approach.

## **8. EXPOSURE RELATED TO COUNTERPARTY CREDIT RISK**

Counterparty Credit Risk exposures for banks are assessed based on Bank’s business requirements and considering counterparty bank’s parameters such as CRAR, net worth, NPA level etc. Counterparty exposures for other entities are assessed subject to exposure ceilings as per the Loan Policy of the Bank. Capital for Counterparty Credit Risk exposure is assessed based on Standardized Approach.

The Bank does not recognize bilateral netting. The credit equivalent amount of derivative exposure is calculated using Current Exposure Method and the balance outstanding as on

30<sup>th</sup> June, 2018 is as under:

(Rs. in crore)

Particulars	Notional Amount	Current Exposure
Foreign exchange contracts	4246.42	126.47
Interest rate contracts	Nil	Nil
<b>Total</b>	<b>4246.42</b>	<b>126.47</b>

#### 9. COMPOSITION OF CAPITAL:

(Rs. in million)

	Amount	Amounts Subject to Pre-Basel III Treatment
<b>Common Equity Tier 1 capital: instruments and reserves</b>		
1.	Directly issued qualifying common share capital plus related stock surplus (share premium)	15665.81
2.	Retained earnings	
3.	Accumulated other comprehensive income (and other reserves)	35124.41
4.	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)	
	Public sector capital injections grandfathered until January 1, 2018	
5.	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	
6.	<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>50790.22</b>
<b>Common Equity Tier 1 capital : regulatory adjustments</b>		
7.	Prudential valuation adjustments	
8.	Goodwill (net of related tax liability)	
9.	Intangibles other than mortgage-servicing rights (net of related tax liability)	402.24
10.	Deferred tax assets	481.14
11.	Cash-flow hedge reserve	
12.	Shortfall of provisions to expected losses	
13.	Securitisation gain on sale	
14.	Gains and losses due to changes in own credit risk on fair valued liabilities	
15.	Defined-benefit pension fund net assets	
16.	Investments in own shares (if not already netted off paid-up capital on reported balance sheet)	

(Rs. in million)			
		Amount	Amounts Subject to Pre-Basel III Treatment
17.	Reciprocal cross-holdings in common equity		
18.	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)		
19.	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)		
20.	Mortgage servicing rights <sup>4</sup> (amount above 10% threshold)		
21.	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)		
22.	Amount exceeding the 15% threshold		
23.	of which : significant investments in the common stock of financial entities		
24.	of which : mortgage servicing rights		
25.	of which : deferred tax assets arising from temporary differences		
26.	National specific regulatory adjustments <sup>Z</sup> (26a+26b+26c+26d)		
26a.	of which : Investments in the equity capital of unconsolidated insurance subsidiaries		
26b.	of which : Investments in the equity capital of unconsolidated non-financial subsidiaries		
26c.	of which : Shortfall in the equity capital of majority owned financial entities which have not been consolidated with the bank		
26d.	of which : Unamortised pension funds expenditures		
	Regulatory Adjustments Applied to Common Equity Tier 1 in respect of Amounts Subject to Pre-Basel III Treatment		
	of which :		
	of which :		
	of which :		

(Rs. in million)			
		Amount	Amounts Subject to Pre-Basel III Treatment
27.	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions		
28.	Total regulatory adjustments to Common equity Tier 1		
29.	<b>Common Equity Tier 1 capital (CET1)</b>	<b>49906.84</b>	
<b>Additional Tier 1 capital : instruments</b>			
30.	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus (share premium) (31+32)		
31.	of which : classified as equity under applicable accounting standards (Perpetual Non-Cumulative Preference Shares)		
32.	of which : classified as liabilities under applicable accounting standards (Perpetual debt Instruments)		
33.	Directly issued capital instruments subject to phase out from Additional Tier 1		
34.	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)		
35.	of which : instruments issued by subsidiaries subject to phase out		
36.	Additional Tier 1 capital before regulatory adjustments		
<b>Additional Tier 1 capital: regulatory adjustments</b>			
37.	Investments in own Additional Tier 1 instruments		
38.	Reciprocal cross-holdings in Additional Tier 1 instruments		
39.	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)		
40.	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions) <sup>9</sup>		
41.	National specific regulatory adjustments (41a+41b)		
41a.	Investments in the Additional Tier 1 capital of unconsolidated insurance subsidiaries		

(Rs. in million)			
		Amount	Amounts Subject to Pre-Basel III Treatment
41b.	Shortfall in the Additional Tier 1 capital of majority owned financial entities which have not been consolidated with the bank		
	Regulatory Adjustments Applied to Additional Tier 1 in respect of Amounts Subject to Pre-Basel III Treatment		
	of which :		
	of which :		
	of which :		
42.	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions		
43.	Total regulatory adjustments to Additional Tier 1 capital		
44.	Additional Tier 1 capital (AT1)		
44a.	Additional Tier 1 capital reckoned for capital adequacy		
45.	<b>Tier 1 capital (T1 = CET1 + Admissible AT1) (29 + 44a)</b>	<b>49906.84</b>	
<b>Tier 2 capital : instruments and provisions</b>			
46.	Directly issued qualifying Tier 2 instruments plus related stock surplus	4500.00	
47.	Directly issued capital instruments subject to phase out from Tier 2	1000.00	
48.	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)		
49.	of which : instruments issued by subsidiaries subject to phase out		
50.	Provisions	2481.30	
51.	<b>Tier 2 capital before regulatory adjustments</b>	<b>3481.30</b>	
<b>Tier 2 capital: regulatory adjustments</b>			
52.	Investments in own Tier 2 instruments		
53.	Reciprocal cross-holdings in Tier 2 instruments		
54.	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)		

(Rs. in million)			
		Amount	Amounts Subject to Pre-Basel III Treatment
55.	Significant investments <sup>13</sup> in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)		
56.	National specific regulatory adjustments (56a+56b)		
56a.	of which : Investments in the Tier 2 capital of unconsolidated insurance subsidiaries		
56b.	of which : Shortfall in the Tier 2 capital of majority owned financial entities which have not been consolidated with the bank		
	Regulatory Adjustments Applied To Tier 2 in respect of Amounts Subject to Pre-Basel III Treatment		
	of which :		
	of which :		
57.	Total regulatory adjustments to Tier 2 capital		
58.	Tier 2 capital (T2)	3481.30	
58a.	Tier 2 capital reckoned for capital adequacy <u>14</u>	3481.30	
58b.	Excess Additional Tier 1 capital reckoned as Tier 2 capital	0	
58c.	<b>Total Tier 2 capital admissible for capital adequacy (58a + 58b)</b>	<b>3481.30</b>	
59.	<b>Total capital (TC = T1 + Admissible T2) (45 + 58c)</b>	<b>53388.14</b>	
	Risk Weighted Assets in respect of Amounts Subject to Pre-Basel III Treatment		
	of which :		
	of which :		
60.	<b>Total risk weighted assets (60a + 60b + 60c)</b>	<b>460304.69</b>	
60a.	of which : total credit risk weighted assets	394948.40	
60b.	of which : total market risk weighted assets	24095.58	
60c.	of which : total operational risk weighted assets	41260.71	
<b>Capital ratios</b>			
61.	Common Equity Tier 1 (as a percentage of risk weighted assets)	10.84%	
62.	Tier 1 (as a percentage of risk weighted assets)	10.84%	
63.	<b>Total capital (as a percentage of risk weighted assets)</b>	<b>11.60%</b>	

(Rs. in million)			
		Amount	Amounts Subject to Pre-Basel III Treatment
64.	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation and countercyclical buffer requirements, expressed as a percentage of risk weighted assets)	7.375%	
65.	of which : capital conservation buffer requirement	1.875%	
66.	of which : bank specific countercyclical buffer requirement	-	
67.	of which : G-SIB buffer requirement		
68.	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	5.34%	
<b>National minima (if different from Basel III)</b>			
69.	National Common Equity Tier 1 minimum ratio (if different from Basel III minimum)	5.5%	
70.	National Tier 1 minimum ratio (if different from Basel III minimum)	7%	
71.	National total capital minimum ratio (if different from Basel III minimum)	9%	
<b>Amounts below the thresholds for deduction (before risk weighting)</b>			
72.	Non-significant investments in the capital of other financial entities		
73.	Significant investments in the common stock of financial entities		
74.	Mortgage servicing rights (net of related tax liability)		
75.	Deferred tax assets arising from temporary differences (net of related tax liability)		
<b>Applicable caps on the inclusion of provisions in Tier 2</b>			
76.	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	2301.80	
77.	Cap on inclusion of provisions in Tier 2 under standardised approach	4936.86	
78.	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	NA	
79.	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	NA	

(Rs. in million)			
		Amount	Amounts Subject to Pre-Basel III Treatment
<b>Capital instruments subject to phase-out arrangements (only applicable between March 31, 2017 and March 31, 2022)</b>			
80.	Current cap on CET1 instruments subject to phase out arrangements	NA	
81.	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	NA	
82.	Current cap on AT1 instruments subject to phase out arrangements	NA	
83.	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	NA	
84.	Current cap on T2 instruments subject to phase out arrangements	NA	
85.	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	NA	

Disclosures pertaining to main features of equity and debt capital instruments and the terms and conditions of equity and debt capital instruments have been disclosed separately on the Bank's website under 'Regulatory Disclosures Section'. The link to this section is <http://ktkbank.com/ktk/BaselDisclosures.jsp>

## 10. EQUITIES – DISCLOSURE FOR BANKING BOOK POSITIONS

The risk oversight relating to the equity portfolio is part of the overall independent risk management structure of the Bank and is subjected to the risk management processes and policies along with Integrated Treasury Policy approved by the Board of Directors of the Bank.

In accordance with the RBI guidelines, entire investment portfolio of the Bank including equity investments is classified on the date of purchase as:

- ❖ HFT - Held for Trading
- ❖ AFS - Available for Sale and
- ❖ HTM - Held to Maturity.

Investments which the Bank intends to hold till maturity are classified as HTM securities. In accordance with the RBI guidelines, equity investments held under the HTM category are classified as banking book for capital adequacy purpose. Equity investments only in the equity of subsidiaries/joint ventures are eligible to be categorized as HTM in accordance

with the RBI guidelines.

Further, investments in Private Equity funds are eligible to be accounted under HTM portfolio for the initial period of 3 years; bank will shift all such portions of draw down for the respective financial year to AFS category. All other investments are required to be classified as HFT / AFS securities.

Further, Investments classified under HTM category are carried at their acquisition cost and not marked to market. Any diminution, other than temporary, in the value of equity investments is provided for.

Profit on sale of investment in the HTM category will be first taken to the Profit and loss account, and thereafter be appropriated to the 'Capital Reserve Account'. The amount so appropriated would be net of taxes and the amount required to be transferred to statutory reserves. Loss on sale of HTM will be recognized in the profit and loss account.

The Bank has classified investments in PE for Rs.317.70 lakhs as at June 30, 2018 under HTM as per prudential guidance. During the period, bank has received distribution (redemption) towards the fund to the tune of Rs.0.69 lakhs and the closing position stands at Rs.317.70 lakhs as on 30.06.2018. On account of this investment, the Bank has not recognized any unrealized gain or loss in the financial statement as of June 30, 2018.

## 11. LEVERAGE RATIO

### Qualitative Disclosure:

Under Basel III, a simple, transparent, non-risk based ratio called leverage ratio has been introduced which is calibrated to act as a credible supplementary measure to the risk based capital requirements. This ratio acts as a "backstop" measure to the risk based capital requirements and constrains the build-up of leverage in the banking sector.

The Leverage Ratio is computed as:

$$\text{Leverage Ratio} = \frac{\text{Capital Measure (Tier I capital)}}{\text{Exposure Measure}}$$

The capital measure is the Tier 1 capital of the risk-based capital framework, taking into account various regulatory adjustments/deductions and the transitional arrangements. The exposure measure is the sum of on-balance sheet exposures, derivative exposures, securities financing transaction (SFT) exposures and off-balance sheet items.

## Summary comparison of accounting assets vs. leverage ratio exposure measure

(Rs. in millions)

	Item	Amount
1.	Total consolidated assets as per published financial statements	706031.78
2.	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	0
3.	Adjustment for fiduciary assets recognized on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	0
4.	Adjustments for derivative financial instruments	1264.68
5.	Adjustment for securities financing transactions (i.e. repos and similar secured lending)	1300.00
6.	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off- balance sheet exposures)	50982.25
7.	Other adjustments (Amount deducted from Capital)	(883.38)
8.	<b>Leverage ratio exposure</b>	<b>758695.33</b>

## Leverage Ratio Common Disclosure

(Rs. in millions)

Sl No	Item	Amount
On-balance sheet exposures		
1.	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	706031.78
2.	(Asset amounts deducted in determining Basel III Tier 1 capital)	(883.38)
3.	<b>Total on-balance sheet exposures</b> (excluding derivatives and SFTs) (sum of lines 1 and 2)	<b>705148.40</b>
Derivative exposures		
4.	Replacement cost associated with all <i>derivatives</i> transactions (i.e. net of eligible cash variation margin)	415.40
5.	Add-on amounts for PFE associated with <i>all</i> derivatives transactions	849.28
6.	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	0
7.	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	0
8.	(Exempted CCP leg of client-cleared trade exposures)	0
9.	Adjusted effective notional amount of written credit derivatives	0
10.	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	0
11.	<b>Total derivative exposures (sum of lines 4 to 10)</b>	<b>1264.68</b>
Securities financing transaction exposures		
12.	Gross SFT <i>assets</i> (with no recognition of netting), after adjusting for sale accounting transactions	4048.70

(Rs. in millions)

Sl No	Item	Amount
13.	(Netted amounts of cash payables and cash receivables of gross SFT assets)	(2798.70)
14.	CCR exposure for SFT assets	50.00
15.	Agent transaction exposures	0
16.	<b>Total securities financing transaction exposures (sum of lines 12 to 15)</b>	<b>1300.00</b>
Other off-balance sheet exposures		
17.	Off-balance sheet exposure at gross notional amount	122586.40
18.	(Adjustments for conversion to credit equivalent amounts)	(71604.15)
19.	<b>Off-balance sheet items (sum of lines 17 and 18)</b>	<b>50982.25</b>
<b>Capital and total exposures</b>		
20.	<b>Tier 1 capital</b>	<b>49906.84</b>
21.	<b>Total exposures (sum of lines 3, 11, 16 and 19)</b>	<b>758695.33</b>
<b>Leverage ratio</b>		
22.	<b>Basel III leverage ratio</b>	<b>6.58%</b>

## 12. LIQUIDITY COVERAGE RATIO (LCR)

### Qualitative Disclosure:

Bank is computing LCR on a daily basis in line with the RBI circular dated June 9, 2014 on "Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards". These guidelines ensure that banks maintain sufficient amount of High Quality Liquidity Assets (HQLAs) to survive 30 days stress scenario so that banks can take corrective measures within such period. These HQLAs have to be 100% of the net cash outflows w.e.f. January 1, 2019. To provide sufficient transition period, the guidelines require maintaining minimum 60% w.e.f. January 1, 2015 and step up of 10% every year to reach 100% by January 1, 2019.

Bank's Asset Liability Management Committee (ALCO) is empowered to monitor and form suitable strategies to maintain stipulated levels of LCR by channelizing funds to target good quality asset and liability profile to meet Bank's profitability as well as liquidity requirements. Funding strategies are formulated by the Treasury and Accounts Department (TAD) in accordance with ALCO guidance. The objective of the funding strategy is to achieve an optimal funding mix which is consistent with prudent liquidity, diversity of sources and servicing costs. Accordingly, TAD estimates daily liquidity requirement. With the help of structural liquidity statement prepared by bank, TAD evaluates current and future liquidity requirement and takes necessary action.

**Quantitative Disclosure:**

(Rs. in Crores)

		<b>Total Average Unweighted Value*</b>	<b>Total Average Weighted Value*</b>
High Quality Liquid Assets			
<b>1.</b>	<b>Total High Quality Liquid Assets (HQLA)</b>	<b>9081.52</b>	<b>8974.59</b>
Cash Outflows			
2.	Retail Deposits and Deposits from small business customers	45407.04	4034.60
(i)	Stable Deposits	10122.06	506.10
(ii)	Less Stable Deposits	35284.98	3528.50
3.	Unsecured Whole Funding, of which:	8137.93	3006.08
(i)	Operational Deposits (all counterparties)	0.00	0.00
(ii)	Non-operational deposits (all counterparties)	8137.93	3006.08
(iii)	Unsecured debt	0.00	0.00
4.	Secured wholesale funding	358.72	90.59
5.	Additional requirements, of which	5457.21	630.82
(i)	Outflows related to derivative exposures and other collateral requirements	1.40	1.40
(ii)	Outflows related to loss of funding on debt products	0.00	0.00
(iii)	Credit and liquidity facilities	5455.81	629.42
6.	Other contractual funding obligations	211.64	211.64
7.	Other contingent funding obligations	3939.60	118.19
<b>8.</b>	<b>TOTAL CASH OUTFLOWS</b>	<b>63512.14</b>	<b>8091.92</b>
Cash Inflows			
9.	Secured lending (e.g. reverse repos)	69.73	0.00
10.	Inflows from fully performing exposures	2246.20	1123.10
11.	Other cash inflows	1880.99	1880.99
<b>12.</b>	<b>TOTAL CASH INFLOWS</b>	<b>4196.92</b>	<b>3004.09</b>
<b>13.</b>	<b>TOTAL HQLA</b>	<b>9081.52</b>	<b>8974.59</b>
<b>14.</b>	<b>TOTAL NET CASH OUTFLOWS</b>	<b>59315.23</b>	<b>5087.83</b>
<b>15.</b>	<b>LIQUIDITY COVERAGE RATIO (%)</b>		<b>176.39</b>

\* Average is calculated based on the previous 3 months (91 Days) data points.