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The Financial Stability Report (FSR) is a semi-annual report prepared by the Financial Stability Directorate. It is available as an electronic version in PDF format in the Publications and Data section at http://www.cbb.gov.bh.

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Preface

A key objective of the Central Bank of Bahrain (CBB) is to ensure the continued soundness and stability of financial institutions and markets. As the single regulator for the Bahraini financial system, the CBB attaches utmost importance in fostering the soundness and stability of the financial system. The CBB recognizes that financial stability is critical to maintaining Bahrain's position as a regional financial center and ensuring that the sector continues to contribute significantly to growth, employment and development in Bahrain. The CBB defines financial stability as follows:

> *Financial stability can be defined as a situation where the financial system is able to function prudently, efficiently and uninterrupted, even in the face of adverse shocks.*

This objective is the primary responsibility of CBB's Financial Stability Directorate (FSD), which conducts regular surveillance of the financial system to identify areas of concern and undertakes research and analysis on issues relating to financial stability. In pursuit of its objective of promoting financial stability, the CBB conducts regular financial sector surveillance, keeping a close watch on developments in individual institutions as well as in the system as a whole.

The Financial Stability Report (FSR) is one of the key components of CBB's financial sector surveillance framework. Produced semi-annually by the CBB's Financial Stability Directorate (FSD), its principal purpose is macro-prudential surveillance, assessing the safety and soundness of the financial system as a whole (intermediaries, markets and payments/settlement systems). The ultimate objective of such macro-prudential analysis is to identify potential risks to financial stability and mitigate them before they develop into systemic financial turbulence.

Financial Soundness Indicators (FSIs) are used to monitor the banking financial sector on a continuous basis. The data appearing in report is compiled by CBB staff. Revisions and corrections of data can be made and incorporated in an updated electronic version of the report.

The FSR is prepared for the CBB management, reviewing recent trends and identifying areas of concern which require supervisory and policy attention. The FSR is also a tool aimed at informing the public.

This new edition of the FSR contains 9 chapters divided into four parts as follows:

- Part I: National and international developments:
  - Chapter 1: International financial developments.
  - Chapter 2: Developments in Bahrain's financial sector and household sector.
- Part II: Developments in the banking sector:
  - Chapter 3: Performance of the banking sector.
  - Chapter 4: Performance of conventional banks.
  - Chapter 5: Performance of Islamic banks.
- Part III: Developments in the non-banking financial sector:
  - Chapter 6: Performance of the insurance sector:
  - Chapter 7: Performance of capital markets
- Part IV: Developments in the Payments and Settlements System , Fintech, and Cyber Security

- Chapter 8: Performance of payment and settlement systems.
- Chapter 9: Fintech and Cyber Security

In its continued effort to ensure financial stability and developing a financial stability mandate, the CBB has created The Financial Stability Committee (FSC) on 20th of July 2017 by Resolution number 49 for year 2017. The committee is chaired by H.E the Governor and has seven members from various directorates within the organization.

The main functions/Goals of the Committee are:

1- To create a Macroprudential Policy Framework
2- Look at Macroprudential Policy Tools to be considered for Macro financial risks
3- Discuss the risks that can affect the soundness of the financial sector.
4- Improve Banking Supervision tools on banking and financial services on a periodic basis to ensure best practices especially DSISBs /DSIFISs.
5- Strengthening relations on international level with other regulating entities to prevent cross-border leakages.

Executive Summary

Global Macro Financial Environment Overview

The global economic and financial conditions improved slightly and risks associated to this environment eased in the second half of 2017. In its Word Economic Outlook, the International Monetary Fund (MF) forecasted a 3.6% growth in 2017 compared with the 3.2% forecasted last year.

Across major advanced economies, US economic growth increased to 2.3% in Q3/2017 from 2.0% in Q1/2017. Europe exceeded expectations despite increased uncertainty following the Brexit. In Q3/2017, Euro Area (19 countries) and the European Union (EU) (28 countries) achieved a growth of 2.6%. The UK's GDP growth decreased from 2.2% in Q1/2017 to 1.7% in Q3/2017. The Brexit vote and its spill over effects had a negative impact on the economic activities of the UK economy.

The Non-Financial Sector Overview

The size of the banking sector assets in Bahrain was USD 188.7 billion as of November 2017 representing 5.9 times GDP in Q3 2017. Retail banking total assets continued growing to reach BD 31.3 billion (USD 83.2 billion) in November 2017 with GCC assets at 22.1% and Europe and American assets at 8.7%. The wholesale banking sector assets declined to USD 105.5 billion with concentrations in GCC (31.5%) and Europe (34.2%).

The total amount of credit given by the retail sector witnessed an increase of 4.8% since May 2017 moving from BD 7,955.3 million to BD 8,338.2 million in November 2017. Total deposits, increased to BD 17,096.1 million in November 2017, where 70.0% of them were domestic deposits. Money supply continued to grow with M2 standing at BD 10,578.0 million in end-November 2017 and. M3 was at BD 12,521.9 million. Personal loans as a percentage of GDP increased to 31.2% in November 2017 reaching BD 3,734.6 million.

Banking Sector

The Capital adequacy ratio (CAR) for the banking sector stood at 19.4% in September 2017. The ratio has increased from 18.7% in March 2017. Non-performing loans (NPL) ratio decreased from 5.9% in March 2017 to 5.7% in September 2017.

As at end-September 2017, return-on-assets (ROA) increased to 0.9% from 0.7% in September 2016. Return-on-equity (ROE) increased from 4.5% in September 2016 to 5.7% in September 2016. Between March 2017 and September 2017, the overall loan-deposit ratio remained stable despite a small decrease from 65.2% in March 2017 to 64.7% in September 2017. Liquid assets as a proportion of total assets increased to reach 25.7%, over the same period.

Conventional Banks

The CAR for conventional retail banks remained constant slight increase from 20.3% in March 2017 to 20.4% in September 2017. The NPL ratio also was stable with minor change from 5.7% to 5.8% over the period. Specific provisions as a proportion of NPLs showed a decrease to 49.5% in September 2017 from 50.0% in March 2017. For *local retail banks*, the NPLs increased to 4.5% in September 2017. For *overseas retail banks*, the NPLs decreased to 8.5% in September 2017.

ROA for conventional retail banks reached 1.2%. Return-on-equity (ROE) for *locally incorporated conventional banks* increased to 10.3% in September 2017. The overall loan-deposit ratio for the segment decreased to 68.7% in September 2017. Liquid assets as a proportion of total assets increased over the period of March 2017 to September 2017 by 11.2% to reach 35.8%, respectively.

As for Wholesale banks, CAR for locally incorporated wholesale banks was 19.2%, an increase from the 18.1% registered in March 2017. NPL ratio remained unchanged at 5.6% of total loans. The NPL ratio of l*ocally-incorporated wholesale banks* increased to 4.5%. O*verseas wholesale* banks witnessed a decrease in its NPL ratio from 7.4% to 6.9% over the same period. Specific provisions as a proportion of NPLs also witnessed a decrease to 64.9% in September 2017.

ROA for the conventional wholesale banks was at 0.8% in September 2017. ROE for *local wholesale banks* was 3.4%. The overall loan-deposit ratio for conventional wholesale banks stood at 61.1%. Liquid assets for wholesale banks as a proportion of total assets decreased by 5.5% to reach 21.9% in September 2017.

Islamic Banks

The CAR of Islamic retail banks increased from 17.1% in March 2017 to 18.2% in September 2017. Non-performing Facilities (NPF) ratio decreased from 27.2% in March 2017 to 26.1% in September 2017. Specific provisioning showed a jump from 39.9% to 44.1% over the same period.

The ROA for Islamic retail banks increased to reach 0.4% in September 2017 compared to 0.2% in September 2016. Return on equity (ROE) increased from 1.6% to 4.5% for the same period. The volume of liquid assets available to Islamic retail banks slightly decreased from 12.4% of total assets in March 2017 to 11.5% in September 2017. The ratio of total facilities to deposits increased from 68.3% in March 2017 to 89.1% in September 2017.

As at end-September 2017, the CAR for Islamic wholesale banks increased from 18.5% in March 2017 to 18.8% in September 2017. The NPF ratio for Islamic wholesale banks stood at 2.4%. Specific provisioning for NPF's increased from 93.8% to 95.8% over the same period.

ROA for Islamic wholesale banks decreased from 1.1% in September 2016 to 0.8% in September 2017. ROE decreased as well from 7.4% to 5.0% over the same period. Liquid assets of Islamic wholesale banks represented 22.9% of total assets, 1.3% higher than the 21.6% registered in March 2017. Additionally, the facilities deposit ratio increased slightly from 61.3% in March 2017 to 61.4% in September 2017.

Insurance Sector

The Insurance sector in Bahrain is made up of three main segments: Conventional, Takaful, and Overseas. Total gross premiums registered at BD 204.1. The conventional firms accounted for the largest segment of total gross premiums (58.6%), followed by Takaful (22.4%) and overseas firms (19.0%).

As of Sep 2017, total assets of conventional insurance firms were BD 1,975.8 million (year on year growth of 13.2%). Takaful firms' assets at Sep 2017 experienced an annual growth by 3.53% reaching BD 159.1. Total assets for overseas firms were BD 282.3 million, recording a growth of 8.3% over the same period.

Viewing the concertation of the overall insurance industry, motor records the highest concentration in Gross Premiums (29.8%), Net Premiums Written (43.1%), and Net Claims (50.2%). Similarly for conventional insurance, motor insurance has the highest concentration for Gross Premiums (36.9%), Net Premiums Written (55.1%) and Net Claims (60.2%).

Overseas insurance companies operations focus more on Long-term (life) insurance with concentration in Gross Premiums (42.1%), Net Premiums written (58.3%) and Net Claims (54.7%). Takaful insurance companies have very high concentration on the Medical and Motor Insurance business lines. Gross Premiums for both sectors represented 58.8%, Net Premiums Written (85.3%), Gross Claims (81.2%), and Net Claims (95.0%).

Capital markets

As at December 2017, Bahrain Bourse recorded a total listing of 43 Companies, 19 Mutual funds and 13 Bonds and Sukuks. The Bahrain All-Share index reached 1331.7 points in December 2017, while the Bahrain Islamic Index reached 1089.3 points. Market capitalization of the Bahrain Bourse stood at BD 3.9 billion, and the price-earnings ratio (P-E ratio) stood at 9.4, an increase from the 8.9 attained in December 2016.

The majority of the value and the volume of shares traded in December 2017 was in the "Commercial Banks" sector whose traded shares by value represented 54.8% of total shares and by volume of shares represented 71.4%. The majority of the number of transactions in December 2017 (1,786 transactions and a 53.6% increase compared to December 2016) was also attained by the "Commercial Banks".

In 2017, two major mergers & acquisitions were announced, and 73 public and private offerings occurred (compared to 62 offerings in 2016) with a total value of USD 14.2 billion. Securities and Investment Co. remained the top broker, in terms of total value of shares traded, with more than 50% of the total market value in 2017.

Payments and Settlement System

The RTGS System provides for Payment and Settlement of Customer transactions as a value addition. The daily average volume of Bank transfers for the second half of 2017 (from 1st July to 31st of December 2017) decreased by 8.4% to 174 transfers compared to 190 transfers for the first half of 2017.

The daily average volume of ATM transactions for the first half of 2017 increased by 3.5% to 46,549 transactions per day compared to 44,591 transactions for the first half of 2017. The daily average value of ATM transactions remained at BD 4.4 million

The daily average volume of cheques for the second half of 2017 decreased by 2.7% when compared to the first half of 2017 from 13,326 cheques to 13,294. The value of those cheques similarly decreased over the same period from BD 41.1 million to BD 40.0 million.

Cyberisk and Fintech

Bahrain is repositioning itself to be a Financial Technology (FinTech) hub in the region combining conventional and Shari'ah compliant FinTech solutions. The CBB has established a dedicated Fintech Unit on the 22nd of October 2017 to ensure best services provided to individual and corporate customers in the financial sector. On 28th May, 2017, the CBB announced the issuance of the Regulatory Sandbox Framework that aims to provide a safe space where business can test FinTech innovative products and services. In April 2017 the CBB issued guidelines for Financing Based Crowdfunding Regulations for both conventional and Islamic lending.

Cyber risk is steadily evolving into a main threat to all industries. Its impact however on the financial services industry is growing into an individually recognised risk by all financial institutions. The CBB addresses these risks through the Cyber Security Survey conducted for the retail banking system. Approximately 91% of retail banks regularly incorporate requirements relating to cyber-security into contracts with vendors/clients. All retail banks conduct regular security awareness sessions to their employees.

Part I:

Developments in the International and Domestic Financial Markets

1. Developments in the International Financial Markets

Chapter

1

Key Points

- The global economic environment continued to improve since the beginning of the year for both advanced and emerging market economies.
- Financial conditions in the advanced economies remain accommodative.
- Stock markets indices reached new record levels in the second half of the year and Equity markets in Europe rebounded strongly.

1.1 Overview

Global economic activity showed signs of recovery with improvement in consumer confidence and investor' sentiments supported by growth in emerging markets and advanced economies. Despite the increase of interest rates by the Federal Reserve Board, monetary policy remained accommodative in the US and other advanced economies with the aim to support economic growth. Despite the anticipated exit of the UK from the Euro Area followed by the US election that have added uncertainty to the global financial markets, overall environment showed some signs of resilience in the beginning of 2017. In the following section, recent trends in the global economy are highlighted and the major financial and economic indicators during the previous six months are looked at.

1.2 Global Macro-financial Environment

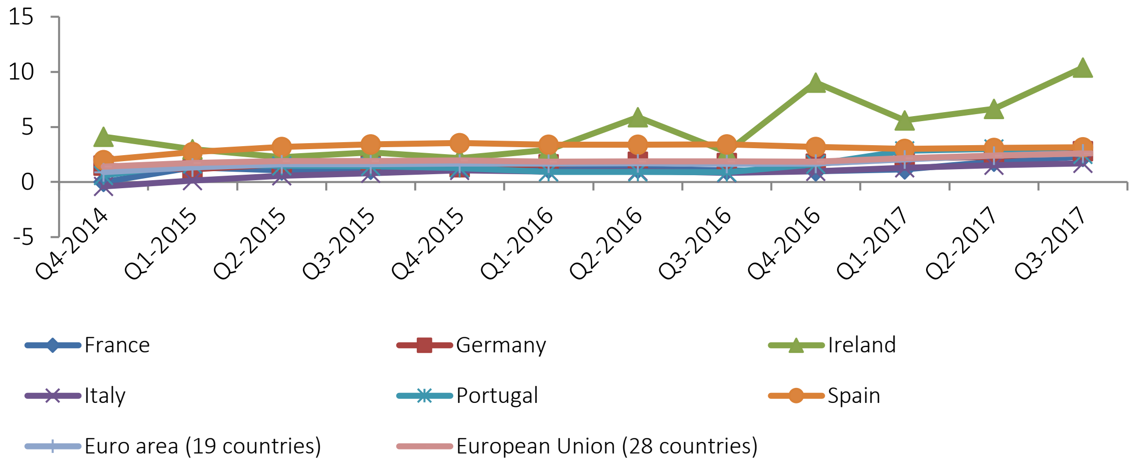
Despite the political and geopolitical risks that have added some risk to financial market, the global economic and financial conditions improved slightly and risks associated to this environment eased in the second half of 2017. In its World Economic Outlook, the International Monetary Fund (MF) is forecasting 3.6% growth in 2017 compared with the 3.2% forecasted last year.

A. Economic Performance

Across major advanced economies, the recovery was stronger in the US as economic growth increased to 2.3% in Q3/2017 from 2.0% in Q1/2017. The US economy was boosted by the restore of confidence and the improvement of consumer sentiments. The recovery in Europe was better than expected despite increased uncertainty following the Brexit, which amplified volatility and raised new concerns in the global financial markets. In Q3/2017, Euro Area (19 countries) and the European Union (EU) (28 countries) achieved a growth of 2.6%. This performance was fuelled by the extraordinary economic boom in Ireland, which achieved 10.4% of growth in the third quarter of 2017. Spain has achieved a moderate economic performance as GDP growth reached 3.1% for Q3/2017, which was a lowest since Q2/2015. In Q3/2017, Portugal registered a growth rate of 2.5% and Italy continues improving its economic performance as it achieved a growth of 1.7%; the highest since the global financial crisis.

Regarding two largest economies in the Eurozone, Germany experienced strong economic activities in the third quarter of 2017 with GDP growth reach 2.8% and France also achieved better than expected recovery as growth rate was 2.3% in the same period.

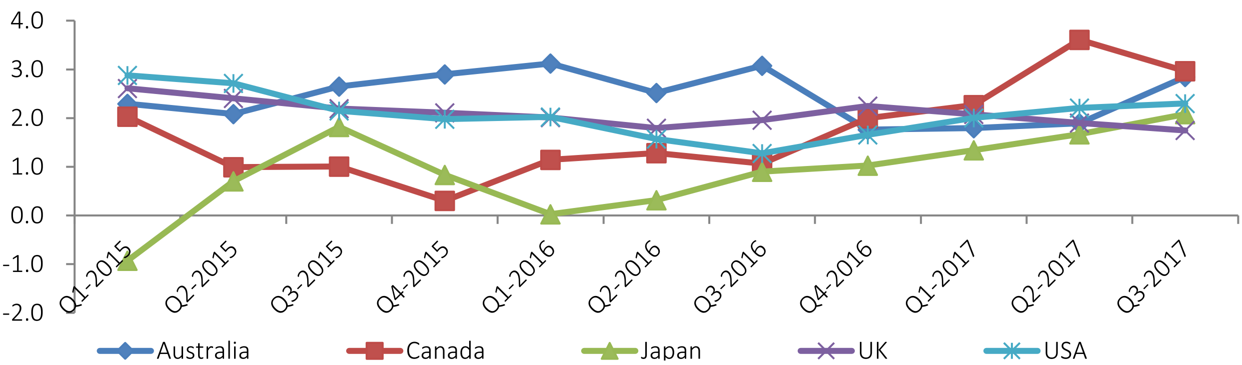
Chart 1-1: Real GDP Growth in Selected Europeans countries (Quaterly%) Seasonally adjusted*



Growth rate compared to the same quarter of previous year, seasonally adjusted
Source: OECD Quarterly National Accounts

The UK's GDP growth decreased from 2.2% in Q1/2017 to 1.7% in Q3/2017. The Brexit vote and its spill over effects had negative impact on the economic activities of the UK economy. Australia's economic performance continued its upward trend as GDP growth was 2.8% in Q3/2017 from 1.8% in Q1/2017. For Japan, economic growth improved from 1.3% in Q1/2017 to 2.1% in Q3/2017.

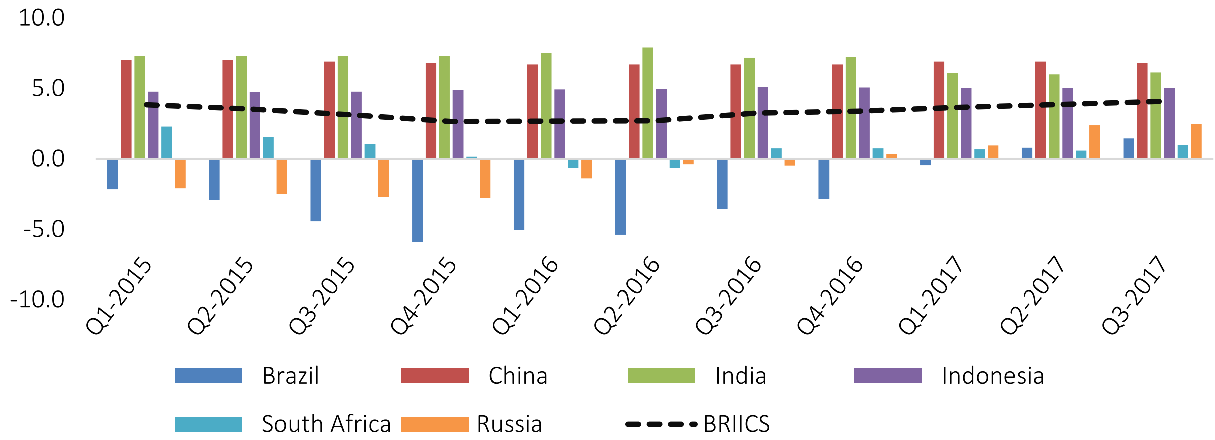
Chart 1-2: Real GDP Growth in Advanced Economies (Quaterly%)*



** Growth rate compared to the same quarter of previous year, seasonally adjusted*
Source: OECD Quarterly National Accounts

As for emerging economies (Chart 1-3), the BRIICS countries' growth was strong as it reached the level of 4.1% in Q3/2017. In China, despite the highly indebted local governments, and the financial sector that continues to pose a significant downside risk, economic growth continued to perform well as it realized as growth rate of 6.8%, a slightly lower than the previous two quarters (6.9%). However, the IMF recently warned about the growing debt-dependency of the world's second biggest economy with China's debt levels posing a stability risk. Brazil's economic performance has shown some signs of recovery after the country fell into recession for the twelfth consecutive quarter. The Brazilian growth rate moved from -0.5% in Q1/2017 to 0.8% in Q2/2017 and it now stood at 1.4% at Q3/2017. Similarly, Russia shifted from a long period of recession to a positive growth in the first three quarter of 2017 and in Q3/2017 it achieved a growth of 2.5%.

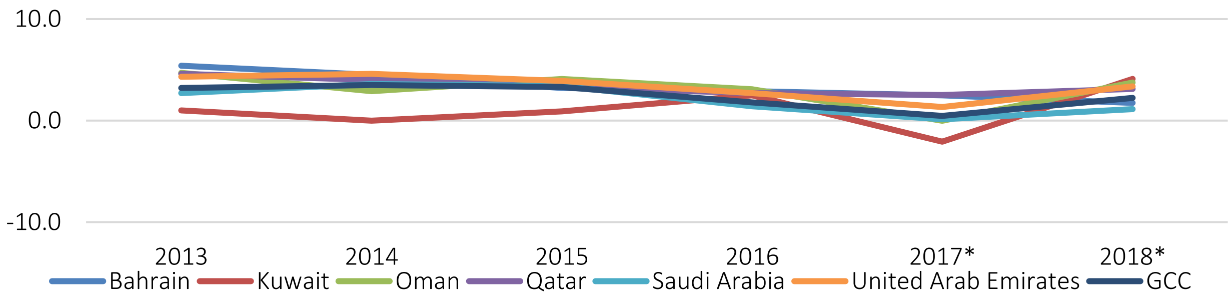
Chart 1-3: Quaterly Real GDP Growth in BRIICS (Quaterly%)*



**Growth rate compared to the same quarter of previous year, seasonally adjusted.*
**Data on Russia is not available since the 4th quarter of 2015.*
Source: OECD Quarterly National Accounts.

Regionally, the drop of energy prices followed by the continuing uncertainty in the global economy have affected the growth of Gulf Cooperation Council (GCC) economies in 2017 as the growth rate was expected to be around 0.5% which is the lowest level since the financial crisis. Projections for 2018 show that the economic condition will improve and the regional economy will grow at a moderate rate of growth of 2.2%.

Chart 1-4: Real GDP Growth in GCC Countries (Annual percent change)

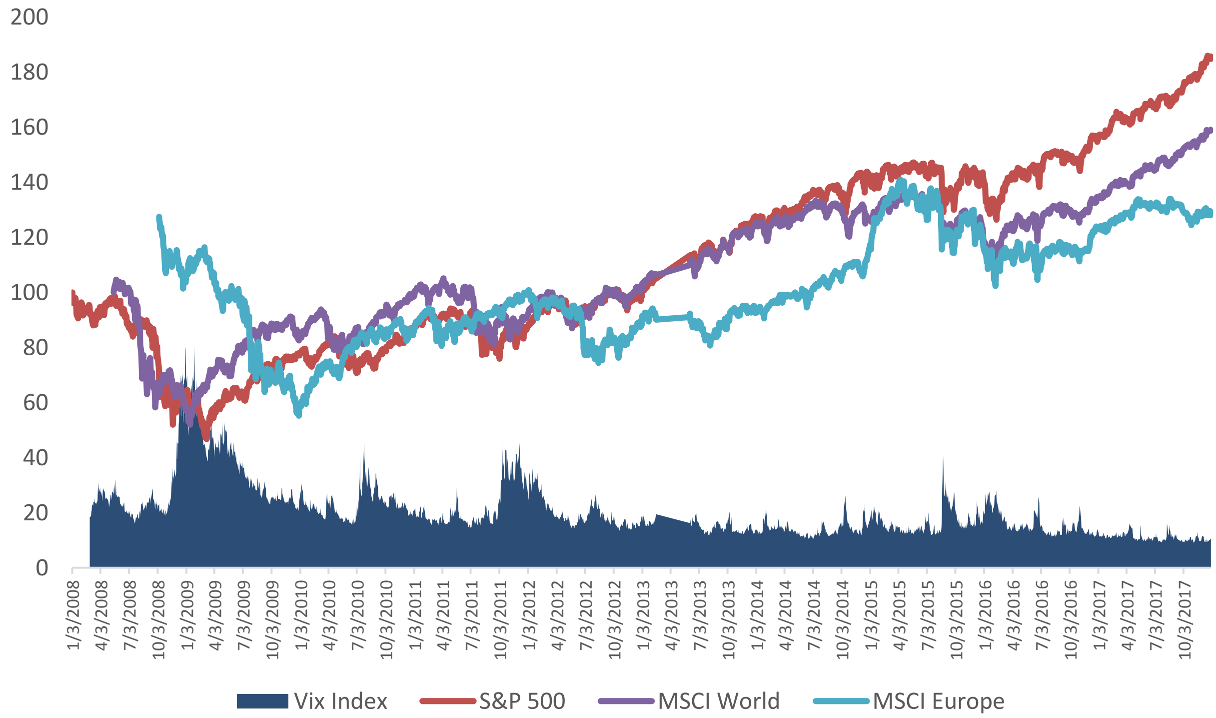


**Forecasts*
Source: IMF Regional Economic Outlook, October 2017

B. Financial Markets

Equity prices have risen across a range of advanced economies. Indices reached new record levels following the presidential election in the US, France and Austria. Equity prices in the Euro Area recovered strongly, supported by signs of economic activities, improving business and consumer confidence. Similarly, the S&P 500 has risen by around 30% since early 2016, reaching a high record since 2007.

Chart 1-5: Global Equity Market Indices (Re-indexed to January 2008)



Source: Bloomberg.

2. Developments in Bahrain's Financial and non-Financial Sector

Chapter 2

Key Points

- The retail banking sector assets showed a slight incline to 31.3 billion USD and wholesale banking sector assets increased to 105.5 billion USD as of end November 2017.
- The volume of credit showed a slight incline to 8,338.2 million in November 2017.
- Household debt and Business debt ratio increased.
- Construction permits decreased and commercial licenses dropped.

2.1 Overview

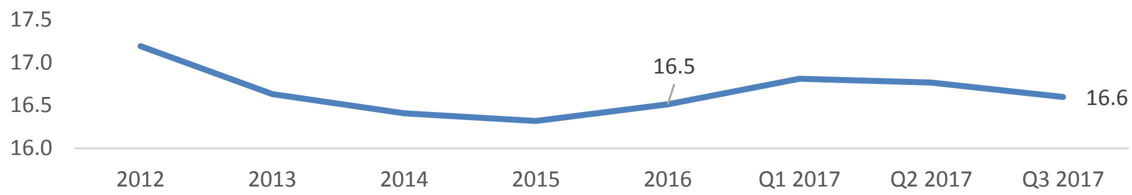
This chapter assesses the recent developments of the Bahraini financial and non-financial sectors and the resilience of the local banking sectors since the last FSR. The financial condition and performance of financial institutions depend to a large extent on the financial condition of their customers (households and enterprises) and their vulnerabilities to changes in the economic environment.

The assessment requires an evaluation of the financial condition and performance of non-financial entities: households, business enterprises, as well as the construction and real estate sector. Households and business enterprises are the major customers of financial institutions. Not only are they sources of deposits, they represent major sources of demand for financial sector products and services.

2.2 The Financial Sector

Bahrain has emerged as a regional financial center. This has been essential to the development of its economy and the financial sector has come to play a significant role in economic activity and employment creation. The banking sector is currently the largest non-oil contributor to GDP representing 16.5% of real GDP as of 2016. By Q3 2017, the banking sector represented 16.6% of real GDP.

Chart 2-1: Size of the Banking Sector to GDP (%)



Source: IGA.

The insurance industry continued to grow during the past few years. Insurance contribution increased to 5.2% of GDP by end of 2016 and 5.4% by Q3 2017. Strong growth over the last five years has been in medical insurance (which now accounts for 20% of total premiums). The insurance market in Bahrain now comprises 24 locally-incorporated firms and 12 overseas firms carrying out insurance, reinsurance, takaful and retakaful. These institutions offer all basic and modern insurance services such as medical and health insurance, long-term insurance (life and savings products).

Bahrain's first Islamic commercial Bank, Bahrain Islamic Bank, was established in 1979 and since that, Bahrain has become the home to the Accounting and Auditing Organization for Islamic Financial Institutions, International Islamic Financial Market, and Islamic International Rating Agency, and the Bahrain Institute of Banking and Finance. In 2014, the Global Islamic Finance Report (GIFR) reveals that Bahrain was ranked fourth over 40 countries by Islamic Finance Country Index (IFCI).

In December 2017, 393 banks and financial institiitions were licneded by the CBB. The banking sector in Bahrain was made up of 101 banks, categorized as follows:

- 29 retail banks (including 6 Islamic retail banks); 13 locally incorporated and 16 branches of foreign banks
- 72 wholesale banks (including 17 Islamic wholesale banks); 30 locally incorporated and 42 branches of foreign banks

As of December 2017, there are 292 non-banking financial institutions operating in Bahrain, including investment business firms, insurance companies (including Takaful and Re-Takaful firms), Representative Offices for conventional banks and specialized licenses.

2.1.1 The Size of the banking sector

The size of the banking sector assets in Bahrain was USD 188.7 billion as of November 2017 representing 5.5 times GDP by the end of the third quarter of 2017. The banking sector started as 11.3 times GDP in 2007 and by Q3 2017, the banking sector was 5.5 times of GDP. The change of the size of the banking sector times GDP is attributed to a decrease in the wholesale banking sector along an increase in GDP. Table 2-1 below shows that the change of the size of wholesale banking sector to GDP. Between 2008 and 2011 the decrease in the banking sector can be explained by wholesale banks adjusting their business models to the international financial crisis and the European debt crisis during these periods.

As for the retail banking sector, it remained between 2.3 to 2.6 times of GDP over the same period. The retail banking sector has continued to grow over the years (USD 49.5 billion in 2007 to USD 84.4 billion in Q3 2017) along with the growth in GDP.

Table 2-1: Evolution of the size of the Banking sector in Bahrain

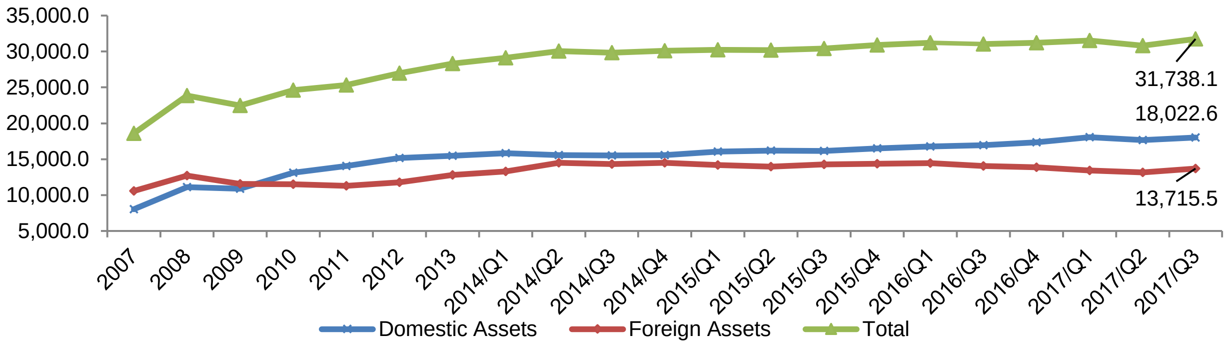
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017*		
											Q1	Q2	Q3
Banking Sector (USD billion)	**245.8**	**252.4**	**221.8**	**222.2**	**197.1**	**186.3**	**192.0**	**189.3**	**191.0**	**186.1**	**188.2**	**186.5**	**189.1**
times GDP	11.3	9.8	9.7	8.6	6.8	6.1	5.9	5.7	6.1	5.8	5.4	5.4	5.5
Retail Sector (USD billion)	**49.5**	**63.5**	**59.7**	65.5	67.4	71.7	75.3	80.0	82.2	83.0	**83.8**	81.9	84.4
times of GDP	2.3	2.5	2.6	2.5	2.3	2.3	2.3	2.4	2.6	2.6	2.4	2.4	2.4
Wholesale Sector (USD billion)	196.3	188.9	162.0	156.7	129.7	114.6	116.7	109.3	108.8	103.0	104.4	104.6	104.7
times of GDP	9.0	7.3	7.1	6.1	4.5	3.7	3.6	3.3	3.5	3.2	3.0	3.0	3.0

Source: CBB Monthly Statistical Bulletin.

** Using 2017 current GDP estimates.*

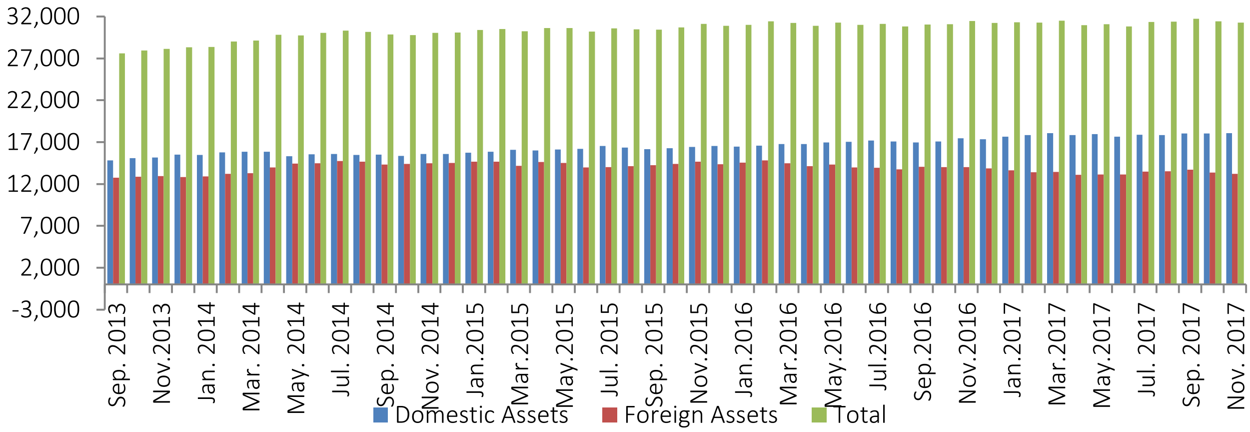
Despite the global uncertainty and the troubles in MENA region, retail banking total assets continued growing since December 2007 to reach BD 31.3 billion (USD 83.2 million) in November 2017 (see Chart 2-3).

Chart 2-2: Retail Banks' Assets (BD million)



Source: CBB Monthly Statistical Bulletin.

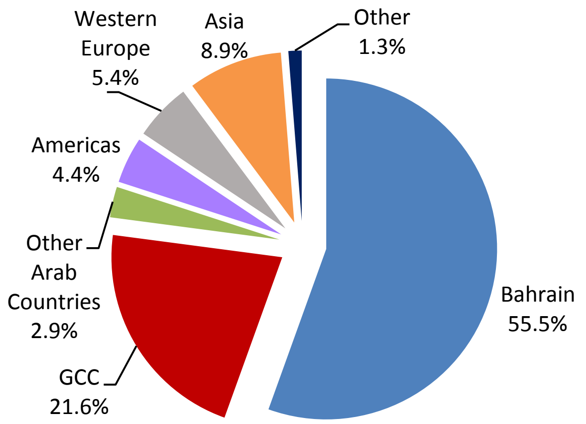
Chart 2-3: Categorization of Retail Banks' Assets (BD million)



Source: CBB Monthly Statistical Bulletin.

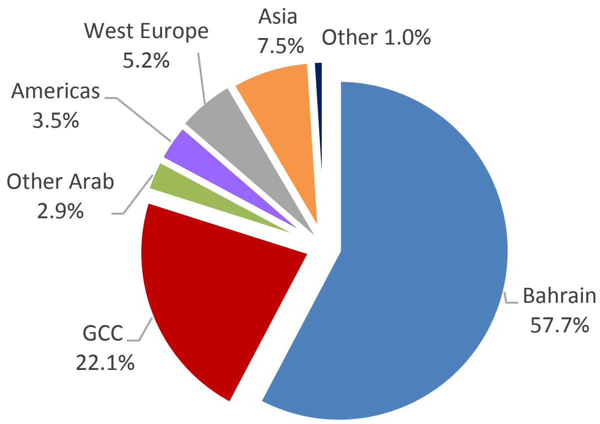
The share of GCC assets of total of total retail banking assets was 22.1%. The level of Europe and American contribution in retail banking showed a slight decline (8.7%). This shows that the retail-banking sector in Bahrain is relatively exposed to foreign risk from GCC countries and lightly exposed to foreign risk from U.S and Europe.

Chart 2-4: Retail Banks' Assets (%) by Geographical Classification (Nov2016)*



** For conventional and Islamic retail banks*
Source: CBB Monthly Statistical Bulletin.

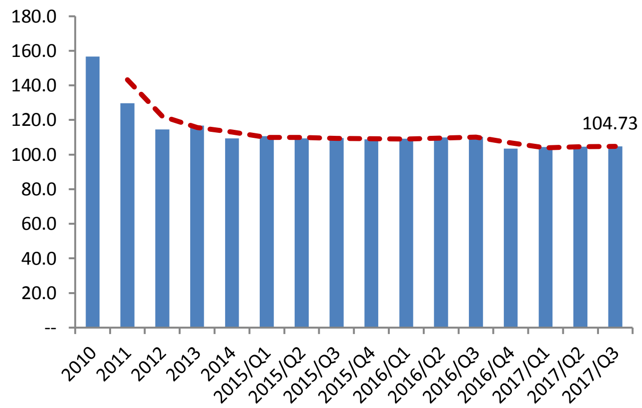
Chart 2-5: Retail Banks' Assets (%) by Geographical Classification (Nov 2017)*



** For conventional and Islamic retail banks*
Source: CBB Monthly Statistical Bulletin.

The wholesale banking sector declined to USD 105.7 billion by end of November 2016 to USD 105.5 in November 2017 (See Charts 2-6 and 2-7).

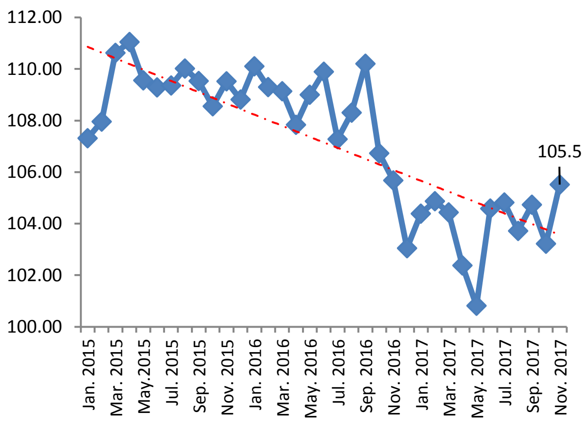
Chart 2-6: Wholsale Banks' Assets (USD Billion)*



--- *Moving average trendline*

** For conventional and Islamic wholesale banks*
Source: CBB Monthly Statistical Bulletin.

Chart 2-7: Wholsale Banks' Assets(USD Billion)*



--- *Linear Trendline*

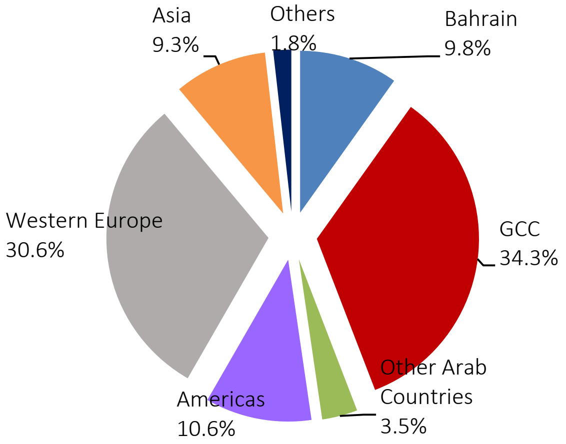
** For conventional and Islamic wholesale banks*
Source: CBB Monthly Statistical Bulletin.

According to the geographical classification of wholesale banks' assets, wholesale banks are exposed to foreign risk from Western Europe and the GCC countries:

- The share of America's total assets decreased considerably to 9.7% in November 2017. This is lower than the total American asset's in November 2016.
- The share of Europe's total assets increased to 34.2%.
- Asian assets increased from 4.4% in 2007 to 9.3% in November 2017.

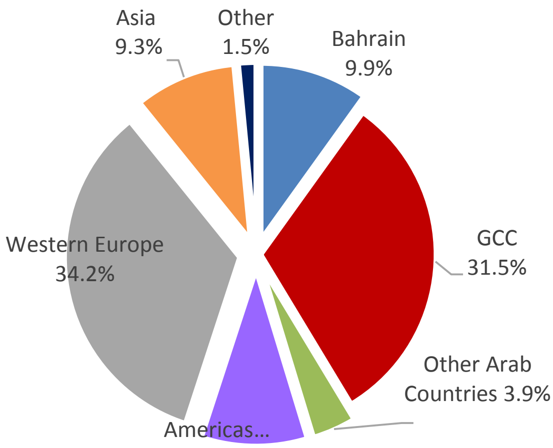
- GCC total assets continued to decrease to a low of 31.5% in November 2017, they represent a smaller portion of Wholesale bank assets now compared to Europe.

Chart 2-8: Wholesale Banks Assets by Geographical Classification (Nov.2016)*



** For conventional and Islamic retail banks*
Source: CBB Monthly Statistical Bulletin.

Chart 2-9: Wholesale Banks Assets by Geographical Classification (Nov 2017)*

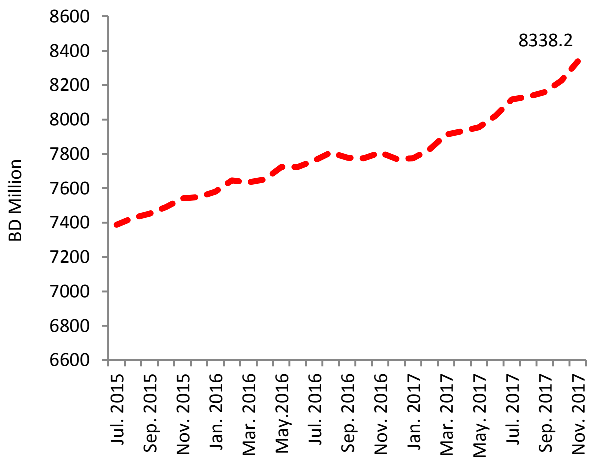


** For conventional and Islamic retail banks*
Source: CBB Monthly Statistical Bulletin.

2.1.2 Credit Developments

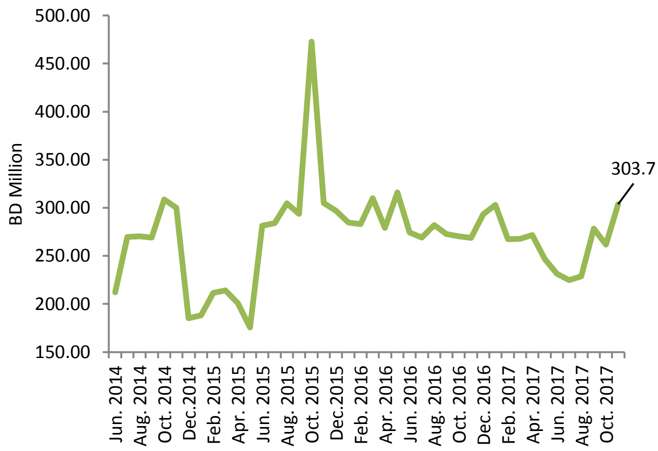
The total amount of credit given by the retail sector witnessed a considerable increase since May 2017 moving from BD 7,955.3 million to BD 8,338.2 million in November 2017 (Chart 2-11). The high credit growth reveals the recovery of the economic activities and the restore of confidence in the Kingdom of Bahrain. Regarding banks' lending to the general government, there was an increase to BD 303.7 million at end-November 2017, from BD 246.6 million at end-May 2017.

Chart 2-10: Loans to the Private Sector (BD Million)*



Source: CBB Monthly Statistical Bulletin.
**Excluding securities*

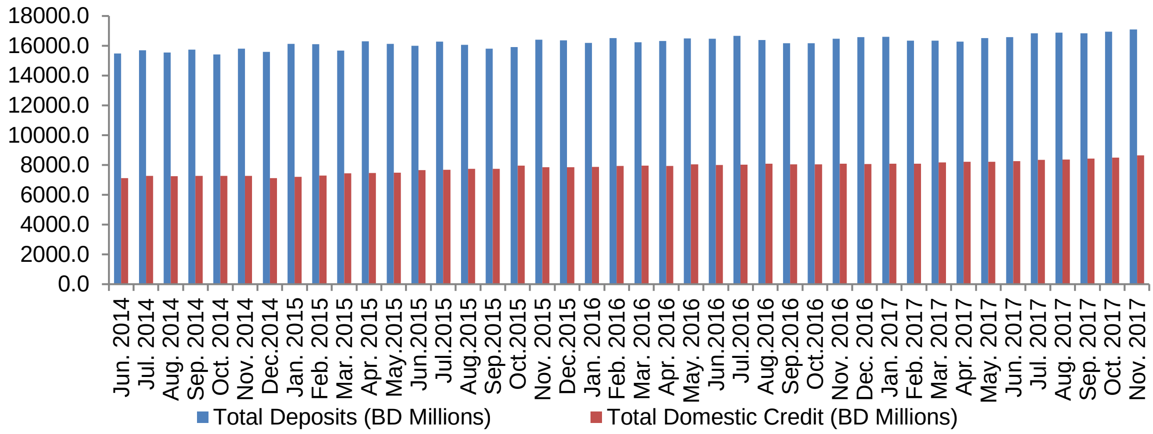
Chart 2-11: Loans to General Government (BD Million) *



Source: CBB Monthly Statistical Bulletin.
**Excluding securities*

As for total deposits, they increased to BD 17,096.1 million in November 2017, where 70.0% of them were domestic deposits. This was followed by an increase in total domestic credits which moved from BD 8,201.9 million at end-May 2017 to 8,614.9 in November 2017 (chart 2-12).

Chart 2-12: Total Deposits and total Domestic Credit (BD Million)



Source: CBB Monthly Statistical Bulletin.

2.1.3 Net Foreign Assets

The net foreign asset (NFA) position of the banking system is the value of the assets that the banking system owns abroad (Foreign Assets) minus the value of the domestic assets owned by foreigners (Foreign Liabilities). A positive NFA balance means that the system is a net lender, while a negative NFA balance shows that it is a net borrower.

Looking at the NFA position by banking segment we will see the position is negative for conventional and Islamic retail banks (net borrowers), while it is positive for conventional and Islamic wholesale banks (net lenders). As of November 2017 the NFA position for retail banks was *negative* USD 2,041.4 million. For wholesale banks, the NFA position was *positive* 963.1 USD million.

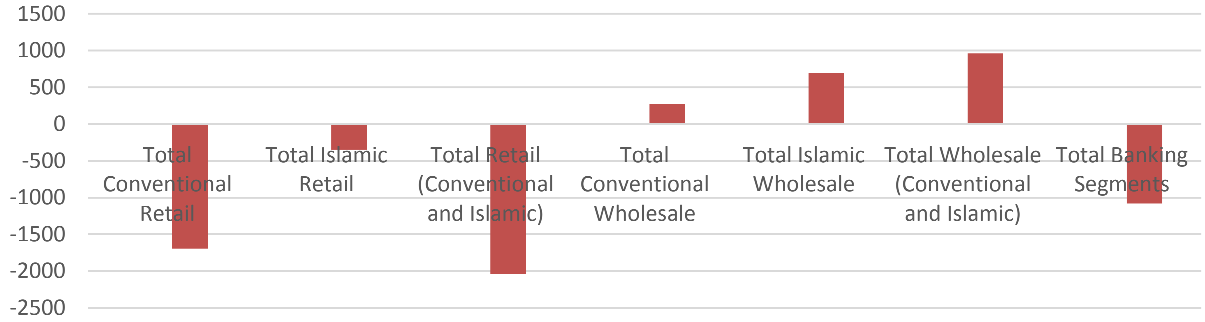
Table 2-2: Net Foreign Assets Postion by Banking Segment (May 2017)

USD million

Banking Segment	Foreign Assets	Foreign Liabilities	Net Foreign Assets
Conventional Retail	32,365.9	34,060.4	(1,694.6)
Islamic Retail	2,782.8	3,129.7	(346.8)
Retail (Conventional and Islamic)	35,148.7	37,190.1	(2,041.4)
Conventional Wholesale	89,487.8	89,214.4	273.4
Islamic Wholesale	5,581.2	4,891.6	689.6
Wholesale (Conventional and Islamic)	95,069.0	94,106.0	963.1
Total Banking Segments	**130,217.7**	**131,296.0**	**(1,078.3)**

Source: CBB.

Chart 2-13: Net Foreign Assets Position by Banking Segment

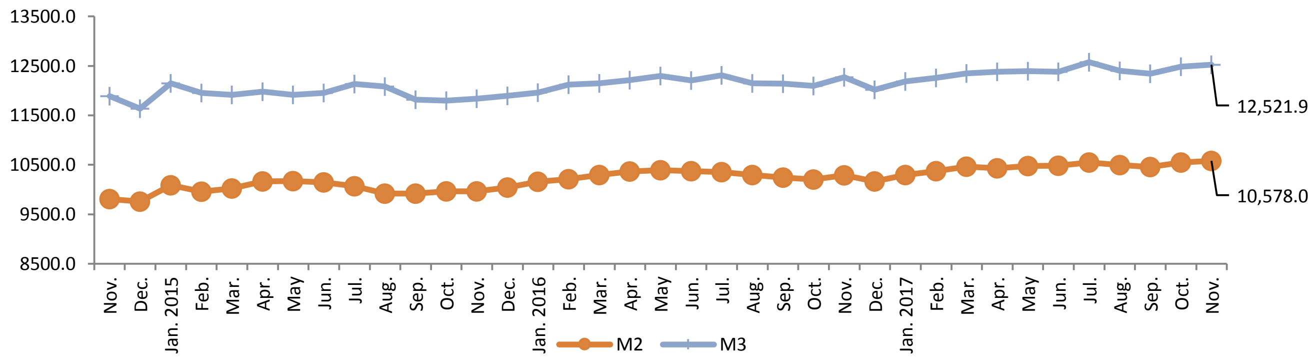


Source: CBB.

2.3 Monetary indictors

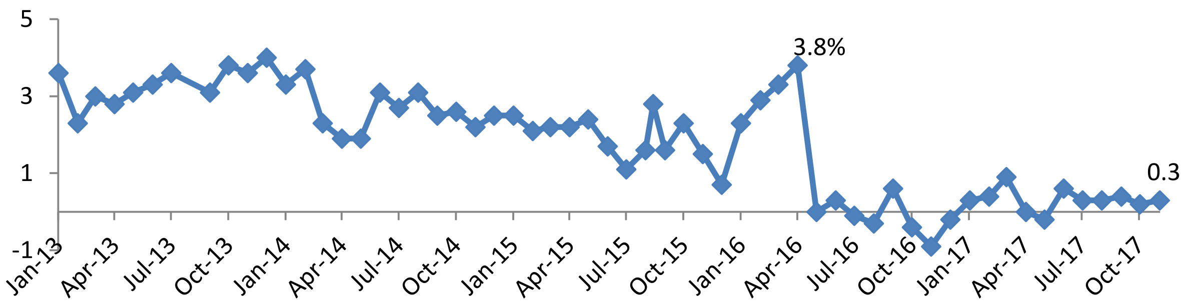
Money supply continued to grow. M2 stood at BD 10,578.0 million in end-November 2017, 0.97% higher than its value of May 2017. M3 was at BD 12,521.9 million in end-November 2017, 1.04% higher than in May 2017 (Chart 2-14).

Chart 2-14: Money Supply (BD Billion) from July 2015 to May 2017



Source: CBB Monthly Statistical Bulletin.

Chart 2-15: Monthly Inflation in 2013-2017 (CPI%)*



**Growth rate compared to the same month of previous year, seasonally adjusted*
Source Information and e-Government Authority (IGA).

Generally speaking, the inflation rate in consumer prices has always been relatively stable in Bahrain, not exceeding 4.0% since 2013. According to Information and E-Government Authority (IGA), inflation increased from -0.2% in May 2017 to 0.3% in November 2017. The largest increases came from the "food and non-alcoholic beverages", and the "furnishing, household equipment and routine household maintenance" sectors.

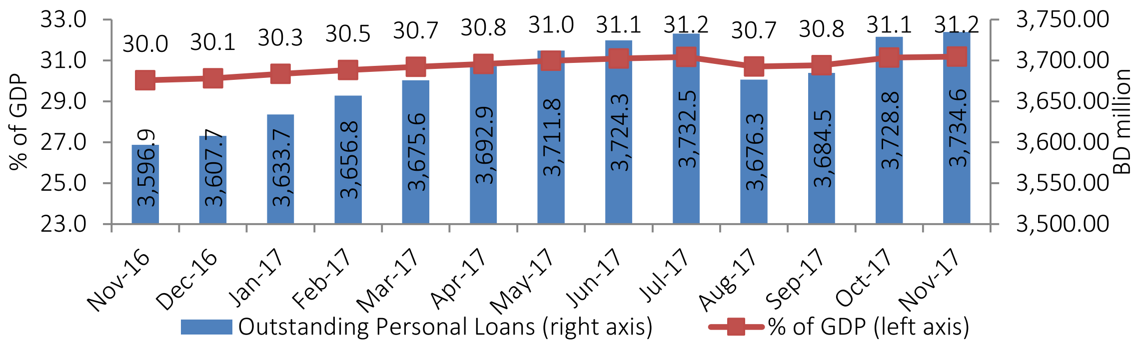
2.4 The Households Sector

The household sector in Bahrain plays an important role in financial stability and the overall economy. The household sector can allocate funds to financial assets through bank deposits and securities, and to non-financial assets from land and other fixed assets. It can also receive funds from financial and non-financial institutions. The construction and real estate sector plays a huge importance on economic developments and is a good indicator of macroeconomic conditions in the country.

2.4.1 Household Debt Ratio

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt saw an increase throughout the period between November 2016 and November 2017 (Chart 2-16).

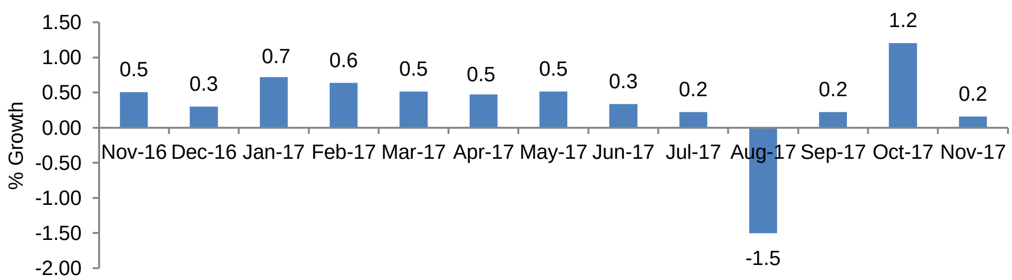
Chart 2-16: Personal Loans and Advances (Volume and % of GDP)



**Using 2016 GDP*
Source: CBB Monthly Statistical Bulletin.

Personal loans as a percentage of GDP remained fairly stable from November 2016 to November 2017. Starting at 30.0% (BD 3,596.9 milllon) in November 2016 the personal loans as a percentage of GDP increased to 31.2% in November 2017 (BD 3,734.6 milllon). There was a 0.61% increase in outstanding personal loans between May 2017 and November 2017.

Chart 2-17: Growth Rate of Total Personal Loans and Advances (%)



Source: CBB Monthly Statistical Bulletin.

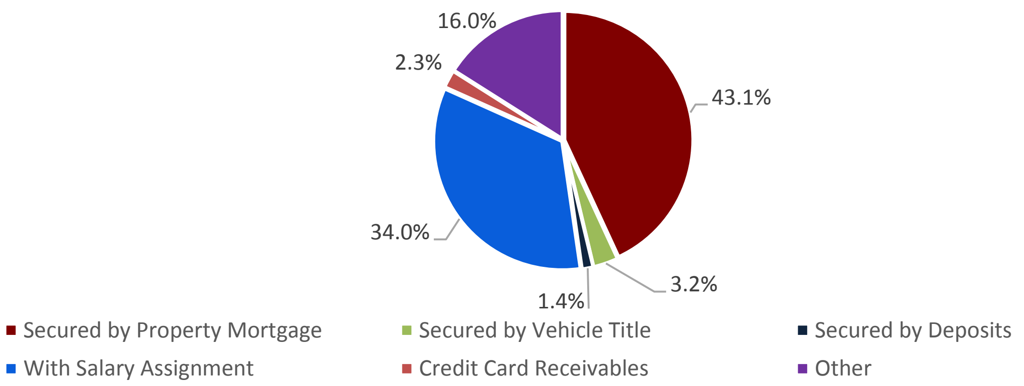
The growth rate in total personal loans saw a decrease between May 2017 and November 2017, rising from 0.5% to 0.2% respectively. The highest growth rate was in personal loans of 1.2% in October 2017 since November 2016. The two main contributors to personal loans as seen in chart 2-18 were personal loans secured by property mortgages which makes up 43.1% of the total personal loans followed by personal loans secured with salary assignments at 34.0% of total personal loans as of end of November 2017.

Table 2-3: Personal Loans Breakdown

BD million	2016-2017						
	May	Jun	Jul	Aug.	Sep.	Oct.	Nov.
Total	3,711.8	3,724.3	3,732.5	3,676.3	3,684.5	3,728.8	3,734.6
Secured by Property Mortgage	1,566.6	1,567.7	1,566.4	1,591.3	1,601.7	1,607.1	1,602.4
Secured by Vehicle Title	121.0	122.1	123.4	120.8	120.2	118.1	116.4
Secured by Deposits	41.2	43.6	43.2	49.6	53.6	53.7	55.9
With Salary Assignment	1,247.1	1,254.4	1,262.5	1,272.0	1,274.9	1,267.3	1,281.7
Credit Card Receivables	78.4	79.1	81.1	81.8	85.0	84.5	86.1
Other	657.5	657.4	655.9	560.8	549.1	598.1	592.1

Source: CBB Monthly Statistical Bulletin.

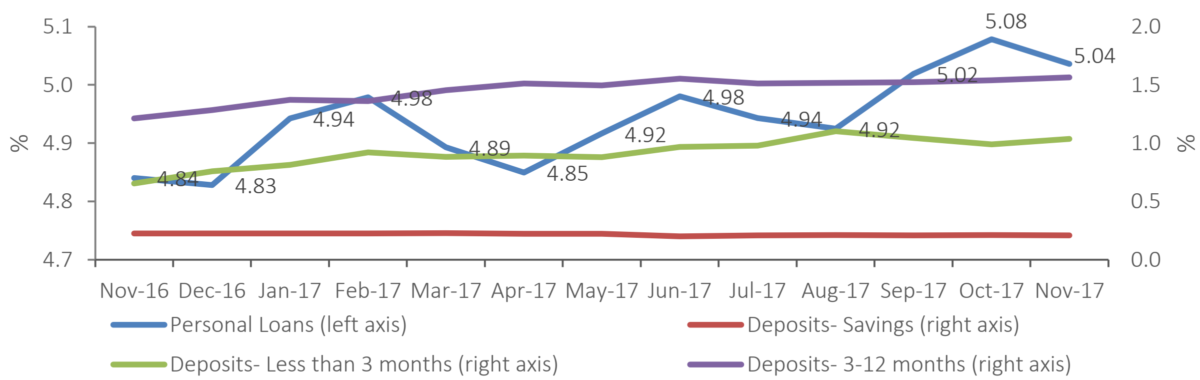
Chart 2-18: Personal Loans Breakdown (November 2017)



Source: CBB Monthly Statistical Bulletin.

Interest rates on personal loans started off at 4.84% in November 2016 and then increased to 5.04% in November 2017 (Chart 2-19). The chart also shows the retail deposit rate for: Saving deposits, time deposits less than 3 months, and time deposits 3 months to 12 months over the same period.

Chart 2-19: Retail Banks- Average Interest Rates on Personal Loans and Interest rates on Deposits (%)

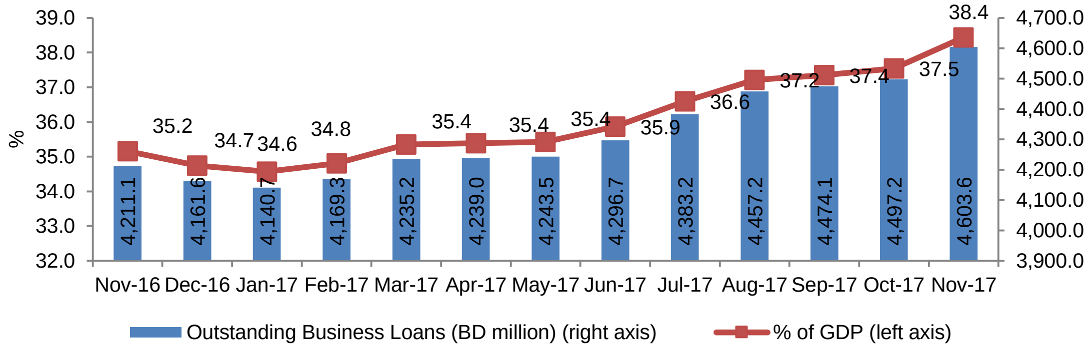


Source: CBB Monthly Statistical Bulletin.

2.4.2 The Bahraini Corporate Sector

Business loans and advances grew between May 2017 and November 2017 from BD 4,243.5 million in May 2017 to BD 4,603.6 million in November 2017 (Chart 2-20). Outstanding business loans as a percentage of GDP increased by 3.2% during this period, ending at 38.4% in November 2017.

Chart 2-20: Business Loans and Advances (Volume and % of GDP)



Source: CBB Monthly Statistical Bulletin.

For the past seven months, the main contributor to the increase in business loans was the loans to the construction and real estate sector. The biggest contributors to business loans in November 2017 are the 'construction and real estate sector' (35.4%) followed by 'trade' (25.0%) and then 'other sectors' (15.1%) (Chart 2-21).

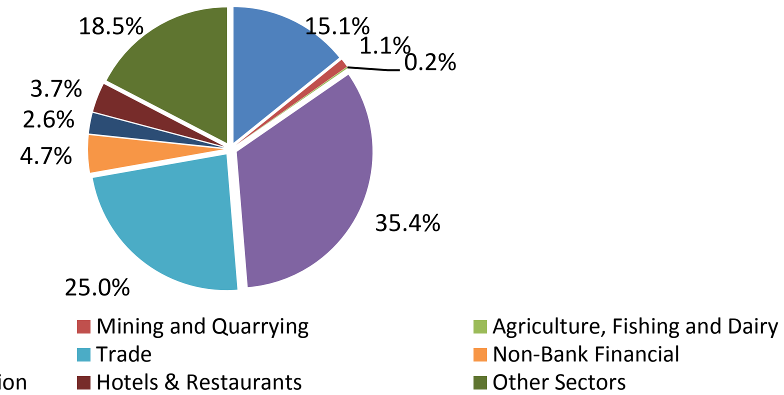
Table 2-4: Business Loans by Sector

Sectors	2016-2017						
	May	Jun	Jul	Aug	Sept	Oct	Nov
Total	**4,243.5**	**4,296.7**	**4,383.2**	**4,457.2**	**4,474.1**	**4,497.2**	**4,603.3**
Manufacturing	590.2	636.3	680.1	707	703.7	691.4	695.1
Mining and Quarrying	28.7	29.4	37.8	39.7	37.5	44.8	50.2
Agriculture, Fishing and Dairy	5.6	6.0	5.4	5.5	6.3	7.1	7.4
Construction and Real Estate	1,380.5	1,412.5	1,386.9	1,434.1	1,486.6	1,537.7	1,631.7
Trade	1,063.5	1,063.2	1,058.2	1,168.8	1,157.1	1,159.1	1,151.0
Non-Bank Financial	338.8	340.6	351.6	200.3	205.0	222.9	217.8
Transportation & Communication	143.4	143.2	122.8	128.9	127.1	123.7	121.1
Hotels & Restaurants	161.9	174.6	171.3	181.1	179.7	170.4	170.6
Other Sectors	530.9	490.9	569.1	591.8	571.1	540.1	850.4

Source: CBB Monthly Statistical Bulletin.

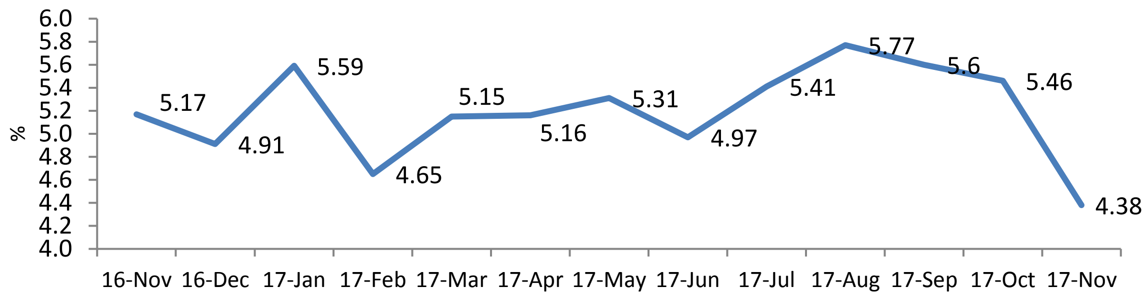
Average interest rates on business loans fluctuated throughout the period. It was at its peak in January 2017 at 5.59%, and at its lowest in November 2017 at 4.38% (Chart 2-22).

Chart 2-21: Business Loans by Sector November 2017



Source: CBB Monthly Statistical Bulletin.

Chart 2-22: Retail Banks' Average Interest Rates on Business Loans (%)



Source: CBB Monthly Statistical Bulletin.

2.4.3 Construction and Real Estate

The total number of construction permits issued by the Ministry of Municipality & Agricultural Affairs has seen a decrease from Q3 2016 to Q3 2017, with a total of 1,696 and 1,357 permits issues respectively.

Table 2-5: Selected Construction Permits by Type

	2016:Q2	2016:Q3	2016:Q4	2017:Q1	2017:Q2	2017:Q3
Renovation	178	167	148	168	122	108
Reclamation	4	2	6	8	3	3
New Construction	921	842	896	900	705	630
Demolition and New Construction	11	6	7	9	5	6
Demolition	145	110	123	136	130	93
Addition	755	569	652	747	618	517
Total	**2,015**	**1,696**	**1,832**	**1,968**	**1,583**	**1,357**

Sources: Ministry of Municipality Affairs and Agriculture

2.5 Overall assessment of the Bahraini Financial sector and non-Financial Sector.

Bahrain's financial sector was influential in fostering economic growth and creating employment opportunities. Bank loans continued their growth with mortgage loans growing steadily. Overall funding conditions have improved and demand for loans has accelerated in Bahrain. Banks operating in Bahrain are well capitalized, funding and liquidity buffers are well above minimum required standards, and non-performing loans continue to drop. Regulatory changes in recent years have helped to improve prudential standards for retail and wholesale banks (conventional and Islamic). All these changes have been beneficial for financial stability and will further strengthen the position of Bahrain as a financial center.

Part II:

Performance of the Banking Sector

3. Overall Banking Sector

Chapter

3

Key Points

- An increase in capital positions.
- Non-performing loans (NPLs) decreased slightly.
- Loan portfolios remain concentrated in some sectors despite the decrease in some sectors, but no significant change from previous quarter
- Stable positive earnings for banks.
- Increase in liquidity position.

3.1 Overview

In this chapter, the performance of the banking sector in the Kingdom of Bahrain is analysed and assessed. This chapter offers macro prudential analysis of the entire banking sector based on a set of selected Financial Soundness Indicators (FSIs).[1] The banking sector in Bahrain is divided into four segments: conventional retail (CR), conventional wholesale (CW), Islamic Retail (IR), and Islamic wholesale (IW). The performance of each banking segment will be analysed in Chapters 4 and 5.

Annex 1 presents selected FSIs for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.

Unless indicated otherwise, Chapter 3, 4, and 5 of the report analyzes data covering the period between end-March 2017 and end-September 2017.

3.2 Overall Banking Sector Performance

Increase in Capital Adequacy Ratio [2]

The Capital adequacy ratio (CAR) for the banking sector stood at 19.4% in September 2017. The ratio has increased from 18.7% in March 2017. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 17.4% in March 2017 to 18.1% in September 2017. Whereas the leverage ratio (ratio of assets over capital) increased from 4.7% to 6.8% during the same period.

[1] This chapter does not contain a section on stress testing. Stress Testing exercises are performed separately in an internal report to obtain information on the potential quantitative impact of hypothetical scenarios on selected Bahraini Domestically Systemically-Important Banks (DSIB's).

[2] The capital adequacy ratio relates total capital to risk-weighted assets (RWA). The discussion excludes overseas retail banks, which do not have prescribed capital levels or ratios.

Table 3-1 Capital Provision Ratios

Indicator	Mar. 2017	Sep. 2017
CAR (%)	18.7	19.4
Tier 1 CAR (%)	17.4	18.1
Leverage (assets/capital)(times)	6.8	6.9

Source: CBB.

Decrease in NPL's

The Non-performing loans (NPL) ratio has been flat remaining within the same range. The NPL ratio decreased from 5.9% in March 2017 to 5.7% in September 2017. The specific provisions as a proportion of NPLs showed a slight decrease to 57.0% in September 2017 from 57.3% in March 2017.

Table 3-2: NPL Ratios

Indicator	Mar. 2017	Sep. 2017
NPL's (% Gross Loans)	5.9	5.7
Specific provisions (% of NPLs) *	57.3	57.0

** Specific provisions as a percentage of NPL's are calculated as specific provisions divided by gross impaired loans.*

Source: CBB.

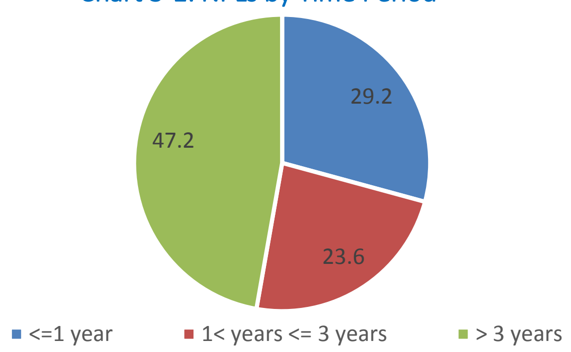
Data on NPL by time segment (up to 1 year, 1 year to 3 years over 3 years) shows that the majority of NPLs in the banking sector are non-performing for over 3 years (47.2% of total of total NPLs). NPL's for over 3 years represented 2.7% of total gross loans. NPLs that are non-performing for up to 3 years represented 52.8% of total of total NPLs. Specific provisioning for NPLs increases as they are non-performing for longer periods of time. As seen in Table 3-3, 71.8% of NPLs are provisioned for loans non-performing for more than 3 years.

Table 3-3: NPL Ratios and Specific Provisions by Time Period

	Up to 1 year	1 up to 3 years	Over 3 years	Total
NPL's (% Gross Loans)	1.7	1.3	2.7	5.7
Specific provisions (% of NPLs)	39.1	49.5	71.8	57.0

Source: CBB.

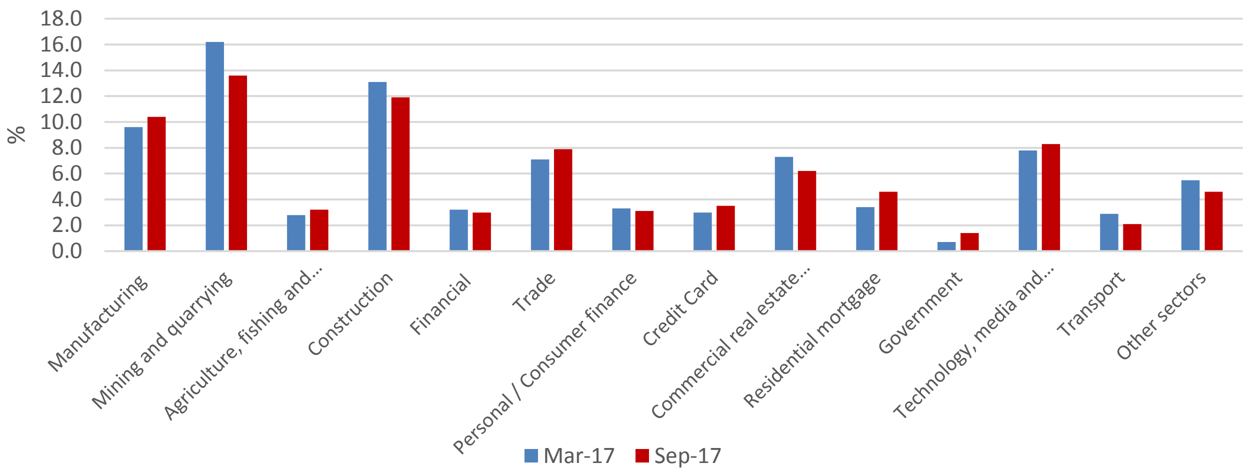
Chart 3-1: NPLs by Time Period



Source: CBB.

Data on the sectoral breakdown of NPLs as a percentage loans in each sector shows some sectors experiencing an increase in impairment, while some experience a decrease and others remaining unchanged (Table 3-3 and Chart 3-1). The overall changes through have been very minimal. The highest increase was in "Residential mortgage" by 1.2% followed by "Manufacturing" and "Trade" by 0.8% and the highest decrease was in "Mining and quarrying" by 2.6%.

Chart 3-2: NPL Ratios by Sectors (%)



Source: CBB.

Table 3-4: NPL Ratios by Sector (%)

	Mar. 2017	Sep. 2017	Change
Manufacturing	9.6	10.4	0.8
Mining and quarrying	16.2	13.6	(2.6)
Agriculture, fishing and forestry	2.8	3.2	0.4
Construction	13.1	11.9	(1.2)
Financial	3.2	3.0	(0.2)
Trade	7.1	7.9	0.8
Personal / Consumer finance	3.3	3.1	(0.2)
Credit Card	3.0	3.5	0.5
Commercial real estate financing	7.3	6.2	(1.1)
Residential mortgage	3.4	4.6	1.2
Government	0.7	1.4	0.7
Technology, media and telecommunications	7.8	8.3	0.5
Transport	3.0	2.1	(0.9)
Other sectors	5.5	4.6	(0.9)

Source: CBB.

Loan portfolios unchanged and concentrated in some sectors

The loan portfolio of *the banking system* remains concentrated in four sectors with no major change in the exposure to the sectors with no sector exceeding a 20% exposure. "Manufacturing" represented the maximum exposure with 15.4% of total loans in September 2017, a decrease from the 15.8% in March 2017.

Table 3-5: Lending Distribution (% Total Loans)*

	Mar. 2017	Sep. 2017	Change
Manufacturing	15.8	15.4	(0.4)
Mining and quarrying	1.6	1.6	0
Agriculture, fishing and forestry	1.7	1.6	(0.1)
Construction	9.6	10.5	0.9
Financial	14.3	14.0	(0.3)
Trade	11.1	10.4	(0.7)
Personal / Consumer finance	8.2	8.3	0.1
Credit Card	0.3	0.3	0
Commercial real estate financing	9.2	9.0	(0.2)
Residential mortgage	4.2	4.1	(0.1)
Government	5.0	4.7	(0.3)
Technology, media and telecommunications	1.8	1.5	(0.3)
Transport	4.9	4.9	0
Other sectors	12.4	13.6	1.2
Top two recipient sectors	**30.1**	**29.4**	**(0.7)**
Real Estate/ Construction Exposure**	**23.0**	**23.6**	**0.6**

Source: CBB.

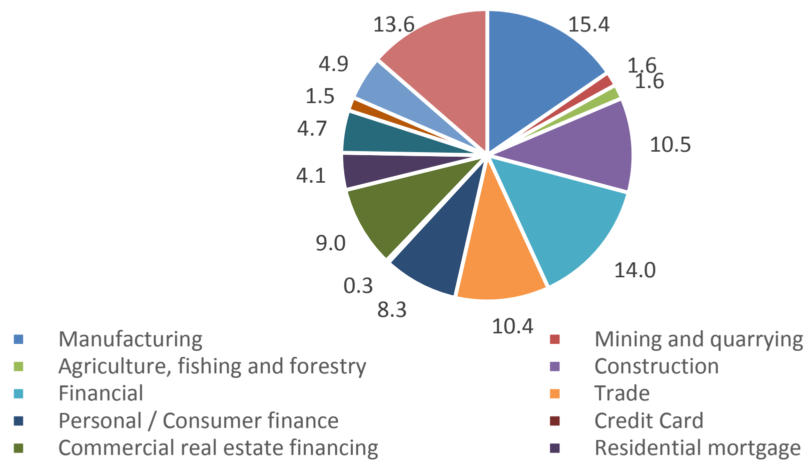
**Figures may not add to a hundred due to rounding*

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

The "Financial" sector that represented 14.0% of total loans down from 14.3% in March 2017. The "Other"[3] sector increased to 13.6% of total loans up from 12.4% over the same period. "Personal/Consumer Finance as percentage of total finance" increased slightly from 8.2% in March 2017 to 8.3% in September 2017.

The top two recipient sectors "Manufacturing" and "Financial" jointly represented 29.4% of loans in September 2017, decreasing 30.1% in March 2017. Exposure to real estate/ construction was 23.6% of total lending in September 2017, a slight increase from 23.0% registered in March 2017.

Chart 3-3: Lending Distribution (% Total loans)



Source: CBB.

[3] The "other sectors" category includes sectors such as "private banking", "services", "tourism", and "utilities".

Increase in profitability

The overall banking sector's profitability indicators have been positive and on the rise since the last issue of the report and remain robust. As at end-September 2017, return-on-assets (ROA) increased to reach 0.9% from 0.7% in September 2016. Return-on-equity (ROE) increased from 4.5% in September 2016 to 5.7% in September 2017. Net interest income (as a % of total income) stood at 66.1% in September 2017 a decrease from 67.8% in September 2016. In addition, operating expenses as a proportion of total income was 53.4% in September 2017 a decrease from the 55.8% registered in September 2016.

Table 3-6: Profitability (%)

	Sep. 2016	Sep. 2017
ROA *	0.7	0.9
ROE**	4.5	5.7
Net interest income (% total income)***	67.8	66.1
Operating expenses (% total income)	55.8	53.4

Source: CBB

**ROA = ratio of net income to assets.*

***ROE = ratio of net profit to tier 1 capital (for locally incorporated banks only).*

**** Net interest income only for Conventional Banks.*

Liquidity position stays resilient

Banks are meeting the legal liquidity coverage ratios and remain resilient to liquidity risk. Banks are submitting pro forma data of the liquidity coverage ratio (LCR), which shows refers to highly liquid assets held by financial institutions to meet short-term obligations. Between March 2017 and September 2017, the overall loan-deposit ratio decreased from 65.2% in March 2017 to 64.7% in September 2017. Liquid assets as a proportion of total assets increased to reach 25.7%, over the same period.

Table 3-7: Liquidity

	Mar. 2017	Sep. 2017
Liquid Asset Ratio (%)	24.3	25.7
Loan-Deposit Ratio	65.2	64.7

Source: CBB.

3.3 Overall Assessment of the Banking Sector

The financial soundness indicators show that the Banking Sector witnessed an increase in capital adequacy ratio. Capital adequacy ratios for the banking sector increased from 18.7% in March 2017 to 19.4% in September 2017. Non-performing loans have shown a slight decrease between periods of March 2017 to September 2017 from 5.9% to 5.7% yet remain stable within the same range. Profitability has increased with ROA being at 1.3% and ROE at 5.7%. Liquidity has increased between March 2017 and September 2017.

In the following two chapters (chapters 4 and 5) of the FSR, the FSIs of the four banking sectors (Conventional Retail, Conventional Wholesale, Islamic Retail, and Islamic Wholesale) are analysed to assess the performance of the sectors in the banking system in Bahrain.

4. Conventional Banks

Chapter

4

Key Points

- An increase in capital positions of conventional retail banks and a decrease in capital positions of conventional wholesale banks.
- Non-performing loans (NPLs) for conventional banks increased.
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Stable earnings with increases for conventional retail banks and conventional wholesale banks.
- Slight increase in liquidity for conventional retail banks and decreases for conventional wholesale banks.

4.1 Overview

This chapter analyses the banking sector under the following categories: conventional retail banks (section 4.2), conventional wholesale banks (section 4.3). Section 4.4 provides an overall assessment of the conventional banking industry. Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations), as at end-September 2016 and compared with end-March 2017.

This chapter offers macroprudential analysis of the conventional banking sector based on a set of selected Financial Soundness Indicators (FSIs).[4]

4.2 Conventional Retail Banks

Increase in capital adequacy [5]

The CAR for conventional retail was unaffected with a minimal increased from 20.3% in March 2017 to 20.4% in September 2017. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 18.6% in March 2017 to 18.8% in September 2017, whereas the leverage ratio (ratio of assets over capital) decreased to 6.5 during the same period. The ratio of non-performing loans (NPLs) net provisions to capital increased to reach 6.6% in September 2017 from 6.0% in March 2017.

[4] This chapter does not contain a section on stress testing. Stress Testing exercises are performed separately in an internal report to obtain information on the potential quantitative impact of hypothetical scenarios on selected Bahraini Domestically Systemically-Important Banks (SIB's).

[5] The capital adequacy ratio relates total capital to risk-weighted assets (RWA). The discussion excludes overseas retail banks, which do not have prescribed capital levels or ratios.

Table 4-1: Local CR Banks' Capital Provisions Ratios

Indicator	Mar. 2017	Sep. 2017
CAR (%)	20.3	20.4
Tier 1 CAR (%)	18.6	18.8
Leverage (assets/capital)(times)	6.6	6.5
NPLs net of provisions to capital	6.0	6.6

Source: CBB.

Non-performing loans remain stable

NPL ratio didn't show any significant change standing at 5.8% in September 2017. The specific provisions as a proportion of NPLs showed a minor decrease to 49.5% in September 2017 from 50.0% in March 2017. The net NPLs of net loans increased slightly from 3.0% in March 2017 to 3.1% in September 2017. For *local retail banks*, the NPLs increased to 4.5% in September 2017. For *overseas retail banks*, the NPLs decreased to 8.5% in September 2017.

Table 4-2: CR Banks' NPL Ratios

Indicator	Mar. 2017	Sep. 2017
NPL's (% Gross Loans)	5.7	5.8
NPL's Local Banks	4.2	4.5
NPL's Overseas Banks	8.8	8.5
Specific provisions (% of NPLs) *	50.0	49.5
Net NPL's (% of net loans)	3.0	3.1

Source: CBB.

** Specific provisions as a percentage of NPL's are calculated as specific provisions divided by gross impaired loans minus interest in suspense.*

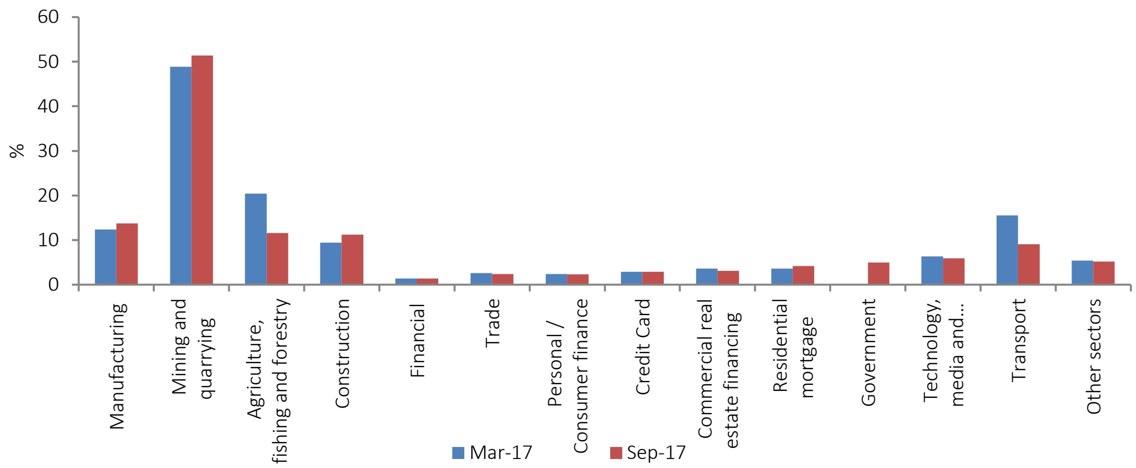
Available data on the sectoral breakdown of NPLs shows some sectors experiencing an increase in impairment, while some experience a decrease (Table 4-3 and Chart 4-1). The highest increase was in "Mining and quarrying" by 2.5%, and the highest decrease was in "Agriculture, fishing, and forestry" by 8.8%.

Table 4-3: CR Bank's NPL Ratios by Sector (%)

	Mar. 2017	Sep. 2017	Change
Manufacturing	12.4	13.7	1.3
Mining and quarrying	48.9	51.4	2.5
Agriculture, fishing and forestry	20.4	11.6	(8.8)
Construction	9.4	11.2	1.8
Financial	1.4	1.4	0.0
Trade	2.6	2.4	(0.2)
Personal / Consumer finance	2.4	2.3	(0.1)
Credit Card	2.9	2.9	0.0
Commercial real estate financing	3.6	3.1	(0.5)
Residential mortgage	3.6	4.2	0.6
Government	0.0	5.0	0.0
Technology, media and telecommunications	6.3	5.9	(0.4)
Transport	15.5	9.1	(6.4)
Other sectors	5.4	5.2	(0.2)

Source: CBB.

Chart 4-1: CR Banks' NPL Ratios by Sector (%)



Source: CBB.

Loan portfolios remain concentrated

The loan portfolio of *retail banks* remains concentrated with no major change in the composition of the loans. The top recipient of loans remains to be the "Commercial real estate financing" sector accounting for 19.0% of total loans in September 2017, compared with 18.8% in March 2017. The "Manufacturing" sector represented 14.9% of total loans followed by the "Personal/Consumer finance" and "Other" sectors at 12.6% and 16.2% respectively of total loans over the same period.

The top two recipient sectors "Commercial real estate financing" and "Manufacturing" jointly represented 35.2% of loans in September 2017. Exposure to real estate/construction was 30.7% of total lending in September 2017, unchanged from the levels in March 2017.

Table 4-4: CR Bank's Lending Distribution by Sector (% Total Loans)*

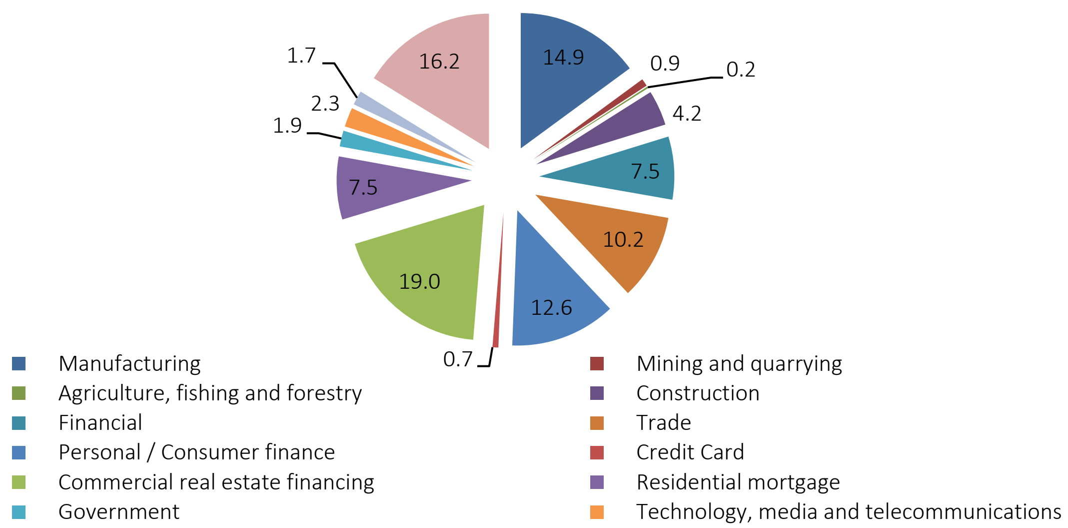
	March 2017	Sep. 2017	Change
Manufacturing	14.3	14.9	0.6
Mining and quarrying	1.0	0.9	(0.1)
Agriculture, fishing and forestry	0.1	0.2	0.1
Construction	4.6	4.2	(0.4)
Financial	7.3	7.5	0.2
Trade	11.5	10.2	(1.3)
Personal / Consumer finance	12.3	12.6	0.3
Credit Card	0.7	0.7	0.0
Commercial real estate financing	18.8	19.0	0.2
Residential mortgage	7.2	7.5	0.3
Government	1.6	1.9	0.3
Technology, media and telecommunications	2.8	2.3	(0.5)
Transport	1.9	1.7	(0.2)
Other sectors	15.9	16.2	0.3
Top two recipient sectors	**34.7**	**35.2**	**0.5**
Real Estate/ Construction Exposure**	**30.7**	**30.7**	**0.0**

Source: CBB

**Figures may not add to a hundred due to rounding*

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-2: CR Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

The loan portfolio of *locally incorporated retail banks* remains concentrated with the top recipient of loans being the "Commercial real estate financing" sector accounting for 19.9% of total loans in September 2017, a decrease from the 20.3% in March 2017. The "Other sectors" represented 15.1% of total loans up from 14.4% followed by the "Manufacturing" sector at 14.3% of total loans over the same period. The top two recipient sectors "Commercial real estate financing" and "Others"[6] jointly

[6] The "others sectors" category includes sectors such as "private banking", "services", "tourism", and "utilities".

represented 35.0% of loans in September 2017, an increase from the 34.8% in March 2017. Exposure to real estate/construction was 35.2% of total lending in September 2017, a slight decrease from the 35.6% registered in March 2017.

Table 4-5: Local CR Bank's Lending Distribution by Sector (% Total Loans)

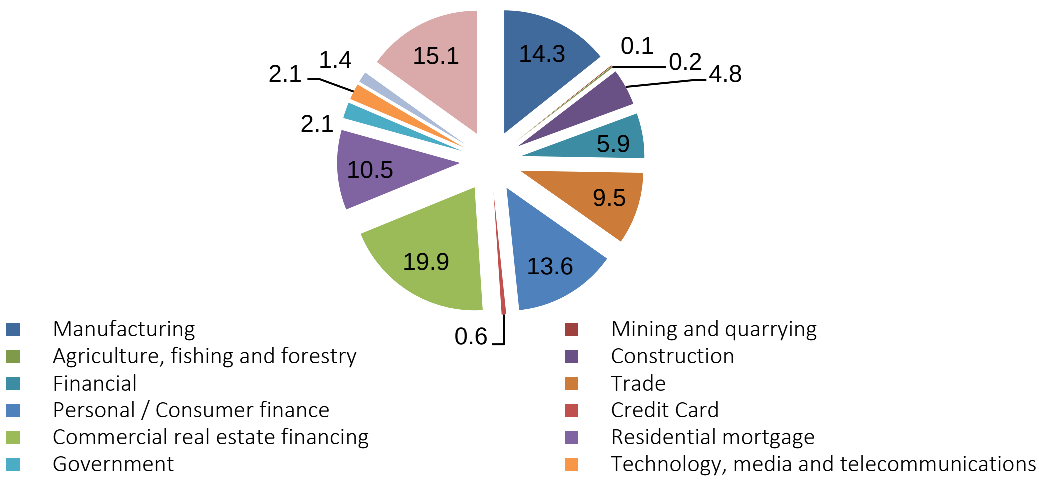
	Mar. 2017	Sep. 2017	Change
Manufacturing	12.9	14.3	1.4
Mining and quarrying	0.2	0.1	(0.1)
Agriculture, fishing and forestry	0.2	0.2	0.0
Construction	5.1	4.8	(0.3)
Financial	6.0	5.9	(0.1)
Trade	10.9	9.5	(1.4)
Personal / Consumer finance	13.3	13.6	0.3
Credit Card	0.6	0.6	0.0
Commercial real estate financing	20.3	19.9	(0.4)
Residential mortgage	10.2	10.5	0.3
Government	2.1	2.1	0.0
Technology, media and telecommunications	2.5	2.1	(0.4)
Transport	1.3	1.4	0.1
Other sectors	14.4	15.1	0.7
Top two recipient sectors	**34.8**	**35.0**	**0.2**
Real Estate/ Construction Exposure**	**35.6**	**35.2**	**(0.4)**

Source: CBB

**Figures may not add to a hundred due to rounding*

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-3: Local CR Bank's Lending Distribution by Sector (% Total Loans)



Source: CBB.

The numbers as of end-September 2017 continue to show high concentration of risk for *overseas retail banks* (Table 4-6 and Chart 4-4). The top recipient of loans was the "Commercial Real Estate Financing" sector with 17.2% of total loans in September 2017, an increase from the 15.8% in March 2017.

Table 4-6: Overseas CR Bank's Lending Distribution by Sector (% Total Loans)

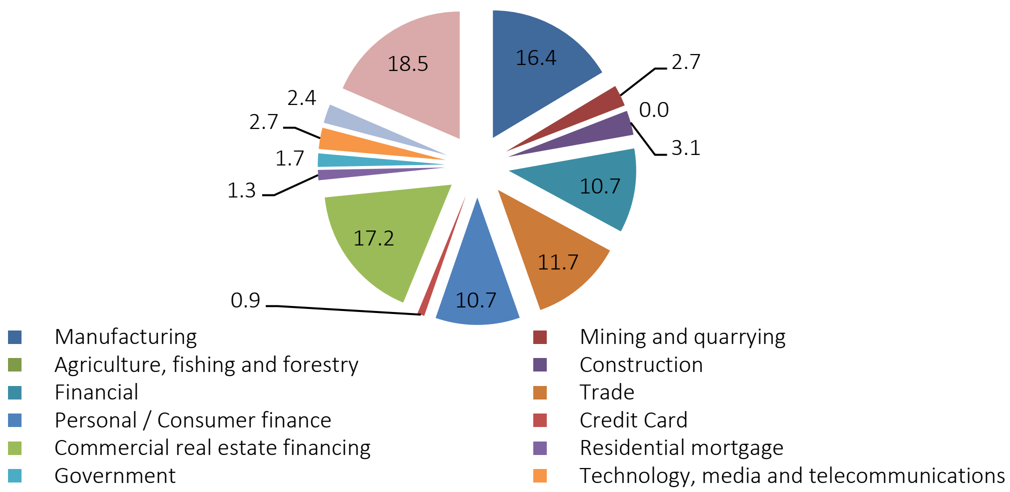
	Mar. 2017	Sep. 2017	Change
Manufacturing	17.0	16.4	(0.6)
Mining and quarrying	2.7	2.7	0.0
Agriculture, fishing and forestry	0.1	0.0	(0.1)
Construction	3.7	3.1	(0.6)
Financial	9.8	10.7	0.9
Trade	12.5	11.7	(0.8)
Personal / Consumer finance	10.2	10.7	0.5
Credit Card	0.8	0.9	0.1
Commercial real estate financing	15.8	17.2	1.4
Residential mortgage	1.3	1.3	0.0
Government	0.7	1.7	1.0
Technology, media and telecommunications	3.4	2.7	(0.7)
Transport	3.1	2.4	(0.7)
Other sectors	18.9	18.5	(0.4)
Top two recipient sectors	**35.9**	**35.7**	**(0.2)**
Real Estate/ Construction Exposure**	**20.8**	**21.6**	**0.8**

Source: CBB.

**Figures may not add to a hundred due to rounding*

*** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-4: Overseas CR Bank's Lending Distribution by Sector (% Total Loans)



Source: CBB.

The top two recipients of loans ("Commercial Real Estate Financing" and "Manufacturing") jointly accounted for 35.7% of total loans. Exposure to real estate/ construction was 21.6% of total lending in September 2017, increasing from 20.8% in March 2017.

Increase in local retail bank profitability

Profitability of the banks was positive. As at end-September 2017, return-on-assets (ROA) increased to reach 1.2%. ROA for *locally incorporated banks* increased to 1.5% in September 2017 from 1.3% in

September 2016. For *overseas banks*, ROA increased from 0.6% in September 2016 to 0.8% in September 2017. Return-on-equity (ROE) for *locally incorporated banks* decreased from 11.4% to 10.3% in September 2017 over the same period.

Net interest income (as a % of total income) increased from 73.9% in September 2016 to 74.5% in September 2017. On the other hand, operating expenses as a proportion of total income decreased significantly from 47.5% in September 2016 to 43.0% in September 2017.

Table 4-7: CR Bank's Profitability (%)

	Sep. 2016	Sep. 2017
ROA *	1.1	1.2
ROA Locally Incorporated Banks	1.3	1.5
ROA Overseas Banks	0.6	0.8
ROE**	11.4	10.3
Net interest income (% total income)	73.9	74.5
Operating expenses (% total income)	47.5	43.0

Source: CBB

**ROA = ratio of net income to assets.*

***ROE = ratio of net income to tier 1 capital (for locally incorporated banks only).*

Liquidity position increased

Between March 2017 and September 2017, bank deposits decreased while non-bank deposits increased for retail banks. Bank deposits decreased to 21.7% in September 2017. Non-bank deposits increased to 78.3% over the same period. The overall loan-deposit ratio for the segment decreased from 71.7% in March 2017 to 68.7% in September 2017. Liquid assets as a proportion of total assets increased over the period of March 2017 to September 2017 to reach 35.8%, respectively. Similarly, liquid assets as a proportion of the short-term liabilities presented an increase from 39.1% to 45.3% over this period.

Table 4-8: CR Bank's Liquidity (%)

	March 2017	Sep. 2017
Liquid Asset Ratio	24.6	35.8
Loan-Deposit Ratio	71.7	68.7
Non-Bank Deposits as a % of total deposits	77.6	78.3

Source: CBB.

The significant increase in the liquid asset ratio was due to the increase in the liquid assets of conventional retail overseas/branches banks. The liquid asset ratio for overseas retail banks increased by 28.4% from 14.5% in March 2017 to 42.9% in September 2017. This significant increase was mainly due to the increase in the liquid assets of National Bank of Kuwait (NBK) with liquid increasing from 0 to BD 2.9 billion and having liquid asset ratio of 54.4% in September 2017.

4.3 Conventional Wholesale Banks

Increase in capital adequacy [7]

As at end-September 2017, the regulatory capital adequacy ratio for locally-incorporated wholesale banks was 19.2%, an increase from the 18.1% registered in March 2017. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) also increased by 1.2% to 18.2% in September 2017 from the 17.0% recorded in March 2017. Furthermore, the leverage ratio (ratio of assets over capital) also witnessed an increase from the 6.8% in March 2017 to 7.0% in September 2017. Finally, the ratio of non-performing loans (NPLs) net of provisions to capital also increased from 4.7% in March 2017 to 5.6% in September 2017. The increase in the CAR and Tier 1 CAR in conventional wholesale banks is not due to an increase in total capital of locally incorporated conventional wholesale banks (which showed only an increase of 1.5%). The change is attributed to a decrease in Risk Weighted Assets (RWA) for the locally incorporated conventional wholesale banks decreasing by 7.0% between March 2016 and September 2017. Investcorp Bank was the reason for this decrease, where the RWAs of the bank decreased by a notable 43% causing its CAR to increase by 12.7% from 17.3% to 29.9%.

Table 4-9: Local CW Bank's Capital Provisions Ratios

Indicator	Mar. 2017	Sep. 2017
CAR (%)	18.1	19.2
Tier 1 CAR (%)	17.0	18.2
Leverage (assets/capital)(times)	6.8	7.0
NPLs net of provisions to capital (%)	4.7	5.6

Source: CBB.

Non-performing loans remain constant

As at end-September 2017, loans classified as non-performing remained unchanged at 5.6% of total loans. The NPL ratio of *Locally-incorporated wholesale banks* increased from 4.2% to 4.5% in September 2017. Additionally, *overseas wholesale* banks witnessed a decrease in its NPL ratio from 7.4% to 6.9% over the same period.

Table 4-10: CW Bank's NPL Ratios

Indicator	Mar. 2017	Sep. 2017
NPL's (% Gross Loans)	5.6	5.6
NPL's Local Banks	4.2	4.5
NPL's Overseas Banks	7.4	6.9
Specific provisions (% of NPLs) *	67.9	64.9
Net NPLs (% of net loans)	1.9	2.1

Source: CBB.

** Specific provisions as a percentage of NPL's are calculated as specific provisions divided by gross impaired loans minus interest in suspense.*

[7] The capital adequacy ratio relates total capital to risk-weighted assets. The discussion excludes overseas wholesale banks, which do not have prescribed capital levels or ratios.

Specific provisions as a proportion of NPLs also witnessed a decrease as well from 67.9% in March 2017 to 64.9% in September 2017. The net NPLs as a % of total loans increased from 1.9% in March 2017 to 2.1% in September 2017.

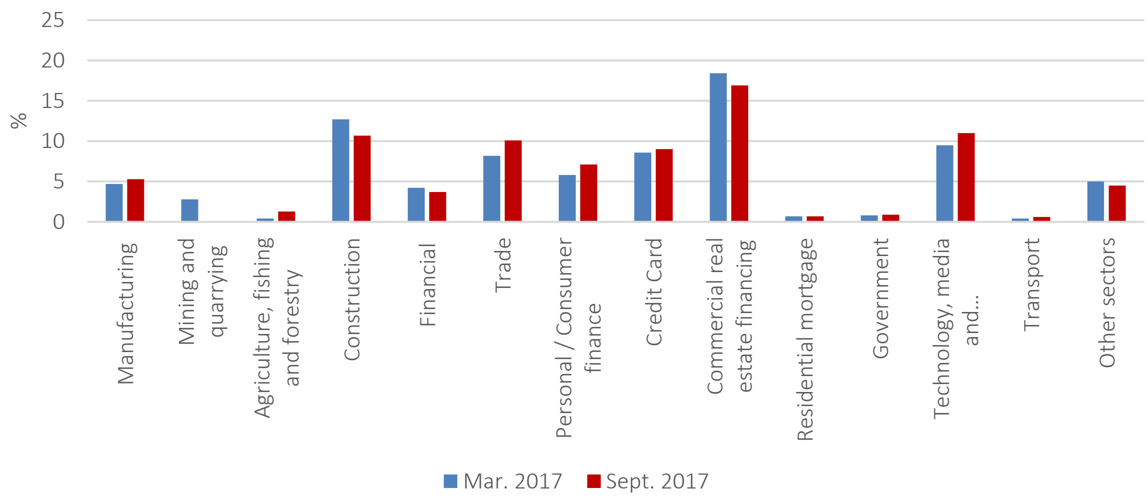
Table 4-12 depicts data on the sectoral breakdown of impaired loans, it demonstrates that impairment in the "Commercial real estate financing" was the highest between all sectors at 16.9% followed by the "Technology, media, and telecommunications" sector with an impairment of 11.0%. The biggest increases were in the "Trade" sector which increased by 1.9% followed by "Technology, media, and telecommunications" which increased by 1.5%. The greatest decrease in impairment was found in the "Mining and quarrying" sector which decreased by 2.7%.

Table 4-11: CW Bank's NPL Ratios by Sector (%)

	Mar. 2017	Sep. 2017	Change
Manufacturing	4.7	5.3	0.6
Mining and quarrying	2.8	0.1	(2.7)
Agriculture, fishing and forestry	0.4	1.3	0.9
Construction	12.7	10.7	(2.0)
Financial	4.2	3.7	(0.5)
Trade	8.2	10.1	1.9
Personal / Consumer finance	5.8	7.1	1.3
Credit Card	8.6	9.0	0.4
Commercial real estate financing	18.4	16.9	(1.5)
Residential mortgage	0.7	0.7	0.0
Government	0.8	0.9	0.1
Technology, media and telecommunications	9.5	11.0	1.5
Transport	0.4	0.6	0.2
Other sectors	5.0	4.5	(0.5)

Source: CBB.

Chart 4-5: CW Bank's NPL Ratios by Sector (%)



Source: CBB.

Loan portfolios remains concentrated despite decreases in some sectors

An examination of lending patterns as at end-September 2017 shows that, for conventional wholesale banks, the top recipient of loans remains to be the "Financial" sector, which accounted for 19.3% of total loans in September 2017 representing a decrease of 1.8% compared to March 2017 (Table 4-13 and Chart 4-6).

Table 4-12: CW Bank's Lending Distribution by Sector (% Total Loans)*

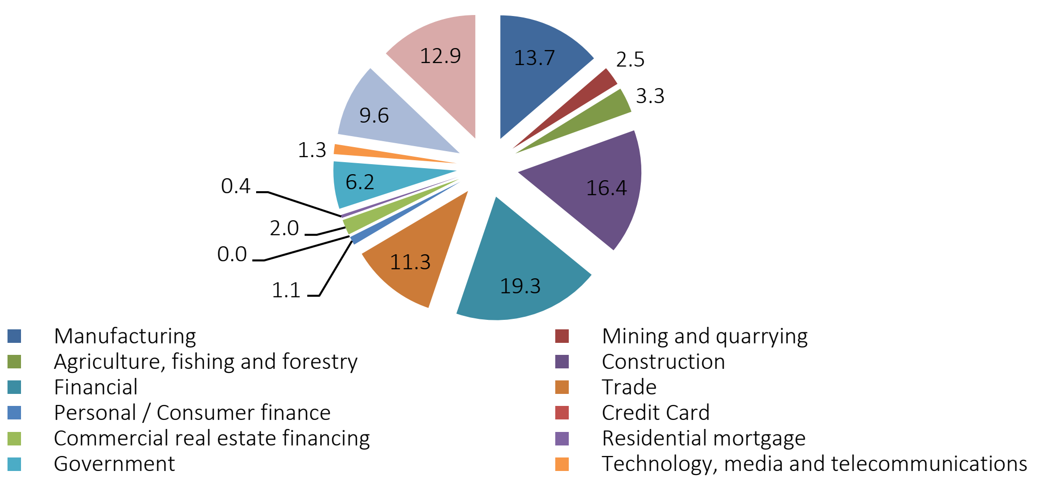
	Mar. 2017	Sep. 2017	Change
Manufacturing	15.0	13.7	(1.3)
Mining and quarrying	2.5	2.5	0.0
Agriculture, fishing and forestry	3.4	3.3	(0.1)
Construction	14.3	16.4	2.1
Financial	21.1	19.3	(1.8)
Trade	11.6	11.3	(0.3)
Personal / Consumer finance	1.1	1.1	0.0
Credit Card	0.0	0.0	0.0
Commercial real estate financing	1.9	2.0	0.1
Residential mortgage	0.3	0.4	0.1
Government	7.3	6.2	(1.1)
Technology, media and telecommunications	1.6	1.3	(0.3)
Transport	9.5	9.6	0.1
Other sectors	10.4	12.9	2.5
Top two recipient sectors	**36.1**	**35.7**	**(0.4)**
Real Estate/ Construction Exposure**	**16.5**	**18.7**	**2.2**

Source: CBB.

**Figures may not add to a hundred due to rounding.*

*** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-6: CW Bank's Lending Distribution by Sector (% Total Loans)



Source: CBB.

The top two sectors in Conventional Wholesale Banks' Lending as a % of total loans are the "Financial" and "Construction" sectors, they jointly account for 35.7% of total lending in September 2017. This varies from the top two sectors in Q12017 which were held by the "Financial" and "Manufacturing" sectors. For *locally-incorporated wholesale banks,* the top recipient of loans is the "Financial" sector, which accounted for 22.5% of total loans in September 2017, representing a decrease from the 23.2% in March 2017 (Table 4-14 and Chart 4-7).

Table 4-13: Local CW Bank's Lending Distribution by Sector (% Total Loans)

	Mar. 2017	Sep. 2017	Change
Manufacturing	21.3	19.0	(2.3)
Mining and quarrying	1.0	1.0	0.0
Agriculture, fishing and forestry	6.2	6.3	0.1
Construction	6.7	7.5	0.8
Financial	23.2	22.5	(0.7)
Trade	14.8	14.8	0.0
Personal / Consumer finance	1.8	1.8	0.0
Credit Card	0.0	0.0	0.0
Commercial real estate financing	2.1	2.0	(0.1)
Residential mortgage	0.6	0.7	0.1
Government	3.5	3.8	0.3
Technology, media and telecommunications	1.4	1.0	(0.4)
Transport	8.8	9.3	0.5
Other sectors	8.6	10.2	1.6
Top two recipient sectors	**44.5**	**41.5**	**(3.0)**
Real Estate/ Construction Exposure**	**9.5**	**10.3**	**0.8**

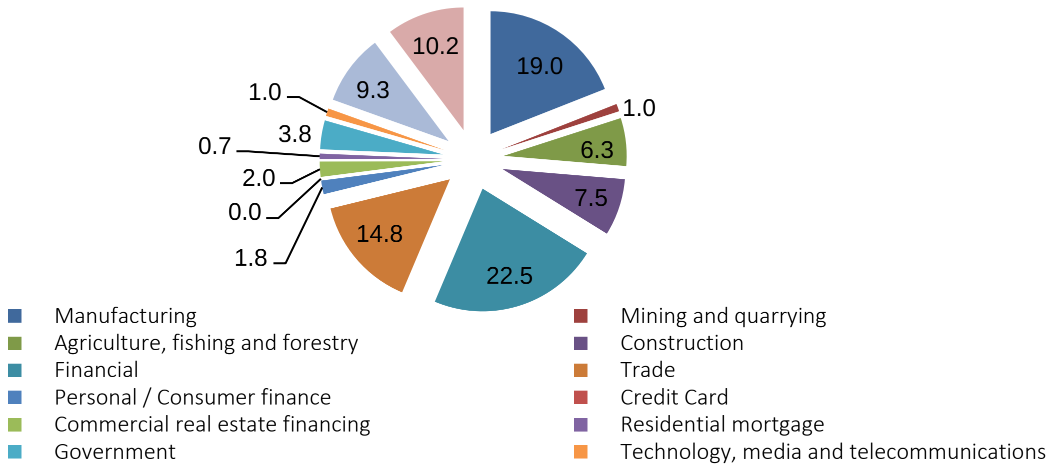
**Figures may not add to a hundred due to rounding.*

*** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Source: CBB.

The highest two sectors continue to be the ("Financial" and "Manufacturing") accounting for 41.5% of total lending in September 2017 while real estate/ construction exposure increased to 10.3% from 9.5`%.

Chart 4-7: Local CW Bank's Lending Distribution by Sector (% Total Loans)



Source: CBB.

While observing *overseas wholesale banks*, the top recipient of loans in September 2017 was the "Construction" sector, with 25.6% of total loans, followed by the "Financial" sector, with 16.0% of total loans, and the "Other" sector with an increase from 12.6% to 15.8% (Table 4-15 and Chart 4-8). The top 2 sectors (Financial and Other) jointly represented 41.6% in September 2017, a decrease of 0.6 from March 2017. Real estate/construction exposure increased from 25.1% in March 2017 to 27.6% in September 2017.

Table 4-14: Overseas CW Bank's Lending Distribution by Sector (% Total Loans)

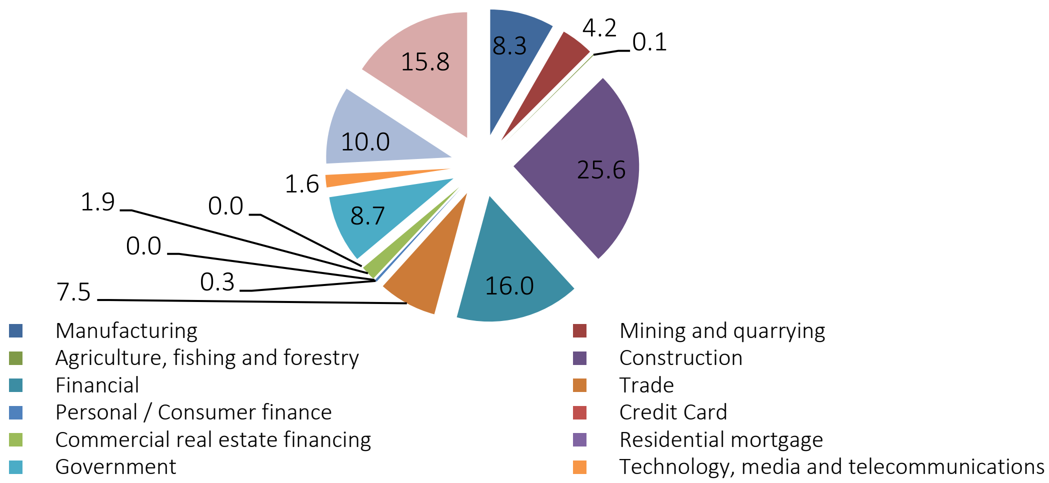
	Mar. 2017	Sep. 2017	Change
Manufacturing	7.3	8.3	1.0
Mining and quarrying	4.3	4.2	(0.1)
Agriculture, fishing and forestry	0.1	0.1	0.0
Construction	23.5	25.6	2.1
Financial	18.7	16.0	(2.7)
Trade	7.8	7.5	(0.3)
Personal / Consumer finance	0.3	0.3	0.0
Credit Card	0.0	0.0	0.0
Commercial real estate financing	1.6	1.9	0.3
Residential mortgage	0.0	0.0	0.0
Government	11.8	8.7	(3.1)
Technology, media and telecommunications	1.8	1.6	(0.2)
Transport	10.3	10.0	(0.3)
Other sectors	12.6	15.8	3.2
Top two recipient sectors	**42.2**	**41.6**	**(0.6)**
Real Estate/ Construction Exposure**	**25.1**	**27.6**	**2.5**

Source: CBB.

**Figures may not add to a hundred due to rounding.*

*** Real Estate/ Construction exposure is the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 4-8: Overseas CW Bank's Lending Distribution by Sector (% Total Loans)



Source: CBB.

Positive earnings for wholesale banks

ROA for the conventional wholesale banking sector was at 0.8% in September 2017, an increase from the 0.6% in September 2016. The ROA for *local wholesale banks* increased from 0.4% to 0.5% over the same period. ROA for overseas wholesale banks also increased from 0.9% to 1.1% over the same period.

ROE for *local wholesale banks* decreased from 2.6% to 3.4%. Net interest income as a proportion of total income decreased from 61.0% to 57.6% in September 2017. Operating expenses as a proportion of total income showed a decrease from 53.2% in September 2016 to 48.1% in September 2017.

Table 4-15: CW Bank's Profitability (%)

	Sep. 2016	Sep. 2017
ROA *	0.6	0.8
ROA Locally Incorporated Banks	0.4	0.5
ROA Overseas Banks	0.9	1.1
ROE**	2.6	3.4
Net interest income (% total income)	61.0	57.6
Operating expenses (% total income)	53.2	48.1

Source: CBB.

**ROA = ratio of net income to assets.*

***ROE = ratio of net income to tier 1 capital (for locally incorporated banks only).*

Liquidity position decreases

As at end-September 2017, the overall loan-deposit ratio for conventional wholesale banks stood at 61.1%, an increase from the 60.2% in March 2017. The loan deposit ratio for *local wholesale banks* decreased to 59.6% in September from 68.1% in March 2017. Over the same period, the loan deposit ratio for *overseas wholesale* bank stood at 62.8% increasing from 52.6%.

Liquid assets for wholesale banks as a proportion of total assets decreased to 21.9% in September 2017 from 27.4% in March 2017. *Locally incorporated wholesale banks* are the contributor to the decrease in liquidity over this period where their liquid asset ratio decreased by 9.1% from the 36.7% in March 2017 to 27.6% in September 2017. *Overseas wholesale banks* had a ratio of 15.1%, a decrease from 16.7% registered in March 2017.

The liquid assets as a proportion of short-term liabilities decreased to 33.5% from 37.6% in March 2017. Lastly, the deposits from non-bank sources as a proportion of total deposits stood at 47.1%, an increase from the 46.2% level achieved in March 2017, bank deposits decreased from 53.8% in March 2017 to 53.0% in September 2017.

Table 4-16: CW Bank's Liquidity (%)

	Mar. 2017	Sep. 2017
Liquid Asset Ratio	27.4	21.9
Loan-Deposit Ratio	60.2	61.1
Non-Bank Deposits as a % of total deposits	46.2	47.1

Source: CBB.

4.4 Overall Assessment of the Conventional Banking Sector

The financial soundness indicators show that conventional banks witnessed a slight increase in capital adequacy ratio. Capital adequacy ratios for conventional retail banks increased to 20.4% in September 2017. Capital adequacy ratio for conventional wholesale banks increased to 19.2% over the same period. Non-performing loans have shown a slight increase between periods of March 2017 to September 2017 from 5.7% to 5.8%, for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing were unchanged at 5.6% in September 2017 compared to March 2017. Loan concentration remains high for conventional retail and decreased for wholesale banks from 36.1% to 35.7%.

As at end-September 2017, return-on-assets (ROA) nearly remained constant at 1.2% for conventional retail banks and for conventional wholesale banks stood at 0.8%. Return-on-equity (ROE) for *local retail banks* decreased from 11.4% in September 2016 to 10.3% in September 2017. ROE for *local wholesale banks* decreased from 2.6% to 3.4% over the same period. For conventional retail banks, liquid assets as a proportion of total assets slightly increased over the period of March 2017 to September 2017 to reach 35.8% due to increase in liquid assets of conventional retail branches. Liquid assets for wholesale banks as a proportion of total assets decreased from 27.4% in March 2017 to 21.9% in September 2017.

5. Islamic Banks

Key Points

- Capital positions for Islamic retail and wholesale banks increased.
- Decrease in non-performing facilities (NPFs) for Islamic retail banks and increase in wholesale banks.
- Concentration of facilities for both Islamic retail banks and Islamic wholesale Banks continues.
- Earnings remained positive for Islamic retail and declines for Islamic wholesale banks.
- Liquidity positions decreased for Islamic retail banks while it increase for Islamic wholesale banks.

Chapter 5

5.1 Overview

This chapter analyzes the banking sector under the following categories: Islamic retail banks (section 5.2) and Islamic wholesale banks (section 5.3). Section 5.4 provides an overall assessment of the Islamic banking industry. Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations), as at end-March 2017 and compared with end-September 2017. This chapter offers macroprudential analysis of the Islamic banking sector based on a set of selected Financial Soundess Indicators (FSIs).[8]

5.2 Islamic Retail Banks

Increase in capital positions

The CAR of Islamic retail banks increased from 17.1% in March 2017 to 18.2% in September 2017. Tier 1 capital remained unchanged at 15.3% in September 2017. The increase in the CAR for Islamic retail banks was due to the increase in the CAR of Kuwait Finance House (KFH). The increase was not due to an increase in the available capital, however it was due to a decrease in the RWAs of the bank by 50.8% causing the CAR to increase from 16.6% in March 2017 to 22.7% in September 2017.

[8]This chapter does not contain a section on stress testing. Stress Testing exercises are performed separately in an internal report to obtain information on the potential quantitative impact of hypothetical scenarios on selected Bahraini Systemically-Important Banks (SIB's).

Table 5-1: IR Capital Provisions Ratios -

Indicator	Mar. 2017	Sep. 2017
CAR (%)	17.1%	18.2%
Tier 1 CAR (%)	15.3%	15.3%
NPFs net of provisions to capital	27.2%	26.1%

Source: CBB.

The ratio of non-performing facilities (NPFs) net of provisions to capital decreased from 27.2% to 26.1% for the same period.

Continuing decrease in non-performing facilities

Non-performing facilities (NPF) ratio decreased to 9.0% in September 2017, compared to 10.1% in March 2017. Specific Provisoining increased from 39.9% in March 2017 to 44.1% in September 2017.

Table5-2: IR NPF Ratios

Indicator	Mar. 2017	Sep. 2017
NPFs (% Gross Facilities)	10.1	9.0
Specific Provisions (% of NPFs)	39.9	44.1

Source: CBB.

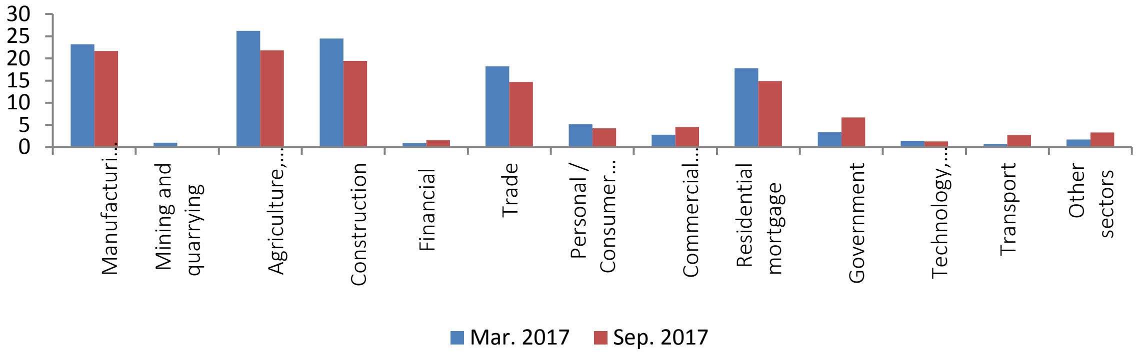
A look at the non-performing facilities by sector indicates that the “Agriculture,fishingand forestry” sector had the highest impairment of 21.8% in September 2017 followed by “Manufacturing” and “constraction” with 21.7% and 19.4% respectively. The biggest declines in NPF’s by sector was in the “constraction” Sector with a 5.1% decrease in NPFs from March 2017 to September 2017. The biggest increase in NPF’s was the “Residential mortgage” sector with an increase of 3.3%.

Table 5-3: IR NPF Ratios by Sector (%)

	Mar. 2017	Sep. 2017	Change
Manufacturing	23.2	21.7	(1.5)
Mining and quarrying	1.0	0.1	(0.9)
Agriculture, fishing and forestry	26.2	21.8	(4.4)
Construction	24.5	19.4	(5.1)
Financial	0.9	1.6	0.7
Trade	18.2	14.7	(3.5)
Personal / Consumer finance	5.2	4.2	(1.0)
Credit Card	2.8	4.5	1.7
Commercial real estate financing	17.8	14.9	(2.9)
Residential mortgage	3.4	6.7	3.3
Government	1.4	1.3	(0.1)
Technology, media and telecommunications	0.7	2.7	2.0
Transport	1.7	3.3	1.6
Other sectors	8.8	3.5	(5.3)

Source: CBB.

Chart 5-1: IR NPF Ratios by Sector (%)



Source: CBB.

Diversification in asset concentration (loan portfolio)

There have been a diversification in the asset concentration among most of the sectors. At the end of September 2017, the top recipient of financing was "Personal / Consumer finance" at 22.3% up from 20.8% in March 2017. The top two recipients of financing ("Personal / Consumer finance" and "Financial") accounted for 37.6 of total facilities extended compared to 37.1% for the top two sectors in September 2017. Moreover, the share of "Commercial real estate financing" sector declined from 12.9% in March 2017 to 11.4% in September 2017.

"Real Estate/ Construction" exposure slightly decreased from 25.6% in March 2017 to 24.0% in September 2017.

Table 5-4: IR Lending Distribution by Sector (%Total Facilities)*

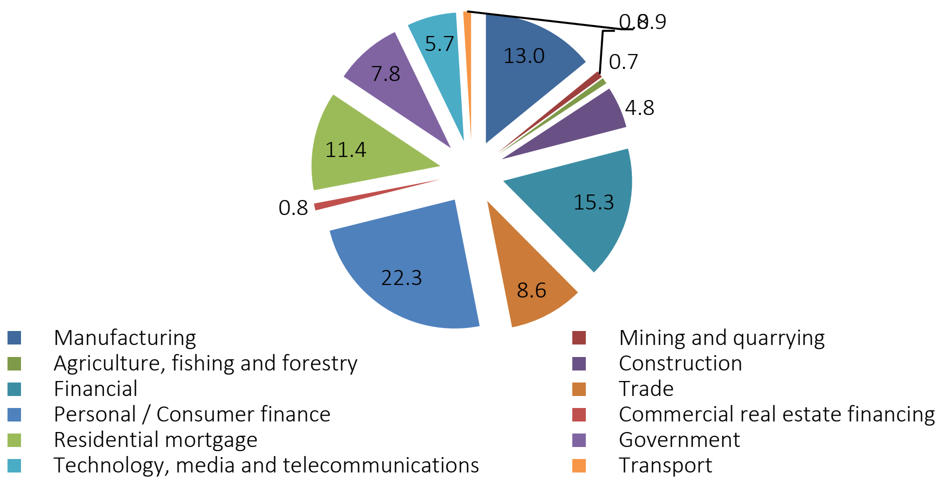
	Mar. 2017	Sep. 2017	Change
Manufacturing	13.2	13.0	(0.2)
Mining and quarrying	0.6	0.8	0.2
Agriculture, fishing and forestry	0.6	0.7	0.1
Construction	3.7	4.8	1.1
Financial	16.3	15.3	(1.0)
Trade	8.4	8.6	0.2
Personal / Consumer finance	20.8	22.3	1.5
Credit Card	0.8	0.8	0.0
Commercial real estate financing	12.9	11.4	(1.5)
Residential mortgage	9.0	7.8	(1.2)
Government	5.8	5.7	(0.1)
Technology, media and telecommunications	0.8	0.9	0.1
Transport	0.9	0.8	(0.1)
Other sectors	6.3	7.1	0.8
Top two recipient sectors	**37.1**	**37.6**	**0.5**
Real Estate/ Construction Exposure**	**25.6**	**24.0**	**(1.6)**

Source: CBB.

**Figures may not add to a hundred due to rounding*

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

Chart 5-2: IR Lending Distribution by Sector (%Total Facilities)



Source: CBB.

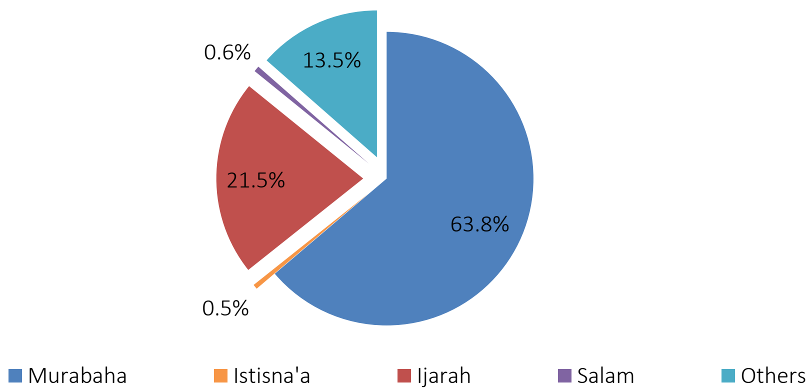
Lending distribution by Islamic instrument remained nearly unchanged over the past quarter. At the end of September 2017, the top recipient of finance was "Murabaha" at 63.8% down from 65.3% in March 2017. This was followed by "Ijarah", which increased from 21.0% to 21.5% for the same period.

Table 5-5: IR Lending Distribution by Islamic Instrument (%Total Facilities)*

	Mar. 2017	Sep. 2017	Change
Murabaha	65.3	63.8	-1.5
Istisna'a	0.6	0.5	-0.1
Ijarah	21.0	21.5	0.5
Salam	0.6	0.6	0.0
Others	12.6	13.5	0.9

**Figures may not add to a hundred due to rounding.*
Source: CBB.

Chart 5-3: IR Lending Distribution by Islamic Instrument (%Total Facilities)



Source: CBB.

Growth in earnings

The return on assets (ROA) for Islamic retail banks increased to reach 0.4% in September 2017 compared to 0.2% in September 2016. Return on equity (ROE) also increased from 1.6% to 4.5% for the same period. In contrast, operating expenses decreased from 82.9% in September 2016 to 78.2% in September 2017.

Table 5-6: IR Profitability (%)

	Sep. 2016	Sep. 2017
ROA*	0.2	0.4
ROE**	1.6	4.5
Operating expenses (% total operating income)	82.9	78.2

Source: CBB

** ROA = ratio of net income to assets*

***ROE = ratio of net income to tier 1 capital*

Minor decrease in liquidity

The volume of liquid assets available to Islamic retail banks decreased from 12.4% of total assets in March 2017 to 11.5% in September 2017. The ratio of total facilities to deposits increased from 86.3% in March 2017 to 89.1% in September 2017.

Table 5-7: IR Liquidity (%)

Indicator	Mar. 2017	Sep. 2017
Liquid Assets (% of total assets)	12.4	11.5
Facilities – deposits ratio (%)	86.3	89.1

Source: CBB.

5.3 Islamic Wholesale Banks

Growth in capital positions

As at end-September 2017, the CAR for Islamic wholesale banks increased from 18.5% in March 2017 to 18.8% in September 2017. Tier1 capital increased from 17.8% to 18.3% over the same period. The ratio of NPFs net of provisions to capital decreased from 0.5% to 0.3%.

Table 5-8: IW Capital Provisions Ratios

Indicator	Mar. 2017	Sep. 2017
CAR (%)	18.5	18.8
Tier 1 CAR (%)	17.8	18.3
NPFs net of provisions to capital	0.5	0.3

Source: CBB.

Increasing non-performing facilities (NPFs)

As of end-September 2017, NPF ratio for Islamic wholesale banks decreased to 2.4%. Provisioning for NPF's increased from 93.8% to 95.8% over the same period.

Table 5-9: IW NPF Ratios

Indicator	Mar. 2017	Sep. 2017
NPFs (% Gross Facilities)	2.6	2.4
Specific Provisioning (% of NPFs)	93.8	95.8

Source: CBB.

The sector with the highest impairment was the "Technology, media and telecommunications" sector with 48.5% in September 2017, up from the 44.4% in March 2017. This was followed by the "Mining and quarrying" and "Construction" sectors.

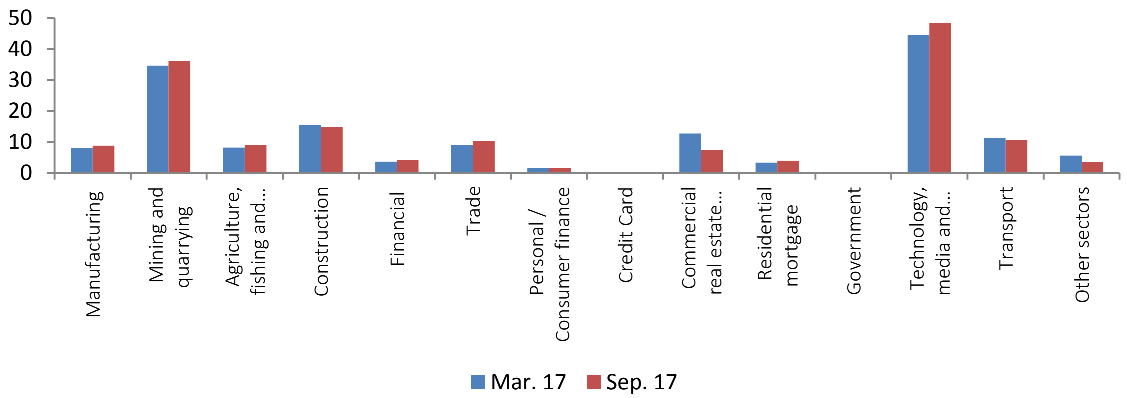
Table 5-10: IW NPF Ratios by Sector (%)

	Mar. 2017	Sep. 2017	Change
Manufacturing	8.1	8.8	0.7
Mining and quarrying	34.6	36.2	1.6
Agriculture, fishing and forestry	8.2	9.0	0.8
Construction	15.5	14.8	(0.7)
Financial	3.6	4.1	0.5
Trade	9.0	10.2	1.2
Personal / Consumer finance	1.6	1.6	0.0
Credit Card	0.0	0.0	0.0
Commercial real estate financing	12.7	7.5	(5.2)
Residential mortgage	3.3	3.9	0.6
Government	0.0	0.0	0.0
Technology, media and telecommunications	44.4	48.5	4.1
Transport	11.3	10.6	(0.7)
Other sectors	5.6	3.6	(2.0)

Source: CBB.

Available data on the sectoral breakdown of non-performing facilities shows that the biggest increase was in the "Technology, media and telecommunications" sector with an increase of 4.1%. The biggest drop was in the "Commercial real estate financing" with a decrease of 5.2% from 12.7% in March 2017 to 7.5% in September 2017.

Chart 5-4: IW NPF Ratios by Sector (%)



Source: CBB.

Decreases in asset concentration (loan portfolio)

At end-September 2017, the "Manufacturing" sector was the top recipient of financing from Islamic wholesale banks, at 25.3%, surpassing "constructions" which had a 0.7% drop. The Financial Sector increased from 9.9% in March 2017 to 13.4% in September 2017.

Table 5-11: IW Lending Distribution by Sector (%Total Facilities)*

	Mar. 2017	Sep. 2017	Change
Manufacturing	25.9	25.3	(0.6)
Mining and quarrying	1.3	1.2	(0.1)
Agriculture, fishing and forestry	1.1	1.0	(0.1)
Construction	14.6	13.9	(0.7)
Financial	9.9	13.4	3.5
Trade	10.5	9.3	(1.2)
Personal / Consumer finance	8.3	7.6	(0.7)
Credit Card	0.0	0.0	0.0
Commercial real estate financing	1.7	1.9	0.2
Residential mortgage	3.6	3.3	(0.3)
Government	6.6	6.4	(0.2)
Technology, media and telecommunications	0.3	0.2	(0.1)
Transport	1.8	1.7	(0.1)
Other sectors	14.4	14.8	0.4
Top two recipient sectors	**40.5**	**40.1**	(0.4)
Real Estate/ Construction Exposure**	**19.9**	**19.1**	(0.8)

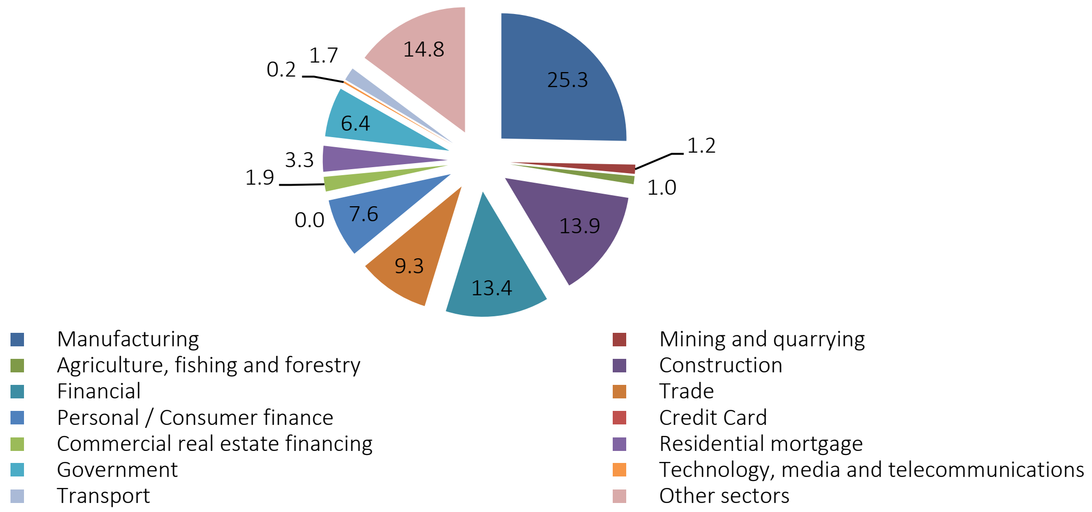
Source: CBB

**Figures may not add to a hundred due to rounding*

*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*

The top two recipient sectors in September 2017 ("Manufacturing" and "Construction") jointly represented 40.1% of total financing, down from 40.5% in March 2017. Real estate/ construction exposure decreased to 19.1% in September 2017 from 19.9% in March 2017.

Chart 5-5: IW Lending Distribution by Sector (%Total Facilities)



Source: CBB

Lending distribution by Islamic instrument shows that at the end of September 2017, the top recipient of finance was "Murabaha" at 90.1%.

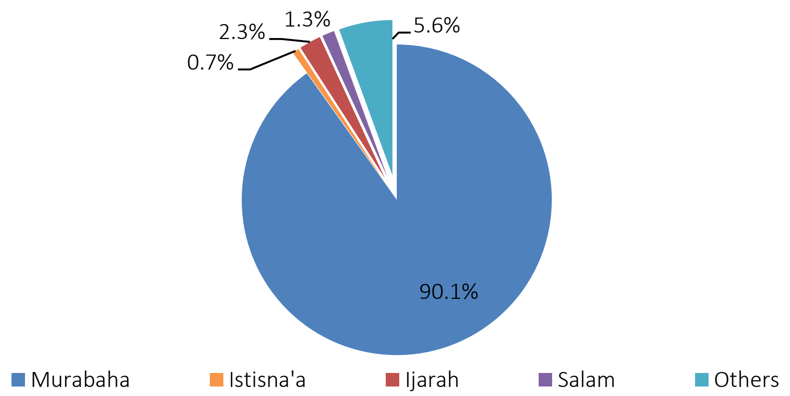
Table 5-12: IW Lending Distribution by Islamic Instrument (%Total Facilities)

	Mar. 2017	Sep. 2017	Change
Murabaha	90.3	90.1	(0.20)
Istisna'a	0.7	0.7	0.00
Ijarah	2.5	2.3	(0.20)
Salam	1.2	1.3	0.10
Others	5.3	5.6	0.30

**Figures may not add to a hundred due to rounding.*

Source: CBB.

Chart 5-6: IW Lending Distribution by Islamic Instrument (%Total Facilities)



Source: CBB.

Decrease in earnings

The earnings performance of Islamic wholesale banks decreased over the period from September 2016 to September 2017. Return on assets (ROA) decreased from 1.1% in September 2016 to 0.8% in September 2017. Return on equity (ROE) also decreased as well from 7.4% to 5.0% in September 2017. Also, operating expenses (as % of total income) decreased from 74.0% in September 2016 to 68.3% in September 2017.

Table 5-13: IW Profitability (%)

	Sep. 2016	Sep. 2017
ROA*	1.1	0.8
ROE**	7.4	5.0
Operating expenses (% total operating income)	74.0	68.3

Source: CBB.

** ROA = ratio of net income to assets.*

***ROE = ratio of net income to tier 1 capital.*

Liquidity position stable with no significant change

As of end-September 2017, liquid assets of Islamic wholesale banks represented 22.9% of total assets, 1.3% higher than the 21.6% registered in March 2017. Additionally, the facilities deposit ratio increased from 61.3% to 61.4% in September 2017.

Table 5-14: IW liquidity (%)

Indicator	Mar. 2017	Sep. 2017
Liquid assets (% of total)	21.6	22.9
Facilities-deposit ratio	61.3	61.4

Source: CBB.

5.4 Overall Assessment of the Islamic Banking Sector

The financial soundness indicators show that Islamic retail banks and wholesale banks capital positions increased to 18.2% and 18.8% respectively during the period between March 2017 and September 2017. Non-performing facilities decreased for Islamic retail and increased for Islamic wholesale to reach 9.0% and 7.4% respectively. Facilities concentration has decreased in some sectors while increasing in others in retail Islamic banks and wholesale Islamic banks.

Earnings declined for Islamic wholesale banks while ROE and ROA increased for Islamic retail banks. Islamic retail banks experienced slight changes in its liquidity position as the facilities to deposits ratio increased while the liquid asset ratio decreased. Islamic wholesale's liquidity positions showed an increase in liquid assets and in facilities to deposit ratio.

Part III:

Developments in the Non-Banking Financial Sector

6. Performance of the Insurance Sector

Chapter

6

Key Points

- Conventional firms account for 77.6% of total insurance industry with BD 204.1 in total gross premiums as of September 2017.
- General insurance contributes for 81.7% of total gross premiums.
- Takaful and Local Conventional insurance firms' performance is concentrated on Motor business line.
- Overseas insurance firms' performance is concentrated on Long-term (Life) business line,
- ROA remains stable and positive whereas ROE increased.

6.1 Overview

This chapter highlights the overall performance of the insurance industry in Bahrain by looking at two main insurance segments: conventional and takaful, their different business lines, and classes. [9]

Chapter 6 of the report analyzes data covering the period between end-September 2016 and end-September 2017, unless otherwise indicated.

The insurance industry has been growing steadily in recent years, mirroring the growth of Bahrain's financial sector, the increased access to financial services and products has led to demand for insurance services. A notable development in recent years has been international insurers developing their regional operations, many of whom have chosen Bahrain as their regional base.

A significant number of insurance companies and organizations have established their presence in Bahrain. As of December 2017, there are a total of 144 insurance organizations licensed and registered in the Kingdom. There are 36 insurance companies: 16 conventional local 12 conventional overseas/foreign branches, and 8 takaful. From these companies, 5 companies are conventional re-insurance firms and 2re-takaful firms.

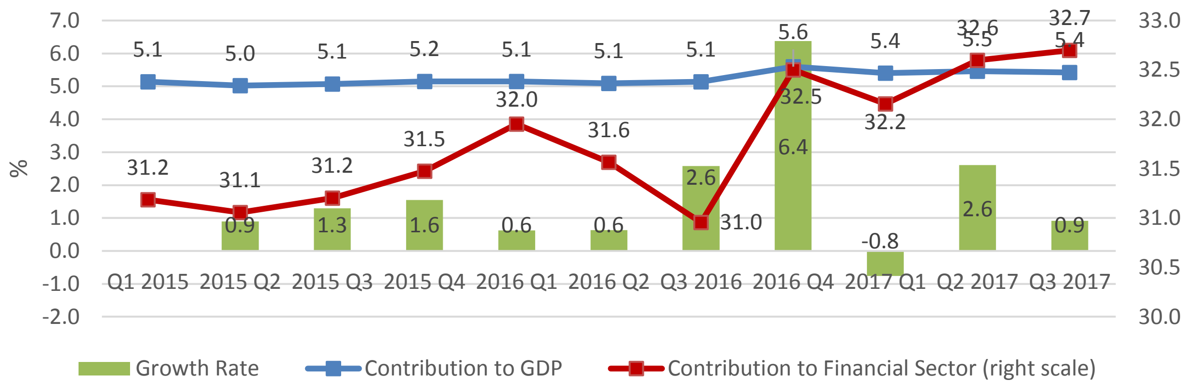
- The remaining 108 other registered insurance licenses include:
  - 32 Insurance Brokers,
  - 4 Insurance Managers,
  - 4 Insurance Consultants,
  - 25 Insurance Firms, brokers and consultants restricted to business outside Bahrain,

[9] Takaful companies are companies conducting takaful business in line with Islamic principles. Overseas insurance companies are branches of foreign companies.

- 29 Registered Actuaries,
- 12 Registered loss Adjusters, and
- 2 Insurance Pools and Syndicates.

As of September 2017, the insurance sector represented 5.4% of the constant GDP, with an annual increase of 9.3% compared to September 2016. The contribution of the Insurance sector to the overall financial sector has remained constant representing 32.7% of the overall financial sector as of September 2017. Chart 6-1 shows the contribution of the Insurance sector to GDP since 2015, along with the quarterly growth rates, and the contribution of the insurance sector to the financial sector.

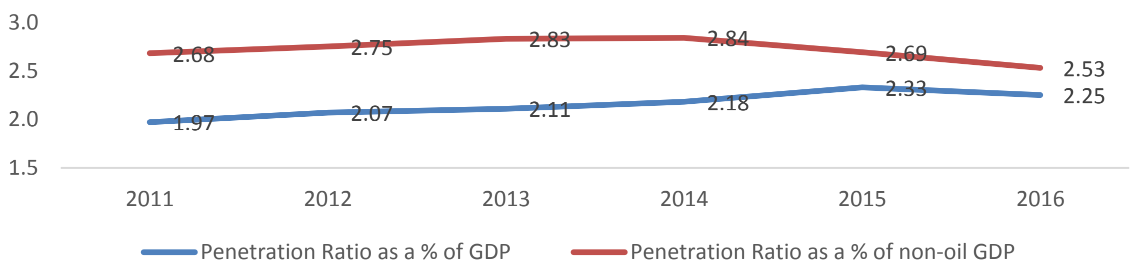
Chart 6-1: Insurance sector Contribution and Growth to GDP



Source: IGA.

As of September 2017, the total gross premiums written in the Industry Kingdom of Bahrain registered at BD 204.1 million compared to the equivalent quarter in 2016 of BD 203.9 million. The importance of the insurance sector to the domestic economy could be presented by the level of the insurance penetration ratio (IPR), which is measured by the ratio of Gross Written Premium (GWP) to current GDP and non-oil GDP. By end of 2016, the gross premiums were around 2.23% of current GDP and 2.5% of current non-oil GDP.

Chart 6-2: Annual trend of Insurance Penetration (GP as % of GDP and non-oil GDP)



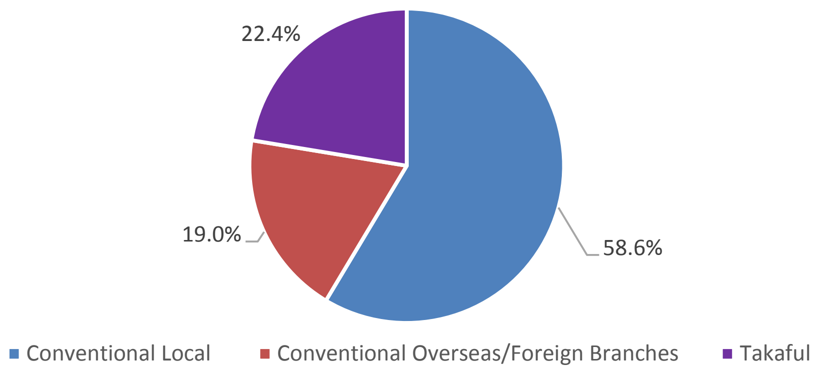
Source: CBB.

6.2 Performance of Overall Insurance Industry

The insurance sector in Bahrain is made up of two main segments: conventional and Takaful. The conventional sector is further divided into local and overseas/branches firms. As of September 2017, conventional insurance represented 77.6% of the total gross premiums accounting for BD 158.4 million. Local conventional and branches represented 58.6% and 19.0% of total gross premiums accounting for

BD 119.6 local and BD38.8 million respectively (Chart 6-3). Takaful firms accounted for BD 45.7 million which is 22.4% of gross premiums in the industry for the same period.

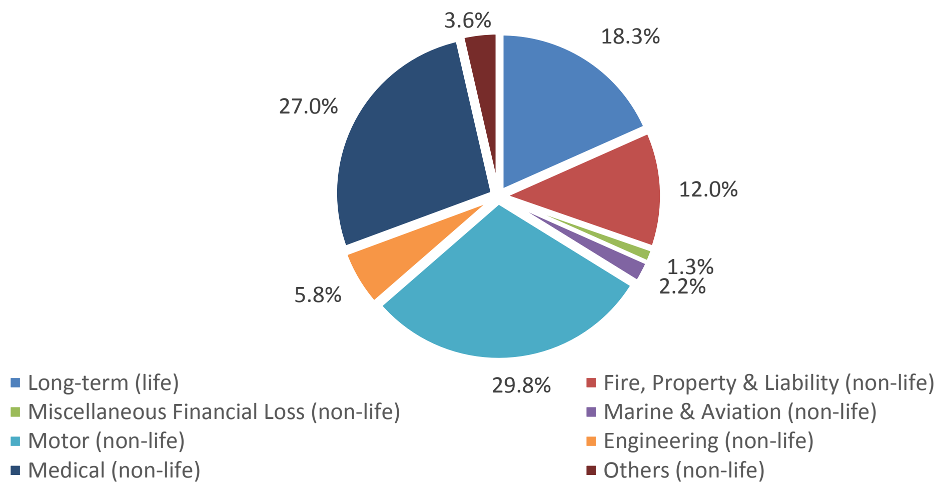
Chart 6-3: Gross Premiums of Insurance Sector by Segment (%)



Source: CBB.

The Insurance products and services in the Kingdom are delivered via two main insurance classes: Life and non-life insurance.[10] As of September 2017, life insurance represented 18.3% of gross premiums while non-life/general insurance represented 81.7% covering the various classes (Graph 6-4).

Chart 6-4: Market Share of Gross Premiums by Business Lines (%)



Source: CBB.

For non-life insurance, motor and medical insurance had the largest share in terms of their contribution to gross premiums accounting for 29.8% and 27.0% respectively. Fire, property, and liability made 12.0% of gross premiums.

The top 3 business lines sectors represented 75.1% of total gross premiums. The high concentration within these sectors can be explained by:

- Banks imposing an obligatory requirement on the customers to have a life insurance prior to getting specific loans.

[10] Non-lice or general insurance includes: Fire, Property & Liability, Miscellaneous Financial Loss, Marine & Aviation, Motor, Engineering, Medical and Others.

- Third party motor insurance being a mandatory requirement.
- Many institutions providing their employees with health insurance.

6.2 Performance of Insurance Sector by Insurance Segment

6.2.1 Conventional Insurance Firms

a. Assets: As of September 2017, total assets of the conventional insurance sector stood at BD 2,191.1 million increasing by 9.2% compared to the BD 2,006.6 million registered in the same quarter of 2016.
   i. Total assets of local insurance Firms were BD 1,930.5 million (81.4% of total assets) with a growth rate of 10.5 since September 2016.
   ii. Total assets of overseas foreign branches were BD 282.3 million (12.5% of total assets) recording a growth of 8.3%
b. Liabilities: As of September 2017, the liabilities of the conventional insurance sector registered at BD 1,687.3 million with a 15.1% increase from the BD 1,466.1 million in September 2016.
   i. The liabilities for local insurance firms registered at BD 1,436.9 million with an increase of 15.8%.
   ii. The liabilities of overseas foreign branches was BD 250.3 million in September 2017 with an increase of 10.9%.
c. Available Capital[11]: Total capital as of September 2017 was at BD 331.5 million decreasing by 3.7% from the BD 344.0 million in the equivalent period of the preceding year.
   i. Total available capital for local insurance was BD 303.8 with a year to year decrease of 3.2%.
   ii. Total available capital for overseas foreign branches insurance dropped by 8.5%. The amount fell from BD 30.2 million in September 2016 to BD 27.7 million in September 2017.

6.2.2 Takaful Insurance Firms

a. Assets: Total assets in takaful firms in September 2017 experienced an annual growth of 3.53% reaching BD 159.1 million compared to BD 153.6 million in September 2016.
b. Liabilities: The liabilities increased, however, in a lower percentage compared to the liabilities increase in conventional insurance firms. The increase of 2.7% from BD 103.7 million in September 2016 to BD 106.5 million in September 2017.
c. Available Capital: Total regulatory capital also experienced an annual increase of 3.6% from BD 44.9 million in September 2017 to BD 46.5 million in September 2017.

[11] As per the CBB Rulebook, equity is a regulatory equity, which means encompasses Tier 1 Capital, Tier 2 Capital and deduction.

6.3 Premiums and Claims Analysis by Class:

6.3.1 Overall Insurance

As of September 2017, the Gross Premiums for the overall insurance sector stood at BD 204.1 million remaining at constant and comparable levels compared to September 2016 (BD 203.9 million). Looking at the performance by class, Marine & Aviation experienced the greatest increase within the rest of the insurance business line, with an annual increase of 10%, followed by Medical and Long-term insurance, both increasing by 7.5% and 6.2% respectively. Whereas on the other hand, Fire, Property & Liability experienced an annual decline by 21% when observing the same period.

As of September 2017 Net Premiums Written were also at constant and comparable levels compared to the previous period registering a value of BD 135.5 million, which is a 2.7% year on year increase from the BD 131.9 million in September 2016. The Engineering class showed the biggest increase in terms of growth over the period increasing by 48.0%, from BD 1.5 million in September 2016 to BD 2.3 million in September 2017. On the other hand, the biggest decline was derived from Others class, decreasing from BD 3.2 million in September 2016 to BD 2.5 million in September 2017.

Gross Claims for the overall insurance industry recorded a significant year on year increase of 89.9% from BD 108.4 million in September 2016 to BD 205.9 million in September 2017. The increase was mainly due to an increase of Fire, Property & Liability business line by 1,672% from BD 3.7 million in September 2016 to BD 65.4 million in September 2017, followed by Engineering class, showing an annual increase of 654% reaching BD 28.3 million in September 2017.

However, Net Claims for the overall insurance industry show a modest increase relative to Gross Claims. An increase of 3.6% was also derived from an annual increase in Fire, Property & Liability business line by 158.1%.

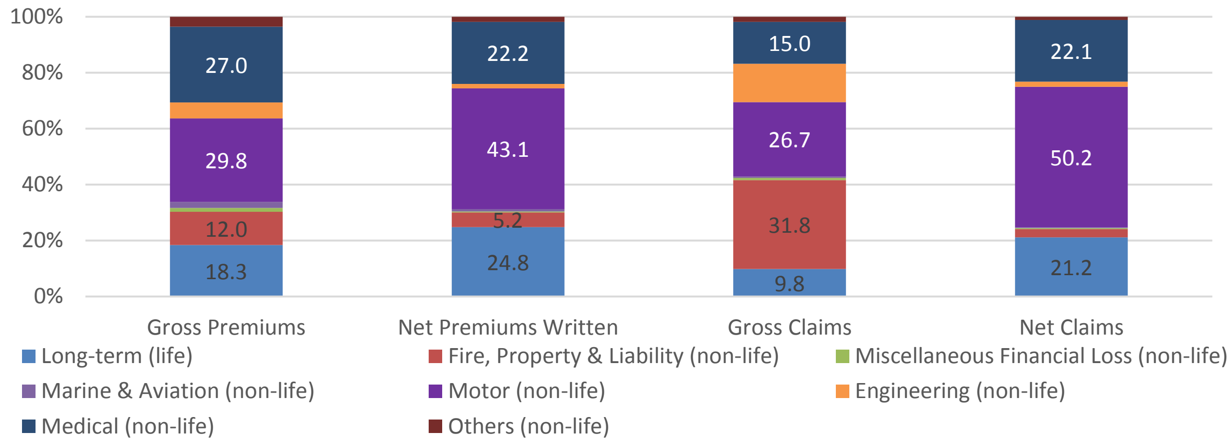
Table 6-1: Gross Premiums and Claims for all Insurance Firms by Class– Bahrain operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017
Long-term (Life)	35,238	37,433	32,406	33,591	16,117	20,152	22,223	17,888
Fire, Property & Liability	30,935	24,447	6,514	7,075	3,692	65,408	959	2,476
Miscellaneous Financial Loss	2,849	2,733	365	488	1,921	1,762	-224	266
Marine & Aviation	4,018	4,420	1,152	1,129	1,267	805	193	257
Motor	57,396	60,794	55,039	58,449	48,028	54,951	36,742	42,401
Engineering	13,687	11,771	1,536	2,272	3,749	28,266	1,394	1,516
Medical	51,353	55,148	31,679	29,995	31,678	30,831	19,605	18,613
Others	8,422	7,339	3,246	2,487	1,963	3,790	603	994
Total	**203,898**	**204,085**	**131,937**	**135,487**	**108,414**	**205,964**	**81,495**	**84,411**

Source: CBB.

The concentrations of premuims and claims by class are viewed in Graph 6-5. For the overall insurance indusrym the exposure in Motor was the highest in Gross Premiums (29.8%), Net Premiums Written (43.1%), and Net Claims (50.2%). Whereas in Gross Claims Fire, Property and Liability had the highest concentrations (31.8%).

Chart 6-5: Concentrations of Gross Premiums and Claims for all Insurance Firms by Class – Bahrain Operations (Q3 2017)



Source: CBB.

6.3.2 Conventional Insurance

The Gross Premiums recorded for conventional insurance (Bahraini operations only) exhibited a decline by 2.9% based on a year on year comparison, where total gross premiums declined from BD 163.2 million in September 2016 to BD 158.4 million in September 2017 (Table 6-2). Where the greatest decline arrived from Fire, Property & Liability business class by 24.2%. While the greatest increase was contributed by Marine & Aviation at 8.2% annual increase, which was not sufficient enough to compensate the drop from Fire, Property & Liability business class. In terms of concentration, Motor and Medical business classes represented 30% and 23.4% respectively of the total gross premiums.

Net Premiums Written reflected no major difference in the for the growth rate as of September 2017, as a growth of 1% was due increase in Miscellaneous Financial Loss followed by Engineering insurance lines. Motor insurance remained the largest in terms of Net Premiums Written concentration as well, accounting for 43.7%, increasing from BD 42.8 million in Q3 2016 to BD 45.8 million in 2017.

Gross Claims on the other hand, increased at an annual rate of 116.6% in Sep 2017 due to a substantial increase in Fire, Property & Liability from merely being at BD 2.9 million in September 2016 accelerating to BD 64.7 million by September 2017. This insurance class furthermore accounted for the highest share in gross claims (36.4%), followed by Motor at 23.7%.

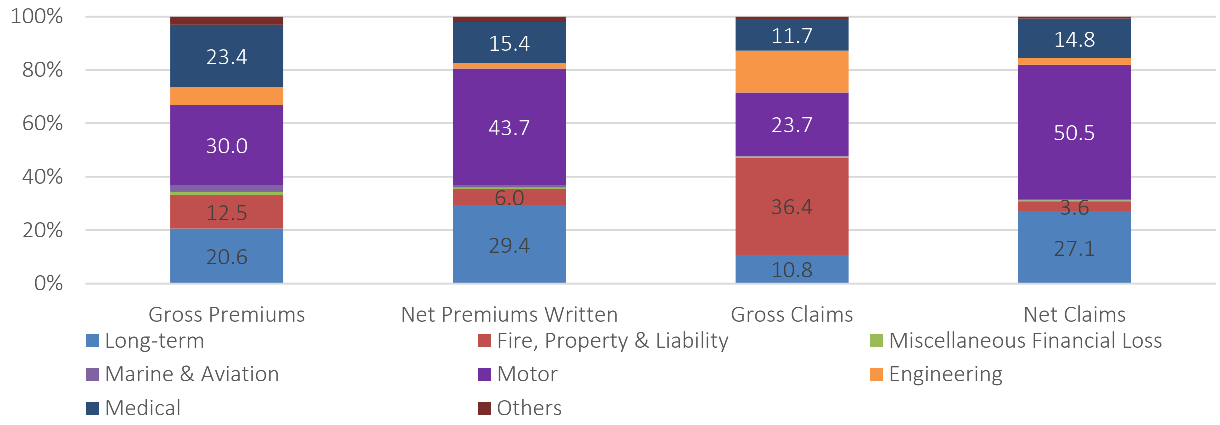
Net Claims however, were constant, but here was an increase coming from Fire, Property & Liability, nonetheless, the highest concentration is behind the Motor insurance class, accounting for 50.5% out by looking at the classes.

Table 6-2: Gross Premiums and Claims of Conventional Insurance by Class – Bahrain operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017
Long-term (Life)	32,120	32,590	30,303	30,413	15085	19,154	21,923	17,504
Fire, Property & Liability	26,208	19,855	5,877	6,329	2,911	64,743	840	2,322
Miscellaneous Financial Loss	2,279	2092	296	461	-598	690	-235	240
Marine & Aviation	3,536	3,825	1,065	1,015	842	527	185	302
Motor	44,580	47,485	42,844	45,770	36,958	42,024	28,312	32,492
Engineering	13,051	10,729	1,382	2,063	3,562	28,066	1367	1,566
Medical	36,344	36,987	19,470	16,049	22,913	20,840	11,791	9,533
Others	5,064	4,796	2,395	2,175	448	1,730	374	464
Total	**163,183**	**158,358**	**103,632**	**104,275**	**82,121**	**177,772**	**64,556**	**64,526**

Motor insurance has the highest exposure in Gross Premiums (30%), Net Premiums Written (43.7%) and Net Claims (50.5%). In terms of Gross Claims, Fire, Property & Liability insurance line contributes by (36.4%), and Motor by (23.7%).

Chart 6-6: Concentrations of Gross Premiums and Claims for Conventional Insurance by Class - Bahrain Operations (Q3 2017)



Source: CBB.

Tables 6-3 below shows a further division of the premiums and claims by class between Local and Overseas firms within the conventional insurance industry for Q3 2017.

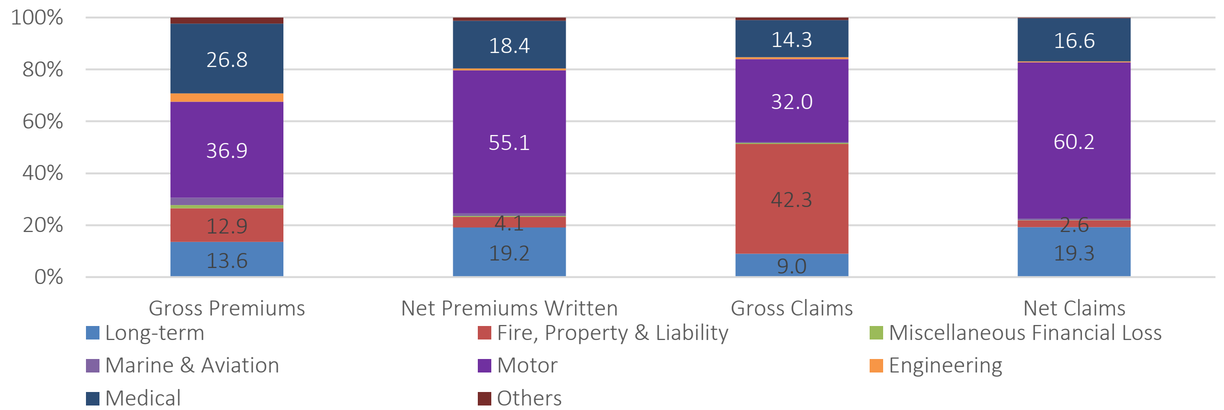
For local conventional insurance, Motor insurance has the highest concentration for Gross Premiums (36.9%), Net Premiums Written (55.1%) and Net Claims (60.2%). Over 50 % of the Net Premiums Written and Net Claims are for the Motor class (Chart 6-7).

Table 6-3: Gross Premiums and Claims of for Conventional Local and Overseas Insurance by Class – Bahrain operations (Q3 2017)

BD '000	Gross Premiums			Net Premiums Written			Gross Claims			Net Claims		
	Local	Overseas	Total	Local	Overseas	Total	Local	Overseas	Total	Local	Overseas	Total
Long-term (Life)	16,265	16,325	32,590	14,825	15,588	30,413	11,100	8,054	19,154	9,635	7,869	17,504
Fire, Property & Liability	15,433	4,422	19,855	3,158	3,172	6,330	51,970	12,773	64,743	1,290	1,033	2,323
Miscellaneous Financial Loss	1,435	657	2,092	230	231	461	474	216	690	92	148	240
Marine & Aviation	3,459	366	3,825	728	288	1,016	476	52	528	255	47	302
Motor	44,143	3,342	47,485	42,603	3,166	45,769	39,299	2,725	42,024	30,101	2,391	32,492
Engineering	3,902	6,826	10,728	585	1,479	2,064	877	27,189	28,066	213	1,353	1,566
Medical	32,061	4,926	36,987	14,249	1,799	16,048	17,534	3,306	20,840	8,298	1,235	9,533
Others	2,857	1,939	4,796	936	1,239	2,175	1,246	483	1,729	159	308	464
Total	**119,555**	**38,803**	**158,358**	**77,314**	**26,961**	**104,275**	**122,976**	**54,796**	**177,772**	**50,042**	**14,384**	**64,426**

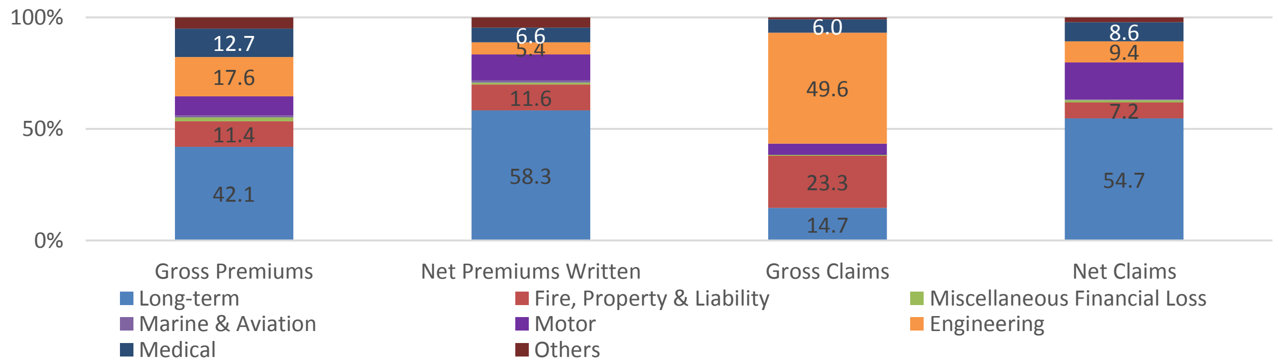
Source: CBB.

Chart 6-7: Concentrations of Gross Premiums and Claims for Conventional Local Insurance by Class - Bahrain Operations (Q3 2017)



Source: CBB.

Chart 6-8: Concentrations of Gross Premiums and Claims for Conventiaonal Overseas Insurance by Class - Bahrain Operations (Q3 2017)



Source: CBB.

Only two foreign overseas branches operations focus more on life insurance and contribute towards the concentration in Gross Premiums (42.1%), Net Premiums written (58.3%) and Net Claims (54.7%).

As For Gross Claims, Engineering and Fire, Property & Liability business lines had the highest share (49.6% and 23.3% respectively).

6.3.3 Takaful

The Gross Premiums for Takaful companies increased on a year on year basis by 12.3%, from BD 40.7 million at Q3 2016 reaching BD 45.7 million in 2017, where the highest increase was attributed by Engineering insurance line, followed by Life Insurance. Medical Insurance line however recorded the highest contributor towards total Takaful gross premiums, accounting for 39.7% of the total.

Net Premiums Written increased by 10% from September 2016 to September 2017, reaching BD 31.2 million. Life Insurance increased on an annual basis by 51.1%, whereas 'Others' decreased by 63.4%. Medical Insurance is the largest in terms of net premiums written, representing around 44.7% of the total.

Gross Claims increased by 6.8% compared to September 2016, with 'Others' registering the highest increase within the same period. Motor and Medical insurance accounted for the largest components in terms of gross claims, representing 45.8% and 35.4% of the total gross claims.

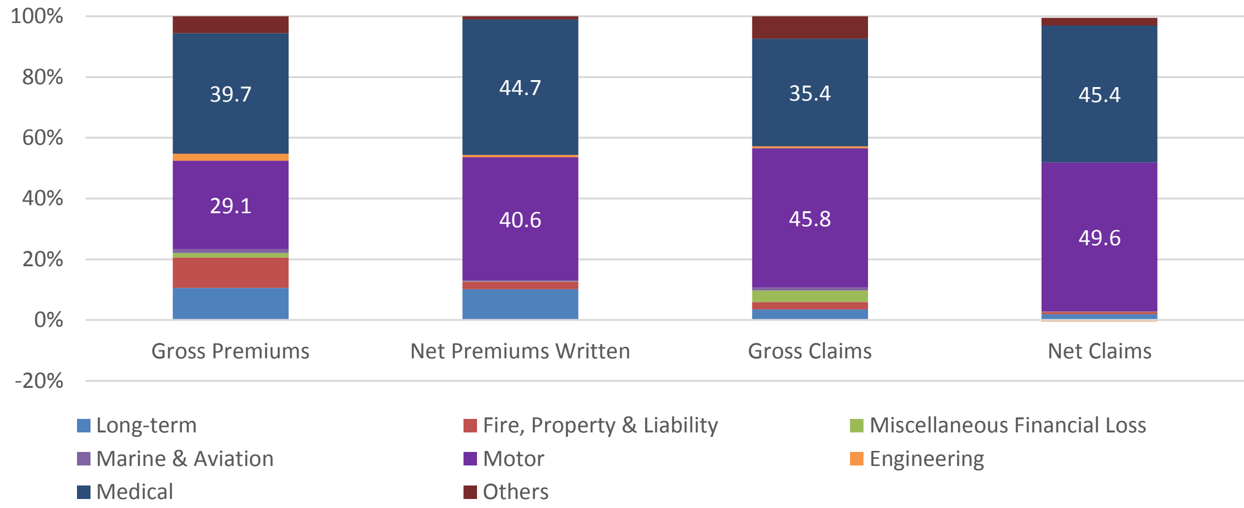
Net Claims increased at a higher percentage compared to gross claims, recording an annual increase of 18.0% at September 2017 with Miscellaneous Financial Loss increasing at the highest rate amongst the other classes. However, it equates to the gross claims in terms of having Motor and Medical representing the largest components of net claims, accounting for 49.6% and 45.4% from the total respectively.

Table 6-4: Gross Premiums and Claims of Takaful Insurance Firms by Class – Bahrain operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017
Long-term (Life)	3,117	4,843	2,103	3,179	1,032	998	300	384
Fire, Property & Liability	4,727	4,592	637	746	780	665	119	153
Miscellaneous Financial Loss	570	641	69	27	2,520	1,072	11	26
Marine & Aviation	481	595	86	114	425	278	8	-46
Motor	12,816	13,309	12,195	12,680	11,070	12,865	8,430	9,909
Engineering	636	1,043	154	209	186	196	27	-50
Medical	15,009	18,161	12,209	13,946	8,764	9,950	7,814	9,080
Others	3,358	2,543	851	311	1,515	2,069	229	527
Total	**40,715**	**45,727**	**28,304**	**31,212**	**26,293**	**28,092**	**16,939**	**19,985**

Source: CBB.

Chart 6-9: Concentrations of Gross Premiums and Claims for Takaful Insurance Firms by Class - Bahrain Operations (Q3 2017)



Source: CBB.

Takaful insurance companies have very high concentration on the Medical and Motor Insurance business lines. Gross Premiums for both sectors represented 58.8%, Net Premiums Written (85.3%), Gross Claims (81.2%), and Net Claims (95.0%).

6.3.4 Retention Ratio and Loss Ratio (By Class)

Life insurance business line registered a retention ratio of 89.7% in September 2017. Observing the non-life insurance, Motor and Medical, accounted for 29.8% and 27 percent of the total Gross Premiums in September 2017 respectively, registered retention ratios of 96.1% for Motor and 54.4% for Medical. Nevertheless, retention ratios were significantly lower for other business lines such as Miscellaneous Financial Loss and Engineering, registering 17.8% and 19.3% respectively.

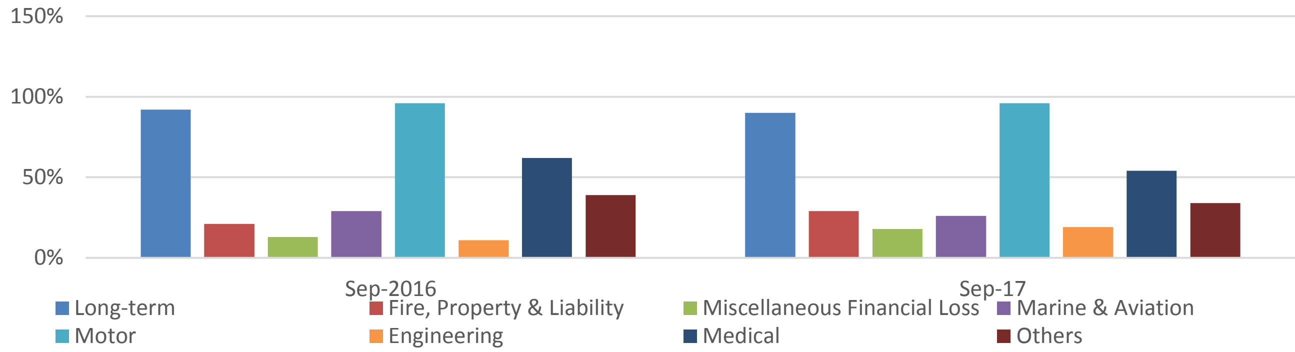
Table 6-5: Retention and Loss Ratios of Overall Insurance Sector

	Retention Ratio 1		Loss Ratio 2	
%	Sep-2016	Sep-2017	Sep-2016	Sep-2017
Long-term	92.0	89.7	67.2	50.8
Fire, Property & Liability	21.1	28.9	16.8	40.9
Miscellaneous Financial Loss	12.8	17.8	-25.9	62.9
Marine & Aviation	28.7	25.5	16.6	24.2
Motor	95.9	96.1	70.0	75.3
Engineering	11.2	19.3	104.9	52.6
Medical	61.7	54.4	75.0	73.3
Others	38.5	33.9	21.7	42.9

1. Net Premiums Written / Gross Premiums
2. Net Claims Incurred/Net Premiums Earned

Source: CBB.

6-10: Retention and Loss Ratios of Insurance Sector



Source: CBB.

6.4 Insurance Profitability:

The insruance industry has continued to show positive results with regards to profitability. Net income increased across all different categories. Conventional insurance firms' net income increased from BD 28.2 million in September 2016 to BD 33.8 million in September 2017, whereas Takaful companies increased from BD 1.2 million September 2016 to BD 2.7 million September 2017.

Table 6-6: Profitability Indicators of Insurance Sector

BD'000	Net Income after taxes *		Total Assets*		Capital Available * As per CBB requirements	
	Sep-16	Sep-17	Sep-16	Sep-17	Sep-16	Sep-17
Conventional	28,161.1	33,766.0	2,006,638.0	2,258,124.5	344,057.5	376,254.3
Local	25,876.0	28,973.1	1,746,106.5	1,975,873.6	313,823.7	348,596.9
Overseas	2,285.1	4,792.9	260,531.5	282,250.9	30,233.8	27,657.4
Takaful	1,105.1	2,658.5	153,626.9	159,049.2	44,906.7	46,517.8
All Insurance	29,266.2	36,424.5	2,160,264.9	2,417,173.8	388,964.1	422,772.0

Source: CBB.
*including results of Shareholders and Participants Funds.

Total assets also increased, conventional insurance firms' total assets increased from BD 2,006.7 million September 2016 to BD 2,258.1 million September 2017. Takaful companies additionally increased from BD 153.6 million September 2016 to BD 159.1 million September 2017, leading to a total increase in the entire insurance industry to BD 2,417.2 million. The capital available also experienced an increase for the entire industry, increasing from BD 388.9 million to BD 422.8 million.

6.5 Performance of Re-Insurance and Re-Takaful Firms in Bahrain

The first Re-Takaful firm licensed by the Central Bank of Bahrain was in 2007. And the number of firms have been increasing since then, reaching 5 conventional Re-Insurance firms and 2 Re-Takaful firms in Bahrain by the end of December 2016. [12]

Table 6-4: Premiums & Claims of Reinsurance & Retakaful Firms Operating in Bahrain (December 2015 and December 2016)

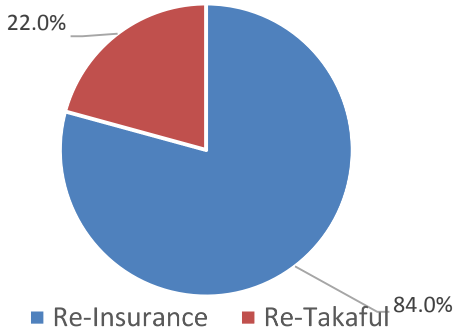
BD'000	Gross Premiums		Retained Premiums		Gross Claims		Net Claims	
	2015	2016	2015	2016	2015	2016	2015	2016
Re-Insurance	318,265	314,083	237,269	236,497	197,591	185,504	162,393	150,460
Re-Takaful	83,354	60,708	74,009	56,694	59,749	46,568	51,346	45,651
Total	397,437	378,972	311,278	293,191	257,339	232,072	213,739	196,111

Source: CBB.

The total amount of gross premiums decreased by 4.6% where the amount dropped from BD 397.473 million to BD 378.972 million.

Re-Takaful decreased more when being compared to Re-Insurance, decreasing by 27.2% and 1.3% respectively. Retained premiums also declined by 5.8%, where the Re-Takaful decreased by 23.4% and Re-Insurance by 0.3%. Gross claims experienced a decline by 9.8%, having Re-Takaful reducing by 22.1% and Re-Insurance by 6.1%. Net claims nevertheless dropped by 8.2%, where Re-Takaful declined by 11.1% and Re-Insurance by 7.3% when comparing the performance in December 2015 and December 2016.

Chart 6-11: Re-Insurance & Re-takaful Gross Premiums/Contributions in December 2016



Source: CBB.

6.6 Regulatory Changes, Market trends and Risks.

As part of the efforts towards enhancement and improvement of the regulatory framework, the CBB introduced its revised and enhanced Operational and Solvency framework for the Takaful and Retakaful industry in 2014 after undergoing deliberations and consultations with the industry and all the stakeholders.

[12] Re-Insurance and Re-takaful figures are provided on an annual basis with end of year comparisons. The analysis looks at the performance of Re-Insurance and Re-Takaful between December 2015 and December 2016.

The problem was that many Takaful firms incurred regulatory deficits in the participants funds for many years despite the fact that CBB gave Takaful and Retakaful firms a transition period of 5 years to assist participants funds in building their own capital. The regulatory deficit arises from the fact that the required capital of the participants' funds usually exceeds the available capital of the participants fund especially in the early years of the funds.

The solution to the problem was to combine both the capital of the shareholders and the capital of the participants in the calculation of the capital available and then compare it with the required capital of the funds. Accordingly, the CBB has amended its rules and regulation to give the effect of such in order to achieve the following main objectives:

- Enhance the competitiveness of the Takaful industry in Bahrain;
- Enhance the public's confidence in Takaful;
- Reduce the burden on Takaful firms in relation to the calculation of available capital and therefore, enabling Takaful firms to be in a level playing field with conventional insurance firms in relation to solvency assessment;
- Eliminate the need for Qard Hassan to address any regulatory deficit and replace it with capital injection from shareholders;
- Increase the probability of surplus distribution to participants;
- Provide more flexibility to participants funds to invest its funds rather than merely concentrating on meeting the solvency requirements; and
- Address gaps associated with the application of a Takaful model such as the availability of liquid assets in the shareholders fund to cover any deficit in participants' funds, standardization of Wakalah fee components and the impairment of Qard Hassan.

It is worth to mention that the CBB continue reviewing and analyzing the updated Takaful Returns submitted by the Takaful Firms to monitor the effect of the new rules which actually show positive financial results in recent years.

7. Performance of Capital Markets

Chapter 7

Key Points

- Increase in the Bahrain All Share & Islamic Indices.
- Year-on-year increase in market capitalization.
- Increase in corporate profitability and decrease in leverage.
- Two key mergers and acquisitions announced.

7.1 Overview

This chapter provides an overview of the capital markets sector in the Kingdom of Bahrain. Furthermore, this chapter will provide statistical insights as to the performance of the mainboard market operated by Bahrain Bourse as a Self-Regulatory Organization ("SRO") as well as relevant data on the issuance of securities and activities pertaining to takeovers, mergers and acquisitions in Bahrain.

In 2002 Bahrain expanded and centralized the scope of the financial sector regulatory supervision to encompass capital markets under the CBB's Capital Markets Supervision Directorate ("CMSD") supervisory umbrella. Henceforth, with the inception of the integrated regulator approach referred to as the "Single Regulatory Model", the CBB became responsible for Bahrain's capital markets with a combination of rule and principle based regulatory framework.

As at December 2017, Bahrain Bourse recorded a total listing of 43 Companies, 19 Mutual funds and 13 Bonds and Sukuks. "Commercial Banks" sector represents the highest value in traded shares by scoring 36.5% of total shares. Nevertheless, the largest 5 companies in terms of Market Capitalization are AUB, ALBH, NBB, GFH, and UGH which account for 58.2% of the total market.

7.2 Bahrain Bourse

Increase in market index

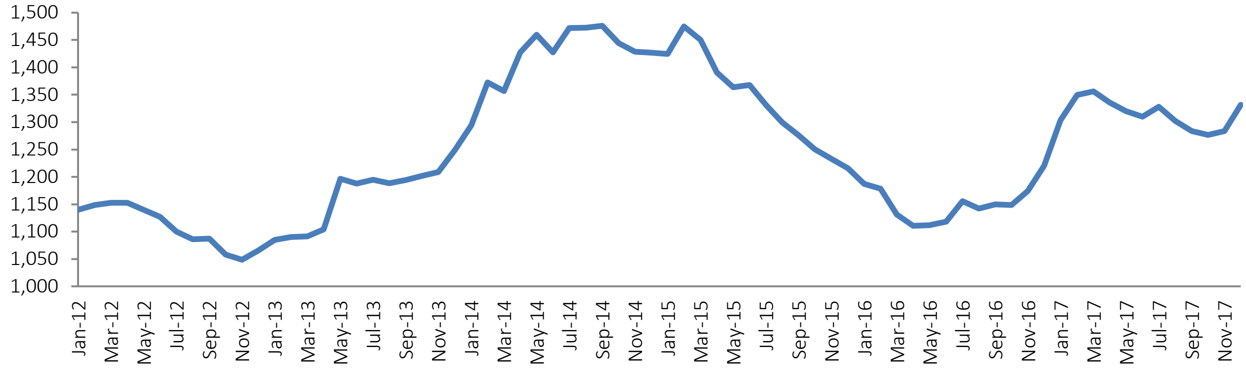
Year-on-year data demonstrates that the Bahrain All Share Index increased by 111.2 points (9.1%) between December 2016 and December 2017 (Table 7-1). Observing this period, the index was at its highest with 1,356 points in March 2017, where the index began to drop until October 2017 where the index scored the lowest point at 1,276.7. Subsequently, the index started to increase reaching 1,331.7 by December 2017 (Chart 7-1). When comparing on a month on month basis, the index increased from 1,283.7 in November 2017 to 1,331.7 in December 2017 (3.7%).

Table 7-1: Key Indicators of Bahrain Bourse

	2012	2013	2014	2015	2016	2017
All Share Index	1,065.6	1,248.9	1,426.6	1,215.9	1,220.5	1,331.7
Highest	1,152.8	1,248.9	1,476.0	1,474.8	1,220.5	1,356.0
Lowest	1,048.8	1,085.9	1,294.3	1,215.9	1,110.5	1,276.7
Market Cap (BD, mil)	5,855.6	6,963.0	8,327.1	7,199.9	7,248.2	8,146.3
Total Value (BD, mil)	110.2	225.9	269.1	110.0	124.5	211.3
Total Volume (mil)	627.7	1,867.8	1,126.1	515.6	734.4	1,129.8
No. of Transactions	10,168	14,197	16,211	11,248	10,592	19,440
No. of Companies Listed	47	47	47	46	44	43

Source: Bahrain Bourse.

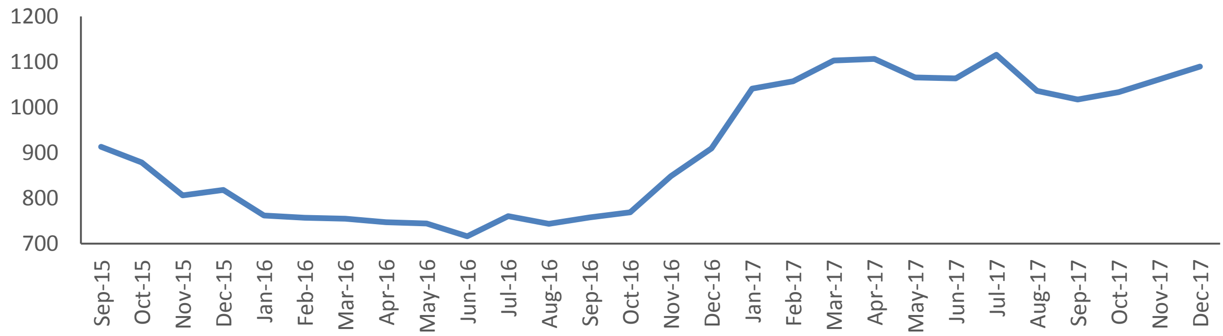
Chart 7-1: Bahrain All-Share Index, Jan 2012-Dec 2017



Source: Bahrain Bourse.

In September 2015, Bahrain Bourse launched the Bahrain Islamic Index. It was the first Islamic finance index in the region, and 17 Shari'ah compliant companies are included within the index. Since its inception, most movements in Bahrain Islamic Index have mirrored that of the Bahrain All-Share Index albeit with different volatilities. Year-on-year data demonstrates that the Bahrain Islamic Index increased by 179.5 points (19.7%) between December 2016 and December 2017 reaching 1089.3 points (Chart 7-2).

Chart 7-2: Bahrain Islamic Index, Sep 2015-Dec 2017



Source: Bahrain Bourse.

Increase in market capitalization

As at end-December 2017, market capitalization of the Bahrain Bourse stood at BD 8.1 billion (Table 7-2). This level of market capitalization is 4.7% higher than the level attained in June 2017 and 12.4% higher year-on-year.

Table 7-2: Market Capitalization on the Bahrain Bourse

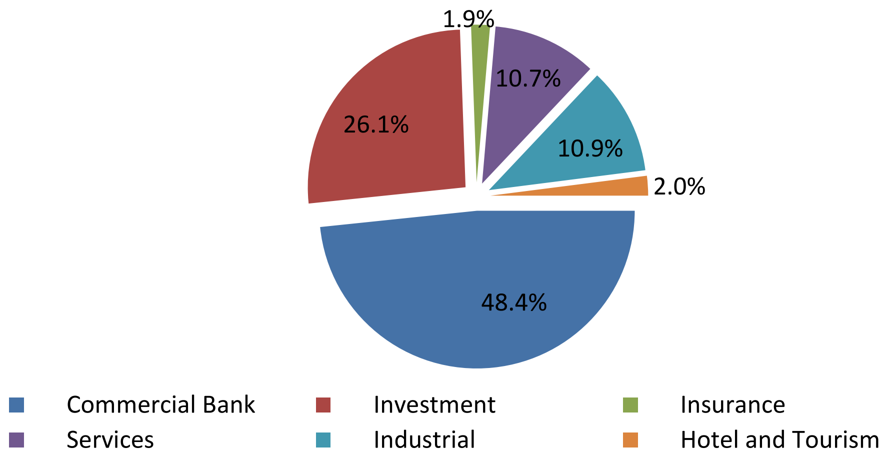
(BD)

Sector	Dec. 2016	Jun. 2017	Dec. 2017	Jun. 2017-Dec. 2017 (% Change)	Dec. 2016-Dec. 2017 (% Change)
Commercial Banks	3,514,830,525	3,838,055,221	3,938,944,714	2.6	12.1
Investment	1,914,779,013	2,004,042,161	2,124,858,983	6.0	11.0
Insurance	140,862,578	148,489,778	157,250,245	5.9	11.6
Services	1,005,531,994	952,755,246	869,030,783	(8.8)	(13.6)
Industrial	473,972,314	667,092,314	891,787,040	33.7	88.2
Hotel and Tourism	198,468,527	166,504,926	164,461,880	(1.2)	(17.1)
Total	**7,248,444,951**	**7,776,939,646**	**8,146,333,645**	**4.7**	**12.4**

Source: Bahrain Bourse.

A breakdown of market capitalization by sector indicates that "Industrial" sector recorded the highest year-on-year increase in market capitalization (88.2%) followed by "Commercial Banks" (12.1%) and "Insurance" (11.6%). "Hotel and Tourism" scored the highest decline among other market capitalization sectors with a 17.1% decrease.

Chart 7-3: Market Capitalization by Sector, December 2017



Source: Bahrain Bourse.

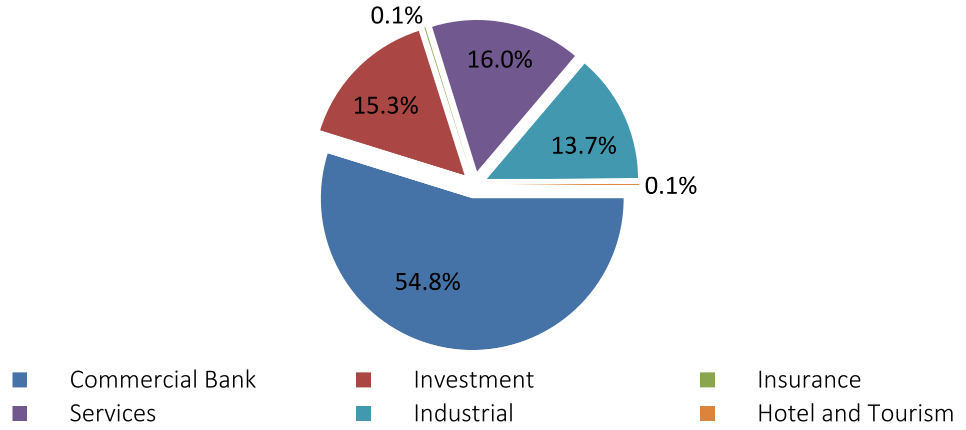
The bulk of the value of shares traded in December 2017 was the "Commercial Banks" sector whose traded shares (by value) represented 54.8% of total shares, which is virtually identical to what was attained in December 2016. The "Services" sector represents the second greatest level at 16.0% of the total value of shares traded in December 2017, which experienced a dramatic increase from the 4.6% recorded in December 2016. Investors interest in "Hotel and Tourism" and "Insurance" sectors were the least during December 2017 whose traded shares by value represented only 0.2% of total traded shares (Table 7-3).

Table 7-3: Sectoral Distribution of Shares Traded by Value (% of all shares traded)

Sector	Dec. 2016	Jun. 2017	Dec. 2017
Commercial banks	54.9	31.6	54.8
Investment	4.1	14.6	15.3
Insurance	35.9	2.6	0.1
Services	4.6	20.4	16.0
Industrial	0.4	30.6	13.7
Hotel and Tourism	0.2	0.4	0.1

**Figures may not add to a hundred due to rounding*
Source: Bahrain Bourse.

Chart 7-4: Sectoral Distribution of Shares Traded by Value (% of all shares traded) in December 2017



Source: Bahrain Bourse.

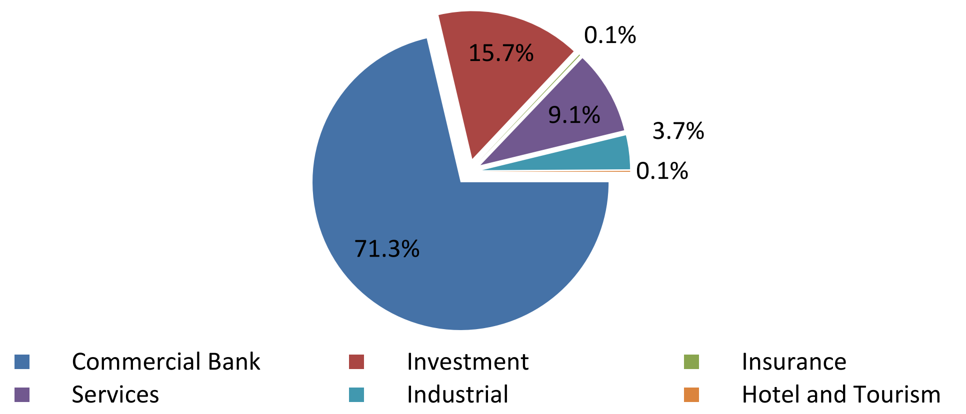
The bulk of the volume of shares traded in December 2017 was the “Commercial banks” sector representing 71.4% of the total volume of shares traded, followed by the “Investment” sector at 15.7%. The lowest level was attained by the “Hotel and Tourism” and “Insurance” sectors at 0.1% each (Table 7-4).

Table 7-4: Sectoral Distribution of Shares Traded by Volume (% of all shares traded)

Sector	Dec. 2016	Jun. 2016	Dec. 2017
Commercial banks	79.1	41.0	71.4
Investment	1.1	24.2	15.7
Insurance	17.5	6.0	0.1
Services	2.1	11.8	9.1
Industrial	0.1	16.9	3.7
Hotel and Tourism	0.1	0.2	0.1

**Figures may not add to a hundred due to rounding*
Source: Bahrain Bourse.

Chart 7-5: Sectoral Distribution of Shares Traded by Volume (% of all shares traded) -December 2017



Source: Bahrain Bourse.

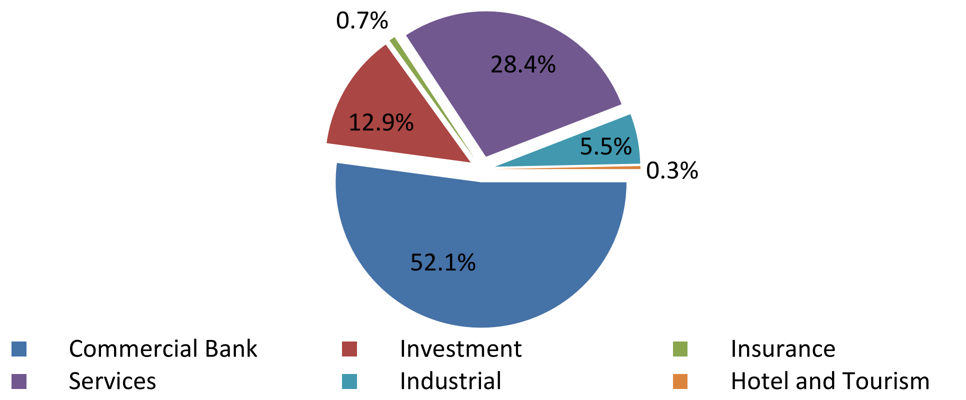
The majority of the number of transactions in December 2017 (1,786 transactions and a 92.9% increase compared to June 2017) was attained by the "Commercial Banks" sector at 931 transactions (52.1% of all transactions), followed by the "Services" sector at 507 transactions (28.4%), and the "Investment" sector at 231 transactions (12.9%) (Table 7-5).

Table 7-5: Number of Transactions by Sector

	Dec. 2016	Jun. 2017	Dec. 2017
Commercial Banks	690	290	931
Investment	127	146	231
Insurance	17	42	12
Services	272	257	507
Industrial	42	176	99
Hotels and Tourism	15	15	6
Total	1,163	926	1,786

Source: Bahrain Bourse.

Chart 7-6: Sectoral Distribution of Number of Transactions Traded (% of all transactions traded) in December 2017



Source: Bahrain Bourse.

Decrease in most GCC Indices

The GCC equity markets was sluggish during 2017 due to a combination of geopolitical factors and some unforeseen events. As a result, most GCC indices recorded negative rates compared to June 2017. Despite this, the highest increase was recorded by the Kuwait Market Index (11.5%) when compared to December 2016, followed by the Bahrain All Share Index with an increase of 9.1%.

Table 7-6: Stock Market Indices in GCC counties

Index	Dec. 2016	Jun. 2017	Dec. 2017*	Jun. 2017 - Dec 2017 (%)	Dec 2016 - Dec 2017 (%)
Bahrain All Share Index	1220.5	1310.0	1331.7	1.7	9.1
Tadawul All Share Index	7210.4	7425.7	7226.3	(2.7)	0.2
Kuwait Market Index	5748.1	6762.8	6408.0	(5.2)	11.5
Qatar Exchange Index	10436.8	9030.4	8523.4	(5.6)	(18.3)
Dubai Financial Market Index	3530.9	3537.4	3370.1	(4.7)	(4.6)
Abu Dhabi Index	4546.4	4425.4	4398.4	(0.6)	(3.3)
Muscat Securities Market Index 30	5782.7	5118.3	5099.3	(0.4)	(11.8)

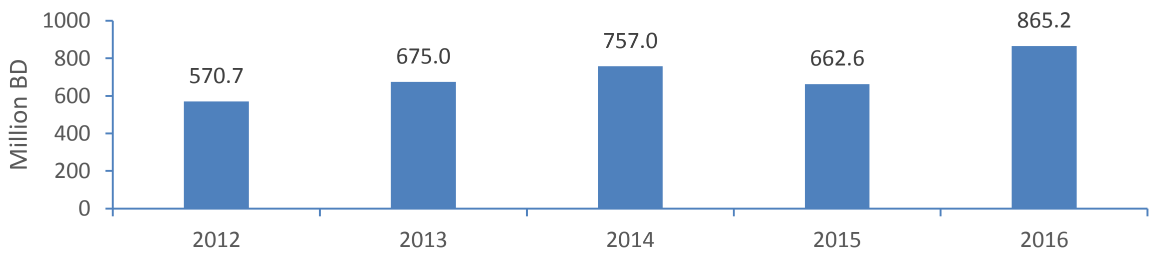
**December 31st, or latest available. Sources: Stock Exchange of Each Country*

7.3 Market Resilience

Increase in corporate profitability

The overall profitability of the Bahraini stock market increased by 30.6% to BD 865.2 million in 2016 from BD 662.6 million in 2015. The increase was mainly driven by the "Investment" and "Commercial Banks" sectors by BD 65.2 and 50.8 million respectively (Chart 7-7). Return on assets increased to 1.5% in 2016 compared to 1.3% in 2015, while return on equity rose to 9.1% in 2016 compared to 8.1% in 2015.

Chart 7-7: Stock Market Net Income



Source: Bahrain Bourse.

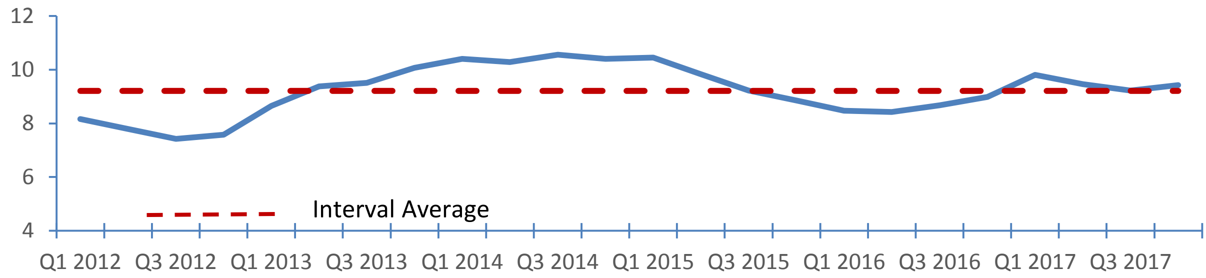
As at December 2017, all sectors experienced progress in their P/E ratio compared to December 2016 except for the Investment and Hotel and Tourism sectors that dropped by 18.8% and 34.7% respectively. The total market P/E ratio was dropping towards the normal P/E range, then rose in the fourth quarter of 2017 to 9.4, a bit higher than the 6 year average (Chart 7-8) (Table 7-7).

Table 7-7: Price-Earnings Multiples

Sector	Dec. 2016	Jun. 2017	Dec. 2017
Commercial banks	9.8	10.5	10.8
Investment	6.9	6.8	5.6
Insurance	13.0	13.4	14.2
Services	10.3	11.4	10.4
Industrial	7.7	13.3	17.8
Hotel and Tourism	11.8	7.6	7.7
Total Market	8.9	9.5	9.4

Source: Bahrain Bourse.

Chart 7-8: Total Market Price-Earnings Multiples

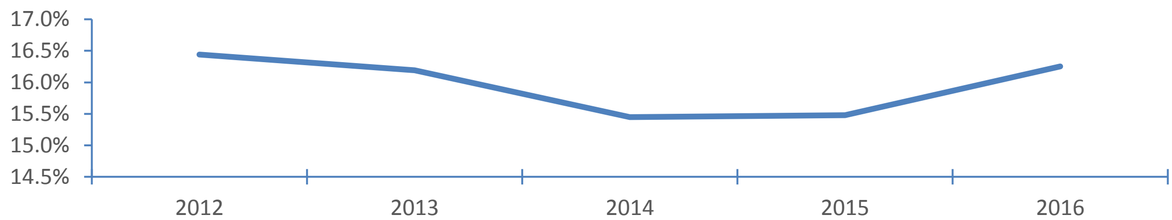


Source: Bahrain Bourse.

Corporate leverage decreased

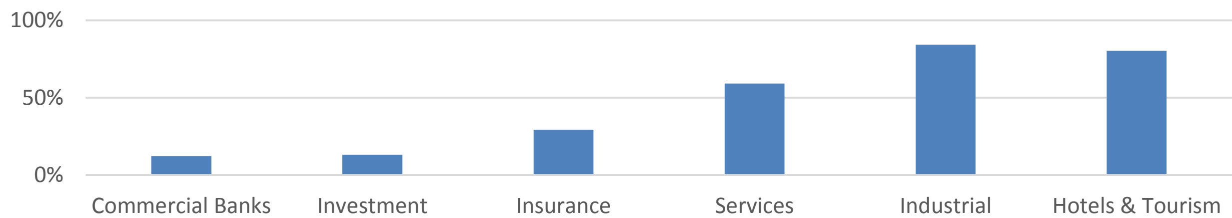
The overall equity-to-assets ratio increased by 0.8% to 16.3% in 2016. Most sectors contributed to the increase with the Industrial sector having the highest increase (4%). The Commercial Banks and Investment sectors have the lowest equity/assets ratio due to the high leverage nature of the sectors (Chart 7-9 & 7-10).

Chart 7-9: Total Equity to Total Assets (%)



Source: Bahrain Bourse.

Chart 7-10: Total Equity/Total Assets by Sector

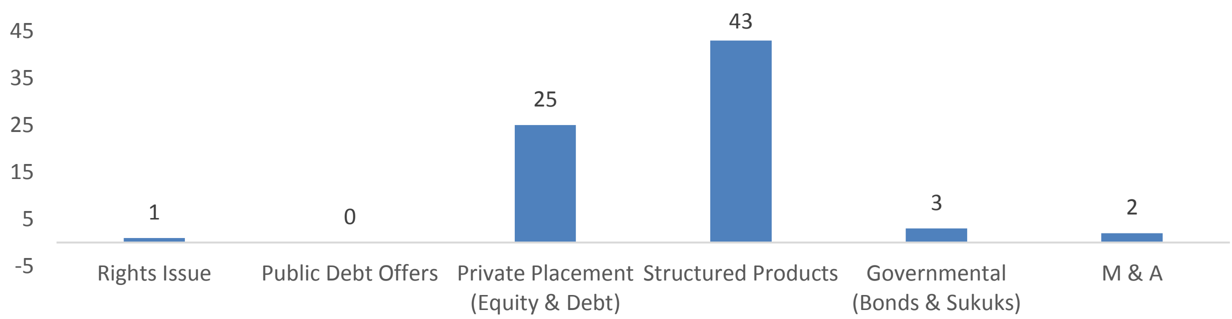


Source: Bahrain Bourse.

7.4 Capital Market Activities

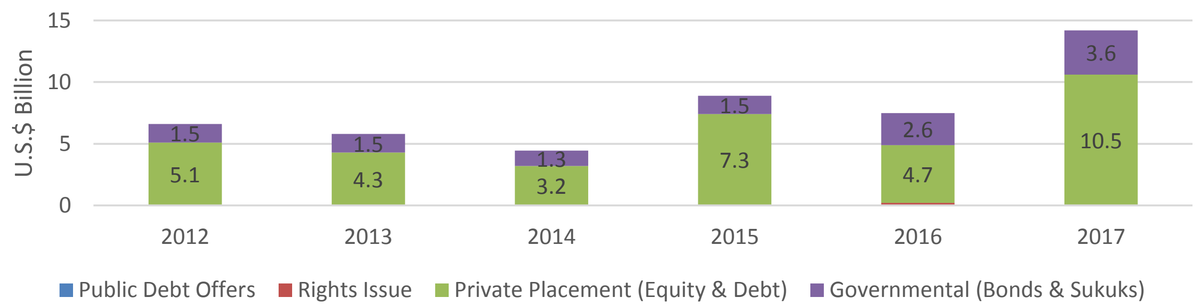
In 2017, the CBB issued its no objection to the issuance of 73 public and private offering documents (compared to 62 offering documents in 2016) after ensuring the completeness of all the information and details as per the CBB Law. The total value of issuances reached USD 14.2 billion, an 89.4% increase as compared to last year (Chart 7-11 & 7-12).

Chart 7-11: Number of Capital Market Activities



Source: CBB.

Chart 7-12: Total Issuance Value



Source: CBB.

Two mergers & acquisitions announced

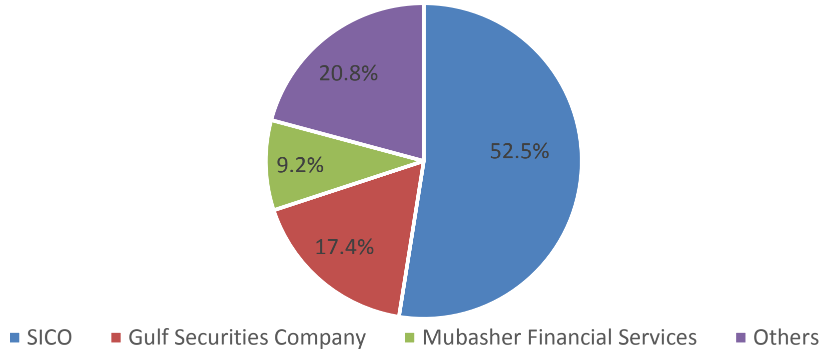
In July 2017, the Board of Directors of Al Ahlia Insurance Company B.S.C. ("Al Ahlia") issued a circular to its shareholders in relation to the offer to acquire 100% of the assets, business and liabilities of Solidarity General Takaful B.S.C(c) ("Solidarity") against the issuance of 2.50 ordinary shares in Al Ahlia for each 1 ordinary share in Solidarity. Pursuant to Shareholder approval and completion of all necessary regulatory requirements, Solidarity General Takaful has merged with Al Ahlia with 3rd December 2017 being the effective Merger Date. The combined entity, has an Authorized Capital of BD 12 million and a Paid Up capital of BD 11.2 million.

In June 2017, a joint public announcement was made to the market regarding the close of Bahrain Kuwait Insurance Company B.S.C. ("BKIC") Unconditional Mandatory Cash Offer to Acquire up to 36.31% of the issued and paid-up ordinary shares of Takaful International Company B.S.C. ("Takaful") which represents all the outstanding shares of Takaful not currently held by BKIC at an offer price of 95 Fils for every share in Takaful.

7.5 Performance of Brokers

For 2017, Bahrain Bourse had 12 active brokers conducting trades in the market. Securities and Investment Co. (SICO) was the top broker in terms of total value of shares traded with more than 50% of the total market value in 2017, while the top three made up 79.2% of the total market.

Chart 7-13: Broker Activity



Source: Bahrain Bourse.

7.6 Mutual Funds

Bahrain Bourse adopts simple listing requirements for mutual funds interested in listing, which positions Bahrain as a safe haven to a thriving mutual funds industry. As at December 2017, there are 20 Open-End mutual funds listed by the Bahrain Bourse with an average net asset value (N.A.V) of USD 70.9. The Khaleej Equity Fund has the highest N.A.V listed at USD 294.4.

7.7 Risks & Challenges in Capital Markets

The significance of cybersecurity risk on capital markets cannot be overlooked putting under consideration the developing landscape of the global markets, which decrees that regulators as well as capital market service providers must remain prudent, progressive and vigilant to minimize such risks. In this regard, the CBB; through the requirements stipulated under the various of Module of CBB Rulebook Volume 6 requires Licensees to have in place a well-designed Disaster Recovery Plan and must maintain at all times a plan of action (referred to as a business continuity plan) setting out the procedures and establishing the systems necessary to restore fair, orderly and transparent operations of any market it operates, in the event of any disruption to the operations of the market.

Moreover, the regulatory framework for capital markets recognized the significance of cybersecurity in the area of operating an equity crowdfunding platform and requires such operators to ensure that cyber-security at all times including the conduct of an IT security penetration testing semi-annually by an independent consultant (discussed in part III of the report). In addition, Capital markets licensees are mandated to maintain relevant systems in place for mitigating and managing operational and other risks.

Among the shared goals of the CBB and the Bahrain Bourse at the moment is to increase liquidity and the number of investors in the market. Such an increase would mean a greater amount of due diligence and responsibility for the CBB as it aims to ensure that all stakeholders involved are adhering to the rules and regulations. With current technological advancements and globalization, listed companies are aiming to increase their global reach and list on multiple exchanges across geographies.

7.8 Developments in Regulation and Initiatives

In addition to participating in joint work meetings of the GCC which aims to harmonize the rules and regulations for the Capital markets in the GCC. During the year 2017, the CBB's CMSD endeavoured to develop and complete the capital markets regulatory and legal frameworks, including Volume 6 of the CBB Rulebook, with its main objectives being to enhance transparency and develop the capital markets, and protect investors. The following section will shed light on the activities that took place in the areas of policy, regulation and market infrastructure in 2017:

7.8.1 Policy and Regulatory Developments

- **Amendments of the Offering of Securities ("OFS") Module of CBB Rulebook Volume 6 :** In line with CMSD circular CMS/L373/17 dated 4th December 2017, all listed companies are required to comply with Paragraph OFS-2.6.7 of the OFS Module in relation to the Employee Stock Option Plan ("ESOP") which stipulates that all listed companies securities held on behalf of the employees under an employee stock option plan or employee share benefit plan, must be held in trust by a trustee subject to the prior written approval of the CBB. The same will take effect as of 31st March 2018.

- **Equity Based Crowdfunding:** In September 2017, the CBB has introduced Equity crowdfunding directives as part of the Markets and Exchanges (MAE) Module of CBB Rulebook Volume 6 which makes provision for the raising of capital through a crowdfunding platform by issuance of ordinary shares by closed, private, family companies, start-up and small and medium size companies, entities engaged in real estate development projects and real estate income properties.

- **Bahrain Investment Market (BIM) Regulations:** The CBB worked closely with Bahrain Bourse on launch of Bahrain Investment Market (BIM), an innovative equity market designed specifically to offer the region's fast-growing small and medium enterprises an alternative means for raising capital. In this regard, an agreement was signed between Bahrain Bourse and Tamkeen to support small and medium enterprises and to. . The Bahrain Bourse signed separate agreements with two advisory firms KPMG and Key point to act as authorized sponsors, who will be authorized service providers (sponsors) for small and medium enterprises listed on BIM market..

7.8.2 Developments in the Bahrain's Capital Markets Infrastructure

- **Bahrain Clear:** On 23rd May 2017, the CBB granted Bahrain Clear a License to operate a clearing, settlement and central depository system under the Clearing, Settlement and Central Depository Module of CBB Rulebook Volume 6.

7.8.3 CMSD's Upcoming Initiatives

- **Short selling and securities lending and borrowing:** With the aim to further enhance the regulatory framework for the capital markets sector and in accordance with the requirements of the CBB Law in general and Article (92) in particular, the CBB has issued the draft regulation for short selling & giving securities on loan. The draft regulation has been issued for industry consultation and the CBB shall issue the final regulation after taking into consideration the industry feedback on the draft regulation.

- **Financial and Administrative Sanctions:** The CMSD's regulatory mandate is to set and enforce high quality capital market industry standards, protect investors and strengthen market integrity while supporting a stimulating capital markets' ecosystem. The Investigation and Enforcement ("IE") team within the CMSD assumes responsibility to ensure effective enforcement of the CBB regulatory requirements with an objective to achieve fairness, transparency, investor protection and safeguard public interests in the Kingdom of Bahrain. In line with the CMSD's objective to develop a transparent regulatory environment, the CMSD introduced the first issue of its Compliance & Enforcement Annual Report in 2016; which provides a comparative overview of CMSD's efforts in 2015-2016. The report identifies and addresses non-compliances, negligence or misconduct, more specifically pertaining to listed companies.

Part IV:

Developments in the Payments Systems, Fintech, and Cybersecurity

8. Payments and Settlements Systems

Chapter

8

Key Points

- The Payment and Settlement Systems in the Kingdom of Bahrain continue to function safely and efficiently.
- Oversight on Payment and Settlement Systems is of the primal tools that ensures stability of the financial system and efficiency of payment transactions.
- Payment and Settlement Systems have undergone crucial changes from the standpoint of products complexity and a range of payment products offered in recent years.
- FinTech challenges to Payment and Settlement Systems.

8.1 Overview

Payment and Settlement Systems are central to the smooth operations of the financial sector and the efficient functioning of the overall economy. Therefore, the safety and soundness of Payment and Settlement Systems is important for the evaluation of risks to financial stability.

Payment and settlement systems are a crucial part of the financial infrastructure of a country. Bahrain's Payment and Settlement Framework continues to function safely, securely and efficiently. The current Payments and Settlement infrastructure in the Kingdom of Bahrain comprises of five main components: i) the Real Time Gross Settlement System (RTGS); ii) the Scripless Securities Settlement System (SSSS); iii) the ATM Clearing System (ATM); iv) the Bahrain Cheque Truncation System (BCTS) and v) the Electronic Fund Transfer System (EFTS).

Since the launch of the EFTS in 2015 by the Benefit Company, which has been overseen by the CBB, there has been increasing numbers of EFTS service providers reaching a total of 25 participants as of 2017. The CBB o assess the EFTS in terms of compliance with the requirements set by the Principles for Financial Market Infrastructures (PFMI) and CBB's Directives.

Bahrain's position in the financial services sector will enable it to become a strategic leader in international financial technology as it provides many of the features that will support the development of a supportive environment for financial technology, including a CBB regulator, innovative human capital, and an advanced ICT infrastructure. The CBB operates and manages the national payment and settlement systems in the Kingdom of Bahrain.

This chapter describes recent trends in the Payment and Settlement Systems.

8.2 Real Time Gross Settlement System (RTGS)

The CBB operates a Real Time Gross Settlement (RTGS) System where all inter-Bank payments are processed and settled in real time on-line mode which went live on the 14th of June, 2007. The RTGS System provides for Payment and Settlement of Customer transactions as a value addition.

The RTGS System enables the Banks to have real time information on, for example, account balances, used and available intra-day credit, queue status, transaction status etc. The RTGS System is multi-currency capable and based on Straight Through Processing (STP). The number of direct participants in the RTGS are twenty eight (28) participants including the CBB (CBB).

The daily average volume of Bank transfers from 1st July, 2017 to 31st December, 2017 (second half of 2017) have decreased by 8.4% to 174 transfers compared to 190 transfers for the period from 1st January, 2017 to 30th June, 2017 (first half of 2017). Furthermore, the daily average volume of Bank transfers for 1st July, 2017 to 31st December, 2017 decreased by 23.3% from 227 transfers to 174 transfers when compared to 1st July, 2016 to 31st December, 2016 (second half of 2016).

Although the daily average volume of Bank transfers through the RTGS are decreasing, the value of those transfers have increased in the second half of 2017 by 18.5% when compared to the first half of 2017 from BD268.9 million to BD318.7 million. Moreover, the daily average value of Bank transfers for the second half of 2017 increased by 22.9% from BD259.3 million to BD318.7 million when compared to the second half of 2016.

Table 8-1: RTGS Bank Transfers Daily Average Volume and Value

RTGS	Daily Average Volume	Daily Average Value (BD million)
1st July, 2015 to 31st December, 2015	408	202.2
1st January, 2016 to 30th June, 2016	288	226.2
1st July, 2016 to 31st December, 2016	227	259.3
1st January, 2017 to 30th June, 2017	190	268.9
1st July, 2017 to 31st December, 2017	174	318.7

Source: CBB.

8.3 Scripless Securities Settlement System (SSSS)

The CBB operates and oversees Scripless Securities Settlement System (SSSS) that provides the Depository and Settlement Services for holdings and transactions in Government Securities including Treasury Bills (T-Bills), Governments Bonds and Islamic Securities (Sukuk). Moreover, the SSSS went live on the 14th of June, 2007 along with the RTGS System.

The number of direct participants are twenty nine (29) participants and indirect participants are thirty four (34) members in the SSSS.

The volume of issues for 1st July, 2017 to 31st December, 2017 increased compared to 1st January, 2017 to 30th June, 2017 by 34.2% from 38 issues to 51 issues. Moreover, the volume of issues has increased in the second half of 2017 by 18.6% compared to the second half of 2016 from 43 issues to 51 issues.

The aggregate value of issues for the second half of 2017 increased by 81.6% from BD2.44 billion in first half of 2017 to BD4.43 billion. Additionally, the aggregate value of issues for the second half of 2017 increased when compared to the second half of 2016 by 44.8% from BD3.06 billion to BD4.43 billion.

Table 8-2: SSSS Aggregate Volume and Value

SSSS	Aggregate Volume	Aggregate Value (BD billion)
1st July, 2015 to 31st December, 2015	45	3.04
1st January, 2016 to 30th June, 2016	41	2.65
1st July, 2016 to 31st December, 2016	43	3.06
1st January, 2017 to 30th June, 2017	38	2.44
1st July, 2017 to 31st December, 2017	51	4.43

Source: CBB.

The volume of issues did not pose problems to the System's processing capacity and the risk of significant participant's failure is minimised due to executing and settling in Real Time Gross Settlement System (RTGS).

The SSSS continued to operate smoothly and efficiently for the period from 1st July, 2017 to 31st December, 2017.

8.4 ATM Clearing System (ATM)

ATM clearing is based on a Deferred Net Settlement (DNS) system. The Benefit Company (BENEFIT) in Bahrain receives and processes all the ATM transactions. The GCC net, a leased line network across the GCC countries, provides for the communication backbone for the transmission of all the ATM transactions and settlement related electronic messages (source: BENEFIT website).

The daily average volume of ATM transactions for the 1st July, 2017 to 31th December 2017, increased by 3.5% to 46,549 transactions per day compared to 44,951 transactions per day for 1st January, 2017 to 30th June 2017. In addition, the daily average volume of ATM transaction increased by 18.6% when comparing the two periods 1st July, 2017 to 31th December 2017 with 1st July, 2016 to 31th December 2016,.

The daily average value of ATM transactions for the second half of 2017 increased slightly by 0.6% yet remaining at BD 4.4 million compared to the first half of 2016. Furthermore, the daily average value of ATM transactions for the second half of 2017 increased by 16.4% compared to the second half of 2016.

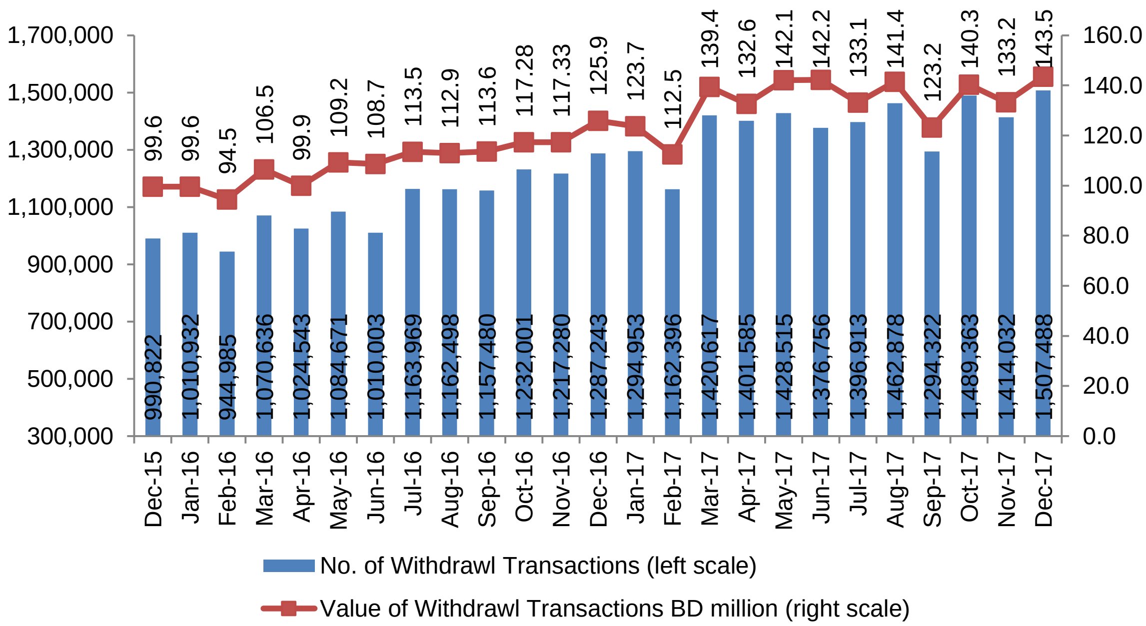
Table 8-3: ATM Transactions Daily Average and Volume

ATM Transitions	Daily Average Volume	Daily Average Value (BD million)
1st January, 2016 to 30th June, 2016	34,143	3.4
1st July, 2016 to 31st December, 2016	39,242	3.8
1st January, 2017 to 30th June, 2017	44,951	4.4
1st July, 2017 to 31st December, 2017	**46,549**	**4.4**

Source: BENEFIT.

Overall, there is an upward trend in both the value and the volume between June 2016 and June 2017 despite a number of decreases. For the second half of 2017, the highest value of withdrawals was witnessed in December 2017 at BD 143.5 million and the lowest value of withdrawals was in September 2017 at BD 123.3 million which showed the biggest decline in the value of transactions for that month. The highest volume of transactions over the past six months was in October 2017 with 1,489,363 transaction. September 2017 also had the lowest volume of transactions over the past six months with 1,294,322.

Chart 8-1: Number and Value of ATM Transactions, June 2015- June 2017



Source: BENEFIT.

8.5 Bahrain Cheque Truncation System (BCTS)

Cheques are seen as one of the most popular instruments in use among Retail Customers and Corporate Customers.

As part of the CBB vision to replace the paper based Automated Cheque Clearing System operated by the CBB, the Bahrain Cheque Truncation System (BCTS) commenced its operations in co-operation with the BENEFIT Company (BENEFIT) on the 13th May, 2012. The launch of the BCTS was a milestone to the

Bahraini financial sector which raised efficiency and Customer satisfaction. Under the BCTS, cheques presented for payment will be scanned at the Bank where the Customer deposits his/her cheque(s) and the electronic images and payment information, instead of the physical cheque, will be transmitted to the BCTS Clearing House.

The main feature of the BCTS is the increasing efficiency and speed of the cheque clearing as it facilitates Bank Customers to have their cheques cleared and obtain their funds on the same day or maximum by the next working day in addition to providing Customers with a more secure and convenient service. The BCTS is operated by BENEFIT and overseen by CBB (CBB).

The number of participants in the BCTS are twenty nine (29) participants. The daily average volume of cheques for the second half of 2017 slightly decreased by 0.2% when compared to the first half of 2017 from 13,326 cheques to 13,294 cheques. In addition, the daily average volume of cheques decreased by 1.0% from 13,432 cheques to 13,294 cheques compared to the second half of 2016.

Furthermore, the daily average value of cheques decreased in the second half of 2017 by 2.7% when compared to the first half of 2017 from BD 41.1 million to BD 40.0 million. Moreover, the daily average value of cheques for the second half of 2017 was exactly the same when compared to the second half of 2016 which is BD40.0 million.

Table 8-4: BCTS Daily Average Volume and Value

BCTS	Daily Average Volume	Daily Average Value (BD million)
1st July, 2015 to 31st December, 2015	13,162	40.4
1st January, 2016 to 30th June, 2016	13,320	41.6
1st July, 2016 to 31st December, 2016	13,432	40.0
1st January, 2017 to 30th June, 2017	13,326	41.1
1st July, 2017 to 31st December, 2017	13,294	40.0

Source: Benefit

The BCTS continued to operate smoothly and efficiently for the period from 1st July, 2017 to 31st December, 2017.

8.6 Electronic Fund Transfer System (EFTS) including Electronic Bill Presentment and Payment (EBPP) System

With the introduction of International Bank Account Number (IBAN) in January, 2012, transfers were easier and less time consuming for both Customers and Banks nevertheless, secured and more convenient. It was perceived that further uses of the IBAN can be utilised. Therefore, the Electronic Fund Transfer System (EFTS) was launched on the 5th of November, 2015, whereas Electronic Bill Presentment and Payment (EBPP) System was launched on the 3rd of October, 2016, operated by the Benefit Company (BENEFIT) and overseen by the CBB.

The EFTS including EBPP is an electronic system that interconnects all Retail Banks in Bahrain with each other and major billers in the Kingdom of Bahrain in order to enhance the efficiency of fund transfers and bill payments promoting a more proactive and forward-thinking banking sector.

The Kingdom of Bahrain took a step forward in line with the global trend of going cashless by introducing the EFTS that enabled electronic fund transfers within Bahrain with three options: Fawri+ Fawri, and Fawateer. Fawri+, Fawri and Fawateer provide fund transfers and real-time bill payments offering the public easier access, faster processes and virtually no mistakes. The number of participants offering outward EFTS Services has reached twenty five (25) participants.

The daily average volume of Fawri+ transfers for the second half of 2017 increased by 40.8% when compared to the first half of 2017 from 843 transfers to 1,187 transfers. Furthermore, the daily average volume of Fawri+ transfers for 1st July, 2017 to 31st December, 2017 increased significantly by 149.4% from 476 transfers to 1,187 transfers when compared to 1st July, 2016 to 31st December, 2016 (second half of 2016).

In addition, the daily average value of Fawri+ transfers increased by 28.5% from BD209,600 to BD269,330 for this period when compared to 1st January, 2017 to 30th June, 2017. Moreover, the daily average value of Fawri+ transfers for 1st July, 2017 to 31st December, 2017 increased by 121.9% from BD121,400 to BD269,330 when compared to 1st July, 2016 to 31st December, 2016.

Table 8-5: EFTS Fawri+ Daily Average Volume and Value

EFTS: Fawri+	Daily Average Volume	Daily Average Value (BD)
1st January, 2016 to 30th June, 2016	229	67,100
1st July, 2016 to 31st December, 2016	476	121,400
1st January, 2017 to 30th June, 2017	843	209,600
1st July, 2017 to 31st December, 2017	1,187	269,330

Source: BENEFIT

The daily average volume of Fawri transfers for the second half of 2017 increased by 16.9% when compared to the first half of 2017 from 17,925 transfers to 20,960 transfers. Moreover, the daily average volume of Fawri transfers for 1st July, 2017 to 31st December, 2017 increased by 67.1% from 12,540 transfers to 20,960 transfers when compared to 1st July, 2016 to 31st December, 2016.

Table 8-6: EFTS Fawri Daily Average Volume and Value

EFTS: Fawri	Daily Average Volume	Daily Average Value (BD million)
1st January, 2016 to 30th June, 2016	8,590	25.1
1st July, 2016 to 31st December, 2016	12,540	33.2
1st January, 2017 to 30th June, 2017	17,925	36.2
1st July, 2017 to 31st December, 2017	20,960	40.8

Source: BENEFIT

In addition, the daily average value of Fawri transfers increased by 12.7% from BD36.2 million to BD40.8 when compared to 1st January, 2017 to 30th June, 2017. Furthermore, the daily average value of Fawri transfers for 1st July, 2017 to 31st December, 2017 increased by 22.9% from BD33.2 million to BD40.8 million when compared to 1st July, 2016 to 31st December, 2016 (second half of 2016).

Table 8-7: EBPP Fawateer Daily Average Volume and Value

EFTS: Fawri	Daily Average Volume	Daily Average Value (BD)
1st July, 2016 to 31st December, 2016[13]	358	38,000
1st January, 2017 to 30th June, 2017	4,460	164,000
1st July, 2017 to 31st December, 2017	5,379	261,000

Source: BENEFIT

The daily average volume of Fawateer transfers for the second half of 2017 increased by 20.6% when compared to the first half of 2017 from 4,460 transfers to 5,379 transfers. Moreover, the daily average volume of Fawateer transfers for 1st July, 2017 to 31st December, 2017 increased enormously by 1,402.5% from 358 transfers to 5,379 transfers when compared to 1st July, 2016 to 31st December, 2016[14].

In addition, the daily average value of Fawateer transfers increased by 59.1% from BD164,000 to BD261,000 when compared to 1st January, 2017 to 30th June, 2017. Furthermore, the daily average value of Fawateer transfers for 1st July, 2017 to 31st December, 2017 increased significantly by 586.8% from BD 38,000 to BD 261,000 when compared to 1st July, 2016 to 31st December, 2016[15] (second half of 2016).

The EFTS including EBPP continued to operate smoothly and efficiently from 1st July, 2017 to 31st December, 2017. The CBB (CBB) continued to assess the EFTS including EBPP in terms of compliance with the requirements set by the Principles for Financial Market Infrastructures (PFMI) and CBB's Directives.

8.7 Financial Inclusion

Financial inclusion refers to individuals, irrespective of income level, and businesses having access to useful and affordable financial products and services to meet their needs (through transactions, payments, savings, credit and insurance). These products and services have to be delivered in a responsible and sustainable way.

In the recent years, policy-makers and regulators around the world have shown a strong interest in Financial Inclusion. The interest arises from the substantial importance of Financial Inclusion in facilitating access to financial services, creating jobs, and improving the standards of living and economic growth.

[13] Fawateer went live on 6th October, 2016.
[14] Fawateer went live on 6th October, 2016.
[15] Fawateer went live on 6th October, 2016.

Financial inclusion efforts in Bahrain aim to ensure that all businesses and households, have access to and can efficiently use the suitable financial services they need to engage in day-to-day transactions (Table 9-1). The CBB's Payment Settlement and Oversight Unit closely monitors developments in the areas of financial inclusion and their impact on domestic, regional and global levels.

The CBB currently gathers some financial inclusion data and is taking a number of initiatives to further develop indicators related to financial inclusion by expanding (1) the scope of the data and (2) its frequency.

Looking at Table 8-8 (covering from 2011 to 2016), it is seen that access to finance measured by the number of Branches and ATM machines per 100,000 people is large. In terms of bank branches per 100,000 people, Bahrain stands at 12. When looking at number of ATM machines per 100,000, Bahrain records 32 ATMs per 100,000 in population.

Table 8-8 : Financial Inclusion Figures for the Kingdom of Bahrain*

	2011	2012	2013	2014	2015	2016
Number of Banks	29	28	27	27	27	27
Number of Branches	136	147	163	167	171	172
Number of Branches per 100,000 in population	*11.4*	*12.2*	*13.0*	*12.7*	*12.5*	*12.1*
Number of ATMs	450	462	471	452	458	*461*
Number of ATMs per 100,000 in population	*37.7*	*38.2*	*37.6*	*34.4*	*33.4*	*32.4*
Number of POS	13,197	14,068	15,395	16,914	18,133	*21,558*
Number of POS per 100,000 in population	*1,104.3*	*1,163.6*	*1,228.5*	*1,286.7*	*1,323.3*	*1,514.2*
Number of Accounts **	1,373,503	1,400,310	1,505,233	1,521,724	1,636,519	1,741,395
Number of Accounts per 1,000 in population	*1,149*	*1,158*	*1,201*	*1,158*	*1,194*	*1,223*
Number of internet/PC linked accounts	286,188	313,783	352,982	471,535	468,746	544,111
ATM Cards (thousands)	1,082.6	1,157.2	1,199.7	1,229.6	1,352.6	1407.7
Debit Cards (thousands)	898.1	976.4	1,002.2	1,010.0	1,097.2	1111.2
Credit Cards (thousands)	189.6	187.7	202.3	222	253.3	290.3
Population	1,195,020	1,208,964	1,253,191	1,314,562	1,370,322	1,423,726

**Retail Banks only (Conventional and Islamic).*
***Includes saving deposits as they are used for payments in Bahrain.*
Source: CBB and IGA.

It can be seen that the number of bank accounts increased remarkably, moving from 1,373,503 in 2011 to 1,741,395 in 2016 respectively, and demonstrating an increase of 26.8%. This confirms the higher inclusion of the financial sector in Bahrain and reveals the easy access to financial services.

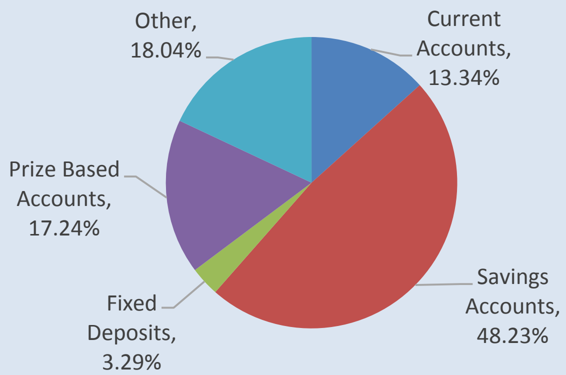
Box 1: FSD Payments and Financial Inclusion Survey

As a step towards establishing a financial inclusion and payments statistics database within the CBB, a survey was conducted by the FSD in January 2018 to analyse customer appetite for retail deposit accounts in Bahrain along with payments statistics. The survey was distributed to all retail banks (conventional and Islamic) within the Kingdom and the survey response rate reached almost 100%.

1. Retail Deposit Accounts

The survey results indicated that as of the 31st of December 2017, more than 48% of retail bank customers in Bahrain held Savings Accounts. Other Account Types came in the second category with almost 18%. Almost 13% of retail customers held current accounts and nearly 17% held prize based accounts (as seen in Box Chart 1). This shows that retail customers have a high appetite for Savings Accounts due to the different features offered by this account type such as providing easy access to funds through debit cards.

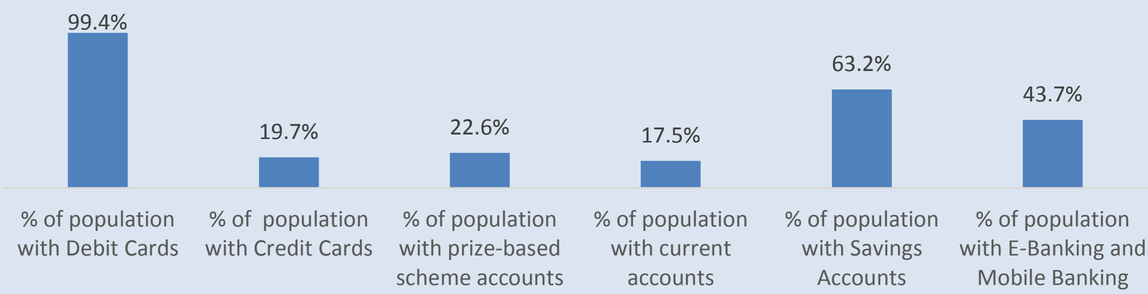
Box Chart 1: Percentage of Retail Customers by deposit account type *(as of 31st Dec 2017)*



Source: FSD Payments Survey

The survey results also showed that the number of Retail Banking customers in Bahrain as of 31st December 2017 exceeds the 2017 population figures for the age group (15-69) by almost 1.4 times. This indicates that Retail Banking Customers tend to hold deposit accounts in several retail banks but also reflects the ease of access that the population has to financial services in Bahrain. This is mirrored in the percentage of the population with debit cards, which reached over 99% of the adult population in 2017 (shown in Box Chart 2).

Box Chart 2: Payments Statistics *(as of 31st Dec 2017)*

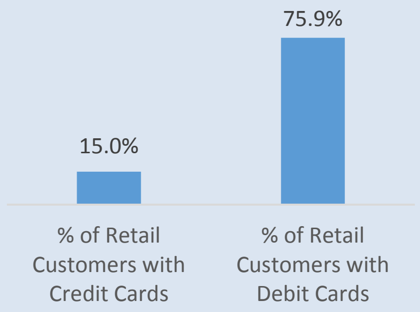


Source: FSD Payments Survey, IGA Population figures 2017

2. Debit and Credit Card Transactions

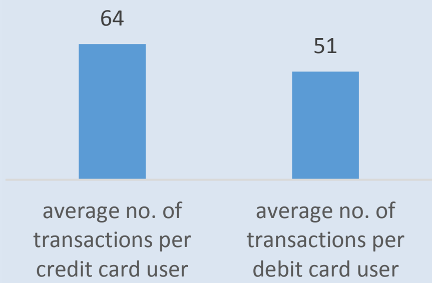
The survey results indicated that retail banking customers in Bahrain own more Debit Cards than Credit Cards despite the fact that the average number of different credit cards offered by retail banks exceeds the number of Debit Cards (as seen in Chart 3). Almost 76% of retail bank customers own debit cards and only 15% own Credit Cards. Retail banks in Bahrain offer an average of 3 different types of credit cards with the highest number being 12 cards, whereas the average number of different debit card types offered is 2 cards with the highest being 3 cards. On the other hand, the number of transactions made by credit card users of retail banks exceeded that of debit cards (as seen in Chart 4). The average number of credit card transactions per credit card user in the period between 01 Jan-31 Dec 2017 totalled 64 transactions while the number of debit card transactions made per debit card user reached 51 transactions.

Box Chart 3: Percentage of Retail Customers with Credit and Debit Cards



Source: FSD Payments Survey

Box Chart 4: Count of Credit and Debit Card Transactions in 2017

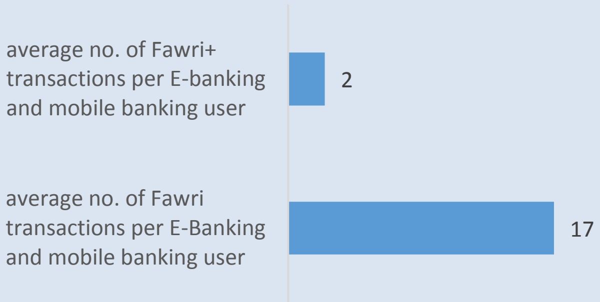


Source: FSD Payments Survey

3. E-Banking and Mobile Banking Account Users

The survey results revealed that almost 44% of the population have an E-Banking and Mobile Banking accounts (shown in Chart 2 above). This statistic was used to identify the usage of the Electronic Fund Transfer Systems (EFTS), Fawri and Fawri+ payment options. Since the inception of the EFTS, the average number of Fawri+ transactions conducted per E-Banking and Mobile Banking user totalled two transactions and as for Fawri, the average number of transactions totalled a count of 17.

Box Chart 5: Count of Fawri and Fawri+ Transactions (since inception to 31st December 2017)



**source: FSD Payments Survey*

9. Fintech and Cyber Security

Chapter

9

Key Points

- Over the past year, the majority of banks reported that only 0-35% of operational risk incidents were cyber security related, whereas only one bank reported that 40-70% of incidents in 2017 were cyber related.
- Almost 96% of retail banks in Bahrain report cyber security incidents to their Board of Directors.
- Retail Banks in Bahrain consider the risk of an employee or other authorized user engaging in misconduct that will result in compromise to the bank's network or data as the most serious of cyber threats along with the bank's network being breached by an unauthorized user.
- The CBB is currently developing a single Information Technology Module for all CBB Licensees.

9.1 Overview

The Kingdom of Bahrain is an established financial hub in the Gulf Cooperation Council (GCC) and Middle East region. Consequently, the Kingdom is repositioning itself to be a Financial Technology (FinTech) hub of the region combining conventional and Shari'ah compliant FinTech solutions. Offering low cost, convenient and instant payments, FinTech has been of great interest to the regulators that were posed with the challenges of regulating, overseeing and ensuring safety and efficiency of those new payment methods.

Cyber risk is steadily evolving into a main threat to all industries. Its impact however on the financial services industry is growing into an individually recognised risk by all financial institutions. Given the innovations in information technology (IT) and financial institutions' increased reliance on IT channels, cyber security is no longer regarded as a technical issue but a main threat to the industry.

The CBB will therefore be addressing developments in Fintech and cyber risk as a recurrent chapter in its Financial Stability Report.

The aim of the chapter is to (1) Highlights the different initiatives of the Central Bank in the fields of Fintech and (2) actively spread awareness about Cyber Risk by warning the financial industry of the large operational, financial and security risks involved with cyber security.

9.2 Fintech and Financial Inclusion

The CBB seeks to make the Kingdom of Bahrain a key player in Fintech through the availability of (1) advanced financing techniques, (2) highly qualified national talent in banking, and (3) access to supportive policies. The CBB has issued a series of measures to strengthen its position as a regional financial center; including guidelines on the regulatory environment to ease the implementation of Fintech's innovative financial services initiatives. Innovation and regulatory sandboxes play a vital role in harnessing the advancement of financial technology solutions to support financial inclusion. The CBB has announced a series of measures towards consolidating its position as a regional financial hub and facilitating a number of Fintech initiatives.

The Kingdom is repositioning itself to be a FinTech hub of the region combining conventional and Shari'ah compliant FinTech solutions in order to enable to achieve higher financial inclusion. The pace of change in the financial services industry has been due to technological advances that have caused paradigm shifts in the sector. A higher degree of financial inclusion enabled through Fintech provides countless benefits to the economy and plays a crucial role in the country's economic and social development.

The Kingdom of Bahrain achieved remarkable progress towards financial inclusion by putting in place a facilitating regulatory and policy environment through its financial regulator. Additionally it stimulated competition in the financial sector by allowing banks and non-banks to innovate and expand access to financial services, which created an advanced and competitive space that has been accompanied with regulations to ensure responsible provision of financial services.

As part of the CBB's ongoing initiatives towards financial digital transformation and developments in digital financial services, the CBB announced the establishment of a dedicated Fintech Unit on the 22nd of October 2017 to ensure the best services are provided to individual and corporate customers in the financial sector.

The proposed Fintech Unit will be responsible for the approval process to participate in the Regulatory Sandbox, supervision of licensed companies' activities and operations, including cloud computing, payment and settlement systems, and monitoring technical and regulatory developments in the Fintech field which will allow industry players to apply innovative products while maintaining the overall safety and soundness of the financial system. This step in the development of the current ecosystem in place is to encourage growth in the Fintech industry and welcoming more local, regional, and international Fintech firms in the Kingdom.

The sections below cover the latest Fintech developments and initiatives within the Kingdom.

9.2.1 Regulatory Sandbox

The CBB has launched a regulatory sandbox in June 2017 that enables emerging businesses and financial technology companies to test their projects and create pioneering solutions for the financial sector and digital financial inclusion.[16] This initiative aims to attract Fintech companies from around the world to develop and expand their business in the Arabian Gulf and MENA Region, which will strengthen Bahrain's position as a center of technology and financial services in the region.

The newly launched sandbox, which includes 6 companies to date, will provide financial technology companies with the opportunity to test and experiment their innovative technology solutions freely. Additionally, the sandbox is also open to CBB licensed companies to take advantage of within an incubating regulatory environment to help develop ideas until they are commercially viable. The period allowed for this arrangement will be nine months and may be extended if need be.

The Sandbox focuses on three criteria items that include:

- Innovation: The solution should be truly innovative or significantly different from existing offerings, or offer a new use for existing technologies.
- Customer benefit: The solution should offer identifiable direct or indirect benefits to customers.
- Technical testing: The solution should have been technically tested in a lab environment and such results should be made available to the CBB.

9.2.2 Crowdfunding

The CBB has also issued guidelines for crowdfunding for both conventional and Islamic lending purposes. For the first time, small and medium-sized companies in Bahrain and the region will be able to raise conventional financing or Shariah-compliant financing through crowdfunding. In April, 2017, the CBB proposed Financing Based Crowdfunding Regulations. Companies operating an electronic financing/lending platform must be licensed in Bahrain under the instructions in Volume V of the CBB Rulebook. CBB anticipates that entrepreneurs will benefit from the global trend in crowdfunding, which provides a feasible alternative to bank financing. The CBB is particularly keen to ensure that the Kingdom has a leading spot in the crowdfunding market.

It is expected that Bahraini entrepreneurs will benefit from the global crowdfunding trend, which provides a viable alternative to bank financing. In particular, the CBB is keen to see Bahrain dominate the Shari'a compliant financing-based crowdfunding market in the region. The demand for Shari'a compliant financing is already high and is expected to see it reflected in the crowdfunding market.
Some of the key highlights of the crowdfunding regulations by CBB are as follows:

- Minimum capital requirement for crowdfunding platform operators is BD 50,000.
- Only Person to Business (P2B) lending / financing is permitted.
- SMEs with paid up capital not exceeding BD 250,000 can raise funds through crowdfunding platforms.

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[16] A Regulatory Sandbox (Sandbox) is a framework and process that facilitates the development of the FinTech industry in a calculated way. It is defined as a safe space in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory and financial consequences of engaging in the activity in question.

- These SMEs may be based in Bahrain or outside; however, in case of foreign SMEs the platform operators have to clearly mention the cross-border and jurisdictional risk financiers have to take.
- It is the responsibility of the lenders/financiers to perform their own creditworthiness assessment on borrowers/fundraisers.
- Crowdfunding platform operators have to comply with the CBB rules on Anti Money Laundering, Combating Financing of Terrorism (AML/CFT), and consumer protection.

9.2.3 Benefit

The Bahrain Credit Reference Bureau (known as BENEFIT) stores, analyzes and categorizes credit information. It also provides innovative payment capabilities, information management solutions, and business process outsourcing services that add value to the financial sector and other stakeholders to manage their business effectively. The BENEFIT Company positions itself in being at the forefront of developing powerful tools for the banking and financial services sector to increase productivity, profitability and customer satisfaction.

The Central Bank also uses BENEFIT's credit data for statistical purposes and performs studies related to financial inclusion to support policy development. The Central Bank is also examining ways to further develop indicators related to financial inclusion, and strongly urges the strengthening of public-private cooperation to create a reinforcing environment for financial inclusion. The services that Benefit offers include:

- Automated Teller Machine (ATM)
- Point of Sale (POS):
- Bahrain Credit Reference Bureau
- Bahrain Cheque Truncation System
- Electronic Fund Transfer System (EFTS)
- Payment Gateway
- Internet Banking Shared Platform
- GCCNet Dispute Management System
- Direct Debit
- Tele Bill Payment through Mobile Phones

9.2.4 Small and Medium Enterprises Support

In addition to the microfinance institutions, the government continues to support micro, small and medium enterprise financing options through its support initiatives; Bahrain Development Bank, and Tamkeen, which constantly develops ways SMEs can obtain formal financing options suitable to the nature of the enterprises, in addition to providing various means of support. Formalizing SME funding through suitable funding channels in the financial system enables higher financial inclusion, and facilitates higher financial coverage.

The crowdfunding initiatives taking place in the Kingdom will help SMEs and start-ups fill gaps in lending and move ahead with developing products and solution which is seen as a vital way both to encourage innovation and support our thriving ecosystem.

9.2.5 Other Initiatives and Remarks

The financial services sector provides services to various categories of the Bahraini population. All payments made by the government, whether in the form of salaries, wages, social benefits or payments to service providers to government agencies, are through formal bank accounts. Women and young adults face no obstacles or any form of barrier preventing access from the financial sector. The government is also currently working on the development of a system that will formalize the wage distribution of foreign workers employed in the private sector. All private institutions will be obliged to pay salaries to their foreign employees through banks, with control of the payment mechanism to ensure that there is no breach of the obligations of companies towards workers.

Efforts have been made by the CBB to prioritize financial inclusion in terms of adopting and implementing a viable national strategy, improving women's, SME, and young people's access to financial services, promoting the protection of consumers of financial services, improving and providing financial coverage data and statistics to support policy development, and promoting awareness and financial education.

The CBB is also currently undertaking efforts to enhance financial coverage and provide financial services through:

1. Conducting a study within the CBB to examine the Wage Protection System.
2. Granting licenses to two microfinance institutions, namely the Ebdaa Bank and the Family Bank (Microfinance Institutions).

9.3 CBB Cybersecurity Initiatives

A. Updates from the CBB TRMST Committee

The Technology Risk Management Security Team (TRMST) was established by the Central Bank of Bahrain on 11 December 2013, chaired by the Director of the IT Directorate and members from the Licensing & Policy Directorate, IT Directorate, Inspection Directorate and the Advisor of the Banking Sector. The Committee’s main objectives are to address the main IT and Cyber Security related matters and take the necessary actions accordingly. The Committee is also required to agree on issues to be addressed by the CBB Guidelines/Rulebooks with regards to technology security measures for banks and financing companies providing E-Banking to their customers and for ancillary service licensees, processing any bank related transactions, including but not limited to card processing, card personalization and internet services.

The TRMST committee continuing working on developing the required E-Banking rules to ensure that the operational and cyber related risks are minimized. The CBB’s IT Security team therefore fulfils a vital function in the regulation of financial institutions in Bahrain. The responsibilities of the CBB are constantly expanding from managing banks and other financial institutions to overseeing retail banks and extended enterprises encompassing cloud networks, mobile devices and ensuring that the exponentially growing amount of data is safely stored and encrypted.

Table9-1 : CBB's TRMS Committee Updates

2016	2017
The CBB's TRMST Committee made changes to the Operational Risk Management Module (OM), which were issued as part of April 2016 updates. Banks are now required to maintain up to date Payment Card Industry Data Security Standards (PCI-DSS) certification. Additional ATM security measures are also now in place.	Amendments made to relevant Rulebook modules of all CBB licensees to consider the use of "cloud computing services" as part of outsourcing services, with additional security measures catered for cloud computing. This was issued to the industry in September 2017.
A circular to All Bank Licensees, Financing Companies, Card Processing and Payment Services Providers and Credit Information Bureaus was issued by the Executive Director of Banking Supervision (EDBS) on 1st June 2016 related to "Cyber Security Risk Management". The circular included requirements to comply with before the end of the year. Detailed IT security requirements are to be developed in future.	Development of a single Information Technology Module for all CBB licensees. This project is in process.
A circular to All Retail Banks and Financing Companies was issued by EDBS on 9th June 2016 related to "Outsourcing of Functions Containing Customer Information".	
The TRMST Committee drafted e-banking guidelines. These guidelines are a statement of industry best practices and when finalized will be issued to financial institutions.	

Source: CBB.

B. CBB Cyber Security Survey

I- Survey Scope & Objectives

As part of The Central Bank of Bahrain's ongoing initiatives to assess the growing cyber risk in the financial services industry, the Cyber Security Survey was relaunched this year for the second time since publishing the survey's pilot results in 2016. The aim of the survey is to assess which cyber threats constitute the most serious of threats to Bahrain's Retail Banking system. The survey received an excellent response rate where the participation rate of retail banks reached almost 100%. In the first part of the survey, retail banks were asked to identify which proportion of their operational risk incidents were cyber security related over the past year. Respondents were asked to choose from three percentage groups (0 to 35%, 40-70%, 75-100%). In the second part of the survey, a list of hypothetical cyber security events were presented and respondents were asked to rank these incidents by the degree of seriousness according to each individual bank's risk perception. In the third part of the survey, respondents were asked a list of four questions that will help us understand whether retail banks are aware of the growing risk of cyber risk.

II- Key Survey Findings:

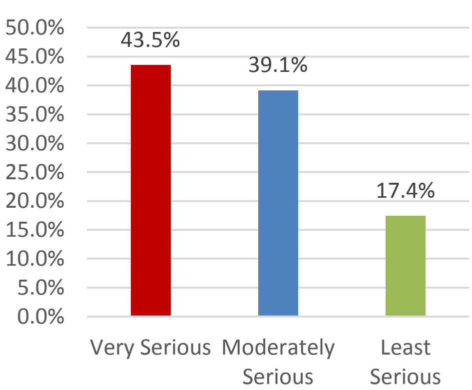
- The survey indicated that 97% of respondents experienced cyber security related incidents that were 0-35% of operational risk incidents recoded over the past year. There was one survey respondent who reported that 40-70% of incidents were cyber related.

- According to the responses received, the only risk categorized by the majority of retail banks, as a moderately serious cyber threat (by almost 52.2%) is in the instance that a bank receives fraudulent emails, purportedly from customers, seeking to direct transfers of customer funds or securities.
- The two cyber threats with the highest classification of being very serious, with a rate of 74%, is in the instance that an employee or other authorized user of the bank's network engages in misconduct resulting in compromise to the bank's network or data and where The bank's network was breached by an authorized user.
- 100% of retail banks have a designated IT Security Officer Position (this percentage went up from 96% in 2016).
- Approximately 91% of retail banks regularly incorporate requirements relating to cyber-security into contracts with vendors/clients (this percentage went up from 83% in 2016).
- 100% of retail banks conduct regular security awareness sessions to their employees (this percentage went up from 87% in 2016).
- Almost 96% of retail banks report cyber security incidents to their Board of Directors (this percentage went up from 87% in 2016).

III- Degree of Seriousness of Hypothetical Cyber Security Events

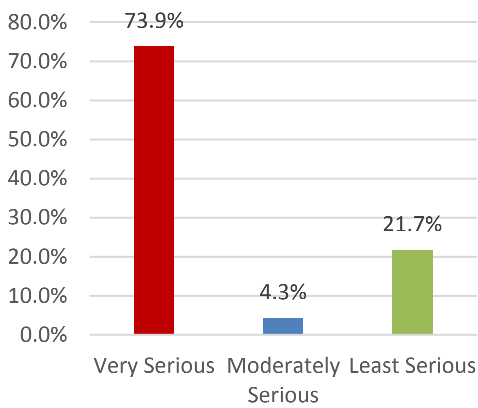
As Chart 9-1 below indicates, almost 43.5% of respondents classified the risk of detecting malware on ore more of their bank's devices as a very serious risk. The other 39% of respondents found this to be a moderately serious threat, which means that they do have adequate policies and procedures in place that can help detect, contain and control the risk. The remaining respondents found this to be a less serious threat by almost 17.4%. Chart 9-2 on the other hand presents the perception of retail banks to the risk event of having the bank's network breached by an authorized user. The majority of retail banks (almost 74%) found this to be a very serious threat while 4.3% classified it as a moderately serious threat and the remaining 21.7% found this to be a less serious one.

Chart 9-1: Detection of Malware on one or more of the bank's devices



Source: CBB Cyber Security Survey 2018.

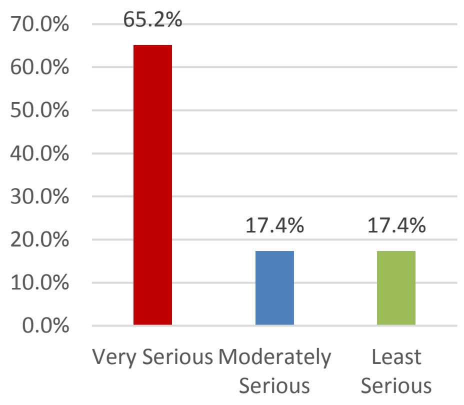
Chart 9-2: The bank's network was breached by an authorized user



Source: CBB Cyber Security Survey 2018.

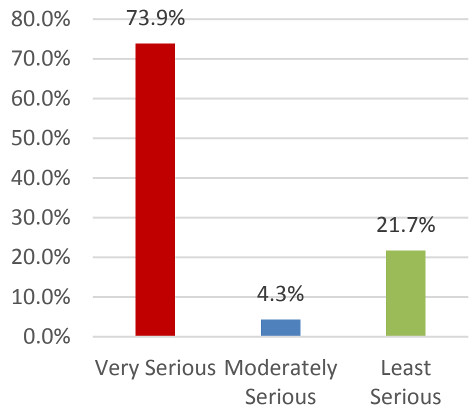
Chart 9-3 below indicates that the majority of retail banks find that fraudulent activity caused by the compromise of a vendor's computer that was used to remotely access the bank's network is a very serious threat according to 65% of the respondents. Whereas only 17.4% of retail banks find this to be a moderately serious threat and the remaining 17.4% regard this as a less serious one. Chart 9-4 ascertains that the majority of retail banks (74%) find that breach of the bank's network or data from an authorized user such as an employee is a very serious threat and only 22% find it to be a less serious one.

Chart 9-3: The compromise of a customer's or vendor's computer used to remotely access the bank's network resulted in fraudulent activity



Source: CBB Cyber Security Survey 2018.

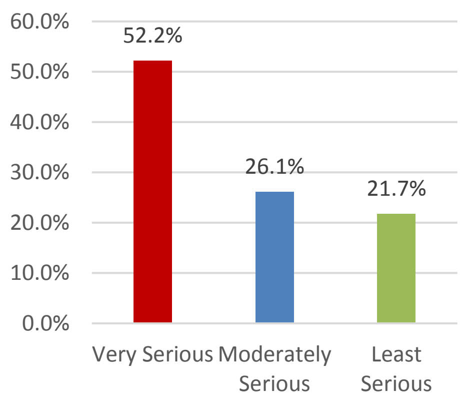
Chart 9-4: The compromise of a customer's or vendor's computer used to remotely access the bank's network resulted in fraudulent activity



Source: CBB Cyber Security Survey 2018.

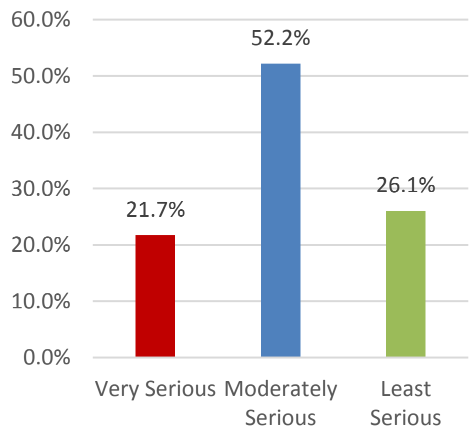
In the instance that a bank was subject to an extortion attempt by an individual or group, threatening to impair access to or breach the bank's data, properties, or networks, almost 52% of retail banks classified this as a very serious threat (Chart 9-5). However, the majority of retail banks categorized the risk of receiving fraudulent emails from customers instructing the bank to transfer funds or securities as a moderately serious threat since systems and authentication levels are already set in place by the majority of banks in Bahrain (Chart 9-6).

Chart 9-5: The bank was the subject of an extortion attempt by an individual or group threatening to impair access to or damage the bank's data, devices, network, or web services



Source: CBB Cyber Security Survey 2018.

Chart 9-6: The bank received fraudulent emails, purportedly from customers, seeking to direct transfers of customer funds or securities

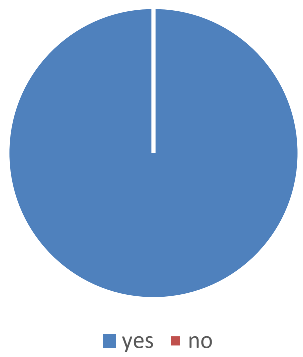


Source: CBB Cyber Security Survey 2018.

IV- Retail Banks' Awareness of the Growing Cyber Risk in the Financial Services Industry

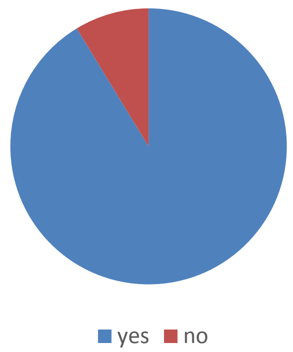
The availability of an Information Security Officer in the majority of retail banks in Bahrain indicates that banks do recognize the importance of the protection of data and networks along with detecting information security vulnerabilities and threats (as seen in chart 9-7 below). There has been an improvement since the last survey was launched in 2016 where 100% of Retail Banks have a dedicated Information Security Officer. This percentage went up from 95% in 2016.

Chart 9-7: Information Security Officer



Source: CBB Cyber Security Survey 2018.

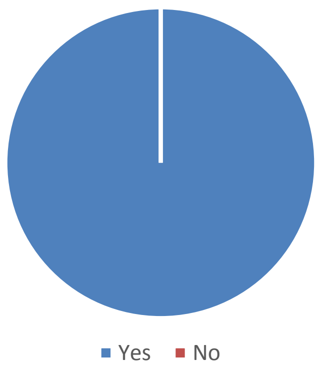
Chart 9-8: Requirements relating to cyber-security are regularly incorporated into contracts with vendors/clients



Source: CBB Cyber Security Survey 2018.

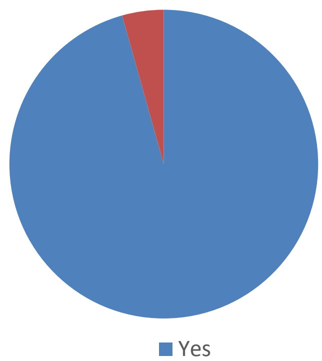
The survey indicates that retail banks are aware of the growing cyber risk in the banking and financial industry through their undertaken initiatives to educate their employees about cyber security and by reporting cyber incidents to the Board of Directors, as shown in charts 9-9 and 9-10.

Chart 9-9: Regular cyber security awareness sessions are conducted to employees



Source: CBB Cyber Security Survey 2018.

Chart 9-10: Reporting cyber security incidents to banks' Board of Directors



Source: CBB Cyber Security Survey 2018.

Annex:

Financial Soundness Indicators and Selected Graphs

Annex 1: Financial Soundness Indicators

Annex1 Table 1:
Selected Financial Soundness Indicators—Overall Banking System

(End of period)

	Sep-16	Mar-17	Sep-17
Capital Adequacy			
CAR (%) *	19.0	18.7	19.4
Tier 1 CAR (%) *	17.5	17.4	18.1
Leverage (Assets/Capital) (Times) *	7.0	6.8	6.9
Asset Quality			
NPL's (% of Total Loans)	5.5	5.9	5.7
Specific Provisions (% of NPL's)	54.1	57.3	57.0
Loan Concentration (Share of Top Two Sectors) (%)	29.3	30.1	29.4
Real Estate/ Construction Exposure (%) **	22.2	23.0	23.6
Earnings			
ROA (%)	0.7	0.3	0.9
ROE (%) ***	4.5	2.1	5.7
Net Interest Income (% of Total Income) ****	67.8	58.5	66.1
Net Fees & Commissions (% of Total Income) ****	16.9	23.6	16.1
Operating Expenses (% of Total Income)	55.8	65.0	53.4
Liquidity			
Liquid Assets (% of Total Assets)	22.8	24.3	25.6
Loan-Deposit Ratio (%)	67.9	65.2	64.7

** Locally-incorporated banks only*
*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*
****ROE is defined as net profit over Tier 1 Capital.*
***** Conventional Banks only*
Source: CBB.

Annex1 Table 2:
Selected Financial Soundness Indicators—Conventional Retail Banks

(End of period)

	Sep-16	Mar-17	Sep-17
Capital Adequacy			
CAR (%) *	19.6	20.3	20.4
Tier 1 CAR (%) *	17.8	18.6	18.8
Leverage (assets/capital) (Times) *	7.7	6.6	6.5
Non-Performing Loans Net Provisions to Capital (%) *	6.1	6.0	6.6
Asset Quality			
NPL's (% of Total Loans)	4.7	5.7	5.8
Specific Provisions (% of NPL's)	49.9	50.0	49.5
Net NPL' (% of Net Loans)	2.4	3.0	3.1
Loan Concentration (Share of Top Two Sectors) (%)	31.7	34.7	35.2
Real Estate/ Construction Exposure (%) **	29.8	30.7	30.7
Earnings			
ROA (%)	1.1	0.2	1.2
ROA Local Banks (%)	1.3	0.5	1.5
ROA Overseas Banks (%)	0.6	-0.3	0.8
ROE (%) ***	11.4	3.8	10.3
Net Interest Income (% of Total Income)	73.9	72.4	74.5
Net Fees & Commissions (% of Total Income)	13.2	15.6	13.9
Operating Expenses (% of Total Income)	47.5	72.6	43.0
Liquidity			
Liquid Assets (% of Total Assets)	24.4	24.6	35.8
Liquid Assets (% of Short-Term Liabilities)	37.1	39.1	45.3
Loan-Deposit Ratio (%)	70.0	71.7	68.7
Non-Bank Deposits (% of Total Deposits)	79.9	77.6	78.3

** Locally-incorporated banks only*
*** Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: CBB.

Annex1 Table 3:
Selected Financial Soundness Indicators—Conventional Wholesale Banks

(End of period)

	Sep-16	Mar-17	Sep-17
Capital Adequacy			
CAR (%) *	19.8	18.1	19.2
Tier 1 CAR (%) *	18.4	17.0	18.2
Leverage (assets/capital) (Times) *	9.4	6.8	7.0
NPL’s Net Provisions to Capital (%) *	7.2	4.7	5.6
Asset Quality			
NPL’s (% of Total Loans)	5.5	5.6	5.6
Specific Provisions (% of NPL’s)	63.0	67.9	64.9
Net NPL' (% of Net Loans)	2.1	1.9	2.1
Loan Concentration (Share of Top Two Sectors) (%)	38.2	36.1	35.7
Real Estate/ Construction Exposure (%) **	12.7	16.5	18.7
Earnings			
ROA (%)	0.6	0.3	0.8
ROA Local Banks (%)	0.4	0.3	0.5
ROA Overseas Banks (%)	0.9	0.4	1.1
ROE (%) ***	3.6	1.9	3.4
Net Interest Income (% of Total Income)	61.0	46.1	57.6
Net Fees & Commissions (% of Total Income)	23.2	36.5	20.7
Operating Expenses (% of Total Income)	53.2	52.2	48.1
Liquidity			
Liquid Assets (% of Total Assets)	24.6	27.4	21.9
Liquid Assets (% of Short-Term Liabilities)	35.4	37.6	33.5
Loan-Deposit Ratio (%)	66.7	60.2	61.1
Non-Bank Deposits (% of Total Deposits)	43.1	46.2	47.1

** Locally-incorporated banks only*
***Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total lending.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: CBB.

Annex1 Table 4:
Selected Financial Soundness Indicators—Islamic Retail Banks

(End of period)

	Sep-16	Mar-17	Sep-17
Capital Adequacy			
CAR (%)	17.1	17.1	18.2
Tier 1 CAR (%)	14.9	15.3	15.3
Leverage (Assets/Capital) (Times)	6.4	7.6	8.5
NPF's Net Provisions to Capital (%)	28.3	27.2	26.1
Asset Quality			
NPF's (% of Total Facilities)	12.1	10.1	9.0
Specific Provisions (% of NPF's)	34.1	39.9	44.1
Net NPF's (% of Net Facilities)	7.8	6.4	5.3
Facilities Concentration (Share of Top Two Sectors) (%)	38.9	37.1	37.6
Real Estate/ Construction Exposure (%) *	29.4	25.6	24.0
Earnings			
ROA (%)	0.2	0.1	0.4
ROE (%) **	1.6	1.7	4.5
Net Income from Own Funds, Current Accounts and Other Banking Activities (% of Operating Income)	58.8	62.6	62.9
Net income from Jointly Financed Accounts and Mudarib Fees (% of Operating Income)	33.5	36.8	36.1
Operating Expenses (% of Total Income)	82.9	77.8	78.2
Liquidity			
Liquid Assets (% of Total Assets)	12.3	12.4	11.5
Facility-Deposit Ratio (%)	82.9	86.3	89.1
Current Accounts from Non-Banks (% of Non-Capital Liabilities, excl. URIA)	29.5	29.2	29.3

** Locally-incorporated banks only*
***Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total financing.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: CBB.

Annex1 Table 5:
Selected Financial Soundness Indicators—Islamic Wholesale Banks

(End of period)

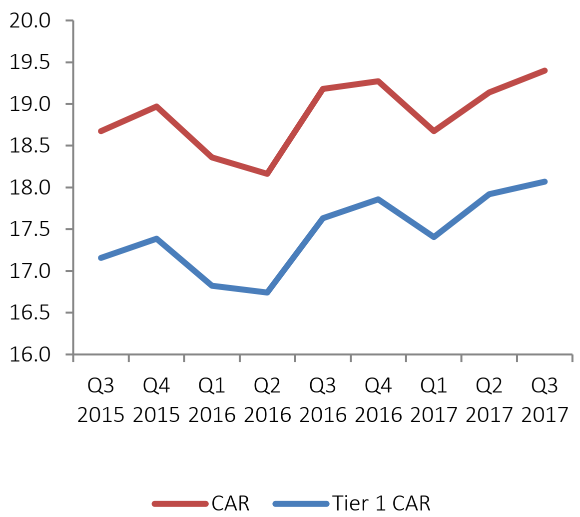
	Sep-16	Mar-17	Sep-17
Capital Adequacy			
CAR (%)	19.3	18.5	18.8
Tier 1 CAR (%)	18.5	17.8	18.3
Leverage (Assets/Capital) (Times)	6.7	6.7	6.5
NPF's Net Provisions to Capital (%)	1.5	0.5	0.3
Asset Quality			
NPF's (% of Total Facilities)	2.9	2.6	7.4
Specific Provisions (% of NPF's)	82.4	93.8	95.8
Net NPF's (% of Net Facilities)	0.5	0.2	2.6
Facilities Concentration (Share of Top Two Sectors) (%)	40.6	40.5	40.1
Real Estate/ Construction Exposure (%) **	27.4	19.9	19.1
Earnings			
ROA (%)	0.2	0.2	0.8
ROE (%) ***	1.6	2.4	5.0
Net income from own funds, current accounts and other banking activities (% of operating income)	55.3	54.8	58.8
Net income from jointly financed accounts and Mudarib fees (% of operating income)	45.4	44.5	40.3
Operating expenses (% of total income)	61.1	73.0	68.3
Liquidity			
Liquid Assets (% of Total Assets)	18.9	21.6	22.9
Facility-Deposit Ratio (%)	61.6	61.3	61.4
Current Accounts from Non-Banks (% of Non-Capital Liabilities, excl. URIA)	43.8	44.0	44.4

** Locally-incorporated banks only*
***Real Estate/ Construction exposure is calculated as the share of the Construction, Commercial real estate financing and Residential Mortgages sectors of total financing.*
**** ROE is defined as net profit over Tier 1 Capital.*
Source: CBB.

Annex 2: Selected Graphs

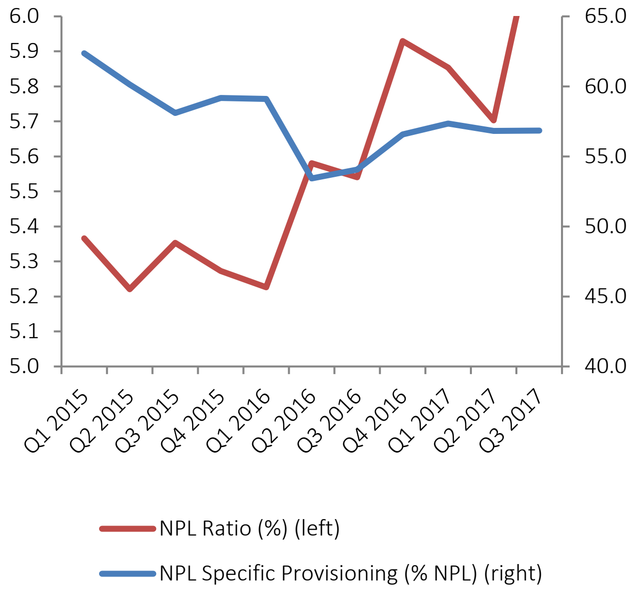
A. Overall Banking Sector

Annex 2 Graph 1: CAR



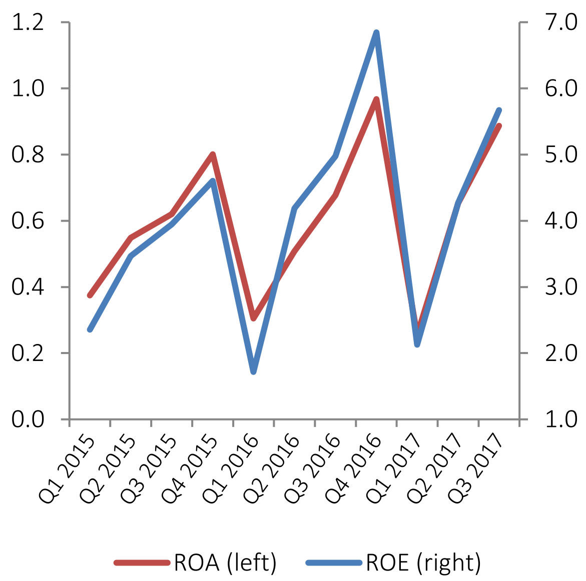
Source: CBB.

Annex 2 Graph 2: NPL and Provisioning



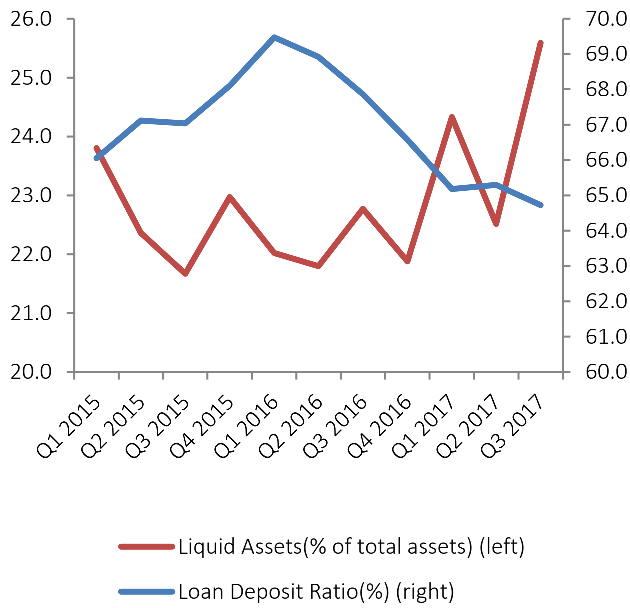
Source: CBB.

Annex 2 Graph 3: Profitability



Source: CBB.

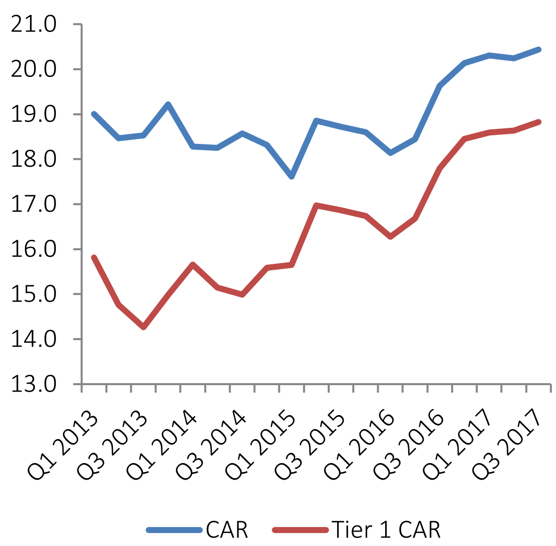
Annex 2 Graph 4: Liquidity



Source: CBB.

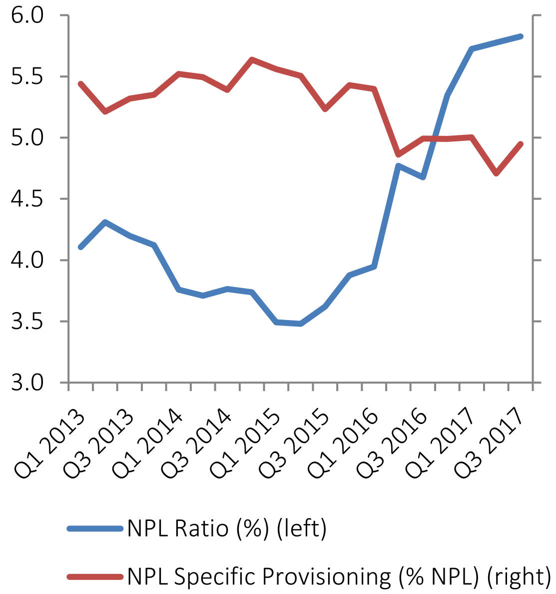
B. Conventional Retail

Annex 2 Graph 5: CAR



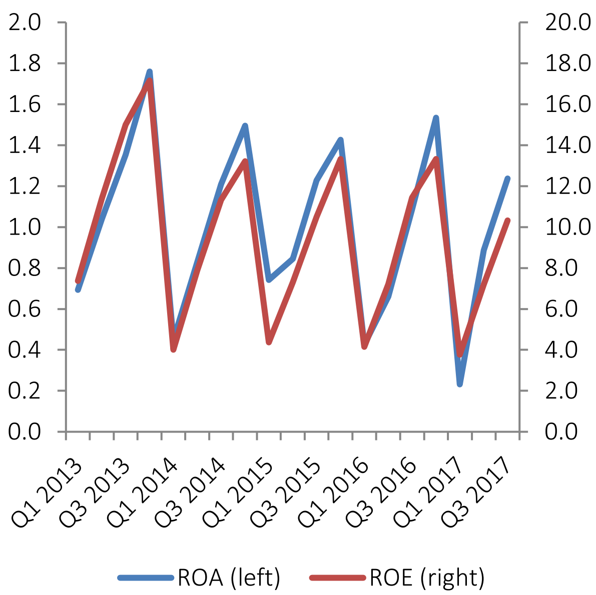
Source: CBB.

Annex 2 Graph 6: NPL and Provisioning



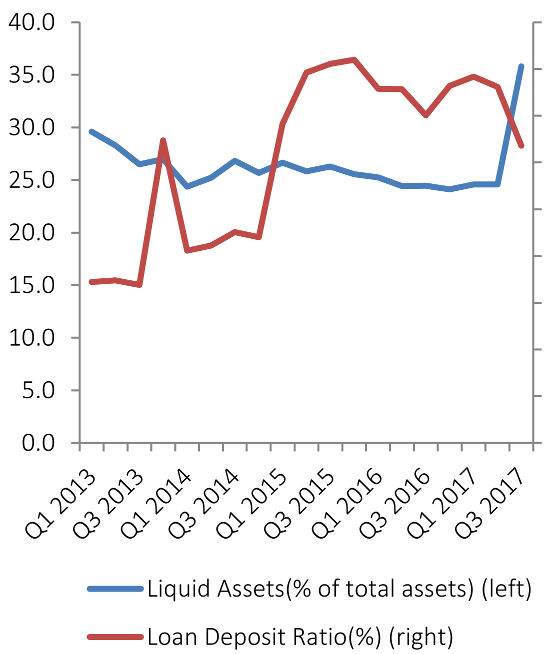
Source: CBB.

Annex 2 Graph 7: Profitability



Source: CBB.

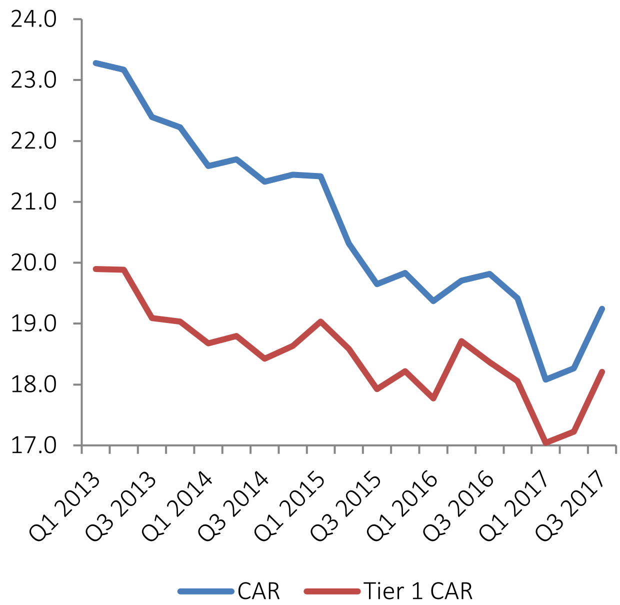
Annex 2 Graph 8: Liquidity



Source: CBB.

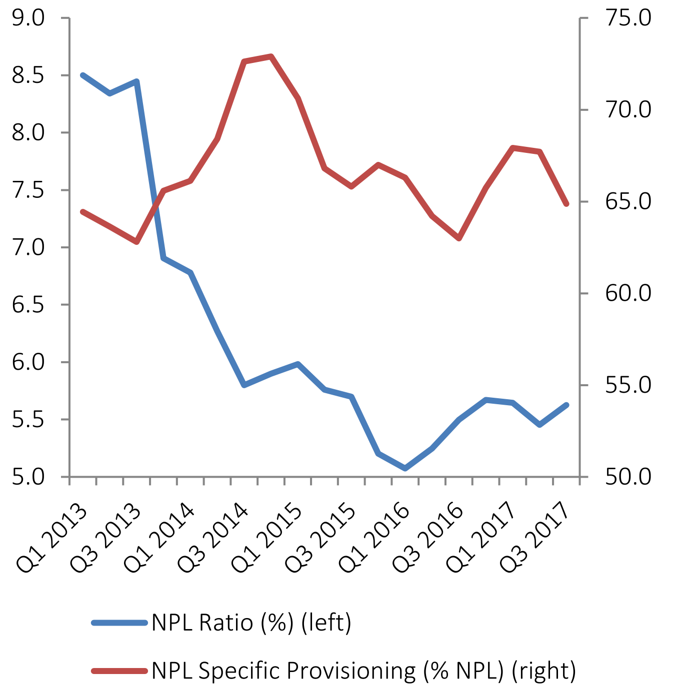
C. Conventional Wholesale

Annex 2 Graph 9: CAR



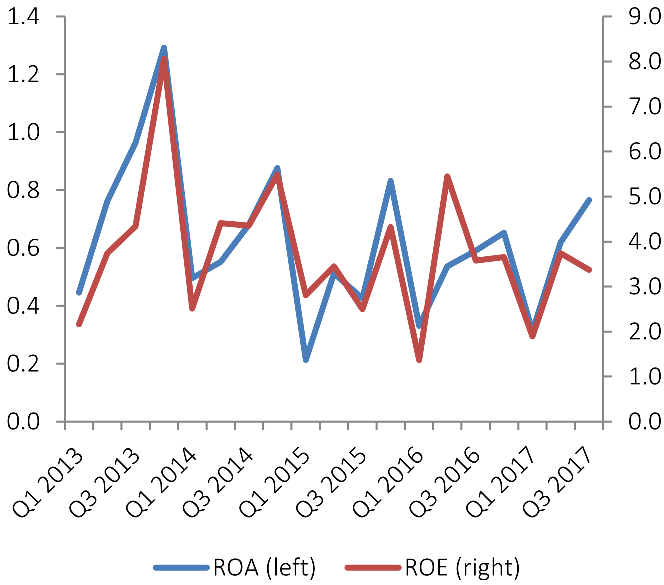
Source: CBB.

Annex 2 Graph 10: NPL and Provisioning



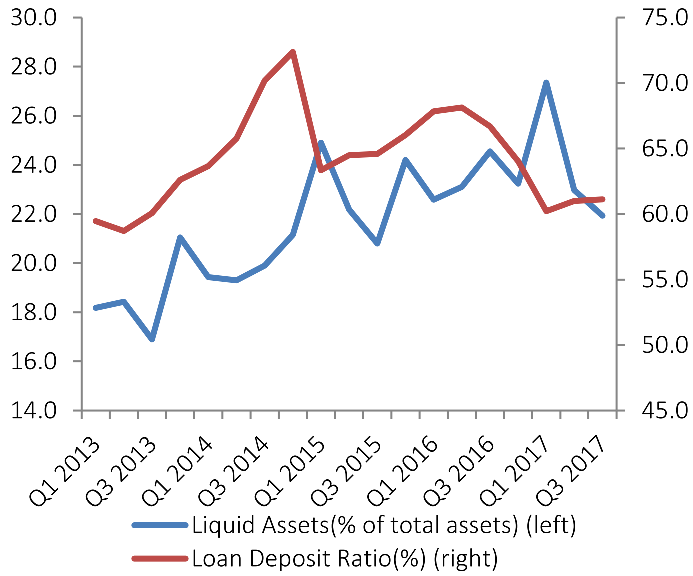
Source: CBB.

Annex 2 Graph 11: Profitability



Source: CBB.

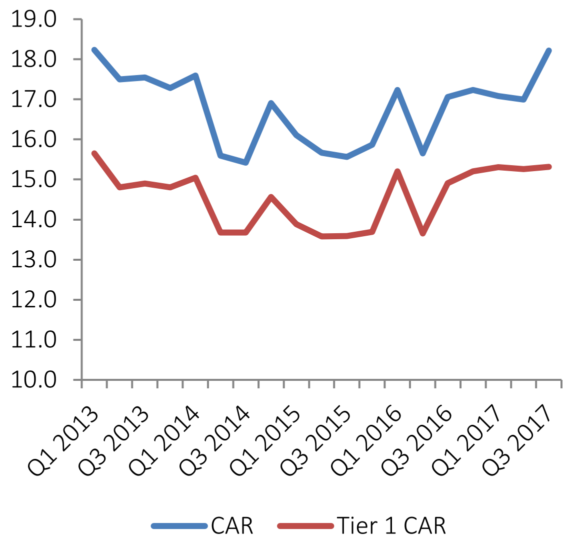
Annex 2 Graph 12: Liquidity



Source: CBB.

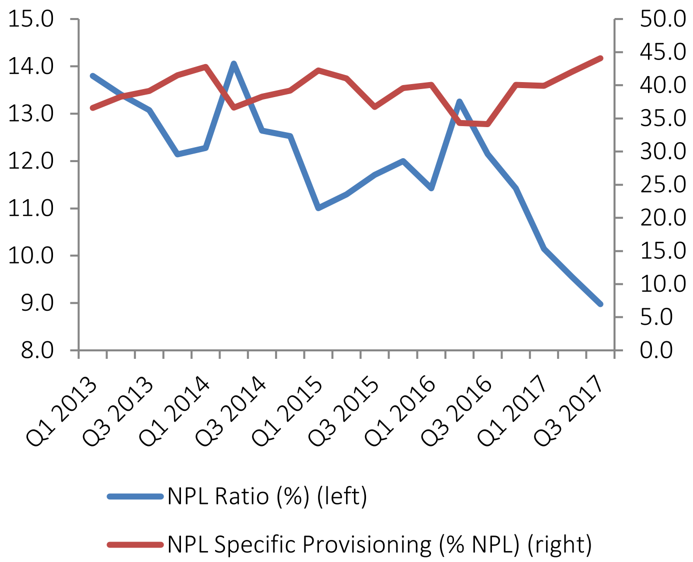
D. Islamic Retail

Annex 2 Graph 13: CAR



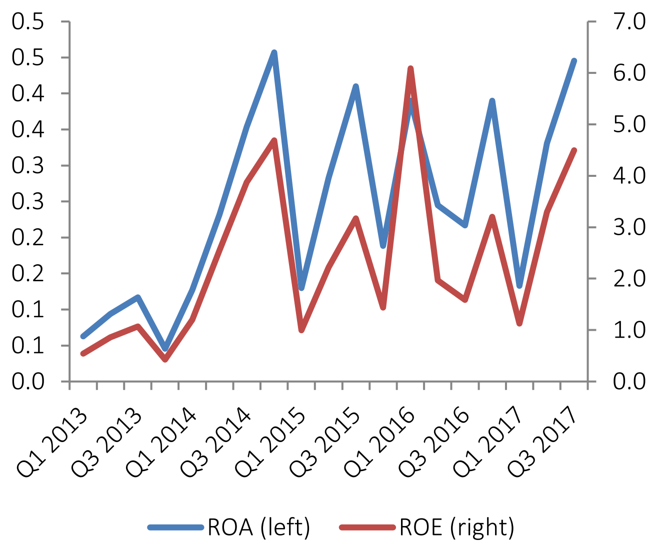
Source: CBB.

Annex 2 Graph 5: NPL and Provisioning



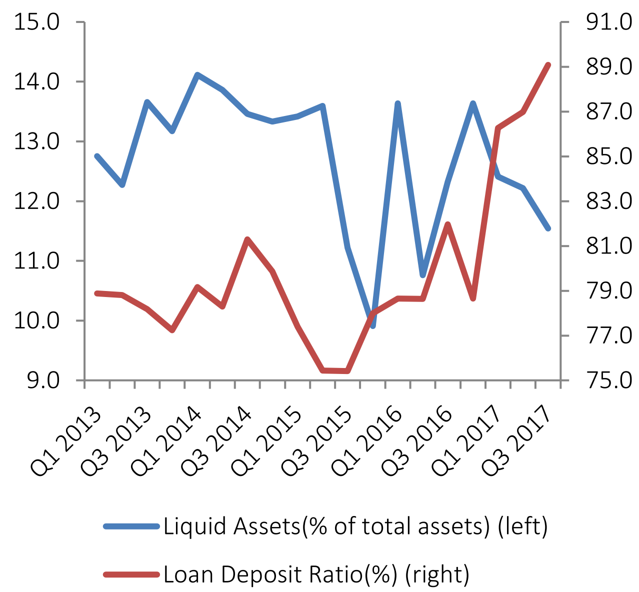
Source: CBB.

Annex 2 Graph 6: Profitability



Source: CBB.

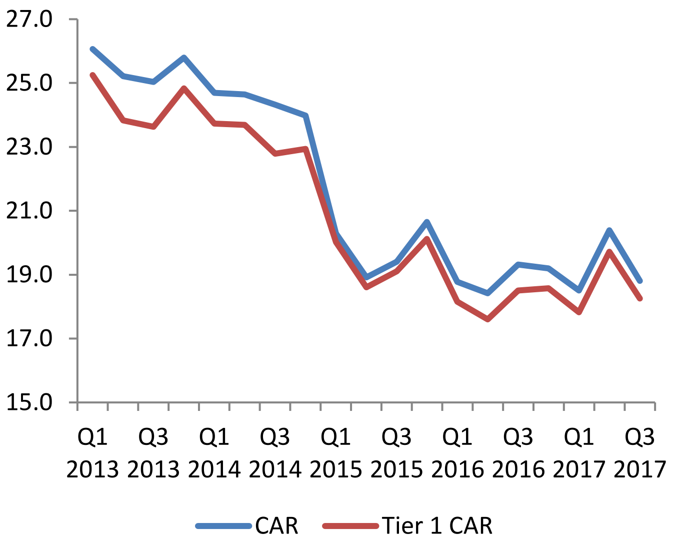
Annex 2 Graph 7: Liquidity



Source: CBB.

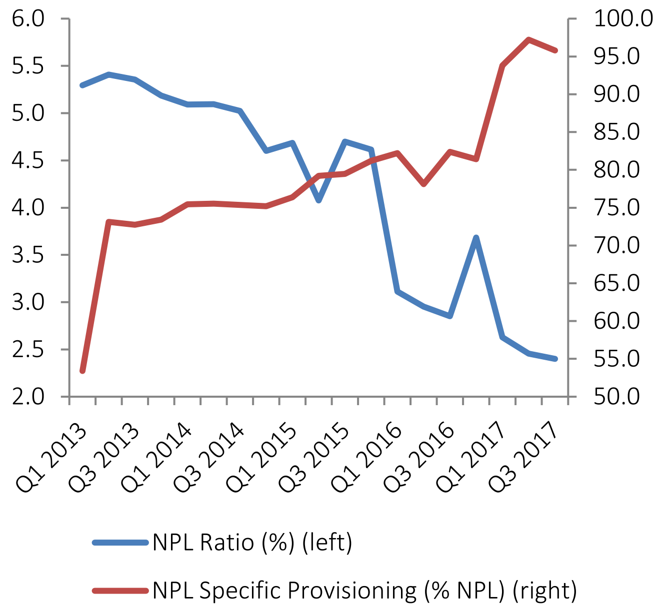
E. Islamic Wholesale

Annex 2 Graph 8: CAR



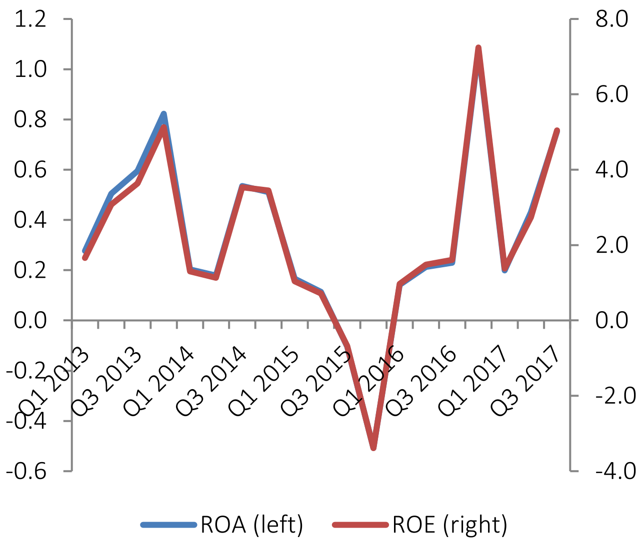
Source: CBB.

Annex 2 Graph 9: NPL and Provisioning



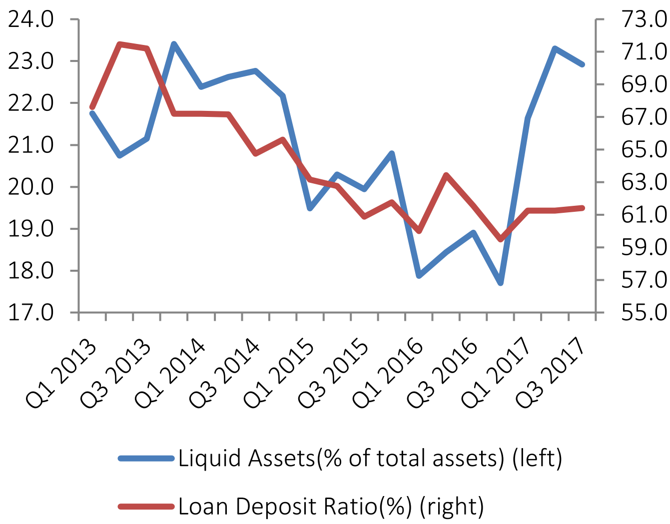
Source: CBB.

Annex 2 Graph 10: Profitability



Source: CBB.

Annex 2 Graph 20: Liquidity



Source: CBB.

List of Acronyms

Acronym	Description
ATM	ATM Clearing System
BCTS	Bahrain Cheque Truncation System
BENEFIT	The Benefit Company
BSE	Bahrain Stock Exchange
CAR	Capital Adequacy Ratio
CBB	Central Bank of Bahrain
CMSD	Capital Markets Supervision Directorate
CRB	Conventional Retail Banks
CWB	Conventional Wholesale Banks
DSIBs	Domestically Systemically Important Banks
EBPP	Electronic Bill Presentment and Payment System
EFTS	Electronic Fund Transfer System
EU	European Union
FinTech	Financial Technology
FSC	Financial Stability Committee
FSD	Financial Stability Directorate
FSIs	Financial Soundness Indicators
FSR	Financial Stability Report
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GP	Gross Premiums
IBAN	International Bank Account Number
IGA	Information and E-Government Authority
IMF	International Monetary Fund
IRB	Islamic Retail Banks
IWB	Islamic Wholesale Banks
JYP	Japanese Yen
LCR	Liquidity Coverage Ratio
NFA	Net Foreign Assets
NPW	Net Premiums Written
NPF	Non-performing Facilities
NPL	Non-performing Loans
NSFR	Net Stable Funding Ratio
P/E ratio	Price Earnings Ratio
PFMI	Principles for Financial Market Infrastructures
POS	Point of Sale
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real Time Gross Settlement
RWA	Risk Weighted Assets
SMEs	Small Medium Enterprises
SSSS	Scripless Securities Settlement System
TRMST	Technology Risk Management Security Team (TRMST)