

Capital Adequacy

What Means from Capital Adequacy and Why is it Important?

Strong capital position is a main component that every institute should consider for their long-term stabilisation. Therefore regulators endeavour to ensure that financial institutions, banks and investment firms have maintained enough capital to ensure smooth running of their business and have strength to meet unexpected economic fluctuations. This measure not only protects depositors within the industry but also the larger economy, as failures of institutions, specially banks, can have wider-scale repercussions.

“Capital Adequacy” is therefore the statutory minimum capital reserve that a financial institution or investment firm must have available under the regulatory provisions and it is compelled to relevant firms to maintain certain level of capital, at any given time against their risk weighted assets. This requirement is measured by, as a percentage of the risk weighted assets and it is called capital adequacy ratio.

$$\text{CAR} = \frac{\text{Tier 1 Capital} + \text{Tier 2 Capital}}{\text{Risk Weighted Assets}}$$

Transformation from Basel I to Basel III

The liquidation of a Europe-based bank in 1974 prompted the group of ten (G-10) nations to set up the Basel Committee on Banking Supervision (BCBS), under the direction and supervision of the Bank of International Settlements, which is in Basel, Switzerland. After the experience of drowning of Europe-based bank and as a result of the liquidation of the same, this Committee instigated the Basel I Accord in 1988 with a view to resilience of financial institutions.

The Basel I Accord was the outcome of a round of consultations and deliberations by central bankers from around the world, which resulted in the publishing by the BCBS of a set of minimum capital requirements for banks. This is also known as the 1988 Basel Accord, and was enforced by law in the G-10

countries in 1992. Basel I was primarily focused on Credit Risk and Risk Weighted Assets (RWA).

The Basel II Accord was introduced following substantial losses in the international markets since 1992, which were attributed to poor risk management practices. From 2004, the Basel II Accord makes it mandatory for financial institutions to use standardised measurements for credit risk, market risk, and operational risk.

Basel III

Basel III is an extension of the Basel II Framework, and introduces new capital and liquidity standards to strengthen the regulation, supervision, and risk management of the whole of the banking and finance sectors.

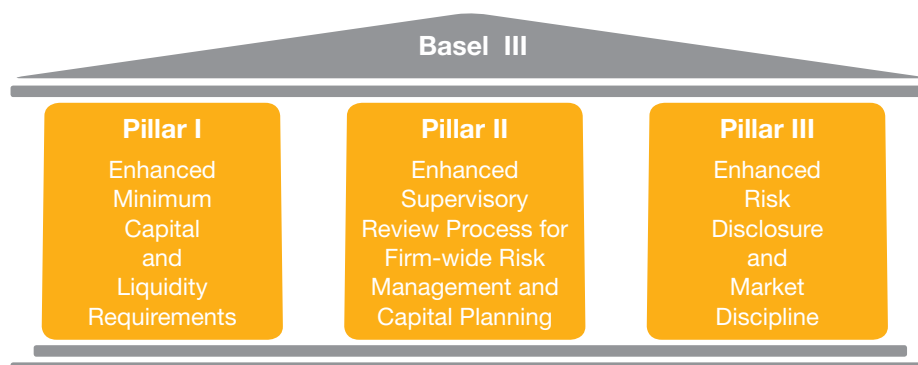
The Basel III requirements were in response to the deficiencies in financial regulation that is revealed by the 2000's financial crisis. Basel III was intended to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage.

The global capital framework and new capital buffers require financial institutions to hold more capital and higher quality of capital than under Basel II rules. The new leverage ratio introduces a non-risk-based measure to supplement the risk-based minimum capital requirements. The new liquidity ratios ensure that adequate funding is maintained in case there are other severe banking crises.

The three pillars as established by Basel II have been revised and strengthened, while the framework itself was extended with astute innovative features:

Main Features of the Basel III

- An additional layer of common equity – the capital conservation buffer – that, when breached, restricts payouts of earnings to help protect the minimum common equity requirement.
- a countercyclical capital buffer, which places restrictions on participation by banks in system-wide credit booms with the aim of reducing their losses in credit bursts.
- Additional proposals for Domestic Systemically Important Banks (D-SIBs), including requirements for supplementary capital, augmented contingent capital and strengthened arrangements for cross-border supervision and resolution. According to the Central Bank of Sri Lanka, banks with a total asset base of over LKR 500 billion, in the latest annual audited Financial Statements will be identified as D-SIBs in the Banking sector.
- a leverage ratio – a minimum amount of loss-absorbing capital, relative to all of a bank's assets and off-balance sheet exposures regardless of risk weighting. Leverage ratio will be implemented in Sri Lanka from 1 July 2018 with observation period already commenced from 1st quarter 2017, which will be monitored by the Central Bank of Sri Lanka.
- Liquidity requirements – a minimum liquidity ratio, the Liquidity Coverage Ratio (LCR), intended to provide enough cash to cover funding needs over a 30-day period of stress; and a longer-term ratio, the Net Stable Funding Ratio (NSFR), intended to address maturity mismatches over the entire balance sheet.



The implementation of the Basel III minimum capital requirements across the banking sector in Sri Lanka, under the Direction No. 01 of 2016 is now effective from 1 July 2017 in transitional phase.

Basel III – Transitional Phase-in-Arrangement of Capital Requirements for Banks with Assets of LKR 500 billion and above

Components of Capital	01.07.2017 %	01.01.2018 %	01.01.2019 %
Common Equity Tier 1	4.50	4.50	4.50
Capital Conservation Buffer	1.25	1.875	2.50
Surcharge on Domestic Systematically Important Banks (D-SIBs)	0.50	1.00	1.50
Additional Tier 1 Capital	1.50	1.50	1.50
Total Tier 1 Capital	7.75	8.875	10.00
Minimum Total Capital Ratio + Capital Conservation Buffer + Capital Surcharge on D-SIBs	11.75	12.875	14.00

Bank of Ceylon begun its preparation towards Basel III from 2015 when CBSL issued first consultancy paper for Basel III implementation in April 2015. By enhancing capital base and applying risk mitigating techniques, Bank was able to maintain the ratio well above the regulatory requirements as of 31 December 2017. Despite the challenging economic and market environment, BoC is well-positioned to meet the Basel III requirements when regulations become fully effective in 1 January 2019.

Basel III Disclosure Requirements

Key Regulatory Ratios – Capital and Liquidity

Item	2017	
	Bank	Group
Basel III		
Regulatory Capital (LKR '000)		
Common equity Tier 1	92,596,974	99,289,566
Tier 1 capital	92,596,974	99,289,566
Total capital	125,460,069	132,382,713
Regulatory Capital Ratios (%)		
Common equity Tier 1 capital ratio (minimum requirement – 6.25%)	10.77	10.87
Tier 1 capital ratio (minimum requirement – 7.75%)	10.77	10.87
Total capital ratio (minimum requirement – 11.75%)	14.59	14.49
Item	Bank	
	2017	2016
Regulatory Liquidity		
Statutory liquid assets (LKR '000)	477,892,172	307,549,721
Statutory Liquid Assets Ratio (%)		
Domestic Banking Unit (Minimum Requirement – 20%)	27.22	21.62
Offshore Banking Unit (Minimum Requirement – 20%)	21.91	28.08
Liquidity coverage ratio – Rupee (minimum requirement 2017 – 80%, 2016 – 70%)	141.46	174.10
Liquidity coverage ratio – All Currencies (minimum requirement 2017 – 80%, 2016 – 70%)	105.04	101.99

Basel III new guidelines were implemented with effect from 1 July 2017.

Basel III Computation of Capital Ratios – 2017

Item	Bank LKR '000	Group LKR '000
Common Equity Tier 1 (CET 1) capital after adjustments	92,596,974	99,289,566
Common Equity Tier 1 (CET 1) capital	97,701,176	100,813,614
Equity capital (stated capital)/assigned capital	20,000,000	20,000,000
Reserve fund	10,427,000	10,427,000
Published retained earnings/(accumulated retained losses)	63,472,250	65,100,871
Published accumulated Other Comprehensive Income (OCI)	2,231,116	2,856,370
General and other disclosed reserves	1,570,810	2,429,373
Unpublished current year's profit/(losses) and gains reflected in OCI	–	–
Ordinary shares issued by consolidated banking and financial subsidiaries held by third parties	–	–
Total Adjustments to CET 1 Capital	5,104,202	1,524,048
Goodwill (net)	–	–
Intangible assets (net)	810,730	1,074,435
Deferred tax assets (net)	–	8,621
Investments in the capital of banking and financial institutions where the Bank does not own more than 10% of the issued ordinary share capital of the entity	449,444	440,991
Significant investments in the capital of financial institutions where the Bank owns more than 10% of the issued ordinary share capital of the entity	3,844,028	–
Additional Tier 1 (AT I) capital after adjustment	–	–
Additional Tier 1 (AT I) capital	–	–
Qualifying additional Tier 1 capital instruments	–	–
Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties	–	–
Total adjustments to AT 1 capital	–	–
Investment in own shares	–	–
Others (specify)	–	–
Tier 2 capital after adjustments	32,863,095	33,093,147
Tier 2 capital	34,275,944	34,275,944
Qualifying Tier 2 capital instruments	26,348,597	26,348,597
Revaluation gains	2,373,396	2,373,396
General provisions	5,553,951	5,553,951
Instruments issued by Consolidated Banking and Financial Subsidiaries of the Bank and held by third parties	–	–
Total Adjustment to Tier 2	1,412,849	1,182,797
Investment in own shares	–	–
Investments in the capital of financial institutions and where the Bank does not own more than 10% of the issued capital carrying voting rights of the issuing entity	1,205,469	1,182,797
Significant investments in the capital of banking and financial institutions where the Bank own more than 10% of the issued ordinary share capital of the entity	207,380	–
CET I capital	92,596,974	99,289,566
Total Tier 1 capital	92,596,974	99,289,566
Total capital	125,460,069	132,382,713

Item	Bank	Group
Total risk-weighted assets (RWA) (LKR '000)	859,663,681	913,616,033
RWAs for credit risk	764,409,191	808,714,937
RWAs for market risk	7,848,707	7,848,707
RWAs for operational risk	87,405,782	97,052,389
CET I capital ratio (including capital conservation buffer, countercyclical capital buffer and surcharge on D-SIBs) (%)	10.77	10.87
of which: Capital conservation buffer	1.25	1.25
of which: Countercyclical buffer	N/A	N/A
of which: Capital surcharge on D-SIBs	0.50	0.50
Total Tier 1 capital ratio (%)	10.77	10.87
Total capital ratio (including capital conservation buffer, countercyclical capital buffer and surcharge on D-SIBs) (%)	14.59	14.49
of which: Capital conservation buffer	1.25	1.25
of which: Countercyclical buffer	N/A	N/A
of which: Capital surcharge on D-SIBs	0.50	0.50

Basel III Computation of Liquidity Coverage Ratio – All Currency (Bank Only)

Item	Amount (LKR '000)			
	2017		2016	
	Total Unweighted Value	Total Weighted Value	Total Unweighted Value	Total Weighted Value
Total stock of High-Quality Liquid Asset (HQLA)	299,081,569	297,359,897	254,050,364	252,153,939
Total adjusted Level 1 assets	295,987,317	295,987,317	252,869,329	252,869,329
Level 1 assets	295,568,225	295,568,225	250,187,864	250,187,864
Total adjusted Level 2A assets	100,000	85,000	100,000	85,000
Level 2 assets	100,000	85,000	100,000	85,000
Total adjusted Level 2B assets	3,413,344	1,706,672	3,762,500	1,881,075
Level 2B assets	3,413,344	1,706,672	3,762,150	1,881,075
Total cash outflows	1,896,131,889	319,951,612	1,648,451,224	291,365,309
Deposits	1,090,725,752	109,072,575	928,546,190	92,854,619
Unsecured wholesale funding	428,492,592	185,171,536	346,481,276	172,670,361
Secured funding transactions	23,782,957	–	26,363,519	–
Undrawn portion of committed (irrevocable) facilities and other contingent funding obligations	353,086,993	25,663,907	347,008,062	25,788,152
Additional requirements	43,595	43,595	52,177	52,177
Total cash inflows	78,429,645	36,858,631	69,394,824	44,137,437
Maturing secured lending transaction backed by collateral	18,388,000	–	1,900,600	–
Committed facilities	–	–	–	–
Other inflows by counterparty which are maturing within 30 days	46,347,809	36,858,631	51,628,626	44,137,437
Operational deposits	13,693,836	–	15,865,598	–
Other cash inflows	–	–	–	–
Liquidity coverage ratio percentage (stock of high quality liquid assets/ total net cash outflows over the next 30 calendar days)* 100 (%)		105.04		101.99

Main Features of Regulatory Capital Instruments

Description of the Capital Instrument

Issuer	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon
Unique identifier	LK0357D20405	LK0357D20421	LK0357D20447	LK0357D20462	LK0357D20439
Governing laws of the instrument	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka
Original date of issuance	25 October 2013	25 October 2013	25 October 2013	25 October 2013	25 October 2013
Par value of instrument (LKR)	100	100	100	100	100
Issued quantity (Number of debentures)	37,843,000	2,155,000	2,000	11,990,000	10,000
Issued quantity (LKR '000)	3,784,300	215,500	200	1,199,000	1,000
Perpetual or dated					
Original maturity date, if applicable	24 October 2018	24 October 2018	24 October 2018	24 October 2021	24 October 2021
Amount recognised in regulatory capital (in LKR '000 as at the reporting date)	756,860	43,100	40	959,200	800
Accounting classification (equity/liability)	Liability	Liability	Liability	Liability	Liability
Coupons/Dividends					
Fixed or floating dividend/coupon	FIXED	FIXED	FLOATING	FIXED	FLOATING
Coupon rate and any related index (%)	13.00	12.60	11.13	13.25	11.13
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible

Description of the Capital Instrument

Issuer	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon
Unique identifier	LK0357D20454	LK0357D20470	LK0357D22500	LK0357D22534	LK0357D22526
Governing laws of the instrument	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka
Original date of issuance	25 October 2013	25 October 2013	22 September 2014	22 September 2014	22 September 2014
Par value of instrument (LKR)	100	100	100	100	100
Issued quantity (Number of debentures)	12,000,000	16,000,000	51,256,350	2,157,800	8,250,600
Issued quantity (LKR '000)	1,200,000	1,600,000	5,125,635	215,780	825,060
Perpetual or dated					
Original maturity date, if applicable	24 October 2022	24 October 2023	21 September 2019	21 September 2019	21 September 2019
Amount recognised in regulatory capital (in LKR '000 as at the reporting date)	1,200,000	1,600,000	2,050,254	86,312	330,024
Accounting classification (equity/liability)	Liability	Liability	Liability	Liability	Liability
Coupons/Dividends					
Fixed or floating dividend/coupon	FIXED	FIXED	FIXED	FIXED	FLOATING
Coupon rate and any related index (%)	13.25	13.75	8.00	7.75	10.43
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible

Description of the Capital Instrument

Issuer	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon
Unique identifier	LK0357D22542	LK0357D22559	LK0357D23201	LK0357D23185	LK0357D23193
Governing laws of the instrument	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka
Original date of issuance	22 September 2014	22 September 2014	6 October 2015	6 October 2015	6 October 2015
Par value of instrument (LKR)	100	100	100	100	100
Issued quantity (Number of debentures)	18,334,950	300	2,885,900	122,200	44,783,860
Issued quantity (LKR '000)	1,833,495	30	288,590	12,220	4,478,386
Perpetual or dated					
Original maturity date, if applicable	21 September 2022	22 September 2022	5 October 2020	5 October 2020	5 October 2020
Amount recognised in regulatory capital (in LKR '000 as at the reporting date)	1,833,495	30	173,154	7,332	2,687,032
Accounting classification (equity/liability)	Liability	Liability	Liability	Liability	Liability
Coupons/Dividends					
Fixed or floating dividend/coupon	FIXED	FLOATING	FIXED	FIXED	FLOATING
Coupon rate and any related index (%)	8.25	10.43	8.25	8.00	11.34
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible

Description of the Capital Instrument

Issuer	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon	Bank of Ceylon
Unique identifier	LK0357D23177	LK0357D23219	LK0357D23763	LK0357D23797	LK0357D23771
Governing laws of the instrument	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka	Laws of Sri Lanka
Original date of issuance	6 October 2015	6 October 2015	29 December 2016	29 December 2016	29 December 2016
Par value of instrument (LKR)	100	100	100	100	100
Issued quantity (Number of debentures)	11,802,560	20,405,480	79,981,764	10,200	7,836
Issued quantity (LKR '000)	1,180,256	2,040,548	7,998,176	1,020	784
Perpetual or dated					
Original maturity date, if applicable	5 October 2023	5 October 2023	28 December 2021	28 December 2021	28 December 2024
Amount recognised in regulatory capital (in LKR '000 as at the reporting date)	1,180,256	2,040,548	6,398,541	816	784
Accounting classification (equity/liability)	Liability	Liability	Liability	Liability	Liability
Coupons/Dividends					
Fixed or floating dividend/coupon	FIXED	FLOATING	FIXED	FLOATING	FIXED
Coupon rate and any related index (%)	9.50	11.34	13.25	10.47	12.75
Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible

Description of the Capital Instrument

Issuer	Bank of Ceylon	Bank of Ceylon
Unique identifier	LK0357D23789	BOC17UL001
Governing laws of the instrument	Laws of Sri Lanka	Laws of Sri Lanka
Original date of issuance	29 December 2016	29 December 2017
Par value of instrument – LKR	100	100
Issued quantity (Number of debentures)	200	50,000,000
Issued quantity (LKR '000)	20	5,000,000
Perpetual or dated		
Original maturity date, if applicable	28 December 2024	28 December 2025
Amount recognised in regulatory capital (in LKR '000 as at the reporting date)	20	5,000,000
Accounting classification (equity/liability)	Liability	Liability
Coupons/Dividends		
Fixed or floating dividend/coupon	FLOATING	FIXED
Coupon rate and any related index (%)	10.47	12.75
Non-cumulative or cumulative	Non-cumulative	Non-cumulative
Convertible or non-convertible	Non-convertible	Non-convertible

Credit Risk Under Standardised Approach

Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects – Bank

Asset Class	As at 31 December 2017					
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures Post-CCF and CRM		RWA and RWA Density	
	On Balance Sheet Amount LKR '000	Off Balance Sheet Amount LKR '000	On Balance Sheet Amount LKR '000	Off Balance Sheet Amount LKR '000	RWA Amount LKR '000	RWA Density ⁽ⁱ⁾ %
Claims on Central Government and CBSL	744,103,499	14,377,840	744,103,499	2,875,568	–	0.00
Claims on foreign sovereigns and their central banks	14,076,995	–	14,076,995	–	13,229,105	93.98
Claims on public sector entities	266,487,443	117,738,026	22,219,935	4,982,987	27,202,923	100.00
Claims on official entities and multilateral development banks	–	–	–	–	–	–
Claims on banks exposures	39,786,210	16,495,852	39,786,210	16,495,852	31,175,173	55.39
Claims on financial institutions	20,634,029	–	20,634,029	–	11,897,065	57.66
Claims on corporates	223,203,521	207,658,167	195,205,660	39,029,515	229,696,555	98.06
Retail claims	431,296,587	81,566,976	396,420,542	12,564,565	337,677,260	82.56
Claims secured by gold	47,728,809	–	47,728,809	–	1,856,163	3.89
Claims secured by residential property	63,201,877	–	63,201,877	–	42,690,911	67.55
Claims secured by commercial real estate	14,951,370	–	14,951,370	–	14,951,370	100.00
Non-performing assets (NPAs) ⁽ⁱ⁾	4,379,161	–	4,379,161	–	5,574,595	127.30
Higher-risk categories	977,012	–	977,012	–	2,442,530	250.00
Cash items and other assets	99,205,282	–	99,205,282	–	46,015,541	46.38
Total	1,970,031,795	437,836,860	1,662,890,381	75,948,487	764,409,191	43.96

Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects – Group

Asset Class	As at 31 December 2017					
	Exposures before Credit Conversion Factor (CCF) and CRM		Exposures Post-CCF and CRM		RWA and RWA Density	
	On Balance Sheet Amount LKR '000	Off Balance Sheet Amount LKR '000	On Balance Sheet Amount LKR '000	Off Balance Sheet Amount LKR '000	RWA Amount LKR '000	RWA Density ⁽ⁱⁱ⁾ %
Claims on Central Government and CBSL	752,065,398	14,377,840	752,065,398	2,875,568	–	0.00
Claims on foreign sovereigns and their central banks	14,076,995	–	14,076,995	–	13,229,105	93.98
Claims on public sector entities	266,487,443	117,738,026	22,219,935	4,982,987	27,202,923	100.00
Claims on official entities and multilateral development banks	–	–	–	–	–	–
Claims on banks exposures	37,069,446	16,495,852	37,069,446	16,495,852	28,458,409	53.13
Claims on financial institutions	20,634,029	–	20,634,029	–	11,897,065	57.66
Claims on corporates	252,836,498	207,658,167	224,838,637	39,029,515	259,329,531	98.28
Retail claims	431,296,587	81,566,976	396,420,542	12,564,565	337,677,260	82.56
Claims secured by gold	47,728,809	–	47,728,809	–	1,856,163	3.89
Claims secured by residential property	63,201,877	–	63,201,877	–	42,690,911	67.55
Claims secured by commercial real estate	14,951,370	–	14,951,370	–	14,951,370	–
Non-Performing Assets (NPAs) ⁽ⁱ⁾	4,379,161	–	4,379,161	–	5,574,595	127.30
Higher-risk categories	162,300	–	162,300	–	405,750	250.00
Cash items and other assets	123,793,849	–	123,793,849	–	65,441,854	52.86
Total	2,028,683,762	437,836,861	1,721,542,348	75,948,487	808,714,936	44.99

Note:

(i) NPAs as per Banking Act Directions on Classifications and Advances, Income recognition and provisioning.

(ii) RWA Density – Total RWA/Exposures Post CCF and CRM.

Exposures by Asset Classes and Risk Weights – Bank

Description Risk Weight		As at 31 December 2017 (Post CCF and CRM)						
		0% LKR '000	20% LKR '000	50% LKR '000	75% LKR '000	100% LKR '000	150% LKR '000	>150% LKR '000
Asset Classes								Total Credit Exposure Amount LKR '000
Claims on Central Government and Central Bank of Sri Lanka		744,103,499	–	–	–	–	–	744,103,499
Claims on foreign sovereigns and their central banks		–	–	1,695,781	–	12,381,214	–	14,076,995
Claims on public sector entities		–	–	–	–	22,219,935	–	22,219,935
Claims on official entities and multilateral development banks		–	–	–	–	–	–	–
Claims on banks exposures		–	14,944,273	7,614,770	–	17,227,167	–	39,786,210
Claims on financial institutions		–	4,471,200	10,320,007	–	5,842,822	–	20,634,029
Claims on corporates		–	1,835,552	2,747,765	–	190,622,343	–	195,205,660
Retail claims		–	–	–	285,231,386	111,189,156	–	396,420,542
Claims secured by gold		38,447,993	9,280,816	–	–	–	–	47,728,809
Claims secured by commercial residential property		–	–	41,021,932	–	22,179,945	–	63,201,877
Claims secured by commercial real estate		–	–	–	–	14,951,370	–	14,951,370
Non-Performing Assets (NPAs)		–	–	–	–	1,988,292	2,390,869	4,379,161
Higher-risk categories		–	–	–	–	–	–	977,012
Cash items and other assets		42,637,252	13,190,611	–	–	43,377,419	–	99,205,282
Total		825,188,744	43,722,452	63,400,255	285,231,386	441,979,663	2,390,869	977,012
								1,662,890,381

Exposures by Asset Classes and Risk Weights – Group

Description		As at 31 December 2017 (Post CCF and CRM)							Total Credit Exposure Amount LKR '000
Asset Classes	Risk Weight	0%	20%	50%	75%	100%	150%	>150%	
		LKR '000	LKR '000	LKR '000	LKR '000	LKR '000	LKR '000	LKR '000	
Claims on Central Government and Central Bank of Sri Lanka		752,065,398	–	–	–	–	–	–	752,065,398
Claims on foreign sovereigns and their central banks		–	–	1,695,781	–	12,381,214	–	–	14,076,995
Claims on public sector entities		–	–	–	–	22,219,935	–	–	22,219,935
Claims on official entities and multilateral development banks		–	–	–	–	–	–	–	–
Claims on banks exposures		–	14,944,273	7,614,770	–	14,510,403	–	–	37,069,446
Claims on financial institutions		–	4,471,200	10,320,007	–	5,842,822	–	–	20,634,029
Claims on corporates		–	1,835,552	2,747,765	–	220,255,320	–	–	224,838,637
Retail claims		–	–	–	285,231,386	111,189,156	–	–	396,420,542
Claims secured by gold		38,447,993	9,280,816	–	–	–	–	–	47,728,809
Claims secured by commercial residential property		–	–	41,021,932	–	22,179,945	–	–	63,201,877
Claims secured by commercial real estate		–	–	–	–	14,951,370	–	–	14,951,370
Non-Performing Assets (NPAs)		–	–	–	–	1,988,292	2,390,869	–	4,379,161
Higher-risk categories		–	–	–	–	–	–	162,300	162,300
Cash items and other assets		47,799,506	13,190,611	–	–	62,803,732	–	–	123,793,849
Total		838,312,897	43,722,452	63,400,255	285,231,386	488,322,189	2,390,869	162,300	1,721,542,348

Market Risk Under Standardised Measurement Method

Item	2017	
	Bank LKR '000	Group LKR '000
(a) Capital charge for interest rate risk	112,204	112,204
General interest rate risk	112,204	112,204
(i) Net long or short position	112,204	112,204
(ii) Horizontal disallowance	–	–
(iii) Vertical disallowance	–	–
(iv) Options	–	–
Specific interest rate risk	–	–
(b) Capital charge for equity	604,055	604,055
(i) General equity risk	324,439	324,439
(ii) Specific equity risk	279,616	279,616
(c) Capital charge for foreign exchange and gold	205,964	205,964
Total capital charge for market risk [(a)+(b)+(c)]	922,223	922,223
Total risk weighted amount for market risk	7,848,707	7,848,707

Operational Risk Under Basic Indicator Approach – Bank

Business Lines	Capital Charge Factor	Fixed Factor	Gross Income as at 31 December 2017		
			1st Year LKR '000	2nd Year LKR '000	3rd Year LKR '000
The basic indicator approach	15%		66,324,079	70,270,961	68,808,549
Capital charges for operational risk			–	–	10,270,179
Risk weighted amount for operational risk			–	–	87,405,782

Operational Risk Under Basic Indicator Approach – Group

Business Lines	Capital Charge Factor	Fixed Factor	Gross Income as at 31 December 2017		
			1st Year LKR '000	2nd Year LKR '000	3rd Year LKR '000
The basic indicator approach	15%		71,016,573	76,299,836	80,756,706
Capital charges for operational risk			–	–	11,403,656
Risk weighted amount for operational risk			–	–	97,052,389

Differences between Accounting and Regulatory Scopes and Mapping of Financial Statement Categories with Regulatory Risk Categories – Bank only

Item	Amount as at 31 December 2017				
	a	b	c	d	e
	Carrying Values Reported in Published Financial Statements LKR '000	Carrying Values Under Scope of Regulatory Reporting LKR '000	Subject to Credit Risk Framework LKR '000	Subject to Market Risk Framework LKR '000	Not Subject to Capital Requirements or Subject to Dedication from Capital LKR '000
Assets	1,951,803,953	1,971,261,258	1,962,790,186	12,965,786	8,471,072
Cash and cash equivalents	72,843,108	72,843,108	72,843,108	862,266	–
Balances with Central Banks	68,689,012	69,212,148	69,212,148	–	–
Placements with banks	8,067,490	25,134,938	25,134,938	–	–
Securities purchased under resale agreements	18,455,555	19,750,000	19,750,000	–	–
Derivative financial instruments	1,618,823	–	–	–	–
Financial instruments – Held for trading	8,359,274	8,208,176	8,192,986	8,057,180	15,190
Financial investments – Loans and receivables	213,167,048	202,432,055	202,432,055	–	–
Loans and advances to customers	1,163,160,914	1,167,114,297	1,167,114,297	–	–
Financial investments – Available for sale	17,921,170	13,668,917	10,682,504	4,046,340	2,986,413
Financial investments – Held to maturity	308,256,082	307,384,458	307,384,458	–	–
Investments in subsidiary companies	6,513,048	6,513,048	1,854,308	–	4,658,740
Investments in associate companies	92,988	92,988	92,988	–	–
Investment properties	2,882,928	2,882,928	2,882,928	–	–
Property, Plant and Equipment	23,046,114	17,031,057	17,031,057	–	–
Leasehold properties	101,481	101,481	101,481	–	–
Intangible assets	810,730	810,729	–	–	810,729
Deferred tax assets	–	–	–	–	–
Other assets	37,818,188	58,080,930	58,080,930	–	–

Item	Amount as at 31 December 2017				
	a	b	c	d	e
	Carrying Values Reported in Published Financial Statements LKR '000	Carrying Values Under Scope of Regulatory Reporting LKR '000	Subject to Credit Risk Framework LKR '000	Subject to Market Risk Framework LKR '000	Not Subject to Capital Requirements or Subject to Dedication from Capital LKR '000
On balance sheet liabilities	1,840,648,878	1,865,353,554	–	–	–
Due to banks	2,203,199	2,203,199	–	–	–
Securities sold under repurchase agreements	44,487,462	44,087,142	–	–	–
Derivative financial instruments	70,715	–	–	–	–
Due to customers	1,546,832,036	1,510,317,734	–	–	–
Other borrowings	178,191,089	175,782,928	–	–	–
Debt securities issued	–	–	–	–	–
Current tax liabilities	1,877,342	1,877,342	–	–	–
Deferred tax liabilities	5,820,329	2,272,386	–	–	–
Other liabilities	18,596,249	86,812,823	–	–	–
Subordinated term debts	42,570,457	42,000,000	–	–	–
Off balance sheet liabilities	507,258,821	522,647,043	457,836,859	–	–
Guarantees	49,450,446	49,450,446	49,450,446	–	–
Performance bonds	34,143,409	34,143,409	34,143,409	–	–
Letters of credit	104,675,380	104,675,380	104,675,380	–	–
Other contingent items	43,212,005	43,212,005	43,212,005	–	–
Undrawn loan commitment	29,679,521	29,679,521	29,679,521	–	–
Other commitments	246,098,060	261,486,282	176,676,098	–	–
Shareholder's equity	20,000,000	20,000,000	–	–	–
Equity Capital (Stated Capital)/Assigned Capital					
of which amount eligible for CET I	20,000,000	20,000,000	–	–	–
of which amount eligible for AT I	–	–	–	–	–
Retained earnings	63,472,250	65,951,935	–	–	–
Accumulated other comprehensive income	3,718,526	400,140	–	–	–
Other reserves	23,964,299	19,555,630	–	–	–
Total shareholder's equity	111,155,075	105,907,705	–	–	–
Total on balance sheet liabilities and equity capital and reserves	1,951,803,953	1,971,261,259	–	–	–

Explanations of Differences between Accounting and Regulatory Exposure Amounts

Difference arises due to fair value adjustments, impairment under incurred loss model on financial instruments and the classification adjustments between line items of the financial position under SLFRSs.

Derivative Financial Instruments

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk, indices etc.

Derivative financial instruments are measured at fair value using forward pricing models in Published Financial Statement and more details are given in Note 24 and Note 40 in this Report.

Loans and Advances to Customers

Allowance for Impairment

Time-based provisions under Central Bank guide lines have been netted off from the amortised cost when arriving loans and advances to the customers under regulatory reporting, however as per LKAS 39 “impairment under incurred loss model” have been netted off from amortised cost when arriving loans and advances to the customers under reporting purposes. More details are given under Note 27.

Day One Difference

When the transaction price differs from the fair value of other observable current market transactions in the same instrument, Bank recognises fair value of such transactions as per LKAS 39. More details are given in Note 4.4.4 and Note 37. However, Bank recognises cost of such transactions under regulatory reporting.

Financial Investment – Available for Sale

Financial Investment available for sale are measured at fair value under published Financial Statements and carried at cost for regulatory reporting purposes.

The details of financial investments – available for sale and the fair valuation of these instruments are disclosed in Note 28 and Note 59 respectively.

The following disclosures are included in Note 60 on Risk Management on pages 290 to 302.

- (i) Summary discussion on adequacy/meeting current and future capital requirement
- (ii) Bank risk management approach
- (iii) Risk management related to key risk exposures

Computation of Capital Adequacy Ratio Under Basel II – 2016

	Bank LKR million	Group LKR million
Tier 1: Core Capital		
Paid-up ordinary shares	15,000	15,000
Permanent reserve fund	7,996	7,996
Published retained profits	54,155	55,659
General and other reserves	1,209	1,764
Non-controlling interests	–	879
Deductions		
50% of investments in unconsolidated banking and financial subsidiaries)	(2,179)	–
Other deductions	(2,053)	(2,150)
Total eligible core capital (Tier 1 capital)	74,128	79,148
Tier 2: Supplementary Capital		
Revaluation reserves (as approved by Central Bank of Sri Lanka)	2,373	2,373
General provisions	4,648	4,647
Approved subordinated term debt	27,378	27,377
Deductions	(3,669)	(1,489)
Total eligible supplementary capital (Tier 2 capital)	30,730	32,909
Total capital base	104,858	112,057

Risk-Weighted Assets – 2016

Computation of Risk-Weighted Assets Business Lines	Bank			Group	
	Risk Weight Factor	On Balance Sheet Assets and Credit Equivalent of Off Balance Sheet Assets LKR million	Risk Weighted Assets LKR million	On Balance Sheet Assets and Credit Equivalent of Off balance Sheet Assets LKR million	Risk weighted Assets LKR million
Assets					
Claims on Government of Sri Lanka and Central Bank of Sri Lanka	0	604,897	–	611,663	–
Claims on foreign sovereigns and their central banks	0-150	18,047	17,217	18,047	17,217
Claims on public sector entities (PSEs)	20-150	72,847	72,847	72,847	72,847
Claims on banks	20-150	63,910	33,074	65,167	34,331
Claims on financial institutions	20-150	26,260	13,486	26,260	13,486
Claims on corporates	20-150	200,222	195,155	226,381	221,314
Retail claims	75-100	374,859	307,972	374,859	307,973
Claims secured by residential property	50-100	54,492	36,135	54,491	36,135
Non-performing assets (NPAs)	50-150	4,457	5,797	4,457	5,797
Cash items	0-20	55,742	2,673	61,280	2,673
Exposures collateralised by cash, gold and Government Securities	0	242,523	–	242,523	–
Property, Plant and Equipment	100	15,584	15,584	26,464	26,464
Other assets	100	34,879	34,875	35,806	35,806
Total exposure		1,768,719	734,820	1,820,245	774,043

Off Balance Sheet Exposures	Credit Conversion Factor %	Assets LKR million	Credit Equivalent LKR million	Assets LKR million	Credit Equivalent LKR million
Direct credit substitutes	100	42,383	42,383	42,383	42,383
Transaction-related contingencies	50	33,839	16,919	33,839	16,919
Short-term self-liquidating trade-related contingencies	20	150,448	30,090	150,448	30,090
Other commitments with and original maturity of up to one year or which can be unconditionally cancelled at any time	0	81,126	–	81,126	–
Commitments with an original maturity up to one year and maturity of over one year	20-50	31,393	15,589	31,393	15,589
Foreign exchange contracts	2-5	157,776	3,155	157,776	3,155
Total off balance sheet exposure		496,965	108,136	496,965	108,136

Market Risk – The Standardised Measurement Approach – 2016

Off Balance Sheet Exposures	Bank LKR million	Group LKR million
Capital Charge for		
Interest rate risk	77	77
Equity	551	551
Foreign exchange and gold	1,359	1,359
Total capital charges for market risk	1,987	1,987
Total risk-weighted assets for market risk	19,872	19,872

Operational Risk – The Basic Indicator Approach – 2016

	Bank LKR million	Group LKR million
Capital Charge for Operational Risk		
Total gross income of three consecutive years	190,071	209,143
Average gross income	63,357	69,714
Total capital charges for operational risk – (15%)	9,503	10,457
Total risk-weighted assets for operational risk	95,035	104,572

Capital Adequacy Summery – 2016

	Bank LKR million	Group LKR million
Computation of Ratios		
Total Risk Weighted Assets		
Total weighted assets for credit risk	734,820	774,043
Total weighted assets for market risk	19,872	19,872
Total weighted assets for operational risk	95,036	104,572
Subtotal	849,728	898,487
Minimum Capital Charges		
Credit risk	73,482	77,404
Market risk	1,987	1,987
Operational risk	9,503	10,457
Total eligible core capital (Tier 1 capital)	74,128	79,148
Total eligible supplementary capital (Tier 2 capital)	30,730	32,909
Total capital base	104,858	112,057
Core capital ratio	8.7%	8.8%
Total capital adequacy ratio	12.3%	12.5%