

BOUBYAN BANK K.S.C.P. AND SUBSIDIARIES



**RISK MANAGEMENT
FOR THE YEAR ENDED 31 DECEMBER 2019**

1. INTRODUCTION AND OVERVIEW

In June 2014, Central Bank of Kuwait (CBK) issued directives on the adoption of the Capital Adequacy Standards (Basel III) under the Basel Committee framework applicable to licensed Islamic banks in Kuwait, effectively replacing and superseding the earlier requirements under the circular issued in 2009 Basel framework (Basel II). The reforms strengthen the quality of capital and introduced several buffer requirements in line with proposals made by the Basel Committee on Banking Supervision (BCBS). The CBK Basel framework consists of three Pillars. Pillar 1 provides a framework for measuring capital requirements for credit, operational and market risks under the “Standardised Approach”. Pillar 2 pertains to the Supervisory Review Process and emphasises the importance of Internal Capital Adequacy Assessment Process (ICAAP) performed by banks. As such, and in compliance with the aforementioned instructions, Boubyan Bank K.S.C.P (the “Bank”) has developed an ICAAP and Stress Testing framework along with its underlying models, policies and procedures. Boubyan Bank continually enhances its ICAAP and Stress Testing framework to maintain its capital commensurate with the overall risks to which the Bank is exposed. Pillar 3 aims to complement the above capital adequacy requirements under Pillar 1 and Pillar 2 by requiring banks to provide a consistent and understandable disclosure framework which facilitates comparison, thus enhancing the safety and soundness of the banking sector in Kuwait.

2. REGULATORY SCOPE OF CONSOLIDATION

The core activities of the Bank and its subsidiaries (collectively the “Group”) are retail, corporate, insurance, investment banking, and asset management, in accordance with Codes of the Islamic Sharia’a, as approved by the Bank’s Sharia’a Supervisory Board. For further details on the Group’s activities, please refer to note 29 of the Group’s consolidated financial statements.

The consolidated financial statements and capital adequacy regulatory reports of the Group have been prepared and consolidated on a consistent basis, unless otherwise disclosed. For additional information on the basis of preparation and basis of consolidation please refer to notes 2 and 3.1 of the Group’s consolidated financial statements for the year ended 31 December 2019.

The principal subsidiaries of the Group are presented in the note 15 of the Group’s consolidated financial statements.

All subsidiaries have been fully consolidated under the regulatory scope of consolidation for regulatory capital calculations.

Significant investments in banking, financial and insurance entities that are outside the scope of regulatory consolidation are required to be subject to the threshold treatment prescribed under the CBK Basel III rules and are risk-weighted and/or capital deducted.

- All the significant investments in banking and financial entities classified as associates under Note 16 of the Group’s consolidated financial statements have been subject to the threshold treatment and risk-weighted as prescribed.
- Other significant investments in banking and financial entities classified as equities have been subject to the threshold treatment and risk-weighted as prescribed.

Other ‘minority’ investments in banking, financial and insurance entities classified as equities have been subject to the prescribed threshold treatment and risk-weighted as required.

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3. CAPITAL STRUCTURE

The Group's regulatory capital comprises:

- a) Common Equity Tier 1 (CET1) Capital which is considered as the core measure of the Group's financial strength and includes share capital, share premium, eligible reserves and retained earnings net of regulatory adjustments,
- b) Additional Tier 1 (AT1) Capital which consists of perpetual tier 1 Sukuk and eligible portion of non-controlling interests, and,
- c) Tier 2 (T2) capital which consists of the allowed portions of general provisions and eligible portion of non-controlling interests.

The Bank's share capital as at 31 December 2019 comprised **2,884,079,860** issued and fully-paid up equity shares.

The regulatory capital for the Group is detailed below:

Table 1	2019	2018
	KD '000s	KD '000s
Regulatory Capital		
Common Equity Tier 1 Capital	546,790	385,348
Additional Tier 1 Capital	75,616	75,658
Tier 1 Capital	622,406	461,006
Tier 2 Capital	37,288	30,871
Total Regulatory Capital	659,694	491,877

4. CAPITAL ADEQUACY RATIOS

The Group ensures adherence to CBK's requirements by monitoring its capital adequacy. The Group's capital forecasting process ensures pro-active actions and plans are in place to ensure that a sufficient capital buffer above minimum levels is in place at all times. This process takes into consideration regulatory capital requirements, stress-testing and the Bank's business plans.

The Minimum Capital Requirements (MCR) and The Capital Adequacy Ratios' (CAR) for the Group under the various levels of regulatory capital expressed as a percentage of risk-weighted assets are detailed below:

Table 2	2019		2018	
	MCR*	CAR	MCR*	CAR
Common Equity Tier 1 capital adequacy ratio	10.00%	16.84%	10.00%	14.25%
Tier 1 capital adequacy ratio	11.50%	19.17%	11.50%	17.05%
Total Regulatory capital adequacy ratio	13.50%	20.32%	13.50%	18.19%

* includes a 2.5% capital conservation buffer and 0.5% D-SIB buffer which are to be met through CET1 capital.

The countercyclical capital buffer has not been required for the year ended 31 December 2019 in the MCR.

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5. PROFILE OF RISK-WEIGHTED ASSETS AND CAPITAL CHARGE

The Group's risk-weighted capital requirements for credit, market and operational risks are shown below.

5.1 Credit risk

The Minimum Capital requirement (MCR) in respect of credit risk as at 31 December 2019 was **KD 384,834 thousand**, (31 December 2018: KD 317,692 thousand) as detailed below:

	2019			2018		
	Gross credit exposure	Risk weighted assets	Minimum capital requirement	Gross credit exposure	Risk weighted assets	Capital charge
Table 3	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	38,939	-	-	33,539	-	-
Claims on sovereigns	646,858	65,081	8,461	392,322	399	52
Claims on international organisations	17,567	-	-	100,877	-	-
Claims on public sector Entities	119,122	9,395	1,221	115,826	1,443	188
Claims on MDBs	25,682	1,618	210	13,209	-	-
Claims on banks	479,236	77,409	10,063	262,058	45,525	5,918
Claims on corporates	2,052,115	1,214,930	157,941	1,245,104	670,593	87,177
Regulatory retail exposure	1,612,895	1,078,337	140,184	1,449,129	894,591	116,297
Past due exposure	20,739	13,855	1,801	9,940	3,039	395
Investments in real estate	46,555	93,109	12,104	24,036	48,072	6,249
Investments and financing to customers	124,281	120,211	15,627	656,438	562,267	73,095
Sukuk exposures	73,677	29,452	3,829	69,396	25,062	3,258
Other exposures*	271,966	256,871	33,393	193,128	192,791	25,063
	5,529,632	2,960,268	384,834	4,565,002	2,443,782	317,692

*"Other exposures" above includes a threshold deduction of **KD 34,014 thousand** (31 December 2018: KD 38,654 thousand) and an amount of **KD 19,613 thousand** (31 December 2018: KD 22,145 thousand) representing the amount of general provision in excess of a maximum of 1.25% of Credit Risk-Weighted Assets, which is allowed in arriving at Tier 2 Capital.

5.2 Market risk:

The total Minimum Capital requirement (MCR) in respect of market risk was **KD 3,751 thousand** arising only from foreign exchange risk, (31 December 2018: KD 3,913 thousand).

5.3 Operational Risk:

The Minimum Capital requirement (MCR) in respect of operational risk was **KD 33,398 thousand**, (31 December 2018: KD 29,948 thousand). This Minimum Capital requirement (MCR) was computed using the Basic Indicator Approach by multiplying the three-year average gross income by a pre-defined beta factor.

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6. RISK MANAGEMENT

The Bank's business operations require identification, measurement, aggregation and effective management of risks and efficient allocation of capital to derive an optimal risk/return ratio. The Bank manages its risks in a structured, systematic and transparent manner through a risk policy which embeds comprehensive risk management into the organisational structure, risk measurement and monitoring processes. The Bank's Risk Management function is independent of business units; it reports directly to the Risk and Compliance Committee of the Board and takes a holistic and objective approach to assist the Board and Executive Management in managing the Bank's risks.

During 2009 the Bank augmented its overall framework for governance and capital planning and management by undertaking an Internal Capital Adequacy Assessment Process (ICAAP), which includes "scenario testing" at periodic, regular intervals. Amongst the key objectives of the ICAAP is to quantify potential risks that the Bank faces and are not covered under Pillar I.

The Bank has updated its ICAAP assessment to reflect the growth and complexity of its Business Model and changes to its risk infrastructure.

In line with the guidelines from the Basel Committee and Central Bank of Kuwait, key principles of the Bank's ICAAP include:

- Responsibilities of the Board and Senior Management.
- Sound Capital Management.
- Comprehensive assessment of Pillar II risks, e.g., Credit (sector and name concentration), Profit Rate Risk, Liquidity, Legal, Reputational and Strategic Risks, Residual Market Risk, Residual Operational Risk and Sharia Risk
- Monitoring and reporting.
- Control and review of the process.

The key features of the Bank's comprehensive Risk Management Policy are:

- The Board of Directors provides overall risk management direction and oversight.
- The Bank's risk appetite is proposed by the Management Executive Committee and approved by the Board of Directors.
- Risk management is embedded in the Bank as an intrinsic process and is a core competency of all its employees.
- The Bank manages its credit, market, operational and liquidity risks in a co-ordinated manner within the organisation.
- The Bank's Internal Audit function reports to the Board Audit Committee and provides independent validation of the business units' compliance with risk policies and procedures and the adequacy and effectiveness of the Risk Management Framework on a bank-wide basis.

The risk management function assists Executive Management in controlling and actively managing the Bank's overall risks. The function also ensures that:

- The Bank's overall business strategy is consistent with its risk appetite approved by the Board of Directors.
- Risk policies, procedures and methodologies are consistent with the Bank's risk appetite.
- Appropriate risk management architecture and systems are developed and implemented.
- Risks and limits of the portfolio are monitored throughout the Bank.

The Bank regularly assesses the adequacy and effectiveness of its Risk Management Framework in the light of the changing risk environment.

6.1 Scope and nature of risk reporting tools

The comprehensive Risk Management Framework enables the Bank to identify, assess, limit and monitor risks using a comprehensive range of quantitative and qualitative tools. Some of these tools are common to a number of risk categories, while others are tailored to the particular features of specific risk categories and enable generation of information such as:

- Credit risk in corporate and consumer financing and other asset exposures, such as collateral coverage ratio, limit utilisation, past-due alerts, etc.
- Quantification of the susceptibility of the market value of single positions or portfolios to changes in market parameters (commonly referred to as sensitivity analysis).
- Quantification of exposure to losses due to extreme movements in market prices or rates.

The Bank regularly assesses the adequacy and effectiveness of its reporting tools and metrics in light of the changing risk environment.

6. RISK MANAGEMENT (CONTINUED)

6.2 Risk management processes

Through the comprehensive Risk Management Framework, transactions and outstanding risk exposures are quantified and compared against authorised limits, whereas non-quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviations are escalated to management for appropriate action.

The key risks assumed by the Bank in its daily operations are outlined below:

6.2.1 Credit risk

Credit risk is defined as the likelihood that a customer or counterparty is unable to meet the contracted financial obligations resulting in a default situation and/or financial loss. These risks arise in the Group's normal course of business.

6.2.2 Credit risk management strategy

The approach to credit risk is based on the foundation to preserve the independence and integrity of the credit risk assessment, management and reporting processes, combined with clear policies, limits and approval structures which guide the day-to-day initiation and management of the Bank's credit risk exposure. This approach comprises credit limits which are established for all customers after a careful assessment of their credit worthiness.

Standing procedures, outlined in the Bank's Credit Policies and Manuals, require that all credit proposals be subjected to detailed screening pending submission to the appropriate credit committee. Whenever necessary, credit facilities are secured by acceptable forms of collateral to mitigate the related credit risks. The Board of Directors defines the Bank's credit risk management strategy and approves credit risk policies to ensure alignment of the Bank's exposure with its Risk Appetite.

6.2.3 Credit risk management structure and governance

Senior management implements the Board of Directors' credit risk strategy and develops policies and procedures for identifying, assessing, monitoring and controlling credit risk.

The Bank's Credit Committee, chaired by the Bank's CEO and comprising senior executives from the business divisions, meets regularly and reviews the Bank's financing portfolios and advises the Board appropriately.

In compliance with CBK regulations, financing to individual Board Members and related parties is fully secured and monitored by the Board Executive Committee. Such transactions are made on substantially the same terms, including profit rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties. All such facilities are approved by the Board of Directors in line with the relative authorities from the Shareholders' General Assembly.

Country limits are determined based on the outlook of economic and political factors, along with the review of reports by rating agencies on the country (where available) and application of local business and market knowledge. Country limit exposures are subject to periodic approval by the Board of Directors or the Board Executive Committee.

6.2.4 Key features of corporate credit risk management

- Credit facilities are granted based on detailed credit risk assessments which consider the purpose of the facility and source of repayment, prevailing and potential macro-economic factors, industry trends and the customer's positioning within its industry peer.
- Internal credit-rating models are regularly reviewed by the Bank risk management function in co-ordination with line management and the Management Credit Committee and continually enhanced in line with industry credit risk management "best practices".
- All new proposals and / or material changes to existing credit facilities are reviewed and approved by either the Board Executive Committee or the Management Credit Committee.
- The credit facility administration process is undertaken by a segregated function to ensure proper execution of all credit approvals and maintenance of documentation, and proactive control over maturities, expiry of limits, collateral valuation and contractual covenants.

6. RISK MANAGEMENT (CONTINUED)**6.2 Risk management processes (continued)****6.2.5 Key features of consumer credit risk management**

- Oversight of consumer finance risk is undertaken by an independent unit directly within Bank Risk Management. Within this framework, limits and approval authorities are exercised by Consumer Banking officers with defined approval authorities.
- Consumer credit risk management functional areas are aligned with key concepts of risk management, namely, governance, control, measurement and reporting.
- Consumer credit risk is managed with three lines of defence. As the first line of defence, Consumer Banking (i.e., underwriting) is responsible for adherence to CBK regulations and guidelines, the credit policies, controls and processes. As second line of defence, the consumer credit risk management team, working independently of the business unit, assesses and ensures implementation of credit risk management discipline & policies. The third line of defence, the Internal Audit function, independently tests, verifies and evaluates controls for effective credit risk management and implementation of policies & procedures.
- All significant financing policies and amendments to policies are reviewed annually by the Management Executive Committee and approved by the Board.
- The Consumer Financing risk assessment for applicants uses risk “scorecard” customer-centric methodologies which incorporate CBK regulatory guidelines and Bank policies related to consumer financing facilities, such as debt-to-income ratio, minimum qualifying income and limits on advances by product type. Additional inputs utilised include applicant characteristics obtained from financing bureaus, particularly Kuwait Credit Bureau statistics, to assist in assessing an applicant’s ability to repay and the probability of default. This model is reviewed and refined continually.

6.2.6 Bank’s credit risk monitoring

The Bank’s exposures are continuously monitored through a system of triggers and early-warning signals aimed at detecting adverse symptoms which could result in deterioration of credit risk quality. The triggers and early-warning systems are supplemented by facility utilisation and collateral valuation monitoring together with a review of upcoming credit facility expiration and market intelligence to enable timely corrective action by management. The results of the monitoring process are reflected in the internal rating process.

Credit risk is monitored on an ongoing basis with formal monthly and quarterly reporting to ensure senior management awareness of shifts in credit quality and portfolio performance along with changing external factors such as economic and business cycles.

Consumer credit risk reporting also includes a “dashboard” for consumer financing, classification and delinquency monitoring.

A specialised and focused team on recovery and collections handles the management and collection of irregular financing facilities.

6.2.7 Bank’s credit risk mitigation strategy

Portfolio diversification is the cornerstone of the Bank’s credit risk mitigation strategy which is implemented through customer, industry and geographical limit structures.

To ensure diversification at the portfolio level, interrelated companies with the same management or ownership structure are classified and treated as one entity. The Risk Appetite requires that the Bank limits its financing concentration per entity to specific percentage of the Bank’s regulatory capital.

Credit risk mitigates such as collateral and guarantees are effective mitigating factors within the Bank’s portfolio and collateral quality is continuously monitored and assessed. Risk transfer in the form of syndications and risk participation arrangements with other banks are used to manage the Bank’s exposures.

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6. RISK MANAGEMENT (CONTINUED)**6.2 Risk management processes (Continued)****6.2.8 Management of credit collateral and valuation**

The main types of collateral accepted by the Bank include:

1. Cash collateral
2. Equity shares
3. Bank guarantees
4. Real estates
5. Sovereign debt instruments
6. Bank debt instruments
7. Collective investment schemes

In accordance with the Bank's credit policies, banks and creditworthy companies and individuals with high net worth are accepted as guarantor counterparties, subject to credit risk assessment. Furthermore, in accordance with the CBK Basel framework, cash collateral, quoted shares, real estates, debt instruments of sovereigns and banks and collective investment schemes are recognised as risk mitigation for capital adequacy purposes.

The custody and daily "mark to market" (revaluation) of financial collateral, inclusive of shares, are performed independent of the business units. Real estate collateral is valued on an annual basis.

The Group's credit exposures were covered by the following eligible financial collateral:

	2019		2018	
	Gross credit exposure KD '000s	Eligible Credit Risk Mitigation KD '000s	Gross credit exposure KD '000s	Eligible Credit Risk Mitigation KD '000s
Table 4				
Cash	38,939	-	33,539	-
Claims on sovereigns	646,858	-	392,322	-
Claims on international organisations	17,567	-	100,877	-
Claims on public sector Entities	119,122	-	115,826	-
Claims on MDBs	25,682	-	13,209	-
Claims on banks	479,236	-	262,058	-
Claims on corporates	2,052,115	289,895	1,245,104	231,429
Regulatory retail exposure	1,612,895	-	1,449,129	-
Past due exposure	20,739	-	9,940	1,608
Investments in real estate	46,555	-	24,036	-
Investments and financing to customers	124,281	4,413	656,438	49,235
Sukuk exposures	73,677	-	69,396	-
Other exposures	271,966	-	193,128	-
	5,529,632	294,308	4,565,002	282,272

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6. RISK MANAGEMENT (CONTINUED)

6.2 Risk management processes (continued)

6.2.9 Gross, average and net credit exposures

The Group's gross credit exposures, average credit exposures and net credit exposures, the former adjusted for credit risk mitigation factors, respectively, are detailed below:

	2019			2018		
	Gross credit exposure KD '000s	Self-funded exposure KD '000s	Funded through investments accounts exposure KD '000s	Gross credit exposure KD '000s	Self-funded exposure KD '000s	Funded through investments accounts exposure KD '000s
Table 5						
Cash	38,939	13,128	25,811	33,539	7,870	25,669
Claims on sovereigns	646,858	218,085	428,773	392,322	92,062	300,260
Claims on international organisations	17,567	5,923	11,644	100,877	23,672	77,205
Claims on public sector Entities	119,122	40,161	78,961	115,826	27,180	88,646
Claims on MDBs	25,682	8,658	17,024	13,209	3,100	10,109
Claims on banks	479,236	178,812	300,424	262,058	76,412	185,646
Claims on corporates	2,052,115	792,073	1,260,042	1,245,104	409,883	835,221
Regulatory retail exposure	1,612,895	543,780	1,069,115	1,449,129	340,052	1,109,077
Past due exposure	20,739	6,992	13,747	9,940	2,332	7,608
Investments in real estate	46,555	46,555	-	24,036	24,036	-
Investments and financing to customers	124,281	41,901	82,380	656,438	154,040	502,398
Sukuk exposures	73,677	24,840	48,837	69,396	16,284	53,112
Other exposures	271,966	178,960	93,006	193,128	120,781	72,347
	5,529,632	2,099,868	3,429,764	4,565,002	1,297,704	3,267,298

	2019			2018		
	Average credit exposure * KD '000s	Self-funded exposure KD '000s	Funded through investments accounts exposure KD '000s	Average credit exposure KD '000s	Self-funded exposure KD '000s	Funded through investments accounts exposure KD '000s
Table 6						
Cash	37,039	11,535	25,504	32,344	6,884	25,460
Claims on sovereigns	551,226	172,002	379,224	388,385	126,198	262,187
Claims on international organisations	71,748	21,617	50,131	88,218	68,917	19,301
Claims on public sector Entities	120,334	37,081	83,253	111,254	28,872	82,382
Claims on MDBs	25,551	7,080	15,471	13,118	10,591	2,527
Claims on banks	323,537	114,321	209,216	291,219	74,165	217,054
Claims on corporates	1,772,543	658,919	1,113,624	1,205,522	367,540	837,982
Regulatory retail exposure	1,535,044	475,130	1,059,914	1,385,760	294,477	1,091,283
Past due exposure	17,908	5,531	12,377	11,674	2,484	9,190
Investments in real estate	30,103	30,103	-	27,776	27,776	-
Investments and financing to customers	346,419	102,164	244,255	635,745	134,905	500,840
Sukuk exposures	76,131	23,406	52,725	65,376	52,098	13,278
Other exposures	236,724	153,501	83,223	184,304	118,808	65,496
	5,141,307	1,812,390	3,328,917	4,440,695	1,313,715	3,126,980

* Based on quarterly average balances

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6. RISK MANAGEMENT (CONTINUED)

6.2 Risk management processes (continued)

6.2.9 Gross, average and net credit exposures (continued)

	2019			2018		
	Net credit exposure	Self-funded exposure	Funded through investments accounts exposure	Net credit exposure	Self-funded exposure	Funded through investments accounts exposure
Table 7	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	38,939	13,128	25,811	33,539	7,870	25,669
Claims on sovereigns	646,858	218,085	428,773	392,322	92,062	300,260
Claims on international organisations	17,567	5,923	11,644	100,877	23,672	77,205
Claims on public sector Entities	119,122	40,161	78,961	115,826	27,180	88,646
Claims on MDBs	25,682	8,658	17,024	13,209	3,100	10,109
Claims on banks	479,236	178,812	300,424	262,058	76,412	185,646
Claims on corporates	1,762,220	688,139	1,074,081	1,013,675	346,485	667,190
Regulatory retail exposure	1,612,895	543,780	1,069,115	1,449,129	340,052	1,109,077
Past due exposure	20,739	6,992	13,747	8,332	1,955	6,377
Investments in real estate	46,555	46,555	-	24,036	24,036	-
Investments and financing to customers	119,868	40,413	79,455	607,203	142,486	464,717
Sukuk exposures	73,677	24,840	48,837	69,396	16,284	53,112
Other exposures	271,966	178,960	93,006	193,128	120,781	72,347
	5,235,324	1,994,446	3,240,878	4,282,730	1,222,375	3,060,355

As at 31 December 2019, **23.7%** of the Group's net credit risk exposure was rated by accredited External Credit Assessment Institutions (ECAIs), (31 December 2018: **19.2%**) as detailed below:

	2019			2018		
	Net credit exposure	Rated exposure	Unrated exposure	Net credit exposure	Rated exposure	Unrated exposure
Table 8	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	38,939	-	38,939	33,539	-	33,539
Claims on sovereigns	646,858	646,858	-	392,322	392,322	-
Claims on international organisations	17,567	17,567	-	100,877	100,877	-
Claims on public sector Entities	119,122	12,537	106,585	115,826	9,672	106,154
Claims on MDBs	25,682	25,682	-	13,209	-	13,209
Claims on banks	479,236	433,436	45,800	262,058	249,952	12,106
Claims on corporates	1,762,220	30,663	1,731,557	1,013,675	-	1,013,675
Regulatory retail exposure	1,612,895	-	1,612,895	1,449,129	-	1,449,129
Past due exposure	20,739	-	20,739	8,332	-	8,332
Investments in real estate	46,555	-	46,555	24,036	-	24,036
Investments and financing to customers	119,868	-	119,868	607,203	-	607,203
Sukuk exposures	73,677	73,677	-	69,396	69,396	-
Other exposures	271,966	-	271,966	193,128	-	193,128
	5,235,324	1,240,420	3,994,904	4,282,730	822,219	3,460,511

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6. RISK MANAGEMENT (CONTINUED)

6.2 Risk management processes (continued)

6.2.9 Gross, average and net credit exposures (continued)

The Group uses external ratings (where available) from Fitch, S&P and Moody's to supplement internal ratings during the process of determining credit limits. Unrated public issue instruments are risk-weighted at 100% for capital adequacy purposes.

The geographical distribution of the gross credit exposure before taking into consideration credit enhancements is as detailed below:

31 December 2019	Middle East	North America	Europe	Asia and Other	Total
Table 9	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	38,939	-	-	-	38,939
Claims on sovereigns	639,606	-	-	7,252	646,858
Claims on international organisations	-	-	-	17,567	17,567
Claims on public sector Entities	118,568	-	-	554	119,122
Claims on MDBs	25,682	-	-	-	25,682
Claims on banks	386,434	22,123	68,076	2,603	479,236
Claims on corporates	2,044,462	-	-	7,653	2,052,115
Regulatory retail exposure	1,612,895	-	-	-	1,612,895
Past due exposure	20,739	-	-	-	20,739
Investments in real estate	16,167	26,208	4,180	-	46,555
Investments and financing to customers	124,281	-	-	-	124,281
Sukuk exposures	73,121	-	-	556	73,677
Other exposures	209,361	-	57,306	5,299	271,966
	5,310,255	48,331	129,562	41,484	5,529,632
31 December 2018	Middle East	North America	Europe	Asia and Other	Total
Table 9	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	33,539	-	-	-	33,539
Claims on sovereigns	384,193	-	4,309	3,820	392,322
Claims on international organisations	-	-	-	100,877	100,877
Claims on public sector Entities	115,322	-	-	504	115,826
Claims on MDBs	13,209	-	-	-	13,209
Claims on banks	234,705	4,007	19,283	4,063	262,058
Claims on corporates	1,245,104	-	-	-	1,245,104
Regulatory retail exposure	1,449,129	-	-	-	1,449,129
Past due exposure	9,727	-	-	213	9,940
Investments in real estate	18,554	-	5,482	-	24,036
Investments and financing to customers	656,438	-	-	-	656,438
Sukuk exposures	66,887	-	303	2,206	69,396
Other exposures	158,561	-	19,459	15,108	193,128
	4,385,368	4,007	48,836	126,791	4,565,002

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6. RISK MANAGEMENT (CONTINUED)

6.2 Risk management processes (continued)

6.2.9 Gross, average and net credit exposures (continued)

The Group's gross credit exposure by residual contractual maturity is as detailed below:

31 December 2019	Up to 3 months	3 – 6 months	6 – 12 months	Over 1 year	Total
Table 10	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	38,939	-	-	-	38,939
Claims on sovereigns	544,945	63,293	16,138	22,482	646,858
Claims on international organisations	16,689	-	-	878	17,567
Claims on public sector Entities	22,738	94,580	-	1,804	119,122
Claims on MDBs	21,830	-	-	3,852	25,682
Claims on banks	349,105	51,028	69,001	10,102	479,236
Claims on corporates	905,516	755,199	243,174	148,226	2,052,115
Regulatory retail exposure	20,884	3,192	15,419	1,573,400	1,612,895
Past due exposure	20,739	-	-	-	20,739
Investments in real estate	-	-	-	46,555	46,555
Investments and financing to customers	96,847	5,404	22,030	-	124,281
Sukuk exposures	49,722	-	-	23,955	73,677
Other exposures	44,543	-	6,291	221,132	271,966
	2,132,497	972,696	372,053	2,052,386	5,529,632

31 December 2018	Up to 3 months	3 – 6 months	6 – 12 months	Over 1 year	Total
Table 10	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Cash	33,539	-	-	-	33,539
Claims on sovereigns	151,727	98,075	44,049	98,471	392,322
Claims on international organisations	100,877	-	-	-	100,877
Claims on public sector Entities	90,128	16,026	-	9,672	115,826
Claims on MDBs	-	-	-	13,209	13,209
Claims on banks	256,869	4,305	47	837	262,058
Claims on corporates	608,308	229,090	217,782	189,924	1,245,104
Regulatory retail exposure	12,405	2,693	13,547	1,420,484	1,449,129
Past due exposure	9,940	-	-	-	9,940
Investments in real estate	-	-	-	24,036	24,036
Investments and financing to customers	560,969	70,996	24,473	-	656,438
Sukuk exposures	-	-	-	69,396	69,396
Other exposures	14,606	-	9,476	169,046	193,128
	1,839,368	421,185	309,374	1,995,075	4,565,002

RISK MANAGEMENT

For the year ended 31 December 2019

6. RISK MANAGEMENT (CONTINUED)

6.2 Risk management processes (continued)

6.2.10 "Past-due" and impairment provisions

Credit facilities are classified as "past-due" when a payment has not been received on its contractual payment date, or if the facility is in excess of pre-approved limits.

A credit facility is considered as "past-due and impaired" if the profit or a principal instalment is past due for more than 90 days and if the carrying amount of the facility is greater than its estimated recoverable value.

"Past due" and "Past-due and impaired" facilities are managed and monitored as "irregular facilities" and are classified into the following four categories which are then used to guide the provisioning process:

Category	Criteria
Watchlist	Irregular for a period up to 90 days (inclusive)
Substandard	Irregular for a period between 91 and 180 days (inclusive)
Doubtful	Irregular for a period between 181 days and 365 days (inclusive)
Bad	Irregular for a period exceeding 365 days

The Group may also include a credit facility in one of the above categories based on management's judgement of a customer's financial and/or non-financial circumstances.

The Group's impaired finance portfolio as at 31 December 2019 was **KD 33,171 thousand** against which a specific provision of **KD 12,476 thousand** has been made, (31 December 2018: KD 28,308 thousand and KD 18,325 thousand), as detailed below:

	2019			2018		
	Impaired finance facilities	Related specific provision	Net balance	Impaired finance facilities	Related specific provision	Net balance
	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Table 11						
Claims on corporates	23,965	9,039	14,926	13,180	8,120	5,060
Regulatory retail exposure	9,206	3,437	5,769	15,128	10,205	4,923
	33,171	12,476	20,695	28,308	18,325	9,983

The geographical distribution of "past-due and impaired" financing and the related specific provision are as follows:

	2019			2018		
	Middle East	Asia	Total	Middle East	Asia	Total
	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s	KD '000s
Table 12						
Past due and impaired financing	33,171	-	33,171	27,793	515	28,308
Related specific provision	4,371	-	4,371	17,810	515	18,325

In accordance with CBK regulations, a minimum general provision of 1% for cash facilities and 0.5% for non-cash facilities is made on all applicable credit facilities (net of certain restricted categories of collateral) which are not subject to specific provisioning.

The adequacy of provisions are regularly evaluated and monitored by the Provisions Committee.

The Bank's total provision as at 31 December 2019 was **KD 69,336 thousand** inclusive of a general provision of **KD 56,735 thousand**, (31 December 2018: KD 71,217 thousand and KD 52,892 thousand), as detailed below:

	2019	2018
	KD '000s	KD '000s
Table 13		
Claim on corporates	40,893	39,029
Regulatory retail exposure	15,842	13,863
	56,735	52,892

The total general provision above includes **KD 2,261 thousand** relating to "non-cash" facilities in accordance with CBK regulations, (31 December 2018: KD 2,186 thousand).

6. RISK MANAGEMENT (CONTINUED)**6.2 Risk management processes (continued)****6.2.10 “Past-due” and impairment provisions (continued)**

The geographical distribution of the general provision on “cash” facilities is as follows:

Table 14	2019	2018
	KD ‘000s	KD ‘000s
Middle East and North Africa	54,474	50,706
	54,474	50,706

The analysis of specific and general provisions is further detailed in note 8 and 13 of the Group’s consolidated financial statements.

6.3 “Market” risk

“Market” risk is defined as the potential loss in value of financial instruments caused by adverse movements in market variables such as profit rates, foreign exchange rates and equity prices.

Market risk results from uncertainty in future earnings arising from changes in profit rates, exchange rates, market prices and volatilities. Speculative Market Risk is not undertaken by the Bank but market risk arises from financing and investment activities.

The strategy for controlling market risk includes:

- Stringent controls and limits.
- Strict segregation of “front”, “middle” and “back” office duties.
- Regular independent reporting of positions.
- Regular independent review of all controls and limits.

6.3.1 Market-Risk management framework

The Market-Risk Management framework governs the Bank’s activities related to market risk. Market risk arising from banking book activities is the primary responsibility of the Bank’s Asset and Liability Management Committee (ALCO) and managed within a structure of approved financing and position limits.

6.4 Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems failure, or from external events. When controls fail to perform, it can lead to legal or regulatory implications, or financial or reputational loss

6.4.1 Operation- risk management framework

The Bank monitors its operational risks through an Operational-Risk Management Framework which defines roles and responsibilities for managing and reporting operational risk. The key components of this framework are Risk Control Self Assessments, comprehensive documented policies, procedures and internal controls.

Through the framework, line management is able to identify, assess and decide in what form and scale it can accept, control and reduce operational risk, together with the form of risk-prevention measures which are necessary. Furthermore, it embeds a culture of transparency of information, escalation of key issues, and accountability for issue resolution. The Bank’s Risk Management collates and reviews actual loss data arising from the Bank’s day-to-day operations to continuously refine its control arrangements.

The operational-risk framework is supplemented by regular reviews from the Bank internal audit function. The Bank has a Business Continuity Plan together with a fully-equipped Disaster Recovery Centre which is tested periodically.

The Bank’s business processes are closely monitored to identify, assess, control and prevent potentially illicit use of the Bank’s services for laundering money and/or financing terrorism. The Bank’s “anti-money laundering” and “combating terrorism-financing” initiatives are regularly reviewed to ensure full compliance with legal and regulatory requirements and international best practices.

6.5 Liquidity risk

Liquidity risk is defined as the inability to generate sufficient financial resources to meet all obligations and commitments as they fall due, or having to access funds to meet payment obligations at an excessive cost. It is the policy of the Bank to maintain adequate liquidity at all times.

The Bank applies a prudent mix of liquidity controls which provide security of access to funds without undue exposure to increased costs of funds from the liquidation of assets, or aggressive bidding for deposits. Liquidity risk is monitored and evaluated daily to ensure that, over the short term and by major currency, the profile of projected future cash inflows is adequately matched to the maturity of liabilities.

RISK MANAGEMENT

For the year ended 31 December 2019

6. RISK MANAGEMENT (CONTINUED)**6.6 Reputation and fiduciary risk**

Reputation risk is defined as the current and prospective impact on earnings and capital arising from negative public opinion which will affect the ability to establish new relationships or services or to continue servicing existing relationships.

Management of reputation risk is an inherent feature of the Group's corporate culture which is embedded as an integral part of the internal control systems. Besides identification and management of risks, the internal control system also incorporates as an ethos the maintenance of business practices of the highest quality towards its customers, shareholders, regulators, general public and fiduciary and non-fiduciary clients.

Through its policies and practices Boubyan ensures proper screening of clients' risk profiles and performance expectations is conducted prior to making investment products or services available to them. Furthermore, once a product or service is sold, appropriate risk and performance projections are clearly communicated, and funds placed under management are treated with due care and professionalism.

During the year, Assets under Management at the Group increased by **46.7%** to reach **KD 348,614 thousand** on 31 December 2019, (31 December 2018: increased by 7.5% to reach KD 237,480 thousand).

7. COMPLIANCE WITH SHARI'A PRINCIPLES

Fatwa & Shari'a Supervisory Board of the Bank is responsible for monitoring the Bank's compliance with its issued fatwa and resolutions. The Shari'a Supervisory Board reviews and approves the contract and agreement forms after obtaining the necessary information to provide its opinion. Random samples of operations related to the Bank's transactions are reviewed through Shari'a supervision according to the annual Shari'a audit plan for all the departments and through the periodic reports provided by the Shari'a supervisory department about the audit processes, field visits, workflow and the validity of implementing the fatwa and resolutions issue by the Shari'a Supervisory Board. Accordingly, an annual report about the Bank's compliance with Shari'a fatwa and resolutions are issued according to those fatwa and resolutions and it is attached along with Bank's annual report and submitted to shareholders in the General Assembly. The external auditors have looked at the procedures adopted by the Shari'a Supervisory Board review all the Shari'a's committee minute of the meeting held during the year and regarding to this and based on CBK circular number (2/RBA/100/2003) issue the report describing the procedures that taken in place during the year to ensure that Bank compliance with Shari'a rules and principles in addition, they disclosed in the report that Bank had comply with all Shari'a Supervisory Board rules and instructions.

According to the law no 46/2003 related to Zakat should be paid by listed companies, the Bank will pay **KD 646 thousand** for the year ended 31 December 2019, (31 December 2018: KD 577 thousand), and it is subject to auditing procedures by external consultant and approval by Ministry of Finance.

The violations related to compliance of Sharia's principles for the year ended 31 December 2019 is **Nil**, (31 December 2018: Nil).

The Shari'a Supervisor Board's remuneration for the year ended 31 December 2019 is **KD 102 thousand**, (31 December 2018: KD 90 thousand).

8. INVESTMENT ACCOUNTS

Investment accounts receive a proportion of profit based on an agreed profit-sharing ratio and bear a share of loss.

Investment accounts take the form of unrestricted Mudaraba or Wakala contracts and include savings accounts and fixed term deposit accounts.

Saving Investment Accounts

These are open-term deposits and the client is entitled to withdraw the balances of these accounts or portions thereof at any time. The profit sharing of saving investment accounts is calculated and distributed monthly and the rate of profits on the accounts balances were ranging between 0.3% and 0.8% based on the product and currency.

Fixed-Term Deposit Investment Accounts

These are fixed-term deposits based on the deposit contract executed between the Bank and the depositor. These deposits have a predetermined maturity date and renewed automatically for a similar period, unless the depositor notifies the Bank in writing of his/her desire not to renew the deposit. The profit sharing of fixed-term deposit investment accounts is calculated monthly and distributed on the month ended after the maturity date and the rate of profits on the accounts balances were ranging between 1.5% and 3% based on the product and currency.

Investment accounts are invested in pools of assets and receive a proportion share of net income from these assets after allocating its proportional share of expenses. These assets are complying with the Codes of the Islamic Sharia'a, as approved by the Bank's Sharia'a Supervisory Board. The Bank does not maintain investment risk reserve or profit equalization reserve.

A weighting factor of 50% is applied on the credit risk-weighted exposures financed from investment accounts.

RISK MANAGEMENT

For the year ended 31 December 2019

9. COMPOSITION OF CAPITAL

9.1 Composition of Regulatory Capital

For regulatory purposes, the capital base is divided into:

- Common Equity Tier 1
- Tier 1 Capital
- Total Capital

Common Equity Tier 1 Capital comprises share capital, share premium, retained earnings, eligible reserves and related eligible non-controlling interests. The book values of Goodwill and Intangibles are deducted along with other regulatory adjustments.

Tier 1 Capital consists of Common Equity Tier 1 Capital and Additional Tier 1 Capital which includes eligible portions of non-controlling interests.

Total Regulatory Capital includes Tier 1 Capital and Tier 2 Capital which consists of the allowed portions of general provisions and certain additional eligible non-controlling interests.

The below table summarizes the composition of capital and ratios:

	2019	2018
	KD '000s	KD '000s
Table 15		
Common Equity Tier 1 Capital before regulatory adjustments	549,548	389,808
Less:		
Total regulatory adjustments to Common Equity Tier 1	2,758	3,264
Deductions from Capital Base arising from Investments in FIs where ownership is > 10%	-	1,196
Common Equity Tier 1 Capital (CET1)	546,790	385,348
Additional Tier 1 Capital (AT1)	75,616	75,658
Tier 1 Capital (T1 = CET1 + AT1)	622,406	461,006
Tier 2 Capital (T2)	37,288	30,871
Total Capital (TC = T1 + T2)	659,694	491,877
Total risk-weighted assets	3,246,032	2,704,257
Capital ratios and buffers		
Common Equity Tier 1 Capital (as percentage of risk-weighted assets)	16.84%	14.25%
Tier 1 Capital (as percentage of risk-weighted assets)	19.17%	17.05%
Total Regulatory Capital (as percentage of risk-weighted assets)	20.32%	18.19%
National minima		
Common Equity Tier 1 minimum ratio including Capital Conservation buffer and D-SIB buffer	10.00%	10.00%
Tier 1 minimum ratio	11.50%	11.50%
Total capital minimum ratio excluding CCY	13.50%	13.50%

A detailed breakdown of the Group's regulatory capital position under the Common Disclosures template as stipulated under the Pillar 3 section of the CBK Basel III Capital Adequacy framework is presented in Table 25.

RISK MANAGEMENT

For the year ended 31 December 2019

10. RECONCILIATION REQUIREMENTS

The basis for the scope of consolidation for accounting and regulatory purposes is consistent for the Group. In order to provide a full reconciliation of all regulatory capital elements to the balance sheet in the audited financial statements, a three-step approach has been mandated under the Pillar 3 disclosures section of the CBK Basel III framework.

Table 16 provides the comparison (Step1) of the balance sheet published in the consolidated financial statement and the balance sheet under the regulatory scope of consolidation. Lines have been expanded and referenced with letters (Step 2) to display the relevant items of the regulatory capital.

31 December 2019 Table 16 - Step 1 and 2 of Reconciliation requirements	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Reference
	KD '000s	KD '000s	
Assets			
Cash and balances with banks	232,393	232,393	
Deposits with Central Bank of Kuwait	306,156	306,156	
Deposits with other banks	427,347	427,347	
Islamic financing to customers	3,728,772	3,728,772	
of which general provisions(netted above) capped for Tier 2 inclusion	37,248	37,248	A
Investment in Sukuk	306,315	306,315	
Other investment securities	101,215	101,215	
Investment in associates	33,144	33,144	
of which goodwill	2,704	2,704	B
of which investments in the capital of banking entities above the threshold deduction that are outside the scope of regulatory consolidation	-	-	C
Investment properties	46,555	46,555	
Other assets	32,422	32,422	
Property and equipment	86,229	86,229	
Total assets	5,300,548	5,300,548	
Liabilities			
Due to banks	236,480	236,480	
Depositors' accounts	4,347,226	4,347,226	
Other liabilities	63,661	63,661	
Total liabilities	4,647,367	4,647,367	
Equity			
Share capital	288,407	288,407	D
Share premium	156,942	156,942	E
Proposed bonus shares	14,420	14,420	F
Treasury shares	(54)	(54)	G
Statutory reserve	31,848	31,848	H
Other reserves	22,114	22,114	I
Retained earnings	35,817	35,817	J
Proposed cash dividends	25,954	25,954	K
Equity attributable to equity holders of the Bank	575,448	575,448	
Non-controlling interests	2,345	2,345	
Perpetual Tier 1 Sukuk	75,388	75,388	
of which limited recognition eligible as CET1 Capital	-	-	
of which limited recognition eligible as AT1 Capital	75,616	75,616	L
of which limited recognition eligible as Tier 2 Capital	40	40	M
Total equity	653,181	653,181	
Total liabilities and equity	5,300,548	5,300,548	

RISK MANAGEMENT

For the year ended 31 December 2019

10. RECONCILIATION REQUIREMENTS (CONTINUED)

31 December 2018 Table 16 - Step 1 and 2 of Reconciliation requirements	Balance sheet as in published financial statements	Under regulatory scope of consolidation	Reference
	KD '000s	KD '000s	
Assets			
Cash and balances with banks	83,805	83,805	
Deposits with Central Bank of Kuwait	244,685	244,685	
Deposits with other banks	237,088	237,088	
Islamic financing to customers	3,262,285	3,262,285	
of which general provisions(netted above) capped for Tier 2 inclusion	30,824	30,824	A
Financial assets at fair value through profit or loss	309,339	309,339	
Available for sale investments	73,500	73,500	
Investment in associates	28,916	28,916	
of which goodwill	2,622	2,622	B
of which investments in the capital of banking entities above the threshold deduction that are outside the scope of regulatory consolidation	1,196	1,196	C
Investment properties	24,036	24,036	
Other assets	24,088	24,088	
Property and equipment	57,036	57,036	
Total assets	4,344,778	4,344,778	
Liabilities			
Due to banks	97,216	97,216	
Depositors' accounts	3,720,935	3,720,935	
Other liabilities	40,667	40,667	
Total liabilities	3,858,818	3,858,818	
Equity			
Share capital	238,847	238,847	D
Share premium	62,896	62,896	E
Proposed bonus shares	11,942	11,942	F
Treasury shares	(643)	(643)	G
Statutory reserve	25,251	25,251	H
Other reserves	19,165	19,165	I
Retained earnings	31,707	31,707	J
Proposed cash dividends	19,092	19,092	K
Equity attributable to equity holders of the Bank	408,257	408,257	
Non-controlling interests	2,315	2,315	
Perpetual Tier 1 Sukuk	75,388	75,388	
of which limited recognition eligible as CET1 Capital			
of which limited recognition eligible as AT1 Capital	75,658	75,658	L
of which limited recognition eligible as Tier 2 Capital	47	47	M
Total equity	485,960	485,960	
Total liabilities and equity	4,344,778	4,344,778	

RISK MANAGEMENT

For the year ended 31 December 2019

10. RECONCILIATION REQUIREMENTS (CONTINUED)

Table 17 provides the relevant lines under 'Table 24: Composition of Regulatory Capital' with cross references to the letters in Table 16, thereby reconciling (Step 3) the components of regulatory capital to the published balance sheet.

31 December 2019

Relevant row number in common disclosure template	Table 17: Step 3 of Reconciliation requirements	Component regulatory capital	Source based on reference letters of the balance sheet from step 2
		KD '000s	
Common Equity Tier 1 capital: instruments and reserves			
1	Directly issued qualifying common share capital plus related stock surplus	445,349	D + E
2	Retained earnings	35,817	J
3	Accumulated other comprehensive income (and other reserves)	68,382	F + H + I
4	Common share capital issued by subsidiaries and held by third parties (minority interest)	-	
5	Common Equity Tier 1 Capital before regulatory adjustments	<u>549,548</u>	
Common Equity Tier 1 Capital : regulatory adjustments			
6	Goodwill	2,704	B
7	Other intangibles other than mortgage-servicing rights (net of related tax liability)	-	
8	Investments in own shares	54	G
9	Deductions from Capital Base arising from Investments in FIs where ownership is > 10%	-	C
10	Total regulatory adjustments to Common Equity Tier 1	<u>2,758</u>	
11	Common Equity Tier 1 Capital (CET1)	<u>546,790</u>	
Additional Tier 1 capital : instruments			
12	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	75,616	L
13	Additional Tier 1 capital before regulatory adjustments	<u>75,616</u>	
Additional Tier 1 Capital : regulatory adjustments			
14	Additional Tier 1 Capital (AT1)	75,616	
15	Tier 1 Capital (T1 = CET1 + AT1)	<u>622,406</u>	
Tier 2 Capital : instruments and provisions			
16	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 12) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	40	M
17	General Provisions included in Tier 2 Capital	37,248	A
18	Tier 2 Capital before regulatory adjustments	<u>37,288</u>	
19	Total capital (TC = T1 + T2)	<u>659,694</u>	

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10. RECONCILIATION REQUIREMENTS (CONTINUED)

31 December 2018

Relevant row number in common disclosure template	Table 17: Step 3 of Reconciliation requirements	Component regulatory capital	Source based on reference letters of the balance sheet from step 2
		KD '000s	
	Common Equity Tier 1 capital: instruments and reserves		
1	Directly issued qualifying common share capital plus related stock surplus	301,743	D + E
2	Retained earnings	31,707	J
3	Accumulated other comprehensive income (and other reserves)	56,358	F + H + I
4	Common share capital issued by subsidiaries and held by third parties (minority interest)	-	
5	Common Equity Tier 1 Capital before regulatory adjustments	<u>389,808</u>	
	Common Equity Tier 1 Capital : regulatory adjustments		
6	Goodwill	2,622	B
7	Other intangibles other than mortgage-servicing rights (net of related tax liability)	-	
8	Investments in own shares	642	G
9	Deductions from Capital Base arising from Investments in FIs where ownership is > 10%	1,196	C
10	Total regulatory adjustments to Common Equity Tier 1	<u>4,460</u>	
11	Common Equity Tier 1 Capital (CET1)	<u>385,348</u>	
	Additional Tier 1 capital : instruments		
12	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	75,658	L
13	Additional Tier 1 capital before regulatory adjustments	<u>75,658</u>	
	Additional Tier 1 Capital : regulatory adjustments		
14	Additional Tier 1 Capital (AT1)	75,658	
15	Tier 1 Capital (T1 = CET1 + AT1)	<u>461,006</u>	
	Tier 2 Capital : instruments and provisions		
16	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 12) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	47	M
17	General Provisions included in Tier 2 Capital	30,824	A
18	Tier 2 Capital before regulatory adjustments	<u>30,871</u>	
19	Total capital (TC = T1 + T2)	<u>491,877</u>	

RISK MANAGEMENT

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11. LEVERAGE RATIO

In October 2014, CBK issued the regulations on the 'Leverage ratio' introduced by BCBS as part of the regulatory reforms package. This transparent and non-risk based metric supplements the Capital ratio to act as a backstop measure to limit excessive build-up of on and off-balance sheet exposures.

The Leverage ratio is a separate, additional requirement from the risk-based capital requirement. It is defined as the 'capital' measure divided by the 'exposure' measure. The capital measure is made up of Tier 1 Capital. The exposure measure is a sum of on-balance sheet assets, derivative exposures; securities finance transactions and off-balance sheet exposures.

The Group is in compliance with the requirements stipulated by CBK for the Leverage ratio set at a minimum of 3%.

The Leverage Ratio for the Group at consolidated level is:

	2019	2018
Table 18		
Tier 1 Capital (KD '000s)	622,406	461,006
Total Exposures (KD '000s)	5,575,567	4,606,606
Leverage Ratio (%)	11.16%	10.01%

The below Table provides the details of the Total Exposures for Leverage Ratio:

	2019	2018
Table 19	KD '000s	KD '000s
On-balance sheet exposures	5,300,548	4,342,156
Exposures to Sharia compliant hedging contracts	12,354	8,131
Off-balance sheet items	262,665	256,319
Total Exposures	5,575,567	4,606,606

Table 26 provides details of the Leverage Ratio in the format stipulated for public disclosure under the Pillar 3 framework

11.1 Leverage Ratio Reconciliation

Table 20 provides the reconciliation of the balance sheet assets from the published financial statement with total exposure amount in the calculation of leverage ratio.

Summary comparison of accounting assets vs leverage ratio exposure measure

	2019	2018
Table 20	KD '000s	KD '000s
Item		
Total consolidated assets as per published financial statements	5,300,548	4,344,778
Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	-	(2,622)
Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	-	-
Adjustments for Exposures to Sharia compliant hedging contracts	12,354	8,131
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	262,665	256,319
Other adjustments	-	-
Leverage ratio exposure	5,575,567	4,606,606

12. LIQUIDITY COVERAGE RATIO DISCLOSURE

12.1 Introduction

In December 2014, the Central Bank of Kuwait (CBK) issued a directive (2/RB/346/2014) to Islamic banks operating in Kuwait on the adoption of the Liquidity Coverage Ratio (LCR) as part of the Central Bank's implementation of the Basel III reforms.

The main objective of the Liquidity Coverage Ratio (LCR) is to ensure the short-term resilience of the liquidity risk management of banks by ensuring that they have sufficient high quality liquid assets (HQLA) to survive a significant stress scenario lasting for a period of 30 days.

12.2 Definition

The LCR is defined as a ratio of Islamic Sharia'a compliant HQLA to the total net cash outflows estimated for the next 30 'calendar' days. HQLA are classified into two categories: "Level 1" and "Level 2" with a cap on "Level 2" assets to the total HQLA. "Level 2 HQLA" are calculated after applying the hair cut provided by the Central Bank of Kuwait on their market values. The net cash outflows are calculated by applying cash outflow and inflow run off factors assigned by the Central Bank of Kuwait. These factors apply to the various categories of liabilities (outflows relating to retail and wholesale deposits, contingent funding obligations and undrawn commitments) and assets (inflows from retail and corporate financing receivables) maturing within 30 days.

The LCR is calculated by dividing the amount of unencumbered HQLA by the estimated net outflows over a stressed 30-day period.

12.3 Regulatory Scope of Reporting and Consolidation

The LCR is reported at local level, including head office and its branches in Kuwait.

The LCR is calculated on a total currency level. For follow up purposes only the LCR is prepared on a stand-alone basis for significant currencies. Significant currencies are defined as those whose aggregate liabilities (on- and off- balance sheet) constitute more than 5% of the bank's total aggregate liabilities. Accordingly, the Bank reports the LCR for Kuwaiti Dinar (KWD) and US Dollar (USD) denominated balances in addition to the total currency level.

12.4 Liquidity Policy and Contingency Funding Plan

The Bank's liquidity management is guided by its Liquidity Policy which is reviewed annually and approved by the Board of Directors. The Liquidity Policy document specifies the main goals, policies and procedures for managing liquidity risk. The Liquidity Policy outlines procedures to identify, measure and monitor liquidity risk parameters in line with regulatory and internal limits, under normal and stress scenarios.

The Liquidity Policy also encompasses the bank's Contingency Funding Plan (CFP), which is approved by the Board of Directors, charts the course to be followed under stressed conditions.

12.5 Funding Strategy and Liquidity Management

While the operational aspect of day-to-day cash flow and liquidity management rests with Treasury, other groups such as Consumer Banking Group (CBG), Corporate Banking Group (COR), Risk Management Division (RMD), and Financial Control Group (FCG) plays a key role in managing and monitoring the longer-term funding profile of the bank under the oversight of the Asset Liability Management Committee (ALCO).

The Bank's long-term strategy has been to maintain a strong and diversified liabilities profile. The bank has embraced a robust funding profile through its wide domestic retail customer base and the diversified wholesale funding customers. The bank's major wholesale funding counterparties comprise mostly of Kuwaiti government and quasi-sovereign agencies with which the Bank has established a strong and long-term relationship.

12.6 Results Analysis and Main Drivers

The Bank's HQLA during the three months ended 31 December 2019, was averaging at **KD 623 Million** (post-haircut) against an average liquidity requirement of **KD 454 Million**. Hence, the LCR averaged **137%** during the last quarter of 2019.

The HQLA is primarily comprised of Level 1 assets which represent cash and reserve balances with the CBK as well as debt issuances by sovereign and Islamic development banks in domestic and foreign currencies. Level 2 assets comprises of debt issuances by International Islamic Liquidity Management Corporation and other non-financial institutions in domestic and foreign currencies. Level 1 assets comprise of **79%** of the total HQLA.

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12. LIQUIDITY COVERAGE RATIO DISCLOSURE (CONTINUED)

12.7 Quantitative Information

Quantitative information on the Liquidity Coverage Ratio is provided in the table below. The values are calculated as the simple average of daily observations over the period between 1 October 2019 and 31 December 2019 for the Bank at Local level.

Table 21

SL.	Description	KD '000s	
		Value before applying flow rates (average)**	Value after applying flow rates (average)**
High-Quality Liquid Assets (HQLA)			
1	Total HQLA (before adjustments)		622,683
Cash Outflows			
2	<u>Retail deposits and small business</u>		
3	• Stable deposits	-	-
4	• Less stable deposits	1,034,914	156,103
5	Deposit, investment accounts and unsecured wholesale funding excluding the deposits of small business customers:		
6	• Operational deposits	-	-
7	• Non-operational deposits (other unsecured commitments)	1,123,269	668,161
8	Secured Funding		-
9	Other cash outflows, including:		
10	• Resulting from Shari'ah compliant hedging contracts	-	-
11	• Resulting from assets-backed sukuk and other structured funding instruments	-	-
12	• Binding credit and liquidity facilities	-	-
13	Other contingent funding obligations	1,414,267	70,713
14	Other contractual cash outflows obligations	94,008	94,008
15	Total Cash Outflows		988,985
Cash Inflows			
16	Secured lending transactions	-	-
17	Inflows from the performing exposures (as per the counterparties)	778,117	535,296
18	Other cash Inflows	-	-
19	Total Cash Inflows	778,117	535,296
LCR			
20	Total HQLA (after adjustments)		622,683
21	Net Cash Outflows		453,689
22	LCR		137%

13. REMUNERATION DISCLOSURE

13.1 Qualitative Information

13.1.1 Governance bodies

The Boubyan Bank Group's remuneration framework is under the supervision of the Board of Directors. As per the Bank's policies and charters, the Board is responsible to review and approve the remuneration policy and oversee the implementation of the remuneration framework.

The Board Nomination and Remuneration Committee (BNRC) comprises three non-executive Board members. Its main responsibility, in terms of remuneration mandates, is to support the board in setting the principles of the Group's remuneration policy and ensures effective implementation in accordance with the Bank's remuneration policy and Corporate Governance Code.

Boubyan Bank remuneration policy is developed and implemented at the Group level and covers Bank's subsidiaries.

The remuneration policy defines three major categories for remuneration treatment, governance and disclosures.

Senior Management: includes all employees in the positions of Assistant General Manager and above and staff whose hiring are subject to approval of regulators. The number of employees in this category as at 31 December 2019 was **38 employees**, (31 December 2018: 35 employees).

Material Risk Takers: includes all employees whose activities and decisions have a material impact on the risk profile of the Bank. The number of employees in this category as at 31 December 2019 was **24 employees**, (31 December 2018: 25 employees).

Financial and Risk Control: includes all head of divisions and head of groups in Financial Control, Risk Management, Compliance, Internal Audit and Anti-Money Laundering functions. The number of employees in this category as at 31 December 2019 was **18 employees**, (31 December 2018: 18 employees).

13.1.2 Remuneration Structure and design

Boubyan Bank's remuneration policy is in line with the strategic objectives of the Group. The policy is designed mainly to attract, retain and motivate high-calibre, skilled and knowledgeable employees, thereby ensuring a sound risk management and sustained profitability.

The Bank's financial remuneration framework has been linked with long-term and short-term performance objectives. The Board-approved Bank's Strategy is transformed into Key Performance Indicators (KPIs) and remuneration is determined based on the achievement of those KPIs towards the overall Group strategy [including financial and non-financial criteria and Key Risk Indicators (KRIs), as appropriate].

The employees of the Bank are entitled to two categories of remuneration, which are as follows:

Fixed remuneration: such remuneration are defined in the employment agreements, and may include fixed salaries (i.e. basic salary, allowances and annual fixed pay as a percentage of basic salary) and other benefits (i.e. medical insurance, air-tickets, and schooling support),

Variable remuneration: such remuneration are driven mainly by performance and guided by the "Employee Incentive Plan". This is in the form of cash bonus and/or Employee Stock Options (ESOP).

The remuneration policy is reviewed by the Board Nomination and Remuneration Committee annually and any amendments should be approved by the Board of Directors.

The risk management, compliance and internal audit functions are independent functions. The risk management and compliance functions are reporting to and assessed by the Board Risk Committee. The internal audit function is reporting to and assessed by the Board Audit Committee. The total remuneration for these positions are determined and approved by the Board Risk Committee and Board Audit committee as a fully independent parties.

Boubyan Bank considers its Group risk profile when determining its annual remuneration pool; the risk profile includes the key risks to which the Group is exposed such as strategic, credit, market, liquidity, and operational.

The overall variable remuneration pool is determined by taking into account of relevant risk metrics. The metrics used to determine the pool are linked with key risk indicators and they are in line with the Group's overall risk strategy. The Group applied the key risk indicators (KRIs) this year without significant change from last year's KRIs.

13. REMUNERATION DISCLOSURE (CONTINUED)**13.1 Qualitative Information (continued)****13.1.3 An Overview on the Key Performance Indicators**

The overall strategy of the Bank is set and approved by the Board and translated into KPIs. These are then documented and communicated to ensure the alignment of management activities to the strategy applied by Senior Management. These KPIs are monitored and reported to the Board on a regular basis.

Remuneration is determined based on the achievement of KPIs toward the overall Group strategy; this includes financial and non-financial criteria and Key Risk Indicators (KRIs) at Bank's level.

The Bank's Performance Management Policy sets the methodology of linking an individual's annual performance with the Bank's overall performance.

The annual remuneration pool for this year was approved by the Board of Directors after review, discussion and recommendation by the Board Nomination and Remuneration Committee. The percentage of approved remuneration was determined based on the Bank-level KPIs.

The performance appraisal form for each position identifies the quantitative weights of individual KPIs; the final scoring of the appraisal is linked with a quantitative formula to determine the level of remunerations.

Since the overall remuneration pool of the Group is linked to Group performance, the Group adjusts the remuneration percentages in case of weak performance and business recessions.

13.1.4 Remuneration Adjustments

The annual remuneration amount (fixed and variable) is reviewed by the Board Nomination and Remuneration Committee and is then subject to review and approval by the Board of Directors'.

The Group remuneration deferment policy ensures an appropriate portion of the variable remuneration of senior employees (including those deemed to have a material impact on the risk profile of the organisation) is deferred.

The deferment of variable remuneration applies to the equity shares as per the ESOP terms. This deferred variable remuneration is subject to clawback in the event of established fraud, misleading information or exceeding the approved risk limits.

13.1.5 Types of Remuneration Components

The Bank has two main remuneration components (fixed and variable). The variable component is mainly linked with performance and is subject to the deferment approach as mentioned above.

The fixed component (salaries, benefits) is on cash basis, while the variable component is on cash or equity basis (ESOP).

The percentage between fixed and variable (cash and equity) is reviewed and approved by the Board on an annual basis.

In case weak performance and business recessions, the Group would try to minimise the percentage of variable remuneration, especially for the Senior Management and Material Risk-Takers.

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13. REMUNERATION DISCLOSURE (CONTINUED)**13.2 Quantitative Information (continued)**

During the year, the Board Nomination and Remuneration Committee met **6 times**, (31 December 2018: 4 times).

The total remuneration paid to the Committee members was **Nil**, (31 December 2018: Nil).

The quantitative disclosures detailed below cover only senior management and other material risk takers.

The number of employees having received a variable remuneration award during 2019 was **47 employees** and they represent **5.9%** of the total number of employees which received a variable remuneration, (31 December 2018: 40 employees representing 6.3% of the total number of employees).

The number of employees who received sign-on awards or guaranteed bonuses during 2019 was **Nil** (31 December 2018: 46).

The total amount of end-of-service benefit paid during 2019 was **KD 284 thousand**; this is related to **6 employees** (31 December 2018: KD 336 thousand related to 4 employees).

The total amount of outstanding deferred remuneration as at 31 December 2019 was **KD 2,559 thousand** (31 December 2018: KD 2,489 thousand).

Total amount of deferred remuneration paid during 2019 was **KD 617 thousand** (31 December 2018: KD 578 thousand).

Total salaries & remuneration granted during reported period

Senior Management

	2019		2018	
	Unrestricted KD '000s	Deferred KD '000s	Unrestricted KD '000s	Deferred KD '000s
Table 22				
Fixed remuneration:				
- Cash	3,944	-	3,695	-
- Others (refer note below)	-	645	-	546
Variable remuneration:				
- Cash	945	-	962	-
- ESOP/DCC	-	899	-	884

Material Risk Takers*

	2019		2018	
	Unrestricted KD '000s	Deferred KD '000s	Unrestricted KD '000s	Deferred KD '000s
Table 23				
Fixed remuneration:				
- Cash	2,281	-	2,349	-
- ESOP/DCC	-	384	-	335
Variable remuneration:				
- Cash	621	-	684	-
- ESOP/DCC	-	610	-	637

Note: This consists of deferred end-of-service benefits in line with Boubyan Bank policy

Employees Category

	2019		2018	
	Number of employees	Remuneration Fixed and Variable KD '000s	Number of employees	Remuneration Fixed and Variable KD '000s
Table 24				
Senior Management	38	6,433	37	6,087
Material Risk Takers*	24	3,896	25	4,005
Financial and Risk Control	18	1,720	18	1,608

* Material Risk Takers are identified as Senior Management

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14. OTHER DISCLOSURES

14.1 Regulatory Capital Composition: Common Disclosure Template

Row Number	Table 25	KD '000s	
		2019	2018
Common Equity Tier 1 Capital: instruments and reserves			
1	Directly issued qualifying common share capital plus related stock surplus	445,349	301,743
2	Retained earnings	35,817	31,707
3	Accumulated other comprehensive income (and other reserves)	68,382	56,358
4	Common share capital issued by subsidiaries and held by third parties (minority interest)	-	-
5	Common Equity Tier 1 capital before regulatory adjustments	549,548	389,808
Common Equity Tier 1 Capital : regulatory adjustments			
6	Goodwill (net of related tax liability)	(2,704)	(2,622)
7	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	(54)	(642)
8	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	-	(1,196)
9	Total regulatory adjustments to Common Equity Tier 1	(2,758)	(4,460)
10	Common Equity Tier 1 Capital (CET1)	546,790	385,348
Additional Tier 1 Capital : instruments			
11	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	75,616	75,658
12	Additional Tier 1 Capital before regulatory adjustments	75,616	75,658
Additional Tier 1 Capital : regulatory adjustments			
13	Additional Tier 1 capital (AT1)	-	-
14	Tier 1 Capital (T1 = CET1 + AT1)	622,406	461,006
Tier 2 Capital : instruments and provisions			
15	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 12) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	40	47
16	General Provisions included in Tier 2 Capital	37,248	30,824
17	Tier 2 capital before regulatory adjustments	37,288	30,871
Tier 2 Capital: regulatory adjustments			
18	National specific regulatory adjustments	-	-
19	Total regulatory adjustments to Tier 2 Capital	-	-
20	Tier 2 Capital (T2)	37,288	30,871
21	Total Capital (TC = T1 + T2)	659,694	491,877
22	Total risk-weighted assets	3,246,032	2,704,257
Capital ratios and buffers			
23	Common Equity Tier 1 (as percentage of risk-weighted assets)	16.84%	14.25%
24	Tier 1 (as percentage of risk-weighted assets)	19.17%	17.05%
25	Total capital (as percentage of risk-weighted assets)	20.32%	18.19%
National minima			
26	Common Equity Tier 1 minimum ratio including Capital Conservation buffer and D-SIB buffer	10.00%	10.00%
27	Tier 1 minimum ratio	11.50%	11.50%
28	Total capital minimum ratio excluding CCY	13.50%	13.50%

RISK MANAGEMENT

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14. OTHER DISCLOSURES (CONTINUED)

14.2 Leverage Ratio: Common Disclosure Template

Table 26

		2019	2018
	Item	KD '000s	KD '000s
	On-balance sheet exposures		
1	On-balance sheet items (excluding Sharia compliant hedging contracts, but including collaterals)	5,300,548	4,344,778
2	(Asset amounts deducted in determining Basel III Tier 1 Capital)	-	(2,622)
3	Total on-balance sheet exposures (excluding Sharia compliant hedging contracts) (sum of lines 1 and 2)	5,300,548	4,342,156
	Exposures to Sharia compliant hedging contracts		
4	Replacement cost associated with all Sharia compliant hedging contracts (i.e. net of eligible cash variation margin)	6,545	5,675
5	Add-on amounts for potential future exposures "PFE" associated with all Sharia compliant hedging contracts	5,809	2,456
6	Gross-up for the collateral of Sharia compliant hedging contracts provided where deducted from the balance sheet assets pursuant to the Bank's accounting policy.	-	-
7	(Deductions of receivables assets for cash variation margin provided in with all Sharia compliant hedging contracts)	-	-
8	(Bank's exposures to exempted Central counter parties "CCP")	-	-
9	Total exposures of Sharia compliant hedging contracts (sum of lines 4 to 8)	12,354	8,131
	Other off-balance sheet exposures		
10	Off-balance sheet exposure (before any adjustment for credit conversion factors)	1,430,815	1,328,296
11	(Adjustments for conversion to credit equivalent amounts)	(1,168,151)	(1,071,977)
12	Off-balance sheet items (sum of lines 10 and 11)	262,664	256,319
	Capital and total exposures		
13	Tier 1 Capital	622,406	461,006
14	Total exposures (sum of lines 3, 9,12)	5,575,567	4,606,606
	Leverage ratio		
15	Leverage ratio (Tier 1 Capital (13)/total exposures (14))	11.16%	10.01%