

# Al Hilal Islamic Banking Services

## Financial Statements

For the year ended 31 December 2018

## Shari'a Compliance Report of Shari'a Supervisory Board

In the name of Allah, The Beneficent, The Merciful  
**AL HILAL ISLAMIC BANKING SERVICES, AHLI BANK SAOG**

### SHARI'A SUPERVISORY BOARD REPORT

All praise to Allah, and peace be upon His messenger, his family, his companions and all followers of his guidance.

To the Board of Directors of Ahli Bank SAOG (the "Bank").

*Assalam Alikum wa Ramat Allah wa Barakatuh*

Shari'a Supervisory Board has reviewed the products and the contracts relating to the transactions which were made by the Bank during the period (01.01.2018 to 31.12-2018) ended 2018 to ensure that they comply with rules and principles of Islamic Shari'a and with the Fatawa issued by the Board.

The Bank's management is responsible for ensuring execution and implementation of resolutions of the Shari'a Supervisory Board and to inform the Shari'a Supervisory Board with regard to the operations and the developments, which require issuance of resolutions from the Shari'a Supervisory Board. The Shari'a Supervisory Board is responsible in monitoring implementation of the decisions from Shari'a perspective and to give its opinion based on the Shari'a audit reports of the Bank.

In opinion of the Board:

- The contracts, transactions and dealings entered into by the Bank during the year ended 2018 are in compliance with Shari'a rules and principles.
- The distribution of profit and charging of losses relating to investment accounts conform to the base that had been approved by the Shari'a Supervisory Board of the Bank in accordance with rules and principles of Islamic Shari'a.
- All earning that has been realized from sources or by means prohibited by rules and principles of Islamic Shari'a have been disposed of by the management of the Bank to charitable causes,
- The calculation of Zakah is in compliance with Shari'a rules and principles.

We beg Allah the Almighty to grant us all the success.

### SHARI'A SUPERVISORY BOARD



**Dr. Ahmed Mohiyeldin Ahmed**  
Chairman



**Dr. Mohammed Taher Al-Ibrahim**  
Member



**Dr. Mustain Ali Abdul Hameed**  
Member



**Dr. Abdul Raouf Abdullah Al-Tobi**  
Member

## Resolutions Issued by SSB during Year 2018

SR.	SSB Meeting	Resolution No.	Subject
1	<b>SSB 21st Meeting on 05-April-2018</b>	2 (SSB-21-2018)	Review of Legal Documents of Diminishing Musharaka for Construction of General Assets i. Diminishing Musharaka Agreement (Assets Under Construction) ii. Undertaking to Purchase iii. Forward Lease Agreement iv. Management Agreement v. Undertaking to Sale vi. Schedule A: Additional Representations and Warranties vii. Schedule B: Additional Undertakings
		3 (SSB-21-2018)	Review and Approval of Amendments in Ijara MBT Agreements: i. Lease Agreement with Promise of Ownership (General Assets) ii. Lease Agreement with Promise of Ownership (Real Estate Assets)
		4 (SSB-21-2018)	Review of Wakala Bil Istithmar Agreement
		5 (SSB-21-2018)	Review and Approval of Review of Risk Policies: ▪ Business Continuity Management Policy ▪ Business Continuity Plan ▪ Operational Risk Framework ▪ Operation Risk Policy
		6 (SSB-21-2018)	Review and Opinion on Shari'a Audit Reports: a- Shari'a Audit Report of Retail Banking 3rd Quarter b- 4th Quarter 2017: i- Shari'a Audit Report of Corporate Banking ii- Shari'a Audit Report of Retail iii- Shari'a Audit Report of SME iv- Shari'a Audit Report of Trade Finance
		2	<b>SSB 22nd Meeting on 05-July-2018</b>
3 (SSB – 22– 2018)	Review of Bank's Policies i. Anti-Money Laundering Policy ii. Compliance Policy iii. Disclosures Policy iv. Customer Complaints Policy		
4 (SSB – 22– 2018)	Review and Opinion on Shari'a Audit Reports of 1st Quarter 2018 i- Shari'a Audit Report of Retail ii- Shari'a Audit Report of Corporate Banking iii- Shari'a Audit Report of SME iv- Shari'a Audit Report of Trade Finance v- Shari'a Audit Report of Treasury		
5 (SSB – 22– 2018)	Review of Al Hilal Islamic Credit Cards Proposal		
6 (SSB – 22– 2018)	Review of Corporate Banking Schedule of Charges		

## Resolutions Issued by SSB during Year 2018 (continued)

SR.	SSB Meeting	Resolution No.	Subject
3	SSB 23rd Meeting on 04-October-2018	2 (SSB – 23 – 2018)	Review of Ahli Bank Policies 1. Asset Management Policy 2. Code of Business Conduct 3. Corporate Governance Policy 4. Corporate Social Responsibility Policy 5. Financial Institutions Policy 6. Fraud Risk Management Policy 7. Human Resources Policy 8. Classification and Measurement Financial Assets
		3 (SSB – 23 – 2018)	Review and Opinion on Shari'a Audit Reports of 2nd Quarter 2018 i- Shari'a Audit Report of Corporate Banking ii- Shari'a Audit Report of Retail iii- Shari'a Audit Report of SME iv- Shari'a Audit Report of Trade Finance v- Shari'a Audit Report of Treasury
		4 (SSB – 23– 2018)	Opinion on Shari'a Audit Report of Corporate Banking for 1ST Quarter 2018
		5 (SSB – 23– 2018)	Review and Approval of supplemental to Diminishing Musharaka Agreement, Supplemental to Lease Agreement, Restated Sale Undertaking, Restated Purchase Undertaking and Management Agreement
		6 (SSB – 23– 2018)	Review of Addition of Wakala Investment Details in Profit Distribution Policy and its Working
		7 (SSB – 23– 2018)	Review of Amendment in the Account Opening Form
		8 (SSB – 23– 2018)	Review of Corporate Banking Customer Conventional Insurance
		9 (SSB – 23– 2018)	Review of Set of Diminishing Musharaka documents for Vehicle Financing i. Dimishing Musharaka Agreement ii. Ijara Agreement iii. Service Agency Agreement iv. Wakala Agreement for Registration of Asset in Name of the Customer v. Services Agency Agreement vi. Purchase Undertaking vii. Sale Undertaking
		10 (SSB – 23– 2018)	Review and Opinion on Transaction Information Sheet of Corporate Customer Abdulah Saleh Al Hashmi

SR.	SSB Meeting	Resolution No.	Subject
4	SSB 24 Meeting on December 24, 2018	2 (SSB – 24– 2018)	Approval of Training Plan for Year 2019
		3 (SSB – 24– 2018)	Approval of Sharia Audit Plan for Year 2019
		4 (SSB – 24– 2018)	Review and Opinion on Shari'a Audit Reports of 3rd Quarter 2018 i- Shari'a Audit Report of Corporate Banking ii- Shari'a Audit Report of Retail iii- Shari'a Audit Report of SME iv- Shari'a Audit Report of Trade Finance v- Shari'a Audit Report of Treasury
		6 (SSB – 24– 2018)	Query about Termination of Ijarah MBT Contract with Existing Customer and finance the Same Property to a New Customer
		7 (SSB – 24– 2018)	Deferment of Charity Amount Reimbursement to 2019
		8 (SSB – 24– 2018)	Waiver to Customer who Settles at Earlier under Services Ijara
		9 (SSB – 24– 2018)	Review and Approval on 1. Board Remuneration Policy 2. Brokerage Policy 3. Capital Management Policy 4. Communications Policy 5. Dividend Policy 6. Expenses Policy 7. FATCA Policy 8. New Product Committee and Procedures 9. Outsourcing Policy 10. Personal Account Dealing Policy 11. Security and Safety Policy and Plan 12. Social and Environment Management System 13. Social Media Policy 14. Voice Recording Policy



KPMG  
4th Floor, HSBC Bank Building  
MBD  
P.O. Box 641  
P.C. 112  
Sultanate of Oman  
Tel +968 24709181  
Fax +968 24700839

## **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AHLI BANK SAOG**

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Al Hilal Islamic Banking Services of Ahli Bank SAOG ("Al Hilal"), set out on pages 147 to 183 which comprise the statement of financial position as at 31 December 2018, income statement, statement of changes in owners' equity, statement of cash flows and statement of sources and uses of charity fund for the year ended 31 December 2018, and notes, comprising a summary of significant accounting policies and other explanatory information. These financial statements and Al Hilal's undertaking to operate its Islamic Window in accordance with Shari'a are the responsibility of Al Hilal's Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amount and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

### **Opinion**

In our opinion, the financial statements present fairly, in all material respect, the financial position of Al Hilal as at 31 December 2018 and of the results of its operations and its cash flows for the year then ended in accordance with the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of Al Hilal and the Financial Accounting Standards ("FAS") issued by AAOIFI.

**Kenneth MacFarlane**

10 March 2019

## Statement of Financial Position

As at 31 December 2018

2017 US\$ '000	2018 US\$ '000		Note	2018 RO '000	2017 RO '000
		<b>ASSETS</b>			
95,099	<b>100,062</b>	Cash and balances with Central Bank of Oman	5	<b>38,524</b>	36,613
5,901	<b>4,345</b>	Due from banks	6	<b>1,673</b>	2,272
121,886	<b>122,010</b>	Murabaha receivables	7	<b>46,974</b>	46,926
157,813	<b>333,205</b>	Musharaka receivables	8	<b>128,284</b>	60,758
38,086	<b>37,249</b>	Investment securities	9	<b>14,341</b>	14,663
358,010	<b>318,530</b>	Ijarah assets - Ijarah Muntahia Bittamleek	10	<b>122,634</b>	137,834
1,112	<b>1,382</b>	Credit Card Receivables	11	<b>532</b>	428
382	<b>603</b>	Service Ijarah	12	<b>232</b>	147
2,673	<b>2,623</b>	Property and equipment	14	<b>1,010</b>	1,029
2,731	<b>3,513</b>	Other assets	15	<b>1,353</b>	1,052
<b>783,693</b>	<b>923,522</b>	<b>TOTAL ASSETS</b>		<b>355,557</b>	<b>301,722</b>
		<b>LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY</b>			
100,281	<b>290,688</b>	Due to banks	16	<b>111,915</b>	38,608
432,758	<b>352,416</b>	Wakala deposits	17	<b>135,680</b>	166,612
30,571	<b>26,826</b>	Customers' current accounts		<b>10,328</b>	11,770
11,309	<b>14,089</b>	Other liabilities	18	<b>5,425</b>	4,354
<b>574,919</b>	<b>684,019</b>	<b>TOTAL LIABILITIES</b>		<b>263,348</b>	<b>221,344</b>
115,642	<b>132,223</b>	Equity of investment account holders	19	<b>50,906</b>	44,522
<b>690,561</b>	<b>816,242</b>	<b>TOTAL LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDERS</b>		<b>314,254</b>	<b>265,866</b>
64,935	<b>64,935</b>	Share capital	20	<b>25,000</b>	25,000
23	<b>(1,200)</b>	Investment fair value reserve		<b>(462)</b>	9
-	<b>5,075</b>	Impairment reserve		<b>1,954</b>	-
-	<b>839</b>	Special Reserve		<b>323</b>	-
28,174	<b>37,631</b>	Retained earnings		<b>14,488</b>	10,847
<b>93,132</b>	<b>107,280</b>	<b>TOTAL OWNERS' EQUITY</b>		<b>41,303</b>	<b>35,856</b>
<b>783,693</b>	<b>923,522</b>	<b>TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNERS' EQUITY</b>		<b>355,557</b>	<b>301,722</b>
21,340	<b>30,909</b>	Contingent liabilities and commitments	22	<b>11,900</b>	8,216

The financial statements and notes 1 to 33 were approved by the Board of Directors on 28 January 2019 and signed on their behalf by:



**Hamdan Ali Nasser Al Hinai**  
Chairman



**Said Abdullah Al Hatmi**  
Chief Executive Officer

The notes and other explanatory information form an integral part of these financial statements.  
Report of the independent Auditors - page 146.

## Statement of Comprehensive Income

For the year ended 31 December 2018

2017 US\$ '000	2018 US\$ '000		Note	2018 RO '000	2017 RO '000
32,899	<b>41,623</b>	Income from financing activities	23	<b>16,025</b>	12,666
1,143	<b>1,462</b>	Income from investing activities	24	<b>563</b>	440
4,325	<b>1,000</b>	Other operating income	25	<b>385</b>	1,665
(753)	<b>2,896</b>	Net impairment on financial assets		<b>1,115</b>	(290)
(3)	-	Impairment on available for sale investments		-	(1)
37,611	<b>46,981</b>			<b>18,088</b>	14,480
(4,112)	<b>(5,649)</b>	Return to investment account holders		<b>(2,175)</b>	(1,583)
2,034	<b>2,242</b>	Islamic Windows' share as Mudarib		<b>863</b>	783
(2,078)	<b>(3,407)</b>	<b>Return to investment account holders before zakah</b>		<b>(1,312)</b>	(800)
		<b>Islamic Window's share in income from financing and investing activities (as Mudarib and Fund owner)</b>		<b>16,776</b>	13,680
35,533	<b>43,574</b>				
327	<b>608</b>	Other operating income from banking services	26	<b>234</b>	126
(3,587)	<b>(7,130)</b>	Profit paid on due to banks		<b>(2,745)</b>	(1,381)
(11,265)	<b>(13,579)</b>	Profit paid on wakala deposits		<b>(5,228)</b>	(4,337)
21,008	<b>23,473</b>	<b>Net operating income</b>		<b>9,037</b>	8,088
(3,174)	<b>(3,784)</b>	Staff expenses	27	<b>(1,457)</b>	(1,222)
(688)	<b>(551)</b>	Depreciation	14	<b>(212)</b>	(265)
(2,031)	<b>(1,972)</b>	Other operating expenses	28	<b>(759)</b>	(782)
(5,893)	<b>(6,307)</b>	<b>Total expenses</b>		<b>(2,428)</b>	(2,269)
15,115	<b>17,166</b>	<b>Profit before taxation</b>		<b>6,609</b>	5,819
(2,236)	<b>(2,457)</b>	<b>Taxation</b>		<b>(946)</b>	(861)
12,879	<b>14,709</b>	<b>Profit for the year</b>		<b>5,663</b>	4,958
		<b>Other comprehensive expense</b>			
		<b>Items that will not be reclassified to profit or loss</b>			
-	<b>(67)</b>	Equity investment at FVOCI net changes in fair value		<b>(26)</b>	-
		<b>Items that will be reclassified to profit or loss</b>			
3	-	Net amount transferred to profit or loss		-	1
-	<b>(1,044)</b>	Debt investment at FVOCI net changes in fair value		<b>(402)</b>	-
3	<b>(1,111)</b>	<b>Other comprehensive expense for the year</b>		<b>(428)</b>	1
12,882	<b>13,598</b>	<b>Total comprehensive income for the year</b>		<b>5,235</b>	4,959

The notes 1 to 33 and other explanatory information form an integral part of these financial statements.  
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## Statement of Changes in Owners' Equity

For the year ended 31 December 2018

	Note	Share capital RO '000	Investment fair value reserve RO '000	Impairment reserve RO '000	Special reserve RO '000	Retained earnings RO '000	Total RO '000
Balance at 1 January 2018		25,000	9	-	-	10,847	35,856
Changes on initial application of IFRS 9		-	(43)	212	-	43	212
<b>At 1 January 2018</b>		<b>25,000</b>	<b>(34)</b>	<b>212</b>	<b>-</b>	<b>10,890</b>	<b>36,068</b>
Profit for the year		-	-	-	-	5,663	5,663
Transfer to impairment reserve		-	-	1,742	-	(1,742)	-
Transfer to special reserve		-	-	-	323	(323)	-
Other comprehensive expense		-	(428)	-	-	-	(428)
<b>At 31 December 2018</b>		<b>25,000</b>	<b>(462)</b>	<b>1,954</b>	<b>323</b>	<b>14,488</b>	<b>41,303</b>
<b>At 31 December 2018 (US\$ '000)</b>		<b>64,935</b>	<b>(1,200)</b>	<b>5,075</b>	<b>839</b>	<b>37,631</b>	<b>107,280</b>

	Note	Share capital RO '000	Investment fair value reserve RO '000	Impairment reserve RO '000	Special reserve RO '000	Retained earnings RO '000	Total RO '000
At 1 January 2017		25,000	8	-	-	8,389	33,397
Profit for the year		-	-	-	-	4,958	4,958
Other comprehensive expense		-	1	-	-	-	1
Cash Dividend paid	20	-	-	-	-	(2,500)	(2,500)
At 31 December 2017		25,000	9	-	-	10,847	35,856
At 31 December 2017 (US\$ '000)		64,935	23	-	-	28,174	93,132

The notes 1 to 33 and other explanatory information form an integral part of these financial statements.  
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# Notes to the Financial Statements

For the year ended 31 December 2018

## 1 LEGAL STATUS AND PRINCIPAL ACTIVITIES

Al Hilal Islamic Banking Services (the Islamic Window) was licensed by Central Bank of Oman (CBO) to operate as an Islamic Banking Window of Ahli Bank SAOG (the Bank). The Islamic Window offers a full range of Islamic banking services and products. The principal activities of the Islamic Window include accepting Sharia compliant customer deposits, providing Sharia compliant financing based on Murabaha, Mudaraba, Musharaka Ijarah, and undertaking investment activities and providing commercial banking services and other investment activities permitted under the Islamic Banking Regulatory Framework (IBRF) issued by the CBO. The Islamic Window was operating through a network of eight branches as at year end (31 December 2017: seven branches).

The registered address of the Islamic Window is PO Box 545, PC 116, Mina Al Fahal, Sultanate of Oman.

The Islamic Window employed 67 employees as at 31 December 2018 (31 December 2017: 60 employees)

## 2 BASIS OF PREPARATION

### 2.1 Statement of compliance

In accordance with the requirements of Section 1.2 of Title 3 of the IBRF issued by CBO, the financial statements are prepared in accordance with Financial Accounting Standards (FAS) issued by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Sharia Rules and Principles as determined by the Sharia Supervisory Board of the Islamic Window and other applicable requirements of CBO. In accordance with the requirements of AAOIFI, for matters which are not covered by AAOIFI and other directives, the Islamic Window uses the relevant International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB).

These financial statements pertain to the Islamic Window operations only and do not include financial results of the Bank. Statement of restricted investment accountholders, statement of Qard fund and Zakat are not presented as these are not applicable. Complete set of financial statements of the Bank is presented separately.

### 2.2 Basis of measurement

The financial statements have been prepared under the historical cost convention except for investments classified as equity type instruments at Fair value through other comprehensive income which have been measured at fair value.

This is the first set of the Bank's annual financial statements in which IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers have been applied. Changes to significant accounting policies are described in Note 3.

### 2.3 Functional and presentation currency

The financial statements are prepared in Rial Omani ('RO') which is the functional and reporting currency for these financial statements. The United States Dollar ('US\$') amounts shown in the financial statements have been translated from Rial Omani at an exchange rate of RO 0.385 to each US\$, and are shown for the convenience of the user of financial statements only. All financial information presented in Rial Omani and US Dollars has been rounded to the nearest thousand, unless otherwise stated.

### 2.4 Use of estimates and judgements

The preparation of financial statements in conformity with FAS requires management to make judgments, estimates and assumptions that may affect the application of policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 5.

### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Islamic Window operations

For the year ended 31 December 2018, the Islamic window has adopted applicable new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on or after 1 January 2018.

The following are the accounting standards which are relevant to the Islamic window and have been applied in the preparation of these financial statements which has resulted in changes to the Islamic window accounting policies and has not affected the amounts reported for prior periods.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 2 BASIS OF PREPARATION (continued)

#### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Islamic Window operations (continued)

##### IFRS 9: Financial Instruments

On 1 January 2018 the Islamic Window adopted IFRS 9 "Financial Instruments" (as revised in July 2014) which replaces IAS 39 "Financial Instruments: Recognition and Measurement". IFRS 9 introduces new requirements for:

- (1) The classification and measurement of financial assets and financial liabilities;
- (2) Impairment of financial assets; and
- (3) General hedge accounting.

The standard also requires entities to provide users of financial statements with more informative and relevant disclosures. Please refer to the Note 3.1 "IFRS 9 Financial Instruments" about the impact on changes in accounting policies.

##### IFRS 15: Revenue from Contracts with Customers

The Islamic window has adopted IFRS 15 as issued by IASB with effective date from 1 January 2018. This standard has superseded all revenue recognition requirements under the earlier standard and provides a principle based approach for revenue recognition with the introduction of concept for revenue recognition for performance obligation as they are satisfied. The Islamic window has assessed the impact of IFRS 15 and concluded that the application of this standard does not have any material impact on Islamic window financial statements.

#### 2.6 The following new standards and amendments have been issued by the International Accounting Standards Board (IASB) but are not yet mandatory for the year ended 31 December 2018:

##### 2.6.1 IFRS 16 Leases; effective for annual periods commencing 1 January 2019.

IFRS 16 "Leases" replaces the guidance and interpretations including IAS 17 "Leases", IFRIC 4 "Determining whether an arrangement contains a lease", SIC 15 "Operating leases - Incentives" and SIC 27 "Evaluating the substance of transactions involving the legal form of a lease". Under IAS 17, leases were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now required lessees to recognise a lease liability reflecting future lease payments and a 'right of use asset' for virtually all lease contracts. It included an optional exemption for certain short term leases and leases of low value assets. However, this exemption can only be applied by lessees. Lessor accounting remains similar to the current standard IAS 17, i.e. lessors continue to classify leases as finance or operating leases.

The Islamic window will adopt the new standard on the required effective date using the modified retrospective approach. The Bank has assessed the impact of IFRS 16 and concluded that the standard doesn't not have any material impact in the Bank's financial statements.

##### 2.6.2 Other Standards

###### FAS 30 – Impairment, credit losses and onerous commitments

"AAOIFI has published this standard which intends to define the accounting principles for impairment and credit losses (including expected credit losses) to be in line with ever-changing global best practices, as well as, provisions needed against anticipated losses on onerous commitments. There are also recommendations with regard to the changes and improvements in accounting for reserves and another standard on accounting for reserves i.e. FAS 35 "Risk Reserves" which shall be adopted simultaneously with the same effective date. Both these standards together supersede the earlier FAS 11 "Provision and Reserves". FAS 30 will be effective from the financial period beginning on or after 1 January 2020. The management is in the process of analyzing the impact of this standard.

### 3 CHANGES IN ACCOUNTING POLICIES

#### 3.1 IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

As permitted by the transitional provisions of IFRS 9, the Islamic Window elected not to restate comparative figures. Accordingly, any adjustments to the carrying amounts of financial assets and financial liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current year.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures were also made only for the current year. The comparative year notes disclosures repeat those disclosures made in the previous year.

The adoption of IFRS 9 has resulted in changes in the Islamic window accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 "Financial Instruments: Disclosure".

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 3 CHANGES IN ACCOUNTING POLICIES (continued)

#### 3.1 IFRS 9 Financial Instruments (continued)

##### 3.1.1 Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. Further details of the impairment requirements are described in more detail in Note 4.16.

##### 3.1.2 Transition

Changes in accounting policies resulting from adoption of IFRS 9 have been applied retrospectively, except as described below.

- Comparative periods have not been restated and the differences in carrying amounts of financial assets and financial liabilities resulting from adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

##### 3.1.3 Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

- (a) The measurement category and the carrying amount of financial assets and liabilities as presented at year ended 31 December 2017 and subsequently as per IFRS 9 at 1 January 2018 are compared and set out as below:

	31-Dec-2017		01-Jan-2018	
	Measurement category	Carrying amount RO '000	Measurement category	Carrying amount RO '000
<b>Financial assets</b>				
Cash and balances with Central Bank of Oman	Amortised cost	36,613	Amortised cost	36,613
Due from banks	Amortised cost	2,272	Amortised cost	2,272
Financing, net	Amortised cost	245,518	Amortised cost	245,778
Investment securities	Held for trading investments - Debt	14,480	Fair value through other comprehensive income	14,474
	Available for sale investments - Equity	183	Fair value through other comprehensive income	183
<b>Financial Liabilities</b>				
Due to banks	Amortised cost	111,915	Amortised cost	111,915
Customers' deposits	Amortised cost	196,914	Amortised cost	196,914
Other liabilities	Amortised cost	4,354	Amortised cost	4,396

Other liabilities includes provisions against financing commitments and financial guarantees

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 3 CHANGES IN ACCOUNTING POLICIES (continued)

#### 3.1 IFRS 9 Financial Instruments (continued)

##### (b) Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

The Islamic window performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics.

The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018;

Financial assets	31-Dec-2017 RO '000	Reclassification RO '000	Remeasurement RO '000	1-Jan-2018 RO '000
<b>Amortised cost</b>				
Cash and balances with Central Bank of Oman	36,613	-	-	<b>36,613</b>
Due from banks	2,272	-	-	<b>2,272</b>
Financing, net				
Opening balance under IAS 39	245,518	-	-	-
Remeasurement: ECL allowance	-	-	260	-
<b>Closing balance under IFRS 9</b>				<b>245,778</b>
<b>Total Amortised cost</b>	<b>284,403</b>	<b>-</b>	<b>260</b>	<b>284,663</b>
<b>Fair value through other comprehensive income</b>				
<b>Debt instruments</b>				
Opening balance under IAS 39	14,480	-	-	-
Reclassification	-	14,480	(6)	-
<b>Closing balance under IFRS 9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14,474</b>
<b>Equity instruments</b>				
Opening balance under IAS 39	183	-	-	-
Reclassification	-	-	-	-
<b>Closing balance under IFRS 9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>183</b>
<b>Total Fair value through other comprehensive income</b>	<b>14,663</b>	<b>14,480</b>	<b>(6)</b>	<b>14,657</b>
<b>Financial liabilities</b>				
<b>Amortised cost</b>				
Due to banks	111,915	-	-	111,915
Customers' deposits	196,914	-	-	196,914
<b>Closing balance under IFRS 9</b>	<b>308,829</b>	<b>-</b>	<b>-</b>	<b>308,829</b>
<b>Other Liabilities</b>				
Opening balance under IAS 39	4,354	-	-	-
Remeasurement: Provision for off-balance sheet	-	-	42	-
<b>Closing balance under IFRS 9</b>	<b>4,354</b>	<b>-</b>	<b>42</b>	<b>4,396</b>

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 3 CHANGES IN ACCOUNTING POLICIES (continued)

#### 3.1 IFRS 9 Financial Instruments (continued)

##### (c) Reconciliation of impairment allowance and provisions balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

	31-Dec-2017 RO '000	Reclassification RO '000	Remeasurement RO '000	1-Jan-2018 RO '000
Due from banks	-	-	-	-
Financing	3,100	-	(260)	2,840
Investment securities	43	43	3	3
Other liabilities	-	-	42	42

### 4 SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below:

#### 4.1 Foreign currency translation

Transactions in foreign currencies are translated into the respective functional currencies of the operations at the spot exchange rates at the dates of the transactions

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the reporting date. Any resulting exchange differences are included in 'other operating income' in the statement of comprehensive income.

The non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date the fair value is determined. Foreign exchange differences arising on translation are recognized in the income statement, except for non-monetary financial assets, such as investments classified as at Fair value through other comprehensive income, which are included in 'investments fair value reserve' in statement of changes in owners' equity. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

#### 4.2 Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, balances with Central Bank of Oman, due from and due to banks and highly liquid financial assets with original maturities of up to three months, which are subject to insignificant risk of changes in their fair value, and are used by the Islamic Window in management of its short term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

#### 4.3 Due from banks

Due from banks comprise wakala placements and nostro accounts. These are stated at cost, less expected credit loss allowance, if any.

#### 4.4 Murabaha receivable

Murabaha receivables are sales on deferred profits. The Islamic Window arranges a Murabaha transaction by buying a commodity (which represents the object of the Murabaha) and then resells this commodity to customer (beneficiary) after computing a margin of profit over cost. The sale price (cost plus profit margin) is repaid in installments by the customer over the agreed period. Murabaha receivables are stated net of deferred profits and expected credit loss allowance, if any.

#### 4.5 Musharaka

In Musharaka based financing, the Islamic Window enters into Musharaka based on Shirkat-ul-milk for financing an agreed share of fixed asset (e.g. house, land, plant or machinery) with its customers and enters into period profit payment agreement for the utilization of the Islamic Window's Musharaka share by the customer.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 4 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 4.6 Investments

Investments comprise investments in debt type and equity type financial instruments.

Investments in these instruments are classified into following categories;

- at amortised cost
- at fair value through profit or loss
- at Fair value through other comprehensive income

##### 4.6.1 Instruments at amortised cost

Investments which have fixed or determinable payments and where the Islamic Window has both the intent and ability to hold to maturity are classified as debt type instrument carried at amortised cost. Such investments are carried at amortised cost, less expected credit loss allowance. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such type of instruments is recognized in the statement of comprehensive income, when the instruments are de-recognised or impaired.

##### 4.6.2 Instruments at fair value through profit or loss

This includes instruments held for the purpose of generating profits from the short term market fluctuations. These are subsequently re-measured at fair value. All related realized and unrealized gains or losses are included in the statement of comprehensive income.

##### 4.6.3 Instruments at Fair value through other comprehensive income

This includes debt type instruments that are not fair valued through income statement or not held at amortised cost. Subsequent to acquisition, investments designated at Fair value through other comprehensive income are re-measured at fair value less expected credit loss allowance, with unrealized gains or losses recognized in owners' equity until the investment is derecognized at which time the cumulative gain or loss previously recorded in owners' equity is recognised in the statement of comprehensive income.

On initial recognition, the Islamic Window makes an irrevocable election to designate certain equity instruments to be classified as investments at Fair value through other comprehensive income. Subsequent to acquisition, these equity instruments are re-measured at fair value with unrealized gains or losses recognized in owners' equity. At time of derecognition of these equity instruments the unrealised gains or losses remains in owners' equity and not recycled to statement of comprehensive income.

#### 4.7 Ijarah assets – Ijarah Muntahia Bittamleek

Ijarah assets (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the assets passes at the end of the lease term, provided that all the lease installments are settled. Depreciation is calculated on systematic basis to reduce the cost of leased assets over the period of lease. The Islamic Window assesses at each reporting date whether there is objective evidence that these assets are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rental receivables) and the estimated recoverable amount. Impairment losses, if any, are recognised in the statement of comprehensive income.

#### 4.8 Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset. Depreciation is provided on a straight-line basis over the estimated useful lives of property and equipment.

The estimated useful lives for the current period are as follows:

	Years
Building	25
Furniture & fixtures	5
Computer and other equipment	5-10
Leasehold improvements	5

The assets' residual values, useful lives and depreciation methods are reviewed and adjusted if appropriate at each reporting date. Capital work in progress is not depreciated until the asset is put to use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 4 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 4.8 Property and equipment (continued)

Gains and losses on disposals are determined by comparing the sale proceeds with the carrying amount and are recognised within 'other operating income' in the statement of comprehensive income.

Repairs and renewals are charged to the income statement when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditures are recognised in the income statement as an expense when incurred.

#### 4.9 Due to banks

It comprises of wakala placements from banks and vostro account balances. Wakala payables are stated at cost less amounts repaid.

#### 4.10 Wakala deposits

The Islamic Window accepts deposits from customers under Wakala arrangement under which a return may be payable to customers as agreed in the agreement. There is no restriction on the Islamic Window for the use of funds received under wakala agreement.

#### 4.11 Customers' current accounts

Customers' current accounts are treated on the basis of "Qard". No profit or loss is passed on to current account holders, however the funds of current accounts are treated as equity for the purpose of profit calculation for investments account holders and any profit earned / loss incurred on those funds are allocated to the equity of the Window.

#### 4.12 Equity of investment account holders

Equity of investment account holders are funds held by the Window in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Window to invest the account holders' funds in a manner which the Window deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. The Window charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalization reserve and Investment risk reserve) and deducting the Window's share of income as a Mudarib. The allocation of income is determined by the management of the Window within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Window and are not charged separately to investment accounts. Investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves, if any. Profit equalisation reserve is the amount appropriated by the Window out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Window out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of any of these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

#### 4.13 Revenue recognition

##### 4.13.1 Due from banks

Income on amounts due from banks is recognised on a time proportion basis over the period of the contract based on the principal amounts outstanding and the profit agreed with the clients.

##### 4.13.2 Murabaha

Income on Murabaha transactions is recognised by proportionately allocating the attributable profits over the period of the transaction where each financial period carries its portion of profit irrespective of whether or not cash is received, net of suspended profit.

##### 4.13.3 Musharaka

Income on Musharaka is recognised on accrual basis, net of suspended profit.

##### 4.13.4 Ijarah

Rentals accrued from ijarah financings net of depreciation charged are taken to the income statement, net of suspended profit.

##### 4.13.5 Income from investments

Income from investments is recognised when earned.

##### 4.13.6 Dividend

Dividend income is recognised when right to receive payment is established.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 4 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 4.13 Revenue recognition (continued)

##### 4.13.7 Fee and commissions

Fee and commission income recognised when earned.

Commission on letters of credit and letters of guarantee are recognised as income over the period of the transaction.

Fees for structuring and arrangement of financing transactions for and on behalf of other parties are recognised when the Islamic Window has fulfilled all its obligations in connection with the related transaction.

##### 4.13.8 Islamic Window share as a Mudarib

The Islamic Windows' share as Mudarib for managing equity of investment accountholders is accrued based on the terms and conditions of the related mudaraba agreement.

##### 4.13.9 Profit suspension

Profit receivable which is doubtful of recovery is excluded from the profit recognised until it is received in cash.

#### 4.14 Provisions

Provisions are recognised when the Islamic Window has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

#### 4.15 Taxation

Taxation is calculated and paid by the Bank on an overall basis. Taxation expense in these financial statements represents allocation of such taxation to the Islamic Window.

#### 4.16 Impairment

##### Policy applicable from 1 January 2018

The Islamic window assess on a forward-looking basis the expected credit losses (ECL) associated with financial assets measured at amortised cost or Fair value through other comprehensive income which mainly include financings, investments (other than equity investments), interbank placements, financing commitments and financial guarantees. The Islamic window recognises a loss allowance and provision for such losses at reporting date. The measurement of ECL reflects:

- an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The Islamic window approach leveraged the existing regulatory capital models and processes for financing portfolios that use the existing Internal Rating based and behavioral credit models. IFRS 9 considers the calculation of ECL by multiplying the Probability of default (PD), Loss Given Default (LGD) and Exposure at Default (EAD).

The Islamic window measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

##### Measurement of ECL

Credit loss allowances are measured using a three-stage approach based on the extent of credit deterioration since origination:

Stage 1 – Where there has not been a significant increase in credit risk (SICR) since initial recognition of a financial instrument, an amount equal to 12 months expected credit loss is recorded. The expected credit loss is computed using a probability of default occurring over the next 12 months. For those instruments with a remaining maturity of less than 12 months, a probability of default corresponding to remaining term to maturity is used.

Stage 2 – When a financial instrument experiences a SICR subsequent to origination but is not considered to be in default, it is included in Stage 2. This requires the computation of expected credit loss based on the probability of default over the remaining estimated life of the financial instrument.

Stage 3 – Financial instruments that are considered to be in default are included in this stage. Similar to Stage 2, the allowance for credit losses captures the lifetime expected credit losses.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 4 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 4.16 Impairment (continued)

##### Measurement of ECL (continued)

For financial assets in Stage 1 and Stage 2, the Islamic window calculates profit income by applying the Effective Profit Rate to the gross carrying amount (i.e., without deduction for ECLs).

The key inputs into the measurement of ECL are the term structure of the following variables:

- (i) Probability of default (PD);
- (ii) loss given default (LGD);
- (iii) exposure at default (EAD)

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

Details of these statistical parameters/inputs are as follows:

PD – The probability of default is an estimate of the likelihood of default over a given time horizon.

EAD – The exposure at default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date.

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

##### Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the financee, then an assessment is made of whether the financial asset is derecognised and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial assets are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition.

##### Write off

Financing receivables together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Islamic window. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the financing impairment account. If a write-off is later recovered, the recovery is credited to the statement of comprehensive income. The policy on write off's remains unchanged.

#### 4.17 Fair value

Fair value is determined for each financial asset individually in accordance with the valuation policies set out below:

- For quoted investments that are traded in organised financial markets, fair value is determined by reference to the quoted market bid prices prevailing on the statement of financial position date.
- For unquoted investments, fair values is determined by reference to recent significant buy or sell transaction with third parties that are either completed or are in progress. Where no recent significant transactions have been completed or are in progress, fair value is determined by reference to the current market value of similar investments. For others, the fair value is based on the net present value of estimated future cash flows, or other relevant valuation methods.
- For investments that have fixed or determinable cash flows, fair value is based on the net present value of estimated future cash flows determined by the Islamic Window using current profit rates. For investments with similar terms and risk characteristics.
- Investments which cannot be remeasured to fair value using any of the above techniques are carried at cost, less impairment loss, if any.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 4 SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 4.18 De-recognition of financial assets and liabilities

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the right to receive cash flows from the asset has expired;
- the Islamic Window retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or
- the Islamic Window has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

#### 4.19 Employee terminal benefits

##### 4.19.1 Terminal benefits

End of service benefits are accrued in accordance with the terms of employment of the Islamic Window's employees at the reporting date, having regard to the requirements of the Oman Labour Law 2003, as amended.

Contribution to a defined contribution retirement plan and occupational hazard insurance for Omani employees in accordance with the Omani Social Insurances Law of 1991 are recognised as an expense in the income statement when incurred.

##### 4.19.2 Short term benefits

Short term benefit obligations are measured on an undiscounted basis and are expensed when the related service is provided.

#### 4.20 Earnings prohibited by Sharia

The Islamic Window is committed to avoid recognising any income generated from non-Islamic sources. Accordingly all non-Islamic income is credited to the charity account where the Islamic Window uses these funds for charitable purposes.

#### 4.21 Zakah

Zakah is calculated in accordance with FAS 9 Zakah using the net assets method. The Islamic Window will calculate the "Zakah base" based on audited financial statements and after approval from Sharia Supervisory Board, notify the Shareholders of their pro-rata share of the Zakah payable annually. Payment of Zakah on the investment accounts and other accounts is the responsibility of investments account holders.

#### 4.22 Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Islamic Window has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

#### 4.23 Sharia Supervisory Board

The Islamic Window's business activities are subject to the supervision of a Sharia Supervisory Board consisting of members appointed by the general assembly of shareholders.

#### 4.24 Joint and self financed

Assets that are jointly owned by the Islamic window and the investment account holders are presented as "jointly financed" in the financial statements. All other assets are "self financed".

#### 4.25 Commingling of funds

The funds of Islamic Window are not commingled with the funds of Conventional Operations of the Bank.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 5 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires management to make judgements, estimates and assumptions that may affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. The Islamic Window's significant accounting estimates are in the followings:

#### 5.1 Financial asset classification

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

#### 5.2 Measurement of the expected credit loss allowance

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and Fair value through other comprehensive income is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note , which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- choosing appropriate models and assumptions for measurement of ECL;
- establishing the number and relative weightings of forward looking scenarios for each type of product/market and the associated ECL; and
- establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates is provided in note 4.16

#### 5.3 Useful life of property and equipment and Ijarah Muntahia Bittamleek

Depreciation is charged so as to write off the cost of assets over their estimated useful lives. The calculation of useful lives is based on management's assessment of various factors such as the operating cycles, the maintenance programs, and normal wear and tear using its best estimates.

#### 5.4 Going concern

The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt on the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

### 5 CASH AND BALANCES WITH CENTRAL BANK OF OMAN

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
2,465	<b>4,655</b>	Cash	<b>1,792</b>	949
92,634	<b>95,407</b>	Clearing account with Central Bank of Oman	<b>36,732</b>	35,664
95,099	<b>100,062</b>		<b>38,524</b>	36,613

### 6 DUE FROM BANKS

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
-	-	Wakala placements	-	-
5,901	<b>4,345</b>	Nostro account balances	<b>1,673</b>	2,272
5,901	<b>4,345</b>		<b>1,673</b>	2,272

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 7 MURABAHA RECEIVABLES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
47,140	<b>38,995</b>	Vehicles	<b>15,013</b>	18,149
87,577	<b>86,945</b>	Personal financing	<b>33,474</b>	33,717
10,257	<b>15,530</b>	Corporate	<b>5,979</b>	3,949
144,974	<b>141,470</b>	Gross receivables	<b>54,466</b>	55,815
(20,416)	<b>(18,683)</b>	Deferred profits	<b>(7,193)</b>	(7,860)
124,558	<b>122,787</b>		<b>47,273</b>	47,955
		Less: Impairment loss allowance		
(2,390)	<b>(304)</b>	Stage 1 & 2	<b>(117)</b>	(920)
(282)	<b>(473)</b>	Stage 3	<b>(182)</b>	(109)
121,886	<b>122,010</b>		<b>46,974</b>	46,926

Murabaha receivables are jointly financed by the Islamic window and investment account holders under Mudaraba and Wakala deposits.

### 8 MUSHARAKA RECEIVABLES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
159,351	<b>335,743</b>	Musharaka receivables	<b>129,261</b>	61,350
		Less: Impairment loss allowance		
(1,538)	<b>(2,538)</b>	Stage 1 & 2	<b>(977)</b>	(592)
157,813	<b>333,205</b>		<b>128,284</b>	60,758

Musharaka receivables are jointly financed by the Islamic window and investment account holders under Wakala deposits.

### 9 INVESTMENT SECURITIES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
		<b>Debt type instrument at fair value through other comprehensive income</b>		
37,611	<b>36,566</b>	Sukuks	<b>14,078</b>	14,480
		<b>Equity type instrument at fair value through other comprehensive income</b>		
475	<b>691</b>	Open end mutual fund & equity	<b>266</b>	183
		Less: Impairment loss allowance		
-	<b>(8)</b>	Stage 1 & 2	<b>(3)</b>	-
38,086	<b>37,249</b>		<b>14,341</b>	14,663

Investment securities are jointly financed by the Islamic window and investment account holders under Wakala deposits.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 10 IJARAH ASSETS - IJARAH MUNTAHIA BITTAMLEEK

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
498,335	<b>474,143</b>	Cost	<b>182,545</b>	191,859
(136,517)	<b>(154,431)</b>	Accumulated depreciation	<b>(59,456)</b>	(52,559)
361,818	<b>319,712</b>	<b>Book value</b>	<b>123,089</b>	139,300
		Less: Impairment loss allowance		
(3,699)	<b>(722)</b>	Stage 1 & 2	<b>(278)</b>	(1,424)
(109)	<b>(460)</b>	Stage 3	<b>(177)</b>	(42)
358,010	<b>318,530</b>	<b>Net book value</b>	<b>122,634</b>	137,834

Ijarah assets are jointly financed by the Islamic window and investment account holders under Mudaraba and Wakala deposits.

### 11 CREDIT CARD RECEIVABLE

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
1,112	<b>1,392</b>	Islamic Credit Card	<b>536</b>	428
		Less: Impairment loss allowance		
-	<b>(10)</b>	Stage 1 & 2	<b>(4)</b>	-
1,112	<b>1,382</b>	<b>Net book value</b>	<b>532</b>	428

### 12 SERVICE IJARAH

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
382	<b>603</b>	Service Ijarah	<b>232</b>	147

Service ijarah assets are jointly financed by the Islamic window and investment account holders under Mudaraba and Wakala deposits.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 13. FINANCING ACTIVITIES

In accordance with CBO circular BM 1149 Banks should continue to maintain and update the risk classification (i.e. standard, special mention, substandard, etc.) of accounts as per the extant CBO norms, including those on restructuring of loans accounts for regulatory reporting purposes.

#### 13.1 Comparison of provision held as per IFRS 9 and required as per CBO norms

Disclosure requirements containing the risk classification-wise gross and net amount outstanding, provision required as per CBO norms, allowance made as per IFRS 9, profit recognised as per IFRS 9 and suspended profit required as per CBO are given below based on CBO circular BM 1149.

Asset Classification as per CBO Norms	Asset Classification as per IFRS 9	Gross Amount RO '000	Provision required as per CBO Norms RO '000	Provision held as per IFRS 9 RO '000	Difference between CBO provision required and provision held RO '000	Net Amount as per CBO norms* RO '000	Net Amount as per IFRS 9 RO '000	Profit recognised in P&L as per IFRS 9 RO '000	Suspended profit as per CBO norms RO '000
(1)	(2)	(3)	(4)	(5)	(6) = (4)-(5)	(7)=(3)-(4)-	(8) = (3)-(5)	(9)	(10)
Standard	Stage 1	273,553	3,439	372	3,067	270,114	273,181	-	-
	Stage 2	7,117	-	25	(25)	7,117	7,092	-	-
	Stage 3	-	-	-	-	-	-	-	-
<b>Subtotal</b>		<b>280,670</b>	<b>3,439</b>	<b>397</b>	<b>3,042</b>	<b>277,231</b>	<b>280,273</b>	<b>-</b>	<b>-</b>
Special Mention	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	19,090	-	979	(979)	19,090	18,111	-	-
	Stage 3	-	-	-	-	-	-	-	-
<b>Subtotal</b>		<b>19,090</b>	<b>-</b>	<b>979</b>	<b>(979)</b>	<b>19,090</b>	<b>18,111</b>	<b>-</b>	<b>-</b>
Substandard	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	252	63	144	(81)	187	108	-	2
<b>Subtotal</b>		<b>252</b>	<b>63</b>	<b>144</b>	<b>(81)</b>	<b>187</b>	<b>108</b>	<b>-</b>	<b>2</b>
Doubtful	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	172	71	101	(30)	97	71	-	4
<b>Subtotal</b>		<b>172</b>	<b>71</b>	<b>101</b>	<b>(30)</b>	<b>97</b>	<b>71</b>	<b>-</b>	<b>4</b>
Loss	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	207	138	136	2	53	71	-	16
<b>Subtotal</b>		<b>207</b>	<b>138</b>	<b>136</b>	<b>2</b>	<b>53</b>	<b>71</b>	<b>-</b>	<b>16</b>
Other items not covered under CBO circular BM 977 and related instructions	Stage 1	64,195	-	21	(21)	64,195	64,174	-	-
	Stage 2	188	-	1	(1)	188	187	-	-
	Stage 3	-	-	-	-	-	-	-	-
<b>Subtotal</b>		<b>64,383</b>	<b>-</b>	<b>22</b>	<b>(22)</b>	<b>64,383</b>	<b>64,361</b>	<b>-</b>	<b>-</b>
<b>Total</b>	<b>Stage 1</b>	<b>337,748</b>	<b>3,439</b>	<b>393</b>	<b>3,046</b>	<b>334,309</b>	<b>337,355</b>	<b>-</b>	<b>-</b>
	<b>Stage 2</b>	<b>26,395</b>	<b>-</b>	<b>1,005</b>	<b>(1,005)</b>	<b>26,395</b>	<b>25,390</b>	<b>-</b>	<b>-</b>
	<b>Stage 3</b>	<b>631</b>	<b>272</b>	<b>381</b>	<b>(109)</b>	<b>337</b>	<b>250</b>	<b>-</b>	<b>22</b>
	<b>Total</b>	<b>364,774</b>	<b>3,711</b>	<b>1,779</b>	<b>1,932</b>	<b>361,041</b>	<b>362,995</b>	<b>-</b>	<b>22</b>

Other items disclosed above includes exposure outstanding and respective provisions held against due from banks, investments, other assets, financing commitments and financial guarantees.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 13. FINANCING ACTIVITIES (continued)

#### 13.2 Restructured Loans

Asset Classification as per CBO Norms	Asset Classification as per IFRS 9	Gross Carrying Amount RO '000	Provision required as per CBO Norms RO '000	Provision held as per IFRS 9 RO '000	Difference between CBO provision required and provision held RO '000	Net Carrying Amount as per CBO norms* RO '000	Net Carrying Amount as per IFRS 9 RO '000	Profit recognised in P&L as per IFRS 9 RO '000	Suspended profit as per CBO norms RO '000
(1)	(2)	(3)	(4)	(5)	(6) = (4)-(5)	(7)=(3)-(4)- (10)	(8) = (3)-(5)	(9)	(10)
Classified as performing	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	2,244	323	190	133	1,921	2,054	-	-
	Stage 3	-	-	-	-	-	-	-	-
<b>Subtotal</b>		<b>2,244</b>	<b>323</b>	<b>190</b>	<b>133</b>	<b>1,921</b>	<b>2,054</b>	<b>-</b>	<b>-</b>
Classified as non-performing	Stage 1	-	-	-	-	-	-	-	-
	Stage 2	-	-	-	-	-	-	-	-
	Stage 3	-	-	-	-	-	-	-	-
<b>Sub total</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total</b>	<b>Stage 1</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
	<b>Stage 2</b>	<b>2,244</b>	<b>323</b>	<b>190</b>	<b>133</b>	<b>1,921</b>	<b>2,054</b>	<b>-</b>	<b>-</b>
	<b>Stage 3</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
	<b>Total</b>	<b>2,244</b>	<b>323</b>	<b>190</b>	<b>133</b>	<b>1,921</b>	<b>2,054</b>	<b>-</b>	<b>-</b>

\*Net of provisions and suspended profit as per CBO norms

#### 6.3 Impairment charge and provisions held

	As per CBO Norms	As per IFRS 9	Difference
Impairment loss charged to profit and loss account	-	(1,115)	1,115
Provisions required as per CBO norms/ held as per IFRS 9	3,711	1,779	1,932
Gross NPL ratio (percentage)	0.21%	0.21%	-
Net NPL ratio (percentage)	0.11%	0.08%	0.03%

In accordance with CBO requirements, where the aggregate provision on portfolio & specific basis computed as per CBO norms is higher than the impairment allowance computed under IFRS 9, the difference, net of the impact of taxation, is transferred to an impairment reserve as an appropriation from the retained earnings.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 14 PROPERTY AND EQUIPMENT

	Building RO '000	Leasehold improvements RO '000	Computer and other equipment RO '000	Furniture RO '000	Capital work in progress RO '000	Total RO '000
<b>Cost:</b>						
At 1 January 2018	477	448	1,284	86	2	2,297
Additions	-	19	140	-	34	193
Transferred from the Bank	-	-	-	-	-	-
Disposals / scrapped	-	-	-	-	-	-
<b>At 31 December 2018</b>	<b>477</b>	<b>467</b>	<b>1,424</b>	<b>86</b>	<b>36</b>	<b>2,490</b>
<b>Accumulated depreciation:</b>						
At 1 January 2018	78	373	752	65	-	1,268
Depreciation	19	48	134	11	-	212
Disposals / scrapped	-	-	-	-	-	-
<b>At 31 December 2018</b>	<b>97</b>	<b>421</b>	<b>886</b>	<b>76</b>	<b>-</b>	<b>1,480</b>
<b>Net book value as at</b>						
<b>At 31 December 2018</b>	<b>380</b>	<b>46</b>	<b>538</b>	<b>10</b>	<b>36</b>	<b>1,010</b>
<b>At 31 December 2018 (US\$ '000)</b>	<b>987</b>	<b>119</b>	<b>1,397</b>	<b>26</b>	<b>94</b>	<b>2,623</b>

	Building RO '000	Leasehold improvements RO '000	Computer and other equipment RO '000	Furniture RO '000	Capital work in progress RO '000	Total RO '000
<b>Cost:</b>						
At 1 January 2017	477	452	1,251	86	2	2,268
Additions	-	-	49	-	13	62
Transferred from the Bank	-	-	13	-	(13)	-
Disposals / scrapped	-	(4)	(29)	-	-	(33)
At 31 December 2017	477	448	1,284	86	2	2,297
<b>Accumulated depreciation:</b>						
At 1 January 2017	59	286	604	57	-	1,006
Depreciation	19	90	148	8	-	265
Disposals / scrapped	-	(3)	-	-	-	(3)
At 31 December 2017	78	373	752	65	-	1,268
<b>Net book value as at</b>						
At 31 December 2017	399	75	532	21	2	1,029
At 31 December 2017 (US\$ '000)	1,036	195	1,382	55	5	2,673

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 15 OTHER ASSETS

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
2,184	<b>2,805</b>	Profit receivable on financing	<b>1,080</b>	841
229	<b>283</b>	Profit receivable on sukuks	<b>109</b>	88
145	<b>327</b>	Prepayments	<b>126</b>	56
173	<b>98</b>	Others	<b>38</b>	67
<u>2,731</u>	<u><b>3,513</b></u>		<u><b>1,353</b></u>	<u>1,052</u>

### 16 DUE TO BANKS

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
100,000	<b>290,460</b>	Wakala acceptances	<b>111,827</b>	38,500
281	<b>228</b>	Vostro account balances	<b>88</b>	108
<u>100,281</u>	<u><b>290,688</b></u>		<u><b>111,915</b></u>	<u>38,608</u>

### 17 WAKALA DEPOSITS

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
339,478	<b>170,366</b>	Financial institutions	<b>65,591</b>	130,699
93,280	<b>182,050</b>	Others	<b>70,089</b>	35,913
<u>432,758</u>	<u><b>352,416</b></u>		<u><b>135,680</b></u>	<u>166,612</u>

### 18 OTHER LIABILITIES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
6,564	<b>6,912</b>	Profit payable	<b>2,661</b>	2,527
3,384	<b>4,003</b>	Accrued expenses and payable	<b>1,541</b>	1,303
3	<b>3</b>	Charity payable	<b>1</b>	1
1,358	<b>3,220</b>	Others	<b>1,241</b>	523
-	<b>(49)</b>	Impairment loss allowance	<b>(19)</b>	-
<u>11,309</u>	<u><b>14,089</b></u>		<u><b>5,425</b></u>	<u>4,354</u>

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 19 EQUITY OF INVESTMENT ACCOUNT HOLDERS

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
		<i>By type:</i>		
115,642	<b>132,223</b>	Saving and Call accounts	<b>50,906</b>	44,522
115,642	<b>132,223</b>		<b>50,906</b>	44,522

The average profit rate for the investment account holders during the year was 2.60 % (2017 : 2.37%). Profit sharing ratio of mudarib as at 31 December 2018 was 40% (2017: 40%)

During the period there is no appropriation to profit equalisation reserve and investment risk reserve and no provision has been charged to income attributable to investment account holders.

### 20 SHARE CAPITAL

The allocated share capital of the Islamic Window is RO 25 million (equivalent to US\$ 64.935 million).

### 21 DIVIDEND PAID AND PROPOSED

The Board of Directors has recommended 10% cash dividend for the year 2018 (31 December 2017: 10% cash dividend). The cash dividend proposed for 2017 was approved by the shareholders in annual general meeting and was paid in 2018.

### 22 CONTINGENT LIABILITIES AND COMMITMENTS

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
1,291	<b>1,782</b>	Guarantees	<b>686</b>	497
49	-	Letter of credits	-	19
20,000	<b>29,127</b>	Financing Commitment	<b>11,214</b>	7,700
21,340	<b>30,909</b>		<b>11,900</b>	8,216

### 23 INCOME FROM FINANCING ACTIVITIES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
7,317	<b>15,242</b>	Musharaka	<b>5,868</b>	2,817
18,722	<b>19,566</b>	Rental income on ijarah assets	<b>7,533</b>	7,208
6,860	<b>6,815</b>	Murabaha	<b>2,624</b>	2,641
32,899	<b>41,623</b>		<b>16,025</b>	12,666

### 24 INCOME FROM INVESTING ACTIVITIES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
1,125	<b>1,418</b>	Income from investments	<b>546</b>	433
18	<b>44</b>	Income from wakala placements	<b>17</b>	7
1,143	<b>1,462</b>		<b>563</b>	440

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 25 OTHER OPERATING INCOME

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
4,325	1,000	Fee and commission, net	385	1,665
4,325	1,000		385	1,665

### 26 OTHER OPERATING INCOME FROM BANKING SERVICES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
327	608	Other operating income	234	126

### 27 STAFF EXPENSES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
1,681	1,875	Salaries and wages	722	647
1,493	1,909	Allowances	735	575
3,174	3,784		1,457	1,222

### 28 OTHER OPERATING EXPENSES

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
1,233	1,192	Operating and administration costs	459	475
644	587	Occupancy costs	226	248
60	99	Advertisement costs	38	23
94	94	Shariah Supervisory Board related expenses	36	36
2,031	1,972		759	782

### 29 ZAKAH

Zakah is directly borne by the owners and unrestricted investment accountholders. The Islamic Window does not collect or pay Zakah on behalf of its owners and its investment accountholders.

### 30 RELATED PARTY TRANSACTIONS

In the ordinary course of business the Islamic Window enters into transactions with major shareholders, directors, senior management, Sharia Supervisory Board and their related concerns. These transactions are conducted on an arm's length basis and are approved by the Islamic Window's management and Board of Directors.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 30 RELATED PARTY TRANSACTIONS (continued)

The year end balances in respect of related parties included in the statement of financial position are as follows:

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
		<b>Directors, Shariah Supervisory Board and senior management</b>		
60	36	Financing assets	14	23
205	278	Customers' deposits	107	79
51	41	Prepaid rent	16	20
		<b>Major shareholders and others</b>		
5	694	Nostro account balances	267	2
475	351	Investment securities	135	183
100,052	100,000	Due to banks - Wakala acceptances	38,500	38,520

The income and expenses in respect of related parties included in the statement of comprehensive income are as follows:

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
		<b>Directors, Shariah Supervisory Board and senior management</b>		
5	3	Profit earned	1	2
94	94	Shariah Supervisory Board related expenses	36	36
123	129	Other operating expenses	50	47
		<b>Major shareholders and others</b>		
4,117	8,761	Profit paid on due to banks	3,373	1,585
16	8	Profit received on due from banks	3	6
-	-	Other operating expenses	-	-

The Islamic window has rented a branch premises from one of the Directors. In accordance with the agreement, an amount of RO 0.047 million equivalent to US\$ 0.123 million was included in the other operating expenses (31 December 2017: RO 0.047 million equivalent to US\$ 0.123 million).

### 31 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is an amount for which an asset could be exchanged, or liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value of investments classified as fair value through other comprehensive income as at 31 December 2018 is RO 14.341 million equivalent to US\$ 37.249 million (31 December 2017: RO 3.490 million equivalent to US\$ 9.065 million) with cost amounts to RO 14.806 million equivalent to US\$ 38.457 million (31 December 2017: RO 3.519 million equivalent to US\$ 9.140 million).

Other than investments the Islamic Window considers that the fair value of other financial instruments is not significantly different to their carrying value.

#### Valuation of financial instruments:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 31 FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The table below analysis of financial instruments measured at fair value at the reporting date:

	2018			2017		
	Level 1 RO '000	Level 2 RO '000	Total RO '000	Level 1 RO '000	Level 2 RO '000	Total RO '000
<b>Financial assets</b>						
Investment - debt type instrument at fair value through profit or loss	-	-	-	-	11,173	11,173
Investment - debt type instruments at fair value through other comprehensive income	2,954	11,121	14,075	3,307	-	3,307
Investment - equity type instrument at fair value through other comprehensive income	-	266	266	183	-	183
	<b>2,954</b>	<b>11,387</b>	<b>14,341</b>	<b>3,490</b>	<b>11,173</b>	<b>14,663</b>
	2018			2017		
	Level 1 US\$ '000	Level 2 US\$ '000	Total US\$ '000	Level 1 US\$ '000	Level 2 US\$ '000	Total US\$ '000
<b>Financial assets</b>						
Investment - debt type instrument at fair value through profit or loss	-	-	-	-	29,021	29,021
Investment - debt type instruments at fair value through other comprehensive income	7,673	28,886	36,558	8,590	-	8,590
Investment - equity type instrument at fair value through other comprehensive income	-	691	691	475	-	475
	<b>7,673</b>	<b>29,577</b>	<b>37,249</b>	<b>9,065</b>	<b>29,021</b>	<b>38,086</b>

No financial instruments are carried at level 2 and level 3 fair values as on 31 December 2018 (31 December 2017: Nil)

### 32 RISK MANAGEMENT

Risk management is an integral part of the Islamic Window's decision making process. The Board of Directors and executive risk committee guide and assist the overall management of the Islamic Window's statement of financial position risks. The Islamic Window manages exposures by setting limits approved by the Board of Directors. The Islamic Window has exposure to the following risk from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.1 Credit Risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss. The Islamic Window controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by the personal guarantees of the counterparty, by collateral in form of mortgage of the objects financed or other tangible security.

##### 32.1.1 Type Of Credit Risk

Financing contracts mainly comprise Murabaha receivables, Musharaka and Ijarah assets.

##### 32.1.1.1 Murabaha Receivable

The Islamic Window finances these transactions through buying a commodity which represents the object of the murabaha and then resells this commodity to the murabaha (beneficiary) at a profit. The sale price (cost plus the profit margin) is repaid in installments by the murabaha over the agreed period. The transactions are secured at times by the object of the murabaha and other times by a total collateral package securing the facilities given to the client.

##### 32.1.1.2 Musharaka

An agreement between the Islamic Window and a customer to contribute to a certain investment enterprise, whether existing or new, or the ownership of a certain property either permanently or according to a diminishing arrangement ending up with the acquisition by the customer of the full ownership. The profit is shared as per the agreement set between both parties while the loss is shared in proportion to their shares of capital or the enterprise.

##### 32.1.1.3 Ijarah - Ijarah Muntahia Bittamleek

This is a lease whereby the legal title of the leased asset passes to the lessee at the end of the Ijarah (lease) term, provided that all Ijarah instalments are settled.

##### 32.1.1.4 Service Ijarah

This is lease of services against agreed rentals. The Islamic Banking Window purchases services from third party, service provider by making full payment and then lease it to the customer through Service Ijarah Contract.

##### 32.1.1.5 Credit Card Receivables

The Islamic Banking Window takes a fee for the credit card services and there are no charges taken on the amount utilized since, it is based on the Qard principle.

#### 32.1.2 Credit risk measurement

##### (a) Financings (including Loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Islamic window measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD).

##### (b) Credit risk grading

The Islamic window uses internal credit risk grading that reflect its assessment of the probability of default of individual counterparties. The bank's internal Risk Rating (RR) system is developed as a 10 grade system - enumerated from RR 1 to RR 10 - to risk rate a customer and to associate a default probability to each rating grade. The ratings will also assist studying the distribution of borrowers, grade wise exposures, transition of credit risk ratings over time, grade wise defaults, Non-Performing Loans (NPL) etc. Risk appetite will also be set in terms of how much of exposure bank expects in various grade bands. The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade.

Credit quality rating	Risk Rating(RR)	Classification
High Standard	RR1 to RR4	Not credit impaired on initial recognition- classified under 'Stage 1'.
Standard	RR5 to RR6	
Special Mention	RR7	Identified SICR since initial recognition but is not deemed to be credit impaired- Classified under 'Stage 2'.
Non performing	RR8 to RR10	Credit impaired- Classified under 'Stage 3'.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.1 Credit Risk (continued)

##### 32.1.3 Exposure to credit risk

The credit exposure of the Bank as on the reporting date is as follows:

	2018				2017
	Stage 1 RO '000	Stage 2 RO '000	Stage 3 RO '000	Total RO '000	Total RO '000
Clearing account with Central Bank of Oman	36,732	-	-	36,732	35,664
Due from banks	1,673	-	-	1,673	2,272
Financing to customers - Gross	273,553	26,207	631	300,391	249,180
Investment securities	14,078	-	-	14,078	14,480
Financing Commitments and financial guarantees	11,712	188	-	11,900	8,216
<b>Gross carrying amount</b>	<b>337,748</b>	<b>26,395</b>	<b>631</b>	<b>364,774</b>	309,812
<b>Impairment loss allowance</b>	<b>393</b>	<b>1,005</b>	<b>381</b>	<b>1,779</b>	3,087
<b>Carrying amount</b>	<b>337,355</b>	<b>25,390</b>	<b>250</b>	<b>362,995</b>	306,725

	2018				2017
	Stage 1 US\$ '000	Stage 2 US\$ '000	Stage 3 US\$ '000	Total US\$ '000	Total US\$ '000
Clearing account with Central Bank of Oman	95,408	-	-	95,408	92,634
Due from banks	4,345	-	-	4,345	5,901
Financing to customers - Gross	710,527	68,070	1,639	780,236	647,221
Investment securities	36,566	-	-	36,566	37,610
Financing Commitments and financial guarantees	30,421	488	-	30,909	21,340
<b>Gross carrying amount</b>	<b>877,267</b>	<b>68,558</b>	<b>1,639</b>	<b>947,464</b>	804,706
<b>Impairment loss allowance</b>	<b>1,021</b>	<b>2,610</b>	<b>990</b>	<b>4,621</b>	8,018
<b>Carrying amount</b>	<b>876,246</b>	<b>65,948</b>	<b>649</b>	<b>942,843</b>	796,688

##### Impaired Financing

The collateral held against impaired financing is RO 0.241 million equivalent to US\$ 0.626 million (31 December 2017: RO 0.287 million equivalent to US\$ 0.745 million).

##### 32.1.4 Expected credit loss measurement

###### Overview of ECL principles

The adoption of IFRS 9 has fundamentally changed the Islamic window financing loss impairment method by replacing incurred loss approach with a forward looking ECL approach. From 1 January 2018, the Islamic window has been recording the allowance for expected credit losses for all financing exposure and other debt financial assets not held at fair value through income statement together with financing commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The ECL Allowance is based on the credit losses expected to arise over the life of the asset (Lifetime ECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on 12 months expected credit loss (12 month ECL). The 12 month ECL is the portion of lifetime ECL that represent the ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting date.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.1 Credit Risk (continued)

##### 32.1.4 Expected credit loss measurement (continued)

The Islamic window has established a policy to perform an assessment on a monthly basis whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

Based on the above process, the Islamic window groups its financing exposure into Stage 1, Stage 2 and Stage 3, as classified below:

##### Stage 1

When financing are first recognised, the Islamic window recognises an allowance based on 12 month ECLs. Stage 1 financing exposure also include facilities where the credit risk has improved and the financing exposure has been reclassified from stage 2.

##### Stage 2

When a financing exposure has shown a significant increase in credit risk since origination, the Islamic window records an allowance for lifetime ECLs. Stage 2 financing exposure also include facilities, where the credit risk has improved and the financing exposure has been reclassified from stage 3.

##### Stage 3

Financing exposure considered credit impaired. The bank records an allowance for lifetime ECLs.

##### Measurement of ECL

The key inputs into the measurement of ECL are given in note 4.16

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

##### ECL Exposure of financial assets and off-balance sheet

The following table contains an analysis of stagewise reconciliation of loss allowance from the opening to the closing balance of financial assets / off balance sheet items by class of financial instrument.

##### Movement in Impairment allowance and provision

	Stage 1 RO '000	Stage 2 RO '000	Stage 3 RO '000	Total RO '000
<b>Opening balance as at 1 January 2018</b>				
Financings	307	2,300	233	2,840
Investment Securities	3	-	-	3
Financing commitments and financial guarantees	5	37	-	42
<b>Net transfer between stages</b>				
Financings	1,999	(1,972)	(27)	-
Investment Securities	-	-	-	-
Financing commitments and financial guarantees	-	-	-	-
<b>Charge for the Year (net)</b>				
Financings	(1,934)	676	175	(1,083)
Investment Securities	-	-	-	-
Financing commitments and financial guarantees	13	(36)	-	(23)
<b>Closing balance as at 31 December 2018</b>				
Financings	372	1,004	381	1,757
Investment Securities	3	-	-	3
Financing commitments and financial guarantees	18	1	-	19

Note: Charge for the year includes suspended profit of RO 9K

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.1 Credit Risk (continued)

##### 32.1.5 Significant increase in credit risk (SICR)

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Islamic window considers both quantitative and qualitative information and analysis, based on the Islamic window's historical experience and expert credit assessment and including forward-looking information. Retail facilities use the number of days past due (DPD) to determine significant increase in credit risk. For non-retail facilities, internally derived credit ratings have been identified as representing the best available determinant of credit risk. The Islamic window assigns each facility a credit rating at initial recognition based on qualitative and quantitative information available about the borrower. Credit risk is deemed to have increased significantly if the credit rating has significantly deteriorated at the reporting date relative to the credit rating at the date of initial recognition. In addition, as a backstop, the Islamic window considers that significant increase in credit risk occurs when an asset is more than 30 DPD.

The following quantitative guidelines are used to determine the staging of accounts:

1. An account will migrate to stage 2 if any of the changes in rating below are met;
  - For risk ratings 1 – 4:  $\geq$  3 notch downgrade
  - For risk rating 5: 2 notch downgrade
  - For risk rating 6 : 1 notch downgrade
2. An account will also migrate to stage 2 if it is more than 30 days past due
3. An account will also be considered stage 2 if has been placed under special mention

In addition to the above, qualitative criteria as per the CBO circular BM 1149 dated 13 April 2017 are being considered for assessing the significant increase in credit risk to corporate customers with limits of OMR 500,000 or more.

##### 32.1.6 Definition of default

The Islamic window considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Islamic window in full, without recourse by the Islamic window to actions such as realising security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation of the Islamic window.

In assessing whether the borrower is in default, the Islamic window considers indicators that are;

- qualitative - e.g. breaches of covenant
- quantitative - e.g. overdue status and non-payment on another obligation of the same issuer to the Islamic window; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instruments is in default and their significance may vary over time to reflect changes in circumstances.

##### Macroeconomic factors, forward looking information (FLI) and multiple scenarios

The measurement of expected credit losses for each stage and the assessment of significant increases in credit risk considers information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information requires significant judgement.

Based on advice from Credit Risk Committee and after considering of external information, the Islamic window formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. This process involves developing additional economic scenarios and considering the relative probabilities of each outcome.

In its models, the Islamic window relies on a broad range of forward looking information as economic inputs, such as: real gross domestic product (GDP) growth and oil revenue (as % of GDP). The inputs and models used for calculating expected credit losses may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are made as temporary adjustments using expert credit judgement.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.2 Liquidity Risk

Liquidity risk is the risk that the Islamic Window 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, manages assets with liquidity in mind, and monitors liquidity on a regular basis.

The Islamic Window's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its obligation when due, under normal and stressed conditions without incurring unacceptable losses or risking damage to the Islamic Window's reputation. The Islamic Window has put in place an approved Contingency Liquidity Plan to facilitate management of liquidity.

Liquidity risk is managed by the Islamic Window through closely monitoring the liquidity gap against the limit fixed.

Adequate liquidity is ensured by Treasury, which receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, placements with banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Islamic Window as a whole. In this process due care is taken to ensure that the Islamic Window complies with all the Central Bank of Oman regulations.

The following table summarises the maturity profile of the Islamic Window assets and liabilities as on the reporting date. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the reporting date to the contractual maturity date and do not take account of the effective maturities as indicated by the Islamic Window's deposit retention history and the availability of liquid funds.

31 December 2018	Upto three months RO '000	Above three months to twelve months RO '000	Above one year to five years RO '000	More than five years RO '000	Total RO '000
<b>Assets</b>					
Cash and balances with Central Bank of Oman	38,524	-	-	-	38,524
Due from banks	1,673	-	-	-	1,673
Financing assets	8,896	12,400	50,943	226,417	298,656
Investment securities	7,678	3,707	764	2,192	14,341
Property and equipment	-	-	-	1,010	1,010
Other assets	240	1,113	-	-	1,353
<b>Total assets</b>	<b>57,011</b>	<b>17,220</b>	<b>51,707</b>	<b>229,619</b>	<b>355,557</b>
<b>Liabilities, equity of investment account holders and owners' equity</b>					
Due to banks	40,658	19,250	52,007	-	111,915
Customers' deposits	49,843	55,498	50,914	40,659	196,914
Other liabilities	1,977	1,958	980	510	5,425
Shareholder's fund	-	-	-	41,303	41,303
<b>Total liabilities, equity of investment account holders and owners' equity</b>	<b>92,478</b>	<b>76,706</b>	<b>103,901</b>	<b>82,472</b>	<b>355,557</b>
<b>Net liquidity gap</b>	<b>(35,467)</b>	<b>(59,486)</b>	<b>(52,194)</b>	<b>147,147</b>	<b>-</b>

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.2 Liquidity Risk (continued)

31 December 2018	Upto three months US\$ '000	Above three months to twelve months US\$ '000	Above one year to five years US\$ '000	More than five years US\$ '000	Total US\$ '000
<b>Assets</b>					
Cash and balances with Central Bank of Oman	100,062	-	-	-	100,062
Due from banks	4,345	-	-	-	4,345
Financing assets	23,106	32,208	132,319	588,097	775,730
Investment securities	19,943	9,629	1,984	5,693	37,249
Property and equipment	-	-	-	2,623	2,623
Other assets	623	2,890	-	-	3,513
<b>Total assets</b>	<b>148,079</b>	<b>44,727</b>	<b>134,303</b>	<b>596,413</b>	<b>923,522</b>
<b>Liabilities, equity of investment account holders and owners' equity</b>					
Due to banks	105,605	50,000	135,083	-	290,688
Customers' deposits	129,462	144,151	132,244	105,608	511,465
Other liabilities	5,135	5,086	2,545	1,323	14,089
Shareholder's fund	-	-	-	107,280	107,280
<b>Total liabilities, equity of investment account holders and owners' equity</b>	<b>240,202</b>	<b>199,237</b>	<b>269,872</b>	<b>214,211</b>	<b>923,522</b>
<b>Net liquidity gap</b>	<b>(92,123)</b>	<b>(154,510)</b>	<b>(135,569)</b>	<b>382,202</b>	<b>-</b>
Above three months to twelve months Above one year to five years More than five years Total					
31 December 2017	Upto three months RO '000	to twelve months RO '000	years RO '000	years RO '000	RO '000
<b>Assets</b>					
Cash and balances with Central Bank of Oman	36,613	-	-	-	36,613
Due from banks	2,272	-	-	-	2,272
Financing assets	6,104	12,027	55,338	172,624	246,093
Investment securities	7,632	3,724	-	3,307	14,663
Property and equipment	-	-	-	1,029	1,029
Other assets	609	443	-	-	1,052
<b>Total assets</b>	<b>53,230</b>	<b>16,622</b>	<b>55,338</b>	<b>176,532</b>	<b>301,722</b>
<b>Liabilities, equity of investment account holders and owners' equity</b>					
Due to banks	108	-	38,500	-	38,608
Customers' deposits	51,041	76,101	61,762	34,000	222,904
Other liabilities	1,163	2,057	866	268	4,354
Shareholder's fund	-	-	-	35,856	35,856
<b>Total liabilities, equity of investment account holders and owners' equity</b>	<b>52,312</b>	<b>78,158</b>	<b>101,128</b>	<b>70,124</b>	<b>301,722</b>
<b>Net liquidity gap</b>	<b>918</b>	<b>(61,536)</b>	<b>(45,790)</b>	<b>106,408</b>	<b>-</b>

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.2 Liquidity Risk (continued)

31 December 2017	Upto three months US\$ '000	Above three months to twelve months US\$ '000	Above one year to five years US\$ '000	More than five years US\$ '000	Total US\$ '000
<b>Assets</b>					
Cash and balances with Central Bank of Oman	95,099	-	-	-	95,099
Due from banks	5,901	-	-	-	5,901
Financing assets	15,855	31,239	143,735	447,262	638,091
Investment securities	19,823	9,673	-	8,590	38,086
Property and equipment	-	-	-	2,673	2,673
Other assets	1,582	2,261	-	-	3,843
<b>Total assets</b>	<b>138,260</b>	<b>43,173</b>	<b>143,735</b>	<b>458,525</b>	<b>783,693</b>
<b>Liabilities, equity of investment account holders and owners' equity</b>					
Due to banks	281	-	100,000	-	100,281
Customers' deposits	132,574	197,665	160,421	88,311	578,971
Other liabilities	3,021	5,343	2,249	696	11,309
Shareholder's fund	-	-	-	93,132	93,132
<b>Total liabilities, equity of investment account holders and owners' equity</b>	<b>135,876</b>	<b>203,008</b>	<b>262,670</b>	<b>182,139</b>	<b>783,693</b>
<b>Net liquidity gap</b>	<b>2,384</b>	<b>(159,835)</b>	<b>(118,935)</b>	<b>276,386</b>	<b>-</b>

#### 32.3 Market Risk

Market risk arises from fluctuations in profit rates, equity prices and foreign exchange rates.

##### 32.3.1 Profit Rate Risk

Profit rate risk is the risk that the Islamic Window will incur a financial loss as a result of mismatch in the profit rate on the Islamic Window's assets and investment account holders. The profit distribution to investment account holders is based on profit sharing agreements. Therefore, the Islamic Window is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Islamic Window's results do not allow the Islamic Window to distribute profits in line with the market rates.

Basel-II Accord has recommended for assessing the impact of profit rate risk by applying upto 200 basis points profit rate sensitivity. Earning impacts of 200 basis points parallel shift in profit rate is provided below;

31 December 2018	2018 RO '000	2018 US\$ '000	2017 RO '000	2017 US\$ '000
Net profit earned	7,303	18,969	6,588	17,112
Impact of +200 bps profit rate increase	351	912	399	1,036
Impact of -200 bps profit rate decrease	(351)	(912)	(399)	(1,036)

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.3 Market Risk (continued)

##### 32.3.2 Foreign Exchange Risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board of Directors have set limits on the overall open position and for open position for each currency. The open position limits include overnight open position and intraday open position. Open positions are monitored on a daily basis and hedging strategies are used to ensure that positions are maintained within established limits. The Islamic Window had the following net exposures denominated in foreign currencies:

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
7,378	<b>1,132</b>	US Dollar	<b>436</b>	4,795
6	<b>283</b>	Euro	<b>109</b>	46
66	<b>127</b>	UAE Dirham	<b>49</b>	6
8	<b>221</b>	GBP Sterling	<b>85</b>	11
291	<b>719</b>	Others	<b>277</b>	12

The Islamic Window takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors set limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions, which are monitored daily.

Changes in the non-parity foreign currency prices as at 31 December 2018 on net assets is considered negligible.

##### 32.3.3 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 equity price risk exposure arises from the investment portfolio.

#### 32.4 Operational Risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Islamic Window cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

#### 32.5 Concentration Risk

Concentration of credit risk arise when a number of counter parties 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 affected similarly by changes in economic, political or other conditions. Concentration of credit risk indicates the relative sensitivity of the Islamic Window's performance to developments affecting a particular industry or geographical location.

The Islamic Window seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentration of credit risk with individuals or group of counterparty in specific locations or businesses. It also obtains appropriate security.

## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.5 Concentration Risk (continued)

	2018					
	Murabaha, gross RO '000	Musharaka, gross RO '000	Ijarah Muntahia Bittamleek RO '000	Other financings, gross RO '000	Due from banks RO '000	Investment securities RO '000
<b>Concentration by industry</b>						
Sovereign	-	-	-	-	-	13,364
Corporate	5,757	124,179	44,944	-	-	977
Personal	41,516	5,082	78,145	768	-	-
Banks	-	-	-	-	1,673	-
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Sovereign	-	-	-	-	-	34,711
Corporate	14,953	322,543	116,738	-	-	2,538
Personal	107,834	13,200	202,974	1,995	-	-
Banks	-	-	-	-	4,345	-
	2017					
	Murabaha, gross RO '000	Musharaka, gross RO '000	Ijarah Muntahia Bittamleek RO '000	Other financings, gross RO '000	Due from banks RO '000	Investment securities RO '000
<b>Concentration by industry</b>						
Sovereign	-	-	-	-	-	13,648
Corporate	3,896	60,426	60,470	-	-	1,015
Personal	44,059	924	78,830	575	-	-
Banks	-	-	-	-	2,272	-
	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>	<b>US\$ '000</b>
Sovereign	-	-	-	-	-	35,449
Corporate	10,119	156,951	157,065	-	-	2,637
Personal	114,439	2,400	204,753	1,494	-	-
Banks	-	-	-	-	5,901	-



## Notes to the Financial Statements (continued)

For the year ended 31 December 2018

### 32 RISK MANAGEMENT (continued)

#### 32.6 Capital Management

The primary objectives of the Islamic Window's capital management are to ensure that the Islamic Window complies with externally imposed capital requirements and that the Islamic Window maintains strong credit ratings and healthy capital ratio in order to support its business and to maximize shareholders value.

The Islamic Window manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Islamic Window may adjust the amount of dividend payment to shareholders or issue, return capital to shareholders or issue capital securities. However, no changes are made in the objectives, policies and processes from the previous years as far as management of capital is concerned.

The risk asset ratio, calculated in accordance with the capital adequacy guidelines of the Basel Committee on Banking Supervision, IBRF and CBO Circular BM 1114 'Regulatory Capital and Composition of Capital Disclosure requirements under Basel III' effective from 31 December 2013, is as follows. As per CBO circular BDS/2018/1 dated 20 March 2018, minimum capital adequacy ratio requirement has been reduced to 11% from 12% with effect from 1 April 2018. As per new ratio, Tier 2 capital will be restricted to 2% from 3%, CET 1, Tier 1 requirements remains unchanged. The Capital buffers are maintained at the Bank level in accordance with BM 1140 'Concept paper on capital buffer requirements under Basel III' dated 30 December 2015.

2017 US\$ '000	2018 US\$ '000		2018 RO '000	2017 RO '000
91,816	<b>93,826</b>	Common Equity Tier 1 (CET1)	<b>36,123</b>	35,349
-	-	Additional Tier 1	-	-
91,816	<b>93,826</b>	Tier 1	<b>36,123</b>	35,349
6,730	<b>3,106</b>	Tier 2	<b>1,196</b>	2,591
98,546	<b>96,932</b>	<b>Total regulatory capital</b>	<b>37,319</b>	37,940
		<b>Risk weighted assets</b>		
537,662	<b>684,875</b>	Credit risk	<b>263,677</b>	207,000
10,205	<b>5,951</b>	Market risk	<b>2,291</b>	3,929
33,956	<b>38,104</b>	Operational risk	<b>14,670</b>	13,073
581,823	<b>728,930</b>	<b>Total risk weighted assets</b>	<b>280,638</b>	224,002
		<b>Capital adequacy ratio</b>		
15.78%	<b>12.87%</b>	CET1 capital expressed as a percentage of total risk weighted assets	<b>12.87%</b>	15.78%
15.78%	<b>12.87%</b>	Total tier I capital expressed as a percentage of total risk weighted assets	<b>12.87%</b>	15.78%
1.16%	<b>0.43%</b>	Tier II capital expressed as a percentage of total risk weighted assets	<b>0.43%</b>	1.16%
16.94%	<b>13.30%</b>	Total regulatory capital expressed as a percentage of total risk weighted assets	<b>13.30%</b>	16.94%

### 33 SOCIAL RESPONSIBILITY

The Islamic Window discharges its social responsibilities through donations to charitable causes and organisations.

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# Al Hilal Islamic Banking Services

## Basel II Pillar III and Basel III Report

31 December 2018



KPMG  
4th Floor, HSBC Bank Building  
MBD  
P.O. Box 641  
P.C. 112  
Sultanate of Oman  
Tel +968 24709181  
Fax +968 24700839

## **INDEPENDENT AUDITORS' REPORT ON FACTUAL FINDINGS TO THE BOARD OF DIRECTORS OF AL HILAL ISLAMIC BANKING - WINDOW OF AHLI BANK SAOG ("AL HILAL") IN RESPECT OF BASEL II - PILLAR III & BASEL III RELATED DISCLOSURES**

We have performed the procedures agreed with you and as prescribed in the Islamic Banking Regulatory Framework ("IBRF") issued by Central Bank of Oman ("CBO") under Circular No. IB 1 dated 18 December 2012 ("the Procedures") with respect to the Basel II - Pillar III Disclosures and Basel III related Disclosures ("the disclosures") of Al Hilal Islamic Banking - Window of Ahli Bank SAOG ("Al Hilal") set out on pages 187 to 227 as at and for the year ended 31 December 2018. The disclosures were prepared by the Management in accordance with requirements of IBRF issued by CBO under Circular No. IB 1 dated 18 December 2012 and BM 1114 dated 17 November 2013. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures, as set out in IBRF issued by CBO under Circular No. IB 1 dated 18 December 2012, were performed solely to assist you in evaluating Al Hilal's compliance with the disclosure requirements set out in CBO's Circular No. IB 1 dated 18 December 2012 and BM 1114 dated 17 November 2013.

We report our findings as follows:

Based solely on performance of the procedures, we found no exceptions.

Because the Procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the disclosures.

Had we performed additional procedures or had we performed an audit or review of the Disclosures in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties other than Central Bank of Oman; and we accept no liability or responsibility to any third party. This report relates only to the Al Hilal's Disclosures and does not extend to the financial statements of Al Hilal taken as a whole or to any other reports of Al Hilal.

**Kenneth MacFarlane**  
10 March 2019

# Basel II Pillar III and Basel III Report

31 December 2018

## 1. INTRODUCTION

In January 2013, Ahlibank SAOG (the Bank) received license from the Central Bank of Oman to operate its Islamic Banking Window under Al Hilal Islamic Banking Services and commenced operations through a network of dedicated Islamic branches. Al Hilal Islamic Banking Services (the Islamic Window) was incorporated in Sultanate of Oman to operate as an Islamic Banking Window of Ahlibank SAOG. The principle activity of the Islamic Window is to carry out banking and other financial trading activities in accordance with Islamic Sharia rules as permitted under the Islamic Banking Regulatory Framework (IBRF) issued by the Central Bank of Oman (CBO) through a network of eight branches as at year end.

The Basel Committee on Banking Supervision recommended revised international capital adequacy standards in 2004, referred as the Basel II capital framework or the revised capital framework. The framework consists of three pillars.

- Pillar 1 makes recommendations for calculation of minimum capital requirements.
- Pillar 2 discusses the key principles of supervisory review and risk management guidance.
- Pillar 3 complements the first two pillars of Basel II by requiring a range of disclosures on capital and risk assessment processes, aimed at encouraging and reinforcing market discipline.

## 2. SCOPE OF APPLICATION

The Islamic Window prepares this report in accordance with the Basel II Accord in conjunction with and as per the directive of the Central Bank of Oman (CBO). The major highlights of the regulations are:

- Islamic Window is required to maintain a minimum capital adequacy ratio of 11%. The Capital buffers are maintained at the Bank level in accordance with BM 1140 'Concept paper on capital buffer requirements under Basel III' dated 30 December 2015, and amended from time to time (CAR is 11% latest as per CBO circular dated March 20, 2018).
- There are three core risk disciplines under the Basel II Banking Accord for which capital is reserved for:
  - **Market Risk:** Market risk is defined as the risk of losses in, on and off balance sheet positions arising from movements in market prices. Main factors contributing to market risk are equity, profit rate, foreign exchange and commodity risk.
  - **Credit Risk:** Credit risk is defined as the risk that a counter party will not settle an obligation for full value, either when due or at any time thereafter.
  - **Operational Risk:** Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events.
- Under the Framework of Capital Adequacy, the Islamic Window is required to provide timely, accurate, relevant and adequate disclosures of qualitative and quantitative information that enables users to assess its activities and risk profile. The capital adequacy returns are required to be submitted to the CBO on a quarterly basis.
- The Bank has a formal "**Disclosure Policy**", which is applicable on the Islamic Window as well, for disclosure of information that it makes available to the general public as well as to the regulatory bodies. This policy is framed to enhance transparency about its activities and promote good governance. The Bank makes information publicly available in accordance with its policy on disclosure of information and applicable regulations.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 3. CAPITAL STRUCTURE

The primary objectives of the Bank's capital management framework is to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and a healthy capital ratio in order to support its business and to maximize shareholders value.

Ahlibank SAOG has following credit ratings at present:

Capital Intelligence		Fitch Rating	
Financial strength rating;	<b>BBB-</b>	Viability rating	<b>bb+</b>
Foreign currency Long Term Rating;	<b>BBB-</b>	Long term foreign currency and local currency IDRs;	<b>BB+</b>
Foreign currency Short term;	<b>A3</b>	Short term foreign currency and local currency IDRs;	<b>B</b>
Support rating;	<b>3</b>	Support rating;	<b>3</b>
Outlook;	<b>Stable</b>	Outlook;	<b>Negative</b>

The process of assessing the capital requirements of the Bank commences with the compilation of the annual business plan by individual business units which are then consolidated into the annual budget plan of the Bank. The annual budget plan provides an estimate of the overall growth in assets, its impact on capital and targeted profitability.

The Bank's Finance department monitors and reports the planned versus actual position, to ensure that the Bank is always adequately capitalized. Risk weighted assets and capital are monitored by the Risk Management department and also periodically assess the quantum of capital available to support assets growth and optimally deploy capital to achieve targeted returns.

Strategic business objectives and future capital needs are assessed within this framework. Normally, the Islamic window employs capital rationing techniques to allocate capital for each of the Islamic window's business risk departments in order to optimize returns.

Sources of future capital are identified and plans put in place to raise and retain capital, under the terms of the framework. The Islamic window also manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Islamic window may adjust the amount of dividend payment to shareholders or issue return capital to shareholders or issue capital securities.

Equity of unrestricted investment account holders (URIA) is not considered as part of regulatory capital and the Islamic window is not reducing its risk weighted assets for jointly financed assets.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 3. CAPITAL STRUCTURE (continued)

The Islamic window's capital structure as at 31 December 2018, based on the CBO guidelines is as follows:

#### CAPITAL ADEQUACY

SI. No	Elements of Capital	2018 RO'000)	2017 RO'000)
<b>Tier I Capital</b>			
1	Paid up capital	25,000	25,000
2	Legal reserves	-	-
3	Subordinated loan reserve	-	-
4	Retained earnings*	11,988	10,847
5	Other non-distributable Reserve	-	-
<b>Total Gross Tier I Capital</b>		<b>36,988</b>	<b>35,847</b>
<b>Deduction</b>			
5	Intangible Assets, including losses, cumulative unrealized losses recognized directly in equity	(865)	(498)
<b>Additional Tier I Capital</b>		<b>-</b>	<b>-</b>
6	Tier 1 Perpetual Bond	-	-
<b>Tier I capital after all deductions</b>		<b>36,123</b>	<b>35,349</b>
<b>Tier II Capital</b>			
7	Revaluation reserves / cumulative fair value gains or losses on fair value through equity instruments	-	4
8	Expected credit loss (stage 1 & 2) on financing	1,196	2,587
9	Subordinated debt	-	-
<b>Total Tier II Capital</b>		<b>1,196</b>	<b>2,591</b>
<b>Total Regulatory Capital</b>		<b>37,319</b>	<b>37,940</b>
Total Amount of unrestricted IAH Funds		50,906	44,522
Investment fair value reserve		(462)	9
Profit equalization reserve (PER)		-	-
Investment Risk Reserve (IRR)		-	-

\* Retained earning is adjusted for proposed cash dividend of RO 2.5 mn.

The Islamic Window follows a capital adequacy framework to link the Bank's annual budget projections and the capital required to achieve business objectives. It is determined by the Bank's strategic planning objectives and capital planning framework. Capital requirements are assessed for credit, operational, market, liquidity and profit rate risks and other risks.

#### Qualitative disclosures

The Islamic window uses a prudential building-block approach as the measurement technique to assess capital adequacy for current and future activities, which is compared with the consolidated eligible capital.

The Islamic window's capital management framework sets out to define, measure, raise and deploy capital in a co-ordinated and consistent manner. Its objective is to maximize its return on capital and, at the same time, provide an adequate cushion to cover any unexpected losses. The Islamic window manages its capital in an integrated manner with the aim of maintaining strong capital ratios and high ratings. This calls for a balanced approach: maintaining capital levels that are sufficient to provide a high return to shareholders; meeting the requirements of regulators, rating agencies and other stakeholders (including deposit holders and senior creditors), and supporting future business growth. The cost of capital and its composition in terms of its quality and stability is also considered.

The Islamic window's capital adequacy ratio is 13.30% as against the CBO requirement of 11% as at 31 December 2018. The Islamic window follows a capital adequacy framework to link the Islamic window's annual budget projections and the capital required to achieve business objectives. It is determined by the Islamic window's strategic planning objectives and capital planning framework. Capital requirements are assessed for credit, operational and market risks. In order to calculate the capital adequacy ratio, the Bank follows the standardized approach forming part of the Pillar 1 requirements of Basel II Norms and adopts rating from CBO's recognized four External Credit Assessment Institutions (ECAI), namely Moody's, Standard & Poors, Fitch and Capital Intelligence, for calculating the risk on its sovereign and bank exposures. In order to equip the requirements of the advanced approaches, the Islamic window has already implemented obligor rating models and the ratings are being tracked regularly.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 3. CAPITAL STRUCTURE (continued)

#### CAPITAL ADEQUACY (continued)

##### Internal Capital Adequacy Assessment Process (ICAAP)

In addition to Pillar I capital adequacy requirements under the Base Case, the Bank also calculates the internal capital requirements for Pillar II risks (i.e. liquidity risk, Rate of Return Risk, concentration risk and other risks including strategic, reputational, legal risks, Shariah non-compliance risk, etc.) for the entire bank, and has completed the ICAAP exercise for years 2018-2022.

#### i. Capital Adequacy Disclosures (RO '000)

As on 31 December 2018

Sl. No	Details	Gross balances (book value)	Net balances (book value)	Risk weighted assets
1	On-balances sheet items	359,610	358,326	259,165
2	Off-balance sheet items	2,269	2,269	4,512
<b>3</b>	<b>Total</b>	<b>361,879</b>	<b>360,595</b>	<b>263,677</b>
4	Tier 1 Capital			36,123
5	Tier 2 Capital			1,196
<b>6</b>	<b>Total Regulatory Capital</b>			<b>37,319</b>
6.1	Capital requirement for credit risk			29,004
6.2	Capital requirement for market risk			252
6.3	Capital requirement for operational risk			1,614
<b>7</b>	<b>Total required capital</b>			<b>30,870</b>
8	Tier 1 Ratio			12.87%
9	Total Capital Ratio			13.30%

As on 31 December 2017

Sl. No	Details	Gross balances (book value)	Net balances (book value)	Risk weighted assets
1	On-balances sheet items	295,189	292,970	206,660
2	Off-balance sheet items	340	340	340
3	Total	295,530	293,311	207,000
4	Tier 1 Capital			35,349
5	Tier 2 Capital			2,591
6	Total Regulatory Capital			37,940
6.1	Capital requirement for credit risk			24,840
6.2	Capital requirement for market risk			471
6.3	Capital requirement for operational risk			1,569
7	Total required capital			26,880
8	Tier 1 Ratio			15.78%
9	Total Capital Ratio			16.94%

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 3. CAPITAL STRUCTURE (continued)

#### CAPITAL ADEQUACY (continued)

##### ii. Computation of Capital Adequacy Ratio (RO '000)

SI. No	Simple Approach	2018	2017
	<b>Details</b>		
1	Tier I Capital (after supervisory deductions)	36,123	35,349
2	Tier II capital (after supervisory deductions and up to eligible limits)	1,196	2,591
3	Risk weighted assets – banking book	263,677	207,000
4	Risk weighted assets – operational risk	14,670	13,073
<b>5</b>	<b>Total Risk Weighted Assets – Banking Book + Operational Risk</b>	<b>278,347</b>	220,073
<b>6</b>	<b>Minimum required capital to support RWAs of banking book and operational risk</b>	<b>30,618</b>	26,409
	i) Minimum required Tier I Capital for banking book and operational risk	25,051	23,818
	ii) Tier II Capital required for banking book and operational risk	5,567	2,591
7	Tier I capital available for supporting trading book	11,072	11,531
8	Tier II capital available for supporting trading book	-	-
9	Risk Weighted Assets – trading book	2,291	3,929
10	Total capital required to support trading book	252	471
11	Minimum Tier I capital required for supporting trading book	72	134
<b>12</b>	<b>Total Regulatory Capital</b>	<b>37,319</b>	37,940
<b>13</b>	<b>Total Risk Weighted Assets – Whole bank</b>	<b>280,638</b>	224,002
<b>14</b>	<b>Common Equity Tier 1 (as a percentage of risk weighted assets)</b>	<b>12.87%</b>	15.78%
<b>15</b>	<b>Tier 1 (as a percentage of risk weighted assets)</b>	<b>12.87%</b>	15.78%
<b>16</b>	<b>BIS Capital Adequacy Ratio</b>	<b>13.30%</b>	16.94%

##### iii. Capital Adequacy Ratio

	2018	2017
Total Risk weighted assets	280,638	224,002
Total eligible capital	37,319	37,940
<b>Capital Adequacy Ratio</b>	<b>13.30%</b>	16.94%

##### iii. Ratio of total capital to total assets

	2018	2017
Total Capital	36,501	37,940
Total assets	355,557	301,722
<b>Total capital to total assets</b>	<b>10.27%</b>	12.57%

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 4. RISK MANAGEMENT OF THE BANK

#### Risk Management Principles

The Bank has an independent Risk Management Department (RMD) that also monitors the Islamic Window core risk areas and reports to the Executive Risk Committee (a Board Committee).

The primary goal of risk management is to ensure that the Bank's asset and liability profile, its trading positions, and its credit and operational activities do not expose it to losses that could threaten its survival. Risk Management assists in ensuring that risk exposures do not become excessive, relative to the Islamic Window's capital and financial positions.

The Islamic Window manages the risks effectively and efficiently by making risk management an integral part of commercial banking business. This emphasizes a clear understanding of business requirements in terms of products, clients, delivery capabilities, competition, regulatory environment, shareholder values and the global economic environment leading the Bank to identifying the various associated risks.

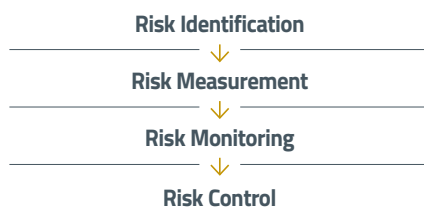
Having identified the risks, the RMD formulate policies and procedures taking into account regulatory requirements and best international practices, so as to monitor and control the risks within pre-determined acceptable limits. The key to this approach is the creation of a responsive organization structure around each of these risk categories with appropriate delegated authority to deliver in line with the business objectives approved by the Board of Directors.

Primary responsibility for the management of risk lies with the business and operational areas are responsible for the generation of risk exposure. Risk management provides an in-depth check against risk decisions and an ongoing platform to evaluate, monitor and sanction risk at the individual transaction and overall portfolio level.

#### Risk Management Structure

The risk management department reports directly to the Executive Risk Committee (a Board Committee).

Risk Management includes the following four elements:



#### Risk framework

The Bank has set up policies and measures to assess capital adequacy in terms of CBO regulations, which have been approved by the Board of Directors. Under these, the Bank assesses its capital against its risk profile, to ensure its capital is sufficient to support all material risks to which it is exposed.

The Board of Directors ensures that the senior management establishes a framework that identifies, measures, monitors and reports all relevant significant risks. The risk management department has identified material risks that the Islamic Window is exposed to, and has defined the framework necessary to measure, monitor, and report these risks on a timely basis. Further, the Sharia risk related compliance are one of the KRIs that the Islamic window has been monitoring as part of other KRIs.

The following Board and Management committees manage and control material risks to the Bank:

#### Board Committees:

- Audit and Compliance Committee
- Executive & Credit Committee
- Executive Risk Committee
- Nomination and Remuneration Committee

#### Management Committees:

- Credit & Investment Committee
- Assets and Liabilities Committee
- Credit Risk Management Committee
- Operational Risk Committee
- IT Steering Committee
- New Product Committee
- Special Assets Committee

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 4. RISK MANAGEMENT OF THE BANK (continued)

#### Policies and Procedures:

The Board of Directors under its terms of reference, controls and directs the Bank on behalf of the shareholders, its conduct of business, setting objectives and strategy by establishing policies under which the Bank operates. The Board of Directors approve the Bank's risk appetite, risk management strategies, policies and the framework for their effective implementation and control, including delegated authorities to the Executive and Credit Committee and Management to approve all risk exposures. In this context, the Board of Directors has approved the following policies:

- |                                            |                                              |
|--------------------------------------------|----------------------------------------------|
| 1. Anti-Money Laundering Manual            | 21. Operational Risk Policy & Procedure      |
| 2. Personal Account Dealing Policy         | 22. Fraud Risk Management Policy             |
| 3. New Product Committee and Procedures    | 23. Liquidity and Funding Policy             |
| 4. Voice Recording Policy                  | 24. Trading Book Policy                      |
| 5. Compliance Policy                       | 25. Risk Management-Approach & Framework     |
| 6. Communications Policy                   | 26. Social and Environment Management System |
| 7. Corporate Governance Policy             | 27. Security and Safety Policy and Plan      |
| 8. Corporate Social Responsibility Policy  | 28. Asset Management Policy                  |
| 9. Dividend Policy                         | 29. Brokerage Policy                         |
| 10. Expenses Policy                        | 30. FATCA Policy                             |
| 11. Capital Management Policy              | 31. Customer Complaints Redressal Policy     |
| 12. Disclosure Policy                      | 32. Profit Distribution Policy               |
| 13. Board Remuneration Policy              | 33. Charity Policy                           |
| 14. Financial Institutions Policy          | 34. Zakah Policy                             |
| 15. Human Resources Policy                 | 35. Cost Sharing Policy                      |
| 16. Outsourcing Policy                     | 36. Segregation of Funds Policy              |
| 17. Code of Business Conduct               | 37. Social Media Policy                      |
| 18. Information Security Management Policy | 38. Shari'a Governance Manual                |
| 19. Business Continuity Management         | 39. Third Party Risk Management Policy       |
| 20. Credit and Investment Policy           |                                              |

All policies are subject to periodical reviews. Any change in law or regulation is deemed to be automatically adopted and implemented immediately upon its issuance (i.e. prior to the final amendment of the underlying policy or procedure).

### 5. CREDIT RISK

#### Credit Risk Principles

Credit risk arises from the potential financial loss resulting from customers / counterparties failing to honor the terms of their contracts. It also includes the risk of loss in portfolio value as a result of migration from lower risk to higher risk categories. The Islamic Window evaluates both settlement and pre-settlement credit risk at the customer level, across all products of the Bank.

Credit risk is the most significant risk incurred by the Islamic Window, and proactive management is critical to the Islamic Window's long-term success.

The Islamic Window has a comprehensive due diligence system for approving credit facilities, and well-defined policies on controlling credit risk at the counter-party, group, economic sector, and country levels.

All corporate, bank and sovereign credit requires independent credit risk review to be approved by authorities, from Level II to the BoD, depending on their delegated credit approval Jurisdiction (CAJ). All credit approvals are strictly in accordance with the regulatory guidelines issued from time to time by the Central Bank of Oman. Exceptions in retail credit exposure are escalated to Risk Management Department for necessary approvals.

Risk Management quantifies the Islamic Window's credit risk appetite in line with the Bank's strategic direction. A well-established process exists to ensure the allocation of capital for the total credit risk to be assumed by the Islamic Window; and measuring the actual use of capital at portfolio level.

With regard to credit culture, Risk Management ensures that the appropriate policies, guidelines, processes and procedures exist to cover all business areas of credit risk. It also ensures the consistent application of credit standards through a diligent Credit Review function and post approval review of financing and investment assets through a financing review Review Mechanism (LRM) function and the periodic review and updating of credit policies, guidelines and procedures.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

The Bank also has a robust system of borrowers' risk ratings that assesses the risk of corporate borrowers and monitors ratings changes periodically.

#### Structure and policies of credit risk management

The credit risk management policies are governed through Credit Risk Management Committee, Executive Risk Committee of the Board and the Board of Directors. The following is the structure of credit risk approval:-



The Bank has set up internal limits and approval authorities at various Management and Board Level Committees or the full Board of Directors based on the product category like Commercial Banking Lending, Country Limits or Limits for lending to Banks / FIs or Sovereigns, the legal nature of the borrowers and their credit risk rating. In the case of a 'split rating' from approved external rating agencies such as S&P, Fitch or Moody's the lower rating normally applies.

The Credit & Investment Policy sets limit criteria for individual exposure, group exposure, internal limits for aggregate exposure to different risk ratings, country limits and economic sector limits. Business with any counter-party does not commence until a credit line has been approved. A strict credit approval process also exists with authority levels delegated to ensure the efficient conduct of business. Country limit proposals cover an assessment of the country's political and economic risks and its credit ratings and outlook. Specific transaction needs shall be through credit application on a case by case basis.

In case of annual reviews, limits are to be renewed at one level down if there is no material change or increase in the exposure.

#### Credit Risk Management

Credit risk management maximizes the Islamic Window's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Credit risk makes up the largest part of the Islamic Window's risk exposure. The Islamic Window has set clear and well defined limits to address different dimensions of credit risk including concentration risk. Credit risk is addressed by performing the following procedures:

- Establishing a sound credit granting process
- Maintaining an appropriate credit administration, monitoring and reporting process
- Ensuring monitoring of the adequacy of controls over credit risk.
- Lending limits

Transaction risk is concerned with the credit risk of a single counter-party. Risk Management ensures that credit is underwritten according to approved standards and that all risks are highlighted in the credit risk review, including policy exceptions. It includes analyzing and reporting on the nature of on- and off-balance sheet counter-party exposure (size, tenor, complexity and liquidity), including secured and unsecured credit facilities. As part of the Banks financing policy, sectoral limits have been set for ensuring that the Islamic window is having a well diversified portfolio, the same is being reviewed by the bank on a regular basis.

Credit facility risk is a part of portfolio credit risk management. Portfolio risk arises because of high positive correlation between individual credit facilities. This may include:

- Concentration of exposure in geographies, sectors, groups, counter-parties or rating categories;
- Interaction with other risks such as Rate of Return risk, FX risk, and broader economic risk;
- Trends in portfolio quality (customers' risk migration, non-performing assets).

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### Past due & credit exposures

The Islamic window has adopted IFRS 9 "Financial Instrument" accounting norm from beginning of 2018 as required by CBO circular BM 1149 dated 13 April 2017.

The adoption of IFRS 9 standard has fundamentally changed the Bank's financing loss impairment method by replacing incurred loss approach with a forward looking expected credit loss (ECL) approach. From 1 January 2018, the bank has been recording the allowance for expected credit losses for all financing exposure and other debt financial assets not held at FVTPL, together with financing commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9 accounting standard.

The ECL Allowance is based on the credit losses expected to arise over the life of the asset (Lifetime ECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on 12 months expected credit loss (12 month ECL). The 12 month ECL is the portion of lifetime ECL that represent the ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting date.

The bank has established a policy to perform an assessment on a monthly basis whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

Based on the above process, the bank groups its financing exposure into Stage 1, Stage 2 and Stage 3, as classified below:

#### Stage 1

When financing are first recognized, the bank recognizes an allowance based on 12 month ECLs. Stage 1 financing exposure also include facilities where the credit risk has improved and the financing exposure has been reclassified from stage 2.

#### Stage 2

When a financing exposure has shown a significant increase in credit risk since origination, the bank records an allowance for lifetime ECLs. Stage 2 financing exposure also include facilities, where the credit risk has improved and the financing exposure has been reclassified from stage 3.

#### Stage 3

Financing exposure considered credit impaired. The bank records an allowance for lifetime ECLs.

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

- The borrower 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 borrower is past due more than 90 days on any material credit obligation of the Bank.

#### Quantitative Disclosure:

#### i) Total gross credit risk exposures, plus average gross exposure over the period broken down by major types of credit exposure as at 31 December 2018:

Sl. No.	Type of Credit Exposure	Average Gross Exposure			Total Gross Exposure		
		31-Dec-18	31-Dec-17	% of total financing	31-Dec-18	31-Dec-17	% of total financing
1	Balances with Central bank of Oman	36,198	31,991	11%	36,732	35,664	10%
2	Sovereign	7,622	1,653	2%	11,936	3,307	3%
3	Banks	1,965	2,324	1%	3,598	2,272	1%
4	Musharaka	97,677	51,375	30%	129,261	61,350	36%
5	Ijarah	133,984	135,994	41%	123,089	139,300	34%
6	Murabaha	47,665	47,697	14%	47,273	47,955	13%
7	Credit Card Receivable	517	406	0%	536	428	0%
8	Service Ijarah	228	48	0%	232	147	0%
9	Other assets & off balance sheet items	4,039	5,419	1%	9,222	5,107	3%
	Total	329,895	276,907	100%	361,879	295,530	100%

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### ii) Credit exposure by risk weighted assets:

Type of credit exposure	31-Dec-18			31-Dec-17		
	Gross Balance	Net Balance	Risk Weighted Assets	Gross Balance	Net Balance	Risk Weighted Assets
Balances with Central bank of Oman	36,732	36,732	-	35,664	35,664	-
Sovereign	11,936	11,936	764	3,307	3,307	828
Banks	3,598	3,598	1,297	2,272	2,272	454
Musharaka	129,261	128,735	123,408	61,350	60,758	58,749
Ijarah	123,089	122,634	83,455	139,300	138,702	112,120
Murabaha	47,273	46,974	47,052	47,955	46,926	32,298
Credit Card Receivable	536	532	536	428	428	428
Service Ijarah	232	232	232	147	147	147
Other Assets & off balance sheet items	9,222	9,221	6,933	5,107	5,107	1,975
<b>Total</b>	<b>361,879</b>	<b>360,595</b>	<b>263,677</b>	<b>295,530</b>	<b>293,311</b>	<b>207,000</b>

#### iii) Credit exposure by business unit:

Type of credit exposure	Business Unit	As of 31 December 2018			As of 31 December 2017		
		Gross Balance	Net Balance	Risk Weighted Assets	Gross Balance	Net Balance	Risk Weighted Assets
Balances with Central bank of Oman		36,732	36,732	-	35,664	35,664	-
Sovereign		11,936	11,936	764	3,307	3,307	828
Banks		3,598	3,598	1,297	2,272	2,272	454
Musharaka	SME	5,069	4,826	3,802	5,522	5,494	4,121
	Corporate	119,110	118,833	117,828	54,904	54,349	54,023
	Retail	5,082	5,076	1,778	924	915	605
Murabaha	SME	882	855	662	-	-	-
	Corporate	4,875	4,844	4,875	3,896	3,857	3,834
	Retail	41,516	41,275	41,515	44,059	43,069	28,464
Ijarah	SME	3,547	3,510	2,665	4,982	4,957	3,718
	Corporate	41,397	41,269	41,397	55,487	54,929	56,789
	Retail	78,145	77,855	39,393	78,831	78,816	51,613
Credit Card Receivable	Retail	536	532	536	428	428	428
Service Ijarah	Retail	232	232	232	147	147	147
Other Assets & off balance sheet items		9,222	9,221	6,933	5,107	5,107	1,975
<b>Total</b>		<b>361,879</b>	<b>360,595</b>	<b>263,677</b>	<b>295,530</b>	<b>293,311</b>	<b>207,000</b>

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### iv) Geographic distribution of exposures by major types of credit exposure (gross):

As at 31 December 2018:

SI. No.	Type of Credit Exposure	Oman	Other GCC Countries	OECD Countries	India	Pakistan	Others	Total
1	Balances with Central bank of Oman	36,732	-	-	-	-	-	36,732
2	Sovereign	11,172	-	-	-	-	764	11,936
3	Banks	1,925	369	-	-	-	1,304	3,598
4	Musharaka	129,261	-	-	-	-	-	129,261
5	Murabaha	47,273	-	-	-	-	-	47,273
6	Ijarah	122,526	563	-	-	-	-	123,089
7	Credit Card Receivable	536	-	-	-	-	-	536
8	Service Ijarah	232	-	-	-	-	-	232
9	Other assets & off balance sheet items	9,222	-	-	-	-	-	9,222
	<b>Total</b>	<b>358,879</b>	<b>932</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,068</b>	<b>361,879</b>

As at 31 December 2017:

SI. No.	Type of Credit Exposure	Oman	Other GCC Countries	OECD Countries	India	Pakistan	Others	Total
1	Balances with Central bank of Oman	35,664	-	-	-	-	-	35,664
2	Sovereign	2,479	-	-	-	-	828	3,307
3	Banks	-	45	-	-	-	2,227	2,272
4	Musharaka	61,350	-	-	-	-	-	61,350
5	Murabaha	47,955	-	-	-	-	-	47,955
6	Ijarah	137,605	1,695	-	-	-	-	139,300
7	Credit Card Receivable	428	-	-	-	-	-	428
8	Service Ijarah	147	-	-	-	-	-	147
9	Other assets & off balance sheet items	5,107	-	-	-	-	-	5,107
	<b>Total</b>	<b>290,735</b>	<b>1,740</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,055</b>	<b>295,530</b>

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### v) Industry or counter party type distribution of exposures, broken down by major types of credit exposure:

As at 31 December 2018:

	Economic Sector	Musharaka	Murabaha	Ijarah	Service Ijarah	Credit Card Receivable	Total	Off Balance Sheet Exposure*
1	Wholesale & Retail Trade	9,439	759	6,241	-	-	16,439	4,053
2	Mining & Quarrying	-	-	-	-	-	-	-
3	Construction	105,076	398	19,550	-	-	125,024	7,450
4	Manufacturing	15	18	2,155	-	-	2,188	-
5	Transport & Communication	3,942	51	242	-	-	4,235	-
6	Electricity, Gas & Water	-	-	-	-	-	-	-
7	Financial Institutions	-	-	-	-	-	-	-
8	Services	608	111	16,055	-	-	16,774	-
9	Personal Financings	5,082	41,516	78,145	232	536	125,511	397
10	Non- Resident Lending	-	-	563	-	-	563	-
11	All Others	5,099	4,420	138	-	-	9,657	-
	<b>Total</b>	<b>129,261</b>	<b>47,273</b>	<b>123,089</b>	<b>232</b>	<b>536</b>	<b>300,391</b>	<b>11,900</b>

\* represents notional exposure as per financial statements

As at 31 December 2017:

	Economic Sector	Musharaka	Murabaha	Ijarah	Service Ijarah	Credit Card Receivable	Total	Off Balance Sheet Exposure*
1	Import Trade	6,163	3,766	163	-	-	10,092	-
2	Export Trade	-	-	-	-	-	-	-
3	Wholesale & Retail Trade	1,807	27	3,901	-	-	5,735	2,708
4	Mining & Quarrying	-	-	-	-	-	-	-
5	Construction	42,011	103	43,748	-	-	85,862	4,508
6	Manufacturing	2,136	-	3,400	-	-	5,536	-
7	Transport & Communication	163	-	354	-	-	517	-
8	Electricity, gas & Water	-	-	-	-	-	-	-
9	Financial Institutions	-	-	-	-	-	-	-
10	Services	3,882	-	1,500	-	-	5,382	200
11	Personal financings	924	44,059	78,831	147	428	124,389	800
12	Agriculture and Allied Activities	-	-	-	-	-	-	-
13	Government	-	-	-	-	-	-	-
14	Non- Resident Lending	-	-	1,695	-	-	1,695	-
15	All Others	4,264	-	5,708	-	-	9,972	-
	<b>Total</b>	<b>61,350</b>	<b>47,955</b>	<b>139,300</b>	<b>147</b>	<b>428</b>	<b>249,180</b>	<b>8,216</b>

\* represents notional exposure as per financial statements

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### vi) Residual contractual maturity of the whole portfolio, broken down by major types of credit exposure.

As at 31 December 2018:

	Time Band	Musharaka	Murabaha	Ijarah	Service Ijarah	Credit Card Receivable	Total	Off Balance Sheet Exposure*
1	Up to 1 month	458	2,329	807	-	268	<b>3,862</b>	2,055
2	1-3 Months	1,406	4,414	1,709	8	268	<b>7,805</b>	3,773
3	3-6 Months	1,098	1,706	1,745	5	-	<b>4,554</b>	1,810
4	6-9 Months	4,417	1,916	2,391	8	-	<b>8,732</b>	2,164
5	9-12 Months	1,394	2,705	2,918	11	-	<b>7,028</b>	2,012
6	1-3 Years	15,625	14,100	17,035	58	-	<b>46,818</b>	81
7	3-5 Years	11,866	10,429	16,862	49	-	<b>39,206</b>	-
8	Over 5 Years	92,997	9,674	79,622	93	-	<b>182,386</b>	5
	<b>Total</b>	<b>129,261</b>	<b>47,273</b>	<b>123,089</b>	<b>232</b>	<b>536</b>	<b>300,391</b>	<b>11,900</b>

\* represents notional exposure as per financial statements

As at 31 December 2017:

	Time Band	Musharaka	Murabaha	Ijarah	Service Ijarah	Credit Card Receivable	Total	Off Balance Sheet Exposure*
1	Up to 1 month	687	2,414	805	-	214	4,120	900
2	1-3 Months	1,230	1,790	1,760	5	214	4,999	1,729
3	3-6 Months	901	3,168	2,055	3	-	6,127	1,700
4	6-9 Months	1,796	1,780	2,516	5	-	6,097	1,715
5	9-12 Months	1,408	2,601	3,342	7	-	7,358	2,085
6	1-3 Years	15,077	13,974	18,921	38	-	48,010	81
7	3-5 Years	11,874	10,871	19,253	31	-	42,029	-
8	Over 5 Years	28,377	11,357	90,648	58	-	130,440	6
	<b>Total</b>	<b>61,350</b>	<b>47,955</b>	<b>139,300</b>	<b>147</b>	<b>428</b>	<b>249,180</b>	<b>8,216</b>

\* represents notional exposure as per financial statements

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### vii) Total Financing broken down by major industry or counterparty type

As at 31 December 2018:

	Economic Sector	Gross financings	Of Which NPLs	ECL stage 1 & 2	ECL stage 3*	Impairment charge/ (reversed) during the Year**	Financings written off during the year
1	Import Trade	9,632	-	369	-	318	-
2	Export Trade	-	-	-	-	-	-
3	Wholesale & Retail Trade	16,439	-	102	-	(309)	-
4	Mining & Quarrying	-	-	-	-	-	-
5	Construction	125,024	18	676	11	(1,050)	-
6	Manufacturing	2,188	-	5	-	(157)	-
7	Electricity , Gas & Water	-	-	-	-	-	-
8	Transport & Communication	4,236	-	7	-	2	-
9	Financial Institutions	-	-	-	-	-	-
10	Services	16,774	-	23	-	4	-
11	Personal Financing	125,511	613	193	370	100	-
12	Non Resident Lending	563	-	-	-	(1)	-
13	All Others	24	-	1	-	1	-
	<b>Total</b>	<b>300,391</b>	<b>631</b>	<b>1,376</b>	<b>381</b>	<b>(1,092)</b>	<b>-</b>

\* Stage 3 ECL include suspended profit of RO 0.022 mn

\*\* Includes suspended profit amounting to RO 0.009 mn

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### vii) Total Financing broken down by major industry or counterparty type (continued)

As at 31 December 2017:

	Economic Sector	Gross financings	Of Which NPLs	General Provisions	Specific Provisions	Suspended profit	Provisions made / (reversed) during the Year	Financings written off during the year
1	Import Trade	10,092	-	101	-	-	(21)	-
2	Export Trade	-	-	-	-	-	-	-
3	Wholesale & Retail Trade	15,708	-	157	-	-	96	-
4	Mining & Quarrying	-	-	-	-	-	-	-
5	Construction	85,862	-	859	-	-	134	-
6	Manufacturing	5,536	-	55	-	-	(11)	-
7	Transport & Communication	517	-	5	-	-	-	-
8	Electricity, gas & Water	-	-	-	-	-	-	-
9	Financial Institutions	-	-	-	-	-	-	-
10	Services	5,382	-	54	-	-	48	-
11	Personal financings	124,388	333	1,688	151	13	55	-
12	Agriculture and Allied Activities	-	-	-	-	-	-	-
13	Government	-	-	-	-	-	-	-
14	Non- Resident Lending	1,695	-	17	-	-	(11)	-
15	All Others	-	-	-	-	-	-	-
	<b>Total</b>	<b>249,180</b>	<b>333</b>	<b>2,936</b>	<b>151</b>	<b>13</b>	<b>290</b>	<b>-</b>

#### viii) Amount of impaired Financing broken down by significant geographical areas including, with the amounts of expected credit loss/ specific and general allowances related to each geographical area

As at 31 December 2018:

	Countries	Gross financings	Of Which NPLs	ECL stage 1 & 2	ECL stage 3*	Impairment charge/ (reversed) during the Year**	Financings written off during the year
1	Oman	299,828	631	1,376	381	(1,091)	-
2	Other GCC Countries	563	-	-	-	(1)	-
3	OECD Countries	-	-	-	-	-	-
4	India	-	-	-	-	-	-
5	Pakistan	-	-	-	-	-	-
6	Others	-	-	-	-	-	-
	<b>Total</b>	<b>300,391</b>	<b>631</b>	<b>1,376</b>	<b>381</b>	<b>(1,092)</b>	<b>-</b>

\* Stage 3 ECL include suspended profit of RO 0.022 mn

\*\* Includes suspended profit amounting to RO 0.009 mn

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### viii) Amount of impaired Financing broken down by significant geographical areas including, with the amounts of expected credit loss/ specific and general allowances related to each geographical area (continued)

As at 31 December 2017:

	Countries	Gross financings	Of Which NPLs	General Provisions	Specific Provisions	Suspended profit	Provisions made / (reversed) during the Year	Financings written off during the year
1	Oman	247,485	333	2,919	151	13	301	-
2	Other GCC Countries	1,695	-	17	-	-	(11)	-
3	OECD Countries	-	-	-	-	-	-	-
4	India	-	-	-	-	-	-	-
5	Pakistan	-	-	-	-	-	-	-
6	Others	-	-	-	-	-	-	-
	<b>Total</b>	<b>249,180</b>	<b>333</b>	<b>2,936</b>	<b>151</b>	<b>13</b>	<b>290</b>	<b>-</b>

#### ix) Movement of gross Financing during the year.

As at 31 December 2018:

Details	Stage 1	Stage 2	Stage 3	Total
1 Opening Balance	219,979	28,868	333	<b>249,180</b>
2 Migration / changes (+ / -)	9,777	(10,082)	305	-
3 New financings	76,041	11,531	-	<b>87,572</b>
4 Recovery of financings	(32,244)	(4,110)	(7)	<b>(36,361)</b>
5 Financing Written Off	-	-	-	-
6 <b>Closing Balance</b>	<b>273,553</b>	<b>26,207</b>	<b>631</b>	<b>300,391</b>

Opening balance includes credit card receivables amounting to RO 0.428 mn.

As at 31 December 2017:

Details	Performing financings		Non-Performing financings			Total
	Standard	Special mention	Sub-Standard	Doubtful	Loss	
1 Opening Balance	226,016	558	22	195	-	<b>226,791</b>
2 Mitigation/ Changes (+/-)	(24,975)	25,241	114	(113)	161	<b>428</b>
3 New financings	36,587	-	-	-	-	<b>36,587</b>
4 Recovery of financings	(14,436)	(144)	(46)	-	-	<b>(14,626)</b>
5 Financing Written Off	-	-	-	-	-	-
6 <b>Closing Balance</b>	<b>222,764</b>	<b>25,655</b>	<b>90</b>	<b>82</b>	<b>161</b>	<b>248,752</b>
7 Provisions Held	(2,936)	-	(23)	(21)	(107)	<b>(3,087)</b>
8 Reserve profit	-	-	(1)	(1)	(11)	<b>(13)</b>
<b>Total</b>	<b>219,828</b>	<b>25,655</b>	<b>66</b>	<b>60</b>	<b>43</b>	<b>245,652</b>

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### Credit Risk Mitigation: Disclosures for portfolio subject to standardized approaches

##### Qualitative disclosure

The Islamic Window classifies its financial assets in one of the following categories:

- Financing receivables;
- Ijara assets – Ijarah Muntahia Bittamleek;
- Equity & debt – type instruments; and
- Credit Card receivable

Financing receivables are principally divided into following Islamic products:

- **Murabaha:** An agreement whereby the Islamic Window sells to a customer a commodity or a property which the Islamic Window has purchased and acquired based on a promise received from the customer to buy the item purchased according to specific terms and conditions. The selling price comprises of the cost of the commodity and an agreed profit margin.
- **Financing Ijarah:** An agreement whereby the Islamic Window (lessor) leases an asset or services to a customer (lessee), for a specific period against certain rent installments. Ijarah could end in transferring the ownership of the asset to the lessee at the end of the lease period.
- **Wakala:** An agreement whereby the Islamic Window provides a certain sum of money to an agent, who invests it according to specific conditions in return for a certain fee (a lump sum of money or a percentage of the amount invested). The agent is obliged to guarantee the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala.
- **Musharaka:** An agreement between the Islamic Window and a customer to contribute to a certain investment enterprise, whether existing or new, or the ownership of a certain property either permanently or according to a diminishing agreement set between both parties while the loss is shared in proportion to their shares of capital in the enterprise.

Credit Risk Mitigation (CRM) encompasses collateral management and credit guarantee arrangements. The policies and processes for on- and off-balance sheet netting (and the extent to which the Islamic Window makes use of them); policies and processes for collateral valuation and management; and a description of the main types of collateral taken are described below.

In respect of real estate collateral, two valuations are obtained if the value of collateral exceeds a particular level: the lowest valuation is used. The Islamic Window also has a mandatory requirement to obtain an insurance policy on real estate collateral (other than land) where the insurance policy is assigned in the Islamic Window's favor. Real estate collateral is valued on regular intervals on need basis based on the assessment of risk and economic scenario prevailing.

The Islamic Window normally accepts the following types of collateral:

- Cash margins and wakala deposits
- Real estate comprising income-producing and non-income-producing assets.
- Shares listed on recognized stock exchanges located in GCC
- Irrevocable and unconditional guarantees / standby LC issued by acceptable Banks
- Debt securities subject to meeting approval criteria.
- Funds subject to meeting approval criteria

The Islamic Window also accepts guarantees of individuals and corporates to mitigate risks, wherever applicable, based on adequate assessment of their creditworthiness.

Management monitors the market value of collateral at regular interval and requests additional collateral in accordance with the underlying agreement in case of shortfall. The management also periodically reviews the collateral cover for determining the adequacy of the allowance for impairment losses.

As per Basel and CBO guidelines the bank stands in possession of the following eligible collateral for the : 1) Cash Exposure covered by Cash collateral stands at RO 2.2 Million; after application of haircut (0%) to the collateral the exposure stands at RO NIL.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 5. CREDIT RISK (continued)

#### Credit Risk Mitigation: Disclosures for portfolio subject to standardized approaches (continued)

##### Quantitative disclosure

Rating	Impairment allowance as at year end	Financings written off during the year	CBO Classification	IFRS 9 Classification
1 – 6	397	-	Standard	Stage 1 & 2
7	979	-	Special mention	
8 – 10	381	-	Non-performing	Stage 3
<b>Total</b>	<b>1,757</b>	<b>-</b>		

### 6. MARKET RISK

#### Qualitative disclosure

Substantially all of the Islamic window businesses are subject to the risk that market prices and rates will move and result in profits or losses for the Islamic window .

#### Market Risk Management Framework

The Islamic window uses a combination of risk sensitivities, stress testing, etc. to manage market risks and establish limits.

#### Shares and investments

The Islamic Window has invested in Al Hilal MENA Fund (an Islamic Fund managed by the Asset Management Division of the Bank) and other share which are recognized this as equity type instruments carried at fair value through other comprehensive income. The fair value of investments as of 31 December 2018 is RO 0.27 mn with cost amounts to RO 0.34mn. The Islamic window also has invested in debt type instrument carried at fair value through other comprehensive income. The fair value of investments as of 31 December 2018 is RO 14.08 mn with a cost amounts to RO 14.47 mn.

#### Rate of Return Risk Principles and Framework

Rate of return risk arises from the possibility that changes in rates of return will affect the value of underlying financial instruments. The Islamic Window is exposed to rate of return 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 Islamic Window's overall goal is to manage rate of return sensitivity so that movements in rates of return do not adversely affect the Islamic Window's net income from financing activities. Rate of return risk is measured as the potential volatility in net income from financing activities caused by changes in market rates of return. The Islamic Window manages this risk by matching or hedging the re-pricing profile of assets and liabilities through various risk management strategies.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 6. MARKET RISK (continued)

#### Rate of Return Risk in Trading Book

Rate of Return risk in the trading book arises from the sensitivity of investment assets to rate of return volatility. Rate of Return Risk in the trading book is controlled through notional exposure limits, stop loss limits, and maximum maturity limits, and is marked to market.

As of 31 December 2018, there were no investments carried at fair value through profit and loss. An analysis of Impact of profit rate risk has been disclosed in note 30.3.1 to financial statements. Profit bearing assets (net of provision) and liabilities according to repricing bucket are as follows:

As of 31 December 2018;

Particular	Effective profit rate	within 3 months RO'000	4 to 12 months RO'000	1 to 5 years RO'000	More than 5 years RO'000	Non-sensitive to profit rate RO'000	Total RO'000
<b>ASSETS</b>							
Cash and balances with Central Bank of Oman		-	-	-	-	38,524	38,524
Due from banks		1,673	-	-	-	-	1,673
Financing Assets	5.75%	11,190	21,352	86,027	179,555	532	298,656
Investments	3.11%	-	-	11,885	2,192	264	14,341
Property and equipment		-	-	-	-	1,010	1,010
Other assets		-	-	-	-	1,353	1,353
Total profit bearing assets		<b>12,863</b>	<b>21,352</b>	<b>97,912</b>	<b>181,747</b>	<b>41,683</b>	<b>355,557</b>
<b>LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS</b>							
Due to banks	4.09%	40,658	19,250	52,007	-	-	111,915
Equity of investment accountholders and other liabilities	3.01%	40,694	42,759	71,986	-	41,475	202,339
Shareholders fund		-	-	-	-	-	41,303
Total		<b>81,355</b>	<b>62,052</b>	<b>124,007</b>	<b>-</b>	<b>88,143</b>	<b>355,557</b>
Net gap		<b>(68,492)</b>	<b>(40,700)</b>	<b>(26,095)</b>	<b>181,747</b>	<b>(46,460)</b>	<b>-</b>
Cumulative net gap		<b>(68,492)</b>	<b>(109,192)</b>	<b>(135,287)</b>	<b>46,460</b>	<b>-</b>	<b>-</b>

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 6. MARKET RISK (continued)

#### Rate of Return Risk in Trading Book (continued)

As of 31 December 2017;

Particular	Effective profit rate	within 3 months RO'000	4 to 12 months RO'000	1 to 5 years RO'000	More than 5 years RO'000	Non-sensitive to profit rate RO'000	Total RO'000
<b>ASSETS</b>							
Cash and balances with Central Bank of Oman		-	-	-	-	36,613	36,613
Due from banks		2,272	-	-	-	-	2,272
Financing Assets	5.60%	8,763	20,426	90,039	126,437	428	246,093
Investments	3.70%	-	-	11,173	3,307	183	14,663
Property and equipment		-	-	-	-	1,029	1,029
Other assets		-	-	-	-	1,052	1,052
Total profit bearing assets		11,035	20,426	101,212	129,744	39,305	301,722
<b>LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS</b>							
Due to banks	3.80%	108	-	38,500	-	-	38,608
Equity of investment accountholders and other liabilities	2.70%	77,349	64,647	61,044	-	24,218	227,258
Shareholders fund		-	-	-	-	35,856	35,856
Total		77,457	64,647	99,544	-	60,074	301,722
Net gap		(66,422)	(44,221)	1,668	129,744	(20,769)	-
Cumulative net gap		(66,422)	(110,643)	(108,975)	20,769	-	-

#### Foreign Exchange Risk

Foreign exchange risk is the risk that the foreign currency positions taken by the Islamic Window may be adversely affected due to volatility in foreign exchange rates. Foreign exchange risk management is ensured through regular measurement and monitoring of open foreign exchange positions. All foreign exchange exposures are centrally managed by the Treasury and are daily marked to market. Limits have been assigned with respect to overnight open exposures, stop loss limits and authorized currencies to monitor and control foreign exchange exposures.

The Islamic window treats its entire Foreign Exchange Exposure under Basel II Standardized approach for capital calculation. The Net open position in all foreign currencies stands at OMR 0.96 mn (OMR 0.96 mn position is in effectively pegged currencies) as on 31st Dec 2018.

#### Capital Charge

The Capital Charge for market risk exposures is measured based on Standardized approach in accordance with the guidelines issued by CBO under Circular BM1009. The Islamic window has implemented standardized duration based approach to arrive at capital requirement for bonds and debt securities. The capital charge for foreign exchange is computed based on three month higher of daily average of sum of net long or short positions held by the Bank. Further, Bank does not hold any trading position in Equity or commodities.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 6. MARKET RISK (continued)

#### Capital Charge (continued)

Table showing capital charge for profit Rate, Equity and foreign exchange risk as on 31 December 2018 is given below:

Type of Risk- Capital Charge (OMR 000)	2018	2017
Profit Rate Risk	-	224
Equity Position Risk	-	-
Foreign Exchange Risk	183.3	90
Percentage of NOP to regulatory capital	2.56%	13.78%
Regulatory ceiling (% to total networth)	40%	40%

Total risk weighted assets for trading book is RO 2.291 mn.

#### Price risk

Impact of 10% fall in price

Investment type	Change in price	Effect on equity (millions)
Regional listed Sukuk	10%	+/- 1,331.4
Foreign listed Sukuk	10%	+/- 76.4
Listed equities	10%	+/- 26.6

#### Rate of Return Risk in Banking Book (RRRBB)

The nature of RRRBB and key assumptions, including assumptions regarding prepayments and behavior of non-maturity deposits, and frequency of RRRBB measurement, are given below. Rate of return risk is limited for Retail Banking book as the financing receivables can be re-priced with any change in the CBO's rate of return and for Corporate Banking financing receivables which are re-priced in line with the market conditions.

Deposits are re-priced based on their final maturity, or if linked to a floating rate index, on the re-pricing date. Deposits that are insensitive to rate of return movements are categorized separately. The earnings at risk are calculated based on rate of return re-pricing gaps. The Islamic Window is confident of sourcing the cheaper source of funds by way of customers' deposits. ALCO along with the risk management department identifies rate of return risk and these are monitored and reported periodically. Rate sensitive exposures are quantified using re-pricing gaps.

#### Investments in the banking book

The Islamic Window's investments will have to be within the overall limits and restrictions as CBO may prescribe from time to time, and only in Sharia compliant product categories.

Also, the Bank has set up internal limits and approval authorities at various Management and Board Level Committees or the full Board of Directors, as a percentage of the Capital Base of the Bank, which apply to the Islamic Window as well. All investment proposals are routed through the ALCO to the relevant approval authority.

In addition to the CBO restrictions on investments by banks, and such internal limits as described above, the following restrictions apply, including the investments made by the Islamic Window:

The Islamic window's appetite for private subscriptions and unlisted / unquoted equity is low, and any such proposals should be adequately justified on a case by case basis, and has to be approved at least by the Executive Credit Committee and by the Board if it exceeds limits structured as a proportion of the Bank's Capital Base.

All investments of the Islamic window should be in either USD or USD pegged GCC currencies and any investments in other currencies should be approved at least by the Executive and Credit Committee if it exceeds limits structured as a proportion of the Bank's Capital Base, after review and recommendation of the ALCO. Aggregate investments in all such currencies should not exceed a limit based on the Bank's Capital Base unless approved by the Board of Directors. This should include all investments through any Fund Manager, or proprietary investments made through the Bank's Asset Management Department.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 6. MARKET RISK (continued)

#### Investments in the banking book (continued)

Any investments of the Islamic window outside the GCC countries or US will have to be specifically approved by at least the Executive and Credit Committee if it exceeds limits structured as a proportion of the Bank's Capital Base. This should include all investments through any Fund Manager, or proprietary investments made through the Bank's Asset Management Department.

The Bank tries to achieve reasonable diversification of its investment portfolio among the economic sectors, and will not exceed a certain limit of its investment portfolio in any particular industry / sector groups listed below:

- a) Trading and retailing
- b) Real Estate development, management and rental income
- c) Construction / contracting and building materials
- d) Travel / tourism, hotels, restaurants, entertainment, health services and education
- e) Warehousing / storage, logistics, supply management and transportation, utilities and Telecom
- f) Oil and Gas
- g) Banking and Financial Services
- h) Conglomerates or Holding Companies investing in any of the above business lines

This should also include all proprietary investments made through the Bank's Asset Management Department.

Any proposal that leads to contravention of the above or any proposal for investment in any sector or industry not listed above will need approval of the Executive Credit Committee.

All investment approval requests for specific transactions or trading limits must be made by the relevant Business Line, approved by the Credit and Investment Committee and submitted to the Executive Credit Committee as delegated. Any approval above those delegated limits is to be elevated to the Board level for approval. Any restrictions on investments as per effective CBO regulations shall apply.

#### Investment Exits / Stop Loss (does not cover Asset Management Division operations)

Exit strategies must be clearly outlined in all investment proposals. In case of a change in the exit strategy, approval from the same approving body must be obtained. Sale of AFS investments to book profit should be approved / ratified by the ALCO.

Unless stated otherwise in the investment application the tolerance level of a decrease in the value of a liquid investment is a maximum of 15%. Any holding with loss equivalent or greater than 10% should be notified to ALCO members. In case the investment is witnessing a material change (downgrading or expected downgrade etc.), the Business Unit must also notify the Credit and Investment Committee outlining the action/remedial plan. Approval for any loss in excess of 15% on liquid investment (unless already specifically allowed as per original investment strategy), will need to be obtained from Credit and Investment Committee and ALCO.

### 7. LIQUIDITY RISK

The Islamic window defines liquidity risk as its ability to meet all present and future financial obligations in a timely manner and without undue effort and cost through unconstrained access to funding at reasonable market rates and without affecting asset growth and business operations.

The following key factors are taken into consideration while assessing and managing the liquidity risk of the Islamic Window:

- The need to have a well-diversified base for funding sources, comprising a portfolio of retail customers, large corporates and institutions, small & medium enterprises, high net worth individuals, without significant concentrations or correlations, thereby diversifying the funding base and mitigating concentration risks.
- Based upon the past behavioral pattern analysis of our main liabilities, management expects large portion of customer deposits to be rolled over at contractual maturity.
- As per the CBO directives, the Bank keeps at least 5% of its deposit liabilities with CBO in the form of clearing balances.
- Commitments for investments and financing are approved after taking into account the Islamic Window's overall liquidity position.

The Islamic Window's projected liquidity needs are analyzed, and optimum alternatives to manage the liquidity risk are discussed and approved in ALCO. The risk management department also independently reviews and evaluates the Bank's ability to access liquidity from different sources.

The Treasury and Risk management departments identify liquidity at risk, which is monitored daily and reported periodically to ALCO. Liquidity and funding policy and a contingency liquidity plan have been established by the Bank, which applies to its Islamic Window as well.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 7. LIQUIDITY RISK (continued)

#### Liquidity and funding Policy

The liquidity and funding policy of the Bank, which applies for its Islamic Window as well, is intended to ensure that liquidity requirements are prudently and effectively managed such that anticipated and unanticipated funding needs are met on an ongoing basis in a controlled manner at the least possible cost.

The Bank's Asset Liability Committee (ALCO) reviews the Liquidity and funding Policy annually and submits recommendations for changes, if any, to the Bank's Chief Executive Officer (CEO) for review and submission to the Executive Committee and Board as applicable.

There are a number of techniques which the Bank uses to manage its Liquidity position and that of its Islamic Window. The key ones are:

- Placing limits on maturity mismatches
- Maintaining a stock of liquid assets
- Diversification of liabilities
- Access to wholesale markets
- Multi-currency liquidity management

The financing ratio, which is the ratio of the financing to deposits and capital, is monitored on a daily basis in line with the regulatory guidelines. Internally the lending ratio is set at a more conservative basis than required by regulation. The Islamic window also manages its liquidity risk on a monthly basis monitoring the liquid ratio which is a ratio of net liquid assets to total assets.

The Islamic window also maintains significant investments in liquid instruments issued by Governments and banks principally for maintaining liquidity.

The CBO also restricts the limits on lending by the commercial banks. The maximum lending ratio permissible as at 31 December 2018 was 87.5%.

Details of the reported financing ratio for the year are as follows:

Ratios	2018	2017
<b>Financing ratio</b>	<b>%</b>	<b>%</b>
Year end	85.76	83.40
Maximum for the year	87.50	87.50
Minimum for the year	75.17	78.76
Average for the year	85.52	85.57
<b>Other Ratios</b>		
Financing to customers to total assets	84.48	82.81
Equity to total assets	11.62	11.88
Liquidity Coverage Ratio	128.60	336.11
Net Stable Funding Ratio	100.76	117.97

#### Stock of Liquid Assets

An adequate stock of high quality liquid assets provides the Islamic Window with the capacity to meet its obligations while any underlying problems affecting liquidity are addressed.

Such assets are clearly identified, their role defined and minimum holding levels are established and agreed by the ALCO. The degree of diversification of the Liquid Assets portfolio is reviewed by the ALCO on a monthly basis.

Further, as per the CBO circular BM 1127 dated December 24, 2014 on Basel III Liquidity Coverage Ratio (LCR), the bank has maintained adequate level of LCR. Further, CBO on October 26, 2016 has issued the guideline for NSFR (Net Stable Funding Ratio) based on the guideline issued by the BCBS. The standard for NSFR is effective from January 1, 2018 with a minimum ratio of 100%.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 7. LIQUIDITY RISK (continued)

#### Diversification of liabilities

The Bank and Islamic Window seek to maintain a diversified funding base, and monitor the degree of diversification in its liability base on a monthly basis. Depositor concentration is reviewed by the ALCO on a monthly basis.

The liquidity and funding policy recognizes the inherent value of the Bank's term depositors. The Islamic Window seeks to establish strong and lasting relationships with depositors and other liability holders so as to foster a stable funding base. Trends in liability balances by category are reviewed by the ALCO on a monthly basis.

The Islamic Window also recognizes that an over reliance on short dated inter-bank deposits can lead to difficulties in extreme market conditions. The exposure to such deposits is reviewed by the ALCO on a monthly basis.

#### Multi-currency liquidity

Where positions in specific foreign currencies are significant to its business, the Islamic Window addresses the measurement and management of liquidity in these individual currencies. It is considered appropriate to consolidate several (usually minor) currencies and monitor the aggregate exposure expressed in base currency.

When monitoring exposure in aggregate, the Islamic Window assesses the convertibility of individual currencies, the timing of access to funds, the impact of potential disruptions to foreign exchange markets, and exchange risks before presuming that surplus liquidity in one currency can be used to meet a shortfall in another currency.

Performance against limits is monitored daily by Treasury with any exceptions being immediately reported to ALCO members. Review of all liquidity positions against limits is performed by Head of Risk Management and Treasury based on figures produced by the Treasury Middle Office / Finance Department.

The Treasurer along with the Head of Risk Management derives and documents the Maturity Profile behavioral adjustments, based on redemptions and withdrawal requests. These are communicated to the ALCO for discussion and acceptance.

#### Limit breaches

All liquidity limit (internal) breaches are notified to the Treasurer, the Head of Finance, Head of Risk Management and ALCO members at the earliest possible opportunity. The notification includes:

- The cause of the breach
- The remedial action taken
- The expected duration of the breach if still current.

Immediate action is taken to remedy the breach. Should such action not be possible, the ALCO and the CEO are notified.

#### Liquidity Contingency Plan:

It is imperative for the Islamic window to maintain an adequate amount of liquid assets as a protection against a possible loss in the event of emergency situation. Bank's Liquidity Contingency Plan (LCP) is approved by Board and addresses the institution's strategy for handling any liquidity crisis. LCP will serve as the blueprint for meeting its funding needs under stress environment in a timely manner and at a reasonable cost. It describes policies and procedures for managing or making up cash flow shortfalls in such situations at both solo and consolidated level.

Islamic window has adopted quantitative and qualitative key warning indicators which is monitored by Market Risk team and presented to ALCO. The members of the Liquidity Crisis Management Team (LCMT) and ALCO are notified immediately should any of the early warning criteria be breached.

In the event of the plan being invoked, ALCO delegates the responsibility for the management of the Bank's liquidity to the LCMT. The LCMT is comprised of CEO (Chairman), DCEO Wholesale Banking, DCEO – Support Services, Head of Finance, Head of Treasury and Head of Risk.

### 8. OPERATIONAL RISK

#### Operational Risk Management Framework

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events.

Losses from external events such as a natural disaster that has a potential to damage the Islamic Window's physical assets or electrical or telecommunication failures that disrupt business are relatively easier to define than losses from internal problems such as employee fraud and product flaws. The risks from internal problems are more closely tied to the Islamic Window's specific products and business lines; they are more specific to the Islamic Window's operations than the risks due to external events. Operational risks faced by the Islamic Window include IT Security, telecom failure, frauds, and operational errors.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 8. OPERATIONAL RISK (continued)

#### Operational Risk Management Framework (continued)

Operational risk is identified and controlled through a series of strong internal controls and audits, well-defined segregation of duties and reporting lines, operational manuals and standards. Internal audit independently reviews the effectiveness of the Islamic Window's internal controls and its ability to minimize the impact of operational risks. The Operational Risk Committee that is the owner of this Framework oversees the Islamic window.

The Islamic Window identifies and assesses the operational risk inherent in its key material products, activities, processes and systems. It also ensures that before any new products or services, activities, processes or systems are introduced; the associated operational risks are properly assessed and mitigated.

Risk identification is vital to the development of operational risk monitoring and control systems. Risk identification considers internal factors such as the Islamic Window's structure, the nature of its activities, the quality of its human resources, organizational changes, and employee turnover. It also examines external factors such as changes in the industry, major political and economic changes, and technological advances.

The Islamic Window has identified the following operational risks and has been implementing an effective framework to manage them:

- Fraud Risk
- Process Risk
- Legal Risk
- People Risk
- Compliance Risk
- IT Risk
- Physical Security Risk
- Shariah Compliance risk

#### Control and Mitigation of Operational Risk

The Islamic Window and the Bank has established policies, processes and procedures to control and mitigate material operational risks. It periodically reviews risk limitation and control strategies and adjusts the operational risk profile accordingly, using appropriate strategies in light of its overall risk appetite and profile.

Towards this, the Islamic Window has implemented Operation Risk Self-Assessment (ORSA) procedure for each of its business segments, where operating risk related to each business area is identified; documented and corresponding control processes are defined and documented. The action points arising from ORSA are reviewed and reported at the Operational Risk Committee on a regular basis. The Islamic Window also has Key Risk Indicators (KRIs) in place and monitors these on a regular basis.

The Islamic Window ensures that there is appropriate segregation of duties and personnel are not assigned responsibilities that may create a conflict of interest or enable them to conceal losses, errors or inappropriate actions.

The Islamic Window ensures adequate internal audit coverage to verify that operating policies and procedures have been implemented effectively.

The Islamic Window takes insurance cover to mitigate operational risk, wherever applicable.

It also ensures that internal practices exist to control operational risk such as:

- maintaining safeguards for access to, and use of, the Islamic Window's assets and records;
- ensuring staff have appropriate expertise and training;
- regularly verifying and reconciling transactions and accounts.

#### Fraud Risk Management

The Islamic window takes effective prevention and detection of fraudulent activities extremely serious and cooperate with the judicial and regulatory authorities and support national, regional and international initiatives to combat fraud. It endeavor to develop a culture of fraud awareness and prevention across all areas of its operations to limit possible financial losses and safeguard the brand and financial reputation of the Islamic window.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 8. OPERATIONAL RISK (continued)

#### Reputational risk

Reputation Risk is negative public opinion/reaction which could cause damage to the Islamic Window's profitability or image. Reputational risk is one of the most complex risks to manage in view of unpredictability, constant change in the operating environment, personnel turnover and multi-cultural environment that the Bank operates in. The Islamic Window identifies, measures, monitors and controls reputation risk arising in the following areas:

- Customer service
- Perception of stakeholders regarding Islamic Window's commitment to their interests
- Quality of products, services and sales practices
- Reporting to stakeholders and external agencies
- Accuracy of information in communications to the public

There are policies and procedures in place to manage and monitor reputation risk.

#### Business Continuity

The Bank has a documented Business Continuity Policy (BCP) and plan which outlines the Business Continuity process to be followed in a disaster scenario, and undertakes comprehensive testing of all its critical systems and processes; this BCP also applies to the processes and systems pertaining to the Islamic Window. The BCP aims to minimize the severity and impact of a disaster while continuing to serve both the business and customers with a lowest achievable detriment in service. The plan considers the following:

- Disaster scenarios and magnitude
- Various steps to mitigate the risk
- Impact on the Bank's business and operations
- The resources required for resuming the operations at the earliest possible time following the disaster.
- Operating processes and available systems at the Disaster Recover (DR) site

During the year 2018, the bank has carried out a comprehensive BCP test including a volume test on a working day in order to test the resilience of the bank's business systems at the DR site. The scope of the test was arrived at based on the Business Impact Analysis (BIA) carried by the Bank and the volume test results were submitted to the Board. The Bank has in place a Crisis Management Team (CMT), and the processes to be followed during a disaster scenario has been detailed out in the BCP documents of the bank.

#### Concentration Risk

Concentration risk arises from exposure to a common set of factors that can produce losses large enough to threaten the Bank's health or ability to maintain its core business. Concentration risk can arise from large exposure to counterparty, a sector or country. Concentration risk can be mitigated by formulating limits, by a thorough check on counterparty's quality or adequate collateral support etc.

As part of ICAAP, thresholds for exposure concentrations has been set up, this will trigger additional capital requirements based on concentration in terms of large exposures to counterparties, sector exposure concentration (excluding retail lending) and geographical exposure concentration (other than to Oman).

#### Information Security Risk

The Islamic window has adopted an Information Security Management System (ISMS) /process and a framework by which the bank ensures, protects and secures information resources that process and maintain information which are vital to its operations. The main component of this framework is the Information Security Policy that provides direction for formulation, implementation, and management of Information Security Management System. Since protection of customer information is the top-most priority, the Bank strives to safeguard the confidentiality, availability and integrity of the data of its customers and business partners at all times.

#### Other Risks

The Islamic window is also exposed to other risks such as reputational risk, strategic risk, business cycle risk, legal risk, residual risk, settlement risk, shariah non-compliance risk, etc. However, currently these risks are not significant to the Bank. The Bank follows standard methodologies for arriving at the capital adequacy requirements of these risks. These risks are assessed and such assessments form part of the Bank's ICAAP process.

#### Operational risk capital charge and risk weighted amount

The Islamic window follows basic indicator approach for determining operational risk. The Capital charge for operational risk under Basic Indicator approach is calculated by taking the average of gross income multiplied by 15%, for each of the last three financial years, excluding years of negative or zero gross income. The gross income includes Net income from financing activities gross of any provisions and depreciation expense on ijarah assets (+) Net income from investment activities (+) fee income (-) investment account holders share of income (-) extraordinary / irregular items of income.

Capital Charge for Operational Risk under Basic Indicator Approach as per Basel II is RO 1.174 mn.

The Risk weighted assets for operational risk as per Basel II is RO 14.670 mn.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 9. DISPLACED COMMERCIAL RISK

Displaced commercial risk (DCR) refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the liabilities, when the return on assets is under performing as compared to competitor's rates.

The Islamic Window manages DCR through the Asset Liability Committee (ALCO). The Islamic Window may forgo its fee in case DCR arises. Rates of returns are benchmarked with other Banks in the market.

### 10. INVESTMENT ACCOUNT HOLDERS

The Islamic Window receives deposits by Investment Account Holders (IAH) under mudaraba contract and Wakala bil Istithmar contract.

#### Investment account holders under mudaraba contract

As per the mudaraba contract the investment account holders authorizes the Islamic Window to invest the account holders' funds in a manner which the Islamic Window deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement, Islamic window can commingle the equity of investment account holders with its own funds (owner's equity) or with other funds the Islamic Window has right to use (current accounts or any other funds not received under Mudaraba mode). As at year end the Islamic Window does not have any investment account under restricted mudaraba contract.

The Islamic Window charges a management fee (Mudarib fee) to IAH. Of the total income from investment accounts, the income attributable to account holders is allocated to investment accounts after setting aside provisions, reserves (profit equalization reserve and investment risk reserve) and deducting the Islamic Window's share of income as a Mudarib. The allocation of income is determined by the management of the Islamic Window within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Total administrative expenses for profit distribution purposes are borne by the Islamic window.

During the year ended December 2018 there were no appropriations made towards Profit equalization and Investment risk reserve. Net profit is allocated to the pool participants based on weighted average balance. Participation factor, weights of profit sharing ratios are pre-decided by the management of the bank and are initiated to the investors. Weighted average balance is calculated at the end of the period by multiplying the participation factor with average balance for the period.

#### Investment account holders under wakala bil istithmar

Under Wakala bil Istithmar arrangement, Islamic window accepts funds from investors as Wakeel and invests in Shari'a compliant assets. Wakeel is entitled to a fixed fee as a lump sum or percentage of fund provided. Expected profit payout is mentioned to investors upfront while any return generated in excess of expected profit is retained by the Islamic window as Wakeel as incentive fee. Wakeel should bear the loss in case of Wakeel's default, negligence or violation of any terms and conditions of the Wakala bil Istithmar agreement, otherwise the loss would be borne by the investor or Muwakil.

#### Mudaraba fee

Mudaraba fee will be deducted from allocated profit as per the pre-agreed ratio as approved by SSB which will be advised to customers through website or by posting in branches. Islamic window can create reserves as allowed by SSB and CBO for smoothing of returns to investors and risk management purposes. Two types of reserves allowed are Profit Equalization reserve (PER) and Investment Risk reserve (IRR).

#### Profit Equalisation Reserve (PER)

PER comprises amounts appropriated out of the gross income from the Mudaraba to be available for smoothing returns paid to the IAH and the shareholders, and consists of IAH portion and a shareholders portion. The percentage (up to a maximum of 10%) being set aside for the purpose is determined by management. Currently, Window is not maintaining any reserves. The basis for computing the amounts to be appropriated are applied in accordance with SSB directions.

#### Investment Risk Reserve (IRR)

This reserve is created out of the depositors' share of profit out of the Net Profit from the Common Pool. Purpose of the reserve is to offset the effect of future losses. The available balance in the reserve account shall be invested in the Common Pool and the profit earned by investing such balance will be added to the reserve account. The basis for computing the amounts to be appropriated are applied in accordance with SSB directions. This is to secure suitable and competitive return to the depositors in case there are certain extra ordinary circumstances, depressing the return, which were anticipated by the depositors. The disposition of the reserve amount will take place with the prior approval of the SSB. In case the balance in the reserve account is not sufficient to face the competition, the shareholders may grant part of their share of profit to the depositors with the approval of SSB.

#### Transfer to or from Profit Equalization reserve (PER)

Percentage to be approved by Bank management subject to internal sharia approval that should be appropriated by Islamic window out of the total common pool profit as per the policy before any distribution takes place, in order to ensure certain level of cushion for the Investment portfolio. Any provisions that are required against the Islamic financing assets or investments will be provided in the books as per the policy which will be in adherence to the central bank revised provisioning policy. The balance of the PER shall also be maintained as a current account.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 10. INVESTMENT ACCOUNT HOLDERS (continued)

#### Transfer to or from (IRR)

In case the rate of return to the depositors in a certain profit distribution period is substantially higher than the market rates, Bank's management may decide to deduct, after taking permission from the SSB, a portion of depositors' share of profit and transfer the same to the IRR.

In case the rate of return to the depositors in a certain profit distribution period is lower than the market, Bank's management may decide to compensate the depositors by transferring the required amount from the said reserve account to increase depositors' return.

#### Assignment of a portion of shareholders' profit to depositors

If required, the Islamic window may decide to allocate some portion from their own profit to a specific deposit category(s). This could be either due to increase in the rate of profit announced by other Islamic Financial Institutions / competitors or to encourage a specific category of depositors.

#### I. Equity of Investment Accountholders – by type (RO '000)

Type	2018	2017
Saving and call accounts	50,906	44,522
<b>Total</b>	<b>50,906</b>	<b>44,522</b>

#### II. Equity of Investment Accountholders – Ratios

RO in '000	2018	2017	2016	2015
<b>Ratios and Returns</b>				
Amount of total net income	6,975	5,758	4,617	4,091
Average amount of assets	328,640	284,225	260,898	215,932
ROA (Net income before IA's distribution / total assets)	2.12%	2.03%	1.77%	1.89%
Amount of total net income	5,663	4,958	4,433	4,024
Average amount of shareholder's equity	38,580	35,856	33,397	31,430
ROE (Net income after IA's distribution / Shareholders equity)	14.68%	13.83%	13.30%	12.80%
<b>PSR - Average Profit Paid</b>				
Profit sharing ratio (Mudarib : Investment Accountholders)	40:60	40:60	70:30	70:30
Average Profit paid to investment accountholders	2.60%	2.37%	1.27%	0.86%
<b>Average Profit distributed per type of IAH</b>				
Savings (RO 100 – RO 999.999)	0.26%	0.26%	0.22%	0.22%
Savings (RO 1,000 – RO 9,999.999)	0.42%	0.42%	0.33%	0.33%
Savings (above RO 10,000)	0.59%	0.58%	0.55%	0.55%
Call Account (RO 100 - RO 999.999)	0.26%	0.30%	0.33%	0.33%
Call Account (RO 1,000 - RO 9,999.999)	0.43%	-	-	-
AI Nama Smart Saving (RO 100 – RO 2,499.99)	0.59%	0.58%	0.22%	0.22%
AI Nama Smart Saving (RO 2,500 – RO 49,999.99)	2.10%	2.08%	1.32%	1.32%
AI Nama Smart Saving (RO 50,000 – RO 499,999.99)	2.67%	2.64%	1.54%	1.54%
AI Nama Smart Saving (500,000 - 999,999.999)	3.22%	3.19%	1.76%	1.71%
AI Nama (Above 1,000,000)	3.60%	3.55%	-	-
Time deposits (below RO 25,000)	-	-	-	0.51%

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 10. INVESTMENT ACCOUNT HOLDERS (continued)

#### III. Assets allocation and distribution of profit (RO '000)

RO in '000	2018	2017	2016	2015
<b>Average Assets Allocated</b>	<b>105,209</b>	<b>86,127</b>	<b>62,114</b>	<b>53,420</b>
<b>Total profits</b>	<b>5,948</b>	<b>5,196</b>	<b>4,577</b>	<b>3,914</b>
Profits to Shareholders	3,765	3,616	3,938	3,692
Profits to IAH	1,310	1,580	639	222
<b>Mudarib Share</b>	<b>873</b>	<b>783</b>	<b>447</b>	<b>140</b>

The calculation and distribution of profit was based on average balances.

There was no appropriation made towards Profit Equalization Reserve and Investment Risk Reserve.

#### IV. PER to IAH Ratio (RO '000)

	2018	2017
Profit equalization reserve (PER)	-	-
Unrestricted investment account holder account (IAH)	<b>50,906</b>	<b>44,522</b>

#### V. Computation of pool income for the year ended 31 December 2018 (RO '000)

	2018	2017
<b>Pool income</b>		
Income from financing	16,378	12,666
Income from placements	555	440
	<b>16,933</b>	<b>13,106</b>
<b>Distribution of Income</b>		
Revenue generated on Mudaraba funds	5,948	5,196
Profit equalization reserve	-	-
Mudarib share	873	783
Investment risk reserve	-	-
Distributable Profit	5,075	4,413
Utilization of reserves	-	-
<b>Share of Profit for IAH and shareholders</b>	<b>5,075</b>	<b>4,413</b>

### 11. MATURITY PROFILE OF ASSETS AND LIABILITIES

The maturity profile of the assets and liabilities at the year-end are based on contractual repayment arrangements. The details of the same are provided in note 32.2 of Islamic window financial statements.

### 12. SUBSIDIARIES AND SIGNIFICANT INVESTMENTS

The Islamic Window does not have any subsidiary or other significant equity investments as on 31 December 2018 (except the investment in Al Hilal MENA Fund as mentioned in 6 above).

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 13. ZAKAH

Zakah is calculated in accordance with FAS 9 Zakah issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) using the net assets method. The Islamic Window will calculate the "Zakah base" based on audited financial statements and after approval from Sharia Supervisory Board, notify the Shareholders of their pro-rata share of the Zakah payable annually, if any. Payment of Zakah on the Investment Accounts and other Accounts is the responsibility of Investments Account Holders

### 14. EARNINGS PROHIBITED BY SHARIA

The Islamic Window is committed to avoid recognizing any income generated from non-Islamic sources. Accordingly all non-Islamic income is credited to the charity account where the Islamic Window uses these funds for charitable purposes. During the year ended 2018, no income has been credited to charity account being prohibited by Sharia. Sources and use of charity by fund has been disclosed in statement of sources and uses of charity fund in Financial Statements.

### 15. COMPENSATION POLICY AND REMUNERATION OF SHARIA Supervisory BOARD (SSB)

In line with the CBO guidelines on remuneration disclosure as part of pillar III, the relevant qualitative and quantitative disclosure are presented in the banks Basel II Pillar III.

Following remuneration of Sharia Board has been approved by the general assembly;

Chairman: RO 9,625 per annum (US\$ 25,000 per annum).

Member: RO 6,738 per annum (US\$ 17,500 per annum).

Sitting fee: US\$ 1,000 per meeting per member, maximum of 5 sitting per year.

Details of Sharia Supervisory Board and meetings attended during the year has been disclosed in corporate governance report.

### 16. GENERAL DISCLOSURES

#### Shari'a governance

Shari'a governance is the most important feature of the Islamic Window. Shari'a governance is defined as a system whereby the Bank attempts and abides by the Shari'a principles in all its activities. The main objective of Shari'a governance framework is to ensure Shari'a compliance at all the times and at all levels and that is to enable the Islamic Window to be perceived as fully Shari'a compliant by all aspects. The key elements of Shari'a governance framework of the Islamic Window are as follows:

- i. Shari'a Supervisory Board (SSB)
- ii. Head Shari'a Audit and Compliance/Internal Shari'a Reviewer (Head SAC)
- iii. Shari'a Audit Unit (SAU)
- iv. Shari'a Compliance Unit (SCU)
- v. Shari'a Risk Control Unit (SRCU)

#### Shari'a audit and compliance department

As per the Shari'a governance structure of the Window, Shari'a Audit and Compliance Unit (SACU) is a full-fledged department of the Bank. The Shari'a Audit and Compliance includes SAU, SCU and SRCU and is led by Head Shari'a Audit and Compliance / Internal Shari'a Reviewer. SACU main function is to objectively examine and evaluate the extent of compliance of the Bank in view of the pronouncements issued by the SSB or its Chairman and in adherence to the regulations issued by CBO.

SACU has direct and regular communication with all levels of management, the SSB, and external auditors and it is provided with full and continuous support of management and the SSB to perform its duties. Shari'a Audit and Compliance works under supervision of the SSB to ensure independence and objectivity in performance of department's tasks.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 16. GENERAL DISCLOSURES (continued)

#### Trainings

The Sharia Audit and Compliance Unit (SACU) prepared a comprehensive training material on Al Hilal Islamic Banking Services Products and their Sharia Principles in both Arabic and English by including essential features of Islamic banking, Sharia structures, process flows, list of legal documentation and Sharia principles underlying to each product. The training material was made in line with Sharia Supervisory Board (SSB) Fatawa, Islamic banking guidelines issued by CBO and AAOIFI Sharia Standards. The training was made as mandatory for all the staff of Al Hilal Islamic Banking Services and AhliBank which was followed by the a test.

The training division has an online training human resource department has launched with an agreement to ensure that information relating Sharia rules and principles for Islamic banking products is shared with all stakeholders so all the participants know about Sharia structure of each product of Al Hilal Islamic, Sharia process flow and legal documentation of financing products. The online program was based on a presentation (in Arabic and English) with a short quiz at the end to ensure understanding.

Along with the online training for all the staff, the specific trainings were also conducted for SME, Corporate, Risk management departments on the topic Sharia Principles of Al Hilal Islamic Banking Services SME Products and their Legal Documents. Further, most branches of Al Hilal islamic window were given with the necessary training on Sharia requirements while preparation of legal documents. Additionally, Head of SACD participated in the newly launched Service Ijara product necessary training program for BMs, ABMs and Operations Department explained Services Ijara Product to the participants from Sharia perspective.

For the year 2018, the Head of SACD logged a timetable of the training to be conducted with the SSB for approval and a copy was sent to the Training and Development Team for tracking. Annual training budget is in place for employees and as part of the bank's overall training and development budget. The continued development, qualification and certification of all Islamic Banking personnel is an ongoing process.

#### Complaints

Ahli Bank has devised "Code of Ethics and Fair Practices - Customer Complaints Redressal Policy & Procedure" and same is implemented for Al Hilal Islamic Banking Services with regard to professional ethics as well as procedure to resolve customers' queries and complaints. According to the policy, any Islamic Banking related enquiries and complaints are sent to related department of Islamic banking to address and advice and there is proper mechanism in place and a responsible person is identified who collects complains and send the same to the relevant staff.

The Islamic window has trained customer services representative in all the branches who provide appropriate guidance to customers in selection of relevant products suitable to the individual investors. Further, complete product booklet is available at the branches and on the Bank's website which can be referred in case of any further clarification is required. Customers call center (can contact number 24577177) or walk in any of the branches to register their complaints.

#### Awareness

The Bank has trained customer services representatives in all the branches and call center staff who provide appropriate guidance to customers with regard to Islamic Banking. Furthermore, product brochures are available at all the branches. Product feature and related SSB Fatawa and glossary of Islamic banking are also available on the website for public information. Additionally, during 2018 Sharia Audit and Compliance team has regularly been meeting with customers and clients and explaining them about Islamic banking products and their conditions.

#### Related Party

Disclosures related to related party and transactions during 2018 are disclosed in note 30 of Islamic window financial statements.

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE

#### 17.1 The 3 Step Approach To Reconciliation

Below disclosures are prepared using three step reconciliation approach as defined in the CP2-Guidelines on composition of capital disclosure requirements issued along with the CBO Circular BM 1114. In step 1, the accounting consolidation is identical to regulatory consolidation therefore the capital reconciliation is started from step 2 onwards.

#### Step 1: Balance Sheet under Regulatory Scope of Consolidation

TABLE 2a - Balance Sheet under Regulatory Scope of Consolidation (RO '000)

Year ended 31 December 2018	Balance sheet as in published financial statements	Under regulatory scope of consolidation
<b>Assets</b>		
Cash and balances with Central Bank of Oman	38,524	38,524
Certificates of deposit	-	-
Due from banks	1,673	1,673
Financings, net	298,656	298,656
Investments in securities	14,341	14,341
Placements with banks	-	-
Property and equipment	1,010	1,010
Deferred tax assets	-	-
Other assets	1,353	1,353
<b>Total assets</b>	<b>355,557</b>	<b>355,557</b>
<b>Liabilities</b>		
Due to banks	111,915	111,915
Customer deposits	196,914	196,914
Current and deferred tax liabilities	-	-
Other liabilities	5,425	5,425
Subordinated bonds	-	-
<b>Total liabilities</b>	<b>314,254</b>	<b>314,254</b>
<b>Shareholders' Equity</b>		
Paid-up share capital	25,000	25,000
Share premium	-	-
Legal reserve	-	-
General reserve	-	-
Retained earnings	14,488	14,488
Cumulative changes in fair value of investments	(462)	(462)
Subordinated debt reserve	-	-
Other Reserves	2,277	2,277
<b>Total shareholders' equity</b>	<b>41,303</b>	<b>41,303</b>
<b>Total liability and shareholders' funds</b>	<b>355,557</b>	<b>355,557</b>

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE (continued)

#### 17.1 The 3 Step Approach To Reconciliation (continued)

##### Step 2: Expansion of Balance Sheet under Regulatory Scope of Consolidation

Table 2b – Expansion of Balance Sheet Under Regulatory Scope of Consolidation (RO '000)

Year ended 31 December 2018	Published financial Statements	Under Regulatory scope of consolidation	Reference
<b>Assets</b>			
Cash and balances with CBO	38,524	38,524	
Due from banks	1,673	1,673	
Financings - Net, of which:	298,656	298,656	
- Financings to domestic customers	-	300,391	
- Provision against financings, of which:	-	(1,735)	
- Stage 3 Impairment allowance and Reserve profit	-	(381)	
- Stage 1 / 2 impairment allowance, of which	-	(1,354)	
- Amount eligible for T2	-	(1,196)	a
- Amount ineligible for T2	-	(158)	
Investments, of which:	14,341	14,341	
- fair value through other comprehensive income	14,344	14,341	
- Stage 1 / 2 impairment allowance, of which	-	(3)	
- amount eligible for T2	-	-	
- amount ineligible for T2	-	(3)	
Fixed assets	1,010	1,010	
- Intangibles (CET1 adjustment)	-	403	
- Other fixed Asset	-	607	
Other assets	1,353	1,353	
<b>Total Assets</b>	<b>355,557</b>	<b>355,557</b>	
<b>Capital &amp; Liabilities</b>			
Paid-up Capital, of which:	25,000	25,000	
- Amount eligible for CET1	-	25,000	b
Reserves & Surplus; of which	16,303	16,303	
- Amount eligible for CET1 (Accumulated gains brought forward)	-	10,847	c
- Amount eligible for T2 (Investments Fair value gains)	-	-	d
- AFS investments fair value loss (CET1 adjustment)	-	(462)	e
- Amount eligible for CET 1 (Retained Earnings)	-	3,163	
- Adjustments to retained earnings (not eligible for CET1)	-	(2,022)	
- proposed stock dividend (Removed from Retained Earnings)	-	2,500	
- Amount eligible for CET1- Reserves (special reserve)	-	323	
- Reserves (impairment reserve - not eligible for CET1)	-	1,954	
<b>Total Capital</b>	<b>41,303</b>	<b>41,303</b>	
Deposits	196,914	196,914	
Due to banks	111,915	111,915	
Other liabilities and provisions	5,425	5,425	
Other liabilities & provisions , of which	-	5,446	
- Stage 1 / 2 impairment allowance, of which	-	(21)	
- amount eligible for T2	-	-	
- amount ineligible for T2	-	(21)	
<b>TOTAL</b>	<b>355,557</b>	<b>355,557</b>	

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE (continued)

#### 17.1 The 3 Step approach to reconciliation (continued)

##### Step 3: Step Reconciliation of Regulatory Capital:

##### Common Equity Tier 1 capital: instruments and reserves (RO' 000)

For the year ended 31 December 2018		Component of regulatory capital reported by Bank	Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2
1	Directly issued qualifying common share (and equivalent for non-joint stock companies) capital plus related stock surplus	25,000	b
2	Retained earnings	11,988	c
3	<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>36,988</b>	
4	Prudential valuation adjustments	<b>(865)</b>	
5	<b>Total regulatory adjustments to Common equity Tier 1</b>	<b>(865)</b>	e
6	<b>Common Equity Tier 1 capital (CET1)</b>	<b>36,123</b>	
<b>Additional Tier 1 capital: instruments</b>			
7	Additional Tier 1 capital (AT1)	-	
	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>36,123</b>	
<b>Tier 2 capital: instruments and provisions</b>			
8	Provisions	1,196	a
9	Fair value reserve of AFS investments	-	d
	<b>Tier 2 capital before regulatory adjustments</b>	<b>1,196</b>	
	<b>Tier 2 capital: regulatory adjustments</b>	<b>-</b>	
	<b>Tier 2 capital (T2)</b>	<b>1,196</b>	
	<b>Total capital (TC = T1 + T2)</b>	<b>37,319</b>	

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE (continued)

#### 17.2 Main Features of Regulatory Capital

Year ended 31 December 2018

<p>1 <b>Al Hilal Islamic Bankings Services - Ahli Bank SAOG</b></p> <p>2 Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)</p> <p>3 Governing law(s) of the instrument Regulatory treatment</p> <p>4 Transitional Basel III rules</p> <p>5 Post-transitional Basel III rules</p> <p>6 Eligible at solo/group/group &amp; solo</p> <p>7 Instrument type (types to be specified by each jurisdiction)</p> <p>8 Amount recognised in regulatory capital (Currency in mil, as of most recent reporting date)</p> <p>9 Par value of instrument</p> <p>10 Accounting classification</p> <p>11 Original date of issuance</p> <p>12 Perpetual or dated</p> <p>13 Original maturity date</p> <p>14 Issuer call subject to prior supervisory approval</p> <p>15 Optional call date, contingent call dates and redemption amount</p> <p>16 Subsequent call dates, if applicable</p> <p><b>Coupons / dividends</b></p> <p>17 Fixed or floating dividend/coupon</p> <p>18 Coupon rate and any related index</p> <p>19 Existence of a dividend stopper</p> <p>20 Fully discretionary, partially discretionary or mandatory</p> <p>21 Existence of step up or other incentive to redeem</p> <p>22 Noncumulative or cumulative</p> <p>23 Convertible or non-convertible</p> <p>24 If convertible, conversion trigger (s)</p> <p>25 If convertible, fully or partially</p> <p>26 If convertible, conversion rate</p> <p>27 If convertible, mandatory or optional conversion</p> <p>28 If convertible, specify instrument type convertible into</p> <p>29 If convertible, specify issuer of instrument it converts into</p> <p>30 Write-down feature</p> <p>31 If write-down, write-down trigger(s)</p> <p>32 If write-down, full or partial</p> <p>33 If write-down, permanent or temporary</p> <p>34 If temporary write-down, description of write-up mechanism</p> <p>35 Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)</p> <p>36 Non-compliant transitioned features</p> <p>37 If yes, specify non-compliant features</p>	<p><b>Common Equity Share Capital</b></p> <p>NA</p> <p>The laws of Oman in the form of Royal Decrees, Ministerial Decisions and CMA and CBO Regulations</p> <p>Common Equity Tier 1</p> <p>Common Equity Tier 1</p> <p>Solo</p> <p>Common Equity Share Capital</p> <p>25 million</p> <p>25 million</p> <p>Shareholders' Equity</p> <p>Capital allocated in 2013</p> <p>Perpetual</p> <p>No maturity</p> <p>No</p> <p>NA</p> <p>NA</p> <p>Floating</p> <p>NA</p> <p>NA</p> <p>Fully discretionary</p> <p>No</p> <p>Noncumulative</p> <p>Non-convertible</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>NA</p> <p>Yes</p> <p>Statutory approach</p> <p>Write down fully</p> <p>Permanent</p> <p>NA</p> <p>NA</p> <p>No</p> <p>NA</p>
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## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE (continued)

#### 17.3 BASEL III common disclosure template

Basel III common disclosure template		(RO' 000)
<b>Common Equity Tier 1 capital: instruments and reserves</b>		
1	Directly issued qualifying common share capital plus related stock surplus	25,000
2	Retained earnings	11,988
3	Accumulated other comprehensive income (and other reserves)	-
4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)	-
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-
6	<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>36,988</b>
<b>Common Equity Tier 1 capital: regulatory adjustments</b>		
7	Prudential valuation adjustments	(462)
8	Goodwill (net of related tax liability)	-
9	Other intangibles other than mortgage-servicing rights (net of related tax liability)	(403)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	-
11	Cash-flow hedge reserve	-
12	Shortfall of provisions to expected losses	-
13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	-
14	Gains and losses due to changes in own credit risk on fair valued liabilities	-
15	Defined-benefit pension fund net assets	-
16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)	-
17	Reciprocal cross-holdings in common equity	-
18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	-
19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	-
20	Mortgage servicing rights (amount above 10% threshold)	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	-
22	Amount exceeding the 15% threshold	-
23	of which: significant investments in the common stock of financials	-
24	of which: mortgage servicing rights	-
25	of which: deferred tax assets arising from temporary differences	-
26	National specific regulatory adjustments	-
27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	-
28	<b>Total regulatory adjustments to Common equity Tier 1</b>	<b>(865)</b>
29	<b>Common Equity Tier 1 capital (CET1)</b>	<b>36,123</b>
<b>Additional Tier 1 capital: instruments</b>		
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus (31+32)	-
31	of which: classified as equity under applicable accounting standards	-
32	of which: classified as liabilities under applicable accounting standards	-
33	Directly issued capital instruments subject to phase out from Additional Tier 1	-

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE (continued)

#### 17.3 BASEL III common disclosure template (continued)

	(RO' 000)	
<b>Basel III common disclosure template</b>		
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-
35	of which: instruments issued by subsidiaries subject to phase out	-
36	<b>Additional Tier 1 capital before regulatory adjustments</b>	-
<b>Additional Tier 1 capital before regulatory adjustments</b>		
37	Investments in own Additional Tier 1 instruments	-
38	Reciprocal cross-holdings in Additional Tier 1 instruments	-
39	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	-
40	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
41	National specific regulatory adjustments	-
	OF WHICH: [INSERT NAME OF ADJUSTMENT]	-
42	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	-
43	<b>Total regulatory adjustments to Additional Tier 1 capital</b>	-
44	<b>Additional Tier 1 capital (AT1)</b>	-
45	<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>36,123</b>
<b>Tier 2 capital: instruments and provisions</b>		
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	-
47	Directly issued capital instruments subject to phase out from Tier 2	-
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	-
49	of which: instruments issued by subsidiaries subject to phase out	-
50	Provisions (provision and fair value reserve)	1,196
51	<b>Tier 2 capital before regulatory adjustments</b>	<b>1,196</b>
<b>Tier 2 capital: regulatory adjustments</b>		
52	Investments in own Tier 2 instruments	-
53	Reciprocal cross-holdings in Tier 2 instruments	-
54	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	-
55	Significant investments in the capital banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	-
56	National specific regulatory adjustments	-
	- OF WHICH: [INSERT NAME OF ADJUSTMENT]	-
	- OF WHICH: ...	-
57	<b>Total regulatory adjustments to Tier 2 capital</b>	-
58	<b>Tier 2 capital (T2)</b>	<b>1,196</b>
59	<b>Total capital (TC = T1 + T2)</b>	<b>37,319</b>

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 17. BASEL III CAPITAL DISCLOSURE (continued)

#### 17.3 BASEL III common disclosure template (continued)

Basel III common disclosure template		(RO' 000)
60	<b>Total risk weighted assets</b>	280,638
60a	Of which: Credit risk weighted assets	263,677
60b	Of which: Market risk weighted assets	2,291
60c	Of which: Operational risk weighted assets	14,670
<b>Capital Ratios</b>		
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	12.87%
62	Tier 1 (as a percentage of risk weighted assets)	12.87%
63	Total capital (as a percentage of risk weighted assets)	13.30%
64	Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB buffer requirement expressed as a percentage of risk weighted assets)	7.000%
65	of which: capital conservation buffer requirement	0.000%
66	of which: bank specific countercyclical buffer requirement	-
67	of which: G-SIB buffer requirement	-
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	2.30%
<b>National minima (if different from Basel 3)</b>		
69	National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum)	7.000%
70	National Tier 1 minimum ratio (if different from Basel 3 minimum)	9.000%
71	National total capital minimum ratio (if different from Basel 3 minimum)	11.000%
<b>Amounts below the thresholds for deduction (before risk weighting)</b>		
72	Non-significant investments in the capital of other financials	135
73	Significant investments in the common stock of financials	-
74	Mortgage servicing rights (net of related tax liability)	-
75	Deferred tax assets arising from temporary differences (net of related tax liability)	-
<b>Applicable caps on the inclusion of provisions in Tier 2</b>		
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	1,196
77	Cap on inclusion of provisions in Tier 2 under standardised approach	2,587
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	-
79	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach	-
<b>Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)</b>		
80	Current cap on CET1 instruments subject to phase out arrangements	-
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-
82	Current cap on AT1 instruments subject to phase out arrangements	-
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-
84	Current cap on T2 instruments subject to phase out arrangements	-
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### 18 LIQUIDITY COVERAGE RATIO

The below liquidity disclosure is prepared in accordance with the requirements of the CBO Circular BM 1127 'Basel III – Framework on Liquidity Coverage Ratio (LCR) and LCR disclosure standard' issued on 24 December 2014. The LCR disclosures is based on the average three month end data points.

<b>LIQUIDITY COVERAGE RATIO (LCR)</b>		<b>(RO '000)</b>	
<b>Common Disclosure Template</b>		<b>Total Unweighted Value (average)</b>	<b>Total Weighted Value (average)</b>
<b>High Quality Liquid Assets</b>			
1	Total High Quality Liquid Assets (HQLA)	-	49,574
<b>Cash Outflows</b>			
2	Retail deposits and deposits from small business customers, of which:	56,882	4,423
3	Stable deposits	24,299	1,164
4	Less stable deposits	32,584	3,258
5	Unsecured wholesale funding, of which:	77,411	38,211
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	-	-
7	Non-operational deposits (all counterparties)	64,764	25,564
8	Unsecured debt	12,647	12,647
9	Secured wholesale funding	-	-
10	Additional requirements, of which	-	-
11	Outflows related to derivative exposures and other collateral requirements	-	-
12	Outflows related to loss of funding on debt products	-	-
13	Credit and liquidity facilities	-	-
14	Other contractual funding obligations	1,938	194
15	Other contingent funding obligations	11,550	11,550
16	<b>TOTAL CASH OUTFLOWS</b>		54,377
<b>Cash Inflows</b>			
17	Secured lending (e.g. reverse repos)	-	-
18	Inflows from fully performing exposures	4,031	2,015
19	Other cash inflows	13,812	13,812
20	<b>TOTAL CASH INFLOWS</b>	17,843	15,828
			<b>Total Adjusted Value</b>
21	<b>TOTAL HQLA</b>		49,574
22	<b>TOTAL NET CASH OUTFLOWS</b>		38,550
23	<b>LIQUIDITY COVERAGE RATIO (%)</b>		128.60%

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### ISLAMIC NSFR

	No Maturity	<6 Months	6 Months to < 1 Year	>= 1 Year	Weighted Value	
<b>ASF ITEM</b>						
1	Capital	<b>37,319</b>	-	-	-	<b>37,319</b>
2	Regulatory Capital	37,319	-	-	-	37,319
3	Other Capital Instruments	-	-	-	-	-
	Retail Deposits and Deposits from small Business					
4	Customers	<b>55,713</b>	<b>1,521</b>	<b>4,266</b>	-	<b>55,941</b>
5	Stable Deposit	11,719	61	37	-	11,227
6	Less Stable Deposit	43,994	1,460	4,229	-	44,714
7	Wholesale Funding	<b>54,152</b>	<b>37,931</b>	<b>31,329</b>	-	<b>61,706</b>
8	Operational	-	-	-	-	-
9	Other Wholesale Funding	54,152	37,931	31,329	-	61,706
10	Liabilities with matching interdependent Assets	-	-	-	-	-
11	Other Liabilities	-	-	-	83,216	83,216
12	NSFR Derivative Liability	-	-	-	-	-
	All other liabilities and equities not included in above					
13	categories	47,288	-	-	-	-
14	Total ASF	-	-	-	-	<b>238,182</b>
<b>RSF ITEMS</b>						
15	Total NSFR high-quality liquid assets (HQLA)	-	-	-	-	-
	Deposits held at other financial institutions for					
16	operational purposes	1,673	-	-	-	837
17	Performing Loans and Securities	-	-	-	-	-
	Performing loans to financial institutions secured by					
18	Level 1 HQLA	-	-	-	-	-
	Performing loans to financial institutions secured by					
19	non- Level 1 HQLA and unsecured performing loans to financial institutions	-	-	-	-	-
	Performing loans to non-financial corporate					
	clients, loans to retail and small business customers,					
	and loans to sovereigns, central banks and PSEs, of					
20	which	-	15,002	15,759	206,238	190,683
	With a risk weight of less than or equal to 35% under					
21	the Basel II Standardised approach for credit risk	-	-	-	62,198	40,429
22	Performing residential mortgages, of which:	-	-	-	-	-
	With a risk weight of less than or equal to 35% under					
23	the Basel II Standardised Approach for credit risk	-	-	-	-	-
	Securities that are not in default and do not qualify as					
24	HQLA, including exchange-traded equities	-	131	-	1,613	1,437
25	Assets with matching interdependent liabilities	-	-	-	-	-

## Basel II Pillar III and Basel III Report (continued)

31 December 2018

### ISLAMIC NSFR (continued)

	No Maturity	<6 Months	6 Months to < 1 Year	>= 1 Year	Weighted Value
26 Other Assets:	-	-	-	-	-
27 Physical traded commodities, including gold	-	-	-	-	-
28 Assets posted as initial margin for derivative contracts and contributions to default funds of CCPs	-	-	-	-	-
29 NSFR derivative assets	-	-	-	-	-
30 NSFR derivative liabilities before deduction of variation margin posted	-	-	-	-	-
31 All other assets not included in the above categories	-	38,524	-	14,419	2,449
32 Off-balance sheet items	-	7,264	3,950	1	561
33 Total RSF	-	-	-	-	<b>236,394</b>
34 <b>NET STABLE FUNDING RATIO</b>	-	-	-	-	<b>100.76%</b>

The financial statements and other related disclosures are also available on the ahlibank's website, to view it on the website refer the link <http://ahlibank.om/investor-relations/financial-reports/>.

The Basel II, Pillar III report is prepared in accordance with the requirements of Basel II, Pillar III disclosures as set out in the CBO circulars BM1009 and BM1027.

Basel III capital and liquidity disclosures are prepared in accordance with CBO Circular BM 1114 'Regulatory Capital and Composition of Capital Disclosure Requirements under Basel III' issued on 17 November 2013, CBO circular dated march 20, 2018 and BM 1127 'Basel III – Framework on Liquidity Coverage Ratio (LCR) and LCR disclosure standard' issued on 24 December 2014, respectively. The NSFR disclosure has been prepared in accordance to CBO Circular reference BM 1147 dated October 26, 2016.

For Al Hilal Islamic Banking Services – Ahli Bank SAOG



**Hamdan Ali Nasser Al Hinai**  
Chairman  
Date: 28 January 2019