



**BASEL- II PILLAR III
QUALITATIVE DISCLOSURES**

31 DECEMBER 2010

Table of contents

<u>Contents</u>	<u>Page</u>
1. GENERAL	1
2. SUBSIDIARIES & SIGNIFICANT INVESTMENTS	1
3. BANK'S CAPITAL STRUCTURE	2
4. BANK'S CAPITAL ADEQUACY	2
5. BANK'S RISK MANAGEMENT	2
6. BANK'S CREDIT EXPOSURES	8
7. EXTERNAL CREDIT ASSESMENT INSTITUTIONS (ECAIs) USED	10
8. CREDIT RISK MITIGATION	10
9. COUNTERPARTY CREDIT RISK	10
10. MARKET RISK CAPITAL CALCULATION	11
11. OPERATIONAL RISK CAPITAL CALCULATION	11
12. EQUITIES (BANKING BOOK POSITIONS)	11
13. BANKING BOOK INTEREST RATE RISK	12

1. GENERAL

Under the directives of Saudi Arabian Monetary Agency (SAMA), banks operating in the Kingdom of Saudi Arabia, implemented new Basel framework commonly known as Basel II framework, with effect from 1 January 2008. In this regard, SAMA's aim is to encourage market discipline through disclosures, which will provide the reader more valuable information about the banks' risks and exposures. Based on this, below are the necessary disclosures required under Basel II Accord's Pillar 3 framework.

2. SUBSIDIARIES & SIGNIFICANT INVESTMENTS

- i) SAMA disclosure requirements apply to Arab National Bank (ANB), as well as to its subsidiaries. A brief description of the bank's subsidiary is as follows:

Arab National Bank Investment Company (ANBI):

A wholly owned (directly and indirectly) Saudi limited liability company, registered in the Kingdom of Saudi Arabia under commercial registration No. 1010239908 issued on 26th Shawal 1428 (corresponding to 7th November 2007). The main activities are to provide investment services and asset management activities related to dealing, managing, arranging, advising and custody of securities regulated by the Capital Market Authority. The subsidiary commenced its operations effective 3rd Muharram 1429 (corresponding to 12th January 2008). Accordingly, ANB started consolidating the financial statements of the above mentioned subsidiary effective 12th January 2008.

Arabian Heavy Equipment Leasing Company:

A 62.5 % owned subsidiary incorporated in the Kingdom of Saudi Arabia, as a Saudi closed joint stock company, under commercial registration no. 1010267489 issued in Riyadh dated 15th Jumada 1, 1430 (10th May 2009). The company is engaged in leasing of heavy equipments and operating in compliance with Shariah principals. The Bank started consolidating the subsidiary's financial statements effective 10th May 2009, when the subsidiary started its operation.

Apart from this, the Bank has made investments in equity in the following entities, which are more than 10%. As per SAMA Basel-II Stipulations, 50% of the equity investment is deducted each from Tier 1 capital and Tier II capital.

Saudi Home Loan Company (SHL):

SHL is a Saudi limited liability company owned 40% by ANB and the remaining 60% by Dar Al Arkan Real Estate Development Company (DAAR), International Finance Corporation (IFC) and Kingdom Installment Company (KIC).

SHL was established as a specialized Islamic home finance company within the Kingdom of Saudi Arabia. Products and services are fully Shari'ah compliant. The company's authorized capital is SAR 2 billion, out of which a total amount of SAR 800 million (ANB's Share 320 million) was paid by the shareholders as of 31st December 2010.

Ejar Cranes & Equipment LLC (Ejar):

ANB has 16.67% (SAR 75 million) ownership interest in the Company. Ejar is a dedicated crane leasing company, which was founded in Dubai at the end of 2006. The company is a joint venture between a number of regional companies involved in providing plant machinery, and specifically cranes. As of 31st December 2010, ANB's paid capital in Ejar reached SAR 64 million.

- ii) Restrictions and impediments on transfer of funds.
There are no restrictions or major impediments on transfer of funds or regulatory capital between the Bank and its fully owned subsidiary, apart from obtaining SAMA approval, when required.

3. BANK'S CAPITAL STRUCTURE

The bank's capital comprises of:

Tier 1 capital which is the core measure of a bank's financial strength from a regulator's point of view. It comprises paid up capital, eligible reserves, retained earnings and adjustments to the effect of IAS-Type valuation on securities held for sale and with 50% deduction of significant minority investment at 10% and above.

Tier II capital, comprises subordinated loan capital, qualifying general provisions with 50% deduction of significant minority investment at 10% and above.

During 2006, ANB issued USD 500 million 10 year subordinated floating rate notes under its USD 850 million Euro Medium Term Note program. The notes carry a special commission rate of Libor plus 83 bps. The notes are non-convertible, unsecured and listed on the London stock exchange. These notes are callable after 5 years from issuance. During 2009, USD 50 Million was purchased from the secondary market & retired.

4. BANK'S CAPITAL ADEQUACY

ANB has established Internal Capital Adequacy Assessment Committee (ICAAC) with the mandate to monitor and ensure that the Bank has adequate capital to support all the risks inherent in its current and future business plans.

ANB's capital adequacy process *inter-alia* includes identification and assessment of all types of material risks, and ensures that besides having enough capital to cover these risks, adequate policies, processes and internal controls are in place to manage these risks in a timely manner. ANB's capital requirements are driven by its specific risk profile and impact its portfolio composition and financial position. While ANB has adhered to the Pillar-I capital calculation methodologies under the Standardized Approaches, as per the guidelines issued by SAMA, it has developed its own methodologies for assessing and allocating capital for Pillar-II risks. At the same time, various stress-testing scenarios are applied to arrive at the stressed capital ratios, with a view to ensure that ANB remains adequately capitalized under stressed conditions during economic down-turns.

As a prudent measure, ANB intends to operate at a certain percentage over and above the minimum capital adequacy requirements of 8% (as stipulated by SAMA), for Pillar-I and II risks, calculated on both Tier 1 & 2 capital. Target and trigger mechanisms are in place to ensure immediate corrective actions, once trigger point is reached, either through decrease in assets/risk profile and/or increase in capital.

5. BANK'S RISK MANAGEMENT

ANB has an independent Risk Management Group, which reports to the Managing Director. The Group is responsible for overall enhancement of the risk culture within the Bank by encouraging open communication with other business/supporting units and developing techniques in alignment with best practices for risk management as well as in compliance with local regulatory requirements.

Risk Management Group has the following five major Departments:

1. Credit Risk
2. Market Risk
3. Operational Risk
4. Credit Admin & Control (CAC)
5. Business Continuity Management (BCM)

5.1 Credit Risk

Credit Risk Department manages the credit exposures arising principally from lending activities. Such lending activities may include loans, advances as well as exposures arising from off-balance sheet financing instruments such as commitments, guarantees and letters of credit.

5.1.1 Strategies and Processes

Credit Risk policies and procedures are established to provide control on credit risk portfolios through periodic assessment of the credit worthiness of obligors, quantifying maximum permissible exposure to specific obligor and continuous monitoring of individual exposures and portfolios.

The Credit Risk policy of the Bank is designed to ensure clear recognition of credit risk management strategies and objectives, which include:

- Strengthening and enhancing Bank's ability to measure and mitigate credit risks on pre-emptive basis to minimize credit losses.
- Strengthening and enhancing Bank's systems and procedures for early problem recognition.
- Strengthening and enhancing credit portfolio management process.
- Compliance with local regulatory requirement and industry's best practices for credit risk management.

The Bank's Credit Risk policy addresses all functions and activities related to the credit lending process, starting from defining the minimum required information for assessing obligor credit worthiness and ending with clear risk-based approval authority mechanism.

5.1.2 Structure & Organization

An independent Credit Risk Department, part of Risk Management Group, is responsible for Policy formulation and Portfolio management for all type of credit risks undertaken by the bank. Furthermore, Credit Group comprising of Credit Review Department has specialized teams for Corporate/Commercial and Retail business units, and are responsible for conducting independent financial analysis and appraisals of Credit proposals, submitted by the respective business units.

ANB has a centralized credit approval process and follows the philosophy of joint approval authority, which is directly linked to the borrower's Probability of Default (PD) and its facility characteristics measured by Loss Given Default (LGD) estimates. Based on afore-

mentioned factors, there are three main layers of approval authorities, and the highest credit authority is vested in the Executive committee, having five Board members, including MD, as its members. The second level of credit approval authority is vested in the Senior Credit Committee, which comprises of MD, Head of Credit Review Division and three or more senior managers of the Bank. The third layer consists of the four levels of approval authorities, which draws its members from the business units and the Credit Review Division.

5.1.3 Risk Measurement & Reporting System

The Bank's loan portfolio can be broadly divided into the following two categories:

A) Corporate and Commercial Loans Portfolio:

Credit Risk tracks trends and identifies weaknesses in the quality of corporate and commercial loans portfolio by employing:

- Obligor & facility risk rating system to assess the quality of obligor and riskiness of facilities.
- Periodic reviews and reporting of aggregate statistics on asset diversification and credit quality for key segments of the portfolio.

Rating system is established with the objective to:

- place the responsibility on business units to regularly evaluate credit risk on exposures and identify problems within their portfolios;
- establish early warning signals for detecting deterioration in credit quality;
- set standard for business units to submit their inputs on problematic exposures;
- provide guidelines to respond and take remedial actions as soon as deterioration in credit quality is detected.

The Bank classifies its exposures into 13 risk categories, of which 10 are for performing obligors and 3 are for non-performing obligors.

Periodic reviews & reporting standards are established to monitor Corporate and Commercial credit portfolio quality and diversification. Regular monthly and quarterly reports are sent to Senior Management/Board's Executive Committee, covering the following:

- Total possible exposure and actual outstanding amount;
- Amount and percentage of exposure outstanding in each risk classification grade;
- Obligor's exposure migration across risk grades from one period to another;
- Overall portfolio risk grade by Region/Business units.

B) Consumer Assets Loans Portfolio:

The major part of Bank's consumer loans and credit card exposures are against salary assignments, and borrowers are employees of selective list of acceptable employers. The consumer

loans' portfolio is driven by strict lending criteria in the form of minimum salary requirements, length of service and pre-specified Debt Service Ratio (DSR).

Periodic reviews & reporting mechanism is in place to monitor the Consumer assets loans portfolio quality and diversification, covering the following:

- Consumer Assets loans portfolio growth from one period to another.
- Consumer Assets loans portfolio distribution by employer.
- Consumer Assets loans portfolio distribution by delinquencies (days past due bucket wise).
- Amount of losses charged-off.

5.1.4 Hedging and Mitigants

Although collaterals and securities are always desirable, being an effective means of reducing risk and enhancing credit quality, however Bank's credit risk policy does not encourage granting credit exposures solely based on collaterals. Collaterals are viewed as a secondary source of repayment or way out in the event that the customer is facing difficulty in repaying the granted credit from its cash flows. The Bank's policy is that credit facilities should always be able to stand on their own (successful repayment from operational cash flows) without relying on the collateral as the primary source of repayment.

The Bank's policy is to consider a credit exposure secured, if it is fully supported by tangible collateral/security and in accordance with minimum requirement in terms of coverage ratios as detailed under:

<u>Type of tangible Collateral Security</u>	<u>Minimum collateral required</u>
Cash Margin	100% of the facility limit
Bank Guarantees	100% of the facility limit
Pledged shares: Corporate/Commercial	150% of the facility limit
Pledged shares: Margin Trading customers	200% of the facility limit
Transfer of Title Deeds	200% of the facility limit

All collaterals and securities are evaluated periodically to ensure that the collateral/security market value against credit exposures are in line with the stipulated coverage ratios. ANB has identified a selective list of companies based on strict criteria, whose shares are accepted as collateral. For Real Estate properties offered to the bank as collateral, the security must be appraised by accredited real estate offices appointed by the Bank prior to giving any acceptance/commitment to the borrower.

Bank Guarantees, held as collateral, should meet strict criteria for acceptance, which includes being unconditional & irrevocable, issued by banks, acceptable to ANB.

As a matter of policy all collaterals should be in the same currency as the underlying credit exposure. Exceptions are made on case-by-case basis with appropriate justification and mitigants.

5.2 MARKET RISK

The primary objective of ANB's market risk management function is to provide a coherent policy and operating framework for a strong Bank-wide management of market risk and liquidity risk.

5.2.1 Strategies and Processes

The Board approves the market risk appetite, in terms of limits, for all types of market risks including foreign currency risk, interest rate risk and equity risk. These limits are either based on notional amount, sensitivity and/or VaR (Value at Risk). The Board has also approved a comprehensive corporate governance frame-work for market risk which includes market risk policy manual that provides guidance to identify, measure and monitor the bank's exposure to market risk.

Liquidity management policy and liquidity limits ensure that liquidity is maintained at sufficient levels to support operations and meet payment demands even under stressed conditions that might arise with a sudden change in the market environment. The bank has also in place a comprehensive stress testing policy and liquidity contingency funding plan.

5.2.2. Structure & Organization

Market Risk Department, which is independent of the business function, monitors all limits and provides periodic market risk reports to ALCO and MRPC members. Market risk and Liquidity risk are overseen by two senior management committees – Asset Liability Committee (ALCO) and Market Risk Policy Committee (MRPC), both headed by MD as the Chairman. ALCO deals with Bank-wide market risk issues as opposed to MRPC, which deals with Treasury specific issues. ALCO meets on a regular basis to discuss the risk exposures vis-à-vis the prevailing market conditions and sets guidelines to manage these risks within the risk appetite set by the Board.

5.2.3. Scope and Nature of Reporting System

Daily Risk Report is provided to Senior Management that covers the trading activity and liquidity ratios. Stress testing for interest rate risk, foreign exchange risk and liquidity risk is conducted on a regular basis and results are presented to ALCO for review. A detailed market risk review is submitted to the Board and Audit Committee on a quarterly basis highlighting major changes in investments portfolio and risk exposures during the quarter.

5.2.4 Hedging and Mitigants

Bank has implemented a dynamic interest rate hedging policy in accordance with the International Accounting Standards. Interest rate derivatives mainly interest rate swaps and futures are used to hedge specific exposures and to keep the interest rate risks within limits. The bank also uses currency swap to hedge specific positions in foreign currencies, when necessary. Effectiveness of all hedges is regularly monitored throughout their term.

5.3 Operational Risk Management

Operational risk is an integral part of ANB's business. ANB defines Operational Risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. Operational risk includes legal and regulatory risk, but excludes strategic and reputational risk.

5.3.1 Strategies & Processes

The operational risk management objectives support ANB's vision through efficient and effective operational processes. Operational risk management aims to:

- Develop a common understanding of Operational Risk across the Bank, so as to assess exposure of businesses to operational risk and take appropriate actions.
- Ensure that there is clear accountability, responsibility and adherence to best practices for management and mitigation of operational risk.
- Help the Business Units to improve internal controls, thereby reducing the probability and potential impact of operational risk losses.
- Minimize losses and customer complaints due to failures of processes.

5.3.2 Structure & Organization

ANB monitors its operational risks through an Operational Risk Management (ORM) framework that defines roles and responsibilities for managing and reporting operational risk.

The governance framework includes Board and Senior Management oversight, risk reporting, escalation and independence of the Operational Risk function. The governance structure has been formed to support the effective management of ORM functions carried out across the Bank. The Bank has established Operational Risk Steering Committee (ORSC) to oversee the activities of Operational Risk. To ensure that highest level of governance is maintained, Internal Audit Division conducts independent assessment and assurance of the activities carried out and reports directly to Audit Committee of the Bank.

5.3.3 Measurement & Reporting System

ANB has established Control and Risk Self Assessment (CRSA) framework to identify the operational risks that arise from business strategy, products & activities, and to evaluate the effectiveness of controls over those risks. These risk are tested and monitored by the business units on a regular basis. The consolidated assessment results are benchmarked with pre-defined risk appetite/acceptable level and appropriate actions initiated to strengthen the control environment. Historical internal loss events and internal audit issues support the completeness and accuracy of the CRSA. An independent review and challenge process also assists in ensuring completeness, accuracy and consistency across the Bank.

The goal of operational risk reporting is mainly to spread awareness of operational risk within the bank. Regular reporting of pertinent information to ORSC/Senior Management supports proactive management of operational risk and helps in identifying problem areas, putting in place corrective action plans and monitoring of outstanding issues.

5.3.4 Hedging & Mitigants

ANB's Loss data management system allows collection and analyzing of loss events (near. miss, actual and potential), identifies new risks or control weaknesses that caused the operational loss, escalating them to appropriate levels of management and to ORSC. The mechanism aims at minimizing any financial consequences of the events and addressing the root causes for refining the control mechanism to reduce re-occurrence of similar losses in future.

5.4 Credit Admin & Control

Credit Admin & Control (CAC) is responsible for ongoing administration of the credit portfolio, which *inter-alia* includes Limit monitoring, Disbursement authorization, Collateral coverage & monitoring; Compliance with terms of approval, Preparation, maintenance and custody of collateral security documentation, Credit checking and Follow up on credit irregularities.

5.5 Business Continuity Management

The mission of Business Continuity Management (BCM) is to plan for the Bank continuing to function as a viable business entity, during a disaster or serious business disruption, and providing for the orderly restoration of essential business services, at the earliest possible time.

BCM achieves its objective by conducting business impact analysis, working with all essential business and support units within the Head Office to identify the impact of disruptions and to prioritize the critical business processes. BCM has developed recovery plans for all critical business processes, defining the level of recovery and resumption service to be offered during a crisis, which has already been tested. A Crisis Management plan has also been developed to define crisis invocation procedures and the roles/responsibilities of crisis management teams.

6. BANK'S CREDIT EXPOSURES

6.1 Definition of Past Due

Exposures that are not settled on their due date are classified as "Past Due" and reflected as such on the Bank's books the following day. The appearance of a loan on the past due list on the day after its due date, by itself, does not imply that there is a problematic credit, as the business units often successfully prompt the customers to settle the amounts within a few days.

6.2 Definition of Impaired Assets:

In determining whether a corporate exposure has become impaired, the Bank makes judgments as to whether there is any observable data indicating decrease in the estimated future cash flows. This evidence may include an indication that there has been an adverse change in the payment status of borrowers. Management uses estimates based on historical loss experience for loans with

similar credit risk characteristics, when estimating the cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

6.3 Definition of Non Performing Assets:

Exposures are classified as non-performing and are placed on the non-accrual status in the following cases:

- The principal of loan or interest payment remains past due more than 90 days after its due date.
- The balance of an overdraft account remains in-active for more than 180 days.

The non-performing exposures migrate across the non-performing risk grades (Substandard, Doubtful, and Loss) according to their days past due and/or deterioration in credit quality.

6.4 Approaches for Specific & General Provisions:

As per Bank's provisioning policy, provisions are estimated depending on risk rating, type of collateral held and expected future recovery.

I. Provisions for Corporate & Commercial portfolio:

The amount of provisions is subject to the following guidelines:

Risk Rating	Grade Name	Provisioning
10	Watch-List	Case by Case basis
11	Substandard	Minimum of 25% of net exposure
12	Doubtful	Minimum of 50% of net exposure
13	Loss	100% of the net exposure

The Specific provisions are made against the impaired exposures by comparing the present value of expected cash-flows with its current carrying amount based on the criteria prescribed by International Accounting Standards – IAS 39.

II. Provisions for Consumer Loans & Credit Cards loans portfolio:

The specific provisions are made against the impaired exposures based on the criteria of Days Past Due (DPD), as per the below table:

Buckets	Days Past Due (DPD)	Provisioning (% of total bucket)
1	1 – 29 days	0%
2	30 – 59 days	15%
3	60 – 89 days	25%
4	90 – 119 days	50%
5	120 – 149 days	75%
6	150 – 179 days	100%
7	180+ days	Write – Off

III. General Provisions:

In addition to specific allowances against individual borrowers, ANB also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a higher risk of default than when it was originally granted. This takes into consideration factors such as any deterioration in country risk, industry, technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

7. EXTERNAL CREDIT ASSESMENT INSTITUTIONS (ECAIs) USED

As per the guidelines provided by SAMA, ANB is using i) Moody's, ii) Standard & Poor's, and iii) Fitch for assigning Risk Weight and calculating Risk Weighted Assets (RWAs) under the Standardized Approach. Obligors, which are not rated by any of these three ECAIs are considered as "un-rated". Only the solicited ratings from the eligible ECAIs are being used for capital adequacy calculations.

8. CREDIT RISK MITIGATION: DISCLOSURES FOR STANDARDIZED AND IRB APPROACHES

ANB is using Basel-II standardized approach to calculate capital charge for credit risk, and has adopted simple approach for calculating Credit Risk Mitigation, The calculation methodologies are based on the guidelines specified by SAMA. ANB has been using following types of collateral for Credit Risk Mitigation (CRM) purposes under the Standardized Approach, as per SAMA guidelines:

- **Financial Collateral:**
The Bank takes only cash as financial collateral for mitigation purpose as per Basel-II Simple Credit Risk Mitigation Approach.
- **Guarantees as collateral:**
The Bank takes guarantees issued by other banks as a credit risk mitigant for its exposures. In such cases, a simple substitution of the risk weight is applied as per Basel-II Simple Credit Risk Mitigation Approach. The Bank has limit structure in place for managing exposure to each bank, which mitigates the concentration risk while using guarantees as eligible collateral.

9. COUNTERPARTY CREDIT RISK

9.1 Objective and Policies

The primary objective of counterparty credit risk management function is to effectively identify, measure and manage all derivatives related counterparty exposures through regular review of counterparty limits and daily monitoring of exposures vs. limits.

9.2 Strategy and Process

Limits for all banking counterparties are approved by Senior Credit Committee based on guidelines approved by the Executive Committee of the Board, these guidelines are detailed in the Bank's Credit Policy Manual. With regard to corporate customers, derivative products are offered only to selective large corporate customers with a demonstrated need to employ these products to manage the financial risks in their businesses.

9.3 Structure and Organization

Treasury Group manages day-to-day counterparty exposures for derivatives within the limits set by the Senior Credit Committee. Credit Control Department monitors and controls the exposures independently so that the exposures remain within the approved limits.

9.4 Scope and Nature of Risk Measurement and Reporting Systems

Capital charge for Over the Counter (OTC) derivative products is calculated using the current exposure method. Under this method potential future exposure is calculated, applying SAMA recommended add-on factors and positive mark-to-market of the transactions.

10. MARKET RISK CAPITAL CALCULATION

ANB maintains a low risk appetite for proprietary trading activity; as a result, trading activity is limited to FX Spots, FX Forwards, Plain vanilla interest rate derivatives and FX derivative instruments. The Bank uses standardized approach to calculate the capital charge for market risk in trading book and intends to move to Internal Model Approach after complying with the required qualitative and quantitative standards of SAMA.

10.1 Strategies and Processes

Board approves the trading limits keeping in view the overall business strategy of the Treasury Group. All traded products are covered by individual product programs, which lay down product description, business strategy, target customers, risk management, back office and accounting processes. The overall trading book limits as approved by the Board includes:

- Notional limit
- Volume limit
- VaR limit
- Sensitivity limit and
- Volatility limit

10.2 Structure and Organization

The Head of Treasury Group is responsible for managing all trading activities on a day-to-day basis within the established trading limits and in accordance with the direction and guidance given by MRPC. Treasury is responsible to identify and recommend to MRPC new trading strategies in specific instruments and target markets that are in accordance with the Bank's risk appetite.

Market Risk Department is responsible for monitoring and comparing trading activity exposures to the Board approved trading risk limits. All trading instruments are regularly marked-to-market and valuation methodologies are reviewed by market risk.

11. OPERATIONAL RISK CAPITAL CALCULATIONS

For the purpose of its capital computation under Basel II, ANB adopted the Alternative Standardized Approach (ASA). Under ASA, the capital charge is computed by categorizing ANB's activities into 8 business lines (as defined by the Basel II framework) and multiplying the business line's twelve quarters' average gross income by a pre-defined beta factor, which is same as for the Standardized Approach except for two business lines — retail banking and commercial banking. For these business lines, Loans and Advances (LARB) — multiplied by a fixed factor 'm' (0.035) — replaces gross income as the exposure indicator, and for both business lines using a beta of 15%.

12. EQUITIES (BANKING BOOK POSITIONS)

12.1 Strategies and Processes

The Bank's equity exposure is diversified across listed local stocks of different industry sectors and mutual funds. The portfolio is managed with a conservative approach to achieve a stable long term return with low market volatility. The Bank has also made Strategic Equity Investments in affiliates and

subsidiaries to achieve diversification of revenue streams and capitalize on the opportunities available in housing finance, equipment leasing and insurance.

12.2 Structure and Organization

A senior management committee manages the Bank's local equity portfolio. Treasury group monitors the portfolio on a day to day basis and makes recommendation to the management committee for purchase or sale of existing stocks within the Board's approved limits. Board has also approved limits for international equity investments to be managed by Treasury Group, however currently there are no positions in international equity. Investments in affiliates and subsidiaries are regularly reviewed and monitored by the strategic investment unit of the bank.

12.3 Scope and Nature of Risk Reporting and/or Measurement Systems

A detailed investment report is submitted to ALCO and MRPC on a regular basis. The report covers details of securities held, their market values, and securities sold/ bought during the period. Valuation for the equity exposures are based on quoted market price, whereas strategic equity investments are held at book value.

13. BANKING BOOK INTEREST RATE RISK

Interest rate risk in the banking book mainly arises from mismatches in re-pricing dates of interest sensitive assets and liabilities. ANB's policy is to achieve a balance between profitability from banking activities and minimizing risk to earnings and capital from changes in interest rates. The Bank's exposure to interest rate risk is managed with the objective that profits are not unduly impacted by the volatility of the interest rates.

13.1 Risk Management and Monitoring Process

The Board approves the acceptable level of interest rate risk in the banking book by setting a limit on interest rate gaps by maturity buckets together with other limits. Treasury Group is responsible for day-to-day management of interest rate risk under the guidance provided by ALCO. Treasury Group monitors the changes in financial markets leading to interest rate movements. Based on future outlook, Treasury takes appropriate interest rate exposures or hedges the existing exposures, if needed. Interest rate derivatives (mainly interest rate swaps) are used to hedge interest rate exposure of the Bank. Interest rate limits are independently monitored by Market Risk Department of Risk Management Group and reported to ALCO.

13.2 Scope and Nature of Risk Reporting and/or Measurement Systems

To manage the Bank's interest rate risk exposure, Market Risk Department uses the following reports:

- Interest rate gap Analysis
- VaR analysis
- Interest rate stress testing
- Impact of rate movements on investment portfolio

ALCO approves key assumptions underlying these reports, which are documented and reviewed on a periodic basis.