بنك دبي الإسلامي
Dubai Islamic Bank

Basel III – Pillar III Disclosures

(For the year ended 31 December 2017)

1. Overview and introduction

This document presents the Pillar 3 disclosures and allows market participants to assess information which includes key pieces of information about Dubai Islamic Bank PJSC (the "Bank") and its subsidiaries (collectively referred to as the "Group") relating to the financial group's structure, capital structure, capital adequacy, risk exposures, risk management objectives and policies, risk assessment process and various supporting quantitative and qualitative disclosures.

The Group is regulated by the Central Bank of the United Arab Emirates ("CBUAE") and follows the Pillar 3 disclosure requirements as stated under the CBUAE guidelines, on the implementation of Basel II accord (November 2009). CBUAE also issued new capital standards for UAE Banks for the Basel III regulatory reporting in 2017. Additional guidelines with respect to Basel III would be issued over the course of 2018 in joint consultations with the UAE Banks.

The CBUAE Basel framework clearly addresses the importance of developing and using better risk management techniques in monitoring and managing risk and intends to strengthen the market discipline and risk management while enhancing the safety and soundness of the banking industry in UAE.

Most of the Pillar III requirements have already been disclosed in the audited consolidated financial statements for the year ended 31 December 2017, which covers in detail the risk and capital management processes of the Bank and its compliance with the Basel Accords. The following disclosures provide qualitative and quantitative information in addition to the consolidated financial statements in order to meet the disclosure requirements of Pillar III.

Regulatory framework

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

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

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

- **Pillar III** - complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy and to encourage market discipline which allows market participants to assess specific information in the scope of particular risk exposures, risk assessment processes, and the capital adequacy of the bank.

Future regulatory developments

The regulation and supervision of financial institutions has undergone a significant shift since the global financial crisis. As per Basel standards and CBUAE guidelines, the regulatory focus on Capital and Liquidity regulations has increased. The CBUAE Basel III Capital and Liquidity regulations are being implemented and in compliance by the Group.

Implementation of revised 2017 guidelines on capital standards for Leverage Ratio, Common Equity Tier 1(CET1), Additional Tier 1(AT1), Capital Buffers like (Capital Conservation Buffer (CCB), Countercyclical Buffer (CCyB) and Domestic Systemically Important Banks Buffer (DSIB) is ongoing. There is close coordination between UAE banks and CBUAE for the smooth implementation of the revised capital standards as per Basel III, IFRS 9 and any forthcoming guidelines or future disclosure requirements.

Implementation and Compliance of Basel framework guidelines

The Bank has been in compliance with Basel Accord guidelines since December 2007, in accordance with CBUAE directives[1] for Standardized Approach for Credit, Market and Operational Risk.

[1] Further as per Basel Pillar II framework, the Bank assigns capital on risks other than Pillar I risk categories. Details on Pillar II methodologies are contained in section "Capital management policies" of this report.

2. Group structure

The Bank consists of Dubai Islamic Bank P.J.S.C. and its subsidiaries. As of 31 December 2017, the Group's interest held directly or indirectly in its subsidiaries is as follows:

	Name of subsidiary	Principal activity	Place of incorporation and operation	Ownership interest and voting power 2017	2016
1.	Dubai Islamic Bank Pakistan Ltd.	Banking	Pakistan	100.0%	100.0%
2.	Tamweel P.S.C	Financing	U.A.E	92.0%	92.0%
3.	DIB Bank Kenya	Banking	Kenya	100.0%	100.0%
4.	Dubai Islamic Financial Services L.L.C.	Brokerage services	U.A.E.	95.5%	95.5%
5.	Deyaar Development P.J.S.C.	Real estate development	U.A.E	44.9%	44.9%
6.	Dar al Shariah Financial & Legal Consultancy L.L.C.	Financial and legal advisory	U.A.E.	60.0%	60.0%
7.	Al Tanmyah Services L.L.C.	Labour services	U.A.E.	99.5%	99.5%
8.	Al Tatweer Al Hadith Real Estate	Real estate development	Egypt	100.0%	100.0%
9.	Al Tameer Modern Real Estate Investment	Real estate development	Egypt	100.0%	100.0%
10.	Al Tanmia Modern Real Estate Investment	Real estate development	Egypt	100.0%	100.0%
11.	Naseej Private Property Management Services (formerly Naseej Fabric Manufacturing L.L.C.)	Property management	U.A.E.	99.0%	99.0%
12.	DIB Printing Press L.L.C.	Printing	U.A.E.	99.5%	99.5%
13.	Al Islami Real Estate Investments Ltd.	Investments	U.A.E.	100.0%	100.0%
14.	Dubai Islamic Trading Center L.L.C.	Trading in vehicles	U.A.E.	100.0%	100.0%

In addition to the above subsidiaries, the following Special Purpose Vehicles ("SPV") were formed by the Group to manage specific transactions, including funds, and are expected to be closed upon completion of transactions:

	Name of SPV	Principal activity	Place of incorporation and operation	Ownership interest and voting power 2017	2016
15.	HoldInvest Real Estate Sarl	Investments	Luxembourg	**100.0%**	100.0%
16.	France Invest Real Estate SAS	Investments	France	**100.0%**	100.0%
17.	SARL Barbanniers	Investments	France	**100.0%**	100.0%
18.	SCI le Sevine	Investments	France	**100.0%**	100.0%
19.	Findi Real Estate SAS	Investments	France	**100.0%**	100.0%
20.	PASR Einudzwanzigste Beteiligunsverwaltung GMBH	Investments	Austria	**100.0%**	100.0%
21.	Al Islami German Holding Co. GMBH	Investments	Germany	**100.0%**	100.0%
22.	Rhein Logistics GMBH	Investments	Germany	**100.0%**	100.0%
23.	Jef Holdings BV	Investments	Netherlands	**100.0%**	100.0%
24.	Al Islami Trade Finance FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
25.	Gulf Atlantic FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
26.	Al Islami Oceanic Shipping Co FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
27.	MESC Investment Company	Investments	Jordan	**40.0%**	40.0%
28.	Levant One Investment Limited	Investments	U.A.E.	**100.0%**	100.0%
29.	Petra Limited	Investments	Cayman Islands	**100.0%**	100.0%
30.	Sequia Investments L.L.C.	Investments	U.A.E.	**99.0%**	99.0%
31.	Blue Nile Investments L.L.C.	Investments	U.A.E.	**99.0%**	99.0%
32.	DIB FM Ltd	Investments	Cayman Islands	**100.0%**	-
33.	Al Ameen	Investments	Cayman Islands	**100.0%**	-

In addition to the registered ownership described above, the remaining equity in the entities 30 and 31 are also beneficially held by the Bank through nominee arrangements.

3. Capital management and policies

The Group's regulatory capital comprises of the following items and calculated as per the guidelines issued by CBUAE:

Tier 1 Capital: comprises of. **(a.)** Common Equity Tier 1 (CET1) and (**b.)** Additional Tier 1 (AT1)**.**

a) **Common Equity Tier 1 (CET1)** comprises of the following items:

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

b) **Additional Tier 1 (AT1)** comprises of the following items:

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

Tier 2 Capital: which is composed of;

i. Banks using the standardized approach for credit risk: general provisions/general loan loss reserves up to a maximum of 1.25 % of credit RWA;
ii. Perpetual equity instruments, not included in Tier 1 capital;
iii. Share premium resulting from the issue of instruments included in Tier 2 capital;
iv. Instruments which are eligible for inclusion of Tier 2;
v. Perpetual instruments issued by consolidated subsidiaries, not included in Tier 1 capital; and
vi. Regulatory adjustments applied in the calculation of Tier 2.

3.1 Capital management objective

The Group key objectives in the capital management process are:

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

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

3. Capital management and policies (continued)

3.2 Regulatory capital

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

The Bank's lead regulator the Central Bank of U.A.E. sets and monitors capital requirements for the Group as a whole. The Group and individual banking operations are directly supervised by their respective local regulators.

Various limits are applied to elements of the capital base as per Basel III guidelines. All banks must comply with the following minimum requirements:

- CET1 must be at least 7.0% of risk weighted assets (RWA);
- Tier 1 Capital must be at least 8.5% of risk weighted assets; and
- Total Capital, calculated as the sum of Tier 1 Capital and Tier 2 Capital, must be at least 10.5% of RWA.

On top of this minimum capital requirement CBUAE has also mandated the Banks to keep additional buffers:

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

For 2017, CCB is effective under transitional arrangement and is required to be kept at 1.25% of the Capital base. For 2018, CCB will be required to be at 1.875% and from 2019; it will be required to be at 2.5% of the Capital base.

CCyB is currently not in effect and until further notice from CBUAE.

The Group has been classified as Domestic Systematically Important Bank (D-SIB) and is required to keep an additional D-SIB[2] buffer of 0.375% of the Capital base for 2018. This buffer will increase up to 0.5% of the Capital base by 2019.

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

[2] DIB has received official communication from CB UAE during Q1 2018 that it qualifies and is classified as Domestic Systematically Important Bank (D-SIB) and will be required to hold additional capital buffers applied to CET1. DIB will start implementing the relevant requirements from 1 July 2018.

4. Capital management and policies (continued)

3.3 Regulatory capital structure

The detailed breakdown of the capital structure of the Group under Basel II and Basel III in accordance with regulations of the Central Bank of the U.A.E. as of 31 December 2017 is as follows:

	Basel III	Basel II	
	2017	**2017**	2016
	AED'000	**AED'000**	AED'000
Tier 1 Capital			
Share capital	**4,942,189**	**4,942,189**	4,942,189
Tier 1 sukuk	**7,346,000**	**7,346,000**	7,346,000
Other reserves	**7,806,273**	**7,806,273**	7,806,273
Retained earnings[3]	**4,744,686**	**6,964,089**	5,641,061
Non-controlling interest	**36,480**	**182,402**	186,252
Treasury shares	**(18,644)**	**(20,716)**	(20,716)
Cumulative deferred exchange losses	**(484,615)**	**(484,615)**	(462,774)
Investment fair value reserve	**(615,389)**	**-**	-
Deduction from capital	**-**	**(362,020)**	(314,850)
Total Tier 1 Capital	**23,756,980**	**26,373,602**	25,123,435
Tier 2 Capital			
Investment fair value reserve	**-**	**(615,389)**	(751,672)
Collective impairment allowance	**1,812,885**	**1,812,885**	1,557,060
Deduction from capital	**(2,072)**	**(362,020)**	(314,850)
Total Tier 2 Capital	**1,810,813**	**835,476**	490,538
Total capital base	**25,567,793**	**27,209,078**	25,613,973

[3] Subsequent to the submission of financial statement to the Board of Directors for approval, the Regulatory Capital as at 31 December 2017 has been revised as per Basel III Capital Supply Standards issued by Central Bank of UAE in January 2018.

The standard requires UAE banks to deduct the proposed dividend for 2018 from retained earnings while determining the regulatory capital.

3. Capital management and policies (continued)

3.4 Capital Adequacy

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

The Group is following the standardized approach for credit, market and operational risk, as permitted by the U.A.E. Central Bank and as per Pillar 1 of Basel II / III.

The Group's capital adequacy ratios as of 31 December 2017 were as follows:

Risk weighted assets

	Basel III	**Basel II**	
	2017	**2017**	2016
	AED'000	**AED'000**	AED'000
Credit risk[4]	**153,202,879**	**146,264,569**	129,748,218
Market risk	**1,959,686**	**1,959,686**	1,056,258
Operational risk	**11,934,690**	**11,934,690**	10,590,092
Total risk weighted assets	**167,097,255**	**160,158,945**	141,394,568
Capital Ratios			
Total regulatory capital expressed as a percentage of total risk weighted assets ("capital adequacy ratio")	**15.3%**	**17.0%**	18.1%
Tier 1 capital to total risk weighted assets after deductions for associates	**14.2%**	**16.5%**	17.8%
Total capital adequacy ratios for each significant bank subsidiary :			
DIB Pakistan ("Basel III Total capital adequacy ratio")	**13.4%**	**--**	11.2%

The Group's Basel III Capital Adequacy ratio as at 31 December 2017 is 15.3% and Tier 1 capital adequacy ratio is 14.2% against the regulatory requirement of minimum of 10.5% and 8.5%, respectively. The Group ensures adherence to CBUAE requirements by implementing high internal limits.

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

During the years ended 31 December 2017 and 2016, the Bank complied in full with all its regulatory capital requirements.

[4] Subsequent to the submission of financial statement to the Board of Directors for approval, the RWA as at 31 December 2017 has been revised as per Basel III Capital Supply Standards issued by Central Bank of UAE in January 2018.

Based on Central Bank of UAE 2018 guidance, UAE banks are to report Significant Investments in Commercial Entities above Materiality Threshold under Other Assets.

3. Capital management and policies (continued)

3.4. Capital adequacy (continued)

3.4.1 Credit risk weighted assets

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

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

The details of Credit Risk Weighted Assets as of 31 December 2016 are as follows:

	Gross Exposure AED'000	Risk Weighted Assets AED'000
Claims on sovereigns	27,819,820	3,997,222
Claims on non-commercial public sector enterprises (PSEs)	2,733,328	132,533
Claims on multilateral development banks	92,391	-
Claims on banks	28,548,307	3,361,330
Claims on corporate and government related entities (GRE)	120,218,331	77,139,946
Claims included in the regulatory retail portfolio	23,630,291	17,767,829
Claims secured by residential property	12,230,924	6,714,615
Claims secured by commercial real estate	9,445,492	9,168,094
Past due financing assets	7,421,487	2,768,656
Higher-risk categories	889,854	894,403
Other assets	9,849,264	7,803,590
Total	242,879,488	129,748,218

3. Capital management and policies (continued)

3.4. Capital adequacy (continued)

3.4.2 Market risk weighted assets

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

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

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

As of 31 December 2017, the capital requirement for Market Risk as per standardized approach was as follows:

	2017 AED'000	2016 AED'000
Profit rate risk	**7,342**	5,429
Foreign exchange risk	**227,284**	120,635
Equity	**536**	686
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Total capital requirement for market risk	**235,162**	126,751
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3.4.3 Operational risk weighted assets

In accordance with Basel II guidelines operational risk charge is computed by multiplying the beta factors of respective banking business activities, subject to and as required by the Standardised Approach. The total capital requirement for Operational Risk as at 31 December 2017 is AED 1,432 million and as of 31 December 2016 was AED 1,271 million.

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

4. Risk management objectives and policies

4.1 Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his responsibilities.

The Group is exposed to various risks including:
- Credit risk;
- Liquidity risk;
- Market risk; and
- Operational risk.

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

4.1.1 Risk management structure

The Board of Directors, supported by the Risk Management Committee (Board and Management) and Risk Management Department, is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

Board of Directors

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

Board Risk Management Committees

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

Risk Management Committee

The day-to-day management of risk has been delegated to Risk Management Committee.

The Risk Management Committee has the overall responsibility to support the Board Risk Management Committee for the development and formulation of the risk strategy, frameworks, policies and limits. It is responsible for ensuring the compliance with all risk limits, monitoring risk exposures and implementing the regulatory guidelines issued by the regulatory bodies (e.g. The Central Bank of the U.A.E.).

Risk Management Department

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

Asset and Liability Management Committee

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

Collections and Remedial Management Committee

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

4. Risk management objectives and policies (continued)

4.1 Introduction (continued)

4.1.1 Risk management structure (continued)

Internal Audit Department

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

4.1.2 Risk measurement and reporting systems

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

Monitoring and controlling risks is primarily performed based on limits established by the Board of Directors and management. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries.

Information compiled from all the businesses is examined and processed in order to analyse the risk profile and identify early risks. This information is presented and explained to the management, management committees, the Risk Management Committee of the management, and Board Risk Management Committee. Specialized reports are presented to the pertinent heads of business and are delivered with a frequency suited to the volatility of the risk. The report includes aggregate credit exposure, limit exceptions, liquidity, operational loss incidents and other risk profile changes. On a monthly basis, detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the provision for impairment losses on a quarterly basis.

4.1.3 Risk mitigation

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

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

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

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

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

4.1.4 Risk concentration

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

4. Risk management objectives and policies (continued)

4.2 Credit risk

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

Credit risk measurement

The Group assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparties. Whilst some of the models for assessment of Real Estate projects are internally developed, others for the Corporate, Contracting and SME businesses have been acquired from Moody's and subsequently optimized and calibrated to the Group's internal rating scale. The models are housed with the Moody's Risk Analyst rating tool.

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

Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of securities for facilities provided, which is a common practice. The Group implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for Islamic financing and investing assets are:

- Mortgages over residential and commercial properties;
- Corporate guarantees;
- Charges over business assets such as premises, machinery, vehicles and inventory; and
- Charges over financial instruments such as deposits and equity investments.

Islamic derivative financial instruments

Credit risk arising from Islamic derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the consolidated financial position.

Credit-related commitments risks

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

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

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

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

	Gross maximum exposure 2017 AED'000	Gross maximum exposure 2016 AED'000
Balances with central banks	**26,481,776**	14,767,767
Due from banks and financial institutions	**4,676,952**	4,546,197
Islamic financing and investing assets	**139,066,896**	120,526,273
Investment in Islamic sukuk measured at amortised cost	**24,022,680**	23,408,660
Other investments measured at fair value	**1,961,733**	1,717,311
Receivables and other assets	**7,893,154**	6,910,186
	204,103,191	171,876,394
Contingent liabilities	**15,685,782**	14,357,080
Commitments	**16,398,423**	19,872,165
Total	**236,187,396**	206,105,639
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4.2.2 Risk concentrations of the maximum exposure to credit risk

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

	2017 AED'000	2016 AED'000
The U.A.E.	**212,992,565**	185,711,262
Other Gulf Cooperation Council (GCC) countries	**6,263,700**	4,286,544
Asia	**10,484,879**	11,177,436
Europe	**5,138,865**	4,023,938
Africa	**797,960**	475,788
Others	**509,427**	430,671
Total	**236,187,396**	206,105,639
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4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

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

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

	Gross Maximum Exposure 2017 AED'000	Gross Maximum Exposure 2016 AED'000
Government	**19,168,786**	18,191,935
Financial Institutions	**44,583,603**	31,090,273
Real estate	**43,068,395**	35,291,610
Contracting	**18,139,228**	17,191,888
Trade	**11,285,179**	11,948,226
Aviation	**19,763,982**	13,121,332
Services and manufacturing	**36,542,763**	36,964,917
Consumer financing	**29,932,627**	28,882,498
Consumer home finance	**13,702,833**	13,422,960
Total	**236,187,396**	206,105,639

4.2.3 Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For commercial Islamic financing and investing facilities, charges over real estate properties, inventory, leased assets and trade receivables, and
- For retail Islamic financing and investing facilities, charge over assets and mortgages over properties.

The Group also obtains guarantees from parent companies for Islamic financing and investing assets granted to their subsidiaries, but the benefits are not included in the above table.

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.4 Gross credit risk exposures as per Basel III standardized approach

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

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

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.4 Gross credit risk exposures as per Basel III standardized approach

The gross credit exposure as per standardized approach with the effect of CRM as of 31 December 2016 is detailed below:

		Credit Risk Mitigation (CRM)			
AED'000	On & Off Balance Sheet Gross Outstanding	Exposure Before Credit Risk Mitigation (CRM)	After CRM	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	27,819,820	27,819,820	–	27,764,801	3,997,222
Claims on non-commercial public sector enterprises (PSEs)	2,733,328	2,733,328	–	2,733,328	132,533
Claims On Multi-Lateral Development Banks	92,391	92,391	–	92,391	–
Claims on banks	28,548,307	28,548,307	–	8,510,381	3,361,330
Claims on corporates and government related enterprises	120,218,331	120,077,357	7,479,213	78,773,565	77,139,946
Claims included in the regulatory retail portfolio	23,630,291	23,627,886	347,524	23,272,198	17,767,829
Claims secured by residential property	12,230,924	12,063,997	–	12,063,997	6,714,615
Claims secured by commercial real estate	9,445,492	9,283,561	142,938	9,196,103	9,168,094
Past due financing assets	7,421,487	3,271,441	591,142	2,677,555	2,768,656
Higher-risk categories	889,854	889,854	293,585	596,268	894,403
Other assets	9,849,264	9,849,264	248,441	9,600,822	7,803,590
Total	242,879,488	238,257,205	9,102,843	175,281,410	129,748,218

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

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

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

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

[5] Also currently using the Comprehensive Credit Risk Mitigation Approach for the treatment of collateral against exposures.

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

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

The gross credit exposures as per standardized approach in terms of rated/unrated assets as of 31 December 2016 is detailed below:

AED'000	Rated	Unrated	Total Gross Outstanding	Exposure Before CRM	After CRM	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	26,340,255	1,479,566	27,819,820	27,819,820	–	27,764,801	3,997,222
Claims on non-commercial public sector enterprises (PSEs)	-	2,733,328	2,733,328	2,733,328	–	2,733,328	132,533
Claims On Multi-Lateral Development Banks	92,391	_	92,391	92,391	–	92,391	_
Claims on banks	25,383,897	3,164,410	28,548,307	28,548,307	–	8,510,381	3,361,330
Claims on corporates and government related enterprises (GREs)	10,982,036	109,236,295	120,218,331	120,077,357	7,479,213	78,773,565	77,139,946
Claims included in the regulatory retail portfolio	_	23,630,291	23,630,291	23,627,886	347,524	23,272,198	17,767,829
Claims secured by residential property	_	12,230,924	12,230,924	12,063,997	_	12,063,997	6,714,615
Claims secured by commercial real estate	_	9,445,492	9,445,492	9,283,561	142,938	9,196,103	9,168,094
Past due financing assets	_	7,421,487	7,421,487	3,271,441	591,142	2,677,555	2,768,656
Higher-risk categories	_	889,854	889,854	889,854	293,585	596,268	894,403
Other assets	_	9,849,264	9,849,264	9,849,264	248,441	9,600,822	7,803,590
Total	62,798,579	180,080,909	242,879,488	238,257,205	9,102,843	175,281,410	129,748,218

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.5 Analysis of credit quality

2017	Balances with central banks and due from banks and financial institutions AED'000	Islamic financing and investing assets AED'000	Investments in Islamic sukuk and other investments at fair value AED'000	Receivables and other assets AED'000	Contingent liabilities and commitments AED'000	Total AED'000
Individually impaired	-	**4,599,691**	-	**680,829**	-	**5,280,520**
Non-impaired exposures						
Neither past due nor impaired	**31,158,728**	**131,087,659**	**25,984,413**	**7,212,326**	**32,084,204**	**227,527,330**
Past due by less than 30 days	-	**1,847,364**	-	-	-	**1,847,364**
Past due by more than 30 days but less than 90 days	-	**1,270,575**	-	-	-	**1,270,575**
Past due by more than 90 days	-	**261,607**	-	-	-	**261,607**
Gross amount	**31,158,728**	**134,467,205**	**25,984,413**	**7,212,326**	**32,084,204**	**230,906,876**
Total gross maximum exposure	**31,158,728**	**139,066,896**	**25,984,413**	**7,893,155**	**32,084,204**	**236,187,396**
Provisions for impairment	-	**(5,732,668)**	-	-	-	**(5,732,668)**
Net carrying amount	**31,158,728**	**133,334,228**	**25,984,413**	**7,893,155**	**32,084,204**	**230,454,728**
2016						
Individually impaired	-	4,438,758	-	680,829	-	5,119,587
Non-impaired exposures						
Neither past due nor impaired	19,313,964	113,060,620	25,125,971	6,229,357	34,229,245	197,959,157
Past due by less than 30 days	-	1,391,833	-	-	-	1,391,833
Past due by more than 30 days but less than 90 days	-	1,305,900	-	-	-	1,305,900
Past due by more than 90 days	-	329,162	-	-	-	329,162
Gross amount	19,313,964	116,087,515	25,125,971	6,229,357	34,229,245	200,986,052
Total gross maximum exposure	19,313,964	120,526,273	25,125,971	6,910,186	34,229,245	206,105,639
Provisions for impairment	-	(5,558,651)	-	-	-	(5,558,651)
Net carrying amount	19,313,964	114,967,622	25,125,971	6,910,186	34,229,245	200,546,988

4. Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.6 Analysis of credit quality (continued)

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

	Moody's equivalent grades	**Total 2017 AED'000**	Total 2016 AED'000
Low risk			
Risk rating class 1 to 4	*Aaa –Baa3*	**167,683,209**	141,546,786
Fair risk			
Risk rating classes 5 to 7	*Ba1-Caa3*	**62,926,443**	59,432,093
High risk			
Risk rating classes 8 to11		**5,577,744**	5,126,760
		236,187,396	206,105,639
		=========	=========

It is the Group policy to maintain accurate and consistent risk ratings across the credit portfolio to facilitate focused management of the applicable risks and the comparison of financing exposures across all lines of business, geographic regions and products.

4.2.7 Analysis by economic sector and geography

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

	Within the U.A.E. AED'000	**Outside the U.A.E. AED'000**	**Total AED'000**
2017			
Government	**4,488,674**	**1,517,555**	**6,006,229**
Financial institutions	**5,076,851**	**1,257,715**	**6,334,566**
Real estate	**25,916,111**	**277,423**	**26,193,534**
Contracting	**6,801,355**	**560,283**	**7,361,638**
Trade	**7,093,302**	**1,124,762**	**8,218,064**
Aviation	**16,847,745**	**150,123**	**16,997,868**
Services and others	**25,708,401**	**2,140,836**	**27,849,237**
Consumer home finance	**13,120,151**	**334,453**	**13,454,604**
Consumer financing	**26,035,602**	**615,553**	**26,651,155**
	131,088,192	**7,978,703**	**139,066,895**
Less: provision for impairment			**(5,732,668)**
Total			**133,334,227**
			=========

4 Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.7 Analysis by economic sector and geography (continued)

2016	Within the U.A.E AED'000	Outside the U.A.E AED'000	Total AED'000
Government	4,473,815	1,219,871	5,693,686
Financial institutions	4,801,953	783,641	5,585,594
Real estate	19,318,258	277,179	19,595,437
Contracting	6,148,022	932,042	7,080,064
Trade	6,312,615	1,080,156	7,392,771
Aviation	10,672,641	171,184	10,843,825
Services and others	23,760,779	1,900,249	25,661,028
Consumer home finance	12,858,808	279,377	13,138,185
Consumer financing	25,038,758	496,925	25,535,683
	113,385,649	7,140,624	120,526,273
Less: provision for impairment			(5,558,651)
Total			114,967,622

4.2.8 Provision for impairment

	2017 AED'000	2016 AED'000
Balance at 1 January	**5,558,651**	5,048,097
Charge for the year		
Specific	**1,653,437**	1,861,022
Collective	**255,825**	251,038
Release to consolidated statement of profit or loss	**(1,073,843)**	(1,149,491)
Write off	**(661,402)**	(452,015)
Balance at 31 December	**5,732,668**	5,558,651
Gross amount of Islamic financing and investing assets, determined to be impaired	**4,599,691**	4,438,758

4.2.9 Impairment assessment

The main considerations for the impairment assessment include whether any payments of principal or profit are overdue by more than 90 days (in line with the U.A.E. Central Bank guidelines) or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant Islamic financing or investing asset on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date.

4 Risk management objectives and policies (continued)

4.2 Credit risk (continued)

4.2.10 Impairment assessment (continued)

Collectively assessed allowances

Allowances are assessed collectively for losses on Islamic financing and investing assets where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. The impairment allowance is reviewed by credit risk management to ensure alignment with the Group overall policy.

Acceptances and contingent liabilities are assessed and provisions made in a similar manner as for Islamic financing and investing assets.

4 Risk management objectives and policies (continued)

4.3 Liquidity risk and funding management

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

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

The primary tool for monitoring liquidity is the maturity mismatch analysis, which is monitored over successive time bands and across functional currencies. Guidelines are established for the cumulative negative cash flow over successive time bands.

4.3.1 Liquidity risk management process

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

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

4.3.2 Funding approach

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

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

4.3.3 Non-derivative cash flows

The table below summarises the maturity profile of the gross cash flows of the Group financial assets and liabilities as at 31 December 2017 and 2016. The amounts disclosed in the table are the contractual gross cash flows, whereas the Group manages the inherent liquidity risk based on expected gross cash flows.

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

4. Risk management objectives and policies (continued)

4.3 Liquidity risk and funding management (continued)

4.3.3 Non-derivative cash flows

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

2016	Less than 3 months AED'000	3 months to 1 year AED'000	1 to 5 years AED'000	Over 5 Years AED'000	Total AED'000
Customers' deposits	66,644,774	48,045,793	10,829,569	35,880	125,556,016
Due to banks and other financial institutions	5,681,411	2,682,873	2,179,545	252,114	10,795,943
Sukuk issued	1,102,500	1,882,413	5,897,633	-	8,882,546
Payables and other liabilities	4,417,931	1,372,250	1,184,670	-	6,974,851
Zakat payable	-	242,289	-	-	242,289
Total liabilities	77,846,616	54,225,618	20,091,417	287,994	152,451,645

4. Risk management objectives and policies (continued)

4.3 Liquidity risk and funding management (continued)

4.3.4 Islamic derivatives financial instruments

Fair values of Islamic derivative financial instruments

The table below shows the positive and negative fair values of Islamic derivative financial instruments, which are equivalent to the market values, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of an Islamic derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of Islamic derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year end and are neither indicative of the market risk nor credit risk.

Unilateral Promise to buy/sell currencies

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

Islamic Swaps

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

				Notional amounts by term to maturity				
	Positive fair value	**Negative fair value**	**Notional amount total**	**Within 3 months**	**Over 3 months to 1 year**	**Over 1 year to 3 years**	**Over 3 to 5 years**	**Over 5 years**
	AED'000	**AED'000**	**AED'000**	**AED'000**	**AED'000**	**AED'000**	**AED'000**	**AED'000**
2017								
Islamic Derivatives held for trading:								
Unilateral promise to buy/sell currencies	**32,532**	**31,202**	**4,030,799**	**3,989,379**	**41,420**	**-**	**-**	**-**
Islamic profit rate swaps	**186,019**	**168,298**	**36,626,604**	**-**	**188,432**	**6,899,255**	**6,199,178**	**23,339,739**
Islamic currency (Call/Put) options	**10,907**	**10,907**	**822,870**	**468,073**	**25,995**	**328,802**	**-**	**-**
Total	**229,458**	**210,407**	**41,480,273**	**4,457,452**	**255,847**	**7,228,057**	**6,199,178**	**23,339,739**
	======	======	========	=======	=======	=======	=======	========
2016								
Islamic Derivatives held for trading:								
Unilateral promise to buy/sell currencies	51,991	54,163	6,960,461	5,938,497	1,021,964	-	-	-
Islamic profit rate swaps	293,354	218,577	26,648,730	1,419,982	531,661	2,812,889	3,551,003	18,333,195
Islamic currency (Call/Put) options	58,278	58,278	1,303,257	-	1,303,257	-	-	-
Total	403,623	331,018	34,912,448	7,358,479	2,856,882	2,812,889	3,551,003	18,333,195
	======	======	========	=======	=======	=======	=======	========

4. Risk management objectives and policies (continued)

4.3 Liquidity risk and funding management (continued)

4.3.5 Contingent liabilities and commitments

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

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

	Less than 3 months AED'000	3 months to 1 year AED'000	1 to 5 years AED'000	Over 5 years AED'000	Total AED'000
2016					
Contingent liabilities:					
Letters of guarantee	9,976,196	1,493,878	223,411	53,921	11,747,406
Letters of credit	2,094,601	515,073	-	-	2,609,674
	12,070,797	2,008,951	223,411	53,921	14,357,080
Capital expenditure commitments	3,417	-	1,448,461	-	1,451,878
Total	12,074,214	2,008,951	1,671,872	53,921	15,808,958

4. Risk management objectives and policies (continued)

4.4 Market risk

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

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

The trading market risk framework comprises the following elements:

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

The policies and procedures and the trading limits are set to ensure the implementation of the Group's market risk policy in day-to-day operations. These are reviewed periodically to ensure they remain in line with the Group's general market risk policy. The Chief Risk Officer ensures that the market risk management process is always adequately and appropriately staffed. In addition to its internal procedures and systems, the Group is required to comply with the guidelines and regulations of the Central Bank of the U.A.E.

4.4.1 Profit margin risk

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

4.4.2 Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group is exposed to profit rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period. The Group manages this risk through risk management strategies.

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

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

The sensitivity of the consolidated statement of profit or loss is the effect of the assumed changes in profit rates on the net income for one year, based on the variable profit rate non-trading financial assets and financial liabilities held at 31 December 2017 and 2016.

Currency	**Increase in basis points**	**2017 AED'000**	2016 AED'000
Sensitivity of net profit income	**50**	**85,979**	40,326

4.4.3 Foreign exchange risk

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

The table below summarises the Group exposure to foreign currency exchange rate risk at 31 December 2017 and 2016. Included in the table are the Group financial instruments at their carrying amounts, categorised by currency.

4. Risk management objectives and policies (continued)

4.4 Market risk (continued)

4.4.3 Foreign exchange risk (continued)

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

4. Risk management objectives and policies (continued)

4.4 Market risk (continued)

4.4.3 Foreign exchange risk (continued)

2016	AED AED'000	USD AED'000	Other G.C.C. AED'000	GBP AED'000	Euro AED'000	Other AED'000	Total AED'000
Financial Assets:							
Cash and balances with central banks	15,601,268	601,442	-	-	-	451,971	16,654,681
Due from banks and financial institutions	1,277,791	2,134,965	190,547	24,064	362,528	556,302	4,546,197
Islamic financing and investing assets, net	82,084,793	27,977,529	1,610,918	-	-	3,294,382	114,967,622
Investment in Islamic sukuk measured at amortised cost	-	22,447,573	-	-	-	961,087	23,408,660
Other investments at fair value	641,464	908,545	147,832	-	-	19,470	1,717,311
Receivables and other assets	5,784,413	283,634	9,838	-	10,102	94,557	6,182,544
Total	105,389,729	54,353,688	1,959,135	24,064	372,630	5,377,769	167,477,015
Financial Liabilities:							
Customers' deposits	100,148,008	17,362,925	41,864	37,872	200,090	4,586,191	122,376,950
Due to banks and other financial institutions	2,036,407	7,427,743	442,979	23	309,116	201,650	10,417,918
Sukuk issued	-	7,695,155	-	-	-	-	7,695,155
Payables and other liabilities	5,454,578	999,439	91,890	551	6,094	152,710	6,705,262
Total	107,638,993	33,485,262	576,733	38,446	515,300	4,940,551	147,195,285
Net on balance sheet	(2,249,264)	20,868,426	1,382,402	(14,382)	(142,670)	437,218	20,281,730
Unilateral promise to buy/sell currencies	2,607,220	(1,445,736)	(1,282,119)	21,998	98,462	(1,806)	(1,981)
Currency position - long/(short)	357,956	19,422,690	100,283	7,616	(44,208)	435,412	20,279,749

4. Risk management objectives and policies (continued)

4.4 Market risk (continued)

4.4.3 Foreign exchange risk (continued)

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

The tables below indicate the extent to which the Group was exposed to currency risk at 31 December 2017 and 2016 on its non-trading monetary assets and liabilities, and forecast cash flows. The analysis is performed for a reasonable possible movement of the currency rate against the AED with all other variables held constant on the consolidated statement of profit or loss (due to the changes in the fair values of currency sensitive non-trading monetary assets and liabilities) and equity (due to the change in fair value of foreign currency denominated available-for-sale equity instruments). A negative amount in the table reflects a potential net reduction in consolidated statement of profit or loss and equity, while a positive amount reflects a net potential increase. The sensitivity analysis does not take account of actions by the Group that might be taken to mitigate the effect of such changes.

Currency	Increase in currency rate in %	Effect on profit or loss 2017 AED'000	Effect on profit or loss 2016 AED'000
US Dollar	+2	**371,246**	388,454
GBP	+2	**1,905**	152
EURO	+2	**1,161**	(884)

Currency	Decrease in currency rate in %	Effect on profit or loss 2017 AED'000	Effect on profit or loss 2016 AED '000
US Dollar	-2	**(371,246)**	(388,454)
GBP	-2	**(1,905)**	(152)
EURO	-2	**(1,161)**	884

4.4.4 Foreign investment

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

The table below indicates the change in recorded profit before tax and equity had the result for the year ended 31 December 2017 and 2016 been translated at exchange rates against the AED adjusted, with all other variables held constant, by the assumed changes below. The sensitivity analyses do not take account of actions by the Group that might be taken to mitigate the effect of such changes.

Currency	Increase in currency rate in %	Effect on profit or loss 2017 AED'000	Effect on equity 2017 AED'000	Effect on profit or loss 2016 AED'000	Effect on equity 2016 AED'000
Pak Rupees	+5	**2,839**	**27,011**	1,626	22,534
Egypt Sterling	+5	**441**	**4,307**	554	3,534

4. Risk management objectives and policies (continued)

4.4 Market risk (continued)

4.4.4 Foreign investment (continued)

Currency	Decrease in currency rate in %	Effect on profit or loss 2017 AED'000	Effect on equity 2017 AED'000	Effect on profit or loss 2016 AED'000	Effect on equity 2016 AED'000
Pak Rupees	**-5**	**(2,569)**	**(23,409)**	(1,471)	(20,388)
Egypt Sterling	**-5**	**(399)**	**(3,897)**	(501)	(3,197)

4.4.5 Equity price risk

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

The effect on equity (as a result of a change in the fair value of equity instruments held as fair value through other comprehensive income (FVTOCI) at 31 December 2017 and 2016) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

Market indices	Change in market Indices %	Effect on other comprehensive income 2017 AED'000	Effect on other comprehensive income 2016 AED'000
Dubai Financial Market	**± 5%**	**21,582**	17,577
Abu Dhabi Exchange	**± 5%**	**1,136**	1,729
Bahrain Stock Exchange	**± 5%**	**1,407**	2,272
Other	**± 5%**	**4,483**	5,201

An increase of 5% in fair value of Level 3 of financial instruments due to change in unquoted market price / valuation of financial instruments as at the reporting date would have increased the net assets attributable to the Bank by AED 50.1 million (2016: AED 44.8 million)

4.5 Operational risk

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

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

The Group is currently using operational risk tracking system, i.e. ORMIS to track operational risk events across the Group. The system houses three years of operational loss data. The subject system is currently enhanced to automate KRI, RCSA and scenario based fraud risk self-assessment modules.

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

4. Risk management objectives and policies (Continued)

4.6 Stress Testing

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

4.7 Regulatory/Compliance Risk

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

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

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

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

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

4.8 Reputational Risk

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

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

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