

BAHRAIN DEVELOPMENT BANK B.S.C. (c)

**Basel II Pillar III Disclosures
For the six months ended**

30 June 2015

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(Expressed in Thousands Bahrain Dinars)

Table 1	Capital structure	3
Table 2	Capital requirement for credit risk	5
Table 3	Capital requirement for market risk	5
Table 4	Capital requirement for operational risk	5
Table 5	Gross credit exposures before subject to credit risk mitigants (CRM)	5
Table 6	Sectoral classification of gross credit exposures	6
Table 7	Credit concentration greater than 15% individual obligor limit	7
Table 8	Counterparty wise breakdown of impaired loans and impairment provision	7
Table 9	Residual contract maturity	8
Table 10	Geographical distribution of impairment provisions for loans and advances to customers	9
Table 11	Movement in impairment provision for loans and advances to customers and interest in suspense	9
Table 12	Past due loans - age analysis	10
Table 13	Credit risk exposure post credit risk mitigation and credit conversion	11
Table 14	Eligible financial collateral and guarantees	11
Table 15	Sensitivity analysis - interest rate risk	12
Table 16	Market risk, Interest rate GAP	13
Table 17	Equity position in the banking book	14
Table 18	Gain on Equity Investments	14
Table 19	Operational & legal risks	14

Bahrain Development Bank B.S.C. (c)
Corporate information

Commercial registration no. 26226 obtained on 20 January 1992

Registered office Building 170
Road 1703
Diplomatic Area
PO Box 20501
Manama
Kingdom of Bahrain

1 REPORTING ENTITY

Bahrain Development Bank B.S.C. (c) ("the Bank" or "BDB") was established as a Bahraini closed shareholding company by Legislative Decree number 19 dated 11 December 1991 and commenced operations on 20 January 1992. The Bank is registered with the Ministry of Industry and Commerce under commercial registration (CR) number 26226. The Bank's registered office is in Kingdom of Bahrain.

The core activities of the Bank consist of advancing loans for project finance, working capital, premises and equipment for developing industries and service sectors such as tourism, health and education in the Kingdom of Bahrain. As part of this activity, the Bank also renders management consultancy services and subscribes to ordinary and preference shares in Bahraini companies. Additionally, loans are advanced for agriculture, fisheries and higher education purposes. Other activities of the Bank comprise making direct contributions towards the economic development of the Kingdom of Bahrain.

As at 30 June 2015, the Group consists of the Bank and its following subsidiary:

Name	Country of incorporation	Ownership interest	Year end
Bahrain Business Incubator Centre (S.P.C.)	Kingdom of Bahrain	100%	31 December

Basis of consolidation

Financial statements incorporate the financial statements of the Bank and its subsidiary. The financial statements of the subsidiary is prepared for the same reporting year as the Bank using consistent accounting policies.

All intra group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated on consolidation.

The subsidiary is consolidated from the date on which control is transferred to the Bank and cease to be consolidated from the date on which control is transferred out of the Bank.

Restrictions on capital and transfer of funds within the Group

Since the Bank's subsidiary is not a regulated financial institution, there is no regulatory impediment to the transfer of retained earnings to the Bank. However, as a separate legally incorporated entity, the transfer of paid in capital and mandatory reserves would require shareholder action. As the sole shareholder (either direct or indirect) in the entity, the Bank has the power to undertake the legal processes for the transfer of such capital. The Bank's subsidiary is registered and domiciled in Bahrain and there are no exchange controls or other restrictions on the transfer of funds.

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 1 - CAPITAL STRUCTURE

The Bank's regulatory capital base comprises of (a) CET 1 capital which includes share capital, reserves and retained earnings. (b) Tier 2 capital which consist of general loan loss provisions.

The Bank's regulatory capital base of BD 76,766 is as detailed below:

	2015	
	<u>CET 1</u>	<u>Tier 2</u>
A. NET AVAILABLE CAPITAL		
Issued and fully paid ordinary shares	65,000	-
Legal / Statutory reserve	1,081	-
Retained earnings	5,146	-
Other reserves	4,048	-
Current interim cumulative net income	245	-
Unrealized gains and losses on available for sale financial instruments	41	-
Unrealized gains arising from fair valuing equities	505	-
General loan loss provisions		700
TOTAL CAPITAL BEFORE REGULATORY DEDUCTIONS	76,066	700
Less : Regulatory deductions	-	-
NET AVAILABLE CAPITAL	76,066	700
TOTAL ELIGIBLE CAPITAL BASE (CET 1 + Tier 2)		76,766
B. CAPITAL ADEQUACY RATIO		2015
Total eligible capital base		76,766
Credit risk weighted exposures		172,153
Market risk weighted exposures		213
Operational risk weighted exposures		14,099
Total risk weighted exposures		186,464
	<u>CET 1</u>	<u>Total</u>
	<u>capital</u>	<u>capital ratio</u>
	<u>ratio</u>	
Capital Adequacy Ratio	40.79%	41.17%

RISK WEIGHTED ASSETS PROFILE AND CAPITAL REQUIREMENT FOR CREDIT, MARKET AND OPERATIONAL RISK

The Bank has adopted the standardized approach for credit risk and basic indicator approach for operational risk for regulatory reporting purpose.

Credit Risk

The Bank has a diversified funded and unfunded credit exposure. These exposures are classified as standard portfolio per CBB's Basel II requirements.

Brief description of applicable standard portfolio are as follows:

a. Claims on banks:

Claims on banks are risk weighted based on external rating agency. Short-term claims on locally incorporated banks are assigned a risk weighting of 20% where such claims on the banks are of an original maturity of three months or less and the claims are denominated and funded in either Bahraini Dinars or US Dollar.

Preferential risk weight that is one category more favorable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain of an original maturity of three months or less denominated and funded in the relevant domestic currency. Such preferential risk weight for short-term claims on banks licensed in other jurisdictions are allowed only if the relevant supervisor also allows this preferential risk weighting to short-term claims on its banks.

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation.

b. Claims on corporates:

Claims on corporates are risk weighted based on credit ratings. Risk weighting for unrated (corporate) claims are assigned at 100%.

c. Loans restructured:

Where possible, the Bank seeks to restructure loans rather than to take ownership of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to impairment assessment, calculated using the loan's original effective interest rate.

d. Equity Portfolio:

Investment in securities and financial entities are risk weighted at a minimum risk weight of 100% for listed entities or 150% for unlisted entities, unless such investments exceed 10% of the eligible capital of investee entity, in which case they are deducted from the Bank's capital.

e. Other exposures:

These are risk weighted at 100%.

f. Related party transactions and balances:

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Bank exercises significant influence, major shareholders, directors and executive management of the Bank. Such related parties in the ordinary course of business at commercial interest and commission rates (Refer note 18 in interim financial information).

Amounts due from related parties are unsecured.

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 2 - REGULATORY CAPITAL REQUIREMENT FOR CREDIT RISK

	2015 Capital requirement
Claims on sovereign	-
Claims on public sector entities	-
Claims on banks	1,406
Claims on corporate	15,873
Regulatory retail exposures	-
Residential retail exposures	-
Equity	947
Other exposures	2,433
TOTAL CREDIT RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)	20,658

TABLE 3 - REGULATORY CAPITAL REQUIREMENT FOR MARKET RISK

The Bank uses the Standardised Approach for calculating market risk capital charges for the following market risk components:

- Equity exposure risk
- Interest rate exposure risk
- Foreign currency exposure risk

The Bank's market risk capital charge is largely composed of foreign currency risk arising from the Bank's foreign exchange exposure on investments denominated mainly in kuwaiti dinars, saudi riyals and USD, and interest rate risk arising on the bond portfolio. The capital requirement for market risk using the Standardised Approach as at 30 June 2015 was as follows:

	Capital requirements		
	2015	Maximum	Minimum
Equity risk capital	-	-	-
Foreign exchange risk capital	17	18	17
Interest rate risk capital	-	-	-
TOTAL MARKET RISK CAPITAL REQUIREMENT (STANDARDISED APPROACH)			26

TABLE 4 - REGULATORY CAPITAL REQUIREMENT FOR OPERATIONAL RISK

The capital requirement for operational risk using the Basic Indicator Approach as at 30 June 2015 amounted to **1,692**

TABLE 5 - GROSS CREDIT EXPOSURES BEFORE SUBJECT TO CREDIT RISK MITIGANTS (CRM)

	2015	2015 Average
Balances with Central Bank of Bahrain	2,248	2,124
Treasury bills and bonds	7,703	9,293
Due from banks and other financial institutions	32,219	31,469
Loans and advances to customers	124,559	117,304
Interest Receivable	148	113
Other assets	2,438	1,807
TOTAL FUNDED EXPOSURES	169,315	162,110
Contingent liabilities	2,599	2,508
Other commitments	15,933	11,465
TOTAL UNFUNDED EXPOSURES	18,532	13,973
TOTAL CREDIT RISK EXPOSURE	187,847	176,083

The gross average credit risk exposure are based on six months and year end prudential return reporting.

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 6 - SECTORAL CLASSIFICATION OF GROSS CREDIT EXPOSURES

	2015		<i>Total</i>
	<i>Funded</i>	<i>Unfunded</i>	
Banks and financial institutions	34,467	-	34,467
Trading and Manufacturing	68,607	-	68,607
Education and Health	3,432	-	3,432
Hospitality, media and transportation	6,045	-	6,045
Fisheries and Agriculture	5,308	-	5,308
Food Processing	4,397	-	4,397
Government	7,703	-	7,703
Others	39,356	18,532	57,888
TOTAL	169,315	18,532	187,847

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 7 - CREDIT CONCENTRATION GREATER THAN 15% INDIVIDUAL OBLIGOR LIMIT

	2015
Total credit exposures in excess of 15% individual obligor limit	<u><u>-</u></u>

Impairment of assets

The Bank assesses at each reporting date whether there is any objective evidence that a specific financial asset is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'impairment event') and that impairment event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated. Evidence of impairment may include indications that the borrower is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that it will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Restructured Credit Facilities

The Bank have BD 4,356 restructured credit facilities during the year period ended 30 June 2015.

Past due exposures

This includes claims, for which the repayment is overdue for more than 90 days. The risk weighting for such loans is either 100 percent or 150 percent is applied depending on the level of provisions maintained against the assets.

TABLE 8 - COUNTERPARTY WISE BREAKDOWN OF IMPAIRED LOANS AND IMPAIRMENT PROVISION

	2015				
	<i>Impaired and past due loans (after provision)</i>	<i>Specific provision</i>	<i>Recoveries</i>	<i>Write off</i>	<i>Collective impairment</i>
Project finance	10,195	12,159	(10)	1,321	700
Fisheries and Agriculture	1,364	-	-	-	-
TOTAL	<u><u>11,559</u></u>	<u><u>12,159</u></u>	<u><u>(10)</u></u>	<u><u>1,321</u></u>	<u><u>700</u></u>

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 9 - RESIDUAL CONTRACTUAL MATURITY

Maturity analysis of assets and liabilities

The table below summarises the maturity profile of the Group's assets and liabilities as at 30 June 2015.

	<i>Up to 1 month</i>	<i>1 to 3 months</i>	<i>3 to 6 months</i>	<i>6 months to 1 year</i>	<i>1 to 3 years</i>	<i>3 to 5 years</i>	<i>5 to 10 years</i>	<i>10 to 20 years</i>	<i>Total</i>
2014									
Assets									
Cash and balances with Central Bank of Bahrain	2,603	-	-	-	-	-	-	-	2,603
Due from banks and other financial institutions	14,311	-	2,968	14,940	-	-	-	-	32,219
Accounts receivable and other assets	-	-	2,586	-	-	-	-	-	2,586
Loans and advances to customers	2,783	1,027	1,281	2,094	23,977	64,288	27,126	1,983	124,559
Available for sale investments	5,867	-	305	3,000	-	-	3,850	-	13,022
Investments in associated companies	-	-	-	-	-	-	253	-	253
Investment property	-	-	-	-	-	-	-	3,548	3,548
Property, plant and equipment	-	-	-	-	-	-	-	10,717	10,717
Total assets	25,564	1,027	7,140	20,034	23,977	64,288	31,229	16,248	189,507
Liabilities									
Deposits	55,249	4,208	164	3,511	10	-	-	-	63,142
Accounts payable and other liabilities	-	4,320	-	-	-	-	-	-	4,320
Long term loans	-	-	636	1,641	9,078	11,016	18,344	5,265	45,980
Total liabilities	55,249	8,528	800	5,152	9,088	11,016	18,344	5,265	113,442
Net liquidity gap	(29,685)	(7,501)	6,340	14,882	14,889	53,272	12,885	10,983	

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 10 - GEOGRAPHICAL DISTRIBUTION OF IMPAIRMENT PROVISIONS FOR LOANS AND ADVANCES TO CUSTOMERS

Bank and its subsidiary is operated locally and Loans granted to Bahrain entities and persons only.

	2015
Bahrain	
Specific impairment provision	12,159
TOTAL	<u>12,159</u>

TABLE 11 - MOVEMENT IN IMPAIRMENT PROVISION FOR LOANS AND ADVANCES TO CUSTOMERS

	2015						<i>Total</i>
	Project finance			Fisheries and agriculture			
	<i>Specific</i>	<i>Collective</i>	<i>Total</i>	<i>Specific</i>	<i>Collective</i>	<i>Total</i>	
Balance at 1 January 2015	13,490	700	14,190	-	-	-	14,190
Amounts written off during the period	(1,321)	-	(1,321)	-	-	-	(1,321)
Charge for the period	1,145	-	1,145	-	-	-	1,145
Recoveries during the period	(1,155)	-	(1,155)	-	-	-	(1,155)
At 30 June 2015	<u>12,159</u>	<u>700</u>	<u>12,859</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>12,859</u>

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 12 - PAST DUE LOANS - AGE ANALYSIS

i) By Geographical area

	2015			<i>Total</i>
	<i>Three months to one year</i>	<i>One to three years</i>	<i>Over three years</i>	
Bahrain	2,326	2,855	6,378	11,559
TOTAL	2,326	2,855	6,378	11,559

ii) By Counterparty wise

	<i>Three months to one year</i>	<i>One to three years</i>	<i>Over three years</i>	<i>Total</i>
	Project finance	2,096	2,611	5,488
Fisheries and Agriculture	230	244	890	1,364
TOTAL	2,326	2,855	6,378	11,559

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 13 - CREDIT RISK EXPOSURE POST CREDIT RISK MITIGATION AND CREDIT CONVERSION

	2015
Claims on sovereign	-
Claims on public sector entities	-
Claims on banks	11,716
Claims on corporate	117,025
Past due exposures	15,250
Equity	7,888
Other exposures	20,274
TOTAL	172,153

TABLE 14 - ELIGIBLE FINANCIAL COLLATERAL AND GUARANTEES

Collateral from borrowers consist of cash deposits, letters of guarantee and real estate properties. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and evaluates the adequacy of the allowance for impairment.

	2015	
	<i>Gross exposure</i>	<i>Eligible CRM</i>
Claims on sovereign	-	-
Claims on public sector entities	-	-
Claims on MDBs	-	-
Claims on banks	11,716	-
Claims on corporate	132,275	268
Equity	7,888	-
Other exposures	20,274	-
TOTAL	172,153	268

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 15 - SENSITIVITY ANALYSIS - INTEREST RATE RISK (IRRBB)

Impact on net interest income for the six months ended 30 June 2015

	2015
Bahraini Dinar	
Assets	133,364
Liabilities	56,962
	<hr/>
(+) 200 basis points	1,528
(-) 200 basis points	(1,528)
US Dollar	
Assets	18,339
Liabilities	36,747
	<hr/>
(+) 200 basis points	(368)
(-) 200 basis points	368
Kuwaiti Dinar	
Assets	5,937
Liabilities	5,800
	<hr/>
(+) 200 basis points	3
(-) 200 basis points	(3)
Saudi Riyals	
Assets	9,972
Liabilities	10,118
	<hr/>
(+) 200 basis points	(3)
(-) 200 basis points	3

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 16 - MARKET RISK, INTEREST RATE GAP

Market risk

Market risk is defined as potential adverse changes in the fair value or future cash flows of a trading position or portfolio of financial instruments resulting from the movement of market variables, such as interest rates, currency rates, equity prices and commodity prices, market indices as well as volatilities and correlations between markets. As its primary tool, the Bank measures its market risk exposure using the Standardised Approach under Basel II.

Interest rate risk

Interest rate risk arises from the possibility that changes in the interest rates will affect future profitability or the fair values of the financial instruments. The Bank is exposed to interest rate risks due to mismatches of interest rate repricing on maturity of assets and liabilities. Positions are monitored periodically to ensure that this is maintained within the established limits. The Bank's assets and liabilities reprice only on maturity.

The Bank's interest rate sensitivity position is based on the maturity dates, as follows

	<i>Up to 1 month</i>	<i>1 to 3 months</i>	<i>3 to 6 months</i>	<i>6 months to 1 year</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Non- interest bearing</i>	<i>Total</i>
2015								
Assets								
Cash and balances with Central Bank of Bahrain	-	-	-	-	-	-	2,603	2,603
Due from banks and other financial institutions	14,311	-	2,968	14,940	-	-	-	32,219
Accounts receivable and other assets	5,867	-	305	3,000	-	-	6,436	15,608
Loans and advances to customers	2,783	1,027	1,281	2,094	88,265	29,109	-	124,559
Total assets	22,961	1,027	4,554	20,034	88,265	29,109	9,039	174,989
Liabilities								
Deposits	55,249	4,208	164	3,511	10	-	-	63,142
Accounts payable and other liabilities	-	-	-	-	-	-	4,320	4,320
Long term loans	-	-	636	1,641	20,094	23,609	-	45,980
Total liabilities	55,249	4,208	800	5,152	20,104	23,609	4,320	113,442
Net liquidity gap	(32,288)	(3,181)	3,754	14,882	68,161	5,500	4,719	

BAHRAIN DEVELOPMENT BANK B.S.C. (c)
 Basel II Pillar III Disclosures
 For the six months ended 30 June 2015
 (Expressed in Thousands Bahrain Dinars)

TABLE 17 - EQUITY POSITION IN THE BANKING BOOK

	2015	
	<i>Net exposure</i>	<i>Capital requirement</i>
Publicly traded	1,450	174
Privately held	3,869	464
TOTAL	5,319	638

TABLE 18 - GAINS ON EQUITY INVESTMENTS

	2015
Realised gains recognised in the statement of profit or loss	184
Unrealised gain recognised in the statement of financial position:	
- CET 1	546
- Tier Two	-

TABLE 19 - OPERATIONAL AND LEGAL RISKS

Operational risk is the risk of loss arising from errors that can be made in instructing payments or settling transactions, breakdown in technology and internal control systems. The Bank uses the Basic Indicator Approach under the Basel II framework for measuring and managing its operating risk. Currently, the Bank conducts its business from a single location. BDB is a retail bank with some restrictions and accordingly, the number of client relationships and volume of transactions at BDB are moderate on average.

BDB's operations are conducted according to well-defined procedures. These procedures include a comprehensive system of internal controls, including segregation of duties and other internal checks, which are designed to prevent either inadvertent staff errors or malfeasance prior to the release of a transaction. The Bank also engages in subsequent monitoring of accounting records, daily reconciliation of cash and securities accounts and other checks to enable it detect any erroneous or improper transactions which may have occurred.

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect the operations of the group. The Group has developed controls and procedures to identify legal risks and believes that losses will not be material.