1 EXECUTIVE SUMMARY

This report has been prepared in accordance with Pillar III disclosure requirements prescribed by the Central Bank of Bahrain, herein referred to as "CBB". The report has been designed to provide BBK Group's stakeholders with detailed information on the Bank's approach in managing capital and risk, having due regard to the operating environment.

The Bank applies the Basel framework in the measurement of its capital adequacy, and in its capital management strategy and risk management framework. CBB's Basel III capital rules and guidelines became effective on 1st January 2015 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel III capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

The disclosures in this report are in addition to the disclosures set out in the consolidated financial statements for the year ended 31 December 2018 presented in accordance with the International Financial Reporting Standards (IFRSs). Disclosures with respect to Corporate Governance and Remuneration are provided in relevant sections of the Annual Report.

2 INTRODUCTION TO THE BASEL III FRAMEWORK

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

- Pillar I: calculation of the Risk Weighted Assets (RWAs) and capital requirement.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar III: rules for the disclosure of risk management and capital adequacy information.

Pillar I

Pillar I prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar I sets out the definition and calculations of the RWAs, and the derivation of the regulatory total capital. Capital adequacy ratios are calculated by dividing regulatory capital by the total RWAs.

Basel III focuses on increasing both the quantity and quality of bank's capital. To this end, Tier 1 capital "T1" must be the main component of capital, and the predominant form of T1 capital must be common shares and reserves. Deductions from capital and prudential filters are generally applied at the level of common equity. The remainder of T1 capital base must be comprised of instruments that are subordinated, have fully discretionary noncumulative dividends or coupons and have neither a maturity date nor an incentive to redeem. In addition, Tier 2 capital "T2" instruments are restricted and have a limit on their contribution to total regulatory capital. Furthermore, Basel III introduced a number of capital buffers to promote the conservation of capital (Capital Conservation Buffer or "CCB"), the build-up of adequate buffers above the minimum required capital during times of good economic conditions that can be drawn down in periods of stress (countercyclical capital buffer) and the high loss absorbency buffer for Domestic Systemically Important Banks (DSIBs).

CBB minimum required total capital adequacy ratio (including CCB) is increased from 12 percent to 12.5 percent, compared to 10.5 percent recommended by the Basel Committee. Moreover, there are newly introduced limits and minima by the CBB under Basel III, such as minimum Common Equity Tier 1 Capital Ratio "CET1" of 9 percent (including CCB) and minimum T1 Capital Ratio of 10.5 percent (including CCB). In the event that the total capital adequacy ratio falls below 12.5 percent, additional prudential reporting requirements apply, and a formal action plan setting out the measures to be taken to restore the ratio above the minimum required level is to be formulated and submitted to the CBB. BBK had been designated as a DSIB by the CBB. Consequently, the CBB requires BBK to maintain an effective minimum total capital adequacy ratio above 14 percent including 1.5 percent as a DSIB buffer.

The table below summarizes the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel III capital adequacy framework:

Credit Risk	Market Risk	Operational Risk
Standardised Approach	Standardised Approach	Basic Indicator Approach
	Internal Models Approach	Standardised Approach

The approach applied by BBK for each risk type is as follows:-

(i) Credit Risk

For regulatory reporting purposes, BBK is using the Standardised Approach for credit risk. Credit risk constitutes nearly 90 percent of the overall risk for the Bank. The Bank has a robust credit risk management architecture which is explained in greater detail in Note 29 and 30 of the Annual Report. The credit RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty's external rating, where available.

(ii) Market Risk

For the regulatory market risk capital requirement, BBK is using the Internal Model Approach based on Value-at-Risk (VaR) model. The use of the Internal Model Approach for the calculation of regulatory market risk capital has been approved by the CBB and the model is subject to periodic independent internal and external validation.

(iii) Operational Risk

All banks incorporated in Bahrain are required to apply the Basic Indicator Approach for operational risk unless approval is granted by the CBB to use the Standardised Approach. The CBB's capital framework does not currently permit the use of the Advanced Measurement Approach (AMA) for operational risk. For regulatory reporting purposes, BBK is currently using the Basic Indicator Approach whereby, the operational risk weighted exposures and regulatory capital requirement are calculated by applying an alpha co-efficient of 15 percent to the average gross income for the preceding three financial years.

2 INTRODUCTION TO THE BASEL III FRAMEWORK continued

Pillar II

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

Under the CBB's Pillar II guidelines, all banks incorporated in Bahrain are required to maintain total capital adequacy ratio above 12.5 percent, except those assigned as DSIB where the minimum capital is 14 percent.

Pillar II comprises two processes:

- an Internal Capital Adequacy Assessment Process (ICAAP), and
- a supervisory review and evaluation process.

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. BBK has developed an ICAAP document and it addresses all components of BBK's risk management, from the daily management of more material risks to the strategic capital management of the Group. The projected growth in risk assets, operating profit, shareholders' funds and the corresponding capital requirement are estimated by the bank as part of the 3 years strategy approved by the Board. In addition, the bank also forecasts the Capital Base whenever there is likely reduction in the capital components, and necessary actions are taken in order to ensure regulatory compliance. The bank has also a Dividend Policy in place as part of capital management strategy. The Bank is evaluating the gaps in current document and the way forward for implementation of the CBB requirements for ICAAP issued in 2018, in line with the timelines specified by CBB.

The Bank uses the RAROC model in its credit decisions in order to assess risk-reward matrix for each credit exposure. The Bank has adopted a Risk Appetite Framework which is reviewed periodically. The Bank also adopts a Risk Management Strategy annually covering all types of relevant risks.

The supervisory review and evaluation process represents the CBB's review of the Group's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process is designed to ensure that institutions identify their material risks, allocate adequate capital, and employ sufficient management processes to support such risks. The supervisory review and evaluation process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar I framework. Other risk types which are not covered by the minimum capital requirements in Pillar I include liquidity risk, interest rate risk in the banking book, strategic risk, concentration risk, reputational risk, and residual risk. These are covered either by capital, or risk management and mitigation processes under Pillar II.

BBK conducts stress testing of its portfolio as part of the ICAAP process. The Bank is evaluating the gaps in current document and the way forward for implementation of the CBB requirements for Stress Testing issued in 2018, in line with the timelines specified by CBB.

Pillar III

Pillar III deals with the Market Discipline guidelines of the regulator to ensure adequate disclosure of risk management practices, corporate governance standards and capital adequacy information. The Bank publishes regulatory disclosures periodically and in the Annual Report.

The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar III disclosure requirements is to complement the first two pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

Under the current regulations, partial disclosure consisting mainly of quantitative analysis is required during half year reporting, whereas full disclosure is required to coincide with the financial year end reporting.

Regulatory Reforms

During the second half of 2018, the CBB issued its regulations on Liquidity Risk Management and Leverage Ratio with an effective date of during 2019. The minimum Liquidity Coverage Ratio, Net Stable Funding Ratio and Leverage Ratio will be part of the Pillar 1 framework.

The Bank is evaluating Expected Credit Losses as per the guidelines in IFRS 9.

3 GROUP STRUCTURE

The Group's financial statements are prepared and published on a full consolidation basis, with all subsidiaries being consolidated in accordance with IFRSs. For capital adequacy purposes, all financial subsidiaries are included within the Group structure. However, the CBB's capital adequacy methodology accommodates both normal and aggregation forms of consolidation.

The principal subsidiaries, associates and joint ventures and basis of consolidation for capital adequacy purposes are as follows:

Subsidiaries	Domicile	Ownership	Consolidation basis
CrediMax B.S.C. (c)	Kingdom of Bahrain	100%	Full Consolidation
Invita Company B.S.C. (c)	Kingdom of Bahrain	100%	Risk Weighted
Invita Claims Management Company*	Kingdom of Bahrain	70%	Risk Weighted
Invita - Kuwait K.S.C.C.*	State of Kuwait	60%	Risk Weighted
Global Payment Services W.L.L. (GPS)**	Kingdom of Bahrain	55%	Full Consolidation
Associates			
Bahrain Liquidity Fund	Kingdom of Bahrain	24%	Risk Weighted
Bahrain Commercial Facilities Company B.S.C.	Kingdom of Bahrain	23%	Risk Weighted
The Benefit Company B.S.C (c)	Kingdom of Bahrain	22%	Risk Weighted
Joint Venture			
Sakana Holistic Housing Solutions B.S.C. (c)	Kingdom of Bahrain	50%	Risk Weighted
Aegila Capital Management Limited	United Kingdom	50%	Risk Weighted
Magnum Partners Holding Limited	Jersey	50%	Risk Weighted
BBK Geojit Securities K.S.C.	State of Kuwait	40%	Risk Weighted
Evoque Holdings Jersey Limited	Jersey	25%	Risk Weighted

* Shareholding through Invita Subsidiary

** Shareholding through CrediMax Subsidiary

There are no restrictions on the transfer of funds or regulatory capital within the Group.

4 STATEMENT OF FINANCIAL POSITION UNDER THE REGULATORY SCOPE OF CONSOLIDATION

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

	Statement of financial position as in published financial statements BD '000	Statement of financial position as per Regulatory Reporting BD '000	Reference
Assets			
Cash and balances with central banks	**191,028**	**191,028**	
Treasury bills	**410,380**	**410,380**	
Deposits and amounts due from banks and other financial institutions	**239,174**	**239,148**	
Loans and advances to customers	**1,772,528**	**1,772,528**	
Of which Expected Credit Loss (1.25% of Credit risk weighted assets)	29,729	29,729	a
Of which net loans and advances (gross of Expected Credit Loss)	1,742,799	1,742,799	
Investment securities	**800,263**	**800,263**	
Of which investments in financial entities under CET1	–	23,361	b
Of which investments in financial entities under Tier 2	–	11,355	c
Of which related to other investments	–	765,547	
Investments in associated companies and joint ventures	**62,935**	**65,616**	
Of which Investment in own shares	820	820	d
Of which equity investments in financial entities	34,061	34,061	e
Of which other investments	28,054	30,735	
Interest receivable and other assets	**77,849**	**76,962**	
Of which deferred tax assets due to temporary differences	1,092	1,092	f
Of which Intangibles	3,167	3,167	g
Of which Interest receivable and other assets	73,590	72,703	
Premises and equipment	**27,543**	**27,277**	
Total assets	**3,581,700**	**3,583,202**	
Liabilities and Equities			
Liabilities			
Deposits and amounts due to banks and other financial institutions	**258,676**	**258,676**	
Borrowings under repurchase agreement	**198,997**	**198,997**	
Term borrowings	**144,542**	**144,542**	
Customers' current, savings and other deposits	**2,374,480**	**2,377,730**	
Interest payable and other liabilities	**104,566**	**103,827**	
Total liabilities	**3,081,261**	**3,083,772**	
Equity			
Share capital	**108,165**	**108,165**	h
Treasury stock	**(2,521)**	**(2,521)**	i
Perpetual tier 1 convertible capital securities	**86,098**	**86,098**	j
Share premium	**41,016**	**41,016**	k
Statutory reserve	**54,082**	**54,082**	l
General reserve	**54,082**	**54,082**	m
Cumulative changes in fair values	**(25,105)**	**(25,105)**	
of which cumulative changes in fair values on bonds and equities	(25,772)	(25,772)	n
of which Fair value changes in cash flow hedges	667	667	o
Foreign currency translation adjustments	**(11,711)**	**(11,711)**	
Of which related to unconsolidated subsidiary	–	(76)	p
Of which related to Parent	–	(11,635)	q
Retained earnings	**148,967**	**148,441**	
Of which employee stock options	2,468	2,468	
Of which Retained earnings	146,499	145,973	r
Appropriations	**44,617**	**44,617**	s
Attributable to the Owners Of the Bank	**497,690**	**497,164**	
Non-controlling interest	**2,749**	**2,266**	
Total equity	**500,439**	**499,430**	
Total liabilities and equity	**3,581,700**	**3,583,202**	

4 STATEMENT OF FINANCIAL POSITION UNDER THE REGULATORY SCOPE OF CONSOLIDATION continued

Legal entities included within the accounting scope of consolidation but excluded from the regulatory scope of consolidation:

Name	Principle activities	Total Assets	Total Equities
Invita Company B.S.C. (c)	Business processing and outsourcing services	4,429	3,690

5 CAPITAL COMPONENTS – CONSOLIDATED

Under the CBB's Basel III capital framework, total regulatory capital consists of Tier 1 capital "T1" and Tier 2 capital "T2". T1 capital is further divided into Common Equity Tier 1 capital "CET1" and Additional Tier 1 capital "AT1". CET1 capital consists of: (a) Issued and fully paid common shares that meet the criteria for classification as common shares for regulatory purposes, (b) Disclosed reserves including: i) General reserves; ii) Legal / statutory reserves; iii) Share premium; iv) Fair value reserves arising from fair valuing financial instruments; and v) Retained earnings or losses (including net profit/ loss for the reporting period, whether reviewed or audited), (c) Common shares issued by consolidated subsidiaries and held by third parties (i.e. minority interest) that meet the criteria for inclusion in CET1, and (d) Regulatory adjustments applied in the calculation of CET1. AT1 capital consists of: (a) Instruments issued by the bank that meet the criteria for inclusion in AT1, (b) Share premium resulting from the issue of instruments included in AT1, (c) Instruments issued by consolidated subsidiaries and held by third parties that meet the criteria for inclusion in AT1 and are not included in CET1, and (d) Regulatory adjustments applied in the calculation of AT1. T2 capital consists of: (a) Instruments issued by the bank that meet the criteria for inclusion in T2, (b) premium resulting from the issue of instruments included in T2, (c) Instruments issued by consolidated subsidiaries of the bank and held by third parties that meet the criteria for inclusion in T2 capital and are not included in T1, (d) Expected Credit Loss reserve for stage 1 and 2 exposures, (e) Asset revaluation reserves which arise from the revaluation of fixed assets and investment properties from time to time in line with the change in market values, and (f) Regulatory adjustments applied in the calculation of T2. At present, the T2 capital of BBK consists solely of Expected Credit Losses reserve for stage 1 and 2 exposures.

The CBB applies various limits and minima to the components of the regulatory capital, as shown in the below table. There is also a restriction on the amount of Expected Credit Losses (ECL) reserve that may be included as part of T2 capital, which should be a maximum of 1.25 percent of the credit risk weighted assets.

	Optional	Minimum Ratio
Components of Consolidated CAR		
Core Equity Tier 1 (CET 1)		6.50%
Additional Tier 1 (AT1)	1.50%	
Tier 1 (T1)		8.00%
Tier 2 (T2)	2.00%	
Total Capital		10.00%
Capital Conservation Buffer (CCB)		2.50%
Domestically Systemic Important Bank (D-SIB) Buffer		1.50%
CAR including Buffers		
CET 1 plus Buffers		10.50%
Tier 1 plus Buffers		12.00%
Total Capital plus CCB		12.50%
Total Capital plus CCB and DSIB Buffer		14.00%

	Optional	Minimum Ratio
Components of Solo CAR		
Core Equity Tier 1 (CET 1)		4.50%
Additional Tier 1 (AT1)	1.50%	
Tier 1 (T1)		6.00%
Tier 2 (T2)	2.00%	
Total Capital		8.00%
Capital Conservation Buffer (CCB)		0.00%

In accordance with the CBB's Basel III capital adequacy framework, certain exposures are required to be deducted from regulatory capital rather than included in RWAs. The CBB's Basel III capital adequacy framework requires that most of the deductions to be made from the CET1.

There are no impediments on the transfer of funds or regulatory capital within the Group other than restrictions over transfers to ensure that minimum regulatory capital requirements are met for subsidiary companies.

The table below provides a detailed breakdown of the bank's regulatory capital components, including all regulatory adjustments. The table also provides reference to the comparison displayed in the previous table between accounting and regulatory statement of financial positions.

	Component of regulatory capital	Amounts subject to pre-2015 treatment	Source based on reference letters of the statement of financial positions under the regulatory scope of consolidation
Common Equity Tier 1: Instruments and reserves			
Directly issued qualifying common share capital plus related stock surplus	146,660		h+i+k
Retained earnings	190,512		p+r+s
Accumulated other comprehensive income and losses (and other reserves)	71,422		l+m+n+o+q
Common Equity Tier 1 capital before regulatory adjustments	**408,594**	**–**	
Common Equity Tier 1 capital: regulatory adjustments			
Other intangibles other than mortgage servicing rights (net of related tax liabilities)	2,534	633	g
Cash flow hedge reserve	667		o
Investments in own shares	820		d
Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	–	23,361	b
Total regulatory adjustments to Common equity Tier 1	**4,021**	**23,994**	
Common Equity Tier 1 capital (CET1)	**404,573**		

	Component of regulatory capital	Amounts subject to pre-2015 treatment	Source based on reference letters of the statement of financial positions under the regulatory scope of consolidation
Additional Tier 1 capital: instruments			
Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	86,098		j
of which: classified as equity under applicable accounting standards	86,098		
Additional Tier 1 capital before regulatory adjustments	**86,098**	**–**	
Additional Tier 1 capital: regulatory adjustments			
Total regulatory adjustments to Additional Tier 1 capital	–	–	
Additional Tier 1 capital (AT1)	**86,098**	**–**	
Tier 1 capital (T1 = CET1 + AT1)	**490,671**		
Tier 2 capital: instruments and provisions			
Provisions	29,729		
Tier 2 capital before regulatory adjustments	**29,729**		
Tier 2 capital: regulatory adjustments			
Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	–	11,355	c
Total regulatory adjustments to Tier 2 capital	–	11,355	
Tier 2 capital (T2)	**29,729**		
Total capital (TC = T1 + T2)	**520,400**		
Total risk weighted assets	**2,658,172**		
Capital ratios and buffers			
Common Equity Tier 1 (as a percentage of risk weighted assets)	15.22%		
Tier 1 (as a percentage of risk weighted assets)	18.46%		
Total capital (as a percentage of risk weighted assets)	**19.58%**		
Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus D-SIB buffer requirement, expressed as a percentage of risk weighted assets)	10.50%		
of which: capital conservation buffer requirement	2.50%		
of which: bank specific countercyclical buffer requirement	N/A		
of which: D-SIB buffer requirement	1.50%		
Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	15.22%		
National minima (where different from Basel III)			
CBB Common Equity Tier 1 minimum ratio	10.50%		
CBB Tier 1 minimum ratio	12.00%		
CBB total capital minimum ratio	14.00%		
Amounts below the thresholds for deduction (before risk weighting)			
Non-significant investments in the capital of other financials	34,716		b+c
Significant investments in the common stock of financials	34,061		e
Deferred tax assets arising from temporary differences (net of related tax liability)	1,092		f
Applicable caps on the inclusion of provisions in Tier 2			
Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	38,309		
Cap on inclusion of provisions in Tier 2 under standardised approach	29,729		a

6 CAPITAL ADEQUACY

The Group's policy is to maintain a strong capital base so as to preserve investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognized, as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout and other discretionary payments and the issue of new shares and other capital instruments.

As per its ICAAP, BBK aims to maintain a minimum total capital adequacy ratio in excess of the capital assessed as per its ICAAP document of 15.95 percent (considering DSIB and CCB). The CBB's current minimum total capital adequacy ratio (including CCB and DSIB) for banks incorporated in Bahrain is set at 14 percent. The total capital adequacy ratio of the Group as at 31 December 2018 was 19.58 percent.

Strategies and methods for maintaining a strong capital adequacy ratio

BBK prepares multi-year strategic projections on a rolling annual basis which include an evaluation of short-term capital requirements and a forecast of longer-term capital resources.

Capital ratios - consolidated and subsidiaries above 5% of group capital

	Total capital ratio	Tier 1 capital ratio
BBK - Consolidated	19.58%	18.46%
CrediMax	71.46%	71.46%

7 CREDIT RISK – PILLAR III DISCLOSURES

This section describes the BBK's exposure to credit risk, and provides detailed disclosures on credit risk in accordance with the CBB's Basel III framework, in relation to Pillar III disclosure requirements.

Definition of exposure classes

BBK has a diversified on and off statement of financial position credit portfolio, the exposures of which are divided into the counterparty exposure classes defined by the CBB's Basel III capital adequacy framework for the standardised approach for credit risk. A high-level description of the counterparty exposure classes, referred to as standard portfolios in the CBB's Basel III capital adequacy framework, and the generic treatments, i.e. the risk weights to be used to derive the RWAs, are as follows:

Sovereigns portfolio

The sovereigns portfolio comprises exposures to governments and their respective central banks. The risk weights are zero percent for exposures in the relevant domestic currency, or in any currency for exposures to GCC sovereigns. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereigns portfolio and treated as exposures with a zero percent risk weighting.

Public Sector Entities (PSE) portfolio

Claims on Bahraini PSEs, and claims on PSEs on domestic currency - which are assigned a zero percent risk weight by their respective country regulator, can be assigned a zero percent risk weight. All other PSEs are risk weighted according to their external ratings.

Banks portfolio

Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short term exposures. Short term exposures are defined as exposures with an original tenor of three months or less. The Bank's portfolio also includes claims on certain investment firms which are risk weighted based on their external credit ratings, though without any option for preferential treatment for short term exposures.

Corporates portfolio

Claims on corporates are risk weighted based on their external credit ratings. A 100 percent risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a zero percent risk weight.

Regulatory retail portfolio

Claims on retail portfolio are risk weighted at 75%, except for past due portfolio.

Mortgage portfolio

Claims which are fully secured by first mortgages on residential property that is or will be occupied by the borrower, or that is leased, must carry a risk weighting of 75 percent. Claims secured by mortgages on commercial real estate are subject to a minimum of 100 percent risk weight. If the borrower is rated below BB-, the risk-weight corresponding to the rating of the borrower must be applied.

Equities portfolio

The equities portfolio comprises equity investments in the banking book. A 100 percent risk weight is assigned to listed equities while unlisted equities are weighted at 150 percent, unless subject to the following treatments. The amount of any significant investments in commercial entities (A "significant investment" in a commercial entity is defined as any investment in the capital instruments of a commercial entity by the bank which is equivalent to or more than 10 percent of the issued common share capital of the issuing commercial entity) above 15 percent (individually) and 60 percent (collectively) of the bank's capital (the "Total Capital materiality thresholds") must be risk weighted at 800 percent. Moreover, significant investments in the common shares of unconsolidated financial entities must be risk weighted at 250 percent.

In addition to the standard portfolios, other exposures are assigned to the following exposure classes:

Investments in funds portfolio

The risk weight for claims on corporate will be used to determine the risk weight for investments in rated funds. Unrated funds will be assigned a risk weight of 100% if listed, and 150% if not listed.

Past due exposures

This includes claims, for which the repayment is overdue for more than ninety days or more. The risk weighting applied for such loans is either 100 percent or 150 percent, depending on the level of provisions maintained against the loan.

Holding of real estate

All holding of real estate by banks (owned directly or by the way of investments in real estate companies, subsidiaries or associated companies or other arrangements such as trusts, funds or REITS) must be risk weighted at 200 percent. Premises occupied by the bank are weighted at 100 percent.

Other assets and holdings of securitisation tranches

Other assets are risk weighted at 100 percent, whereas securitization exposures are risk weighted at 20 percent to 1,250 percent, depending on the external rating.

All BBK's holding of securitizations if any is reported part of the bank's investment portfolio.

Large exposures

The excess amount of any exposure above 15% of the bank's regulatory capital to any counterparty or a group of closely related counterparties must be risk weighted at 800%, unless it is an exempted exposure in accordance with the requirements of the CBB Rulebook.

External rating agencies

BBK uses ratings issued by Moody's and Fitch to derive the risk weightings under the CBB's Basel III capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to represent the rating for regulatory capital adequacy purposes.

Credit risk presentation under Basel III

The credit risk exposures presented in most of this report differ from the credit risk exposures reported in the consolidated financial statements. Differences arise due to the application of different methodologies, as illustrated below:-

- Under the CBB's Basel III framework, off statement of financial position exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off statement of financial position exposure is multiplied by the relevant CCF applicable to the off statement of financial exposure position category. Subsequently, the exposure is treated in accordance with the standard portfolios as referred to above in this report, in the same manner as on statement of financial position exposures.
- In case of Over-the-Counter (OTC) derivative contracts, in addition to the default risk capital requirements for counterparty credit risk, the bank must add a capital charge to cover the risk of mark-to-market losses on the expected counterparty risk (such losses being known as credit value adjustments or CVA).
- Credit risk exposure reporting under Pillar III is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty. For example, a loan to a bank would be classified in the Bank's standard portfolio under the capital adequacy framework although is classified in loans and advances in the consolidated financial statements.
- Certain eligible collateral is applied to reduce exposure under the Basel III capital adequacy framework, whereas no such collateral netting is applicable in the consolidated financial statements.
- Based on the CBB's Basel III guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements.

8 CAPITAL REQUIREMENT FOR RISK WEIGHTED EXPOSURE

	Gross credit exposures (before risk mitigation) BD '000	Eligible financial collateral BD '000	Credit risk after risk mitigation BD '000	Risk weighted asset BD '000	Regulatory capital required 14.0% BD '000
Sovereign	936,977	–	936,977	33,750	4,725
Public sector entities	12,462	–	12,462	–	–
Banks	460,888	–	460,888	260,507	36,471
Corporates	1,510,820	16,543	1,494,277	1,279,375	179,112
Regulatory retail	446,413	356	446,057	334,543	46,836
Mortgage	90,349	96	90,253	67,690	9,477
Investment in securities	97,618	–	97,618	154,578	21,641
Past Due	63,558	102	63,456	66,181	9,265
Real Estate	67,183	–	67,183	117,699	16,478
Other assets and cash items	92,223	–	92,223	63,959	8,954
Total Credit Risk	**3,778,491**	**17,097**	**3,761,394**	**2,378,282**	**332,959**
Market Risk	–	–	–	37,613	5,266
Operational Risk*	–	–	–	242,277	33,919
Total Risk Weighted Exposure	**3,778,491**	**17,097**	**3,761,394**	**2,658,172**	**372,144**

* The Bank is currently using the Basic Indicator Approach whereby the operational risk weighted exposures and regulatory capital requirement are calculated by applying an alpha co-efficient of 15 percent to the average gross income for the preceding three financial years adjusted for exceptional income. The amount of adjusted average gross income for the year 2018 is BD 129,214 thousand.

Credit Risk Mitigation and Collateral valuation policy

BBK employs a range of techniques to mitigate risk in its credit portfolio. Credit risk mitigation includes an objective assessment of the counterparty's capacity and willingness to meet its commitments in the normal course. The bank strives to optimize facility structure, collateral, lending covenants, terms and conditions.

The Bank has detailed policies and procedures for valuing collateral/ securities offered for various credit facilities. The collateral is valued, at minimum, quarterly or annually, based on the type of security. More frequent valuations are also considered if warranted by market volatility and declining trends in valuations are observed. The collaterals and support include mortgages, cash collaterals, marketable securities, personal and corporate guarantees and guarantees from sovereigns and financial institutions. The basis of valuation for different types of securities such as equity, debt, and real estate is also clearly defined in the policies.

9 FUNDED, UNFUNDED AND AVERAGE CREDIT EXPOSURE

Total gross credit exposures	Total funded credit exposure BD '000	Total un-funded credit exposure BD '000	Average quarterly credit exposure BD '000
Sovereign	936,488	489	967,767
Public sector entities	12,462	–	13,718
Banks	437,473	23,415	441,222
Corporates	1,359,774	151,046	1,562,501
Regulatory retail	446,413	–	430,885
Mortgage	90,349	–	91,919
Investment in securities	97,618	–	100,021
Past due	63,558	–	53,174
Real estate	67,183	–	61,890
Other assets and cash items	92,223	–	91,947
Total credit risk	**3,603,541**	**174,950**	**3,815,044**

10 CONCENTRATION OF CREDIT RISK BY REGION (EXPOSURES SUBJECT TO RISK WEIGHTING)

	GCC BD '000	North America BD '000	Europe BD '000	Asia BD '000	Others BD '000	Total BD '000
Cash and balances with central banks	186,218	–	–	4,810	–	**191,028**
Treasury bills	405,802	–	–	4,578	–	**410,380**
Deposits in banks and other financial institutions	156,115	32,878	29,651	20,445	60	**239,149**
Loans and advances to customers	1,538,494	52	105,457	131,357	34,000	**1,809,360**
Investments in associated companies	47,400	–	14,715	–	–	**62,115**
Investment securities	566,535	9,412	102,007	95,948	26,809	**800,711**
Other assets	85,235	–	747	4,816	–	**90,798**
Total funded exposure	**2,985,799**	**42,342**	**252,577**	**261,954**	**60,869**	**3,603,541**
Unfunded commitments and contingencies	140,673	189	14,006	19,768	314	**174,950**
Total credit risk	**3,126,472**	**42,531**	**266,583**	**281,722**	**61,183**	**3,778,491**

11 CONCENTRATION OF CREDIT RISK BY INDUSTRY (EXPOSURES SUBJECT TO RISK WEIGHTING)

	Trading and manufacturing BD '000	Banks and other financial institutions BD '000	Construction and real estate BD '000	Government and public sector BD '000	Individuals BD '000	Others BD '000	Total BD '000
Cash and balances with central banks	–	20,334	–	170,694	–	–	**191,028**
Treasury bills	–	–	–	410,380	–	–	**410,380**
Deposits in banks and other financial institutions	–	239,149	–	–	–	–	**239,149**
Loans and advances to customers	572,711	221,583	355,590	9,276	506,983	143,217	**1,809,360**
Investments in associated companies	–	43,156	14,353	–	–	4,606	**62,115**
Investment securities	112,444	175,193	22,388	423,384	–	67,302	**800,711**
Other assets	–	–	–	–	–	90,798	**90,798**
Total funded exposure	**685,155**	**699,415**	**392,331**	**1,013,734**	**506,983**	**305,923**	**3,603,541**
Unfunded commitments and contingencies	90,556	26,051	40,115	206	126	17,896	**174,950**
Total credit risk	**775,711**	**725,466**	**432,446**	**1,013,940**	**507,109**	**323,819**	**3,778,491**

12 CONCENTRATION OF CREDIT RISK BY MATURITY (EXPOSURES SUBJECT TO RISK WEIGHTING)

	Within 1 month BD '000	1 to 3 months BD '000	3 to 6 months BD '000	6 to 12 months BD '000	1 to 5 years BD '000	5 to 10 years BD '000	10 to 20 years BD '000	Above 20 years BD '000	Total BD '000
Cash and balances with central banks	115,423	–	–	–	–	–	–	75,605	**191,028**
Treasury bills	62,576	123,292	99,185	125,327	–	–	–	–	**410,380**
Deposits in banks and other financial institutions	195,199	37,735	–	6,215	–	–	–	–	**239,149**
Loans and advances to customers	252,312	146,143	111,192	138,859	828,905	241,108	29,634	61,207	**1,809,360**
Investments in associated companies	–	–	–	–	–	–	–	62,115	**62,115**
Investment securities	38,574	19,786	29,669	18,729	300,215	260,266	28,325	105,147	**800,711**
Other assets	56,269	–	–	–	31,792	249	1,024	1,463	**90,798**
Total funded exposure	**720,353**	**326,956**	**240,046**	**289,130**	**1,160,912**	**501,623**	**58,983**	**305,537**	**3,603,541**
Unfunded commitments and contingencies	43,146	21,853	25,407	58,103	14,978	8,709	731	2,023	**174,950**
Total credit risk	**763,499**	**348,809**	**265,453**	**347,233**	**1,175,890**	**510,332**	**59,714**	**307,560**	**3,778,491**

13 IMPAIRED LOANS AND PROVISIONS

	Impaired loans BD '000	Stage 3: Lifetime ECL credit-impaired BD '000	Stage 1: 12 month ECL and Stage 2: Lifetime ECL not credit-impaired BD '000	Net specific charges during the year BD '000	Write off during the year BD '000
Trading and manufacturing	100,525	55,704	17,003	2,976	3,042
Banks and other financial institutions	4,456	4,795	421	306	–
Construction and real estate	19,304	9,115	6,501	112	9,485
Government and public sector	16,188	8,860	–	–	–
Individuals	8,247	7,767	10,649	2,525	11,263
Others	2,069	990	2,258	556	–
Total	**150,789**	**87,231**	**36,832**	**6,474**	**23,790**

14 AGEING OF IMPAIRED AND PAST DUE LOANS BY REGION

	GCC BD '000	North America BD '000	Europe BD '000	Asia BD '000	Others BD '000	Total BD '000
3 months up to 1 year	76,162	–	3,007	4,058	–	**83,227**
1 to 3 years	61,632	–	–	6	–	**61,638**
Over 3 years	5,911	–	–	13	–	**5,924**
Total past due and impaired loans	**143,705**	**–**	**3,007**	**4,077**	**–**	**150,789**
Stage 3: Lifetime ECL credit- impaired	(86,162)	–	–	(1,069)	–	**(87,231)**
Stage 1: 12-month ECL and stage 2 : Lifetime ECL not credit- impaired	(35,816)	–	(150)	(785)	(81)	**(36,832)**

15 AGEING OF IMPAIRED AND PAST DUE LOANS BY INDUSTRY

	Trading and manufacturing BD '000	Banks and other financia institutions BD '000	Construction and real estate BD '000	Government and public sector BD '000	Individuals BD '000	Others BD '000	Total BD '000
3 months up to 1 year	63,195	3,007	12,697	–	2,349	1,979	**83,227**
1 to 3 years	37,252	1,449	3,996	16,188	2,689	64	**61,638**
Over 3 years	78	–	2,611	–	3,209	26	**5,924**
Total past due and impaired loans	**100,525**	**4,456**	**19,304**	**16,188**	**8,247**	**2,069**	**150,789**

16 RESTRUCTURED LOANS

	BD '000
Loans restructured during the year	45,250
Impact of restructured facilities and loans on provisions	2,427

The above restructuring did not have any significant impact on present and future earnings and were primarily extensions of the loan tenor, revisions in interest rate, and additional collateral received.

17 MARKET RISK DISCLOSURES FOR BANKS USING THE INTERNAL MODELS APPROACH (IMA) FOR TRADING PORTFOLIOS

The "Market Risk Internal Model" is being used to measure Value-at-Risk (VaR) for calculating Capital Charge arising from Market Risk exposures (mainly Foreign Exchange and Interest Rate Risk positions) of the Trading Book. The VaR Model quantifies the maximum potential loss that could occur in the Trading book risk positions under normal market conditions, at 99% confidence level, on a 10-day horizon.

BBK maintains a prudent approach to Manage Market Risk exposures guided by Market Risk Policy and Procedure. The Position, Stoploss and VaR limits are monitored by Treasury Middle Office (reporting to Risk and Credit Administration Department and Independent of Business unit) and a daily risk report is circulated to the Senior Management.

In addition to the above, the Treasury Middle Office also carries out valuation of the Investment Portfolio independently as per the internal policies and procedures. Furthermore BBK also conducts Stress Testing and Back Testing of Market Risk positions.

The summary of VaR of the trading book for the period January 2018 to December 2018 is as follows:

VaR Results for 2018 (10 day 99%)

Global (BAHRAIN and KUWAIT)

1 January 2018 to 31 December 2018

Asset class	Limit BD '000	VaR 31 December 2018 BD '000	High VaR BD '000	Low VaR BD '000	Average VaR BD '000
Foreign exchange	641	199	260	125	178
Interest rate	151	2	5	0	1
	792	**201**	**262**	**127**	**179**

The Bank conducts Backtesting of VaR on a daily basis in compliance with CBB regulations to validate the internal VaR model and to check whether or not the model can predict potential losses with a fair degree of accuracy. Under Backtesting, the daily VaR numbers are compared with the mark-to-market profit or loss figures (on actual average Profit and Loss basis and also hypothetical Profit and Loss basis). If this comparison is close enough, the Backtest raises no issues regarding quality of the risk measurement model.

The Backtesting results for the period January-December 2018 confirmed that there was Nil occasion on which a daily trading loss exceeded VaR figure.

17 MARKET RISK DISCLOSURES FOR BANKS USING THE INTERNAL MODELS APPROACH (IMA) FOR TRADING PORTFOLIOS continued

Stress Testing

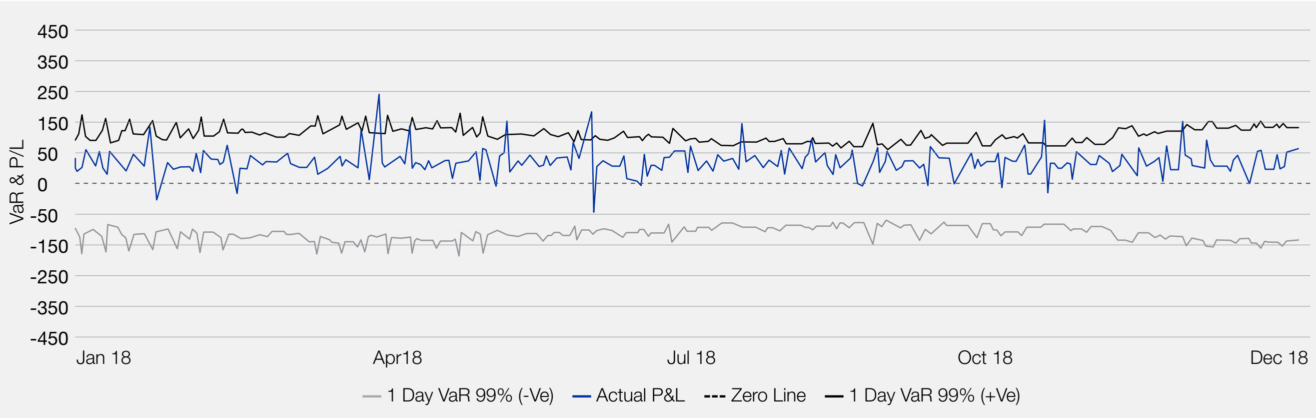
The Bank conducts stress testing of VaR, under various 'What If' scenarios such as increasing volatility and varying correlations. The stress testing methodology uses historical data capturing periods of significant disturbance and covering all types of risks associated with the asset classes which are included in the trading book of the Bank.The stress VaR are then tabulated under each "what if" scenario and compared with corresponding Capital Adequacy Ratio (CAR). It was observed that the CAR was within the norm prescribed by CBB, under each stressed scenario.

Month end VaR (10 day 99%)

Month	VaR in BD'000
January 2018	199
February 2018	181
March 2018	181
April 2018	204
May 2018	200
June 2018	196
July 2018	163
August 2018	127
September 2018	142
October 2018	152
November 2018	196
December 2018	201

The following graph shows the daily average Profit and Loss (Actual Average P&L basis) vis-à-vis one day VaR, for the review period.

Value- at-Risk Backtesting January – December 2018



18 CONCENTRATION RISK TO INDIVIDUALS WHERE THE TOTAL EXPOSURE IS IN EXCESS OF SINGLE OBLIGOR LIMIT OF 15%

	BD '000
Sovereign	846,273
Total	**846,273**

19 CREDIT DERIVATIVES EXPOSURE

BBK is not exposed to any credit derivatives as at 31 December 2018.

20 EQUITY POSITIONS IN THE BANKING BOOK

	BD '000
Publicly traded equity shares	42,941
Privately held equity shares	23,489
Total	**66,430**
Capital required	9,300

21 GAINS ON EQUITY INSTRUMENTS

	BD '000
Realised gains/ losses in statement of profit or loss	–
Realised gains/ losses in retained earnings	(507)
Unrealised gains/ losses in CET1 Capital	(13,527)