Ithmaar Bank

Basel II Pillar III Quantitative Disclosures
At 30 June 2013

Ithmaar Bank B.S.C
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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 interim condensed consolidated financial statements for the six month period ended 30 June 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 interim condensed consolidated financial information for the six month period ended 30 June 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 interim 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

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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	(9,197)
	Accumulated losses	(122,507)
	Minority interest in the equity of subsidiaries	39,203
	Aggregation	66,051
	Sub-Total	**339,982**
	Regulatory deductions:	
	Goodwill	(29,904)
	Loss for the period	(3,339)
	Total Tier 1 capital before PCD deductions	**306,739**
B	**Tier 2 Capital**	
	General Provision	7,507
	Profit Equalization Reserves	2,263
	Unrealized gains arising from fair valuations (45%)	9,287
	Aggregation	16,512
	Total Tier 2 capital before PCD deductions	**35,569**
C	**Total Available Capital (A+B)**	**342,308**
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	(1,620)
	Excess over maximum permitted large exposure limit	(24,138)
	Total Deductible Items	**(63,320)**
E	**Total Eligible Capital (C-D)**	**278,988**

(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	37,296	4,476
Claims on other Public Sector entities	1,040	125
Banks	50,168	6,020
Corporate portfolio	167,943	20,153
Investments in securities	344,352	41,322
Holding of real estate	405,682	48,682
Regulatory retail	814	98
Residential mortgage	9,049	1,086
Past due financings	29,185	3,502
Other assets	57,011	6,841
Aggregation	565,292	67,835
Total	**1,667,832**	**200,140**

Exposure funded by Unrestricted Investment Accounts (URIA)

	Risk weighted assets	Capital requirement
Banks	74	9
Corporate portfolio	32,261	3,871
Equity portfolio	10,066	1,208
Holding of real estate	13,877	1,665
Regulatory retail	52,782	6,334
Past due financings	28,477	3,417
Total	**137,537**	**16,504**

(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	203,707	204,286
Commodity and other placements with banks, financial and other institutions	153,619	161,474
Murabaha and other financings	1,189,190	1,186,597
Musharaka financing	15,980	15,873
Investments	950,012	934,127
Other assets	99,241	98,195
Fixed assets	41,948	42,948
Intangible assets	88,148	89,477
Total on balance sheet credit exposure	**2,741,845**	**2,732,977**
Credit risk exposure relating to off balance sheet items are as follows:		
Financial guarantees and irrevocable letters of credit	375,426	379,280
Financing commitments, Undrawn facilities and other credit related liabilities	876,362	843,402
Total off balance sheet credit exposure	**1,251,788**	**1,222,682**
Total credit exposure	**3,993,633**	**3,955,659**
Total credit exposure financed by URIA	**695,800**	**687,592**
Total credit exposure financed by URIA (%)	**17%**	**17%**

Average gross credit exposures have been calculated based on the average of balances outstanding during the six month period ended 30 June 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	97,133	64,571	41,467	536	-	203,707
Commodity and other placements with banks, financial and other institutions	-	115,415	38,204	-	-	153,619
Murabaha and other financings	675,686	376,100	83,471	25	53,908	1,189,190
Musharaka financing	15,980	-	-	-	-	15,980
Investments	439,321	444,006	51,871	11,817	2,997	950,012
Other assets	51,735	28,428	12,408	6,670	-	99,241
Fixed assets	21,956	19,838	154	-	-	41,948
Intangible assets	9,675	76,902	1,571	-	-	88,148
Total on balance sheet items	**1,311,486**	**1,125,260**	**229,146**	**19,048**	**56,905**	**2,741,845**
Off balance sheet items	**972,357**	**265,781**	**10,341**	**2,709**	**600**	**1,251,788**
Total credit exposure	**2,283,843**	**1,391,041**	**239,487**	**21,757**	**57,505**	**3,993,633**

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

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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	203,707	-	-		-	-	-	203,707
Commodity and other placements with banks, financial and other institutions	153,619	-	-	-	-	-	-	153,619
Murabaha and other financings	150,801	362,158	54,744	94,525	269,128	92,270	165,564	1,189,190
Musharaka financing	448	4,338	-	-	3,181	699	7,314	15,980
Investments	622,863	15,988	223,525	43,640	6,232	406	37,358	950,012
Other assets	44,431	26	11,046	26,885	9,619	2	7,232	99,241
Fixed assets	11,572	-	29,613	-	-	-	763	41,948
Intangible assets	88,148	-	-	-	-	-	-	88,148
Total on balance sheet items	**1,275,589**	**382,510**	**318,928**	**165,050**	**288,160**	**93,377**	**218,231**	**2,741,845**
Off balance sheet items	**656,329**	**410,105**	**10,472**	**138,543**	**4,324**	**14,354**	**17,661**	**1,251,788**
Total credit exposure	**1,931,918**	**792,615**	**329,400**	**303,593**	**292,484**	**107,731**	**235,892**	**3,993,633**

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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	203,707	-	-	-	-	-	-	203,707
Commodity and other placements with banks, financial and other institutions	95,736	10,303	47,580	-	-	-	-	153,619
Murabaha and other financings	170,682	174,719	237,443	356,643	223,357	22,530	3,816	1,189,190
Musharaka financing	300	-	1,756	7,217	6,056	651	-	15,980
Investments	38,211	131,185	152,609	243,004	300,302	4,899	79,802	950,012
Other assets	39,450	481	40,682	11,509	129	6,990		99,241
Fixed assets	62	163	413	6,234	19,897	15,179	-	41,948
Intangible assets	-	-	-	2,768	-	85,380	-	88,148
Total on balance sheet items	**548,148**	**316,851**	**480,483**	**627,375**	**549,741**	**135,629**	**83,618**	**2,741,845**
Off balance sheet items	**733,891**	**30,982**	**246,947**	**228,128**	**11,840**	**-**	**-**	**1,251,788**
Total credit exposure	**1,282,039**	**347,833**	**727,430**	**855,503**	**561,581**	**135,629**	**83,618**	**3,993,633**

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 30 June 2013 were as follows:

Affiliated companies	166,558
Directors & key management	5,030
Total	**171,588**

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

Non-banks	60,974
Total	**60,974**

(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	93,464	69,151	24,313
Agriculture	5,335	2,199	3,136
Construction	34,257	4,991	29,266
Finance	804	592	212
Trade	47,930	24,167	23,763
Personal	29,049	5,578	23,471
Real estate	13,065	7,461	5,604
Technology and telecommunications	354	319	35
Transportation	1,869	811	1,058
Other sectors	11,215	3,241	7,974
Total	**237,342**	**118,510**	**118,832**
Ageing analysis			
Over 3 months up to 1 year	49,195	1,646	47,549
Over 1 year up to 3 years	22,093	5,548	16,545
Over 3 years	166,054	111,316	54,738
Total	**237,342**	**118,510**	**118,832**

Movement in impairment provisions	**Relating to owners**	**Relating to unrestricted investment accounts**	**Total**
At 1 January 2013	90,647	20,731	111,378
Charge for the period	3,370	1,221	4,591
Write back during the period	(2,899)	-	(2,899)
Addition due to acquisition of associate	8,487	-	8,487
Utilized during the period	(1,422)	(61)	(1,483)
Exchange differences	(1,564)	-	(1,564)
At 30 June 2013	**96,619**	**21,891**	**118,510**

(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	124,456	79,800	44,656
Middle East	109,160	38,045	71,115
Europe	3,726	665	3,061
Total	**237,342**	**118,510**	**118,832**

15. Details of credit facilities outstanding that have been restructured during the six month period ended 30 June 2013:

Restructured financings during the six month period ended 30 June 2013 aggregated to BD 11.2 million. This restructuring had an impact of BD 0.09 million on present earnings during the six month period ended 30 June 2013. Further, this restructuring is expected to have positive impact of BD 0.25 million on the Group's future earnings in 2013. 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	626,686	97,230
Retail	90,112	11,700
Public sector entities	58,720	582
Past due financings	57,814	4,380
Total	**833,332**	**113,892**

Exposure funded by Unrestricted Investment Accounts

	Gross Exposure	Eligible Financial Collateral
Corporate portfolio	131,264	23,725
Past due financings	68,299	2,348
Total	**199,563**	**26,073**

(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		
	30 June 2013	Maximum Value	Minimum Value	30 June 2013	Maximum Value	Minimum Value
Foreign exchange risk	53,118	53,118	51,403	6,374	6,374	6,168
Aggregation	62,011	62,011	43,777	7,441	7,441	5,253
Total	**115,129**	**115,129**	**95,180**	**13,815**	**13,815**	**11,421**

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 30 June 2013 aggregated to BD 19.6 million.

19. Tier one capital ratios and Total capital ratios:

	Tier One Capital Ratio	Total Capital Ratio
Ithmaar consolidated	11.68%	13.39%
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:	9.13%	11.42%
Faysal Bank Limited		

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20. Equity position in Banking book

At 30 June 2013, the Group's investment securities aggregated to BD 456.6 million. Out of the total investment securities, BD 17.1 million were listed investment securities and the remaining BD 439.5 million represented unlisted investment securities.

Cumulative realized losses from sale of investment securities during the six month period ended amounted to BD 0.5 million. Total unrealized gains recognized in the interim condensed consolidated statement of changes in owners' equity amounted to BD 4.1 million.

At 30 June 2013, capital requirements using standardized approach aggregated to BD 17.5 million for listed investment securities and BD 24.7 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:

	30 June		31 December				
	2013	2012	2012	2011	2010	2009	2008
Income from unrestricted investment accounts	18,771	16,894	35,139	25,608	23,203	18,411	18,862
Less: return to unrestricted investment accounts	(14,207)	(13,391)	(26,686)	(24,512)	(21,261)	(16,888)	(14,276)
Group's share of income from unrestricted investment accounts as a Mudarib	**4,564**	**3,503**	**8,453**	**1,096**	**1,942**	**1,523**	**4,586**

For the six month period ended 30 June 2013 the return to unrestricted investment accountholders based on the average balance outstanding during six month period stood at 4.8%. The Group's share of income from unrestricted investment account (Mudarib) including management fee for the six month period ended 30 June 2013 as a percentage of gross income from unrestricted investment accounts stood at 7.3%.

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

	30 June		31 December				
	2013	2012	2012	2011	2010	2009	2008
Profit Equalization Reserve							
As at 1 January	3,793	7,015	7,015	3,074	1,168	1,374	781
Transfer to Provisions	(2,524)	-	(5,274)	-	-	-	-
Net addition	994	1,034	2,052	3,941	2,266	-	593
Net utilization	-	-	-	-	(360)	(206)	-
As at period ended	**2,263**	**8,049**	**3,793**	**7,015**	**3,074**	**1,168**	**1,374**
Amount appropriated as a percentage of gross profit	5%	6%	6%	15%	10%	-	3%
Provisions							
As at 1 January	33,313	25,958	25,958	26,302	24,289	17,554	14,452
Net addition	1,221	1,231	2,415	549	2,060	6,735	3,102
Transfer from Profit Equalization Reserve	2,524	-	5,274	-	-	-	-
Net utilization	(631)	-	(334)	-	(47)	-	-
Reclassification	-	-	-	(893)	-	-	-
As at period ended	**36,427**	**27,189**	**33,313**	**25,958**	**26,302**	**24,289**	**17,554**

At 30 June 2013, the ratio of profit equalization reserve and provisions to equity of unrestricted investment accountholders stood at 0.3% and 5% respectively.

At 30 June 2013, the ratio of financings to URIA stood at 61%.

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

	30 June		31 December				
	2013	2012	2012	2011	2010	2009	2008
				Percentage			
7 Days	0.25	0.25	0.25	0.30	0.50	0.50	0.52
30 Days	1.67	2.00	1.90	2.31	3.00	3.17	3.26
90 Days	2.17	2.67	2.48	2.90	3.25	3.25	3.27
180 Days	2.67	3.00	2.90	3.25	3.50	3.50	3.51
360 Days	3.17	3.50	3.40	3.50	3.70	3.63	3.68

(Expressed in thousands of Bahraini Dinars unless otherwise stated)

24. 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	PKR	EUR	BD	AED
Total profit rate exposure	172,496	40,217	45,404	377,736	98,473
Rate shock (assumed) (+/-)	0.01%	0.15%	0.15%	0.41%	0.13%
Total estimated impact (+/-)	**17**	**60**	**68**	**1,549**	**128**

25. 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 30 June 2013 were as follows:

	Long/(Short)
Pakistani Rupee	36,911
Euro	(21,783)
United States Dollars	59,668
Polish Zloty	21,803
UAE Dirham	(98,473)
Hong Kong Dollar	25,465

26. Performance Ratios:

	30 June		31 December				
	2013	2012	2012	2011	2010	2009	2008
Return on average assets *	-0.21%	0.04%	-0.38%	-0.91%	-2.18%	-4.13%	1.80%
Return on average Shareholders' equity *	-2.50%	0.20%	-5.23%	-10.20%	-21.99%	-30.26%	2.20%
Cost to operating income Ratio *	97.72%	93.36%	85.38%	121.71%	72.06%	139.31%	51.51%

*Years 2012, 2011, 2010 and 2009 are based on the AAOIFI framework, while 2008 is based on IFRS.

27. Legal contingencies and compliance:

At 30 June 2013, the Group had contingent liabilities towards customer claims aggregating to BD 139.1 million. The management is of the view that these claims are not likely to result into potential liabilities. During the period ended 30 June 2013, the Bank paid penalty of BD3 thousand imposed by the CBB due to delay in compliance of regulatory submission requirement.