

## Directors' Report to the Shareholders



Dear shareholders,

It gives me great pleasure to present on behalf of the Board of Directors the annual report of your bank for the year ended December 31, 2014.

The Board have proposed final cash dividend of Rs. 5.5 per share (55%) for the year ended December 31, 2014. This will be presented for approval in the forthcoming Annual General Meeting of the bank by the shareholders. This translates into 86% dividend payout of the bank's distributable profit for the year 2014 (after statutory reserve allocation) and is the highest in the banking industry. This high payout shows bank's strong capital position with continuous focus on increasing stakeholder value by capitalising on opportunities to drive strong performance for the organisation and even higher payouts to the shareholders in the years ahead.

During year 2014, the bank focused on balancing growth, profitability and risk management. Profit before tax increased by 15 billion from Rs. 7 billion in 2013 to Rs. 22 billion in 2014. The increase in profit before tax was mainly due to 16% increase in net interest income and 23% increase in non-interest income offset, in part, by 13% increase in non-interest expenses and around 40% reduction in provisions. Profit after tax increased by 173% from Rs.5.5 billion for the year ended December 31, 2013 to Rs. 15 billion in December 31, 2014. Earnings per share was Rs. 7.06 in year 2014 as against Rs. 2.59 of last year.

Net interest income increased from Rs. 38.2 billion in 2013 to Rs. 44.1 billion in 2014 reflecting an increase of 16%. The bank is giving greater focus on getting low cost deposits and consequently improving cost of fund. In order to bolster net interest income, your bank is expanding into high yielding advance salary, agriculture financing and gold loans. During the year, the investment portfolio was reprofiled by making investment in comparatively high return Pakistan Investment Bonds. The Bank's balance sheet increased by 13% during the year under review. Due to the above-factors the bank was able to increase interest income by 16%. Non-performing GoP guaranteed loans remain a big drag on profitability and have impacted the interest income considerably.

The non-interest income increased by 23% from Rs. 25.6 billion in 2013 to Rs.31.4 billion in 2014. The increase in non-interest income was primarily due to higher capital gains. After an impressive 2013, your bank again recorded substantial gains in money and capital markets with booking of capital gains in excess of Rs. 8.9 billion in government securities and equity market in the year 2014 which are higher by 129% from last year. Furthermore, the bank also recorded significant foreign exchange income in year 2014 which increased by 22% over last year. Dividend income was lower by Rs. 837 million due to reduction in portfolio size and lower pay outs by some of the companies. Fee income increased by 5% from Rs.11.5 billion in 2013 to Rs. 12.1 billion in 2014 despite downward revision in agency commission, impact of which was offset through higher volumes. The increase in fee income was driven by focusing on increasing fee income streams from retail, commercial and corporate banking.

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Non-interest expenses increased by 13% from Rs. 36.3 billion in 2013 to Rs. 41.1 billion in 2014. Staff cost increased was on lower side at 6% due to net retirements during the year. Other administrative expenses increased by 15% due to change in accounting estimate for depreciation in respect of certain categories of fixed assets and commencement of amortization for core banking software. Excluding the above, net increase is 9% which is in line with inflation, greater technology related expenses and higher business volumes. Your bank is focusing on further strengthening compliance function to minimise the risk of regulatory non-compliance and avoid regulatory penalties.

Provisions were lower by 39% from Rs. 20.4 billion in 2013 to Rs.12.4 billion in 2014 due to last year base impact. This year some good recoveries were realized from non-performing loans. However, some large accretions to non-performing loans (NPLs) diluted the reversals impact.

Total assets increased by 13% from Rs.1, 365 billion at December, 2013 to Rs.1,543 billion at December 31, 2014. Total deposits increased by 12% from Rs. 1,101 billion at December 31, 2013 to Rs.1, 234 billion at December 31, 2014. Savings deposits increased by 11% from Rs.314 billion at December 31, 2013 to Rs.348 billion at December 31, 2014. Current deposits including remunerative deposits increased by 20% from Rs. 447 billion at December 31, 2013 to Rs.535 billion at December 31, 2014. Term deposits marginally decreased from Rs. 291 billion at December 31, 2013 to Rs.289 billion at December 31, 2014. The current and savings account (CASA) ratio was 72% at December, 2014 compared to 69% at December 31, 2013 which helped in reducing the cost of funds and in improving profitability of the bank. Total advances marginally increased by 3% from Rs.708 billion at December 31, 2013 to Rs.728 billion at December 31, 2014 primarily due to increase in retail advances. Net NPL ratio decreased from 4.2% at December 31, 2013 to 3.6% at December 31, 2014.provision coverage improved to 81.2% as on December 31, 2014 from 77.6% of last year.

The bank continued to expand its branch network in Pakistan which increased from 1,342 branches at December 31, 2013 to 1,354 branches at December 31, 2014.

The Bank is subject to capital adequacy guidelines stipulated by State Bank of Pakistan. The total capital adequacy ratio of the Bank at December 31, 2014 was 17.4% with Tier-1 capital adequacy ratio of 11.8%.

During 2014, the main focus was on increasing CASA deposits and in CASA major emphasis was on increasing current accounts. The bank launched two current accounts products by the name "NBP Choice" and has planned saving account products which will be launched during the first quarter of 2015.

"NBP Advance Salary" continued to perform exceptionally well and has been a major contributor in the bank's advances and profitability. The product has performed in all areas of growth, profitability and quality lending. SME financing is an important product and has great potential for economic growth. Your bank believes that SME sector plays vital role in the country's growth. Recognizing the importance of this area, despite current law and order situation, power shortages, high real inflation and interest rates, the bank continued to extend financing in this area, resultantly the bank's SME portfolio grew by 8%.

NBP being the largest public sector bank and the biggest lending institution has always led the way in product innovation and penetrating into neglected market segments. During the year the bank spearheaded the roll out of Prime Minister's Youth Business Loan (PMYBL) Scheme. Ever since the announcement of PMYBL program under the aegis of the State Bank of Pakistan and the Ministry of Finance, NBP has made significant progress in successfully implementing this scheme. NBP is confident that this program will not only be beneficial for the bank, but will also facilitate the SMEs in leading a positive multiplier effect, thereby yielding sustainable economic growth through greater financial inclusion.

Pakistan is primarily an agrarian economy. Keeping in view the importance of financing for Agriculture sector, your bank always gives special emphasis on this segment. Consequently, the bank has the largest agriculture portfolio in the commercial banking industry in Pakistan.

The banking market in Pakistan is swiftly moving towards branchless/mobile banking to provide prompt and better customer service. Since the bank has the highest number of accounts amongst all banks in the country, it need to keep pace with the technological advancements taking place in the industry. The bank has commenced setting up of a dedicated

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Alternate Delivery Channels (ADC)/ payments function. This area will assist the bank in offering branchless/mobile banking solutions to its existing and future customers, while working closely with the telecommunication operators in the country. Similarly the bank has also ventured into offering payment solutions through plastic cards and have already firmed up the required agreements with VISA International and China Union Pay. Your bank plans to initially launch prepaid / debit cards during the first quarter of 2015.

The Islamic banking plans to convert 150 National Bank conventional branches to Islamic banking by June 2017. As part of this plan, one (1) conventional branch was successfully converted to Islamic Banking Branch (IBB) in 2014 and have plan to convert 64 more branches to Islamic banking branches in 2015.

Your bank has a separate Assets Recovery Group to monitor and settle non-performing loans (NPLs) portfolio. Despite energy crises, deteriorating social conditions and poor economic growth, the bank managed to record reversal of provision of over Rs.4 billion during the year resulting in positive impact on the bank's profitability. The bank took a number of steps for reduction in NPLs inter alia merging of Assets Rehabilitation Wing (ARW) of Corporate & Investment Banking Group under Assets Recovery Group for coordinated recovery efforts, focusing settlements through legal course as well as out of court negotiations.

The bank has a dedicated Global Home Remittances Management Group which since its inception in 2009, has been playing a significant role in helping the growth of home remittances to Pakistan through its fast, reliable, convenient and secure services.

In line with the regulatory framework and bank's own business strategy, the bank has developed credit policy document which is regularly updated to bring further refinement in credit rules & procedures with the changing requirements. The bank aims at quality credit decisions through comprehensive evaluation, identification & mitigation of credit risks. Credit monitoring function has also been further specialized by formulation of separate functions dedicated to monitoring of overseas credit, domestic credit and project financing.

Your bank has been constantly striving to improve risk management standards. Considering the complexity of operations and needs of the local macro-economic and banking landscape, the bank has taken steps to further strengthen its risk management design and inculcate a culture of prudent risk management across its activities. During the year implementation of CAD plan was started throughout the country with approval of CAD Policy & Procedures Manual. This plan is now being rolled out in domestic regions, overseas and Islamic branches.

The bank has hired the services of a top consultant to undertake a comprehensive BPR and COSO exercise aimed at overall business process improvement, advanced risk management and strengthening of the overall control environment including internal controls over financial reporting (ICFR).

The Core Banking Application (CBA) was implemented in additional 254 NBP branches in 2014 (taking the branches to 273 which were on CBA as on December 31, 2014) enabling the bank to provide better customer services as well as ensuring efficiency across its attributed business functions. CBA rollout in remaining 1100 plus NBP branches is under implementation in 2015 to utilize maximum benefit of automation and facilitating NBP customers with enhanced services.

Your bank has planned to add 1000 ATMs to its network by 2015, out of which 250 ATM project is under implementation and remaining 750 ATMs are planned to be installed by the end of 2015. During 2014, over 400 branches infrastructure was equipped with connectivity and equipment to facilitate customers with faster processing. NBP is one of the first banks to implement latest technology by procuring top end IBM Power8 machine that is expected to result in better customer services.

The bank accelerated its efforts to strengthen compliance culture in the organization. Special emphasis has been placed on following the regulations on Anti Money Laundering (AML) and Know Your Customer (KYC).

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### Statement under Code of Corporate Governance

The Board of Directors is aware of its responsibilities under the Code of Corporate Governance and is pleased to report that:

- The financial statements, prepared by the management of the Bank, present fairly its state of affairs, the result of its operations, cash flows and changes in equity.
- Proper books of account of the bank have been maintained.
- Appropriate accounting policies have been consistently applied in preparation of financial statements. Accounting estimates are based on reasonable and prudent judgment.
- International Accounting Standards, as applicable in Pakistan, have been followed in preparation of financial statements and any departure there from has been adequately disclosed in the Annual Accounts.
- The system of internal control is sound in design and has been effectively Implemented and monitored.
- There are no significant doubts upon the Bank's ability to continue as a going concern.
- There has been no material departure from the best practices of corporate governance.
- Performance highlights for the last six year are attached.
- Value of investments of Employees' Pension Fund and Employees' Provident Fund as at December 31, 2014 (un audited) were Rs 35,521 million and Rs 13,124 million respectively.
- Pattern of Shareholding, complying with the requirements prescribed by the code is included in the Annual Report.
- Statement of Compliance with Code of Corporate Governance is included in the Annual Report.
- We have criteria for nomination of Bank's executives on the Boards of other companies where NBP is an investor company.
- The committees of Board of Directors along with their terms of reference / charter, meetings held during the year and attendance by each director have been separately disclosed in the Annual Report.

The number of board meeting held during the year was 10 and attended by the directors as follows:

S.No	Name of Director	Designation	Total Meeting Attended
1	Mr. Muneer Kamal	Chairman	10
2	Syed Ahmed Iqbal Ashraf	President	8
3	Mr. Shahid Aziz Siddiqi	Director	10
4	Mr. Farrakh Qayyum	Director	10
5	Mr. Rana Assad Amin	Director	9
6	Mr. Iftikhar A. Allahwala	Director	8
7	Mr. Muhammad Naeem	Director	9
8	Mr. Tariq Kirmani	Director	10
9	Mr. Zahid Hussain upto (6-3-2014)	Director	1
10	Mr. Wasiq Mahmood upto (3-3-2014)	Director	1
11	Dr. Shujat Ali (upto 3-3-2014)	Director	1

### Statement of Internal Controls

The Board is pleased to endorse the statement made by management relating to internal controls including management's evaluation of ICFR. The Management's Statement on Internal Control is included in the Annual Report.

### Corporate Social Responsibility

The Board is pleased to endorse the Corporate Social Responsibility initiatives taken by your bank, included in the Annual Report.

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## Risk Management Framework

Effective Risk Management is fundamental to the success of a Bank, and is recognized as one of the Bank's strategic priorities. NBP has a strong, disciplined risk management culture where risk management is a responsibility shared by all of the Bank's employees, management and BoD members. The primary goals of Risk Management are to ensure that the outcomes of risk-taking activities are consistent with the Bank's strategies and risk appetite, and that there is an appropriate balance between risk and reward.

Risk Management Group at NBP is staffed with young professionals having the requisite technical skills. The Bank executed Basel-II project under the guidance of external professional consultants, to significantly enhance risk management capacity across the full spectrum of the institution. Similarly BPR & COSO project is in process of execution under the consultancy of external professional consultants to review and enhance the existing processes and controls mechanism at NBP. This has enabled Risk Management Group to play a more effective role in the achievement of its objectives and assisting the Board and senior management to fulfill their responsibilities of risk oversight. Risk management is viewed in an integrated manner, including Credit Risk, Market Risk, Liquidity Risk and Operational Risk.

NBP's Board of Directors and Senior Management are fully committed to strengthening the risk management practices in NBP and an enabling risk structure, comprising:

- Board Risk Committee (BRC)
- Executive Risk Management Committee (ERMC)
- Independence of Risk Management Function
- Representation of Risk Management in Asset Liability Committee (ALCO).
- Representation of Risk Management in Credit Committee (CC) is mandatory while discussing any policies, product plans, programs and portfolio reviews.

In view of above, several initiatives were undertaken and achieved, some of which are listed below:

- Implementation of Risk Tolerance / Concentration Policy
- Development of Internal Risk Rating Models - NBP Saibaan Scorecard, NBP Advance Salary Scorecard, NBP Agriculture Scorecard
- Development of Transaction-wise Capital Charge Calculation Model
- Development of VaR & Back-testing Framework
- Development of various frameworks for management of risks i.e. MRM Framework and ALM Framework, etc
- Development of Risk Management Framework for Overseas Branches
- Review of various Product Manuals, Policies, Procedures & Frameworks
- Implementing / strengthening mechanism for collection of on-going Operational Risk incidents directly from the field functionaries
- Development of ORM database based on Audit's Major Control Lapses Reports
- Monitoring of bank-wide Operational Risk Tolerance limits as defined in the Operational Risk Strategy Document
- Initiation of Key Risk Indicators (KRIs) reporting on defined formats from relevant stakeholders
- Development of Business Line Mapping (BLM) Excel Based Model & Policy
- Establishment of PMO for BPR & COSO Implementation Project with in RMG & completion of two phases of BPR & COSO Implementation Project, Third Phase is underway
- Development of Web Based Application for Enhanced Data Collection of F-256 & SCA
- Approval of CAD Remediation Plan by CC & BoD
- Implementation of CAD Plan in 11 regions including Corporate Branch, Karachi



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### Events after the Balance Sheet date

There have not been any material events that occurred subsequent to the date of the Balance Sheet that require adjustments to the enclosed financial statements, except those which have already been made or disclosed.

### Change in the Board of Directors

We are pleased to welcome Mr. Muhammed Naeem and Iftikhar Allahwala on the Board of National Bank of Pakistan and are confident that the bank will benefit immensely from their rich experience and enlightened leadership. We also would like to express our sincere gratitude to Dr. Shujat Ali, Mr. Zahid Husain and Mr. Wasiq Mehmood, outgoing directors of the bank. Their contribution and support towards the bank's progress is duly recognized.

### Awards & Recognitions

In June 2014 M/s JCR-VIS Credit Rating Company again re-affirmed the entity rating of the bank at "AAA/A1+", one of the highest by the company for any bank in Pakistan.

### Profit & Loss Appropriation

The profit for the year 2014 after carryover of accumulated profit of 2013 is proposed to be appropriated as follows:-

	Rs in millions
Profit Before Tax	22,001
Taxation	
- Current	9,481
- Prior year (s)	-
- Deferred	(2,508)
	<u>6,973</u>
After Tax Profit	<u>15,028</u>
Un-appropriated profit brought forward	48,046
Other comprehensive income - net of tax	(436)
Transfer from surplus on revaluation of fixed assets	<u>126</u>
Profit available for appropriations	<u>62,764</u>
Transfer to Statutory Reserve (10% of after tax profit)	(1,503)
Cash dividend paid	<u>(4,255)</u>
Un-appropriated profit carried forward	<u><u>57,007</u></u>

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### Future Outlook

Year 2015 will be a year of new opportunities and challenges for NBP as well as the banking industry. The bank is focusing on consolidation and recoveries to bring down the non-performing loans. New products will be offered to generate additional streams of revenue and efforts will be made to reach new markets and customers for further growth in market share and retain market leadership position. Your bank is building a liability team to develop new deposit products which will enable the bank to increase average deposit per account. The branch network will be increased for both conventional and Islamic banking in urban and rural areas. Focus is on low risk retail products like Advance Salary, Agriculture and Gold Loans to customers.

The bank has undertaken a number of plans in the areas of information technology upgradation with major projects like CBA implementation (rollout of which across the domestic network is expected to be completed by year end 2015), expansion of ATM network (1,000 to be added by year end 2015), and branchless banking. Your bank intends to open new ATM facilitation centres for pensioners and utility bills collection through biometric verification. Trade finance and home remittances business will be increased through targeting new customers and products.

Your bank will continue to invest in HR capacity building through training. Efforts will be made to improve 'expense management' and achieve greater operational efficiency. Greater emphasis is being placed on improving internal controls and regulatory compliance.



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### Pattern of Shareholding

The pattern of shareholding as at December 31, 2014 is given in Annual Report.

### Earnings per share

The basic and diluted after tax earnings per share for the year 2014 is Rs. 7.06

### Appointment of Auditors

The Board of Directors on the recommendation of the Board Audit Committee, has recommended M/s. KPMG Taseer Hadi & Co., Chartered Accountants and M/s. Ernst & Young Ford Rhodes Sidat Hyder, Chartered Accountants to be the external auditors of the bank for the year ending December 31, 2015 with 10% increase in their fee paid in 2014 subject to approval by the shareholders at the Annual General Meeting. Both the firms, eligible, have offered themselves for appointment.

### Acknowledgement

Lastly we are confident that our employees through their commitment and hard work will further strengthen the bank's leadership position. We would like to express our appreciation to the stakeholders, regulators and valued customers for their support and trust in NBP.

For and on behalf of the Board of Directors

**Syed Ahmed Iqbal Ashraf**

President

Karachi

Dated: February 26, 2015