



## **RISK AND CAPITAL MANAGEMENT DISCLOSURES**

**FOR THE SIX MONTHS  
30 June 2016**

*These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), CBB Rule Book, Volume I for Conventional banks. These disclosures should be read in conjunction with the Notes, in particular the Significant Accounting Policies and Financial Risk Management, in the Bank’s Financial Statements for the year ended 31 December 2015.*

*These disclosures have been reviewed by the Bank’s external auditors KPMG based upon agreed-upon procedures as required under Para PD-A.2.4 of the PD Module.*



## EXECUTIVE SUMMARY

The Central Bank of Bahrain's (CBB) Basel 3 rules outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2015.

NBB has adopted the Standardized Approach for Credit Risk, Market Risk and the Basic Indicator Approach for Operational Risk to determine the capital requirement. This report consists of the Basel Committee's Pillar 3 disclosures and other disclosure requirements as stipulated by the CBB. The report contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on capital adequacy.

As at 30 June 2016, the Bank's total risk weighted assets amounted to BD 1,174.7 million; Common Equity Tier 1 (CET1) and Total Regulatory Capital amounted to BD 328.3 million and BD 340.8 million respectively. Accordingly, CET 1 Capital Adequacy Ratio and Total Capital Adequacy Ratio were 27.95 percent and 29.01 percent respectively. These ratios exceed the minimum capital requirements under the CBB's Basel 3 framework.

The Bank views these disclosures as an important means of increased transparency and accordingly has provided extensive disclosures in this report that is appropriate and relevant to the Bank's stakeholders and market participants.

### CBB CAPITAL ADEQUACY RULES:

The CBB Capital Adequacy Rules provides guidance on the risk measurements for the calculation of capital requirements. Conventional bank licenses are required to meet the following minimum CAR requirements:

Components of consolidated CARs				
	Optional	Minimum Ratio Required	Capital conservation buffer (CCB)	CAR including CCB
Common Equity Tier 1 (CET1)		6.5 %	2.5 % comprising of CET1	9.0 %
Additional Tier 1 (AT1)	1.5 %			10.5 %
<b>Tier 1 (T1)</b>		<b>8.0 %</b>		
Tier 2 (T2)	2.0 %			
<b>Total Capital</b>		<b>10.0 %</b>		

The regulatory adjustments (i.e. deductions) including amounts above the aggregate 15% limit for significant investments in financial institutions, mortgage service rights, and deferred tax assets from temporary differences, are fully deducted from CET1 by 1 January 2019. This regulatory adjustments being at 20% of the required adjustments to CET 1 on 1 January 2015, 40% on 1 January 2016, 60% on 1 January 2017, 80% on 1 January 2018, and reach 100% on 1 January 2019. During the transition period, the remainder not deducted from CET1, which continues to be risk weighted as per the Rulebook.

Banks are required to maintain a Capital Conservation Buffer (CCB) of 2.5%, comprising of CET1 above the regulatory minimum Total Capital ratio of 10.0%. Capital distribution constraints will be imposed when the CCB fall below 2.5%. The constraints imposed only relate to distribution, and not the operations of the licensed banks.

The Basel III framework consists of three mutually reinforcing pillars:

- i. Pillar 1: Minimum capital requirements for credit risk, market risk and operational risk.
- ii. Pillar 2: Supervisory review of capital adequacy including Internal Capital Adequacy Assessment process (ICAAP)
- iii. Pillar 3: Market discipline including rules for disclosure of risk management and capital adequacy.

## SCOPE OF APPLICATION

The Bank operates as an independent banking institution with headquarters in Bahrain and branches in Bahrain, the United Arab Emirates and Saudi Arabia. The Bank's capital adequacy requirements are computed on a consolidated basis. The Bank does not have any subsidiaries.

## RISK AND CAPITAL MANAGEMENT

The Bank is exposed to the following types of risks:

- credit risk
- liquidity risk
- market risk
- interest rate risk
- operational risk

### Risk management framework

The overall authority for risk management in the Bank is vested in the Board of Directors. The Board authorises appropriate credit, liquidity and market risk policies as well as operational guidelines based on the recommendation of Management. The Bank has established various committees that review and assess all risk issues. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and nature of operations or risk. The Risk Group (RG) of the Bank provides the necessary support to senior management and the business units in all areas of risk management. This Group functions independent of the business units and reports directly to the Chief Executive Officer. The Group comprises of a Credit Review department (responsible for pre-approval analysis of credit / investment proposals as well as risk policy and procedures management), Credit Administration department (responsible for post approval implementation and follow up), Legal department (responsible for management of legal risk), Market and Operational Risk Management department (responsible for market risk and operational risk).

The Audit Committee of the Board is responsible for monitoring compliance with the Bank's policies and procedures and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by the Internal Audit department, which undertakes both regular and adhoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee and to Management.

### Credit Risk

Credit Risk represents the potential financial loss as a consequence of a customer's inability to honour the terms and conditions of a credit facility. Such risk is measured with respect to counterparties for both on-balance sheet assets and off-balance sheet items.

The Bank acknowledges that credit risk is an inherent and substantial cost that needs to be set against income. Risk is just one aspect of the triangle for any economic capital system and must be seen in conjunction with capital requirements and returns. The Bank evaluates risk in terms of the impact on income and asset values and the evaluation reflects the Bank's assessment of the potential impact on its business on account of changes in political, economic and market conditions and in the credit worthiness of its clients. Risk management at the Bank has always been conservative and proactive with the objective of achieving a balanced relation between risk appetite and expected returns.

The Bank monitors and manages concentration risk by setting limits on exposures to countries, sectors, products and counterparty groups. Stringent criteria is used by Credit Review Department in setting such limits and these have ensured that the impact of any adverse developments on the Bank's income stream and capital strength is limited. Prior to launch of any new asset product, based on a comprehensive risk analysis, product specific transaction approval criteria are set. Similarly, prudent norms have been implemented to govern the Bank's investment activities, which specify to the Bank's Treasury department the acceptable levels of exposure to various products, based on its nature, tenor, rating, type, features, etc.

The Bank has well laid out procedures, to not only appraise but also regularly monitor credit risk. Credit appraisal is based on the financials of the borrower, performance projections, market position, industry outlook, external ratings (where available),

track record, product type, facility tenor, account conduct, repayment sources and ability, tangible and intangible security, etc. Regular reviews are carried out for each account and risks identified are mitigated in a number of ways, which include obtaining collateral, counter-guarantees from shareholders and/or third parties. Adequate margins are maintained on the collateral to provide a cushion against adverse movement in the market price of collateral. Not only are regular appraisals conducted to judge the credit worthiness of the counterparty but day-to-day monitoring of financial developments across the globe by the Business Units and Credit Review Department ensures timely identification of any events affecting the risk profile.

The Business Units of the Bank are responsible for business generation and initial vetting of proposals to make sure that the Bank's risk acceptance criteria are met. Credit facilities in excess of BD 250,000 or falling outside pre-approved product criteria are referred to Credit Review Department, which analyses the proposal and puts forth its recommendations prior to approval by the appropriate authorities. In addition to rigorous credit analysis, the terms and conditions of all credit facilities are strictly implemented by the Credit Administration Department. An internal grading system and review process ensures prompt identification of any deterioration in credit risk and consequent implementation of corrective action.

The Bank's internal ratings are based on a 10-point scale, which takes into account the financial strength of a borrower as well as qualitative aspects to arrive at a comprehensive snapshot of the risk of default associated with the borrower. Ratings are further sub-divided into categories, which reflect estimates of the potential maximum loss in an event of default. Risk Ratings assigned to each borrower are reviewed at least on an annual basis. Regular monitoring of the portfolio enables the Bank to identify accounts, which witness deterioration in risk profile. Consumer credit facilities, which are granted based on pre-defined criteria such as salary assignment, maximum repayment obligation as a percentage of salary, etc are excluded from this rating system.

The Bank also uses the ratings by established rating agencies, viz., Moody's, Standard & Poor and Fitch as part of the appraisal process while considering exposures to rated entities.

For purposes of comparison, the Bank's internal ratings are mapped to Moody's and Standard & Poor (S&P) ratings as under:

<b><u>Bank's Internal Ratings Scale</u></b>	<b><u>Equivalent to Moody's and S&amp;P ratings</u></b>
1	AAA/Aaa
2	AA/Aa2
3	A/A2
4	BBB+/Baa1
5	BBB-/Baa3
6	BB/Ba2
7	B+/B1
8 - 10	CCC/Caa to C

However, the above mapping is not intended to reflect a direct relationship between the Bank's internal ratings and the corresponding rating of the external agencies since the basis and methodology differ.

### **Liquidity Risk**

Liquidity Risk is the potential inability of a bank to meet its financial obligations on account of a maturity mismatch between assets and liabilities. Liquidity risk management ensures that funds are available at all times to meet the funding requirements of the Bank.

The asset/liability management policies of the Bank define the proportion of liquid assets to total assets with the aim of minimising liquidity risk. The Bank maintains adequate liquid assets such as inter-bank placements, treasury bills and other readily marketable securities, to support its business and operations. The Treasury Department monitors the maturity profile of assets and liabilities so that adequate liquidity is maintained at all times.

The Bank's ability to maintain a stable liquidity profile is primarily on account of its success in retaining and growing its customer deposit base. The marketing strategy of the Bank has ensured a balanced mix of demand and time deposits. Stability of the deposit base thus minimises the Bank's dependence on volatile short-term borrowings. Further, investment securities with contractual maturities of more than three months can also be readily liquidated. Considering the effective maturities of deposits based on retention history and in view of the ready availability of liquid investments, the Bank is able to ensure that

sufficient liquidity is always available. The Asset Liability Committee (ALCO) chaired by the Chief Executive Officer reviews the Liquidity Gap Profile and the Liquidity scenario and addresses strategic issues concerning liquidity.

### **Market Risk**

Market Risk is the risk of potential losses arising from movements in market prices of interest rate related instruments and equities in the trading portfolio and foreign exchange and commodities holdings throughout the Bank. The Bank's trading activities are governed by conservative policies that are clearly documented, by adherence to comprehensive limit structures set annually and by regular reviews. Quality and rating are the main criteria in selecting a trading asset. The Bank uses the standardized method for allocating market risk capital based on the risk assessed for underlying factors of interest rate risk, equity risk, foreign exchange risk, options risk and commodity risk. Daily reports in this regard are submitted to senior management for review and decision making purposes.

### **Interest Rate Risk**

Interest Rate Risk is measured by the extent to which changes in the market interest rates impact margins, net interest income and the economic value of the Bank's equity. Net interest income will be affected as a result of volatility in interest rates to the extent that the re-pricing structure of interest bearing assets differs from that of liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while, selectively positioning itself to benefit from near-term changes in interest rate levels. The Treasurer is primarily responsible for managing the interest rate risk. Reports on overall position and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, ALCO regularly reviews the interest rate sensitivity profile and its impact on earnings.

The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. The Bank uses various techniques for measuring and managing its exposure to interest rate risk. Duration analysis is used to measure the interest rate sensitivity of the fixed income portfolio. Duration of the portfolio is governed by economic forecasts, expected direction of interest rates and spreads. Modified Duration gives the percentage change in value of the portfolio following a 1 percent change in yield. Interest rate swaps and forward rate agreements are used to manage the interest rate risk. The Bank uses interest rate gap analysis to measure the interest rate sensitivity of its annual earnings due to re-pricing mismatches between rate sensitive assets, liabilities and derivatives positions.

### **Operational Risk**

Operational Risk is the risk of monetary loss on account of human error, fraud, systems failures or the failure to record transactions. In order to manage and mitigate such risks, the Bank ensures that proper systems and resources (financial and personnel) are available to support the Bank's operations. Proper segregation of duties and other controls (including reconciliation, monitoring and reporting) are implemented to support the various operations, especially credit, treasury and electronic banking activities.

Detailed operational guidelines are spelt out in the Operations Manual to specify the steps to be followed in handling any transaction. These steps are designed to mitigate the risks arising from errors, omissions and oversights in dealing with customer instructions and transaction processing. The overriding principles in drawing up operational processes are that transactions must be scrutinized by a "checker" independent from the "originator" prior to booking and that there should be a clear audit trail for post facto scrutiny. The Bank's Fraud Manual and the Code of Conduct provide necessary guidance to mitigate risks and ensure that adequate controls are in place for detecting suspicious transactions. Any changes to operational procedures need to be processed through the Internal Audit Department, who ensure that satisfactory control mechanisms are in place in all procedures.

Specific limits are set up to mitigate and monitor the Bank's exposure including limits on maximum branch cash limit, maximum teller limit, maximum payment authorization limit, signature authorities, etc. Documented policies and procedures, approval and authorization process for transactions, documented authority letters, process of verification of transaction details and activities, reconciliation of key activities, dual custody of financial assets like demand drafts, cheques etc. and insurance coverage of various operational risks are the key pillars of the operational risk management process.

The Bank has an Operational Risk Management Department within the RG to independently monitor and manage all aspects of operational risk on a bank wide basis. The Bank also has a dedicated Operational Risk Management Committee to supervise,

monitor and review operational risk issues and ensure that adequate mitigants are developed and implemented for all operational risk issues.

The scope of the Internal Audit department encompasses audits and reviews of all business units, support services and branches. The internal audit process focuses primarily on assessing risks and controls and ensuring compliance with established policies, procedures and delegated authorities. New products and services are reviewed by the Internal Audit department and assessed for operational risks prior to their implementation. The Internal Audit department is operationally independent and reports significant internal control deficiencies to the Audit Committee.

The Bank has a Business Continuity Plan (BCP) to ensure that the critical activities are supported in case of an emergency. The BCP is approved by the Board of Directors.

### **Risk Monitoring and Reporting**

Systems and processes are in place to regularly monitor and report risk exposures to the Board of Directors and senior management to effectively monitor and manage the risk profile of the Bank.

The Board of Directors are provided with quarterly risk reports covering credit, market, liquidity, operational, concentration and other risks.

Senior management is provided with a daily report on market risk and monthly reports on other risks. Reports on capital adequacy and internal capital adequacy assessment are provided to senior management on a monthly basis. In addition, stress testing on capital adequacy is undertaken once a year or more frequently in times of need and communicated to Board of Directors and senior management for appropriate decisions.

### **Capital Management**

The Bank's policy is to maintain sufficient capital to sustain investor, creditor and market confidence and to support future development of the business. The impact of the level of capital on return on shareholder's equity is also considered and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank's capital management framework is intended to ensure that there is sufficient capital to support the underlying risks of the Bank's business activities and to maintain a well-capitalised status under regulatory requirements. The Bank has a comprehensive Internal Capital Adequacy Assessment Process (ICAAP) that includes Board and senior management oversight, monitoring, reporting and internal control reviews, to identify and measure the various risks that are not covered under Pillar 1 risks and to regularly assess the overall capital adequacy considering the risks and the Bank's planned business strategies. The non Pillar 1 risks covered under the ICAAP process include concentration risk, liquidity risk, interest rate risk in the banking book and other miscellaneous risks. The ICAAP also keeps in perspective the Bank's strategic plans, credit growth expectations, future sources and uses of funds, dividend policy and the impact of all these on maintaining adequate capital levels. In addition, the ICAAP process also includes stress testing on the Bank's capital adequacy to determine capital requirement and planning to ensure that the Bank is adequately capitalised in line with the overall risk profile.

The Bank ensures that the capital adequacy requirements are met on a consolidated basis and also with local regulator's requirements, if any, in countries in which the Bank has branches. The Bank has complied with regulatory capital requirements throughout the year.

Prior approval of the Central Bank of Bahrain is obtained by the Bank before submitting any proposal for distribution of profits for shareholders approval.

## CAPITAL STRUCTURE AND CAPITAL ADEQUACY

The Bank's paid up capital consists only of ordinary shares, which have proportionate voting rights. The Bank does not have any other type of capital instruments.

<b>As at 30 June 2016</b>	<b>In BD 000s</b>
<b>Common Equity Tier 1 (CET1)</b>	
Issued and full paid ordinary shares	115,950
Shares under employee share incentive scheme	(1,644)
Statutory reserve	57,975
Share Premium	2,528
General & other reserves	47,748
Retained earnings	109,325
Current year profits	31,716
Unrealised gains and losses on available for sale financial instruments	(20,017)
Deduction from CET 1 (significant investments in common stock of financial entities)	(15,243)
<b>Total Common Equity Tier 1 (CET1)</b>	<b>328,338</b>
Additional Tier 1 (AT1)	-
<b>Total Tier 1 (T1)</b>	<b>328,338</b>
<b>Tier 2 Capital (T2)</b>	
General loan loss provision subject to 1.25% of credit risk weighted assets	12,430
<b>Total Tier 2 (T2)</b>	<b>12,430</b>
<b>Total Capital Base (Tier 1 + Tier 2)</b>	<b>340,768</b>

### Capital structure, minimum capital and capital adequacy

<i>As at 30 June 2016</i>	<b>Credit Exposure before credit risk mitigant</b>	<b>Eligible credit Risk mitigant</b>	<b>Credit Exposure after credit risk mitigant</b>	<b>Risk weighted exposure</b>	<b>Capital Requirement at 12.5 %</b>
<b>In BD 000s</b>					
Sovereigns	1,659,219	-	1,659,219	-	-
PSE	139	-	139	-	-
Banks	297,941	-	297,941	150,433	18,804
Corporates	527,461	43,302	484,159	260,621	32,578
Regulatory retail	369,866	1,462	368,404	276,303	34,538
Residential mortgages	18,767	-	18,767	14,075	1,759
Past due exposures	56,618	560	56,058	65,079	8,135
Investments in equities/funds	81,614	-	81,614	153,333	19,167
Securitisation exposures	20	-	20	10	1
Others assets	95,477	7,411	88,066	74,527	9,316
<b>Total Credit Risk Exposure</b>	<b>3,107,122</b>	<b>52,735</b>	<b>3,054,387</b>	<b>994,381</b>	<b>124,298</b>
<b>Market Risk</b>				<b>20,015</b>	<b>2,502</b>
<b>Operational Risk</b>				<b>160,339</b>	<b>20,042</b>
<b>Total Risk Weighted Assets</b>				<b>1,174,735</b>	<b>146,842</b>
<b>Capital Adequacy Ratio</b>				<b>29.01%</b>	
<b>CET1 Capital Adequacy Ratio</b>				<b>27.95%</b>	

## **CREDIT RISK**

The Bank has a diversified on and off balance sheet credit portfolio, which are divided into counter party exposure classes in line with the CBB's Basel 3 capital adequacy framework for the Standardized approach for credit risk. A high-level description of the counter party exposure classes and the risk weights used to derive the Risk Weighted Assets are as follows:

### ***Sovereigns Portfolio***

The sovereign portfolio comprises exposures to governments and their respective central banks. The risk weights are 0 percent for exposures in the relevant domestic currency of the sovereign, or for any exposures to GCC governments. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereign portfolio and treated as exposures with a 0 percent risk weighting.

### ***PSE Portfolio***

Public sector entities (PSEs) are risk weighted according to their external ratings except for Bahrain PSEs and domestic currency claims on other PSEs that are assigned a 0 percent risk weight by their respective country regulator, are consequentially allowed a 0 percent risk weight by CBB for computation purposes.

### ***Banks Portfolio***

Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short-term exposures to banks in their country of incorporation. Short-term exposures are defined as exposures with an original tenor of three months or less and denominated and funded in the respective domestic currency. The preferential risk weight for short-term claims is allowed on exposures in Bahraini Dinar/US Dollar in the case of Bahraini incorporated banks.

### ***Corporates Portfolio***

Claims on corporates are risk weighted based on their external credit ratings. A 100 percent risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a 0 percent risk weight.

### ***Regulatory Retail Portfolio***

Claims on individuals or to a small business with an annual turnover below BD 2mn; the maximum aggregated retail exposure to one counterparty must not exceed an absolute limit of BD 250,000. These claims are risk weighted at 75%.

### ***Residential mortgages***

Lending fully secured by first mortgages on residential property that is or will be occupied by the borrower or that is leased. These claims are risk weighted at 75%.

### ***Equities / Funds Portfolio***

The equities portfolio comprises equity investments in the banking book, i.e. the available-for-sale securities portfolio. The credit (specific) risk for equities in the trading book is included in market risk RWAs for regulatory capital adequacy calculation purposes.

A 100 percent risk weight is assigned to listed equities and funds. Unlisted equities and funds are risk weighted at 150 percent. Investments in rated funds are risk weighted according to the external credit rating. Investments in companies engaged primarily in real estate are included in other assets and risk weighted at 200 percent. Significant investments in listed and unlisted equities of financial entities are aggregated and the excess above the 10% of CET1 is deducted from equity; the amount not deducted is risk weighted at 250%.

In addition to the standard portfolios, other exposures are risk weighted as under:

### ***Past due exposures***

All past due loan exposures, irrespective of the categorisation of the exposure are classified separately under the past due exposures asset class. A risk weighting of either 100 percent or 150 percent is applied depending on the level of specific provision maintained against the exposure.

### ***Other assets and holdings of securitisation tranches***

Other assets are risk weighted at 100 percent. Securitisation tranches are risk weighted (ranging from 20 percent to 350 percent) based on their external credit ratings and resecuritisation tranches are risk weighted (ranging from 40 percent to 650 percent)



based on their external credit ratings. Exposures to securitisation & resecuritisation tranches that are rated below BB- or are unrated are deducted from regulatory capital rather than subject to a risk weight. Investments in real estate and also in bonds, funds and equities of companies engaged primarily in real estate are included in other assets and risk weighted at 200 percent.

#### External Credit Assessment Institutions (ECAI)

The Bank uses ratings issued by Standard & Poor's, Moody's and Fitch to derive the risk weightings under the CBB's Basel 3 capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to represent the rating for regulatory capital adequacy purposes.

The following are gross credit risk exposures considered for Capital Adequacy Ratio calculations comprising of banking book exposures:

*As at 30 June 2016*

**In BD 000s**

	Six months	
	As at 31-06-2016	2016 Average
Cash and balances at central banks	102,415	101,925
Treasury bills	595,100	506,235
Placements with banks and other financial institutions	112,044	150,668
Loans and advances	1,028,844	1,068,663
Investment securities	1,032,574	1,045,662
Other assets	95,282	104,171
<b>Total assets</b>	<b>2,966,259</b>	<b>2,977,324</b>
Non-derivative banking commitments and contingent liabilities (notional)	251,571	279,014
Derivatives (notional)	1,183,358	1,024,355

#### INDUSTRY OR COUNTERPARTY EXPOSURE

*As at 30 June 2016*

In BD 000s	Govt	Mfg / Trdg	Banks/ FIs	Const	Personal	Others	Total
Cash and balances at central banks	-	-	102,415	-	-	-	102,415
Treasury bills	595,100	-	-	-	-	-	595,100
Placements with banks and other financial	-	-	112,044	-	-	-	112,044
Loans and advances *	179,809	114,710	182,124	85,575	391,794	88,593	1,042,605
Investment securities	891,897	6,144	111,719	1,130	-	21,684	1,032,574
Investment in associates and Other assets	15,177	216	52,332	50	1,542	25,965	95,282
<b>Total assets</b>	<b>1,681,983</b>	<b>121,070</b>	<b>560,634</b>	<b>86,755</b>	<b>393,336</b>	<b>136,242</b>	<b>2,980,020</b>
Non-derivative banking commitments and contingent liabilities (notional)	130,197	33,030	40,219	32,030	453	15,642	<b>251,571</b>
Derivatives (notional)	-	-	1,183,358	-	-	-	<b>1,183,358</b>

\*Gross of general provision of BD 13,761.

The above includes certain exposures to customers / counter parties, which are in excess of 15 percent of the Bank's capital base. These have the approval of the Central Bank of Bahrain or are exempt exposures under the large exposures policy of the Central Bank of Bahrain. The table below gives details of these exposures:

<b>Counterparty</b>	<b>Counterparty Type</b>	<b>Total Exposure</b>
Counterparty A	Sovereign	1,521,947
Counterparty B	Sovereign	190,255
Counterparty C	Central Bank	104,347

#### **GEOGRAPHIC DISTRIBUTION OF EXPOSURE**

<b>In BD 000s</b>	<b>Middle East</b>	<b>USA</b>	<b>Europe</b>	<b>Rest of World</b>	<b>Total</b>
Cash and balances at central banks	102,415	-	-	-	102,415
Treasury bills	595,100	-	-	-	595,100
Placements with banks and other financial institutions	106,102	1,402	2,900	1,640	112,044
Loans and advances *	1,004,357	-	17,138	21,110	1,042,605
Investment securities	1,004,366	1,280	378	26,550	1,032,574
Investment in associates and Other assets	92,628	26	2,483	145	95,282
<b>Total assets</b>	<b>2,904,968</b>	<b>2,708</b>	<b>22,899</b>	<b>49,445</b>	<b>2,980,020</b>
Non-derivative banking commitments and contingent liabilities (notional)	233,022	66	16,098	2,385	<b>251,571</b>
Derivatives (notional)	477,157	212,440	183,404	310,357	<b>1,183,358</b>

\*Gross of general provision of BD 13,761.

#### **RESIDUAL CONTRACTUAL MATURITY**

*As at 30 June 2016*

<b>In BD 000s</b>	<b>Upto 3 months</b>	<b>3 to 6 months</b>	<b>6 months to 1 year</b>	<b>1 year to 3 years</b>	<b>3 years to 5 years</b>	<b>5 years to 10 years</b>	<b>10 years to 20 years</b>	<b>Over 20 years</b>	<b>Total</b>
Cash and balances at central banks	102,415	-	-	-	-	-	-	-	102,415
Treasury bills	297,166	67,882	230,052	-	-	-	-	-	595,100
Placements with banks and other financial institutions	93,168	15,416	3,460	-	-	-	-	-	112,044
Loans and advances *	282,957	45,371	108,137	271,314	216,661	100,414	16,903	848	1,042,605
Investment securities	70,924	2,314	12,601	228,705	438,576	200,162	21	79,271	1,032,574
Investment in associates and Other assets	15,540	285	731	4,462	5,783	5,350	-	63,131	95,282
<b>Total assets</b>	<b>862,170</b>	<b>131,268</b>	<b>354,981</b>	<b>504,481</b>	<b>661,020</b>	<b>305,926</b>	<b>16,924</b>	<b>143,250</b>	<b>2,980,020</b>
Non-derivative banking commitments and contingent liabilities (notional)	72,088	74,702	23,705	36,781	41,933	2,330	32	-	<b>251,571</b>
Derivatives (notional)	410,724	97,647	109,973	79,829	293,425	191,760	-	-	<b>1,183,358</b>

\*Gross of general provision of BD 13,761.

### *Past due exposures*

In accordance with the Bank's policy and Central Bank of Bahrain guidelines, loans on which payment of interest or repayment of principal are 90 days past due, are defined as non-performing.

The Bank has systems and procedures in place to generate alerts in case of past dues in any account. A stringent classification process is followed for all accounts with past dues of over 90 days. The Bank applies rigorous standards for provisioning and monitoring of non-performing loans. Level of provisions required is determined based on the security position, repayment source, discounted values of cash flows, etc and adequate provisions are carried to guard against inherent risks in the portfolio.

The Bank considers evidence of impairment for loans and advances at both specific and collective level.

All individually significant loans and advances are assessed for specific impairment. Specific provision for impairment, pertaining to individually significant impaired loans and advances, is determined based on the difference between the net carrying amount and the estimated recoverable amount of the loans and advances, measured at present value of estimated future cash flows from such loans and advances and discounting them based on their original effective interest rate. If a loan has a floating interest rate, the discount rate is the current effective rate determined under the contract.

Impairment and uncollectability is also measured and recognized on a portfolio basis for a group of loans and advances with similar credit risk characteristics, that are not individually identified as impaired, on the basis of estimates of incurred losses that are inherent but not yet specifically identified within the loans and advances portfolio at the statement of financial position date. The estimates are based on internal risk ratings, historical default rates, rating migrations, loss severity, macroeconomic and other relevant factors with historic loss experience being adjusted to reflect the effect of prevailing economic and credit conditions.

### **Ageing analysis of impaired and past due loans and advances:**

<i>As at 30 June 2016</i>	<b>In BD'000s</b>
Over 3 months to 1 year	11,612
1 to 3 years	24,087
Over 3 years	57,001
<b>Total</b>	<b>92,700</b>

### **Geographical location of impaired and past due loans and advances:**

<b>As at 30 June 2016</b>	<b>Loan Amount</b>	<b>Specific Impairment Provision</b>	<b>Collective Impairment Provision</b>
<b>In BD'000s</b>			
Bahrain	77,674	24,673	10,494
Other GCC countries	15,026	11,412	2,789
Others	-	-	478
<b>Total</b>	<b>92,700</b>	<b>36,085</b>	<b>13,761</b>

## Industry/sector wise breakdown of impaired and past due loans and advances:

In BD'000s	As at 30 June 2016			For the six months ended 30 June 2016	
	Loan Amount	Specific Impairment Provision	Collective Impairment Provision	Specific Impairment Charge	Write Offs
Manufacturing / trading	8,784	838	1,830	492	89
Construction	52,588	12,459	1,365	(274)	-
Personal	12,249	11,142	6,249	324	186
Others	19,079	11,646	4,317	7	8
<b>Total</b>	<b>92,700</b>	<b>36,085</b>	<b>13,761</b>	<b>549</b>	<b>283</b>

## Movement in impairment provision for loans and advances:

In BD'000s	Specific Impairment Provision	Collective Impairment Provision	Total Impairment Provision
<b>At 1 January 2016</b>	35,819	12,815	48,634
Charge for the period	1,521	1,000	2,521
Amounts written off against provision	(283)	-	(283)
Recoveries, transfers & write backs	(972)	(54)	(1,026)
<b>At 30 June 2016</b>	<b>36,085</b>	<b>13,761</b>	<b>49,846</b>

## Restructuring

During the six months ended 30 June 2016, no credit facilities were restructured. Restructuring concessions mainly related to deferral of loan installments to assist customers overcome temporary cash crunch situations or to realign the repayment with the borrowers'/projects' revised cash flow projections.

## CREDIT RISK MITIGATION

The reduction of the capital requirement attributable to credit risk mitigation is calculated in different ways, depending on the type of credit risk mitigation, as under:

*Adjusted exposure amount:* The Bank uses the comprehensive method for eligible financial collateral such as cash and equities listed on a recognized stock exchange. The exposure amount and financial collateral, where applicable, are adjusted for market volatility through the use of supervisory haircuts (for currency mis-matches, price volatility and maturity-mismatches) that are specified by the CBB.

*Substitution of counterparty:* The substitution method is used for eligible guarantees (only sovereigns, banks or corporate entities with ECAI ratings higher than that of the counterparty; guarantees issued by corporate entities may only be taken into account if their rating corresponds to A- or better) whereby the rating of the counterparty is substituted with the rating of the guarantor.

## COLLATERAL AND VALUATION PRINCIPLES

The main collaterals taken for risk mitigation on credit exposures are deposits held by customers, pledge of quoted shares, residential/commercial property mortgage, investment securities, counter-guarantees from other banks, etc. Other risk mitigants considered include salary and end of service benefits assignment for personal loans, personal guarantees of promoters etc. However, for purposes of capital adequacy computation, only eligible collateral recognized under Basel 3 is taken into consideration and there are no significant concentrations in such eligible collateral taken for credit risk mitigation.

The Bank's Credit Policy defines the types of acceptable collateral and the applicable haircuts or loan-to-value ratio. The Bank has a system of independent valuation of collateral. In the case of real estate, valuation is done by independent valuer at regular intervals as stipulated in the Bank's credit policy. In respect of quoted shares and other securities, the valuation is done based on the closing price on the stock exchange. The market value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. In general, lending is based on the customer's repayment capacity and not the collateral value. However, collateral is considered as a secondary alternative to fall back on in the event of default.

Eligible financial collateral, guarantees and credit derivatives, presented by standard portfolio are as under:

As at 30 June 2016 In BD'000s	Off which secured by eligible			
	Gross credit exposure	Financial Collateral	Guarantees & Credit Derivatives	Credit exposure after risk mitigation
Sovereigns	1,659,219	-	-	1,659,219
PSE	139	-	-	139
Banks	297,941	-	-	297,941
Corporates	527,461	43,302	-	484,159
Regulatory retail	369,866	1,462	-	368,404
Residential mortgages	18,767	-	-	18,767
Past due exposures	56,618	560	-	56,058
Investments in equities/funds	81,614	-	-	81,614
Securitisation exposures	20	-	-	20
Others assets	95,477	7,411	-	88,066
<b>Total</b>	<b>3,107,122</b>	<b>52,735</b>	<b>-</b>	<b>3,054,387</b>

#### On and off-Balance Sheet netting:

The legal documents that the Bank obtains from customers include clauses that permit the Bank to offset the customer's dues to the Bank against the Bank's dues to the customer. Thus, if the same legal entity has obtained credit facilities from the Bank and also maintains credit balance with the Bank, the Bank has the legal right to set-off the credit balances against the dues. In case of certain counter party banks, the Bank has entered into specific netting agreements that provide for netting on and off-balance sheet exposures.

The amount of financial assets and financial liabilities set off under netting agreements amounted to BD 66.8 million at 30 June 2016.

#### MARKET RISK

The Bank uses the standardized method for allocating market risk capital. The Bank has clearly documented policies and procedures for the management and valuation of the trading portfolio. The Treasury Operations department, which is independent of the front office, is responsible for valuation which is done on a daily basis, based on quoted market prices from stock exchanges, independent third parties or amounts derived from cash flow models as appropriate.

Amounts in BD '000 Risk Type	As at 30-06-2016	Capital Charge		
		Maximum	Minimum	Average
Interest Rate Risk	1,495.0	1,938	691	1,367
Equities Risk	48.6	65	48	54
Foreign Exchange Risk	53.5	264	19	54
Commodities Risk				
Options Risk	4.1	6	4	5
<b>Total minimum capital required for market risk</b>	<b>1,601.2</b>			
Multiplier	12.5			
<b>Market Risk weighted exposure under the Standardized Method</b>	<b>20,015</b>			

## OPERATIONAL RISK

Whilst the Bank recognizes that operational risks cannot be eliminated in its entirety, it constantly strives to minimise operational risks (inherent in the Bank's activities, processes and systems) by ensuring that a strong control infrastructure is in place throughout the organisation and enhanced where necessary. The various procedures and processes used to manage operational risks are regularly reviewed and updated and implemented through effective staff training, close monitoring of risk limits, segregation of duties, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, and financial management and reporting. In addition, regular internal audit and reviews, business continuity planning and arrangements for insurance cover are in place to complement the processes and procedures.

The Bank presently follows the Basic Indicator Approach for assessing the capital requirement for Operational Risk. The capital requirement of BD 20.0 million is based on the gross operating income (excluding profit/loss on Investments held under Available for Sale, Held to Maturity categories and any exceptional items of income) for the last 3 years multiplied by 12.5 (the reciprocal of the 8 percent minimum capital ratio) to arrive at the operational risk-weighted exposure.

## EQUITY POSITION IN BANKING BOOK

The Bank holds certain investments in equity securities as part of its strategic holdings and others are held with the objective of capital appreciation and realizing gains on sale thereof. All equity positions in the Banking book are classified as "Available for Sale". The accounting policies for "Available for Sale" instruments are described in detail in the Financial Statements under "Significant Accounting Policies".

### Details of equity investments

As at 30 June 2016

In BD 000s	Balance Sheet Value	Capital Requirement @ 12.5% of Risk Weighted Assets
Non Significant investment in the common shares		
Listed Equities	25,156	3,333
Unlisted Equities	2,928	549
Significant investment in the common shares of financial entities >10%	43,490	13,591
<b>Total</b>	<b>71,574</b>	<b>17,472</b>
Realised gain / (Loss) (recorded in Income Statement during the period)	3,845	
Unrealised gains and losses from fair valuing equities	23,669	
Deduction from CET 1 (Significant investments in common stock of financial entities)	15,243	

## **INTEREST RATE RISK IN BANKING BOOK**

Interest Rate Risk is measured by the extent to which changes in the market interest rates impact margins, net interest income and the economic value of the Bank's equity. The Bank's asset and liability management process is utilised to manage interest rate risk through the structuring of on-balance sheet and off-balance sheet portfolios. Net interest income will be affected as a result of volatility in interest rates to the extent that the re-pricing structure of interest bearing assets differs from that of interest bearing liabilities. The Bank's goal is to achieve stable earnings growth through active management of the assets and liabilities mix while, selectively positioning it to benefit from near-term changes in interest rate levels.

Overall non-trading interest rate risk positions are managed by the Treasury department, which uses investment securities, placements with banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's non-trading activities. Reports on overall position and risks are submitted to senior management for review and positions are adjusted if deemed necessary. In addition, ALCO regularly reviews (at least on a monthly basis) the interest rate sensitivity profile and its impact on earnings. Strategic decisions are made with the objective of producing a strong and stable interest income stream over time.

Duration analysis is used to measure the interest rate sensitivity of the fixed income portfolio. Duration of the portfolio is governed by economic forecasts, expected direction of interest rates and spreads. Modified Duration gives the percentage change in value of the portfolio following a 1 percent change in yield. Modified Duration of the Bank's fixed income portfolio was 1.30 percent on 30 June 2016 implying that a 1 percent parallel upward shift in the yield curve could result in a drop in the value of the portfolio by BD 3.45 million.

Deposits without a fixed maturity are considered as repayable on demand and are accordingly included in the overnight maturity bucket. The Bank usually levies a pre-payment charge for any loan or deposit, which is repaid/withdrawn before the maturity date, unless it is specifically waived. This prepayment charge is to take care of any interest rate risk that the Bank faces on account of such prepayments and accordingly, no assumptions regarding such pre-payments are factored for computation of interest rate risk in the banking book.

The Bank uses interest rate gap analysis to measure the interest rate sensitivity of its annual earnings due to re-pricing mismatches between rate sensitive assets, liabilities and derivatives' positions. The asset and liability re-pricing profile of various asset and liability categories is set out below:

<i>As at 30 June 2016</i>	<b>Upto 3 months</b>	<b>3 to 6 months</b>	<b>6 months to 1 year</b>	<b>1 year to 5 years</b>	<b>Over 5 years</b>	<b>Rate insensitive</b>	<b>Total</b>
<b>In BD 000s</b>							
Cash and balances at central banks	-	-	-	-	-	102,415	<b>102,415</b>
Treasury bills	297,166	67,882	230,052	-	-	-	<b>595,100</b>
Placements with banks and other financial institutions	82,720	15,416	3,460	-	-	10,448	<b>112,044</b>
Loans and advances *	470,302	89,816	55,592	332,034	81,100	-	<b>1,028,844</b>
Investment securities	82,183	303	10,759	659,890	230,574	48,865	<b>1,032,574</b>
Investment in associates and Other assets	-	-	-	-	-	95,282	<b>95,282</b>
<b>Total assets</b>	<b>932,371</b>	<b>173,417</b>	<b>299,863</b>	<b>991,924</b>	<b>311,674</b>	<b>257,010</b>	<b>2,966,259</b>
<b>Liabilities and equity</b>							
Due to banks and financial institutions	355,394	954	4,027	-	-	31,894	<b>392,269</b>
Borrowings under repurchase agreements	-	-	-	-	-	-	-
Customers' deposits	796,822	345,850	113,521	5,692	-	934,016	<b>2,195,901</b>
Other Liabilities	-	-	-	-	-	34,806	<b>34,806</b>
Equity	-	-	-	-	-	343,283	<b>343,283</b>
<b>Total liabilities and equity</b>	<b>1,152,216</b>	<b>346,804</b>	<b>117,548</b>	<b>5,692</b>	-	<b>1,343,999</b>	<b>2,966,259</b>
<b>On Balance-sheet interest rate sensitivity gap</b>	<b>(219,845)</b>	<b>(173,387)</b>	<b>182,315</b>	<b>986,232</b>	<b>311,674</b>	<b>(1,086,989)</b>	<b>(0)</b>
<b>Off Balance-sheet interest rate gap</b>	565,015	-	-	(373,255)	(191,760)	-	-
<b>Cumulative Interest rate sensitivity gap</b>	<b>345,170</b>	<b>171,783</b>	<b>354,098</b>	<b>967,075</b>	<b>1,086,989</b>	<b>(0)</b>	-

\*Net of general provision of BD 13,761.

The interest rate risk management process is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to an interest rate shock of 200bps increase / decrease. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

<b>As at 30 June 2016</b>	<b>200 bps parallel increase</b>	<b>200 bps parallel decrease</b>
<b>In BD 000s</b>		
As at period ended above	(6,906)	6,906
Average for the period	(7,120)	7,120
Minimum for the period	(6,454)	6,454
Maximum for the period	(7,880)	7,880

#### **RELATED PARTY**

Certain related parties (major shareholders, directors of the Bank and families and companies of which they are principal owners, key management personnel and associates) were customers of the Bank in the ordinary course of business. The transactions with these parties were made on an arm's length basis. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank. Typically, key management personnel include the Chief Executive Officer and persons directly reporting to him. Balances at the reporting date in regard to related parties and transactions during the six months with related parties comprised the following:



Amounts in BD '000	Directors & Key		
	Majority Shareholder	Personal Management	Associates
<b>As at 30 June 2016</b>			
Loans and advances	161,111	7,736	-
Treasury bills, bonds and equities	1,484,496	-	48,824
Customers' deposits	154,528	45,038	4,098
Contingent liabilities for irrevocable commitments, guarantees and other contingencies	66,595	5,736	-
<b>For the six months ended 30 June 2016</b>			
Loans advanced	38	7,008	-
Loans repaid	38	5,424	37,661
Net increase / (decrease) in overdrafts	(3,197)	1,262	-
Treasury bills, bonds and equities purchased	660,480	-	10,000
Treasury bills, bonds and equities matured/sold	544,844	-	-
Interest income	28,069	174	305
Interest expense	894	185	13
Share of profit of associates	-	-	1,702
Directors Remuneration and sitting fees	85	159	-
Short term employee benefits	-	1,732	-
Post employment retirement benefits	-	331	-

No impairment losses have been recorded during the year against balances outstanding with related parties and no specific allowance has been made for impairment losses on balances with related parties at 30 June 2016.

#### SIGNIFICANT NET OPEN FOREIGN CURRENCY POSITIONS

As at 30 June 2016	In BD'000s
US Dollar (long position) - unhedged	13,528
UAE Dirhams (long position) - unhedged	5,138
Saudi Riyal (long position) - unhedged	23,193
Qatari Riyal (long position) - unhedged	10,620

## DERIVATIVE AND FOREIGN EXCHANGE FINANCIAL INSTRUMENTS

a) The following table summarises for each type of derivative and foreign exchange financial instrument, the aggregate notional amounts, the replacement cost and the fair value:

As at 30 June 2016

In BD'000s	Contract/ Nominal Amount	Replacement cost	Fair Value
<b>Interest rate contracts</b>			
Interest rate swaps	565,014	-	(40,670)
Options	2,406	49	49
<b>Sub-total</b>	<b>567,420</b>	<b>49</b>	<b>(40,621)</b>
<b>Foreign exchange contracts</b>			
Outright spot and forward contracts	315,069	1,224	574
Swap agreements	300,869	1,497	(265)
<b>Sub-total</b>	<b>615,938</b>	<b>2,721</b>	<b>309</b>
<b>Total</b>	<b>1,183,358</b>	<b>2,770</b>	<b>(40,312)</b>

b) The remaining maturity profile by each class of derivative and foreign exchange financial instrument based on contract/notional principal amounts is as follows:

As at 30 June 2016

In BD'000s	Upto 1 year	More than one year	Total
<b>Interest rate contracts</b>			
Interest rate swaps	-	565,014	565,014
Options	2,406	-	2,406
<b>Sub-total</b>	<b>2,406</b>	<b>565,014</b>	<b>567,420</b>
<b>Foreign exchange contracts</b>			
Outright spot and forward contracts	315,069	-	315,069
Swap agreements	300,869	-	300,869
<b>Sub-total</b>	<b>615,938</b>	<b>-</b>	<b>615,938</b>
<b>Total</b>	<b>618,344</b>	<b>565,014</b>	<b>1,183,358</b>

## LEGAL CLAIMS

As at 30 June 2016, there were legal suits pending against the Bank aggregating to BD 0.58 million. Based on the opinion of the Bank's legal advisors, management believes that no liability is likely to arise from the suits and does not consider it necessary to carry any specific provision in this respect.