

Atlas Bank Limited Corporate Governance Ratings

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Date: *March 15, 2010*

Rating Summary

Current Rating: *CGR- 7 (Moderately High Level of Corporate Governance)*

Date: *March 15, 2010*

Previous Rating: *CGR- 7 (Moderately High Level of Corporate Governance)*

Rating Rationale

Institutional Overview & Recent Developments

Atlas Bank Limited (ABK) was incorporated in 2003 as Dawood Bank Limited, and was subsequently acquired by Atlas Group in December, 2005 to form ABK. The bank is registered on all stock exchanges of Pakistan with its registered office situated in Karachi. The bank currently operates through a network of 40 branches (FY08: 40).

The bank has one wholly owned subsidiary, Atlas Capital Markets Limited, which is engaged in brokerage and advisory services. Other than this, the bank has seventeen other associated concerns which including the following entities:

- Atlas Asset Management Limited
- Atlas Insurance Limited
- Atlas Engineering Limited
- Atlas Battery Limited
- Atlas Honda Limited
- Honda Atlas Cars Limited
- Atlas Power Limited
- Shirazi Investments (Pvt) Limited
- DEG- Deutche Investitions (DEG)

During November 2009, the management of ABK formally announced that Suroor Investments Limited (SIL), a Mauritius based firm, has entered in an agreement with the sponsors of the bank to acquire 58.3% stake in ABK. SIL has also recently acquired controlling stakes in Arif Habib Bank Limited and entered into agreement to acquire Mybank Limited. Prior to this deal, Atlas Bank Limited has also been linked with KASB Bank Limited and Silk Bank Limited for potential mergers; however the said deals never materialized.

Regulatory Compliance

We have received a certificate from the management confirming that to the best of their knowledge they have complied with all rules and regulations governing the business of banking in Pakistan, except for some deviations from the applicable statutes on accounts of procedural lapses during day to day operations of the bank.

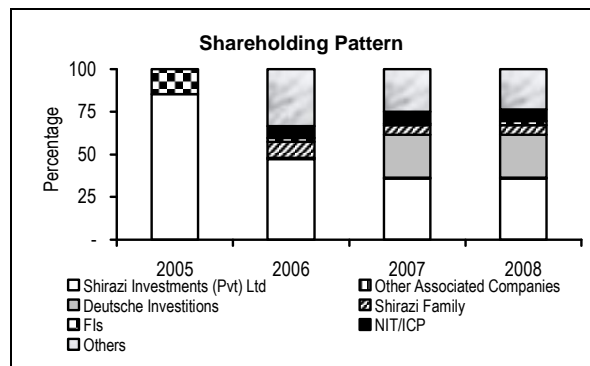
During FY08, the bank's penalties increased to Rs. 7m from Rs. 3.4m in FY07. These penalties were imposed by the State Bank of Pakistan (SBP) mostly on issues highlighted in their inspection report for year 2007.

Penalties imposed by SBP on other peer banks reported in the past two financial years are as follows. These primarily pertain to SBP inspections of 2006 and 2007:

Bank	FY2008	FY2007
Bank of Khyber	32.9m	21.0m
Mybank	8.4m	5.3m
Atlas Bank	7.0m	3.4m
JS Bank	0.7m	0.6m
Arif Habib Bank	0.2m	0.3m
Silk Bank	0.8m	4.6m

Ownership Structure

As evident from the graph below, major proportion of the bank's shareholding rests with Shirazi Investments (Pvt) Limited which is the parent company of Atlas Group, followed by DEG-Deutche Investitions. The following graph shows the changes in the bank's shareholding pattern since FY05.



As discussed previously, the shareholding of the bank is expected to change in the coming months, on account of its acquisition by SIL and subsequent merger with AHBL and MyBank (subject to the approval of regulators). In line with this, Shirazi Capital (Pvt) Limited (part of Atlas Group) has entered into an agreement with DEG to purchase its entire shareholding in ABK.

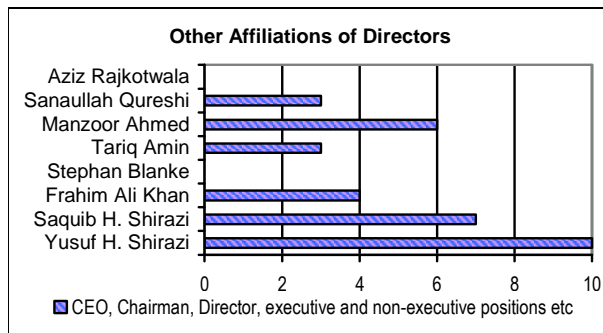
Board of Directors

The Board of Directors (BoD) comprises eight directors including one executive director (CEO) and seven non-executive directors. In substance, the bank has two directors who can be considered as independent directors.

The position of the Chairman is held by Mr. Yusuf H. Shirazi, while Mr. Aziz Rajkotwala is the President / CEO of ABK. Mr. Yusuf H. Shirazi has over 46 years of chairmanship experience to his credit and possesses degrees of Arts and Law. Mr. Rajkotwala is an MBA by qualification and is a seasoned professional with 37 years of banking and industry experience.

Of the seven directors, three directors are elected directors while two directors have been nominated by financial institutions. The remaining two directors were co-opted in place of out going directors. Mr. Saquib H. Shirazi replaced Mr. Aamir H. Shirazi on September 29, 2008, whereas Mr. Sanaullah Qureshi replaced Mr. S. Salim Raza (now Governor of SBP) on February 16, 2009. Mr. Qureshi is qualified Chartered Accountant and possesses around 52 years of experience. Mr. Saquib H. Shirazi is an MBA from Harvard Business School and has 17 years of professional experience to his credit. Of the nominee directors, one director represents National Investment Trust Limited, while the other director has been nominated by DEG. Except for Mr. Rajkotwala, none of the other board members have any significant level

of local banking experience, absence of which may reflect adversely on the Board’s ability to effectively fulfil its responsibility.



As manifested in the above graph, a number of directors have affiliations with other institutions. The CCG of Pakistan mandates that no listed company shall have a person as their director if that person is serving as a director of ten other ‘listed companies’. Mr. Yusuf H. Shirazi (Chairman) is affiliated with ten other companies, however four of these companies are unlisted, hence appointment of Mr. Yusuf H. Shirazi as a director of ABK is in compliance with CCG. However, as per best practices of Corporate Governance none of the directors should be on the Boards of more than 5 companies. Currently, 2 other directors, apart from the Chairman, are on the Boards of more than 5 companies.

As per the declaration submitted by directors, none of the members of the BoD or their spouses are involved in stock brokerage.

The quality of deliberation of BoD meetings was found to be adequate and detailed. The board was actively involved in reviewing bank’s financial statements; internal control and governance practices; policy making; key performance indicators; and performance of board committees.

According to the management, the bank currently does not have any platform to provide formal orientation to any new incoming or existing directors. However, we were informed that any new incoming director is provided with the memorandum of association and articles of association along with the minutes of previous meetings to serve as an orientation program and to create an understanding about the bank’s operations.

The Board of ABK has constituted four board committees, which including the Board Audit

Committee (BAC), Board Executive Committee (BEC), Board Human Resource Committee (BHRC), Board Compliance and Risk Management Committee (BCRMC).

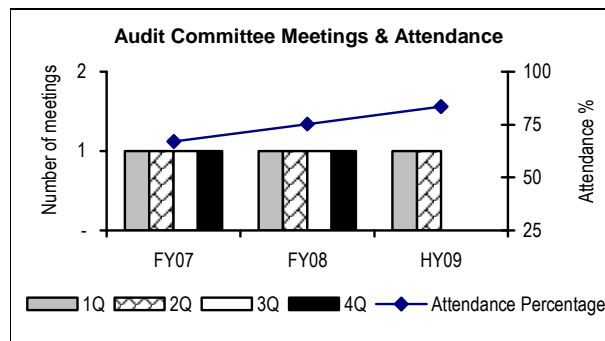
Committee	# of members	Quorum	# of meetings from FY07-HY09
BAC	3	2	10
BEC	5	2	10
BCRMC	3	2	11
BHRC	3	2	9

Terms of reference (TOR) of all the Board Committees have been duly approved by the BoD. In line with international best practices the company secretary is the secretary to BAC and BEC. However, the secretary to BHRC is Mr. Salman Munir (Group Head of Human Resource), whereas secretary of BCRMC is Mr. Humayun Bawkhher (Group Head of Enterprise Risk Management).

Director	BEC	BAC	BCRMC	BHRC
Mr. Saquib H. Shirazi	✓		✓	
Mr. Frahim Ali Khan	✓*	✓	✓*	✓*
Mr. Aziz Rajkotwala	✓		✓	✓
Mr. Tariq Amin	✓	✓*		✓
Mr. Stephan Blanke		✓		
Mr. Sanaullah Qureshi	✓			

* Chairman of the committee

The Board's Audit Committee is chiefly responsible to (i)ensure existence of a sound internal control system; (ii)assess the quality of existing systems; and (iii)review of internal audit reports. In addition to this BAC also oversees the appointment of external auditors and head of internal audit, reviews the periodical financial statements, approves the internal audit plan, and considers the conclusions of internal investigations with respective management responses to it. All three members of the BAC are non-executive directors, which is in compliance with CCG.



The CEO, CFO, the head of Internal Audit and representatives of external auditors attended BAC meetings where necessary. In compliance with Code of Corporate Governance the BAC also met with representatives external auditors without the presence of the head of Internal Audit and CFO. The BAC also met with the Head of Internal Audit in the absence of CFO and external auditors. The quality of deliberations of the BAC was found to be adequate with a major focus towards financial statements, internal audit reports, management letter and SBP citations.

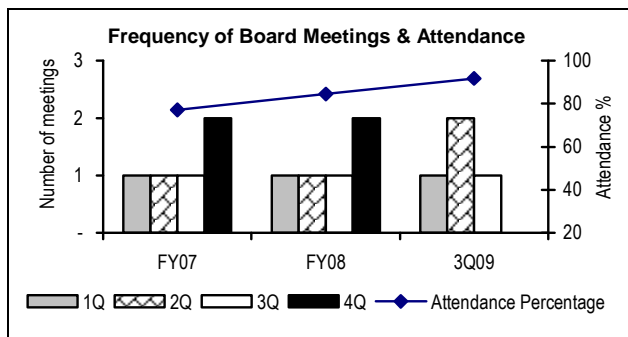
The basic purpose of the Board Executive Committee is to watch over matters pertaining to the operations of the bank which includes approval of ABK's Strategic Business Plan, approval of Annual Operational Plan, approve CAPEX over and above the budget, recommending adoption of specific policies, ensuring bank's compliance with SBP regulations and to delegate powers and authorities of CEO. The overall attendance BEC meetings stood at 60% from July'08 to June'09, while the number of meetings conducted during the same period amounted to three. Due to non-availability of quorum, the committee held no meeting during 4Q08, which is non-compliance with approved TOR of BEC that requires it to meet once every quarter.

During our review of Board and its Committee minutes, we noted that there were expense over-runs during FY08 vis-à-vis budget, which were noted with concern by the Board. However, as per management, the said expense overruns pertained to newly opened branches during FY08; related expenditure was already committed by the management and could not be promptly curtailed. Nevertheless, adequate budgeting of branch related expenditure in the first instance and attainment of prior approval from BEC before expense exceeded budget would have been more in line with corporate governance best practices.

The Board's Compliance & Risk Management Committee is responsible to oversee and monitor risk management policies and procedures of ABK; monitor overall compliance in relation to regulatory directives and guidelines; authorization of tolerable deviations from approved limits; ensure adequate allocation of resources to compliance and risk management function of the bank; and ensure employees of the bank have appropriate expertise to take, monitor and control risk.

In addition to this, the TOR of the committee also incorporates BCRMC's oversight functions relating to credit risk, market risk, liquidity risk, operational risk and compliance risk. As per the TOR, BCRMC is required to have at least one meeting each quarter with a quorum of two members. In line with this, the committee held five meetings during July'08-June'09. The overall attendance of members during the same period registered at 83.4%. In FY09 the bank has faced delinquency issues, particularly in the SME portfolio while it was also involved in a liquidity crisis. Although the bank has taken necessary steps to address these issues a more proactive approach may have allowed ABK to handle the crisis better.

The Board Human Resource Committee reviews and recommends HR policies and procedures, staff rules, compensation, bank's succession plan, and human resource strategy. The overall attendance BHRC meetings stood at 100% from July'08 to June'09, while the number of meetings conducted during the same period amounted to only two. The committee held no meeting during 4Q08 and 2Q09, and therefore is in non-compliance with approved TOR of BHRC which requires it to meet once every quarter.



Meeting fee of Rs. 10,000 is paid to all non-executive directors (other than those representing financial institutions) for attending board and board committee meetings. Fee paid to non-executive

directors amounted to Rs. 0.22m in FY08 (FY07: Rs. 0.17m).

With regards to attendance by the departmental heads in the meetings of BoD and its committees, the company secretary and the CFO are the regular attendees of Board meetings, where as they and various group heads are invited on a periodic basis to attend Board Committees to provide explanation on areas pertaining to their departments. The respective group heads also gave a number of presentations to the Board and its Committees.

Regulation G-1 of Prudential Regulations mandates that each individual director of a bank should attend at least half of the meetings held during the 'financial year'. ABK was able to achieve compliance with the above stated regulation during FY08.

Director	FY07	FY08	3Q09
Mr. Yusuf H Shirazi	100%	100%	100%
Mr. Aamir H. Shirazi	67%	100%	N/A
Mr. Frahim Ali Khan	100%	80%	100%
Mr. Manzoor Ahmed	N/A	67%	75%
Mr. Saquib H. Shirazi	100%	100%	100%
Mr. S.Salim Raza	100%	80%	N/A
Mr. Stephan Blanke	N/A	80%	50%
Mr. Tariq Amin	60%	80%	100%
Mr. Tariq Iqbal Khan	0%	0%	N/A
Mr. Aziz Rajkotwala	80%	100%	100%
Mr. Sanaullah Qureshi	N/A	N/A	100%
Mr. Sherali Mundrawala	100%	N/A	N/A

With regards to powers and authorities of Board, Board Committees, Chairman, and the CEO, the bank has clearly defined and approved lines for each of them.

Executive Management

The executive management of the bank comprises an adequate mix of experienced and qualified professionals. Mr. Aziz Rajkotwala has been the CEO of the bank since FY07 and has more than three decades of experiences in areas of operations, treasury, corporate, commercial and consumer banking. Prior to joining Atlas Group, Mr. Rajkotwala was working as Group Executive International Banking at Habib Bank Limited. The overall organization structure includes the following groups:

- Treasury/Investments/Corporate Banking
- Commercial Banking
- SME Banking

- Retail and Consumer Banking
- Enterprise Risk Management
- Compliance & Op Risk Management
- Enterprise Operation
- Information Technology
- Finance
- Human Resource
- Internal Audit

Except for the head of internal audit, all group heads of the bank directly report to the CEO. The head of internal audit reports to the Board Audit Committee. During CY08, no appraisal of the Head of Internal Audit was conducted by the Audit Committee on grounds that he had not completed one year of service yet. Appraisal for FY09 is currently under process.

Since our last review, no new group was established; however, keeping in view the size of the bank and scaling down of operations in view of the impending acquisition/merger, Corporate Banking was made part of Treasury & Investment Banking Group, whereas Administration was merged with Enterprise Operations.

The Treasury and Investment Division is divided into three different areas, namely, front office, middle office and back office. The front office is mainly responsible for executing day to day transaction, while the middle office has the responsible for market risk management. Although the middle office is a part of Treasury Group, it works independently and directly report to the Enterprise Risk Management. The back office performs and maintains the booking and records of transactions, respectively. The corporate finance section is also under direct supervision of the group head.

The group uses 'ADAMS' as their management information system which is fully integrated with their core banking system 'AB-2'. All money market transactions are approved by the head of treasury and are subsequently reviewed by Enterprise Risk Management and ALCO. The middle office reviews the credit ratings and financial statements of all the counter parties for the same.

For equity transactions the group uses research reports of various brokerage houses, namely AKD Securities, JS Global and KASB Securities. While developing an internal research department would further enhance the risk evaluation process for

investments, due to the volatility in equity market performance and the bank's own liquidity constraints, activity of the equity desk has remained limited and there are currently no plans for expanding scope of its operations.

To hire a new employee for the bank, the HR receives request from the senior management of the bank, which is then compared with budgeted headcount of that particular year. The HR first considers internal candidates suitable for any position; however, if any suitable candidate is not available then external candidates are called for the vacant position through public advertisement. After screening the suitable candidates the HR refers them to the respective group heads which then further shortlists the candidates. On an occasional basis, the HR also receives hiring recommendation from various group heads.

Afterwards, the HR in consultation of the group head invites the candidate for the interview which is conducted according to a standardized matrix. If the recruitment is for grade 9 & 8 then the CEO also participates in the interview, whereas for grade 7 and above employees a representative of BHRC also conducts the interview of the candidate. When the final candidate is selected for the position, HR, together with verification of resume particulars, negotiates the grade and salary with the person and makes the final offer.

Aggressive hiring at the executive, middle and lower management level primarily took place during FY07. During our review of Board Audit Committee minutes, we noted that the significant proportion of ABK's staff was hired through referrals (469) rather than through public advertisement as per standard procedure. Also, proper and timely verification of employee antecedents was not performed pending which salary of such employees was frozen for an extended period of time. While management has taken steps to expedite the verification process the same has yet to be completed; allowing unverified personnel with continued access to the bank's premises and systems is a control issue.

As per management, following standard hiring procedures was not feasible at the time in view of the aggressive hiring needs of the bank. Also, subsequent hiring of staff was done through standard procedures and all opening were publicly advertised. The bank published its first advertisement during December 2007. On recommendation of the Audit Committee, the HR Group, initiated verification of antecedents of

staff hired through referrals during FY08 and to date verification of only 17 employees is pending.

The evaluation of each employee covers the period from January 1 to December 31, and is conducted during January of each year. Performance evaluations for FY08 were conducted in January'09, while for FY07 evaluations were conducted during January'08 and July'08.

The performance evaluation of each staff is done by his/her supervisor and is based on work accomplishments; competence and behavioural standards, progress achieved, and future learning and development plans. The observations of the supervisor are filled on a separate appraisal form and the employee is rated accordingly; which are outstanding, very good, good, fair and poor. The employee classified as poor is recommended for quarterly evaluations or termination.

On voluntary resignation by an employee, the staff member submits his/her resignation letter to the immediate supervisor. Subsequent to the approval of resignation, the requisition is forwarded to the HR for approval and exit interview. For grade 8 and above CEO approval is also obtained. As a standard operating procedure the bank also has a forced termination policy which is only applicable in case of any serious charge against the employee. However, as per management, an employee can also be recommended for termination on the base of his/her poor performance.

The bank has a defined succession planning for each group, such that in absence of group head the second most senior person of the respective group is made in-charge. In case the CEO of ABK is not present, Mr. Farooq Saleem (Group Head Treasury) assumes the office of Mr. Rajkotwala as the acting CEO. During June08-June09, Mr. Rajkotwala was absent for a total of 16.5 days.

The Enterprise Operations Group primarily has two functions which are administration and centralised operations. The centralised operations function is further divided into trading operations (letter of guarantees and letter of credits), account opening, clearing, settlement, chequebook issuance and recalculation. During the outgoing year, with the help of an external consultant the Group successfully completed the fixed asset tagging assignment which has eliminated all the previously un-reconciled issues relating to operating assets of the bank.

The Commercial Banking Group is primarily responsible to manage advances to entities having turnover in the range of Rs. 600m and Rs. 3b. The business unit only prepares proposals and forwards them to the ERM for evaluation. On account of the impact of overall economic environment on the mid-tier corporate clients there has been reduction in lending activity. Resultantly, staff strength of the group has now reduced to 16 from 30 in FY08.

The Retail and Commercial Banking Group has four different functions namely, Retail Banking (deposits), Consumer Financing, Service Quality, and Marketing. In terms of performance, the retail banking (deposits) unit has underperformed in attracting core deposits, whereas the bank has more or less put on hold its consumer financing activities keeping in view the general infection levels in the same across the banking sector. The staff hired for consumer financing have been accordingly assigned various other responsibilities.

ABK has five management committees including Management Committee, Human Resource Committee, Risk Management & Credit Committee, Assets and Liabilities Committee (ALCO), and I.T. Steering Committee.

The management committee comprises 12 group heads, representing all functions of the bank, with the CEO as the chairman of the committee. The committee was constituted in April, 2006 and reconstituted during October 2007. The committee primarily acts in an advisory capacity to the CEO. In addition to this, the committee implements Board approved policies, develops business plans and strategies, monitor variances, and oversee all affairs of the bank.

The members of ALCO include the group heads of Treasury, Finance, Enterprise Risk Management, Commercial Banking, SME, Retail Banking, Compliance and the CEO as the Chairman. As per the TOR, ALCO is responsible for managing the maturity profiles of bank's assets and liabilities, product pricing, liquidity profile, investment, and counter party limits for money market and foreign exchange transactions.

Like most small and mid sized commercial banks, ABK witnessed severe liquidity crises during the last quarter of FY08, largely emanating from withdrawals of fixed deposits. As per management, this was a systemic risk and liquidity risk management policies

cannot cater to such events. However, had the management adapted a more proactive stance in timely curtailment of ABK's lending activities specifically towards SMEs keeping in view its short-term deposit maturity profile, the institution might have been in a better position to handle such a massive withdrawal.

The bank became non-compliant with SBP's Statutory Liquidity Requirements during the same period. On account of its liquidity issues, ABK utilized SBP financing of Rs. 2.6b, which was eventually paid back in February '09. Liquidity of the bank has remained stable since then. The bank has also improved the quality of discussion during ALCO meeting via enhancing the quantum of risk analysis.

The Risk Management & Credit Committee prepares reviews and recommends risk mitigation strategies for credit risk, market risk, operational risk and liquidity risk. The committee also focuses on performance of asset portfolio, adequacy of credit approval processes, provisioning against infected assets, credit limits, preparation of various risk related policies. The members of the committee include the CEO, group heads of Treasury, Compliance, Enterprise Risk Management, Commercial Banking, Retail Banking, and SME. The committee also comprises of heads of credit policy and Basel II. In FY08, the bank faced severe liquidity crisis while portfolio delinquency trends or on the rise in FY09. Although, the management has taken necessary steps to arrest these trends, a more proactive approach may have allowed the bank to better withstand the liquidity crisis and rising delinquency issues.

The Human Resource Committee formulates policy and ensures implementation relating to personnel including recruitment, training, promotion, compensation, retirement, and disciplinary cases.

The key objective of the IT Steering Committee is to develop and maintain information system/technology system of the bank in congruence with the bank's overall objectives and goals. Additionally, the committee also provides guidance in formulating IT policy to support business operations.

The Chairman of all committees is the CEO which is inline with international best practices of corporate governance.

The management of the bank initiated process of implementing a new core banking system T-24 during

FY07. The implementation was initially planned to be completed by September'08. Nevertheless, on account technical difficulties and delay at the part of consultant (NDC), the implementation was slightly delayed. ABK made some T-24 modules live in FY08; however, on account of system stability issues, ABK rolled back to AB-2. Presently, the bank is using an updated version of AB-2, while plans to implement the T-24 have been put on hold as the bank is in process of possibly merging with two other local banks.

The bank maintains a 'cold' disaster recovery site in Lahore which is fed with back-up (on daily basis) at the end of the day. Other than this, the I.T group also takes at least two back-ups daily to accommodate any unprecedented system interruptions. These back-ups are stored at one of the bank's branch safety vaults located in Karachi. The management has informed us that in-case of complete system failure, the bank would require around 12-hours to fully activate its operations through its cold disaster recovery site.

Financial Transparency

Financial statements for FY08 were prepared within the time line defined by the regulators. Annual accounts for the year ended December 31, 2008 were approved by the board in their 30th meeting held on February 28, 2009. After approval from the Board, the company obtained the signed audit report from their external auditors and subsequently presented the account to the shareholders for approval on March 30, 2009 in the Annual General Meeting.

According to the external auditors of ABK, the financial statements for the year ended December 31, 2008 were prepared in accordance with the applicable regulatory requirements and the approved accounting standards. The audit report for FY08 and interim review report for HY09 were unqualified reports.

However, in their review report for HY09, the external auditors of the bank included a 'paragraph of emphasis' pertaining to the extension provided by SBP to ABK for meeting the minimum capital requirement of Rs. 5b till November 30, 2009. However, on account of on going merger negotiations with two local commercial banks, the central bank has further extended the deadline for ABK to meet the MCR by March 31, 2010.

The time taken for the preparation and audit of the annual financial statements in the recent past is as under:

Year End	Audit Report
FY05	Feb 11, 2006
FY06	March 2, 2007
FY07	Feb 22, 2008
FY08	Feb 28, 2009

The Finance Division uses Auto Banking (AB-2) and Oracle Financial for preparing, internal and external reports. External reports mainly include quarterly, interim and annual financial statements. These reports are prepared and issued on, both, standalone and consolidated basis. Internal reports prepared by financial division of the bank primarily include monthly performance report, monthly management accounts, and quarterly management accounts. According to the management these are prepared within 5 days, 9 days and 10 days from the end of the month, respectively. Furthermore, these reports also reviewed by the senior management of the bank on time to time basis. One sample of each report was also provided to JCR-VIS.

The overall layout and the design of the bank's website were found to be good. The website of the bank has the last three annual financial statements for public review. Additionally, the quarterly and half yearly reports for FY2007-09 are also available. Furthermore the website of the bank has (i) profile of the bank and group companies; (ii) list of Board and Management Committees together with the names of their members (iii) separate sections for different banking segments; (iv) media centre (v) career section; (vi) information regarding its branch and ATM network; (v) bancassurance section; (vi) corporate social responsibility section; (vii) contact us section; (viii) account opening forms; and (ix) list of unclaimed deposits. However, there is still room for improvement to bring the website in-line with the international best practices. Inclusion of the following articles/sections in the website will further enhance its utility to stakeholders:

- Disclosure of Rating Outlook and Rating Watch status on the ratings (identifying name of the rating agency), on the face of the website.
- Corporate governance section
- Profiles of members of the board
- Description of the process for performance evaluation of the board, its committees and individual directors, and key executives
- Profiles of executive management

- Charter of board committees
- A description of the company's risk management policy and internal compliance and control system
- Code of conduct
- Environment/Health and Safety section
- Investor relations section on the home-page
- Search engine

The annual report of FY08 included a comprehensive Chairman's review which highlighted economic and business conditions, banks overall financial performance and included the following sections:

- Risk Management
- Compliance & Op Risk
- Human Resource
- Small and Medium Enterprise
- Information Technology
- Board of Directors

The directors' disclosure in the annual report of ABK for FY2008 had identified the number of executive and non-executive directors. The annual report for FY2008 had also mentioned the names of all the senior executives of the bank; however their respective designations were not stated. Moreover, as per international best practice, inclusion of brief experience and education profile of the directors and the senior executives may further enhance the transparency of the annual report.

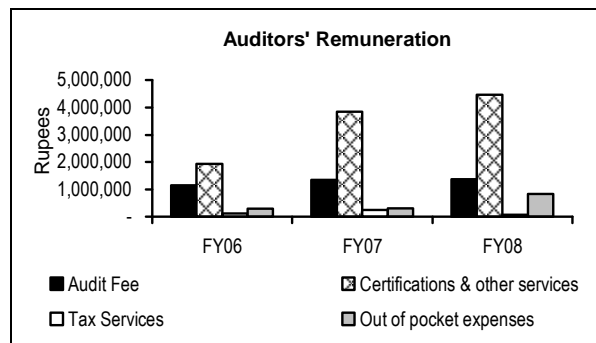
Together with the names of the members, brief TORs of all the board committees were part of the bank's annual report-2008. Moreover, in addition to the requirements of the Code of Corporate Governance 2002, the director's report published in the 2008 annual report had also enclosed all the necessary attributes/sections as per the best practices. These included the following sections/information:

- Risk Management Framework
- Credit and Corporate Governance Ratings
- Roles and responsibilities of Board Committees
- Role and responsibilities of Management Committees

The annual report of ABK also included sections of value addition and branch network. Inclusion of corporate responsibility section and bank's code of

ethics would further enhance the level of disclosures in the annual report.

External auditors of the bank are M/s. Ernst & Young Ford Rhodes Sidat Hyder (Chartered Accountants). The auditors have been cleared by the quality control committee of the Institute of Chartered Accountants of Pakistan to audit listed entities and moreover, are also in the 'A' category of State Bank of Pakistan's panel of auditors. The associated period of external auditors with the bank is four years (including 2009) and is within stipulated time period of five years. For the past two periods (FY07 and FY08) the external auditors have delayed the issuance of management letter vis-à-vis the stipulated time.



As evident in the above graph, the external auditors also provide other services in addition to annual audit and interim reviews. However, according to management, these services/certifications provided by the auditors were not in conflict with the performance of their audit procedures as they were either related to the same or necessitated by statutory requirements.

Self Regulation

The Compliance & Op Risk Group ensures bank's conformity with the laid down policies, procedures, laws and regulations, and corresponds with the regulatory authorities on the bank's behalf. The compliance testing of branches in the southern region is done on random basis while the same is done for every branch located in the northern part of Pakistan. For branches situated in the central region top five volumes based branches are tested each year. The Group currently uses an internally developed Anti Money Laundering (AML) system which is maintained on MS Excel worksheet. The data from all branches is imported via AB-2 to the designated AML sheet and is monitored according to preset parameters. On a broad basis, the system allows the

bank to monitor transaction on following four dimensions:

1. World Check: The name of executor and beneficiary (where possible) of each transaction is matched with a global list of high risk individuals, such as terrorists, politicians, known frauds, etcetera.
2. Currency Transaction Monitoring: Each withdrawal, deposit, fund transfer and online transaction which is above the defined thresholds is analysed by an AML analyst and where the transaction appears dubious or suspicious, the group, with the help of branch personnel, initiates an internal investigation. In the case of a negative conclusion the particulars of the transaction are submitted to Financial Monitoring Unit, formed under the Anti Money Laundering Ordinance.
3. Remittance Monitoring: Profile history of remitter and remittee are both monitored (mostly through internet search) and where possible financials of the same are also checked.
4. High Risk Monitoring: This exercise is done by the Risk Profiling Unit of ABK. The unit, on its own motion, has identified specific (riskier) customers and every transaction executed by these customers is monitored irrespective of the set thresholds.

Mr. Asad Saleem has informed us that the bank has been having negotiations with SAS Solution to implement an internationally recognized Anti Money Laundering Software. Complete implementation of this system will further enhance the risk management and monitoring system of the bank.

The Audit group comprises of eight members including the Head of Internal Audit. The group is responsible to evaluate and validate the effectiveness of controls and monitor and contribute to the control systems of the bank. The group performs its function independently and is directly reportable to the Board Audit Committee. The group is divided into two teams, with three individuals in each of them who perform audit of various branches and departments of the bank.

During FY08, the group performed 39 audits of branches and 13 audits of various departments. The numbers of the same stood at 28 and 6 for FY09, respectively. Each audit report (with its working papers) is reviewed by the Head of Internal Audit. Subsequent to the review, the draft reports are

circulated to respective branches and group heads to obtain comments on the observations within 15 days of issuance of draft report. After the comments are obtained, on both resolved and outstanding issues, the report is circulated to the Board Audit Committee. For outstanding issues the group regularly exercises follow-ups with respective branches and groups. With regards to the quality internal audit report, there is still room for further improvement in the format, wherein the inclusion of specific risks and recommendations associated with the observations may improve the usability and effectiveness of the report.

During our review of Board and Audit Committee minutes we noted that the members of the above had shown concerns over the occurrence of collusive fraud at one of the ABK's branch, increase in SBP citations and penalties imposed by the same, high proportion of hiring of staff through referrals, role of ALCO and certain internal control weaknesses at branch level.

The collusive fraud occurred at a Lahore (DHA) branch of ABK and was detected by the Compliance Group of the bank. The compliance personnel through their anti money laundering system identified existence of dubious accounts which were used by staff posted at the branch to misappropriate funds of deposit holders. On finalization of the entire internal investigation, the management of the bank terminated the accused employees and initiated legal proceedings against the same. To mitigate the risk of occurrence of any similar kind of event, the bank has introduced an SMS alert system which immediately informs any debit or credit entry to the customer in his/her account. Moreover, the bank also obtains withdrawal confirmations from its customers where the encashment is more than Rs. 0.3m.

The Board and Audit Committee on several occasions expressed their concern over continuous increase in SBP and internal audit citations including documentation related issues and directed the management to take stringent actions to overcome the weaknesses in the bank's operations and system by enhancing the risk management and compliance functions of the bank.

As per the management, they have now improved the monitoring functions of Enterprise Risk Management Group, Credit Administration Department, Compliance Group, Operations Group the bank has now revised its credit and liquidity risk (contingency

plan) policies. The credit administration department in collaboration with compliance and respective credit groups has now introduced a follow-up mechanism in which relationship managers are regularly reminded to check their documentation statuses with their clients. To counter weaknesses in the control system of the bank, the management of ABK took steps to timely check the eCIBs of borrowers and also formed a reconciliation department to ensure that no transaction remain un-reconciled past 90 days.

The account opening and 'Know Your Customer' documentation function was centralised during August'08 and was made part of Operations Group of ABK. All account opening forms and documents submitted by customers are digitally scanned and are submitted online to the centralised operations department. The operations department, together with performing a world check, verifies the CNIC of the customer through 'Verisys' system of NADRA, subsequent to which all other documentation is also scrutinized by the department. After the said processes are completed, the operations department intimates the branch on the same day to open the deposit account of the respective customer. According to the management, the average time taken for the whole process is around 3 hours.

The effectiveness of the aforementioned development however remains to be seen, and can be mainly gauged by (i) reduction in citations made by SBP; and (ii) reduction in internal audit observations.

With regards to implementation of the COSO (internal control) framework, the bank has not yet hired any consultant as the management of ABK believes that it would not be cost effective to implement the framework while the bank is the phase of negotiating mergers with other local commercial banks.

The Enterprise Risk Management Group is divided into four different departments namely, Special Asset Management, Middle Office and Basel II, Credit Risk Control, and Lahore Region (effective from May'09). Additionally, the middle office of treasury reports to the ERM. The group presently has 31 permanent employees. To improve its credit risk processes the bank updated its credit risk policy and introduced a new version (version 2) during FY09. The changes incorporated in the new policy mainly include:

- Three initials system where all three designated officers signing the credit

disbursement approval will be jointly and severally liable for any detrimental financial impacts

- Senior credit officers will personally visit the premises/places of the borrowers to assess the genuineness of information submitted by the borrower.
- Change in internal risk rating methodology, with inclusion of judgemental ratings as well.
- All relationship based lending will be revisited once every year. According to the management, at the end of 3Q09, the relationship managers of ABK had reassessed around 80% of their total clients.

The bank also now conducted various industrial studies during FY08 and HY09 to identify the problematic business sectors of the country. The bank conducted reviews of automotive, construction, power, textile and energy. Keeping in view the liquidity crunch witnessed by the bank during the outgoing year, the bank also introduced a contingency funding plan which is now in addition to the bank's standard liquidity risk policy.

During FY09, the Board approved three new policies, namely, Other Real Estate Owned Supplementary Policy, Fixed Assets Management Policy, and Restructuring/Rescheduling and Write-off Policy, as required by SBP guidelines. Moreover, treasury middle office was also able to duly submit to the SBP their Internal Capital Adequacy Assessment (ICAAP) model. ICAAP is an internal assessment process, required by the Basel II framework, which measures the capital adequacy of bank in relation to its overall risk profile and exposures to which the bank is exposed in its operational activities and strategy for maintaining capital levels.

Stakeholder Relations

At present, ABK may be considered as a small sized (new) bank in growth phase. Resultantly, the bank has relatively high operating cost vis-à-vis its spread and low current and saving account base (CASA) base, and has thus not reached the optimal level where it can earn healthy profits. Moreover, the increasing trend of non-performing assets and provisioning against the same, particularly in the SME portfolio, has further dampened profitability of the bank. As of September 30, 2009, the overall gross and net infection of the bank increased to 11.3% and 6.8%, respectively as opposed to 6.9% and 3.4% at the end of FY08, respectively. ABK had a net loss of Rs.

1.01b in FY08, which increased to Rs. 1.46b in 3Q09. On account of underachievement of targets, the board has become involved in the performance evaluation of group heads.

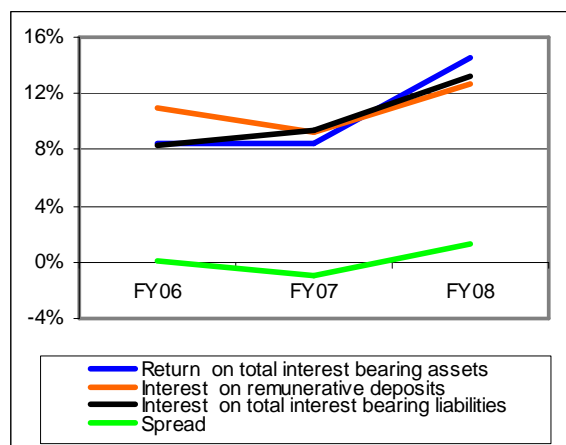
The bank has accumulated losses to the tune of Rs. 2.8b at the end of 3Q09. ABK currently does not comply with minimum capital requirement (MCR) of SBP, and has obtained an extension from the central bank in this regard. With the bank currently in negotiations with SIL for taking over ABK and potential merger with two other local banks, the management of ABK is positive that the bank will overcome the said issue of MCR.

Being a loss making bank, ABK, in compliance with Companies Ordinance, 1984, has not yet paid any dividends to its shareholders.

The quality of notices sent out to the shareholders is at par with the general industry practice. The last annual general meeting was held on normal working day in normal working hours in Karachi at the bank's registered office. The company has an independent share registrar [THK Associates (Pvt) Limited] who is responsible for share transfer services.

According to the company secretary of the bank, all communications and dealings with stock exchanges and other regulatory authority are handled by the company secretary himself, the bank has made no default on this part.

Depositors of any commercial bank are one of the major stakeholders as funds placed by them form the core of institution's resource base. With a significant proportion of high cost fixed deposits, the average return on deposits has remained on the higher side; however, on account of aggressive lending in the SME sector, where returns are high, spread improved in FY08.



* Spread has been calculated against remunerative assets/liabilities (including deposits). Trend of overall spread may differ.

In 3Q09 however, spread has declined due to continuing increase in cost of funds coupled with decline in yield on markup earning assets. In view of rising delinquency and liquidity issues, financing activity was curtailed with funds being deployed in the inter-bank market and in low risk government securities, which are highly liquid though also carrying lower yield.

Following are the Current Account-Saving Account balances per branch of ABK vis-à-vis its peers:

Bank	FY2008	3Q09
JS Bank	135.2m	97.5m
Mybank	122.7m	n/a*
Arif Habib Bank	132.8m	n/a
Atlas Bank	168.5m	206.5m
Bank of Khyber	322.1m	n/a
Silk Bank	246.8m	n/a

* not available

The above table indicates that while these numbers have significant room for improvement, they are favourably comparable to other peer banks. Excluding saving account balances, which are relatively more volatile than current account deposits, ABK's performance is relatively weaker in the peer group despite heavy branch expenditures.

To facilitate its customers and monitor the standard of service at branches the ABK has a formed a separate service quality department which falls under the umbrella of Retail & Consumer Banking Group of the Bank. For high quality service at branches the bank has set internal service benchmarks which each and every staff member of the bank has to follow. To

monitor performance of the branches the service quality department regularly performs 'mystery shopping' exercises in which independent personnel make a surprise visit at the branches as a customer in disguise. To assist customers and obtaining complaints the bank has formed a state of the art 24-hours call centre which uses SIEBEL, which is a renowned front end customer dealing system.

Staff Bonus policy was implemented during April, 2008, and the bank distributed bonuses to the tune of Rs. 25.8m to its 154 out of 827 employees. The bonuses were distributed as per the bank's variable compensation policy which states that staff members of ABK are rewarded according to the contribution made by them towards the success of the bank. However no bonus was distributed during FY09 due to loss in the previous year. With regards to perquisites, the bank provides the following benefits to all of its employees (with defined limits for each grade):

- Vehicle
- House loan
- Personal loan
- Provident fund scheme
- Leave entitlement
- Health insurance
- Group life insurance
- Accident insurance

It is pertinent to mention here that the bank has currently stopped providing some of the aforementioned perquisites, mainly attributable to the lower profitability over the outgoing year and current financial year. At the time of resignation, if an employee has an outstanding loan obtained from the bank, the terms of the loan are automatically converted to commercial terms from discounted terms.

At the end of HY09 the bank employed 1,177 (FY08: 1,469) employees and included 176 executives, 577 officers, 15 non-clerical staff and 409 outsourced. The number of employees further reduced to 1,085 by the end of FY09. The decrease in total number of employees was in line with Board directives regarding curtailment of expenses and was largely voluntary in nature.

The bank has a separate whistle blowing policy in place and employee who identifies the loop holes in completely kept in confidence. As per the Head of

HR, complains can be registered with both the HR and supervisor of that employee. On receipt of complain an independent inquiry officer is assigned to investigate the matter and appropriate disciplinary action is taken, if required, as per the forced resignation/ termination policy of the bank.

Although a board approved donation policy exists, the bank did not pay any donation to any charitable organization during 2007 and 2008 JCR-VIS