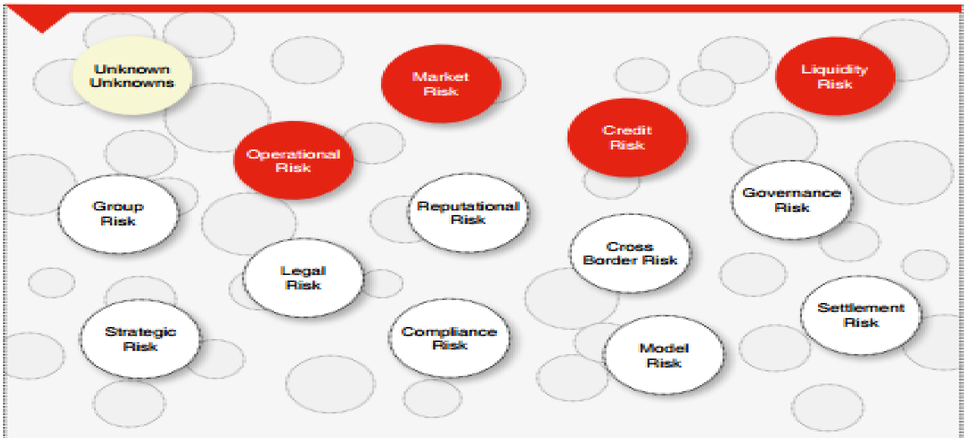
Sustained profitability through Risk Management

The strategy of the Bank is ensuring sustained profitability through good times and bad times. Taking risks is inherent in any bank's strategic plan. The Bank's risk philosophy is that the risk should be taken in line with the Bank's risk appetite and it should fit in with the Bank's business strategy. The need of the economy is resilient banks which create shareholder value. Risk management continues to be a key area of focus providing the framework for a stable foundation of the Bank.

Integrated Risk Management at NDB

Based on self-assessment the Bank has identified several risk categories in addition to the main risk categories (Credit, Market & Operational Risk) which are material to Bank. The other risk categories include Liquidity Risk, Interest Rate Risk in the Banking Book, Underestimation of Credit Risk in Standardized Approach, Residual Credit Risk, Concentration Risk, Compliance Risk, Legal Risk, Strategic Risk, Reputational Risk, Model Risk and Settlement Risk. The Integrated Risk Management Framework, which is approved by the Board, spells out the Bank's approach to Risk Management. The framework is underpinned by a set of key principles which serves as the foundation.

RISK UNIVERSE



Risk Principles

Risk Appetite & Strategy	Establishment of a risk appetite and strategy which articulates the nature, type and level of risk the Bank is willing to assume and is approved by the Board.
Capital Management	Capital management is driven by the Bank's strategic objectives and accounts for the regulatory, economic and commercial environments in which the Bank operates.
Governance & Oversight	Proper governance and oversight through a clear, effective and robust governance structure with well-defined, transparent and consistent lines of responsibility established.
Risk Culture	Promotion of a strong risk culture that supports and provides appropriate standards and incentives for professional and responsible behaviour.
Risk Policies & Processes	Implementation of policies to ensure that risk management practices and processes are effective at all levels and execution of sound risk management processes to actively identify, measure, control, monitor and report risks inherent in all products, activities, processes, systems and exposures.
Infrastructure	Ensure sufficient resources and systems infrastructure are in place to enable effective risk management.

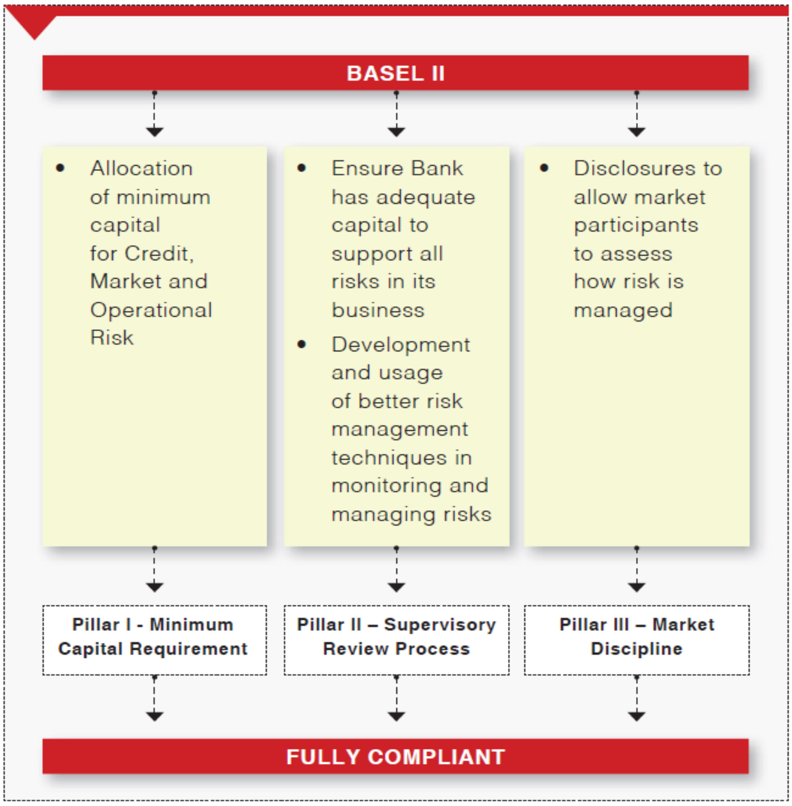
Risk Appetite and Strategy

Risk Appetite is defined as the quantum of risk the Bank is willing to assume in different areas of business in achieving its strategic objectives and ensuring maintenance of desired risk profile. The Risk Appetite Framework and tolerance limits have been defined by the Board in consultation with the Senior Management of the Bank in-line with the Bank's overall business strategy, providing clear direction to the business units for ongoing operations and risk management. The Risk Appetite framework and Risk Tolerance limits are reviewed and adjusted by the Board when required based on developments in the operating environment.

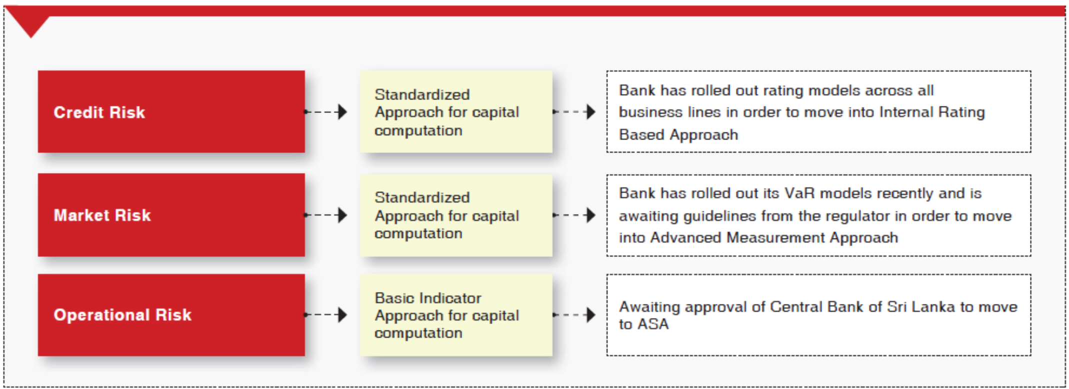
Capital Management

The Bank's approach to capital management is driven by strategic objectives and guided by the BASEL principles. The Bank is fully compliant with the BASEL regulatory requirements and has already embarked on its journey towards advanced approaches in order to optimize on capital.

BASEL II FRAMEWORK



ADVANCED APPROACHES OF PILLAR I



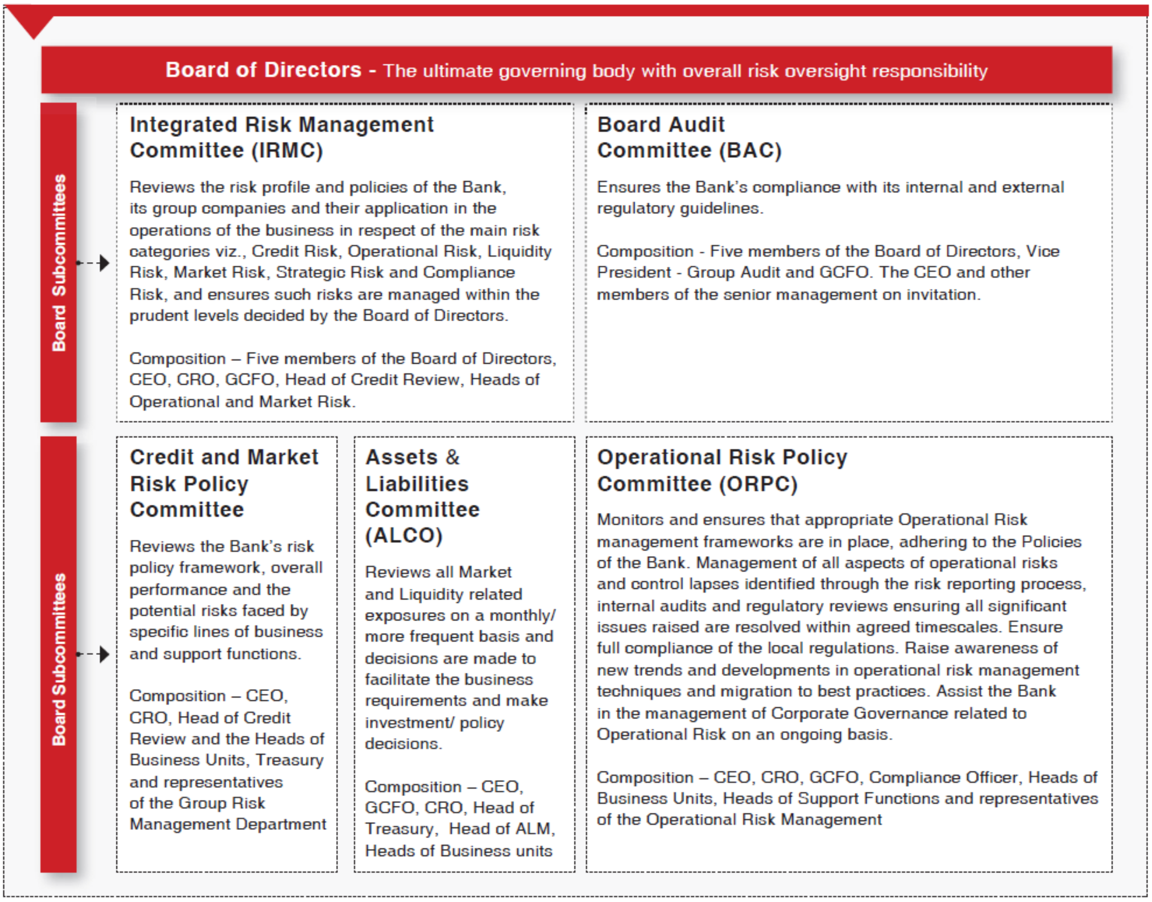
BASEL III is the new global regulatory standard on managing capital and liquidity of banks. Bank is fully compliant with BASEL III regulatory requirements.

The Bank has in place, a comprehensive Stress Testing Policy and Framework which is in line with the regulatory guidelines as well as international best practices. Stress tests are conducted at various frequencies in-line with the Board approved framework and details of those are reported to Board. The outcome of stress testing process is monitored carefully and remedial actions taken in case of breaches. Further stress testing is used by the Bank as a tool to supplement other risk management approaches.

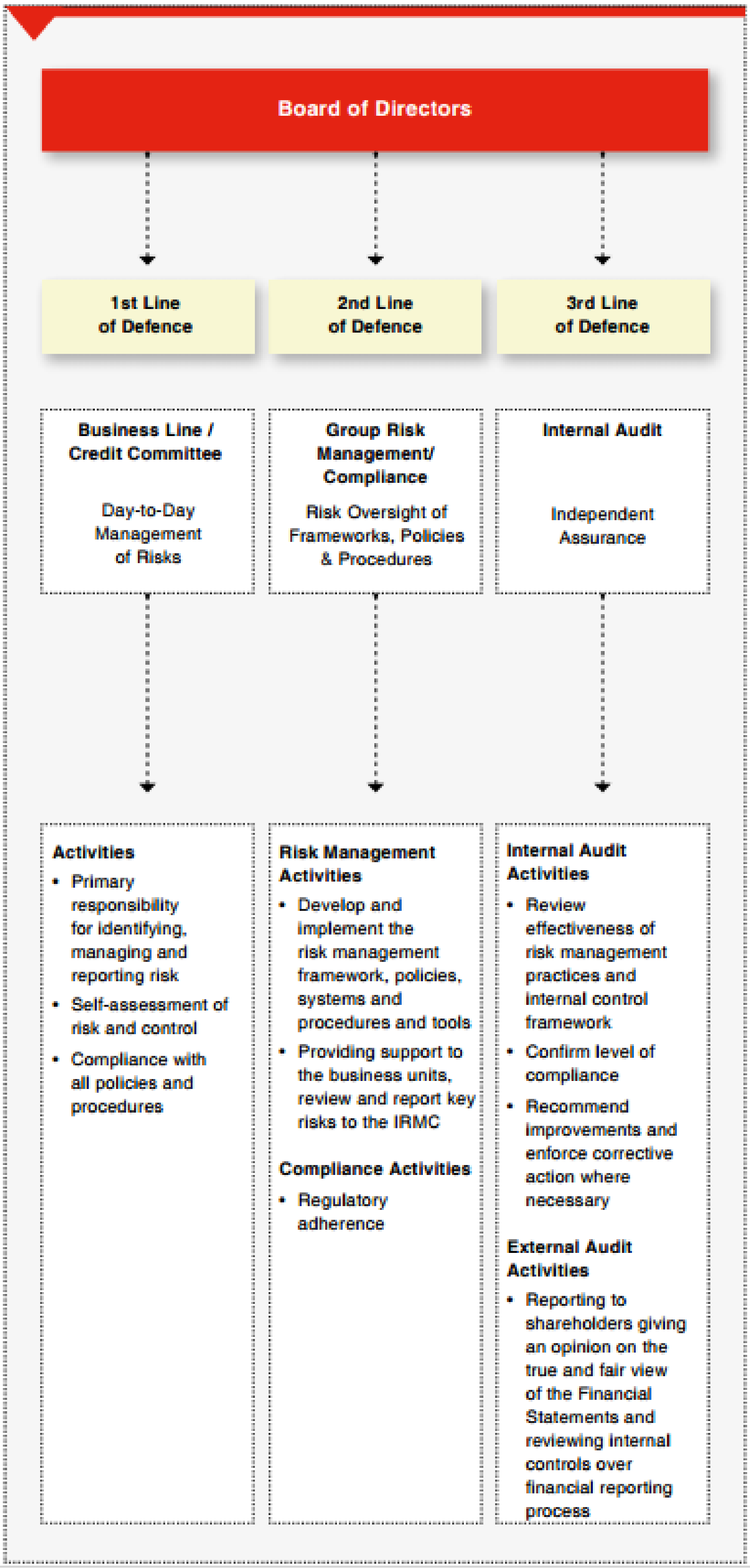
Governance & Oversight

The Bank's Board of Directors has the overall responsibility for risk management and sets the tone at the top through its risk appetite. In discharging its governance responsibility, it operates through Integrated Risk Management Committee (IRMC) and the Board Audit Committee (BAC). The Bank's Risk Management Division is independent of the business units and reports directly to the Integrated Risk Management Committee.

RISK GOVERNANCE MODEL



RISK GOVERNANCE MODEL



Risk Culture

A strong risk culture is the fundamental tenet of the Bank's risk management and serves as the foundation upon which a strong risk management structure is built.

RISK CULTURE

Characteristics	Bank's Context
Commonality of Purpose, Values and Ethics	
People's individual interests, values and ethics are aligned with those of the Bank	Each individual is committed to upholding Bank values
Universal Adoption and Application	
Risk is considered in all activities, from strategic planning to day-to-day operations	- Adoption of the risk governance model - Operational Risk Officers in all vital Departments
A Learning Organization	
The collective ability of the organization to manage risk more effectively is continuously improving	- Risk analyst newsletter circulated across the Bank to improve awareness - ELearning modules in Risk Management and Compliance in place
Understanding the Value of Effective Risk Management	
People understand the value of risk management	- Various campaigns carried out on risk and compliance focused areas

Credit Risk Management

- ✓ Credit risk is the risk that the bank will incur a loss because its customers or counterparties fail to discharge their contractual obligations. NDB Bank has a well-defined credit policy approved by the Board of Directors. It defines the
  - credit culture of the Bank
  - specify prohibited lending which the Bank under no circumstances will entertain
  - set acceptable risk parameters
  - set remedial and recovery actions

- ✓ The bank manages and controls credit risk by
  - setting limits on the amount of risk it is willing to accept for individual/ group counterparties and industry concentrations, and by monitoring exposures in relation to such limits.
  - established credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, assess the potential loss and take corrective action.
  - Counterparty limits are established by the use of a Credit risk rating system, which assigns each counterparty a risk rating and Risk ratings are subject to regular revision.

- ✓ Impairment assessment - The Bank has in a place a detailed impairment policy approved by the Board of Directors
  - Individually assessed allowances - determines the allowances appropriate for each individually significant loans or receivables on an individual basis if there is any objective evidence of a loss based on the above.
  - Collectively assessed allowances - assessment is made for groups of assets with similar risk characteristics. The collective assessment takes account of data from the loan portfolio (such as loan types, industry codes and level of arrears).

- ✓ Collateral and other credit enhancements - The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral.

Please refer the latest Annual Report for further details.

Market Risk Management

The market risk can be defined as the potential for adverse change in the market value of trading and investing positions. Risk can arise from adverse changes in interest rates, foreign exchange rates, equity prices, commodity prices and credit spreads.

Under a well-defined governance structure the risks are identified assessed controlled and reported to ensure that the Bank operates within specified risk appetite levels.

Organization Structure and Market Risk Management (MRM) Unit

The MRM unit is a part of the larger Group Risk Management, which is responsible for identifying, measuring, monitoring, and reporting on Market and Liquidity risks arising from the bank's activities; including Treasury Middle Office functions.

The major responsibilities / functions of the MRM unit are described below -

1. Policy and limits Formulation
2. Risk Measurement Methodologies
3. Risk analytics and mitigants
4. Reporting and Communication

The Market Risk Management processes:

- **Risk Identification:** seeks to identify all sources of market risk and adopts in policy methods to do so
- **Risk Measurement:** provides meaningful assessment of current levels of market risk factors, exposures and is capable of identifying any excessive exposure that might arise taking into consideration diversification benefits
- **Risk Mitigation and Control:** involves setting limits to control market risk exposures and vulnerabilities so that they remain within the BOD-approved risk tolerance levels and ensure prompt management attention when certain limits are breached
- **Risk Monitoring and Control:** encompasses continual checking, supervision and critical observation in order to ensure adherence to limits and policies, and ensuring that the market risk profile stays within the tolerance boundaries approved by the BOD

Market Risk Management Framework

The Bank is also equipped with a well-defined policy framework consists of roles and responsibilities, procedures, risk measurement framework, risk monitoring, reporting and controls taking in to account rules and regulations and the best industry practice

The Market risk limits are key controls designed to ensure the Bank is not exposed to risks beyond a pre-defined risk appetite. The Board resides the authority to approve the Market risk limit framework, supported by Integrated Risk Management Committee (IRMC), Asset Liability Management Committee (ALCO) and Market Risk Management, considering the Balance Sheet structure, business needs and the risk profile of the Bank. . Prudential internal limits have been defined for Interest rate risk, price risks and foreign exchange risks for close monitoring of exposures. All exposure limits are subject to annual review and are linked to Bank's capital base to ensure adequate and efficient capital allocation/ planning.

Market Risk Measurement and Assessment

Market Risk Management aims to accurately measure all types of market risk by a comprehensive set of risk metrics reflecting economic and regulatory requirements. These metrics are monitored on a daily, weekly, monthly and quarterly basis.

Key Market Risk metrics:

- Standardized Measurement Method for Capital charge
- Stress tests: Portfolio Stress Testing, business level stress testing Economic Value of Equity
- Scenario/ Sensitivity analysis.
- Duration analysis
- FX Risk monitoring metrics
- Value at Risk Measurement
- Stop loss limits

The results of the above metrics are monitored against internal prudential limits where applicable. Where limits are exceeded, Market Risk Management is responsible for identifying and escalating those excesses to the senior management on a timely basis.

Please refer the latest Annual Report for further details.

Liquidity Risk Management

Liquidity risk arises due to unmatched maturities of assets and liabilities, that hinders honoring commitments as and when they fall due or will have to do so at an excessive cost. Thus the overall funding strategy takes into consideration both timing and size of business and investment together with the various sources of funding.

Effective liquidity risk management is essential to maintain the confidence of depositors and counterparties as well as to ensure that the Bank's core businesses continue to generate revenue, even under adverse conditions.

Liquidity Risk Management Process:

The responsibility for the liquidity risk management of the Bank rests with the ALCO. Bank's Treasury/ALM units are responsible for executing the day-today liquidity management of the Bank within the parameters set by ALCO. Key liquidity measures are managed and monitored on a daily, weekly or monthly basis to ensure that the Bank meets the regulatory as well as the internal prudential limits whilst meeting the customer demands without incurring unacceptable losses.

Liquidity Risk Management Framework

The objective of our liquidity framework is to ensure that all anticipated funding commitments can be met when due and allow us to withstand liquidity stresses whilst maintaining our business profile. It is designed to be adaptable to changing business models, market and regulations.

The Bank maintains well-articulated liquidity risk management Policies and procedures, which drive the level of liquidity risk exposures and determine the business size and maturities which ensure that it has at all times sufficient liquidity to meet its financial obligations at a fair market price.

The Bank is equipped with a comprehensive Liquidity Contingency Funding Plan (LCFP) linked to the Business Continuity Plan, which is in line with the regulatory guidelines. The LCFP clearly defines the responsibilities of the Liquidity Management Team and ensures the business continuity through close monitoring of the Bank's liquidity position against the pre-defined liquidity risk trigger points. Trigger points have been defined taking into consideration the Bank specific and systemic triggers which would cause a liquidity crisis. Action Plans are set out under each level of liquidity crisis (Mild, Moderate, Severe) with responsibilities assigned to a Liquidity Management Team nominated from all areas of business to ensure that all stakeholders of the Bank are safeguarded.

The Bank has entered in to reciprocal liquidity funding agreements with identified counterpart banks to ensure stability.

Liquidity Risk Measurement and Assessment

Liquidity Risk Management aims to accurately measure all types of liquidity risk by a comprehensive set of risk metrics reflecting economic and regulatory requirements. These metrics are monitored on a daily, weekly, monthly and quarterly basis.

Key Liquidity Risk metrics:

- Regulatory Risk measures on Liquidity Risk; - Liquid asset ratio (LAR), statutory reserve requirement (SRR) and liquidity coverage ratio (LCR).
- Prudential liquidity management ratios/limits – Advances to deposits (ADR), Commitment limit, Swap funding limit.

  Liquidity Gap Analysis – The maturities of assets and liabilities are placed under different time bands according to the residual time to maturity and non-maturity items as per CBSL recommended/ Bank specific behavioral assumptions. Exposure limits are in place for each time bucket and are monitored against the same.

- Stress Testing – Frequent stress test is carried out to assess the unforeseen liquidity crisis scenarios and as a forward looking risk management tool.

The results of the above metrics are monitored against internal/external prudential limits where applicable. Where limits are exceeded, Market Risk Management is responsible for identifying and escalating those excesses to the senior management on a timely basis and ensure corrective action are taken.

Please refer the latest Annual Report for further details.

Operational Risk Management

The Operational Risk Management unit is notably responsible for:

- Developing, communicating and maintaining Operational Risk policy and guidelines.
- Developing and continuously improving the (enterprise-wide) Operational Risk Management process.
- Raising awareness of Operational Risk Management across the Bank.
- Providing support with the implementation of the Operational Risk Management process and the interpretation of related policy and guidelines.
- Co-ordinating the group operational risk management tools and activities; Part of the co-ordination tasks relate to the development and roll-out of the operational risk management methodologies (e.g. tooling, training, systems) to be adopted by the Bank.
- Developing and implementing a corporate “Operational Risk Management Database” that includes information relating to operational risk, for example, loss events.
- Ensure process changes are identified during BORSB meetings or through any other channel/input and relevant risks arising from those are assessed and managed.

In addition to the Operational Risk Management unit, the Operational Risk Committees have been set up at Bank level, as well as Business levels and Support function levels. The operational risk function includes Operational Risk Managers (ORMs) in the Business units and Support function, who are responsible for implementing the Bank’s procedures and guidelines, and for monitoring and managing operational risks, with the support of the staff in the business lines and support functions and in close collaboration with the respective Business / Support function Heads, under the authority of the Bank’s Head of Operational Risk.

The Bank holds capital for operational risk equal to the average over the previous three years of a fifteen percentage of positive annual gross income- BIA (Basic Indicator Approach)

The Bank has made an application seeking approval from CBSL to move to advanced approaches.

The Bank is concerned and committed to ensuring that the outsourced parties continue to uphold and extend the high standard of customer care and service excellence that has become synonymous with NDB. Hence due diligence tests are routinely carried out to assess the performance of these outsourced parties through a sub-committee established to monitor outsourced activities for the Bank.

Operational Risk Monitoring Process

The framework specifically established by the Basel II regulations (the Capital Requirements Directive and “Sound practices for the management and supervision of operational risk”) have been implemented, on the basis of existing procedures wherever possible. Those notably include:

- Gathering of internal data on operational risk losses/events
- Risk and Control Self–Assessment (RCSA) processes
- Key Risk Indicators (KRI)
- Scenario Analysis
- Key Control Design Validation
- Business Continuity planning and crisis management

The Bank's classification of operational losses in seven Basel event categories is the cornerstone of its risk modelling, ensuring consistency throughout the system and enabling analysis across the Bank.

Insurance Cover in Operational Risk Management

The Bank has a comprehensive insurance policy as a measure to mitigate risks. This falls within the framework of risk mitigation and control which in turn is an integral component of the risk management framework of the Bank. The policies cover the following aspects;

- General risks
- Risks arising from operations
- Theft / fraud
- Professional liability
- Operating losses

Please refer the latest Annual Report for further details.