As a provider of banking and financial services, risk is at the core of our day-to-day activities. The Bank's risk philosophy is that the risk should be taken in line with the Bank's risk appetite and it should fit in with the Bank's business strategy, assist the decision-making process and enhance management effectiveness and also optimize capital utilization.

Business of banking naturally entails assuming 'Risks' in all business transactions. As a result, 'Risk Management' remains to gain prominence as a key strategic focus in managing banks effectively in today's impulsive financial markets. The vision of Risk Management is to proactively assist the business in delivering superior shareholder value by ensuring an optimal trade-off between risks and rewards whilst upholding strong liquidity and adequate capital positions at all times combined with a robust asset quality. The operating model within the Bank ropes this vision and cascades the actions to fulfil same.

The changing nature of today's business world is increasing the scope and potential impact of the risks faced. The ability of a bank to take strategic initiatives within pre-defined and consistent risk framework can be considered as a speciality that can make a distinction for a bank to ensure safety to all stakeholders in today's competitive market scenario. Hence, the Bank has recognised the risk management capabilities as a 'journey' rather than a destination and is committed to maintain and continuously improve its risk management framework and capabilities through a number of initiatives including substantial investments in IT, training and development of human resources. The management of the risks inherent in the loan portfolio remained a focal point for the Bank in the current year, even as the Bank continued its strategy to expand the loan book to greater levels.

The objectives of the risk management framework are:

1. Establish common principles and standards to identify, measure, evaluate, monitor and manage significant risks to the Bank on a forward looking basis.
2. Define the Bank's risk appetite and align the Bank's portfolios and business strategy accordingly.
3. Provide a shared framework and language to improve awareness of risk management.
4. To provide clear accountability and responsibility for risk management.
5. Optimize risk return decisions.
6. Maintain Bank's capital adequacy and strong liquidity position.
7. Further strengthen governance, controls and accountability across the organization.

In addition to the main risks, the Bank has considered twelve other risks which are material to it. The decision is based on directions given by the Central Bank of Sri Lanka (CBSL) and self-assessment of most important risk categories which need a separate mention from an ICAAP perspective. These risk categories include, Liquidity Risk, Interest Rate Risk in the Banking Book, Underestimation of Credit Risk in Standardized Approach, Residual Credit Risk, Concentration Risk, Compliance Risk, Legal Risk, Strategic Risk, Model Risk, Group Risk, Settlement Risk and Reputational Risk.

Our risk culture is fundamental to the delivery of the Bank and Group's strategic priorities. It may be characterised as conservative, control-based and organized supported by a robust risk governance structure. The Bank's risk management framework is employed at all levels of the organization, and is instrumental in aligning the behaviour of individuals with the overall attitude to assuming and managing risk and ensuring that our risk profile is aligned to our risk appetite. In an attempt to cultivate risk-based decision-making by the business lines, the Group Risk Department plays an active role as a mentor and facilitator by instigating new ways of knowledge transfer, and it is one of the core values of the department's culture.

Playing an Active Role in Creating a Learning Culture

Keeping abreast with risk management concepts and having a broader view by various business lines have been understood as of pivotal importance by the Bank. When equipped with such knowledge the business

lines become sounder in their credit decisions. The Bank believes in grooming its own people by its own people. Therefore in order to broaden the business lines exposure to risk related areas the Group Risk Department has initiated a quarterly news bulletin. The bulletin titled 'Risk Analyst' was launched in September 2014 and has been published twice for the year 2014. For each periodical, the staff members contribute articles covering various aspects of risk such as new and emerging developments in risk management, clarifications on risk concepts, policies and procedures, case studies etc. The newsletter is accessible in the Bank's e-library and in the intra-net. This initiative has enabled the Group Risk Department to grow personally and professionally and build fulfilling careers.

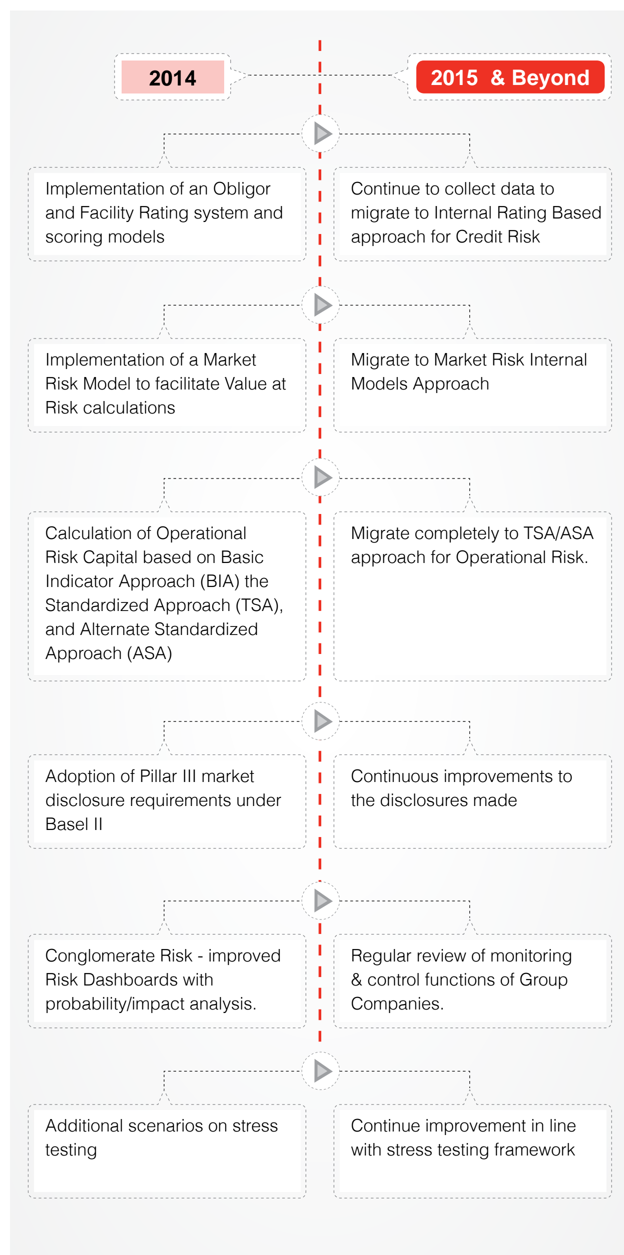
As an integral part of disseminating knowledge among staff, continuous training, advice and awareness programmes have also been considered as an element of the Group Risk Department. Throughout the year the staff members volunteered as resource persons for Bankwide trainings across all business lines at Head office and also at Regional offices.

The Risk Profile of the Bank at a Glance

Highly diversified and short tenor portfolio	i. We have a well-diversified portfolio of loans and advances and income streams across geographies, industry sectors and products ii. In Wholesale Banking 77% of loans and advances are short-term and we hold a diverse mix of collateral, valued conservatively iii. Our top 20 corporate exposures are stable as a proportion of capital resources and highly diversified iv. Our asset quality remains good
Strong capital and liquidity position	i. We remain well capitalised and our Statement of Financial Position (Balance Sheet) remains highly liquid ii. We remain a net provider of liquidity to interbank markets iii. Our customer deposit base is diversified by type and maturity iv. We have a substantial portfolio of liquid assets which can be realised if a liquidity stress occurs. Liquidity position acceptable even under stressed scenarios
Robust risk governance structure and experienced senior management team	i. We have a clear statement of risk appetite which is aligned to the Bank's strategy; it is approved by the Board ii. We continuously monitor our risk profile to ensure it remains within our risk appetite and regularly conduct stress tests iii. We review and adjust our exposures, underwriting standards and limits in response to observed and anticipated changes in the external environment and expectations iv. We have a very experienced Group Risk Department and our risk committees are staffed by experienced leaders v. We have a robust risk management framework which assigns accountability and responsibility for the management and control of risk. vi. We maintain a consistent and highly selective approach to large corporate credit underwriting

Risk Management Initiatives 2014, 2015 and Beyond

Details of risk management initiatives undertaken during the year and planned for the next three years are summarised below:



Risk Appetite, Objectives, Framework

Risk appetite is defined as the level and the nature of risk that the Bank is willing to take in order to pursue its articulated mission on behalf of its shareholders subject to constraints imposed by other stakeholders such as lenders, regulators and customers.

In the event, the risk appetite threshold has been breached, risk management and business controls are implemented to bring the exposure level back within the accepted range. Risk appetite, thus, translates into operational measures such as limits or qualitative checkpoints for the dimensions of capital, earnings volatility and concentration risk etc.

In order to effectively implement risk appetite the Bank has defined quantitative indicators (e.g., capital adequacy level and risk limits) or qualitatively embedded same in the policies and procedures (e.g., underwriting criteria).

The Bank has taken into account the following factors when defining its risk appetite:

Internal and External Input

The Bank assesses its risk appetite against both the internal & external environment it is facing. The risk appetite is not only consistent with business strategy and growth targets but is also in line with the interests of external stakeholders such as shareholders and regulators.

Internal Inputs Considered when Defining its Risk Appetite	External Inputs Considered when Defining its Risk Appetite
The Bank's overall business strategy	The interest of the regulatory agencies
The Bank's business growth target	The credit rating agencies
Stakeholder return objectives	Equity analysts
Cost of capital	Shareholders
	Other capital providers

Coverage of Risks

The Bank has formulated its risk appetite covering the following categories:

- Bankwide level
- Risk Category level
  - Credit Risk
  - Market Risk
  - Operational Risk
  - Concentration Risk
  - Liquidity Risk
  - Interest Rate Risk (in Banking Book)
  - Compliance Risk

The risk appetite framework and risk tolerance limits have been defined with the consultation and engagement of Board and the Senior Management of the Bank in line with the Bank's overall business strategy, providing clear direction to the business units for on-going operation and risk management.

The risk appetite is assessed at monthly intervals to check for any breaches and reported to the Senior Management and to the Board. In the event of a breach, appropriate management action is drawn to bring down the risk level within the risk appetite set.

Group Risk Management

Aggregating the risks of Group Companies remains a challenge due to their diverse business models and risk profiles. The Group Companies are engaged in investment banking, capital market activities, unit trust management and property management activities.

However, the Bank believes the 'Group Risk' is greatly mitigated as;

1. Possible financial impact to the Bank is limited to the amount invested in these companies in the form of equity, at the time the companies were incorporated.
2. NDB Capital Holding PLC (de-listed), the largest subsidiary by size, is listed, thereby regulated by the SEC as well.
3. There is representation by the Bank's Directors/Key Management Personnel on the Boards of Directors/ Board Audit, Risk & Compliance Committee of its subsidiaries, thereby ensuring full and sufficient knowledge of subsidiaries' operations and risk profiles.
4. Due to the governance structure mandated by the laws governing banking and limited liability companies, all inter-company transactions are at arms-length and full disclosure of such transactions are made.
5. Natural mitigation from the fact that the Bank is the holding company and owns the largest Statement of Financial Position in the Group.
6. NDB Securities Ltd., and NDB Wealth Management Ltd. being licensed stock brokers and Unit Trust Managers are regulated by the SEC.
7. Risk Reporting framework by the group companies to Centralised Group Risk Department of NDB/the Integrated Risk Management Committee (IRMC)/ Board for review/direction.

As part of our regular risk and cross-risk analysis, sensitivities of the key portfolio risks are reviewed through a bottom-up risk assessment and through a top-down macro-economic and regulatory scenario analysis. These approaches allow us to capture risks that have an impact across our risk inventories and business divisions or those that are relevant only to specific portfolios.

We are also focused on ensuring that we act proactively to identify potential macro-economic and regulatory changes and assess the possible impact on our business model or processes.

Emerging Risk Table

Risk	Risk Level	Description	Mitigants
Regulatory changes and compliance	Low	- The nature and impact of future changes in economic policies, laws and regulations are not predictable and may run counter to our strategic interests. These changes could also affect the volatility and liquidity of financial markets and more generally the way we conduct business and manage capital and liquidity - Although we seek to comply with all applicable laws and regulations, we may be subject to regulatory actions and investigations across our subsidiaries, the outcome of which is generally difficult to predict and could be material to the Group	- We review key regulatory developments in order to anticipate changes and their potential impact on our performance - We respond both unilaterally and through our participation in industry groups to consultation papers and discussions initiated by regulators. The focus of these activities is to develop the framework for a stable and sustainable financial sector and economy - Internal Capital Adequacy Assessment Process (ICAAP) to analyse/assess our capital requirements under stressed scenarios to maintain stability
Financial markets instability	Moderate	- Financial markets volatility or a sudden dislocation could affect our performance, through its impact on the mark-to-market valuations of assets in our available-for-sale and trading portfolios or the availability of capital or liquidity - Financial markets instability also increases the likelihood of default by our corporate customers and financial institution counterparties	- We assess carefully the financial position of our counterparties and their credit rating (IDR) according to their systemic importance, when setting limits and adjusting our exposure levels accordingly - Portfolio valuations are carried out through mark-to-market exercise and ensure the results are within our pre-defined risk appetite - We maintain robust processes to assess the suitability and appropriateness of products and services we provide to our clients and customers
Exchange rate movements	Low	- Changes in exchange rates affect the value of our assets and liabilities denominated in foreign currencies - Sharp currency movements can also impact trade flows and the wealth of clients, both of which could have an impact on our performance	- We actively monitor exchange rate movements and adjust our exposure accordingly within our prudential limit framework. Stress tests are being performed to ensure least impact to the Financial Statements on a daily basis - Low exposure to the unhedged positions given internal policy and strengthened supervision by the regulators on minimizing open foreign currency positions - We assess the impact of exchange rate movements on our counter parties business and impact on meeting debt obligations

Risk	Risk Level	Description	Mitigants
Risk of adverse movements in interest rates	Moderate	- The risk of potential losses due to changes in the fixed income security portfolios - The sensitivity of the Statement of Financial Position due to a change in interest rates	- The duration of the bond portfolio is monitored regularly to assess sensitivity of bond portfolio to interest rate changes. The impact of the Trading portfolio is minimal due to the Bank holding treasury bills and bonds with short-term maturities. Available-For-Sale (AFS) portfolio of bills and bonds is managed within the pre-defined risk parameters - The impact due to the change in interest rates is managed within the pre-defined limits to minimize the adverse impact on interest rate changes
Geopolitical events	Moderate	- We face a risk that geopolitical tensions or segments in our footprint could impact trade flows, our customers' ability to pay, and our ability to manage capital	- We actively monitor the situations (e.g. Situation in Russia and Ukraine, ban on fish exports to EU, declining oil prices in the global market etc.) that could have an impact and conduct regular stress tests of the impact of such events on our portfolios, which inform assessments of risk appetite and any need to take mitigating action
Risk of fraud	Moderate	- The risk of fraud and other criminal activities is growing as criminals become more sophisticated and as they take advantage of the increasing use of technology in society	- We have a broad range of measures in place to monitor and mitigate this risk. - Controls are embedded in our policies and procedures across a wide range of the Group's activities, such as origination, recruitment, physical and information security
Risk of Natural Disasters	Moderate	- Natural disasters can have an impact on the performance of the customers' operations and their ability to meet debt obligations - It can also have an impact on the Bank's operations and inability to continue business from current location	- In situations of natural disasters (both local and overseas), stress tests are carried out to assess the impact of such events on the portfolio and appropriate action is taken to mitigate the risk - A formalized and tested Business Continuity Plan is in place and is able to switch over to the Disaster Recovery site
Active Share market operations	High	- This leads to frequent changes in share ownership and hence affects group structuring which could have an impact on credit concentrations and complying with regulations	- Closely monitor share market movements - Internal policies on single/group borrower limits are stringent than regulatory requirements

Risk	Risk Level	Description	Mitigants
Risk arising from inability to meet maturing deposit liabilities	Low	- The Bank's liquidity position can affect the ability to meet liability requirements as they fall due - Low liquidity in the markets may result in unexpected stresses to the Bank	- The Bank monitors a number of prudential liquidity ratios as per CBSL risk directions which are discussed at the Assets and Liabilities Committee (ALCO) and IRMC committees. Liquidity stress testing is carried out at regular intervals to identify any fall in Liquidity measures of the Bank. The Bank has maintained a healthy liquidity position throughout the year and has adhered to the Liquid Asset Ratio (LAR) above the statutory requirement - The Bank was least dependant on short-term interbank borrowings during the year

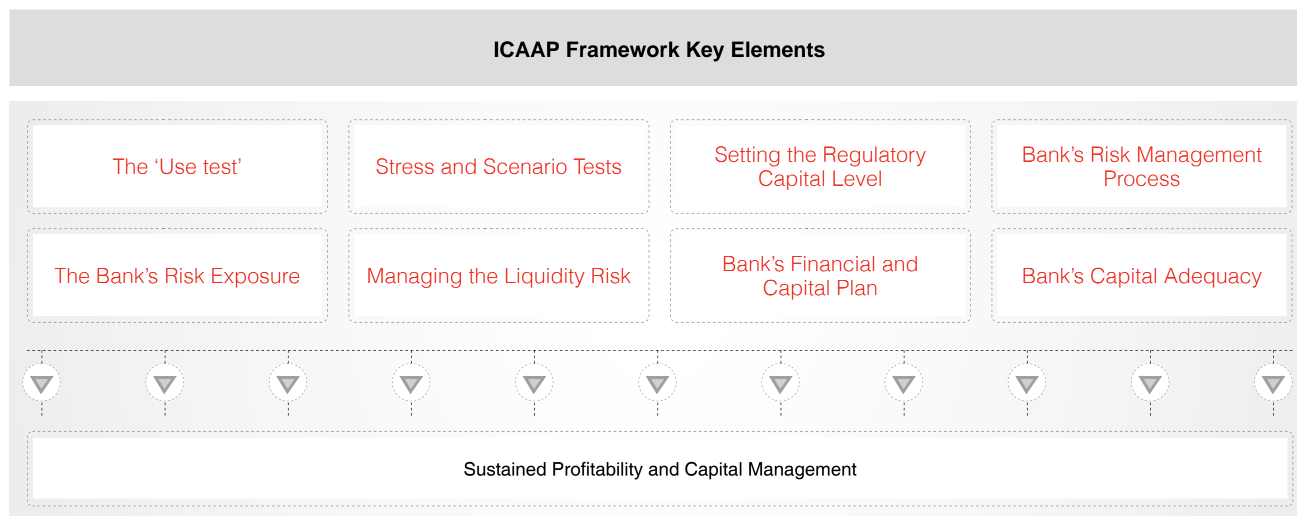
Sustained Profitability and Capital Management

The strategy of the Bank is ensuring sustained profitability through good times and bad times. The need of the economy is, resilient banks which create shareholder value. BASEL regulations have been introduced worldwide to ensure resilience of the individual banks as well as the banking system as a whole.

ICAAP Framework

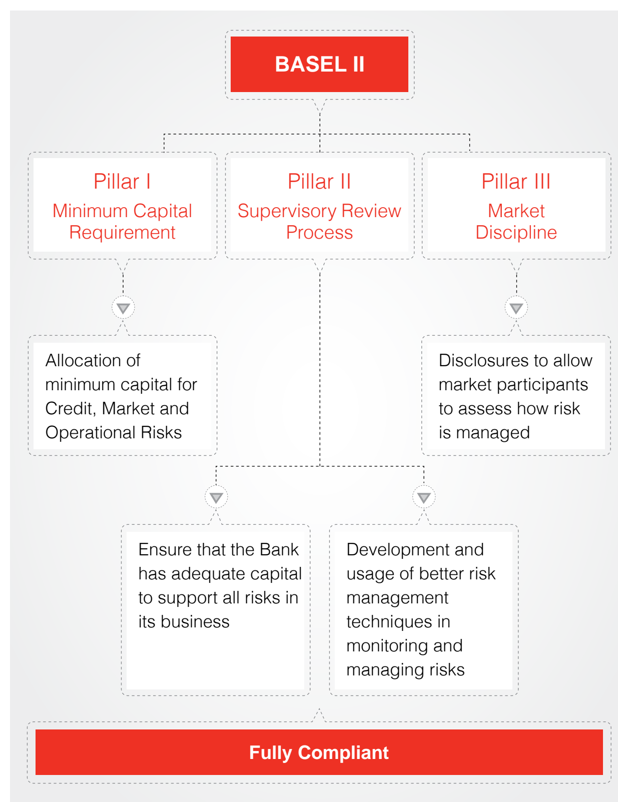
Capital helps protect individual banks from insolvency, thereby promoting safety and soundness in the overall banking system. Minimum regulatory capital requirements under Pillar 1 establish a threshold below which a sound bank's regulatory capital must not fall. The Pillar 2 (Supervisory Review Process - SRP) requires banks to implement an internal process, called the Internal Capital Adequacy Assessment Process (ICAAP), for assessing their capital adequacy in relation to their risk profiles as well as a strategy for maintaining their capital levels. The Pillar 2 also requires the supervisory authorities to subject all banks to an evaluation process/Supervisory Review Process (SRP) and to initiate such supervisory measures on that basis, as might be considered necessary.

The ICAAP would be in addition to a bank's calculation of regulatory capital requirements. The Bank has put in place an Internal Capital Adequacy Assessment Process and has adhered to same from January 2013. The Bank's ICAAP process strengthens the risk management practices and capital planning process.



BASEL II

The Bank is fully compliant with the BASEL II regulatory requirements. The Bank identifies and measures all material risks faced in its business and ensures that the Bank has adequate capital to support all risks at all times. The Bank also ensures that its capital is adequate to absorb losses even under stressed conditions. These details are disclosed to all stakeholders of the Bank to ensure awareness among them on how the Bank manages its risks.



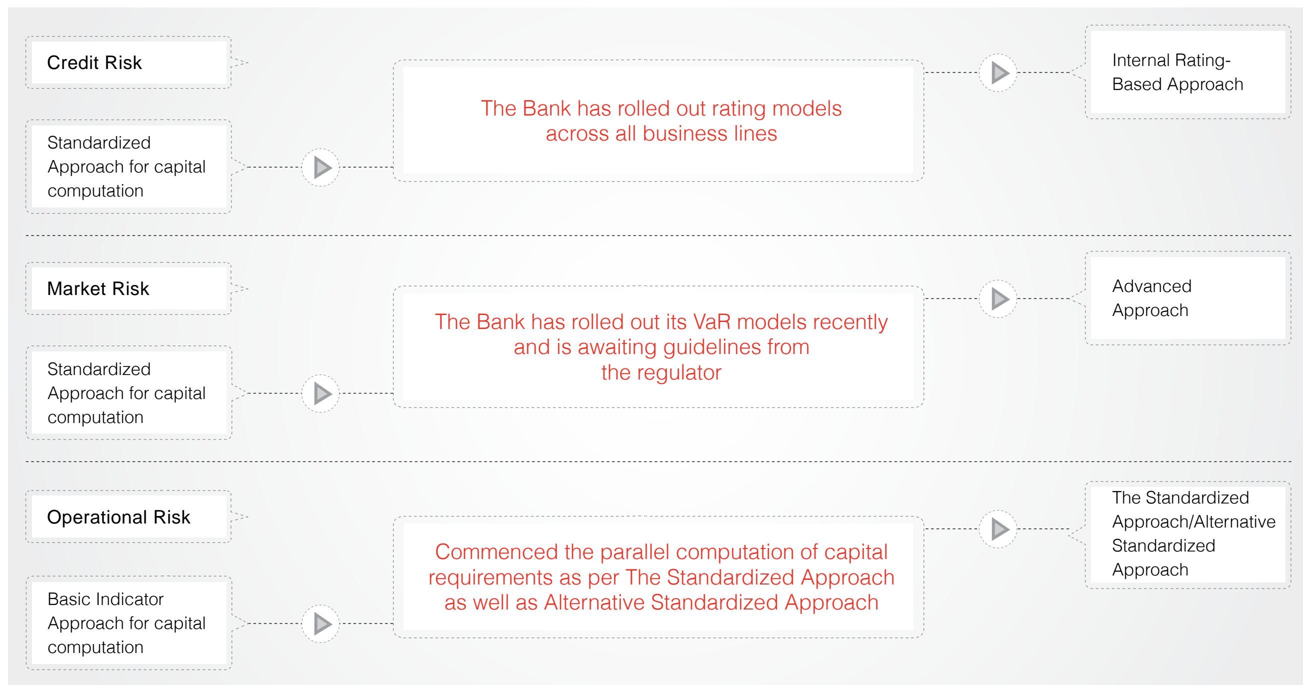
Journey Towards Advanced Approaches of Pillar I

The Bank has already embarked on its journey towards advanced approaches of minimum capital computation under Pillar I in order to optimize on capital allocation. Thinking ahead, the Bank is in the process of automating its capital computation process in terms of Credit and Market Risk. This pioneering strategic move will help the Bank to optimize usage of shareholder capital, which will be critical in the next few years for all banks. The automation of manual processes will ensure accuracy and better conformance to guidelines.

Credit Risk - The Bank is currently using the Standardized Approach for the capital computation for Credit Risk. With the intention of moving to Internal Rating Based approaches, the Bank has rolled out rating models with the assistance of CRIISIL Risk and Infrastructure Solutions Ltd., India. The system supports the Probability of default (PD) and Loss given default (LGD) computations.

Market Risk - The Bank uses The Standardized Approach for the capital computation for Market Risk. the Bank has already rolled out its Value at Risk (VaR) models and is awaiting guidelines from the regulator to move to advanced approach of capital computation for Market Risk.

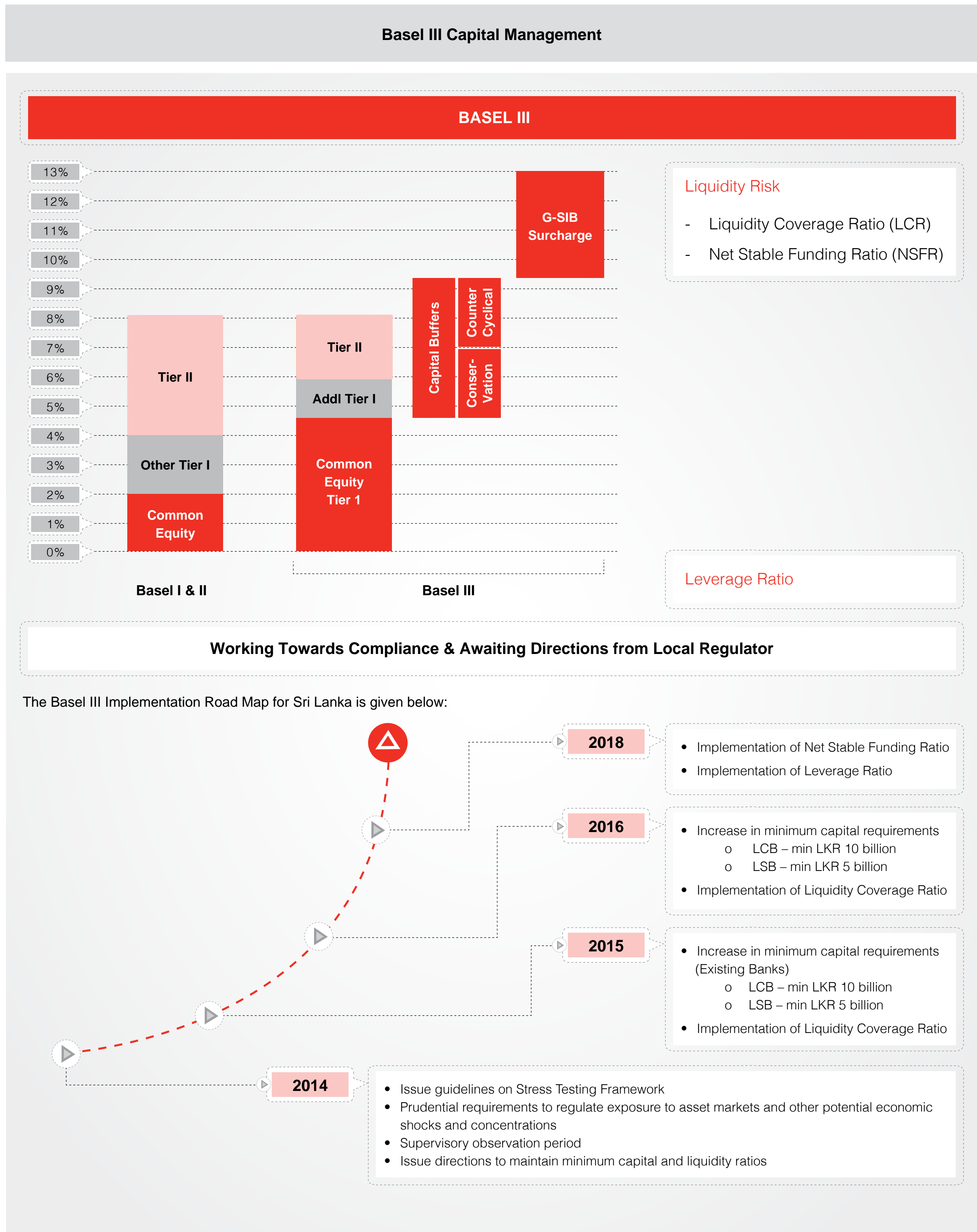
Operational Risk - The Bank is currently using the Basic Indicator Approach for the operational risk capital computation. The Bank has also commenced the parallel computation of capital requirements as per The Standardized Approach(TSA) as well as Alternative Standardized Approach (ASA).



BASEL III and Capital Management

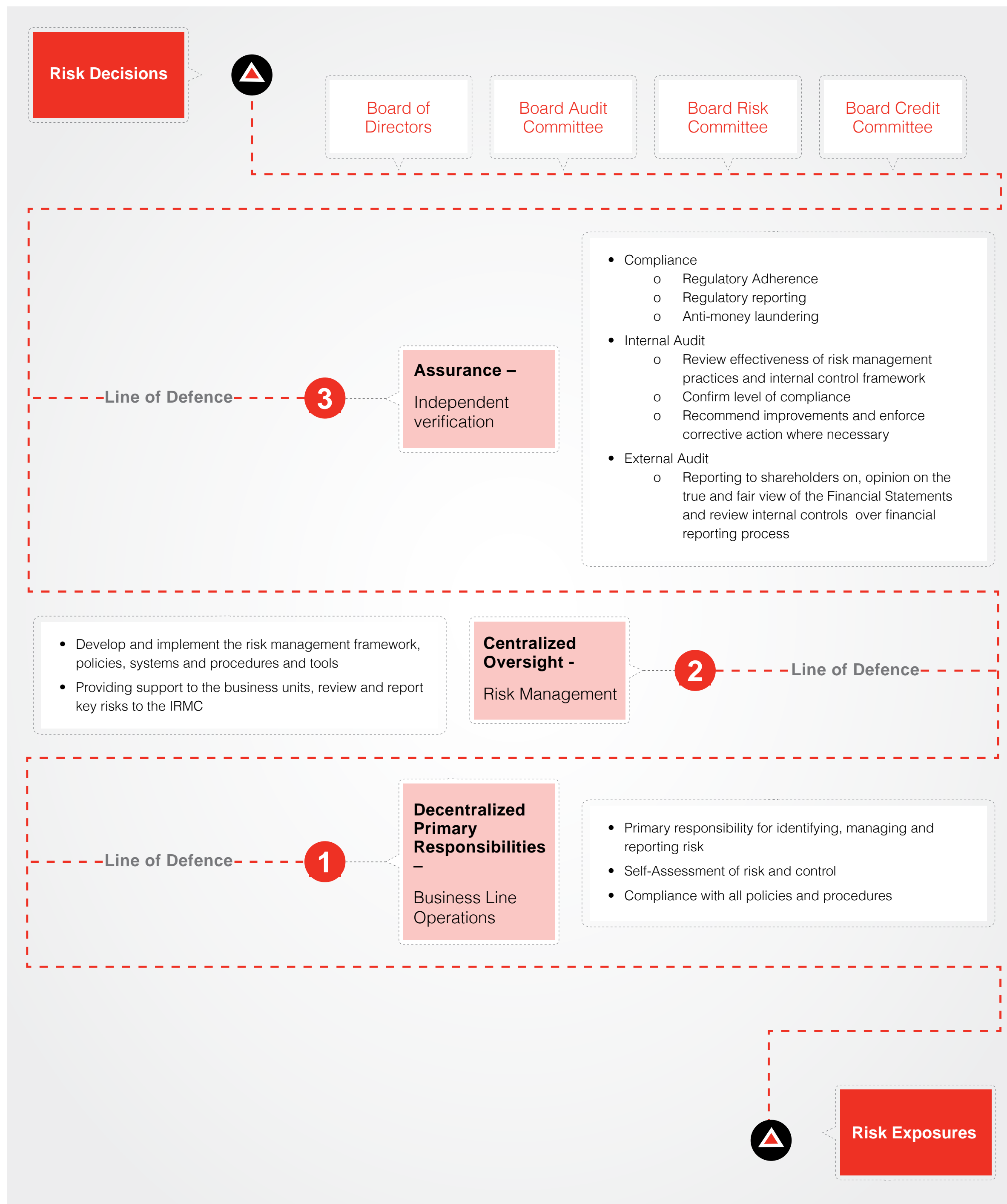
BASEL III is the new global regulatory standard on managing capital and liquidity of banks. With the introduction of BASEL III the capital requirements of banks will increase with an aim to raise the quality, quantity, consistency and transparency of capital base and improve the loss absorbing capacity.

The BASEL III implementation Road Map for Sri Lanka is given below:



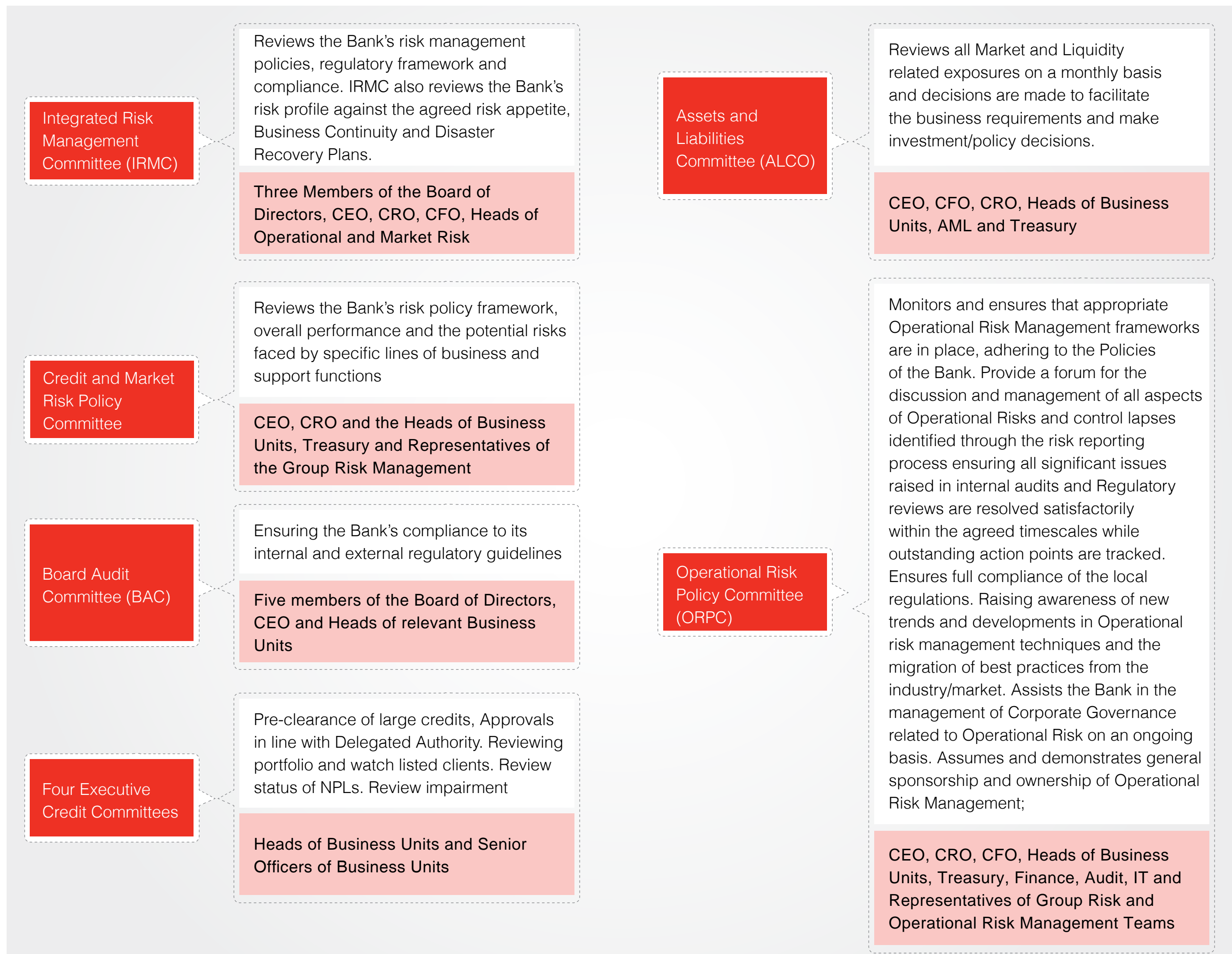
With the implementation of BASEL III the Banks will be required to increase and also improve the quality of capital. Considering the requirements, the Bank initiated steps to automate its capital computation process in terms of Credit and Market Risks which would help to optimize usage of shareholder capital. From a liquidity point of view, the Bank computes required the Liquidity ratios as per the BASEL III guidelines.

Integrated Risk Management at Bank



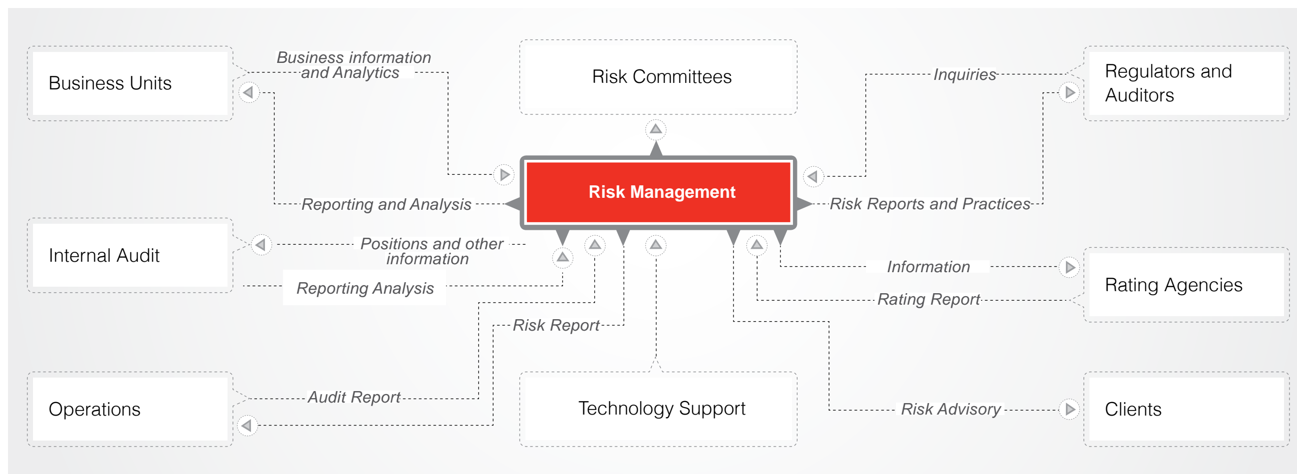
Risk Governance

The Bank's Board of Directors has the overall responsibility for risk management and sets the tone at the top for an effective management of risks through its risk appetite. In discharging its governance responsibility, it operates through two key committees, namely the Integrated Risk Management Committee (IRMC) and the Board Audit Committee (BAC) which have been formed in compliance with the CBSL Direction No. 11 of 2007 on Corporate Governance. The Bank believes in combining the specialized knowledge of the business units and risk professionals in forming sub-committees for the management of risks.



Relationship With Other Units

The relationships between the risk management and other sections of the Bank and external parties are highlighted below:



Group Risk

The Group Risk Management Department is independent of the business units. It monitors and reports directly to the Integrated Risk Management Committee and the CEO. Several units within the Group Risk Department contribute to the management of risk and co-ordinates across the business lines to guarantee risk management is impeccably integrated into the Bank's corporate culture.

Credit Risk

Credit risk is the risk of a financial loss if a customer or counterparty to a financial instrument fails to meet a payment obligation under a contract. It arises principally from direct lending, trade finance and leasing business, and also from Off-balance sheet products such as letters of credit and guarantees. Credit risk generates the largest regulatory capital requirement of the risks we incur. The Bank manages the Credit Risk in the entire portfolio as well as individual credits or transactions.

Objectives of Credit Risk Management

- Ensure optimal risk-reward pay-off for the Bank and to maximise returns
- Maintain a quality portfolio by minimising the non-performing loans and probable losses
- Deliberately manage its risk asset portfolio to ensure that the risk of excessive concentration to any industry, sector or individual customer is minimized and thereby maintain a well-diversified portfolio
- Ensure that exposures to any industry or customer are determined by the regulatory guidelines, clearly defined internal policies, debt service capability and balance sheet management guidelines:
- Avoid all conflict of interest situations and report all insider-related credits to appropriate bodies

Process

At the Bank, credit risk management is considered to be a value addition activity rather than being confined only to a regulatory compliance function.

- Credit Policy

The Bank has a well-defined credit policy approved by the Board of Directors. It defines the

- Credit culture of the Bank
- Specify target markets for lending
- Specify prohibited lending which the Bank under no circumstances will entertain due to either the very high risks involved in such proposals and/or its negative social/ethical consideration
- Set acceptable risk parameters
- Set remedial and recovery actions

- Structured and Standardized Credit Approval Process

Depending on the nature of the project/product standardized formats have been designed and evaluations are carried out by competent staff. There are clear guidelines set to ensure that;

- Credit is extended only to suitable and well-identified customers and never where there is any doubt as to their ethical standards and record, where the source of repayment is unknown or speculative nor where the purpose/destination of funds is undisclosed,
- Never to take a credit risk where, the ability of the customer to meet obligations is based on the most optimistic forecast of events.
- Risk considerations shall have priority over business and profit considerations;
- Ensure that the primary source of repayment for each credit is from an identifiable cash flow from the counterparty's normal business operations or other financial arrangements; the realisation of security remains a fall-back option;
- Adopt a pricing mechanism that reflects variation in the risk profile of various exposures to ensure that higher risks are compensated by higher returns;
- The financial performance of borrowers is to be continuously monitored and frequently reviewed, as is the manner in which the borrower operates his accounts.

- Delegation of Authority

Final authority and responsibility for all activities that expose the Bank to credit risk rests with the Board of Directors and the Board of Directors has delegated approval authority to the CEO, with authority to re-delegate limits to the Executive Credit Committees and the Business Lines. All approval limits are name specific and are based on the individual experience, facility type, collateral in order to ensure accountability and to mitigate any judgmental errors.

- There are four Executive Credit Committees representing the four Business Lines and these Committees comprise senior officers of the business lines.
- The delegated authority limits are reviewed periodically and the Bank follows the four-eyes principle' (i.e. minimum of two officers signing a credit proposal).
- lending decisions are based on detailed credit evaluations carried out by Relationship Managers and reviewed/ approved by designated approving authority.

- Internal Risk Ratings of Obligors

The credit portfolio of the Bank is risk-rated using an internally-developed system that takes into account quantitative as well as qualitative factors. The rating scale ranges from Triple A to B4 and the ratings of every obligor is reviewed at least annually or more frequently if required. This rating system is used as a guide for account monitoring, provisioning/collective impairment, granting delegated authority and pricing.

During the year the Bank invested and rolled out the new Internal Risk Rating system which runs on a sophisticated work flow based software and hosts obligor risk rating, facility risk rating and retail score cards to suit the diverse client portfolios of the Bank. This move facilitates accurate quantification of the expected loss of Bank's portfolio, and also complies with the Central Bank Direction No. 07 of 2011 on IRMC.

The Bank has deployed varying models to gauge the default risk associated with Large Corporate, Mid Corporate, SME and Non-Banking Financial Institutes. All of these models are structured in a manner incorporating both quantitative and qualitative parameters which contributes and reflects realistic probabilities of default in respective models. These models are structured broadly to measure risks arising out of industries the obligors are engaged with, financial position of the obligor, management capacity and specific business related risks. These models are fine tuned to reflect the underlying credit risks of the loan book. The ratings derived from different models are then mapped to a Bankwide single point indicator rating scale based on the underlying probability of default and various other factors including risks inherent to specific model population. The risk rating model implemented facilitates both obligor and facility rating. Whilst obligor rating will indicate the expected probability of default (PD), the facility rating indicates the expected loss given default (LGD). The expected probability of default takes into account the characteristics of the obligor assessed via industry, business, management and financial risk silos, whilst facility rating takes into account the type of the facility, nature of the collateral and realisability as well. Using the expected probability of default and the loss given default calculated via obligor rating and facility rating models, the system facilitates arriving at an expected loss for a specific credit.

- Risk Scoring

The Bank deploys custom made scorecards to underwrite consumer assets. These scorecards were developed using Bank's own data and re-weighted to align them for more recent economic conditions. Such scorecards take in to account the customer demographics together with credit worthiness of individuals and disposable income in deciding the level of accommodation of credit. In addition to above, the Bank also carries out a pre-screening of employers of salaried employees who seek consumer credit from the Bank in order to ensure that their level of income generation will not get interrupted in the foreseeable future. In this way the Bank acts more responsibly as such an approach would negate possibility of overspending by consumers based on uncertain future income.

- Risk Pricing

The Bank also views pricing for risk as fundamental to credit risk management. Thus steps have been taken to price the credit risk using more scientific methods and blending it with prevailing market sentiments to contain off-market operations. The newly implemented Internal Risk Rating system facilitates calculation of Risk Adjusted Return on Capital (RAROC). This enables the Bank to link capital to expected losses.

- Post Sanction Review and Monitoring Mechanism

Post sanction review and monitoring is carried out to ensure quality of credit is not compromised. Any deteriorating credits with emphasis on internal and external early warning signals are identified and such accounts are 'Watch Listed'. The watch listed clients are monitored closely with quarterly reports submitted to the Executive Credit Committees. Further, based on the watch lists the Bank assesses the Portfolio at Risk in the event, such accounts deteriorate further. Non-performing assets are identified at an early stage, enabling management to take action as appropriate.

- Prudential Limits

The industry and portfolio limits are set by the Board of Directors on the recommendation of the Group Risk Department. Credit Risk Management monitors compliance with approved limits. Desired diversification is achieved by setting maximum exposure limits on;

- Single/group obligor limits - limits are more stringent than the limits set by the regulator and on a prudential basis the Off-balance sheet items are considered at face value instead of credit equivalent of such exposures
- Prudential group exposure limit
- Substantial exposure limit
- Industry/economic sector limit

- Portfolio Management

Credit portfolio management is an important function within the overall credit risk management function. Need for such critical and objective portfolio management emanates from the need to optimize the benefits associated with diversification. It also helps the Bank to identify and address potential adverse impact of concentration of exposures. The Bank has a well-structured portfolio management mechanism which evaluates exposures on the basis of industry concentration, rating quality, internally established pre-specified early warning indicators apart from regulator imposed quantitative ceiling on single borrower and aggregate exposure. Based on the feedback from the credit portfolio management, the credit origination criterion is amended prudently to insulate portfolios from further deterioration. The portfolio management team also undertakes, apart from regular portfolio reviews, stress tests and scenario analysis when the external environment, both local and global, undergoes swift changes. Credit portfolio management envisages mitigating credit risks to a great extent by stipulating prudential risk limits on various risk parameters. As such, the Bank has established single borrower limit, limits for related party borrowings and aggregate limit for large exposures as prescribed by the regulators. Moreover the Bank has also established maximum exposure limits to different industry segments. Such limits are clearly spelt out in the credit policy and the authority for permitting any deviations on an exceptional basis is also clearly documented. The Bank adopts a similar mechanism to assess the risks associated with Off-balance sheet exposures. As part of the credit portfolio management and monitoring procedures, the exposures in off-balance sheet products such as forward exchange contracts, guarantees and letters of credit are treated with utmost care.

KRIs supplement the overall portfolio management system, by providing a view of the credit risk of the portfolio as well as acting as an early warning system. Some of the KRIs monitored and reported to Board Integrated Risk Management Committee are given below:

KRI	Purpose
Portfolio of the Bank Industry Portfolio	To assess the trends in comparison with industry and measure performance against budgets/risk appetite
Market Share	
NPLs of the Bank Industry NPLs	
NPL ratio of the Bank Industry NPL ratio	
Provision Cover of the Bank Industry Provision Cover	
Open Loan Position	
ROE %	
TIER I %	To assess compliance with regulatory limits and the Bank's risk appetite
TIER II %	

- Credit Risk Mitigation

The Bank adopts various mechanisms to mitigate the credit risk of the loans book.

- Ways out analysis - the primary source is established through a conservative evaluation of whether the borrower's realistic projected cash flows will be sufficient to repay their debts. This is further mitigated by a second way out in the event of unforeseen adverse circumstances and availability of collateral alone does not make an unacceptable proposal viable. Exemptions on collateral are allowed in the event the borrower demonstrates strong and reliable financial performance.

- Documentation of credit transactions with adequate terms, conditions and covenants in a comprehensive and legally enforceable basis.
- Obtaining of collateral in line with the Bank's policy and ensuring it is supported by enforceable documentation. Collateral policy differs from business line to business line according to the products offered.

The main types of collateral taken by the Bank are

- immovable and movable property mortgages,
- cash deposits,
- mortgages on stocks and book debts, and
- corporate and personal guarantees.

It is the Bank's policy to be on a *pari passu* status with other lenders. A decision to the contrary may be acceptable only where a ***non pari passu*** position is accepted due to unavailability of security as a result of the Bank being a late entrant to the relationship or is supported by strong financial position of the entity financed. Facilities under product programmes are governed by guidelines given in such individual programmes.

In instances where facilities are granted without collateral, the Bank ensures that its position will not be subordinated to other creditors' interests. In such instances, the Bank generally requires either a negative pledge agreement not to encumber any assets without permission of the Bank or a *pari pasu* clause, whereby the debtor will treat the Bank equally with respect to collateral with all current and future lenders.

The Bank has a panel of valuers who have been selected based on the criteria set out by the Central Bank of Sri Lanka. The Bank ensures that the valuations are carried out and reviewed as following:

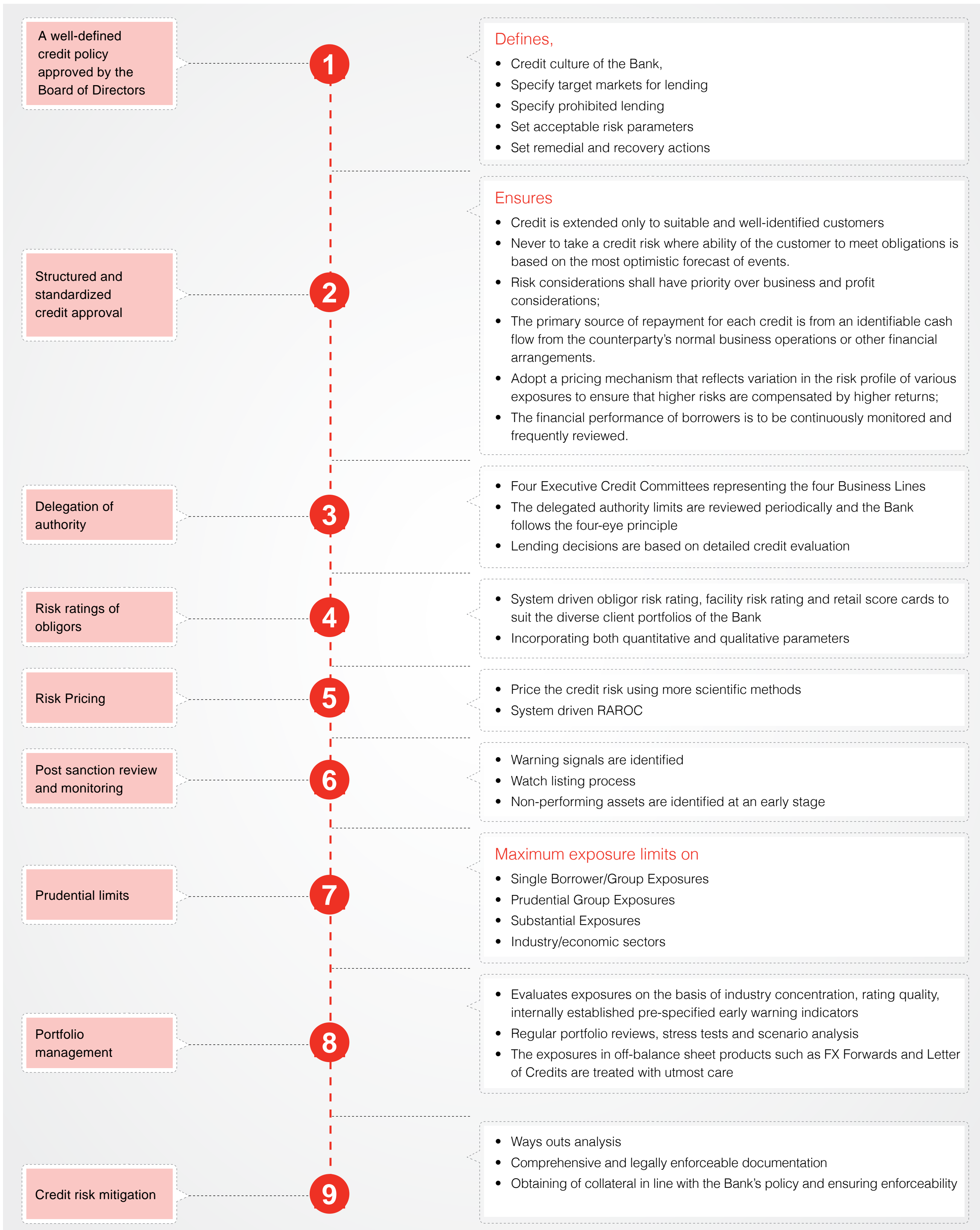
Facilities in NPL:

- For facilities granted against residential property occupied by the borrower for residential purposes: every four years
- For all other NPL facilities: every three years

Performing facilities:

- Watch listed clients with working capital facilities: every three years
- Single A rated clients with working capital facilities: every five years

No value is considered if valuations are not in line with the time frames set out as per the CBSL Guidelines.


Process of Sound Credit Risk Management
A well-defined credit policy approved by the Board of Directors
1
Defines,
• Credit culture of the Bank,
• Specify target markets for lending
• Specify prohibited lending
• Set acceptable risk parameters
• Set remedial and recovery actions
Structured and standardized credit approval
2
Ensures
• Credit is extended only to suitable and well-identified customers
• Never to take a credit risk where ability of the customer to meet obligations is based on the most optimistic forecast of events.
• Risk considerations shall have priority over business and profit considerations;
• The primary source of repayment for each credit is from an identifiable cash flow from the counterparty's normal business operations or other financial arrangements.
• Adopt a pricing mechanism that reflects variation in the risk profile of various exposures to ensure that higher risks are compensated by higher returns;
• The financial performance of borrowers is to be continuously monitored and frequently reviewed.
Delegation of authority
3
• Four Executive Credit Committees representing the four Business Lines
• The delegated authority limits are reviewed periodically and the Bank follows the four-eye principle
• Lending decisions are based on detailed credit evaluation
Risk ratings of obligors
4
• System driven obligor risk rating, facility risk rating and retail score cards to suit the diverse client portfolios of the Bank
• Incorporating both quantitative and qualitative parameters
Risk Pricing
5
• Price the credit risk using more scientific methods
• System driven RAROC
Post sanction review and monitoring
6
• Warning signals are identified
• Watch listing process
• Non-performing assets are identified at an early stage
Prudential limits
7
Maximum exposure limits on
• Single Borrower/Group Exposures
• Prudential Group Exposures
• Substantial Exposures
• Industry/economic sectors
Portfolio management
8
• Evaluates exposures on the basis of industry concentration, rating quality, internally established pre-specified early warning indicators
• Regular portfolio reviews, stress tests and scenario analysis
• The exposures in off-balance sheet products such as FX Forwards and Letter of Credits are treated with utmost care
Credit risk mitigation
9
• Ways outs analysis
• Comprehensive and legally enforceable documentation
• Obtaining of collateral in line with the Bank's policy and ensuring enforceability

- Impairment Process

Impairment of Financial Assets

The Bank has in place a detailed impairment policy approved by the Board of Directors.

For accounting purposes, the Bank uses an incurred loss model for the recognition of losses on impaired financial assets. At each reporting date the Bank and the Group assesses whether there is objective evidence of a specific loss event. This means that losses are recognized when objective evidence of a specific loss event has been observed.

Triggering events include the following:

- Significant financial difficulty of the customer
- A breach of contract such as default of payment
- Where the Bank grants the customer a concession due to the customer experiencing financial difficulty
- It becomes probable that the customer will enter bankruptcy or other financial re-organization
- Observable data that suggests that there is a decrease in the estimated future cash flows from the loans, to name a few.

Individually Assessed Allowances

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis if there is any objective evidence of a loss based on the above. Items considered when determining allowance amounts include

- The sustainability of the counterparty's business plan,
- Its ability to improve performance if it is in a financial difficulty,
- projected receipts and the expected payout, should bankruptcy ensue,
- The availability of other financial support,
- The realisable value of collateral and the timing of the expected cash flows.

Impairment allowances are evaluated monthly.

Collectively Assessed Allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant (including credit cards, residential mortgages, Government debt and unsecured consumer lending) and for individually significant loans and advances that have been assessed individually and found not to have been impaired.

The Bank generally bases its analyses on historical experience and economic factors. These factors include

Economic Factors	Historical Experience
Unemployment rates	Historical losses on the portfolio
Changes in laws	Levels of arrears
Changes in regulations	Credit utilisation
Other relevant consumer data	Loan to collateral ratios

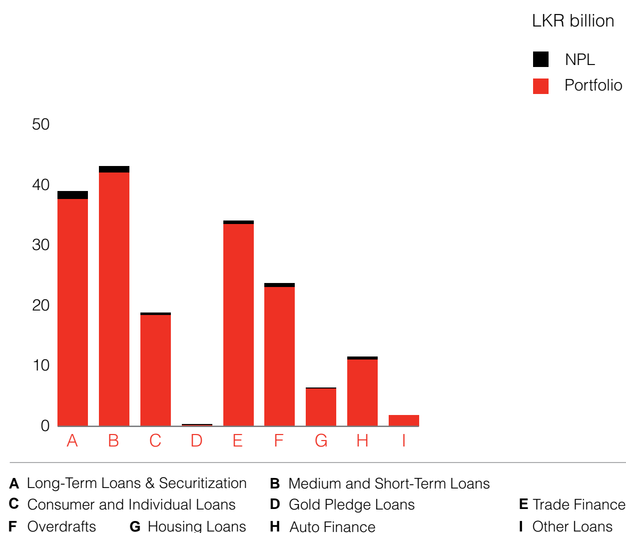
The Bank may use the aforementioned factors as appropriate to adjust the impairment allowances. Allowances are evaluated separately at each reporting date with each portfolio.

Graphical Analysis

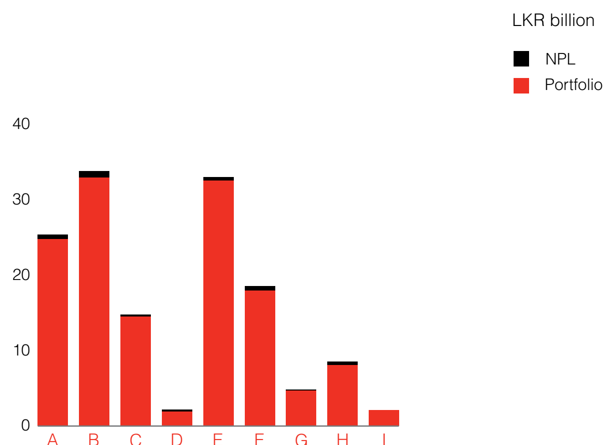
The graphical analysis given below depicts the extent of analysis and the quality of the portfolio.

Product Concentration

Product Concentration as at 31.12.2014



Product Concentration as at 31.12.2013

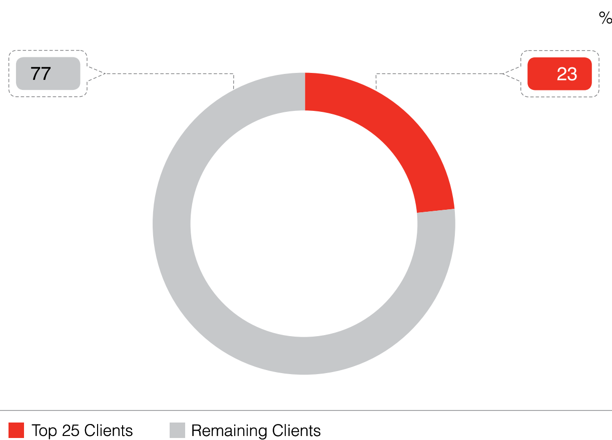


A Long-Term Loans & Securitization **B** Medium and Short-Term Loans
C Consumer and Individual Loans **D** Gold Pledge Loans **E** Trade Finance
F Overdrafts **G** Housing Loans **H** Auto Finance **I** Other Loans

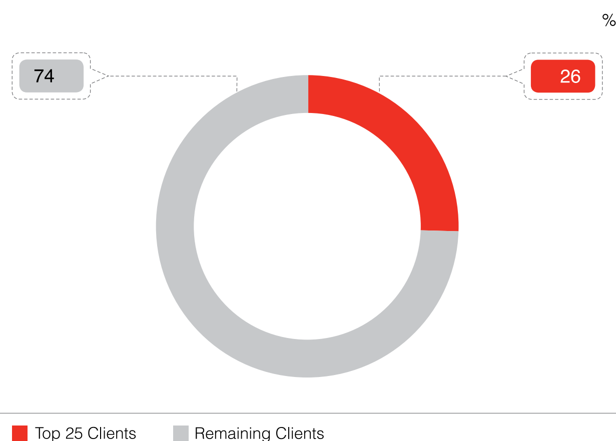
Group Concentration

- In compliance with the CBSL limits on group exposures and single borrowers.
- The substantial exposures of the Bank accounted for only 60.7% of the capital base and was well within the risk appetite of the Bank.
- The top 25 clients accounted for only 23.2% of the portfolio and the portfolio was not concentrated on a particular client or a group.

Group Concentration as at 31.12.2014

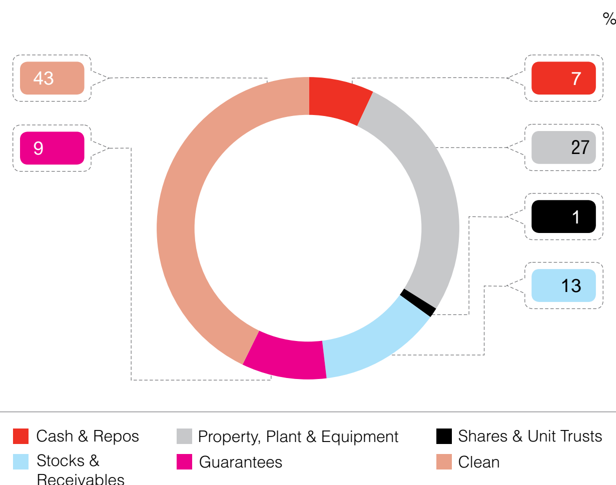


Group Concentration as at 31.12.2013



Collateral Concentration

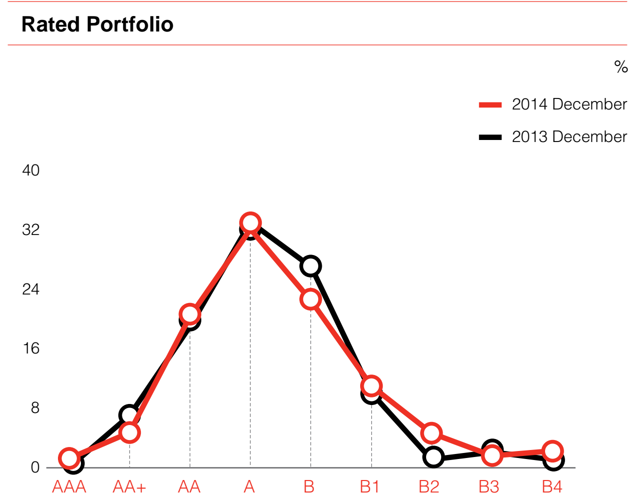
Collateral Concentration 31.12.2014



Rated Portfolio

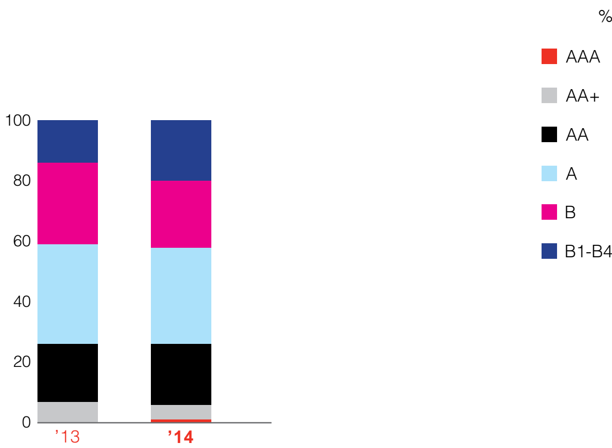
Portfolio distribution based on internal rating is as follows:

Rated Portfolio



The portfolio continue to be concentrated on A rated clients and the composition was within the risk appetite of the Bank.

Concentration of Counterpart Exposure as at 31 December

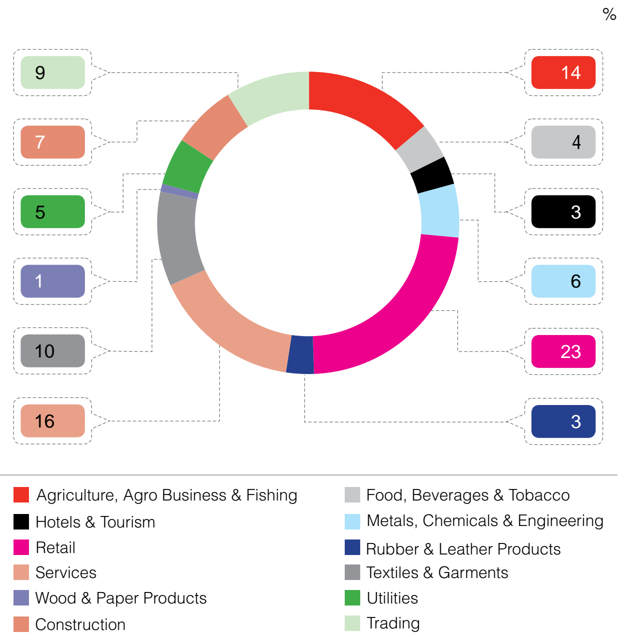


Sector Concentration

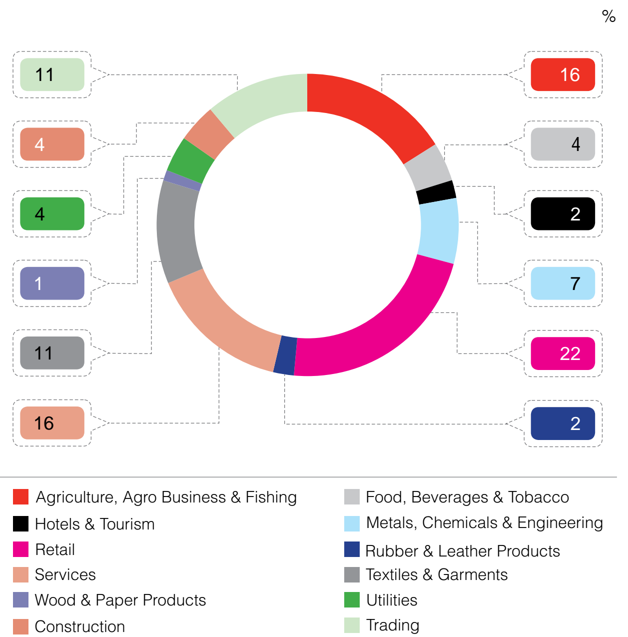
Bank analyses sector-wise NPL ratios and rating wise distribution of Borrowers in various Sectors to identify sector stresses in advance.

Bank was also in compliance with the minimum lending requirement of 10% to the Agricultural sector.

Sector-wise Distribution of Portfolio as at 31.12. 2014

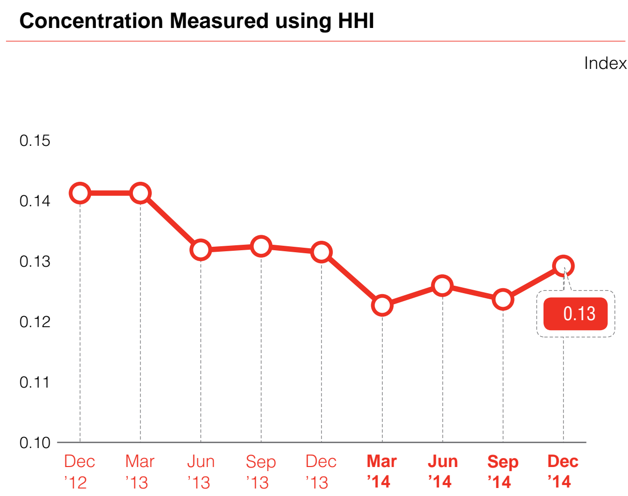


Sector-wise Distribution of Portfolio as at 31.12. 2013



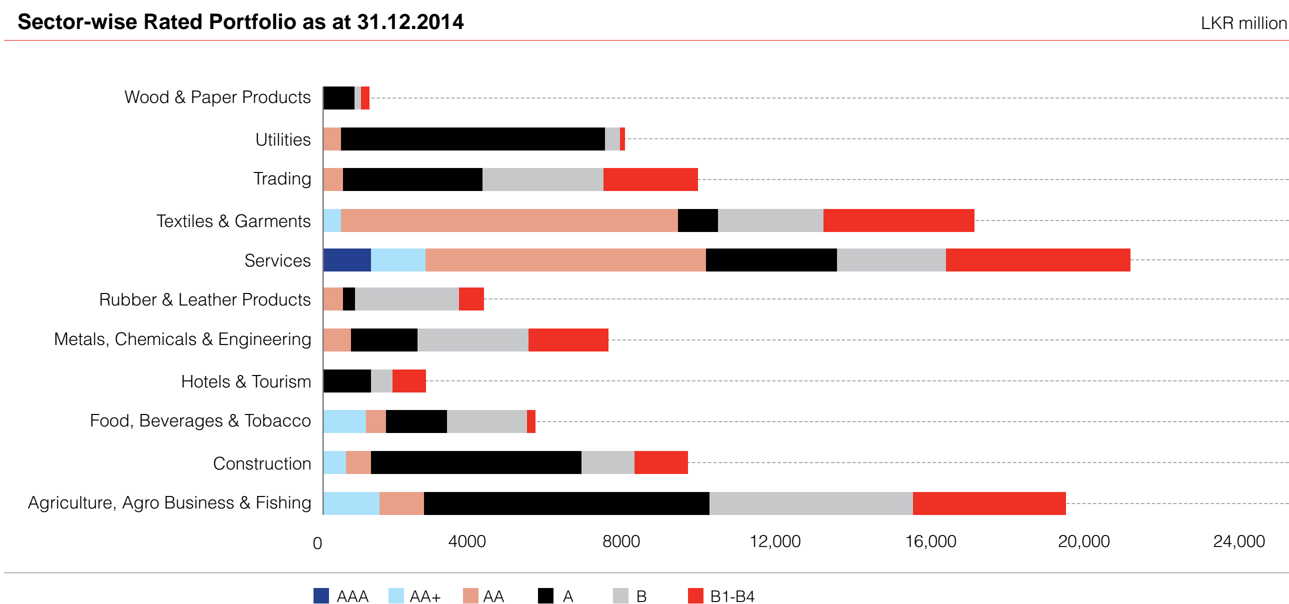
Concentration measured using Herfindahl-Hirschman Index (HHI).

Concentration Measured using HHI

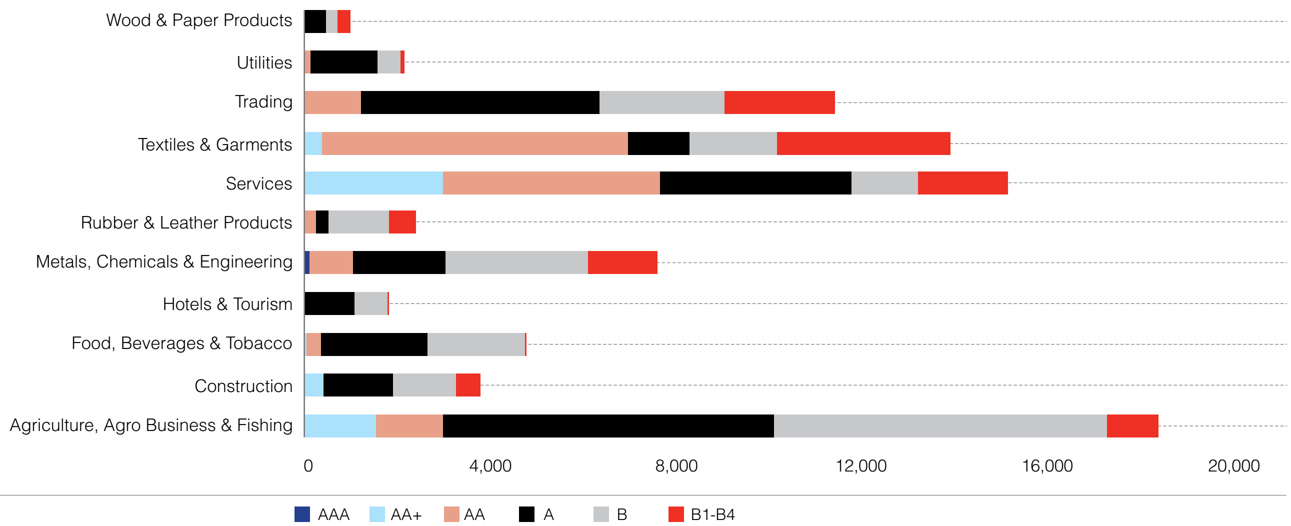


Sector-wise Rated Portfolio

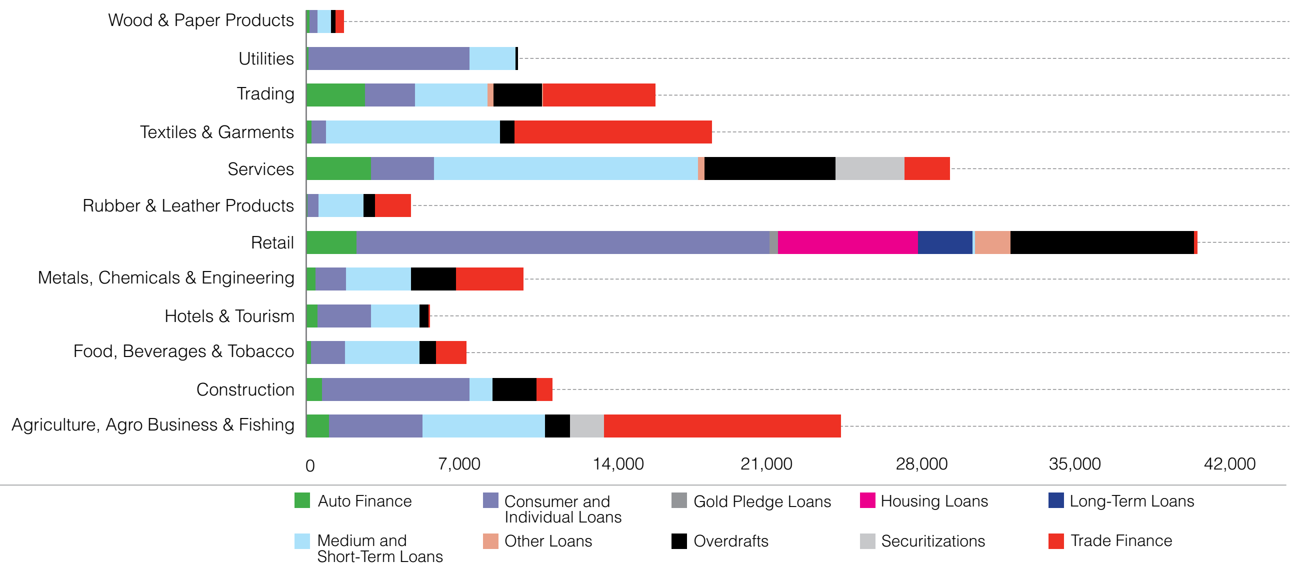
Sector-wise Rated Portfolio as at 31.12.2014



Sector-wise Rated Portfolio as at 31.12.2013 LKR million



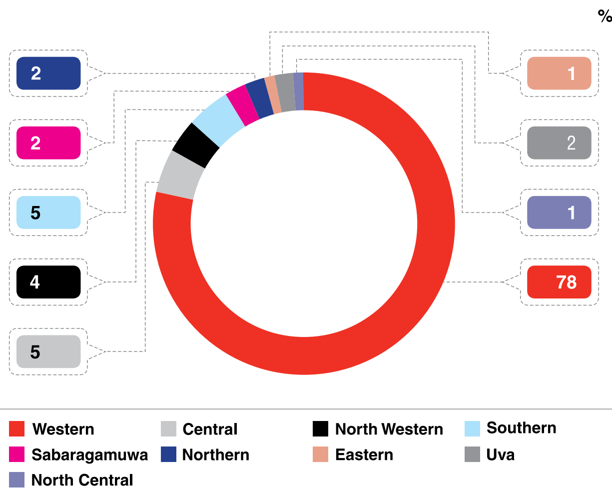
Sector-wise Portfolio Product-wise as at 31.12.2014 LKR million



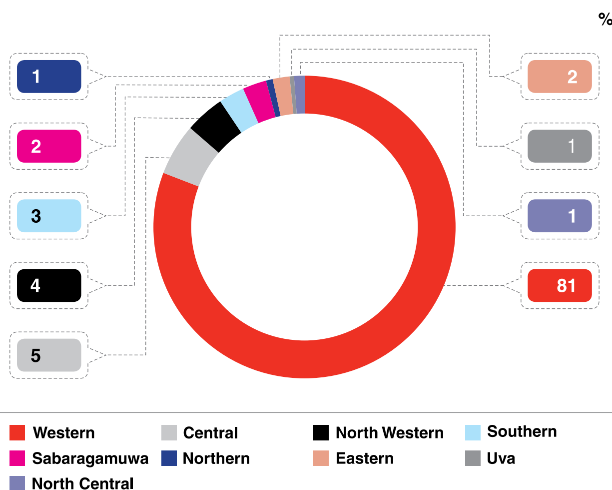
Geographical Concentration

Based on the economic activity highest concentration is in Western Province though the branch network is spread throughout the country. Concentration in Western Province declined during the year due to disbursement to infrastructure and power projects funded by the Bank.

Geographical Concentration of Portfolio as at 31.12.2014



Geographical Concentration of Portfolio as at 31.12.2013

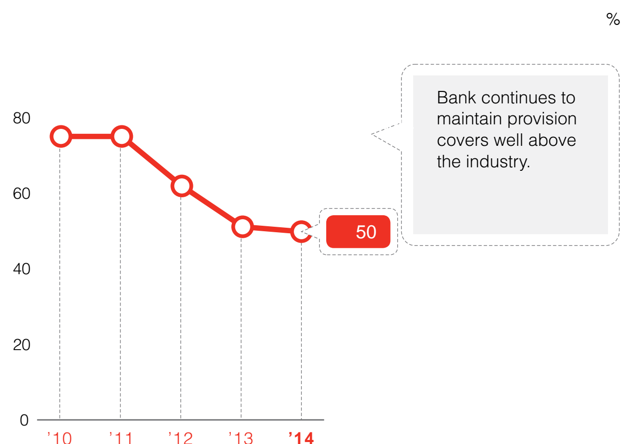


Non-Performing Loans

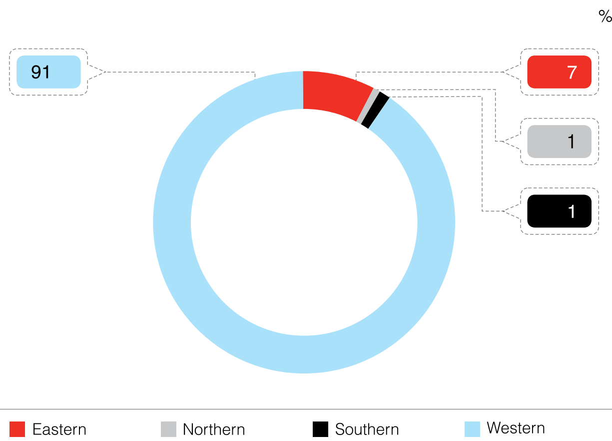
Gross NPL

Provisioning and Impairment

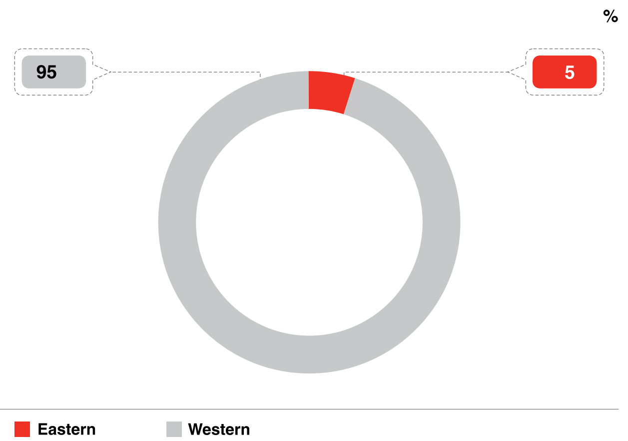
Specific Provision on NPLs



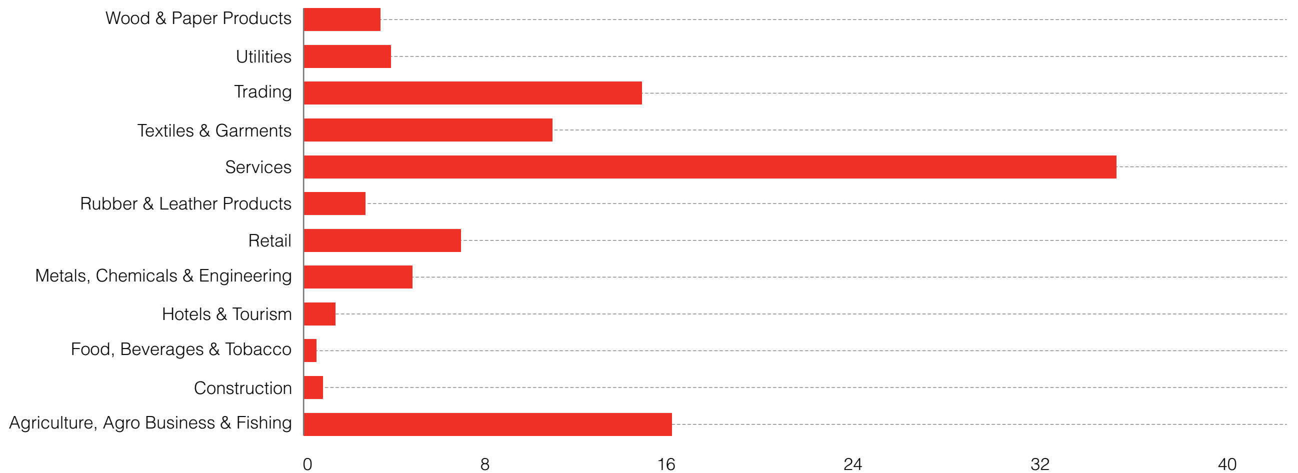
Individual Impairment - Geography-wise as at 31.12.2014



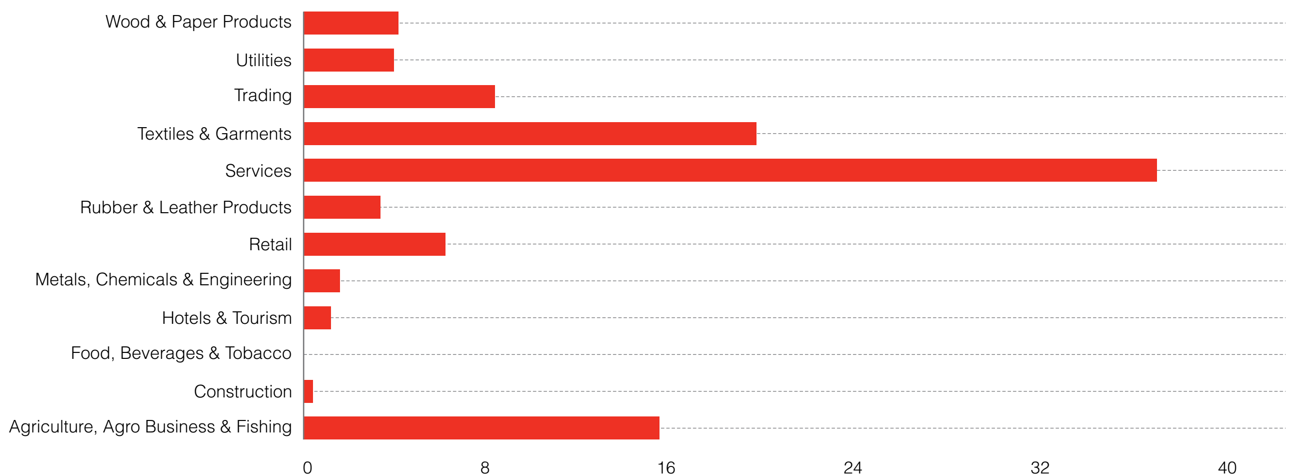
Individual Impairment - Geography-wise as at 31.12.2013



Individual Impairment - Sector-wise as at 31.12.2014



Individual Impairment - Sector-wise as at 31.12.2013



Market Risk

With the evolvement of Risk Management in Banks the management of Market Risk has become an important and a vital area. The Credit risk which was the main concern of risk managers/supervisors in the past have now changed the perception with increasing attention on Market Risk Management functions. The main reasons to focus the attention on Market Risk could be highlighted as follows:

- Banks are more exposed to risk of exchange rates, interest rate or prices as they deal more on trading activities to gain profits by the volatilities in the Financial markets.
- A sudden or unexpected economic condition could turn the whole organisation to a crisis situation within a very short period.
- The evolution of BASEL regulatory Guidelines has driven the Banks to strengthen on Market Risk Management processes and functions on an on-going basis.

In broader terms Market Risk is defined as the risk of losses in both On and Off-balance sheet positions caused by movements in prices or rates of foreign exchange, interest rates, equity, commodity, and credit spreads. When talking about Market Risk we cannot talk about it in isolation as Management of Liquidity Risk goes hand in hand with Market Risk Management.

Objective of Market Risk Management

The primary objectives of Market Risk Management is to ensure that the Business lines of a Bank optimise the risk-reward relationship within the Bank's pre-defined risk appetite and do not expose the Bank to unacceptable losses.

The establishment and monitoring of MRM/ALM exposures against limits is a key control function from the perspective of ensuring that the Bank keeps within the overall risk appetite set out by the Board and Senior Management.

The activities of the Market Risk Management are not directed purely at loss mitigation but also assist towards analysing the inter-relationship of risk, reward and capital. Thus, the focus is not on restricting the Business Units from taking risk, but assuring that risks are taken where it is most optimal given the rewards and capital consumption.

Policy Framework for Market Risk Management

Risk monitoring is guided by a well-defined policy framework and limit structure designed to suit the business model and the balance sheet structure reflecting the risk appetite of the Bank. The Board supported by Integrated Risk Management Committee (IRMC) approves the risk parameters as recommended by the Asset and Liability Management Committee (ALCO) and Market Risk Management to support the business need.

Bank's comprehensive risk management framework covers the Market, Liquidity, Asset and Liability Risks and proactively manages the exposures against the pre-defined risk parameters. Prudential internal limits have been defined for liquidity risks, price risks, exchange risks and asset/liability risks for close monitoring of exposures. All exposure limits are linked to the Bank's capital base to ensure adequate and efficient capital allocation/planning. These limits are subject to annual review and are monitored on a daily, weekly and monthly basis. Where limits are exceeded, Market Risk Management is responsible for identifying and escalating those excesses to the senior management on a timely basis.

Process

Market Risk Management defines and implements a framework to systematically identify, assess, monitor and report our Market Risk and support management and mitigation. Market Risk managers identify existing and potential future Market Risks through active portfolio analysis and engagement with the business areas.

The key functions of Market Risk Management will include Policy formulation, Risk Measurement methodologies, systems and control, reporting and communication.

- Policy Formulation - Policy formulation/renewal will be carried out considering the regulatory concerns and material changes on MRM/ALM Limit monitoring process.
- Risk measurement methodologies - Limits are assessed and recommended to ALCO for approval (Asset Liability Management Committee).
- Risk Monitoring - All limits in force are monitored on a pre-defined time bands
- Risk Reporting Communication and Approval - MRM/ ALM risk activities are identified and monitored on a timely basis. This includes timely investigation and reporting of limit excesses for approval.

Market Risk Measurement and Assessment

Market Risk Management aims to accurately measure all types of market risk by a comprehensive set of risk metrics reflecting economic and regulatory requirements.

In accordance with economic and regulatory requirements, we measure market and related risks by using key risk metrics such as:

- Metrics for Market Risk Standardized Approach
- Three types of stress tests: Portfolio stress testing, business level stress testing and event risk scenarios
- Market risk economic capital, including traded default risk
- Sensitivities
- Market value/Notional (concentration risk)
- Duration analysis
- FX Risk monitoring metrics

Selected KRIs are highlighted below which provide a view of the market risk indicators which are monitored and reported to Board Integrated Risk Management Committee:

Indicator	Limit	Position
Price Sensitivity of the balance sheet (LKR million) *- P/L impact for a 1% change in interest rate*	(500)	177
Mark to Market of Debt Trading Portfolio (LKR million)	(60)	5.18
Bank's Net Open Position +/- (USD million)	8	(0.73)
Stress testing results on Net Open Position (LKR million)	(170)	(5.11)

These measures are viewed as complementary to each other and in aggregate define the Market Risk Framework, by which all businesses can be measured and monitored.

Market Risk Analytics

Open Exposure Position Monitoring

Daily foreign exchange (FX) open positions are monitored to ensure that the Bank is operating within the regulatory limits as well as internal prudential limits on open exposures. Bank's FX net open position is subject to daily stress testing to assess the ability to withstand adverse impacts to the exchange rate variations and is managed within the set parameters.

Position as at 31.12.2014 (USD '000)

	Foreign Exchange Transaction Categories								
Item	Cash	Tom	Spot	Forward	Options	Other Derivative Transactions	Receivables/ Payables	Other Transactions	Total
Overall net position at the closing of the normal working hours of the previous day, Long (+)/Short(-)	-15,579	-31,249	-6,572	53,095					-305
Adjustment entries									
Overall net position at the beginning of the day, Long(+)/ Short(-)	-15,579	-31,249	-6,572	53,095	0	0	0	0	-305
Transactions during the day									
Purchases/Receivables from	3,139		2,000	300					5,439
Central Bank of Sri Lanka									
Licensed Commercial Banks			2,000						2,000
Other Customers	3,139	0	0	300	0	0	0	0	3,439
Against Exports	292								292
SIA & Government Securities by Non-Resident Customers	17								17
Other	2,830			300					3,130
Sales/Payables to	5,515	0	0	409	0	0	0	0	5,924
Central Bank of Sri Lanka									0
Licensed Commercial Banks	2,000								2,000
Other Customers	3,515	0	0	409	0	0	0	0	3,924
Against Exports	2,155								2,155
SIA & Government Securities by Non-Resident Customers	101								101
Others	1,259			409					1,668
Net Position Long(+)/Short(-)	-2376		2000	-109	0	0	0	0	-485
Central Bank of Sri Lanka	0	0	0	0	0	0	0	0	0
Licensed Commercial Banks	-2,000	0	2,000	0	0	0	0	0	0
Other Customers	-376	0	0	-109	0	0	0	0	-485
Overall net position at the closing of the day, Long(+)Short(-)	-17,955	-31,249	-4,572	52,986	0	0	0	0	-790
Applicable Net Open Position Limit Long(+)/Short(-)					9,000				

Sensitivity Analysis

Daily sensitivity analysis is carried out on major foreign currency Net Open Positions (NOP) giving positive and negative shocks to the spot rates to determine the impact of the profit or loss to the Bank's Statement of Profit or Loss. Bank's Statement of Financial Position too is subject to sensitivity analysis based on the duration of its interest sensitive assets and liabilities which is carefully managed within the set limit.

Exchange Rate Sensitivity of Major Foreign Currency Net Open Positions as at 31.12.2014

		LKR Depreciate						LKR Appreciate
Spot Rate Shocks		-5%	-2.5%	-1%	Spot rate	1%	2.5%	5%
Currency	Net Open Position							
USD	924,352	6,100,724	3,050,362	1,220,145	132.00	(1,220,145)	(3,050,362)	(6,100,724)
GBP	28,032	287,942	143,971	57,588	205.44	(57,588)	(143,971)	(287,942)
EUR	68,560	550,456	275,228	110,091	160.58	(110,091)	(275,228)	(550,456)
JPY	(119,351,485)	(6,594,916)	(3,297,458)	(1,318,983)	1.11	1,318,983	3,297,458	6,594,916
AUD	3,924	21,245	10,622	4,249	108.27	(4,249)	(10,622)	(21,245)
Total		365,450	182,725	73,090		(73,090)	(182,725)	(365,450)

The possible impact of exchange rate movements on the major NOP of major Foreign Currency Positions is monitored to evaluate the impact on the P/L and ensure it is within acceptable levels.

Interest Rate Sensitivity of the Balance Sheet as at 31 December 2014

The price sensitivity of the Balance Sheet was managed within the pre-defined risk parameters whilst maximizing the market potential on interest sensitive assets and liabilities.

The maturity gap analysis of interest sensitive assets and liabilities distributed into a number of pre-defined time bands according to their residual time to maturity is given below:

	Up to 1 Month LKR '000	1-3 Months LKR '000	3-6 Months LKR '000	6-12 Months LKR '000	1-3 Years LKR '000	3-5 Years LKR '000	Over 5 LKR '000	Non Sensitive LKR '000	Total LKR '000
Assets									
Cash	1,844,434	–	–	–	–	–	–	–	1,844,434
Due from Banks	10,061,424	659,500	–	–	–	–	–	–	10,720,924
Investments - Current	14,023,109	27,939,933	1,019,261	13,969,801	2,834,673	4,076,310	18,667	4,439,675	68,321,428
Investments - Non-performing	–	–	–	–	–	–	–	–	–
Loans and receivables - current	56,317,364	29,513,274	11,244,174	11,449,579	31,537,502	18,309,530	15,329,869	–	173,701,292
Loans and receivables - Non-performing	–	–	–	–	–	–	–	2,171,671	2,171,671
Fixed Assets	–	–	–	–	–	–	–	2,180,626	2,180,626
Other Assets	–	–	–	–	–	–	–	3,905,410	3,905,410
Total Assets	82,246,331	58,112,707	12,263,435	25,419,380	34,372,174	22,385,840	15,348,536	12,697,382	262,845,785
Liabilities									
Total Capital Fund	–	–	–	–	–	–	–	22,298,046	22,298,046
Deposits	56,498,436	25,425,108	25,473,599	35,443,021	4,822,831	1,466,951	–	–	149,129,946
Borrowings	18,812,446	17,463,664	4,625,680	6,707,433	3,704,154	9,256,654	18,592,143	–	79,162,174
Other liabilities	483,164	636,735	756,219	571,848	259,035	74,707	–	9,473,910	12,255,618
Total liabilities	75,794,046	43,525,506	30,855,498	42,722,303	8,786,020	10,798,312	18,592,143	31,771,956	262,845,784
Period Gap	6,452,284	14,587,201	(18,592,063)	(17,302,923)	25,586,154	11,587,528	(3,243,607)	(19,074,574)	–

Mark to Market Exercise

Trading portfolios of Securities (Treasury Bills/Bonds), Equity and Foreign Currency Options are subject to mark to market exercise on a daily basis and are monitored against the set stop loss limits. Prompt management action is taken where necessary ensuring minimum loss situations to the portfolios.

Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its financial obligations in a timely manner at reasonable prices. Financial obligations include liabilities to depositors, payments due under derivative contracts, settlement of securities borrowings and repurchase transactions, lending and investment commitments.

Effective liquidity-risk management is essential to maintain the confidence of depositors and counterparties as well as to ensure that the Bank's core businesses continue to generate revenue, even under adverse conditions.

Objective of Liquidity Risk Management

The objective of our liquidity framework is to ensure that all anticipated funding commitments can be met when due and allow us to withstand liquidity stresses whilst maintaining our business profile. It is designed to be adaptable to changing business models, market and regulations.

The liquidity position of the Bank further strengthened in 2014 with the funding from the Multi National funding agencies and inflows of customer deposits during the

year which resulted in an advance to core funding ratio of 98.0% as at 31 December 2014 reflecting the strong liquidity profile of the Statement of Financial Position. The Bank will continue to focus on liability generation, which will be a necessary pre-condition for significant asset growth.

Policy Framework for Liquidity Risk Management

The Bank maintains well-articulated liquidity risk management policies and procedures, which drive the level of liquidity risk exposures and determine the business size and maturities which ensure that it has at all times sufficient liquidity to meet its financial obligations at a fair market price.

The responsibility for the liquidity risk management of the Bank is carried out by ALCO. The Bank's Treasury/ ALM units are responsible for executing the day-to-day liquidity management of the Bank within the parameters set by ALCO.

Also the Bank monitors key liquidity metrics on a regular basis, both on local currency and foreign currency balance sheets and prudential limits are set to better manage the liquidity profile of the Bank.

Process

Liquidity measurement could be measured through Stock approach or flow approach. Under the stock approach liquidity is measured in terms of key ratios which portray the liquidity stored in the Statement of Financial Position. In flow approach a statement of Maturities of Assets and Liabilities will be prepared placing all cash flows in time bands according to the residual time to maturity.

A satisfactory trade-off between liquidity and profitability is maintained by categorizing liquidity shortfalls in the Statement of Financial Position into suitable time buckets, placing exposure limits on each time bucket to monitor the liquidity mismatch gaps. These limits correspond to the liquidity available to the Bank through various fund providers, at an agreed level of confidence.

We have carefully assessed and revised our Statement of Financial Position maturity mismatch limits in order to optimize market opportunities which are being effectively managed by our Asset Liability Management Desk. Separate gap limits are set for the local currency and foreign currency Statement of Financial Position based on the size and the nature of the Bank's Statement of Financial Position.

The Bank is equipped with a comprehensive Liquidity Contingency Funding Plan (LCFP) linked to the Business Continuity Plan, which is in line with the regulatory guidelines. The LCFP clearly defines the responsibilities of the Liquidity Management Team and ensures the business continuity through close monitoring of the Bank's liquidity position against the pre-defined liquidity risk trigger points. Trigger points have been defined taking into consideration the Bank specific and systemic triggers which would cause a liquidity crisis. Action Plans are set out under each level of liquidity crisis (Mild, Moderate, Severe) with responsibilities assigned to a Liquidity Management Team nominated from all areas of business to ensure that all stakeholders of the Bank are safeguarded. We have also entered into reciprocal liquidity funding agreements with identified counterpart bank to ensure stability.

Liquidity Risk Analytics Liquid Asset Ratio

Our principal mechanism for implementation of the liquidity policy is to maintain the Bank's liquid assets to liabilities ratio above the regulatory defined ratio of 20%. The internally set prudential liquidity limits/ratios would give us early warnings of any areas of concern. The Bank has maintained a healthy Liquid Asset Ratio throughout the year.

Statutory Liquid Asset ratio (LAR)

As at 31 December 2014	2014	2013
Domestic Banking Unit	**23.85**	26.22
Foreign Currency Banking Unit	**25.10**	26.06

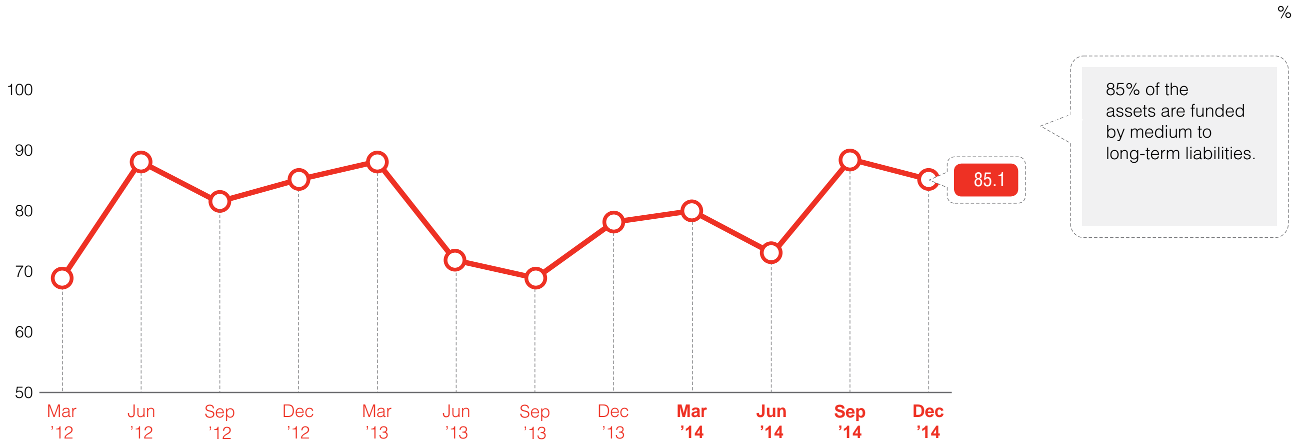
Advances to Deposits Ratio

This is defined as the ratio of total loans and advances to customers relative to deposits available which has been maintained within the set parameters. The increasing trend in customer deposits in line with the advances has proven the positive trend in Statement of Financial Position growth.

Medium Term Funding (MTF) Ratio

Healthy MTF ratio throughout the year represents the stable funds available for the Bank to fund the long-term assets of the Statement of Financial Position.

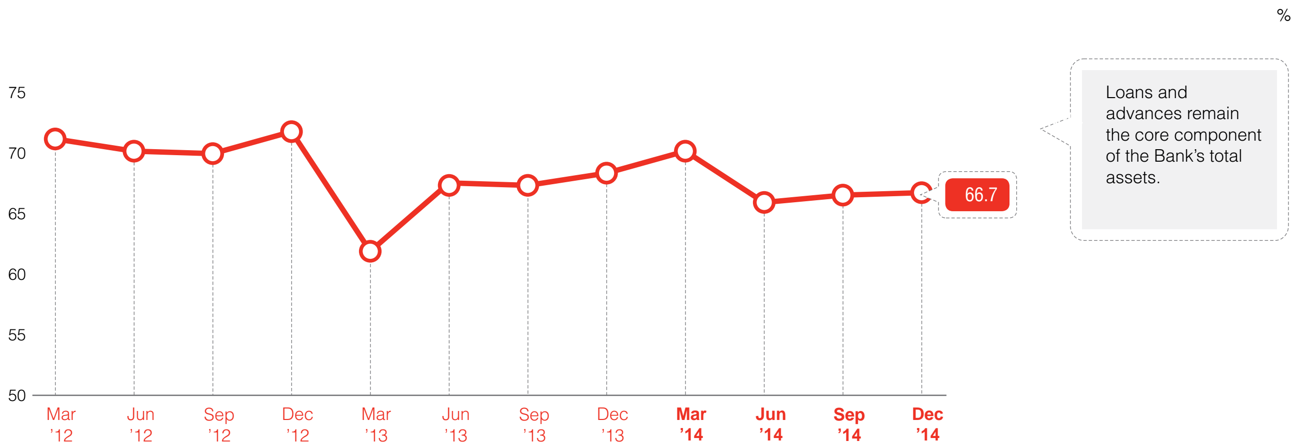
Medium-Term Funding Ratio



Net Loans to Total Assets Ratio

The consistency in the net loans to total assets ratio of the Bank reflects that the Bank has maintained the share of loans and advances in total asset base focusing mainly on loans and advances.

Net Loans to Total Assets Ratio



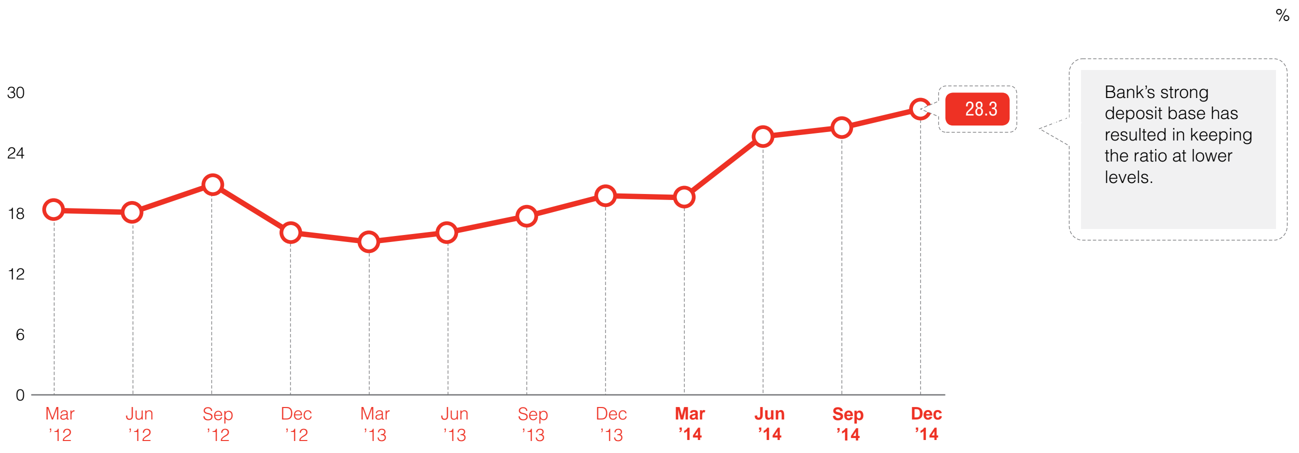
Liquid Assets to Short-Term Liabilities

The statutory liquid asset ratio has been maintained above the regulatory requirement at all times. Hence the Liquid Assets to Short-term liabilities (< one year) would definitely result a higher ratio than the statutory level. The Bank maintained this ratio at a prudent level whilst meeting the commitments on a daily basis.

Purchased Funds to Total Assets

The Bank has maintained the purchased funds to total assets ratio below 30% throughout the year. The ratio has increased in relation to the expansion of the Asset base during the period.

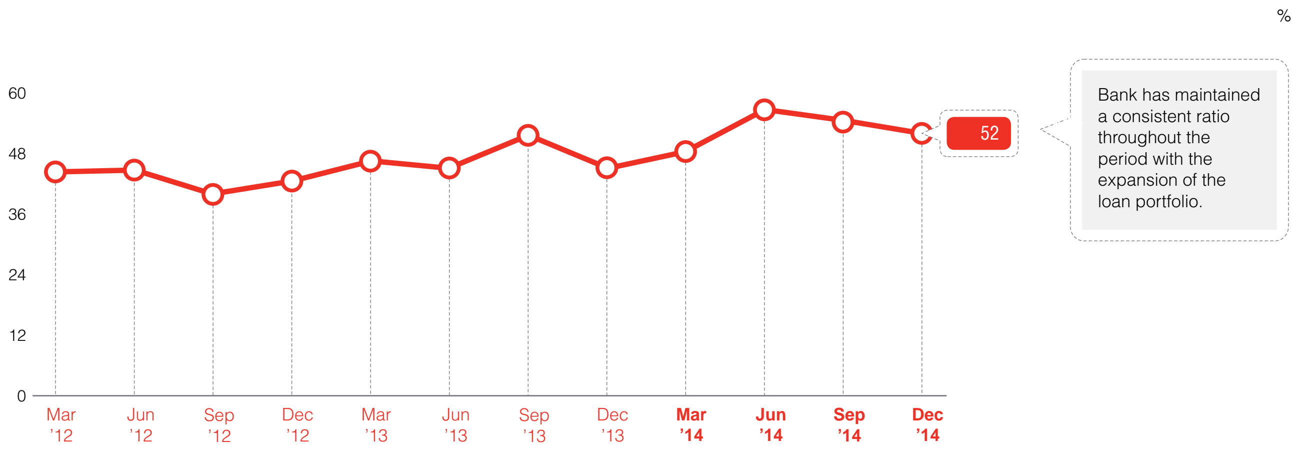
Purchased Funds to Total Assets Ratio



Commitments to Total Loans

With the expansion of the Statement of Financial Position the Bank's total loan portfolio has increased during the year. A parallel shift in the Commitments and the Commitments to total loans ratio has been evident during the period.

Commitments to Total Loans Ratio



Key Risk Indicators

Selected KRIs are highlighted below which provide a view of the Liquidity Risk indicators where regulatory/ internal limits are set and monitored on pre-defined intervals, which provides early warning signals on liquidity position of the Bank.

Indicator	Limit	Position
Statutory Liquid Asset Ratio	20	25.91
Advances to Deposit Ratio	111	98.0
Medium-term Funding Ratio	110	85.11
Commitment Limit - LKR billion	100	93.93

Liquidity Gap Analysis of Foreign Currency Denominated Assets and Liabilities

The gap analysis of foreign currency denominated assets and liabilities will provide the cash flow obligations which will assist in managing the foreign exchange liquidity in a prudential manner.

Liquidity Gap Analysis for Foreign Currency Denominated Assets and Liabilities - as at 31 December 2014.

In USD 000	Up to 1 Month	1 - 3 Months	3 - 6 Months	6 - 12 Months	1 - 3 Years	3 - 5 Years	Over 5 Years	Total
Total Assets	154,478	100,140	34,123	17,281	80,469	37,707	136,875	561,072
Total Liabilities	56,703	156,500	46,369	111,583	24,365	46,426	119,124	561,071
Net Liquidity Gap	97,774	-56,360	-12,246	-94,302	56,104	-8,719	17,750	0

Segregation of Duties

Clear segregation of duties has been established between different business units ensuring prudent control and monitoring mechanisms. The Treasury Front Office reports to the Chief Executive Officer and Treasury Back Office reports to Head of Operations. The Market Risk Unit reports directly to the Head of the Group Risk Department who is a member of Bank's Assets and Liabilities Committee (ALCO). All senior level staff attached to the Market Risk Unit, the Treasury Front Office and the Treasury Back Office have obtained the internationally recognised ACI qualification offered by the Financial Markets Association, as required by the CBSL directives and are competent in their job profile.

The ALCO comprising the senior management from the Treasury, Risk Management, Finance and all business units of the Bank together with the Market Risk Management Unit is responsible for the supervision and management of market risks. The ALCO meets on a monthly basis and whenever circumstances demand. Its main responsibilities are:

- to decide on the required maturity profile and mix of incremental assets and liabilities;
- to monitor the structure and composition of the Bank's assets and liabilities and decide on product pricing for deposits and advances;
- to articulate the interest rate view of the Bank and decide on future business strategy;
- to review and articulate funding policy;
- to decide the transfer pricing policy of the Bank;
- to evaluate risks involved in launching new products.

ALCO is the governing body for market risk, liquidity risk and asset liability risk management and the implementation of the Bank's risk management policies, procedures and systems is delegated to the Head of Market Risk Management who reports to the Head of the Group Risk Department. Market and liquidity risks are addressed at ALCO on a monthly basis and at the Board IRMC level on a monthly and quarterly basis.

The market risk management in the Bank is evolving very fast and there is greater emphasis on strengthening systems and people with adequate training and system support.

Market and Liquidity Risk Reporting

Risk reporting creates transparency on the risk profile and facilitates the understanding of the core market and liquidity risk drivers to all levels of the organisation. The Board, Senior Management and Risk Management Committees receive regular reporting, as well as ad hoc reporting as required, on market risk, liquidity risk, regulatory capital and stress testing. Senior Risk Committees receive risk information at a number of frequencies, including weekly, monthly or quarterly.

Additionally, Market Risk Management produces daily and weekly market risk specific reports and daily limit excess reports for management review and action. Such reports include:

- Daily market risk report on foreign exchange/debt trading to Treasury, Finance, CEO and GRM
- Daily limit exception report to Treasury and GRM
- Weekly/monthly liquidity risk report on internal/external liquidity trends/analysis to ALCO and IRMC
- Monthly market risk reports on foreign exchange, liquidity, deposit concentration, country exposure reports to ALCO
- Monthly ALM reports to ALCO
- Quarterly market, ALM and liquidity reports to CMRPC and IRMC
- Quarterly risk assessment report to the Board

The risk management is ever evolving and demands greater transparency and increased accountability when it comes to risk measures, risk management processes and their underlying systems. The banks should always try to stand ahead on those areas in order to win competitive advantages.

Operational Risk

Operational risk consists of losses incurred due to the inadequacy or failure of the internal processes, human errors, systems or external events such as natural disasters including legal risk. The Bank has developed frameworks, management tools and a control infrastructure to enhance the management and control of the operational risks that are inherent to its various activities across the Group.

Objectives of Operational Risk Management

The Operational Risk Management Unit (ORMU) is established within Group Risk Management Department and works towards the following objectives:

- Reduce losses from operational failure and in particular to avoid potentially large or catastrophic losses;
- Ensure better control of operations through increased understanding of risk activities within various business units, the Board and Senior Management will lead to improvements in the control of operations and the emergence of a more proactive operational risk management culture;
- Provide early warning signals of deterioration in the Bank's internal control system - raise awareness of operational risk in the Bank from top to bottom through the implementation of an enterprise-wide operational risk approach.
- Improve performance measurement by way of improved understanding of its operational risk profile shall enable appropriate allocation of risk and economic capital to individual lines of business, which would allow improved performance measurement and evaluation of activities.

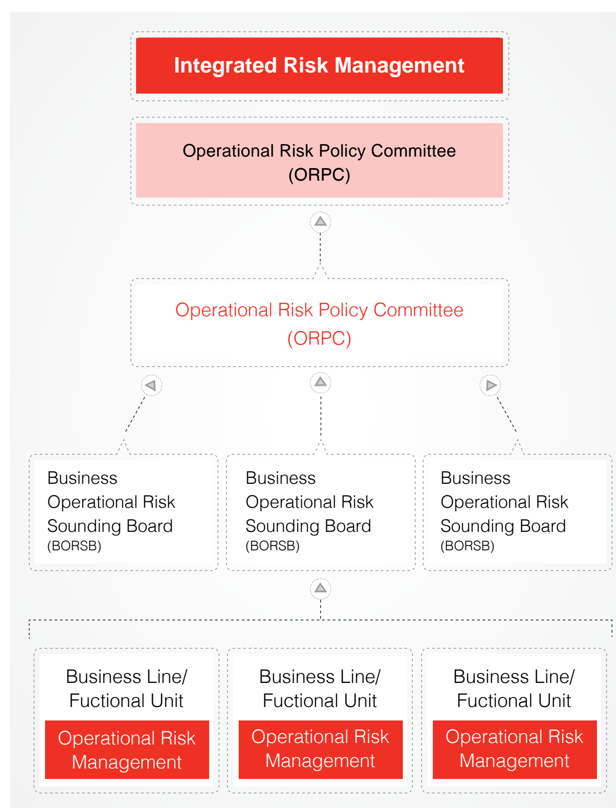
Operational Risk Governance

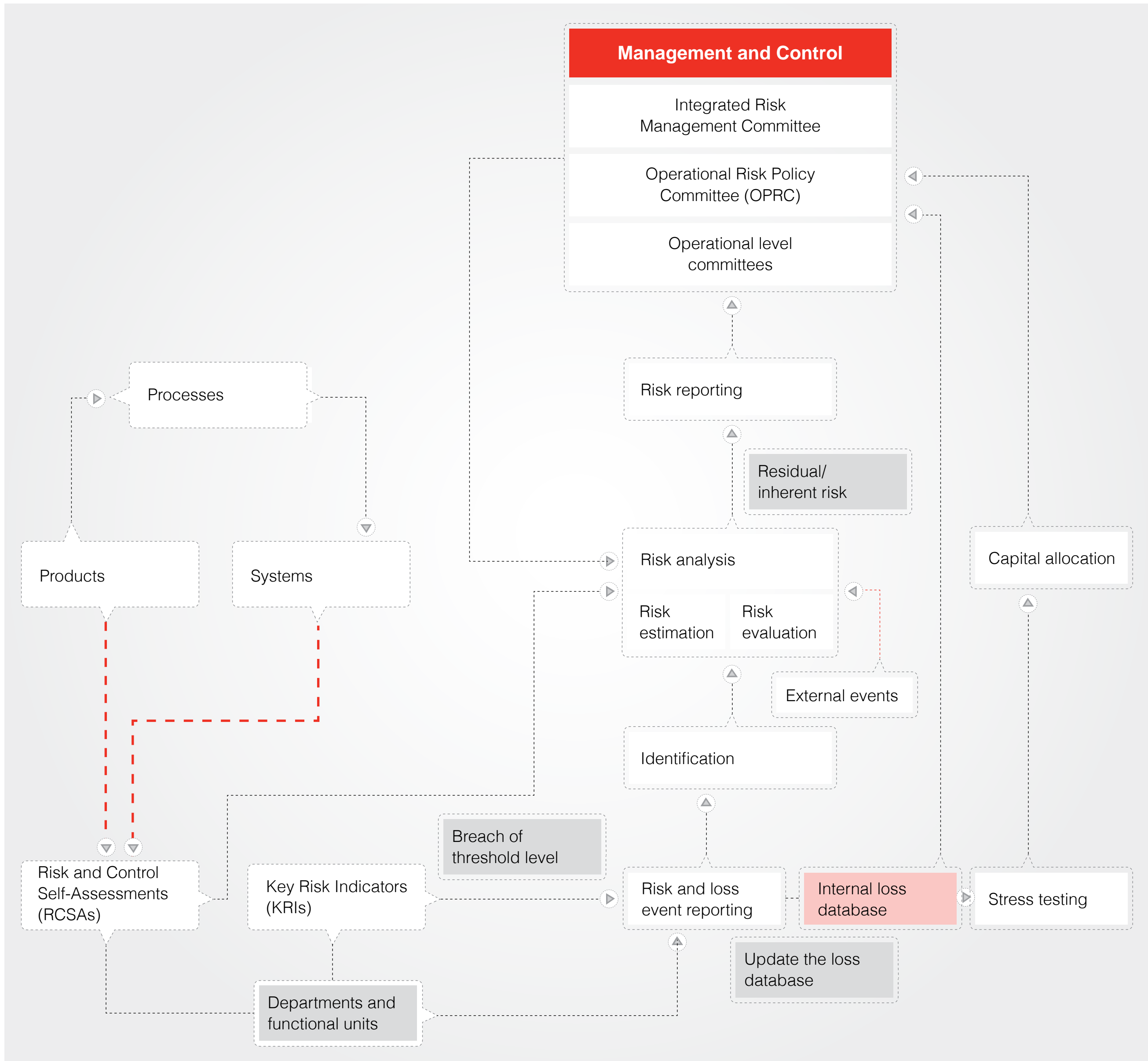
Staff at all levels is accountable for directing and controlling the operational risks in his/her area of responsibility. Board of Directors is responsible for the overall risk levels and in ensuring risks are managed appropriately and the management is vested with the required authority to implement the related control framework. The IRMC submits regular operational risk assessments to the Board, seeking its views, concurrence or specific directions.

The Operational Risk Policy Committees headed by the CEO, which has been set up at Bank level provide a forum for the discussion and management of all aspects of operational risks/losses and control lapses, monitor and ensure that appropriate operational risk management frameworks are in place, adhering to the policies of the Bank.

Business Operational Risk Sounding Boards (BORSB) have been setup at key business function and support function levels to discuss operational risk matters encompassing responsibilities such as:

- Provide a forum for the identification, assessment, mitigation and subsequent monitoring of business level operational risk trends and issues.
- Ensure that there is full compliance with internal policies and relevant regulations, as well as the Bank's Operational Risk Management Framework.
- Promote and sustain a high level of operational risk management discipline culture within the business or Support function.
- Review the business or function's operational risks and ensure appropriate ownership, actions for closure within the agreed target date and progress for all risks.





Operational Risk Management Process

While the ORMU functions as the command and control centre in managing operational risks, Operational Risk Managers (ORMs) have also been appointed in the Business and Supporting units under the authority of the Bank's Head of Operational Risk. The ORMs operate from the respective business units/ support functions, collaborating closely with the business/support function heads and responsible for implementing the Bank's procedures and guidelines, monitoring and managing operational risks, with the

support of the staff. The Bank has implemented a software-based solution to assist in the management of operational risk.

The Operational Risk Management Unit is notably responsible for:

- Devising and implementing the Bank's operational risk policy in co-operation with the business units and support functions.
- Promoting an operational risk culture throughout the Group
- Defining at Group level, methods for identifying, measuring, managing and monitoring operational risk, in co-operation with the Business units and Support functions.
- Maintaining the Bank's Business Continuity Plan (BCP) and Crisis Management Policy, managing the policy and coordinating its implementation.

The Bank has been guided by the Basel II Regulations (the Capital Requirements Directive and 'sound practices for the effective management and supervision of operational risk) in the design and implementation of the broad framework to manage operational risks. This is a comprehensive end-to-end process encompassing risk identification, assessment, reporting, management and control.

Sound frameworks, techniques and toolsets have been implemented to ensure the effectiveness of the above process. They notably include:

- Risk and Control Self-Assessment (RCSA)
- Key Risk Indicators (KRI)
- Gathering of Internal Data on Operational Risk Events and Losses
- Scenario Analysis and Stress Testing
- Business Continuity Planning and Crisis Management

Risk and Control Self-Assessment (RCSA)

Risk and Control Self-Assessment (RCSA) is a framework designed to identify, estimate and assess the Bank's exposure to operational risks arising out of routine adherence to procedure and processes inherent to the various business lines and functional units of the Bank. Controls and mitigants that adequately counteract the risks are introduced thereby minimizing the impact and incidence of losses.

Its objectives are as follows:

- Identifying and assessing the major operational risks to which each business unit or support function is inherently exposed (the 'intrinsic' risks), while disregarding prevention and control systems.
- Assessing the quality of major risk prevention and mitigation measures, including their effectiveness in detecting and preventing major risks and/or their capacity to reduce their financial impact.
- Assessing the major risk exposure of each business unit or support function that remains once the risk prevention and mitigation measures are taken into account (the 'residual' risk), while disregarding insurance coverage.
- Correcting any deficiencies in risk prevention and mitigation measures and implementing corrective action plans.

As part of this exercise, major risks of a given scope are described using a double scale of impact and probability.

Inherent Risk

	Probability				
Impact	Rare	Unlikely	Possible	Likely	Almost Certain
Very High					
High					
Medium	1		3	1	
Low		7	8		
Very Low					

Residual Risk

	Probability				
Impact	Rare	Unlikely	Possible	Likely	Almost Certain
Very High					
High					
Medium					
Low	2	3			
Very Low	13	2			

**The values inside the heat map indicate the number of risks.*

Key Risk Indicators (KRI)

KRIs supplement the overall operational risk management system, by providing a dynamic view of changes in business line risk profiles as well as an early warning system to identify potential events that affect the day-to-day business activities and consequently have an impact on the entire Bank. Some of the KRIs monitored are given below:

System	Core Banking System Downtime
	ATM Downtime
	No. of cyber attacks
HR	Staff turnover
	No. of disciplinary actions
Finance	Reconciliations not submitted
Compliance	Issues raised by external professional bodies
Operational losses	Severity of losses
	Number of fraud incidents

KRIs that may have a significant impact on the entire Bank is reported to the Operational Risk Policy Committee and the Board Integrated Risk Management Committee.

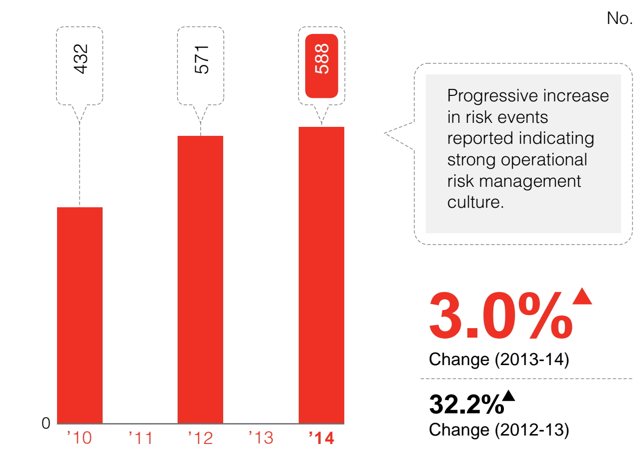
Internal Risk Events and Loss Data Collection

The Bank has been compiling a database of risk events and loss data reported since 2010 and maintained centrally to supplement the effectiveness of the operational risk management function. It has served to:

- Facilitate meeting capital adequacy requirements for operational losses set by the regulator.
- Identify trends in loss events and achieve a deeper understanding of risk areas.
- Enable operational staff to define and implement appropriate corrective actions.
- Sharpen the existing operational risk management concepts and tools.

Risk events reporting by the business units and support functions indicates the inculcating of a strong Operational risk culture through the line ORMs well-supported by the respective heads of units.

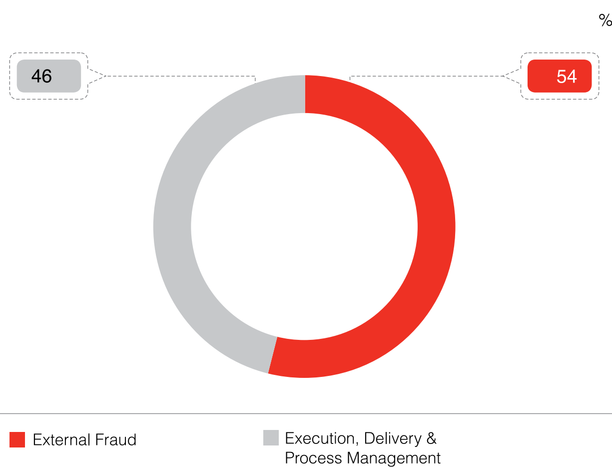
Risk Events Reported



The operational loss recognition follows a formal approval process defined in the Operational Risk Policy where both Gross and Net losses are recorded in the General Ledger and such losses above the value of LKR 100,000/- are reported to the Board Integrated Risk Management Committee on a monthly basis and losses over LKR 500,000/- are reported to the regulator on a quarterly basis.

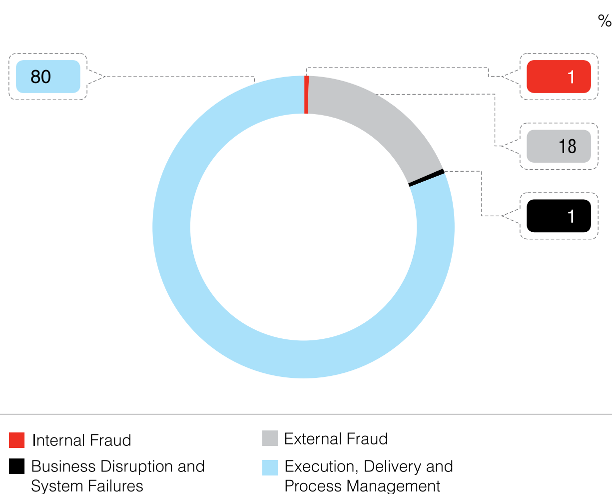
The Bank's classification of operational losses in seven Basel event categories is the cornerstone of its risk modelling, ensuring consistency throughout the system and enabling analysis across the Bank.

Operational Losses as per Basel II Loss Classification 2014



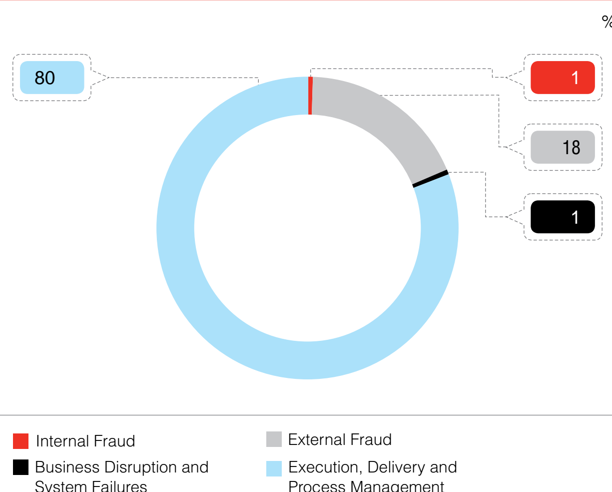
Operational Losses reported were pertaining to Retail Banking, Payment and Settlements and Trading and Sales.

Operational Losses as per Basel II Loss Classification 2013



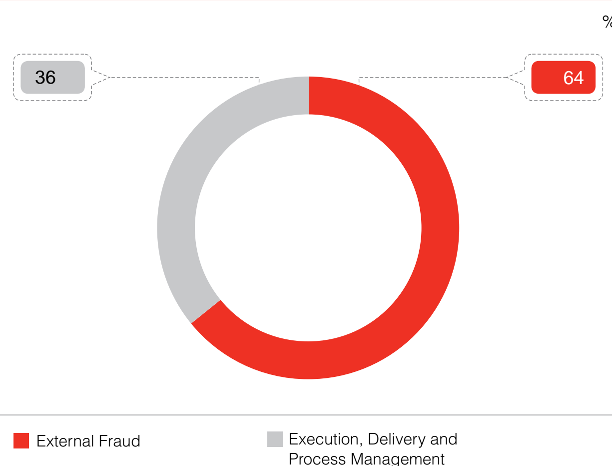
Operational Losses reported were pertaining to Retail Banking, Commercial Banking, Payment and Settlements and Trading and Sales.

Operational Losses as per Basel II Loss Classification (Retail Banking) 2013



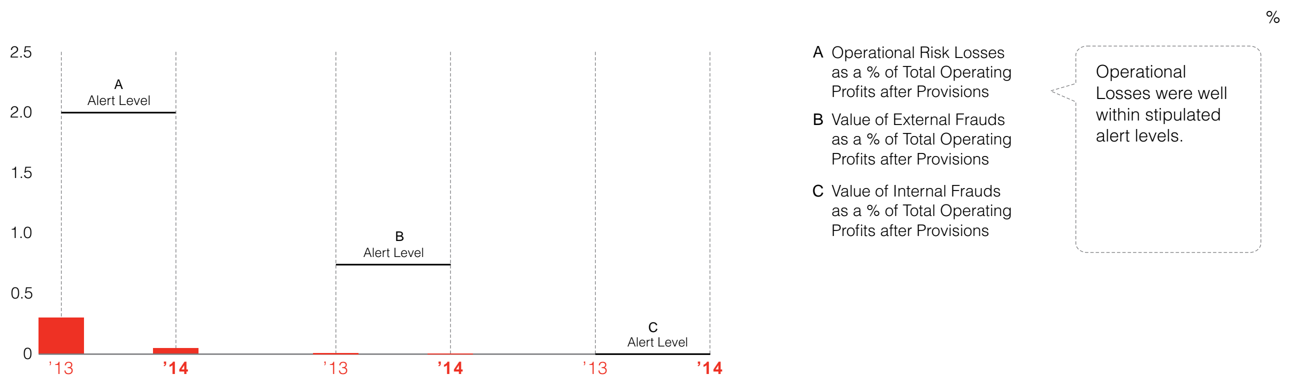
Losses reported under business lines, Commercial Banking and Payment and Settlement fall under ‘Business Disruption and System Failures’ while Trading and Sales losses fall under ‘Execution, Delivery and Process Management’.

Operational Losses as per Basel II Loss Classification (Retail Banking) 2014



All losses reported under business lines, Payment and Settlement and Trading and Sales fall under Basel loss category ‘Execution, Delivery and Process Management’.

Actual Operational Losses against Alert Levels



Business Continuity Planning and Crisis Management

In order to cover the risks of crisis that threaten the safety of staff, customers and service providers, the security of assets, the continuity of operations and confidence in the Bank's reputation, the Bank's Business Continuity Management Policy requires that a full set of up-to-date and exercised plans be in place encompassing a minimum of: Crisis Management Plan (CMP), Business Continuity Plan (BCP) and IT Disaster Recovery Plan (IT DRP) amongst other relevant plans including a Pandemic Plan.

These plans are drawn upon integrating Enterprise Risk Management (ERM) Framework and effective Business Impact Analysis (BIA) processes and methodologies which anticipates all forms of threats and/or crisis that are inherent in the Business Environment.

Communications, Security and Safety and other Emergency Response Teams and exercised plans are all part of the Banks' business continuity management commitment that is showcased undoubtedly within this framework.

The Governance of business continuity management is steered through the Crisis Management Team comprising of senior most management and co-ordinated by the Banks' Business Continuity Manager.

BCP Drills are carried out on a predetermined schedule which includes minimum of two full functional drills which includes all critical business units which is over and above the stipulated guidelines by the Central Bank of Sri Lanka. The statuses of drills are monitored at the Operational Risk Policy Committee and the Board Integrated Risk Management Committee.

Insurance Cover in Operational Risk Management

The Bank has a comprehensive insurance policy as a measure to mitigate risks. This falls within the framework of risk mitigation and control which in turn is an integral component of the risk management framework of the Bank. This policy will be reviewed and further enhanced in the near future.

Description of Coverage

General Risks

Building and their contents, including IT equipment, are insured at their replacement value. Liability other than professional liability (i.e., relating to operations, Directors, vehicles, etc.) is covered by insurance policies.

Risks Arising from Operations

Insurance is only one of the measures to offset the consequences of the risks inherent in the Bank's activity. It complements the risk monitoring policy led by the Bank and also by its internal controls.

Theft/Fraud

These risks are included in the 'Bankers Indemnity Cover' policy that insures all the Bank's financial activities around the country. Fraudulent actions by an employee or by a third party acting on its own or with the aid of an employee with the intent to obtain illicit personal gain or through malice are covered.

Professional Liability

The consequences of any legal action against staff or managers as a result of their professional activity are insured under the Bank's Bankers Indemnity Policy (BID).

Operating Losses

The consequences of any accidental interruptions to activity are insured under a Bank wide policy. This policy supplements the business continuity plans. The amounts insured are designed to cover losses incurred between the time of the event and the implementation of an emergency solution.

Computer Crime

The adverse consequences surfacing while using computer systems and software are covered by the Bank's BID policy. The policy covers fraudulent input and modification via computer systems, electronic computer programmes, electronic data and media, computer viruses, electronic and telefacsimile communications, electronic transmissions, electronic securities and voice incinerated transfers.

Outsourcing

The Bank is concerned and committed to ensuring that the outsourced parties continue to uphold and extend the high standard of customer care and service excellence that has become synonymous with the Bank. Hence due diligence tests are routinely carried out to assess the performance of these outsourced parties through a sub-committee established to monitor outsourced activities for the Bank.

Operational Risk Capital Measurement

Current Practice

Since 2009, the Bank has used the Basic Indicator Approach (BIA) as proposed by the Capital Requirements Directive, to measure operational risk. This approach notably makes it possible to:

- Gain an understanding of the risk exposures.
- Identify the impact on the Bank's risk profile and determine the overall capital requirements.
- Enhance the Bank's operational risk culture and overall management, by introducing a virtuous cycle of risk identification, management and mitigation.

The Bank holds capital for operational risk equal to the average over the previous three years of a 15% of positive annual gross income.

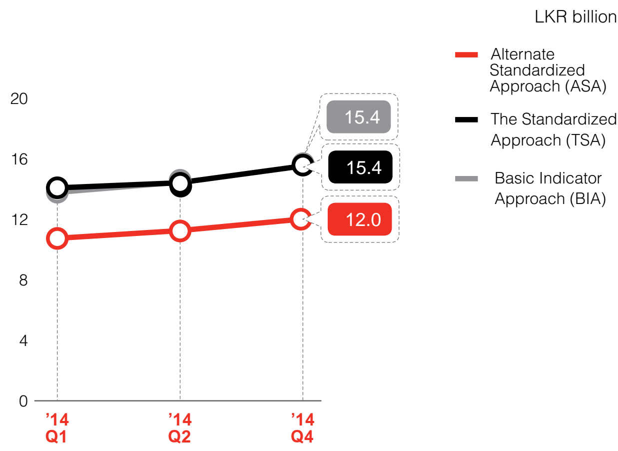
The Bank's regulatory capital requirements for operational risks within the scope of BIA (Basic Indicator Approach) requirements are calculated using the above stated formula. The Bank's capital requirements for operational risks were LKR 15.48 billion. at the end of 2014. The Bank has been conducting parallel computation of capital in terms of The Standardised Approach (TSA) with effect from December 2011 in line with the Draft Guidelines.

Future Outlook

With the issuance of new direction in 2014, Central Bank of Sri Lanka has awarded Banks that use BIA the option of moving to either the Standardized Approach (TSA) or the Alternate Standardised Approach (ASA) in order to improve the quality of operational risk management and to enhance the effectiveness of internal capital adequacy requirements.

As such, Bank has evaluated all 3 approaches in terms of relevance, economy and appropriateness to the risk profile. We remain committed to embrace any change that will serve the organization well in terms of improved quality of operational risk capital calculation and reporting.

Capital Charge Comparison



New Developments and Initiatives

Ebola Virus Disease

Circular/Instructions issued by the Ministry of Health on Ebola Virus Disease (EVD) have been circulated to all staff to educate them on transmission, symptoms, diagnosis and prevention even though any alerts pertaining to EVD outbreak for South Asian region has not been announced by the World Health Organization or any other Government institution. However, from Business Continuity Management perspective a 'Pandemic Plan' which consists of detailed response phases based on alerts from relevant authorities providing internal information and guidelines was drafted.

Other Risks

There may be other risks such as model risk, settlement risk and group risk, which may be relevant to the Bank but not captured in the risk appetite framework. The reasons for non-inclusion of same for the risk appetite framework are as follows:

Strategic Risk

Strategic risk is the most fundamental of business risks and at its very basic, can be defined as the current and prospective risk to earnings and viability arising from,

- Adverse changes in business environment with respect to the economy, political landscape, regulations, technology actions of competitors.
- Adverse business decisions.
- Improper implementation on at decisions.
- Lack of responsiveness to changes in the business environment.

Strategic risk for a bank like NDB can manifest itself through lack of well-defined long-term strategy but more importantly because of failure to appropriately communicate and implement the strategy or due to unforeseen changes in the socio-political, economic or business environment. Drawing of appropriate response plans to tweak the strategy to suit the changes in the business environment is essential to management of strategic risk.

The Bank has a well-formulated 5-year strategic plan, which is articulated by the Board and the corporate management. The strategic plans are drawn at various level of granularity e.g. a branch level strategy will detail the growth targets at branch level whereas a department level strategy will feature the achievement metrics at that level. The implementation of strategy is checked through monthly meetings where variances from the growth targets are analyzed and corrective actions recommended.

The strategic plan is also linked to individual employee performance through a goal setting process and periodic performance reviews are carried out to motivate employees and create a performance culture to ensure that business goals and objectives are achieved, thus mitigating strategic risk.

Reputational Risk Management

Reputation risk is risk of indirect loss (current or prospective) arising from one or multiple stakeholders adverse experience while dealing with the institution or which resulted in an adverse perception of the institution. It can also be understood as the potential that negative publicity regarding the Bank's business practices, whether true or not, will cause a decline in customer base, costly litigation or revenue reduction.

Reputation risk management and mitigation aspects are embedded in the Bank's policies and procedures, training programmes, the business continuity plan and through the Audit and Board Risk Management Committees.

The Bank monitors its reputation risk profile through a set of early warning indicators based on the reputation risk drivers and the factors within the reputation risk scorecard ensure that the overall reputation risk profile remains low. The risk mitigation and control processes for reputation risk at the Bank are designed to consider appropriate response actions to address the risks identified. A Customer Complaint Handling Process has been established under which the customers have a range of options through which they can forward their grievances to the Bank, by way of letters, using our public help line that is manned on a 24 - hour basis, through the Bank website or social media.

Legal Risk

Legal risk is understood more from its consequences, which is incurrence of penalties, fines and sometimes loss of reputation due to the institution being on the other side of law. Legal risk may vary from institution to institution depending on the manner in which it conducts its business and the documentation it follows and is closely related to compliance and regulatory risk.

Legal risk in the Bank can manifest itself through:

- Business not being conducted in accordance with applicable laws.
- Inadequate legal documentation of securities and collateral accepted for credit risk mitigation.
- Legal repercussions of lacunae in documents, forms, advertisements.
- Other modes of conduct and communication adopted by the Bank.
- Intellectual property not being adequately protected.

Legal risk is owned and managed by the Legal Department and the Legal Department is assisted by third party lawyers as and when necessary to obtain an independent opinion.

Compliance Risk

Very closely related with reputation and legal/ regulatory risk, compliance risk is defined as the risk of legal or regulatory sanctions, material financial loss, or loss to reputation and integrity an institution may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organizational standards, and codes of conduct applicable to its business activities. Bank is compliant with all CBSL regulations and thus the compliance risk is minimal.

The Bank has a well laid out Board approved Compliance Charter, which defines the fundamental principles, roles and responsibilities of the compliance function within the organisation as well as its relationship with senior management, the Board of Directors and the business and operational functions.

Model Risk

The Bank has just rolled out the new rating models for all business lines at both obligor and facility level and is in the process of rating the clients using the models. The Bank has also automated computation of Value at Risk (VaR) numbers for Market Risk. Similarly, the Bank intends to migrate to an Operational Risk VaR computation system in the future. Hence, with time, measures will be adopted to validate the models. Based on the above, the Bank would, assess the model risks once the Bank starts using models and advanced approaches in the future.

Settlement Risk

Settlement Risk refers to the risk arising on account of failed trades with counterparty banks in the foreign currency transactions. Settlement Risk arises from possible losses when the Bank is in a foreign exchange transaction pays the currency it sold but does not receive the currency it bought. Forward Contract settlement failures can arise from counterparty default, operational problems, and other factors. Settlement risk exists for any traded product. Currently, the Bank has a procedure for regular monitoring of limit utilisation, failed trades & excess monitoring. Settlement Risk is currently controlled by way of prudent allocation and monitoring of counterparty limits including Maximum Daily Delivery Risks (MDDR) limits for counterparts.

Stress Testing Methodology and Results

Item	Amount LKR million
Regulatory Capital	
Core Capital	19,888
Capital Base	28,932
Calculation of Risk-weighted Amount	
Credit Risk	172,070
Market Risk	9,596
Operational Risk	15,481
Calculation of Capital Adequacy Ratios (%)	
Core Capital	10.09
Total Capital Ratio	14.68
Stressed Capital Ratio	12.30

Credit Risk

Stress testing is the process of determining the effect of a change to a portfolio due to extreme realistic events. Management reviews the outcomes of the stress tests and where necessary determines, appropriate mitigating actions such as reviewing and changing risk appetite in order to manage the risks identified by potential stresses.

Credit Risk Scenarios

The Bank has implemented stress tests to measure the resilience of its lending portfolio to adverse movements by applying low, moderate and high impact shocks on hypothetical scenarios.

1. An increase in the NPLs in the loan book	
Revised CAR %	
2. A negative shift in NPL categories on the Bank's credit portfolio	
Revised CAR %	
3. Fall in FSV of mortgaged collateral in credit portfolio	
Revised CAR %	

Market Risk

Losses beyond the confidence level are not captured by certain models, which therefore gives no indication of the size of unexpected losses in these situations. This is complemented by regular stress testing of market risk exposures to highlight the potential risk that may arise from extreme market events that are rare but plausible.

Stress testing is an integral part of the market risk management framework and considers both historical market events and forward-looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in market liquidity that often occurs. Stress scenarios are regularly updated to reflect changes in risk profile and economic events. ALCO considers the results of stress tests as part of its supervision of risk appetite. Regular stress test scenarios are applied to interest rates, liquidity ratios, exchange rates, commodity prices and equity prices. Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the businesses.

	Scenario 1	Scenario 2	Scenario 3
	5% Increase	10% Increase	20% Increase
	14.6	14.5	14.3

	Scenario 1	Scenario 2	Scenario 3
	50% Increase	80% Increase	100% Increase
	14.5	14.4	14.4

	Scenario 1	Scenario 2	Scenario 3
	10% Decline	20% Decline	40% Decline
	14.7	14.6	14.6

Bank's Foreign Currency Net Open Position Stress Test Results As At 31 December 2014

Bank's net foreign currency position is tested on a daily basis under four stressed scenarios giving adverse shocks of 5%, 10%, 15% and 25% to the exchange rate to arrive at the maximum loss scenarios the Bank is exposed to and is monitored against the limits set.

Limit is set at the minimum level of shock (Scenario 1) as an early warning where the Bank will take action to ensure that it does not surpass the first level of shock and reach worse case scenarios.

As at 31 December 2014

	Net Position	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Magnitude of Shock (adverse)		5%	10%	15%	25%
Spot Rate movement	132.00	138.60	145.20	151.80	165.00
Position Profit/loss (LKR)	(774,327)	(5,110,556)	(10,221,112)	(15,331,668)	(25,552,781)

The stress results of the Bank's Overnight Net Open Position is managed well within the risk limit and monitored on a daily basis.

Liquidity Stress Test Results as at 31 December 2014

Liquidity stress testing is carried out under three different scenarios which covers Bank specific and system specific conditions, where different magnitudes of shocks are given to individual and or total Liquid Liabilities. The results are monitored against the limit and the minor level of result (at 5%) will be considered as the management action point.

The Bank managed to maintain a healthy Liquid Asset Ratio well above the internal limit which is more stringent than the regulatory limit even under the stressed scenarios.

Stress Testing for Liquidity Risk - December 2014				
Banks average Liquid Asset Ratio for the month		25.91		
Stress testing on Liquid Asset Ratio				
		Magnitude of Shocks on Liquid Asset Ratio.		
Scenario No.	Stress Scenarios	5%	10%	15%
		Revised LAR. after relevant shocks.		
1.	Adverse impact on MM and Institutional Borrowings/Drop in Market Liquidity	24.99	24.04	23.08
2.	Run down on CASA and Time Deposits	23.24	20.37	17.28
3.	Impact on Total Liquid Liabilities	22.25	18.21	13.73

Operational Risk

Scenario analyses primarily serve the purposes of contributing towards the capital calculation to cover operational risks and informing the Bank about potentially significant areas of risk. For the calculation of capital requirements, the Bank uses stress tests to measure its exposure to potential losses.

The Bank does its operational risk stress testing using two approaches:

- Operational Risk Value at Risk (OpVaR) based Stress Testing

This is calculated based on the Bank's internal loss data and using the Monte-Carlo simulation; however, the capital requirement based on OpVaR is less than operational risk capital calculated based on BIA approach. Hence, no additional capital is allocated.

- BIA - based Stress Testing

Stress scenario considers that 18% of stress has been applied on gross income and while comparing the same with BIA capital, 3% of additional stressed capital is required.