بنك دبي الإسلامي
Dubai Islamic Bank

Basel III - Pillar III Disclosures

(Annual 2018)

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1. Overview and introduction

This document presents the Pillar III disclosures which complements the Basel III minimum capital requirements and the supervisory review process of Dubai Islamic Bank PJSC with its financial subsidiaries ("DIB" or the "Bank") and including its non-financial subsidiaries (collectively referred to as the "Group").The disclosures are related to the Group's structure, capital structure, capital adequacy, risk exposures, risk assessment process, risk management objectives and policies. The disclosures consist of both quantitative and qualitative information and are provided at the consolidated level.

The Bank is regulated by the Central Bank of the United Arab Emirates ("CBUAE") and follows the Pillar 3 disclosure requirement guidelines issued by the CBUAE. In February 2017, the new Basel III capital regulations issued by CBUAE came into effect for all Banks in the UAE. Additional guidelines for Basel III were issued over the course of 2018 in joint consultations with the UAE Banks.

The CBUAE Basel framework addresses the importance of developing and using enhanced risk management techniques in monitoring and managing risk and intends to strengthen the market discipline and risk management practice of UAE banks.

The Pillar III disclosures provide qualitative and quantitative information in order to meet the disclosure requirements. Some of the Pillar III requirements have been disclosed in the audited consolidated financial statements for the year ended 31st December 2018, which covers the risk and capital management processes of the Bank and its compliance with the Basel Accords.

Regulatory framework

The Basel Accord framework is structured on the following three main pillars:

- **Pillar I** - defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by the banks' own regulatory fund;

- **Pillar II** - addresses a bank's Internal Capital Adequacy Assessment Process ("ICAAP") for assessing overall capital adequacy in relation to risks other than Pillar I. Pillar II also introduces the Supervisory Review and Evaluation Process ("SREP"), which is used as a tool to assess the internal capital adequacy of banks; and

- **Pillar III** - complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy which encourages market discipline that also allows market participants to assess specific information.

Future regulatory developments

The regulation and supervision of financial institutions has undergone a significant change since the global financial crisis. As per Basel standards and CBUAE guidelines, regulatory focus on Capital regulation have increased. The CBUAE Basel III Capital regulations have been implemented and are complied by the Bank.

All revised capital standards for 2018 as per Basel III guidelines on capital standards for Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Capital Buffers like Capital Conservation Buffer (CCB), Countercyclical Buffer (CCyB) and Domestic Systemically Important Banks Buffer (DSIB) are implemented. There is close coordination between UAE banks and CBUAE for the smooth implementation of any forthcoming new guidelines and disclosure requirements.

In October 2018, CBUAE issued draft Standards on the revised Pillar III disclosure requirements which is currently in consultation with the UAE Banks and will replace the existing Pillar III disclosure requirements that were issued in 2009. The revised requirements shall be implemented in the 2019 Pillar III disclosures of the Bank.

Implementation and Compliance of Basel framework guidelines

The Bank has been in compliance with Basel Accord guidelines since December 2007, in accordance with CBUAE directives on Standardized Approach for Credit, Market and Operational Risk.

In compliance with the CBUAE guidelines and Basel accords, these disclosures include information on the Bank's risk management objectives and policies, risk assessment processes and computation, capital management and capital adequacy.

2. Group Structure - Information on Subsidiaries and Significant Investments

The Group consists of Dubai Islamic Bank P.J.S.C. and its subsidiaries. As of 31st December 2018, the Group's interest held directly or indirectly in its financial and non-financial subsidiaries are as follows:

	Name of subsidiary	Principal activity	Place of incorporation and operation	Ownership interest and voting power	
				2018	2017
1.	Dubai Islamic Bank Pakistan Ltd.	Banking	Pakistan	**100.0%**	100.0%
2.	Tamweel P.S.C	Financing	U.A.E	**92.0%**	92.0%
3.	DIB Bank Kenya	Banking	Kenya	**100.0%**	100.0%
4.	Dubai Islamic Financial Services L.L.C.	Brokerage services	U.A.E.	**95.5%**	95.5%
5.	Deyaar Development P.J.S.C.	Real estate development	U.A.E	**44.9%**	44.9%
6.	Dar al Shariah Financial & Legal Consultancy L.L.C.	Financial and legal advisory	U.A.E.	**60.0%**	60.0%
7.	Al Tanmyah Services L.L.C.	Labour services	U.A.E.	**99.5%**	99.5%
8.	Al Tatweer Al Hadith Real Estate	Real estate development	Egypt	**100.0%**	100.0%
9.	Al Tameer Modern Real Estate Investment	Real estate development	Egypt	**100.0%**	100.0%
10.	Al Tanmia Modern Real Estate Investment	Real estate development	Egypt	**100.0%**	100.0%
11.	Naseej Private Property Management Services	Property management	U.A.E.	**99.0%**	99.0%
12.	DIB Printing Press L.L.C.	Printing	U.A.E.	**99.5%**	99.5%
13.	Al Islami Real Estate Investments Ltd.	Investments	U.A.E.	**100.0%**	100.0%
14.	Dubai Islamic Trading Center L.L.C.	Trading in vehicles	U.A.E.	**100.0%**	100.0%
15.	Madinat Bader Properties Co. L.L.C.	Real Estate Development	U.A.E.	**100.0%**	-

In addition to the registered ownership described above, the remaining equity in the entities 4, 7, 11 and 12 are also beneficially held by the Group through nominee arrangements.

Below is the list of special purpose vehicles which were formed to manage specific transactions including funds, and are expected to be closed upon completion of the related transactions:

	Name of SPV	Principal activity	Place of incorporation and operation	Ownership interest and voting power	
				2018	2017
16.	HoldInvest Real Estate Sarl	Investments	Luxembourg	**100.0%**	100.0%
17.	France Invest Real Estate SAS	Investments	France	**100.0%**	100.0%
18.	SARL Barbanniers	Investments	France	**100.0%**	100.0%
19.	SCI le Sevine	Investments	France	**100.0%**	100.0%
20.	Findi Real Estate SAS	Investments	France	**100.0%**	100.0%
21.	PASR Einudzwanzigste Beteiligunsverwaltung GMBH	Investments	Austria	**100.0%**	100.0%
22.	Al Islami German Holding Co. GMBH	Investments	Germany	**100.0%**	100.0%
23.	Rhein Logistics GMBH	Investments	Germany	**100.0%**	100.0%
24.	Jef Holdings BV	Investments	Netherlands	**100.0%**	100.0%
25.	Al Islami Trade Finance FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
26.	Gulf Atlantic FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
27.	Al Islami Oceanic Shipping Co FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
28.	MESC Investment Company	Investments	Jordan	**40.0%**	40.0%
29.	Levant One Investment Limited	Investments	U.A.E.	**100.0%**	100.0%
30.	Petra Limited	Investments	Cayman Islands	**100.0%**	100.0%
31.	Sequia Investments L.L.C.	Investments	U.A.E.	**99.0%**	99.0%
32.	Blue Nile Investments L.L.C.	Investments	U.A.E.	**99.0%**	99.0%
33.	DIB FM Ltd	Investments	Cayman Islands	**100.0%**	100.0%
34.	Al Ameen	Investments	Cayman Islands	**100.0%**	100.0%

In addition to the registered ownership described above, the remaining equity in the entities 31 and 32 are also beneficially held by the Bank through nominee arrangements.

3. Capital management structure and policies as per Basel III

The Bank's regulatory capital comprises of the following items which are calculated as per the guidelines issued by CBUAE:

Tier 1 Capital comprises of the following:

a) Common Equity Tier 1 (**CET1**):

Common Equity Tier 1 (**CET1**) includes the following items:

i. Common shares issued by the bank which are eligible for inclusion in CET1;
ii. Share premium resulting from the issue of instruments included in CET1;
iii. Retained earnings;
iv. Legal reserves;
v. Statutory reserves;
vi. Accumulated other comprehensive income and other disclosed reserves; and
vii. Other regulatory adjustments applied in the calculation of CET1 relating to items that are included in equity but are treated differently for capital adequacy calculation purposes.

b) Additional Tier 1 (**AT1**):

Additional Tier 1 (**AT1**) includes the following items:

i. Instruments issued by the bank which are eligible for inclusion in AT1 and are not included in CET1;
ii. Stock surplus, or share premium, resulting from the issue of instruments included in AT1;
iii. Instruments issued by consolidated subsidiaries of the bank and held by third parties which are eligible for inclusion in AT1 and are not included in CET1; and
iv. Regulatory adjustments applied in the calculation of AT1.

Tier 2 Capital:

Tier 2 includes the following items:

i. Banks using the standardized approach for credit risk: general provisions/general loan loss reserves up to a maximum of 1.25 % of Credit RWA;
ii. Share premium resulting from the issue of instruments included in Tier 2 capital;
iii. Instruments which are eligible for inclusion of Tier 2; and
iv. Regulatory adjustments applied in the calculation of Tier 2.

3.1 Capital management objectives

The Bank's key objectives in the capital management process are:

- To comply and maintain sufficient capital to meet minimum capital requirement set by the CBUAE;
- To safeguard the Bank's ability to continue as a going concern and increase the returns for the shareholders;
- To ensure Basel III compliance in terms of capital and liquidity ratios;
- Maintain strong and sufficient capital to support the bank's risk appetite, in line with the objectives of the medium term strategic plans and facilitate the expanding business developments;
- Maintain adequate capital to withstand ICAAP stress scenarios including additional requirements; and
- To support the Bank's credit rating.

The primary objective of the Bank's capital management policies is to ensure that it has sufficient capital to cover the risks associated with its activities. The assessment of the various risks across the Bank and their likely impact is carried out annually with ICAAP. As part of ICAAP, Risk Management identifies various risks the Bank is exposed to as part of its day-to-day operations. The Bank establishes policies and procedures, frameworks and methodologies; and contingency plans to measure, manage and mitigate the impact of such risks.

3. Capital management structure and policies as per Basel III (continued)

3.2 Regulatory capital

The capital management process of the Bank is aligned with the overall business strategy. The Bank conducts capital planning in conjunction with the strategic business and financial planning exercise. The Bank develops medium-term strategic plan on a rolling basis which is updated annually. Detailed business plan and budget for the year is prepared based on the medium-term plan. The overall strategic plan and budget are approved by the Board of Directors of the Bank. The business plan and budget for the year are cascaded down to the individual businesses. The detailed business plan and budget provides the foundation for financial risk management.

The Bank's lead regulator, the CBUAE sets and monitors capital requirements for the Bank as a whole. The Bank and individual banking operations are directly supervised by their respective local regulators.

The Bank's regulatory capital is composed of following tiers:

- CET1 which includes fully paid up capital, statutory reserve, general reserve, retained earnings, exchange translation reserve and investment fair value reserve. Regulatory adjustments under Basel III include deductions of deferred tax assets, investments in banking and financial entities;

- Tier 1 capital, which includes CET1, with additional items that consist of AT1 capital instruments and certain non-controlling interests in subsidiaries; and

- Tier 2 capital, which includes collective impairment allowance and qualifying subordinated liabilities.

Various limits are applied to elements of the capital base:

- Tier 2 capital cannot exceed 67% of tier 1 capital;

- CET1 capital must be a minimum of 7% of risk weighted assets; and

- Qualifying subordinated capital cannot exceed 50% of tier 1 capital.

On top of this minimum capital requirement, the CBUAE has also mandated the U.A.E banks to keep additional buffers:

The additional capital buffers (Capital Conservation Buffer (CCB) and Countercyclical Capital Buffer (CCyB) maximum up to 2.5% for each buffer) over and above the minimum CET1 requirement of 7%.

For 2018, CCB is required to be kept at 1.875% and from 2019; it will be required to be at 2.5%. CCyB is currently not in effect.

The Bank has been classified as a Domestic Systematically Important Bank (D-SIB) and was required to keep an additional D-SIB buffer of 0.375% for 2018. This buffer will increase to 0.5% in 2019.

Capital adequacy and consumption of regulatory capital are monitored on a regular basis by the Bank's management, employing techniques based on the guidelines issued by the Basel Committee and the CBUAE. The required information is filed with the regulators on a quarterly basis.

The Bank assets are risk weighted as to their relative credit, market, and operational risk. Credit risk includes both on and off-balance sheet risks. Market risk is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices and includes profit rate risk, foreign exchange risk, equity exposure risk, and commodity risk. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events.

The Bank is following the standardised approach for credit, market and operational risk, as permitted by the CBUAE.

3. Capital management structure and policies as per Basel III (continued)

3.3 Regulatory capital structure

Capital adequacy and the use of regulatory capital are monitored on a regular basis by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the CBUAE.

No changes have been made to the objectives, policies and processes from the previous year. However, they are under constant review by management.

During the years ended 31st December 2018 and 2017, the Bank complied in full with all its externally imposed capital requirements.

Capital Adequacy Ratio (CAR) under Basel III in accordance with regulations of the CBUAE is as follows:

	2018	2017
	AED'000	AED'000
Common Equity Tier 1 (CET1)		
Share capital	**6,589,585**	4,942,189
Other reserves	**10,860,963**	7,806,273
Retained earnings	**6,267,023**	4,744,686
Cumulative deferred exchange losses	**(1,051,515)**	(501,187)
Investment fair value reserve	**(850,362)**	(615,389)
Non-controlling interest	**-**	36,480
Total CET 1 Capital	**21,815,694**	16,413,052
Additional Tier 1 Capital (AT1)		
Tier 1 Sukuk	**6,978,700**	7,346,000
Deduction from capital	**-**	(2,072)
Total AT1 Capital	**6,978,700**	7,343,928
Total Tier 1 Capital	**28,794,394**	23,756,980
Tier 2 Capital		
Collective impairment allowance	**2,021,725**	1,812,885
Deduction from capital	**-**	(2,072)
Total Tier 2 Capital	**2,021,725**	1,810,813
Total Capital Base	**30,816,119**	25,567,793

3. Capital management structure and policies as per Basel III (continued)

3.4 Capital Adequacy

The Bank is computing and reporting risk weighted assets (RWA) in accordance with guidelines of the CBUAE.

Risk weighted assets

	Basel III	Basel III
	2018	2017
	AED'000	AED'000
Risk weighted assets		
Credit risk	**161,737,978**	153,202,879
Market risk	**1,520,866**	1,959,686
Operational risk	**13,266,610**	11,934,690
Total risk weighted assets	**176,525,454**	167,097,255

The Bank's capital adequacy ratios as of 31st December 2018 were as follows:

Capital Ratios		
Capital adequacy ratio	**17.5%**	15.3%
Tier 1 Capital ratio	**16.3%**	14.2%
Common Equity Tier 1 ratio	**12.4%**	9.8%
Total capital adequacy ratios for each significant bank subsidiary :		
DIB Pakistan ("Basel III Total capital adequacy ratio")	**14.0%**	13.4%

The Bank's Basel III Capital Adequacy ratio as at 31st December 2018 is 17.5% and Tier 1 capital adequacy ratio is 16.3% against the regulatory requirement of minimum of 12.75% and 10.75%, respectively. The Bank ensures adherence to the CBUAE requirements by implementing high internal limits.

The capital adequacy ratio for the year 2018 has been calculated after considering the impact of the proposed dividend as required by Capital Supply Standard and the related guidance issued by the CBUAE.

The financial subsidiaries of the Bank are regulated by their local supervisors who set and monitor their capital adequacy requirements. CBUAE monitors the capital adequacy requirements of the Bank at a financial group level.

3. Capital management structure and policies as per Basel III (continued)

3.4. Capital adequacy (continued)

3.4.1 Credit risk weighted assets

The details of Credit Risk Weighted Assets as of 31st December 2018 are as follows:

	Gross Exposure AED'000	Risk Weighted Assets AED'000
Claims on sovereigns	**45,000,457**	**7,746,833**
Claims on non-commercial public sector enterprises (PSEs)	**2,497,595**	**-**
Claims on multilateral development banks	**155,694**	**-**
Claims on banks	**41,682,408**	**4,183,427**
Claims on corporate and government related entities (GRE)	**156,079,933**	**99,967,366**
Claims included in the regulatory retail portfolio	**24,197,035**	**18,021,764**
Claims secured by residential property	**12,868,488**	**6,928,586**
Claims secured by commercial real estate	**10,116,868**	**9,640,128**
Past due financing assets	**7,438,094**	**3,621,307**
Higher-risk categories	**838,933**	**818,022**
Other assets	**10,590,073**	**10,810,544**
Total	**311,465,578**	**161,737,978**

The details of Credit Risk Weighted Assets as of 31st December 2017 are as follows:

	Gross Exposure AED'000	Risk Weighted Assets AED'000
Claims on sovereigns	35,443,567	5,607,465
Claims on non-commercial public sector enterprises (PSEs)	2,386,833	21,663
Claims on multilateral development banks	92,443	-
Claims on banks	28,189,327	3,865,087
Claims on corporate and government related entities (GRE)	135,800,335	90,721,798
Claims included in the regulatory retail portfolio	25,047,820	18,366,944
Claims secured by residential property	13,315,962	6,980,161
Claims secured by commercial real estate	8,858,615	8,418,879
Past due financing assets	7,300,925	3,432,495
Higher-risk categories	869,607	864,032
Other assets	10,196,153	14,924,355
Total	267,501,587	153,202,879

3. Capital management structure and policies as per Basel III (continued)

3.4. Capital adequacy (continued)

3.4.2 Market risk weighted assets

Market risk weighted assets subject to capital charge are based on the following risks:

- Profit rate risk;
- Foreign exchange risk; and
- Equity risk.

The scope of capital charges on market risk weighted assets is restricted to 'trading book' only for the profit rate risk and equity positions. Foreign exchange risk is applicable to the Bank's overall positions.

As of 31st December 2018, the capital requirement for Market Risk as per standardized approach was as follows:

	2018 AED'000	2017 AED'000
Profit rate risk	**24,442**	7,342
Foreign exchange risk	**135,249**	227,284
Equity	**-**	536
Total capital requirement for market risk	**159,691**	235,162

3.4.3 Operational risk weighted assets

In accordance with Basel III guidelines operational risk charge is computed by multiplying the beta factors of respective banking business activities, subject to and as required by the Standardised Approach. The total capital requirement for Operational Risk as at 31st December 2018 is AED 1,393 million and as of 31st December 2017 was AED 1,432 million.

No changes have been made to the capital management objectives, policies and processes from the previous year.

4. Risk management objectives and policies

4.1 Introduction

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls.

The Bank is exposed to various risks including:

- Credit risk;
- Liquidity risk;
- Market risk; and
- Operational risk.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

4.1.1 Risk management structure

The Board of Directors, supported by the Board Risk Management Committee, Risk Management Committee and Risk Management Department, is ultimately responsible for identifying, monitoring and controlling risks; however, there are other independent bodies / functions responsible for managing and monitoring risks in the front-end and middle offices.

Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and policies.

Board Risk Management Committees

The Board Risk Management Committee ("BRMC") has the overall responsibility for the development of the risk strategies, frameworks, policies and risk appetite, and for recommending these strategies and policies to the Board of Directors. It is responsible for the fundamental risk issues, and manages and monitors relevant risk decisions.

Risk Management Committee

The day-to-day management of risk has been delegated to Risk Management Committee of the Management. The Risk Management Committee has the overall responsibility to support the BRMC for the development and formulation of the risk strategy, frameworks, policies and risk appetite. It is responsible for ensuring the compliance with all risk limits, monitoring risk exposures and implementing the regulatory guidelines issued by the local regulatory bodies.

Risk Management Department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure risk remains within the acceptable range as approved by the Board Risk Management Committee and the Board of Directors. The department is responsible for credit administration, portfolio management, credit risk, market risk and operational risk controls.

Asset and Liability Management Committee

Asset and Liability Management Committee ("ALCO") is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Remedial Management Committee

The Remedial Committee is primarily responsible for the management of remedial and past-due customer exposures under the ownership of Collections and Special Assets Management Department ("C & SAM").

Model Risk Management Committee

Model Risk Management Committee is responsible for monitoring model developments, recalibrations, commissioning and decommissioning of production model deployment. Verification of model validation & monitoring reports.

Internal Audit Department

Risk management processes throughout the Bank are audited periodically by the Internal Audit Department which examines both the adequacy of the policies and procedures and the Bank's compliance with the same. Internal Audit Department comments on the results of their assessments with management, and reports its findings and recommendations to the Board Audit Committee.

4. Risk management objectives and policies (continued)

4.1 Introduction (continued)

4.1.2 Risk measurement and reporting systems

The Bank measures risks using qualitative as well as quantitative methods for credit, market, liquidity and operational risks. Further, the Bank also uses quantitative analysis and methods to support revisions in business and risk strategies as and when required. These analysis and methods reflect both the expected loss likely to arise in normal course of business or unexpected losses in an unforeseen event based on statistical techniques and probabilities derived from historical experience. The Bank also runs stress scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on risk appetite established by the Board of Directors and management. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept.

Information compiled from all the businesses is examined and processed in order to analyse the risk profile and identify risks. This information is presented and explained to the management committees, the Risk Management Committee, and Board Risk Management Committee. Specialized reports are presented to the pertinent heads of business and are delivered with suitable frequency. The report includes aggregate credit exposure, limit exceptions, liquidity, operational loss incidents and other risk profile changes.

4.1.3 Model risk management and governance

The Bank uses a number of quantitative/statistical models in financial and business activities, measuring and reporting expected credit losses under the IFRS 9.

Model risk is the potential for adverse consequences from decisions based on wrong interpretation of the model results and incorrect use of model outputs and reports. All models, including risk management, valuation and regulatory capital models, are required to meet strict validation criteria, including effective challenge of the model development process and a sufficient demonstration of model development evidence incorporating a comparison of alternative theories and approaches.

To manage the model risks, the Bank has developed and implemented Model Governance Framework which contains Bank wide model development, implementation, validation policies and practices. According to the framework, all internally or externally developed risk quantification models that directly affect the financial reporting on expected credit losses require validation periodically (internally or externally). The Framework establishes a systematic approach to manage the development, implementation, approval, validation and ongoing use of models. It sets out an effective governance and management structure with defined roles and responsibilities, policies and controls for managing model risk. The Framework is reviewed on a regular basis to ensure it meets regulatory standards and international best practices.

4.1.4 Risk mitigation

As part of its overall risk management, the Bank uses various methods to manage exposures resulting from changes in credit risks, liquidity risks, market risks (including profit rate risk, foreign exchange risk, and equity price risk), and operational risks.

The Bank seeks to manage its credit risk exposures through diversification of financing and investing activities to avoid undue concentration of risk with individuals and groups of customers in specific locations or businesses. The Bank actively uses collateral to reduce its credit risks.

In order to guard against liquidity risk, management has diversified funding sources and assets are managed with a view on overall liquidity in consideration of maintaining a healthy balance of liquid assets (i.e. cash and cash equivalents).

The market risks are managed on the basis of predetermined asset allocation across various asset categories and continuous appraisal of market conditions for movement and expectation of foreign currency rates, bench mark profit rates and equity exposures.

To manage all other risks, the Bank has developed a detailed risk management framework to identify and apply resources to mitigate the risks.

4.1.5 Risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

4. Risk management objectives and policies (continued)

4.2 Credit risk

In order to avoid excessive identified concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio of credit risks which are controlled and managed accordingly.

Credit risk measurement

The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparties. The models for assessment of Real Estate and SME segments are internally developed, whilst the Corporate and Contracting segments has been acquired from Moody's model and subsequently optimized and calibrated to the Bank's internal rating scale. The models are housed in the Moody's Risk Analyst rating tool.

The rating models are kept under review and upgraded as necessary. The Bank regularly validates the performance of the credit rating and their predictive power with regard to default events.

Credit-related commitments risks

The Bank makes available to its customers guarantees and letters of credit which require that the Bank make payments in the event that the customer fails to fulfil certain obligations to other parties. This exposes the Bank to similar risks as applied to Islamic financing and investing assets and these are mitigated by the same control processes and policies.

Collateral

The Bank employs a range of policies and practices to mitigate credit risk. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for Islamic financing and investing assets are:

- Mortgages over residential and commercial properties;
- Financial guarantees or credit default swaps;
- Charges over business assets such as premises, machinery, vehicles and inventory;
- Charges over financial instruments such as deposits and equity investments; and
- Assignment of other receivables etc.

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.1 Maximum exposure to credit risk without taking account of any collateral and other credit mitigation

The table below shows the maximum exposure to credit risk by class of financial asset, including Islamic derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of risk mitigation and collateral agreements.

	Gross maximum exposure 2018 AED'000	Gross maximum exposure 2017 AED'000
Balances with central banks	**20,878,794**	26,481,776
Due from banks and financial institutions	**8,297,032**	4,676,952
Islamic financing and investing assets	**150,465,957**	139,066,896
Investment in Islamic sukuk measured at amortised cost	**31,268,322**	24,022,680
Other investments measured at fair value	**1,687,824**	1,961,733
Receivables and other assets	**6,646,455**	7,893,154
	219,244,384	204,103,191
Contingent liabilities	**15,432,639**	15,685,782
Commitments	**18,686,154**	16,398,423
Total	**253,363,177**	236,187,396

4.2.2 Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The Bank's financial assets, before taking into account any collateral held or other credit mitigation can be analysed by the following geographical regions:

	2018 AED'000	2017 AED'000
The U.A.E.	**224,421,279**	212,697,755
Other Gulf Cooperation Council (GCC) countries	**9,647,147**	6,558,510
Asia	**13,405,831**	10,484,879
Europe	**4,416,400**	5,138,865
Africa	**467,606**	797,960
Others	**1,004,914**	509,427
Total	**253,363,177**	236,187,396

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.2 Risk concentrations of the maximum exposure to credit risk (continued)

An industry sector analysis of the Bank's financial assets, before taking into account collateral held or other credit risk mitigation, is as follows:

	Gross Maximum Exposure 2018 AED'000	Gross Maximum Exposure 2017 AED'000
Government	**23,494,616**	19,168,786
Financial Institutions	**46,141,576**	44,583,603
Real estate	**48,386,477**	43,068,395
Contracting	**14,233,003**	18,139,228
Trade	**11,136,355**	11,285,179
Aviation	**21,852,705**	19,763,982
Services and manufacturing	**44,742,199**	36,542,763
Consumer financing	**29,498,112**	29,932,627
Consumer home finance	**13,878,134**	13,702,833
Total	**253,363,177**	236,187,396

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.3 Gross credit risk exposures as per Basel III standardized approach (continued)

The gross credit exposure as per standardized approach with the effect of CRM as of 31st December 2018 is detailed below:

December 2018		Credit Risk Mitigation (CRM)			
AED'000	On & Off Balance Sheet Gross Outstanding	Exposure Before Credit Risk Mitigation (CRM)	Credit Risk Mitigation (CRM)	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	45,000,457	45,000,457	–	45,000,148	7,746,833
Claims on non-commercial public sector enterprises (PSEs)	2,497,595	2,497,595	–	2,497,595	–
Claims On Multi-Lateral Development Banks	155,694	155,694	–	155,694	–
Claims on banks	41,682,408	41,682,408	9,750	11,921,017	4,183,427
Claims on corporates and government related enterprises	156,079,933	156,061,955	10,958,600	101,738,528	99,967,366
Claims included in the regulatory retail portfolio	24,197,035	24,195,571	371,581	23,817,905	18,021,764
Claims secured by residential property	12,868,488	12,725,878	10,658	12,715,221	6,928,586
Claims secured by commercial real estate	10,116,868	10,102,730	575,810	9,754,471	9,640,128
Past due financing assets	7,438,094	3,577,525	586,463	2,921,168	3,621,307
Higher-risk categories	838,933	838,933	293,585	545,348	818,022
Other assets	10,590,073	10,325,380	124,221	10,201,160	10,810,544
Total	**311,465,578**	**307,164,126**	**12,930,669**	**221,268,255**	**161,737,978**

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.3 Gross credit risk exposures as per Basel III standardized approach

The gross credit exposure as per standardized approach with the effect of CRM as of 31st December 2017 is detailed below:

December 2017		Credit Risk Mitigation (CRM)			
AED'000	On & Off Balance Sheet Gross Outstanding	Exposure Before Credit Risk Mitigation (CRM)	Credit Risk Mitigation (CRM)	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	35,443,567	35,443,567	–	35,443,258	5,607,465
Claims on non-commercial public sector enterprises (PSEs)	2,386,833	2,386,833	–	2,386,833	21,663
Claims On Multi-Lateral Development Banks	92,443	92,443	–	92,443	–
Claims on banks	28,189,327	28,189,327	3,103	8,806,232	3,865,087
Claims on corporates and government related enterprises	135,800,335	135,506,690	11,489,919	92,288,535	90,721,798
Claims included in the regulatory retail portfolio	25,047,820	25,044,756	857,808	24,179,879	18,366,944
Claims secured by residential property	13,315,962	13,158,407	428	13,157,979	6,980,161
Claims secured by commercial real estate	8,858,615	8,677,977	377,703	8,538,579	8,418,879
Past due financing assets	7,300,925	3,461,021	612,242	2,798,930	3,432,495
Higher-risk categories	869,607	869,607	293,585	576,021	864,032
Other assets	10,196,153	10,196,153	186,331	10,009,822	14,924,355
Total	267,501,587	263,026,780	13,821,120	198,278,511	153,202,879

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.4 Gross credit risk exposures as per standardised approach (continued)

The gross credit exposures as per standardized approach in terms of rated/unrated assets as of 31st December 2018 is detailed below:

AED'000	Rated	Unrated	Total Gross Outstanding	Exposure Before CRM	Credit Risk Mitigation	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	34,642,978	10,357,479	45,000,457	45,000,457	–	45,000,148	7,746,833
Claims on non-commercial public sector enterprises (PSEs)	–	2,497,595	2,497,595	2,497,595	–	2,497,595	–
Claims On Multi-Lateral Development Banks	155,694	–	155,694	155,694	–	155,694	–
Claims on banks	37,465,446	4,216,962	41,682,408	41,682,408	9,750	11,921,017	4,183,427
Claims on corporates and government related enterprises (GREs)	10,226,789	145,853,144	156,079,933	156,061,955	10,958,600	101,738,528	99,967,366
Claims included in the regulatory retail portfolio	–	24,197,035	24,197,035	24,195,571	371,581	23,817,905	18,021,764
Claims secured by residential property	–	12,868,488	12,868,488	12,725,878	10,658	12,715,221	6,928,586
Claims secured by commercial real estate	–	10,116,868	10,116,868	10,102,730	575,810	9,754,471	9,640,128
Past due financing assets	–	7,438,094	7,438,094	3,577,525	586,463	2,921,168	3,621,307
Higher-risk categories	–	838,933	838,933	838,933	293,585	545,348	818,022
Other assets	–	10,590,073	10,590,073	10,325,380	124,221	10,201,160	10,810,544
Total	82,490,907	228,974,671	311,465,578	307,164,126	12,930,669	221,268,255	161,737,978

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.4 Gross credit risk exposures as per standardised approach (continued)

The gross credit exposures as per standardized approach in terms of rated/unrated assets as of 31st December 2017 is detailed below:

AED'000	Rated	Unrated	Total Gross Outstanding	Exposure Before CRM	Credit Risk Mitigation	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	34,072,004	1,371,563	35,443,567	35,443,567	–	35,443,258	5,607,465
Claims on non-commercial public sector enterprises (PSEs)	_	2,386,833	2,386,833	2,386,833	–	2,386,833	21,663
Claims On Multi-Lateral Development Banks	92,443	–	92,443	92,443	–	92,443	–
Claims on banks	25,084,210	3,105,117	28,189,327	28,189,327	3,103	8,806,232	3,865,087
Claims on corporates and government related enterprises (GREs)	10,021,205	125,779,130	135,800,335	135,506,690	11,489,919	92,288,535	90,721,798
Claims included in the regulatory retail portfolio	–	25,047,820	25,047,820	25,044,756	857,808	24,179,879	18,366,944
Claims secured by residential property	_	13,315,962	13,315,962	13,158,407	428	13,157,979	6,980,161
Claims secured by commercial real estate	_	8,858,615	8,858,615	8,677,977	377,703	8,538,579	8,418,879
Past due financing assets	–	7,300,925	7,300,925	3,461,021	612,242	2,798,930	3,432,495
Higher-risk categories	–	869,607	869,607	869,607	293,585	576,021	864,032
Other assets	–	10,196,153	10,196,153	10,196,153	186,331	10,009,822	14,924,355
Total	69,269,862	198,231,725	267,501,587	263,026,780	13,821,120	198,278,511	153,202,879

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.5 Analysis of credit quality

2018	Balances with central banks and due from banks and financial institutions AED'000	Islamic financing and investing assets AED'000	Investments in Islamic sukuk and other investments at fair value AED'000	Receivables and other assets AED'000	Contingent liabilities and commitments AED'000	Total AED'000
Individually impaired	**-**	**5,030,370**	**-**	**1,069,895**	**-**	**6,100,265**
Non-impaired exposures						
Neither past due nor impaired	**29,175,826**	**142,005,402**	**32,956,146**	**5,576,560**	**34,118,793**	**243,832,727**
Past due by less than 30 days	**-**	**1,899,731**	**-**	**-**	**-**	**1,899,731**
Past due by more than 30 days but less than 90 days	**-**	**1,310,317**	**-**	**-**	**-**	**1,310,317**
Past due by more than 90 days	**-**	**220,137**	**-**	**-**	**-**	**220,137**
Gross amount	**29,175,826**	**145,435,587**	**32,956,146**	**5,576,560**	**34,118,793**	**247,262,912**
Total gross maximum exposure	**29,175,826**	**150,465,957**	**32,956,146**	**6,646,455**	**34,118,793**	**253,363,177**
Provisions for impairment	**-**	**(5,727,372)**	**(89,797)**	**(660,224)**	**-**	**(6,477,393)**
Net carrying amount	**29,175,826**	**144,738,585**	**32,866,349**	**5,986,231**	**34,118,793**	**246,885,784**
2017						
Individually impaired	-	4,599,691	-	680,829	-	5,280,520
Non-impaired exposures						
Neither past due nor impaired	31,158,728	131,087,658	25,984,413	7,212,326	32,084,204	227,527,329
Past due by less than 30 days	-	1,847,364	-	-	-	1,847,364
Past due by more than 30 days but less than 90 days	-	1,270,575	-	-	-	1,270,575
Past due by more than 90 days	-	261,607	-	-	-	261,607
Gross amount	31,158,728	134,467,204	25,984,413	7,212,326	32,084,204	230,906,875
Total gross maximum exposure	31,158,728	139,066,895	25,984,413	7,893,155	32,084,204	236,187,395
Provisions for impairment	-	(5,732,668)	-	-	-	(5,732,668)
Net carrying amount	31,158,728	133,334,227	25,984,413	7,893,155	32,084,204	230,454,727

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.6 Credit risk exposure of the Banks's financial assets for each internal risk rating

	Moody's equivalent grades	Total 2018 AED'000	Total 2017 AED'000
Low risk			
Risk rating classes 1 to 3	Aaa – A3	**107,497,972**	104,602,628
Moderate risk			
Risk rating classes 4 to 5	Baa1 – Ba3	**109,157,850**	94,747,239
Fair risk			
Risk rating classes 6 to 7	B1 - Caa3	**30,459,297**	31,259,785
Default			
Risk rating classes 8 to11	Ca - C	**6,248,058**	5,577,744
		253,363,177	236,187,396

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of financing exposures across all lines of business, geographic regions and products. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank rating policy. The attributable risk ratings are assessed and updated regularly.

4.2.7 Analysis by economic sector and geography

The details of financing and investing assets by economic activity and geography are as below:

	Within the U.A.E. AED'000	Outside the U.A.E. AED'000	Total AED'000
2018			
Government	**5,745,492**	**1,521,827**	**7,267,319**
Financial institutions	**5,830,020**	**644,686**	**6,474,706**
Real estate	**28,581,368**	**261,913**	**28,843,281**
Contracting	**5,799,483**	**964,868**	**6,764,351**
Trade	**7,564,031**	**682,717**	**8,246,748**
Aviation	**18,770,762**	**113,493**	**18,884,255**
Services and others	**31,220,294**	**3,178,972**	**34,399,266**
Consumer home finance	**13,357,669**	**290,197**	**13,647,866**
Consumer financing	**25,396,744**	**541,421**	**25,938,165**
	142,265,863	**8,200,094**	**150,465,957**
Less: provision for impairment			**(5,727,372)**
Total			**144,738,585**

4 Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.7 Analysis by economic sector and geography (continued)

2017	Within the U.A.E. AED'000	Outside the U.A.E. AED'000	Total AED'000
Government	4,488,674	1,517,555	6,006,229
Financial institutions	5,076,851	1,257,715	6,334,566
Real estate	25,916,111	277,423	26,193,534
Contracting	6,506,545	855,093	7,361,638
Trade	7,093,302	1,124,762	8,218,064
Aviation	16,847,745	150,123	16,997,868
Services and others	25,708,401	2,140,836	27,849,237
Consumer home finance	13,120,151	334,453	13,454,604
Consumer financing	26,035,602	615,553	26,651,155
	130,793,382	8,273,513	139,066,895
Less: provision for impairment			(5,732,668)
Total			133,334,227

4.2.8 Provision for impairment

	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000	2017 AED'000
Balance at 1 January	**1,810,964**	**-**	**3,921,704**	**5,732,668**	5,558,651
Reversal on transition to IFRS 9	**(1,810,964)**	**-**	**-**	**(1,810,964)**	-
ECL recognized on adoption of IFRS 9	**1,380,253**	**696,072**	**-**	**2,076,325**	-
Balance at 1 January - restated	**1,380,253**	**696,072**	**3,921,704**	**5,998,029**	5,558,651
Impairment charge during the year	**(348,732)**	**311,109**	**1,827,006**	**1,789,383**	1,909,262
Write back/recoveries during the year	**-**	**-**	**(869,492)**	**(869,492)**	(1,073,843)
Write off	**-**	**-**	**(1,165,634)**	**(1,165,634)**	(661,402)
Exchange and other adjustments	**(17,438)**	**(344)**	**(7,132)**	**(24,914)**	-
Balance at 31 December	**1,014,083**	**1,006,837**	**3,706,452**	**5,727,372**	5,732,668

5 Impairment assessment

5.1 Impairment of financial assets

5.1.1 IFRS 9 Impairment method of financial assets

The IFRS 9 approach is based on the Basel framework, particularly on the past rating, default and loss data used.

Excepted credit loss

The Expected Credit Loss (ECL) has a three stage approach which is based on the change in credit quality of financial assets since initial recognition. Expected credit losses reflects the present value of all cash shortfalls related to default events in either (i) over the following twelve months or (ii) over the expected life of a financial instrument depending on credit deterioration from inception.

An impairment or loss allowance will be recognized for expected credit losses on debt instruments classified in financial assets at amortized cost or at fair value through equity, for lease receivables and for loan commitments and financial guarantees given. These impairments and allowances are recognised as soon as the loan is granted or as soon as the bonds are acquired, without waiting for the occurrence of an objective evidence of impairment.

The objective is to provide a gradual and phased approach to the recognition of loss allowances for credit risk symmetrically to the recognition in profit/ (loss) of the credit margin included in the interest income (profit for Islamic Banks).
The financial assets concerned will be allocated to three categories according to the gradual increase in their credit risk since initial recognition. Impairment will be booked to each of these categories as follows:

- Under Stage 1, where there has not been a significant increase in credit risk since initial recognition, an amount equal to 12 months ECL will be recorded. The 12 months ECL is calculated as the portion of life time ECL that represents the ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12 months ECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12 month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by the original effective profit rate.
- Under Stage 2, where there has been a significant increase in credit risk since initial recognition but the financial instruments are not considered credit impaired, an amount equal to the default probability weighted lifetime ECL will be recorded. The PD and LGD are estimated over the lifetime of the instrument and the expected cash shortfalls are discounted by the original effective profit rate.
- Under the Stage 3, where there is objective evidence of impairment at the reporting date these financial instruments will be classified as credit impaired and an amount equal to the lifetime ECL will be recorded for the financial assets.

When estimating ECL for undrawn commitments, the Bank estimates the expected portion of the commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the financing is drawn down. The expected cash shortfalls are discounted at an approximation to the expected effective profit rate on the financing.

The Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the ECL provision. For this purpose, the Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk-adjusted rate relevant to the exposure.

The measurement of ECL is forward looking and requires the use of reasonable and supportable forecasts of future economic conditions in the determination of significant increases in credit risk and measurement of ECL.

Measurement of ECL

The Bank calculates ECLs based on probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the effective profit rate. A cash shortfall is the difference between the cash flows that are due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive. IFRS 9 considers the calculation of ECL by multiplying the Probability of default (PD), Loss Given Default (LGD) and Exposure at Default (EAD). The Bank has developed methodologies and models taking into account the relative size, quality and complexity of the portfolios.

These parameters are generally derived from internally developed statistical models and other historical data and are adjusted to reflect forward-looking information.

Details of these statistical parameters/inputs are as follows:

- The probability of default (PD) is an estimate of the likelihood of default over a given time horizon;
- The exposure at default (EAD) is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date; and

The loss given default (LGD) is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realization of any collateral. It is usually expressed as a percentage of the EAD.

5 Impairment assessment (continued)

5.1 Impairment of financial assets (continued)

5.1.2 Carrying value of gross exposure by internal risk rating category and by ECL stage

As at 31 December 2018

	Gross exposure (AED'000)				Expected credit loss (ECL) (AED'000)			
	Stage 1	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Low	**43,505,321**	**-**	**-**	**43,505,321**	**7,338**	**-**	**-**	**7,338**
Moderate	**77,090,046**	**4,576,803**	**-**	**81,666,849**	**871,351**	**294,077**	**-**	**1,165,428**
Fair	**11,653,006**	**8,610,411**	**-**	**20,263,417**	**135,394**	**712,760**	**-**	**848,154**
Default	**-**	**-**	**5,030,370**	**5,030,370**	**-**	**-**	**3,706,452**	**3,706,452**
Total	**132,248,373**	**13,187,214**	**5,030,370**	**150,465,957**	**1,014,083**	**1,006,837**	**3,706,452**	**5,727,372**

As at 01 January 2018

	Gross exposure (AED'000)				Expected credit loss (ECL) (AED'000)			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Low	39,660,420	-	-	39,660,420	44,134	-	-	44,134
Moderate	69,945,035	5,110,553	-	75,055,588	1,051,402	224,155	-	1,275,557
Fair	12,537,921	7,213,275	-	19,751,196	284,717	471,917	-	756,634
Default	-	-	4,599,691	4,599,691	-	-	3,921,704	3,921,704
Total	122,143,376	12,323,828	4,599,691	139,066,895	1,380,253	696,072	3,921,704	5,998,029

6 Liquidity risk and funding management

6.1 Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stressed circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding, if required.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains statutory deposits with the central banks. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The high quality of the asset portfolio ensures its liquidity and coupled with the Bank's own funds and stable customer deposits help form a stable funding source. Even under adverse conditions, the Bank has access to the funds necessary to cover customer needs and meet its funding requirements.

The primary tool (in addition to other tools) for monitoring liquidity is the maturity mismatch analysis, which is monitored over successive time bands and across functional currencies. Also cumulative negative cash flow over successive time bands are being monitored.

6.1.1 Liquidity risk management process

The Bank liquidity risk management process, as carried out within the Bank and monitored by a separate team in Bank Treasury department, includes:

- Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are financed by customers;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Monitoring financial position liquidity ratios against internal and regulatory requirements
- Managing the concentration and profile of Islamic financing and investing exposures maturities; and
- Monitoring liquidity ratios

6.2 Funding approach

Sources of liquidity are regularly reviewed by management to maintain a wide diversification by currency, geography, provider, product and term.

During the year ended 31st December 2013 and 31st December 2015, the Bank issued Tier 1 Sukuk of AED 3,673 million (USD 1,000 million) each to diversify sources of funding to support business growth.

6.2.1 Non-derivative cash flows

The table below summarises the maturity profile of the gross cash flows of the Bank financial assets and liabilities as at 31st December 2018 and 2017. The amounts disclosed in the table are the contractual gross cash flows, whereas the Bank manages the inherent liquidity risk based on expected gross cash flows.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the management expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

6. Liquidity risk and funding management (continued)

6.2 Funding Approach (continued)

6.2.2 Non-derivative cash flows

2018	**Less than 3 months AED'000**	**3 months to 1 year AED'000**	**1 to 5 years AED'000**	**Over 5 Years AED'000**	**Total AED'000**
Customers' deposits	**68,569,499**	**79,407,021**	**9,557,776**	**159,677**	**157,693,973**
Due to banks and other financial institutions	**5,484,613**	**5,672,249**	**2,154,680**	**-**	**13,311,542**
Sukuk issued	**-**	**260,752**	**13,546,483**	**286,057**	**14,093,292**
Payables and other liabilities	**4,348,863**	**2,146,949**	**1,232,898**	**-**	**7,728,709**
Zakat payable	**-**	**305,202**	**-**	**-**	**305,202**
Total liabilities	**78,402,975**	**87,792,173**	**26,491,837**	**445,734**	**193,132,718**

2017	Less than 3 months AED'000	3 months to 1 year AED'000	1 to 5 years AED'000	Over 5 Years AED'000	Total AED'000
Customers' deposits	68,517,162	72,527,140	7,874,749	19,302	148,938,353
Due to banks and other financial institutions	8,516,206	5,915,537	568,863	-	15,000,606
Sukuk issued	-	-	9,679,979	140,132	9,820,111
Payables and other liabilities	2,587,816	3,646,078	1,225,013	-	7,458,907
Zakat payable	-	280,372	-	-	280,372
Total liabilities	79,621,184	82,369,127	19,348,604	159,434	181,498,349

Assets available to meet all of the liabilities and to cover outstanding commitments include cash and balances with central banks, Islamic financing and investing assets, other investments at fair value and items in the course of collection.

7. Liquidity risk and funding management (continued)

6.2 Funding Approach (continued)

6.2.3 Islamic derivatives financial instruments

Fair values of Islamic derivative financial instruments

The table below shows the positive and negative fair values of Islamic derivative financial instruments, which are equivalent to the market values, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of an Islamic derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of Islamic derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end.

				Notional amounts by term to maturity				
	Positive fair value	Negative fair value	Notional amount total	Within 3 months	Over 3 months to 1 year	Over 1 year to 3 years	Over 3 to 5 years	Over 5 years
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
2018								
Islamic Derivatives held for trading:								
Unilateral promise to buy/sell currencies	**73,860**	**67,990**	**7,038,180**	**4,896,909**	**2,141,271**	**-**	**-**	**-**
Islamic profit rate swaps	**436,988**	**379,819**	**45,851,853**	**-**	**1,202,317**	**6,410,036**	**6,759,527**	**31,479,973**
Islamic currency (Call/Put) options	**4,654**	**4,655**	**557,652**	**-**	**557,652**	**-**	**-**	**-**
Total	**515,502**	**452,464**	**53,447,685**	**4,896,909**	**3,901,240**	**6,410,036**	**6,759,527**	**31,479,973**
2017								
Islamic Derivatives held for trading:								
Unilateral promise to buy/sell currencies	32,532	31,202	4,030,799	3,989,379	41,420	-	-	-
Islamic profit rate swaps	186,019	168,298	36,626,604	-	188,432	6,899,255	6,199,178	23,339,739
Islamic currency (Call/Put) options	10,907	10,907	822,870	468,073	25,995	328,802	-	-
Total	229,458	210,407	41,480,273	4,457,452	255,847	7,228,057	6,199,178	23,339,739

Unilateral Promise to buy/sell currencies

Unilateral promises to buy/sell currencies are promises to either buy or sell a specified currency at a specific price and date in the future. The actual transactions are executed on the value dates, by exchanging the purchase/sale offers and acceptances between the relevant parties and delivering (exchanging) the relevant currencies on spot basis.

Islamic Swaps

Islamic Swaps are based on a Waa'd (promise) structure between two parties to buy a specified Sharia'a compliant asset at an agreed price on the relevant date in future. It is a conditional promise to purchase an asset through a unilateral purchase undertaking. Islamic swap structure comprises profit rate swap and currency swap. For Islamic profit rate swaps, counterparties generally exchange fixed and floating rate profit payments by executing the purchase/sale of asset under "Murabaha Sale Agreement" in a single currency. For Islamic currency swaps, fixed or floating profit payments as well as cost of underlying asset are exchanged in different currencies, by executing the purchase/sale of asset under "Murabaha Sale Agreement".

6. Liquidity risk and funding management (continued)

6.2 Funding Approach (continued)

6.2.4 Contingent liabilities and commitments

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments:

	Less than 3 months AED'000	3 months to 1 year AED'000	1 to 5 years AED'000	Over 5 years AED'000	Total AED'000
2018					
Contingent liabilities:					
Letters of guarantee	**11,434,751**	**1,484,130**	**654,260**	**7,587**	**13,580,728**
Letters of credit	**724,993**	**1,027,808**	**99,110**	**-**	**1,851,911**
	12,159,744	**2,511,938**	**753,370**	**7,587**	**15,432,639**
Capital expenditure commitments	**-**	**-**	**867,525**	**-**	**867,525**
Total	**12,159,744**	**2,511,938**	**1,620,895**	**7,587**	**16,300,164**

	Less than 3 months AED'000	3 months to 1 year AED'000	1 to 5 years AED'000	Over 5 years AED'000	Total AED'000
2017					
Contingent liabilities:					
Letters of guarantee	12,201,897	1,367,421	213,217	51,067	13,833,602
Letters of credit	1,466,525	381,959	3,695	-	1,852,179
	13,668,422	1,749,380	216,912	51,067	15,685,781
Capital expenditure commitments	2,763	-	1,510,826	-	1,513,589
Total	13,671,185	1,749,380	1,727,738	51,067	17,199,370

7. Market risk

7.1 Market risk

Market risk arises from changes in market rates such as profit rates, foreign exchange rates and equity prices, as well as in their correlation and implied volatilities. Market risk management is designed to limit the amount of potential losses on open positions which may arise due to unforeseen changes in profit rates, foreign exchange rates or equity prices. The Bank is exposed to diverse financial instruments including securities, foreign currencies, equities and commodities.

The Bank pays considerable attention to market risk. The Bank uses appropriate models, as per standard market practice, for the valuation of its positions and receives regular market information in order to regulate market risk.

The trading market risk framework comprises the following elements:

- Limits to ensure that risk-takers do not exceed aggregate risk and concentration parameters set by senior management; and
- Independent mark-to-market valuation, reconciliation of positions and tracking of stop-losses for trading positions on a timely basis.

The policies and procedures and the trading limits are set to ensure the implementation of the market risk policy in day-to-day operations. These are reviewed periodically to ensure they remain in line with the Bank's general market risk policy. In addition to its internal procedures and systems, the Bank is required to comply with the guidelines and regulations of the CBUAE.

7.1.1 Profit margin risk

The Bank is not significantly exposed to risk in terms of repricing of its customer deposits since, in accordance with Islamic Sharia'a, the Bank does not provide contractual rates of return to its depositors or investment account holders. The return payable to depositors and investment account holders is based on the principle of the Mudaraba and Wakala by which the depositors and investment account holders agree to share the profit or loss made by the Bank's Mudaraba asset pool over a given period.

7.1.2 Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank 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. The Bank manages this risk through risk management strategies.

The effective profit rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current rate for a floating rate instrument or an instrument carried at fair value.

The following table demonstrates the sensitivity to a reasonable possible change in profit rates, with all other variables held constant, of the Bank's consolidated statement of profit or loss.

The sensitivity of the consolidated statement of profit or loss is the effect of the assumed changes in profit rates on the net income for one year, based on the variable profit rate non-trading financial assets and financial liabilities held at 31st December 2018 and 2017.

Currency	**Increase in basis points**	**2018 AED'000**	2017 AED'000
Sensitivity of net profit income	**50**	**103,051**	85,979

7.1.3 Foreign exchange risk

The Bank has income recorded in its overseas subsidiaries and is therefore exposed to movements in the foreign currency rates used to convert income into the Bank's presentation currency, the U.A.E. Dirham.

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31st December 2018 and 2017. Included in the table are the Bank's financial instruments at their carrying amounts, categorised by currency.

7.1 Market risk (continued)

7.1.3 Foreign exchange risk (continued)

2018	AED	USD	Other G.C.C.	GBP	Euro	Other	Total
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Financial Assets:							
Cash and balances with the central banks	21,394,566	677,421	-	-	-	473,539	22,545,526
Due from banks and financial institutions	6,646,321	1,230,936	107,023	6,670	45,572	260,510	8,297,032
Islamic financing and investing assets, net	105,553,606	33,875,485	1,190,589	-	-	4,118,905	144,738,585
Investment in Islamic sukuk measured at amortised cost	-	29,920,263	-	-	-	1,258,262	31,178,525
Other investments at fair value	725,103	816,957	129,257	-	-	16,507	1,687,824
Receivables and other assets	4,280,643	1,218,948	24,294	-	59,170	321,737	5,904,792
Total	138,600,239	67,740,010	1,451,163	6,670	104,742	6,449,460	214,352,284
Financial Liabilities:							
Customers' deposits	119,322,369	24,347,270	5,193,372	1,613,694	200,413	4,980,198	155,657,316
Due to banks and other financial institutions	5,202,653	7,646,502	-	11,706	28	342,339	13,203,228
Sukuk issued	-	12,181,831	-	-	-	189,137	12,370,968
Payables and other liabilities	5,888,914	1,671,641	153,064	39,802	18,055	273,436	8,044,912
Total	130,413,936	45,847,244	5,346,436	1,665,202	218,496	5,785,110	189,276,424
Net on balance sheet	8,186,303	21,892,766	(3,895,273)	(1,658,532)	(113,754)	664,350	25,075,860
Unilateral promise to buy/sell currencies	3,978,294	(6,205,769)	449,841	1,752,604	116,116	(93,867)	(2,781)
Currency position - long/(short)	12,164,597	15,686,997	(3,445,432)	94,072	2,362	570,483	25,073,079

7.1 Market risk (continued)

7.1.3 Foreign exchange risk (continued)

2017	AED AED'000	USD AED'000	Other G.C.C. AED'000	GBP AED'000	Euro AED'000	Other AED'000	Total AED'000
Financial Assets:							
Cash and balances with central banks	26,877,125	673,481	-	-	-	334,642	27,885,248
Due from banks and financial institutions	3,181,987	1,001,893	122,452	5,961	65,450	299,209	4,676,952
Islamic financing and investing assets, net	94,085,401	34,114,239	1,170,306	-	-	3,964,281	133,334,227
Investment in Islamic sukuk measured at amortised cost	-	22,623,411	-	-	-	1,399,269	24,022,680
Other investments at fair value	765,295	1,022,805	154,666	-	-	18,967	1,961,733
Receivables and other assets	6,683,851	344,625	24,618	-	12,797	116,129	7,182,020
Total	131,593,659	59,780,454	1,472,042	5,961	78,247	6,132,497	199,062,860
Financial Liabilities:							
Customers' deposits	119,084,616	20,760,283	2,095,651	32,981	153,625	5,053,795	147,180,951
Due to banks and other financial institutions	6,028,029	8,571,220	97,950	12	92	180,251	14,877,554
Sukuk issued	-	8,521,108	-	-	-	137,599	8,658,707
Payables and other liabilities	6,005,849	1,054,997	101,923	6,320	17,801	223,573	7,410,463
Total	131,118,494	38,907,608	2,295,524	39,313	171,518	5,595,218	178,127,675
Net on balance sheet	475,165	20,872,846	(823,482)	(33,352)	(93,271)	537,279	20,935,185
Unilateral promise to buy/sell currencies	2,834,093	(3,461,355)	438,748	128,611	54,966	4,329	(608)
Currency position - long/(short)	3,309,258	17,411,491	(384,734)	95,259	(38,305)	541,608	20,934,577

7.1 Market risk (continued)

7.1.3 Foreign exchange risk (continued)

Sensitivity analysis - impact of fluctuation of various currencies on net income and equity

The tables below indicate the extent to which the Bank was exposed to currency risk at 31st December 2018 and 2017 on its non-trading monetary assets and liabilities, and forecasted cash flows. The analysis is performed for a reasonable possible movement of the currency rate against the AED with all other variables held constant on the consolidated statement of profit or loss (due to the changes in the fair values of currency sensitive non-trading monetary assets and liabilities) and equity (due to the change in fair value of foreign currency denominated available-for-sale equity instruments). A negative amount in the table reflects a potential net reduction in consolidated statement of profit or loss and equity, while a positive amount reflects a net potential increase.

Currency	Increase in currency rate in %	Effect on profit or loss 2018 AED'000	Effect on profit or loss 2017 AED'000
US Dollar	+2	315,424	371,246
GBP	+2	1,881	1,905
EURO	+2	2,099	1,161

Currency	Decrease in currency rate in %	Effect on profit or loss 2018 AED'000	Effect on profit or loss 2017 AED '000
US Dollar	-2	(315,424)	(371,246)
GBP	-2	(1,881)	(1,905)
EURO	-2	(2,099)	(1,161)

7.2 Foreign investment

The table below indicates the change in recorded profit before tax and equity had the result for the year ended 31st December 2018 and 2017 been translated at exchange rates against the AED adjusted, with all other variables held constant, by the assumed changes below. The sensitivity analyses do not take account of actions by the Bank that might be taken to mitigate the effect of such changes.

Currency	Increase in currency rate in %	Effect on profit or loss 2018 AED'000	Effect on equity 2018 AED'000	Effect on profit or loss 2017 AED'000	Effect on equity 2017 AED'000
Pak Rupees	+5	4,013	25,113	2,839	27,011
Egypt Sterling	+5	396	4,588	441	4,307

Currency	Decrease in currency rate in %	Effect on profit or loss 2018 AED'000	Effect on equity 2018 AED'000	Effect on profit or loss 2017 AED'000	Effect on equity 2017 AED'000
Pak Rupees	-5	(3,631)	(21,685)	(2,569)	(23,409)
Egypt Sterling	-5	(358)	(4,151)	(399)	(3,897)

7 Market risk (continued)

7.3 Equity price risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The non-trading equity price risk exposure arises from the Bank's investment portfolio.

The effect on equity (as a result of a change in the fair value of equity instruments held as fair value through other comprehensive income (FVTOCI) at 31st December 2018 and 2017) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

Market indices	**Change in market Indices**	**Effect on other comprehensive income**	Effect on other comprehensive income
	%	**2018 AED'000**	2017 AED'000
Dubai Financial Market	**± 5%**	**8,737**	21,582
Abu Dhabi Exchange	**± 5%**	**509**	1,136
Bahrain Stock Exchange	**± 5%**	**1,212**	1,407
Other	**± 5%**	**3,301**	4,483

An increase of 5% in fair value of Level 3 financial instruments due to change in unquoted market price / valuation of financial instruments as at the reporting date would have increased the net assets attributable to the Bank by AED 48.5 million (2017: AED 50.1 million)

8. Operational risk

8.1 Operational risk

Operational risk is the potential exposure to financial or other damage arising from inadequate or failed internal processes, people or systems.

The Bank has developed a detailed operational risk framework. The framework clearly defines roles and responsibilities of individuals/units across different functions of the Bank that are involved in performing various operational risk management tasks. Operational Risk Management Framework will ensure that operational risks within the Bank are properly identified, monitored, managed and reported. Key elements of the framework include process mapping, setting up loss data base, setting up of KRIs, risk analysis and risk management reporting.

The Bank is currently using operational risk tracking system, i.e. ORMS to track operational risk events across the Bank. The system houses five years of operational loss data. The subject system is also capable to record KRI, RCSA and scenario based fraud risk self-assessment. In addition to ORMS, the Bank is also implementing eGRC system (centralized governance framework) for all control activities.

Each new product introduced is subject to a risk review and signoff process where all relevant risks are identified and assessed by departments independent of the risk-taking unit proposing the product. Variations of existing products are also subject to a similar process. Business and support units are responsible for managing operations risk in their respective functional areas. They operate within the Bank’s operational risk management framework and ensure that risk is being managed within their respective business units. The day-to-day management of operations risk is through the maintenance of a comprehensive system of internal controls, supported by robust systems and procedures to monitor transaction positions and documentation, as well as by maintenance of key backup procedures and business contingency planning.

9. Stress Testing and Regulatory Compliance

9.1 Stress Testing

The Bank conducts stress testing exercise over three year horizon by considering risk factors based on macroeconomic variables at various levels of stress scenarios to determine its impact on the level of capital adequacy of the Bank. The tests are considered as an important tool for capital planning and strategy development.

9.2 Regulatory/Compliance Risk

Regulatory risk is defined as the risk of regulatory sanctions, material financial or reputational losses, as a result of failure to comply with laws, regulations, license conditions, supervisory requirements, self-regulatory industry codes of conduct requirements and related internal policies, procedures and organizational standards.

The Bank has mainly three major operational centers - UAE, Pakistan and Kenya. The Bank also has minority interest in Indonesia, Sudan, and Bosnia. The Bank's primary regulators in the three major operational centres are:

- UAE Central Bank;
- Securities & Commodities Authority;
- Dubai Financial Services Authority;
- State Bank of Pakistan; and
- Central Bank of Kenya.

Given the broad regulatory requirements for the Bank's businesses and Corporate Governance, any failure in policy, systems and internal controls can adversely impact a regulatory requirement. Accordingly, proper monitoring of regulatory compliance underpins the effective management of regulatory compliance across the Bank.

Regulatory risk increases during regulatory change and crystallizes when there is a failure to meet requirements of law, regulation or code applicable to the financial services industry. Non-compliance can lead to fines, public reprimands, damage to reputation, enforced suspension of operations or, in extreme cases, withdrawal of authorizations to operate.

9.3 Reputational Risk

Reputational risk is defined as a damage or loss to the Bank's reputation due to one or more events such as negative publicity on Bank's practices, conduct and financial c conditions. The Bank has clearly identified the sources of reputational events, such as:

- Compliance with legal and regulatory obligations;
- Business practices followed;
- Standard of products and service quality;
- Information technology security and data integrity;
- Association with customers, suppliers and partners;
- Crises management;
- External communication; and
- Achievements of financial targets.

The Bank actively manages the identified business risks that could lead to reputational events and the risk assessments made can be considered as moderate risk.