ICAAP POLICY
2013

NCC Bank

नेपाल क्रेडिट एण्ड कमर्स बैंक लि.

Nepal Credit & Commerce Bank Ltd.

NCC Bank
नेपाल क्रेडिट एण्ड कमर्स बैंक लि.
Nepal Credit & Commerce Bank Ltd.
(नेपाल राष्ट्र बैंकबाट 'क' वर्गको इजाजतपत्रप्राप्त संस्था)

Corporate Office :
NB Building, Bagbazar
Kathmandu, Nepal
Post Box No.: 12559
Tel : 4246991, Fax : 977-1-4244610
TLX No.: 2812 NBOC NP, 2843 NBOCKTM NP
SWIFT : NBOCNPKA
E-mail : corporate@nccbank.com.np

CFO
for information &
necessary actions
Ramesh
3/4/2070

Ref.No.NCC Bank/BS/02/2070/71

मिति : २०७०/०४/१३

श्रीमान कार्यकारी निर्देशकज्यू
नेपाल राष्ट्र बैंक
बैंक सुपरिवेक्षण विभाग
केन्द्रीय कार्यालय
बालुवाटार, काठमाण्डौं ।

नेपाल राष्ट्र बैंक
बैंक सुपरिवेक्षण विभाग

विषय : **ICCAP Policy पेश गरिएको सम्बन्धमा ।**

महोदय,

उपरोक्त सम्बन्धमा यस बैंकको मिति २०७०/०४/११ गते बसेको संचालक समितिको बैठक नं. ३८० बाट स्वीकृत यस बैंकको **ICCAP Policy** यसै साथ संलग्न गरी पठाईएको व्यहोरा अनुरोध गर्दछौं ।

भवदीय,

नेपाल क्रेडिट एण्ड कमर्स बैंक लि.
Nepal Credit & Commerce Bank Ltd.

(रमेश राज अर्याल)
प्रमुख संचालन अधिकृत तथा कम्पनी सचिव

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"ICAAP Policy 2013"

of

Nepal Credit & Commerce Bank Limited

1. Introduction

1.1 Executive Summary

"ICAAP Policy 2013" shall provide guidelines for the preparation of Internal Capital Adequacy Assessment Process (ICAAP) which is a set of policies, methodologies, techniques and procedures to assess the capital adequacy requirements in relation to the Bank's risk profile and effectiveness of its risk management, control environment and strategic planning. Internal capital adequacy assessment process (ICAAP) is a comprehensive process of managing all material risks and effective system for assessing and maintaining adequate capital at NCC Bank which requires Board of Directors and Senior Management oversight, monitoring, reporting and internal control reviews at regular intervals to ensure the alignment of regulatory capital requirement with the true risk profile of the Bank and thus ensure long term safety and soundness of the Bank.

The main objective of ICAAP Policy is to develop safe and sound financial system by way of sufficient amount of qualitative capital and risk management practices. Internal Capital Adequacy Assessment Process is intended to

- Intensify the governance and organizational effectiveness for risk and capital management.
- Fetch transparency on the capital assessment process by understanding the key issues of capital requirement including oversight for reviewing capital requirements.
- Evaluate the opportunities to ascertain the usage of capital across the organization.
- Determine the basis to have an informed view on capital requirements to measure the Bank's position on regulatory capital adequacy requirements.

2. Internal Capital Adequacy Process (ICAAP)

Banks take on risks in order to earn a return; therefore management system to identify and take on well priced risks becomes ever more important in today's competitive banking market.

Nepal Credit & Commerce Bank Limited (NCC Bank) has its plan, policies, manual and working methodology in place to manage all kinds of risks inherent in the Banking business. The Bank shall have separate internal procedures and structures for assessing its overall capital adequacy in relation to risk profile inherent in its business which shall also be commensurate with the nature, size and complexity. Bank's internal assessment of capital shall be adequate to cover all material risks to which it is exposed and shall use internal risk models. To manage various banking risks, the Bank has established different control mechanisms including robust internal control system, segregation of duties amongst the staffs, formation of various directors and management level committees for different functions, appropriate delegation of authorities to such committees and shall establish an independent Risk Management Department. Apart from that, the Bank has strong reporting system to minimize the banking risks.

As a part of ICAAP implementation, NCC Bank shall submit various reports to the Board of Directors and Risk Management Committee regularly.

2.1 Core Focus Area and Need of the ICAAP Policy

The major focus of the ICAAP is to analyze the future needs of the Banks in its Capital Adequacy. It is the policy for maintaining capital adequacy for the Bank.

The policy also covers the area of shareholder returns, rating objectives for the Bank as a whole or for certain securities being issued, avoidance of regulatory intervention, protection against uncertain events, depositor protection etc.

ICAAP takes into account the supervisory powers that might be applied in a Bank in case of failure to follow the regulatory requirements. All the hidden risks that are ignored at the time of calculation of Capital Adequacy Ratio as per the Standard Simplified Ratio needs to be identified and properly accounted for.

2.2 Bank's Objective and Business Strategy

The objective of NCC Bank is to be one of the leading Commercial Bank in the banking industry by fulfilling the interest of the stakeholders as well as by providing satisfaction to the customers offering innovative products and by developing and retaining highly motivated and committed staffs. It directs all its efforts to increase the shareholders fund by considering the risk factors.

NCC Bank will set the business strategy annually taking in due consideration the current financial position of the Bank, including the strategic position, balance sheet strength, future profitability and long term objective. The business strategy which will be developed shall properly align risks, capital adequacy and performance targets so that statutory compliance and desired level of performance is duly met. The setting of the business strategy thus ensures that risk and capital requirement is proactively managed to the level desired by the Management, Board of Directors and Shareholders and is matching with overall long term business strategy of the Bank.

With the number of financial institutions in the market and limited market size, the Bank expects competition to further intensify during coming year.

The business strategy of NCC Bank will mainly include the Risk and Capital Plan.

2.3 Future Capital Requirement and Planning

NCC Bank has been operating with composition of following Primary Capital and Supplementary Capital as at Chaitra End 2069.

	Capital Fund	Amount in Millions
I	**Core Capital (Tier 1)**	**2,026.36**
a	Paid up Equity Share Capital	1,400.00
b	Share Premium	0.08
c	Proposed Bonus Equity Shares	70.00
d	Statutory General Reserves	377.78
e	Retained Earnings	26.49
f	Un-audited current year cumulative profit	238.88
g	Other Free Reserve	15.18
h	Less: Investment in equity of institutions with vested interests	39.60
i	Less: Loan& Facilities extended to Related Parties & Restricted Lending	62.45
II	**Supplementary Capital (Tier 2)**	**165.19**
a	General loan loss provision	153.18
b	Exchange Equalization Reserve	4.63
c	Investment Adjustment Reserve	7.37
	Total Capital Fund (Tier I and Tier II)	**2,191.54**
	CAPITAL ADEQUACY RATIOS	
	Tier 1 Capital to Total Risk Weighted Exposures	10.52%
	Tier 1 and Tier 2 Capital to Total Risk Weighted Exposures	11.38%

For the future need of Capital and Capital Adequacy, NCC Bank has planned to capitalize its profit as a Bonus Shares. Bank has proposed and passed 5% of the paid up capital i.e. 70 millions (net) as a Bonus Shares in the 15th annual general meeting for the fiscal year 2068/69 and further, Bank has planned to propose at least 9% i.e. 132.3 millions (net) of its paid of capital as Bonus in the fiscal year 2069/70.

3. Major Elements of ICCAP

i. Board and Senior Management Oversight
ii. Sound Capital Assessment
iii. Comprehensive assessment of risks
iv. Stress Testing
v. Monitoring and Reporting
vi. Internal Control and Review

3.1 Boards and Senior Management Oversight

Board and Management shall jointly ensure that formality and sophistication of the risk management processes are appropriate in light of the Bank's risk profile and Business Plan and shall put in place credible and consistent policies and procedures to identify measure and report all material risks that the Bank faces. Board shall ensure that the Policy Framework is comprehensive for key business and support functions, and establish a method for monitoring compliance of the same.

Board shall be primarily responsible for ensuring the current and future capital needs of the Bank in relation to strategic objectives. Management shall review and understand the nature and level of various risks that the Bank is confronting in the course of different business activities and how this risk relates to capital levels and accordingly implement sound risk management framework specifying control measures to tackle each risk factor.

Board shall ensure that the ICAAP does not become mere compliance activity only but ensure its integration into ongoing operations and planning.

3.2 Sound Capital Assessment

In order to be able to make a sound capital assessment the Bank shall have the following:

- Policies, Procedures and Process designed to ensure to identify, measure and report all material risks
- Process that relates Capital to the level of risk;
- Process that states Capital Adequacy goals with respect to risk, taking account of the bank's strategic focus and Business Plan; and
- Processes of internal control reviews and audit to ensure the integrity of the overall management process.

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3.3 Comprehensive Assessment of Risks

A comprehensive risk assessment system shall be established to deal with all significant risks related to the bank. The various Department Heads such as Chief Risk Officer or Chief Treasury or In-charge Branch Operation Department or Such Department Heads as designated by Chief Executive Officer shall be accountable to identify the impact of the risks involved in the specific unit's operational activities.

3.4 Stress Testing

Stress testing is an important management tool that alerts Bank Management to adverse unexpected outcomes related to a variety of risks and provides an indication of how much capital might be needed to absorb losses in case of large shock occurs. Stress testing is a tool that supplements other risk management approaches and measures.

Bank shall analyze the result of Stress testing as per the stress testing guidelines and systematically assess its impact on the financial position, profitability, liquidity and Bank's available Capital on a periodic basis.

3.5 Monitoring and Reporting

The Bank has to identify, assess and mitigate all the risks including credit, operational and market risks. The Bank shall establish an adequate system in place for monitoring and reporting risk exposures and assessing how the changing risk profile affects the need for Capital. The Senior Management and Board of Directors on a regular basis receive the report regarding the risk profile of the Bank and its Capital needs. All the material risks are to be identified, measured, monitored and reported by Management to the Board of Directors.

A formal monitoring and reporting mechanism shall be established which requires providing the Senior Management with necessary information on the risk profile, trends and the Capital requirements. The Bank shall also strengthen an adequate system for monitoring and reporting risk exposures and assessing how the Bank's changing risk profile affects the need for Capital. Such report shall be put to the Board on regular basis. These reports shall:

- Evaluate the level and trend of material risks and their effect on Capital levels;
- Evaluate the sensitivity and reasonableness of key assumptions used in the Capital assessment measurement system;
- Determine that the Bank holds sufficient capital against the various risks and is in compliance with established Capital Adequacy goals; and
- Assess its future Capital requirements based on the Bank's reported risk profile and make necessary adjustments to the Bank's Strategic Plan accordingly.

3.6 Internal Control and Review

The internal control structure of the Bank is essential for sound capital assessment process. Effective control of the capital assessment process includes an independent review and involvement of both internal as well as external audits wherever appropriate. The Bank conducts the regular review of its risk management process to ensure its integrity, accuracy, and reasonableness. Major areas to be reviewed are:

- Appropriateness of the process adopted by the Bank for capital assessment.
- Identification of large exposures and risk concentrations.
- Accuracy and appropriateness of the data input used in the assessment process.
- Stress Testing and analysis of assumptions and inputs.
- Assessment of aggregated risk through the process of risk aggregation methodology.

Bank has implemented various policies and guidelines for internal controls. They are:

- Investment Policy & Assets Liabilities Management Guidelines
- Finance Administrative Rules
- Credit Policy Guidelines (CPG)
- Know Your Customer Due Diligence and Anti-Money Laundering Policy
- Information Technology Policy & Guidelines
- Staff Rules & Regulations

The Bank has its own Internal Audit Department. The Internal Audit Department conducts audit of the Bank as per the annual audit plan and submits the report to the management.

4. Principles of Internal Capital Adequacy Assessment Process

4.1 Bank's ICAAP shall be based on the following major principles:

4.1.1 Bank's ICAAP shall be commensurate to the nature, scale and complexity of the activities of the Bank and shall be subject to regular internal review to ensure that they remain comprehensive.

4.1.2 Bank's internal capital targets shall be consistent with its risk profile and operating environment as well as meet supervisory requirements.

4.1.3 It shall be ensured that Bank's ICAAP shall be issued by the designated authority within the Bank, duly communicated to all the staff members and enforceable immediately.

4.1.4 ICAAP shall form an integral part of the Management process and decision making culture of the Bank.

4.2 The result of the ICAAP shall be reviewed monthly by the management and shared with the Board as per requirement.

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4.3 ICAAP Policy itself shall be reviewed at least annually to see whether the risks are covered adequately or not and whether capital coverage reflects the actual risk profile of the Bank. Such review process shall be subject to independent assessment by the internal audit function. Any changes in the Bank's strategic focus, business plan, operating environment or other factors that materially affect assumptions or methodologies used in the ICAAP shall initiate appropriate adjustments to the Internal Capital Adequacy Assessment Process. New risks that occur in the business of the Bank shall be identified and incorporated into the Internal Capital Adequacy Assessment Process.

4.4 ICAAP shall be based on the risks faced by the Bank. The level of own funds shall be kept adequate in alignment with the Bank's risk profile and operating environment. The adequacy of the Bank's Capital shall be function of its risk profile. The Bank shall set capital targets consistent with risk profile and operating environment. The Bank may take other considerations into account in deciding how much capital to hold.

4.5 ICAAP shall be comprehensive and capture all the material risks and shall include at least the following risks:

4.5.1 Credit Risk: comprise the following risks.

- Credit Risk
- Counterparty Credit Risk
- Concentration Risk
- Equity Risk in Banking Book
- Securitization Risk
- Country & Transfer Risk
- Residual risk

4.5.2 Market Risk

- Interest Rate Risk
- Equity Risk
- Foreign Exchange Risk

4.5.3 Operational Risk

- People Risk
- Process Risk
- System Risk
- External Events Risk

4.5.4 Compliance Risk

4.5.5 Other Risks

- Strategic Risk

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- Reputation Risk
- Business Risk
- Any other risk identified.

ICAAP shall be based on identification of risks and management of these risks. Identification of risk is dynamic process. The Bank shall adopt prudent risk-taking and shall apply best practices to mitigate any risk over and above its risk appetite.

The Bank's risk management structure shall be dependent on risk level of transactions, complexity of transactions, size of bank, scale of business activities, significance of new markets and new transactions (e.g. international business lines and trading activities) etc.

4.6 ICAAP shall be forward-looking and take into account the Bank's strategic plans and how they relate to macroeconomic factors.

4.7 ICAAP shall be based on adequate measurement and assessment processes well documented. The results and findings of the ICAAP shall be fed into Bank's evaluation of its strategy and risk appetite.

4.8 ICAAP shall produce a reasonable outcome especially overall capital number and assessment. The Bank shall if required explain to supervisor about its ICAAP (which shall cover all material risks) and its own funds requirements.

5. Internal Capital Adequacy Assessment Process

5.1 Risk Management System

Risk Management System of the Bank consists of the following sections:

i. Risk Appetite.
ii. Risk Identification.
iii. Risk Assessment.
iv. Risk Monitoring & Reporting.
v. Stress Testing & Scenario Testing.

5.2 Risk Appetite

Risk appetite is the amount of risk that a Bank is willing to take on in pursuit of profit; it is closely related to the bank's business strategy. A risk-appetite statement is the formal way of expressing these risks. Developing the risk-appetite statement is a keystone of the Bank's approach to risk and business strategy as a whole.

Our risk strategy statement is expressed as follows:

- Balanced Performance across business units;
- Positive development of earnings quality;
- Compliance with regulatory capital requirements;
- Capital Adequacy;

- Diversified, Stable & Safe Funding and
- Strategic Liquidity allowing for business planning within the liquidity risk tolerance and regulatory requirements.

The business strategy set out by NCC Bank mainly includes the Risk & Capital Plan and risk appetite, which allows the Bank to:

- set capital adequacy goals with respect to risk, considering our strategic focus and business plans;
- assess our risk-bearing capacity with regard to internal and external requirements (i.e. regulatory and economic capital); and
- apply stress testing to assess the impact on the capital demand, capital base and liquidity position.

Sound risk management is the essence of banking and the aim of the Bank is to achieve proper balance between risk and return based on assessment of potential risk developments in both normal and stressed conditions.

5.3 Risk Identification

The Management and Board of Directors of the Bank identify all the risks as a regular process. Loan is processed and disbursed after the proper analysis of the client's credit worthiness, risk categorization via Internal Ratings, Past Performance, Marketability, etc.

5.4 Risk Assessment

The new regulatory Capital Accord (Basel II) places increased emphasis on risk management and integrated bank-wide management. Banks are required to employ suitable procedures and systems in order to ensure their Capital Adequacy in the long term with due attention to all material risks. All material risks faced by the Bank has addressed in the capital assessment process. Nepal Rastra Bank recognizes that all risks can not be measured precisely. However, Bank has developed a process to estimate risks with reasonable certainties. All the three risks that have direct impact on the Capital Adequacy level will be managed in a structured manner with clear roles and responsibilities.

6 Credit Risk

6.1 Credit Risk Overview & Review

Credit risks are the risk associated with the probability of default of loan provided by the Bank. This includes non-repayment of capital and/or interest within the agreed time frame, at the agreed rate of interest and in the agreed currency. Hence, the credit risks comprises of the highest risk exposure of the Bank.

The Bank adopts methodologies for the assessment of credit risk involved in the exposure to individual borrowers or counterparties as well as at the portfolio level. At a minimum, credit review assessment covers internal risk

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ratings, risk concentration, portfolio analysis and large exposures. For reviewing the credit risk, following factors are taken into consideration:

- Industry/Business
- Financial Statements and Cash Flow
- Facility Structure
- Security Coverage
- Transaction
- Account Profitability
- Others

6.2 Credit Risk Assessment, Process and Approval

The individual borrowers are assessed for their credit worthiness, collateral security etc. The credit approval process being followed at Bank has somewhat consistent lending process and related internal controls. Following elements supplement properly functioning of the credit approval process:

- Pre-established loan processing flow, which sets out the proper movement of credit proposals within the approving channels.
- Loan information and credit analysis are properly documented and carried out on standardized formats
- Loan applications are analyzed against established credit criteria
- Loan funds are disbursed through proper channels after obtaining securitization of loans
- Generally, loan renewals are subject to the same criteria and credit evaluation process as when first approved.
- Loans decisions are made and approved by competent authority with the appropriate authorization and accountability
- Approving authorities shall be delegated formal lending limits in accordance with their credentials / experience

6.3 Credit Risk Mitigation

The Bank uses various collaterals both financial as well as non-financial, guarantees. The main financial collaterals include bank deposits and gold, while main non-financial collaterals include land and building, plant and machinery, residential and commercial mortgages. The guarantees include guarantees given by corporate, bank and personal guarantees.

The Credit Policy Guideline of the Bank explains about Collateral Management which underlines the eligibility requirements for credit risk mitigants (CRM) for Capital computation as per Basel II guidelines. The Bank reduces its credit exposure to counterparty with the value of eligible financial collateral to take account of the risk mitigating effect of the collateral. To account for the volatility in the value of collateral, haircut is applied based on the type, issuer, maturity, ratings and revaluation frequency of the collateral. Haircut percentage is being followed as suggested by the Framework. The Bank revalues various financial collaterals at varied frequency depending on the type of collateral. The processes for collateral valuation and empanelment of valuators are also done by the Credit Policy Guideline of the Bank.

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Bank shall maintain necessary level of following financings to reduce the credit risk.

- Financing of Loan against FDR.
- Gold Loans.
- Loan against Government Securities.
- Others as per market and regulators need.

The Board of Director is final authority for the accessing credit risk and credit approval.

6.4 Credit Concentration Risk

Risk concentration in a single exposure or group of exposures with the potential to reduce the overall quality of the assets of the Bank as well as increase the losses enough which threatens the health and core operations of the Bank will be minimized. Hence, the Banks should have in place internal policies, systems and controls to identify, measure, monitor and control their credit risk concentrations. However, it is required that the extent of credit risk concentration is to be assessed at the time of assessment of Capital Adequacy under review process. The Bank clearly documents the framework set for managing the credit risk concentration and should set a limit for the same. The Management of the Bank conducts periodic stress testing of the risk concentration and reviews the results. This test will help to identify the potential changes in the market conditions which might have adverse impact upon the performance of the Bank.

7 Operational Risk

Operational risks are risk of loss resulting from inadequate internal factors like process, people and systems and/or from external factors. Operational Risks are highly important as it entails cent percent loss to the Bank in the event of its occurrence. The major contributor of the Operation Risk is qualitative and is difficult to be quantified. The Bank has been following the process specified under Capital Adequacy Framework for calculation of Operational Risk of the Bank. Operational Risks are assessed employing the Basic Indicators Approach as set out by Capital Adequacy Framework issued by Nepal Rastra Bank. The Bank's appetite for tolerance of operational shall be periodically set and reviewed at regular intervals.

8 Market Risk

Market Risks are the risk arise out of adverse movement in exchange rates, interest rates, liquidity and equity are covered under market risk management. The Bank has been following the process specified under Capital Adequacy Framework for managing and computing exchange risk in the market. Interest rate risk, liquidity risk and equity risk are assessed at a regular interval to strengthen the market risk management. Management of market risk is done on the basis of tolerance level set by the Board.

Bank has an ALCO Committee which reviews the Market Risk faced by the Bank at regular intervals. Internal Process such as GAP analysis, deposit mix, analysis of government policies and its impact upon Bank is done by the ALCO committee.

9 Compliance Risk

Compliance Risk is the risk resulting from non-compliance with laws and regulations and lack of adequate documentation to demonstrate compliance and risk from failure to comply with financial reporting standards, agreements or regulatory requirements. The main Compliance Risk components are generally referred to as regulatory, financial reporting and legal risk. We are constantly monitoring and mitigating Compliance Risk through the adoption of appropriate policies and timely reporting as per the regulatory requirements. There is a separate Compliance Department to inform the staff about the regulations to be followed in daily practice and carrying out the banking transactions. The Department also conforms that regulatory norms are complied properly.

10 Liquidity Risk

Liquidity Risks refer to the risks of probable losses at the time of liquidity crisis. Liquidity risk arises from funding needs during difficult markets and capital adequacy challenges. Liquidity risk is that short-term assets values are not sufficient to match short-term liabilities or unexpected cash outflows. The Bank as per the approved guidelines from the Board has been maintaining liquid assets to deposit ratio and has been monitoring the same very closely. The investments for liquid asset mainly comprises of Government Securities: Treasury Bills maturing within 364 days and Bonds. Our Central Bank as per their Open Market Committee proceedings brings REPOs and Reverse REPOs in the market as per the market requirement and has been letting the Banks to utilize the Standing Liquidity Facility (SLF) against the holding of Government Securities as the last resort for liquidity requirement.

Liquidity of the Bank is assessed, measured, and maintained by Treasury Department by ensuring minimal compliance with the ratios (i.e. CRR, SLR, Credit to Deposit Ratio and Liquidity Ratio) as prescribed by Nepal Rastra Bank on daily basis. The Department also maintains investments over and above the prescribed limit to cope with the unprecedented liquidity risks that the Bank is ever exposed to.

11 Qther Risks

Bank identifies assess and monitors other risks such as reputation risks and strategic risks at regular interval in addition to the above mentioned risks. Bank should regularly discusses various other prominent risks that it faces or likely to face in the execution of its day to day activity and address them appropriately.

12 Risk Monitoring & Reporting

The Bank has to identify, assess and mitigate all the risks including credit, operational and market risks. The Bank has an adequate system in place for monitoring and reporting risk exposures and assessing how the changing risk

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profile affects the need for Capital. The Senior Management and Board of Directors on a regular basis receive the report regarding the risk profile of the Bank and its Capital needs. All the material risks are to be identified, measured, monitored and reported by Management to the Board of Directors.

12.1 Credit Risk Measurement

In order to measure the Credit Risk, Simplified Standardized Approach (SSA) shall be used as mentioned below. Any changes in the provisions of unified directive and any other regulatory requirement shall automatically form part of the following format.

For assessing Internal Capital Adequacy against Credit Risk, it shall be measured by using Simplified Standardized Approach (SSA) as per the table below.

Simplified Standardized Approach (SSA)

(Amount in NPR)

	CREDIT RISK WEIGHTED EXPOSURES	Previous Month	This Month
a	Risk Weighted Exposure for Credit Risk as per Basel II		
b	Risk Weighted Exposure for Counterparty Credit Risk		
c	Risk Weighted Exposure for Concentration Risk		
d	Risk Weighted Exposure for Equity Risk in Banking Book		
e	Risk Weighted Exposure for Securitization Risk		
f	Risk Weighted Exposure for Country & Transfer Risk		
g	Risk Weighted Exposure for Residual risk		
	Total Credit Risk Weighted Exposures		
	CAPITAL		
a	Core Capital (Tier 1)		
b	Supplementary Capital (Tier 2)		
	Total Capital		
	CAPITAL ADEQUACY RATIOS		
a	Tier 1 Capital to Total Credit Risk Weighted Exposures		
b	Tier 1 and Tier 2 Capital to Total Credit Risk Weighted Exposures		

12.2 Operation Risk Measurement

In order to measure Operation Risk, Basic Indicator Approach shall be used as mentioned below. Any changes in the provisions of unified directives and any other regulatory requirement shall automatically form part of this format.

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For assessing Internal Capital Adequacy against Operation Risk, it shall be measured by using Basic Indicator Approach (BIA) as per the table below.

<u>Basic Indicator Approach (BIA)</u>

(Amount in NPR)

	Particulars	Previous Month	This Month
a	Operation Risk Weight Exposure as per Basel II		
b	Risk Weighted Exposure for People Risk		
c	Risk Weighted Exposure for Process Risk		
d	Risk Weighted Exposure for System Risk		
e	Risk Weighted Exposure for External Events Risk		
Total Operation Risk Weight Exposure			
CAPITAL			
Core Capital (Tier 1)			
Supplementary Capital (Tier 2)			
Total Capital			
CAPITAL ADEQUACY RATIOS			
a	Tier 1 Capital to Total Operation Risk Weighted Exposure		
b	Tier 1 and Tier 2 Capital to Total Operation Risk Weighted Exposure		

12.3 Market Risk Measurement

In order to measure Market Risk the following format shall be used as shown below. Any changes in the provisions of unified directives and any other regulatory requirement shall automatically form part of this format

For assessing Internal Capital Adequacy against Market risk, it shall be measured based on fixed percentage of Net Open Position including other risk as per below table.

Measurement of Market Risks

(Amount in NPR)

Particulars		Previous Month	This Month
a	Market Risk Weight Exposure as per Basel		
b	Risk Weighted Exposure for Equity Risk		
c	Risk Weighted Exposure for Interest Rate Risk		
Total Market Risk Weight Exposure			
CAPITAL			
Core Capital (Tier 1)			
Supplementary Capital (Tier 2)			
Total Capital			
CAPITAL ADEQUACY RATIOS			
a	Tier 1 Capital to Total Market Risk Weighted Exposure		
b	Tier 1 and Tier 2 Capital to Total Market Risk Weighted Exposure		

12.4 Liquidity Risk Measurement

In order to measure Liquidity Risk the following format shall be used as shown below. Any changes in the provisions of unified directives and any other regulatory requirement shall automatically form part of this format.

For assessing Internal Capital Adequacy against Liquidity Risk, it shall be measured based on Net Liquid Asset to Total Deposit Ratio as per the below table

<u>Measurement of Liquidity Risk</u>

Amount in NPR'000

Particulars		Previous Month	This Month
a	Net Liquid Asset (a)		
b	Total Deposit (b)		
c	Net Liquid Asset to Total Deposit Ratio (c)		
d	Amount @ 1% of Total Deposit if ratio <20%		
e	Additional Provisioning by ALCO		
Total Liquidity Risk Weight Exposure			
CAPITAL			
Core Capital (Tier 1)			
Supplementary Capital (Tier 2)			
Total Capital			
CAPITAL ADEQUACY RATIOS			
a	Tier 1 Capital to Total Liquidity Risk Weighted Exposure		
b	Tier 1 and Tier 2 Capital to Total Liquidity Risk Weighted Exposure		

12.5 Other Risk Measurement

Any additional risks other than mentioned above is observed, such risks shall be duly identified, materiality assessed and quantified for due inclusion in Risk weighted exposures under appropriate heads. In order to measure Other Risks the following format shall be used as presented below.

For assessing Internal Capital Adequacy against Other Risk, it shall be measured by criteria set by ALCO based on inputs from Risk Management Committee.

Amount in NPR 000

	Particulars	Previous Month	This Month
a	Strategic Risk		
b	Reputation Risk		
c	Business Risk		
d	Concentration risk		
e	Interest Rate Risk		
f	Underwriting risk		
g	Pension risk		
h	Transfer risk		
i	Weaknesses in Credit Risk Mitigation		
j	Any other risk identified by ALCO		
	Risk Weight Exposure as decided by ALCO		
	Total Other Risk Weight Exposure		
	CAPITAL		
	Core Capital (Tier 1)		
	Supplementary Capital (Tier 2)		
	Total Capital		
	CAPITAL ADEQUACY RATIOS		
a	Tier 1 Capital to Total Other Risk Weighted Exposure		
b	Tier 1 and Tier 2 Capital to Total Other Risk Weighted Exposure		

13 Risk Aggregation Methodology

Once the risks have been identified and quantified, individual risks also have to be aggregated to determine the Bank's overall risk in the ICAAP. NCC Bank shall adopt the Capital Adequacy Ratio calculation as per Capital Adequacy Framework issued by Nepal Rastra Bank as risk aggregation methodology. Under Pillar 1 of the Capital Adequacy Framework, Bank's overall minimum capital requirement is calculated as the sum of capital requirements for the Credit Risk, Operational Risk and Market Risk. Since, the minimum capital requirement as prescribed by Nepal Rastra Bank is mandatory, risk calculated as ICAAP either determine no additional capital is needed, or additional capital is required above Pillar 1 levels. Other risk such as compliance risk, reputation risk, compliance risk etc not included under CAR Framework are internally identified, assessed and mitigated by the Management.

14 Stress and Scenario Testing

Stress and scenario testing an important management tool that alerts Bank Management to adverse unexpected outcomes related to a variety of risks and provides an indication of how much capital might be needed to absorb losses in case large shock occurs. Stress testing is a tool that supplements other risk management approaches and measures.

14.1 Description of Methods

NCC Bank shall adopt the stress and scenario testing methodology prescribed in Stress Testing Guidelines issued by Nepal Rastra Bank.

14.2 Results of Stress Testing

The result of stress testing is discussed and communicated to Board and Senior Management level on quarterly basis. Bank also sends the report to Nepal Rastra Bank in compliance of the NRB Directive issued.

14.3 Scenario analysis and Sensitivity Analysis

Scenario analysis and sensitivity analysis is conducted through the model developed by Nepal Rastra Bank. However, on need basis Bank shall also adopt other advanced techniques and develop other scenarios.

14.4 Gap Analysis

Gap analysis is the major tool used by the Bank for liquidity risk analysis. It is a scenario analysis where the assets and liabilities are kept in the different buckets as per their maturity and the decision is taken by the analysis of the bucket by the ALCO.

15 Calculation of Internal Capital Adequacy

Overall Capital Fund including Core Capital (Tier I) and Supplementary Capital (Tier II) shall be based on Capital adequacy Framework forming a Part of Unified Directives No 1 issued by Nepal Rastra Bank.

Internal Capital Adequacy shall be computed on monthly basis.

For prudent internal Capital Adequacy, endeavor shall be made to maintain Capital Adequacy of 0.5 % over and above the regulatory requirement after taking into account any addition made by Regulator after its supervisory review.

In case of Capital Adequacy is above Regulatory requirement but below stipulated by this policy, the same shall be put to the Risk Management

Committee and the Board for update with reasons and appropriate justifications.

16 Implementation of the ICAAP

The ICAAP will be integrated upfront into the formulation of business strategy of the Bank with the specific aim of enhancing awareness of the fact that strategic decisions involve risks which have to be offset with risk coverage capital. Similarly, ICAAP implementation will be supplemented with proper communication and continuous review and changes.

16.1 Comparison of ICAAP's outcome with the regulative capital requirements; Justification of Differences

The ICAAP result shall be discussed and compared with regulatory capital requirement at least once in a year. However, the quantitative business strategy and capital planning done by the Bank annually shall be used as a benchmark for all the decisions being made in the Bank. The ICAAP result shall reflect the comparison of the annual quantitative business strategy and capital planning against the actual status. The same result shall also be compared against the regulatory requirements and differences shall be discussed in details.

The comparison of ICAAP outcome with the regulatory capital requirements shall be prepared by Finance & Planning Department until the establishment of a separate Risk Management Department and discussed in details with Senior Management, ALCO, Risk Management Committee and Board of Directors eventually.

16.2 Internal Control Mechanisms applied in respect of ICAAP

An independent Risk Management Department shall be set up in the Bank which reports to the Senior Management on regular basis about the results of ICAAP.

Similarly, the ICAAP results will ultimately be discussed in ALCO and Risk Management Committee and reported to the Board of Directors at least once in a quarter and discussed in details. The BOD is entitled with the responsibility to ensure that sound internal control mechanism has been devised and implemented for ICAAP adoption. Similarly, the BOD regularly reviews that internal control system devised for ICAAP is working properly and if need arises appropriate changes shall be made. Similarly, the BOD may ask for other reports in cases where risks are realized suddenly or unexpectedly.

NCC Bank has also set up Risk Management Committee as per NRB Guidelines chaired by Director where in ICAAP results are reported and discussed in detail in the meeting.

16.3 Management Decision made on the basis of ICAAP

ICAAP would lose its value if it is viewed as the risks reporting tool only. It is used as crucial criteria to be met in the decision making process of the

Bank. The results and reports generated by the ICAAP serve as a basis for Management decisions and Bank control. The Management must make its decisions independently and on the basis of the information of all relevant risks and other risk factors ensure that adequate Capital is maintained at all times.

16.4 Results of an independent review of ICAAP

For the review of sufficiency of ICAAP internal control mechanism and its proper compliance in the bank, the BOD may call for independent review by internal or external auditors. As per the result of an independent review, the BOD may change the ICAAP internal control mechanism accordingly.

16.5 Planned changes in the ICAAP

As mandated by the ICAAP guidelines issued by Nepal Rastra Bank, ICAAP result, internal control mechanism and its compliance in the Bank shall be independently reviewed at least once in a year. The quantitative result of the ICAAP and the review report with the appropriate changes in the ICAAP policy of the Bank shall be reported to Nepal Rastra Bank within a month after the end of the Fiscal Year.

16.6 Board and Senior Management discussion on ICAAP

The Board and Senior Management discussion on the result of ICAAP is a part of internal control mechanism embedded in the ICAAP policy. The Board and Senior Management discussion on ICAAP shall be properly documented.

17 Reporting

17.1 Internal Reporting

"Internal Capital Adequacy Assessment Report" shall be prepared by the Finance & Planning Department of the Bank in a monthly reporting basis and shall be circulated to relevant authorities for further review and action. Quarter end reports shall also be additionally tabled at ALCO, Risk Management Committee and Board for review and discussions.

Other reports shall also be generated as per requirement to evaluate the risks.

Formats of these reports shall be as circulated by the Management from time to time.

Preparation of report shall be guided by the following:

Practicality: Reports shall provide all essential information specifically the comparison of the Bank's overall risks with its risk cover.

Acceptable: The report shall be in line with the needs of the target group.

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Transparent: The report shall contain clear, comprehensible and accurate information.

Comprehensiveness: Reports shall cover all material risks and types of risk coverage capital as well as supervisory aspects.

Timeliness: The reporting system shall be designed in such a way that gaps between target and actual risk positions can be reported as quickly as possible in order to enable the appropriate countermeasures to be taken in due time.

Continuity: Reports shall be compiled at regular (monthly/quarterly etc.) intervals and their content shall be presented in a consistent format.

17.2 NRB Reporting

Apart from the reporting requirement mentioned in other points above, the Bank shall report the formulation and implementation of the ICAAP to Nepal Rastra Bank on an annual basis within one month of fiscal year end. The Bank shall report if there are any changes made in the previous ICAAP or its outcome including but not limited to the following:

1. Executive summary
2. Background of the ICAAP process;
3. Statement of Bank's attitude to risk;
4. Business strategy;
   a. Risk strategy and risk appetite by risk types;
   b. Target risk profile;
   c. Actual risk profile and possible change in this profile;
5. Capital Planning;
   a. Business Plan and Capital Plan
   b. Risk limits and use of these limits in capital allocation;
   c. Summary of capital composition and capital planning;
   d. Target capital adequacy;
6. Risk Assessment;
   a. Risk definitions
   b. List of identified risks
   c. Description of risk assessment methods by risks
   d. Risk assessment and capital need by risks
   e. Assessment for aggregated risks
   f. Description of risk aggregation methodology
7. Stress and Scenario testing;
   a. Description of methods
   b. Results of stress testing,
   c. Scenario analysis and Sensitivity analysis;

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8. Implementation of the ICAAP.

a. Comparison of ICAAP's outcome with the regulative capital requirements; justification of differences
b. Internal control mechanisms applied in respect of ICAAP
c. Management decisions made on the basis of ICAAP
d. Results of an independent review of ICAAP
e. Planned changes in the ICAAP
f. Board and Senior Management discussion on ICAAP

17.3 Checks and Reviews

Internal Audit Department shall review the computation of internal capital adequacy on monthly basis. This review shall focus on whether the assessment of Internal capital has been done as per the laid down Policy Framework or not.

Internal Audit Department shall review on annual basis whether the risks the Bank is exposed to have been properly identified or not, whether appropriate risk assessment methods have been implemented or not, whether Capital need of the Bank represents True and Fair view of the Risks the Bank is exposed to. Based on the review the Bank may consider appropriate changes in computation of Internal Capital Adequacy requirement.

18 Review of the ICAAP Policy

The ICAAP shall be reviewed by the Senior Management and Board within one month of end of the Financial Year. In case of emergency need, the number of review of the ICAAP can be increased. Any changes in Nepal Rastra Bank Directives or any other regulatory changes shall be automatically form a part of this policy.