Risk and Capital Management Disclosure

for the period ended 30 June 2021

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1 Background

The Public Disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD-1: Annual Disclosure requirements, CBB Rule Book, Volume 2 for Islamic Banks. Rules concerning the disclosures under this section are applicable to Bahrain Islamic Bank B.S.C. (the "Bank") being a locally incorporated Bank with a retail banking license, and its subsidiaries together known as (the "Group").

The Board of Directors seeks to optimise the Group's performance by enabling the various Group business units to realise the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and the Group risk policy framework.

2 Statement of Financial Position Under the Regulatory Scope of Consolidation

The table below shows the reconciliation between the statement of financial position in the published financial statements (accounting statement of financial position) and the regulatory statement of financial position.

Table – 1. Statement of Financial Position (PD- 1.3.14)

	Statement of Financial position as per published financial statements 30 June 2021 BD'000	***Statement of Financial position as per Regulatory Reporting 30 June 2021 BD'000***	***Reference***
ASSETS			
Cash and balances with banks and Central Bank	**47,405**	**47,405**	
Gross placements with financial institutions	*144,164*	*144,164*	
Less: Expected credit loss (stage 3)	*(3,770)*	*(3,770)*	
Less: Expected credit loss (stage 1 and stage 2)	*(8)*	*-*	
Net placements with financial institutions	**140,386**	**140,394**	
Gross financing assets	*606,466*	*606,466*	
Less: Expected credit loss (stage 3)	*(18,443)*	*(18,443)*	
Less: Expected credit loss (stage 1 and stage 2)	*(9,030)*	*-*	
Net financing assets	**578,993**	**588,023**	
Gross investment securities	*274,503*	*274,503*	
Less: Expected credit loss (stage 3)	*(26,092)*	*(26,092)*	
Less: Expected credit loss (stage 1 and stage 2)	*(180)*	*-*	
Net investment securities	**248,231**	**248,411**	
Ijarah Muntahia Bittamleek	**225,131**	**225,131**	
Gross ijarah rental receivables	*24,475*	*24,475*	
Less: Expected credit loss (stage 3)	*(1,260)*	*(1,260)*	
Less: Expected credit loss (stage 1 and stage 2)	*(1,216)*	*-*	
Net ijarah rental receivables	**21,999**	**23,215**	
Investment in associates	**18,375**	**18,375**	
Investment in real estate	**16,109**	**16,109**	
Property and equipment	**13,671**	**13,671**	
Other assets	**7,552**	**7,552**	
TOTAL ASSETS	**1,317,852**	**1,328,286**	

Table – 1. Statement of Financial Position (PD- 1.3.14) (continued)

LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			***Reference***
Liabilities			
Placements from financial institutions	**133,697**	**133,697**	
Placements from non-financial institutions and individuals	**201,761**	**201,761**	
Borrowings from financial institutions	**19,067**	**19,067**	
Customers' current accounts	**277,259**	**277,259**	
Other liabilities	**31,498**	**31,299**	
of which: Expected credit loss - Off balance sheet exposures (stage 3)	-	-	
of which: Expected credit loss - Off balance sheet exposures (stage 1 and stage 2)	199	-	
of which: Other liabilities	31,299	31,299	
Total Liabilities	**663,282**	**663,083**	
Total Equity of Investment Accountholders	**531,600**	**531,600**	
Owners' Equity			
Share capital	**106,406**	**106,406**	**a**
Subordinated Mudaraba (AT1)	**25,000**	**25,000**	**b**
Treasury shares	**(892)**	**(892)**	**c**
Shares under employee share incentive scheme	**(175)**	**(175)**	**d**
Share premium	**206**	**206**	**e**
Statutory reserve	**4,736**	**4,736**	**f**
Real estate fair value reserve	**2,178**	**2,178**	**g**
Investment securities fair value reserve	**1,773**	**1,773**	**h**
Expected credit loss	**-**	**10,633**	**i**
of which: amount eligible for Tier 2 capital subject to a maximum of 1.25% of credit risk weighted assets	-	8,166	**j**
of which: amount ineligible for Tier 2 capital	-	2,467	**k**
Profit for the period	**2,599**	**2,599**	**l**
Retained earnings brought forward	**(18,861)**	**(18,861)**	**m**
of which: Retained earnings as of 1 January 2021	(18,031)	(18,031)	
of which: Zakah and Donations approved	(372)	(372)	
of which: Issuance costs of AT1	(458)	(458)	
Total Owners' Equity	**122,970**	**133,603**	
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY	1,317,852	1,328,286	

3 Capital Adequacy

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders, issue sukuk etc.

The Group's capital structure is primarily made up of its paid-up capital, and including reserves. From a regulatory perspective, the significant amount of the Group's capital is in Tier 1 form as defined by the CBB, i.e., most of the capital is of a permanent nature.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities, and future sources and uses of funds. To assess its capital adequacy requirements in accordance with CBB requirements, the Group adopts the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk, and Standardised Approach for its Market Risk. Allocation of assets between equity shareholders and profit sharing investment accounts are based on the profit distribution on equity investment accountholders policy approved by the Board.

All transfer of funds or regulatory capital within the Group is carried out after proper approval process.

For the purposes of guidance, every table was cross referenced with the relevant paragraph number of the Central Bank of Bahrain's Public Disclosures Module.

3 Capital Adequacy (continued)

Table – 2. Capital Structure (PD-1.3.13, and 1.3.14)

The following table summarises the eligible capital as of 30 June 2021 after deductions for Capital Adequacy Ratio (CAR) calculation:

	CET 1 BD'000	*AT1 & T2 BD'000*	*Source based on reference letters of the statement of financial position under the regulatory scope of consolidation*
Components of capital			
Issued and fully paid ordinary shares	**106,406**	**-**	**a**
General reserves	**-**	**-**	
Legal / statutory reserves	**4,736**	**-**	**f**
Share premium	**206**	**-**	**e**
Retained earnings brought forward	**(18,861)**	**-**	**m**
COVID-19 concessionary measures adjustments*:			
Modification loss and Governement subsidy, net	**12,897**		
Aggregate ECL provision relating to stage 1 and 2	**4,258**		
Current period profits	**2,599**		**l**
Unrealized gains and losses on available for sale financial instruments	**1,773**	**-**	**h**
Less:			
Employee stock incentive program funded by the bank (outstanding)	**175**	**-**	**d**
Treasury shares	**892**	**-**	**c**
Total Common Equity Tier 1 capital after the regulatory adjustments above (CET1 d)	**112,947**	**-**	
Instruments issued by parent company (AT1 Subordinated Mudaraba)		**25,000**	
Assets revaluation reserve - property, plant, and equipment		**2,178**	**g**
Expected credit loss (ECL) - stages 1 & 2		**8,166**	**j**
Total Available AT1 & T2 Capital		**35,344**	
Total Capital		**148,291**	

*As per CBB circular 06/226/2020 issued on 21 June 2020 on Regulatory concessionary measures, aggregate of modification loss and incremental ECL provision for stage 1 and 2 from March to December 2020 added back to Tier 1 capital.

		Amount of exposures BD'000
Total Credit Risk Weighted Assets		**653,312**
Total Market Risk Weighted Assets		**305**
Total Operational Risk Weighted Assets		**117,482**
Total Regulatory Risk Weighted Assets		**771,099**
Investment risk reserve (30% only)		**-**
Equalization reserve (30% only)		**409**
Total Adjusted Risk Weighted Exposures		**770,690**
TOTAL CAPITAL ADEQUACY RATIO		**19.24%**
Minimum requirement		**12.5%**
CET 1 ratio	**9.0%**	
Tier 1 ratio	**10.5%**	
Total Capital ratio	**12.5%**	
Amounts below the thresholds for dededuction		
i) Non-significant investment in capital of financial entities		**3,315**
ii) Significant investment in capital of financial entities		**3,979**
		7,294

3 Capital Adequacy (continued)

AT1 Subordinated Mudaraba

During the period, the Bank issued a Subordinated Mudaraba Sukuk (Basel III compliant Additional Tier 1 capital securities) of BD 25 million to meet minimum regulatory requirements relating to total equity as prescribed by Central bank of Bahrain. The issue was at par and was fully subscribed for and paid in cash by the Parent.

Summary of key terms and conditions of this issue are as follows:

a. Profits on these securities shall be distributed on a semi-annual basis subject to and in accordance with terms and conditions on the outstanding par value of the securities at an expected rate of 7.5% p.a.
b. Security holder will not have a right to claim the profits and such event will not be considered as an event of default.
c. Subordinated Mudaraba is invested in a general mudaraba pool of assets on an unrestricted comingled basis.
d. In the event of non-viability, the Sukuk certificates will be converted either in full or in part in accordance with the conversion rules and procedures.
e. The Sukuk certificates carry a call option after 5 years from the date of issue.

The Subordinated Mudaraba is recognized under the owners' equity in the condensed interim consolidated statement of financial position and the profits paid to rab al-maal (security holder) will be accounted for as appropriation of profits.

Issuance costs of BD 458 thousand representing BD 394 thousand underwriting fee to the Parent and BD 64 thousand other transaction costs have been adjusted in the retained earnings.

3 Capital Adequacy (continued)

Table – 3. Capital requirements by type of Islamic financing contracts (PD-1.3.17)

The following table summarises the amount of exposures as of 30 June 2021 subject to standardised approach of credit risk and related capital requirements by type of Islamic financing contracts:

	Exposure			*Risk Weighted Assets**			*Capital Requirements*		
	Self-Financed BD'000	*IAH BD'000*	*Total BD'000*	*Self-Financed BD'000*	*IAH [3] BD'000*	*Total BD'000*	*Self-Financed BD'000*	*IAH BD'000*	*Total BD'000*
Credit Risk Weighted Assets									
Funded									
Cash and balances with banks and Central Bank	22,777	24,628	47,405	4,427	-	4,427	553	-	553
Murabaha and Wakala receivables - interbank	131,691	8,703	140,394	31,370	622	31,992	3,921	78	3,999
Murabaha receivables*	265,195	238,156	503,351	208,201	56,092	264,293	26,025	7,012	33,037
Musharaka receivables*	44,610	40,062	84,672	37,745	10,169	47,914	4,718	1,271	5,989
Investment in Sukuk	119,685	107,482	227,167	-	-	-	-	-	-
Investment in equity and funds	21,244	-	21,244	75,599	-	75,599	9,450	-	9,450
Ijarah Muntahia Bittamleek and rental receivables*	130,843	117,503	248,346	83,590	22,520	106,110	10,449	2,815	13,264
Investment in associates	18,375	-	18,375	45,165	-	45,165	5,646	-	5,646
Investment in real estate	16,109	-	16,109	32,217	-	32,217	4,027	-	4,027
Property and equipment	13,671	-	13,671	13,671	-	13,671	1,709	-	1,709
Other assets	7,552	-	7,552	11,544	-	11,544	1,443	-	1,443
	791,752	536,534	1,328,286	543,529	89,403	632,932	67,941	11,176	79,117
Unfunded									
Commitments and contingent liabilities	132,659	-	132,659	20,380	-	20,380	2,548	-	2,548
Total Credit Risk Weighted Assets	924,411	536,534	1,460,945	563,909	89,403	653,312	70,489	11,176	81,665
Total Market Risk Weighted Assets	305	-	305	305	-	305	38	-	38
Total Operational Risk Weighted Assets	117,482	-	117,482	117,482	-	117,482	14,685	-	14,685
Total Risk Weighted Assets	1,042,198 [1]	536,534 [2]	1,578,732	681,696	89,403	771,099	85,212	11,176	96,388

* The risk weighted assets are net of credit risk mitigant.

[1] The exposure is gross of expected credit loss Stages 1 & 2 of BD 5,500 thousand.

[2] The exposure is gross of expected credit loss Stages 1 & 2 of BD 4,934 thousand.

[3] For assets funded through IAH only 30% of exposure is considered.

3 Capital Adequacy (continued)

Table – 4. Capital requirements for market risk (PD-1.3.18)

The following table summarises the amount of exposures as of 30 June 2021 subject to standardised approach of market risk and related capital requirements:

Market Risk - Standardised Approach	
Foreign exchange risk (BD'000)	**24**
Total of Market Risk - Standardised Approach	**24**
Multiplier	**12.5**
Risk Weighted Exposures for CAR Calculation (BD'000)	**305**
Total Market Risk Exposures (BD'000)	**305**
Total Market Risk Exposures - Capital Requirement (BD'000)	**38**

Table – 5. Capital requirements for operational risk (PD-1.3.30 (a & b) and PD-1.3.19)

The following table summarises the amount of exposures as of 30 June 2021 subject to basic indicator approach of operational risk and related capital requirements:

Indicators of operational risk	
Average Gross income (BD'000)	**62,657**
Multiplier	**12.5**
	783,213
Eligible Portion for the purpose of the calculation	**15%**
Total Operational Risk Exposure (BD'000)	**117,482**
Total Operational Risk Exposures - Capital Requirement (BD'000)	**14,685**

Table – 6. Capital Adequacy Ratios (PD-1.3.20)

The following are Capital Adequacy Ratios as of 30 June 2021 for total capital and CET 1 capital:

	Total capital ratio	***T1 Capital ratio***	***CET 1 capital ratio***
Top consolidated level	**19.24%**	**17.90%**	**14.66%**

4 Risk Management

4.1 Group-wide Risk Management Objectives

The risk management philosophy of the Group is to identify, capture, monitor, and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximising the returns intended to optimise the Group's shareholder return and maintaining it’s risk exposure within self-imposed parameters.

In addition to satisfying the minimum regulatory capital requirements of CBB, the Group seeks to constantly identify and quantify, to the extent possible, the various risks that are inherent in the normal course of its business.

The Group reviews and aligns its risk appetite in line with its evolving business plan, and changing economic and market scenarios, in addition to evolving regulatory requirements. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks. To monitor and report exposures to these identified risks, the Group adopted a comprehensive enterprise-wide Risk Management Framework that encompasses the risk limit, monitoring, and reporting structures.

4.2 Strategies, Processes and Internal Controls

4.2.1 Group’s risk strategy

The Group maintains a risk appetite and strategy document that is reviewed on an annual basis. It also maintains a comprehensive Risk Management Framework that is approved by the Board. These are also supported by appropriate limit structures. These policies provide an enterprise-wide integrated risk management framework for the Group.

The Risk Management Framework identifies risk objectives, policies, strategies, and risk governance both at the Board and management level.

Limit structures serve as key components in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with its own policies and methodology documents.

There are appropriate internal controls in place to ensure that the integrity of the risk management identification, monitoring and reporting systems. This is conducted through periodic internal audit, in addition to external validation, when required.

4 Risk Management (continued)

4.2 Strategies, Processes, and Internal Controls (continued)

4.2.2 Credit risk

The Group manages its credit risk exposure by evaluating each new product/activity with respect to the credit risk introduced by it, in addition to ongoing review of existing credit risk exposures. The Group has established a limit structure to avoid concentration of risks for counterparty, sector, and geography.

4.2.3 Market risk

The Group proactively measures and monitors the market risk in its portfolio using appropriate measurement techniques such as limits on its foreign exchange open positions. The Group periodically carries out stress testing to assess the impact of adverse market conditions on its market risk sensitive portfolio.

The Group has established a limit structure to monitor and control the market risk in its trading portfolio. These limits include maximum Stop-loss limits and position limits. As at 30 June 2021, the group does not maintain any trading portfolio.

4.2.4 Operational risk

The Group has carried out Risk Control Self-Assessment ("RCSA") exercises on a regular basis to record potential risks, controls and events on a continuous basis across different business and support functions. Key operational risk reports are delivered to all relevant stakeholders in the Bank on a periodic basis.

The Group has a mechanism to review the policies and procedures in effect.

4.2.5 Equity price risk

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the investment portfolio. Currently, acquiring additional equity investments are off-strategy.

4.2.6 Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The profit distribution to investment accountholders is based on profit sharing agreements.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits in line with market rates.

4.2.7 Displaced Commercial Risk

Displaced Commercial Risk ("DCR") refers to the market pressure to pay returns that exceed the rate that has been earned on the assets financed by the liabilities, when the return on assets is underperforming as compared with competitors rates.

The Group manages its Displaced Commercial Risk by placing gap limits between the returns paid to investors and market returns.

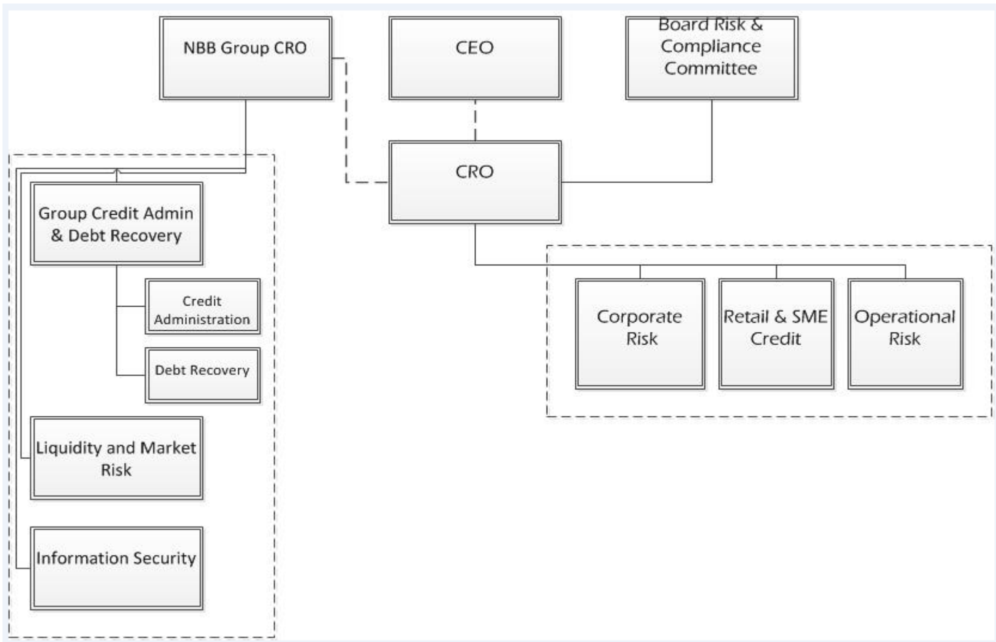
The Group manages its DCR as outlined in the Group's Profit Distribution On Equity of Investment Accountholders Policy. The Group may forego its mudarib fee in case displaced commercial risk arises. The Group benchmarks its rates with other leading banks in the market.

All the above strategies used have been effective throughout the reporting year.

4 Risk Management (continued)

4.3 Structure and Organisation of Risk Management Function

Risk Management Structure includes all levels of authorities (including Board level Risk & Compliance Committee, in addition to the NBB Group reporting), organisational structure, people, and systems required for the smooth functioning of risk management processes in the Group. The responsibilities associated with each level of risk management structure and authorities include the following:



The board retains ultimate responsibility and authority for all risk matters, including:

a Establishing overall policies and procedures; and

b. Delegating authority to Board Risk and Compliance Committee, Board Executive Committee, Credit and Investment Committee, the Chief Executive Officer and further delegation to management to approve and review.

4 Risk Management (continued)

4.4 Risk Measurement and Reporting Systems

Based on risk appetite of the Group, the Group has put in place various limits. These limits have been approved by the Board of Directors. Any limit breaches are reported to the respective senior management committees and the Board by the Credit and Risk Management Department (“CRMD”). The limits are reviewed and revised at least on an annual basis or when is deemed required.

The Group has developed a risk measurement and reporting system that generates various types of reports which has enhanced the monitoring process of the Group.

4.5 Credit Risk

4.5.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending and investment activities. The Group controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are secured by suitable tangible collateral whereever deemed necessary.

The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical area, and industry sector. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Corporate counterparties are regularly assesed by the use of a credit risk classification system. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision by the Credit Review Unit (“CRU”). Any changes to the Credit Risk Policy will be approved by the Board.

All credit proposals undergo a comprehensive risk assessment examining the customer’s financial condition, trading performance, nature of the business, quality of management, and market position, etc. This has further strengthened the approval process. The credit approval decision is made based on such ratings and terms and conditions are decided.
Retail credit is assessed by the Retail Credit Unit prior to booking as against the Bank's approved retail financing credit criteria.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the Group. Corporate contracts/facilities are reviewed on an annual basis by CRU, or more frequently based on the client's credit condition.

4.5.2 Types of credit risk

Exposures subject to credit risk comprise of due from banks and financial institutions, murabaha receivables, musharaka, sukuk, commitments to finance and financial instruments resulting in contingencies (guarantees and letter of credit) and other assets.

Due from banks and financial institutions

Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables.

Murabaha receivables

The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then reselling this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in installments by the Murabeh over the agreed period. The transactions are secured either by the object of the Murabaha contract (in case of real estate finance) or by a total collateral package securing the facilities given to the Murabeh.

Musharaka investments

Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

Ijarah Muntahia Bittamleek

The legal title of the assets under Ijarah muntahia bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration, or gradual sale, provided that all Ijarah installments are settled.

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.3 Credit impaired exposures

The Group defines facilities as credit impaired facilities which are overdue for a period of 90 days or more, any exposure against which specific impairment provision is held irrespective of whether the customer is currently in arrears or not, and customers which are classified in stage 3 and are in cooling off period in line with CBB guidelines. It is a Group policy to classify all facilities of a counterparty as credit impaired if one or more facilities meets the conditions for credit impaired facilities.

As a policy, the Group places any facility where there is reasonable doubt about the collectability of the receivable on a non-accrual basis, irrespective of whether the customer concerned is currently in arrears or not. In such cases, income is recognised to the extent that it is actually received.

For general and specific impairment assessments, the Group classifies its credit exposures into Stage 1, Stage 2 and Stage 3, based on impairment methodology followed, as described below:-

Stage 1 (12 months ECL): for exposures subject to credit risk where there has not been a significant increase in credit risk since initial recognition and that are not credit-impaired on origination, the group recognises an allowance based on the 12-month ECL. All accounts at origination would be classified as Stage 1 with the exception of Purchased or Originated Credit Impaired (POCI) assets.

Stage 2 (lifetime ECL not credit impaired): for exposures subject to credit risk where there has been a significant increase in credit risk since initial recognition but they are not credit-impaired, the group recognises an allowance for the lifetime ECL for all exposures classified in this stage based on the actual / expected maturity profile including restructured or rescheduled exposures.

Stage 3 (lifetime ECL credit impaired): for credit-impaired exposures, the group recognises the lifetime ECL. Default identification process i.e. DPD of 90 more is used as Stage 3.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

(i) Probability of Default (PD);
(ii) Loss Given Default (LGD); and
(iii) Exposure At Default (EAD).

These parameters are generally derived from internally developed statistical models and other historical data. They are adjusted to reflect forward-looking information.

Corporate PD estimates are calculated based on statistical rating models, and assessed using rating tools tailored to various categories of counterparties and exposures. These statistical models are based on internally compiled data comprising both quantitative and qualitative factors. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD.

Retail PD estimates are measured using Observed Default Estimation at the segment level and thus PD is calculated based at DPD bucket level for each segment separately. Under this analysis, the delinquency status of accounts will be tracked at an interval of one year with a moving month cycle.

Debt type instruments Portfolio, Nostro and Interbank Placements portfolio is assessed for SICR using external ratings, the group obtains PD estimates from Moody's / Standard & Poor's (S&P) / Fitch or any other external ratings.

LGD is the magnitude of the likely loss if there is a default. The group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, relevant industry and recovery costs of any collateral that is integral to the exposures.

EAD represents the expected exposure in the event of a default. The group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortization. The EAD of funded exposures is the gross carrying amount. For financing commitments and financial guarantees, the EAD includes the amount drawn, as well as potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts.

4.5.4 External credit assessment institutions

The Group relies on external ratings for rated corporate customers and counterparties. The Group uses Standard & Poor's, Fitch, Moody's and Capital Intelligence to provide ratings for such counterparties. In case of unrated counterparties, the Group will assess the credit risk on the basis of defined parameters. These ratings are used for risk assessment and calculation of risk weighted equivalents. The Group's policy has the mapping of the external ratings with the internal ratings used by the Group and the corresponding internal rating is allocated to the exposure accordingly to transfer it in the Group's banking book.

4.5.5 Definition of Geographical distribution

The geographic distribution of the credit exposures is monitored on an ongoing basis by the Group's Risk Management Department and reported to the Board on a quarterly basis. The Group's classification of geographical area is according to its business needs and the distribution of its portfolios.

4.5.6 Concentration risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being overexposed to a single customer, industry sector, or geographic region. As per CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's prior approval for any planned exposure to a single unconnected counterparty, or group of closely related counterparties, exceeding 15% of the bank's consolidated total capital. Also, banks are required to obtain the CBB's prior approval for any planned exposure to connected counterparties exceeding 25% of their consolidated total capital at an aggregate level.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

4.5.7 Credit risk mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals and guarantees to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-compliance with credit contracts, through sale of collaterals, netting agreements, and guarantees. The Group uses on-balance sheet netting as a credit risk mitigation technique only if there is a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable, and is able to determine at any time those assets and liabilities with the same counterparty that are subject to the netting agreement.

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured and supported by assignments, guarantees, etc. as appropriate.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.7 Credit risk mitigation (continued)

The market value of tangible collateral security is properly evaluated by the Group's approved valuers (for properties) or as per the suitable valuation methodology as outlined in the Bank's Credit Risk Mitigation Policy. The value of such security is considered only to the extent of the outstanding exposure of relevant credit facilities.

Financing to value percentage of securities and list of acceptable securities to the bank are governed through Board approved policies.

The majority of the Group's current credit portfolio is secured through mortgage of real estate properties. The Group may dispose off the assets as a last resort after carrying out due legal process.

4.5.7.1 General policy guidelines of collateral management

Acceptable Collateral: The Group has developed guidelines for acceptable collateral. Assets offered by customers must meet the following criteria to qualify as acceptable collateral:

a. Assets must be maintaining their value, at the level prevalent at inception, until maturity date of the facility granted;
b. Such assets should be easily convertible into cash, if required (liquidity);
c. There should be a reasonable market for the assets (marketability); and
d. The Group should be able to enforce its rights over the asset if necessary (enforceability).

Ownership: Prior to valuation or further follow up on the offered collateral, Credit Administration ensures satisfactory evidence of the borrower's ownership of the assets.

Valuation: All assets offered as collateral are valued by an appropriate source either in-house (through another department in the Group) or by an external appraiser (real estate related collateral). The Group maintains a list of independent appraisers, approved by management.

a. **Valuation of shares and financial securities**: The Group performs in-house valuation on the following types of securities:

- For shares listed in active markets, quoted bid prices are utilized;
- For unquoted shares and stakes in collective investment undertakings (CIUs), valuation is determined based on (i) present value of future cashflows and/or (ii) net asset value as and when financials are available; and
- For sukuk, collateral value is based on net realizable value.

b. **Valuation of real estate and others:** Besides assets mentioned above, the valuation of following securities are also conducted with the help of external valuers:

- Real Estate;
- Equipment and machinery; and

The Credit Administration requests the concerned department to arrange for the valuation from approved valuators. In the case of real estate, re-evaluations are conducted at least annually by Bank approved evaluators, who must also be RERA approved.

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.7 Credit risk mitigation (continued)

4.5.7.1 General policy guidelines of collateral management (continued)

The following additional guidelines are also followed by the Group:

a. No facility should be disbursed until credit documentation is properly signed and security/guarantees required have been signed and registered, where required. Exceptional cases can be considered by sanctioning authorities; and

b. All documents received as security or support for credit facilities should be lodged in the safe custody through the Credit Administration and should be kept under dual control. The Group must ascertain that collateral providers are authorised and acting within their capacity.

4.5.7.2 Guarantees

In cases where a letter of guarantee from a parent company or a third party is accepted as a credit risk mitigant, the Group ensures that all guarantees are irrevocable, and should be in line with internal policies. Also no maturity (negative) mismatch is permissible between the guarantee and exposure.

4.5.7.3 Custody / collateral management

The assets, or title to the asset, will be maintained in the Group’s custody or with custodians approved by the Group. Adequate systems and controls exist to confirm the assets held with each custodian.

The release of collateral without full repayment of all related financial obligations can be done only if the approved level of security coverage is maintained post the release otherwise it requires authorisation of the same level that originally approved and sanctioned the facility. Substitution of collateral is permitted if the new collateral would further minimise the Group’s risk exposure.

When collateral is released to the customer, the Head of Credit Administration obtains and maintains in his records acknowledgement of receipt from the customer or his/her authorised representative.

4.5.8 Counterparty credit risk

The Group has adopted the Standardised Approach to allocate capital for counterparty credit risk. The Group has put in place an internal counterparty limit structure which is based on internal / external ratings for different types of counterparties. The Group has also set concentration limits as a percentage of its capital based on internal and external grades. In case of a counterparty rating downgrade / deterioration, the Group may require further collateral or advise the counterparty to reduce its exposure on a case by case basis.

4.5.8.1 Exposure

The measure of exposure reflects the maximum loss that the Group may suffer in case a counterparty fails to fulfill its commitments. Exposure shall always be calculated on the basis of approved limits or actual outstanding exposure (Financing facilities, Investments or others), whichever is higher.

4.5.8.2 Counterparty

A counterparty is defined as an obligor (individual/company/other legal entity), a guarantor of an obligor, or a person receiving funds from the Group, the issuer of a security in case of a security held by the Group, or a party with whom a contract is made by the Group for financial transactions.

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.8 Counterparty credit risk (continued)

4.5.8.3 Group exposure

Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. For this purpose, a Group is two or more counterparties related in such a way that financial soundness of one may affect the financial soundness of the other(s) and one of them has a direct or indirect control over the other(s).

4.5.8.4 Connected counterparties

Connected counterparties' includes companies or persons connected with the Group, including, in particular; controllers of the Group (and their appointed board representatives); subsidiaries, associates and related parties of the Group; holders of controlled functions in the Group and their close family members; members of the Shari'a Supervisory Board.

4.5.8.5 Large exposure

Large exposure is any exposure whether direct, indirect, or funded by equity of investment accountholders to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Group's capital base.

Prior written approval from the CBB is required in the following cases:

a. If any unconnected counterparty (single/group) exposure exceeds 15% of Group's Capital Base;
b. If any facility (new/extended) to any connected counterparty exceeds 25% of the consolidated total capital at an aggregate level

4.5.8.6 Maximum exposure

The Group has set an internal maximum exposure limit in the light of CBB guidelines.

4.5.8.7 Reporting

The Group reports large counterparty exposures (as defined above) to CBB on a periodic basis. The Group reports the exposures on a gross basis without any set-off. However, debit balances on accounts may be offset against credit balances where both are related to the same counterparty, provided the Group has a legally enforceable right to do so.

4.5.8.8 Other matters

As a Group's strategy, exposure to connected counterparties may be undertaken only when negotiated and agreed based on commercial terms.

The Group shall not assume any exposure to its external auditors.

4.5.9 Related party transactions

The disclosure relating to related party transactions has been made in the reviewed condensed consolidated interim financial information for the period ended 30 June 2021. All related party transactions have been made on commercial terms.

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 7. Credit Risk Exposure (PD-1.3.23(a))

The following table summarises the amount of gross funded and unfunded credit exposure (before deducting credit risk mitigant) as of 30 June 2021 and average gross funded and unfunded exposures over the period ended 30 June 2021:

	Total gross credit exposure BD'000	**Average gross credit exposure over the period BD'000*
Funded		
Cash and balances with banks and Central Bank	**47,405**	**50,513**
Placements with financial institutions	**140,386**	**106,004**
Financing assets	**578,993**	**575,311**
Investment in Sukuk	**226,987**	**227,299**
Investment in equity and funds	**21,244**	**22,828**
Ijarah Muntahia Bittamleek and rental receivables	**247,130**	**237,029**
Investment in associates	**18,375**	**18,333**
Investment in real estate	**16,109**	**16,167**
Property and equipment	**13,671**	**13,745**
Other assets	**7,552**	**7,607**
Total	**1,317,852**	**1,274,836**
Unfunded		
Commitments and contingent liabilities	**132,659**	**137,124**
Total	**1,450,511**	**1,411,960**

*Average balances are computed based on quarter end balances.

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 8. Credit Risk – Geographic Breakdown (PD-1.3.23(b))

The following table summarises the geographic distribution of exposures as of 30 June 2021, broken down into significant areas by major types of credit exposure:

	North America BD'000	*Europe BD'000*	*Middle East BD'000*	*Other BD'000*	*Total BD'000*
Cash and balances with banks and Central Bank	**4,219**	**274**	**42,902**	**10**	**47,405**
Placements with financial institutions	**-**	**-**	**140,386**	**-**	**140,386**
Financing assets	**-**	**-**	**578,993**	**-**	**578,993**
Investment in Sukuk	**-**	**-**	**226,987**	**-**	**226,987**
Investment in equity and funds	**-**	**-**	**21,244**	**-**	**21,244**
Ijarah Muntahia Bittamleek and rental receivables	**-**	**-**	**247,130**	**-**	**247,130**
Investment in associates	**-**	**-**	**18,375**	**-**	**18,375**
Investment in real estate	**-**	**-**	**16,109**	**-**	**16,109**
Property and equipment	**-**	**-**	**13,671**	**-**	**13,671**
Other assets	**15**	**-**	**7,537**	**-**	**7,552**
Total	**4,234**	**274**	**1,313,334**	**10**	**1,317,852**
Unfunded					
Commitments and contingent liabilities	**-**	**-**	**132,659**	**-**	**132,659**
Total	**4,234**	**274**	**1,445,993**	**10**	**1,450,511**

*Geographical distribution of exposure into significant areas by major type of credit exposure is based on counterparty's country of incorporation.

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 9. Credit Risk – Industry Sector Breakdown (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 30 June 2021 by industry, broken down into major types of credit exposure:

	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate and Construction BD'000	Personal & Consumer Finance BD'000	Governmental Organisation BD'000	Others BD'000	Total BD'000
Funded							
Cash and balances with banks and Central Bank	-	22,777	-	-	24,628	-	47,405
Placements with financial institutions	-	114,787	-	-	25,599	-	140,386
Financing assets	84,654	12,658	69,870	356,984	20,727	34,100	578,993
Investment in Sukuk	-	-	-	-	226,987	-	226,987
Investment in equity and funds	-	2,682	17,493	-	-	1,069	21,244
Ijarah Muntahia Bittamleek and rental receivables	-	-	13,737	208,332	20,941	4,120	247,130
Investment in associates	-	3,979	5,449	-	-	8,947	18,375
Investment in real estate	-	-	16,109	-	-	-	16,109
Property and equipment	-	-	-	-	-	13,671	13,671
Other assets	-	154	3,992	1,341	-	2,065	7,552
Total	84,654	157,037	126,650	566,657	318,882	63,972	1,317,852
Unfunded							
Commitments and contingent liabilities	41,725	711	18,769	45,306	12,082	14,066	132,659
Total	126,379	157,748	145,419	611,963	330,964	78,038	1,450,511

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 10. Credit Risk – Financing Facilities to Highly Leveraged or Other High Risk Counterparties (PD-1.3.23(e))

The following balances represent the financing facilities to highly leveraged or other high risk counterparties as of 30 June 2021:

Counterparties	*Gross* *BD'000*	*Stage 3 ECL* *BD'000*	*Net** *BD'000*
Counterparty # 1	**10,250**	**-**	**10,250**
Counterparty # 2	**6,929**	**551**	**6,378**
Counterparty # 3	**5,983**	**4,489**	**1,494**
Counterparty # 4	**3,422**	**-**	**3,422**
	26,584	**5,040**	**21,544**

*Gross of expected credit loss stage 1 and 2 of BD 385 thousand.

Table – 11. Credit Risk – Concentration of Risk (PD-1.3.23(f))

The Bank has the following exposures that are in excess of the individual obligor limit of 15% of the Bank's capital as of 30 June 2021:

Counterparties	*Gross* *BD'000*	*Stage 3 ECL* *BD'000*	*Net*** *BD'000*
Counterparty # 1*	**199,135**	**-**	**199,135**
Counterparty # 2*	**50,227**	**-**	**50,227**
Counterparty # 3	**30,206**	**-**	**30,206**
Counterparty # 4	**27,180**	**-**	**27,180**
	306,748	**-**	**306,748**

*Represents exempted large exposures.

**Gross of expected credit loss stage 1 and 2 of BD 405 thousand.

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 12. Credit Risk – Residual Contractual Maturity Breakdown (PD-1.3.23(g) PD-1.3.38)

The following table summarises the maturity profile of the total assets based on contractual maturities as at 30 June 2021. All the assets with no fixed contractual maturities are disclosed under no fixed maturity:

	Up to One month BD'000	*1-3 months BD'000*	*3-6 months BD'000*	*6-12 months BD'000*	*1-3 years BD'000*	*3-5 years BD'000*	*5-10 years BD'000*	*10-20 years BD'000*	*Over 20 years BD'000*	*No fixed maturity BD'000*	*Total BD'000*
Assets											
Cash and balances with banks and Central Bank	23,840	-	-	-	-	-	-	-	-	23,565	47,405
Placements with financial institutions	140,386	-	-	-	-	-	-	-	-	-	140,386
Financing assets	16,547	24,577	39,840	59,820	180,669	144,817	82,600	25,182	4,941	-	578,993
Investment in Sukuk	-	21,401	1,006	-	58,669	103,793	42,118	-	-	-	226,987
Investment in equity and funds	-	-	-	-	-	-	-	-	-	21,244	21,244
Ijarah Muntahia Bittamleek and rental receivables	1,560	2,469	5,490	7,666	32,053	34,512	62,077	82,909	18,394	-	247,130
Investment in associates	-	-	-	-	-	-	-	-	-	18,375	18,375
Investment real estate	-	-	-	-	-	-	-	-	-	16,109	16,109
Property and equipment	-	-	-	-	-	-	-	-	-	13,671	13,671
Other assets	796	570	745	139	417	892	-	-	-	3,993	7,552
Total Assets	183,129	49,017	47,081	67,625	271,808	284,014	186,795	108,091	23,335	96,957	1,317,852

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 13. Credit Risk – Credit Impaired Exposures, Past Due Exposures, and Impariment Allowances by industry sector (PD-1.3.23(h) PD-1.3.24(b) PD-1.3.24(d))

The following table summarises the credit impaired facilities, past due facilities, and impairment allowances disclosed by major industry sector as of 30 June 2021:

	Credit impaired or past due Islamic financing contracts* BD'000	Aging of credit impaired or past due Islamic financing contracts				Stage 3 ECL				Stage 1 & 2 ECL		
		Less than 3 months BD'000	3 months to 1 year BD'000	1 to 3 years BD'000	Over 3 years BD'000	Balance at the beginning of the period BD'000	Charge for the period (net)** BD'000	Write-offs during the period BD'000	Balance at the end of period BD'000	Balance at the beginning of the period BD'000	Charge for the period (net)** BD'000	Balance at the end of period BD'000
Trading and Manufacturing	43,136	39,575	411	3,150	-	10,776	(1)	-	10,775	2,939	846	3,785
Real Estate	10,360	9,455	905	-	-	116	(36)	-	80	1,743	(172)	1,571
Banks and Financial Institutions	77	77	-	-	-	32	(32)	-	-	191	133	324
Personal / Consumer Finance	31,211	24,255	2,279	4,138	539	7,884	163	11	8,036	2,032	445	2,477
Others	4,038	3,327	611	100	-	828	(16)	-	812	1,841	248	2,089
Total	**88,822**	**76,689**	**4,206**	**7,388**	**539**	**19,636**	**78**	**11**	**19,703**	**8,746**	**1,500**	**10,246**

*Gross of expected credit loss of BD 20,611 thousand.
**Net of transfers between stages.

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 14. Credit Risk – Credit Impaired Exposures, Past Due Exposures, and Impariment Allowances (by geographic area) (PD-1.3.23(i) PD-1.3.24(c))

The following table summarises the credit impaired facilities, past due facilities, and impairment allowances by geographical area as of 30 June 2021:

	Credit impaired or past due or impaired Islamic financing contracts BD'000	*Stage 3 ECL BD'000*	*Stage 1 & 2 ECL BD'000*
Middle East	**88,822**	**19,703**	**10,246**

Table – 15. Credit Risk – Restructured Financing Facilities (PD-1.3.23(j))

The following table summarises the aggregate amount of restructured corporate financing facilities during the year as of 30 June 2021:

	Gross Outstanding BD'000	*Stage 3 ECL BD'000*	*Net BD'000*
Total Islamic Financing [(1)]	856,072	19,703	836,369
Restructured financing facilities* [(2)]	13,235	315	12,920
Percentage	**1.55%**	**1.60%**	**1.54%**

*Excludes facilities restructured during the year amounting to BD 4,965 thousand which are past due as of 30 June 2021. The nature of the concessions include alignment of the payment terms with the clients' expected cash flows.

(1) Gross of expected credit loss Stages 1 and 2 of BD 10,246 thousand.

(2) Gross of expected credit loss Stages 1 and 2 of BD 843 thousand.

4 Risk Management (continued)

4.5 Credit Risk (continued)

Table – 15. Credit Risk – Restructured Financing Facilities (PD-1.3.23(j)) (continued)

Deferrals due to CBB COVID-19 concessionary measures:

During the second quarter of 2020, based on a regulatory directive issued by the CBB as concessionary measures to mitigate the impact of COVID-19, the one-off modification losses amounting to BD 14,711 thousand arising from the 6-month payment holidays provided to financing customers without charging additional profit was recognized directly in equity. The modification loss was calculated as the difference between the net present value of the modified cash flows calculated using the original effective profit rate and the current carrying value of the financial assets on the date of modification. The Group had provided payment holidays on financing exposures amounting to BD 554,875 thousand (first deferral - March 2020 to September 2020) as part of its support to impacted customers.

In September 2020, December 2020, and May 2021, the CBB issued another regulatory directive to extend the concessionary measures, i.e. holiday payments to customers till end of December 2020, June 2021, and December 2021 respectively. However, customers will be charged profits during this holiday payment extension period, and hence the Group does not expect significant modification loss as a result of the extension. The Group has provided payment holidays on financing exposures amounting to BD 200,435 thousand for the second deferral (September 2020 to December 2020) and BD 218,446 thousand for the third deferral (January 2021 to June 2021). The Group is still in the process of finalizing the fourth deferral (July 2021 to December 2021).

Table – 16. Credit Risk Mitigation (PD-1.3.25 (b) and (c))

The following table summarises the exposure as of 30 June 2021 by type of Islamic financing contract covered by Shari'a-compliant collateral eligible as per CA module of volume 2 of the CBB Rule Book:

	Total exposure covered by	
	Tamkeen Guarantee BD'000	Others BD'000
Financing assets	4,695	106,106
Ijarah Muntahia Bittamleek and rental receivables	-	30,420
Total	4,695	136,526

Table – 17. Counterparty Credit (PD-1.3.26 (b))

The following table summarises the counterparty credit risk exposure covered by collateral after the application of haircuts as of 30 June 2021:

	Financing assets BD'000	Ijarah Muntahia Bittamleek and rental receivables BD'000	Total BD'000
Exposures:			
Secured*	110,801	30,420	141,221
Unsecured*	468,192	216,710	684,902
Total	578,993	247,130	826,123
Collateral held:			
-Cash	24,579	421	25,000
-Guarantees	1,937	-	1,937
-Shares	4,746	-	4,746
-Real Estate	3,763	20,096	23,859
Total	35,025	20,517	55,542
Collateral as a percentage of secured exposure	31.61%	67.45%	39.33%

A haircut of 30% is applied on the Real Estate collateral.

*The financing assets and Ijarah Muntahia Bittamleek exposures are net of ECL.

4.6 Market Risk

4.6.1 Introduction

The Group has accepted the definition of market risk as defined by CBB as the risk of losses in on- and off-balance sheet positions arising from movements in market prices.

4 Risk Management (continued)

4.6 Market Risk (continued)

4.6.2 Sources of market risk

For the Group, market risk may arise from movements in profit rates, foreign exchange markets, equity markets, or commodity markets. A single transaction or financial product may be subject to any number of these risks.

Profit rate risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The profit distribution to equity of investment accountholders is based on profit sharing agreements.

Foreign exchange risk is the sensitivity of financial products to changes in spot foreign exchange rates. The value of the Group's portfolio which is denominated in a number of currencies may be exposed to these risks when converted back to the Group's base currency.

Equity price risk is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity. The Group has established a limit structure to monitor and control the market risk in its equity type instruments portfolio. These limits include maximum Stop-loss limits and position limits. As at 30 June 2021, the group did not have any trading portfolio. Currently, any new equity investments are off-strategy.

Commodity risk is defined as inherent risk in financial product arising from their sensitivity to changes in commodity prices. Since prices in commodity markets are determined by fundamental factors (i.e. supply and demand of the underlying commodity) these markets may be strongly correlated within particular sector and less correlated across sectors.

4.6.3 Market risk strategy

The Group's Board is responsible for approving and reviewing the risk strategy and significant amendments to the risk policies. The Group's senior management is responsible for implementing the risk strategy approved by the Board, and continually enhancing the policies and procedures for identifying, measuring, monitoring, and controlling risks.

In line with the Group's risk management objectives and risk tolerance levels, the specific strategies for market risk management include:

a. The Group will proactively measure and continually monitor the market risk in its portfolio;
b. The Group will at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
c. The Group will establish a limit structure to monitor and control the market risk in its portfolio. These limits will include position limits, and maximum/stop loss limits;
d. The Group will carry out stress testing periodically using the worst case scenarios to assess the effects of changes in the market value due to changing market conditions; and
e. The Group will clearly identify the foreign currencies in which it wishes to deal in and actively manage its market risk in all foreign currencies in which it has significant exposure.

4 Risk Management (continued)

4.6 Market Risk (continued)

4.6.4 Market risk measurement methodology

Market risk measurement techniques include the use of a number of techniques for market risk measurement. The risk measurement techniques mentioned in this section are used for measuring market risk in both trading book as well as banking book.

The various techniques which are used by the Group for the measurement, monitoring and control of market risk are as follows:

a. Overnight open positions;
b. Stop loss limits;
c. Stress Testing; and
d. Profit rate risk gap analysis.

4.6.5 Market risk monitoring and limits structure

The CRMD proposes through the Board Risk and Compliance Committee (BRCC) and Board the tolerance for market risk. Based on these tolerances, Risk Unit and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates.

4.6.6 Limits monitoring

The Treasury Department and Risk Unit monitor the risk limits for each transaction, ensure that the limits are well within set parameters, and report periodically to top management.

4.6.7 Breach of limits

In case a limit is breached, the escalation and approval process will follow the Board-approved delegated authority limits. The limits are revised at least annually or when deemed required.

4.6.8 Portfolio review process

On a monthly basis, Risk Unit reviews the Group's assets and liabilities portfolio to evaluate the overall corporate exposure to market risk. As part of the review, Risk Unit also monitors the Group's overall market exposure against the risk tolerance limits set by the Board. Risk Unit also reviews the adherence to approved limits to control the market risk. Changes, if any, in market risk limits are communicated to business units after review by the CRO/CEO and approval by the ALCO and BRCC, as per the delegated authorities approved by the Board.

4.6.9 Reporting

Risk Unit generates at regular periodic intervals market risk management reports. These reports aim to provide the Group's senior management with an up-to-date view of its market risk exposure.

4.6.10 Stress testing

Stress tests produce information summarising the Group's exposure to extreme, but possible, circumstances and offer a way of measuring and monitoring the portfolio against extreme price movements of this type. The Group's Risk Unit employs different stress categories: profit rates and foreign exchange rates. For each stress category, the worst possible stress shocks that might realistically occur in the market are defined.

4 Risk Management (continued)

4.6 Market Risk (continued)

4.6.11 Foreign subsidiary
The Group does not have any foreign subsidiary.

Table – 18. Market Risk Capital Requirements (PD-1.3.27 (b))

The following table summarises the maximum and minimum capital requirement for foreign exchange risk for the period:

	Foreign exchange risk BD'000
Maximum value capital requirement	**38**
Minimum value capital requirement	**24**

4.7 Operational Risk

4.7.1 Introduction
Operational risk is the risk of loss arising from system failure, human error, fraud, or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit. Insurance risk transfer is also a tool through which certain operational risks are mitigated. With respect to the management oversight process, operational risk appetite thresholds are set to control and monitor enterprise-wide operational loss.

4.7.2 Sources of operational risk
The different sources of operational risks faced by the Group can be classified broadly into the following categories:

a. People risk which arises due to staffing inadequacy, unattractive remuneration structure, lack in staff development policies, lack in procedures for appointment, unhealthy professional working relationship, and unethical environment;

b. Processes risk which arises due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting;

c. Systems (Technology) risk which arises due to integrity of information - lacking in timeliness of information, omission and duplication of data, hardware failures due to power surge, obsolescence or low quality;

d. External risk which arises due to natural or non-natural (man made) disaster; and

e. Legal risk which arises due to contractual obligations.

4.7.3 Operational risk management strategy
As a strategy, the Group will identify the sources of operational risks in coordination with each business unit. The Group carried out Risk Control Self-Assessments ("RCSA"), and plans to do a continuous and on-going exercise to identify the operational risks it is exposed to.

4 Risk Management (continued)

4.7 Operational Risk (continued)

4.7.3 Operational risk management strategy (continued)

The Group on a continuous basis will:

a. assess the effectiveness of controls associated with identified risks;
b. regularly monitor operational risk profiles and material exposures to losses / loss events;
c. identify stress events and scenarios to which it is vulnerable and assess their potential impact, and the probability of aggregated losses from a single event leading to other risks;
d. Monitoring and reporting of operational risk is through the Operational Risk Management Forum (ORMF), a management-level committee responsible for monitoring and discussing the operational risks emanating from the group's activities; and
e. Effecting appropriate contingency and business continuity planning that takes into account the operational risks facing the Group, and providing BCP and operational risk training at a Bank-wide level on the same to ensure that this is fostered across the organization.

4.7.4 Operational risk monitoring and reporting

The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to senior management to highlight operational risks through ongoing, periodic reviews.

The objective of the reporting process is to ensure relevant information is provided to senior management and the Board to enable the proactive management of operational risk. The process ensures a consistent approach for providing information that enables appropriate decision making and action taking.

The group has a legal department dedicated to monitor any legal risk arising out of contracts / agreements entered into by the group on a day to day basis. The department also liaises with external lawyers for legal cases filed by the group against delinquent accounts for recovery or any legal cases filed against the group.

4.7.5 Operational risk mitigation and control

For those risks that cannot be controlled, the business units in conjunction with Risk Unit will decide whether to accept the risks, reduce the level of business activity involved, transfer the risk outside the Group, or withdraw from the associated activity completely. Risk Unit facilitates the business units in co-developing the mitigation plans. The group deals with the pending legal cases through internal and external lawyers depending upon the severity of the cases.

As of the period ended 30 June 2021, the Group is defending a claim from the Official Committee Of Unsecured Creditors Of Arcapita Bank B.S.C. (c) against it based on a preliminary judgement. While the Group has a right to appeal against this judgement, a provision of USD 14 million (BD 5.3 million) has been made, which consists of USD 10 million (BD 3.8 million) for the principal amount and USD 4 million (BD 1.5 million) towards the estimated profit that may be imposed by the court.

As of 30 June 2021, except for the claim from the Official Committee Of Unsecured Creditors Of Arcapita Bank B.S.C. (c) against the Bank, the Group did not have any material legal contingency from pending legal actions. Based on management estimates there is no potential liability arising from these pending legal actions.

Table - 19. Operational Risk Exposure (PD-1.3.30 (a) & (b))

The following table summarises the amount of exposure subject to basic indicator approach of operational risk and related capital requirements:

	Gross income		
	2020	**2019**	**2018**
	BD'000	**BD'000**	**BD'000**
Total Gross Income	**53,977**	**68,242**	**65,752**
Indicators of operational risk			
Average Gross income (BD'000)			**62,657**
Multiplier			**12.5**
			783,213
Eligible Portion for the purpose of the calculation			**15%**
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE (BD'000)			**117,482**

As at 30 June 2021, there are four shari'a audit observations that are expected to be resolved during the course of the year.

4 Risk Management (continued)

4.8 Equity Position in the Banking Book

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio. To date, the Bank does not carry significant equity position risk in its banking book.

The accounting policies, including valuation methodologies and their related key assumptions, are consistent with those disclosed in the consolidated financial statements for the year ended 31 December 2020. Equity type instruments carried at fair value through equity and investment properties are kept for capital gain purposes, all other investments including investments in associates are kept for strategic long term holdings.

Table – 20. Equity Position Risk in Banking Book (PD-1.3.31 (b), (c) & (g))

The following table summarises the amount of total and average gross exposure of equity investments and funds as of 30 June 2021:

	Total gross exposure [1] BD'000	*Average gross exposure [2] BD'000*	*Publicly traded BD'000*	*Privately held BD'000*	*Risk weighted assets BD'000*	*Capital Requirements BD'000*
Equity investments	34,312	34,298	-	34,312	74,945	**9,368**
Funds	436	436	-	436	654	**82**
Total	**34,748**	**34,734**	**-**	**34,748**	**75,599**	**9,450**

[1] Balances are gross of provision of BD 13,504 thousand.
[2] Average balances are computed based on quarter end balances.

Table – 21. Equity Gains or Losses in Banking Book (PD-1.3.31 (d), (e) & (f))

The following table summarises the cumulative realised and unrealised gains or (losses) during the period ended 30 June 2021:

	BD'000
Cumulative realised gain arising from sales or liquidations in the reporting period	**-**
Total unrealised losses recognised in the consolidated statement of financial position but not through consolidated statement of income	**-**
Unrealised gains included in CET 1 Capital	**1,773**
Unrealised gains included in Tier 2 Capital	**-**

4 Risk Management (continued)

4.9 Equity of Investment Accountholders ("IAH")

The Group may require to decrease or increase losses or profit on certain IAH accounts for the purpose of income smoothing. Thus the Group is exposed to some of the price risk on assets funded by equity of Investment Accountholders ("IAH"). The CBB requires the Group to maintain capital to cover the price risk arising from 30% of assets funded by IAH on a pro-rata basis.

The Group is authorised by the IAH to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Group deems appropriate without laying down any restrictions as to where, how, and for what purpose the funds should be invested. Under this arrangement the Group can commingle the equity of investment accountholders investment funds with its own funds (owner's equity) or with other funds the Group has the right to use (e.g. current accounts or any other funds which the Group does not receive on the basis of Mudaraba contract). The IAH and the Group generally participate in the returns on the invested funds; however, the Group does not share profits with IAH resulting from investing current accounts and other funds received on the basis other than mudaraba contracts. In such type of contract, the Group is not liable for any losses incurred on the joint pool other than the loss resulting from gross negligence or wilful misconduct on the part of the Group or due to the Group's violation of the terms and conditions as agreed between the Group and the IAH. During the year, the Group waived 13% of profit from mudarib fees in order to maintain a competitive profit distribution to IAH.

After adopting FAS 31, all new funds raised using wakala structure, together called "wakala pool" are comingled with the Bank's pool of funds based on an underlying mudaraba agreement. This comingled pool of funds is invested in a common pool of assets in the manner which the Group deems appropriate without laying down restrictions as to where, how and what purpose the funds should be invested.

The amount received from the customer on account of equity of investment accountholders is not invested completely in the portfolio of selected investments as the Group is required to maintain a cash reserve with CBB. In addition, the Group requires to set aside certain amount to meet operational requirements. The income allocated to the equity of investment accountholders deposits being received is in accordance with the utilisation of such funds. The utilisation rate is determined by the ALCO with the approval of Shari'a Supervisory Board.

Proposal for new products is initiated by the business lines within the Group and ALCO review such proposal to ensure that the new product is in line with the Group's business and risk strategy. All new products require the approval of the Shari'a Supervisory Board of the Bank. The business lines of the Group have expertise in creating high end value added products offering a wide range of products, expected return, tenors, and risk profile. Information on new products or any change in the existing products will be placed on the Group's website or published in the media.

These accounts are made available to customers through Retail Banking (to include the Thuraya Banking segment), in addition to the Group's Corporate and Institutional Banking division. The Group has designed a Customer Experience and Process Governance Unit to address customer dissatisfaction which reports to Chief Retail Banking. The complaints are investigated by personnel not directly related to the subject matter of the complaints.

The Group offers equity of investment accountholders in different currencies for maturity periods ranging from 1 month, 3 months, 6 months, 9 months, 12 months, and 36 months. The customer signs a written contract covering all terms and conditions of the investment, including tenor, basis of profit allocation, and early withdrawal. This is made available to both retail and corporate customers.

Because equity of investment accountholders is a significant funding source for the Group, the Group regularly monitors rate of return offered by competitors to evaluate the expectation of its IAH. The Group's policy provide whole or partial waiver of the mudarib share of income from investment in order to provide a reasonable return to its investors.

4 Risk Management (continued)

4.9 Equity of Investment Accountholders ("IAH") (continued)

The Group has written policies and procedures applicable to its portfolio of Equity of investment accountholders. Equity of investment accountholders funds are invested and managed in accordance with Shari'a requirements.

Profits of an investment jointly financed by the Group and the equity of investment accountholders shall be allocated between them according to the contribution of each of the Group and the IAH in the jointly financed investment. Operating expenses incurred by the Group are not charged to investment account. In case of the loss resulting from the transactions in a jointly financed investment, such loss shall first be deducted from undistributed profits, if any. Any excess of such loss shall be deducted from Investment Risk Reserve (IRR). Any remaining of such loss shall be deducted from the total balance of fund available in the Joint pool, as at that date, in the respective ratio of the Group's and IAH's respective contribution to the comingled pool. The Bank proportionately allocates non-performing assets (past due greater than 90 days) to the IAH pool of assets. The ECL charge is also allocated to the IAH pool, in proportion of the non-performing assets financed by IAH to the total non-performing assets. Amounts recovered from these non-performing assets shall be subject to allocation between IAH and owners' equity.

In case of early withdrawal of IAH fund before completion of the term, the effective utilisation method will be applied.

In case of term deposits, the IAH account holders can withdraw funds on a premature basis by paying a nominal amount of fees / penalty; such penalties are offered for charity.

Additional disclosures such as the below are disclosed in the Bank's website:
a. Characteristics of investors for whom investment account may be appropriate
b. Purchase redemption and distribution procedures
c. Product information and the manner in which the products are made available to investors

Governance of IAH

a. Shariah review of allocation of assets and resultant income;

b. Disclosure of profit rates on deposit products and mudaraba fees either in the branch or website;

c. ALCO discusses the profit rate to be offered to URIA accounts. Any exceptional profit rates offered to customers are subject to approval by the relevant authority.

Table – 22. Equity of Investment Accountholders by Type (PD-1.3.33 (a))

The following table summarises the breakdown of equity of investment accountholders accounts as of 30 June 2021:

	BD'000
Banks and financial institutions	**51,089**
Individuals and non-financial institutions	**480,511**
Total	**531,600**

Table – 23. Equity of Investment Accountholders Ratios (PD-1.3.33 (d) & (f))

The following table summarises the return on average assets and mudarib share as a percentage of the total investment profit for the period ended 30 June 2021:

Profit Paid on Average IAH Assets *	**0.72%**
Mudarib Fee to Total income from jointly financed assets	**38.42%**

*Average assets funded by IAH have been calculated using month end balances.

4 Risk Management (continued)

4.9 Equity of Investment Accountholders ("IAH") (continued)

Table – 24. Equity of Investment Accountholders Ratios (PD-1.3.33 (e) & (g))

The following table summarises the profit distributed to IAH and financing ratios to the total of IAH by type of investment for the year period 30 June 2021:

	Average declared rate of return	*Proportion of total profit distributed by type of IAH*	*Proportion of IAH investments to total IAH*
Saving accounts (including VEVO)	**0.06%**	**2.97%**	**32.64%**
Defined accounts - 1 month	**0.35%**	**0.35%**	**0.67%**
Defined accounts - 3 months	**0.35%**	**0.12%**	**0.24%**
Defined accounts - 6 months	**0.40%**	**0.20%**	**0.35%**
Defined accounts - 9 months	**0.50%**	**0.00%**	**0.01%**
Defined accounts - 1 year	**0.55%**	**1.74%**	**2.19%**
Investment certificates	**2.90%**	**0.00%**	**0.00%**
IQRA	**1.15%**	**1.60%**	**0.97%**
Tejoori	**0.06%**	**3.04%**	**33.50%**
Customer special deposits	**1.37%**	**28.46%**	**9.88%**
Wakala - Financial institutions	**0.73%**	**6.58%**	**11.04%**
Wakala - Non-financial institutions and individuals	**3.63%**	**54.94%**	**8.53%**
		100%	**100%**

The calculation and distribution of profits was based on quarterly average balances.

Table – 25. Equity of Investment Accountholders to Total Financing (PD-1.3.33 (h) & (i))

The following table summarises the percentage of counterparty type to total financing for each type of Shari'a-compliant contract to total financing as of 30 June 2021:

	Percentage of Counterparty Type to Total Financing					
	Self Financed		*IAH*		*Total*	
	BD'000	*%*	*BD'000*	*%*	*BD'000*	*%*
Gross financing assets*						
Murabaha	**265,195**	**52.69%**	**238,156**	**47.31%**	**503,351**	**100.00%**
Corporate	*121,496*	*52.69%*	*109,108*	*47.31%*	*230,604*	*100.00%*
Retail	*143,699*	*52.69%*	*129,048*	*47.31%*	*272,747*	*100.00%*
Musharakah	**44,610**	**52.69%**	**40,062**	**47.31%**	**84,672**	**100.00%**
Corporate	*1,753*	*52.69%*	*1,574*	*47.31%*	*3,327*	*100.00%*
Retail	*42,857*	*52.69%*	*38,488*	*47.31%*	*81,345*	*100.00%*
Total	**309,805**	**52.69%**	**278,218**	**47.31%**	**588,023**	**100.00%**
Gross Ijarah Muntahia Bittamleek and rental receivables**						
Corporate	*20,631*	*52.69%*	*18,528*	*47.31%*	*39,159*	*100.00%*
Retail	*110,212*	*52.69%*	*98,975*	*47.31%*	*209,187*	*100.00%*
Total	**130,843**	**52.69%**	**117,503**	**47.31%**	**248,346**	**100.00%**
ECL Stage 1 and 2	**(5,398)**	**52.69%**	**(4,848)**	**47.31%**	**(10,246)**	**100.00%**
Total	**435,250**	**52.69%**	**390,873**	**47.31%**	**826,123**	**100.00%**

*Net of expected credit loss (Stage 3) of BD 18,443 thousands.

**Net of expected credit loss (Stage 3) of BD 1,260 thousands.

4 Risk Management (continued)

4.9 Equity of Investment Accountholders ("IAH") (continued)

Table – 26. Equity of Investment Accountholders Share of Profit by account type (PD-1.3.33 (d) (l) (m) & (n))

Account Type	*Gross on equity of IAH BD'000 A*	*Transfer to equalization reserve BD'000 B*	*Average mudaraba %*	*Mudarib fees BD'000 C*	*Release IRR BD'000 D*	*Profit paid to IAH BD'000 (A-B-C+D)*	*Ratio of PER to IAH %*
Tejoori	**4,049**	**26**	**98.00%**	**3,968**	**-**	**55**	**0.89%**
Saving	**3,481**	**23**	**97.99%**	**3,411**	**-**	**47**	**1.03%**
Vevo	**436**	**3**	**97.93%**	**427**	**-**	**6**	**8.23%**
IQRA Deposits	**132**	**-**	**78.06%**	**103**	**-**	**29**	**27.27%**
Defined deposit	**1,743**	**-**	**67.99%**	**1,185**	**-**	**558**	**2.06%**
Wakala	**2,758**	**-**	**59.70%**	**1,647**	**-**	**1,111**	**1.30%**
	12,599	**52**		**10,741**	**-**	**1,806**	

Table – 27. Equity of Investment Accountholders Share of Profit (PD-1.3.33 (l) (m) & (n))

The following table summarises the share of profits earned by and paid out to profit sharing investment accounts and the Group as Mudarib for the period ended 30 June 2021:

Share of profit allocated to IAH before transfer to/from reserves - BD '000	12,599
Percentage share of profit earned by IAH before transfer to/from reserves	2.37%
Net return on equity of IAH - BD '000	1,858
Share of profit paid to IAH after transfer to/from reserves - BD '000	1,806
Percentage share of profit paid to IAH after transfer to/from reserves	0.34%
Share of profit paid to Bank as mudarib - BD '000	10,741

Table – 28. Equity of Investment Accountholders Percentage Return to Profit Rate of Return (PD-1.3.33 (q))

The following table summarises the average distributed rate of return or profit rate on profit sharing investment accounts for the year ended 30 June 2021:

	3 months	*6 months*	*12 months*	*36 months*
Percentage of average distributed rate of return to IAH	**1.07%**	**1.59%**	**1.23%**	**2.92%**

Table – 29. Equity of Investment Accountholders Type of Assets (PD-1.3.33 (r) & (s))

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets for the six months period ended 30 June 2021:

	As of 31-Dec-20 BD'000	*Movement during the period BD'000*	*As of 30-Jun-21 BD'000*
Cash and balances with banks and Central Bank	**23,786**	**842**	**24,628**
Murabaha and Wakala receivables - interbank	**26,022**	**(17,319)**	**8,703**
Gross financing assets*	**248,613**	**29,605**	**278,218**
Gross Ijarah Muntahia Bittamleek and rental receivables*	**91,476**	**26,027**	**117,503**
Investment securities	**108,227**	**(745)**	**107,482**
Expected credit loss	**(3,864)**	**(1,070)**	**(4,934)**
Total	**494,260**	**37,340**	**531,600**

* Net of ECL stage 3.

4 Risk Management (continued)

4.9 Equity of Investment Accountholders ("IAH") (continued)

Table – 30. Equity of Investment Accountholders Profit Earned and Paid (PD-1.3.33 (w))

The following table summarises the amount and rate of return of profits earned by the Group and paid out to equity of investment accountholders over the past five years:

	Profit Earned (jointly financed)		*Profit Paid to (IAH)*	
	BD'000	***%***	***BD'000***	***%***
2021	**27,957**	4.72%	**1,806**	0.69%
2020	**53,169**	4.92%	**4,009**	0.81%
2019	**57,396**	5.37%	**12,685**	2.97%
2018	**53,939**	4.86%	**13,939**	1.77%
2017	**47,315**	4.51%	**11,364**	1.43%

Table – 31. Treatment of assets financed by IAH (PD-1.3.33 (v))

	Assets BD'000	***RWA BD'000***	***RWA for Capital Adequacy Purposes BD'000***	***Capital Requirements BD'000***
Cash and balances with banks and Central Bank	24,628	-	-	-
Murabaha and Wakala receivables - interbank	8,703	2,073	622	78
Financing assets [(1)]	278,218	220,870	66,261	8,283
Investment in Sukuk [(2)]	107,482	-	-	-
Ijarah Muntahia Bittamleek and rental receivables [(1)]	117,503	75,067	22,520	2,815
	536,534	**298,010**	**89,403**	**11,176**

[(1)] The exposure is gross of ECL stage 1 and 2 of BD 4,848 thousand.
[(2)] The exposure is gross of ECL stage 1 and 2 of BD 86 thousand.

4.10 Liquidity Risk

4.10.1 Introduction
Liquidity risk is defined as "the risk that the Group will be unable to meet its obligations as they come due because of an inability to obtain adequate funding or to liquidate assets".

4.10.2 Sources of liquidity risk
The sources of liquidity risk can broadly be categorised in the following:

a. Funding risk is the risk of not being able to fund net outflows due to unanticipated withdrawal of capital or deposits;

b. Call risk is the risk of crystallisation of a contingent liability; and

c. Event risk is the risk of rating downgrades or other negative public news leading to a loss of market confidence in the Group.

4 Risk Management (continued)

4.10 Liquidity Risk (continued)

4.10.3 Bank’s funding strategy
The Board reviews the funding strategy on an annual basis and amends the existing strategy, as deemed necessary. For this purpose, all business units advise the Treasurer of their projected liquidity requirements and contributions at the start of each year as part of annual budgeting process.

The funding strategy highlights any anticipated liquidity shortfalls, the funding requirements to finance these shortfalls and their impact on the statement of financial position. The Group's Liquidity Risk Management Policy address liquidity contingency plan to deal with stressed scenarios and outline an action plan that can be taken in the event of liquidity stress situation.

4.10.4 Liquidity risk strategy
The Group monitors the liquidity position by comparing maturing assets and liabilities over various time buckets to include short term, medium term, and long-term buckets. The Group carries out stress testing periodically using the worst case scenarios to assess the effects of changes in market conditions on the liquidity of the Group. As a strategy the Group maintains a large customer base and good customer relationships.

The Group manages funding requirements through the following sources: Current accounts, savings accounts, other URIA accounts, interbank lines, and borrowing by leverage of Sukuk portfolio. Appropriate thresholds are set for attaining funding from each source in the Group's Risk Appetite Framework.

In fulfilment of Basel III and regulatory requirements, the Group reports the Liquidity Coverage Ratio ("LCR") and the Net Stable Funding Ratio ("NSFR") on a monthly and quarterly basis, respectively. In efforts to maintain both metrics above the regulatory and internal limits, the Bank adopts the following strategies:

LCR: The Bank intends on maintaining its LCR within the prescribed regulatory and internal limits through the gradual build up of its customer deposit base and uncumbered High Quality Liquid Assets ("HQLA"), predominantly through sovereign bonds and high grade fixed income assets.

NSFR: The Bank intends on building a stable funding profile by maintaining a balanced trade-off between available and required stable funding, specifically focusing on building its retail deposit base and build up of capital, with particular focus on stable funding to build its longer-term liquidity.

4.10.5 Liquidity risk measurement tools
The Group is monitoring the liquidity risk through ALCO.

4.10.6 Liquidity risk monitoring
The Group has set the tolerance for liquidity risk which are communicated to the Risk Unit and Treasury Department. Based on these tolerances, Risk Unit and Treasury have established appropriate risk limits that maintain the Group’s exposure within the strategic risk tolerances over a range of possible changes in liquidity situations due to cash flows in current accounts, and IAH accounts.

4.10.7 Liquidity limits structure
The Group uses a combination of different limits to ensure that liquidity is managed and controlled in an optimal manner. The Group has set the following limits for monitoring liquidity risks:

a. Liquidity Gap limits; and
b. Liquidity Ratio limits.

4.10.8 Liquidity risk stress testing
To evaluate whether the Group is sufficiently liquid, behavior of the Group’s cash flows under different conditions are observed.

4.10.9 Contingency funding plan
The Group does contingency funding exercises which details procedures to be followed by the Group, in the event of a liquidity crisis or a situation where the Group faces stressed liquidity conditions. The contingency funding plan will be an extension of day to day liquidity management and involves maintenance of an adequate amount of liquid assets and management of access to funding resources. The ALCO members discuss and monitor the situation over regular time-intervals to ensure sufficient liquidity in the Group.

4 Risk Management (continued)

4.10 Liquidity Risk (continued)

Table – 32. Liquidity Ratios (PD-1.3.37)

The following table summarises the liquidity ratios for the past five years:

	2021	*2020*	*2019*	*2018*	*2017*
Due from banks and financial institutions / Total Assets	**10.65%**	3.67%	6.22%	10.74%	6.58%
Islamic Financing / Customer Deposits [1]	**77.04%**	75.81%	80.92%	83.31%	80.04%
Customer Deposits [1] / Total Assets	**81.37%**	85.30%	78.71%	71.85%	75.32%
Short term assets [2] / Short term liabilities [3]	**16.42%**	8.94%	16.59%	22.97%	20.35%
Liquid Assets [4] / Total Assets	**12.27%**	5.66%	8.15%	13.11%	9.38%
Growth in Customer Deposits	**3.71%**	7.29%	3.00%	(0.67%)	17.62%
Leverage ratio	**13.82%**	12.02%	12.00%	14.30%	15.91%

[1] Customer deposits include customer current accounts, commodity murabaha deposits from financial institutions, placements from non-financial institutions and individuals and IAH.

[2] Short term assets includes cash and balances with banks and placements with financial institutions (maturing in a year).

[3] Short term liabilities includes customer current accounts, other liabilities, placements from financial institutions (maturing within one year) and IAH (maturing within one year).

[4] Liquid assets includes cash and balances with banks and Central Bank (excluding CBB reserve) and placements with financial institutions (maturing in a year).

Table – 33. Maturity Analysis (PD-1.3.37, PD-1.3.38)

The following table summarises the maturity profile of the total assets, total liabilities and equity of investment accountholders based on contractual maturities as at 30 June 2021. All the assets with no fixed contractual maturities are disclosed under no fixed maturity:

	Up to 3 months BD'000	*3-6 months BD'000*	*6-12 months BD'000*	*1-3 years BD'000*	*Over 3 years BD'000*	*No fixed maturity BD'000*	*Total BD'000*
Assets							
Cash and balances with banks and Central Bank	**23,840**	**-**	**-**	**-**	**-**	**23,565**	**47,405**
Placements with financial institutions	**140,386**	**-**	**-**	**-**	**-**	**-**	**140,386**
Financing assets	**41,124**	**39,840**	**59,820**	**180,669**	**257,540**	**-**	**578,993**
Investment in Sukuk	**21,401**	**1,006**	**-**	**58,669**	**145,911**	**-**	**226,987**
Investment in equity and funds	**-**	**-**	**-**	**-**	**-**	**21,244**	**21,244**
Ijarah Muntahia Bittamleek and rental receivables	**4,029**	**5,490**	**7,666**	**32,053**	**197,892**	**-**	**-** 247,130
Investment in associates	**-**	**-**	**-**	**-**	**-**	**18,375**	**18,375**
Investment real estate	**-**	**-**	**-**	**-**	**-**	**16,109**	**16,109**
Property and equipment	**-**	**-**	**-**	**-**	**-**	**13,671**	**13,671**
Other assets	**1,366**	**745**	**139**	**417**	**892**	**3,993**	**7,552**
Total Assets	**232,146**	**47,081**	**67,625**	**271,808**	**602,235**	**96,957**	**1,317,852**
Liabilities And Equity Of Investment Accountholders							
Placements from financial institutions	**85,995**	**28,685**	**5,652**	**13,365**	**-**	**-**	**133,697**
Placements from non-financial institutions and individuals	**85,359**	**43,894**	**72,253**	**255**	**-**	**-**	**201,761**
Borrowings from financial institutions	**-**	**-**	**19,067**	**-**	**-**	**-**	**19,067**
Customers' current accounts	**277,259**	**-**	**-**	**-**	**-**	**-**	**277,259**
Other liabilities	**31,498**	**-**	**-**	**-**	**-**	**-**	**31,498**
Equity of investment accountholders	**438,150**	**18,845**	**37,269**	**35,969**	**1,367**	**-**	**531,600**
Total Liabilities And IAH	**918,261**	**91,424**	**134,241**	**49,589**	**1,367**	**-**	**1,194,882**

4 Risk Management (continued)

4.11 Profit Rate Risk

Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of funding due to the sources of finance.

A fundamental review and reform of major profit rate benchmarks is being undertaken globally. There is uncertainty as to the timing and the methods of transition for replacing existing benchmark interbank offered rates (IBORs) with alternative rates.

As a result of these uncertainties, there could be an impact on the values of financial contracts entered by the Bank. While the IBOR continues to be used as a reference rate in financial markets and is used in the valuation of instruments with maturities that exceed the expected end date for IBOR. The transition impact assessment was conducted in line with regulatory requirements.

Senior management identifies the sources of profit rate risk exposures based upon the current as well as forecasted balance sheet structure of the Group. The profit rate risk in the Group may arise due to the following transactions:

a. Murabaha transactions;
b. Wakala transactions;
c. Ijarah Muntahia Bittamleek;
d. Sukuk; and
e. Musharaka investments.

The profit distribution to equity of investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

4.11.1 Sources of Profit Rate Risk
The different profit rate risks faced by the Group can be classified broadly into the following categories:

a. Re-pricing risk which arises from timing differences in the maturity (for fixed rate) and re-pricing (for floating rate) of assets, liabilities and off balance sheet positions. As profit rates vary, these re-pricing mismatches expose the Group's income and underlying economic value to unanticipated fluctuations;
b. Yield curve risk which arises when unanticipated shifts of the yield curve have adverse effects on the Group's income and/or underlying economic value;
c. Basis risk which arises from imperfect correlation in the adjustment in the rate earned on products priced and the rate paid on different instruments with otherwise similar re-pricing characteristics. When profit rates change, these differences can give rise to unexpected changes in the cash flows and earnings spread between assets, liabilities, and off balance sheet instruments of similar maturities or re-pricing frequencies; and

d. Displaced Commercial Risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the liabilities, when the return on assets is under performing as compared with competitors rates.

4 Risk Management (continued)

4.11 Profit Rate Risk (continued)

4.11.2 Profit rate risk strategy
The Group is subject to profit rate risk on its financial assets and financial liabilities. The Group recognises income on certain of its financial assets on a time-apportioned basis. As a strategy the Group:

a. has identified the profit rate sensitive products and activities it wishes to engage in;
b. has established a structure to monitor and control the profit rate risk of the Group;
c. measures profit rate risk through establishing maturity/re-pricing schedule that distributes profit rate sensitive assets, liabilities and off-balance sheet items in pre-defined time bands according to their maturity; and
d. makes efforts to match the amount of floating rate assets with floating rate liabilities in the banking book.

4.11.3 Profit rate risk measurement tools
The Group uses the following tools for profit rate risk measurement in the banking book:

a. Re-pricing gap analysis which measures the arithmetic difference between the profit-sensitive assets and liabilities of the banking book in absolute terms; and
b. Basis Point Value ("BPV") analysis which is the sensitivity measure for all profit rate priced products and positions. The BPV is the change in net present value of a position arising from basis point shift in the yield curve. This quantifies the sensitivity of the position or portfolio to changes in profit rates.

4.11.4 Profit rate risk monitoring and reporting
The Group has implemented information systems for monitoring, controlling and reporting profit rate risk. Reports are provided on a timely basis to all relevant stakeholders in the Group on a periodic basis.

Table – 34. Profit Rate Risk in Banking Book (PD-1.3.40 (b))

The following table summarises the profit rate gap position as of 30 June 2021:

	Up to 3 months BD'000	*3-6 months BD'000*	*6-12 months BD'000*	*1-3 years BD'000*	*Over 3 years BD'000*	*Total BD'000*
Assets						
Placements with financial institutions	**140,386**	**-**	**-**	**-**	**-**	**140,386**
Financing assets	**41,124**	**39,840**	**59,820**	**180,669**	**257,540**	**578,993**
Ijara Muntahia Bittamleek and rental receivables	**4,029**	**5,490**	**7,666**	**32,053**	**197,892**	**247,130**
Investment in Sukuk	**21,401**	**1,006**	**-**	**58,669**	**145,911**	**226,987**
Total profit rate sensitive assets	**206,940**	**46,336**	**67,486**	**271,391**	**601,343**	**1,193,496**
Liabilities And Equity Of Investment Accountholders						
Placements from financial institutions*	**85,995**	**28,685**	**5,652**	**13,365**	**-**	**133,697**
Placements from non-financial institutions and individuals	**85,359**	**43,894**	**72,253**	**255**	**-**	**201,761**
Borrowings from financial institutions	**-**	**-**	**19,067**	**-**	**-**	**19,067**
Customers' current accounts**	**-**	**-**	**-**	**-**	**-**	**-**
Equity of investment accountholders	**438,150**	**18,845**	**37,269**	**35,969**	**1,367**	**531,600**
Total profit rate sensitive liabilities and IAH	**609,504**	**91,424**	**134,241**	**49,589**	**1,367**	**886,125**
Profit rate gap	**(402,564)**	**(45,088)**	**(66,755)**	**221,802**	**599,976**	**307,371**

*Placements from financial institutions includes frozen accounts of BD 9,524 thousand.

**The Bank uses expected withdrawal pattern to classify its saving accounts into different maturity buckets. The remaining IAH balances are disclosed on a contractual basis.

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200 bp in profit rates as of 30 June 2021:

	Effect on value of Asset BD'000	***Effect on value of Liability BD'000***	***Effect on value of Economic Capital BD'000***
Upward rate shocks:	**(5,204)**	**14,253**	**9,049**
Downward rate shocks:	**5,204**	**(14,253)**	**(9,049)**

4 Risk Management (continued)

4.11 Profit Rate Risk (continued)

Table – 35. Quantitative Indicators of Financial Performance and Position (PD-1.3.9 (b) PD-1.3.33 (d))

The following table summarises the basic quantitative indicators of financial performance for the past 5 years:

	2021	*2020*	*2019*	*2018*	*2017*
Return on average equity	**4.79%**	(11.58%)	5.21%	9.48%	8.50%
Return on average assets	**0.43%**	(1.03%)	0.50%	0.91%	0.90%
Cost to Income Ratio	**45.96%**	60.00%	59.30%	55.47%	61.92%

Table – 36. The following table summarises the historical data over the past five years in relation to Profit Sharing Investment Accounts (PD-1.3.41):

The details of income distribution to Profit Sharing Investment Accounts (PSIA) for the last five years:

	2021	2020	*2019*	*2018*	*2017*
Allocated income to IAH	**12,599**	16,551	35,686	41,162	36,010
Distributed profit	**1,806**	4,009	12,685	13,939	11,364
Mudarib fees	**10,741**	12,476	23,001	27,223	24,646

	2021	*2020*	*2019*	*2018*	*2017*
Balances (BD '000s):					
Profit Equalization Reserve (PER)	**1,362**	1,310	1,245	1,245	1,245
Investment Risk Reserve (IRR)	**-**	-	-	1,177	1,177
PER Movement	**52**	66	-	-	-
IRR Movement	**-**	-	(1,177)	-	420
Ratios (%):					
Income allocated to IAH / Mudarabah assets %	**2.13%**	1.53%	3.34%	3.71%	3.43%
Mudarabah fees / Mudarabah assets %	**1.81%**	1.16%	2.15%	2.45%	2.35%
Distributed profit / Mudarabah assets %	**0.31%**	0.38%	1.19%	1.26%	1.08%
Rate of Return on average IAH %	**0.90%**	0.98%	1.70%	1.76%	1.57%
Profit Equalization Reserve / IAH %	**0.32%**	0.32%	0.29%	0.16%	0.16%
Investment Risk Reserve / IAH %	**-**	-	-	0.15%	0.15%

4.12 CBB Penalties (PD 1.3.44)

During the period, the CBB imposed financial penalties of BD 20,150 regarding CBB Directives on EFTS.

5 Glossary of Terms

ALCO	Assets and Liabilities Committee
BCP	Business Continuity Plan
BisB	Bahrain Islamic Bank B.S.C.
BPV	Basis Point Value
BRCC	Board Risk and Compliance Committee
CA Module	Capital Adequacy Module
CAR	Capital Adequacy Ratio
CBB	Central Bank of Bahrain
CRMD	Credit and Risk Management Department
CR & AD	Credit Review and Analysis Department
C&IC	Credit and Investment Committee
DCR	Displaced Commercial Risk
Excom	Executive Committee
FX	Foreign Exchange
GM-C&RM	General Manager-Credit and Risk Management
Group	Bahraini Islamic Bank B.S.C. and its subsidiaries
HR Committee	Human Resource Committee
IAH	Investment Account Holder
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IT Committee	Information Technology Committee
IRR	investment Risk Reserve
MLG	Minimum Liquidity Guidelines
PCD	Prudential Consolidation and Deduction Requirements Module
PD	Public Disclosure
PER	Profit Equalisation Reserve
PSIA	Profit Sharing Investment Account
RCSA	Risk and Control Self-Assessment
RMC	Risk Management Committee
RWE	Risk Weighted Exposures
VaR	Value-at-Risk
L/C	Letter of Credit
L/G	Letter of Guarantee
ECL	Expected Credit Losses