Ithmaar Bank

# Basel II Pillar III Quantitative Disclosures
# At 31 December 2013

**Ithmaar Bank B.S.C**
**Basel II Pillar III Quantitative Disclosures at 31 December 2013**

## INDEX

بنك الإثمار
Ithmaar Bank

## 1. Background

The Public Disclosure (PD) module of the Central Bank of Bahrain (CBB) rulebook was introduced with effect from January 2008. The disclosures in this report are in addition to the disclosures set out in the Group's consolidated financial statements for the year ended 31 December 2013, presented in accordance with Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). These disclosures are mainly related to compliance with the Basel II Pillar III Quantitative disclosure requirements and should be read in conjunction with the Group's consolidated financial statements and annual report for the year ended 31 December 2013.

## 2. Basel II Framework

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

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

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

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

## 3. Methodology

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

- Line by line consolidation is performed for the risk exposures and eligible capital of all the subsidiaries within the Group with the exception of Ithmaar's banking subsidiaries incorporated outside Kingdom of Bahrain which are operating under Basel II compliant jurisdictions, where full aggregation is performed of the risk weighted exposures and eligible capital as required under Prudential Consolidation and Deduction module (PCD).
- Pro-rata aggregation of risk weighted exposures and eligible capital of Ithmaar's significant investments (20% – 50%) in banking and other financial entities as required under PCD module.

## 4. Approaches adopted for determining regulatory capital requirements

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

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

## 5. Group Structure

The Group's consolidated financial statements are prepared and published on a full consolidation basis, with all subsidiaries being consolidated in accordance with AAOIFI. However, the CBB's consolidated capital adequacy methodology accommodates both line-by-line and aggregation forms of consolidation.

Line by line consolidation is performed for the risk exposures and eligible capital of all the subsidiaries within the Group except for the following:

| Subsidiary | Country of Incorporation | Ownership | Approach |
|---|---|---|---|
| Faysal Bank Limited | Pakistan | 66.6 per cent | Full Aggregation |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 6. Consolidated Capital Structure for capital adequacy purpose

| | | |
|---|---|---|
| **A** | **Tier 1 Capital** | |
| | Issued and fully paid-up ordinary capital | 274,283 |
| | **Reserves** | |
| | General reserves | 21,385 |
| | Statutory reserve | 14,360 |
| | Share Premium | 56,404 |
| | Others | (8,147) |
| | Accumulated losses | (122,508) |
| | Minority interest in the equity of subsidiaries | 28,132 |
| | Aggregation | 66,842 |
| | **Sub-Total** | **330,751** |
| | **Regulatory deductions:** | |
| | Goodwill | (4,712) |
| | Loss for the year | (33,072) |
| | **Total Tier 1 capital before PCD deductions** | **292,967** |
| **B** | **Tier 2 Capital** | |
| | General Provision | 15,250 |
| | Profit Equalization Reserves | 473 |
| | Unrealized gains arising from fair valuations (45%) | 6,905 |
| | Aggregation | 10,287 |
| | **Total Tier 2 capital before PCD deductions** | **32,915** |
| **C** | **Total Available Capital (A+B)** | **325,882** |
| **D** | **General deductions from Tier 1 & 2 under PCD Module** | |
| | Deduction of unconsolidated financial subsidiaries which are aggregated or deducted | (37,562) |
| | Deduction of unconsolidated financial associates which are aggregated or deducted | (1,686) |
| | Excess over maximum permitted large exposure limit | (25,116) |
| | **Total Deductible Items** | **(64,364)** |
| **E** | **Total Eligible Capital (C-D)** | **261,518** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 7. Disclosure of the regulatory capital requirements for credit risk under standardized approach

**Exposure funded by Self Finance**

| | Risk weighted assets | Capital requirement |
|---|---|---|
| Claims on sovereign | 33,589 | 4,031 |
| Banks | 61,841 | 7,421 |
| Corporate portfolio | 197,478 | 23,697 |
| Investments in securities | 388,318 | 46,598 |
| Holding of real estate | 330,541 | 39,665 |
| Regulatory retail | 637 | 76 |
| Past due financings | 26,118 | 3,134 |
| Other assets | 74,579 | 8,949 |
| Aggregation | 564,534 | 67,744 |
| **Total** | **1,677,635** | **201,315** |

**Exposure funded by Unrestricted Investment Accounts (URIA)**

| | Risk weighted assets | Capital requirement |
|---|---|---|
| Claims on Banks | 26 | 3 |
| Corporate portfolio | 27,848 | 3,342 |
| Equity portfolio | 7,634 | 916 |
| Holding of real estate | 13,208 | 1,585 |
| Regulatory retail | 58,430 | 7,012 |
| Past due financings | 24,646 | 2,958 |
| **Total** | **131,792** | **15,816** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 8. Gross credit exposures:

| | Gross credit exposure | Average gross credit exposure |
|---|---|---|
| **Credit risk exposure relating to on balance sheet assets are as follows:** | | |
| Cash and balances with banks and central banks | 224,568 | 214,716 |
| Commodity and other placements with banks, financial and other institutions | 187,867 | 178,598 |
| Murabaha and other financings | 1,188,924 | 1,186,464 |
| Musharaka financing | 23,412 | 19,589 |
| Investments | 937,787 | 928,014 |
| Other assets | 100,731 | 98,940 |
| Fixed assets | 43,417 | 43,682 |
| Intangible assets | 84,276 | 87,541 |
| **Total on balance sheet credit exposure** | **2,790,982** | **2,757,544** |
| **Credit risk exposure relating to off balance sheet items are as follows:** | | |
| Financial guarantees and irrevocable letters of credit | 358,744 | 370,939 |
| Financing commitments, Undrawn facilities and other credit related liabilities | 1,000,423 | 905,432 |
| **Total off balance sheet credit exposure** | **1,359,167** | **1,276,371** |
| **Total credit exposure** | **4,150,149** | **4,033,915** |
| **Total credit exposure financed by URIA** | **764,936** | **722,160** |
| **Total credit exposure financed by URIA (%)** | **18.43%** | **17.90%** |

Average gross credit exposures have been calculated based on the average of balances outstanding during the year ended 31 December 2013.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 9. Geographical distribution of credit exposures:

| | Asia/ Pacific | Middle East | Europe | North America | Others | Total |
|---|---|---|---|---|---|---|
| **On-balance sheet items** | | | | | | |
| Cash and balances with banks and central banks | 105,571 | 67,911 | 25,967 | 25,119 | - | 224,568 |
| Commodity and other placements with banks, financial and other institutions | 1,078 | 145,699 | 38,932 | - | 2,158 | 187,867 |
| Murabaha and other financings | 661,506 | 398,347 | 85,146 | 49 | 43,876 | 1,188,924 |
| Musharaka financing | 23,412 | - | - | - | - | 23,412 |
| Investments | 453,830 | 426,705 | 47,803 | 9,449 | - | 937,787 |
| Other assets | 50,776 | 23,877 | 19,922 | 6,156 | - | 100,731 |
| Fixed assets | 20,223 | 23,152 | 42 | - | - | 43,417 |
| Intangible assets | 9,024 | 73,721 | 1,531 | - | - | 84,276 |
| **Total on balance sheet items** | **1,325,420** | **1,159,412** | **219,343** | **40,773** | **46,034** | **2,790,982** |
| **Off balance sheet items** | **1,076,534** | **271,244** | **10,555** | **-** | **834** | **1,359,167** |
| **Total credit exposure** | **2,401,954** | **1,430,656** | **229,898** | **40,773** | **46,868** | **4,150,149** |

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

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 10. Industrial distribution of credit exposures:

| | Banks and financial institutions | Trading and manufacturing | Property and construction | Services | Private Individuals | Textile | Others | Total |
|---|---|---|---|---|---|---|---|---|
| **On-balance sheet items** | | | | | | | | |
| Cash and balances with banks and central banks | 224,545 | - | - | - | - | - | 23 | 224,568 |
| Commodity and other placements with banks, financial and other institutions | 187,867 | - | - | - | - | - | - | 187,867 |
| Murabaha and other financings | 180,027 | 478,516 | 74,695 | 43,883 | 278,046 | 40,062 | 93,695 | 1,188,924 |
| Musharaka financing | 3,374 | 8,471 | - | 7,146 | 4,099 | 322 | - | 23,412 |
| Investments | 612,936 | 61,362 | 213,532 | 41,242 | 7,502 | 809 | 404 | 937,787 |
| Other assets | 71,462 | 2,739 | 11,803 | 155 | 13,577 | 5 | 990 | 100,731 |
| Fixed assets | 20,922 | - | 22,495 | - | - | - | - | 43,417 |
| Intangible assets | 84,276 | - | - | - | - | - | - | 84,276 |
| **Total on balance sheet items** | **1,385,409** | **551,088** | **322,525** | **92,426** | **303,224** | **41,198** | **95,112** | **2,790,982** |
| **Off balance sheet items** | **489,380** | **485,122** | **201,417** | **13,337** | **31,638** | **3,889** | **134,384** | **1,359,167** |
| **Total credit exposure** | **1,874,789** | **1,036,210** | **523,942** | **105,763** | **334,862** | **45,087** | **229,496** | **4,150,149** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 11. Maturity breakdown of credit exposures:

| | Up to 1 Month | 1-3 Months | 3-12 Months | 1-5 Years | 5-10 Years | 10-20 Years | Over 20 Years | Total |
|---|---|---|---|---|---|---|---|---|
| **On-balance sheet items** | | | | | | | | |
| Cash and balances with banks and central banks | 224,568 | - | - | - | - | - | - | 224,568 |
| Commodity and other placements with banks, financial and other institutions | 148,935 | 28,091 | 10,841 | - | - | - | - | 187,867 |
| Murabaha and other financings | 175,359 | 170,148 | 182,065 | 398,383 | 251,325 | 11,644 | - | 1,188,924 |
| Musharaka financing | 4,177 | 5,312 | 4,539 | 7,538 | 1,846 | - | - | 23,412 |
| Investments | 96,380 | 162,360 | 114,358 | 232,535 | 21,486 | 9,237 | 301,431 | 937,787 |
| Other assets | 41,737 | 4,865 | 39,673 | 5,016 | 9,440 | - | - | 100,731 |
| Fixed assets | 45 | 19 | 813 | 5,832 | 5,104 | 3,202 | 28,402 | 43,417 |
| Intangible assets | - | - | - | 2,749 | 3,546 | 48,360 | 29,621 | 84,276 |
| **Total on balance sheet items** | **691,201** | **370,795** | **352,289** | **652,053** | **292,747** | **72,443** | **359,454** | **2,790,982** |
| **Off balance sheet items** | **243,193** | **256,568** | **195,864** | **587,829** | **75,713** | **-** | **-** | **1,359,167** |
| **Total credit exposure** | **934,394** | **627,363** | **548,153** | **1,239,882** | **368,460** | **72,443** | **359,454** | **4,150,149** |

## 12. Related-party balances under credit exposure

A number of banking transactions are entered into with related parties in the normal course of business. The related party balances included under credit exposure at 31 December 2013 were as follows:

| | |
|---|---|
| Affiliated companies | 165,485 |
| Directors & key management | 4,931 |
| **Total** | **170,416** |

**Concentration of risk to individual counterparties where the credit exposure is in excess of the 15% individual obligor limit:**

| | |
|---|---|
| Non-banks | 59,823 |
| **Total** | **59,823** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 13. Past due and impaired financings and related provisions for impairment:

| | Gross exposure | Impairment provisions | Net exposure |
|---|---|---|---|
| **Analysis by industry** | | | |
| Manufacturing | 87,845 | 69,708 | 18,137 |
| Agriculture | 4,684 | 2,157 | 2,527 |
| Construction | 33,190 | 5,038 | 28,152 |
| Finance | 771 | 559 | 212 |
| Trade | 46,005 | 18,542 | 27,463 |
| Personal | 10,228 | 2,416 | 7,812 |
| Real estate | 22,761 | 7,632 | 15,129 |
| Technology and telecommunications | 344 | 313 | 31 |
| Transportation | 1,518 | 779 | 739 |
| Other sectors | 26,319 | 17,756 | 8,563 |
| **Total** | **233,665** | **124,900** | **108,765** |
| **Ageing analysis** | | | |
| Over 3 months up to 1 year | 47,708 | 1,409 | 46,299 |
| Over 1 year up to 3 years | 26,925 | 5,298 | 21,627 |
| Over 3 years | 159,032 | 118,193 | 40,839 |
| **Total** | **233,665** | **124,900** | **108,765** |

| **Movement in impairment provisions** | Relating to owners | Relating to unrestricted investment accounts | Total |
|---|---|---|---|
| At 1 January | 90,647 | 20,731 | 111,378 |
| Charge for the year | 15,563 | 2,449 | 18,012 |
| Write back during the year | (6,872) | - | (6,872) |
| Addition due to acquisition of associate | 8,487 | - | 8,487 |
| Utilized during the year | (2,078) | (115) | (2,193) |
| Exchange differences | (6,176) | 2,264 | (3,912) |
| At 31 December | **99,571** | **25,329** | **124,900** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 14. Past due and impaired financings by geographical areas:

| Analysis by Geography | Gross exposure | Impairment Provisions | Net exposure |
|---|---|---|---|
| Asia / Pacific | 122,553 | 78,971 | 43,582 |
| Middle East | 107,661 | 45,927 | 61,734 |
| Europe | 3,451 | 2 | 3,449 |
| **Total** | **233,665** | **124,900** | **108,765** |

## 15. Details of credit facilities outstanding that have been restructured during the year:

Restructured financings during the year ended 31 December 2013 aggregated to BD 84.9 million. This restructuring had an impact of BD 0.2 million on present earnings during the year ended 31 December 2013. Further, this restructuring is expected to have positive impact of BD 5.1 million on the Group's future earnings in 2014. Extension of maturity dates was the basic nature of concessions given to all the restructured facilities.

## 16. Credit exposures which are covered by eligible financial collateral:

**Exposure funded by Self Finance**

| | Gross Exposure | Eligible Financial Collateral |
|---|---|---|
| Corporate portfolio | 630,604 | 74,935 |
| Retail Portfolio | 92,677 | 12,164 |
| Past due financings | 52,125 | 3,791 |
| **Total** | **775,406** | **90,890** |

**Exposure funded by Unrestricted Investment Accounts**

| | Gross Exposure | Eligible Financial Collateral |
|---|---|---|
| Corporate portfolio | 115,158 | 22,330 |
| Retail Portfolio | 260,035 | 346 |
| Past due financings | 65,312 | 8,354 |
| **Total** | **440,505** | **31,030** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

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

| | Risk weighted assets | | | Capital requirement | | |
|---|---|---|---|---|---|---|
| | 31 December 2013 | Maximum Value | Minimum Value | 31 December 2013 | Maximum Value | Minimum Value |
| Foreign exchange risk | 53,963 | 53,118 | 53,963 | 6,476 | 6,374 | 6,476 |
| Aggregation | 23,634 | 62,011 | 23,634 | 2,836 | 7,441 | 2,836 |
| **Total** | **77,597** | **115,129** | **77,597** | **9,312** | **13,815** | **9,312** |

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

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

The alpha coefficient has been set at 15% under CBB Basel II guidelines. The capital requirement for operational risk at 31 December 2013 aggregated to BD 19.23 million.

## 19. Tier one capital ratios and Total capital ratios:

| | Tier One Capital Ratio | Total Capital Ratio |
|---|---|---|
| Ithmaar consolidated | 11.17% | 12.77% |
| Significant Bank subsidiaries whose regulatory capital amounts to over 5% of group consolidated regulatory capital whether on a stand-alone or sub-consolidated basis are as follows: | | |
| Faysal Bank Limited | 9.73% | 11.23% |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 20. Equity position in Banking book

At 31 December 2013, the Group's investment securities aggregated to BD 492.4 million. Out of the total investment securities, BD 13 million were listed investment securities and the remaining BD 479.4 million represented unlisted investment securities.

Cumulative realized losses from sale of investment securities during the year amounted to BD 0.6 million. Total unrealized loss recognized in the consolidated statement of changes in owners' equity amounted to BD 2.3 million.

At 31 December 2013, capital requirements using standardized approach aggregated to BD 18 million for listed investment securities and BD 29.5 million for unlisted investment securities before aggregation/pro-rata aggregation of investments in Banking and other financial entities.

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

| | 31 December | | | | |
|---|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **2010** | **2009** |
| Income from unrestricted investment accounts | 38,000 | 35,139 | 25,608 | 23,203 | 18,411 |
| Less: return to unrestricted investment accounts | (29,079) | (26,686) | (24,512) | (21,261) | (16,888) |
| Group's share of income from unrestricted investment accounts as a Mudarib | **8,921** | **8,453** | **1,096** | **1,942** | **1,523** |

For the year ended 31 December 2013 the return to unrestricted investment accountholders based on the average balance outstanding during the year stood at 5.57%. The Group's share of income from unrestricted investment account (Mudarib) including management fee for the year ended 31 December 2013 as a percentage of gross income from unrestricted investment accounts stood at 8.36%.

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 22. Movement in Profit Equalization Reserve and Provisions – URIA:

| | 31 December | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| **Profit Equalization Reserve** | | | | | |
| As at 1 January | 3,793 | 7,015 | 3,074 | 1,168 | 1,374 |
| Net addition | 1,954 | 2,052 | 3,941 | 2,266 | - |
| Transfer to impairment provisions | (4,787) | (5,274) | - | - | - |
| Net utilization | - | - | - | (360) | (206) |
| **As at 31 December** | **960** | **3,793** | **7,015** | **3,074** | **1,168** |
| Amount appropriated as a percentage of gross profit | 5% | 6% | 15% | 10% | - |
| **Provisions** | | | | | |
| As at 1 January | 33,313 | 25,958 | 26,302 | 24,289 | 17,554 |
| Net addition | 2,449 | 2,415 | 549 | 2,060 | 6,735 |
| Transfer from Profit Equalization Reserve | 4,787 | 5,274 | - | - | - |
| Net utilization | (684) | (334) | - | (47) | - |
| Reclassification | | - | (893) | - | - |
| **As at 31 December** | **39,865** | **33,313** | **25,958** | **26,302** | **24,289** |

At 31 December 2013, the ratio of profit equalization reserve and provisions to equity of unrestricted investment accountholders stood at 0.13% and 5.33% respectively.

At 31 December 2013, the ratio of financings to URIA stood at 57.8%.

The following table summarizes the breakdown of URIA and impairment provisions

| | 31 December | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| URIA : Banks | 45,110 | 13,262 | 21,964 | 31,511 | 31,510 |
| URIA : Non-Banks | 703,412 | 646,911 | 534,727 | 419,367 | 339,085 |
| Provisions : Banks | 2,402 | 669 | 1,024 | 1,838 | 2,065 |
| Provisions : Non-Banks | 37,463 | 32,644 | 24,934 | 24,464 | 22,224 |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 23. Gross return from Restricted Investment Accounts (RIA)

| | 31 December | | | | |
|---|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **2010** | **2009** |
| Gross income | 1,613 | 101 | 908 | 2,836 | 2,090 |
| Mudarib fee | 226 | 305 | 1,061 | 4,618 | 6,768 |

## 24. Average declared rate of return on General Mudaraba deposits:

| | 31 December | | | | |
|---|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **2010** | **2009** |
| | Percentage | | | | |
| 7 Days | 0.25 | 0.25 | 0.30 | 0.50 | 0.50 |
| 30 Days | 1.49 | 1.90 | 2.31 | 3.00 | 3.17 |
| 90 Days | 1.99 | 2.48 | 2.90 | 3.25 | 3.25 |
| 180 Days | 2.49 | 2.90 | 3.25 | 3.50 | 3.50 |
| 360 Days | 2.97 | 3.40 | 3.50 | 3.70 | 3.63 |

## 25. Profit rate risk:

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

| | **USD** | **EUR** | **PKR** | **BD** | **AED** |
|---|---|---|---|---|---|
| Total profit rate exposure | 192,712 | 60,941 | 70,678 | 383,466 | 106,803 |
| Rate shock (assumed) (+/-) | 0.21% | 0.21% | 0.90% | 0.30% | 0.01% |
| **Total estimated impact (+/-)** | **405** | **128** | **636** | **1,150** | **11** |

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

## 26. Currency risk:

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Substantial portion of the Group's assets and liabilities are denominated in US Dollars, Bahraini Dinars and Pakistani Rupee. Bahraini Dinars and Saudi Riyal are pegged to US Dollars and as such currency risk is minimal

The significant net foreign currency positions at 31 December 2013 were as follows:

| | **Long/(Short)** |
|---|---|
| Pakistani Rupee | 34,768 |
| Euro | (22,891) |
| United States Dollars | 63,367 |
| Polish Zloty | 18,763 |
| UAE Dirham | (106,799) |
| Hong Kong Dollar | 25,624 |

## 27. Liquidity Ratios

| | **31 December** | | | | |
|---|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **2010** | **2009** |
| Liquid assets to total assets | 14.78% | 13.74% | 12.80% | 13.48% | 17.02% |
| Short term assets to short term liabilities | 66.97% | 56.98% | 63.80% | 63.44% | 83.39% |

## 28. Legal contingencies and compliance:

At 31 December 2013, the Group had contingent liabilities towards customer and other claims aggregating to BD 152.5 million. The management is of the view that these claims are not likely to result into potential liabilities. During the year 2013, the Bank paid penalty of BD Three thousand imposed by the CBB due to delay in compliance of regulatory submission requirement.