PUBLIC DISCLOSURES
30 June 2017

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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.

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 2017, and is organized as follows:

- an overview of the approach taken by ABC Islamic Bank (E.C.) [the Bank] to Pillar I including the profile of the risk-weighted assets according to the "standard portfolio" as defined by the Central Bank of Bahrain [the CBB].

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

- 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 I1I and AAOIFI, primarily on account of the following:

- As per the CBB Basel III framework, off balance sheet exposures are converted into 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. In the interim condensed consolidated financial statements, the nominal values of credit-related contingent items are considered off-statement of financial position.

- Under this 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'a].

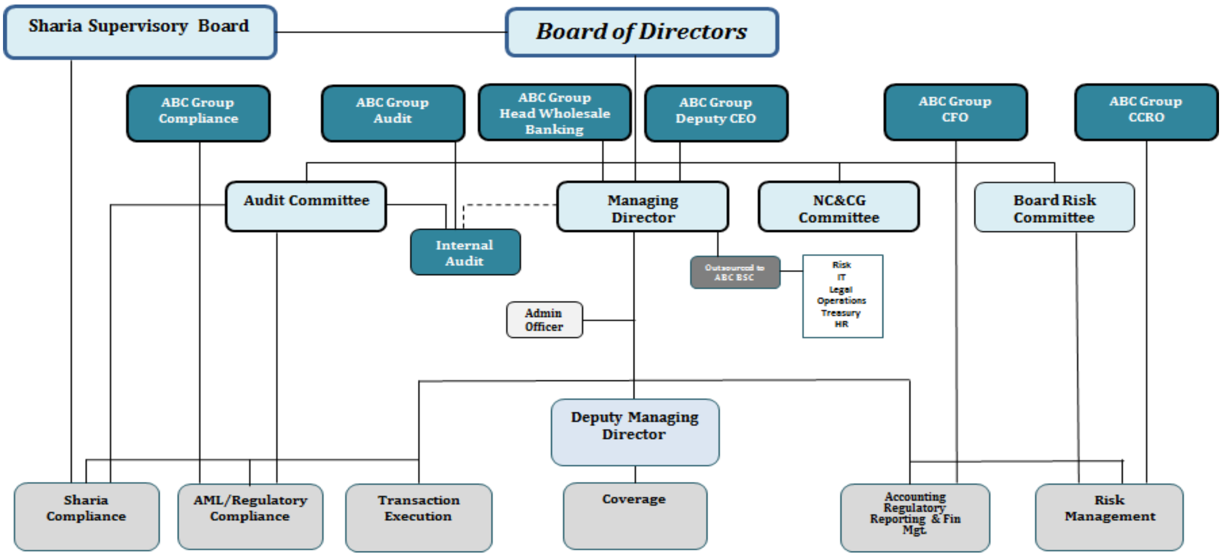
Arab Banking Corporation B.S.C. [ABC], which operates under a wholesale banking licence issued by the CBB, holds 100% of the share capital of the Bank.

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 2017 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$62 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 Group’s capital base comprises of Tier 1 capital which includes share capital, reserves, retained earnings, current year profit and unrealized gains arising from fair valuing equities.

The issued and paid-up share capital of the Bank was US$ 132.5 million at 30 June 2017 comprising of 1,325,000 shares of US$ 100 each.

Breakdown of capital base

US$ million	**Tier 1**	**Tier 2**	**Total**
Issued and fully paid ordinary shares	132.5	-	132.5
Legal / statutory reserves	21.9	-	21.9
Retained profit brought forward	151.2	-	151.2
Profit for the period	15.1	-	15.1
Unrealized gains arising from fair valuing equities	1.5	-	1.5
Capital base	**322.2**	**-**	**322.2**
Risk weighted assets [RWA]			
Credit risk			855.5
Market risk			-
Operational risk			129.2
			984.7
Tier 1 ratio			**32.7%**
Capital adequacy ratio			**32.7%**

5. Capital adequacy ratio [CAR]

The objective of capital management at ABC and 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. . The determination to pay dividends on an on-going basis and the amount thereof will depend upon, among other things, the Group's earnings, its dividend policy, the requirement to set aside minimum statutory reserves, capital requirements to support the 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 2017 was 32.7% compared with the minimum regulatory requirement of 12.5%. The Tier 1 ratio was 32.7% 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%.

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; and
- 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%.

ii) Credit exposure and risk-weighted assets

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	367,916	367,916	-	59,351	-	59,351	7,419
Claims on public sector entities	65,372	43,935	21,437	-	-	-	-
Claims on banks	408,187	407,969	218	225,448	-	225,448	28,181
Claims on corporates	552,823	541,322	11,501	493,714	11,501	505,215	63,152
Past due exposures	2,500	2,500	-	3,750	-	3,750	469
Project finance	86,863	86,863	-	60,804	-	60,804	7,600
Other	966	966	-	966	-	966	121
Total	**1,484,627**	**1,451,471**	**33,156**	**844,033**	**11,501**	**855,534**	**106,942**

Monthly average gross exposures and the risk-weighted assets at 30 June 2017 were US$ 1,548,617 thousand and US$ 885,615 thousand respectively.

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

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	609,489	601,051	8,438	464,878	1,200	466,078	58,260
Ijara	220,598	206,399	14,199	103,779	-	103,779	12,972
Ijara Rec	921	921	-	499	-	499	62
Sukuk	627,884	627,884	-	268,616	-	268,616	33,577
Equity	3,070	3,070	-	3,070	-	3,070	384
LC	10,519	-	10,519	-	10,301	10,301	1,288
Other	12,146	12,146	-	3,191	-	3,191	399
Total	**1,484,627**	**1,451,471**	**33,156**	**844,033**	**11,501**	**855,534**	**106,942**

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$ 129.2 million, with minimum capital requirement of US$ 16.2 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 *US$ thousands*	129,146
Amount of non-Shari'a compliant income *US$ thousands*	185
Number of Shari'a violations	Nil

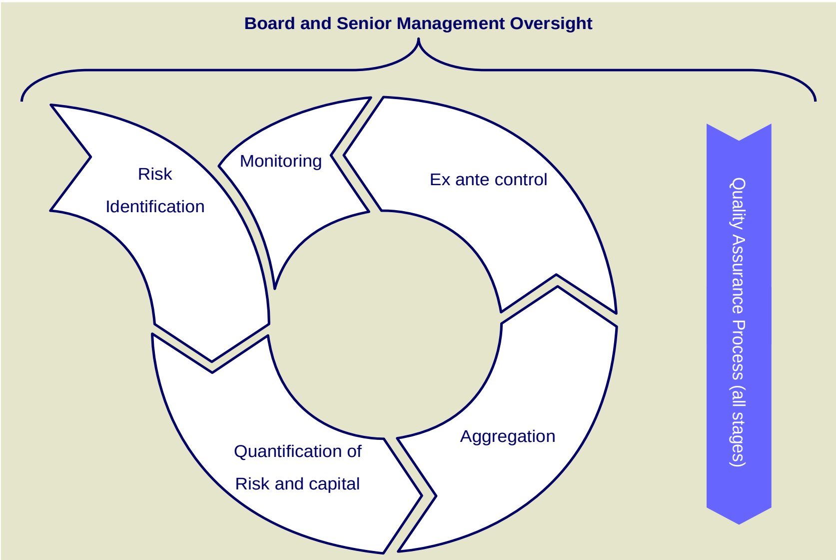
7. Risk management

7.1 Introduction

Risk is inherent in ABC's activities and is managed through a process of on-going identification, measurement and monitoring, subject to risk limits and other controls. ABC 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:

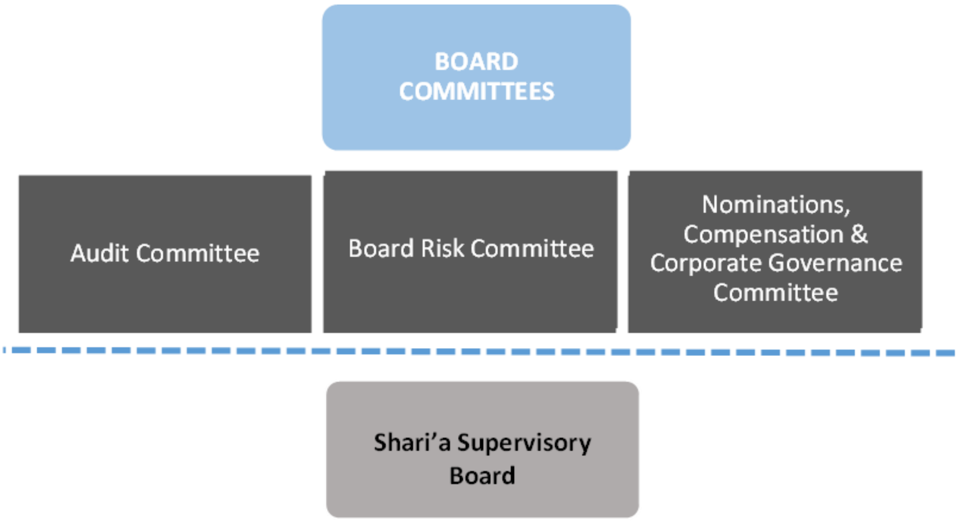


7.2 Risk management structure

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

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 Shari'a Supervisory Board:



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 the ABC Group's wholesale and retail lending portfolios, setting country and other high-level Group limits, dealing with impaired assets, provisioning and general credit policy matters.

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 allocation. GALCO monitors the ABC Group's liquidity and market risks, and the ABC Group's risk profile in the context of economic developments and market fluctuations. GALCO is assisted by tactical sub-committees for Capital & Liquidity Management, Investments and Structural Foreign Exchange.

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

The **Group Compliance Oversight Committee (GCOC)** is responsible for strengthening the focus on compliance within the 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 **Group IT Risk Committee (GITRC)** is responsible for the development, approval and periodic review of the frameworks for the management of IT risk and information security in the ABC Group.

The **Group Business Continuity Committee (GBCC)** is responsible for proposing, approving and monitoring the implementation of Group-wide policies and procedures for disaster recovery and business continuity management.

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 ABC Group's activities, and makes recommendations to the relevant central committees appropriate policies and procedures for managing exposure.

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.

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 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. A collective impairment provision is also maintained to cover unidentified possible future losses.

As at 30 June 2017, the Group's three largest exposures in excess of 15% of the capital base are shown below:

US$ Thousands

	On Balance Sheet Exposure	Off Balance Sheet Exposure	Total Exposure
Counterparty [A]	89,155	-	89,155
Counterparty [B]	86,808	-	86,808
Counterparty [C]	82,137	-	82,137

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.

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:

US$ thousands	Exposures	Guaranteed	Collateral*	Net exposure
Funded Exposures (Murabaha)	62,128	-	77,816	(15,688)
Unfunded Exposures (LC)	28,291	-	435	27,856

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

7.3 Geographical distribution of exposures

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:

US$ Thousands

Country / Region	Gross exposure	Percentage of exposure
UAE	468,368	31.55%
Saudi Arabia	333,498	22.46%
Bahrain	308,600	20.79%
Europe (Including Turkey)	184,799	12.45%
Qatar	112,672	7.59%
Other MENA Countries	23,399	1.58%
Kuwait	27,089	1.82%
Other Asia	15,072	1.01%
Oman	11,130	0.75%
Total	**1,484,627**	**100.00%**

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

US$ Thousands **Type of Financing / Region**	**Bahrain**	**Saudi Arabia**	**Kuwait**	**Qatar**	**UAE**	**Oman**	**Other MENA countries**	**Other Asia**	**Europe (Including Turkey)**	**Total**
Sovereigns	143,034	-	-	-	157,995	-	6,176	15,072	45,639	367,916
Claims on public sector entities	65,372	-	-	-	-	-	-	-	-	65,372
Claims on banks	63,658	-	14,072	22,091	238,560	-	218	-	69,588	408,187
Claims on Corporates	35,570	274,406	-	84,457	71,813	-	17,005	-	69,572	552,823
Past due exposures	-	2,500	-	-	-	-	-	-	-	2,500
Project finance	-	56,592	13,017	6,124	-	11,130	-	-	-	86,863
Other	966	-	-	-	-	-	-	-	-	966
Total	**308,600**	**333,498**	**27,089**	**112,672**	**468,368**	**11,130**	**23,399**	**15,072**	**184,799**	**1,484,627**

7.4 Industrial sector analysis of the exposures

The industrial sector analysis of exposures is as follows:

US$ Thousands	**Gross exposure**	**Funded exposure**	**Un-funded exposure**
Financial Institutions	582,881	582,663	218
Government	367,916	367,916	-
Manufacturing	209,040	192,863	16,177
Trading	157,347	152,137	5,210
Other	47,528	39,698	7,830
Construction	46,767	43,046	3,721
Commercial Real Estate	37,539	37,539	-
Transportation	35,609	35,609	-
Total	**1,484,627**	**1,451,471**	**33,156**

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

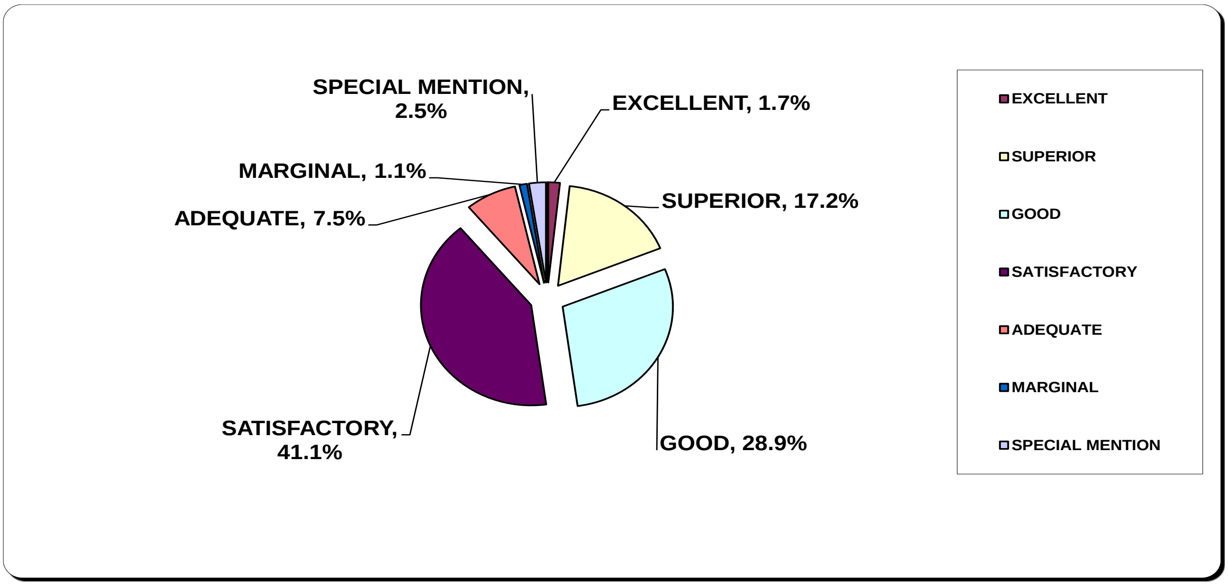
US$ Thousands ***Type of Financing/Industry***	**Financial Institutions**	**Commercial real estate**	**Manu-facturing**	**Con-struction**	**Trading**	**Govern-ment**	**Trans-portation**	**Other**	**Total**
Sovereigns	-	-	-	-	-	367,916	-	-	**367,916**
Claims on public sector entities	24,986	-	23,469	-	-	-	-	16,917	**65,372**
Claims on banks	408,187	-	-	-	-	-	-	-	**408,187**
Claims on Corporates	149,708	37,539	98,708	44,267	157,347	-	35,609	29,645	**552,823**
Past due exposures	-	-	-	2,500	-	-	-	-	**2,500**
Project finance	-	-	86,863	-	-	-	-	-	**86,863**
Other	-	-	-	-	-	-	-	966	**966**
Total	**582,881**	**37,539**	**209,040**	**46,767**	**157,347**	**367,916**	**35,609**	**47,528**	**1,484,627**

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:

US$ Thousands	**Gross credit exposure**	**Rated exposure**	**Unrated exposure**
Claims on Corporates	552,823	119,297	433,526
Claims on banks	408,187	368,459	39,728
Sovereigns	367,916	367,916	-
Project finance	86,863	-	86,863
Claims on public sector entities	65,372	41,903	23,469
Past due exposures	2,500	-	2,500
Other	966	-	966
Total	**1,484,627**	**897,575**	**587,052**

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.

7.6 Maturity analysis of funded exposures

Residual contractual maturity analysis 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	Over 20 years	Total over 12 months	Undated	Total
Sovereigns	6,176	68,591	6,250	12,500	93,517	155,181	119,165	-	274,346	53	367,916
Claims on public sector entities	2,433	16,516	-	-	18,949	24,986	-	-	24,986	-	43,935
Claims on banks	89,726	96,667	-	15,145	201,538	201,599	1,762	-	203,361	3,070	407,969
Claims on Corporates	153,614	100,361	119,635	10,683	384,293	157,029	-	-	157,029	-	541,322
Past due exposures	-	-	-	-	-	-	-	2,500	2,500	-	2,500
Project finance	1,017	-	9,183	10,251	20,451	57,674	8,738	-	66,412	-	86,863
Other	-	-	-	-	-	-	-	-	-	966	966
Total	**252,966**	**282,135**	**135,068**	**48,579**	**718,748**	**596,469**	**129,665**	**2,500**	**728,634**	**4,089**	**1,451,471**

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	Over 20 years	Total over 12 months	Undated	Total
Murabaha	236,734	266,236	88,541	9,540	601,051	-	-	-	-	-	601,051
Sukuk	4,088	-	30,169	15,145	49,402	457,555	120,927	-	578,482	-	627,884
Equity	-	-	-	-	-	-	-	-	-	3,070	3,070
Other	11,127	-	-	-	11,127	-	-	-	-	1,019	12,146
Ijara Rec	84	424	413	-	921	-	-	-	-	-	921
Ijara	933	15,475	15,945	23,894	56,247	138,914	8,738	2,500	150,152	-	206,399
Total	**252,966**	**282,135**	**135,068**	**48,579**	**718,748**	**596,469**	**129,665**	**2,500**	**728,634**	**4,089**	**1,451,471**

7.7 Maturity analysis of unfunded exposures

Residual contractual maturity analysis of the Group's major types of unfunded 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	Total
Claims on public sector entities	-	-	-	7,238	7,238	14,199	-	14,199	21,437
Claims on banks	75	-	-	143	218	-	-	-	218
Claims on Corporates	862	5,540	3,760	63	10,225	132	1,144	1,276	11,501
Total	**937**	**5,540**	**3,760**	**7,444**	**17,681**	**14,331**	**1,144**	**15,475**	**33,156**

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	5-10 years	Total over 12 months	Total
Murabaha	-	1,200	-	7,238	8,438	-	-	-	8,438
Ijara	-	-	-	-	-	14,199	-	14,199	14,199
LC	937	4,340	3,760	206	9,243	132	1,144	1,276	10,519
Total	**937**	**5,540**	**3,760**	**7,444**	**17,681**	**14,331**	**1,144**	**15,475**	**33,156**

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:

US$ thousands	Notional principal	Credit exposure*
Trade-related contingent items	12,091	2,418
Transaction-related contingent items	16,200	8,100
Undrawn facilities and other commitments	48,873	22,637
RWA for contingent items		**11,501**

* Credit exposure is after applying CCF.

At 30 June 2017, the Group held cash collaterals in relation to credit-related contingent items amounting to US$ 435 thousand.

7.8 Funding category

US$ Thousands	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 payables	432,458	619,177	56,556	2,369	1,110,560	-	-	-	-	-	1,110,560
Equity	-	-	-	-	-	-	-	-	-	322,194	322,194
Total	**432,458**	**619,177**	**56,556**	**2,369**	**1,110,560**	**-**	**-**	**-**	**-**	**322,194**	**1,432,754**

7.9 Penalties imposed on customers

Penalties imposed on customers during the period were US$ 185 thousand. This amount represents penalty fees received from customers for making late payments. Such amounts are disposed of to charitable causes.

7.10 Impairment of assets

Impairment and un-collectability of financial assets

Each quarter, 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.

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.

7.11 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, monitored and controlled by the Credit Risk Group [CRG] with strategic oversight exercised by ABC's GALCO. The CRG's Treasury and Financial Market Risk [T&FMR] 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 GALCO. The T&FMR includes market risk, middle office, liquidity risk and product control. This function also has an additional reporting line to GCFO.

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.

- **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 Group applies BPV on the sukuk portfolio and the non-technical risk measures in its liquidity management at the Group level. For the non-technical measures, notional limits are set for investment products, which are approved by the GALCO.

- **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**

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. In addition, the GALCO regularly reviews the current and expected future profitability of the Bank's traditional banking activities and has embarked on a number of initiatives to reduce sensitivity of the banking book to profit rate fluctuations.

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 2017, a 200 basis points (2%) parallel shift in interest rates would potentially impact the Group's economic value by US$9.2 million.

US$ millions	Within 1 month	1-3 months	3-6 months	6-12 1 year	1 to 5 Years	Over 5 years	Non-profit bearing	Total
Assets								
Bank balances	599	-	-	-	-		10,528	11,127
Investments	-	65,000	120,075	15,000	336,500	77,500	3,077	617,152
Murabaha receivables	403,884	162,587	26,965	7,615	-	-	-	601,051
Ijarah receivables	-	-	-	-	-	-	921	921
Ijarah	25,513	88,480	89,906	-	-	-	2,500	206,399
Equipment	-	-	-	-	-	-	24	24
Other assets	-	-	-	-	-	-	6,689	6,689
Total assets	**429,996**	**316,067**	**236,946**	**22,615**	**336,500**	**77,500**	**23,739**	**1,433,363**
liabilities and owners' equity								
Other liabilities	-	-	-	-	-	-	10,609	10,609
Murabaha payables	432,458	619,177	56,556	2,369	-	-	-	1,110,560
Owners' equity	-	-	-	-	-	-	322,194	322,194
Total liabilities and owners' equity	**432,458**	**619,177**	**56,556**	**2,369**	**-**	**-**	**332,803**	**1,443,363**
Off B/S items								
Tabdeel	212,500	401,575	(30,000)	(15,000)	(451,575)	(117,500)	-	-
Total off B/S items	**212,500**	**401,575**	**(30,000)**	**(15,000)**	**(451,575)**	**(117,500)**	**-**	**-**
Profit rates sensitivity gap	210,038	98,465	150,390	5,246	(115,075)	(40,000)	(309,064)	-
Cumulative profit rates sensitivity gap	210,038	308,503	458,893	464,139	349,064	309,064	-	-

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.

7.12 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$ 3,070 thousand.

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

The following table summarises the liquidity ratios as at 30 June 2017:

Liquid assets ratio	46.4%
Short-term assets to short-term liabilities	62.1%

7.14 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 ABC includes legal 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.

ABC applies the 'Standardised Approach' for calculating its Pillar 1 operational risk capital. As at 30 June 2017, the Group's total capital charge in respect of operational risk was USD 129.2 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.

7.15 Legal risk

Examples of legal risk include inadequate documentation, legal and regulatory incapacity, insufficient authority of a counterparty and contract invalidity/unenforceability. Legal Counsel and the Corporate Secretary bear responsibility for identification and management of this risk. They consult with internal and external legal counsels. All Major Group subsidiaries have their own in-house legal departments, acting under the guidance of the Legal Counsel, which aims to facilitate the business of the Group by providing proactive, business-oriented and creative advice.

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 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 ABC 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:** Assessed using the Value at Risk (VaR) metric

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.

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	51,881
Claims on Directors and senior management	404
Claims on staff	347

b. Liabilities to related parties

US$ thousands	
Connected deposits	1,007,274
Other liabilities	1,485

c. Income and expenses arising from dealing with related parties

US$ thousands	
Income from Murabaha receivables	192
Profit on Murabaha payables	7,838
Fees paid to ABC (B.S.C.)	55
Charges by ABC (B.S.C.)	350
Board remuneration	72
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 / Securities

US$ thousands	**Ageing**	**Principal***	**Provisions**	**Net book value**
Islamic financing	-	-	-	-
Securities	Over 3 years	-	12,184	-

Securities

The Group has specific impairment provisions of US$ 12,184 thousand on its securities portfolio, all of the securities are from GCC countries.

10.3 Restructured assets

As at 30 June 2017, Carrying amount of financial assets whose terms have been renegotiated as at period end was US$ 34,205 thousand.

10.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the period ended 30 June 2017.

10.5 Movement in specific and collective impairment provisions

US$ thousands	Specific provision for securities
As at 1 January 2017	12,184
Amounts written off	-
As at 30 June 2017	**12,184**

10.6 Industry sector analysis of the specific impairment provisions charges

Impairment of US$ 3,684 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 2017, the equity position of the Group amounted to US$ 3,070 thousand, all of which is quoted.

US$ thousands	
Gross unrealized gains recognized in the statement of financial position	1,526
Unrealized gains included in Tier 1 capital	1,526