BASEL III - Pillar 3 DISCLOSURES OF TAMILNAD MERCANTILE BANK LTD.
As on 31st December 2013

Table DF-2

Capital Adequacy

Qualitative Disclosures

A. A summary discussion of the Bank's approach to assessing the adequacy of its capital to support current and future activities.

The Bank is following standardized approach, Standardized Duration approach and Basic Indicator approach for measurement of capital charge in respect of credit risk, market risk and operational risk respectively.

In computation of Capital for credit risk under Standardized Approach, the Bank has relied upon the Borrower wise data captured from each individual branch. For this purpose, our Information Technology Department has provided one report in finacle where the required particulars as per Basel norms were extracted at HO level directly from Core Banking Solution. The various aspects of Basel III norms are imparted to field level staff regularly through circulars and letters for continuous purification of data.

The Bank has used the credit risk mitigation in computation of capital for credit risk, as prescribed in the RBI guidelines under Standardized Approach. The capital for credit risk on Loans and Advances, market risk and operational risk as per the prescribed approaches have been computed at the bank's Head Office and aggregated to arrive at the bank's CRAR position. The bank has followed the RBI guidelines in force, to arrive at the eligible capital, risk weighted assets and CRAR.

Besides computing CRAR under the Pillar I requirement, the Bank also periodically undertakes stress testing in various risk areas to assess the impact of stressed scenario or plausible events on asset quality, liquidity, profitability and capital adequacy. As regards the adequacy of capital to support the future activities, the bank has drawn an assessment of capital requirement for five years with the approval of the Board. The surplus CRAR acts as a buffer to support the future activities. Moreover, the headroom available for the bank for mobilizing Tier 1 and Tier 2 capital shall additionally support capital structure to meet the required CRAR against future activities.

The Bank has a strong Common Equity Tier 1 as the entire components of CET1 capital comprises of Paid up Capital, Reserve & Surpluses and retained earnings.

The bank conducts Internal Capital Adequacy Assessment Process (ICAAP) on annual basis to assess the sufficiency of its capital funds to cover the risks specified under Pillar- II of Basel guidelines. The adequacy of Bank's capital funds to meet the future business growth is also assessed in the ICAAP document. In line with the RBI guidelines for implementing the New Capital Adequacy Frame Work under Basel III, the bank has successfully migrated to the framework from April 01, 2013.

Minimum capital requirements under Basel-III:

Under the Basel III Capital Regulations, Banks are required to maintain a minimum Pillar 1 Capital (Tier-I + Tier-II) to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and countercyclical capital buffer etc.) Besides this minimum capital requirement, Basel III also provides for creation of capital conservation buffer (CCB). The CCB requirements are to be implemented from March 31, 2015 in phases and are to be fully implemented by March 31, 2018 to the extent of 2.5% of Risk weighted Assets

The total regulatory capital fund under Basel- III norms will consist of the sum of the following categories and banks are required to maintain 11.50% of Risk Weighted Assets (9% + 2.5%) by March 2018 with the phase in requirements under CCB from 2015.

- Tier 1 Capital comprises of:-
    - Common Equity Tier 1 capital (with a minimum of 5.5%)
    - Additional Tier 1 capital (1.50%)
    - Total Tier 1 capital of minimum 7%

- Tier 2 Capital (2%)
    - Total Tier 1 + Tier 2 should be more than 9%

- Capital Conservation Buffer (CCB). (with a minimum of 2.5%)
    - Total capital including CCB should be 11.5%

Quantitative Disclosure

(□ in crore)

a)	Capital requirement for Credit Risk: (@9% on risk Weighted Assets)		
	• Portfolios subject to Standardised Approach		1124.29
	• Securitisation exposures		Nil
b)	Capital requirements for Market Risk:		
	• Standardised Duration Approach		31.84
	o Interest Rate Risk	27.66	
	o Foreign Exchange Risk	2.70	
	o Equity Risk	1.48	
c)	Capital requirements for Operational Risk:		
	• Basic Indicator Approach		134.40
	Total Capital required @9%		1290.53
d)	Total Capital funds available		2057.95
	Total Risk Weighted Assets		14339.16
	Common Equity Tier I CRAR		13.78%
	Tier I CRAR		13.78%
	Tier II CRAR		0.57%
	Total CRAR		14.35%

2. Risk exposure and Assessment

Risk is an integral part of banking business in an ever dynamic environment, which is undergoing radical changes both on the technology front and product offerings. The main risks faced by the bank are credit risk, market risk and operational risk. The bank aims to achieve an optimum balance between risk and return to maximize shareholder value. The relevant information on the various categories of risks faced by the bank is given in the ensuing sections. This information is intended to give market participants a better idea on the risk profile and risk management practices of the bank.

The Bank has a comprehensive risk management system in order to address various risks and has set up an Integrated Risk Management Department (RMD), which is independent of operational departments. Bank has a Risk Management Committee of Board functioning at apex level for formulating, implementing and reviewing bank's risk management measures pertaining to credit, market and operational risks. Apart from the Risk Management Committee of the Board at apex level, the Bank has a strong Bank-wide risk management structure comprising of Risk Management Committee of

Executives (RMCE) assisted by Asset Liability Management Committee (ALCO) at senior management level.

The Bank has formulated the required policies such as Loan Policy, Credit Risk Management Policy, ALM Policy, Operational Risk Policy, Investment Policy, Foreign Exchange Risk Management Policy, Policy for Hedging Foreign Currency Loan Exposure, Concurrent Audit Policy, Inspection Policies, IS Audit Policy, KYC policy, Post Credit Supervision Policy, Stock Audit Policy, Out Sourcing Policy, Risk Based Internal Audit Policy, Stress Testing Policy, Disclosure Policy, ICAAP Policy, etc for mitigating the risks in various areas and monitoring the same. The bank continues to focus on refining and improving its risk measurement systems.

Table DF-3

CREDIT RISK: GENERAL DISCLOSURES

Qualitative Disclosures:

a) Credit Risk

Credit risk is the possibility of losses associated with diminution in the credit quality of borrowers or counter-parties. In a Bank's portfolio, Credit Risk arises mostly from lending activities of the Bank, as a borrower is unable to meet his financial obligations to the lender. It emanates from potential changes in the credit quality / worthiness of the borrowers or counter-parties.

Credit Rating & Appraisal Process

The Bank has well structured internal credit rating framework and well-established standardized credit appraisal / approval processes. Credit Rating is a decision-enabling tool that helps the bank to take a view on acceptability or otherwise of any credit proposal. In order to widen the scope and coverage further and strengthen the credit risk management practices, the bank has developed additional risk sensitive rating models in-house during the year 2008-09 and 2009-10.
The internal rating factors takes into consideration the quantitative and qualitative issues relating to management risk, business risk, industry risk, financial risk, credit discipline, and also risk mitigation, based on the collaterals available.

Credit rating, as a concept, has been well internalized within the Bank. The rating for eligible borrower is reviewed at least once in a year. The Bank uses the credit ratings for deciding the interest rates on borrowal accounts. The advantage of credit rating is that it enables to rank different proposals and do meaningful comparison.

The bank follows a well-defined multi layered discretionary power structure for sanction of loans. Credit Approval Grid has been constituted at H.O for considering in-principle approval for taking up fresh credit proposals above a specified cut-off.

Credit Risk Management Policies

The Bank has put in place a well-structured Credit Risk Management Policy duly approved by the Board. The Policy document defines organization structure, role & responsibilities and, the processes whereby the Credit Risks carried by the Bank can be identified, quantified & managed within the framework that the Bank considers consistent with its mandate and risk tolerance.

Credit Risk is monitored on a bank-wide basis and compliance with the risk limits approved by Board/Risk Management Committee of Board is ensured.

The Bank has taken earnest steps to put in place best credit risk management practices in the bank. In addition to Credit Risk Policy, the bank has also framed Board approved

Loan Policy, Investment Policy etc. which forms integral part in monitoring Credit risk in the bank. Besides, the bank has implemented a policy on Collateral Management and Credit Risk Mitigation with the approval of the Board which lays down the details of securities (both Primary and Collateral) normally accepted by the Bank and administration of such securities to protect the interest of the Bank. These securities act as mitigation against the credit risk to which the bank is exposed.

Classification of Non Performing Assets

The Bank follows the prudential guidelines issued by the RBI on classification of non-performing assets as under,

i) interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
ii) the account remains ‘out of order’ if the outstanding balance remains continuously in excess of sanctioned limits / DP for more than 90 days in respect of Overdraft/Cash Credit (OD/CC).
iii) the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted
iv) the installment of principal or interest thereon remains overdue for two crop seasons for short duration crop.
v) the installment of principal or interest thereon remains overdue for one crop season for long duration crops.

Where the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter, the account is classified as non-performing. A non-performing asset ceases to generate income for the bank.

	(₹ in crore)	
Quantitative Disclosures	**Applicability to our Bank**	
b. Total gross credit risk exposures, Fund based and Non-Fund based separately	FB NFB	16785.36 7970.62
c. Geographic distribution of exposures, Fund based and Non-Fund based separately	FB	NFB
• Domestic	16785.36	7970.62
• Overseas	-	-
d. Industry type distribution of exposures, fund based and non-fund based separately.	Annexed	
e. Residual contractual maturity breakdown of assets	Annexed	
f. Amount of NPAs (Gross)	432.20	
• Substandard	271.56	
• Doubtful	113.48	
• Of which DF1	76.22	
• DF2	29.21	
• Df3	8.05	
• Loss	47.16	
g. Net NPAs	235.11	
h. NPA Ratios		
• Gross NPAs to gross advances	2.57	
• Net NPAs to net advances	1.42	
i. Movement of NPAs (Gross)		
• Opening Balance	315.34	
• Additions	200.68	
• Reductions	83.82	
• Closing Balance	432.20	
j. Movement of provisions for NPAs		
• Opening Balance	156.38	
• Provisions made during the period	65.85	

• Write off	-
• Reductions	25.51
• Write back of excess provisions / Transfers	-
• Closing Balance	196.72
k. Amount of Non-Performing investments	0.06
l. Amount of provisions held for non-performing investments	0.06
m. Movement of provisions for depreciation on investments	
• Opening Balance	11.38
• Provisions made during the period	0.08
• Write-off	-
• Write-back of excess provisions	-
• Closing Balance	11.46

<u>Residual Contractual Maturity Breakdown of assets</u>

<u>(□ in crore)</u>

Day1	2-7D	8-14D	15-28D	29D-3M	>3-6M	>6M-1 Year	>1 to 3 Years	>3 to 5 Years	>5 Years
2412.89	284.53	409.13	764.50	2838.37	2607.30	5868.33	6711.77	2454.82	1848.50

(Covers Gross Assets for Domestic Operations)

<u>INDUSTRY WISE CREDIT OUTSTANDINGS as on 31.12.2013</u>

(□ in crore)

Industry Name	Outstanding
Mining and Quarrying (incl. Coal)	**82.64**
Coal	52.70
Others	29.14
Food Processing	**493.10**
Sugar	34.63
Edible Oils and Vanaspathi	66.03
Tea	0.00
Others	392.44
Beverage & Tobacco	**18.43**
Textiles	**1972.04**
Cotton Textiles	237.30
Jute Textiles	2.10
Man-Made Textiles(handicraft/Khadi)	0.90
Silk	0.00
Woolen	0.00
Other Textiles	1732.64
Out of total textiles to Spinning mills	869.18
Leather & Leather Products	**9.69**
Wood and Wood Products	**74.62**
Paper & Paper Products	**155.72**
Petroleum, Coal Products and Nuclear Fuels	**0.15**
Chemicals and Chemical Products	**146.51**
Fertilizer	4.69
Drugs & Pharmaceuticals	13.48
Petro Chemicals	1.12
Others	127.22
Rubber, Plastic & their Products	**54.79**
Glass and Glass Ware	**0.05**
Cement and Cement Products	**3.86**
Basic Metal and Metal Products	**365.92**
Iron and Steel	275.51
Other Metal and Metal Products	90.41

All Engineering	**183.49**
Electronics	36.36
Others	147.13
Vehicles, Vehicle Parts and Transport Equipments	**7.27**
Gems & Jewellery	**16.47**
Construction	**78.72**
Infrastructure	**1199.95**
Transport	380.48
Railways	0.00
Roadways	357.89
Airport	0.00
Waterways	0.00
Others	22.59
Energy	819.13
Electricity (generation-transportation & distribution)	819.13
State Electricity Boards	94.07
Others	725.06
Telecommunication	0.34
Other Industries	**768.35**
Of which, printing industry	100.35
All Industries	**5631.77**
Residuary Other Advances	**11153.59**
Total Loans & Advances	**16785.36**

The following industry is having exposure of more than 5% of gross credit exposure as on 31.12.2013.

1. Textile Industry - 7.97%

Table DF – 4

CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO THE STANDARDISED APPROACH

Qualitative disclosures:

a) General Principle:

In accordance with RBI guidelines, the Bank had adopted Standardized Approach of the New Capital Adequacy Framework (NCAF) for computation of capital for Credit Risk with effect from 31.03.2009. In computation of capital, the bank has assigned risk weights to different assets classified as prescribed by the RBI.

External Credit Ratings:

Ratings of borrowers by External Credit Rating Agencies (ECRA) assume importance in the light of guideline for implementation of the New Capital Adequacy Framework (Basel-II). Exposures on Corporate / PSEs / Primary Dealers are assigned with risk weights based on the external ratings. For this purpose, the Reserve Bank of India has permitted Banks to use the rating of the six domestic ECRAs namely (a) Credit Analysis and Research Ltd., (CARE), (b) CRISIL Ltd., (c) India Ratings and Research P. Ltd., (India Ratings)., (d) ICRA Ltd., (e) Brickwork Ratings India P. Ltd (Brickwork) and (f) SMERA Rating Limited (SMERA). In consideration of the above guidelines the bank has decided to accept the ratings assigned by all these ECRAs.

The bank has well-structured internal credit rating mechanism to evaluate the credit risk associated with a borrower and accordingly the systems are in place for taking credit decisions as regards to acceptability of proposals, and level of exposures and pricing.

In case of bank's investment in particular issues of Corporate / PSEs, the issue specific rating of the approved ECRAs are reckoned and accordingly the risk weights have been applied after a corresponding mapping to rating scale provided.

As regards the coverage of exposures by external ratings as relevant for capital computation under Standardized Approach, the process need to be popularized among the borrowers so as to take the benefit of capital relief available for better rating of its customers. At the same time, the Bank is well aware and prepared for the application of higher risk weight (100%) for the unrated exposures relating to all fresh sanctions or renewals in excess of the threshold limit prescribed by Reserve Bank of India. The Bank follows below mentioned procedures as laid down in the Basel II guidelines for usage of external ratings:

- Rating assigned by one rating agency is used for all the types of claims on the borrowing entity.
- Long term ratings are used for facilities with contractual maturity of one year & above.
- Short term ratings are generally applied for facilities with contractual maturity of less than one year.

Quantitative Disclosures

For exposure amounts after risk mitigation subject to the standardized approach, amount of a bank's outstanding (rated and unrated) in the following three major risk buckets as well as those that are deducted as per risk mitigation are given below;

(**₹ in crore**)

Risk Weight	Rated	Unrated	Total
Below 100%	0.61	10923.52	10924.13
100%	460.21	5841.98	6302.19
More than 100%	450.98	1483.26	1934.24
Total Outstanding after mitigation	911.80	18248.76	19160.56
Deducted (as per Risk Mitigation)	31.04	5564.38	5595.42
Total outstanding	942.84	23813.14	24755.98

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