

Disclosure on Market Discipline under Pillar-III of BASEL-II

Background: These disclosures under Pillar III of Basel II are made following “Prudential Guidelines on Capital Adequacy and Market Discipline” (CAMD) for Financial Institutions (FIs) issued by Bangladesh Bank (Central Bank of Bangladesh) in December 2011. These quantitative and qualitative disclosures are intended to complement the Minimum Capital Requirement (MCR) under Pillar I and Supervisory Review Process (SRP) under Pillar II of Basel II. The purpose of these disclosures is to present relevant information on adequacy of capital in relation to overall risk exposures of the FI so that the market participants can assess the position and direction of the FI in making economic decisions.

Consistency and Validation: The quantitative disclosures are made on the basis of consolidated along with its separate audited financial statements of LankaBangla Finance Limited (LBFL) and its Subsidiaries as at and for the year ended 31 December 2018 prepared under relevant international accounting and financial reporting standards as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) and related circulars/instructions issued by Bangladesh Bank from time to time.

Information presented in the ‘Quantitative Disclosures’ section can easily be verified and validated with corresponding information presented in the consolidated audited financial statements for 2018 of LBFL and its Subsidiaries along with separate audited financial statements for 2018 of the FI available on the website of the Bank (www.lankabangla.com).

A. Scope of application

Qualitative Disclosures

(a) The framework applies to LankaBangla Finance Limited (LBFL) on ‘**Consolidated Basis**’ as there were three subsidiaries of the FI as on the reporting date i.e. 31 December 2018. However, ‘**Solo Basis**’ information has been presented beside those of ‘Consolidated Basis’ to facilitate comparison.

(b) The FI has three subsidiaries; all of them have been operational on the reporting date. These are LankaBangla Securities Limited (LBSL), LankaBangla Investments Limited (LBIL) and LankaBangla Asset Management Company Limited (LBAMCL).

LankaBangla Securities Ltd.: LankaBangla Securities Limited (LBSL) is a public limited company. As a member of Dhaka Stock Exchanges Ltd. and Chittagong Stock Exchange Ltd. the principal activities of the Company are buying, selling and settlement of securities on behalf of investors and in its own portfolio. LBFL holds 90.90% shares of LBSL. LBSL has two subsidiaries which were fully consolidated in the financial statements of LBSL. The subsidiaries are as under:

LankaBangla Information System Limited (LBISL): It is a private limited Company incorporated in May 2013. LBSL holds 99.8% shares of (LBISL).

BizBangla Media Limited: It is a private limited company incorporated in January 2011. The main objectives of the company are to carry on business of printing, publishing of newspaper, journals, magazines, periodicals, books, pamphlets and other literary and nonliterary works and undertakings, radio, television broadcastings. LBSL holds 80% shares of the Company.

LankaBangla Investments Ltd (LBIL): It is public limited Company although it was incorporated as private limited company in 2010. It obtained required license from BSEC in 2011 and started full-fledged operations of merchant banking, portfolio management, underwriting, etc. It is a fully owned subsidiary of LBFL.

LankaBangla Asset Management Company Ltd. (LBAMCL): It is incorporated as private limited company in 2007. It got license from BSEC in 2012 as an asset management company. It also received registration certificate from BSEC in 2016 to act as an Alternative Investment Fund Manager. It is a fully owned subsidiary of LBFL. The financials of all subsidiaries are fully consolidated and all

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intercompany transactions and balances are eliminated.

The rules and regulations of DFIM of Bangladesh Bank that govern 'Single Borrower Exposure Limit' for the customers are equally applicable for the LBFL in financing its own subsidiaries. LBFL is following latest Bangladesh Bank circular in determining maximum amount of finance to the subsidiaries of the Company.

Quantitative Disclosures

Not Applicable.

B. Capital Structure

Qualitative Disclosures

As per Basel II guidelines, regulatory capital consists of Tier-1 (Core) capital and Tier 2 (supplementary) capital. Core capital comprises of highest quality capital elements and supplementary capital represents other elements which fall short of some of the characteristics of the core capital but contribute to the overall strength of an FI.

Conditions for maintaining regulatory capital: The FI complied with all the required conditions for maintaining regulatory capital as stipulated in the Basel II guidelines as per the following details:

Particulars	Status of Compliance
The amount of Tier 2 capital will be limited to 100% of the amount of Tier 1 capital	Complied
50% of revaluation reserves for fixed assets and 45% of revaluation reserves for securities eligible for Tier 2 capital.	Complied
Revaluation reserve for equity instruments up to 10%	Complied
General provision up to a limit of 1.25% of risk weighted asset for credit risk may be included in Tier 2 capital	Complied
Subordinated bond in Tier 2 capital can be maximum 30% of Tier 1 Capital	Complied
Minimum capital to RWA Ratio (CAR) will be 10%	Complied

Quantitative Disclosures as on 31st December

In BDT Million

Particulars	2018		2017	
	Solo	Consolidated	Solo	Consolidated
Fully paid up Capital	5,132	5,132	3,183	3,183
Statutory Reserve	1,615	1,615	1,473	1,473
Non-repayable share premium account	-	1,091	-	1,091
General reserve	-	53	-	51
Retained earnings	2,298	1,932	2,452	2,369
Minority interest in subsidiaries	-	111	-	101
Share money deposit (for right share)	-	-	160	160
Less: Book value of Goodwill	-	(234)	-	(234)
Tier 1 Capital	8,718	9,700	7,268	8,194

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Tier 2 Capital	2,049	2,376	534	534
Total Eligible Capital	10,768	12,076	7,802	8,728

C. Capital Adequacy

Qualitative Disclosures

Assessing regulatory capital in relation to overall risk exposures of an FI is an integrated and comprehensive process. LBFL follows the risk weighted asset-based approach (standardized Approach for credit risk & Market Risk and Basic Indicator Approach for Operational Risk) in assessing the adequacy of capital to support current and projected business activities. The LBFL focuses on strengthening risk management and control environment rather than increasing capital to cover up weak risk management and control practices. LBFL has been generating most of its incremental capital from retained profit (stock dividend and statutory reserve transfer etc.) and occasional issue of right shares to support incremental growth of Risk Weighted Assets (RWA). Besides meeting regulatory capital requirement, the FI maintains adequate capital to absorb material risks foreseen. Therefore, the Capital to Risk Weighted Assets Ratio (CRAR) remains consistently within the comfort zone during 2018. The surplus capital maintained by LBFL will act as buffer to absorb all material risks and to support the future activities. To ensure the adequacy of capital to support the future activities, the FI assesses capital requirements periodically considering future business growth. Risk Management Division (RMD) under guidance of the SRP team/RMC (Risk Management Committee), is taking active measures to identify, quantify, manage and monitor all risks to which the FI is exposed to.

Quantitative Disclosures as on 31st December

Amount in BDT Million

Particulars	2018		2017	
	Solo	Consolidated	Solo	Consolidated
Capital requirement for Credit Risk	6,073	5,928	5,957	5,818
Capital requirement for Market Risk	396	1,025	354	1,113
Capital requirement for Operational Risk	374	511	293	371
Minimum capital requirement (MCR)	6,843	7,464	6,604	7,302

Particulars	2018		2017	
	Solo	Consolidated	Solo	Consolidated
Core capital maintained	8,718	9,700	7,268	8,194
Supplementary Capital Maintained	2,049	2,376	534	534
Total Risk Weighted Asset	68,430	74,639	66,043	73,026
Common Equity Tier-1 Capital Ratio	12.74%	13.00%	11.00%	11.22%
Tier-2 Capital Ratio	2.99%	3.18%	0.81%	0.73%
Capital Adequacy Ratio	15.74%	16.18%	11.81%	11.95%

D. Credit Risk

Qualitative Disclosures

Credit risk is defined as the probability of failure of counterparty to meet its obligation as per agreed terms. FIs are very much prone to credit risk due to its core activities i.e. lending to corporate, Consumer, SME, another bank/FI. The main objective of credit risk management is to minimize negative impact

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through adopting proper mitigates and to limit credit risk exposures within acceptable limit.

Credit risk management has been independent of origination of business functions to establish better control and to reduce conflicts of interest. The Head of Credit Risk Management (Chief Credit Officer or CCO) has well-defined responsibility for management of credit risk. Final authority and responsibility for all activities that expose the FI to credit risk rests with the Board of Directors. The Board however delegated authority to the Managing Director and CEO or other officers of the credit risk management division.

The Board of Directors (BoD) sets credit policies and delegates authority to the management for setting procedures, which together has structured the credit risk management framework in the FI. The Credit Policy Manual contains the core principles for identifying, measuring, approving, and managing credit risk in the FI and is designed to meet the organizational requirements that exist today as well as to provide flexibility for future. These policies represent the minimum standards for credit extension by the FI and are not a substitute of experience and good judgment.

Definitions of past due and impaired credit:

To define past due and impairment through classification and provisioning, the FI follows Bangladesh Bank Circulars and Guidelines. General provisions ranging from 0.25% to 5% on unclassified loans (standard/SMA) and specific provisions on classified loans (20% for substandard, 50% for doubtful and 100% for bad-loss) are made on the basis of quarter-end review by the management and instructions contained in DFIM Circular. Provisions and interest suspense are separately shown under other liabilities as per DFIM Circular instead offsetting with loans.

Specific provisions for classified loans and general provisions for unclassified loans are measured following BB prescribed provisioning rates as mentioned below:

Particulars	Rates of provision
General provision on:	
Unclassified standard loans and advances (except SME)	1.00%
Unclassified standard loans to small and medium enterprises	0.25%
Unclassified SMA loans and advances	5.00%
Specific provision on:	
Substandard loans and advances	20.00%
Doubtful loans and advances	50.00%
Bad & loss loans and advances	100.00%

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Quantitative Disclosures as on 31st December:

Total gross credit risk (risk weighted) exposures:

Amount in BDT Million

Particulars	2018		2017	
	Solo	Consolidated	Solo	Consolidated
Cash and cash equivalents	0	0	0	0
Claims on Bangladesh Govt. & Bangladesh Bank	0	0	0	0
Claims on NBFIs and Banks	1,378	1,723	1,450	1,851
Claims on corporate (including OBS exposures)	23,923	23,923	15,545	15,545
Claims on Retail and SME (Including OBS exposures)	3,860	3,860	10,781	10,781
Consumer Finance	11,955	11,955	12,711	12,711
Claims fully secured by residential & Commercial Property	6,199	6,199	5,846	5,846
Past due claims	1,787	1,787	1,968	1,968
All other assets	11,627	9,835	11,273	9,476
Total	60,729	59,282	59,574	58,178

Geographical distribution of exposures (without netting eligible financial collateral) as on 31st December 2018:

Amount in BDT million

Location	Solo	Consolidated
Dhaka	47,150	50,771
Chittagong	9,888	10,684
Sylhet	711	840
Jessore	1,387	1,387
Narshindi	378	552
Comilla	499	520
Bogra	861	861
Barisal	342	342
Khulna	449	545
Mymensingh	851	851
Others	1,267	1,323
Total	63,785	68,676

Industry or counterparty type distribution of exposure and NPL (without netting eligible financial collateral): Solo Basis:

Amount in BDT million

Particulars	31/12/2018	Mix (%)	NPL	NPL % of Total Portfolio
Garments and Knitwear	2,138.69	3.35%	173.13	0.27%
Textile	1,820.80	2.85%	75.26	0.12%
Food Production and Processing	4,008.56	6.28%	107.88	0.17%

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Industries				
Jute and Jute-Products	183.67	0.29%	0.00	0.00%
Leather and Leather-Goods	521.55	0.82%	0.00	0.00%
Iron, Steel and Engineering	2,101.06	3.29%	91.63	0.14%
Pharmaceuticals and Chemicals	933.98	1.46%	0.96	0.00%
Cement and Allied Industry	1,525.51	2.39%	27.40	0.04%
Telecommunication and IT	971.65	1.52%	0.00	0.00%
Paper, Printing and Packaging	601.38	0.94%	11.30	0.02%
Ship Manufacturing Industry	0.00	0.00%	0.00	0.00%
Glass, Glassware and Ceramic Industries	440.98	0.69%	14.02	0.02%
Power, Gas, Water & Sanitary Service	852.71	1.34%	21.68	0.03%
Transport and Aviation	1,049.67	1.65%	102.63	0.16%
Trade and Commerce	9,513.67	14.92%	414.99	0.65%
Agriculture	831.28	1.30%	47.34	0.07%
Housing	13,196.62	20.69%	456.99	0.72%
Brokerage & Securities	3,719.31	5.83%	0.00	0.00%
Others Loan	19,373.50	30.37%	753.26	1.18%
Total	63,784.58	100.00%	2,298.45	3.60%

Residual contractual maturity of credit exposure (without netting eligible financial collateral) as on 31st December 2018:

Particulars	Amount in BDT million	
	Solo	Consolidated
On demand	2,723	2,932
In not more than three months	14,130	15,213
In more than three months but not more than one year	13,305	15,041
In more than one year but not more than five years	15,955	17,179
In more than five years	17,672	18,311
Total	63,785	68,676

Gross Non-Performing Assets (NPAs): Solo

On the reporting date i.e. 31 December 2018, Gross Non-Performing Assets stood at BDT 2,298.45 million.

Non-Performing Assets (NPAs) to Outstanding Loans & advances: Solo

On the reporting date i.e. 31 December 2018, Non-Performing Assets (NPAs) to Outstanding Loans & advances was 3.60%.

Movement of Non-Performing Assets (NPAs): Solo

Particulars	Amount in BDT Million	
	2018	
Opening balance		1899
Additions during the year		888

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Reductions during the year	489
Closing balance	2298

Movement of Specific Provisions for NPAs (Provisions for classified loans)

Amount in BDT Million

Particulars	2018
Opening balance	709
On fully provided debt written off during the year	(247)
Write back of excess provisions	(50)
Specific provision for the year	371
Provision held at the end of the year	783

E. Equities: Banking Book Positions

Qualitative Disclosures

Investment in equity securities by LBFL is broadly categorized into two types: Quoted securities (Ordinary shares, Mutual Funds) and Un-quoted securities. Unquoted securities are categorized as banking book exposures which are further subdivided into two groups: unquoted securities which are invested without any expectation that these will be quoted in near future (i.e. held to maturity) and securities that are acquired under private placement or IPO or strategically held for a longer term and are going to be traded in the secondary market after completing required formalities or meeting some requirements.

Discussion of important policies covering the valuation and accounting of equity holdings in the banking book:

Investment in Marketable securities: Investment in listed securities are carried at cost. Adequate provision has been made considering each individual investment (where market price is less than cost) as guided by Bangladesh Bank. Unrealized gains are not recognized in the profit and loss account.

Investment in Non-Marketable securities: Investment in unlisted securities are reported at cost under cost method. Adjustment is given for any shortage of book value over cost for determining the carrying amount of investment in unlisted securities.

Investment in subsidiaries: Investments in subsidiaries are accounted for under the cost method of accounting in the Company's separate financial statements in accordance with BAS-27. Accordingly, investments in subsidiaries are stated in the Company's statement of financial position at cost, less impairment losses (if any).

- Provision for shares against unrealized loss (gain net off) has been made according to Bangladesh Bank (BB) circular.

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Quantitative Disclosures as on 31st December 2018:

Amount in BDT Million

Particulars	Solo		Consolidated	
	At Cost	At Market Value	At Cost	At Market Value
Value of Quoted securities	2,086	1,978	5,283	5,125
Value of Unquoted securities	124	124	230	230

Particulars	Solo	Consolidated
The cumulative realized gains (losses) arising from sales and liquidations in the reporting period/Net gain/(loss) on sale of quoted securities	80	352.64
Total unrealized gains (losses) / Provision for revaluation of shares	(108)	(342.29)
Total latent revaluation gains (losses)	-	-
Any amount of the above included in Tier 2 capital	-	-
Capital charge required for quoted securities:	396	1,025
Specific risk	198	513
General market risk	198	513

F. Interest rate risk in the banking book (IRRBB)

Qualitative Disclosures

(a) General Disclosure

Interest Rate Risk is the risk which affects the FI's financial condition due to changes of market interest rates. Changes in interest rates affect both the current earnings (earnings perspective) and also the net worth of the FI (economic value perspective). FI assesses the interest rate risk both in earning and economic value perspective.

The process of interest rate risk management by the FI involves determination of the business objectives, expectation about future macro-economic variables and understanding the money markets and debt market in which it operates. Interest rate risk management also includes quantifying the appetite for market risk to which FI is comfortable.

The FI uses the following approach to manage interest rate risks inherent in the Balance sheet:

Simple Gap Analysis: Traditional Gap analysis of on-balance sheet Asset Liability Management (ALM) involves careful allocations of assets and liabilities according to re-pricing/maturity buckets. This approach quantifies the potential change in net interest income using a specified shift in interest rates, e.g. 100 or 200 basis points, or a simulated future path of interest rates.

Assumptions: For Gap analysis, FI considers the following:

- For fixed-rate contract, remaining maturity is considered.

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- For contracts with provision of re-pricing, time remaining for next re-pricing is considered.
- For assets and liabilities which lack definitive re-pricing interval or for which there is no stated maturity, FI determines the core and volatile portion. For assets, volatile portion is bucketed till 3 months using historical repayment behavior and stable portion is bucketed in 6-12 months' bucket. For liabilities, volatile portion is bucketed till 1 year using historical withdrawal behavior and stable portion is bucketed in over 1-year segment.

Also, following assumptions are met:

- The main assumption of gap analysis is that interest rate moves on a parallel fashion. In reality however, interest rate does not move parallel.
- Contractual repayment schedule is met.
- Re-pricing of assets and liabilities takes place in the midpoint of time bucket.
- The expectation that loan payment will occur in schedule.

Quantitative Disclosures:

Funding Gap Analysis:

Funding GAP Analysis attempts to determine the potential impact on net interest income (NII) due to changes in interest rate.

Result of Funding Gap analysis as on December 31, 2018:

Particulars	3 months	6 months
For 1% increase/decrease in interest rate, impact on NII	BDT ± 2.19 Million	BDT ± 2.48 Million
For 2% increase/decrease in interest rate, impact on NII	BDT ± 4.37 Million	BDT ± 4.97 Million

Duration GAP Analysis:

The focus of the Duration Analysis is to measure the level of a FI's exposure to interest rate risk in terms of sensitivity of Market Value of its Equity (MVE) to interest rate movements. Duration Gap can be used to evaluate the impact on the Market Value of Equity of the FI under different interest rate scenarios. ALCO monitors the Leveraged Liability Duration and duration gap of the total FI balance sheet on a quarterly basis to assess the impact of parallel shift of the assumed yield curve.

Particulars	31 December 2018
Duration of Asset	4.16
Duration of Liabilities	2.84
Duration Gap	1.32
Changes in equity for change in interest rate (1%)	1.20%
Changes in equity for change in interest rate (2%)	2.40%

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G. Market Risk

Qualitative Disclosures

Market Risk: Market Risk is defined as the possibility of loss due to changes in the market variables. It is the risk that the value of on/off-balance sheet positions will be adversely affected by movements in equity price, interest rate and currency exchange rates. The objective of our market risk policies and processes is to obtain the best balance of risk and return whilst meeting customers' requirements. The primary sources of market risk for the company are:

Interest rate risk: Arising from changes in yield curves, credit spreads and implied volatilities on interest rate options.

Equity price risk: Arising from changes in the prices of equities, equity indices, equity baskets and implied volatilities on related options.

Company has a comprehensive Treasury Manual, Asset-Liability Management Policy, Investment Policy approved by the BoD to assess, monitor and manage all the above market risks. Various internal limits have been set to monitor market risk and capital requirement is assessed as per standardized approach of Basel II.

Methods used to measure Market Risk: FI applies maturity method in measuring interest rate risk in respect of securities in trading book. The capital charge for entire market risk exposure is computed under the standardized approach using the maturity method and in accordance with the guideline issued by Bangladesh Bank.

Market Risk Management System: To manage the interest rate risk, ALCO regularly monitors various ratios and parameters. Of the ratios, the key ratios that ALCO regularly monitors are Liquidity Coverage Ratio (LCR) and Maximum Cumulative Outflow (MCO), Liquid asset to total assets, Volatile liability dependency ratio, Snap liquidity ratio and Short term borrowing to Liquid assets ratio. ALCO also regularly monitors the interest rate sensitive gap and duration gap of total portfolio.

Quantitative Disclosures as on December 31:

Capital charge (Solo basis) for market risk:

Amount in BDT Million

	Particulars	2018	2017
a	Interest rate risk	-	-
b	Equities	395.5	353.66
c	Foreign exchange risk	0.01	0.01
d	Commodity risk	-	-
	Total	395.6	353.67

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H. Operational Risk

Qualitative Disclosures

Operational Risk: Operational risk is the risk of loss arising from fraud, unauthorized activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organization and covers a wide spectrum of issues. We seek to minimize exposure to operational risk, subject to cost benefit trade-offs. The FI captures some identified risk events associated with all functional departments of the FI through standard reporting format.

Views of Board on system to reduce Operational Risk: The policy for measuring and managing operational risks is approved by the Board in line with the relevant guidelines of Bangladesh Bank. Audit Committee of the Board directly oversees the activities of Risk Management Division (Audit & Inspection Unit, Internal Control & Compliance Unit, Enterprise Risk Management Unit) to protect against all operational risks. As a part of continued surveillance, the management committee (MANCOM), Risk Management Committee and Risk Management Division regularly review different aspects of operational risks and suggest formulating appropriate policies, tools & techniques for mitigation of operational risk.

Performance gap of executives and staffs: LBFL is an equal opportunity employer. It recognizes the importance of having the right people at right positions to achieve organizational goals. Our recruitment and selection are governed by the philosophy of fairness, transparency and diversity. Understanding what is working well and what requires further improvement is essential to our performance management system. The performance management process aims to clarify what is expected from employees as well as how it is to be achieved.

Our learning and development strategy puts special focus on continuous professional development to strengthen individuals' skill set by removing weaknesses to perform the assigned job with perfection. We have a wide range of internal and external training programs to enhance capabilities as well as minimize performance gap that will contribute more to bottom line.

Peoples' performance is assessed on the basis of performance objectives and key performance indicators (KPI) set at the beginning of each year. Decisions related to rewards and recognitions for the employees are taken on the basis of how well the assigned KPIs are met.

Potential external events: The overall environment within which an FI operates creates certain externalities which could affect business performance directly such as:

Fraud Risk is the risk of incurring losses as a result of an intentional act or omission by a third party involving dishonesty, for personal and/or business gain, to avoid personal and/or business loss, or to conceal improper or unauthorized activity. This includes facilitation, misrepresentation, money laundering, terrorist financing, theft, forgery and cyber-crime.

Business Continuity Risk is the risk of incurring losses resulting from the interruption of normal business activities, i.e. interruptions to our infrastructure as well as to the infrastructure that supports our businesses.

Information Security Risk is the risk of an event which could result in the compromise of organizational assets, including, but not limited to, unauthorized use, loss, damage, disclosure or modification of organization assets. It includes the risk of cyber threats on the organization.

Regulatory Compliance Risk is the risk of incurring regulatory sanctions (including restrictions on business activities, fines or enhanced reporting requirements), financial and/or reputational damage arising from our failure to comply with applicable laws, rules and regulations.

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Vendor Risk arises from adverse events and risk concentrations due to failures in vendor selection, insufficient controls and oversight over a vendor and/or services provided by a vendor and other impacts to the vendor itself.

Policies and processes to mitigate operational risk: Enterprise Risk Management Unit is primarily responsible for risk identification, measurement, monitoring, control, and reporting of operational risk. This unit identifies risk issues primarily through review of Departmental Control Function Check List (DCFCL) and reports to Head of ICCD (Internal Control and Compliance Division). DCFCL is a self-assessment process for detecting 'high' risk areas and finding mitigation of those risks. The committee titled 'Risk Management Committee (BRMC)' also oversees the operational risk issues.

Approach for calculating capital charge for operational risk: The FI applies 'Basic Indicator Approach' of Basel II as prescribed by BB. Under this approach, FIs have to calculate average annual gross income (GI) of last three years and multiply the result by 15% to determine required capital charge. Gross Income is the sum of 'Net Interest Income' and 'Net non-interest income' of a year or 'Total Operating Income' of the FI with some adjustments as noted below. Gross Income (GI) shall:

- Be gross of any provision (e.g. for unpaid interest),
- Be gross of operating expenses, including fees paid to outsourcing service providers,
- Include lost interest i.e. interest suspense on classified loans (SS, DF, BL).

Quantitative Disclosures as on 31st December:

Amount in BDT million

Particulars	2018		2017	
	Solo	Consolidated	Solo	Consolidated
Capital charge for operational risk	374.5	510.7	293.20	371.34