Basel II
Pillar 3 – Disclosures
December 2012

Note to Readers

This document is prepared in accordance with OSFI expectations (OSFI letters dated July 13, 2011 on Implementation of disclosures for Basel II Pillar 3 enhancements and revisions, and June 14, 2012 on Basel Pillar 3 public disclosures) on inclusion full qualitative and quantitative disclosures applicable to State Bank of India (Canada) as required on an annual basis.

The Pillar 3 Disclosures for 2012 have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards ('IFRS'). Therefore, some information in the Pillar 3 Disclosures is not directly comparable with the financial information in the Bank's Audited Financial Statement for 2012.

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Overview of Reporting Entity

State Bank of India (Canada) (the "Bank") is a wholly owned subsidiary of State Bank of India (the "parent bank") and is licensed to operate in Canada as a bank with full banking powers under the Bank Act (Canada) as a foreign bank subsidiary. The Bank's registered office is at 200 Bay Street, Suite 1600, Toronto, Ontario M5J 2J2, Canada. The Bank is involved in corporate and retail banking.

Significant subsidiaries

The Bank has no subsidiaries or entities for consolidation.

Public Disclosure Policy

The Bank has implemented a formal Public Disclosure Policy. It addresses the Bank's approach for determining the disclosure applicable to the Bank and the internal control process over it. This policy is approved by the board of directors and is subject to annual review and approval.

Regulatory Capital

Capital management

Capital levels for Canadian banks are regulated pursuant to guidelines issued by OSFI. Regulatory capital is allocated to two tiers: Tier 1 and Tier 2. Total capital is defined as the total of Tier 1 and Tier 2 capital less deductions as prescribed by OSFI.

Capital ratios are calculated by dividing Tier 1 and Total capital by risk-weighted assets ("RWA"). The calculation of RWA is determined by OSFI prescribed rules relating to on-balance sheet and off-balance sheet exposures.

In addition to the Tier 1 and Total capital ratios, Canadian banks are required to ensure that their assets-to-capital multiple, which is calculated by dividing gross adjusted assets by total capital, does not exceed a maximum level prescribed by OSFI.

(in thousands of Canadian dollars)

	Basel II as at December 31, 2012
	$
Regulatory capital and capital ratios:	
Tier 1 capital:	
Common shares	**117,784**
Contributed surplus	**5,934**
Retained earnings	**981**
Total Tier 1 capital	**124,699**
Tier 2 capital:	
Subordinated debt	**20,000**
Total regulatory capital	**144,699**
Capital ratios:	
Tier 1 capital	**28.35%**
Total capital	**32.90%**
Assets to capital multiple	**4.5**

Subordinated Debt

As at December 31, 2012, the Bank has subordinated debt, which is unsecured and subordinated to deposits and other liabilities, issued to its parent bank in the amount of $20,000. The subordinated debt is measured at amortized cost, using the effective interest method. The debt bears interest at the rate of 6 month Canadian LIBOR plus 1% per annum, payable semi-annually in arrears, until December 31, 2025. The subordinated debt is presently Basel compliant.

The Bank is in compliance with the requirements for assets to capital multiple and risk-based Tier 1 and capital ratios.

Internal Capital Adequacy Process ("ICAAP")

In October 2010, OSFI issued a Guideline E-19, Internal Capital Adequacy Assessment Process (ICAAP) for Deposit-Taking Institutions, to outline their expectations with respect to an institution's internal capital adequacy process as described in Part 3 of the Basel II Framework. It is OSFI's expectation that every federally regulated financial institution ("FRFI"), including Canadian subsidiaries of foreign banks, will put into place an ICAAP that covers the operations from the top level regulated entity in Canada. In all instances, the ICAAP should reflect the FRFI's own circumstances, and not just those of a related group.

The Bank developed its own detailed Internal Capital Adequacy Process document in accordance with OSFI expectations that covers the following six main components:

(i) Board and senior management oversight;

(ii) Sound capital assessment and planning;

(iii) Comprehensive assessment of risks;

(iv) Stress testing;

(v) Monitoring and reporting; and

(vi) Internal control review.

The responsibility for overall capital allocation principles and decisions rests with the Bank’s Board of Directors. The Board of Directors monitors total capital against all material risks identified with respect to the Bank’s business lines.

Through the internal governance processes, the Bank’s senior management is responsible for the investment and capital allocation decisions and assessments, and ensures that returns on investment are adequate after taking account of capital (capital vs. risk) requirements.

The Bank prepares its strategic business plan including capital forecasts within its Annual Budget and Capital planning process.

Risk-Weighted Assets

(in thousands of Canadian dollars)

	Net exposure	RWA
Credit Risk	**664,404**	**406,624**
Market Risk	**-**	**-**
Operational Risk	**-**	**33,250**
Total Risk-Weighted Assets	**664,404**	**439,874**

Capital requirements for credit risk are subject only to standardized approach; capital requirements for operational risk are subject to basic indicator approach.

Gross Credit Risk Exposure

(in thousands of Canadian dollars)

	On Balance sheet exposure	Undrawn commitments	OTC Derivatives	Other Off Balance Sheet Items	Total	RWA
Corporate	**260,044**	**5,600**	**-**	**7,782**	**273,426**	**257,130**
Sovereign	**-**	**-**		**-**	**-**	**-**
Bank	**363,042**	**-**	**4,283**	**-**	**367,325**	**135,518**
Residential Mortgages	**17,543**	**699**	**-**	**-**	**18,242**	**4,373**
Other Retail	**8,205**	**-**	**-**	**-**	**8,205**	**2,963**
Other	**8,579**	**-**	**-**	**-**	**8,579**	**6,640**
Total Gross Credit Exposure	**657,413**	**6,299**	**4,283**	**7,782**	**675,777**	**406,624**

Credit Risk Exposure by Geography

(in thousands of Canadian dollars)

	On Balance sheet exposure	Undrawn commitments	OTC Derivatives	Other Off Balance Sheet Items	Total
Canada	**489,776**	**6,299**	**1,077**	**7,782**	**504,934**
United States	-	-	-	-	-
India	**141,772**	-	**3,206**	-	**144,978**
Other countries	**25,865**	-	-	-	**25,865**
Total	**657,413**	**6,299**	**4,283**	**7,782**	**675,777**

Credit Risk Exposure by industry

(in thousands of Canadian dollars)

	On Balance sheet exposure	Undrawn commitments	OTC Derivatives	Other Off Balance Sheet Items	Total
Bank	**363,042**	-	**4,283**	-	**367,325**
Financial Service	**23,751**	**552**	-	-	**24,303**
Manufacturing	**78,256**	**1,102**	-	**5,179**	**84,537**
Mining	-	-	-	**473**	**473**
Real Estate	**438**	-	-	**434**	**872**
Transportation	**20,558**	**3,946**	-	**1,188**	**25,692**
Communications	**39,592**	-	-	-	**39,592**
Wholesale	**2,094**	-	-	**190**	**2,284**
Retail	**3,638**	-	-	-	**3,638**
Service	**20,538**	-	-	**308**	**20,846**
Other	**105,506**	**699**	-	**10**	**106,215**
Total	**657,413**	**6,299**	**4,283**	**7,782**	**675,777**

Residual Contractual Maturity Breakdown

Residual contractual maturity breakdown of the whole portfolio broken down by major types of credit exposure are currently not available.

Allowance and Impaired Loans

(in thousands of Canadian dollars)

	Individual Allowances	Collective Allowances	Total Allowances	Impaired loans
Corporate	**11,374**	**2,929**	**14,303**	**15,199**
Sovereign	**-**	**-**	**-**	**-**
Bank	**-**	**72**	**72**	**-**
Residential Mortgages	**-**	**15**	**15**	**-**
Other Retail	**-**	**48**	**48**	**-**
Other	**-**		**-**	**-**
Total Gross Credit Exposure	**11,374**	**3,064**	**14,438**	**15,199**

Disclosures for Portfolios subject to the Standardized Approach

The External Credit Assessment Institution (ECAI) used by the Bank is Standard and Poor's ('S&P'). S&P Ratings are recognized by the OSFI as an eligible ECAI and are used to assess the credit quality of all exposure classes, where applicable, using the credit quality assessment scale that is set out by the OSFI in the OSFI Guideline 'Capital Adequacy Requirement (CAR) – Simpler Approaches'.

In accordance with the OSFI CAR Guideline, the risk weight applied to a claim on a bank is dependent on the credit assessment of the sovereign in the bank's country of incorporation. The bank risk weight is one notch less favorable than that which applies to its sovereign of incorporation. The following risk weights apply to claims on DTIs and banks:

Credit assessment of Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
DTI/Bank Risk Weight (Sovereign Credit quality step 1 plus notch)	20%	50%	100%	100%	150%	100%

Risk Weighted Net Exposures after Risk Mitigation

(in thousands of Canadian dollars)

	0%	1% -50%	51% -100%	101% -150%	151% -200%
Standardized approach	**18,016**	**302,251**	**343,812**	**325**	**-**

Credit Risk mitigation used for Standardized Approach

		(in thousands of Canadian dollars)
	Eligible financial collateral	Eligible guarantees
Corporate	**2,985**	**2,650**
Sovereign	**-**	**-**
Bank	**-**	**-**
Residential Mortgages	**-**	**-**
Other Retail	**5,242**	**-**
Other	**-**	**-**
Total Gross Credit Exposure	**8,227**	**2,650**

Counterparty Credit Risk Exposures

Derivatives

In the ordinary course of business, the Bank uses derivative financial instruments, primarily over-the-counter foreign exchange contracts and interest rate contacts to manage its exposure to currency and interest rate fluctuations, as part of the Bank's asset liability management program.

The Bank economically hedges exposure on its assets and liabilities by entering into foreign exchange contracts and interest rate contacts. These derivatives are not designated for hedge accounting and are carried at fair value, with changes in fair value being recorded in other income.

Notional amounts of derivative contracts serve as reference for calculating payments and are a common measure of business volume. The following is a summary of the notional amounts, by remaining term to maturity, of the Bank's derivative positions at the statement of financial position date:

(in thousands of Canadian dollars)

	Within 1 year	1 to 5 years	Over 5 years	Total
	$	$	$	$
Foreign exchange contracts	72,489	36,051	-	108,540
Interest rate contracts	30,022	64,685	-	94,707
	102,511	100,736	-	203,247

The following is a summary of the fair value of the Bank's derivative portfolio at the statement of financial position date classified by positive and negative fair values:

(in thousands of Canadian dollars)

	Positive fair value	Negative fair value	Net fair value
	$	$	$
Foreign exchange contracts	700	(732)	(32)
Interest rate contracts	732	(1,602)	(870)
	1,432	(2,334)	(902)

Current replacement cost is the positive fair value of outstanding derivative financial instruments, which represents the Bank's derivative credit exposure.

Credit equivalent amount is the current replacement cost for favourable contracts plus an amount for the future credit exposure associated with the potential for future changes in currency rates for the contracts. Future credit exposure is calculated using a formula prescribed by OSFI.

Risk-weighted amount represents the credit equivalent amount weighted according to the creditworthiness of the counterparty, using factors prescribed by OSFI.

The following is a summary of the Bank's derivative positions and related credit exposures as at December 3, 2012:

(in thousands of Canadian dollars)

	Current replacement cost	Credit equivalent amount	Risk-weighted amount
	$	$	$
Canada			
Foreign exchange contracts	139	500	100
Other Countries			
Foreign exchange contracts	561	2,727	2,267
Interest rate contracts	732	1,055	1,055
	1,432	4,282	3,422

Reconciliation of changes in the allowances for loan impairment

	(in thousands of Canadian dollars)
Specific allowance for impairment:	
Balance at January 1	25,848
Impairment loss for the year:	
Charges for the year	564
Recoveries	534
write-offs	(15,517)
Other movements	(55)
Balance at December 31, 2012	11,374
Collective allowance for impairment	
Balance at January 1	3,628
Impairment loss for the year:	
Charges for the year	(702)
Other movements	138
Balance at December 31, 2012	3,064
Total allowance for credit losses	14,438

Interest Rate Risk

An analysis of the Bank's interest rate risk by the contractual repricing or maturity dates, whichever is earlier, as at December 31, 2012, is as follows:

(in thousands of Canadian dollars)

	Floating rate	3 months or less	3months to 1 year	1 to 5 years	Over 5 years	Non-rate sensitive	Total
	$	$	$	$	$	$	$
Assets							
Cash and bank balances	9,021	102,268	180,000	-	-	2,274	293,563
Loans and advances to banks	-	28,065	-	-	-	-	28,065
Loans and advances to customers	103,385	76,421	43,870	41,058	-	15,198	279,932
Allowance for credit losses	-	-	-	-	-	(14,438)	(14,438)
Investment securities	-	-	-	44,687	-	-	44,687
Other assets	-	-	-	-	-	11,174	11,174
	112,406	206,754	223,870	85,745	-	14,208	642,983
Liabilities and Shareholder's Equity							
Deposits from banks	-	-	19,866	-	-	6,619	26,485
Deposits from customers	205,570	37,968	155,395	52,409	-	8,698	460,040
Other liabiliities	-	-	-	-	-	10,648	10,648
Subordinated debt	-	-	20,000	-	-	-	20,000
Shareholder's equity	-	-	-	-	-	125,810	125,810
	205,570	37,968	195,261	52,409	-	151,775	642,983
Excess (deficiency) of assets over liabilities and shareholder's equity	(93,164)	168,786	28,609	33,336	-	(137,567)	-
Off-balance sheet position							
Swap assets	-	(49,696)	24,892	24,804	-	-	-
Swap liabilities	-	20,012	19,870	(39,882)	-	-	-
Off-balance sheet gap	-	(29,684)	44,762	(15,078)	-	-	-
Total gap	(93,164)	139,102	73,371	18,258	-	(137,567)	-

Based on the Bank's interest rate positions at December 31, 2012, an immediate and sustained 100 basis point rise in interest rates across all currencies and maturities would increase net income before income taxes by approximately $568 thousands over the next 12 months.

Remuneration paid to Key Management Personnel

Key management personnel ("KMP") are those persons who have authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. The definition of KMP in lAS 24, *Related Party Disclosures*, specifies a role and is not limited to a person. KMP include directors (both executive and non-executive) and other members of the management team with significant authority and responsibility for planning, directing and controlling the Bank's activities.

Key management personnel include the senior management, which is composed of the President & Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Risk Officer, Chief Compliance Officer, SVP Credit, VP TF/Retail and Treasury and VP Business Development (BD).

Remuneration of President & Chief Executive Officer, Chief Operating Officer, VP TF/Retail and Treasury and VP (BD) is determined by parent bank in accordance with its group remuneration policy. Remuneration of the other senior management members is determined by Human Resources Committee of the Board/Board.

Apart from Director fees, the Bank does not provide other benefits to Non-Executive Directors.

There was no change to the remuneration policy as well as process during the year. The Bank does not provide any cash-based or deferred remuneration to senior management personnel. The variable remuneration given to local senior management personnel is year-end bonus, which is based on the established performance appraisal system as well as prescribed in their individual contracts.

Senior management (and all employees) of the Bank participate in the Bank's group benefit plan (which provides certain health care, life insurance and other benefits)

KMP compensation for the year ended December 31, 2012 was $1,300 thousands. This includes all short-term benefits, including director's fees.

In addition, during the year ended December 31, 2012 the Bank had disbursed personal loans to the KMP in the amount of $2 thousands.

General Qualitative Disclosures

As a financial intermediary, the Bank is exposed to various types of risks. The objective of the risk management framework at the Bank is to ensure that the key risks facing the Bank are identified, understood, measured and monitored and that the policies and procedures established to address these risks are strictly adhered to.

The key principles underlying the risk management framework at the Bank are:

(a) The Board of Directors has oversight over the risks assumed by the Bank. Specific Board Committees have been constituted to facilitate focused oversight over these risks.

(b) Policies approved from time to time by the Board of Directors form the governing framework for each type of risk. The business activities are undertaken within this policy framework.

(c) There is an independent Risk Management Department in the Bank to facilitate independent evaluation, monitoring and reporting of risks and which functions independently of the business.

The key risks that the Bank is primarily exposed to include credit, market (including interest rate risk and foreign exchange risk), liquidity risk and operational risk. The approach of management to handle the key risks facing the Bank is outlined below:

(a) Credit risk:

Credit risk is the risk that unexpected losses may arise as a result of the Bank's borrowers or market counterparties failing to meet their obligations to pay. The Bank's Credit Risk Management Policy (the "CRMP"), which is approved by its Board of Directors describes the principles that underlie and drive the Bank's approach to credit risk management, together with the systems and processes through which it is implemented and administered. The CRMP aims to maximize the Bank's risk-adjusted rate of return whilst maintaining the Bank's credit risk exposure within limits and parameters, as approved by the Board of Directors of the Bank.

The Bank has a well defined approach to assessment of commercial credit risk - a credit officer proposing the transaction followed by an independent credit committee assessment of the same. The CRMP lays down a structured and standardized credit approval process, which includes a well-established procedure of independent and comprehensive credit risk assessment and the assignment of an internal risk rating to the borrower. The risk rating is a critical input for the credit approval process and is also an input in arriving at the credit risk spread and level of collective allowance for the proposal.

With respect to retail loans, the Bank's approach requires – an officer proposing the transaction followed by an assessment of the same by a designated officer with suitably delegated authority and where this is in excess of the delegated authority, by an independent credit committee.

The approval process is delegated to various officials and committees as per the guidelines approved by the Board of Directors. Credit proposals are approved by these officials and committees based on, among other things, the amount and internal risk rating of the facility. There is a Corporate Credit Committee (the "CCC") which recommends all proposals that are beyond its powers for consideration of the Risk Management Committee of the Board/Board of Directors.

Monitoring credits, whilst ongoing, can also be triggered by any material credit event coming to the Bank's notice through either primary or secondary sources. All borrower accounts are reviewed at least on an annual basis.

Credit risk is also managed at the portfolio level by monitoring and reporting to the Risk Management Committee ("RMCB") of the Board/Board of Directors on the key parameters of risk concentration, namely, product specific exposures, large exposures, industry / sectoral exposures and country/geographical exposures.

Impairment of loans and allowance for credit losses

Losses for impairment are recognized when there is objective evidence that impairment of a loan or a portfolio of loans has occurred as a result of a loss event and where the loss event has an impact on the estimated future cash flows of the loan or portfolio of loans. Impairment losses are recorded as charges to the statement of comprehensive income. The carrying amount of impaired loans on the statement of financial position is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognized. Objective evidence is represented by observable data that comes to the attention of the Bank and includes events that indicate:

- significant financial difficulty of the borrower;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- a high probability the borrower will enter bankruptcy or a financial reorganization;
- a measurable decrease in the estimated future cash flows from the loan or the underlying assets that back the loan; and
- the Bank for economic and other reasons relating to the borrower's financial difficulty, granting the borrower a concession that the Bank would not otherwise consider.

Loans where interest and principal is contractually past due 90 days in arrears are generally recognized as impaired, unless management determines the loan is fully secured, the collection

of the debt is in process, and the collection efforts are reasonably expected to result in repayment of the loan or in restoring it to a current status within 180 days from the date payment has become contractually in arrears. Finally, a loan that is contractually 180 days in arrears is classified as impaired in all situations.

Credit Risk Ratings are assigned to each loan on a scale of 1 to 8, with credits rated SBIC1 through SBIC4 considered "Satisfactory", SBIC5 being "Especially mentioned" and SBIC6 treated as "Sub-standard".

The following table presents the gross loans outstanding as at December 31 that were neither past due nor impaired:

(in thousands of Canadian dollars)

	2012
	$
Risk rating categories:	
Satisfactory (SBIC1 through 4)	**236,489**
Especially mentioned (SBIC5)	**50,775**
Substandard (SBIC6)	**5,534**

An exposure rated SBIC7 and SBIC8 is classified as impaired under “Doubtful” and “Loss” categories, respectively. For loans in SBIC7 and SBIC8, losses are identifiable on an individual basis and accordingly a specific allowance is established.

As at December 31, 2012, the total gross impaired loans were $15,199 thousands against which an allowance of $11,374 thousands was recorded.

Individually assessed loans and advances

The Bank considers evidence of impairment for loans and advances at an individual level. For all loans that are considered individually significant, the Bank assesses on a case-by-case basis at each reporting period whether an individual allowance for loan losses is required.

For those loans where objective evidence of impairment exists, impairment losses are determined by considering the following factors:

- The Bank's aggregate exposure to the borrower;
- The realizable value of security and the likelihood of successful repossession;
- The amount and timing of expected receipts and recoveries;

- The likely proceeds available on liquidation or bankruptcy;
- The viability of the borrower's business model and ability to generate sufficient cash flows to service its debt obligations; and
- The extent of other creditors' commitment which ranks ahead of the Bank.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Specific allowances are recorded on these individual loans on an account-by-account basis to reduce their carrying value to the estimated realizable amount. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances:

Impairment is assessed on a collective basis to cover:

- Losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- Losses from a homogeneous group of loans that are not considered individually significant.

Loans for which the evidence of loss has been specifically identified on an individual basis, the underlying metrics, including the probability of default, loss given default and exposure at default, for each customer is derived from the Bank's internal rating systems as a basis for determining the collective allowance.

The level of collective allowance is reassessed each quarter and may fluctuate as a result of changes in portfolio volumes, concentrations and risk; analysis of developing trends in probability of loss, severity of loss and exposure at default factors; and management's current assessment of indicators that may have affected the condition of the portfolio.

The loan impairment charges and other credit risk provisions is charged to the statement of comprehensive income and comprises the amounts written off during the year, net of recoveries on amounts written off in prior years, and changes in provisions.

Write-off of loans and advances:

Loans and the related impairment allowances are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realization of security. In circumstances where the net

realizable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognized, the excess is written back by reducing the loan impairment allowance account, accordingly.

Credit Risk Mitigation

The Bank's approach when granting credit facilities is to do so on the basis of capacity to repay rather than place primary reliance on credit risk mitigants. Depending on a customer's standing and the type of product, facilities may be provided unsecured.

Mitigation of credit risk is nevertheless a key aspect of effective risk management and takes many forms.

The Bank's general policy is to promote the use of credit risk mitigation, justified by commercial prudence and good practice as well as capital efficiency. Specific, detailed policies cover the acceptability, structuring and terms of various types of business with regard to the availability of credit risk mitigation, for example in the form of collateral security. These policies, together with the determination of suitable valuation parameters, are subject to regular review to ensure that they are supported by empirical evidence and continue to fulfill their intended purpose.

The most common method of mitigating credit risk is to take collateral.

Collateral and other security enhancements:

The Bank holds collateral against business and personal loans in the form of mortgage interest over property, cash and term deposits, other security over assets, and guarantees.

Policies and procedures provide bank officer with through direction for the protection of the Bank's position from the start of a customer relationship, for instance in requiring standard terms and conditions or specifically agreed documentation permitting the offset of credit balances against debt obligations, and through controls over the integrity, current valuation and, if necessary, realization of collateral security.

Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and are not updated at least at each annual review of the relationship, except when a loan is renewed or when a loan is individually assessed as impaired.

(b) Market risk:

Market risk is the uncertainty of earnings faced by the Bank as a result of volatility in market factors (i.e., interest rates, exchange rates, asset prices, etc.). The policies approved by the Board of Directors for addressing market risk are Security and Investment Policy and Enterprise Risk Management Policy. The Asset Liability Management Committee ("ALCO") considers various investment and treasury operations matters, including the implementation of risk mitigation measures. Furthermore, an independent Treasury-Back Office is set up to monitor and report the various risk limits.

The key risks to which the Bank is exposed from a market risk perspective relate to:

(i) Interest rate risk:

Interest rate risk is defined as the exposure of a bank's financial condition to adverse movements in interest rates. Earnings from interest-sensitive investments and the overall value of the investment portfolio will be impacted by changes in interest rates. The Enterprise Risk Management Policy currently sets out the measurement process to include the use of repricing gap reports and estimation of the sensitivity of the Bank's net interest income to a 200-basis-point adverse change in the level of interest rates. The adverse impact of a 200-basis-point parallel shift in interest rates shall not exceed 5% of the Bank's net capital funds as at the end of the previous year.

(ii) Foreign exchange risk:

The risk arises due to positions in non-Canadian dollar-denominated assets and liabilities in those currencies. The risk originates as a result of the impact on revenue due to the potential revaluation of non-Canadian dollar assets and liabilities. The aggregate net overnight open exchange position across all foreign currencies as per Enterprise Risk Management Policy shall not exceed the lower of U.S. $5 million or 20% of Regulatory Capital.

(iii) Liquidity risk:

Liquidity risk relates to the potential difficulty in accessing financial markets in order to meet payment obligations. It includes both the risk of unexpected increase in the cost of funding the assets and the risk of being unable to liquidate investments in a timely manner at a reasonable price. Treasury ensures that adequate liquidity is maintained at all times through systematic funds planning and maintenance of liquid investments, as well as by focusing on more stable funding sources, such as retail deposits in the long term. In addition, liquidity stress testing analysis is regularly performed by Risk Department to assess the Bank's ability to withstand an extreme crisis situation.

Treasury is responsible for managing the market risk of treasury positions and the day-to-day liquidity of the Bank. It is subject to periodic review by Internal Audit, and is approved by the Board of Directors. Senior management also regularly monitors the positions taken on a daily

basis. The ALCO and the RMCB undertake a periodic review of the market risk and liquidity position of the Bank.

(c) Operational risk:

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems or from external events.

The Bank has developed and implemented an Operational Risk Management framework which is embedded in the Enterprise Risk Management Policy. The Operational Risk Management framework covers the aspects pertaining to minimizing losses due to process failures, losses due to fraud, impact of failures in technology/systems and continuity in the Bank's operations. Operational Losses are reported to the Risk Management Committee.

The Bank has implemented its risk control and self-assessment approach to identify and ensure effective control of its operational risks.

To identify operational risks in new products/processes, all such proposals are examined by the Bank Management Committee, comprising senior management, after obtaining inputs from all the relevant groups and control functions in the Bank.

The Bank has developed and implemented a Business Continuity Plan ("BCP"). This plan is designed to facilitate continuity in critical business operations in the event of a disaster or an emergency situation. The BCP has been formulated on the basis of a business impact analysis carried out for the individual groups involving identification of critical activities and determination of their recovery time objectives. BCP is reviewed by the Risk Management of the Board and approved by the Board of Directors.

The Bank has developed and implemented an Outsourcing Policy to mitigate outsourcing risks and ensure the application of a standardized approach for all outsourcing arrangements entered into by the Bank. All proposed outsourcing arrangements are assessed for their criticality prior to outsourcing, and the proposal is approved by the Board of Directors.

Group risk management framework:

The Bank is subject to the group risk management framework, which has been developed by the parent bank, in order to identify, evaluate and manage key risks on a group-wide basis. The framework is applicable to all overseas bank entities, including the subsidiaries, of the parent.