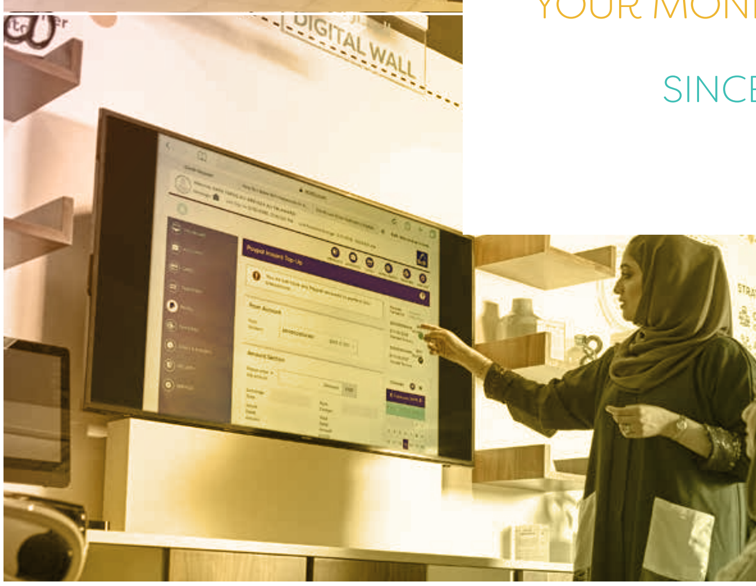
بنك البحرين الإسلامي BisB



SIMPLIFYING
YOUR MONEY MATTERS

SINCE 1979

40 YEARS

ANNUAL REPORT **2018**

We are here to make your life simpler by streamlining all of your business transactions

Overview

4 Corporate Profile
5 Our Brand Promise
6 Our Guiding Principles
7 Brand Values
8 Financial Highlights
9 Operational Highlights

Business Review

10 Board of Directors Report
12 Board of Directors
14 Sharia'a Supervisory Board
18 Chief Executive Officer Report
20 Executive Management
26 Review on Operations
30 Risk Management
32 Remuneration Disclosures
38 Corporate Social Responsibility
40 Corporate Governance Review
53 Sharia'a Supervisory Board report

Consolidated Financial Statements

55 Independent Auditors' Report
56 Consolidated Statement of Financial Position
57 Consolidated Statement of Income
58 Consolidated Statement of Cash Flows
59 Consolidated Statement of Changes in Owners' Equity
60 Consolidated Statement of Sources and Uses of Good Faith Qard Fund
61 Consolidated Statement of Sources and Uses of Zakah and Charity Fund
62 Notes to the Consolidated Financial Statements

Risk and Capital Management Disclosure

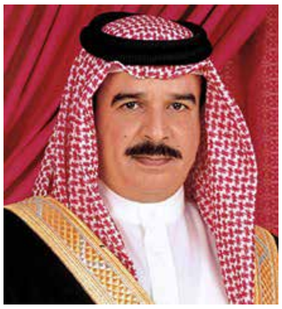
105 Background
105 Statement of Financial Position under the Regulatory Scope of Consolidation
106 Capital Adequacy
109 Risk Management
134 Glossary of Terms

Bahrain Islamic Bank B.S.C.
Diplomatic Area
P.O. Box 5240, Manama, Kingdom of Bahrain Tel: (+973) 17 515 151
Fax: (+973) 17 535 808
Email: corporate.communications@bisb.com
www.bisb.com

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

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

CORPORATE PROFILE

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 Bank license from the Central Bank of Bahrain and is listed on the Bahrain Bourse.

At the end of 2018, the Bank's paid up capital was BD 106 million, while total assets stood at BD 1,279 million. The Bank's modern branch network comprises 4 branches, 4 innovative financial malls, 1 Digital branch and 51 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.

4 BRANCHES

4 FINANCIAL MALLS

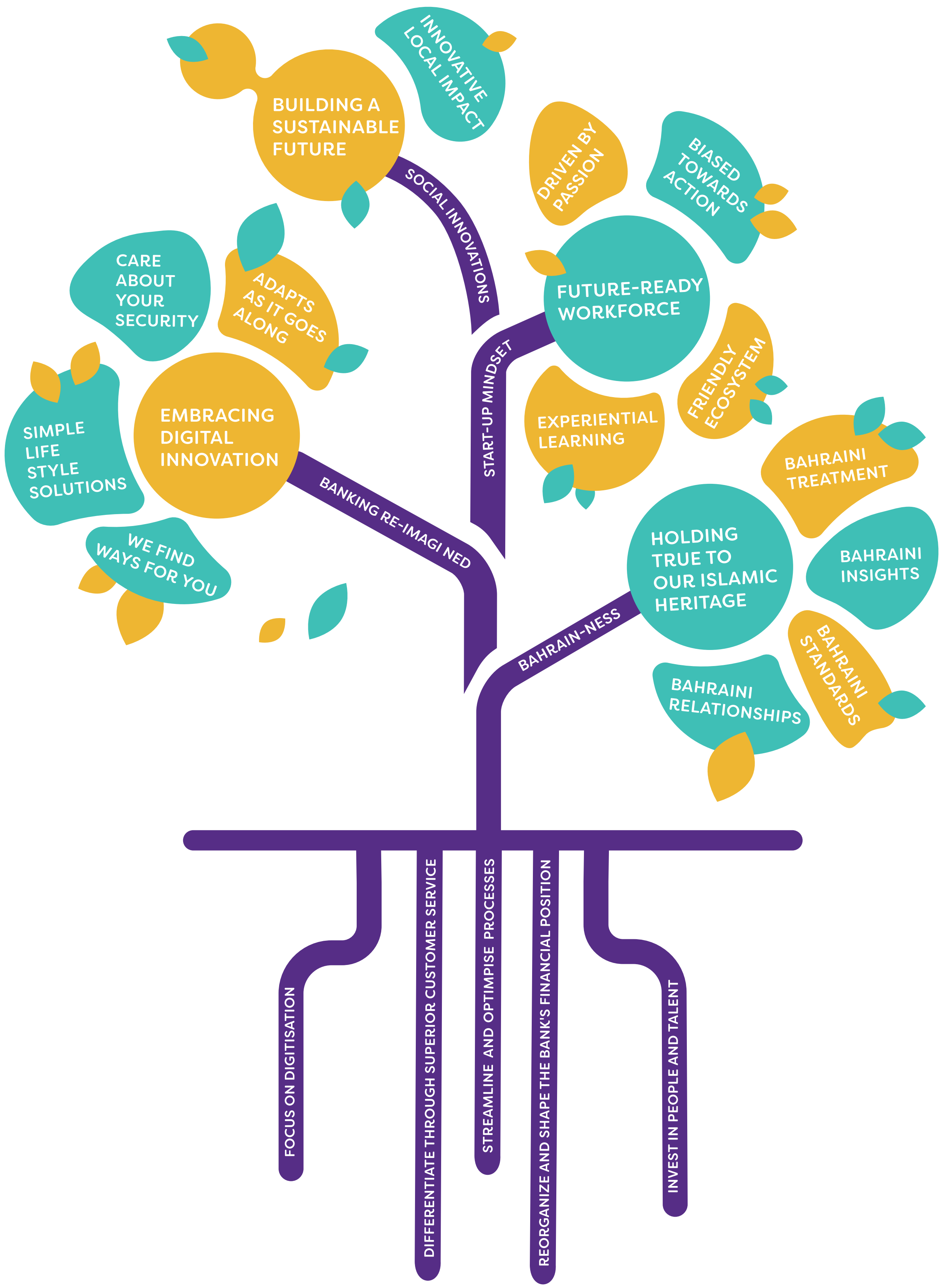
51 ATM's

1 DIGITAL BRANCH

OUR BRAND PROMISE

“Fueled by **Bahraini** devotion, we craft new ways of **Simplifying Your Money Matters**”

OUR GUIDING PRINCIPLES



BRAND VALUES

Bahraini
Innovative
Simple Bold

Bahraini

In light of our local religion, we follow the values and norms of Islam by being generous, modest, polite and respectful of others. We are hospitable and treat everyone with warmth. We desire to establish trust and build relationships with people before doing business. Family at home and at work is important to us and we are loyal to them. We care about the people we interact with and offer a helping hand. We are modern, intelligent and very literate.

Innovative

We move mountains to create more effective processes, products and ideas. Being innovative does not necessarily mean inventing something new, it is about challenging the status quo and adapting to changes in demands to deliver better products or services to everyone around us.

Simple

We strive for clarity and consistency, making decisions pragmatically and focusing on the bare essentials. We acknowledge that banking is complicated, so we go out of our way to find streamlined solutions to simplify the lives of everyone around us.

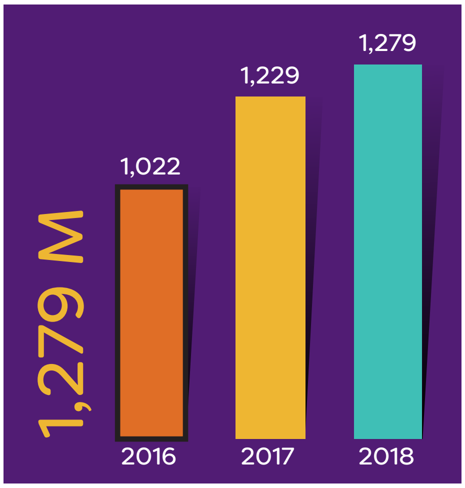
Bold

We think big, we're never afraid to cross boundaries in order to drive transformational growth. Without compromising on our values, we challenge the norms in order to make our mark, differentiating ourselves from the competition so we can continue to be recognized as the leading Islamic Bank in the Kingdom of Bahrain.

FINANCIAL HIGHLIGHTS

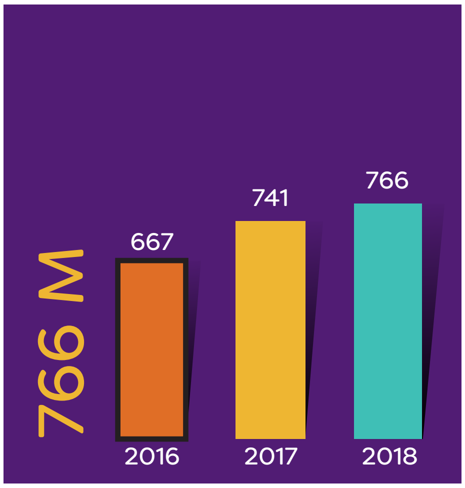
Total Assets

BD Millions



Total Islamic Financing

BD Millions

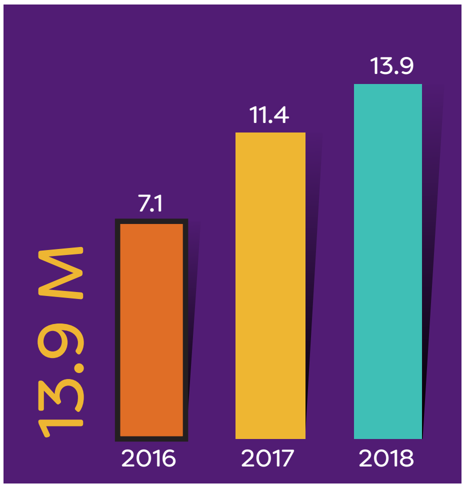


Total Operating Income

BD Millions

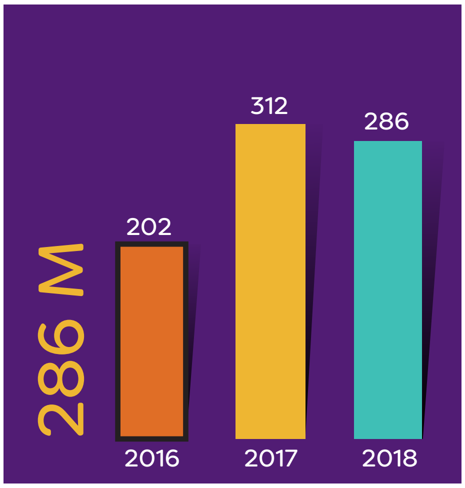
Net Return on Equity of Investment Accountholders

BD Millions



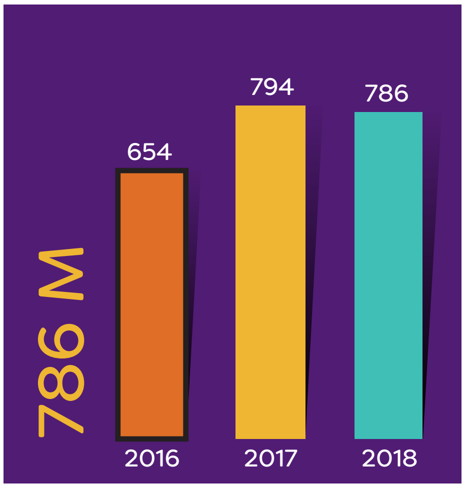
Investments

BD Millions



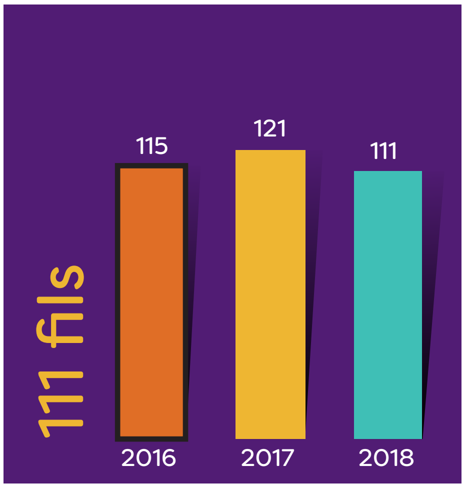
Unrestricted Investment Accounts

(BD Millions)



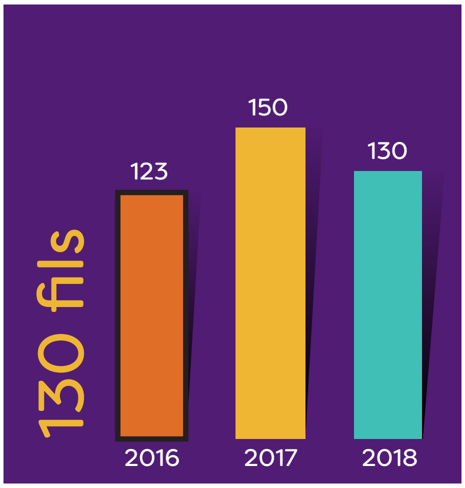
Book Value Per Share

Bahraini fils



Share Price

Bahraini fils



OPERATIONAL HIGHLIGHTS

1

Simplifying Our Customers' Experience

BisB has embraced the philosophy of making every part of its customer experience easy, friendly, and streamlined. Front-line and support groups are focused on delivering on that commitment. Each point of customer contact is addressed, from digital interface, to transactional requirements, to branch visits, bringing simplicity to their money matters.

2

Financial performance

Diligent financial management across the bank resulted in healthy asset growth of 4.1% with an attendant increase in liabilities of 20.2%. Net profit rose by 12% year on year. Operational expenses reduced by BD 1.3 million.

3

Retail Banking

Excellent advances were made in the areas of customer service and product offerings, with significant numbers of our customers choosing to migrate to the Retail Digital system banking channels. Further expansion of our linkages with local property developers provided access to competitive rates for homebuyers, while a revamp of the Wealth Management Services suite for High Net Worth clients focused on enhanced lifestyle experiences.

4

Corporate and Institutional Banking

Strong emphasis on transactional banking during the year resulted in more than 40% of our client base utilizing our BisB Corporate Digital Services. Core business remained channeled toward local enterprises, supporting the economy in corporate and SME companies within the Kingdom. Assets grew by 10.5% and income from financing raised by 18.8%

5

IT Infrastructure

Primary focus firmly centered on strengthening the continued support for BisB's Digital transformation efforts in our Retail and Corporate divisions. Much groundwork has already been done in introducing a Business Process Management system as well as a User Interface development platform to usher in end-to-end automated and streamlined operations across the bank.

6

Brand, Marketing, and Corporate Communications – Reinforcing our DNA

Assiduous attention to a total revamp to BisB's Brand Promise resulted in a clear bank-wide grasp of our DNA guiding principles and values. The tenets of 'Bahrain-ness', 'Banking re-imagined', 'Start-up mindset', and 'Social Innovations' are incorporated in our Brand Promise – 'Fueled by Bahraini devotion, we craft new ways to simplify your money matters'. Elsewhere, a comprehensive overhaul of our social networking channels and our website has strengthened our communication capacity.

BOARD OF DIRECTORS REPORT

BD 11.4 Million

NET PROFIT FOR THE YEAR

Technology was the dominant theme in 2018 and is expected to continue well into the future. BisB continues to invest in technology platforms and to strengthen technical capabilities within the Bank.

12%

the Bank has achieved another year of solid performance with a 12% growth in net profits over 2017.

In the name of Allah, the Most Beneficent. Prayers and Peace be upon the last Apostle and Messenger, His Comrades and Relatives.

On behalf of the Board of Directors, I am privileged to present the annual report and consolidated financial statements of Bahrain Islamic Bank for 2018. As the Bank's Back to Basics strategy finishes its last year, BisB continues to make significant strides in nearly every aspect of the Bank.

The turbulent events throughout the region I spoke about in 2017 have carried forward deep into 2018. Despite that, the Bank has achieved another year of solid performance with a 12% growth in net profits over 2017. Earnings stood at BD 11.4 million, which translates to earnings per share of 10.83 fils compared to 9.65 fils in 2017.

With strict adherence to a prudent risk appetite, financing assets stood at BD 765.8 million compared to BD 740.7 million in 2017.

Technology was the dominant theme in 2018 and is expected to continue well into the future. BisB continues to invest in technology platforms and to strengthen technical capabilities within the Bank. Our most recent investment was in a much-needed business planning management architecture (BPM), which will enable the Bank to adapt to fast-changing technological trends.

Another critical pillar is our people. Our commitment to invest in Bahraini talent continues unabated as we hone the Bank's succession line in preparation of our future leaders.

We expect 2019 to carry similar challenges. However, I remain optimistic about BisB's future and our ability to adapt to fast regulatory and technological changes. We have come a long way in improving nearly every aspect of the bank's operations but there is always much more to be accomplished.

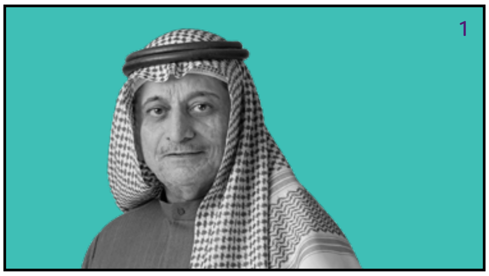
On behalf of the shareholders, the Directors record their grateful thanks and sincere appreciation to His Majesty King Hamad bin Isa Al Khalifa – the King of Bahrain; to His Royal Highness Shaikh Khalifa bin Salman Al Khalifa - the Prime Minister; to His Royal Highness Shaikh Salman bin Hamad Al Khalifa – the Crown Prince, Deputy Supreme Commander and First Deputy Prime Minister.

The Directors also express thanks to all Government ministries and authorities – in particular to the Central Bank of Bahrain and the Ministry of Industry, Commerce & Tourism for their invaluable guidance, kind consideration and constant support.

The Directors are grateful for the guidance and counsel of the Bank's Sharia'a Supervisory Board. The committed dedication of BisB's management and staff is also acknowledged, as well as our loyal customers and business partners, for their trust 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. Brigadier Ebrahim Abdullah Al-Mahmoud
Vice Chairman of the Board of Directors

Non-Executive & Non-Independent Director
Appointed on 28 May 2017.

Brigadier Ebrahim Abdulla Al Mahmood currently serves as CFO of Bahrain Defense Force (BDF) after having held many positions, such as: Director of Military Consumer Association, Head of Internal Audit Division, Head of Financial Control Division and Assistant Financial Controller. Brigadier Ebrahim Al Mahmood is the Vice Chairman of Bahrain Aluminum Extrusion Company (Balexco), a Board Member of the Military Pension Fund and the Military Consumer Association.

Brigadier Ebrahim Al Mahmood is a certified Arab accountant and holds a master's degree in public administration from the Portland State University, USA, and a B.Sc. in Economics from the University of Kuwait. In addition to his participation in many training courses in the areas of management, leadership and development, and has a professional experience of more than 37 years.

3. Mr. Talal Ali Al Zain
Board Member

Non-Executive & Independent Director
Re-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 Al Zain 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 and attended the Management Development Program at Harvard Business School.

4. Mr. Khalid Yousif Abdul Rahman
Board Member

Non-Executive & Non-Independent Director
Appointed on 23 March 2016.

Mr. AbdulRahman is Vice Chairman and Chief Executive Officer of Yousif AbdulRahman 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 the National Bank of Bahrain and Bahrain Ship Repairing & Engineering Company. He gained his B.Sc in 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. AbdulRahman has over 40 years of professional experience.

5. Mr. Khalil Ebrahim Nooruddin
Board Member

Non-Executive & Independent Director
Re-elected on 23 March 2016.

Mr. Khalil Ebrahim 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 eight 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. CFA charter holder, 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 of professional experience.

6. Mr.Ebrahim Husain Ebrahim Aljassmi
Board Member

Non-Executive & Independent Director
Re-elected on 23 March 2016.

Mr. Ebrahim Husain 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 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; he has over 35 years of experience in both conventional and Islamic banking.

7. Mr. Othman Ebrahim Naser Al Askar
Board Member

Non-Executive & Independent Director
Re-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 in 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 of professional experience.

8. Mr. Muhammad Zarrug Rajab
Board Member

Non-Executive & Non-Independent Director
Re-appointed on 23 March 2016.

Mr. Muhammad Zarrug Rajab holds a Bachelors degree in Accountancy and is a fellow member of the Institute of Chartered Accountants in England & Wales. He also 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, Governor of Libyan Central Bank, and Libyan Foreign Investment. Muhammad Rajab has over 45 years of professional experience.

9. Mr. Mohammed Ahmed Abdulla
Board Member

Non-Executive & Non-Independent Director
Re-appointed on 23 March 2016.

Mr. Mohammed Ahmed Abdulla is the Head of Strategic Initiatives and Business Development 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 and Board Member of Aegila Capital Management, UK. 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 in the years 2000 and 2001. Mr. Mohammed has more than 18 years of professional experience.

SHARIA'A SUPERVISORY BOARD

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

- Former Head of Arabic Language and Islamic Studies Department at the University of Bahrain.
- Member of the Supreme Council for Islamic Affairs, Bahrain.
- Member of the Shari'a Supervisory Board of Bahrain Central Bank, Oman Central Bank, AlBaraka Bahrain Group, Takaful International, and ABC Islamic Bank Kingdom of Bahrain and London.
- Preacher at a number of Bahrain's masjdes since 1973.
- He gives lessons in Quran interpretation, jurisprudence, principles of jurisprudence and preaching.
- He has participated and been a speaker in a number of jurisprudence, educational, economic, intellectual, social and cultural conferences and seminars.

2. Rev. Shaikh
Mohammed Jaffar Al Juffairi
Vice Chairman

- Studied at Al Ahliya University of Najaf, and joined the hawza studies for higher education in Sharia Sciences (comparative studies).
- Judge of the High Shari'a Court of Appeal and seconded as President of the High Shari'a Court, Ministry of Justice, Kingdom of Bahrain.
- Former Member of the Zakat Committee, Ministry of Justice.
- He has participated in a number of Islamic committees, courses, seminars and conferences.

3. Rev. Shaikh
Adnan Abdullah Al Qattan
Member

- Judge of the High Shari'a, Ministry of Justice, Kingdom of Bahrain.
- Chairman of the Orphans and Widows Care Committee, of the Royal Court.
- Chairman of the Pilgrimage Mission, of the Kingdom of Bahrain.
- Puisne Justice of the High Shari'a Court.
- Preacher of Ahmed Al Fateh Islamic Mosque.
- He has participated in a number of Islamic committees, courses, seminars and conferences.
- He worked as a lecturer at the Islamic Studies Department, University of Bahrain.
- Member of the Shari'a Supervisory Board of Alsalam Bank, Ibdar Bank, and LMC.

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

- Member of the Shari'a Supervisory Board at Central Bank of Bahrain, Abu Dhabi Islamic Bank, UAE, Sharjah Islamic Bank, UAE, Ithmaar Bank, Kingdom of Bahrain, Gulf Finance House, Kingdom of Bahrain, ABC Islamic Bank, Kingdom of Bahrain, ABC Islamic Bank, London and others.
- Member of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).
- Holds a number of awards, First Degree Award of Capability for Islamic services within and outside Bahrain 2007, from the King of Bahrain, Euro Money Award for innovation in Islamic banking supervision, Malaysia 2007, Malaysia Award for contribution to Islamic banking.
- He has participated and been a speaker in a number of jurisprudence, educational, economic, intellectual, social and cultural conferences and seminars.

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

- Professor of Comparative Jurisprudence and Faculty of Sharia and Islamic Studies, University of Kuwait.
- Member of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI),
- Member of the Shari'a Supervisory Board at Boubyan Bank – State of Kuwait, Alahli Bank, Investment Dar – State of Kuwait, Kuwait Zakat House.
- He has participated and been a speaker in a number of jurisprudence, educational, economic, intellectual, social and cultural conferences and seminars.

SIMPLIFYING
YOUR MONEY MATTERS
SINCE 1979


Financing to Deposits Growth
Description BHD '000
Jan 2016
Feb 2016
Mar 2016
April 2016
May 2016
June 2016
July 2016
Aug 2016
Sep 2016
Oct 2016
Nov 2016
Dec 2016
Jan 2017
Feb 2017
Financing 386,822 390,774 390,330 394,382 396,226 401,099 402,289 408,988 412,761 412,963 416,634 419,256 423,984 426,226
Deposits 482,005 481,130 481,130 486,788 488,529 494,346 490,419 488,337 497,795 499,845 502,773 502,898 494,614 497,925
Growth in Financing
Growth in Deposits
Financing to Deposits Ratio
510,000
490,000
470,000
450,000
430,000
410,000
390,000
370,000
88%
86%
84%
82%
80%
78%
76%
74%
Dec 2015
Jan 2016
Feb 2016
Sep 2016
Oct 2016
Nov 2016
Dec 2016
Jan 2017
Feb 2017
The increase in the financing to
A larger decrease in deposits
current and saving accounts.
A sharp spike in financing in
MBT financing.
A large decrease in deposits
by BD 10m
and Tejoori by BD 3m.
BisB

CHIEF EXECUTIVE OFFICER REPORT

12%

Improvement in Net Profits

Our innovation lab continues to draw attention in the local banking industry, led by a young and energetic innovation team.

"Our journey to build a best in class Islamic institution is just in its infancy."

In the name of Allah, the Most Beneficent. Prayers and Peace be upon the last Apostle and Messenger, His Comrades and Relatives.

Political and economic uncertainties throughout the region remained the underlying theme in 2018. Oil prices saw significant fluctuations ending the year at lower than earlier anticipated prices.

Liquidity throughout the region, especially in Bahrain, remained precious and continued to command hefty premiums on the part of the local banks. As a result, cost of funds spiked with an increase of 39.3%. However, a focused campaign towards funding diversification at BisB proved beneficial for the Bank.

Our Back-to Basics strategy, as it comes into its final year, continued to be the guiding road map towards our rebuilding journey in 2018. The Bank achieved a marked growth of 12% in net profits, 1.4% in the number of customer accounts, and equally important, a reduction of BD1.3 million in operational expenses.

Our focus on technology continued to play a significant part in the Bank's operating model, fueled by the need for continuous improvement in our processes in order to achieve efficiencies and provide the best customer experience possible. Our innovation lab continues to draw attention in the local banking industry, led by a young and energetic innovation team. In 2018, we invested in a business planning management architecture, which is essential for our technology team to provide APIs in a short period of time thus facilitating collaboration with external technology partners.

No advancements can be made without the relentless focus on investing in our Bahraini talent. We introduced training programs at all levels of the Bank with heavy emphasis on compliance, information security, and leadership skills for mid-level and senior managers. The year witnessed the recruitment, and internal promotions, of critical senior roles - all Bahrainis. Mr. Mazar Jalal joined the Bank as Chief Governance and Compliance Officer. Ms. Eman Ali was the first Bahraini woman in the history of BisB to be promoted to Head of Central Operations. Mr. Ameer Dairi was promoted to Chief Financial Officer as part of developing local talent.

Our journey to build a best in class Islamic institution is just in its infancy. We have a long way to go and many obstacles to tackle. However, I remain confident and optimistic that, with the guidance of the Almighty Allah, and with an agile and dynamic management team and the invaluable support of our Board of Directors, BisB is well on its way.

Hassan Amin Jarrar
Chief Executive Officer

EXECUTIVE MANAGEMENT

Hassan Amin Jarrar
Chief Executive Officer

Mr. Hassan Amin Jarrar is one of the most prominent banking leaders in the region with more than 30 years of international, regional and local banking experience. Prior to his appointment as Chief Executive Officer of Bahrain Islamic Bank in July, 2015, 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 B.Sc. in Finance from California State University, San Jose. He is Chairman of Liquidity Management Center, and serves on the Boards of Bahrain Bourse, the Bahrain Association of Banks, Tamkeen, and Bahrain Economic Development Board, Thomson Reuters MENA Regulatory, advisory board.

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 M.Sc. (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.

Dalal Ahmed Al Qais
Head of Retail Banking

Ms Al Qais is a highly experienced retail banker. Prior to her appointment in late 2017 as the first Bahraini lady to hold the position of Head of Retail Banking for the Bank, she headed the Consumer Banking Division of Standard Chartered Bank in Bahrain, with regional responsibilities covering Bahrain, Qatar and Oman. During her 16 years with Standard Chartered Bank, her management roles covered retail branch banking, SMEs, credit cards, and wealth management. Ms Al Qais also brings to the Bank in-depth knowledge of consumer banking digitization channels. She holds a Master Degree in Finance and a Bachelor's Degree in Management and Marketing.

Fahim Ahmed Shafiqi
Chief Risk Officer

Mr. Fahim Ahmed is an experienced Banker with over 20 years of international experience gained through various roles in corporate banking, project finance and risk management spanning the markets of GCC, Africa 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 University of Warwick UK.

Ameer Abdul Ghani Dairi
Chief Financial Officer

With over 19 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 is a board member representing BisB in LMC and Abaad Real Estate, 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.

Mazar Rashid Mohammed Jalal
Head of Compliance

Mazar Rashid Mohammed Jalal has over 18 years of experience in the financial services industry, covering Asset Management, Risk Management, Corporate Governance and Compliance. Prior to joining BisB, he was Head of Compliance at Kuwait Finance House, Bahrain. Mazar has had an extensive interface with various Central Bank regulators in the field of compliance and corporate governance, AML procedures, and FATCA, among others. He holds a BSc. in Accounting from the University of Bahrain, and a Diploma in Islamic Banking and Insurance from the Institute of Islamic Banking and Insurance, UK and Wales, with which he also has an Associate Fellowship. In 2014 , he acquired the International Diploma in Compliance (with Distinction) as recommended by the Central Bank of Bahrain.

EXECUTIVE MANAGEMENT

Hussain Ebrahim Al Banna
Head of Treasury Department

Mr. Hussain is a banking professional with more than 14 years of conventional as well as Islamic banking experience in various capacities. His banking experience started in 2004 when he joined BNP Paribas in the Regional Treasury Operations. In early 2005, he was selected for the prestigious Executive Management Trainee Program at Bank of Bahrain and Kuwait (BBK) and in the same year, he joined the Treasury & Investments department. He joined BisB in 2008 and is currently Assistant General Manager heading the treasury department . He holds a Bachelor's degree in Banking and Finance from the University of Bahrain and has successfully completed Treasury & Capital Markets diploma from Bahrain Institute of Banking & Finance (BIBF).

Khalid Mahmood Abdulla
Head of Internal Audit

Mr. Khalid Mahmood has over 22 years of experience in Accounting, Auditing, Banking and Sharia. 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 Andersen and Bahrain National Gas Company (BANAGAS). Khalid is a Certified Public Accountant (CPA) California, USA, and attended the Leadership Development Program at Darden School of Business, University of Virginia, USA.

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 in depth 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).

Osama Ali Nasr
Head of Information Technology

Mr. Osama Nasr holds a Master's degree in Information System Management from the University of Liverpool in the United Kingdom. In addition to his participation in several courses and workshops specialized in his field of work. He is currently the head of information technology in BisB. Mr. Osama Nasr has extensive professional experience in various areas of information technology. Prior to joining Bahrain Islamic Bank in 2007 as head of Application Services in the information technology department, Mr. Osama has held various key positions in a number of specialized companies in the information technology services in and outside of the Kingdom of Bahrain. Mr. Osama has over 20 years of exposure and knowledge in information technology. In addition to his current rule in BisB, he is a Non-Executive member of Global Payment Services- GPS W.L.L.

Mahmood Qannati
Head of Marketing & Corporate Communications

Mr. Mahmood Qannati has extensive local and regional experience in marketing, communication and brand identity management for more than 17 years. Prior to joining Bahrain Islamic Bank, he held several senior positions at Standard Chartered Bank including Regional Marketing Head, and Regional Head of Marketing and Corporate Communications at SIGNA in the United Arab Emirates. He holds a Master's degree in Marketing Information Systems from the University of Sunderland and a Bachelor of Marketing degree from the University of Bahrain.

Maisa Jawdat Shunnar
Head of Business Planning & Transformation

Ms. Shunnar has over 20 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 National Bank of Abu Dhabi as a Transformation Manager. She drove major changes across the bank such as the centralization of the non-core business activities and building the shared services center. In previous assignments, Ms. Shunnar headed the Business Process Re-engineering Department in the Electronic Government of Bahrain and she served as the Manager of Performance and 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 and 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). Furthermore, Ms. Shunnar has acquired a Certificate from Oxford University on Fintech and a Diploma in Islamic Finance Studies from CIMA, UK.

Eman Ali Abdulla Ebrahim
Head of Central Operations

Ms. Eman Ali Abdulla Ebrahim has more than 20 years of Banking Operations experience, extending through front and back office coordination for Trade Finance, Treasury and Islamic Finance. She is well-versed in conventional and Islamic banking operations, products and services support. Eman joined BisB in 2006, after eight years with Ahli United Bank in customer service and related support functions.

YEARS

SIMPLIFYING
YOUR MONEY MATTERS
SINCE 1979

Simplifying through Innovation Lab

BisB's Digital Branch at Galleria Mall gives direct automated access for customers to execute their banking transactions at the branch by themselves, or with video linkage to the Bank's call center.

Simplifying through Customer Focus

In 2018, we invested in a business planning management architecture, which is essential for our technology team to provide APIs in a short period of time thus facilitating collaboration with external technology partners.

Simplifying through Digital Branch

REVIEW ON OPERATIONS

More than **40%** of existing Corporate Banking active clients have migrated to the new online banking system. In addition, the department initiated and established escrow account and custody services.

Our Businesses

Retail Banking

2018 was a progressive year for Retail Banking. Against a backdrop of fierce market competition, our financial performance was satisfactory. Fee and commission income rose by 8.3%, total asset growth of 2.3% accompanied an increase in customer deposits of 4.6%.

In qualitative areas of customer service and product offerings, we have made excellent headway. The impetus of the digitization program initiated in 2017 has seen commendable migration of customers to our Retail Digital system. We launched our new fully Digital Branch at the Galleria Mall, which will mark another milestone in our range of automated services, extending convenience and simplicity in our retail channels. The revamp of the Customer Call Centre added a further dimension in improved customer experience. In the course of the year we signed an exclusive partnership with Paypal, expanding eCommerce facilities to our customers.

In the property financing market, we have linked with a range of leading property development companies, Bin Faqeeh, Royal Ambassador Property Management, and Kingdom Properties Real Estate to offer prospective buyers and investors attractive down payment terms on their purchases.

In other areas, we have restyled and simplified our approach to our cards business, improving the mix of returns on the utilization of our various cards. An overhaul of our Al Thuraya Wealth Management Services provides a more complete value proposition for our High Net Worth customers, complementing our existing products and services with an enhanced emphasis on travel and lifestyle experiences.

Corporate and Institutional Banking

Corporate and Institutional Banking performed well in the face of various external challenges during 2018. Assets grew by 10.5% and income from financing rose by 18.8%.

Significant impetus to growth for the department were participations in two major financing syndications for Bahrain Petroleum Company and Gulf Air respectively. These organizations are among the main drivers supporting Bahrain's economic vision 2030. BisB has taken a lead in supporting the sovereign economy and promoting the business expansion of companies within the Kingdom.

Additional growth factors for the division during 2018 have been achieved by developing new bilateral limits with counterparties outside of Bahrain, thereby diversifying the bank's current sources of funding. Furthermore, the Corporate and Institutional Banking division has satisfied all of the existing syndication repayments from the bank's operating cash flows during the year, with no refinancing required.

The division focused strongly on transactional banking during the year, having successfully launched the BisB Corporate Digital platform. More than 40% of existing active clients have platform migrated to the new online banking. In addition, the department initiated and established the real estate escrow account, custody services and sukuk trading.

BisB also partnered with Tamkeen on financing between "Export Bahrain".

A new program, 'Shine', aiming to build core capabilities in values-based leadership, effective team performance, coaching skills, time management, delegation, ownership and diversity management, was introduced to support those managers who completed last year's 'Rising Stars' program.

We anticipate continuing challenges within 2019 with tight liquidity and restructurings as the economy remains under pressure. The department will intensify its digital support services to simplify business operations to all customers. In addition, we will expand our credit card services to customers and further support our SMEs, as they are vital pillars of the economy. In line with this, we recently engaged as one of the main financiers for export-led SMEs in Bahrain, associated with "Export Bahrain". Financial Institutions division will continue to diversify its sources of funding for the organization and provide enhanced services to its clients.

Treasury

2018 was more eventful than expected. The rise of protectionism, trade tariffs, the global slowdown in advanced as well as emerging economies, and a series of hikes in benchmark rates by the Federal Reserve, led to a tightening of global liquidity and a revision of global economic growth projections by the International Monetary Fund. The GCC region was not immune to these dynamic shifts. The drop in the oil price toward $50 per barrel, the regional rush towards implementing Value Added Tax, and rating actions on Bahrain sovereign credit amplified liquidity pressures vis-a-vis a strengthening U.S Dollar.

Despite these market conditions, BisB continued meeting its obligations by fully repaying three bilateral commitments of US$ 133 million in addition to a full repayment of its US$ 101 million maturity for its first-ever syndicated facility. This further consolidated our credit story during times of tight liquidity, and helped cater over US$ 200 million of new repurchase facilities at lower spreads versus the year earlier. It included our first-ever term repurchase agreement against a backdrop of rising benchmark rates.

In terms of portfolio management, the sovereign portfolio constitutes more than 93.4% of the Sukuk and income from investment in Sukuk rose by 59%.

Treasury, in coordination with Retail Wealth Management and Corporate & Institutional Banking, has successfully tested our new platform for client Sukuk trading and order management. Our treasury system is undergoing a complete maintenance program and further upgrade in order to meet the new regulatory and international liquidity standards.

Our Business Enablers

Human Resources

Human Resources constantly touches every pillar of the Bank's 'Back to Basics' strategy, with the vision to establish BisB as an employer of choice. Diversity and inclusion efforts continue with the encouragement of active engagement between the management team and employees. Backing the initiative of empowering qualified women, gender equality was further demonstrated by promotion of one of our experienced ladies to Head the Central Operations function and another promotion of the first lady to head a Sharia'a Audit function in Bahrain.

Acknowledging the importance of women in the workforce and in line with the Kingdom of Bahrain's strategy to empower women, we designed a development program targeting our ladies, who represent 34% of our manpower. The program ran on multiple levels of development in order to maximise the opportunities for progression and development (personal and professional mastery).

We worked on transforming Human Resources from being traditional to contemporary. Migrating the manual processes to automation was a full year effort where the new HR platform now introduces a number of digital channels and applications, affording both employees and managers greater and more flexible self-service access to HR-related products, information, services requests, performance management, and managing learning. To continue the HR transformation, we have also designed and implemented a bank-wide competency framework that supports BisB's future growth aspirations. The competencies will be used to manage performance, recruit and promote staff.

Training and Development

A new program, 'Shine', aiming to build core capabilities in values-based leadership, effective team performance, coaching skills, time management, delegation, ownership and diversity management, was introduced to support those managers who completed last year's 'Rising Stars' program. The program includes a blended learning approach, such as self-reflection, and learning alliances with work-based assignment and trainer-led workshops.

Our 'High Potential Proposition – HiPos', program is designed to identify and provide individuals who display high potential to operate at leadership and succession level. The program is designed to take into consideration individual development needs and the future leadership capabilities required by the bank. It comprises a series of diagnostic stages that take participants through psychometrics, business simulation, and individual coaching sessions for the purpose of building a significant development plan.

We ensure the development of line managers' capabilities by designing and implementing a program to provide employees at People Managers level with the skills needed to maximize team performance, enhance working relationships, and achieve better leadership impact. The program consists of a curriculum of specially designed training modules to build three core leadership capabilities – manage self, manage teams and manage tasks.

REVIEW ON OPERATIONS Cont'd

'Simplicity' is at the heart of the BisB brand promise. Everything we do in the Technology Department is in pursuit of fulfilling this value. Through technology and digital innovation, the team continually seeks to improve the customer experience, offering simpler ways to deliver BisB products and services to existing and potential customers.

Optimising Branches Capabilities program was initiated to cover all the basics of banking and BisB product, processes, documentation, compliance and regulatory issues. Staff participating in the program were expected to demonstrate the required competencies through knowledge assessment and practical demonstration.

Technology

'Simplicity' is at the heart of the BisB brand promise. Everything we do in the Technology Department is in pursuit of fulfilling this value. Through technology and digital innovation, the team continually seeks to improve the customer experience, offering simpler ways to deliver BisB products and services to existing and potential customers.

The year 2018 proved another exciting landmark in our digital transformation journey, offering our clients instant delivery services of debit cards at their branch as well as instant cheque books delivered into the hand of our customer as he walks into any branch or service center. BisB also introduced assisted self-service machines, managed by remote tellers offering services in multi-locations through our centralized workforce. The team is working continuously to enhance further our award-winning app, 'BisB Digital' for Retail and Corporate businesses by introducing new services that will support the enrichment of the customer experience as well as increase the app utilization.

Additionally, the Department undertook another upgrade to the bank's technology infrastructure by establishing a Business Process Management system, and a rich User Interface development platform, paving the way to enable the development of end-to-end automated and streamlined operations in 2019.

In the coming year, the Technology Department will focus on four main areas: simplified, increased self-services; automation of back-office operations; continued service improvement of BisB Digital services; support of the businesses to develop and deliver new products and services which are simple and rich in customer experience.

Brand, Marketing, and Corporate Communications

In 2018, BisB invested enormous time, energy and focus on defining and consolidating our Brand DNA, the ethos of the institution. The DNA guiding principles, promise and values are encapsulated in our Brand Promise:

'Fueled by Bahraini devotion, we craft new ways to simplify your money matters'

In absolute support of the Brand Promise, our Pillars are:

Bahrain-ness – Instilling our Bahraini insights and local values in our daily tasks and our business approach, cementing 'Bahrain-ness' as a living value.

Banking re-imagined – Constantly finding new and innovative solutions for our customers, applying modern technology with world-class security measures.

Start-up mindset – Beyond the boundaries of a creative space, our BisB Innovation Lab fosters idea generation in an environment of continuous learning.

Social Innovations – At the heart and soul of everything we do, impacting positively on the local communities we serve.

Reinforcement of these concepts was launched in a Town Hall meeting to cascade these principles throughout the entire organization, emphasizing our front-line customer engagement, our middle and back office support, our technological interaction across all divisions and departments to enhance and simplify the experience for BisB's most important stakeholders – our customers.

In the course of the year, we revamped our social networking channels, delivering more immediacy to our corporate communications internally and externally, including a successful 'Yammer' roll out to all staff. Our website has received a complete makeover, making it fresher, simpler, and more user-friendly.

We welcome 2019 as we work to continue strengthening the awareness of BisB's brand in our marketplace.

Central Operations/ Business Planning and Transformation/ General Services

The major support groups within BisB coordinate to ensure timely and efficient cohesion across the organization.

Working together with the transformation team, Central Operations seeks to streamline operational processes in all front office divisions. In 2018, in order to ensure the highest level of service through simplifying the money matters of our valued customers, implementation of automation was a primary objective.

Through strengthening its base by focusing on its five 'Back to Basics' pillars for the past three years and the innovative culture it has created across the different layers, BisB strategy for the upcoming years will focus on differentiation through innovation and consistently providing a superior customer experience. Business Planning and Transformation department embraces the bank's DNA with its guiding principles to further invigorate and emphasize innovation and a startup mind set.

The 2019 strategy for the bank's core businesses and supporting functions is to build on and deliver new solutions in every part of the customer's experience. In the continuous improvement journey and drive to simplification, BisB follows an Omni Channel banking approach coupled with a smart banking experience through these different channels to ensure a consistent customer experience.

Compliance

At BisB, the Board encourages and promotes a strong compliance and governance culture. A specialized committee reviews and reports the bank's compliance with applicable rules and regulations on a regular basis. Compliance with regulatory requirements not only improves BisB's overall standing in the industry, but also safeguards the bank from financial penalties. Regional and International correspondent banks may consider de-risking local banks with substandard compliance functions.

BisB aims to position itself as a role model for other banks in the industry and invests accordingly in its compliance framework. In 2018, the bank took major steps to enhance its compliance and governance culture. Leadership plays a vital role in setting the right objectives. A senior industry resource was appointed to revamp and lead the compliance function, as well as doubling the department's resources. A subject matter expert was appointed to assist in reviewing and aligning BisB's compliance-related policies and procedures with regulatory requirements and best industry practice. The bank has also created compliance coordinators across all functions. These coordinators receive frequent training from the compliance department. One of the main objectives in having coordinators within the businesses and other control functions is to ensure that no product or service is rolled out without appropriate governance.

Change management, including adopting new technology to simplify business, is vital to survive in today's competitive environment. The compliance department explores ways to embed compliance within the business process. Added to the role of compliance at BisB of reviewing historic transactions and events is the identification of regulatory issues at early stages and recommending appropriate controls.

Corporate Social Responsibility

Social innovation remains a key priority for BisB. The bank continuously invests in the local communities it serves, contributing to social well-being and improving the fabric of society.

Throughout the year, our dedicated Sharia'a-compliant community investments supported our annual Zakat contributions. In addition, our employees donated their own time and effort to help the less fortunate. With the heavy rainfalls in 2018, various areas in Bahrain required assistance. The bank's volunteers came to the aid of families by renovating houses, repairing the disastrous effects of the water damage, and providing financial support to cover their educational, Eid and Ramadan month needs.

BisB ensured an active key industry presence by sponsoring events such as the World Islamic Conference; AAOIFI's and the World Bank's 16th annual conference for Islamic Banking and Finance; the second forum of Islamic Sharia'a Advisors and Legal experts, all of which contribute to the economic development of the Kingdom of Bahrain as a whole.

The bank will launch its new corporate responsibility program in 2019, focusing on investing in initiatives which foster education in a digital age, creating a positive and sustainable impact on local communities.

RISK MANAGEMENT

At the heart of the Bank's activities is the risk management function, through which the ongoing identification, measurement, monitoring and reporting of all of the Bank's inherent risks is conducted; the risks considered are identified in the Bank's risk strategy and in line with the Bank's risk appetite, which are set and guided by the Board of Directors. These elements foster a sound risk management culture at the Bank, for which all of the individuals in the institution are accountable for in their related area of expertise.

The risk culture is effected through appropriate policies, controls, and risk monitoring systems, and the Board ensures that this is implemented effectively. This framework includes internal limits for the various types of risk to which the bank may be exposed. Moreover, appropriate management information systems are in place to monitor risk exposures, and accordingly report the same to the relevant stakeholders.

The Bank is primarily exposed to credit risk, liquidity risk, market risk (including profit rate risk, equity price risk, and foreign exchange 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, income streams, and optimize portfolio quality 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's risk appetite is embodied through its risk strategy; BisB reviews and aligns its risk appetite in line with its evolving business plan, and changing economic and market scenarios, in addition to evolving regulatory requirements. The Bank also assesses its tolerance for specific risk categories and its strategy to manage these risks. To monitor and report exposures to these identified risks, the Bank adopted a comprehensive enterprise-wide Risk Management Framework that encompasses the risk limit identification, monitoring, and reporting structures.

Risk management framework

The Bank's risk management framework 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.

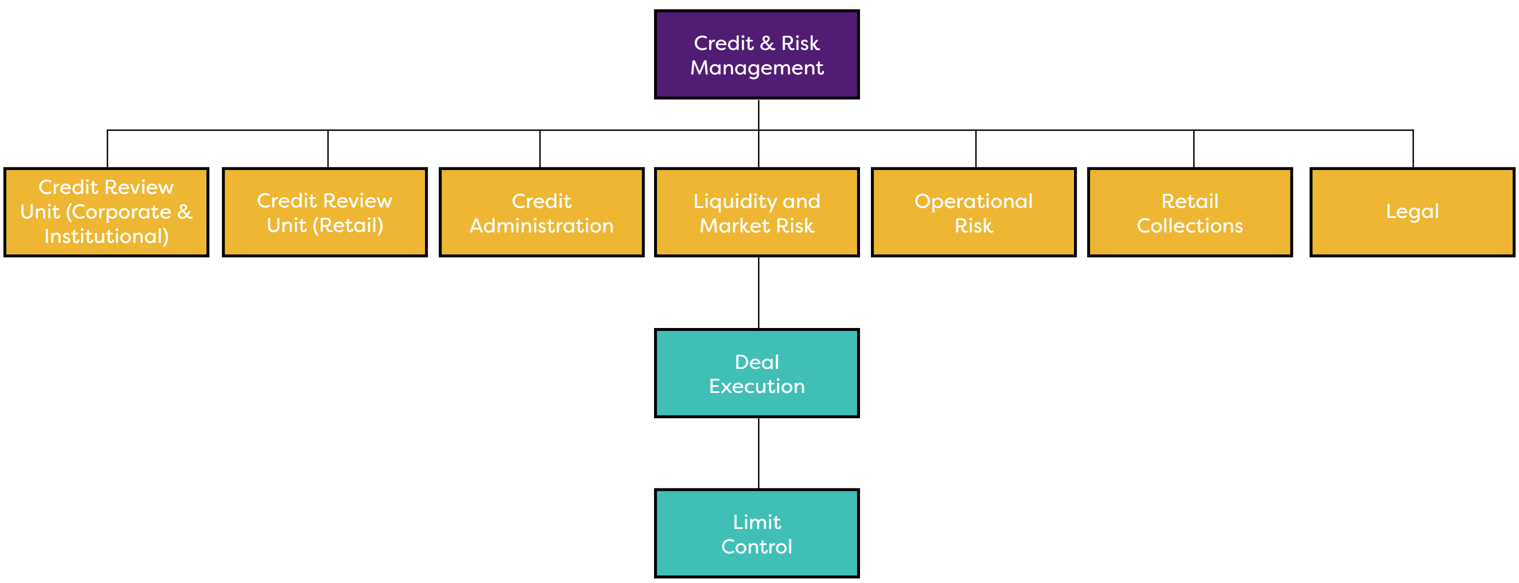
The Credit & Risk Management (C&RM) division – headed by the Chief Risk Officer - has day-to-day responsibility for managing the risks involved across all areas of the Bank. C&RM provides independent identification, measurement, monitoring and control of all risk parameters, while liaising with the business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

C&RM is currently in the process of upgrading its current risk management infrastructure following the regulations effected by the Central Bank of Bahrain during the course of 2018. The regulations are related to the Basel III accord, and specifically tackle liquidity and reputational risk, in additional to the Bank's internal capital planning and management. The regulations specifically focus on enterprise-risk management.

Key developments are detailed below:

- Amending the existing ICAAP framework
- Strengthening of the Liquidity Risk Management of the Bank
- Implement more sophisticated stress testing methodologies, and to link the same to the Bank's business strategy and risk systems
- Enhancement in the MIS and the risk reporting to the Board and the Management
- Ensuring the ongoing compliance with the policies of the Bank, and monitoring the enterprise-wide risk through various systems and processes

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 proposed remuneration framework are summarised 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. 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 Bahrain Commercial Companies Law, in any financial year. Board remuneration is subject to approval of the shareholders in the Annual General Meeting as well as Ministry of Commerce, Industry and Tourism. 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 be determined by the financial performance of the business are as 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 judgement 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

REMUNERATION DISCLOSURES Cont'd

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.

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:

Elements of variable remuneration	Payout percentages	Vesting period	Retention	Malus	Clawback
Upfront 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:

Elements of variable remuneration	Payout percentages	Vesting period	Retention	Malus	Clawback
Upfront cash	50%	immediate	-	-	Yes
Upfront 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	2018	2017
Sitting fees	*153	*141
Remuneration	**282	283

*Includes NRC sitting fees as of 31 Decemebr 2018 amounted to BD 15 thousand (2017: BD 7 thousand).

**Subject to AGM and regulatory approval.

(b) Sharia's Supervisory Board

BD 000's	2018	2017
Remuneration, Fees and Expenses	65	111

REMUNERATION DISCLOSURES Cont'd

(c) Employee Remuneration

2018

BD 000's	Number of staff	Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					Total
						Upfront		Deferred			
		Cash	Others	(Cash / Shares)	(Cash / Shares)	Cash	Shares	Cash	Shares	Others	
Approved persons											
- Business lines	6	914	-	-	-	141	-	34	168	-	1,257
- Control & Support	17	1,463	-	-	-	177	25	-	100	14	1,779
Other material risk takers	-	-	-	-	-	-	-	-	-	-	-
Other staff	342	8,816	-	-	-	848	-	-	-	-	9,664
Total	365	11,193	-	-	-	1,166	25	34	268	14	*12,700

*Includes end of service compensations & includes staff cost of employees who have left the bank during the year.

2017

BD 000's	Number of staff	Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					Total
						Upfront		Deferred			
		Cash	Others	(Cash / Shares)	(Cash / Shares)	Cash	Shares	Cash	Shares	Others	
Approved persons											
- Business lines	6	1,646	-	-	-	114	-	26	131	-	1,917
- Control & Support	9	1,124	-	-	-	90	13	-	52	-	1,279
Other material risk takers	-	-	-	-	-	-	-	-	-	-	-
Other staff	345	9,012	-	-	-	790	-	-	-	-	9,802
Total	360	11,782	-	-	-	994	13	26	183	-	*12,998

*Includes end of service compensations.

Deferred awards disclosures

2018

BD 000's	Cash	Shares		Total
		Number	BD 000's	
Opening balance	75	3,730,964	469	544
Awarded during the period	34	2,250,743	293	327
Paid out / released during the period	(18)	(1,205,294)	(162)	(180)
Service, performance and risk adjustments	-	-	-	-
Corporate action adjustment	-	181,330	110	110
Closing balance	91	4,957,743	710	801

Number of shares for the 2018 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.

2017

BD 000's	Cash	Shares		Total
		Number	BD 000's	
Opening balance	67	2,897,480	353	420
Awarded during the period	26	1,412,147	198	224
Paid out / released during the period	(18)	(578,663)	(82)	(100)
Service, performance and risk adjustments	-	-	-	-
Corporate action adjustment	-	-	-	-
Closing balance	75	3,730,964	469	544

CORPORATE SOCIAL RESPONSIBILITY

Since inception, BisB has been committed to supporting the social and economic development of the Kingdom of Bahrain. As a concerned corporate citizen, we have put in place a comprehensive corporate social responsibility programme that provides financial assistance to various charitable, educational, medical, cultural and sporting organizations and events, and deserving causes; and also supports the development of Bahrain's financial services industry. In line with the Bank's business philosophy, we are particularly keen to support initiatives that foster entrepreneurship and that encourage the development of tomorrow's leaders.

Organizing the Second Forum of Islamic Transactions

Sponsoring AAOIFI Conference

Sponsoring WIBC Conference

CORPORATE GOVERNANCE REVIEW

Corporate Governance Framework

Bahrain Islamic Bank B.S.C. ("BisB" or the "Bank") is committed to upholding the highest standards of corporate governance by way of balancing entrepreneurship, regulatory compliance, and industry best practices, while creating value for all stakeholders. It also involves having the right checks and balances in place throughout the organization to ensure that the Bank's processes are within an adequate, efficient and robust internal control and governance framework.

Statement of Responsibility

The Board is ultimately accountable to the shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value through strategic initiatives. The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Executive Management, and maintaining a dialogue with the Bank's shareholders. The Board has established the following Committees to assist it in carrying out its responsibilities:

1. **Executive Committee ("EC");**
2. **Audit, Compliance & Governance Committee ("ACGC"); and**
3. **Nomination & Remuneration Committee ("NRC").**

The Risk Management function of the Bank had a dual reporting to Board's EC and ACGC however, during the second half of 2018, an independent Board Risk Committee ("BRC") was also established. Accordingly, the reporting of the Risk Management function is directed to the BRC.

BisB's corporate governance framework is built on a code of business conduct, policies, procedures, internal controls, risk management, Sharia review and audit, internal and external audit and compliance functions. The framework is based on effective communications, transparent disclosures, performance measurement and accountability. An independent Internal Audit function is established within the Bank that reports directly functionally to the ACGC.

Code of Business Conduct

BisB conducts its business in accordance with the highest standards of ethical behavior. A Code of Business Conduct has been developed, based on the CBB's Principals of Business regulations, to govern the personal and professional conduct of the directors and employees of the Bank. The code is based on the following principals:

1. **Integrity**
2. **Conflicts of Interest**
3. **Due Skill, Care and Diligence**
4. **Confidentiality**
5. **Market Conduct**
6. **Customer Assets**
7. **Customer Interest**
8. **Relations with Regulators**
9. **Adequate Resources**
10. **Management, System & Controls**

The requirements under each of the above principals are made available to the Board and employees of the Bank. The Board monitors any exceptions to the above principals by way of reviewing formal reports issued to the Board's Audit, Compliance & Governance Committee.

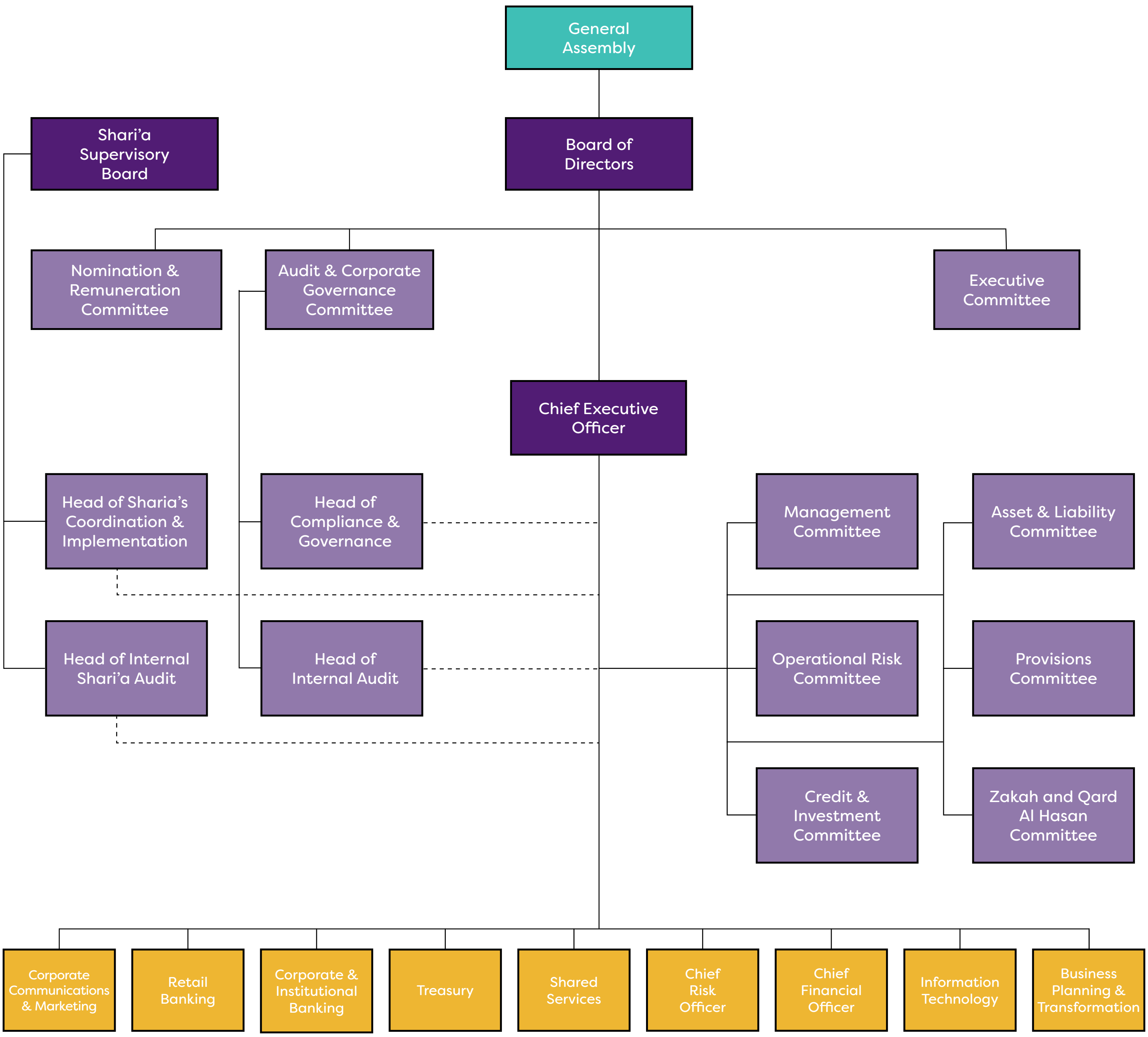
Compliance

Compliance is an independent function that reports to the ACGC. The Compliance function, guided by the Board approved Policies, works with various business and controlled functions of the Bank to ensure compliance with the applicable rules and regulations of the Central Bank of Bahrain.

Communications

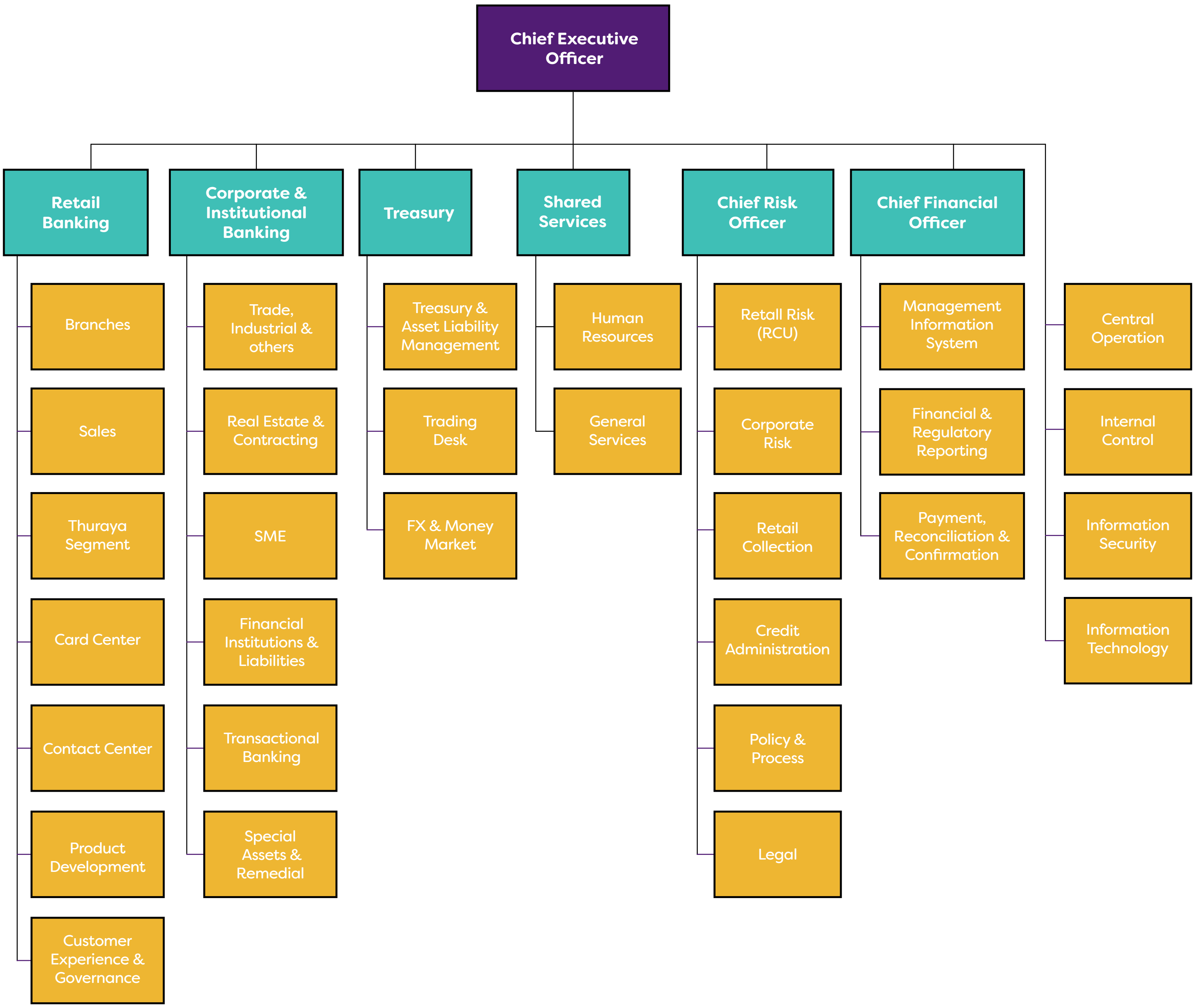
BisB conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communication channels include the annual report, website and regular announcements in the appropriate local media.

Governance Framework



CORPORATE GOVERNANCE REVIEW Cont'd

Bank's structure



Board of Directors

Composition

Profiles of Board Members are listed on page 12 & 13 of this annual report.

No.	Director	Designation	Start Date	Term
1	Dr. Esam Abdulla Fakhro	Non-Executive & Non-Independent	23rd March 2016	First
2	Brigadier Ebrahim Abdulla Al Mahmood	Non-Executive & Non-Independent	28th May 2017	First
3	Khaled Yusuf AbdulRahman	Non-Executive & Non-Independent	23rd March 2016	First
4	Mohammed Ahmed Abdulla (Until 2nd December 2018)	Non-Executive & Non-Independent	23rd March 2016	Second
5	Talal Ali Al Zain	Non-Executive & Independent	23rd March 2016	Second
6	Khalil Ebrahim Nooruddin	Non-Executive & Independent	23rd March 2016	Second
7	Ebrahim Husain Ebrahim Aljassmi	Non-Executive & Independent	23rd March 2016	Second
8	Othman Ebrahim Naser Al Askar	Non-Executive & Independent	23rd March 2016	Second
9	Muhammad Zarrug Rajab	Non-Executive & Non-Independent	23rd March 2016	Second

Board of Directors' Responsibilities

The primary responsibility of the Board of Directors is to provide effective governance over the Bank's affairs for the benefit of its stakeholders, and to balance the interests of its 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 will approve and oversee the implementation of the Bank's strategies and will review and approve the Bank's strategic plan. As part of its strategic review process the Board will review major action and business plans, set performance objectives and oversee major investments, divestitures and acquisitions. The Board is also ultimately responsible to ensure effective risk management function, regulatory compliance, adequate internal controls as well as compliance with Sharia rulings. Every year, at an annual Board strategy session, the Board will formally reassess the Bank's objectives, strategies and plans.

One of the Board's most important responsibilities is identifying, evaluating and selecting candidates for the Board of Directors. The Board will seek members from diverse professional backgrounds who combine a broad spectrum of experience and expertise with a reputation for integrity. Directors should have had experience in positions with a high degree of responsibility, be leaders in the companies or institutions with which they are affiliated and be selected based upon the contributions they can make to the Board.

The Board may not necessarily carry out all these responsibilities but should ensure that these have been delegated to various board committees or executive management committees to act on their behalf and communicate periodic reports to the Board for their review.

Induction of New Directors

The Bank provides an orientation program for new Directors which shall include presentations by senior management on the Bank's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its operations, its Code of Conduct, its management structure and executive officers and its internal and external auditors.

Code of Conduct

The Bank adopts a Code of Conduct and other internal policies and guidelines to comply with the laws, rules and regulations that govern the Bank's business operations. The Code of Conduct applies to all employees of the Bank as well as to Directors.

Review of Internal Control Processes and Procedures

Audit, Compliance & Governance Committee assists the Board in fulfilling its oversight responsibility relating to the performance of the internal audit function, which regularly reviews and ensures adherence to internal control processes and procedures.

CORPORATE GOVERNANCE REVIEW Cont'd

Board Membership

The Board of Directors' membership term is three years, subject to renewal. Shareholders owning 10% or more of the share capital must nominate a representative on the Board of Directors in proportion to the number of Board members. A secret ballot is held at the Ordinary General Meeting for the remaining Board members. The Board of Directors elect, by a secret ballot, a Chairman and Vice Chairman for a renewable term of three years.

Membership of the Board of Directors can be terminated in the following cases:

- If a member fails to attend at-least 75% of the meetings without a reasonable excuse;
- If he/she tenders his resignation in writing;
- If he/she fails to fulfill any related conditions referred to the Bank's Memorandum of Association;
- If he is appointed or elected in violation of the provisions of the CBB Law and/or Bahrain Commercial Companies Law;
- If he abuses his membership for carrying on other business that competes with or is detrimental to the company's business; or
- If the shareholder who nominates him applied for his removal.

Board Meetings and Attendance

Minimum Number of Meetings Required = 4

Members	22-Jan	12-Feb	28-Mar	07-May	13-Aug	05-Nov	10-Dec
Dr. Esam Abdulla Fakhro	✓	✓	✓	✓	✓	✓	✓
Brig. Ebrahim Abdulla Al Mahmood	✓	✓	✓	✓	✓	✓	✓
Mr. Khalid Yousif Abdul Rahman	✓	✓	✓	✓	✓	✓	✓
Mr. Talal Ali Abdulla Al-Zain	✓	✓	✓	✓	✓	✗	✓
Mr. Khalil Ebrahim Nooruddin	✓	✓	✓	✓	✓	✓	✓
Mr. Muhammad Zarruq Rajab	✓	✓	✓	✓	✗	✓	✓
Mr. Ebrahim Husain Ebrahim Al-Jassmi	✓	✓	✓	✓	✓	✓	✓
Mr. Othman Ebrahim Naser Al-Askar	✓	✓	✗	✓	✗	✓	✓
Mr. Mohammed Ahmed (Until 2nd December 2018)	✓	✓	✓	✓	✓	✓	*N/A*

Board Committees' Members

Board Committee	Members	Objectives
Executive Committee (EC)	**Brig. Ebrahim Abdulla Al Mahmood*** Chairman Members • Khalil Ebrahim Nooruddin • Khaled Yusuf AbdulRahman • Mohammed Ahmed Abdulla • Hassan Amin Jarrar (non-voting)	The objective of the EC of the Bank is to undertake the duties and responsibilities delegated by the Board of Directors to assist the Board in the fulfilment of its duties to the Bank and its shareholders.
Audit & Corporate Governance Committee (ACGC)	**Ebrahim Husain Aljassmi** Chairman Members • Othman Ebrahim Al Askar • Muhammad Zarrug Rajab	The ACGC oversights the integrity and reporting of the Bank's quarterly and annual financial statements. It also covers review of audit findings, relevant risk reporting, provisions and impairments as well as compliance with legal and regulatory requirements.
Nomination and Remuneration Committee (NRC)	**Dr. Esam Abdulla Fakhro** Chairman Members • Talal Ali Al Zain • Ebrahim Husain Aljassmi	The NRC is responsible for developing and recommending changes from time to time in the Bank's nomination and remuneration policy, including the variable payment policy. It is also entrusted to identify and recommend persons occupying senior positions including board members.

Executive Committee Meetings and Attendance

Minimum Number of Meetings Required = 4

Members	03-Jan	11-Feb	06-Mar	23-Apr	25-Jun	23-Oct	18-Nov
Brig. Ebrahim Abdulla Al Mahmood	✓	✓	✓	✓	✓	✓	✓
Khalil Ebrahim Nooruddin	✓	✓	✓	✓	✓	✓	✓
Mohammed Ahmed	✓	✓	✓	✓	✓	✓	✓
Khaled Yusuf AbdulRahman	✓	✓	✓	✓	✓	✓	✓
Hassan Amin Jarrar (non-voting)	✓	✓	✓	✓	✗	✓	✓

Audit, Compliance & Corporate Governance Committee Meetings and Attendance

Minimum Number of Meetings Required = 4

Members	01-Feb	26-Mar	06-May	10-Jul	12-Aug	22-Oct	04-Nov	11-Dec
Ebrahim Husain Aljassmi	✓	✓	✓	✓	✓	✓	✓	✓
Othman Ebrahim Al Askar	✓	✓	✓	✓	✓	✓	✓	✓
Muhammad Zarrug Rajab	✓	✓	✓	✓	✗	✗	✓	✓

CORPORATE GOVERNANCE REVIEW Cont'd

Nomination & Remuneration Committee Meetings and Attendance

Minimum Number of Meetings Required = 2

Members	15-Jan	30-Jan	18-Feb	20-May	12-Dec
Dr. Esam Abdulla Fakhro	✓	✓	✓	✓	✓
Talal Ali Al Zain	✓	✓	✓	✓	✓
Mr. Ebrahim Husain Al Jassmi	✓	✓	✓	✓	✓

Evaluation of the Board and Each Committee

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.

Board of Directors Remuneration and Sitting Fees

The Board of Directors are paid an annual remuneration as approved by the shareholders at the Ordinary General Meeting. While the amount of the remuneration is not directly linked to the performance of the Bank, factors such as the Bank's performance, industry comparison and the time and effort committed by the Directors to the Bank, are considered for determining the total remuneration. In addition, Directors are paid sitting fees for attending the various subcommittees of the Board of Directors. Non-resident directors are also entitled to travel expenses. Further details on the remunerations paid to Board as well as Senior Management are available under the remuneration disclosures of the annual report.

Shari'a Supervisory Board

Objective

The main objective of Shari'a Supervisory Board is to advise the Bank on any Shari'a matter and to ensure compliance with the Shari'a tenets and requirements in their operations. The Shari'a Supervisory Board is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that the Bank is in compliance with Shari'a rules and AAOIFI. The profiles of the Shari'a Supervisory Board are listed on page 14-15 of this annual report.

The Shari'a Supervisory Board has established a Shari'a Coordination & Implementation function to assist the Bank in its day to day management of business. The Sharia Supervisory Board has also established an independent Internal Shari'a Audit function that reports any exceptions to the Shari'a fatwas and guidelines.

Shari'a Board Meetings

Members	06-Mar	14-May	03-Sep	01-Nov
Sh. Dr. Abdul Latif Al Mahmood	✓	✓	✓	✓
Sh. Mohammed Al Juffairi	×	✓	×	×
Sh. Adnan Al Qattan	✓	✓	✓	✓
Sh. Dr. Nedham Yacoubi	✓	×	✓	✓
Sh. Dr. Essam Al Enizi	✓	✓	×	✓

Executive Management

The management structure that clearly defines roles, responsibilities and reporting lines, is available in the annual report of the Bank. Within the management structure there are separate committees responsible to meet on a regular basis to discuss and decide on the various strategic and tactical issues within their respective areas.

Name & Designation	Profession	Experience in years	Qualification
Hassan Amin Jarrar Chief Executive Officer	Banking	30	BSc in Finance from California State University, San Jose.
Wesam A.Aziz Baqer Head of Corporate Banking	Banking	17	MSc (Economics) in Finance and Investment Management from the University of Aberdeen, Scotland. BS in Business Administration from the University of Bahrain. Certified Financial Adviser (CeFA).
Dalal Ahmed Al Qais Head of Retail Banking	Banking	17	MBA in Finance from AMA University. BSc in Business Management from the University of Bahrain.
Ameer Abdul Ghani Dairi Chief Financial Officer	Accounting	19	CPA from New Hampshire Board of Accountancy. Certified Management Accountant (CMA) licensed by the Chartered Institute of Management Accountants, USA. BSc in Accounting from University of Bahrain.
Fahim Ahmed Shafiqi Chief Risk Officer	Banking	20	Diploma in Islamic Finance (CDIF). MBA from University of Warwick, UK.
Eman Ali Abdulla Ebrahim Head of Central Operations	Banking	22	Associate Diploma in Accounting, University of Bahrain
Hussain Ebrahim Al Banna Head of Treasury	Banking	15	BSc in Banking & Finance from the University of Bahrain. Treasury & Capital Markets Diploma, BIBF.
Dawood Khalil Al Ashhab Head of HR & General Services	Human Resources	19	BS in Public Administration. Certified coach from the Gallup University, UK.
Mahmood Qannati Head of Marketing & Corporate Communication	Marketing	18	MSc in Computer Based Information Systems from the University of Sunderland. BSc in Marketing from the University of Bahrain.
Osama Ali Nasr Head of IT	Information Technology	21	MSc in Information Systems Management from the University of Liverpool. BSc in Computer Science from Al-Isra University, Jordan.
Khalid Mahmood Head of Internal Audit	Auditing	24	CPA from American Institute of Certified Public Accountants.
Mazar Rashed Jalal Head of Compliance & Governance	Banking	18	BSc in Accounting from the University of Bahrain. International Compliance Associate Diploma from UK. Diploma in Islamic Banking and Insurance from UK, Wales.
Mohammed Ayada Mattar Money Laundering Reporting Officer	Banking	14	Masters in Finance from AMA International University. Certified Anti-Money Laundering Specialist. Diploma in Governance, Risk & Compliance from International Compliance Association.

CORPORATE GOVERNANCE REVIEW Cont'd

Maisa Jawdat Shunnar Head of Strategy Implementation & Transformation	Strategy Implementation & Transformation	19	BSc in Business Administration majoring in Computer Information Systems from University of Houston (Texas, USA). Masters of Business Communication & Leadership, Jones International University, Colorado, USA.
Hamad Farooq Al- Shaikh Head of Sharia Coordination & Implementation	Banking	14	Master degree of Sharia At ALEmam ALAwzaie University in Lebanon Chartered Islamic Finance Professional Advanced Diploma in Islamic Commercial Jurisprudence Bachelor Degree in Law and Sharia from Qatar University
Eman Mohammed AlBinghadeer Head of Internal Sharia Audit	Banking	14	Professional Diploma in Sharia Auditing – CIBAFI. CSIA – Certified Specialist in Islamic Accounting – CIBAFI. CIB – Certified Islamic Banker – CIBAFI. CSAA – Certified Sharia Adviser and Auditor – AAOIFI. Diploma in Computing and Business Studies – Bournemouth University and Technology Centre – UK.

Management Committees

Committee(s)	Members	Objectives
Management Committee (MANCO)	**Hassan Amin Jarrar** Chairman Members • Wesam A.Aziz Baqer • Dalal Ahmed Al Qais • Ameer Abdul Ghani Dairi • Fahim Ahmed Shafiqi • Eman Ali Abdulla Ebrahim • Dawood Khalil Al Ashhab • Osama Ali Nasr • Mazar Rashed Jalal • Maisa Jawdat Shunnar	MANCO is the highest management body that reviews the Bank's strategy implementation. In addition, the Committee also plays a significant role in establishing the policies, procedures and frameworks covering risk management, compliance, retail and corporate banking. The Committee also monitors the performance of business, support and control functions of the Bank.
Asset & Liability Committee (ALCO)	**Ameer Abdul Ghani Dairi** Chairman Members • Hassan Amin Jarrar • Dalal Ahmed Al Qais • Fahim Ahmed Shafiqi • Hussain Ebrahim Al Banna • Wesam A.Aziz Baqer	The purpose of Asset & Liability Committee is to act as a decision making body and guiding force responsible for balance sheet planning from risk return perspective, including strategic management of yield and liquidity risks.
Credit & Investment Committee (C&IC)	**Hassan Amin Jarrar** Chairman Members • Wesam A.Aziz Baqer • Dalal Ahmed Al Qais • Fahim Ahmed Shafiqi (Dissenting Vote)	C&IC determines the Credit & Investment Policy of the Bank, identified possible risks assumed by the Bank for different types of transactions. The C&IC has the authority to make a decision on approval or rejection or proposed transactions within its authority as well as to monitor the performance and quality of the Bank's credit & Investment portfolios.

Qard Al Hassan, Donation & Zakah Committee	**Hamad Farooq AlShaikh** Chairman Members • Khaled Waheeb AlNasser • Nada Ishaq Abdul Karim • Hamad Al Bassam	The main objective of Qard Al Hassan, Donation 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.
Provisioning Committee (PC)	**Fahim Ahmed Shafiqi** Chairman Members • Ameer Abdul Ghani Dairi • Khalid Mahmood (Observer) • Saleh Al Mehri (Secretary)	Provisioning Committee reviews the Bank's provisions as well as formulates policies with a view to maintain the strategic risk level objectives.
Operational Risk Committee (ORC)	**Fahim Ahmed Shafiqi** Chairman Members • Sohail Kabeer • Wesam A.Aziz Baqer • Dalal Ahmed Al Qais • Ameer Abdul Ghani Dairi • Eman Ali Abdulla Ebrahim • Dawood Khalil Al Ashhab • Osama Ali Nasr • Mazar Rashed Jalal	The purpose of the Operational Risk Committee is to: a) Oversee and review the Bank's operational risk framework. b) Assist the management in fulfilling its operational risk management responsibilities as defined by applicable laws and regulations.

Succession Planning

Succession planning in the Bank is driven by our Business strategy and forward looking approach. The primary objective of the plan is to develop people to meet future demands of the Bank. On an annual basis, the Human Resources Department of the Bank reviews and consults the Board's Nomination & Remuneration Committee to ensure availability of a practical and executable succession plan.

Related Party Transactions and Conflict of Interest

Under the Bahrain Commercial Companies Law and the Central Bank of Bahrain's regulations are required to disclose potential conflicts as well as refrain from participating in any conflicted decisions. This includes potential conflicts that may arise when a Director takes up a position with another company or has any material transactions with the Bank. In addition, exposures to major shareholder, directors and senior management are governed by the regulations of the Central Bank of Bahrain.

Related party transactions are entered into in compliance with Article 189 of the Commercial Companies Law. All material service providers are selected following a satisfactory tendering process which is governed by the vendor management policy of the Bank. Any director or member of the senior management conflicted is excluded throughout the decision making process. Details of related party transactions, carried out at arm's length, are disclosed in Note 26 of the financial statements.

Material Transactions Requiring Board Approval

The Board has delegated certain authorities to the Executive Management to ensure smooth and effective day to day management however, all material financing transaction, as provided in the delegation of authority matrix of the Bank, are subject to Board approval. Furthermore, major decisions such as change in strategy, changes in the organization structure, capital expenditures, amending policies and hiring executive management is subject to either Board or relevant Board committees.

CORPORATE GOVERNANCE REVIEW Cont'd

Exceptions to CBB's Corporate Governance Regulations

Banks are required to comply with the High Level Controls (HC) Module of the CBB Rulebook. The HC Module contains both Rules and Guidance; Rules must be complied with, but Guidance may either be complied with or non-compliance explained to the shareholders and to the CBB. Exceptions to guidance are explained as follows:

Reference	Explanation
HC1.3.13	HC-1.3.13 states that no one person should hold more than three directorships in public companies in the Kingdom of Bahrain, with the provision that no conflict of interest may exist. Dr. Essam Abdulla Fakhro, the Chairman of the Board, holds more than three directorships in public companies in the Kingdom of Bahrain. The Board is of the opinion that this does not impact the effectiveness and efficiency of the Board of Directors, as he provides adequate attention to his responsibilities and there is no conflict of interest between his other directorships and that of the Bank.
HC-1.4.6	HC 1.4.6 states that the Chairman of the Board of Directors should be an independent director. The Bank's Chairman, Dr. Essam Abdulla Fakhro is nominated by the National Bank of Bahrain (NBB) which is a Controller of the Bank. Accordingly, Dr. Fakhro is reported as a Non-Independent Director. The Board is of the view since BisB has no business transactions with NBB, there exist no conflict of interest and therefore, the chairmanship of Mr. Fakhro is appropriate.
HC-1.8.2	HC-1.8.2 states that the Board should establish a Corporate Governance Committee of at least three independent members and HC-1.8.5 allows combination of committees. The Bank has combined the responsibility of the Corporate Governance Committee with that of the Audit Committee. The Board is of the view that this does not compromise the high standards of corporate governance as the Audit Committee has sufficient resources and time to discharge its duties and holds sufficient number of meetings to fulfil its responsibilities.
HC-5.3.2	HC-5.3.2 states that the Remuneration Committee should include only independent directors or, alternatively, only non-executive directors of whom a majority are independent directors and the chairman is an independent director. The Remuneration Committee of the Bank is combined with the Nomination Committee as allowed under HC-1.8.5. The Chairman of the Nomination & Remuneration Committee, Dr. Essam Abdulla Fakhro, is treated as Non-Independent on the basis that his nomination is through NBB, a Controller of the Bank. The Board is of the view that since the remuneration of the Board is governed by the Bahrain Commercial Company Law, there exist no conflict of interest in Dr. Fakhro being the Chairman of the Board.

Employments of Relatives

The Bank has a policy in place on employment of relatives to prevent the potential conflict of interest. As a matter of policy, employment of relatives is not allowed however, in case of any exception, the approval of the Board's Nomination & Remuneration Committee is sought.

Remuneration of the External Auditors

KPMG Fakhro was the Bank's external auditors for the financial year ended 31 December 2018. The details of the audit fee paid to the auditors during the year 2018 as well as the details of non-audit services and fees paid are held at the Bank's premises, which is available to eligible shareholders upon specific request.

Information on Products & Services & Availability of Financial Information

New product information, announcements and information related to all stakeholders are made available in a timely manner through various channels of communication which may include publications, website, direct mailers, electronic mail and local media. In addition, the Consolidated Financial Statements of at least past 5 years in addition to all supplementary disclosures required by CBB regulations, are available in the Bank's website.

Customer Complaints

The Quality Assurance Department is responsible for managing customer complaints. BisB customers may use the Bank's website or the call center for lodging a complaint. All complaints are logged, monitored and reported to the CBB. A user friendly guide is made available to customers by way of a conspicuous notice and Bank's website.

Whistle Blower Policy

The Board has adopted a Whistle Blower Policy which provides all employees an opportunity to raise any observation regarding unethical and improper practices or any other wrongful conduct of a financial or legal nature in the Bank and to prohibit managerial personnel from taking any adverse action against employees for doing so.

Major Shareholders Ownership (5% and above)

Shareholder	Nationality	Number of Shares	Percentage	Type of Ownership
National Bank of Bahrain	Bahraini	309,206,266	29.06%	Majority Sovereign
Social Insurance Organisation	Bahraini	154,604,585	14.53%	Sovereign
Social Insurance Organisation - Military Pension Fund	Bahraini	154,604,587	14.53%	Sovereign
Islamic Development Bank	Saudi	153,423,081	14.42%	Sovereign
General Council of Kuwaiti Awqaf	Kuwaiti	76,366,321	7.18%	Sovereign

Note: No other shareholder owns 5% or more shares of the Bank.

Distribution of Ownership of Shares by Nationality

Country	Percentage	Number of Shares
Kingdom of Bahrain	72.76%	774,222,968
Kingdom of Saudi Arabia	15.32%	163,023,180
Kuwait	8.73%	92,853,577
United Arab Emirates	2.95%	31,372,134
Qatar	0.13%	1,381,185
Others	0.11%	1,205,543
Total	**100.00%**	**1,064,058,587**

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

Directors	Shares as of 31st Dec 2017	Sold During 2018	Acquired During 2018	Shares as of 31st Dec 2018
Dr. Esam Abdulla Fakhro	50,000	0	2,500	52,500
Brig. Ebrahim Abdulla Al Mahmood	0	0	0	0
Mohammed Ahmed Abdulla	0	0	0	0
Khaled Yusuf AbdulRahman	0	0	0	0
Talal Ali Al Zain	0	0	0	0
Khalil Ebrahim Nooruddin	0	0	0	0
Ebrahim Husain AlJassmi	192,044	0	9,602	201,646
Othman Ebrahim Al Askar	88,044	0	4,402	92,446
Muhammad Zarrug Rajab	134,232	0	6,711	140,943

CORPORATE GOVERNANCE REVIEW Cont'd

Shari'a Supervisory Board				
Shaikh Dr. Abdul Latif Mahmood Al Mahmood	169,124	0	8,456	177,580
Shaikh Dr. Nedham Mohamed Saleh Yacoubi	12,607	0	630	13,237
Shaikh Mohammed Jaffar Al Juffairi	0	0	0	0
Shaikh Adnan Abdulla Al Qattan	0	0	0	0
Shaikh Dr. Essam Khalaf Al Enizi	0	0	0	0
Approved Persons				
Hassan Amin Jarrar – Chief Executive Officer	336,837	73,597	563,817	827,057
Wesam A.Aziz Baqer –Head of Corporate Banking	70,769	0	85,759	156,528
Dalal Ahmed Al Qais – Head of Retail Banking	0	0	0	0
Khalid Mahmood –Head of Internal Audit	77,729	0	62,609	140,338
Ameer Abdul Ghani Dairi – Chief Financial Officer	0	0	0	0
Fahim Ahmed Shafiqi – Chief Risk Officer	4,030	0	61,906	65,936
Dawood Khalil Al Ashhab – Head of Human Resources & General Services	0	53,603	53,603	0
Eman Ali Abdulla - Head of Central Operations	0	0	0	0
Hamad Farooq AlShaikh – Head of Shari'a Supervisory Department	0	0	0	0
Eman Mohammed AlBinghadeer - Head of Shari'a Internal Audit	0	0	0	0
Mahmood Qannati - Head of Marketing & Corporate Communications	0	0	4,500	4,500
Hussain Ebrahim Al Banna - Head of Treasury	0	0	0	0
Osama Ali Nasr - Head of IT	0	0	12,675	12,675
Maisa Jawdat Shunnar - Head of Strategy Implementation & Transformation	0	0	0	0
Khaled Waheeb AlNasser - Head of Internal Control	0	0	0	0
Nayef Naser Yusuf - Head of Special Assets	13,699	0	684	14,383
Mazar Jalal - Head of Compliance & Governance	0	0	0	0
Mohammed Ayada Matar - Money Laundering Reporting Officer	0	0	0	0
Hamad Hussain Al Qattan - Deputy Money Laundering Reporting Officer	0	0	0	0
Ali Yousif Al Aradi - Head of Branches	0	0	0	0
Mohammed Adnan Al Ansari - Deputy Money Laundering Reporting Officer	0	0	0	0

As of 31st December 2018, the total number of shares held by Board of Directors, Shari'a Supervisory Board members and the Approved Persons of the Bank are 1,899,769 which represents 0.18% of the total issued shares of the Bank.

The shares held by the Approved Persons includes shares granted by the Bank under the Share Incentive Scheme.

SHARIA'A SUPERVISORY BOARD REPORT

FOR THE YEAR ENDED ON 31/12/2018

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 2018, in fulfillment to the mandate conferred upon it by BisB's Articles of Association:

- In coordination with the Sharia Coordination and implementation, the Sharia Supervisory Board has monitored the implementation on the Bank's products and its applicable fees and the relevant policies and procedures, in addition to advising and providing fatwas in regards to the finance agreements up to 31st December 2018 to ensure the Bank's adherence to the provisions and principles of Islamic Sharia'a.
- 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 Plan and 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 12 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 (16) meetings during the year and issued (98) decisions and fatwas, and approved (80) contracts.
- The Sharia Supervisory Board confirms that it has, along with the Sharia Coordination and implementation Department and Internal Sharia Audit Department, fulfilled all the CBB 's Sharia Supervisory Governance requirements.
- The Sharia Board has reviewed the financial statements for the year ended on 31st December 2018, 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 Abdulla Al Qattan Member

Shaikh. Dr. Nedham M. Saleh Yacoubi Member	Shaikh. Dr. Essam Khalaf Al Onazi Member

CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS

55 Independent Auditors' Report
56 Consolidated Statement of Financial Position
57 Consolidated Statement of Income
58 Consolidated Statement of Cash Flows
59 Consolidated Statement of Changes in Owners' Equity
60 Consolidated Statement of Sources and Uses of Good Faith Qard Fund
61 Consolidated Statement of Sources and Uses of Zakah and Charity Fund
62 Notes to the Consolidated Financial Statements

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 subsidiary (together the "Group") which comprise the consolidated statement of financial position as at 31 December 2018, 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 2018, 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 Commercial Companies Law and Volume 2 of the Rule Book issued by the Central Bank of Bahrain (CBB), 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 report is consistent with the consolidated financial statements;

c) we are not aware of any violations during the year of the Commercial Companies Law, the CBB and Financial Institutions Law No. 64 of 2016 (as amended), 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
24 February 2019

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2018

	Note	2018 BD'000	2017 BD'000
ASSETS			
Cash and balances with banks and Central Bank	3	65,437	69,666
Placements with financial institutions	4	137,450	80,845
Financing assets	5	578,953	561,822
Investment securities	6	240,053	258,399
Ijarah Muntahia Bittamleek	8	165,730	164,397
Ijarah rental receivables	8	21,141	14,483
Investment in associates	7	21,643	23,739
Investment in real estate	10	24,284	29,831
Property and equipment	9	13,641	14,270
Other assets	11	11,062	11,195
TOTAL ASSETS		**1,279,394**	**1,228,647**
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			
Liabilities			
Placements from financial institutions		114,744	67,872
Placements from non-financial institutions and individuals		7,255	-
Borrowings from financial institutions	12	96,386	101,576
Customers' current accounts		133,244	131,666
Other liabilities	13	24,025	11,507
Total Liabilities		**375,654**	**312,621**
Equity of Investment Accountholders	14	**785,991**	**793,756**
Owners' Equity			
Share capital	15	106,406	101,339
Treasury shares	15	(892)	(864)
Shares under employee share incentive scheme		(391)	(498)
Share premium		120	98
Reserves		12,506	22,195
Total Owners' Equity		**117,749**	**122,270**
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY		**1,279,394**	**1,228,647**

The consolidated financial statements were approved by the Board of Directors on 24 February 2019 and signed on its behalf by:

Dr. Esam Abdulla Fakhro	Brig. Ebrahim Abdulla Al Mahmood	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 INCOME

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 BD'000	2017 BD'000
INCOME			
Income from financing	18	43,110	40,507
Income from investment in Sukuk		10,829	6,808
Total income from jointly financed assets		53,939	47,315
Return on equity of investment accountholders		(41,162)	(36,010)
Group's share as Mudarib		27,223	24,646
Net return on equity of investment accountholders	14.5	(13,939)	(11,364)
Group's share of income from jointly financed assets (both as mudarib and investor)		40,000	35,951
Expense on placements from financial institutions		(2,043)	(1,018)
Expense on placements from non-financial institutions and individuals		(57)	-
Expense on borrowings from financial institutions		(4,034)	(2,032)
Fee and commission income		7,547	7,642
Income from investment securities	19	216	513
Income from investment in real estate	20	(556)	213
Share of results of associates, net	7	86	(1,103)
Other income	21	4,372	2,740
Total income		45,531	42,906
EXPENSES			
Staff costs		12,588	12,611
Depreciation	9	1,473	1,570
Other expenses	22	11,194	12,387
Total expenses		25,255	26,568
Profit before impairment allowances		20,276	16,338
Impairment allowance, net	23	(8,895)	(6,197)
PROFIT FOR THE YEAR		11,381	10,141
BASIC AND DILUTED EARNINGS PER SHARE (fils)	25	10.83	9.65

Dr. Esam Abdulla Fakhro
Chairman

Brig. Ebrahim Abdulla Al Mahmood
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 CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 BD'000	2017 BD'000
OPERATING ACTIVITIES			
Profit for the year		11,381	10,141
Adjustments for non-cash items:			
Depreciation	9	1,473	1,570
Impairment allowance, net	23	8,895	6,197
Loss on sale of investment in associates		-	83
Impairment on investment in real estate	20	204	119
Loss on sale of investment in real estate	20	531	39
Gain on sale of investment securities		-	(3)
Gain on foreign exchange revaluation		29	-
Recoveries from written off accounts		(3,472)	-
Share of results of associates, net	7	(86)	1,103
Operating profit before changes in operating assets and liabilities		18,955	19,249
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain		100	(1,440)
Financing assets		(34,485)	(57,605)
Ijarah Muntahia Bittamleek		(8,359)	(18,808)
Other assets		(693)	739
Customers' current accounts		1,578	(800)
Other liabilities		11,729	(3,596)
Placements from financial institutions		44,719	(24,582)
Placements from non-financial institutions and individuals		7,255	-
Equity of investment accountholders		(7,765)	139,440
Net cash from operating activities		33,034	52,597
INVESTING ACTIVITIES			
Capitalized expenditure of investment in real estate		-	(28)
Disposal of investment in real estate		3,480	314
Disposal of investment in associates		-	1,348
Purchase of investment securities		(75,590)	(119,546)
Purchase of property and equipment		(845)	(1,193)
Disposal of property and equipment		1	-
Proceeds from disposal of investment securities		95,504	3,538
Net cash from / (used in) investing activities		22,550	(115,567)
FINANCING ACTIVITIES			
Purchase of treasury shares		-	(301)
(Repayment) / drawdown of borrowings from financial institutions		(5,190)	90,156
Dividends paid		(72)	(4,827)
Net cash (used in) / from financing activities		(5,262)	85,028
NET INCREASE IN CASH AND CASH EQUIVALENTS		50,322	22,058
Cash and cash equivalents at 1 January		112,794	90,736
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		163,116	112,794
Cash and cash equivalents comprise of:			
Cash on hand	3	15,318	13,042
Balances with CBB, excluding mandatory reserve deposits	3	242	3,654
Balances with banks and other financial institutions excluding restricted balances	3	10,106	15,253
Placements with financial institutions with original maturities less than 90 days	4	137,450	80,845
		163,116	112,794

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 2018

					Reserves					
2018	Share capital BD'000	Treasury shares BD'000	Shares under employee share incentive scheme BD'000	Share premium BD'000	Statutory reserve BD'000	Real estate fair value reserve BD'000	Investment securities fair value reserve BD'000	Retained earnings BD'000	Total reserves BD'000	Total owners' equity BD'000
Balance at 1 January 2018	101,339	(864)	(498)	98	2,977	6,145	745	12,328	22,195	122,270
Impact of adopting FAS 30 (note 2a)	-	-	-	-	-	-	-	(13,943)	(13,943)	(13,943)
Impact of adopting FAS 30 by associate (note 2a)	-	-	-	-	-	-	-	(350)	(350)	(350)
Balance at 1 January 2018 (restated)	101,339	(864)	(498)	98	2,977	6,145	745	(1,965)	7,902	107,977
Profit for the year	-	-	-	-	-	-	-	11,381	11,381	11,381
Bonus shares declared for 2017	5,067	(28)	(34)	(35)	-	-	-	(4,970)	(4,970)	-
Transfer to zakah fund	-	-	-	-	-	-	-	(265)	(265)	(265)
Transfer to charity fund	-	-	-	-	-	-	-	(200)	(200)	(200)
Shares allocated during the year	-	-	141	57	-	-	-	-	-	198
Net movement in investment securities fair value reserve	-	-	-	-	-	-	(27)	-	(27)	(27)
Net movement in real estate fair value reserve	-	-	-	-	-	(1,315)	-	-	(1,315)	(1,315)
Transfer to statutory reserve	-	-	-	-	1,138	-	-	(1,138)	-	-
Balance at 31 December 2018	**106,406**	**(892)**	**(391)**	**120**	**4,115**	**4,830**	**718**	**2,843**	**12,506**	**117,749**
2017										
Balance at 1 January 2017	101,339	(563)	(604)	56	1,963	5,361	531	8,389	16,244	116,472
Profit for the year	-	-	-	-	-	-	-	10,141	10,141	10,141
Dividends declared for 2016	-	-	-	-	-	-	-	(5,051)	(5,051)	(5,051)
Transfer to zakah fund	-	-	-	-	-	-	-	(137)	(137)	(137)
Purchase of treasury shares	-	(301)	-	-	-	-	-	-	-	(301)
Shares allocated during the year	-	-	106	42	-	-	-	-	-	148
Net movement in investment securities fair value reserve	-	-	-	-	-	-	214	-	214	214
Net movement in real estate fair value reserve	-	-	-	-	-	784	-	-	784	784
Transfer to statutory reserve	-	-	-	-	1,014	-	-	(1,014)	-	-
Balance at 31 December 2017	101,339	(864)	(498)	98	2,977	6,145	745	12,328	22,195	122,270

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 2018

	Qard Hasan receivables BD'000	Funds available for Qard Hasan BD'000	Total BD'000
Balance at 1 January 2018	**71**	**57**	**128**
Uses of Qard fund			
Marriage	**10**	**(10)**	**-**
Others (Waqf)	**26**	**(26)**	**-**
Total uses during the year	**36**	**(36)**	**-**
Repayments	**(36)**	**36**	**-**
Balance at 31 December 2018	**71**	**57**	**128**
Balance at 1 January 2017	65	63	128
Uses of Qard fund			
Marriage	13	(13)	-
Others (Waqf)	24	(24)	-
Total uses during the year	37	(37)	-
Repayments	(31)	31	-
Balance at 31 December 2017	71	57	128

	2018 BD'000	2017 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 2018

	2018 BD'000	2017 BD'000
Sources of zakah and charity funds		
Undistributed zakah and charity funds at the beginning of the year	259	222
Non-Islamic income / late payment fee	374	510
Contributions by the Bank for zakah	265	137
Contributions by the Bank for donations	200	-
Total sources of zakah and charity funds during the year	1,098	869
Uses of zakah and charity funds		
Philanthropic societies	366	253
Aid to needy families	381	357
Islamic events	37	-
Total uses of funds during the year	784	610
Undistributed zakah and charity funds at the end of the year	314	259

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

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 (2017: eight), all operating in the Kingdom of Bahrain.

The consolidated financial statements include the results of the Bank and its wholly owned subsidiary (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 24 February 2019.

a. Basis of preparation

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

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.

b. Statement of Compliance

The consolidated financial statements are prepared in accordance with the Financial Accounting Standards ("FAS") 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.

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 except for changes arising from adoption of FAS 30 as set out below.

a. New standards, amendments, and interpretations

i) New standards, amendments, and interpretations issued and effective:

There are no AAOIFI accounting standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2018 that would be expected to have a material impact on the Group.

ii) New standards, amendments, and interpretations issued but not yet effective:

(i) Early adoption of FAS 30 – Impairment, credit losses and onerous commitments

AAOIFI has issued FAS 30 Impairment, credit losses and onerous commitments with effective date of 1 January 2020 with early adoption permitted. FAS 30 replaces FAS 11 Provisions and reserves and parts of FAS 25 Investment in Sukuk, shares and similar instruments that deals with impairment. The Group early adopted the standard as of 1 January 2018 as mandated by CBB. The objective of this standard is to establish the principles of accounting and financial reporting for the impairment and credit losses on various Islamic financing, investment and certain other assets of Islamic financial institutions (the institutions), and provisions against onerous commitments enabling in particular the users of financial statements to fairly assess the amounts, timing and uncertainties with regard to the future cash flows associated with such assets and transactions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

a. New standards, amendments, and interpretations (Continued)

ii) New standards, amendments, and interpretations issued but not yet effective: *(Continued)*

(i) Early adoption of FAS 30 – Impairment, credit losses and onerous commitments *(Continued)*

FAS 30 classifies assets and exposures into three categories based on the nature of risks involved (i.e. credit risk and other risks) and prescribes three approaches for assessing losses for each of these categories of assets 1) Credit losses approach, 2) Net Realizable Value approach ("NRV") and 3) Impairment approach.

For the purpose of the standard, the assets and exposures shall be categorized, as under:

- Assets and exposures subject to credit risk (subject to credit losses approach):
  - Receivables; and
  - Off-balance sheet exposures;
- Inventories (subject to net realizable value approach); and
- Other financing and investment assets and exposures subject to risks other than credit risk (subject to impairment approach), excluding inventories.

Credit losses approach for receivables and off balance sheet exposures uses a dual measurement approach, under which the loss allowance is measured as either a 12-month expected credit loss or a lifetime expected credit loss.

i. Expected Credit Losses (ECL)

FAS 30 introduces the credit losses approach with a forward-looking 'expected credit loss' model. The new impairment model will apply to exposures which are subject to credit risk. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for Significant Increase in Credit Risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Identifying groups of similar financial instruments for the purpose of measuring ECL.

ii. Changes in Accounting Policies

The key changes to the Group's accounting policies resulting from the adoption of FAS 30 are summarised below. As permitted by the transitional provisions of FAS 30, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of exposures subject to credit risk as at the date of transition where recognized in the opening balance of retained earnings at 1 January 2018. Since the comparative financial information has not been restated, the accounting policies in respect of these items for comparative periods are based on respective standards as disclosed in the audited financial statements as of and for the year ended 31 December 2017.

(a) Impact of adopting FAS 30

Disclosures of FAS 30 transition impact is set out below:

The following table reconciles the carrying amounts of exposures subject to credit risk under FAS 11 to the carrying amounts under FAS 30 as at 1 January 2018:

	Original carrying amount under FAS 11	Re-measurement*	New carrying amount under FAS 30
		BD'000	
Cash and balances with banks and Central Bank	69,666	-	69,666
Placements with financial institutions	80,845	(3)	80,842
Financing assets	561,822	(12,031)	549,791
Investment in Sukuk	227,906	(96)	227,810
Ijarah Muntahia Bittamleek and Ijarah rental receivables	178,880	(1,142)	177,738
Other receivables	1,991	(60)	1,931
Commitments	148,540	(611)	147,929
	1,269,650	**(13,943)**	**1,255,707**

*Re-measurement is due to increase in impairment allowance due to change from incurred to expected credit loss (ECL).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

a. New standards, amendments, and interpretations (Continued)

ii) New standards, amendments, and interpretations issued but not yet effective: *(Continued)*
(i) Early adoption of FAS 30 – Impairment, credit losses and onerous commitments *(Continued)*
ii. Changes in Accounting Policies *(Continued)*
(a) Impact of adopting FAS 30 *(Continued)*

The following table shows the carrying amounts of exposures subject to credit risk as of 1 January 2018 by stage:

	Stage 1	Stage 2	Stage 3	Total
		BD'000		
Cash and balances with banks and Central Bank	69,666	-	-	69,666
Placements with financial institutions	80,842	-	-	80,842
Financing assets	441,746	96,007	12,038	549,791
Investment in Sukuk	226,741	-	1,069	227,810
Ijarah Muntahia Bittamleek and Ijarah rental receivables	154,108	9,914	13,716	177,738
Other receivables	-	1,931	-	1,931
Commitments	143,416	4,506	7	147,929
	1,116,519	**112,358**	**26,830**	**1,255,707**

The following table reconciles the impairment allowance recorded under FAS 11 to that of FAS 30 as at 1 January 2018:

	31 December 2017 (FAS 11)	Re-measurement	1 January 2018 (FAS 30)
		BD'000	
Placements with financial institutions	-	3	3
Financing assets	15,167	12,031	27,198
Investment in Sukuk	11,481	96	11,577
Ijarah Muntahia Bittamleek and Ijarah rental receivables	13,175	1,142	14,317
Investment in associates	2,830	-	2,830
Investment in equity and funds	8,638	-	8,638
Other receivables	-	60	60
Commitments*	-	611	611
	51,291	**13,943**	**65,234**

** Disclosed as part of other liabilities.*

(b) Impact on owners' equity

	Owners' equity BD'000
Balance as at 31 December 2017 (as previously reported)	122,270
Recognition of expected credit losses under FAS 30	(13,943)
Impact of adopting FAS 30 by associate	(350)
Opening balance as at 1 January 2018 (restated)	**107,977**

b. 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 Group, 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. 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.

d. Placements with and borrowings from financial institutions

i) 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.

ii) Borrowings from financial institutions

Borrowings from financial institutions comprise borrowings obtained through murabaha contract recognized on the origination date and carried at amortized cost.

e. Financing assets

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

f. Murabaha financing

Murabaha financing consist mainly of deferred sales transactions 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.

g. 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.

h. Investment securities

Investment securities comprise debt type instruments carried at amortised cost and 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.

i) 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.

ii) 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 are 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

i. Measurement principles

i) 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 Group is unable to determine a reliable measure of fair value on a continuing basis are stated at cost less impairment allowances.

ii) 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.

j. 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.

k. 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 installments 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.

l. 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 in a 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

m. 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

n. Equity of investment accountholders

Equity of investment account holders are funds held by the Group in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Group to invest the account holders' funds 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. The Group 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 Group's share of income as a Mudarib. The allocation of income is determined by the management of the Group 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 Group 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.

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 Group 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 Group 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.

o. 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.

p. 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.

q. 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.

r. 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.

s. Dividends and board remuneration

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

t. Derecognition of financial assets and liabilities

i) 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 has 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.

ii) Financial liabilities

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

u. 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.

v. 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.

w. Offsetting

Financial assets and financial liabilities are only offset and the net amount is 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.

x. Income recognition

i) 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.

ii) Musharaka

Profit or losses in respect of the Group'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.

iii) Sukuk

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

iv) 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.

v) Ijarah Muntahia Bittamleek

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

x. Income recognition (Continued)

vi) Dividend income

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

vii) 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.

y. 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.

z. Impairment of exposures subject to credit risk

i) Policy applicable from 1 January 2018

The Group recognizes loss allowances based ECL on the following:

- Bank balances and placements with banks;
- Financing assets;
- Ijarah Muntahia Bittamleek and rental receivables;
- Investment in Sukuk - debt type securities at amortised cost;
- Financial guarantee contracts issued; and
- Commitments to finance.

The Group measures loss allowances at an amount equal to lifetime ECLs, except for the following, which are measured at 12-month ECLs:

- Debt-type securities that are determined to have low credit risk at the reporting date; and
- Other debt-type securities and bank balances for which credit risk (i.e. the risk of default occurring over he expected life of the financial instrument) has not increased significantly since initial recognition.

When determining whether the credit risk of an exposure subject to credit risk has increased significantly since initial recognition when estimating ECLs, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and informed credit assessment including forward-looking information.

The Group assumes that the credit risk on an exposure subject to credit risk has increased significantly if it is more than 30 days past due.

The Group considers an exposures subject to credit risk to be in default when:

- the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security, if any is held; or
- the financial asset is more than 90 days past due.

The Group considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Group considers this to be BBB- or higher per S&P.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

z. Impairment of exposures subject to credit risk (Continued)

i) Policy applicable from 1 January 2018 (Continued)

The Group applies a three-stage approach to measuring ECL on exposures subject to credit risk. Exposures migrate through the following three stages based on the change in credit quality since initial recognition;

Stage 1: 12-months ECL

Stage 1 includes exposures subject to credit risk on initial recognition and that do not have a significant increase in risk since initial recognition or that have low credit risk. 12-month ECL is the expected credit losses that from default events that are possible within 12 months after the reporting date. It is not the expected cash shortfalls over the 12-month period but the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12-months.

Stage 2: Lifetime ECL - not credit impaired

Stage 2 includes exposures subject to credit risk that have had a significant increase in credit risk since initial recognition but that do not have objective evidence of impairment. For these assets, lifetime ECL are recognised. Lifetime ECL are the expected credit losses that result from all possible default events over the expected life of the financial instrument. Expected credit losses are the weighted average credit losses with the life-time probability of default ('PD').

Stage 3: Lifetime ECL - credit impaired

Stage 3 includes exposures subject to credit risk that have objective evidence of impairment at the reporting date in accordance with the indicators specified in the CBB's rule book. For these assets, lifetime ECL is recognised.

The maximum period considered when estimating ECLs is the maximum contractual period over which the Group is exposed to credit risk.

(i) Measurement of ECL

ECL is a probability-weighted estimate of credit losses. It is measured as follows:

- Exposures subject to credit risk that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);
- Exposures subject to credit risk that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- Undrawn commitments to finance: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows that the Group expects to receive; and
- Financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Group expects to recover.

ii) Restructured exposures

If the terms of an exposures subject to credit risk are renegotiated or modified or an existing exposures subject to credit risk is replaced with a new one due to financial difficulties of the borrower, the exposures subject to credit risk should be derecognized and ECL is calculated using the cash shortfalls from the existing exposures subject to credit risk that are discounted from the expected date of derecognition to the reporting date using the original effective profit rate of the existing exposures subject to credit risk.

iii) Credit-impaired exposures

At each reporting date, the Group assesses whether exposures subject to credit risk are credit-impaired. An exposure subject to credit risk is 'credit-impaired' when one or more events that have detrimental impact on the estimated future cash flows of the exposures have occurred.

Evidence that an exposure subject to credit risk is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default;
- the restructuring of a financing facility by the Group on terms that the Group would not consider otherwise; or
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization.

(iv) Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as a deduction from gross carrying amount of exposures subject to credit risk.

(v) Write-off

Exposures subject to credit risk are written off either partially or in their entirety only when the Group has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to other income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

z. Impairment of exposures subject to credit risk (Continued)

ii) Policy applicable before 1 January 2018

(i) Impairment of financial assets at amortized cost

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.

aa. Equity investments classified at Fair Value Through Equity (FVTE) - Applicable to 2017 and 2018

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.

bb. 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:

i) Applicable from 1 January 2018

(i) Impairment of exposures subject to credit risk

- Establishing the criteria for determining whether credit risk on exposures subject to credit risk has increased significantly since initial recognition, determining methodology for incorporating forward looking information into measurement of ECL and selection and approval of models used to measure ECL is set out in note 2. z and note 27.
- Impairment on Ijarah rental receivables: key assumptions used in estimating recoverable cash flows is set out in note 2. z.
- Determining inputs into ECL measurement model including incorporation of forward looking information is set out in note 2. z and note 27.

ii) Applicable before 1 January 2018

(i) Impairment of financing assets

Financing assets are evaluated for impairment on a basis described in accounting policy, [refer to note 2. z]. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

bb. Use of estimates and judgements in preparation of the consolidated financial statements (Continued)

iii) Applicable for 2017 and 2018:

(i) Going concern

The Group'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.

(ii) 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. h].

(iii) 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 Group 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.

cc. 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.

dd. Customers' current accounts

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

ee. 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.

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 Group are recognised as an expense in the consolidated 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 consolidated income statement.

The Group also operates a voluntary employee saving scheme under which the Group 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 Group. The scheme is in the nature of defined contribution scheme and contributions by the Group are recognised as an expense in the consolidated income statement when they are due.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ee. Employees' benefits (Continued)

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.

ff. 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.

gg. 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'.

hh. 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.

ii. URIA protection scheme

Investment accounts held within the Group'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

	2018 BD'000	2017 BD'000
Cash on hand	15,318	13,042
Balances with CBB, excluding mandatory reserve deposits	242	3,654
Balances with banks and other financial institutions	14,772	17,765
	30,332	34,461
Mandatory reserve with CBB	35,105	35,205
	65,437	69,666

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

Balances with banks and other financial institutions include an amount of BD 4,666 thousand (2017: BD 2,512 thousand) which is not available for use in the day-to-day operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	2018 BD'000	2017 BD'000
Commodity Murabaha	54,975	53,519
Deferred profits	(6)	(5)
	54,969	53,514
Wakala	82,486	27,331
	137,455	80,845
Impairment allowance	(5)	-
	137,450	80,845

5. FINANCING ASSETS

	2018 BD'000	2017 BD'000
Murabaha (note 5.1)	481,612	455,501
Musharaka (note 5.2)	97,341	106,321
	578,953	561,822

5.1 Murabaha

	2018 BD'000	2017 BD'000
Tasheel	217,622	206,855
Tawarooq	214,778	195,474
Altamweel Almaren	82,128	64,912
Letters of credit refinance	32,819	27,229
Motor vehicles Murabaha	7,858	9,625
Credit cards	18,596	17,992
Others	46	58
	573,847	522,145
Qard fund	71	71
Gross receivables	573,918	522,216
Deferred profits	(65,253)	(52,695)
Impairment allowance	(27,053)	(14,020)
	481,612	455,501

Non-performing Murabaha financing outstanding as of 31 December 2018 amounted to BD 71,265 thousand (2017: BD 34,436 thousand).

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

5. FINANCING ASSETS (CONTINUED)

5.1 Murabaha (Continued)

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

	2018 BD'000	2017 BD'000
Commercial	120,762	95,128
Financial institutions	26,310	32,693
Others including retail	361,593	341,700
	508,665	469,521

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

5.2 Musharaka

	2018 BD'000	2017 BD'000
Musharaka in real estate	100,127	107,468
Provision for impairment	(2,786)	(1,147)
	97,341	106,321

Non-performing Musharaka financing outstanding as of 31 December 2018 amounted to BD 4,920 thousand (2017: BD 3,678 thousand).

5.3 The movement on impairment allowances is as follows:

2018	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	2,367	9,486	15,345	27,198
Net movement between stages	1,302	(4,304)	3,002	-
Net charge for the year	(1,512)	(2,036)	10,079	6,531
Write-backs	-	-	(784)	(784)
Write-off	-	-	(3,106)	(3,106)
At 31 December 2018	**2,157**	**3,146**	**24,536**	**29,839**

2017	Specific	Collective	Total
At 1 January 2017	16,560	10,141	26,701
Net movement between stages	-	-	-
Net charge for the year	6,254	(1,092)	5,162
Write-backs	(3,489)	-	(3,489)
Write-off	(13,207)	-	(13,207)
At 31 December 2017	6,118	9,049	15,167

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

6. INVESTMENT SECURITIES

a. Debt type instruments*

	2018 BD'000	2017 BD'000
Quoted Sukuk - carried at amortised cost		
Gross balance at beginning of the year	176,806	89,706
Acquisitions	41,891	89,474
Disposals and redemptions	(57,970)	(2,374)
Gross balance at the end of the year	160,727	176,806
Impairment allowance	(23)	-
Net balance at the end of the year	160,704	176,806
Unquoted Sukuk - carried at amortised cost		
Gross balance at beginning of the year	62,581	32,683
Acquisitions	33,699	30,072
Disposals and redemptions	(37,534)	(223)
Foreign currency translation changes	(21)	49
Gross balance at the end of the year	58,725	62,581
Impairment allowance	(12,196)	(11,481)
Net balance at the end of the year	46,529	51,100

b. Equity type instruments

	2018 BD'000	2017 BD'000
Quoted shares - at fair value through equity		
Gross balance	-	2,392
Impairment allowance	-	(1,704)
Disposals	-	(688)
Net balance at the end of the year	-	-
Unquoted shares - at cost less impairment		
Gross balance	28,436	24,963
Impairment allowance	(9,784)	(8,638)
Net balance at the end of the year	18,652	16,325
Unquoted managed funds - at cost less impairment		
Gross balance	14,168	14,168
Impairment allowance	-	-
Net balance at the end of the year	14,168	14,168
Total net investment securities	**240,053**	**258,399**

* As of 31 December 2018, debt type instruments includes Sukuk of BD 134,895 thousand (2017: BD 25,057 thousand) pledged against borrowings from financial institutions of BD 96,386 thousand (2017: BD 63,488 thousand) (note 12).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

6. INVESTMENT SECURITIES (CONTINUED)

The movement on impairment allowances on debt type instruments (Sukuk) is as follows:

2018	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	96	-	11,481	11,577
Net movement between stages	-	-	-	-
Net charge for the year	(44)	-	707	663
Recoveries / write-backs	-	-	-	-
Write-off	-	-	-	-
Foreign exchange movement	-	-	(21)	(21)
At 31 December 2018	**52**	**-**	**12,167**	**12,219**

2017	Specific	Collective	Total
At 1 January 2017	9,105	-	9,105
Net movement between stages	-	-	-
Net charge for the year	2,327	-	2,327
Recoveries	-	-	-
Write-off	-	-	-
Foreign exchange movement	49	-	49
At 31 December 2017	11,481	-	11,481

During the year impairment of BD 1,147 thousand (2017: BD 1,013 thousand) was provided on equity investments.

7. INVESTMENT IN ASSOCIATES

	2018 BD'000	2017 BD'000
At 1 January	23,739	26,487
Share of results of associates, net	86	(1,103)
Share of changes in investee's equity	(27)	17
Disposals	-	(1,431)
Impact of adopting FAS 30	(350)	-
Foreign currency translation changes	(29)	89
Impairment allowance	(1,776)	(320)
At 31 December	**21,643**	**23,739**

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:

	2018 BD'000	2017 BD'000
Total assets	196,652	200,373
Total liabilities	77,726	80,925
Total revenues	4,508	5,086
Total net loss	(1,373)	(810)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

7. INVESTMENT IN ASSOCIATES (CONTINUED)

Investment in associates comprise of:

Name of associate	Ownership %	Country of incorporation	Nature of business
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.

8. IJARAH MUNTAHIA BITTAMLEEK

	2018				2017			
	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	204,063	7,540	-	211,603	178,374	7,540	2,503	188,417
Additions	41,541	-	-	41,541	36,238	-	-	36,238
Settlements / adjustments	(28,192)	-	-	(28,192)	(10,549)	-	(2,503)	(13,052)
At 31 December	217,412	7,540	-	224,952	204,063	7,540	-	211,603
Accumulated depreciation:								
At 1 January	46,093	1,113	-	47,206	33,936	226	2,503	36,665
Charge for the year	20,931	887	-	21,818	17,014	887	-	17,901
Settlements / adjustments	(9,802)	-	-	(9,802)	(4,857)	-	(2,503)	(7,360)
At 31 December	57,222	2,000	-	59,222	46,093	1,113	-	47,206
Net Book Value	160,190	5,540	-	165,730	157,970	6,427	-	164,397

Ijarah Muntahia Bittamleek and Ijarah rental receivable of BD 200,414 thousand (2017: BD 192,055 thousand) is net of impairment allowance of BD 13,543 thousand (2017: BD 13,175 thousand refer note 27 (a). During the year an impairment release of BD 774 thousand (2017: charge of BD 299 thousand) refer note 23.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

9. PROPERTY AND EQUIPMENT

	2018						
	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	**5,521**	**7,651**	**3,837**	**11,519**	**890**	**569**	**29,987**
Additions / Transfers	**-**	**-**	**401**	**817**	**10**	**(383)**	**845**
Disposals	**-**	**-**	**(74)**	**(24)**	**(6)**	**-**	**(104)**
At 31 December	**5,521**	**7,651**	**4,164**	**12,312**	**894**	**186**	**30,728**
Depreciation:							
At 1 January	**-**	**2,223**	**3,404**	**9,287**	**803**	**-**	**15,717**
Charge for the year	**-**	**260**	**217**	**946**	**50**	**-**	**1,473**
Relating to disposed assets	**-**	**-**	**(74)**	**(23)**	**(6)**	**-**	**(103)**
At 31 December	**-**	**2,483**	**3,547**	**10,210**	**847**	**-**	**17,087**
Net Book Value	**5,521**	**5,168**	**617**	**2,102**	**47**	**186**	**13,641**

	2017						
	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	5,521	7,651	3,814	10,367	883	558	28,794
Additions	-	-	23	1,152	7	11	1,193
At 31 December	5,521	7,651	3,837	11,519	890	569	29,987
Depreciation:							
At 1 January	-	1,962	3,144	8,298	743	-	14,147
Charge for the year	-	261	260	989	60	-	1,570
At 31 December	-	2,223	3,404	9,287	803	-	15,717
Net Book Value	5,521	5,428	433	2,232	87	569	14,270

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

10. INVESTMENT IN REAL ESTATE

	2018 BD'000	2017 BD'000
Land	23,966	27,796
Buildings	318	2,035
	24,284	29,831

	2018 BD'000	2017 BD'000
Movement in investment in real estate:		
At 1 January	29,831	29,510
Capitalized expediture	-	28
Disposal	(4,028)	(372)
Fair value changes	(1,519)	665
At 31 December	24,284	29,831

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

Investment in real estate is stated at fair value, 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 classified as category 2 of fair value hierarchy.

11. OTHER ASSETS

	2018 BD'000	2017 BD'000
Repossessed assets*	5,103	5,689
Receivables**	3,224	2,475
Staff advances	1,717	1,608
Prepaid expenses	803	1,138
Other	215	285
	11,062	11,195

*Repossessed assets are net of impairment allowance of BD 585 thousand (2017: Nil).

**Impairment on receivables includes Stage 1 BD 5 thousand, Stage 2 BD 127 thousand (2017: collective provision of BD Nil thousand) and Stage 3 BD 101 thousand (2017: specific provision of BD Nil thousand). During the year impairment charge of BD 173 thousand was provided (2017: Nil) representing BD 5 thousand (stage 1), BD 67 thousand (stage 2) and BD 101 thousand (stage 3).

12. BORROWINGS FROM FINANCIAL INSTITUTIONS

Represents term murabaha facilities of BD 96,386 thousand (2017: BD 101,576 thousand) secured by pledge over Sukuk of BD 134,895 thousand (2017: BD 25,057 thousand) maturing within 9 months from year end. The average rate of borrowings is 3.49% (note 6).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

13. OTHER LIABILITIES

	2018 BD'000	2017 BD'000
Managers' cheques	3,560	1,833
Payable to vendors	3,874	708
Accrued expenses	3,551	3,618
Life insurance (Takaful) fees payable	845	999
Dividends payable	928	1,000
Zakah and charity fund	314	259
Other	10,953	3,090
	24,025	11,507

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

	2018 BD'000	2017 BD'000
Type of Equity of Investment Accountholders		
Customer investment accounts		
Balances on demand	296,140	303,345
Contractual basis	489,851	490,411
	785,991	793,756

14.2 Assets in which IAH funds were invested

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

	2018 BD'000	2017 BD'000
Asset		
Cash and balances with banks and Central Bank	44,993	30,334
Financing assets, net	440,882	429,390
Ijarah Muntahia Bittamleek and rental receivables, net	142,304	131,545
Investment securities, net	157,812	189,478
Investment in real estate	-	5,329
Other assets	-	7,680
	785,991	793,756

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 allocated BD 42,351 thousand of ECL (2017: Collective provision of BD 3,778 thousand) to the IAH.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

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 as agreed contractually with the customers:

	2018			2017		
	Utilization	Mudarib Share	Profit to IAH	Utilization	Mudarib Share	Profit to IAH
Account type						
Tejoori	90%	97.49%	2.51%	90%	97.39%	2.61%
Savings	90%	97.47%	2.53%	90%	97.39%	2.61%
Vevo	90%	97.41%	2.59%	90%	97.39%	2.61%
IQRA	100%	72.99%	27.01%	100%	71.75%	28.25%
Time deposits	100%	45.50%	54.50%	100%	43.56%	56.44%

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 mudaraba contract.

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

14.4 Equity of Investment Accountholders Reserves

	2018 BD'000	Movement BD'000	2017 BD'000
Profit equalisation reserve	1,245	-	1,245
Investment risk reserve	1,177	-	1,177

14.5 Return on equity of investment accountholders

	2018 BD'000	2017 BD'000
Gross return to equity of investment accountholders	41,162	36,430
Group's share as a Mudarib	(27,223)	(24,646)
Allocation to profit equalization reserve	-	-
Allocation to investment risk reserve	-	(420)
Net return on equity of investment accountholders	13,939	11,364

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

15. OWNERS' EQUITY

a. Share capital

	2018 BD'000	2017 BD'000
i. Authorised		
2,000,000,000 shares (2017: 2,000,000,000 shares) of BD 0.100 each	**200,000**	200,000
ii. Issued and fully paid up		
1,064,058,587 shares (2017: 1,013,389,130 shares) of BD 0.100 each	**106,406**	101,339

b. Treasury Shares

	2018		2017
	Number of Shares	BD'000	BD'000
At 31 December	**5,855,358**	**892**	864

	2018 BD'000
Cost of treasury shares	**892**
Market value of treasury shares	**761**

The treasury shares as a percentage of total shares in issue is 0.55%

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.

c. Reserves

i) Statutory reserve

During the year the Bank has appropriated BD 1,138 thousand (2017: 1,014 thousand) to the statutory reserve representing 10% of the profit for the year BD 11,381 thousand (2017: 10,141 thousand). The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of CBB.

ii) 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.

iii) Real estate fair value reserve

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

iv) Investment fair value reserve

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

15. OWNERS' EQUITY (CONTINUED)

d. Additional information on shareholding pattern

i) 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:

		2018		2017	
Names	**Nationality**	**Number of shares**	**% holding**	Number of shares	% holding
National Bank of Bahrain	Bahraini	**309,206,266**	**29.06%**	294,482,159	29.06%
Social Insurance Organisation	Bahraini	**154,604,585**	**14.53%**	147,242,463	14.53%
Social Insurance Organisation - Military Pension Fund	Bahraini	**154,604,587**	**14.53%**	147,242,464	14.53%
Islamic Development Bank	Saudi	**153,423,081**	**14.42%**	146,117,221	14.42%
General Council of Kuwaiti Awqaf	Kuwaiti	**76,366,321**	**7.18%**	72,729,830	7.18%

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

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

	2018			2017		
	Number of shares	**Number of shareholders**	**% of total outstanding shares**	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	**137,353,127**	**3,244**	**12.91%**	145,805,613	3,232	14.38%
1% and less than 5%	**78,854,583**	**4**	**7.41%**	59,769,380	3	5.90%
5% and less than 10%	**76,273,875**	**1**	**7.17%**	72,729,830	1	7.18%
10% and less than 50%	**771,577,002**	**4**	**72.51%**	735,084,307	4	72.54%
	1,064,058,587	**3,253**	**100.00%**	1,013,389,130	3,240	100.00%

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

Categories:

	2018		2017	
	Number of shares	**Number of directors**	Number of shares	Number of directors
Less than 1%	**487,535**	**4**	464,320	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):

	2018		2017	
	Number of shares	**Percentage of Shareholding**	Number of shares	Percentage of Shareholding
Directors	**487,535**	**0.046%**	464,320	0.046%
Shari'a supervisory members	**190,817**	**0.018%**	181,731	0.018%
Senior management	**1,202,534**	**0.113%**	777,167	0.077%
	1,880,886	**0.177%**	1,423,218	0.141%

e. Proposed appropriations

The Board of Directors propose the appropriation for zakah of BD 179 thousand in 2018 (2017: BD 265 thousand), charitable donations of BD 250 thousand in 2018 (2017: BD 200 thousandl) and dividends amounting to BD Nil thousand (2017: bonus shares as dividends amounting to BD 5,066 thousand) which are subject to shareholders' approval in the ensuing Annual General Meeting.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

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:

	2018 BD'000	2017 BD'000
Letters of credit and acceptances	6,166	5,470
Guarantees	66,316	74,159
Credit cards	34,048	30,508
Altamweel Almaren	15,405	19,033
Operating lease commitments*	327	223
Commitments to finance	35,422	19,147
	157,684	148,540

*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:

	2018 BD'000	2017 BD'000
Within one year	182	170
After one year but not more than five years	145	53
	327	223

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.

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 emphasises on 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

17. CAPITAL ADEQUACY (CONTINUED)

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

	2018 BD'000	2017 BD'000
CET 1 Capital before regulatory adjustments	112,919	116,125
Less: regulatory adjustments	-	-
CET 1 Capital after regulatory adjustments	112,919	116,125
T 2 Capital adjustments	12,559	13,283
Regulatory Capital	125,478	129,408

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 Approach for its Market Risk. The capital requirements for these risks are as follows:

	2018 BD'000	2017 BD'000
Risk weighted exposure:		
Total Credit Risk Weighted Assets	618,293	571,069
Total Market Risk Weighted Assets	11,891	10,702
Total Operational Risk Weighted Assets	103,812	86,085
Total Regulatory Risk Weighted Assets	733,996	667,856
Investment risk reserve (30% only)	353	353
Profit equalization reserve (30% only)	374	374
Total Adjusted Risk Weighted Exposures	733,269	667,129
Capital Adequacy Ratio	17.11%	19.40%
Tier 1 Capital Adequacy Ratio	15.40%	17.41%
Minimum requirement	12.5%	12.5%

18. INCOME FROM FINANCING

	2018 BD'000	2017 BD'000
Income from murabaha financing	25,755	23,483
Income from placements with financial institutions	1,903	1,093
Income from musharaka financing	5,923	6,580
Income from Ijarah Muntahia Bittamleek	9,529	9,351
	43,110	40,507

19. INCOME FROM INVESTMENT SECURITIES

	2018 BD'000	2017 BD'000
Dividend income	216	513
	216	513

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

20. INCOME FROM INVESTMENT IN REAL ESTATE

	2018 BD'000	2017 BD'000
Loss on sale	(531)	(39)
Rental income	179	371
Impairment charge	(204)	(119)
	(556)	213

21. OTHER INCOME

	2018 BD'000	2017 BD'000
Recoveries from previously written off financing	4,491	1,883
Foreign exchange (loss) / gain	(123)	489
Others	4	368
	4,372	2,740

22. OTHER OPERATING EXPENSES

	2018 BD'000	2017 BD'000
Marketing and advertisement expenses	2,123	2,811
Information technology related expenses	1,558	1,602
Card Centre expenses	2,181	1,951
Premises and equipment expenses	918	1,150
Communication expenses	662	920
Professional services	916	1,254
Board remunerations	266	500
Board of directors sitting fees	153	141
Shari'a committee fees & expenses	65	111
Others	2,352	1,947
	11,194	12,387

23. IMPAIRMENT ALLOWANCE, NET

	2018 BD'000	2017 BD'000
Financing assets (note 5.3)	5,747	2,238
Ijarah rental receivables (note 8)	(774)	299
Investments in Sukuk (note 6)	663	2,327
Investments at fair value through equity (note 6)	1,147	1,013
Investment in associate (note 7)	1,776	320
Placements with financial institutions	3	-
Other assets	758	-
Commitments	(425)	-
	8,895	6,197

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

24. ZAKAH

The total Zakah payable as of 31 December 2018 amounted to BD 1,961 thousand (2017: BD 1,875 thousand) of which the Bank has BD 179 thousand Zakah payable (2017: BD 265 thousand) based on the statutory reserve, general reserve and retained earning as at 1 January 2018. The Zakah balance amounting to BD 1,782 thousand or 1.7 fils per share (2017: BD BD 1,610 thousand or 1.6 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:

	2018	2017
Profit for the year in BD'000	11,381	10,141
Weighted average number of shares	1,051,093,326	1,050,452,146
Basic and diluted earnings per share (fils)	10.83	9.65

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

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:

	2018				
	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	-	21,643	-	-	21,643
Other assets	-	-	-	285	285
Liabilities and Equity of investment accountholders					
Borrowings from financial institutions	-	-	-	-	-
Customers' current accounts	-	177	425	77	679
Other liabilities	-	-	500	-	500
Equity of investment accountholders	48,972	-	695	980	50,647
Income					
Income from financing	-	-	105	-	105
Share of results of associates, net	-	86	-	-	86
Return on equity of investment accountholders	(1,512)	-	(33)	(35)	(1,580)
Expense on borrowings from financial institutions	(532)	-	-	-	(532)
Expenses					
Other expenses	-	-	(484)	-	(484)
Staff costs	-	-	-	(1,405)	(1,405)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

26. RELATED PARTY TRANSACTIONS (CONTINUED)

	2017				
	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	-	-	1,580	-	1,580
Investment in associates	-	23,739	-	-	23,739
Other assets	-	-	-	268	268
Liabilities and Equity of investment accountholders					
Borrowings from financial institutions	38,991	-	-	-	38,991
Customers' current accounts	-	122	453	109	684
Other liabilities	-	-	517	-	517
Equity of investment accountholders	47,092	-	1,923	1,206	50,221
Income					
Income from financing	-	-	98	-	98
Share of results of associates, net	-	(1,103)	-	-	(1,103)
Return on equity of investment accountholders	(1,469)	-	(28)	(39)	(1,536)
Expense on borrowings	(750)	-	-	-	(750)
Expenses					
Other expenses	-	-	(753)	-	(753)
Staff costs	-	-	-	(1,439)	(1,439)

Compensation of the key management personnel is as follows:

	2018 BD'000	2017 BD'000
Short term employee benefits	**1,143**	1,178
Other long term benefits	**262**	261
	1,405	1,439

Key management personnel includes staff at the grade of assistant general manager or above.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT

a. 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. The risks and the processes to mitigate these risks have not significantly changed from the previous year.

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

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

c. 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:

i. Establishing overall policies and procedures; and

ii. 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 has 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): The CIC determines the Credit & Investment Policy of the bank, identifies possible risk assumed by the bank for different transactions. The CIC has the authority to make final decision on approval or rejection of proposed transactions within its delegated authority as well as to monitor the performance and quailty of the bank's credit and investment portfolio. The purpose of CIC is to assist managment in fulfilling its oversight responsibiliites relating to the credit & investment objectives, policies, controls, procedures and related activities, including but not limited to the review of the bank's investment and credit exposures, credit, investment, per party, concentration and group limits.

The Credit & Risk Management (C&RM) division – headed by the Chief Risk Officer - 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, and Credit Administration.

d. 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 Credit & Risk Management Department (C&RM) to the relevant management/Board-level committee. The limits are reviewed and revised periodically, as required by the relevant policy and regulatory requirements.

e. Credit Risk
Credit risk is considered to be the most significant and pervasive risk for the Group. The Group takes on exposure to credit risk, which is the risk that the counter-party to a financial transaction will fail to discharge an obligation causing the Group to incur a financial loss. Credit risk arises principally from financing (credit facilities provided to customers), investment in Sukuk and from cash and deposits held with other banks. Further, there is credit risk in certain off-balance sheet financial instruments, including guarantees relating to purchase and sale of foreign currencies, letters of credit, acceptances and commitments to extend credit. Credit risk monitoring and control is performed by the Credit and Risk Management Department which sets parameters and thresholds for the Group's financing activities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

i) ECL – Significant increase in credit risk (SICR)

To determine whether credit risk has significantly increased since initial recognition, the Group will compare the risk of default at the assessment date with the risk of default at initial recognition. This assessment is to be carried out at each assessment date.

For the Corporate portfolio, The Group assess for significant increase in credit risk (SICR) at a counterparty level as internal rating is currently carried out at a counterparty level and rating is not assigned at facility level. The Group maintains a facility level rating being the counterparty's internal rating at date of facility origination and date of assessment.

For the Retail portfolio, Group currently manages its retail portfolio at a facility level. However, assessment for SICR on the retail portfolio is done on a counterparty level. Days past due (DPD) of individual facilities will reflect on the counterparty SICR assessment.

ii) Generating the term structure of PD

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Group collects performance and default information about its credit risk exposures analyzed by type of product and borrower as well as by credit risk grading.

The Group employs statistical models to analyze the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

This analysis includes the identification and calibration of relationships between changes in default rates and macro-economic factors as well as in-depth analysis of the impact of certain other factors (e.g. forbearance experience) on the risk of default. The macro economic factors used in this analysis are shortlisted from the list given below:

(i) Gross domestic product, constant prices;
(ii) Total investments;
(ii) Gross national savings;
(iii) Inflation, average consumer prices;
(iv) Volume of imports of goods and services;
(v) Volume of exports of goods and services (including oil);
(vi) Population;
(vii) General government revenue;
(viii) General government total expenditure;
(ix) General government net lending / borrowing; and
(x) General government net debt.

Based on consideration of a variety of external actual and forecast information, the Group formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios (i.e. on incorporation of forward-looking information). The Group then uses these forecasts to adjust its estimates of PDs.

For Corporate portfolio, through the yearly review of the corporate portfolio, the Group observes yearly performances to compute a count based PD over the one year horizon for the past 5 years. These PDs are grouped as per internal risk ratings (i.e. from 1 to 7). An average default rate of the 5 yearly observed default provides the through the cycle PDs. Where a counterparty is not rated, PD assigned for rating 6 is used.

In relation to the retail portfolio, the portfolio is segmented by product, as demonstrated below:

(i) Auto finance;
(ii) Mortgage finance;
(iii) Tasheel Finance and Others; and
(iv) Credit cards.

PDs for each segment are measured using Observed Default Estimation and thus PD is calculated based on DPD bucket level for each segment separately. Under this analysis, the delinquency status of accounts is tracked at an interval of one year with a moving month cycle. A minimum of 5 year DPD data is considered.

iii) Determining whether credit risk has increased significantly

In determining whether credit risk has increased significantly since initial recognition, the Group uses its internal credit risk grading system, external risk ratings, delinquency status of accounts, restructuring, expert credit judgement and, where possible, relevant historical experience.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

iii) Determining whether credit risk has increased significantly *(Continued)*

Using its expert credit judgment and, where possible, relevant historical experience, the Group may determine that an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such and whose effect may not otherwise be fully reflected in its quantitative analysis on a timely basis.

As a backstop, the Group considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

The Group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews and validations:

The Group classifies its financial instruments into stage 1, stage 2 and stage 3, based on the applied impairment methodology, as described below:

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

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

Stage 3 (lifetime ECL credit impaired): For credit-impaired exposures subject to credit risk, the Group recognises the lifetime ECL. Default identification process i.e. DPD of 90 more is used as stage 3.

iv) Definition of 'Default'

The Group definition of default is aligned with regulatory guidelines and internal credit risk management practices. Defaulted assets will fall under the Stage 3. In general, a counterparty is considered in default and hence relevant exposure or a group of exposures is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the exposure or group of exposures that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment; rather the combined effect of several events may have caused the impairment losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that an exposure or group of exposures is impaired includes observable data that comes to the attention of the holder of the exposure.

In general, counterparties with facilities exceeding 90 days past dues are considered in default.

v) Incorporation of forward looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an exposure has increased significantly since its initial recognition and its measurement of ECL. The Group annually source macro-economic forecast data for eleven variables from the International Monetary Fund (IMF) database for Bahrain.

Macro-economic variables checked for correlation with the probability of default for the past five years and only those variables for which the movement can be explained are used. Management judgement is exercised when assessing the macroeconomic variables.

vi) Measurement of ECL

The Group measures an ECL at an individual instrument level taking into account the projected cash flows, PD, LGD, CCF and discount rate. For portfolios wherein instrument level information is not available, the Group carries out ECL estimation on a collective basis.

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

(i) probability of default (PD);

(ii) loss given default (LGD); and

(iii) exposure at default (EAD).

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

***vi) Measurement of ECL (**Continued)*

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

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

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

The period of exposure limits the period over which possible defaults are considered and thus affects the determination of PDs and measurement of ECLs (especially for Stage 2 accounts with lifetime ECL).

Subject to using a maximum of a 12-month PD for exposures subject to credit risk for which credit risk has not significantly increased, the Group measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Group considers a longer period. The maximum contractual period extends to the date at which the Group has the right to require repayment of an advance or terminate a financing commitment or guarantee.

vii) Modified exposures subject to credit risk

The contractual terms of exposures subject to credit risk may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

When the terms of a exposure are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- Its remaining lifetime PD at the reporting date based on the modified terms; with
- The remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

The Group renegotiates exposures to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy, forbearance of exposures is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of profit payments and amending the terms of loan covenants. Both retail and corporate financing exposures are subject to the forbearance policy.

For exposures modified as part of the Group's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Group's ability to collect profit and principal and the Group's previous experience of similar forbearance action. As part of this process, the Group evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired / in default. A customer needs to demonstrate consistently good payment behaviour over a period of time (12 months) before the exposure is no longer considered to be credit-impaired/ in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

viii) 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;

(i) Collateral security, fully covering the exposure; or

(ii) 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.

Collateral coverage by type of credit exposure:

2018	Properties BD'000	Others BD'000	Total BD'000
Financing assets	650,819	52,924	703,743
Ijarah Muntahia Bittamleek and rental receivables	221,745	27,647	249,392
	872,564	80,571	953,135

2017	Properties BD'000	Others BD'000	Total BD'000
Financing assets	678,305	55,207	733,512
Ijarah Muntahia Bittamleek and rental receivables	226,133	27,709	253,842
	904,438	82,916	987,354

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2018 amounts to BD 192,505 thousand (31 December 2017: 180,740 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.

ix) 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.

	2018 BD'000	2017 BD'000
Balances with banks and Central Bank	50,119	56,624
Placements with financial institutions	137,450	80,845
Financing assets	578,953	561,822
Ijarah Muntahia Bittamleek and Ijarah rental receivables	186,871	178,880
Investment debt securities	207,233	227,906
	1,160,626	1,106,077
Letters of credit, guarantees and acceptances	72,482	79,629

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

x) 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 2018 BD'000	31 December 2017 BD'000	**31 December 2018 BD'000**	31 December 2017 BD'000	**31 December 2018 BD'000**	31 December 2017 BD'000
Geographical region						
Middle East	**1,260,338**	1,194,057	**1,153,369**	1,091,639	**157,684**	148,540
North America	**5,751**	10,473	**258**	229	**-**	-
Europe	**13,285**	24,107	**7,265**	13,628	**-**	-
Other	**20**	10	**753**	881	**-**	-
	1,279,394	1,228,647	**1,161,645**	1,106,377	**157,684**	148,540
Industry sector						
Trading and manufacturing	**124,846**	105,018	**46,076**	19,022	**39,771**	25,211
Aviation	**17,128**	-	**11,925**	53,029	**-**	-
Real Estate	**173,360**	211,603	**79,832**	43,352	**40,790**	47,843
Banks and financial institutions	**206,594**	171,187	**249,184**	216,833	**1,403**	4,379
Personal / Consumer	**430,374**	391,662	**526,956**	472,366	**34,935**	33,590
Government Organization	**256,390**	251,777	**146,193**	165,358	**20,159**	21,081
Others	**70,702**	97,400	**101,479**	136,417	**20,626**	16,436
	1,279,394	1,228,647	**1,161,645**	1,106,377	**157,684**	148,540

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

xi) Credit quality of exposures subject to credit risk

(i) The following table sets out information about the credit quality of exposures subject to credit risk, unless specifically indicated:

	31 December 2018			
	Stage 1	Stage 2	Stage 3*	Total
Financing assets (Funded exposure)				
Low risks	357,627	22,913	-	380,540
Acceptable risks	113,067	31,572	-	144,639
Watch list	344	7,084	-	7,428
Non performing	-	-	76,185	76,185
Gross exposure	**471,038**	**61,569**	**76,185**	**608,792**
Less: ECL	(2,157)	(3,146)	(24,536)	(29,839)
Financing assets carrying amount	**468,881**	**58,423**	**51,649**	**578,953**
Ijarah Muntahia Bittamleek and Ijarah rental receivables				
Low risks	157,789	1,469	-	159,258
Acceptable risks	11,723	927	-	12,650
Watch list	-	9,653	-	9,653
Non performing	-	-	18,853	18,853
Gross exposure	**169,512**	**12,049**	**18,853**	**200,414**
Less: ECL	(399)	(2,320)	(10,824)	(13,543)
Ijarah Muntahia Bittamleek and Ijarah rental receivables carrying amount	**169,113**	**9,729**	**8,029**	**186,871**
Investment in Sukuk				
Low risks	199,326	-	-	199,326
Acceptable risks	7,583	-	-	7,583
Watch list	-	-	-	-
Non performing	-	-	12,543	12,543
Gross exposure	**206,909**	**-**	**12,543**	**219,452**
Less: ECL	(52)	-	(12,167)	(12,219)
Investment in Sukuk carrying amount	**206,857**	**-**	**376**	**207,233**
Placements with financial institutions				
Low risks	137,455	-	-	137,455
Acceptable risks	-	-	-	-
Watch list	-	-	-	-
Non performing	-	-	-	-
Gross exposure	**137,455**	**-**	**-**	**137,455**
Less: ECL	(5)	-	-	(5)
Placements with financial institutions carrying amount	**137,450**	**-**	**-**	**137,450**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

	31 December 2018			
	Stage 1	Stage 2	Stage 3*	Total
Balances with Banks				
Low risks	15,014	-	-	15,014
Acceptable risks	-	-	-	-
Watch list	-	-	-	-
Non performing	-	-	-	-
Gross exposure	**15,014**	**-**	**-**	**15,014**
Less: ECL	-	-	-	-
Balances with Banks carrying amount	**15,014**	**-**	**-**	**15,014**
Other Receivables				
Low risks	-	-	-	-
Acceptable risks	1,423	1,802	-	3,225
Watch list	-	-	-	-
Non performing	-	-	101	101
Gross exposure	**1,423**	**1,802**	**101**	**3,326**
Less: ECL	(5)	(127)	(101)	(233)
Other Receivables carrying amount	**1,418**	**1,675**	**-**	**3,093**
Total funded exposures subject to credit risk carrying amount	**998,733**	**69,827**	**60,054**	**1,128,614**

*This includes BD 37,829 thousand of exposures in the cooling off period.

Commitments				
Gross exposure	**40,820**	**405**	**159**	**41,384**
ECL	(171)	(3)	(11)	(185)
Commitments carrying amount	**40,649**	**402**	**148**	**41,199**

(ii) The following table shows the movement in ECL in various stages:

At 1 January 2018	**3,012**	**11,184**	**39,570**	**53,766**
Transfer to Stage 1	**2,471**	**(1,323)**	**(1,148)**	**-**
Transfer to Stage 2	**(111)**	**2,708**	**(2,597)**	**-**
Transfer to Stage 3	**(27)**	**(4,837)**	**4,864**	**-**
Net movement between stages	**2,333**	**(3,452)**	**1,119**	**-**
Charge for the year (net)	**(2,556)**	**(2,136)**	**10,077**	**5,385**
Write-off	**-**	**-**	**(3,106)**	**(3,106)**
Foreign exchange movement	**-**	**-**	**(21)**	**(21)**
At 31 December 2018	**2,789**	**5,596**	**47,639**	**56,024**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

e. Credit Risk (Continued)

	31 December 2017					
	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	-	-	38,112	16,814	12,550	67,476
Specific impairment	-	-	(6,118)	(11,277)	(11,481)	(28,876)
Carrying value	-	-	31,994	5,537	1,069	38,600
Past due but not impaired:						
up to 30 days	-	-	62,977	13,181	-	76,158
31 to 60 Days	-	-	8,585	1,050	-	9,635
61 to 90 days	-	-	7,468	711	-	8,179
Carrying value	-	-	79,030	14,942	-	93,972
Neither past due nor impaired	17,765	77,145	452,238	135,120	27,001	709,269
Carrying value	17,765	77,145	452,238	135,120	27,001	709,269
Sovereign	38,859	3,700	7,609	25,179	199,836	275,183
Carrying value	38,859	3,700	7,609	25,179	199,836	275,183
Collective impairment	-	-	(9,049)	(1,898)	-	(10,947)
	56,624	80,845	561,822	178,880	227,906	1,106,077

Restructured facilities during the year amounted to BD 11,267 thousand (2017: BD 24,586 thousand).

f. 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. The Group has leveraged part of its Sukuk portfolio by obtaining medium term financing maturing in one year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

f. Liquidity Risk (Continued)

i) 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.

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2018 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	30,332	-	-	-	-	-	35,105	65,437
Placements with financial institutions	129,809	-	-	7,641	-	-	-	137,450
Financing assets	38,539	33,252	37,585	52,871	190,771	225,935	-	578,953
Ijarah Muntahia Bittamleek and rental recievables	661	14,592	2,015	3,505	21,351	144,747	-	186,871
Investment securities	-	5,774	20,069	1,611	50,017	129,763	32,819	240,053
Investment in associates	-	-	-	-	-	-	21,643	21,643
Investment in real estate	-	-	-	-	-	-	24,284	24,284
Property and equipment	-	-	-	-	-	-	13,641	13,641
Other assets	2	771	520	595	642	1,765	6,767	11,062
TOTAL ASSETS	**199,343**	**54,389**	**60,189**	**66,223**	**262,781**	**502,210**	**134,259**	**1,279,394**
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Placements from financial institutions	84,681	11,643	-	9,184	9,236	-	-	114,744
Placements from non-financial institutions and individuals	-	-	-	7,255	-	-	-	7,255
Borrowings from financial institutions	36,799	14,343	-	45,244	-	-	-	96,386
Customers' current accounts	26,648	-	-	-	-	106,596	-	133,244
Other liabilities	24,025	-	-	-	-	-	-	24,025
Equity of investment accountholders	184,394	125,390	87,384	119,493	29,991	239,339	-	785,991
TOTAL LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS	**356,547**	**151,376**	**87,384**	**181,176**	**39,227**	**345,935**	**-**	**1,161,645**
Liquidity gap	**(157,204)**	**(96,987)**	**(27,195)**	**(114,953)**	**223,554**	**156,275**	**134,259**	**117,749**
Cumulative liquidity gap	**(157,204)**	**(254,191)**	**(281,386)**	**(396,339)**	**(172,785)**	**(16,510)**	**117,749**	**-**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

f. Liquidity Risk (Continued)

i) Maturity profile of Group's assets and liabilities *(Continued)*

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2017 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	34,461	-	-	-	-	-	35,205	69,666
Placements with financial institutions	80,845	-	-	-	-	-	-	80,845
Financing assets	23,595	28,150	29,159	63,784	65,411	351,723	-	561,822
Ijarah Muntahia Bittamleek and rental recievables	10,193	8,309	162	56	4,222	155,938	-	178,880
Investments securities	11,295	40,179	27,603	10,167	34,766	103,896	30,493	258,399
Investment in associates	-	-	-	-	-	-	23,739	23,739
Investment in real estate	-	-	-	-	-	-	29,831	29,831
Property and equipment	-	-	-	-	-	-	14,270	14,270
Other assets	5	310	397	357	1,527	8,599	-	11,195
TOTAL ASSETS	160,394	76,948	57,321	74,364	105,926	620,156	133,538	1,228,647
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Placements from financial institutions	61,086	6,786	-	-	-	-	-	67,872
Borrowings from financial institutions	-	63,488	-	38,088	-	-	-	101,576
Customers' current accounts	26,333	-	-	-	-	105,333	-	131,666
Other liabilities	11,507	-	-	-	-	-	-	11,507
Equity investment accountholders	206,961	102,475	146,113	72,960	9,334	255,913	-	793,756
TOTAL LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS	305,887	172,749	146,113	111,048	9,334	361,246	-	1,106,377
Liquidity gap	(145,493)	(95,801)	(88,792)	(36,684)	96,592	258,910	133,538	122,270
Cumulative liquidity gap	(145,493)	(241,294)	(330,086)	(366,770)	(270,178)	(11,268)	122,270	-

g. Market Risk

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".

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

27. RISK MANAGEMENT (CONTINUED)

g. Market Risk (Continued)

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.

As at the consolidated statement of financial position date, the Group has unquoted (equities and Sukuk) of BD 122 million (31 December 2017: 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 exposures denominated in foreign currencies as of 31 December:

	Equivalent Long (short) 2018 BD '000	Equivalent Long (short) 2017 BD '000
Currency		
Pound Sterling	**(1,075)**	(1,020)
Euro	**(1,084)**	(985)
CAD	**(50)**	(4)
JPY	**(15)**	(6)
Kuwaiti Dinars	**(9,619)**	(8,659)

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 exposures in 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.

iv) Commodity risk

Commodity risk is defined as inherent risk in financial products 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.

h. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

28. SEGMENTAL INFORMATION

For management purposes, the Group is organized 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 2018			
	Corporate BD'000	**Retail BD'000**	**Investment BD'000**	**Total BD'000**
Total net income	**10,139**	**23,611**	**11,781**	**45,531**
Total expenses	**(5,157)**	**(17,914)**	**(2,184)**	**(25,255)**
Provision for impairment	**(3,808)**	**(740)**	**(4,347)**	**(8,895)**
Profit for the year	**1,174**	**4,957**	**5,250**	**11,381**
Other information				
Segment assets	**365,325**	**465,835**	**448,234**	**1,279,394**
Segment liabilities, and equity	**410,663**	**544,700**	**324,031**	**1,279,394**

	31 December 2017			
	Corporate BD'000	Retail BD'000	Investment BD'000	Total BD'000
Total income	10,732	27,170	5,004	42,906
Total expenses	(5,043)	(18,154)	(3,371)	(26,568)
Provision for impairment	(7,399)	529	673	(6,197)
Profit / (loss) for the year	(1,710)	9,545	2,306	10,141
Other information				
Segment assets	330,624	455,535	442,488	1,228,647
Segment liabilities, and equity	450,926	517,873	259,848	1,228,647

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2018

29. FINANCIAL INSTRUMENTS

a. 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 and Ijarah Muntahia Bittamleek, 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. None of the Group's financial instruments are at fair value.

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.

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 charitable 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 five 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

CONTENTS

1. Background.... 105
2. Statement of Financial Position under the Regulatory Scope of Consolidation.... 105
3. Capital Adequacy 106
4. Risk Management
   - 4.1 Group-wide Risk Management Objectives.... 109
   - 4.2 Strategies, Processes and Internal Controls.... 110
   - 4.3 Structure and Organisation of Risk Management Function.... 111
   - 4.4 Risk Measurement and Reporting Systems 111
   - 4.5 Credit Risk 111
   - 4.6 Market Risk.... 121
   - 4.7 Operational Risk 123
   - 4.8 Equity Position in the Banking Book 124
   - 4.9 Equity of Investment Accountholders ("IAH") 125
   - 4.10 Liquidity Risk 129
   - 4.11 Profit Rate Risk 131
   - 4.12 CBB Penalties 133
5. Glossary of Terms.... 134

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

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 subsidiary together known as (the "Group").

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

2. Statement of Financial Position under the Regulatory Scope of Consolidation

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

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

	Statement of Financial position as per published financial statements 31 December 2018 BD'000	Statement of Financial position as per Regulatory Reporting 31 December 2018 BD'000	Reference
ASSETS			
Cash and balances with banks and Central Bank	**65,437**	**65,437**	
Gross Placements with financial institutions	137,455	137,455	
Less: Expected credit loss (stage 3)	-	-	
Less: Expected credit loss (stage 1 and stage 2)	(5)	-	
Net placements with financial institutions	**137,450**	**137,455**	
Gross financing assets	608,792	608,792	
Less: Expected credit loss (stage 3)	(24,536)	(24,536)	
Less: Expected credit loss (stage 1 and stage 2)	(5,303)	-	
Net financing assets	**578,953**	**584,256**	
Gross investment securities	262,056	262,056	
Less: Expected credit loss (stage 3)	(21,951)	(21,951)	
Less: Expected credit loss (stage 1 and stage 2)	(52)	-	
Net investment securities	**240,053**	**240,105**	
Ijarah Muntahia Bittamleek	**165,730**	**165,730**	
Gross ijarah rental receivables	34,684	34,684	
Less: Expected credit loss (stage 3)	(10,824)	(10,824)	
Less: Expected credit loss (stage 1 and stage 2)	(2,719)	-	
Net ijarah rental receivables	**21,141**	**23,860**	
Investment in associates	**21,643**	**21,643**	
Investment in real estate	**24,284**	**24,284**	
Property and equipment	**13,641**	**13,641**	
Gross other assets	11,295	11,295	
Less: Expected credit loss (stage 3)	(101)	(101)	
Less: Expected credit loss (stage 1 and stage 2)	(132)	-	
Net other assets	**11,062**	**11,194**	
TOTAL ASSETS	**1,279,394**	**1,287,605**	

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

2. Statement of Financial Position Under The Regulatory scope of Consolidation (Continued)

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

	Statement of Financial position as per published financial statements 31 December 2018 BD'000	Statement of Financial position as per Regulatory Reporting 31 December 2018 BD'000	Reference
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			
Liabilities			
Placements from financial institutions	114,744	114,744	
Placements from non-financial institutions and individuals	7,255	7,255	
Borrowings from financial institutions	96,386	96,386	
Customers' current accounts	133,244	133,244	
Other liabilities	24,025	23,851	
of which: Expected credit loss - Off balance sheet exposures (stage 3)	11	11	
of which: Expected credit loss - Off balance sheet exposures (stage 1 and stage 2)	174	-	
of which: Other liabilities	23,840	23,840	
Total Liabilities	375,654	375,480	
Equity of Investment Accountholders	785,991	785,991	
Owners' Equity			
Share capital	106,406	106,406	a
Treasury shares	(892)	(892)	b
Shares under employee share incentive scheme	(391)	(391)	c
Share premium	120	120	d
Statutory reserve	4,115	4,115	e
Real estate fair value reserve	4,830	4,830	f
Investment securities fair value reserve	718	718	g
Expected credit loss	-	8,385	h
of which: amount eligible for Tier 2 capital subject to a maximum of 1.25% of credit risk weighted assets	-	7,729	i
of which: amount ineligible for Tier 2 capital	-	656	j
Profit for the year	11,381	11,381	k
Retained earnings brought forward	(8,538)	(8,538)	l
Total Owners' Equity	117,749	126,134	
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY	1,279,394	1,287,605	

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.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

3. Capital Adequacy (Continued)

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, and 1.3.14)

The following table summarises the eligible capital as of 31 December 2018 after deductions for Capital Adequacy Ratio (CAR) calculation:

	CET 1 BD'000	T2 BD'000	Source based on reference letters of the statement of financial position under the regulatory scope of consolidation
Components of capital			
Issued and fully paid ordinary shares	106,406	-	a
General reserves	-	-	
Legal / statutory reserves	4,115	-	e
Share premium	120	-	d
Retained earnings brought forward	(8,538)	-	l
Current period profits	11,381		k
Unrealized gains and losses on available for sale financial instruments	718	-	g
Less:			
Employee stock incentive program funded by the bank (outstanding)	391	-	c
Treasury shares	892	-	b
Total Common Equity Tier 1 capital after the regulatory adjustments above (CET1 d)	112,919	-	
Assets revaluation reserve - property, plant, and equipment		4,830	f
Expected credit loss (ECL) - stages 1 & 2		7,729	i
Total Available AT1 & T2 Capital		12,559	
Total Capital		125,478	

	Amount of exposures BD'000
Total Credit Risk Weighted Assets	618,293
Total Market Risk Weighted Assets	11,891
Total Operational Risk Weighted Assets	103,812
Total Regulatory Risk Weighted Assets	733,996
Investment risk reserve (30% only)	353
Equalization reserve (30% only)	374
Total Adjusted Risk Weighted Exposures	733,269
CAPITAL ADEQUACY RATIO	17.11%
Minimum requirement	12.5%

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

3. Capital Adequacy (Continued)

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

The following table summarises the amount of exposures as of 31 December 2018 subject to standardised approach of credit risk and related capital requirements by type of Islamic financing contracts:

	Exposure			Risk Weighted Assets*			Capital Requirements		
	Self-Financed BD'000	IAH BD'000	Total BD'000	Self-Financed BD'000	IAH [3] BD'000	Total BD'000	Self-Financed BD'000	IAH BD'000	Total BD'000
Credit Risk Weighted Assets									
Funded									
Cash and balances with banks and Central Bank	20,444	44,993	65,437	7,423	-	7,423	928	-	928
Murabaha and Wakala receivables - interbank	137,455	-	137,455	42,324	-	42,324	5,291	-	5,291
Murabaha receivables*	115,916	370,140	486,056	100,351	96,131	196,482	12,544	12,016	24,560
Musharaka receivables*	23,420	74,780	98,200	19,843	19,008	38,851	2,480	2,376	4,856
Investment in Sukuk	49,434	157,851	207,285	5,053	4,840	9,893	632	605	1,237
Investment in equity and funds	32,820	-	32,820	115,717	-	115,717	14,465	-	14,465
Ijarah Muntahia Bittamleek and rental receivables*	45,214	144,376	189,590	26,048	24,953	51,001	3,256	3,119	6,375
Investment in associates	21,643	-	21,643	48,100	-	48,100	6,013	-	6,013
Investment in real estate	24,284	-	24,284	48,569	-	48,569	6,071	-	6,071
Property and equipment	13,641	-	13,641	13,641	-	13,641	1,705	-	1,705
Other assets	11,194	-	11,194	16,299	-	16,299	2,037	-	2,037
	495,465	792,140	1,287,605	443,368	144,932	588,300	55,422	18,116	73,538
Unfunded									
Commitments and contingent liabilities	157,684	-	157,684	29,993	-	29,993	3,749	-	3,749
Total Credit Risk Weighted Assets	653,149	792,140	1,445,289	473,361	144,932	618,293	59,171	18,116	77,287
Total Market Risk Weighted Assets	11,891	-	11,891	11,891	-	11,891	1,486	-	1,486
Total Operational Risk Weighted Assets	103,812	-	103,812	103,812	-	103,812	12,977	-	12,977
Total Risk Weighted Assets	[1] 768,852	[2] 792,140	1,560,992	589,064	144,932	733,996	73,634	18,116	91,750

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

[1] The exposure is gross of expected credit loss Stages 1 & 2 of BD 2,062 thousand.

[2] The exposure is gross of expected credit loss Stages 1 & 2 of BD 6,149 thousand.

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

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

3. Capital Adequacy (Continued)

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

The following table summarises the amount of exposures as of 31 December 2018 subject to standardised approach of market risk and related capital requirements:

Market Risk - Standardised Approach	
Foreign exchange risk (BD'000)	951
Total of Market Risk - Standardised Approach	**951**
Multiplier	12.5
Risk Weighted Exposures for CAR Calculation (BD'000)	**11,891**
Total Market Risk Exposures (BD'000)	**11,891**
Total Market Risk Exposures - Capital Requirement (BD'000)	**1,486**

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 2018 subject to basic indicator approach of operational risk and related capital requirements:

Indicators of operational risk	
Average Gross income (BD'000)	55,366
Multiplier	12.5
	692,081
Eligible Portion for the purpose of the calculation	15%
Total Operational Risk Exposure (BD'000)	**103,812**
Total Operational Risk Exposures - Capital Requirement (BD'000)	**12,977**

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

The following are Capital Adequacy Ratios as of 31 December 2018 for total capital and CET 1 capital:

	Total capital ratio	CET 1 capital ratio
Top consolidated level	17.11%	15.40%

4. Risk Management

4.1 Group-wide Risk Management Objectives

The risk management philosophy of the Group is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximising the returns intended to optimise the Group's shareholder return 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's risk appetite is embodied through its risk strategy; BisB reviews and aligns its risk appetite in line with its evolving business plan, and changing economic and market scenarios, in addition to evolving regulatory requirements. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks. To monitor and report exposures to these identified risks, the Group adopted a comprehensive enterprise-wide Risk Management Framework that encompasses the risk limit, monitoring, and reporting structures.

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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 Management Framework 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.

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

4.2.2 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, and maturity limits. As at 31 December 2018, 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. Operational risk key risk indicators are monitered and reported on a periodic basis to all relevant stakeholders in the Group.

The Group has established 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 in line with market rates.

4.2.7 Displaced Commercial Risk

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

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

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

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

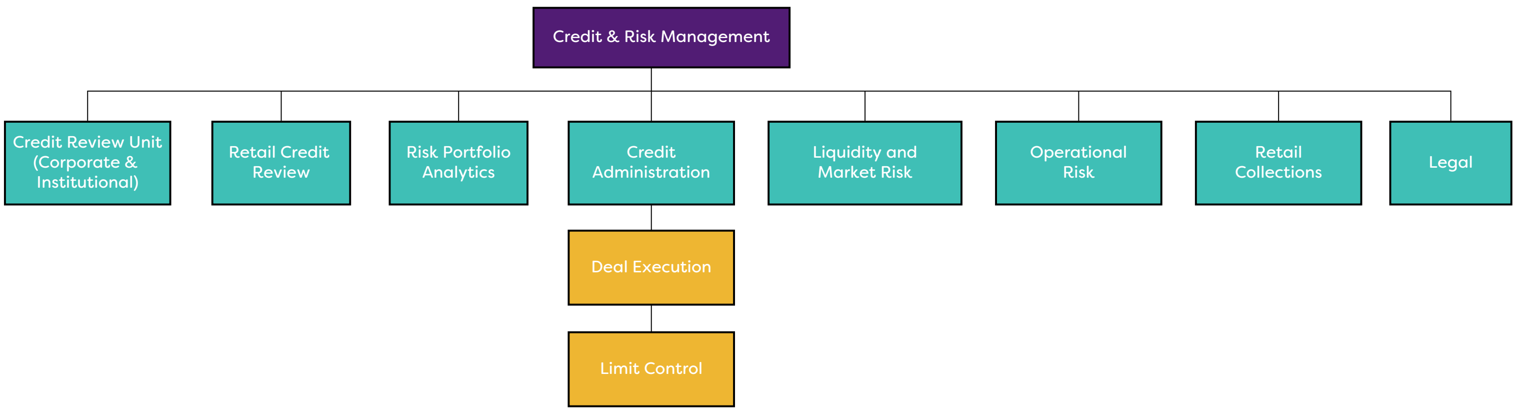
RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

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 and Investment 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 secured by suitable tangible collateral whereever deemed necessary.

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

All credit proposals undergo a comprehensive risk assessment examining the customer's financial condition, trading performance, nature of the business, quality of management, and market position, etc. In addition, the Group 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, or more frequently based on the client's credit condition.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.2 Types of credit risk

Financing contracts mainly comprise of due from banks and financial institutions, murabaha receivables, musharaka investments, and other exposures subject to credit risk comprising Ijarah Muntahia Bittamleek and rental receivables, commitments to finance and financial instruments resulting in contingencies (guarantees and letter of credit).

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 installments are settled.

4.5.3 Credit impaired exposures

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

As a policy, the Group places 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. Income is recognised to the extent that it is actually received.

For general and specific impairment assessments, The Group classifies its financial instruments into stage 1, stage 2 and stage 3, based on the applied impairment methodology, as described below:-

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

Stage 2 (lifetime ECL not credit impaired): for financial instruments where there has been a significant increase in credit risk since initial recognition but they are not credit-impaired, the Group recognises an allowance for the lifetime ECL for all financings categorized in this stage based on the actual / expected maturity profile including restructuring or rescheduling of facilities.

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

Measurement of ECL

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

(i) probability of default (PD);
(ii) loss given default (LGD); and
(iii) exposure at default (EAD).

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

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

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

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.3 Credit impaired exposures (Continued)

Measurement of ECL (Continued)

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

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

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

4.5.4 External credit assessment institutions

The Group relies on external ratings for rated corporate customers and counterparties. The Group uses Standard & Poor's, Fitch, Moody's and Capital Intelligence to provide ratings for such counterparties. In case of unrated counterparties, the Group will assess the credit risk on the basis of defined parameters. These ratings are used for risk assessment and calculation of risk weighted equivalents. The Group's policy has the mapping of the external ratings with the 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 the Group's Risk Management Department and reported to the Board on a quarterly basis. The Group's classification of geographical area is according to its business needs and the distribution of its portfolios.

4.5.6 Concentration risk

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

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

4.5.7 Credit risk mitigation

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

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

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

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 outstanding exposure of relevant credit facilities.

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

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.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.7.1 General policy guidelines of collateral management

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

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

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

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

a. Valuation of shares and 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 with the help of external valuers:

- 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. The Group must ascertain that collateral providers are authorised and acting within their capacity.

4.5.7.2 Guarantees

In cases where a letter of guarantee from a parent company or a third party is accepted as a credit risk mitigant, the Group ensures that all guarantees are irrevocable, 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 custodians 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.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

4.5.8 Counterparty credit risk

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

4.5.8.1 Exposure

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

4.5.8.2 Counterparty

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

4.5.8.3 Group exposure

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

4.5.8.4 Connected counterparties

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

4.5.8.5 Large exposure

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

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

a. If any unconnected counterparty (single/group) exposure exceeds 15% of Group's Capital Base;

b. If any facility (new/extended) to any connected counterparty exceeds 25% of the consolidated total capital at an aggregate level

4.5.8.6 Maximum exposure

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

4.5.8.7 Reporting

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

4.5.8.8 Other matters

As a Group's strategy, exposure to connected counterparties may be undertaken only when negotiated and agreed 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 2018. All related party transactions have been made on arm's length basis.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

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

The following table summarises the amount of gross funded and unfunded credit exposure (before deducting credit risk mitigant) as of 31 December 2018 and average gross funded and unfunded exposures over the year ended 31 December 2018:

	Total gross credit exposure BD'000	*Average gross credit exposure over the year BD'000
Funded		
Cash and balances with banks and Central Bank	65,437	65,522
Placements with financial institutions	137,450	91,735
Financing assets	578,953	565,256
Investment in Sukuk	207,233	220,213
Investment in equity and funds	32,820	30,875
Ijarah Muntahia Bittamleek and rental receivables	186,871	181,963
Investment in associates	21,643	22,181
Investment in real estate	24,284	26,176
Property and equipment	13,641	13,744
Other assets	11,062	11,624
Total	1,279,394	1,229,289
Unfunded		
Commitments and contingent liabilities	157,684	159,441
Total	1,437,078	1,388,730

*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 2018, broken down into significant areas by major types of credit exposure:

	North America BD'000	Europe BD'000	Middle East BD'000	Other BD'000	Total BD'000
Cash and balances with banks and Central Bank	5,748	516	59,153	20	65,437
Placements with financial institutions	-	-	137,450	-	137,450
Financing assets	-	10,508	568,445	-	578,953
Investment in Sukuk	-	2,261	204,972	-	207,233
Investment in equity and funds	-	-	32,820	-	32,820
Ijarah Muntahia Bittamleek and rental receivables	-	-	186,871	-	186,871
Investment in associates	-	-	21,643	-	21,643
Investment in real estate	-	-	24,284	-	24,284
Property and equipment	-	-	13,641	-	13,641
Other assets	3	-	11,059	-	11,062
Total	5,751	13,285	1,260,338	20	1,279,394

*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

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

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

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2018 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	Personal & Consumer Finance BD'000	Governmental Organisation BD'000	Others BD'000	Total BD'000
Funded							
Cash and balances with banks and Central Bank	-	30,089	-	-	35,348	-	65,437
Placements with financial institutions	-	137,450	-	-	-	-	137,450
Financing assets	111,470	25,757	83,980	298,670	19,022	40,054	578,953
Investment in Sukuk	-	376	7,656	-	197,360	1,841	207,233
Investment in equity and funds	-	6,313	26,465	-	-	42	32,820
Ijarah Muntahia Bittamleek & rental receivables	13,376	-	21,502	130,008	21,788	197	186,871
Investment in associates	-	4,713	4,370	-	-	12,560	21,643
Investment in real estate	-	-	24,284	-	-	-	24,284
Property and equipment	-	-	-	-	-	13,641	13,641
Other assets	-	1,896	5,103	1,696	-	2,367	11,062
Total	124,846	206,594	173,360	430,374	273,518	70,702	1,279,394
Unfunded							
Commitments and contingent liabilities	39,771	1,403	40,790	34,935	20,159	20,626	157,684
Total	164,617	207,997	214,150	465,309	293,677	91,328	1,437,078

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 2018:

	Gross BD'000	Stage 3 ECL BD'000	Net* BD'000
Counterparties			
Counterparty # 1	11,820	941	10,879
Counterparty # 2	10,538	-	10,538
Counterparty # 3	9,156	-	9,156
Counterparty # 4	4,494	889	3,605
Counterparty # 5	3,710	3,335	375
Counterparty # 6	1,095	985	110
	40,813	6,150	34,663

*Gross of expected credit loss stage 1 and 2 of BD 674 thousand.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

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

The Group has the following exposures that are in excess of the individual obligor limit of 15% of the Group's capital as of 31 December 2018:

	Gross BD'000	Stage 3 ECL BD'000	Net** BD'000
Counterparties*			
Counterparty # 1	186,284	-	186,284
Counterparty # 2	73,454	-	73,454
Counterparty # 3	24,318	-	24,318
Counterparty # 4	24,084	-	24,084
Counterparty # 5	20,522	-	20,522
	328,662	-	328,662

*Represents exempted large exposures.

**Gross of expected credit loss stage 1 and 2 of BD 89 thousand.

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

The following table summarises the maturity profile of the total assets based on contractual maturities as at 31 December 2018. All the assets with no fixed contractual maturities are disclosed under no fixed maturity:

	Up to One month BD'000	1-3 months BD'000	3-6 months BD'000	6-12 months BD'000	1-3 years BD'000	3-5 years BD'000	5-10 years BD'000	10-20 years BD'000	Over 20 years BD'000	No fixed maturity BD'000	Total BD'000
Assets											
Cash and balances with banks and Central Bank	30,332	-	-	-	-	-	-	-	-	35,105	65,437
Placements with financial institutions	129,809	-	-	7,641	-	-	-	-	-	-	137,450
Financing assets	38,539	33,252	37,585	52,871	190,771	137,665	60,103	24,259	3,908	-	578,953
Investment in Sukuk	-	5,773	20,069	1,611	50,017	1,257	128,506	-	-	-	207,233
Investment in equity and funds	-	-	-	-	-	-	-	-	-	32,820	32,820
Ijarah Muntahia Bittamleek and rental receivables	661	14,592	2,015	3,505	21,351	40,727	45,309	49,542	9,169	-	186,871
Investment in associates	-	-	-	-	-	-	-	-	-	21,643	21,643
Investment real estate	-	-	-	-	-	-	-	-	-	24,284	24,284
Property and equipment	-	-	-	-	-	-	-	-	-	13,641	13,641
Other assets	2	771	520	595	642	1,765	-	-	-	6,767	11,062
Total Assets	199,343	54,388	60,189	66,223	262,781	181,414	233,918	73,801	13,077	134,260	1,279,394

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

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

The following table summarises the credit impaired facilities, past due facilities, and impairment allowances disclosed by major industry sector as of 31 December 2018:

		Aging of credit impaired or past due Islamic financing contracts				Life-time ECL				* 12 months ECL		
	Credit impaired or past due Islamic financing contracts BD'000	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 for the year (net) BD'000	Charge-offs during the year* BD'000	Balance at the end of year BD'000	Balance at the beginning of the year BD'000	Charge for the year (net) BD'000	Balance at the end of year BD'000
Trading and Manufacturing	56,286	44,980	10,596	468	242	659	6,704	(1,615)	8,978	3,593	(2,137)	1,456
Real Estate	60,468	33,268	1,124	1,546	24,530	15,823	1,427	4,214	13,036	1,595	1,515	3,110
Banks and Financial Institutions	84	72	-	12	-	14	30	-	44	84	555	639
Personal / Consumer Finance	26,387	17,767	2,507	2,906	3,207	8,640	470	51	9,059	6,018	(3,754)	2,264
Others	17,153	10,345	2,280	4,289	239	2,953	916	(374)	4,243	2,136	(1,583)	553
Total	**160,378**	**106,432**	**16,507**	**9,221**	**28,218**	**28,089**	**9,547**	**2,276**	**35,360**	**13,426**	**(5,404)**	**8,022**

*Net of transfers between stages.

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

The following table summarises the credit impaired facilities, past due facilities, and impairment allowances by geographical area as of 31 December 2018:

	Non-performing or past due or impaired Islamic financing contracts BD'000	Stage 3 ECL BD'000	Stage 1 &2 ECL BD'000
Middle East	160,378	35,360	8,022
Total	**160,378**	**35,360**	**8,022**

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 2018:

	Outstanding BD'000	Stage 3 ECL BD'000	Net BD'000
Total Islamic financings [(1)]	809,206	35,360	773,846
Restructured financing facilities* [(2)]	5,527	677	4,850
Percentage	**0.68%**	**1.91%**	**0.63%**

*Excludes facilities restructured during the year amounting to BD 5,740 thousand which are past due as of 31 December 2018.

(1) Gross of expected credit loss Stages 1 and 2 of BD 8,022 thousand.

(2) Gross of expected credit loss Stages 1 and 2 of BD 146 thousand.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.5 Credit Risk (Continued)

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

The following table summarises the exposure as of 31 December 2018 by type of Islamic financing contract covered by eligible collateral:

	Total exposure covered by	
	Tamkeen Guarantee BD'000	Others BD'000
Financing assets	34,936	37,455
Ijarah Muntahia Bittamleek and rental receivables	51	24,295
Total	**34,987**	**61,750**

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 2018:

	Financing assets BD'000	Ijarah Muntahia Bittamleek and rental receivables BD'000	Total BD'000
Exposures:			
Secured*	72,391	24,346	96,737
Unsecured*	506,562	162,525	669,087
Total	**578,953**	**186,871**	**765,824**
Collateral held:			
- Cash	9,420	89	9,509
- Guarantees	5,235	-	5,235
- Shares	5,673	-	5,673
- Real Estate	3,211	15,795	19,006
Total	**23,539**	**15,884**	**39,423**
Collateral as a percentage of secured exposure	32.52%	65.24%	40.75%

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

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

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

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 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. 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, and maturity limits. As at 31 December 2018, the group did not have any trading portfolio.

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

4.6.3 Market risk strategy

The Group's Board is responsible for approving and reviewing (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:

a. The Group will manage its market risk exposure by evaluating each new product / activity with respect to the market risk introduced by it;

b. The Group will proactively measure and continually monitor the market risk in its portfolio;

c. The Group will at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;

d. 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, and maturity limits;

e. 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;

f. The Group will match the amount of floating rate assets with floating rate liabilities; and

g. 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. Stress Testing; and

d. Profit rate risk gap analysis.

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)
4.6 Market Risk (Continued)

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 Unit and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates.

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

4.6.7 Breach of limits
In case a limit is breached, an approval 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 annually or when deemed required.

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

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

4.6.10 Stress testing
Stress tests produce information summarising the Group's exposure to extreme, but possible, circumstances and offer a way of measuring and monitoring the portfolio against extreme price movements of this type. The Group's Risk Unit employs different stress categories: profit rates, foreign exchange rates, and equity 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 for the year:

	Foreign exchange risk BD'000
Maximum value capital requirement	1,486
Minimum value capital requirement	951

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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:

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

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

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

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

e. Legal risk which arises due to contractual obligations.

4.7.3 Operational risk management strategy

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

The Group on a continuous basis will:

a. assess the effectiveness of controls associated with identified risks;

b. regularly monitor operational risk profiles and material exposures to losses / loss events;

c. identify stress events and scenarios to which it is vulnerable and assess their potential impact, and the probability of aggregated losses from a single event leading to other risks;

d. monitoring and reporting of operational risk is through the Operational Risk Management Forum (ORMF), a management-level committee responsible for monitoring and discussing the operational risks emanating from the Group's activities; and

e. effecting appropriate contingency and business continuity planning that takes into account the operational risks facing the Group, and providing training on the same to ensure that this is fostered across the organization.

4.7.4 Operational risk monitoring and reporting

The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to senior management 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 Group has a legal department dedicated to monitor any legal risk arising out of contracts / agreements entered into by the Group on a day to day basis. The department also liaises with external lawyers for legal cases filed by the group against delinquent accounts for recovery or any legal cases filed against the Group.

4.7.5 Operational risk mitigation and control

The business units, in consultation with Risk 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 Unit will decide whether to accept the risks, reduce the level of business activity involved, transfer the risk outside the Group, or withdraw from the associated activity completely. Risk Unit facilitates the business units in co-developing the mitigation plans. The Group deals with the pending legal cases through internal and external lawyers depending upon the severity of the cases.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.7 Operational Risk (Continued)

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		
	2017 BD'000	2016 BD'000	2015 BD'000
Total Gross Income	60,654	53,993	51,453
Indicators of operational risk			
Average Gross income (BD'000)			55,366
Multiplier			12.5
			692,081
Eligible Portion for the purpose of the calculation			15%
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE (BD'000)			**103,812**

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 consistent with those disclosed in the consolidated financial statements as of 31 December 2018. 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 2018:

	Total gross exposure [(1)] BD'000	Average gross exposure [(2)] BD'000	Publicly traded BD'000	Privately held BD'000	Risk weighted assets BD'000	Capital Requirements BD'000
Equity investments	28,436	25,831	-	28,436	59,990	7,499
Funds	14,168	14,168	-	14,168	55,727	6,966
Total	**42,604**	**39,999**	**-**	**42,604**	**115,717**	**14,465**

(1) Balances are gross of provision of BD 9,784 thousand.

(2) Average balances are computed based on quarter end balances.

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

The following table summarises the cumulative realised and unrealised gains or (losses) during the year ended 31 December 2018:

	BD'000
Cumulative realised gain arising from sales or liquidations in the reporting period	-
Total unrealised losses recognised in the consolidated statement of financial position but not through consolidated statement of income	-
Unrealised gains included in CET 1 Capital	718
Unrealised gains included in Tier 2 Capital	-

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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; however, the Group does not share profits with IAH resulting from investing current accounts and other funds received on the basis other than mudaraba contracts. In such type of contract, the Group is not liable for any losses incurred on the joint pool other than the loss resulting from gross negligence or wilful misconduct on the part of the Group or due to the Group's violation of the terms and conditions as agreed between the Group and the IAH. During the year, the Group waived 32% of profit from mudarib fees in order to maintain a 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 Group. The business lines of the Group have expertise in creating high end value added products offering a wide range of products, expected return, tenors, and risk profile. Information on new products or any change in the existing products will be placed on the Group's website or published in the media.

These accounts are made available to customers through Retail Banking (to include the Thuraya Banking segment), in addition to the Group's Corporate and Institutional Banking division. The Group has designed 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. This is made available to both retail and corporate customers.

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

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.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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

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. During the year the Group has allocated Stage 1 and Stage 2 ECL allowances towards IAH. The Group temporarily allocates certain 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 Group 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. Impairment provisions (if any) relating to non-performing assets allocated to IAH are allocated to the equity shareholders. Any recoveries from such accounts are also allocated to the equity shareholders.

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

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

Additional disclosures such as the below are disclosed in the Group's website;

a. Characteristics of investors for whom investment account may be appropriate;

b. Purchase redemption and distribution procedures; and

c. Product information and the manner in which the products are made available to investors.

Governance of IAH

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

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

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

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

The following table summarises the breakdown of equity of investment accountholders accounts as of 31 December 2018:

	BD'000
Banks and financial institutions	73,203
Individuals and non-financial institutions	712,788
Total	**785,991**

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 2018:

Profit Paid on Average IAH Assets*	1.84%
Mudarib Fee to Total income from jointly financed assets	50.47%

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

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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

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

The following table summarises the profit distributed to IAH and financing ratios to the total of IAH by type of investment for the year ended 31 December 2018:

	Average declared rate of return	Proportion of total profit distributed by type of IAH	Proportion of IAH investments to total IAH
Saving accounts (including VEVO)	0.13%	1.19%	16.96%
Defined accounts - 1 month	0.80%	0.26%	0.53%
Defined accounts - 3 months	0.80%	0.09%	0.17%
Defined accounts - 6 months	0.85%	0.16%	0.32%
Defined accounts - 9 months	0.95%	0.00%	0.00%
Defined accounts - 1 year	1.00%	0.95%	1.62%
Investment certificates	3.50%	0.00%	0.00%
IQRA	1.50%	0.51%	0.60%
Tejoori	0.13%	1.57%	20.72%
Customer special deposits	2.03%	95.27%	59.08%
		100%	100%

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

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

The following table summarises the percentage of counterparty type to total financing for each type of Shari'a-compliant contract to total financing as of 31 December 2018:

	Percentage of Counterparty Type to Total Financing					
	Self Financed		IAH		Total	
	BD'000	%	BD'000	%	BD'000	%
Gross financing assets*						
Murabaha	**115,916**	**23.85%**	**370,140**	**76.15%**	**486,056**	**100.00%**
Corporate	68,647	23.85%	219,201	76.15%	287,848	100.00%
Retail	47,269	23.85%	150,939	76.15%	198,208	100.00%
Musharakah	**23,420**	**23.85%**	**74,780**	**76.15%**	**98,200**	**100.00%**
Corporate	2,067	23.85%	6,596	76.15%	8,663	100.00%
Retail	21,353	23.85%	68,184	76.15%	89,537	100.00%
Total	**139,336**	**23.85%**	**444,920**	**76.15%**	**584,256**	**100.00%**
Gross Ijarah Muntahia Bittamleek and rental receivables**						
Corporate	14,008	23.85%	44,731	76.15%	58,739	100.00%
Retail	31,206	23.85%	99,645	76.15%	130,851	100.00%
Total	**45,214**	**23.85%**	**144,376**	**76.15%**	**189,590**	**100.00%**
ECL Stage 1 and 2	(1,913)	23.85%	(6,109)	76.15%	(8,022)	100.00%
Total	**182,637**	**23.85%**	**583,187**	**76.15%**	**765,824**	**100.00%**

*Net of expected credit loss (Stage 3) of BD 24,536 thousands.

**Net of expected credit loss (Stage 3) of BD 10,824 thousands.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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

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

	Gross return on equity of IAH BD'000	Transfer to equalization reserve BD'000	Average mudaraba %	Mudarib fees BD'000	Transfer to IRR BD'000	Profit paid to IAH BD'000
Account Type	A	B		C	D	(A-B-C-D)
Tejoori	8,427	-	97.49%	8,208	-	219
Saving	6,028	-	97.47%	5,878	-	150
Vevo	631	-	97.41%	615	-	16
IQRA Deposits	266	-	72.99%	195	-	71
Defined deposit	25,810	-	45.50%	12,327	-	13,483
	41,162	-		27,223	-	13,939

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 2018:

Share of profit allocated to IAH before transfer to/from reserves - BD '000	41,162
Percentage share of profit earned by IAH before transfer to/from reserves	5.24%
Share of profit paid to IAH after transfer to/from reserves - BD '000	13,939
Percentage share of profit paid to IAH after transfer to/from reserves	1.77%
Share of profit paid to Bank as mudarib - BD '000	27,223

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 2018:

	3 months	6 months	12 months	36 months
Percentage of average distributed rate of return to IAH	1.88%	1.72%	1.83%	3.59%

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 2018:

	As of 30-Jun-18 BD'000	Movement During the period BD'000	As of 31-Dec-18 BD'000
Cash and balances with banks and Central Bank	30,989	14,004	44,993
Gross financing assets*	415,474	29,446	444,920
Gross Ijarah Muntahia Bittamleek and rental receivables*	133,058	11,318	144,376
Investment securities	158,120	(269)	157,851
Expected credit loss (Stage 1 and 2)	(4,668)	(1,481)	(6,149)
Total	732,973	53,018	785,991

*Net of ECL stage 3.

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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

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

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

	Profit Earned (jointly financed)		Profit Paid to (IAH)	
	BD'000	%	BD'000	%
2018	**53,939**	**4.86%**	**13,939**	**1.77%**
2017	47,315	4.51%	11,364	1.43%
2016	38,977	4.51%	8,356	0.97%
2015	37,188	4.78%	5,733	0.74%
2014	31,237	4.63%	7,539	1.12%

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	44,993	-	-	-
Financing assets (1)	444,920	383,797	115,139	14,392
Investment in Sukuk (2)	157,851	16,133	4,840	605
Ijarah Muntahia Bittamleek (1)	144,376	83,177	24,953	3,119
	792,140	**483,107**	**144,932**	**18,116**

(1) The exposure is gross of ECL stage 1 and 2 of BD 6,109 thousand.
(2) The exposure is gross of ECL stage 1 and 2 of BD 40 thousand.

4.10 Liquidity Risk

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

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

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

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

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

4.10.3 Group'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.

RISK AND CAPITAL MANAGEMENT DISCLOSURE

FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.10 Liquidity Risk (Continued)

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 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.

The bank manages funding requirements through the following sources: Current accounts, savings accounts, other URIA accounts, interbank lines, and borrowing by leverage of Sukuk portfolio.

4.10.5 Liquidity risk measurement tools

The Group is monitoring the liquidity risk through ALCO

4.10.6 Liquidity risk monitoring

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

4.10.7 Liquidity limits structure

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

a. Liquidity Gap limits; and

b. Liquidity Ratio limits

4.10.8 Liquidity risk stress testing

To evaluate whether the Group is sufficiently liquid, behavior of the Group's cash flows under different conditions are observed.

4.10.9 Contingency funding plan

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

Table – 32. Liquidity Ratios (PD-1.3.37)

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

	2018	2017	2016	2015	2014
Due from banks and financial institutions / Total Assets	10.74%	6.58%	6.12%	7.49%	7.83%
Islamic Financing / Customer Deposits (1)	83.31%	80.04%	85.13%	80.53%	74.48%
Customer Deposits (1) / Total Assets	71.85%	75.32%	77.43%	77.50%	64.74%
Short term assets (2) / Short term liabilities (3)	22.97%	20.35%	18.53%	22.38%	33.86%
Liquid Assets (4) / Total Assets	13.11%	9.38%	8.95%	10.26%	10.24%
Growth in Customer Deposits	(0.67%)	17.62%	6.64%	7.48%	(8.24%)

(1) Customer deposits includes customer current accounts and IAH.

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

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

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

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

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

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

a. has identified the profit rate sensitive products and activities it wishes to engage in;

b. has established a structure to monitor and control the profit rate risk of the Group;

c. measures profit rate risk through establishing maturity/re-pricing schedule that distributes profit rate sensitive assets, liabilities and off-balance sheet items in pre-defined time bands according to their maturity; and

d. makes efforts to match the amount of floating rate assets with floating rate liabilities in the banking book.

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

a. Re-pricing gap analysis which measures the arithmetic difference between the profit-sensitive assets and liabilities of the banking book in absolute terms; and

b. Basis Point Value ("BPV") analysis which is the sensitivity measure for all profit rate priced products and positions. The BPV is the change in net present value of a position arising from basis point shift in the yield curve. This quantifies the sensitivity of the position or portfolio to changes in profit rates.

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.11 Profit Rate Risk (Continued)

4.11.4 Profit rate risk monitoring and reporting

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

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

The following table summarises the profit rate gap position as of 31 December 2018:

	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	129,809	-	7,641	-	-	137,450
Financing assets	71,791	37,585	52,871	190,771	225,935	578,953
Ijarah Muntahia Bittamleek and rental receivables	15,253	2,015	3,505	21,351	144,747	186,871
Investment in Sukuk	5,773	20,069	1,611	50,017	129,763	207,233
Total profit rate sensitive assets	222,626	59,669	65,628	262,139	500,445	1,110,507
Liabilities And Equity Of Investment Accountholders						
Placements from financial institutions*	96,323	-	9,185	9,236	-	114,744
Placements from non-financial institutions and individuals	-	-	7,255	-	-	7,255
Borrowings from financial institutions	51,143	-	45,243	-	-	96,386
Equity of investment accountholders**	309,784	87,384	119,493	29,991	239,339	785,991
Total profit rate sensitive laibilities and IAH	457,250	87,384	181,176	39,227	239,339	1,004,376
Profit rate gap	(234,624)	(27,715)	(115,548)	222,912	261,106	106,131

*Placements from financial institutions excludes frozen accounts of BD 9,236 thousand.

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

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200 bp in profit rates as of 31 December 2018:

	Effect on value of Asset BD'000	Effect on value of Liability BD'000	Effect on value of Economic Capital BD'000
Upward rate shocks:	(5,772)	10,349	4,577
Downward rate shocks:	5,772	(10,349)	(4,577)

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

4. Risk Management (Continued)

4.11 Profit Rate Risk (Continued)

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:

	2018	2017	2016	2015	2014
Return on average equity	9.48%	8.50%	7.45%	11.88%	11.80%
Return on average assets	0.91%	0.90%	0.83%	1.21%	1.00%
Cost to Income Ratio	55.47%	61.92%	56.44%	51.68%	55.10%

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:

	2018	2017	2016	2015	2014
Allocated income to IAH	41,162	36,010	29,301	29,961	23,379
Distributed profit	13,939	11,364	7,131	5,187	7,287
Mudarib fees	27,223	24,646	22,170	24,774	16,092

	2018	2017	2016	2015	2014
Balances (BD '000s):					
Profit Equalization Reserve (PER)	1,245	1,245	1,245	995	395
Investment Risk Reserve (IRR)	1,177	1,177	757	227	103
PER Movement	-	-	250	600	100
IRR Movement	-	420	530	124	40
Ratios (%):					
Income allocated to IAH / Mudarabah assets %	3.71%	3.43%	3.39%	3.85%	3.46%
Mudarabah fees / Mudarabah assets %	2.45%	2.35%	2.57%	3.18%	2.38%
Distributed profit / Mudarabah assets %	1.26%	1.08%	0.83%	0.67%	1.08%
Rate of Return on average IAH %	1.76%	1.57%	1.15%	0.86%	1.11%
Profit Equalization Reserve / IAH %	0.16%	0.16%	0.19%	0.17%	0.07%
Investment Risk Reserve / IAH %	0.15%	0.15%	0.12%	0.04%	0.02%

4.12 CBB Penalties (PD 1.3.44)

The CBB penalty imposed upon the Bank amounted to BD 100 during the period regarding Bahrain Credit Reference Bureau records.

RISK AND CAPITAL MANAGEMENT DISCLOSURE
FOR THE YEAR ENDED 31 DECEMBER 2018

5. Glossary of Terms

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