



ALLIANCE ISLAMIC BANK

Alliance Islamic Bank Berhad (776882-V)

**PILLAR 3 REPORT
FOR THE FINANCIAL YEAR ENDED
31 MARCH 2017**



Overview

Bank Negara Malaysia's ("BNM") guidelines on capital adequacy require Alliance Islamic Bank Berhad ("the Bank") to maintain an adequate level of capital to withstand potential losses arising from its operations. BNM's capital adequacy guidelines cover 3 main aspects:

- (a) Pillar 1 - covers the calculation of risk-weighted assets for credit risk, market risk and operational risk.
- (b) Pillar 2 - involves assessment of other risks (e.g. rate of return rate risk in the banking book, liquidity risk and concentration risk) not covered under Pillar 1. This promotes adoption of forward-looking approaches to capital management and stress testing / risk simulation techniques.
- (c) Pillar 3 - covers disclosure and external communication of risk and capital information by banks.

The Bank maintains a strong capital base to support its current activities and future growth, to meet regulatory capital requirements at all times and to buffer against potential losses.

To ensure that risks and returns are appropriately balanced, the Bank has implemented a Group-wide Integrated Risk Management Framework, with guidelines for identifying, measuring, and managing risks. This process includes quantifying and aggregating various risks in order to ensure the Bank has sufficient capital to cushion unexpected losses and remain solvent. Within the Alliance Bank Group, Alliance Islamic Bank leverages on centralized services provided by the Group, including risk management functions.

In summary, the capital management process involves the following:

- (i) Monitoring of regulatory capital and ensuring that the minimum regulatory requirements and approved internal ratios are adhered to.
- (ii) Estimation of capital requirements based on ongoing forecasting and budgeting process.
- (iii) Regular reporting of regulatory and internal capital ratios to senior management and the Board.

In addition, the Bank's capital adequacy under extreme but plausible stress scenarios are periodically assessed via a Group-wide stress test exercise. The results of the stress tests are reported to senior management, to provide them with an assessment of the financial impact of such events on the Group's earnings and capital.

The Bank's Pillar 3 Disclosure is governed by the Bank Disclosure Policy on Capital Adequacy Framework for Islamic Banks ("CAFIB") - Pillar 3 which sets out the minimum disclosure standards, the approach for determining the appropriateness of information disclosed and the internal controls over the disclosure process which covers the verification and review of the accuracy of information disclosed.

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1.0 Scope of Application

The Pillar 3 Disclosure provided in this document is in respect of the Bank, which is involved in Islamic banking financial services.

There are no significant restrictions or other major impediments on transfer of funds or regulatory capital between the Bank and its holding company, Alliance Bank Malaysia Berhad.

There were no capital deficiencies in the Bank as at the financial year end.

The capital adequacy information is computed in accordance with Capital Adequacy Framework for Islamic Banks. The Bank has adopted the Standardised Approach for credit risk and market risk; and the Basic Indicator Approach for operational risk.

2.0 Capital

The capital management of the Bank is under the purview of Alliance Bank Group's ("the Group") capital management with the objectives:

- (i) To maintain sufficient capital to meet the regulatory capital requirements as set forth by BNM;
- (ii) To maintain sufficient capital to support the Bank's risk appetite and facilitate future business growth; and
- (iii) To meet the expectations of key stakeholders, including shareholders, investors, regulators and rating agencies.

In line with this, the Bank aims to maintain capital adequacy ratios that are above the regulatory requirement, while balancing shareholders' desire for sustainable returns and prudential standards .

The Bank carries out stress testing to estimate the potential impact of extreme but plausible events on the Bank's earnings, statement of financial position and capital. The results of the stress tests are to facilitate the formulation of contingency plans where warranted. The results of the stress tests are tabled to the Group Risk Management Committee for approval.

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2.0 Capital (contd.)

2.1 Capital Adequacy Ratios

The capital adequacy ratios of the Bank are as follows:

| | 2017 | 2016 |
|--------------------------------------------|----------------|----------------|
| <u>Before deducting proposed dividends</u> | | |
| CET I/ Tier I capital ratio | 13.430% | 13.375% |
| Total capital ratio | <u>14.509%</u> | <u>14.399%</u> |
| <u>After deducting proposed dividends</u> | | |
| CET I/ Tier I capital ratio | 13.430% | 13.044% |
| Total capital ratio | <u>14.509%</u> | <u>14.068%</u> |

The Bank's capital ratios comply with the prescribed capital adequacy ratios under BNM's Capital Adequacy Framework for Islamic Banks.

2.2 Capital Structure

The following tables present the components of Common Equity Tier I ("CET I"), Tier I and Tier II capital:

| | 2017 RM'000 | 2016 RM'000 |
|---------------------------------------------------------|------------------------------|------------------------------|
| <u>CET I Capital</u> | | |
| Paid-up share capital | 345,045 | 345,045 |
| Share premium | 54,955 | 54,955 |
| Retained profits | 215,766 | 187,800 |
| Statutory reserve | 224,720 | 205,558 |
| Revaluation reserves | 151 | 5,380 |
| | <u>840,637</u> | <u>798,738</u> |
| Less: Regulatory adjustment | | |
| - Goodwill and other intangibles | (914) | (510) |
| - Deferred tax assets | (2,083) | - |
| - 55% of revaluation reserves | (83) | (2,959) |
| Total CET I Capital / Total Tier I Capital | <u>837,557</u> | <u>795,269</u> |
| <u>Tier II Capital</u> | | |
| Collective assessment allowance and regulatory reserves | 67,243 | 60,853 |
| Total Tier II Capital | <u>67,243</u> | <u>60,853</u> |
| Total Capital | <u>904,800</u> | <u>856,122</u> |

2.0 Capital (contd.)

2.3 Risk Weighted Assets ("RWA") and Capital Requirements

Regulatory Capital Requirements

The following table presents the minimum regulatory capital requirement of the Bank:

| 2017 Exposure Class | Gross Exposures RM'000 | Net Exposures RM'000 | Risk- Weighted Assets RM'000 | Capital Requirements RM'000 | | | | | | | | |
|---------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|---------------------------------------|-----------------------------------|---|---|---|--------|---|--|--|--|
| (i) <u>Credit Risk</u> | | | | | | | | | | | | |
| On-balance sheet exposures: | | | | | | | | | | | | |
| Sovereigns/Central banks | 1,098,092 | 1,098,092 | - | - | | | | | | | | |
| Public sector entities | 55,268 | 55,268 | 11,054 | 884 | | | | | | | | |
| Banks, Development Financial Institutions ("DFIs") and Multilateral Development Banks ("MDBs") | 747,008 | 747,008 | 149,402 | 11,952 | | | | | | | | |
| Takaful Companies, Securities Firm and Fund Managers | 10,493 | 10,493 | 10,493 | 840 | | | | | | | | |
| Corporates | 2,487,952 | 2,430,721 | 1,816,508 | 145,321 | | | | | | | | |
| Regulatory retail | 2,955,037 | 2,860,960 | 2,290,978 | 183,278 | | | | | | | | |
| Residential Real Estate ("RRE") financing | 2,394,854 | 2,393,733 | 1,082,218 | 86,578 | | | | | | | | |
| Higher risk assets | - | - | - | - | | | | | | | | |
| Other assets | 60,813 | 60,813 | 43,742 | 3,499 | | | | | | | | |
| Defaulted exposures | 29,118 | 28,336 | 31,674 | 2,534 | | | | | | | | |
| Total on-balance sheet exposures | 9,838,635 | 9,685,424 | 5,436,069 | 434,886 | | | | | | | | |
| Off-balance sheet exposures: | | | | | | | | | | | | |
| Credit-related off-balance sheet exposures | 474,379 | 436,443 | 339,268 | 27,141 | | | | | | | | |
| Defaulted exposures | 308 | 306 | 458 | 37 | | | | | | | | |
| Total off-balance sheet exposures | 474,687 | 436,749 | 339,726 | 27,178 | | | | | | | | |
| Total on and off-balance sheet exposures | 10,313,322 | 10,122,173 | 5,775,795 | 462,064 | | | | | | | | |
| (ii) <u>Market Risk (Note 4.0)</u> | | | | | | | | | | | | |
| | <table><tr><td>Long Position</td><td>Short Position</td></tr><tr><td>40,694</td><td>-</td></tr><tr><td>-</td><td>-</td></tr><tr><td>40,694</td><td>-</td></tr></table> | Long Position | Short Position | 40,694 | - | - | - | 40,694 | - | | | |
| Long Position | Short Position | | | | | | | | | | | |
| 40,694 | - | | | | | | | | | | | |
| - | - | | | | | | | | | | | |
| 40,694 | - | | | | | | | | | | | |
| Profit rate risk | | - | 19,590 | 1,567 | | | | | | | | |
| Foreign currency risk | | - | - | - | | | | | | | | |
| (iii) <u>Operational Risk</u> | - | - | 440,869 | 35,270 | | | | | | | | |
| Total | 10,313,322 | 10,122,173 | 6,236,254 | 498,901 | | | | | | | | |

2.0 Capital (contd.)

2.3 RWA and Capital Requirements (contd.)

Regulatory Capital Requirements (contd.)

The following table presents the minimum regulatory capital requirement of the Bank (contd.):

| 2016 Exposure Class | Gross Exposures RM'000 | Net Exposures RM'000 | Risk- Weighted Assets RM'000 | Capital Requirements RM'000 |
|---------------------------------------------------------|---------------------------------------|-------------------------------------|-------------------------------------------------|--------------------------------------------|
| (i) Credit Risk | | | | |
| On-balance sheet exposures: | | | | |
| Sovereigns/Central banks | 1,949,472 | 1,949,472 | - | - |
| Public sector entities | 30,579 | 30,579 | 6,116 | 489 |
| Banks, DFIs and MDBs | 179,486 | 179,486 | 35,897 | 2,872 |
| Takaful Companies, Securities Firm and Fund Managers | 10,457 | 10,457 | 10,457 | 837 |
| Corporates | 2,097,625 | 2,040,407 | 1,539,368 | 123,149 |
| Regulatory retail | 2,903,920 | 2,819,727 | 2,227,674 | 178,214 |
| RRE financing | 2,473,179 | 2,472,035 | 1,184,570 | 94,766 |
| Higher risk assets | - | - | - | - |
| Other assets | 40,326 | 40,326 | 40,326 | 3,226 |
| Defaulted exposures | 78,911 | 78,911 | 104,752 | 8,380 |
| Total on-balance sheet exposures | <u>9,763,955</u> | <u>9,621,400</u> | <u>5,149,160</u> | <u>411,933</u> |
| Off-balance sheet exposures: | | | | |
| Credit-related off-balance sheet exposures | 516,520 | 481,951 | 385,346 | 30,828 |
| Defaulted exposures | 14,466 | 14,466 | 21,627 | 1,730 |
| Total off-balance sheet exposures | <u>530,986</u> | <u>496,417</u> | <u>406,973</u> | <u>32,558</u> |
| Total on and off-balance sheet exposures | <u>10,294,941</u> | <u>10,117,817</u> | <u>5,556,133</u> | <u>444,491</u> |
| (ii) Market Risk (Note 4.0) | | | | |
| | Long Position | Short Position | | |
| Profit rate risk | - | - | - | - |
| Foreign currency risk | - | - | - | - |
| | - | - | | |
| (iii) Operational Risk | | | | |
| | - | - | 389,682 | 31,175 |
| Total | <u>10,294,941</u> | <u>10,117,817</u> | <u>5,945,815</u> | <u>475,666</u> |

Note:

The Bank does not use Profit-sharing Investment Account ("PSIA") as a risk absorbent mechanism.

The Bank does not have exposure to any Large Exposure Risk for equity holdings specified in BNM's Guidelines on Investment in Shares, Interest-in-Shares and Collective Investment Schemes.

3.0 Credit Risk

Credit risk is the risk of financial loss resulting from the failure of the Bank's customers or counterparties to fulfil their contractual obligations to pay their financing or to settle financial commitments. Credit risk arises mainly from financing and advances activities and holding of debt securities.

Credit Risk Management

The Board, via the Group Risk Management Committee ("GRMC"), established a Credit Risk Management Framework ("CRMF") which outlines the broad principles for managing credit risk of the Bank.

Credit approval is under the purview of the Board, Management Credit Committee and Credit Underwriters, depending on the size and complexity of the financing.

Retail financing are subject to portfolio reviews and corporate financing are subject to periodic individual customer or group reviews. The Portfolio Review Committee for the respective lines of business, assisted by embedded risk units, helps to manage the portfolio quality. The process also ensures alignment of business strategy with the Bank's risk appetite.

Potential problematic financing is identified through our Early Warning Framework and thematic reviews, where applicable. Recovery of impaired financing are carried out internally or through authorised agents.

The Portfolio Review Committees for the respective lines of business, assisted by embedded risk units, helps to manage the portfolio quality. Portfolio risk reports are reviewed and action plans are formulated to manage identified risks.

Entity level Risk Dashboards are escalated to the Group Risk Management Committee and the Board for deliberation and strategic direction.

Group Risk Management is responsible to assess adequacy and effectiveness of the risk management framework, policies and guidelines. Embedded risk units are responsible for monitoring business activities and ensuring that they are carried out within the approved policies and business models.

Stress testing is used to identify potential vulnerable risk areas of the Bank's portfolios to stress and the impact to earnings and capital. Stress tests are performed using different market and economic assumptions to assess possible vulnerability and effective mitigating actions when required.

Group Internal Audit reviews the Bank's credit processes regularly and recommends corrective measures or enhancements. These reviews provide senior management with assurance that the policies, processes and guidelines are adhered to.

Impaired Financing and Provisions

Past due accounts are financing accounts with any payment of principal and/or profit due and not paid, but are not classified as impaired. Financing are classified as impaired if the mandatory impairment thresholds are exceeded or judgmentally impaired when there are reasonable grounds to believe that the customer may not be able to pay the entire financing amount.

Individual assessments are performed on impaired accounts with principal outstanding exceeding RM1 million. The discounted cashflow method will be used to determine the recoverable amounts. The remaining financing portfolios are then collectively assessed for impairment allowance provision.

Please refer to Note 2(g)(i) of the audited financial statements for accounting policies on impaired financing.

3.0 Credit Risk (contd.)

3.1 Distribution of Credit Exposures

(a) Geographical Distribution

The following tables represent the Bank's major types of gross credit exposure by geographical distribution. Exposures are allocated to the region in which the customer is located and are disclosed before taking into account of any collateral held or other credit enhancements and after allowance for impairment where applicable.

| | Geographical region | | | | |
|----------------------------------------------|---------------------|------------------|------------------|----------------|----------------|
| | Northern | Central | Southern | Sabah | Sarawak |
| 2017 | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| Cash and short-term funds | - | 170,255 | - | - | - |
| Financial assets held-for-trading | - | 40,694 | - | - | - |
| Financial investments available-for-sale | - | 2,071,758 | - | - | - |
| Financial investments held-to-maturity | - | 80,957 | - | - | - |
| Financing and advances | 536,000 | 4,994,893 | 1,050,673 | 499,299 | 168,090 |
| Statutory deposits with Bank Negara Malaysia | - | 274,288 | - | - | - |
| Total on-balance sheet | 536,000 | 7,632,845 | 1,050,673 | 499,299 | 168,090 |
| Financial guarantees | 9,607 | 107,699 | 12,627 | 2,427 | 13 |
| Credit related commitments and contingencies | 171,450 | 683,029 | 185,340 | 429,411 | 34,153 |
| Total off-balance sheet | 181,057 | 790,728 | 197,967 | 431,838 | 34,166 |
| Total credit exposure | 717,057 | 8,423,573 | 1,248,640 | 931,137 | 202,256 |

| | Geographical region | | | | |
|----------------------------------------------|---------------------|------------------|------------------|----------------|----------------|
| | Northern | Central | Southern | Sabah | Sarawak |
| 2016 | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| Cash and short-term funds | - | 1,014,248 | - | - | - |
| Financial assets held-for-trading | - | - | - | - | - |
| Financial investments available-for-sale | - | 1,277,242 | - | - | - |
| Financial investments held-to-maturity | - | 233,390 | - | - | - |
| Financing and advances | 435,940 | 4,819,096 | 1,090,166 | 493,130 | 170,499 |
| Statutory deposits with Bank Negara Malaysia | - | 271,870 | - | - | - |
| Total on-balance sheet | 435,940 | 7,615,846 | 1,090,166 | 493,130 | 170,499 |
| Financial guarantees | 14,210 | 88,223 | 11,214 | 1,863 | 53 |
| Credit related commitments and contingencies | 198,452 | 722,333 | 190,008 | 453,392 | 71,014 |
| Total off-balance sheet | 212,662 | 810,556 | 201,222 | 455,255 | 71,067 |
| Total credit exposure | 648,602 | 8,426,402 | 1,291,388 | 948,385 | 241,566 |

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3.0 Credit Risk (contd.)

3.1 Distribution of Credit Exposures (contd.)

(b) Industry Distribution

The following table represents the Bank's major types of gross credit exposure by sector. The analysis is based on the sector in which the customers are engaged.

| | Government and Central Bank RM'000 | Financial, Takaful and Business Services RM'000 | Transport, Storage and Communication RM'000 | Agriculture, Manufacturing, Wholesale & Retail Trade RM'000 | Construction RM'000 | Household RM'000 | Others RM'000 | Total RM'000 |
|-------------------------------------------------|---------------------------------------------|-------------------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------------------|------------------------|---------------------|------------------|-------------------|
| 2017 | | | | | | | | |
| Cash and short-term funds | 170,255 | - | - | - | - | - | - | 170,255 |
| Financial assets held-for-trading | - | 40,694 | - | - | - | - | - | 40,694 |
| Financial investments available-for-sale | 541,332 | 1,266,551 | 162,197 | 30,571 | 71,107 | - | - | 2,071,758 |
| Financial investments held-to-maturity | 80,957 | - | - | - | - | - | - | 80,957 |
| Financing and advances | - | 791,276 | 77,478 | 2,163,982 | 137,237 | 4,021,509 | 57,473 | 7,248,955 |
| Statutory deposits with Bank Negara Malaysia | 274,288 | - | - | - | - | - | - | 274,288 |
| Total on-balance sheet | 1,066,832 | 2,098,521 | 239,675 | 2,194,553 | 208,344 | 4,021,509 | 57,473 | 9,886,907 |
| Financial guarantees | - | 3,301 | 111 | 122,212 | 6,429 | 42 | 278 | 132,373 |
| Credit related commitments and contingencies | - | 184,731 | 7,135 | 871,006 | 74,046 | 50,927 | 315,538 | 1,503,383 |
| Total off-balance sheet | - | 188,032 | 7,246 | 993,218 | 80,475 | 50,969 | 315,816 | 1,635,756 |
| Total credit exposure | 1,066,832 | 2,286,553 | 246,921 | 3,187,771 | 288,819 | 4,072,478 | 373,289 | 11,522,663 |

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3.0 Credit Risk (contd.)

3.1 Distribution of Credit Exposures (contd.)

(b) Industry Distribution (contd.)

The following table represents the Bank's major types of gross credit exposure by sector. The analysis is based on the sector in which the customers are engaged. (contd.)

| | Government and Central Bank RM'000 | Financial, Takaful and Business Services RM'000 | Transport, Storage and Communication RM'000 | Agriculture, Manufacturing, Wholesale & Retail Trade RM'000 | Construction RM'000 | Household RM'000 | Others RM'000 | Total RM'000 |
|-------------------------------------------------|---------------------------------------------|-------------------------------------------------------------|------------------------------------------------------|-------------------------------------------------------------------------|------------------------|---------------------|------------------|-------------------|
| 2016 | | | | | | | | |
| Cash and short-term funds | 1,014,248 | - | - | - | - | - | - | 1,014,248 |
| Financial assets held-for-trading | - | - | - | - | - | - | - | - |
| Financial investments available-for-sale | 482,235 | 577,279 | 172,265 | - | 45,463 | - | - | 1,277,242 |
| Financial investments held-to-maturity | 233,390 | - | - | - | - | - | - | 233,390 |
| Financing and advances | - | 565,228 | 41,799 | 2,059,690 | 129,894 | 4,179,927 | 32,293 | 7,008,831 |
| Statutory deposits with Bank Negara Malaysia | 271,870 | - | - | - | - | - | - | 271,870 |
| Total on-balance sheet | 2,001,743 | 1,142,507 | 214,064 | 2,059,690 | 175,357 | 4,179,927 | 32,293 | 9,805,581 |
| Financial guarantees | - | 2,991 | 41 | 78,162 | 34,194 | - | 175 | 115,563 |
| Credit related commitments and contingencies | - | 244,761 | 5,212 | 893,105 | 58,022 | 114,234 | 319,865 | 1,635,199 |
| Total off-balance sheet | - | 247,752 | 5,253 | 971,267 | 92,216 | 114,234 | 320,040 | 1,750,762 |
| Total credit exposure | 2,001,743 | 1,390,259 | 219,317 | 3,030,957 | 267,573 | 4,294,161 | 352,333 | 11,556,343 |

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3.0 Credit Risk (contd.)

3.1 Distribution of Credit Exposures (contd.)

(c) Residual Contractual Maturity

The following table represents the residual contractual maturity for major types of gross credit exposure for on-balance sheet exposures of financial assets of the Bank:

| | <u>Up to 1 month</u> | <u>>1-3 months</u> | <u>>3-6 months</u> | <u>>6-12 months</u> | <u>>1 year</u> | <u>Total</u> |
|----------------------------------------------|----------------------|-----------------------|-----------------------|------------------------|-------------------|------------------|
| | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| 2017 | | | | | | |
| Cash and short-term funds | 170,255 | - | - | - | - | 170,255 |
| Financial assets held-for-trading | - | 575 | - | - | 40,119 | 40,694 |
| Financial investments available-for-sale | 436,776 | 313,111 | 51,793 | 30,014 | 1,240,064 | 2,071,758 |
| Financial investments held-to-maturity | - | 80,957 | - | - | - | 80,957 |
| Financing and advances | 947,651 | 305,242 | 123,332 | 18,029 | 5,854,701 | 7,248,955 |
| Statutory deposits with Bank Negara Malaysia | - | - | - | - | 274,288 | 274,288 |
| Total on-balance sheet exposure | 1,554,682 | 699,885 | 175,125 | 48,043 | 7,409,172 | 9,886,907 |
| 2016 | | | | | | |
| Cash and short-term funds | 1,014,248 | - | - | - | - | 1,014,248 |
| Financial assets held-for-trading | - | - | - | - | - | - |
| Financial investments available-for-sale | 104,982 | 84,756 | 1,294 | 55,103 | 1,031,107 | 1,277,242 |
| Financial investments held-to-maturity | - | 3,103 | - | 150,110 | 80,177 | 233,390 |
| Financing and advances | 1,155,970 | 370,958 | 241,656 | 234,055 | 5,006,192 | 7,008,831 |
| Statutory deposits with Bank Negara Malaysia | - | - | - | - | 271,870 | 271,870 |
| Total on-balance sheet exposure | 2,275,200 | 458,817 | 242,950 | 439,268 | 6,389,346 | 9,805,581 |

3.0 Credit Risk (contd.)

3.2 Past Due Financing and Advances Analysis

- (a) Past due but not impaired financing and advances are financing where the customers have failed to make a principal and/or profit payment when contractually due, and include financing which are due one or more days after the contractual due date but not more than 3 months.

Past due financing and advances are analysed as follows:

| | 2017 RM'000 | 2016 RM'000 |
|-------------------------|------------------------|------------------------|
| Past due up to 1 month | 236,651 | 245,717 |
| Past due > 1 - 2 months | 71,233 | 56,437 |
| Past due > 2 - 3 months | 18,106 | 11,663 |
| | 325,990 | 313,817 |

Past due financing and advances analysed by sector:

| | 2017 RM'000 | 2016 RM'000 |
|---------------------------------------------------------|------------------------|------------------------|
| Financial, takaful and business services | 12,186 | 10,343 |
| Transport, storage and communication | 4,137 | 1,069 |
| Agriculture, manufacturing, wholesale & retail trade | 34,154 | 30,945 |
| Construction | 2,451 | 3,917 |
| Household | 270,779 | 265,144 |
| Others | 2,283 | 2,399 |
| | 325,990 | 313,817 |

Past due financing and advances analysed by significant geographical areas:

| | 2017 RM'000 | 2016 RM'000 |
|-----------------|------------------------|------------------------|
| Northern region | 26,287 | 25,380 |
| Central region | 203,751 | 198,331 |
| Southern region | 70,389 | 61,481 |
| Sabah region | 20,973 | 22,211 |
| Sarawak region | 4,590 | 6,414 |
| | 325,990 | 313,817 |

3.0 Credit Risk (contd.)

3.3 Impaired Financing and Advances Analysis

Impaired financing and advances analysed by sectors:

| | 2017 RM'000 | 2016 RM'000 |
|---------------------------------------------------------|----------------|----------------|
| Financial, takaful & business services | - | 2,068 |
| Transport, storage and communication | 250 | 24 |
| Agriculture, manufacturing, wholesale & retail trade | 11,395 | 60,897 |
| Construction | 2,052 | 128 |
| Household | 37,691 | 45,030 |
| Others | 1 | 566 |
| | <u>51,389</u> | <u>108,713</u> |

Impairment allowances on impaired financing and advances analysed by sectors:

| | Individual impairment allowance RM'000 | Collective impairment allowance RM'000 | Individual impairment made / write-back during the year (net) RM'000 | Individual impairment write-off for the year (net) RM'000 |
|---------------------------------------------------------|-------------------------------------------------|-------------------------------------------------|----------------------------------------------------------------------------------------|--------------------------------------------------------------------------|
| 2017 | | | | |
| Financial, takaful & business services | - | 5,278 | - | (2,031) |
| Transport, storage & communication | - | 810 | - | - |
| Agriculture, manufacturing, wholesale & retail trade | 1,352 | 24,258 | 1,277 | (2,784) |
| Construction | 564 | 1,369 | 564 | - |
| Household | 564 | 44,979 | 325 | (697) |
| Others | - | 642 | (4) | (560) |
| | <u>2,480</u> | <u>77,336</u> | <u>2,162</u> | <u>(6,072)</u> |
| 2016 | | | | |
| Financial, takaful & business services | 2,031 | 3,898 | 2,031 | - |
| Transport, storage & communication | - | 382 | - | - |
| Agriculture, manufacturing, wholesale & retail trade | 2,859 | 26,172 | 2,716 | (437) |
| Construction | - | 1,373 | - | - |
| Household | 1,016 | 37,621 | 683 | - |
| Others | 564 | 463 | 5 | - |
| | <u>6,470</u> | <u>69,909</u> | <u>5,435</u> | <u>(437)</u> |

3.0 Credit Risk (contd.)

3.3 Impaired Financing and Advances Analysis (contd.)

Impaired financing and advances and impairment allowances analysed by significant geographical areas:

| | Impaired financing and advances RM'000 | Individual impairment allowance RM'000 | Collective impairment allowance RM'000 |
|-----------------|-------------------------------------------------|-------------------------------------------------|-------------------------------------------------|
| 2017 | | | |
| Northern region | 2,262 | - | 7,320 |
| Central region | 36,393 | 266 | 54,416 |
| Southern region | 8,733 | 1,709 | 9,737 |
| Sabah region | 3,492 | 505 | 4,405 |
| Sarawak region | 509 | - | 1,458 |
| | <u>51,389</u> | <u>2,480</u> | <u>77,336</u> |
| 2016 | | | |
| Northern region | 3,137 | - | 6,212 |
| Central region | 94,178 | 6,064 | 48,790 |
| Southern region | 6,914 | 406 | 8,662 |
| Sabah region | 3,426 | - | 4,946 |
| Sarawak region | 1,058 | - | 1,299 |
| | <u>108,713</u> | <u>6,470</u> | <u>69,909</u> |

Movements in financing impairment allowances are analysed as follows:

| | 2017 RM'000 | 2016 RM'000 |
|----------------------------------------------------|----------------|----------------|
| Individual assessment allowance: | | |
| At beginning of year | 6,470 | 1,350 |
| Allowance made during the year (net) | 2,162 | 5,435 |
| Amount written-off | (6,072) | (437) |
| Transfer (to)/from collective assessment allowance | (80) | 122 |
| At end of year | <u>2,480</u> | <u>6,470</u> |
| Collective assessment allowance: | | |
| At beginning of year | 69,909 | 55,445 |
| Allowance made during the year (net) | 43,635 | 39,150 |
| Amount written-off | (36,288) | (24,564) |
| Transfer from/(to) individual assessment allowance | 80 | (122) |
| At end of year | <u>77,336</u> | <u>69,909</u> |

3.0 Credit Risk (contd.)

3.4 Assignment of Risk-Weights for Portfolio Under the Standardised Approach

The following tables represent the credit exposures by risk-weights and after credit risk mitigation:

| 2017 Risk- Weights | Exposures after netting and credit risk mitigation | | | | | | | | | Total exposures after netting and credit risk mitigation RM'000 | Total Risk- Weighted Assets RM'000 |
|--------------------------------------|----------------------------------------------------|----------------------------------------|--------------------------------------|--------------------------------------------------------------------------------|----------------------|--------------------------------|----------------------------|------------------------------------|---------------------------|-----------------------------------------------------------------------------------|------------------------------------------------|
| | Sovereigns /Central banks RM'000 | Public sector entities RM'000 | Banks, DFIs and MDBs RM'000 | Takaful companies, Securities firms and Fund managers RM'000 | Corporates RM'000 | Regulatory retail RM'000 | RRE financing RM'000 | Higher risk assets RM'000 | Other assets RM'000 | | |
| 0% | 1,158,092 | - | - | - | 297,430 | - | - | - | - | 1,455,522 | - |
| 20% | - | 65,268 | 747,008 | - | 395,979 | 111 | 486 | - | 21,338 | 1,230,190 | 246,038 |
| 35% | - | - | - | - | - | - | 1,329,368 | - | - | 1,329,368 | 465,279 |
| 50% | - | - | - | - | 4 | 2,660 | 897,772 | - | - | 900,436 | 450,218 |
| 75% | - | - | - | - | - | 2,388,740 | 1,514 | - | - | 2,390,254 | 1,792,691 |
| 100% | - | - | - | 10,493 | 1,991,570 | 585,017 | 179,517 | - | 39,474 | 2,806,071 | 2,806,071 |
| 150% | - | - | - | - | 6,567 | 3,765 | - | - | - | 10,332 | 15,498 |
| Total exposures | 1,158,092 | 65,268 | 747,008 | 10,493 | 2,691,550 | 2,980,293 | 2,408,657 | - | 60,812 | 10,122,173 | 5,775,795 |
| Risk-weighted assets by exposures | - | 13,054 | 149,402 | 10,493 | 2,080,618 | 2,383,571 | 1,094,915 | - | 43,742 | 5,775,795 | |
| Average risk weight | - | 20% | 20% | 100% | 77% | 80% | 45% | - | 72% | 57% | |
| Deduction from Capital base | - | - | - | - | - | - | - | - | - | - | |

3.0 Credit Risk (contd.)

3.4 Assignment of Risk-Weights for Portfolio Under the Standardised Approach (contd.)

The following tables represent the credit exposures by risk-weights and after credit risk mitigation (contd.):

| 2016 Risk- Weights | Exposures after netting and credit risk mitigation | | | | | | | | | Total exposures after netting and credit risk mitigation RM'000 | Total Risk- Weighted Assets RM'000 |
|--------------------------------------|----------------------------------------------------|----------------------------------------|--------------------------------------|--------------------------------------------------------------------------------|----------------------|--------------------------------|----------------------------|------------------------------------|---------------------------|-----------------------------------------------------------------------------------|------------------------------------------------|
| | Sovereigns /Central banks RM'000 | Public sector entities RM'000 | Banks, DFIs and MDBs RM'000 | Takaful companies, Securities firms and Fund managers RM'000 | Corporates RM'000 | Regulatory retail RM'000 | RRE financing RM'000 | Higher risk assets RM'000 | Other assets RM'000 | | |
| 0% | 2,009,472 | - | - | - | 208,325 | - | - | - | - | 2,217,797 | - |
| 20% | - | 30,579 | 179,486 | - | 365,892 | - | - | - | - | 575,957 | 115,191 |
| 35% | - | - | - | - | - | - | 1,236,745 | - | - | 1,236,745 | 432,861 |
| 50% | - | - | - | - | - | 2,110 | 976,067 | - | - | 978,177 | 489,088 |
| 75% | - | - | - | - | - | 2,496,380 | 2,248 | - | - | 2,498,628 | 1,873,971 |
| 100% | - | - | - | 10,648 | 1,752,453 | 454,806 | 283,265 | - | 40,326 | 2,541,498 | 2,541,499 |
| 150% | - | - | - | - | 64,664 | 4,309 | - | 42 | - | 69,015 | 103,523 |
| Total exposures | 2,009,472 | 30,579 | 179,486 | 10,648 | 2,391,334 | 2,957,605 | 2,498,325 | 42 | 40,326 | 10,117,817 | 5,556,133 |
| Risk-weighted assets by exposures | - | 6,116 | 35,897 | 10,648 | 1,922,630 | 2,334,608 | 1,205,845 | 63 | 40,326 | 5,556,133 | |
| Average risk weight | - | 20% | 20% | 100% | 80% | 79% | 48% | 150% | 100% | 55% | |
| Deduction from Capital base | - | - | - | - | - | - | - | - | - | - | |

3.0 Credit Risk (contd.)

3.4 Assignment of Risk-Weights for Portfolio Under the Standardised Approach (contd.)

For the purpose of determining counterparty risk-weights, the Bank uses external credit assessments from Rating Agency Malaysia ("RAM"), Malaysian Rating Corporation ("MARC"), Standard and Poor's ("S&P"), Moody's, and Fitch. In the context of the Bank's portfolio, external credit assessments are mainly applicable to banks/financial institutions and rated corporations. The Bank follows the process prescribed under BNM Capital Adequacy Framework for Islamic Banks (CAFIB)-Basel II to map the ratings to the relevant risk weights. The ratings are monitored and updated regularly to ensure that the latest and most appropriate risk-weights are applied in the capital computation.

The following tables show the rated credit exposures according to ratings by approved Eligible Credit Assessment Institutions ("ECAIs"), or as prescribed under the CAFIB:

2017

| Exposure Class | Ratings by Approved ECAIs* | | | | | | Total |
|---------------------------------------------------------------------------------|----------------------------|----------------------|-------------------|----------------------|------------------|-----------|-----------|
| | Moody's | Aaa to Aa3 / P-1 | A1 to A3 / P-2 | Baa1 to Ba3 / P-3 | B1 to C / Others | Unrated | |
| | S&P | AAA to AA- / A-1 | A+ to A- / A-2 | BBB+ to BB- / A-3 | B+ to D / Others | Unrated | |
| | Fitch | AAA to AA- / F1+, F1 | A+ to A- / A-2 | BBB+ to BB- / F3 | B+ to D | Unrated | |
| | RAM | AAA to AA3 / P-1 | A+ to A3 / P-2 | BBB1+ to BB3 / P-3 | B to D / NP | Unrated | |
| | MARC | AAA to AA- / MARC-1 | A+ to A- / MARC-2 | BBB+ to BB- / MARC-3 | B+ to D / MARC-4 | Unrated | |
| | | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| On and Off Balance-Sheet Exposures | | | | | | | |
| (i) Exposures risk weighted using Sovereigns and Central Banks rating | | | | | | | |
| Sovereigns and Central Banks (See Note 1) | | - | 1,158,092 | - | - | - | 1,158,092 |
| Public Sector Entities | | - | - | - | - | - | - |
| Corporates | | - | 297,430 | - | - | - | 297,430 |
| | | - | 1,455,522 | - | - | - | 1,455,522 |
| (ii) Exposures risk weighted using Banking Institutions long term rating | | | | | | | |
| Banks, MDBs and FDIs | | 747,008 | - | - | - | - | 747,008 |
| Exposures risk weighted using Banking Institutions short term rating | | | | | | | |
| Banks, MDBs and FDIs | | - | - | - | - | - | - |
| | | 747,008 | - | - | - | - | 747,008 |
| (iii) Exposures risk weighted using Corporate long term rating | | | | | | | |
| Public Sector Entities | | 15,264 | - | - | - | 50,004 | 65,268 |
| Corporates | | 395,979 | - | - | - | 2,072,880 | 2,468,859 |
| Takaful Cos, Securities Firms & Fund Managers | | - | - | - | - | 10,493 | 10,493 |
| Exposures risk weighted using Corporate short term rating | | | | | | | |
| Public Sector Entities | | - | - | - | - | - | - |
| Corporates | | - | - | - | - | - | - |
| Takaful Cos, Securities Firms & Fund Managers | | - | - | - | - | - | - |
| | | 411,243 | - | - | - | 2,133,377 | 2,544,620 |

Note 1: The Federal Government and Central Bank of Malaysia are accorded 0% risk weight as provided under the Capital Adequacy Framework for Islamic Banks.

*Upper Range = Long Term Rating, Lower Range = Short Term Rating

3.0 Credit Risk (contd.)

3.4 Assignment of Risk-Weights for Portfolio Under the Standardised Approach (contd.)

The following tables show the rated credit exposures according to ratings by approved ECAIs (contd.):

2016

| Exposure Class | Ratings by Approved ECAIs* | | | | | Total |
|---------------------------------------------------------------------------------|----------------------------|----------------------|-------------------|----------------------|------------------|-----------|
| | Moody's | Aaa to Aa3 / P-1 | A1 to A3 / P-2 | Baa1 to Ba3 / P-3 | B1 to C / Others | Unrated |
| | S&P | AAA to AA- / A-1 | A+ to A- / A-2 | BBB+ to BB- / A-3 | B+ to D / Others | Unrated |
| | Fitch | AAA to AA- / F1+, F1 | A+ to A- / A-2 | BBB+ to BB- / F3 | B+ to D | Unrated |
| | RAM | AAA to AA3 / P-1 | A+ to A3 / P-2 | BBB1+ to BB3 / P-3 | B to D / NP | Unrated |
| | MARC | AAA to AA- / MARC-1 | A+ to A- / MARC-2 | BBB+ to BB- / MARC-3 | B+ to D / MARC-4 | Unrated |
| | | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| On and Off Balance-Sheet Exposures | | | | | | |
| (i) Exposures risk weighted using Sovereigns and Central Banks rating | | | | | | |
| Sovereigns and Central Banks (See Note 1) | - | 2,009,472 | - | - | - | 2,009,472 |
| Public Sector Entities | - | - | - | - | - | - |
| Corporates | - | 208,325 | - | - | - | 208,325 |
| | - | 2,217,797 | - | - | - | 2,217,797 |
| (ii) Exposures risk weighted using Banking Institutions long term rating | | | | | | |
| Banks, MDBs and FDIs | 179,486 | - | - | - | - | 179,486 |
| Exposures risk weighted using Banking Institutions short term rating | | | | | | |
| Banks, MDBs and FDIs | - | - | - | - | - | - |
| | 179,486 | - | - | - | - | 179,486 |
| (iii) Exposures risk weighted using Corporate long term rating | | | | | | |
| Public Sector Entities | 30,579 | - | - | - | - | 30,579 |
| Corporates | 365,893 | - | - | - | 1,890,953 | 2,256,846 |
| Takaful Cos, Securities Firms & Fund Managers | - | - | - | - | 10,648 | 10,648 |
| Exposures risk weighted using Corporate short term rating | | | | | | |
| Public Sector Entities | - | - | - | - | - | - |
| Corporates | - | - | - | - | - | - |
| Takaful Cos, Securities Firms & Fund Managers | - | - | - | - | - | - |
| | 396,472 | - | - | - | 1,901,601 | 2,298,073 |

Note 1: The Federal Government and Central Bank of Malaysia are accorded 0% risk weight as provided under the Capital Adequacy Framework for Islamic Banks.

*Upper Range = Long Term Rating, Lower Range = Short Term Rating

Note:

There is no outstanding securitisation contract at the Bank that required disclosure of ratings and short term rating of securitisation by approved ECAIs.

3.0 Credit Risk (contd.)

3.5 Credit Risk Mitigation ("CRM")

As a practical approach towards mitigating credit risk, the Bank accepts a wide range of collaterals. Main types of collateral acceptable to the Bank include cash, guarantees, commercial and residential real estates, and physical collateral/ financial collateral, e.g. motor vehicles or shares. Guarantees are accepted only when the financial standing of the guarantors have been ascertained.

However, for capital computation purposes, the Bank guidelines apply more restrictive rules on collaterals that qualify as credit mitigants. As a result, not all of the collaterals accepted by the Bank can be used to reduce the Bank's capital adequacy requirement.

The following tables represent the Bank's credit exposure including off-balance sheet items under the standardised approach, the total exposure (after, where applicable, eligible netting benefits) that is covered by eligible guarantees and credit derivatives; and eligible collateral after haircuts, allowed under the Capital Adequacy Framework for Islamic Banks.

| 2017 Exposure Class | Exposures before CRM RM'000 | Exposures covered by guarantees/ credit derivatives RM'000 | Exposures covered by eligible financial collateral RM'000 | Exposures covered by other eligible collateral RM'000 |
|------------------------------------------------------------------------------------|-----------------------------------|---------------------------------------------------------------------------|--------------------------------------------------------------------------|-------------------------------------------------------------------|
| <u>Credit Risk</u> | | | | |
| On-balance sheet exposures: | | | | |
| Sovereigns/Central banks | 1,098,092 | - | - | - |
| Public sector entities | 55,268 | - | - | - |
| Banks, DFIs and MDBs | 747,008 | - | - | - |
| Takaful Companies, Securities Firm and Fund Managers | 10,493 | - | - | - |
| Corporates | 2,487,952 | - | 57,231 | - |
| Regulatory retail | 2,955,037 | - | 94,077 | - |
| RRE financing | 2,394,854 | - | 1,121 | - |
| Higher risk assets | - | - | - | - |
| Other assets | 60,813 | - | - | - |
| Defaulted exposures | 29,118 | - | 782 | - |
| Total on-balance sheet exposures | 9,838,635 | - | 153,211 | - |
| Off-balance sheet exposures | | | | |
| Off-balance sheet exposures other than OTC derivatives or credit derivatives | | | | |
| | 474,379 | - | 37,936 | - |
| Defaulted exposures | 308 | - | 2 | - |
| Total off-balance sheet exposures | 474,687 | - | 37,938 | - |
| Total on and off-balance sheet exposures | 10,313,322 | - | 191,149 | - |

3.0 Credit Risk (contd.)

3.5 Credit Risk Mitigation ("CRM") (contd.)

| 2016 Exposure Class | Exposures before CRM RM'000 | Exposures covered by guarantees/ credit derivatives RM'000 | Exposures covered by eligible financial collateral RM'000 | Exposures covered by other eligible collateral RM'000 |
|------------------------------------------------------------------------------------|-----------------------------------|---------------------------------------------------------------------------|--------------------------------------------------------------------------|-------------------------------------------------------------------|
| <u>Credit Risk</u> | | | | |
| On-balance sheet exposures: | | | | |
| Sovereigns/Central banks | 1,949,472 | - | - | - |
| Public sector entities | 30,579 | - | - | - |
| Banks, DFIs and MDBs | 179,486 | - | - | - |
| Takaful Companies, Securities Firm and Fund Managers | 10,457 | - | - | - |
| Corporates | 2,097,625 | - | 57,218 | - |
| Regulatory retail | 2,903,920 | - | 84,193 | - |
| RRE financing | 2,473,179 | - | 1,144 | - |
| Higher risk assets | - | - | - | - |
| Other assets | 40,326 | - | - | - |
| Defaulted exposures | 78,911 | - | - | - |
| Total on-balance sheet exposures | 9,763,955 | - | 142,555 | - |
| Off-balance sheet exposures: | | | | |
| Off-balance sheet exposures other than OTC derivatives or credit derivatives | 516,520 | - | 34,569 | - |
| Defaulted exposures | 14,466 | - | - | - |
| Total off-balance sheet exposures | 530,986 | - | 34,569 | - |
| Total on and off-balance sheet exposures | 10,294,941 | - | 177,124 | - |

3.0 Credit Risk (contd.)

3.6 Off-Balance Sheet Exposures and Counterparty Credit Risk

Off-balance sheet exposures of the Bank are mainly from the commitments to extend credit including the unutilised or undrawn portions of credit facilities.

The off-balance sheet exposures and their related counterparty credit risk of the Bank are as follows:

| | Principal Amount RM'000 | Positive Fair Value of Derivative Contracts RM'000 | Credit Equivalent Amount RM'000 | Risk- Weighted Assets RM'000 |
|-------------------------------------------------------------|----------------------------------------|---------------------------------------------------------------------------|----------------------------------------------------|-------------------------------------------------|
| 2017 | | | | |
| <u>Credit-related exposures</u> | | | | |
| Direct credit substitutes | 108,034 | - | 108,034 | 96,880 |
| Transaction-related contingent items | 45,963 | - | 22,982 | 12,315 |
| Short-term self-liquidating trade- related contingencies | 24,339 | - | 4,868 | 4,316 |
| Irrevocable commitments to extend credit: | | | | |
| - maturity exceeding one year | 157,730 | - | 78,865 | 69,221 |
| - maturity not exceeding one year | 1,299,690 | - | 259,938 | 156,994 |
| | <u>1,635,756</u> | <u>-</u> | <u>474,687</u> | <u>339,726</u> |

| | Principal Amount RM'000 | Positive Fair Value of Derivative Contracts RM'000 | Credit Equivalent Amount RM'000 | Risk- Weighted Assets RM'000 |
|-------------------------------------------------------------|----------------------------------------|---------------------------------------------------------------------------|----------------------------------------------------|-------------------------------------------------|
| 2016 | | | | |
| <u>Credit-related exposures</u> | | | | |
| Direct credit substitutes | 91,683 | - | 91,683 | 80,064 |
| Transaction-related contingent items | 48,841 | - | 24,420 | 12,309 |
| Short-term self-liquidating trade- related contingencies | 23,902 | - | 4,780 | 4,291 |
| Irrevocable commitments to extend credit: | | | | |
| - maturity exceeding one year | 309,451 | - | 154,726 | 141,021 |
| - maturity not exceeding one year | 1,276,885 | - | 255,377 | 169,288 |
| | <u>1,750,762</u> | <u>-</u> | <u>530,986</u> | <u>406,973</u> |

4.0 Market Risk

For Islamic banking, market risk refers to fluctuations in values of tradable, marketable or leaseable assets (including sukuk) and in off-balance sheet individual portfolios such as restricted investment accounts. This risk relates to the current and future volatility of market values of specific assets, e.g. the market value of a Sukuk or Murabahah assets purchased to be delivered over a specific period; and of foreign exchange rates.

Market Risk Management

The Board, via the GRMC provides oversight on market risk management activities. Its responsibilities include reviewing and approving risk management policies, risk exposures and limits whilst ensuring the necessary infrastructure and resources are in place.

At senior management level, the Group Assets and Liabilities Management Committee ("GALCO") manages the Bank's market risk by reviewing and recommending market risk frameworks and policies; ensuring that market risk limits and parameters are within the approved thresholds; and aligning market risk management with business strategy and planning.

Organisationally, market risks are managed collectively via the Three Lines of Defence concept. Group Financial Markets, as the risk taking unit assumes ownership of the risk and manages the risk within the approved policies, risk limits and parameters as set by the GRMC or GALCO. The risk control function is undertaken by Group Risk Management which provides independent monitoring, valuation and reporting of the market exposures. This is supplemented by periodic review by Group Internal Audit.

For the Bank, market risk is managed on an integrated approach which involves the following processes:

- (i) Identification of market risk in new products and changes in risk profiles of existing exposures.
- (ii) Assessment of the type and magnitude of market risks which takes into account the activity and market role undertaken.
- (iii) Adoption of various market risk measurement tools and techniques to quantify market risk exposures.
- (iv) Scheduled and exception reporting on market risk exposures.

Market risk exists in the Bank's activities in sukuk and money market instruments which are transacted primarily by Group Financial Markets (treasury) department. Trading positions are held intentionally for short-term resale and with the intent of benefiting from actual or expected short-term price movements while banking book positions are held until maturity or as available-for-sale. Hence, these positions are susceptible to market movements.

These exposures are governed by approved policies, risk limits and parameters which are set vis-a-vis the Bank's risk appetite and strategy. Besides that, treasury activities are monitored and reported independently by Group Market Risk on a daily basis. Any limit breaches or exceptions are reported to GALCO and GRMC.

4.0 Market Risk (contd.)

Hedging Policies and Strategies

The Bank had established a hedging policy which outlines the broad principles and policies governing hedging activities by the Bank. Generally, the Bank enters into hedges to manage or reduce risk exposures. All hedging strategies are approved by the GALCO and monitored independently by Group Market Risk. Further, all hedging strategies are designated upfront and recorded separately under the hedging portfolios. Hedging positions and effectiveness, if any, are monitored and reported monthly to senior management.

Market risk capital charge

For the Bank, the market risk charge is computed on the standardised approach and the capital charges are mainly on the Islamic bonds/sukuk.

Regulatory capital requirements

The risk-weighted assets and capital requirements for the various categories of risk under market risk are as follows:

| | Risk-Weighted Assets RM'000 | Capital Requirements RM'000 |
|-----------------------------|---------------------------------------|---------------------------------------|
| 2017 | | |
| Profit rate risk | | |
| - General profit rate risk | 9,542 | 763 |
| - Specific profit rate risk | 10,048 | 804 |
| | <u>19,590</u> | <u>1,567</u> |
| Equity risk | | |
| - General profit rate risk | - | - |
| - Specific profit rate risk | - | - |
| | <u>-</u> | <u>-</u> |
| Foreign exchange risk | - | - |
| | <u>19,590</u> | <u>1,567</u> |
| 2016 | | |
| Profit rate risk | | |
| - General profit rate risk | - | - |
| - Specific profit rate risk | - | - |
| | <u>-</u> | <u>-</u> |
| Equity risk | | |
| - General profit rate risk | - | - |
| - Specific profit rate risk | - | - |
| | <u>-</u> | <u>-</u> |
| Foreign exchange risk | - | - |
| | <u>-</u> | <u>-</u> |

5.0 Operational Risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk but excludes strategic and reputation risks.

Operational Risk Management

Management, escalation and reporting of operational risks are instituted through the Group Operational Risk Management Committee, Group Risk Management Committee as well as the Board.

The Board, via the GRMC provides oversight on operational risk management activities.

On a senior management level, Group Operational Risk Management (GORMC) manages the day-to-day operational risk exposures. Amongst the roles and responsibilities of GORMC include:

- (i) Provide strategic guidance on operational issues and monitor implementation of ORM framework
- (ii) Review and monitor operational risk issues, reports and action plans
- (iii) Evaluate and agree on initiatives to strengthen operational processes or infrastructure
- (iv) Promote risk awareness and operational risk management culture

The Bank practices operational risk management as outlined in the ORM Framework, in accordance with Basel and regulatory guidelines. The Bank applies operational risk tools and methodologies in the identification, assessment, measurement, control and monitoring of operational risks. Other efforts by the Bank include the ORM awareness training which is given to all staff, and regular business continuity and disaster recovery plans.

The Bank adopts Basic Indicator Approach for computation of operational RWA.

6.0 Rate of Return Risk in the Banking Book

Rate of return risk in the banking book ("RORBB") arises from exposure of banking book positions to profit rate movements. Changes in profit rate affect the Bank's earnings by changing its net profit income and the level of other profit rate sensitive income and expenses. It also affects the underlying value of banking assets, liabilities and off-balance sheet instruments as the present value of future cash flows change when profit rate change.

Risk Governance

RORBB is managed collectively by GALCO, Group Financial Markets, Group Finance and Group Risk Management. Each of the above parties has defined roles and responsibilities to provide oversight and manage RORBB within the defined framework and structure as approved by the GRMC/Board. GALCO assumes the overall responsibility in managing RORBB by setting the directions, strategy and risk limits/parameters for the Bank. Group Financial Markets is tasked to execute the approved strategy by managing the assets/liabilities as well as the funding and liquidity needs of the Bank. Group Finance and Group Risk Management provide support in respect of risk monitoring and reporting of the banking book exposures; and ensuring regulatory as well as accounting requirements are met.

6.0 Rate of Return Risk in the Banking Book (contd.)

RORBB Management

The guiding principles in managing RORBB include:

- (i) Adopting a prudent approach to manage RORBB in ways that commensurate with the Group's size and business activities. This is achieved via establishing robust RORBB policies, measures and strategies which is complemented by regular monitoring and reporting.
- (ii) Checking to ensure that RORBB are accurately measured and any mismatches identified, reviewed and reported monthly to GALCO.
- (iii) Setting proper gapping limits and the limits monitored closely.
- (iv) Practicing comprehensive RORBB reporting and review process, with aggregated information and supporting details to facilitate assessment of the Group's sensitivity to changes in market conditions.

The Bank uses a range of tools, including the following primary measures to quantify and monitor RORBB:

- (i) Repricing gap analysis to measure profit rate from the earnings perspective i.e. impact of profit rate changes to earnings in the short term.
- (ii) Net profit income simulation to assess the impact of profit rate changes on short term earnings volatility.
- (iii) Economic value of equity ("EVE") simulation which measures long term profit rate exposure through deterioration in capital base based on adverse profit rate movements.

Group Risk Management performs independent monitoring of the profit rate benchmarks to ensure compliance. Any exceptions are reported and appropriate remedial actions are taken, where necessary. Schedule reporting via risk dashboards are provided to senior management, GRMC and the Board. The risk dashboards provide a visual gauge ("dashboard view") on the RORBB of the Bank.

The Bank is guided by BNM's guidelines and Basel standards on management of RORBB.

The following tables present the Bank's projected sensitivity to a 100 basis point parallel shock to profit rates across all maturities applied on the Bank's profit sensitivity gap as at reporting date.

| | 2017 | 2016 |
|------------------------------------|------------------|------------------|
| | + 100 bps | + 100 bps |
| | RM'000 | RM'000 |
| Impact on net profit income | | |
| Ringgit Malaysia | <u>12,816</u> | <u>11,818</u> |
| Impact on Economic value | | |
| Ringgit Malaysia | <u>46,948</u> | <u>49,084</u> |

7.0 Shariah Governance Disclosures

Shariah Non-Compliance Risk arises from the risk of failure to comply with Shariah rules and principles as determined by Shariah Advisory Council of Bank Negara Malaysia and the Bank's Shariah Committee. To manage the risks, the Bank has adopted the following guiding principles:

- (i) A sound Shariah Compliance Framework which governs the operations of the Bank and outlines the roles of key functionalities within the Bank, including but not limited to the Shariah risk management process. This is in line with the Shariah Governance Framework issued by BNM.
- (ii) The Board of Directors, assisted by the Shariah Committee and Senior Management, provide oversight on Shariah compliance aspects of the Islamic Bank's overall operations. This amongst others include:
 - Oversight and implementation of the Shariah Compliance Framework.
 - Regular review of non-Shariah compliant income and issues.
 - Addressing non-Shariah compliance findings.
 - Ensuring compliance with regulatory and internal requirements including disclosures.
- (iii) Appointment of qualified Shariah Committee member who also serves as Board member; serving as a 'bridge' between the Board and the Shariah Committee.
- (iv) Ongoing Shariah reviews and training to raise risk awareness and ensure compliance to Shariah rules and principles. This includes:
 - Regular assessment on Shariah compliance in the activities and operations of the Bank. The findings of the review are reported to the Shariah Committee for deliberation and decision.
 - Performing research and studies on Shariah issues, including providing day-to-day Shariah advice and consultancy to relevant parties.
 - Conducting Shariah-related training and ongoing engagement with relevant parties to raise awareness on Shariah non-compliance risk.
- (v) Escalation and reporting processes of non-Shariah compliance income and issues governed through designated escalation channels, which include the Board and Shariah Committee.

Non-Shariah Compliant Income And Events

During the financial period, there were 3 Shariah non-compliance events detected from the ongoing reviews of the Bank's operational processes. Necessary efforts had been taken to rectify each Shariah non-compliant event, which was escalated to and tracked by the Shariah Committee and Board of Directors. The Shariah non-compliant income of RM729,164 had been disposed of in accordance with Shariah Committee's decision, except for a sum of RM2,051 which is pending disposal.