Template 6

Summary Discussion on Adequacy/Meeting Current and Future Capital Requirements

The strategic plan is developed annually with a 5 year planning horizon and holds detailed P&L and balance sheet information. The bank carefully analyses the CAR against increases in risk weighted assets in line with the budget expansion and business volumes.

Currently the Bank is adequately capitalized and its capital adequacy ratio (CAR) is well above the minimum regulatory requirements. The Bank's industry sector exposures are also relatively diverse. Also, Bank's portfolio are not overly exposed to any counter-party. Further, the bank will deliberate on strategically curtailing risk weighted assets exposure if required.

The bank always strives to achieve the reasonable profit growth in line with the banking industry average and profit generated is retained for the future business expansion. Capital generated through retained profit over the years could be considered as one of the primary source of capital to the Bank.

Template 13

Bank Risk Management Approach & Risk Culture

We promote a strong risk culture where employees at all levels are responsible for the management and escalation. We expect employees to exhibit behaviours that support a strong risk culture in line with our Code of Business Conduct and ethics. It is the responsibility of Senior Management of SBI SL to establish a robust and pervasive risk culture and clear policies.

Further, in line with bank's global procedure and practices, the bank has developed an integrated framework in order to assess and appropriately manage various risk exposures of SBI SL.

The Risk Management & Compliance functions are independent from business lines and reporting directly to the DGM Risk & DGM (Regulatory Compliance) at International Banking Group, Corporate Centre, Mumbai, India.

Risk Management Committee (RCOM) & Escalation Mechanism

The RCOM has the overall responsibility for monitoring the risk management processes in State Bank of India –Sri Lanka Operations (SBI SL). The objectives of RCOM is to derive the most appropriate strategy for SBI SL in terms of the risk taken, expectation of the future and the potential consequences of PILLAR I & II risks. The Committee supervise broad risk categories i.e. credit, credit concentration, market, operational, country, residual, liquidity, interest rate, reputational, strategic, compliance and IT/IS risks and have the power to determine the risk appetite as well as the risk management strategies for SBI SL. The Committee take prompt corrective action to mitigate the effects of specific risks in the case such risks are at levels beyond the prudent levels decided by the Committee and keep Corporate Centre ,India informed. Also, RCOM ensure that all strategies conform to the bank's risk appetite and the level of exposure.

A comprehensive Policy Framework

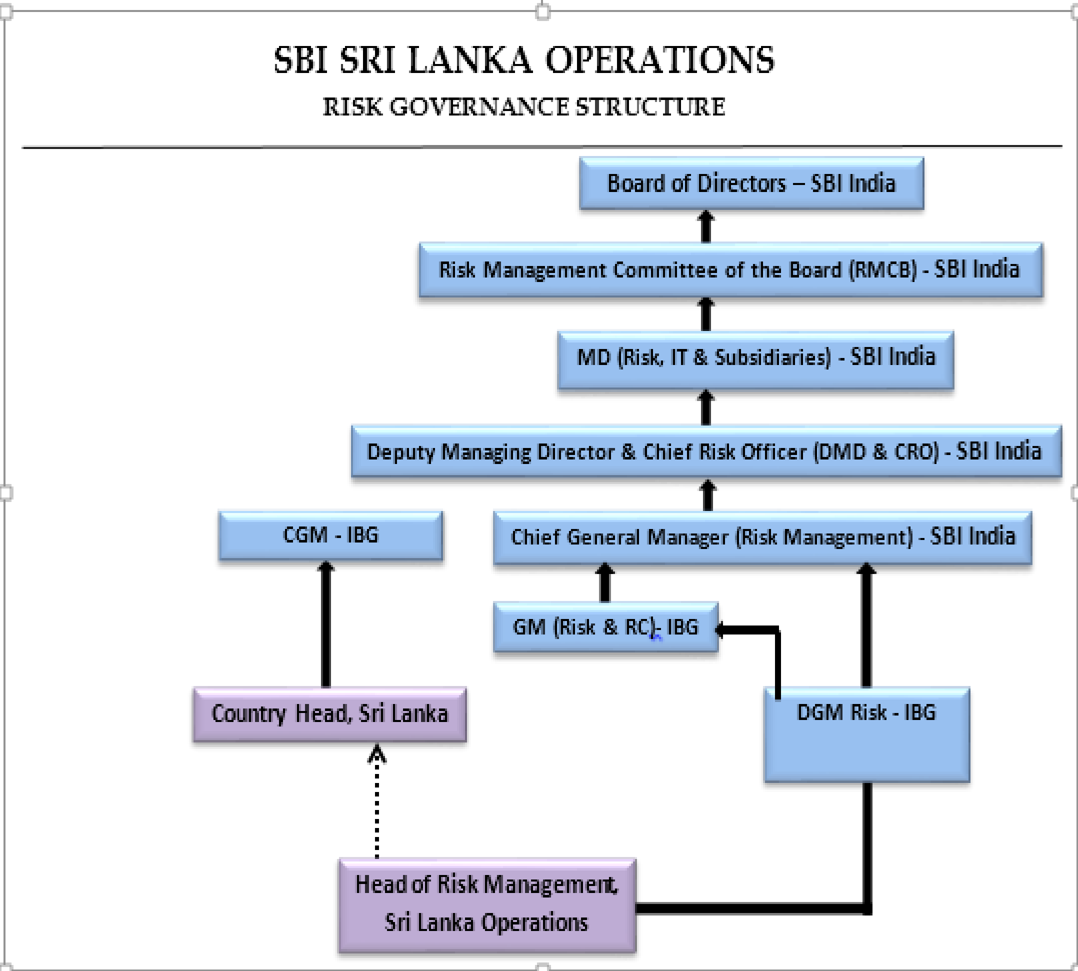
The Bank has set up a comprehensive Integrated Risk Management Framework with the aim to establish a process to effectively identify, measure, manage, control and monitor risks faced by the Bank within its risk appetite while facilitating achievement of strategic goals in the long run preserving and safeguarding the capital of the bank. Risk Management Framework takes into account all plausible risks and uncertainties the Bank is exposed to. The components of the Bank's IRMF include risk governance comprising Board oversight, Management and respective committees, wel defined risk capacity, appetite and tolerance levels, Risk * Control Self- Assessment, system of internal control, infrastructure, risk culture and contingency planning for business continuity, disaster recovery and contingency funding. IRMF is subject to an annual review or more frequently if the circumstances so warrant, taking into account changes in the regulatory and operating environments.

Risk Appetite

The bank has clearly defined Risk Appetite and it clearly communicates its tolerance levels for its material risks in both qualitative and quantitative terms and is a key component of the risk management framework. Aided by the solid Integrated Risk Management Framework the bank monitors its risk profile using risk dashboard monthly for each risk categories on an ongoing basis and takes remedial action for any deviations to ensure that it is kept within the risk appetite.

Risk Governance

The Risk Management function is independent from business lines and reporting directly to the DGM Risk at International Banking Group, India. DGM Risk –IBG reports to CGM Risk Management through GM Risk & Compliance. CGM Risk Management reports to Deputy Managing Director & Chief Risk Officer (DMD & CRO). DMD & CRO reports to MD (Risk, IT & Subsidiaries) who in turn reports to Risk Management Committee of the Bank (Board Sub-Committee), thereby making risk management an independent function.



Credit Risk

Credit risk refers to the potential loss resulting from the failure of a customer/ borrower or counterparty to honour its financial or contractual obligations to the Bank. Credit risk can arise from both on and off balance sheet activities consisting of commitments and contingencies. The total credit risk of the Bank constitutes counterparty risk, concentration risk, residual risk and settlement risk. It is managed in line with the Loan policy which is reviewed on an annual basis. For regulatory capital computation purposes, SBI SL uses Basel Standardized Approach. The Bank has adopted stringent credit risk management process to mitigate the risk associated with the loan book by way of following strategic initiatives:

- The SBI Sri Lanka manages credit risk carefully by applying a strict set of criteria while dealing with institutions and individuals of credit worthiness and ensuring exposure to counterparties are appropriately secured. Risk tolerance limits for SBI SL's activities in credit risks are outlined in the Loan policy. A consistent standard have been adapted for the origination, documentation and maintenance of the documents for extension of credit.

- Bank uses a sophisticated Loan Life Cycle Management System (LLMS) which generate credit proposal and Customer Risk Rating against specified parameters. The ratings lie on a scale between SB 1 (zero risk) to SB 16 (default grade) and these ratings are validated Independently by Credit Rating Assessment Validation Committee.

- The Bank has in place a scheme of delegation of Financial Powers for Foreign offices which has a graded authority structure. The Executive Committee of the Central Board (ECCB) has full powers for sanctioning credit facilities. The sanction powers have been delegated down the line to committees of officials at various administrative offices and to individual line functionaries based on total indebtedness and whether the facility is secured or unsecured.

- Prudential risk limits have been stipulated for various risk parameters. Credit risk limits are set by obligator, concentration, industry, and geography/ country. Bank considers bench mark ratios, with flexibility for deviation in deserving cases. The conditions subject to which deviation are permitted and the authority for permitting such deviation should be clearly spelt out in the loan policy.

- Emphasis is given on maintaining a diversified portfolio of risk assets in line with capital desired to support such a portfolio.

- Apart from the above, there are various credit risk mitigating techniques adopted by the Bank viz pre sanctioning recommendation by Risk Management for credit facilities, post sanction loan review mechanism by Loan Review Officer attached to Risk Management department.

- SBI SL has a separate guideline on NPA Management which is incorporated in the Credit Policy. It describes Bank's policy on NPA management, recovery and proactive initiatives to contain net NPAs in conformity with international standards.

- Bank takes a consistent approach towards early problem recognition, classification of problems exposure and remedial action has been adapted.

- Risk based pricing: Pricing is linked to grade of the risk in the exposure. When a borrower's credit risk increases, the Bank demands a higher credit risk premium by way of increasing the interest rate.

- Stress testing for Bank credit portfolio will be conducted at quarterly intervals and results to be analyzed for chalking out appropriate remedial action for risk mitigation.

- Impairment on the potential delinquents by way of reviewing objective evidence assessments by the business units and adequacy of impairment provisions to absorb credit risk of the lending book.

Credit Concentration Risk

The concentration risk denotes the risk arising from uneven distribution of counterparties, business sectors (Sectorial concentration) or geographical regions (geographical concentration), which is capable of generating losses large enough to affect the solvency.

Concentration risk arises in Bank's assets, liabilities, and off-balance sheet items as well. SBI SL recognizes that there are two types of concentration risks that are pertinent to SBI SL namely, Name Concentration and Sector Concentration. Apart from commonly used methods of economic sector and name concentration mentioned above, the SBI SL reviews Borrower rating distributions, Age analysis, geographical distribution, country risk, funding concentration etc for portfolio level monitoring.

The exposure to single borrowers, group borrowers and large borrowers are such exposure limits that are monitored by SBI SL against the prudential limits set by regulators. In addition to the prudential exposure limits, the substantial exposure norms which are in-house limits set within the prudential norms are intended to further help in monitoring credit concentrations. The exposure ceiling is fixed in relation to the Bank's Capital funds. Frequent monitoring and stringent control mechanisms are in place to ensure that the risk of concentrations on different types of exposure tables above are within the tolerance level of the Bank. SBI SL has not exceeded the various tolerance limits set under concentration risk categories. Reports on all substantial exposures are submitted to ALCO or RCOM if there is a deviation from these limits. No breaches have been reported in substandard exposure norms during past one year.

Country Risk

Country risk is the risk that an occurrence within a particular country could have an adverse effect on the Bank directly by impairing the value of the exposures purchased / underwritten or indirectly through an obligor's inability to meet its obligations to the Bank.

The Bank assesses country exposure of countries where the bank has funded and non-funded exposures. The Bank has set maximum exposure limits on all the countries where the Bank has funded and non-funded exposures. These limits are reviewed at regular intervals and all foreign offices are advised accordingly.

The country wise exposure limits and utilization levels are monitored centrally and at foreign office levels through an automated system.

The Board of the Bank has formulated a policy on Country Risk Management and adopted a model for computation of country risk limits across the Bank. The Country Risk evaluation is being reviewed quarterly by the Board (SBI –India) with a provision to review the rating of specific country, based on any major events in that country. Also, country limits and the policy are being renewed every year on the basis of experience gained and requirements.

The country risk is being examined along with credit and other **risks** by the respective sanctioning authority/ committee which take a holistic view of the credit/ investment proposals at the sanctioning stage.

SBI Sri Lanka has not breached any country risk exposure limits for past 12 months.

Market Risk

Market Risk is the risk that the value of 'on' or 'off' balance sheet positions will be adversely affected by movements in market interest, currency exchange rates, equity & commodity prices. The associated market risks and measurement techniques are given below.

The Bank is exposed to Market Risk because of positions held in its trading portfolio (Trading Book) as well as their non-trading business including the treasury operations (Banking Book).SBI SL's market risk arises mainly from non-trading portfolio (Banking Book) since trading book is negligible and consists only limited forex exposures. Exposure to market risk arises mainly from Interest Rate Risk and Forex risk as the Bank has negligible exposure to commodity related price risk and equity price risk.

Bank has a comprehensive market risk management policy and limit management framework. Bank monitors market risk against various limits, risk assessments and Management Action Triggers (MATs). Bank use Value at Risk, sensitivity analysis and stress testing on open positions, mark to market on daily basis to identify the exposure at risk.

Treasury plays an important role in managing both banking/ trading book and asset and liability position of the Bank and duties are segregated in line with the best practices in to front office, middle office and back office. Treasury Middle Office (TMO) ensures that the treasury front office deals within its limits set out as per Bank's risk appetite treasury back office reconciles and escalates key issues promptly.

The TMO of Risk Department independently measures, monitors and reports on market risk exposures using market risk dashboards and assists in review of the Bank's market risk related policies and exposure limits supporting ALCO for decision making. ALCO manages market risk exposures and profitability ensuring that risks taken are commensurate with the rewards and managed within the risk appetite of the Bank. The Risk Management Committee is responsible for setting up policies and other standards for managing market risk.

SBI SL has adopted the Standardized Measurement Method (SMM) for calculation of the Market Risk capital charge.

Operational Risk

Operational Risk Management Framework enables the Bank to identify, measure, monitor and control the inherent risks of the business / operations units to mitigate losses. SBI SL collects data through Loss events, KRIs,

RCSAs, Whistle blowing; prepare and analyze various MIS including monthly KRI reports against three levels of thresholds, loss data & near-miss events, Risk registers through RCSA process and KRI trend analysis.

As part of the Bank's initiative to migrate from manual reporting of operational risk loss data / near miss events to system based reporting, the Bank has rolled-out the Incident Management Module (IMM) which enable the Bank to capture various attributes of operational loss incidents to timely & consistently report, document, analyze and monitor the Bank's operational events, losses and near miss events. Thus, the structured approach towards operational risk incidents and management thereof would bring in an overall integrity besides standardization of collection and accounting process.

The BCP of the Bank covers all arrears of banking operations with agreed arrangements for brining events under control. The BCP & DR testing are carried out semi- annually to ensure the business resilience in an event of a major system disruption.

Also, all the main processes are covered through separate Standard Operating Procedures (SOPs) .In addition to the above, a committee namely 'Preventive Vigilance Committee' is conducted on quarterly basis by each branch to serve as an effective tool for creating vigilance awareness amongst the members of the staff leading to prevention of frauds at the Branch Level.

The Capital Charge for Operational Risk is computed using the Basic Indicator Approach (BIA) for SBI SL.

Liquidity Risk Review

Liquidity risk is the risk that the Bank will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without affecting either daily operations or the financial condition of the Bank.

For liquidity management, SBI SL currently follows a combination of the stock approach and the flow approach. Under the Stock Approach, certain standard ratios are computed and prudential limits are set for standard ratios. In addition to the key ratios monitored under stock approach, bank monitors liquidity risk in bank's balance sheet via prudential liquidity ratios defined by the regulators ir. Statutory Liquid Asset Ratio (SLAR), Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) etc.

Under the Flow approach, Bank conducts gap analysis in two methods viz. behavioral and actual. In the actual method, SBI SL considers contractual residual maturity of assets and liabilities. Under behavioral analysis, 'assets & liabilities are categorized according to the behavioral study'. The maturity gap limits are calculated and monitored against both negative and positive gap limits. Levels of compliance to these limits are monitored monthly by Risk department and the exceptions are reported to the Risk Management Committee of SBI Sri Lanka for corrective actions and for information. All exceptions are subsequently reported to the Chief General Manager-International Banking Group, India. SBI SL has not reported any breaches both in positive and negative gaps for the period from April 2018 to March 2019.

The Bank also conducts stress tests to gauge the impact under different intensities of liquidity stress. Liquidity Risk is monitored by ALCO. SBI Sri Lanka has also formulated a Contingency Funding Plan (CFP) as part of the ALM Policy to meet the gap between asset and liability under stressed scenarios.

Interest Rate Risk

Interest Rate Risk (IRR) arises due to the difference in re-pricing of Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which will have an impact on the future income and expenses and its economic value.

SBI SL manages the above risk using following tools / methodologies.

- Maturity Gap Analysis, where the interest sensitive assets (RSA) and liabilities (RSL) are categorized under different time buckets and the impact on Net Interest Income for a determined change in rate movement is assessed in the short term, i.e. up to one year.
- Bank has adopted the Modified Duration Gap approach for analyzing the changes in Economic Value of Equity, which requires the mapping of assets and liabilities into different time buckets based on their Maturity.

The Bank's tolerance limits, in respect of gaps for re-pricing maturity time buckets are not breached during the year under review. Also, SBI Sri Lanka's duration of assets is more than the duration of liabilities thereby implying that the assets are more sensitive to changing interest rates than liabilities. As per the modified duration calculations, drop in economic value of equity for a 200 basis point change in interest rate are within the prudential tolerance limits.

Periodical stress testing are performed to assess the impact on sudden rate movements on the portfolio.

ALCO has been delegated with powers to decide the interest rate on deposits and benchmark lending rate or base rate on advances. ALCO has also been delegated with powers to set various risk parameters to manage the interest rate risk like prudential limit for rate sensitive gaps, earnings at risk limits, and duration of investment portfolio etc.

Reputation Risk

Reputation risk refers to the potential adverse effects which can arise from the Bank's reputation being tarnished due to factors such as unethical practices, regulatory actions, customer dissatisfaction, complaints, and adverse publicity, unable to meet obligations.

The Bank remains committed to continuously strive to maintain and improve its reputation in all the businesses it operates. Reputation Risk Management Framework has been developed for enhanced Reputation Risk Management in the Bank. Reputation Risk Events within the bank, there would be a two tier reporting structure for assessment and reporting of events. As part of this, Reputation Risk Working Group (RRWG) comprising senior officials, has been constituted for centralized and regular review of reputation risk related incidents in the Bank.

Compliance Risk

SBI SL has robust policy and processes for management of compliance risk and has a well-functioning compliance department to manage compliance aspects on a day to day basis. SBI SL is within the compliance risk appetite set i.e. "Amount of regulatory fines and penalties paid with respect to non-compliance with laws, standards, clauses, and statutes applicable to the functioning of the Bank". No incidences have been observed with regard to the regulatory fines and penalties paid with respect to non-compliance with laws, standards, clauses, statutes applicable to the functioning of the Bank for the year ended 31.03.2019.

Stress Testing

Stress testing is an important part of risk management function in the Bank and is considered as an integral part of ICAAP under Pillar II. SBI SL has a robust Stress Testing Policy which describes the procedure for identifying principal risk factors, frequency, methodology for constructing stress tests, procedure for setting risk tolerance limits and process of monitoring stress loss limits adopted by SBI SL to set the remedial actions and delegation of authority for remedial actions to manage the risks which the Bank is exposed. The Stress Testing Policy is subject to annual review.

Credit Risk Stress Testing

With respect to Credit Risk, the SBI SL has undertaken stress testing considering stress situations of Baseline, Medium and Severe intensity to assess the impact on the Capital Adequacy Ratio (CAR) and the profitability of SBI SL.

The stress test for Credit Risk assesses the following:

- the impact of asset quality downgrade
- the impact of large borrowers defaults
- the impact of Increase in Non-Performing Advances (NPA) in Top Industry Sectors
- the impact of Increase in NPA in Specific Industry Sectors
- movements in NPAs with negative change in Gross Domestic Production (GDP)

Foreign Exchange Risk Stress Testing

The stress test for foreign exchange (FX) risk assesses the impact of changes in the exchange rate movements on the Bank's open positions including reserves and consequently, its capital requirements. The aggregate position is stressed by 10%, 15%, and 20% under baseline, medium to high stress scenarios in adverse scenario of the currency positions held by the Bank.

Liquidity Risk Stress Testing

The Bank's Liquidity position is gauged under potential deposit runs, and Loan Roll-overs (Different Products) for Baseline, Medium and Severe Stress scenarios. SBI SL conducts a stress test to monitor its Liquid Asset Ratio. Also, stress tests are conducted to evaluate the resilience of the Bank towards the fall in liquid liabilities.

Interest Rate Risk in Banking Book Stress Testing

The change of interest rate scenarios are constructed for the purpose of stress testing. The rate shocks are applied across all buckets for gauging the impact on earnings at risk (EaR) and economic value of equity (EVE).