

Disclosures on Risk Based Capital (Basel II)

For the year ended 31 December 2010

1. Capital Structure

1.1 Qualitative Disclosure

The capital of Dhaka Bank Limited is segregated into Tier-1 & Tier-2 capital. Tier-1 capital is 68% of total capital and comprises of 42% Paid up capital & 40% Statutory Reserve. Tier-2 capital is 32% of total capital and comprises of 67% Non-convertible Subordinated Bond & 26% General Provision. Tier-2 Capital is 46% of Tier-1 capital.

Non-convertible Subordinated Bond

The Bank issued Redeemable Non Convertible Subordinated Bond of Taka 2,000,000,000 for a term of 7years to strengthen the capital base of the bank on the consent of SEC vide letter no.SEC/CI/CPLC-10/2001-256 dt.09.09.2010. As per BRPD Circular No. 10 dt.25 November 2002 and BRPD Circular No. 13 dt.14 October 2009 issued by Bangladesh Bank, Tk.1,893,799,308 of Subordinated Bond being 30% of Tier-I capital has been considered as a component of Supplementary Capital (Tier-2) of the Bank.

Quantitative Disclosure:

Sl. No.	Particulars	Amount Tk. (Crore)
1	Amount of Tier-1 capital	
	➤ Fully Paid-up Capital	265.96
	➤ Statutory Reserve	255.38
	➤ Other Reserve	0.38
	➤ Retained Earnings	109.55
	Total	631.27
	Less : Other deductions from Capital	
	Capital Charge (50% from Tier-1) for exceeding the approved limit Under Section 26(2) of Bank Company Act, 1991	18.93
	Total Tier-1 Capital (A)	612.34
2	Amount of Tier-2 capital	
	General Provision	74.20
	Provision for Off Balance Sheet Exposure	25.91
	Revaluation Reserve for HTM & HFT Securities (50%)	13.35
	Non-convertible Subordinated Bond	189.38
	Exchange Equalization Account	-
	Total	302.84
	Less : Other deductions from Capital	
	Capital Charge (50% from Tier-1) for exceeding the approved limit Under Section 26(2) of Bank Company Act, 1991	18.93
	Total	283.91
	Total Tier-2 Capital (B)	
	Total Capital (A+B)	896.25

2. CAPITAL ADEQUACY

Qualitative Disclosure:

Dhaka Bank's policy is to maintain 1-2% higher than the minimum required capital. The bank strictly follows the guidelines of Bangladesh Bank regarding capital adequacy.

Quantitative Disclosure:

Sl. No.	Particulars	Amount Tk. (Crore)
1		
	➤ Capital requirement for Credit Risk	687.90
	➤ Capital requirement for Market Risk	37.74
	➤ Capital requirement for Operational Risk	73.73
2	Total Capital Ratio	10.09%
	Total Tier-1 Capital Ratio	6.89%
	Total	

3. Credit Risk

Qualitative Disclosure:

Credit risk is the risk of financial loss resulting from failure by a client or counterparty to meet its contractual obligations to the Bank. **Credit risk** arises from the bank's dealings with or lending to corporate, individuals, and other banks or financial institutions. Dhaka Bank is managing Credit Risk through a robust process that enables the bank to proactively manage loan portfolios in order to minimize losses and earn an acceptable level of return for shareholders.

3.1 Definitions of past due and impaired

Special mention:

These assets have potential weaknesses thus deserve management's close attention. If left uncorrected, these weaknesses may result in a deterioration of the repayment prospects of the borrower.

Sub-standard:

These are the loans where bank has reason to doubt about the repayment of the loan although recovery prospect is encouraging.

Doubtful:

Full repayment of principal and interest is unlikely and the possibility of loss is extremely high.

Bad /Loss:

These are the loans that have a bleak recovery possibility.

Unclassified:

These are the loans where bank is fully satisfied about its repayment.

3.2 Methods Used to Measure Credit Risk

Credit risk is inherent in traditional banking products such as loans, commitments to lend and contingent liabilities (for example, letters of credit) as well as in “traded products”: repurchase agreements (repos and reverse repos); and securities borrowing and lending transactions. The risk control processes applied to these products are fundamentally the same, although the accounting treatment varies, as they can be carried at amortized cost or fair value, depending on the type of instrument and, in some cases, the nature of the exposure.

3.3 Credit Risk Management System

Credit risk is controlled and monitored by establishing appropriate limits and operational controls to constrain credit exposure to individual counter parties and counterparty groups. There are specific policies and procedures applicable to different business segments.

Credit risk regulatory capital requirements are computed based on the standardized approach prescribed by Bangladesh Bank. In The Standardized Approach credit risk is measured in a standardized manner supported by external credit assessments. Under this approach, risk weightings are mapped to exposure types.

3.4 Credit Risk Mitigation

Taking collateral is the most common way to mitigate credit risk. The Bank generally takes collaterals in the form of pledges of sufficient eligible marketable securities or cash, mortgages over the property etc. All of the collaterals taken do not necessarily qualify for availing capital relief under the capital adequacy framework. To ensure with a high degree of certainty that the collateral value will cover the exposure, discounts (“haircuts”) are generally applied to the current market value. These reflect the quality, liquidity, volatility and, in some cases, the complexity of the individual instruments. Exposures and collateral values are continuously monitored, and margin calls or close-out procedures are enforced, when the market value of collateral falls below a predefined trigger level. Concentrations within individual collateral portfolios and across clients are also monitored where relevant and may affect the discount applied to a specific collateral pool.

3.5 Policies and Processes for Collateral Valuation and Management

The bank has developed stringent process on collateral management. The collaterals issued by the bank as the risk mitigant (for capital calculation under standardized approach) comprise of financial collaterals (Bank deposits, Gold, Debt securities, equities, units of mutual funds etc). A detail process of calculation of correct valuation and application of haircut has been put in place with the help of flexcube (State of the art banking software Dhaka Bank).

Guarantees which are direct, explicit, irrevocable and unconditional, are taken into consideration by the Bank for calculating capital requirement. Use of such guarantees for capital calculation purpose is strictly as per Bangladesh Bank Risk Based Capital Adequacy Guidelines on the subject.

Majority of financial collaterals held by the Bank are by way of own deposits, which do not have any issue in realization. As such, there is no risk concentration on account of nature of collaterals.

The total exposure for disclosed credit risk portfolio (under the standardized approach) is covered by:

Figures in Tk. Crore

	31.12.2010
Eligible financial collateral after the application of Haircut	425.12

Quantitative Disclosure:

Particulars	Amount Tk. (Crore)
Total gross credit risk	7643.28
Funded Domestic	6615.11
Non-Funded Domestic	1028.17
Geographical distribution of exposures	
- Domestic	7643.28
- Overseas	-
Cash and Cash equivalents	-
Claims on Bangladesh Government and Bangladesh Bank	-
Claims on Banks & NBFIs:	230.49
Claims on Corporate	4213.78
Claims included in retail portfolio & Small Enterprise	528.64
Claims on Consumer Loan	86.89
Claims fully secured by residential property	47.68
Claims fully secured by commercial real estate	130.30
Past due claims	259.22
Other categories	559.85
Credit Risk Mitigation	558.26
Risk weighted assets for On-balance sheet items	6615.11
Claims secured by financial collateral	426.85
Risk weighted assets for Off-balance sheet exposure	1028.17
Gross Non Performing Assets (NPAs)	290.86
Non Performing Assets (NPAs) to Outstanding Loans & Advances	4.57%
Movement of Non Performing Assets (NPAs)	
Opening Balance	294.61
Additions	275.15
Reductions	(278.90)
Closing Balance	290.86

Movement of specific provisions for NPAs	
Opening	148.80
Fully provided debt written off	(82.31)
Recoveries of amounts previously written off	6.89
Specific provision for the year	160.27
Provision no longer required due to recoveries	(85.51)
Closing Balance	148.14

4. Market Risk

Qualitative Disclosure:

4.1 Views of BOD on trading/investment activities

Market risk is the risk that the fair value of future cash flows of the financial instruments will fluctuate due to changes in different market variables, namely:

- Interest Rate Risk
- Equity Position Risk
- Foreign Exchange Risk
- Commodity Risk

All these risks are monitored by the Treasury. The foreign exchange risk is managed by setting limits on open foreign exchange position.

The Bank's Investment during the year 2010 was Tk.844 crore. Investment was mostly in long term Government Securities which stood at Tk.710 Crore. The Government Treasury Bonds were purchased at higher rate of interest to cover the increased SLR arising from the growth of deposit liabilities.

4.2 Methods Used to Measure Market Risk

To measure of market risk the Bank uses – Value-at-Risk (VaR).

4.3 Market Risk & Liquidity Risk Management Policies and System

The objective of investment policy covering various facet of Market Risk, is to assess and minimize risks associated with treasury operations by extensive use of risk management tools. Broadly it encompasses policy prescriptions for managing systematic risk, credit risk, market risk, operational risk and liquidity risk in treasury operations.

For market arising out of various products in trading book of the Bank and its business activities, the bank sets regulatory internal and ensure adherence thereto. Limits for exposure to counter-parties, industries and countries are monitored and the risks are controlled through Stop Loss limits, Overnight limit, Daylight limit, Aggregate Gap limit, Value at Risk (VAR) limit for Forum, Inter-bank dealing and investment limit etc.

For the Market Risk Management of the bank, it has a mid-office with separate Desks for Treasury & Asset Liability Management (ALM)

Asset Liability Management Committee (ALCO) is primarily responsible for establishing the market risk management, asset liability management of the bank, procedures thereof, implementing core risk management framework issued by regulator, best risk management practices followed globally and ensuring that internal parameters, procedures, practices/policies and risk management prudential limits are adhered to.

Liquidity risk of the bank is assessed through 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 limit fixed thereon. Further bank is also monitoring the liquidity position through various stock ratios. The bank is proactively using duration gap and interest rate forecasting to minimize the impact of interest rate changes.

4.4 Market Risk in Trading Book.

Market risk regulatory capital requirements are computed based on the standardized approach prescribed by BB.

Quantitative Disclosure:

SIn	Particulars	Amount (Crore Tk)
1	The capital requirements for:	
	➤ Interest Rate Risk	10.77
	➤ Equity position risk	21.44
	➤ Foreign exchange risk	5.55
	➤ Commodity risk	-
	Total	

5. OPERATIONAL RISK

Qualitative Disclosure:

5.1 Views of BOD on system to reduce Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems (for example failed IT systems, or fraud perpetrated by a DBL employee), or from external causes, whether deliberate, accidental or natural. It is inherent in all of the Bank's activities. Operational risks are monitored and, to the extent possible, controlled and mitigated.

The Bank's approach to operational risk is not designed to eliminate risk altogether but rather, to contain risks within levels deemed acceptable by senior management.

All functions, whether business, control or logistics functions, must manage the operational risks that arise from their activities. Operational risks are pervasive, as a failure in one area may have a potential impact on several other areas. The Bank has therefore established a cross-functional body to actively manage operational risk as part of its governance structure.

The foundation of the operational risk framework is that all functions have adequately defined their roles and responsibilities. The functions can then collectively ensure that there

is adequate segregation of duties, complete coverage of risks and clear accountability. The functions use their controls to monitor compliance and assess their operating effectiveness in several ways, including self-certification by staff, tracking of a wide range of metrics (for example, the number and characteristics of client complaints, deal cancellations and corrections, un-reconciled items on cash and customer accounts, and systems failures), and the analysis of internal and external audit findings.

5.2 Performance Gap of Executives and Staffs

Dhaka Bank always tries to be the best pay master in the sector and ensure best workplace safety for its employees to avoid inconsistent employment practices and unsound workplace safety by way of discrimination regarding employee's compensation, health and safety.

5.3 Potential External Events

The bank invests heavily in IT infrastructure for better automation and online transaction environment. The bank also has huge investment on alternative power supply (both UPS & generators) and network links to avoid business description and system failure. The Bank's IT system does not allow any kind of external access to avoid external fraud by way of theft/ hacking of information assets, forgery etc. Dhaka Bank invests heavily on security from terrorism and vandalism to avoid damage to physical assets.

5.4 Approach for Calculating Capital Charges for Operational Risk

For local regulatory capital measurement purposes, the Bank follows the Basic Indicator Approach.

Quantitative Disclosure:

Sln	Particulars	Tk. (Crore)
1	The capital requirements for:	
	• Operational Risk	73.74