

KHALEEJI
COMMERCIAL
BANK

المصرف
الخليجي
التجاري

KHALEEJI

ANNUAL REPORT



REACHING NEW HEIGHTS

Khaleeji Commercial Bank BSC
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Licensed by the Central Bank of Bahrain as a Retail Islamic Bank.

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



His Royal Highness
Prince Khalifa Bin Salman Al-Khalifa
The Prime Minister



His Majesty
King Hamad Bin Isa Al-Khalifa
The King of Bahrain



His Royal Highness
Prince Salman Bin Hamad Al-Khalifa
The Crown Prince & Deputy Supreme
Commander of Bahrain Defence Force &
First Deputy Prime Minister



01

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Dr. Ahmed Khalil Al Mutawa
Chairman

02 CHAIRMAN'S MESSAGE

Dear Shareholders,

On behalf of the Board of Directors, it is my pleasure to present the annual report of Khaleeji Commercial Bank (the “Bank”) for the year ended 31 December 2017.

The Bank has invested in the institution’s local and regional positioning this year, where it was successful in enhancing its activities and services through implementing a strategy of studying the market and investing in available opportunities targeting services that meet the Bank’s client expectations. This has been reflected in the positive results in terms of enhancing the services and financial performance, despite the huge challenges that the banking sector is currently facing.

Year 2017 has noticed significant economic variations mainly from the geopolitical developments, which has in its nature affected the volatility of financial markets and currencies on a global and regional scale. This in addition to the main challenge that is currently facing the GCC countries in terms of diversifying their economic revenue and income streams away from oil, resulting in the regional development of implementing the Value Added Tax (VAT) at a rate of 5.00% and sin tax on various products along with elimination and redirection of various subsidies while continuing the reduction of public spending.

OVERALL PERFORMANCE

Despite the adverse market and economic challenges, the Bank during 2017 was able to achieve the strategic goals set by the board, where the management's efforts and the trust and support of the shareholders and clients played a major role. The Bank was in an exceptional basis able to develop the products and services and achieve a good financial performance backed by strong liquidity, capital adequacy and effective Risk Management.

A positive indicator of the Bank's performance this year is the growth of total assets from BD 765 million in 2016 to BD 785 million in 2017, a growth of 2.6%. Net profit of BD 0.8 million in 2017 compared to BD 5.3 million in 2016. Financing assets increased by 2.1% compared to 2016 to reach BD 460.3 million. Commercial banking accounts for 80.8% of total revenue. It should be noted that the Bank avoided high concentration accounts, resulting in a decrease of 14.6% in deposits during the year from BD 581.1 million in 2016 to BD 496.0 million in 2017.

As a result, the Bank, thanks to Allah, achieved a net profit for the year 2017 of BD 0.8 million compared to BD 5.3 million achieved in 2016 and a decrease of 84.6% over the previous year. These results will contribute to achieving a lot of stability for the work system in the future and will prepare the way to achieve better financial results, God willing, in the coming years. The bank maintained a strong liquid assets rate of 22.2% and a capital adequacy ratio of 17% compared to the required regulatory requirement of 12.5%, which is higher than legal requirements.

As the Bank continued to execute its strategic plan, the Board and the Management conducted a review to ensure that assets, especially those acquired prior to the new business model reflect realisable and fair value. Based on this review the Board decided to take an amount of BD 7.5 million as provisions for the year ended 31 December 2017, such conservative approach has been taken in dealing with the assets which were impaired or likely to be impaired in the short to medium term and is in-line with the Bank's strategy implementation.

Being considered as one of the leading Islamic Financial Institutions in the Kingdom of Bahrain, The Bank was able to successfully cross list in Dubai Financial Market (DFM) during Q4 2017. This step is considered as a paradigm shift in the Bank's operations and embodies the focused goals

towards creating a suitable environment for the shareholders to trade their shares and strengthen the Bank's share market price. Such goal was accomplished through the trust and support from shareholders that resulted from the achievements made throughout the past years. The Bank has implemented various studies for regions that maintain outstanding economic growth, such growth the United Arab Emirates is currently witnessing has encouraged the Bank's management to choose Dubai Financial Market (DFM) as a launch platform for the Bank's shares trading outside the Kingdom of Bahrain in order to provide the best investment results for the Bank's shareholders and clients.

Furthermore the Bank, with its confidence in the economic vision 2030 that is directed towards achieving a stable and improved standard of living for all Bahraini Nationals and the creation of market opportunities for individuals and corporates operating in Bahrain, has partnered with Bahrain Institute for Banking and Finance (BIBF) and conducted "KHCB's Economic Diversification Forum" which was sponsored by Bahrain's Economic and Development Board (EDB). The Forum's aim was to shed light on the importance of economic diversification in Bahrain in which the Forum (in its first inauguration) strengthened the Bank's brand and introduced the institution as a strategic partner in the Kingdom's economic development. That in addition to highlighting the importance of collective work between the private and public sectors in supporting the national initiatives to reach towards continued stability through tackling and discussing challenges along with opportunities in various diversified sectors that the Government has adopted.

The Bank is continuing to seek enhancing its positioning among leading Islamic Institutions in the Kingdom of Bahrain and the same is witnessed through the Bank's increasing number of clients during the year 2017. This has led to the Bank taking important growth initiatives to be implanted during 2018 and the years to come which includes enhancing the Bank's financing portfolio by introducing innovative products for individual and corporates alike.

LOOKING AHEAD

The Board believes that the Bank has established a solid foundation from which to execute the strategic plan and capitalise on opportunities currently available in the market. In order to achieve this, the Bank will work on growing and diversifying its products and services that are offered

through the branches and electronic channels in order to reach and widen the customers' base along with focus on the service/product quality that will enable improving the Bank's positioning locally and regionally. From another angle, the Bank will explore other options; which includes viable acquisitions of other entities and asset portfolios as well as forming strategic alliances or mergers with other financial institutions.

In addition, the Bank believes continuation of investment in the human resource aspect is key towards achieving and overcoming and upcoming challenges, as such resource is considered as the main focal point and backbone of the institution. In addition, focus on investment in Information Technology and enhancing the Risk Management.

APPRECIATION

On behalf of the Board, I would like to express my gratitude to his Majesty King Hamad Bin Isa Al Khalifa; His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister; and His Royal Highness Prince Salman Bin Hamad Al Khalifa, the Crown Prince and Deputy Supreme Commander of Bahrain Defence Force and First Deputy

Prime Minister for their encouragement of the growth of the private sector and the development of the banking and finance industry in Bahrain. I also extend my thanks to all government ministries, the Central Bank of Bahrain, and Bahrain Bourse for their continued guidance and support.

Special appreciation is due to the Bank's shareholders, clients and business partners for their on-going confidence and loyalty; and to the Bank's management and staff for their hard work and dedication.

Allah the almighty is the purveyor of all success.



Dr. Ahmed Khalil Al Mutawa
Chairman

**Khaleeji Commercial Bank
will continue practicing
financial affairs with
poise and fortitude while
investing its long expertise
in Islamic financing.**



KHCB will continue on the path of growth and expansion, whilst exploring and capitalizing on opportunities in key local and regional markets.

03 BOARD OF DIRECTORS



Dr. Ahmed Khalil Al Mutawa
Chairman



Mr. Albulkarim Ahmed Bucheery
Vice Chairman



Mr. Hisham Al Rayes
Board Member



Sh. Ahmed Bin Isa Al Khalifa
Board Member



Mr. Abdulla Abdulkarim Showaier
Board Member



Dr. Khalid Mohammed Al Khazraji
Board Member



Mr. Fawad Tariq Khan
Board Member



Mr. Luay Hasan Ahmadi
Board Member



Mr. Yousef Ibrahim Al Ghanim
Board Member



Mr. Mohammad Abdulmohsen Al Rashed
Board Member

04 MANAGEMENT TEAM



Mr. Tawfeeq Mohamed Bastaki
Acting CEO - Chief Risk Officer



Mr. Mahdi Abdulnabi Mohammed
DGM - Support Services



Mr. Yaser Ismaeel Mudhafar
Chief Financial Officer



Mr. Husam Ghanem Saif
AGM - Treasury and Capital Markets



Mr. Mazen Salman Sater
AGM - Retail Banking



Mr. Khaled Mohamed Turki
AGM - Corporate and International Banking



Mr. Mohammed Abdulla Saleh
AGM - Human Resources and Corporate Communications



Mr. Ahmed Abdulrahman Seyadi
AGM - Information Technology



Mr. Talal Nabeel Al Mahroos
Head of Investments



Mr. Abdul-Nasser Omar Al-Mahmood
Head of Shari'a Compliance



Mr. Mohammed Abdulla Al Tamimi
Head of Compliance and MLRO



Mr. Mohammed Hamad Fakhri
Head of Internal Audit

KHCB's ability to adapt and transform to market conditions is one of the strengths that will leads its customers and shareholders towards a profitable future.

VISION

To become the stronghold of the domestic economy and regional Islamic Banking by providing unique, innovative and trustworthy Shari'a compliant products, services and investment opportunities for our clients.

MISSION

Emerge as a catalyst in the economic development of Bahrain, the GCC and the MENA region, maximize client and shareholder value in accordance with the principles of Shari'a, contribute towards stable growth of Islamic Banking and provide a challenging, composed and optimistic environment for our employees to be innovative and attain their professional milestones.





Mr. Tawfeeq Mohamed Bastaki
Acting CEO - Chief Risk Officer

05 EXECUTIVE MANAGEMENT REPORT

The banking sector in the Kingdom of Bahrain has faced a challenging year in 2017 given the local and international economy's situation due to many variables and conditions, which contributed to slowing the economy of the Gulf States, including the Kingdom of Bahrain. Despite these factors, KHCB was able to achieve stable financial results that reflected our success in implementing our strategic objectives as required, which we were keen to review and adapt to suit market fluctuations.

We begin the year 2018 and its challenges with great confidence in maintaining our leading position in the market as one of the leading Islamic banks in the Kingdom of Bahrain, armed with an experienced board of directors, staff and solid financial base.

2017 NOTABLE ACHIEVEMENTS

The year 2017 will remain engraved in KHCB's history for witnessing the listing of the bank's shares on the Dubai Financial Market. The move came in the context of the bank's efforts to expand its activities and develop the services it provides to shareholders and investors, in light of the growth witnessed by the bank in expanding its base of clients and presence in Bahrain's market.

The bank also launched a range of innovative products and services designed to meet the personal needs of customers as well as the growing needs of the local market, as part of our strategy of focusing on our primary business model.

Similarly, 2017 marked remarkable success for the Corporate International Banking Division, not only in the

Kingdom of Bahrain but the Gulf region. We implemented a number of financing agreements for clients from financial institutions, major corporations, sovereign funds, non-banking financial institutions, and representative offices of high-income individuals outside the Kingdom of Bahrain, as part of a conservative strategy that focuses on portfolio and income diversification from commercial finance and banking.

The bank continued its achievements in the field of investment banking by pursuing successful returns through a well-studied business plan that promotes asset value, based on improving and developing assets in some projects, besides entering into initial agreements with local developers, which will accelerate the pace of exits.

Regarding Treasury and Capital Markets activities, the bank, in line with its directives to maintain its financial position under unstable economic conditions, has benefited from the high financial solvency of successful Sukuk transactions, which are a safe investment with high financial returns. Sukuk's portfolio saw a significant increase of 52.9% of the amount 113 million in 2017 compared to 74 million in 2016.

On the other hand, the bank adopted a number of infrastructure development projects for its technical systems, operations, and support services in 2017. The most prominent of these was in the field of security and protection of electronic payment card data, by receiving the International Accreditation Certificate (PCI DSS) in its latest version (3.2) from CISA Information Security LLC, one of the international companies specialised in the application of the highest standards of security and protection of bank card information of all types.

SOCIAL RESPONSIBILITY

KHCB firmly believes in its social responsibility through the adoption of initiatives of sustainable development, community investment and charitable work, supporting initiatives of charity and civil society organisations, and sponsoring events and conferences. The most notable were the AAOIFI conference and the activities of Injaz Bahrain in 2017. The bank also continued to train university students as a part of its endeavours to graduate a new generation of qualified bankers to steer this sector towards a new horizon.

ORGANISATIONAL DEVELOPMENT

The processes of training and development are key to our business model. The bank annually carries out a series of training programs for all employees to ensure the

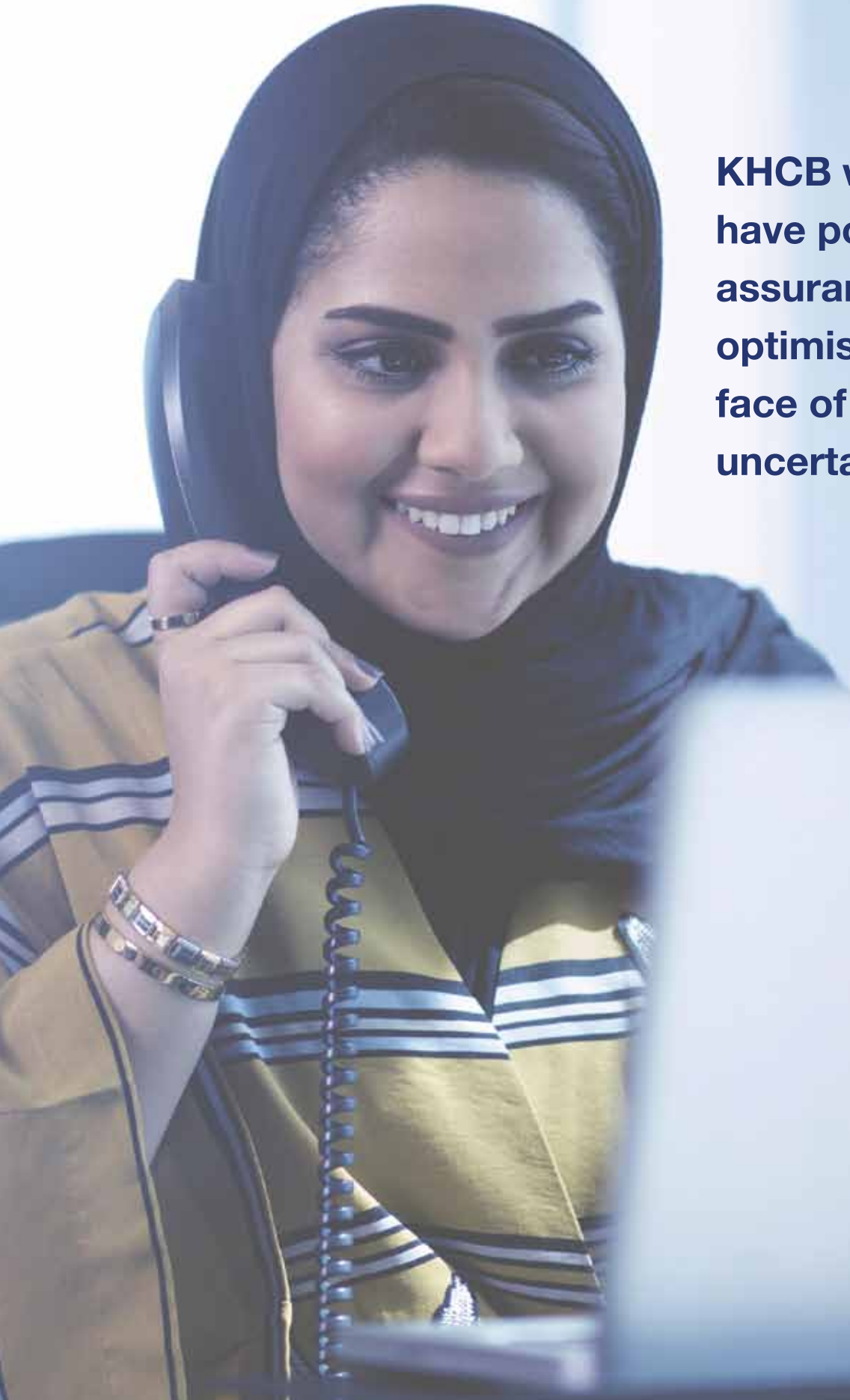
provision of qualified cadre that deliver the highest levels of performance and achievement. This undoubtedly reflects positively in the level of services provided. We have been keen to raise their skills through continuous training and education to acquire technical and professional knowledge and expertise, using the latest technology, internationally recognised financial accounting and control standards, which contributed to the preparation of qualified national cadres to occupy leadership positions in the bank, in line with the its strategic plans.

The bank was also keen to strengthen administrative management and governance at all levels through continuous training and development of business mechanisms and policies to ensure the achievement of our strategic objectives and plans to achieve the interests of our shareholders. The bank organised a number of workshops in this regard, most prominently for members of the Board and the Executive Management, in cooperation with Chartered Institute of Public Relations based in San Juan, USA. This touched on many topics related to governance, key skills for board members, risk management, roles and responsibilities of management, property issues, shareholder governance strategies, with emphasis on the importance of developing long-term partnerships as a key to sustainable and successful institutional growth.

CONCLUSION

Despite the ability of the Kingdom of Bahrain to adapt to changes, outlooks for the coming year still indicate challenges. The bank's primary business has proven strong in light of the bank's performance in recent years. The bank has also demonstrated its ability to achieve stable and strong results despite these difficult economic conditions. In view of this, we will continue to achieve our goals and consolidate our position as one of the leading Islamic banks in the region. In conclusion, I would like to take this opportunity to express my sincere gratitude to the Government of the Kingdom for its facilitations to the banking sector. I would also like to thank the Chairman, the Board of Directors, the Executive Management and the bank's staff for their commitment and efforts during this year, as well as our clients and shareholders for their continued support and confidence.

Mr. Tawfeeq Mohamed Bastaki
Acting CEO - Chief Risk Officer



**KHCB will always
have positive
assurance and
optimism in the
face of financial
uncertainty.**

06 SHARI'A SUPERVISORY BOARD

Khaleeji Commercial Bank is guided by a Shari'a Supervisory Board consisting of three distinguished scholars. This Board reviews the bank's activities to ensure that all products and investment transactions comply fully with the rules and principles of Islamic Shari'a, and consists of:

Sh. Dr. Fareed Yaqoob Al-Miftah
Chairman

Experience

- Member of the Supreme Council of Islamic Affairs.
- Undersecretary of the Ministry of Justice & Islamic Affairs - Bahrain.
- Former judge of the high Shari'a Court.
- Former Lecturer at the University of Bahrain.

Qualification

- Ph.D. from the University of Edinburgh - United Kingdom.

Sh. Dr. Fareed Mohammed Hadi
Executive Member

Experience

- Assistant Professor at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain.
- Member of Shari'a Supervisory Board of a number of Islamic banks.

Qualification

- Ph.D. in Ibn Hazm's Methodology of Jahala, University of Edinburgh - UK.
- Ph.D. in Al-Bukhari's Methodology, University of Mohammed V - Morocco.

Sh. Dr. Nizam Mohammed Saleh Yaquby
Member

Experience

- Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank - UAE.
- Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank - Bahrain.
- Executive Member of the Shari'a Supervisory Board of Ithmaar Bank - Bahrain.
- Board Member of the Dow Jones Islamic index.
- Member of Shari'a Supervisory Board of a number of Islamic banks & insurance companies.

07 CORPORATE GOVERNANCE

CORPORATE GOVERNANCE STRUCTURE

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organized and how they operate in practice ultimately aims at leading the Bank towards successfully meeting its strategic objectives. The Board of Directors is accountable to the Bank's shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance and effective risk management.

The Bank is in compliance with the Corporate Governance Code (CGC), the Public Disclosure Module and the Stock Exchange Disclosure Standards set by the CBB. The corporate governance philosophy of the Bank is to be fully ethical and transparent in all dealings. In pursuit of this goal the Board of Directors have approved a Corporate Governance Framework, Director's Conflict of Interest Policy and the Bank Key Persons' Dealing Policy. The Bank, through its Board and Committees, endeavors to deliver the highest governing standards for the benefit of its stakeholders.

The Bank is committed to continuously reviewing and developing its corporate governance standards to ensure compliance with the requirements of the revised corporate governance framework being implemented by the Central Bank of Bahrain and other regulatory bodies, and also to keep abreast with international best practice.

BOARD OF DIRECTORS

The Board of Directors comprises of 10 members. The chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the CEO and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees, will oversee the management of the Bank.

BOARD COMMITTEES STRUCTURE

The Board of Directors has constituted three committees with specific delegated authorities.

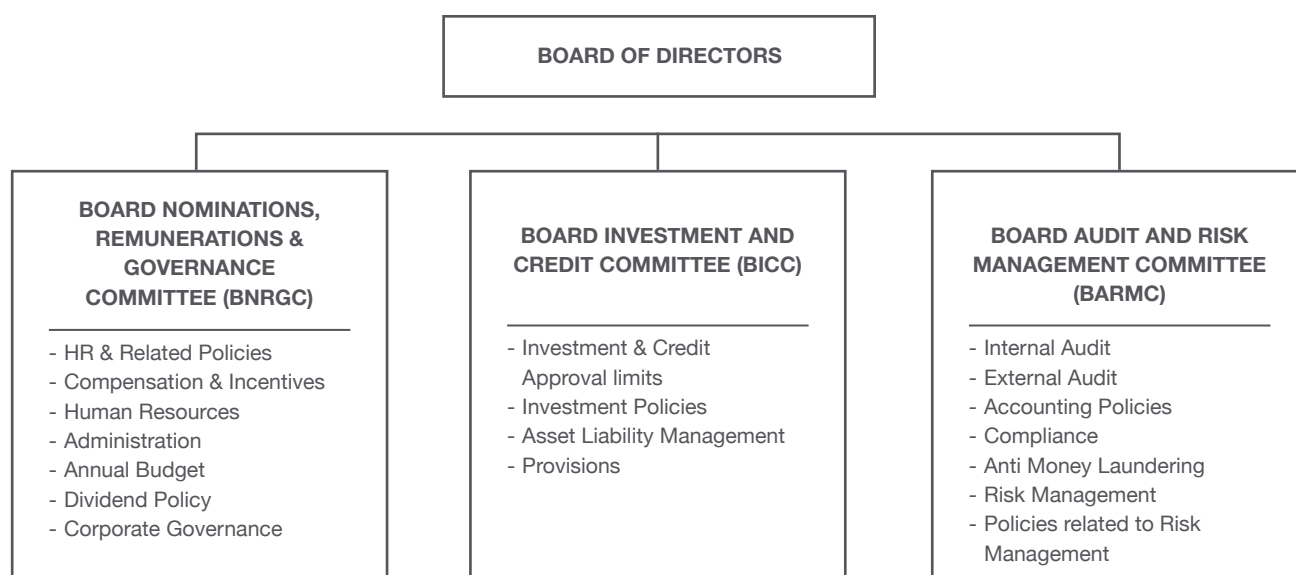
- **Board Audit and Risk Management Committee (BARMC)**, which is responsible for internal and external audit, compliance and anti-money laundering. Beside its responsibility in ensuring that the Bank's overall risk management framework is effective and that key risks are managed within parameters established by the Board (During the year, the Board Audit Committee (BAC) and the Board Risk Management Committee (BRMC) were merged into one committee Board Audit and Risk Management Committee (BARMC)).
- **Board Investment & Credit Committee (BICC)**, which is responsible for investment and credit approvals, setting limits and tolerances for different risks, asset liability management, monitoring asset impairment, creation of loss provisions, maintaining banking relationships as well as for the oversight of the off-balance sheet vehicles.
- **Board Nominations, Remunerations and Governance Committee (BNRGC)**, which is responsible for setting policies for compensation and incentives, human resources and administration. It is also responsible for the corporate governance framework of the Bank.

The Chairman, the Board of Directors and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance and Shari'a Compliance.

Meetings of the Board and its committees are held as and when required but in accordance with the Regulations the Board meets at least once a quarter. The Board of Directors met 6 times. In addition to physical meetings,

several written resolutions were circulated to the Directors for approval by mail and facsimile. The Bank held its AGM and EGM on 14 March 2017.

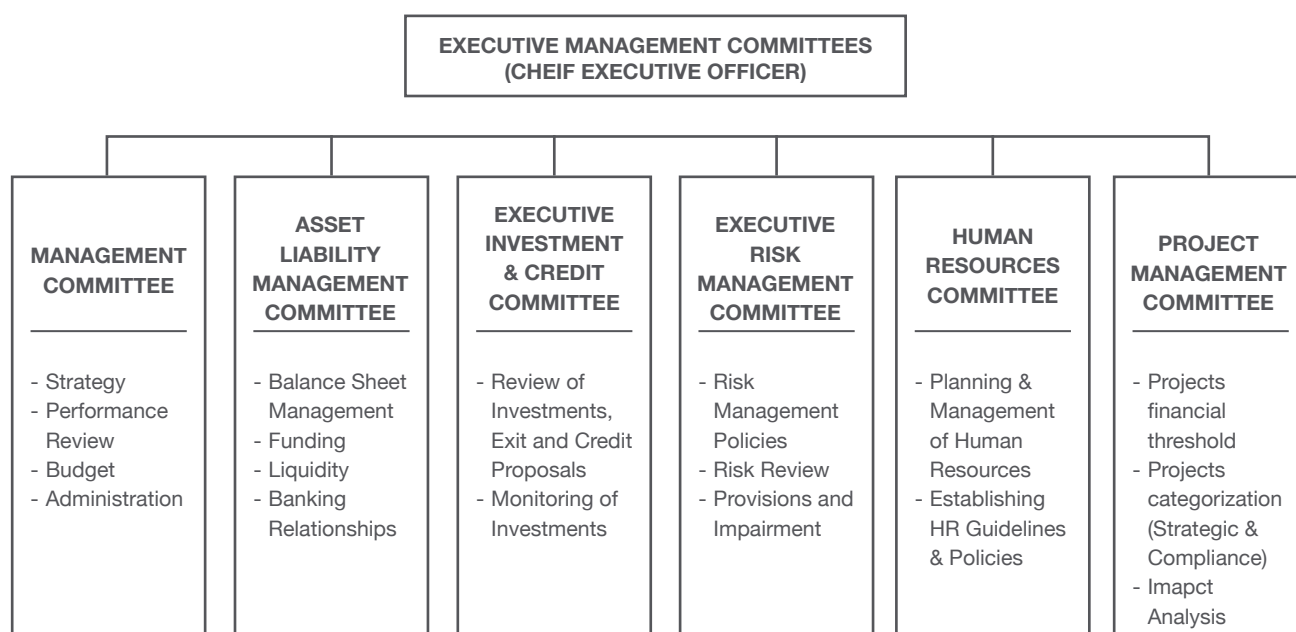
During the year, the Board Audit and Risk Management Committee (BARMC) hold 7 meetings, the Board Investment and Credit Committee (BICC) hold 5 meetings, and the Board Nominations, Remunerations and Governance Committee (BNRGC) hold 4 meetings.



EXECUTIVE MANAGEMENT COMMITTEES

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer (CEO) who is responsible for implementing the

Bank's strategic plan. The CEO manages the Bank through the following management committees:



08 RISK MANAGEMENT

RISK MANAGEMENT FRAMEWORK

Risk is inherent in the Bank's business and effective management of risk is seen as a core requirement to create shareholder value. It is a process by which the Bank identifies key risks, sets consistent understandable risk measures, chooses which risk to mitigate, transfer, avoid or accept and by what means and to establish procedures to monitoring the resulting risk position. Effective risk management is the cornerstone of sound operating performance and capital structure. The Board of Directors of the Bank has an overall responsibility for establishing the Bank's risk culture and ensuring that an effective risk management framework is in place. The Board approves and periodically reviews the risk management policies and risk strategies of the Bank. Risk Management is a process by which the Bank identifies key risks, sets risk measures and establishes procedures to monitor the residual risk and is driven by the objective of controlling risk to ensure that value is created for shareholders.

The Bank is exposed to risks, which include, but are not limited to, credit, market, and liquidity, reputational and operational risk. The Bank's aim is to achieve an appropriate balance between risk and return and minimize any potential adverse impact on its financial performance.

The assumption of risks by the Bank is guided by certain fundamental principles such as protection of investor and shareholder funds by the adoption of sound credit and investment analysis, adoption of effective "risk reward" strategies to optimize stakeholders returns, and adherence to prudent levels of exposure concentration.

The Board has established an Executive Credit and Investment Committee (ECICOM), which is responsible for developing and implementing the Bank's risk management policies and procedures in all areas of the Bank's operations. The committee consists of Heads of Business units and other functional/support units in the Bank, and reports regularly to the Board Audit & Risk Management Committee.

The Risk Management Department of the Bank, independent of the business units, is responsible for the

day to day oversight and management of the various risks faced by the Bank. The Chief Risk Officer directly reports to the Board Audit & Risk Management Committee and administratively to the Chief Executive Officer. The Risk Management Department, together with the Internal Audit and Compliance Departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

RISK MANAGEMENT POLICIES

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor adherence to such limits. The Bank's risk policy as approved by the Board of Directors, analyses and sets out the risk appetite by way of limits for Credit Risk, (includes concentration risk) liquidity risk, market risk (Including profit rate risk and currency risk) and Capital Adequacy. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, as well as products and services offered.

The Bank, through its training, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and responsibilities and their accountability. The Bank's risk management policies identify approval authorities, reporting requirements, and the procedures for referring risk related issues to executive management, ECICOM and the Board, as appropriate. Policies are in place to address all major categories of risk including liquidity, investment and credit, market, currency, operational, legal, reputational, and regulatory risks.

CREDIT AND INVESTMENT RISK

The Bank has well defined policies for managing credit and investment risks. These include delegated approval authority limits, concentration limits, maximum exposure limits, etc. Credit and investment risk is defined as the potential that the counter party will fail to meet its obligations in accordance with the agreed terms. Credit and investment limits to clients are approved after thorough assessment of

counterparty's past track record and financial position as well as legal and market risks associated with it. In most cases exposures are fully or partially secured by acceptable collateral securities.

A separate Risk Management Department, independent of the business units, is responsible for the oversight of Bank's Credit and Investment risk. The Risk Management Department reviews every credit and investment proposal and records its recommendation before the same is submitted for approval. Fair valuation of the investments are reviewed by the Investment and Financial Control departments along with Risk Management and impairment tests done for credit exposures systematically and periodically as per the Bank's approved policies. It is the Bank's policy to ensure that adequate provisions are made for expected credit or investment losses. The Bank's policy on Impairment & Provisioning lays down guidelines for the creation of adequate allowance for impairment losses that represents the estimated future loss on its portfolio. Cross border exposures, exposures to Sovereigns, banks and other financial institutions are guided by risk limits set for these entities and approved by the Board of Directors based on various risk factors. The exposures are regularly monitored by the management to ensure that they remain within the set risk appetite.

The Credit Management department ensures that credit facilities are only released upon obtaining the required approvals and documentation. Exceptions if any are duly approved by the appropriate approval authority. It also monitors excess over limits, past dues, overdue reviews and exceptions to the policy and escalates to the relevant committee. It also follows up on all pending documentation, irregularities if any, and monitoring of non-performing accounts and for the purpose of provisioning. All relationships and investments are reviewed annually and non-performing accounts are reviewed more often. Problematic accounts are reviewed regularly to evaluate and work out the strategy adopted.

ECAI RATINGS

The Bank has adopted CBB guidelines for utilization of external ratings, where available, by External Credit Assessment Institutions (ECAI) for the purpose of risk assessment. In case of multiple ECAI rating of a single counterparty, the lowest of all is taken to assign the relevant risk category. The Bank complies with all the qualitative requirements stipulated by CBB for the recognition process and eligibility criteria of ECAI rating in the credit risk management policy of the Bank. ECAI ratings are applied, where applicable to all financing exposures with counterparty credit risks.

LIQUIDITY RISK

Liquidity risk is defined as the risk of failure in meeting liquidity requirements to the Bank's customers and investors when they fall due (i.e. funds not available to meet liabilities). The policy guidelines for the management of liquidity risk are laid down by the Board of Directors. The Treasury Department of the Bank is responsible for liquidity management in the Bank on a daily basis under the guidance and supervision of the Asset Liability Management Committee (ALCO). The liquidity risk policy sets liquidity limits, targets, and ratios to aid a strong liquidity management. In compliance with Basel Accord requirements and CBB guidelines, the Bank's liquidity limit management includes Liquidity Coverage Ratios (LCR) and Net Stable Funding Ratios (NSFR).

Any breaches or deviations are reported to the ALCO, which is chaired by the CEO and has senior executives of the Bank as members. The ALCO committee periodically monitors the level of liquid assets maintained by the Bank and follows a maturity laddered approach for managing liquidity risk in the short and long term of business cycle.

The Bank's approach to managing liquidity is to ensure that it will always have sufficient liquidity, adequate product mix and the right maturity profile to meet its liabilities under both normal and stressed conditions, without incurring unacceptable losses or causing damage to the Bank's reputation. The Bank's main source of funding is from customer deposits, and interbank deposits and financings. The bank also monitors for any concentration of customer deposit base. Contingency plans are in place to withstand any specific or incidental market crisis and are reviewed by the ALCO periodically.

MARKET RISK

Market risk is the risk that changes in market parameters, such as profit rates, equity prices, foreign exchange rates and credit spreads, (not relating to changes in the obligors / issuers credit standing), will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while optimizing the return on risk.

PROFIT RATE RISK

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair value of financial instruments due to changes in market profit rates. The Bank's policy on profit rate risk management aims to enable identification,

measurement, monitoring, control and reporting of profit rate risks in a timely manner. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands.

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and nonstandard profit rate scenarios. Positions are monitored on a periodic basis to ensure they are maintained within the established limits.

FOREIGN EXCHANGE RISK

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank's foreign exchange risk is managed on the basis of limits on net open positions set by the Board of Directors and a continuous assessment of current and expected exchange rate movements. The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios.

The Bank does not engage in foreign exchange trading and, where possible, matches currency exposures inherent in certain assets with liabilities in the same or correlated currency.

OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequate or failures in systems processes, people or those related to external events. It is inherent in every business organisation and covers a wide range of issues. Failure to manage operational risk can result in financial and reputational losses as well as legal, compliance and regulatory consequences.

The Bank manages operational risk through on-going monitoring of the control environment that the Bank operates in. This includes maintenance of well-defined policies and standard operating procedures; continuous monitoring of predefined risk triggers and immediate escalation of operational risk incidents reporting to the management. The Bank ensures operational risk is thoroughly and closely managed on daily basis.

The Risk Management Department is responsible for the identification monitoring and management of operational risk in the Bank through the operational risk management system. A Board approved operational risk framework is also in place. The operational Risk management framework is guided by the following principles:

- Management of operational risk is the responsibility of the senior management of each segment of business;

- Appropriate and regular management reports;
- Risk assessment of critical businesses to identify risks facing each department and the risk inherent in its process and products.
- Periodic reviews to ensure that the circumstances under which they were identified have not changed significantly,
- Collection of operational risk loss data and reporting individual cases to senior management.
- All risks are identified and loss data reported are analyzed for underlying causes and mitigants put in place.

The Risk Management Department on periodic basis conducts operational risk assessment on each department of the Bank and provides recommendation for process enhancements. The Risk Management department also provides ongoing awareness on operational risks to all staff members. Operational risks findings are periodically reported to the ECICOM and the Board.

Management of operational risk is the responsibility of Senior Management of each segment of business unit. While the responsibility of overseeing the process lies with Operational Risk Unit in accordance with the Operational Risk Management Framework. Internal Audit independently reviews effectiveness of the Bank's internal controls and its ability to minimize the impact of operational risks.

BUSINESS CONTINUITY MANAGEMENT

Within the Bank is the implementation and management of preventative measures, planning and preparation to ensure the Bank can continue to operate following an incident, significant unplanned event or major operational disruption. The Bank ensures that its systems and procedures are resilient to ensure business continuity through potential situations of failure.

The Bank has put in place Business Continuity Plans (BCP) to ensure that its business runs effectively in the event of most unforeseen disasters as required by the Central Bank of Bahrain's Business Continuity Guidelines. The Bank continuously strengthens and enhances its existing plans by implementing a robust business continuity framework to ensure that its systems and procedures are resilient and ready to meet 'emergency situations.'

LEGAL AND REGULATORY RISK

Legal risk includes the risk of unexpected loss from transactions and/ or contracts not being enforceable under applicable laws or from unsound documentation. Legal and regulatory risk may also arise from litigation initiated by clients against the Bank on certain transactions. The

Bank has a full-fledged legal department which provides necessary inputs and guidance to all other departments on any legal issues that may arise. The Bank also hires external legal advisors for advice when necessary, and to handle litigations.

Regulatory risk includes the risk of non-compliance with regulatory and legal requirements. The Bank has an independent compliance department which monitors the level of compliance with regulatory requirements by other departments of the Bank. It also acts as the focal point in all interactions with the Central Bank of Bahrain. The Compliance Department is also responsible for the Bank's anti-money laundering initiatives.

CAPITAL ADEQUACY & THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

The Bank complies with Basel III requirements for capital measurements. Under this, the Bank is expected to maintain a minimum prescribed ratio of total capital to total risk weighted assets. The CBB also requires the Bank to establish a process to monitor the overall capital adequacy of the Bank, taking into account all relevant risk factors.

The Board of Directors has approved an Internal Capital Adequacy Assessment Process (ICAAP) to satisfy this requirement. The ICAAP is a requirement under Pillar 2 of the Basel Accords in line with the CBB requirements which seek to ensure appropriate identification, measurement, aggregation and monitoring of all risks the Bank is exposed to and to relate the level of internal capital of the Bank to its overall risk profile and business plan.

The Bank has adopted a structured approach for identifying and assessing capital required for each of the major risk categories by employing appropriate methodologies. The total of such individual risk capitals is taken as the overall capital requirement. The ICAAP also incorporates guidelines to assess the future capital needs of the Bank in line with its business plans over its strategic time horizon.

STRESS TESTING

Regulatory and internal capital adequacy computations are based on past data. While future projections are done on the assumption that the business environment continues to be normal. It is essential for the Bank to measure sensitivity of its capital to serious adverse changes in external and internal risk environments and changes in business cycles.

The Bank has developed a stress testing model for the purpose which provides an estimate of capital adequacy under a variety of stress scenarios. The first step in the process is identifying relevant stress factors that can affect the Bank's revenues, liquidity, asset quality, business growth, etc. Each item in the Bank's balance sheet is then

revalued on the basis of different combinations of these risk factors and at various levels of severity. The capital adequacy levels at these stress scenarios are computed on current as well as forecasted balance sheets to identify the likely worst case scenarios which will help the Bank identify preventive management actions where necessary.

The Risk Management Department conducts such stress tests twice in a year and the results are reported to the Board of Directors along with suggested remedial actions if necessary.

REPUTATIONAL RISK

Reputational risk arises when a business practice or an event has the potential to materially and negatively influence the public and stakeholders trust and confidence in whether their perception is true or not. Reputation may be intangible but it is a highly prized asset. Failure to manage this risk, can have serious impact on the Bank's business which may also lead to costly litigation that would in turn have an adverse impact on liquidity and capital adequacy of the Bank.

Strong corporate reputation is an invaluable asset to any organization and if ever diminished, it's the most difficult to restore among all the other assets of the organization. Reputation has a vital impact on the long term prosperity of the organization. The senior management, through the relevant committees, examines issues that can have adverse impact on the Bank's reputation and issues guidelines to address these. The Bank also under its ICAAP provides separate capital against this risk.

DISCLOSURES

The Bank recognizes its continuous disclosure obligations set forth by the Central Bank of Bahrain (CBB), Bahrain Stock Exchange and other relevant regulatory bodies. The Bank has approved policies related to external communications & disclosures in line with Basel II & CBB requirements which ensure disclosure of all relevant information to stakeholders in a timely manner. The Pillar 3 disclosure and Corporate Governance Code requirements prescribed by the Central Bank of Bahrain (CBB) are part of this annual report.

KHCB will empower its clients by providing the best services available and responding to their different needs, creating long term relationships with them.



09 SHARI'A SUPERVISORY BOARD REPORT

PRAYERS AND PEACE UPON THE LAST APOSTLE AND MESSENGER, OUR PROPHET MOHAMMED, HIS FAMILY AND COMPANIONS.

In compliance with our terms of appointment, the Shari'a Supervisory Board "SSB" hereby present the following report to the Shareholder on the activities of Khaleeji Commercial Bank "KHCB" and its subsidiaries for the financial year ending on 31/12/2017.

The SSB has reviewed the Bank's activities and subsidiaries which includes the Bank investments, financing, contracts, agreements, structures and products. In addition to the consolidated financial statement as of 31/12/2017, in order to ensure that KHCB adheres to fatwas and decisions issued by SSB and the Shari'a Stenders issued by Accounting and Auditing Organization for Islamic Financial Institutions "AAOIFI".

The SSB appreciates the effort of the internal Shari'a Compliance Department in continues review, auditing of the bank's activities, and the preparation of periodic Shari'a reports that show the commitment of KHCB in its activities and applications to the fatwas and decisions of SSB.

RESPECTIVE RESPONSIBILITIES OF BOARD OF DIRECTORS AND "SSB"

The SSB believes that as a general principle and practice, KHCB's management is responsible for ensuring that it conducts its business in accordance with Islamic Shari'a rules and principles. The SSB's responsibility to form an independent Shari'a opinion based on our review of the Bank's operations and to prepare this report.

BASIS OF OPINION

Based on SSB's Fatwas and decisions, AAOIFI standards and Shari'a Audit Plan, the SSB conducted Shari'a audit and review through its periodic meetings and its executive member, in coordination with the Shari'a Compliance Department through the examination of documents and transactions by conducting samples test method. Moreover, the distribution of profits and loss 'if any' on investment accounts is compatible with established AAOIFI standard. The SSB is further satisfied that any income that is prohibited by the provisions and principles of Islamic Shari'a has been transferred to charity account. In addition, Zakah pool was calculated on the basis of net asset method. The shareholders are responsible of payment of their portion of Zakah on their shares.

OPINION

The SSB is satisfied that the Bank's activities, services, Financing and Investments are in compliance with the Islamic Shari'a rules and principles.

We pray Allah the almighty to grant us all success and prosperity.

Sh. Dr. Fareed Yaqoob Al-Miftah
Chairman

Sh. Dr. Fareed Mohammed Hadi
Executive Member

Sh. Dr. Nizam Mohammed Saleh Yaqoobi
Board Member

10 INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017, the consolidated statements of income, the changes in equity, cash flows, changes in restricted investment accounts and sources and uses of zakah and charity fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

RESPECTIVE RESPONSIBILITIES OF BOARD OF DIRECTORS AND AUDITORS

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

BASIS OF OPINION

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

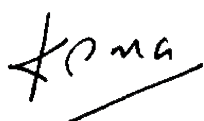
OPINION

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2017 and of its consolidated results of operations, its consolidated cash flows, its consolidated changes in equity, its consolidated changes in restricted investment accounts and its consolidated sources and uses of zakah and charity fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

REPORT ON OTHER REGULATORY REQUIREMENTS

As required by the Bahrain Commercial Companies Law and Volume 2 of the Rule Book issued by the Central Bank of Bahrain (CBB), we report that:

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the chairman's report is consistent with the consolidated financial statements;
- c) we are not aware of any violations during the year of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, the Bahrain Bourse rules and procedures or the terms of the Bank's memorandum and articles of association that would have had a material adverse effect on the business of the Bank or on its financial position; and
- d) satisfactory explanations and information have been provided to us by management in response to all our requests.



11 CONSOLIDATED FINANCIAL STATEMENTS

11 CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2017 / BD 000'S

	Note	31 December 2017	31 December 2016
ASSETS			
Cash and bank balances	3	75,787	56,006
Placements with financial institutions	4	33,969	78,714
Financing assets	5	354,504	355,377
Investment in sukuk	6	113,347	74,154
Assets acquired for leasing	7	97,193	92,839
Lease rentals receivables	7	8,590	2,573
Investment in equity securities	8	52,203	55,121
Investment in real estate	9	20,163	21,508
Development property		6,003	6,003
Other assets		15,706	14,496
Property and equipment	10	7,755	8,208
Total Assets		785,220	764,999
LIABILITIES			
Placements from financial institutions		124,265	59,079
Placements from non-financial institutions and individuals	11	61,359	100,649
Medium-term borrowing	12	41,308	-
Customers' current accounts		74,833	75,814
Other liabilities	13	7,953	8,311
Total liabilities		309,718	243,853
Equity of investment account holders	14	359,818	404,651
OWNER'S EQUITY			
Share capital	15	105,000	105,000
Statutory reserve		8,159	7,962
Treasury shares		(10,212)	(8,832)
Employee share incentive scheme		(70)	(182)
Retained earnings		10,162	8,751
Total equity attributable to shareholders of the parent (page 7)		113,039	112,699
Non-controlling interest		2,645	3,796
Total liabilities, equity of investment account holders and owners' equity		785,220	764,999

The consolidated financial statements, which consist of pages 25 to 80, were approved by the Board of directors on 07 February 2018 and signed on its behalf by:

Dr. Ahmed Khalil Al Mutawa
Chairman

Abdulkarim Ahmed Bucheery
Vice Chairman

Tawfeeq Mohamed Bastaki
Acting Chief Executive Officer

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

11 CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

	Note	2017	2016
Income from financing assets and assets acquired for leasing		27,368	26,198
Income from placements with financial institutions		761	643
Income from sukuk	16	4,736	3,002
Income from equity securities		(1,658)	652
Fees and other income		2,644	5,422
Total income before return to investment account holders		33,851	35,917
Less: Return to investment account holders before Bank's share as Mudarib	14	(14,884)	(16,286)
Bank's share as a Mudarib	14	7,436	9,130
Return to investment account holders		(7,448)	(7,156)
Finance expense on placements from financial institutions, non-financial institutions and individuals		(4,612)	(2,976)
Finance expense on medium-term borrowing		(648)	-
Total income		21,143	25,785
Staff cost	17	6,674	5,988
Other operating expenses	18	6,181	5,568
Total expenses		12,855	11,556
Profit for the year before impairment allowances		8,288	14,229
Net impairment charge	19	(7,470)	(8,921)
PROFIT FOR THE YEAR		818	5,308
Attributable to:			
Shareholders of the parent		1,969	5,310
Non-controlling interest		(1,151)	(2)
		818	5,308
Earnings per share			
Basic and diluted earnings per share (fils)	24	2.04	5.49

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

11 CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

2017	<i>Equity attributable to shareholders of the parent</i>							<i>Total Equity</i>
	<i>Share Capital</i>	<i>Statutory reserve</i>	<i>Treasury shares</i>	<i>Employee share incentive scheme</i>	<i>Retained earnings</i>	<i>Total</i>	<i>Non-Controlling interest</i>	
Balance at 1 January 2017	105,000	7,962	(8,832)	(182)	8,751	112,699	3,796	116,495
Profit for the year	-	-	-	-	1,969	1,969	(1,151)	818
Total recognised income and expense for the year	-	-	-	-	1,969	1,969	(1,151)	818
Transfer to statutory reserve	-	197	-	-	(197)	-	-	-
Net treasury shares purchased	-	-	(1,380)	-	-	(1,380)	-	(1,380)
Issue of shares under incentive scheme	-	-	-	112	-	112	-	112
Transfer to Zakah fund	-	-	-	-	(361)	(361)	-	(361)
Balance at 31 December 2017	105,000	8,159	(10,212)	(70)	10,162	113,039	2,645	115,684

11 CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S (CONTINUED)

2016	<i>Equity attributable to shareholders of the parent</i>								<i>Total Equity</i>
	<i>Share Capital</i>	<i>Statutory reserve</i>	<i>Treasury shares</i>	<i>Employee share incentive scheme</i>	<i>Investment fair value reserve</i>	<i>Retained earnings</i>	<i>Total</i>	<i>Non-Controlling interest</i>	
Balance at 1 January 2016	100,000	7,411	(8,136)	(284)	(86)	8,998	107,903	3,798	111,701
Movement in fair value of investments	-	-	-	-	322	-	322	-	322
Disposal of equity securities	-	-	-	-	(236)	-	(236)	-	(236)
Profit for the year	-	-	-	-	-	5,310	5,310	(2)	5,308
Total recognised income and expense for the year	-	-	-	-	86	5,310	5,396	(2)	5,394
Issue of bonus shares	5,000	-	-	-	-	(5,000)	-	-	-
Transfer to statutory reserve	-	551	-	-	-	(551)	-	-	-
Net treasury shares purchased	-	-	(696)	-	-	-	(696)	-	(696)
Issue of shares under incentive scheme	-	-	-	102	-	-	102	-	102
Transfer to Zakah fund	-	-	-	-	-	(6)	(6)	-	(6)
Balance at 31 December 2016	105,000	7,962	(8,832)	(182)	-	8,751	112,699	3,796	116,495

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

11 CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

	Note	2017	2016
OPERATING ACTIVITIES			
Receipts / (disbursements) relating to financing assets, net		23,286	(18,071)
Payment for asset acquired for leasing, net		(10,543)	(26,548)
Receipt of profit on short-term placements		760	643
Returns paid to investment account holders		(7,533)	(7,041)
(Withdrawals) / receipts from investment account holders, net		(44,834)	33,381
Payment of profit on placements		(4,612)	(2,976)
Payment for expenses		(13,228)	(12,364)
Other receipts		2,643	3,879
Payment for charity		(427)	(40)
(Withdrawals) / receipts in customers' current accounts, net		(981)	9,965
Placements from financial institutions, net		65,186	12,072
Placements from non-financial institutions and individuals, net		(39,290)	52,338
Net payment to CBB reserve account		2,395	(985)
Income from sukuk received		4,015	2,844
Placements with financial institutions		(1,048)	-
Net cash (used in) / generated from operating activities		(24,211)	47,097
INVESTING ACTIVITIES			
Purchase of sukuk		(59,054)	(32,983)
Purchase of equity securities		-	(84)
Proceed from redemption / sale of sukuk		19,465	21,757
Proceed from redemption / sale of equity securities		92	10,236
Proceeds from disposal of development property		-	1,081
Proceeds from disposal of Investment in real estate		700	1,800
Purchase of investment in real estate		(248)	-
Receipt of dividends / income from equity securities		399	708
Disposal / (Purchase) of property and equipment, net		41	(420)
Net cash (used in) / generated from investing activities		(38,605)	2,095
FINANCING ACTIVITIES			
Purchase of treasury shares, net		(1,380)	(696)
Drawdown of medium-term borrowing		41,004	-
Finance expense paid on medium-term borrowing		(425)	-
Net cash generated from / (used in) financing activities		39,199	(696)
Net (decrease) / increase in cash and cash equivalents		(23,617)	48,496
Cash and cash equivalents at 1 January		114,865	66,369
Cash and cash equivalents at 31 December		91,248	114,865
Cash and cash equivalent comprise:			
Cash and bank balances (excluding CBB reserve)	3	58,327	36,151
Placements with financial institutions with original maturities of 90 days or less	4	32,921	78,714
		91,248	114,865

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

11 CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

2017	Balance at 1 January 2017			Movements during the year						Balance at 31 December 2017		
	No of units (000's)	Aver- age value per share BD	Total BD 000's	Invest- ment (with- draw- als) BD 000's	Revalu- tion BD 000's	Gross in- come/ (loss) BD 000's	Divi- dends paid BD 000's	Bank's fees as an agent BD 000's	Admin- stration ex- penses BD 000's	No of units (000's)	Aver- age value per share BD	Total BD 000's
Safana Investment WLL (RIA 1) and NS12	6,304	1.00	6,304	(50)	-	-	-	-	-	6,254	1.00	6,254
Janayen Holding Limited (RIA 4)	-	-	-	-	-	-	-	-	-	-	-	-
Shaden Real Estate Investment WLL (RIA 5)	3,652	1.00	3,652	(123)	-	-	-	-	-	3,529	1.00	3,529
Locata Corpora- tion Pty Ltd (RIA 6)	2,633	0.38	993	-	-	-	-	-	-	2,633	0.38	993
			10,949	(173)	-	-	-	-	-			10,776

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

11 CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S (CONTINUED)

2016	Balance at 1 January 2016			Movements during the year						Balance at 31 December 2016		
	No of units (000's)	Average value per share BD	Total BD 000's	Invest- ment (with- drawals) BD 000's	Revalu- tion BD 000's	Gross income/ (loss) BD 000's	Dividends paid BD 000's	Bank's fees as an agent BD 000's	Admin- stration ex- penses BD 000's	No of units (000's)	Average value per share BD	Total BD 000's
Safana Investment WLL (RIA 1) and NS12	8,313	1.00	8,313	(2,009)	-	-	-	-	-	6,304	1.00	6,304
Janayen Holding Limited (RIA 4)	48,082	0.18	8,500	(8,524)	-	24	-	-	-	-	-	-
Shaden Real Estate Investment WLL (RIA 5)	3,728	1.00	3,728	(76)	-	-	-	-	-	3,652	1.00	3,652
Locata Corpora- tion Pty Ltd (RIA 6)	2,633	0.38	993	-	-	-	-	-	-	2,633	0.38	993
			21,534	(10,609)	-	24	-	-	-			10,949

The accompanying notes 1 to 34 form an integral part of these consolidated financial statements.

11 CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

	2017	2016
Sources of zakah and charity fund		
At 1 January	723	727
Contributions by the Bank	361	7
Non-Islamic income	17	29
Total sources	1,101	763
Uses of zakah and charity fund		
Contributions to charitable organisations	427	40
Total uses	427	40
Undistributed zakah and charity fund at 31 December	674	723

19 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

1. REPORTING ENTITY

Khaleeji Commercial Bank BSC ("the Bank"), a public shareholding company, was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under an Islamic retail banking license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003. The Bank's shares are listed on the Bahrain Bourse. Effectively on 19 December 2017, the Bank's shares were listed on Dubai Financial Markets.

The Bank's activities are regulated by the Central Bank of Bahrain (CBB) and supervised by a Religious Supervisory Board to ensure adherence to Shari'a rules and principles in its transactions and activities.

The principal activities of the Bank include providing banking and investment products and services to retail customers, high net worth individuals, corporate entities, and financial institutions. These include retail and corporate banking, consumer finance, wealth management, structured investment products and project financing facilities which comply with Islamic Shari'a rules and principles as determined by the Bank's Shari'a Supervisory Board.

The consolidated financial statements include the financial statements of the Bank and its subsidiaries (together "the Group"). The significant subsidiaries are as follows:

<i>Name</i>	<i>Country of incorporation</i>	<i>% holding 2017</i>	<i>% holding 2016</i>	<i>Nature of business</i>
Hawafiz Khaleeji Management Company BSC (c)	Bahrain	100%	100%	To hold shares for the beneficial interest of the employee incentive scheme. (refer note 20)
Harbour West 2 Real Estate SPC	Bahrain	100%	100%	To hold property for the beneficial interest of the Bank.
Harbour West 4 Real Estate SPC	Bahrain	100%	100%	To hold property for the beneficial interest of the Bank.
Surooh Limited	Cayman Islands	19.08%	19.08%	To construct and sell properties at "Oryx Hills".
Eqarat Al Khaleej	Cayman Islands	10%	10%	To buy, sell and let-out income producing properties across the GCC.
True Horse Real Estate L.L.C.	UAE	100%	100%	Buying and selling of real estate.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year, except for those changes arising from revised / new AAOIFI financial accounting standards.

i. New standards, amendments, and interpretations effective from 1 January 2017

There are no AAOIFI accounting standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2017 that would be expected to have a material impact on the Group.

ii. New standards, amendments and interpretations issued but not yet effective

FAS 30 - Impairment, credit losses and onerous commitments

AAOIFI has issued FAS 30 Impairment, Credit losses and onerous commitments in 2017. FAS 30 will replace FAS 11 Provisions and Reserves and parts of FAS 25 Investment in Sukuk, shares and similar instruments that deals with impairment. The objective of this standard is to establish the principles of accounting and financial reporting for the impairment and credit losses on various Islamic financing, investment and certain other assets of Islamic financial institutions (the institutions), and provisions against onerous commitments enabling in particular the users of financial statements to fairly assess the amounts, timing and uncertainties with regard to the future cash flows associated with such assets and transactions.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ii. New standards, amendments and interpretations issued but not yet effective (Continued)

FAS30 classifies assets and exposures into three categories based on the nature of risks involved (i.e. credit risk and other risks) and prescribes three approaches for assessing losses for each of these categories of assets 1) Credit Losses approach, 2) Net Realizable Value approach ("NRV") and 3) Impairment approach.

For the purpose of the standard, the assets and exposures shall be categorized, as under:

- a. Assets and exposures subject to credit risk (subject to credit losses approach):
 - i. Receivables; and
 - ii. Off-balance sheet exposures;
- b. Inventories (subject to net realizable value approach)
- c. Other financing and investment assets and exposures subject to risks other than credit risk (subject to impairment approach), excluding inventories.

Credit losses approach for receivables and of balance sheet exposures uses a dual measurement approach, under which the loss allowance is measured as either a 12-month expected credit loss or a lifetime expected credit loss.

Expected credit losses

FAS 30 introduces the credit losses approach with a forward-looking 'expected credit loss' model. The new impairment model will apply to financial assets which are subject to credit risk. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing benchmark of similar financial assets for the purposes of measuring ECL.

The standard shall be effective from the financial periods beginning on or after 1 January 2020. Early adoption is permitted. As mandated by the regulator all Islamic banks are required to early adopt FAS 30 from 1 January 2018.

The Group estimates the FAS 30 transition amount will reduce shareholders' equity by approximately BD 9,558 thousand as at 1 January 2018. The estimated impact relates primarily to the increase in the allowance for credit losses under the new impairment requirements. The Group continues to revise, refine and validate the impairment models and related process controls which may change the actual impact on adoption.

(a) Statement of compliance

The financial statements have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI'). In line with the requirement of AAOIFI, for matters that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standards.

(b) Basis of preparation

The consolidated financial statements are presented in Bahraini Dinars, being the principal currency of the Bank's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain investments carried at fair value.

The Group classifies its expenses in the income statement by the nature of expense method.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 21.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. Control is presumed to exist, when the Group owns more than 50% of voting rights on an entity.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction and usually voting rights are relevant for the operating of such entities. An investor that has decision-making power over an investee and exposure to variability of returns determines whether it acts as a principal or as an agent to determine whether there is a linkage between power and returns. When the decision maker is an agent, the link between power and returns is absent and the decision maker's delegated power does not lead to a control conclusion. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE. The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors.

The financial statements of SPE are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 22

(ii) Associates

Associates are those entities over which the Group holds exercises significant influence, but not control or joint control, over the financial and operating policies.

Investments in associates are initially recognised at cost and the carrying amount is adjusted to recognise the Group's share of the post-acquisition profits or losses of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

The carrying amount of the equity accounted investment is tested for impairment in accordance with the policy described in note 2 (m).

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency.

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain equity securities measured at fair value through equity, are included in investments fair value reserve.

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in an exchange differences.

(e) Investment securities

Investment securities comprise investments in equity securities and investments in sukuk. Investment securities exclude investments in subsidiaries and equity accounted investees (refer note 2(c))

(i) Classification

The Group segregates its investment securities into debt-type and equity-type instruments. Debt-type instruments are investments that have terms that provide fixed or determinable payments of profits and capital. Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence a residual interest in the assets of an entity after deducting all its liabilities.

Debt-type Instruments:

A debt-type investment is classified and measured at amortised cost only if the instrument is managed on a contractual yield basis or the instrument is not held for trading and has not been designated at FVTIS. Debt-type investments at amortised cost include investments in medium to long-term sukuk.

All Investments in debt-type instruments are carried at amortised cost, which are only sukuk.

Equity-type investments:

Investments in equity type instruments are classified in the following categories: 1) at fair value through income statement ('FVTIS') or 2) at fair value through equity ('FVTE'), consistent with its investment strategy.

The Bank has one investment in equity securities that is designated at FVTIS. The rest are classified as investments at fair value through equity.

(ii) Recognition and de-recognition

Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument.

Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Investment securities (Continued)

(iii) Measurement

Investment securities are measured initially at fair value, which is the value of the consideration given. For FVTIS investments, transaction costs are expensed in the income statement. For other investment securities, transaction costs are included as a part of the initial recognition.

Subsequent to initial recognition, investments carried at FVTIS and FVTE are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at FVTIS are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of investments carried at FVTE are recognised in the consolidated statement of changes in equity and presented in a separate fair value reserve within equity. The fair value gains/losses are recognised taking into consideration the split between portions related to owners' equity and equity of investment account holders. When the investments carried at FVTE are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Subsequent to initial recognition, debt-type investments, other than those carried at FVTIS, are measured at amortised cost using the effective profit method less any impairment allowances.

(iv) Measurement principles

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectability. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. When available, the Group measure the fair value of an instruments using the quoted price in an active market for that instrument.

For unquoted investments at fair value, the Group uses recognised valuation techniques for fair valuation. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

Valuation adjustments are recorded to allow for bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

When there is no quoted price or other appropriate methods from which to derive fair value, investments are carried at cost less impairment.

(f) Financing assets

Financing assets comprise Shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Mudharaba, Istisna and Wakala contracts. Financing assets are recognised on the date they are originated and are carried at their amortised cost less impairment allowances, if any.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Placements with and from financial institutions, non-financial institutions and individuals

These comprise inter-bank and over the counter customer placements made/received using Shari'a compliant contracts. Placements are usually for short-term and are stated at their amortised cost.

(h) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and bank balances (excluding CBB reserve account), and placement with financial institutions with original maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

(i) Assets acquired for leasing

Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each reporting date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rental receivables) and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

(j) Investment in real estate

Real estate properties held for rental, or for capital appreciation purposes, or both, are classified as investment in real estate. Investments in real estate are carried at cost less depreciation and impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment in real estate includes plots of land held for capital appreciation purposes, villas and buildings held for earning rentals.

Land is not depreciated. Buildings are depreciated over 25 years.

(k) Development properties

Development property consists of villas being developed for sale in the ordinary course of business and costs incurred in bringing such property to its saleable condition.

Development property is stated at lower of cost or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less costs to complete development and selling expenses.

(l) Property and equipment

Property and equipment is stated at cost, net of accumulated depreciation and impairment allowances, if any. Property includes land which is not depreciated. Other equipment is depreciated using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

(m) Impairment of assets

Financial assets

The Group assesses at each reporting date whether there is objective evidence a financial asset is impaired. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy,

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(m) Impairment of assets (Continued)

Financial assets (Continued)

the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Financial assets carried at amortised cost

These include financing assets, debt-type instruments, and receivables. For financial assets carried at amortised cost, impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. Recovery of written off financial assets is credited to impairment charge for the year. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific asset and collective level.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

Equity investments classified at fair value through equity (FVTE)

In the case of investments in equity securities classified as FVTE and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is an objective evidence of impairment. The group considers a decline of 30% to be significant and a period of nine months to be prolonged. If any such evidence exists, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in income statement - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

For FVTE investments carried at cost less impairment due to the absence of reliable measure of fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

Non-financial assets

The carrying amount of the Group's non-financial assets (other than for financial assets covered above), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash generating unit. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. Separately recognised goodwill is not amortised and is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on separately recognised goodwill are not reversed. As at December 2017, the Bank did not have any goodwill recognised.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n) Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Bank. The transaction are measured at the cash equivalent amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

(o) Equity of investment account holders

Equity of investment account holders are funds held by the Bank in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Bank charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income as a Mudarib. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Only the income earned on pool of assets funded from IAH are allocated between the owners' equity and investment account holders. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

The Bank charges specific provision and collective provision to owners' equity. Amounts recovered from these impaired assets is not subject to allocation between the IAH and owners' equity.

Investment accounts are carried at their book values and include amounts retained towards profit equalisation, investment risk reserves, if any. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of any of these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

(p) Restricted investment accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudharaba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Group in the consolidated financial statements.

(q) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

(r) Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised in the income statement on sale of treasury shares.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(s) Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10 per cent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 per cent of the paid up share capital.

(t) Revenue recognition

Income from Murabaha and Wakala contracts are recognised on a time-apportioned basis over the period of the contract using the effective profit method.

Profit or losses in respect of the Bank's share in **Musharaka and Mudharaba financing** transaction that commence and end during a single financial period are recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka and Mudharaba financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the agreements.

Istisna'a revenue and the associated profit margin is recognised using the percentage of completion method.

Income from assets acquired for leasing (Ijarah Muntahia Bittamleek) are recognised proportionately over the lease term.

Income from sukuk and income/expenses on placements is recognised at its effective profit rate over the term of the instrument.

Dividend income is recognised when the right to receive is established.

Rental income is recognised on a straight line basis over the term of the contract.

Fees and commission income that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

(u) Earnings prohibited by Shari'a

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable purposes.

(v) Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 Zakah using the net assets method. Zakah is paid by the Group based on the eligible reserve and retained earnings balances at the end of the year and the remaining Zakah is payable by individual shareholders. The Bank calculates and notifies the shareholders of their pro-rata share of the Zakah payable annually. The Group also pays Zakah on the balance of treasury shares held at the year-end based on the pro-rata share of Zakah. The calculations of Zakah is approved by the Shari'a Supervisory Board. Payment of Zakah on the unrestricted investment and other accounts is the responsibility of the investment account holders.

(w) Employee benefits

(i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(ii) Post-employment benefits

Pensions and other social benefits for Bahraini employees are covered by the Social Insurance Organisation scheme, which is a “defined contribution scheme” in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in income statement when they are due.

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the reporting date.

These benefits are in the nature of “defined benefit scheme” and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Bank. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

(iii) Share-based employee incentive scheme

The grant-date fair value of equity-settled share-based payment arrangements granted to employees is generally recognised as an expense, with a corresponding increase in equity, over the vesting period of the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

For share-based payment awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

(x) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(y) Trade date accounting

All “regular way” purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

(z) Offsetting

Financial assets and liabilities are offset only when there is a legal or Shari’a based enforceable right to set-off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

(aa) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(bb) URIA Protection Scheme

Funds held with the Bank in investment accounts and current accounts are covered by the Deposit and URIA Protection Scheme (“the Scheme”) established by the Central Bank of Bahrain regulation in accordance with Resolution No (34) of 2010.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) (bb) URIA Protection Scheme (Continued)

The Scheme applies to all eligible accounts held with the Bank subject to certain specific exclusions, maximum total amount entitled and other regulations governing the establishment of a Deposit and URIA Protection Scheme and a Deposit Protection Board.

(cc) Repossessed assets

In certain circumstance, properties are repossessed following the foreclosure on financing facilities that are in default. Repossessed properties are measured at the lower of carrying value and fair value less cost to sell.

(dd) Medium term Borrowing

Medium-term borrowing represents borrowing obtained through murabaha contract recognized on the origination date and carried at amortized cost.

3. CASH AND BANK BALANCES

	31 December 2017	31 December 2016
Cash	8,134	6,888
Balances with banks	24,461	17,112
Balances with the Central Bank:		
- Current account	25,732	12,151
- Reserve account	17,460	19,855
	75,787	56,006

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2017	31 December 2016
Gross Murabaha and Wakala receivable	33,996	78,757
Less: Deferred profits	(27)	(43)
	33,969	78,714

The average profit rate on placement with financial institutions for 2017 was 1.59% per annum (31 December 2016: 1.53% per annum). Placements with financial institutions with original maturities of 90 days or less is BD 32,921 (31 December 2016: 78,714).

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

5. FINANCING ASSETS

	31 December 2017	31 December 2016
Murabaha	335,064	334,632
Musharaka	6,918	8,765
Wakala	21,482	29,386
Mudharaba	1,137	1,155
Istisna	-	7
	364,601	373,945
Less: Impairment allowances - specific	(6,730)	(15,164)
Less: Impairment allowances - collective	(3,367)	(3,404)
	354,504	355,377

Murabaha financing receivables are net of deferred profits of BD 23,039 thousand (2016: BD 31,004 thousand).

The movement on impairment allowances is as follows:

2017	Specific	Collective	Total
At 1 January 2017	15,164	3,404	18,568
Net charge for the year (note 19)	4,794	(37)	4,757
Write-off	(13,228)	-	(13,228)
At 31 December 2017	6,730	3,367	10,097

2016	<i>Specific</i>	<i>Collective</i>	<i>Total</i>
At 1 January 2016	10,284	3,484	13,768
Net charge for the year (note 19)	7,686	(80)	7,606
Write-off	(2,806)	-	(2,806)
At 31 December 2015	15,164	3,404	18,568

6. INVESTMENT IN SUKUK

	31 December 2017	31 December 2016
Debt type instruments - at amortized cost		
- Quoted sukuk	113,200	73,443
- Unquoted sukuk	147	711
	113,347	74,154

Debt type instruments are net of specific impairment allowances of BD 1,417 thousand (2016: BD 1,021 thousand).

During the year, impairment charge of BD 396 thousand (31 December 2016: BD 589 thousand) was recognised on unquoted debt type instruments carried at amortised cost.

* Includes Sukuk of BD 48,888 thousands pledged against medium-term borrowing of BD 41,308 thousands.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

7. ASSETS ACQUIRED FOR LEASING

	2017	2016
Cost		
At 1 January	104,816	75,326
Additions during the year	21,873	40,866
Settlements / adjustments during the year	(6,694)	(11,376)
At 31 December	119,995	104,816
Accumulated depreciation		
At 1 January	11,977	7,515
Charge for year	13,415	7,611
Settlements during the year	(2,590)	(3,149)
At 31 December	22,802	11,977
Net book value at 31 December	97,193	92,839

At 31 December 2017, accrued lease rental receivable amounted to BD 8,590 thousand (2016: BD 2,573 thousand). Lease rental receivable is net of collective provision of BD 1,052 thousand (2016: BD 959 thousand) and specific provision of BD 79 thousand (2016: Nil). During the year, an impairment allowance of BD 173 thousand (2016: BD 236 thousand) was made on the lease rental receivables.

Of the total net book value of assets acquired for leasing, consumer financing amounted to BD 88,984 thousand (2016: BD 88,277 thousand).

8. INVESTMENT IN EQUITY SECURITIES

	31 December 2017	31 December 2016
<i>At fair value through income statement</i>		
- Unquoted equity securities (at fair value)	13,148	15,148
<i>At fair value through equity</i>		
- Unquoted equity securities (carried at cost less impairment)*	39,055	39,973
	52,203	55,121

* Unquoted equity securities at fair value through equity comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. These investments are carried at cost less impairment in the absence of a market price or a reliable measure of fair value. The Group intends to exit these investments principally by means of private placements, strategic buy outs or sale of underlying assets.

During the year, impairment charge of BD 1,311 thousand (31 December 2016: BD 1,852 thousand) was recognised on equity securities carried at cost.

Unquoted equity securities carried at cost are net of specific impairment allowances of BD 12,876 thousand (2016: BD 10,493 thousand). During the year, the Group has written off fully provided for investments of BD 2,988 thousand (2016: BD 5,111).

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

9. INVESTMENT IN REAL ESTATE

	<i>Land</i>	<i>Building</i>	2017 Total	2016 Total
Cost				
At 1 January	19,620	3,246	22,866	20,223
Additions	294	248	542	5,088
Disposals	(453)	(631)	(1,084)	(2,445)
Impairment (note 19)	-	(790)	(790)	-
At 31 December	19,461	2,073	21,534	22,866
Accumulated Depreciation				
At 1 January	-	1,358	1,358	1,152
Charge for year	-	73	73	261
Disposals	-	(60)	(60)	(55)
At 31 December	-	1,371	1,371	1,358
Net book value at 31 December	19,461	702	20,163	21,508

Subsequent to the year end, the group sold a building at a loss of BD 790 thousand. The carrying value has been adjusted to reflect this loss.

10. PROPERTY AND EQUIPMENT

	<i>Land</i>	<i>Furniture and fixtures</i>	<i>Computers</i>	<i>Motor vehicle and Other equipment</i>	<i>Work-in- progress</i>	2017 Total	2016 Total
Cost							
At 1 January	6,714	4,377	3,939	495	691	16,216	15,896
Additions	-	16	136	42	197	391	463
Capitalisation	-	30	848	10	(888)	-	-
Disposals	-	-	(433)	(5)	-	(438)	(143)
At 31 December	6,714	4,423	4,490	542	-	16,169	16,216
Accumulated Depreciation							
At 1 January	-	4,118	3,532	358	-	8,008	7,611
Charge for year	-	90	268	53	-	411	497
Disposals	-	-	-	(5)	-	(5)	(100)
At 31 December	-	4,208	3,800	406	-	8,414	8,008
Net book value at 31 December 2017	6,714	215	690	136	-	7,755	8,208
Net book value at 31 December 2016	6,714	259	407	137	691	8,208	

12 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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11. PLACEMENTS FROM NON-FINANCIAL INSTITUTIONS AND INDIVIDUALS

	31 December 2017	31 December 2016
Non-financial institutions	14,417	46,077
Individuals	46,942	54,572
	61,359	100,649

These represent placements in the form of Murabaha and Wakala contracts. These are net of deferred profit of BD 1,856 thousand (2016: BD 2,501 thousand).

12. MEDIUM-TERM BORROWING

During the year, the group obtained two medium-term Murabaha facilities of BD 41,308 thousand secured by pledge over sukuk of BD 48,888 thousand

13. OTHER LIABILITIES

	31 December 2017	31 December 2016
Mudaraba profit accrual	2,860	2,945
Employee related accruals	189	251
Zakah and charity payable (page 12)	674	723
Payable for Istisna'a contracts	27	111
Other payables and accrued expenses	4,203	4,281
	7,953	8,311

14. EQUITY OF INVESTMENT ACCOUNT HOLDERS

The funds received from investment account holders have been commingled and jointly invested with the Bank in the following asset classes as at 31 December:

	31 December 2017	31 December 2016
Balances with banks	24,461	17,112
CBB reserve account	17,460	19,855
Placements with financial institutions	33,969	78,714
Debt type instruments - sukuk	113,199	73,444
Financing assets	170,729	215,526
	359,818	404,651

As at 31 December 2017, the balance of profit equalisation reserve and investment risk reserve was Nil (2016: Nil).

Only the profits earned on pool of assets funded from IAH are allocated between the owners' equity and IAH. The Bank did not charge any administration expenses to investment accounts.

Following is the average percentage for profit allocation between owner's equity and investment accountholders.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

14. EQUITY OF INVESTMENT ACCOUNT HOLDERS (CONTINUED)

	2017		2016	
	Mudarib share	IAH shares	Mudarib share	IAH shares
1 month Mudharaba *	73.34%	26.66%	78.46%	21.54%
3 months Mudharaba	58.58%	41.42%	69.23%	30.77%
6 months Mudharaba	55.30%	44.70%	66.79%	33.21%
12 months Mudharaba	37.99%	62.01%	46.83%	53.17%
18 months Mudharaba	80.55%	19.45%	42.56%	57.44%
24 months Mudharaba	25.63%	74.37%	38.41%	61.59%
36 months Mudharaba	12.22%	87.78%	-	-

* Includes savings, Al Waffer and Call Mudaraba accounts.

During the year, average mudarib share as a percentage of total income allocated to IAH was 41.86% (2016: 53.57%) as against the average mudarib share contractually agreed with IAH. Hence the Bank sacrificed average mudarib fees of 16.94% (2016: 11.23%).

The Bank does not share profits resulting from the assets funded through current accounts and other funds received on the basis other than mudarba contract.

The funds raised from IAH are deployed in the assets on a priority basis after setting aside certain amount in cash and placement with Banks for liquidity management purposes.

15. SHARE CAPITAL

	31 December 2017	31 December 2016
Authorised:		
3,000,000,000 ordinary shares of BD 0.100 each	300,000	300,000
Issued and fully paid up:		
1,050,000,000 ordinary shares (2016: 1,050,000,000) of BD 0.100 each	105,000	100,000

The Bank has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2017, the Group holds 90,644,113 as treasury shares (2016: 83,480,840 shares).

Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares:

	Nationality	Number of shares	% of total outstanding shares
GFH Financial Group *	Bahrain	493,490,918	47.00
Goldilocks Investment Company Limited	UAE	104,779,110	9.98
Emirates Islamic Bank PJSC	UAE	88,322,425	8.41
Khaleeji Commercial Bank B.S.C	Bahrain	86,000,346	8.19

* As at 31 December 2017, these shares representing 47% (2016: 47%) were held by KHCB Asset Company on behalf of GFH Financial Group, which is considered as the parent of the Bank for financial reporting purposes.

19 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

16. INCOME FROM SUKUK

	2017	2016
Profit earned on debt-type Sukuk	4,628	3,205
Gain / (Loss) on sale of Sukuk	108	(203)
	4,736	3,002

17. STAFF COST

	2017	2016
Salaries and short-term benefits	5,679	5,152
Social insurance expenses	852	789
Other staff expenses	143	47
	6,674	5,988

18. OTHER OPERATING EXPENSES

	2017	2016
Premises cost	1,114	1,132
Advertisement and marketing expenses	1,256	1,221
Professional fees	757	513
Information technology expenses	446	430
Board expenses	356	108
Communication expenses	313	257
Distribution channel expenses	537	430
Other administrative expenses	991	980
Depreciation expenses	411	497
	6,181	5,568

19. NET IMPAIRMENT CHARGE

	2017	2016
Financing assets (note 5)	4,757	7,606
Investments in Sukuk (note 6)	396	589
Lease rental receivable (note 7)	173	236
Investments at fair value through equity (note 8)	1,311	1,852
Investment in real estate (note 9)	790	-
Other assets	43	1,004
Recoveries from previously written off financing assets	-	(2,366)
	7,470	8,921

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

20. SHARE-BASED EMPLOYEE INCENTIVE SCHEME

The group has incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ("Hawafiz"), to hold the beneficial interest of the shares under the scheme.

The shareholders, in their annual general meeting held on 30 March 2015, approved the employee share based incentive scheme (the "scheme") which is in line with the CBB's Sound Remuneration Practices. Under the share incentive scheme, certain covered employees are granted the Bank's shares as compensation for their performance.

As per the scheme, the share awards from each performance year will vest immediately but will be released over three years period from the date of grant. The share awards are subject to an additional retention period of six months from the date of completion of deferred period, after which the employee is unconditionally allowed to sell the shares in the market. The scheme allows the Bank Nomination, Remuneration and Governance Committee ("BNRGC") to determine that, if appropriate, un-awarded shares can be forfeited or clawed back in certain situations.

As at 31 December 2017, 4,643,767 shares (2016: 6,277,632 shares) were held by Hawafiz. During the year 1,091,962 shares (2016: 2,551,770 shares) were awarded to the employees as awards under the terms of the scheme subject to a three year deferment period. During the year the Bank transferred 1,633,866 shares (2016: 855,966 shares) to the employees.

21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

Judgements

Classification of investments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as debt type instruments carried at fair value through equity or amortised cost, or equity-type instruments carried at fair value through equity or fair value through income statement. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [refer note 2 (e)].

Special purpose entities

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group's intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

Estimations

Impairment of equity investments

The Group determines that equity securities carried at fair value are impaired when there is an objective evidence of impairment and there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 9 months as prolonged.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (CONTINUED)

Estimations (Continued)

Impairment of equity investments (Continued)

For unquoted investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment.

In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

Fair value of unquoted equity securities

The Group determines the fair value of unquoted investments by using valuation techniques. This includes using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analysis or market multiples for similar instruments. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments.

Significant judgment is required to be made by the Group and the Board of Directors in the selection of an approach that would reflect the best measure of fair value of the investments. The choice of the models used for valuation on each reporting period may have a significant impact on the fair value of investments and the amounts reported in the consolidated financial statements. The Bank has adopted price earning multiple approach for its unquoted equity security.

The potential effect of using reasonable possible alternative assumptions for valuing the investments resulting in 5% decrease/increase in the market multiple would increase/decrease the reported fair value by BD 650 thousand (31 December 2016: BD 757 thousand). The corresponding impact would be on the profit or loss reported by the Group.

Impairment of financing assets

Financing assets are evaluated for impairment on a basis described in accounting policy, refer to note 2 (f). Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets/ collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

For the purposes of a collective evaluation of impairment, financing assets are grouped on the basis of similar credit risk characteristics (that is, considers asset type, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (CONTINUED)

Estimations (Continued)

Net realisable value of development property

Development property is stated at lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less estimated selling expenses. The management engaged independent valuers to estimate the residual value of the development property based on estimated market selling prices for similar properties. Net realisable value estimates are made at a specific point in time, based on market conditions and information about the expected use of development property. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events. It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the development property.

22. ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its investment entities, which involves making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of BD 240.97 million (31 December 2016: BD 234.69 million). During the year, the Bank has not charged any management fees (2016: BD Nil) for the management of these assets.

23. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the parent company, other significant shareholders and entities over which the Bank and the shareholders exercises significant influence, directors, sharia board members and executive management of the Bank.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were:

Categories*	Number of Shares	Number of Directors
Less than 1%	1,050,763	1

* Expressed as a percentage of total outstanding shares of the Bank.

Compensation of key management personnel

Key management personnel of the Bank comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank.

The key management personnel compensation during the year is as follows:

	2017	2016
Board member fees and allowances	314	93
Salaries and other short-term benefits	1,328	1,031

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

23. RELATED PARTY TRANSACTIONS (CONTINUED)

The related party balances and transactions (except for compensation of key managerial personnel) included in these consolidated financial statements are as follows:

31 December 2017	Associates	Directors / Key management personnel and shari'a board members	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	-	967	5,710	1,388	8,065
Investment in equity securities	-	-	2,284	23,794	26,078
Other assets	4,727	-	-	1,029	5,756
Liabilities					
Placement from financial institutions and others	-	-	15,091	-	15,091
Customers' current accounts	55	-	595	1,359	2,009
Equity of investment account holders	592	241	21,034	875	22,742
31 December 2016	Associates	Directors / Key management personnel and shari'a board members	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	-	-	-	-	-
Investment in equity securities	127	-	2,284	25,387	27,798
Other assets	4,678	-	-	918	5,596
Liabilities					
Customers' current accounts	10	-	88	1,903	2,001
Equity of investment account holders	446	150	19,935	917	21,448

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

23. RELATED PARTY TRANSACTIONS (CONTINUED)

2017	Associates	Directors / Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from financing assets and assets acquired for leasing	-	48	334	87	469
Income from equity securities	-	-	-	-	-
Fees and other income	7	-	-	-	7
Expenses					
Finance expense on placements from financial institutions, non-financial institutions and individuals	-	-	369	-	369
Return to investment account holders	30	7	302	25	364
Staff cost	-	1,328	-	-	1,328
Other expenses	-	-	-	-	-
(Recoveries) / Impairment	-	-	-	842	842
2016	Associates	Key management personnel	Parent company / other significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Income from financing assets and assets acquired for leasing	6	-	-	-	6
Income from equity securities	-	-	-	-	-
Fees and other income	17	-	1,893	-	1,910
Expenses					
Return to investment account holders	12	2	155	8	177
Staff cost	-	1,031	-	-	1,031
Other expenses	-	-	4	21	25
(Recoveries) / Impairment	-	-	(2,366)	1,852	(514)

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24. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year adjusted for impact arising from shares issued under the employee share incentive scheme.

Basic EPS	2017	2016
Profit attributable to parent for the year (BD 000's)	1,969	5,310
Weighted average number of equity shares (Nos. in 000's)	963,071	967,119
Basic earnings per share (in fils)	2.04	5.49

The Bank did not have any dilutive instruments as of 31 December 2017 and December 2016.

25. SHARI'A SUPERVISORY BOARD

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

26. ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investment account holders. The Bank currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. During the year, the Shari'a Supervisory Board has computed Zakah payable of BD 556 thousand (2016: BD 420 thousand) of which BD 431 thousand (2016: 355) represents the Zakah computed on the statutory reserve and cumulative retained earnings as at 31 December 2017, payable by the Bank. The remaining Zakah balance amounting to BD 125 thousand or 0.12 fils per share (2016: BD 65 thousand or 0.061 fils per share) is due and payable by the shareholders. The Bank will pay Zakah of BD 11 thousand (2016: BD 5 thousand) on the treasury shares held as of 31 December 2017 based on 0.12 fils per share.

27. SEGMENT REPORTING

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker (Board of Directors) to make decisions about resource allocation to each segment and assess its performance and for which discrete financial information is available. An operating segment is divided into business segment and geographic segments. For management purposes, the Group is organised into two major business segments:

- Corporate and retail banking

Providing customer services such as accepting Mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides financing facilities (in the form of Commodity Murabaha, Musharaka, Istisna'a and Ijarah facilities) to corporate clients and High-Networth-Individuals and consumer finance products. This segment includes money market and treasury services in the form of short term Commodity Murabaha and Wakala to banks, financial institutions and investments in sukuk to manage funding of the Group

- Investment banking

Primarily relates to conceptualising of investment deals and performing roles of an arranger, lead manager, and administrator of the funds (involves structuring of deals, raising of funds through private placement and fund administration). Also offers products like Restricted Investment Accounts (RIA) and management of funds raised through the RIA structures. Also involves carrying out strategic investments in the form of equity contribution (either in the funds created and managed by the Bank or other institutions).

Segment performance is measured based on results for each department as mentioned in the internal management reports that are reviewed by the Board of directors on a quarterly basis. Segment results is used to measure performance as management

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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27. SEGMENT REPORTING (CONTINUED)

Investment banking (Continued)

believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate in these industries.

The Bank reports directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment cost respectively. Indirect costs and corporate overheads are treated as unallocated. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures.

The Group primarily operates from Bahrain and does not have any overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 29 (b) to the consolidated financial statements.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments (if any) are conducted on an arm's length basis

31 December 2017	<i>Investment Banking</i>	<i>Corporate and Retail Banking</i>	<i>Unallocated</i>	<i>Total</i>
Cash and bank balances	7	75,780	-	75,787
Placements with financial institutions	1,094	32,875	-	33,969
Financing assets	-	354,504	-	354,504
Investment in sukuk	-	113,347	-	113,347
Assets acquired for leasing (including lease rentals receivable)	-	105,783	-	105,783
Investment in equity securities	52,203	-	-	52,203
Investment in real estate	20,163	-	-	20,163
Development property	6,003	-	-	6,003
Other assets	10,341	3,541	1,824	15,706
Property and equipment	-	-	7,755	7,755
Total segment assets	89,811	685,830	9,579	785,220
Placements from financial institutions	-	124,265	-	124,265
Placements from non - financial institutions and individuals	-	61,359	-	61,359
Medium-term borrowing	-	41,308	-	41,308
Customers' current accounts	1,094	73,739	-	74,833
Other liabilities	2,002	4,435	1,516	7,953
Total segment liabilities	3,096	305,106	1,516	309,718
Equity of investment account holders	-	359,818	-	359,818
Restricted investment accounts	10,776	-	-	10,776

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27. SEGMENT REPORTING (CONTINUED)

2017	Investment Banking	Corporate and Retail Banking	Unallocated	Total
Income from financing assets and assets acquired for leasing	-	27,368	-	27,368
Income from placements with financial institutions	25	736	-	761
Income from sukuk	-	4,736	-	4,736
Income from equity securities	(1,658)	-	-	(1,658)
Fees and other income	(92)	2,736	-	2,644
Total income before return to investment account holders	(1,725)	35,576	-	33,851
Less: Return to investment account holders before Bank's share as Mudarib	-	(14,884)	-	(14,884)
Bank's share as a Mudarib	-	7,436	-	7,436
Return to investment account holders	-	(7,448)	-	(7,448)
Less: Expense on placements from financial institutions, non-financial institutions and individuals	-	(4,612)	-	(4,612)
Finance expense on medium-term borrowing	-	(648)	-	(648)
Total segment income	(1,725)	22,868	-	21,143
Staff cost	667	2,670	3,337	6,674
Other expenses	349	1,825	4,007	6,181
Total segment expenses	1,016	4,495	7,344	12,855
Segment results before impairment allowances	(2,741)	18,373	(7,344)	8,288
Net impairment allowances	(2,101)	(5,369)	-	(7,470)
Segment results	(4,842)	13,004	(7,344)	818

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27. SEGMENT REPORTING (CONTINUED)

31 December 2016	<i>Investment Banking</i>	<i>Corporate and Retail Banking</i>	<i>Unallocated</i>	<i>Total</i>
Cash and bank balances	-	56,006	-	56,006
Placements with financial institutions	1,759	76,955	-	78,714
Financing assets	-	355,377	-	355,377
Investment in sukuk	-	74,154	-	74,154
Assets acquired for leasing (including lease rentals receivable)	-	95,412	-	95,412
Investment in equity securities	55,121	-	-	55,121
Investment in real estate	21,508	-	-	21,508
Development property	6,003	-	-	6,003
Other assets	10,659	2,752	1,085	14,496
Property and equipment	-	-	8,208	8,208
Total segment assets	95,050	660,656	9,293	764,999
Placements from financial institutions	-	59,079	-	59,079
Placements from non - financial institutions and individuals	-	100,649	-	100,649
Customers' current accounts	1,759	74,055	-	75,814
Other liabilities	1,745	4,296	2,270	8,311
Total segment liabilities	3,504	238,079	2,270	243,853
Equity of investment account holders	-	404,651	-	404,651
Restricted investment accounts	10,949	-	-	10,949

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27. SEGMENT REPORTING (CONTINUED)

2016	<i>Investment Banking</i>	<i>Corporate and Retail Banking</i>	<i>Unallocated</i>	<i>Total</i>
Income from financing assets and assets acquired for leasing	-	26,198	-	26,198
Income from placements with financial institutions	14	629	-	643
Income from sukuk	-	3,002	-	3,002
Income from investment securities	652	-	-	652
Fees and other income	2,369	3,053	-	5,422
Total income before return to investment account holders	3,035	32,882	-	35,917
Less: Return to investment account holders before Bank's share as Mudarib	-	(16,286)	-	(16,286)
Bank's share as a Mudarib	-	9,130	-	9,130
Return to investment account holders	-	(7,156)	-	(7,156)
Less: Expense on placements from financial institutions, non-financial institutions and individuals	-	(2,976)	-	(2,976)
Total segment income	3,035	22,750	-	25,785
Staff cost	599	2,395	2,994	5,988
Other expenses	318	1,684	3,566	5,568
Total segment expenses	917	4,079	6,560	11,556
Segment results before impairment allowances	2,118	18,671	(6,560)	14,229
Net impairment allowances	(1,852)	(7,069)	-	(8,921)
Segment results	266	11,602	(6,560)	5,308

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28. MATURITY PROFILE

The maturity profile of placements with and from financial institutions, financing assets, assets acquired for leasing, (including lease rental receivable), and equity of investment account holders has been presented using their contractual maturity period. For other balances, maturity profile is based on expected cash flows/ settlement profile of the respective assets and liabilities.

31 December 2017	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	66,167	3,212	4,821	1,587	-	75,787
Placements with financial institutions	32,921	-	1,048	-	-	33,969
Financing assets	71,931	31,456	54,039	115,068	82,010	354,504
Investment in sukuk	64,459	-	-	48,888	-	113,347
Assets acquired for leasing (including lease rental receivable)	1,898	1,710	3,313	20,089	78,773	105,783
Investment in equity securities	-	-	-	52,203	-	52,203
Investment in real estate	-	-	-	-	20,163	20,163
Development property	-	-	-	-	6,003	6,003
Other assets	10,605	931	93	397	3,680	15,706
Property and equipment	-	-	-	-	7,755	7,755
Total assets	247,981	37,309	63,314	238,232	198,384	785,220
Liabilities						
Placements from financial institutions	91,652	14,319	11,505	6,789	-	124,265
Placements from non-financial institutions and individuals	21,341	11,090	27,641	-	1,287	61,359
Medium-term borrowing	-	-	-	41,308	-	41,308
Customers' current account	46,997	10,566	6,418	3,760	7,092	74,833
Other liabilities	2,393	638	739	4,183	-	7,953
Total liabilities	162,383	36,613	46,303	56,040	8,379	309,718
Equity of investment account holders	175,109	32,670	47,852	15,192	88,995	359,818
Restricted investment accounts	-	4,522	-	6,254	-	10,776
Commitments and financial guarantees	3,863	19,336	17,242	26,695	1	67,137

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28. MATURITY PROFILE (CONTINUED)

31 December 2016	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	56,006	-	-	-	-	56,006
Placements with financial institutions	77,686	-	1,028	-	-	78,714
Financing assets	26,154	16,977	40,784	81,503	189,959	355,377
Investment in sukuk	74,154	-	-	-	-	74,154
Assets acquired for leasing (including lease rental receivable)	148	7	13	1,354	93,890	95,412
Investment in equity securities	-	-	-	55,121	-	55,121
Investment in real estate	-	-	-	-	21,508	21,508
Development property	-	-	-	-	6,003	6,003
Other assets	851	-	41	9,975	3,629	14,496
Property and equipment	-	-	-	-	8,208	8,208
Total assets	234,999	16,984	41,866	147,953	323,197	764,999
Liabilities						
Placements from financial institutions	59,079	-	-	-	-	59,079
Placements from non-financial institutions and individuals	19,127	13,598	63,654	2,553	1,717	100,649
Customers' current account	47,595	10,870	6,448	3,777	7,124	75,814
Other liabilities	2,785	581	824	4,121	-	8,311
Total liabilities	128,586	25,049	70,926	10,451	8,841	243,853
Equity of investment account holders	166,175	42,392	53,392	28,958	113,734	404,651
Restricted investment accounts	-	6,304	-	4,645	-	10,949
Commitments and financial guarantees	31,720	17,264	25,836	12,001	1,645	88,466

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS

(a) Industry sector

31 December 2017	<i>Banks and financial institutions</i>	<i>Real estate</i>	<i>Others</i>	<i>Total</i>
Assets				
Cash and bank balances	75,787	-	-	75,787
Placements with financial institutions	33,969	-	-	33,969
Financing assets	11,011	75,688	267,805	354,504
Investment in sukuk	11,857	146	101,344	113,347
Assets acquired for leasing (including lease rentals receivable)	-	105,715	68	105,783
Investment in equity securities	13,147	35,387	3,669	52,203
Investment in real estate	-	20,163	-	20,163
Development property	-	6,003	-	6,003
Other assets	1,050	5,781	8,875	15,706
Property and equipment	-	6,715	1,040	7,755
Total assets	146,821	255,598	382,801	785,220
Liabilities				
Placements from financial institutions	124,265	-	-	124,265
Placements from non-financial institutions and individuals	-	-	61,359	61,359
Medium-term borrowing	41,308	-	-	41,308
Customers' current accounts	2,688	11,448	60,697	74,833
Other liabilities	-	2,003	5,950	7,953
Total liabilities	168,261	13,451	128,006	309,718
Equity of investment account holders				
Restricted investment accounts	-	9,783	993	10,776
Commitments and financial guarantees	619	24,645	41,873	67,137

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FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (CONTINUED)
(a) Industry sector (Continued)

31 December 2016	<i>Banks and financial institutions</i>	<i>Real estate</i>	<i>Others</i>	<i>Total</i>
Assets				
Cash and bank balances	56,006	-	-	56,006
Placements with financial institutions	78,714	-	-	78,714
Financing assets	12,358	88,245	254,774	355,377
Investment in sukuk	1,885	10,058	62,211	74,154
Assets acquired for leasing (including lease rentals receivable)	-	94,488	924	95,412
Investment in equity securities	15,147	36,305	3,669	55,121
Investment in real estate	-	21,508	-	21,508
Development property	-	6,003	-	6,003
Other assets	1,085	5,718	7,693	14,496
Property and equipment	-	6,740	1,468	8,208
Total assets	165,195	269,065	330,739	764,999
Liabilities				
Placements from financial institutions	59,079	-	-	59,079
Placements from non-financial institutions and individuals	-	-	100,649	100,649
Customers' current accounts	3,343	11,849	60,622	75,814
Other liabilities	-	2,752	5,559	8,311
Total liabilities	62,422	14,601	166,830	243,853
Equity of investment account holders	39,683	21,446	343,522	404,651
Restricted investment accounts	-	9,956	993	10,949
Commitments and financial guarantees	723	27,571	60,172	88,466

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (CONTINUED)

(b) Geographic sector

31 December 2017	GCC countries	Europe	America	Asia	Australia	Total
Assets						
Cash and bank balances	61,083	2,933	11,761	10	-	75,787
Placements with financial institutions	33,969	-	-	-	-	33,969
Financing assets	337,937	16,531	-	36	-	354,504
Investment in sukuk	113,347	-	-	-	-	113,347
Assets acquired for leasing (including lease rental receivable)	105,783	-	-	-	-	105,783
Investment in equity securities	29,279	-	-	19,256	3,668	52,203
Investment in real estate	20,163	-	-	-	-	20,163
Development property	6,003	-	-	-	-	6,003
Other assets	14,881	15	-	810	-	15,706
Property and equipment	7,755	-	-	-	-	7,755
Total assets	730,200	19,479	11,761	20,112	3,668	785,220
Liabilities						
Placements from financial institutions	124,265	-	-	-	-	124,265
Placements from non-financial institutions and individuals	61,359	-	-	-	-	61,359
Medium-term borrowing	41,308	-	-	-	-	41,308
Customers' current accounts	67,332	6,921	-	580	-	74,833
Other liabilities	7,953	-	-	-	-	7,953
Total liabilities	302,217	6,921	-	580	-	309,718
Equity of investment account holders	354,290	3,043	-	2,485	-	359,818
Restricted investment accounts	9,783	-	-	-	993	10,776
Commitments and financial guarantee	65,893	1,244	-	-	-	67,137

Concentration by location for financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (CONTINUED)

(b) *Geographic sector (Continued)*

31 December 2016	GCC countries	Europe	America	Asia	Australia	Total
Assets						
Cash and bank balances	47,152	2,790	6,057	7	-	56,006
Placements with financial institutions	78,714	-	-	-	-	78,714
Financing assets	336,485	18,892	-	-	-	355,377
Investment in sukuk	74,154	-	-	-	-	74,154
Assets acquired for leasing (including lease rental receivable)	95,412	-	-	-	-	95,412
Investment in equity securities	30,985	-	-	20,468	3,668	55,121
Investment in real estate	21,508	-	-	-	-	21,508
Development property	6,003	-	-	-	-	6,003
Other assets	13,777	15	-	704	-	14,496
Property and equipment	8,208	-	-	-	-	8,208
Total assets	712,398	21,697	6,057	21,179	3,668	764,999
Liabilities						
Placements from financial institutions	59,079	-	-	-	-	59,079
Placements from non-financial institutions and individuals	100,649	-	-	-	-	100,649
Customers' current accounts	74,025	1,692	-	97	-	75,814
Other liabilities	8,311	-	-	-	-	8,311
Total liabilities	242,064	1,692	-	97	-	243,853
Equity of investment account holders	401,529	484	-	2,638	-	404,651
Restricted investment accounts	9,956	-	-	-	993	10,949
Commitments and financial guarantees	88,414	52	-	-	-	88,466

30. FAIR VALUE

a) Fair value of financial instruments

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value of quoted sukuk carried at amortised cost of BD 113,199 thousand (31 December 2016: BD 73,443 thousand) is BD 112,077 thousand as at 31 December 2017 (31 December 2016: BD 72,423 thousand).

In case of financing assets and lease receivables, the average profit rate of the portfolio is in line with current market rates for similar facilities and hence after consideration of adjustment for prepayment risk and impairment charges it is expected that the current value would not be materially different to fair value of these assets. Other than equity investments carried at cost of BD 39,519 thousand (2016: BD 39,973 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values due to their short-term nature.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

30. FAIR VALUE (CONTINUED)

b) Fair value hierarchy

The table below analyses the financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31 December 2017	Level 1	Level 2	Level 3	Total
Unquoted equity type securities carried at fair value through income statement	-	-	13,148	13,148
	-	-	13,148	13,148

31 December 2016	Level 1	Level 2	Level 3	Total
Unquoted equity type securities carried at fair value through income statement	-	-	15,148	15,148
	-	-	15,148	15,148

The table below shows the reconciliation of movements in value of investments measured using Level 3 inputs:

	2017	2016
At 1 January	15,148	15,148
Total gains or losses in income statement	(2,000)	-
Purchases	-	-
At 31 December	13,148	15,148

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31. RISK MANAGEMENT

Introduction and overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the Group's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations, if any, to the Board. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Board Audit and Risk Management Committee.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Audit and Risk Management Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit and Risk Management Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit and Risk Management Committee.

CREDIT RISK

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's exposures to placements with financial institutions, financing assets, outstanding assets acquired for leasing, investment in sukuk and receivables classified under other assets. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure, etc.).

The Bank monitors the total exposure to assets acquired for leasing (including lease rentals receivable) on a cumulative basis for monitoring of market risk and credit risk.

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Credit & Investment Committee (ECICOM). A separate Risk Management and Credit Management Department (RMD), reporting to the ECICOM is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for approval to the Board of Directors.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Smaller exposures are approved by the heads of business units within the appetite approved and granted by the Board of Directors. Larger facilities require approval by the Chief Executive Officer, ECICOM, Board Investment and Credit Committee or the full Board, as the case may be.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

31. RISK MANAGEMENT (CONTINUED) CREDIT RISK (CONTINUED)

- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review of facilities are subject to the same process.
- Limiting concentrations of exposure to counterparties, countries and industries in respect of financing assets, assets acquired for leasing as well as investments.
- Developing and maintaining the Bank's risk gradings in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The risk grading framework for the Bank's financing portfolio consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive/committee as appropriate on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. RMD also provides advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.
- Each business unit is required to implement the Bank's credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank credit processes are undertaken by Internal Audit.

19 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) CREDIT RISK (CONTINUED)

Exposure to credit risk

31 December 2017	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment in sukuk	Other financial assets	Total
Impaired:						
Grade 8-10 Impaired	-	55,045	5,926	1,564	-	62,535
Unrated	-	-	-	-	5,869	5,869
Allowance for impairment	-	(6,730)	(79)	(1,417)	(997)	(9,223)
Carrying amount	-	48,315	5,847	147	4,872	59,181
Past due but not impaired:						
Grade 1-6 Low-Fair Risk	-	19,965	8,432	-	-	28,397
Grade 7 Watch list	-	8,690	10,599	-	-	19,289
Past due comprises:						
Up to 30 days	-	18,235	10,512	-	-	28,747
30-60 days	-	7,332	2,793	-	-	10,125
60-90 days	-	3,088	5,726	-	-	8,814
Carrying amount	-	28,655	19,031	-	-	47,686
Neither past due nor impaired:						
Grade 1-6 Low-Fair Risk	33,969	272,260	79,612	113,200	-	499,041
Grade 7 Watch list	-	8,641	2,345	-	-	10,986
Unrated	-	-	-	-	10,834	10,834
Carrying amount	33,969	280,901	81,957	113,200	10,834	520,861
Less:						
Collective impairment provisions	-	(3,367)	(1,052)	-	-	(4,419)
Total	33,969	354,504	105,783	113,347	15,706	623,309

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FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) CREDIT RISK (CONTINUED) Exposure to credit risk (Continued)

31 December 2016	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rental receivable)	Investment in sukuk	Other financial assets	Total
Impaired:						
Grade 8-10 Impaired	-	42,978	2,793	1,733	-	47,504
Unrated	-	-	-	-	6,740	6,740
Allowance for impairment	-	(15,165)	-	(1,021)	(1,957)	(18,143)
Carrying amount	-	27,813	2,793	712	4,783	36,101
Past due but not impaired:						
Grade 1-6 Low-Fair Risk	-	28,511	10,934	-	-	39,445
Grade 7 Watch list	-	2,512	1,716	-	-	4,228
Past due comprises:						
Up to 30 days	-	24,490	10,487	-	-	34,977
30-60 days	-	5,521	1,113	-	-	6,634
60-90 days	-	1,012	1,050	-	-	2,062
Carrying amount	-	31,023	12,650	-	-	43,673
Neither past due nor impaired:						
Grade 1-6 Low-Fair Risk	78,714	286,995	79,697	73,442	-	518,848
Grade 7 Watch list	-	12,950	1,231	-	-	14,181
Unrated	-	-	-	-	9,713	9,713
Carrying amount	78,714	299,945	80,928	73,442	9,713	542,742
Less:						
Collective impairment provisions	-	(3,404)	(959)	-	-	(4,363)
Total	78,714	355,377	95,412	74,154	14,496	618,153

Impaired financial assets

Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure and these fall under risk grades 8, 9 and 10, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

Past due but not impaired exposures

The exposure pertains to financing assets where contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of subsequent collections, the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

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31. RISK MANAGEMENT (CONTINUED) CREDIT RISK (CONTINUED)

Renegotiated facilities

During the year, facilities of BD 25,160 thousands (2016: BD 28,471 thousand) were renegotiated, out of which BD 2,000 thousand (2016: BD 15,047 thousand) are classified as neither past due nor impaired as of 31 December 2017. The renegotiated terms usually require settlement of profits accrued till date on the facility and/or part payment of the principal and/or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD. Of the total past due facilities of BD 117,168 thousand (2016: BD 74,279 thousand) only instalments of BD 13,352 thousand (2016: BD 20,142 thousand) are past due as at 31 December 2017.

Allowances for impairment

The Bank makes provisions for impairment on individual assets classified under grades 8,9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves and consideration of the value of the collateral securities available. On a collective basis, the Bank has provided for impairment losses based on management's judgment of the extent of losses incurred but not identified based on the current economic and credit conditions.

Non-accrual basis

Bank classifies financing facility/Sukuk as non-accrual status, if the facility / Sukuk is past due greater than 90 days or there is reasonable doubt about the collectability of the receivable amount. The profits on such facilities are not recognized in the income statement until there are repayments from the borrower or the exposure is upgraded to regular status.

Write-off policy

The Bank writes off an asset/security balance (net of any related allowances for impairment losses) when it determines that the asset/security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. During the year, the Bank has written off financing facilities amounting to BD 13,228 thousand (2016: BD 2,806 thousand) which were fully impaired. The Bank has recovered BD 38 thousand from a financing facility written off in previous years (2016: 2,366).

Collaterals

The Bank holds collateral against financing assets and receivables from assets acquired for leasing in the form of mortgage/pledge over property, listed securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated periodically, generally at annual intervals. Collateral generally is not held against exposure to other banks and financial institutions. An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable. The collateral values considered for disclosure are restricted to the extent of the outstanding exposures.

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31. RISK MANAGEMENT (CONTINUED) CREDIT RISK (CONTINUED) Collaterals (Continued)

	As at 31 December 2017			As at 31 December 2016		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Against impaired						
Property	28,545	5,844	34,389	14,585	2,785	17,370
Other	2,175	-	2,175	3,222	-	3,222
Against past due but not impaired						
Property	23,193	21,428	44,621	27,620	17,910	45,530
Other	5,182	-	5,182	2,110	-	2,110
Against neither past due nor impaired						
Property	94,368	78,575	172,943	94,323	77,404	171,727
Equities	-	-	-	398	-	398
Other	25,566	20	25,586	32,243	-	32,243
Total	179,029	105,867	284,896	174,501	98,099	272,600

The average collateral coverage ratio on secured facilities is 126.86% at 31 December 2017 (31 December 2016: 114.47%).

For analysis of concentration of total assets and liabilities refer note 29.

Further, for financing assets and assets acquired for leasing the Bank monitors concentrations of credit risk by sector and by geographic location.

12 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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31. RISK MANAGEMENT (CONTINUED) CREDIT RISK (CONTINUED) Collaterals (Continued)

An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by Sector	As at 31 December 2017			As at 31 December 2016		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
Banking and finance	11,011	-	11,011	12,358	-	12,358
Real estate	39,771	105,715	145,486	59,457	94,488	153,945
Construction	35,917	-	35,917	28,788	-	28,788
Trading	90,691	-	90,691	99,777	-	99,777
Manufacturing	45,090	-	45,090	39,389	-	39,389
Others	132,024	68	132,092	115,608	924	116,532
Total carrying amount	354,504	105,783	460,287	355,377	95,412	450,789

Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from RMD.

LIQUIDITY RISK

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Bank's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The daily liquidity position is monitored by FCD. The Bank has in place a Liquidity Contingency Plan, the elements of which are periodically tested. Tools for implementation of regular stress testing under various scenarios are in place. All liquidity policies and procedures are subject to review by ALCO and approval by appropriate authorities. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO members.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) LIQUIDITY RISK (CONTINUED)

Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and bank balances and placements with financial Institutions and investments in sukuk net of sukuk pledged against medium-term borrowing less placements from financial institution, and deposits comprise current accounts, placements from non-financial institutions and individuals, and equity of investment account holders.

Details of the reported Bank ratio of net liquid assets to deposits and customers current accounts at the reporting date and during the reporting period were as follows:

	2017 %	2016 %
At 31 December	9.3	25.81
Average for the period	18.26	20.26
Maximum for the period	29.97	26.21
Minimum for the period	5.15	11.81

For maturity profile of assets and liabilities refer note 28.

MARKET RISK

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income, future cash flows or the value of its holdings of financial instruments. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

The Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure and profit rate gap.

The Bank does not do any trading in foreign exchange. The Bank does not engage in proprietary trading of foreign exchange derivatives. All foreign exchange income/ losses arising out of customer transactions and revaluation of statement of financial position assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rests with the Treasury department.

Overall authority for market risk management is vested with ALCO. The RMD is responsible for the development of detailed risk management policies (subject to review and approval by appropriate approval authorities) and the Financial Control Department is responsible for the day-to-day review of their implementation.

19 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) MARKET RISK (CONTINUED)

Exposure to profit rate risk–non–trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

A summary of the Bank's profit rate gap position at 31 December 2017 is as follows:

31 December 2017	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	32,921	-	1,048	-	-	33,969
Financing assets	51,219	12,275	53,402	62,832	174,776	354,504
Assets acquired for leasing (including lease rental receivable)	-	7	-	7,777	97,999	105,783
Investments securities (sukuk)	-	-	284	147	112,916	113,347
Total profit rate sensitive assets	84,140	12,282	54,734	70,756	385,691	607,603
Liabilities and investment accounts						
Placements from financial institutions	91,652	14,319	11,505	6,789	-	124,265
Medium-term borrowing	-	-	-	41,308	-	41,308
Placements from non-financial institutions and individuals	7,630	9,660	24,606	19,463	-	61,359
Customers' current accounts	1,286	-	-	-	-	1,286
Equity of investments account holders	190,691	66,559	88,789	13,778	1	359,818
Total profit rate sensitive liabilities and investment accounts	291,259	90,538	124,900	81,338	1	588,036
Profit rate gap	(207,119)	(78,256)	(70,166)	(10,582)	385,690	19,567

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) MARKET RISK (CONTINUED)

31 December 2016	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	77,686	-	1,028	-	-	78,714
Financing assets	26,154	16,977	40,784	81,503	189,959	355,377
Assets acquired for leasing (including lease rental receivable)	148	7	13	1,354	93,890	95,412
Investments securities (sukuk)	74,154	-	-	-	-	74,154
Total profit rate sensitive assets	178,142	16,984	41,825	82,857	283,849	603,657
Liabilities and investment accounts						
Placements from financial institutions	44,234	-	-	14,845	-	59,079
Placements from non-financial institutions and individuals	16,270	15,045	53,982	14,447	905	100,649
Customers' current accounts	1,930	-	-	-	-	1,930
Equity of investments account holders	216,220	88,076	84,536	15,819	-	404,651
Total profit rate sensitive liabilities and investment accounts	278,654	103,121	138,518	45,111	905	566,309
Profit rate gap	(100,512)	(86,137)	(96,693)	37,746	282,944	37,348

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

	100bp parallel increase / decrease	50bp increase / decrease
At 31 December 2017	±196	±98
At 31 December 2016	±373	±187

Overall non-trading profit rate risk positions are managed by Treasury department, which uses short term investment securities, placement with banks and placement from banks to manage the overall position arising from the Bank's non-trading activities.

12 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) MARKET RISK (CONTINUED)

Exposure to foreign exchange risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group had the following significant net exposures denominated in foreign currency as of 31 December.

	2017 BHD Equivalent	<i>2016 BHD Equivalent</i>
US Dollars*	14,237	(23,085)
Other GCC Currencies *	(7,707)	26,783
Euros	(297)	3,580
Australian Dollars	4,607	4,608
Kuwaiti Dinars	3,544	3,074
Sterling Pounds	480	984
Indian Rupee	9	7

(*) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahrain Dinars and other GCC currencies except for Kuwaiti Dinars are effectively pegged to the US Dollars.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus/minus increase in exchange rates, for currencies other than US Dollars, other GCC currencies.

An analysis of the Bank's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2017 BHD Equivalent	<i>2016 BHD Equivalent</i>
Euros	±15	±179
Australian Dollars	±230	±230
Kuwaiti Dinars	±177	±154
Sterling Pounds	±24	±49
Indian Rupees	-	-

Exposure to other price risks—non-trading portfolios

Credit spread risk on debt securities is subject to regular monitoring by RMD, but is not currently significant in relation to the overall financial position of the Bank.

The Group's unquoted equity securities carried at cost are exposed to risk of changes in equity values. Refer to note 21 for significant estimates and judgments in relation to impairment assessment of unquoted equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment and Credit Committee.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED)

OPERATIONAL RISK

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the bank. The Bank already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

The Bank has completed conducting one cycle of Risk Control Self-Assessment (RCSA) of Operational risk for majority of the departments of the Bank to identify the important Key Risk Areas, Key Risk Indicators and Key Risk Triggers. Furthermore for the remaining departments Key Risk Areas have been identified and the next process will be the identification of Key Risk Indicators and Key Risk Triggers. The RCSA process is a continuous process and will be conducted at regular frequencies across the Bank. It will be an annual process to review all the KRI's. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Bank is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

CAPITAL MANAGEMENT

The Central Bank of Bahrain (CBB) sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The capital adequacy regulations of CBB is based on the principles of Basel III of the IFSB guidelines.

The Bank's regulatory capital is analysed into two tiers:

- *Tier 1 capital: includes CET1 and AT1.*

CET1 comprise of ordinary share capital that meet the classification as common shares for regulatory purposes, disclosed reserves including share premium, general reserves, legal / statutory reserve, common shares issued by consolidated banking subsidiaries of the Bank and held by third parties, retained earnings after regulatory adjustments relating to goodwill and items that are included in equity which are treated differently for capital adequacy purposes.

AT1 comprise instruments issued by consolidated banking subsidiaries of the Bank held by third parties which meet the criteria of AT1, and regulatory adjustments applied in calculation of AT1.

- *Tier 2 capital, includes instruments issued by the Bank that meet the criteria for inclusion in Tier 2 capital, stock surplus resulting from issue of Tier 2 capital, instruments issued by consolidated banking subsidiaries of the Bank held by third parties that meet the criteria for inclusion in Tier 2, general provisions held against unidentified losses on financing and qualify for inclusion within Tier 2, asset revaluation reserve from revaluation of fixed assets and instruments purposes and regulatory adjustments applied in the calculation of Tier 2 capital.*

The regulatory adjustments are subject to limits prescribed by the CBB requirements, these deductions would be effective in a phased manner through transitional arrangements from 2016 to 2018. The regulations prescribe higher risk weights for certain exposures that exceeds materiality thresholds. These regulatory adjustments required for certain items such as goodwill on mortgage service right, deferred tax assets, cash flow hedge reserve, gain on sale of related securitization transactions, defined benefit pension fund assets and liabilities, investment in own shares and reciprocal cross holdings in the capital of Banking and financial entities, investment in the capital of Banking and financial entities that are outside the scope of regulatory consolidation and where the Bank does not own more than 10% of issued common shares capital of the entity and significant investments in the capital of banking and financial entities that are outside the scope of regulatory consolidation.

As at 31 December 2017 the Bank has made regulatory adjustments of BD 11,325 thousand (2016: 10,386 thousand) in line with the CBB requirements.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

19 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017 / BD 000'S

31. RISK MANAGEMENT (CONTINUED) CAPITAL MANAGEMENT (CONTINUED)

The Bank's regulatory capital position at 31 December was as follows:

	31 December 2017	31 December 2016
Total risk weighted exposure	683,784	628,875
Tier 1 capital:		
- CET 1 capital prior to regulatory adjustments	123,141	121,462
- Less: regulatory adjustments	(11,325)	(10,386)
CET 1 after regulatory adjustments	111,816	111,076
AT 1	-	-
Tier 2 capital:	4,419	4,362
Total regulatory capital	116,235	115,438
Total regulatory capital expressed as a percentage of total risk weighted assets	17.00%	18.36%
Liquidity coverage ratio	111.99%	154.25%
Net stable funding ratio	196.01%	80.80%
Leverage ratio	19.02%	19.92%

The Bank has complied with all externally imposed capital requirements throughout the year.

Capital allocation

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board.

32. COMMITMENTS

The commitments contracted in the normal course of business of the Bank:

	2017	2016
Undrawn commitments to extend finance	48,747	65,797
Financial guarantees	18,390	22,669
	67,137	88,466

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2017 due to the performance of any of its projects.

33. SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations.

34. COMPARITIVES

Certain prior year amounts have been regrouped to conform the current year's presentation. Such regrouping did not affect previously reported profit for the year or owner's equity.

13 RISK MANAGEMENT DISCLOSURES

**(Based on Basel 3 and IFSB guidelines)
31 December 2017**

These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, and Volume II for Islamic Banks. To avoid any duplication, information required under PD module but already disclosed in other sections of annual report has not been reproduced. These disclosures are part of the annual report for the year ended 31 December 2017 and should be read in conjunction with the consolidated financial statements for the year ended 31 December 2017 and other sections of the annual report.

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RISK MANAGEMENT DISCLOSURES

EXECUTIVE SUMMARY

The Central Bank of Bahrain's ("CBB") Basel III guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2016. Banks are required to maintain minimum capital adequacy ratio of 12.5% on a consolidated basis [i.e. CET1 – 6.5%, AT1-1.5%, Tier 2 – 2% and CCB – 2.5%] and a capital adequacy ratio of 8% on a solo basis [i.e. CET1 – 4.5%, AT1 – 1.5% and Tier 2 – 2%]. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports, of the CBB Rule Book, Volume II for Islamic Banks. Section PD-1.3: Disclosures in Annual Reports. Section PD-1.3 reflects the requirements of Basel II - Pillar III and the Islamic Financial Services Board's ("IFSB") recommended disclosures for Islamic banks and PD 3.1.6 highlights the requirement to make quantitative disclosures described in PD-1.3 on their web site along with the yearly financial statements.

The disclosures in this report are in addition to or in some cases, serve to clarify the disclosures set out in the consolidated financial statements for the year ended 31 December 2017, presented in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"). To avoid any duplication, information required under PD module but already disclosed in other sections of the annual report has not been reproduced in these disclosures.

All figures presented in this section are reported in Bahraini Dinars (in thousand) and are as of 31 December 2017 unless otherwise stated.

Khaleeji Commercial Bank BSC ("the Bank" or "KHCB") has adopted the Standardised Approach for Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk to determine its capital requirements, details of which are given in section 2. This section contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on risk components and capital adequacy.

The Bank's common equity tier I (CET1), Additional tier I (AT1) and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel III framework.

The Banks total risk weighted assets as at 31 December 2017 amounted to BD 685,413 thousand. Credit risk accounted for 89.8%, market risk 1.3% and operational risk 8.9% of the total risk weighted assets. Common equity tier I and total regulatory capital were BD 111,816 thousand and BD 116,235 thousand respectively as at 31 December 2017.

At 31 December 2017, Bank's CET1, AT1 and total adequacy ratios were 16.31% and 16.96% respectively.

13 RISK MANAGEMENT DISCLOSURES

1. GROUP STRUCTURE

The Bank operates under a retail banking license granted by the CBB on 20 October 2003. The Bank has 6 subsidiaries. These are not significant to the Bank. The subsidiaries set-up is primarily special purpose entities with nominal capital to execute specific investment transactions. The subsidiaries qualify as commercial entities as per the CBB guidelines and are risk weighted as investments for capital adequacy computation purposes, except for one entity, Hawafiz Khaleeji Management Company BSC (c), which was consolidated for capital adequacy computation.

2. INTRODUCTION TO BASEL III & RISK MANAGEMENT

The CBB has mandated that the Basel Committee on Banking Supervision's ("Basel Committee"), Basel III capital adequacy framework is applicable to all banks incorporated in the Kingdom of Bahrain from 1 January 2015. The Bank has accordingly taken steps to comply with these requirements. The Basel III framework is intended to strengthen risk management practices and processes within the financial institutions.

CBB's capital adequacy framework is based on three pillars, consistent with the Basel III framework adopted by the Basel Committee, as follows:

- Pillar I: calculation of the risk weighted assets ("RWA" or "RWA's") and capital requirement.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process ("ICAAP").
- Pillar III: rules for disclosure of risk management and capital adequacy information.

Pillar I

Pillar I defines the regulatory minimum capital requirements for each bank to cover the credit risk, market risk and operational risk inherent in its business model. It also defines the methodology for measurement of these risks and the various elements of qualifying capital. The capital adequacy ratio is calculated by dividing the regulatory capital base by total RWA's. CBB has mandated that the ratio be maintained at a minimum of 12% and has set a trigger ratio of 12.5%. If the capital adequacy ratio falls below 12.5%, additional prudential reporting requirements apply, and a formal action plan to restore the ratio above the trigger level is to be formulated and submitted to the CBB.

The table below summarizes the Pillar I risks and the approach used by the Bank to calculate the RWA's in each case in accordance with the CBB's Basel III capital adequacy framework:

Risk Type	Approach used by the Bank
Credit Risk	Standardised Approach
Market Risk	Standardised Approach
Operational Risk	Basic Indicator Approach

Pillar II

Pillar II defines the process of supervisory review of an institution's risk management framework and, ultimately its capital adequacy.

Pillar II comprises two processes:

- An Internal Capital Adequacy Assessment Process ("ICAAP"), and
- A supervisory review and evaluation process.

The Bank has in place ICAAP procedures for computation of economic capital for all risks including those not covered under Pillar I. The Bank regularly monitors its internal capital adequacy ratio to ensure that there is adequate cover for all risks faced by the Bank.

13 RISK MANAGEMENT DISCLOSURES

2. INTRODUCTION TO BASEL III & RISK MANAGEMENT (CONTINUED)

Pillar III

Pillar III complements the other two pillars and focuses on enhanced transparency in disclosure of information by the Banks to promote better market discipline. The information to be disclosed covers all areas including business performance, capital adequacy, risk management, etc. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move towards more advanced forms of risk management.

In April 2008, CBB published a paper covering the detailed disclosure requirements to be followed by licensed banks in Bahrain to be in compliance with Pillar III under the Basel II framework. This document is prepared in accordance with these directives.

2.1 The risk management function

The Board of Directors has overall responsibility for risk management in the Bank. The Board lays down the risk management policies of the Bank and quantifies its risk appetite through appropriate definitions of various risk limits and tolerances. The Board discharges its risk management responsibilities through the Board Audit & Risk Management Committee ("BARMC").

The Board has established an Executive Risk Management Committee ("ERMC"), which is responsible for developing and monitoring Bank risk management policies in the specified areas. The committee consists of heads of business and other functional units in the Bank and reports regularly to the BARMC. The committee meets on a monthly basis as per set agenda and its Terms of Reference covering all risk issues and policy matters.

The day to day risk management functions are performed by the Risk Management Department ("RMD") of the Bank. RMD is responsible to ensure that the policies laid down by the Board are consistently implemented across the Bank and to review the adequacy of these policies periodically. It monitors all risk taking activities and ensures that the risk limits defined by the Board are complied with. The department has specialized personnel dealing with Credit, Market, and Operational Risks. It is independent of all risk taking functions in the Bank and reports to the BARMC through the ERMC chaired by the CEO.

The Asset Liability Management Committee ("ALCO") of the Bank acting through the Treasury Department monitors the Bank's liquidity position and recommends appropriate action to the Board where necessary. There is a high level of coordination between the RMD, ERMC and ALCO.

The RMD prepares a risk overview report on a quarterly basis which covers in detail the various risks faced by the Bank and the same is discussed at the ERMC, BARMC and the Board on a quarterly basis.

The Bank considers that its overall risk management strategies have been effective throughout the reporting period.

All policies having significant impact on the overall internal control framework existing in the Bank are subject to periodic review and approval by the Board of Directors.

The RMD, together with the Internal Audit and Compliance Departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO

3.1 Capital management

The Bank's policy is to maintain a strong capital base to develop and retain investor, creditor and market confidence and to sustain business growth. The Bank recognises the impact of a high level of capital on shareholders' returns, while not losing sight of the security and market confidence afforded by a sound capital base. The Bank aims to maintain a minimum total capital adequacy ratio significantly in excess of that mandated by the CBB.

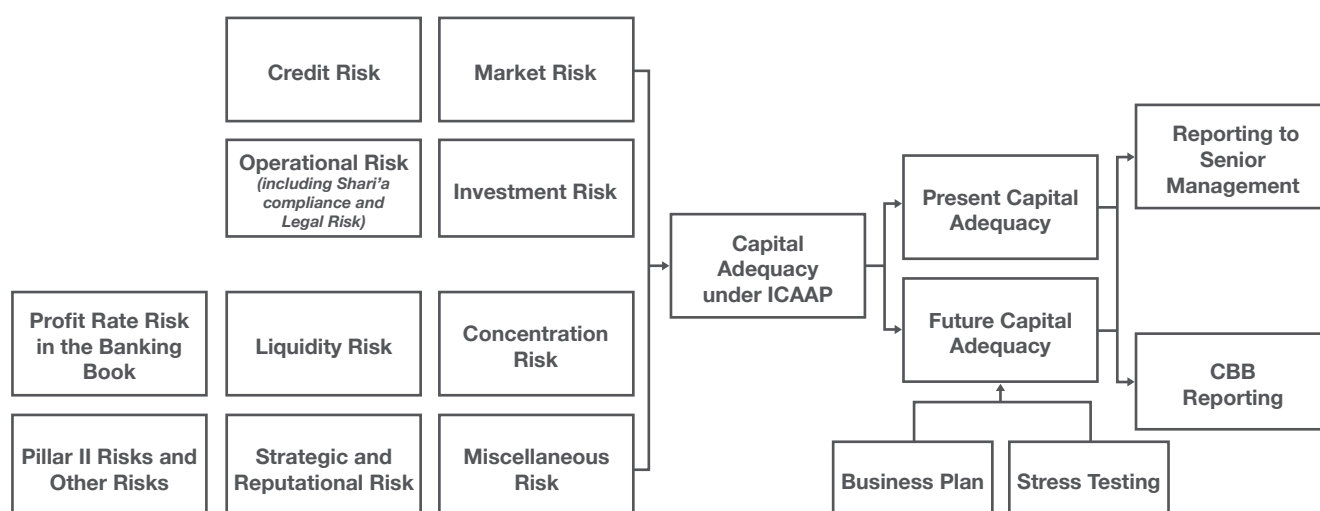
13 RISK MANAGEMENT DISCLOSURES

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.2 Internal Capital Adequacy Assessment Process (“ICAAP”)

The Bank has an established ICAAP as per the requirements under Pillar II of Basel II. ICAAP prescribes procedures and measures designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank’s risks. It also defines an appropriate level of internal capital in relation to the Bank’s overall risk profile and business plan.

ICAAP framework at the Bank



3.2.1 Risk addressed by the ICAAP

Risk Type	Metrics based on which internal capital is allocated
Credit risk Market risk Investment risk Operational risk	Regulatory capital adequacy guidelines to be used as proxy for internal capital for Pillar I risks
Liquidity risk	Maximum cumulative maturity gap, Liquidity ratio, Financing to deposit ratio
Profit rate risk (banking book)	Revaluation / sensitivity of the re-pricing gaps
Credit concentration risk	Thresholds for counterparty, country, sector exposures
Fiduciary risk	Size of off balance sheet special purpose vehicles (RIA's) & Large Investment Products
Reputational risk	Credit quality, Operational risk, Reputation related loss
Other risks (strategic, Shari'a / regulatory compliance, business cycle)	Additional capital based on Pillar I risk weighted exposures

13 RISK MANAGEMENT DISCLOSURES

BD 000's

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.3 Statement of Financial position under the regulatory scope of consolidation

The table below shows the link between the statement of financial position in the published financial statements (accounting statement of financial position) and the regulatory statement of financial position.

	<i>Statement of Financial position as in published financial statements</i>	<i>Statement of Financial position as per Regulatory Reporting</i>	<i>Reference</i>
ASSETS			
Cash and bank balances	75,787	75,780	
Placements with financial institutions	33,969	33,969	
Gross Financing Assets	357,871	360,774	a
Less: General Provision	(3,367)	-	b
Net Financing assets	354,504	360,774	a
Investment in sukuk	113,347	113,347	
Assets acquired for leasing	97,193	97,193	
Gross Lease rentals receivables	9,642	9,642	
Less: General Provision	(1,052)	-	c
Net Gross Lease rental receivables	8,590	9,642	
Investment in equity securities	52,203	52,203	
Of which related to equity investment in financial entities	13,148	13,148	
Of which related to CET1	1,113	1,113	d
Of which related to other investments	37,942	37,942	
Investment in real estate	20,163	18,519	a
Development property	6,003	-	a
Other assets	15,706	15,890	a
Property and equipment	7,755	7,755	
Total Assets	785,220	785,072	
LIABILITIES			
Placements from financial institutions	124,265	126,805	a
Placements from non-financial institutions and individuals	61,359	61,359	
Customers' current accounts	74,833	72,458	a
Medium-term borrowing	41,308	41,308	
Other liabilities	7,953	5,976	a
Total liabilities	309,718	307,906	
Equity of investment account holders	359,818	359,818	
OWNERS' EQUITY			
Share capital	105,000	105,000	e
Statutory reserve	8,159	8,159	f
Treasury shares	(10,212)	(10,212)	g
Employee share incentive scheme	(70)	(70)	h
Retained earnings	10,162	10,052	i
Total equity attributable to shareholders of the parent	113,039	112,929	
Collective impairment provision which qualify as capital	-	4,419	b+c
Non-controlling interest	2,645	-	a
Total liabilities, equity of investment account holders and owners' equity	785,220	785,072	

13 RISK MANAGEMENT DISCLOSURES

BD 000's

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.4 Composition of Capital as at 31 December 2017

	<i>Component of regulatory capital</i>	<i>Amounts subject to pre-2015 treatment</i>	<i>Source based on reference letters of the statement of financial position under the regulatory scope of consolidation</i>
Common Equity Tier 1: Instruments and reserves			
Directly Issued qualifying common share capital plus related stock surplus	113,089	-	e+g+h
Retained earnings	10,052	-	i
Common Equity Tier 1 capital before regulatory adjustment	123,141	-	
Common Equity Tier 1 capital: regulatory adjustments			
Investment in own shares	10,212	-	g
Investment in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	1,113	-	d
Total regulatory adjustment to Common equity Tier 1	11,325	-	
Common Equity Tier 1 capital (CET1)	111,816	-	
Additional Tier 1 capital: Instruments			
Additional Tier 1 capital before regulatory adjustments	-	-	
Additional Tier 1 capital: regulatory adjustments			
Total regulatory adjustment to additional Tier 1 capital	-	-	
Additional Tier 1 capital (AT1)	-	-	
Tier 1 capital (T1 = CET1 + AT1)	111,816	-	
Tier 2 capital: instruments and provisions			
Provisions	4,419	-	b+c
Tier 2 capital before regulatory adjustments	4,419	-	
Tier 2 capital: regulatory adjustments			
Total regulatory adjustment to Tier 2 capital	-	-	
Tier 2 capital (T2)	-	-	
Total Capital (TC = T1 + T2)	116,235	-	
Total risk weighted assets	685,413	-	

13 RISK MANAGEMENT DISCLOSURES

BD 000's

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.4 Composition of Capital as at 31 December 2017 (Continued)

	Component of regulatory capital	Amounts subject to pre-2015 treatment	Source based on reference letters of the statement of financial position under the regulatory scope of consolidation
Capital ratios and buffers			
Common Equity Tier 1 (as a percentage of risk weighted assets)	16.31%	-	
Tier 1 (as a percentage of risk weighted assets)	16.31%	-	
Total capital (as a percentage of risk weighted assets)	16.96%	-	
Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB buffer requirement, expressed as a percentage of risk weighted assets)	9.00%	-	
of which: capital conservation buffer requirement	2.50%	-	
of which: bank specific countercyclical buffer requirement	N/A	-	
of which: G-SIB buffer requirement	N/A	-	
Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	16.31%	-	
National minima including CCB (where different from Basel III)			
CBB Common Equity Tier 1 minimum ratio	9.00%	-	
CBB Tier 1 minimum ratio	10.50%	-	
CBB total capital minimum ratio	12.50%	-	
Applicable caps on the inclusion of provisions in Tier 2			
Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	4,419	-	b+c

3.5 Unconsolidated legal entities for regulatory purposes

- a Legal entities that are included within the accounting scope of consolidation but excluded from the regulatory scope of consolidation:

Legal Entity name	Entity classification as per CBB Rules & Guidelines	Treatment by the Bank for regulatory purposes	Extracts of financial information as at 31 December 2017 (Amount in BD 000's)	
			Total assets	Total equity
Harbour West 2 Real Estate SPC	Commercial entity	Risk weighted (look through approach)	9,757	9,757
Harbour West 4 Real Estate SPC	Commercial entity	Risk weighted (look through approach)	6,042	6,042
Eqarat Al Khaleej	Commercial entity	Risk weighted	4,773	795
Surooh LTD	Commercial entity	Risk weighted	6,514	2,935
True Horse Real Estate L.L.C.	Commercial entity	Risk weighted (look through approach)	5,090	5,090

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RISK MANAGEMENT DISCLOSURES

BD 000's

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.6 Disclosure template for main feature of regulatory capital instruments

1.	Issuer	Khaleeji Commercial Bank B.S.C
2.	Unique identifier	KHCB
3.	Governing law(s) of the instrument	All applicable laws and regulations of the Kingdom of Bahrain
Regulatory treatment		
4.	Transitional CBB rules	Common Equity Tier 1
5.	Post-transitional CBB rules	Common Equity Tier 1
6.	Eligible at solo/group/group & solo	Group and solo
7.	Instrument type (types to be specified by each jurisdiction)	Equity Shares
8.	Amount recognised in regulatory capital (Currency in mil, as of most recent reporting date)	BD 105 million
9.	Par value of instrument	BD 0.100
10.	Accounting classification	Shareholders' Equity
11.	Original date of issuance	Various
12.	Perpetual or dated	Perpetual
13.	Original maturity date	No Maturity
14.	Issuer call subject to prior supervisory approval	No
15.	Optional call date, contingent call dates and redemption amount	Not applicable
16.	Subsequent call dates, if applicable	Not applicable
Coupons / dividends		
17.	Fixed or floating dividend/coupon	Dividend as decided by the Shareholders
18.	Coupon rate and any related index	Not applicable
19.	Existence of a dividend stopper	Not applicable
20.	Fully discretionary, partially discretionary or mandatory	Fully discretionary
21.	Existence of step up or other incentive to redeem	No
22.	Noncumulative or cumulative	Non-cumulative
23.	Convertible or non-convertible	Non-convertible
24.	If convertible, conversion trigger (s)	Not applicable
25.	If convertible, fully or partially	Not applicable
26.	If convertible, conversion rate	Not applicable
27.	If convertible, mandatory or optional conversion	Not applicable
28.	If convertible, specify instrument type convertible into	Not applicable
29.	If convertible, specify issuer of instrument it converts into	Not applicable
30.	Write-down feature	No
31.	If write-down, write-down trigger(s)	Not applicable
32.	If write-down, full or partial	Not applicable
33.	If write-down, permanent or temporary	Not applicable
34.	If temporary write-down, description of write-up mechanism	Not applicable
35.	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Not applicable
36.	Non-compliant transitioned features	No
37.	If yes, specify non-compliant features	Not applicable

13 RISK MANAGEMENT DISCLOSURES

BD 000's

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.7 Capital structure, minimum capital requirements and capital adequacy

Eligible capital	31 December 2017
Common Equity Tier 1 (CET1)	
Issued and fully paid ordinary shares	105,000
Less: Employee stock incentive program funded by the bank (outstanding)	(70)
Statutory reserve	8,159
Retained earnings	10,052
Total CET1 capital prior to the regulatory adjustments	123,141
Less: Investment in own shares	(10,212)
Less: Investments in financial entities where ownership is < 10% of the issued common share capital (amount above 10% CET1a)	(1,113)
Total Common Equity Tier 1 capital after the regulatory adjustments	111,816
Other Capital	
AT1	-
General financing loss provision - (Tier 2)	4,419
Total available AT1 & T2 Capital	4,419
Total Capital	116,235
RISK WEIGHTED ASSETS	
Credit risk weight exposures	615,654
Market risk weight exposures	8,638
Operational risk weight exposures	61,121
Total risk weighted assets	685,413
Capital adequacy ratio (CET1 and T1)	16.31%
Capital adequacy ratio (Total capital)	16.96%

The above capital adequacy ratios are calculated by dividing the respective regulatory capital base by the total RWA's.

Risk weighted assets

Credit risk

For regulatory reporting purposes, the Bank calculates the capital requirements for credit risk based on the standardised approach. Under this approach, the on and off-balance sheet credit exposures are assigned risk weights based on the type of counterparty, type of the exposure, and source of funding (equity of investment account holders ("IAH") or own funds). Further for capital adequacy computations, 100% of the RWA's is reckoned for self-financed assets while only 30% is considered for assets funded through equity of IAH. The risk weights for types of counterparties and exposures are prescribed by CBB.

Market risk

The Bank uses the standardised approach to measure market risk. Market risk for the Bank is primarily on account of the foreign exchange exposures that are considered as specific risks. As per the CBB guidelines, capital for foreign exchange risk is computed at 8% of overall net open foreign currency positions of the Bank and this is multiplied by 12.5 to derive the market RWA's.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

3. CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (CONTINUED)

3.7 Capital structure, minimum capital requirements and capital adequacy (Continued)

Operational risk

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the CBB Capital Adequacy Module for Islamic Banks. According to this approach, the Bank's average gross income for the past three financial years is multiplied by a fixed coefficient alpha of 15% set by the CBB to arrive at the capital required and a multiple of 12.5 is used to arrive at the RWA's that are subject to capital charge.

Break-up of capital requirement in accordance with the Capital Adequacy Module of the CBB for the year ended 31 December 2017 is as follows:

Exposure classification	Exposure			Risk Weighted Assets *			Capital requirement @ 12.5%		
	Self-financed	IAH	Total	Self-financed	IAH	Total	Self-financed	IAH	Total
Cash and collection items	8,127	-	8,127	-	-	-	-	-	-
Sovereigns	26,025	107,807	133,832	-	-	-	-	-	-
Banks	-	58,430	58,430	-	5,705	5,705	-	713	713
PSEs Treated as Sovereigns	-	³ 21,701	21,701	-	4,428	4,428	-	554	554
Corporates	164,598	160,313	324,911	180,319	47,921	228,240	22,540	5,990	28,530
Past due facilities	53,189	-	53,189	77,045	-	77,045	9,631	-	9,631
Investment in equities / sukuks	24,159	-	24,159	98,236	-	98,236	12,280	-	12,280
Holdings of real estate	58,960	-	58,960	199,898	-	199,898	24,987	-	24,987
Other assets	2,103	-	2,103	2,103	-	2,102	263	-	263
Credit Risk	¹ 337,161	² 348,251	685,412	557,601	58,054	615,654	69,701	7,257	76,958
Market Risk	8,638	-	8,638	8,638	-	8,638	1,080	-	1,080
Operational Risk	61,121	-	61,121	61,121	-	61,121	7,640	-	7,640
Total	406,920	348,251	755,171	627,360	58,054	685,413	78,421	7,257	85,678

¹ Excludes credit risk mitigants of BD 118,499 thousand

² Excludes credit risk mitigants of BD 11,567 thousand

³ Includes exposure of BD 2,850 thousand with zero risk weight

* For capital adequacy computations, 100% of the RWA's is reckoned for self-financed assets while only 30% is considered for assets funded through equity of IAH.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK

4.1 Credit risk management

Credit Risk is the risk that counterparty fails to meet its obligations in accordance with agreed terms and conditions. The major sources of credit risk in the Bank are under the following classes of assets:

- Placements with financial institutions,
- Financing assets,
- Assets acquired for leasing (including lease rentals receivable), and
- Investments in Sukuk.

For the purpose of capital adequacy computation (as well as certain other tables below) the following have also been considered as a part of credit risk:

- Investments in quoted and unquoted equity,
- Investment in real estate, and
- Other assets (including property and equipment).

The Bank has the necessary internal processes for assessing, monitoring and controlling credit risk both at the individual credit and portfolio levels. Credit limits are approved after a thorough assessment which takes into account the financial strength of the counterparty, the technical feasibility and economic viability of the business being financed, the adequacy and quality of the cash flow available for repayment, etc. in addition to availability of collateral security by way of physical assets or guarantees. The RMD reviews every credit proposal and incorporates its remarks on the proposal before the same is considered by the appropriate authority as per delegated approval levels granted by the Bank's Board of Directors.

At the portfolio level, the Board has established risk concentration limits for single counterparties and related counterparties forming a business group, geographical and economic sectors as well as exposures to counterparties related to the Bank and/or its major shareholders. The RMD regularly monitors compliance with these limits and deviations if any are reported regularly to the Senior Management, Executive Risk Management Committees and the Board of Directors.

4.2 Levels of exposure

The table below shows gross credit exposure along with average credit exposure broken down under different exposure classes as at 31 December 2017:

Gross / Average Credit Exposures	Average Exposure ¹	Gross Exposure		
		Self-financed	IAH	Total
Cash and bank balances	60,205	33,859	41,921	75,780
Placement with financial institutions	53,475	-	33,969	33,969
Financing assets	357,282	190,046	170,728	360,774
Investment in sukuk	101,926	147	113,200	113,347
Assets acquired for leasing	97,036	97,193	-	97,193
Lease rentals receivable	5,586	9,642	-	9,642
Investment in equity securities	54,576	52,203	-	52,203
Investments in associates	4,612	4,610	-	4,610
Investment in real estate	21,104	18,519	-	18,519
Development property	6,003	-	-	-
Other assets (Including property and equipment)	18,278	19,035	-	19,035
Total funded exposures	780,083	425,254	359,818	785,072
Financial guarantees	21,432	7,885	-	7,885
Undrawn commitments to extend finance	46,799	23,620	-	23,620
Total unfunded exposures ²	68,234	31,505	-	31,505

¹ Represents quarterly average balances for the year ended 31 December 2017.

² Represents unfunded exposures amounts after considering their credit conversion factors.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.3 Concentration of credit risk

4.3.1 Geographic distribution

The geographical exposure profile as at 31 December 2017 was as follows:

31 December 2017	GCC Countries	Europe	America	Asia	Australia	Total
Assets						
Cash and bank balances	61,083	2,933	11,761	10	-	75,787
Placement with financial institutions	33,969	-	-	-	-	33,969
Financing assets	337,937	16,531	-	36	-	354,504
Investment in sukuk	113,347	-	-	-	-	113,347
Assets acquired for leasing (including lease rentals receivable)	105,783	-	-	-	-	105,783
Investment in equity securities	29,279	-	-	19,256	3,668	52,203
Investment property	20,163	-	-	-	-	20,163
Development property	6,003	-	-	-	-	6,003
Other assets	14,881	15	-	810	-	15,706
Property and equipment	7,755	-	-	-	-	7,755
Total funded exposures	730,200	19,479	11,761	20,112	3,668	785,220
Financial guarantees	9,783	-	-	-	993	10,776
Undrawn commitments to extend finance	65,893	1,244	-	-	-	67,137
Total unfunded exposures	75,676	1,244	-	-	993	77,913

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.3 Concentration of credit risk (Continued)

4.3.2 Industry / sector-wise distribution

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry/ sector wise exposure as at 31 December 2017 was as follows:

31 December 2017	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	75,787	-	-	75,787
Placement with financial institutions	33,969	-	-	33,969
Financing assets *	11,011	75,688	267,805	354,504
Investment in sukuk	11,857	146	101,344	113,347
Assets acquired for leasing (including lease rentals receivable)	-	105,715	68	105,783
Investment in equity securities	13,147	35,387	3,669	52,203
Investment property	-	20,163	-	20,163
Development property	-	6,003	-	6,003
Other assets	1,050	5,781	8,875	15,706
Property and equipment	-	6,715	1,040	7,755
Total funded exposure	146,821	255,598	382,801	785,220
Financial guarantees	-	9,783	993	10,776
Undrawn commitments to extend finance	619	24,645	41,873	67,137
Total unfunded exposure	619	34,428	42,866	77,913

* Financing asset exposures have been classified based on the purpose of financing.

4.3.3 Transactions with related counterparties

Related counterparties are those entities which are related to the Bank through significant shareholding, control, or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of related counterparties, the Bank strictly follows the guidelines issued by CBB.

Detailed break up is presented in note 23 of the consolidated financial statements for the year ended 31 December 2017.

4.3.4 Exposures exceeding materiality thresholds

The Bank is required to carry out capital adjustments (deduction) for its exposure to significant investments in capital of banking and financial entities subject to certain materiality thresholds as defined in the Capital Adequacy Module ("CA Module") of the CBB Rule Book.

Further, the exposures in excess of limits prescribed by Credit Risk Management Module ("CM Module") (single obligor limit of 15% of total capital and aggregate limit for connected counterparty exposure of 25% of total capital) are subject to risk weight of 800%. For investment in a financial entity where ownership is < 10% of the issued common capital, 40% of the amount exceeding 10% of CET1 (a) is subject to deduction from CET1 (a). The following table summarises the exposures exceeding regulatory limits as of 31 December 2017:

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.3 Concentration of credit risk (Continued)

4.3.4 Exposures exceeding materiality thresholds (Continued)

Counterparty	Exposure type	Total exposure	Total exposure as a % of eligible capital	Exposures risk weighted @ 800%
Connected counterparties	Investments, financing and other assets	41,536	35.73%	12,415
Investment in financial entities	Investment in financial entities <10%	13,148	11.31%	1,855

* In line with the transitional provisions of CA module 60% of the exposure exceeding materiality threshold (BD 1,113 thousand) has been considered for regulatory capital adjustment.

4.3.5 Exposures in highly leveraged counterparties

The following balances represent the financing facilities to highly leveraged or other high risk counterparties as of 31 December 2017:

Counterparties	Gross BD '000	Provision BD '000	Net BD '000
Counterparty # 1	9,651	-	9,651

4.3.6 Residual contractual maturity of the credit portfolio and investment in sukus

The Bank's policy allows exposures up to a maximum period of 7 years for corporate customers and 25 years for retail customers with any exceptions to be approved by the Board of directors. The Bank constantly monitors the residual maturity profile of its assets to ensure that any mismatch with the maturity of its liabilities is kept within acceptable limits. The contractual residual maturity profile by type of financing contract of the Bank's credit portfolio and investment in sukus is given in the table below:

Maturity Scale	< 1 M	1 - 3 M	3 - 6 M	6M - 1Y	1 - 3Y	3 - 5Y	5 - 10Y	10 - 20Y	Over 20Y	Total
Credit portfolio:										
Murabaha	16,989	50,082	30,974	51,292	98,797	55,466	23,278	55	-	326,933
Musharaka	496	263	55	1,892	3,570	282	-	-	-	6,558
Mudharaba	-	9	27	54	206	215	625	-	-	1,136
Wakala	3,825	267	400	801	12,495	2,089	-	-	-	19,877
Istisna	-	-	-	-	-	-	-	-	-	-
Ijarah	831	1,067	1,710	3,313	20,089	14,333	29,571	30,467	4,402	105,783
Total	22,141	51,688	33,166	57,352	135,157	72,385	53,474	30,522	4,402	460,287
Investment in sukuk	64,459	-	-	-	48,888	-	-	-	-	113,347
Grand Total	86,600	51,688	33,166	57,352	184,045	72,385	53,474	30,522	4,402	573,634

The Board approved internal cap for real estate exposure at 40% of total assets. The Bank's real estate exposure as of 31 December 2017 and 2016 are within the policy limit.

4.4 Equity risk in banking book

The Bank has certain equity investments classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. For regulatory capital computation purposes, the Bank's equity investments in the banking book include unquoted equity investments, and investments in associates being non-financial entities.

Please refer to notes 2 of the consolidated financial statements for policies covering the accounting of equity holdings, including the accounting policies and valuation methodologies used, key assumptions and practices affecting valuation.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.4 Equity risk in banking book (Continued)

The RMD works alongside the Investment Department at all stages of the deal cycle, from pre-investment due diligence to exit, and provides an independent review of every transaction. An impairment assessment of investments takes place every quarter with inputs from the Investment department and RMD. Quarterly updates of investments are reviewed by the Board of Directors and are submitted to the CBB.

The Bank's equity investments are predominantly in its own products, which includes private equity and infrastructure development projects. The intent of such investments is a later stage exit along with the investors, by means of strategic sell outs at the project level or through initial public offerings. The Bank also has a strategic investment portfolio which is aligned with the long term investment objectives of the Bank.

Information on equity investments	Amount
Privately held	52,203
Dividend income	455
Revaluation Loss during the period	(2,000)

The following are the categories under which equity investments are included in the capital adequacy computations as per the requirements of the CBB rules:

Equity investments in banking book	Gross exposure		Risk weighted exposure		Capital charge @12.5%	
	Self-financed	IAH	Self-financed	IAH	Self-financed	IAH
Unlisted	15,719	-	21,932	-	2,741	-
Investments in unlisted real estate companies	28,662	-	114,648	-	14,331	-
Unquoted equity investment in excess of large exposure limit	7,822	-	62,576	-	7,822	-
Total	52,203	-	199,156	-	24,894	-

4.5 Risk grading of exposures

The Bank has an internal risk grading system for credit exposures based on a 10 point scale in which grades 8 through 10 are non-performing. Each counterparty credit exposure is assigned a risk grade based on several quantitative and qualitative factors, including financial strength, past record and availability of collateral security. The grading is done at the time of assuming an exposure and on each renewal and/or periodical review of the same. The grading sheets are prepared by the Business Department and reviewed by the RMD. Grades are continuously monitored by the Bank's Credit Administration Unit within RMD and exposures are downgraded depending on the days past due, if any based on clear criteria laid out in the Bank's credit policy. Further, the grading for corporate customers is also subject to review at least on an annual basis. Movement of grades for credit exposures is reported quarterly to the Board.

13 RISK MANAGEMENT DISCLOSURES

4 CREDIT RISK (CONTINUED)

4.5 Risk grading of exposures (Continued)

The Bank relies on credit/risk ratings for financial institutions, as they are generally rated by an ECAI, as per the following guidelines:

- The Bank will use ratings issued by ECAIs approved by the Central Bank of Bahrain (“CBB”) only. These currently comprise S&P, Moody’s, Fitch, Capital Intelligence (“C.I.”), and Islamic International Rating Agency (“IIRA”). See Ratings Mapping below for further details;
- Ratings will be used consistently for risk assessment purposes from selected ECAIs;
- The Bank will utilize the lowest rating, in case of multiple ECAIs rating for any financial institutions;
- The Bank will not use the issue specific risk rating of an un-rated financial institutions except in case of specific investment in that financing instrument or bank claim pari passu to the issuer;
- Domestic currency ratings will be used to assess claims in domestic currency while foreign currency rating would be used for foreign currency exposures;
- Short-term rating of the financial institutions cannot be used for risk assessments of un-rated long-term claims.

Different ECAIs issue different coding-references to refer to the risk rating of the financial institutions. The following rating equalization table, provided by CBB, is to be used to map the ECAIs ratings into the Bank’s internal ratings:

S&P	Moody's	Fitch	C.I.	IIRA	Internal		
					Grade	Description	
AAA	Aaa	AAA	AAA	AAA	1	Prime	Investment Grades
AA+	Aa1	AA+	AA+	AA+	2	Excellent	
AA	Aa2	AA	AA	AA	2		
AA-	Aa3	AA-	AA-	AA-	2		
A+	A1	A+	A+	A+	3	Strong	
A	A2	A	A	A	3		
A-	A3	A-	A-	A-	3		
BBB+	Baa1	BBB+	BBB+	BBB+	4	Good	
BBB	Baa2	BBB	BBB	BBB	4		
BBB-	Baa3	BBB-	BBB-	BBB-	4		
BB+	Ba1	BB+	BB+	BB+	5	Satisfactory	Non-Investment Grades
BB	Ba2	BB	BB	BB	5		
BB-	Ba3	BB-	BB-	BB-	5		
B+	B1	B+	B+	B+	6	Acceptable	
B	B2	B	B	B	6		
B-	B3	B-	B-	B-	6		
CCC+	Caa1	CCC+	C+	CCC+	7	Watch-list	
CCC	Caa2	CCC	C	CCC	7		
CCC-	Caa3	CCC-	C-	CCC-	7		
CC	Ca	CC	D	CC	7		
C	C	C	-	C	7		
D	-	D	-	D	8	Sub-standard	Classified
-	-	-	-	-	9	Doubtful	
-	-	-	-	-	10	Loss	

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RISK MANAGEMENT DISCLOSURES

4 CREDIT RISK (CONTINUED)

4.5 Risk grading of exposures (Continued)

Please refer to note 31 of the consolidated financial statements for the year ended 31 December 2017, for details of the grading profile of credit exposures of the Bank.

4.6 Past dues, impaired accounts, provisions

Customers may occasionally fail to meet their obligations to the Bank on due dates. Any amount not paid when due is classified as past due and the Bank initiates focused recovery efforts on such accounts. Any account which is past due for 30 days or more is classified as "Watch List"/ Grade 7 and clearly defined procedures are in place for follow-up and monitoring of such accounts.

However, if the account remains past due for a continuous period of 90 days it is considered as non-performing and classified as Grade 8. The Bank conducts a comprehensive review of all such accounts on a quarterly basis and where provisions are necessary; those exposures are classified as impaired. Provisions are created through income statement where necessary. Such provisions are made on the basis of expected shortfall in present value of projected future cash flows from the assets / securities and the estimates of such cash flows are done on a conservative basis.

On each year-end, the Bank reviews all financial assets classified at fair value through equity for any objective evidence that the financial assets are impaired. In case of any such evidence, the asset is revalued at lower of cost of acquisition and its estimated recoverable amount and a provision is created for the difference amount through the income statement.

For a detailed policy on impairment of financial assets, please refer to note 2 (m) of the consolidated financial statements for the year ended 31 December 2017.

For the quantitative disclosures relating to exposures which were past due or impaired as of 31 December 2017, please refer to note 31 of the consolidated financial statement for the year ended 31 December 2017.

During the year 2017, the Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In addition, the Bank has maintained a collective provision at a certain percentage of unimpaired assets based on the internal risk grades assigned to counterparties. The total collective provision thus maintained works out to approximately 1% of its financing assets, assets acquired for leasing, and lease rentals receivable. This practice is in line with the CBB requirements and the industry best practice in Bahrain.

For break-up of provisions on financing assets, sukuk, assets acquired for leasing and equity securities, please refer to notes 5, 6, 7 and 8, respectively, of the consolidated financial statement for the year ended 31 December 2017.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)**4.6 Past dues, impaired accounts, provisions (Continued)**

4.6.1 Geographical and sector-wise break-up of impairment allowances and impaired / past due accounts (financing facilities)

	<i>GCC Countries</i>	<i>Europe</i>	<i>Asia</i>	<i>Total</i>
Impaired:				
3 months to 1 year	55,027	-	-	55,027
1 year to 3 years	5,554	-	-	5,554
More than 3 years	390	-	-	390
	60,971	-	-	60,971
Less: specific impairment allowance:				
At 1 January 2017	15,165	-	-	15,165
Charge during the year	7,528	-	-	7,528
Write back during the year	(2,656)	-	-	(2,656)
Write off during the year	(13,228)	-	-	(13,228)
	6,809	-	-	6,809
Carrying amount	54,162	-	-	54,162
Past due but not impaired, including substandard:				
Up to 3 months	47,512	172	2	47,686
3 months to 1 year	-	-	-	-
More than 1 year	-	-	-	-
	47,512	172	2	47,686
Collective impairment allowance *	(4,237)	(182)	-	(4,419)

* Collective impairment allowance is allocated based on exposure excluding impaired exposures on which specific provision is maintained.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.6 Past dues, impaired accounts, provisions (Continued)

4.6.1 Geographical and sector-wise break-up of impairment allowances and impaired / past due accounts (financing facilities) (Continued)

	<i>Banks and financial institutions</i>	<i>Real estate</i>	<i>Others</i>	<i>Total</i>
Impaired:				
3 months to 1 year	-	16,082	38,945	55,027
1 year to 3 years	-	1,562	3,992	5,554
More than 3 years	-	207	183	390
	-	17,851	43,120	60,971
Less: specific impairment allowance:				
At 1 January 2017	-	4,186	10,979	15,165
Charge during the year	-	1,072	6,456	7,528
Write back during the year	-	(1,695)	(961)	(2,656)
Write off during the year	-	(1,968)	(11,260)	(13,228)
	-	1,595	5,214	6,809
Carrying amount	-	16,256	37,906	54,162
Past due but not impaired, including substandard:				
Up to 3 months	-	26,237	21,449	47,686
3 months to 1 year	-	-	-	-
More than 1 year	-	-	-	-
	-	26,237	21,449	47,686
Collective impairment allowance *	(121)	(1,769)	(2,529)	(4,419)

* Collective impairment allowance is allocated based on exposure excluding impaired exposures on which specific provision is maintained.

4.7 Renegotiated facilities

For disclosure of renegotiated facilities, please refer to note 31 of the consolidated financial statements for the year ended 31 December 2017.

4.8 Legal action and write-off of exposures

The Bank has policy for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. As of 31 December 2017, the Bank was involved in 107 litigations for recovery of dues from clients amounting to BD 17,950 thousand in addition, there were claims by 4 of the clients against the Bank amounting to BD 338 thousand in relation to restricted investment accounts and customer accounts.

The Bank has a policy that permits write-off of exposures when there is no possibility of recovery of the dues through legal and other means.

4.9 Penalties for delayed payments

In cases where customers delay the payment of dues to the Bank, the Bank has the right to collect penalties, subject to the provisions of the agreement between the customer and the Bank. The Bank recovers such penalties from customers when the amounts are significant. As per policy, such penalties are maintained in a separate account and used for charity purposes approved by the Bank's Shari'a Board.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.9 Penalties for delayed payments (Continued)

The Bank has a policy of creating a contribution for Charity and Zakah fund for any non-Islamic income earned. During the year ended 31 December 2017, an amount of BD 17 thousand was thus transferred to Charity and Zakah fund.

For quantitative disclosures, please refer to consolidated statement of sources and uses of charity and Zakah fund in the consolidated financial statements for the year ended 31 December 2017.

4.10 Credit risk mitigation

The Bank uses a variety of tools to mitigate its credit risk, the primary one being that of securing the exposure by suitable collateral security. While existence of collateral security is not a policy precondition for financing, in practice a large part of existing exposures are at least partially supported by collateralised security. The Bank has clear policies on the type of assets that can be accepted as collateral security and the mode of valuation of these assets. In general, all assets accepted as collateral are valued at least once in a year. The legal validity and enforceability of the documents used for creating these collaterals have been established by external legal experts.

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 31 December 2017 is given in the table below:

Collateral Type	Murabaha	Musharaka	Mudharaba	Wakala	Istisna	Ijara	Value of collateral ¹	Gross Exposure ²	% of cover	% of Total
Real estate	237,346	18,180	229	3,777	-	134,599	394,130	272,365	145%	58%
Listed securities	-	-	-	-	-	-	-	-	-	0%
Unlisted securities	-	-	-	-	-	-	-	-	-	0%
Bank guarantee	-	-	-	-	-	-	-	-	-	0%
Cash collateral	28,160	-	-	-	-	98	28,258	52,102	54%	11%
Others	8,478	-	-	-	-	-	8,478	25,271	34%	5%
Unsecured	-	-	-	-	-	-	-	124,680	-	26%
Total	273,984	18,180	229	3,777	-	134,697	430,866	474,418		

¹ Represents collateral values based on the last valuation carried out based on the Bank's valuation policy including collaterals which exceed the book value of facility.

² The amounts are gross of collective impairment allowance of BD 4,419 thousand and specific impairment allowance of BD 6,810 thousand.

Real estate properties are reckoned at values certified by qualified valuers. Other physical assets like machinery are valued at book value, invoice value or as certified by an outside expert. Listed securities are valued at market price while un-listed ones are carried at cost less impairment. The Bank has an approved panel of valuers for real estate property. Valuation exercise is supervised by RMD, independent of the business units.

Facilities are also often secured by personal / corporate guarantees, joint ownership of vehicles, assignment of contract proceeds, assignment of insurance policies, etc. However under the Bank's credit policy these are not treated as tangible securities and the value of such guarantees/ assignments, though significant in many cases, are taken as nil for the purpose of the above analysis.

Assets financed under Ijara Muntahia Bittamleek are considered at par with physical collateral and included under Real Estate or Others in the above calculations.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

4 CREDIT RISK (CONTINUED)

4.10 Credit risk mitigation (Continued)

The declared value of exposures in all cases is the gross exposure before any provisions. The Bank does not carry out any on or off balance sheet netting for the securities held. The Bank has not claimed any capital relief for Credit Risk Mitigation under Section CA 4.7 of the Capital Adequacy Module of CBB rule book and hence all exposures are risk weighted at their gross values for the purpose of computation of capital adequacy ratio.

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities.

4.11 Regulatory capital requirements by type of financing contracts

Financing contract	Exposure		Credit Risk Weighted Assets		Capital Requirement @ 12.5%	
	Self-financed	IAH	Self-financed	IAH	Self-financed	IAH
Murabaha	178,822	153,467	180,289	42,554	22,536	5,319
Ijara assets (including lease rentals receivable)	105,783	-	-	-	-	-
Musharaka	6,918	-	6,918	-	865	-
Mudharaba	1,137	-	1,137	-	142	-
Wakala	4,221	17,261	4,221	5,178	528	647
Istisna	-	-	-	-	-	-
Total	296,881	170,728	192,565	47,732	24,071	5,966

5 MARKET RISK

5.1 Market risk management

Market risk is the risk that changes in market prices, such as foreign exchange rates, profit rates, equity prices, and commodity prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

CBB rules require that the Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure and sukuk exposure, although this is quite limited. There is also an extent of profit rate risk arising out of mismatches in its asset liability structure. The Bank has well-defined policies approved by the Board with clear risk limits and thresholds to effectively manage its market risk.

In 2012, the Bank had commenced trading in Sukuks on a very selective basis. To begin with trading will be restricted to listed and traded sukuks issued by sovereign/ quasi sovereign entities or by other GCC issuers with an investment grade rating from Moody's or S&P. The size of the trading book at the end of the year was Nil.

The sukuk risk is monitored by marking to market of the portfolio on a daily basis. The size of the portfolio and more importantly the number of instruments is too small for any statistical model to be reliable.

The Bank has formulated a comprehensive Sukuk Trading and Sukuk Fund Participation policy duly approved by the Board of Directors. The primary objective being trading in Sukuks and participation in Sukuk funds and or other fixed income Shari'a compliant structured products as a part of Treasury Business. The policy sets clear guidelines for Sukuk Trading and participation in Sukuk funds, limits, Target market, sectors, country, tenor, Stop loss triggers and actions and reporting. The portfolio is monitored on a mark to mark basis and reported to the ALCO.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

5 MARKET RISK (CONTINUED)

5.1 Market risk management (Continued)

The ALCO committee reviews these investments as part of the overall monitoring of cash management and treasury and investment activities of the Bank.

Details on market risk management, net exposures and sensitivities are given as part of note 31 of the consolidated financial statements for the year ended 31 December 2017.

5.2 Regulatory capital allocation against market rate risk

The table below shows the market risk position for each category of the market risk as at 31 December 2017 along with the maximum and minimum values during the period:

	<i>As at 31 December</i>	<i>Max</i>	<i>Min</i>
Equity position risk	-	-	-
Market risk on trading positions in sukuk *	-	-	-
Foreign exchange risk	691	1,650	645
Commodity risk	-	-	-
Total (A)	691	1,650	645
Risk Weighted Assets (A x 12.5)	8,638	20,625	8,063
Capital requirement @ 12.5%	1,080	2,578	1,008

* Represents 30% of the exposure since these sukuk investments are allocated from IAH pool.

6 OPERATIONAL RISK

6.1 Operational risk management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems, and/ or from external events which includes but is not limited to, legal risk and Shari'a compliance risk. Operational risk is an inherent part of normal business operations. Whilst operational risk cannot be eliminated entirely, the Bank endeavors to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. Various procedures and processes used to manage operational risk including effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting.

Details on operational risk management are given as part of note 31 of the consolidated financial statements for the year ended 31 December 2017.

RMD monitors all operational processes to ensure that the Board directives are fully implemented and deviations are reported if any to the Senior Management and to the Board. The department has specialised personnel engaged in this process. The Bank has implemented an Operational Risk Management System which monitors Key Risk Indicators and controls across all major areas of operation and generates appropriate triggers as and when pre-defined risk events occur (through breach of triggers set) and also generates periodical update report to the Board and to the Management. In addition, the Bank's policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

6 OPERATIONAL RISK (CONTINUED)

6.1 Operational risk management (Continued)

The Bank's operational risk management framework includes components such as Key Risk Indicators ("KRI's"), operational loss data and Risk & Control Self-Assessment across the Bank. These are monitored periodically which helps in quickly detecting and correcting deficiencies in processes and procedures. The collected data is maintained to create a loss database which could be the starting point for a more advanced operational risk measurement approach in future.

6.2 Litigation

As of the reporting date, the Bank has no material legal contingencies including pending legal actions except as reported in Para 4.8 above. The Bank has a dedicated legal team which provides legal advice and services to all business units of the Bank.

6.3 Shari'a compliance

The Shari'a Supervisory Board ("SSB") is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that they are in compliance with the rules and principles of Islamic Shari'a. The Bank also has a dedicated internal Shari'a reviewer, who performs an ongoing review of the compliance with the fatwas and rulings of the SSB on products and processes and also reviews compliance with the requirements of the Shari'a standards prescribed by AAOIFI. The SSB reviews and approves all products and services before launching and offering to the customers and also conducts periodic reviews of the transactions of the Bank. An annual audit report is issued by the SSB confirming the Bank's compliance with Shari'a rules and principles.

6.4 Regulatory capital allocation against operational risk

The Bank uses the Basic Indicator Approach in calculating its regulatory capital requirement for operational risk.

The risk weighted assets and capital requirement for operational risk as at 31 December 2017 is as given below:

Average gross income for 3 years (A)	32,598
Operational Risk Weighted Assets (B) = A x 15% x 12.5	61,121
Capital requirement = B x 12.5%	7,640

7 OTHER RISKS

7.1 Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its financial obligations on account of a maturity mismatch between assets and liabilities. The Bank's approach to manage liquidity is to ensure that it will always have sufficient funds to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee ("ALCO"), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the bank, as well as gap limits under each time bucket of the maturity ladder. It is the Bank's policy to keep adequate level of high quality liquid assets such as inter-bank placements and sukuks to ensure that funds are available to meet maturing Mudharaba deposits, current accounts and other liabilities, as and when they fall due. The day to day management of liquidity risk is the responsibility of the Treasury Department, which monitors the sources and maturities of assets and liabilities closely, and ensures that limits stipulated by the ALCO are complied with. RMD and Financial Control Department ("FCD") monitors the liquidity position and any violations are reported to ALCO, ERM and the Board of Directors.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

7 OTHER RISKS (CONTINUED)

7.1 Liquidity risk (Continued)

For maturity profile of assets and liabilities, please refer to note 28 of the consolidated financial statements for the year ended 31 December 2017.

The following are the key liquidity ratios which reflect the liquidity position of the Bank:

	<i>Figures in %</i>				
	<i>2017</i>	<i>2016</i>	<i>2015</i>	<i>2014</i>	<i>2013</i>
Interbank assets to interbank liabilities	47.02%	162.20%	115.60%	176.87%	222.39%
Liquid assets to total assets	22.19%	27.30%	22.75%	25.23%	27.80%
Liquid assets to total deposits	35.12%	35.94%	30.65%	34.69%	38.46%
Net liquid assets to total deposits	10.07%	25.78%	20.96%	23.03%	27.50%

7.2 Profit rate risk in the banking book

The other principal risk to which the banking book is exposed, is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the RMD in its day-to-day monitoring activities.

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 200 basis points (bps) parallel fall or rise across all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

	<i>200bp parallel increase / decrease</i>
At 31 December 2017	±391
At 31 December 2016	±746

7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit market transactions (primarily interbank placements), the Bank has established a matrix of counterparty limits based on external credit rating of such counterparties. Such limits are constantly monitored by the RMD. As at 31 December 2017, the Bank did not have any open position in foreign currency risk management instruments.

7.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. To manage this risk, the Bank has established exposure limits to various geographic regions and industry sectors. Such limits are monitored by the RMD and deviations, if any, are reported to the Board on quarterly basis. As at 31 December 2017, there has been no violation of the Board approved limits under any head. For break-up of exposure geography and industry/ sector wise, please refer to notes 4.3.1 and 4.3.2 above.

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RISK MANAGEMENT DISCLOSURES

7 OTHER RISKS (CONTINUED)

7.5 Reputational risk

Reputation risk is the risk that negative perception regarding the Bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base that could have an adverse impact on liquidity or capital of the Bank. This may also lead to litigation against the bank which apart from avoidable legal expenses will also damage Bank's credibility which in turn will adversely affect business growth and profitability. Being an Islamic Bank, reputation is an important asset and one of the issues that could affect the Bank's reputation is the inability to exit from investments, lower than expected returns on investments, growth of non-performing asset portfolio and poor communication to investors. The Bank has a well-developed and coherently implemented communication strategy to cover such contingencies. The Bank also allocates additional capital for such risks under its ICAAP.

7.6 Displaced commercial risk

Displaced commercial risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by equity of investment account holders. This can be due to the return on such assets being lower than that of competitors. The Bank has adequate policies and procedures in place to identify, monitor and address all potential risks that may arise from such activities. Please refer to the section on IAH for further details.

7.7 Other risks

Other risks include strategic risk, fiduciary risks, and regulatory risks, etc. which are inherent in all business and are not easily measurable or quantifiable. The Bank's Board has overall responsibility for approving and reviewing the risk strategies and amendments to the risk policies. The Bank senior management is responsible for implementing the risk strategy approved by the Board. The management also ensures that internal systems of corporate governance and regulatory compliance for management of fiduciary and reputational risks are robust and effective. The Bank also allocates additional capital for such risks under its ICAAP.

8 PRODUCT DISCLOSURES

8.1 Product descriptions & consumer awareness

The Bank has a disclosure policy which applies to all modes of communication to the public including written, oral and electronic communications. These disclosures are made on a timely basis in a manner required by applicable local and regulatory requirements.

The Bank offers a comprehensive mix of Shari'a compliant commercial and investment banking products. This include, apart from traditional financing products, a range of innovative structured investment products like funds, repackaged investments and restricted Mudharaba's. The Investment Department of the Bank has expertise in creating innovative high-end and value added products offering a wide range of structures, expected returns, tenors and risk profiles.

Proposal for any new product is initiated by individual business lines within the Bank. The Executive Risk Management Committee ("ERMC") of the Bank reviews such proposal to ensure that the new product/ business are in line with the Bank's business and risk strategy. All new products will need the approval of the Board of Directors and the Shari'a Supervisory Board of the Bank.

Information on new products or any change in existing products will be placed on the Bank's website www.khcbonline.com and / or published in the media. Product details are also shared with customers and the general public through brochures and / or, advertisements.

8.2 Complaint handling

The Bank takes disputes and complaints from all customers very seriously. These have the potential for a breakdown in relationships and can adversely affect the Bank's reputation. Left unattended these can also lead to litigation and possible censure by the regulatory authorities. The Bank has a comprehensive policy on handling of external complaints, approved by the Board. All employees of the Bank are aware of and abide by this policy.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

8 PRODUCT DISCLOSURES (CONTINUED)

8.2 Complaint handling (Continued)

The Bank has a designated an officer for handling of all external complaints and his contact details are displayed on the website and also at the Branch and in all printed publicity materials. Complaints are normally investigated by persons not directly related to the subject matter of the complaint. The Bank endeavors to address all complaints within five working days. Wherever this is not possible, the customer is contacted directly and a time frame for rectification of his complaint is advised. A periodical report on status of complaints is also submitted to the Board.

8.3 Equity of investment account holders (IAH's)

The Bank accepts funds in the form of Mudharaba from small investors and high net worth individuals. Equity of investment account holders ("IAH") represents funds offered by customers to the Bank to be invested in a Shari'a compliant manner, at the Bank's discretion as Mudharib. All IAH accounts are on profit sharing basis, but the Bank does not guarantee any particular level of return. Any loss arising from the investment will be borne by the customer except in the case of the Bank's negligence. The Bank charges a Mudharib fee as its share of profit.

The Bank accepts IAH funds in Bahraini Dinar, US Dollar and other international and GCC currencies for maturity periods ranging from 1 month to 36 months. The Bank completes its full range of KYC due diligence prior to accepting any investment. The customer also signs a written agreement covering all terms and conditions of the investment including tenor, basis of profit allocation, early withdrawal, etc.

Since 2009, the Bank offers a savings account product called "Al-Waffer" which entitles the investors to certain prizes in cash and in kind, decided based on a raffle draws held on monthly, quarterly and annual basis apart from the normal share of profits declared and distributed after reducing the Mudharib fees.

IAH is a significant funding source for the Bank and the returns offered to investors are in line with the market. However, any shortfall in yield on the investments made out of these funds exposes the Bank to displaced commercial risk. The Bank regularly monitors rate of return offered by competitors to evaluate the expectations of its IAH's. Bank's policy also provides for whole or partial waiver of the Mudharib share of income from investments due to it, to provide a reasonable return to its investors.

The Bank comingles its own funds and IAH funds and these are invested together. The Bank has identified two pools of assets where the IAH funds are invested and the income from which is allocated to such accounts. One pool is short term in nature to meet IAH short term investment requirements. The other pool is long term in nature to meet their long term investment requirements. Out of the gross income the investor's share is computed after deducting the Mudharib share. The profit allocation schedule signed by the customer prior to investment contains the scheme of allocation of the Mudharib share. Administrative expenses incurred for management of the funds are borne directly by the Bank and are not charged separately to investment accounts. Equity of IAH's are carried at their book value.

Subject to the provisions thereof, deposits held with the Bank are covered by the Deposit Protection Scheme established by the CBB regulation concerning the establishment of a Deposit Protection Scheme and a Deposit Protection Board.

The details of income distribution to (IAH) for the last five years are given below:

	2017	2016	2015	2014	2013
Allocated income to IAH	14,884	16,286	16,933	12,843	13,315
Distributed profit	7,447	7,156	7,382	8,841	8,719
Mudharib fees *	7,437	9,130	9,551	4,002	4,596
As at 31 December					
IAH ¹	383,561	380,975	378,596	336,010	260,609
Profit Equalisation Reserve (PER)	-	-	-	-	-
Investment Risk Reserve (IRR)	-	-	-	-	-
Profit Equalisation Reserve-to-IAH (%)	-	-	-	-	-
Investment Risk Reserve-to-IAH (%)	-	-	-	-	-

¹ Represents average balance.

* Includes contribution towards deposit protection scheme.

13 RISK MANAGEMENT DISCLOSURES

BD 000's

8 PRODUCT DISCLOSURES (CONTINUED)**8.3 Equity of investment account holders (IAH's) (Continued)**

Ratio of financing of the IAH by type of IAH contracts as at 31 December 2017:

Type of IAH contracts	Ratio of financing
1 Month Mudharaba ¹	36.05%
3 Months Mudharaba	3.18%
6 Months Mudharaba	4.21%
12 Months Mudharaba	28.40%
18 Months Mudharaba	0.04%
24 Months Mudharaba	2.08%
36 Months Mudharaba	0.06%
VIP Mudharaba	25.97%
Total	100.00%

¹ Includes saving account, Al-Wafer account and Call Mudharaba accounts.

Ratio of profit distributed to PSIA by type of IAH (based on tenor):

Mudharaba Tenor	Profit distribution amount in BD					Ratio of profit paid as a percentage of total				
	2017	2016	2015	2014	2013	2017	2016	2015	2014	2013
1 Month ¹	959	834	1,009	1,304	1,488	12.9	11.6	13.7	14.7	17.1
3 Months	297	405	350	380	680	4.0	5.7	4.7	4.3	7.8
6 Months	1,012	1,346	1,330	1,455	1,100	13.6	18.8	18.0	16.5	12.6
12 Months	3,024	3,039	3,667	4,179	3,606	40.6	42.5	49.7	47.3	41.4
18 Months	6	8	2	1	-	0.1	0.1	-	-	-
24 Months	239	25	5	75	228	3.2	0.4	0.1	0.8	2.6
VIP	3	1,499	1,019	1,447	1,617	-	20.9	13.8	16.4	18.5
PER and IRR Expenses	1,907	-	-	-	-	25.6	-	-	-	-
Total	7,447	7,156	7,382	8,841	8,719	100.0	100.0	100.0	100.0	100.0

¹ Includes saving account, Al-Wafer account and Call Mudharaba accounts.

Distribution of profits by type of IAH products:

Year	Avg. profit earned from IAH assets (%age of asset)	PER set aside as a %age of IAH assets	IRR set aside as a %age of IAH assets	Mudharib fees as a %age of IAH assets	Profit paid as a %age of IAH assets
2017	3.88	-	-	1.94	1.94
2016	4.27	-	-	2.40	1.88
2015	1.95	-	-	2.57	1.99
2014	3.82	-	-	1.19	2.63
2013	5.11	-	-	1.76	3.35

13 RISK MANAGEMENT DISCLOSURES

BD 000's

8 PRODUCT DISCLOSURES (CONTINUED)

8.3 Equity of investment account holders (IAH's) (Continued)

Following are the average profit rates declared and distributed to the investors by the Bank:

	2017	2016	2015	2014	2013
1 Month Mudharaba ¹	0.64%	0.64%	0.78%	1.15%	1.12%
3 Months Mudharaba	1.79%	1.55%	1.75%	2.19%	2.98%
6 Months Mudharaba	3.07%	2.85%	2.69%	3.08%	3.64%
12 Months Mudharaba	2.81%	2.62%	2.75%	3.39%	4.27%
18 Months Mudharaba	2.73%	2.67%	2.80%	3.30%	-
24 Months Mudharaba	3.49%	3.01%	2.91%	4.92%	5.07%
36 Months Mudharaba	3.39%	-	-	-	-
VIP Mudharaba	2.39%	2.32%	2.00%	3.49%	4.09%

¹ Includes saving account, Al-Wafer account and Call Mudharaba accounts.

The Bank refers to the group of commercial Islamic banks incorporated in the Kingdom of Bahrain so as to benchmark the rate of return on IAH.

IAH account by type of assets:

The following table summarises the movement in type of assets in which the IAH funds are invested and allocated among various type of assets for the year ended 31 December 2017:

Particular	Allocation at 1 January 2017	Movement	Allocation at 31 December 2017	Proportion of total assets (%)	% of funding by IAH as at 31 December 2017
Cash and bank balances	36,967	4,954	41,921	11.65%	55.32%
Placements with financial institutions	78,714	(44,745)	33,969	9.44%	100.00%
Financing assets:	215,528	(44,799)	170,729	47.45%	48.32%
- Murabaha	215,521	(44,799)	170,729	47.45%	48.32%
- Istisna	7	(7)	-	-	-
Investment securities - Sukuk	73,442	39,757	113,199	31.46%	99.87%
Total	404,651	(44,833)	359,818		

Variations in Mudarib's agreed profit-sharing ratio from the contractually agreed ratio

	2017	2016	2015	2014	2013
Average mudarib share as a percentage of total income allocated to IAH	41.86%	53.57%	55.68%	40.26%	35.43%
Average mudarib share contractually agreed with IAH	58.80%	64.80%	62.81%	52.44%	50.97%
Average mudarib fees sacrificed by the Bank	16.94%	11.23%	7.13%	12.18%	15.54%

13 RISK MANAGEMENT DISCLOSURES

8 PRODUCT DISCLOSURES (CONTINUED)

8.4 Restricted Investment Accounts (RIA's)

The Bank offers Restricted Investment Accounts ("RIA's") to both small investors and high net worth individuals in the GCC. The Bank structures its RIA products to offer its customers an opportunity to choose from a wide range of returns, maturity periods, sectors, asset classes and risk levels. No RIA product was introduced/ marketed by the Bank in 2017.

All RIA offering documents ("Offering Document") are drafted and issued with input from the Bank's Investment Banking, Shari'a, Financial Control, Legal and Risk Management Departments to ensure that the Investors have sufficient information to make an informed decision after considering all relevant risk factors.

The Board of Directors is responsible for providing clear guidelines for the development, management and risk mitigation of its RIA investments and to ensure that there exist sound management and internal control systems to ensure that the interests of the IAH's are protected at all times. Wherever it is necessary for the Bank to establish Special Purpose Vehicles ("SPV's") for management of the investment, the Board ensures that the management of such SPV's is conducted in a professional and transparent manner by a duly appointed Board.

The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities. The Bank's Policy regarding its fiduciary responsibilities to the RIA investors and their funds, includes the following:

- Ensuring that the investment structure, Offering Documents and the investment itself are fully compliant with Islamic Shari'a principles and the CBB regulations;
- Appropriately advising investors, as part of the RIA Offering Document, of all the relevant and known risk factors and making it clear that the investment risk is to be borne by the investor before accepting the investment funds;
- Completing all necessary legal and financial due diligence on investments undertaken on behalf of the investors with the same level of rigor as the Bank requires for its own investments;
- Ensuring that the funds are invested strictly in accordance with the provisions outlined in the Offering Documents;
- Putting in place suitable resources and systems to manage and administer the investment and any necessary RIA SPV(s) and to proactively manage all risks;
- Preparing and disseminating periodical investment updates to investors on a regular basis during the tenor of the investment;
- Distributing the capital and profits to the investor in a just and equitable manner as Mudarib; and
- In all matters related to the RIA, RIA SPV(s) and the investment, act with the same level of care, good faith and diligence as the Bank would apply in managing its own investments.

Within the Bank, the above mentioned responsibilities and functions are provided, managed and monitored by qualified and experienced professionals from the Investment Banking, Shari'a, Financial Control, Legal, Investment Administration and the Risk Management Departments.

Investment update reports are prepared and disseminated by the Bank to the RIA Investors on a periodic (at least on a half yearly) basis outlining any material contracts / decisions, investment performance, distribution (if any) or exit criteria / information.

13 RISK MANAGEMENT DISCLOSURES

8 PRODUCT DISCLOSURES (CONTINUED)

8.4 Restricted Investment Accounts (RIA's) (Continued)

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					2017	2016	2015	2014	2013

RIA 1 - Safana	An investment structure designed to participate in the equity interest of Safana Investment WLL. A company established for the purpose of acquiring reclaimed land to subdivide and sell. In 2011, the Bank made an offer to buy back < BD 20,000 of each investors funds in RIA 1 at par. This offer was formalized in a letter to investors dated 25 May 2011. A total of 74 of the 95 RIA 1 investors accepted the offer at a cost of BD 1,220,000 to the Bank and resulting in a total of 39 investors being fully exited from the RIA. As a result, total investors funds have reduced to BD 8.34 million.	2007	61.78% over product tenor	Bullet payment on maturity	-	-	-	-	-
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KHCB and NS12 recently appointed Key Point to work out an in-kind exit scheme for the RIA investors by offering the 19 plots. Scheme documents has been received from Key Point and approved by KHCB and NS 12 management to be circulated to investors.

Approved Scheme Documents have been circulated by Key Point to all investors and followed by a workshop conducted at KHCB offices on the 24th August 2016, to explain and answer any queries or information needed to exercise the Plots Application Forms.

Last date of returned Application Forms was 7th September 2016, along with the Opening Date which was held at 24th Floor, KHCB Offices managed and monitored by Key Point and witnessed By KHCB employs; the result was 6 plots were allotted out of 19 plots.

The in-kind exit scheme has been completed and an open auction held on 22nd November, 2016 to allow maximum opportunities to the Investors to re-participate once again on the remaining plots. KPMG was engaged By KHCB to audit the whole In-kind exit process.

Following the 3 allotment rounds of which RIA 1 investors participated, 6 plots have been allocated.

Total revise fund BD 6,304,000.

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RISK MANAGEMENT DISCLOSURES

8 PRODUCT DISCLOSURES (CONTINUED)

8.4 Restricted Investment Accounts (RIA's) (Continued)

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					2017	2016	2015	2014	2013
RIA 5 - North Gate	<p>A restricted investment product which owns a 6.0% stake in Shaden Real Estate Investment WLL which in turn (through its subsidiaries), holds a parcel of reclaimed land measuring approximately 3.875 million Sq. Meters (located in Al-Hidd, Muharraq). The mixed-use plot will be sold to end users subsequent to the completion of infrastructure works.</p> <p>During Q1 2015, the Bank effected a buy-back option to all RIA investors for up to an amount of BD 30,000 plus 5% premium for all investors. RIA investors holding BD 30,000 and below will be exited in full. A detailed letter was sent to all RIA investors in this regard. The offer was made valid up to 15 June 2015 AND during Q3 2015 the Bank paid 5.62% as partial redemption to the remaining investors.</p>	2008	90.66% over product tenor	Bullet return at maturity	-	-	-	-	-
RIA 6 - Locata	<p>A Restricted Mudaraba product which entitles the investors beneficial ownership of 25% equity share capital of Locata Corporation Pty Ltd., a company incorporated in Australia. The Company has invented a new and patented wireless radiolocation technology and shall use this funding to scale up its production capacity, sales/marketing channels and further product enhancement capabilities. During the year, 479 shares were bought back from investors.</p>	2009	110.54% over product tenor	Bullet return at maturity	-	-	-	-	-

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES

9.1 Corporate governance structure

The Bank is governed by the Commercial Companies Law No. 21 of 2001 (the "Companies Law"), the Kingdom of Bahrain Corporate Governance Code (the "CGC"), volume 2 and volume 6 of the Rulebook of the CBB (and in particular the High-Level Controls ("HC Module")), and the Bahrain Stock Exchange Law of 1987 (collectively, the "Regulations").

The Bank has adopted the CGC which was effective from January 2011. The corporate governance policies of the Bank are aligned with the requirements of HC Module of the CBB Rulebook.

The Bank acknowledges its responsibility to all of its stakeholders and is committed to the highest standards of corporate governance. The Bank believes good corporate governance enhances stakeholder value and provides an appropriate guidance to the Board, its committees, and the Bank's Executive Management to carry out their duties in the best interest of the Bank and its stakeholders. The Bank maintains the highest levels of transparency, accountability and good management through the adoption and monitoring of corporate strategies, goals and policies to comply with its regulatory and ethical responsibilities.

9.2 Code of conduct

The Board has approved a code of conduct for all staff of the Bank and the Board members. The Code includes the process of dealing with conflict of interests. It also binds the Directors, Executive Management and staff to the highest standard of professionalism and diligence on discharging their duties. All Board members and senior management of the Bank have affirmed compliance with the Code of Conduct. A declaration is made by the Board members prior to each Board meeting confirming that they have disclosed all external appointments and notified the Chairman if there have been any changes to their external appointments since the previous meeting. Board members are excluded from dealings in matters related to an external entity where they hold an appointment at that entity.

9.3 Compliance with regulations

The Bank ensures compliance with the regulations applicable to an Islamic licensed bank at all times. It would report any non-compliance with the guidelines should there be any. The Bank's obligations to comply with the Regulations have been addressed through following a Corporate Governance Handbook in accordance with the corporate governance ("CG") and the High-Level Controls Module of the CBB Rulebook. The CG Handbook was developed to manage the Board and committees Charter, Management Committee Charters, Board and Management Code of Conduct, Conflict of Interest Policy, Whistle Blowing Policy, Corporate Governance Guidelines, Social Responsibility, Directors' Appointment Agreement, Board and Directors' Evaluation, and a Key Persons' Dealing Policy.

The Bank is committed to continuously review and develop its corporate governance policies to ensure compliance with the changing requirements of the Regulations and to ensure compliance with the international corporate governance best practice. The Bank, through its Board and Board Committees, endeavors to deliver the highest standards of governance for the benefit of its stakeholders.

9.4 Board of directors

As at 31 December 2017, the Board of the Bank comprise ten members. Members of the Board were elected/ appointed for a three year renewable term during the Annual General Meeting ("AGM") meeting held on March 2017. The current composition of the Board complies with the requirements of the Regulations, except one requirements stated in paragraph 9.15 below.

- On 14th March 2017, The Board unanimously decided to appoint Dr. Ahmed Khalil Al Mutawa as Chairman of the Board of Directors, and Mr. Abdulkarim Ahmed Bucheery as a Vice Chairman.
- On 26th September 2017, Mr. Fawad Tariq Khan was appointed as an Executive Director, representing Shuaa Capital, to complete the unexpired term of his predecessor Mr. Housseem Bin Al Haj Amor who resigned his office on 1st June 2017.
- On 11th November 2017, Mr. Luay Hasan Ahmadi was appointed as an Executive Director, representing GFH Financial Group B.S.C., to complete the unexpired term of his predecessor Mr. Khaleefa Yousif Al Mehairi who resigned his office on 5th October 2017.

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.4 Board of directors (Continued)

The Board Nominations, Remunerations and Governance Committee (“BNRGC”) reviews the skills and qualifications required of directors on periodic basis for potential nominee director. A nominee director may be elected by the shareholders upon receiving majority of votes during the election process. Positions at the Board are filled in compliance with the Bank’s Articles of Association and the Commercial Companies Law. A Director’s membership to the Board shall terminate in the event that, amongst other things, the Director is convicted of an offence of dishonor or breach of trust or is declared bankrupt.

The Chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the CEO and maintaining a dialogue with the Bank’s stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank’s operations and decision-making. The Board, either directly or through its various committees, will oversee the management of the Bank.

The Board has formalized the division of work responsibilities between the Board and the Bank’s management. Working in consultation with the Bank’s management team, the Board provides oversight for the overall management of the Bank’s business. The Board reviews and approves the corporate strategy for the Bank and has overall responsibility for risk management, financial reporting and corporate governance issues. Matters that specifically require Board approval include, amongst other things, the financial statements and the acquisition and disposal of companies. The Board also ensures that the Bank upholds the Bank’s core values including the values set out in the Bank’s internal policies.

The Board Audit and Risk Management Committee (“BARMC”) in addition to the functions of control, ensures that all policies prescribed are reviewed and updated on annual basis. The Risk management department in conjunction with the Internal Audit and Control unit ensures the policies and procedures are updated and adhered to under the oversight of the related management committees. The Board is also responsible for approving any related party transaction as per the Bank’s authority matrix. Related party transactions concerning a Board member should be minimally approved by the Board Investment and Credit Committee (“BICC”). In addition, any material transaction defined by the Bank (10% of the Banks’ capital) should be approved by the Board. The preparation of the consolidated financial statements of the Bank and the Group’s undertaking to operate in accordance with Islamic Sharia rules and principles is the responsibility of the Board of Directors. The duties, functions, and responsibilities are detailed in the Bank’s Corporate Governance Framework.

Members of the Board have access to the Bank’s management at all times. The CEO together with the Bank’s senior management monitors the Bank’s performance against pre-set corporate objectives and manages the Bank’s day-to-day affairs based upon the policies, objectives, strategies and guidelines lay down and approved by the Board from time to time.

The Board of Directors of the Bank comprises of Executive and Non-Executive Directors. The Board has four independent members (out of a total of eight Directors). This is to ensure compliance with the CGC requirement that requires at least one third of the Bank’s Board to comprise independent and non-executive Directors.

Upon appointment, each Director is provided with a comprehensive, formal and tailored induction which includes, amongst other things, a review of the Board’s role and duties and the relevant Director’s roles and duties to the Bank; meetings with the bank’s senior management; visits to the Bank’s branches and other sites; presentations to explain the Bank’s strategic plans and significant financial, accounting, risk and legal issues and compliance programs; and meetings with internal and external auditors and legal counsel. In accordance with paragraph 1.9.1 of the HC module of CBB Rulebook, the Board and its committees are also individually evaluated and assessed for their performance effectiveness. The Board has conducted an evaluation of its performance and the performance of each committee and each individual director during the year 2017.

Each independent Director of the Bank is a professional in their field and possesses a background in the financial and banking field.

The names, title, and other positions held by the Board of Directors are set out below:

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.4 Board of directors (Continued)

Dr. Ahmed Khalil Al-Mutawa **Chairman**

Experience:

- Director since June 2012 (Non-Independent and Non-Executive).
- Over 20 years of experience in economics and financial sectors.
- Nominated by GFH Financial Group BSC.
- Vice Chairman of GFH Financial Group BSC.
- Chairman of Falcon Cement Company - Bahrain
- Board Member of Dubai University College - UAE.
- Board Member of Dunia Finance - UAE.

Qualification:

- Ph.D. in Economics from Georgetown University - USA.
- Master in Economics from University of North Carolina - USA.
- Bachelor in Economics from University of Cairo - Egypt.

Sh. Ahmed Bin Isa Al Khalifa **Board Member**

Experience:

- Director since March 2017 (Independent and Non-Executive)
- Over 29 years of experience in governance and project & information management
- Currently the Assistant Undersecretary of Nationality, Passports & Residence Affairs (NPRA) at the Ministry of Interior - Bahrain
- Board Member of the Labor Market Regulatory Authority
- Member of the Executive Committee of Bahrain Airport Company

Qualification:

- Master Certificate in Project Management from the George Washington University - USA
- BSc in Computer Science from Saint Edwards University - USA

Abdulkarim Ahmed Bucheery **Vice Chairman**

Experience:

- Director since March 2017 (Independent and Non-Executive)
- Over 40 years of experience in banking and financial sectors
- Chairman of Bahrain Bourse - Bahrain
- Chairman of Bahrain Clear Co. - Bahrain
- Chairman of KMB management Solution - Bahrain
- Vice Chairman of Ibdar Bank - Bahrain
- Chairman of the Nomination and Remuneration Committee of the Board of Naseej Co. - Bahrain
- Member of the Executive Advisory Committee of Arab Tourism Co. - KSA

Qualification:

- BSc in Economics Science from Aleppo University - Syria

Dr. Khalid Mohammed Al Khazraji **Board Member**

Experience:

- Director since March 2017 (Independent and Non-Executive)
- Over 30 years of experience from three major sectors: academic, government and private sectors. In academic, he was the associate dean of School of Business and Economic at the UAE University. In government, he held the position of the Deputy Minister of Labor. Finally in private sector, he was the Deputy Chairman of Majed Al Futtaim Retail and a business owner
- Major professional contributions to the UAE's Ministry of Labor
- Major professional contributions to the United Arab Emirates University
- Participation in various training workshops, conferences & programs in the US & Switzerland
- Chairman of Al Kawthar Investment Company - UAE
- Member of the Board of Trustee of Mohammed Bin Rashid School of Government - UAE
- Member of the Board of Trustee of the University of Dubai - UAE
- Adjunct Professor at the University of Dubai - UAE

Qualification:

- Ph.D. in Business Administration from the University of Mississippi, USA
- Master in Business Administration from Loyola University, USA
- Bachelor in Business Administration from the University of Miami, USA

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.4 Board of directors (Continued)

Abdulla Abdulkarim Showaiter

Board Member

Experience:

- Director since February 2008 (Non-Independent and Non-Executive).
- Over 39 years of experience in the banking industry.
- Board Member of First Energy Bank - Bahrain.
- Advisor to the Board Ajman Bank - UAE

Qualification:

- Attended several courses in the field of banking and finance

Fawad Tariq-Khan

Board Member

Experience:

- Director since September 2017 (Non-Independent and Executive)
- Over 13 years of experience in the field of management & investment
- Nominated by SHUAA Capital, UAE
- General Manager of SHUAA Capital, UAE
- Director, Arab Gateway Fund
- Director, Asia for Economic Consultancy
- Director, Dammam Rayhaan Fund
- Investment Committee Member, Frontier Opportunities Fund I.L.P.
- Director, Gulf Finance Corporation psc
- Director, Jeddah Centro Fund
- Representative, Septech Holdings Ltd.
- Director, SHL Global Investments
- Director, SHUAA 1 Commercial Broker LLC
- Director, SHUAA 2 Commercial Broker LLC
- Director, SHUAA 3 Commercial Broker LLC
- Director, SHUAA 4 Commercial Broker LLC
- Director, SHUAA Capital International Ltd.
- Director, SHUAA Capital psc
- Director, SHUAA Capital Saudi Arabia
- Director, SHUAA Corporate Director Ltd.
- Investment Committee Member, SHUAA Hospitality Fund I.L.P.
- Director, SHUAA Saudi Arabia Holding Ltd.
- Director, SHUAA Saudi Hospitality Fund
- Chairman, SHUAA Securities Egypt
- Chairman, SHUAA Securities LLC
- Director, North Care Plc
- Director, BLD Partners GP
- Director, BLD Mezzanine Partners GP
- Director, BLD Holdings Ltd
- Director, Krypto Capital GP
- Director, Business Bay Fund Limited
- Director, BBD Partners GP

Qualification:

- MSc in Business Studies, University College Dublin Michael Smurfit Graduate Business School, Ireland
- BSc in Computer Science & Economics, University College Cork, Ireland

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.4 Board of directors (Continued)

Luay Hasan Ahmadi

Board Member

Experience:

- Director since November 2017 (Non-Independent and Executive)
- Over 19 years of experience in the field of management & investment
- Nominated by GFH Financial Group
- Chief Placement Officer of GFH Financial Group
- Senior Executive Officer of GFH Capital Limited

Qualification:

- Master in Science from George Washington University - USA
- Bachelor in Business Management from George Washington University - USA

Mohammad Abdulmohsen Al Rashed

Board Member

Experience:

- Director since March 2017 (Non-Independent and Non-Executive).
- Over 9 years of experience in the field of business & finance
- Nominated by GFH Financial Group
- Consultant, Rashed Al Rashed & Sons Group of Companies - KSA
- Chairman, Food Capital Company - KSA
- Director, Fine Food Co. - KSA
- Director, Alshifa Medical Syringe MFG Co. - KSA
- Director, Orange Fuel Company - KSA
- Director, Mahra Co. - KSA
- Director, Human Resources Development Fund "Hadaf" - KSA
- Director, Hawadi Co. - KSA
- Director, Rimal Co. - KSA
- Director, Express Parcel Co. - KSA

Qualification:

- Bachelor in Business Management from Fairleigh Dickinson University - Canada

Hisham Ahmed Al-Rayes

Board Member

Experience:

- Director since June 2012 (Non-Independent and Executive)
- Over 20 years of experience in the financial and banking sector
- Nominated by GFH Financial Group
- Chief Executive Officer and Board Member of GFH Financial Group BSC
- Managing Director of GFH Capital Limited
- Chairman Tunis Bay Project Co. - Tunisia
- Chairman Gulf Holding Company - Kuwait
- Chairman, Royal Ranches Marrakesh - Morocco.
- Chairman of Balexco - Bahrain
- Vice Chairman of Falcon Cement Co

Qualification:

- Master in Business Administration from University of DePaul - USA
- Bachelor of Science in Electrical / Electronic Engineering from University of Bahrain

Yousef Ibrahim Al Ghanim

Board Member

Experience:

- Director since March 2017 (Non-Independent and Non-Executive)
- Over 10 Years of experience in the financial and banking sector
- Deputy General Manager for Investment & Development of Alam Almesila General Trading Company - Kuwait
- Acting CEO & Head of the Executive Committee of Alaman Investment Co. - Kuwait
- Board Member of Alaman Investment Co. - Kuwait

Qualification:

- Bachelor in Accounting from Kuwait University
- Certificate in Credit Management from the Institute of Banking Studies - Kuwait

* The qualifying criteria for 'Independent Directors' are as per the Corporate Governance guidelines of the CBB.

The Chairman, the Board of Directors, and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance and Shari'a Compliance.

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.5 Board of directors' interests

The members of the Board collectively held 1,050,763 shares in the Bank as of the year ended 31 December 2017 (2016: 1,050,763 shares).

Director's name	No. of Shares As of December 2016	No. of Shares As of December 2017	Movement During the Year	% of SubTotal Shares
Dr. Ahmed Khalil Al-Mutawa	-	-	-	-
Abdulkarim Ahmed Bucheery	-	-	-	-
Abdulla Abdulkarim Showaiter	1,050,763	1,050,763	0	0.10%
Sh. Ahmed Bin Isa Al Khalifa	-	-	-	-
Fawad Tariq Khan	-	-	-	-
Hisham Ahmed Al-Rayes	-	-	-	-
Dr. Khalid Mohamed Al Khazraji	-	-	-	-
Luay Hassan Ahmadi	-	-	-	-
Mohammed Abdulmohsen Al Rashed	-	-	-	-
Yousif Ebrahim Al Ghanim	-	-	-	-
Total	1,050,763	1,050,763	0	0.10%

9.6 Distribution of ownership shares by nationality

The Bank's Register of Shareholders as at 31 December 2017 indicates a total of 690 shareholders who collectively owned 1,050,000,000 (One Billion, fifty million) share with a nominal value of BD 0.100 (One Hundred Fils) each. The breakdown of shareholders in the Bank by nationality is as follows:

Nationality	No. of equity shares held	% of shareholders
Bahraini	642,200,009	61.16%
Non-Bahraini	407,799,991	38.84%
Total	1,050,000,000	100.00%

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.7 Board committees

The Board of Directors has constituted three Committees with specific delegated authorities.

Committee	Members	Primary responsibilities
Board Nominations, Remunerations and Governance Committee (BNRGC)	<ul style="list-style-type: none"> • Dr. Khalid Mohamed Al Khazraji • Sh. Ahmed Bin Isa Al Khalifa • Mohamed Abdulmohsen Al Rashed • Sh. Dr. Fareed Yaqoob Al Mufta 	<ul style="list-style-type: none"> • Human Resources. • Compensation and incentives. • Administration. • Corporate Governance.
Board Audit and Risk Management Committee (BARMC)	<ul style="list-style-type: none"> • Abdulkarim Ahmed Bucheery • Yousif Ebrahim Al Ghanim • Luay Hasan Ahmadi 	<ul style="list-style-type: none"> • Internal Audit. • External Audit. • Compliance. • Anti-Money Laundering. • Risk management. • Policies related to risk management.
Board Investment and Credit Committee (BICC)	<ul style="list-style-type: none"> • Dr. Ahmed Khalil Al-Mutawa • Abdulla Abdulkarim Showaiter • Fawad Tariq Khan • Hisham Ahmed Al-Rayes 	<ul style="list-style-type: none"> • Investment & credit approval. • Setting limits. • Investment policies. • Asset Liability Management. • Banking relationship. • Oversight of Off-Balance Sheet Vehicles.

Meetings of the Board and its committees are held as and when required but in accordance with the Regulations the Board meets at least once a quarter. The Board of Directors met six times in 2017. The Bank held its AGM and EGM on 14 March 2017. In addition to physical meetings, several written resolutions were circulated to the Directors during 2017 for approval by mail and facsimile.

During the year, the Board Audit and Risk Management Committee (BARMC) held seven meetings, the Board Investment and Credit Committee (BICC) held five meetings, and the Board Nominations, Remunerations and Governance Committee (BNRGC) held four meetings.

The Board of Directors and its committees receive regular reports on various aspects of the Bank's business from senior management as well as from Internal Audit, Risk Management, Financial Control, and Operations Departments.

9.8 Board committees meeting dates

• Board meetings

Director's name	Meetings dates during the year 2017						Attendance %
	8 th Feb.	14 th Mar.	10 th May	11 th Jun.	26 th Sep.	8 th Nov.	
Dr. Ahmed Khalil Al Mutawa	✓	✓	✓	✓	✓	✓	100%
Abdulkarim Ahmed Bucheery ¹	-	✓	✓	✓	✓	✓	100%
Ahmed Bin Isa Al Khalifa ¹	-	✓	✓	✓	✓	✓	100%
Abdulla A.Kareem Showaiter	✓	✓	✓	✓	✓	✓	100%
Dr. Khalid Mohamed Al Khazraji ¹	-	✓	✓	✓	✓	✓	50%
Mohamed A.Mohsen Al Rashed ¹	-	✓	✓	✓	✓	✓	100%
Hisham Ahmed Al Rayes	✓	✓	✓	✓	✓	✓	100%
Yousif Ebrahim Al Ghanim ¹	-	✓	✓	-	-	✓	less than 75%
Fawad Tariq Khan ²	-	-	-	-	✓	✓	100%
Luay Hasan Ahmadi ³	-	-	-	-	-	✓	100%

¹ Joined the Board on 14th March 2017

² Joined the Board on 26th September 2017

³ joined the Board on 8th November 2017

Mr. Housseem Bin Al Haj Amor joined the Board on 14th March 2017, and resigned his office on 1st June 2017

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.8 Board committees meeting dates (Continued)

Mr. Khalifa Al Mehairi joined the Board on 14th March 2017, and resigned his office on 5th October 2017

- BICC meetings

Director's name	Meetings dates during the year 2017				
	8 th Feb.	10 th May	26 th Sep.	8 th Nov.	20 th Dec.
Dr. Ahmed Khalil Al Mutawa	✓	✓	✓	✓	✓
Abdulla A.Kareem Showaiter	✓	✓	✓	✓	✓
Hisham Ahmed Al Rayes	✓	✓	✓	✓	✓
Fawad Tariq Khan ¹	-	-	-	-	-

¹ Joined the Committee on 20th December 2017

- BNRGC meetings

Director's name	Meetings dates during the year 2017			
	7 th Feb.	9 th May	27 th Sep.	8 th Nov.
Dr. Khalid Mohamed Al Khazraji ¹	-	✓	✓	✓
Sh. Ahmed Bin Isa Al Khalifa ¹	-	✓	✓	✓
Mohamed A. Mohsen Al Rashed ¹	-	✓	✓	✓
Sh. Dr. Fareed Yaqoob Al Muftah	✓	✓	✓	✓

¹ Joined the Committee on 14th March 2017

- BARMC meetings

Director's name	Meetings dates during the year 2017					
	25 th Jan.	7 th Feb.	23 rd May	1 st Aug.	26 th Sep.	7 th Nov.
Abdulkarim Ahmed Bucheery ¹	-	-	✓	✓	✓	✓
Yousif Ebrahim Al Ghanim ¹	-	-	✓	✓	-	✓
Fawad Tariq Khan ²	-	-	-	-	✓	✓
Luay Hasan Ahmadi ³	-	-	-	-	-	-

¹ Joined the Committee on 14th March 2017

² Joined the Committee from 26th September 2017 to 7th November 2017

³ Joined the Committee on 8th November 2017

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.9 Shari'a Supervisory Board

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

Sh. Dr. Fareed Yaqoob Al-Miftah
Chairman

Experience:

- Member of the Supreme Council of Islamic Affairs.
- Undersecretary of the Ministry of Justice & Islamic Affairs - Bahrain.
- Former Judge of the high Shari'a Court.
- Former Lecturer at the University of Bahrain.

Qualification:

- Ph.D. from the University of Edinburgh - United Kingdom.

Sh. Dr. Fareed Mohammed Hadi
Executive Member

Experience:

- Assistant Professor of Jurisprudence (Fiqh) and Hadeeth at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain.
- Bachelor Program Manager in Shari'a for Banking and Finance, University of Bahrain.
- Vice President of the Association of Shari'a scholars in GCC.
- Member of Shari'a Supervisory Board of a number of Islamic banks.

Qualification:

- Ph.D. in Ibn Hazm's Methodology of Jahala, University of Edinburgh - UK.
- Ph.D. in Al-Bukhari's Methodology, University of Mohammed V - Morocco.

Sh. Dr. Nizam Mohammed Saleh Yaqoobi
Member

Experience:

- Member of the Shari'a council of Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI).
- Member of the Shari'a Board of the Central Bank of Bahrain - Bahrain.
- Member of Shari'a Supervisory Board of the Dow Jones Islamic index.
- Member of Shari'a Supervisory Board of a number of Islamic banks & insurance companies.

9.10 Executive management committees

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer (CEO) who is responsible for implementing the Bank's strategic plan. The CEO manage the Bank through the following management committees:

Committee	Primary responsibilities
Management Committee	Strategy, Performance review, Budget, Human Resources, Administration
Asset Liability Management Committee	Balance sheet management, Funding, Liquidity, Banking Relationships
Executive Credit & Investment Committee	Review of investments, Exit and credit proposals, Monitoring of investments
Executive Risk Management Committee	Risk Management policies, Risk review, Provisions and impairment

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.11 Executive management & other senior management

During 2017, as an interim arrangement, Mr. Tawfeeq Mohamed Bastaki, the DGM - Chief Risk Officer, assumed the duties and responsibilities of the Chief Executive Officer on an acting basis.

The names and title of each member of executive and other Senior Management are set out below:

Tawfeeq Mohamed Bastaki

Chief Risk Officer - Acting Chief Executive Officer

Experience:

- Over 37 years of experience in Corporate Banking, Structured Finance, Retail Banking, Risk, Governance, and Compliance
- Joined the Bank in 2015

Qualification:

- Masters in Finance from DePaul University - USA.
- B.Sc. in Islamic Financing from University College of Bahrain - Bahrain.
- Advanced Banking Diploma from Bahrain Institute of Banking and Finance (BIBF).
- Executive Diploma "Post Graduate" in Business Management from the University of Bahrain.

Hussam Ghanem Saif

Assistant General Manager - Treasury and Capital Markets

Experience:

- Over 27 years of experience in treasury and Islamic banking.
- Joined the Bank in 2007.

Qualification:

- Graduate with a degree in Business Administration & Management from Western International University, London - UK.

Mahdi Abdulnabi Mohammed

Deputy General Manager, Support Services

Experience:

- Over 36 years of banking experience.
- Joined the Bank in 2005.

Qualification:

- Diploma, Banking Studies, Intermediate Level - BIBF
- Diploma, Banking Studies, Advance Level - BIBF
- Diploma, Advanced Management - University of Bahrain
- Certified Diploma in Accounting & Finance - The Chartered Association of Certified Accountants (ACCA)
- Investment Representative Certification (Series 7).
- MBA, General Business Administration - The University of Strathclyde, Scotland, United Kingdom.
- Managing Strategically, Leading for Results - Harvard Business School, Executive Education.

Yaser Ismaeel Mudhafar

Chief Financial Officer

Experience:

- Over 19 years of extensive experience in the Islamic banking industry and Audit.
- Joined the Bank in 2006.

Qualification:

- Certified Public Accountant (CPA) from the American Institute of Certified Public Accountants.
- Certified Islamic Professional Accountant (CIPA) from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).
- Executive MBA from University of Bahrain.
- Advance Diploma Executive Leadership (University of Virginia - Darden Business School) - USA.

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.11 Executive management & other senior management (Continued)

Mazen Salman Sater

Assistant General Manager - Retail Banking

Experience:

- Over 20 years of banking experience.
- Joined the Bank in 2016.

Qualification:

- Master in Business Administration, Major Marketing & Change Management from DePaul University - USA
- Bachelor degree in Business and Marketing from St. Edward's University - USA

Khalid Mohamed Turki

Assistant General Manager - Corporate & International Banking

Experience:

- Over 32 years of experience in the Banking Sector.
- Joined the Bank in 2006.

Qualification:

- Diploma in Business "Post Graduate" from University of Bahrain.
- Executive Management Diploma from University of Bahrain.
- Diploma in Advance Banking Studies from Bahrain Institute of Banking and Finance (BIBF).
- Diploma in Basic Supervision from University of Bahrain.
- Diploma in Computer Science from University of Bahrain.
- Attended the Leading Strategy Execution in Financial Services Program organized by Harvard Business School.

Abdul-Nasser Omar Al-Mahmood

Head of Shari'a Compliance

Experience:

- Over 26 years of experience in Shari'a Audit and Islamic banking.
- Joined the Bank in 2008.

Qualification:

- Master's in Business Administration with thesis in Shari'a Control and Review in Islamic Banks.
- B.Sc. in Shari'a and Islamic studies.
- Associate Diploma in Shari'a Control.

Mohammed Abdulla Saleh

Assistant General Manager - Human Resources and Corporate Communications

Experience:

- Over 15 years of experience in Management, Islamic Banking, Corporate Governance, Compliance, Anti-money Laundering, and Human Resources.
- Joined the Bank in 2009.

Qualification:

- Master's in IT, Media and E-Commerce Law from the University of Essex - UK.
- B.Sc. in Law from Dubai Police Academy - UAE.
- Advanced Diploma in Islamic Finance from Bahrain Institute of Banking and Finance (BIBF).
- Diploma in Business Management from the University of Bahrain.
- ICA International Diploma in Compliance from the International Compliance Association ICA.
- Attended the Waqf Fund - Leadership Grooming Program for Islamic Banks at Ivey Business School in Western University (Canada & Hong Kong).

Ahmed Abdulrahman Seyadi

Assistant General Manager - Information Technology

Experience:

- Over 25 years of experience in the Banking Sector.
- Joined the Bank in 2006.

Qualification:

- Executive Master in Business Administration from University of Bahrain.
- Diploma in Business "Post Graduate" from University of Bahrain.
- Diploma in Executive Management from University of Bahrain.
- Advanced Diploma in Banking Studies from Bahrain Institute of Banking and Finance (BIBF).
- Associated Diploma in Accounting from University of Bahrain.
- Attended the Leading Strategy Execution in Financial Services Program organized by Harvard Business School.

Talal Nabeel Al-Mahroos

Head of Investments

Experience:

- Over 13 years of experience in Investments and Islamic Banking.
- Joined the Bank in 2006.

Qualification:

- B.Sc. in Banking & Finance - University of Bahrain.
- Advanced Diploma Executive Leadership (University of Virginia - Darden Business School) - USA.

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.11 Executive management & other senior management (Continued)

Mohamed Hamad Fakhri Head of Internal Audit

Experience:

- Over 10 years of experience in Internal Audit, Risk Management, Governance and controls both in Islamic Retail and Investments Banking sectors.
- Joined the Bank in 2012.

Qualification:

- B.Sc. in Accounting - University of Bahrain.
- CFA charter holder from CFA Institute - USA
- Certified Internal Auditor (CIA) from the Institute of Internal Auditors - USA

Mohammed Abdulla Al Tamimi Head of Compliance and MLRO

Experience:

- Over 10 years of experience in Compliance, Anti-money Laundering, Banking Supervision, Islamic Banking, and Corporate Governance.
- Joined the Bank in 2013.

Qualification:

- B.Sc. in Banking and Finance from the University of Bahrain.
- Advanced Diploma in Islamic Finance from Bahrain Institute of Banking and Finance (BIBF).
- International Diploma in Compliance from the International Compliance Association.
- Certified Anti Money Laundering Specialist (CAMS) from the Association of Certified Anti Money Laundering Specialist (ACAMS).

9.12 Executive and senior management interests

The following table indicates the executive and senior management shareholding as 31 December 2017:

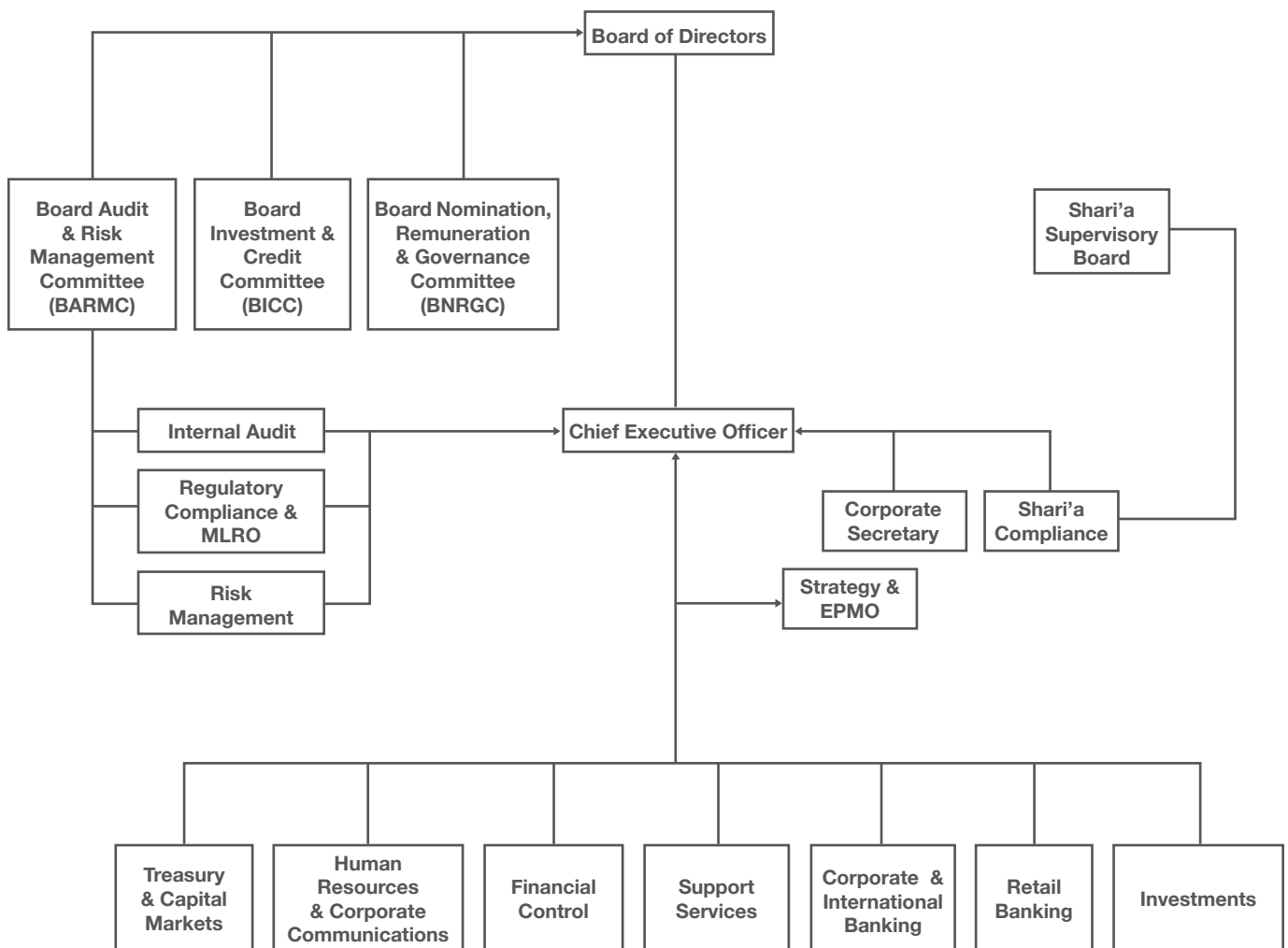
Executive and senior management	Number of outstanding shares at 31 December 2017	Number of outstanding shares at 31 December 2016
Tawfeeq Mohammed Bastaki	67,301	20,918
Mahdi Abdulnabi Mohammed	998,596	1,580,889
Khalid Mohamed Turki	137,730	47,562
Hussam Ghanem Saif	182,872	659,827
Yaser Ismail Mudhafar	283,159	582,301
Mazen Salman Sater	Nil	Nil
Mohammed Abdulla Saleh	Nil	Nil
Ahmed Abdulrahman Seyadi	207,708	437,193
Abdul-Nasser Omar Al-Mahmood	Nil	Nil
Talal Nabeel Al Mahroos	Nil	Nil
Mohammed Abdulla Al Tamimi	Nil	Nil
Mohamed Hamad Fakhri	5,083	5,083
Total	1,882,449	3,333,773

13 RISK MANAGEMENT DISCLOSURES

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

9.13 Organizational chart

Set out below is the Bank's organization chart, which outlines the different committees and the lines of reporting.



9.14 Executive compensation

The Bank has both a short-term and long-term compensation structure for its executive management which has been developed based on current market surveys and industry norms. The Bank also had an incentive scheme where in eligible employees were awarded a combination of shares and cash incentives on achievement of pre-determined performance targets. For further details please refer note 23 of the consolidated financial statements for the year ended 31 December 2017. The Board of Directors is entitled to sitting fees and their annual remuneration is subject to the approval of the shareholders at the end of each year.

13 RISK MANAGEMENT DISCLOSURES

9.15 Shari'a compliance, regulatory compliance and anti-money laundering

Compliance with Shari'a laws, regulatory and statutory requirements is an ongoing process and the Bank is conscious of its responsibilities in observing all applicable provisions and best international practices in its functioning. The Bank has established the Shari'a Compliance Function and the Regulatory Compliance Function in keeping with Basel and CBB guidelines. The respective units act as a focal point for all Shari'a and regulatory compliance and for adapting other best practice compliance principles.

Anti-Money Laundering measures form an important area of the Compliance Function. The Bank has an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure approved by the Board, which contains sound Customer due diligence measures, procedure for identifying and reporting suspicious transactions, a program for periodic awareness training to staff, record-keeping, and a designated Money Laundering Reporting Officer (MLRO). The Bank's Anti-Money Laundering measures are reviewed by independent external auditors every year and their report is submitted to the CBB. The Bank is committed to combating money laundering and is in compliance with the guidelines issued by the CBB in relation to Anti-Money Laundering requirements.

The Bank is in compliance with the requirements of the HC Module of the CBB Rulebook, except for the following:

- HC 1.4.6: that requires the chairman of the Board to be an independent director.
- HC 3.2.1: that requires establishing an audit committee of at least three directors of which the majority must be independent including the Chairman.

9.16 Audit fees charged by the external auditor and other non-audit services provided by the external auditor and fees paid

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.

9.17 Penalties paid to the Central Bank of Bahrain

During 2017, the Bank was subject to two penalties: a penalty of BD 600, imposed by the CBB as a result of the delay in the submission of a periodic report, and a penalty of BD 10,000 relating to the classification of certain assets of the Bank.

10 FINANCIAL PERFORMANCE

Following are basic quantitative indicators of the financial performance:

	2017	2016	2015	2014	2013
Return on average equity	0.71%	4.77%	7.48%	3.00%	-16.06%
Return on average assets	0.11%	0.77%	1.27%	0.53%	-3.69%
Finance income to finance expense	221.37%	264.91%	231.02%	197.05%	147.77%
Cost-to-income *	60.80%	44.82%	53.64%	75.80%	156.56%

* Cost excludes impairment allowances.

For detailed discussion on the performance for the year, kindly refer to Chairman's report on the consolidated financial statement for the year ended 31 December 2017.

13 RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES

The Bank's total compensation policy, which includes the variable remuneration policy, sets out the Bank's policy on remuneration for directors and senior management and the key factors that were taken into account in setting the policy.

In 2014, the Bank has adopted the Sound Remuneration Practices issued by the Central Bank of Bahrain and has proposed revisions to its variable remuneration framework. The revised policy framework and incentive components were approved by the shareholders in the annual general meeting held on March 2015. The policy is effective starting 2014 annual performance incentives and would be fully implemented for future periods.

The key features of the remuneration framework have been summarized below.

11.1 Remuneration strategy

It is the Bank's basic compensation philosophy to provide a competitive level of total compensation to attract and retain qualified and competent employees. The Bank's variable remuneration policy will be driven primarily by a performance based culture that aligns employee interests with those of the shareholders of the Bank. These elements support the achievement of our objectives through balancing reward for both short-term results and long-term sustainable performance. Our strategy is designed to share our success, and to align employees' incentives with our risk framework and risk outcomes.

The quality and long-term commitment of all of our employees is fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to maintaining a career with the Bank, and who will perform their role in the long-term interests of shareholders. The Bank's reward package comprise the following key elements:

1. fixed pay;
2. benefits;
3. annual performance bonus; and
4. the long term performance incentive plan

A robust and effective governance framework ensures that the Bank operates within clear parameters of its compensation strategy and policy. All compensation matters, and overall compliance with regulatory requirements, are overseen by the Nomination, Remuneration and Governance Committee of the Board (BNRGC).

The Bank's remuneration policy in, particular, considers the role of each employee and has set guidance depending on whether an employee is a Material Risk Taker and / or an Approved Person in business line, control or support functions. An Approved Person is an employee whose appointment would require prior regulatory approval because of the significance of the role within the Bank and an employee is considered a Material Risk Taker if they head of significant business lines and any individuals within their control who have a material impact of the Bank's risk profile.

In order to ensure alignment between what we pay our people and our business strategy, we assess individual performance against annual and long-term financial and non-financial objectives summarised in line with our performance management system. This assessment also takes into account adherence to the Bank's values, risk and compliance measures above all and acting with integrity. Altogether, performance is therefore judged not only on what is achieved over the short and long-term but also importantly on how it is achieved, as the BNRGC believes the latter contributes to the long-term sustainability of the business.

11.2 BNRGC role and focus

The BNRGC has oversight of all reward policies for the Bank's employees. The BNRGC is the supervisory and governing body for compensation policy, practices and plans. It is responsible for determining, reviewing and proposing variable remuneration policy for approval by the Board. It is responsible for setting the principles and governance framework for all compensation decisions. The BNRGC ensures that all persons must be remunerated fairly and responsibly. The remuneration policy is reviewed on a periodic basis to reflect changes in market practices and the business plan and risk profile of the Bank.

13 RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.2 BNRGC role and focus (Continued)

The responsibilities of the BNRGC as regards the variable compensation policy of the Bank, as stated in its mandate, include, but are not limited to, the following:-

- Approve, monitor and review the remuneration system to ensure the system operates as intended.
- Approve the remuneration policy and amounts for each Approved Person and Material Risk-Taker, as well as total variable remuneration to be distributed, taking account of total remuneration including salaries, fees, expenses, bonuses and other employee benefits.
- Ensure remuneration is adjusted for all types of risks and that the remuneration system takes into consideration employees that earn same short-run profit but take different amount of risk on behalf of the bank.
- Ensure that for Material Risk Takers, variable remuneration forms a substantial part of their total remuneration.
- Review the stress testing and back testing results before approving the total variable remuneration to be distributed including salaries, fees, expenses, bonuses and other employee benefits.
- Carefully evaluate practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. The BNRGC will question payouts for income that cannot be realized or whose likelihood of realization remains uncertain at the time of payment.
- Ensure that for approved persons in risk management, internal audit, operations, financial controls and compliance functions the mix of fixed and variable remuneration is weighted in favor of fixed remuneration
- Recommend Board member remuneration based on their attendance and performance and in compliance with Article 188 of the Bahrain Commercial Companies Law.
- Ensure appropriate compliance mechanisms are in place to ensure that employees commit themselves not to use personal hedging strategies or remuneration-and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements.

As outlined in the Corporate Governance section of the Annual Report, the Board is satisfied that all non-executive directors are independent including the BNRGC members. The BNRGC comprises of the following members:

BNRGC member name	Appointment date	Number of meetings attended
Dr. Khalid Mohamed Al Khazraji	March 2017	3
Sh. Ahmed Bin Isa Al Khalifa	March 2017	3
Mr. Mohamed A.Mohsen Al Rashed	March 2017	3
Sh. Dr. Fareed Yaqoob Al Muftah	February 2015	4

The aggregate remuneration paid to the BNRGC members during the year in the form of sitting fees amounted to BD 19 thousand (2016: 3 thousand).

11.3 External consultants

Consultants were appointed to advise the Bank on amendments to its variable remuneration policy to be in line with the CBB's Sound Remuneration Practices and industry norms. This included assistance in designing an appropriate Share-based Incentive Scheme for the Bank. The BNRGC had appointed consultants to perform a pay benchmarking exercise to assist them in reviewing the total compensation offered by the Bank.

11.4 Scope of application of the remuneration policy

The remuneration policy has been adopted on a bank-wide basis and shall not apply to its non-banking subsidiaries and operations.

11.5 Board remuneration

The Bank's board remuneration is determined in line with the provisions of Article 188 of the Bahrain Commercial Companies Law, 2001. The board of directors' remuneration will be capped so that the total remuneration (excluding sitting fees) does not exceed 10% of the Bank's net profit, after all the required deductions outlined in Article 188 of the Companies law, in any financial year. The board remuneration is subject to approval of the shareholders in the Annual General Meeting. Remuneration of non-executive directors do not include performance-related elements such as grants of shares, share options or other deferred stock-related incentive schemes, bonuses or pension benefits.

13 RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.6 Variable remuneration for staff

The variable remuneration is performance related and consists primarily of the annual performance bonus award. As a part of the staff's variable remuneration, the annual bonus rewards delivery of operational and financial targets set each year, the individual performance of the employees in achieving those targets, and their contribution to delivering the Bank's strategic objectives.

The Bank has adopted a Board approved framework to develop a transparent link between variable remuneration and performance. The framework is designed on the basis that the combination of meeting both satisfactory financial performance and achievement of other non-financial factors, would, all other things being equal, deliver a target bonus pool for the employees, prior to consideration of any allocation to business lines and employees individually. In the framework adopted in determining the variable remuneration pool, the BNRGC aims to balance the distribution of the Bank's profits between shareholders and employees.

The key performance metrics at the bank level include a combination of short term and long term measures and include profitability, solvency, liquidity and growth indicators. The performance management process ensures that all goals are appropriately cascaded down to respective business units and employees.

In determining the amount of variable remuneration, the Bank starts from setting specific targets and other qualitative performance measures that would result in a target top-down bonus pool. The bonus pool is then adjusted to take account of risk via the use of risk-adjusted measures (including forward-looking considerations).

The BNRGC carefully evaluates practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. BNRGC demonstrates that its decisions are consistent with an assessment of the Bank's financial condition and future prospects.

The Bank uses a formalized and transparent process to adjust the bonus pool for quality of earnings. It is the Bank's objective to pay out bonuses out of realized and sustainable profits. If the quality of earnings is not strong, the profit base could be adjusted based on the discretion of the BNRGC.

For the overall Bank to have any funding for distribution of bonus pool; thresholds of financial targets have to be achieved. The performance measures ensure that the total variable remuneration is generally considerably contracted where subdued or negative financial performance of the Bank occurs. Furthermore, the target bonus pool as determined above is subject to risk adjustments in line with the risk adjustment and linkage framework.

Remuneration of control functions

The remuneration level of staff in the control and support functions allows the Bank to employ qualified and experienced personnel in these functions. The Bank ensures that the mix of fixed and variable remuneration for control and support function personnel should be weighted in favor of fixed remuneration. The variable remuneration of control functions is based on function-specific objectives and is not determined by the individual financial performance of the business area they monitor.

The Bank's performance management system plays a major role in deciding the performance of the support and control units on the basis of the objectives set for them. Such objectives are more focused on non-financial targets that include risk, control, compliance and ethical considerations as well as the market and regulatory environment apart from value adding tasks which are specific to each unit.

Variable compensation for business units

The variable compensation for the business units is primarily decided by the key performance objectives set through the performance management system of the Bank. Such objectives contain financial and non-financial targets, including risk control, compliance and ethical considerations as well as market and regulatory environment. The consideration of risk assessment in the performance evaluation of individuals ensures that any two employees who generate the same short-run profit but take different amounts of risk on behalf of the bank are treated differently by the remunerations system.

13 RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.7 Risk assessment framework

The purpose of the risk linkages is to align variable remuneration to the risk profile of the Bank. In its endeavor to do so, the Bank considers both quantitative measures and qualitative measures in the risk assessment process. Both quantitative measures and human judgment play a role in determining risk adjustments. The risk assessment process encompasses the need to ensure that the remuneration policy designed reduces employees' incentives to take excessive and undue risk is symmetrical with risk outcomes and has an appropriate mix of remuneration that is consistent with risk alignment.

The Bank's BNRGC considers whether the variable remuneration policy is in line with the Bank's risk profile and ensures that through the Bank's ex-ante and ex-post risk assessment framework and processes, remuneration practices where potential future revenues whose timing and likelihood remain uncertain are carefully evaluated.

Risk adjustments take into account for all types of risk, including intangible and other risks such as reputation risk, liquidity risk and the cost of capital. The Bank undertakes risk assessment to review financial and operational performance against the business strategy and risk performance prior distribution of the annual bonus. The Bank ensures that total variable remuneration does not limit its ability to strengthen its capital base. The extent to which capital needs to be built up is a function of a bank's current capital position and its ICAAP.

The bonus pool takes into account the performance of the Bank which is considered within the context of the Bank's risk management framework. This ensures that the variable pay pool is shaped by risk considerations and Bank-wide notable events.

The size of the variable remuneration pool and its allocation within the bank takes into account the full range of current and potential risks, including:

- (a) The cost and quantity of capital required to support the risks taken;
- (b) The cost and quantity of the liquidity risk assumed in the conduct of business; and
- (c) Consistency with the timing and likelihood of potential future revenues incorporated into current earnings.

The BNRGC keeps itself abreast with the Bank's performance against the risk management framework. The BNRGC will use this information when considering remuneration to ensure the return, risk and remuneration are aligned.

Risk adjustments

The Bank has an ex-post risk assessment framework which is a qualitative assessment to back-test actual performance against risk assumptions.

In years where the Bank suffers material losses in the financial performance, the risk adjustment framework would work as follows:

- There would be considerable contraction of the Bank's total variable remuneration.
- At the individual level, poor performance by the Bank would mean individual KPIs are not met and hence employee performance ratings would be lower
- Reduction in value of deferred shares or awards
- Possible changes in vesting periods and additional deferral applied to unvested rewards
- Lastly, if the qualitative and quantitative impact of a loss incident is considered significant, a malus or clawback of previous bonus awards may be considered.

The BNRGC, with Board's approval, can rationalize and make the following discretionary decisions:

- Increase / reduce the ex-post adjustment
- Consider additional deferrals or increase in the quantum of share awards
- Recovery through malus and clawback arrangements

13 RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.7 Risk assessment framework (Continued)

Malus and Clawback framework

The Bank's malus and clawback provisions allows the Bank's Board of Directors to determine that, if appropriate, unvested elements under the deferred bonus plan can be forfeited/ adjusted or the delivered variable compensation could be recovered in certain situations. The intention is to allow the Bank to respond appropriately if the performance factors on which reward decisions were based turn out not to reflect the corresponding performance in the longer term. All deferred compensation awards contain provisions that enable the Bank to reduce or cancel the awards of employees whose individual behavior has had a materially detrimental impact on the Bank during the concerned performance year.

Any decision to take back an individual's award can only be taken by the Bank's Board of Directors.

The Bank's malus and clawback provisions allows the Bank's Board to determine that, if appropriate, vested / unvested elements under the deferred bonus plan can be adjusted/ cancelled in certain situations. These events include the following:

- Reasonable evidence of willful misbehavior, material error, negligence or incompetence of the employee causing the Bank/the employee's business unit to suffer material loss in its financial performance, material misstatement of the Bank's financial statements, material risk management failure or reputational loss or risk due to such employee's actions, negligence, misbehavior or incompetence during the concerned performance year.
- The employee deliberately misleads the market and / or shareholders in relation to the financial performance of the Bank during the concerned performance year.
- Clawback can be used if the malus adjustment on the unvested portion is insufficient given the nature and magnitude of the issue.

11.8 Components of Variable remuneration

Variable remuneration has following main components:

Upfront cash	The portion of the variable compensation that is awarded and paid out in cash on conclusion of the performance evaluation process for each year.
Deferred cash	The portion of variable compensation that is awarded and paid in cash on a pro-rata basis over a period of 3 years.
Upfront share awards	The portion of variable compensation that is awarded and issued in the form of shares on conclusion of the performance evaluation process for each year.
Deferred shares	The portion of variable compensation that is awarded and paid in the form of shares on a pro-rata basis over a period of 3 years.

All deferred awards are subject to malus provisions. All share awards are released to the benefit of the employee after a six month retention period from the date of vesting. The number of equity share awards is linked to the Bank's share price as per the rules of the Bank's Share Incentive Scheme. Any dividend on these shares is released to the employee along with the shares (i.e. after the retention period).

13 RISK MANAGEMENT DISCLOSURES

BD 000's

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.9 Deferral of variable remuneration

All employees above the grade of a Senior Manager shall be subject to deferral of variable remuneration as follows:

Element of variable remuneration	General Manager and above	Senior Managers and above	Deferral period	Retention	Malus	Clawback
Upfront cash	40%	50%	immediate	-	-	Yes
Upfront shares	-	10%	immediate	6 months	Yes	Yes
Deferred cash	10%	-	Over 3 years	-	Yes	Yes
Deferred share awards	50%	40%	Over 3 years	6 months	Yes	Yes

The BNRGC, based on its assessment of role profiles and risk taken by an employee could increase the coverage of employees that would subject to deferral arrangements.

11.10 Details of remuneration paid

(a) Board of directors

	2017	2016
• Sitting Fees	314	93
• Remuneration	Nil	Nil
• Others *	42	15

* This represents airfare, accommodation, transportation and food and beverages paid on behalf of the Board members.

(b) Employee remuneration

	Number of staff	Fixed remuneration		Variable remuneration					Total
		Cash	Others	Upfront		Deferred			
				Cash	Shares	Cash	Shares	Others	
Approved persons									
- Business lines	6	805	16	33	-	8	41	-	903
- Control & support	10	727	25	46	4	2	26	-	830
Other material risk takers	4	263	10	14	2	1	12	-	302
Other staff	225	3905	310	294	3	-	13	-	4,525
Total	245	5,700	361	387	9	11	92	-	6,560

13 RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.10 Details of remuneration paid (Continued)

	Number of staff	Fixed remuneration		Variable remuneration					Total
		Cash	Others	Upfront		Deferred			
				Cash	Shares	Cash	Shares	Others	
Approved persons									
- Business lines	6	868	14	24	1	6	27	-	940
- Control & support	12	647	24	64	9	-	36	-	780
Other material risk takers	4	250	8	14	1	2	14	-	289
Other staff	243	3,626	277	305	-	-	-	-	4,208
Total	265	5,391	323	407	11	8	77	-	6,217

(c) Deferred awards

	2017				Total (Amount)
	Cash (Amount)	Shares (Number)	Shares (Amount)	Others (Amount)	
Opening balance	38	4,200,421	303	-	341
Awarded during the period	10	1,637,970	90	-	100
Paid out / released during the period	(12)	(1,633,867)	(92)	-	(104)
Corporate action	-	-	-	-	0
Service, performance and risk adjustments	-	(20,114)	1	-	1
Closing balance	35.5	4,184,410	302	-	338

	2016				Total (Amount)
	Cash (Amount)	Shares (Number)	Shares (Amount)	Others (Amount)	
Opening balance	34	4,489,243	253	-	287
Awarded during the period	8	-	88	-	96
Paid out / released during the period	(4)	(855,966)	(40)	-	(44)
Corporate action	-	223,696	-	-	0
Service, performance and risk adjustments	-	(28,186)	2	-	2
Closing balance	38	3,828,787	303	-	341

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RISK MANAGEMENT DISCLOSURES

11 REMUNERATION RELATED DISCLOSURES (CONTINUED)

11.10 *Details of remuneration paid (Continued)*

(d) Severance pay

During the year 2017 the Bank paid BD 2,676 as an ex-gratia.

11.11 **Board approved policy on the employment of relatives of approved persons:**

The Bank does not permit the employment of immediate relatives of current employees. Employment of other relatives is permitted. However, employees who are relatives shall not be placed within the same department or same direct line of supervision. In case of marriage, the Bank reserves the right to terminate the employment of one of the spouses. The HR will disclose to the board of directors on an annual basis relatives of any approved persons occupying controlled functions within the Bank up to the 4th degree of kinship.