# Basel II – Pillar 3 Disclosures
# For the Year Ended 31st December 2020

# Table of Contents

# Executive Summary

Pillar 3 disclosures are important reporting requirements as per AMBD & Basel II. AMBD is of the view that enhancing market transparency is best supported by the provision of disclosures based on a common framework. Pillar 3 disclosures (market discipline) act as an effective means of informing the market about the risk position of a bank in a consistent and comparable manner.

The disclosure is designed to complement the two other pillars of Basel II requirements, namely the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2), which allow transparency on key pieces of information on the capital structure, risk exposure, risk assessment processes and capital adequacy of the Group.

The disclosure has been prepared in accordance with the Guideline rules laid out in the AMBD guideline (specified in Notice BU/N-4/2018/54) and be reported to AMBD on a semi-annual basis. This report consists of qualitative and quantitative information using tables in the following pages. An explanation of approaches adopted by the Group for measuring the minimum capital requirement are discussed in subsequent sections of this report.

## 1.0 Scope of Application

The name of the top corporate entity in the group, to which these regulations apply, is Bank Islam Brunei Darussalam Berhad ("BIBD") and its subsidiaries ("the Group"). The consolidated financial statements are prepared in accordance with the requirement of International Financial Reporting Standards ("IFRS"), International Accounting Standards ("IAS") and Autoriti Monetari Brunei Darussalam ("AMBD").

There is no difference between our accounting and reporting in the consolidation to our subsidiaries.

## 2.0 Capital Structure

The authorized, issued, and paid up capital of the Group comprises of 724,749,512 shares at BND 0.70 each as at 31st December 2020.

**Table (1) - Consolidated Capital Structure as at 31st December 2020.**

| Tier 1 Capital | Amounts in BND '000s |
|---|---|
| Core capital (Tier 1 capital) | 1,269,881 |
| Supplementary capital (Tier II capital) | 18,586 |
| Less: Investments in Associates and Subsidiaries | (7,080) |
| **Total Regulatory capital after deductions (Capital Base)** | 1,281,387 |

The total capital base reported as per Audited Financials as of 31st December 2020 – BND1,281,387,000.

## 3.0 Capital Adequacy

The Group is subject to compliance to the capital adequacy guidelines stipulated by AMBD under the Capital Adequacy Framework dated 13 February 2019 (version 1.1) of which is in line with the framework of Basel Committee of Banking Supervision ("BCBS"). The approach taken by The Group to assess the adequacy of its capital is based on these guidelines. As stipulated by AMBD in its guidelines (specified in Notice BU/N-4/2017/39), the Group is required to maintain a minimum Tier 1 Capital Adequacy Ratio ("CAR") of 5% and minimum total CAR of 10%. BIBD has been assigned a D-SIB status since 1st June 2020, which will carry additional 2.5% above the minimum total CAR.

The Group's strategy is to keep adequate capital levels all the time, to meet regulatory requirements while aiming to optimize the return to shareholder's capital. In accordance with the capital management strategy, the Group recognizes balance between efficiency, flexibility and adequacy in the consideration of capital management. The following considerations where detailed in the Internal Capital Adequacy Assessment Process ("ICAAP") submitted on the 30th of June and already fully approved by AMBD:

- The development of a capital management strategy, which includes levels of capital buffers, contingent plans, the availability of capital deployed and the various forms of capital instruments (if any); and

- Simulating its capital measures using stress and scenario testing that includes the possibility of variability from planned outcomes, unexpected scenarios, and the impact of concentrations.

**Table (2) - Capital Adequacy as at 31st December 2020- Basel II**

| **Quantitative Disclosures** | RWA Amount (BND 000's) | Capital Charged (BND 000's) |
|---|---|---|
| **Capital Requirements** | | |
| 1. Credit Risk – Standardized Approach | 5,696,379 | 5,696,379 |
| 2. Market Risk – Standardized Approach | 82,728 | 6,618 |
| 3. Operational Risk - Basic Indicator Approach | 621,815 | 49,745 |
| **Total** | **6,400,922** | |
| **Capital amount** | | |
| 1. Tier 1 | 1,269,881 | - |
| 2. Total Regulatory Capital | 1,281,387 | - |
| **Capital Ratio** | | |
| 1. Tier 1 | 19.8% | - |
| 2. Total Regulatory Capital | 20.0% | - |

**Table (3) – Standard portfolio as at 31st December 2020**

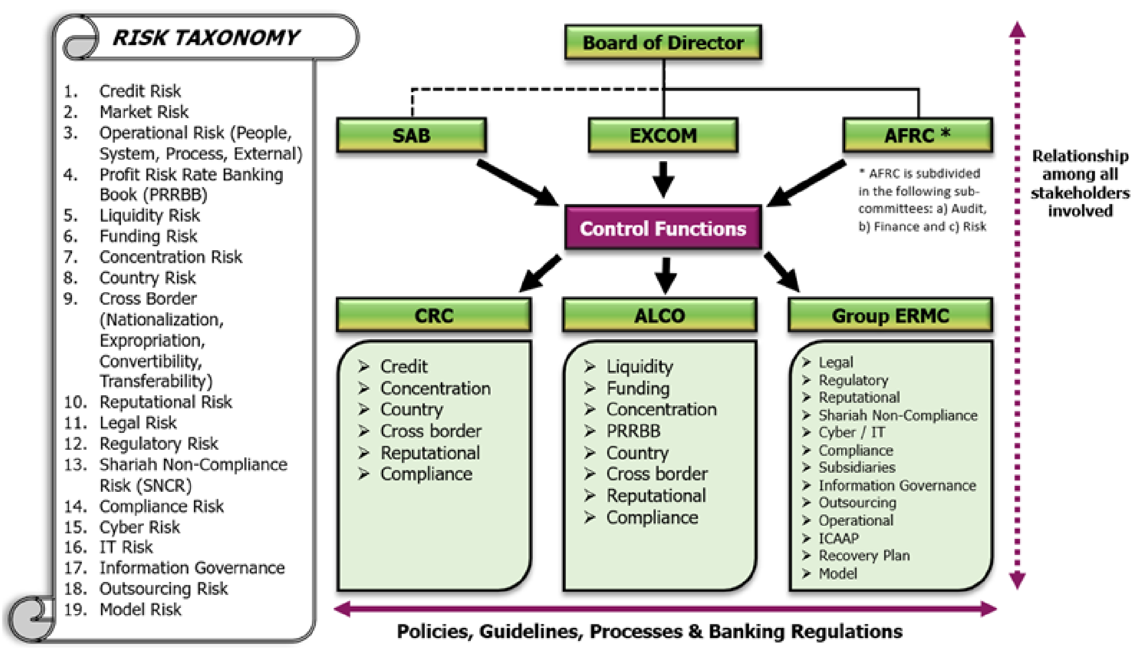
| Quantitative Disclosures^ | RWA Amount (BND 000's) |
|---|---|
| **Capital Requirements** | |
| a) Claims on Sovereign and Central Banks | 100,933 |
| b) Claims on Public Sector Entities (PSEs) | - |
| c) Claims on Multilateral Development Banks (MDBs) | 10,994 |
| d) Claims on Banks and Financial Institutions Exposure | 1,377,334 |
| e) Exposure to Corporates | 1,278,877 |
| f) Regulatory Retail Portfolio (including claims on SMEs eligible 75% risk weight | 1,290,111 |
| g) Claims secured by Residential Property (qualifying 35% RWA only) | 48,630 |
| h) Equity Portfolio | 319,793 |

^The disclosures are the standard portfolio as per required by AMBD as per the guidance on pillar 3 (paragraph 3.2.2)

## 4.0 Risk Management

The objective of the Group Risk Management is to ensure that all relevant risks of the bank; categorized under the nineteen (19) risk classifications (Risk Taxonomy) are properly identified and well-understood, measured and assessed; avoided, mitigated and/or controlled, as appropriate; monitored, and reported. This will include establishing a process, using effective risk measurement techniques and management information systems, for monitoring and reporting on the bank's risk profile and its consistency with the bank's risk appetite and strategic and business plans within an Enterprise Risk View.

The Group Risk Governance Structure refers; all the nineteen (19) risk classifications are managed under a risk governance model whereby each risks classification are reported/escalated to the dedicated/delegated executive committees as per below.



In addition to this, Group Risk Management also adopted Group Risk Culture of 80:10:10; whereby it stipulated the dedicated role and responsibilities of three (3) lines of defense as follows:-

| | |
|---|---|
| 1st line: Business units | : Risk owner 80% |
| 2nd line: Risk Management and compliance | : Risk oversight, policy and methodology 10% |
| 3rd line: Internal Audit | : Risk assurance 10% |

On the same note, RMD provide ongoing support, guidance and oversight function to all 1st LOD's risk activities through five (five) dedicated units as follow :-

1) Corporate Credit Risk – To ensure a healthy balance sheet for Corporate portfolios by overseeing credit related matters from operational, tactical and strategic level.
2) Retail Credit Risk – To ensure a healthy balance sheet for retail portfolios by overseeing credit related matters from operational, tactical and strategic level
3) Market Risk – Overseeing and perform credit risk evaluation for newly proposed cross-border exposures but not limited to International Sukuk and syndication financing.
4) Cyber/IT Risk and Project Management Unit – Overseeing and perform risk assessment analysis to the IT/Cyber risk management activities and Project related i.e. ICAAP.
5) Operational Risk – Overseeing and perform risk assessment analysis on 1st LOD's risk activities for both operational and Shariah Non- Compliance Risks

**Risk management functional and governance structure**

The Group has aligned its risk organisational responsibilities with the objective of ensuring a common view of risks across the Group. As a matter of good business practice and prudence, the Board of Director ("BOD") has delegated responsibility of the Group's risk management functions to the Audit, Finance and Risk Committee ("AFRC") which has being subdivided into three sub-committees: (1) Audit Sub-Committee, (2) Finance Sub-Committee and (3) Risk Sub-committee that oversight specific scope and functions within the bank and is an independent and clearly segregated body from the business divisions. Shariah Advisory Body ("SAB") main roles and responsibilities are to advise the Bank on the operations of its Islamic banking business in order to ensure that every aspect of the Bank operations and activities are compliant with Shariah principles.

The BOD via the Group's Executive committee ("ExCom") which is at the same level as the AFRC has also being delegated responsibility for the oversight of the Group credit risk throughout the Credit Risk Committee ("CRC"), Market Risk throughout the Asset & Liabilities Committee ("ALCO") and Operational Risk, ICAAP, Recovery Plan and Others throughout the Enterprise Risk Management Committee ("ERMC").

Risk Management Division is a separate division, reporting to the CEO, responsible for managing the Group's risks, including the following:

- To conform with statutory, regulatory and internal risks requirements.
- To support management in building a healthy credit portfolio in line with the Group's overall strategy and risks appetite;
- To develop an increasing ability to recognise, measure and avoid or mitigate potential risk issues;

The Group has a strong management risk culture, where the Risk Management team plays and important role as a 2nd line of defense, having in place the proper Risk Governance, Controls and Monitoring process. Given that, minimizing losses is as important as growing sustainable revenues.
Risk Strategy ("RS") is a holistic document with aligned the Group's general objectives respect to its Risks Appetite Statement ("RAS"), as follows:

- To consistently exceed minimum regulatory capital requirements
- To ensure sufficient levels of liquidity and funding
- To manage the level of risk in the portfolio to an acceptable level
- To maintain favourable external debt ratings

Annually, Risk Strategy ("RS") and Risks Appetite Statement ("RAS") are review and approved at Board level.

The Key Risks Indictor ("KRI") and RAS are inputted by Risk coordinator on a monthly basis and reviewed and monitored by Operational Risk via a system called B-WISE and reports to Enterprise Risk Management Committee ("ERMC") on a quarterly basis. B-WISE also acts as a Central Depository for important documentation such as policy, SOP, regulatory guideline that are only limited user can have access to.

Within the scope of the IT & Cyber Risk Management Framework, Risk Management has a daily follow up with internal IT division in order to track any events (IT and Cyber Risk) and monitoring process within the B-WISE system for both in internal and external context.

Sharia compliance is a cornerstone for The Group as the leading Islamic bank in Brunei Darussalam and in order to comply with The Group Corporate Governance, there is zero tolerance to any deviation with this respect. And always in full alignment with the Shariah Financial Supervisory Board ("SFSB").

## 5.0 <u>Credit Risk</u>

Credit risk arises as a result of customers' or counterparties' failure to meet their contractual obligations when they fall due. These obligations arise from the Group's direct financing operations, trade finance and investments undertaken by the Group. The Group's exposure to credit risk is primarily from its financing activities to retail, and corporate borrowers', including small & medium enterprises ("SMEs"), financial institutions and Investments.

The Group has adopted the Standardized Approach (Basel) for measuring minimum capital requirement for credit risk.

Exposures after application of eligible credit risk mitigants, are multiplied by the specified risk weight to arrive at the Risk Weighted Asset (RWA). Off-balance sheet exposures are adjusted using product type specified Credit Conversion Factors (CCF) before determining the RWAs.

Retail credit exposures are managed on a product program basis. Credit product program are assessed jointly between credit risk and business units. The Bank use internal risk scoring model (application and Behavioral scorecard) for credit application, evaluation and approval. Reviews on credit program are conducted on a regular basis to assess the performance of the portfolio.

Corporate credit risks are assessed by business units and evaluated/approved in accordance to the Group's Credit Risk Governance. Each borrower is assigned a credit rating (S&P Methodology) based on the assessment of relevant qualitative and quantitative factors including a borrower's financial position, types of facilities and proposed securities or collateral. Group wide hierarchy of credit approving authorities and committee structures (governance) are in place to ensure appropriate underwriting standards are enforced consistently within the Group.

Reviews are conducted with not more than 12 months from last implementation date or no more than 18 months from last approval/renewal date with updated information on borrower's financial position, market position, industry and economic condition coupled with conduct of the account. Corrective actions are taken when there are signs of credit deterioration.

Counterparty credit risk exposures are managed via counterparty limits either on a single name basis or counterparty group basis which adheres to the Guidance on Single Borrowing Limit issued by AMBD. The Group monitors and manages its exposures to counterparties on a day-today basis.

To avoid concentration of credit risk in its financing and advances portfolio, the Group imposes limits and related lending guidelines for:

- Sovereign;
- Economic sector and subsector;
- Single customer groups;
- Financial institutions (Banks and non-bank);
- Counterparties; and
- Collaterals.

The Group has established a dedicated team of Collections and Recovery to effectively manage vulnerable borrowers in the retail portfolio and a special asset group for the corporate portfolio. Special attention is given to the close monitoring account and watchlist process, where all borrowers are frequently and intensively monitoring (weekly, monthly and quarterly) in order to accelerate the remedial action.

## 5.1 Past Due & Impaired Facilities

A financial asset is considered as past due if any amount is due under a contract (profit, principal, fee or other amount) or has not been paid in full at the date when it was due. An exposure is considered past due from the first day of missed payment, even when the amount of the exposure of the past due amount, as applicable, is not considered material.

Credit impaired financial asset: A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired, include observable data about the following events:

A. Significant financial difficulty of the issuer or the borrower;
B. A breach of contract, such as a default or past due event (more than 90 DPD);
C. The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession (s) that the lender(s) would not otherwise consider;
D. It is becoming probable that the borrower will enter bankruptcy or other financial reorganization;
E. The disappearance of an active market for that financial asset because of financial difficulties
F. The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses

**Individual Provision**

Internally, the Group determines the individual provision by individually assessing all gross principal outstanding; Consumer Banking amount of B$500,000 and above, and Corporate Banking amount of B$1,000,000 and above, by analyzing a combination of several effects of other trigger events which may lead to an individual impairment. Objective evidence that a financial asset or group of assets are impaired includes observable data that comes to the attention of the Group about the following events:

**Mandatory Criteria:**

- Past due more 90 days (pursuant to Basel II)

**Other trigger events:**

- Significant financial difficulty of the customer;
- Breach of contract, such as a default or delinquency in profit or principal payments;
- Probable information that a customer will enter bankruptcy;
- Adverse changes in the payment status of the customer (i.e. an increasing number of delayed payments)
- Local economic conditions that correlate with defaults on assets in a segment (i.e. a decrease in property prices in a relevant area or adverse changes in industry conditions that affect customers in a segment).

**Collective Provision**

Collective provisioning in the Group is done based on Expected Credit Loss ("ECL") in line with IFRS9 and the Basel Committee on Banking Supervision ("BCBS") guidance on credit risk and accounting for the ECL. These provisions are calculated by multiplying the probability of default ("PD") by the Loss given default ("LGD") and by the exposure at default ("EAD").

## 5.2 Credit Risk Management Process

The Group seeks to manage and control the most important part of its risk profile, that is Credit Risk, by adhering to the guidelines stipulated by AMBD (circular NO. BU/G-2/2018/10) and most importantly embed a culture of risk awareness throughout the organization. It is by way of these guidelines; the Group is aiming to address the following areas:

1. Establishing an appropriate credit risk environment
2. Operating under a sound credit process
3. Maintaining an appropriate credit administration, measurement and monitoring process
4. Ensuring adequate controls over the credit risk

**Policies and processes**
The Credit Policy of the Group has been prepared with the broad objective of meeting the following goals:

1. Adhere to the guidelines or policies pronounced by AMBD; and
2. Hold a diversified good quality asset portfolio through risk-based lending.

In order to assess the credit risk associated with any financing proposal; the Group assesses a variety of risks relating to the borrower and the relevant industry. The Group evaluates obligor's risk by considering:

1. The obligor's financial position by analyzing its financial statements, history of financial performance, and cash flow adequacy;
2. The obligor's relative business competitiveness, business strategy, market position and operating efficiency; and
3. The quality of management by analyzing their track record, payment record and financial performance.

The Group evaluates industry risk by considering:

1. Certain industry characteristics, such as position of the industry in the economy, cyclicality, seasonality and government policies relating to the industry;
2. The competitiveness of the industry; and
3. Certain industry statistics, including industry growth rate, return on asset, return on equity, operating margins and earnings stability.

## 5.3 Credit Ratings

Credit ratings enable the Group to accurately assess the quality of its credit portfolio and it is essential that the appropriate ratings are applied to each credit on a pro-active basis. The Group has adopted a credit risk rating methodology by S&P that is Basel II compliant and is based on the following scale.

**External Credit Assessment Institutions ("ECAI")**

External credit assessments (or external ratings) on the counterparty (borrower) or specific securities issued by the counterparty (the issuer) are the basis for the determination of risk weights under the Standardised Approach for exposures to sovereigns, central banks, public sector entities, banks, corporates as well as certain other specific portfolios.

In accordance with the rules and principles laid down by the Basel Committee, AMBD has identified the following international rating agencies as ECAIs for the purposes of risk weighting exposures for capital adequacy purposes:

1. Moody's
2. Standard and Poor's ("S&P")
3. Fitch Rating

In respect of exposures/obligors that have multiple ratings from the eligible ECAIs for the purpose of risk weight computation, the Group is complying with the guideline as stipulated in the Capital Adequacy Framework by AMBD.

**Internal Risk Rating Model**

The Group noted that not all Credits are rated by the ECAI. In most case, for those that do not have ECAI rating, the Group has adopted models approach whereby the Group assign credit rating (internally) by subscribing the model from S&P using "S&P scorecard Model" to evaluate the credit risk.

On top of the credit proposal paper, the business unit will have to submit a templated format to generate the risk rating for each client. RMD will then review the input and either to support the proposed rating or to recommend to over-ride.

## 5.4 Credit Risk Related Disclosures

**Table 4 (a) – Gross credit exposure by major type of credit exposure as on 31st December 2020**

| Segment (B$'000) | Total |
|---|---:|
| Cash and short-term deposit and placement with financial institution | 3,668,490 |
| Investments | 1,058,163 |
| Financing and advances | 4,076,456 |
| Derivative financial assets | 48,393 |
| On-balance sheet total | 8,851,502 |
| Commitment and contingencies | 298,314 |
| Other Off- Balance Sheet exposures | 328,920 |
| Total Non-Funded | 627,234 |
| **Grand Total** | **9,478,736** |

**Table 4 (b) - Gross Credit Exposures by Geography as on 31st December 2020**

| Geographic Distribution (B$'000) | Brunei | Asia (ex-Brunei) | Others | Total |
|---|---|---|---|---|
| Cash and short-term deposit and placement with financial institution | 266,658 | 2,658,404 | 743,428 | 3,668,490 |
| Investments | - | 1,030,115 | 28,048 | 1,058,163 |
| Financing and advances | 3,659,820 | 79,439 | 337,197 | 4,076,456 |
| Derivative financial assets | 4,847 | 24,860 | 18,686 | 48,393 |
| **On-balance sheet total** | **3,931,325** | **3,792,818** | **1,127,359** | **8,851,502** |
| Commitment and contingencies | 298,314 | - | - | 298,314 |
| Other Off- Balance Sheet exposures | 328,856 | 64 | - | 328,920 |
| **Total Non-Funded** | **627,170** | **64** | **-** | **627,234** |
| **Total** | **4,558,495** | **3,792,882** | **1,127,359** | **9,478,736** |

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**Table 4(c) – Net exposure by industry by major credit exposure as at 31st December 2020**

| Industry Segment (B$'000) | Cash and short-term and deposit and placement with financial institution | Balance with Autoriti Monetari Brunei Darussalam | Brunei Government Sukuks | Investments | Derivative financial assets | Financing and advances | Financing lease receivable | Other assets | On-balance sheet total | Commitment and contingencies |
|---|---|---|---|---|---|---|---|---|---|---|
| Agriculture | - | - | - | - | - | 15,908 | - | - | 15,908 | 11,922 |
| Financial | 3,667,992 | - | - | 518,591 | 48,393 | 79,434 | - | - | 4,314,410 | 145,629 |
| Manufacturing | - | - | - | 5,708 | - | 66,062 | - | - | 71,770 | 129,986 |
| Transportation | - | - | - | 33,499 | - | 911,521 | - | - | 945,020 | 9,963 |
| Infrastructure | - | - | - | - | - | 31,219 | - | - | 31,219 | 71,346 |
| Traders | - | - | - | - | - | 97,234 | - | - | 97,234 | 21,483 |
| Service | - | - | - | 25,144 | - | 65,859 | 12,588 | - | 103,591 | 24,120 |
| Residential Property (personal) | - | - | - | - | - | 795,236 | - | - | 795,236 | 41,307 |
| Commercial (property development) | - | - | - | 25,061 | - | 401,297 | - | - | 426,358 | 17,808 |
| Tourism | - | - | - | - | - | 9,017 | - | - | 9,017 | 3,233 |
| Telecommunication and Information technology | - | - | - | 9,638 | - | 2,269 | - | - | 11,907 | 2,158 |
| Personal and consumption financing | - | - | - | - | - | 1,024,422 | - | - | 1,024,422 | 79,563 |
| Oil and Gas | - | - | - | - | - | 509,760 | - | - | 509,760 | 68,716 |
| Others | - | 488,898 | 10,000 | 438,674 | - | - | - | 45,957 | 983,529 | - |
| **Total** | **3,667,992** | **488,898** | **10,000** | **1,056,315** | **48,393** | **4,009,238** | **12,588** | **45,957** | **9,339,381** | **627,234** |

**Table 4 (d) - Net Credit Exposures by Residual Contractual Maturity as on 31st December 2020**

| Residual contractual maturity (B$'000) | Carrying amount | Gross nominal inflow/(outflow) | Less than 3 months | 3-6 months | 6-12 months | 1-3 years | 3-5 years | Over 5 years | No specific maturity |
|---|---|---|---|---|---|---|---|---|---|
| Cash, balance and placements with banks | 2,622,110 | 2,622,289 | 2,622,289 | - | - | - | - | - | - |
| Balance with AMBD | 488,898 | 488,898 | 335,269 | 46,604 | 57,590 | 10,437 | - | 38,998 | - |
| Placement with and financing and advances to banks | 1,045,882 | 1,053,455 | 420,550 | 222,227 | 410,678 | - | - | - | - |
| Government Sukuks | 10,000 | 10,000 | 10,000 | - | - | - | - | - | - |
| Investments | 1,262,249 | 1,355,045 | 82,587 | 51,844 | 42,334 | 357,339 | 417,114 | 198,200 | 205,627 |
| Derivatives financial assets | 48,393 | 48,273 | 44,573 | 2,971 | 729 | - | - | - | - |
| Financing and advances | 4,009,238 | 4,635,380 | 665,967 | 219,371 | 345,049 | 1,453,253 | 758,840 | 1,192,900 | - |
| Finance lease receivable | 12,588 | 28,500 | 180 | 180 | 360 | 1,440 | 1,540 | 24,800 | - |
| Other assets | 45,957 | 45,957 | 32,473 | 2,732 | 238 | 3,617 | 3,307 | 3,590 | - |
| **Grand Total** | **9,545,315** | **10,287,797** | **4,213,888** | **545,929** | **856,978** | **1,826,086** | **1,180,801** | **1,458,488** | **205,627** |

**Table 4 (e) – Impaired financing/facilities and non-performing financing/facilities by Industry Segment as on 31st December 2020**

| Industry Segments (B$'000) | Overdue | | | Allowance for losses | Total impaired assets net of Provision | Other information |
|---|---|---|---|---|---|---|
| | Less than 90 days | 90 days and above | Total | | | Write-offs |
| Retails | 9,230 | 45,911 | 55,141 | 29,563 | 25,578 | 16,657 |
| Corporate | 74,024 | 38,727 | 112,751 | 20,163 | 92,588 | 212 |
| **Grand Total** | **83,254** | **84,638** | **167,892** | **49,726** | **118,166** | **16,869** |

**Table 4 (f) – Impaired financing/facilities and past due financing/facilities by Geographic Distribution as on 31st December 2020**

| Geographic distribution (B$'000) | Brunei | Asia (ex-Brunei) | Total |
|---|---|---|---|
| At 1 January 2020 | 146,689 | - | 146,689 |
| Classified as impaired during the year | 64,837 | - | 64,837 |
| Reclassified as performing | (7,169) | - | (7,169) |
| Amount received | (19,596) | - | (19,596) |
| Amount written off against allowances | (16,869) | - | (16,869) |
| **At 31 December 2020** | **167,892** | - | **167,892** |

**Table 4 (g) – Movement in the allowance for losses on financing and advances**

| Movement in the allowance for losses on financing and advances (B$'000) | Total |
|---|---|
| At 1 January 2020 | 69,589 |
| Allowance made during the year | 14,498 |
| Amount written off during the year | (16,869) |
| **At 31 December 2020** | **67,218** |

## 6.0 Credit Risk Mitigation

The Group use the following techniques to mitigate the credit risks to which it is exposed. The general requirements for the use of credit risk mitigation (CRM) and eligibility criteria, detailed methodologies and specific requirements follow AMBD Capital Adequacy framework dated 13 February 2019 (version 1.1) Ref number AMBD/R/BAS/SP/04:

1. Collateralised transactions; and
2. On-balance sheet netting.

The main types of collaterals taken by the Group currently are as follows:

- For mortgages – charges over residential properties;
- For auto financing – ownership claims over the vehicles financed;
- For commercial property financing – charges over the properties financed;
- For other financing – charges over business assets such as premises, inventories, vessels, vehicles, assignment of receivables or under lien deposits and others; and
- Legally binding written guarantees.

**Table 5 - Credit Risk Mitigation – Standardized Approach as on 31st December 2020**

| Standard portfolio^ (RWA BND '000) | Total exposure (after on-or off-balance sheet netting), after the application of haircuts | Covered by eligible financial collateral | Covered by guarantees/ credit derivatives | Total exposure |
|---|---|---|---|---|
| Sovereign | 100,933 | - | - | 100,933 |
| Multilateral Development Banks (MDBs) | 10,994 | - | - | 10,994 |
| Public Sector Entities | - | - | - | - |
| Banks | 1,531,385 | - | (154,051) | 1,377,334 |
| Corporate | 1,345,985 | - | (67,108) | 1,278,877 |
| Regulatory Retail | 1,342,377 | - | (52,266) | 1,290,111 |
| Residential Retail | 48,630 | - | - | 48,630 |
| Equity | 319,793 | - | - | 319,793 |

^ The disclosures are the standard portfolio as per required by AMBD as per the guidance on pillar 3 (paragraph 3.2.2)

## 7.0 Counterparty Credit Risk

Counterparty credit risk ("CCR") is the risk that a counterparty to a transaction may default before completing the settlement period of the transaction. To date, this risk applies to FX transactions only (spot & outright). An economic loss occurs if the transaction or portfolio of transactions with the counterparty has a replacement cost or outstanding loan amount that exceeds any collateral posted by the counterparty before the transaction(s) could be unwind, in the case of a counterparty default.

As part of the overall credit risk assessment, the credit limit is approved by CRC and by ExCom (depending on the approving amount) based on the financial strength, credit rating, country, industry and single name concentration limits while also balancing this with the whole borrower/counterparty relationship.

Estimating the exposure amount/pre-settlement risk is critical for calculating the capital requirements for CCR. The exposure under the CCR consist of two components: Potential future exposure ("PFE") and the Replacement cost ("RC").

The Group calculate the PFE by multiplying the total notional principal amount of the foreign exchange contracts book times the add on factor, split by residual maturity as follows: -

| Residual Maturity | Add-on Factor |
|---|---|
| One year or less | 2.0% |
| Over one year to five years | 5.0% |
| Over five years | 7.5% |

The Group calculates the current RC of the contract by marking the contract to market value (marked to market), thus capturing the replacement cost without the need for estimation. The Group then adds up the PFE and the RC to get the final current exposure of the CCR.

**Table 6 – Total Exposure at default for Counterparty Credit Risk as on 31st December 2020**

| Counterparty Credit Risk | Exposure Amount in BND'000s | RWA in BND'000s |
|---|---|---|
| Counterparty Credit Risk | 138,637 | 45,223 |
| **Total Exposure amount** | **138,637** | **45,223** |

## 8.0 Market Risk

**Overview**

The Group uses the Standardized Approach to calculate the regulatory capital requirements related to market risk (covering profit rates, equity, foreign exchange, commodity and options).

Market risk is defined as the uncertainty of market value and earning from changes in profit rate, exchange rate, market prices and volatilities. The Group assumes market risk from trading and investments activities and from retail and corporate financing.

The Group's asset and liabilities profile can be characterized as that of a standard retail bank. Stress testing and sensitivity analysis are performed to assess the impact from changes in the yield curve for income on a monthly basis and for market value on a quarterly basis.

**Governance**

Market risk of the Group is managed by the Market Risk unit of the Risk Management Division. Market risk report is presented monthly to the Group's ALCO and quarterly to AFRC committee. The management of the market risk for subsidiaries is managed at Group level. ALCO provides general guidelines to the parameters and limits applied in deriving the report's outcome. ALCO maintains the policy and procedures with regards to the market risk framework that are consistent and in-line with the short and long-term strategic goals and directions of the Board of Directors.

**Table 7 - Total Capital Requirement for Market Risk under Standardized Approach as on 31st December 2020**

| Total Capital Requirement for Market Risk Under Standardized Approach as on 31st December 2020 | | |
|---|---|---|
| **Market Risk** | **Amount in BND'000s** | **Amount in BND'000s (RWA)** |
| Profit rate risk | 132,222 | 6,423 |
| Equity position risk | - | - |
| Foreign exchange risk | 2,439 | 195 |
| Commodity risk | - | - |
| **Total Capital Requirement** | **134,661** | **6,618** |

## 8.1 Foreign Exchange Risk of the Group

**Trading positions**
The Group controls the foreign exchange risk within the FX portfolio by limiting the open exposure to individual currencies, and on an aggregate basis.

**Overall (trading and non-trading positions)**
To mitigate the risk of loss due to foreign currency rate changes the Group will match its positions as closely as possible.

Trading is always conducted to ensure that internal limit set limits are adhered to the policy.

Positions will be analyzed on a daily basis, whereby a currency risk report will be produced. If there is a breached against the policy, a report will be generated for the Treasurer and the Chief Risk Officer. The foreign currency position is presented for the Board of Directors at the end of each quarter.

**Foreign exchange risk of the subsidiaries**
The subsidiaries' nature of business does not maintain neither trading positions nor have significant exposure to foreign exchange risk.

## 9.0 Operational Risk

The Group is adopting the basic indicator approach (Basel) at present, for calculation of regulatory capital requirements for operational risk. The capital charge is calculated fixed at 15% to the three years average of positive gross income, which complied with AMBD Capital Adequacy Framework February 2019 (version 1.1) (Reference AMBD/R/BAS/SP/04).

According to Basel; Operational risks defined as the risk of loss resulting from inadequate, or failed internal process, people or systems or from external events. For the Bank, operational risks are systematically identified at the Group-Wide level (all Division and subsidiaries).

As a 1$^{st}$ LOD, all divisions including subsidiaries has appointed their Risk Coordinators ("RC") and to date, there are a total of 40 Risk Coordinators on Group Wide Level. The role and responsibilities as an RCs, is to conduct self-identifying their own risk/control analysis and monitoring its control effectiveness respectively. This also includes reporting any risk events/incidents to ORM for their ongoing escalation to Senior Management and Executive Committees' information. This includes the identification of its root-cause analysis, its preventive mitigation measures and to record the actual operational losses (if any) .

As the 2$^{nd}$ LOD, ORM will oversight on the 1$^{st}$ LOD's risk activities to ensure a sound, robust and effective risk management approach in place. adherence. This is not limited to ongoing risk awareness which includes the Bank's Risk Taxonomy (19 risk Classification) to Group-Wide level.

The Group classifies Operational Risk to the following risk types:

- People
- Process

- System
- External

Operational risk exposures are rated 'high', 'medium' or 'low' in accordance with defined risk assessment matrix criteria. All risks (inclusive inherent and residual risks) are captured/recorded in the Group-Wide Level's Risk Appetite Statement ('RAS') and Key Risk Indicators ("KRI") by 1st LOD on monthly basis and monitored/oversight by ORM as 2nd LOD.

The ERM Committee oversees the management of Bank's Risk Taxonomy (19 risk classifications) inclusive operational risks across the Group, supported by all business unit heads. The ERM Committee operates on the basis of terms of reference derived from the Enterprise Risk Management Framework– an oversight function in managing all the type of risks that can impact/may impact on the bank's capabilities to achieve its strategic goals and business objectives. This will allow that Management to understand the risk profile, maintain the adequate risk controls and mitigation up to the BIBD Group's risk appetite acceptable level as approved by the BOD Level.

## 10.0 Funding and Liquidity Risk

Funding & Liquidity risk is defined as the current and prospective risk arising from the Group's inability to efficiently meet present and future funding needs or regulatory obligations when they are due, which may adversely affect the daily operations and incur unacceptable losses.

The Group seeks to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. The Group also seeks to ensure that it has an adequate level of stable funding from diversified sources.

The key elements of the Group's liquidity policy are as follows:

1) Maintaining a diversified funding base consisting of customer deposits (both retail and corporate) and wholesale market deposits;
2) Carrying a portfolio of High Quality Liquid Assets ("HQLA");
3) Monitoring liquidity ratios, maturity mismatches and behavioural characteristics of the Group's financial assets and liabilities.

The Treasury & Global Markets Division manages the Group's day-to-day liquidity position. The Group maintains a portfolio liquid asset (HQLA), Sukuks, money market placements with banks, to ensure that sufficient liquidity is maintained.

## 11.0 Equity Investment in the Banking Book

The Group is exposed to equity investment in the Banking Book as follow:

**Table 8 – Equity Investment for the year as at 31st December 2020**

| Equity Investment (B$'000) | Total |
|---|---|
| Investments in associate | 23,475 |
| Investments in Joint Venture | 18,368 |
| Investment in Quoted Securities | 205,934 |
| Investment in Unquoted Securities | 341 |
| **Grand Total** | **248,118** |

## 12.0 Profit Rate Risk in Banking Book (PRRBB)

Profit rate risk arises from the possibility that changes in market rates will affect future profitability, cash flows or the fair values of financial instruments. Profit Rate Risk in the Banking Book (PRRBB) is defined as the exposure of the non-trading financial instruments to market rates.

The Group is exposed to profit rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period.

For measuring the overall profit sensitivity in the Banking book, the Group conducts stress tests on the sensitiveness of the assets and liabilities by simulating 100/300/800 basis points parallel shifts to the yield curve and assessing the impact on its Net profit Income and Capital.

**Table 9 - following impact on the net profit income and regulatory capital for the year of a movement in interest yield curves as at 31st December 2020.**

| Group (BND'000) | 1% increase | 1% decrease | 3% increase | 3% decrease | 8% increase | 8% decrease |
|---|---|---|---|---|---|---|
| 2020 | 8,677 | (8,677) | 26,031 | (26,031) | 69,416 | (69,416) |