Al Baraka Islamic Bank B.S.C. (c)

Basel III, Pillar III Disclosures

31 December 2016

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1 INTRODUCTION

Al Baraka Islamic Bank B.S.C. (c) (the "Bank") is a closed shareholding company incorporated in the Kingdom of Bahrain on 21 February 1984. The Commercial Registration of the Bank was renewed on 7 January 2008 to change the status from exempt closed joint stock company to closed joint stock company. The Bank operates under a Retail Bank's licence number RB/025 issued by the Central Bank of Bahrain (CBB). The Bank has eight commercial branches in the Kingdom of Bahrain.

The principal activities of the Bank and its subsidiary (the "Group") are taking demand, saving and investment accounts, providing Murabaha finance, Ijara financing and other Shari'a compliant forms of financing as well as managing investors' money on the basis of Mudaraba or agency for a fee, providing commercial banking services and other investment activities. The Bank's registered office is at Bahrain Bay, P.O. Box 1882, Manama, Kingdom of Bahrain.

For details on the Group's subsidiary as of 31 December 2016, refer note 2 of the consolidated financial statements of the Group.

The public disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD-3: Public Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks.

2 CAPITAL ADEQUACY

To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the standardised approach for its credit risk, basic indicator approach for its operational risk and standardised measurement approach for its market risk. The CBB capital adequacy requirement is minimum accepted level for capital adequacy. The credit committee of the Group identify and approve assets suitable for funding by equity of Investment Accountholders

For the purpose of computing the Capital Adequacy Ratio ("CAR") and preparation of the PIRI form, the Group's financial subsidiary (Al Baraka Bank (Pakistan) Limited) and significant investment Itqan Capital Company are consolidated, as per the requirement of the CA Module, effectively from 01 January 2015 based on the approval obtained from the CBB. As a result of consolidation of Itqan Capital for regulatory purposes, the amounts in certain tables within the quantitative disclosures might not match the amounts reported in the audited consolidated financial statements of the Group. Therefore, they might not be comparable with the audited financial statements in certain cases with respect to Bank's investment in Itqan Capital.

2 CAPITAL ADEQUACY (continued)

Table – 1. Capital structure

The following table summarises the eligible capital after deductions for Capital Adequacy Ratio (CAR) calculation in accordance with Basel III requirements as of:

	31 December 2016			31 December 2015		
	CET 1	AT1	Tier 2	CET 1	AT1	Tier 2
	US $ '000	US $ '000	US $ '000	US $ '000	US $ '000	US $ '000
Common Equity Tier 1 (CET1)						
Issued and fully paid ordinary shares	122,458			122,458		
General reserves	8,687			8,687		
Statutory reserves	22,699			22,478		
Retained earnings	3,266			884		
Current interim cumulative net income / losses	543			2,037		
Unrealized gains and losses on available for sale financial instruments	1,700			(416)		
Gains and losses resulting from converting foreign currency subsidiaries to the parent currency	(9,316)			(11,789)		
Other reserves	(114)			(173)		
Total CET1 capital before minority interest	149,923			144,166		
Minority interest in banking subsidiaries	36,146			19,370		
Total CET1 capital prior to regulatory adjustments	186,069			163,536		
Less:						
Goodwill	45,264			34,741		
Intangible other than mortgage servicing rights	819			505		
Deferred tax assets	18,813			6,716		
Total CET 1 capital after the regulatory adjustments above (CET 1a)	121,173			121,574		
Other Capital (AT1 & T 2)						
Instruments issued by parent company		25,000	6,000		-	6,000
Instruments issued by banking subsidiaries to third parties		1,150	11,666		48	14,319
Assets revaluation reserve - property, plant, and equipment		-	1,193		-	1,193
General financing loss provisions		-	3,284		-	2,130
Total Available AT1 & T2 Capital		26,150	22,143		48	23,642
Total CET 1 Capital	121,173			121,574		
Total T1 Capital		147,323			121,622	
Total Capital			169,466			145,264

2 CAPITAL ADEQUACY (continued)

Table – 2. Capital requirement by type of islamic financing contracts

The following table summarises the capital requirements by type of islamic financing contracts:

	31 December 2016 Capital requirements US $ '000	*31 December 2015 Capital requirements US $ '000*
Type of islamic financing contracts		
Sales receivables	**22,807**	19,937
Ijara Muntahia Bittamleek & Ijara income receivable	**12,035**	10,948
Musharaka	**11,081**	5,537
	45,923	36,422

Table – 3. Capital requirement for market risk

The following table summarises the amount of exposures subject to standardised approach of market risk and related capital requirements as of:

	31 December 2016		*31 December 2015*	
	Self Financed US $ '000	**Financed by IAH US $ '000**	*Self Financed US $ '000*	*Financed by IAH US $ '000*
Market risk - standardised approach				
Foreign exchange risk	**7,154**	-	6,017	-
Total of market risk - standardised approach	**7,154**	**-**	6,017	-
Multiplier	**12.50**	**12.50**	12.50	12.50
	89,425	**-**	75,213	-
Eligible Portion for the purpose of the calculation	**100%**	**30%**	100%	30%
Risk Weighted Exposures ("RWE") for CAR Calculation	**89,425**	**-**	75,213	-
Total market RWE		**89,425**		75,213
		12.50%		12.50%
Minimum capital requirement		**11,178**		9,402

2 CAPITAL ADEQUACY (continued)

Table – 4. Capital Requirements for operational risk

The following table summarises the amount of exposures subject to basic indicator approach of operational risk and related capital requirements as of:

	31 December 2016	*31 December 2015*
	US $	*US $*
Indicators of operational risk		
Average gross income	**102,586**	86,867
Multiplier	**12.5**	12.5
	1,282,325	1,085,838
Eligible Portion for the purpose of the calculation	**15%**	15%
Total operational RWE	**192,349**	162,876
	12.50%	12.50%
Minimum capital requirement	**24,044**	20,359

2 CAPITAL ADEQUACY (continued)

Table – 5. Capital adequacy ratios

The following are capital adequacy ratios for total capital and tier 1 capital as of:

	31 December 2016			*31 December 2015*		
	Total capital ratio	**Tier 1 capital ratio**	**CET 1 capital ratio**	Total capital ratio	Tier 1 capital ratio	CET 1 capital ratio
Group's Capital adequacy ratio	**16.58%**	**14.42%**	**11.86%**	16.97%	14.21%	14.20%
Minimum regulatory requirements*	**12.50%**	**10.50%**	**9.00%**	12.50%	10.50%	9.00%
Al Baraka Bank Pakistan Limited **	**20.41%**	**16.93%**	**16.93%**	25.17%	19.99%	13.91%
Itqan Capital Company	**33.97%**	**33.97%**	**33.97%**	34.48%	34.48%	34.48%

** Minimum required by CBB regulations under Basel III, this includes capital conversion buffer of 2.5%*

***The subsidiary's Capital adequacy ratio computed in accordance with the CBB requirements.*

Legal restrictions on capital and income mobility

Distributing profits by subsidiary to the parent is subject to compliance with applicable laws and regulations in Pakistan. Such distribution should go through the legal and regulatory channels applicable in relevant jurisdiction (i.e. Pakistan). Mobilsation of capital, reserves and equivalent funds out of the subsidiary to the parent is subject to the local rules and regulations. The parent is not subject to any restriction to support its subsidiary in the form of deposits or capital. However, as a procedure and approval has to be obtained from the CBB for increasing investment in subsidiary.

Table - 6. The Group's financial subsidiary capital adequacy ratios

The following is the Group's financial subsidiary capital adequacy ratio prepared on the basis of SBP requirements, which may differ from the CBB requirements, as of:

	31 December 2016			*31 December 2015*		
	Total capital ratio	**Tier 1 capital ratio**	**CET 1 capital ratio**	Total capital ratio	Tier 1 capital ratio	CET 1 capital ratio
Capital adequacy ratio	**10.35%**	**8.66%**	**8.66%**	14.47%	11.62%	11.62%
Minimum regulatory requirements*	**10.00%**	**7.50%**	**6.00%**	10.00%	7.50%	6.00%

**There are no capital conversion buffer required as per SBP requirements.*

3 RISK MANAGEMENT

Risk management is an integral part of the Group's decision-making process. The risk management committee and executive committees, guide and assist with overall management of the Group's consolidated statement of financial position risks. The Group manages exposures by setting limits approved by the Board of Directors. The Group risk management strategies have been effectively implemented during the year in line with the objective defined.

a) Credit risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss. The Group controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by the personal guarantees of the counterparty, by collateral in form of mortgage of the objects financed or other tangible security.

Table – 7. Credit risk exposure

The following table summarises the amount of gross funded and unfunded credit exposures and average gross funded and unfunded exposures as of:

	31 December 2016				*31 December 2015*			
	Self financed		***Financed by IAH***		*Self financed*		*Financed by IAH*	
	Total gross credit exposure US $ '000	****Average gross exposure over the period US $ '000***	***Total gross credit exposure US $ '000***	****Average gross credit risk exposure over the period US $ '000***	*Total gross credit exposure US $ '000*	**Average gross credit exposure over the period US $ '000*	*Total gross credit exposure US $ '000*	**Average gross credit exposure over the period US $ '000*
Funded								
Cash and balances with banks and financial institutions	**230,758**	**177,413**	**50,243**	**47,548**	171,873	199,268	66,048	95,131
Sales receivables	**3,002**	**3,097**	**739,582**	**631,293**	3,454	6,458	606,230	592,279
Mudaraba financing	**-**	**-**	**776**	**194**	-	-	-	-
Ijara Muntahia Bittamleek	**18,302**	**18,906**	**261,466**	**258,061**	19,475	15,175	246,923	239,746
Musharaka	**-**	**-**	**316,728**	**222,068**	-	-	154,260	137,103
Investments	**360,278**	**328,119**	**174,517**	**141,111**	291,142	265,395	132,464	177,269
Investment in real estate	**7,493**	**7,600**	**-**	**-**	7,446	6,342	-	-
Ijara income receivables	**1,713**	**1,259**	**28,892**	**26,986**	1,101	907	22,365	21,592
Premises and equipment	**32,203**	**28,072**	**-**	**-**	27,214	24,728	-	-
Other assets	**83,028**	**60,842**	**26,041**	**21,800**	50,583	48,171	16,304	20,798
Unfunded exposure								
Contingencies and commitments	**200,360**	**202,137**	**-**	**-**	174,285	177,317	-	-
	937,137	**827,445**	**1,598,245**	**1,349,061**	746,573	743,761	1,244,594	1,283,918

*Average balances are computed based on quarter end balances.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 8. Credit risk – geographic breakdown

The following table summarises the geographic distribution of exposures, broken down into significant areas by major types of credit exposure as of:

	31 December 2016				31 December 2015			
	Self financed *geographic area		**Financed by IAH *geographic area**		Self financed *geographic area		Financed by IAH *geographic area	
	Middle East US $ '000	**Other Asian countries US $ '000**	**Middle East US $ '000**	**Other Asian countries US $ '000**	Middle East US $ '000	Other Asian countries US $ '000	Middle East US $ '000	Other Asian countries US $ '000
Cash and balances with banks	**40,587**	**190,171**	**26,242**	**24,001**	44,260	127,613	37,851	28,197
Sales receivables	**3,002**	**-**	**472,141**	**267,441**	3,454	-	356,758	249,472
Mudaraba financing	**-**	**-**	**-**	**776**	-	-	-	-
Ijara Muntahia Bittamleek	**18,302**	**-**	**220,257**	**41,209**	19,475	-	201,884	45,039
Musharaka	**-**	**-**	**76**	**316,652**	-	-	101	154,159
Investments	**218,227**	**142,051**	**81,020**	**93,497**	171,123	120,019	106,128	26,336
Investment in real estate	**7,493**	**-**	**-**	**-**	7,446	-	-	-
Ijara income receivables	**1,713**	**-**	**25,758**	**3,134**	1,101	-	20,412	1,953
Premises and equipment	**11,537**	**20,666**	**-**	**-**	11,713	15,501	-	-
Other assets	**10,916**	**72,112**	**2,536**	**23,505**	10,444	40,139	1,861	14,443
	311,777	**425,000**	**828,030**	**770,215**	269,016	303,272	724,995	519,599

* Segmental information is presented in respect of the Group's geographical segments. The geographical segments are based upon the location of the units responsible for recording the transactions and reflects the manner in which financial information is evaluated by management and the Board of Directors. For financial reporting purposes, the Group is divided into two geographical segments, Middle East and Other Asian Countries. Other Asian Countries predominantly includes operations in Pakistan.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 9. Credit risk – counterparty type breakdown

The following table summarises the distribution of funded and unfunded exposure by counterparty type as of:

	31 December 2016				*31 December 2015*			
	Self financed		***Financed by IAH***		*Self financed*		*Financed by IAH*	
	Funded US $ '000	***Unfunded US $ '000***	***Funded US $ '000***	***Unfunded US $ '000***	*Funded US $ '000*	*Unfunded US $ '000*	*Funded US $ '000*	*Unfunded US $ '000*
Cash items	**24,579**	**-**	**8,229**	**-**	11,344	-	12,352	-
Claims on Sovereigns	**415,598**	**-**	**92,322**	**-**	332,128	-	64,549	-
Claims on Public Sector Entities	**60,344**	**7,069**	**145,601**	**-**	55,482	3,907	52,530	-
Claims on banks	**51,322**	**21,906**	**294,704**	**-**	42,559	41,604	256,581	-
Claims on corporate	**20,986**	**171,101**	**663,507**	**-**	6,862	128,334	612,872	-
Mortgage	**-**	**-**	**203,607**	**-**	-	-	155,495	-
Past dues receivables	**-**	**-**	**53,626**	**-**	-	-	34,733	-
Regulatory Retail Portfolio	**-**	**284**	**96,061**	**-**	440	-	28,662	-
Equity investment	**11,556**	**-**	**471**	**-**	11,243	-	350	-
Investment in Funds	**7,865**	**-**	**5,000**	**-**	1,050	-	5,000	-
Holding of Real Estate	**58,254**	**-**	**12,361**	**-**	58,421	-	7,298	-
Other assets	**86,273**	**-**	**22,756**	**-**	52,759	440	14,172	-
	736,777	**200,360**	**1,598,245**	-	572,288	174,285	1,244,594	-

For the purpose of rating, the Group is using External Credit Assessment Institutions (ECAIs) Standard & Poors, Moodys, Capital Intelligence, Fitch and other approved credit rating agencies for assigning risk weight to assets.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 10. Credit risk – related party transactions

All transactions with related parties have been made on arms length basis. The following table summarises the balances with related parties as of:

	31 December 2016		*31 December 2015*	
	Self financed	***Financed by IAH***	*Self financed*	*Financed by IAH*
	Funded US $ '000	***Funded US $ '000***	*Funded US $ '000*	*Funded US $ '000*
Cash and balances with bank	**-**	**914**	-	209
Sales Receivable	**-**	**48,548**	-	35,499
Musharaka	**-**	**2,156**	-	1,420
Ijara Muntahia Bittamleek	**-**	**583**	-	740
Investments	**14,576**	**18,028**	17,283	-
Ijara Income Receivable	**-**	**81**	-	78
Other Assets	**2,688**	**-**	2,672	1
Contingencies and commitments	**4,432**	**-**	10,242	-
	21,696	**70,310**	30,197	37,947

The Group's intra-group transactions are as follows:

	31 December 2016	*31 December 2015*
	Self financed ***US $ '000***	*Self financed US $ '000*
Assets		
Investment in a subsidiary	**82,662**	61,961
Subordinated mudaraba sukuk	**-**	19,500
Equity investment in Itqan Capital	**54,342**	54,342
Other receivables	**-**	952
	137,004	136,755
Contingencies and commitments		
Letters of credit	**4,054**	187
Guarantees	**285**	285
Acceptances	**3,098**	2,385
	7,437	2,857

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 11. Credit risk – concentration of risk

The Group follows the Central Bank of Bahrain's guidelines with respect to the definition and measurement of large exposures at the consolidated level as stipulated in the Central Bank of Bahrain Rulebook for Islamic Banks.

The following are the balances representing the concentration of risk to individual counterparties as of 31 December 2016:

Counterparties *	***Funded*** ***US $ '000***
Counterparty # 1	**158,695**
Counterparty # 2	**157,520**
Counterparty # 3	**100,944**
Counterparty # 4	**64,712**
Counterparty # 5	**55,689**
Counterparty # 6	**55,624**
Counterparty # 7	**43,405**
Counterparty # 8	**39,912**
Counterparty # 9	**37,480**
Counterparty # 10	**33,171**
Counterparty # 11	**28,200**

* These exposures are in excess of individual obligor limits. Further, these exposures are either exempt or undertaken after obtaining due approval from Central Bank of Bahrain.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 11. Credit risk – concentration of risk (continued)
The following are the balances representing the concentration of risk to individual counterparties as of 31 December 2015:

Counterparties *	*Funded* *US $ '000*
Counterparty # 1	121,684
Counterparty # 2	104,857
Counterparty # 3	88,163
Counterparty # 4	79,522
Counterparty # 5	44,181
Counterparty # 6	42,568
Counterparty # 7	39,389
Counterparty # 8	32,411
Counterparty # 9	28,226

* These exposures are in excess of individual obligor limits. Further, these exposures are either exempt or undertaken after obtaining due approval from Central Bank of Bahrain.

Past due and non-performing facilities

Past due represents installments that are not received on the contractual repayments date. The Group defines non-performing facilities as the facilities that are overdue for period of 90 days or more. These exposures are placed on a non-accrual status with income being recognised to the extent that it is actually received/distributed. It is the Group's policy, except for the subsidiary which is following their local regulations, that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as past due.

Highly leveraged counter parties

Highly leveraged counter parties are determined by the Credit and Risk Management Department on case by case basis according to industry types and credit policies and procedures of the Group. Each industry has clear established leverage ratios set in place internally which are considered threshold for measuring how leveraged is our counterpart (Low, Medium/Acceptable or High). Any excess over such determined ratios, the customer is classified as highly leveraged with high risk. This ratio will have a big impact on Internal Rating / Grading of the customer.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 12. Credit risk – credit quality of Islamic financing contracts by counterparty type

The following table summarises the aging of non performing facilities disclosed by counterparty type as of:

	31 December 2016					31 December 2015				
			Aging of non performing facilities					Aging of non performing facilities		
	Past due but performing US $ '000	Non-performing Islamic financing contracts US $ '000	90 days to 1 year US $ '000	1 year to 3 years US $ '000	Over 3 years US $ '000	Past due but performing US $ '000	Non-performing Islamic financing contracts US $ '000	90 days to 1 year US $ '000	1 year to 3 years US $ '000	Over 3 years US $ '000
Corporates	**16,785**	**67,139**	**28,327**	**12,056**	**26,756**	27,938	36,312	14,404	2,755	19,152
Investment Firms	**433**	**18,645**	**-**	**-**	**18,645**	5	18,805	-	-	18,805
Individuals	**1,205**	**12,453**	**10,671**	**826**	**956**	374	3,431	2,543	353	535
Others	**10,288**	**11,196**	**879**	**3,080**	**7,237**	12,581	10,117	1,429	1,643	7,046
	28,711	**109,433**	**39,877**	**15,962**	**53,594**	40,898	68,665	18,376	4,751	45,538

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 13. Credit Risk – provision against financing facilities by counterparty type

The following table summarises the total provisions against financing facilities disclosed by counterparty type as of 31 December 2016:

	Specific allowances							
	Opening Balance	***Charges during the year***	***Amalgamation during the year***	***Write-Back during the year***	***Write-offs during the year***	***Transferred to investment risk reserve***	***Exchange difference on opening balance***	***Balance at the end of the year***
	US $ '000	***US $ '000***	***US $ '000***	***US $ '000***	***US $ '000***	***US $ '000***	***US $ '000***	***US $ '000***
Corporates	**23,936**	**5,676**	**13,388**	**(5,813)**	**-**	**-**	**33**	**37,220**
Investment Firms	**6,110**	**7,129**	**-**	**-**	**-**	**-**	**(52)**	**13,187**
Individuals	**766**	**357**	**1,065**	**(230)**	**(1)**	**-**	**1**	**1,958**
Others	**3,122**	**799**	**166**	**(644)**	**-**	**-**	**3**	**3,446**
	33,934	**13,961**	**14,619**	**(6,687)**	**(1)**	**-**	**(15)**	**55,811**

A collective provision of US $ 0.7 million was charged during the year and accumulated balance has been increased to US $ 3.3 million as at 31 December 2016.

The following table summarises the total provisions against non performing financing facilities disclosed by counterparty type as of 31 December 2015:

	Specific allowances						
	Opening Balance	*Charges during the year*	*Write-Back during the year*	*Write-offs during the year*	*Transferred from investment risk reserve*	*Exchange difference on opening balance*	*Balance at the end of the year*
	US $ '000	*US $ '000*	*US $ '000*	*US $ '000*	*US $ '000*	*US $ '000*	*US $ '000*
Corporates	24,637	2,810	(2,415)	(94)	-	(1,002)	23,936
Investment Firms	21,936	3,870	(3,870)	(15,481)	-	(345)	6,110
Individual	879	179	(188)	(82)	-	(22)	766
Others	2,631	1,244	(633)	(13)	-	(107)	3,122
	50,083	8,103	(7,106)	(15,670)	-	(1,476)	33,934

A collective provision of US $ 0.6 million was charged during the year and accumulated balance has been increased to US $ 2.1 million as at 31 December 2015.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 14. Credit risk – non performing facilities and provisions

The following table summarises the total non performing facilities and provisions disclosed by geographical area as of:

	31 December 2016			*31 December 2015*		
	Non-performing Islamic financing contracts US $ '000	***Specific provision US $ '000***	***Collective provision* US $ '000***	*Non-performing Islamic financing contracts US $ '000*	*Specific provision US $ '000*	*Collective provision US $ '000*
Middle East	**41,115**	**15,495**	**2,535**	30,069	6,484	1,860
Other Asian countries	**68,318**	**40,316**	**749**	38,596	27,450	270
	109,433	**55,811**	**3,284**	68,665	33,934	2,130

* Collective provision is calculated based on estimates by the management keeping in view general economic and market conditions, effecting investment and financing portfolio of the Group.

Table – 15. Credit risk – restructured Islamic financing contracts

The following table summarises the total outstanding Islamic financing contracts that were restructured during the year as of:

	31 December 2016 Total US $ '000	*31 December 2015 Total US $ '000*
Restructured Islamic financing contracts	**63,875**	16,213

The amount represents total facilities restructured during the year. Further, there is no significant impact of the renegotiated Islamic financing contracts on the provisions as well as present and future earnings.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 16. Counterparty credit risk exposure
The following table summarises the counterparty credit risk exposure covered by collateral as of:

	31 December 2016		*31 December 2015*	
	Gross positive FV of contracts *US $ '000*	**** Collateral held US $ '000***	Gross positive FV of contracts *US $ '000*	** Collateral held US $ '000*
Cash and balances with banks and financial institutions	**281,001**	**-**	237,921	-
Sales receivables	**742,584**	**428,640**	609,684	397,567
Mudaraba financing	**776**	**776**	-	-
Ijara Muntahia Bittamleek	**279,768**	**106,823**	266,398	113,649
Musharaka	**316,728**	**316,652**	154,260	154,159
Investments	**534,795**	**-**	423,606	-
Investment in real estate	**7,493**	**-**	7,446	-
Ijara income receivables	**30,605**	**-**	23,466	-
Premises and equipment	**32,203**	**-**	27,214	-
Other assets	**109,069**	**-**	66,887	-
	2,335,022	**852,891**	1,816,882	665,375

* Collaterals values have been restricted to outstanding exposure of financing facilities.

Table – 17. Counterparty credit risk exposure
The following table summarises exposure by type of Islamic financing contract that is covered by eligible collateral after the application of haircuts as of:

	31 December 2016		*31 December 2015*	
	Gross positive FV of contracts US $ '000	***Collateral held US $ '000***	*Gross positive FV of contracts US $ '000*	*Collateral held US $ '000*
Ijara Muntahia Bittamleek & Ijara income receivable	**310,373**	**69,534**	289,864	82,512

b) Market risk
Market risk arises from fluctuations in profit rates, equity prices and foreign exchange rates.

Table – 18. Market risk capital requirements
The following table summarises the capital requirement for each category of market risk as of:

	31 December 2016		*31 December 2015*	
	Sukuk risk US $ '000	***Foreign exchange risk US $ '000***	*Sukuk risk US $ '000*	*Foreign exchange risk US $ '000*
RWE	**-**	**89,429**	-	75,213
Capital requirements (12.5%)	**-**	**11,179**	-	9,402
Maximum value of RWE	**-**	**89,429**	3	75,428
Minimum value of RWE	**-**	**75,218**	-	70,968

3 RISK MANAGEMENT (continued)

b) Market Risk (continued)

Table – 19. Equity position risk in Banking Book

The following table summarises the total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2016:

	Total gross exposure US $ '000	***Average gross exposure over the period US $ '000***	***Publicly held US $ '000***	***Privately held US $ '000***	***Capital requirement US $ '000***
Managed funds	**6,000**	**6,000**	**-**	**6,000**	**306**
Private equity	**22,716**	**18,467**	**15,516**	**7,200**	**3,731**
Real estate related	**43,283**	**34,902**	**-**	**43,283**	**12,702**
	71,999	**59,369**	**15,516**	**56,483**	**16,739**

Investments stated at a carrying amount of US $ 166.5 million are placed in custody of a financial institution and such instruments having face value US $ 45.119 million were pledged to secure a borrowing line.

The following table summarises the total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2015:

	Total gross exposure US $ '000	*Average gross exposure over the period US $ '000*	*Publicly held US $ '000*	*Privately held US $ '000*	*Capital requirement US $ '000*
Managed funds	6,000	6,020	-	6,000	306
Private equity	14,643	14,295	11,237	3,406	1,989
Real estate related	27,243	31,386	-	27,243	12,831
	47,886	51,701	11,237	36,649	15,126

The investments stated at a carrying amount of US $ 161 million are placed in custody of a financial institution against borrowing line.

Table – 20. Equity gains or losses in Banking Book

The following table summarises the cumulative realised and unrealised gains or (losses) during the year ended:

	31 December 2016 US $ '000	*31 December 2015 US $ '000*
Cummulative realised gains arising from sale or liquidation	**2,942**	901
Total unrealised gains/ (losses) recognised in the balance sheet but not through P&L	**1,700**	(416)
Unrealised gross gains/ (losses) included in Tier One Capital	**1,700**	(416)
Assets revaluation reserve - property, plant, and equipment	**1,193**	1,193

Profit Rate Risk:

The Bank generates funds mainly through profit sharing arrangements or agency modes. The Bank continously monitor the profit rates prevailing in the domestic/ regional markets (issued by competitors). Further, the following factors also affects the determination of profit rates:

• Availability of profitable opportunities in the market
• Key economic fundamentals and liquidity levels
•Policy interest rates promulgated by domestic and leading global monetary agencies.

3 RISK MANAGEMENT (continued)
b) Market Risk (continued)

Table – 21. Profit rate mismatch
As of 31 December 2016

	Up to 3 months US $ '000	*3 to 6 months US $ '000*	*6 months to 1 year US $ '000*	*1 to 3 years US $ '000*	*Over 3 years US $ '000*
Receivables	**391,810**	**170,117**	**97,407**	**41,301**	**41,949**
Mudaraba financing	**776**	**-**	**-**	**-**	**-**
Ijara Muntahia Bittamleek	**13,597**	**8,382**	**15,377**	**66,308**	**206,709**
Musharaka	**19,848**	**737**	**9,804**	**65,700**	**220,639**
Investments-Sukuk	**2,954**	**143,412**	**609**	**123,705**	**192,117**
Profit rate sensivtive assets	**428,985**	**322,648**	**123,197**	**297,014**	**661,414**
Borrowings	**30,582**	**-**	**-**	**60,000**	**-**
Equity of investment accountholders	**696,872**	**233,404**	**250,970**	**223,456**	**193,543**
Subordinated debt	**1,631**	**-**	**1,366**	**5,463**	**38,018**
Profit rate sensivtive liabilities	**729,085**	**233,404**	**252,336**	**288,919**	**231,561**
Profit rate gap	**(300,100)**	**89,244**	**(129,139)**	**8,095**	**429,853**
Profit rate sensitivity (50BPS)	**(1,501)**	**446**	**(646)**	**40**	**2,149**

As of 31 December 2015

	Up to 3 months Strategic	*3 to 6 months Strategic*	*6 months to 1 year Strategic*	*1 to 3 years Strategic*	*Over 3 years Strategic*
Receivables	307,063	148,187	59,184	53,265	41,985
Ijara Muntahia Bittamleek	13,918	8,134	21,281	74,041	172,490
Musharaka	2,242	2,208	3,663	17,001	129,146
Investments-Sukuk	13,522	-	7,000	152,566	201,810
Profit rate sensivtive assets	336,745	158,529	91,128	296,873	545,431
Borrowings	27,407	-	-	38,000	-
Equity of investment accountholders	545,015	197,445	179,775	184,423	137,936
Subordinated debt	1,705	-	1,364	5,456	14,197
Profit rate sensivtive liabilities	574,127	197,445	181,139	227,879	152,133
Profit rate gap	(237,382)	(38,916)	(90,011)	68,994	393,298
Profit rate sensitivity (50BPS)	(1,187)	(195)	(450)	345	1,966

c) Equity of Investment Accountholders

The Group manages and deploys Equity of IAH according to its Article of Association – Chapter 3 on Rules of Business. In this respect, the Bank invests its own funds separately or jointly with amount received from Equity of Investment Account Holders. These funds received are managed in accordance with Shari' a requirements and standard of prudence is applied in the context of managing the overall portfolios to enable the Bank to exercise its fiduciary responsibilities. The Group is authorised by Equity of Investment Accountholders to invest the funds on the basis of Mudaraba, Murabaha, Salam, Ijara transactions and other forms of contract in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The composition, characteristics, diversification, and concentration of portfolios are monitored within appropriate risk limits and indicators detailed in the Group's credit risk, liquidity risk, and other risks policies of the group. The strategic objectives of the investments of the funds are:

a) Investment in Shari' a compliant opportunities;
b) Targeted returns;
c) Compliance with credit and Investment policy and overall business plan; and
d) Diversified portfolio.

Funds are invested in Shari' a compliant commercial or consumer financing as well as short, medium, and long term investments excluding strategic investments. A due diligence process is in place which is consistent with business and risk policy guidelines of the Group after deduction of mandatory reserves and making allowance for short-term liquidity requirements.

Under all the aforesaid arrangement the Group can commingle the IAH funds with its own funds (Self-Financed). Some of the assets right from inception is designated exclusively as Self Financed by the Group. These self financed assets are deducted from total assets to arrive at "Jointly Financed Assets". To segregate the Jointly Financed Assets into self financed and Investment accountholders (IAH), the Group applies formula to identify the proportional share of each fund's in the Jointly Financed Assets .

The Group's share of profit as a Mudarib for managing equity of IAH and their share of income is based on the terms and conditions of the related Mudarib agreements. These funds are invested in Islamic modes of financing and investments including murabaha, salam, istisna, wakala, musharaka, mudaraba and ijara. The Group is offering these accounts for saving and term accounts ranging from 1 months to 5 years. There are no separate designations for portfolio managers, investment advisors and trustee. IAH accounts are managed at Head Office and subsidiary levels by relevant departments.

Investors' share of income is calculated based on the income generated from joint investment accounts after deducting the expenses related to investment pool "mudarib expenses". Mudarib expenses include all expenses incurred by the Group, including specific provisions, but excluding staff cost and depreciation. The Group's "mudarib profit" is deducted from investors' share of income before distributing such income. In some cases, equity of IAH withdrawn before maturity and without completing contractual period are entitled to profits for the outstanding period.

The basis applied by the Group in arriving at the investment accountholders share of income is [total investment income less investment pool expenses] divided by [average funds generating income (shareholders and equity of investment accountholders) times average funds of equity of IAH].

Investment risk reserve

The Group deducts investment risk reserve as per approved policy from time to time from the profit distributable to equity of investment accountholders of its Bahrain operations, after allocating the Mudarib share in order to cater against future losses for equity of IAH.

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Profit equalisation reserve
The Group appropriates a certain amount in excess of the profit to be distributed to equity of investment accountholders before taking into consideration the mudarib share of income. This is used to maintain a certain level of return on investment for equity of IAH.

Displaced commercial risk
The Group is exposed to displaced commercial risk in the event of having equity of IAH profit rates that are lower than market rates. The Group has mitigated this risk through the setting up of reserves that will be used in case of a drop in IAH profit rates. The policies and procedures for displaced commercial risk are formulated and implemented at the segment level (Pakistan and Bahrain).

Complaint procedure / awareness programs
A complaint management system is established; procedures on handling complaints have been developed, new Complaints form has been introduced, a number of complaints channels are available where customers can communicate through branches, call centre, email, dedicated staff number and web-site. Monitoring procedures have been developed as well.

The Group uses it's website, print and electronic media for consumer awareness program and to inform about new products.

Penalty charges
A financial penalty of US $ 7 thousand (2015: US $ 0.4 thousand) was charged by the CBB during the year ended 31 December 2016 mainly in lieu of anomalies in electronic funds transferred.

A financial penalty of US $ 5 thousand (2015: US $ 3 thousand) was charged by SBP to the Group's subsidiary in Pakistan during the year ended 31 December 2016.

Non-Shari'a complaint income
The Group has received US $ 382 thousand (2015: US $ 348 thousand) from customers as penalty for default or other non sharia compliant sources, which was disposed through charity contribution.

Table – 22. Equity of Investment Accountholders
The following table summarises the breakdown of equity of IAH and the analysis of profit equalisation reserve, investment risk reserve and return on equity of IAH as of:

	31 December 2016 US $ '000	*31 December 2015 US $ '000*
IAH - Banks	**270,666**	217,415
IAH - Non-banks	**1,324,689**	1,024,282
Profit equalisation reserve	**551**	558
Investment risk reserve	**2,339**	2,339
	1,598,245	1,244,594

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 23. Ratio of reserves to total IAH

The following table summarises the ratio of reserves to the total amount of equity of IAH as of:

	31 December 2016	*31 December 2015*
PER to IAH (%)	**0.03%**	0.04%
IRR to IAH (%)	**0.15%**	0.19%

Table – 24. Equity of Investment Accountholders by Islamic financing product type

The following table summarises the percentage of IAH financing for each type of Shari's-compliant contract to total equity of IAH financing as of:

	31 December 2016	*31 December 2015*
Sales receivable	**54.89%**	58.87%
Mudaraba	**0.06%**	0.00%
Musharaka	**23.51%**	14.98%
Ijara Muntahia Bittamleek & Ijara income receivable	**21.55%**	26.15%

Table – 25. Equity of Investment Accountholders by Counterparty Type

The following table summarises the percentage of equity of investment accountholders for each category of counterparty to total equity as of:

Counterparty type

	31 December 2016	*31 December 2015*
Banks	**17.06%**	17.61%
Investment Firms	**5.38%**	2.86%
Corporates	**15.88%**	16.64%
Residentials	**49.83%**	51.08%
Others	**11.86%**	11.80%

Table – 26. Investment Accountholders share of profit

The following table summarises the share of profits earned by and paid out to equity of IAH and the Group as Mudarib for the year ended:

	31 December 2016	*31 December 2015*
Administrative expenses charged to equity of investment accountholders	**5,755**	3,405
Share of profits earned by IAH, before transfers to/from reserves	**61,137**	69,244
Percentage share of profit earned by IAH before transfer to/from reserves	**4.53%**	5.40%
Share of profit paid out to IAH after Mudarib fee and transfer to/from reserves	**44,558**	51,697
Percentage share of profit paid out to IAH after Mudarib fee and transfer to/from reserves	**3.30%**	4.03%
Share of profit paid out to Bank as mudarib	**16,579**	17,547
Mudarib Fee to total Investment Profits	**27.12%**	25.34%

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 27. Movement in profit equalisation reserve

The following table summarises the movement in profit equilisation reserve during the year ended:

	31 December 2016 US $ '000	*31 December 2015 US $ '000*
Balance at 1 January	**558**	574
Foreign exchange loss	**(7)**	(16)
	551	558
Percentage of the profit earned on equity of investment accountholders appropriated to profit equilisation reserve	**Nil**	Nil

Table – 28. Movement in investment risk reserve

The following table summarises the movement in investment risk reserve during the year ended:

	31 December 2016 US $ '000	*31 December 2015 US $ '000*
Balance at 1 January	**2,339**	2,338
Amount apportioned from income allocable to equity of investment accountholders	**-**	2
Exchange difference	**-**	(1)
	2,339	2,339
Percentage of the profit earned on equity of investment accountholders appropriated to investment risk reserve	**Nil**	Nil

The profit equalisation reserve and investment risk reserve will revert to IAH as per terms and conditions of the Mudaraba contract.

As IAH funds are commingled with the Group's funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits.

The Group's share, as Mudarib, in the profits of IAH is up to a maximum of 70% (31 December 2015: up to 70%) as per the terms of IAH agreements.

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 29. Equity of Investment Accountholders by type of assets

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets and the changes in the asset allocation for the year ended 31 December 2016:

	Opening Actual Allocation US $ '000	***Movement US $ '000***	***Closing Actual Allocation US $ '000***
Cash and balances with banks	**66,048**	**(15,805)**	**50,243**
Sales receivable	**606,230**	**133,352**	**739,582**
Ijara Muntahia Bittamleek	**246,923**	**14,543**	**261,466**
Musharaka	**154,260**	**162,468**	**316,728**
Investments	**132,464**	**42,053**	**174,517**
Ijara income receivables	**22,365**	**6,527**	**28,892**
Other assets	**16,304**	**9,737**	**26,041**
	1,244,594	**353,651**	**1,598,245**

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets for the year ended 31 December 2015:

	Opening actual allocation US $ '000	*Movement US $ '000*	*Closing actual allocation US $ '000*
Cash and balances with banks	96,842	(30,794)	66,048
Sales receivable	615,838	(9,608)	606,230
Ijara Muntahia Bittamleek	221,040	25,883	246,923
Musharaka	116,382	37,878	154,260
Investments	199,237	(66,773)	132,464
Ijara income receivables	13,144	9,221	22,365
Other assets	27,220	(10,916)	16,304
	1,289,703	(45,109)	1,244,594

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 30. Equity of Investment Accountholders profit earned and paid

The following table summarises the amount and percentage of profits earned and paid out to profit sharing investment accounts over the past five years:

	Profit earned		*Profit paid to IAH*	
	US $ '000	*%age*	*US $ '000*	*%age*
2016	***61,137***	***4.53%***	***44,558***	***3.30%***
2015	69,244	5.40%	51,696	4.03%
2014	72,635	6.05%	58,786	4.90%
2013	68,754	6.37%	55,662	5.15%
2012	75,886	7.75%	61,441	6.27%

Table - 31. Treatment of assets financed by Equity of Investment Accountholders

The following table summarises the treatment of assets financed by IAH in the calculation of risk weighted assets (RWA) for capital adequacy purposes as of 31 December 2016:

	RWA US$ '000	*RWA for capital adequacy purposes US$ '000*	*Capital charges US$ '000*
Type of Claims			
Claims on Sovereign	**56,981**	**17,094**	**2,137**
Claims on PSEs	**8,028**	**2,408**	**301**
Claims on Banks	**176,616**	**52,985**	**6,623**
Claims on Corporates	**636,092**	**190,828**	**23,854**
Mortgage	**71,906**	**21,572**	**2,697**
Regulatory Retail Portfolio	**207,228**	**62,168**	**7,771**
Past due facilities	**78,567**	**23,570**	**2,946**
Investment in securities	**8,399**	**2,520**	**315**
Holding of Real Estates	**49,444**	**14,833**	**1,854**
Other Assets	**22,756**	**6,827**	**853**
	1,316,017	**394,805**	**49,351**

The following table summarises the treatment of assets financed by IAH in the calculation of risk weighted assets (RWA) for capital adequacy purposes as of 31 December 2015:

	RWA US$ '000	*RWA for capital adequacy purposes US$ '000*	*Capital charges US$ '000*
Type of Claims			
Claims on Sovereign	46,229	13,869	1,734
Claims on PSEs	18,157	5,447	681
Claims on Banks	143,416	43,025	5,378
Claims on Corporates	576,966	173,090	21,636
Mortgage	162,104	48,631	6,079
Regulatory Retail Portfolio	15,733	4,720	590
Past due facilities	44,930	13,479	1,685
Investment in securities	9,786	2,936	367
Holding of Real Estates	29,191	8,757	1,095
Other Assets	14,172	4,252	532
	1,060,684	318,206	39,777

3 RISK MANAGEMENT (continued)

d) Off-balance sheet equity of Investment Accountholders

Off-balance sheet equity of Investment accountholders is invested and managed in accordance with Shari'a requirements.

The Group as fund manager will manage and administer the investment account in a proper, diligent and efficient manner in accordance with applicable laws and local regulations.

The Group has appropriate procedures and controls in place commensurate to the size of its portfolio which includes:

(a) Organizing its internal affairs in a responsible manner, ensuring it has appropriate internal controls and risk management systems and procedures and controls designed to mitigate and manage such risks;

(b) Observing high standards of integrity and fair dealing in managing the scheme to the best interest of its investors; and

(c) Ensuring that the Group has the requisite level of knowledge and experience for the tasks that is undertaken and is competent for the work undertaken.

Table – 32. Off-balance sheet equity of Investment Accountholders by Islamic product type

The following table summarises the breakdown of Off-balance sheet equity of IAH by type of islamic financing contracts as of:

Islamic products

	31 December 2016	*31 December 2015*
Sales receivables	**87.62%**	90.91%
Investments	**12.38%**	9.09%

Table – 33. Off-balance sheet equity of Investment Accountholders by counterparty type

The following table summarises the percentage of financing for each category of counterparty to total financing as of:

Counterparty type

	31 December 2016	*31 December 2015*
Banks	**87.62%**	78.12%
Corporate	**12.38%**	21.88%

3 RISK MANAGEMENT (continued)

d) Off-balance sheet equity of Investment Accountholders (continued)

Table – 34. Off-balance sheet equity of Investment Accountholders by type of assets
The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets and the changes in the asset allocation for the year ended 31 December 2016:

	Opening actual allocation US$ '000	***Movement US$ '000***	***Closing actual allocation US$ '000***
Sales receivables	**94,677**	**(28,092)**	**66,585**
Investments	**9,462**	**(57)**	**9,405**
	104,139	**(28,149)**	**75,990**

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets and the changes in the asset allocation for the year ended 31 December 2015:

	Opening actual allocation US$ '000	*Movement US$ '000*	*Closing actual allocation US$ '000*
Sales receivables	101,930	(7,253)	94,677
Investments	9,718	(256)	9,462
	111,648	(7,509)	104,139

Table – 35. Off-balance sheet equity of Investment Accountholders historical returns
The following table summarises the historical returns over the past five year:

	Dec 2016 US$ '000	*Dec 2015 US$ '000*	*Dec 2014 US$ '000*	*Dec 2013 US$ '000*	*Dec 2012 US$ '000*
Gross Income	**1,810**	1,782	1,772	105	1,209
Mudarib Fee	**118**	77	99	47	168

The Group's share of profit as a Mudarib for managing Off-balance sheet equity of Investment accountholders and their share of income is based on the terms and conditions of the related mudarib agreements. These mudarib agreements are done at the individual Counter party level.

e) Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on regular basis. The liquidity management policy at a minimum includes the following:

a. Provide clear guidance on the composition and role of the asset/liability committee or such other committee or department responsible for managing liquidity.

b. Establish approval processes to ensure adherence to liquidity risk management processes.

c. Require periodic calculations to determine the extent to which the segments are funding long-term assets with short-term liabilities.

3 RISK MANAGEMENT (continued)

e) Liquidity risk (continued)

d. Establish liquidity ratio benchmarks, e.g. parameters for the funding of long-term assets with short-term liabilities to guide liquidity management and the method for computing liquidity indicators.

e. Establish limits on the degree of concentrations that are deemed acceptable. This should:

i) Ensure diversification of funding by origin and term structure by, for example, guarding against concentration by individuals or groups of depositors, types of deposit instruments, market sources of deposit, geographical sources, term to maturity, and deposit currencies. Where concentrations occur, the segments manage their assets and liquidity profile to mitigate the risk; and

ii) Set procedures for the orderly restoration of the liquidity position in the event of loss of funding where such concentrations are unavoidable. In addition, the segments conduct an impact analysis on its dependency on any such concentrations.

f. Provide for periodic review of the deposit structure. The review should include the volume and trend of various types of deposits offered, maturity distributions of time deposits, profit rate paid on each type of deposit, prevailing market profit rate, limits on large time deposits, public funds, and non-resident deposits.

g. Provide for the review of alternate funding sources including stand-by facilities and lines of credit.

h. Establish a framework for the composition of assets.

i. Assess the acceptable mismatch in combination with currency commitments. The segments undertake separate analysis of their strategy for each currency individually. They set and regularly review limits on the size of cash flow mismatches over particular time horizons for foreign currencies in aggregate, and for each significant currency.

Table – 36. Liquidity ratios

The following table summarises the liquidity ratios as of:

	31 December 2016	*31 December 2015*
Liquid assets to total assets	**20.69%**	20.53%
Short term assets to short term liabilities	**74.41%**	60.90%

Table – 37. Quantitative indicators of financial performance and position

	Dec 2016*	*Dec 2015*	*Dec 2014*	*Dec 2013*	*Dec 2012*
Return on average equity	1.2%	3.5%	1.2%	0.6%	-6.1%
Return on average assets	0.1%	0.3%	0.1%	0.1%	-0.8%
Cost to Income Ratio	82.5%	88.5%	92.7%	91.1%	98.4%

* Return based on total income and equity (including non-controlling interest)

4 OTHERS

The responsibility for payment of Zakat is on individual shareholders and investment accountholders. However, in Pakistan, Zakah is deducted at source from the Equity of Investment accountholders as required by local laws.

The Group has dedicated staff and hires services of professional firms to ensure compliance with applicable laws and regulations. Further, the legal cases are actively followed in collaboration of legal councils and directly monitored by the strategic management.