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

Basel III, Pillar III Disclosures

31 December 2017

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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 2017, 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 ("IAH").

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 and might not be comparable with the disclosures of the current period ended 31 December 2017.

In order to ensure compliance with instructions of Central Bank of Bahrain, the Bank has prepared a detailed capitalization plan to increase the equity to BD 100 million (USD: 265 million). In this respect, the parent and majority shareholder will provide Additional Tier-1 Capital in the form of perpetual subordinated debt amounted to USD 110 million. Simultaneously, the existing subordinated debts amounted to USD 31 million will be repaid to holding company upon approval by the CBB. Said capitalization process will be duly completed in first quarter of year 2018 after completing requisite legal formalities and securing approvals from competent authorities.

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 2017			31 December 2016		
	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			22,699		
Retained earnings	(2,841)			3,809		
Unrealized gains and losses on available for sale financial instruments	525			1,700		
Gains and losses resulting from converting foreign currency subsidiaries to the parent currency	(13,914)			(9,316)		
Other reserves	(117)			(114)		
Total CET1 capital before minority interest	137,497			149,923		
Minority interest in banking subsidiaries	27,257			36,146		
Total CET1 capital prior to regulatory adjustments	164,754			186,069		
Less:						
Goodwill	37,421			45,264		
Intangible other than mortgage servicing rights	4,411			819		
Deferred tax assets	19,731			18,813		
Total CET 1 capital after the regulatory adjustments above (CET 1a)	103,191			121,173		
Other Capital (AT1 & T 2)						
Instruments issued by parent company		25,000	6,000		25,000	6,000
Instruments issued by banking subsidiaries to third parties		1,725	16,773		1,150	11,666
Assets revaluation reserve - property, plant, and equipment		-	1,193		-	1,193
General financing loss provisions		-	4,134		-	3,284
Total Available AT1 & T2 Capital		26,725	28,100		26,150	22,143
Total CET 1 Capital	103,191			121,173		
Total T1 Capital		129,916			147,323	
Total Capital			158,016			169,466

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 2017 Capital requirements US $ '000	*31 December 2016 Capital requirements US $ '000*
Type of Islamic financing contracts		
Receivables	22,875	22,807
Ijara Muntahia Bittamleek & Ijara income receivable	11,747	12,035
Musharaka	17,393	11,081
	52,015	45,923

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 2017		*31 December 2016*	
	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	6,930	-	7,154	-
Total of market risk - standardised approach	6,930	-	7,154	-
Multiplier	12.50	12.50	12.50	12.50
	86,625	-	89,425	-
Eligible Portion for the purpose of the calculation	100%	30%	100%	30%
Risk Weighted Exposures ("RWE") for CAR Calculation	86,625	-	89,425	-
Total market RWE		86,625		89,425
		12.50%		12.50%
Minimum capital requirement		10,828		11,178

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 2017 *US $*	*31 December 2016* *US $*
Indicators of operational risk		
Average gross income	118,387	102,586
Multiplier	12.5	12.5
	1,479,838	1,282,325
Eligible Portion for the purpose of the calculation	15%	15%
Total operational RWE	221,976	192,349
	12.50%	12.50%
Minimum capital requirement	27,747	24,044

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 2017			31 December 2016		
	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	15.06%	12.38%	9.84%	16.58%	14.42%	11.86%
Minimum regulatory requirements*	12.50%	10.50%	9.00%	12.50%	10.50%	9.00%
Al Baraka Bank Pakistan Limited **	21.85%	16.18%	16.18%	20.41%	16.93%	16.93%
Itqan Capital Company	33.43%	33.43%	33.43%	33.97%	33.97%	33.97%

** Minimum required by CBB regulations under Basel III*

***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). Mobilisation 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 2017			31 December 2016		
	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	10.36%	7.69%	8.66%	10.35%	8.66%	8.66%
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 2017				*31 December 2016*			
	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	171,060	155,083	48,393	50,410	230,758	177,413	50,243	47,548
Receivables	4,766	10,780	723,820	767,951	3,002	3,097	739,582	631,293
Mudaraba financing	-	-	-	-	-	-	776	194
Ijara Muntahia Bittamleek	26,291	23,598	239,319	248,288	18,302	18,906	261,466	258,061
Musharaka	64,128	54,629	275,513	268,991	-	-	316,728	222,068
Investments	385,234	403,366	114,126	115,582	360,278	328,119	174,517	141,111
Investment in real estate	6,782	6,788	-	-	7,493	7,600	-	-
Ijara income receivables	3,212	2,934	40,073	35,903	1,713	1,259	28,892	26,986
Premises and equipment	38,530	36,196	-	-	32,203	28,072	-	-
Other assets	76,060	79,898	32,956	32,646	83,028	60,842	26,041	21,800
Unfunded exposure								
Contingencies and commitments	224,666	223,601	-	-	200,360	202,137	-	-
	1,000,729	996,873	1,474,200	1,519,771	937,137	827,445	1,598,245	1,349,061

*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 2017				31 December 2016			
	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	36,797	134,263	29,210	19,183	40,587	190,171	26,242	24,001
Receivables	4,766	-	459,761	264,059	3,002	-	472,141	267,441
Mudaraba financing	-	-	-	-	-	-	-	776
Ijara Muntahia Bittamleek	26,291	-	216,886	22,433	18,302	-	220,257	41,209
Musharaka	-	64,128	49	275,464	-	-	76	316,652
Investments	257,922	127,312	63,587	50,539	218,227	142,051	81,020	93,497
Investment in real estate	6,782	-	-	-	7,493	-	-	-
Ijara income receivables	3,212	-	35,543	4,530	1,713	-	25,758	3,134
Premises and equipment	15,319	23,211	-	-	11,537	20,666	-	-
Other assets	6,644	69,416	3,346	29,610	10,916	72,112	2,536	23,505
	357,733	418,330	808,382	665,818	311,777	425,000	828,030	770,215

* 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 2017				31 December 2016			
	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	31,146	-	8,164	-	24,579	-	8,229	-
Claims on Sovereigns	310,330	-	70,926	-	415,598	-	92,322	-
Claims on Public Sector Entities	160,981	27	38,484	-	60,344	7,069	145,601	-
Claims on banks	97,719	51,657	301,390	-	51,322	21,906	294,704	-
Claims on corporate	18,833	172,970	622,569	-	20,986	171,101	663,507	-
Mortgage	-	-	221,323	-	-	-	203,607	-
Past dues receivables	2,479	-	71,704	-	-	-	53,626	-
Regulatory Retail Portfolio	-	12	99,451	-	-	284	96,061	-
Equity investment	11,429	-	604	-	11,556	-	471	-
Investment in Funds	5,899	-	-	-	7,865	-	5,000	-
Holding of Real Estate	48,110	-	10,763	-	58,254	-	12,361	-
Other assets	89,137	-	28,822	-	86,273	-	22,756	-
	776,063	224,666	1,474,200	-	736,777	200,360	1,598,245	-

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 2017		*31 December 2016*	
	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	-	224	-	914
Receivable	-	10,643	-	48,548
Musharaka	-	2,825	-	2,156
Ijara Muntahia Bittamleek	-	382	-	583
Investments	14,636	18,058	14,576	18,028
Ijara Income Receivable	-	72	-	81
Other Assets	698	-	2,688	-
Contingencies and commitments	5,396	-	4,432	-
	20,730	32,204	21,696	70,310

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

	31 December 2017	*31 December 2016*
	Self financed US $ '000	*Self financed US $ '000*
Assets		
Investment in a subsidiary	84,201	82,662
Equity investment in Itqan Capital	54,342	54,342
	138,543	137,004
Contingencies and commitments		
Letters of credit	91	4,054
Guarantees	-	285
Acceptances	324	3,098
	415	7,437

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 2017:

Counterparties *	*Funded* *US $ '000*
Counterparty # 1	137,987
Counterparty # 2	101,245
Counterparty # 3	92,709
Counterparty # 4	75,396
Counterparty # 5	49,438
Counterparty # 6	43,060
Counterparty # 7	37,952
Counterparty # 8	32,916
Counterparty # 9	28,174

* 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 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.

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.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Highly leveraged counter parties

Highly leveraged counter parties are determined by the Credit 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. In this respect, the high risk exposure classified by the bank is as follows:

2017	US $ '000
Counterparty # 1	8,156
Counterparty # 2	1,833
Counterparty # 3	1,227
Counterparty # 4	774
Counterparty # 5	49

2016	US $ '000
Counterparty # 1	43,405
Counterparty # 2	8,047
Counterparty # 3	5,051
Counterparty # 4	4,497
Counterparty # 5	2,187
Counterparty # 6	152
Counterparty # 7	124
Counterparty # 8	9

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 2017					31 December 2016				
			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	20,737	82,838	43,949	16,977	21,912	16,785	67,139	28,327	12,056	26,756
Investment Firms	238	15,493	-	15,493	-	433	18,645	-	-	18,645
Individuals	878	9,358	2,849	5,563	946	1,205	12,453	10,671	826	956
Others	8,067	22,995	8,119	6,835	8,041	10,288	11,196	879	3,080	7,237
	29,920	130,684	54,917	44,868	30,899	28,711	109,433	39,877	15,962	53,594

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 2017:

	Specific allowances							
	Opening Balance US $ '000	*Charges during the year US $ '000*	*Amalgamation during the year US $ '000*	*Write-Back during the year US $ '000*	*Write-offs during the year US $ '000*	*Transferred to Investment risk reserve US $ '000*	*Exchange difference on opening balance US $ '000*	*Balance at the end of the year US $ '000*
Corporates	37,220	5,283	-	(5,690)	-	478	(1,866)	35,425
Investment Firms	13,187	-	-	-	-	-	195	13,382
Individuals	1,958	611	-	(222)	-	161	(77)	2,431
Others	3,446	2,167	-	(123)	-	-	(182)	5,308
	55,811	8,061	-	(6,035)	-	639	(1,930)	56,546

A collective provision of US $ 0.8 million was charged during the year and accumulated balance has been increased to US $ 4.1 million as at 31 December 2017.

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

	Specific allowances							
	Opening Balance US $ '000	*Charges during the year US $ '000*	*Amalgamation during the year US $ '000*	*Write-Back during the year US $ '000*	*Write-offs during the year US $ '000*	*Transferred to investment risk reserve US $ '000*	*Exchange difference on opening balance US $ '000*	*Balance at the end of the year US $ '000*
Corporates	23,936	5,676	13,388	(5,813)	-	-	33	37,220
Investment Firms	6,110	7,129	-	-	-	-	(52)	13,187
Individual	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.

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 2017			31 December 2016		
	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	61,390	18,489	3,345	41,115	15,495	2,535
Other Asian countries	69,294	38,057	789	68,318	40,316	749
	130,684	56,546	4,134	109,433	55,811	3,284

* 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 2017 Total US $ '000	*31 December 2016 Total US $ '000*
Restructured Islamic financing contracts	46,603	63,875

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 2017		31 December 2016	
	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	219,453	-	281,001	-
Receivables	728,586	421,509	742,584	428,640
Mudaraba financing	-	-	776	776
Ijara Muntahia Bittamleek	265,610	76,892	279,768	106,823
Musharaka	339,641	339,593	316,728	316,652
Investments	499,360	-	534,795	-
Investment in real estate	6,782	-	7,493	-
Ijara income receivables	43,285	-	30,605	-
Premises and equipment	38,530	-	32,203	-
Other assets	109,016	-	109,069	-
	2,250,263	837,994	2,335,022	852,891

* 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 2017		31 December 2016	
	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	308,895	52,924	310,373	69,534

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 2017	31 December 2016
	Foreign exchange risk US $ '000	Foreign exchange risk US $ '000
RWE	86,625	89,429
Capital requirements (12.5%)	10,828	11,179
Maximum value of RWE	89,152	89,429
Minimum value of RWE	86,619	75,218

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 2017:

	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	1,000	4,750	-	1,000	25
Private equity	36,048	35,439	13,304	22,743	3,661
Real estate related	23,853	30,319	-	23,853	12,293
	60,901	70,508	13,304	47,596	15,979

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

Table – 20. Equity gains or losses in Banking Book
The following table summarises the cumulative realised and unrealised gains during the year ended:

	31 December 2017 US $ '000	*31 December 2016 US $ '000*
Cummulative realised gains arising from sale or liquidation	2,055	2,942
Total unrealised gains recognised in the balance sheet but not through P&L	525	1,700
Unrealised gross gains included in Tier One Capital	525	1,700
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 continuously 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

The following are the profit rate mismatch between the rate of return on assets and the expected funding due to the sources of finance as of:

	31 December 2017				
	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	446,530	137,608	59,946	66,883	17,619
Ijara Muntahia Bittamleek and Ijara Income Receivables	30,964	9,827	15,516	64,396	188,193
Musharaka	28,327	1,172	9,300	80,519	220,323
Investments-Sukuk	7,470	5,212	46,780	185,400	192,976
Profit rate sensitive assets	**513,291**	**153,819**	**131,542**	**397,198**	**619,111**
Medium term financing	48,601	29,214	-	22,000	-
Equity of investment accountholders	678,361	201,721	215,846	189,447	188,826
Subordinated debt	1,837	-	1,294	5,175	48,727
Profit rate sensitive liabilities	**728,799**	**230,935**	**217,140**	**216,622**	**237,553**
Profit rate gap	**(215,508)**	**(77,116)**	**(85,598)**	**180,576**	**381,558**
Profit rate sensitivity (200bps)	**(4,310)**	**(1,542)**	**(1,712)**	**3,612**	**7,631**

	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 and Ijara Income Receivables	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 sensitive assets	428,985	322,648	123,197	297,014	661,414
Medium term financing	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 sensitive 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 (200bps)	(6,002)	1,785	(2,583)	162	8,597

3 RISK MANAGEMENT (continued)

b) Market Risk (continued)

This table contains the mismatch amongst profit bearing assets and liabilities to ensure compliance with financial reporting framework public disclosure requirements. However, in lieu of inherent nature of Islamic Banking, such mismatches does not exists amongst assets and liabilities carried by the Bank as the bank has profit and loss sharing mudarba agreement with Investment accountholders whereby in case of any decrease in profit rates the corresponding impact has to be shared with the customers as per the mudaraba arrangement. It's hereby elaborated that the assets base represents receivable against various modes of sales/ deployment of funds under wakala and mudaraba arrangements, assets and receivables against Ijara and participations in ventures under Musharaka arrangements. While these assets are finance through capital, current accounts, funds received under mudaraba contract, payables against purchase and predominantly through funds received under profit sharing or Mudarba contracts. Therefore, the table given is just indicative of profit mismatches amongst assets and liabilities under various contracts.

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 funds generated from various sources (Self-Financed). In this regards, the Bank at inception designate each asset separately as "Self" and "Jointly" financed, except liquid assets which are managed collectively. Further, the jointly financed assets are segregated proportionately based on amounts of funds contributed by each category of investors.

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 three months are not entitled to any income. Equity of IAH held for more than three months and withdrawn before their maturity are entitled to income only after deducting a penalty charge equivalent to three months income.

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

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.

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 $ 2 thousand (2016: US $ 7 thousand) was charged by the CBB during the year ended 31 December 2017 for anomalies related to electronic fund transfers.

A financial penalty of US $ 230 thousand (2016: US $ 5 thousand) was charged by SBP to the Group's subsidiary in Pakistan during the year ended 31 December 2017 for various non-compliances.

Non-Shari'a complaint income

The Group has received US $ 999 thousand (2016: US $ 382 thousand) from customers as penalty for default and 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 2017 US $ '000	*31 December 2016 US $ '000*
IAH - Non-banks	1,230,387	1,324,689
IAH - Banks	241,540	270,666
Profit equalisation reserve	572	551
Investment risk reserve	1,701	2,339
	1,474,200	1,598,245

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 2017	*31 December 2016*
PER to IAH (%)	**0.04%**	0.03%
IRR to IAH (%)	**0.12%**	0.15%

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 2017	*31 December 2016*
Receivable	**56.60%**	54.89%
Mudaraba	**0.00%**	0.06%
Musharaka	**21.55%**	23.51%
Ijara Muntahia Bittamleek & Ijara income receivable	**21.85%**	21.55%

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 2017	*31 December 2016*
Banks	**16.56%**	17.06%
Investment Firms	**3.79%**	5.38%
Corporates	**19.65%**	15.88%
Residentials	**47.33%**	49.83%
Others	**12.67%**	11.86%

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 2017	*31 December 2016*
Administrative expenses charged to equity of investment accountholders	**7,079**	5,755
Share of profits earned by IAH, before transfers to/from reserves	**71,861**	61,137
Percentage share of profit earned by IAH before transfer to/from reserves	**4.73%**	4.53%
Share of profit paid out to IAH after Mudarib fee and transfer to/from reserves	**53,553**	44,558
Percentage share of profit paid out to IAH after Mudarib fee and transfer to/from reserves	**3.52%**	3.30%
Share of profit paid out to Bank as mudarib	**18,308**	16,579
Mudarib Fee to total Investment Profits	**25.48%**	27.12%

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 equalisation reserve during the year ended:

	31 December 2017 US $ '000	*31 December 2016 US $ '000*
Balance at 1 January	551	558
Foreign exchange loss	21	(7)
	572	551
Percentage of the profit earned on equity of investment accountholders appropriated to profit equalisation 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 2017 US $ '000	*31 December 2016 US $ '000*
Balance at 1 January	2,339	2,339
Amount apportioned from income allocable to equity of investment accountholders	(639)	-
Exchange difference	1	-
	1,701	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 2016: 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 2017:

	Opening Actual Allocation US $ '000	*Movement US $ '000*	*Closing Actual Allocation US $ '000*
Cash and balances with banks	50,243	(1,850)	48,393
Receivable	739,582	(15,762)	723,820
Mudaraba financing	776	(776)	-
Ijara Muntahia Bittamleek	261,466	(22,147)	239,319
Musharaka	316,728	(41,215)	275,513
Investments	174,517	(60,391)	114,126
Ijara income receivables	28,892	11,181	40,073
Other assets	26,041	6,915	32,956
	1,598,245	(124,045)	1,474,200

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 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
Receivable	606,230	133,352	739,582
Mudaraba financing		776	776
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

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*
2017	*71,861*	*4.73%*	*53,553*	*3.52%*
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%

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 2017:

	RWA US$ '000	*RWA for capital adequacy purposes US$ '000*	*Capital charges US$ '000*
Type of Claims			
Claims on Sovereign	**27,383**	**8,215**	**1,027**
Claims on PSEs	**6,099**	**1,830**	**229**
Claims on Banks	**167,905**	**50,372**	**6,297**
Claims on Corporates	**590,506**	**177,152**	**22,144**
Mortgage	**228,989**	**68,697**	**8,587**
Regulatory Retail Portfolio	**68,174**	**20,452**	**2,557**
Past due facilities	**94,841**	**28,452**	**3,557**
Investment in securities	**1,046**	**314**	**39**
Holding of Real Estates	**43,054**	**12,916**	**1,615**
Other Assets	**28,822**	**8,647**	**1,081**
	1,256,819	**377,047**	**47,133**

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

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 is not engaged in investment management activities or in managing funds. Therefore, the investments policies or risk parameters related to funds management are not relevant amid with specific nature of such business. The exposures given above are raised predominantly under agency arrangements/ syndications with specified institutional customers . In this respect, the respective nature, associated risks and returns measures are duly disclosed.

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 2017*	*31 December 2016*
Sales receivables	88.79%	87.62%
Investments	11.21%	12.38%

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 2017*	*31 December 2016*
Banks	89.44%	87.62%
Corporate	10.56%	12.38%

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 2017:

	Opening actual allocation US$ '000	*Movement US$ '000*	*Closing actual allocation US$ '000*
Receivables	66,585	9,424	76,009
Investments	9,405	189	9,594
	75,990	9,613	85,603

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*
Receivables	94,677	(28,092)	66,585
Investments	9,462	(57)	9,405
	104,139	(28,149)	75,990

Table – 35. Off-balance sheet equity of Investment Accountholders historical returns

The following table summarises the historical returns over the past five year:

	Dec 2017 US$ '000	*Dec 2016 US$ '000*	*Dec 2015 US$ '000*	*Dec 2014 US$ '000*	*Dec 2013 US$ '000*
Gross Income	1,491	1,810	1,782	1,772	105
Mudarib Fee	105	118	77	99	47

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.

Table – 36. Off-balance sheet equity of Investment Accountholders foreign currency translation risk

	31 December 2017		
Currency	*Exposure US$ '000*	*Sensitivity*	*Amount US$ '000*
Euro	6,195	20%	1,239

	31 December 2016		
Currency	*Exposure US$ '000*	*Sensitivity*	*Amount US$ '000*
Euro	1,275	20%	255

3 RISK MANAGEMENT (continued)

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.

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 – 37. Liquidity ratios

The following table summarises the liquidity ratios as of:

	31 December 2017	*31 December 2016*
Liquid assets to total assets	17.15%	20.69%
Short term assets to short term liabilities	57.14%	74.41%

Table – 38. Quantitative indicators of financial performance and position

	*Dec 2017**	*Dec 2016*	*Dec 2015*	*Dec 2014*	*Dec 2013*
Return on average equity	-2.7%	1.2%	3.5%	1.2%	0.6%
Return on average assets	-0.2%	0.1%	0.3%	0.1%	0.1%
Cost to Income Ratio	103.1%	82.5%	88.5%	92.7%	91.1%

* 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.