Amãna Bank

Risk Related Disclosures

Contents

Amãna Bank

1. **Summary Discussion on Adequacy/Meeting Current and Future Capital Requirements**

Capital Requirement under Basel III

Minimum Requirement covered under Pillar 1 of Basel III regulations has been complied which required the capital buffers to be implemented. Amãna Bank is maintaining the capital to comply with the buffer requirement to maintain Capital Adequacy Ratio (CAR) at 12.5% by 2019 that is applied for banks which carry an asset base of less than LKR 500 billion.

Assessment of the capital has been reviewed by Internal Capital Adequacy Assessment Process (ICAAP) which assesses the risks that are not covered in the Pillar I in order to meet the capital ratio/buffer requirement required by the regulator. ICAAP was prepared in line with Basel III capital buffer requirement and assessed the capital under various stress scenarios for smooth functioning of the Bank.

Internal Capital Adequacy Assessment Process (ICAAP)

ABL has carried out the Internal Capital Adequacy Assessment Process (ICAAP) as required by Central Bank of Sri Lanka (CBSL) under Banking Act Direction No. 01 of 2016 on Capital Requirement under Basel III for Licensed Commercial Banks and Licensed Specialised Banks issued on 29 December 2016.

Capital helps protect individual banks from insolvency, thereby promoting safety and soundness in the overall banking system. Minimum regulatory capital requirements under Pillar I establish a threshold below which a bank's regulatory capital must not fall. Pillar II requires banks to implement an internal process, called the Internal Capital Adequacy Assessment Process (ICAAP). ICAAP helps to compute the minimum internal capital requirement for its current and future business strategies and financial plans for the next 3 years via a comprehensive risk assessment process on its portfolio risk exposures, its risk management practices towards its material risks and potential capital planning buffer required in the event of stress.

Capital Adequacy is used to describe the adequacy of Bank's aggregate capital in relation to the risks which arise from its assets and its Off-Balance Sheet transactions, its dealing operations and its human resource activities, technology and external environment. The aim is to ensure minimum capital, commensurate with risks assumed by the Bank, is maintained as a buffer to absorb foreseeable future credit, market and operational losses.

The compilation of the ICAAP report is spearheaded by the Management Committee, a cross functional team which consists of resource personnel from Risk, Audit and Finance departments.

ICAAP report helps the Bank meet the following objectives:

i. Ensure that the Bank is adequately capitalised beyond the minimum regulatory capital requirements under Pillar I at all times;

ii. Ensure a comprehensive coverage of risks facing the Bank covering not only the Pillar I risks but also other risks (Pillar II and Pillar III) which are not covered in Pillar I. Further, the ICAAP document shall also aim to address inadequacies in risk management process of Pillar I risks through related risks categories (example: Residual credit risk, under-estimation of credit risk in standardised approach).

iii. Formulate a process that forms an integral part of the Bank's risk management processes so as to enable the Board of Directors and senior management to assess the risks that are inherent in their activities and are material to the Bank on an on-going basis.

iv. Have a process for assessing the overall capital adequacy in relation to the risk profile.

v. Enable the Bank to withstand adverse business conditions by evaluating the adequacy of capital in stress scenarios.

vi. Usage of risk management in general business decisions and budgets, day-to-day activities such as evaluating individual credit decision process and in overall strategic planning of the Bank.

vii. Embark upon a continuous process for improvement in risk management techniques, policies, processes, systems and overall awareness of the Bank.

Capital Planning

A detailed and comprehensive budget is prepared on yearly basis for the immediate year based on the Bank's latest overall strategic plan for next 3 years. The strategic plan has been developed by making high-level assumptions concerning future prospects of the economy and the Bank's strategic outlook.

Further, the Bank has done capital projections based on certain business strategies and underlying assumptions, which are covered in the Bank's Internal Capital Adequacy Report 2017. (ICAAP)

Risk Appetite

Risk appetite helps the Bank understand and manage risks by translating risks metrics and methods into strategic decisions, reporting, and day to day business decisions. It is the core instrument for better aligning overall Bank's strategy, capital allocation, and risk.

In order to effectively implement Risk appetite a Bank has defined quantitative indicators (e.g., capital adequacy level and risk limits) and qualitatively embedded in the policies and procedures (e.g. assessment criteria). The Bank's risk policy and risk limits are designed to be consistent with the defined risk appetite.

Risks Categories

The risk appetite statements are categorized based Bank wide, on pillar I and II risks. The statements are defined as per the risk metrics, indicators and current status.

The Banks's business strategy and risk appetite will be communicated by the Board of Directors to all business units in order to provide a clear direction for on-going operations and risk management.

Material Risk Assessment

A risk assessment is prepared to address all material risk as they relate to Pillar II including all risk explicitly captured in minimum regulatory Capital Requirement as well as risks that are not fully captured under minimum regulatory capital requirements.

Bank has conducted assessment on all identified Risk such as Credit Risk, market Risk, Operational Risk, Concentration Risk Foreign Exchange Risk , Equity Risk , Rate Risk ,Liquidity Risk , Asset and Market Liquidity Risk , Compliance Risk Process Risk , IT Risk , Strategic Risk , Reputational Risk , Legal Risk, Business Continuity Risk , People Risk etc. Based on the assessment major risks have identified as material and the capital allocation were made accordingly.

Few of the risk have been considered as potentially material risks which under closure monitoring.

The definition of each risk type has been benchmarked against Basel guidelines, various regulatory guidelines and general market practices.

The Bank understands the definition of its existing and potential risks before conducting the risk materiality analysis. The risk library will be updated during each annual ICAAP review to ensure its relevance and completeness

Stress testing at both Bank-wide level and risk level allow the Bank to estimate the potential impact on income and capital as a result of significant changes in market conditions, credit environment, liquidity demands, or other risk factors. Each program is developed with input from a broad base of stakeholders, and results are integrated into management decision-making processes for capital, funding, market risk limits, and credit risk strategy. Bank-wide stress testing is also integrated with both the strategic and financial planning processes.

Stress Testing is a mandatory function in Risk Management in the Bank and is considered as an important part of ICAAP under Pillar II. The Bank has adopted the common market practices on Stress Testing.

The Bank identifies an appropriate range of realistic adverse circumstances and events in which the identified risk crystallizes. The selection is governed by the assessing the business vulnerability and practical challenges related to data availability and sophistication of the Bank's risk management systems.

The outcome of the stress testing exercise would enable the Bank to:

Meet the risk as it arises and for mitigating the impact of manifestation of that risk;

Meet the liabilities and short falls as they fall due; and

Meet the minimum CAR requirements.

The results of the various stress tests are reported to the Board Integrated Risk Management Committee (BIRMC), and become an essential ingredient of Bank's risk management systems. Then the Bank documents the stress tests undertaken, the underlying assumptions, the results and the outcomes.

The Bank has put in place a stress-testing framework incorporated in the ICAAP document for its major risk categories, which are credit risk, market risk, operational risk, concentration Risk, rate risk and liquidity risk. Further, it is required for the Bank to estimate their capital requirements / explain how Bank would be affected by an economic recession or downswings in business cycle or markets relevant to its activities. The analyses on the same have been covered in the ICAAP report 2017.

2. Bank Risk Management Approach, Risk Management Related Key Risk Exposures & Systems & Controls to ensure Reliability & Prudency of Valuation Estimates

The Bank's risk management strategy is based on the need to assess the Bank's susceptibility to the risk while minimizing adverse impacts of credit risk, market risk, and operational risk on resources, earnings and cash flows through a robust framework of integrated risk management. The Bank has ensured that its portfolios/ exposures remain aligned to the risk appetite and strategy whilst proactively managing risks supported by strong forward-looking risk identification.

BIRMC reviews and assesses the Bank's overall risk and to focus on policy recommendations and strategies in an integrated manner and forward to Board of Directors (BoD) for approvals where necessary.

Risk Management Functional and Governance Structure

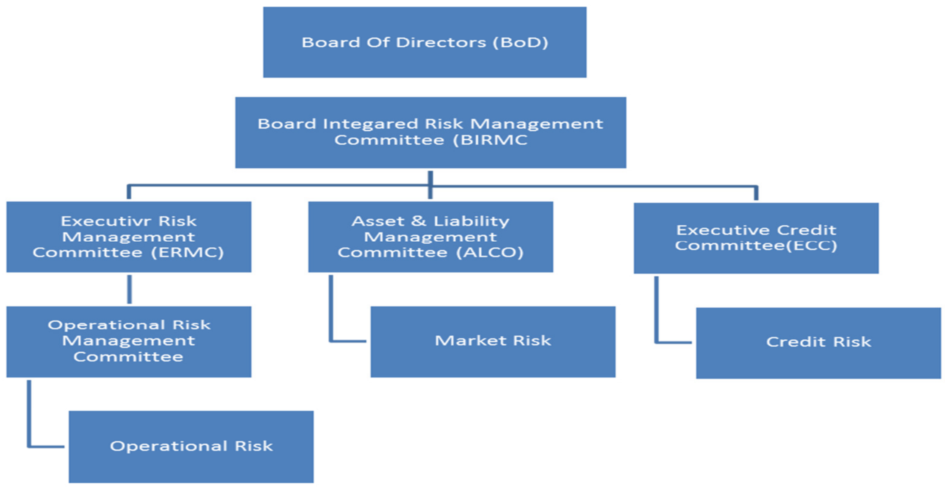
The Bank has realigned its risk organizational responsibilities with the objective of ensuring a common view of risks across the Bank.

A strong and pervasive integrated risk management culture provides a Bank with a sound foundation of risk management framework consistent with the Bank's objectives, risk tolerance, control standards and management philosophy. In an organization everyone is a risk manager and organizations need dynamic risk officers to direct and embed a culture of risk management across the organization.

The risk governance structure outlines the key responsibilities for decisions on risk taking and risk oversight in the Bank.

The following illustrates the Bank's governance structure and the alignment of the individual risk management committees to this structure.

Functional Structure



To carry out the risk management function, a dedicated Risk Management Department (RMD) that is independent of profit and volume targets has already been established by the Bank. The RMD is headed by the Chief Risk Officer (CRO). Along with the CRO, the RMD reports functionally to the BIRMC and administratively to the CEO.

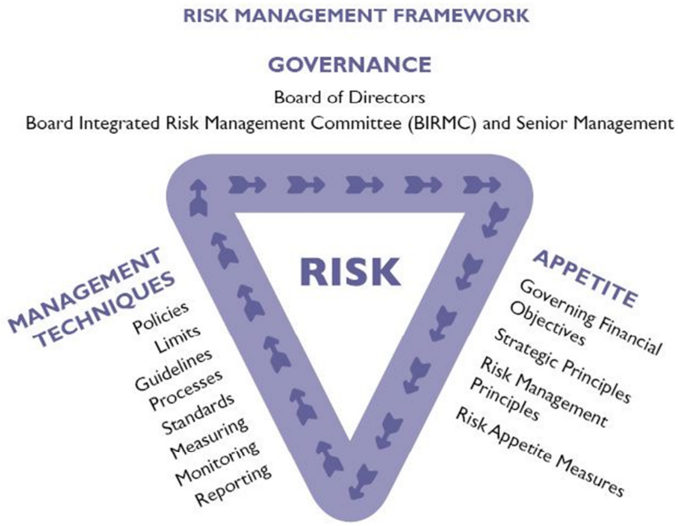
The Board, through the BIRMC, has an essential oversight role in risk management. In attending to this duty, BIRMC will:

Include members who have an adequate understanding of risk management;
Given the means to understand the risk profile of the Bank and the Bank's performance against it;

Set basic goals for the Bank's risk appetite and strategy, such as ratings or earnings-volatility targets, with senior management and act as guideposts for senior management in implementing risk management policies and procedures throughout the Bank;

Ensure that the Risk function is adequately staffed with professionals who are sufficiently competent in managing and monitoring all risks within the Bank and that they can avail of appropriate systems and tools.

The Bank’s risk management framework is applied on an enterprise-wide basis and consists of three key elements as depicted below



- The Board Integrated Risk Management Committee (BIRMC), which is a sub-committee of the Board of Directors, meets quarterly to review and assess the Bank’s overall risks and to focus on policy recommendations and strategies in an integrated manner.
- The Board Audit Committee (BAC) is entrusted with the responsibility of ensuring the Bank’s compliance to its internal and external regulatory guidelines and meets at least on a quarterly basis to address, assess and management action to any matters of concern.
- The Bank’s Assets & Liabilities Committee (ALCO) reviews all market, liquidity related exposures, excesses on a monthly basis, and decisions are made to facilitate the business requirements. These decisions are further reviewed at BIRMC and approved by the Board of Directors.

Typical Roles/Responsibilities in Setting Risk Appetite

Stakeholders	Roles/Responsibilities
Board of Directors	Review and approve risk appetite Review strategic objectives and positioning
BIRMC	Understand the risk profile of the Bank and the Bank's performance against same Set basic goals for the Bank's risk appetite and strategy, such as ratings or earnings-volatility targets with Senior Management and issue guidelines for Senior Management in implementing Risk Management Policies and Procedures throughout the Bank Ensure that the Risk Function is adequately staffed with professionals who are sufficiently competent in managing and monitoring all risks within the Bank and that they can avail of appropriate systems and tools
CEO, CRO and Senior Management	Set business strategy Identify availability of capital Coordinate process of aligning risk appetite and risk strategy with business strategy and capital capacity Oversee monitoring, reporting and governance around the risk appetite process Align business lines and goals within the risk parameters Communicate risk appetite Promote risk culture Communicate and integrate objectives throughout the business processes Embed risk appetite-related goals in performance objectives and compensation rewards
Business/Support Unit Heads	Propose key initiatives in light of economic, risk and competitive outlook Align risk policies, processes and limits used in managing day-to-day business operations with the metrics contained in the risk appetite statement

Policies for principle risk areas are in place covering areas of credit, market, and operational. Policies are supported by **Guidelines** and further supported by **operational manuals** to ensure policies are implemented properly and effectively.

Stress Testing

Stress testing is an essential risk management tool used to assess Bank's potential vulnerabilities to stressed business conditions. Sound stress testing practices enables the Board and Senior Management to make a more informed forward looking assessment of risks when determining Bank's risk appetite, business strategies and contingency plans.

The internally developed scenarios shall include economic recession scenarios, one of which must be a prolonged recession, to assess its ability to withstand and mitigate such scenarios. These scenarios have been applied in Internal Capital Adequacy Assessment Process annually.

Sensitivity and scenario analyses

The Bank uses a range of stress testing methodologies such as sensitivity and scenario analysis to ensure that its stress testing is comprehensive. Sensitivity analysis estimates the impact on the value of a portfolio of exposures arising from assumed movements in a single risk factor or several closely related risk factors.

Supervisory Review and Evaluation

As part of the Bank's Risk-Based Supervisory Framework and evaluation of ICAAP, Stress Testing shall be reviewed and evaluated. The Bank shall be required to take action to improve its capital or risk management processes in order to address any adverse scenario impact conducted through stress Testing.

Market Risk Management

Market risk is the risk of loss from changes in market prices and rates (including rates, credit spreads, foreign exchange rates, equity prices and commodity prices), the correlations among them and their levels of volatility.

Strategy for Market Risk Management is covered under strategic plan and the same is reviewed annually. Policies for Market risk Management, liquidity risk Management, Asset & Liabilities have been approved by The Board of Directors and the same are in place. Annual review on treasury related policies and the limits.

Market Risk appetite and the tolerance of the bank are reviewed by the BIRMC and approved by the BoD on an annual basis through the Integrated Risk management Frame work of Amana Bank.

Strategy for Risk Management is covered under strategic plan and the same is reviewed annually.

Market risk report is reviewed monthly at ALCO and the risk tolerance of Market risk criteria are assessed and reported to BIRMC monthly (Through Risk Dashboard).

Risk Middle office is conducting stress testing for FX, Equity, Gold and Liquidity on a periodic basis. Aggregate level of stress testing is conducted on a quarterly basis.

Prudential limits approved by the BoD are monitored by the Risk Middle office of the Bank.

Rate Risk

The risk of loss due to changes in the level, slope and curvature of the yield curve, the volatility of rates and prepayment rates.

Credit Spread Risk

The risk of loss due to changes in the market price of credit or the creditworthiness of issuers.

Foreign Currency Risk

The risk of loss due to changes in spot and forward prices and the volatility of currency exchange rates.

Equity Risk

The risk of loss due to changes in the prices and the volatility of individual equity instruments and equity indices.

Commodity Risk

The risk of loss due to changes in spot and forward prices and the volatility of precious and base metals.

Equity Position Risk

The Bank holds investment portfolios for investment purposes. These portfolios expose the Bank to rate risks, credit spread and equity risks. Equity position risk arises due to changes in individual equity prices. The Bank's equity portfolio is classified as Held for Trading (HFT) and Available for Sale (AFS) portfolios. HFT portfolio comprise of equities purchased with a view to take advantage of short term capital gains. The equities in AFS portfolio are purchased in order to realise capital gains in the medium term and for dividend income.

The performance of the equity portfolio is monitored by the Equity Investment Committee (EIC) and ALCO. The Board of Directors has laid down sector, portfolio and loss limits to control and mitigate the risks of the equity portfolio

Refer annual report 2017 under Risk Management section for further Market Risk assessment and analysis

Market risk mainly arises from activities undertaken by the Bank's Treasury and foreign exchange, equity, commodity and money market portfolios. A Board approved limit structure has been adopted by the Bank to mitigate and monitor its market risk. Further, the Board of Directors and the Management have ensured effective monitoring and management of market risk with the following:

The Bank classifies quoted equity exposures into either Trading or Available for Sale (AFS) portfolios and manages those portfolios separately. Market risk for the portfolios is monitored based on a Value at Risk (VaR) methodology and also using other sensitivity analyses.

Objectives of the Methodologies used to Assess Market Risk

Value at Risk (VaR)

VaR is a method of measuring market risk based on a common confidence interval and time horizon. It is a statistical estimate of expected potential loss that is derived by translating the risk of any financial instrument into a common standard.

The Bank calculates general market risk and equity specific risk VaR using historical simulation based on 365 days of market data. Changes in VaR between reporting periods are generally due to changes in levels of exposure, volatilities and/or correlations among asset classes. VaR is also used to evaluate risks arising in certain funding and investment portfolios. Back Testing is also an important and necessary part of the VaR process, by validating the quality and accuracy of the Bank's VaR model.

Stress Testing

VaR measures potential losses in normally active markets. Accordingly, stress testing examines the impact that abnormally large swings in market factors and periods of prolonged inactivity might have on trading portfolios. The stress testing programme is designed to identify key risks and quantify potential losses from abnormal events. The Bank subjects its trading and investment portfolios to stress tests on a periodic basis, using stress tests based on risk factor sensitivities and specific market events. The stress testing programme is an essential component of the Bank's comprehensive risk management framework which complements the current VaR methodology and other risk measures and controls employed by the Bank. Risk Middle Office conducted the stress testing on an aggregate level and reported to ALCO and BIRMC on a quarterly basis.

Sensitivity Analysis

Sensitivity analysis assesses the effect of changes in rates on current earnings and on the economic value of shareholders' equity related to AFS portfolios. It is applied globally to each of the major currencies within the Bank's operations.

Gap Analysis

Gap analysis is used to assess the rate sensitivity of the Bank's operations. Under gap analysis, rate sensitive assets and liabilities and Off Balance Sheet instruments are assigned to defined time periods on the basis of expected re-pricing dates.

Rate Risk

Rate risk arising from the Bank's financing and investment activities is managed in accordance with the Board approved policies and limits, which are designed to control the risk to net financing income and economic value of shareholders' equity.

Mismatches in maturity of assets and liabilities that mature or are re-priced during a specified time period, does have an impact on the Bank's exposure to rate risk. In order to manage and mitigate such risks, ALCO reviews the re-pricing of assets and liabilities on a monthly basis.

The Bank's rate risk is limited due to the business model adopted where majority of customer deposits have been taken on the profit and loss sharing basis.

However, rate risk is monitored by measuring the impact on rate sensitive maturity gaps with yield curve shifts of parallel and non-parallel nature.

Earnings perspective involves analysing the impact of changes in the profit rate on accrual or reported earnings in the near term, measured by changes in the Net profit Margin. Economic Value perspective involves analysing the changes of impact of profit on the expected cash flows on assets minus the expected cash flows on liabilities plus the net cash flows on off-balance-sheet items. The level of profit rate changes is an important factor to choose fixed/floating rate assets/liabilities, their maturities and hedging decisions.

Bank ICAAP report has outlined the approaches of Re-pricing Gap Approach and Economic Value of Equity (EVE) Approach and done assessment on the same. Under Re-pricing Gap Approach, the assets and liabilities are grouped into the time intervals or buckets according to the time until re-pricing. The Bank's GAP then equals to the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL), which is further used to identify the Bank's rate risk and to develop strategy to manage the same. The policy parameter that is observed and analysed under this analysis is the Earnings at Risk (EaR).

Economic Value of Equity (EVE) analyses the dynamic behaviour of market value of equity with response to varying market rate scenarios. Broadly, the EVE is defined as the difference between the market value of assets and market value of liabilities in response to a change in the market rate. The linkage between the two is established via modified duration of rate sensitive assets and liabilities

Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its financial obligations in a timely manner without incurring high cost.

Effective liquidity risk management is essential in order to maintain the confidence of depositors and counterparties, manage cost of funds, and to enable business units to continue to generate revenue, even under adverse circumstances.

Liquidity risk is managed within the framework of policies and limits that are approved by the Board of Directors. The Board of Directors receive reports on risk exposures and performance against approved limits. ALCO provides senior management oversight of liquidity risk and meets at least monthly to discuss the Bank's liquidity profile.

BIRMC reviews and assesses the Bank's overall risk and to focus on policy recommendations and strategies in an integrated manner.

Reporting related to liquidity risk will be reported to BIRMC through Asset & Liabilities Committee

Internal control processes and contingency plans for managing liquidity risk have been developed by the Bank under the Assets and Liabilities Management Policy of the Bank

Adequate liquid assets are maintained by the Bank to ensure the Statutory Liquid Assets Ratio (SLAR) is maintained in accordance with the regulatory requirements.

Regulations require banks to maintain Liquidity Coverage Ratio (LCR) in respect of Rupee Liquidity Minimum Requirement for local currency operations and All Currency Liquidity Minimum Requirement for overall operations. This ratio was introduced under Basel III Liquidity Standards and CBSL expects banks to maintain a minimum ratio as 80% in 2017 and 90% in 2018 and 100% in 2019.

Liquid assets are defined for the purposes of the liquidity ratio which are mainly cash and cash equivalents and placements with banks. Adequate liquid assets are maintained due to the Bank's operational business model adopted and to ensure the Statutory Liquid Asset Ratio is maintained as per regulatory requirements. Liquidity Coverage ratio under Basel III is also monitored which are highly liquid assets held by the bank to meet short-term obligations.

The Bank manages its Liquidity Risk through well-defined component policies such as Asset and Liability management Policy, Contingency Funding Plan, Deposit Concentration Limits and Contingent lines with other banks.

At present the Bank manages and monitors its liquidity on the following lines:
The Bank prepares structural liquidity statement reports as per CBSL defined maturity ladder bucketing.

Assets and Liabilities Committee (ALCO) do the overall liquidity monitoring of the Bank.

Assets & Liabilities Management (ALM) policy is clearly defined in terms of its scope and application.

Liquidity Risk is managed within the framework of policies and limits that are approved by the Board of Directors. The Board of Directors receives reports on risk exposures and performance against approved limits.

ALCO provides senior management oversight of liquidity risk and meets monthly to review the Bank's liquidity profile.

Liquidity Risk and Funding Management

Internal control processes and contingency plans for managing liquidity risk have been developed by the Bank under the Assets and Liabilities Management policy of the Bank. This incorporates an assessment of expected cash flows and the availability of liquid funds which could be used if required.

As required by the Provisions of Section 93 of the Monetary Law Act, a cash balance is required to be maintained with Central Bank of Sri Lanka. As at 31 December 2017, the minimum cash reserve requirement was 7.5% (2016 - 7.5%) of the Rupee liabilities of the Domestic Banking Unit. There is no reserve requirement for foreign currency deposit liabilities of the Domestic Banking Unit.

The Bank monitors the mix of deposits closely and concentrates on mobilizing zero or low cost deposits such as current accounts and savings accounts as a source of major funding.

Refer annual report 2017 under Risk Management section for further Liquidity Risk assessment and analysis.

Operational Risk Management

Operational Risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events, which includes legal risk. This definition excludes Strategic and Reputation Risks. Therefore, in line with the Basel II risk management framework and leading practices, operational risk in the Bank is composed of the following risk types: operations risk, legal risk, regulatory compliance risk, financial crime risk, people risk, property risk, technology risk, vendor risk, financial risk and environmental risk. While the overall Operational Risk management responsibility is with RMD, different departments such as Legal, Compliance, IT manages the individual risks, which can be classified as operational risk.

Operational Risk exposure is managed through a comprehensive set of internal controls and management processes that include risk assessment (identification, description and estimation), risk evaluation, reporting, mitigation, residual risk reporting and monitoring and control associated with the Bank's business operations as an on-going activity.

The Bank's approach to managing Operational Risk is to adopt practices that are fit and prudent to suit the organizational maturity and relevant business environments.
The tools used by the Bank for Operational Risk identification are:

Risk Control Self-Assessment (RCSA)
Key Risk Indicators (KRI)
Internal Operational Risk Events and Losses
Review of New Products and Processes

The Board of Directors is responsible for sound corporate governance and approves the Bank's Operational Risk Management Policy and Business Continuity Management Policy.

The Board of Directors is further responsible for ensuring that Senior Management takes steps to identify measure, monitor and control all risks encountered by the Bank.

Strategy for Risk Management is covered under strategic plan and the same is reviewed annually.

BIRMC reviews and assesses the Bank's overall risk and to focus on policy recommendations and strategies in an integrated manner.

Reporting related to Operational risk will be reported to BIRMC through Operational Risk Management Committee (ORMC) / Executive Risk Management Committee (ERMC).
Update on the Loss event data, Key Risk Indicators and the RCSA are reported to ORMC/ERMC and then BIRMC periodically.

Operational Risk report is reviewed at ORMC and the risk tolerance of Operational Risk criteria are assessed and reported to BIRMC monthly (through circulation).

Risk & Control Self-assessment is being conducted to all branches and units. Status update on all RCSA is reported to management Committee updating the identified risks and suggested controls.

Internal Audit Department is responsible for independently assessing and testing the risks and controls respectively, as well as assessing the effectiveness of the Operational Risk management framework of the Bank.

The final step of the Operational Risk Management process is to monitor unresolved risks until the point when the risk exposures are within the risk appetite of the Bank. This involves periodic reassessment of risk grades to capture changes in environment that may increase or decrease potential impact of the risks.

The Banking industry uses insurance as a highly developed operational risk management and mitigation tool. Insurance policies of the Bank are reviewed on a periodic basis and the same process is monitored by Operational Risk management through RCSA as the use of insurance helps to transfer the risk of low frequency and high severity losses that might occur as a result of the events such as fire, theft, damage to physical asset by natural disaster, etc.

Risk reviews on new products, processes and external suppliers including outsourced service providers are undertaken by the Bank.

Outsourced activities are carried out based on the CBSL guidelines from the Direction on Outsourcing of Business Operations of the Licensed Commercial Banks. A report on outsourced activities is submitted to CBSL on a periodic basis. The implementation of the Outsourcing Policy was monitored to ensure compliance with CBSL Directive No.7 of 2010 on Outsourcing of Business Operations of the Licensed Commercial Banks and guidelines.

Refer annual report 2017 (Page No. 76) for the details of activities that have been outsourced together with parties and basis for payment for such services.

As an integral component of the Bank's risk management framework, the Bank has deployed a Business Continuity Plan (BCP) enabling it to be adequately prepared to continue its business in the event of a disaster.

The Bank has successfully conducted DR Testing in April 2017 from the Bank's DR Site in respect of its critical business operations. BCP/DR Drill Reports highlighting test results, technical & operational functions, issues encountered, lessons learnt and risk mitigation measures adopted during the testing process were reported to the Regulator with the review and recommendation of the BIRMC along with the approval of the Board of Directors well within stipulated deadlines of the Regulator.

Refer annual report 2017 under Risk Management section for further details on Operational Risk assessment.

Information Technology Risk

Information technology risk includes the failure to respond human error, internal fraud through software manipulation, external fraud by intruders, obsolesce in applications and machines, reliability issues, mismanagement, and of course the effect of natural disasters

IT Losses due to:

- System down-time or failure
- Security breaches, both internal and external have been observed and sent to CBSL on a quarterly basis as per the guideline stipulated by the CBSL.

IT related issue and the risk are tabled at Operational Risk Management Committee periodically. Bank has developed an IT policy which approved by the BoD, which consists of IT security related objectives and processes. RCSA under operational risk is used in order to identify, assess and mitigate IT related issues.

The Bank has raised IT Security awareness levels among the Bank staff which is also being extended to its customers as well.

In order to ensure information security of IT services the Bank launched several initiatives, with the end result of it being very recently recognised and awarded with the certification for ISO/IEC 27001:2013. This is indeed a noteworthy achievement, as many banks in the industry are yet to reach this status

Credit Risk Management

Overview

Credit Risk is the loss arising from failure of the counterparty to perform according to its contractual arrangements with the Bank. It includes failure in the repayment of capital plus the Bank's profit/mark-up in full within the agreed tenure and in the agreed currency.

Credit risk arises from the financing and investment activities of the Bank. Risk identification and evaluation hence focuses on identifying sources giving rise to credit risk, which typically revolves around appraisal of the borrower and facility characteristics and the economic/ socio-political and industrial environment to assess the borrower's willingness and ability to repay their obligation to the Bank in full.

Managing Credit Risk

Managing Credit Risk through Portfolio Management

The Bank continuously strengthens its monitoring mechanism of the credit risk to ensure regular, more and frequent review of the portfolio. This helps the Bank to understand any emerging risk trends, aligning its credit risk appetite to its business strategy, whilst promoting risk based business decision making. This exercise covers analysis of the portfolio based on industry sectors, products, geographies and trends in NPA, etc.

In addition, stress tests/scenario analyses are carried out to assess the impact of any material changes in the external environment with suitable recommendations to restructure the portfolio.

The credit evaluation process follows procedures for pre-clearance of credit proposals, credit proposals being prepared in pre-determined formats, financial appraisal, independent review of financial and non-financial information such as credit ratings, security & covenants and credit approval based on delegation of authority (DA).

The Board of Directors holds the overall responsibility for ensuring implementation of the Bank's credit risk management framework. The BIRMC has been delegated with the responsibility of managing the Bank's overall credit risk. At an executive level, credit authority has been further delegated to Executive Credit Committees (ECCs) which are headed by CEO and CRO respectively. The Credit Risk Management Department conducts independent reviews of the credit risks lying with the business units and makes recommendations on credit policies, prudential limits on sector exposures and counter party exposures in order to make improvements.

The policy guidelines are used to manage the incidence of credit risk, which is spelt out in the Credit Risk Policy ensuring stringent pre/post credit risk management in line with the risk appetite of the Bank, the regulations of the Central Bank of Sri Lanka and the globally accepted Basel guidelines. A post-approval hindsight review of credit approved is carried out by an independent committee which makes recommendations as appropriate for action and reports to the Board Audit Committee.

Culture of Responsible Financing

The Bank has been successful in developing a culture of risk awareness and responsible financing through comprehensive training of the credit team and continuous discussions at regular credit committee meetings which bore results in improving the skills of front end staff.

Developments in 2017

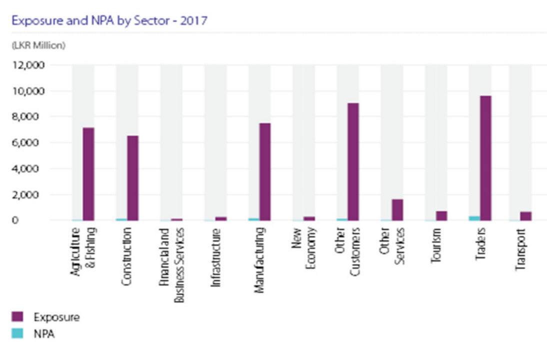
Apart from employee training on credit appraisal, risk acceptance and overall awareness on Credit Risk, the Bank has been consciously looking into reviewing the existing risk score models of SME, Corporate and Retail banking towards achieving a comprehensive Risk score model. The Bank is also in the process of consulting experts in the field to identify a suitable model which will support the aspirations of a growing Bank like Amãna.

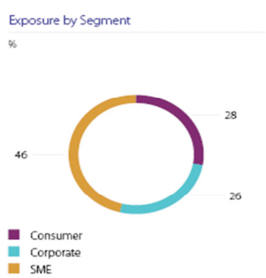
Credit Risk Performance in 2017

The Bank's gross advance portfolio grew by 12.2% during the year, upheld by SME, Corporate and Retail financing under which the leasing portfolio growth was relatively moderate. Conscious efforts to rebalance the portfolio towards SME and Retail Banking have resulted in an overall improvement in the risk profile.

Default Risk

Default risk is the key component of credit risk and is potential losses which may arise from the default of a borrower or counterparty. Whilst the Bank maintains a financing book of Rs 43.4 Bn recording a growth of 12.2% from the previous year of 2016, its gross NPA ratio was maintained at 1.89% which is below the industry average. Continuous focus on credit quality, strengthened credit appraisal mechanism, rigorous monitoring and strong recovery efforts have been the key contributors in managing lower NPAs.





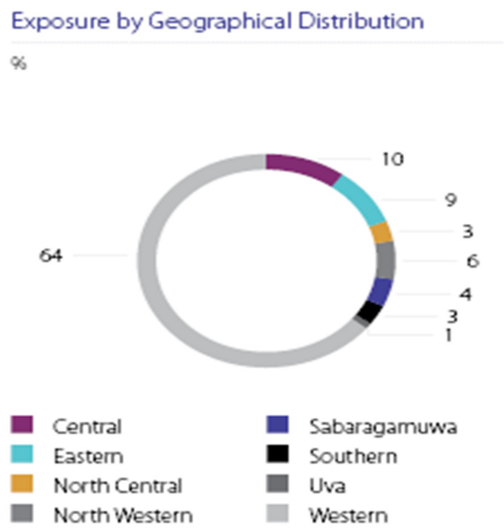
Concentration Risk

Concentration risk is the probability of loss arising from significantly imbalanced credit exposure to a particular individual, group, industry sector or geographical area. The Bank's prudential Single Borrower Exposure Limits are more stringent than the ceiling set by the regulator.

The Bank maintains a healthy concentration among main sectors such as Trading, Agriculture, Manufacturing, etc. However, the Bank continuously conducts stress testing exercises and scenarios analyses to understand any emerging trends in the market/industry and contain lending to industries which are experiencing difficulties.

As a growing Bank, Amãna has been continuously focussing on financing Small and Medium Enterprises (SME) and emerging corporates together with Retail Financing for its portfolio growth.

Western province contributes to the majority of financing by the Bank and the balance is proportionately distributed among other branches in the regions.



The sector exposure limits, which are also approved by the Board of Directors, are reviewed periodically taking into account changes in internal/external factors in order to mitigate risk and explore business opportunities.

In order to mitigate the concentration risk, the Bank's appetite for credit exposures is predefined for:

- Single borrower
- Group of related borrowers
- Major economic sectors

Concentration risk is monitored closely, and the relevant limits are reviewed and changed periodically to suit the changes in economic and environmental outlook, Bank's policies and regulatory requirements.