Bank Alfalah Limited
Bangladesh Operations
Disclosure under Pillar-III of Basel-II for the year ended December 2012

These qualitative and quantitative disclosures have been made in accordance with Bangladesh Bank vide BRPD Circular No. 10 dated March 10, 2010 and BRPD Circular No. 24 dated August 03, 2010. The purpose is to comply with the requirement for having adequate capital and the Supervisory review process under Pillar II. These disclosures are intended to assess information about the Banks exposure to various risks.

Market Discipline Disclosures

As per Bangladesh Bank guidelines, the Bank has migrated to Basel-II framework as on 31.03.2009 under parallel reporting regime to existing BRPD Circular No. 10, dated November 24, 2002. From January 01, 2010 Basel-II regime has started into effect and the guideline on Risk Based Capital Adequacy (RBCA) has come into effect with its subsequent supplements/revisions.

Under Pillar-III of the framework, "Basel-II Disclosures" of Bank Alfalah Limited as on December 31, 2012 are as under:

1. Capital Management

The objective of managing capital is to safeguard the Bank's ability to continue as a going concern, so that it could continue to provide adequate returns to shareholders by pricing products and services commensurately with the level of risk. It is the policy of the Bank to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholder's return is also recognized and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

Goals of managing capital

The goals of managing capital of the Bank are as follows:

- To be an appropriately capitalized institution, considering the requirements set by Bangladesh Bank.
- Maintain strong ratings and to protect the Bank against unexpected events; and
- Availability of adequate capital at a reasonable cost so as to enable the Bank to operate adequately and provide reasonable value addition for the shareholders and other stakeholders.

Risk Management

The Bank has in place an approved integrated risk management framework for managing credit risk, market risk, liquidity risk and operational risk as evidenced by its Board approved "Risk Management Policy" and "Risk Management & Internal Control" manual.

Following is the governance structure and important policies on Risk Management of the Bank:

- The Board of Directors through its sub-committee called 'Board Risk Management Committee' (BRMC) oversees the overall risk of the Bank.
- RMD is the organisational arm performing the functions of identifying, measuring, monitoring and controlling the various risks and assists the Apex level committee and the various sub-committees in conversion of policies into action.
- An independent risk review function exists at the Bank in the form of Internal Audit Group that reports directly to the Board Audit Committee.
- The Bank has extensively pursued the implementation of Basel-II in the Bank. In order to meet the requirement, many steps have been taken by the Bank. Progress has been made in implementation of Risk based Pricing & Approval Grids in the Bank. Moreover, in order to enhance data integrity and the reliability regarding MCR (Minimum Capital Requirement) calculation, automation of CAR (Capital Adequacy Ratio) calculation is in process and is functional in significant branches of the Bank. Moreover, for Pillar 2 disclosures ICAAP exercise was also conducted.
- As a policy the reporting line of the risk management function has been kept completely independent of the businesses divisions and Credit Group.

In terms of RBCA guidelines on Basel-II framework, the Bank has adopted the Standardized Approach for Credit Risk, Standardized (rule based) Approach for Market Risk and Basic Indicator Approach for Operational Risk. In addition to regulatory capital requirement of computation as per Pillar-I, the Bank also assesses Interest Rate Risk, Equity Risk, and Foreign Exchange Risk on a regular basis to assess adequacy of the capital available as a cushion to withstand shocks from business environment adversities.

In view of the above context, following disclosures are made by the Bank in terms of RBCA:

1. Capital Structure
2. Capital Adequacy
3. Assets
4. Credit Risk
5. Market Risk
6. Operational risk
7. Internal Capital Adequacy Assessment Process (ICAAP)

1. Capital Structure

Qualitative Disclosure

Bank Alfalah Limited Bangladesh capital structure consists of Tier-I and Tier-II capital. The regulatory capital is broadly classified into three categories - Tier-I, Tire-II and Tier-III. Tier-I capital includes paid-up equity capital, statutory reserves, other disclosed free reserves, capital reserves and innovative perpetual debt instruments (Tier-I bonds) eligible for inclusion in Tier-I capital that comply with requirement specified by Bangladesh Bank.

Elements of Tier-II capital include revaluation reserve, general provision and loss reserve, upper Tier-II instruments (upper Tier-II bonds) and subordinate debt instruments (lower Tier-III bonds) eligible for inclusion in Tier-II capital.

The use of Tier-III capital (short term subordinated debt) is limited only for part of the explicit capital charge for market risks. The Bank does not have any Tier-III capital.

As on December 31, 2012 the Bank has a paid up capital of BDT 447.93 crore. The computation of the amount of Core (Tier-I) and Supplementary (Tier-II and Tier-III) Capitals shall be subject to the following conditions:

1. Eligible Tier-II plus Tier-III capital shall not exceed total Tier-I capital.
2. Fifty percent (50%) of Asset Revaluation Reserves shall be eligible for Tier-II i.e. Supplementary Capital.
3. A minimum of about 20% of market risk needs to be supported by Tier-I capital. Supporting of Market Risk from Tier-III capital shall be limited up to a maximum of 250% of a bank's Tier-I capital that is available after meeting credit risk capital requirement.
4. Up to 50% of Revaluation Reserves for Securities shall be eligible for Supplementary Capital.
5. Subordinated debt shall be limited to a maximum of 30% of the amount of Tier-I capital and shall also include rated and listed subordinated debt instruments/bonds raised in the capital market.

Quantitative Disclosure

Bank Alfalah Limited's capital structure is being enumerated as under:

	2012 BDT	2011 BDT
a) Core capital (Tier-I)		
Fund Deposited with BB	4,479,334,485	4,542,869,945
Retained Earnings	124,680,896	98,752,504
	4,604,015,381	**4,641,622,449**
Deductions from Tier-1 (Core Capital)	-	-
Total Eligible Tier-I Capital	**4,604,015,381**	**4,641,622,449**
b) Supplementary capital (Tier II)		
General Provision (UC loans & OBS (Limited to 1.25% of RWA)	75,772,258	85,221,207
Revaluation Reserve for Securities up to 50%	18,612,758	-
	94,385,016	**85,221,207**
Deductions from Tier-2 (Core Capital)	-	-
Total Eligible Tier-II Capital	**94,385,016**	**85,221,207**
c) Additional supplementary capital (Tier III)	-	-
A. Total Eligible Capital	**4,698,400,397**	**4,726,843,656**

2. Capital Adequacy

Qualitative Disclosure

The Bank is subjected to the capital adequacy guidelines stipulated by Bangladesh Bank, which are based on the framework of the Basel Committee on Banking Supervision. As per the capital adequacy guidelines, the Bank is required to maintain a minimum CAR of 10.00% with regard to Credit Risk, Market Risk and Operational Risk. Subsequently this minimum CAR as prescribed by Bangladesh Bank vides BRPD Circular No.10 dated March 10, 2010 as follows:

Period	CAR %
January 01, 2010 to June 30, 2010	8%
July 01, 2010 to June 30, 2011	9%
July 01, 2011 to ongoing	10%

Bank has adopted Standardized Approach for Credit Risk, Standardized (rule based) Approach for Market Risk and Basic Indicator Approach (BIA) for Operational Risk for computing CAR.

Quantitative Disclosure

At the close of business on December 31, 2012 in terms of aforesaid Circular, available Core Capital of the Bank was BDT 4,604,015,381 as against a minimum capital requirement of BDT 4,000,000,000 or BDT 772,134,887 (10% of RWA as per Basel-II). Supplementary Capital of the Bank was BDT 94,385,016 thus resulting in a total of BDT 4,698,400,397 thereby appearing a surplus capital of BDT 698,400,397 over and above BDT 4 billion at that date. Details are shown below:

	2012 BDT	2011 BDT
Total assets including off-Balance Sheet items	16,318,658,650	15,429,025,473
Total risk-weighted assets (RWA)	7,721,348,874	7,732,447,073
10% of Total RWA	772,134,887	773,244,707
A. Total Eligible Capital	**4,698,400,397**	**4,726,843,656**
B. Total required capital	4,000,000,000	4,000,000,000
(10% of RWA or BDT 4,000,000,000 whichever is higher)		
Capital Surplus / (Shortfall) [A-B]	698,400,397	726,843,656
Capital adequacy ratio	60.85%	61.13%
Amount of Regulatory Capital to meet unforeseen loss		
Amount to meet Credit Risk	662,782,934	717,959,524
Amount to meet Market Risk	48,068,824	8,127,614
Amount to meet Operational Risk.	61,283,129	47,157,568
Some additional capital over MCR maintained by the banks	698,400,397	726,843,656

3. Assets

Bank's assets comprises of cash, balance with other banks, investments in treasury bills and bond, investments in share portfolio, loan and advances, physical assets and other assets.

Loans and advances represented 41.56% of total assets of the Bank. The classified loan ratio was 6.16% indicating efficient asset management of the Bank.

Nature of Assets

Assets of Bank Alfalah are categorized as per the following:

- Banking Book Asset
- Trading Book Asset

In general, banking book assets comprise assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity. On the contrary, trading book assets refer to the book of financial instruments held with the intention for short-term trading. It refers to those assets held primarily for generating profit on short-term differences in prices/yields.

Banking book and trading book assets represent 88.90% and 11.10% respectively of the total assets.

The major components of the earning assets and non-earning assets for the bank are as follows:

Earning Assets

- Loans & advance
- Investments in securities
- Money at call & short notice
- Balance with other banks and FIs

Non-Earning Assets

- Cash in hand
- Balance with Bangladesh Bank for CRR maintenance
- Fixed Assets
- Other assets

Assets are monitored under the purview of ALCO on a regular basis to cope with unexpected risk. Assets are classified as per the directive of the Bangladesh Bank. Classified assets are the Default Loans in respect to which recipient/beneficiary fails to make timely payment of interest or principal as per the agreed schedule for repayment.

Bank categorized classified loans in following three (03) categories following the Bangladesh Bank guidelines:

- Sub-standard
- Doubtful
- Bad/Loss

Addition/Reduction of Classified Assets

Classified loans stood at BDT 33.92 crore as on December 31, 2012 whereas it was BDT 9.85 crore as on December 31, 2011 representing an increase of BDT 24.07 crore.

	2012 **BDT**	**2011** **BDT**
1. Cash in Hand & Balance with BB (Excluding Fcy)	623,895,670	677,372,644
2. Balance with BB (Fcy as part of Capital)	2,213,589,485	4,542,869,945
3. Claims on Other Banks	680,606,990	690,558,794
a) Balance with other banks	360,606,990	10,558,794
b) Money at Call & Short Notice	320,000,000	680,000,000
4. Investment (HTM)	2,505,441,491	298,850,602
a) Government (under lien with BB as part of Capital)	2,415,441,491	68,742,502
b) Qualifying (banks, etc)	-	220,000,000
c) Others	90,000,000	10,108,100
5. Loans & Advances	5,502,595,325	5,840,804,947
a) Classified	339,173,505	98,542,485
SS	197,067,683	20,842,587
DF	58,801,874	-
BL	83,303,948	77,699,898
b) Unclassified	5,163,421,820	5,742,262,462
6. Risk Weighted Assets	6,627,829,344	6,132,071,567
a) Below 100% RW	791,031,725	776,502,553
b) 100% RW	3,900,396,501	2,254,754,722

c) Above 100% RW	1,936,401,117	3,100,814,292
7. Rated Status	6,627,829,344	6,132,071,567
a) Rated Assets	3,008,053,069	1,775,998,613
b) Unrated Assets	3,619,776,275	4,356,072,954
8. Other assets (Including Fixed Assets)	626,122,954	614,310,027
A. Total Banking Book Assets (1+2+3+4+5+8)	**12,152,251,916**	**12,664,766,959**
B. Trading Book Assets		
1. FC held in Hand	2,112,960	2,142,391
2. FC held in BB & Nostro Account	440,043,209	310,677,448
3. Investment (Trading)	1,075,581,896	-
a) Govt. (Part of Govt. HTM, if held above the required SLR amount)	-	-
b) HFT	1,075,643,396	-
c) AFS (if any)	-	-
B. Total Trading Book Assets (1+2+3)	1,517,799,565	312,819,839
Total Assets (A+B)	**13,670,051,481**	**12,977,586,798**

4. Credit Risk

Overview of the Bank's Credit Risk Management Policy

Credit Risk Management processes encompasses identification, assessment, measurement, monitoring and control of the credit exposures. In the Bank's experience, a key to effective credit risk management is a well thought out business strategy. The Bank's focus over the coming years will be to further enhance risk models, processes and systems infrastructure, in line with its ambition to bring maximum sophistication to risk management function.

The Bank, as per Central Bank Guidelines, has migrated to Basel-II as on March, 2009 with the standardised approach. For credit risk, procedural manual has been developed, which also incorporates a comprehensive system of cross-checks for data accuracy. Simultaneously, processes have been set for fine-tuning systems & procedures, information technology capabilities and risk governance structure to meet the requirements of the advanced approaches as well.

At Bank Alfalah Limited, the management has laid down the road-map to move towards the implementation of Basel-II advanced approaches, which shall provide a sophisticated platform for prudent risk management practices.

The Credit Risk Management comprises of the Credit Risk Department that looks after all the aspects of credit risk and conducts portfolio analysis and stress testing on a regular basis. The Head of Credit Risk Management Department reports to the Country Head. Country Credit Committee Bangladesh (CCCB) has been set up to ensure implementation of the credit risk policy/strategy/credit plan approved by Head Office and to monitor credit risk on a bank-wide basis and ensure compliance with limits approved by the Bank.

The Bank has built-up and maintained a sound loan portfolio in terms of well-defined Credit Policy approved by the board. Its credit evaluation system comprises of well-designed credit appraisal, sanctioning and review procedures for the purpose of emphasising prudence in lending activities and ensuring the high quality of asset portfolio. As part of prudential practices the Risk Management Division conducts pre-fact validation of major cases from integrated risk point of view. The Bank manages its portfolio of loan assets with a view to limit concentrations in terms of risk quality, geography, industry, maturity and large exposure. Internal rating based portfolio analysis is also conducted frequently.

A sophisticated Internal Credit Rating System has been developed by the Bank, which is capable of quantifying counter-party risk in accordance with the best practices. The system takes into consideration qualitative and quantitative factors of the counter- party and generates an internal rating vis-à-vis anticipated customer behaviour. The system is continuously reviewed for best results in line with the Bangladesh Bank's guidelines for Internal Credit Rating. Moreover, the system is backed by secured database with backup support and is capable of generating MIS reports providing snapshot of the entire portfolio for strategising and decision making. The System now also has the capability to auto generate alerts on accounts showing weakness in financials and hence requiring a more vigilant monitoring.

The adherence to Risk-appetite statement approved by the Board is monitored by RMD. Further the compliance of regulatory & internal limits is also monitored and any deviations are ratified from the competent authorities.

Credit Monitoring Division (CMD) keeps a watch on the quality of the credit portfolio in terms of its strengths, weaknesses and vulnerabilities, and identifies weakening accounts relationships and reports it to the appropriate authority with a view to not only arrest deterioration but also to pre-empt any regulatory classification. CMD maintains a Watchlist of such accounts which IS generated on quarterly basis and is also reviewed by RMD.

A Centralized Credit Administration Division under Operations Group is working towards ensuring that terms of approval of credit sanctions and regulatory stipulations are complied, all documentation including security documentation is regular & fully enforceable and all disbursements of approved facilities are made only after necessary authorization by CAD.
Special attention is paid by the management in respect of Non-performing Loans (NPL). Special Asset Management Department is functional and handles this responsibility in compliance with the regulatory requirements. The Risk Management Division also monitors the NPL portfolio of the Bank and reports the same to BRMC.

Proactive credit-risk management practices in the form of Integrated Bank-wide Risk Management and Internal Control Framework, adherence to Basel-II accord, constitute the important risk management measures the bank is engaged in for mitigating these exposures. The current focus is on augmenting the Bank's abilities to quantify risk in a consistent, reliable and valid fashion which will ensure advanced level of sophistication in the Credit Risk measurement and management in the years ahead.

Qualitative Disclosures

Bank Alfalah Limited is using The Standardized Approach (TSA) of BB Basel-II accord for the purpose of estimating Credit Risk Weighted Assets. Under TSA Banks are allowed to take into consideration external rating(s) of counter-party's for the purpose of calculating Risk Weighted Assets. A detailed procedural manual specifying return-based formats, methodologies and processes for deriving Credit Risk Weighted Assets in accordance with the BB Basel-II Standardized Approach is in place and firmly adhered.

External Ratings

Bangladesh Bank Basel-II guidelines require banks to use ratings assigned by specified External Credit Assessment Agencies (ECAIs) namely CRAB, CRISL, ECRL, NCRL, ACRSL, Alpha Credit Rating Limited-ACRL, WASO Credit Rating Company (BD) Limited, Moodys, Fitch and Standard & Poors. The Bank uses these ECAIs to rate its exposures denominated in Bangladeshi currency on certain corporates and banks incorporated in Bangladesh.

The Bank uses external ratings for the purposes of computing the risk weights as per the Basel-II framework. For exposures with a contractual maturity of less than or equal to one year, short-term rating given by approved Rating Agencies is used, whereas for long-term exposure with maturity of greater than one year, long-term rating is used. Where there are two ratings available, the lower rating is considered and where there are three or more ratings the second - lowest rating is considered.

Credit Risk Mitigation Policy

The Bank defines collateral as the assets or rights provided to the Bank by the borrower or a third party in order to secure a credit facility. The Bank would have the rights of secured creditor in respect of the assets/contracts offered as security for the obligations of the borrower/obligor.

Collateral Valuation and Management

As stipulated in the BB Basel-II guidelines, the Bank uses the comprehensive approach for collateral valuation. Under this approach, the Bank reduces its credit exposure to counterparty when calculating its capital requirements to the extent of risk mitigation provided by the eligible financial collateral as specified in the Basel-II guidelines. In line with Basel-II guidelines, the Bank makes adjustments in eligible collaterals received for possible future fluctuations in the value of the collateral in line with the requirements specified by BB guidelines. These adjustments, also referred to as 'haircuts', to produce volatility-adjusted amounts for collateral, are reduced from the exposure to compute the capital charge based on the applicable risk weights.

Types of Collateral taken by the Bank

Bank Alfalah Limited determines the appropriate collateral for each facility based on the type of product and counterparty. In case of small and medium enterprises financing, fixed assets are generally taken as security for long tenor loans and current assets for working capital finance usually backed by mortgage. In case of working capital facilities for large corporate relationships, facilities are also being allowed against creation of charges over current & fixed assets of the respective companies to mitigate any eventuality. For project finance, security of the assets of the borrower and assignment of the underlying project contracts is generally obtained. Other security such as cash collateral, TDRs, charges on receivables are also obtained by the Bank. Moreover, in order to cover the entire exposure Personal Guarantees of Directors are also obtained by the Bank. The valuation of the properties is carried out by an approved independent valuation agency.

The decision on the type and quantum of collateral for each transaction is taken by the credit approving authority as per the credit approval authorization approved by the BoD. For facilities provided as per approved product policies (retail products, loan against shares etc.), collateral is taken in line with the policy.

Types of Eligible Financial Collateral

For credit risk mitigation purposes, the Bank considers all types of financial collaterals that are eligible under BB Basel-II accord. This includes Cash/TDRs, securities issued by Government of Bangladesh such as T-BilIs & T-Bonds, certain debt securities rated by a recognized credit rating agency, and guarantees from certain specified entities. In general, for Capital calculation purposes, in line with the BB Basel-II requirements, the Bank recognizes only eligible collaterals as mentioned in the

BB Basel-II accord.

In addition to collaterals, Guarantees also secure the transactions by reducing credit risk. Where guarantees are direct, explicit, irrevocable and unconditional banks may consider such credit protections in calculating capital requirements through a substitution approach e.g., lower rating/risk weight of guarantor than the counterparty will lead to reduced capital charges.

Credit Concentration Risk

Credit concentration risk arises mainly due to concentration of exposures under various categories viz, industry, geography, and single/group borrower exposures. Within credit portfolio, as a prudential measure aimed at better risk management and avoidance of concentration of risks, the BB has prescribed regulatory limits on banks' maximum exposure to single borrower and group borrowers. Moreover, in order to restrict the industry concentration risk, BAL's annual credit plan spells out the maximum allowable exposure that it can take on specific industries. Additionally, the newly developed Internal Rating System allows the Bank to monitor risk rating concentration of counterparties against different grades/scores ranging from 1—12 (1 being the best and 10—12 for defaulters).

Total Exposures of Credit Risk	**2012 BDT**	**2011 BDT**
1. Funded	**13,793,905,895**	**12,890,073,063**
a) Domestic	13,793,905,895	12,890,073,063
b) Overseas	-	-
2. Non-Funded	**912,791,526**	**1,623,264,381**
a) Domestic	912,791,526	1,623,264,381
b) Overseas	-	-
3. Distribution of Risk Exposure by Claims		
Claims on Sovereigns and Central Banks	6,581,229,644	5,399,467,951
Claims on Banks and Securities Firms	1,483,177,820	2,348,233,363
Claims on Corporate (excl. Medium Enterprise loan)	1,321,121,455	2,492,752,487
Claims on the Retail & Small Enterprises (excl. consumer loan)	173,626,019	280,011,193
Claims secured by residential property	-	20,291,800
Other Categories:	1,218,384,622	1,721,806,866
Past due Loans / NPL	305,593,096	98,542,485
Off-Balance Sheet Items	912,791,526	1,623,264,381
4. Credit Risk Mitigation		
Claims Secured by Financial Collateral	662,121,034	-
Net Exposure after the Application of Haircuts.	4,164,039,264	3,734,056,510
Claims Secured by Eligible Guarantee	-	-
Maturity wise Classification of Loans and advances :		
With a residual maturity of BDT		
Re-payable on Demand	-	-
Not more than 3 months	2,604,650,873	2,185,519,687
Over 3 months but not more than 1 year	2,580,691,562	3,070,145,242
Over 1 year but not more than 5 years	317,252,890	585,140,016
Over 5 years	-	-
	5,502,595,325	**5,840,804,945**
Country-wise Classification of Loans and advances:		
Inside Bangladesh		
Conventional Banking		
Current Finance	2,658,136,643	2,015,667,763
Term Finance	737,874,359	953,512,065

Own acceptance purchased	456,935	-
Credit Card	-	-
Staff Loan	6,651,166	3,730,116
Trust Receipts	127,545,947	256,389,946
	3,530,665,050	**3,229,299,890**
Islamic Banking		
Morabaha (LPO)	1,091,886,265	1,193,645,824
Trust Receipts	141,580,601	153,517,489
Own acceptance Purchased	150,124,460	70,864,900
Payment against documents	-	-
Morabaha Manual	40,761,848	40,761,848
Staff Morabaha	42,716,592	23,887,551
	1,467,069,766	**1,482,677,612**
Outside Bangladesh	-	-
	4,997,734,816	**4,711,977,502**
Bills purchased and discounted (Morabaha export bills) :		
Inside Bangladesh	504,860,509	1,128,827,443
Out side Bangladesh		-
	504,860,509	**1,128,827,443**
	5,502,595,325	**5,840,804,945**

Maturity wise Classification of Bills Purchased and discounted:

Re-payable:-		
Within 1 month	263,667,222	-
Over 1 month but less than 3 months	146,013,846	152,212,885
Over 3 months but less than 6 months	95,179,441	889,116,889
6 months or more	-	87,497,669
	504,860,509	**1,128,827,443**

Sector-wise Classification of loans and advances:

Sectors		
Agriculture, forestry, hunting and fishing	347,979,438	473,962,000
Automobile and transportation equipment	83,488,636	87,979,000
Chemical and pharmaceuticals	383,594,801	445,491,000
Cement	49,558,006	44,100,000
Sugar	56,343,339	114,574,000
Construction	253,789,439	426,178,000
Electronics and electrical appliances	87,298,190	65,267,000
Financial institution	548,983,793	480,820,000
Garments (Knit and woven)	35,343,339	83,576,000
Housing	-	-
Information technology and telecom	198,021,974	304,820,000
Iron and steel	1,110,930,752	628,186,000
Footwear and leather garments	104,003,767	133,710,000
Paper, printing and packaging	102,428,664	108,433,000
Power/electricity, gas, water, sanitary	101,628,731	-
Wholesale and retail trade	36,438,436	153,039,000
Exports and imports	894,818,486	1,322,936,000
Transport, storage and communication	27,428,374	26,934,000
Textile, yarn and spinning	568,126,929	446,707,000

Services	8,952,336	100,450,000
Others	503,437,894	393,642,945
	5,502,595,325	**5,840,804,945**

Grouping of Loans and advances as per Classification Rules of Bangladesh Bank:

Unclassified:		
Standard including staff loan	5,119,400,075	5,715,181,224
Special Mention Account (SMA)	44,021,745	27,081,236
	5,163,421,820	**5,742,262,460**
Classified:		
Substandard	197,067,683	20,842,587
Doubtful	58,801,874	-
Bad or loss	83,303,948	77,699,898
	339,173,505	**98,542,485**
Total	**5,502,595,325**	**5,840,804,945**

Maintenance of Specific Provision

Bank follows BB guidelines regarding loan classifications, provisioning and any other issues related to Non Performing Loan (NPL). Bank's internal credit guidelines also directs on managing of NPL, loan provisioning review procedure, debt write-off, facility grading, reporting requirements, interest recognitions. While dealing with NPL, bank's decision is always complied by local rules and regulations as well as group guidelines which are more conservative than the local regulations.

Specific provision for all classified loan i.e. Sub-standard, Doubtful, and Bad Loss are maintained by the bank as per Bangladesh Bank guideline. In the year Bank provided BDT 7.48 crore for specific provisions.

Policies and processes for maintaining specific provision

Bank mainly maintained specific provision against classified loan accordingly to Bangladesh Bank BRPD Circular No. 19 "Loan Classification and Provisioning" dated December 27, 2012 and BRPD Circular No. 14 "Master Circular: Loan Classification and Provisioning" dated September 24, 2012 and other guidelines time to time issued by the Bangladesh Bank.

Banks maintained specific provision at the following rates in respect of classified Continuous, Demand and Fixed Term Loans:

1. Sub-standard 20%
2. Doubtful 50%
3. Bad/Loss 100%

At the time of determining Gross Income for calculating operational risk, specific provision and other items are grossed up with Net Profit.

	2012	**2011**
	BDT	**BDT**
A. Gross Non Performing Assets (NPAs)		
Non Performing Assets (NPAs) to Outstanding Loans & Advances	6.16%	1.69%
B. Movement of Non Performing Assets (NPAs)		
Opening Balance	83,743,635	92,850,414
Additions	255,429,870	5,692,071
Reductions	-	-
Closing Balance	**339,173,505**	**98,542,485**
C. Movement of Specific Provisions for NPAs		
Opening Balance	31,094,563	22,707,432
Provisions made during the period	43,696,399	-
Write-off	-	-
Write-back of Excess Provisions/Prov. Reversed	-	(3,999,500)
Closing Balance	**74,790,962**	**18,707,932**

5. Market Risk

Qualitative Disclosure

Trading book consists of positions in financial instruments held with trading intent. A capital charge is applicable for financial instruments which are free from any restrictive covenants on tradability in line with Basel-II guidelines issued by Bangladesh Bank. Generally, investments in 'Held for Trading' portfolios are focal parts of the Trading Book. In addition, positions should be valued prudently.

Bank has a comprehensive Treasury and Investment Policy which inter alia covers assessment, monitoring and management of all the above market risks. Bank has defined various internal market risks and is computing the capital requirement as per standardized approach of Basel-II.

Methods used to measure Market risk

Bank defines market risk as the risk of loss in on-balance sheet and off-balance sheet positions arising from movements in market prices. Under market risk management, interest rate risk, equity price risk and foreign exchange risks are monitored. Bank adopted Standardized (rule based) Approach for measuring Market Risks.

Interest Rate Risk

The possibility of a reduction in the value of a security, especially T-Bill & T-Bond, resulting from a rise in interest rates. This risk can be reduced by diversifying the durations of the fixed-income investments that are held at a given time.

Foreign Exchange Risk

The Bank has fixed maximum daylight and overnight exposure for foreign exchange exposures in various currencies. Also, stop loss limit and single deal limits are in place for monitoring the forex operations of the Dealers.

Market Risk Management system

Bank has well defined Risk Management Policy, Investment Policy, Asset-Liability Management Policy etc. which covers important areas of market risk management.

Policies and processes for mitigating market risk

Detailed policies are operational for Investment Management, Asset Liability Management and Market Risk Management, which deal in detail the various strategies and processes for monitoring Market Risk.

In order to deal with the market risk issues, the Bank has in place a Treasury and Investment Policy. The policy details the various tools and guidelines for market risk identification, market risk measurement and risk mitigation. Bank has constituted Asset Liability Management Committee to oversee the Risk Management and ALM functions in the Bank and monitor the progress in its implementation.

Besides these following tools are used for market risk management / mitigation:

(a) Delegation of Powers- Bank has well-defined discretionary powers for different level of authorities of the Bank for taking investment decisions.
(b) Prudential Limits - Various limits such as exposure limit, stop loss limits, duration etc. have been fixed.
(c) Asset Liability Management Committee (ALCO) - Under Risk Management architecture of Bank ALCO committee of executives is constituted and is monitoring management of liquidity and interest rate risk. ALCO support group of executives / officers is constituted to support ALCO.

Quantitative Disclosure	2012 BDT	2011 BDT
Capital Requirements for -		
Interest Rate Risk	3,052,307	3,302,994
Equity Position Risk	-	-
Foreign Exchange Risk	45,016,517	4,824,620
Commodity Risk	-	-
	48,068,824	**8,127,614**

6. Operational Risk

Qualitative Disclosure

Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputation risk.

Policies and processes for mitigating operational risk

Bank has put in place the following measures to control and mitigate operational risks:

- Instructions, circulars, job descriptions, training programmes etc. including Operational and Other Manuals
- Delegation of financial powers at various levels of officers for different type of financial transactions
- Inputs on operational risk are included in the relevant training programmes
- Bank obtains insurance coverage for potential operational risks
- A system of prompt submission of reports on frauds is in place
- A Key Risk Indicator (KRI) module is in place to gauge operational risk against set parameters.
- An automated Operational Loss Database (OPLDB) module provides early warning signals about occurrence of risk events that enable modeling of future operational loss events.

Quantitative Disclosure

	2012 BDT	2011 BDT
Capital Requirements for Operational Risk	61,283,129	47,157,568

7. Internal Capital Adequacy Assessment Process (ICAAP)

ICAAP is a bank's explanation of its internal capital adequacy assessment process. Pillar 2 of Basel-II capital accord links capital requirement more closely to bank's own internal evaluation of risk. Bank Alfalah firmly believes that the spirit of ICAAP lies in the implementation of advanced approaches and hence in order to obtain full benefits of ICAAP, the bank would have to conduct its ICAAP based on the advanced approaches. However, to start with, the bank has based its ICAAP on 'Standardized + Stress Testing' methodology.

Stress tests are an important tool for analyzing a bank's risk profile. As part of the Basel-II implementation, Bangladesh Bank had launched the mandatory stress testing on banks from June 2010 with the objective as to assess the effect of possible unfavorable events on the bank's regulatory capital requirements, internal assessments of its capital needs and earnings. The ICAAP conducted by the bank entails a number of stress tests intended to determine the additional capital needed to ensure that the capital requirement is always complied with, even during severely distressed economic conditions.

The Bank's ICAAP includes an assessment of the capital requirement under Pillar 2 as well as bank's internal evaluation of risks for operational risk. The ICAAP conducted by Bank Alfalah not only ensures that it has sufficient capital in relation to its risk profile but adequate risk management techniques and systems are also being used and further developed by the bank.