ITHMAAR BANK B.S.C. (C)

Public Disclosures as at 30 June 2019

Ithmaar Bank B.S.C. (C)
Public Disclosures at 30 June 2019

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1. Background

The public disclosures under this section have been prepared in accordance with the Central Bank of Bahrain (CBB) requirements outlined in its Public Disclosure Module (PD), CBB Rule Book, Volume II for Islamic Banks. The disclosures in this report are in addition to the disclosures set out in Ithmaar Bank B.S.C (C)'s (Ithmaar Bank/Bank/Group) consolidated financial statements for the period ended 30 June 2019, presented in accordance with Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

2. Basel III Framework

CBB has issued Basel III guidelines for the implementation of Basel III capital adequacy framework for Banks incorporated in the Kingdom of Bahrain.

The Basel III framework provides a risk based approach for calculation of regulatory capital. The Basel III framework is expected to strengthen the risk management practices across the financial institutions.

The Basel III framework is based on three pillars as follows:-

- Pillar I: Minimum capital requirements including calculation of the capital adequacy ratio
- Pillar II: Supervisory review process which includes the Internal Capital Adequacy Assessment Process
- Pillar III: Market discipline which includes the disclosure of risk management and capital adequacy information.

3. Capital management

Ithmaar Bank's capital management policy provides guidelines to ensure that it meets the capital requirements as mandated by the CBB and is able to estimate an appropriate capital level in order to support its business growth. Capital management also ensures that shareholders' value is protected and enhanced.

Regulatory capital is the minimum capital that is required by regulatory authority, to be maintained by Ithmaar Bank commensurate to the underlying risks. Ithmaar Bank has adopted the capital charge computations and adequacy ratios as per Basel III guidelines, and CBB Capital Adequacy regulations & directives.

Capital management is a coordinated effort by the Business, Risk Management, and Financial Control departments and is a part of a broader Internal Capital Adequacy Assessment Process (ICAAP). ICAAP covers the capital charge for all material risks in Pillar 1 and Pillar 2. ICAAP also recommends an internal capital adequacy ratio target over and above the regulatory requirement to absorb any un-expected losses arising due to Pillar 2 risks. The adequacy and sufficiency of capital ratio is also tested with a mechanism of stress scenario across various risk dimensions on a periodical basis. A comprehensive risk assessment of the Business and Budget Plans is independently performed by the Risk Management Department (RMD), which among others, assesses the capital requirement of Ithmaar Bank supporting both current and future activities. Ithmaar Bank's capital position is monitored on a regular basis and reported to the Asset Liability Management Committee (ALCO), the Audit Governance and Risk Management Committee (AGRMC) and the Board of Directors.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

3. Capital management (continued)

Capital Adequacy Methodology:

As per the requirements of CBB's Basel III capital adequacy framework, the method for calculating the consolidated capital adequacy ratio for the Group is summarized as follows:

- Line by line consolidation is performed for the risk exposures and eligible capital of all the Financial Institutions subsidiaries within the Group with the exception of the Bank's banking subsidiaries incorporated outside Kingdom of Bahrain which are operating under Basel III compliant jurisdictions, where full aggregation is performed of the risk weighted exposures and eligible capital as required under CA module of CBB rulebook.

- All significant investments in commercial entities are risk weighted if these are within 15% of the capital base at individual level and 60% at aggregate level. Any exposure over and above the threshold of 15% are risk weighted at 800%.

- All exposures exceeding the large exposure limit as per Credit Risk Management (CM) module of CBB rulebook are risk weighted 800%.

4. Approaches adopted for determining regulatory capital requirements

The approach adopted for determining regulatory capital requirements under CBB's Basel III guidelines is summarised as follows:

Credit Risk	Standardised approach
Market Risk	Standardised approach
Operational Risk	Basic Indicator approach

5. Regulatory Capital components

Step 1: Disclosure of Balance Sheet under Regulatory scope of Consolidation

The Bank's subsidiaries (consolidated line by line for accounting purposes) have the following treatment for regulatory purposes

Name	Total assets	Total Equity	Ownership	Country of Incorporation	Principal business activity	Regulatory Treatment
Faysal Bank Limited	1,316,619	96,327	67%	Pakistan	Banking	Aggregation
Dilmunia Development Fund I L.P.	62,627	50,566	58%	Cayman Islands	Real estate	Risk weight
Sakana Holistic Housing Solutions B.S.C. (C) (Sakana) *	2,196	2,408	50%	Kingdom of Bahrain	Mortgage finance	Line by line consolidation

* Under voluntary liquidation.

The reconciliation from published financial information to regulatory return is as follows:

Balance sheet as per published financial statements	2,834,110
FAS 30 Transitional impact	32,007
Aggregation	30,947
Balance sheet as in Regulatory Return	**2,897,064**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

5. Regulatory Capital components (continued)

Step 2: Reconciliation of published financial balance sheet to regulatory reporting as at 30 June 2019

Assets	As per published financial statements	As per Consolidated PIRI	Reference
Cash and balances with banks and central banks	280,465	280,465	
Commodity and other placements with banks, financial and other institutions	88,220	88,220	
Murabaha and other financings	1,553,788	1,553,788	
Musharaka financing	187,565	187,565	
Sukuk and investment securities	354,367	354,367	
Assets acquired for leasing	151,023	151,023	
Other assets	79,540	79,540	
Investment in real estate	2,878	2,878	
Development Properties	79,296	79,296	
Fixed assets	17,381	17,381	
Intangible assets	39,587	39,587	
FAS 30 transitional impact	-	32,007	
Aggregation	-	30,947	
Total Assets	**2,834,110**	**2,897,064**	**-**
Liabilities & Unrestricted Investment Accounts (URIA)			
Unrestricted Investment Accounts	983,185	983,185	
Total liabilities	1,708,832	1,708,832	
Total Liabilities & URIA	**2,692,017**	**2,692,017**	-
Minority Interest	65,890	65,890	
Owners' Equity			
Share capital	100,000	100,000	**A**
Reserves	2,888	2,888	
of which eligible for CET1	-	13,700	**E**
Accumulated losses	(26,685)	(26,685)	
of which eligible for CET1	-	(30,212)	**B**
FAS 30 transitional impact	-	32,007	**D**
Aggregation	**-**	30,947	
Total Owners' Equity	**76,203**	**139,157**	
Total Liabilities + Owners' Equity	**2,834,110**	**2,897,064**	

Step 3: Composition of Capital Common Template (transition) as at 30 June 2019

Composition of Capital and mapping to regulatory reports	Component of regulatory capital	Reference numbers of balance sheet under the regulatory scope of consolidation from step 2	Amount subject to pre- 2015 treatment
Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	100,000	A	-
Accumulated losses	(30,212)	B	-
Expected Credit Losses (ECL) Stages 1 & 2	(52,762)	C	
of which FAS 30 Transitional impact	32,007	D	
Reserves	13,700	E	-
Aggregation & deductions	53,646		-
Total CET1 capital	**116,379**		-
FAS 30 Transitional impact	11,264		-
Aggregation & deductions	11,514		-
Total T2 Capital	**22,778**		-
Total Capital	**139,157**		-
Total Adjusted Risk Weighted Assets (RWA)	**1,057,524**		-
Capital Adequacy Ratio (CaR)	**13.16%**		

6. Tier one capital ratios and Total capital ratios:

	Tier One Capital Ratio (including conservation buffer)	Total Capital Ratio (including conservation buffer)
Bank's consolidated	11.00%	13.16%
Significant Bank subsidiaries whose regulatory capital amounts to over 5% of group consolidated regulatory capital whether on a stand-alone or sub-consolidated basis are as follows:		
Faysal Bank Limited	15.15%	17.06%

7. Risk Management

7.1 Risk Management Objectives

Risk is an integral part of Ithmaar Bank's business and managing it is critical to Bank's continuing success and profitability. The essence of effective risk management is to enhance shareholders' and Investment Account Holders' value through business profits commensurate with the risk appetite of Ithmaar Bank and seeks to minimize the potential adverse effects on its financial performance. Ithmaar Bank has over the years, developed risk management into a core competency and remains well positioned to meet imminent challenges. Risk Management at Bank has always been prudent and proactive with the objective of achieving the optimum balance between risk and expected returns.

Ithmaar Bank has adopted an integrated risk management framework to proactively identify, assess, manage and monitor risks in its decisions and operations. The Bank's risk management framework is based on guidelines issued by the Central Bank of Bahrain (CBB), sound principles of risk management issued by Bank of International Settlements, international best practices and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) wherever applicable.

7.2 Strategies, Processes and Internal Controls

7.2.1 Risk Management Strategy

Ithmaar Bank's Risk Management Charter lays the foundations for a risk governance structure. The risk strategy in terms of the overall risk appetite, risk tolerance levels and risk management methodologies are assimilated in the various risk policies and the Internal Capital Adequacy Assessment Process (ICAAP) report of Ithmaar Bank which are reviewed and approved by the Board of Directors. The risk strategy is reviewed annually in line with the Bank's business strategy. The Board also oversees the establishment and implementation of risk management systems and policies for all processes and risk exposure.

The process of risk management is carried out by an independent control function; the Risk Management Department (RMD) headed by the Chief Risk Officer with a direct reporting line to the AGRMC. The Department is mandated with identifying, quantifying and assessing all risks and recommending appropriate prudential limits and risk management methodologies within the parameters of the overall risk management strategy approved by the Board.

A well-defined governance structure is implemented where authority levels are clearly laid down for all transactions. Furthermore, the culture of Risk is embedded in the Business through a rigorous set of controls, checks and balances. As part of Ithmaar Bank's continuous improvement initiatives, Ithmaar Bank reviews existing risk policies and procedures and develops new policies and procedures by benchmarking the same to changes or new requirements in the regulatory and external environment. The Board reviews and approves the Business Discretionary Powers policy which establishes the approval authorities and limits for specific transactions.

7.2.2 Equity Risk in Banking Book

Ithmaar Bank's exposure to equity risk in the Banking book relates to its investment exposures. Ithmaar Bank has a dedicated Asset Management Department for managing the existing investments. The Board has established an Asset Management Policy which establishes the guidelines relating to management of investments.

All investment exposures are reviewed annually and presented to the management committee or Board level committees depending on the asset value.

7.2.3 Material Transactions- Board Approval

All financing and investment exposures above a defined value requires the approval of the Board. Additionally, all related party transactions and irrespective of their value require the approval of the Board.

7. Risk Management (continued)

7.3 Risk Measurement and Reporting System

The risk appetite of Ithmaar Bank is approved by the Board. To enable the effective monitoring of the activities of the Bank and to be compliant with the risk appetite approved by the Board, appropriate measurement processes, monitoring of exposures vis-à-vis limits as provided in the various risk management policies are in place. The risk policies set guidelines to limit concentration risk within the portfolio by large exposure, connected counterparty, country, industry, tenor and products. Ithmaar Bank uses a robust management information system to monitor its exposures and concentrations by various dimensions. Exceptions to the limits as provided in the policies are escalated to the appropriate authority.

7.4 Credit Risk

Capital charge for credit risk is computed under the Standardized Approach.

7.4.1 Credit Risk Management Structure

Credit risk management structure in Ithmaar Bank includes all levels of authorities, organizational structure, people and systems required for the smooth functioning of Credit risk management processes.

The Bank has a well-defined organizational structure with clearly articulated roles and responsibilities for the Credit risk management function in the Bank.

The Bank has proper processes in place, not only to apprise but also regularly monitor credit risk. Ithmaar Bank has established a General Financing Policy which details the core business principles, which are central to the Bank’s Credit culture, as well as general guidelines for permitted and restricted transactions. The policy states the Credit assessment methodology and the detailed standards for documentation of client information.

Ithmaar Bank manages its Credit risk arising from its banking exposures by implementing robust policies and procedures with respect to identification, measurement, mitigation, monitoring and controlling the risks.

7. Risk Management (continued)

7.4.1.1 Corporate credit risk (including financial institutions)

Corporate credit risk represents the potential financial loss as a consequence of a customer's inability to honor the terms and conditions of the credit facility. Corporate credit risk is managed by proper assessment of risks inherent in an individual credit proposal and also ongoing review of the corporate credit portfolio to ensure its compliance to the credit risk appetite of Ithmaar Bank. In addition to the rigorous credit analysis, the covenants for each facility are strictly monitored by the Credit Administration Department.

Ithmaar Bank has proper processes in place, not only to appraise but also regularly monitor credit risk. Regular reviews are carried out for each account and risks identified are mitigated in a number of ways, which includes obtaining collateral, assignment of receivables and counter-guarantees. The corporate accounts are rated on a internal credit risk rating model, this enhances the process of credit review and ensures timely identification of any deterioration of the corporate's status and corrective actions can be implemented. The internal credit risk rating model incorporates both quantitative and qualitative risk parameters for the grading and classification of corporate customers. The Bank has in place policy guidelines to map the external ratings to internal ratings.

A centralized credit risk management system is in place where all corporate credit and financial institutions proposals are independently reviewed by the Risk Management Department (RMD) before the same are approved by appropriate approval authorities.

All credit exposures are reviewed and rated at least annually and appropriate provisions are maintained for any classified account as per the provisioning policy in line with relevant CBB guidelines. However, each investment exposure is evaluated individually for impairment assessment on its merits, strategy, and estimated recoverability.

In respect of corporate performing accounts, provisioning based on the guidelines of FAS30 – Expected Credit Losses (ECL) is provided. The Bank has in place an automated application for the computation of ECL based on risk parameters configured in the application.

7.4.1.2 Retail credit risk

Retail credit is offered to customers primarily based on approved product programs which defines the risk acceptance criteria. Overdue amounts in the retail credit portfolio are closely monitored to mitigate the possibility of the individual accounts from slipping into non-performing status. The retail credit product programs are regularly reviewed to ensure their compliance with existing regulatory guidelines and enhance marketability. In all its initiatives, the interest of the customer is accorded as Top Priority.

The retail credit portfolio is reviewed at monthly intervals.

In respect of retail performing accounts, provisioning based on the guidelines of FAS30 – Expected Credit Losses (ECL) is provided. The Bank has in place an automated application, for the computation of ECL based on risk parameters configured in the application.

Unrestricted Funds Under Management (FUM) assets

The FUM Policy provides detailed guidelines for the assets suitable for funding by unrestricted investment accounts, it clearly provides that the funds in unrestricted investment account will be used for funding low risk assets.

7.4.2 Concentration Risk

The risk policies set guidelines to limit concentration risk within the portfolio by larger exposure, connected counterparty, country, industry, tenor and products. Ithmaar Bank uses a robust management information system to monitor its exposures and concentrations by various dimensions. A Limit Management Policy is in place, this policy provides guidelines on the threshold limits. As per CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain CBB's prior approval for any proposed exposure to a single counterparty, or group of connected counterparties, exceeding 15% of the regulatory capital base.

7. Risk Management (continued)

7.4.3 Credit Portfolio Management

Portfolio management is an integral part of the credit risk management process that enables Ithmaar Bank to limit concentrations, reduce volatility, increase liquidity and achieve optimum earnings. It does so by incorporating portfolio strategy and planning, performance assessment and reporting functions into one comprehensive management process. The Risk Management Department is responsible for carrying out the activities in relation to credit risk portfolio management in coordination with business and support departments. The Risk Management Department seeks information from different business units and Financial Control Division on a regular basis to perform this function. The Risk Management Department undertakes the review, monitoring and control of limits structures based on the portfolio diversification parameters.

7.4.4 Country Exposure

The Limits Management Policy provides exposure limits for countries; the limits are based on the ratings assigned to the country by the External Credit Assessment Institutions (ECAIs). Exposure vis-à-vis limits assigned to the countries are monitored on an on-going basis and status thereof is submitted to the AGRMC at quarterly intervals.

7.4.5 Credit Risk Mitigation

Ithmaar Bank uses a variety of tools to mitigate its credit risk, the primary one being that of securing the exposure by suitable collaterals. While the existence of collaterals is not a precondition for credit, exposures are fully or partially collateralized as a second line of defense. The Bank has in place a Credit Risk Mitigation policy which provides guidelines on the types of assets that may be accepted as collateral and the methodology of valuation of these assets. In general, all collaterals are valued periodically depending on the collateral type. The legal validity and enforceability of the documents used for collateral have been established by qualified personnel, including lawyers and Sharia scholars.

Ithmaar Bank's credit portfolio is supported by various types of collateral such as real estate, listed equity, cash and guarantees. Ithmaar prefers liquid and marketable credit collateral; however other types of collateral are accepted provided that such collateral can be reasonably valued. Third party guarantees are accepted as collateral only after analyzing the financial strength of the guarantors.

The following types of collateral are accepted by the Bank:

- Primary Collaterals
- Collateral Support

Primary Collaterals constituting assets of the type Real Estate properties, fixed charge over Moveable properties and Cash Collaterals are required to meet the following essential conditions:

- It is a tangible or an intangible (financial) asset;
- A ready secondary market is easily identifiable;
- A monetary-value can be easily attached to the asset;
- Can be easily converted into cash without incurring additional costs (such as dismantling costs);
- Can be legally assigned or mortgaged to the Bank within applicable laws; and
- The Bank can maintain unquestionable control over the asset.

Collateral Support are assets that do not meet the essential conditions stipulated in Primary Collaterals above. These assets may be accepted by the Bank as means to control the counterparty's exposure rather than basing credit decisions on their values.

7. Risk Management (continued)

7.4.5 Credit Risk Mitigation (continued)

These following assets are considered as Collateral Support:

- Pledge or mortgage of saleable goods or plant and machinery provided the charge can be legally registered;
- Fixed charges over moveable assets, not legally registered or difficult to reasonably value;
- Second charge on real estate properties and moveable assets;
- Pledge of unlisted securities such as shares, bonds and debentures;
- Registered assignment of life insurance endowment policies - to the extent of cash surrender-value;
- Third-party or Corporate guarantees issued by individuals / institutions other than banks;
- Assignment of contract proceeds, lease, or rent;
- Investments in Restricted Investment Accounts managed by the Bank other than those already obtained as collateral against existing exposures.

7.4.5.1 Collateral valuation

Collaterals when taken are identified as having reasonable value, their value would however change over a period of time due to prevailing economic conditions, plant and machinery becoming obsolete due to technological advancements, due to passage of time and due to increase in availability of similar collateralized securities. Listed securities are valued at monthly intervals, unlisted securities are valued at annual intervals, Real estate properties are valued at least once in two years' intervals, and special assets of the nature of marine vessels and aircrafts are valued at annual intervals. Value of collaterals are accounted post assigning various levels of haircuts depending on the type of collateral, the same are provided in the Credit Risk Mitigation Policy.

7.4.5.2 Guarantees

Guarantees are taken from individuals and Corporates. In cases where a letter of guarantee from the counterparty's parent company or from a third party is offered as credit risk mitigant, it is ensured that the guarantees must be irrevocable and unconditional, If the guarantor is located outside Bahrain, legal opinion is obtained from a legal counsel domiciled in the country of guarantor (overseas) regarding the enforceability of the guarantee, further the financial position of the guarantor is adequately analyzed to determine the value and commercial viability of the guarantee.

7.4.5.3 Collateral Concentration

Ithmaar Bank has established internal limits to avoid over concentration on certain class of collaterals. Prudent maximum limits have been set for the acceptance of collaterals as credit risk mitigation.

7.4.5.4 Collateral Management

Documents related to collaterals provided to Ithmaar Bank is managed by the Credit Administration department. Appropriate policies and procedures are in place for the management of the collateral, in respect of valuation, maintenance of the original documents, temporary release and permanent release of such collaterals. An adequate MIS supporting the management of the collateral is in place.

7. Risk Management (continued)

7.4.6 Classification of credit exposures

The Bank has in place a detailed policy for Classification Provisioning and Write-Off, this policy provides detailed guidelines for classification and provisions of credit facilities.

All credit exposures are classified as past due and impaired when any installment is past due for 90-days or more. However, each investment exposure is evaluated individually for impairment assessment on its merits, strategy, and estimated recoverability. Accounts with past dues over a 90 days' period are classified into categories Sub-Standard, Doubtful and Loss assets. Appropriate provisions are maintained for any classified account as per the provisioning policy in line with relevant CBB guidelines. Ithmaar Bank follows, except the subsidiary entities which may follow their own regulatory guidelines, a time-based criteria of past due days to estimate the specific provisioning requirements, and past due accounts are reviewed periodically.

In respect of General Provisions, the Bank has subscribed to the provisions of FAS30 for the computation of Expected Credit Losses (ECL), as per the directives of Central Bank of Bahrain. In order to enable the computation of the ECL, a detailed policy FAS30 Expected Credit Policy' is in place. The Bank has automated the computation of the ECL by implementing a software application called the Loan Impairment Calculator with effect from 1 January 2018.

7.4.7 Counterparty Credit Risk

Counterparty is defined as an individual, legal entity, guarantor being financed by Ithmaar Bank. Definition also includes Issuer of securities held as collateral by Ithmaar Bank. The Bank had adopted the Standardized Approach to allocate capital for counterparty credit risk. The Credit Risk Mitigation Policy provides guidelines for securing the exposures to Counterparties. Limits for Connected Counter parties of Ithmaar Bank and Country and Industry limits are also in place. In case of deterioration in the counterparty's credit rating, additional collateral may be called for or the exposure to the counterparty is reduced. The Classification, Provisioning and Write-off Policy provides detailed guidelines for classification and provisioning for exposures to counterparty's which are classified.

Policy guidelines for expected credit losses is enumerated in the 'FAS30 – Expected Credit Losses' policy of the Bank.

7.4.8 ECAI Ratings

Ithmaar Bank has subscribed to the CBB guidelines for the utilization of external ratings, where available, by External Credit Assessment Institutions (ECAI) for the purpose of risk assessment. In case multiple ECAI ratings are available for a single counterparty, the lowest of them is taken to assign the relevant risk category. Standard and Poors, Moodys and Fitch ratings are considered while assigning the corresponding risk weights for the exposures. The Bank complies with all the qualitative requirements stipulated by the CBB for the recognition process and eligibility criteria of ECAI rating in the Credit Risk Management policy. ECAI ratings are applied, where applicable, to all credit and investment exposures.

7. Risk Management (continued)

7.4.9 Related party transactions

As per the Bank's policies, connected counterparties ' includes companies or persons connected with the Bank, including, in particular; controllers of the bank (and their appointed board representatives) as defined in Chapter GR-5 of the CBB Rulebook; subsidiaries, associates and related parties of the bank as defined by IFRS; holders of controlled functions in the bank as defined by Module LR-1A of the CBB Rulebook and their close family members as defined by IFRS - IAS 24; members of the Shari'a Supervisory Board.

The erstwhile Ithmaar Bank B.S.C. (now Ithmaar Holding B.S.C.) has undergone major reorganization in 2017. As part of this reorganization, Ithmaar Holding B.S.C. and its wholly owned subsidiaries Ithmaar Bank B.S.C. (C) and IB Capital B.S.C.(C) have executed certain contracts between three entities and as most of the Directors are common for all three entities, there is an apparent conflict of interest as these contracts were approved by Directors who represented both entities who were party to the contracts. Given the reorganization requirements, ownership structure and Directors being common, contracts between these entities are considered as related party transactions but the conflict of interest is not considered to be applicable to ensure minimum quorum for voting.

Declarations of Interest:
On taking office, Members of the Board of Directors of the Bank are required to disclose all interests and relationships which could or might be seen to affect their ability to perform their duties as a Member of the Board of Directors. Any such interests declared shall be recorded in the Board of Director's Register of Interests, which are maintained by the shareholders affairs unit. This declaration of interest is updated on an annual basis.

Approval of Related Party Transactions:
• All related party transactions are approved by the Board of Directors.
• Where applicable, persons who have interests in the transaction under discussion abstain from voting on the approval of the proposed related party transaction, except where the transaction is required as part of the reorganization.
• Approval of a transaction shall be considered irrespective of the settlement method, whether settled in cash or otherwise.
• Certain related party transactions may require advance notice to and approval by the CBB and / or any other applicable regulatory authority as per CBB rulebook and the Limit Management Policy of the Bank.
• In particular, Members of the Board of Directors of the Bank disclose all relevant information which might give rise to a conflict of interest, or a perceived conflict of interest. Each Member of the Board of Directors inform the Bank when there are changes in his / her interests, and the Shareholders affairs unit update the Register of Interests at least on an annual basis.

During 2019, Directors having conflict of interests in the transaction under discussion abstained from voting on the approval of the proposed related party transaction.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

8. Disclosure of the regulatory capital requirements for credit risk under standardized approach:

Exposure funded by Self Finance

	Risk weighted assets	Capital requirement
Claims on sovereign	1,956	245
Claims on banks	33,757	4,220
Claims on corporate portfolio	140,365	17,546
Investments in equity securities	631	79
Holding of real estate	29,700	3,713
Regulatory retail portfolio	215	27
Past due facilities	7,705	963
Other assets	19,654	2,457
Aggregation	485,176	60,647
Total	**719,159**	**89,897**

Exposure funded by Unrestricted Investment Accounts (URIA)

	Risk weighted assets	Capital requirement
Claims on corporate portfolio	65,967	8,246
Regulatory retail portfolio	98,192	12,274
Past due facilities	17,797	2,225
Total	**181,956**	**22,745**

URIA assets are risk weighted as per the counterparty classification in line with CBB regulations using alpha factor of 30% in accordance with CA module CA-1.1.11.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

9. Gross credit exposures:

	Gross credit exposure	Average gross credit exposure
Credit risk exposure relating to on balance sheet assets are as follows:		
Cash and balances with banks and central banks	280,465	248,802
Commodity and other placements with banks, financial and other institutions	88,220	87,138
Murabaha and other financings	1,553,788	1,618,827
Musharaka financing	187,565	187,208
Assets acquired for leasing	151,023	152,941
Investments	357,245	468,388
Other assets	79,540	79,313
Development Properties	79,296	79,296
Fixed assets	17,381	17,592
Intangible assets	39,587	41,451
Total on balance sheet credit exposure	**2,834,110**	**2,980,956**
Credit risk exposure relating to off balance sheet items are as follows:		
Financial guarantees and irrevocable letters of credit, acceptance and endorsements	172,246	216,385
Financing commitments, Undrawn facilities and other credit related liabilities	586,002	714,588
Total off balance sheet credit exposure	**758,248**	**930,973**
Total credit exposure	**3,592,358**	**3,911,929**
Total credit exposure financed by URIA	**1,150,684**	**1,149,441**
Total credit exposure financed by URIA (%)	**32.03%**	**29.38%**

The average gross credit exposure represent average balances for 2018 and 30 June 2019

Exposures amounting to BD4.9 million are covered by guarantee.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

10. Geographical distribution of credit exposures:

	Asia	Middle East	Europe	Others	Total
On-balance sheet items					
Cash and balances with banks and central banks	162,695	96,921	11,454	9,395	280,465
Commodity and other placements with banks, financial and other institutions	19,571	68,649	-	-	88,220
Murabaha and other financings	542,420	996,315	9,527	5,526	1,553,788
Musharaka financing	187,565	-	-	-	187,565
Assets acquired for leasing	-	151,023	-	-	151,023
Investments	356,616	629	-	-	357,245
Other assets	48,570	30,699	271	-	79,540
Development Properties	-	79,296	-	-	79,296
Fixed assets	16,742	639	-	-	17,381
Intangible assets	4,032	35,555	-	-	39,587
Total on balance sheet items	**1,338,211**	**1,459,726**	**21,252**	**14,921**	**2,834,110**
Off balance sheet items	**727,091**	**31,118**	**-**	**39**	**758,248**
Total credit exposure	**2,065,302**	**1,490,844**	**21,252**	**14,960**	**3,592,358**

The Group uses the geographical location of the credit exposures as the basis to allocate to the respective geographical region as shown above.

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11. Industrial distribution of credit exposures:

	Banks and Financial Institutions	Trading and manufacturing	Property and construction	Services	Individuals	Textile	Others	Total
On-balance sheet items								
Cash and balances with banks and central banks	280,465	-	-	-	-	-	-	280,465
Commodity and other placements with banks, financial and other institutions	88,220	-	-	-	-	-	-	88,220
Murabaha and other financings	734,732	326,124	29,626	21,040	327,664	23,437	91,165	1,553,788
Musharaka financing	24,656	73,805	9,537	9,289	44,399	786	25,093	187,565
Assets acquired for leasing	1,237	15,118	-	84	134,584	-	-	151,023
Investments	291,280	59,182	-	4,396	-	-	2,387	357,245
Other assets	21,349	406	18,312	5,733	31,973	-	1,767	79,540
Development Properties	-	-	79,296	-	-	-	-	79,296
Fixed assets	16,742	-	639	-	-	-	-	17,381
Intangible assets	39,587	-	-	-	-	-	-	39,587
Total on balance sheet items	**1,498,268**	**474,635**	**137,410**	**40,542**	**538,620**	**24,223**	**120,412**	**2,834,110**
Off balance sheet items	**262,733**	**297,884**	**6,731**	**58,143**	**2,148**	**12,639**	**117,970**	**758,248**
Total credit exposure	**1,761,001**	**772,519**	**144,141**	**98,685**	**540,768**	**36,862**	**238,382**	**3,592,358**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

12. Maturity breakdown of credit exposures & funding liabilities:

12.1 Contractual maturity breakdown of credit exposures & funding liabilities:

	Up to 1 Month	1-3 Months	3-12 Months	1-5 Years	5-10 Years	10-20 Years	Over 20 Years	Total
On-balance sheet items								
Cash and balances with banks and central banks	280,465	-	-	-	-	-	-	280,465
Commodity and other placements with banks, financial and other institutions	70,718	12,388	-	5,114	-	-	-	88,220
Murabaha and other financings	182,662	128,323	166,179	863,282	210,963	2,379	-	1,553,788
Musharaka financing	1,117	3,433	41,377	98,201	19,029	24,408	-	187,565
Assets acquired for leasing	48	209	543	1,764	6,538	71,653	70,268	151,023
Investments	37,386	147,734	38,227	9,303	124,595	-	-	357,245
Other assets	47,784	5,758	14,608	6,347	5,043	-	-	79,540
Development Properties	-	-	-	79,296	-	-	-	79,296
Fixed assets	634	1,547	412	2,708	12,080	-	-	17,381
Intangible assets	-	-	-	-	28,361	-	11,226	39,587
Total on balance sheet items	**620,814**	**299,392**	**261,346**	**1,066,015**	**406,609**	**98,440**	**81,494**	**2,834,110**
Off balance sheet items	443,620	88,140	131,598	93,935	955	-	-	**758,248**
Total credit exposure	**1,064,434**	**387,532**	**392,944**	**1,159,950**	**407,564**	**98,440**	**81,494**	**3,592,358**
Customers' current accounts	571,866	-	-	-	-	-	-	571,866
Due to banks, financial and other institutions	253,149	26,784	48,780	69,280	6,398	-	-	404,391
Due to investors	385,862	84,292	117,481	4,351	-	-	-	591,986
Equity of unrestricted investment accountholders	382,107	103,673	394,335	103,070	-	-	-	983,185
	1,592,984	**214,749**	**560,596**	**176,701**	**6,398**	**-**	**-**	**2,551,428**

12.2 Behavioral maturity breakdown of credit exposures & funding liabilities:

	Up to 1 Month	1-3 Months	3-12 Months	1-5 Years	5-10 Years	10-20 Years	Over 20 Years	Total
On-balance sheet items								
Cash and balances with banks and central banks	208,729	1,030	9,401	61,305	-	-		280,465
Commodity and other placements with banks, financial and other institutions	72,185	16,035						88,220
Murabaha and other financings	137,248	65,951	382,694	794,379	152,714	20,802		1,553,788
Musharaka financing	41,924	19,731	52,716	54,130	11,575	7,489		187,565
Assets acquired for leasing	-	-	162	2,047	-	78,546	70,268	151,023
Investments	41,057	152,340	21,115	42,372	97,317	3,044		357,245
Other assets	173	5,252	36,881	31,258	5,976	-	-	79,540
Development Properties	-	-	-	79,296	-	-	-	79,296
Fixed assets	16	7	1,196	1,381	2,030	12,751		17,381
Intangible assets	-	-	-	-	28,361	-	11,226	39,587
Total on balance sheet items	**501,332**	**260,346**	**504,165**	**1,066,168**	**297,973**	**122,632**	**81,494**	**2,834,110**
Off balance sheet items	443,620	88,140	131,598	93,935	955	-	-	**758,248**
Total credit exposure	**944,952**	**348,486**	**635,763**	**1,160,103**	**298,928**	**122,632**	**81,494**	**3,592,358**
Customers' current accounts	2,534	7,172	26,830	319,374	127,719	88,237		571,866
Due to banks, financial and other institutions	73,609	40,040	34,269	137,513	118,960	-		404,391
Due to investors	85,320	83,798	128,531	123,952	97,760	72,625		591,986
Equity of unrestricted investment accountholders	8,132	31,068	35,654	870,883	21,486	15,962		983,185
	169,595	**162,078**	**225,284**	**1,451,722**	**365,925**	**176,824**	**-**	**2,551,428**

13. Related-party balances under credit exposure:

A number of banking transactions are entered into with related parties in the normal course of business. The related party balances included under credit exposure at 30 June 2019 were as follows:

Affiliated companies	621,669
Directors & key management	4,965
Total	**626,634**

The Bank has an exposure of BD 0.6 billion to an individual related counterparty which represents an exposure in excess of the 15% of the individual obligor limit.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

14. Past due and impaired financings and related provisions for impairment:

	Gross exposure	Impairment provisions	Net exposure
Analysis by industry			
Manufacturing	44,158	43,488	670
Agriculture	3,222	2,242	980
Construction	22,370	3,051	19,319
Finance	2,742	903	1,839
Trade	35,241	25,683	9,558
Personal	23,706	9,867	13,839
Real estate	6,529	5,963	566
Other sectors	9,338	1,842	7,496
Total	**147,306**	**93,039**	**54,267**
Ageing analysis			
Over 3 months up to 1 year	23,918	12,958	10,960
Over 1 year up to 3 years	14,145	4,398	9,747
Over 3 years	109,243	75,683	33,560
Total	**147,306**	**93,039**	**54,267**

Details of impairment provisions at 30 June 2019	**Relating to owners**	**Relating to unrestricted investment accounts**	**Total**
At 1 January	87,729	8,173	95,902
Charge for the period	6,490	681	7,171
Write back during the period	(251)	(92)	(343)
Utilised during the period	(6)	-	(6)
Exchange differences and other movements	(9,384)	(301)	(9,685)
At 30 June 2019	**84,578**	**8,461**	**93,039**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

15. Past due and impaired financings by geographical areas:

Analysis by Geography	Gross exposure	Impairment Provisions	Net exposure
Asia	82,408	69,454	12,954
Middle East	59,098	22,436	36,662
Europe	5,800	1,149	4,651
Total	**147,306**	**93,039**	**54,267**

16. Details of credit facilities outstanding that have been restructured during the period ended 30 June 2019:

Restructured financings during the period ended 30 June 2019 aggregated to BD3.1 million (31 December 2018: BD7.6 million). This restructuring had an impact of BD0.4 million (31 December 2018: BD1.3 million) on present earnings during the period ended 30 June 2019. Further, this restructuring is expected to have positive impact of BD0.2 million (31 December 2018: BD0.5 million) Group's future earnings. Extension of maturity dates was the basic nature of concessions given to all the restructured facilities.

17. Credit exposures which are covered by eligible financial collateral:

Exposure funded by Self Finance

	Gross Exposure	Eligible Financial Collateral
Corporate portfolio	351,475	6,466
Regulatory retail portfolio	357	70
Past due financings	7,184	1,269
Total	**359,016**	**7,805**

Exposure funded by Unrestricted Investment Accounts

	Gross Exposure	Eligible Financial Collateral
Corporate portfolio	418,353	16,841
Regulatory retail portfolio	436,451	40
Past due financings	46,467	87
Total	**901,271**	**16,968**

Counterparty Credit Risk (CCR)

	Gross Positive Fair Value of Contracts	Netting Benefit	Credit Risk Mitigation	Net Value Exposure at Default	Risk Weighted Assets
Foreign Exchange Contracts	9,236	-	-	9,236	8,438
Total	**9,236**	**-**	**-**	**9,236**	**8,438**

18. Market Risk

Market risk is the risk of potential loss arising from change in the value of any exposure due to adverse changes in the underlying benchmark market rates, i.e. foreign exchange rates, equity prices and profit rates.

The Market Risk Management Policy address all aspects of market risk. Implementation of the policy, procedures and monitoring of regulatory and internal limits for Ithmaar Bank is the responsibility of the relevant business units with oversight by the Asset-Liability Committee (ALCO) and the AGRMC.

The capital charge for market risk is computed as per the standardized approach.

18.1 The key market risk factors that the Bank is exposed to are discussed below

18.1.1 Foreign exchange risk:

Foreign exchange risk is the risk that the foreign currency positions taken may be adversely affected due to volatility in foreign exchange rates. The responsibility for management of foreign exchange risk rests with the Treasury Department. Foreign exchange risk management in Ithmaar Bank is ensured through regular measurement and monitoring of open foreign exchange positions. The foreign exchange transactions carried out by Ithmaar Bank are on behalf of customers, are on a back-to-back basis, and no proprietary positions are assumed by the Bank.

18.1.2 Profit rate risk:

Profit rate risk is the risk that Ithmaar Bank will incur a financial loss as a result of mismatch in the profit rate on the assets, investment account holders and customer liabilities. The profit distribution is based on profit sharing agreements instead of guaranteed return to investment account holders. However, the profit sharing arrangements will result in displaced commercial risk when Ithmaar Bank's results may not allow Ithmaar to distribute profits in line with the market rates.

18.1.3 Price risk:

Investment price risk is the risk of reduction in the market value of Ithmaar Bank's portfolio as a result of diminution in the market value of individual investment.

18.1.4 Commodity risk:

The Bank does not have exposure to the commodity market.

18.2 Market risk management strategy

The market risk strategy is approved by the Board and amendments to the policies are approved by the Board. The senior management is responsible for implementing the risk strategy approved by the Board, and continually enhancing the policies and procedures for identifying, measuring, monitoring and controlling risks.

Strategies for market risk management includes:

1 The Bank will comply with the provisions of the market risk strategy while assuming any market risk exposures.
2 A limit structure has been established to monitor and control the market risk in its portfolio.
3 Each new product/process is reviewed to manage the market risk.
4 Appropriate measurement techniques are in place to proactively measure and monitor market risk.
5 Stress testing is conducted regularly to assess the impact of changes in the market variables.
6 Sufficient capital will be held at all times to meet the capital requirements in line with CBB Basel III Pillar I requirements.

18. Market Risk (continued)

18.3 Market risk management measurement and monitoring

The various techniques used by the Bank for the purposes of measuring and monitoring of market risk are as follows:

- Overnight forex open positions
- Profit rate gap analysis
- Earnings at Risk
- Economic Value

Risk Management Department of the Bank monitors the positions vis-à-vis the limits approved by the Board.

18.4 Limits monitoring

Regulatory/In-House Policy Limits and guidelines as approved by the Board are strictly adhered to, deviations if any are immediately escalated and action taken wherever necessary.

18.5 Portfolio review process

As part of the risk review process, Risk Management Department monitors Ithmaar Bank's overall exposure to market risk. Reports of such review is submitted to the ALCO and the AGRMC.

18.6 Management Information System

Reports on market risk are a calendar item at the meetings of the ALCO and AGRMC. The reports provide Ithmaar Bank’s ALCO and AGRMC an update on the market risk exposure in the books.

18.7 Stress Testing

Ithmaar Bank employs multiple categories of stress testing, profit rates, foreign exchange rates and equity prices. For each category the worst possible shocks that might realistically occur in the market are considered for stress testing.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

19. Disclosure of regulatory capital requirements for market risk under the standardized approach:

	Risk weighted assets			Capital requirement		
	30 June 2019	Maximum Value	Minimum Value	30 June 2019	Maximum Value	Minimum Value
Foreign exchange risk	2,401	7,918	2,401	300	990	300
Aggregation						
Foreign exchange risk	215	136	215	27	17	27
Profit Rate Risk (Trading Book)	8,505	7,455	8,505	1,063	932	1,063
Equity Position Risk	27,529	30,257	27,529	3,441	3,782	3,441
Total	**38,650**	**45,766**	**38,650**	**4,831**	**5,721**	**4,831**

20. Currency risk:

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Substantial portion of the Group's assets and liabilities are denominated in US Dollars, Bahraini Dinars, UAE Dirhams and Pakistani Rupee. Bahraini Dinars and UAE Dirhams are pegged to US Dollars and as such currency risk is minimal. The Bank's investment in FBL is in Pak Rupees (PKR) and exposes the Bank to foreign exchange risk. The cumulative foreign exchange loss as of 30 June 2019 amounted to BD43.2 million (31 December 2018: BD31.6 million) (included in the foreign exchange translation reserve statement of changes in equity).

The significant net foreign currency positions at 30 June 2019 were as follows:

	Long/(Short)
Pakistani Rupee	38,200
United States Dollars	222,759

21. Equity position in Banking book

At 30 June 2019, the Group's sukuk and investment securities aggregated to BD345.5 million (31 December 2018: BD490.1 million). Out of the total investment securities, BD17.8 million (31 December 2018: BD21.6 million) were listed investment securities and the remaining BD327.7 million (31 December 2018: BD468.5 million) represented unlisted investment securities.

Cumulative realized loss from sale of investment securities during the period ended 30 June 2019 amounted to BD0.7 million (31 December 2018: BD0.5 million). Total unrealized loss recognized in the consolidated statement of changes in owners' equity amounted to BD3.3 million (31 December 2018: BD3.4 million).

At 30 June 2019, capital requirements using standardized approach aggregated to BD0.2 million (31 December 2018: BD0.2 million) for listed investment securities and BD0.03 million (31 December 2018: BD0.1 million) for unlisted investment securities after aggregation/pro-rata aggregation of investments in Banking and other financial entities.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

22. Profit Rate Risk in the Banking Book

Profit rate risk in Ithmaar Bank's banking book is the risk of adverse changes in expected net earnings and economic value of the balance sheet resulting from the impact of changes in profit rates on mismatched maturity and repricing assets and liabilities in the banking book.

22.1. Following are the sources of profit rate risk:

• Maturity mismatch: The non-alignment of maturities/re-pricing dates of assets and liabilities gives rise to profit rate risk. In the case of fixed profit rates, maturities are considered whereas for floating or variable profit rates the re-pricing/rollover dates are considered.

• Basis value risk: Assets and liabilities with similar maturities/re-pricing dates and highly, though imperfectly, correlated profit rate benchmarks (USD-LIBOR and BIBOR) are exposed to basis risk.

• Profit rate curve risk: Changes to the values, slope and shape of the profit rate curve that impact the assets and liabilities of Ithmaar Bank in a dissimilar manner gives rise to profit rate risk.

• Risk of counterparty's options underlying assets: The availability of options, with Ithmaar Bank's counterparties, to make prepayments or early withdrawals can leave Ithmaar Bank with excess or deficit funds that need to be invested or funded again at unknown profit rates.

22.2. Profit rate risk strategy

The Board of Ithmaar Bank approves and reviews the profit rate risk strategy and amendments to the Market risk policies. The ALCO is responsible for implementing the profit rate risk strategy approved by the Board. As a strategy the following measures are initiated:

• Strive to maintain appropriate spread between cost of funds and yield on financing
• Reduce the maturity/repricing mismatch gap between assets and liabilities
• Review the profit rate offered on liabilities products to remain competitive in the market
• Identify profit rate sensitive products Ithmaar Bank wishes to engage in

22.3. Measurement of profit rate risk

The Bank has adopted the following methods for profit rate risk measurement in the banking book:

• Re-pricing gap analysis: measures the gap between the Rate Sensitive Assets (RSAs) and Rate Sensitive Liabilities (RSLs).

• Economic value of equity (EVE) – Duration Gap: This measures the loss in value of the portfolio due a small change in profit rates. Ithmaar Bank will adopt EVE measure using duration (weighted-average term to- maturity of the security's cash-flows) estimates for various time bands. Assumptions for the computation of economic value are subscribed from Basel II guidelines and international best practices.

• Income Effect - Earnings-at-risk (EaR): Earnings perspective involves analyzing the impact of changes in profit rates on accrual or reported earnings in the near term. In the earnings perspective, the focus of analysis is the impact of changes in profit rates on accrual or reported earnings. Ithmaar Bank also performs a stress testing of the impact of 200 basis points on the capital of the Bank.

22.4. Profit rate risk monitoring and reporting

Profit rate risk is monitored by reviewing the repricing profile of the Rate Sensitive Assets and Rate Sensitive Liabilities.

MIS on profit rate risk, including the impact of shift in profit rates on the earnings and economic value is presented to the ALCO and the AGRMC.

22.5. Disclosure of Profit rate risk:

Profit rate risk is the risk that the value of the financial instrument will fluctuate due to changes in the market profit rates.

	USD	PKR	AED
Total profit rate exposure	263,407	167,853	120,931
Rate shock (assumed) (+/-)	0.95%	3.30%	0.54%
Total estimated impact (+/-)	**2,502**	**5,539**	**653**

23. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events which includes but not limited to legal risk and Sharia compliance risk. This definition excludes strategic and reputational risks.

Ithmaar Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, Ithmaar Bank is able to manage the operational risks to an acceptable level.

23.1 Operational risk management strategy

The Bank has in place a robust framework for the management of Operational Risk. Policies and Procedures on Operational Risk provide detailed guidelines for management of Operational Risks in Ithmaar Bank.

All new products and processes are reviewed to identify the operational risks therein and mitigants are put in place.

The approach to Operational Risk includes emphasis on:

• Establishment of an effective governance structure with clear reporting lines and segregation of duties.

• Maintenance of an effective internal control environment.

• Escalation and resolution of risk and control incidents and issues.

23.2 Operational risk monitoring and reporting

Report on Operational Risk events is submitted by the support and business departments, the events are reviewed and discussed, and shortcomings are resolved, external loss events are also recorded and reviewed in terms of its relevance to Ithmaar Bank's operations.

A robust Risk Control and Self-Assessment process has been implemented; whereby significant risks in a process are identified and evaluated taking into consideration the inherent risk and residual risk.

Key Risk Indicators (KRIs) for all the significant risk areas have been developed and trends thereof are being monitored. Ithmaar Bank has also established bank-wide Key Risk Indicators (KRI) which are constantly monitored to assess the overall operational risk profile.

The AGRMC is periodically updated on the operational risk profile which include the review of the operational risk events, KRI monitoring and details of any operational risk event leading to financial or reputational loss.

23.3 Operational risk mitigation and control

The Operational Risk management process through RCSA, KRI and loss reporting is complemented by the department-level procedures which ensure that concerned staffs are well aware of their responsibilities and processes associated with their responsibilities.

The RCSA process also helps to identify the material operational risks and decision on appropriate controls to be implemented to mitigate the risks is arrived at. At times a decision is taken whether to accept the risks, reduce the level of activity involved, transfer the risk, or withdraw from the associated activity completely jointly by the Risk Management Department along with the concerned business/support department.

The Risk Management Department in consultation with the Legal department monitors the pending legal cases against Ithmaar Bank. Wherever required Risk Management Department in coordination with the Legal Department assesses the impact of legal cases on the Operational and Reputational risk profile.

23. Operational Risk (continued)

23.4 Business Continuity Plan

Ithmaar Bank has in place a Business Continuity Policy which deals with policy initiatives to ensure that Ithmaar continues its critical activities following a disastrous event.

This provides the plan for continuity of business operations at all times in case of any potential disruptions resulting from unanticipated loss of services or infrastructure.

Disaster Recovery Site has been set up at Galali Branch. The premises are well equipped with the required infrastructure. A Business Continuity Steering Committee has been set up, which oversee the implementation of the Business Continuity Plan in Ithmaar Bank.

23.5 Information Secuirty

Ithmaar Bank's Information Security and compliance function within RMD role is to prevent disruptions of the Information Security systems as it would impact Bank's business objective, its operations and also impede the main pillars of Information Security (Confidentiality, Integrity, and Availability).
The function continually strengthens and improves the overall capabilities of the information security management system by ensuring that Ithmaar Bank's Information Security process is complete, reliable and adhering to international standards.

It is also ensured that information security related operations continue to be carried out in line with international standards such as (IEC/ISO 27001 and PCI-DSS). It is also ensured that on-going training and awareness on information security is provided to the employees of the Bank. Towards this end on-line training and awareness sessions on information security is provided to the employees of the Bank.

The Bank is IEC/ISO 27001 and PCI-DSS certified, this reflects the importance assigned to information security by the Bank.

The Information Security Function actively preforms various task in terms of:

- Cyber and Information security training
- Security Certification compliance and assurance
- Review and preparation of Information security policies and procedures
- Incident response management
- Active monitoring and auditing of Applications and systems
- Provides reports and assistance to the information security steering committee
- Engagement in Bank's on-going projects
- Bank's compliance with Bahrain Information security laws and Regulatory requirements

23.6 Reputation Risk

Reputation risk is the risk that an event will adversely affect Ithmaar Bank's reputation in the market, which, in turn, may adversely impact its ability to effectively undertake its activities.

Sound corporate governance is a cornerstone in managing reputation risk. Ithmaar Bank has in place a Reputational Risk Management Policy which details Ithmaar Bank's multi-faceted approach relating to the management of reputational risk. Ithmaar Bank also has a Corporate Governance Policy and a Code of Ethics and Business Conduct Policy for the members of the Board, management and staff. This Code helps to build an atmosphere of professionalism, integrity and ethical behaviour within Ithmaar Bank to avoid reputation risks.

24. Disclosure of regulatory capital requirements for operational risk under the basic indicator approach:

For regulatory reporting, the capital requirement for operational risk is calculated based on basic indicator approach. According to this approach, the Bank's average gross income over the preceding three financial years is multiplied by a fixed alpha coefficient.

The alpha coefficient has been set at 15% under CBB Basel III guidelines. The capital requirement for operational risk at 30 June 2019 aggregated to BD15.1 million (31 December 2018: BD16.8 million).

25. Liquidity Risk

Liquidity ratios:	**30 June 2019**
Liquid assets to total assets	13.01%
Short term assets to short term liabilities	47.73%

26. Legal contingencies

At 30 June 2019, the Group had contingent liabilities towards customer and other claims aggregating to BD81.7 million (31 December 2018: BD91.9 million). The management is of the view that these claims are not likely to result into potential liabilities.

During the period, the Bank was subject to one financial penalty of BD60,000 relating to disclosures on certain charges.

27. Displaced Commercial Risk

Ithmaar Bank is exposed to rate of return risk in the context of its Profit Sharing Investment Accounts (PSIA) fund management. An increase in benchmark rates may result in Investment Account Holder (IAH)s' having expectations of a higher rate of return. As per mudaraba agreement, IAHs are eligible for the actual return earned on the assets and all losses in normal course of business on PSIA are borne by the IAHs, Ithmaar Bank may however, under market pressure pay a return that exceeds the rate that has been actually earned on assets funded by IAHs.

This increased rate of return risk may result in displaced commercial risk where Ithmaar Bank may forgo its share of profits as modareb to match the IAHs.

27.1 The following mechanism / guidelines are followed to avoid the displaced commercial risk in the Bank:

Expected Rate of Returns to IAHs
ALCO on periodic basis reviews the expected rates offered to IAHs to revise and adjust them with the benchmark rates. Business units offering PSIAs products monitors benchmark rates being offered by the relevant competitors and overall trend and recommend changes in the expected rates offered by Ithmaar Bank. This pro-active approach of adjusting the expected profit rates minimizes the displaced commercial risks.

Profit Equalization and Investment Risk Reserves (PER & IRR)
A central principle of Islamic finance is that an investor participating in a Modaraba contract must bear all losses in normal course of business and are eligible for actual rate of returns earned on the assets. However, Ithmaar Bank, to fulfill its fiduciary responsibility or to match benchmark rates or to avoid displaced commercial risk, creates reserves to make good such losses or meet the shortfall in expected returns. These reserves may be in the form of Profit Equalization Reserve and Investment Risk Reserves for PSIA Funds.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

28. Gross income from Mudaraba and profit paid to Unrestricted Investment Accountholders:

	30 June 2019		30 June 2018	
	Percentage to URIA assets	Amount	Percentage to URIA assets	Amount
Income from unrestricted investment accounts	3.5%	39,700	2.9%	32,913
Less: return to unrestricted investment accounts	-2.3%	(26,926)	-1.7%	(19,633)
Group's share of income from unrestricted investment accounts as a Mudarib	1.1%	**12,774**	1.2%	**13,280**

29. Average declared rate of return on General Mudaraba deposits:

	30 June 2019	31 December 2018
30 Days	1.45	1.20
90 Days	1.85	1.60
180 Days	2.10	1.85
360 Days	2.90	2.50
3 Years	3.10	2.70

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

30. Movement in Profit Equalization Reserve and Investment Risk Reserve:

	30 June 2019
Profit Equalization Reserve	8,973
As at 30 June 2019	
Amount appropriated as a percentage of gross income	1.7%
Investment Risk Reserve	1,288
As at 30 June 2019	
Amount appropriated as a percentage of gross income	1.8%

At 30 June 2019, the ratio of profit equalization reserve, investment risk reserve and provisions against equity of unrestricted investment accountholders stood at 0.9%, 0.1% and 1.9% respectively.

30 June 2019, the ratio of financings to URIA stood at 85.8%.

31 December 2018, the percentage of each type of Islamic financing to total URIA financing was as follows:

	Percentage Financing to Total URIA Financing
Murabaha and other financings	60.04%
Musharaka financing	22.21%
Assets acquired for leasing	17.75%

The following table summarizes the breakdown of URIA and impairment provisions

	30 June 2019
Exposure : Banks	217,057
Exposure : Non-Banks	933,627
Provisions : Non-Banks	19,116

31. Other disclosures

The audit fees charged and non-audit services provided by external auditors will be made available to the shareholders as and when requested. Such details will be made available to the Bank’s shareholders as per their specific request provided that these disclosures would not negatively impact the Bank's interest and its competition in the market.

Deposits and Unrestricted Investment Accounts held with the Bank in the Kingdom are covered by the Regulation Protecting Deposits and Unrestricted Investment Accounts issued by the CBB in accordance with Resolution No.(34) of 2010.