Disclosures on Risk Based Capital (Basel II)

United Commercial Bank is subject to the risk based regulatory capital adequacy framework in line with Basel II has fully come into force from January 01, 2010 as stipulated by Bangladesh Bank. The Basel II framework consists of three-mutually reinforcing pillars:

Pillar 1: Minimum capital requirements for credit risk, market risk and operational risk
Pillar 2: Supervisory review of capital adequacy
Pillar 3: Market discipline

Market discipline (Pillar 3) comprises a set of disclosures on the capital adequacy and risk management framework of the Bank. These disclosures are intended for market participants to assess key information about the Bank's exposure to various risks and to provide a consistent and understandable disclosure framework for easy comparison among banks operating in the market.

Scope of Application

Pillar 3 disclosures apply to United Commercial Bank Limited as a single entity. The risk based regulatory capital adequacy framework is applied to Bank only Solo Basis as has no subsidiary. The Bank has computed the Capital Adequacy Ratio adopting the following approaches;

a. Standardized Approach for Credit Risk for computing Capital Adequacy under Basel II, using national discretion for:
    - Accepting the credit rating agencies as external credit assessment institutions (ECAI) for claims on Corporate Customers;
    - Accepting Credit Risk Mitigates (CRM) against the financial securities & guarantees of loan exposure.
b. Standardized (Rule Based) Approach for Market Risk and Basic Indicator Approach for Operational Risk.

Capital Structure:

The Bank's capital structure consists of Tier I capital and Tier II capital. Capital Structure of the Bank is as under as on December 31, 2010; **(Provisional)**

Eligible Capital

(BDT in Million)

Sl.	Particulars	Amount
1.	**Tier-1 (Core Capital)**	
1.1	Fully Paid-up Capital	2,909.95
1.2	Statutory Reserve	2,567.62
1.3	General Reserve	91.58
1.4	Retained Earnings	1,436.12
	Sub-Total:	**7005.27**

2.	**Tier-2 (Supplementary Capital)**	
2.1	General Provision (Unclassified Loans + SMA + Off Balance Sheet Exposure)	1,551.08
2.2	Assets Revaluation Reserves up to 50%	228.24
2.3	Revaluation Reserve for Securities up to 50%	170.75
2.4	Revaluation Reserve for equity instruments up to 10%	117.57
	Sub-Total	**2,067.64**
	Total Eligible Capital	**9,072.91**

Capital Adequacy

For accessing Capital Adequacy the Bank has adopted Standardized Approach for Credit Risk, Standardized (Rule Based) Approach for Market Risk and Basic Indicator Approach for Operational Risk. Capital Requirement and Adequacy of the Bank as on December 31, 2010 are as under;

(BDT in million)

Capital requirement for Credit Risk	125,648.63
Capital requirement for Market Risk	8,836.81
Capital requirement for Operational Risk	9,595.61
Total Capital Requirement under Pillar-I	12,967.25
Tier 1 Capital Adequacy Ratio:	4.86
Tier 2 Capital Adequacy Ratio:	1.44

Credit Risk

Credit risk is defined as the probability that a borrower or counterparty may fail to meet its obligations in accordance with the agreed terms and conditions. In other words, it is the loss associated with degradation in the credit quality of borrowers or counterparties. In a Bank's portfolio, losses stem from outright default due to the inability or unwillingness of the customer or counterparty to meet commitments in relation to lending, trading, settlement and other financial transactions. Alternatively, losses result from reduction in portfolio value arising from actual or perceived deterioration in credit quality. Credit risk emanates from a bank's on and off balance sheet dealings with an individual, firm, company, corporate entity, bank, financial institution or a sovereign.

Methods used to measure Credit Risk

As per Central Bank's Guidelines, the Bank follows Standardized Approach for measurement of Credit Risk adopting the credit rating agencies As External Credit Assessment Institutions (ECAI) for claims on Corporate Customers and Credit Risk Mitigates (CRM) against the financial securities & guarantees of loan exposure.

Credit Risk Management

The global economic crisis has radically changed the credit risk environment not only of the developed countries but also of the emerging and developing countries. The economy has slumped with loan defaults soaring around the world. The Board of Directors and the Management play their due role to manage the credit risk efficiently amid this credit crunch. UCBL manages its credit risk in the following manner:

Credit Risk Management Policy Given the fast changing dynamic global economy and the increasing pressure of globalization, liberalization, consolidation and disintermediation, United Commercial Bank has a robust credit risk management policy and procedures that are sensitive and responsive to these changes. A clearly defined, well-planned, comprehensive and appropriate Credit Risk Management Policy of the Bank provide a board guideline for the Credit Operation towards efficient management of its Credit portfolio.
Delegation of Credit Approval Credit approval authorities are carefully segregated between CRM and the Business Units with appropriate level of management for check and balance between control and business consideration. Proper delegation of credit approval ensures full transparency and accountability at all levels.
Credit Quality and Portfolio Diversification The well practiced 5Cs principles of Credit i.e. Character, Capacity, Capital, Conditions and Collateral are followed professionally in the credit evaluation stage. Evaluation of repayment ability, character of financial discipline and its key personnel, financial health of the borrower and other qualitative and quantitative information are gathered so that credit facilities are allowed in a manner so that Bank's optimum asset quality is ensured. Concentration of credit is carefully avoided to minimize risk. Credit Lines have been segregated focusing on regulatory requirements and with respect to sector, industry, geographical region, maturity, size, economic purpose etc.
Large Loan limit and Credit Facility on business Consideration The Bank watchfully avoids name lending. Credit facility shall be allowed absolutely on business consideration after conducting due diligence. No credit facility is allowed simply considering the name and reputation of the key person of the borrowing company. In all cases, viability of business, credit requirements, and security offered, cash flow and risks level are meticulously and professionally analyzed.
Separation of Credit Administration Credit Administration Division has been segregated from Credit Risk Management Division in line with Central Bank's Guidelines. CRMD assess credit risks and suggest mitigations before recommendation of every credit proposal whereas Credit Administration confirms that adequate security documents are in place before disbursement.

Early Warning system Performance of loans is regularly monitored to trigger early warning system to address the loans whose performance show any deteriorating trend. It enables the Bank to grow its credit portfolio in a sustainable way to ensure higher quality and lower risk with the ultimate objective to protect the interest of depositors and shareholders.
Provision For Classified Loans and Advances, Bank maintains enough provision. Thus, the Bank has adequate shock absorbing capacity in case of loss of impaired assets.
Independent Internal Audit and Board Audit Cell Internal Control and Compliance Division (ICCD) independently verifies and ensures, at least once in a year, compliance with approved lending guidelines, Bangladesh Bank guidelines, operational procedures, adequacy of internal control and documentation. Board Audit Division directly reports to the Board/Audit Committee the overall quality, performance, recovery status, risks status, adequacy of provision of loan portfolio for information and guidance.
Creating Credit Risk Awareness Culture Strong emphasis has been placed to create credit risk awareness among all lending employees within the Bank. Awareness programs have been conducting regularly to create a risk-conscious culture and empower them with the capability to identify, control and manage Credit Risks more effectively.

Geographical Distribution of Credit Exposure

(BDT in million)

DIVISION	AMOUNT	%
Dhaka	64,925.80	69.47%
Chittagong	18,348.69	19.63%
Khulna	4,467.56	4.78%
Rajshahi	3,682.63	3.94%
Sylhet	1,836.61	1.97%
Barisal	199.08	0.21%
TOTAL	93,460.37	100.00%

Industry Type Distribution of Exposure

(BDT in million)

RMG & accessories	7,956.65	8.51%
Textile industries	4,080.63	4.37%
Agriculture	334.05	0.36%
Food products & processing	1,151.41	1.23%
Jute industries	770.53	0.82%

Leather & leather products	46.28	0.05%
Paper & paper products industries	2,351.94	2.52%
Wood & wooden products	579.31	0.62%
Chemical & chemical products	1,207.84	1.29%
Cement industries	249.64	0.27%
Glass & glassware product industries	2.53	0.00%
Brick field, auto bricks, tiles	409.21	0.44%
Engineering, basic metal & products	2,865.24	3.07%
Ship re-cycling	471.39	0.50%
Educational institute, hotel, restaurant	943.35	1.01%
Telecommunication	993.20	1.06%
Transport & communication	2,707.57	2.90%
Diagnostic/medical/clinic	782.90	0.84%
Housing industry	6,269.80	6.71%
Construction (other than housing)	5,993.93	6.41%
Tea manufacturing	176.43	0.19%
Electronics media	184.72	0.20%
Power & energy	985.61	1.05%
Commercial trade financing	28,720.71	30.73%
Others	23,225.49	24.85%
	93460.37	**100.00%**

Residual Contractual Maturity wise Distribution of Exposure

(BDT in Million)

Particulars	Amount
Upto 1 Month	13,563.28
Over 1 Month Upto 3 Month	13,516.44
Over 3 Month Upto 12 Month	30,105.88
Over 1 year Upto 5 Years	24,763.92
Over 5 Years	11,510.85
Total	93,460.37

Loans & Advances and Provision

(BDT in Million)

	Outstanding Loans & Advances	Provision against Loans & Advances
Total Loans and Advances	93,460.37	1,476.63
Un-Classified Loans & Advances	92,341.39	1,143.08
Classified Loans and Advances	1,118.98	333.55
Substandard (SS)	246.39	6.65
Doubtful (DF)	145.99	36.06
Bad/Los (BL)	726.61	290.84

Equities: Disclosures for Banking Book Positions

(BDT in Million)

	Cost Price	Market Price
Investment in Quoted Share	1,682.56	2,858.21

Realized Gains	882.70
Unrealized Gains	1,280.19
Unrealized Losses	104.54
Net Unrealized Gains	1,175.65
Amount included in Tier-2 Capital	117.57

Capital requirement for Equity Risk (Specific & General)	514.50
Supervisory Provision against Classified Equity Investment	104.60

Interest Rate Risk in the Banking Book

Interest Rate Risk in the Banking Book reflects the changes in the financial position of the Bank including potential loss that the bank faces in the event of change in market interest rate. This has an impact on earning of the bank through Net Interest Earning as well as on Market Value of Equity or net worth.

Thus this risk would have an impact on both earning potential and economic value of the Bank.

a) The Bank uses following measures for deriving value of capital requirement for interest rate risk.

  i) Modified duration gap

  ii) Simulation on market value of equity

  iii) Impact of average interest rate fluctuation demonstrated in last 12 months from the date of computation. In the event of lack of data for last twelve month the bank considers data of maximum period available.

b) The Bank ensures that interest rate risk is not included within the market risk.

Market Risk

Market risk is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices. The market risk positions subject to the risks pertaining to interest rate related instruments and equities in the trading book and Foreign exchange risk and commodities risk throughout the Bank. Signifies the risk of loss arising out of decrease in market portfolio arising out of market risk factors. The bank has considered interest rate risk on banking book separately and the impact of interest rate risk on the trading book will not be considered here.

Methods used to measure Market Risk:

Standardized (Rule Based) Approach is used to measure the Market Risk of the Bank whereas for Interest Rate Risk and Equity Risk both General and Specific risk factors are applied for calculating capital charge and for Foreign Exchange and Commodities only General risk factor is applied.

Capital Charges for Market Risk

(BDT in Millions)

Sl.	Market Risk	Capital Charge
A.	Interest Rate Related instruments	251.90
B.	Equities	514.50
C.	Foreign Exchange Position	28.90
D.	Commodities	-
	Total	**795.30**

Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Recognizing the importance of information technology in banking business, the Bank has considered information technology risk as an independent risk.

The Bank has a separate Operational Risk policy addressing specific issues involving Operational Risk.

Methods used to measure Operational Risk:

Basic Indicator Approach is used to measure Operational Risk where capital charge is 15% on three years average gross income of the Bank.

Capital Charges for Operational Risk

(BDT in Millions)

Sl.	Operational Risk	2008	2009	2010	Capital Charge
	Gross Income	4,217.66	5,192.05	7,862.47	863.61