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# Pillar III Disclosure June 2010



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## Introduction

Since December 2008, the Siam Commercial Bank has adopted the new capital management framework based on Basel II. The implementation of this framework is in accordance with the guidelines of the Bank of Thailand (BOT).

The Basel II framework is comprised of three distinct pillars, each of which is a critical element in strengthening the stability of financial institutions:

- **Pillar I** provides guidelines for the calculation of minimum capital requirements.
- **Pillar II** outlines the key principles for the supervisory review process and the related risk management concepts.
- **Pillar III** complements the first two pillars by requiring a set of disclosures on capital and risk assessment processes, aimed at encouraging and reinforcing market discipline.

Under Pillar III, the BOT requires reporting to be on a semi-annual basis: 30 June and 31 December. The half-yearly report is comprised of two parts. The first section discloses quantitative information on capital structure and its adequacy, including the composition of risk-weighted assets. The second part provides an overview of market risk management practices including the capital requirement.

The annual disclosure report provides more explanatory details in terms of qualitative and quantitative information on the bank's risk management policies and framework, as well as the measures adopted to monitor and report these matters in line with the Basel II framework.

The disclosure report is made available to market participants within four months following the date of the financial statements under the Investor Relations section of the Bank's website at [http://www.scb.co.th/en/abt/abt\\_ivr.shtml](http://www.scb.co.th/en/abt/abt_ivr.shtml) and will be included as a supplement to the next audited financial statements.

This disclosure is not required to be audited by external auditors. However, it is consistent with information used internally and is provided to BOT.

## Scope of Application

### ***Standardized approach***

The Bank has adopted the Standardized Approach for measuring credit risk, market risk and operational risk in order to compute its regulatory capital requirements.

### ***Non-Consolidated or Solo basis***

In line with the BOT guidelines, the capital adequacy calculation and Pillar III disclosure are provided based on a non-consolidated basis. Following the implementation of the Consolidated Supervision framework imposed by the BOT, the Bank will adopt the consolidated basis to compute capital requirements and the first set of disclosure on a consolidated basis will be available by the end of April 2011.

## Regulatory Capital

### Capital management

#### Objective

The Bank's capital management policies and procedures are developed to ensure that its capital

- will provide a cushion for unexpected losses arising from the risks it underwrites and that this cover is in excess of the regulatory requirements at all times; and
- is sufficient to support the risk profile of the Bank and its growth based on its business strategy and is able to withstand losses sustained during an economic downturn.

The Bank's senior management reviews the capital adequacy periodically taking into account the needs of its underlying businesses and any imminent regulatory changes.

### Capital structure and adequacy

#### Capital structure

The regulatory capital is comprised of Tier 1 and Tier 2 capital:

- **Tier 1** represents the highest quality component of capital in so far as it provides a permanent and unrestricted commitment of funds. It includes:
  - Fully paid-up common and preferred shares
  - Premium on shares
  - Appropriated retained earnings
  - Legal reserve
- **Tier 2** representing non-permanent capital consists of:
  - Long-term subordinated liabilities (less 20% of amortization in each of the last 5 year prior to maturity)
  - General provisions (1.25% of total risk-weighted assets)
  - Revaluation reserves for land and buildings (limited to 50%-70% eligibility), and
  - Unrealized gains on available for sale securities (limited to 45% eligibility)

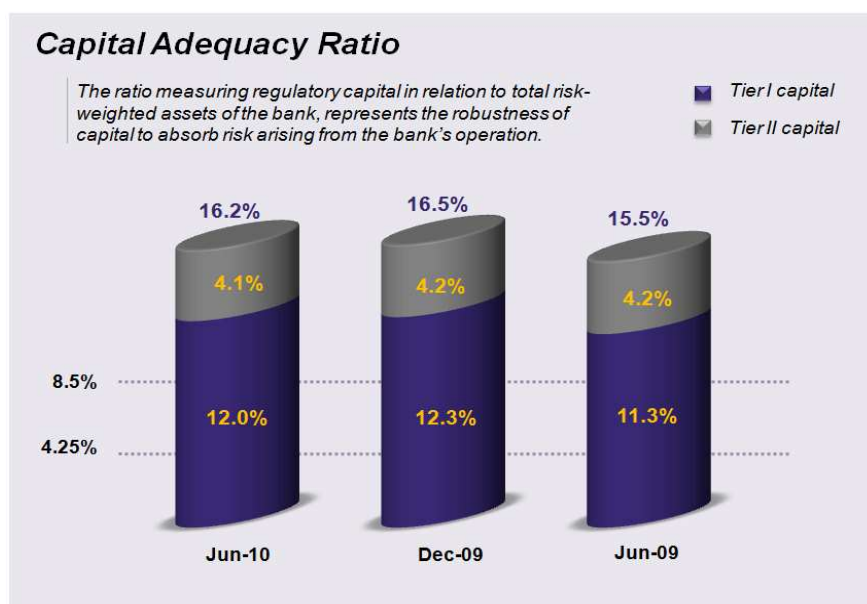
#### Capital adequacy

As stated earlier, capital provides a cushion against the risks the Bank underwrites and, therefore, maintaining an adequate capital level is of critical importance to the Bank's economic soundness.

The regulatory guidelines provides the minimum level of capital the Bank must maintain at all times; 8.5% of risk weighted assets to cover credit risk, market risk and operational risk. Further the Bank must maintain, at least, 4.25% of this capital in Tier 1 capital.

The chart and tables below provide details of the Bank's capital resources, risk weighted assets, capital adequacy ratios, and capital requirements by risk type as at 30 June 2010 and 31 December 2009. The Bank's total capital adequacy and tier 1 ratios as at 30 June 2010 stood at 16.16% and 12.03%, which although lower than at the end of the last year by 0.31% and 0.23% respectively, were still well beyond the BOT minimum regulatory requirements.

**Figure 1: Capital Adequacy Ratio and Tier 1 Ratio (Standardized Approach)**



**Table 1: Comprehensive Capital Structures and Capital Adequacy**

*In THB millions*

**Regulatory Capital**

**Tier 1 Capital**

|                                | 30-Jun-10 | 31-Dec-09 |
|--------------------------------|-----------|-----------|
| Paid-up Capital                | 33,924    | 33,920    |
| Paid-up Preferred shares       | 68        | 72        |
| Premium on shares              | 11,124    | 11,124    |
| Legal Reserve                  | 6,034     | 5,063     |
| Appropriated Retained Earnings | 63,780    | 64,073    |

**Total Tier 1 Capital**

**Tier 2 Capital**

|  | 30-Jun-10 | 31-Dec-09 |
|--|-----------|-----------|
| Revaluation Surplus on Land and Building Appraisal | 6,518     | 6,559     |
| Revaluation Surplus on AFS Investment              | 974       | 917       |
| General Provision                                  | 11,939    | 11,642    |
| Subordinated Debt                                  | 20,000    | 20,000    |

**Total Tier 2 Capital subject to limits**

**Total Regulatory Capital**

**Risk Weighted Assets**

|                  | 30-Jun-10 | 31-Dec-09 |
|------------------|-----------|-----------|
| Credit Risk      | 832,837   | 814,124   |
| Market Risk      | 27,997    | 27,621    |
| Operational Risk | 94,309    | 89,661    |

**Total Risk Weighted Assets**

**Total Risk-Weighted Capital Ratio (%)**

**Tier 1 Risk-Weighted Capital Ratio (%)**

**Minimum Regulatory Capital Adequacy Ratio (%)**

**Minimum Tier 1 Risk-Weighted Capital Ratio (%)**

|   | 30-Jun-10      | 31-Dec-09      |
|---|----------------|----------------|
| <b>Total Tier 1 Capital</b>                   | <b>114,931</b> | <b>114,252</b> |
| <b>Total Tier 2 Capital subject to limits</b> | <b>39,431</b>  | <b>39,118</b>  |
| <b>Total Regulatory Capital</b>               | <b>154,362</b> | <b>153,370</b> |
| <b>Total Risk Weighted Assets</b>             | <b>955,144</b> | <b>931,406</b> |
| <b>Total Risk-Weighted Capital Ratio (%)</b>  | <b>16.16%*</b> | <b>16.47%</b>  |
| <b>Tier 1 Risk-Weighted Capital Ratio (%)</b> | <b>12.03%</b>  | <b>12.27%</b>  |

**8.50%**

**8.50%**

**4.25%**

**4.25%**

\*Note: Appropriation of profit after interim dividend distribution for the first half of 2010 are not included in this computation. If included, the total risk-weighted capital ratio and the Tier 1 risk-weighted capital ratio would be 17.06% and 12.93% respectively)

### **Continuous strong CAR**

- Capital adequacy ratio (CAR) and Tier I ratio at the end of the current period remained well above regulatory requirement.

### **High quality of capital composition**

- 12.03% out of 16.16% represents Tier 1 capital, attesting to the ability of the bank's capital to absorb losses in an economic downturn.
- No capital deduction under Tier I and Tier II underscore that there were no unusual capital items that might unduly diminish the bank's capital.

### **Global economic revival effect**

- Due to the upward trend within the economy and stock exchange in 1H10, the increase in Tier II is underpinned by the revaluation surplus on AFS investment that has compensated for the redemption of eligible subordinated debts that was issued in 2000.

**Table 2: Minimum Capital Requirements by Risk Type**

| <i>In THB millions</i>   | <b>30-Jun-10</b> | <b>31-Dec-09</b> |
|--|------------------|------------------|
| <b>Credit Risk – Standardized</b>  |                  |                  |
| <b>Performing</b>  |                  |                  |
| Governments, Central Banks, MDBs <sup>1</sup> and PSEs <sup>2</sup> treated as Sovereign | 38               | 76               |
| Banks and PSEs <sup>2</sup> treated as Bank  | 1,585            | 1,839            |
| Corporates <sup>3</sup> and PSEs <sup>2</sup> treated as Corporate                       | 43,778           | 43,262           |
| Retail   | 9,114            | 7,995            |
| Retail Mortgage Loans  | 8,028            | 7,460            |
| Other Assets   | 6,330            | 6,308            |
| <b>Non-Performing</b>  | 1,919            | 2,261            |
| <b>First-to-Default Credit Derivatives and Securitisation</b>                            | -                | -                |
| <b>Total Minimum Capital Requirements for Credit Risk</b>                                | <b>70,791</b>    | <b>69,201</b>    |
| <b>Market Risk – Standardized Approach</b>   |                  |                  |
| Interest Rate Risk   | 1,818            | 1,656            |
| Foreign Exchange Risk  | 561              | 692              |
| <b>Total Minimum Capital Requirements for Market Risk</b>                                | <b>2,380</b>     | <b>2,348</b>     |
| <b>Operational Risk – Standardized Approach</b>  |                  |                  |
| <b>Total Minimum Capital Requirements for Operational Risk</b>                           | <b>8,016</b>     | <b>7,621</b>     |

<sup>1</sup> Multilateral development banks

<sup>2</sup> Non-central government public sector entities

<sup>3</sup> Including claims on individuals and their groups with business purposes but exceeding conditions of claims on retail

***Minimum Capital Requirement***

- Overall, current minimum capital required increased by 2.55% as a result of economic recovery and business growth in the first half of 2010. However, the proportion of capital consumed by type of risk remained unchanged.

***Higher capital to support asset growth***

- The high level of capital provides a basis for the Bank to continue to pursue business strategies that have resulted in expansion of its loan portfolios within the prudent risk-reward parameters that it has adopted.

## Market risk

### **Market Risk Management**

Market risk refers to the risk that the bank may be exposed to loss from changes in both on and off balance sheet positions as a result of any movement in market risk factors: exchange rates, interest rates, equity prices, credit spreads, and commodity prices.

The Bank has divided market risk into two categories: trading book and banking book.

- **Trading books** comprises positions in a financial instruments held with a trading intent and for a short period, with an intention to sell and/or to benefit from changes in prices or arbitrage.
- **Banking books** comprises of the bank's assets and liabilities as well as off balance sheet items and financial instruments which are intended to be held for a longer period or till maturity for interest rate risk management or for liquidity purposes.

Market Risk Management of the trading book is governed by Market Risk Policy Guide (MPG) and Trading Book Policy (TBP), which are approved by the Board of Directors. The policies set out the framework that will enable the Bank to follow expectations of its regulators and international best practices.

### **Capital Treatment for Market Risk**

The Bank uses the Standardized Approach to calculate market risk capital requirements in accordance with the BOT guidelines. The table below identifies the minimum capital requirements for its trading book businesses between 30 June 2010 and 31 December 2009.

**Table 3: Minimum Capital Requirement of Market Risk (Standardized Approach)**

| <i>In THB millions</i>                                    | 30-Jun-10    | 31-Dec-09    |
|---|--------------|--------------|
| Interest Rate Risk  | 1,818        | 1,656        |
| Equity Position Risk                                      | -            | -            |
| Foreign Exchange Risk                                     | 561          | 692          |
| Commodity Risk  | -            | -            |
| <b>Total Minimum Capital Requirements for Market Risk</b> | <b>2,380</b> | <b>2,348</b> |

### **Small movement in market risk**

- The minimum capital requirement for Market Risk slightly increased between June 2010 and December 2009 due to an increase in interest rate trading activity while the net foreign exchange position was lower.