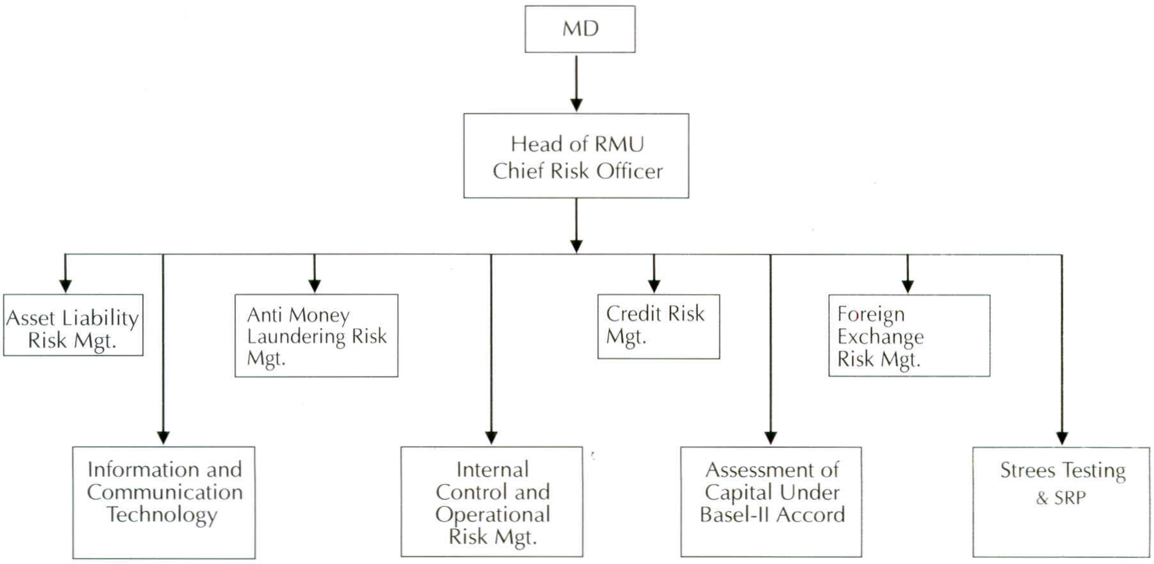
Risk Management:

Shahjalal Islami Bank Ltd. introduces Risk Management Unit (RMU) to analyze and measure business risk with taking effective steps to reduce the risks involved in the business of Banking.

SJIBL has set up a separate Risk Management Unit in line with the regulatory requirement to address and supervise the existing and potential business and capital risks. This specialized unit cautions the bank against any financial and operational risk at macro level impacting the micro functionalities. It intimate the management of various kinds of core risk as prescribed by the Bangladesh Bank in different functional areas: credit, foreign exchange, asset and liability management, internal control and compliance, money-laundering and information communication technology risks, apart from capital adequacy risk.

Reporting line of Risk Management Unit direct to the Deputy Managing Director of the Bank with reporting to the Audit Committee of the Board of Directors of the Bank as and when required. The Risk Management Unit is headed by a Deputy Managing Director who is the Chief Risk Officer (CRO) of the Bank. The Organogram of the RMU is given below which emphasis on management of different risk profiles of the Bank:



The RMU reviews quarterly the risk status of the bank and based on qualitative and quantitative Key Risk Indicators (KRI) on different risk areas, place a monthly Risk Management Paper (RMP) entailing Credit Risk, Market Risk, Operation Risk, Liquidity Risk, Sustainability Risk, Capital Adequacy Risk and Earning risk components of the risk domain to the Managing Director. Risk Management Paper is also submitted to the Bangladesh Bank as compliance report on quarterly basis.

Importance of the RMU:

In early 2003 and 2004 Bangladesh Bank issued guidelines on the followings six (6) core risks to comply the Risk Management in the Banking sector:

1. Investment Risk Management (IRM)
2. Asset Liability Risk Management (ALCO)
3. Foreign Exchange Risk Management
4. Internal Control and Compliance Risk Management
5. Anti Money Laundering Risk Management
6. Information Technology Risk Management

When world recession had started in 2008 & 2009 and heavily affected world economy as well as Bangladesh economy also at that time. Due to simplicity of financial system in Bangladesh, our Banking sector was not severely affected. Bangladesh Bank introduced Risk Management Unit (RMU) to supervise all core risk in banking which will assist to create business environment with analysis of risk and to reduce the risk associated in banking.

Risk Management Process (Term of References):

- Collect all relevant data from different models and information systems for analyzing risk.
- Assess the quality, completeness, and correctness of all relevant data/information needed to analyze risks.
- Highlight risky portfolios and deficiencies of the bank on timely manner with recommendations and suggestions.
- Analyze data/information through preparation of paper named Risk Management paper.
- Identify, evaluate/measure, control and monitor major risks in line with the standard set in the policy guideline to avoid unnecessary loss and ensure the banks in pricing all risk correctly.
- Oversee the capital management function of the bank in consistency with the Risk Based Capital Adequacy Measurement Accord (Basel-II).
- Identify, Assess and quantify key transaction risks inherent in a given transaction to ensure that the quality of the assumption are tested against due diligence carried out by different operational business units.
- Review market conditions and take precautionary measures towards facing abnormal market situation and vulnerability of investments of the Bank.
- Analyze the bank's own resilience capacity towards facing financial difficulties of the bank.
- Ensure through independent oversight that different risks are identified, evaluated, monitored, and reported within the established risk management framework.
- Take necessary steps to bring the position within limit and also assess and measure volatility of market and vulnerability of investment from time to time.
- Conduct periodic stress tests so that any errors/mistakes/lapses are eliminated gradually during daily operations of the Bank.
- Exercise governance and oversight over the bank's risk rating systems to ensure that they are fit for purpose and adequately utilized to control risk in the bank.

Risk Based Capital Adequacy:

To cope with the international best practices and to make the bank's capital more risk sensitive as well as more shock resilient, 'Guidelines on Risk Based Capital Adequacy (RBCA) for Banks' (Revised regulatory capital framework in line with Basel II) have been introduced from January 01, 2009 parallel to existing BRPD Circular No. 10, dated November 25, 2002. At the end of parallel run period, Basel II regime has been started and the guidelines on RBCA has come fully into force from January 01, 2010 with its subsequent supplements/revisions. Instructions regarding Minimum Capital Requirement (MCR), Adequate Capital, and Disclosure requirement as stated in these guidelines have to be followed by all scheduled banks for the purpose of statutory compliance.

Accordingly, these guidelines have been reviewed on the basis of feedback received. Now, the required adjustments, revisions and supplements have been included in the guidelines. The SJIBL follows the instructions contained in the revised 'Guidelines on Risk Based Capital Adequacy for Banks' (Namely Revised Regulatory Capital Framework for banks in lines with Basel-II, dated 29, December, 2010). These guidelines are articulated with the following areas, viz;

A) Introduction and constituents of Capital,
B) Credit Risk,
C) Market Risk,
D) Operational Risk,
E) Supervisory Review Process,
F) Supervisory Review Evaluation Process,
G) Market Discipline
H) Different kind of Reporting Formats
I) Many other information

Credit Risk:

Credit risk is the potential that a bank borrower or counterparty fails to meet its obligation in accordance with agreed term.

Market Risk:

Market risk is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices. The market risk positions subject to this requirement are:

a) The risks pertaining to interest rate related instruments and equities in the trading book; and
b) Foreign exchange risk and commodities risk throughout the bank (both in the banking and in the trading book).

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 reputational risk.

Capital Adequacy:

Total equity of the Bank on 31.12.2009 was Tk.5,429.97 million and the total equity stood to Tk.7,746.83 million on 31.12.2010, which was 10.08%of the Risk Weighted Assets as against the requirement of 9.00%
The core capital was 8.78% of Risk Weighted Assets as on 31st December 2010 as against requirements of 4.5%.

"Risk Based Capital Adequacy" for Bank's (Basel-II):

As statutory compliance of Bangladesh Bank, Revised Risk Based Capital Adequacy (Basel-II) of our Bank with submission of report to Bangladesh bank has been practicing on quarterly basis with effect from 2009.In this regard; Bank has established Basel-II implementation Team and conducted workshops for Executives and Officers of the Bank both in Head Office and branch level for its successful implementation. A comparative quantitative feature of Risk Weighted Assets (RWA) and Minimum Capital Requirements (MCR) for December 2009 and December 2010 under Basel-II is furnished hereunder.

Particulars	2010	2009
Eligible Capital:	Tk.in Crore	Tk. in Crore
1.Tier-1 (Core Capital)	674.83	467.60
2.Tier-2 (Supplementary Capital)	99.85	75.40
3.Tier-3 (Eligible for market Risk only)	-	-
Total Eligible Capital (1+2+3)	**774.68**	**543.00**
Total Risk Weighted Assets (RWA)	7,688.88	5,704.47
Capital Adequacy Ratio (CAR)	10.08%	9.52%
Core Capital to RWA	8.78%	8.20%
Supplementary Capital to RWA	1.30%	1.32%
Minimum Capital Requirement (MCR)	692.00	456.36

Supervisory Review Process:

The key principle of the supervisory review process (SRP) of SJIBL is that "banks have a process for assessing overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital at an adequate level". Banks have an exclusive body (called SRP team) where risk management unit is an integral part, and a process document (called Internal Capital Adequacy Assessment Process-ICAAP) is under process for assessing their overall risk profile, and a strategy for maintaining the adequate capital.

Importance of SRP:

The supervisory review process is planned not only to ensure adequate capital to compensate all the risks in the business of Banking, but also to be confident that bank has better risk management techniques in monitoring and managing the risks.

The supervisory review process is considered the following three main areas:

- Risks considered under Pillar 1 that are not fully captured by the MCR process (e.g. credit concentration risk);
- Risk factors not taken into account by the MCR process (e.g. interest rate risk in the banking book, business and strategic risk); and
- Risk factors external to the bank (e.g. business cycle effects).

Composition of SRP Team:

SJIBL has a well-designated SRP Team, which will aid to adopt Basel-II Capital Accord successfully. SRP Team of SJIBL has been formed comprising of the following Executives:

1.	Mr.Md.Abdul Jabber Chowdhury	Deputy Managing Director	Head of the team
2.	Mr.Md.Ghulam Wahab	Executive Vice President	Member
3.	Mr.Anisul Kabir	Executive Vice President	Member
4.	Mr.Md.Nazimuddoula	Executive Vice President	Member
5.	Mr.Imtiaz Uddin Ahmed	Senior Vice President	Member
6.	Mr.Md.Ziaullah Khan	Senior Vice President	Member
7.	Mr.Sayed Abul Hashem	Senior Vice President	Member
8.	Mr.Md.Ashraful Azim	Sr. Asstt. Vice President	Member Secretary

Risks to be covered under SRP:

Residual risks:

As institutions mitigate risks by way of collaterals, the collaterals can pose additional risks (legal and documentation risks), which may deteriorate the impact of risk mitigation. Residual risk arises due to the following reasons. For example-

- The liquidation procedure of the collateral is difficult and time consuming,
- The valuation of the collateral is inappropriate (e.g. overvaluation).

Credit concentration risk:

Credit concentration risk may arise from exposure to a single entity / group and/or exposures in the same economic or geographic sector and/or credit concentration in dependent industries. Downturn in concentrated activities and/or areas may cause huge losses to a bank relative to its capital and can threaten the bank's health or ability to maintain its core operations. So, SJIBL consider the concentration risk at the time of investment and try to investment in thrust sector as per Bangladesh Bank guidelines and time to time directives.

Interest rate risk in the banking book:

Interest rate risk in the banking book has to be taken into account as a potential risk. Sources and types of interest rate risks in banking book are:

- Gap or mismatch risk
- Basis risk
- Net Interest position risk

Liquidity risk:

Liquidity risk occurs when a bank is unable to fulfill its commitments in time when payment falls due. Liquidity risk is defined as the current or prospective threat to an institution's earnings and capital as a result of the possibility that it will not be able to meet its short-term payment obligations at any point in time without this involving unacceptable costs or losses. The purpose of daily liquidity measurements is to ensure that the institution remains solvent in its day-to-day operations at all times.

Such a situation means that the Bank will not be able to meet its obliga tions as they fall due or will not be able to fund increases in assets, for ex ample, as a result of firm commitments. It is the risk that the volume and timing of (potential) cash inflows and outflows are not adequately matched, whereby a shortfall arising at any point in time cannot be made up by selling assets or by obtaining refinancing because:

- The market for the asset in question has inadequate liquidity;
- The Bank has insufficient (liquid) assets to sell or to pledge in order to obtain refinancing;
- The Bank is insufficiently solvent and as a result has insufficient borrow ing capacity;
- The Bank has insufficient funding relationships.

Settlement risk:

Settlement risk arises when an executed transaction is not settled as the standard settlement system. Settlement risk addresses to the credit risk and liquidity risk elements.

Reputation risk:

Reputation risk is the current or prospective indirect risk to earnings and capital arising from adverse perception of the image of the financial institution on the part of customers, counter parties, shareholders, investors or regulators.

Strategic risk:

Strategic risk means the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, or from the overlooking of changes in the business environment.

Environmental risk:

Environmental and climate change risk refers to the uncertainty or probability of losses that originates from any adverse environmental or climate change events (natural or man-made) and/or the non-compliance of the prevailing national/Bangladesh Bank environmental regulation

Stress Testing:

The Bangladesh Bank issued a guidelines on Stress Testing vide their DOS circular No.01dated 21 April, 2010 for the commercial banks to make more effective and to evaluate & assess the risk adherence with the Bank.

Stress testing, as defined by BIS, is a risk management technique used to evaluate the potential effects on an institution's financial condition of a specific event and/or movement in a set of financial variables. It refers to the process to cover multiple risk measures across categories and complement tradition risk models. It is also an integral parts of the BIS Capital Adequacy framework. The traditional focus of stress testing relates to exceptional but plausible events.

Reasons for Stress Testing in SJIBL:

Extreme market movements or crises in the past reveal the inadequacy of managing risks based only on normal business conditions and historical trends. In particular, crises in the1990's (e.g. Asian Crisis) and current financial turmoil have augmented the importance of better understanding of potential vulnerabilities in the financial system and the measures to assess these vulnerabilities for both the regulators and the bankers. The regulators and managers of the financial system around the globe have developed a number of quantitative techniques to assess the potential risks to the individual institutions as well as financial system. A range of quantitative techniques that could serve the purpose is widely known as 'stress testing'. IMF and Basel Committee on banking supervision have also suggested for conducting stress tests on the financial sector.

Framework for Regular Stress Testing :

For Shahjalal Islami Bank Ltd. the stress-testing framework involves the scope of the risks covered and the Process/procedure to carry out the stress test. This framework is flexible enough to adopt advanced models for stress testing. It involves the following:

1. A well constituted organizational structure defining clearly the roles and responsibilities of the persons involved in the exercise.
2. Defining the coverage and identifying the data required and available.
3. Identifying, analyzing and proper recording of the assumptions used for stress testing.
4. Calibrating the scenarios or shocks applied to the data and interpreting the results.
5. An effective management information system that ensures flow of information to the senior management to take proper measures to avoid certain extreme conditions.
6. Setting the specific trigger points to meet the benchmarks/standards set by the Bangladesh Bank.
7. Ensuring a mechanism for an ongoing review of the results of the stress test exercise and reflecting in the policies and limits set by management and board of directors.