Disclosures on Risk Based Capital (Basel II)
Year Ended December 31, 2012

BRAC Bank Limited

1 Gulshan Avenue, Gulshan, Dhaka-1212, Bangladesh

Executive Summary

The Basel II disclosures presented in this document are related to BRAC Bank Limited (BBL) for the year ended December 31, 2012. These disclosures have been made in accordance with the Bangladesh Bank BRPD circular # 35 dated December 29, 2010 titled as the "**Guidelines on Risk Based Capital Adequacy**" for Banks in line with Basel II. The Basel II framework consists of the following three-mutually reinforcing pillars:

a. **Pillar I**: This prescribes minimum capital requirements for Credit Risk, Market Risk and Operational Risk.

b. **Pillar II**: This prescribes the Supervisory Review Process through which overall capital adequacy in relation to the risk profile is to be assessed.

c. **Pillar III**: This depicts Market Discipline and comprises a set of disclosures on the capital adequacy and risk management framework of the Bank.

These disclosures are intended for the market participants to assess key information about the BBL's exposure to various risks and to provide a consistent and understandable disclosure framework for easy comparison among other banks operating in the market.

1 Scope of Application

1.1 Qualitative Disclosure

BRAC Bank Limited has associated companies namely BRAC Asset Management Company Limited and BRAC Impact Ventures Limited and the four subsidiaries that are within the scope of application and inclusive of this disclosure. The subsidiaries are BRAC EPL Investments Limited, BRAC EPL Stock Brokerage Limited, b-Kash Limited, BRAC SAAJAN Exchange Limited (SWMTL), UK.

According to BRPD Circular-12, 24, 35 (dated March 29, 2010, August 03, 2010 & December 29, 2010 respectively), investments in subsidiaries have been consolidated for the purpose of assessing capital adequacy, the ratio of which is calculated both on Consolidated and Solo basis. The consolidated financial statements have been prepared in accordance with Bangladesh Accounting Standard 27: Consolidated financial statements and accounting for investments in subsidiaries.

1.2 Quantitative Disclosure

The assets, liabilities, revenue and expenses of the subsidiaries are combined with the BBL's consolidated audited financial statement as of year ended December 31, 2012 which ensures the elimination of inter-company transactions, balances and intra-group gains on transactions between group companies.

2. Capital Structure

2.1 Qualitative Disclosure

In Tier 1 Capital, 45% is Paid-up Capital with 34% is Statutory Reserve, 16% is Share Premium with remaining 5% being Retained Earnings.

2.2 Quantitative Disclosure

And in the Tier 2 capital 30% is General Provision with 7% being Asset Revaluation Reserve and 63% is Perpetual Subordinated Debt.

(Amount in Taka)

Particulars	Consolidated	SOLO
Tier – I (Core Capital)		
Fully paid up capital/ Capital deposited with BB	3,854,822,400	3,854,822,400
Statutory reserve	2,934,017,286	2,934,017,286
Non-repayable share premium account	1,740,102,253	1,406,000,000
General reserve	-	-
Retained Earnings	1,914,456,974	1,401,587,740
Minority interest in subsidiaries	449, 607,676	-
Share money deposit	23,741,603	-
Non-cumulative irredeemable preference shares	-	-
Dividend equalization accounts	-	-
Sub-total	**10,916,748,192**	**9,596,427,426**
Deductible from Tier – I (Core Capital)		
Book value of Goodwill	1,427,468,912	-
Shortfall in provision required against classified assets irrespective of any relaxation allowed	-	-
Deficit on account of revaluation of investment in AFS category	-	-
Any increase in equity capital resulting from a securitization transaction	-	-
Deferred tax income arising from "Loan loss provision"	945,577,274	945,577,274
Investment in subsidiary	-	-
Sub-total	**2,373,046,187**	**945,577,274**
Total Eligible Tier – I Capital	**8,543,702,006**	**8,650,850,152**
Tier – II (Supplementary Capital)		
General Provision	1,226,457,889	1,226,457,889
Asset revaluation reserve	279,060,563	279,060,563
Preference Share	-	-
Perpetual Subordinated debt	2,563,110,602	2,595,255,046
Sub-total	**4,068,629,054**	**4,100,773,498**
Total Eligible Tier – II Capital	**4,068,629,054**	**4,100,773,498**
Tier-III (Eligible for Market Risk only)		
Short term Subordinated Debt	-	-
Total Supplementary Capital	**4,068,629,054**	**4,100,773,498**
Total Capital	**12,612,331,059**	**12,751,623,649**

3. Capital Adequacy

3.1 Qualitative Disclosure

BRAC Bank Limited with its focused strategy on risk management has always been consistent in maintaining capital adequacy ratio above the regulatory requirements. BBL has been successfully managing the incremental growth of the Risk Weighted Assets by ensuring diversification of the portfolio in SME, retail and corporate segments. However, RWA is also managed by taking collaterals against its loans. BBL strives to extend its relationship with corporate clients having good credit rating. While computing the capital adequacy, BBL has applied Standardized Approach for Credit Risk and Market Risk and Basic Indicator Approach for Operational Risk.

3.2 Quantitative Disclosure

(Amount in Taka)

Description	Consolidated	Solo
Capital requirement for Credit Risk (10% of RWA)	10,066,377,917	9,058,925,479
Capital requirement for Market Risk	464,067,972	464,067,972
Capital requirement for Operational Risk	1,745,525,089	1,626,445,958
Total Capital Required	**12,275,970,978**	**11,149,439,409**
Capital Adequacy Ratio		
On core Capital (Against a standard of minimum 5%)	6.96%	7.76%
On actual Capital (Against a standard of minimum 10%)	10.27%	11.44%

4. Credit Risk

4.1 Qualitative Disclosure

Credit Risk: Credit risk is the risk of financial losses resulting from the failure by a client or counterparty to meet its contractual obligations to the Bank. Credit risk arises from the Bank's dealings with or lending to corporate, individuals, and other banks or financial institutions.

Corporate Credit Policy: BRAC Bank Limited is managing its Credit Risk through a Board directed and approved Corporate Credit Policy in line with the Bangladesh Bank Core Risk Management Guidelines, which outlined robust processes and procedures to ensure the quality of its assets portfolio. The Credit Policy also contains the general principles to govern the implementation of detailed lending procedures and risk grading systems of the borrowers. And, as such, it specifically addresses the areas of (a) Loan Originating; (b) Credit Approval; (c) Credit Administration; (d) Risk Management; and (e) Monitoring, Collection and Recovery activities.

Credit Risk Management: At BBL, a holistic approach towards risk management is taken, where socioeconomic and environmental impacts of the decisions made are emphasized upon. This particular practice is the hallmark of BRAC Bank's credit risk management objective. In the last couple of years, it has been focusing on adopting environmental risk management programs through the assistance, guidance, and/or requirements provided by IFC/ Shore Cap as well as regulatory guidelines. Bringing in social and environmental risk assessment into the credit approval process contributes to the wellbeing of the society. Moreover, as the lion share of the total revenue of BRAC Bank Limited comes from credit operations, particularly through SME Lending, so the future prospect of the Bank depends on quality of asset portfolio. Thus efficient management of the Loans and Advances is of paramount importance for the bank. To support our SME borrowers' businesses which are geographically spread-out all over the country including the rural areas, CRM centers have been established across the country. These centers perform an independent pre-approval visit to ensure credit-worthiness for the proposal to consider, hence covering 100% of the SME underwriting throughout the country.

There are differentiated and dedicated credit models for SME Banking, Retail Banking and Wholesales Banking working under CRM to ensure the quality asset growth of the bank while implementing the risk mitigation strategies for each portfolio. There is a distributed collection model that consistently follows up with the borrowers for the timely repayments. A wing named 'Special Asset Management (SAM)' deals with nonperforming assets through amicable settlement, execution of decrees and arrangements of auctions to sell the mortgaged properties. SAM is also engaged to monitor Early Alert Accounts. At BBL, we are very keen to identify, measure, monitor and control credit risk and ensure that adequate capital against these risks are maintained, at the same time they are satisfactorily compensated against the risk of potential losses.

Definition of Past due and Impaired Credit: Bank's provision for loans and advances is created based on the period of arrears by following Bangladesh Bank BRPD Circulars No. 16 of December 06, 1998, 09 of May 14, 2001, 09 and 10 of August 20, 2005, 05 of June 05, 2006, 8 of August 07, 2007, 10 of September 18, 2007, 05 of April 29, 2008, 32 of October 12, 2010, 14 of September 23, 2012 and 19 of December 27, 2012 respectively. This is also reviewed by the management as and when requisite.

(Amount in Taka)

Description	Consolidated	Solo
Capital charge for Credit Risk	**10,066,377,917**	**9,058,925,479**
On- Balance sheet	9,717,790,888	8,710,338,450
Off- Balance sheet	348,587,029	348,587,029

4.2. Quantitative Disclosure

a. Total Gross Credit Risk Exposure Broken down by Major Types of Credit Exposure

(Amount in Taka)

Overdrafts	4,710,164,722
Demand Loans	19,494,823,274
Term Loans	18,321,674,745
Lease Receivables	149,995,042
Small and Medium Enterprise	56,891,987,570
Credit Card	2,833,983,083
Staff Loans	620,673,330
Sub Total	**103,023,301,767**
Bill Purchased and Discounted	601,136,190
Total	**103,624,437,957**

b. Geographical Distribution, Broken down in Significant Areas by Major Types of Credit Exposures

(Amount in Taka)

Dhaka Division	69,986,225,886
Chittagong Division	16,698,358,818
Khulna Division	5,037,871,529
Sylhet Division	1,809,688,537
Barisal Division	2,437,352,934
Rajshahi Division	5,132,047,480
Rangpur Division	2,522,892,773
Total	**103,624,437,957**

c. Industry or Counterparty Type Distribution of Exposure Broken down by Major Types of Credit Exposure

(Amount in Taka)

Government	-
Private:	
Agriculture, Fishing, forestry and dairy farm	1,008,793,926
Industry (Jute, Textile, Garments, Chemical, Cement etc.)	13,912,549,341
Working Capital Financing	5,912,717,720
Export Credit	892,858,079
Commercial Credit	64,711,025,785
Small and Cottage industries	1,106,690,193
Miscellaneous	16,079,802,913
Total	**103,624,437,957**

d. Residual Contractual Maturity Breakdown of the Whole Portfolio, Broken down by Major Types of Credit Exposure

(Amount in Taka)

Repayable on Demand	19,658,566,821
More than 1 month to 3 months	11,396,250,882
More than 3 months to 1 year	24,645,013,575
More than 1 year to 5 years	37,825,673,561
More than 5 years	10,098,933,117
Total	**103,624,437,957**

e. By Major Industry or Counterparty Type. Amount of impaired loans and past due loans with provisions

(Amount in Taka)

Status	Outstanding Loans & Advances	Base for Provision	% of required provision	Required Provision
Unclassified				
All unclassified loans (except SME financing, Consumer financing, BHs/ MBs/ SDs ,Housing Finance and loans for professional)	35,050,277,071	35,050,277,071	1%	350,502,771
SME Financing	43,151,367,862	43,151,367,862	0.25%	107,878,420
Loans to BHs/MBs/SDs against shares etc	1,765,033,407	1,765,033,407	2%	35,300,668
Housing Finance and Loans for Professional	8,794,915,604	8,794,915,604	2%	175,898,312
Consumer Finance	3,589,290,911	3,589,290,911	5%	179,464,546
Special Mention Account (SMA)	3,015,779,003	3,015,779,003	5%	150,788,950
Sub Total				999,833,666
Classified – Specific Provision				
Substandard	1,434,071,781	1,262,859,835	20%	252,571,967
Doubtful	1,088,896,958	1,006,361,726	50%	503,180,863
Bad/ Loss	5,114,132,029	4,649,504,757	100%	4,649,504,757
Sub Total				5,405,257,587
Required Provision for Loans and Advances	**6,405,091,254**			
Total Provision Maintained			6,509,051,804	
Excess/ (Short) provision at December 31, 2012			103,960,550	

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f. Maintenance of Specific Provision and Movement of Non Performing Assets (NPAs)

(Amount in Taka)

Gross Non Performing Assets (NPAs)	7,637,100,768
NPAs to Outstanding Loans and Advances	7.37%
Movement of NPAs	
Opening Balance	**5,239,542,550**
Change over the period	2,397,558,218
Closing Balance	**7,637,100,768**
Movement of Specific Provision for NPAs	
Opening Balance	3,535,702,665
Provision made during the period	3,302,774,899
Write Off	1,321,883,649
Interest Waiver	-
Write back of excess provision	-
Closing Balance	5,516,593,915

5. Equities: Disclosure for Banking Book Positions

5.1 Qualitative Disclosure

All investment securities including acquisition charges associated with the investment are initially recognized at cost. Premiums are amortized and discount accredited, using the effective yield method and are taken to discount income. The valuation methods of Marking to Market for investment used are **i.** ***Held to Maturity (HTM)*** and by definition the investments which have "Fixed or determinable" payments and fixed maturity that the group has the positive intent and ability to hold to maturity ***ii. Held for Trading (HFT)*** is a method where investments are acquired principally for the purpose of selling or repurchasing or in short trading or if designated as such by the management. ***iii. Revaluation:*** According to DOS Circular no.-05, dated 26th May 2008, the HFT securities are revalued once each week using Marking to Market concept and the HTM securities are amortized once a year according to Bangladesh Bank guidelines. The HTM securities are also revaluated if they are reclassified to HFT category with the Board's approval.

5.2 Quantitative Disclosure

(Amount in Taka)

Unquoted Shares	
Particular	**Cost of holding**
Industrial and Infrastructure Development Finance Co. Ltd.	24,442,502
Central Depository Bangladesh Ltd.	6,277,770
BRAC EPL Investments Ltd.	752,715,794
BRAC EPSL Stock Brokerage Ltd.	1,344,147,500
B-Kash Ltd.	14,509,500
BRAC Asset Management Company Ltd.	12,500,000
BRAC Saajan Exchange Limited	59,388,531
Dun & Bradstreet Rating Agency of Bangladesh Limited	12,497,600
Documenta Limited	10,000,000
BRAC Impact Ventures Limited	4,800,000

Preference shares	
Summit Purbanchal & Uttaranchal Power Co Ltd	250,451,000

As on the reporting date i.e. December 31, 2012 BRAC Bank has a balance of unquoted investment as above with **BDT 250,451,000** as Preference shares.

(Amount in Taka)

Quoted Shares			
Particular	**Cost of holding**	**Market Value**	**Unrealized Gain/ Loss**
Ordinary shares	2,660,546,666	2,132,706,473	(527,840,193)

On the other hand, an amount of **BDT (527,840,193)** stood as **Unrealized Gain/Loss** as on reporting date December 31, 2012.

(Amount in Taka)

		At 10% of Market Value
General Market Risk	2,132,706,473	213,270,647
Specific Risk	2,132,706,473	213,270,647
Total capital charge		**426,541,295**

Against quoted equity investment amounting to **BDT 2,132,706,473**, capital charge of equity for specific and general market risk is **426,541,295** at 10% Risk Weight.

6. Interest Rate Risk in the Banking Book (IRRBB)

6.1 Qualitative Disclosure

a. Interest Rate Risk in the Banking Book (IRRBB)

It is the risk related to interest income arising from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities. Changes in interest rates affect the underlying value of the bank's assets, liabilities, and off-balance-sheet (OBS) instruments because the present value of future cash flows (and in some cases, the cash flows themselves) change when interest rates change.

b. Approach of Assessing IRRB

In BRAC Bank Limited, the Asset & Liability Management (ALM) unit under the supervision of Asset and Liability Committee (ALCO) is responsible for managing market risk arising from BRAC Bank's banking book activities. Our interest rate risk management involves the application of four basic elements in the management of assets, liabilities, and OBS instruments. These are (a) appropriate senior management oversight; (b) adequate risk management policies and procedures, (c) appropriate risk measurement, monitoring, and control functions; and d) comprehensive internal controls.

c. Techniques of Addressing IRRB

Following techniques for managing the IRRB in BRAC Bank Limited are applied:

i. **Re-pricing Schedules**: It is the simplest techniques for measuring a bank's interest rate risk exposure and that is generating a maturity/re-pricing schedule that distributes interest-sensitive assets, liabilities, and OBS positions into a certain number of predefined time bands according to their maturity (if fixed-rate) or time remaining to their next re-pricing (if floating-rate). Those assets and liabilities lacking definitive re-pricing intervals (e.g. sight deposits or savings accounts) or actual maturities that could vary from contractual maturities are assigned to re-pricing time bands according to the judgment and past experience of the bank.

ii. Gap Analysis: It helps to assess the interest rate risk of current earnings. To evaluate earnings exposure, interest rate-sensitive liabilities in each time band are subtracted from the corresponding interest rate-sensitive assets to produce a re-pricing "gap" for that time band. This gap is then multiplied by an assumed change in interest rates to yield an approximation of the change in net interest income that would result from such an interest rate movement.

ii. Duration: A maturity/re-pricing schedule is also used to evaluate the effects of changing interest rates on a bank's economic value by applying sensitivity weights to each time band. Typically, such weights are based on estimates of the duration of assets and liabilities that fall into each time band.

iv. Quarterly Stress Testing: It is conducted on quarterly basis as per the directives of Bangladesh Bank to gain better insight into the vulnerable issue of IRRB.

6.2 Quantitative Disclosure

Duration of Asset	1.23
Duration of Liability	0.3
Duration Gap (in Years)	0.95

7. Market Risk

7.1 Qualitative Disclosure

BRAC Bank Limited is exposed to Market Risk mostly stemming from the risks pertaining to interest rate related instruments and equities in the trading book and foreign exchange and commodity risk both in the banking and trading book.

a. Methods Used to Measure Market Risk
Standardized (Rule Based) Approach is used to measure the market risk as per the guidelines of Bangladesh Bank where, for Interest Rate Risk and Equity Risk both General and Specific risk factors are applied for calculating required capital charges against Market Risk.

b. Market Risk Management System

i. Asset Liability Management: Changes in market liquidity and or interest rate exposes Bank's business to the risk of loss. As such BRAC Bank Limited gives adequate emphasis so that the level of balance sheet risks is effectively managed. Appropriate policies and procedures have been established as per the guidelines of Bank's Board of Directors (BOD) including relevant circular guidelines of Bangladesh Bank to control and limit these risks and proper resources are available for the evaluation and control of these risks. The Asset Liability Committee (ALCO) of the bank monitors Balance Sheet and liquidity risk of the bank.

ii. Foreign Exchange Risk Management:
Treasury department is vested with the responsibility to measure and minimize the risk associated with bank's assets and liabilities including Foreign Exchange Risk. All Treasury functions are clearly demarcated between Treasury Front Office and Back Office. The Front Office is involved only in dealing activities while the Back Office is responsible for related support and monitoring functions. All the Treasury Front and Back Office personnel are guided as per Bangladesh Bank Core Risk Management guidelines. And they have separate and independent reporting lines to ensure segregation of duties and accountabilities. Dealing room is equipped with Reuter's information, voice screen recorder.

7.2 Quantitative Disclosure

(Amount in Taka)

The Capital requirement for	
Interest Rate Risk	0
Equity Position Risk	426,541,295
Commodity Risk	0
Foreign Exchange Risk	37,526,678

8. Operational Risk

8.1 Qualitative Disclosure

a. Operational Risk: Operation risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and system or from external events. This definition includes legal risk, but excludes strategic or reputation risk. The Board of Directors (BOD) of BRAC Bank Limited and its Management firmly believe that efficient management of operational risks always contribute to the earnings of the Bank and at the same time secure the interest of its customers and shareholders. To materialize this understanding into reality, there are dedicated risk management associates across the Bank that consistently work for managing the Operational Risks using effective tools and techniques implemented through polices and processes.

b. Performance Gap of Executive and Staff: To reduce knowledge gap and assist in the development of our personnel, user friendly Operations Manual have been developed and enclosed with functional processes for all employees who are the end users of these processes. This is a critical initiative for the Bank because having a mapped out process enables users to operate more efficiently, enhances knowledge amongst staff and fills in the holes in operations. All the policies and processes address clear responsibilities and accountabilities of all employees.

c. Mitigation of Operational Risk : In BRAC Bank, a dedicated department under the Risk Management Division (RMD) consistently works in Operational Risk identification, assessment and implementing appropriate risk mitigation strategies across the Bank. It helps to create awareness about various types of risks in the pan bank and enhances management of significant risk exposures by escalating all risk issues timely and concisely to the MANCOM and Enterprise Risk Management Committee (ERMC). The team works in collaboration with all the departments in the Bank for minimizing the Operational Risk exposures by collating information from key stakeholders of processes across all functions of the bank, Incident Reports, Potential Loss Reports, Internal Audit Reports, External Audit Reports and various other sources to identify gaps, risks, compliance and control failures to ensure reporting of significant risks and corporate governance issues. Such maintenance of a bank-wide risk management framework enables every department to independently identify, assess and respond to changes in the operating environment.

d. Enterprise Risk Management Committee (ERMC): Facilitation of Enterprise Risk Management Committee (ERMC) meeting, which takes place in every month to ensure Bank's risk governance and compliance with Bangladesh Bank directives for minimizing the Bank's enterprise level risk issues, is one of the core initiatives in pursuit of eliminating operational risk. ERMC is an independent body composed of Bank's Management Committee (MANCOM) Members which is also an extended supervisory management of the Board of Directors of BRAC Bank and works in strategy setting across the enterprise for the matters of risk management.

e. Approach for Calculating Capital Charges for Operational Risk: Basic Indicator Approach (BIA) is followed to calculate the capital charges for Operational Risk as per the guidelines of Bangladesh Bank. As per BIA, the capital charge for Operations Risk is a fixed percentage denoted by α (alpha) of average positive gross annual income of the bank over the past three years.

Conclusion

BRAC Bank set examples by smoothly facilitating any changes and creating enabling environment for other market players to get enlightened from their journey. In the year 2013, we wish to concentrate on the quality of our portfolio even more as we are committed to work for people, planet and profit. With the mindset to be a sustainable bank, we thoroughly assess every individual before boarding in as customer. While we intend to bolster the economic growth of our nation on ethical ground at the same time in the pursuit of excellence in service quality we constantly strive to inculcate service culture into DNA of all our employees and in the process create an enabling service environment for all.

8.2 Quantitative Disclosure

(Amount in Taka)

Year	Gross Income (GI)	Weight @15%	15% of Average GI
2012	11,463,703,611	15%	1,719,555,541
2011	10,758,869,719	15%	1,613,830,458
2010	10,306,345,820	15%	1,545,951,873
Positive Gross Income of three years			
	32,528,919,151	15%	1,626,445,958