



PUBLIC DISCLOSURES
30 June 2015

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1. Introduction

ABC Islamic Bank and its subsidiary (the Group), being an integral part of Arab Banking Corporation Group (ABC), complies with the Central Bank of Bahrain (CBB) reporting requirements, within the Basel III risk management framework implemented on 1 January 2015.

This document gathers together all the elements of the disclosures required under Pillar III, which are not covered in the interim condensed consolidated financial statements for the period ended 30 June 2015, and is organized as follows:

Firstly, it gives an overview of the approach taken by ABC Islamic Bank (E.C.) [the Bank] to Pillar I and provides the profile of the risk-weighted assets according to the “standard portfolio” as defined by the Central Bank of Bahrain [the CBB].

Secondly, an overview of risk management practices and framework at the Bank is presented with specific emphasis on credit, market and operational risks and the related monitoring processes and credit mitigation initiatives are set out.

Finally, this document provides all other disclosures required under the Public Disclosure Requirements Module of the CBB.

The disclosures are in addition to the interim condensed consolidated financial statements and are presented in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI] and the relevant provisions of the CBB and Financial Institutions Law. For matters which are not covered by AAOIFI standards, the Bank and its subsidiary [together the Group] uses the International Financial Reporting Standards [IFRS]. However, the credit risk exposures detailed here differ from the credit risk exposures reported in the interim condensed consolidated financial statements due to different methodologies applied respectively under Basel III and AAOIFI, primarily on account of the following:

- Under the Basel III framework, 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 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 statement of financial position exposure. In the interim condensed consolidated financial statements, the nominal values of credit-related contingent items are considered off-statement of financial position.
- Under the risk management section, the credit exposures are classified as per the ‘Standard Portfolio’ approach set out in the CBB’s Basel III capital adequacy framework covering the ‘Standardised Approach’ for credit risk. In the case of guaranteed exposures, the exposures would normally be reported based on the guarantor. However, in the consolidated financial statements the assets are presented based on asset class (i.e Islamic financing facilities, securities, etc.)
- 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 part of the regulatory capital base, whereas these items are netted off against assets in the interim condensed consolidated financial statements.

2. Group structure

The Bank 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’ah].

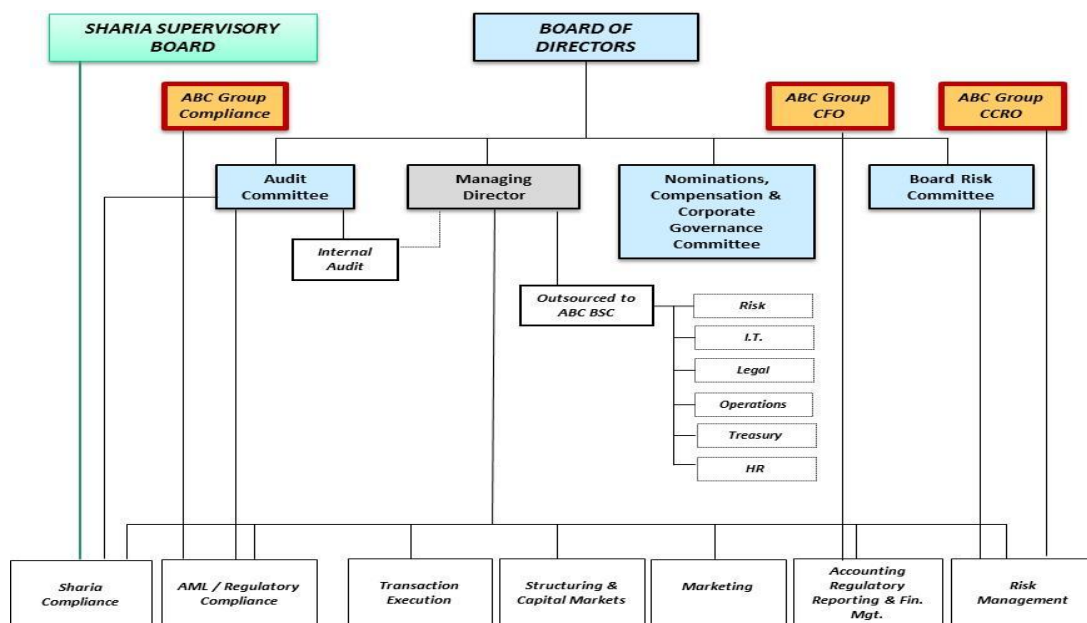
Arab Banking Corporation B.S.C. [ABC], which operates under a wholesale banking licence issued by the CBB, holds 100% of the share capital of the Bank.

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

The ownership in the subsidiary as at 30 June 2015 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 BOD, Audit Committee, 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 fixed annual remuneration and related expenses, 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.

3. 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\$6 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.

4. Capital structure

The issued and paid-up share capital of the Bank was US\$ 132.5 million at 30 June 2015, comprising of 1,325,000 shares of US\$ 100 each.

Breakdown of capital base

<i>US\$ million</i>	Tier 1	Tier 2	Total
Issued and fully paid ordinary shares	132.5	-	132.5
Legal / statutory reserves	17.6	-	17.6
Retained profit brought forward	112.8	-	112.8
Profit for the period	10.9	-	10.9
Unrealized gains arising from fair valuing equities	0.6	-	0.6
Capital base	274.4	-	274.4
Risk weighted assets [RWA]			
Credit risk			1,150.8
Market risk			-
Operational risk			113.2
			1,264.0
Tier 1 ratio			21.7%
Capital adequacy ratio			21.7%

5. Capital adequacy ratio [CAR]

The purpose of capital management at the Group is to ensure the efficient utilisation of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations. 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 issue capital / Tier 2 securities and / or adjust the amount of dividend payment to shareholders. No changes have been made in the objectives, policies and processes from the previous years.

The Group's total capital adequacy ratio as at 30 June 2015 was 21.7% compared with the minimum regulatory requirement of 12.5%. The Tier 1 ratio was 21.7% for the Group. The Group ensures adherence to the CBB's requirements by monitoring its capital adequacy against higher internal limits.

6. Profile of risk-weighted assets and capital charge

The Group has adopted the standardised approach for credit, market and operational risks for regulatory reporting purposes. The Group's risk-weighted capital requirements for credit, market and operational risks are given below:

6.1 Credit risk

i) Definition of exposure classes per Standard Portfolio

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard Portfolio approach mentioned under the CBB's Basel III capital adequacy framework covering the standardised approach for credit risk.

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

a. Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain and 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 the aforementioned, are risk-weighted based on their credit ratings.

b. Claims on public sector entities [PSEs]

Listed Bahrain PSEs are assigned 0% risk weight. Other sovereign PSEs, in the relevant domestic currency and for which the local regulator has assigned risk weight as 0%, are assigned 0% risk weight by the CBB. PSEs other than the aforementioned are risk-weighted based on their credit ratings.

c. Claims on multilateral development banks [MDBs]

All MDBs are risk-weighted in accordance with their credit rating, except for banks part of the World Bank Group which is risk-weighted at 0%.

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d. 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 may be assigned a risk weighting of 20% where such claims on the banks are of an original maturity of three months or less and the claims are denominated and funded in either Bahraini Dinars or US Dollars.

Preferential risk weights that are one category more favourable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain of an original maturity of three months or less 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.

e. Claims on corporates

Claims on corporates are risk-weighted based on credit ratings. Risk weights for unrated corporate claims are assigned at 100%.

f. Past due exposures

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

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the facility.
- 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the facility.

g. Equity portfolios

Investments in listed equities are risk-weighted at 100% while unlisted equities are risk weighted at 150%.

h. Project finance exposures

Exposures on project finance are risk-weighted according to the Regulatory Slotting Criteria, in which the risk weighting ranges between 70% and 250%.

i. Other exposures

These are risk-weighted at 100%.

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ii) Credit exposure and risk-weighted assets

<i>US\$ Thousands</i>	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	271,308	268,339	2,969	84,226	2,969	87,195	10,899
Claims on public sector entities	16,309	16,309	-	16,309	-	16,309	2,039
Claims on banks	525,853	525,546	307	322,870	-	322,870	40,359
Claims on corporates	669,111	629,531	39,580	566,291	39,580	605,871	75,734
Past due exposures	33,460	33,460	-	16,730	-	16,730	2,091
Project finance	141,896	141,896	-	99,327	-	99,327	12,416
Other	2,494	2,494	-	2,494	-	2,494	312
Total	1,660,431	1,617,575	42,856	1,108,247	42,549	1,150,796	143,850

Since the period end position is representative of the risk positions of the Group during the year, average gross exposures are not disclosed separately.

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

<i>US\$ Thousands</i>	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	900,476	870,210	30,266	770,670	30,266	800,936	100,118
Ijara	280,967	280,967	-	143,049	-	143,049	17,881
Ijara Rec	609	609	-	409	-	409	51
Sukuk	386,368	386,368	-	170,136	-	170,136	21,267
Due from financial institution	60,003	60,003	-	12,001	-	12,001	1,500
Equity	2,106	2,106	-	2,106	-	2,106	263
LC	12,590	-	12,590	-	12,283	12,283	1,535
Other	17,312	17,312	-	9,876	-	9,876	1,235
Total	1,660,431	1,617,575	42,856	1,108,247	42,549	1,150,796	143,850

6.2 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.

6.3 Operational risk

In accordance with the standardised methodology, the risk weight with respect to operational risk is US\$ 113.2 million, with minimum capital requirement of US\$ 14.1 million (at 12.5%). This capital charge was computed by categorising the Group's activities into two business lines (out of the eight business lines defined by the Basel III framework) and multiplying the business line's three-year average gross income by a pre-defined beta factor.

Indicators of operational risk exposures:

Gross income <i>US\$ thousands</i>	113,181
Amount of non-Shari'a compliant income <i>US\$ thousands</i>	6
Number of Shari'a violations	Nil

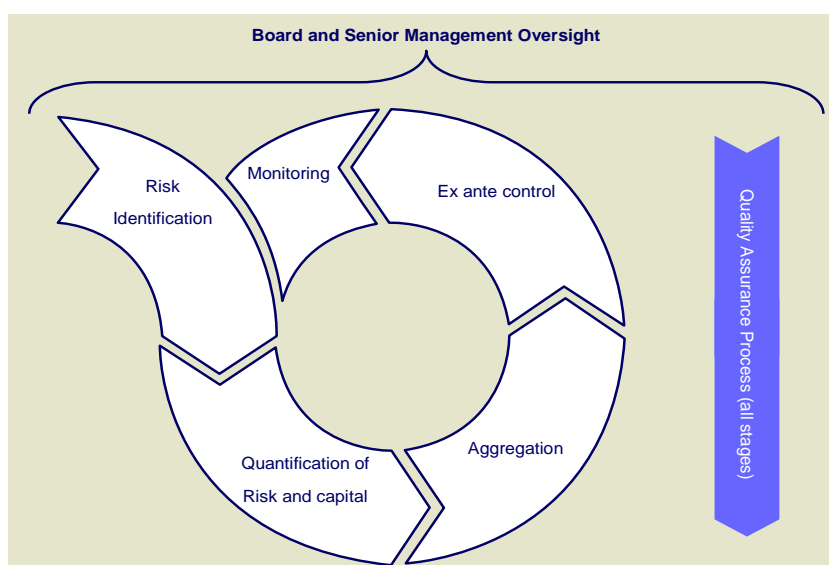
7. Risk management

7.1 Introduction

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

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

Figure 1:



7.2 Risk management structure

The Board Risk Committee (BRC) sets ABC's Risk Strategy/Appetite and Policy Guidelines. Executive Management is responsible for their implementation.

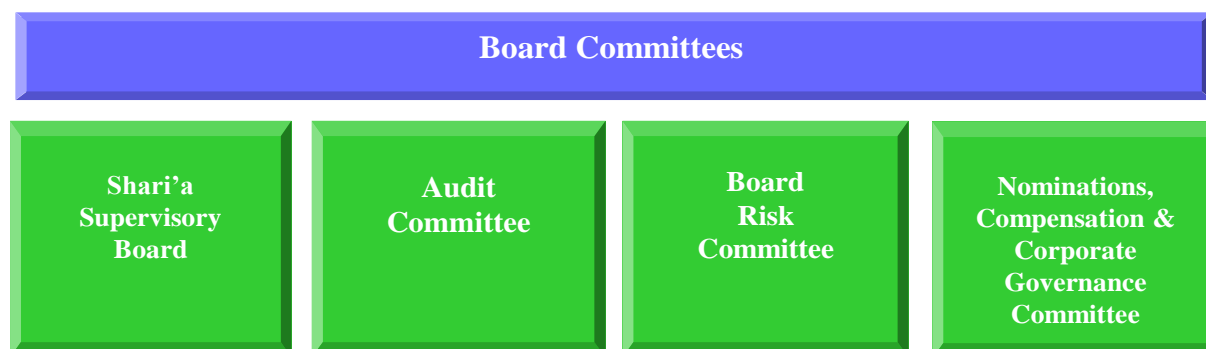
Figure 2: Risk management structure



Within the broader governance infrastructure, the Board Committees carry the main responsibility of best practice management and risk oversight. At this level, the BRC oversees the definition of risk appetite, risk tolerance standards and risk process standards to be kept in place. The BRC is also responsible for co-ordinating with other Board Committees for monitoring compliance with the requirements of the regulatory authorities in the various countries in which ABC operates.

The **Head Office Credit Committee [HOCC]** is responsible for credit decisions at the higher levels of ABC's wholesale and retail lending portfolio, setting country and other high level ABC limits, dealing with impaired assets, provisioning and general credit policy matters.

In addition to being part of the above structure, through the outsourcing of the support functions including the credit approval, the Group has the following risk management structure:



ABC's **Asset and Liability Committee (ALCO)** is responsible for defining long-term strategic plans and policy, as well as short-term tactical initiatives for prudently directing asset and liability allocation. ALCO monitors ABC's liquidity and market risks, and the risk profile, in the context of economic developments and market fluctuations. ALCO is assisted by tactical sub-committees for Capital & Liquidity Management; Investments; Structural FX.

ABC's **Operational Risk Management Committee (ORCO)** is responsible for defining long-term strategic plans and short-term tactical initiatives for the identification, prudent management, control and measurement of ABC's exposure to operational risk and other non-financial risks. ORCO frames policy and oversees the operational risk function. Specialist risk committees, such as the ABC Group Compliance Oversight Committee, the ABC Group Business Continuity Committee and the ABC Group IT Risk Committee are responsible for the proper management of certain categories of non-financial risk.

The **Credit & Risk Group (CRG)** is 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 ABC's activities, recommending to the relevant central committees appropriate policies and procedures for managing exposure.

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.

PUBLIC DISCLOSURES**30 June 2015****Credit risk**

ABC's portfolio and credit exposures are managed in accordance with the Group Credit Policy, which applies ABC Group-wide qualitative and quantitative guidelines, with particular emphasis on avoiding undue concentrations or aggregations of risk. ABC'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.

The first level of protection against undue credit risk is through ABC's counterparty, country, industry and other risk threshold limits, together with customer and customer group credit limits. The BRC and the HOCC sets these limits and allocates them between ABC and its banking subsidiaries. A tiered hierarchy of delegated approval authorities, based on the risk rating of the customer under ABC's internal credit rating system, controls credit exposure to individual customers or customer groups.

Credit limits are prudent, and ABC uses standard mitigation and credit control technologies.

ABC employs a Risk-Adjusted Return on Capital (RAROC) measure to evaluate risk/reward at the transaction approval stage. This is aggregated for each business segment and business unit, and for ABC as a whole. It is upgraded when appropriate.

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. ABC Group Audit, meanwhile, carries out separate risk asset reviews of business units, to provide an independent opinion on the quality of their credit exposures, and adherence to credit policies and procedures. These measures, collectively, constitute the main lines of defence against undue risk for ABC.

ABC remains committed to developing the credit skills of its entire staff involved in the credit process within the Bank. To this end in late 2012, a training initiative was launched as a means of both enhancing and unifying credit standards across ABC. The new initiative, entitled Credit Culture Transformation or "CCT@ABC", harnesses the expertise of Moody's Analytics to deliver a broad bespoke training programme, ranging from corporate analysis through to the structuring skills required to preserve the quality of the Bank's asset book. In 2014, several training sessions were organised across the Group as part of this program and it is intended that further topics will be added to the training programme as it is developed going forward.

Credit exposures that have significantly deteriorated are segregated and supervised more actively by the CRG's Remedial Loans Unit (RLU). Subject to minimum loan loss provision levels mandated under the 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, which complies with IAS 39 reporting. Collective impairment provision is also maintained to cover unidentified possible future losses.

As at 30 June 2015, the Group's three largest exposures in excess of 15% of the capital base are shown below:

<i>US\$ Thousands</i>	On and off- Balance Sheet Exposure
Counterparty [A]	100,226
Counterparty [B]	60,491
Counterparty [C]	60,003

Excessive risk concentration

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.

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

Single name concentrations are monitored on an individual basis. ABC's internal economic capital methodology for credit risk addresses concentration risk through the application of single-name concentration add-on. Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties exceeding 15 percent of the regulatory capital base. This restriction applies only at the consolidated level of the ABC Group and, hence, the Bank has several exposures that exceed 15% of its capital base. However, none of these exposures exceed 15% of ABC's capital base.

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, guarantees from banks and guarantees from ABC.

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:

<i>US\$ thousands</i>	Exposures	Guaranteed	Collateral*	Net exposure
Funded Exposures (Murabaha)	33,460	33,460	3,642	29,818
Funded Exposures (Sukuk)	1,500	1,500	-	1,500
Unfunded Exposures (LC)	44,805	-	1,533	43,272

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

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The Bank's nature of business, being an Islamic bank, results in concentration of exposures in the Muslim world. Moreover, the Bank's approved concentration of activities, which is also in line with its role within the ABC Group, has large concentration in the GCC countries, as illustrated in the table below:

<i>US\$ Thousands</i>		
Country / Region	Gross exposure	Percentage of exposure
Saudi Arabia	623,223	37.53%
UAE	432,269	26.03%
Europe (Including Turkey)	231,463	13.94%
Bahrain	157,355	9.48%
Other MENA Countries	76,160	4.59%
Qatar	71,875	4.33%
Other Asia	32,384	1.95%
Kuwait	21,216	1.28%
Oman	14,486	0.87%
Total	1,660,431	100.00%

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

<i>US\$ Thousands</i>										
Type of Financing / Region	Bahrain	Saudi Arabia	Kuwait	Qatar	UAE	Oman	Other MENA countries	Other Asia	Europe (Including Turkey)	Total
Sovereigns	53	-	-	-	163,662	-	49,475	32,384	25,734	271,308
Claims on public sector entity	-	-	-	-	-	-	16,309	-	-	16,309
Claims on banks	121,870	-	-	35,214	193,864	-	307	-	174,598	525,853
Claims on Corporates	28,869	495,521	2,691	26,087	74,743	-	10,069	-	31,131	669,111
Past due exposures	4,069	29,391	-	-	-	-	-	-	-	33,460
Project finance	-	98,311	18,525	10,574	-	14,486	-	-	-	141,896
Other	2,494	-	-	-	-	-	-	-	-	2,494
Total	157,355	623,223	21,216	71,875	432,269	14,486	76,160	32,384	231,463	1,660,431

7.4 Industrial sector analysis of the exposures

The industrial sector analysis of exposures is as follows:

<i>US\$ Thousands</i>			
	Gross exposure	Funded exposure	Un funded exposure
Financial Institutions	638,611	638,304	307
Government	287,617	284,648	2,969
Manufacturing	246,260	232,369	13,891
Trading	227,900	221,950	5,950
Commercial Real Estate	104,216	104,216	-
Construction	67,242	47,503	19,739
Transportation	48,433	48,433	-
Other	25,452	25,452	-
Mining & Quarrying	14,700	14,700	-
Total	1,660,431	1,617,575	42,856

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

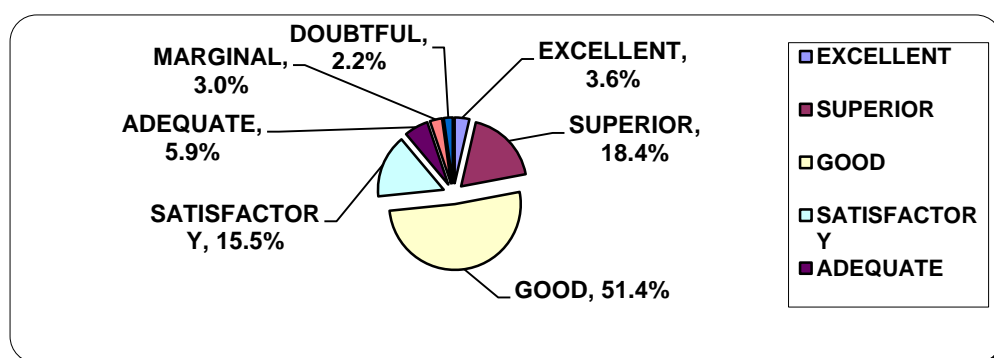
<i>US\$ Thousands</i>										
<i>Type of Financing/Industry</i>	Financial Institutions	Commercial real estate	Manu- facturing	Con- struction	Trading	Govern- ment	Trans- portation	Mining & Quarrying	Other	Total
Sovereigns	-	-	-	-	-	271,308	-	-	-	271,308
Claims on public sector entity	-	-	-	-	-	16,309	-	-	-	16,309
Claims on banks	524,353	-	-	-	1,500	-	-	-	-	525,853
Claims on Corporates	110,189	104,216	119,064	67,242	197,009	-	48,433	-	22,958	669,111
Past due exposures	4,069	-	-	-	29,391	-	-	-	-	33,460
Project finance	-	-	127,196	-	-	-	-	14,700	-	141,896
Other	-	-	-	-	-	-	-	-	2,494	2,494
Total	638,611	104,216	246,260	67,242	227,900	287,617	48,433	14,700	25,452	1,660,431

7.5 Exposure by external credit rating

The Group uses external ratings from Standard & Poor’s, Moody’s, Fitch Ratings and Capital Intelligence [accredited External Credit Assessment Institutions (ECAI’s)]. The breakdown of the Group’s exposure into rated and unrated categories is as follows:

<i>US\$ Thousands</i>	Gross credit exposure	Rated exposure	Unrated exposure
Claims on Corporates	669,111	117,755	551,356
Claims on banks	525,853	524,046	1,807
Project finance	141,896	-	141,896
Sovereigns	271,308	204,511	66,797
Past due exposures	33,460	-	33,460
Claims on public sector entity	16,309	-	16,309
Other	2,494	-	2,494
Total	1,660,431	846,312	814,119

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 rating and Capital Intelligence agencies.



Percentages have been calculated internally based on the sum of funded counterparty exposure and unfunded exposures before applying credit conversion factors.

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

<i>US\$ Thousands</i>	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	5-10 years	Over 20 years	Total over 12 months	Undated	Total
Sovereigns	-	1,057	21,633	47,614	70,304	119,484	78,498	-	197,982	53	268,339
Claims on public sector entity	-	-	9,282	7,027	16,309	-	-	-	-	-	16,309
Claims on banks	115,419	-	21,821	-	137,240	383,163	1,537	-	384,700	3,606	525,546
Claims on Corporates	138,385	130,915	173,658	65,693	508,651	95,927	24,953	-	120,880	-	629,531
Past due exposures	-	-	-	-	-	-	-	33,460	33,460	-	33,460
Project finance	1,221	-	8,978	10,538	20,737	76,876	44,283	-	121,159	-	141,896
Other	-	-	-	-	-	-	-	-	-	2,494	2,494
Total	255,025	131,972	235,372	130,872	753,241	675,450	149,271	33,460	858,181	6,153	1,617,575

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

<i>US\$ Thousands</i>	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	5-10 years	Over 20 years	Total over 12 months	Undated	Total
Murabaha	169,551	128,095	217,496	106,493	621,635	215,115	-	33,460	248,575	-	870,210
Sukuk	6,470	-	5,045	-	11,515	268,365	104,988	-	373,353	1,500	386,368
Due from FI	60,003	-	-	-	60,003	-	-	-	-	-	60,003
Equity	-	-	-	-	-	-	-	-	-	2,106	2,106
Other	14,765	-	-	-	14,765	-	-	-	-	2,547	17,312
Ijara Rec	309	256	44	-	609	-	-	-	-	-	609
Ijara	3,927	3,621	12,787	24,379	44,714	191,970	44,283	-	236,253	-	280,967
Total	255,025	131,972	235,372	130,872	753,241	675,450	149,271	33,460	858,181	6,153	1,617,575

7.7 Maturity analysis of unfunded exposures

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

<i>US\$ Thousands</i>	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	Total Over 12 months	Total
Sovereigns	-	-	1,818	1,151	2,969	-	-	2,969
Claims on banks	-	307	-	-	307	-	-	307
Claims on Corporates	12	1,160	11,241	14,730	27,143	12,437	12,437	39,580
Total	12	1,467	13,059	15,881	30,419	12,437	12,437	42,856

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

<i>US\$ Thousands</i>	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	-	-	9,319	14,841	24,160	6,106	6,106	30,266
LC	12	1,467	3,740	1,040	6,259	6,331	6,331	12,590
Total	12	1,467	13,059	15,881	30,419	12,437	12,437	42,856

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Unfunded exposures include credit-related financial instruments, comprising of letters of credit, guarantees and commitments and are measured in accordance with the calculation of credit risk-weighted assets in the CBB's Basel II capital adequacy framework.

For credit-related contingent items, the nominal value is converted to an exposure through the application of a CCF. The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off-Balance sheet notional amounts into an equivalent on-statement of financial position.

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

The table below summarises the notional principal amounts and the relative exposures before applying credit risk mitigation:

<i>US\$ thousands</i>	Notional principal	Credit exposure*
Trade-related contingent items	32,708	6,542
Transaction-related contingent items	12,097	6,049
Undrawn facilities and other commitments	60,530	30,265
RWA for contingent items		42,549

* Credit exposure is after applying CCF.

At 30 June 2015, the Group held cash collaterals in relation to credit-related contingent items amounting to US\$ 1,533 thousand.

7.8 Penalties imposed on customers

Penalties imposed on customers during the period were US\$ 6 thousand. This amount represents penalty fees received from customers for making late payments. Such amounts are disposed of to charitable causes.

7.9 Impairment of assets**Impairment and un-collectability of financial assets**

An assessment is made at each quarter end to determine whether there is objective evidence that a specific financial asset or group of financial assets may be impaired. If such evidence exists, an impairment loss is recognised in the consolidated statement of income.

Evidence of impairment may include:

- Significant financial difficulty, default or delinquency in interest or principal payments
- The probability that it will enter bankruptcy or other financial reorganisation
- A measurable decrease in estimated future cash flows, such as changes in arrears or economic conditions, which correlate with defaults.

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Impairment is determined as follows:

- (a) for assets carried at amortised cost, impairment is based on the present value of estimated future cash flows discounted at the original effective profit rate;
- (b) for assets carried at fair value, impairment is the difference between cost and fair value; and
- (c) for assets carried at cost, impairment is based on the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

The Group uses the provision account to record impairments except for equity and similar investments, which are written down, with future increases in their fair value being recognised directly in equity.

Impairment losses on financial assets

On a quarterly basis the Group assesses whether any provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes in such provisions.

Impairment against specific groups of financial assets

In addition to specific provisions against individually significant facilities and investments, the Group also makes a provision to cover impairment against specific group of financial assets where there is a measurable decrease in estimated future cash flows. This provision is based on any deterioration in the internal grade of the financial asset since it was granted. The amount of provision is based on the historical loss pattern for facilities within each grading and is adjusted to reflect current economic changes.

The internal grading process takes into consideration factors such as collateral held, deterioration in country risk, industry and technological obsolescence, as well as identified structural weakness or deterioration in cash flows.

7.10 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 market rates or prices related to profit rates, equity prices, credit spreads, foreign exchange rates and commodity prices.

ABC has established risk management policies and limits within which exposure to market risk is measured and controlled by the Credit Risk Group [CRG] with strategic oversight exercised by ABC's ALCO. The CRG's Treasury and Financial Market Risk unit is responsible for the development and implementation of market risk policy, risk measurement and monitoring framework, and the review of all trading and investment products/ limits before submission to ALCO.

The Group classifies market risk into the following:

- **Non-trading market risk in securities**
Non-trading market risk arises from market factors impacting securities that are held for long-term investment.

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▪ **Asset and liability risk**

Non-trading asset and liability risk exposures arise where the re-pricing characteristics of the Group's assets do not match with those of liabilities.

▪ **Liquidity Risk**

Liquidity risk is the risk that maturing and encashable assets may not cover cash flow obligations (liabilities). In this respect, the Group is supported by ABC, through the provision of a line of credit to cover any shortfall in liquidity. Accordingly, the Group's liquidity needs are taken into consideration in ABC's liquidity management.

ABC 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 profit rate and 'Greeks' for options)
- Stress Testing / Scenario Analysis
- Non-Technical Risk Measures (e.g. nominal position values, stop loss vs. P&L, and concentration risk).
- Forward-looking analysis of distress using CDS prices, equity prices and implied volatilities
- A price-discovery and liquidity assessment process to assess liquidity risk of the AFS portfolio
- Hedge funds analytics, including mapping risk factors of hedge fund managers to market risk drivers.

On an annual basis, ABC's BRC reviews and approves VaR trading limits, BPV trading and investment Limits, and Non-Technical Trading and Investment Limits.

It should be noted that the Bank applies BPV on the sukuk portfolio and the non-technical risk measures in its liquidity management at the Bank level. For the non-technical measures, notional limits are set for investment products, which are approved by the Board Risk Committee.

▪ **Currency risk**

The Group is exposed to foreign exchange rate risk through its structural positions. In general, the Group uses matched currency funding to eliminate such a risk.

▪ **Profit rate risk**

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group is exposed to profit rate risk as a result of mismatches of profit rate re-pricing of assets and liabilities. The most prominent market risk factor for the Bank is profit rates. This risk is minimised as the Group's rate sensitive assets and liabilities are mostly floating rate, where the duration risk is lower. In general, the Group translates fixed rate instruments to floating rate to better manage the duration in the asset book.

▪ **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.

▪ **Profit Rate Risk in the Banking Book [PRRBB]**

The Bank uses the BPV approach to control PRRBB. BPV measures changes in economic value resulting from changes in profit rates. In the BPV methodology, the modified duration approach and, for some products, the effective duration approach is used to measure the PRRBB. Modified duration is a good measure of linear risk for profit rate sensitive products.

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The BPV measure incorporates the entire rate sensitive segment of the statement of financial position for the Group and is classified into appropriate buckets. Non-maturity profit rate sensitive assets and liabilities are bucketed in the short term. Equity is excluded from these computations.

As at 30 June 2015, an immediate shift by 200 basis points in profit rates would potentially impact the Group's economic value by US\$ 1,759 thousand.

At the period end, the Group was exposed to profit rate risk on its financial assets and financial liabilities. The following table indicates the profit rates during the period expressed as a percentage of the principal outstanding.

<i>US\$ thousands</i>	<i>%</i>
Investments	1.46 – 6.25
Murabaha receivables	0.10 – 4.78
Ijara	0.93 – 6.10
Murabaha payables	0.17 – 2.29

7.11 Equity position risk

Equity position risk arises from the possibility that changes in the price of equities or equity indices will affect future profitability or the fair values of financial instruments. As of the reporting date, the Bank had an equity position amounting to US\$ 2,106 thousand.

7.12 Liquidity risk

The Group's principal sources of liquidity are deposits placed with the subsidiary funds raised through commodity Murabahas. However, for any shortfall in liquidity, the Bank relies on ABC; hence, the Group's liquidity needs are taken into consideration in ABC's liquidity management process. ABC maintains liquid assets at prudential levels to ensure that cash can quickly be made available to honour all its obligations, even under adverse conditions. ABC is generally in a position of excess liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Minimum Liquidity Guideline [MLG] is used to manage and monitor daily liquidity. The MLG represents the minimum number of days ABC can survive the combined outflow of all deposits and contractual draw-downs under market value driven encashability scenarios.

In addition, an internal liquidity / maturity profile is generated to summarise the actual liquidity gaps versus the revised gaps based on internal assumptions.

The following table summarises the liquidity ratios as at 30 June 2015:

Liquid assets ratio	30.2%
Short-term assets to short-term liabilities	71.8%

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7.13 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

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.

ABC applies the 'Standardised Approach' for calculating its Pillar 1 operational risk capital. As at 30 June 2015, the Group's total capital charge in respect of operational risk was USD 113.2 million.

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

The ABC Group-wide framework has to be implemented by all entities that Arab Banking Corp (B.S.C.) controls directly or indirectly.

The operational risk management framework is being introduced across ABC, following the Operational Risk Committee's rolling two-year 'master plan'. Local operational risk committees implement corresponding plans at the subsidiary levels.

ABC currently employs 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
- Risk scenarios
- Key risk and performance indicators
- New product approval process.

Operational risk tolerance

ABC uses quantitative and qualitative elements to classify actual and potential operational risks as 'very high', 'high', 'medium', 'low' or 'very low'. 'Very high' and 'high' risks must be mitigated. They can only be accepted at the ABC Group level.

A separate escalation procedure requires, among other things, that the Senior Management of ABC be immediately informed of all risk events classified 'very high' or 'high' that have either happened or are likely to happen.

7.14 Legal risk

Inadequate documentation, legal and regulatory incapacity, insufficient authority of a counterparty and contract invalidity or unenforceability are all examples of legal risk. Identification and management of this risk are the responsibilities of the Head Office Legal & Compliance Department [LCD] and are carried out through consultation with internal and external legal counsels, together with close monitoring of the litigation cases involving the Group, as well as ABC.

8. Business Continuity

ABC has robust 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. These plans provide each ABC subsidiary with the necessary guidelines and procedures in case of an emergency. The business continuity plans cover local and regional risk scenarios. Continuous updates of these plans are performed regularly, to ensure that they are kept up to date with changes in each ABC unit.

9. Capital management

Internal Capital Adequacy Assessment Process [ICAAP]

The Group’s capital management aims to maintain an optimum level of capital to enable it to pursue strategies that build long-term shareholder value, whilst always meeting minimum regulatory ratio requirements. The diagram below illustrates this concept:



Among the key principles driving capital management at the Group include:

- Adequate capital is maintained as buffer for unexpected losses to protect stakeholders, i.e. shareholders and depositors; and
- Return on capital is maximised to generate sustainable returns above the cost of capital.

The methodologies for internally estimating capital for ABC’s key risks are as follows:

- a. **Credit risk:** Assessed on the basis of Foundation IRB Risk Weights (FIRB). This supports the internal estimation of economic capital per business segment, business unit and aggregated at the Group level. ABC uses stress-testing to review its risk exposure against budgeted levels.
- b. **Market risk:** Computed for both the trading and the banking books per the guidelines provided in Basel III.

VaR measures the worst expected loss over a given timeframe, under normal market conditions and at a given confidence interval. It provides an aggregate view of the portfolio’s risk that

accounts for leverage, correlations and current positions. The Group uses the Historical Simulation Approach to measure VaR. The key model assumptions for the trading portfolio are:

- 2-year historical simulation
- 1-day VaR
- 99% (one tail) confidence interval

The historical simulation method provides a full valuation going back in time, such as over the last 500 days, by applying current weights to a time series of historical returns.

ABC uses the stress-testing methodology to review its exposures against historical and ABC-specific extreme scenarios.

- c. **Operational risk:** Applied on the Standardised Approach basis.
- d. **Other risks:** such as liquidity, strategic and reputational risks are currently captured providing a capital buffer.

Supervisory Review and Evaluation Process [SERP]

The CBB is the lead regulator for the ABC Group, and sets and monitors capital requirements on both a consolidated and an unconsolidated basis. Individual banking subsidiaries are regulated directly by their local banking supervisors, who set and monitor their capital adequacy requirements.

The CBB requires each Bahrain-based bank or banking group to maintain a minimum ratio of total capital to risk-weighted assets of 12.5%, taking into account both on- and off-balance sheet transactions. However, under the SERP guidelines the CBB would also make an individual risk assessment of all banks and, instead of applying a standard minimum capital adequacy requirement, the supervisor may allow a lower capital adequacy ratio in excess of 8% for a bank with sound risk management capabilities.

The CBB initiated this assessment process in first quarter of 2008. The ABC Group's capital management strategy is currently to maintain a buffer over the 12.5% minimum regulatory capital requirement to account for liquidity, concentration, reputation, strategic, country and other risks while enhancing its risk management and risk control infrastructure. This would ultimately allow ABC to achieve a successful assessment and pursue possible lower capital requirements from the CBB. At the same time, senior management strongly believes in the economic value of capital, and is committed to maximising intrinsic value for all stakeholders

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 at arm's length basis.

a. Exposures to related parties

US\$ thousands

Claims on shareholders	143,635
Claims on Directors and senior management	755
Claims on staff	512

PUBLIC DISCLOSURES**30 June 2015****b. Liabilities to related parties***US\$ thousands*

Connected deposits	1,125,300
Other liabilities	2,282

c. Income and expenses arising from dealing with related parties*US\$ thousands*

Income from Murabaha receivables	48
Profit on Murabaha payables	3,859
Fees paid to ABC (B.S.C.)	112
Charges by ABC (B.S.C.)	350
Board remuneration	72
Shari'a Supervisory Board	45

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 / Securities*US\$ thousands*

	Ageing	Principal*	Provisions	Net book value
Islamic financing	Over 3 years	33,460	-	33,460
Securities	Over 3 years	-	13,131	-

* Carrying values of US\$ 33,460 thousand have been guaranteed by ABC. All non-performing financing facilities are from GCC countries. The industry sector analysis of the non-performing facilities of US\$ 29,391 thousand is in the trading sector and US\$ 4,069 thousand in the financial institution sector.

Securities

The Group has specific impairment provisions of US\$ 13,131 thousand on its securities portfolio, all of the securities are from GCC countries.

10.3 Restructured assets

As of 30 June 2015, there were no financial assets whose terms were renegotiated during the period.

10.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the period ended 30 June 2015.

PUBLIC DISCLOSURES**30 June 2015****10.5 Movement in specific and collective impairment provisions**

<i>US\$ thousands</i>	Specific provision for securities
As at 1 January 2015	13,131
Additional provisions made	-
As at 30 June 2015	13,131

10.6 Industry sector analysis of the specific impairment provisions charges

Impairment of US\$ 4,631 thousand is in the financial institution sector and US\$ 8,500 thousand in the construction and real estate sector.

10.7 Equity positions in the banking book

As at 30 June 2015, the equity position of the Group amounted to US\$ 2,106 thousand, all of which is quoted.

<i>US\$ thousands</i>	
Gross unrealized gains recognized in the statement of financial position	562
Unrealized gains included in Tier 1 capital	562

10.8 Quantitative indicators of financial performance, position and liquidity risk

	2010	2011	2012	2013	2014	June 2015
Cost / income ratio %	30.8	40.8	43.3	30.6	30.5	23.4
Return on average equity %	1.2	3.6	3.6	5.0	5.9	8.1*
Return on average assets %	0.2	0.7	0.8	1.2	1.3	1.5*
Liquidity assets ratio %	30.6	25.9	17.7	8.9	22.5	30.2
Short term assets to short term liabilities %	39.1	43.2	72.2	62.9	55.7	71.8
Risk asset ratio – Tier 1 %	24.2	26.5	25.3	26.2	22.2	21.7
Risk asset ratio – Total %	24.5	27.5	26.2	27.6	23.6	21.7

* Annualised