Deutsche Bank AG, Colombo Branch

Risk Disclosure

as at 30 June 2015

Passion to Perform
Risk Management Framework
The diversity of our business model requires us to identify, assess, measure, aggregate and manage our risks, and to allocate our capital among our businesses. We operate as an integrated group through our divisions, business units and infrastructure functions. Risk and capital are managed via a framework of principles, organizational structures and measurement and monitoring processes that are closely aligned with the activities of the divisions and business units.

- Core risk management responsibilities are embedded in the Management Board and delegated to senior risk management committees responsible for execution and oversight. The Supervisory Board regularly monitors the risk and capital profile.
- We operate a three-line of defense risk management model whereby front office functions, risk management oversight and assurance roles are played by functions independent of one another.
- Risk strategy is approved by the Management Board on an annual basis and is defined based on the Group Risk Appetite and Strategic and Capital Plan in order to align risk, capital and performance targets.
- Cross-risk analysis reviews are conducted across the Group to validate that sound risk management practices and a holistic awareness of risk exist.
- All major risk classes are managed via risk management processes, including: credit risk, market risk, operational risk, liquidity risk, business risk, reputational risk, model risk and compliance risk (MaRisk, i.e., minimum requirements for risk management). Modeling and measurement approaches for quantifying risk and capital demand are implemented across the major risk classes. Non-standard risks (reputational risk, model risk, compliance risk) are implicitly covered in our economic capital framework, primarily within operational and strategic risk.
- Monitoring, stress testing tools and escalation processes are in place for key capital and liquidity thresholds and metrics.
- Systems, processes and policies are critical components of our risk management capability.
- Recovery planning provides the escalation path for crisis management governance and supplies senior management with a list of actions designed to improve the capital and liquidity positions in a stress event.
- Resolution planning is closely supervised by our home resolution authority. It provides a strategy to manage Deutsche Bank in case of default. It is designed to prevent the need for taxpayer bailout and strengthen financial stability by the continuation of critical services delivered to the wider economy.

Risk Governance
From a supervisory perspective, our operations throughout the world are regulated and supervised by relevant authorities in each of the jurisdictions in which we conduct business. Such regulation focuses on licensing, capital adequacy, liquidity, risk concentration, conduct of business as well as organizational and reporting requirements. The European Central Bank in connection with the competent authorities of EU countries which joined the Single Supervisory Mechanism via the Joint Supervisory Team act in cooperation as our primary supervisors to monitor our compliance with the German Banking Act and other applicable laws and regulations as well as, from January 1, 2014, the CRR/CRD 4 framework, as implemented into German law, as applicable.
From an internal governance perspective, we have several layers of management to provide cohesive risk governance:

- The Supervisory Board is required to be informed regularly and – as necessary – on special developments in our risk situation, risk management and risk controlling, as well as on our reputation and material litigation cases. It has formed various committees to handle specific tasks. At the meetings of the Risk Committee, the Management Board reports on credit, market, liquidity, operational as well as litigation and reputational risks. It also reports on credit risk strategy, credit portfolios, loans requiring a Supervisory Board resolution pursuant to law or the Articles of Association, questions of capital resources and matters of special importance due to the risks they entail. The Risk Committee deliberates with the Management Board on issues of the aggregate risk disposition and the risk strategy.

- The Integrity Committee monitors the Management Board’s measures that promote the company’s compliance with legal requirements, authorities’ regulations and the company’s own in-house policies. It also reviews the Bank’s Code of Business Conduct and Ethics, monitors and analyzes the Bank’s legal and reputational risks and advocates their avoidance.

- The Audit Committee monitors, among other matters, the effectiveness of the risk management system, particularly the internal control system and the internal audit system.

- The Management Board is responsible for managing Deutsche Bank Group in accordance with the law, the Articles of Association and its Terms of Reference with the objective of creating sustainable value in the interest of the company, thus taking into consideration the interests of the shareholders, employees and other stakeholders. The Management Board is responsible for establishing a proper business organization, encompassing an appropriate and effective risk management. In agreement with the Supervisory Board and with the aim to ensure an effective governance of resources and risk, the Management Board has established the Capital and Risk Committee (“CaR”) and the Risk Executive Committee (“Risk ExCo”) whose roles are described in more detail below:
The following functional committees are central to the management of risk in Deutsche Bank:

- **The CaR** oversees and controls integrated planning and monitoring of our risk profile and capital capacity, providing an alignment of risk appetite, capital requirements and funding/liquidity needs with Group, divisional and sub-divisional business strategies. It provides a platform to discuss and agree strategic issues impacting capital, funding and liquidity among Risk, Government & Regulatory Affairs, Finance and the business divisions. The CaR initiates actions and/or makes recommendations to the Management Board. It is also responsible for monitoring our risk profile against our risk appetite on a regular basis and ensuring escalation or other actions are taken. The CaR monitors the performance of our risk profile against early warning indicators and recovery triggers, and provides recommendations to the Management Board to invoke defined processes and/or actions under the recovery governance framework if required.

- **Our Risk ExCo**, as the most senior functional committee of our risk management, identifies, controls and manages all risks including risk concentrations at Group level. It is responsible for risk policy, the organization and governance of risk management and oversees the execution of risk and capital management including identification, assessment and risk mitigation, within the scope of the risk and capital strategy (Risk and Capital Demand Plan) approved by the Management Board. The Risk ExCo is supported by sub-committees that are responsible for dedicated areas of risk management, including several policy committees, the Portfolio Risk Committee ("PRC") and the Group Reputational Risk Committee ("GRRC").
In February 2015, it was agreed to move the GRRC from a sub-committee of the Risk ExCo to report directly into the Management Board.

- The PRC supports the Risk ExCo and the CaR with particular emphasis on the management of Group-wide risk patterns. The PRC, under a delegation of authority from the CaR has responsibility for the day-to-day oversight and control of our Internal Capital Adequacy Assessment Process ("ICAAP"). The PRC also oversees our Group-wide stress tests, reviews the results and proposes management action, if required. It monitors the effectiveness of the stress test process and drives continuous improvement of our stress testing framework.

- The Living Wills Committee ("LWC") is the dedicated sub-committee of the CaR with focus on recovery and resolution planning. It oversees the implementation of our recovery and resolution plans and enhancements to the Group’s operational readiness to respond to severe stress or the threat of a severe stress.

- The Regulatory Capital Committee is a further sub-committee of our Capital and Risk Committee. It is tasked with oversight on our risk quantification models. To promote a comprehensive oversight, it is supported by several sub-committees that cover certain kinds of models and model-related matters.

Multiple members of the CaR are also members of the Risk ExCo which facilitates the information flow between the two committees.

Our Chief Risk Officer ("CRO"), who is a member of the Management Board, has Group-wide, supra-divisional responsibility for the management of all credit, market and operational risks as well as for the comprehensive control of risk, i.e. including liquidity risk, and continuing development of methods for risk measurement. In addition, the Chief Risk Officer is responsible for monitoring, analyzing and reporting risk on a comprehensive basis, including asset and liability gap, capital, liquidity, legal, compliance and regulatory risks.

The CRO has direct management responsibility for the following risk management functions: Credit Risk Management, Market Risk Management, Operational Risk Management and Liquidity Risk Control.

These are established with the mandate to:

- Support that the business within each division is consistent with the risk appetite that the CaR has set within a framework established by the Management Board;
- Determine and implement risk and capital management policies, procedures and methodologies that are appropriate to the businesses within each division;
- Approve credit, market and liquidity risk limits;
- Conduct periodic portfolio reviews to keep the portfolio of risks within acceptable parameters; and
- Develop and implement risk and capital management infrastructures and systems that are appropriate for each division.

In addition to the heads for these risk management functions, dedicated regional Chief Risk Officers for Germany, for the Americas and for Asia-Pacific, and divisional Chief Risk Officers for
Deutsche AWM and NCOU have been appointed to establish a holistic risk management coverage.

The heads of the aforementioned risk management functions as well as the regional and divisional Chief Risk Officers have a direct reporting line into the CRO.

Furthermore, several teams within the risk management functions cover overarching aspects of risk management. Their mandate is to provide an increased focus on holistic risk management and cross-risk oversight to further enhance our risk portfolio steering. Key objectives are to:

- Drive key strategic cross-risk initiatives and establish greater cohesion between defining portfolio strategy and governing execution, including regulatory adherence;
- Provide a strategic and forward-looking perspective on the key risk issues for discussion at senior levels within the bank (risk appetite, stress testing framework);
- Strengthen risk culture in the bank; and
- Foster the implementation of consistent risk management standards.

Our Finance, Risk and Group Audit functions operate independently of our business divisions. It is the responsibility of the Finance and Risk departments to quantify and verify the risk that we assume and maintain the quality and integrity of our risk-related data. Group Audit examines, evaluates and reports on the adequacy of both the design and effectiveness of the systems of internal control including the risk management systems.

The Asset and Liability Committee of DB Colombo (ALCO) provides the forum for managing the capital, funding and liquidity risk of DB Colombo. Regular ALCO voting members include representatives of Finance, Treasury, Compliance representatives of the various business divisions and risk management. The ALCO has responsibility for aligning the capitalization requirements as well as liquidity and funding needs of DB Colombo’s activities, driven by the risk profile of the businesses and risk appetite of the bank. It reviews the capital, liquidity and funding profile on a regular basis and decides on measures to avoid regulatory and/or bank-internal limit breaches. The ALCO establishes a link between the local, regional and Group’s perspective on capital, liquidity and funding.

DB Colombo’s risk management function is separate from the business units. It resides with COO and is an independent function for risk management across all businesses and all risk types. In DBCL the COO takes on the role of the head of a dedicated risk management function and as such is independent from business activities. She is part of the Exco and is responsible for all matters related to risk management. In particular, the COO is responsible for taking all necessary measures to establish a sound and strong risk culture and governance (e.g. sufficient resources, training sessions). She is responsible for monitoring, analyzing and reporting risk on a comprehensive basis and must ensure that risk and capital management as well as measurement and monitoring processes are closely aligned to the activities of the Group Divisions.

Risk Culture
We seek to promote a strong risk culture throughout our organization. A strong risk culture is designed to help reinforce our resilience by encouraging a holistic approach to the management of risk and return throughout our organization as well as the effective management of our risk, capital and reputational profile. We actively take risks in connection with our business and as such the following principles underpin risk culture within our group:
- Risk is taken within a defined risk appetite;
- Every risk taken needs to be approved within the risk management framework;
- Risk taken needs to be adequately compensated; and
- Risk should be continuously monitored and managed.

Employees at all levels are responsible for the management and escalation of risks. We expect employees to exhibit behaviors that support a strong risk culture. To promote this our policies require that behavior assessment is incorporated into our performance assessment and compensation processes. We have communicated the following risk culture behaviors through various communication vehicles:

- Being fully responsible for our risks;
- Being rigorous, forward looking and comprehensive in the assessment of risk;
- Inviting, providing and respecting challenges;
- Trouble shooting collectively; and
- Placing Deutsche Bank and its reputation at the heart of all decisions.

To reinforce these expected behaviors and strengthen our risk culture, we conduct a number of group-wide activities. Our Board members and senior management frequently communicate the importance of a strong risk culture to support a consistent tone from the top. To further strengthen this message, we have reinforced our targeted training. In 2014, our employees attended more than 88,000 mandatory training modules globally including, for example, Global Information Security Awareness, An Introduction to MaRisk and the newly introduced ‘Tone from the Top’ module. As part of our ongoing efforts to strengthen our risk culture, we review our training suite regularly to develop further modules or enhance existing components.

In addition, along with other measures to strengthen our performance management processes, we have designed and implemented a process to tie formal measurement of risk culture-related behaviors to our employee performance assessment, promotion and compensation processes. This process has been in place in our CB&S and GTB divisions since 2010 and has subsequently been rolled out to all divisions and functions. This process is designed to further strengthen employee accountability.

Further measures are already being reviewed and will be added to the program in 2015.

**Risk Appetite and Capacity**

Risk appetite expresses the level of risk that we are willing to assume within our risk capacity in order to achieve our business objectives, as defined by a set of minimum quantitative metrics and qualitative standards. Risk capacity is defined as the maximum level of risk we can assume in both normal and distressed situations before breaching regulatory constraints and our obligations to stakeholders.

Risk appetite is an integral element in our business planning processes via our Risk and Capital Demand Plan, to promote the appropriate alignment of risk, capital and performance targets, while at the same time considering risk capacity and appetite constraints. We leverage the stress testing process to test the compliance of the plan also under stressed market conditions. Top-down risk appetite serves as the limit for risk-taking for the bottom-up planning from the business functions.

The Risk Appetite Framework (RAF) at DB Colombo, as reviewed and approved by the local Management board annually, is embedded top-down in ensuring that risk taking activities at DB Colombo is consistent with the Group’s strategy, business and risk overviews, as well as the local regulatory environment.
Key objectives of the RAF are to:

- Articulate DB Colombo’s risk appetite statement clearly via both quantitative metrics and qualitative statements;
- Detail an overall approach in communicating risk appetite across and within DB Colombo;
- Set ultimate boundaries for DB Colombo’s risk/reward target setting;
- Ensure that DB Colombo has sufficient financial resources to support daily business at any given point in time and to absorb stressed market events;
- Be able to anticipate emerging risks and be adaptive towards changing economic and regulatory developments;
- Provide the basis for ongoing monitoring of our risk profile through DB Colombo’s ‘Risk and Capital Profile’ report; and
- Define the levels at which escalation and/or recovery measures will be triggered.

In facilitating a consistent understanding of the nomenclatures around risk appetite, all key definitions established at DB Group level are adapted at DB Colombo as below:

- Risk Appetite Framework: The entire framework of embedding risk appetite across DB Colombo includes:
  - Setting Risk Appetite Statement (RAS) by the local Management Board to clearly articulate a consistent understanding of risk appetite for both internal and external stakeholders as well as with the Group’s risk appetite;
  - Communicating risk appetite by relating high-level principles contained within RAS to quantifiable limits at higher granularity levels;
  - Monitoring the alignment of risk profile against risk appetite and establishing an escalation matrix, as part of risk governance framework.

- Risk Capacity: Maximum level of risk DB Colombo can assume in both normal and distressed situations in order to remain above regulatory minimum requirements (constraints) and other obligations to stakeholders.

- Risk Appetite: Level of risk that DB Colombo is willing to assume within its risk capacity in order to achieve its business objectives, defined by a set of minimum quantitative metrics and qualitative standards.

- Risk Target: Level of risk that DB Colombo has set as part of its Strategic Planning process aligned with its risk appetite, supporting the DB Colombo’s overall goals & ambitions;

- Risk Limit: Quantitative measures based on forward looking assumptions that govern risk-taking decisions at operational levels to remain within the defined risk appetite and manage the trajectory towards the Risk Target; and-

- Risk Profile: Point in time assessment of overall risk exposures faced by DB Colombo, which is closely monitored and managed via the ‘Risk and Capital Profile’ report to ensure its alignment with risk appetite.

DB Colombo’s Risk Appetite Statement articulates the overall tone from the top in pursuing risk across the DB Colombo and supports our Group’s risk culture, in reinforcing our holistic risk management practices. In conjunction to DB Colombo’s Risk Appetite Statement, DB Colombo desires to:

- Maintain robust risk profile and capital adequacy;
- Ensure stable funding and strategic liquidity allowing for business planning within the liquidity risk appetite and regulatory requirements;
- Avoid any undue concentrations within portfolios considering multiple dimensions (e.g. counterparty, region/country, industries, products/ asset classes and business lines);
- Focus on holistic management of risks including emerging portfolio hotspots;
- Promote balanced risk adjusted performance across businesses;
- Achieve positive development of earnings quality;
- Impose boundaries for risk-taking activities by using a set of risk limits at more granular levels i.e. business units and legal entities;
- Comply with regulatory requirements and place DB and its reputation at the heart of all decisions;
- Be fully responsible for accepting adequately compensated risks within defined risk appetite and risk management framework; and
- Minimize any negative environmental, social and reputational impacts of our business activities.

These statements are then further translated into principles forming part of the guidelines for managing material risks in DB Colombo and justifying the motivations of taking or mitigating certain risks.

Similarly to DB Group, DB Colombo assigns 3 key risk appetite metrics that are sensitive to the material risks to which we are exposed to and which are able to function as key indicators of our financial health in terms of earnings, liquidity and capital requirements. These metrics are Capital Adequacy ratios, Economic Capital Adequacy (ECA) ratio and Stressed Net Liquidity Position (SNLP).

In order to determine risk appetite and capacity, different triggers and thresholds are set on a forward looking basis and the escalation requirements are defined for further action. The levels chosen reflect on DB Colombo’s strategic focus and business plan as well as additional internal and external stakeholders. Key risk appetite metrics are assessed under stress scenarios within the regularly performed benchmark and compares them to their respective Red-Amber-Green (RAG) thresholds.

Monitoring of risk profile using key risk appetite metrics is established using a traffic light framework, in which that the RAG thresholds are calibrated as below:

- Normal (Green): Performances are in line with DB Colombo’s preparedness to accept risk to achieve its business objectives and risk management is considered to be operating in a normal environment. As part of normal risk management, measures are actively taken to ensure that the risk profile remains within our risk appetite, and move towards the externally disclosed strategic target as in the Risk and Capital Demand plan.
- Critical (Amber): Issues that may position threats to DB Colombo’s business model, deviate from our desired risk appetite and undermine the stakeholder expectations. Heightened risk management or even recovery measures may be applied in reference to the escalation matrix, in ensuring timely intervention and avoiding the most costly recovery measures.
- Crisis (Red): Once the risk capacity is crossed, recovery is invoked if not already triggered in the amber range. Targeted recovery measures are executed to ensure we move out of this crisis range.
In the event that DB Colombo’s desired risk appetite is breached under either normal or stress scenarios, an escalation governance matrix as predefined locally is applied so these breaches are highlighted to the ALCO. As such, the ALCO has to review and decide if further escalation to the Group and/or mitigating actions are required to bring risk profile back to the desired risk appetite range. Amendments to the risk appetite framework at DB Colombo must be approved by ALCO.

**Risk Assessment and Reporting**

**Risk Metrics**

We use a broad range of quantitative and qualitative methodologies for assessing and managing risks. As a matter of policy, we continually assess the appropriateness and the reliability of our quantitative tools and metrics in light of our changing risk environment. Some of these tools are common to a number of risk categories, while others are tailored to the particular features of specific risk categories. The advanced internal tools and metrics we currently use to measure, manage and report our risks are:

- **RWA equivalent.** This is defined as total risk-weighted assets (“RWA”) plus a theoretical amount for specific allocated Common Equity Tier 1 capital deduction items if these were converted into RWA. RWA form the key factor in determining the bank’s regulatory capital adequacy as reflected in the Common Equity Tier 1 capital ratio. RWA equivalents are used to set targets for the growth of our businesses and monitored within our management reporting systems. As a general rule, RWA are calculated in accordance with the currently valid CRR/CRD 4 framework, as implemented into German law (where necessary) and used within our forward looking risk and capital planning processes. Additionally, Risk weighted assets are computed in accordance with the Capital Adequacy Guidelines issued by the Central Bank of Sri Lanka.

- **Expected loss.** We use expected loss as a measure of our credit and operational risk. Expected loss is a measurement of the loss we can expect induced by defaults within a one-year period from these risks as of the respective reporting date, based on our historical loss experience. When calculating expected loss for credit risk, we take into account credit risk ratings, collateral, maturities and statistical averaging procedures to reflect the risk characteristics of our different types of exposures and facilities. All parameter assumptions are based on statistical considerations of up to nine years based on our internal default and loss history as well as external benchmarks. We use expected loss as a tool of our risk management process and as part of our management reporting systems. We also consider the applicable results of the expected loss calculations as a component of our collectively assessed allowance for credit losses included in our financial statements. For operational risk we determine the expected loss from statistical averages of our internal loss history, recent risk trends as well as forward looking estimates.

- **Return on risk-weighted assets (“RoRWA”).** In times of regulatory capital constraints, RoRWA has become an important metric to assess our client relationships’ profitability, in particular for credit risk. RoRWA is currently the primary performance measure and continues to attract more attention than the previously used RARoC profitability measure based on economic capital.

- **Value-at-risk.** We use the value-at-risk approach to derive quantitative measures for our trading book market risks under normal market conditions and by means of the stressed value-at-risk under stressed market conditions. Our respective value-at-risk figures play a role in both internal and external (regulatory) reporting. For a given portfolio, value-at-risk measures the potential future loss (in terms of market value) that, under normal/stressed market conditions, is not expected to be exceeded with a defined confidence level in a defined period. The value-at-risk for a total portfolio represents a measure of our diversified
market risk (aggregated, using pre-determined correlations) under normal/stressed market conditions in that portfolio.

- Economic capital. Economic capital measures the amount of capital we need to absorb very severe unexpected losses arising from our exposures. “Very severe” in this context means that economic capital is set at a level to cover with a probability of 99.98% the aggregated unexpected losses within one year. We calculate economic capital for credit risk, for market risk including trading default risk, for operational risk and for business risk.

**Stress testing**

We have a strong commitment to stress testing performed on a regular basis in order to assess the impact of a severe economic downturn on our risk profile and financial position. These exercises complement traditional risk measures and represent an integral part of our strategic and capital planning process. Our stress testing framework comprises regular Group-wide stress tests based on internally defined benchmark and more severe macroeconomic global downturn scenarios. We include all material risk types into our stress testing exercises. The time-horizon of internal stress tests is one year. Our methodologies undergo regular scrutiny from internal experts as well as regulators to review whether they correctly capture the impact of a given stress scenario. These analyses are complemented by portfolio- and country-specific stress tests as well as regulatory requirements, such as annual reverse stress tests and additional stress tests requested by our regulators on the group or legal entity level. Moreover, a capital planning stress test is performed annually to assess the viability of our capital plan in adverse circumstances and to demonstrate a clear link between risk appetite, business strategy, capital plan and stress testing. An integrated procedure allows us to assess the impact of ad-hoc scenarios that simulate potential imminent financial or geopolitical shocks.

The initial phase of our internal stress tests consists of defining a macroeconomic downturn scenario by dbResearch in cooperation with business specialists. dbResearch monitors the political and economic development around the world and maintains a macro-economic heat map that identifies potentially harmful scenarios. Based on quantitative models and expert judgments, economic parameters such as foreign exchange rates, interest rates, GDP growth or unemployment rates are set accordingly to reflect the impact on our business. The scenario parameters are translated into specific risk drivers by subject matter experts in the risk units. Using internal models metrics such as RWA, losses and economic capital under stress are computed by risk type. These results are aggregated at the Group level, and key metrics such as the SNLP and Capital adequacy ratios under stress are derived. Stress testing results and the underlying scenarios are reviewed across risk types on various levels by senior managers within Risk, Finance and the business units. After comparing these results against our defined risk appetite, senior management decides on specific mitigation actions to remediate the stress impact in alignment with the overall strategic and capital plan if certain limits are breached. The results also feed into the annual recovery planning which is crucial for the recoverability of the bank in times of crisis. The outcome is presented to senior management up to the Management Board to raise awareness on the highest level as it provides key insights into specific business vulnerabilities and contributes to the overall risk profile assessment of the bank. In 2014 we remained well capitalized within our internal stress testing program under various severe stress events. By choosing actions out of our pool of maintained recovery measures we would have been able to mitigate shortfalls under those stress scenarios directly. A reverse stress test is performed annually in order to challenge our business model to determine the severity of
scenarios that would cause us to become unviable. Such a reverse stress test is based on a hypothetical macroeconomic scenario or idiosyncratic event and takes into account severe impacts of major risks on our results. Comparing the hypothetical macroeconomic scenario that would be necessary to result in our non-viability according to the reverse stress, to the current economic environment, we consider that the probability of occurrence of such a hypothetical macroeconomic scenario is extremely low. Given the extremely low probability of the reverse stress test scenario, we do not believe that our business continuity is at risk.

Risk Reporting and Measurement Systems
We have centralized risk data and systems supporting regulatory reporting and external disclosures, as well as internal management reporting for credit, market, operational (including legal risk), business, reputational, liquidity risk, model risk and compliance risk (in accordance with MaRisk). The risk infrastructure incorporates the relevant legal entities and business divisions and provides the basis for tailor-made reporting on risk positions, capital adequacy and limit utilization to the relevant functions on a regular and ad-hoc basis. Established units within Finance and Risk assume responsibility for measurement, analysis and reporting of risk while promoting sufficient quality and integrity of risk-related data. Our risk management systems are reviewed by Group Audit following a risk-based audit approach.

The main reports on risk and capital management that are used to provide the central governance bodies with information relating to Group Risk Exposures are the following:

- Our Risk and Capital Profile is presented quarterly to the ALCO and the Management. It comprises an overview of the current risk, capital and liquidity status of the Group, also incorporating information on regulatory capital and economic capital adequacy.
- An overview of our capital, liquidity and funding is presented to the ALCO by the Group Treasurer every month. It comprises information on key metrics.
- Branch-wide macroeconomic stress tests that are performed monthly/quarterly and reported to ALCO
- The above reports are complemented by a suite of other standard and ad-hoc management reports of Risk and Finance, which are presented to several different senior committees responsible for risk and capital management at Group and entity level.

Risk Inventory
We face a variety of risks as a result of our business activities, as described below. Credit risk, market risk and operational risk attract regulatory capital. As part of our internal capital adequacy assessment process, we calculate the amount of economic capital from credit, market, operational and business risk to cover risks generated from our business activities taking into account diversification effects across those risk types. Furthermore, our economic capital framework implicitly covers additional risks, e.g. reputational risk and refinancing risk, for which no dedicated economic capital models exist. Liquidity risk is excluded from the economic capital calculation since it is covered separately. The risk inventory is updated, regularly at least once a year or at other times if needed, by running a risk identification and materiality assessment process in line with MaRisk. In 2014 reputational risk, compliance risk and model risk were newly assessed as material on a Group basis.
Risk Management Framework – Material Risks

Risk management frameworks of credit, market, operational and liquidity risks are narrated in the Sections “Credit Risk”, “Trading Market Risk”, “Nontrading Market Risk”, “Operational Risk”, and “Liquidity Risk”. We describe the risk management approaches for other material risks here, as below:

Strategic Risk

Strategic risk represents the risk of suffering unexpected operating losses (i.e. negative earnings) during the period covered by the model due to decreases in operating revenues which cannot be compensated by cost reductions. Strategic risk covers only revenue or cost volatility which is not attributable to position taking (market risk), credit losses (credit risk) and operational events (operational risk) since these elements are already covered in the respective risk types explicitly. We aim to mitigate strategic risk within our business units through portfolio diversification designed to reduce dependency on individual or a small set of markets or products, products innovations and close monitoring of the execution of our strategic and capital plan, and ensuring flexibility of the cost base, i.e. through outsourcing.

Reputational Risk

Our reputational risk is governed by the Reputational Risk Management Program (RRM Program). The RRM Program was established to provide consistent standards for the identification, escalation and resolution of reputational risk issues that arise from transactions with clients or through different business activities. Primary responsibility for the identification, escalation and resolution of reputational risk issues resides with the business divisions. Each employee is under an obligation, within the scope of his/her activities, to analyze and assess any imminent or intended transaction in terms of possible risk factors in order to minimize reputational risks. If a potential reputational risk is identified, it is required to be referred for further consideration at a sufficiently senior level within that respective business division. If issues remain, they should then be escalated for discussion among appropriate senior members of the relevant Business and Control Groups. Reputational risk issues not addressed to satisfactory conclusion through such informal discussions must then be escalated for further review and final determination via the established reputational risk escalation process.

The Group Reputational Risk Committee (“GRRC”) provides review and final determinations on all reputational risk issues and new client adoptions, where escalation of such issues is deemed necessary by senior Business and Regional Management, or required under the Group policies and procedures. Throughout 2014 the GRRC was a sub-committee of the Risk ExCo but it has since been elevated to be a sub-committee of the Management Board, with effectiveness in February 2015.

Model Risk

A new Model risk function was established in 2014 by DB Group to be implemented across the branches in due course aggregating all core model risk management activities across the bank into one independent function:

- Model validation provides independent validation of the methodological aspects of models. The key objectives of model validation are to verify that models are performing as expected, in line with their design objectives and business uses, and to aim to ensure that models are
logically and conceptually sound and assess the appropriateness and accuracy of the implementation methodology;
- Model risk governance supports establishment of a front-to-back model risk management framework which includes defining common standards for model development, usage and validation; identification and remediation of issues and inconsistencies in modeling; and maintenance of a bank-wide model inventory; and
- Key senior management forums to address model risk are the Group Model Risk Management Committee (“GMRMC”) and the Pricing Model Risk Management Committee (“PMRMC”). Both are subcommittees of the CaR and the Risk ExCo, and act on behalf of the Management Board. The PMRMC is responsible for management and oversight of model risk from valuation models (front office models that are used for official pricing and risk management of trading positions). The GMRMC is responsible for management and oversight of model risk from risk and capital models.

**Compliance Risk**
Compliance manages this risk through the following:

- Identifying material rules and regulations where non-compliance could lead to endangerment of the Bank’s assets (supported by the bank’s business divisions, infrastructure functions or Regional Management);
- Advising and supporting the Management Board concerning the adherence to material rules and regulations as well as acting to implement effective procedures for compliance with applicable material rules and regulations, and the setup of the corresponding controls;
- Monitoring the coverage of new or changed material rules and regulations by our business divisions, infrastructure functions or Regional Management including potential implementation plans for appropriate controls. Compliance is not explicitly requested to run its own monitoring programs but has the right to carry out monitoring activities;
- Assessing the coverage of all existing material rules and regulations by the bank’s business divisions, infrastructure functions or Regional Management and existence of a corresponding control environment; and
- Reporting to the Management and Supervisory Boards on at least an annual basis and on an ad hoc basis.
- In DB Colombo Branch, Compliance reports to local Executive Committee.

**Credit Risk**
Credit risk arises from all transactions where actual, contingent or potential claims against any counterparty, borrower, obligor or issuer (which we refer to collectively as “counterparties”) exist, including those claims that we plan to distribute (see below in the more detailed section Credit Risk). These transactions are typically part of our traditional nontrading lending activities (such as loans and contingent liabilities), traded bonds and debt securities available for sale or our direct trading activity with clients (such as OTC derivatives, foreign exchange forwards and Forward Rate Agreements).

We distinguish between three kinds of credit risk:
- Default (Counterparty) risk, the most significant element of credit risk, is the risk that counterparties fail to meet contractual obligations.
- Settlement risk is the risk that the settlement or clearance of transactions will fail. It arises whenever the exchange of cash, securities and/or other assets is not simultaneous leaving us exposed to a potential loss should the counterparty fail.
Country risk is the risk that we may experience unexpected default or settlement risk and subsequent losses in a given country, due to a range of macro-economic or social events primarily affecting counterparties in that jurisdiction including: political and social upheaval, nationalization and expropriation of assets, government repudiation of indebtedness, or disruptive currency depreciation or devaluation. Country risk also includes transfer risk which arises when debtors are unable to meet their obligations owing to an inability to transfer assets to non-residents due to direct sovereign intervention.

Risk Concentration
Risk concentrations refer to a loss potential through unbalanced distribution of dependencies on specific risk drivers and can occur within specific risk types (i.e. intra-risk concentrations) as well as across different risk types (inter-risk concentrations). They are encountered within and across counterparties, businesses, regions/countries, legal entities, industries and products, impacting the aforementioned risks. The management of risk concentrations is integrated in the management of individual risk types and monitored on a regular basis. The key objective of managing risk concentrations is to avoid any undue concentrations on our portfolio which we seek to achieve through a quantitative and qualitative approach as follows:

- Intra-risk category review are assessed and monitored by the individual risk disciplines (Credit, Market, Operational Risk Management and others). This is supported by limit setting on different levels according to risk type.
- Inter-risk concentrations are managed by quantitative top-down stress-testing and qualitative bottom-up reviews identifying and assessing risk themes independent of any risk type and providing a holistic view across the bank.

The most senior governance body for the oversight of risk concentrations throughout 2014 was the Portfolio Risk Committee (PRC), which is a subcommittee of the Capital and Risk Committee (CaR) and the Risk Executive Committee (Risk ExCo).

Risk Management Tools
We use a comprehensive range of quantitative and qualitative methodologies for assessing and managing risks. As a matter of policy, we continually assess the appropriateness and the reliability of our quantitative tools and metrics in light of the changing risk environment. Some of these tools are common to a number of risk categories, while others are tailored to the particular features of specific risk categories. The advanced internal tools and metrics we currently use to measure, manage and report its risk are:

- Economic capital: Economic capital measures the amount of capital we need to absorb very severe unexpected losses arising from its exposures. "Very severe" in this context means that economic capital is set at a level to cover with a probability of 99.98% the aggregated unexpected losses within one year. We calculate economic capital for the default risk, transfer risk and settlement risk elements of credit risk, for market risk including traded default risk, for operational risk and for general business risk. The Group continuously reviews and enhances its economic capital model as appropriate. It uses economic capital to show an aggregated view of its risk position from individual business lines up to its consolidated Group level. In addition, the Group considers economic capital, in particular for credit risk, when the Group measures the risk-adjusted profitability of its client relationships.

- Expected loss. We use expected loss as a measure of our credit and operational risk. Expected loss is a measurement of the loss we can expect induced by defaults within a one-year period from these risks as of the respective reporting date, based on our historical loss experience. When calculating expected loss for credit risk, we take into account credit risk ratings, collateral, maturities and statistical averaging procedures to reflect the risk characteristics of our different types of exposures and facilities. All parameter assumptions are based on statistical averages of up to nine years based on our internal default and loss history as well as external benchmarks. We use expected loss
as a tool of our risk management process and as part of our management reporting systems. We also consider the applicable results of the expected loss calculations as a component of our collectively assessed allowance for credit losses included in our financial statements. For operational risk we determine the expected loss from statistical averages of our internal loss history, recent risk trends as well as forward looking expert estimates.

− Value-at-risk. We use the value-at-risk approach to derive quantitative measures for our trading book market risks under normal market conditions. Our value-at-risk figures play a role in both internal and external (regulatory) reporting. For a given portfolio, value-at-risk measures the potential future loss (in terms of market value) that, under normal market conditions, will not be exceeded with a defined confidence level in a defined period. The value-at-risk for a total portfolio represents a measure of our diversified market risk (aggregated, using pre-determined correlations) in that portfolio.

− Stress testing. Credit, market and operational risk as well as liquidity risk are subject to a program of regular stress tests. The stress testing framework at Group level comprises regular Group wide stress tests based on series of benchmark and more severe macroeconomic global downturn scenarios (provided by dbResearch) consistently applied across risk types, annual reverse and capital plan relevant stress test as well as ad-hoc scenarios.

− We also supplement our risk type specific analysis of credit, market, operational and liquidity risk with stress testing. For credit risk management purposes, we perform stress tests to assess the impact of changes in general economic conditions or specific parameters on our credit exposures or parts thereof as well as the impact on the creditworthiness of our portfolio. For market risk management purposes, we perform stress tests because value-at-risk calculations are based on relatively recent historical data, only purport to estimate risk up to a defined confidence level and assume good asset liquidity. Therefore, they only reflect possible losses under relatively normal market conditions. Stress tests help us determine the effects of potentially extreme market developments on the value of our market risk sensitive exposures, both on our highly liquid and less liquid trading positions as well as our investments. The correlations between markets risk factors used in our current stress tests are estimated from historic volatile market conditions and proved to be consistent with those observed during recent periods of market stress. We use stress testing to determine the amount of economic capital we need to allocate to cover our market risk exposure under the scenarios of extreme market conditions we select for our simulations. For operational risk management purposes, we perform stress tests on our economic capital model to assess its sensitivity to changes in key model components, which include external losses. For liquidity risk management purposes, we perform stress tests and scenario analysis to evaluate the impact of sudden stress events on its liquidity position.

− Regulatory risk assessment. The Group’s operations throughout the world are regulated and supervised by relevant authorities in each of the jurisdictions in which it conducts business. Such regulation relates to licensing, capital adequacy, liquidity risk concentration, conduct of business as well as organizational and reporting requirements. Primarily, the Group is subject to comprehensive regulation and supervision by the BaFin and the Deutsche Bundesbank (referred to as “Bundesbank”), the German Central Bank. The BaFin supervises the operations of German banks to ensure that they are in compliance with the German Banking Act and other applicable laws and regulations. The Bundesbank supports the BaFin and closely cooperates with it. The German Banking Act and the rules and regulations there under implement certain recommendations of the Basel Committee on Banking Supervision, as well as certain European Union directives relating to banks. It addresses issues such as regulatory capital, risk-based capital adequacy and consolidated supervision.

DB Colombo Branch is governed and supervised by the Central Bank of Sri Lanka and needs to adhere compliance with the Banking Act No 30 of 1988 and amendments thereto.
Credit Risk Management Principles and Strategy
We measure and manage our credit risk following the below philosophy and principles:

The key principle of credit risk management is client due diligence which is aligned with the Group’s country and industry portfolio strategies. Prudent client selection is achieved in collaboration with the Group’s business line counterparts as a first line of defense. In all group divisions, consistent standards are applied in the respective credit decision processes.

We actively aim to prevent undue concentration and long tail-risks (large unexpected losses) by ensuring a diversified credit portfolio, effectively protecting the bank’s capital in all market conditions. Client, industry, country and product-specific concentrations are actively assessed and managed against our risk appetite.

We aim to avoid large directional credit risk on a counterparty and portfolio level by applying stringent underwriting standards combined with a pro-active hedging and distribution model and collateralization of portfolio where feasible.

We are selective in taking outright cash risk positions unless secured, guaranteed and/or adequately hedged. Exceptions to this general principle are lower risk, short-term transactions and facilities supporting specific trade finance requests as well as low risk businesses where the margin allows for adequate loss coverage.

− Every extension of credit or material change to a credit facility (such as its tenor, collateral structure or major covenants) to any counterparty requires credit approval at the appropriate authority level. Credit approval authorities are assigned to individuals according to their qualifications, experience and training, and these are reviewed periodically.

− We measure and consolidate overall credit exposures to each obligor on a global basis that applies across the consolidated Group, in line with regulatory requirements of the German Banking Act (Kreditwesengesetz).

In DB Colombo, concentration risk is managed through compliance of the Single Borrower Limit Direction issued by the Central Bank of Sri Lanka

Credit Risk Ratings and Rating Governance

Credit Risk Ratings
A basic and key element of the credit approval process is a detailed risk assessment of each credit-relevant counterparty. When rating a counterparty we apply in-house assessment methodologies, scorecards and our 21-grade rating scale for evaluating the credit-worthiness of counterparties. The majority of our rating methodologies are authorized for use within the advanced internal rating based approach under applicable Basel rules. Our rating scale enables us to compare our internal ratings with common market practice and ensures comparability between different sub-portfolios of our institution. Several default ratings therein enable us to incorporate the potential recovery rate of unsecured defaulted counterparty exposures. We generally rate our counterparties individually, though certain portfolios of purchased or securitized receivables are rated on a pool basis. Ratings are required to be kept up-to-date and documented. The algorithms of the rating procedures for all counterparties are recalibrated frequently on the basis of the default history as well as other external and internal factors and expert judgments.

Rating Governance
All our rating methodologies have to be approved by the Capital Methodology Committee (“CMC”), a sub-committee of the Regulatory Capital Committee, before the methodologies are used for credit decisions and capital calculation for the first time or before they are significantly changed. Regulatory approval may be required in addition. The results of the regular validation processes as stipulated by internal policies have to be brought to the attention of the CMC, even if the validation results do not lead to a change
Credit Risk Measures
The key credit risk measures we apply for managing our credit portfolio, including in transaction approval and the setting of risk appetite, are internal limits and credit exposure under these limits. Credit limits set forth maximum credit exposures we are willing to assume over specified periods. In determining the credit limit for counterparty, we consider the counterparty’s credit quality by reference to our internal credit rating. Credit limits are credit exposures are both measured on a gross and net basis where net is derived by deducting hedges and certain collateral from respective gross figures. For derivatives, we look at current market values and the potential future exposure over the lifetime of a transaction. We generally also take into consideration the risk-return characteristics of individual transactions and portfolios.

Credit Approval and Authority
Credit limits are established by the Credit Risk Management function via the execution of assigned credit authorities. Credit approvals are documented by the signing of the credit report by the respective credit authority holders and retained for future reference.

Credit authority is generally assigned to individuals as personal credit authority according to the individual’s professional qualification and experience. All assigned credit authorities are reviewed on a periodic basis to ensure that they are adequate to the individual performance of the authority holder.

Credit Risk Management (CRM) is responsible for approving credit facilities for any credit or lending by Deutsche Bank AG, Colombo Branch apart from staff loans. The CRM officers with relevant credit authority are based in India for local credits and in different global locations for Multi National Credits (MNCs). All credit approvals are made by the relevant regional or global offices as applicable.

Where an individual’s personal authority is insufficient to establish required credit limits, the transaction is referred to a higher credit authority holder or where necessary to an appropriate credit committee such as the CIB Underwriting Committee. Where personal and committee authorities are insufficient to establish appropriate limits the case is referred to the Management Board for approval.

Credit Risk Mitigation
In addition to determining counterparty credit quality and our risk appetite, we also use various credit risk mitigation techniques to optimize credit exposure and reduce potential credit losses. Credit risk mitigants, described more fully below, are applied in the following forms:

- Comprehensive and enforceable credit documentation with adequate terms and conditions
- Collateral held as security to reduce losses by increasing the recovery of obligations.
- Risk transfers, who shift the probability of default risk of an obligor to a third party including hedging executed by the Credit Portfolios Strategies Group.
- Netting and collateral arrangements which reduce the credit exposure from derivatives and repo- and Repo-style transactions.

Collateral Held as Security for Loans
We regularly agree on collateral to be received from or to be provided to customers in contracts that are subject to credit risk. Collateral is security in the form of an asset or third-party obligation that serves to mitigate the inherent risk of credit loss in an exposure, by either substituting the borrower default risk or improving recoveries in the event of a default. While collateral can be an alternative source of repayment, it generally does not replace the necessity of high quality underwriting standards.

We segregate collateral received into the following two types:
- Financial and other collateral, which enables us to recover all or part of the outstanding exposure by liquidating the collateral asset provided, in cases where the borrower is unable
or unwilling to fulfill its primary obligations. Cash collateral, securities (equity, bonds), collateral assignments of other claims or inventory, equipment (e.g., plant, machinery and aircraft) and real estate typically fall into this category.

- Guarantee collateral, which complements the borrower’s ability to fulfill its obligation under the legal contract and as such is provided by third parties. Letters of credit, insurance contracts, export credit insurance, guarantees and risk participations typically fall into this category.

Risk Transfers
Risk transfers to third parties form a key part of our overall risk management process and are executed in various forms, including outright sales, single name and portfolio hedging, and securitizations. Risk transfers are conducted by the respective business units and by the Credit Portfolio Strategies Group (“CPSG”), in accordance with specifically approved mandates.

CPSG manages the residual credit risk of loans and lending-related commitments of the institutional and corporate credit portfolio; the leveraged portfolio and the medium-sized German companies’ portfolio within our Corporate Divisions of CB&S and GTB.

Acting as a central pricing reference, CPSG provides the respective CB&S Division with an observed or derived capital market rate for loan applications; however, the decision of whether or not the business can enter into the credit risk remains exclusively with Credit Risk Management.

CPSG is concentrating on two primary initiatives within the credit risk framework to further enhance risk management discipline, improve returns and use capital more efficiently:

- To reduce single-name and industry credit risk concentrations within the credit portfolio and
- To manage credit exposures actively by utilizing techniques including loan sales, securitization via collateralized loan obligations, default insurance coverage and single-name and portfolio credit default swaps.

Concentrations within Credit Risk Mitigation
Concentrations within credit risk mitigations taken may occur if a number of guarantors and credit derivative providers with similar economic characteristics are engaged in comparable activities with changes in economic or industry conditions affecting their ability to meet contractual obligations.

We use a comprehensive range of quantitative tools and metrics to monitor its credit risk mitigating activities. These also include monitoring of potential concentrations within collateral types supported by dedicated stress tests.

For the purpose of mitigating credit risk in our lending portfolio we also make use of financial and other physical collateral. Reflecting the Group’s security financing activity, a significant portion of collateral taken relates to fixed income and equity securities. Further collateral is taken in form of cash and deposits as well as real estate.

Monitoring Credit Risk
Ongoing active monitoring and management of credit risk positions is an integral part of our credit risk management framework. The key monitoring focus is on quality trends and on concentrations along the dimensions of counterparty, industry, country and product specific risks to avoid undue concentrations of credit risk. On a portfolio level, significant concentrations of credit risk could result from having material exposures to a number of counterparties with similar economic characteristics, or who are engaged in comparable activities, where these similarities may cause their ability to meet contractual obligations to be affected in the same manner by changes in economic or industry conditions.

Our portfolio management framework supports a comprehensive assessment of concentrations within our credit risk portfolio in order to keep concentrations within acceptable levels.
Counterparty Risk Management
Credit-related counterparties are principally allocated to credit officers within credit teams which are aligned to types of counterparty (such as financial institution or corporate) or economic area (i.e. emerging markets) and dedicated rating analyst teams. The individual credit officers have the relevant expertise and experience to manage the credit risks associated with these counterparties and their associated credit related transactions. It is the responsibility of each credit officer to undertake ongoing credit monitoring for their allocated portfolio of counterparties. We also have procedures in place intended to identify at an early stage credit exposures for which there may be an increased risk of loss.

In instances where we have identified counterparties where there is a concern that the credit quality has deteriorated or appears likely to deteriorate to the point where they present a heightened risk of loss in default, the respective exposure is generally placed on a “watch list”. We aim to identify counterparties that, on the basis of the application of our risk management tools, demonstrate the likelihood of problems well in advance in order to effectively manage the credit exposure and maximize the recovery. The objective of this early warning system is to address potential problems while adequate options for action are still available. This early risk detection is a tenet of the Group’s credit culture and is intended to ensure that greater attention is paid to such exposures.

Industry Risk Management
To manage industry risk, we have grouped our corporate and financial institutions counterparties into various industry sub-portfolios. For each of these sub-portfolios an “Industry Batch report” is prepared usually on an annual basis. This report highlights industry developments and risks to our credit portfolio, reviews concentration risks, analyzes the risk/reward profile and incorporates an economic downside stress test. Finally, this analysis is used to define credit strategies for portfolio in question.

The Industry Batch reports are presented to the Group CRM Portfolio Committee, a sub-committee of the Risk Executive Committee and are submitted afterwards to the Management Board. In accordance with an agreed schedule, a select number of Industry Batch reports are also submitted to the Risk Committee of the Supervisory Board. In addition to these Industry Batch reports, the development of the industry sub-portfolios is regularly monitored during the year and is compared to the approved sub-portfolio strategies. Regular overviews are prepared for the Group CRM Portfolio Committee to discuss recent developments and to agree on actions where necessary.

Country Risk Management
Avoiding undue concentrations also from a regional perspective is an integral part of our credit risk management framework.

The Country Limit framework covers all major risk categories which are managed by the respective divisions in Risk:
- Credit Risk: Limits are established for counterparty and credit risk exposures in a given country to manage the aggregate credit risk subject to country-specific economic and political events. These limits include exposures to entities incorporated locally as well as subsidiaries of foreign multinational corporations. Separate Transfer Risk Limits are established as sub-limits to these counterparty credit limits and apply to DB cross-border exposures.
- Market Risk: Limits are established to manage trading positions risk in emerging markets and are set based on the P&L impact of potential stressed market events on those positions.
- Treasury Risk: Exposures of one DB entity to another (Funding, Capital or Margin) are subject to limits given the transfer risk inherent in these cross-border positions.
- Gap Risk: Limits established to manage the risk of loss due to intra-country wring-way risk exposure.
Our country risk ratings represent a key tool in the management of country risk. They are established by the independent dbResearch function within Deutsche Bank and include:

- **Sovereign rating:** A measure of the probability of the sovereign defaulting on its foreign or local currency obligations.
- **Transfer risk rating:** A measure of the probability of a “transfer risk event.” i.e. the risk that an otherwise solvent debtor is unable to meet his obligations due to inability to obtain foreign currency or to transfer assets as a result of direct sovereign intervention.
- **Event risk rating:** A measure of the probability of major disruptions in the market risk factors relating to a country. (Interest rates, credit spreads etc).

All sovereign and transfer risk ratings are reviewed, at least annually, by the Cross Risk Review Committee, although more frequent reviews are undertaken when deemed necessary.

The Group charges its group divisions with the responsibility of managing their country risk within the approved limits. The regional units within Credit Risk Management monitor our country risk based on information provided by Risk Operations and the Group’s finance function. The Cross Risk Review Committee also reviews data on transfer risk.

**Product Specific Risk Management**

Complementary to our counterparty, industry and country risk approach, we focus on product specific risk concentrations and selectively set limits where required for risk management purposes. In this context, a key focus is put on underwriting caps. These caps limit the combined risk for transactions where we underwrite commitments with the intention to sell down or distribute part of the risk to third parties.

**Settlement Risk Management**

Our trading activities may give rise to risk at the time of settlement of those trades. Settlement risk is the risk of loss due to the failure of counterparty to honor its obligations (to deliver cash or other assets) as contractually agreed.

For many types of transactions, we mitigate settlement risk by closing the transaction through a clearing agent, which effectively acts as a stakeholder for both parties, only settling the trade once both parties have fulfilled their sides of the contractual obligation.

Where no such settlement system exists, the simultaneous commencement of the payment and the delivery parts of the transaction is common practice between trading partners (free settlement). In these cases, we may seek to mitigate the settlement risk through the execution of bilateral payment netting agreements. We also participate in industry initiatives to reduce settlement risks. Acceptance of settlement risk on free settlement trades requires approval from our credit risk personnel, either in the form of preapproved settlement risk limits, or through transaction-specific approvals. We do not aggregate settlement risk limits with other credit exposures for credit approval purposes, but take the aggregate exposure into account when we consider whether a given settlement risk would be acceptable.

**Credit Risk Tools – Economic Capital for Credit Risk**

We calculate economic capital for the default risk, country risk and settlement risk as elements of credit risk. In line with our economic capital framework, economic capital for credit risk is set at a level to absorb with a probability of 99.98 % very severe aggregate unexpected losses within one year.

Our economic capital for credit risk is derived from the loss distribution of a portfolio via Monte Carlo Simulation of correlated rating migrations. The loss distribution is modeled in two steps. First, individual credit exposures are specified based on parameters for the probability of default, exposure at default and loss given default. In a second step, the probability of joint defaults is modeled through the introduction of economic factors, which correspond to geographic regions and industries. The simulation of portfolio losses is then performed by an internally developed model, which takes rating migration and maturity effects into account. Effects due to wrong-way
derivatives risk (i.e., the credit exposure of a derivative in the default case is higher than in non default scenarios) are modeled by applying our own alpha factor when deriving the Exposure at Default for derivatives and securities financing transaction under Basel 2.5 internal models method. The alpha factor is identical with the one used for the risk-weighted assets calculation, yet subject to a lower floor of 1.0. For December 31, 2014 the alpha factor was calibrated to 1.11. We allocate expected losses and economic capital derived from loss distributions down to transaction level to enable management on transaction, customer and business level.

Credit Exposures
Counterparty credit exposure arises from our traditional non-trading lending activities which include elements such as loans and contingent liabilities. Counterparty credit exposure also arises via our direct trading activity with clients in certain instruments which include OTC derivatives like FX forwards. A default risk also arises from the Group’s positions in traded credit products such as bonds.

We define our credit exposure by taking into account all transactions where losses might occur due to the fact that counterparties may not fulfill their contractual payment obligations.

Our credit lending activities are governed by the Principles for Managing Credit Risk. These principles define the general risk philosophy for credit and country risk and its methods to actively manage this risk. The principles define key organizational requirements, roles and responsibilities as well as process principles for credit and country risk management and are applicable to all lending activities undertaken by us.

Asset Quality
All loans where known information about possible credit problems of borrowers causes our management to have serious doubts as to the collectability of the borrower’s contractual obligations are included in this section.

Past Due Loans
Loans are considered to be past due if contractually agreed payments of principal and/or interest remain unpaid by the borrower, except if those loans are acquired through consolidation. The latter are considered to be past due if payments of principal and/or interest, which were expected at a certain payment date at the time of the initial consolidation of the loans, are unpaid by the borrower.

Renegotiated and Forborne Loans
For economic or legal reasons we might enter into a forbearance agreement with a borrower who faces or will face financial difficulties in order to ease the contractual obligation for a limited period of time. A case by case approach is applied for our corporate clients considering each transaction and client specific facts and circumstances. Forbearances are restricted and depending on the economic situation of the client, our risk management strategies and the local legislation. In case a forbearance agreement is entered into, an impairment measurement is conducted as described below, an impairment charge is taken if necessary and the loan is subsequently recorded as impaired.

Loans that have been renegotiated in such a way that, for economic or legal reasons related to the borrower’s financial difficulties, we granted a concession to the borrower that we would not otherwise have considered are disclosed as renegotiated loans and are a subset of forborne loans.
Impairment of Loans and Allowance for Loan Losses
Credit Risk Management regularly assesses whether there is objective evidence that a loan or group of loans is impaired. A loan or group of loans is impaired and impairment losses are incurred if:

- There is objective evidence of impairment as a result of a loss event that occurred after the initial recognition of the asset and up to the balance sheet date (a “loss event”),
- The loss event had an impact on the estimated future cash flows of the financial asset or the group of financial assets, and
- A reliable estimate of the loss amount can be made.

Credit Risk Management’s loss assessments are subject to regular review in collaboration with Group Finance. The results of this review are reported to and approved by an oversight committee comprised of Group Finance and Risk senior management.

If there is evidence of impairment the impairment loss is generally calculated on the basis of discounted expected cash flows using the original effective interest rate of the loan. If the terms of a loan are renegotiated or otherwise modified because of financial difficulties of the borrower without qualifying for a derecognition of the loan, the impairment loss is measured using the original effective interest rate before modification of terms. We reduce the carrying amount of the impaired loan by the use of an allowance account and recognize the amount of the loss in the consolidated statement of income as a component of the provision for credit losses. We record increases to our allowance for loan losses as an increase of the provision for loan losses in our income statement. Charge-offs reduce our allowance while recoveries, if any, are credited to the allowance account. If we determine that we no longer require allowances which we have previously established, we decrease our allowance and record the amount as a reduction of the provision for loan losses in our income statement. When it is considered that there is no realistic prospect of recovery and all collateral has been realized or transferred to us, the loan and any associated allowance for loan losses is charged off (i.e., the loan and the related allowance for loan losses are removed from the balance sheet). While we assess the impairment for our corporate credit exposures individually, we assess the impairment of our smaller-balance standardized homogeneous loans collectively. Our collectively assessed allowance for non-impaired loans reflects allowances to cover for incurred losses that have neither been individually identified nor provided for as part of the impairment assessment of smaller balance homogeneous loans.

Credit Review Process
According to Deutsche Bank AG, Colombo Branch management, the credit review procedures performed are as below:

Regular credit reviews by relevant regional or global offices: all debtors or debtors’ groups are regularly reviewed subject to the policy and procedures applicable in the relevant regional or global offices and also depending on any changes of Deutsche Bank’s internal credit rating and updated situations which may affect the repayment ability of reviewed debtors.

Deutsche Bank AG, Colombo Branch does not have approval authority, it normally submits all of the credit review reports to be acknowledged or approved by the regional office. All non-performing loans shall be managed and monitored by the relevant regional or global office.

There is no credit review policy for loans granted to Deutsche Bank AG, Colombo Branch’s staff. The loans are granted to existing staff and their repayment is made by deduction from the employee’s salary.
Market Risk
Market risk arises from the uncertainty concerning changes in market prices and rates (including interest rates, equity prices, foreign exchange rates and commodity prices), the correlations among them and their levels of volatility.

− Trading market risk: arises primarily through the market-making and trading activities in the various cash and derivative markets.
− Non-trading market risk: arises from assets and liabilities that are typically on our books for a longer period of time (i.e. non-consolidated strategic investments, alternative asset investments, sight and saving deposits, and equity compensation), but where the inherent value is still dependent on the movement of financial markets and parameters.
− Traded default risk: arises from defaults and rating migrations.

Market risk Management Framework
The Bank uses a combination of risk sensitivities, value-at-risk and stress testing metrics to manage market risks and establish limits. Value-at-risk is a common metric used in the management of trading market risks.

The Management Board and Group Risk Committee, supported by Group Market Risk Management, which is part of the independent risk management function, set a Group-wide value-at-risk limit for the market risks in the trading book. Group Market Risk Management sub-allots this overall limit to the Group Divisions. Below that, limits are allocated to specific business lines and trading portfolio groups and geographical regions. In addition to the Bank’s main market risk value-at-risk limits, also stress testing and sensitivity limits are operated.

The Bank’s value-at-risk for the trading businesses is based on internal model. In October 1998, the German Banking Supervisory Authority (now the BaFin) approved the internal value-at-risk model for calculating market risk capital for the Group for both the general and specific market risks. Since then the model has been periodically refined and approval has been maintained.

Types of market risk
Substantially all of the Bank’s businesses are subject to the risk that market prices and rates will move and result in profits or losses. The Bank distinguishes among four types of market risk

− Interest rate risk including credit spread
− Equity price risk (where applicable);
− Foreign exchange risk; and
− Commodity price risk (where applicable)

The interest rate and equity price risks consist of two components each. The general risk describes value changes due to general market movements, while the specific risk has issuer-related causes.

Risk Management Tools
The following are the most important quantitative tools and metrics currently used to measure, manage and report market risk:

Value-at-Risk. The Bank uses the value-at-risk approach to derive quantitative measures for trading book market risks under normal market conditions. The value-at-risk figures play a role in internal reporting. For a given portfolio, value-at-risk measures the potential future loss (in terms of market value) that, under normal market conditions, will not be exceeded with a defined confidence level in a defined period. The value-at-risk for a total portfolio represents a
measure of diversified market risk (aggregated using pre-determined correlations) in that portfolio.

**Stress Testing.** While value-at-risk, calculated on a daily basis, supplies forecasts for potential large losses under normal market conditions, it is not adequate to measure the tail risks of the portfolios. The Bank therefore also performs regular stress tests in which it values the trading portfolios under severe market scenarios not covered by the confidence interval of the value-at-risk model.

**Value-at-Risk Analysis**

The **value-at-risk approach derives** a quantitative measure for the trading book market risks under normal market conditions, estimating the potential future loss (in terms of market value) that will not be exceeded in a defined period of time and with a defined confidence level. The value-at-risk measure enables to apply a constant and uniform measure across all of the trading businesses and products. It also facilitates comparisons of market risk estimates both over time and against the daily trading results. The Bank calculates value-at-risk using a 99% confidence level and a holding period of one day. The Bank’s value-at-risk model is designed to take into account the following risk factors: interest rates, equity prices, foreign exchange rates and commodity prices, as well as their implied volatilities. The model incorporates both linear and, especially for derivatives, nonlinear effects of the risk factors on the portfolio value. The statistical parameters required for the value-at-risk calculation are based on a 261 trading day history (corresponding to at least one calendar year of trading days) with equal weighting being given to each observation. The Bank calculates value-at-risk using the Monte Carlo simulation technique and assuming that changes in risk factors follow a normal or logarithmic normal distribution. To determine the aggregated value-at-risk, the Bank uses historically observed correlations between the different general market risk classes. However, when aggregating general and specific market risks, it is assumed that there is zero correlation between them.

The value-at-risk analysis should also be viewed in the context of the limitations of the methodology the Bank uses and are therefore not maximum amounts that can be lost on the market risk positions. The limitations of the value-at-risk methodology include the following:

− The use of historical data as a proxy for estimating future events may not capture all potential events, particularly those that are extreme in nature.
− The assumption that changes in risk factors follow a normal or logarithmic normal distribution. This may not be the case in reality and may lead to an underestimation of the probability of extreme market movements.
− The correlation assumptions used may not hold true, particularly during market events that are extreme in nature.
− The use of a holding period of one day assumes that all positions can be liquidated or hedged in that period of time. This assumption does not fully capture the market risk arising during periods of illiquidity, when liquidation or hedging in that period of time may not be possible.
− The use of a 99 % confidence level does not take account of, nor makes any statement about, any losses that might occur beyond this level of confidence.
− The Bank calculates value-at-risk at the close of business on each trading day. The Bank does not subject intraday exposures to intraday value-at-risk calculations.
− Value-at-risk does not capture all of the complex effects of the risk factors on the value of positions and portfolios and could, therefore, underestimate potential losses.

The Group acknowledges the limitations in the value-at-risk methodology by supplementing the value-at-risk limits with other position and sensitivity limit structures, as well as with stress testing, both on individual portfolios and on a consolidated basis.
The calculated value-at-risk numbers for DB Colombo are used for internal control purposes only, the calculation of regulatory capital being based on the Standardized Approach specified by the Central Bank of Sri Lanka. At the Group level, however, value-at-risk numbers are used for both internal control and Regulatory Capital calculation for market risk.

**Back-Testing**

The Bank uses back-testing in the trading units to verify the predictive power of the value-at-risk calculations. In back-testing, the hypothetical daily profits and losses are compared under the buy-and-hold assumption with the estimates from the value-at-risk model. The Bank analyzes performance fluctuations and assesses the predictive power of the value-at-risk model, which in turn allows improvement of the risk estimation process.

**Hedging**

The Bank manages its risk from derivatives activity on a portfolio basis. Specific hedges undertaken, if any are ring fenced from the transactions undertaken for trading/market making purposes and held in separate designated portfolio for easy identification and control.

**Liquidity Risk**

Liquidity risk is the risk arising from the Bank's potential inability to meet all payment obligations when they come due or only being able to meet these obligations at excessive costs. Liquidity risk is managed through the Asset and Liability Committee ("ALCO"). This committee, chaired by Treasury, is responsible for both statutory and prudential liquidity management.

Liquidity risk is monitored through the Integrated Risk Management Framework and the internal DB Colombo branch liquidity policy. Ongoing liquidity management is discussed as a regular item at the Sri Lanka ALCO meeting, which takes on a monthly basis. At the ALCO meeting, DB Colombo Branch's liquidity position, limit utilization, changes in exposure and liquidity policy compliance are presented to the committee.

DB Colombo branch's liquidity risk model is based on three main liquidity risk models. (1) Stress testing and scenario analysis; (2) Funding matrix; (3) Maximum cash outflow (MCO) modeling.

Stress testing and scenario analysis are used to evaluate the impact of sudden stress events on our liquidity positions. The scenario types cover institution-specific events (e.g. severe rating downgrade), market related event, as well as a combination of both which links a systemic market shock with a multi notch rating downgrade. Stress test results show overall net liquidity position across 8 weeks.

Funding matrix addresses the long-term liquidity risk management issue of the branch. This identifies the excess or shortfall of assets over liabilities in each time bucket, facilitating management of open liquidity exposures.

Maximum cash outflow ("MCO") limits allows Treasury to monitor and control excessive short-term funding gaps up to an eight week period on a daily basis. The MCO limits are calibrated based on the local liquidity stress tests result and reviewed on a regular basis to reflect changes in the balance sheet profile of the entity.
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Contingency Plan
In general, the Bank’s business model is flexible enough to adjust to structural changes in market and funding conditions within a time frame of about eight weeks. This section includes a description of tactical countermeasures available in the first eight weeks of a stress event.

If the stress event extends beyond an eight-week horizon, additional strategic countermeasures can be mobilized, such as reducing the funded balance sheet and increasing stable funding sources where possible. Such a situation is likely to impact the Bank as a whole and, hence, direction would be taken from the global Liquidity Management Committee (LMC). The Group-wide operating level is not necessarily linked to the contingency levels of the affiliated entities. It could therefore be the case that the Bank as a whole may still be operating under normal market conditions while one of the local entities has implemented its contingency plan. It is, however, very likely that implementation of the Group contingency plan is closely linked to that of major locations like Tokyo, Singapore, Frankfurt, London and New York. In case of activation of any local contingency plan, the Treasurer will immediately advise the Regional Treasurer and Global Head of Liquidity Risk Management.

Contingency Event
Certain trigger indicators are followed internally and in the market by Treasury and FIC during the course of normal business. These include but are not limited to:

Internal indicators:
- Daily MCO limit utilization report,
- Daily interbranch limit utilization report,
- Monthly stress testing results,
- Monthly Funding Matrix, and
- Regulatory liquidity requirements.

External indicators:
- Deutsche Bank rating and rating trend, and
- Deutsche Bank borrowing rate in the local market.

In the eventual case that these areas identify potential liquidity stress situations, Treasury must without delay investigate the causes of the excess, assess the anticipated impact on the Bank and decide whether the situation requires immediate action and/or whether a meeting of the LMC should be called. Treasury will be responsible for implementation and follow-up. The ALCO will be informed at the next regular meeting.

Other quantitative disclosures as required by Banking Act Direction No & of 2011 on Integrated Risk Management Framework for Licensed Banks (Section H)

Operational Risk

Definition of Operational Risk
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It includes legal risk but excludes business and reputational risk.

We have categorized operational risks into the following risk types for our 2014 self assessment process:

- **Origination & Execution Risk** is the risk that deficiencies and/or errors in the origination of products/services/transactions, their execution, inappropriate business practices, or contractual obligations will result in losses.
Fraud Risk is the risk of incurring losses as a result of an intentional act or omission by an employee or 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 the falsification or alteration of records and reports, facilitation, breach of trust, intentional omission, misrepresentation, concealment, misleading, and the abuse of one’s position.

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 (including third party vendors) and the communities in which we are located.

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.

Information Technology Risk is the risk that our information technology will lead to quantifiable losses due to inadequate information technology and processing in terms of manageability, exclusivity, integrity, controllability, and continuity.

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.

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.

Fiduciary Service Risk is the risk to fail to act in the best interest of our clients when advising, investing, accounting for or safeguarding client assets, including the failure to prevent, detect or correct negligence and/or violations of fiduciary responsibilities, and the failure to appropriately address fiduciary conflicts of interests that may arise.

Financial Reporting and Recording Risk is the risk that a mis-reporting or mis-recording in the financial statements results in an operational risk related event and, potentially, an operational risk related loss.

Real Estate Risk or Facilities and Infrastructure risk is the risk of incurring a loss resulting from damage to or the loss-of-use of the bank’s Facilities/Infrastructure.

Staff Risk is the risk that shortcomings in processes and procedures related to the employment of internal staff either directly generate a loss or indirectly contribute to the occurrence of events in other risk categories.

Tax Compliance Risk describes operational risk related to the filing of tax returns and other tax related tasks, e.g. failure to file advance tax returns, being subject to a tax audit, or incurring tax payments etc.

Transaction Processing Risk is the risk that deficiencies in transaction processing or in our internal processes or controls result in losses. The risk is caused by human error, IT applications system failure and inadequate process design.

Legal Risk may materialize in any of the above risk types due to the fact that in each type, we may be the subject of a claim or proceedings alleging non-compliance with contractual or other legal or statutory responsibilities; or we may otherwise be subject to losses allegedly deriving from other legal circumstances. We will migrate to a new risk taxonomy covering non-financial risks such as transaction processing risk, project and transformation risk and reputational risk through the course of 2015 to support the risk assessment process.

Organizational & Governance Structure
The Head of Operational Risk Management (“ORM”) chairs the Operational Risk Management Committee (“ORMC”), which is a permanent sub-committee of the Risk Executive Committee and is comprised of those responsible for managing operational risk from our divisions and infrastructure functions. It is the main decision-making committee for all operational risk management matters.

While the day-to-day management of operational risk is the primary responsibility of our business divisions and infrastructure functions, the ORM function manages the cross divisional and cross
regional operational risk as well as risk concentrations and promotes a consistent application of our operational risk management framework across the bank. Through our business partnership model, we aim to maintain close monitoring and high awareness of operational risks.

**Strengthening controls through “Three Lines of Defense”**

The Three Lines of Defense program is an integral part of Deutsche Bank’s strategic agenda. It was initiated in the fourth quarter of 2013 by the Management Board in the context of heightened regulatory standards. The program builds on lessons learned from past control failures and aims to reinforce Deutsche Bank’s non-financial risk management capabilities and compliance culture across all corporate divisions and infrastructure functions. Furthermore, it is intended to maintain consistency across the ongoing control enhancement initiatives throughout the bank. Deutsche Bank defines the Three Lines of Defense as follows:

− The First Line of Defense includes all corporate divisions and selected infrastructure functions. First Line of Defense units are ultimately accountable for all risks and controls in their business processes.
− The Second Line of Defense encompasses all control functions such as Risk, Compliance, Legal, Human Resources, Finance and Tax. These are responsible for the design of Deutsche Bank’s policy framework and independent risk assessment. Second Line of Defense units are independent from the First Line of Defense.
− The Third Line of Defense is Group Audit which is responsible for providing independent and objective assurance on the effectiveness of risk management, internal controls and governance processes.

In 2014, the program performed a systematic review of Deutsche Bank’s non-financial risk and control organizations and supporting management processes. This led to the following changes:

− The Bank established dedicated control units in each First Line of Defense to reinforce the division’s accountability for the management of their control environment.
− The risk and control responsibilities across the Second Line of Defense control functions were realigned within a common risk and control framework. For selected risks new initiatives were launched to further strengthen Deutsche Bank’s control framework.
− The risk and control assessment approach was enhanced towards an integrated framework shared by all three Lines of Defense to ensure the use of common standards.

Key themes for 2015 are the further build-out of the control organization, the rollout of the enhanced risk and control assessment framework as well as continuing the work across all three Lines of Defense regarding specific control enhancements. This also includes the rollout of the enhanced Three Lines of Defense model into the regions.

**Managing Our Operational Risk**

We manage operational risk based on a Group-wide consistent framework that enables us to determine our operational risk profile in comparison to our risk tolerance, to systematically identify operational risk themes and concentrations, and to define risk mitigating measures and priorities. The global operational risk framework is applicable to all risk types included in the definition for operational risk.

In order to cover the broad range of operational risk types as outlined in the definition of operational risk, our framework contains a number of operational risk management techniques. These aim to efficiently manage the operational risk in our business and are used to identify, assess and mitigate operational risks:

− The continuous collection of operational risk loss events, as a prerequisite for operational risk management, includes detailed analyses, the identification of mitigating actions, and timely information of the senior management. All losses above € 10,000 are collected in our “db-Incident Reporting System” (“dbIRS”). For DB Colombo branch no threshold exists.
The Lessons Learned process is triggered for events, including near misses, above €1 million. This process includes, but is not limited to:

- systematic risk analyses, including a description of the business environment in which the loss occurred, previous events, near misses and event-specific Key Risk Indicators ("KRI")
- consideration of any risk management decisions connected with the specific risk taken
- root cause analyses
- review of control improvements and other actions to prevent or mitigate the recurrence, and
- assessment of the residual operational risk exposure.

The Lessons Learned process is an important means of identifying emerging areas of risk and to define appropriate risk mitigating actions. All corrective actions are captured and monitored for resolution via actions plans in our tracking system "dbTrack". The execution of corrective actions is reported on a monthly basis to senior management via the ORMC.

We systematically utilize information on external loss events occurring in the banking industry to prevent similar incidents from happening to us, e.g. by particular deep dive analyses or risk profile reviews.

In addition to internal and external loss information, scenarios are utilized and actions are derived from them. The set of scenarios consists of relevant external scenarios provided by a public database and internal scenarios. The latter are generated to complete our risk profile.

Regular operational risk profile reports at a Group level for our business divisions, for the countries in which we operate and for our infrastructure functions, are reviewed and discussed with the departments’ senior management. Regular risk profile reviews enable us to detect changes in the business units’ risk profiles as well as risk concentrations across the Group early on, and to take appropriate corrective actions.

We assess and approve the impact of changes on our risk profile as a result of new products, outsourcing activities, strategic initiatives, and acquisitions and divestments.

Once operational risks are identified, mitigation is required following the "as low as reasonably practicable (ALARP)" principle by balancing the cost of mitigation with the benefits thereof, and formally accepting the residual operational risk. Risks which violate applicable national or international regulations and legislation cannot be accepted; once identified, such risks must always be mitigated.

When we implement risk mitigating measures, we monitor them until they are resolved within our tracking tool "dbTrack". Residual operational risks rated higher than "important" need to be accepted by the risk bearing division and the ORMC.

We perform top risk analyses in which the results of the aforementioned activities are considered. The Top Risk Analyses are a primary input for the annual operational risk management strategy and planning process. Besides the operational risk management strategic and tactical planning, we define capital and expected loss targets which are monitored on a regular basis within a quarterly forecasting process.

We continuously seek to enhance the process to assess whether identified issues require a broader approach across multiple entities and locations within Deutsche Bank. A review of material findings is performed in order to assess their relevance to areas of the Bank other than where they originated.

KRI s are used to monitor the operational risk profile and alert the organization to impending problems in a timely fashion. KRI s allow the monitoring of the bank’s control culture and business environment and trigger risk mitigating actions. They facilitate the forward looking management of operational risks, based on early warning signals returned by the KRI s.

In our bottom-up self assessment ("SA") process, which is conducted at least annually, areas with high risk potential are highlighted, and risk mitigating measures to resolve issues are identified. On a regular basis we conduct risk workshops aiming to evaluate risks specific to local legal entities and the countries we operate in, and take appropriate risk mitigating actions.
Additional functions, methodologies and tools implemented by the responsible divisions are utilized to complement the global operational risk framework and specifically address the risk types. These include but are not limited to:

- A “Legal Risk Management” ("LRM") function in the Legal Department was established in 2013. This function is exclusively dedicated to the identification and management of legal risk. In addition to being used for reporting purposes, LRM’s analysis is applied to our control framework as it relates to legal risk in order to promote that it is sufficiently robust, including remediation of highlighted issues (whether via new or existing initiatives); and also as a further means of Legal’s input being a significant decision-making criterion for our businesses. The LRM function has a mandate to undertake a broad variety of tasks aimed at proactively managing legal risk, including: devising, implementing and overseeing an annual Legal Risk Assessment Program; agreeing and participating in resulting portfolio reviews and mitigation plans; and administering the Legal Lessons Learned process. The LRM function also coordinates Legal’s response to DB’s Three Lines of Defense program.
- The “Legal Risk Assessment Program” enables us to analyze existing and historic legal risks and, importantly, to better assess the potential for future legal risk events. This requires the participation of the business division (represented by Divisional Control Officer, “DCO”), Legal Advisory, LRM and ORM, and involves a primary self assessment on pre-defined terms by the business and a secondary assessment by the relevant Legal Advisory teams in order to form a global view of that business’ products, activities and locations.
- The “Legal Lessons Learned process” is a means of identifying, on a quarterly basis, legal risks arising from our activities; and of devising appropriate steps to remediate, mitigate or prevent such risks in future. The Legal Lessons Learned process is a retrospective one, whereby existing or completed matters are considered with a view to identifying legal lessons that can be learned from those matters and taking such steps as may be necessary for those legal lessons to be learned. Overall management of the Legal Lessons Learned process is the responsibility of the LRM function, working with ORM, DCO and the Legal Department via its Operating Committees.
- The operational risk from outsourcing is managed by the Vendor Risk Management (VRM) Process and documented in the VRM database. The outsourcing risk is assessed and managed for all outsourcing arrangements individually, following the Vendor Risk Management Policy and in line with the overall ORM framework. A broad governance structure is established to promote appropriate risk levels.
- Fraud Risk is managed based on section 25a of the German Banking Act (KWG) as well as other legal and regulatory requirements via a risk based approach, governed by the Global Anti-Fraud Policy and corresponding Compliance and Anti-Money-Laundering (AML) framework. In line with regulatory requirements, a global risk assessment is performed on a regular basis. Within the general management of operational risks, dedicated Fraud Risk relevant aspects are part of the self assessment process.
- Deutsche Bank manages Business Continuity (BC) Risk with its Business Continuity Management (BCM) Program which outlines core procedures for the relocation or the recovery of operations in response to varying levels of disruption. Within this program, each of our core businesses functions and infrastructure groups set up, maintain and periodically test business continuity plans (“BC Plans”) to promote continuous and reliable service. The BCM Program has defined roles and responsibilities which are documented in corporate standards. Compliance with these standards is monitored regionally by dedicated business continuity teams. Reporting to the Group Resiliency Committee, which is a sub-committee of the Group Operating Committee, is a quarterly requirement. Furthermore, key information on the established BCM control environment feed into operational risk KRIs.
- The operational risk in Technology is managed within the technology area, following international standards for IT management. Applications and IT infrastructure are catalogued and assessed on a regular basis. Stability monitoring is established. Key outcomes of the established assessment and control environment are used as input for operational risk metrics such as KRIs or self assessments.
- A new Operational Risk Assessment Policy for Change-the-Bank Processes has been implemented for material systems and process changes. All material change initiatives are
assessed for operational risks stemming from process/systems changes via an embedded ORM framework for change-the-bank operational risk assessments. Identified risks and mitigating actions are tracked in Deutsche Bank’s system as mentioned above.

Although we have established a comprehensive framework for managing operational risks, including specific methodologies and techniques, we nevertheless face a trend of increasing operational risk losses and capital demand as has been the case with much of our industry. In a consolidated effort to continuously enhance the operational risk management framework, we recently added top risk analyses as an additional reporting component to our management reporting:

The top risk analysis aims to identify our most critical risks and those of our respective business divisions in terms of probability and severity. With the inclusion of the top risk reporting component in the standard global operational risk management reporting, we increase the engagement of senior management in the operational risk management process by providing transparency of our operational risk portfolio for the regions in which we operate and our business divisions. It forms a comprehensive report on a global level. This facilitates senior management’s conversations on our top risks and strengthens ownership and accountability by presenting specific action plans for risk mitigation, including responsibilities and target dates, adapted to our risk tolerance.

Below we show selected examples for the usage of the top risk analysis and actions derived from this process to mitigate the inherent risks. In line with our main peers and the general situation throughout the financial industry, we currently identify among our top risks such topics that result directly or as second order effects from the financial crisis:

- Uncertainty of litigation outflow: Improper and potentially improper business practices of the past were revealed by or following the crisis and further litigation has been induced by the change in market sentiment resulting from the crisis. These have led and may in future lead to significant regulatory fines or settlements from lawsuits initiated by respective business counterparties.
- Regulatory driven change agenda: The multiplicity of new regulatory requirements, as a reaction to the financial crisis, have already placed significant burden and cost on us, but could lead to additional regulatory sanctions in case of non-compliance.
- Internally driven change agenda: In order to meet profitability targets it is necessary for us to increase efficiency. In combination with the above mentioned points this results in pressure on us to re-organize and streamline our portfolios and business processes. The respective change initiatives bear potential transition risk or could potentially expose us to new operational risks.

In response to the challenges of the financial crisis, ORM introduced a set of measures and revised tools to improve the operational risk management of the top risks by strengthening the organizational robustness and enhancing the risk management processes. The key projects are outlined below:

**Operational Risk Management Target Operating Model**

We are currently redefining the responsibilities for managing operational risks within the Group under adoption of the Three Lines of Defense program. Key changes and improvements within the Three Lines of Defense model affect the roles and responsibilities of the first and second lines of Defense, risk taxonomies and the organizational structure of ORM. Regarding risk taxonomies ORM takes the second line control function responsibility for the following non-financial risk types: transaction processing risk, project and transformation risk and reputational risk. This will be reflected in the organizational structure of ORM.
Self Assessment process as part of ORM’s Target Operating Model

We have initiated a project to review the self assessment processes and to enhance the resulting qualitative risk management information set. This will align, connect and integrate key non-financial risk assessment processes (e.g. for operational, compliance and legal risks).

OR assessments on change initiatives

In reaction to our comprehensive change agenda, and our inherent operational project risks, we set up a specific operational risk assessment. For critical control initiatives, i.e. those initiatives considered crucial to the success of our cultural change program, specific operational risk assessments of the internal control environment were introduced to assess the operational risk impact of such initiatives onto the Group.

Measuring Our Operational Risks

We calculate and measure the regulatory and economic capital for operational risk using the internal Advanced Measurement Approach ("AMA") methodology. Our AMA capital calculation is based upon the loss distribution approach ("LDA"). Gross losses from historical internal and external loss data (Operational Riskdata eXchange Association ("ORX") consortium data), adjusted for direct recoveries, and external scenarios from a public database (IBM OpData) complemented by internal scenario data are used to estimate the risk profile (that is, a loss frequency and a loss severity distribution). Thereafter, the frequency and severity distributions are combined in a Monte Carlo simulation to generate potential losses over a one year time horizon. Finally, the risk mitigating benefits of insurance are applied to each loss generated in the Monte Carlo simulation. Correlation and diversification benefits are applied to the net losses in a manner compatible with regulatory requirements to arrive at a net loss distribution at Group level, covering expected and unexpected losses. Capital is then allocated to each of the business divisions and both, a qualitative adjustment and an expected loss deduction, are performed.

The qualitative adjustment ("QA") reflects the effectiveness and performance of the day-to-day operational risk management activities via KRIIs and self assessment scores, focusing on the business environment and internal control factors. The qualitative adjustment is applied as a percentage adjustment to the final capital number. This approach makes qualitative adjustments transparent to the management of the businesses and provides feedback on their risk profile as well as on the success of their management of operational risks. It thus provides incentives for the businesses to continuously improve the management of operational risks in their areas.

The expected loss ("EL") for operational risk is based on historical loss experience and expert judgment, considering business changes denoting the expected cost of operational losses for doing business. To the extent it is considered in the divisional business plans, it is deducted from the AMA capital figure within certain constraints. The unexpected losses per business division (after QA and EL) are aggregated to produce the Group AMA capital figure.

Regulatory and economic capital for operational risk is calculated on a quarterly basis. The used internal data are captured in a snapshot at the beginning of the quarterly production cycle and undergo a quality assurance and sign-off process. Therefore, the complete history of previous quarters’ internal losses is taken into account in the calculation of the capital figures. ORX external data is submitted by the ORX members and also undergo quality assurance and sign-off. These data are recognized in the capital calculation at the earliest after six months. For the additional external loss data sourced from the IBM OpData (formerly named OpVantage), we use the data that are available twice a year (in the first and third quarters).

Economic capital is derived from the 99.98 % percentile, allocated to the business divisions, and used for performance measurement and resource allocation purposes, providing an incentive to manage operational risks, and optimizing the utilization of economic capital. The regulatory capital for operational risk applies the 99.9 % percentile. Economic and regulatory capital are calculated for a time horizon of one year.
Continued Operational Risk Framework Development

The AMA model is subject to continuous validation and enhancement, as we attempt to adequately reflect our risk profile. As part of the continuous enhancement and validation of our model we submitted model changes to BaFin and are awaiting approval from the joint supervisory team (BaFin and ECB). These model changes include an improved validation and recalibration methodology for insurance recoveries, changes to the modeling of the loss frequency as well as an enhanced scoring mechanism for the self assessment results in our AMA model.

Further, we have submitted an additional model change request to BaFin to replace the €1 billion economic capital safety margin, which we have continuously applied since its implementation in 2011. This model change, which adds increased forward looking aspects to the AMA model, will result in higher economic capital even after we remove the safety margin. This change will make our model more risk sensitive by including reasonably possible litigation losses in our “Relevant Loss Data” set. Reasonably possible litigation losses may result from ongoing and new legal matters which are reviewed quarterly and are based on the judgment provided by our Legal Department.

While our dialogue with the joint supervisory team on these model enhancements is on-going, management has decided to recognize the impact of these model changes in the second quarter 2014 wherever they will lead to an increase in the capital requirement over the models that have previously been approved by BaFin.

Our Operational Risk Management Stress Testing Concept

We conduct stress testing on a regular basis and separate from our AMA methodology, to analyze the impact of extreme macro scenarios on our capital and the profit-and-loss account. In 2014, ORM took part in all firm-wide stress test scenarios and assessed and contributed the impact of operational risk to the various stress levels of the scenarios. The impact of operational risk on macro stress test scenarios has been moderate and remained in the expected range in regards to capital.

Our AMA Model Validation and Quality Assurance Review Concept

We independently validate all our AMA model components such as but not limited to scenario analysis, KRI s and Self Assessments, Expected Loss and internal loss data individually. The results of the validation exercise are summarized in validation reports and issues identified are followed up for resolution. This promotes enhancement of the methodologies. The validation activities performed in 2013 detected areas of improvement in our AMA model regarding the estimation of the loss frequency and the use of reasonably possible litigation losses. The results of this validation lead to model enhancements which increased the economic capital.

Quality Assurance Reviews are performed for the AMA components requiring data input provided by business divisions and result in capital impact. The AMA components data and documentation is challenged and compared across business divisions to help us maintain consistency and adequacy for any capital calculation.

Role of Corporate Insurance/Deukona

The definition of our insurance strategy and supporting insurance policy and guidelines is the responsibility of our specialized unit Corporate Insurance/Deukona (CI/D). CI/D is responsible for our global corporate insurance policy which is approved by our Management Board.

CI/D is responsible for acquiring insurance coverage and for negotiating contract terms and premiums. CI/D also has a role in the allocation of insurance premiums to the businesses. CI/D specialists assist in devising the method for reflecting insurance in the capital calculations and in arriving at parameters to reflect the regulatory requirements. They validate the settings of insurance parameters used in the AMA model and provide respective updates. CI/D is actively involved in industry efforts to reflect the effect of insurance in the results of the capital calculations.
We buy insurance in order to protect ourselves against unexpected and substantial unforeseeable losses. The identification, definition of magnitude and estimation procedures used are based on the recognized insurance terms of “common sense”, “state-of-the-art” and/or “benchmarking”. The maximum limit per insured risk takes into account the reliability of the insurer and a cost/benefit ratio, especially in cases in which the insurance market tries to reduce coverage by restricted/limited policy wordings and specific exclusions. We maintain a number of captive insurance companies, both primary and re-insurance companies. However, insurance contracts provided are only considered in the modeling/calculation of insurance-related reductions of operational risk capital requirements where the risk is re-insured in the external insurance market.

The Group regulatory capital figure includes a deduction for insurance coverage. Currently, no other risk transfer techniques beyond insurance are recognized in the AMA model.

CI/D selects insurance partners in strict compliance with the regulatory requirements specified in the Solvency Regulations and the Operational Risks Experts Group recommendation on the recognition of insurance in advanced measurement approaches. The insurance portfolio as well as CI/D activities are audited by Group Audit on a risk based approach.

Managing Operational Risk at Deutsche Bank AG, Colombo Branch

Deutsche Bank AG, Colombo Branch manages operational risk according to policies and guidelines set locally or by Group that enable the bank to determine the OR profile in comparison to Deutsche Bank’s risk appetite and systematically identify OR themes and concentrations to define appropriate risk mitigating measures and priorities. The most important ones are:

- Principles for Managing Operational Risk – Deutsche Bank Group
- Operational Risk Management (ORM) Events Policy
- Operational Risk Toolset Policy
- Operational Risk Acceptance Policy
- Vendor Risk Management Policy
- Minimum Requirements for Handling and Recording of Complaints - DB Group and Divisional and Functional Policies and Key Operating Procedures.

At local level, the Country Chief Operating Officer acts as the Country Operational Risk Officer (CORO) and is responsible for adequate monitoring and reporting to ORM. As part of the country governance, in addition to the mandatory and primary divisional OR management, the CORO must be informed by all local divisions and functions about OR related matters locally enabling her to fulfill her responsibilities.

The Country Flashcard is prepared on a regular basis representing current operational risks in Sri Lanka and to be reviewed and discussed with the regional ORM management. CORO presents the Country Flashcard to local OPCO. The flashcard is built on new operational risk events that have taken place, trend analysis and economic capital over the past quarters and key actions agreed and tracked via dbTrack which is the central tracking system for OR risk and tracking items.

Deutsche Bank AG, Colombo Branch has implemented the risk management processes and systems as being conducted at the Group level. As mentioned above, Deutsche Bank Group has applied an advance model approach (AMA) for operational risk management and implemented the economic capital (EC) to calculate the capital charged while Deutsche Bank AG, Colombo Branch, with the guidance from the Central Bank of Sri Lanka, uses the Basic Indicator Approach (BIA) to calculate the capital.
Details of activities that have been outsourced together with parties and basis of payment for such services:

Deutsche Bank is involved in Outsourcing which involves procurement of activities, functions or processes from vendors in connection with the execution of banking transactions, financial services or other typical activity of a DB Legal Entity which would otherwise be carried out by the outsourcing DB Legal Entity.

With respect to activities outsourced locally, a few non-core activities have been outsourced to third party vendors. Such activities are performed within the DB Colombo premises under the supervision of DB Colombo staff excluding cash pick-up, document archival, and processing of payroll which are handled outside DB Colombo premises. Costs pertaining to all locally outsourced activities given below.
With reference to locally performed activities by third parties, payments are made on the basis of duties performed and rates have been negotiated between the bank and vendors. Payments are based on the scope of work delivered.

Details of investment in appropriate information technology, if any and other risk mitigation techniques taken during the reporting period

Background:
Deutsche Bank AG, Colombo branch operates two sites in Sri Lanka, Primary site in order to carry out daily business activities and the Disaster Recovery Site.

Majority of applications and infrastructure components used by Colombo branch are hosted out of bank’s regional data centers, mainly from Asia Pacific Computer Center (APCC) in Singapore. Only regulatory mandated applications and few Deutsche Bank applications required for the local operation are hosted in Colombo branch. Locally hosted applications do not have any direct interface with any external parties.

Furthermore, with reference to IT Security Management, the following ongoing risk mitigation methodologies and/or controls are implemented, where applicable, at bank’s core infrastructure which are hosted in Regional and Global data centers.

Network and Security Perimeter Layers:
Following have been implemented at global/regional network platform of Deutsche Bank. From the technical perspective, Network Access Control, Network Intrusion Detection System (NIDS), Network Zoning, Monitoring using Security Incident Management (SIM), Infrastructure Penetration Testing, Virtual Private Networks (VPN’s), Network AntiVirus, measures on Distributed Denial of Service (DDOS) and Stateful Firewall have been implemented on our network platform.
With reference to the physical safety of network infrastructure, network components are hosted in Secure Telecom Equipment Rooms (TER).

Endpoint Protection:
All end user computing devices such as desktops and laptops have been secured using Device Scanning techniques using Symantec Endpoint Protection, CyberArmor Personal Firewalls, NAC (network), Encryption Plus / BitLocker for hard disks.

Host and Application Security:
Host level security has been ensured by implementing Access Controls, continuous monitoring using Host intrusion detections, Enterprise State Monitoring, Penetration Testing, Anti-Malware solutions and regular Operation System Patching mechanisms.
Furthermore all our secured data centers cater for Disaster Recovery requirements. Hosting of
Deutsche Bank

services have been properly segregated on Production, Development and User Acceptance Testing (UAT) environments at platform level. With reference to Application Security, bank conducts Vulnerability Assessments, incident monitoring and risk assessments and follows structured ID Administration processes.

Data Security:
With reference to data security, bank has adopted various industry standard best practices in applicable areas. Some examples of data security practices include Data Leakage Prevention (DLP) methodologies, application Authentication and Authorization, Data Archive / Backup / Restore / Replication, File Server Encryption methods.

Details of due-diligence tests of third party service providers
Deutsche Bank carries out due diligence tests on the third party service providers globally/regionally for the activities handled at the Regional Smart Sourcing Centres located in major Hubs. With regard to locally outsourced activities, necessary due diligence tests are carried out on an annual basis covering corporate records, shareholder information, business contracts, legal and financial data, management/ staff review, litigation, audit, filing, insurance, business continuity etc.

Details of a contingency plan in place to handle failure situations
Business Continuity Management Program:
Deutsche Bank Group proactively manages Business Continuity Risk by implementing a Business Continuity Program, compliant with globally and locally applicable laws and regulations and aligned to industry best practice, which aims to improve the resiliency of the Bank and includes Recovery and Crisis Management planning, systematic testing and continuous improvement. Business Continuity Management (BCM) is the management process used to ensure business continuity capabilities are maintained across the bank, enabling the business to resume relevant business activities after disruptions affecting:

− People
− Facilities
− Technical infrastructure
− Information assets
− Operations

The aim of BCM is to:

− Protect people
− Protect the Deutsche Bank franchise
− Mitigate risk
− Meet regulatory requirements
− Safeguard revenues
− Sustain stable financial markets and customer confidence

Deutsche Bank’s BCM policy statement articulates the desired focus on business continuity and its effectiveness which is reflected below:

− A risk based and scenario driven Business Continuity Program is developed, implemented and maintained depending on the business process criticality and dependencies to reduce single point of failure, increase resiliency and accelerate business resumption.
− A Testing and Exercise Program of recovery capability is developed, implemented and maintained to prove the recoverability of each business function.
− A Reporting framework is developed, implemented and maintained to ensure proper transparency of compliance with the CM & BCM program aiming at different hierarchical levels to identify gaps and to specify improvement programs.

We, at Deutsche bank use a web portal “eBCM” which is a home grown tool to manage business continuity program compliance at an organization level. Businesses in Deutsche Bank has
business continuity plans and test results recorded in eBCM along with their critical processes, recovery strategies, minimum operating requirements (business impact analysis) and dependencies. Minimum operating requirements talks about critical resources including technical requirements.

Business Continuity is an integral part of Deutsche Bank's normal business operations. It is part of business planning, and an integral component and important responsibility of all Managers with defined roles and responsibilities. Business continuity plans are well integrated with the overall risk management plan for the organization. We regularly report country / business risks to senior leadership in different forums within organization so that appropriate mitigation measures can be taken to protect interest of our shareholders, customers and employees from BCM aspect. The ultimate reporting of CSBC function is to the DB Management Board.

Business Functions are required to monitor BCM deliverables for their vendors: For all critical or significant risk rated outsourced or internally relocated services, the retained organization has to ensure the vendor follows the minimum BCM Lifecycle requirements outlined by Deutsche Bank. The final decision in cases of doubt rests with BCM. The Business Function Recovery Time Objective also applies to those functions or processes delivered by a vendor.

There have been no major operational viz. system or human failures and financial losses incurred by the bank due to such failures during this reporting period and the previous financial year.

**Interest Rate Risk in the banking book**
The vast majority of the interest rate risk and foreign exchange risk arising from the non-trading assets and liability positions in the Banking book are transferred through internal hedges to the Global Markets: FIC business line within the Corporate Banking & Securities Division and is managed on the basis of Value-at-Risk, as reflected in the trading Value-at-Risk numbers.
Other disclosures

Capital

Bank Supervision Circular dated 29th July 2010 requires Banks to maintain minimum Core Capital of LKR 3 bn at the end of the reporting period, with an enhancement to LKR 4 bn by 31 December 2013 and LKR 5 Bn by 31 December 2015.

DB Colombo Branch’s Core Capital as at 30th June 2015 is LKR 9.9 bn, comprised as follows:

<table>
<thead>
<tr>
<th>Core Capital Instruments</th>
<th>30th June 2015</th>
<th>31st Dec 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assigned capital</td>
<td>4,410</td>
<td>4,410</td>
</tr>
<tr>
<td>Statutory Reserves</td>
<td>487</td>
<td>487</td>
</tr>
<tr>
<td>Investment Fund Account Reserve</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>3,194</td>
<td>3,194</td>
</tr>
<tr>
<td>Special Reserve</td>
<td>1,781</td>
<td>1,781</td>
</tr>
<tr>
<td>Total (*)</td>
<td>9,873</td>
<td>9,873</td>
</tr>
</tbody>
</table>

Tier II Capital instruments (at exchange rates on reporting date)

<table>
<thead>
<tr>
<th></th>
<th>30th June 2015</th>
<th>31st Dec 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subordinated Term Debt (**)</td>
<td>1,295</td>
<td>1,384</td>
</tr>
<tr>
<td>(**) Value considered for CAR</td>
<td>518</td>
<td>554</td>
</tr>
</tbody>
</table>

The Subordinated Term Debt of EUR 8,666,041.86/- was issued by Deutsche Bank Privat- und Geschäftskunden AG on 31st October 2007 for a period of ten (10) years. This instrument complies with the terms and conditions stipulated in Bank Supervision Direction No. 9 of 2007, Maintenance of Capital Adequacy Ratio and has been duly approved by the Bank Supervision Department of the Central Bank of Sri Lanka.

Capital Management

The DB Group’s Treasury function manages the DB Group’s capital at group level and locally in each region. The allocation of financial resources, in general, and capital, in particular, favors business portfolios with the highest positive impact on the DB Group’s profitability and shareholder value.

Treasury implements the DB Group’s capital strategy, which itself is developed by the DB Group Capital and Risk Committee and approved by the DB Group Management Board. The Group is committed to maintain its sound capitalization. Overall capital demand and supply are constantly monitored and adjusted, if necessary, to meet the need for capital from various perspectives. These include book equity based on IFRS accounting standards, regulatory capital and economic capital.

The allocation of capital, determination of the DB Group’s funding plan and other resource issues are presented to and approved by the DB Group Capital and Risk Committee.

The DB Group conducts an annual planning process to determine the DB Group’s future strategic direction, decide on key initiatives and allocate resources to the businesses. The DB Group’s plan comprises profit and loss, capital supply and capital demand, other resources, such as headcount, and business-specific key performance indicators. This process is performed at the business division level comprising the next five years, with business unit details for the first three years. In addition, the first of the five years are detailed by quarter (operative plan). Based upon a range of economic scenarios, the business areas discuss their strategic development
with the required risk management functions in order to align their revenue potential with the Group’s risk appetite/resources. Group Strategy & Planning and Finance coordinate the strategic planning process and present the resulting strategic plan to the Group Executive Committee for discussion and final approval. The final plan is also presented to the Supervisory Board at the beginning of each year. The approved planned risk-weighted assets and capital deduction items form the basis for quarterly capital demand limits by business area. The risk and performance plans feed into Treasury’s capital and liquidity planning. Depending on the development of risk-weighted assets and capital deduction items, Treasury regularly updates contingency measures in light of the Group’s Tier 1 capital ratio target.

Regional capital plans covering the capital needs of the DB Group’s branches and subsidiaries are prepared on a semi-annual basis and presented to the DB Group Investment Committee. Local Asset and Liability Committees attend to the needs of legal and regulatory capital requirements under the stewardship of regional Treasury teams. Furthermore, they safeguard compliance with requirements such as restrictions on dividends allocable for remittance to Deutsche Bank AG or on the ability of the Group’s subsidiaries to make loans or advances to the parent bank. In developing, implementing and testing the DB Group’s capital and liquidity, the DB Group takes such legal and regulatory requirements into account.

3.1.2 Capital adequacy

Internal Capital Adequacy Assessment Process (ICAAP)

ICAAP requires banks to identify and assess risks, maintain sufficient capital to face these risks and apply appropriate risk-management techniques to ensure adequate capitalization on an ongoing basis, i.e. internal capital supply to exceed internal capital demand.

DB Colombo Branch differentiates between regulatory and economic capital demand. While regulatory capital demand is based on the calculation of risk-weighted assets according to the requirements set out by the Basel Committee and amended by the Central Bank of Sri Lanka, economic capital demand is based on DB Group’s estimate of the risk exposure of the entity based on internal risk models.

When reviewing the ICAAP it should be noted that Deutsche Bank operates as an integrated Group through its business divisions and the infrastructure functions. Risk and capital are managed through a framework of principles, organizational structures as well as measurement and monitoring processes that are closely aligned with the activities of our group divisions. Therefore, outcome of such review results from the mutual efforts contributed from the Group Level, the Regional Level and the Local Level. The local capital adequacy assessment is part of the ongoing oversight that is performed by the Asset and Liability Committee (ALCO) of DB Colombo Branch, with ultimate oversight by the local management.

In general, responsibility for the four elements of the local ICAAP framework is divided between DB Group and DB Colombo according to the following guidelines:

- **Risk governance and strategy**: The management of DB Colombo ensures the definition and implementation of a business and risk strategy for DB Colombo that is closely aligned with Group’s strategy. The quarterly Risk and Capital report ensures transparency on ICAAP at a local senior management level.
- **Risk management by major risk category**: While local capital management focuses on the demand for local regulatory capital to support the business, the same risks are naturally part of the Group’s economic capital. Economic capital covers credit, market, operational and business risk, and is allocated to the entity on a quarterly basis. This ensures full understanding of the economic risk position taken by the entity. To manage these risks, risk management guidelines and policies at a DB Group level are also followed at the legal entity level, e.g., adherence to limits, credit approval processes, New Product Approval (NPA), etc.
− **Risk methods – analytics and modelling:** Risk measurement methods are primarily developed centrally by DB Group and transferred to DB Colombo. Regular training is held and updates provided by the Group to ensure full understanding of methodologies. Group methodologies are also adapted and extended if required due to specific local regulatory requirements (e.g. for specific stress testing purposes) upon approval by the Group.

− **Risk infrastructure, processes and policies:** Risk infrastructure is defined at the DB Group level and DB Colombo is supported by existing infrastructure and processes at DB Group. Furthermore, DB Colombo has its own infrastructure, processes and policies in place that complement Group standards and – upon agreement with DB Group - follow local regulatory requirements.

### Risk Weighted Assets and Capital requirement

<table>
<thead>
<tr>
<th>In TLKR</th>
<th>30th June 2015</th>
<th>31st Dec 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core capital</td>
<td>4,410,451</td>
<td>4,410,461</td>
</tr>
<tr>
<td>Assigned capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves</td>
<td>2,267,806</td>
<td>2,267,806</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>3,194,276</td>
<td>3,194,276</td>
</tr>
<tr>
<td>Tier I adjustments ( Def Tax &amp; IIE balances)</td>
<td>(22,054)</td>
<td>(22,054)</td>
</tr>
<tr>
<td>Tier I adjusted capital</td>
<td>9,850,485</td>
<td>9,850,489</td>
</tr>
<tr>
<td>Tier II capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gen prov</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subdebt</td>
<td>517,840</td>
<td>553,559</td>
</tr>
<tr>
<td>Total Capital</td>
<td>10,368,329</td>
<td>10,404,048</td>
</tr>
</tbody>
</table>

| Risk-weighted amount for credit risk        | 13,320,053      | 12,948,991     |
| Risk-weighted amount for market risk        | 2,196,950       | 1,912,140      |
| Risk-weighted amount for operational risk   | 5,874,255       | 6,683,003      |
| **Total risk-weighted amount**              | **21,391,256**  | **21,426,034** |

**Ratios:**  
- Min required  
  - Tier I ratio - 5% | 46.05% | 45.97%  
  - Total Capital Ratio - 10% | 48.47% | 48.56%

DB Colombo has assessed the impact of Basel III additional capital requirements and Leverage Ratio based on Consultation Paper issued by Central Bank of Sri Lanka on 30th June 2015 and it is envisaged that all requirements will be met within the stipulated timeframe.