Qualitative and Quantitative Disclosures under Pillar -3 of Basel-II

The disclosures (qualitative and quantitative) under the revised Risk Based Capital Adequacy (RBCA) framework as advised by Bangladesh Bank based on the audited financial position of the bank as of 31st December, 2010 are presented below:

a) Scope of Application

b) Capital Structure

c) Capital Adequacy

d) Credit Risk

e) Equities: Disclosures for Banking book positions

f) Interest Rate Risk in the Banking Book (IRRBB)

g) Market Risk

h) Operational Risk

A) Scope of application

Qualitative Disclosures

a) The name of the top corporate entity to which this framework applies: **Al-Arafah Islami Bank Limited.**

b) Consolidation for accounting purposes

Consolidated financial statements are the financial statements of a group (parent and subsidiaries) presented into one. This offers the benefit of viewing the whole group's combined financial information together to see how all companies are doing jointly.

A group consists of a parent entity and all its subsidiaries. The control exercised by the parent entity is the power to govern the financial and operating policies of the subsidiary (ies) so as to obtain benefits from its activities.

Scope

Consolidated financial statements represent combination of the financials of all subsidiaries of the parent entity. This consolidation is required when a parent owns 50 percent or more shares in the subsidiary (ies) with controlling authority.

Procedures

In preparing consolidated financial statements, an entity combines the financial statements of the parent entity and its subsidiaries and the items covered are mainly assets, liabilities, equity, income and expenses. However intra group balances, transactions, income and expenses are eliminated in full.

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are of the same date. Consolidated financial statements are prepared using uniform accounting policies for both the parent entity and the subsidiary (ies).

Minority interest is presented in the consolidated statement of financial position within equity segment but separately from the equity of the owners of the parent entity.

Consolidation for regulatory purposes

Banks having subsidiaries have been advised to consolidate their financial statements following accounting standards as set by the regulators to assess capital adequacy. As such the bank has prepared capital adequacy report on Solo basis as well as on consolidated basis.

If subsidiaries financials are not consolidated with that of the Bank, investments in subsidiary (ies) by the bank will be deducted at 50% from Tier 1 and 50% from Tier 2 capital of the bank. The assets representing the investments in subsidiaries whose capital had been deducted from that of the parent would not be included in total assets for the purposes of computing CAR.

Al-Arafah Islami Bank Limited is the parent company of AIBL Capital Market Services Limited which is established on 21st September 2010 to perform merchant banking activities in Bangladesh. A brief description of AIBL Capital Market Services Limited is as follows:

Name	:	AIBL Capital Market Services Limited
Date of Incorporation	:	21st September, 2010
Date of Commencement	:	21st September, 2010
Authorised Capital	:	Tk. 1,000 crore
Paid up Capital	:	Tk. 400 crore
Ownership	:	Tk. 207.00 crore (51.75%)

Quantitative Disclosures:

Al-Arafah Islami Bank Limited has one subsidiary: Al-Arafah Islami Bank Limited and the assets and liabilities of this subsidiary are consolidate with the financial of the parent company.

B) Capital structure

Qualitative Disclosures:

a) The regulatory capital under Basel-II is composed of

(I) Core Capital (Tier-1),

(II) Supplementary Capital (Tier-2)

(III) Additional Supplementary Capital (Tier-3) [only for market risk],

Tier-1 capital comprises highest quality capital items which are permanent in nature and allows a bank to absorb losses on an ongoing basis and includes paid-up capital, statutory reserve, general reserve, retained earnings, minority interest in subsidiaries,

Tier-2 capital lacks some of the characteristics of the core capital but bears loss absorbing capacity to a certain extent General provision, revaluation reserves etc are part of Tier 2 capital.

Tier-1 capital of the bank as of December 31, 2010 is Tk. 958.28 crore which is 91.15 % of total eligible capital and out of total Tier 1 capital 48.81 % is paid up capital & 17.55 % is statutory reserve. Tier-2 capital of the bank which is Tk 93.00 crore constituting 8.85 % of total eligible capital and the major contributors are general provision 96.53% & asset revaluation reserves 3.47 %.

The bank has already increased its Tier-1 capital by issuing right shares worth Tk.233.86 crore in 2010.

Qualitative Disclosures:

	Figures in crore taka
b) The total amount of Tier-I capital	**958.28**
Paid-up capital	467.73
Non- repayable share premium account	-
Statutory Reserve	168.18
General Reserve	-
Retained earnings	127.48
Minority interest in subsidiaries	194.89
Non cumulative irredeemable preference shares	-
Dividend equalization account	-
c) The total amount of Tier-2 and Tier-3 capital	**93.00**
d) Other deductions from capital	**-**
e) Total eligible capital	**1051.28**

C) Capital Adequacy

Qualitative Disclosures:

a)To calculate Minimum Capital Requirement (MCR) under pillar-I of Basel-II framework as per the guideline of Bangladesh Bank, Al-Arafah Islami Bank Limited is presently following Standardized Approach for assessing and mitigating Credit Risk, Standardized Rule Based Approach for quantifying Market Risk and Basic Indicator Approach for Operational measurement.

Quantitative Disclosures:

	Figures in crore taka
b) Capital Requirement for Credit Risk	596.82
c) Capital Requirement for Market Risk	9.56
d) Capital Requirement for Operational Risk	47.53
Total Requirement	**652.91**
e) Total and Tier 1 capital ratio:	
o For the consolidated group:	
- CAR	14.49%
- Tier- 1 Capital Ratio	13.21%
o For stand alone	
- CAR	12.56%
- Tier-1 Capital Ratio	11.01%

D) Credit Risk

Qualitative Disclosures:

a) Definition of past due and impaired assets (for accounting purposes)

A loan payment that has not been made as of its due date is termed as past due. Payment may be made for repayment/ renewal/rescheduling or as an installment of a claim.

The past due claims are discussed below:

Special Mention Accounts (SMA):

A claim which is overdue for 90 days or more will be classified as Special Mention Account.

When a loan is classified as SMA, it needs constant monitoring and supervision as the repayment probability decreases.

Sub-Standard (SS):

The repayment of the loan has been put in doubt but the recovery is not unlikely.

Doubtful (DF):

There is less possibility of recovery of the overdue amount and probability of loss is high.

Bad /Loss (B/L):

These are the loans which have almost turned unrecoverable.

Approaches followed for specific and general allowances:

I) Specific provision:

Substandard	:	20%
Doubtful	:	50%
Bad/Loss	:	100%

Ii) General Provision:

a) 1% to 5% on different categories of unclassified loans.

b) 1% on Off Balance sheet exposure.

c) 5% on the outstanding amount of loans kept in the 'Special Mention Account' after netting off the amount of Interest Suspense.

For classification of loan, specific and general allowances the bank follows Master Circular-Loan Classification and Provisioning vide BRPD circular no-05 dated June 05, 2006; and as advised by Bangladesh Bank from time to time.

In addition to the above mentioned objective criteria, loans can be classified on the basis of subjective judgment taking into consideration the factors such as uncertainty or doubt of repayment, continuous loss of capital, adverse situation, decrease of value of securities, legal suit etc.

However, Bangladesh Bank can classify any claim on the basis of their subjective judgment as well as can ask the Bank to buildup additional provision on non-performing loans.

Credit Risk Management Policy

The bank has established Credit Risk Management framework as directed by Bangladesh Bank through introduction or Risk Management (CRM) policy guide along with implementation of the Credit Risk Grading (CRG). This framework defines CRM structure, role, responsibilities and the processes to identify, quantify, and manage risk within the framework under the given policy .The CRM policy is reviewed from time to time for adoption of new techniques/policies for measurement and management of risk in line with the socio-economic scenario and investment environment of the country.

Quantitative Disclosures:

	Figures in crore taka
a) Funded:	
General Investment	
i) In Bangladesh	1,792.47
Murabaha Investment	2,166.54
Bai-Muajjal Investment	886.76
Hire Purchase Investment	82.77
Pre shipment Investment	98.73
Quard	0.15
Sub Total	5,027.42
ii) Out side Bangladesh	-
Total	5,027.42
Less Unearned Profit on Investment	312.08
	4,715.34
Bill Purchased & Discount	
Payable in Bangladesh	609.54
Payable out side Bangladesh	33.42
Sub Total	642.96
Total Funded	**5,358.30**
b) Total Non Funded:	933.14
c) Geographical distribution of exposures	
Region Based	
Dhaka	3,954.09
Chittagong	965.97
Sylhet	46.01
Rajshahi	395.49
Khulna	252.81
Barisal	56.01
Sub Total	**5,670.38**
Less Unearned Profit on Investment	312.08
Total	**5,358.30**
d) Country based	
Domestic	5,358.30
Overseas	-
e) Major Industry wise distribution of exposures	
Agriculture, Fishing and Foresty	68.54
Industry	1,427.70
Construction	251.29
Water works & Sanatary Service	10.22
Transport & communication	153.58
Storage	1.80
Trade Finace	3,278.60
Miscellaneous	478.65
Total	5,670.38
Less Unearned Profit on Investment	312.08
Total	**5,358.30**

f) Residual contractual maturity breakdown of the whole portfolio

Repayable on demand	-
Up to 1 month	350.19
More than 1 month but less than 3 months	450.86
More than 3 months but less than 1 year	1,874.37
More than 1 year to less than 5 year	1,682.63
More than 5 year	1,000.26
Total	**5,358.30**
g) Gross Non Performing Assets- (NPAs)	61.04
Non performing assets to outstanding Investment (loans and advances)	1.14%
h) Movement of Non Performing Assets (NPAs)	
Opening balance	60.81
Additions	23.09
Reductions	22.85
Closing balance	61.05
i) Movement of specific provisions for NPAs	
Opening balance	17.31
Fully Provision Debt Written off	(6.55)
Provision made during the period	0.66
Recoveries of amount previously write off	2.33
Closing balance	**13.75**

E) Equities: Disclosures for Banking Book Positions

Qualitative Disclosures:

a) The bank holds unquoted equities intent of which is not trading and the same are shown as banking book asset in balance sheet. As these securities are not quoted or traded in the bourses they are shown in the balance sheet at the cost price and no revaluation reserve has been created against these equities.

Quantitative Disclosures:

b) Values of investments (for unquoted securities) as disclosed in the Balance Sheet:

Figures in crore taka

Name of the Scrip .	value
Central Depository Bangladesh Ltd	0.88
Total	0.88

c) As investment in unquoted equities does not have any maturity, we have calculated capital charge on the basis of its risk weight which is 125% of investment value.

F) Interest Rate Risk in the Banking Book (IRRBB)

Qualitative Disclosures:

Interest rate risk is the exposure of a bank's financial condition due to adverse movements in interest rates. Changes in interest rates affect a bank's earnings by changing its net interest income and the level of other interest sensitive income and operating income. Changes in interest rates also affect the underlying value of the banks assets, liabilities and off-balance-sheet instruments because the economic value of future cash flows changes when interest rates change.

Interest rate risk in the banking book can be measured on the basis of:

1) Earning perspective-net interest income earned in the given reporting period

2) Economic value perspective- net interest income measured in a given point in time such as Economic Value of Capital

Quantitative Disclosures:

Maturity GAP on Banking Book Assets & Liabilities
As on December 31, 2010

Figure in crore taka

Particulars	Up to 1 month	1 to 3 month	3 to 12 month	I to 5 years	Above 5 years	Total
Asset						
Cash in hand	424.58	-	-	-	-	424.58
Balance with other banks & Financial Institute	0.53	28.19	-	-	-	28.72
Placement with other banks & Financial Institute	90.00	230.00	500.00	-	-	820.00
Investment in Sharea & Securities (only HTM)	-	-	-	210.00	0.88	210.88
Investment (Loans and Advances)	350.19	450.86	1,874.36	1,682.63	1,000.25	5,358.29
Fixed Assets				32.89	32.65	65.54
Other Assets	21.79	31.03	32.89	125.66	222.43	433.80
Total	887.09	740.08	2,407.25	2,051.18	1,256.21	7,341.81
Liabilities						
Placement from other banks & Financial Institute	118.00	70.00	380.00	-	-	568.00
Deposits	558.38	569.53	1,915.97	2,059.67	193.85	5,297.40
Provision and other liabilities	74.80	47.01	95.11	125.23	226.84	568.99
Deferred Tax Liabilities/Assets	-	-	1.36	-	-	1.36
Total	751.18	686.54	2,392.44	2,184.90	420.69	6,435.75
GAP	135.91	53.54	14.81	(133.72)	835.52	906.06
Cumulative Gap	135.91	189.45	204.26	70.54	906.06	

Impact of Upward Interest Rate on Banking Book for One Year in Different Time Buckets

Figure in crore taka

Particular/ shock	Minor	Moderate	Major
Increase in interest rate	1.00%	2.00%	3.00%
Period	Upto 1 month		
Gap	135.91	135.91	135.91
Impact on Nil (Net Interest Income)	0.11	0.23	0.34
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	0.07	0.13	0.20
Period	1 to 3 month		
Gap	53.54	53.54	53.54
Impact on NII(Net Interest Income)	0.09	0.18	0.27
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	0.05	0.10	0.15
Period	3 to 12 month		
Gap	14.81	14.81	14.81
Impact on NII(Net Interest Income)	0.11	0.22	0.33
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	0.06	0.13	0.19

Impact of Downward Interest Rate on Banking Book for One Year in Different Time Buckets

Figure in crore taka

Particular/ shock	Minor	Moderate	Major
Decrease in interest rate	(1.00%)	(2.00%)	(3.00%)
Period	Upto 1 month		
Gap	135.91	135.91	135.91
Impact on Nil (Net Interest Income)	(0.11)	(0.23)	(0.34)
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	(0.07)	(0.13)	(0.20)
Period	1 to 3 month		
Gap	53.54	53.54	53.54
Impact on Nil (Net Interest Income)	(0.09)	(0.18)	(0.27)
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	(0.05)	(0.10)	(0.15)
Period	3 to 12 month		
Gap	14.81	14.81	14.81
Impact on NII(Net Interest Income)	(0.11)	(0.22)	(0.33)
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	(0.06)	(0.13)	(0.19)

Impact of Upward Interest Rate on Banking Book for up to One Year (Cumulative)

Figure in crore taka

Particular/shock	Minor	Moderate	Major
Increase in interest rate	1.00%	2.00%	3.00%
Gap	204.26	204.26	204.26
Period(Year)	1 Year		
Impact on Nil (Net Interest Income)	2.04	4.09	4.13
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	1.17	2.35	3.52

Impact of Downward Interest Rate on Banking Book for up to One year (Cumulative)

Figure in crore taka

Particular/shock	Minor	Moderate	Major
Decrease in interest rate	(1.00%)	(2.00%)	(3.00%)
Gap	204.26	204.26	204.26
Period(Year)	1 Year		
Impact on Nil (Net Interest Income)	(2.04)	(4.09)	(6.13)
Applicable tax rate	42.50%	42.50%	42.50%
Tax adjusted impact on Nil	(1.17)	(2.35)	(3.52)

G) Market Risk

Qualitative Disclosures:

a) View of the Board of Directors on trading/investment activities:

Trading book consists of positions in financial instruments held with trading intent or in order to hedge other elements of the Trading Book. The portfolio of investment includes Government Treasury Bills and Bonds, Prize Bonds, Shares of listed Public Limited Companies etc. Bank always desires to invest in high yield areas and also has ensured maintenance or Statutory Liquidity Requirements (SLR) as fixed by Bangladesh Bank.

Methods used to measure Market Risk:

Market risk is the possibility of losing assets in the balance sheet and off- balance sheet positions due to volatility in the market variables viz. interest rate, foreign exchange rate, reinvestment and price. The bank measures impact on profitability and impact on asset prices under market risk through Maturity GAP Analysis, Sensitivity Analysis, VAR, Mark to Market and has adopted Standardized Measurement approach for measuring Market Risks under Basel-II

Market Risk Management System:

The Bank has its own Market Risk Management System which includes Asset Liability Risk Management (ALM) and Foreign Exchange Risk Management under core risk management guidelines.

Policies and processes for mitigating market risk:

- Risk Management and reporting is based on parameters such as Duration, PV, Exposure and Gap Limits, VaR etc, in line with the global best practices.
- Risk Profiles are analyzed and mitigating strategies / processes are suggested by the Asset Liability Committee (ALCO). Their effectiveness is monitored on an on-going basis.
- Forex Open Position limits (Day limit / Overnight limit), Deal-wise cut-loss limits, Stop-loss limit, Profit / Loss in respect of cross currency trading are properly monitored and exception reporting is regularly carried out.
- Holding of equities is monitored regularly so that the investment remains within the limit as set by Bangladesh Bank.
- Asset liability management committee (ALCO) analyzes market and determines strategies to attain business goals.

Quantitative Disclosures:

b) The capital requirements for:

	Figures in crore taka
Interest rate risk	-
Equity position risk	3.06
Foreign exchange risk	6.50
Commodity risk	-
Total	**9.56**

H) Operational risk

Qualitative Disclosures

a) View of the Board of Directors on system to reduce Operational Risk:

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.

Al-Arafah Islami Bank Limited has established an effective integrated operational risk management framework to mitigate the operational fist; The focus of operational risk is on low probability/high loss vs. high probability/low loss events.

Performance Gap of Executives and Staffs:

The bank offers competitive pay package to its employees based on performance and merit. It always tries to develop corporate culture where employees can exert their highest involvement and commitment to work and organization with high ethical standards in order to build a congenial atmosphere.

Policies and processes for mitigating operational risk:

The Bank has adopted policies which deal with managing different operational risk. Internal control and compliance-division in conjunction with the Risk Management Unit (RMU) has been performing the supervisory and monitoring, works to manage operational risk.

Approach for calculating capital charge for operational risk:

The Bank has adopted Basic Indicator Approach (BIA) to compute capital charge against operational risk under Basel -II as per Bangladesh Bank Guidelines.

Quantitative Disclosures:

	Figures in crore taka
b) The capital requirements for operational risk	**47.53**

Calculation of Capital Charge for Operational Risk
Basic Indicator Approach

Year	Gross Income (GI)	Average GI	15% of Average GI
Dec-08	217.14	316.83	47.53
Dec-09	269.35		
December 2010	464.01		
Total GI	950.5		