ITHMAAR BANK B.S.C. (C)

Public Disclosures as at 30 June 2023

Ithmaar Bank B.S.C. (C)
Public Disclosures at 30 June 2023

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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) condensed consolidated interim financial information for the period ended 30 June 2022, 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 Internal Capital Adequacy Assessment Process (ICAAP) policy provides the required guidelines and methodologies to assess the Bank's capital requirements for Pillar 1 and Pillar 2 risks and thereby ensures that the Bank meets the capital requirements as mandated by the CBB in line with the Capital Adequacy (CA) module for Pillar 1 risks and the ICAAP Module for all pillar 2 risks. Capital management also ensures that shareholders’ value is protected and enhanced.

The Bank adopts a Pillar I + Pillar II approach for capital estimation as recommended under CBB guidelines. Under this approach, the Bank calculates the Pillar I capital or minimum regulatory capital requirements in accordance to CBB’s capital adequacy guidelines as prescribed in the CA module of the CBB rulebook. Secondly, additional capital or pillar II capital requirement is calculated separately based on an “add-on” approach, where the additional capital requirements are added onto the calculated Pillar I capital requirements, to arrive at the Bank’s internal capital requirements as per CBB guidelines. To ensure that the business model is thoroughly examined and subject to sufficient analysis, ICAAP is supported with comprehensive Stress Testing in line with the Stress Testing Module of CBB rulebook.

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, Risk, Nomination and Remuneration Committee (AGRNRC) 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 at 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	1,652,719	100,906	67%	Pakistan	Banking	Aggregation
Dilmunia Development Fund I L.P.	65,390	56,975	92%	Cayman Islands	Real estate	Risk weight

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

Balance sheet as per published financial statements	2,202,515
FAS 30 Transitional impact	21,630
Modification loss & ECL transitional impact	18,403
Aggregation	29,784
Balance sheet as in Regulatory Return	**2,272,332**

(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 2023

Assets	**As per published financial statements**	**As per Consolidated PIRI**
Cash and balances with banks and central banks	151,744	151,744
Commodity and other placements with banks, financial and other institutions	44,043	44,043
Murabaha and other financings	594,000	594,000
Musharaka financing	492,517	492,517
Sukuk and investment securities	694,689	694,689
Investment in associates	115	115
Assets acquired for leasing	304	304
Other assets	106,780	106,780
Investment in real estate	3,946	3,946
Development Properties	56,831	56,831
Fixed assets	51,163	51,163
Intangible assets	6,383	6,383
FAS 30 Transitional impact	-	21,630
Modification loss & ECL transitional impact	-	18,403
Aggregation	-	29,784
Total Assets	**2,202,515**	**2,272,332**
Liabilities & Unrestricted Investment Accounts (URIA)		
Unrestricted Investment Accounts	893,370	893,370
Other liabilities	1,232,322	1,232,322
Total Liabilities & URIA	**2,125,692**	**2,125,692**
Non-controlling interests	39,140	39,140
Owners' Equity		
Share capital	100,000	100,000
Reserves	(53,699)	(53,699)
of which eligible for CET1	-	(37,097)
Accumulated losses	(8,618)	(8,618)
of which eligible for CET1	-	(52,429)
FAS 30 Transitional impact	-	21,630
Modification loss & ECL transitional impact	-	18,403
Aggregation	-	29,784
Total Owners' Equity	**37,683**	**107,500**
Total Liabilities + Owners' Equity	**2,202,515**	**2,272,332**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

5. Regulatory Capital components (continued)

Step 3: Common disclosure template as at 30 June 2023

Common Equity Tier 1 capital: instruments and reserves:	**Amount**
Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	100,000
Retained earnings	(52,429)
of which Modification loss including ECL provisions relating to stage 1 & 2	18,403
Expected Credit Losses (ECL) Stages 1 & 2	(52,762)
of which FAS 30 Transitional impact	21,630
Reserves	(37,097)
Aggregation & deductions	82,824
Common Equity Tier 1 capital before regulatory adjustments	**80,569**
Total regulatory adjustments to Common equity Tier 1	**80,569**
Tier 1 capital (T1 = CET1 + AT1)	**80,569**
Tier 2 capital: instruments and provisions:	
FAS 30 Transitional impact	5,475
Tier 2 capital (T2)	**5,475**
Total capital (TC = T1 + T2)	**86,044**
Total Risk Weighted Assets (RWA)	**622,705**
Capital ratios and buffers:	
Common Equity Tier 1 (as a percentage of risk weighted assets)	**12.94%**
Tier 1 (as a percentage of risk weighted assets)	**12.94%**
Capital Adequacy Ratio (CaR)	**13.82%**
Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus D-SIB buffer requirement, expressed as a percentage of risk weighted assets)	
of which: capital conservation buffer requirement	2.5
of which: bank specific countercyclical buffer requirement	N/A
of which: D-SIB buffer requirement	N/A
National minimum including CCB (where different from Basel III)	
CBB Common Equity Tier 1 minimum ratio	9.0
CBB Tier 1 minimum ratio	10.5
CBB total capital minimum ratio	12.5

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	12.94%	13.82%
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	14.55%	17.55%

7. Risk Management

7.1 Risk Management Objectives

Risk is an integral part of Ithmaar Bank's business and managing it is critical to Ithmaar'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 seek 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 Ithmaar 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 CBB, sound principles of risk management issued by Bank of International Settlements, international best practices and 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 ICAAP report of Ithmaar Bank. 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 AGRNRC. 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 credits exposures are at least reviewed and rated periodically 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.

All provisoning requirements for financing and investment exposures are discussed and approved by the Investment and Credit Committee of the Bank.

Unrestricted FUM assets

The Funds under Management 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. The Risk Appetite Framework 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 and support units 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 Risk Appetite Framework 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 AGRNRC 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.

In case of assets pledged as part of financing contracts, the Bank considers the pledged assets as collateral at a value determined post the valuation of the assets. The valuation guidelines and the haircuts applied on the pledged assets are as per the Credit Risk Mitigation Policy of the Bank.

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;
- 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 quarterly 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.

The Bank has defined practices for disposal or enforecement of collateral. On the Debtors default, the Bank (i.e. the secured party) can either take possession of the collateral or file a case against the debtor for enforcement of security. The Bank sends a reasonable authenticated notification of disposal through the court. The notice is intended to provide the debtor and other interested parties , an opportunity to monitor the disposition of the collateral. A specific amount of time is normally given to the borrowers during which they can pay off the debt or the property will be sold through the court. The final settlement of the matter will be in line with the decision taken by the court/judge.

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. 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 legal and natural persons connected with the Bank, including, in particular; controllers of the Bank (and Board members, senior management and key staff of the controller, the controller's appointed Board representatives, subsidiaries and associated companies of controllers including their Board members, senior management and key staff), approved persons of the licensee, as defined by Module LR-1A, and their close family members (as defined by IFRS – IAS 24); associated companies not mentioned hereinabove, unconsolidated subsidiaries and members of the Shari'a Supervisory Board ('SSB'), if any.

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 2022, Directors having conflict of interests in the transaction under discussion abstained from voting on the approval of the proposed related party transaction, except where the transaction is required as part of the reorganization.

(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 banks	15,990	1,999
Claims on corporate portfolio	10,420	1,303
Past Due Facilities	16	2
Other assets	531	66
Aggregation	406,653	50,832
Total	**433,610**	**54,202**

Exposure funded by Unrestricted Investment Accounts (URIA)

	Risk weighted assets	Capital requirement
Claims on corporate portfolio	3,626	453
Past due facilities	793	99
Total	**4,419**	**552**

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	151,744	137,061
Commodity and other placements with banks, financial and other institutions	44,043	31,242
Murabaha and other financings	594,000	586,255
Musharaka financing	492,517	532,994
Assets acquired for leasing	304	304
Investments	698,750	761,044
Other assets	106,780	87,154
Development Properties	56,831	57,056
Fixed assets	51,163	55,454
Intangible assets	6,383	7,476
Total on balance sheet credit exposure	**2,202,515**	**2,256,040**
Credit risk exposure relating to off balance sheet items are as follows:		
Financial guarantees and irrevocable letters of credit, acceptance and endorsements	172,142	178,243
Financing commitments, Undrawn facilities and other credit related liabilities	406,616	473,837
Total off balance sheet credit exposure	**578,758**	**652,080**
Total credit exposure	**2,781,273**	**2,908,120**
Total credit exposure financed by URIA	**658,631**	**736,262**
Total credit exposure financed by URIA (%)	**23.68%**	**25.32%**

The average gross credit exposure represent average balances for 2023 and 2022

Exposures amounting to BD4.7 million are covered by guarantee.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

10. Geographical distribution of credit exposures:

	Asia	Middle East	Europe	Total
On-balance sheet items				
Cash and balances with banks and central banks	122,225	29,519	-	151,744
Commodity and other placements with banks, financial and other institutions	33,654	10,389	-	44,043
Murabaha and other financings	221,202	362,499	10,299	594,000
Musharaka financing	492,517	-	-	492,517
Assets acquired for leasing	-	304	-	304
Investments	660,710	38,040	-	698,750
Other assets	87,283	19,481	16	106,780
Development Properties	-	56,831	-	56,831
Fixed assets	50,632	531	-	51,163
Intangible assets	3,230	3,153	-	6,383
Total on balance sheet items	**1,671,453**	**520,747**	**10,315**	**2,202,515**
Off balance sheet items	**557,466**	**21,292**	**-**	**578,758**
Total credit exposure	**2,228,919**	**542,039**	**10,315**	**2,781,273**

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

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

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	151,744	-	-	-	-	-	-	151,744
Commodity and other placements with banks, financial and other institutions	44,043	-	-	-	-	-	-	44,043
Murabaha and other financings	306,961	116,160	24,011	52,325	6,304	-	88,239	594,000
Musharaka financing		169,720	-	25,271	51,310	-	246,216	492,517
Assets acquired for leasing	-	-	-	304	-	-		304
Investments	49,215	7,061	1,719	640,755	-	-	-	698,750
Other assets	17,395	99	5,740	6,083	12,566	-	64,897	106,780
Development Properties	-	-	56,831	-	-	-		56,831
Fixed assets	50,632	-	531	-	-	-	-	51,163
Intangible assets	3,230	2,115	-	-	-	-	1,038	6,383
Total on balance sheet items	**623,220**	**295,155**	**88,832**	**724,738**	**70,180**	**-**	**400,390**	**2,202,515**
Off balance sheet items	**142,083**	**230,708**	**38,812**	**53,906**	**6,801**	**39,369**	**67,079**	**578,758**
Total credit exposure	**765,303**	**525,863**	**127,644**	**778,644**	**76,981**	**39,369**	**467,469**	**2,781,273**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

12. 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	151,514	-	230	-	-	-	-	151,744
Commodity and other placements with banks, financial and other institutions	-		44,043	-	-	-	-	44,043
Murabaha and other financings	-	121,396	-	455,819	16,785		-	594,000
Musharaka financing	268,868	81,002		116,931	25,716			492,517
Assets acquired for leasing	-	-	-	304	-	-	-	304
Investments		13,926	28,044	595,244	61,536	-	-	698,750
Other assets	4,433		81,322	16,412	4,613	-	-	106,780
Development Properties	-	-	-	56,831	-	-	-	56,831
Fixed assets		3,999	268	7,626	39,270	-	-	51,163
Intangible assets	-	-	-	-	3,185	722	2,476	6,383
Total on balance sheet items	**424,815**	**220,323**	**153,907**	**1,249,167**	**151,105**	**722**	**2,476**	**2,202,515**
Off balance sheet items	**325,759**	**91,924**	**99,585**	**58,001**	**3,489**	**-**	**-**	**578,758**
Total credit exposure	**750,574**	**312,247**	**253,492**	**1,307,168**	**154,594**	**722**	**2,476**	**2,781,273**
Customers' current accounts	-	-	196,346	430,280	-	-	-	626,626
Due to banks, financial and other institutions	166,664	-		49,658	221,504	-	-	437,826
Due to investors	4,386	-	-	37	-	-	-	4,423
Equity of unrestricted investment accountholders	-	177,246		716,124	-	-	-	893,370
	171,050	**177,246**	**196,346**	**1,196,099**	**221,504**	**-**	**-**	**1,962,245**

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 2023 were as follows:

Affiliated companies	333,090
Directors & key management	55
Total	**333,145**

(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	22,589	17,497	5,092
Agriculture	1,283	1,071	212
Construction	22,784	9,547	13,237
Finance	133	109	24
Trade	53,728	40,760	12,968
Personal	2,190	1,491	699
Other sectors	18,486	3,465	15,021
Total	**121,193**	**73,940**	**47,253**
Ageing analysis			
Over 3 months up to 1 year	46,387	23,799	22,588
Over 1 year up to 3 years	5,511	4,337	1,174
Over 3 years	69,295	45,804	23,491
Total	**121,193**	**73,940**	**47,253**

Details of impairment provisions at 30 June 2023	**Total**
At 1 January	79,771
Charge for the period	2,292
Write back during the period	(1,784)
Exchange differences	(6,339)
At 31 December	**73,940**

(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	47,114	43,143	3,971
Middle East	74,079	30,797	43,282
Total	**121,193**	**73,940**	**47,253**

16. Details of credit facilities outstanding that have been restructured during the period

Gross restructured financings during the period ended 30 June 2023 aggregated to BD16 million with an ECL of BD1.8 million (31 December 2022: Gross BD15.9 million with an ECL of BD2.6 million).Further, this restructuring is expected to have positive impact of BD0.7 million (31 December 2022: BD1 million).on the 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	344,515	4,501
Total	**344,515**	**4,501**

Exposure funded by Unrestricted Investment Accounts

	Gross Exposure	Eligible Financial Collateral
Corporate portfolio	69,177	5,209
Regulatory retail portfolio	89	697
Past due financings	26,438	-
Total	**95,704**	**5,906**

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	4,635	-	-	4,635	4,698
Total	**4,635**	**-**	**-**	**4,635**	**4,698**

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 AGRNRC.

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.

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 AGRNRC.

18.6 Management Information System

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

18.7 Stress Testing

Ithmaar Bank conduct stress testing of its portfolio as part of the ICAAP process in accordance with stress testing module of the CBB.

The Bank's stress testing framework is embedded in the overall risk management process. The Bank has established an adequate governance process for effective oversight and implementation of the stress testing framework.

(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 2023	Maximum Value	Minimum Value	30 June 2023	Maximum Value	Minimum Value
Foreign exchange risk	19,936	19,936	18,508	2,492	2,492	2,314
Aggregation						
Foreign exchange risk	848	848	742	106	106	93
Profit Rate Risk (Trading Book)	42,180	42,180	24,242	5,273	5,273	3,030
Equity Position Risk	10,990	10,990	15,077	1,374	1,374	1,885
Total	**73,954**	**73,954**	**58,569**	**9,244**	**9,244**	**7,322**

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 2023 amounted to BD83.7 million (31 December 2022: BD67 million) (included in the foreign exchange translation reserve attributable to equity holders and unrestricted investment account holders).

The significant net foreign currency positions at 30 June 2023 were as follows:

	Long/(Short)
Pakistani Rupee	228,808
United States Dollars	115,344

21. Equity position in Banking book

At 30 June 2023, the Group's sukuk and investment securities aggregated to BD688.1 million (31 December 2022: BD817 million). Out of the total investment securities, BD114.4 million (31 December 2022: BD817 million) were listed investment securities and the remaining BD573.7 million (31 December 2022: BD695.4 million) represented unlisted investment securities.

Cumulative realized loss from sale of investment securities during the period ended 30 June 2023 amounted to BD52.6 million (31 December 2022: BD21 million). Total unrealized loss recognized in the consolidated statement of changes in owners' equity amounted to BD1.8 million (31 December 2022: BD1.8 million).

At 30 June 2023, capital requirements using standardized approach aggregated to BD0.16 million (31 December 2022: BD0.2 million) for listed investment securities and BD0.02 million (31 December 2022: BD0.03 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 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 AGRNRC.

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. The impact of every 200 basis point change is as follows:

	USD	PKR	AED
Total profit rate exposure	115,114	172,605	126,740
Rate shock (assumed) (+/-)	2.00%	2.00%	2.00%
Total estimated impact (+/-)	**2,302**	**3,452**	**2,535**

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 Bank has an Operational Risk Management Committee (ORMC) which supervises the effective implementation of the Operational Risk across all banking activities. Results of all Operational Risk monitoring and management activites and initiatives are presented to the ORMC.

The AGRNRC 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 is 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 Security

Ithmaar Bank's Information Security and compliance function within RMD role is to prevent disruptions and protect data stored in 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, Availability and Privacy).

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

The Reputational Risk Management is defined as the risk arising risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding. Reputational risk is multidimensional and reflects the perception of other market participants. Furthermore, it exists throughout the organization and exposure to reputational risk is essentially a function of the adequacy of the bank's internal risk management processes, as well as the manner and efficiency with which management responds to external influences on bank-related transactions. Reputational risk also may affect a bank's liabilities, since market confidence and a bank's ability to fund its business are closely related to its reputation.

The Bank has developed a framework and has identified various factors that can impact its reputation. Management of reputation risk is an inherent feature of the Bank's corporate culture which is embedded as an integral part of the internal control systems. Besides identification and management of risks, the internal control system also incorporates as an ethos the maintenance of business practices of the highest quality towards its customers, shareholders, regulators, general public and fiduciary/ nonfiduciary clients.

The Bank also adopts risk mitigation approaches that refer to shaping products, business transactions and other processes that may result in a reputational risk.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

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 2023 aggregated to BD13.8 million (31 December 2022: BD19 million).

25. Liquidity Risk

Liquidity risk is the risk that Ithmaar Bank is unable to meet its financial obligations as they fall due, which could arise due to mismatches in cash flows.

Liquidity risk arises either:

• From the inability to manage unplanned decreases or changes in funding sources; or
• from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Liquidity risk management ensures that funds are available at all times to meet the funding requirements, Funding and liquidity management is performed centrally by the Treasury, with oversight from the ALCO. ALCO is responsible for setting the framework and for effective monitoring of Ithmaar Bank's liquidity risk. Ithmaar Bank's liquidity policies are designed to ensure it will meet its obligations as and when they fall due, by ensuring it is able to generate funds from the market, or have sufficient High Quality Liquid Assets (HQLAs) to sell and raise immediate funds without incurring unacceptable costs and losses. The Bank regularly monitors the concentration in the funding sources and ensures that the funding sources are adequately diversified. The Bank monitors and manages the funding from each of the funding sources such as current accounts and URIA accounts and has established appropriate limits to prevent concentration of funding sources and ensure diversification of funding.

The Liquidity Risk Management Policy also sets out the minimum acceptable standards for the management of Ithmaar Bank's assets and liabilities including maintenance of HQLAs, prudent assets and liabilities maturity mismatch limits, and a mechanism of monitoring liquidity risk in the Bank.

25.1. Liquidity risk monitoring and reporting

ALCO monitors liquidity risk, including liquidity mismatch limits, maintenance of regulatory and internal liquidity ratios including Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) and various other liquidity ratios as required under the provisions of the LM Module and the funding maturity profile on a regular basis. Risk Management Department submits a quarterly report to the AGRNRC which includes an analysis of Ithmaar Bank's adherence to various liquidity risk metrics established in the Risk Appetite Framework of the Bank.

25.2. Liquidity Stress Testing

Stress testing of the liquidity risk profile of Ithmaar Bank based on certain Board approved parameters is also performed and presented to the AGRNRC on a quarterly basis.

25.3. Liquidity Contingency Management

Ithmaar Bank has also a Liquidity Contingency Policy which provides guidelines to manage either temporary or longer-term disruptions in its ability to fund some or all of its activities in a timely manner and at a reasonable cost.

25.4. Liquidity ratios:

	30 June 2023
Liquid assets to total assets	8.89%
Short term assets to short term liabilities	68.89%

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

25.5. Liquidity ratios:

The Liquidity Coverage Ratio (LCR) of Ithmaar Bank as of 30 June 2023 was 100%. The average 90 day LCR as of 30 June 2023 was 102%. The detailed breakdown of the average 90 day LCR as of 30 June 2023 is detailed below.

	Description	Total Unweighted Value (average)	Total Weighted Value (average)
HIGH-QUALITY LIQUID ASSETS (HQLA)			
1	Total HQLA	-	445,830
CASH OUTFLOWS			
2	Retail deposits and deposits from small business customers, of which:	-	-
3	Stable deposits	596	18
4	Less stable deposits	583,155	56,825
5	Unsecured wholesale funding, of which:	-	-
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	27,420	6,855
7	Non-operational deposits (all counterparties)	593,111	389,948
8	Unsecured debt	-	-
9	Secured wholesale funding	-	-
10	Additional requirements, of which:	-	-
11	Outflows related to derivative exposures and other collateral requirements	2,609	2,609
12	Outflows related to loss of funding on debt products	-	-
13	Credit and liquidity facilities	92,277	7,493
14	Other contractual funding obligations	51,960	51,960
15	Other contingent funding obligations	372,492	18,625
16	**TOTAL CASH OUTFLOWS**	**-**	**534,333**
CASH INFLOWS			
17	Secured lending (eg reverse repos)	167,258	96,656
18	Inflows from fully performing exposures		
19	Other cash inflows	-	-
20	**TOTAL CASH INFLOWS**	**167,258**	**96,656**
21	**TOTAL HQLA**	-	**445,830**
22	**TOTAL NET CASH OUTFLOWS**	-	**437,677**
23	**LIQUIDITY COVERAGE RATIO (%)**	-	**102%**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

25.6. Net Stable Funding Ratio:

The Net stable Funding Ratio (NSFR) of the Bank as of 30 June 2022 was 122%. The detailed breakdown of the NSFR as of 31 December 2022 is detailed below.

No.	Item	Unweighted Values (i.e. before applying relevant factors)				Total weighted value
		Nov specified maturity	Less than 6 months	More than 6 months and less than one year	Over one year	
Available Stable Funding (ASF):						
1	**Capital:**	**80,569**	**-**	**-**	**5,475**	**86,044**
2	Regulatory Capital	80,569	-	-	-	80,569
3	Other Capital Instruments	-	-	-	5,475	5,475
4	**Retail deposits and deposits from small business customers:**	**-**	**579,162**	**46,551**	**3,420**	**568,166**
5	Stable deposits	-	31,429	669	32	30,525
6	Less stable deposits	-	547,733	45,882	3,388	537,641
7	**Wholesale funding:**	**-**	**588,022**	**258,519**	**319,235**	**607,782**
8	Operational deposits	-	-	-	-	-
9	Other wholesale funding	-	588,022	258,519	319,235	607,782
10	**Other liabilities:**	**-**	**256,254**	**-**	**3,953**	**3,953**
11	NSFR Shari'a-compliant hedging contract liabilities	-	9,312	-	-	-
12	categories	-	246,942	-	3,953	3,953
13	**Total Available Stable Funding (ASF):**	-	-	-	-	**1,265,945**
Required Stable Funding (RSF):						
14	Total NSFR high-quality liquid assets (HQLA)	-	-	-	-	43,260
15	Deposits held at other financial institutions for operational purposes	-	-	-	-	-
16	**Performing loans and securities:**	**-**	**333,951**	**128,893**	**687,222**	**768,120**
17	Performing loans to financial institutions secured by Level 1 HQLA	-	-	-	-	-
18	Performing loans to financial institutions secured by non-Level 1 HQLA and unsecured performing loans to financial institutions	-	50,890	5,544	9,833	20,239
19	Performing loans to non- financial corporate clients, loans to retail and small business	-	283,061	123,349	519,930	645,146
20	'- With a risk weight of less than or equal to 35% as per the CBB Capital Adequacy Ratio guidelines	-	-	-	135,849	88,302
21	Performing residential mortgages, of which:	-	-	-		
22	'- With a risk weight of less than or equal to 35% under the CBB Capital Adequacy Ratio Guidelines	-	-	-	20,506	13,329
23	Securities that are not in default and do not qualify as HQLA, including exchange-traded equities	-	-	-	1,104	1,104
24	**Other assets:**	**-**	**243,148**	**-**	**-**	**243,148**
25	Physical traded commodities, including gold	-	-	-	-	-
26	Assets posted as initial margin for Shari'a-compliant hedging contracts and contributions to default funds of CCPs	-	-	-	-	-
27	NSFR Shari'a-compliant hedging assets	-		-	-	-
28	NSFR Shari'a-compliant hedging contract liabilities before deduction of variation margin posted	-	1,862	-	-	1,862
29	All other assets not included in the above categories	-	241,286	-	-	241,286
30	Off Balance Sheet items	-	503,531	-	-	25,177
31	**Total RSF**					**1,079,705**
32	**Net Stable Funding Ratio (%)**					**117%**

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

25.7. Leverage Ratio

S No.	Description	Amount
1	**Tier 1 Capital**	**80,569**
	On Balance Sheet Assets	
2	Self Finance	488,878
3	URIA	1,713,636
4	Off Balance (with conversion CCFs)	273,539
5	**Total Assets (2+3*(0.3)+4)**	**1,276,508**
6	**Leverage Ratio (1/5)**	**6.31%**

26. Legal contingencies

At 30 June 2023, the Group had contingent liabilities towards customer and other claims aggregating to BD41.8 million (31 December 2022: BD52.9 million). The management is of the view that these claims are not likely to result into potential liabilities.

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 risk.

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 2023		31 December 2022		31 December 2021		31 December 2020		31 December 2019	
	Percentage to URIA assets	Amount	Percentage to URIA assets	Amount	Percentage to URIA assets	Amount	Percentage to URIA assets	Amount	Percentage to URIA assets	Amount
Income from unrestricted investment accounts	13.6%	121,147	9.7%	176,985	5.3%	113,495	5.6%	91,603	6.4%	82,551
Less: return to unrestricted investment accounts & provisions	-8.4%	(74,837)	-5.2%	(93,914)	-2.8%	(60,011)	-3.4%	(55,655)	-4.2%	(54,359)
Group's share of income from unrestricted investment accounts as a Mudarib	5.2%	**46,310**	4.6%	**83,071**	3.3%	**53,484**	2.2%	**35,948**	2.2%	**28,192**

For the period ended 30 June 2023 the return generated from unrestricted investment accountholders based on the average balance outstanding during the period stood at 2.3% per annum (2022: 4.8%). The return paid to unrestricted investment accountholders based on the average balance outstanding during the period at 2.9% per annum (31 December 2022: 3.2%).

Limits for investment in each category of asset are applied as per the bank's board approved risk management policies.

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

	30 June 2023	31 December 2022	31 December 2021	31 December 2020	31 December 2019
30 Days	1.50	1.45	1.25	1.27	1.41
90 Days	1.75	1.70	1.50	1.55	1.81
180 Days	1.90	1.85	1.68	1.80	2.06
360 Days	2.55	2.50	2.33	2.45	2.80
3 Years	2.85	2.80	2.58	2.75	3.04

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

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

	30 June 2023
Profit Equalization Reserve	1,563
Net utilisation during the period	(1,563)
As at 30 June 2023	-
Investment Risk Reserve	
As at 30 June 2023	Nil

At 30 June 2023, the ratio of profit equalization reserve and provisions against equity of unrestricted investment accountholders stood Nil and 6.1% respectively.

30 June 2023, the ratio of financings to URIA stood at 73.7%.

31 December 2022, 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	100.00%

The following table summarizes the breakdown of URIA and impairment provisions

	31 December 2022
Exposure : Banks	234,739
Exposure : Non-Banks	658,631

31. Performance ratios:

	30 June	31 December			
	2023	2022	2021	2020	2019
Return on average assets	0.17%	0.30%	0.16%	-0.36%	0.08%
Return on average Shareholders' equity	4.24%	7.77%	-1.09%	-23.71%	-1.64%
Cost to operating income Ratio	62.22%	69.40%	84.72%	83.36%	81.26%

32. 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.

Non-sharia compliant income for the period amounted to BD0.3 million

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.