AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED – MUMBAI BRANCH
Basel II: Pillar 3 Disclosures as at 31 March 2012

1. Background

Australia and New Zealand Banking Group Limited – Mumbai Branch ('ANZ India' or 'the Bank') is a branch of Australia and New Zealand Banking Group Limited ('ANZ'), which is incorporated in Australia with Limited Liability.

In October 2010, ANZ received the final approval from the Reserve Bank of India ('RBI') to open a branch in Mumbai to carry out banking business. The Bank commenced its banking business in India from 2 June, 2011. The Bank has only one branch in India as on 31 March 2012.

Disclosures made hereunder are in accordance with Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) – Market Discipline (Pillar 3). Since this is first year of India Operations, no comparative data has been provided.

2. Key Management Committees, Functions and Frameworks

India Executive Committee ('India EXCO')

India EXCO is the apex committee of the Bank and has the authority to exercise all of the powers and discretions of the Board at the country level. India EXCO takes ownership of the Bank's business in India and fulfils the regulatory responsibility of conducting periodic reviews/ approvals as specified by RBI from time to time. The committee is chaired by Chief Executive Officer India. India EXCO is an in-country committee.

Key responsibilities of the India EXCO are:

- Approving all key business policies.
- Investigating and reviewing policy breaches for credit, operational and market risks; and approving remediation actions.
- Monitoring governance and compliance with Credit, Operational and Market risk management policies, procedures and systems (including risk models) in India and instigating any necessary corrective actions to address deviations.
- Undertaking activities to support the development of new products to be introduced by the Bank.

India Assets and Liabilities Committee ('India ALCO')

India ALCO is a sub-committee of the International and Institutional Banking ALCO ('I&IB ALCO') and is responsible for the oversight and strategic management of the India balance sheet, liquidity and funding positions and capital management activities.

India ALCO's mandate for managing balance sheet, liquidity and funding and capital activities include, but are not limited to:

- Liquidity and funding;
- Capital (book, regulatory and economic);

- Non-traded Interest Rate Risk, including the investment of capital and other non-interest bearing products;
- Balance sheet structure including capital and revenue flows, but excluding traded foreign exchange exposures;
- Approval and oversight of traded market risk;
- Policy, control and compliance activities for all balance sheet, liquidity and funding and capital related risks; and
- Recommendations / noting to I&IB ALCO for any key local decision taken at the ALCO

Risk Management Committee ('India RMC')

India RMC is a sub-committee of regional RMC and acts as a forum to ensure adequate awareness and debate of all significant risk issues that the Bank faces. India RMC has management oversight and presides over credit, operational and market risk within the Bank.

Key responsibilities of the India RMC are:

- Acting as the ultimate point of escalation against agreed Risk/Return standards across division.
- Overseeing Country/Business Level Credit, Operational and Market Risk strategies.
- Recommending country risk strategies.
- Identifying actions and mandating requirements into the resolution of country risk issues.
- Reviewing and approving (for in-country adoption of regionally / globally approved products) country new and amended products/programs, and ensuring that they meet Group Policy parameters.
- Consider key activities across the bank and their risk implications, and action accordingly.

3. Regulatory Framework

The Bank operates as a scheduled commercial bank and is required to maintain capital ratios at par with locally incorporated banks.

Capital Adequacy requirements are outlined in the following circulars:

- Master Circular – Prudential Norms on Capital Adequacy – Basel I Framework;
- Master Circular – Prudential Guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework ('NCAF'), commonly referred as Basel II guidelines.

Presently, banks in India are required to have a parallel run of the revised framework. Banks are required to apply the prudential guidelines on capital adequacy (per both guidelines mentioned above) on an on-going basis and compute their Capital to Risk Weighted Assets Ratio ('CRAR'). Under the parallel run (which continues till 31 March 2013) Banks are required to hold capital sufficient to meet the Basel II minimum capital requirements subject to a prudential floor of 80% of minimum capital requirement computed under the Basel I framework.

As per NCAF, currently Banks should adopt Standardised Approach (SA) for credit risk and Basic Indicator Approach (BIA) for operational risk. Banks shall continue to apply the Standardised Duration Approach (SDA) for computing capital requirement for market risks.

Basel II guidelines are structured around three 'Pillars' which are outlined below:

- Pillar 1 sets out minimum regulatory capital requirements
- Pillar 2 sets out key principles for supervisory review of Bank's risk management framework and its capital adequacy
- Pillar 3 aims to encourage market discipline by developing set of disclosure requirements by banks that allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes and hence the capital adequacy of the Bank. Further, providing disclosures that are based on a common framework is an effective means of informing the market about exposure to those risks and provides a consistent and comprehensive disclosure framework than enhances comparability, an effective means of informing the market about exposure to those risks and provides a consistent and comprehensive disclosure framework than enhances comparability.

4. Scope of Application

In terms of RBI circular dated 12 December, 2006 on Financial Regulation of Systemically Important NBFCs and Banks Relationship with them, NBFCs promoted by the parent / group of a foreign bank having presence in India, which is a subsidiary of the foreign bank's parent / group or where the parent / group is having management control would be treated as part of that foreign bank's operations in India and brought under the ambit of consolidated supervision. As at 31 March, 2012 no such group owned NBFC is in operations in India, accordingly framework for consolidated supervision does not apply to the Bank.

The bank does not have any subsidiaries in India and consequently not required to prepare Consolidated Financial Statements. The Bank does not have any interest in insurance entities.

5. Capital Structure

Tier 1 capital mainly comprises of

- Interest free capital funds injected by Head Office
- Statutory Reserves calculated at 25% net profits of each year.

Intangible assets, debit balance in Profit and Loss Account have been deducted from above to arrive at Tier I capital.

Tier 2 capital mainly comprises of

- General provision on Standard Assets
- Provision for Country Exposures

The Capital structure as at 31 March, 2012 is as presented below

(Amount in ₹ '000)

Tier I Capital	
Head Office capital	5,854,184
Statutory Reserves	2,236
Debit balance in Profit and Loss Account (Including losses brought forward from Previous period)	(121,847)
Intangibles	(206,124)
Total Tier I Capital	**5,528,449**
Tier II Capital	
General Provisions and other eligible provisions	72,902
Total Tier II Capital	**72,902**
Total Eligible Capital (Tier I + II Capital)	**5,601, 351**

6. Capital Adequacy

The Bank aims to hold sufficient capital to meet the minimum regulatory requirements at all times. The Bank's capital management strategy is two fold:

- To satisfy the Basel II Regulatory Capital requirements set out by RBI in the Master Circular; and
- To minimise the possibility of the Bank's capital falling below the minimum regulatory requirement by maintaining a capital buffer (in excess of the Basel II minimum requirements) sufficient to cover Pillar 2 risks and the capital impact of a moderate (1 in 7 years) or a severe (1 in 25 years) stress scenario over a 1 year horizon.

The Bank's capital management is mainly guided by current capital position, current and future business needs, regulatory environment and strategic business planning. The bank continuously focuses on effective management of risk and corresponding capital to support the risk. India ALCO and India EXCO emphasises on the growth opportunities supported by cost effective capital.

As at 31 March 2012 CRAR stood at 25.50% as per BASEL II norms and 28.57% as per BASEL I norms. The Bank is adequately capitalised presently. Summary of the Bank's capital requirement for credit, market and operational risk and CRAR as at 31 March 2012 is presented below.

(Amount in ₹ '000)

Minimum Regulatory Capital Requirements	
Capital requirements for Credit risk (a)	**1,693,967**
Portfolios subject to standardised approach	1,693,967
Securitisation exposures.	-
Capital requirements for Market risk (b)	**96,573**
Standardised duration approach	
- Interest rate risk	51,573
- Foreign exchange risk (including gold)	45,000
- Equity risk	-
Capital requirements for Operational risk (c)	**186,495**
Basic indicator approach	186,495
Total Minimum Regulatory Capital (a+b+c)	**1,977,035**
Risk Weighted Assets and Contingents	**21,967,058**
Credit Risk	18,821,857
Market Risk	1,073,032
Operational Risk	2,072,169
Capital Ratios	
Tier - I Capital	25.17%
Tier - II Capital	0.33%
Total Capital	**25.50%**

7. Credit Risk: General Disclosures for all Banks

Structure and organisation of credit risk management

India RMC is responsible for all aspects of risk management, including credit risk. It approves the credit exposure/ concentration limits, risk management policy (involving risk identification, risk measurement/ grading, risk mitigation and control), credit risk management structure, credit pricing policy, etc. in accordance with extant regulatory guidelines. India EXCO is apprised of key risks affecting the business. It ensures country's risk profile remains within the agreed group risk appetite.

The Bank takes credit risk within a well defined framework that lays out the fundamental principles and guidelines for its management. Primary objective is management of risk concentration within risk appetite and within regulator defined prudential limits. This framework is top down and has four main components:

- Credit principles
- Credit policies
- Line of Business/ Segment Specific Procedures
- Organisation and People.

Key aspects of the Bank's Credit Risk Management Policy are

- Analysis of customer risk
- Approval of limits and transactions

- Managing and monitoring customers
- Working out problem loans

Credit is extended on the basis of the Bank's credit risk assessment and credit approval requirements and is not subject to any influences external to these requirements. All legal entities, with which the Bank has or is considering having, a credit relationship, is assigned a credit rating reflecting the probability of default and each facility assigned a security indicator reflecting the 'loss given default'. Each country to which the Bank has or is considering having, a credit exposure, is assigned a country rating reflecting the risk of economic or political events detrimentally impacting a country's willingness or capacity to secure foreign exchange to service its external debt obligations.

Risk grade assignment and risk grade reviews are subject to approval by the appropriate independent risk representative. Each assigned risk grade is reviewed at an interval (never greater than 1 year) and whenever new material information relating to the customer or facility is obtained or becomes known. The Bank has an effective credit risk management system and clearly documented credit delegations which define levels of authority for credit approval. The quality of all credit relationships is monitored to provide for timely identification of problem credits and prompt application of remedial actions. Problem credits are managed to minimise losses, maximise recoveries and preserve the Bank's reputation, with attention to measurement of extent of impairment, exposure and security cover, provisioning, remediation, workout & losses. Specialist remediation and workout skills will be applied to the management of all problem credits.

Collateral is a means of mitigating the risk involved in providing credit facilities and will be taken where obtainable and necessary to meet risk appetite requirements. Main types of collateral accepted are property, plant & machinery, current assets, cash and stand-by letters of credit. Reliance on collateral is not a substitute for appropriate credit assessment of a customer or be used to compensate for inadequate understanding of the risks. Collateral arrangements for each facility are reviewed annually to confirm the fair value of collateral and to ensure there is no impediment to realisation. The fair value of collateral will be its realisable value net of realisation costs.

7.1 Total gross credit risk exposures as at 31 March, 2012

(Amount in ₹ '000)

Fund Based	
Claims on Banks	2,143,962
Investments (HTM)	-
Loans and Advances	13,187,239
Other Assets and Fixed Assets	779,353
Non Fund Based	
Non Market Related Off Balance sheet items (Contingent Credits and Exposures)	1,165,712
Market Related (Foreign Exchange (Fx) and Derivative contracts)	1,545,591

Notes:

Non Fund Based credit risk exposure has been computed as under:

- In case of exposures other than FX and derivative contracts, credit equivalent is arrived at by multiplying the underlying contract or notional principal amounts with the credit conversion factors prescribed by RBI under the Basel II capital framework.

- In case of Foreign exchange and derivative contracts, credit equivalents are computed using the current exposure method as prescribed by RBI.

7.2 Geographic distribution of exposures, Fund based and Non-fund based separately

Since all the exposures provided under Para 7.1 above are domestic, the disclosures on geographic distribution of exposures, both fund and non-fund based, has not been made.

7.3 Industry type distribution of exposures as at 31 March, 2012

(Amount in ₹ '000)

Industry Name	**Fund Based**	**Non Fund Based**
All Engineering	200,000	-
Chemicals, Dyes, Paints etc.	**2,043,196**	-
of which :Drugs and Pharmaceuticals	834,446	-
of which :fertiliser	700,000	
Food Processing	3,000,000	-
Infrastructure	1,345,814	-
Iron & Steel	432,438	-
Mining	442,613	-
NBFC	2,190,000	-
Other Industries	522,438	-
Other Metals & Metal Products	145,172	-
Rubber & Rubber Products.	404,457	-
Sugar	600,326	-
Trading	1,860,786	-
Total Loans & Advances	**13,187,239**	**-**
Claims on Banks	2,143,962	**-**
Investments (HTM)	-	**-**
Other Assets and Fixed Assets	779,353	**-**
Total Exposure	**16,110,555**	**-**

Notes:

Fund Based Exposure comprises of Loans & Advances, Claims on Banks and Investment in HTM & Other Assets (including fixed Assets)

Non Fund Based Exposure comprises of Non Market Related Off-Balance sheet items (Contingent Credits and Exposures)

7.4 Residual contractual maturity breakdown of assets as at 31 March, 2012

(Amount in ₹ '000)

	Cash and Bank balances with RBI	Balances with Banks and money at call and short notice	Investments	Advances	Fixed Assets	Other Assets	Total Assets
Day 1	590,082	4,153,893	428,445	660	-	-	5,173,080
2 to 7 days	44,330	-	223,981	3,243,961	-	6,806	3,519,078
8 to 14 days	16,788	-	84,824	296,121	-	174	397,907
15 to 28 days	141,002	1,000,000	712,433	2,550,787	-	51,217	4,455,440
29days and upto 3 months	133,177	1,000,000	672,895	3,104,644	-	32,994	4,943,710
Over 3 months and upto 6 months	149,939	2,950,000	757,585	3,370,925	-	97,800	7,326,249
Over 6 months and upto 1 year	293,671	200,000	1,483,811	620,140	-	1,761,540	4,359,162
Over 1 year and upto 3 years	26,145	-	132,102	-	-	-	158,247
Over 3 years and upto 5 years	69	-	348	-	-	-	417
Over 5 years	4,616	-	23,325	-	399,365	383,035	810,342
Total	*1,399,819*	*9,303,893*	*4,519,748*	*13,187,239*	*399,365*	*2,333,566*	*31,143,632*

7.5 Details of Non-Performing Assets (NPAs) - Gross and Net

(Amount in ₹ '000)

	As at 31 March 2012
Substandard	NIL
Doubtful 1	NIL
Doubtful 2	NIL
Doubtful 3	NIL
Loss	NIL
Gross NPAs	NIL
Provisions and Interest in Suspense	NIL
Net NPAs	NIL

7.6 NPA Ratios

(Amount in ₹ '000)

	As at 31 March 2012
Gross NPAs to gross advances	NIL
Net NPAs to net advances	NIL

7.7 Movement of NPAs (Gross)

(Amount in ₹ '000)

	For the year ended 31 March 2012
Opening balance	NIL
Additions	NIL
Reductions	NIL
Closing balance	NIL

7.8 Movement of provisions for NPAs

(Amount in ₹ '000)

	For the year ended 31 March 2012
Opening balance	NIL
Provisions made during the period	NIL
Write-off	NIL
Write-back of excess provisions	NIL
Closing balance	NIL

7.9 Amount of Non-Performing Investments

There are no non-performing investments as at 31 March 2012.

7.10 Amount of provisions held for Non-Performing Investments

There are no provisions held for non-performing investments as at 31 March 2012 as there are no non performing investments.

7.11 Movement of provisions for depreciation on investments

(Amount in ₹ '000)

	For the year ended 31 March 2012
Opening balance	NIL
Provisions made during the period	NIL
Write-off	NIL
Write-back of excess provisions	NIL
Closing balance	NIL

8. Credit Risk: Disclosures for Portfolios Subject to the Standardised Approach

The Bank uses short term / long term issuer rating instruments of the accredited rating agencies viz, CARE, CRISIL, ICRA and Fitch to assign risk weights as per RBI guidelines. For Non resident corporate and foreign banks ratings issued by the international rating agencies like S&P, Moody's and Fitch are used for assigning risk weights.

For assets having a contractual maturity of more than a year long term credit ratings assigned by the above mentioned rating agencies are used.As at 31 March 2012 all of the Bank's exposures were un-rated. Below attached is the summary as at 31 March 2012.

(Amount in ₹ '000)

Nature Of exposure	Gross Credit Exposure	Credit Risk Mitigation	Net Exposure (Before Provision)	Credit Risk weight bucket summary			Deduction from Capital
				< 100%	100%	>100 %	
Fund Based							
Claims on Banks	2,143,962	-	2,143,962	2,143,962	-	-	-
Investments (HTM)	-	-	-	-	-	-	-
Loans and Advances	13,187,239	-	13,187,239	-	13,187,239	-	-
Other Assets and Fixed Assets	779,355	-	779,355	-	779,355	-	-
Non Fund Based							
Non Market Related Off Balance sheet items (Contingent Credits and Exposures)	1,165,712	-	1,165,712	515,167	650,544	-	-
Market Related (Foreign Exchange (FX) and derivative contracts)	1,545,591	-	1,545,591	836,324	709,266	-	-

9. Credit Risk Mitigation: Disclosures for Standardised Approaches

RBI Basel II guidelines allow following credit risk mitigants to be recognized for regulatory capital purposes under the comprehensive approach

- Eligible financial collateral which included cash (deposited with the Bank), gold, securities issued by Central and State governments, Kisan Vikas Patra, National Savings Certificate, life insurance policies, certain debt securities rated by a recognised credit rating agencies, mutual fund units.
- On balance sheet netting, which is confined to loans and advances and deposits where banks have legally enforceable netting arrangements, involving specific lien with proof of documentation.
- Guarantees where these are direct, explicit, irrevocable and unconditional. Further, the eligible guarantors would comprise :
    - Sovereigns, sovereign entities stipulated as per Basel II guidelines, banks and primary dealers with a lower risk weight than the counterparty;
    - other entities rated AA (-) or better

These credit risk mitigation techniques are subject to specific conditions given in Basel II guidelines.

Main types of collateral accepted by the Bank are property, plant & machinery, current assets, cash and stand-by letters of credit. Collateral arrangements for each facility are reviewed annually to confirm the fair value of collateral and to ensure there is no impediment to realisation. The fair value of collateral will be its realisable value net of realisation costs.

Credit Risk Mitigation details as at 31 March 2012 are as below

(Amount in ₹ '000)

Exposure covered by eligible financial collateral after application of haircuts	NIL
Exposure covered by guarantees	NIL

10. Securitisation Exposures: Disclosure for Standardised Approach

The Bank has not securitised any asset for the year under review hence no disclosures have been made.

11. Market Risk

Market risk arises when changes in market rates, prices and volatilities lead to a decline in the value of assets and liabilities, including financial derivatives. Market risk is generated through both trading and banking book activities.

The Bank conducts trading operations in interest rates, foreign exchange and securities.

The Bank has a detailed risk management and control framework to support its trading and balance sheet activities. The framework incorporates a risk measurement approach to quantify the magnitude of market risk within trading and balance sheet portfolios.

The management of Risk Management is supported by a comprehensive limit and policy framework to control the amount of risk that the Group will accept. Market risk limits are allocated at various levels and are reported and monitored by Market Risk on a daily basis. The detailed limit framework allocates individual limits to manage and control asset classes, risk factors and profit and loss limits.

To facilitate the management, measurement and reporting of market risk, the Bank has grouped market risk into two broad categories:

- Traded market risk

  This is the risk of loss from changes in the value of financial instruments due to movements in price factors for both physical and derivative trading positions. Trading positions arise from transactions where the Bank acts as principal with customers, financial exchanges or interbank counterparties.

- Non-traded market risk (or balance sheet risk)

  This comprises the management of non-traded interest rate risk and liquidity.

Value at Risk ('VaR') measure

A key measure of market risk is Value at Risk (VaR). VaR is a statistical estimate of the possible daily loss and is based on historical market movements.

The Bank measures VaR at a 97.5% and 99% confidence interval. This means that there is a 97.5% or 99% chance that the loss will not exceed the VaR estimate on any given day. The Group's standard VaR approach for both traded and non-traded risk is historical simulation. The Group calculates VaR using historical changes in market rates, prices and volatilities over the previous 500 business days. Traded and non-traded VaR is calculated using a one-day holding period.

It should be noted that because VaR is driven by actual historical observations, it is not an estimate of the maximum loss that the Group could experience from an extreme market event. As a result of this limitation, the Group utilises a number of other risk measures (e.g. stress testing) and risk sensitivity limits to measure and manage market risk.

To supplement the VaR methodology, the Bank applies a wide range of stress tests, both on individual portfolios and at a Group level. The Bank's stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on market risk exposures of the Bank. Standard stress tests are applied on a daily basis and measure the potential loss arising from applying extreme market movements to individual and groups of individual price factors.

12. Liquidity Risk

Liquidity risk is the risk that the bank has insufficient capacity to fund increases in assets or is unable to meet its payment obligations as they fall due. The timing mismatch of cashflows and the related liquidity risk is inherent in all banking operations and is closely monitored by the bank.

The bank maintains a portfolio of liquid assets to manage potential stresses in funding sources. The minimum level of liquidity portfolio assets to hold is based on a range of the Bank specific and general market liquidity stress scenarios such that potential cash flow obligations can be met over the short to medium term.

The bank's liquidity and funding risks are governed by a detailed policy framework of the group. The core objective of the framework is to ensure that the bank has sufficient liquidity to meet obligations as they fall due, without incurring unacceptable losses.

Key principles of the Bank's approach to liquidity risk management include:

- Maintaining the ability to meet all payment obligations in the immediate term. Ensuring that the bank has the ability to meet 'survival horizons' under a range of the Bank group specific and general market liquidity stress scenarios to meet cash flow obligations over the short to medium term.
- Maintaining strength in the bank's balance sheet structure to ensure long term resilience in the liquidity and funding risk profile.
- Limiting the potential earnings at risk implications associated with unexpected increases in funding costs or the liquidation of assets under stress.
- Ensuring the liquidity management framework is compatible with local regulatory requirements.
- Preparation of daily liquidity reports and scenario analysis, quantifying the bank's positions.

- Targeting a diversified funding base, avoiding undue concentrations by investor type, maturity, market source and currency.
- Holding a portfolio of high quality liquid assets to protect against adverse funding conditions and to support day-to-day operations.
- Establishing detailed contingency plan to cover liquidity crisis events.
- Management of liquidity and funding risks are locally overseen by India ALCO

Scenario modelling:

A key component of the Group's liquidity management framework is scenario modelling. The Bank mainly assesses liquidity under different scenarios, including the 'going-concern' and 'name-crisis'.

'Going-concern': reflects the normal behaviour of cash flows in the ordinary course of business. The group policy requires that the bank should be able to meet all commitments and obligations under a going concern scenario, within the bank's normal funding capacity, over at least the following 30 calendar days. In estimating the funding requirement, the bank models expected cash flows by reference to historical behaviour and contractual maturity data.

'Name-crisis': refers to a potential name-specific liquidity crisis which models the behaviour of cash flows where there is a problem (real or perceived) which may include, but is not limited to, operational issues, doubts about the solvency of the Group or adverse rating changes. Under this scenario the bank may have significant difficulty rolling over or replacing funding. The requirements of the scenario are that the Bank must remain cash flow positive for eight calendar days.

Liquidity crisis contingency planning

The bank has a Liquidity Crisis Contingency Plan (the Plan) to articulate a risk management framework to protect depositors, creditors and shareholders should the Bank be involved in either a 'market liquidity' event, or a 'name specific' liquidity crisis event. The purpose of the framework is to outline the core management actions, resources and capabilities used to respond to and resolve any material liquidity crisis impacting the Bank.

This Plan outlines those management actions necessary to alleviate a Group or Australia or the Bank liquidity crisis event. The Plan supplements and adheres to the group liquidity crisis plan to form a general management framework for potential liquidity risk of the Bank, by establishing specific local issues and management strategies that need to be considered in a liquidity crisis event.

Capital requirement for Market Risk is provided in Table no 3. Capital & Risk Weighted Assets above

13. Operational Risk

The Bank understands and manages operational risk efficiently and effectively, allocating appropriate capital to cover expected and unexpected losses to protect depositors, customers and shareholders. The bank's operational risk measurement and management framework will support its people to effectively manage the risks in their day-to-day decision making, provide quality service to the customer and ensure regulatory compliance.

An effective and embedded governance structure is also built for managing operational risk in line with the bank's values, culture, strategy and appetite. The oversight of operational risk management is conducted via three clearly articulated layers of risk management – Three lines of defence:

- The area where the risk originates is responsible for managing the risk. This is defined as 'the First Line of Defence'.
- To ensure appropriate challenge and oversight, there is a dedicated and independent operational risk management function. This is 'the Second Line of Defence'.

  The first and second lines of defence have defined roles, responsibilities and escalation paths to support effective two way communication and management of operational risk. There are also on-going review mechanisms in place to ensure the framework continues to meet organisational needs and regulatory requirements.
- 'The Third Line of Defence' has an independent oversight role within the governance structure and is performed by Internal Audit. Internal Audit provides independent and objective assurance to management that the first and second lines of defence are functioning as intended.

The Bank periodically identifies and assesses its exposure to material operational risk within all existing and new products, processes, projects and systems, and assesses the key controls in place to manage these risks. Compliance to the operational risk measurement and management framework is monitored using one or more of the following mechanisms, but is not limited to:

- Half yearly Risk Certification
- Periodic Control Testing
- Internal Audit Reviews
- Periodic External Reviews
- Compliance Monitoring

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

The objective of balance sheet interest rate risk management is to secure stable and optimal net interest income over both the short (next 12 months) and long term. Non-traded interest rate risk relates to the potential adverse impact of changes in market interest rates on the Branch's future net interest income. This risk arises from two principal sources: mismatches between the re-pricing dates of interest bearing assets and liabilities; and the investment of capital and other non-interest bearing liabilities in interest bearing assets.

The extent of mismatching between the re-pricing characteristics and timing of interest bearing assets and liabilities at any point has implications for future net interest income. The Branch quantifies the potential variation in future net interest income as a result of these re-pricing mismatches.

The re-pricing gaps themselves are constructed based on contractual re-pricing information. However, for those assets and liabilities where the contractual term to re-pricing is not considered to be reflective of the actual interest rate sensitivity (for example, products priced at the Group's discretion), a profile based on historically observed and/or anticipated rate sensitivity is used. This treatment excludes the effect of basis risk between customer pricing and wholesale market pricing.

The Bank's approach is to transfer market risk from the businesses to Treasury using a funds transfer price (FTP).

Earnings at Risk (EAR)

The Bank uses Earnings at Risk (EaR) as an estimate of the amount of the next 12 months' income that is at risk from interest rate movements over a 1 month holding period, expressed to a 97.5% level of statistical confidence. It is calculated by applying a statistically derived interest rate shock to static repricing gaps over the first 12 months.

The Bank monitors the sensitivity of EAR to a 200 basis point parallel shift in interest rate, over a one year horizon.

The position as at 31 March 2012 is as below

(Amount in ₹ '000)

Currency	**Interest Rate Risk Shocks**	
	200bp up	**200bp down**
Rupees	9,407	(9,407)
USD	11,716	(11,716)

Economic Value at Risk

Economic Value at Risk is an estimate of the impact of interest rate changes on the banking book's market value, expressed to a 97.5% level of statistical confidence and using a 1 day holding period.

The position as at 31 March 2012 is as below

(Amount in ₹ '000)

Currency	**Value at Risk**
Combined	3,685