Bank ABC Islamic

Basel III – Risk and Pillar III Disclosures 30 June 2020

Basel III – Risk and Pillar III

30 June 2020

Contents

1. Introduction

Bank ABC Islamic or ABC Islamic Bank (E.C.) and its subsidiary ("the Group" or "ABCIs") is an integral part of Bank ABC (Arab Banking Corporation Group ("Bank ABC Group" or "ABC")) and complies with the Central Bank of Bahrain (CBB) reporting requirements, within the Basel III risk management framework.

This document comprises of the Group's capital and risk management disclosures for the period ended 30 June 2020 with reference to that of the Bank ABC Group where appropriate. The disclosures in this document are in addition to the interim condensed consolidated financial statements for the period ended 30 June 2020 presented in accordance with International Financial Reporting Standards (IFRS) and AAOIFI.

Its principal purpose is to meet the disclosure requirements set by the Central Bank of Bahrain (CBB) directives on public disclosures under the Basel III framework. This report describes ABCIs risk management and capital adequacy policies and practices – including detailed information on the capital adequacy process and incorporates all the elements of the disclosures required under Pillar III and is organised as follows:

- An overview of the approach taken by Bank ABC and its subsidiaries [together "the ABC Group"] to Pillar I, including the profile of the risk-weighted assets (RWAs) according to the standard portfolio, as defined by the CBB.

- An overview of risk management practices and framework at the Bank ABC Group with specific emphasis on credit, market and operational risks. Also covered are the related monitoring processes and credit mitigation initiatives.

- Other disclosures required under the Public Disclosure Module of the CBB Rulebook Volume 2.

The CBB supervises Bank ABC on a consolidated basis. Individual banking subsidiaries are supervised by the respective local regulator. Bank ABC Group's capital has been prepared based on the Basel III framework and Capital Adequacy Module of the CBB Rulebook Volume 1.

For regulatory reporting purposes under Pillar I, the Group has adopted the standardised approach for credit risk, market risk and operational risk.

The Group's total risk-weighted assets as of 30 June 2020 amounted to US$ 892.5 million (December 2019: US$ 1,259.6 million), of which 80.5% pertained to credit risk and 19.5% to operational risk. The total capital adequacy ratio amounted to 32.3% (December 2019:30%), compared to the minimum regulatory requirement of 12.5%.

2. The Basel III framework

The CBB implemented the Basel III framework from 1 January 2015.

The Basel Accord is built on three pillars:

- **Pillar I** defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by the bank's eligible capital funds.

- **Pillar II** addresses a bank's internal processes for assessing overall capital adequacy in relation to risks, namely the Internal Capital Adequacy Assessment Process. Pillar II also introduces the Supervisory Review and Evaluation Process (SERP), which assesses internal capital adequacy.

- **Pillar III** complements Pillar I and Pillar II by focusing on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

a. Pillar I

Banks incorporated in the Kingdom of Bahrain are required to maintain a minimum capital adequacy ratio (CAR) of 12.5% and a Tier 1 ratio of 10.5%. Tier 1 capital comprises of share capital, reserves, retained earnings, non-controlling interests, profit for the year and cumulative changes in fair value.

In case the CAR of the Group falls below 12.5%, additional prudential reporting requirements apply and a formal action plan setting out the measures to be taken to restore the ratio above the target should be submitted to the CBB**.**

The CBB allows the following approaches to calculate the RWAs (and hence the CAR).

Credit risk	Standardised approach
Market risk	Standardised, Internal models approach.
Operational risk	Standardised, Basic indicator approach.

The Group applies the following approaches to calculate its RWAs:

- **Credit risk - Standardised approach: t**he Group applies the standardised approach for credit risk. The RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty's external rating, where available.

- **Market risk – Standardised approach.**

- **Operational risk – Standardised approach:** regulatory capital is calculated by applying a range of beta coefficients from 12% -18% on the average gross income for the preceding three years – applied on the relevant eight Basel defined business lines.

b. Pillar II

Pillar II comprises of two processes, namely:

- an Internal Capital Adequacy Assessment Process (ICAAP), and
- a Supervisory Review and Evaluation Process (SREP).

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. The ICAAP allows the bank to assess the level of capital that adequately supports all relevant current and future risks in the business. The ICAAP and the internal processes that support it should be proportionate to the nature, scale and complexity of the activities of the bank.

The ABC Group's ICAAP is designed to ensure that it has sufficient capital resources available to meet regulatory and internal capital requirements, even during periods of economic or financial stress. The ICAAP addresses all components of ABC Group's risk management, from the daily management of more material risks to the strategic capital management.

The CBB's Pillar II guidelines require each bank to be individually assessed by the CBB in order to determine an individual minimum capital adequacy ratio. Pending finalisation of the assessment process, all banks incorporated in Bahrain are required to maintain a 12.5% minimum capital adequacy ratio and a Tier 1 ratio of 10.5% for the consolidated group.

The SREP is designed to review the arrangements, strategies, processes and mechanisms implemented by a bank to comply with the requirements laid down by the CBB, and evaluates the risks to which the bank is/ could be exposed. It also assesses risks that the bank poses to the financial system.

The SREP also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks, in addition to the credit, market and operational risks addressed in the core Pillar I framework. Other risk types, which are not covered by the minimum capital requirements in Pillar I, include liquidity risk, profit rate risk in the banking book and concentration risk. These are covered either by capital, or risk management and mitigation processes under Pillar II.

c. Pillar III

Prescribes how, when and at what level information should be disclosed about an institution's risk management and capital adequacy practices.

Pillar III complements the minimum risk based capital requirements and other quantitative requirements (Pillar I) and the supervisory review process (Pillar II), and aims to promote market discipline by providing meaningful regulatory information to investors and other interested parties on a consistent basis. The disclosures comprise detailed qualitative and quantitative information.

The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures, and to encourage all banks, via market pressures, to move towards more advanced forms of risk management.

The Group's disclosures meet the minimum regulatory requirements and provide disclosure of the risks to which it is exposed, both on- and off-balance sheet.

3. Group structure and overall risk and capital management

a. Group structure

ABCIs is an exempt joint stock company incorporated in the Kingdom of Bahrain on 10 December 1985 and registered with the Ministry of Industry and Commerce under commercial registration number 16864. The Group operates under a wholesale Islamic banking licence issued by the CBB and are engaged in financial trading in accordance with the teachings of Islam [Shari'a].

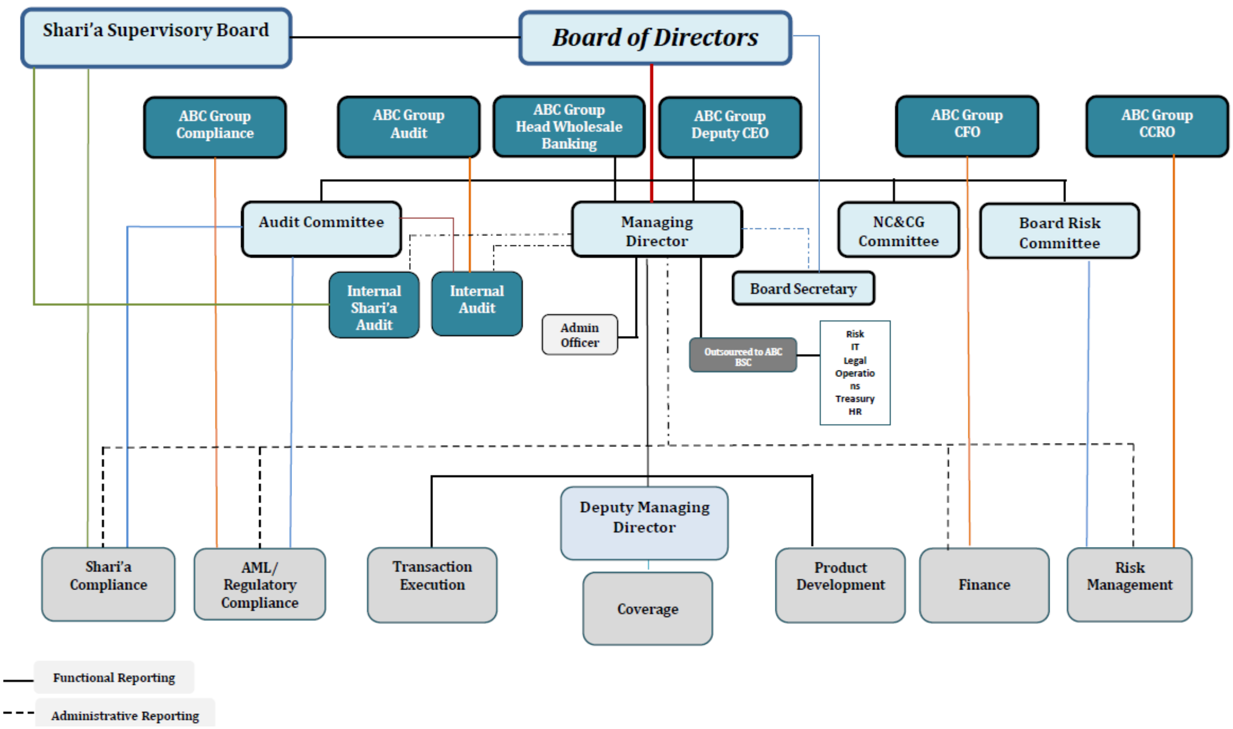
Arab Banking Corporation (B.S.C.) (known as Bank ABC), which operates under a wholesale banking licence issued by the CBB, holds 100% of the share capital of the Bank.

The condensed consolidated financial statements and capital adequacy regulatory reports of the Bank and its subsidiary have been prepared and consolidated on a consistent basis.

The ownership in the subsidiary as at 30 June 2020 is as follows:

Name	Nature of business	Country of incorporation	Amount and % of holding
ABC Clearing Company	Islamic Investment Company	Cayman Islands	US$ 2,000 and 100% management shares

Whilst the Board of Directors [BOD] supervise the overall activities of the Bank, the Board Audit Committee, the Board Risk Committee and the Nomination, Compensation and Corporate Governance Committee are tasked with overseeing the respective areas. The following chart shows the organisational structure of the Bank, including the reporting lines to the various BOD committees.



The Bank has in place comprehensive policies regarding the remuneration and benefits provided to members of the BOD and its committees, senior management and staff. With regard to directors, compensation comprises of a- monthly retainer fees b- travelling and/or accommodation expenses while attending Board and Board Committee meeting, while for senior management and staff, compensation comprises a number of fixed elements, covering salary, allowances and benefits, in addition to variable, performance-related elements.

The Group is committed to best practices of Corporate Governance Principles and Guidelines and as such, communicates all relevant information to its stakeholders punctually and clearly through a variety of channels, including a well-maintained website.

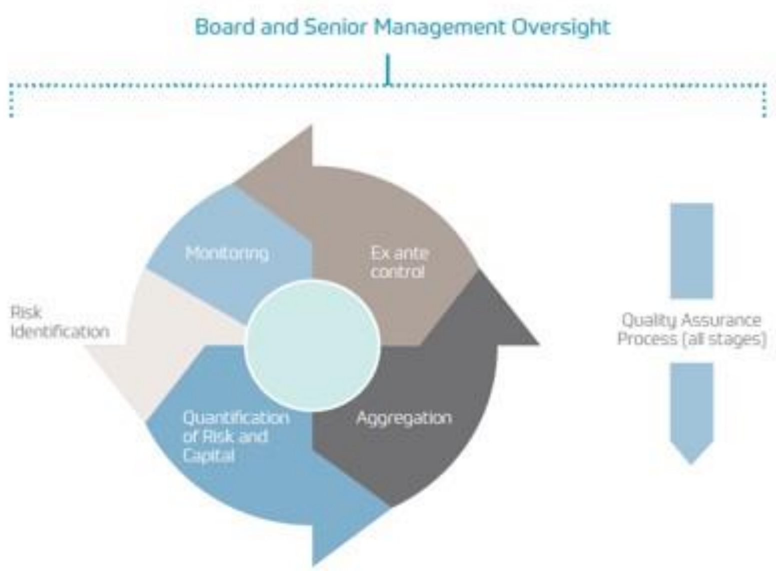
The parent bank, Arab Banking Corporation (B.S.C.) (known as Bank ABC), was incorporated in 1980 in the Kingdom of Bahrain by an Amiri decree and operates under a conventional wholesale banking license issued by the CBB.

b. Risk and capital management

Risk is inherent in the ABC Group's activities and is managed through a process of on-going identification, measurement and monitoring, subject to risk limits and other controls. The ABC Group is exposed to credit, market, liquidity, interest rate, operational, legal, IT and strategic risks, as well as other forms of risk inherent in its financial operations.

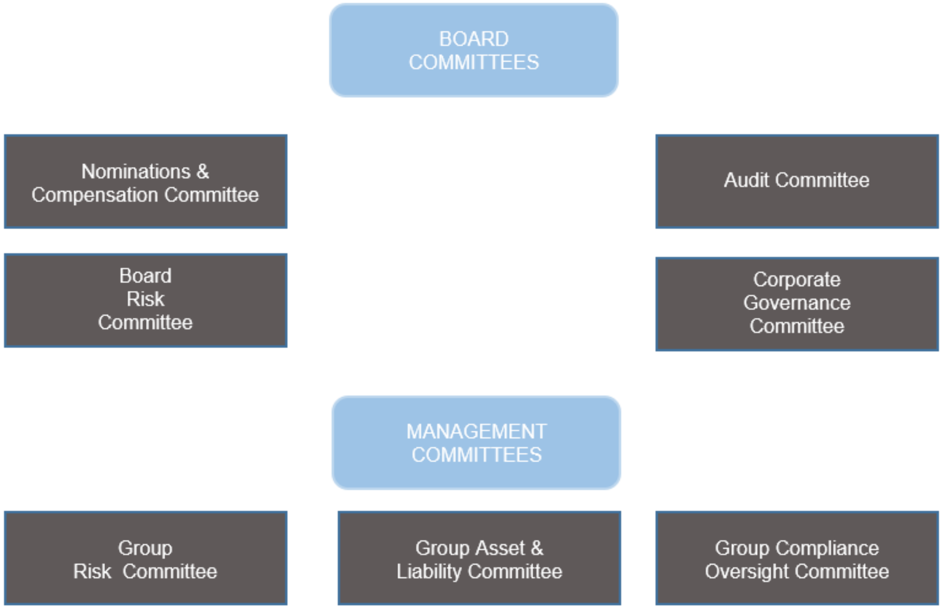
Over the last few years, the ABC Group has invested heavily in developing a comprehensive and robust risk management infrastructure. This includes credit, market and operational risk identification processes; risk measurement models and rating systems; and a strong business process to monitor and control these risks. *Figure 1* outlines the various congruous stages of the risk process.

Figure 1: Risk process cycle

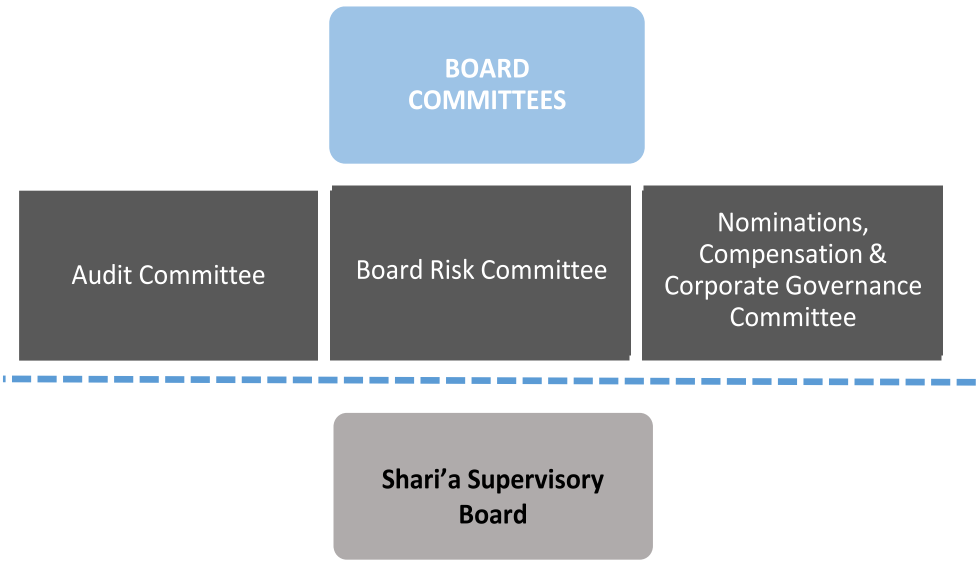


The Board of Directors of Bank ABC, under advice from the Board Risk Committee (BRC), sets the ABC Group's Risk Strategy/Appetite and Policy Guidelines. Executive management is responsible for their implementation.

Figure 2: Risk management governance structure



In addition to being part of the above structure, through the outsourcing of the support functions including risk and credit approval, the Group has the following risk management governance structure, including a Shariah Supervisory Board:



Within the broader governance infrastructure, the Board Committees carry the main responsibility for best practice management and risk oversight. At this level, the BRC oversees the definition of risk/reward guidelines, risk appetite, risk tolerance standards, and risk policies and standards. The BRC is also responsible for coordinating with other Board Committees in monitoring compliance with the requirements of the regulatory authorities in the various countries in which the Group operates. The current committee structure provides for two management committees reporting to the Board Risk Committee and one to Audit Committee.

The primary objectives of the **Group Risk Committee (GRC)** is to define, develop and monitor the Bank ABC Group's overarching risk management framework taking into account the Bank ABC Group's strategy and business plans. In addition, the GRC is responsible for highlighting, discussing and monitoring key regulations, both local and international, as applicable to the businesses and geographies where the Bank ABC Group operates. The GRC will report relevant matters to the BRC, advising and informing them as required on the Bank ABC Group's risk exposures and framework and on key regulatory and risk matters. The GRC is assisted by specialised sub-committees to manage credit risk (Group Credit Committee (GCC)), operational risk (Group Operational Risk Committee), operational resilience (Group Operational Resilience Committee), Group risk management framework, policies & procedures, management of Group model risk and risk systems (Group Regulatory and Analytics Committee).

The **Group Asset and Liability Committee (GALCO)** is responsible for defining long-term strategic plans and policy, as well as short-term tactical initiatives for prudently directing asset and liability management and capital allocation. GALCO monitors the Bank ABC Group's capital, funding, liquidity and market risks, and the Bank ABC Group's risk profile in the context of economic developments and market fluctuations. GALCO is assisted by technical sub-committees for Capital Management and Liquidity Management.

The **Group Compliance Oversight Committee (GCOC)** is responsible for strengthening the focus on compliance within the Bank ABC Group's risk management framework. GCOC is the senior oversight committee Group-wide for compliance risks and policies, and reports to the Group Audit Committee.

The **Credit & Risk Group (CRG)** is the second line function responsible for centralised credit policy and procedure formulation, country risk and counterparty analysis, approval/review and exposure reporting, control and risk-related regulatory compliance, remedial loans management and the provision of analytical resources to senior management. Additionally, it identifies market and operational risks arising from the Bank ABC Group's activities, and makes recommendations to the relevant central committees appropriate policies and procedures for managing exposure.

c. Internal Audit

Group Internal Audit functions as a third line of defense and has a reporting line, independent of management, directly to the Board Audit Committee. The primary objective of Group Audit is to provide an independent opinion and review on the design and operating effectiveness of the control environment across the group on all aspects of risk management, including adherence to Bank's policies and procedures. The Board Audit Committee reviews and approves Internal Audit's plans and resources, and evaluates the effectiveness of Internal Audit.

d. Risk types

The major risks arising out of the Group's business activities are; credit risk, market risk, operational risk and liquidity risk. The following sections illustrate how these risks are managed and controlled.

i. Risk in Pillar I

Pillar I addresses three specific types of risks, namely credit, market and operational risk. Pillar I forms the basis of calculation of regulatory capital.

CREDIT RISK

Credit risk is defined as the risk of default on a debt that may arise from a borrower or counterparty failing to fulfil payment obligations in accordance with agreed terms. The goal of credit risk management is to manage the credit risk portfolio in line with the approved Group Risk Appetite Standards.

The ABC Group's portfolio and credit exposures are managed in accordance with the Group Credit Policy, which applies Group-wide qualitative and quantitative guidelines, with particular emphasis on avoiding undue concentrations or aggregations of risk. The ABC Group's banking subsidiaries are governed by specific credit policies that are aligned with the Group Credit Policy, but may be adapted to suit local regulatory requirements as well as individual units' product and sectoral needs.

In addition to the customer and customer group credit limits, the first level of protection against undue credit risk is provided by the ABC Group's portfolio risk appetite for counterparty, country and industry concentration. The BRC and the HOCC set these limits and allocate them between the Group and its banking subsidiaries.

A tiered hierarchy of delegated approval authorities, based on the risk rating of the customer under the ABC Group's internal credit rating system, controls credit exposure to individual customers or customer groups.

Credit limits are prudent, and the ABC Group uses standard mitigation and credit control techniques.

The ABC Group employs a Risk-Adjusted Return on Capital (RAROC) measure to evaluate risk/reward at the transaction approval stage.

The following measures, collectively, constitute the three lines of defence against undue risk for the Group:

Business unit account officers are responsible for day-to-day management of existing credit exposures, and for periodic review of the client and associated risks, within the framework developed and maintained by the CRG. Along with CRG, the Group Assets Quality Review team conducts an independent second line review of the risk assets of the Group.

Group Audit functions as a third line of defence as defined in Section 2.c.

On 1 January 2018, the Group has adopted International Financial Reporting Standard 9 Financial Instruments (IFRS 9) and AAOIFI's FAS 30 (FAS 30). IFRS 9 / FAS 30 fundamentally change the loan loss impairment methodology. The standards incorporate a forward-looking expected credit loss (ECL) approach. The Group is required to record an allowance for expected losses for all loans and other debt type financial assets not held at fair value through profit or loss, together with financing commitments and financial guarantee contracts. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.

ABC groups its financial assets into Stage 1, Stage 2 and Stage 3, based on the IFRS 9 / FAS 30 methodology, as described below:

- **Stage 1 – (12 months ECL):** For exposures where there has not been a significant increase in credit risk (SICR) since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

- **Stage 2 – (Lifetime ECL - not credit impaired):** For exposures where there has been a SICR since initial recognition but that are not credit impaired, a lifetime ECL is recognised.
- **Stage 3 – (Lifetime ECL - credit impaired):** Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. As this uses the same criteria as under IAS 39, the Group's methodology for specific provisions remains unchanged. For financial assets that have become credit impaired, a lifetime ECL is recognised.

Financial asset is classified as impaired (Stage 3) when there is objective evidence that the asset is impaired/defaulted.

Credit exposures that are impaired/defaulted (Stage 3 assets) are segregated and supervised more actively by the CRG's Remedial Loans Unit (RLU). Subject to minimum loan loss provision levels mandated under the Bank ABC Group Credit Policy, specific provisions in respect of impaired assets are based on estimated potential losses, through a quarterly portfolio review and adequacy of provisioning exercise.

As part of enhancing its robust risk management infrastructure, the Bank ABC Group has rolled out a new credit management system which will vastly enhance the credit workflow and the Group's reporting capabilities.

MARKET RISK

Market risk is the risk that the Group's earnings or capital, or its ability to support its business strategy, will be impacted by changes in profit rates, equity prices, credit spreads, foreign exchange rates and commodity prices.

The Bank ABC Group has established risk management policies and limits within which exposure to market risk is measured, monitored and controlled by the CRG, with strategic oversight exercised by GALCO. The CRG's Market Risk (MR) unit is responsible for the development and implementation of market risk policy, the risk measurement and monitoring framework, and the review of all trading and investment products / limits before submission to GALCO. The MR includes market risk, middle office and liquidity risk.

The Bank ABC Group classifies market risk as follows:

- **Trading market risk** arises from movements in market risk factors that affect short-term trading
- **Non-trading market risk in securities** arises from market factors affecting securities held for long-term investment
- **Non-trading asset and liability risk** exposures arise where the re-pricing characteristics of the Group's assets do not match those of its liabilities.

The Bank ABC Group adopts a number of methods to monitor and manage market risks across its trading and non-trading portfolios. These include:

- Value-at-Risk (VaR) (i.e. 1-day 99th percentile VaR using the 'historical simulation' methodology)
- Sensitivity analysis (i.e. basis-point value (BPV) for interest rates and 'Greeks' for options)
- Stress testing / scenario analysis
- Non-technical risk measures (e.g. nominal position values, stop loss vs. Profit & Loss, and concentration risk)

As a reflection of the Bank ABC Group's risk appetite, limits are established against the aforementioned market risk measures. The BRC approves these limits annually and the MR reports on them daily. The MR reports risk positions against these limits, and any breaches, to senior management and the GALCO.

Currency rate risk

The ABC Group's trading book has exposures to foreign exchange risk arising from cash and derivatives trading. Additionally, structural balance sheet positions relating to net investment in foreign subsidiaries expose the Group to foreign exchange risk. These positions are reviewed regularly and an appropriate strategy for managing structural foreign exchange risk is established by the GALCO. Group Treasury is responsible for executing the agreed strategy. ABC Islamic maintains no trading book, hence this risk is not relevant to the Bank.

Profit rate risk

The ABC Group trading, investment and banking activities expose it to profit rate risk. Profit rate risk is the risk that an investment's value will be affected by changes in the level, slope, and curvature of the yield curves, the volatilities of profit rates, and potential disruptions to profit rate equilibrium.

Equity price risk

Equity position risk arises from the possibility that changes in the prices of equities, or equity indices, will affect the future profitability, or the fair values, of financial instruments. The Group is exposed to equity risk in its trading position and investment portfolio, primarily in its core international and GCC markets.

Commodity risk (price risk)

The Group would be exposed to commodity risk if it holds commodity for its Murabaha transactions. However, in order to minimise or eliminate this risk, the Group limits its holding of commodity to the day of the transaction and it settles its position for each specific transaction, hence eliminating overnight price risk in the commodities traded.

OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems — or from external events. Operational risk in Bank ABC includes legal risk and information technology (IT) risk. Reputational impact, regulatory impact and impact on clients and operations are taken into consideration when assessing the impact of actual and potential operational risk events.

The ABC Group applies modern, proven methodologies for the qualitative management of its operational and other non-financial risks after adapting them to the Group's size, nature, complexity and risk profile.

The various components of the operational risk management framework and the tools for the management of operational risk are approved by the ABC Group Operational Risk Committee and then the framework is cascaded across the ABC Group entities.

The implementation of the framework is governed by the Group Operational Risk Management Committee's rolling 'master plan'. Local operational risk committees implement corresponding plans at the subsidiary levels.

The ABC Group has implemented the following tools for the management of operational risks:

- Internal loss data and incidents, near miss events
- Risk and control self-assessments (bottom-up and top-down)
- Group-wide control standards
- Key risk and performance indicators
- New product approval process.

All loss events and relevant incidents are captured in a group-wide incident database. The threshold for reporting loss events is US$ 50.

The ABC Group has defined a number of group-wide key risk indicators covering all the key business and supporting processes.

The ABC Group has an approach for control testing by the first line and providing assurance over the results of the controls tested by the second line.

Incidents and performance vis-a-vis key risk indicators, results of Risk & Control Self-Assessments and implementation of group-wide control standards are reported to the ABC Group and unit level Operational Risk Committees.

The methodology for management of operational risk is closely aligned to the methodologies used by ABC Group Compliance and Internal Audit.

The ABC Group had implemented a Governance, Risk and Compliance solution in 2017. This group-wide solution is being shared by Audit, Risk and Compliance to track, manage and report the risks and issues identified.

Operational risk tolerance

The ABC Group has expressed operational risk tolerance in the Board approved Group Risk Appetite Statement in terms of gross loss amounts related to operational risk events. In addition, the Group uses quantitative and qualitative elements to classify actual and potential non-financial risks as ‘critical’, ‘moderate’, ‘significant’, or ‘minor’. Timeframes have been defined within which action plans must be prepared for the treatment of control weaknesses, rated ‘critical’, ‘significant’ or ‘moderate’.

In line with the Board-led ABC Group risk appetite statement, operational risk tolerance is set and monitored by the Board.

Shari’a compliance

Shari’a compliance risk is an operational risk facing Islamic banks which may lead to non-recognition of income, reputational loss and resulting franchise risk on grounds of non-Shari’a compliance. To manage such risks, the Shari’a Compliance Officer of the Group has been tasked to conduct regular Shari’a compliance reviews to ensure that documentation, procedures and execution of transactions are in accordance with the Shari’a Standards issued by AAOIFI and Shari’a rules and principles as determined by the Shari’a Supervisory Board (the “SSB”). The results of such reviews are regularly reported to the SSB. Cases of Shari’a non-compliance (if any) are thoroughly investigated to establish their causes and to introduce adequate controls to avoid their recurrence in the future.

Shari’a non-compliant earnings during the period amounted to US$22 thousand. It mainly represents penalty fees received from customers for making late payments. Such amounts are kept in a special suspense account and disposed of to charitable causes.

The SSB of the Group consists of three Islamic scholars (Chairman and two members). The SSB meets periodically or as and when there is a need to hold a meeting. The members receive a fixed sum of money as attendance fee for every meeting they attend, in addition to a fixed amount paid annually to each member as remuneration, irrespective of the number of meetings held during the year or the financial results of the Group.

Information Technology Risk

Given the importance of Information Technology (IT) within the ABC Group and the increasing risk of Cyber risk, an IT Risk Management function is in place under Operational Risk Management. The role of IT Risk Management is to identify risks within Information Technology and Information Security, and to ensure adequate controls are in place to mitigate these risks. The ABC Group has adopted CoBIT 5 as a reference control framework for IT, and ISO 27k series, NIST and SanS for Information Security.

Business Continuity Management

The ABC Group has robust and regularly tested business continuity plans – both in order to meet local and international regulatory obligations, and in order to protect the ABC Group's business functions, assets and employees. The business continuity plans cover various local and regional risk scenarios, (including Cyber risk scenarios). The business continuity plans are kept up to date in order to deal with changes in the internal and external environment at both ABC Group and unit level. Furthermore, all relevant stakeholders receive appropriate training to ensure that they understand their roles and responsibilities when business continuity plans are activated.

The ABC Group also has a Crisis Management framework in place that ensures information is communicated efficiently and effectively to all stakeholders in case of a severe incident.

Fraud risk

Bank ABC Group has a Fraud Risk Management function in place. This function is responsible for the development and maintenance of the Fraud Risk Management strategy. The function is tasked to facilitate the identification of various types of External and Internal Fraud Risks and Incidents impacting the Bank ABC Group through structured deep dive assessments. For occurrences of Fraud an incident response management process is in place, root cause analysis is performed and corrective actions are implemented. The function also undertakes the responsibility for timely reporting Incidents to Bahrain local Regulator – Central Bank of Bahrain (CBB) as per the latest regulatory guidelines issued in October 2018.

Legal risk

Examples of legal risk include inadequate documentation, legal and regulatory incapacity, insufficient authority of a counterparty and contract invalidity/unenforceability. ABC Group Legal Counsel bears responsibility for identification and management of this risk. They consult with internal and external legal counsels.

The ABC Group is currently engaged in various legal and/or regulatory matters which arise in the ordinary course of business. Bank ABC Islamic does not currently expect to incur any liability with respect to any actual or pending legal and/or regulatory matter which would be material to the financial condition or operations of the Group.

ii. Risk in Pillar II

LIQUIDITY RISK

Liquidity risk is the risk that maturing and encashable assets may not cover cash flow obligations (liabilities). The ABC Group maintains liquid assets at prudent levels to ensure that cash can quickly be made available to honour all its obligations, even under adverse conditions. The ABC Group is generally in a position of excess liquidity, its principal sources of liquidity being its deposit base and inter-bank financing.

The Liquidity Risk Management framework ensures that the key risk indicators are monitored proactively and regularly reported to senior management. The Bank ABC Group regularly conducts liquidity stress testing that ensures Liquidity Survival Horizon (LSH) is always maintained

Intraday Liquidity risks are managed by monitoring actual daily cashflows against forecasted levels. ABC Group maintains sufficient quantum of Liquid Assets Buffer and the intraday liquidity requirements are relatively low. Given the extent of liquidity buffers in the form of HQLA, the potential impact of double duty of HQLA for intraday liquidity risk is very low and has minimal impact on Liquidity Coverage Ratio (LCR).

The Bank ABC Group also carries out a comprehensive Internal Liquidity Adequacy Assessment Process (ILAAP) exercise that includes, amongst other things, scenario-based stress tests to evaluate the robustness of the liquidity management framework and the effectiveness of the contingency funding plan. The Bank ABC Group's Liquid Asset Buffer (LAB) and it's Contingency Funding Plan (GCFP) ensure that the Bank ABC Group can withstand potential liquidity shocks and market disruptions.

The Bank ABC Group maintains liquid assets at prudent levels to ensure that cash can quickly be made available to honour all its obligations, even under adverse conditions. The Bank ABC Group is generally in a position of excess liquidity, its principal sources of liquidity being its Balances with Central Banks, High Quality Liquid Assets and Marketable Securities.

The LSH metric is used to manage and monitor liquidity on a daily basis. The LSH represents the minimum number of days the Group can survive the combined outflow of all deposits and contractual draw downs, under normal market conditions.

A maturity gap report, which reviews mismatches, is used to monitor medium and long term liquidity.

The liquidity requirement of Bank ABC Islamic are built into the models and taken care off at the ABC Group level.

The following table summarises the liquidity ratios as at 30 June 2020:

Liquid assets ratio	46.2%
Short-term assets to short-term liabilities	68.2%

PROFIT RATE RISK IN BANKING BOOK

The exposure to profit rate risk in the banking book (PRRBB) arises due to mismatches in the re-setting of profit rates of assets and liabilities. The fact that the Group's rate-sensitive assets and liabilities are predominantly floating rate helps to mitigate this risk. In order to manage the overall profit rate risk, the Group generally uses matched currency funding and translates fixed-rate instruments to floating rate. Similarly, Bank ABC Islamic minimizes its exposure to profit rate risk by swapping its fixed rate exposures to floating ones and obtain matched currency fundings.

The Group measures and controls PRRBB using a number of qualitative and quantitative measures. Qualitative measures include a thorough assessment of the impact of changes in profit rates on the Bank's banking instruments during the annual budget and capital planning process. Current and expected future profit rates are integral components driving the annual capital planning process.

Quantitative measures employed include limits, profit rate sensitivity gap analysis, duration analysis, and stress testing to measure and control the impact of profit rate volatility on the Bank's earnings and economic value of equity. These measures are applied separately for each currency and consolidated at a Group's level. The gap analysis measures the interest rate exposure arising from differences in the timing and/or amounts of loans and deposits in pre-specified time bands. Duration analysis measures the sensitivity of the banking book to a 1 basis point change in profit rates. Stress tests include the impact of parallel and non-parallel shifts in profit rates on banking activities. All these measures are reported to the GALCO on a regular basis.

As at 30 June 2020, a 200 basis points (2%) parallel shift in profit rates would potentially impact the Group's economic value by US$2 million.

US$ thousands	**Within 1 month**	**1-3 months**	**3-6 months**	**6-12 1 year**	**Over Years**	**Non-profit bearing**	**Total**
Assets							
Bank balances	-	-	-	-	-	17,758	17,758
Due from financial institutions	-	4,928	-	-	-	-	4,928
Investments	-	-	-	76,889	811,699	2,412	891,000
Murabaha receivables	792,570	327,673	60,200	31,683	-	-	1,212,126
Ijarah	58,232	-	115,979	-	-	-	174,211
Equipment	-	-	-	-	-	216	216
Other assets	-	-	-	-	-	8,589	8,589
Total assets	**850,802**	**332,601**	**176,179**	**108,572**	**811,699**	**28,975**	**2,308,828**
liabilities and owners' equity							
Other liabilities	-	-	-	-	-	83,778	83,778
Murabaha and other payables	354,298	-	6	220,148	-	-	574,452
Equity of Investment Account Holders	335,389	862,555	142,833	30,605	-	-	1,371,382
Owners' equity	-	-	-	-	-	279,216	279,216
Total liabilities and owners' equity	**689,687**	**862,555**	**142,839**	**250,753**	**-**	**362,994**	**2,308,828**
Off B/S items							
Tabdeel	126,000	693,075		(76,075)	(743,000)	-	-
Total off B/S items	**126,000**	**693,075**	**-**	**(76,075)**	**(743,000)**	**-**	**-**
Profit rates sensitivity gap	287,115	163,121	33,340	(218,256)	68,699	(334,019)	-
Cumulative profit rates sensitivity gap	287,115	450,236	483,576	265,320	334,019	-	

The profit rate gap analysis set out in the table above assumes that all positions run to maturity, i.e., no assumptions on financing prepayments. Deposits without a fixed maturity have been considered in the 'less than one month' bucket.

CONCENTRATION RISK

Concentrations arise when a number of counterparties are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location. Concentrations could also arise as a result of large exposure to a single / group of related counterparties. The Group assesses the concentration risk under its ICAAP and makes an appropriate capital assessment for this risk.

Country risk or Cross-border risk arises from the uncertainty relating to a counterparty, not being able to fulfil its obligations to the Group, due to political/ geo-political or economic reasons.

Industry risk is the risk of adverse developments in the operating environment for a specific industry segment leading to deterioration in the financial profile of counterparties operating in that segment and resulting in increased credit risk across this portfolio of counterparties.

In order to avoid excessive concentrations of risk, Group risk appetite, policies and procedures include specific guidelines to focus on country, industry and counterparty limits, and the importance of maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Under the single obligor regulations of the CBB and other host regulators, the CRG and its local equivalents have to obtain approval for any planned exposures above specific thresholds to single counterparties, or groups of connected counterparties. Bank ABC Islamic, being a wholly owned subsidiary of a Bahrain based bank, is allowed under the CBB Rulebook to leverage on the capital base of its parent bank.

As at 30 June 2020, the largest Group's exposures in excess of the 15% obligor limit to individual counterparties were as shown below:

US$ Thousands

	On Balance Sheet Exposure	Off Balance Sheet Exposure	Total Exposure
Counterparty [A]	546,243	-	546,243
Counterparty [B]	252,280	-	252,280
Counterparty [C]	161,142	-	161,142

COMPLIANCE RISK

Compliance Risk is the risk of legal or regulatory sanctions, material financial loss, or loss to reputation the Group may suffer as a result of its failure to comply with laws, regulations, rules, reporting requirements, standards and codes of conduct applicable to the Group's activities.

Front-line functions within the Group are responsible for the management of their specific compliance risks and control environment. The Compliance Function is responsible for assuring, on an ongoing basis, that key Compliance related control processes within the first line of defence are in place and operating effectively.

REPUTATIONAL RISK

Reputational Risk is multidimensional and reflects the perception of market participants. It exists throughout the organization and exposure to reputational risk is essentially a function of the adequacy of the entity's internal risk management processes, as well as the manner and efficiency with which management responds to external influences.

The Group implements a robust governance and management framework, which has a significant involvement of senior management to proactively address any risk(s) to the Group's reputation. Furthermore, the management believes that reputation risk requires active administration and involvement of senior members of the Group as against setting aside capital for its management.

Risk mitigation, collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral held by the Group mainly include cash, marketable securities and guarantees from banks.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Exposures by type of Islamic financing contract that are covered by guarantees or by eligible collaterals are as follows:

US$ thousands	Exposures	Guaranteed	Collateral*	Net exposure
Funded Exposures (Murabaha)	104,629	-	134,660	(30,031)

* The utilization of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

e. Monitoring and reporting

The monitoring and reporting of risk is conducted on a daily basis for market and liquidity risk, and on a monthly or quarterly basis for credit and operational risk. Risk reporting is regularly made to senior management, the Board and the Board Risk Committee (BRC). The BRC receives internal risk reports covering market, credit, operational and liquidity risk.

As part of the capital management framework, capital adequacy ratios for the Group and its subsidiaries are reported to GALCO, the Board and the BRC on a regular basis.

4. Regulatory capital requirements and the capital base

The Group manages its capital structure and maintains capital based on its strategic business plans taking into account anticipated economic conditions and the risk characteristics of its activities. The objective is to maintain a strong capital base to support the risks inherent in our businesses and markets, meeting both local and consolidated regulatory capital requirements at all times.

The Group manages the capital position through various measures that include administrating a dividend policy that balances financial stability and growth objectives with shareholders returns; raising capital via equity, AT1 and sub-ordinated debt instruments, etc. based on a set of defined capital triggers; risk distribution or risk participation to reduce capital demand; and deleveraging to create capital capacity.

The determination of dividend payout will depend upon, amongst other things, the Group's earnings, its dividend policy, the requirement to set aside minimum statutory reserves, capital requirements to support growth (organic and inorganic), regulatory capital requirements, approval from the CBB and applicable requirements under Bahrain Commercial Companies Law, as well as other factors that the Board of Directors and the shareholders may deem relevant

No changes have been made in the objectives, policies and processes from the previous year.

The Group's total capital adequacy ratio as at 30 June 2020 was 32.3% compared with the minimum regulatory requirement of 12.5%. The composition of the total regulatory capital requirement was as follows:-

Risk weighted assets [RWA]	
Credit risk	718.8
Market risk	-
Operational risk	173.7
Total Risk weighted assets	**892.5**
Tier 1 ratio	**31.3%**
Capital adequacy ratio	**32.3%**

The Group ensures adherence to the CBB's requirements by monitoring its capital adequacy against higher internal limits detailed in the Bank's Board-approved risk appetite statement under the strategic risk objective "Solvency".

The management believes that there are no impediments on the transfer of funds or reallocation of regulatory capital within the Group, subject to restrictions to ensure minimum regulatory capital requirements at the local level.

a. Capital requirement for credit risk

For regulatory reporting purposes, the Group calculates the capital requirements for credit risk based on the standardised approach. Under the standardised approach, on- and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. The exposure categories are referred to in the CBB's Basel III capital adequacy framework as standard portfolios. The primary standard portfolios are claims on sovereigns, claims on banks and claims on corporates. Following the assignment of exposures to the relevant standard portfolios, the RWAs are derived based on prescribed risk weightings. Under the standardised approach, the risk weightings are provided by the CBB and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the CBB. The Group uses ratings assigned by Standard & Poor's, Moody's, Fitch Ratings and Capital Intelligence.

Provided below is a counterparty asset class-wise breakdown of the Credit RWA and associated capital charge. The definition of these asset classes (as per the standard portfolio approach under the CBB's Basel III Capital Adequacy Framework) is set out in section 5 of this document.

Credit exposure and risk-weighted assets – Self Finance

US$ Thousands	**Gross credit exposure**	**Funded Exposure**	**Un-Funded Exposure**	**Risk-weighted assets for Funded Exposures**	**Risk-weighted assets for Un-Funded Exposures**	**Total Risk Weighted Assets**	**Capital Charge (12.5%)**
Sovereigns	179,529	179,529	-	14,616	-	14,616	1,827
Claims on public sector entities	67,549	67,549	-	2,596	-	2,596	324
Claims on banks	541,165	541,165	-	224,302	-	224,302	28,038
Claims on corporates	274,980	234,897	40,083	241,466	40,083	281,549	35,194
Other	263	263	-	263	-	263	33
Total	**1,063,486**	**1,023,403**	**40,083**	**483,243**	**40,083**	**523,326**	**65,416**

Credit exposure and risk-weighted assets – Financed by IAH

US$ Thousands	Gross credit exposure	Funded Exposure	Un-Funded Exposure	Risk-weighted assets for Funded Exposures	Risk-weighted assets for Un-Funded Exposures	Total Risk Weighted Assets	Capital Charge (12.5%)
Sovereigns	285,385	285,385	-	6,972	-	6,972	872
Claims on public sector entities	107,409	107,409	-	1,238	-	1,238	155
Claims on banks	482,298	482,299	-	52,802	-	52,802	6,600
Claims on corporates	437,249	373,512	63,737	115,187	19,121	134,308	16,788
Other	418	418	-	125	-	125	16
Total	**1,312,759**	**1,249,023**	**63,737**	**176,324**	**19,121**	**195,445**	**24,431**

Breakdown of capital requirements for credit risk per type of Islamic financing contract is as follows:

Self Finance

US$ Thousands Type of Financing	Gross credit exposure	Funded Exposure	Un-Funded Exposure	Risk-weighted assets for Funded Exposures	Risk-weighted assets for Un-Funded Exposures	Total Risk Weighted Assets	Capital Charge (12.5%)
Murabaha	610,217	606,356	3,861	351,306	3,861	355,167	44,396
Ijara	68,937	68,937	-	37,830	-	37,830	4,729
Sukuk	327,220	327,220	-	87,435	-	87,435	10,929
Due from financial institution	1,937	1,937	-	1,937	-	1,937	242
Equity	931	931	-	931	-	931	116
LC	36,222	-	36,222	-	36,222	36,222	4,528
Other	18,022	18,022	-	3,804	-	3,804	476
Total	**1,063,486**	**1,023,403**	**40,083**	**483,243**	**40,083**	**523,326**	**65,416**

Monthly average gross exposures and the risk-weighted assets at 30 June 2020 were US$ 917,958 thousand and US$ 463,638 thousand respectively.

Financed by IAH

US$ Thousands Type of Financing	Gross credit exposure	Funded Exposure	Un-Funded Exposure	Risk-weighted assets for Funded Exposures	Risk-weighted assets for Un-Funded Exposures	Total Risk Weighted Assets	Capital Charge (12.5%)
Murabaha	620,252	614,113	6,139	115,076	1,842	116,918	14,615
Ijara	109,616	109,616	-	18,046	-	18,046	2,256
Sukuk	520,314	520,314	-	41,709	-	41,709	5,214
Due from financial institution	3,081	3,081	-	924	-	924	115
Equity	1,481	1,481	-	444	-	444	55
LC	57,598	-	57,598	-	17,279	17,279	2,160
Other	418	418	-	125	-	125	16
Total	**1,312,759**	**1,249,023**	**63,737**	**176,324**	**19,121**	**195,445**	**24,431**

Monthly average gross exposures and the risk-weighted assets at 30 June 2020 were US$1,392,349 thousand and US$ 213,224 thousand respectively.

b. Capital requirement for market risk

The Group, with assistance from ABC, minimizes its market risk through:

(i) match-funding its assets to reduce its profit rate risk;
(ii) not taking commodity price risk by squaring position on transaction by transaction basis;

(iii) funding exposures in the same currency and, hence, avoiding any foreign exchange currency risk; and
(iv) maintaining no sukuk trading position.

Accordingly, the Group maintains no capital charge for market risk.

c. Capital requirement for operational risk

The Group applies the "Standardised Approach" for calculating its Pillar I operational risk capital. As at 30 June 2020, the total capital charge in respect of operational risk was USD 13.9 million. A breakdown of the operational risk capital charge is provided below:

US$ Thousands

Basel Business Line	Average 3 years gross income	Beta factors	Pillar I capital charge operational risk
Corporate finance	1,756	18 %	149
Trading & sales	4,174	18 %	1,375
Retail banking	-	12 %	-
Commercial banking	85,490	15 %	11,729
Payment & settlement	-	18 %	-
Agency services	43	15 %	11
Asset management	-	12 %	-
Retail brokerage	-	12 %	-
Total	**91,463**		**13,898**

Indicators of operational risk exposures:

Gross income *US$ thousands*	173,717
Amount of non-Shari'a compliant income *US$ thousands*	22
Number of Shari'a violations	Nil

d. Capital base

The Group's capital base comprises:
(i) Tier 1 capital: share capital, reserves, retained earnings, profit for the year and unrealized gains arising from fair valuing equities; and
(ii) Tier 2 capital: expected credit losses.

The issued and paid-up share capital of the bank is US$ 132.5 million at 30 June 2020, comprising 1.325 million shares of US$ 100 each.

The Group's capital base and risk weighted assets is summarised below:

Capital base and Risk weighted assets (RWA)	US$ million
Capital base	
CET 1	**279.0**
AT 1	**-**
Total Tier 1 capital	**279.0**
Tier 2	**9.0**
Total capital base	**288.0**
Risk weighted assets	
Credit risk	**718.8**

Market risk	**-**
Operational risk	**173.7**
Total Risk weighted assets	**892.5**
CET 1 ratio	**31.3%**
Tier 1 ratio	**31.3%**
Capital adequacy ratio	**32.3%**

5. Credit risk - Pillar III disclosures

a. Definition of exposure classes

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the standard portfolio approach under the CBB's Basel III Capital Adequacy Framework, covering the standardised approach for credit risk.

The principal descriptions of the counterparty classes, along with the risk weights to be used to derive the risk-weighted assets, are as follows:

I. Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain and other GCC sovereigns are risk-weighted at 0%. Claims on all other sovereigns are given a risk weighting of 0% where such claims are denominated and funded in the relevant domestic currency of that sovereign. Claims on sovereigns, other than those mentioned above, are risk-weighted based on their credit ratings.

II. Claims on public sector entities (PSEs)

Bahrain PSEs, as defined by the CBB rulebook, are assigned a 0% risk weighting. Other sovereign PSEs, where claims are denominated in the relevant domestic currency and for which the local regulator has assigned a risk weighting of 0%, are assigned a 0% risk weighting by the CBB. PSEs other than those mentioned above are risk-weighted based on their credit ratings.

III. Claims on multilateral development banks (MDBs)

All MDBs are risk-weighted in accordance with the banks' credit ratings, except for those members listed in the World Bank Group, which are risk-weighted at 0%.

IV. Claims on banks

Claims on banks are risk-weighted based on the ratings assigned to them by external rating agencies. However, short-term claims on locally incorporated banks are assigned a risk weighting of 20% where such claims on the banks are of original maturities of three months or less, and are denominated and funded in either Bahraini dinars or US dollars.

Preferential risk weights that are one category more favorable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain, with original maturities of three months or less and denominated and funded in the relevant domestic currency. Such preferential risk weights for short-term claims on banks licensed in other jurisdictions are allowed only if the relevant supervisor also allows this preferential risk weighting to short-term claims on its banks.

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation.

V. Claims on the corporate portfolio

Claims on the corporate portfolio are risk-weighted based on credit ratings. Risk weightings for unrated corporate claims are assigned at 100%.

VI. Past due exposures

The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), is risk-weighted as follows:

- 150% risk weighting when specific provisions are less than 20% of the outstanding amount of the loan; and
- 100% risk weighting when specific provisions are greater than 20% of the outstanding amount of the loan.

VII. Equity portfolios

Investments in listed equities are risk weighted at 100% while those in unlisted equities are risk weighted at 150%. Significant Investment in the common shares of unconsolidated financial institutions are risk weighted at 250% if lesser than the threshold as required by the CBB's Basel III capital adequacy framework.

VIII. Other exposures

These are risk weighted at 100%.

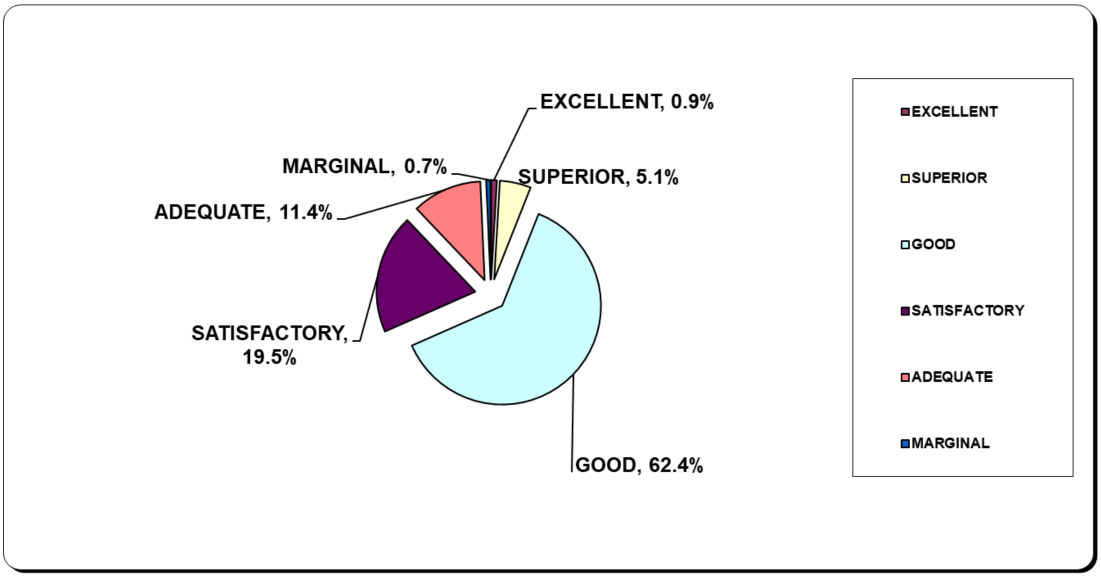
b. External rating agencies

The Group uses external ratings from Standard & Poor’s, Moody’s, Fitch Ratings and Capital Intelligence (accredited external credit assessment institutions). The breakdown of the Group’s exposure into rated and unrated categories is as follows:

	Self Finance			Financed by IAH		
US$ Thousands	**Gross credit exposure**	**Rated exposure**	**Unrated exposure**	**Gross credit exposure**	**Rated exposure**	**Unrated exposure**
Claims on Corporates	274,980	29,439	245,541	437,249	46,812	390,437
Claims on banks	541,165	512,749	28,416	482,298	437,113	45,185
Sovereigns	179,529	179,529	-	285,385	285,385	-
Claims on public sector entities	67,549	19,459	48,090	107,409	30,942	76,467
Other	263	-	263	418	-	418
Total	**1,063,486**	**741,176**	**322,310**	**1,312,759**	**800,252**	**512,507**

The Group has a policy of maintaining accurate and consistent risk methodologies. It uses a variety of financial analytics, combined with market information, to support risk ratings that form the main inputs for the measurement of counterparty credit risk. All internal ratings are tailored to the various categories, and are derived in accordance with the Group's credit policy. They are assessed and updated regularly. Each risk rating class is mapped to grades equivalent to Standard & Poor’s, Moody’s, Fitch and Capital Intelligence rating agencies.

The Group’s credit risk distribution (based on internal risk ratings) at 30 June 2020 is shown below.



c. Credit risk presentation under Basel III

The credit risk exposures detailed here differ from the credit risk exposures reported in the consolidated financial statements, due to different methodologies applied respectively under Basel III and International Financial Reporting Standards as well as AAOIFI. These differences are as follows:

- As per the CBB Basel III framework, off balance sheet exposures are converted into on balance sheet equivalents by applying a credit conversion factor (CCF). The CCF varies between 20%, 50% or 100% depending on the type of contingent item.
- The consolidated financial statements categorise financial assets based on asset class (i.e. securities, loans and advances, etc.). This section categorises financial assets into credit exposures as per the "Standard Portfolio" approach set out in the CBB's Basel III capital adequacy framework. In the case of exposures with eligible guarantees, it is reported based on the category of guarantor.
- Eligible collateral is taken into consideration in arriving at the net exposure under the Basel III framework, whereas collateral is not netted in the interim condensed consolidated financial statements.
- Under the Basel III framework, certain items are considered as a part of the regulatory capital base, whereas these items are netted off against assets in the interim condensed consolidated financial statements.

d. Credit exposure

Geographical distribution of exposures

The geographical distribution of exposures, impaired assets and the related impairment provisions can be analysed as follows:

US$ Thousands	**Self Finance**		**Financed by IAH**	
Country / Region	**Gross Exposure**	**Percentage of Exposure**	**Gross Exposure**	**Percentage of Exposure**
UAE	270,507	11.38%	430,135	18.10%
Bahrain	541,387	22.78%	482,567	20.31%
Saudi Arabia	159,683	6.72%	253,912	10.69%
Kuwait	47,536	2.00%	75,588	3.18%
Europe (Including Turkey)	21,946	0.92%	34,897	1.47%
Other Asia	13,641	0.57%	21,691	0.91%
Other MENA Countries	4,674	0.20%	7,431	0.31%
Oman	3,566	0.15%	5,670	0.24%
Qatar	546	0.02%	868	0.04%
Total	**1,063,486**	**44.75%**	**1,312,759**	**55.25%**

The geographical distribution of gross credit exposures by major type of credit exposures can be analysed as follows:

Self Finance

US$ Thousands **Type of Financing / Region**	**Bahrain**	**Saudi Arabia**	**Kuwait**	**Qatar**	**UAE**	**Oman**	**Other MENA countries**	**Other Asia**	**Europe (Including Turkey)**	**Total**
Sovereigns	50,956	-	-	-	107,137	-	-	13,641	7,795	**179,529**
Claims on public sector entities	64,954	-	1,363	-	-	1,232	-	-	-	**67,549**
Claims on banks	392,130	-	30,149	-	104,969	1,937	-	-	11,980	**541,165**
Claims on Corporates	33,084	159,683	16,024	546	58,401	397	4,674	-	2,171	**274,980**
Other	263	-	-	-	-	-	-	-	-	**263**
Total	**541,387**	**159,683**	**47,536**	**546**	**270,507**	**3,566**	**4,674**	**13,641**	**21,946**	**1,063,486**

Financed by IAH

US$ Thousands **Type of Financing / Region**	**Bahrain**	**Saudi Arabia**	**Kuwait**	**Qatar**	**UAE**	**Oman**	**Other MENA countries**	**Other Asia**	**Europe (Including Turkey)**	**Total**
Sovereigns	80,940	-	-	-	170,358	-	-	21,691	12,396	**285,385**
Claims on public sector entities	103,283	-	2,167	-	-	1,959	-	-	-	**107,409**
Claims on banks	245,317	-	47,939	-	166,913	3,081	-	-	19,048	**482,298**
Claims on Corporates	52,609	253,912	25,482	868	92,864	630	7,431	-	3,453	**437,249**
Other	418	-	-	-	-	-	-	-	-	**418**
Total	**482,567**	**253,912**	**75,588**	**868**	**430,135**	**5,670**	**7,431**	**21,691**	**34,897**	**1,312,759**

Industrial sector analysis of exposures

The industrial sector analysis of exposures is as follows:

	Self Finance			Financed by IAH		
US$ Thousands	Gross exposure	Funded exposure	Un-funded exposure	Gross exposure	Funded exposure	Un-funded exposure
Financial Institutions	563,322	563,322	-	517,531	517,531	-
Government	179,529	179,529	-	285,385	285,385	-
Other	75,623	62,663	12,960	120,249	99,642	20,607
Manufacturing	102,946	88,097	14,849	163,695	140,084	23,611
Trading	51,382	46,593	4,789	81,702	74,087	7,615
Transportation	43,705	43,143	562	69,496	68,603	893
Commercial real estate	9,652	9,652	-	15,349	15,349	-
Construction	5,317	2,444	2,873	8,453	3,885	4,568
Agriculture	5,294	2,281	3,013	8,418	3,627	4,791
Telecomm	26,716	25,678	1,038	42,481	40,830	1,651
Total	**1,063,486**	**1,023,402**	**40,084**	**1,312,759**	**1,249,023**	**63,736**

The industrial sector analysis of gross credit exposures by major types of credit exposures can be analysed as follows:

Self Finance

US$ Thousands

Type of Financing/Industry	Financial Institutions	Commercial Real Estate	Manu-facturing	Con-struction	Trading	Govern-ment	Trans-portation	Agriculture	Telecomm	Other	Total
Sovereigns	-	-	-	-	-	179,529	-	-	-	-	**179,529**
Claims on public sector entities	9,746	-	33,702	-	-	-	14,388	-	-	9,713	**67,549**
Claims on banks	541,165	-	-	-	-	-	-	-	-	-	**541,165**
Claims on Corporates	12,411	9,652	69,244	5,317	51,382	-	29,317	5,294	26,716	65,647	**274,980**
Other	-	-	-	-	-	-	-	-	-	263	**263**
Total	**563,322**	**9,652**	**102,946**	**5,316**	**51,382**	**179,529**	**43,705**	**5,294**	**26,716**	**75,623**	**1,063,486**

Financed by IAH

US$ Thousands

Type of Financing/Industry	Financial Institutions	Commercial Real Estate	Manu-facturing	Con-struction	Trading	Govern-ment	Trans-portation	Agriculture	Telecomm	Other	Total
Sovereigns	-	-	-	-	-	285,385	-	-	-	-	**285,385**
Claims on public sector entities	15,497	-	53,589	-	-	-	22,878	-	-	15,445	**107.409**
Claims on banks	482,298	-	-	-	-	-	-	-	-	-	**482,298**
Claims on Corporates	19,736	15,349	110,106	8,453	81,702	-	46,618	8,418	42,481	104,386	**437,249**
Other	-	-	-	-	-	-	-	-	-	418	**418**
Total	**517,531**	**15,349**	**163,695**	**8,453**	**81,702**	**285,385**	**69,496**	**8,418**	**42,481**	**120,249**	**1,312,759**

Maturity analysis of funded exposures

Residual contractual maturity of the Group's major types of funded credit exposures are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	5-10 years	Total over 12 months	Undated	Total
Sovereigns	-	-	-	5,014	5,014	224,465	235,382	459,847	53	464,914
Claims on public sector entities	-	62,424	5,572	6,644	74,640	34,926	65,392	100,318	-	174,958
Claims on banks	374,426	104,929	-	270,516	749,871	216,475	54,705	271,180	2,412	1,023,463
Claims on Corporates	226,652	167,531	68,902	59,346	522,431	72,563	13,415	85,978	-	608,409
Other	-	-	-	-	-	-	-	-	681	681
Total	**601,078**	**334,884**	**74,474**	**341,520**	**1,351,956**	**548,429**	**368,894**	**917,323**	**3,146**	**2,272,425**

Residual contractual maturity analysis of the Group's funded credit exposures per type of Islamic financing contract are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	5-10 years	Total over 12 months	Undated	Total
Murabaha	575,259	334,027	60,410	250,773	1,220,469	-	-	-	-	1,220,469
Sukuk	8,114	-	-	76,494	84,608	447,596	315,330	762,926	-	847,534
Due from financial institution	-	-	-	-	-	5,018	-	5,018	-	5,018
Equity	-	-	-	-	-	-	-	-	2,412	2,412
Other	17,705	-	-	-	17,705	-	-	-	734	18,439
Ijara	-	857	14,064	14,253	29,174	95,815	53,564	149,379	-	178,553
Total	**601,078**	**334,884**	**74,474**	**341,520**	**1,351,956**	**548,429**	**368,894**	**917,323**	**3,146**	**2,272,425**

61.4% of Group assets are financed by equity of IAH, while 38.6% are self financed.

Maturity analysis of unfunded exposures

In accordance with the calculation of credit risk-weighted assets in the CBB's Basel III capital adequacy framework, unfunded exposures are divided into the following exposure types:

(i) **Credit-related contingent items** comprising letters of credit, acceptances, guarantees and commitments.

(ii) **Derivatives** including tabdeel, wa'ad in the profit rate, foreign exchange, equity and credit markets.

The residual contractual maturity analysis of unfunded exposures is as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	Total Over 12 months	Total
Claims on Corporates	20,533	7,083	25,661	19,071	72,348	31,472	31,472	103,820
Total	**20,533**	**7,083**	**25,661**	**19,071**	**72,348**	**31,472**	**31,472**	**103,820**

Residual contractual maturity analysis of the Group's unfunded credit exposures per type of Islamic financing contract are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	Total over 12 months	Total
Murabaha	-	-	-	10,000	10,000	-	-	10,000
LC	20,533	7,083	25,661	9,071	62,348	31,472	31,472	93,820
Total	**20,533**	**7,083**	**25,661**	**19,071**	**72,348**	**31,472**	**31,472**	**103,820**

e. Funding category

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	Undated	Total
Murabaha payables	691,368	861,377	142,415	250,674	1,945,834	-	1,945,834
Equity	-	-	-	-	-	279,216	279,216
Total	**691,368**	**861,377**	**142,415**	**250,674**	**1,945,834**	**279,216**	**2,225,050**

f. Impaired assets and provisions for impairment

The Group has established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition of an asset by considering the change in the risk of default occurring over the remaining life of the financial instrument. If such evidence exists, the assets are moved to the respective "Stages" mentioned above and appropriate ECLs recognised.

Financial assets whose terms have been renegotiated

Carrying amount of financial assets whose terms have been renegotiated as at 30 June 2020 was US$54,981.

6. Equity of Investment Accountholders

a. Treatment of assets financed by Equity of Investment Accountholders

The following table summarises the treatment of assets financed by IAH in the calculation of risk weighted assets (RWA) for capital adequacy purposes as of 30 June 2020:

US$ Thousands	RWA	RWA for capital adequacy purposes	Capital charges
Sovereigns	23,241	6,972	872
Claims on public sector entities	4,126	1,238	155
Claims on banks	176,006	52,802	6,600
Claims on Corporates	447,693	134,308	16,788
Other	418	125	16
Total	**651,485**	**195,445**	**24,431**

b. Equity of Investment Accountholders by Islamic financing product type

The following table summarises the percentage financing supported by IAH for each type of contract:

Murabaha	49.2%
Ijara	8.8%
Sukuk	41.7%
Due from financial institution	0.2%

c. Equity of Investment Accountholders profit earned and paid

	Amount	%
Profit earned	23,746	61.4%
Profit paid	13,143	84.8%

d. Equity of Investment Accountholders by Counterparty Type

The following table summarises the percentage of equity of investment accountholders for each category of counterparty to total equity

Banks	99.8%
Corporates	0.2%

7. Off balance sheet exposure and securitisations

a. Credit related contingent items

As mentioned previously, for credit-related contingent items the nominal value is converted to an exposure through the application of a credit conversion factor (CCF). The CCF is set at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off-statement of financial position notional amounts into an equivalent on-statement of financial position exposure.

Undrawn loans and other commitments represent commitments that have not been drawn down or utilised at the reporting date. The nominal amount is the base upon which a CCF is applied for calculating the exposure. The CCF ranges between 20% and 50% for commitments with original maturities of up to one year and over one year respectively. The CCF is 0% for commitments that can be unconditionally cancelled at any time.

The table below summarises the notional principal amounts and the relative exposure before the application of credit risk mitigation:

US$ thousands	**Notional principal**	**Credit exposure***
Short-term self-liquidated trade-related contingent items	12,140	2,428
Transaction-related contingent items	128,082	64,387
Direct credit substitute, guarantee and acceptances	27,005	27,005
Undrawn facilities and other commitments	20,000	10,000
RWA for contingent items		**103,820**

* Credit exposure is after applying CCF.

b. Derivatives

Most of the Group's derivative trading activities relate to sales, positioning and arbitrage. Sales activities involve offering products to customers. Positioning involves managing market risk positions with the expectation of profiting from favourable movements in prices, rates or indices.

The Group uses forward foreign exchange contracts, currency options and currency swaps to hedge against specifically identified currency risks. Additionally, the Group uses profit rate swaps and profit rate futures to hedge against the profit rate risk arising from specifically identified financing and securities bearing fixed profit rates.

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations, and is limited to the positive fair value of instruments that are favourable to the Group. The majority of the Group's derivative contracts are entered into with other financial institutions, and there was no significant concentration of credit risk in respect of contracts with positive fair value with any individual counterparty as at 30 June 2019.

c. Counterparty credit risk

Counterparty credit risk (CCR) is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity or credit markets defaults prior to the maturity of the contract.

The counterparty credit risk for derivatives is subject to credit limits on the same basis as other credit exposures. Counterparty credit risk arises in both the trading book and the banking book exposures.

In accordance with the credit risk framework in the CBB's Basel III capital adequacy framework, the Group uses the current exposure method to calculate counterparty credit risk exposure of derivatives. Counterparty credit exposure is defined as the sum of replacement cost and potential future exposure. The potential future exposure is an estimate that reflects possible changes in the market value of the individual contract, and is measured as the notional principal amount multiplied by an add-on factor.

In addition to the default risk capital charge for CCR, the Group also holds capital to cover the risk of mark-to-market losses on the expected counterparty risk arising out of over-the-counter derivative transactions, namely a Credit Valuation Adjustment (CVA). The Standardised CVA Risk Capital Charge, as prescribed under CBB's Basel III guidelines, is employed for the purpose. As of 30th June 2020 the CVA capital charge for the portfolio was US$ 8.1 million.

8. Capital management

Our strategy and objectives underpin our capital management framework which is designed to maintain sufficient levels of capital to support our organic and inorganic business plans, and to withstand extreme but plausible stress conditions. The capital management objective aims to maintain an optimal capital structure to enhance shareholder's returns while operating within the Group's risk appetite limits and comply with regulatory requirements at all times.

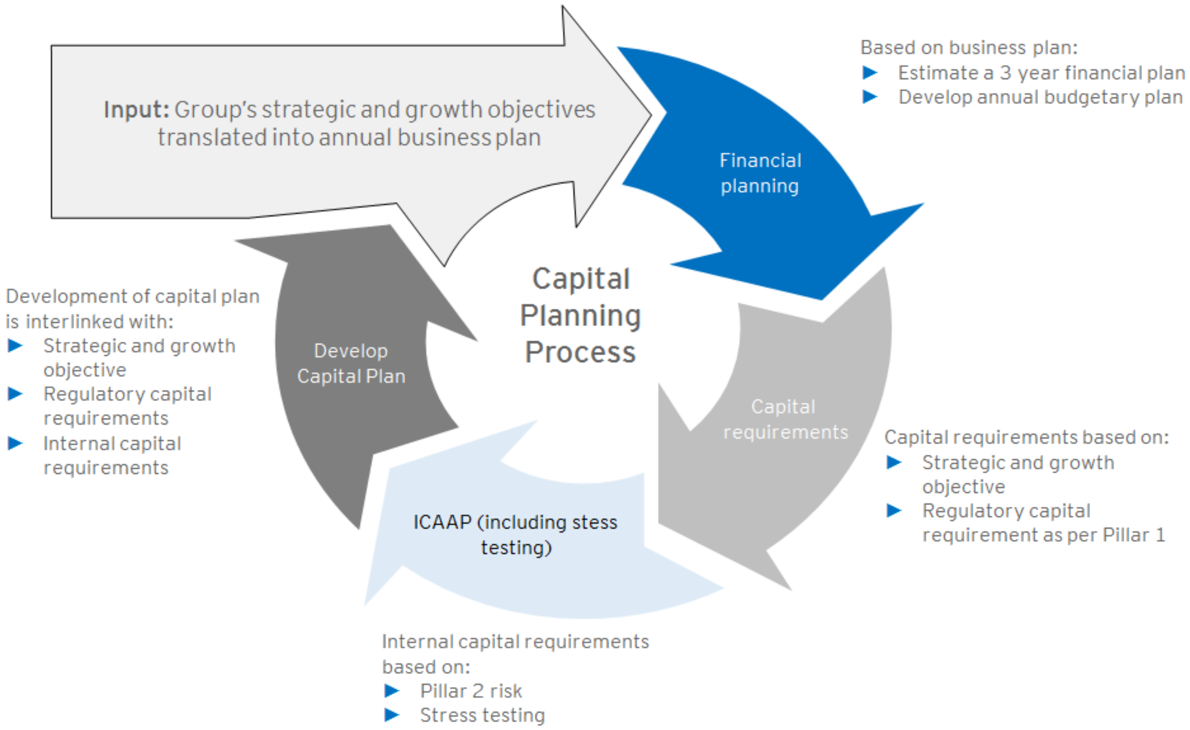
Our approach to capital management is driven by our strategic objectives, considering the regulatory, economic and business environment in our major markets. It is our objective to maintain a strong capital base to support the risks inherent in our businesses and markets, meeting both local and consolidated regulatory capital requirements at all times.

a. Internal Capital Adequacy Assessment Process (ICAAP)

Our capital management approach is supported by a Capital Management Framework and the Internal Capital Adequacy Assessment Process ('ICAAP'), which enables us to manage our capital in a proactive and consistent manner. The framework incorporates a variety of approaches to assess capital requirements for different kinds of risks and is evaluated on an economic and regulatory capital basis. The ABC Group's ICAAP is designed to:

- Inform the Board of the ongoing assessment of the Bank's risks, and how the Bank intends to mitigate those risks. It also evaluates the current and future capital requirements that is necessary having considered other mitigating factors;
- Ensure that the Bank's capital position remains adequate in the event of an extreme but plausible global and regional economic stress conditions;
- Demonstrate that the Bank establishes and applies a strong and encompassing governance framework in addition to a robust risk and capital management, planning and forecasting process; and

- Provide a forward-looking view, in relation to solvency on the Bank's risk profile to ensure that it is in line with the Board's Risk Appetite limits.



The ICAAP allocates internal capital for each of these material sources of risks and assesses the overall capital requirements for Pillar 1 and Pillar 2 Risks. Our assessment of capital adequacy is aligned to our assessment of risks. These include credit, market, operational, pensions, structural foreign exchange risk, residual risks and interest rate risk in the banking book.

In addition to the assessment of capital requirements for Credit, Market and Operational Risks under Pillar 1 of the regulatory capital framework, the Group assesses capital requirements for risks not covered in Pillar 1 under Pillar 2A and for stress events under Pillar 2B.

Pillar 2A Risks

The Pillar 2A measurement framework for the key risk categories is summarized below:

Material Sources of Risk (Pillar 2A)	Methodology
Credit Risk	Additional capital required for credit risk under ICAAP based on the Foundation Internal Ratings based approach
Concentration Risk Name Concentration Sector Concentration Geographic Concentration	Capital requirements assessed for Name, Sector and Geographic concentration risks using the HHI approach
Counterparty Credit Risk	No capital add-on under ICAAP as Pillar 1 is assessed to be sufficient

Material Sources of Risk (Pillar 2A)	Methodology
Market Risk	The Group uses the 'Historical Simulation Approach' to measure VaR. The key model assumptions for the trading portfolio are: 2-year historical simulation 1-year VaR 99% (one tail) confidence interval This is further augmented by a stress analysis under Pillar 2B. Pillar 1 capital requirement was deemed sufficient for Market Risk.
Operational Risk Conduct Risk Non Conduct Risk	Based on peak historical losses over a five year period.
Liquidity and Funding Risk	Liquidity as funding risk is covered under ILAAP and sufficient Liquid Asset Buffers (LAB) held to address this risk
Interest Rate Risk in the Banking Book (IRRBB)	Capital requirements assessed based on Basel IRRBB 2016 guidelines (BCBS 368)
Pension Obligation Risk	Capital requirements assessed based on an actuarial assessment of pension fund obligations by computing the gap between the present value of all defined pension obligations and the value of the pension fund scheme assets which is complemented with a stressed assessment using a set of stress scenarios
Strategic Risk	Regular review of strategy in view of the changing technology, regulatory and business landscape
Reputational Risk	Robust governance and management framework with significant involvement of senior management to proactively address any risk(s) to the Group's reputation

Pillar 2B - Stress Testing
Pillar 2B represents capital requirements to be assessed through Stress Testing and Scenario Analysis. Stress testing alerts the Bank's management to adverse unexpected outcomes related to a variety of risks and provides an indication of how much capital might be needed to absorb losses should large shocks occur. A summary of the approach followed for stress testing is as follows:
The ICAAP considers 2 scenarios (mild and deep recession) which are described through a series of events and these are translated into equivalent macro-economic variables under Stressed economic conditions. The stress scenarios draws upon the Moody's predefined scenarios (Data buffet).

The Moody's model takes into account exogenous, endogenous and other factors to generate macro-economic scenario for each country which translate to Z score and stress PD.

In addition to this, management overlay of minimum 1-in-7 floor for mild stress and 1-in-25 for deep recession has been applied for 2019. Further, single name defaults were applied to ensure that the model has sufficient severity to stress the portfolio. The Stress scenarios are translated into equivalent macro-economic variables under Stressed economic conditions over a three-year horizon.

The degree of stress on Risk Factors (e.g. Probability of Default) have been calibrated through normalised stresses of varying severity levels (e.g. 1 in 4, 1 in 7, 1 in 10, 1 in 15 or 1 in 25 type event) on a given Transition Matrix for the respective years and all Rating PDs are updated and estimated based on new Master scale

Expected Loss (for defaulted and non-defaulted assets) was computed, compared and adjusted with the accounting provisions in the baseline projections to determine impact of loan impairments for base year. Impact on capital of the above is assessed and suitable management actions were identified to mitigate the impact of stress while making overall capital adequacy assessments.

Based on the ICAAP assessment, the Group maintains adequate levels of capital buffers to meet its business growth over the planning horizon and withstand extreme but plausible stress.

Annual Planning Cycle

Our annual budget results in a RWA requirements to support the growth plans and assesses the availability of Capital and this is approved by the Board. Regular forecasts of RWA and Capital resources are reviewed and the capital ratios are monitored against these forecasts.

Capital Allocation

The responsibility for ABC Group's capital allocation principles rests with the Group's Management Committee. The capital allocation disciplines are enforced through the ABC Group Balance Sheet Management function that operates under the directions of the ABC Group Chief Financial Officer. Through our internal governance processes, we seek to maintain discipline over our investment and capital allocation decisions, and seek to ensure that returns on capital meet the Group's management objectives. The ABC Group strategy is to allocate capital to businesses and entities to support growth objectives where above hurdle returns have been identified based on their regulatory and economic capital needs.

We manage business returns with a Risk Adjusted Return on Capital (**RAROC**) measure that has been further enhanced and embedded during the year.

9. Material transactions

Transactions requiring approval by the Board include large credit transactions, related party transactions and any other significant strategic, investment or major funding decisions in accordance with Board approved policies and procedures.

10. Other Disclosures

10.1 Related party transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's senior management, and are based on arm's length rationale.

a. Exposures to related-parties

US$ thousands

Claims on shareholders	546,243
Claims on Directors and senior management	316
Claims on staff	255

b. Liabilities to related parties

US$ thousands

Connected deposits	1,623,410
Other liabilities	71,050

c. Income and expenses arising from dealing with related parties

US$ thousands	
Income from Murabaha receivables	1,338
Profit on Murabaha payables	73
Return on equity of investment account holders	13,133
Charges by ABC (B.S.C.)	350
Board of Directors	69
Shari'a Supervisory Board	60

10.2 Ageing analysis of non-performing / impaired Islamic financing and securities

In accordance with the guidelines issued by the CBB, credit facilities are placed on non-accrual status and profit suspended when either principal or profit is overdue by 90 days, whereupon profit credited to income is reversed. Following an assessment of impairment, specific provision is established if there is objective evidence that a credit facility is impaired.

An ageing analysis of all non-performing Islamic financing facilities on non-accrual basis, together with their related provisions, is as follows:

Islamic financing

US$ thousands

Ageing	Principal	Provisions	Net book value
Nil	Nil	Nil	Nil

Securities

US$ thousands

Ageing	Principal	Provisions	Net book value
3 months to 1 years	15,000	7,936	7,064
Over 3 years	8,500	8,500	-

The Group has specific impairment provisions of US$ 16,436 thousand on its securities, all of the securities are from GCC countries.

10.3 Restructured assets

As at 30 June 2020, Carrying amount of financial assets whose terms have been renegotiated as at period end was US$ 54,981 thousand.

10.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the period ended 30 June 2020.

10.5 Movement in specific and collective impairment provisions

US$ thousands	Specific provision for securities
As at 1 January 2020	8,500
Additional during the year	7,936
As at 30 June 2020	**16,436**

10.6 Industry sector analysis of the specific impairment provisions charges

Impairment of US$ 8,500 thousand in the trading sector and US$ 7,936 thousand in health care services.

10.7 Equity positions in the banking book

As at 30 June 2020, the equity position of the Group amounted to US$ 2,412 thousand, all of which is quoted.

US$ thousands	
Gross unrealized gains recognized in the statement of financial position	868
Unrealized gains included in Tier 1 capital	868

10.8 Penalties imposed on customers

Penalties imposed on customers during the year were US$ 22 thousand. This amount represents penalty fees received from customers for making late payments. Such amounts are disposed of to charitable causes.

10.9 Quantitative indicators of financial performance and position

	June 2020 *	Dec 2019	Dec 2018	Dec 2017
Return on average equity	9.1%	10.4%	9.4%	7.9%
Return on average assets	1.4%	2.0%	1.9%	1.6%

* *Annualised*