Alubaf Arab International Bank B.S.C(c)

BASEL III PILLAR III DISCLOSURES

31 DECEMBER 2019

ALUBAF Arab International Bank B.S.C. (c)
Basel III -Pillar III disclosures
As at 31 December 2019

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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 III 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 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, Commerce and Tourism under Commercial Registration (CR) number 12819. The Bank operates under a wholesale banking license issued by the CBB. The Bank’s registered office is at Alubaf Tower, Al Seef District, P O Box 11529, Manama, Kingdom of Bahrain.

The Bank is majority owned by Libyan Foreign Bank (Shareholding 99.50%), 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 and Tier II capital, which includes expected credit loss, stage 1 and 2 (ECL Stage 1 & 2) provision.

The Bank's issued and paid up capital was US$ 250 million as at 31 December 2019, comprising of 5 million equity shares of US$ 50 each.

Break down of Capital Base		
	US$ '000s	**US$ '000s**
	CET I	**Tier II**
Share Capital	250,000	-
Statutory reserve	25,631	-
Retained earnings	23,478	-
Current interim net profit	28,741	-
Cumulative fair value changes on FVOCI Investments (Debt)	1,787	-
Total CET I capital prior to regulatory adjustments	**329,637**	-
Less: intangibles other than mortgage rights	**(1,464)**	-
Add: cash flow hedge reserve	**442**	-
Total CET I capital after regulatory adjustment	**328,615**	-
Expected credit losses (ECL) Stage 1 & 2	-	6,937
Total	**328,615**	**6,937**
Total available capital		**335,552**

ALUBAF recorded a net profit of US$ 28,741 thousand for the year ended 31 December 2019 and transferred 10% of net profit (US$ 2,874 thousand) to Statutory reserve.
The Bank proposed a dividend of US$ 15,000 thousand, i.e., US$ 3 per Ordinary share for the year 2019.

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:
The Bank's capital adequacy ratio of 50.99% is well above the minimum regulatory requirement of 12.5%.

	US$ '000
Total Eligible Capital Base	**335,552**
Risk weighted assets (RWA)	
Credit risk	589,831
Market risk	1,675
Operational risk	66,528
	658,034
CET I ratio	**49.94%**
Capital adequacy ratio	**50.99%**

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.

(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) Any exposure exceeding 15% of Total capital

Claims on Banks or Corporate and other sovereigns or equity exposure that exceed 15% of total capital are risk weighted at 800%.

(g) Other exposures

These are risk weighted at 100%.

Credit exposure and risk weighted assets (*US$ '000)*

	Funded exposures	Unfunded exposures	Gross credit exposures	Eligible collateral	Risk weighted assets	Capital charge
Claims on sovereigns	567,048	-	**567,048**	**-**	**72,220**	**9,028**
Claims on banks	517,164	78,871	**596,035**	**4,807**	**432,698**	**54,087**
Claims on corporate	64,837	-	**64,837**	**-**	**74,977**	**9,372**
Past due exposures	-	-	**-**	**-**	**-**	**-**
Equity portfolio	-	-	**-**	**-**	**-**	**-**
Other exposures	9,936	-	**9,936**	**-**	**9,936**	**1,242**
Total	**1,158,985**	**78,871**	**1,237,856**	**4,807**	**589,831**	**73,729**

Gross credit exposure before credit risk mitigation (*US$ '000)*

	Gross credit exposure	Average monthly gross exposure
Claims from Sovereigns	567,048	521,819
Claims from Banks	517,164	554,154
Claims on Corporate	64,837	59,488
Other exposures	9,936	2,405
Total funded exposure	**1,158,985**	**1,137,866**
Unfunded exposures	**78,781**	**81,318**
Gross credit exposures	**1,237,856**	**1,219,184**

Average monthly balance represents the average of the sum of twelve-month end balance for the year ended 31 December 2019.

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 charge**	**Maximum value**	**Minimum value**
Foreign exchange risk	1,675	209	2,375	100

5.3 Operational risk

In accordance with the Basic indicator approach, the total capital charge in respect of operational risk was US$ 8,316 thousand on operational risk weighted exposure of US$ 66,528 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 of three years’ 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 rulebook.

6. Risk Management

Risk is inherent in the Bank’s business activities and is managed through a process of ongoing identification, measurement, controlling and monitoring. The Bank is exposed to credit risk, market and operational risk. Risk strategies of the Bank to mitigate the various risks were effective throughout the year. Following is the Risk and Capital Management Structure:

Board of Directors

Board Audit, Risk & Compliance Committee
Management Risk Committee
Asset Liability Management Committee

The Board of Directors is responsible for the best practice management and risk oversight. Board of Directors defines the risk appetite and risk tolerance standards and oversees that risk process standards are in place. At the second level, 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. Senior management is responsible for monitoring credit lending portfolio, country limits, interbank limits, and general credit policy matters, which are reviewed and approved by the Board of Directors.

Independent internal audit of risk management process is conducted and its findings are to the Audit, Risk and Compliance Committee, which is appointed by the Board of Directors.

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 2019, the Bank's exposure in excess of 15% of the obligor limits to individual counterparties is shown below:

US $ '000	Funded exposure	Unfunded exposure	Total
Counterparty A *	414,168	Nil	414,168
Counterparty B *	52,345	Nil	52,345

* Comprise of exempted large exposure to sovereign and bank.

Risk mitigation –collateral

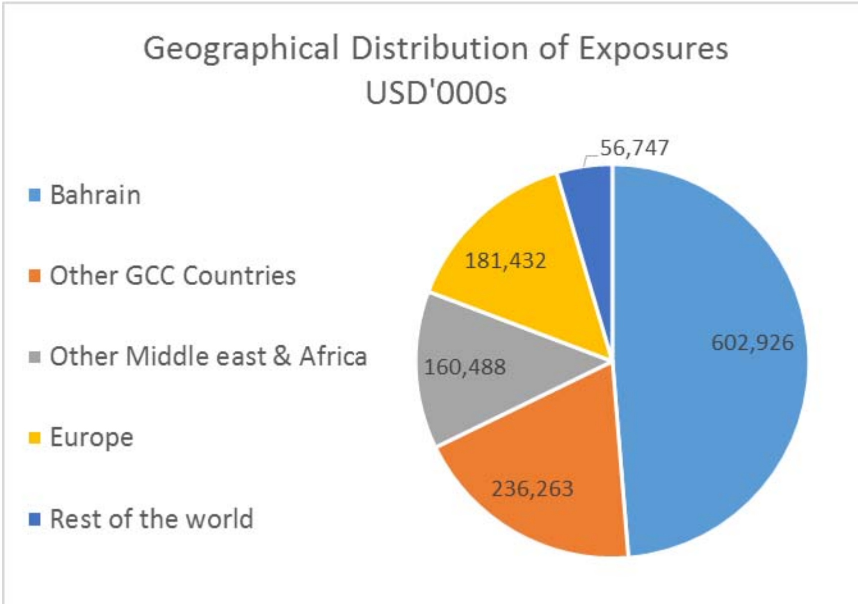
The amount and type of collateral depends on an assignment of the credit risk, credit rating and market conditions of the counterparty. The types of collateral mainly include cash collaterals for both funded and unfunded credit exposures, which is liquidated on maturity/expiry date. However, the impact on cash collateral will be nil with credit downgrade.

Majority of the collateral taken by the Bank is in cash; therefore, concentration risk is not significant. For further details on refer note 22.2 of the annual audited financial statements for the year ended 31 December 2019.

6.2 Geographical distribution of exposures

Geographical distribution of exposures based on residence is summarized below:

US$'000	Gross credit exposure	Funded exposure	Unfunded exposure
Bahrain	602,926	602,926	-
Other GCC Countries	236,263	233,829	2,434
Other Middle east & Africa	160,488	105,677	54,811
Europe	181,432	160,522	20,910
Rest of the world	56,747	56,031	716
Total	**1,237,856**	**1,158,985**	**78,871**

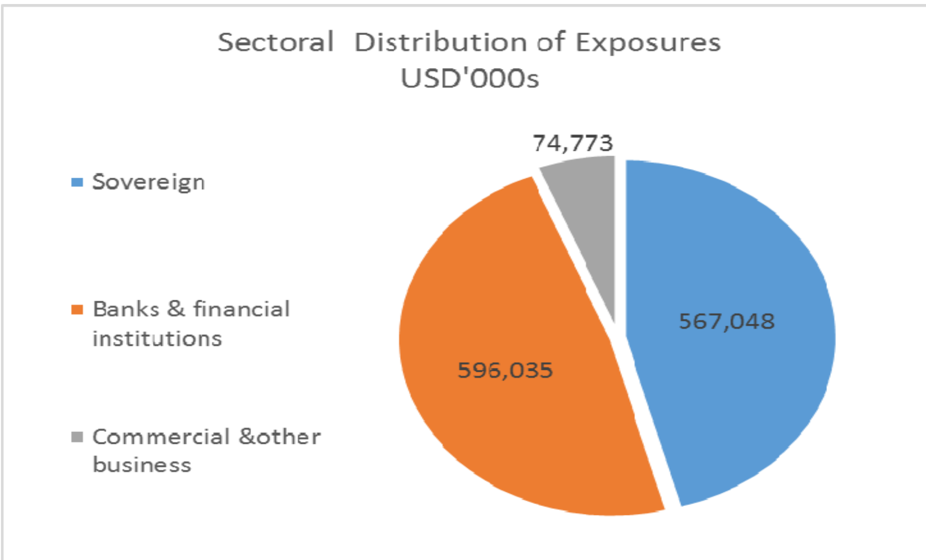


The geographical distribution of gross credit exposures by major type of credit exposures can be analyzed as follows:

US$ '000	Bahrain	Europe	Other GCC Countries	Other Middle East and Africa	Rest Of the world	Total
Claims from Banks	139,703	119,591	165,299	36,540	56,031	**517,164**
Claims from Sovereigns	448,251	-	49,660	69,137	-	**567,048**
Claims on Corporate	5,036	40,931	18,870	-	-	**64,837**
Other exposures	9,936	-	-	-	-	**9,936**
Total funded exposure	**602,926**	**160,522**	**233,829**	**107,346**	**56,031**	**1,158,985**
Unfunded exposures	-	**20,910**	**2,434**	**54,811**	**716**	**78,871**
Gross credit exposures	**602,926**	**181,432**	**236,263**	**160,488**	**56,747**	**1,237,856**

6.3 Industry sector analysis of exposures is summarized below:

US$ '000	Gross credit exposure	Funded exposure	Unfunded exposure
Sovereign	567,048	567,048	-
Banks & financial institutions	596,035	517,164	78,871
Commercial & other business	74,773	74,773	-
Total	**1,237,856**	**1,158,985**	**78,871**



The industry sector analysis of gross credit exposures by major types of credit exposures can be analyzed as follows:

USD '000s	Banks & financial institutions	Commercial & other businesses	Sovereign	Total
Claims from Banks	517,164	-	-	**517,164**
Claims from Sovereigns	-	-	567,048	**567,048**
Claims on Corporate	-	64,837	-	**64,837**
Other exposures	-	9,936	-	**9,936**
Total funded exposure	**517,164**	**74,773**	**567,048**	**1,158,985**
Unfunded exposures	**78,871**	**-**	**-**	**78,871**
Gross credit exposures	**596,035**	**74,773**	**567,048**	**1,237,856**

6.4 Exposure by external credit rating

The Bank uses external credit ratings from Standard & Poors, Moodys and Fitch, which are accredited External Credit Assessment Institutions (ECAI). The Bank assigns 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 are chosen. The breakdown of the Bank's exposure into rated and unrated categories is as follows:

US$ '000	Funded exposure	Unfunded exposure	Rated-High standard grade exposure	Rated-Standard grade exposure	Unrated exposure
Claims on Banks	517,164	78,871	156,862	329,883	109,290
Claims on Sovereigns	567,048	-	11,167	548,070	7,811
Claims on Corporate	64,837	-	-	41,208	23,629
Other exposures	9,936	-	-	-	9,936
Total	**1,158,985**	**78,871**	**168,029**	**919,161**	**150,666**

6.5 Maturity analysis of funded exposures

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

US$ '000	*Within 1 month*	*1-3 months*	*3-12 months*	*Total within 1 year*	*1-10 years*	*Total*
Claims on Sovereigns	77,234	195,316	106,782	**379,332**	187,716	**567,048**
Claims on Banks	343,174	87,228	38,724	**469,126**	48,038	**517,164**
Claims on Corporate	91	5,267	16,579	**21,937**	42,900	**64,837**
Other exposures	46	500	10	**556**	9,380	**9,936**
Total	**420,545**	**288,311**	**162,095**	**870,951**	**288,034**	**1,158,985**

6.6 Maturity analysis of unfunded exposures

US$ '000	*Over one year*	*Total*
Claims from Banks	78,871	**78,871**
Total	**78,871**	**78,871**

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.
Derivatives including futures, forwards, swaps and options in the interest rate and foreign exchange. Derivatives are exposed to market risk, which requires a separate capital charge as prescribed under the Basel III guidelines. Also, refer to Audited financial statements for the year ended 31 December 2019, Note 23.

6.7 Impairment of assets

The Bank had adopted IFRS 9 methodology of recording impairment of assets, effective 1 January 2018. IFRS 9 adoption fundamentally changes to a forward looking and expected credit loss (ECL) approach . The Bank records an allowance for expected losses for all loans and other debt type financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECL associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.
Refer Disclosures made under Section 7 for details of impaired loans and relative specific provision made during 2019.

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 because of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period. The Bank manages this risk by matching the re-pricing 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 2019 for a change in 200 basis points will result in an increase or decrease on statement of income by US$ 3,223 thousand for US$ denominated and US$ 662 on AED denominated financial instruments.

Currency risk arises from the movement of the rate of exchange over a period of time. The Bank's currency risk is mainly towards assets and liabilities denominated in GBP and Euro, 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, also, refer to Audited financial statements for year ended 31 December 2019, note 22.3.2.

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 2019, 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 performed 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 programs 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 50.99% 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 12.5% 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 parties represent shareholders, directors and key management personnel of the Bank, and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's management.

US$ '000	***31-Dec-19***
Statement of profit or loss	
Interest & similar income	172
Interest expense	15,820
Fee and commission income	1,054
Assets	
Cash and balances with banks	7,391
Deposit with banks and financial institutions	-
Loans and advances	4,561
Interest receivable	38
Other assets	45
Liabilities	
Deposits from banks and other financial institutions	519,918
Due to banks and other financial institutions	20,635
Interest payable	1,692
Other liabilities	336
Contingent liabilities	
Letters of credit and letters of guarantee	23,403
Assets under management	21,535

7.2 Impaired loans and relative provision (stage 3):

USD'000s	**1 to 3 year**	**over 3 years**	**Total**
Gross impaired loans (stage 3)	26,057	66,950	**93,007**
Less: Specific Provision (stage 3)	26,057	66,950	**93,007**
Net outstanding 31 December 2019	**-**	**-**	**93,007**

Movement in impairment provision including Expected credit losses - Loans and advances

USD'000s	Stage 1	Stage 2	Stage 3	Total
Loans				
At beginning of the year	3,651	2,636	99,471	**105,758**
Transfer to Stage 1	1	(1)	-	**-**
Transfer to Stage 2	-	-	-	**-**
Transfer to Stage 3	-	(2,635)	2,635	**-**
Net re-measurement loss allowance	303	-	18,133	**18,,436**
(Write back)/(Recoveries)/Write off	(2,020)	-	(27,128)	**(29,148)**
Exchange difference	-	-	(104)	**(104)**
Balance as at 31 December 2019	**1,935**	**-**	**93,007**	**94,942**

Movement in expected credit losses – Investments

USD'000s	Stage 1	Stage 2	Total
Investments			
At beginning of the year	463	1,488	**1,951**
Transfer to Stage 1	-	-	**-**
Transfer to Stage 2	(54)	54	**-**
Transfer to Stage 3	-	-	**-**
Net re-measurement loss allowance	(90)	2,790	**2,700**
(Write back)/(Recoveries)/Write off	-	-	**-**
Balance as at 31 December 2019	**319**	**4,332**	**4,651**

Movement in expected credit losses - Other Financial Assets and Off-Balance Sheet Items:

-

USD'000s	Stage 1	Stage 2	Total
At beginning of the year	808	-	**808**
Transfer to Stage 1	-	-	**-**
Transfer to Stage 2	(1)	1	**-**
Transfer to Stage 3	-	-	**-**
Net re-measurement loss allowance	(458)	1	**(457)**
(Write back)/(Recoveries)/Write off	-	-	**-**
Balance as at 31 December 2019	**349**	**2**	**351**

Specific Provision by Geographic and Sector (Stage 3):

USD '000s	**Europe**	**Other Middle East and Africa**
Banks & Financial Institutions	-	41,772
Sovereigns	-	2,804
Corporate	20,418	28,013
Total	**20.418**	**72,589**

Expected Credit loss (Stage 1 & 2) provision of US$ 6,937 thousand as at 31 December 2019 is not for any specific geographic region.

7.3 Restructured facilities:

US$ '000	***31-Dec-19***
Gross balance of any restructured credit facilities as at 31 December 2019	*5,908*
Total	***5,908***

During the year ended 31 December 2019, no loans were restructured. The facilities restructured prior to year 2019 have been categorized as per IFRS -9 requirement and required Expected credit loss provision (ECL) has been considered during the year.

7.4 Assets sold under recourse agreements: The Bank did not enter into any recourse agreements during the year ended 31 December 2019.

7.5 Equity positions in the banking book : Nil