Disclosures on Risk Based Capital (Basel II)

1. Introduction

In accordance with Pillar III of the revised Framework for International Convergence of Capital Measurement and Capital Standards ('BASEL II') adopted under the Bangladesh Bank rules and regulations on risk based capital adequacy (issued through Revised RBCA Guidelines, dated December 29, 2010), we are now required to make a more in-depth and expanded public disclosure regarding our risk profile (capital structure, capital adequacy, risk management, and risk measurement).

2. Disclosure Policy

Bank calculates Risk Weighted Assets (RWA) under the following approaches as per BASEL II guidelines (BRPD circular no.35, dated December 29, 2010):

a) Standardized approach for credit risk, b) Standardized approach for market risk and, c) Basic indicator approach for operational risk.

3. Scope of Application:

The Risk Based Capital Adequacy framework applies to all banks on Solo and Consolidated basis, where the framework on 'Solo' basis refers to all positions of the bank, and its local and overseas branches/offices, and 'Consolidated' basis includes subsidiary companies. Mutual Trust Bank Limited applies both the frameworks "Solo" and "Consolidated" basis, as the bank has three (3) subsidiaries, namely i) MTB Securities Limited ii) MTB Capital Limited iii) MTB Exchange (UK) Limited.

4. Components of Disclosure Framework:

(i) Regulatory capital ii. Capital adequacy iii. Credit risk in banking book iv. Specific provisions v. Equities: disclosures for banking book positions vi. Interest rate risk in the banking book vii. Market risk in trading book viii. Operational risk

i. Regulatory Capital

a. Qualitative Disclosures

The terms and conditions of the main features of all capital instruments have been segregated in terms of eligibility criteria (BRPD circular no. 35 dated 29th December 2010, and other instructions given by Bangladesh Bank).

Core Capital (Tier-I) of MTB is comprised of paid up capital, statutory reserve, general reserve and retained earnings. Supplementary Capital (Tier-II) comprises of general provisions (on unclassified loans and off-balance sheet exposure), revaluation reserves for securities up to 50% and MTB's partially convertible subordinate bond, as approved by Bangladesh Bank (BB), and Bangladesh Securities and Exchange Commission (BSEC).

The Bank does not have any Tier-III Capital.

b. Quantitative Disclosures

BDT in Millions

Particulars	Solo	Consolidated
Total Eligible Capital		
Tier-I Capital:		
Paid up capital	3,077.63	3,077.63
Statutory reserve	2,276.08	2,276.08
General reserve	276.78	276.78
Retained earnings	653.37	617.30
Minority Interest in Subsidiaries		0.11
Total Tier-I Capital	6,283.86	6,247.90
Tier-II Capital:		
General Provision	1,204.35	1,204.35
Revaluation Reserves for Securities up to 50%	260.14	260.14
Subordinated debt	1,000.00	1,000.00
Total Tier-II Capital	2,464.49	2,464.49
Tier III Capital		
Total eligible capital	8,748.35	8,712.39

ii. Capital Adequacy

a. Capital Calculation Approach

Assessment of capital adequacy is carried out in conjunction with the capital adequacy reporting to the Bangladesh Bank (BB): standardized approach for credit & market risk and basic indicator approaches for operational risk.

b. Capital of the Bank

In Percentage

Capital Adequacy Ratio (CAR)	Solo	Consolidated
Total		
MTB	10.82%	10.77%
Requirement as per BB *The surplus will act as buffer against risks to support future activities.*	10.00%	10.00%
Tier 1		
MTB	7.77%	7.72%
Requirement as per BB	5.00%	5.00%

BDT in Millions

Risk Weighted Assets	2014	2013
Risk Weighted Assets	80,930.04	70,345.80
Capital:-		
MTB	8,712.39	8,136.60
Requirement as per BB	8,093.00	7,034.58
Surplus	619.39	1,102.02

I. Our policy is to maintain a strong capital ratio with high rating.

II. We try to maintain capital at reasonable level to absorb all material risks.

III. The surplus is to meet Stress Tests and ICAAP requirements. Our strategy is to maintain 1-2% capital buffer.

MTB ensures compliance with the regulatory requirements, and satisfaction of external rating agencies and other stakeholders including depositors.

c. Capital Management

Initiative to ensure adequate capital encompasses: - Issuance of subordinated debt to raise Tier-2 capital, and minimizing gap between Tier-1 and Tier-2 capital.

- Consistently encouraging borrowers to complete external credit rating to assess counterparty Credit Risk status, and to reduce capital requirements.
- Improving and enhancing collateral coverage through efforts to obtain eligible collateral.
- Assessment of risk profile and credit rating of new clients.

MTB's CAR is periodically reviewed and assessed by the Risk Management Division (RMD), and reported to senior management. Moreover, MTB has planned to initiate:

- Revaluation of fixed assets to enhance supplementary capital,
- Revaluation of collateral securities for ensuring periodical assessment of asset coverage and ascertaining asset quality,
- Revaluation of securities to strengthen Tier-II Capital.

BDT in Millions

Capital Adequacy	Solo	Consolidated
Capital requirement for Credit Risk	7,211.62	7,108.18
Capital requirement for Market Risk	343.06	415.64
Capital requirement for Operational Risk	533.10	569.18
Total and Tier-1 capital ratio:		
- Core capital to total capital (%)	71.83%	71.71%
- For standalone Tier 1 capital out of maintained CAR (%)	7.77%	7.72%

III. Credit Risk in Banking Book

a. Qualitative Disclosure

MTB managers credit risk through a robust process that enables the bank to proactively manage its loan portfolio in order to minimize losses, and earn an acceptable level of return for shareholders.

b. Credit Risk Management at MTB

MTB's Credit Policy Manual (CPM), approved by the Board of Directors, defines organizational structure, roles and responsibilities and processes whereby credit risks can be identified, quantified, and managed. Credit instruction manuals address regulatory issues and establish control points. MTB Credit approvals clearly specifies all conceivable aspects including eligibility of the borrower, requirement of paper/information/documents, borrower's stake and all other related issues related to borrowing. The credit policy encompasses all operational issues of credit right from selection of borrower to the ultimate recovery including transfer process of delinquent account and treatment of slow overdue accounts, SMA or classified loan accounts. MTB manages credit risk through continuous measuring and monitoring of risks at obligor (borrower) levels and portfolio level and follows Bangladesh Bank prescribed Credit Risk Grading (CRG) model, and has developed a credit appraisal/approval process. The CRG model captures quantitative and qualitative issues related to management risk, business risk/industry risk, financial risk, security risk and relationship risk while assessing the overall grading of borrowers. External credit ratings of our clients are also being done. Till date MTB's total number of rated clients is 656, which was 282 in 2013. For ensuring smooth and quality credit operations; good governance, quick approvals, better control, and making safe and secured lending has been emphasized.

b. Loan Classification

All the loans and advances are grouped into four categories for the purpose of classification, which are; (i) Continuous Loan (ii) Demand Loan (iii) Fixed Term Loan and (iv) Short-term Agricultural and Micro-Credit.

Continuous & Demand Loans are classified as:

- Sub-standard - if past due for 3 months or more, but less than 6 months;
- Doubtful - if past due for 6 months or more, but less than 9 months;
- Bad/Loss - if past due for 9 months or more.

Fixed Term Loans amounting up to 10 lacs are classified as:

- Sub-standard - if the defaulted installment is equal to or more than the amount of installment (s) due within 6 (Six) months;
- Doubtful - if the defaulted installment is equal to or more than the amount of installment (s) due within 9 (Nine) months;
- Bad/Loss - if the defaulted installment is equal to or more than the amount of installment (s) due within 12 (Twelve) months.

Fixed Term Loans for more than 10 lacs are classified as:

- Sub-standard - if the defaulted installment is equal to or more than the amount of installment (s) due within 3 (Three) months;
- Doubtful - if the defaulted installment is equal to or more than the amount of installment (s) due within 6 (Six) months;
- Bad/Loss - if the defaulted installment is equal to or more than the amount of installment (s) due within 9 (Nine) months.

Short-term Agricultural and Micro Credit are classified as:

- Sub-standard - if the irregular status continues after a period of 12 (twelve) months;
- Doubtful - if the irregular status continues after a period of 36 (thirty-six) months;
- Bad/Loss - if the irregular status continues after a period of 60 (sixty) months.

A continuous credit, demand loan or term loan which remains overdue for a period of 60 days or more is classified as a "Special Mention Account (SMA)".

BDT in Million

Credit Risk	Amount
a) Total gross credit risk exposures broken down by major types of credit exposure	
Term Loan	18,704.41
Time Loan	328.82
SME Financing	7,027.54
Consumer Financing	502.38
Retail Financing	1,951.35
General Loans	2,436.05
Demand Loan	643.12
Payment Against Documents (PAD)	290.41
Trust Receipts	7,208.58
Lease Finance	380.54
House Building Loan	2,409.25
Staff/Employee Loan	577.26
Loans and Advances - Off-shore Banking Unit	598.01

BDT in Million

Credit Risk	Amount
Loan to subsidiaries	2,668.08
Cash Credit	15,942.71
Secured Overdraft	11,838.66
Bills purchased and discounted	
Payable in Bangladesh	2,123.32
Payable outside Bangladesh	76.73
b) Geographical distribution of exposures, broken down in significant areas by major types of credit exposure.	
Urban	
Dhaka Division	51,149.08
Chittagong Division	16,795.32
Rajshahi Division	2,206.32
Sylhet Division	729.34
Khulna Division	1,131.32
Rangpur Division	1,302.31
Barisal Division	49.90

Rural	
Dhaka Division	2,224.34
Chittagong Division	961.69
Rajshahi Division	555.52
Sylhet Division	35.78
Khulna Division	0.00
Rangpur Division	0.00
Barisal Division	0.00
c) Industry or counter-party type distribution of exposures, broken down by major types of credit exposure.	
Agriculture	1,150.83
RMG	4,098.52
Textile	6,033.22
Ship-Building	754.04
Ship-Breaking	1,178.46
Other Manufacturing Industry	14,297.26
SME loans	4,918.47
Construction	1,031.42
Power, Gas	7,76.09
Transport, Storage and Communication	711.85
Trade Service	12,215.66
Commercial real-estate financing	4,150.19
Residential real-estate financing	1,025.04
Consumer credit	1,590.21
Capital Market	4,248.62
NBFIs	7,728.91
Others	11,232.12
d) Residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposure	
On Demand	5,736.35
Not more than three months	27,839.92
More than three months but less than one year	18,788.33
More than one year but less than five years	18,273.26
More than five years	6,503.04

iv. Specific Provisions - Guidelines for Loan Loss Provisions

The Bank follows Bangladesh Bank (BB) guidelines regarding loan classification, provisioning, and any other issues related to Non-Performing Loan (NPL), internal credit guidelines, direct loan provisioning, review procedure, debt write-off, facility grading, reporting requirement and interest recognition.

Particulars	Rate
General Provision	
Against all unclassified loans of Small and Medium Enterprise (SME)	0.25%
Against all unclassified loans and off-balance sheet exposures (other than loans under Consumer Financing, Loans to Brokerage House, Merchant Banks, Stock dealers etc., Special Mention Account as well as SME Financing.)	1%
On unclassified amount for (i) Housing Finance and (ii) Loans for Professionals to set up business under Consumer Financing Scheme, Brokerage House, Merchant Banks, Stock dealers, etc.	2%
On unclassified amount for Consumer Financing other than Housing Finance, Loans for Professionals and Loans to share business	5%
On the outstanding amount of loans kept in the 'Special Mention Account'.	5%
Specific Provision	
Specific provision on Sub-standard Loans and advances:	20%
Specific provision on Doubtful Loans and advances:	50%
Specific provision on Bad and Loss Loans and advances:	100%

Throughout the year 2014, we reviewed loans and advances to assess whether objective evidence of impairment had arisen.

Movement of NPA and specific provision for NPA

The following table gives MTB's movement of NPAs and specific provision for NPA

BDT in Million/Percentage

Gross Non Performing Assets (NPAs)	Amount
Non Performing Assets (NPAs) to Outstanding Loans & advances (%)	2.67%
Movement of Non Performing Assets (NPAs)	
Opening balance	2,155.77
Additions	
Reductions	95.49
Closing Balance	2,060.28
Movement of specific provisions for NPAs	
Opening balance	989.51
Provisions made during the period	406.61
Less: Write-off	(440.84)
Write-back of excess provisions	
Closing Balance	955.28

Amount of Impaired Loans

BDT in Million

Particulars	Amount
Continuous Loans	651.39
Demand Loans	166.98
Term Loans	1,237.35
Short-Term Agro-Credit and Micro-Credit	4.56
Total	2,060.28

Specific and General Provisions

Specific and general provisions were made on the amount of classified and unclassified loans and advances/investments respectively, exposures of off-balance sheet, and off-shore banking units of the Bank.

BDT in Million

Particulars	Amount
Provision on classified loans and advances/ investments including Off-shore banking unit	955.28
Provision on unclassified loans and advances/ investments	896.33
Provision on Off-balance sheet exposure	308.02
Total	2,159.63

v. Equities: Disclosures For Banking Book Positions

MTB's stock brokerage functions are undertaken by a subsidiary - MTB Securities Limited as a corporate member of Dhaka Stock Exchange Limited (Member No. 197). For equity financing, only investment in unquoted securities are considered as Banking Book assets; investment in equity for relationship or strategic reason is considered under trading book. Investment in equity securities are broadly categorized into two parts:

i) Quoted securities (common or preference shares and mutual funds) traded in the secondary market (trading book assets). ii) Unquoted securities are categorized as banking book equity exposures which are further sub-divided into two groups:

a) Unquoted securities which are invested without any expectation that these will be quoted in near future i.e. Held To Maturity (HTM);

b) Unquoted securities acquired under private placement or IPO which are going to be traded in the secondary market after completing required formalities.

The primary aim is capital gain or dividend income. Dividends received from these equity securities are accounted for as and when received. Both quoted and un-quoted equity securities are valued at cost, and necessary provisions are maintained if the prices fall below the cost price. As per Bangladesh Bank (BB) guidelines, Held For Trading (HFT) equity securities are mark-to-market (revalued) once a week, and HTM equity securities are amortized annually. HTM securities are revalued if reclassified to HFT (with approval of the Board of Directors). The quoted shares of the bank are valued at cost or market price, whichever is lower.

BDT in Million

Equities	Amount
a) Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value Cost price	 1,085.88
Market price	860.37
*Difference	(225.51)
b) Cumulative realized gains (losses) arising from sales and liquidations in the reporting period	
c) Total unrealized gains (losses)	(225.51)
d) Total latent revaluation gains (losses)	0.00
e) Any amounts of the above included in Tier 2 capital	0.00
f) Capital requirements broken down by appropriate equity groupings, consistent with the bank's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory provisions regarding regulatory capital requirements Specific Risk General Market Risk	 152.43 152.43

vi. Interest Rate Risk In the Banking Book

Interest rate risk occurs when changes in market interest rates adversely affect a bank's financial condition, affecting both current earnings (earnings perspective) and net worth of the bank (economic value perspective).

The short term impact of changes in interest rates is on the bank's Net Interest Income (NII). Longer term, changes in interest rates impact asset cash flows, liabilities, and off-balance sheet items. This poses a risk to the net worth of the bank, arising out of all re-pricing mismatches, and other interest rate sensitive positions. MTB assesses the economic value at risk due to interest rate shock on a quarterly basis.

BDT in Million

Interest Rate Risk in the banking book			Amount
Total Risk Sensitive Assets			56,447.40
Total Risk Sensitive Liabilities			52,247.00
Cumulative Gap			
< 3months			2,727.20
3-6 months			5,867.80
6-12 months			(4,394.60)
CAR before Shock (%)			10.77%
Assumed Change in Interest Rate (%)	1%	2%	3%
Net Interest Income and Repricing impact (%)			
CAR after Shock (%)	9.50%	8.23%	6.96%

vii. Market Risk

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

i) Interest rate movements; ii) Currency- foreign exchange rate movements; iii) Equity- stock price movements; iv) Commodity- commodity price movements.

MTB's Market Risk Policy, approved by the Board, covers assessment, monitoring, and management of the above market risks. The Board sets limits and reviews compliance on a regular basis, in order to provide cost effective funding to finance asset growth, and trade related transactions.

a. Methods Used to Measure Market Risk

Standardized approach for market risk calculates the minimum capital requirement, for each risk sub-category, in terms of two separately calculated capital charges for "specific risk" and "general market risk".

b. Market Risk Management System

The Treasury Department manages market risk covering liquidity, interest rate, and foreign exchange risks, with oversight from Asset Liability Management Committee (ALCO), comprising of senior executives of the bank. ALCO is chaired by the Managing Director and CEO. ALCO meetings are held at least once in a month.

c. Policies and Process for Managing Market Risk

There are approved limits for credit deposit ratio, liquid asset to total asset ratio, maturity mismatch, commitments for both on-balance sheet and off-balance sheet items, and borrowing from money market and foreign exchange position. The limits are monitored and enforced on a regular basis to mitigate market risks. The Treasury Department of the Bank reviews the prevailing market conditions, exchange rates, foreign exchange position, and transaction to mitigate foreign exchange risks on a daily basis. Foreign exchange risk is computed on the sum of net short positions, or net long positions, whichever is higher of the foreign currency positions held by the bank. The bank adopts the maturity method in measuring interest rate risk in respect of securities in trading book. In order to mitigate risk related to market, RMD of MTB has internally developed 'Value at Risk' module (VaR) to analyze equity investment (own portfolio), and Foreign Exchange position of the bank.

BDT in Million

Quantitative Disclosure of Market Risk	Amount
Capital Requirement for:	
Interest Rate related instruments	73.57
Equities	304.86
Foreign Exchange Position	37.21
Commodity Risk	-
Total	415.64

viii. Operational Risk

Operational risk arises from inadequate or failed internal processes, people and systems, or from external causes, whether deliberate, accidental or natural - inherent in all of the Bank's activities. The policy for operational risks including internal control and compliance risk is approved by the Board, taking into account relevant guidelines of Bangladesh Bank. The Audit Committee of the Board directly oversees the activities of the Internal Control and Compliance Division (ICCD) with the object of mitigating all operational risks.

a. Performance Gap of Executives and Staff

MTB has made efforts to be the best pay master and ensures workplace safety for employees with consistent employment practices and non-discrimination regarding compensation, health and safety. Our strong brand image plays an important role in employee motivation. Combination of all these has acted in a judicious manner to narrow the gap significantly.

b. Systems

MTB has invested heavily in IT infrastructure for better automation, online transaction platform and network links to avoid business disruption and system failure. The Bank's IT system does not allow any kind of external access, safeguarding from external fraud (theft/ hacking of information assets, forgery etc.).

c. Policies and Processes for Managing Operational Risk

The preparation of policy guidelines on risk-based internal audit system is under process. According to the guidelines, the activities of branches will be rated in terms of their risk status. It is the policy of the bank to conduct audit on all the branches at least once a year. ICCD directly reports to the Managing Director and CEO, and the Audit Committee of the Board.MTB has also Risk Management Division in place. Its objectives are mainly to identify, assess, monitor, control and manage operational risks and also rectify risk events, and implement any additional procedures required for compliance. Human Resource Division of MTB has also introduced a vigorous Performance Management System (PMS) to evaluate human resources in terms of performance, and instill a performance-based culture within the organization.

BDT in Million

Quantitative Disclosure of Operational Risk	Amount
The Capital requirement for:	
Operational Risk	569.18