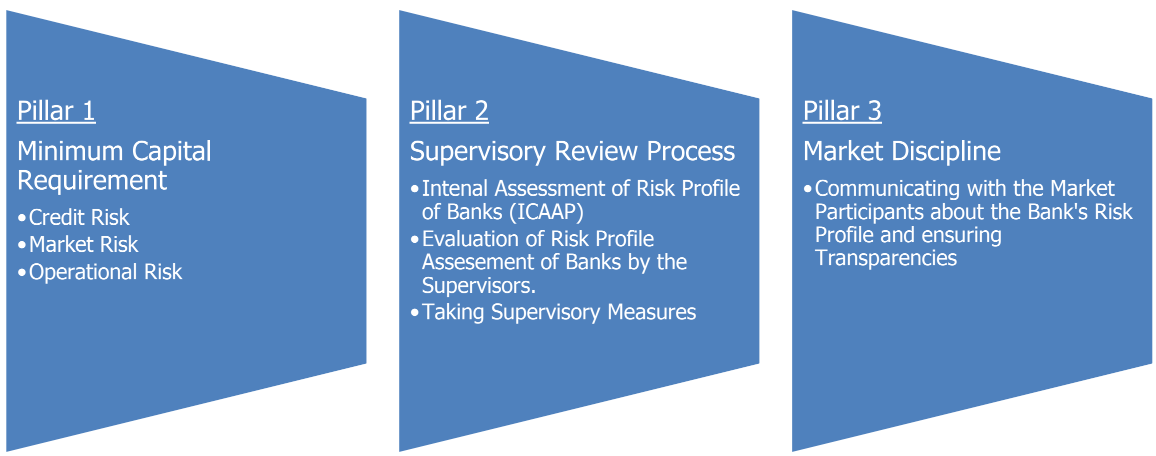
Disclosures on Risk Based Capital (Basel II)

The Market Disclosure on risk based capital adequacy framework has been prepared in accordance with the Bangladesh Bank's BRPD Circular no. 24 dated August 03 of 2010 regarding the Guidelines on 'Risk Based Capital Adequacy of Banks' under Basel II framework.

Risk based capital adequacy in line with Basel II framework has fully come into force from January 01, 2010 as stipulated by Bangladesh Bank. Under the framework Minimum Capital Requirement, Supervisory Review Process and Market Disclosure requirements must be followed by all the scheduled banks of Bangladesh as for regulatory compliance. The Basel II framework consists of three-mutually reinforcing pillars:



Under Pillar 1 of this framework, the Bank considers only three types of risk; namely Credit Risk, Market Risk & Operational Risk and measures the minimum capital requirement against these risks. In case of identifying both credit and market risk, the Bank resorts to the Standardized Approach. For measuring the operational risk, Basic Indicator Approach is followed.

Under Pillar 2, the Basel II Framework addresses all other risks that are not considered in the Pillar I. Here the Bank assesses the risks under ICAAP for measuring the Additional Capital Requirement. The supervisor will evaluate the risk assessment process of the Bank and give directions to the acceptability process.

Under Pillar 3 of the framework, Market discipline 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 as well as in a consolidated form. The risk based regulatory capital adequacy framework is applied to Bank both on Solo Basis as well as on Consolidated Basis.

- 'Solo Basis' refers to all position of the Bank including the Offshore Banking Unit.
- 'Consolidated Basis' refers to all position of the Bank and its subsidiary companies.

The consolidated financial statements of UCBL consists of the statements of:

- United Commercial Bank Limited
- UCB Securities Limited
- UCB Investment Limited

UCB Securities Limited

Among the two subsidiaries, UCB Securities Limited has been fully consolidated with the Bank. It was incorporated in Bangladesh as a private limited company with limited liability as on the January 28 of 2010 under the Company Act 1994. The company has commenced its operations in small scale. In case of Solo Basis, the investment in UCB Securities Ltd is grouped as Venture Capital Investment in calculating the credit risk of balance sheet exposure. In the process of consolidating the UCB Securities Ltd, the assets of this subsidiary has been consolidated under credit risk of balance sheet exposure.

UCB Investment Limited

The UCB Investment Ltd, the second subsidiary of the Bank, was incorporated as a private limited company as on the August 03 of 2011 under the Company Act 1994. This subsidiary is yet to commence its regular operation and identified as an inactive one. For this reason, the Bank's investment in this subsidiary has been treated as allowable deduction for regulatory capital calculation in calculating the capital adequacy of the Bank on Solo basis.. However, in case of Consolidated form of capital adequacy measurement, the impact of UCB Investment Ltd has been ignored.

The Bank has computed the Capital Adequacy Ratio adopting the following approaches;

a. Standardized Approach for Credit Risk to compute 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.

b. Standardized (Rule Based) Approach for Market Risk and Basic Indicator Approach for Operational Risk.

Capital Structure

The structure of the capital base of the Bank is comprised of both Tier I and Tier II capital.

Tier I Capital

The highest quality of capital components comprises the Tier I capital. This is also known as Core Capital. The components of Tier I capital are:

- Paid-up capital
- Non-repayable share premium account
- Statutory reserve
- General reserve
- Retained earnings
- Minority Interest in subsidiaries
- Non-cumulative irredeemable preference shares
- Dividend equalization account

Tier II Capital

The components of Tier II capital lacks some quality of Tier I capital, but strengthen the capital base of the Bank. This includes:

- General Provision
- Asset Revaluation Reserve
- All other preference shares
- Subordinated debt with remaining maturity of more than 5 years
- Exchange equalization account.
- Revaluation reserves for securities
- Revaluation reserves for equity instruments.

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, 2011;

Eligible Capital

(BDT in million)

Sl.	Particulars	Solo	Consolidated
1.	**Tier-1 (Core Capital)**		
1.1	Fully Paid-up Capital	7,274.88	7,274.88
1.2	Statutory Reserve	3,594.28	3,594.28
1.3	Non-repayable Share premium account	1,454.98	1,454.98
1.4	General Reserve	26.58	26.58
1.5	Retained Earnings	1,977.32	1,974.08
	Sub-Total:	**14,328.04**	**14,324.80**
	Allowable Deduction:		
	Investment in Subsidiaries	50.00	0.00
	Total Tier I Capital	**14,278.04**	**14,324.80**

Sl.	Particulars	Solo	Consolidated
2.	**Tier-2 (Supplementary Capital)**		
2.1	General Provision (Unclassified Loans + SMA + Off Balance Sheet Exposure)	1,820.09	1,820.09
2.2	Assets Revaluation Reserves up to 50%	741.62	741.62
2.3	Revaluation Reserve for Securities up to 50%	76.19	76.19
2.4	Revaluation Reserve for equity instruments up to 10%	11.12	11.12
	Sub-Total	**2,649.02**	**2,649.02**
	Allowable Deduction:		
	Investment in Subsidiaries	50.00	0.00
	Total Tier II Capital	**2,599.02**	**2,649.02**
	Total Eligible Capital	**16,877.06**	**16,973.82**

Capital Adequacy

For accessing Capital Adequacy the Bank has adopted Standardized Approach for Credit Risk measurement, Standardized (Rule Based) Approach for Market Risk measurement and Basic Indicator Approach for Operational Risk measurement. Capital Requirement and Adequacy of the Bank as on December 31, 2011 are as under;

(BDT in million)

Particulars	Solo	Consolidated
Capital requirement for Credit Risk	13,761.08	13,763.48
Capital requirement for Market Risk	631.57	631.57
Capital requirement for Operational Risk	1,130.54	1,130.54
Total Capital Requirement under Pillar-I	15,523.19	15,525.60
Tier 1 Capital Adequacy Ratio:	9.20	9.23
Tier 2 Capital Adequacy Ratio:	1.67	1.70

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.

Past Due/Impaired Loans

Bank classifies loans and advances (loans and bill discount in the nature of an advance) into performing and non-performing loans (NPL) in accordance with the Bangladesh Bank guidelines in this respect. An NPA (impaired0 is defined as a loan or an advance where interest and/ or installment of principal remain overdue for more than 90 days in respect of a Continuous credit, Demand loan or a Term Loan etc.

Classified loan is categorized under following 03 (three) categories:

1. Sub-standard
2. Doubtful
3. Bad & Loss

Any continuous loan will be classified as:

- 'Sub-standard' if it is past due/over due for 6 months or beyond but less than 9 months.
- 'Doubtful' if it is past due/over due for 9 months or beyond but less than 12 months.
- 'Bad/Loss' if it is past due/over due for 12 months or beyond.

Any Demand Loan will be classified as:

- Sub-standard' if it remains past due/overdue for 6 months or beyond but not over 9 months from the date of claim by the bank or from the date of creation of forced loan.
- Doubtful' if it remains past due/overdue for 9 months or beyond but not over 12 months from the date of claim by the bank or from the date of creation of forced loan.
- Bad/Loss' if it remains past due/overdue for 12 months or beyond from the date of claim by the bank or from the date of creation of forced loan.

In case of any installment(s) or part of installment(s) of a Fixed Term Loan is not repaid within the due date, the amount of unpaid installment(s) will be termed as `defaulted installment'.

In case of Fixed Term Loans, which are repayable within maximum five years of time:

- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 6 (six) months, the entire loan will be classified as ''Sub-standard''.
- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 (twelve) months, the entire loan will be classified as ''Doubtful''.
- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 18 (eighteen) months, the entire loan will be classified as ''Bad/Loss''.

In case of Fixed Term Loans, which are repayable in more than five years of time:

- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 (twelve) months, the entire loan will be classified as "Sub-standard".
- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 18 (eighteen) months, the entire loan will be classified as "Doubtful".
- If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 24 (twenty four) months, the entire loan will be classified as "Bad/Loss".

Approaches followed for Specific & General Allowances and Statistical Methods

As per the guideline of Bangladesh Bank regarding the provisioning of loans & advances, the Bank has followed the following approaches in calculating the Specific & General Allowances:

Types of Loans & Advances		Provision				
		UC	SMA	SS	DF	BL
Consumer	House Building & Professionals	2%	5%	20%	50%	100%
	Other than Housing Finance & Professionals to setup business	5%	5%	20%	50%	100%
Provision for loan against shares		2%	5%	20%	50%	100%
Short term Agri. Credit and Micro Credit		5%	5%	20%	50%	100%
Small & Medium Enterprise Finance		1%	5%	20%	50%	100%
Others		1%	5%	20%	50%	100%

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 provides a board guideline for the Credit Operation towards efficient management of its Credit portfolio.

Delegation of Credit Approval

Major credit exposures to individual borrowers, groups of connected counterparties and portfolios of retail exposures are reviewed by the Head Office Credit Committee (HOCC) and HOCC recommend the loan to the approval authority. All credit approval authorities are delegated by the Board of Directors to executives based on their capability, experience & business acumen. Credit origination and approval roles are segregated in all cases. 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.

Credit Monitoring and Early Warning system

The Bank regularly monitors the performance of loan portfolio and external events both at branch level as well as on head office level. The HOCC & PAMC meets regularly to assess the impact of external events and trends on the credit risk portfolio and to define and implement our response in terms of appropriate changes. Action trigger point has been set to identify accounts according to Early Warning system to address the loans whose performances show any deteriorating trend. Recovery division has been given the responsibility to handle these delicate issues with caution. 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.

Distribution of Credit Exposure by Major Types

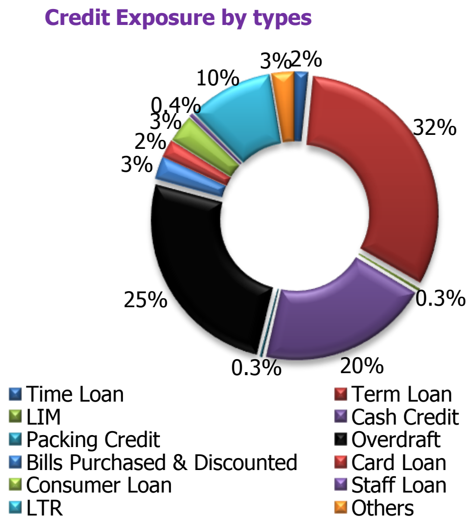
(BDT in million)

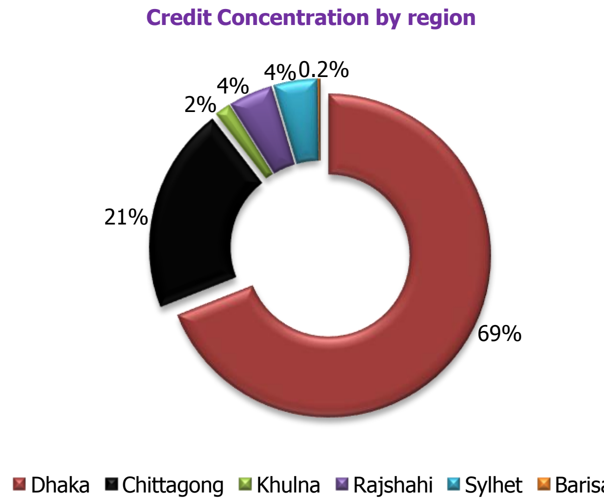
Types of Credit Exposure	Amount	%
Time Loan	1,732.11	1.50%
Overdraft	29,290.80	25.36%
Cash Credit	23,012.35	19.92%
Term Loan	36,697.34	31.77%
LTR	11,327.07	9.81%
LIM	370.62	0.32%
Packing Credit	312.72	0.27%
Demand Loan	9.20	0.01%
Bills Purchased & Discounted	3,044.62	2.64%
Card Loan	2,400.33	2.08%
Consumer Loan	3,773.67	3.26%
Staff Loan	506.82	0.44%
Others	3,028.68	2.62%
Total	**115,506.33**	**100.00%**

Geographical Distribution of Credit Exposure

(BDT in million)

DIVISION	AMOUNT	%
Dhaka	79,724.51	69.02%
Chittagong	23,681.03	20.50%
Khulna	1,843.70	1.60%
Rajshahi	5001.94	4.33%
Sylhet	4978.45	4.31%
Barisal	276.70	0.24%
TOTAL	**1,15,506.33**	**100.00%**





Industry Type Distribution of Exposure

Types of Credit Exposure	Amount (in million Taka)	%
RMG & accessories	8,168.41	7.07%
Textile industries	5,454.70	4.72%
Agriculture	817.26	0.71%
Food products & processing	5,752.88	4.98%
Jute industries	875.44	0.76%
Leather & leather products	142.72	0.12%
Paper & paper products industries	2,460.42	2.13%
Wood & wooden products	268.50	0.23%
Chemical & chemical products	2,280.24	1.97%
Cement industries	336.45	0.29%
Glass & glassware product industries	41.04	0.04%
Brick field, auto bricks, tiles	532.84	0.46%
Engineering, basic metal & products	2,442.74	2.11%
Ship re-cycling	68.75	0.06%
Educational institute, hotel, restaurant	533.45	0.46%
Telecommunication	1,370.37	1.19%
Transport & communication	4,309.20	3.73%
Diagnostic/medical/clinic	946.71	0.81%
Housing industry	11,478.38	9.94%
Construction (other than housing)	7,087.50	6.14%
Tea manufacturing	0.00	0.00%
Electronics media	226.40	0.20%
Power & energy	1,715.22	1.48%
Commercial trade financing	33,824.91	29.28%
Others	24,371.80	21.10%
Total	**115,506.33**	**100.00%**

Residual Contractual Maturity wise Distribution of Exposure

(BDT in Million)

Particulars	Amount
Upto 1 Month	14,407.00
Over 1 Month Upto 3 Month	23,776.98
Over 3 Month Upto 12 Month	36,890.45
Over 1 year Upto 5 Years	29,220.80
Over 5 Years	11,211.10
Total	**115,506.33**

Loans & Advances and Provision

(BDT in Million)

	Outstanding Loans & Advances	Provision against Loans & Advances
Total Loans and Advances	115,506.33	2,177.14
Un-Classified Loans & Advances	113,438.78	1,417.48
Classified Loans and Advances	2,067.55	759.66
Substandard (SS)	256.68	14.88
Doubtful (DF)	460.93	146.54
Bad/Los (BL)	1,349.94	598.24

Equities: Disclosures for Banking Book Positions

The major portion of the Bank's holding of equity exposure is mainly with the purpose of capital gain.

The quoted shares are valued both at cost price and market price basis. However, the unquoted shares are valued at their cost price.

(BDT in Million)

	Cost Price	Market Price
Investment in Quoted Share	2,302.63	2,413.81

	Amount
Realized Gains	273.82
Unrealized Gains	629.11
Unrealized Losses	517.93
Net Unrealized Gains	111.18
Amount included in Tier-2 Capital	11.12

Capital requirement for Equity Risk (Specific & General)	482.76
Supervisory Provision against Classified Equity Investment	0.00

Capital Requirement as per Grouping of Equity:

(BDT in Million)

Sector	Cost Price	Market price	Capital Charge for Specific Risk	Capital Charge for General Risk	Total Capital Charge
Bank	276.49	437.33	43.73	43.73	87.47
Bond	80.01	88.48	8.85	8.85	17.70
Cement	122.14	98.72	9.87	9.87	19.74
Ceramics	125.91	69.53	6.95	6.95	13.91
Engineering	150.5	116.27	11.63	11.63	23.25
Food & Allied	26.69	17.81	1.78	1.78	3.56
Fuel & Power	262.97	204.28	20.43	20.43	40.86
Information Technology	1.26	1.26	0.13	0.13	0.25
Insurance	89.17	74.25	7.43	7.43	14.85
Investment	429.83	346.07	34.61	34.61	69.21
NBFI	89.21	306.39	30.64	30.64	61.28
Others	0.05	0.05	0.01	0.01	0.01
Pharmaceuticals & Chemicals	342.38	230.8	23.08	23.08	46.16
Service	114.52	45.34	4.53	4.53	9.07
Telecom	150.3	342.81	34.28	34.28	68.56
Textile	31.16	24.86	2.49	2.49	4.97
Travel & Leisure	10.04	9.56	0.96	0.96	1.91
Total	**2,302.63**	**2,413.81**	**241.38**	**241.38**	**482.76**

Interest Rate Risk in the Banking Book

Interest Rate Risk in the Banking Book reflects the shocks to the financial position of the Bank including potential loss that the bank may face in the event of adverse 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 a trading book concept. It may be 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 due to 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.
The Board approves all policies related to market risk, sets limits and reviews compliance on a regular basis. The objective is to provide cost effective funding last year to finance asset growth and trade related transaction.

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.

Management System of Market Risk:
The duties of managing the market risk including liquidity, interest rate and foreign exchange risk lies with the Treasury Division under the supervision of ALCO committee. The ALCO committee is comprised of senior executives of the Bank, who meets at least one time in a month during the ALCO meeting. The committee evaluates the current position of the Bank and gives directions to mitigate the market risk exposure to a minimum level.

Capital Charges for Market Risk

(BDT in Millions)

Sl.	Market Risk	Capital Charge
A.	Interest Rate Related instruments	96.91
B.	Equities	482.76
C.	Foreign Exchange Position	51.90
D.	Commodities	-
	Total	**631.57**

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.

Views of BOD on system to reduce Operational Risk:

The responsibility of mitigating the operational risk of the Bank lies with Internal Control & Compliance Division under the guidance of Audit Committee of the Board. The audit committee delivers policies and directions from time to time to keep the operating efficiency of the Bank up to the mark.

Performance gap of executives and staffs:

The Bank identifies the loop holes among the effectiveness of the employees and executives. These loop holes are removed by arranging appropriate training programs, offering competitive packages and providing best working environment. In this process, the Bank kept the performance gap of executives and staffs to a minimum level.

Potential external event:

No potential external event is expected to expose the Bank to significant operational 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 last three years average positive gross income of the Bank.

Capital Charges for Operational Risk

(BDT in Millions)

Sl.	Operational Risk	2009	2010	2011	Capital Charge
	Gross Income	5,192.05	7,861.30	9,557.55	1,130.54