Basel III – Pillar III Disclosures

2020

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بنك دبي الإسلامي
Dubai Islamic Bank

1. Overview and Introduction

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

The Bank is regulated by the Central Bank of the United Arab Emirates ("CBUAE") and follows the Pillar 3 disclosure requirement guidelines issued by the CBUAE. In February 2017, new Basel III capital regulations issued by CBUAE came into effect for all Banks in the UAE. Additional guidelines for Basel III were issued over the course of 2019/2020.

The CBUAE Basel III framework addresses the importance of developing and implementing enhanced risk management techniques for monitoring and managing the risks and intends to strengthen the market discipline and risk management practices of UAE Banks.

The Pillar III disclosures provide both qualitative and quantitative information at Group level in order to meet the disclosure requirements. Some of the Pillar III requirements have been disclosed in the audited consolidated financial statement for the year ended 31 December 2020, which covers the risk and capital management processes of the Group and its compliance with the Basel Accords.

1.1 Basel Regulatory Framework

The Basel Accord framework consists of following three main pillars:

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

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

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

1.2 Differences between Financial Statements and Pillar III Reporting of Credit Risk Exposures

Credit risk exposures reported under Pillar III differ in respect of the following vis-à-vis financial statements:

- As per CBUAE Basel framework, off balance sheet exposures are converted, by applying a credit conversion factor (CCF), into equivalent credit exposures;
- Deferred Tax Assets and Intangible assets are deducted from Capital and not taken under credit risk weighted assets;
- Commercial subsidiaries are completely deconsolidated and only the investments at cost in those entities are taken for risk weight purposes; reserves and retained earnings in these companies are deducted from the group capital. Any intra group loans to such entities are treated as third party loans for risk weighting purposes;
- Under the comprehensive credit risk mitigation approach, eligible collaterals are considered, subject to regulatory haircuts, to estimate and report net exposure;
- General provisions are not netted off against loans but used as Tier 2 capital up to 1.25% of Credit RWA;

1.3 Future Regulatory Developments

The regulation and supervision of financial institutions has undergone a significant change since the global financial crisis. CBUAE Basel III capital regulations have been implemented and are complied by the Bank.

All revised capital standards for 2020 as per Basel III guidelines on capital standards for Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Capital Buffers such as Capital Conservation Buffer (CCB) and Domestic Systemically Important Banks Buffer (DSIB) are implemented. There is close coordination between UAE Banks and CBUAE for the smooth implementation of any forthcoming new guidelines and disclosure requirements.

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1. Overview and Introduction (continued)

1.3 Future Regulatory Developments (continued)

In November 2020, CBUAE has issued final standards on the Pillar III disclosure requirements which will replace the current Pillar III disclosure requirements. The revised requirements will become effective from Q4 2021.

Implementation and Compliance of Basel Framework Guidelines

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

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

Verification:

The Pillar III disclosures for the year ended 31 December 2020 have been appropriately verified internally, but are not subject to audit by the Bank's external auditor.

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2. Group Structure - Information on Subsidiaries and Significant Investments

The Group consists of Dubai Islamic Bank P.J.S.C. and its subsidiaries. As of 31 December 2020, the Group's interest held directly or indirectly in its financial and non-financial subsidiaries are as follows:

	Name of subsidiary	Principal activity	Place of incorporation and operation	Ownership interest and voting power	
				2020	2019
1.	Dubai Islamic Bank Pakistan Ltd.	Banking	Pakistan	**100.0%**	100.0%
2.	Noor Bank P.J.S.C.	Banking	U.A.E	**100.0%**	-
3.	Tamweel P.S.C	Financing	U.A.E	**92.0%**	92.0%
4.	DIB Bank Kenya Ltd.	Banking	Kenya	**100.0%**	100.0%
5.	Dubai Islamic Financial Services L.L.C.	Brokerage services	U.A.E.	**99.0%**	99.0%
6.	Deyaar Development P.J.S.C.	Real estate development	U.A.E	**44.9%**	44.9%
7.	Dar al Shariah Financial & Legal Consultancy L.L.C.	Financial and legal advisory	U.A.E.	**60.0%**	60.0%
8.	Al Tanmyah Services L.L.C.	Labour services	U.A.E.	**99.5%**	99.5%
9.	Al Tatweer Al Hadith Real Estate	Real estate development	Egypt	**100.0%**	100.0%
10.	Al Tameer Modern Real Estate Investment	Real estate development	Egypt	**100.0%**	100.0%
11.	Al Tanmia Modern Real Estate Investment	Real estate development	Egypt	**100.0%**	100.0%
12.	Naseej Private Property Management Services	Property management	U.A.E.	**99.0%**	99.0%
13.	Dubai Islamic Bank Printing Press L.L.C.	Printing	U.A.E.	**99.5%**	99.5%
14.	Al Islami Real Estate Investments Ltd.	Investments	U.A.E.	**100.0%**	100.0%
15.	Dubai Islamic Trading Center L.L.C.	Trading in vehicles	U.A.E.	**100.0%**	100.0%
16.	Creek Union Limited FZ LLC	Investments	U.A.E	**100.0%**	100.0%
17.	Madinat Bader Properties Co. L.L.C.	Real Estate Development	U.A.E.	**99.0%**	99.0%
18.	Premium Marketing Services L.L.C	Outsourcing and Marketing activities	U.A.E	**100.0%**	-
19.	Noor BPO L.L.C	Outsourcing and Consultancy services	U.A.E	**100.0%**	-
20.	Zawaya Realty L.L.C	Real Estate Management Services	U.A.E	**100.0%**	-

In addition to the registered ownership described above, the remaining equity in the entities 5, 8, 12, 13 and 17 are also beneficially held by the Bank through nominee arrangements.

Below is the list of Special Purpose Vehicles (SPV) which were formed to manage specific transactions including funds, and are expected to be closed upon completion of the related transactions:

	Name of SPV	Principal activity	Place of incorporation and operation	Ownership interest and voting power	
				2020	2019
21.	HoldInvest Real Estate Sarl	Investments	Luxembourg	**100.0%**	100.0%
22.	France Invest Real Estate SAS	Investments	France	**100.0%**	100.0%
23.	SARL Barbanniers	Investments	France	**100.0%**	100.0%
24.	SCI le Sevine	Investments	France	**100.0%**	100.0%
25.	Al Islami Trade Finance FZ L.L.C.	Investments	U.A.E.	**100.0%**	100.0%
26.	MESC Investment Company	Investments	Jordan	**40.0%**	40.0%
27.	Levant One Investment Limited	Investments	U.A.E.	**100.0%**	100.0%
28.	Petra Limited	Investments	Cayman Islands	**100.0%**	100.0%

2. Group Structure - Information on Subsidiaries and Significant Investments (continued)

29.	Deyaar Investments LLC	Investments	U.A.E.	**Controlling Interest**	Controlling Interest
30.	Deyaar Funds LLC	Investments	U.A.E.	**Controlling Interest**	Controlling Interest
31.	Sequia Investments L.L.C.	Investments	U.A.E.	**99.0%**	99.0%
32.	Blue Nile Investments L.L.C.	Investments	U.A.E.	**99.0%**	99.0%
33.	DIB FM Ltd	Investments	Cayman Islands	**100.0%**	100.0%
34.	Noor Sukuk Company Limited	Investments	Cayman Islands	**100.0%**	-
35.	Noor Tier 1 Sukuk Limited	Investments	Cayman Islands	**100.0%**	-
36.	Noor Structured Certificates Ltd.	Investments	Cayman Islands	**100.0%**	-
37.	Noor Derivatives Limited	Investments	Cayman Islands	**100.0%**	-

In addition to the registered ownership described above, the remaining equity in the entities 29, 30, 31 and 32 are also beneficially held by the Bank through nominee arrangements.

3. Capital Management Structure and Policies

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 and 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.

3.1 Capital Management Objectives

The Bank objectives with managing capital, which is a broader concept than the 'equity' on the face of consolidated financial position are:

- To maintain optimal capital level, both in terms of quality and quantity, and in line with regulatory and internal targets for capital adequacy ;
- To Support Risk Appetite and future business plans and to optimize shareholder value;
- To maintain financial strength, absorb losses so as to withstand adverse economic conditions, allow for growth opportunities and meet other risk management and business objectives.

3.2 Regulatory Capital

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

The Bank's regulatory capital is analysed into following tiers:

- Common Equity Tier 1 (CET1), which includes fully paid up capital, statutory reserve, general reserve, retained earnings, exchange translation reserve and investment fair value reserve. Regulatory adjustments under Basel III, which includes deductions of deferred tax assets, investments in banking and financial entities and other threshold deductions;
- Tier 1 capital, which includes CET1, with additional items that consist of Tier 1 capital instruments and certain non-controlling interests in subsidiaries; and
- Tier 2 capital, which includes collective impairment allowance and qualifying subordinated liabilities, if any.

CBUAE has put in regulatory thresholds for Common Equity Tier 1, Tier 1 and overall regulatory Capital.

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

The Bank was recognized as Domestic Systemically Important Bank (D-SIB) during the year ended 31 December 2018 and is accordingly required to keep a D-SIB buffer of 0.5% in addition to the CCB of 2.5%.

As per the Central Bank regulation for Basel III, the minimum capital requirement as at 31 December 2020 is 13.5% inclusive of capital conservation buffer of 2.5% and D-SIB buffer of 0.5%. However, effective from 15 March 2020 until 31 December 2021, banks are allowed to tap into the capital conservation buffer up to a maximum of 60% and to use 100% of their D-SIB buffer without supervisory consequences, as part of the measures adopted by the CBUAE to help banks deal with the COVID-19 crisis. Further, CBUAE has issued guidance on Accounting Provisions and Capital Requirements - Transitional Arrangement dated 22 April 2020. The Prudential Filter allows banks to add back increases in IFRS9 ECL provision, stage 1 and 2, from 31 December 2019 to the regulatory capital and transition over 5 years.

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

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

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

3 Capital Management Structure and Policies (continued)

3.2 Regulatory Capital (continued)

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

	2020	2019
	AED'000	AED'000
Common Equity Tier 1 (CET1)		
Share capital	**7,240,744**	6,589,585
Other reserves	**13,784,668**	10,860,963
Retained earnings	**8,414,214**	7,602,471
Cumulative deferred exchange losses	**(1,176,707)**	(1,094,745)
Investment fair value reserve	**(1,102,451)**	(1,174,698)
Prudential filters transitional adjustment	**27,340**	-
Intangible assets	**(219,205)**	-
Deferred tax assets	**(40,442)**	(36,224)
Total CET 1 Capital	**26,928,161**	22,747,352
Additional Tier 1 Capital		
Tier 1 Sukuk	**11,937,250**	6,427,750
Total Additional Tier 1 Capital	**11,937,250**	6,427,750
Total Tier 1 Capital	**38,865,411**	29,175,102
Tier 2 Capital		
Collective impairment allowance	**2,561,671**	2,155,925
Total Tier 2 Capital	**2,561,671**	2,155,925
Total capital base	**41,427,082**	31,331,027
Risk weighted assets		
Credit risk	**204,933,644**	172,474,010
Market risk	**2,582,249**	2,158,934
Operational risk	**16,564,437**	14,922,142
Total risk weighted assets	**224,080,330**	189,555,086
Capital Ratios		
Capital adequacy ratio	**18.5%**	16.5%
Tier 1 Capital ratio	**17.3%**	15.4%
Common Equity Tier 1 ratio	**12.0%**	12.0%

The capital adequacy ratio for the year 2020 has been calculated after considering the impact of the proposed dividend as required by Capital Supply Standard and the related guidance issued by Central Bank of the UAE.

Total capital adequacy ratios for each significant banking subsidiary:		
DIB Pakistan ("Basel III total capital adequacy ratio")	**16.7%**	14.0%
DIB Kenya ("Basel III Total capital adequacy ratio")	**16.2%**	15.3%

3 Capital Management Structure and Policies (continued)

3.2 Regulatory Capital (continued)

The capital adequacy ratio for the year ended 31 December 2020 has been calculated after considering the impact of the proposed dividend as required by the Capital Supply Standard and the related guidance issued by the CBUAE.
The financial subsidiaries of the Bank are regulated by their local supervisors who set and monitor their capital adequacy requirements. CBUAE monitors the capital adequacy requirements of the Bank at a financial group level.

3.3 Tier 1 Sukuk

SPV ("the Issuer")	Date of issuance	Discretionary profit rate	Callable period	Issuance amount Equivalent AED '000	
				31 December 2020	31 December 2019
DIB Tier 1 Sukuk (2) Limited	January 2015	6.75% per annum paid semi-annually	On or after January 2021	**3,673,000**	3,673,000
DIB Tier 1 Sukuk (3) Limited	January 2019	6.25% per annum paid semi-annually	On or after January 2025	**2,754,750**	2,754,750
DIB Tier 1 Sukuk (4) Limited	November 2020	4.63% per annum paid semi-annually	On or after May 2026	**3,673,000**	-
Noor Tier 1 Sukuk Limited	May 2016	6.25% per annum paid semiannually	On or after June 2021	**1,836,500**	-
				11,937,250	6,427,750

Tier 1 Sukuk is a perpetual security in respect of which there is no fixed redemption date and constitutes direct, unsecured, subordinated obligations (senior only to share capital) of the Bank subject to the terms and conditions of the Mudaraba Agreement. The Tier 1 Sukuk are listed on the Irish Stock Exchange and Dubai Financial Market / Nasdaq Dubai callable by the Bank after the "First Call Date" or any profit payment date thereafter subject to certain redemption conditions.

The net proceeds of Tier 1 Sukuk are invested by way of Mudaraba with the Bank (as Mudareb) on an unrestricted co-mingling basis, by the Bank in its general business activities carried out through the Mudaraba Common pool.

At the Issuer's sole discretion, it may elect not to make any Mudaraba profit distributions expected and the event is not considered an event of default. In such event, the Mudaraba profit will not be accumulated but forfeited to the issuer. If the Issuer makes a non-payment election or a non-payment event occurs, then the Bank will not (a) declare or pay any distribution or dividend or make any other payment on, and will procure that no distribution or dividend or other payment is made on ordinary shares issued by the Bank, or (b) directly or indirectly redeem, purchase, cancel, reduce or otherwise acquire ordinary shares issued by the Bank.

3 Capital Management Structure and Policies (continued)

3.4 Risk Weighted Assets

3.4.1 Credit Risk Weighted Assets

The details of Credit Risk Weighted Assets as of 31 December 2020 are as follows:

	Gross Exposure AED'000[1]	**Risk Weighted Assets AED'000**
Claims on sovereigns	**74,038,786**	**9,872,753**
Claims on non-commercial public sector enterprises (PSEs)	**3,663,505**	**-**
Claims on multilateral development banks	**-**	**-**
Claims on banks	**10,830,095**	**4,553,466**
Claims on corporate and government related entities (GRE)	**153,796,853**	**119,570,623**
Claims included in the regulatory retail portfolio	**26,101,673**	**19,613,654**
Claims secured by residential property	**21,887,006**	**14,219,561**
Claims secured by commercial real estate	**11,765,589**	**10,904,274**
Past due financing assets	**15,668,475**	**10,765,802**
Higher-risk categories	**1,355,180**	**2,032,770**
Other assets	**16,790,973**	**13,400,741**
Total	**335,898,136**	**204,933,644**

The details of Credit Risk Weighted Assets as of 31 December 2019 are as follows:

	Gross Exposure AED'000	Risk Weighted Assets AED'000
Claims on sovereigns	47,834,224	10,010,869
Claims on non-commercial public sector enterprises (PSEs)	2,322,837	-
Claims on multilateral development banks	156,142	-
Claims on banks	9,978,625	4,234,538
Claims on corporate and government related entities (GRE)	136,515,226	104,153,535
Claims included in the regulatory retail portfolio	26,016,259	18,856,457
Claims secured by residential property	13,944,194	7,738,447
Claims secured by commercial real estate	10,149,136	9,925,709
Past due financing assets	8,758,447	5,308,521
Higher-risk categories	704,178	615,889
Other assets	13,016,841	11,630,045
Total	269,396,109	172,474,009

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.

[1] As per BRF 95

3 Capital Management Structure and Policies (continued)

3.4 Risk Weighted Assets (continued)

3.4.2 Market Risk Weighted Assets (continued)

As of 31 December 2020, the capital requirement for Market Risk as per standardized approach was as follows:

	2020 AED'000	2019 AED'000
Profit rate risk	92,433	108,651
Foreign exchange risk	204,526	182,800
Equity	-	5
Total capital requirement for market risk	**296,959**	291,456

3.4.3 Operational Risk Weighted Assets

In accordance with Basel III guidelines operational risk charge is computed by multiplying the beta factors of respective banking business activities as required by the Standardised Approach. The total capital requirement for Operational Risk as at 31 December 2020 is AED 1,904 million (31 December 2019: AED 2,014 million).

3.5 Qualitative Risk Disclosures

For each separate risk area (credit, market, operational and equity risk) banks are required to describe their risk management objectives and policies, which primarily include strategies, processes, organization framework, reporting and measurement systems. These disclosures are discussed and are set out in the "Risk Management" section of the DIB 2020 Annual Report and Notes 47 refers to capital management of the audited consolidated financial statements. Also, refer to section 4 of this report for cross-referencing information.

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4. Risk Management Objectives and Policies

4.1 Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement and monitoring and is 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 but not limited to:

- Credit risk;
- Liquidity risk;
- Market risk;
- Operational risk;
- Reputational risk;
- Regulatory / compliance risk; and
- Sharia compliance risk

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

4.1.1 Risk Management Structure

The Board of Directors, supported by; the Board Risk Compliance and Governance Committee, Risk Management Committee of the management and Group Risk Management Department, is ultimately responsible for identifying, monitoring and controlling risks. Additionally there are other independent bodies / functions also 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 Compliance and Governance Committees

The Board Risk Compliance and Governance 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 monitoring of risk has been delegated to Risk Management Committee of the management.

The Risk Management Committee has the overall responsibility to support the Board Risk Compliance and Governance Committee for the development and formulation of the risk strategies, 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.).

Group Risk Management Department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure risk remains within the acceptable range as approved by the Board Risk Compliance and Governance 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 Bank's assets and liabilities. It is also primarily responsible for the funding and liquidity risks of the Bank.

4 Risk Management Objectives and Policies (continued)

4.1 Introduction (continued)

4.1.1 Risk Management Structure (continued)

Group Internal Audit Department

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

Internal Sharia Audit Department

Compliance with Sharia and the Fatawa issued by the ISSC of the Bank in all the matters of the Bank including the execution of the transactions are audited periodically by the Internal Sharia Audit Department which examines the adequacy of the procedures and the Group's compliance with the Fatawa and guidance of the ISSC. Internal Sharia Audit Department discusses the findings of their assessments with the management and submits the findings along with responses of the relevant departments and its recommendations to the ISSC then to the Board Audit Committee.

Group Compliance Department

The Group has an independent Compliance function, with the necessary mandate and authority to enforce and monitor compliance on a Group wide basis. This includes compliance with the applicable laws and regulations across the various jurisdictions where the Group operates as well as those of the USD / EU clearing centers.

Compliance policies covering key areas such as Sanctions, Anti Money Laundering (AML), Counter Terrorist Financing (CTF), Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS) are applicable Group wide and are supplemented where necessary to address any unique local requirements. These policies are supported by automated screening and monitoring systems and associated investigation teams to help comply with the Sanctions, AML, CTF, FATCA and CRS requirements. Independent Compliance Monitoring is undertaken to provide assurance over the effectiveness of controls. Mandatory Compliance Training is provided to all relevant staff both at onboarding and periodically thereafter to help ensure that key requirements are complied with.

Sharia Compliance Unit

Moreover, there is a Sharia Compliance Unit under Internal Sharia Control Department of the Bank which constantly monitors Sharia Risk and Sharia compliance level of the Bank and submits its quarterly reports to the ISSC and the management.

4.1.2 Risk Measurement and Reporting Systems

The Group measures risks using qualitative as well as quantitative 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 but plausible, 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, and Board Risk Compliance and Governance Committee. Specialized reports are presented to the pertinent heads of business that a delivered with a frequency suited to the volatility of the risk. The report includes aggregate credit exposure,

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4 Risk Management Objectives and Policies (continued)

4.1 Introduction (continued)

4.1.2 Risk Measurement and Reporting Systems (continued)

limit exceptions, liquidity, operational loss incidents and other risk profile changes. On a monthly basis, detailed reporting of industry, customer and geographic risks also takes place. Senior management assesses the appropriateness of the provision for impairment losses on a quarterly basis.

4.1.3 Model Risk Management

The Bank uses a number of quantitative models in many of its financial and business activities from underwriting a credit facility to reporting expected credit losses under IFRS 9 and many other areas.

To manage the model risks, the Bank has developed and implemented Model Risk Management Policy which contains Bank wide development, implementation and validation policies and practices. According to the framework, all internally or externally developed risk quantification models that directly affect the financial reporting on expected credit losses require validation periodically (internally or externally). Model Risk Management Committee (MRMC) is responsible for overseeing all model related development, implementation of framework and performance of the models. MRMC reports to Risk Management Committee of the Bank.

The Framework establishes a systematic approach to manage the development, implementation, approval, validation and ongoing use of models. It sets out an effective governance and management structure with clearly defined roles and responsibilities, policies and controls for managing model risk. The Framework is reviewed on a regular basis to ensure it meets regulatory standards and international practices. Any major change to the Framework is approved by the Risk Management Committee upon recommendation of MRMC.

The Bank has an independent validation function that performs independent model validation. It provides Fit-for-Purpose, Conditional Approval or Not Fit-for-Purpose recommendation to MRMC to approve the use of the new risk quantification / valuation models. In addition to new model validation, the validation function also evaluates the performance of existing models through an annual validation process.

4.1.4 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 mitigate its credit risks.

In order to guard against liquidity risk, management has diversified funding sources and assets are managed with overall liquidity in consideration maintaining a healthy quality 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 prices.

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

4.1.5 Risk Concentration

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

4.2.1 Credit Risk Measurement

The Group assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparties. These segments include: Corporate, Contracting, SME, FI and Real Estate. Models are developed with the external support of accredited consultants and are also subjected to external validation. Models are calibrated to the Group's internal rating scale, and are housed within the Moody's CreditLens platform.

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.

4.2.2 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.

4.2.3 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.

4.2.4 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.

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

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

	Gross Maximum Exposure 2020 AED'000[2]	Gross Maximum Exposure 2019 AED'000
Balances with central banks	**27,005,414**	19,598,494
Due from banks and financial institutions	**6,451,509**	6,251,739
Islamic financing and investing assets	**205,089,878**	156,994,111
Investment in Islamic Sukuk measured at amortised cost	**35,461,891**	33,343,437
Other investments measured at fair value	**1,110,962**	1,266,235
Receivables and other assets	**10,397,637**	9,406,206
	285,517,291	226,860,222
Contingent liabilities	**14,842,674**	14,454,548
Commitments	**27,095,313**	19,440,465
Total	**327,455,278**	260,755,235

[2] Financial assets as per financial statement

4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

4.2.6 Risk concentrations of the maximum exposure to credit risk

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

	2020 AED'000	2019 AED'000
The U.A.E.	**292,727,776**	228,699,898
Other Gulf Cooperation Council (GCC) countries	**11,681,221**	10,364,264
Asia	**14,284,729**	14,595,349
Europe	**6,805,688**	5,804,403
Africa	**419,558**	543,349
Others	**1,536,306**	747,972
Total	**327,455,278**	260,755,235

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

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

	Gross Maximum Exposure 2020 AED'000	Gross Maximum Exposure 2019 AED'000
Government	**54,067,144**	27,589,909
Financial Institutions	**54,073,712**	44,856,620
Real estate	**63,030,203**	51,764,791
Contracting	**12,137,645**	13,831,768
Trade	**13,159,738**	12,440,448
Aviation	**22,562,428**	19,808,739
Services and manufacturing	**54,361,717**	44,778,960
Consumer financing	**32,678,443**	30,874,518
Consumer home finance	**21,384,248**	14,809,482
Total	**327,455,278**	260,755,235

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4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

4.2.7 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 2020 is detailed below:

December 2020 AED'000	On & Off Balance Sheet Gross Outstanding	Credit Risk Mitigation (CRM)		Net exposure after CCF	Risk Weighted Assets
		Exposure Before Credit Risk Mitigation (CRM)	Credit Risk Mitigation (CRM)		
Claims on sovereigns	74,038,786	74,038,786	_	73,978,986	9,872,753
Claims on non-commercial public sector enterprises (PSEs)	3,663,505	3,663,505	_	3,567,880	_
Claims On Multi-Lateral Development Banks	_	_	_	_	_
Claims on banks	10,830,095	10,830,096	14,738	10,823,411	4,553,466
Claims on corporate and government related enterprises	153,796,853	153,228,413	10,031,201	129,572,147	119,570,623
Claims included in the regulatory retail portfolio	26,101,673	26,101,261	65,406	26,037,876	19,613,654
Claims secured by residential property	21,887,006	21,814,631	15,992	21,814,631	14,219,561
Claims secured by commercial real estate	11,765,589	11,649,720	220,040	11,068,712	10,904,274
Past due financing assets	15,668,475	9,182,155	24,684	9,166,855	10,765,802
Higher-risk categories	1,355,180	1,355,180	_	1,355,180	2,032,770
Other assets	16,790,973	16,790,860	1,820,482	16,790,860	13,400,741
Total	**335,898,136**	**328,654,608**	**12,192,544**	**304,176,539**	**204,933,644**

4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

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

The gross credit exposure as per standardized approach with the effect of CRM as of 31 December 2019 is detailed below:

December 2019		Credit Risk Mitigation (CRM)			
AED'000	On & Off Balance Sheet Gross Outstanding	Exposure Before Credit Risk Mitigation (CRM)	Credit Risk Mitigation (CRM)	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	47,834,224	47,834,224	–	47,110,334	10,010,869
Claims on non-commercial public sector enterprises (PSEs)	2,322,837	2,322,837	–	2,322,837	–
Claims On Multi-Lateral Development Banks	156,142	156,142	–	156,142	–
Claims on banks	9,978,625	9,978,625	16,713	9,955,814	4,234,538
Claims on corporate and government related enterprises	136,515,226	136,509,756	9,434,215	105,115,608	104,153,535
Claims included in the regulatory retail portfolio	26,016,259	26,014,098	1,025,682	24,985,765	18,856,457
Claims secured by residential property	13,944,194	13,802,754	–	13,802,754	7,738,447
Claims secured by commercial real estate	10,149,136	10,051,183	132,774	9,934,034	9,925,709
Past due financing assets	8,758,447	4,339,072	1,801	4,302,801	5,308,521
Higher-risk categories	704,178	704,178	293,585	410,593	615,889
Other assets	13,016,841	13,016,841	62,113	12,954,728	11,630,045
Total	269,396,109	264,729,710	10,966,882	231,051,409	172,474,009

4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

4.2.8 Gross credit risk exposures as per standardised approach

The gross credit exposures as per standardized approach in terms of rated/unrated assets as of 31 December 2020 is detailed below:

AED'000	Rated	Unrated	Total Gross Outstanding	Exposure Before CRM	Credit Risk Mitigation	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	16,673,721	57,365,065	74,038,786	74,038,786	_	73,978,986	9,872,753
Claims on non-commercial public sector enterprises (PSEs)	_	3,663,505	3,663,505	3,663,505	–	3,567,880	_
Claims On Multi-Lateral Development Banks	_	_	_	_	_	_	_
Claims on banks	8,392,518	2,437,577	10,830,095	10,830,096	14,738	10,823,411	4,553,466
Claims on corporate and government related enterprises (GREs)	8,022,236	145,774,617	153,796,853	153,228,413	10,031,201	129,572,147	119,570,623
Claims included in the regulatory retail portfolio	_	26,101,673	26,101,673	26,101,261	65,406	26,037,876	19,613,654
Claims secured by residential property	_	21,887,006	21,887,006	21,814,631	15,992	21,814,631	14,219,561
Claims secured by commercial real estate	_	11,765,589	11,765,589	11,649,720	220,040	11,068,712	10,904,274
Past due financing assets	_	15,668,475	15,668,475	9,182,155	24,684	9,166,855	10,765,802
Higher-risk categories	_	1,355,180	1,355,180	1,355,180	_	1,355,180	2,032,770
Other assets	_	16,790,973	16,790,973	16,790,860	1,820,482	16,790,860	13,400,741
Total	33,088,475	302,809,661	335,898,136	328,654,608	12,192,544	304,176,539	204,933,644

4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

4.2.8 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 2019 is detailed below:

AED'000	Rated	Unrated	Total Gross Outstanding	Exposure Before CRM	Credit Risk Mitigation	Net exposure after CCF	Risk Weighted Assets
Claims on sovereigns	20,447,784	27,386,440	47,834,224	47,834,224	_	47,110,334	10,010,869
Claims on non-commercial public sector enterprises (PSEs)	_	2,322,837	2,322,837	2,322,837	–	2,322,837	_
Claims On Multi-Lateral Development Banks	156,142	_	156,142	156,142	_	156,142	_
Claims on banks	7,976,303	2,002,322	9,978,625	9,978,625	16,713	9,955,814	4,234,539
Claims on corporate and government related enterprises (GREs)	10,544,573	125,970,653	136,515,226	136,509,756	9,434,215	105,115,608	104,153,535
Claims included in the regulatory retail portfolio	_	26,016,259	26,016,259	26,014,098	1,025,682	24,985,765	18,856,457
Claims secured by residential property	_	13,944,194	13,944,194	13,802,754	_	13,802,754	7,738,447
Claims secured by commercial real estate	_	10,149,136	10,149,136	10,051,183	132,774	9,934,034	9,925,709
Past due financing assets	_	8,758,447	8,758,447	4,339,072	1,801	4,302,801	5,308,521
Higher-risk categories	_	704,178	704,178	704,178	293,585	410,593	615,889
Other assets	_	13,016,841	13,016,841	13,016,841	62,113	12,954,728	11,630,045
Total	39,124,802	230,271,307	269,396,109	264,729,710	10,966,882	231,051,409	172,474,009

4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

4.2.9 Analysis of credit quality

Carrying value of exposure by internal risk rating category and by stage

As at 31 December 2020

	Gross book values (AED'000)					Expected credit loss (AED'000)				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Low	67,446,626	-	-	-	67,446,626	19,162	-	-	-	19,162
Moderate	91,197,679	6,431,144	-	-	97,628,823	773,725	312,057	-	-	1,085,782
Fair	17,900,696	10,052,806	-	-	27,953,502	339,785	624,562	-	-	964,347
Default	-	-	10,838,957	1,221,971	12,060,928	-	-	6,314,658	16,899	6,331,557
Total Islamic financing	**176,545,001**	**16,483,950**	**10,838,957**	**1,221,971**	**205,089,879**	**1,132,672**	**936,619**	**6,314,658**	**16,899**	**8,400,848**
Balances with CB, due from banks and FIs	33,456,923	-	-	-	33,456,923	2,918	-	-	-	2,918
Investments in Islamic Sukuk and other investments at FV	36,528,591	-	44,261	-	36,572,853	96,363	-	22,131	-	118,493
Receivables and other assets	7,573,482	645,464	2,178,691	-	10,397,637	-	10,000	876,403	-	886,403
Total Non- Financing	**77,558,996**	**645,464**	**22,22,952**	**-**	**80,427,413**	**99,281**	**10,000**	**898,534**	**-**	**1,007,814**
Contingent liabilities and commitments	41,937,987	-	-	-	41,937,987	30,913	-	-	-	30,913
Gross maximum exposure to credit risk	**296,041,985**	**17,129,414**	**13,061,909**	**1,221,971**	**327,455,279**	**1,262,865**	**946,619**	**7,213,192**	**16,899**	**9,439,575**

As at 31 December 2019

	Gross book values (AED'000)					Expected credit loss (AED'000)				
	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total
Low	43,764,785	-	-	-	43,764,785	9,668	-	-	-	9,668
Moderate	81,014,810	5,793,870	-	-	86,808,680	850,024	330,841	-	-	1,180,865
Fair	13,887,833	6,307,642	-	-	20,195,475	216,303	635,104	-	-	851,407
Default	-	-	6,225,171	-	6,225,171	-	-	4,038,743	-	4,038,743
Total Islamic Financing	138,667,428	12,101,512	6,225,171	-	156,994,111	1,075,995	965,945	4,038,743	-	6,080,683
Balances with CB, due from banks and FIs	25,850,233	-	-	-	25,850,233	3,566	-	-	-	3,566
Investments in Islamic Sukuk and other investments at FV	34,609,672	-	-	-	34,609,672	99,579	-	-	-	99,579
Receivables and other assets	6,311,120	1,321,952	1,773,134	-	9,406,206	-	-	630,294	-	630,294
Total Non-Financing	66,771,025	1,321,952	1,773,134	-	69,866,111	103,145	-	630,294	-	733,439
Contingent liabilities and commitments	33,895,013	-	-	-	33,895,013	-	-	-	-	-
Gross maximum exposure to credit risk	239,333,466	13,423,464	7,998,305	-	260,755,235	1,179,140	965,945	4,669,037	-	6,814,122

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4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

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

	Moody's equivalent grades	Total 2020 AED'000	Total 2019 AED'000
Low risk			
Risk rating classes 1 to 3	Aaa – A3	**142,538,119**	105,962,274
Moderate risk			
Risk rating classes 4 to 5	Baa1 – Ba3	**128,494,414**	117,632,360
Fair risk			
Risk rating classes 6 to 7	B1 - Caa3	**43,413,692**	29,933,278
Default			
Risk rating classes 8 to11	Ca - C	**13,009,053**	7,227,323
		327,455,278	260,755,235

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

4.2.11 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
2020			
Government	**22,719,913**	**3,691,050**	**26,410,963**
Financial institutions	**8,398,452**	**1,076,379**	**9,474,831**
Real estate	**41,908,952**	**493,451**	**42,402,403**
Contracting	**4,193,307**	**1,146,929**	**5,340,236**
Trade	**7,091,342**	**1,068,915**	**8,160,257**
Aviation	**20,425,447**	**120,522**	**20,545,969**
Services and others	**38,341,686**	**3,607,718**	**41,949,404**
Consumer home finance	**29,115,345**	**546,695**	**29,662,040**
Consumer financing	**20,884,627**	**259,149**	**21,143,776**
	193,079,071	**12,010,808**	**205,089,879**
Less: provision for impairment			**(8,400,848)**
Total			**196,689,031**

4. Risk Management Objectives and Policies (continued)

4.2 Credit Risk (continued)

4.2.11 Analysis by Economic Sector and Geography (continued)

2019	Within the U.A.E. AED'000	Outside the U.A.E. AED'000	Total AED'000
Government	6,277,755	2,852,836	9,130,591
Financial institutions	5,816,744	944,382	6,761,126
Real estate	32,289,495	511,083	32,800,578
Contracting	5,073,452	944,228	6,017,680
Trade	7,514,410	713,249	8,227,659
Aviation	17,488,595	-	17,488,595
Services and others	31,840,318	3,540,207	35,380,525
Consumer home finance	26,134,291	501,520	26,635,811
Consumer financing	14,283,393	268,153	14,551,546
	146,718,453	10,275,658	156,994,111
Less: provision for impairment			(6,080,683)
Total			150,913,428

4.2.12 Provision for impairment (Islamic financing and investing assets)

2020	**Stage 1 AED'000**	**Stage 2 AED'000**	**Stage 3 AED'000**	**POCI AED'000**	**Total AED'000**
Balance at 1 January	1,075,996	965,945	4,038,742	-	6,080,683
Impairment charge during the year	56,676	225,236	4,065,946	16,899	4,364,757
Write back/recoveries during the year	-	-	(555,363)	-	(555,363)
Transfer to other stages	-	(254,562)	254,562	-	-
Write off	-	-	(1,642,234)	-	(1,642,234)
Exchange and other adjustments	- -	-	153,005	-	153,005
Balance at 31 December	**1,132,672**	**936,619**	**6,314,658**	**16,899**	**8,400,848**

2019	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	POCI AED'000	Total AED'000
Balance at 1 January	1,014,083	1,006,837	3,706,452	-	5,727,372
Impairment charge during the year	61,123	(40,646)	2,074,820	-	2,095,297
Write back/recoveries during the year	-	-	(434,522)	-	(434,522)
Write off	-	-	(1,311,317)	-	(1,311,317)
Exchange and other adjustments	789	(246)	3,310	-	3,853
Balance at 31 December	1,075,995	965,945	4,038,743	-	6,080,683

5. Impairment Assessment

5.1 Impairment of Financial Assets

Financial assets that are measured at amortized cost are assessed for impairment at each reporting date.

The Bank applies a three-stage approach to measure allowance for credit losses, using an expected credit loss approach as required under IFRS 9, for the following categories of financial instruments that are measured at amortized cost:

- Islamic financing and investing assets and investment in Islamic Sukuks;
- Off-balance sheet instruments issued;
- Financial guarantee contracts issued;
- Due from banks and financial institutions;
- Balances with Central Banks; and
- Other financial assets

Financial assets migrate through three stages based on the change in credit risk since initial recognition. No impairment loss is recognized on equity investments.

Excepted credit loss impairment model

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

- Under Stage 1, where there has not been a significant increase in credit risk since initial recognition, an amount equal to 12 months ECL will be recorded. The 12 months ECL is calculated as the portion of life time ECL that represents the ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12 months ECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12 month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original effective profit rate;
- Under Stage 2, where there has been a significant increase in credit risk since initial recognition but the financial instruments are not considered credit impaired, an amount equal to the default probability weighted lifetime ECL will be recorded. The PD and LGD are estimated over the lifetime of the instrument and the expected cash shortfalls are discounted by an approximation to the original effective profit rate; and
- Under the Stage 3, where there is objective evidence of impairment at the reporting date these financial instruments will be classified as credit impaired and an amount equal to the lifetime ECL will be recorded for the financial assets, with the PD set at 100%.

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

The Bank's liability under each guarantee is measured at the higher of the amount initially recognized less cumulative amortization recognized in the income statement, and the ECL provision. For this purpose, the Bank estimates ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk-adjusted rate relevant to the exposure. The ECL model is forward looking and requires the use of reasonable and supportable forecasts of future economic conditions in the determination of significant increases in credit risk and measurement of ECL.

COVID-19 and Expected Credit Loss (ECL)

Governments and banks in many jurisdictions have introduced extraordinary measures to alleviate the financial and economic impact of COVID-19. The relief measures include a range of different payment moratoriums to customer, liquidity support and capital relief by regulators.

The Group has considered the extraordinary conditions and environment due to COVID 19, along with measures provided by the Central Bank of UAE under Targeted Economic Support Scheme (TESS) for determining ECL requirements as on the reporting date, as applicable. These "TESS" related disclosures are discussed and are set out in the DIB 2020 Annual Report and Note 49 refers to TESS disclosure of the audited consolidated financial statement. The Group has also considered guidelines issued by the

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5. Impairment Assessment (continued)

5.1 Impairment of Financial Assets (continued)

International Accounting Standards Board (IASB) on 27 March 2020 and Basel Committee issued on 4 April 2020 on determination of expected credit losses.

In accordance with the Basel committee guidelines, the extraordinary support measures should be taken into account by banks when calculating ECLs. It also agreed on amendments to the transitional arrangements for the regulatory capital treatment of ECLs.

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

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

Details of these statistical parameters/inputs are as follows:

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

Macroeconomic factors, forward looking information and multiple scenarios

IFRS 9 requires an unbiased and probability weighted estimate of credit losses by evaluating a range of possible outcomes that incorporates forecasts of future economic conditions.

When estimating the ECLs, the Bank considers three scenarios (a base case, an upside and a downside) with a weightage of 40%, 30% and 30% respectively. Each of these is associated with different PDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted financing are expected to be recovered, including the probability that the financing will cure and the value of collateral or the amount that might be received for selling the asset.

In its ECL models, the Bank relies on a broad range of forward looking information as economic inputs, such as:

- Real house prices – Abu Dhabi and Dubai
- Money supply
- Effective exchange rate – real broad index
- General government finance - expenditure
- Commodity prices
- Consumer price index
- National accounts – compensation of employees
- National accounts – real import of goods and services

Macroeconomic factors and forward looking information are required to be incorporated into the measurement of ECL as well as the determination of whether there has been a significant increase in credit risk since origination. Measurement of ECLs at each reporting period should reflect reasonable and supportable information at the reporting date about past events, current conditions and forecasts of future economic conditions. The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

Assessment of significant increase in credit risk

The assessment of a significant increase in credit risk is done on a relative basis. To assess whether the credit risk on a financial asset has increased significantly since origination, the Bank compares the risk of default occurring over the expected life of the financial assets at the reporting date to the corresponding risk of default at origination, using key risk indicators that are used in the Bank's existing risk management processes. At each reporting date, the assessment of a change in credit risk will be individually assessed for those considered individually significant and at the segment level for retail exposures.

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5. Impairment Assessment (continued)

5.1 Impairment of Financial Assets (continued)

The group of assets are moved from stage 1 to stage 2 if:

- the probability of default changes beyond the Bank's established threshold related to the initial recognition;
- an instrument is past due beyond 30 days; and
- An instrument's credit risk is considered higher based on qualitative criteria of the Bank.

The instruments moved to stage 2 from stage 1 remain in the stage until they perform for a sustained period as per Bank's policy. Movement from stage 2 to stage 3 are based on whether the financial assets are credit impaired at the reporting date.

Experienced credit judgment

The Bank's ECL allowance methodology requires the use of experienced credit judgment to incorporate the estimated impact of factors not captured in the modelled ECL results, in all reporting periods.

When measuring ECL, the Bank considers the maximum contractual period over which the Bank is exposed to credit risk. All contractual terms are considered when determining the expected life, including prepayment options and extension and rollover options.

Default definition followed by the Bank for impairment assessment remains in line with the guidelines of IFRS 9, without any recourse to the assumptions, and consistent with regulatory requirements.

Expected life

When measuring expected credit loss, the Bank considers the maximum contractual period over which the Bank is exposed to credit risk. All contractual terms are considered when determining the expected life, including prepayment, and extension and rollover options.

Definition of default

The Bank considers a financial asset to be in default when:

- it is established that due to financial or non-financial reasons the customer is unlikely to pay its credit obligations to the Bank in full without recourse by the Bank to actions such as realizing security (if any is held); or
- The customer is past due 90 days or more on any material credit obligation to the Bank.

In assessing whether a customer is in default, the Bank considers indicators that are:

(i) qualitative - e.g. material breaches of covenant;
(ii) quantitative - e.g. overdue status and non-payment on another obligation of the same customer / customer group to the banks; and
(iii) Based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financing exposure is in default and their significance may vary over time to reflect changes in circumstance

Renegotiated financing facilities

The Bank sometimes makes concessions or modifications to the original terms of financing as a response to the customer's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a financing forborne when such concessions or modifications are provided as a result of the customer's present or expected financial difficulties and the Bank would not have agreed to them if the customer had been financially healthy. Indicators of financial difficulties include defaults on covenants or that a customer may not be in a position to honour contractual commitments. Forbearance may involve extending the payment arrangements and the agreement of new financing conditions.

Once the terms have been renegotiated, any impairment is measured using the original effective profit rate as calculated before the modification of terms. It is the Bank's policy to monitor forborne financing to help ensure that future payments continue to be likely to occur. Classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a financing, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

5. Impairment Assessment (continued)

5.1 Impairment of Financial Assets (continued)

When the financing has been renegotiated or modified but not derecognized, the Bank also reassesses whether there has been a significant increase in credit risk. The Bank also considers whether the assets should be classified as Stage 3. Once an asset has been classified as forborne, it will remain forborne for a minimum 12-month probation period. In order for the financing to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of its facilities has to be considered performing;
- The probation period of one year has passed from the date the forborne contract was considered performing; and
- Regular payments of more than an insignificant amount of principal or profit have been made during the probation period.

Acquired financing

All acquired financing is initially measured at fair value on the date of acquisition. As a result no allowance for expected credit losses is recorded in the consolidated statement of financial position on the date of acquisition. Acquired financing may fit into either of the two categories: performing financing or Purchased or Originated Credit Impaired (POCI) financing.

Purchased performing financing follow the same accounting as originated performing financing and are reflected in Stage 1 on the date of the acquisition. They will be subject to a 12 month ECL which is recorded as a provision for expected credit losses in the consolidated statement of profit or loss when the carrying value of these assets exceed the nominal values of acquired exposure. The fair value adjustment set up for these financing on the date of acquisition is amortized into profit income over the life of these financing.

POCI financing are separately presented and are always subject to lifetime allowance for credit losses. Any changes in the expected cash flows since the date of acquisition are recorded as a charge / recovery in the provision for credit losses in the consolidated statement of profit or loss at the end of all reporting periods subsequent to the date of acquisition.

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6. Liquidity Risk

6.1 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 Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The 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 high quality of the asset portfolio ensures its liquidity and coupled with the Group's own funds and stable customer deposits help form a stable funding source. Even under adverse conditions, the Group has access to the funds necessary to cover customer needs and meet its funding requirements.

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

6.1.1 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:

- 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

Liquidity Management under COVID-19

COVID 19 crises has also affected liquidity in global and regional markets. CBUAE proactively addressed the concern considering its pervasive impact on the overall economy by providing Zero Cost Funding to all eligible banks and easing out regulatory Cash Reserve Requirement (CRR) for banks and reduced the CRR on demand deposits from 14% to 7%. In order to pass on benefits of liquidity support measures to customers, the CBUAE reduced the liquidity ratio (LCR) minimum threshold to 70%. The Bank's ALCO and Liquidity Management Committee has been meeting on a regular basis with particular focus on liquidity management. The Bank has proactively considered exploring new options for expanding its liabilities base (changed tenors and currency) and focused on its capital market funding plan. The Bank is strengthening its liquidity buffers by timing disbursements to customers along with strict focus on enhancing deposit relationships across all customer segments.

6.2 Funding Approach

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

The Bank issued Tier 1 Sukuk of AED 3,673 million (USD 1,000 million) each during the year ended 31 December 2013 and 31 December 2015 and AED 2,755 million (USD 750 million) during the year ended 31 December 2019 to diversify sources of funding to support business growth.

6.2.1 Non-derivative cash flows

The table below summarises the maturity profile of the gross cash flows of the Group financial assets and liabilities as at 31 December 2020 and 2019. 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.

6. Liquidity Risk (continued)

6.2 Funding Approach (continued)

6.2.1 Non-derivative cash flows (continued)

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.

	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
2020					
Customers' deposits	**109,725,565**	**73,425,657**	**26,724,668**	**115,596**	**209,991,486**
Due to banks and other financial institutions	**1,017,044**	**10,948,900**	**1,565,181**	**-**	**13,531,125**
Sukuk issued	**-**	**1,906,739**	**12,785,307**	**5,697,372**	**20,389,418**
Payables and other liabilities	**3,708,867**	**2,830,346**	**1,364,888**	**10,531**	**7,914,632**
Zakat payable	**-**	**346,018**	**-**	**-**	**346,018**
Total liabilities	**114,451,476**	**89,457,660**	**42,440,044**	**5,823,499**	**252,172,679**
Contingent liabilities:					
Letters of guarantee	**11,783,304**	**1,225,210**	**353,084**	**544**	**13,362,142**
Letters of credit	**1,023,295**	**290,162**	**167,075**	**-**	**1,480,532**
	12,806,599	**1,515,372**	**520,159**	**544**	**14,842,674**
Capital expenditure commitments	**9,335**	**-**	**1,081,651**	**-**	**1,090,986**
Total contingent liabilities and commitments	**12,815,934**	**1,515,372**	**1,601,810**	**544**	**15,933,660**

	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
2019					
Customers' deposits	79,007,795	69,490,524	18,784,535	5,968	167,288,822
Due to banks and other financial institutions	3,643,219	2,995,802	2,573,263	-	9,212,284
Sukuk issued	-	2,788,266	13,231,779	179,243	16,199,288
Payables and other liabilities	3,365,945	3,562,161	1,164,799	15,706	8,108,611
Zakat payable	-	326,895	-	-	326,895
Total liabilities	86,016,959	79,163,648	35,754,376	200,917	201,135,900
Contingent liabilities:					
Letters of guarantee	11,286,923	1,228,202	371,727	50,270	12,937,122
Letters of credit	1,142,972	366,407	4,841	-	1,514,220
	12,429,895	1,594,609	376,568	50,270	14,451,342
Capital expenditure commitments	9,730	-	705,463	-	715,193
Total contingent liabilities and commitments	12,439,625	1,594,609	1,082,031	50,270	15,166,535

6 Liquidity Risk (continued)

6.2 Funding Approach (continued)

6.2.1 Non-derivative cash flows (continued)

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

6.2.2 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.

				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 year	Over 3 to 5 years	Over 5 years
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
2020								
Islamic Derivatives held for trading:								
Unilateral promise to buy/sell currencies	**405,447**	**309,430**	**12,836,473**	**3,486,309**	**9,350,164**	**-**	**-**	**-**
Islamic profit rate swaps	**1,476,818**	**1,388,879**	**68,024,353**	**2,750**	**2,440,446**	**13,013,911**	**10,583,068**	**41,984,178**
Islamic currency (Call/Put) options	**6,269**	**6,108**	**537,587**	**208,877**	**211,174**	**117,536**	**-**	**-**
Total	**1,888,534**	**1,704,417**	**81,398,413**	**3,697,936**	**12,001,784**	**13,131,447**	**10,583,068**	**41,984,178**
2019								
Islamic Derivatives held for trading:								
Unilateral promise to buy/sell currencies	92,966	93,242	11,145,753	4,789,269	6,356,484	-	-	-
Islamic profit rate swaps	762,551	649,060	58,353,599	1,406,305	3,601,355	10,877,838	16,747,950	225,720,151
Islamic currency (Call/Put) options	629	629	5,498	-	5,498	-	-	-
Total	856,146	742,931	69,504,850	6,195,574	9,963,337	10,877,838	16,747,950	225,720,151

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 compliant asset at an agreed price on the relevant date in future. It is a conditional promise to purchase an asset through a unilateral purchase undertaking.

6. Liquidity Risk (continued)

6.2 Funding Approach (continued)

6.2.2 Islamic derivatives financial instruments (continued)

Islamic swap structure comprises profit rate swap and currency swap. For Islamic profit rate swaps, counterparties generally exchange fixed and floating rate profit payments by executing the purchase/sale of asset under "Murabaha Sale Agreement" in a single currency.

For Islamic currency swaps, fixed or floating profit payments as well as cost of underlying asset are exchanged in different currencies, by executing the purchase/sale of asset under "Murabaha Sale Agreement".

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7. Market Risk

7.1 Market Risk

Market risk is the risk that the value of financial instruments in the Group's books could produce a loss because of changes in future market conditions. The Group takes on market risks in the pursuit of its strategic and business objectives. The Group predominantly pursues opportunities in the market that exposes itself to the following categories of market risk - which are actively managed and monitored:

- Profit rate risk: losses in value due to changes in the level, slope and curvature of yield curves, the volatility of profit rates and changes in credit spreads; and
- Foreign exchange risk: losses in value due to exposures to changes in spot prices, forward prices and volatilities of currency rates.

As part of the Group's risk management framework, an extensive governance processes is applied to the market risk taking activities. This governance framework includes, inter alia:

- Approval by the Board Risk Compliance and Governance Committee of a set of risk limits with appropriate monitoring, reporting and limits excesses' escalation procedures;
- Independent valuation of financial instruments in the Trading Book and measurement of market risk;
- A comprehensive set of policies, procedures and limits; and
- Monitoring a wide range of risk metrics appropriate for the respective trading activities - such as risk sensitivities, gross and net open positions, Value-at-Risk (VaR) and stop-loss limits.

7.1.1 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 common and wakala asset pool over a given period.

7.1.2 Profit rate risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The 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 2020 and 2019.

Currency	Increase in basis points	2020 AED'000	2019 AED'000
	50	202,212	76,602

7. Market Risk (continued)

7.1 Market Risk (continued)

7.1.3 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 Bank's exposure to foreign currency exchange rate risk at 31 December 2020 and 2019. Included in the table are the Bank's financial instruments at their carrying amounts, categorised by currency.

2020	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 the central banks	28,670,787	85,481	-	-	-	449,320	29,205,588
Due from banks and financial institutions	316,859	4,522,586	1,114,537	33,724	109,951	350,934	6,448,591
Islamic financing and investing assets, net	134,376,711	55,773,638	1,533,889	32,931	21,112	4,950,750	196,689,031
Investment in Islamic Sukuk measured at amortised cost	-	33,831,655	-	-	-	1,523,260	35,354,915
Other investments at fair value	339,594	658,143	100,633	-	-	12,592	1,110,962
Receivables and other assets	5,335,170	3,387,295	298,100	-	175,321	217,265	9,413,151
Total	169,039,121	98,258,798	3,047,159	66,655	306,384	7,504,121	278,222,238
Financial Liabilities:							
Customers' deposits	152,029,526	27,338,582	17,955,049	434,457	2,271,260	5,896,344	205,925,218
Due to banks and other financial institutions	4,882,088	8,186,541	-	20,047	5,711	401,691	13,496,078
Sukuk issued	-	18,576,381	-	-	-	167,750	18,744,131
Payables and other liabilities	4,148,786	3,345,280	196,591	12,807	56,868	334,077	8,094,409
Total	161,060,400	57,446,784	18,151,640	467,311	2,333,839	6,799,862	246,259,836
Net on balance sheet	7,978,721	40,812,014	(15,104,481)	(400,656)	(2,027,455)	704,259	31,962,402
Unilateral promise to buy/sell currencies	334,359	(10,401,163)	7,762,289	397,233	1,988,035	21,530	102,283
Currency position - long/(short)	8,313,080	30,410,851	(7,342,192)	(3,423)	(39,420)	725,789	32,064,685

7. Market Risk (continued)

7.1 Market Risk (continued)

7.1.3 Foreign exchange risk (continued)

2019	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	20,171,339	613,433	74	135	260	483,254	21,268,495
Due from banks and financial institutions	1,635,462	3,732,142	474,845	38,301	51,017	316,406	6,248,173
Islamic financing and investing assets, net	108,789,637	36,420,858	1,267,118	-	-	4,435,815	150,913,428
Investment in Islamic Sukuk measured at amortised cost	-	32,101,855	-	-	-	1,142,003	33,243,858
Other investments at fair value	542,996	594,831	109,905	-	-	18,503	1,266,235
Receivables and other assets	5,226,550	2,975,841	80,568	-	32,695	355,365	8,671,019
Total	136,365,984	76,438,960	1,932,510	38,436	83,972	6,751,346	221,611,208
Financial Liabilities:							
Customers' deposits	124,187,496	25,834,875	8,826,331	79,557	248,616	5,241,542	164,418,417
Due to banks and other financial institutions	3,697,530	5,200,135	3	8	27	249,044	9,146,747
Sukuk issued	-	14,675,936	-	-	-	176,009	14,851,945
Payables and other liabilities	6,139,106	1,828,861	189,452	1,614	66,512	280,595	8,506,140
Total	134,024,132	47,539,807	9,015,786	81,179	315,155	5,947,190	196,923,249
Net on balance sheet	2,341,852	28,899,153	(7,083,276)	(42,743)	(231,183)	804,156	24,687,959
Unilateral promise to buy/sell currencies	6,327,692	(9,901,210)	3,399,984	41,856	148,383	(12,666)	4,039
Currency position - long/(short)	8,669,544	18,997,943	(3,683,292)	(887)	(82,800)	791,490	24,691,998

7. Market Risk (continued)

7.1 Market Risk (continued)

7.1.3 Foreign exchange risk (continued)

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

The tables below indicate the extent to which the Group was exposed to currency risk at 31 December 2020 and 2019 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 2020 AED'000	Effect on profit or loss 2019 AED'000
US Dollar	+2	608,217	379,959
GBP	+2	(68)	(18)
EURO	+2	(788)	(1,656)

Currency	Decrease in currency rate in %	Effect on profit or loss 2020 AED'000	Effect on profit or loss 2019 AED '000
US Dollar	-2	(608,217)	(379,959)
GBP	-2	68	18
EURO	-2	788	1,656

7.2 Foreign Investment

The Group has 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 profit before tax and equity had the result for the year ended 31 December 2020 and 2019 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 2020 AED'000	Effect on equity 2020 AED'000	Effect on profit or loss 2019 AED'000	Effect on equity 2019 AED'000
Pak Rupees	+5	4,196	30,129	4,303	26,645
Egypt Sterling	+5	279	5,890	309	5,502

Currency	Decrease in currency rate in %	Effect on profit or loss 2020 AED'000	Effect on equity 2020 AED'000	Effect on profit or loss 2019 AED'000	Effect on equity 2019 AED'000
Pak Rupees	-5	(3,796)	(26,219)	(3,894)	(23,067)
Egypt Sterling	-5	(253)	(5,327)	(280)	(4,978)

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7. Market Risk (continued)

7.1 Market Risk (continued)

7.3 Equity Price Risk

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The non-trading equity price risk exposure arises from the 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 2020 and 2019) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

Market indices	Change in market Indices	Effect on other comprehensive income	Effect on other comprehensive income
		2020	2019
	%	**AED'000**	AED'000
Dubai Financial Market	**± 5%**	**2,883**	14,943
Abu Dhabi Exchange	**± 5%**	**1,808**	1,210
Bahrain Stock Exchange	**± 5%**	**1,475**	1,293
Other	**± 5%**	**3,549**	3,816

An increase of 5% in fair value of Level 3 financial instruments due to change in unquoted market price / valuation of financial instruments as at the reporting date would have increased the net assets attributable to the Bank by AED 45.9 million (2019: AED 35.6 million).

8. Operational Risk

8.1 Operational Risk

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

The Group has developed a detailed operational risk management 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. ORMS to track operational risk events across the Group. The system houses five years of operational loss data. The subject system is also capable to record KRI, RCSA and scenario based fraud risk self-assessment.

In addition to ORMS, the Bank is also implementing eGRC system (centralized governance framework) for all control activities.

Each new product introduced is subject to a risk review and signoff process where all relevant risks are identified and assessed by departments independent of the risk-taking unit proposing the product. Variations of existing products are also subject to a similar process. Business and support units are responsible for managing operations risk in their respective functional areas. They operate within the 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.

9. Regulatory Compliance

9.1 Reputational Risk

Reputational risk is the risk of potential loss of earnings and future revenue, loss in market value or lack of liquidity supply due to deterioration of reputation. It also includes the threat to the brand value of a financial institution. Reputational risk can arise as a consequence of failures with a strong negative perception amongst clients, shareholders, creditors or the public. The Group has measures to ensure a positive perception of the Group and that overall risk management ensures appropriate management of reputational risk.

9.2 Regulatory / Compliance Risk

Regulatory/Compliance risk is the risk of reputational and/or financial losses due to the failure to comply with applicable laws, regulations or sanctions. The Group has an independent Compliance function, with the necessary mandate and authority to enforce and monitor compliance on a Group wide basis. This includes compliance with the applicable laws and regulations across the various jurisdictions where the Group operates as well as those of the USD / EU clearing centers.

Compliance policies covering key areas such as Sanctions, Anti Money Laundering (AML), Counter Terrorist Financing (CTF), Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS) are applicable Group wide and are supplemented where necessary to address any unique local requirements. These policies are supported by automated screening and monitoring systems and associated investigation teams to help comply with the Sanctions, AML, CTF, FATCA and CRS requirements. Independent Compliance Monitoring is undertaken to provide assurance over the effectiveness of controls. Mandatory Compliance Training is provided to all relevant staff both at onboarding and periodically thereafter to help ensure that key requirements are complied with.

9.3 Non Shariah compliance risk

In compliance with the Sharia Governance Standard for Islamic Financial Institutions issued by the Higher Sharia Authority of the Central Bank of UAE (“HSA”) on 21 April 2020 (the “Standard”), the Bank’s Board of Directors (“Board”) is ultimately responsible for the Bank’s compliance with Sharia principles. The ISSC is the highest authority in the Bank from a Sharia governance perspective.

The Board is expected to be aware of Sharia non-compliance risk and its potential impact on the Bank. The Board Risk, Compliance and Governance Committee (“BRCGC”) supervises and monitors management of Sharia non-compliance risk, and set controls in relation to this type of risk, in consultation with ISSC and through the Internal Sharia control Department of the Bank. (“ISCD”). The BRCGC ensures the availability of an information system that enables the Bank to measure, assess and report Sharia non-compliance risk. Reports are provided in a timely manner to the Board and Senior Management, in formats suitable for their use and understanding.

The Bank implements effective internal Sharia controls adopting the three lines of defence approach where each line is independent, which includes:

- The first line of defence, represented by the business line, sets clear policies, procedures, and controls, approved by Internal Sharia Supervision Committee of the Bank (“ISSC”), and executes the business activities in a manner compliant with the principles of sharia at all times;
- The second line of defence, represented by the ISCD, undertakes amongst the others the sharia compliance and sharia risk functions;
- The third line of defence represented by Internal Sharia Audit Department (“ISAD”), undertakes the post execution risk based sharia audit of the Bank and reports the findings to the ISSC.