

بنك اليوباف العربي الدولي ش.م.ب.م. (م)
ALUBAF ARAB INTERNATIONAL BANK B.S.C (C)



BASEL II PILLAR III DISCLOSURES

31 DECEMBER 2009

ALUBAF Arab International Bank B.S.C (c)
Basel II -Pillar III disclosures
As at 31 December 2009

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1. Introduction

Central Bank of Bahrain (“CBB”), the regulating body for Banks and Financial Institutions in the Kingdom of Bahrain, provides a common framework for the implementation of Basel II accord.

The Basel II framework is based on three pillars:

- Pillar I defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by own regulatory funds.
- Pillar II addresses the Bank’s internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory review and Evaluation Process (SREP), which assesses the internal capital adequacy.
- Pillar III complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

This document gathers together all the elements of the disclosure required under Pillar III and complies with the public disclosure module of CBB, in order to enhance corporate governance and financial transparency. This disclosure report is in addition to the financial statements presented in accordance with International Financial Reporting Standards (IFRS).

2. Corporate Structure

ALUBAF Arab International Bank B.S.C. (c) ("the Bank") is a closed Bahraini joint stock company incorporated in the Kingdom of Bahrain and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the Central Bank of Bahrain under the new integrated licensing framework. The Bank’s registered office is at Wind Tower Building, 2nd Floor, Diplomatic Area, P O Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank (Shareholding 97.11%), a bank registered in Libya.

3. Capital Structure

The Bank's capital base comprise of Tier I Capital, which includes share capital, statutory reserve and retained earnings.

The issued and paid up share capital of the Bank was US \$ 100 million as at 31 December 2009 comprising of 2 million shares of US\$ 50 each.

Break down of Capital Base

	<i>US\$ '000</i>
	<i>Tier I</i>
Share capital	100,000
Statutory reserve	2,649
Retained earnings	8,052
Tier I Capital base	<u>110,701</u>
Less: Regulatory deductions	-
Net Available Capital Base	<u>110,701</u>

The Bank recorded a net profit of US\$ 8,189 thousand for the year ended 31 December 2009 and transferred 10% of profits (US\$ 819 thousand) towards Statutory reserve. The Bank proposed a dividend of US\$ 1,500 thousand, i.e. US\$ 0.75 per Ordinary share for the year 2009.

Pursuant to the approval in Annual general meeting held on 22nd March 2010, the Bank has increased its Paid up share capital to USD 200 Million in April 2010, subsequent to the year ended 31 December, 2009.

4. Capital Adequacy Ratio (CAR)

The purpose of capital management at the Bank is to ensure the efficient utilization of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations.

The Bank manages its capital structure and makes adjustments in the light of changes in economic conditions and risk characteristics of its activities.

Capital adequacy ratio calculation:

	<i>US\$ '000</i>
Tier I Capital Base	110,701
Risk weighted assets (RWA)	
Credit risk	371,747
Market risk	488
Operational risk	13,340
	<u>385,575</u>
Capital adequacy ratio	<u>28.71%</u>

The Bank's capital adequacy ratio of 28.71% is well above the minimum regulatory requirement of 12%.

5. Profile of risk-weighted assets and capital charge

The Bank has adopted the standardized approach for credit risk, market risk and the Basic indicator approach for operational risk for regulatory reporting purposes. The Bank's risk weighted capital requirement for credit, market and operational risks are given below:

5.1 Credit risk

Definition of exposure classes per Standard Portfolio

The Bank has funded and unfunded credit portfolio. The exposures are classified as per the Standard portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the standardized approach for credit risk.

The descriptions of the counterparty classes along with the risk weights 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 are risk weighted at 0%, while claims on other sovereigns, denominated in a non-relevant currency and unrated are assigned a risk weight of 100%.

(b) 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 and claims maturing within three months and denominated in Bahrain Dinars or US Dollars are risk weighted at 20%. Other claims on banks, which are in foreign currency, are risk weighted using standard risk weights ranging from 20% to 100%. Unrated claims on banks are assigned a risk weight of 20% & 50% respectively.

(c) Claims on corporate portfolio

Claims on corporate portfolio are risk weighted based on external credit ratings and are assigned a risk weight of 100% for unrated corporate portfolio.

(d) Past due exposure

Past due exposures include Loans and advances of which interest or repayment of principal are due for more than 90 days; Past due exposures, net of specific provisions are risk weighted as follows:

- (a) 150% risk weight, when specific provisions are less than 20% of the outstanding amount of loan.
- (b) 100% risk weight, when specific provisions are greater than 20% of the outstanding amount of the loan.

(e) Equity portfolios

Investments in listed equities are risk weighted at 100%.

(f) Other exposures

These are risk weighted at 100%.

5. Profile of risk-weighted assets and capital charge (continued)

Credit exposure and risk weighted assets

US\$ '000	Funded exposures	Unfunded exposures	Gross credit exposures	Eligible collateral	Risk weighted	Capital requirement
Claims on sovereigns	51,605		51,605		43,561	5,228
Claims on banks	646,325	242,424	888,749	48,484	292,146	35,058
Claims on corporate	24,527		24,527		24,527	2,943
Past due	1,850		1,850		2,775	333
Equity portfolio	36		36		36	4
Other exposures	8,702		8,702		8,702	1,044
Total	733,045	242,424	975,469	48,484	371,747	44,610

Gross credit exposure before credit risk mitigation

US\$ '000s	Gross credit exposure	Average monthly balance
Claims from Sovereigns	51,605	47,614
Claims from Banks	646,325	430,557
Claims on Corporate	24,527	16,885
Past Due	1,850	2,017
Equity Portfolio	36	38
Other exposures	8,702	6,783
Total funded exposure	733,045	503,894
Unfunded exposures	242,424	210,265
Gross credit exposures	975,469	714,159

Average monthly balance represents the average of the sum of twelve month end balance for the year ended 31 December 2009.

5.2 Market risk

The Bank's capital requirement for market risk in accordance with the standardised methodology is as follows:

	US\$ '000			
	Risk weighted exposures	Capital requirement	Maximum value	Minimum value
Foreign exchange risk	450	54	616	125
Equities position risk	38	5	50	38
Total	488	59		

5. Profile of risk-weighted assets and capital charge (continued)

5.3 Operational risk

In accordance with the Basic indicator approach, the total capital charge in respect of operational risk was US\$ 1,601 thousand on operational risk weighted exposure of US\$ 13,340 thousand. This operational risk weighted exposure is computed using the Basic indicator approach, where a fixed percentage (Alpha), which is 15% of the average previous three year annual gross income, is multiplied by 12.5 operational capital charge; years with positive gross income are counted for computation of capital charge. This computation is as per CBB Capital adequacy rulebook.

6. Risk Management

Risk is inherent in the Banks business activities and is managed through a process of on- going identification, measurement, controlling and monitoring. The Bank is exposed primarily to credit risk and to a limited extent to market and operational risk.

The Board of Directors is responsible for the best practice management and risk oversight. Board of Directors oversees the definition of risk appetite, risk tolerance standards and risk process standards to be kept in place. At the second level, the senior management is responsible for credit decisions on lending portfolio, setting country limits and interbank limits and general credit policy matters, which are reviewed and approved by the Board of Directors. Executive management is responsible for the identification and evaluation on a continuous basis of all significant risks to the business and implementation of appropriate internal controls to minimize them. This is done through the senior management reporting timely to Board of Directors for their decision making and implementation.

6.1 Credit risk concentrations and thresholds

The first level of protection against undue credit risk is through country and industry threshold limits, together with individual borrower threshold limits. Single name concentrations are monitored on an individual basis. 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% of the regulatory capital base.

As at 31 December 2009, the Bank's exposures in excess of 15% of the obligor limits to individual counterparties are shown below:

US \$ '000	Funded exposure	Unfunded exposure	Total
Counterparty A *	68,177	Nil	68,177
Counterparty B	40,679	Nil	40,679
Counterparty C	Nil	28,112	28,112

* These are interbank deposits maturing within 6 months from 31 December 2009.

6. Risk Management (continued)

Risk mitigation – collateral

The amount and type of collateral depends on an assignment of the credit risk of the counterparty. The types of collateral mainly include cash collaterals in relation to credit related contingent items. The amount and type of collateral depends on an assignment of credit risk of the counterparty. The types of collateral mainly include cash collaterals in relation to credit related contingent items, which is liquidated on maturity/expiry date.

6.2 Geographical distribution of exposures is summarized below:

US\$ '000	Gross credit exposure	Funded exposure	Unfunded exposure
Bahrain	340,806	340,806	-
Other GCC Countries	77,438	77,438	-
Other Middle East & Africa	413,417	170,993	242,424
Europe	123,587	123,587	-
Rest of the world	20,221	20,221	-
Total	975,469	733,045	242,424

6.3 Industrial sector analysis of exposures is summarized below:

US\$ '000	Gross credit exposure	Funded exposure	Unfunded exposure
Sovereign	53,307	53,307	-
Banks & financial institutions	903,724	661,300	242,424
Commercial & business	11,890	11,890	-
Others	6,548	6,548	-
Total	975,469	733,045	242,424

6.4 Exposure by external credit rating

The Bank uses external credit ratings from Standard & Poors, Moodys and Fitch ratings, which are accredited External Credit Assessment Institutions (ECAI's). The Bank assigns the risk weights through the mapping process provided by CBB to the rating grades. The Bank uses the highest risk weight associated, in case of two or more eligible ECAI's are chosen. The breakdown of the Bank's exposure into rated and unrated categories is as follows:

6. Risk Management (continued)

6.4 Exposure by external credit rating (continued)

US\$ '000	Funded exposure	Unfunded exposure	Rated-High exposure	Rated-Standard exposure	Unrated exposure
Claims on sovereigns	51,605		8,044		43,561
Claims on banks	646,325	242,424	169,174	293,778	425,797
Claims on corporate	24,527				24,527
Past due	1,850				1,850
Equity portfolio	36				36
Other exposures	8,702				8,702
Total	733,045	242,424	177,218	293,778	504,473

6.5 Maturity analysis of funded exposures

Residual contractual maturities of the Bank's exposures are as follows:

US\$ '000	Within 1 month	1-3 months	3-12 months	Total within 1 year	1-5 years	10-20 years	Undated	Total
Claims on Sovereigns	-	-	5,491	5,491	5,382	40,679	53	51,605
Claims on Banks	580,165	23,000	31,823	638,437	11,337	-	-	646,325
Claims on Corporate	14,527	-	5,000	19,527	5,000	-	-	24,527
Past Due	-	-	1,850	1,850	-	-	-	1,850
Equity Portfolio	-	-	-	-	-	-	36	36
Other exposures	1,773	136	483	2,392	-	-	6,310	8,702
Total	596,465	23,136	44,647	667,697	21,719	40,679	6,399	733,045

The Bank does not have any exposure maturing within 5-10 years or more than 20 years.

6.6 Maturity analysis of unfunded exposures

US\$ '000	Notional principal	Within 1 month	1-3 months	3-12 months	Total within 1 year
Claims on Banks-contingent items	242,424	45,671	196,753	-	242,424
Total	-	46,671	196,753	-	242,424

6. Risk Management (continued)

Credit-related contingent items:

Credit related contingent items comprise letters of credit confirmations, acceptance and guarantees. For credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor (CCF). The CCF applied is at 20% to convert off balance sheet notional amounts into an equivalent on balance sheet exposure.

6.7 Impairment of assets

The Bank makes an assessment at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, an impairment loss is recognised in the statement of income.

Evidence of impairment may include indications that a borrower is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that the borrower will enter bankruptcy or other financial re-organisation and where, observable data indicates, that there is a measurable decrease in the estimated future cash flows such as changes in arrears or economic conditions that correlate with defaults.

Refer Disclosures made under 7.2 for details of Impaired loans and relative specific provision made during 2009.

6.8 Market Risk

Market risk is the risk of potential financial loss that may arise from adverse changes in the value of a financial instrument or portfolio of financial instruments due to movements in interest rates, foreign exchange rates and equity prices. This risk arises from asset - liability mismatches, changes that occur in the yield curve and foreign exchange rates. Given the Bank's low risk strategy, aggregate market risk levels are considered very low.

Interest rate risk on the Banking book arises from the possibility that changes in interest rates will affect the value of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or reprice in a given period. The Bank manages this risk by matching the repricing of assets and liabilities through basis point value approach, which measures changes in economic value resulting from changes in interest rates. The Bank's interest rate sensitivity position as of 31 December 2009 for a change in 25 basis points will result in an increase or decrease on statement of income by +/- US\$ 237 thousand.

Currency risk arises from the movement of the rate of exchange over a period of time. The Banks currency risk is limited to Euro denominated assets and liabilities, as Bahrain Dinars and GCC Currencies (except Kuwaiti Dinars) are pegged to US Dollars. The Bank limits this risk by monitoring positions on a regular basis. Thus, the Banks exposure to currency risk is minimal and insignificant.

6. Risk Management (continued)

6.8 Market Risk (continued)

Liquidity risk is the risk that the Bank will be unable to meet its funding requirements. Liquidity risk can be caused by market disruptions or a credit downgrade which may cause certain sources of funding to dry up immediately. During 2009, the Bank depended mainly on its own capital and assets were managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents and deposits with banks.

6.9 Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems, or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely, however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal, the Bank intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to senior management and the Board of Directors.

Operational functions of booking, recording and monitoring of transactions are carried by staff that are independent of the individuals initiating the transactions. Each business line including Operations, Information Technology, Human Resources, Compliance and Financial Control – is further responsible for employing the aforementioned framework processes and control programmes to manage its operational risk within the guidelines established by the Bank policy, and to develop internal procedures that comply with these policies.

6.10 Capital management :

Internal Capital Adequacy Assessment Process (ICAAP)

The Bank's capital management aims to maintain an optimum level of capital to enable it to pursue the Bank's corporate strategies whilst meeting regulatory ratio requirements.

Comprehensive assessment of economic capital, i.e., credit, market and operational risks and processes relating to other risks such as liquidity, is made, reviewed and monitored regularly. The Bank's capital adequacy ratio of 28.71% is well above the regulatory requirement and provides a healthy cushion against any stress conditions.

Supervisory Review and Evaluation Process (SREP):

Central Bank of Bahrain (CBB) is the regulator for the Bank and sets the minimum capital requirement. CBB requires the Bank to maintain a 12% minimum ratio of total capital to risk weighted assets, taking into account both on balance sheet and off balance sheet exposures. The Bank maintains a strong and healthy capital adequacy ratio.

7. Other Disclosures

7.1 Related Party transactions

Related party represents major shareholders, directors, key management personnel and entities significantly influenced by such parties. Pricing policies are at arm's length and approved by executive management and Board of Directors.

31 December 2009
US\$ '000

Exposures to related parties:	578
Liabilities to related parties:	
Connected deposits	125,656

7.2 Impaired loans and relative provision:

31 December 2009
US\$ '000

Gross impaired loans	2,250
Less: Specific provision	(400)
Net impaired loans	1,850

Movement in impairment provision:

	Specific	Collective	Total
Opening specific provision	-	-	-
Specific charge for the year	<u>400</u>	<u>300</u>	<u>700</u>
Closing specific provision	<u>400</u>	<u>300</u>	<u>700</u>

The impaired loans and provisions against it relates to commercial and business loans in Other GCC Countries.

The collaterals consist of securities and properties which are managed by the syndicated agent and valued on an annual basis.

All past due loans are impaired and are past due for a period of one to three years.

7.3 Restructured facilities:

31 December 2009
US\$ '000

Balance of any restructured credit facilities as at year end	42,529
Loans restructured during the year	1,850
Impact of restructured credit facilities on present and future earnings	-

7.4 Assets sold under recourse agreements: The Bank did not enter into any recourse agreements during the year ended 31 December 2009.

7.5 Equity positions in the banking book : None