



Risk and Capital Management Disclosure

for the period ended 30 June 2023

Bahrain Islamic Bank B.S.C.
Risk and Capital Management Disclosure
For the year ended 30 June 2023

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1 Background

The Public Disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD-1: Annual Disclosure requirements and PD-3.1.6 Semi-annual Disclosures, CBB Rule Book, Volume 2 for Islamic Banks. Rules concerning the disclosures under this section are applicable to Bahrain Islamic Bank B.S.C. (the "Bank") being a locally incorporated Bank with a retail banking license, and its subsidiaries together known as (the "Group").

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

2 Statement of Financial Position Under the Regulatory Scope of Consolidation

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

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

	<i>Statement of Financial position as per published financial statements</i> 30 June 2023	<i>Statement of Financial position as per Regulatory Reporting</i> 30 June 2023	<i>Reference</i>
	BD'000	BD'000	
ASSETS			
Cash and balances with banks and Central Bank	60,224	60,224	
Gross placements with financial institutions	41,148	41,148	
Less: Expected credit loss (stage 3)	(3,686)	(3,686)	
Less: Expected credit loss (stage 1 and stage 2)	(3)	-	
Net placements with financial institutions	37,459	37,462	
Gross financing assets	666,273	666,273	
Less: Expected credit loss (stage 3)	(21,081)	(21,081)	
Less: Expected credit loss (stage 1 and stage 2)	(12,077)	-	
Net financing assets	633,115	645,192	
Gross investment securities	303,449	303,449	
Less: Expected credit loss (stage 3)	(26,794)	(26,794)	
Less: Expected credit loss (stage 1 and stage 2)	(148)	-	
Net investment securities	276,507	276,655	
Ijarah Muntahia Bittamleek	313,402	313,402	
Less: Expected credit loss (stage 3)	(1,617)	(1,617)	
Less: Expected credit loss (stage 1 and stage 2)	(1,864)	-	
Net Ijarah Muntahia Bittamleek	309,921	311,785	
Investment in associates	8,115	8,115	
Investment in real estate	16,176	16,176	
Property and equipment	13,679	13,679	
Other assets	15,465	15,465	
TOTAL ASSETS	1,370,661	1,384,753	

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

LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY		Reference
Liabilities		
Placements from financial institutions	143,252	143,252
Placements from non-financial institutions and individuals	282,203	282,203
Financing from financial institutions	110,236	110,236
Customers' current accounts	208,386	208,386
Other liabilities	44,316	44,161
<i>of which: Expected credit loss - Off balance sheet exposures (stage 3)</i>	1,310	1,310
<i>of which: Expected credit loss - Off balance sheet exposures (stage 1 and stage 2)</i>	155	-
<i>of which: Other liabilities</i>	42,851	42,851
Total Liabilities	788,393	788,238
Total Equity of Investment Accountholders	442,709	442,709
Owners' Equity		
Share capital	106,406	106,406
Treasury shares	(892)	(892)
Shares under employee share incentive scheme	(169)	(169)
Share premium	206	206
Statutory reserve	6,606	6,606
Real estate fair value reserve	1,320	1,320
Investment securities fair value reserve	1,585	1,585
Expected credit loss	-	14,247
<i>of which: amount eligible for Tier 2 capital subject to a maximum of 1.25% of credit risk weighted assets</i>	-	8,883
<i>of which: amount ineligible for Tier 2 capital</i>	-	5,364
Profit for the period	6,035	6,035
Retained earnings brought forward	(6,538)	(6,538)
<i>of which: Retained earnings as of 1 January 2023</i>	(4,217)	(4,217)
<i>of which: Zakah and donations approved</i>	(420)	(420)
<i>of which: Profit distribution on AT1 Capital</i>	(1,901)	(1,901)
Equity Attributable to Parent's Shareholders	114,559	128,806
Subordinated Mudaraba (AT1)	25,000	25,000
Total Owners' Equity	139,559	153,806
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY	1,370,661	1,384,753

3 Capital Adequacy

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

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

The Group's capital structure is primarily made up of its paid-up capital, AT1 instruments and 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 follows the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk, and Standardised Approach for its Market Risk. Allocation of assets between equity shareholders and profit sharing investment accounts are based on the profit distribution on equity investment accountholders policy approved by the Board.

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

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

3 Capital Adequacy (continued)

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

The following table summarises the eligible capital as of 30 June 2023 after deductions for Capital Adequacy Ratio (CAR) calculation:

	<i>CET 1 BD'000</i>	<i>AT1 & T2 BD'000</i>	<i>Source based on reference letters of the statement of financial position under the regulatory scope of consolidation</i>
Components of capital			
Issued and fully paid ordinary shares	106,406	-	a
General reserves	-	-	
Statutory reserves	6,606	-	e
Share premium	206	-	d
Retained earnings brought forward	(6,538)	-	l
COVID-19 concessionary measures adjustments*:			
<i>Modification loss and Government subsidy, net</i>	12,897		
<i>Aggregate ECL provision relating to stage 1 and 2</i>	4,258		
<i>Less: amortization of modification loss and government subsidy</i>	(2,859)		
Current period profits	6,035		k
Unrealized gains and losses on available for sale financial instruments	1,585	-	g
Less:			
Employee stock incentive program funded by the bank (outstanding)	169	-	c
Treasury shares	892	-	b
Total Common Equity Tier 1 capital after the regulatory adjustments above (CET1)			
	<u>127,535</u>	<u>-</u>	<u></u>
Instruments issued by parent company (AT1 Subordinated Mudaraba)		25,000	m
Assets revaluation reserve - property, plant, and equipment		1,320	f
Expected credit loss (ECL) - stages 1 & 2		8,883	i
Total Available AT1 & T2 Capital			
		<u>35,203</u>	<u></u>
Total Capital			
		162,738	

As per the CBB circular OG/226/2020 the aggregate of modification loss and ECL provision, amount must be deducted on an annual basis from CET1 in equal proportions over a three-year period from 1 January 2022 to 31 December 2024. Further, as per the CBB circular OG/417 /2021 the benefit of amortization of modification loss was extended until 30 June 2022. Further, CBB in its circular ODG/28/2022, communicated that the amortization of modification loss and 2020 ECL (management overlay) must be amortized starting from 1 January 2023. During the period, out of the modification loss of BD 17,155, an amount BD 2,859 thousand representing modification loss net of government subsidy was deducted from CET1 for the period ended 30 June 2023.

	<i>Amount of exposures BD'000</i>
Total Credit Risk Weighted Assets	710,621
Total Market Risk Weighted Assets	411
Total Operational Risk Weighted Assets	119,149
Total Regulatory Risk Weighted Assets	
	<u>830,181</u>
Investment risk reserve (30% only)	-
Profit equalization reserve (30% only)	11
Total Adjusted Risk Weighted Exposures	
	<u>830,170</u>
TOTAL CAPITAL ADEQUACY RATIO	
	<u>19.60%</u>
Minimum requirement	<u>12.5%</u>
CET 1 ratio	9.0%
Tier 1 ratio	10.5%
Total Capital ratio	12.5%

3 Capital Adequacy (continued)

AT1 Subordinated Mudaraba

In 2021, the Bank issued a Subordinated Mudaraba Sukuk (Basel III compliant Additional Tier 1 capital securities) of BD 25 million to meet minimum regulatory requirements relating to total equity as prescribed by Central bank of Bahrain. The issue was at par and was fully subscribed for and paid in cash by the Parent.

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

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

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

During 2023, an amount of BD 1,901 thousand (2022: BD 1,901 thousand) were paid to AT1 holders as profit distributions.

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3 Capital Adequacy (continued)

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

The following table summarises the amount of exposures as of 30 June 2023 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	27,088	33,136	60,224	4,980	-	4,980	623	-	623
Murabaha and Wakala receivables - interbank	37,462	-	37,462	7,925	-	7,925	991	-	991
Murabaha receivables*	368,291	191,064	559,355	281,979	43,886	325,865	35,247	5,486	40,733
Musharaka receivables*	56,516	29,321	85,837	46,687	7,266	53,953	5,836	908	6,744
Investment in Sukuk	168,666	87,502	256,168	-	-	-	-	-	-
Investment in equity and funds	20,487	-	20,487	72,744	-	72,744	9,093	-	9,093
Ijarah Muntahia Bittamleek*	205,286	106,499	311,785	122,455	19,058	141,513	15,307	2,382	17,689
Investment in associates	8,115	-	8,115	26,103	-	26,103	3,263	-	3,263
Investment in real estate	16,176	-	16,176	32,352	-	32,352	4,044	-	4,044
Property and equipment	13,679	-	13,679	13,679	-	13,679	1,710	-	1,710
Other assets	15,465	-	15,465	15,464	-	15,464	1,933	-	1,933
	937,231	447,522	1,384,753	624,368	70,210	694,578	78,047	8,776	86,823
Unfunded									
Commitments and contingent liabilities	96,230	-	96,230	16,043	-	16,043	2,005	-	2,005
Total Credit Risk Weighted Assets	1,033,461	447,522	1,480,983	640,411	70,210	710,621	80,052	8,776	88,828
Total Market Risk Weighted Assets	411	-	411	411	-	411	51	-	51
Total Operational Risk Weighted Assets	119,149	-	119,149	119,149	-	119,149	14,894	-	14,894
Total Risk Weighted Assets	1,153,021⁽¹⁾	447,522⁽²⁾	1,600,543	759,971	70,210	830,181	94,997	8,776	103,773

* The risk weighted assets are net of credit risk mitigant of BD 44,665 thousand.

(1) The exposure is gross of expected credit loss Stages 1 & 2 of BD 9,434 thousand and net of expected credit loss Stage 3 of BD 28,284 thousand.

(2) The exposure is gross of expected credit loss Stages 1 & 2 of BD 4,813 thousand and net of expected credit loss Stage 3 of BD 12,028 thousand.

(3) For assets funded through IAH only 30% of exposure is considered. (CA-1.1.12)

3 **Capital Adequacy (continued)**

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

The following table summarises the amount of exposures as of 30 June 2023 subject to standardised approach of market risk and related capital requirements:

Market Risk - Standardised Approach

Foreign exchange risk (BD'000)	33
Total of Market Risk - Standardised Approach	33
Multiplier	12.5
Risk Weighted Exposures for CAR Calculation (BD'000)	411
Total Market Risk Exposures (BD'000)	411
Total Market Risk Exposures - Capital Requirement (BD'000)	51

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

The following table summarises the amount of exposures as of 30 June 2023 subject to basic indicator approach of operational risk and related capital requirements:

Indicators of operational risk

Average Gross income (BD'000)	63,546
Multiplier	12.5
	794,325
Eligible Portion for the purpose of the calculation	15%
Total Operational Risk Exposure (BD'000)	119,149
Total Operational Risk Exposures - Capital Requirement (BD'000)	14,894

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

The following are Capital Adequacy Ratios as of 30 June 2023 for total capital and CET 1 capital:

	<i>Total capital ratio</i>	<i>T1 Capital ratio</i>	<i>CET 1 capital ratio</i>
Top consolidated level	19.60%	18.37%	15.36%

4 Risk Management

4.1 Group-wide Risk Management Objectives

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

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

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

4.2 Strategies, Processes and Internal Controls

4.2.1 Group's risk strategy

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

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

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

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

4 Risk Management (continued)

4.2 Strategies, Processes, and Internal Controls (continued)

4.2.2 Credit risk

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

4.2.3 Market risk

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

The Group has established a limit structure to monitor and control the market risk in its trading portfolio. These limits include maximum Stop-loss limits and position limits. As at 30 June 2023, the group does not maintain any trading portfolio.

4.2.4 Operational risk

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

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

4.2.5 Equity price risk

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

4.2.6 Profit rate risk

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

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

4.2.7 Displaced Commercial Risk

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

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

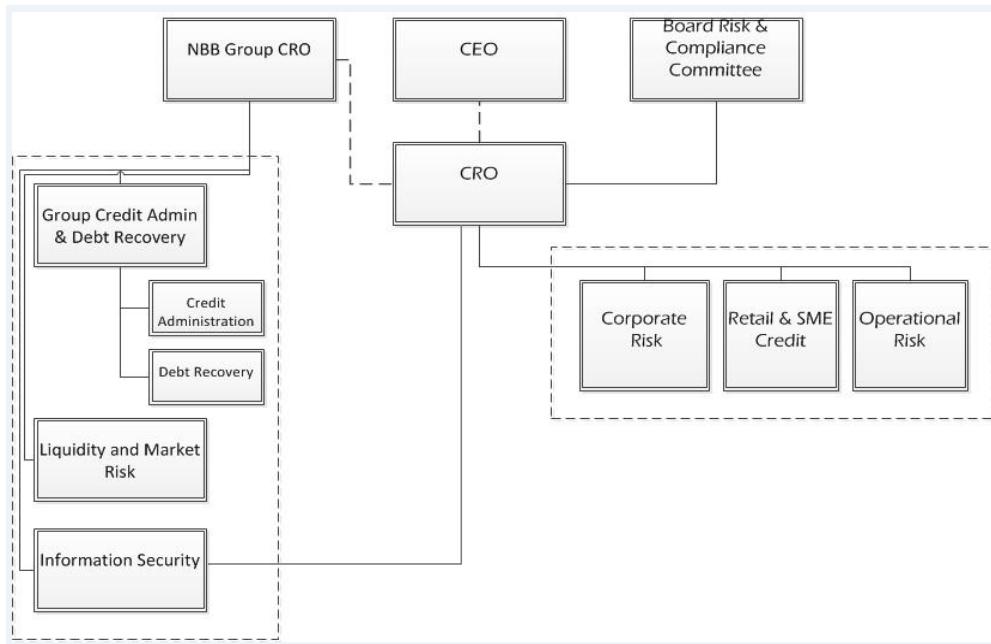
The Group manages its DCR as outlined in the Group's Profit Distribution On Equity of Investment Accountholders Policy. The Group may forego its mudarib fee in case displaced commercial risk arises. The Group benchmarks its rates with other leading banks in the market.

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

4 Risk Management (continued)

4.3 Structure and Organisation of Risk Management Function

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



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

- a. Establishing overall policies and procedures; and
- b. Delegating authority to Board Risk and Compliance Committee, Board Executive Committee, Credit and Investment Committee, the Chief Executive Officer and further delegation to management to approve and review.

4 Risk Management (continued)

4.4 Risk Measurement and Reporting Systems

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

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

4.5 Credit Risk

4.5.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending and debt-type 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 wherever deemed necessary.

The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical area, and industry sector. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Corporate counterparties are regularly assessed by the use of a credit risk classification system. Counterparty limits are established after a comprehensive credit assessment and after factoring in a counterparty risk rating generated by the Credit Risk Rating System. 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, operating performance, nature of the business, quality of management, and market position, etc. The credit approval decision is made based on such risk assessment.

Retail credit is assessed by the Retail Credit Unit prior to booking as against the Bank's approved retail financing credit criteria.

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

4.5.2 Types of credit risk

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

Due from banks and financial institutions

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

Murabaha receivables

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

Musharaka investments

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

Ijarah Muntahia Bittamleek

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

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.3 Credit impaired exposures

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

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

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

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

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

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

Measurement of ECL

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

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

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

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

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

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

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

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

4.5.4 External credit assessment institutions

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

4.5.5 Definition of Geographical distribution

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

4.5.6 Concentration risk

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

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

4.5.7 Credit risk mitigation

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

Generally, the Group extends credit facilities only where supported by audited financial statement and/or adequate tangible collateral security. 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 such personal guarantor is to be compiled/estimated by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.7 Credit risk mitigation (continued)

The market value of tangible collateral security is properly evaluated by the Group's approved valuers (for properties) or as per the suitable valuation methodology as outlined in the Bank's Credit Risk Mitigation Policy.

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

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

4.5.7.1 General policy guidelines of collateral management

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

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

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

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

- a. **Valuation of shares and financial securities:** The Group performs in-house valuation on the following types of securities:
 - For shares and securities listed in active markets, quoted bid prices are utilized;
 - For unquoted shares and stakes in collective investment undertakings (CIUs), valuation is determined based on (i) present value of future cashflows and/or (ii) net asset value as and when financials are available; and
 - For sukuk, collateral value is based on net realizable value.
- b. **Valuation of real estate and others:** Besides assets mentioned above, the valuation of following securities are also conducted with the help of external valuers and/or independent reports:
 - Real Estate;
 - Equipment and machinery; and

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

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.7 Credit risk mitigation (continued)

4.5.7.1 General policy guidelines of collateral management (continued)

The following additional guidelines are also followed by the Group:

- a. No facility should be disbursed until credit documentation is properly signed and security/guarantees required have been signed and registered, where required. Exceptional cases can be considered by sanctioning authorities; and
- b. All documents received as security or support for credit facilities should be lodged in the safe custody through the Credit Administration and should be kept under dual control. The Group must ascertain that collateral providers are authorised and acting within their capacity.

4.5.7.2 Guarantees

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

4.5.7.3 Custody / collateral management

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

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

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

4.5.8 Counterparty credit risk

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

4.5.8.1 Exposure

The measure of exposure reflects the maximum loss that the Group may suffer in case a counterparty fails to fulfill its commitments, or loss that may arise due to exposures relating to concentration per product, asset classes, collateral, segments, country, region, currencies, market, etc. Exposure shall always be calculated on the basis of approved limits or actual outstanding exposure (financing facilities, investments or others), whichever is higher.

4.5.8.2 Counterparty

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

4 Risk Management (continued)

4.5 Credit Risk (continued)

4.5.8 Counterparty credit risk (continued)

4.5.8.3 Group exposure

Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. For this purpose, a Group is two or more counterparties that are related (both directly or indirectly) either through the existence of a control relationship or economic interdependence.

4.5.8.4 Connected counterparties

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

4.5.8.5 Large exposure

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

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

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

4.5.8.6 Maximum exposure

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

4.5.8.7 Reporting

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

4.5.8.8 Other matters

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

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

4.5.9 Related party transactions

The disclosure relating to related party transactions has been made in the reviewed condensed financial information for the year ended 30 June 2023. All related party transactions have been made on commercial terms.

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following table summarises the amount of gross funded and unfunded credit exposure (before deducting credit risk mitigant) as of 30 June 2023 and average gross funded and unfunded exposures over the period ended 30 June 2023:

	Total gross credit exposure BD'000	*Average gross credit exposure over the period BD'000
Funded		
Cash and balances with banks and Central Bank	60,224	59,541
Placements with financial institutions	37,459	51,690
Financing assets	633,115	624,254
Investment in Sukuk	256,020	247,587
Investment in equity and funds	20,487	20,512
Ijarah Muntahia Bittamleek	309,921	311,565
Investment in associates	8,115	8,537
Investment in real estate	16,176	14,918
Property and equipment	13,679	13,752
Other assets	15,465	15,857
Total	1,370,661	1,368,213
Unfunded		
Commitments and contingent liabilities	96,230	98,457
Total	1,466,891	1,466,670

*Average balances are computed based on quarter end balances.

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following table summarises the geographic distribution of exposures as of 30 June 2023, broken down into significant areas by major types of credit exposure:

	<i>North</i> America <i>BD'000</i>	<i>Europe</i> BD'000	<i>Middle</i> East <i>BD'000</i>	<i>Other</i> BD'000	<i>Total</i> BD'000
Cash and balances with banks and Central Bank	8,104	175	51,903	42	60,224
Placements with financial institutions	-	-	37,459	-	37,459
Financing assets	-	-	633,115	-	633,115
Investment in Sukuk	-	-	256,020	-	256,020
Investment in equity and funds	-	-	20,487	-	20,487
Ijarah Muntahia Bittamleek	-	-	309,921	-	309,921
Investment in associates	-	-	8,115	-	8,115
Investment in real estate	-	-	16,176	-	16,176
Property and equipment	-	-	13,679	-	13,679
Other assets	7,657	-	7,808	-	15,465
Total	15,761	175	1,354,683	42	1,370,661
Unfunded					
Commitments and contingent liabilities	-	-	97,540	-	97,540
Total	15,761	175	1,452,223	42	1,468,201

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

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following table summarises the distribution of funded and unfunded exposures as of 30 June 2023 by industry, broken down into major types of credit exposure:

	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate and Construction BD'000	Personal & Consumer Finance BD'000	Governmental Organisation BD'000	Others BD'000	Total BD'000
Funded							
Cash and balances with banks and Central Bank	-	21,471	-	-	38,753	-	60,224
Placements with financial institutions	-	37,459	-	-	-	-	37,459
Financing assets	78,904	14,901	76,164	381,441	49,335	32,370	633,115
Investment in Sukuk	-	-	-	-	256,020	-	256,020
Investment in equity and funds	-	2,547	16,806	-	-	1,134	20,487
Ijarah Muntahia Bittamleek	27	-	11,567	249,435	48,824	68	309,921
Investment in associates	-	4,237	3,878	-	-	-	8,115
Investment in real estate	-	-	16,176	-	-	-	16,176
Property and equipment	-	-	-	-	-	13,679	13,679
Other assets	-	4,079	-	1,695	-	9,691	15,465
Total	78,931	84,694	124,591	632,571	392,932	56,942	1,370,661
Unfunded							
Commitments and contingent liabilities	10,013	9,005	11,362	41,015	17,531	8,614	97,540
Total	88,944	93,699	135,953	673,586	410,463	65,556	1,468,201

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following balances represent the financing facilities to highly leveraged or other high risk counterparties as of 30 June 2023:

Counterparties	Gross BD'000	Stage 3 ECL	Net* BD'000
		BD'000	
Counterparty # 1	8,543	-	8,543
Counterparty # 2	7,217	551	6,666
Counterparty # 3	3,777	-	3,777
	19,537	551	18,986

*Gross of expected credit loss stage 1 and 2 of BD 146 thousand.

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

The Bank has the following exposures that are in excess of the individual obligor limit of 15% of the Bank's capital as of 30 June 2023:

Counterparties	Gross BD'000	Stage 3 ECL	Net** BD'000
		BD'000	
Counterparty # 1*	229,055	-	229,055
Counterparty # 2*	39,501	-	39,501
Counterparty # 3*	29,810	-	29,810
Counterparty # 4*	24,692	-	24,692
	323,058	-	323,058

*Represents exempted large exposures.

**Gross of expected credit loss stage 1 and 2 of BD 530 thousand.

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following table summarises the maturity profile of the total assets based on contractual maturities as at 30 June 2023. All the assets with no fixed contractual maturities are disclosed under no fixed maturity:

	<i>Up to One month</i> <i>BD'000</i>	<i>1-3 months</i> <i>BD'000</i>	<i>3-6 months</i> <i>BD'000</i>	<i>6-12 months</i> <i>BD'000</i>	<i>1-3 years</i> <i>BD'000</i>	<i>3-5 years</i> <i>BD'000</i>	<i>5-10 years</i> <i>BD'000</i>	<i>10-20 years</i> <i>BD'000</i>	<i>Over 20 years</i> <i>BD'000</i>	<i>No fixed maturity</i> <i>BD'000</i>	<i>Total</i> <i>BD'000</i>
Assets											
Cash and balances with banks and Central Bank	22,879	-	-	-	-	-	-	-	-	37,345	60,224
Placements with financial institutions	37,459	-	-	-	-	-	-	-	-	-	37,459
Financing assets	12,576	36,636	36,064	85,775	176,749	172,990	74,645	30,574	7,106	-	633,115
Investment in Sukuk	-	-	-	58,604	82,768	58,455	56,193	-	-	-	256,020
Investment in equity and funds	-	-	-	-	-	-	-	-	-	20,487	20,487
Ijarah Muntahia Bittamleek	1,586	2,724	4,924	9,691	40,996	42,833	84,493	100,765	21,909	-	309,921
Investment in associates	-	-	-	-	-	-	-	-	-	8,115	8,115
Investment real estate	-	-	-	-	-	-	-	-	-	16,176	16,176
Property and equipment	-	-	-	-	-	-	-	-	-	13,679	13,679
Other assets	128	930	5,452	158	545	508	-	-	-	7,744	15,465
Total Assets	74,628	40,290	46,440	154,228	301,058	274,786	215,331	131,339	29,015	103,546	1,370,661

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following table summarises the credit impaired facilities, past due facilities, and impairment allowances disclosed by major industry sector as of 30 June 2023:

Credit impaired or past due	Aging of credit impaired or past due Islamic financing contracts								Stage 3 ECL				Stage 1 & 2 ECL			
	Less than 3 months				3 months to 1 year				Balance at the beginning of the period		Charge for the period (net)**		Write-offs during the period		Balance at the end of the period	
	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	BD'000	
Trading and Manufacturing	47,103	31,867	10,417	2,296	2,523	14,995	2,362	6,395	10,962	5,284	(1,805)	3,479				
Real Estate	30,058	29,409	645	4	-	1,921	1,237	1,679	1,479	2,201	(329)	1,872				
Banks and Financial Institutions	-	-	-	-	-	33	(33)	-	-	278	15	293				
Personal / Consumer Finance	55,216	42,718	6,959	2,872	2,667	8,527	904	17	9,414	3,781	(135)	3,646				
Others	20,674	19,438	802	434	-	694	149	-	843	4,715	(64)	4,651				
Total	153,051	123,432	18,823	5,606	5,190	26,170	4,619	8,091	22,698	16,259	(2,318)	13,941				

*Gross of expected credit loss of BD 26,511 thousand.

**Net of transfers between stages.

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

4 Risk Management (continued)

4.5 Credit Risk (continued)

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

The following table summarises the credit impaired facilities, past due facilities, and impairment allowances by geographical area as of 30 June 2023:

	<i>Credit impaired or past due or impaired Islamic financing contracts BD'000</i>	<i>Stage 3 ECL BD'000</i>	<i>Stage 1 & ECL BD'000</i>
Middle East	153,051	22,698	13,941

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

The following table summarises the aggregate amount of restructured corporate financing facilities during the year as of 30 June 2023:

	<i>Gross Outstanding BD'000</i>	<i>Stage 3 ECL BD'000</i>	<i>Net BD'000</i>
Total Islamic financing ⁽¹⁾	979,675	22,698	956,977
Restructured financing facilities* ⁽²⁾	12,221	1	12,220
Percentage	1.25%	0.00%	1.28%

*Excludes facilities restructured during the period amounting to BD 6,151 thousand which are past due as of 30 June 2023. The nature of the concessions include alignment of the payment terms with the clients' expected cash flows.

⁽¹⁾ Gross of expected credit loss Stages 1 and 2 of BD 13,941 thousand.

⁽²⁾ Gross of expected credit loss Stage 2 of BD 1,223 thousand.

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 30 June 2023 by type of Islamic financing contract covered by Shari'a-compliant collateral eligible as per CA module of volume 2 of the CBB Rule Book:

	Total exposure covered by		
	Tamkeen Guarantee BD'000	Others BD'000	
Financing assets			
Ijarah Muntahia Bittamleek	1,098	88,272	
	-	26,594	
Total	1,098	114,866	

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

The following table summarises the counterparty credit risk exposure covered by collateral after the application of haircuts as of 30 June 2023:

	Financing assets BD'000	Ijarah Muntahia Bittamleek BD'000	Total BD'000
Exposures:			
Secured*	89,370	26,594	115,964
Unsecured*	543,745	283,327	827,072
Total	633,115	309,921	943,036
Collateral held:			
-Cash	21,775	362	22,137
-Guarantees	1,249	-	1,249
-Real Estate**	3,755	17,540	21,295
Total	26,779	17,902	44,681
Collateral as a percentage of secured exposure			
	29.96%	67.32%	38.53%

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

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

4.6 Market Risk

4.6.1 Introduction

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

4 Risk Management (continued)

4.6 Market Risk (continued)

4.6.2 Sources of market risk

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

Profit rate risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The profit distribution to equity of investment accountholders is based on profit sharing agreements. One of the methods the Bank uses to manage profit rate risk is through the use of profit rate swaps. For further detail on profit rate swaps, please refer to the reviewed condensed consolidated interim financial information for the period ended 30 June 2023.

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 enters into foreign exchange swap contracts (Waad) to manage against foreign exchange fluctuations.

Equity price risk is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity. The Group has established a limit structure to monitor and control the market risk in its equity type instruments portfolio. These limits include maximum Stop-loss limits and position limits. As at 30 June 2023, the group did not have any trading portfolio. Currently, any new equity investments are off-strategy.

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

4.6.3 Market risk strategy

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

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

- a. The Group proactively measures and continually monitors the market risk in its portfolio;
- b. The Group at all times holds sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
- c. The Group establishes a limit structure to monitor and control the market risk in its portfolio. These limits includes position limits, and maximum/stop loss limits;
- d. The Group carries out stress testing periodically using the worst case scenarios to assess the effects of changes in the market value due to changing market conditions; and
- e. The Group clearly identifies the foreign currencies in which it wishes to deal in and actively manages its market risk in all foreign currencies in which it has significant exposure.

4 Risk Management (continued)

4.6 Market Risk (continued)

4.6.4 Market risk measurement methodology

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

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

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

4.6.5 Market risk monitoring and limits structure

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

4.6.6 Limits monitoring

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

4.6.7 Breach of limits

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

4.6.8 Portfolio review process

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

4.6.9 Reporting

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

4.6.10 Stress testing

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

4 Risk Management (continued)

4.6 Market Risk (continued)

4.6.11 Foreign subsidiary

The Group does not have any foreign subsidiary.

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

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

	<i>Foreign exchange risk BD'000</i>
Maximum value capital requirement	51
Minimum value capital requirement	33

4.7 Operational Risk

4.7.1 Introduction

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

4.7.2 Sources of operational risk

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

- a. People risk which arises due to staffing inadequacy, unattractive remuneration structure, lack in staff development policies, lack in procedures for appointment, unhealthy professional working relationship, and unethical environment;
- b. Processes risk which arises due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting;
- c. Systems (Technology) risk which arises due to integrity of information - lacking in timeliness of information, omission and duplication of data, hardware failures due to power surge, cyber-attacks, obsolescence or low quality;
- d. External risk which arises due to natural or non-natural (man made) disaster; and
- e. Legal risk which arises due to contractual obligations.

4.7.3 Operational risk management strategy

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

4 Risk Management (continued)

4.7 Operational Risk (continued)

4.7.3 Operational risk management strategy (continued)

The Group on a continuous basis will:

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

4.7.4 Operational risk monitoring and reporting

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

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

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

4.7.5 Operational risk mitigation and control

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

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

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

	Gross income		
	2022 BD'000	2021 BD'000	2020 BD'000
Total Gross Income	70,552	66,109	53,977
<hr/>			
Indicators of operational risk			
Average Gross income (BD'000)		63,546	
Multiplier		12.5	
		<hr/>	794,325
Eligible Portion for the purpose of the calculation			15%
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE (BD'000)			<hr/> 119,149

As at 30 June 2023, there are 15 significant shari'a audit observations that are expected to be resolved during the course of the year.

4 Risk Management (continued)

4.8 Equity Position in the Banking Book

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

The accounting policies, including valuation methodologies and their related key assumptions, are consistent with those disclosed in the reviewed condensed consolidated interim financial information for the period ended 30 June 2023. Equity type instruments carried at fair value through equity and investment properties are kept for capital gain purposes, all other investments including investments in associates are kept for strategic long term holdings.

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

The following table summarises the amount of total and average gross exposure of equity investments and funds as of 30 June 2023:

	Total gross exposure ⁽¹⁾ BD'000	Average gross exposure ⁽²⁾ BD'000	Publicly traded BD'000	Privately held BD'000	Risk weighted assets BD'000	Capital Requirements BD'000
Equity investments	34,329	34,354	-	34,329	72,090	9,011
Funds	436	436	-	436	654	82
Total	34,765	34,790	-	34,765	72,744	9,093

⁽¹⁾ Balances are gross of impairment allowance of BD 14,278 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 during the year ended 30 June 2023:

	BD'000
Cumulative realised gain arising from sales or liquidations in the reporting period	-
Total unrealised losses recognised in the consolidated statement of financial position but not through consolidated statement of income	-
Unrealised gains included in CET 1 Capital	1,585
Unrealised gains included in Tier 2 Capital	-

4 Risk Management (continued)

4.9 Equity of Investment Accountholders ("IAH")

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

The Group is authorised by the IAH to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Group deems appropriate without laying down any restrictions as to where, how, and for what purpose the funds should be invested. Under this arrangement the Group can commingle the equity of investment accountholders investment funds with its own funds (owner's equity) or with other funds the Group has the right to use (e.g. current accounts or any other funds which the Group does not receive on the basis of Mudaraba contract). The IAH and the Group generally participate in the returns on the invested funds; however, the Group does not share profits with IAH resulting from investing current accounts and other funds received on the basis other than mudaraba contracts. In such type of contract, the Group is not liable for any losses incurred on the joint pool other than the loss resulting from gross negligence or wilful misconduct on the part of the Group or due to the Group's violation of the terms and conditions as agreed between the Group and the IAH. During the year, the Group waived 18% of profit from mudarib fees in order to maintain a competitive profit distribution to IAH.

After adopting FAS 31 in 2020, all new funds raised using wakala structure, together called "wakala pool" are comingled with the Bank's pool of funds based on an underlying mudaraba agreement. This comingled pool of funds is invested in a common pool of assets in the manner which the Group deems appropriate without laying down restrictions as to where, how and what purpose the funds should be invested.

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

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

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

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

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

4 Risk Management (continued)

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

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

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

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

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

Additional disclosures such as the below are disclosed in the Bank's website:

- a. Characteristics of investors for whom investment account may be appropriate
- b. Purchase redemption and distribution procedures
- c. Product information and the manner in which the products are made available to investors

Governance of IAH

- a. Shariah review of allocation of assets and resultant income;
- b. Disclosure of profit rates on deposit products and mudaraba fees either in the branch or website;
- c. ALCO discusses the profit rate to be offered to URIA accounts. Any exceptional profit rates offered to customers are subject to approval by the relevant authority.

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

The following table summarises the breakdown of equity of investment accountholders accounts as of 30 June 2023:

	BD'000
Banks and financial institutions	50,778
Individuals and non-financial institutions	391,931
Total	442,709

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

The following table summarises the return on average assets and mudarib share as a percentage of the total investment profit for the period ended 30 June 2023:

Profit Paid on Average IAH Assets *	0.12%
Mudarib Fee to Total income from jointly financed assets	25.13%

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

4 Risk Management (continued)

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

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

The following table summarises the profit distributed to IAH and financing ratios to the total of IAH by type of investment for the period ended 30 June 2023:

	<i>Average declared rate of return</i>	<i>Proportion of total profit distributed by type of IAH</i>	<i>Proportion of IAH investments to total IAH</i>
Saving accounts (including VEVO)	0.06%	2.52%	38.02%
Defined accounts - 1 month	1.17%	0.77%	0.58%
Defined accounts - 3 months	1.17%	0.29%	0.23%
Defined accounts - 6 months	1.22%	0.47%	0.34%
Defined accounts - 9 months	1.32%	0.01%	0.01%
Defined accounts - 1 year	1.62%	3.72%	2.13%
Investment certificates	2.75%	0.00%	0.00%
IQRA	2.00%	2.65%	1.20%
Tejoori	0.05%	2.16%	37.70%
Customer special deposits	3.52%	46.30%	9.78%
Wakala - Financial institutions	2.19%	32.61%	1.86%
Wakala - Non-financial institutions and individuals	3.63%	8.50%	8.14%
		100%	100%

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

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

The following table summarises the percentage of counterparty type to total financing for each type of Shari'a-compliant contract to total financing as of 30 June 2023:

	<i>Percentage of Counterparty Type to Total Financing</i>					
	<i>Self Financed</i> <i>BD'000</i>	<i>%</i>	<i>IAH</i> <i>BD'000</i>	<i>%</i>	<i>Total</i> <i>BD'000</i>	<i>%</i>
Gross financing assets*						
Murabaha	368,291	65.84%	191,064	34.16%	559,355	100.00%
<i>Corporate</i>	173,123	65.84%	89,814	34.16%	262,937	100.00%
<i>Retail</i>	195,168	65.84%	101,250	34.16%	296,418	100.00%
Musharakah	56,516	65.84%	29,321	34.16%	85,837	100.00%
<i>Corporate</i>	838	65.84%	436	34.16%	1,274	100.00%
<i>Retail</i>	55,678	65.84%	28,885	34.16%	84,563	100.00%
Total	424,807	65.84%	220,385	34.16%	645,192	100.00%
Gross Ijarah Muntahia Bittamleek**						
<i>Corporate</i>	40,021	65.84%	20,762	34.16%	60,783	100.00%
<i>Retail</i>	165,265	65.84%	85,737	34.16%	251,002	100.00%
Total	205,286	65.84%	106,499	34.16%	311,785	100.00%
ECL Stage 1 and 2	(9,179)	65.85%	(4,762)	34.15%	(13,941)	100.00%
Total	620,914	65.84%	322,122	34.16%	943,036	100.00%

*Net of expected credit loss (Stage 3) of BD 21,081 thousands.

**Net of expected credit loss (Stage 3) of BD 1,617 thousands.

4 Risk Management (continued)

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

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

Account Type	Gross on equity of IAH BD'000 A	Transfer to equalization reserve BD'000 B	Average mudaraba %	Mudarib fees BD'000 C	Release PER BD'000 D	Profit paid to IAH BD'000 (A-B-C-D)	Ratio of PER to IAH %
Teioori Saving	4,371 3,761	25 22	98.00% 98.00%	3,727 3,207	567 488	52 44	0.02% 0.03%
Vevo	540	3	98.00%	461	70	6	0.20%
IQRA Deposits	155	-	61.22%	83	20	52	0.70%
Defined deposit	1,679	-	30.52%	448	218	1,013	0.06%
Wakala	1,056	-	11.42%	105	137	814	0.10%
	11,561	50		8,031	1,500	1,980	

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 30 June 2023:

Share of profit allocated to IAH before transfer to/from reserves - BD '000	11,561
Percentage share of profit earned by IAH before transfer to/from reserves	2.61%
Net return on equity of IAH - BD '000	530
Release of PER - BD '000	1,500
Share of profit paid to IAH after transfer to/from reserves - BD '000	1,980
Percentage share of profit paid to IAH after transfer to/from reserves	0.45%
Share of profit paid to Bank as mudarib - BD '000	8,031

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 period ended 30 June 2023:

	3 months	6 months	12 months	36 months
Percentage of average distributed rate of return to IAH	2.12%	2.55%	3.62%	0.00%

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 30 June 2023:

	As of 31-Dec-22 BD'000	Movement during the period BD'000	As of 30-Jun-23 BD'000
Cash and balances with banks and Central Bank	18,543	14,593	33,136
Murabaha and Wakala receivables - interbank	-	-	-
Gross financing assets*	238,500	(18,115)	220,385
Gross Ijarah Muntahia Bittamleek*	109,795	(3,296)	106,499
Investment securities	89,733	(2,231)	87,502
Expected credit loss	(6,163)	1,350	(4,813)
Total	450,408	(7,699)	442,709

* Net of ECL stage 3.

4 Risk Management (continued)

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

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

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

	<i>Profit Earned (jointly financed)</i>		<i>Profit Paid to (IAH)</i>	
	<i>BD'000</i>	<i>%</i>	<i>BD'000</i>	<i>%</i>
2023	31,962	5.21%	1,980	0.90%
2022	62,049	5.09%	3,970	0.88%
2021	55,834	4.62%	3,501	0.68%
2020	53,169	4.92%	4,009	0.81%
2019	57,396	5.37%	12,685	2.97%

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

	<i>Assets BD'000</i>	<i>RWA BD'000</i>	<i>RWA for Capital Adequacy Purposes BD'000</i>		<i>Capital Requirements BD'000</i>
			<i>Capital Requirements BD'000</i>		
Cash and balances with banks and Central Bank	33,136	-	-	-	-
Financing assets ⁽¹⁾	220,385	170,506	51,152	6,394	
Investment in Sukuk ⁽²⁾	87,502	-	-	-	
Ijarah Muntahia Bittamleek ⁽¹⁾	106,499	63,527	19,058	2,382	
	447,522	234,033	70,210	8,776	

⁽¹⁾ The exposure is gross of ECL stage 1 and 2 of BD 4,762 thousand.

⁽²⁾ The exposure is gross of ECL stage 1 and 2 of BD 51 thousand.

4.10 Liquidity Risk

4.10.1 Introduction

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

4.10.2 Sources of liquidity risk

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

- a. Funding risk is the risk of not being able to fund net outflows due to unanticipated withdrawal of capital or deposits;
- b. Call risk is the risk of crystallisation of a contingent liability; and
- c. Event risk is the risk of rating downgrades or other negative public news leading to a loss of market confidence in the Group.

4 Risk Management (continued)

4.10 Liquidity Risk (continued)

4.10.3 Bank's funding strategy

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

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

4.10.4 Liquidity risk strategy

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

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

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

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

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

4.10.5 Liquidity risk measurement tools

The Group is monitoring the liquidity risk through ALCO.

4.10.6 Liquidity risk monitoring

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

4.10.7 Liquidity limits structure

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

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

4.10.8 Liquidity risk stress testing

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

4.10.9 Contingency funding plan

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

4 Risk Management (continued)

4.10 Liquidity Risk (continued)

Table – 32. Liquidity Ratios (PD-1.3.37)

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

	2023	2022	2021	2020	2019
Due from banks and financial institutions / Total Assets	2.73%	5.12%	6.56%	3.67%	6.22%
Islamic Financing / Customer Deposits ⁽¹⁾	94.22%	89.06%	82.63%	75.81%	80.92%
Customer Deposits ⁽¹⁾ / Total Assets	73.02%	75.02%	79.19%	85.30%	78.71%
Short term assets ⁽²⁾ / Short term liabilities ⁽³⁾	8.20%	11.78%	11.44%	8.94%	16.59%
Liquid Assets ⁽⁴⁾ / Total Assets	4.39%	7.46%	8.08%	5.66%	8.15%
Growth in Customer Deposits	(2.04%)	(2.58%)	1.47%	7.29%	3.00%
Leverage ratio	13.87%	13.88%	13.88%	12.02%	12.00%

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

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

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

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

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

The following table summarises the maturity profile of the total assets, total liabilities and equity of investment accountholders based on contractual maturities as at 30 June 2023. All the assets with no fixed contractual maturities are disclosed under no fixed maturity:

	Up to 3 months BD'000	3-6 months BD'000	6-12 months BD'000	1-3 years BD'000	Over 3 years BD'000	No fixed maturity BD'000	Total BD'000
Assets							
Cash and balances with banks and Central Bank	22,879	-	-	-	-	37,345	60,224
Placements with financial institutions	37,459	-	-	-	-	-	37,459
Financing assets	49,212	36,064	85,775	176,749	285,315	-	633,115
Investment in Sukuk	-	-	58,604	82,768	114,648	-	256,020
Investment in equity and funds	-	-	-	-	-	20,487	20,487
Ijarah Muntahia Bittamleek	4,310	4,924	9,691	40,996	250,000	-	309,921
Investment in associates	-	-	-	-	-	8,115	8,115
Investment real estate	-	-	-	-	-	16,176	16,176
Property and equipment	-	-	-	-	-	13,679	13,679
Other assets	1,058	5,452	158	545	508	7,744	15,465
Total Assets	114,918	46,440	154,228	301,058	650,471	103,546	1,370,661
Liabilities And Equity Of Investment Accountholders							
Placements from financial institutions	104,123	25,721	705	12,703	-	-	143,252
Placements from non-financial institutions and individuals	97,197	71,680	98,040	15,286	-	-	282,203
Financing from financial institutions	-	40,106	70,130	-	-	-	110,236
Customers' current accounts	208,386	-	-	-	-	-	208,386
Other liabilities	44,317	-	-	-	-	-	44,317
Equity of investment accountholders	408,294	9,066	12,938	12,375	36	-	442,709
Total Liabilities And IAH	862,317	146,573	181,813	40,364	36	-	1,231,103

4 Risk Management (continued)

4.11 Profit Rate Risk

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

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

The majority of LIBOR and other Interbank Offer Rates are discontinued after 31 December 2021 and replaced with certain Alternative Reference Rates ("ARRs"), with the exception of certain USD LIBOR rates where cessation ended on 30 June 2023. The transition away from the IBORs covered most of the business units and support functions of the Group.

The Group Assets and liabilities committee monitors and manages the Group's transition to alternative rates. The committee evaluates the extent to which contracts reference IBOR cash flows, whether such contracts will need to be amended as a result of IBOR reform and how to manage communication about IBOR reform with counterparties.

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

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

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

4.11.1 Sources of Profit Rate Risk

The different profit rate risks faced by the Group can be classified broadly into the following categories:

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

4 Risk Management (continued)

4.11 Profit Rate Risk (continued)

4.11.2 Profit rate risk strategy

The Group is subject to profit rate risk on its financial assets, financial liabilities, and Islamic hedging instruments. 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, Islamic hedging instruments, and off-balance sheet items in pre-defined time bands according to their maturity; and
- d. makes efforts to match the amount of floating rate assets with floating rate liabilities in the banking book.

4.11.3 Profit rate risk measurement tools

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

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

4.11.4 Profit rate risk monitoring and reporting

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

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

The following table summarises the profit rate gap position as of 30 June 2023:

	<i>Up to 3 months BD'000</i>	<i>3-6 months BD'000</i>	<i>6-12 months BD'000</i>	<i>1-3 years BD'000</i>	<i>Over 3 years BD'000</i>	<i>Total BD'000</i>
Assets						
Placements with financial institutions	37,459	-	-	-	-	37,459
Financing assets	49,212	36,064	85,775	176,749	285,315	633,115
Ijara Muntahia Bittamleek	4,310	4,924	9,691	40,996	250,000	309,921
Investment in Sukuk	-	-	58,604	82,768	114,648	256,020
Other assets*	-	3,728	-	-	-	3,728
Total profit rate sensitive assets	90,981	44,716	154,070	300,513	649,963	1,240,243
Liabilities And Equity Of Investment Accountholders						
Placements from financial institutions**	104,123	25,721	705	12,703	-	143,252
Placements from non-financial institutions and individuals	97,197	71,680	98,040	15,286	-	282,203
Financing from financial institutions	-	40,106	70,130	-	-	110,236
Equity of investment accountholders***	408,294	9,066	12,938	12,375	36	442,709
Other liabilities****	1,685	-	-	-	-	1,685
Total profit rate sensitive liabilities and IAH	611,299	146,573	181,813	40,364	36	980,085
On-balance sheet profit rate gap	(520,318)	(101,857)	(27,743)	260,149	649,927	260,158
Off-balance sheet exposures	66,044	7,409	7,555	8,397	8,135	97,540
Total profit rate gap	(454,274)	(94,448)	(20,188)	268,546	658,062	357,698

* Other assets relate to fair value and the receivable of the profit rate swap entered into during the year.

** Placements from financial institutions includes frozen accounts of BD 8,928 thousand.

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

**** Other liabilities relate to payable on profit rate swap entered into during the year.

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200 bp in profit rates as of 30 June 2023:

	<i>Effect on value of Asset BD'000</i>	<i>Effect on value of Liability BD'000</i>	<i>Effect on value of Economic Capital BD'000</i>
Upward rate shocks:	2,460	(3,381)	(921)
Downward rate shocks:	(2,460)	3,381	921

4 Risk Management (continued)**4.11 Profit Rate Risk (continued)****Table – 35. Quantitative Indicators of Financial Performance and Position (PD-1.3.9 (b) PD-1.3.33 (d))**

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

	2023	2022	2021	2020	2019
Return on average equity	8.84%*	9.61%*	5.53%*	(11.58%)	5.21%
Return on average assets	0.89%	0.94%	0.48%	(1.03%)	0.50%
Cost to Income Ratio	59.02%	52.29%	47.10%	60.00%	59.30%

* Average equity includes AT1 Subordinated Mudaraba of BD 25 million

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

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

	2023	2022	2021	2020	2019
Allocated income to IAH	8,561	23,362	23,979	16,551	35,686
Distributed profit	1,980	3,970	3,501	4,010	12,685
Mudarib fees	8,031	19,306	20,388	12,476	23,001
Balances (BD '000s):					
Profit Equalization Reserve (PER)	36	1,486	1,400	1,310	1,245
Investment Risk Reserve (IRR)	-	-	-	-	-
PER Movement	(1,450)	86	90	65	-
IRR Movement	-	-	-	-	(1,177)
Ratios (%):					
Income allocated to IAH / Mudarabah assets %	1.40%	1.92%	1.99%	1.53%	2.96%
Mudarabah fees / Mudarabah assets %	1.31%	1.58%	1.69%	1.16%	1.91%
Distributed profit / Mudarabah assets %	0.32%	0.33%	0.29%	0.38%	1.05%
Rate of Return on average IAH %	0.27%	0.97%	0.86%	0.98%	1.70%
Profit Equalization Reserve / IAH %	0.01%	0.37%	0.33%	0.32%	0.29%
Investment Risk Reserve / IAH %	0.00%	0.00%	0.00%	0.00%	0.00%

4.12 CBB Penalties (PD 1.3.44)

During the period, the CBB imposed financial penalties of BD 712 regarding CBB Directives on EFTS.

Bahrain Islamic Bank B.S.C.

Risk and Capital Management Disclosure

For the period ended 30 June 2023

5 Glossary of Terms

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