

BASEL II PILLAR 3 DISCLOSURES – 31st MARCH 2011

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BASEL II PILLAR 3 DISCLOSURES – 31st MARCH 2011

1. Scope of application

ING Vysya Bank Limited (IVBL) is a Commercial Bank, originally incorporated on 29-Mar-1930 as “The Vysya Bank Ltd”. The name of the Bank was changed to “ING Vysya Bank Limited” (IVBL) and the fresh certificate of incorporation consequent to the name change was granted on 01-Nov-2002. ING Vysya Financial Services Limited (IVFSL) is the wholly owned subsidiary of IVBL. IVFSL is engaged in marketing of IVBL products as well as providing referral services for the Bank. The consolidation with the subsidiary ING Vysya Financial Services Limited is as per Accounting Standard 21 (AS-21). While computing the consolidated Bank’s Capital to Risk Weighted Assets Ratio (CRAR), the Bank’s investment in the equity capital of the wholly owned subsidiary is deducted 50% from Tier 1 capital and 50% from Tier 2 capital. The subsidiary of the Bank is not required to maintain any regulatory capital. The Bank has no interest in any insurance entity.

2. Capital Structure

The authorized equity share capital of the Bank is Rs.350 Crore consisting of Rs.35 Crore equity shares of Rs.10/- each. As of March 2011, the issued capital stood at Rs.121.28 Crore consisting of Rs.12.13 Crore of equity shares of Rs.10/- each. The subscribed and paid-up share capital is Rs.120.99 Crore consisting of 12.10 Crore equity shares of Rs. 10/- each. The equity share capital of the Bank is in line with the provisions of the Companies Act, 1956 and any other applicable laws or regulations.

The debt capital of the Bank includes perpetual debt that qualifies as Tier 1 capital and subordinated and upper Tier 2 debt that qualifies for inclusion as Tier 2 capital. The Tier 1 perpetual bonds are non-cumulative in nature and carry a call option after 10 years with an interest step up of 100 bps. The interest on these bonds is payable quarterly. The Upper Tier 2 bonds are cumulative in nature with an original maturity of 15 years and a call option after 10 years. There is an interest step up option after 10 years of 100 bps. The Lower tier 2 bonds are Unsecured, Redeemable, Non-Convertible, Subordinated bonds and have a maturity between 9-10 years. The interest on these bonds is payable annually.

The repayment of principal and payment of interest on all the types of bonds mentioned above are as per the RBI regulations issued in this regard.

Capital Funds	(Rs. in Crore)
Tier I Capital (unadjusted)	2,630.80
Total Capital Funds (unadjusted)	3575.80
Tier I Capital	
Paid-up Capital	120.99
Reserves and Surplus	2,397.20

Innovative Perpetual Debt Instruments	112.61
Total Tier I Capital (Unadjusted)	2,630.80
<u>Deductions</u>	
Investments in Subsidiaries	1.05
Deferred Tax Asset	152.81
Other Intangible Assets	13.27
Total Deductions	167.13
Total Tier I Capital (Adjusted)	2,463.67
Upper Tier II Bonds	339.59
Subordinated Debt eligible for Lower Tier II	442.00
Revaluation Reserves	46.90
General Provisions and loss Reserves	116.51
Others	0.00
Tier II Capital (Unadjusted)	945.00
<u>Deductions</u>	
Investments in Subsidiaries	1.05
Total Deductions	1.05
Total Tier II Capital (Adjusted)	943.95
Tier I & Tier II Capital (Adjusted)	3,407.62

Debt capital instruments eligible for inclusion under Tier-1 and Tier-2 capital

(Rs. in Crore)

	Tier 1	Upper Tier 2	Lower Tier 2
Total amount outstanding as at 31 March 2011 – INR and Foreign currency	112.61	339.59	600.00
Amount raised during the year – INR and Foreign currency	Nil	Nil	Nil
Amount eligible to be reckoned as capital funds - INR	112.61	339.59	442.00

Note: Foreign Currency amounts are reported in INR at the forex rate as at 31 March 2011.

3. Capital adequacy

The Capital adequacy assessment process of the Bank is intended to ensure that an adequate level of capital and an optimum mix of the different components of capital is maintained by the Bank to support its strategy. This is integrated with the Bank's annual planning process that takes into consideration the growth assumptions across business segments and mapping of the relevant risk weights to the projected growth so that adequate capital is maintained to cover the minimum regulatory requirement and a reasonable cushion over the regulatory minimum.

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Bank’s budgeting and planning process with updates of expected ratios reviewed regularly during the year by Asset Liability Committee (ALCO). The Bank’s ALCO has set internal triggers and target ranges for capital management, and oversees adherence to these on an ongoing basis. The Board also oversees the capital adequacy of the Bank on a quarterly basis.

Summary of the Bank’s capital requirement as at 31 March 2011 is presented below:

	Capital requirements for Risk Types	Amount (In Rs. Crore)
A	Capital requirements for Credit Risk	
	Portfolios subject to standardized approach	2141.30
	Securitization exposures	1.48
B	Capital requirements for Market Risk	
	Standardized duration approach	51.61
	Interest rate risk	35.96
	Foreign exchange risk (including gold)	13.50
	Equity risk	2.15
C	Capital requirements for Operational Risk	
	Basic Indicator approach	175.57
	Total Capital requirements for above Risk types	2369.96
	Total Risk Weighted Assets	26,333.03
	Capital Adequacy Ratio of the Bank – Total	12.94%
	Capital Adequacy Ratio of the Bank - Tier I	9.36%

4. Credit risk – General disclosures

Credit risk management – Policy framework

For the identification, measurement, mitigation, monitoring and governance of Credit Risk, the Bank has laid down various Policies like Credit Risk Policy, Country Risk Policy, Counterparty Risk Policy, Customer Appropriateness and Suitability Policy, and Break Clause Policy. Other documents related to the New Capital Adequacy Framework implementation in the Bank like Stress Testing Policy, ICAAP Policy, Credit Risk Mitigation and Collateral Management Policy have also been laid down. The policies generally define:

- Exposure Norms,
- Underwriting standards,
- Regulatory requirements, and
- Negative list and restricted exposures.

These policies are reviewed annually or more frequently if required. Exhaustive Credit Risk manuals and guidelines detailing the mode of implementation of the policies have also been put into practice.

Credit risk management – Structural framework

Risk Management and Review Committee of the Board (RMRC) is responsible for managing Credit Risk function, among others, and meets at least once a quarter.

Credit Risk Management Department (CRMD), headed by Chief Risk Officer (CRO), manages this function at the departmental level, both at Corporate Office and Regional levels. The Chief Risk Officer (CRO) is assisted by senior executives dealing with credit risk of Wholesale assets, Retail assets and Consumer Finance portfolio, to ensure that growth in business is consistent with the internal risk appetite of the Bank and the credit quality of the portfolio is maintained at all times. Specialized Credit Risk Managers handle risk areas of Counterparty Risk, Country Risk, etc.

The organization structure further consists of:

- Credit Policy Committee, reporting to RMRC, which is involved in formulating all relevant policy guidelines and procedures, and for immediate action on RBI guidelines on credit related matters;
- Board Credit Committee (BCC), which has Credit Exposure approval powers beyond Rs.150 Crore for Wholesale Bank and Rs.100 Crore for Retail Bank. Joint Monthly Meeting (JMM) is conducted both at Corporate Office and at the Zonal Offices to review Portfolio and the continued health of the Portfolio. However, the JMMs have no credit approval powers.
- Operations Department to assure high standards of loan documentation, security creation and compliance with pre-disbursal terms and conditions;
- Asset Recovery Committees and Loan Review Department, which track delinquencies, identify ‘Watch List’ accounts, and give guidance on remedial management; and
- Collections Department and Special Loans Management Group (SLMG) are involved in recovery and management of delinquent accounts including enforcement of securities, legal action through Debt Recovery Tribunal (DRT) or other processes, etc. SLMG also computes the loan loss provisions as per regulatory requirements.

Credit Approval

- The way credit exposure is approved has changed between May and Jun 2010. The Bank dispensed with the Committee approach and switched over to Signature Approval Process (SAP). Authorised signatories from both Business Units and Credit Approval Department accord sanctions jointly. Risk deals with the Risk profiling of the Client, the credit proposition, provides credit rating for the client and also suggests mitigants.

Credit risk management models / methods / processes

The Credit Risk Policy is a business oriented statement, within the purview of regulatory requirements. It is one of the core Credit Risk Management documents, and is reviewed at least once in a financial year, or more frequently if necessitated by the changing business environment. The policy describes what constitutes an “Acceptable Borrower / Facility” for the Bank. It also adheres to assessing financial requirements of the borrower, and specifies the exposure and the product lending norms. The exposure norms- prudential, industry, sector, etc., are also outlined in this document. The policy also specifies the norms relating to review / renewal of loans, conducting of sample review of credit approvals by higher authorities, conducting of portfolio review and review of irregular / stressed accounts. In addition, there are ‘Restricted Lists’ of industries to which either exposures should not be taken or taken selectively by the Bank. The ‘Negative Lists’ of industries / activities to which Bank ensures that exposures are not taken are in areas which are not in line with the Risk Appetite statement of the Bank.

The Bank follows the below mentioned principles to manage credit risk:

- Standard appraisal and underwriting standards for approval of credit exposures is followed. Different rating methods, depending upon the type of borrower and size of exposure, are prescribed. For Corporates, commodity traders, Banks & financial institutions, etc., appropriate Basel Compliant Rating Models (developed originally by ING) are followed. For emerging corporate, Business Banking and certain types of agriculture exposures, an internally developed rating methodology is in place. Certain template products under Business Banking are put through score card based selection methods.
- Credit policy prescribes exposure and tenor caps based on risk rating of the borrower. Individual and Group exposure norms, as per the ‘Prudential Norms’ of RBI are followed. These guidelines ensure that there is no credit concentration on any individual corporate or group. Apart from this, a Risk-grid has been established, where individual exposure limits and tenors are capped based on risk rating of the company/borrower. To ensure dispersal of credit risk across different industries / segments, the Bank has prescribed specific ceilings on those industries where it has exposures.
- There is emphasis on efficient credit administration, covering obtaining proper legal documentation, putting through day-to-day transactions, periodical unit visits and security verification, monitoring & follow-up and recovery.
- Country risk and Counterparty risk are reviewed by specialized desks and deviations from established procedures or limits are reviewed on a regular basis at JMM, RMRC, etc.
- Credit Audit is conducted at various offices which act as dispensation points / approval authorities, in addition to vertical audit of various credit products. Risk based audit of branches also addresses credit risk aspects at the time of audit of branches / offices. In addition to this, risk department visits branches and conducts

sample reviews of credits approved at the branch / business unit level for better credit administration.

As a general principle, the Credit Risk Policy stipulates churning of 5% of accounts on a Year-on-Year basis.

Stress testing and scenario analysis

Stress testing framework and a process of stress testing have been elaborated in the Stress Testing Policy of the Bank. The Policy applicable to the Bank is in accordance with the RBI circular DBOD.No.BP.BC.101/21.04.103/2006-07 on stress testing.

Significant Risk Factors affecting the Bank in the preceding year with respect to default levels and economic conditions and management reactions to the same

CRMD reviews credit growth, portfolio concentrations, delinquencies, NPA accretions, etc., at regular intervals. Based on this, decisions like tightening product norms, discontinuing certain products in specified geographies, moderating sector exposures, exiting potential problem accounts, etc., are taken. These are reviewed at Zonal and Corporate Office levels.

The Executive Asset Recovery Management Committee (EARMC) at the Corporate Office (for outstanding of \geq Rs 1crore) and Regional EARMCs (for outstanding of $<$ Rs 1crore) are the acting bodies for reviewing irregular accounts and suggesting strategies for recovery. Portfolio / Industry / Product reviews are placed to the Risk Management Committees for their review and feedback.

In the current financial year, while the Bank has observed reduced levels of default and less additions to NPA as compared to the previous financial year, concerns persist with respect to inflation, increase in interest rates (thereby implying higher cost of funds for borrowers) and increased commodity prices (thereby implying higher raw material costs). Also, increased levels of stress were noticed in the Micro Finance Institutions (MFI) segment due to extraneous factors. Appropriate remedial measures were discussed with other lenders to this segment to address the situation.

Loans affected by business slow-down or for other valid reasons were restructured in accordance with RBI’s guidelines.

Definitions of “past due” and “impaired” within the Bank

Bank follows the prudential norms prescribed by RBI and the definitions of ‘Past due’, ‘Out of Order’ and ‘Overdue’ are as under:

- ***Impaired / Non – Performing Assets (NPAs)***

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank. A NPA is a loan or an advance where:

- a) interest and / or installment of principal remain overdue for a period of more than 90 days in respect of a term loan;
- b) the account remains 'out of order' in respect of an overdraft / Cash Credit (OD / CC);

- c) a bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted;
- d) for short duration crop loans, an installment of principal or interest thereon remains overdue for two crop seasons; and
- e) for long duration crop loans, an installment of principal or interest thereon remains overdue for one crop season.

- **Out of order / past due status**

An account is treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there have been no credits for a continuous period of 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts are also regarded as 'out of order'.

- **Overdue**

Any amount due to the Bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the Bank. Overdues greater than 30 days are reviewed at regular intervals. Overdues greater than 60 days are included in 'Watch List' / 'Stressed Accounts' and monitored on continuous basis.

Details of Credit risk exposure

Gross Credit Risk / Exposures as on 31-03-11	Rs. in Crore
Fund based exposure	36,744.23
Non- Fund based exposure	8,839.82
Total	45,584.05

Notes:

1. Fund based exposures include Funded Advances outstanding of Rs. 23602 cr, Investments of Rs. 11020 Crore others Rs. 2121 Crore and excludes Cash in hand.
2. Non fund based exposures include Letter of Credit, Bank Guarantees and the Loan Equivalent Factor ('LEF') of Financial Market transactions.
3. The above numbers exclude fixed assets and other assets, although they have been reckoned as exposures and capital maintained for the same.

The Bank has exposures in the domestic segment only.

Distribution of credit risk exposure by Industry type*

(Rs. in Crore)

Industry classification	Total Fund based Outstanding (excluding investments)
Agri and allied activities	2510.70
Industry – Micro, Small, Medium & Large	8363.80
Services	2673.19
Trade	3244.41
Commercial Real Estate	964.39
NBFC	1268.31
Consumer Finance	4930.75
Total	23955.55

* Net Advances as of 31 Mar 11 stood at INR 23602.1 Cr. The figures refer to the position as of last reporting Friday of the financial year 2010-11.

Residual contractual maturity breakdown of assets

Rs. in Crore

Maturity Bucket	Cash and Balances with Banks	Investments	Advances	Other Assets including Fixed Assets
1- 14 days	849.7	1800.2	3048.9	11.3
15 to 28 days	80.4	456.1	1336.7	38.3
29 days to 3 months	415.7	2090.9	2495.1	85.8
Over 3 months and up to 6 months	138.3	690.9	2208.3	130.6
Over 6 months and up to 1 year	372.6	1016.8	3108.0	363.9
Over 1 year and up to 3 years	240.5	1917.6	4714.1	421.5
Over 3 years and up to 5 years	190.0	1422.7	2637.8	222.7
Over 5 years	234.1	1625.4	4053.3	595.6
Total	2521.4	11020.7	23602.1	1869.7

Movement of NPAs and Provision for NPAs

Amount of NPAs (Gross)*

(Rs. in Crore)

	31.03.2010	31.03.2011
Substandard	132.96	38.40
Doubtful 1	90.89	92.83
Doubtful 2	10.66	24.15
Doubtful 3	0.00	0.00
Loss	0.00	0.00
Gross NPA	234.51	155.38

Net NPAs:

(Rs. in Crore)

	31.03.2010	31.03.2011
NET NPA	221.83	91.78

NPA Ratios:

	31.03.2010	31.03.2011
Gross NPAs* to gross advances	1.27%	0.66%
Net NPAs to net advances	1.20%	0.39%

Movement of NPAs (Gross)*

(Rs. in Crore)

	31.03.2010	31.03.2011
Opening bal. as on 01-04	209.39	234.51
(+) Additions	410.03	236.02
(-) Reductions	384.91	315.15
Closing bal. as on 31-03	234.51	155.38

*Gross NPA's as per item 2 of Annex to DBOD.BP.BC.No.46/21.04.048/2009-10 after considering technical write-off.

Movement of provisions for NPAs

(Rs. in Crore)

	31.03.2010	31.03.2011
Opening bal as on 01-04	Nil	Nil
(+) Provisions made during the period	229.63	156.10
(-) Technical Write-offs	229.63	156.10
Closing bal as on 31-03	Nil	Nil

Amount of Non-Performing Investments (NPIs) and Provisions held, Movement of provisions for depreciation on investments

Amount of provisions held for non-performing investments: INR 30.01 Crore.

	31.03.2010	31.03.2011
Opening bal.as on 01.04	-	-
(+) Provisions made during the period	-	30.01
(-) Write-off/Write-back of excess provisions	-	-
Closing bal.as on 31.03	-	30.01

Amount of Non-Performing Investment: INR 30.01 Crore.

Movement of provisions for depreciation on investments

(Rs. in Crore)

	31.03.2010	31.03.2011
Opening bal.as on 01.04	5.88	4.12
(+) Provisions made during the period	-	31.29
(-) Write-off/Write-back of excess provisions	1.76	-
Closing bal.as on 31.03	4.12	35.41

5. Credit Risk: Disclosures for Portfolios subject to the Standardized Approach

Use of rating agencies

RBI has identified four domestic credit rating agencies (CARE, CRISIL, FITCH India and ICRA Limited) and three international credit rating agencies (Fitch, Moodys and Standard & Poor) whose rating assessments can be used by the Banks for their capital assessment under standardized approach. Bank loan rating as well as issuer ratings available in the public domain are used for the capital adequacy assessments and these ratings are used and applied in accordance with the prevalent regulatory guidelines.

Details of Gross credit exposure based on Risk Weight

Risk bucket	Amount outstanding (Rs. Crore) as on 31-03-11
Below 100% risk weight	28,687.40
100% risk weight	13,976.14
More than 100% risk weight	2,920.50
Deducted	2.10

6. Credit Risk Mitigation: Disclosures for Standardized Approaches

Policies & Processes

The Credit Risk Mitigation and Collateral Management Policy approved by the Board sets the framework for collateral acceptability, valuation and management within the Bank. This covers the types of collateral taken by the Bank and defines the process for valuation and management of these collaterals. This covers collateral management on a Macro level and from the point of view of the new capital adequacy framework (Basel II).

The Bank has utilized credit risk mitigation in the case of Bank’s own deposits, Government Securities, Debt Oriented Mutual Funds and gold, wherever the Collateral is identifiable, marketable and enforceable and complies with RBI requirements. Sovereign exposures and Sovereign guaranteed exposures are risk weighted as per RBI directives.

A system of physical verification / periodical updation of the valuation of the collateral (within a period not exceeding three years) are followed. For Housing Loans, the frequency of valuation has been decided as once in 5 years. Periodicity for unit visits also is prescribed in the Credit Risk Policy and the Credit Risk Manuals. The Bank has set up Credit Operation Team/s (Business Banking and Agri Rural Banking Operations, General Lending Operations, Consumer Finance Operations) at all important centers to ensure perfection of documentation and to comply with charge registration matters. Electronic filing of Charge Registration with ROC in digital format is ensured by Operations. Insurance of securities is also assured. The Bank complies with RBI requirements for collateral eligibility to be treated as a Credit Risk mitigant.

Types of collateral taken by the Bank

The main types of collateral taken by the Bank are Current Assets, Plant and Machinery, Land and Building, Liquid Assets like gold, cash or fixed deposits with the Bank, Capital Market related collateral, Guarantees provided by promoters/ Central Government/State Government/ Banks/ Financial Institutions/ Other Corporates/ ECGC, etc.

- the exposure (after where applicable on- or off-balance sheet netting) that is covered by eligible financial collateral after the application of haircuts – INR 1207.32 Crore.

Type of Guarantor / Counterparty and their Credit Worthiness

The types of Guarantor’s recognized for credit risk mitigation are guarantees by Central Government, State Governments, ECGC, Banks and Corporates. The effect given for these guarantees are in line with RBI stipulations.

- the exposure (after where applicable on- or off-balance sheet netting) that is covered by guarantees / credit derivatives (where specifically permitted by RBI) – INR 1875.40 Cr.
- * exposure in case of non-fund based refers to outstanding adjusted for Credit Conversion factor.
- Concentration risk within the Credit Risk Mitigants taken

The Bank does not face concentration risk arising out of certain types of borrowers/ industries/ tenor as Caps have been set and are monitored. Concentration risk in terms of the mitigation taken also does not arise as the range of collateral taken, the type of borrower offering it, the location of the collateral are varied.

7. Securitization: Disclosure for Standardized Approach

In respect of securitization transactions, the Bank’s role is limited as an investor. The outstanding book value of securitized exposure as on 31 Mar’11 was Rs 82.43 Crore (with the highest credit quality “AAA”). The Bank monitors market risk on the securitization exposures mainly through daily calculation of mark to market and Value at Risk measures. In respect of Credit risk, the RWA is calculated based on applicable external rating as per the regulatory guidelines.

In accordance with the RBI guidelines, with effect from 1 February 2006, the Bank accounts for any loss arising from securitization immediately at the time of sale. The profit / premium arising from securitization is amortized over the life of the securities issued or to be issued by the special purpose vehicle to which the assets are sold.

Portfolio buy-outs

In addition to the above, the Bank purchases loans through direct assignments. The main portfolios that are purchased are Road Transport Operator loans, Loan for purchase of Agricultural implements, Gold loan portfolios, etc. These buyouts are as per the Portfolio Buy-out Policy of the Bank.

Quantitative Disclosures – Banking book

- a) Aggregate amount of securitization exposures retained or purchased and the associated capital charges, broken down between exposures and further broken down into different risk weight bands for each regulatory capital approach

Risk Type	In Crore
Exposure	82.43
Rating	AAA
RWA	16.49
Capital Charge	1.48

- b) Exposures that have been deducted entirely from Tier 1 capital, credit enhancing Interest Only Strips deducted from total capital, and other exposures deducted from total capital (by exposure type).
Nil

Quantitative Disclosures – Trading book

- a) Aggregate amount of exposures securitized by the Bank for which the Bank has retained some exposures and which is subject to the market risk approach, by exposure type -
Nil

- b) Aggregate amount of securitization exposures retained or purchased as on 31st March 2011

(Rs. in Crore)

S. No	Type of securitization	Amount (in Crore BV)
Securities purchased		
1.	Home and Home equity loans	82.43
2.	Liquidity facility	Nil
3.	Credit enhancement	Nil
4.	Other commitments	Nil

Note: The above mentioned securitized portfolio is classified under Available for Sale (AFS) category of Investment book.

c) Aggregate amount of securitization exposures retained or purchased separately for:

- Securitization exposures retained or purchased subject to Comprehensive Risk Measure for specific risk; and

S. No	Type of securitization	Amount (in INR Crore BV)
Securities purchased		
1.	Home and Home equity loans	82.43
2.	Liquidity facility	Nil
3.	Credit enhancement	Nil
4.	Other commitments	Nil

- Risk weight bands of securitization exposures on the basis of book value

(Rs. in Crore)

Risk weight bands	Amount
Less than 100%	82.43
100%	-
More than 100%	-
Deductions	
-Entirely from Tier I capital	-
-Credit enhancing Interest Only Strips deducted from Total Capital	-
-Credit enhancement (cash collateral)	-

Note: The above mentioned securitized portfolio is classified under AFS category of investment book.

8. Market risk in trading book

Market risk management – Policy framework

The base for management of market risk is the Board approved Investment Policy that lays down the scope. It also reflects the market risk appetite of the Bank and lays down adherence to regulatory guidelines. All limit types pertaining to investment or trading activities are detailed in this policy. In addition, product mandates control the type and nature of products invested or traded in.

The Board has approved the Investment Policy for the financial year 2010-11. The policy is reviewed on a half-yearly basis or more frequently, as deemed appropriate.

Market Risk Management – Governance framework

The Market Risk Management Department (MRMD) reports to the CRO. MRMD identifies, measures, reports and controls the market risk exposures in the Bank. The market risk due to the volatility of market variables is managed by active monitoring of the Board-approved limits. Further to limit setting and monitoring, the Bank's market risk is monitored through statistical tools like Value at Risk, Basis Points Value, Present Value 01 and event risk calculations on all trading portfolios.

The Board and senior management are kept informed of the market risk issues and exposures on a regular basis. The Board approves the objectives, policies and methodologies of the market risk department. At regular intervals, notes are placed before the senior management and Board to assess the treasury operations and market risks inherent in such operations. The Treasury review is placed on a monthly basis to ALCO and members of Board and includes a separate section on market risk. Any approval for limit excesses is sent to the appropriate authority (including the Board, if required) as per the Investment Policy on delegated authority.

ALCO actively meets and discusses the interest rate risk and liquidity issues besides looking into Asset Liability Management (ALM) and the Investment Committee discusses the Investments and investment policies related matters. The Financial Markets (FM) Department, on behalf of ALCO, manages the day-to-day operations. ALCO reports to the Board through the RMRC.

The Market Risk Management Department in the Bank operates independently of the treasury dealing room. It monitors the operations of the treasury front office and checks the limits as laid down in the policy. The exposures are reported finally to management.

Financial Market Operations operates independently of the dealing room, with its own independent processing systems. Their staff handles all confirmations, payments and authorizations in the Financial Market operations systems and related activities.

Market risk management models/ methods/ processes

The tools used for measuring, monitoring and controlling market risks are commensurate with the nature and composition of the investments and trading activities of the Bank.

Limit checks, revaluation and pricing of securities are independently done on a daily basis through MRMD's own systems. The Bank uses an in-house developed module to capture VaR, and the same is back tested for model effectiveness as well. The variance covariance method is used for calculating VaR for a 1-day horizon at 99% confidence level. Historical method is used to calculate FX-Options VaR. 250-days historical simulation is applied at 99% confidence. The module also calculates the bpv's and stress scenarios.

FX risk in the books is independently controlled on an overall basis by MRMD through monitoring:

- Day light limits
- Overnight limits
- Nostro limits
- Stop loss limits
- Gap limits
- Overall Position limits

The Investment Policy does not allow any fresh equity positions. The current minor equity positions are largely illiquid but the Bank explores the possibility of a sale as and when an opportunity arises.

Stress testing and scenario analysis

The framework and scenarios for stress testing have been outlined in detail in the Market Risk Measurement Policy. While the Value at Risk methodology assumes ‘normality’, reality has shown problems with this assumption. In general, it turns out that extreme scenarios are more likely to happen than what is to be expected under the assumption of normality. In order to be aware of extreme swings, the Bank undertakes stress tests. For event risk, a set of possible combinations is calculated. Based on the outcome of the results, limits may be adjusted and re-approved by competent authority.

There are broadly two categories of stress tests used, viz. sensitivity and scenario tests. Sensitivity tests are normally used to assess the impact of change in one variable on the Bank’s position. Scenario tests include simultaneous moves in a number of variables.

As per Basel II, the stress test limits are set in such a way that it never exceeds more than 20% of the Bank’s capital. Accordingly, the other risk limits are derived from this principle.

Portfolios covered by standardized duration approach

The following portfolios are covered by the standardized duration approach:

- AFS (available for sale)
- HFT (held for trading) for Money Market, Foreign Exchange and derivatives
- Foreign Exchange from Banking books

The market risk positions subject to capital charge requirement are:

- (i) The risks pertaining to interest rate related instruments and equities in the trading book; and
- (ii) Foreign exchange risk (including open position in precious metals) throughout the Bank (both Banking and trading books)

Capital requirements for Market Risk

(Rs. in Crore as of 31st March 11)

Interest Rate (a+b)	
a. General Market Risk	33.11
b. Specific Risk	2.85

Equity(c+d)	
c. General Market Risk	1.08
d. Specific Risk	1.08
Foreign Exchange and Gold	13.50
Total Capital Charge for Market Risk	51.61
RWA for market risks	573.49

9. Operational risk

ING Vysya Bank Ltd has defined operational risk as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. While legal risk is covered within the framework of operational risk, strategic and business risks are excluded.

The Bank has various Policies (Operational Risk Policy, Information Security Risk Policy, Security Policy, Outsourcing Policy, Crisis Management Policy and Anti-Fraud Policy) in place to ensure effective management of Operational risks.

The Bank has developed a comprehensive framework supporting the process identifying, measuring and monitoring operational, information and security risks. In order to make the operational risk management process more effective and integrated for the business units, legal, compliance and operational risk functions in the Bank work in an integrated manner with similar processes for identifying and measuring the risks.

Operational Risk Management framework

For effective management of the Bank’s operational risk exposure, the Bank has set up an independent Operational Risk Management function, which is responsible to develop and implement policies and procedures for effective management of the Bank’s operational risk exposure. The unit follows the Board approved Operational Risk Management Policy for effective implementation of operational risk management across various business units of the Bank.

Risk Management structure

The Bank has a well defined operational risk management structure with Operational risk committees (ORCs) being set up at country and business line (Retail, Wholesale and Private Banking) level. The core members of the committee include representatives from business, operations, IT, HR and risk management functions. The business line ORC are set up for Wholesale and Retail Banking functions of the Bank, meet once in a month to discuss the operational issues identified, and takes necessary steps to mitigate the risk. The country ORC is held on a quarterly basis while the Private Banking ORCs are held bi-monthly.

In addition to the ORCs, the Risk Management and Review Committee (RMRC) at the highest level meets periodically to analyze and take necessary steps to mitigate the risks

that the Bank is exposed to. The Board and senior management are kept informed of operational risk issues on a periodic basis.

Risk Reporting

The Bank uses the Non-Financial Risk Dashboard (NFRD) as an operational risk reporting tool. The NFRD provide a clear overview to the management on the key operational risk issues along with their risk rating, thereby enabling the management to prioritize and take effective decisions on risk mitigation. The report also provides an overview on the progress of the mitigation plans along with a due date and person to act for the identified operational risks.

Strategies and Processes

The Bank has adopted ‘three lines of defense’ model. The Business forms part of first line of defense and are responsible for execution of Bank’s risk policies, minimum standards and framework set by the second line of Defense. The risk management function forms part of the second line of defense and is responsible to partner and support the first line of defense in their risk management activities. The Audit department forms part of the third line of defense and is responsible to provide an independent assurance of the design and effectiveness of internal controls over the risks.

The Bank promotes effective management of operational, information and security risk by involving the Business Units in the risk management process. This is achieved by raising operational risk awareness, increasing transparency, improving early warning information system, and allocating risk ownership and responsibilities. While the Operational Risk Management function supports the Business Units in identifying and assessing the operational risk exposure, the Business Units are responsible to take appropriate steps to put controls in place for the operational risks.

The operational risk assessment has been made an integral part of the Bank's risk management process. The Bank uses various tools and processes for identification, assessment and monitoring of operational risk. The table below gives an overview of the risk management processes and the tools used for effective management of operational risks.

Risk Management Processes	Examples of risk management tools
Risk Governance	- Operational Risk Committee
	- Compliance program
	- Product Approval process
	- Risk awareness programs
Risk Identification	- Risk and Control Self Assessments/Integrated Risk Assessments
	- Operational Risk events
Risk Measurement	- Incident Reporting and Analysis
	- Quality of Control Scorecards

Risk Management Processes	Examples of risk management tools	
Risk Monitoring	-	Audit Findings Action Tracking
	-	Key Risk Indicator reporting
	-	Operational risk dashboard
Risk Mitigation	-	Information Security plans and implementation
	-	Crisis management planning
	-	Personal and physical security planning

The Bank has an internal risk footprint, which it uses to identify the risk level and the subsequent risk rating. Further, the Bank has a centralized loss data capture mechanism that it uses for effective management of operational events and losses. The Bank currently uses a scorecard approach to measure the effectiveness of the operational risk management across the Bank. This approach is based on the maturity of the operational risk management in the Bank.

Operational risk capital

The Bank currently qualifies for the Basic Indicator Approach operational risk capital assessment. The capital requirement for operational risk has been estimated as per the Basel II related regulatory guidelines prescribed by the Reserve Bank of India.

10. Interest Rate Risk (IRR) in the Banking book

Changes in interest rates affect a Bank's earnings by changing its net interest income and the level of other interest sensitive income and operating expenses. For the purpose of monitoring and management, interest rate risk is separated into four sources, viz., - re-pricing risk, yield curve risk, basis risk and optionality.

Identification, measurement, mitigation, monitoring and governance of IRR are prescribed in and followed as per the directions in the Market Risk Measurement Policy and the Investment Policy. The IRR measurement and reporting is performed on monthly frequency to ALCO and quarterly to Board.

Interest rate risk arising due to re-pricing of those assets and liabilities which do not have a maturity date (e.g. Current and Savings Accounts and Cash Credit/Overdraft products) is managed by distributing these assets into various maturity buckets based on an approved 'replication model'. The model is independently developed by Market Risk and is approved by ALCO as directed by RBI before application. This model is reviewed on a yearly basis (or in case of changing market conditions, as deemed appropriate). The model primarily assumes a core portion of these products as long-term assets/liabilities and replicates the same in higher tenure buckets (versus volatile portion which is replicated in the short term).

Similarly, risk arising due to loan prepayments and/or deposits pre-closures is also managed by levying a penalty on such transaction. Market Risk independently ascertains the cost of such 'optionality' through respective behavioral studies on an annual basis and the same is

approved by ALCO on a yearly basis. The cost of optionality in the study is derived using the historical pre-closure values and option pricing theories.

Market risk manages the interest rate risk of the Banking books by pro-actively and periodically employing the tools as mentioned above. Managing and monitoring the interest rate risk exposure arising out of normal business activity is executed within the following risk limits / framework:

- Mismatch per bucket (cumulative and normal gap limits);
- Earning at Risk limit;
- VaR limit for ALM book and fraction VaR limit for the Capital book;
- Event risk limit; and
- Duration mismatch.

The type and level of structural and mismatch interest rate risk of the Bank is managed and monitored from two perspectives: from an economic value perspective and an earnings perspective.

Economic Value perspective involves analyzing the impact of changes in interest rates on expected cash flows on assets, minus the expected cash out-flows on liabilities, plus the net cash flows of off-balance sheet items.

Earning perspective involves analyzing the impact of changes in interest rates on accruals or reported earnings in the following year. The Bank monitors the Earnings at Risk (EaR) with respect to net interest income (NII) based on a 100 basis points adverse change in the level of interest rates. This is measured by Net Interest Income (NII) or Net Interest Margin (NIM).

The Bank combines both methodologies to analyze both effects simultaneously.

Earnings impact perspective

(Original Currency in Crores as of 31-Mar-11)

	TOTAL (INR)	INR	EUR	USD	GBP	JPY
EaR -100 bps parallel (year 1)	-20.97	-26.56	0.01	0.11	0.00	0.00
EaR - 100 bps parallel (year 2)	-23.12	-24.13	0.00	0.02	0.00	0.00
EaR - 100 bps parallel (year 3)	-32.01	-32.70	0.00	0.01	0.00	0.00

Economic Value perspective

(INR in Crore as of 31-Mar-11)

NPV Impact	Total	INR	EUR	USD	GBP	JPY
+ 50 bps	-85.45	-86.89	0.28	1.05	0.11	0.00
+100 bps	-170.90	-173.78	0.56	2.10	0.22	0.00