



بنك الخليج المتحد
ش.م.ب. (مقفلة)
United Gulf Bank B.S.C. (Closed)

Basel III, Pillar 3

Risk Management and Capital Adequacy Disclosures

31 December 2019





Table of Contents

EXECUTIVE SUMMARY.....	3
BACKGROUND.....	4
1. INTRODUCTION TO THE BASEL III FRAMEWORK.....	5
1.1 Pillar 1 – Minimum Capital Requirements	5
1.2 Pillar 2 – Supervisory Review Process (“SRP”)	7
1.3 Pillar 3 – Market Discipline	7
2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES.....	8
2.1 Group Structure	8
2.2 Risk Management Structure and Processes	9
2.3 Types of Risk	11
2.4 Risks under Pillar 1	12
2.5 Risks under Pillar 2	18
2.6 Monitoring and Reporting	19
3. CAPITAL ADEQUACY	20
3.1 Capital Structure and capital adequacy	20
3.2 Capital adequacy ratio of consolidated group	27
3.3 Capital requirements for credit risk.....	27
3.4 Capital requirements for market risk.....	28
3.5 Capital requirements for operational risk.....	29
4. CREDIT RISK – PILLAR 3 DISCLOSURES	30
4.1 Categories of exposure classes	30
4.2 Categories of exposure by industry	31
4.3 Categories of exposure by geography and region	32
4.4 Categories of exposure by maturity.....	32
4.5 Categories of exposure by related parties	33
4.6 Provisions against Expected Credit Losses	33
4.6.1 Industry-wise movement of provisions	33
4.6.2 Geographic movement of provisions.....	34
4.7 Restructured loans	34
4.8 Past due and impaired loans	34
4.9 Exposure over the individual obligor limits	34
4.10 Equity position in banking book	35
4.11 Collateral.....	37



5.	MARKET RISK – PILLAR 3 DISCLOSURES.....	37
6.	OPERATIONAL RISK – PILLAR 3 DISCLOSURES.....	37
7.	OFF STATEMENT OF FINANCIAL POSITION EXPOSURE	38
8.	PILLAR 2 RISKS	38
8.1	Liquidity Risk	38
8.2	Disclosure concerning interest rate risk in the banking book.....	38
8.3	Concentration Risk	40
9.	INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS.....	40
10.	REMUNERATION POLICY AND RELATED DISCLOSURES	41
10.1	NRC role and focus	41
10.2	Approved Persons and Material Risk Takers.....	43
10.3	Remuneration strategy.....	43
10.4	Board remuneration	44
10.5	Variable remuneration for staff.....	44
10.6	Remuneration of control functions.....	45
10.7	Variable compensation for business units	45
10.8	Risk assessment framework	46
10.9	Risk adjustments	46
10.10	Malus and Clawback framework	47
10.11	Components of variable remuneration	47
10.12	UGB Remuneration Disclosure Report for Approved Persons & MRT	48
11.	PENALTIES.....	49
12.	CONCLUSION.....	49



EXECUTIVE SUMMARY

As a bank, incorporated in the Kingdom of Bahrain, United Gulf Bank B.S.C. (c) (“UGB” or “the Bank”) has complied with the Basel III Capital Adequacy Framework effective 1 January 2015. This is in accordance with the Central Bank of Bahrain’s (“the CBB”) Basel III guidelines.

The Risk Management and Capital Adequacy Disclosures fulfill the Pillar 3 requirements of the Basel III Accord. The objective of implementing Pillar 3 is to improve market discipline through effective public disclosure and to complement the reporting templates under Pillar 1 and Pillar 2. The spirit of market discipline can be summed up in the phrase ‘accountability through transparency’.

The disclosures have been provided in accordance with the Public Disclosures (“PD”) module of the CBB’s Rulebook volume 1. They meet the requirements of Basel III (Pillar 3) and International Financial Reporting Standard (“IFRS”) 7. The PD module sets out required disclosures to allow market participants to assess key pieces of information on the scope of application, capital structure, risk exposures, risk assessment processes, and the capital adequacy of the financial institution. The information provided in this document, is also in line with UGB’s Disclosure Policy that was updated and approved by the Board of Directors on 13 November 2017.

The CET 1, Tier 1 and Total consolidated capital adequacy ratios of UGB as at 31 December 2019 were over the CBB’s thresholds of 9.0%, 10.5% and 12.5% (including Capital Conservation Buffer “CCB” of 2.5%) respectively. UGB’s consolidated CET 1 ratio was 14.62%, Tier 1 ratio was 18.11% and Total Capital ratio was 19.70% as of 31 December 2019, with total risk weighted assets being US\$ 983 million. This comprises 89.4% for credit risk, 9.5% for operational risk and 1.2% for market risk.

All figures in this report are as at 31 December 2019 (unless otherwise stated), and have been reported using IFRS, that are applicable at the consolidated level of UGB and its subsidiaries. Agreed upon procedures have been performed on the Public Disclosures by Ernst & Young (UGB’s external auditors) in accordance with PD module issued by the CBB.

Figures contained in these disclosures are subject to rounding adjustments and in certain instances, the sum of the numbers in a column or a row in tables contained in this document may not conform exactly to the total figure given for that column / row or cross referred with numbers in financial statements or annual reports.



BACKGROUND

United Gulf Bank B.S.C. (c) is a closed joint stock company incorporated in the Kingdom of Bahrain in 1980, under Commercial Registration (CR) number 10550. The Bank's registered office is UGB Tower, Diplomatic Area, P.O. Box 5964, Manama, Kingdom of Bahrain.

The Bank operates in the Kingdom of Bahrain under a Wholesale Banking License issued by the CBB. The principal activities of the Bank and its subsidiaries ('the Group') comprise of investment and commercial banking. Investment banking include asset portfolio management, corporate finance, advisory, investment in quoted and private equity funds, real estate, capital markets, international banking and treasury functions. Commercial banking includes extending loans and other credit facilities, accepting deposits and current accounts from corporate and institutional customers.

The Bank's parent company is United Gulf Holding Company ("UGHC") which owns 100% shares of the Bank and ultimate holding company is Kuwait Projects Company (Holding) K.S.C. ("KIPCO"). UGHC is incorporated in the Kingdom of Bahrain as a joint stock company and is listed on the Bahrain Bourse. KIPCO is incorporated in the State of Kuwait and is listed on the Kuwait Stock Exchange.



1. INTRODUCTION TO THE BASEL III FRAMEWORK

The new capital adequacy module of the CBB rulebook volume 1 was introduced with effect from 1 January 2015. The transitional arrangements (which ended on 31 December 2018) for implementing the new standards help to ensure that the banking sector can meet the higher capital standards through reasonable earnings retention and capital raising, while still supporting lending to the economy.

The CBB's Basel III Framework can be summarized as follows:

- | | |
|-----------------|--|
| Pillar 1 | Minimum capital requirements for credit, market and operational risks, defining eligible capital instruments and prescribing rules for calculating Risk Weighted Assets ("RWA"). |
| Pillar 2 | Supervisory review and evaluation process including the Internal Capital Adequacy Assessment Process ("ICAAP") to assess risks not covered under Pillar 1, identify capital relating to these risks and ensuring that the Bank has sufficient capital (generated from internal / external resources), to cover the relevant risks. |
| Pillar 3 | Market discipline through public disclosures that are designed to provide transparent information on capital structures and risk management. It allows market participants to assess the risk and capital profiles of banks. |

The three pillars are designed to be mutually reinforcing and are meant to ensure a capital base that corresponds to the overall risk profile of the Bank.

1.1 Pillar 1 – Minimum Capital Requirements

Pillar 1 of the Basel III Accord published by the Bank of International Settlements, covers the minimum regulatory capital requirement that a bank is expected to maintain to cover credit, market and operational risks stemming from its operations. It sets out the basis for the consolidation of entities for capital adequacy reporting requirements, the definition and calculations of risk-weighted assets and the various options given to banks to calculate these risk weighted assets.

The following table summarizes the approaches available for calculating risk - weighted assets for each risk type, in accordance with the CBB's Basel III capital adequacy framework.

Methodologies available for determining regulatory capital requirements

Credit Risk	Market Risk	Operational Risk
Standardized approach	Standardized Approach	Basic Indicator Approach
	Internal Models Approach	Standardized Approach

1. INTRODUCTION TO THE BASEL III FRAMEWORK (continued)

1.1 Pillar 1 – Minimum Capital Requirements (continued)

On a group-wide basis, UGB's capital management framework is intended to ensure that there is sufficient capital to support the underlying risks of the Bank's business activities, and to maintain a "well-capitalized" status under the CBB's regulatory requirements. Basel III transitional capital requirements became effective on 1 January 2015 with a transition period of up to 31 December 2018 for full implementation. There are three categories of risk-based capital under Basel III transitional arrangements: Core Equity Tier 1 Capital (CET 1), Tier 1 Capital and Total Capital. Banks incorporated in the Kingdom of Bahrain are required to maintain regulatory minimum ratios of 6.5% CET 1, 8.0% Tier 1, and 10.0% Total Capital. There is also a requirement for banks to maintain a Capital Conservation Buffer (CCB) of 2.5%. Therefore, the required Capital Adequacy Ratios (CAR) including CCB for CET 1, Tier 1 and Total Capital are 9.0%, 10.5% and 12.5% respectively.

UGB assesses its capital adequacy relative to the risks underlying its business activities and takes proactive measures to ensure that it operates above these. The approach adopted by the Bank for each type of risk is as follows:

- i) **Credit Risk** – UGB uses the standardized approach for determining the charge for credit risk. The standardized approach incorporates the use of external ratings to determine risk factors. Financial collaterals are used wherever applicable in order to mitigate the underlying risk. The risk weighted assets are determined by multiplying the credit exposure (less specific provisions) by a risk weight factor (determined in accordance with the CBB regulations), that is a function of the type of counterparty, and the counterparty's external rating. A risk weight factor of 100% is used for all unrated exposures, except, exposures to unrated multilateral development banks, banks and investment firms which are risk weighted at 50%.
- ii) **Market Risk** – For regulatory reporting purposes, UGB uses the standardized approach. This incorporates a charge for general risk and specific risk on its equities, funds, and foreign exchange exposures.
- iii) **Operational Risk** – Under the CBB's Basel III framework, it is mandated that all banks incorporated in the Kingdom of Bahrain, use the basic indicator approach for operational risk. The only exception is when specific approval is granted by the CBB to use the standardized approach. UGB determines its capital charge for operational risk, by applying an alpha coefficient of 15% to the average gross income for the preceding three financial years. Figures for any year in which annual gross income is negative or zero is excluded from both the numerator and denominator when calculating the average.

1. INTRODUCTION TO THE BASEL III FRAMEWORK (continued)

1.2 Pillar 2 – Supervisory Review Process (“SRP”)

The second pillar of Basel III is aimed at encouraging financial institutions to develop self-control processes that enable them to:

- Identify any risks not previously considered in Pillar 1;
- Identify capital relating to these risks; and
- Ensure that the business has sufficient capital (generated from internal / external resources), to cover the relevant risks.

Pillar 2 encompasses two processes – namely, the ICAAP and a Supervisory Review and Evaluation Process. The ICAAP involves appropriate identification, assessment and measurement of residual risks, and ensures that the Bank has sufficient capital resources available to meet regulatory and internal capital requirements, even during periods of intensive economic or financial stress. Considerable work has been done by UGB to fulfill the requirements under Pillar 2.

1.3 Pillar 3 – Market Discipline

Pillar 3 of the Basel III Accord, imposes certain disclosure requirements with an objective to ensure that there is greater transparency on the transactions and the risk strategy of a bank. It is assumed that the reactions of market participants (shareholders, creditors, counterparties and external rating agencies amongst others) will have a disciplining effect in terms of their assessment about the bank's risk profile and the level of capitalization. Under the current regulations, qualitative and quantitative analysis, need to be presented to comply with the prudential disclosure guidelines.



2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES

The objective of this section is to set out the consolidation principles and the capital base of UGB for the purpose of disclosure with the Pillar 1 guidelines. It also describes the policies and the corporate governance processes that are applicable in the management and control of risk and capital.

2.1 Group Structure

The full legal name of the top corporate entity to which the disclosure requirements apply is United Gulf Bank B.S.C. (c). The Group produces consolidated financial statements. These are prepared and published on a full consolidation basis, with all principal subsidiaries being consolidated in accordance with IFRS. The Bank maintains an up to date checklist of all applicable IFRS and disclosure requirements. For capital adequacy purposes, all material subsidiaries are included within the Group structure. No additional disclosures are required due to listing requirements of the Group's subsidiaries. The principal subsidiaries for capital adequacy purposes are as follows:

Name of the subsidiary	Country of incorporation	Ownership at 31 December		Year of incorporation
		2019	2018	
Held directly				
KAMCO Investment Company K.S.C.P. [KAMCO]	Kuwait	60%	86%	1998
United Gulf Financial Services Company-North Africa	Tunisia	84%	84%	2008
United Gulf Realty International, Ltd [UGRIL]	British Virgin Islands	100%	100%	2012
United Gulf Asset Company S.P.C.	Bahrain	100%	100%	2017
Held through KAMCO				
Al Dhiyafa United Real Estate Company W.L.L.	Kuwait	100%	100%	2007
Al Jazi Money Market Fund	Kuwait	51%	51%	2007
Al Tadamon United Holding Co	Kuwait	100%	96%	2017
Al Zad Real Estate W.L.L.	Kuwait	100%	99%	2007
Bukeye Power Project Advisory Co	U.S.A.	50%	50%	2017
Bukeye Power Project Manager Ltd	Jersey	100%	100%	2017
Carnation Advisory Company LLC	U.S.A.	75%	75%	2018
Carnation Manager limited	U.K.	100%	100%	2018
First Brokerage	Kuwait	93%	-	1985
Flint Advisor Company LLC	Jersey	46%	46%	2017
Flint Manager Ltd	U.S.A.	100%	100%	2017
Global Investment House	Kuwait	-	71%	1998
Global DIFC	Kuwait	100%	-	2013
Global Saudi	Saudi Arabia	100%	-	2016
KAMCO Egypt Holding Ltd	U.A.E.	100%	100%	2018
Kamco GCC Opportunistic Fund	Kuwait	100%	100%	2013
KAMCO Investment Company (DIFC) Limited	U.A.E.	100%	100%	2016
KAMCO MENA Plus (DIFC)	U.A.E.	100%	100%	2019
KAMCO Mena Plus Fixed Income Fund	Kuwait	-	38%	2016
Kubbar United Real Estate Co	Kuwait	100%	-	2017
Kuwait Private Equity Opportunity Fund	Kuwait	73%	73%	2004
Nawasi United Holding Co	Kuwait	100%	96%	2017
North Africa Real Estate Co.	Kuwait	100%	100%	2014
Plans United Real Estate Co	Kuwait	100%	-	2017
Project Plaza Investor Inc	U.S.A.	100%	-	2019
S17P02V Holding Ltd	U.A.E.	-	100%	2018
Shuroq Investment Services	Oman	77%	-	1998

Manafae Investment Company Kuwait is the Group's only significant minority investment in financial entities that forms part of the regulatory adjustments. As the investment is less than the cap of 10% of the Bank's CET1c regulatory capital, no deductions were made to the Bank's CET1c regulatory capital.

As of 31 December 2019, KAMCO Investment Fund, an associate of the Bank through its subsidiary KAMCO, attracts risk weights of 800% for exposure above 15% of the Bank's regulatory capital on a consolidated basis.

2.2 Risk Management Structure and Processes

UGB's risk management framework and governance structure are intended to provide comprehensive controls and ongoing management of the major risks inherent in the Bank's business activities. Its philosophy is based on the principles that reiterate:

- A sound knowledge base, experience and judgment of Senior Management and Risk Management staff are the cornerstone of a successful risk mitigation program;
- Vigilance, discipline and attention to detail are mandatory; and
- Policies and procedures must be clear, well communicated, understood and implemented in letter and spirit.

The Board of Directors (Board) of UGB is the ultimate authority for setting overall strategy, risk parameters, limits, capital adequacy ratios and tolerances, within which the Bank operates. The Board reviews the Bank's overall risk profile, significant risk exposures as well as the policies, procedures and controls that have been incorporated in accordance with the regulations. The Board has delegated day-to-day decision making to the Executive Committee (EC) that comprises three directors. The EC meets in between Board meetings to approve all proposals that exceed the threshold of the Investment Committee. The Board Audit Committee assists the Board in carrying out its responsibilities regarding internal controls, internal and external audit, compliance with laws, financial reporting practices, accounting policies, corporate governance and the review of UGB's strategy and business plans.

The Investment Committee comprising the Chief Executive Officer and the Chief Financial Officer, is responsible for approving or recommending approval to the EC, limits for individual exposures, investments and concentrations towards banks, countries, industries, risk rating classes or other special risk asset categories. The Head of Credit and Risk Management is the Secretary of this Committee and participate in meetings as a non-voting member.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.2 Risk Management Structure and Processes (continued)

Apart from the above, the Bank has a Risk and Compliance Committee that is responsible for the monitoring and assessment of risks facing the Bank, the review of compliance with internal and external guidelines, the review of risk frameworks and methodologies, and the assessment of the impact on the Bank from new regulatory requirements.

The Nominating & Remuneration Committee (NRC), comprising of three board members, assists the Board in assessing the skill sets of Board members and ensures that there is an appropriate mix of eminent persons having an independent standing in their respective field / profession and who can effectively contribute to UGB's business and policy decisions. The NRC also recommends / reviews the remuneration policies for the Board and senior management.

The IT Steering Committee, headed by the Chief Executive Officer and members include the Chief Financial Officer and other senior management team members, is responsible for assisting the Board in the supervision of IT related activities. It ensures that it minimizes the risks associated with UGB's investment in information technology and that it contributes to the attainment of technology related corporate objectives.

The Assets and Liabilities Committee (ALCO) provides a forum for the review of assets and liabilities on UGB's statement of financial position. It monitors the tenor and cost / yield profiles of the various components and evaluates the Bank's statement of financial position both from interest rate sensitivity and liquidity points of view. Corrective adjustments based on perceived trends and market conditions, liquidity and foreign exchange exposures and positions are recommended.

The Internal Audit and Quality Assurance Department provides the Board Audit Committee and Senior Management with an ongoing process of independent and objective assessment and assurance on effectiveness and quality of controls.

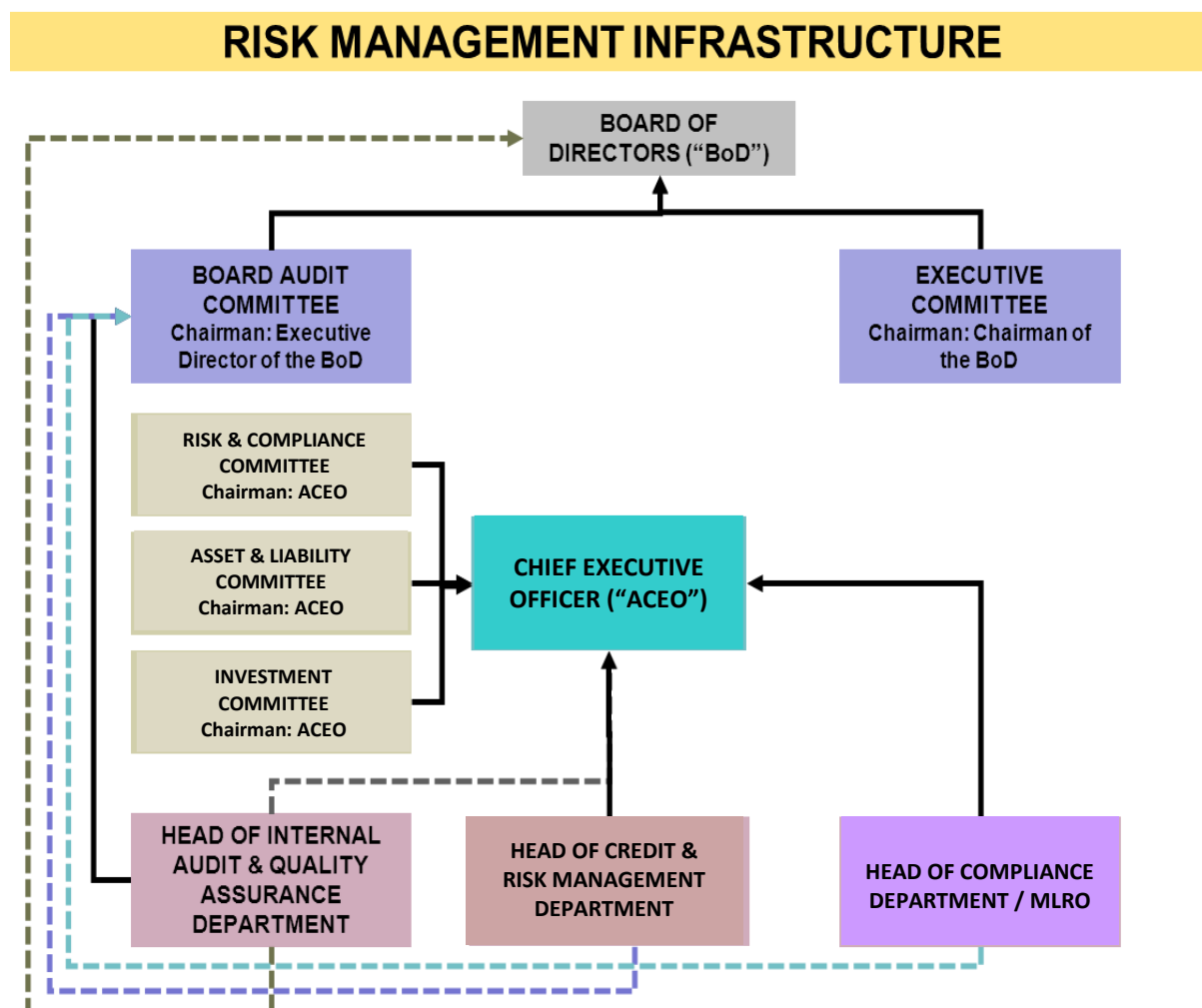
On 15 March 2010, the Ministry of Commerce and Industry of the Kingdom of Bahrain introduced a Corporate Governance Code (the Code) applicable to the Group. The Code is based upon nine core principles of corporate governance that adhere to international best practices. The Code includes recommendations to apply the principles, as well as recommendations, which support the implementation of good corporate governance. The Code is issued in a "comply or explain" framework, which means companies should comply with the recommendations, or give an explanation in the case of non-compliance.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.2 Risk Management Structure and Processes (continued)

Corporate Governance report for the year ended 31 December 2019 has been prepared by the Bank and is available on the Bank's website www.ugbbh.com.

The governance structure for risk management can be depicted as follows:



2.3 Types of Risk

The major types of risk that UGB is primarily exposed to include credit, market, operational, liquidity and funding, interest rate risk, single name and geographical concentration, strategic and legal / reputational risks. The first three comprise part of the Pillar 1 assessment, while the latter four are considered under Pillar 2.



2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.4 Risks under Pillar 1

i) Credit Risk

Credit Risk is defined as the risk that UGB's clients or counterparties will be unable or unwilling to pay interest, repay the principal or other dues to fulfill their contractual obligations under loan agreements or other credit facilities. UGB adopts the standardized approach for calculating credit risk weighted assets. These are determined by multiplying the exposure by a risk weight factor that is a function of the counterparty's external rating issued by accredited external credit rating agencies approved by the CBB. The overall credit exposures as at 31 December 2019 can be summarized as follows:

Gross exposures	US\$ 000
Funded	
Demand and call deposits with banks	71,369
Placements with banks	236,278
Investments carried at FVTPL	13,070
Held-to-maturity investments	280
Loans and receivables	37,833
Other assets	74,222
	<u>433,052</u>
Unfunded	
Letters of guarantee	2,237
Derivative financial assets	521
	<u>2,758</u>
	<u><u>435,810</u></u>

The year-end position of the gross credit exposure is the representative of the Group's risk position during the year and accordingly the average gross credit exposure of the Group for the year ended 31 December 2019 is not disclosed.

Assigning risk ratings to an individual risk exposure is a subjective process. The factors that are considered while determining the rating are:

- Risk category / Issuer rating
- Investment size (per name or risk category)
- Industry sector
- Asset class (liquid - illiquid)
- Country / region
- Maturity / expected maturity
- Yield / Interest rate (fixed / floating, coupon / non - coupon bearing)

Although some of these criteria are more important than others, each is an integral part of the decision-making process for asset allocation.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.4 Risks under Pillar 1 (continued)

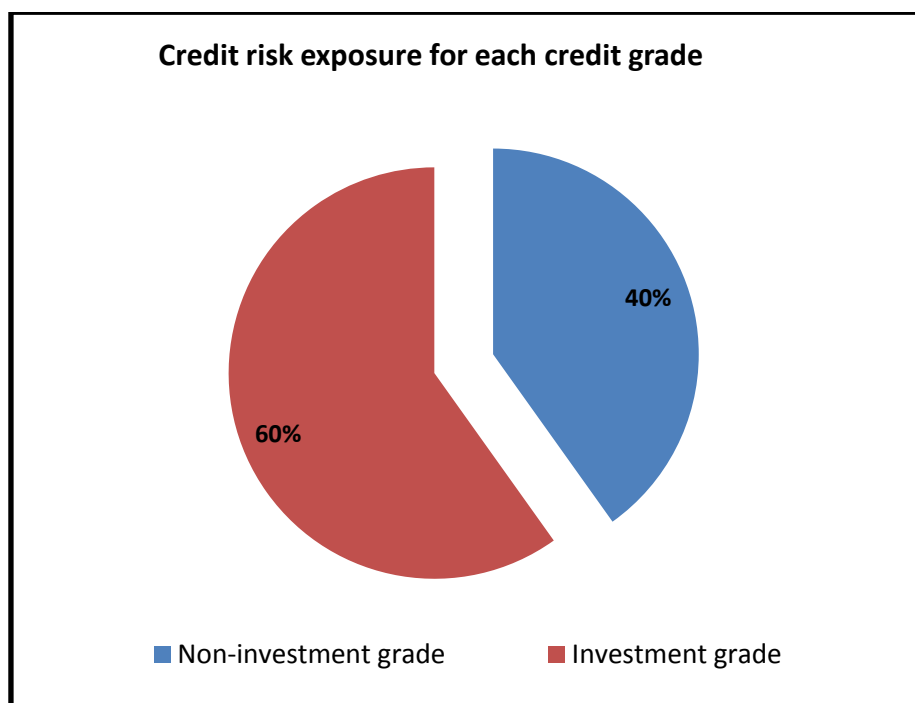
i) Credit Risk (continued)

Risk Category / Issuer Rating

Whenever available, UGB uses ratings assigned by the CBB accredited rating agencies, which mainly include Moody's, Standard and Poor's and Fitch. For unrated exposures, an internal rating is assigned based on subjective evaluation by the originating department, in consultation with Credit and Risk Management. However, internally assigned ratings are indicative and are not considered for capital adequacy purposes.

The rating system classifies ratings BBB- or greater as "Investment Grade", i.e. higher quality credits with AAA being of undoubted credit worthiness. Ratings ranging from BB+ to B / CCC / D are designated as "Non-Investment Grade", with D representing a default investment. The individual rating influences the approval matrix, portfolio mix and diversification, the capital allocation to the business groups (ensuring the proper risk-return balance) and the investment review cycle.

Breakdown of the Risk Asset Portfolio by rating as at 31 December 2019 is presented below:



2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.4 Risks under Pillar 1 (continued)

i) Credit Risk (continued)

Investment Size

The absolute exposure per issuer is determined by the CBB's guidelines on maximum exposure limits that stipulate that aggregate outstanding to an individual counterparty or a group of closely related counterparties, should not exceed 15% of the bank's consolidated capital base. In accordance with the CBB rules, the Bank has a Large Exposure policy (approved by the Board), which stipulates guidelines for monitoring all existing large exposures. Further details on large exposures are disclosed in Section 8.3.

Industry Sector

UGB's risk policies and procedures define twelve industry groups that have been established for classifying its portfolio. These twelve categories represent a distillation of the Moody's standard industry classification guide. The emphasis on industry diversification is to ensure that UGB avoids undue concentration in any one or more industry groups that could be vulnerable to an economic downturn or a structural shift – "cyclical" industry sectors. The Bank's strategy also aims at achieving a wide balance across the industry category spectrum, based on the premise that more industries are better than a few. The Bank also avoids certain sectors that are historically known for a greater extent of volatility (e.g. airlines, shipbuilding, early stage high technology and venture capital—unless on a diversified fund basis). This is primarily because these industries are exposed to structural difficulties, an absence of industry comparisons, or cannot be adequately analyzed in terms of resident analytical expertise. Investments in sensitive industries like gambling and armaments are not permissible under the Bank's risk policy.

Asset Class

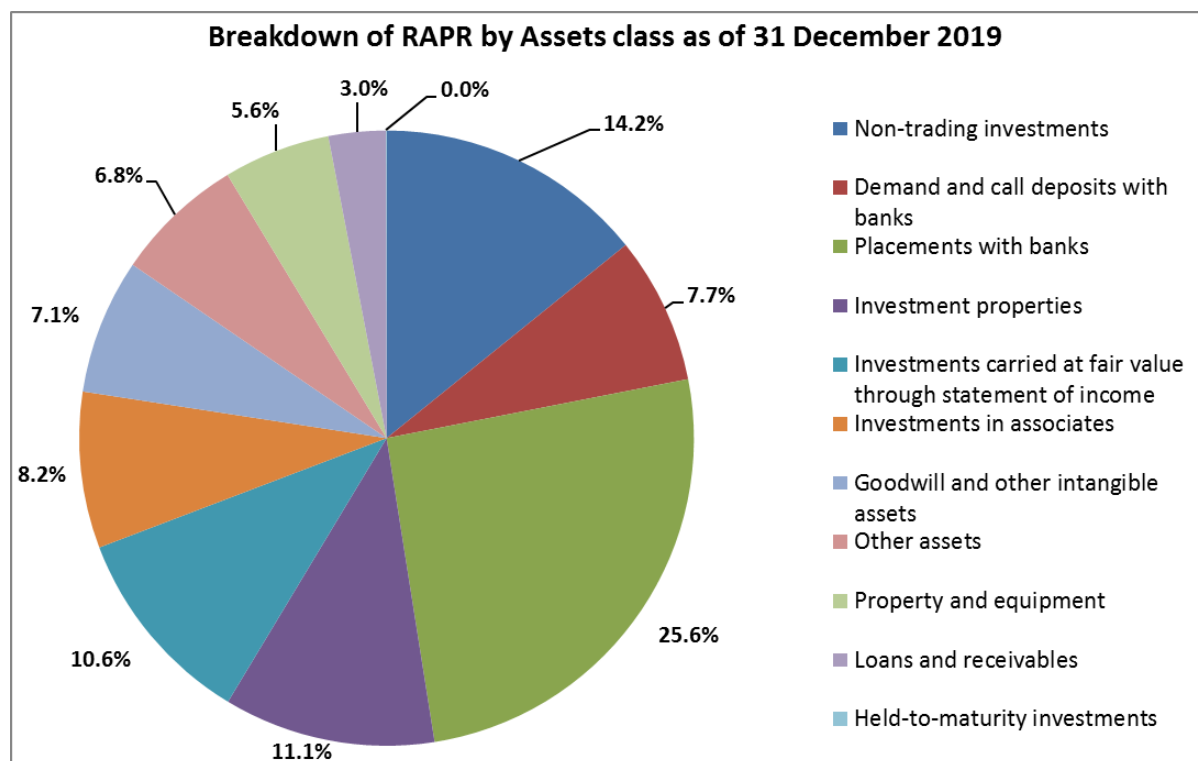
The asset class of the investment is usually determined by its ability to be sold or traded i.e. the extent of liquidity. If pricing is identical for the same risk but offered in a variety of asset classes, UGB's risk policy recommends its investment in a tradable security as opposed to a loan, for which an imperfect secondary market usually exists. In further defining this criterion, risk assets are categorized in terms of "liquid / marketable" and "illiquid". Liquid / marketable assets normally comprise publicly quoted debt securities and quoted equities that have the ability to be sold promptly at minimal or no price discount within 48 hours. A further sub-category of liquid / marketable is defined as "highly liquid". These assets comprise US Treasury bills and certain AAA Corporate bonds that can be sold "on the wire" i.e. instantly with little / no price discount risk. All other risk assets such as commercial customer loans, private subordinated debt, unquoted equities, private equity funds & direct investments and real estate are defined as illiquid. These assets are not readily traded or marketable other than over a long period of time and at a potential discount.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.4 Risks under Pillar 1 (continued)

i) Credit Risk (continued)

The following graph illustrates the breakdown of the Risk Asset Portfolio Report (RAPR) by assets as at 31 December 2019.



Where appropriate, UGB seeks to minimize its credit risk using a variety of techniques including, but not limited to:

- Operating under a sound credit and investment approval process;
- Maintaining appropriate credit administration, measurement and monitoring;
- Ensuring adequate controls over the credit risk process;
- Seeking third party guarantees of the counterparty's obligations;
- Procuring collateral against the investment or facility; and
- Entering into netting agreements.

UGB actively manages and monitors credit risk in accordance with well-defined policies and procedures that have been approved by the Board. Limits are set on the amount of risk that the Bank is willing to accept against individual counterparties, related parties and geographical and industry concentrations.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.4 Risks under Pillar 1 (continued)

i) Credit Risk (continued)

Continuous monitoring of the Bank's assets through various reports and reviews is key to timely and accurate identification of any impairment. A monthly risk asset review report is produced by the Credit and Risk Management Department in which all assets are assessed based on rating, industry, and geographic exposure in addition to a number of other parameters. The purpose of this report is also to ensure compliance with both external regulatory requirements and internal risk policy guidelines. Additionally, a semiannual review of all assets is prepared detailing performance and outlining recent developments and future outlook.

Detailed information on the Bank's credit risk exposures including geographical distribution, industry/sector allocation, details of collateral and other credit enhancements and bifurcation based on internal ratings has been provided in Note 4 of these disclosures.

ii) Market Risk

Market risk is defined as the loss of the value of a financial instrument or a portfolio of financial instruments due to an adverse change in market prices or rates. Market Risk within UGB arises from the trading of equities and investment activities.

The categories of market risk to which UGB is exposed to are as follows:

- Equity risk that arises from exposures to changes in the price and volatility of individual equities or funds. UGB's equity risk principally arises from its trading activities, which are largely focused on the Kuwait equity market.
- Foreign exchange risks that result from exposure to change in the price and volatility of currency spot and forward rates.

UGB's policy guidelines for market risk have been vetted by the Board in compliance with the rules and guidelines provided by the CBB. The Bank seeks to manage the market risks it faces, through diversification of exposures across dissimilar markets, industries and products. In order to effectively manage market risk exposures in addition to the exercise of business judgment and management experience, the Bank utilizes limit structures including those relating to asset classes, capital markets and industry sectors.

iii) Operational Risk

Operational Risk is defined as the risk of loss arising from inadequate or failed internal processes, people, systems or external events. It is an inherent risk faced by all banks and covers various incidents including business interruption and systems failures, internal and external fraud, transaction execution and process management, employment practices and workplace safety, customer and business practices and damage to physical assets.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.4 Risks under Pillar 1 (continued)

iii) Operational Risk (continued)

UGB's ability to properly identify, assess, manage, measure, monitor and report risk is critical to its financial strength and profitability. A comprehensive set of risk management policies, processes and limits are in place to provide guidelines and parameters. They are continually updated with the objective of incorporating best practices, changes in market factors and changes in the regulatory environment.

In accordance with the Basel guidelines, UGB has developed a comprehensive operational risk framework, whereby all activities and processes of the Bank are analysed, residual risks identified, measured and reported as appropriate.

Exception and excess exposure reporting is done by the Credit and Risk Management Department, succession planning, business continuity planning, reliable management reporting and supervision by the Internal Audit Department and the Board Audit Committee is also adhered to by the Bank.

The management of operational risk is the responsibility of every employee. The operational risk framework is built around a comprehensive Risk Control Self-Assessment (RCSA) that identifies all major risks stemming from activities of each department of the Bank. The Risk and Compliance Committee periodically reviews the results of the RCSA. UGB has further enhanced its Operational Risk Framework, supported by a fully automated Operational Risk System. The system comprises of modules for loss database, RCSA, key risk indicators and exposure monitoring.

In a bid to mitigate operational risk, UGB has introduced internal controls and processes based on the principle of checks and balances and segregation of duties. The intention is to minimize the risk by ensuring that there is a culture of strong control throughout the organization. The management of operational risk in the Bank is the responsibility of every employee.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.5 Risks under Pillar 2

In accordance with the ICAAP process, UGB assesses risks that are not part of the calculation of the regulatory capital adequacy ratio. Chief among these are:

i) Liquidity Risk

Liquidity risk stems from the inability to procure sufficient cash flow to meet UGB's financial obligations as and when they fall due. The risk arises due to the timing differences between the maturity profile of the Bank's assets and liabilities. In the wake of the global crises, liquidity risk has been of concern to regulators and financial institutions. This is evident when entities are forced to sell assets much below their intrinsic value / market price, unable to raise deposits or need to borrow funds at excessively high rates.

In order to ensure that the Bank can meet its financial obligations as they fall due, there is a close monitoring of UGB's assets and liabilities position. Besides other functions, ALCO evaluates the statement of financial position from a structural, liquidity and sensitivity point of view. The whole process is aimed at ensuring availability of sufficient liquidity to fund the Bank's ongoing business activities, effectively managing maturity mismatches between assets and liabilities, managing market sensitivities, and ensuring that the Bank has the capacity to fund its obligations as they fall due. Daily, weekly and monthly reports are generated to monitor key liquidity ratios and to ensure the maintenance of a diversified funding base in terms of individual loans and maturities.

UGB has established a funding strategy that provides effective diversification in the sources and the tenor of funding. It maintains an ongoing presence in its chosen funding markets. Strong relationships are also maintained with fund providers to promote the effective diversification of funding resources. As at 31 December 2019, the liquidity ratio of the Bank under normal scenario as reported to the CBB was 76.16%. This is strictly monitored to ensure that it remains above the regulatory level of 25 percent at all times.

ii) Interest Rate Risk in the Banking Book

Interest rate risk on the banking book arises as a result of mismatches in the re-pricing or maturity of interest rate sensitive financial assets and liabilities. This is also known as re-pricing risk. Additionally, UGB is exposed to basis value risk, which results from a change in the relationship between the yields / yield curves of long and short positions with the same maturity in different financial instruments. This in effect means that the long and short positions no longer fully hedge each other.

UGB identifies the sources of interest rate risk and the interest rate risk sensitive products and activities. It proactively measures and monitors the interest rate risk in the banking book. The Bank also periodically carries out stress testing to assess the effect of extreme movements in interest rates that could expose the Bank to high risks. A conscious effort is also made to match the amount of floating rate assets with floating rate liabilities in the banking book. UGB also enters into certain transactions in order to hedge exposures arising from day-to-day banking and investment activities. These hedge transactions may be instruments such as interest rate swaps (IRS) to convert a floating rate asset / liability into a fixed rate one or vice-versa. The Bank continuously monitors the effectiveness of the hedges.

2. GROUP STRUCTURE AND OVERALL RISK MANAGEMENT PROCESSES (continued)

2.5 Risks under Pillar 2 (continued)

iii) Concentration Risk

Concentration of exposures in credit portfolios is an important aspect of credit risk that is monitored separately by UGB. This risk can be considered from either a micro (idiosyncratic) perspective or a macro (systemic) perspective. The first type - name concentration, relates to imperfect diversification of risk in the portfolio either because of its small size or because of large exposures to specific individual obligors. The second type - sector concentration, relates to imperfect diversification across systemic components of risk, namely industry sectorial factors.

Concentration risk is captured in UGB's framework using internal and external regulations that cap the maximum exposure to any single obligor. There are established limits in place that set thresholds for aggregate industry, asset classes and geography. The actual levels of exposure are monitored against approved limits and regularly reviewed by Senior Management and the Board.

iv) Legal Risk

Legal risk is defined as the loss that may arise as a result of the inability to enforce contracts and agreements that the Bank has entered into with its counterparties. In order to mitigate this risk, UGB uses industry standard master agreements whenever available. Expert legal advice is sought on legal structures and arrangements to which the Bank is a party. Proper execution and completion of all legal contracts is ensured prior to committing funds to the transactions. All legal documents are reviewed on a periodic basis to ensure their ongoing enforceability. These are also maintained under dual custody.

2.6 Monitoring and Reporting

The monitoring and reporting of risk is conducted on a timely basis. The regular forums, in which risk related issues are highlighted and discussed, are the weekly Management meetings, the quarterly Risk and Compliance Committee Meetings and the semi-annual investment reviews.



3. CAPITAL ADEQUACY

UGB's overall capital requirements under Pillar 1, is calculated by aggregating:

- the credit risk charge using the standardized approach;
- the market risk charge using the standardized approach; and
- the operational risk charge using the basic indicator approach.

The following table shows the Bank's (and its main subsidiary) overall minimum capital requirement of 12.5% and capital adequacy position under Pillar 1 as of 31 December 2019.

Total Minimum Capital Requirement	Consolidated US\$ 000	KAMCO US\$ 000
Credit Risk (Standardized)	109,751	59,737
Operational Risk (Basic Indicator)	11,649	7,307
Market Risk (Standardized)	1,431	-
Total required Capital	122,831	67,043
Total Available Capital	193,601	184,307
Excess Capital Over Minimum Capital Requirement	70,770	117,264

3.1 Capital Structure and capital adequacy

The primary objectives of the Group's capital management are to ensure that the Group complies with capital requirements of the CBB and that the Group maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholders' value. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders or issue capital securities. There were no changes in the capital structure of the Bank during the year ended 31 December 2019.



3. CAPITAL ADEQUACY (continued)

3.1 Capital Structure and capital adequacy (continued)

The total regulatory capital (CET 1, Tier 1 and Tier 2) calculated in accordance with the CBB guidelines are as follows:

CAPITAL COMPONENTS - CONSOLIDATED	CET 1 US\$ 000	AT 1 US\$ 000	T 2 US\$ 000
Tier 1 Capital			
Common Equity Tier 1 (CET1)			
Issued and fully paid ordinary shares	116,132		
General reserves	31,763		
Legal / Statutory reserves	52,032		
Share premium	5,687		
Retained earnings	4,491		
Current interim cumulative net income / losses	11,420		
Accumulated other comprehensive income and losses (and other reserves)	(10,578)		
Total CET1 capital before minority interest	210,947		
Total minority interest in banking subsidiaries given recognition in CET1 capital	21,071		
Total CET1 capital prior to regulatory adjustments	232,018		
Less:			
Goodwill	52,174		
Intangible assets	13,417		
Cash flow hedge reserve	148		
Total CET 1 capital after the regulatory adjustments above (CET1 a)	166,279		
Less: Investment in financial entities where ownership is < 10% of the issued common share capital (amount above 10% CET1a)	22,589		
Total Common Equity Tier 1 capital after the regulatory adjustments (CET1 b)	143,690		
Less: Deductions from CET1 b	-		
Total Common Equity Tier 1 capital after the regulatory adjustments (CET1 c)	143,690		
Less: Deductions from CET1 c	-		
Total Common Equity Tier 1 capital after the regulatory adjustments (CET1 d)	143,690		
Other Capital (AT1 & T 2)			
Instruments issued by parent company		33,000	-
Instruments issued by banking subsidiaries to third parties		3,512	4,683
General loan loss provisions		-	10,975
Total Available AT1 & T2 Capital		36,512	15,658
Investment in financial entities where ownership is < 10% of the issued common share capital (amount above 10% CET1a)		2,259	-
Net Available Capital after regulatory adjustments before Applying Haircut		34,253	15,658
Net Available Capital after Applying Haircut	143,690	34,253	15,658
Total Tier 1		177,943	
Total Capital			193,601



3. CAPITAL ADEQUACY (continued)
3.1 Capital Structure and capital adequacy (continued)

Composition of Capital – Reconciliation Requirements:

Step 1: Disclose the reported balance sheet under the regulatory scope of consolidation as of 31 December 2019

	Balance sheet as in published financial statements	Consolidated PIR data
Assets	US\$ 000	US\$ 000
Cash and balances with central banks	71,369	318
Due from banks and other financial institutions	236,110	307,328
Investments at fair value through statement of income	97,778	97,778
Loans and advances to customers	27,778	28,929
Non-trading investments	131,048	131,048
Held-to-maturity investments	280	280
Investments in associated companies	75,774	127,948
Interest receivable and other assets	62,933	89,663
Investment properties	102,713	102,713
Property and equipment	51,849	51,849
Goodwill and other intangibles	65,591	-
Total assets	923,223	937,854
Liabilities		
Due to banks and other financial institutions	307,784	307,784
Deposits from Customers	22,647	22,647
Long term loans	36,875	36,875
Bonds	131,948	131,948
Interest payable and other liabilities	90,965	90,965
Total liabilities	590,219	590,219
Equity		
Share capital	116,132	116,132
Share premium	5,687	5,687
Statutory reserve	52,032	52,032
General reserve	31,763	31,763
Cumulative changes in fair values	(6,009)	(6,008)
Foreign currency translation adjustments	(4,569)	(4,569)
Retained earnings	15,911	15,910
Collective impairment provision	-	14,632
Attributable to the owners of the Bank	210,947	225,579
Non-controlling interests	89,057	89,056
Perpetual Tier 1 capital facility	33,000	33,000
Total equity	333,004	347,635
Total Liabilities and equities	923,223	937,854



3. CAPITAL ADEQUACY (continued)

3.1 Capital Structure and capital adequacy (continued)

Step 2: Expand the lines of the regulatory balance sheet to display all of the components used in the definition of capital disclosure template as of 31 December 2019

	Balance sheet as in published financial statements	Consolidated PIR data	Ref.
Assets	US\$ 000	US\$ 000	
Cash and balances with central banks	71,369	318	
Due from banks and other financial institutions	236,110	307,328	
Investments at fair value through statement of income	97,778	97,778	
Investments held to maturity	280	280	
Loans and advances to customers	27,778	28,929	
of which specific provisions	(37,562)	(37,562)	
of which loans and advances (gross of provisions)	65,340	66,491	
Non-trading investments	131,048	131,048	
of which related to equity investments in financial entities	39,964	39,964	
of which related to CET1	37,705	37,705	a
of which related to Tier 1	2,259	2,259	
of which related to Tier 2	-	-	
of which related to other AFS investments	91,084	91,084	
of which equity investments in financial entities	-	-	
Investments in associated companies	75,774	127,948	
of which equity investments in financial entities	11,140	11,140	
of which other investments	64,634	64,634	
of which Goodwill	-	52,174	d
Interest receivable and other assets	62,933	89,663	
of which deferred tax assets due to temporary differences	-	-	e
of which Interest receivable and other assets	62,933	89,663	
Investment properties	102,713	102,713	
Property and equipment	51,849	51,849	
Goodwill	65,591	-	d
Total assets	923,223	937,854	



3. CAPITAL ADEQUACY (continued)

3.1 Capital Structure and capital adequacy (continued)

Step 2: Expand the lines of the regulatory balance sheet (continued)

	Balance sheet as in published financial statements	Consolidated PIR data	Ref.
	<i>US\$ 000</i>	<i>US\$ 000</i>	
Liabilities			
Due to banks and other financial institutions	307,784	307,784	
Deposits from Customers	22,647	22,647	
Term borrowings	36,875	36,875	
Subordinated debt	131,948	131,948	
Interest payable and other liabilities	90,965	90,965	
Total liabilities	590,219	590,219	
Equity			
Share capital (net of Treasury shares)	116,132	116,132	
of which amount eligible for CET 1	116,132	116,132	f
of which amount eligible for AT 1	-	-	
Share premium	5,687	5,687	g
Statutory reserve	52,032	52,032	h
General reserve	31,763	31,763	i
Treasury shares reserve	-	-	
Cumulative changes in fair values	(6,009)	(6,003)	
of which unrealized gains and losses on available for sale financial instruments	6	6	j
of which gains and losses on derivatives held as cash flow hedges	148	148	k
of which unrealized gains and losses from fair valuing equities	(6,157)	(6,157)	l
Foreign currency translation adjustments	(4,569)	(4,575)	m
Retained earnings	15,911	15,910	
of which Treasury shares reserve	-	-	n
of which Retained earnings	15,911	15,910	o
Collective impairment provision	-	14,632	p
Subordinated debts	-	-	
of which Tier 2 capital instruments	-	-	q
Attributable to the owners of the Bank	210,947	225,578	
Non-controlling interests	89,057	89,056	
Perpetual Tier 1 capital facility	33,000	33,000	r
Total equity	333,004	347,634	
Total Liabilities and equities	923,223	937,853	

3. CAPITAL ADEQUACY (continued)
3.1 Capital Structure and capital adequacy (continued)

Step 3: Map each of the components that are disclosed in Step 2 to the composition of capital disclosure templates

		Component of regulatory capital	Source
Common Equity Tier 1: Instruments and reserves			
1	Directly issued qualifying common share capital plus related stock surplus	121,819	f+g
2	Retained earnings	15,911	o
3	Accumulated other comprehensive income and losses (and other reserves)	73,217	h+i+j+k+l+m+n
5	Common shares issued by subsidiaries and held by third parties (amount allowed in group CET1)	21,071	
6	Common Equity Tier 1 capital before regulatory adjustments	232,018	
Common Equity Tier 1 capital: regulatory adjustments			
8	Goodwill (net of related tax liabilities)	52,174	d
9	Other intangibles other than mortgage servicing rights (net of related tax liabilities)	13,417	d
11	Cash flow hedge reserve	148	k
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)	22,589	
28	Total regulatory adjustments to Common equity Tier 1	88,328	
29	Common Equity Tier 1 capital (CET1)	143,690	
Additional Tier 1 capital: instruments			
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	33,000	r
31	of which: classified as equity under applicable accounting standards	33,000	r
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)	3,512	
36	Additional Tier 1 capital before regulatory adjustments	36,512	
Additional Tier 1 capital: regulatory adjustments			
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 the 10% threshold)	2,259	
43	Total regulatory adjustments to Additional Tier 1 capital	2,259	
44	Additional Tier 1 capital (AT1)	34,253	
45	Tier capital (T1 = CET1 + AT1)	177,943	
Tier 2 capital: instruments and provisions			
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)	4,683	
50	Provisions	10,975	p
51	Tier 2 capital before regulatory adjustments	15,658	
Tier 2 capital: regulatory adjustments			
58	Tier 2 capital (T2)	15,658	
59	Total capital (TC = T1 + T2)	193,601	
60	Total risk weighted assets	982,649	
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of risk weighted assets)	14.62%	
62	Tier 1 (as a percentage of risk weighted assets)	18.11%	
63	Total capital (as a percentage of risk weighted assets)	19.70%	
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)	9.00%	
65	of which: capital conservation buffer requirement	2.50%	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets)	14.62%	
National minima (where different from Basel III)			
69	CBB Common Equity Tier 1 minimum ratio	6.50%	
70	CBB Tier 1 minimum ratio	8.00%	
71	CBB total capital minimum ratio	10.00%	
Amounts below the thresholds for deduction (before risk weighting)			
72	Non-significant investments in the capital of other financials	37,705	
73	Significant investments in the common stock of financials	11,140	
Applicable caps on the inclusion of provisions in Tier 2			
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	14,632	p
77	Cap on inclusion of provisions in Tier 2 under standardised approach	10,975	



3. CAPITAL ADEQUACY (continued)

3.1 Capital Structure and capital adequacy (continued)

Disclosure template for main features of regulatory capital instruments			
1	Issuer	United Gulf Bank	United Gulf Bank
2	Unique identifier	Share ticker: UGB	Not listed
3	Governing law(s) of the instrument	Laws and regulations of the Kingdom of Bahrain	Laws and regulations of the Kingdom of Bahrain
	<i>Regulatory treatment</i>		
4	Common Equity Tier 1	Additional Tier 1	Additional Tier 1
5	Common Equity Tier 1	Eligible	Eligible
6	Group and solo	Group and solo	Group and solo
7	Instrument type	Common shares	Perpetual Subordinated Loan
8	Amount recognised in regulatory capital	US\$ 116 million	US\$ 33 million
9	Par value of instrument	US\$ 0.5 per share	US\$ 33 million
10	Accounting classification	Shareholders' Equity	Equity
11	Original date of issuance	Various	Mar-2016
12	Perpetual or dated	Perpetual	Perpetual
13	No maturity	No maturity	No maturity
14	Issuer call subject to prior supervisory approval	No	Yes
15	Not applicable	Not applicable	Not applicable
16	Not applicable	Not applicable	Not applicable
	<i>Coupons / dividends</i>		
17	Floating dividends	Fixed coupon	Fixed coupon
18	Not applicable	10.5% p.a.	10.5% p.a.
19	Not applicable	Yes	Yes
20	Fully discretionary	Fully discretionary	Fully discretionary
21	No	No	No
22	Noncumulative	Noncumulative	Noncumulative
23	Convertible or non-convertible	Not applicable	Non-convertible
24	Not applicable	Not applicable	Not applicable
25	Not applicable	Not applicable	Not applicable
26	Not applicable	Not applicable	Not applicable
27	Not applicable	Not applicable	Not applicable
28	Not applicable	Not applicable	Not applicable
29	Not applicable	Not applicable	Not applicable
30	Write-down feature	No	Yes
31	Not applicable	Non-Viability Event	Non-Viability Event
32	Not applicable	Partial	Partial
33	Not applicable	Permanent	Permanent
34	Not applicable	Not applicable	Not applicable
35	Position in subordination hierarchy in liquidation	Not applicable	Tier 2 subordinated instruments
36	Non-compliant transitioned features	None	None
37	If yes, specify non-compliant features	Not applicable	Not applicable

* The Additional Tier 1 facility has no impact on the earnings or dividends of the Group for the year ended 31 December 2019.



3. CAPITAL ADEQUACY (continued)

3.1 Capital Structure and capital adequacy (continued)

There are no impediments on the transfer of funds or regulatory capital between UGB and its subsidiaries, other than restrictions over transfers to ensure minimum regulatory capital requirements that are necessitated for subsidiary companies.

3.2 Capital adequacy ratio of consolidated group

UGB's policy is to maintain a strong capital base to preserve investor, creditor and market confidence and to sustain the future development of the business. The capital structure may be adjusted through the dividend payout, the issue of new equity, subordinated term finance, and Tier 1 capital securities.

The capital adequacy ratios of UGB and its significant subsidiary as at 31 December 2019 were as follows:

Capital Adequacy Ratio	Consolidated US\$ 000	KAMCO US\$ 000
Total Eligible Capital Base	193,601	184,307
Credit Risk Weighted Exposure	878,011	477,893
Operational Risk Weighted Exposure	93,188	58,454
Market Risk Weighted Exposure	11,450	-
Total Risk Weighted Exposure	982,649	536,347
Core Equity Tier 1 (CET 1) Ratio	14.62%	33.11%
Tier 1 Ratio	18.11%	33.11%
Total Capital Adequacy Ratio	19.70%	34.36%

The CBB's minimum capital adequacy ratios for banks incorporated in the Kingdom of Bahrain at a consolidated level are as follows:

	Minimum Ratio Required	Capital Conservation Buffer (CCB)	CAR including CCB
CET 1	6.5%	2.5%	9.0%
Tier 1	8.0%	2.5%	10.5%
Total Capital	10.0%	2.5%	12.5%

3.3 Capital requirements for credit risk

For regulatory reporting purposes, UGB calculates the capital requirements for credit risk based on the standardized approach. Under the standardized approach, on and off statement of financial position credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. The exposure categories are referred to in the CBB's Basel III capital adequacy framework as 'standard portfolios'.



3. CAPITAL ADEQUACY (continued)

3.3 Capital requirements for credit risk (continued)

The primary standard portfolios are claims on sovereigns, claims on Public Sector Entities (PSEs), claims on banks, claims on corporate, investments in securities, holdings of real estate and other assets. Under the standardized approach, the risk weightings are provided by the CBB and are determined based on the counterparty's external credit rating. The external credit ratings are derived from various eligible external rating agencies approved by the CBB.

An overview of the exposures, Risk Weighted Assets (RWAs) and capital requirements for credit risk analyzed by the standardized approach is presented in the table below:

	Total exposure	Risk Mitigant	Exposure after risk mitigant	RWA	Capital requirement	Rated exposure after risk mitigant
	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Cash items	6	-	6	-	-	-
Total Claims on Sovereigns	318	-	318	-	-	318
Total Claims on Banks	319,777	24,479	295,298	95,063	11,883	292,540
Claims on Corporates including Insurance Companies & Category 3 Investment Firms	40,974	3,598	37,376	104,625	13,078	20,561
Investments in Securities	298,357	-	298,357	428,605	53,576	-
Holding of Real Estate	78,335	-	78,335	144,411	18,051	-
Other Assets	105,307	-	105,307	105,307	13,163	-
Total	843,074	28,077	814,997	878,011	109,751	313,418

3.4 Capital requirements for market risk

The Bank uses the standardized approach to calculate the regulatory capital requirements relating to general and specific market risk. The resultant measure of market risk is multiplied by 12.5, to determine the market risk-weighted exposure on a basis that is consistent with credit risk-weighted exposure.

The RWAs and capital requirements for market risk are presented in the table below:

Capital Requirement for Market Risk	RWA	Capital Requirement
	US\$ '000	US\$ '000
Equity Position Risk	-	-
Foreign Exchange Risk	4,725	591
Total	4,725	591



3. CAPITAL ADEQUACY (continued)

3.4 Capital requirements for Market Risk (continued)

The minimum and maximum values of capital requirements for equity position risk and foreign exchange risk over the last one year are as follows:

Capital Requirement for Market Risk	Equity Position Risk US\$ '000	Foreign Exchange Risk US\$ '000
Minimum Values	-	542
Maximum Values	-	1,431

3.5 Capital requirements for operational risk

For regulatory reporting purposes, the capital requirement for operational risk is calculated according to the basic indicator approach. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by a fixed alpha coefficient. The alpha coefficient has been set at 15 per cent in the CBB's Basel III capital adequacy framework. The capital requirement for operational risk as at 31 December 2018 amounted to US\$ 4,802 thousand.

The following table summarizes the amount of exposure subject to basic indicator approach of operational risk and related capital requirements:

	Gross income		
	2019 US\$ '000	2018 US\$ '000	2017 US\$ '000
Total Gross Income	39,095	39,280	1,688
Average Positive Gross Income (US\$ '000)			26,688
Alpha (%)			15%
			4,003
Multiplier			12.5
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE			50,038

4. CREDIT RISK – PILLAR 3 DISCLOSURES

This section provides detailed disclosures on credit risk in accordance with the CBB's Basel III framework in relation to Pillar 3 requirements:

4.1 Categories of exposure classes

UGB's credit exposures are categorized as per the Basel III capital adequacy framework for the standardized approach for credit risk. The appropriate risk weights are used to derive the risk-weighted assets.

Total Claims on Sovereigns

Exposures to the Kingdom of Bahrain, the CBB and to other sovereigns and their central banks in the relevant domestic currencies are risk weighted at 0%. Claims to other sovereigns in non-relevant currencies are risk weighted subject to External Credit Assessment Institutions ("ECAI") ratings with 100% used for unrated.

Total Claims on PSEs

Public Sector Entities are risk weighted subject to ECAI ratings with 100% used for unrated.

Total Claims on MDBs

Exposures to eligible Multilateral Development Banks ("MDBs") are risk weighted at 0%, whereas exposures to non-eligible MDBs are risk weighted subject to ECAI ratings with 50% used for unrated.

Total Claims on Banks

The exposure under claims on banks is risk weighted based on their ECAI ratings. A preferential risk weight treatment is available for qualifying short-term exposures to claims on foreign banks licensed in Bahrain funded in the relevant domestic currency, i.e. BD or US\$.

Total Claims on Corporates

Claims on corporates are risk weighted according to their ECAI ratings. A 100% risk weightage is assigned to all exposure pertaining to unrated corporates.

Past Due Exposures

The Bank defines non-performing facilities as the facilities that are overdue for a period of 90 days or more. These exposures are placed on a non-accrual status with income being recognized to the extent that it is actually received. It is the Bank's policy that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as past due, not only the overdue installments/payments.

All past due loan exposures are assigned a risk weighting of either 100% or 150%, depending on the level of provisions maintained against them. The weightage is on the outstanding loan amount, net of provisions and interest in suspense.

Equity Investments

In accordance with CBB Basel III guidelines, all equity exposures are categorized into listed and unlisted categories, with corresponding risk weights of 100% or 150% for the purposes of determining the capital charge. Equity exposures to significant investment in the common shares of financial entities (where the exposure is within 10% of the Bank's CET1 C capital are risk weighted at 250%.



4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.1 Categories of exposure classes (continued)

Holding of Real Estate

All direct real estate related exposures are risk weighted at 200% for the purposes of calculating the capital charge, while premises occupied by the Bank are risk weighted at 100%. These include direct or indirect exposures to real estate / real estate related development and management companies.

Other Assets

Other assets are risk weighted at 100% as per Basel III and the CBB norms.

4.2 Categories of exposure by industry

The breakdown of the overall credit exposure by industry before considering collaterals held or other credit enhancements was as follows:

	<i>Trading and Manufac- -turing</i>	<i>Banks & Other Financial Institutions</i>	<i>Construction and real estate</i>	<i>Individuals and Others</i>	<i>Total</i>
Gross credit exposure by industry	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Funded exposures					
Demand and call deposits with banks	-	71,369	-	-	71,369
Placements with banks	-	236,278	-	-	236,278
Investments carried at FVTPL	-	13,070	-	-	13,070
Held-to-maturity investments	-	280	-	-	280
Loans and receivables	-	1,500	-	36,333	37,833
Other assets	39	16,086	1,109	56,988	74,222
	39	338,583	1,109	93,321	433,052
Unfunded exposures					
Letters of guarantee	-	2,237	-	-	2,237
Derivative financial assets	-	521	-	-	521
	-	2,758	-	-	2,758
Total	39	341,341	1,109	93,321	435,810



4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.3 Categories of exposure by geography and region

Given the Bank's track record, geographical exposures of UGB are limited to a strong focus on assets issued / incorporated in the GCC (in particular Kuwait), Middle East and North Africa and European Union Countries. The breakdown of the overall credit exposure by geography before considering collaterals held or other credit enhancements was as follows:

	<i>Gulf Co-operation Council (G.C.C.)</i>	<i>MENA (excluding G.C.C.)</i>	<i>Europe</i>	<i>Americas</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Demand and call deposits with Banks	35,361	1,957	837	33,214	71,369
Placements with banks	206,551	29,727	-	-	236,278
Investments carried at FVTPL	13,070	-	-	-	13,070
Held-to-maturity investments	-	280	-	-	280
Loans and advance	33,858	3,975	-	-	37,833
Other assets	42,663	26,363	3,100	2,096	74,222
Letters of guarantee	165	2,072	-	-	2,237
Derivative financial assets	521	-	-	-	521
Total	332,189	64,374	3,937	35,310	435,810

4.4 Categories of exposure by maturity

The Bank strives to construct a portfolio that is well balanced in terms of anticipated cash flows originating from redemptions, maturities and exits. A disproportionate number of redemptions in any given fiscal year are discouraged in a view to avoid reinvestment risk (i.e. cash flows being reinvested in a different interest rate environment) and price volatility risk. The latter increases with a longer-term portfolio, as the longer the term of a security the more volatile the price. The Bank also tracks expected maturities vs. actual maturities as part of its normal risk management strategies.

	<i>Up to 3 months</i>	<i>3 months to 1 year</i>	<i>1 to 5 years</i>	<i>No fixed maturity</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Gross credit exposure by maturity					
Demand and call deposits with banks	71,051	-	-	318	71,369
Placements with banks	221,533	14,745	-	-	236,278
Investments carried at FVTPL	13,070	-	-	-	13,070
Held-to-maturity investments	-	-	280	-	280
Loans and receivables	1,552	19,904	16,377	-	37,833
Other assets	17,630	56,592	-	-	74,222
Letters of guarantee	-	2,237	-	-	2,237
Derivative financial assets	-	-	521	-	521
Total	324,836	93,478	17,178	318	435,810



4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.5 Categories of exposure by related parties

The related party exposures, net of expected credit losses, including off statement of financial position items are transacted at commercial terms that are mutually agreed between the counterparties.

	<i>Parent</i>	<i>Associates</i>	<i>Other related parties</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Demand and call deposits with banks	-	-	1,689	1,689
Placements with banks	-	-	25,270	25,270
Loans and receivables	-	-	7,441	7,441
Other assets	-	3,621	7,098	10,719
Letters of guarantee	-	-	150	150

4.6 Provisions against Expected Credit Losses

The movement in provisions for expected credit losses is as follows:

	<i>Stage 1</i>	<i>Stage 2</i>	<i>Stage 3</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
Provisions for Expected Credit Losses				
As at 1 January 2019	13,795	2,171	9,572	25,538
Amount written off	(430)	-	-	(430)
Provided (reversed) during the year	728	(1,670)	(673)	(1,615)
Other movements	37	2	4	43
Balance at 31 December 2019	14,130	503	8,903	23,536

4.6.1 Industry-wise movement of provisions

The movement in provisions as per the industry sector of the underlying exposures is as follows:

	<i>Banks and other financial institutions</i>	<i>Construction and real estate</i>	<i>Individuals and Others</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
As at 1 January 2019	3,446	-	22,092	25,538
Amount written off	(380)	-	(50)	(430)
Reversed during the year	(1,064)	-	(551)	(1,615)
Other movements	-	-	43	43
Balance at 31 December 2019	2,002	-	21,534	23,536



4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.6 Provisions against Expected Credit Losses (continued)

4.6.2 Geographic movement of provisions

The movement in provisions as per the geographic location of the underlying exposures is as follows:

	<i>Gulf Co-operation Council(G.C.C.)</i>	<i>MENA (Excluding G.C.C.)</i>	<i>Total</i>
	<i>US\$ 000</i>	<i>US\$ 000</i>	<i>US\$ 000</i>
As at 1 January 2019	13,231	12,307	25,538
Amount written off	-	(430)	(430)
Provided (reversed) during the year	500	(2,115)	(1,615)
Other movements	-	43	43
Balance at 31 December 2018	13,731	9,805	23,536

4.7 Restructured loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. The carrying amounts of the loans, whose terms have been renegotiated, as at 31 December 2019 and 31 December 2018 were US\$ nil.

4.8 Past due and impaired loans

The Group past due and impaired loans as of 31 December 2019 amounted to US\$ 8,915 thousand (31 December 2018: US\$ 10,534 thousand) which were primarily acquired as part of the acquisition of GIH by KAMCO during the year. All impaired loans as of 31 December 2019 and 31 December 2018 have been past due for more than 1 year.

4.9 Exposure over the individual obligor limits

Under the CBB's rules governing maximum single exposure, banks incorporated in Bahrain are required to obtain the regulator's approval for any planned exposure to a single counterparty or group of connected counterparties that exceed 15% of the regulatory capital base.

The following exposures were risk weighted at 800% in arriving at credit risk weighted assets:

	US\$ 000
Equity investments exceeding 15% of Total Capital	1,767
Other exposures exceeding large exposure limits including exposures to controllers	4,812

4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.10 Equity position in banking book

UGB's business model is focused on offering investment banking and commercial banking services through a network of financial services entities spread across the Middle East North Africa (MENA) region. These entities are treated as strategic assets of the Bank held with long-term perspective and contribute significantly towards the Bank's bottom line.

These strategic assets if treated as an associate are initially recognized at cost and adjusted thereafter for the post acquisition change in the Group's share of net assets of the investee, using the equity method. The Group recognizes in the consolidated statement of income, its share of the total recognized profit or loss of the associate from the date that influence, or ownership effectively commences, until the date that it effectively ceases. Distributions received from an associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the Group's share in the associate arising from changes in its equity that have not been recognized in the associate's profit or loss. The Group's share of those changes is recognized directly in equity. Unrealized gains on transactions with an associate are eliminated to the extent of the Group's share in the associate.

An assessment of an associate is performed when there is an indication that the asset has been impaired, or that impairment losses recognized in prior years no longer exist. Whenever the impairment requirements of IAS 36 indicate that investment in an associate may be impaired, the entire carrying amount of investment is tested by comparing its recoverable amount with its carrying value. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. Goodwill is included in the carrying amount of an investment in associate and is therefore not separately tested for impairment.

The reporting dates of the associate and the Group are identical and the associate's accounting policies conform to those used by the Group for like transactions and events in similar circumstances. Additionally, the Bank also has a portfolio of opportunistic direct investments held in the banking book. These investments are held for medium to short term and mostly include private equity and fund of hedge funds. For accounting purposes, these are classified as investments carried at fair value through other comprehensive income.

Investments carried at fair value through other comprehensive income are those non-derivative financial assets that are designated as fair value through other comprehensive income or are not classified as investment at fair value through the profit and loss or loans and advances. After initial recognition, investments carried at fair value through other comprehensive income are measured at fair value with gains and losses being recognized as a separate component of equity, until the investment is derecognized at which time the cumulative gain or losses previously reported in equity is recognized in the consolidated statement of other comprehensive income.



4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.10 Equity position in banking book (continued)

The breakdown of the Bank's equity, mutual funds and debt position in the banking book are as follows:

Investments in Trading and Banking Books	Trading Book US\$ '000	Banking Book US\$ '000	Capital Requirement	
			Trading Book US\$ '000	Banking Book US\$ '000
Debt Securities	-	13,350	-	1,669
Listed	-	12,245	-	1,531
Unlisted	-	1,105	-	138
Equity Securities and Mutual Funds	2	147,920	2	25,002
Listed	2	43,730	2	5,466
Unlisted	-	104,190	-	19,536
Managed Funds	-	67,834	-	12,501
Listed	-	3,494	-	437
Unlisted	-	64,340	-	12,064
Total Investments in Financial Instruments	2	229,104	2	39,171
Investment Properties				
Cost		95,419		
Market Value		102,713		
Interest in Consolidated Subsidiaries and Associated Companies		127,948		
Cumulative realized losses arising from sale or liquidation during the period				US\$000 (2,981)
Unrealised losses recognized in the balance sheet but not through profit or loss				(3,317)
Unrealised gains recognized in the balance sheet but not through profit or loss				5,300

All unrealized gains and losses are recognized in Common Equity Tier 1 capital of the Group.

4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.11 Collateral

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

The main types of collateral obtained comprise of cash margins, charges over real estate properties, inventory, trade receivables, and bank guarantees.

The Group also obtains guarantees from companies for loans to their subsidiaries. The Bank monitors the market value of collateral and requests additional collateral in accordance with the underlying agreement, during its review of the adequacy of the allowance of impairment losses.

Counterparty credit risk exposure covered by collateral is disclosed in section 3.3.

5. MARKET RISK – PILLAR 3 DISCLOSURES

Market risk is defined as the loss of the value of a financial instrument or a portfolio of financial instruments due to an adverse change in market prices or rates. This has the impact of a potential reduction in net income or decrease in the equity value in UGB's consolidated financial statements. The Bank's trading activities principally comprise trading equity securities, and foreign exchange. There are limits in place to monitor positions, volumes, concentrations, maturities and allowable losses.

As mentioned in Section 3.4, the Bank uses the standardized approach to determine the charge for market risk.

6. OPERATIONAL RISK – PILLAR 3 DISCLOSURES

UGB's Operational Risk Framework incorporates suitable risk management policies and procedures to enable the Bank to identify, assess, monitor and control / mitigate operational risk. It transcends from best industry practices and Basel III regulatory requirements and provides means to develop key risk indicators (KRIs) and includes mapping of processes into lines of business. The policy also provides procedures and sets responsibilities for day-to-day tracking and monitoring of operational risks and outlines minimum reporting and analysis requirements.

UGB has automated its Operational Risk Framework through the implementation of a robust system. This system consists of three key modules – namely the operational loss database, risk and control self-assessments and key risk indicators. The system allows the Bank to monitor, mitigate and report its operational risk exposures on a real time basis.



7. OFF STATEMENT OF FINANCIAL POSITION EXPOSURE

UGB's non-funded exposure for the purposes of determining credit risk weighted assets for the Basel III framework comprises:

- Credit related contingent items: These are mainly guarantees, letters of credit and undrawn commitments to investments. For credit related contingent items, the nominal value is converted into an exposure at default using the appropriate credit conversion factor (CCF). The CCF factors range from 20% to 100% depending on the type of contingent item and its maturity. The objective is to convert off statement of financial position notional amounts into an equivalent on statement of financial position exposure, in order to capture risks relating to counterparty credit and/or liquidity.
- Derivative and foreign exchange instruments: These include forward contracts and interest rate swaps, which have been used to hedge UGB's underlying positions.

Further information on off-statement of financial position items is disclosed in Notes 29 and 30 to the Group's annual consolidated financial statements as of 31 December 2019.

8. PILLAR 2 RISKS

8.1 Liquidity Risk

Liquidity risk stems from the inability to procure sufficient cash flow to meet UGB's financial obligations as and when they fall due. The risk arises due to the timing differences between the maturity profile of the Bank's assets and liabilities. Positions are monitored on a daily basis and proactive measures are taken to ensure that there is adequate liquidity at all times. Further details on the maturity profile of assets and liabilities are included in section 8.2.

8.2 Disclosure concerning interest rate risk in the banking book

Sensitivity of net interest income

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's consolidated statement of income based on the consolidated statement of financial position as of 31 December 2019.

Interest Rate Risk in the Banking Book

Currency	Increase in basis points	Sensitivity of net interest income
		US\$ '000
KD	200	(748)
USD	200	1,438
EUR	200	(106)
GBP	200	11
Others	200	232



8. PILLAR 2 RISKS (continued)

8.2 Disclosure concerning interest rate risk in the banking book (continued)

The decrease in the basis points will have an opposite impact on the net interest income.

The sensitivity of the consolidated statement of income is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate financial assets and financial liabilities held at 31 December 2018, including the effect of hedging instruments.

There are no material interest bearing securities in non-trading investments and hence no sensitivity of equity has been disclosed.

Interest rate sensitive assets and liabilities

The details of interest rate sensitive assets, liabilities and off-balance sheet exposures broken down based on their repricing frequency are as follows:

	Up to 3 months US\$ 000	3 months to 1 year US\$ 000	Over 1 year US\$ 000	Non-interest rate sensitive US\$ 000	Total US\$ 000
Assets					
Bank demand and call deposits	71,051	-	-	318	71,369
Placements with banks	198,360	37,750	-	-	236,110
Investments, carried at FVTPL	13,070	-	-	84,708	97,778
Non-trading investments	-	-	-	131,048	131,048
Held-to-maturity investments	-	-	280	-	280
Loans and advance	1,552	19,904	6,322	-	27,778
Interest receivable and other assets	-	-	-	62,933	62,933
Investment in associated companies	-	-	-	75,774	75,774
Investment properties	-	-	-	102,713	102,713
Properties and equipment	-	-	-	51,849	51,849
Goodwill	-	-	-	65,591	65,591
Total assets	284,033	57,654	6,602	574,934	923,223
Liabilities					
Due to banks and other FIs	227,784	80,000	-	-	307,784
Deposits from customers	22,646	1	-	-	22,647
Loans payable	-	26,390	10,485	-	36,875
Long term bonds	-	-	131,948	-	131,948
Interest payable and other liabilities	-	-	-	90,965	90,965
Total liabilities	250,430	106,391	142,433	90,965	590,219
On balance sheet gap	33,603	(48,737)	(135,831)	483,969	333,004
Cumulative gap	33,603	(15,134)	(150,965)	333,004	
Off balance sheet items					
Interest rate Swaps	-	-	75,000	-	75,000
Forward foreign exchange contracts	392,498	134,808	19,621	-	546,927

8. PILLAR 2 RISKS (continued)

8.3 Concentration Risk

Concentration Risk is captured in UGB's framework using internal and external regulations that cap the maximum exposure to any single obligor. There are established limits in place that set thresholds for aggregate industry, name lending and geography. Under the CBB's rules governing maximum single exposure, banks incorporated in the Kingdom of Bahrain are required to obtain the regulator's approval for any planned exposure to a single counterparty or group of connected counterparties that exceed 15% of the regulatory capital base. As at 31 December 2019, an exposure of US\$ 137,062 thousand comprised of exempted exposures that exceeded 15% of the capital base and accordingly not risk weighted at 800%. Unexempted exposures that exceeded 15% of the capital base and risk weighted at 800% are disclosed in section 4.9 to this document.

9. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

ICAAP is requirement of Pillar II norms of Basel III, and involves appropriate identification and measurement of risks, and maintaining an appropriate level of internal capital in alignment with the Bank's overall risk profile and business plan. The objective of the Bank's ICAAP is to ensure that adequate capital is retained at all times to support the risks the Bank undertakes in the course of its business.

The Bank recognizes that its earnings are the first line of defense against losses arising from business risks, and that capital is one of the tools to address such risks. Also important is establishing and implementing documented procedures; defining and monitoring internal limits on the Bank's activities / exposures; strong risk management, compliance and internal control processes; as well as adequate provisions for credit, market and operational losses. However, since capital is vital to ensure continued solvency, the Bank's objective is to maintain sufficient capital such that a buffer above regulatory capital adequacy requirement is available to meet risks arising from fluctuations in asset values, revenue streams, business cycles, and expansion and future requirements. The Bank's ICAAP identifies risks that are material to the Bank's business and the capital that is required to be set aside for such risks.

The Bank seeks to achieve the following goals by implementing an effective capital management framework:

- Meet the regulatory capital adequacy requirement and maintain a prudent buffer;
- Generate sufficient capital to support overall business strategy;
- Integrate capital allocation decisions with the strategic and financial planning process;
- Enhance Board and Senior Management's ability to understand how much capital flexibility exists to support the overall business strategy;
- Enhance the Bank's understanding on capital requirements under different stress scenarios; and
- Build and support the link between risks and capital and tie performance to both of them.

10. REMUNERATION POLICY AND RELATED DISCLOSURES

Effective 1 January 2014, the CBB determined regulatory requirements for remuneration in banks through the directives under Module HC (Higher level controls). In accordance therewith, banks are required to document their remuneration policies in the overall context in order to make them comprehensible as well as disclose them.

UGB's Remuneration policy adopts regulations concerning Sound Remuneration Practices issued by the CBB. The revised policy framework and incentive components were first approved by the Nominating and Remunerations Committee (NRC) on 27 January 2015 and the shareholders at the Annual General Meeting held on 30th March 2015. The remuneration policy was last reviewed by the Bank's NRC on 6 March 2019.

The revised remuneration framework outlines the Bank's total compensation approach, which includes the variable remuneration policy, and sets out UGB's policy on remuneration for Directors, Senior Management, Material Risk Takers, Control Functions and other employees, outlining the procedure and determining factors for variable compensation distribution across the Bank.

10.1 NRC role and focus

As authorized by the Board of Directors, UGB's NRC comprising three independent Directors is the supervisory and governing body for compensation policy, practices and plans. In this context, the NRC is authorized to approve the remuneration system as well as all components of fixed and variable remuneration (if applicable) and for adjustment of the basic remuneration according to competence levels. It has oversight of all reward policies for the Bank's employee, and is responsible for determining, reviewing and proposing a variable remuneration policy for approval by the Board. It is also responsible for setting the principles and governance framework for all compensation decisions. The NRC ensures that all persons must be remunerated fairly and responsibly. The remuneration policy is reviewed on a periodic basis to reflect changes in market practices, the business plan, and the risk profile of the Bank.

10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.1 NRC role and focus (continued)

The responsibilities of the NRC are enumerated in their Charter which was last approved by the Board of Directors on 1 August 2018. Their mandate with respect to the Bank's variable remuneration policy includes but is not limited to the following:

1. Review UGB's remuneration policies for approved persons and material risk-takers, such that these are consistent with the corporate values and strategy of the bank and operates as intended;
2. Approve the remuneration policy and amounts for each approved person and material risk-taker, as well as the total variable remuneration to be distributed (if applicable), taking account all its components;
3. Approve, monitor and review the remuneration system to ensure the system operates as intended; and
4. Recommend Board member remuneration based on their attendance and performance and in compliance with Article 188 of the Bahrain Commercial Companies Law.¹
5. Ensure remuneration is adjusted for all types of risks, and that the remuneration system takes into consideration employees who generate the same short-run profit but take different amounts of risk on behalf of the Bank.
6. Review the stress testing and back testing results before approving the total variable remuneration to be distributed, including salaries, fees, expenses, bonuses and other employee benefits.
7. Ensure appropriate compliance mechanisms are in place to ensure that employees commit themselves not to use personal hedging strategies or remuneration and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements.

No external consultants' advice has been sought for this purpose during the year ended 2018.

As mentioned in the Corporate Governance Report, the NRC met twice during 2018 and consequently met the requirement of the CBB of having at least two meetings in any financial year. Attendance of each Member is recorded in the minutes of NRC Meetings held during the year:

		Mubarak Al Maskati	Bader Al Awadhi	Mohammed Haroon
1	26 February 2019	x	x	x
2	6 March 2019	x	x	x

¹ HC 5.2.1

10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.2 Approved Persons and Material Risk Takers

In particular, UGB's remuneration policy considers the role of each employee, and has set guidance on whether an employee is a Material Risk Taker and / or an Approved Person in a business line, control or support function. An Approved Person is an employee whose appointment requires prior regulatory approval because of the significance of the role within the Bank. An employee is considered a Material Risk Taker if he / she is the Head of a significant business line, or any individuals within their control who have a material impact on the Bank's risk profile. The list of approved persons and material risk takers was identified and reviewed by the NRC at their meeting held on 16 January 2020.

In order to ensure alignment between remuneration paid and risk profile of the Bank, UGB assesses individual performance against annual and long-term financial and non-financial objectives summarized in the Bank's performance management system. This assessment also takes into account adherence to UGB's values, risks and compliance measures, and above all, their contribution towards maintaining reputational risk at the lowest level. Altogether, performance is therefore judged not only on what is achieved over the short and long-term, but importantly, also on how it is achieved.

The key features of the Bank's remuneration framework are summarized below.

10.3 Remuneration strategy

It is UGB's basic compensation philosophy to provide a competitive level of total compensation to attract and retain qualified and competent employees. The purpose is to ensure the sustainable success of the bank such that all approved persons and material risk-takers are compensated fairly and responsibly. Every effort is made to ensure that while compensation is enough to attract, retain and motivate competent employees, the Bank avoid paying more than deemed necessary for that purpose.

The Bank's variable remuneration policy reflects the strong link between remuneration and performance. It is driven primarily by a performance-based culture that aligns employee interests with those of the shareholders of UGB. These elements support the achievement of the Bank's objectives through balancing rewards for both short-term results and long-term sustainable performance. UGB's strategy is designed to share success, and to align employees' incentives with the Bank's risk framework and risk outcomes. The quality and long-term commitment of all employees is fundamental to UGB's success. The Bank therefore aims to attract, retain and motivate the very best people who are committed to maintaining a career with UGB, and who will perform their role in the long-term interests of the shareholders.

10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.4 Board remuneration

At the annual general assembly that will be held on 25 March 2020, it is proposed to get the shareholder's approval to pay an aggregate amount of US\$ 195,000 to the Chairman, Vice Chairman and five other members of the Board of Directors, as their fees for 2019. This represents \$ 180,000 of sitting fees and \$ 15,000 of attendance fee for attending Board of Directors and Board Committees meetings. Remuneration of Directors does not include performance-related elements such as grants of shares, share options or other deferred stock-related incentive schemes, bonuses or pension benefits.

10.5 Variable remuneration for staff

In addition to the fixed annual salary, each employee can in principle also receive variable remuneration. This payment is subject to the profit and financial situation of the bank. The amount of the variable remuneration is determined by the results of the performance appraisal of the unit and the overall achievement profile of the employee. Payment of this variable remuneration is in all cases at the discretion of the NRC. Payment of a variable remuneration does not constitute a legal claim. This regulation forms an integral component of the individual employment contracts and is recognized by all employees concerned. The variable remuneration is an "add on" and offers no incentives for mismanagement or to accept disproportionately high risks. In all cases, it is approved by the NRC.

Individual contractual rights to additional benefits in the event of termination of employment are not mandatory. No guaranteed variable remuneration has been agreed for any of the employees of the Bank.

The Bank has adopted a framework to develop a transparent link between variable remuneration and performance. The framework is designed on the basis of meeting both satisfactory financial performance and the achievement of other non-financial factors; and which will deliver a target bonus pool for staff, prior to consideration of any allocation to business lines and individual employees. Key corporate performance metrics include a combination of short-term and long-term measures, and include profitability, solvency and liquidity.

In determining the amount of variable remuneration, the NRC starts by setting specific targets and other qualitative performance at a Bank-wide level that result in a target bonus pool. The bonus pool is then adjusted to take account of risk by the use of risk-adjusted measures.

The NRC carefully evaluates practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. The Committee demonstrates that its decisions are consistent with an assessment of the Bank's financial condition and future prospects. UGB uses a formalized and transparent process to adjust the bonus pool for quality of earnings. It is the Bank's objective to pay bonuses out of realised and sustainable profits. If the quality of earnings is not strong, the profit base could be adjusted based on the discretion of the NRC.

For the Bank to have sufficient funding for distribution of a bonus pool, threshold financial targets have to be achieved. The performance measures ensure that total variable remuneration is considerably contracted where subdued or negative financial performance of the Bank occurs.

10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.5 Variable remuneration for staff (continued)

Furthermore, the target bonus pool as determined above is subject to risk adjustments in line with the risk assessment framework. This includes the following parameters:

- The total bonus pool shall not exceed 15% of the Realised gains for the year before variable pay or bonus;
- The impact of the Bonus Pool is not more than 0.25% on the Capital Adequacy as computed as per Basle III guidelines; and
- The Bonus Pool shall not exceed 50% of the Total Fixed Remuneration paid for UGB during the financial year.

The aggregate remuneration for UGB Senior Management paid during 2019 was US\$ 2.33 million (2018: US\$ 2.38 million). No variable bonus has been paid for 2019 as of date (March 2020).

10.6 Remuneration of control functions

Employees in the risk management, internal audit, operations, financial controls, internal audit, and compliance departments are deemed to be independent of business. Consequently, UGB's policy is to ensure that they are remunerated in a manner that is independent of the business areas they oversee and commensurate with their key role in the bank. This is based on the premise that effective independence and appropriate authority of such staff are necessary to preserve the integrity of financial risk and management's influence on incentive remuneration. The amount of variable remuneration (if paid out) is limited in proportion to the fixed salary and is paid out principally on the achievement of the objectives and targets of the underlying functions.

The actual amount of variable remuneration paid out in any year, is based on results achieved by the bank in the financial year and the performance of the employee. The latter is documented through a written appraisal about the employee's overall performance. As far as quantitative performance results are taken as the basis, success is measured in a performance appraisal as part of the staff member accomplishing his/her job responsibilities. The formula used to determine variable pay for employees in Control and Support areas is a function of the base bonus multiple, bank Score i.e. Overall performance of the bank, Unit Score and Individual employee score.

10.7 Variable compensation for business units

The variable remuneration of the business units is primarily determined by key performance objectives set through the performance management system of the Bank. Such objectives contain financial and non-financial targets, including risk control, compliance and ethical considerations, as well as market and regulatory requirements. The consideration of risk assessments in the performance evaluation of individuals ensures that any two employees who generate the same short run profit but take different amounts of risk on behalf of the Bank, are treated differently by the remuneration system. The formula used to determine variable pay for employees in business units is a function of the base bonus multiple, bank Score i.e. Overall performance of the bank, Risk Adjustment scores and Individual employee score.

10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.8 Risk assessment framework

The purpose of risk adjustments is to align variable remuneration to the risk profile of the Bank. In this respect, UGB considers both quantitative and qualitative measures in the key performance indicators designed as part of the risk assessment process. Both quantitative measures and human judgment play a role in determining any risk adjustments. The risk assessment process encompasses the need to ensure that the remuneration policy reduces employees' incentive to take excessive and undue risks; is symmetrical with risk outcomes; and delivers an appropriate mix of remuneration that is risk-aligned. The NRC considers whether the variable remuneration policy is in line with UGB's risk profile; and ensures that through the Bank's ex-ante and ex-post risk assessment framework and processes, remuneration practices where potential future revenues whose timing and likelihood remain uncertain, are carefully evaluated.

Risk adjustments take into account major risks such as capital adequacy targets and liquidity profile parameters. UGB undertakes risk assessments to review financial and operational performance against business strategy and risk performance prior to distribution of the annual bonus. This includes metrics relating to Return on equity, Return on Risk Weighted assets, Net Operating Profit and Cost / Income Ratio. At the end of the year, if the evaluation results in a variation of results achieved vis a vis the risk factors originally set for the Bank, the bank score will be adjusted downwards using pre-approved bank Score adjustment factors. UGB hence ensures that total variable remuneration does not limit its ability to strengthen its capital base.

The bonus pool takes into account the performance of the Bank, which is considered within the context of its risk management framework. This ensures that the variable pay pool is shaped by risk considerations and Bank-wide notable events.

10.9 Risk adjustments

UGB has an ex-post risk assessment framework which is a qualitative assessment to back-test actual performance against prior risk assumptions.

In years where the Bank suffers material losses in its financial performance, the risk adjustment framework will work as follows:

- There will be considerable contraction of the Bank's total variable remuneration.
- At an individual level, poor performance by the Bank will mean individual KPIs are not met, and hence employee performance ratings will be lower and therefore eligible for lower variable pay.
- Reduction in the value of deferred shares or awards.
- Possible changes in vesting periods and additional deferral applied to unvested rewards.
- If the qualitative and quantitative impact of a loss incident is considered significant, a malus or clawback (see below) of previous variable awards may be considered.

The NRC, with the Board's approval, can rationalise and make the any discretionary decisions which may result in increase / reduce the ex-post adjustment or decide to shrink or withdraw the bonus pool if the performance does not meet objectives.

10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.10 Malus and Clawback framework

The Bank's malus and clawback provisions allow the NRC to determine that, if appropriate, unvested portions under the deferred bonus plan can be forfeited / adjusted, or the delivered variable remuneration recovered in certain situations. The intention is to allow UGB to respond appropriately if the performance factors on which reward decisions were based turn out not to reflect the corresponding performance in the longer-term. All deferred compensation awards contain provisions that enable the Bank to reduce or cancel the awards of employees whose individual behaviour has had a materially detrimental impact on UGB during the concerned performance year.

Any decision to take back an individual's award can only be made by the NRC. The Bank's malus and clawback provisions as per the Remuneration Policy, allow the Committee to determine that if appropriate, vested / unvested elements under the deferred bonus plan can be adjusted / cancelled in certain situations. Clawback can be used if the malus adjustment on the unvested portion is insufficient given the nature and magnitude of the issue.

10.11 Components of variable remuneration

Variable remuneration has following main components:

Upfront cash	The portion of the variable compensation that is awarded and paid out in cash on conclusion of the performance evaluation process for each year.
Deferred Cash	The portion of variable compensation that is awarded and paid in cash on a pro-rata basis over a period of 3 years.
Upfront Phantom share awards	The portion of variable compensation that is awarded and issued in the form of phantom shares on conclusion of the performance evaluation process for each year.
Deferred phantom shares	The portion of variable compensation that is awarded and paid in the form of phantom shares on a pro-rata basis over a period of 3 years.



10. REMUNERATION POLICY AND RELATED DISCLOSURES (continued)

10.12 UGB Remuneration Disclosure Report for Approved Persons & MRT

Members of the Board of Directors:

amounts in US\$

Total value of remuneration awards for the current fiscal year	31-Dec-18	31-Dec-19
	Unrestricted	Unrestricted
Fixed remuneration		
• Sitting fees	180,000	180,000
• Other *	15,000	15,000
Remuneration paid to NRC members	-	-
No. of NRC Meetings	2	2

* Other includes per diem for attending Board of Directors and Board Committees meetings

Approved persons and MRT:

amounts in US\$

Total value of remuneration awards for the current fiscal year	31-Dec-18		31-Dec-19	
	Unrestricted	Deferred	Unrestricted	Deferred
Fixed remuneration				
• Cash-based	2,359,947	-	2,600,894	-
• Shares and share-linked instruments	-	-	-	-
• Severance	-	-	-	-
• Other	-	-	-	-
Variable remuneration				
• Cash-based	-	-	-	-
• Shares and share-linked instruments	-	-	-	-
• Other*	289,058	-	-	-
Number of Approved Persons & MRT	13	-	13	-

* 2018: As approved by the NRC, other includes annual performance related bonus of US\$ 38,527 and US\$ 250,531 awarded to certain senior members for additional responsibilities undertaken under UGH.

Total Remuneration All Employees

amounts in US\$

Total value of remuneration awards for the current fiscal year	31-Dec-18		31-Dec-19	
	Unrestricted	Deferred	Unrestricted	Deferred
Fixed remuneration				
• Cash-based	3,684,915	-	3,974,342	-
• Shares and share-linked instruments	-	-	-	-
• Severance	-	-	-	-
• Other	-	-	-	-
Variable remuneration				
• Cash-based	-	-	-	-
• Shares and share-linked instruments	-	-	-	-
• Other *	372,944	-	-	-
Number of Employees	38	-	41	-

* 2018: Other includes annual performance related bonus of US\$ 122,413 and US\$ 250,531 awarded to certain senior members as a one-time compensation awarded for additional responsibilities undertaken for corporate restructuring.

No guaranteed bonuses or sign-on benefits were awarded / paid during the years ended 31 December 2019 or 31 December 2018.



11. PENALTIES

During the year ended 31 December 2019, no penalties were imposed on the Bank by the CBB or any other regulatory body. We confirm to the best of our knowledge and belief, that no violation of the Bahrain Commercial Companies Law, Central Bank of Bahrain and Financial Institutions Law and the Central Bank of Bahrain directives and the Memorandum and Articles of Association of the Bank has occurred during the year ended 31 December 2019. Accordingly, the Bank has complied with all the terms of its banking license.

In addition, we also confirm to the best of our knowledge and belief, that there are no material pending legal cases outstanding as at 31 December 2019.

12. CONCLUSION

The Risk Management and Capital Adequacy Disclosures focus solely on the Pillar 3 requirements of the Basel III Accord. Further information on the Bank and its salient subsidiaries and associates, is available in the Annual Report and the Corporate Governance Report for the year ended 31 December 2019. Both documents are available in the Investor Relations Section of the Bank's website www.ugbbh.com

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