BisB بنك البحرين الإسلامي

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Annual Report 2016

Annual Report 2016

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Licensed as an Islamic Retail Bank by the Central Bank of Bahrain

Bahrain Islamic Bank members of staff contributed to the
design of this Annual Report Cover

His Royal Highness Prince Khalifa bin Salman Al Khalifa

The Prime Minister of the Kingdom of Bahrain

His Majesty King Hamad bin Isa Al Khalifa

The King of the Kingdom of Bahrain

His Royal Highness Prince Salman bin Hamad Al Khalifa

The Crown Prince, Deputy Supreme Commander and First Deputy Prime Minister

Shine with BisB...
Share our Journey

www.bisb.com

Banking… at home

Banking… on the move

Banking… together

Corporate Profile

The leading Islamic commercial bank in Bahrain

Incorporated in 1979 as the first Islamic bank in the kingdom of Bahrain, and the fourth in the GCC. Bahrain Islamic Bank (BisB) has played a pivotal role in the development of the Islamic banking industry and the Kingdom's economy. The Bank operates under an Islamic Retail banking licence from the Central Bank of Bahrain and is listed on the Bahrain Bourse.

At the end of 2016, the Bank's paid up capital was BD 101 million, while total assets stood at BD 1042 million. The Bank's modern branch network comprises 5 branches, 4 innovative financial malls, and 56 ATMs located throughout the Kingdom.
A steadfast focus on continuous innovation, strong corporate governance and risk management, employee development, and the use of state of the art technology to deliver superior customer service, has cemented Bahrain Islamic Bank's position as the leading Sharia'a – compliant bank in the Kingdom.

5
Branches

4
Financial Malls

56
ATMs

Our vision

To be the preferred Islamic Financial Partner going beyond boundaries to grow together.

Our mission

Our mission is to deliver value to:

1. **Customers**
Exceed their expectations and build loyalty.

2. **Employees**
Nurturing and retaining talent.

3. **Shareholders**
Maximising consistent returns.

4. **Community**
Honouring our social commitment to society.

Financial Highlights

Total Assets
BD Million

1042m

2016	**1042**
2015	976
2014	875

Total Financing
BD Million

678m

2016	**678**
2015	590
2014	510

Total Operating Income
BD Million

50m

2016	**50**
2015	47
2014	50

Investors' Share in Income
BD Million

8.4m

2016	**8.4**
2015	5.7
2014	7.5

Investments
BD Million

200m

2016	**200**
2015	202
2014	208

Unrestricted Investment Accounts BD Million

758m

2016	**758**
2015	693
2014	642

Book Value per share
BD Fils

115fils

2016	**115**
2015	90
2014	85

Share Price
BD Fils

123fils

2016	**123**
2015	143
2014	148

Operational Highlights

1

Retail Banking

Keeping the customer at the core of its activity through enhanced product offerings, BisB generated solid growth in the retail banking division. In an increasingly competitive local market, the attention to quality service resulted in an increase of 12.1% in the retail customer financing, and 11% growth in market share.

2

Corporate Banking Segmentation

BisB strengthened its corporate business by focusing on a more defined portfolio segmentation management, leading to higher quality assets in its chosen financing sectors, government, quasi-government business, real estate construction, trade, and small and medium enterprises.

3

Improving the Customer Experience

The creation of a dedicated Service Quality control unit within BisB gives customers direct and faster real-time reaction, better enabling the Bank to resolve their issues in a positive manner.

4

Leveraging Technology IT infrastructure

The commitment to eBanking and eProducts places BisB's services at its customers' fingertips. The opening of the pioneering first Digital branch at Diplomat Area in Manama is the forerunner of further Digital outlets across the country.

5

Solid Financial results

Amid regional and international uncertainty, BisB achieved steady profitability of BD 8.4 million, 15% reduction of Non-performing financing, and a strong Capital Adequacy ratio of 20.3%

6

International recognition

BisB's success continues to be recognized globally with the 2016 'Best Performing Bank in Bahrain' Award from the World Islamic Banking Conference. This award reflects performance across multiple meaures locally, regionally, and internationally.

Investing in People and Talents

Experienced Staff

BisB has introduced a broad range of learning skills programs to enhance the capability and knowledge of its personnel

Board of Directors Report

"We have added the Ishraq five pillars of performance to our Back to Basics strategy, encompassing reorganizing our financial position; streamlining and optimizing processes; focusing on digitization; investing in people and talents; and differentiating through superior customer service"

In the name of Allah, the Most Beneficent, the Most Merciful. Prayers and Peace be upon the Last Apostle and Messenger, Our Prophet Mohammed, His Comrades and Relatives.

On behalf of the Board of Directors, it is my privilege to present the annual report and consolidated financial statements of Bahrain Islamic Bank (BisB) for the year ended 31 December 2016.The five-year plan for the Bank is now in its third year, and we have added the Ishraq five pillars of performance to our Back to Basics strategy, reorganizing our financial position; streamlining and optimizing processes; focusing on digitization; investing in people and talents; and differentiating through superior customer service. The growing impact of these initiatives is being reflected in positive improvements in all areas of BisB.

In an increasingly competitive local banking market and uncertain global economic environment, stable earnings resulted in revenues of BD 41.7 million and net profit for the year of BD 8.4 million. Earnings per share were 8.41 fils compared with 13.36 fils in 2015.

Balance sheet footings grew to BD 1,042 million with owners' equity of BD 116 million. Liquid assets remained strong at BD 90.7 million. The Bank has maintained its conservative approach to impairment provisioning by providing BD 9.7 million in 2016 versus BD 9 million in the previous year.

Net Profit
for the year

8.4m

The retail and corporate banking businesses performed well, growing their financing portfolio by 12.1% and 12.3 % respectively. The emphasis on customer service underpins much of that success, with a newly-formed dedicated unit for service quality assurance and real time response to customer issues.

In consonance with our desire to maintain the highest measure of prudent risk management within the Bank, we have strengthened further the quality of our risk management processes as well as our corporate governance framework. Training and development of our people at all levels of personnel, coupled with enhanced cutting edge technology systems, heightens our capability to deliver the best possible customer experience.

The Board would like to place on record its grateful thanks both to my predecessor as Chairman, Abdul Razaq Al Qassim, who retired from the Board in March 2016, and also to Fatima Abdulla Budhaish, for their valuable contributions during their tenure as Directors of BisB. We welcome Khaled Yusuf AbdulRahman as incoming Director. The new Board will endeavour to continue the solid progress already achieved.

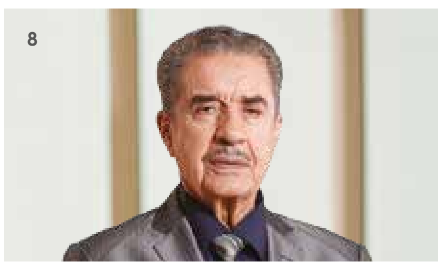
Despite the economic difficulties in the region, the Kingdom of Bahrain remains an attractive destination for corporate and financial businesses. However, 2017 will not be without its challenges. Lingering uncertainty over the price of oil, and the attendant pressures on liquidity, is expected to continue upward pressure on banks' cost of funds. The immediacy of civil conflict in the region, and an international economic malaise, all give cause for caution. However, with the strong platform of a focused business strategy and a dedicated management team, we are optimistic about the direction of the Bank.

On behalf of the shareholders, the Directors express their grateful thanks and sincere appreciation to His Majesty King Hamad bin Isa Al Khalifa-the King of Bahrain, to His Royal Highness Shaikh Khalifa bin Salman Al Khalifa – the Prime Minister, to His Royal Highness Shaikh Salman bin Hamad Al Khalifa – the Crown Prince, Deputy Supreme Commander and First Deputy Prime Minister, and to all Government ministries and authorities – especially the Central Bank of Bahrain and the Ministry of Industry, Commerce & Tourism, for their constant guidance, kind consideration and support.

The Directors' appreciation of the advice and supervision of BisB's Sharia'a Supervisory Board is also acknowledged, as is the unstinting dedication and service from the management and staff of the Bank, whose commitment contributes so much to the health of the organization. To our business partners and loyal customers, we thank each and every one for their continuous invaluable support and confidence in Bahrain Islamic Bank.

Dr. Esam Abdulla Fakhro
Chairman of the Board

Board of Directors



1. Dr. Esam Abdulla Fakhro
Chairman
Non-Executive & Non-Independent Director
Appointed on 23 March 2016

Dr. Esam Fakhro is a holder of PhD Degree in Mechanical Engineering from London University. He was awarded the Bahrain Medal – First Class. He is also a member of the Supreme Council for Education Development, and a member of the board of Trustees of AMA International University. Dr. Fakhro was a former member of the Economic Development Board. Previously, he chaired the Aluminum Bahrain Co. (ALBA), in addition to chairing the Bahrain Chamber of Commerce & Industry, and the Federation of GCC Chambers. Dr. Fakhro was a former member of Mumtalakat Company. Currently, he chairs Abdullah Yousif Fakhro & Sons Group in the field of transport and electronics, as well as foods and financial services. Dr. Fakhro is also the Chairman of the Board of Directors of the Bahrain Cinema Company. In addition, he assumes the post of the Deputy Chairman of National Bank of Bahrain, and the Qatar Bahrain Cinema Company. He is also a member of the Board of Directors of Trafco and Bahrain Livestock Company.

2. Brig. Khalid Mohammed Al Mannai
Vice Chairman
Non-Executive & Non-Independent Director
Appointed on 23 March 2016

Brigadier Khalid Mohammed Al Mannai is the General Manager of the Bahrain Military Pension Fund, and one of the co-founders of the GCC Expanded Military Pension Coverage Committee. He joined the Military Pension Fund after spending 31 years with the Bahrain Defence Force. Brigadier Al Mannai is a Board Member of Bahrain Telecommunications Company (Batelco), the Social Insurance Organisation (SIO) and Osool Asset Management Company. He holds an MBA from Sheffield Hallam University, UK; and has over 36 years' professional experience.

3. Mr. Talal Ali Al Zain
Board Member
Non-Executive & Independent Director
Elected on 23 March 2016

Mr. Talal Ali Al Zain was the Chief Executive Officer of PineBridge Investments Middle East BSC (c), and Co-Head of Alternative Investments at PineBridge Investments. Prior to this, he was Board Member and CEO of Bahrain Mumtalakat Holding Company; having previously spent 18 years with Investcorp Bank as Managing Director and Co- Head of Placement & Relationship Management. Talal was Vice President of Private Banking International and Head of Investment Banking Middle East with Chase Manhattan Bank; as well as a Corporate Banker with Citibank Bahrain. Talal is a Board Member of Alubaf Arab International Bank and the Bahrain Association of Banks. He previously chaired and served as a board member on many corporations including McLaren, the Bahrain Economic Development Board, Gulf Air, and the Bahrain International Circuit. He holds an MBA in Business Administration (majoring in Finance) from Mercer University, Atlanta, USA; a BA in Business Administration (majoring in Accounting) from Oglethorpe University, Atlanta, USA.

4.Mr. Khalil Ebrahim Nooruddin
Board Member
Non-Executive & Independent Director
Elected on 23 March 2016

Mr. Khalil Ibrahim Nooruddin is an experienced banker, at both an executive and board level. Currently, he is the Managing Partner of Capital Knowledge, a consulting and training company. Over the past five years, he has concluded several consulting assignments for financial institutions, working on strategy formulation and implementation. Prior to this, Khalil Nooruddin worked for Investcorp Bank, Bahrain; UBS Asset Management in London and Zurich; and Chase Manhattan Bank in Bahrain. He is an active member of several civil and professional societies in Bahrain. A Chartered Financial Analyst, Mr. Nooruddin holds an MSc in Quantitative Analysis from the Stern Business School at New York University, USA; and a BSc in Systems Engineering from the King Fahd University of Petroleum & Minerals, Saudi Arabia. He has over 30 years' professional experience.

5. Mr. Ebrahim Hussain Ebrahim Aljassmi
Board Member
Non-Executive & Independent Director
Elected on 23 March 2016

Mr. Ebrahim Hussain Ebrahim Aljassmi was the Chief Executive Officer & Board Member of Khaleeji Commercial Bank until June 2012, and continued as Board Member until July 2013, and currently is a board member of Takaful International and Ibdar Bank. Prior to this, he was Chief Executive Officer of the Liquidity Management Centre. Previously, at the Arab Banking Corporation, he held the positions of Vice President-Global Marketing Unit, Vice President-Treasury & Marketable Securities Department, and General Manager-ABC Securities. He has also worked for BBK Financial Services Company, and Shamil Bank. He holds an MBA from the University of Bahrain and a Bachelor's degree in Economics from the University of Kuwait; and has over 35 years' experience in both conventional and Islamic banking.

6. Mr. Othman Ebrahim Naser Al Askar
Board Member
Non-Executive & Independent Director
Elected on 23 March 2016

Mr. Othman Ebrahim Al Askar is the Director of the Investment Department of Waqf public foundation of the State of Kuwait. He joined the awqaf foundation 1995, and held various positions before taking up his current post in 2010. Prior to this, he was Head of the Investment and Banks Department at Kuwait Public Transport Company. Othman Al Askar is a Board Member of the Educational Holding Group, Kuwait; and a former Board Member of Rasameel Structured Finance Company, Kuwait. He holds a BSc in Business Administration and Economics from the Washington Center University, USA; and has over 29 years' professional experience.

7. Mr. Khalid Yousif Abdul Rahman
Board Member
Non-Executive & Non-Independent Director
Appointed on 23 March 2016

Mr. Khalid Yousif Abdul Rahman is Vice Chairman and Chief Executive Officer of Yousif Abdul Rahman Engineer Holding Company W.L.L. He is also Chairman of Food Supply Company Limited, Vice Chairman of National Establishment of Technical and Trade Services, Vice Chairman of National Transport Company, and Vice Chairman of Awal Dairy Company. He is a member of the Board of several major companies in Bahrain, including National Bank of Bahrain, Bahrain Ship Repairing & Engineering Company, and Asmak. He gained his B.Sc Mechanical Engineering from Plymouth Polytechnic, UK, and is a registered member of Bahrain Society of Engineers and the Committee for Organizing Engineering Professional Practice (COEPP) Mechanical Engineering Cat. B. Mr. Abdul Rahman has over 40 years of professional experience.

8. Mr. Muhammad Zarrug Rajab
Board Member
Non-Executive & Non-Independent Director
Appointed on 23 March 2016

Muhammad Zarrug Rajab holds a Bachelors degree in Accountancy and is a fellow member of the Institute of Chartered Accountants in England & Wales. He has held senior posts in Libya including the Auditor General, the Minister of Treasury, Head of Libyan Peoples' Congress, the Prime Minister from 1983 to 1985, Convener of Libyan Central Bank, and Libyan Foreign Investment. Muhammad Rajab has over 45 years' professional experience.

9. Mr. Mohammed Ahmed Abdulla
Board Member
Non-Executive & Non-Independent Director
Appointed on 23 March 2016

Mr. Mohammed Ahmed is the Head of Asset Management at Osool Asset Management Company. Prior to Osool, he held senior management positions at Credit Suisse AG-Bahrain Branch and Credit Suisse AG-Dubai. He started his career at HSBC Middle East, before moving to Merrill Lynch-Bahrain where he spent 7 years. Mohammed Ahmed is a Board Member, Chairman of the Nomination & Remuneration Committee and Audit Committee Member at both the Medgulf Group and Medgulf Allianz Takaful. Furthermore, he is a Board Member and Vice Chairman of the Audit Committee of Bahrain Commercial Facilities Company. He holds a Bachelor's degree in Accounting from the University of Bahrain, and is accredited to the National Association of Securities Dealers and the National Futures Association. Mr. Mohammed has more than 18 years' professional experience.

Sharia'a Supervisory Board

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4


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1. Rev. Shaikh
Dr. Abdul Latif Mahmood Al Mahmood
Chairman

Shaikh Al Mahmood is a Member of the Sharia'a Supervisory Board of Takaful International and ABC Islamic Bank, Kingdom of Bahrain; ABC Islamic Bank, London; and the Joint Sharia'a Supervisory Board of AlBaraka Group. He has been a Preacher at a number of Bahrain's mosques since 1973; and a lecturer in Quran interpretation, jurisprudence and preaching. Shaikh Al Mahmood is a regular participant in jurisprudence, educational, economic, intellectual, social and cultural conferences and seminars. He holds a PhD from the Shariah Al-Zaytuna College, Tunisia.

2. Rev. Shaikh
Mohammed Jaffar Al Juffairi
Vice Chairman

Shaikh Aljuffairi is a former Judge of the High Sharia'a Court of Appeal, Kingdom of Bahrain; and seconded as President of the High Sharia'a Court, Ministry of Justice. He is a Friday Imam and speaker.

3. Rev. Shaikh
Adnan Abdullah Al Qattan
Member

Shaikh Al Qattan is a Preacher at the Ahmed Al Fateh Islamic Mosque. He is a Judge of the High Sharia'a, Ministry of Justice, Kingdom of Bahrain; a Puisne Justice of the High Sharia'a Court; and a lecturer at the Islamic Studies Department, University of Bahrain. Shaikh Al Qattan is Chairman of the Orphans and Widows Care Committee of the Royal Court; and the Pilgrimage Mission; and a Member of the Board of Directors of Sanabil for Orphan Care. He is a regular participant in Islamic committees, courses, seminars and conferences.

4. Rev. Shaikh
Dr. Nedham Mohammed Saleh Yacoubi
Member

Shaikh Yacoubi is a Member of several Sharia'a Supervisory Boards around the world, including Bahrain Islamic Bank, Ithmaar Bank, Gulf Finance House and ABC Islamic Bank, Kingdom of Bahrain; Abu Dhabi Islamic Bank and Sharjah Islamic Bank, UAE; ABC Islamic Bank, London; and the Islamic Accounting Standards Organization, Bahrain. He is the recipient of numerous awards in the field of Islamic Finance. He has a doctorate in Islamic studies.

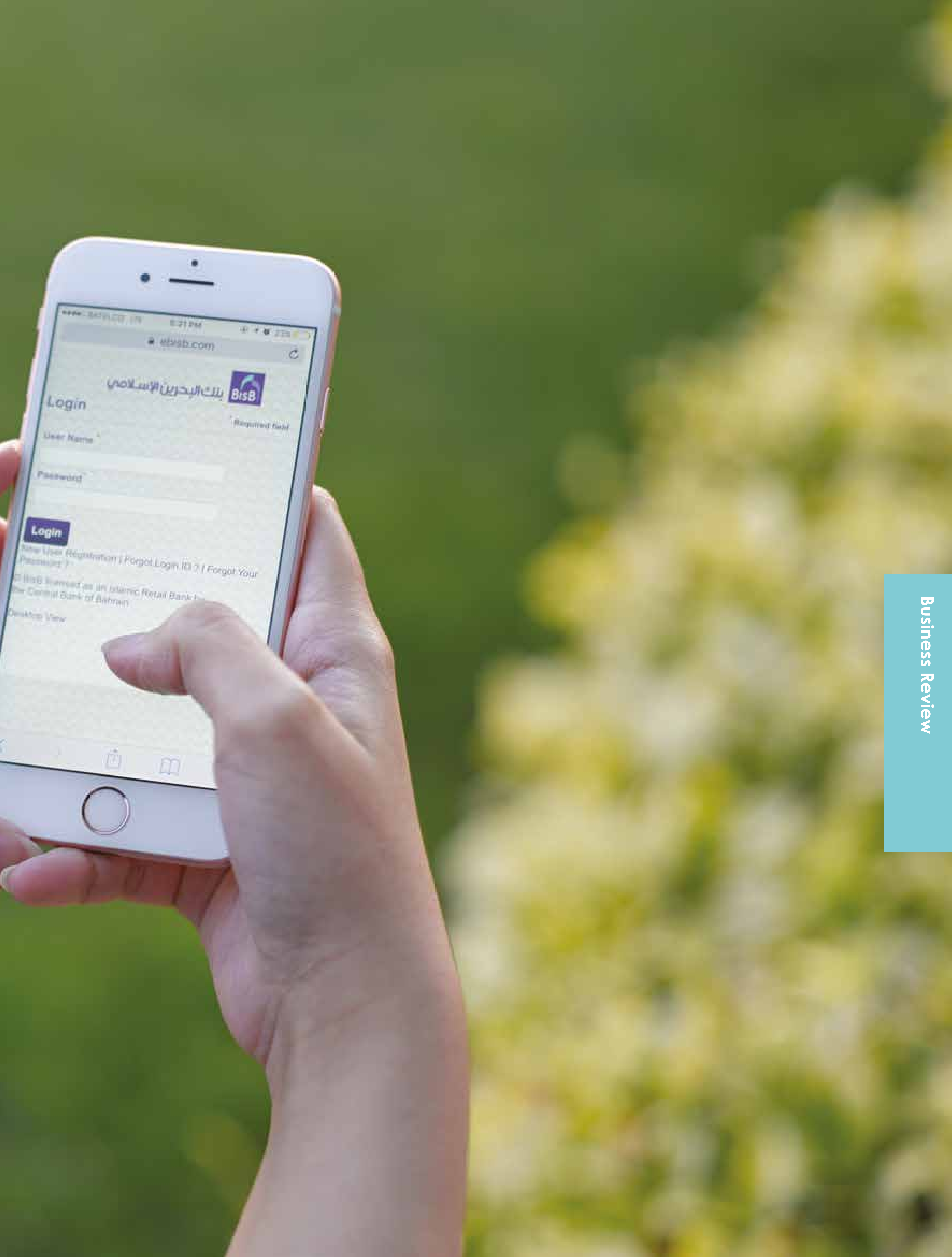
5. Rev. Shaikh
Dr. Essam Khalaf Al Enizi
Member

Shaikh Al Enizi is a Member of Sharia'a and Islamic Studies Faculty at the University of Kuwait. He is a Member of the Sharia'a Supervisory Committee at Boubayan Bank, Al Sham Bank, and Investment Dar, Kuwait; He holds a PhD from the University of Jordan - Specialization Fiqh and the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

Banking…
on the move

eChannels

Customers banking at their fingertips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User Name
Password
Login
New User Registration | Forgot Login ID ? | Forgot Your Password ?
Desktop View

Chief Executive Officer Report

"Our objective to rebuild an institution based on strong financial fundamentals and true Islamic values to deliver the best customer experience remains unwavering"

In the name of Allah, the Most Beneficent, the Most Merciful.

2016 was a building year for the Bank, a year in which the Ishraq Back to Basics strategy was launched, entailing re-organizing our financial position; streamlining and optimizing processes; focusing on digitization; investing in people and talents; and differentiating through superior customer service. It has been inspiring to see the BisB family embrace and show support for the strategy to refine and grow the institution. It has resonated with us all and we are up to the challenge.

Our objective to rebuild an institution based on strong financial fundamentals and true Islamic values to deliver the best customer experience remains unwavering. The continuing commitment to the Ishraq Back to Basics strategy will ensure it is met, Inshallah.

Financial

In a highly competitive market, BisB remained profitable at BD 8.4 million for the year. Liquidity remained sound at BD 90.7 million, while the bank's asset base grew to BD 1,042 million, and total income of BD 41.7 million.

Depressed oil prices throughout the year weighed heavily on the regional and global economies. Pressure on local GCC government liquidity has had a parallel effect in the local markets, causing severe competition and a spike in the institutional cost of funds. Despite the resultant increased pressure from aggressive pricing and asset products offerings from local Islamic and traditional banks, we have grown our commercial segment by 12.3 % in 2016 and retail by 12.1 %.

Legacy NPFs and NPAs will continue to be a major focal point. A special dedicated unit has been activated to not only address legacy non-yielding and non-core assets but also to expedite the management of corporate remedial assets.

A 15% reduction in net Non-performing financing (BD 9.4 million) was achieved as we pursue a vigorous reduction program.

Cost control continues as an imperative. We have upgraded high quality senior management and adjusted historically low management salary bands to catch up with the market. Focus on appropriate reduction in costs has resulted in renegotiating key vendor contracts, reducing expense outgoings and optimizing administrative processes, but much work still lies ahead on the cost reduction front.

Positive advances have been made in securing our financial position by redefining the approach to risk management based on enhancing our risk governance, solidifying our provisioning policy and ensuring we have the right risk culture within the organization.

Business Growth

Despite the intensely competitive environment, the Retail and Corporate departments performed well. What differentiated 2016 revenues from previous years was that these earnings came from the Bank's core business. This critical transformation is the base for future quality earnings which will provide stability and clearer financial forecasting.

Unprecedented initiatives continue to focus on the development of our Bahraini talent with special emphasis on gender equality and by providing intensive training and development programs across all levels of management and staff. Our constant aim is to improve our people's skill sets and heighten their contribution to BisB.

We have established an induction program, introduced learning weeks to nurture the development of all personnel, and implemented soft skills training for selected departments, and introduced a certification program for all customer-facing relationship managers.

In our efforts to prepare the next generation of executive management, we have initiated succession plans for senior roles and invested in executive leadership programs through Darden University in partnership with Bahrain Institute of Banking & Finance.

However, succession planning is not restricted to senior management. Rather it is designed to reach all levels of employees. This has been demonstrated by an active staff rotation program among various departments and in recently identifying underutilized talents in the Bank.

Customer Service

Significant advances were achieved in streamlining and optimizing processes in many front line and back office operational areas of the Bank, as we looked to simplify delivery of best practice internal and external customer service.

We have tightened our policies and procedures for retail and corporate banking to increase turnaround time efficiency as well as IT and Central Operations to expedite processes.

To ensure no customer calls are missed, we have routed calls received at Branches to the Contact Centre. We have updated customer SMS notifications to include all types of transactions, and have introduced OTP for customers to ensure a higher level of security for online transactions.

An intense reorganization of our Service Quality Management and handling of Customer Complaints capability has resulted in significant improvements, with a dedicated team proactively involved at all levels of customer interface.

AT A GLANCE

Assets up

7%

Customer Deposits up

7%

Income from core Activities up

9%

Impairment Provisions Down

9%

Capital Adequacy Ratio, as of 31 December 2016, was a healthy

20.3%

Chief Executive Officer Report

Continued

Focus on Digitization

A total overhaul of the Information Technology activities has begun, which will result in a radical change in the way BisB delivers and services the digitization requirements of the various stakeholders within the organization.

The Information Technology team seeks to remove barriers, finding more effective means to deliver end-to-end digital services to BisB's customers.

Internally, the department is moving toward partnership engagements with the various business units, while optimizing costs and more efficient utilization of IT resources.

The department fully supports the revamped approach to eBanking and eChannels in the Retail and Corporate Banking businesses, bringing us closer to our core clientele and making their banking experience easier and more efficient.

BisB embarked on Phase 1 of its pioneering Digital Branch at Diplomatic Area Branch, a first of its kind project empowering customers to manage their banking transactions through digital channels.

Corporate Governance

The Board of Directors and management of the Bank recognize the proper relationship between them which guides the well-being of the institution. The invaluable guidance and counsel from the Board is greatly appreciated as management implements the day to day operation of BisB.

Close engagement continues with our regulators and stakeholders, the Central Bank of Bahrain, the Bahrain Bourse, the Ministry of Labour and other relevant regulatory authorities within the Kingdom.

BisB is pleased once more to report that with constant awareness of regulatory adherence requirements, and supervision of our internal controls, the Bank has maintained regulatory compliance, with only one infraction in 2016. An isolated incident at one of our branches attracted a fine of BD 10,000 from the Central Bank of Bahrain. However, we moved swiftly to address the root cause of the issue and took disciplinary action accordingly.

Our new approach toward effective internal communication is to flatten the organization and to treat each member of staff as a BisB family member. We encourage openness amongst all staff and management in order to provide unambiguous understanding and implementation of the Ishraq Back to Basics strategy.

Future Outlook

2017 will likely pick up where 2016 left off. Continued low oil prices, regional geo-political stability, with added pressure on liquidity, will likely result in yet higher cost of funds for banks. This cost will naturally have to be reflected in financing margins.

Local and regional governments are expected to continue their borrowings through the issuance of Sukuks and bonds.

We are confident in the direction of the core business of the Bank. However, real challenges will remain in reducing some of the residual legacy non-performing assets, which are proving difficult to dispose of expeditiously. Vigilance will remain our constant watchword.

The culture of the institution continues to evolve with unrelenting emphasis on core Islamic values: transparency; treating customers fairly; hard work; and above all, a high level of ethical standards and conduct.

In 2017, we will continue to focus on Bahrain as our major market. On a highly exceptional basis, the untapped non-Muslim segment will see more emphasis. Asset growth opportunities outside of Bahrain may also be considered.

Acknowledgements

We put on record our deep appreciation of the constant support from the Central Bank of Bahrain, the Bahrain Bourse, The Ministry of Industry, Commerce & Tourism, and our shareholders. The invaluable advice and counsel from our dedicated Board of Directors is acknowledged with gratitude as is the steady and wise guidance and supervision of the Sharia'a Supervisory Board. Without loyal customers and business partners no bank can prosper, and we are immensely grateful to all of these valued relationships. To our management and staff, whose commitment and dedication is witnessed daily, we thank you sincerely for your contribution to BisB.

Allah the Almighty is the Purveyor of all success.

Hassan Amin Jarrar
Chief Executive Officer

Working together, dedicated to strong Islamic values

Executive Management

1. Hassan Amin Jarrar
Chief Executive Officer

Mr. Hassan Amin Jarrar is one of the most prominent banking leaders in the region with more than 27 years of international, regional and local banking experience. Mr. Jarrar's diverse career in Banking includes extensive experience in retail, SME, and corporate banking in the Middle East and the US. Regionally, Mr. Jarrar served as Chief Executive Officer of Standard Chartered Bank, Head of Corporate and SME Banking at Abu Dhabi Commercial Bank, and Head of Corporate Banking, Abu Dhabi at Mashreq Bank. Internationally, he has two decades of experience in key management positions in leading banking institutions in the United States; namely with Security Pacific Bank, and Bank of America. Mr Jarrar holds a BSc in Finance from California State University, San Jose, and serves on the Boards of the Bahrain Association of Banks, Bahrain Institute of Banking and Finance (BIBF) and Tamkeen.

2. Mohammed Ahmed Hassan Janahi
Deputy Chief Executive Officer

Mr. Mohammed Ahmed Hassan Janahi is a veteran banker with a vast experience in banking & financial operations over a span of 46 years. He commenced his career with the Bahrain Islamic Bank (BisB) in 2007 in the position of General Manager Support Services. In September 2014, he assumed his current position. Prior to joining BisB, Mr. Janahi assumed a number of senior executive positions in Citibank, National Bank of Bahrain, Baraka Islamic Bank and Gulf Air in Bahrain.

Mr. Janahi attended numerous courses on administrative sciences, banking and leadership at renowned universities and institutes in Europe and USA. In addition, he also attended a number of intensive and diversified workshops at leading institutions and banks, including Citibank, Financial Times and the Executive Development Institute in London.

3. Abdulrahman Mohammed Turki
General Manager - Retail Banking

Abdulrahman Turki has over 37 years' experience in banking. He took up his current position as General Manger Retail Banking at BisB in 2008. Prior to this, he was Head of Islamic Retail Banking Unit at Commercial Bank of Qatar; Abdul Rahman held various positions with a number of other prominent regional banks, after starting his career with Aluminium Bahrain. Abdulrahman holds an MBA degree from the University of Strathclyde, Scotland, UK.

4. Fahim Ahmed Shafiqi
Chief Risk Officer

Mr. Fahim Ahmed is an experienced Banker with over 17 years of international experience gained through various roles in corporate banking and risk management spanning the markets of Pakistan, Qatar, Oman, UAE and the UK. Prior to joining BisB, Mr. Ahmed held the position of Chief Risk Officer at Standard Chartered Bank Bahrain. He has a Diploma in Islamic Finance (CDIF), and holds an MBA from the UK's University of Warwick.

5. Khalid Mahmood Abdulla
Head of Internal Audit

Khalid Mahmood has over 21 years of experience in Accounting, Auditing, Banking and Sharia'a. He took up his current position with BisB in 2006. Prior to this, he was Head of Internal Audit at Al Baraka Islamic Bank, having started his career with Arthur Anderson. Khalid is a Certified Public Accountant (CPA) California, USA, and attended the Leadership Development Program at Darden School of Business, University of Virginia, USA.

6. Wesam Abdul Aziz Baqer
Head of Corporate & Institutional Banking

Mr. Wesam Baqer is an experienced Banking professional with a diverse career covering all facets of Corporate Banking, Private Banking, and Business Development. Mr. Baqer joined BisB in 2008 as the Head of the Corporate Banking. Previously, he held the same post at National Bank of Kuwait. Prior to that, he managed corporate relationships with HSBC for 8 years. He is a board member representing BisB in various companies and is an active member in charitable and community service societies in Bahrain.

Mr. Baqer completed an Executive Management Leadership Diploma from Darden Graduate School of Business, University of Virginia (USA). He also holds an MSc (Economics) in Finance and Investment Management from the University of Aberdeen, Scotland, and a BS in Business Administration from the University of Bahrain. He is a Certified Financial Adviser (CeFA), and a member of the Chartered Institute of Bankers.

7. Dawood Khalil Al Ashhab
Head of Human Resources & General Services

Mr. Dawood Al Ashhab brings to the Bank a wealth of international banking experience and an indepth knowledge of HR Management best practice. Prior to joining BisB, Mr Al Ashhab managed the human resources team regionally at Standard Chartered Bank, covering the Bank's Bahrain, Oman, Qatar, Jordan and Saudi Arabia offices. Mr. Al Ashhab holds a BS in Public Administration, is a certified coach from the prestigious Gallup University, UK, and is a member of the Society of HR Management (SHRM).

8. Ameer Abdul Ghani Dairi
Acting Chief Financial Officer

With over 16 years of experience in financial management. Mr. Ameer Abdul Ghani Dairi is a Certified Public Accountant (CPA) from New Hampshire Board of accountancy, USA and a Certified Management Accountant (CMA) licensed by the Chartered Institute of Management Accountants, USA. He also holds a B.Sc. in Accounting from the University of Bahrain and has had a broad commercial banking career in Bahrain. Mr. Dairi has been with Bahrain Islamic Bank since 2007.

Executive Management

Continued

9. Khalid Abdulrahman Nass

Head of Compliance and Anti-Money Laundering

Mr Khaled AR Nass has over 15 years experience in compliance; accounting; and financial management. He is heading and managing the compliance and anti-money laundering functions in BisB, in addition to coordination with all statutory regulators, including the Central Bank of Bahrain, Bahrain Bourse, Ministry of Industry and Commerce and Ministry of Interior. He joined BisB in 2007 following a three-year spell as a Bank Examiner with the Central Bank of Bahrain. His duties cover all compliance matters for the Bank, Anti-Money Laundering prevention and FATCA. All Corporate Governance Policies and Procedures within BisB also fall under his remit. Mr Nass has an M.B.A from Webster University, Orlando, FL, USA; a B.Sc degree in Finance from the University of Central Florida, Orlando FL, USA; Certifications from International Compliance Academy and Global Academy of Financial management, with distinctions.

10. Maisa Jawdat Shunnar

Head of Strategy Implementation and Transformation

Ms. Shunnar is a qualified, trained and seasoned professional with over 17 years of rich and insightful experience, in a vastly international environment (USA & Middle East). Prior to holding her current position in BisB, Ms. Shunnar worked in the National Bank of Abu Dhabi (NBAD) as a Transformation Manager overseeing the aggregated change activity within the Bank. She drove major changes across the bank such as the centralization of the non-core business activities and the building of the shared services center. In previous assignments, Ms. Shunnar headed the Business Process Re-engineering (BPR) Department in the Electronic Government of Bahrain and she served as the Manager of Performance & Productivity Improvements for EDS on the Gulf Air Account. Prior to moving to the Middle East, Ms. Shunnar worked in Shell Oil & Gas and for the City of Houston in the State of Texas, USA. Ms. Shunnar is a certified & accredited trainer for the United Nations on Business Process Re-engineering. Ms. Shunnar holds a B.Sc. degree in Business Administration majoring in Computer Information Systems from the University of Houston (Texas, USA), and a Master degree in Business Communication and Leadership from Jones International University (Colorado, USA).

Clearly defined corporate governance principles guide the relationship between the Board and the Management

Review of Operations

BUSINESS DIVISIONS

Retail Banking

The bank's retail banking business experienced stable growth in 2016. For the eighth consecutive year, our customer base and market share continued to increase, with satisfying strong expansion in our major product offerings and services. Relentless fierce competition in the retail banking has become the norm, making BisB's performance all the more gratifying.

Retail total assets growth of 8.8% contributed to the overall market share increase of 11.19%. In our main products, steady growth was seen in mortgage financing and we also continued to support financing of the Social Housing scheme for Bahraini citizens. Tas'heel Personal Finance expanded as did auto financing and the Vevo Youth Account; both the Iqra Investment Scheme also grew. Tejoori savings account products excelled with the introduction of added new categories of prizewinners. BisB's credit card business has become the highest growing card business in Bahrain and enjoyed another excellent year.

The Card Centre received praise from Visa International for 'the unsurpassed excellence in providing Visa credit card services and debit cards and the substantial growth of the Visa debit and credit card portfolio, and welcomes all aspects of cooperation through its strategic partnership with BisB.'

Our Ishraq Back to Basics strategy has seen a comprehensive review of fundamental procedures, with functional criteria identified to streamline and improve efficiencies throughout the retail network. Operational procedures benchmarks are being enhanced, removing ambiguity, and driving our efforts toward providing the best customer banking experience in Bahrain.

"For the eighth consecutive year, our customer base and market share continued to increase, with satisfying strong expansion in our major product offerings and services"

“The increase in booked assets derived from diversification of the portfolio by financing government/quasi –government projects, large family businesses, oil and gas, trading and SME customers”

eBanking and mobile banking business is expanding rapidly and will become more prominent as we continue to embrace and absorb digitization into our service orientation. BisB’s first digital branch was opened late in the year at Diplomat Branch. The development of our eChannel platform will give our customers access to state of the art service quality.

The Bank acknowledges that customer loyalty is precious. In recognition of that, we have revamped our Quality Assurance and Customer Care capabilities in order to respond in real time to customer issues. The response to date has been spectacular as we aim to be the leading service provider in our marketplace.

In 2017, we will adopt a remodelling approach to our branches service.
All segments of BisB’s product offerings to its customer base and loyalty programs will be reviewed to introduce more relevant and attractive value propositions for each respective customer segment.

We will continue to give the support to the social housing/pari passu products.

From the existing solid base, the prospect of further outstanding growth beckons in our Card business.

Ongoing programs will deliver high-quality training for branch front line officers, direct sales personnel and in our Thuraya (Private Banking) unit.

Corporate & Institutional Banking

Despite difficult market conditions throughout 2016, Corporate & Institutional Banking Division experienced a successful year.

Total assets grew by 16%. The main growth driver was the GCC Marshall Plan for Bahrain, which continued to show financing opportunities in areas of housing, construction, and infrastructure. The expansion in these areas also trickled down to benefit the trading and service sectors.

BisB also supported small and medium businesses (SMEs) as they are a critical pillar of the economy.

The increase in booked assets derived from diversification of the portfolio by financing government/quasi – government projects, large family businesses, oil and gas, trading and SME customers.

Further excellent progress in the management of Non-Performing Assets (NPAs) resulted in a reduction of 15% (BD 9.4 million). Strong monitoring procedures are in place to identify potential troubled assets early. The account monitoring is independent of the relationship management. An enhanced monitoring team which includes the legal team are involved in the management of NPAs.

For 2017, with anticipated tight liquidity and a contingent rise in the cost of funds, Corporate & Institutional Banking Division will maintain its focus on government and quasi-government business, real estate/ construction, trade and small and medium companies. The division will seek to spread its portfolio risk by selective participation in regional syndications, and appropriate debt substitutes.

Recent segmentation reorganization within the division will provide more focus and stronger account relationship management.

Review of Operations
Continued

Treasury

2016 began with the price of oil at US$25 per barrel, fluctuating through the year to its December closing price of US$52. This unpredictability created constant regional market nervousness. The rating agencies' downward adjustment of Bahrain debt compounded trading difficulties. Against this continuing testing global economic backdrop, the Bank's Treasury activities remained steady, with maintenance of liquidity management a key priority. BisB fully repaid a US$100 million bilateral loan and raised US$30 million in further bilateral loans. All of the Bank's obligations were met in a timely manner as BisB continued to be an active participant in the market.

The sukuk portfolio of low-risk weighted assets grew 18% to BD 17.416 million with the sovereign portfolio constituting 70% of the Sukuk book.

Liquidity will remain the major challenge for 2017 as the global landscape has plateau-ed. Competition on pricing and returns for local retail and capital assets competition is cut-throat.

A prospective upgrade in BisB's dealing systems, with more straight-forward technology, will add greater efficiency to Treasury's trading activities. The bank will continue to explore Islamic derivatives.

Human Capital

2016 was a watershed year for BisB's Human Resources activities, as the department moved steadily toward its ultimate goal of transforming from a service delivery mode to a business partnership with each of its internal stakeholders.

The goal of staff empowerment, through the newly introduced SAP Success Factors system will enhance the automation of manual HR transactions and processes, with less line management intervention, which will supplement initiatives to drive staff and management involvement in decision-making processes.

Change Management related to automation alignment and corporate values' reinforcement will contribute to management's goal to move toward a more efficient working model for BisB.

BisB became more performance driven with the introduction of a revamped, more robust performance management system. Scorecards will track performance as a whole on a quality basis to measure progress. Real time performance is also being recognized.

Job evaluation on BisB roles have been assessed, and functions redefined toward a leaner and improved efficiency model throughout the Bank. Internal appointments to pivotal roles have been made, and further positions to strengthen risk areas have been filled.

Focus on core HR processes gives BisB a competitive advantage in terms of quality personnel recruitment.

All staff and their families are part of the BisB family. Continued involvement through the CEO's Majlis and 'open door' policy encourages staff to 'speak up'. The focus on engagement and roll out of social activities fosters collegial bonding.

In early 2017, the introduction of an engagement tool enables staff and line managers to express how they feel within BisB. The use of intranet as a one-stop shop concept allows staff to learn what's happening within the Bank, including policies, and mechanisms for feedback.

"BisB's new digital services will promote growth, long-term profitability, and continuing innovative solutions to the Bank's customers"

Training and Development

The Ishraq five-pillars strategy re-establishes BisB's values across the organization. Human Resources immersion specifically in the core value of 'Investing in People and Talents' has generated a raft of programs targeted at inclusion for all sectors of staff.

Training and development of people is a cornerstone in building the BisB of the future, capable of matching the best in class in the industry.

In 2016, four senior executives attended the prestigious Darden leadership course.

The introduction of Succession Planning for sensitive, senior roles in the Bank's management will ensure the highest quality leadership steering BisB's Executive Management for years ahead.

Other programs were introduced to uplift line managers' capabilities, as well as leadership training to improve operational skills. BisB's Rising Stars program was launched in October 2016 to uplift leadership capabilities in preparing future leaders and successors. During the year, Human Resources made available a series of monthly 'Learning Week' sessions to imbed soft skills across the institution. Additionally, executive coaching for executive management and mentoring programs for middle managers were provided.

Focused training on Anti-Money Laundering and Fraud Management for front office staff was also made available to comply with the regulatory requirement.

BisB collaborated extensively with Tamkeen and the Bahrain Institute for Banking and Finance in selected training and development programs such as the Development Centre for the Operation Department and Project Management Programs.

In 2017, Human Resources will continue to develop a strong strategic partnership approach with its various stakeholders. Empowerment will remain key, as the further roll out of the SAP Success Factors system will govern the automation of many HR processes.

Information Technology

Information Technology department leads the digitization of BisB, a key pillar of the Bank's Ishraq Back to Basics strategy, leveraging best practice technology tools and systems to deliver superior internal and external customer experience.

Through technology, the team continually seeks to remove barriers to business, finding better and more effective ways to bring BisB's products and services to its customer base.

A comprehensive overhaul of the department's organization will facilitate easier access and execution of vital systems offerings to our various stakeholders. We seek to change from a service request response environment to one which develops bilateral partnerships across the Bank, proactively engaging with other departmental and divisional colleagues.

During the year, the implementation of the Business Intelligence Tool (BI SAP) has helped business users to improve performance. It enables timely and more informed decisions, combining and connecting with data across all systems of the Bank. Information Technology department also introduced further new features to the Anti-Money Laundering system, which tracks funds flows and automatically monitors suspicious fund movements.

For 2017, we will develop a two-way communication interfacing channel with end-users in order to streamline requirement priorities across the Bank, while continuing to support the strategic direction of the businesses. Information Technology department will work in concert with the respective businesses to introduce a new mobile banking product, further digital branches, and replace the current Internet banking system with an improved version.

Review of Operations

Continued

The new digital services will enable BisB to promote growth, long-term profitability, and continuing innovative solutions to the Bank's customers.

Central Operations

Central Operations enjoyed a good year through 2016, with emphasis on streamlining and optimizing transactional processes. A comprehensive review resulted in many functions moving from the Branches to the Operations unit, building further on the moves undertaken in the previous year and enabling front line officers to focus on their customers.

Among internal procedures updated were a revised upward 'gate' on physical scrutiny on cheque amounts in line with market practice, and an automated post-dated cheques system with due date repository.

Related to external partnerships, the department engaged successfully in Phase 2 of EFTS with BENEFIT and the Central Bank of Bahrain. We also worked closely with Housing Bank in further automation of the social housing finance scheme.

During the year, several staff pursued CITF courses, enhancing their trade finance skills. Personnel were also given access to Islamic Banking and language communication classes. The rotation of personnel was reinforced with a backup 'buddy' system, ensuring the highest level of functional cover within the department.

The coming year will see further focus on centralization of operations related to corporate customers.

Strategy Implementation and Transformation

Building on the Board approved 5-year plan, the fundamental Ishraq Back to Basics strategy of the Bank is the platform for the future of BisB. It incorporates the vision and mission of BisB and permeates all levels of strategy implementation and transformation within the organization.

The Strategy Implementation and Transformation department is the focal point for channelling the elements for that strategy to and from the respective departments in BisB.

In 2016, much progress was achieved in collating, formulating and disseminating the relevant data to breathe life into the strategy.

The five points of Ishraq encompass: ensuring the strength of our financial position; streamlining and optimizing processes; digitization; investing in people and talents; and differentiating through superior customer service. This mantra guides the inputs to the planning and approach to the Bank's business lines and support units.

In 2017, as the strategy becomes more embedded in BisB's corporate psyche, Strategy Implementation and Transformation will work with every segment within the Bank to continue to drive the business in our common direction.

General Services

BisB's General Services department operates and maintains the day to day services essential for the running of the Bank. These include the upkeep, appearance and renovations of the Branch network premises and the Head Office; interface with vendors on procurement matters; physical onsite security issues; utilities, transport and mail services; and liaison for property management where the Bank is present.

In 2016, the department oversaw the physical project management and installation of the new Digital Branch in Diplomatic Area. New cameras were procured for the complete upgrade of all of our ATMs across the country, as per the Central Bank of Bahrain regulations.

An aggressive cost reduction program in areas such as electricity consumption resulted in the conversion to LED of all light fittings in the Head Office, as well as motion-detector switches. The department will continue to seek areas for further cost controls where applicable.

Corporate Communications

In 2016, BisB continued to embrace transparency in both internal and external communications activities. Promotional outreach extended through relationships with media and sponsorship presence in financial industry functions.

The encouragement of enhanced linkage between management and staff through a policy of open communication led to flattening of the reporting chain of command through the organization, while regular meetings of the CEO's staff Majlis were a welcome feature for all levels of personnel.

The Bank's internal health initiatives included campaigns related to Breast Cancer for women staff and Prostate Cancer for male staff. Additionally, a spread of social activities, all of which serve to bring our personnel closer to the BisB family, saw staff involvement in events for Mother's Day and Labour Day; distribution of Ramadan gifts; Bahrain Women's Day; desert camping; National Day celebration; and an orphans' day out. In sports, the Bank's football team won the Al Najma Banker's League Cup tournament, while others took part in the Bahrain Marathon relay.

Bahrain Islamic Bank was the recipient of the 23rd Annual World Islamic Banking Conference Performance Award 2016 as the Best Performing Islamic Bank – Bahrain.

In publications, Corporate Communications department printed the second version of 'Sharia'a Fatawa' Book, and the English version of 'Mufeed' Book.

“Human Resources department moved steadily toward its ultimate goal of transforming from a service delivery mode to a business partnership with each of its internal stakeholders”

Risk Management

As an inherent part of the Bank's activities, risk is managed through a process of ongoing identification, measurement, monitoring and reporting in line with the risk appetite of the Bank, which is set and guided by the Board of Directors. This process of risk management is critical to the continued profitability of BisB, and all individuals within the institution are personally accountable for the risk exposures relating to their responsibilities.

The Bank is exposed primarily to credit risk, liquidity risk, market risk (including profit rate, equity price and currency risks), operational risk, reputational risk and Sharia'a-compliance risk.

Risk management philosophy

The risk management philosophy of BisB is to identify, capture, monitor and manage the various dimensions of risk. The objective is to protect asset values and income streams so that the interests of the Bank's stakeholders are safeguarded; while optimising shareholders' returns, and maintaining risk exposure within the parameters set by the Board.

The Bank has defined its risk appetite within the broad framework of its Risk Management Framework. BisB reviews and aligns its risk appetite in line with its evolving business plan, and changing economic and market scenarios. The Bank also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Risk management framework

BisB has in place a comprehensive enterprise-wide integrated Risk Management Framework. This embraces all levels of authorities, organisational structure, people and systems required for the smooth functioning of risk management policies within the Bank.

The Board of Directors retains ultimate responsibility and authority for all risk matters, including establishing overall policies and procedures. The Board is assisted in fulfilling its responsibilities by the Chief Executive, and various Board-level and Management committees.

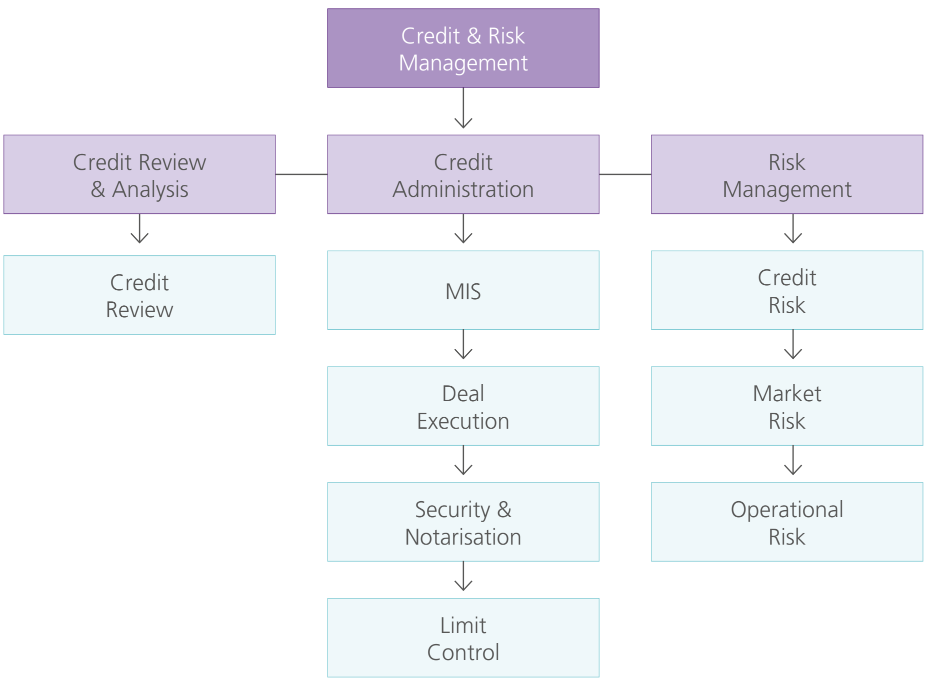
The Credit & Risk Management (C&RM) division – headed by the Chief Risk Officer reporting to the Chief Executive on a day-to-day administrative basis, has day-to-day responsibility for managing the risks involved across all areas of the Bank. C&RM provides independent identification, measurement, monitoring and control of all risk parameters, while liaising with the business divisions that ultimately own the risks. C&RM comprises a number of specialist units, including Risk Management, Credit Review & Analysis, Credit Administration, Benefit Credit Reference Bureau Reporting.

Taking into consideration the current global and regional market conditions, the Bank continued to place the highest priority on further strengthening its risk management infrastructure during 2016 and as a result the Bank has an improved risk management mechanism in place.

Key developments and initiatives achieved include:

- Amending the Credit Risk Management Policy and Risk Management Framework Providing an external training programme to business units and C&RM on Credit review, rating and restructuring
- Implementation of Moody's Risk Analyst system to further strengthen the credit approval process
- Ensuring the ongoing compliance with the policies of the Bank, and monitoring the enterprise-wide risk through various systems and processes
- Monitoring Sharia'a-compliant risk as well as the other risks to which BisB is exposed.

Note: Additional information on the Bank's risk management framework, policies, processes and procedures is included in the Notes to the Consolidated Financial Statements and the Basel III Pillar 3 Public Disclosure sections of this annual report.



Remuneration Disclosures

The Bank's total compensation approach, which includes the variable remuneration policy and the Share Incentive Scheme, sets out the Banks's policy on remuneration for Directors and senior management and the key factors that are taken into account in setting the policy.

The Bank adopted regulations concerning Sound Remuneration Practices issued by the Central Bank of Bahrain. The revised policy framework and incentive components were approved by the Board of Directors and the policy came into effect as of January 2014.

The key features of the remuneration framework are summarized below.

Remuneration strategy

It is the Bank's basic compensation philosophy to provide a competitive level of total compensation to attract and retain qualified and competent employees. The Bank's variable remuneration policy will be driven primarily by a performance based culture that aligns employee interests with those of the shareholders of the Bank. These elements support the achievement of the Bank's objectives through balancing rewards for both short-term results and long-term sustainable performance. This strategy is designed to share success, and to align employees' incentives with the risk framework and risk outcomes.

The quality and long-term commitment of all BisB's employees is fundamental to success. The Bank therefore aims to attract, retain and motivate the very best people who are committed to maintaining a career with the Bank, and who will perform their role in the long- term interests of shareholders. The Bank's reward package comprises the following key elements:

1. Fixed pay
2. Benefits
3. Annual performance bonus

A robust and effective governance framework ensures that the Bank operates within clear parameters of its compensation strategy and policy. All compensation matters, and overall compliance with regulatory requirements, are overseen by the Board Nomination & Remuneration Committee (NRC).

The Bank's remuneration policy in particular, considers the role of each employee and has set guidance on whether an employee is a Material Risk Taker and / or an Approved Person in a business line, control or support function. An Approved Person is an employee whose appointment requires prior regulatory approval because of the significance of the role within the Bank; and an employee is considered a Material Risk Taker if they are the Head of a significant business line or any individuals within their control who have a material impact on the Bank's risk profile.

In order to ensure alignment between what BisB pays its people and the business strategy, individual performance is assessed against annual and long-term financial and non-financial objectives summarized in the performance management system. This assessment also takes into account adherence to the Bank's values, risks and compliance measures and above all integrity. Altogether, performance is therefore judged not only on what is achieved over the short and long-term, but also importantly on how it is achieved, as the NRC believes the latter contributes to the long-term sustainability of the business.

NRC role and focus

The NRC has oversight of all reward policies for the Bank's employees. The NRC is the supervisory and governing body for compensation policy, practices and plans. It is responsible for determining, reviewing and proposing variable remuneration policy for approval by the Board. It is responsible for setting the principles and governance framework for all compensation decisions. The NRC ensures that all persons must be remunerated fairly and responsibly. The remuneration policy is reviewed on a periodic basis to reflect changes in market practices, the business plan and risk profile of the Bank.

The responsibilities of the NRC with regards to the Bank's variable remuneration policy, as stated in its mandate, include but are not limited to, the following:

- Approve, monitor and review the remuneration system to ensure the system operates as intended.
- Approve the remuneration policy and amounts for each Approved Person and Material Risk-Taker, as well as total variable remuneration to be distributed, taking account of total remuneration including salaries, fees, expenses, bonuses and other employee benefits.
- Ensure remuneration is adjusted for all types of risks and that the remuneration system takes into consideration employees that earn the same short-run profit but take different amounts, of risk on behalf of the Bank.
- Ensure that for Material Risk-Takers, variable remuneration forms a substantial part of their total remuneration.
- Review the stress testing and back testing results before approving the total variable remuneration to be distributed including salaries, fees, expenses, bonuses and other employee benefits.
- Carefully evaluate practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. The NRC will question payouts for income that cannot be realised or whose likelihood of realisation remains uncertain at the time of payment.
- Ensure that for Approved Persons in risk management, internal audit, operations, financial control and compliance functions, the mix of fixed and variable remuneration is weighted in favour of fixed remuneration.

- Recommend Board member remuneration based on their attendance and performance and in compliance with Article 188 of the Bahrain Commercial Companies Law.
- Ensure appropriate compliance mechanisms are in place to ensure that employees commit themselves not to use personal hedging strategies or remuneration-and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements.

Scope of application of the remuneration policy

The variable remuneration policy has been adopted on a bank-wide basis.

Board remuneration

The Bank's Board remuneration is determined in line with the provisions of Article 188 of the Bahrain Commercial Companies Law, 2001. The Board of Directors' remuneration will be capped so that total remuneration (excluding sitting fees) does not exceed 10% of the Bank's net profit after all required deductions as outlined in Article 188 of the Companies law, in any financial year. Board remuneration is subject to approval of the shareholders in the Annual General Meeting and MOIC approval. Remuneration of non-executive Directors does not include performance-related elements such as grants of shares, share options or other deferred stock-related incentive schemes, bonuses or pension benefits.

Variable remuneration for staff

Variable remuneration is performance related and consists primarily of the annual performance bonus award. As a part of staff's variable remuneration, the annual bonus rewards delivery of operational and financial targets set each year, the individual performance of the employees in achieving those targets, and their contribution to delivering the Bank's strategic objectives.

The Bank has adopted a Board approved framework to develop a transparent link between variable remuneration and performance. The framework is designed on the basis of meeting both satisfactory financial performance and the achievement of other non-financial factors, that will, all other things being equal, deliver a target bonus pool for employees, prior to consideration of any allocation to business lines and employees individually. In the framework adopted for determining the variable remuneration pool, the NRC aims to balance the distribution of the Bank's profits between shareholders and employees.

Key performance metrics at the Bank level include a combination of short term and long term measures and include profitability, solvency, liquidity and growth indicators. The performance management process ensures that all goals are appropriately cascaded down to respective business units and employees.

In determining the amount of variable remuneration, the Bank starts from setting specific targets and other qualitative performance measures that result in a target bonus pool. The bonus pool is then adjusted to take account of risk via the use of risk-adjusted measures (including forward-looking considerations).

The NRC carefully evaluates practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. NRC demonstrates that its decisions are consistent with an assessment of the Bank's financial condition and future prospects.

The Bank uses a formalised and transparent process to adjust the bonus pool for quality of earnings. It is the Bank's objective to pay out bonuses out of realised and sustainable profits. If the quality of earnings is not strong, the profit base could be adjusted based on the discretion of the NRC.

For the overall Bank to have any funding for distribution of a bonus pool, threshold financial targets have to be achieved. The performance measures ensure that total variable remuneration is generally, considerably contracted where subdued or negative financial performance of the Bank occurs. Furthermore, the target bonus pool as determined above is subject to risk adjustments in line with the risk assessment and linkage framework.

Remuneration of control functions

The remuneration level of staff in the control and support functions allows the Bank to employ qualified and experienced personnel in these functions. The Bank ensures that the mix of fixed and variable remuneration for control and support function personnel should be weighted in favour of fixed remuneration. The variable remuneration of control functions is to be based on function-specific objectives and is not to be determined by the financial performance of the business area they monitor.

The Bank's performance management system plays a major role in deciding the performance of the support and control units on the basis of the objectives set for them. Such objectives are more focused on non-financial targets that include risk, control, compliance and ethical considerations, as well as the market and regulatory environment apart from value adding tasks which are specific to each unit.

Variable compensation for business units

The variable remuneration of the business units is primarily determined by key performance objectives set through the performance management system of the Bank. Such objectives contain financial and non-financial targets, including risk control, compliance and ethical considerations as well as market and regulatory requirements. The consideration of risk assessments in the performance evaluation of individuals ensures that any two employees who generate the same short-run profits but take different amounts of risk on behalf of the Bank are treated differently by the remuneration system.

Risk assessment framework

The purpose of risk linkages is to align variable remuneration to the risk profile of the Bank. In its endeavour to do so, the Bank considers both quantitative measures and qualitative measures in the risk assessment process. Both quantitative measures and human judgment play a role in determining any risk adjustments. The risk assessment process encompasses the need to ensure that the remuneration policy as designed reduces employees' incentives to take excessive and undue risks, is symmetrical with risk outcomes, and delivers an appropriate mix of remuneration that is risk aligned.

The NRC considers whether the variable remuneration policy is in line with the Bank's risk profile, and ensures that through the Bank's ex-ante and ex-post risk assessment framework and processes, remuneration practices where potential future revenues whose timing and likelihood remain uncertain are carefully evaluated.

Risk adjustments take into account all types of risk, including intangible and other risks such as reputation risk, liquidity risk and the cost of capital. The Bank undertakes risk assessments to review financial and operational performance against business strategy and risk performance prior to distribution of the annual bonus. The Bank ensures that total variable remuneration does not limit its ability to strengthen its capital base. The extent to which capital needs to be built up is a function of the bank's current capital position and its ICAAP.

The bonus pool takes into account the performance of the Bank which is considered within the context of the Bank's risk management framework. This ensures that the variable pay pool is shaped by risk considerations and Bank-wide notable events.

The size of the variable remuneration pool and its allocation within the bank takes into account the full range of current and potential risks, including:

(a) The cost and quantity of capital required to support the risks taken;

(b) The cost and quantity of the liquidity risk assumed in the conduct of business; and

(c) Consistency with the timing and likelihood of potential future revenues incorporated into current earnings.

The NRC keeps itself abreast of the Bank's performance against the risk management framework. The NRC will use this information when considering remuneration to ensure returns, risks and remuneration are aligned.

Risk adjustments

The Bank has an ex-post risk assessment framework which is a qualitative assessment to back-test actual performance against prior risk assumptions.

In years where the Bank suffers material losses in its financial performance, the risk adjustment framework will work as follows:

- There will be considerable contraction of the Bank's total variable remuneration.
- At an individual level, poor performance by the Bank will mean individual KPIs are not met and hence employee performance ratings will be lower.
- Reduction in the value of deferred shares or awards.
- Possible changes in vesting periods and additional deferral applied to unvested rewards.
- Lastly, if the qualitative and quantitative impact of a loss incident is considered significant, a malus or clawback of previous variable awards may be considered.

The NRC, with the Board's approval, can rationalise and make the following discretionary decisions:

- Increase / reduce the ex-post adjustment
- Consider additional deferrals or increase in the quantum of non- cash awards
- Recovery through malus and clawback arrangements

Malus and Clawback framework

The Bank's malus and clawback provisions allow the Board of Directors to determine that, if appropriate, unvested elements under the deferred bonus plan can be forfeited / adjusted or the delivered variable remuneration recovered in certain situations. The intention is to allow the Bank to respond appropriately if the performance factors on which reward decisions were based turn out not to reflect the corresponding performance in the longer term. All deferred compensation awards contain provisions that enable the Bank to reduce or cancel the awards of employees whose individual behaviour has had a materially detrimental impact on the Bank during the concerned performance year.

Any decision to take back an individual's award can only be made by the Bank's Board of Directors.

Remuneration Disclosures
Continued

The Bank's malus and clawback provisions allow the Board to determine that, if appropriate, vested / unvested elements under the deferred bonus plan can be adjusted / cancelled in certain situations. These events include the following:

- Reasonable evidence of willful misbehaviour, material error, negligence or incompetence of the employee causing the Bank/ the employee's business unit to suffer material loss in its financial performance, material misstatement of the Bank's financial statements, material risk management failure or reputational loss or risk due to such employee's actions, negligence, misbehavior or incompetence during the concerned performance year.
- The employee deliberately misleads the market and/or shareholders in relation to the financial performance of the Bank during the concerned performance year.
- Clawback can be used if the malus adjustment on the unvested portion is insufficient given the nature and magnitude of the issue.

Components of Variable remuneration

Variable remuneration has the following main components:

Upfront Cash:

The portion of the variable compensation that is awarded and paid out in cash on conclusion of the performance evaluation process for each year.

Deferred Cash:

The portion of variable compensation that is awarded and paid in cash on a pro-rata basis over a period of 3 years.

Upfront shares:

The portion of variable compensation that is awarded and issued in the form of shares on conclusion of the performance evaluation process for each year.

Deferred shares:

The portion of variable compensation that is awarded and paid in the form of shares on a pro-rata basis over a period of 3 years.

All deferred awards are subject to malus provisions. All share awards are released to the benefit of the employee after a six-month retention period from the date of vesting. The number of equity share awards is linked to the Bank's share price as per the rules of the Bank's Share Incentive Scheme. Any dividend on these shares is released to the employee along with the shares (i.e. after the retention period).

Deferred compensation

The CEO, his deputies and 5 most highly paid business line employees are subject to the following deferral rules:

Element of variable remuneration	Payout percentages	Vesting period	Retention	Malus	Clawback
Up-front cash	40%	immediate	-	-	Yes
Deferred cash	10%	3 years	-	Yes	Yes
Deferred share awards	50%	3 years	6 months	Yes	Yes

All other covered staff, i.e. Assistant General Manager level and above are subject to the following deferral rules:

Element of variable remuneration	Payout percentages	Vesting period	Retention	Malus	Clawback
Up-front cash	50%	immediate	-	-	Yes
Up-front share awards	10%	immediate	6 months	Yes	Yes
Deferred share awards	40%	3 years	6 months	Yes	Yes

The NRC, based on its assessment of the role profile and risk taken by an employee could increase the coverage of employees that will be subject to deferral arrangements.

Details of remuneration paid

(a) Board of Directors & committees

BD 000's	2016	2015
Sitting Fees	178	148
Remuneration	283*	-

*Subject to AGM and requlatory approvel.

(b) Employee remuneration

2016

		Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					
						Upfront		Deferred			
BD 000's	Number of staff	Cash	Others	(Cash / Shares)	(Cash / Shares)	Cash	Shares	Cash	Shares	Others	Total
Approved persons											
- Business lines	6	1,094	40	-	-	87	-	22	109	-	1,352
- Control & Support	8	832	-	-	-	47	8	-	32	-	919
Other material risk takers	-	-	-	-	-	-	-	-	-	-	-
Other staff	347	8,521	-	-	-	669	-	-	-	-	9,189
TOTAL	**361**	**10,447**	**40**	-	-	**803**	**8**	**22**	**141**	-	**11,460**

2015

		Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					
						Upfront		Deferred			
BD 000's	Number of staff	Cash	Others	(Cash / Shares)	(Cash / Shares)	Cash	Shares	Cash	Shares	Others	Total
Approved persons											
- Business lines	6	775	-	188	-	92	-	23	115	-	1,193
- Control & Support	6	793	-	-	-	33	5	-	20	-	851
Other material risk takers	-	-	-	-	-	-	-	-	-	-	-
Other staff	342	7,284	-	-	-	735	-	-	-	-	8,091
TOTAL	354	8,852	-	188	-	860	5	23	135	-	10,063

Includes end of service compensations.

Remuneration Disclosures
Continued

Deferred awards disclosures

2016

BD 000's	Cash	Shares Number	Shares BD 000's	Total
Opening balance	49	2,141,578	268	317
Awarded during the period	22	1,210,241	262	284
Paid out / released during the period	(4)	(443,893)	(64)	(68)
Service, performance and risk adjustments	-	-	-	-
Corporate action adjustment	-	84,429	-	-
Closing balance	67	2,992,356	466	533

Number of shares for the 2016 deferred share awards has been calculated using estimated year end share prices as the award price in accordance with the Share plan policy of the Bank will be determined at a later date.

2015

BD 000's	Cash	Shares Number	Shares BD 000's	Total
Opening balance	13	604,751	90	103
Awarded during the period	37	1,766,360	210	246
Paid out / released during the period	-	-	-	-
Service, performance and risk adjustments	-	-	-	-
Corporate action adjustment	-	(229,533)	(32)	(32)
Closing balance	49	2,141,578	268	317

Corporate Responsibility

BisB is proud of its commitment to social responsibility in the communities we serve, and contributes to the social well-being and economic development of the Kingdom of Bahrain. Our support of the Islamic Banking industry in the country takes the form of participation and sponsoring of key industry events. In 2016 this included the World Islamic Banking Conference and the World Bank Annual Conference on Islamic Banking & Finance.

We continue to support vigorously a number of charitable, medical, educational and social organizations, and encourage participation of our staff and management in local community activities.

In collaboration with Ahmed Al Fateh Islamic Centre, The Bank organized "Iqraa" competition for the Holy Quran during Ramadan.

"Together, draw a smile on their faces." An initiative for orphans.

WIBC Conference 2016 Sponsorship.

Corporate Governance Review

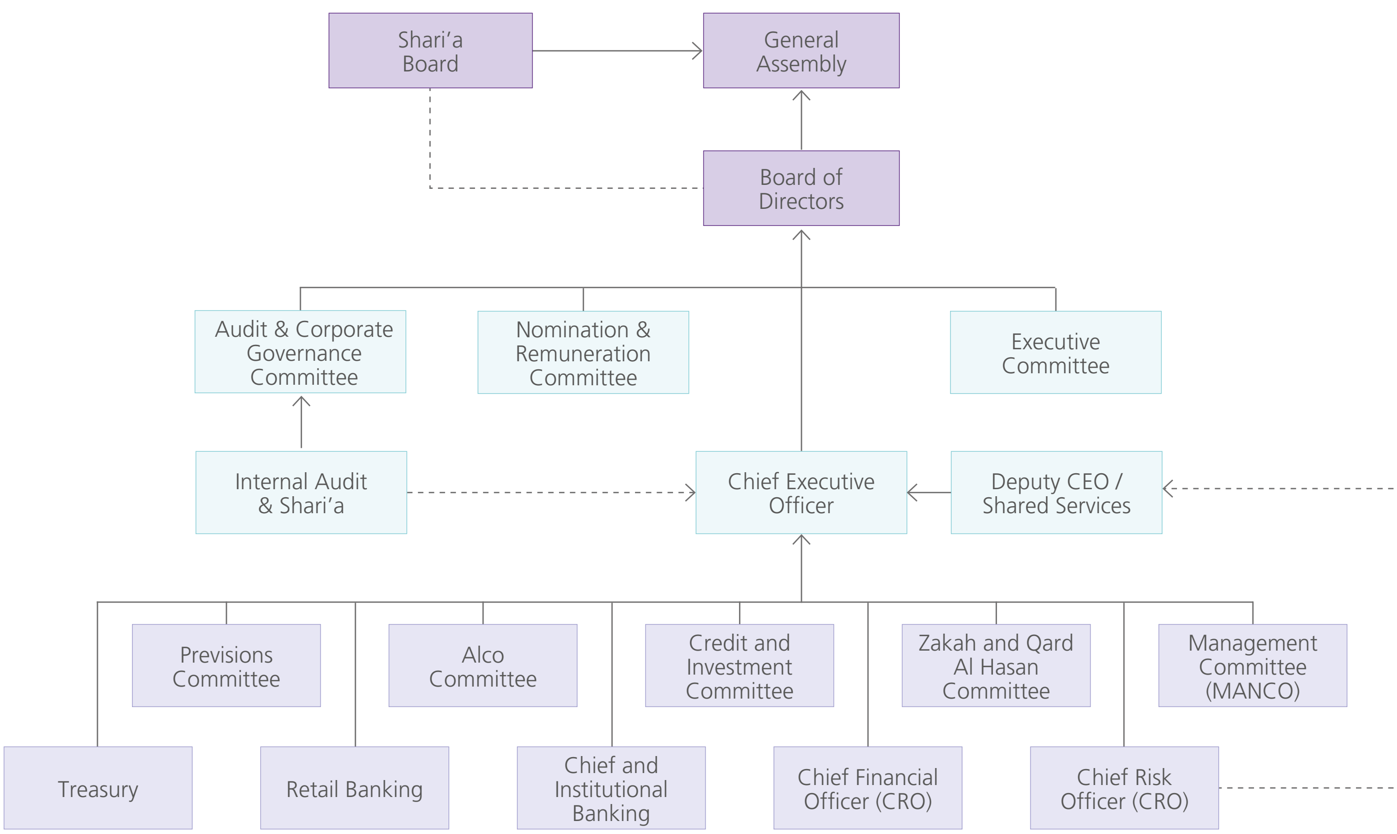
CORPORATE GOVERNANCE REVIEW

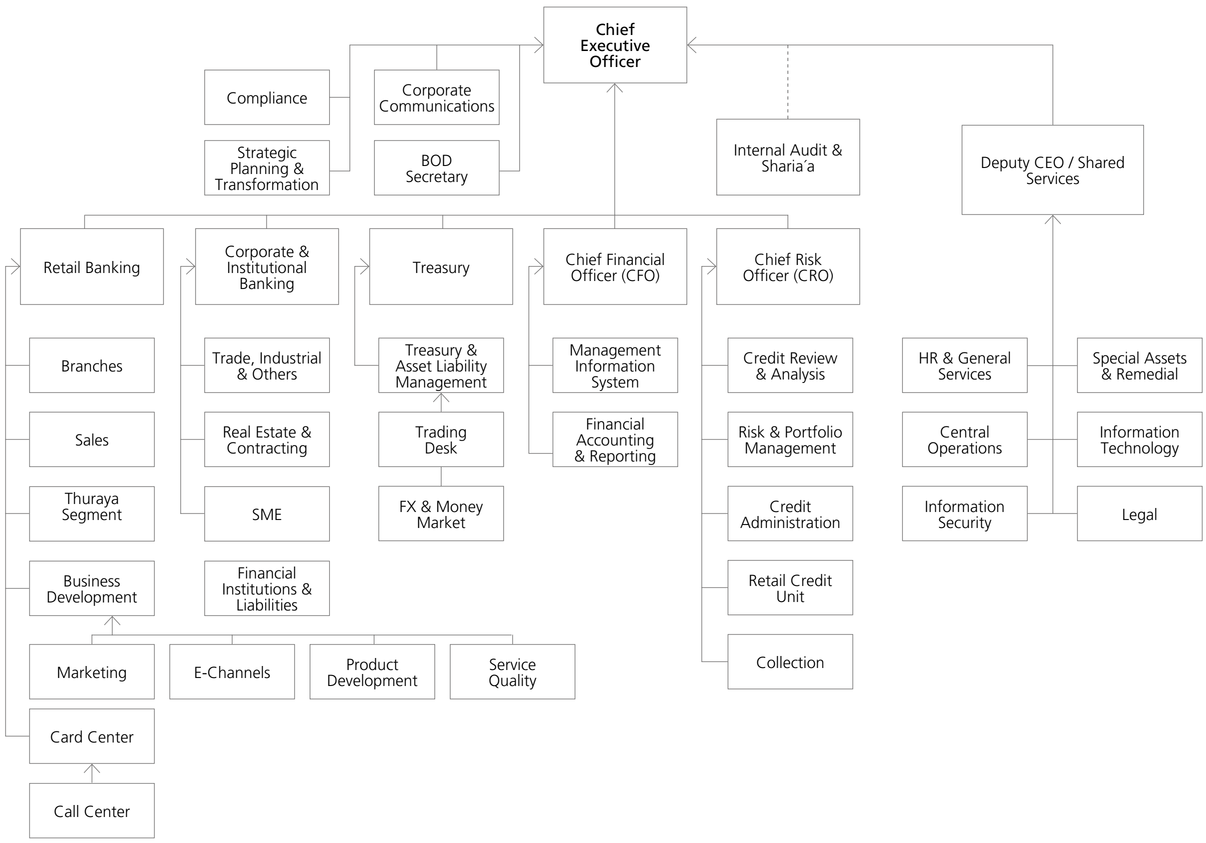
As a code of conduct and value driven organization, BisB is committed to uphold the highest standards of corporate governance, and the Central Bank of Bahrain's High- Levels Control Module (and its amendments). The Bank seeks to balance entrepreneurship, compliance and industry best practice, while creating value for all stakeholders. This includes, but is not limited to, conducting the policy and affairs of BisB in compliance with regulatory requirements. It also involves having the right checks and balances in place throughout the organization to ensure that the right things are always done in the right way. The Bank remains unwavering in its commitment to good corporate governance and will consistently and transparently communicate with its regulators, shareholders and stakeholders. Committed to achieve high standards of Compliance, the Bank introduced a series of training and awareness courses on different banking areas including corporate governance, policies & procedures, and specialized anti-fraud courses. Moreover, during the year 2016, BisB has introduced its 'Rising Stars Program', a six-month internal leadership-training program designed to enhance the skills and knowledge of key individuals within the organization. The "Rising Stars Program" is part of BisB's 'Ishraq' Back to Basics internal transformation strategy which focuses on five main pillars introduced to optimize and develop aspects of the bank's business, its people and processes with an aim to grow the Bank's foundations and achieve its vision and mission.

Members of the 'Rising Stars' program were also given the chance to interact and share their thoughts with Senior Management on a 'Strategy day-out'.

Bank's structure

Board of Directors & Executive Management





Developments in 2016

- Rolling out 'Ishraq' Strategy embraced the theme of 'Going back to basics' which constitute the basic pillars of the Bank for the coming three years. Ishraq (Arabic meaning 'bright new beginning') reflects the new positive drive of the bank and a new beginning for all of the employees. The five point Ishraq star is a symbol of the five strategic points or pillars that the new program is built upon. These five pillars are:
  - Investing in people & talent
  - Re-organising and shaping the Bank's financial position
  - Streamlining and optimizing processes
  - Focusing on digitization
  - Differentiating through superior customer service
- Representing an outstanding leap in providing services to its clients, the Bank inaugurated its first digital Branch in Bahrain where all services will be conducted through digital means. All banking services will be carried out automatically and electronically and within the shortest possible time.
- Successful launching of the Bank's capital increase exercise.
- Moody's has raised the long term rating of the Bank from caa1 to b3 issuer ratings with a positive outlook, the first rating of its kind for the Bank since Moody's started rating the Bank 7 years back.

- Distribution of bonus shares amounting to 4% of paid-up capital as of 31 December 2015 as dividends to the shareholders.
- AGM of 2015 held on 23 March 2016, involved the election of new Board members for the next three years.
- Board structure remained unchanged, except for new appointed representatives of NBB, Dr. Esam Abdulla Fakhro (Chairman) and Mr. Khaled Yusuf AbdulRahman (Board member) replacing Mr. Abdul Razaq Al Qassim (former Chairman) and Mrs. Fatima Budhaish (former Board member).
- Appointed world class trainers to deliver Corporate Governance and Anti-fraud courses.
- Significant reduction in the Bank's non-performing assets.
- Online AML training rolled out for all relevant staff as per CBB's requirements stipulated in Financial Crimes (FC) Module.
- Responded to the following CBB Consultation Papers:
  - Proposed Shari'a Governance Module (Module SG) for CBB Rulebook Volume 2
  - Retail Banks Prior Approval for New or Expanded Products
  - Draft Law for the Enactment of the Real Estate Regulation
  - Technical Note on Stress Testing for IIFS
  - Proposed Amendments to Remuneration Rules

Board of Directors

Role and Responsibilities of the Board

The primary responsibility of the Board of Directors is to provide effective governance over the Bank's affairs for the benefit of the shareholders; and to balance the interests of BisB's diverse constituencies, including associated concerns, employees and other stakeholders. In all actions taken by the Board, the Directors are expected to exercise their business judgment in what they reasonably believe to be in the best interests of the Bank.

The Board approves and oversees the implementation of the Bank's strategies; and reviews and approves the Bank's strategic plan. As part of its strategic review process, the Board reviews major plans of action and business plans; sets performance objectives; and oversees major investments, divestitures and acquisitions. Every year, at an annual Board strategy session, the Board formally reassesses the Bank's objectives, strategies and plans. The Board's responsibilities are described in more detail in the Corporate Governance Report published on the Bank's website, and in the Charter of the Board of Directors.

Board Composition

The Board of Directors of BisB comprises nine Non- Executive Directors, of which four are Independent Directors. Each term of the Board of Directors consists of three years. The last re-election of the Bank's Board of Directors was held at the Bank's Annual General Meeting (AGM) on 23 March 2016. Profiles of Board Members are listed on page 12 of this annual report.

1. Dr. Esam Abdulla Fakhro (Appointed on: 23-03-2016 replacing Abdul Razak Al Qassim)
2. Brigadier Khalid Mohammed Al Mannai (Re-appointed on: 23-03-2016).
3. Khaled Yusuf AbdulRahman (Appointed on: 23-03-2016 replacing Fatima Abdulla Budhaish).
4. Mohammed Ahmed Abdulla (Re-appointed on: 23-03-2016).
5. Talal Ali Al Zain (Re-elected on: 23-03-2016).
6. Khalil Ebrahim Nooruddin (Re-elected on: 23-03-2016).
7. Ebrahim Husain Ebrahim AlJassmi (Re-elected on: 23-03-2016).
8. Othman Ebrahim Naser Al Askar (Re-appointed on: 23-03-2016).
9. Muhammad Zarrug Rajab (Re-appointed on: 23-03-2016)

Induction of new directors

The Board-approved Corporate Governance Policy requires each new Director to receive a formal and tailored induction from the Chairman and Senior Management, with respect to BisB's vision and strategic direction; core values including ethics; corporate governance practices; and financial matters and business operations.

Board Committees

The Board constitutes three Committees - Executive Committee, Audit & Corporate Governance Committee and Remuneration & Nomination Committee. Each of these committees has its own Charter that describes the responsibilities of its members.

Board Committee Membership and Objectives

Board Committee	Members	Objectives
Executive Committee	Khalid Mohammed Al Mannai (Chairman) *Members* • Khalil Ebrahim Nooruddin • Khaled Yusuf AbdulRahman* • Mohammed Ahmed Abdulla** • Hassan Amin Jarrar (non-voting member) * Joined as a member of the committee on 04 Oct 2016 replacing Ebrahim Husain AlJassmi. ** Joined as a member of the committee on 31 Mar 2016 replacing Talal Ali Al-Zain.	Review of strategy and performance. Review of new investment proposals, credit proposals, and exit strategies. The committee meets at least six times per year.
Audit & Corporate Governance Committee	Ebrahim Husain AlJassmi* (Chairman) *Members* • Othman Ebrahim Al Askar • Muhammad Zarrug Rajab * Re-joined as Chairman of the committee on 03 Nov 2016 replacing Khaled Yusuf AbdulRahman who was appointed as NBB's representative during the AGM held 23 Mar 2016, and selected as Chairman of the committee on a temporary basis.	Oversight of integrity and reporting of the Bank's quarterly and annual financial statements. Review of risk, provision and impairment. Compliance with legal and regulatory requirements. The committee meets at least four times per year.
Nomination and Remuneration Committee	Dr. Esam Abdulla Fakhro* (Chairman) *Members* • Khalid Mohammed Al Mannai • Talal Ali Al-Zain** * Appointed on 23 Mar 2016 as NBB's representative replacing the former Chairman Abdul Razak Abdulla Al Qassim. ** Joined as a member of the committee on 23 March 2016 replacing Moh'd Ahmed Abdulla.	Oversight of the compensation and remuneration policy. Oversight of recruitment & promotion of key personnel and Board members. The committee meets at least two times per year. The current committee structure includes two non-independent members and one independent member. This was adopted due to the limited number of independent Board members and will be re-visited in the the near future. Temporary CBB clearance was obtained on the current structure.

Corporate Governance Review
Continued

Evaluation of the Board and its Committees

The Nomination and Remuneration Committee carried out an evaluation of the Board and its Committees through the distribution of questionnaires to each Board Member, followed by an assessment of the Committees and Members. The Committee expressed its satisfaction with the positive results.

Directors' Remuneration

The aggregate Board sitting fees, including travel expenses, totaled BD 178,000 in 2016.

Directors' Attendance

The Board of Directors met nine times during 2016, details of which are given in the following table. This exceeds the minimum requirement of having at least four meetings in any given year, as stipulated by the Central Bank of Bahrain.. The table also shows attendance of Directors at Board Committee meetings.

Members	28 Jan	21 Feb	23 Mar	02 May	07 Aug	10 Aug	06 Nov	14 Dec	15 Dec
Dr. Esam Abdulla Fakhro (Appointed on: 23 Mar 2016 as NBB's representative replacing Abdul Razaq Al Qassim)	–	–	✓	✓	✓	✓	✓	✓	✓
Abdul Razak Abdulla Al Qassim (Replaced by Dr. Esam Abdulla Fakhro on: 23 Mar 2016)	✓	✓	–	–	–	–	–	–	–
Khalid Mohammed Al Mannai (Re-appointed on: 23 Mar 2016)	×	✓	✓	✓	✓	✓	✓	×	×
Khaled Yusuf AbdulRahman (Appointed as NBB's representative replacing Fatima Abdulla Budhaish on: 23 Mar 2016)	–	–	×	✓	✓	✓	✓	✓	✓
Fatima Abdulla Budhaish (Replaced by Khaled Yusuf AbdulRahman on: 23 Mar 2016)	✓	×	–	–	–	–	–	–	–
Mohammed Ahmed Abdulla (Re-appointed on: 23 Mar 2016)	✓	✓	✓	✓	✓	✓	✓	✓	✓
Talal Ali Al Zain (Re-elected: 23 Mar 2016)	×	✓	✓	✓	✓	×	×	✓	✓
Khalil Ebrahim Nooruddin (Re-elected on: 23 Mar 2016)	✓	✓	✓	✓	✓	✓	✓	✓	✓
Ebrahim Husain AlJassmi (Re-elected on: 23Mar 2016)	×	✓	✓	✓	✓	✓	✓	✓	✓
Othman Ebrahim Al Askar (Re-appointed on: 23 Mar 2016)	✓	✓	✓	✓	✓	✓	✓	✓	✓
Muhammad Zarrug Rajab (Re-appointed on: 23 Mar 2016)	✓	✓	✓	✓	✓	✓	✓	✓	✓

Board Meetings & Attendance in 2016:

Executive Committee Meetings & Attendance:

Members	12 Jan	31 Mar	20 Apr	12 Jun	26 Jun	26 Jul	02 Aug	04 Oct	29 Nov
Khalid Mohammed Al Mannai	✓	✓	✓	✓	✓	✓	✓	✓	✓
Khalil Ebrahim Nooruddin	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mohammed Ahmed Abdulla	–	✓	✓	✓	✓	✓	✓	✓	✓
Khaled Yusuf AbdulRahman	–	–	–	–	–	–	–	✓	✓
Ebrahim Husain AlJassmi	–	✓	✓	✓	✓	✓	✓	–	–
Talal Ali Al-Zain	✓	–	–	–	–	–	–	–	–
Hassan Amin Jarrar	✓	✓	✓	×	✓	✓	✓	✓	✓

Audit & Corporate Governance Committee Meetings & Attendance

Members	09 Feb	21 Feb	13 Mar	24 Apr	02 May	08 Aug	03 Nov	13 Dec
Ebrahim Husain AlJassmi	✓	✓	✓	–	–	–	✓	✓
Khaled Yusuf AbdulRahman	–	–	–	✓	✓	✓	–	–
Othman Ebrahim Al Askar	✓	✓	✓	✓	✓	✓	✓	✓
Muhammad Zarrug Rajab	✓	✓	✓	✓	✓	✓	✓	✓

Nomination & Remuneration Committee Meetings & Attendance:

Members	21 Feb	07 Mar	30 Aug
Dr. Esam Abdulla Fakhro	–	–	✓
Abdul Razak Abdulla Al Qassim	✓	✓	–
Khalid Mohammed Al Mannai	✓	✓	✓
Mohammed Ahmed Abdulla	✓	✓	–
Talal Ali Al-Zain	–	–	✓

Shareholders Ownership (5% and above)

Shareholder	Nationality	Number of Shares	Percentage
Social Insurance Organization (Military, GOSI & Civil)	Bahrain	294,484,927	29.06%
National Bank of Bahrain	Bahrain	294,482,159	29.06%
Islamic Development Bank	Saudi Arabia	146,117,221	14.42%
Kuwait Awqaf Public Foundation	Kuwait	72,729,830	7.17%

Corporate Governance Review
Continued

Distribution of Ownership of Shares by Nationality

Country	Percentage	Number of Shares
Kingdom of Bahrain	73.120%	740,988,582
Kingdom of Saudi Arabia	15.080%	152,801,646
Kuwait	8.670%	87,855,115
United Arab Emirates	2.980%	30,160,940
Qatar	0.130%	1,316,990
Others	0.030%	265,857
Total	100.00%	1,013,389,130

Changes in Distribution of Ownership shares of Directors, Shari'a Members and Approved Persons

Directors	Shares as of 31st Dec 2015	Shares as of 31st Dec 2016
Dr. Esam Abdulla Fakhro (Appointed on: 23 Mar 2016 as NBB's representative replacing Abdul Razaq Al Qassim)	-	-
Abdul Razak Abdulla Al Qassim (Replaced by Dr. Esam Abdulla Fakhro on: 23 Mar 2016	84,658	-
Khalid Mohamed Al Mannai	-	-
Mohammed Ahmed Abdulla	-	-
Khaled Yusuf AbdulRahman (Appointed as NBB's representative replacing Fatima Abdulla Budhaish on: 23 Mar 2016)	-	-
Fatima Abdulla Budhaish (Replaced by Khaled Yusuf AbdulRahman on: 23 Mar 2016)	84,658	-
Talal Ali Al Zain	-	-
Khalil Ebrahim Nooruddin	-	-
Ebrahim Husain AlJassmi	184,658	192,044
Othman Ebrahim Al Askar	84,658	88,044
Muhammad Zarrug Rajab	129,070	134,232

Changes in Distribution of Ownership shares of Directors, Shari'a Members and Approved Persons

Shari'a Members	Shares as of 31st Dec 2015	Shares as of 31st Dec 2016
Shaikh Dr. Abdul Latif Mahmood Al Mahmood	157,035	168,216
Shaikh Dr. Nedham Mohamed Saleh Yacoubi	12,123	12,607
Shaikh Mohammed Jaffar Al Juffairi	-	-
Shaikh Adnan Abdulla Al Qattan	-	-
Shaikh Dr. Essam Khalaf Al Enizi	-	-
Approved Persons	**Shares as of 31st Dec 2015**	**Shares as of 31st Dec 2016**
Hassan Amin Jarrar – Chief Executive Officer	-	206,573
Mohammed Ahmed Hassan Janahi – Deputy Chief Executive Officer	-	50,385
A. Rahman Mohammed Turki – GM, Retail	21,369	52,934
Wesam A.Aziz Baqer – AGM, Corporate Banking	6,929	22,375
Khalid Mohammed Al Doseri – Chief Financial Officer	-	31,112
Khalid Mahmood – AGM, Internal Audit	-	34,705
Fahim Shafiqi – Chief Risk Officer	-	-
Dawood Khalil AlAshhab – AGM, Human Resources & General Services	-	2,918
Hassan A. Wahab Al Khan – AGM, Central Operations	-	10,800
Hamad Farooq AlShaikh – Senior Manager Head of Shari'a	-	-
Hussain AlBanna – Senior Manager, Acting Head of Treasury	-	-
Hassan Abu Hassan – AGM, Head of IT	-	6,694
Osama Muein – Head of Special Assets	-	-
Maisa Shunnar – Head of Strategy Implementation & Transformation	-	-
Khaled A.Rahman Nass – Senior Manager, Head of Compliance & AML	-	-
Mohammed Adnan AlAnsari – Deputy MLRO	-	-

Performance-Linked Management Incentive Structure

BisB implements a Performance Management Scheme, which is linked to incentives and competencies on an annual basis, for management and staff. The Bank pays monthly salaries, allowances and bonuses for the Chief Executive, General Managers, Senior Managers and Managers.

Management Committees

A number of Management Committees are put in place to assist the CEO and Management Team in carrying out their duties, and to ensure that there is adequate supervision of the Bank's activities.

Management Committees - Membership & Objectives

Committee(s)	Members	Objectives
Management Committee (MANCO)	Hassan Amin Jarrar (Chairman) *Members* • Mohammed Ahmed Hassan Janahi • A. Rahman Turki • Fahim Shafiqi • Khalid Al Doseri • Khalid Mahmood • Wesam A.Aziz Baqer • Hassan Abu Hassan • Dawood Al Ashhab • Hassan A.Wahab Al Khan • Khalid A.Rahman Nass • Maisa Shunnar	The main objective of the MANCO is to review the Bank's strategy, business performance and updates, follow up on the bank's internal and external projects. That, in addition to conducting a review of key risks and issues facing the bank, and issuing resolutions for the smooth execution of work.
Asset & Liability Committee (ALCO)	Hassan Amin Jarrar (Chairman) *Members* • Mohammed Ahmed Hassan Janahi • A. Rahman Turki • Fahim Shafiqi • Khalid Al Doseri • Nader Al Bastaki* * Nader AlBastaki last working day was on 30 Nov 2016.	The main objective of ALCO is to manage and monitor the liquidity risk of the Bank on a coordinated and consistent basis.
Credit & Investment Committee (C&IC)	Hassan Amin Jarrar (Chairman) *Members* • Fahim Shafiqi • A. Rahman Turki • Wesam A.Aziz Baqer • Nader Al Bastaki* * Nader AlBastaki last working day was on 30 Nov 2016.	The main objectives of C&IC is to exercise due care, diligence and skill to oversee, direct and review the management of credit risk within the financing portfolio of the Bank and reviewing policies and strategies for achieving investment objectives.
Qard Al Hassan, Donation & Zakah Committee	Mohammed Ahmed Hassan Janahi (Chairman) *Members* • Hamad Farooq AlShaikh • Khaled Waheeb AlNasser • Ali Hassan Duaij	The main objective of Qard Al Hassan and Zakah Committee is to discharge the Group's social responsibilities toward its society through distributing zakah, charity funds, donations & good faith Qard for marriage, medical treatments, etc.

Committee(s)	Members	Objectives
Provisioning Committee	Hassan Amin Jarrar (Chairman) *Members* • Mohammed Ahmed Hassan Janahi • Fahim Shafiqi • Khalid Al Doseri • Khalid Mahmood (observer)	The main objective of Provisioning Committee is to assist the CEO in reviewing the bank's provisions. In addition, the Committee would be responsible in formulating provision policies with a view to maintain the strategic risk level objectives of the bank.

Succession Planning

Succession planning in the bank is driven by our Business strategy and future focused. The primary objective of the plan is to develop our people to meet future demands of the bank. The output is better internal resourcing and highly capable people filling our key positions. Our process ensures that we meet our regulatory commitments.

Compliance

In accordance with CBB guidelines, the Bank has a designated Head of Compliance, who is independent and reports directly to the Chief Executive Officer and Board of Directors; and has direct access to Senior Management and all confidential information of the Bank. The Compliance function acts as the central coordinator for all regulatory matters relating to the CBB, Bahrain Bourse, and other regulatory bodies. BisB has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain, including appropriate anti- money laundering policies.

Anti-Money Laundering

BisB has a designated Money Laundering Reporting Officer (MLRO). The Bank has implemented an anti-money laundering and terrorism financing policy, and annually trains its staff on the identification and reporting of suspicious activities and transactions. BisB follows prudent practices related to 'Customer Due Diligence', 'Beneficial Ownership' and 'Know Your Customer' principles. In accordance with CBB requirements, the MLRO regularly reviews the effectiveness of the Bank's AML/CFT procedures, systems and controls.

Customer Complaints

The Complaints Resolution Unit of the Quality Assurance Department is responsible for managing customer complaints. After receiving a complaint, the Unit routes it to the concerned department for their response. After analyzing the response, the customer is contacted accordingly. BisB customers may use the Bank's website or the call centre for lodging a complaint. All complaints are logged, monitored and reported to the CBB.

Code of Conduct

BisB conducts itself in accordance with the highest standards of ethical behavior. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders The Code applies to directors, management, staff and temporary workers; and independent contractors and consultants, whether engaged by or otherwise representing the Bank and its interests.

Disclosure and Communications

BisB conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include an annual report, corporate brochure and website, and regular announcements in the appropriate local media. As part of its disclosure and communication strategy, the Bank's website (www.bisb.com) is the repository of financial information, together with Board of Directors' reports and financial commentary, financial statements, relevant information on BisB such as its key products and services, and press releases.

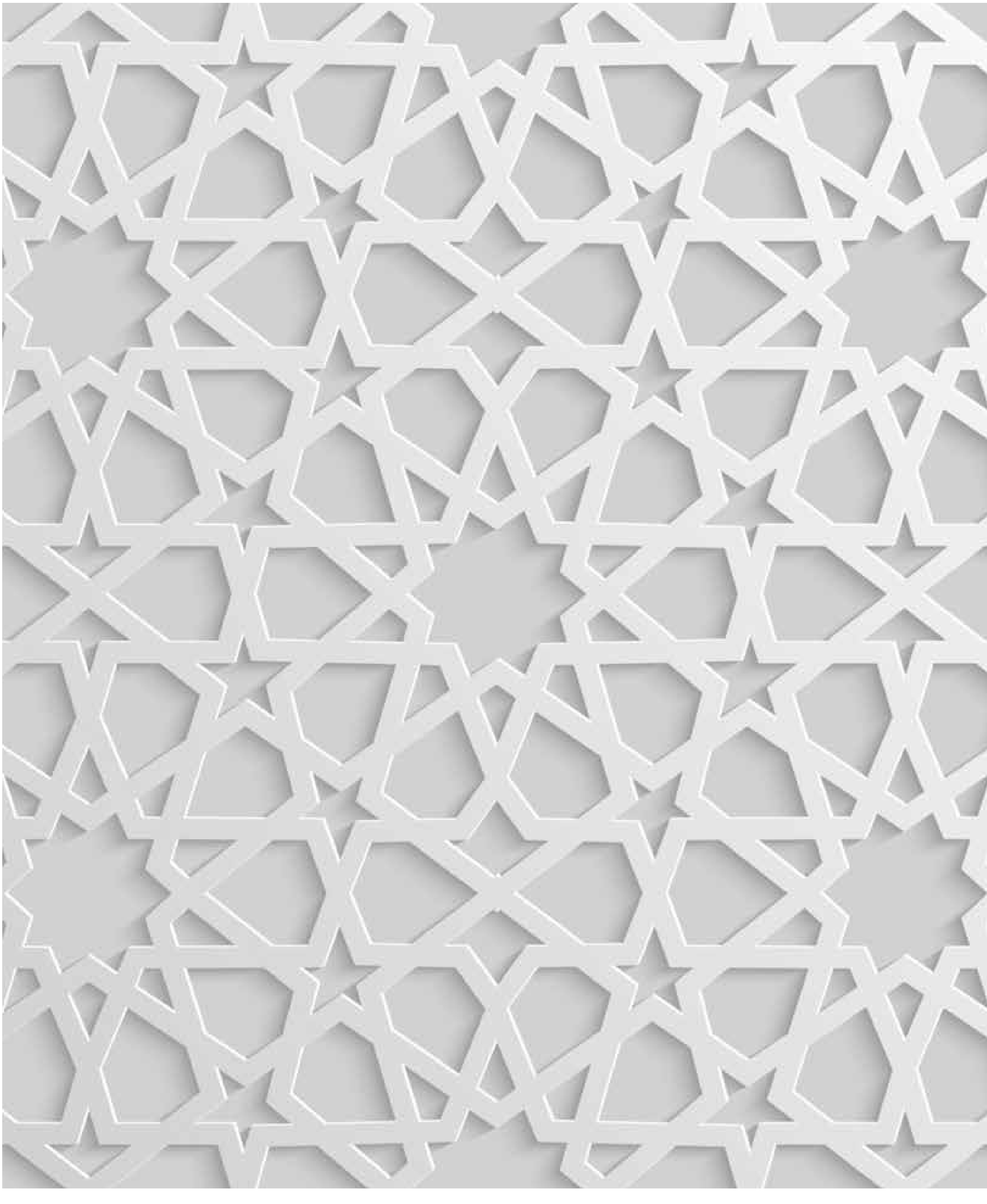
Note: Additional information is included in the BisB Corporate Governance report 2016, which is posted on the Bank's website: www.bisb.com.

Banking... together

Here for you 24/7

Digital branch banking provides timeless banking service


الخدمات المصرفية عبر
internet banking
محطتك الرقمية
سريعة وميسرة
terminal to a
and easier
experience
Internet banking



Sharia'a Supervisory Board Report

For the year ended 31st December 2016

In The Name of Allah, most Gracious, most Merciful Peace and Blessings Be Upon His Messenger.

To the shareholders of Bahrain Islamic Bank B.S.C.

Assalam Alaykum Wa Rahmatu Allah Wa Barakatoh.

The Sharia'a Board hereby present the following report on its activities in supervising the Bank's finances and investments from a Sharia perspective for the financial year ending on 31st December 2016, in fulfillment to the mandate conferred upon it by BisB's Articles of Association:

- The Sharia'a Supervisory Board monitored the operations, related to the Bank throughout the year ended on 31st December 2016 to express opinion on the Bank's adherence to the provisions and principles of Islamic Sharia'a in its activities by following the fatwas, decisions and the specific guidelines issued from our side.
- The Sharia'a Supervisory Board believes that ensuring the conformity of Bank's activities and investments with the provisions of Islamic Sharia'a is the sole responsibility of the Management while the Sharia'a Supervisory Board is only responsible for expressing an independent opinion and preparing a report to you.
- We planned with the Sharia'a Internal Audit department to carry out monitoring functions by obtaining all the information and clarifications that were deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a and Fatwas and decisions of the Sharia'a Board.
- Our supervision constituted of inspection, documenting of policies followed by the Bank on the basis of examining each kind of operation either directly or indirectly by the internal Sharia'a Department in conformity with the methodology approved by the Sharia'a Board.
- The Sharia'a Internal Audit department performed its mission of auditing the transactions executed by the Bank and submitted its periodic reports to the Sharia'a Supervisory Board, which confirmed the Bank's adherence in its dealings and investments with the Sharia'a Board's fatwas and decisions.
- The 14 reports submitted by Internal Sharia Audit Department to the Sharia'a Supervisory Board included results of auditing the files, contracts, executed deals in fulfillment to the Sharia'a Board annual approved audit plan. The Sharia'a Board obtained the requested information and explanations from the departments it deemed necessary to confirm that the Bank did not violate the Sharia principles and Fatwas and decisions of the Sharia'a Board.
- The Sharia Board and its Committees held (14) meetings during the year and issued (73) decisions and fatwas, and approved (58) contracts.
- The Sharia Board has reviewed the financial Statements for the year ended on 31st December 2016, the income statement, the attached notes and the Zakat calculation methods. The Sharia'a Supervisory Board believes that:

1. All the Financial Statements inspected by the Sharia'a Board conform to what has been approved by the Board, and to the standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions AAOIFI.
2. Contracts, and transactions conducted by the Bank throughout were in accordance with the standard contracts pre-approved by the Sharia'a Supervisory Board.
3. The distribution of profit and allocation of losses on investment accounts was in line with the basis and principles approved by the Sharia'a Supervisory Board and in accordance to Islamic Sharia.
4. Any gains resulted from sources or means prohibited by the provisions and principles of Islamic Sharia'a, have been directed to the Charity and Donations Fund.
5. Zakah was calculated according to the provisions and principles of Islamic Sharia'a, by the net invested assets method. And the shareholders should pay their portion of Zakah on their shares as stated in the financial report.
6. The Bank was committed to the Sharia'a standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI).

We pray that Allah may grant all of us further success and prosperity.

Wassalam Alaykum Wa Rahmatu Allah Wa Barakatoh.

Shaikh Dr. A.Latif Mahmood Al Mahmood
Chairman

Shaikh Mohammed Jaffar Al Juffairi
Vice Chairman

Shaikh Adnan Abdullah Al Qattan
Member

Shaikh Dr. Nedham M. Saleh Yacoubi
Member

Shaikh Dr. Essam Khalaf Al Onazi
Member

Financial Statements 2016

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Independent Auditors' Report

To the Shareholders of Bahrain Islamic Bank B.S.C.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Bahrain Islamic Bank B.S.C. (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of income, cash flows, changes in owners' equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, and of its consolidated results of operations, its consolidated cash flows, its consolidated changes in owners' equity, its consolidated sources and uses of good faith qard fund, and its consolidated sources and uses of zakah and charity fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Report on other regulatory requirements

As required by the Bahrain Commercial Companies Law and Volume 2 of the Central Bank of Bahrain Rule Book, we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;

b) the financial information contained in the chairman's statement is consistent with the consolidated financial statements;

c) we are not aware of any violations during the year of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, the Bahrain Bourse rules and procedures or the terms of the Bank's memorandum and articles of association that would have had a material adverse effect on the business of the Bank or on its financial position; and

d) satisfactory explanations and information have been provided to us by management in response to all our requests.

KPMG Fakhro
Partner Registration No. 100
12 February 2017

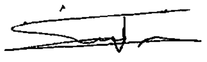
Consolidated Statement of Financial Position

As at 31 December 2016

	Note	**2016 BD'000**	2015 BD'000
ASSETS			
Cash and balances with banks and Central Bank	3	**63,208**	61,114
Placements with financial institutions	4	**63,805**	73,150
Financing assets	5	**526,637**	475,648
Investment securities	6	**145,731**	130,635
Ijarah Muntahia Bittamleek	8	**151,752**	113,938
Ijarah rental receivables	9	**8,618**	19,815
Investment in associates	7	**26,487**	28,116
Investment in real estate	11	**28,066**	43,601
Property and equipment	10	**15,881**	16,640
Other assets	12	**12,003**	13,691
TOTAL ASSETS		**1,042,188**	976,348
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			
Liabilities			
Placements from financial institutions		**103,874**	93,516
Customers' current accounts		**152,647**	157,300
Other liabilities	13	**14,879**	16,616
Total Liabilities		**271,400**	267,432
Equity of Investment Accountholders	14	**654,316**	599,404
Owners' Equity			
Share capital	15	**101,339**	97,441
Treasury shares	15	**(563)**	(563)
Shares under employee share incentive scheme		**(604)**	(879)
Share premium		**56**	2,794
Reserves		**16,244**	10,719
Total Owners' Equity		**116,472**	109,512
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY		**1,042,188**	976,348

The consolidated financial statements, which consist of pages 56 to 89, were approved by the Board of Directors on 12 February 2017 and signed on its behalf by:

Dr. Esam Abdulla Fakhro
Chairman



Khalid Mohammed Al Mannai
Vice Chairman

Hassan Amin Jarrar
Chief Executive Officer

The attached notes 1 to 33 form an integral part of these consolidated financial statements.

Consolidated Statement of Income

For the year ended 31 December 2016

	Note	**2016 BD'000**	2015 BD'000
INCOME			
Income from financing	18	**34,881**	33,530
Income from investment in Sukuk		**4,096**	3,659
Total income from jointly financed assets		**38,977**	37,189
Return on equity of investment accountholders		**(29,301)**	(29,961)
Group's share as Mudarib		**22,170**	24,774
Net return on equity of investment accountholders	14.5	**(7,131)**	(5,187)
Group's share of income from jointly financed assets (both as mudarib and investor)		**31,846**	32,002
Expense on placements from financial institutions		**(1,225)**	(546)
Fee and commission income		**6,768**	5,955
Income from investment securities	19	**739**	739
Income from investment in real estate	20	**(563)**	1,194
Share of results of associates, net	7	**(437)**	(711)
Other income	21	**4,544**	3,086
Total income		**41,672**	41,719
EXPENSES			
Staff costs		**11,181**	10,212
Depreciation	10	**1,519**	1,554
Other expenses	22	**10,820**	9,795
Total expenses		**23,520**	21,561
Profit before impairment allowances		**18,152**	20,158
Impairment provisions on financing, net	23.1	**(2,091)**	(5,203)
Impairment provisions on investments, net	23.2	**(7,641)**	(3,750)
PROFIT FOR THE YEAR		**8,420**	11,205
BASIC AND DILUTED EARNINGS PER SHARE (fils)	25	**8.41**	13.36

Dr. Esam Abdulla Fakhro	**Khalid Mohammed Al Mannai**	**Hassan Amin Jarrar**
Chairman	Vice Chairman	Chief Executive Officer

The attached notes 1 to 33 form an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2016

	Note	**2016 BD'000**	2015 BD'000
OPERATING ACTIVITIES			
Profit for the year		**8,420**	11,205
Adjustments for non-cash items:			
Depreciation	10	**1,519**	1,554
Impairment provisions on financing, net	23.1	**2,091**	5,203
Impairment provisions on investments, net	23.2	**7,641**	3,750
Impairment charge on investment in real estate	20	**82**	339
Loss / (gain) on sale of investment in real estate	20	**843**	(1,166)
Share of results of associates, net	7	**437**	711
Gain on disposal of property and equipment		**-**	(72)
Operating profit before changes in operating assets and liabilities		**21,033**	21,524
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain		**300**	(3,010)
Financing assets		**(52,789)**	(71,256)
Ijarah Muntahia Bittamleek		**(26,697)**	(19,165)
Other assets		**1,822**	(8,885)
Customers' current accounts		**(4,653)**	3,821
Other liabilities		**(1,711)**	102
Placements from financial institutions		**10,358**	17,946
Equity of investment accountholders		**54,912**	48,859
Net cash from / (used in) operating activities		**2,575**	(10,064)
INVESTING ACTIVITIES			
Purchase of investment in real estate		**-**	(1,092)
Disposal of investment in real estate		**12,868**	11,980
Purchase of investment securities		**(51,681)**	(52,546)
Purchase of property and equipment		**(760)**	(1,481)
Disposal of property and equipment		**-**	506
Proceeds from disposal of investment securities		**30,073**	43,382
Net cash (used in) / from investing activities		**(9,500)**	749
FINANCING ACTIVITIES			
Rights issue		**-**	19,888
Dividends paid		**(26)**	(4)
Net cash (used in) / from financing activities		**(26)**	19,884
NET CHANGE IN CASH AND CASH EQUIVALENTS		**(6,951)**	10,569
Cash and cash equivalents at 1 January		**97,687**	87,118
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		**90,736**	97,687
Cash and cash equivalents at year end comprise of:			
Cash on hand	3	**12,829**	12,011
Balances with CBB, excluding mandatory reserve deposits	3	**3,877**	4,936
Balances with banks and other financial institutions excluding restricted balances	3	**10,225**	7,590
Placements with financial institutions with original maturities less than 90 days	4	**63,805**	73,150
		90,736	97,687

The attached notes 1 to 33 form an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Owners' Equity

For the year ended 31 December 2016

					Reserves								
	Share capital BD'000	Treasury shares BD'000	Shares under employee share incentive scheme BD'000	Share premium BD'000	Statutory reserve BD'000	General reserve BD'000	Real estate fair value reserve BD'000	Investments fair value reserve BD'000	Retained earnings / (accumulated losses) BD'000	Total reserves BD'000	Equity attributable to owners of the parent BD'000	Non-controlling interest BD'000	Total owners' equity BD'000
Balance at 1 January 2016	**97,441**	**(563)**	**(879)**	**2,794**	**1,121**	**-**	**7,085**	**621**	**1,892**	**10,719**	**109,512**	**-**	**109,512**
Profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**8,420**	**8,420**	**8,420**	**-**	**8,420**
Bonus shares	**3,898**	**-**	**(23)**	**(2,794)**	**-**	**-**	**-**	**-**	**(1,081)**	**(1,081)**	**-**	**-**	**-**
Shares allocated during the year	**-**	**-**	**298**	**56**	**-**	**-**	**-**	**-**	**-**	**-**	**354**	**-**	**354**
Net movement in investments fair value reserve	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(90)**	**-**	**(90)**	**(90)**	**-**	**(90)**
Net movement in real estate fair value reserve	**-**	**-**	**-**	**-**	**-**	**-**	**(1,724)**	**-**	**-**	**(1,724)**	**(1,724)**	**-**	**(1,724)**
Transfer of profit to statutory reserve	**-**	**-**	**-**	**-**	**842**	**-**	**-**	**-**	**(842)**	**-**	**-**	**-**	**-**
Balance at 31 December 2016	**101,339**	**(563)**	**(604)**	**56**	**1,963**	**-**	**5,361**	**531**	**8,389**	**16,244**	**116,472**	**-**	**116,472**
Balance at 1 January 2015	93,967	(563)	-	-	11,809	1,000	7,361	1,101	(35,591)	(14,320)	79,084	11	79,095
Profit for the year	-	-	-	-	-	-	-	-	11,205	11,205	11,205	-	11,205
Shares issued during the year	940	-	(940)	-	-	-	-	-	-	-	-	-	-
Shares allocated during the year	-	-	61	30	-	-	-	-	-	-	91	-	91
Rights issue	17,094	-	-	2,794	-	-	-	-	-	-	19,888	-	19,888
Write off of accumulated losses	(14,560)	-	-	(30)	(11,809)	(1,000)	-	-	27,399	14,590	-	-	-
Net movement in investments fair value reserve	-	-	-	-	-	-	-	(480)	-	(480)	(480)	-	(480)
Net movement in real estate fair value reserve	-	-	-	-	-	-	(276)	-	-	(276)	(276)	-	(276)
Transfer of profit to statutory reserve	-	-	-	-	1,121	-	-	-	(1,121)	-	-	-	-
Net movement in non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	(11)	(11)
Balance at 31 December 2015	97,441	(563)	(879)	2,794	1,121	-	7,085	621	1,892	10,719	109,512	-	109,512

The attached notes 1 to 33 form an integral part of these consolidated financial statements.

Consolidated Statement of Sources and Uses of Good Faith Qard Fund

For the year ended 31 December 2016

	Qard Hasan receivables BD'000	Funds available for Qard Hasan BD'000	Total BD'000
Balance at 1 January 2016	**60**	**68**	**128**
Uses of Qard fund			
Marriage	**5**	**(5)**	**-**
Others (Waqf)	**21**	**(21)**	**-**
Total uses during the year	**26**	**(26)**	**-**
Repayments	**(21)**	**21**	**-**
Balance at 31 December 2016	**65**	**63**	**128**
Balance at 1 January 2015	80	48	128
Uses of Qard fund			
Marriage	9	(9)	-
Others (Waqf)	9	(9)	-
Total uses during the year	18	(18)	-
Repayments	(38)	38	-
Balance at 31 December 2015	60	68	128

	2016 BD'000	2015 BD'000
Sources of Qard fund		
Contribution by the Bank	**125**	125
Donation	**3**	3
	128	128

The attached notes 1 to 33 form an integral part of these consolidated financial statements.

Consolidated Statement of Sources and Uses of Zakah and Charity Fund

For the year ended 31 December 2016

	2016 BD'000	2015 BD'000
Sources of zakah and charity funds		
Undistributed zakah and charity funds at the beginning of the year	**472**	282
Non-Islamic income / late payment fee	**248**	616
Donations	**1**	-
Total sources of zakah and charity funds during the year	**721**	898
Uses of zakah and charity funds		
Philanthropic societies	**139**	103
Aid to needy families	**360**	323
Total uses of funds during the year	**499**	426
Undistributed zakah and charity funds at the end of the year	**222**	472

The attached notes 1 to 33 form an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

31 December 2016

1. REPORTING ENTITY

Bahrain Islamic Bank B.S.C. (the "Bank") was incorporated in the Kingdom of Bahrain in 1979 by Amiri Decree No.2 of 1979 and registered with the Ministry of Industry and Commerce ("MOIC") under Commercial Registration (CR) number 9900, to carry out banking and other financial trading activities in accordance with the teachings of Islam (Shari'a). The Bank operates under an Islamic retail banking license issued by the Central Bank of Bahrain ("CBB"). The Bank's Shari'a Supervisory Board is entrusted to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities. The Bank is listed on the Bahrain Bourse.

The Bank's registered office is at Building 722, Road 1708, Block 317, Manama, Kingdom of Bahrain.

The Bank has nine branches (2015: ten), all operating in the Kingdom of Bahrain.

The consolidated financial statements include the results of the Bank and its subsidiaries (together the "Group"). The Bank holds 100% of the share capital of Abaad Real Estate Company B.S.C. (c).

Abaad Real Estate Company B.S.C. (c) ("Abaad")

Abaad was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorised and fully paid-up share capital of BD 25 million. Abaad started operations in 2007. The main activity of Abaad is investment in real estate (in accordance with the Islamic Shari'a rules and principles).

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors issued on 12 February 2017.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting polices applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous years.

a. New standards, amendments, and interpretations

New standards, amendments, and interpretations effective from 1 January 2016:

FAS 27 – Investments Accounts

FAS 27 Investments accounts was issued in December 2014 replacing FAS 5 – 'Disclosures of Bases for Profit Allocation between Owner's Equity and Investment Account Holders' and FAS 6 – 'Equity of Investment Account Holders and their Equivalent'. This standard is effective for financial periods beginning 1 January 2016. The adoption of this standard did not have a significant impact on the financial statements of the Group. Additional disclosures are set out in note 14.

New standards, amendments and interpretations issued but not yet effective

No new standards, amendments to standards and interpretations have been issued but not yet effective for annual periods beginning on or after 1 January 2017.

Early adoption

The Group did not early adopt any new standards during the year.

b. Statement of Compliance

The consolidated financial statements are prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), and the Bahrain Commercial Companies Law. In accordance with the requirements of AAOIFI, for matters for which no AAOIFI standard exists, the Group uses guidance from the relevant International Financial Reporting Standards ("IFRS") issued by International Accounting Standards Board.

c. Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for "investment in real estate", "equity type instruments carried at fair value through equity" and "equity type instruments carried at fair value through income statement" that have been measured at fair value.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 2 dd.

The consolidated financial statements have been presented in Bahraini Dinars ("BD"), which is also the functional currency of the Group's operations. All the values are rounded to the nearest BD thousand except when otherwise indicated.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

d. Basis of consolidation

Subsidiaries are all entities (including special purpose entities) controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group to the date that control seizes.

The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All intra-group balances, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

e. Cash and cash equivalents

For the purpose of the consolidated cash flows statement, "cash and cash equivalents" consist of cash on hand, balances with the Central Bank of Bahrain excluding mandatory reserve deposits, balances with banks and other financial institutions and placements with financial institutions with original maturities of 90 days or less when acquired.

f. Placements with financial institutions

Placements with financial institutions comprise commodity Murabaha receivables and Wakala receivables. Commodity Murabaha receivables are stated at amortised cost net of deferred profits and provision for impairment, if any. Wakala receivables are stated at amortised cost less provision for impairment, if any.

g. Financing assets

Financing assets comprise Shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha and Musharaka. Financing assets are recognised on the date at which they are originated and carried at their amortised cost less impairment allowance, if any.

h. Murabaha financing

Murabaha financing consist mainly of deferred sales transactions (Murabaha) which are stated net of deferred profits and provisions for impairment, if any.

Murabaha financing are sales on deferred terms. The Group arranges a Murabaha transaction by buying a commodity (which represents the object of the Murabaha) and then resells this commodity to a Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus profit margin) is repaid in instalments by the Murabeh over the agreed period.

i. Musharaka financing

Musharaka financing are stated at the fair value of consideration given less impairment, if any.

Musharaka financing are a form of capital partnership. Musharaka financing capital provided by the Group at inception in kind (if other than cash) is measured at the fair value of the assets. If the valuation of the assets results in a difference between fair value and book value, such difference is recognised as profit or loss to the Group.

j. Investment securities

Investment securities comprise debt type instruments carried at amortised cost, equity type instruments carried at fair value through equity.

All investments securities, are initially recognised at fair value, being the value of the consideration given including transaction costs directly attributable to the acquisition, except in the case of investments carried at fair value through income statement, where transaction costs are expensed in the consolidated income statement.

Debt type instruments carried at amortised cost

These are investments which have fixed or determinable payments of profit and capital. Subsequent to initial recognition, these are measured at amortised cost using the effective profit rate method less impairment, if any. Any gain or loss on such instruments is recognised in the consolidated income statement when the instruments are de-recognised or impaired.

Equity type instruments carried at fair value through equity

Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence residual interest in the assets of entity after reducing all its liabilities. On initial recognition equity-type instruments that are not designated to fair value through income statement shall be classified as investments at fair value through equity.

Subsequent to acquisition, these are remeasured at fair value, with unrealised gains and losses recognised in a separate component of equity until the investment is derecognised or the investment is considered as impaired. On derecognition or impairment, the cumulative gain or loss previously recorded in equity is recognised in the consolidated income statement for the year.

Impairment losses on equity type instruments carried at fair value through equity are not reversed through the consolidated income statement and increases in their fair value after impairment are recognised directly in owners' equity.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

k. Measurement principles

Fair value measurement

For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the reporting date.

For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument, which is substantially the same or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group at current profit rates for contracts with similar terms and risk characteristics.

Investments classified at fair value through equity where there is no quoted price or the Bank is unable to determine a reliable measure of fair value on a continuing basis, such investments are stated at cost less impairment allowances.

Amortised cost

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectability. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

l. Investment in associates

Associates are all entities in which the Group holds, between 20% and 50% of the voting rights and exercises significant influence, but not control or joint control, over the financial and operating policies of the entities. Investment in associates are accounted for using the equity method of accounting.

Investments in associates are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor’s share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor’s proportionate interest in the investee arising from the changes in the investee’s equity. When the Group’s share of losses exceeds its interest in an associate, the Group’s carrying amount is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investments in associates are impaired. If this is the case the Group calculates the amount of impairment as being the difference between the recoverable amount of the associates and the carrying value and recognises this amount in the consolidated income statement.

Accounting policies of the associates are consistent with the policies adopted by the Group.

m. Ijarah Muntahia Bittamleek

Ijarah Muntahia Bittamleek are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each reporting date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rental receivables) and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

n. Investment in real estate

Properties held for rental, or for capital appreciation purposes, or both, are classified as investment in real estate. Investments in real estate are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, investments in real estate are re-measured to fair value and changes in fair value (only gains) are recognised as property fair value reserve in the consolidated statement of changes in owners' equity.

Losses arising from changes in the fair values of investment in real estate are firstly adjusted against the property fair value reserve to the extent of the available balance and then the remaining losses are recognised in the consolidated income statement. If there are unrealised losses that have been recognised in the consolidated income statement in previous financial periods, the current period unrealised gain shall be recognised in the consolidated income statement to the extent of crediting back such previous losses in the consolidated income statement. When the property is disposed of, the cumulative gain previously transferred to the property fair value reserve, is transferred to the consolidated income statement.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

o. Property and equipment

Property and equipment is recognised at cost. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated income statement as incurred. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets as follows;

Buildings	25 to 35 years
Fixtures and fittings	5 years
Equipment	5 years
Furniture	5 years

p. Equity of investment accountholders

Equity of investment account holders are funds held by the Bank in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.
The Bank charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income as a Mudarib. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts. Only profits earned on pool of assets funded from IAH are allocated between the owners' equity and IAH.

Only the income earned on pool of assets funded from IAH are allocated between the owners' equity and investment account holders.

Investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves, if any. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of any of these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

q. Investment risk reserve

Investment risk reserves are amounts appropriated out of the income of equity of investment accountholders, after allocating the Mudarib share, in order to cater for future losses for equity of investment accountholders.

r. Profit equalisation reserve

The Group appropriates a certain amount in excess of the profit to be distributed to equity of investment accountholders after taking into consideration the Mudarib share of income. This is used to maintain a certain level of return on investment for equity of investment accountholders.

s. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 issued by AAOIFI using the net invested funds method. Zakah is paid by the Group based on the consolidated figures of statutory reserve, general reserve and retained earning balances at the beginning of the year. The remaining Zakah is payable by individual shareholders. Payment of Zakah on equity of investment accountholders and other accounts is the responsibility of investment accountholders.

t. Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

u. Dividends and board remuneration

Dividends are recognised as liabilities in the year in which they are declared / approved by the shareholders.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

v. Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the right to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the assets, but has transferred control of the asset; or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

Financial liabilities

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

w. Treasury shares

These are own equity instruments of the Group which are reacquired through its own broker. Treasury shares are deducted from equity and accounted for at weighted average cost. Consideration paid or received on the purchase or sale of the Group's own equity instruments is recognised directly in equity. No gain or loss is recognised in consolidated income statement on the purchase, sale, issue or cancellation of own equity instruments.

x. Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where the Group uses these funds for social welfare activities.

y. Offsetting

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legal or religious enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

z. Income recognition

Murabaha and Wakala

Income from Murabaha and Wakala contracts is recognised on a time-apportioned basis over the period of the contract using the effective profit rate method.

Musharaka

Profit or losses in respect of the Bank's share in Musharaka financing transaction that commence and end during a single financial period is recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the Musharaka agreement.

Sukuk

Income from Sukuk is recognised using the effective profit rate over the term of the instrument.

Placements with financial institutions

Income on placements from financial institutions is recognised proportionately over the period of the contract based on the principal amounts outstanding and the profit agreed with clients.

Ijarah Muntahia Bittamleek

Income from Ijarah Muntahia Bittamleek is recognised proportionately over the lease term.

Dividends income

Dividend is recognised when the right to receive payment is established.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

z. Income recognition (Continued)

Fee and commission income

Fees and commission income that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

aa. Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Bahraini Dinars at the rate of exchange ruling at the consolidated statement of financial position date. All differences are taken to the consolidated income statement.

Translation gains or losses on non-monetary items carried at fair value are included in owners' equity as part of the fair value adjustment.

bb. Impairment of financial assets

An assessment is made at each consolidated financial position date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on the terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrower or issuers in the group or economic conditions that correlate with the defaults in the group. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the estimated cash equivalent value, is recognised in the consolidated income statement. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted. Impairment is determined as follows:

(a) For equity-type securities carried at fair value through equity, a significant or prolonged decline in fair value below its cost is an objective evidence of impairment. If such evidence exists, impairment is measured as the difference between acquisition cost and current fair value, less any impairment loss previously recognised in the consolidated income statement.

For equity type instruments carried at fair value through equity, impairment losses recognised in the consolidated income statement are subsequently reversed through equity.

For investments classified at fair value through equity but carried at cost less impairment due to the absence of reliable fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the carried value of the investment.

(b) For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

These include debt-type instruments, financing assets and receivables. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific assets and collective level. When the Group considers that there are no realistic prospects of recovery of the asset, the relevant accounts are written off. If the amount of impairment loss subsequently decreases and decrease can be related objectively to an event occurring after impairment was recognized, then the previously recognised impairment loss is reversed through income statement.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar credit risk characteristics. In assessing collective impairment the Group uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

cc. Use of estimates and judgements in preparation of the consolidated financial statements

In the process of applying the Group's accounting policies, management has made estimates and judgements in determining the amounts recognised in the consolidated financial statements. The most significant use of judgements and estimates are as follows:

Going concern

The Bank's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

Classification of investments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as debt type instruments carried at fair value through equity or amortised cost, or equity-type instruments carried at fair value through equity or fair value through income statement. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [refer note 2.j].

Impairment of equity investments

The Group determines that equity securities carried at fair value through equity are impaired when there is a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 9 months as prolonged.

For unquoted equity investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment. In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

Impairment of financing assets

Financing assets are evaluated for impairment on a basis described in accounting policy, refer to note 2.bb. Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets/ collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

For the purposes of a collective evaluation of impairment, financing assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Group's grading process that considers asset type, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

dd. Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

ee. Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Bank. The transactions are measured at the cash equivalent amount received by the Bank at the time of transaction are measured at the cash equivalent amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

ff. Employees' benefits

i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus as profit sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

ff. Employees' benefits (Continued)

ii) Post-employment benefits

Pension and other benefits for Bahraini employees are covered by Social Insurance Organisation Scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in income statement when they are due.

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under Bahraini labour law, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the reporting date.

These benefits are in the nature of "defined benefits scheme" and any increase or decrease in the benefit obligation is recognised in the Income Statement.

The Bank also operates a voluntary employee saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by the Board of trustees who are employees of the Bank. The scheme is in the nature of defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

iii) Share based employee incentive scheme

The grant-date fair value of equity settled share-based payment arrangements granted to employees is generally recognised as an expense, with a corresponding increase in equity, over the vesting period of the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

For share based awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

gg. Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

hh. Repossessed assets

In certain circumstances, property is repossessed following the foreclosure on financing facilities that are in default. Repossessed properties are measured at the lower of carrying amount and fair value less costs to sell and reported within 'other assets'.

ii. Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10 per cent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 percent of the paid up share capital.

jj. URIA protection scheme

Investment accounts held with the Bank's Bahrain operations are covered by the regulation protecting URIA issued by the Central Bank of Bahrain in accordance with Resolution No (34) of 2010. The scheme applies to all eligible accounts held with Bahrain offices of the Bank subject to specific exclusions, maximum total amount entitled and other regulations governing the establishment of a URIA Protection Scheme and a URIA Protection Board.

3. CASH AND BALANCES WITH BANKS AND CENTRAL BANK

	2016 **BD'000**	2015 BD'000
Cash on hand	**12,829**	12,011
Balances with CBB, excluding mandatory reserve deposits	**3,877**	4,936
Balances with banks and other financial institutions	**12,737**	10,102
	29,443	27,049
Mandatory reserve with CBB	**33,765**	34,065
	63,208	61,114

The mandatory reserve with CBB is not available for use in the day-to-day operations.

Balances with banks and other financial institutions includes an amount of BD 2,512 thousand which is not available for use in the day-to-day operations.

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	2016 BD'000	2015 BD'000
Commodity Murabaha	**43,511**	59,116
Deferred profits	**(27)**	(7)
	43,484	59,109
Wakala	**20,321**	14,041
	63,805	73,150

5. FINANCING ASSETS

	2016 BD'000	2015 BD'000
Murabaha (note 5.1)	**417,098**	371,881
Musharaka (note 5.2)	**109,539**	103,767
	526,637	475,648

5.1 Murabaha

	2016 BD'000	2015 BD'000
Tasheel	**225,868**	226,578
Tawarooq	**136,348**	128,068
Altamweel Almaren	**68,355**	41,008
Letters of credit refinance	**29,198**	18,343
Motor vehicles Murabaha	**13,058**	14,769
Credit cards	**15,894**	13,920
Others	**70**	230
	488,791	442,916
Qard fund	**65**	60
Gross receivables	**488,856**	442,976
Deferred profits	**(45,781)**	(46,808)
Provision for impairment	**(25,977)**	(24,287)
	417,098	371,881

Non-performing Murabaha financing outstanding as of 31 December 2016 amounted to BD 30,951 thousand (2015: BD 19,011 thousand).

The Group considers the promise made in the Murabaha to the purchase orderer as obligatory.

The composition of the Murabaha financing portfolio before provision for impairment by sector is as follows:

	2016 BD'000	2015 BD'000
Commercial	**73,780**	51,094
Financial institutions	**16,214**	4,530
Others including retail	**353,082**	340,544
	443,076	396,168

The Group exposures of Murabaha financing portfolio is concentrated in Middle East.

5.2 Musharaka

	2016 BD'000	2015 BD'000
Musharaka in real estate	**110,263**	106,761
Provision for impairment	**(724)**	(2,994)
	109,539	103,767

Non-performing Musharaka financing outstanding as of 31 December 2016 amounted to BD 4,731 thousand (2015: BD 4,938 thousand).

6. INVESTMENT SECURITIES

	2016 BD'000	2015 BD'000
i) Debt type instruments		
Quoted Sukuk - carried at amortised cost		
Balance at 1 January	**20,486**	18,819
Acquisitions	**41,254**	2,740
Disposals and redemptions	**(114)**	(1,073)
Balance at 31 December	**61,626**	20,486
Unquoted Sukuk - carried at amortised cost		
Balance at 1 January	**80,295**	66,989
Acquisitions	**10,427**	49,806
Disposals and redemptions	**(29,959)**	(36,500)
	60,763	80,295
Provision for impairment	**(9,106)**	(4,914)
Balance at 31 December	**51,657**	75,381
ii) Equity type instruments		
Quoted shares - at fair value through equity		
Balance at 1 January	**2,392**	2,392
Provision for impairment	**(1,704)**	(1,373)
Balance at 31 December	**688**	1,019
Unquoted shares - at cost less impairment		
At 1 January	**24,963**	29,201
Write off	**-**	(4,238)
Provision for impairment	**(7,371)**	(5,418)
Balance at 31 December	**17,592**	19,545
Unquoted managed funds - at cost less impairment		
Balance at 1 January	**14,444**	36,541
Foreign currency translation changes	**(36)**	(301)
Disposals	**-**	(5,809)
Write off	**(240)**	(15,987)
Provision for impairment	**-**	(240)
Balance at 31 December	**14,168**	14,204
Total net investment securities	**145,731**	130,635

7. INVESTMENT IN ASSOCIATES

	2016 BD'000	2015 BD'000
At 1 January	**28,116**	30,835
Share of results of associates, net	**(437)**	(711)
Share of changes in investee's equity	**(92)**	(366)
Provision for impairment	**(1,100)**	(1,642)
At 31 December	**26,487**	28,116

Summarised financial information of associates that have been equity accounted in these consolidated financial statements, not adjusted for percentage of ownership held by the Group:

	2016 BD'000	2015 BD'000
Total assets	**209,079**	217,141
Total liabilities	**79,670**	85,954
Total revenues	**5,925**	9,057
Total net loss	**(856)**	(51)

7. INVESTMENT IN ASSOCIATES (Continued)

Investment in associates comprise:

Name of associate	Ownership %	Country of incorporation	Nature of business
Takaful International Company B.S.C.*	22.75%	Bahrain	Takaful International Company B.S.C. was incorporated in 1989, and carries out Takaful and Retakaful activities in accordance with the teachings of Islamic Shari'a under a license issued by the Central bank of Bahrain, the regulator
Liquidity Management Centre B.S.C. (c)	25.00%	Bahrain	Liquidity Management Centre B.S.C. (c) was incorporated in 2002 as a bank, licensed and regulated by the Central Bank of Bahrain to facilitate the creation of an Islamic inter-bank market that allow Islamic financial services institutions to effectively manage their assets and liabilities.
Arabian C Real Estate Company	19.00%	Kuwait	Arabian C Real Estate Company is a Kuwaiti Shareholding Company incorporated in accordance with the Kuwaiti Commercial Companies law. The company's activity focuses on real estate development and the overall management of a variety of strategic investments in the real estate and infrastructure sectors in GCC/MENA region.
Al Dur Energy Investment Company	29.41%	Bahrain	Al Dur Energy Investment Company is an exempt company with limited liability incorporated in the Cayman Islands on 10 June 2009 and operates under registration number 227032. The company operates in the Kingdom of Bahrain with the sole purpose of holding a 15% indirect interest in a power and water plant project company, Al Dur Power and Water Company B.S.C.(c), in the Kingdom of Bahrain.

* Takaful International Company B.S.C. is a listed company on the Bahrain Bourse. The latest available quoted price of BD 0.100 per share was as of 22 April 2015, no further trades have taken place on the company's shares since that date. The estimate fair value of the investment based on this price is BD 1,422 thousand (2014: BD 2,062 thousand).

8. IJARAH MUNTAHIA BITTAMLEEK

	2016				2015			
	Properties BD'000	Aviation related assets BD'000	Others BD'000	Total BD'000	Properties BD'000	Aviation related assets BD'000	Others BD'000	Total BD'000
Cost:								
At 1 January	**147,165**	**7,540**	**3,253**	**157,958**	124,749	7,540	6,130	138,419
Additions	**47,648**	**-**	**-**	**47,648**	42,464	-	-	42,464
Settlements / adjustments	**(16,439)**	**-**	**(750)**	**(17,189)**	(20,048)	-	(2,877)	(22,925)
At 31 December	**178,374**	**7,540**	**2,503**	**188,417**	147,165	7,540	3,253	157,958
Accumulated depreciation:								
At 1 January	**35,087**	**7,540**	**1,393**	**44,020**	47,031	7,540	3,990	58,561
Charge for the year	**10,495**	**-**	**1,110**	**11,605**	10,749	-	-	10,749
Settlements / adjustments	**(11,646)**	**(7,314)**	**-**	**(18,960)**	(22,693)	-	(2,597)	(25,290)
At 31 December	**33,936**	**226**	**2,503**	**36,665**	35,087	7,540	1,393	44,020
Net book value:								
As at 31 December	**144,438**	**7,314**	**-**	**151,752**	112,078	-	1,860	113,938

9. IJARAH RENTAL RECEIVABLES

	2016 BD'000	2015 BD'000
Gross Ijarah rental receivables	**21,888**	33,005
Provision for impairment	**(13,270)**	(13,190)
	8,618	19,815

Non-performing Ijarah rental receivables as of 31 December 2016 is BD 17,630 thousand (2015: BD 31,452 thousand).

10. PROPERTY AND EQUIPMENT

	2016						
	Lands BD'000	**Buildings BD'000**	**Fixture and fitting BD'000**	**Equipment BD'000**	**Furniture BD'000**	**Work in progress BD'000**	**Total BD'000**
Cost:							
At 1 January	**6,755**	**7,651**	**3,695**	**9,782**	**869**	**516**	**29,268**
Additions	**-**	**-**	**119**	**585**	**14**	**42**	**760**
At 31 December	**6,755**	**7,651**	**3,814**	**10,367**	**883**	**558**	**30,028**
Depreciation:							
At 1 January	**-**	**1,699**	**2,853**	**7,393**	**683**	**-**	**12,628**
Charge for the year	**-**	**263**	**291**	**905**	**60**	**-**	**1,519**
At 31 December	**-**	**1,962**	**3,144**	**8,298**	**743**	**-**	**14,147**
Net Book Value	**6,755**	**5,689**	**670**	**2,069**	**140**	**558**	**15,881**

	2015						
	Lands BD'000	Buildings BD'000	Fixture and fitting BD'000	Equipment BD'000	Furniture BD'000	Work in progress BD'000	Total BD'000
Cost:							
At 1 January	7,143	7,387	3,393	9,065	823	410	28,221
Additions	-	264	302	763	46	106	1,481
Disposals	(388)	-	-	(46)	-	-	(434)
At 31 December	6,755	7,651	3,695	9,782	869	516	29,268
Depreciation:							
At 1 January	-	1,439	2,517	6,550	614	-	11,120
Charge for the year	-	260	336	889	69	-	1,554
Relating to disposed assets	-	-	-	(46)	-	-	(46)
At 31 December	-	1,699	2,853	7,393	683	-	12,628
Net Book Value	6,755	5,952	842	2,389	186	516	16,640

11. INVESTMENT IN REAL ESTATE

	2016 BD'000	2015 BD'000
Land	**25,777**	41,006
Buildings	**2,289**	2,595
	28,066	43,601

	2016 BD'000	2015 BD'000
At 1 January	**43,601**	53,934
Capitalized expediture	**-**	1,092
Disposal	**(13,728)**	(10,814)
Fair value changes	**(1,807)**	(611)
At 31 December	**28,066**	43,601

Investment in real estate comprises properties located in the Kingdom of Bahrain and the United Arab Emirates.

Investment in real estate held for capital appreciation is stated at fair value as at 31 December, which has been determined based on valuations performed by independent third party property valuers who have the qualification and experience of valuing similar properties in the same location. Fair value of Investments in real estate is calssified as category 2 of fair value hierarchy.

12. OTHER ASSETS

	2016 BD'000	2015 BD'000
Repossessed assets	**6,916**	5,245
Receivables	**2,438**	4,761
Staff advances	**1,665**	1,324
Prepaid expenses	**945**	696
Other	**39**	1,665
	12,003	13,691

13. OTHER LIABILITIES

	2016 BD'000	2015 BD'000
Managers' cheques	**4,748**	3,786
Payable to vendors	**2,837**	1,626
Accrued expenses	**2,990**	3,312
Life insurance (Takaful) fees payable	**1,568**	1,844
Dividends payable	**776**	802
Zakah and charity fund	**222**	472
Other	**1,738**	4,774
	14,879	16,616

14. EQUITY OF INVESTMENT ACCOUNTHOLDERS

The Group comingles the Investment account holders' (IAH) funds with the owners' equity. In line with its policy, the Group utilizes the funds from IAH to finance assets.

14.1 Equity of investment accountholders balances

	2016 BD'000	2015 BD'000
Type of Equity of Investment Accountholders		
Customer investment accounts		
Balances on demand	**313,612**	290,862
Contractual basis	**340,704**	308,542
	654,316	599,404

14.2 Assets in which IAH funds were invested

Assets in which IAH funds were invested as at 31 December are as follows:

	2016 BD'000	2015 BD'000
Asset		
Cash and balances with banks and Central Bank	**31,361**	29,086
Gross financing assets	**374,770**	342,998
Gross Ijarah Muntahia Bittamleek and rental receivables	**126,217**	118,826
Collective impairment	**(3,885)**	(4,450)
Investment securities	**113,750**	92,076
Investment in real estate	**3,196**	13,621
Other assets	**8,907**	7,247
	654,316	599,404

The Bank temporarily allocates non-performing assets (past due greater than 90 days) from IAH to the equity shareholders and charges the specific impairment provisions to the owners' equity. Amounts recovered from these impaired assets is not subject to allocation between the IAH and owners' equity. The Bank takes remedial action on these non-performing assets and once these assets become performing, the assets and related income are allocated between the IAH and owners' equity.

The Bank charges IAH with their share of collective impairment provisions on financing facilities not past due and past due less than 90 days.

During the year, the Bank did not charge any administration expenses to investment accounts.

14. EQUITY OF INVESTMENT ACCOUNTHOLDERS (Continued)

14.3 Profit distribution by account type

Following is the average percentage of profit allocation between the owner's accounts applied during the year for each type of IAH account and the percentage of funds invested in assets (utilization):

	2016			2015		
	Utilization	Mudhareb Share	Profit to IAH	Utilization	Mudhareb Share	Profit to IAH
Account type						
Tejoori	**90%**	**96.95%**	**2.69%**	90%	97.22%	2.42%
Savings	**90%**	**96.84%**	**2.80%**	90%	97.02%	2.59%
Vevo	**90%**	**97.12%**	**2.53%**	90%	97.21%	2.42%
Iqra	**100%**	**65.69%**	**32.02%**	100%	72.09%	26.43%
Time deposits	**100%**	**62.74%**	**35.03%**	100%	72.37%	26.16%

During the year, the Group did not increase its percentage of profits as mudarib. Further, the Group did not receive any incentive from profits of investment account holders.

The Group does not share profits with IAH resulting from investing current accounts and other funds received on the basis other than mudarba contract.

Funds from IAH are invested in assets on a priority basis.

14.4 Equity of Investment Accountholders Reserves

	2016 BD'000	Movement BD'000	2015 BD'000
Profit equalisation reserve	**1,245**	**250**	995
Investment risk reserve	**757**	**530**	227

14.5 Return on equity of investment accountholders

	2016 BD'000	2015 BD'000
Gross return to equity of investment accountholders	**30,081**	30,685
Allocation to profit equalization reserve	**(250)**	(600)
Group's share as a Mudarib	**(22,170)**	(24,774)
Allocation to investment risk reserve	**(530)**	(124)
Net return on equity of investment accountholders	**7,131**	5,187

15. OWNERS' EQUITY

		2016 BD'000	2015 BD'000
(i)	**Share capital**		
a)	*Authorised*		
	2,000,000,000 shares (2015: 2,000,000,000 shares) of BD 0.100 each	**200,000**	200,000
b)	*Issued and fully paid up*		
	1,013,389,130 shares (2015: 974,412,625 shares) of BD 0.100 each	**101,339**	97,441

(ii)	**Treasury Shares**	2016 Number of Shares	2016 BD'000	2015 BD'000
	At 31 December	**3,065,167**	**563**	563

	2016 BD'000
Cost of treasury shares	**563**
Market value of treasury shares	**377**

15. OWNERS' EQUITY (Continued)

The treasury shares as a percentage of total shares in issue is 0.37%.

Owners' equity instruments which are reacquired are deducted from equity. No gain or loss is recognised in the consolidated income statement on the purchase, sale, issue or cancellation of the Group's own equity instruments.

(iii) Reserves

Statutory reserve
A transfer has been made of BD 842 thousand (2015: 1,121 thousand) representing 10% of the profit for the year BD 8,420 thousand (2015: 11,205 thousand). The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of CBB.

General reserve
The general reserve is established in accordance with the articles of association of the Bank and is distributable following a resolution of shareholders at a general meeting and the approval of CBB. The Group may transfer any amount to the general reserve, as approved by the shareholders at a general meeting, out of the net income for the year after appropriating statutory reserve.

Real estate fair value reserve
This represents cumulative unrealised revaluation gains on investment in real estate. This reserve is transferred to the income statement upon sale of the investment in real estate.

Investment fair value reserve
This represents the net unrealised gains or losses on equity investments relating to self financed investments.

(iv) Additional information on shareholding pattern

1) Names and nationalities of the major shareholders and the number of shares in which they have an interest of 5% or more of outstanding shares:

		2016		2015	
Names	**Nationality**	**Number of shares**	**% holding**	Number of shares	% holding
National Bank of Bahrain	Bahraini	**294,482,159**	**29.06%**	283,155,923	29.06%
Social Insurance Organisation	Bahraini	**147,242,463**	**14.53%**	141,579,292	14.53%
Social Insurance Organisation					
- Military Pension Fund	Bahraini	**147,242,464**	**14.53%**	141,579,293	14.53%
Islamic Development Bank	Saudi	**146,117,221**	**14.42%**	140,497,329	14.42%
General Council of Kuwaiti Awaqaf	Kuwaiti	**72,729,830**	**7.18%**	69,932,530	7.18%

2) The Group has only one class of shares and the holders of these shares have equal voting rights.

3) Distribution schedule of shares, setting out the number and percentage of holders in the following categories:

	2016			2015		
	Number of shares	**Number of shareholders**	**% of total outstanding shares**	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	**145,893,657**	**3,266**	**14.39%**	140,197,699	3,376	14.39%
1% up to less than 5%	**59,769,380**	**3**	**5.90%**	57,470,559	3	5.90%
5% up to less than 10%	**72,641,786**	**1**	**7.18%**	69,932,530	1	7.18%
10% up to less than 50%	**735,084,307**	**4**	**72.54%**	706,811,837	4	72.53%
	1,013,389,130	**3,274**	**100.00%**	974,412,625	3,384	100.00%

15. OWNERS' EQUITY (Continued)

Details of Directors' interests in the Group's shares as at the end of the year were:

Categories:

	2016		2015	
	No. of shares	**No. of directors**	No. of shares	No. of directors
Less than 1%	**414,320**	**3**	438,632	4

The following is the number of shares, and percentage of shareholding of Directors, Shari'a supervisory members and senior management (Assistant General Managers and above):

	2016		2015	
	No. of shares	**Percentage of Shareholding**	No. of shares	Percentage of Shareholding
Directors	**414,320**	**0.041%**	438,632	0.045%
Shari'a supervisory members	**180,823**	**0.018%**	169,158	0.017%
Senior management	**418,496**	**0.041%**	603,537	0.062%
	1,013,639	**0.100%**	1,211,327	0.124%

v) Proposed appropriations

The Board of Directors propose the appropriation for zakah of BD 137 thousand in 2016 (2015: BD nil) and cash dividend of 5% amounting to BD 5,051 thousand (2015: bonus shares as dividends amoutning to BD 3,898 thousand) which are subject to regulatory and shareholders' approval in the ensuing Annual General Meeting.

16. COMMITMENTS AND CONTINGENT LIABILITIES

Credit related commitments

These include commitments to enter into financing contracts which are designed to meet the requirements of the Group's customers.

Letters of credit and guarantees commit the Group to make payments on behalf of customers.

The Group has the following credit related commitments and contingent liabilities on behalf of customers:

	2016 BD'000	2015 BD'000
Letters of credit and acceptances	**6,182**	2,918
Guarantees	**43,966**	40,971
Credit cards	**26,103**	45,883
Operating lease commitments *	**356**	1,238
	76,607	91,010

* The Group has entered into commercial leases for certain branches. The remaining average period of these leases ranges between 1 month and 3 years with renewal terms included in the contracts. Renewals are at the option of the Bank. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 December are as follows:

	2016 BD'000	2015 BD'000
Within one year	**3**	70
After one year but not more than five years	**353**	1,168
	356	1,238

17. CAPITAL ADEQUACY

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 or issue Sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

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17. CAPITAL ADEQUACY (Continued)

The Group's capital structure primarily consists of its paid-up capital, including share premium and reserves. From a regulatory perspective, a significant amount of the Group's capital is classified as Tier 1 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.

The Central Bank of Bahrain issued the final regulation to give effect to the Basel III framework which came into effect on 1 January 2015. The Basel III framework significantly revises the definition of regulatory capital. The framework emphasis common equity as the predominant component of tier 1 capital by adding a minimum common equity tier 1 (CET 1) capital ratio. The Basel III rules also require institutions to hold capital buffers. For the purpose of calculating CET 1 capital, the regulatory adjustments (deductions) including amounts above the aggregate limit for significant investments in financial institutions, mortgage servicing rights, and deferred tax assets from temporary differences, will be deducted from CET1 over a phased manner to be fully deducted by 1 January 2019. The Bank's current capital position is sufficient to meet the new regulatory capital requirements.

The classification of the Group's capital in accordance with the regulatory requirements is as follows:

	2016 BD'000	2015 BD'000
CET 1 Capital before regulatory adjustments	**111,111**	102,571
Less: regulatory adjustments	**-**	-
CET 1 Capital after regulatory adjustments	**111,111**	102,571
T 2 Capital adjustments	**11,961**	14,426
Regulatory Capital	**123,072**	116,997

To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardised Measurement Approach for its Market Risk. The capital requirements for these risks are as follows:

	2016 BD'000	2015 BD'000
Risk weighted exposure:		
Total Credit Risk Weighted Assets	**527,820**	587,023
Total Market Risk Weighted Assets	**12,226**	15,589
Total Operational Risk Weighted Assets	**66,722**	57,153
Total Regulatory Risk Weighted Assets	**606,768**	659,765
Investment risk reserve (30% only)	**227**	68
Equalization reserve (30% only)	**374**	299
Total Adjusted Risk Weighted Exposures	**606,167**	659,398
Capital Adequacy Ratio	**20.30%**	17.73%
Tier 1 Capital Adequacy Ratio	**18.33%**	15.55%
Minimum requirement	**12.5%**	12.5%

18. INCOME FROM FINANCING

	2016 BD'000	2015 BD'000
Income from Murabaha financing	**20,143**	19,889
Income from placements with financial institutions	**341**	139
Income from Musharaka financing	**6,300**	6,781
Income from Ijarah Muntahia Bittamleek	**8,097**	6,721
	34,881	33,530

19. INCOME FROM INVESTMENT SECURITIES

	2016 BD'000	2015 BD'000
Dividend income	**739**	739
	739	739

20. INCOME FROM INVESTMENT IN REAL ESTATE

	2016 BD'000	2015 BD'000
(Loss) / gain on sale	**(843)**	1,166
Rental income	**362**	367
Impairment charge	**(82)**	(339)
	(563)	1,194

21. OTHER INCOME

	2016 BD'000	2015 BD'000
Recoveries from previously written off financing	**3,499**	-
Foreign exchange (loss) / gain	**(1,001)**	1,222
Others	**2,046**	1,864
	4,544	3,086

22. OTHER EXPENSES

	2016 BD'000	2015 BD'000
Marketing and advertisement expenses	**2,670**	1,678
Information technology related expenses	**1,312**	1,016
Card Centre expenses	**1,203**	1,865
Premises and equipement expenses	**1,233**	1,259
Communication expenses	**952**	780
Professional services	**933**	620
Board remunerations	**300**	535
Board of directors sitting fees	**178**	125
Shari'a committee fees & remuneration	**85**	45
Others	**1,954**	1,872
	10,820	9,795

23. IMPAIRMENT PROVISIONS

23.1 Impairment provisions on financing

	Specific impairment		Collective impairment		Total	
	2016 BD'000	2015 BD'000	2016 BD'000	2015 BD'000	2016 BD›000	2015 BD'000
At 1 January	**29,145**	31,578	**11,326**	10,818	**40,471**	42,396
Charge for the year	**3,924**	7,003	**1,225**	1,119	**5,149**	8,122
Recoveries and write backs	**(3,058)**	(2,919)	**-**	-	**(3,058)**	(2,919)
	866	4,084	**1,225**	1,119	**2,091**	5,203
Amounts written off against provision	**(2,474)**	(6,517)	**(117)**	(611)	**(2,591)**	(7,128)
At 31 December	**27,537**	29,145	**12,434**	11,326	**39,971**	40,471

24. IMPAIRMENT PROVISIONS (Continued)

23.1 Impairment provisions on financing (Continued)

The above impairment provision relates to the following:

	2016 BD'000	2015 BD'000
Murabaha financing	**25,977**	24,287
Musharaka financing	**724**	2,994
Ijarah Muntahia Bittamleek	**13,270**	13,190
	39,971	40,471

23.2 Impairment provisions on investments

	2016 BD'000	2015 BD'000
At 1 January	**14,998**	33,418
Charge for the year *	**7,641**	4,925
Recoveries and write backs	**-**	(1,175)
	7,641	3,750
Amounts written off against provision	**(1,907)**	(21,817)
Foreign currency translation changes	**(43)**	(353)
At 31 December	**20,689**	14,998

* Impairment charge includes BD 1,100 thousand (2015: BD 1,642 thousand) impairment charge on investment in associate.

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2016 amounts to BD 97,468 thousand (31 December 2015: BD 112,863 thousand). The collateral consists of cash, securities and properties. The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

The Group has taken all the specific and investment provisions allocated to the non performing assets against its own capital. Hence the equity of investment accountholders was not charged for any specific and investment provision for impairment.

24. ZAKAH

The total Zakah payable as of 31 December 2016 amounted to BD 1,627 thousand (2015: BD 1,289 thousand) of which the Bank has BD 137 thousand Zakah payable (2015: BD nil) based on the statutory reserve, general reserve and retained earning as at 1 January 2016. The Zakah balance amounting to BD 1,490 thousand or 1.5 fils per share (2015: BD 1,289 thousand or 1.3 fils per share) is due and payable by the shareholders.

25. EARNINGS PER SHARE

Basic and diluted earnings per share is calculated by dividing the net profit or loss for the year by the weighted average number of shares during the year as follows:

	2016	2015
Profit for the year in BD'000	**8,420**	11,205
Weighted average number of shares	**1,001,030**	838,384
Basic and diluted earnings per share (fils)	**8.41**	13.36

Basic and diluted earnings per share are the same since the Group has not issued any instruments that would have a dilutive effect.

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26. RELATED PARTY TRANSACTIONS

Related parties comprise of major shareholders, directors of the Bank, senior management, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Bank. The transactions with these parties were made on commercial terms.

The significant balances and transactions with related parties at 31 December were as follows:

	2016				
	Shareholders BD'000	**Associates and joint ventures BD'000**	**Directors and related entities BD'000**	**Senior management BD'000**	**Total BD'000**
Assets					
Financing assets	**-**	**-**	**1,615**	**-**	**1,615**
Investment in associates	**-**	**26,487**	**-**	**-**	**26,487**
Other assets	**-**	**-**	**-**	**402**	**402**
Liabilities and Equity of investment accountholders					
Placements from financial institutions	**-**	**-**	**-**	**-**	**-**
Customers' current accounts	**-**	**1,719**	**431**	**152**	**2,302**
Other liabilities	**-**	**1,568**	**360**	**-**	**1,928**
Equity of investment accountholders	**65,656**	**602**	**1,218**	**1,142**	**68,618**
Income					
Income from financing	**-**	**-**	**86**	**-**	**86**
Share of results of associates, net	**-**	**(437)**	**-**	**-**	**(437)**
Return on equity of investment accountholders	**(658)**	**(5)**	**(15)**	**(35)**	**(713)**
Expense on placements from financial institutions	**(304)**	**-**	**-**	**-**	**(304)**
Expenses					
Other expenses	**-**	**-**	**(563)**	**(1,422)**	**(1,985)**

	2015				
	Shareholders BD'000	Associates and joint ventures BD'000	Directors and related entities BD'000	Senior management BD'000	Total BD'000
Assets					
Financing assets	-	-	2,074	17	2,091
Investment in associates	-	25,397	-	-	25,397
Other assets	-	-	-	201	201
Liabilities and Equity of investment accountholders					
Placements from financial institutions	37,700	-	-	-	37,700
Customers' current accounts	-	968	520	247	1,735
Other liabilities	-	1,844	-	-	1,844
Equity of investment accountholders	41,567	275	1,255	917	44,014
Income					
Income from financing	-	4	151	1	156
Share of results of associates	-	(711)	-	-	(711)
Return on equity of investment accountholders	(472)	(1)	(1)	(27)	(501)
Expense on placements from financial institutions	(248)	-	-	-	(248)
Expenses					
Other expenses	-	-	(705)	(1,009)	(1,714)

26. RELATED PARTY TRANSACTIONS (Continued)

Compensation of the key management personnel is as follows:
Key management personnel includes staff at the grade of assistant general manager or above.

	2016 BD'000	2015 BD'000
Short term employee benefits	**1,226**	849
Other long term benefits	**196**	160
	1,422	1,009

27. RISK MANAGEMENT

Introduction
Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. These risks and the processes to mitigate these risks have not significantly changed from the previous year.

The Group is exposed mainly to credit, liquidity, market and operational risks.

Risk management objectives
The risk management philosophy of the Group is to identify, 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 while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its risk strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Risk appetite of the Group is articulated in terms of the following dimensions:

1. Adequate capital level;
2. Stable profitability and growth;
3. Sufficient liquidity; and
4. Sound reputation.

Structure and Organization of the Risk Management Function
Risk Management Structure includes all levels of authorities, organizational structure, people and systems required for the effective functioning of risk management processes in the Group. The responsibilities associated with each level of the 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 the Executive Committee, Credit and Investment Committee, Chief Executive Officer and further delegation to the management to approve and review.

Executive Committee (EC) comprises of four designated members of the Board of Directors. The Executive Committee is delegated authority by the Board to manage the ongoing activities of the Group. Decisions are taken by the Executive Committee either at periodic meetings or if the need arises, by circulation.

Credit and Investment Committee (CIC): As delegated by the Board of Directors and as per approved terms of reference, the Committee has been delegated with authorities and responsibilities including, approving extension or renewal of credit facilities, granting temporary excesses to customers with credit facilities approved by the Board, approving early repayments of facilities, monitoring the performance and quality of the Group's credit portfolio and overseeing the administration and effectiveness of and compliance with, the Group's credit policies through the review of such processes, reports and other information as it deems appropriate.

27. RISK MANAGEMENT (Continued)

Risk Measurement and Reporting Systems

Based on the risk appetite, the Group has put in place various limits. These limits have been approved by the Board. Any limit breach is reported by the Risk Management Department (RMD) to the Credit Committee. The limits are reviewed and revised at least annually (or earlier if required).

a) Credit Risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss.

Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, such as obtaining collateral 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-performance of credit contracts through collaterals, netting agreements and guarantees.

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.

Notwithstanding the above, when facilities are extended to family owned limited liability entities, the following is normally obtained;

a. Collateral security, fully covering the exposure; or

b. Joint and several guarantees of shareholders directly involved in managing the entity as well as of shareholders owing at least 80% of the shares of the entity.

Third party guarantees in support of credit facilities are accepted only after review and approval of appropriate guarantor lines.

(i) Gross maximum exposure to credit risk

The market value of tangible collateral security is properly evaluated by the Group approved surveyors (for properties) or based on publicly available quotations. Only the amount of such security equivalent to the exposure is taken into account while considering credit facilities.

The CIC periodically reviews and approves the value of securities. It has also approved a list of acceptable securities.

The table below shows the gross maximum exposure to credit risk for the components of the consolidated statement of financial position, including credit related commitments. The figures represent gross exposure, without taking account of any collateral held or other credit enhancements.

	2016 **BD'000**	2015 BD'000
Balances with banks and Central Bank	**50,379**	49,103
Placements with financial institutions	**63,805**	73,150
Financing assets	**526,637**	475,648
Ijarah Muntahia Bittamleek and Rental Recievables	**160,370**	133,753
Investment debt securities	**113,283**	95,867
	914,474	827,521
Letters of credit, guarantees and acceptances	**76,251**	89,772

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27. RISK MANAGEMENT (Continued)

a) Credit Risk (Continued)

(ii) Risk concentrations of the maximum exposure to credit risk

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

The distribution of the Group's assets, liabilities, equity of investment accountholders, commitments and contingent liabilities by geographic region and industry sector is as follows:

	Assets		Liabilities and equity of investment accountholders		Commitments and contingent liabilities	
	31 December 2016 BD'000	31 December 2015 BD'000	**31 December 2016 BD'000**	31 December 2015 BD'000	**31 December 2016 BD'000**	31 December 2015 BD'000
Geographical region						
Middle East	**1,030,644**	967,215	**924,205**	865,149	**76,607**	91,010
Rest of Asia	**-**	-	**849**	917	**-**	-
North America	**5,801**	5,241	**83**	68	**-**	-
Europe	**5,743**	3,892	**579**	702	**-**	-
	1,042,188	976,348	**925,716**	866,836	**76,607**	91,010
Industry sector						
Trading and manufacturing	**79,901**	60,541	**42,443**	26,318	**14,276**	13,267
Aviation	**-**	518	**1,977**	10,768	**820**	701
Real Estate	**197,234**	236,509	**22,266**	20,509	**2,298**	1,817
Banks and financial institutions	**136,130**	126,933	**131,837**	109,900	**669**	646
Personal / Consumer	**381,084**	333,181	**441,795**	426,838	**427**	1,403
Government Organization	**132,860**	117,266	**143,222**	101,252	**-**	-
Others	**114,979**	101,400	**142,176**	171,251	**58,117**	73,176
	1,042,188	976,348	**925,716**	866,836	**76,607**	91,010

(iii) Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal classification. The table below shows the credit quality by class of asset, based on the Group's credit rating system. Amounts reported are gross of any collective provision for impairment.

	31 December 2016					
	Balances with banks and Central Bank BD'000	**Placements with financial institutions BD'000**	**Financing assets BD'000**	**Ijarah Muntahia Bittamleek and rental receivables BD'000**	**Investment securities (Sukuk) BD'000**	**Total BD'000**
Past due and impaired	**-**	**-**	**52,251**	**28,608**	**12,560**	**93,419**
Specific impairment	**-**	**-**	**(16,560)**	**(10,977)**	**(9,106)**	**(36,643)**
Carrying value	**-**	**-**	**35,691**	**17,631**	**3,454**	**56,776**
Past due but not impaired:						
Less than 30 days	**-**	**-**	**37,962**	**16,005**	**-**	**53,967**
31 to 60 Days	**-**	**-**	**12,041**	**1,345**	**-**	**13,386**
61 to 90 days	**-**	**-**	**9,460**	**432**	**-**	**9,892**
Carrying value	**-**	**-**	**59,463**	**17,782**	**-**	**77,245**
Neither past due nor impaired	**12,737**	**63,805**	**441,099**	**119,691**	**27,682**	**665,014**
Carrying value	**12,737**	**63,805**	**441,099**	**119,691**	**27,682**	**665,014**
Sovereign	**37,642**	**-**	**525**	**7,559**	**82,147**	**127,873**
Carrying value	**37,642**	**-**	**525**	**7,559**	**82,147**	**127,873**
Collective impairment	**-**	**-**	**(10,141)**	**(2,293)**	**-**	**(12,434)**
	50,379	**63,805**	**526,637**	**160,370**	**113,283**	**914,474**

27. RISK MANAGEMENT (Continued)

a) Credit Risk (Continued)
(iii) Credit quality per class of financial assets (Continued)

	31 December 2015					
	Balances with banks and Central Bank BD'000	Placements with financial institutions BD'000	Financing assets BD'000	Ijarah Muntahia Bittamleek and rental receivables BD'000	Investment securities (Sukuk) BD'000	Total BD'000
Past due and impaired	-	-	48,756	43,065	12,575	104,396
Specific impairment	-	-	(17,979)	(11,156)	(4,914)	(34,049)
Carrying value	-	-	30,777	31,909	7,661	70,346
Past due but not impaired:						
Less than 30 days	-	-	26,205	10,001	-	36,206
31 to 60 Days	-	-	6,666	1,602	-	8,268
61 to 90 days	-	-	3,536	393	-	3,929
Carrying value	-	-	36,407	11,996	-	48,403
Neither past due nor impaired	10,102	73,150	408,198	91,881	28,021	611,352
Carrying value	10,102	73,150	408,198	91,881	28,021	611,352
Sovereign	39,001	-	9,569	-	60,185	108,755
Carrying value	39,001	-	9,569	-	60,185	108,755
Collective impairment	-	-	(9,302)	(2,034)	-	(11,336)
	49,103	73,150	475,649	133,752	95,867	827,521

Restructured facilities during the year amounted to BD 20,580 thousand (2015: BD 3,789 thousand).

b) Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its liabilities when they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. To guard against this risk, the Group has a large customer base and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, commodity Murabaha, Wakala receivables, credit lines and quoted investments.

Maturity profile of Group's assets and liabilities

The table below summarises the maturity profile of the Group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period from the consolidated statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Group's retention history of its equity of investment accountholders

27. RISK MANAGEMENT (Continued)

b) Liquidity Risk (Continued)

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2016 was as follows:

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	No fixed maturity BD '000	Total BD '000
ASSETS								
Cash and balances with the banks and Central Bank	**29,442**	**-**	**-**	**-**	**-**	**-**	**33,766**	**63,208**
Placements with financial institutions	**63,805**	**-**	**-**	**-**	**-**	**-**	**-**	**63,805**
Financing assets	**23,480**	**15,488**	**23,248**	**49,452**	**82,910**	**332,059**	**-**	**526,637**
Ijarah Muntahia Bittamleek and Rental Recievables	**11,542**	**2,091**	**21**	**63**	**1,506**	**145,147**	**-**	**160,370**
Investment securities	**97**	**1,504**	**3,798**	**-**	**38,685**	**101,647**	**-**	**145,731**
Investment in associates	**-**	**-**	**-**	**-**	**-**	**-**	**26,487**	**26,487**
Investment in real estate	**-**	**-**	**-**	**-**	**-**	**-**	**28,066**	**28,066**
Property and equipment	**-**	**-**	**-**	**-**	**-**	**-**	**15,881**	**15,881**
Other assets	**379**	**1,665**	**-**	**-**	**3,044**	**-**	**6,915**	**12,003**
Total assets	**128,745**	**20,748**	**27,067**	**49,515**	**126,145**	**578,853**	**111,115**	**1,042,188**
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Placements from financial institutions	**84,117**	**8,180**	**11,577**	**-**	**-**	**-**	**-**	**103,874**
Customers' current accounts	**152,647**	**-**	**-**	**-**	**-**	**-**	**-**	**152,647**
Other liabilities	**14,879**	**-**	**-**	**-**	**-**	**-**	**-**	**14,879**
Equity of investment accountholders	**433,806**	**77,119**	**84,079**	**50,014**	**5,003**	**-**	**4,296**	**654,317**
Total liabilities and equity of investment accountholders	**685,449**	**85,299**	**95,656**	**50,014**	**5,003**	**-**	**4,296**	**925,717**
Liquidity gap	**(556,704)**	**(64,551)**	**(68,589)**	**(499)**	**121,142**	**578,853**	**106,819**	**116,471**
Cumulative liquidity gap	**(556,704)**	**(621,255)**	**(689,844)**	**(690,343)**	**(569,201)**	**9,652**	**116,471**	**-**

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2015 was as follows:

	Up to 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 months to 1 year BD '000	1 to 3 years BD '000	Over 3 years BD '000	No fixed maturity BD '000	Total BD '000
ASSETS								
Cash and balances with the banks and Central Bank	27,049	-	-	-	-	-	34,065	61,114
Placements with financial institutions	73,150	-	-	-	-	-	-	73,150
Financing assets	25,049	3,532	13,614	27,451	78,663	327,339	-	475,648
Ijarah Muntahia Bittamleek and Rental Recievables	6,059	96	6	41	11,580	115,971	-	133,753
Investments securities	5,143	16,472	7,793	500	22,524	78,203	-	130,635
Investment in associates	-	-	-	-	-	-	28,116	28,116
Investment in real estate	-	-	-	-	-	-	43,601	43,601
Property and equipment	-	-	-	-	-	-	16,640	16,640
Other assets	4,342	1,324	-	-	2,780	-	5,245	13,691
Total assets	140,792	21,424	21,413	27,992	115,547	521,513	127,667	976,348
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Placements from financial institutions	63,288	30,228	-	-	-	-	-	93,516
Customers' current accounts	157,300	-	-	-	-	-	-	157,300
Other liabilities	16,616	-	-	-	-	-	-	16,616
Equity investment accountholders	362,827	116,463	72,053	38,919	5,652	-	3,490	599,404
Total liabilities and equity of investment accountholders	600,030	146,691	72,053	38,919	5,652	-	3,490	866,836
Liquidity gap	(459,238)	(125,267)	(50,640)	(10,927)	109,895	521,513	124,177	109,513
Cumulative liquidity gap	(459,238)	(584,505)	(635,145)	(646,072)	(536,177)	(14,664)	109,513	-

27. RISK MANAGEMENT (Continued)

c) Market Risk

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

(i) Profit rate risk

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 Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities, and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. 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.

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

(ii) Equity price risk

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. In addition to Group performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

In order to measure the risk of equity on its financial positions, the Group adopts a sensitivity analysis on its quoted equity portfolio for a 10% increase of the portfolio value with all other variables remaining constant. The effect of a similar decrease in equity prices is expected to be equal and opposite to the effect of the increase shown.

Equity price risk variation as of 31 December is as follows:

2016	**Increase in equity price %**	**Sensitivity of profit or loss BD'000**	**Sensitivity of equity BD'000**
Kuwait Stock Exchange	+10	69	-
2015			
Kuwait Stock Exchange	+10	102	-

As at the consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 133 million (31 December 2015: BD 115 million). The impact of changes in the value of these unquoted equities and sukuk and the related impact on equity will only be reflected when the financial instrument is sold or deemed to be impaired.

iii) Foreign exchange risk

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.

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

	Equivalent Long (short) 2016 BD '000	Equivalent Long (short) 2015 BD '000
Currency		
Pound Sterling	**(1,016)**	4
Euro	**(1,051)**	(10,131)
CAD	**(3)**	(4,295)
JPY	**(3)**	(1,122)
Kuwaiti Dinars	**(10,131)**	-

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant foreign exchange risk.

Moreover, as the Group does not have significant exposure to other currencies, movement of the currency exchange rates against the Bahraini Dinar with other variables held constant will have an immaterial impact on the consolidated income statement and owners' equity.

27. RISK MANAGEMENT (Continued)

c) Market Risk (Continued)

iv) Commodity risk

Commodity risk is defined as inhernt 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.

d) Operational Risk

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.

28. SEGMENTAL INFORMATION

For management purposes, the Group is organised into three major business segments;

Corporate	Principally handling equity of corporate investment accountholders', corporate current accounts, and providing Islamic financing facilities to corporate customers.
Retail	Principally handling equity of individual retail customers' investment accountholders', retail current accounts, and providing Islamic financing facilities to individual customers.
Investment	Principally handling equity of banks' and financial institutions' investment accountholders, providing money market, trading and treasury services as well as the management of the Group's investment activities. Investment activities involve handling investments in local and international markets and investment in properties.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Transfer charges are based on a pool rate which approximates the cost of funds.

Segment information is disclosed as follows:

	31 December 2016			
	Corporate BD'000	**Retail BD'000**	**Investment BD'000**	**Total BD'000**
Total net income	**12,928**	**27,868**	**876**	**41,672**
Total expenses	**(3,791)**	**(17,140)**	**(2,589)**	**(23,520)**
Provision for impairment	**251**	**(2,342)**	**(7,641)**	**(9,732)**
Profit / (loss) for the year	**9,388**	**8,386**	**(9,354)**	**8,420**
Other information				
Segment assets	**277,177**	**452,746**	**312,265**	**1,042,188**
Segment liabilities, and equity	**304,460**	**512,642**	**225,086**	**1,042,188**

	31 December 2015			
	Corporate BD'000	Retail BD'000	Investment BD'000	Total BD'000
Total income	10,906	25,909	4,904	41,719
Total expenses	(2,744)	(14,217)	(4,600)	(21,561)
Provision for impairment	(4,417)	(786)	(3,750)	(8,953)
Profit / (loss) for the year	3,745	10,906	(3,446)	11,205
Other information				
Segment assets	239,128	416,251	320,969	976,348
Segment liabilities, and equity	277,850	490,128	208,370	976,348

The Group operates solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

29. FINANCIAL INSTRUMENTS

Fair value hierarchy
Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction.

Fair values of quoted securities / Sukuk are derived from quoted market prices in active markets, if available. In case of financing assets the average profit rate of the portfolio is in line with current market rates for similar facilities and hence after consideration of adjustment for prepayment risk and impairment charges it is expected that the current value would not be materially different to fair value of these assets. Other than equity investments and managed funds carried at cost of BD 31,760 thousand (2015: BD 33,749 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values due to their short-term nature.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December:

2016	**Level 1 BD'000**	**Level 2 BD'000**	**Level 3 BD'000**	**Total BD'000**
Investments carried at fair value through equity				
Quoted equity securities	**688**	**-**	**-**	**688**
	Level 1	Level 2	Level 3	Total
2015	BD'000	BD'000	BD'000	BD'000
Investments carried at fair value through equity				
Quoted equity securities	645	-	-	645

Transfers between Level 1, Level 2 and Level 3
During the year ended 31 December 2016, there were no transfers between Level 1 and Level 2, and no transfers into or out of Level 3.

30. EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a Qard fund account where the Group uses these funds for various charatable purposes. The movements in these funds is shown in statement of sources and uses of good faith Qard fund. The non-Islamic income includes the penalties charged on late repayments for Islamic facilities.

31. SHARI'A SUPERVISORY BOARD

The Group's Shari'a Supervisory Board consists of three Islamic scholars who review the Group's compliance with general Shari'a principles and specific Fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

32. SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through Zakah and charity fund's expenditures and donations to good faith Qard fund for marriage, refurbishment, medical treatments, etc.

33. COMPARATIVE FIGURES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect previously reported profit for the year or total owners' equity.

Risk and Capital Management Disclosure

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Risk and Capital Management Disclosure

31 December 2016

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 II 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 link 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 in published financial statements 2016 BD'000	Statement of Financial position as per Regulatory Reporting 2016 BD'000	Reference
Assets			
Cash and balances with banks and Central Bank	**63,208**	**63,208**	
Placements with financial institutions	**63,805**	**63,805**	
Gross financing assets	553,338	553,338	
Less: sepcific impairment provisions	(16,560)	(16,560)	a
Less: collective impairment provisions	(10,141)	(10,141)	a
Net financing assets	**526,637**	**526,637**	
Investment securities	**145,731**	**145,731**	
Ijarah Muntahia Bittamleek	**151,752**	**151,752**	
Gross ijarah rental receivables	21,888	21,888	
Less: sepcific impairment provisions	(10,977)	(10,977)	b
Less: collective impairment provisions	(2,293)	(2,293)	b
Net ijarah rental receivables	**8,618**	**8,618**	
Investment in associates	**26,487**	**26,487**	
Investment in real estate	**28,066**	**28,066**	
Property and equipment	**15,881**	**15,881**	
Other assets	**12,003**	**12,003**	
TOTAL ASSETS	**1,042,188**	**1,042,188**	
Liabilities, Equity Of Investment Accountholders and Owners' Equity			
Placements from financial institutions	**103,874**	**103,874**	
Customers' current accounts	**152,647**	**152,647**	
Other liabilities	**14,879**	**14,879**	
Total Liabilities	**271,400**	**271,400**	
Equity of Investment Accountholders	**654,316**	**654,316**	
Owners' Equity			
Share capital	**101,339**	**101,339**	c
Treasury shares	**(563)**	**(563)**	d
Shares under employee share incentive scheme	**(604)**	**(604)**	e
Share premium	**56**	**56**	f
Statutory reserve	**1,963**	**1,963**	g
Real estate fair value reserve	**5,361**	**5,361**	h
Investment fair value reserve	**531**	**531**	i
Profit for the year	**7,578**	**7,578**	j
Retained earnigs brought forward	**811**	**811**	k
Total Owners' Equity	**116,472**	**116,472**	
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY	**1,042,188**	**1,042,188**	

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. No changes were made in the objectives, policies, and processes from the previous years.

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. All assets funded by profit sharing investment accounts are subject to Board approval.

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.

Table – 2. Capital Structure (PD-1.3.12, 1.3.13, and1.3.14)

The following table summarises the eligible capital as of 31 December 2016 after deductions for Capital Adequacy Ratio (CAR) calculation:

Components of capital	CET 1 BD'000	T2 BD'000	Source based on reference letters of the statement of financial position under the regulatory scope of consolidation
Issued and fully paid ordinary shares	101,339	-	c
General reserves	-	-	
Legal / statutory reserves	1,963	-	g
Share premium	56	-	f
Retained earnings brought forward	811	-	k
Current year profits	7,578		j
Unrealized gains and losses on available for sale financial instruments	531	-	i
Less:			
Employee stock incentive program funded by the bank (outstanding)	604	-	e
Treasury Shares	563	-	d
Total Common Equity Tier 1 capital after the regulatory adjustments above (CET1 d)	111,111	-	
Assets revaluation reserve - property, plant, and equipment		5,363	h
General financing loss provisions		6,598	53% (a+b)
Total Available AT1 & T2 Capital		11,961	
Total Capital		123,072	

3. Capital Adequacy (Continued)

Table – 2. Capital Structure (PD-1.3.12, 1.3.13, and1.3.14) (Continued)

	Amount of exposures BD'000
Total Credit Risk Weighted Assets	**527,820**
Total Market Risk Weighted Assets	**12,226**
Total Operational Risk Weighted Assets	**66,722**
Total Regulatory Risk Weighted Assets	**606,768**
Investment risk reserve (30% only)	**227**
Equalization reserve (30% only)	**374**
Total Adjusted Risk Weighted Exposures	**606,167**
CAPITAL ADEQUACY RATIO	**20.30%**
Minimum requirement	**12.5%**

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

The following table summarises the amount of exposures as of 31 December 2016 subject to standardised approach of credit risk and related capital requirements by type of Islamic financing contracts:

	Exposure			Risk Weighted Asstes*			Capital Requirments		
	Self-Financed BD'000	IAH BD'000	Total BD'000	Self-Financed BD'000	IAH 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	31,847	31,361	63,208	6,372	-	6,372	797	-	797
Placements with financial institutions	63,805	-	63,805	15,566	-	15,566	1,946	-	1,946
Financing assets*	154,883	371,754	526,637	137,988	91,561	229,549	17,249	11,445	28,694
Investments	31,982	113,749	145,731	25,296	30,495	55,791	3,162	3,812	6,974
Ijarah muntahia bittamleek*	35,022	125,348	160,370	39,762	26,384	66,146	4,970	3,298	8,268
Investment in associates	26,487	-	26,487	63,156	-	63,156	7,895	-	7,895
Investment in real estate	24,870	3,196	28,066	49,739	1,918	51,657	6,217	240	6,457
Property and equipment	15,881	-	15,881	15,881	-	15,881	1,985	-	1,985
Other assets	3,096	8,907	12,003	3,099	4,747	7,846	387	593	980
	387,873	654,315	1,042,188	356,859	155,105	511,964	44,608	19,388	63,996
Unfunded									
Commitments and contingent liabilities	76,607	-	76,607	15,856	-	15,856	1,982	-	1,982
Total Credit Risk Weighted Assets	464,480	654,315	1,118,795	372,715	155,105	527,820	46,590	19,388	65,978
Total Market Risk Weighted Assets	-	-	-	12,226	-	12,226	-	-	-
Total Operational Risk Weighted Assets	-	-	-	66,722	-	66,722	-	-	-
Total RWA	464,480	654,315	1,118,795	451,663	155,105	606,768	46,590	19,388	65,978

*The risk wighted asstes are net off credit risk mitigant.

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

The following table summarises the amount of exposures as of 31 December 2016 subject to standardised approach of market risk and related capital requirements:

Market Risk - Standardised Approach	
Foreign exchange risk (BD'000)	**978**
Total of Market Risk - Standardised Approach	978
Multiplier	**12.5**
RWE for CAR Calculation (BD'000)	**12,226**
Total Market Risk Exposures (BD'000)	12,226
Total Market Risk Exposures - Capital Requirement (BD'000)	**1,528**

3. Capital Adequacy (Continued)

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 31 December 2016 subject to basic indicator approach of operational risk and related capital requirements:

Indicators of operational risk	
Average Gross income (BD’000)	**35,585**
Multiplier	**12.5**
	444,813
Eligible Portion for the purpose of the calculation	**15%**
Total Operational Risk Exposure (BD'000)	**66,722**
Total Operational Risk Exposures - Capital Requirement (BD'000)	8,340

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

The following are Capital Adequacy Ratios as of 31 December 2016 for total capital and CET1 capital:

	Total capital ratio	**CET1 capital ratio**
Top consolidated level	**20.30%**	**18.33%**

4. Risk Management

4.1 Bank-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 while 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 and maintain appropriate internal capital levels as per the ICAAP framework. The main objective of the Group’s ICAAP is to ensure that adequate capital is retained at all times to support the risks the Group undertakes in the course of its business.

The Group has an established internal capital adequacy assessment process (ICAAP) as per the requirements under Pillar III of Basel III. ICAAP prescribed measures are designed to ensure appropriate identification, measurement, aggregation and monitoring of the Group’s risk. It also defines an appropriate level of internal capital in relation to the Group’s overall risk profile and business plan.

4.2 Strategies, Processes, and Internal Controls

4.2.1 Group’s risk strategy

Risk Charter defines the Group’s risk strategy. Comprehensive Risk Management Policy Framework 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 charter identifies risk objectives, policies, strategies, and risk governance both at the Board and management level. The capital management policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses.

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.

The Group is exposed to various types of risk, such as market, credit, profit rate, liquidity and operational, all of which require comprehensive controls and ongoing oversight. The risk management framework summarises the spirit behind Basel III, which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities and segregation of duties, adequate information and communication channels, monitoring risk management activities, and correcting deficiencies.

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. 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 although they are insignificant. The Group regularly 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 equity type instruments portfolio. These limits include maximum Stop-loss limits, position limits, VaR limits, and maturity limits. As at 31 December 2016, the group did not have 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.

The Group has established a clear segregation of duties, through documentation and implementation of policies and procedures. This ensures objectivity, security, and avoids conflicts of interest. Maker checker concept and dual eye principles are applied across the Group, where possible.

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. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

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 Group's management believes that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities, and equity of investment account holders. The profit distribution to investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

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

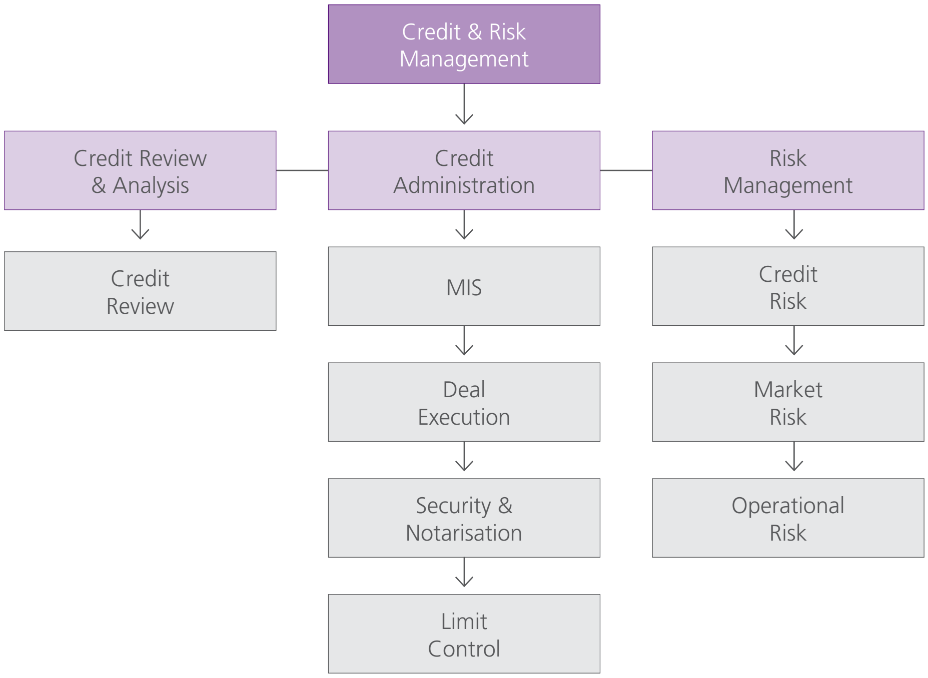
The Group manages its Displaced Commercial Risk as outlined in the Risk Charter of the Group. The Group may forego its fee in case displaced commercial risk arises. The Group benchmarks its rates with other leading banks in the market.

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 committee), 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 Executive Committee, Credit Committee, the Chief Executive Officer and further delegation to management to approve and review.

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 mostly secured by collateral in the form of mortgage financed or other tangible securities.

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. 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 and Analysis Unit ("CRAU"). Any changes to the Credit Risk Policy will be approved by the Board.

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.1 Introduction (Continued)

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. In addition, the Group has implemented Moody's Risk Analyst system in 2016 which has different rating models and generates ratings after taking into consideration quantitative and qualitative factors. This has further strengthened the approval process. The credit approval decision is then made and terms and conditions are set.

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 CRAU.

4.5.2 Types of credit risk

Financing contracts mainly comprise of due from banks and financial institutions, Murabaha receivables, Musharaka investments, and Ijarah muntahia bittamleek.

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 at times by the object of the Murabaha contract (in case of real estate finance) and other times 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 instalments are settled.

4.5.3 Past Due and impaired Islamic financing

The Group defines non-performing facilities as the facilities that are overdue for a period of 90 days or more. These exposures are placed on a non-accrual status with income being recognised to the extent that it is actually received. It is the Group's policy that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as non performing, not only the overdue instalments/payments.

As a policy, the Group places on a non-accrual basis any facility where there is reasonable doubt about the collectability of the receivable, irrespective of whether the customer concerned is currently in arrears or not.

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 ratings used by the Group and the corresponding 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 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 counterparty, or group of connected counterparties, exceeding 15% of the regulatory capital base.

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. Risk Management (Continued)

4.5 Credit Risk (Continued)

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-performance of credit contracts through collaterals, netting agreements, and guarantees.

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.

The market value of tangible collateral security is properly evaluated by the Group's approved valuers (for properties) or based on publicly available quotations. The value of such security is considered only to the extent of the ouststanding exposure of relevent credit facilities.

From time to time, the Credit and Investment Committee reviews and approves the loan-able value of securities. It has also approved a list of acceptable securities.

The majority of the Group's current credit portfolio is secured through mortgage of commercial 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 Collaterals:

The Group has developed guidelines for acceptable collaterals. 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 goods: Where competent staff is available within the Group, the valuation is conducted in-house. The Group performs in-house valuation on the following types of securities:
- Pledge of shares of local companies;
- Pledge of international marketable shares and securities; and
- Pledge and hypothecation of goods.

Quoted shares are valued at the quotes available from stock exchanges, periodicals, etc.

b. Valuation of real estate and others: Besides assets mentioned above the valuation, of following securities are also conducted:
- Real Estate;
- Equipment and machinery; and
- Precious metals and jewels.

The Credit Administration requests the concerned department to arrange for the valuation from approved valuators.

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 will be lodged in the safe custody through the Credit Administration and should be kept under dual control. Group must ascertain that collateral providers are authorised and acting within their capacity.

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.7.2 Guarantees

In cases where a letter of guarantee from parent company or a third party is accepted as a credit risk mitigant, the Group ensures that all guarantees are irrevocable, legal opinion has been obtained from a legal counsellor domiciled in the country of guarantor (overseas) regarding the enforceability of the guarantee, if the guarantor / prime obligor is domiciled outside Bahrain and all guarantees should be valid until full settlement of the facilities. 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 custodian approved by the Group. The Credit Administration will obtain confirmation of the assets held with each custodian on an annual basis.

The release of collateral without full repayment of all related financial obligations 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 counterparty fails to fulfil 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.

4.5.8.3 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 are companies or individuals connected with the Group or its subsidiaries and associated companies (whether such association is due to control or shareholding or otherwise), Directors and their associates (whether such association is due to control, family links or otherwise), members of the Shari'a Supervisory Board, management and other staff, and shareholders holding more than 10% or more of the equity voting rights in the Group.

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 counterparty (single/group) exposure exceeds 15% of Group's Capital Base; and
b. If any facility (new/extended) to an employee is equal or above BD100,000 (or equivalent).

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. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.8.8 Other matters

As a Group's strategy, exposure to connected counterparties may be undertaken only when negotiated and agreed on an arm's length basis.

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 consolidated financial statements as of 31 December 2016. All related party transactions have been made on arm's length basis.

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

The following table summarises the amount of gross funded and unfunded credit exposure as of 31 December 2016 and average gross funded and unfunded exposures over the year ended 31 December 2016:

	Total gross credit exposure BD'000	*Average gross credit exposure over the year BD'000
Funded		
Cash and balances with banks and central Bank	**63,208**	**64,938**
Placements with financial institutions	**63,805**	**63,349**
Financing assets	**526,637**	**516,382**
Investments securities	**145,731**	**132,924**
Ijarah muntahia bittamleek & rental receivables	**160,370**	**150,534**
Investment in associates	**26,487**	**27,548**
Investment in real estate	**28,066**	**33,001**
Property and equipment	**15,881**	**16,166**
Other assets	**12,003**	**11,564**
Total	**1,042,188**	**1,016,406**
Unfunded		
Commitments and contingent liabilities	**76,607**	**76,059**
Total	**1,118,795**	**1,092,465**

*Average balances are computed based on quarter end balances.

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

The following table summarises the geographic distribution of exposures as of 31 December 2016, broken down into significant areas by major types of credit exposure:

	North America BD'000	Europe BD'000	Middle East BD'000	Total BD'000
Cash and balances with banks and central Bank	**5,801**	**91**	**57,316**	**63,208**
Placements with financial institutions	**-**	**-**	**63,805**	**63,805**
Financing assets	**-**	**-**	**526,637**	**526,637**
Investments securities	**-**	**5,692**	**140,039**	**145,731**
Ijarah muntahia bittamleek & rental receivables	**-**	**-**	**160,370**	**160,370**
Investment in associates	**-**	**-**	**26,487**	**26,487**
Investment real estate	**-**	**-**	**28,066**	**28,066**
Property and equipment	**-**	**-**	**15,881**	**15,881**
Other assets	**-**	**-**	**12,003**	**12,003**
Total	**5,801**	**5,783**	**1,030,604**	**1,042,188**

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

Risk and Capital Management Disclosure

31 December 2016

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.9 Related party transactions (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 31 December 2016 by industry, broken down into major types of credit exposure:

	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate BD'000	Aviation 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	-	25,566	-	-	-	37,642	-	63,208
Placements with Financial institutions	-	63,805	-	-	-	-	-	63,805
Financing assets	76,668	16,214	76,834	-	275,663	4,750	76,508	526,637
Investments securities	-	20,594	34,956	-	-	82,147	8,034	145,731
Ijarah muntahia bittamleek & rental receivables	3,233	312	44,151	-	103,747	7,559	1,368	160,370
Investment in associates	-	7,648	6,311	-	-	-	12,528	26,487
Investment in real estate	-	-	28,066	-	-	-	-	28,066
Property and equipment	-	-	-	-	-	-	15,881	15,881
Other assets	-	1,991	6,916	-	1,674	-	1,422	12,003
Total	79,901	136,130	197,234	-	381,084	132,098	115,741	1,042,188
Unfunded								
Commitments and contingent liabilities	14,276	669	2,298	820	427	-	58,117	76,607
Total	94,177	136,799	199,532	820	381,511	132,098	173,858	1,118,795

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 31 December 2016:

	Gross BD'000	Provision BD'000	Net BD'000
Counterparties			
Counterparty # 1	8,338	3,335	5,003
Counterparty # 2	8,627	-	8,627
Counterparty # 3	3,755	1,730	2,025
	20,720	5,065	15,655

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

The following balances represent the concentration of risk to individual counterparties as of 31 December 2016:

	Total BD'000
Counterparties	
Counterparty # 1	12,528
	12,528

Risk and Capital Management Disclosure

31 December 2016

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.9 Related party transactions (Continued

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

The following table summarises the residual contractual maturity of the whole credit portfolio as of 31 December 2016, broken down by major types of credit exposure:

	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	29,442	-	-	-	-	-	-	-	-	33,766	63,208
Placements with financial institutions	63,805	-	-	-	-	-	-	-	-	-	63,805
Financing assets	23,480	15,488	23,248	49,452	82,910	105,926	171,378	36,518	18,237	-	526,637
Investments securities	97	1,504	3,798	-	38,685	4,161	95,910	-	1,576	-	145,731
Ijarah muntahia bittamleek & rental receivables	11,542	2,091	21	63	1,506	6,178	25,893	60,083	52,993	-	160,370
Investment in associates	-	-	-	-	-	-	-	-	-	26,487	26,487
Investment real estate	-	-	-	-	-	-	-	-	-	28,066	28,066
Property and equipment	-	-	-	-	-	-	-	-	-	15,881	15,881
Other assets	379	1,665	-	-	3,044	-	-	-	-	6,915	12,003
Total Assets	128,745	20,748	27,067	49,515	126,145	116,265	293,181	96,601	72,806	111,115	1,042,188

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

The following table summarises the impaired facilities, past due facilities, and allowances disclosed by major industry sector as of 31 December 2016:

	Non/performing or past due or impaired Islamic financing contracts BD'000	Aging of non-performing or past due or impaired Islamic financing contracts				Specific allowances				* General allowances		
		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 year BD'000	Charge during the year BD'000	Charge-offs and recoveries during the year BD'000	Balance at the the end of year BD'000	Balance at the beginning of the year BD'000	Net charge for the period BD'000	Balance at the end of year BD'000
Trading and Manufacturing	34,173	27,966	4,412	1,496	299	530	863	352	1,041	-	-	-
Real Estate	70,277	18,749	10,077	857	40,594	28,240	2,150	4,563	25,827	-	-	-
Banks and Financial Institutions	-	-	-	-	-	-	-	-	-	-	-	-
Personal / Consumer Finance	34,694	27,821	2,714	1,566	2,593	352	198	535	15	-	-	-
Others	18,960	9,278	8,257	1,184	241	24	713	82	655	-	-	-
No specific sector	-	-	-	-	-	-	-	-	-	11,326	1,108	12,434
Total	158,104	83,814	25,460	5,103	43,727	29,146	3,924	5,532	27,538	11,326	1,108	12,434

* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

** This includes amounts not due and amounts past due less than 90 days relating to non-performing or past due or impaired Islamic financing contracts.

The Group's collective retail model uses the net flow rate method, where probability of default is calculated on an account level segregated by buckets of number of days past due. Loss given default is at annual average recovery rates, which is reviewed annually.

The Group's collective corporate model uses the expected loss method. Data is grouped in economic sectors and probability of default and loss given default is calculated for these sectors.

In assessing specific impairments, the Group uses different criteria including Discounted Cash Flow method to ascertain the impairment, if any.

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.9 Related party transactions (Continued

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

The following table summarises the past due facilities and allowances financed by own capital and current account and profit sharing investment account disclosed by geographical area as of 31 December 2016:

	Non-performing or past due or impaired Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000
Middle East	**158,104**	**27,538**	**12,434**
Total	**158,104**	**27,538**	**12,434**

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

The following table summarises the aggregate amount of restructured financing facilities during the year as of 31 December 2016:

	Outstanding BD'000	Provision BD'000	Net of Provision BD'000
Total Islamic Financing	726,978	39,971	687,007
Restructured financing facilities	9,643	-	9,643
Percentage	**1.33%**	**0.00%**	**1.40%**

Exposures amounting to BD 10,937 thousand were restructured during the year were excluded from Table 15 and included in Table 13 and 14 above.

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

The following table summarises the exposure as of 31 December 2016 by type of Islamic financing contract covered by eligible collateral:

	Total exposure covered by	
	Eligible collateral BD'000	Guarantees BD'000
Financing assets	**12,044**	**15,900**
Ijarah muntahia bittamleek & rental receivables	**20,721**	**831**
Total	**32,765**	**16,731**

Type of Guarantees	Guarantees BD'000	Risk Weighted BD'000
Tamkeen Guarantee	**14,316**	**8,435**
Bank Guarantee	**2,415**	**1,835**
Total	**16,731**	**10,270**

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.9 Related party transactions (Continued

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 31 December 2016:

	Financing assets BD'000	Ijarah muntahia bittamleek and rental recievables BD'000	Total BD'000
Exposures:			
Secured*	**96,538**	**40,243**	**136,781**
Unsecured*	**430,099**	**120,127**	**550,226**
Total	**526,637**	**160,370**	**687,007**
Collateral held:			
- Cash	**11,193**	**797**	**11,990**
- Guarantees	**15,900**	**831**	**16,731**
- Real Estate	**851**	**19,924**	**20,775**
Total	**27,944**	**21,552**	**49,496**
Collateral as a percenage of secured exposure	**28.95%**	**53.55%**	**36.19%**

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

*The financing assets and ijraha muntahia bittamleek exposures are net of provision.

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.

4.6.2 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 Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities, and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. 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.

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. In addition to Group performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

Commodity risk is defined as inherant 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. Risk Management (Continued)

4.6 Market Risk (Continued)

4.6.3 Market risk strategy
The Group's Board is responsible for approving and reviewing (at least annually) 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:

1 The Group will manage its market risk exposure by evaluating each new product / activity with respect to the market risk introduced by it;
2 The Group will proactively measure and continually monitor the market risk in its portfolio;
3 The Group will at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
4 The Group will establish a limit structure to monitor and control the market risk in its portfolio. These limits will include position limits, maximum/stop loss limits, factor sensitivity limits, VaR limits and maturity limits;
5 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;
6 The Group will periodically carry out back testing of market risk assessment models in order to evaluate their accuracy and the inherent model risk;
7 The Group will match the amount of floating rate assets with floating rate liabilities; and
8 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.

4.6.4 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. Factor sensitivity limits;
d. VaR limits; and
e. Profit rate risk gap analysis.

4.6.5 Market risk monitoring and limits structure
The Asset and Liability Committee (ALCO) proposes through the Executive Committee and Board the tolerance for market risk. Based on these tolerances, Risk and Compliance 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 and Compliance 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, an approval from the CEO is required to continue with the transaction. An immediate report is provided to the ALCO after every significant limit breach. This breach is also reported to and approved by the Executive Committee (EXCOM). The limits are revised at least bi-annually or when deemed required.

4.6.8 Portfolio review process
On a monthly basis, Risk and Compliance Unit reviews the Group's assets and liabilities portfolio to evaluate the overall corporate exposure to market risk. As part of the review, Risk and Compliance Unit also monitors the Group's overall market exposure against the risk tolerance limits set by the Board. Risk and Compliance 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 GM-C&RM/CEO and approval by the ALCO or EXCOM, as per the delegated authorities approved by the Board. Balance sheet exposure is being reviewed on a quarterly basis by the Board level Audit and Risk committees.

4.6.9 Reporting
Risk and Compliance 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. Risk Management (Continued)

4.6 Market Risk (Continued)

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 and Compliance Unit employs four stress categories: profit rates, foreign exchange rates, equity prices, and commodity prices. For each stress category, the worst possible stress shocks that might realistically occur in the market are defined.

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 as of 31 December 2016:

	Foreign exchange risk BD'000
Maximum value capital requirement	**1,528**
Minimum value capital requirement	**975**

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.

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;

1. 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;
2. Processes risk which arises due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting; and
3. Systems (Technology) risk which arise 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.
4. Legal risk which arised 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.

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; and
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.

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 for the quick detection and correction of deficiencies in the policies, processes, and procedures for managing operational risk 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 Bank has a legal department dedicated to monitor any legal risk arising out of contracts / agreements entered into by the Bank on a day to day basis. The department also liases with external lawyers for legal cases filed by the bank against deliquent accounts for recovery or any legal cases filed against the Bank.

4. Risk Management (Continued)

4.7 Operational Risk (Continued)

4.7.5 Operational risk mitigation and control

The business units, in consultation with Risk and Compliance Units will determine all material operational risks and decide the appropriate procedures to be used to control and/or mitigate the risks.

For those risks that cannot be controlled, the business units in conjunction with Risk and Compliance 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 and Compliance Unit facilitates the business units in co-developing the mitigation plans. Bank deals with the pending legal cases through internal and external lawyers depending upon the severity of the cases.

4.7.6 Business Continuity Plan (BCP)

The Group has also developed a comprehensive business continuity plan detailing the steps to be taken in the event of extreme conditions to resume the Group's operations with minimum delay and disturbance. The plan is in implementation stage. Elements of contingency plans and disaster recovery processes include operating systems, physical space, telecommunications , and resources.

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

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

	Gross income		
	2015 BD'000	2014 BD'000	2013 BD'000
Total Gross Income	**40,704**	**32,290**	**33,761**
Indicators of operational risk			
Average Gross income (BD'000)			**35,585**
Multiplier			**12.5**
			444,813
Eligible Portion for the purpose of the calculation			**15%**
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE (BD'000)			**66,722**

Risk and Compliance Unit ensures that the BCP is kept up to date and tested once a year in a simulated environment to ensure that it can be implemented in emergency situations and that the management and staff understand how it is to be executed. Results of this testing conducted by Risk and Compliance Unit is evaluated by the GM-C&RM and presented to the EXCOM/Board for evaluation.

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.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the consolidated financial statements as of 31 December 2016. 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 based financing structures by types of financing contracts and investments as of 31 December 2016:

	Total gross exposure BD'000	* Average gross exposure BD'000	Publicly traded BD'000	Privately held BD'000	Risk weighted assets BD'000	Capital Requirements BD'000
Sukuk	113,283	99,527	-	113,283	14,591	**1,824**
Equity investments	18,280	19,230	688	17,592	13,323	**1,665**
Funds	14,168	14,167	-	14,168	27,878	**3,485**
Total	**145,731**	**132,924**	**688**	**145,043**	**55,792**	**6,974**

*Average balances are computed based on quarter end balances.

4. Risk Management (Continued)

4.8 Equity Position in the Banking Book (Continued)

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 year ended 31 December 2016:

	BD'000
Cumulative realised gain arising from sales or liquidations in the reporting period	**(1,792)**
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	**531**
Unrealised gains included in Tier 2 Capital	**5,363**

4.9 Equity of Investment Accountholders ("IAH")

The Group may require to decrease or increase loses 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. 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 Bank waved 0.7% of profit from mudarabah fees in order maintain competitive profit distribution to IAH.

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.

The Group has designed special Quality of Service and Complaints Management Unit which reports to GM Retail. 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.

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 Mudarab share of income from investment in order to provide a reasonable return to its investors.

The Group comingles its own funds and equity of investment accountholders funds which are invested together. The equity of investment accountholders funds are invested into assets and income from these assets are allocated to such account.

The Group has already developed 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 temporarily allocates non-performing assets (past due greater than 90 days) from IAH to the equity shareholders and charges the specific impairment provisions to the owners' equity. Amounts recovered from these impaired assets is not subject to allocation between the IAH and owners' equity. The Bank takes remedial action on these non-performing assets and once these assets become performing, the assets and related income are allocated between the IAH and owners' equity.

4. Risk Management (Continued)

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

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 fundson 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 avialble to investors

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 31 December 2016:

	BD'000
Individuals and non-financial institutions	**654,316**
Financial institutions' investment accounts	**103,874**
Total	**758,190**

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 year ended 31 December 2016:

Profit Paid on Average IAH Assets *	**1.14**
Mudarib Fee to Total IAH Profits	**56.88%**

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

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 ended 31 December 2016:

Account Type	Average declared rate of return	Proportion of profit distributed to total IAH	Proportion of to total IAH
Saving accounts (including VEVO)	0.13%	**2.27%**	**19.51%**
Defined accounts - 1 month	0.80%	**0.58%**	**0.70%**
Defined accounts - 3 months	0.80%	**0.22%**	**0.27%**
Defined accounts - 6 months	0.85%	**0.35%**	**0.43%**
Defined accounts - 9 months	0.95%	**0.00%**	**0.00%**
Defined accounts - 1 year	1.00%	**2.13%**	**2.18%**
Investment certificates	3.50%	**0.18%**	**0.02%**
IQRA	1.50%	**1.02%**	**0.71%**
Tejoori	0.13%	**3.04%**	**28.42%**
Customer special deposits	1.73%	**90.21%**	**47.76%**
		100%	**100%**

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

4. Risk Management (Continued)

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

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 31 December 2016:

	Percentage of Counterparty Type to Total Financing					
	Self Financed BD'000	%	IAH BD'000	%	Total BD'000	%
Gross financing assets*						
Murabaha	**129,754**	**30.42%**	**296,819**	**69.58%**	**426,573**	**100%**
Corporate	60,229	27.89%	155,722	72.11%	215,951	100%
Retail	69,525	33.01%	141,097	66.99%	210,622	100%
Musharakah	**32,253**	**29.27%**	**77,951**	**70.73%**	**110,204**	**100%**
Corporate	6,293	29.11%	15,322	70.89%	21,615	100%
Retail	25,960	29.30%	62,629	70.70%	88,589	100%
Total	**162,007**	**30.18%**	**374,770**	**69.82%**	**536,777**	**100%**
Gross Ijarah Muntahia Bittamleek and rental receivables and rental receivables**						
Corporate	6,939	20.58%	26,777	79.42%	33,716	100%
Retail	29,508	22.88%	99,440	77.12%	128,948	100%
Total	**36,447**	**22.41%**	**126,217**	**77.59%**	**162,664**	**100%**
Collective provision	**(8,549)**	**68.76%**	**(3,885)**	**31.24%**	**(12,434)**	**100%**
Total	**189,905**	**27.64%**	**497,102**	**72.36%**	**687,007**	**100%**

*Net of specific provisions of BD 16,560 thousands.
**Net of specific provisions of BD 10,977 thousands.

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

	Gross return on equity of IAH BD'000 A	Transfer to equalization Reserve BD'000 B	Average Mudaraba %	Mudarib fees BD'000 C	Transfer to IRR BD'000 D	Profit paid to IAH BD'000 (A-B-C-D)
Account Type						
Tejoori	**8,108**	**67**	**97%**	**7,531**	**26**	**484**
Saving	**5,107**	**42**	**97%**	**4,731**	**16**	**318**
Vevo	**460**	**4**	**97%**	**428**	**1**	**27**
IQRA Deposits	**227**	**2**	**64%**	**140**	**7**	**78**
Defined deposit	**16,179**	**135**	**60%**	**9,340**	**480**	**6,224**
	30,081	**250**		**22,170**	**530**	**7,131**

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 year ended 31 December 2016:

Share of profit allocated by IAH before transfer to/from reserves - BD '000	30,081
Percentage share of profit earned by IAH before transfer to/from reserves	4.60%
Share of profit paid to IAH after transfer to/from reserves - BD '000	7,131
Percentage share of profit paid to IAH after transfer to/from reserves	1.09%
Share of profit paid to Bank as mudarib - BD '000	22,170

Risk and Capital Management Disclosure

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4. Risk Management (Continued)

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

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 31 December 2016:

	3 months	6 months	12 months	36 months
Percentage of average distributed rate of return to profit rate of return	**0.80%**	**0.92%**	**1.09%**	**3.50%**

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 year ended 31 December 2016:

	As of 30 June 2016 BD'000	Movement During the Period BD'000	As of 31 December 2016 BD'000
Cash and balances with banks and Central Bank	**30,617**	**744**	**31,361**
Gross financing assets	**394,131**	**(19,361)**	**374,770**
Gross Ijarah Muntahia Bittamleek and rental receivables	**92,854**	**33,363**	**126,217**
Collective impairment	**(3,979)**	**94**	**(3,885)**
Investment securities	**94,552**	**19,198**	**113,750**
Investment in real estate	**1,456**	**1,740**	**3,196**
Other assets	**7,240**	**1,667**	**8,907**
Total	**616,871**	**37,445**	**654,316**

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 Allocated to IAH		Profit Paid to (IAH)	
	000'BD	%age	000'BD	%age
2016	**30,081**	**3.48%**	**7,131**	**0.85%**
2015	**30,685**	4.02%	**5,733**	0.75%
2014	**23,491**	3.55%	**7,539**	1.14%
2013	**32,849**	4.98%	**11,124**	1.69%
2012	**30,662**	5.21%	**13,993**	2.38%

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	31,361	-	-	-
Financing assets*	374,770	305,205	91,561	11,445
Investment in sukuk	85,524	17,455	5,237	655
Investment Securities	28,226	84,194	25,258	3,157
Ijarah muntahia bittamleek*	126,217	87,946	26,384	3,298
Investment in Real Estate	3,196	6,393	1,918	240
Other Assets	8,907	15,824	4,747	593
	658,201	**517,017**	**155,105**	**19,388**

4. Risk Management (Continued)

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.

4.10.3 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 Risk Charter and Liquidity 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 different time buckets of up to 1 month, 1-3 months, 3-6 months, 6 months to 1 year, 1-3 years, and over 3 years. 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 Treasury Department, in conjunction with Risk and Compliance Unit periodically reviews/updates (at least annually) the liquidity risk strategy which is evaluated by ALCO before presenting to the EXCOM and the Board for approval.

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 and Compliance Unit and Treasury Department. Based on these tolerances, Risk and Compliance 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, unrestricted investment accounts and restricted investment 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;
b. Liquidity Ratio limits; and
c. Minimum Liquidity Guideline ("MLG").

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:

	2016	2015	2014	2013	2012
Due from banks and financial institutions / Total Assets	**6.12%**	7.49%	7.83%	20.28%	15.90%
Islamic Financing / Customer Deposits excluding banks	**85.13%**	80.53%	74.48%	62.49%	64.87%
Customer Deposits / Total Assets	**77.43%**	77.50%	64.74%	67.83%	68.87%
Short term assets / Short term liabilities	**18.53%**	22.38%	33.86%	78.41%	60.59%
Liquid Assets / Total Assets	**8.95%**	10.26%	10.24%	22.27%	17.78%
Growth in Customer Deposits	**6.64%**	7.48%	(8.24%)	7.66%	8.36%

Short term assets includes cash and balances with banks and placements with FI's
Short term liabilities includes customer current accounts, other liablities, placemnets from FI's (maturing within one month) and EIAH (maturing within one month).
Liquid assets includes cash and balances with banks and Central Bank (exluding CBB reserve) and placements with FI's
Customer deposits includes customer current accounts and EIAH.

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.

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 Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. 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.

4.11.2 Profit rate risk strategy

The Group is not exposed to interest rate risk on its financial assets as no interest is charged. However, the fair value of financial assets may be affected by current market forces including interest rates. 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 limit 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.

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4. Risk Management (Continued)

4.11 Profit Rate Risk (Continued)

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 a 1 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 EXCOM and the Board of Directors. The Risk and Compliance Unit monitors these limits regularly. GM-C&RM reviews the results of gap limits and exceptions, if any, and recommends corrective action to be taken which is approved by ALCO or EXCOM, according to authority parameters approved by the Board.

Table – 33. Profit Rate Risk in Banking Book (PD-1.3.40 (b))

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 31 December 2016:

	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	**63,805**	**-**	**-**	**-**	**-**	**63,805**
Financing assets	**38,968**	**23,248**	**49,452**	**82,910**	**332,059**	**526,637**
Ijarah muntahia Bittamleek and rental receivables and rental receivables	**13,633**	**21**	**63**	**1,506**	**145,147**	**160,370**
Investments securities (sukuk and quaoted shares)	**1,601**	**3,798**	**-**	**39,373**	**69,200**	**113,972**
Total profit rate sensitive assets	**118,007**	**27,067**	**49,515**	**123,789**	**546,406**	**864,784**
Liabilities and Equity of Investment Accountholders						
Placements from financial institutions	**92,297**	**11,577**	**-**	**-**	**-**	**103,874**
Customers' current accounts	**152,647**	**-**	**-**	**-**	**-**	**152,647**
Equity of investment accountholders	**510,925**	**84,079**	**50,014**	**5,003**	**-**	**650,021**
Total profit rate sensitive laibilities and IAH	**755,869**	**95,656**	**50,014**	**5,003**	**-**	**906,542**
Profit rate gap	**(637,862)**	**(68,589)**	**(499)**	**118,786**	**546,406**	**(41,758)**

	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:	**(2,687)**	**2,687**	**-**
Downward rate shocks:	**15,977**	**(15,977)**	**-**

Table – 34. 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:

	2016	2015	2014	2013	2012
Return on average equity	**7.45%**	11.88%	11.80%	8.26%	(42.31%)
Return on average assets	**0.83%**	1.21%	1.00%	0.70%	(4.33%)
Cost to Income Ratio	**56.44%**	51.68%	55.10%	53.44%	80.14%

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4. Risk Management (Continued)

4.11 Profit Rate Risk (Continued)

4.11.4 Profit rate risk monitoring and reporting (Continued)

Table – 35. 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:

	2016	2015	2014	2013	2012
Allocated income to IAH	**29,301**	29,961	23,379	32,849	28,496
Distrbuted pofit	**7,131**	5,187	7,287	10,829	13,931
Mudarib fees	**22,170**	24,774	16,092	22,021	14,565

As at 31 December 2016:	**2016**	2015	2014	2013	2012
Balances (BD '000s):					
Profit Equalization Reserve (PER)	**250**	600	100	295	-
Investemnt Risk Reserve (IRR)	**530**	124	40	-	63
PER Movment	**(350)**	500	(195)	295	-
IRR Movement	**406**	84	40	(63)	63
Ratios (%):					
Income allocated to IAH / Mudarabah assets %	**3.39%**	3.85%	3.46%	4.87%	4.71%
Mudarabah fees / Mudarabah assets %	**2.57%**	3.18%	2.38%	3.26%	2.40%
Distributed profit / Mudarabah assets %	**0.83%**	0.67%	1.08%	1.61%	2.31%
Rate of Return on IAH %	**1.15%**	0.86%	1.11%	1.62%	2.15%
Profit Equalization Reserve / IAH %	**0.19%**	0.17%	0.07%	0.05%	0.00%
Investemnt Risk Reserve / IAH %	**0.12%**	0.04%	0.02%	0.01%	0.01%

CBB Penalties (PD 1.3.44)

The CBB penalty imposed upon the Bank amounted to BD 10 thousand during the year regarding teller fraud case.

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