



## **BASEL III PILLAR 3 DISCLOSURES**

**At 31 December 2022**

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## 1. Executive Summary

This document provides the disclosures pertaining to risk and capital management for Alubaf Arab International Bank B.S.C. (c) (the “Bank”) and its wholly owned subsidiary, Bahrain Real Estate Development Company (together the “Group”) as of 31 December 2022. The purpose of the document is to enhance the financial transparency through better public disclosure (as required by Central Bank of Bahrain public disclosure module) and facilitate the market discipline to align with Basel III accord.

Central Bank of Bahrain (“CBB”), the regulating body for banks and financial institutions in the Kingdom of Bahrain has issued the directives relating to public disclosures. The disclosure requirements in PD module of CBB rulebook follow the requirements of Basel III Pillar 3 and are in addition to, or in some cases serve to clarify, the disclosure requirements of International Financial Reporting Standards (“IFRS”). This document gathers all the elements of the disclosures required under Pillar III and complies with the public disclosure module of CBB (including companies’ law), in order to enhance corporate governance and financial transparency. The Pillar 3 disclosures are to be read in conjunction with the consolidated financial statements of the Group presented in accordance with IFRS as of 31 December 2022 as well as the capital disclosures and liquidity disclosures published separately on the Group’s website.

For regulatory reporting purposes, the Group has adopted the standardized approach for credit and market risk and the basic indicator approach for operational risk to determine the capital requirements under Pillar 1. The Group’s total risk-weighted assets as of 31 December 2022 amounted to US\$ 632 million (December 2021: US\$ 789 million), comprising 90.81% of credit risk, 0.05% of market risk and 9.14% of operational risk weighted assets. The total consolidated capital adequacy ratio stood at 52.89% (December 2021: 43.34%), compared to the minimum regulatory requirement of 12.50%.

Figures in \$ 000s	Dec 2022	Dec 2021
Tier 1 capital	330,147	336,105
Tier 2 capital	3,943	5,917
<b>Total Capital</b>	<b>334,090</b>	<b>342,022</b>
Credit risk weighted assets	573,549	726,325
Market risk weighted assets	338	74
Operational risk weighted assets	57,754	62,816
<b>Total Risk Weighted assets</b>	<b>631,641</b>	<b>789,215</b>
<b>Tier 1 Capital Ratio</b>	<b>52.27%</b>	<b>42.59%</b>
<b>Total Capital Ratio</b>	<b>52.89%</b>	<b>43.34%</b>

There are no restrictions on the transfer of funds or regulatory capital within the Group and there are no differences in the basis of consolidation for accounting and regulatory purposes for the subsidiary within the Group.

## 2. Basel III Framework

The CBB’s Basel III framework is based on three pillars, consistent with framework developed by the Basel Committee, as follows: -

- Pillar 1: the calculation of risk-weighted assets (“RWAs”) and capital requirements for credit, market and operational risks.
- Pillar 2: the supervisory review process, including the Internal Capital Adequacy Assessment Process (“ICAAP”).
- Pillar 3: the disclosure of risk management and capital adequacy information.

### 2.1 Pillar 1

Pillar 1 prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar 1 sets out the definition and calculations of the RWAs, and the derivation of the regulatory capital base. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total RWAs. As at 31 December 2022, all Banks incorporated in the Kingdom of Bahrain were required to maintain a minimum capital adequacy ratio of 12.50 percent and a tier 1 ratio of 10.50 percent. In the event that the capital adequacy ratio falls below 12.50 percent, additional prudential reporting requirements apply and a formal action plan setting out the measures to be taken to restore the ratio above the target level is to be formulated and submitted to the CBB.

The table below summarizes the Group’s approach for calculating RWAs and capital requirements for each risk type in accordance with the CBB’s Basel III capital adequacy framework:

Approaches for determining regulatory capital requirements		
Credit risk	Market risk	Operational risk
Standardized approach	Standardized approach	Basic indicator approach

#### a) Credit Risk

For regulatory reporting purposes, the Group applies the standardized approach for credit risk. The RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty’s external rating, where available.

#### b) Market Risk

For the regulatory market risk capital requirement, the Group applies the standardized approach based on net open position of foreign currencies as per Capital Adequacy (the “CA”) module of the CBB rule book.

#### c) Operational Risk

Under the CBB’s Basel III capital adequacy framework, all banks incorporated in Bahrain are required to apply the basic indicator approach for operational risk with prior notification to CBB unless approval is granted by the CBB to use the standardized approach. Currently, the Group uses the Basic Indicator Approach for calculating its capital requirement for operational risk.

## 2.2 Pillar 2

Pillar 2 defines the process of supervisory review of an institution's risk and capital management framework and, ultimately, its capital adequacy. Under the Pillar 2 guidelines, each Bank is required to internally assess its capital requirements taking into consideration all material risks through the ICAAP assessment process and establish internal minimum capital limits.

Pillar 2 comprises of two processes: -

- An ICAAP review; and
- A supervisory review and evaluation process.

### **Internal Capital Adequacy Assessment Process:**

The Group has a capital management and planning framework which ensures adequate capital is available for any expected/unexpected loss and to support its strategic growth opportunities. The capital planning of the Group is carried out through ICAAP which covers inter-alia:

- Forecast of the strategic and business growth plan of the Group over the next 3 years
- Quantitative and qualitative assessment of various external and internal risk factors
- Assessment of capital adequacy under normal and stress scenarios
- Planning of capital action, if any, required to accomplish the strategic and financial objectives of the Group.

The Group has a comprehensive ICAAP that includes board and senior management oversight, monitoring, reporting and internal control reviews, to identify and measure the various risks that are not covered under Pillar 1 risks and to regularly assess the overall capital adequacy considering the risks and the Group's planned business strategies. The non-Pillar 1 risks covered under the ICAAP process include concentration risk, liquidity risk, interest rate risk in the banking book, reputational risk and strategic risks. The ICAAP also keeps in perspective the Group's strategic plans, credit and investment growth expectations, future sources and uses of funds, dividend policy and the impact of all these on maintaining adequate capital levels. In addition, the ICAAP process also includes stress testing on the Group's capital adequacy to determine the capital requirement and planning to ensure that the Group is adequately capitalized in line with the overall risk profile.

The Group has complied with regulatory capital requirements throughout the period. The Group's consolidated capital adequacy ratio of 52.89% is well above the regulatory requirement and provides a healthy cushion against any stress conditions.

### **Supervisory Review and Evaluation Process:**

The supervisory review and evaluation process represent the CBB's review of the Bank's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process are designed to ensure that Banks identify their material risks and allocate adequate capital, and employ sufficient management processes to support such risks. The supervisory review and evaluation process also encourage institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar 1 framework. Other risk types which are not covered by the minimum capital requirements in Pillar 1 include: -

- Liquidity risk
- Concentration risk
- Interest rate risk in the banking book (IRRBB)
- Reputational risk
- Strategic risk

These are covered either by capital, or risk management and mitigation processes under Pillar 2.

### **2.3 Pillar 3**

In the CBB's Basel III framework, the third pillar prescribes how, when, and at what level information should be disclosed about an institution's risk management and capital adequacy practices. The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar 3 disclosure requirements is to complement the first two pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all Banks, via market pressures, to move towards more advanced forms of risk management. Under the current regulations, partial disclosures consisting mainly of quantitative analysis is required during half year reporting, whereas full disclosure is required to coincide with the financial year-end reporting. In this report, the Group disclosures are beyond the minimum regulatory requirements and provide disclosure of the risks to which it is exposed, both on- and off-balance sheet. The disclosures in this report are in addition to the disclosures set out in the consolidated financial statements presented in accordance with IFRS and accordingly these disclosures should be read in conjunction with the Group's consolidated financial statements for the year ended 31 December 2022.

## **3. Organizational structure, Risk and Capital Management**

### **3.1 Organization structure**

The Group operates under a wholesale banking license issued by Central Bank of Bahrain, to provide Treasury, Loan and Trade finance banking solutions. The Group's customer base includes primarily Corporate, Banks, Financial Institutions, Governments and Semi-government Entities, Public Sector Companies in the GCC, MENA & European markets as well as other countries across the world.

The Group's largest single shareholder is Libyan Foreign Bank (99.50%); other shareholders comprise of National Bank of Yemen (0.28%) and Yemen Bank for Reconstruction and Development (0.22%). Libyan Foreign Bank (LFB) is 100% owned by the Central Bank of Libya.

The Group's consolidated financial statements are prepared and published in accordance with IFRS. Regulatory capital is reported to the CBB on a regular basis (at least on quarterly basis by way of submitting the Prudential Information Return report) in accordance with CBB guidelines.

### **3.2 Risk and Capital Management**

The Group maintains a prudent and disciplined approach to risk-taking by upholding a comprehensive set of risk management policies, processes and limits, employing professionally qualified people with the appropriate skills, investing in technology and training, and actively promoting a culture of sound risk management at all levels. A key tenet of this culture is the clear segregation of duties and reporting lines between personnel transacting business and personnel processing that business. The Group's risk management is underpinned by its ability to identify, measure, aggregate and manage the different types of risk it faces.

The overall authority for risk management in the Group is vested in the Board of Directors. The Board defines the risk appetite and risk tolerance standards and oversees that adequate risk management standards are in place. The Board also approves appropriate risk policies that form part of its risk management framework, based on the recommendation of management. The Board is supported by the Audit, Risk and Compliance Committee ("ARCC") which oversees the risk management, compliance and internal audit activities as well as ensuring integrity of the consolidated financial statements.

### 3.2 Risk and Capital Management (continued)

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. The Group has established various management committees that review and assess all risk issues. Approval authorities are delegated to different functionaries in the hierarchy depending on the amount, type of risk and nature of operations or risk and the same is codified in the Delegations of Authority (DOA) document approved by the Board.

The risk management department of the Group provides the necessary support to senior management and the business units in all areas of risk management. The risk management function under the Chief Risk Officer (the "CRO") is independent of the business units of the Group, reporting to the ARCC and administratively to the Chief Executive Officer (the "CEO"). The Financial Control Department is responsible for the capital planning process.

Independent internal audit of the risk management process is conducted and its findings are presented to the ARCC.

Following is the governance structure for Risk and Capital Management in the Group:

Board of Directors					
Board Audit, Risk and Compliance Committee					
Chief Executive Officer					
Asset and Liability Committee (ALCO)	Management Risk Committee (MRC)	Credit Investment Committee (CIC)	Special Asset Management Committee (SAMC)	Cyber Security Committee (CSC)	Insurance Coverage Committee (ICC)

The risk, liquidity and capital management responsibilities are set out in the table below:

Chief Executive Officer	
Head of Financial Control Department	Chief Risk Officer *
Capital management framework Regulatory Reporting	Risk management framework and policies Credit Management Credit risk Market risk Operational risk Cyber Security risks Liquidity and Other risks ICAAP and Stress Testing

\* CRO is an independent function which reports to the ARCC, and administratively to the CEO.

The Group's capital management policies aim to ensure that the Group complies with regulatory capital requirements as well as to ensure adequate availability of capital to meet the Group's strategic growth requirements and maximize shareholder value.

### **3.3 Risk Types**

The major risks associated with the Group's business activities are credit, market and operational risks. Additionally, other material risks that the Group is exposed to include – liquidity risk, concentration risk, interest rate risk in banking book, reputational risk and strategic risk. These risks are continuously monitored and mitigated through effective process of ongoing identification, measurement, controlling and monitoring throughout the year. The following section provides the way these risks are managed and controlled.

### **3.4 Risks in Pillar I**

Basel III Pillar 1, which forms the basis for the calculation of the regulatory capital requirement, addresses three specific risk types: credit risk, market risk and operational risk:

#### **a) Credit risk**

The credit risk is the main financial risk relative to the other risks for the Group because of its nature of business to finance and invest. Credit risk represents the potential financial loss as a consequence of a customer's inability to honour the terms and conditions of a credit facility. Such risk is measured with respect to counterparties for both on-balance sheet assets and off-balance sheet items. The Group measures and manages Credit Risk by adhering to the following principles:

- Consistent standards are applied across all customers in the risk-evaluation process using a rating system. The Group has in place a systematic credit rating system which provides a framework for objective risk assessment;
- The exposure should be reasonable in relation to the customer's creditworthiness, capital position or net worth components, and the customer should be able to substantiate its repayment ability;
- Every extension of credit or material change to a credit facility (such as its tenor, collateral structure or major covenants) to any counterparty requires credit approval at the appropriate authority level;
- The Group regularly follows up on developments in the customer's financial position in order to assess whether the basis for the granting of credit has changed; and
- The Group assumes risks within the limits guided under its risk management framework and other rules prescribed by the CBB from time to time.

The Group has in place a credit risk management framework comprising of detailed credit risk management policies and procedures, regular credit assessments and monitoring, internal rating grades, credit administration activities, collateral management and early warning indicator monitoring. Regular reviews are carried out for each exposure and risks identified are mitigated in a number of ways, which include obtaining collaterals or guarantees. The credit risks are continuously monitored for changes in external environments and other economic challenges that may impact the counterparty's credit profile as part of early warning indicator monitoring. Similarly, prudent norms have been implemented to govern the Group's investment activities, which specify to the Group's Treasury and Investment department, the acceptable levels of exposure to various products, based on its nature, tenor, rating, type, features and other relevant factors.

The business units of the Group are responsible for business generation and initial credit review of proposals in accordance with the stipulated policy requirements. The Group has an independent credit management unit which is responsible to perform a rigorous independent credit analysis for the counterparty and assign an internal credit rating reflecting the level of credit risk.

In addition, the independent credit administration unit ensures that adherence to the terms and conditions of all credit facilities are strictly implemented and collateral coverage is monitored. The Group has an internal grading system and review process which ensures identification of any deterioration in credit risk and consequent implementation of corrective action. The Group's internal ratings are based on a 20-point scale (AAA to Loss), which considers the financial strength of a borrower as well as qualitative aspects to arrive at a comprehensive snapshot of the risk of default associated with the borrower. The internal rating model is reviewed and validated periodically by an independent external consultant to ensure robustness of the model in terms of stability and discriminatory power of the ratings. Risk ratings assigned to each borrower are reviewed on at least an annual basis. Regular monitoring of the portfolio enables the Group to identify accounts, which witness deterioration in risk profile.



## b) Market Risk

Market risk is the potential impact of adverse price movements such as benchmark interest rates, foreign exchange prices, equity prices and commodity prices on the Bank's earnings and capital. The exposure to market risk occurs throughout the contract which may negatively affect the earnings and value of an asset. The categories of market risk to which the Group is exposed are as follows:

**Interest rate risk** results from exposure to changes in the level, slope, curvature and volatility of interest rates and credit spreads.

**Foreign exchange risk** results from exposure to changes in the price and volatility of currency spot and forward rates. The principal foreign exchange risk arises from the Group's foreign exchange positions in the banking book including its proprietary positions as well as positions arising from client servicing.

**Equity risk** arises from exposures to changes in the price and volatility of individual equities or equity indices. The Group does not maintain any equity exposures as at the reporting date and therefore is not exposed to equity price risks.

**Commodity risk** arises from exposures to changes and volatility of commodity prices. The Group does not maintain any exposures to commodities as at the reporting date and therefore is not exposed to commodity price risks.

The Group does not have material exposure to market risk on account of its limited trading activities. The Group's market risk management framework comprises of a various concentration limits to diversify its market risk exposures as well as stop loss limits to minimize losses. The main market risk exposures arise from its forex risk exposures, wherein the Group maintains net open position limits for each active currency which are monitored on a daily basis.

## c) Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and 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. The Operational Risk Management Framework (the "ORMF") is codified in the Group's operational risk management policy and broadly comprises of the following:

- Well defined governance framework and delegation of authorities;
- Detailed policies and procedures for all activities of the Group;
- Segregation of duties and internal controls;
- Risk and Controls Self-assessments;
- Identifying and monitoring of Key Risk Indicators; and
- Incident reporting and collection of losses from operational incidents, including near misses.

Qualitative and quantitative methodologies are used to identify and assess operational risk and to provide management with information for determining appropriate mitigating factors. These include a database of operational risk incidents; monitoring of key risk indicators, which can provide an early warning of possible risk; and a Risk and Control self-assessment (the "RCSA") process to analyse business activities and identify operational risks related to those activities. The management of operational risk has a key objective of minimising the impact of losses suffered in the normal course of business (expected losses) and to avoid or reduce the likelihood of suffering a large extreme (unexpected) loss.

### c) Operational Risk (continued)

The RCSA is performed on an annual basis, by obtaining senior management inputs to enhance the control environment of the Group. The Group's risk management department coordinates with the heads of departments and the respective risk champions in each department, to conduct the RCSA assessments. As part of such assessments, the key operational risks within each department's activities are evaluated along with the controls available to mitigate or minimize such risks. Based on these assessments, each department maintains a risk register for its risks, which is reviewed and updated on an ongoing basis. Further, the Group identifies and maintains a list of Key Risk Indicators (KRIs) which are monitored on a monthly basis and reported to management and Board.

Heads of departments and functions throughout the Group are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data. Operational incidents are monitored on an ongoing basis through the Group's operational risk management system, and the same are reported to management on a monthly basis and to the Board on a quarterly basis. Moreover, the operational incident reports are reviewed jointly by risk management and the respective department for root cause analysis and to introduce additional controls to minimize chances of similar incident recurring.

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 as well support line is further responsible for employing the aforementioned framework processes and control programs to manage its operational risk within the guidelines established by the Group policy, and to develop internal procedures that comply with these policies. Operational risk is also managed through effective staff training and frequent review and enhancement of internal controls of the various activities of the Group. Further, the Group has in place the Business Continuity and Disaster Recovery Policy (BCP/DRP) to ensure that the Group is prepared and has contingency plans in place in the event of a disaster so that business is minimally impacted in such situations. The Group also maintains a well-established framework and policy for managing Cyber Security risks.

## 3.5 Risk in Pillar II

### a) Liquidity Risk

Liquidity risk is defined as the risk to the Group's earnings and capital arising from its inability to meet timely obligations as and when they come due without incurring unacceptable losses. The Group follows a conservative liquidity risk management strategy aligned with its business model. The strategy aims to address:

- Funding liquidity risk and
- Market liquidity risk

The Group utilizes the liquidity management tools in line with Basel III and CBB guidelines on liquidity risk management. The Liquidity Coverage Ratio "LCR" addresses the sufficiency of a stock of high-quality liquid assets to meet short-term liquidity needs under specified scenarios. Under LCR, the objective is to ensure that Group maintains an adequate level of unencumbered, high quality liquid assets that can be converted into cash to meet its liquidity needs, under specific prescribed cash inflows and outflows scenarios, for a 30-day time horizon.

**a) Liquidity Risk (continued)**

The Net Stable Funding Ratio “NSFR” addresses longer-term structural liquidity mismatches. Under NSFR, the objective is to promote more medium and long-term funding of assets through the establishment of a minimum acceptable amount of stable funding over a one-year horizon. The Group maintains its liquidity standards with stable long term and short-term liquidity ratios (NSFR, LCR, Liquidity Ratio etc.) above the regulatory limits.

The Group has in place a liquidity risk management framework comprising of liquidity and funding strategy, liquidity risk limits, procedures for monitoring and reporting liquidity risks, liquidity stress testing and contingency planning. The liquidity risk management framework is codified in the Group’s Liquidity Risk Management Policy approved by the Board.

The Group performs periodic stress testing of its liquidity risk profile to assess its impact on capital and liquidity position.

**b) Credit concentration risk**

Credit Concentration Risk is the risk that the Group’s exposures are concentrated to a sector/industry, geography, product, single party and customer Groups, or countries which impacts the Group’s capital position. It is the risk of exposure to a single counterparty and Group of related counterparties, as well as the exposure to selected economic sectors or countries, that has the potential to produce losses large enough (relative to the Group’s size) to undermine the health of the Group. The existence of exposure concentration can lead to underestimation of Pillar I risks. The Group monitors counterparty, sector and geographic concentration risks and manages them through limits on the same. Regular reports are prepared and analysed to ensure that undesired concentrations are avoided.

Concentration risk is captured in the Group’s Pillar 2 capital framework which considers single-name concentrations, Geographical and Industry concentrations in the credit portfolio and capital requirements to cover concentration risks are assessed.

**c) Interest rate risk in the Banking book**

Interest rate risk is the exposure of a Group’s financial condition to adverse movements in interest rates. Changes in Interest rates affect a Group’s earnings by changing its net Interest income and the level of other Interest-sensitive income and operating expenses. Changes in Interest rates also affect the underlying value of the Group’s assets, liabilities, and off-balance-sheet (OBS) instruments because the present value of future cash flows change when interest rates change.

The Group monitors the re-pricing gap and the market value of asset and liabilities as part of interest rate risk management and also assesses the impact of a shift in market interest rates on the expected net interest income of the Group as well as the impact on the Group’s economic value of Equity.

The Group assesses the earnings at risk due to a shift of 200 bps in benchmark interest rates for allocating capital to cover its interest rate risk in the banking book.

**d) Reputational Risk**

Reputational risk is the risk of losses resulting from adverse perceptions about the Group, its brand and relationship by its various stakeholders that is caused by a variety of internal and external factors. The Group has developed a reputational risk management framework that ensures reputational risk is managed and mitigated and the same is codified in the reputational risk management policy of the Group.

## e) Strategic Risk

Strategic risks refer to the risk that the Group would be exposed in the event of business strategy and plan not materializing. It is the risk to earnings and profitability arising from strategic decisions, changes in the business conditions and improper implementation of decisions. Thus, a strategic risk arises due to adopting wrong strategies and choices that can cause loss to the Group in the form of a reduction in shareholder value and loss of earnings.

The strategic risk is managed through monthly reviews of performance versus budgeted performance and periodic reviews of the Group's performance and alignment with the strategic plan.

## 4. Regulatory capital requirements and the capital base

### 4.1 Capital base

The Group's Capital base comprise of Tier I capital, which mainly includes share capital, statutory reserve, retained earnings and fair value changes for investments fair valued through other comprehensive income ("FVOCI") and Tier II capital, which includes provision for expected credit loss ("ECL") for stage 1 and 2 exposures.

The Group's issued and paid up capital amounted to US\$ 250 million as at 31 December 2022, comprising of 5 million equity shares of US\$ 50 each.

The regulatory capital base is set out in the table below: -

Break down of Capital Base	US\$ '000s	US\$ '000s
	CET I	Tier II
Share Capital	250,000	-
Statutory reserve	31,075	-
Retained earnings	53,223	-
Cumulative fair value changes on FVOCI Investments (Debt)	(11,841)	-
All other reserves (proposed dividend and ECL*)	9,298	-
<b>Total CET I capital prior to regulatory adjustments</b>	<b>331,755</b>	-
<b>Less: intangibles other than mortgage rights</b>	<b>(1,608)</b>	-
<b>Total CET I capital after regulatory adjustment</b>	<b>330,147</b>	-
<b>Add: Expected credit loss, Stage 1 and 2 in Tier 2</b>	-	<b>3,943</b>
<b>Total</b>	<b>330,147</b>	<b>3,943</b>
<b>Total available capital</b>		<b>334,090</b>

Common equity tier 1 (CET 1) comprises of share capital, statutory reserve, retained earnings, and unrealized gains or losses arising on the measurement to fair value of investment securities adjusted with regulatory adjustment for intangible assets and the \*provision for expected credit losses in line with CBB circular No. OG/106/2020 dated 17<sup>th</sup> March 2020. The Group does not maintain any additional-Tier 1 (AT1) capital.

Tier II capital includes provision for expected credit loss on stage 1 and 2 exposures.

#### 4.2 Regulatory capital requirements

For regulatory reporting purposes, the Group calculates the capital requirements as per follows:

- **Credit Risk** - Credit risk capital requirements are based on the standardized approach. Under the standardized approach, on- and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. The exposure categories are referred to in the CBB's Basel III capital adequacy framework as standard portfolios. The primary standard portfolios are claims on sovereigns, claims on banks and claims on corporates. Following the assignment of exposures to the relevant standard portfolios, the RWAs are derived based on prescribed risk-weightings. Under the standardized approach, the risk weightings are provided by the CBB and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the CBB. The Group uses ratings assigned by Standard & Poor's, Moody's and Fitch.
- **Market Risk** – The Group uses a Standardized approach to calculate the regulatory capital requirements relating to market risk.
- **Operational Risk** - The capital requirement for operational risk is calculated in accordance with the basic indicator approach. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by alpha coefficient of 15% as prescribed in the CBB's Basel III capital adequacy framework.
- **Capital adequacy ratio calculation:**

The Group's consolidated capital adequacy ratio of 52.89% is well above the minimum regulatory requirement of 12.50%.

	US\$ '000
Credit risk weighted assets	573,549
Market risk weighted assets	338
Operational risk weighted assets	57,754
<b>Total Risk weighted assets (RWA)</b>	<b>631,641</b>
<b>Total Eligible Capital Base</b>	<b>334,090</b>
<b>CET I ratio</b>	<b>52.27%</b>
<b>Capital adequacy ratio</b>	<b>52.89%</b>

## 5. Credit Risk-Pillar 3 disclosures

This section describes the Group's exposure to credit risk and provides detailed disclosures on credit risk in accordance with the CBB's Basel III framework in relation to Pillar III disclosure requirements.

### 5.1 Definition of exposure classes per Standard Portfolio

The Group has a diversified on- and off-balance sheet credit portfolio, the exposures of which are divided into the counterparty exposure classes defined by the CBB's Basel III capital adequacy framework for the standardized approach for credit risk. A high-level description of the counterparty exposure classes and 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 respective central banks. Claims on Bahrain and GCC governments are risk weighted at 0%. Foreign currency claims on other sovereign exposures are risk-weighted based on their external credit ratings or if unrated at 100%.

#### (b) Claims on PSE

Public sector entities (PSEs) are risk-weighted according to their external ratings with the exception of Bahrain PSEs, and domestic currency claims on other PSEs which are assigned a 0% risk weight by their respective country regulator.

#### (c) 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 maturing within three months and denominated in Bahraini Dinars or US Dollars are risk weighted at 20%. Other claims on banks, are risk weighted using standard risk weights ranging from 20% to 150%. Unrated claims on banks are assigned a risk weight of 50%.

#### (d) 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.

#### (e) Equity portfolios

Investments in listed equities are risk weighted at 100%, and investments in unlisted equities are risk weighted at 150%.

#### (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 include investment property risk weighted at 200% and other assets risk weighted at 100%.

#### (h) 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 is 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.

## 5.2 Credit exposure and risk weighted assets

US\$ '000	Funded exposures	Unfunded exposures	Gross credit exposures*	Eligible collateral	Risk weighted assets	Capital charge
Claims on banks	483,122	14,319	497,441	12,355	268,888	33,611
Claims on sovereigns	564,089	-	564,089	-	133,819	16,727
Claims on corporate	92,814	100	92,914	100	137,122	17,140
Other exposures	20,321	-	20,321	-	32,040	4,005
Past Due	1,680	-	1,680	-	1,680	210
<b>Total</b>	<b>1,162,026</b>	<b>14,419</b>	<b>1,176,445</b>	<b>12,455</b>	<b>573,549</b>	<b>71,693</b>

\*Balances are gross of provision for stage 1 and 2 expected credit losses.

### 5.2 (a). Gross credit exposure before credit risk mitigation

US\$ '000	Funded credit exposure	Average monthly gross exposure*
Claims from Sovereigns	564,089	574,776
Claims from Banks	483,122	480,518
Claims on Corporate	92,814	52,483
Other exposures	20,321	20,504
Past dues	1,680	1,901
<b>Total funded exposure</b>	<b>1,162,026</b>	<b>1,130,182</b>
<b>Unfunded exposures</b>	<b>14,419</b>	<b>19,241</b>
<b>Gross credit exposures</b>	<b>1,176,445</b>	<b>1,149,423</b>

\*Average monthly balance represents the average of the sum of twelve-month end balance for the year ended 31 December 2022.

### 5.3 Exposure by external credit rating

The Group uses external credit ratings from Standard & Poor's, Moody's and Fitch, which are accredited External Credit Assessment Institutions (ECAI). The Group assigns risk weights through the mapping process provided by CBB to the rating grades.

The breakdown of the Group'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	Eligible collateral	Risk weighted assets	Capital charge
Claims on Banks	483,122	14,319	138,297	246,001	113,143	12,355	268,888	33,611
Claims on Sovereigns	564,089	-	11,156	550,392	2,541	-	133,819	16,727
Claims on Corporate	92,814	100	-	40,199	52,715	100	137,122	17,140
Other exposures	20,321	-	-	-	20,321	-	32,040	4,005
Past Due	1,680	-	-	-	1,680	-	1,680	210
<b>Total</b>	<b>1,162,026</b>	<b>14,419</b>	<b>149,453</b>	<b>836,592</b>	<b>190,400</b>	<b>12,455</b>	<b>573,549</b>	<b>71,693</b>

### 5.4 Geographical distribution of exposures

Geographical distribution of exposures based on residence of the counterparties is summarized below:

US\$'000	Gross credit exposure	Funded exposure	Unfunded exposure
Bahrain	528,870	528,870	-
Europe	240,029	239,929	100
Other GCC Countries	248,553	248,553	-
Other Middle east & Africa	137,313	122,994	14,319
Rest of the world	21,680	21,680	-
<b>Total</b>	<b>1,176,445</b>	<b>1,162,026</b>	<b>14,419</b>



#### 5.4 Geographical distribution of exposures (continued)

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

US\$ '000	Bahrain	Europe	Other GCC Countries	Other Middle East and Africa	Rest of the world	Total
Claims from Banks	135,574	126,466	178,261	27,567	15,254	483,122
Claims from Sovereigns	384,712	34,178	56,760	83,693	4,746	564,089
Claims on Corporate	-	79,282	13,532	-	-	92,814
Other exposures	8,584	3	-	11,734	-	20,321
Past Due	-	-	-	-	1,680	1,680
<b>Total funded exposure</b>	<b>528,870</b>	<b>239,929</b>	<b>248,553</b>	<b>122,994</b>	<b>21,680</b>	<b>1,162,026</b>
<b>Unfunded exposures</b>	<b>-</b>	<b>100</b>	<b>-</b>	<b>14,319</b>	<b>-</b>	<b>14,419</b>
<b>Gross credit exposures</b>	<b>528,870</b>	<b>240,029</b>	<b>248,553</b>	<b>137,313</b>	<b>21,680</b>	<b>1,176,445</b>

#### 5.5 Industry sector analysis of exposures

US\$ '000	Gross credit exposure	Funded exposure	Unfunded exposure
Banks & financial institutions	497,441	483,122	14,319
Commercial & other business	113,235	113,135	100
Sovereign	565,769	565,769	-
<b>Total</b>	<b>1,176,445</b>	<b>1,162,026</b>	<b>14,419</b>

### 5.5 Industry sector analysis of exposures (continued)

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

USD '000s	Banks & financial institutions	Commercial & other businesses	Sovereign	Total
Claims from Banks	483,122	-	-	483,122
Claims from Sovereigns	-	-	564,089	564,089
Claims on Corporate	-	92,814	-	92,814
Other exposures	-	20,321	-	20,321
Past Due Exposures	-	-	1,680	1,680
<b>Total funded exposure</b>	<b>483,122</b>	<b>113,135</b>	<b>565,769</b>	<b>1,162,026</b>
<b>Unfunded exposures</b>	<b>14,319</b>	<b>100</b>	<b>-</b>	<b>14,419</b>
<b>Gross credit exposures</b>	<b>497,441</b>	<b>113,235</b>	<b>565,769</b>	<b>1,176,445</b>

### 5.6 Maturity analysis of funded exposures

Residual contractual maturities of the Group'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 Banks	366,993	82,650	21,727	471,370	11,752	483,122
Claims on Sovereign	69,576	196,692	75,016	341,284	222,805	564,089
Claims on Corporate	85	5,490	15,982	21,557	71,257	92,814
Other exposures	15	-	42	57	20,264	20,321
Past Due Exposures	-	-	-	-	1,680	1,680
<b>Total</b>	<b>436,669</b>	<b>284,832</b>	<b>112,767</b>	<b>834,268</b>	<b>327,758</b>	<b>1,162,026</b>

### 5.7 Maturity analysis of unfunded exposures

US\$ '000	Within 1 month	1-3 months	3-12 months	Total within 1 year	1-10 Years	Total
Claims on Banks	2,631	7,261	4,427	14,319	-	14,319
Claims on Corporates	-	-	100	100	-	100
Claims on Sovereign	-	-	-	-	-	-
<b>Total</b>	<b>2,631</b>	<b>7,261</b>	<b>4,527</b>	<b>14,419</b>	<b>-</b>	<b>14,419</b>

## 5.8 Off- Balance sheet exposures

### i. 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 factors range from 20 percent to 100 percent depending on the type of contingent item, and is intended to convert off balance sheet notional amounts into equivalent on balance sheet exposures.

Credit commitments and unutilized approved credit facilities represent commitments that have not been drawn down or utilized. The notional amount provides the calculation base to which a CCF is applied for calculating the EAD. The CCF ranges between 0 percent and 100 percent depending on the approach, product type and whether the unutilized amounts are unconditionally cancellable or irrevocable.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities.

At 31 December 2022, the Group held credit-related contingent items & commitment amounting to US\$ 72.1 million.

### ii. Derivatives and Foreign exchange instruments:

Derivatives including futures, forwards, swaps and options in the interest rate and foreign exchange. The Group’s derivative and foreign exchange activities are predominantly short-term in nature.

Derivatives and foreign exchanges exposures are exposed to market risk and settled on net basis. Due to currency movement or interest rate changes, the contract may result into net asset or liability.

## 5.9 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, residential and commercial real estate and securities for both funded and unfunded credit exposures, which is liquidated on maturity/expiry date. For capital adequacy ratio calculation purposes mainly cash collaterals are considered as risk mitigants.

## 5.10 Impairment of assets

The Group had adopted IFRS 9 methodology of recording impairment of assets, effective 1 January 2018. IFRS 9 adoption fundamentally changed to a forward looking and expected credit loss (ECL) approach. The Group 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.

## 5.10 Impairment of assets (continued)

### i. Impaired loans and related provisions (stage 3):

USD'000s	1 to 3 year	over 3 years	Total
Gross impaired loans (stage 3)	-	41,324	41,324
Less: Specific Provision (stage 3)	-	(41,324)	(41,324)
<b>Net outstanding 31 December 2022</b>	-	-	-

### ii. Movement in impairment provision including expected credit losses - Loans and advances

USD'000s	Stage 1	Stage 3	Total
<b>Loans:</b>			
At beginning of the year	2,267	41,303	43,570
Provided during the period	1,011	21	1,032
Reversals and write backs	(935)	-	(935)
<b>Balance as at 31 December 2022</b>	<b>2,343</b>	<b>41,324</b>	<b>43,667</b>

### iii. Movement in expected credit losses – Investments

USD'000s	Stage 1	Stage 2	Stage 3	Total
<b>Investments</b>				
At beginning of the year	857	1,517	-	2,374
Transfer to Stage 2	(278)	278		-
Transfer to Stage 3		(411)	411	
Provided during the period	363	1,343	2,891	4,597
Reversals during the period	(86)	(859)	-	(945)
<b>Balance as at 31 December 2022</b>	<b>856</b>	<b>1,868</b>	<b>3,302</b>	<b>6,026</b>

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

USD'000s	Stage 1	Stage 2	Stage 3	Total
At beginning of the year	275	-	3,735	4,010
Provided during the period	127	1	-	128
Reversals during the period	(228)	-	-	(228)
Exchange difference		-	(238)	(238)
<b>Balance as at 31 December 2022</b>	<b>174</b>	<b>1</b>	<b>3,497</b>	<b>3,672</b>

### v. Specific provision for impaired assets by geography and sector (Stage 3):

USD '000s	Other Middle East and Africa
Banks & Financial Institutions	33,536
Corporate	11,286
Sovereigns	3,302
<b>Total</b>	<b>48,124</b>

### 5.11 **Restructured facilities**

During the year ended 31 December 2022, no facilities were restructured.

## 6. Market risk - Pillar 3 disclosures

For allocating capital to market risks, the Group uses the Standardized Measurement Method (SMM) for the measurement of market risk and capital allocation based on net open position of foreign currencies as defined under the CA module of CBB Rulebook:

US\$ '000	Risk weighted exposures	Capital charge	Maximum value	Minimum value
Foreign Exchange Risk	338	42	338	63

Currency risk arises from the movement of the rate of exchange over a period of time. The Group'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 Group manages this risk through net open position limits established for each currency and monitoring net open currency positions on a daily basis.

## 7. Operational risk- Pillar 3 disclosures

Whilst operational risk cannot be eliminated in its entirety, the Group endeavours to minimize it by ensuring that a strong control infrastructure is in place throughout the organization. The various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, other control strategies, including business continuity planning and insurance, are in place to complement the procedures, as applicable.

The Group has in place an ORMF to manage and control its operational risk in a cost-effective manner within targeted levels of operational risk consistent with the Group's risk appetite. The ORMF defines minimum standards and processes, and the governance structure for the management of operational risk and internal controls.

The Group adopted the Basic indicator approach in line with CBB regulation to compute total capital charge in respect of operational risk. The operational risk capital charge amounted to US\$ 4,620 thousand on operational risk weighted exposure of US\$ 57,754 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 12.50; years with positive gross income are counted for computation of capital charge.

## 8. Pillar 2 Risk Disclosures

### a. Credit concentration risk

Concentration risk is the credit risk stemming from not having a well-diversified credit portfolio, i.e. the risk inherent in doing business with large customers or being overexposed in particular industries or geographic regions. The Group has calculated the exposure concentration risk under Bank Pillar 2 capital framework using Herfindahl–Hirschman Index (HHI).

**a. Credit concentration risk (continued)**

Under the CBB’s single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB’s approval for any exposure to a single counterparty or Group of connected counterparties exceeding 15% of the regulatory capital base.

As at 31 December 2022, the Group’s exposure in excess of 15% of the obligor limits to individual counterparties is shown below:

US\$ ‘000	On Balance sheet exposure	Off-Balance sheet exposure	Total
Counterparty A *	384,712	-	384,712

\* Comprises of exempted large exposure to sovereign.

The Group has already put in place credit risk management policies as well as and monitoring tools to proactively assess Exposure Concentration risk. The Group has internal limits to monitor and control concentration in sectors, geography and counterparty. Regular reports are prepared and analysed to ensure that undesired concentrations are avoided.

**b. Liquidity Risk**

The Group maintains adequate liquid assets such as inter-bank placements, treasury bills and other readily marketable securities, to support its business and operations. The Group monitors the maturity profile of its assets and liabilities so that adequate liquidity is maintained at all times. The Group monitors the stability of its funding base on an ongoing basis by ensuring maintaining strong relationship with its key depositors. The Asset Liability Committee “ALCO” reviews the liquidity gap profile and the liquidity stress testing results and addresses strategic issues concerning liquidity risk.

Refer Liquidity risk disclosures made under Section 28 of Consolidated Financial Statement for the year ended 31 December 2022. In accordance with Liquidity Risk Management module of CBB, the Group computes the Net Stable Funding ratio “NSFR” and Liquidity Coverage ratio “LCR” and maintain these ratios greater than 100% respectively.

As of December 31, 2022, the Group’s NSFR stood at 136% and LCR is 416% (Refer Liquidity Disclosures in the Consolidated Financial Statements as of 31 December 2022).

**c. Interest rate risk in Banking Book**

The Group 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 Group manages this risk by matching the re-pricing of assets and liabilities and monitoring the interest rate repricing gap by buckets. The Group measures its interest rate sensitivity by measuring the earnings at risk and change in economic value of equity due to a 200-bps parallel shock in interest rates. The ALCO regularly reviews the interest rate gap and sensitivity profile and takes decisions to ensure stability of interest income stream over time.

The following table demonstrates the sensitivity to 200 basis points increase in interest rates, with all other variables held constant, of the Group’s statement of income for the year ended 31 December 2022:

c. Interest rate risk in Banking Book (continued)

US\$ '000	31 December 2022
impact	Sensitivity of net Interest income
+/-	4,488

The details of interest rate sensitive assets and liabilities are as follows:

Interest Rate Risk Gap Report							
Balance Sheet Items (Figures in USD 000s)	Less than 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	Over one year	Total Non- Interest rate sensitive	Total Assets and Liabilities
<b>ASSETS</b>							
Balances & Deposits with Banks and financial institutions	399,927	267,889	29,185	28,275	-	11,882	737,158
Investment Securities	7,500	11,243	-	12,867	216,213	730	248,553
Loans and advances	12,935	1,637	16,032	25,006	93,759	-6,501	142,868
Investment in property	-	-	-	-	-	11,734	11,734
Interest Receivable	4,276	4,063	1,066	293	-	130	9,828
Other asset and Property, Equipment & Software	-	-	-	-	-	8,572	8,572
<b>TOTAL (A)</b>	<b>424,638</b>	<b>284,832</b>	<b>46,283</b>	<b>66,441</b>	<b>309,972</b>	<b>26,547</b>	<b>1,158,713</b>
<b>LIABILITIES</b>							
Deposits from Bank and other financial institutions	295,816	32,000	161,263	60,000	-	124,315	673,394
Due to banks and other financial institutions	39,095	-	-	-	-	75,543	114,638
Due to customers	-	-	-	-	-	23,598	23,598
Interest payable	874	243	1,205	895	-	24	3,241
Other liabilities	-	-	-	-	-	11,480	11,480
<b>TOTAL (B)</b>	<b>335,785</b>	<b>32,243</b>	<b>162,468</b>	<b>60,895</b>	<b>-</b>	<b>234,960</b>	<b>826,351</b>
<b>Interest Rate Gap (A-B)</b>	<b>88,853</b>	<b>252,589</b>	<b>-116,185</b>	<b>5,546</b>	<b>309,972</b>	<b>-208,413</b>	<b>332,362</b>
<b>Cumulative Gap</b>	<b>88,853</b>	<b>341,442</b>	<b>225,257</b>	<b>230,803</b>	<b>540,775</b>	<b>332,362</b>	

#### d. Reputational Risk

Group relies upon a reputation for integrity in order to maintain its existing business and to pursue its strategies for growth and new business. The Group has no risk appetite for reputational risk and a number of initiatives are dedicated to the avoidance of reputational damage, including controls relating to maintaining regulatory compliance, anti-money laundering controls and data security.

Group has prepared a scorecard to evaluate Reputational risk score based on guidance provided by CBB and Group's internal as well external operating environment. The score derived from the scorecard is used to assess the capital requirements for reputational risk.

#### e. Strategic risk

Business / strategic risk primarily arises out of either wrong strategic direction and or wrong strategy/ business plan implementation that could have an adverse impact on the Group's profitability and capital positions. The Group has various monitoring mechanisms including Key Performance Indicators, Performance Reports etc. The same are reviewed on a periodic basis to assess any deviation from the approved business plans that could impact the Group's performance in terms of its profitability, asset growth, financial health etc. The strategic risk is managed through monthly reviews of performance versus budgeted performance and periodic reviews of the Group's performance and alignment with the strategic plan.

The Group quantifies the strategic/ business risk based on earning volatility approach, comparing the volatility in budgeted vs actual gross income and gross cost of the Group, over a period of last 6 years. The earnings volatility is adjusted based on application of sustainability and contribution factors. The final adjusted volatility (value at risk) at a confidence level is annualized to estimate the pillar 2 strategic risk capital charge.

### 9. Other disclosures:

- a. **Related Party transactions:** Related parties represent 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 management. The balances and transactions with the related parties are disclosed in note 26 of the consolidated financial statements for the year ended 31 December 2022.
- b. **Assets sold under recourse agreements:** The Group did not enter into any recourse agreement during the year ended 31 December 2022.
- c. **Equity positions in the banking book:** Nil.
- d. **Leverage Ratio**

US\$ '000	31 December 2022
Total exposure on-balance sheet (all unweighted)	1,158,713
Total off-balance sheet items - with relevant Credit Conversion Factors	14,419
<b>Total</b>	<b>1,173,132</b>
<b>Tier One Capital</b>	<b>330,147</b>
<b>Leverage Ratio</b>	<b>28.14%</b>