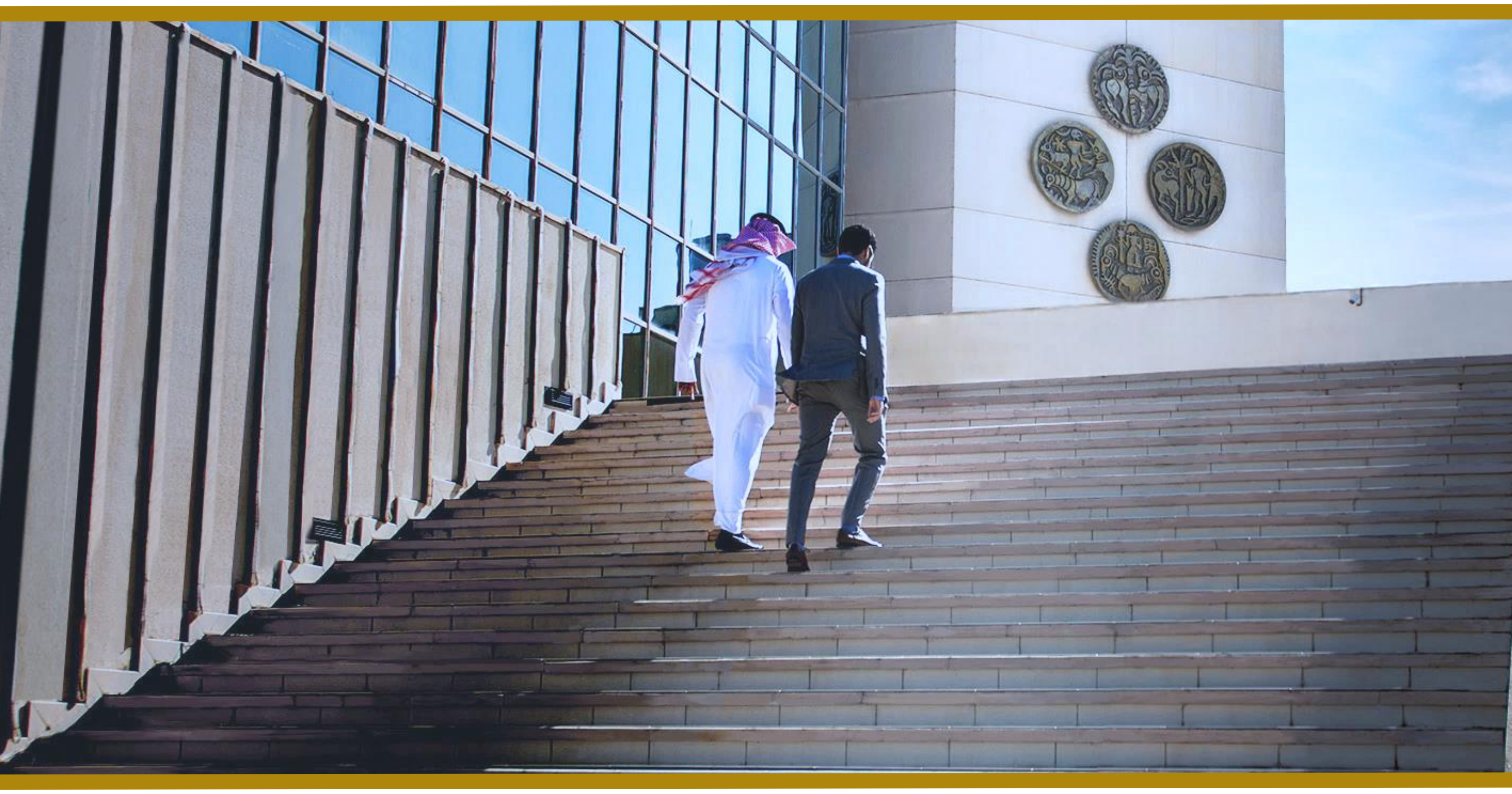
مصرف البحرين المركزي

Central Bank of Bahrain

FINANCIAL STABILITY REPORT

MARCH 2020 | ISSUE NO. 28



A Century of Banking

قرن من الخدمات المصرفية

Financial Stability Report- March 2020|Issue no. 28

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The Financial Stability Report (FSR) is a semi-annual report prepared by the Central Bank of Bahrain's (CBB) Financial Stability Directorate (FSD). The FSR is available online in PDF format under the Publications and Data section on the CBB's website at http://www.cbb.gov.bh.

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Preface

This issue of the FSR covers developments in the Bahraini financial system during the second half of 2019, prior to the COVID-19 pandemic. Implications of the pandemic globally, regionally, and locally will be the focus of the next issue of the FSR that will cover the first half of 2020.

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:

> *A situation where the financial system is able to function prudently, efficiently and uninterrupted, through providing financial services continuously 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 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 edition of the FSR contains 11 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 the non-banking financial sector
    - Chapter 8: Performance of capital markets.

- Part IV: Developments in the Payments and Settlements System, FinTech, and Cyber Security:
    - Chapter 9: Performance of payment and settlement systems.
    - Chapter 10: FinTech and Financial Inclusion.
    - Chapter 11: 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 Macro-Prudential Policy Framework
2- Look at Macro-Prudential 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.

The COVID-19 Crisis

The Coronavirus (COVID-19) pandemic brought substantial human suffering and major economic disruption around the world. The impact of COVID-19 on individuals, societies, and economies is rapidly developing. The global community is still looking at different scenarios on the effects on the global economy which range in severity with a possible global financial crisis at worst.

COVID-19 arrived when the global economy was already showing signs of a slowdown. Since the pandemic, financial markets were affected while bond yields, oil, and stock markets have sharply fallen with further market disruption expected. The International Monetary Fund said it expects a global recession this year. The global growth for 2020 is expected to be negative with a recession that is of the magnitude of the global financial crisis and recovery to start in 2021.

Containment and protective measures such as quarantines, travel bans, border closures, curfews and social distancing have been imposed by many countries. The consequences have been significant and are expected to continue with disruptions to various sectors. Timely and decisive actions by health authorities, central banks, fiscal, regulatory and supervisory authorities can help contain the virus outbreak and offset the economic impact of the pandemic.

It is currently hard to assess the global impact on the pandemic. Authorities have pro-actively intervened to calm markets by taking decisive and coordinated actions and making necessary policies to mitigate the impact, which come with difficult economic and financial trade-offs. As the situation develops further, more action will be required, which may require coordination at the national and international levels. Monitoring, containing and mitigating the effects of the corona virus are top priorities to provide stability to the global economy and financial markets, boost confidence, and prevent deep and prolonged economic effects.

With regards to regulatory and supervisory authorities, responses must aim to preserve financial stability and the soundness of the financial systems while sustaining economic activity. Supportive policies can restore confidence and aid the recovery of any disruptions. Extraordinary monetary and fiscal actions have already been taken by many countries to boost economies:

- Central banks must support demand and confidence by preventing a tightening of financial conditions, lowering borrowing costs for households and firms, and ensuring market liquidity.
- Central banks must ensure liquidity to support market functioning and ease stresses (example: open market operations, expanded term lending). Resources in the financial and banking system must be available where they are needed.
- Central banks must work with financial institutions to make sure they provide continued access to funding for market participants (individuals, households, SME's and local businesses) that are more likely to face temporary difficulties.
- Monetary policies need to remain supportive. Policies have already become more accommodative over the past year in many countries, with widespread cuts in interest rates.
- On the fiscal side, fiscal policy must provide substantial support for affected people and firms and additional fiscal stimulus may be necessary to prevent long-lasting economic damage from the pandemic.

CBB and Government Initiatives

In light of the recent global outbreak of COVID-19 and the preventative measures taken by the Government of the Kingdom of Bahrain to contain the virus, CBB issued a number of directives to preserve the health and safety of citizens, residents, and workers in the financial sector. In addition, several measures were issued to mitigate the effects of financial implications on financial services customers affected by COVID-19, as well as on financial institutions and merchants, and to assist them in mitigating these implications in addition to protecting the stability of the financial sector in the Kingdom of Bahrain.

CBB's Regulatory Measures as Part of Precautionary Efforts to Contain COVID-19

Date	Measures
16th March 2020	• CBB cut key policy interest rate. • CBB's key policy interest rate on the one-week deposit facility was cut from 1.75% to 1.00%. CBB also decided to cut the overnight deposit rate from 1.50% to 0.75%, the one-month deposit rate from 2.20% to 1.45%, and CBB lending rate from 2.45% to 1.70%.
18th March 2020	• CBB urged providers of POS devices to communicate with merchants to sterilize such devices regularly and to require customers to directly enter and remove their cards from the POS devices. • CBB urged all licensees to follow and implement sterilization instructions issued by the Ministry of Health and submit a report on this. The CBB also instructed licensees to communicate with the public by covering the measures taken to ensure the safety of their employees and customers in the press or through social media. • The volume limit of contactless (NFC) transactions on POS devices has been increased to BD50/- without the need to use a PIN code. The CBB also instructed its licensees to adhere to the requirements of continuation of operations and services. • A cap of 0.8% has also been set on merchant fees imposed by local banks and finance companies on debit card transactions to reduce merchant and company costs (0.35% to the acquirer, 025% to the issuer, 0.2% to the benefit company). • CBB also issued several regulatory measures for a period of six months to contain any financial repercussions on customers of the banking sector, which will be reviewed by the CBB at the end of this period in consultation with the banking sector. These measures aim to provide more liquidity and flexibility to enable banks to continue providing financing to their customers. • CBB required retail banks, financing companies and microfinance institutions to postpone instalments for any borrower or credit card holder affected by the economic repercussions of the Coronavirus without fees or interest on interest or increase in the percentage of profit / interest for a period of 6 months, unless the borrower agrees to pay within a shorter period. • CBB provided retail banks concessionary repo arrangements with up to 6 months at zero percent on a case by case basis. • CBB reduced cash reserve ratio for retail banks from 5% to 3%. • CBB requested to relax the LTV for new residential mortgages or Bahrainis except Mazaya loans.

20th March 2020	• In light of the current situation faced by the Kingdom of Bahrain and in order to preserve the health and safety of citizens and residents, the Central Bank of Bahrain urges consumers to communicate through the National Suggestion & Complaint System "Tawasul" or through the CBB website https://www.cbb.gov.bh/complaint-form/ or by calling 17547789/17547360, instead of personally visiting the Consumer Protection Office at the CBB. Thank you for your cooperation and wishing you good health and safety.
23rd March 2020	• CBB instructed Money Changers to disinfect all incoming currency notes and wholesale imported notes to limit the risk of exposure to the Coronavirus (COVID-19). • Under the instructions, Money Changers are required to disinfect incoming currency and wholesale imported notes with Ultraviolet Germicidal Irradiation (UVGI) or by isolating notes for 72 hours. • Money Changers Licensees are also required to equip employees with Personal Protective Equipment (PPE) as per recommendations outlined by the Ministry of Health.

Source: Central Bank of Bahrain (CBB).

Other Measures were taken by the Ministry of Finance and National Economy, Ministry of Labour and Social Development, Ministry of Industry, Minister of Electricity and Water Affairs. A financial and economic package of BD 4.3 billion was announced through a press conference with continuation of the government's efforts to maintain sustainable growth, stressing that the health and safety of citizens and residents is a top priority that all government efforts are directed to.

Other Government Measures as Part of Precautionary Efforts to Contain COVID-19

Date	Measures
17th March 2020	• In accordance with article (87) of the constitution and the social insurance law, the government will introduce a bill that will allocate 215 BD million from the unemployment fund in order to finance the private sector's payroll for the second quarter of this year. • The government will allocate 150 BD million to sponsor electricity and water bills for all individual and corporate subscribers for each of the months "April, May and June" of the current year, not to exceed the bills for the same period of last year for each subscriber. • Exemption of businesses from municipal fees for the second quarter of this year, which amounts a total value of 25 BD million. • Exemption of industrial and commercial enterprises from rent fees of government industrial land for the second quarter of this year • Tourist facilities and facilities are exempt from tourism fees for April, May and June this year. • Doubling the size of the liquidity fund by 100 million Bahraini dinars to 200 million Bahraini dinars. • A package of decisions from the Central Bank of Bahrain to raise the lending capacity of banks by the equivalent of BD 3.7 billion, to give them the flexibility to deal with customer requests to postpone instalments or additional financing. • Redirecting the Labour Fund's "Tamkeen" programs for companies affected by the current conditions with restructuring of loans in cooperation with banks, with a total value of BD 60 million.

Source: Ministry of Finance and National Economy (MOFNE).

CBB Circulars

In the light of the current situation concerning the potential impact of COVID-19, the CBB directives were based on a number of circulars that are available on the CBB Rulebook on the CBB website.

CBB Circulars as Part of Precautionary Efforts to Contain COVID-19

Date/ Circular	Licenses	Subject
5th March 2020 EDBS/KH/C/21/2020	All Banks All Financing Companies All Micro-Finance Companies	Concessionary Measures to Mitigate the Impact of Coronavirus
8th March 2020 EDBS/KH/C/24/2020	Ahli United Bank National Bank of Bahrain Credimax Arab Financial Services Payment International Enterprises Sadad Electronic Payment System The Benefit Company	Measures to Mitigate the Impact of Coronavirus
11th March 2020 EDBS/KH/C/25/2020	All Banks All Financing Companies All Micro-Finance Institutions All Ancillary Services All Representative Offices	Disinfection Instructions
11th March 2020 EDFIS/C/024/2020	Self-Regulatory Organisations (SRO) SRO Members Crypto-asset Licensees All listed Companies	Disinfection Instructions
12th March 2020 EDBS/KH/C/26/2020	All Retail Banks	Services Continuity Measures
17th March 2020 OG/106/2020	All Banks All Financing Companies All Microfinance Companies All Ancillary Services Providers	Regulatory Measures to Contain the Financial Repercussions of the Covid-19
19th March 2020 OG/108/2020	All CBB Licensees All Listed Companies	Upcoming General Meetings
23rd March 2020 EDBS/KH/C/30/2020	All Retail Banks All Financing Companies All Microfinance Companies	Implementation Guidelines Regarding the 6th Months Deferral
24th March 2020 EDBS/KH/C/30/2020	All Retail Banks All Financing Companies All Microfinance Companies	Implementation Guidelines Regarding the 6th Months Deferral
11th March 2020 EDFIS/C/032/2020	Self-Regulatory Organisations (SRO) SRO Members Crypto-asset Licensees	Services Continuity Measures
30th March 2020 EDBS/KH/C/33/2020	All Banks	Deferral of Implementation of Announced Regulator Policy Requirements
30th March 2020 OG/124/2020	All listed Companies All locally incorporated banks	Exemption for First Quarter Financial Results Preparation and Publication
30th March 2020 CMS/C/010/20	SRO Members	Market Intermediaries responsibility Amid COVID-19

1st April 2020 EDBS/KH/C/34/2020	Ancillary Service Providers Financing Companies Microfinance Institutions	Agreed Upon Procedures for Financial Crime (FC) Module
1st April 2020 EDBS/KH/C/35/2020	All Banks	Agreed Upon Procedures for Financial Crime (FC) Module
1st April 2020 EDFIS/C/034/2020	All Insurance Licensees	Agreed Upon Procedures for Financial Crime (FC) Module
1st April 2020 EDFIS/C/035/2020	All Investment Firms	Agreed Upon Procedures for Financial Crime (FC) Module
1st April 2020 EDFIS/C/036/2020	All Money Changers All Non-Bank Representative Offices All Administrators/Registrars All Trust Services Providers Ancillary Services Providers- Third Party Administrators	Agreed Upon Procedures for Financial Crime (FC) Module
1st April 2020 EDFIS/C/037/2020	Self-Regulatory Organizations (SRO) SRO Members Crypto-asset Licensees	Agreed Upon Procedures for Anti-Money laundering and Combating of Financial Crimes (AML) Module)
1st April 2020 CMS/C/011/20	All Listed Companies	Market Fairness and Integrity Amid COVID-10 Developments
2nd April 2020 EDBS/KH/C/36/2020	All Banks	Date Sensitive Reporting Requirements Extensions/Exemptions Under Rulebooks (Volume 1 and 2)
2nd April 2020 EDBS/KH/C/37/2020	All Financing Companies All Microfinancing Companies	Date Sensitive Reporting Requirements Extensions/Exemptions Under Rulebooks (Volume5)
2nd April 2020 EDBS/KH/C/38/2020	All Banks	Date Sensitive Reporting Requirements Extensions/Exemptions Under Rulebooks (Volume 5)
8th April 2020 OG/148/2020	All Licensees	Additional COVID-19 Precautionary Measures
12th April 2020 OG/152/2020	All Retail Banks	Directive on Use of Salary Transfers to Bahrainis by the Government

Source: CBB.

Executive Summary

Global Macro Financial Environment Overview

According to the International Monetary Fund's World Economic Outlook, growth was 2.9% in 2019 which was lower to the 3.6% realized last year and the lowest level since 2008–09. Global economic growth is expected to slow down across almost all major economies next year. Monetary policy remains accommodative in the US other advanced economies to support economic growth following the Federal Reserve cuts in interest rates amid growing concerns of a potential global slowdown.

Across major advanced economies, In the US economic growth decreased to 2.5% in Q4/2019 from 2.3% in Q4/2018. The economic performance in Europe decelerated slightly during the second half of the year due to increased geopolitical risk and uncertainty following the Brexit, which amplified volatility. In Q4/2019, the Euro Area (19 countries) and the European Union's (EU) (28 countries) growth has also experienced a slowdown as it moved from of 1.2% and 1.5% in Q4/2018 to 0.9% and 1.1% in Q4/2019 respectively. Within the Brexit, the UK's GDP growth decreased from 1.4% in Q4/2018 to 1.1% in Q4/2019.BRIICS countries' growth was also decelerating as it reached the level of 3.68% in Q4/2019 from 3.86% in Q4/2018

Financial and non-Financial Sectors Overview

The size of the assets of the banking sector in Bahrain was USD 204.9 billion as of December 2019, and in December 2019, the banking sector was 5.4 times of GDP, retail banking total assets continued growing to reach BD 35.4 billion (USD 91.8 billion) in December 2019 with GCC assets at 24.6% and Western Europe and American assets at 9.6%. The wholesale banking sector showed a decrease to USD 110.8 in December 2019, with concentrations in the GCC (31.3%) and Western Europe (29.7%). The Islamic banking sector assets (which represent 15.7% of the total banking sector assets) increased to USD 32.1 billion in December 2019 with concentrations in Bahrain (73.3%) and GCC (9.7%).

The total amount of credit given to the private sector (business and personal) by retail banks witnessed a considerable stagnation since June 2019 moving from BD 9,545.1 million to BD 9,434.7 million in December 2019. Total deposits increased to BD 17,964.4 million in December 2019, where 73.1% of them were domestic deposits. Money supply continued to grow. M2 stood at BD 12,052.2 million in end-December 2019 and M3 was at BD 13,671.9 million in end-December 2019 Personal loans as a percentage of GDP decreased to 29.4% by December 2019 (BD 4,296.1 millIon and business loans were at BD 5,138.6 million in December 2019 and 35.2% of GDP..

Overall Banking Sector

The capital adequacy ratio (CAR) for the banking sector stood at 19.2% in December 2019. The ratio has increased from 19.0% in June 2019 and The NPL ratio decreased to 4.8% in December 2019.

Return-on-assets (ROA) remained stable at 1.1% from December 2018 to December 2019 return-on-equity (ROE) increased to 7.9% from 6.6% in December 2018. Between June 2019 and December 2019, the overall loan-deposit ratio increased from 70.8% to 71.5%. Liquid assets as a proportion of total assets increased from 25.1% to 25.5%, over the same period.

Conventional Banks

The CAR for conventional retail increased from 19.8% in June 2019 to 21.1% in December 2019 The NPL ratio decreased to 4.9% in December 2019 from 5.5% in June 2019. The specific provisions remained constant at 66% in December 2019. For local retail banks, the NPLs slightly decreased to 3.9% in December 2019. For overseas retail banks, the NPLs decreased from 7.3% in June 2019 to 7.0% in December 2019.

as at end-December 2019, ROA increased to 1.8%. ROE for *locally incorporated banks* decreased to 14.2 from 14.3 during the same period. The overall loan-deposit ratio for the segment decreased to 65.8% in December 2019 from 67.9% in June 2019 Liquid assets as a proportion of total assets increased from 35.9% in June 2019 to 36% in December 2019

As for wholesale banks the CAR for locally-incorporated wholesale banks decreased to 18.6% in December 2019. The NPL ratio decreased to 4.5% in December 2019. The NPL ratio of l*ocally-incorporated wholesale banks* decreased from 6.5% in June 2019 to 5.1% in December 2019. Additionally, *overseas wholesale* banks witnessed a decrease in its NPL ratio from 4.2% to 4.0% over the same period. Specific provisions as a proportion of NPLs also witnessed a decrease to 70.8% in December 2019.

ROA for the conventional wholesale banking sector increased to 0.9% in December and ROE for *local wholesale banks* increased to 4.8%. the overall loan-deposit ratio for conventional wholesale banks stood at 68.5%. Liquid assets for wholesale banks as a proportion of total assets increased to 21.3% in December 2019.

Islamic Banks

The CAR of Islamic retail banks increased from 17.3% in June 2019 to 18.3% in December 2019. Non-performing facilities (NPF) ratio increased to 10.4% in December 2019. Specific Provisoining decreased to 36.7% in December 2019.

The return on assets (ROA) for Islamic retail banks decreased to 0.4% in December 2019. Return on equity (ROE) also decreased from 6.7% to 4.7% for the same period. The volume of liquid assets available to Islamic retail banks slightly decreased from 17.7% of total assets in June 2019 to 17.5% in December 2019. The ratio of total facilities to deposits decreased from 95.9% in June 2019 to 92.5% in December 2019.

the CAR for Islamic wholesale banks decreased to 17.4% in December 2019. As of end-December 2019, NPF ratio for Islamic wholesale banks remained at 1.1%. Provisioning for NPFs increased from 91.7% to 93.8% over the same period.

Return on assets (ROA) decreased from 0.9% in December 2018 to 0.7% in December 2019. Return on equity (ROE) also decreased from 6.9% to 6.4% in the same period. As of end-December 2019, liquid assets of Islamic wholesale banks represented 17.7% of total assets. Additionally, the facilities deposit ratio decreased from 73.0% in June 2019 to 69.9% in December 2019.

Insurance Sector

The Insurance sector in Bahrain is made up of two main segments: conventional and takaful. Total gross premiums registered BD 145.2 million as of September 2019. The conventional local firms accounted for the largest segment of total gross premiums (54.7%), followed by Takaful (31.9%) and conventional overseas branches (13.4%).

As of December 2018, total assets of conventional insurance firms were BD 2,311.3 million, a YoY increase of 4.7%. Takaful firms' assets experienced an annual growth by 5.6% reaching BD 202.4 million.

Viewing the concertation of the overall insurance industry, motor records the highest concentration in Gross Premiums (28.2%), Net Premiums Written (38.2%), Gross Claims (47.7%), and Net Claims (48.1%). Similarly, for conventional insurance, motor insurance has the highest concentration for Gross Premiums (28.3%), Net Premiums Written (38.0%), Gross Claims (48.8%) and Net Claims (48.3%).

Takaful insurance companies have very high concentration on the medical and motor Insurance business lines. Gross Premiums for both sectors represented (66.5%), Net Premiums Written (78.4%), Gross Claims (88.9%), and Net Claims (97.0%).

Non-Bank Financial Institutions

The two main segments of the non-Bank Financial Institutions sector are investment businesses and money changers. In December 2019, total assets of investment businesses increased by 30.4% to BD 439.6 million. This significant increase is due to a few wholesale banks changing their licenses to Category 1 investment firms. Investment business firms' profit declined by 83.7% reaching BD 863.8 million in Q4 2019. Profits of Category 1 firms decreased by 98.0%, while Category 2 firms' profits decreased by 74.3%.

During 2019, money changers' purchase of foreign currencies amounted to 9,760.0 billion, while the sale of foreign currencies was recorded at 10,394.2 billion for the year. A breakdown of Money Changers turnover indicates that "Asian" currency group recorded the highest YoY percentage increase in sales with 123.8%. The largest decline in sales, excluding Other, was the "European" currency group with 27.9%. As for purchases, the top YoY increase is also "Asia" with 81.3%. The largest decline for purchases was also the "European" currencies with 40.4%.

Capital markets

As of 31st December 2019, Bahrain Bourse recorded a total listing of 44 Companies, 10 Mutual funds and 14 Bonds and Sukuk. During 2019, there were 20 companies that closed the year higher and 14 closed lower and 10 remained unchanged. Bahrain All Share Index increased by 20% (273 points) for the year reaching 1,610 points, while the Bahrain Islamic Index reached 760.04 points. As of end of 2019, market capitalization of the Bahrain Bourse stood at BD 10.13 billion, and the price-earnings ratio (P-E) ratio stood at 11.3, an increase from the 9.7 attained in December 2018.

The majority of the value and the volume of shares traded in June 2019 was in the commercial bank sector whose traded shares by value represented 67.0% and by volume represented 60.0% of total shares. The majority of the number of transactions in December 2019 (20,712 transactions) was attained by the commercial banks sector representing 47.0% of total transactions. As of December

2019, there was 1 M&A between NBB and BisB, and 98 private offerings occurred with a total value of USD 14.5 billion.

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 2019 (from 1st July to 31st December 2019) decreased to 165 transfers compared to 176 transfers for the first half of 2019.

The daily average volume of ATM transactions for the first second half of 2019 increased by 3.5% to 59,157 transactions per day compared to 57,161 transactions per day for the first half of 2019. The daily average value of ATM transactions for the first half of 2019 reached 5.2 million.

The daily average volume of cheques for the first half of 2019 decreased compared to the second half of 2018 from 12,133 cheques to 11,870 cheques. The daily average value of cheques decreased in the second half of 2019 by 5.0% when compared to the first half of 2019 from BD36.3 million to BD34.5 million

FinTech, Innovation, and Financial Inclusion

Bahrain is repositioning itself to be a Financial Technology (FinTech) hub in the region combining conventional and Shariah 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. The sandbox includes 35 companies as of end of 2019.

As of end of 2019, Point of Sale (POS) transactions reached 73.7 million in terms of volume and BD 2.4 billion in terms of value with a 14.3% and 23.1% increase respectively. As of 2019, 79.3% of the volume of transactions and 77.1% of the value of transactions came from cards issued inside Bahrain compared to 76.1% and 77.1% in2018 respectively.

Cyber Security

Cyber risk is steadily evolving into a main threat to all industries. Its impact on the financial services industry is growing into a recognised risk by all financial institutions. In October 2019, the CBB participated in a survey issued by the Financial Stability Board which covers Cyber Incidence Response and Recovery by National Authorities. The CBB's Economic Research Unit created a survey that was sent to systematically important Retail Banks in Bahrain to understand the best practices used in Response and Recovery functions used to identify the cause, impact, and mitigation. Throughout he second half of 2019, the CBB continued to work on cyber security initiatives and regulations.

Part I:

Developments in the International and Domestic Financial Markets

Chapter 1 Developments in the International Financial Markets

Key Highlights

Global Growth	USA Growth	Euro Area Growth	EU Growth	UK Growth	BRIIC'S Growth
2.9%	2.3%	0.9%	1.1%	1.1%	3.6%

- The global economic conditions deteriorated and the risks to the global outlook have increased during the second half of 2019.
- Uncertainty and geopolitical tensions have put downward pressure on financial sector in Europe and Asia leading to significant deceleration in growth.
- Disruptive trade wars and tariffs between China and the US and then Europe and the US have raised concern to the global financial stability.
- Stock markets indices drop in the second half of 2019 and Equity markets in Europe have endured a volatile couple of months.

1.1 Overview

Since the last Financial Stability Report (FSR), the global economic activity has tightened after growing trade tensions between the US and China and the US and Europe rising political risk and financial stability issue. With exit of the UK from the Euro Area, overall environment showed some uncertainty in the beginning of the second half of 2019. Global economic growth is expected to slow down across almost all major economies next year. Monetary policy remains accommodative in the US other advanced economies to support economic growth following the Federal Reserve cuts in interest rates amid growing concerns of a potential global slowdown. In the following sections, recent trends in the global economy are highlighted and the major financial and economic indicators during the previous six months are looked at.

Chapter 1 covers the developments in the international financial markets prior to the COVID-19 pandemic.

1.2 Global Macro-financial Environment

The global geopolitical risks and increasing trade protectionism have added some risk to financial market. The global economic and financial conditions deteriorated slightly, and risks associated to this environment increased in the second half of 2019. According to the International Monetary Fund's (IMF) World Economic Outlook (WEO), global growth was at 2.9% in 2019 lower to the 3.6% realized last year and, also the lowest level since 2008–09.

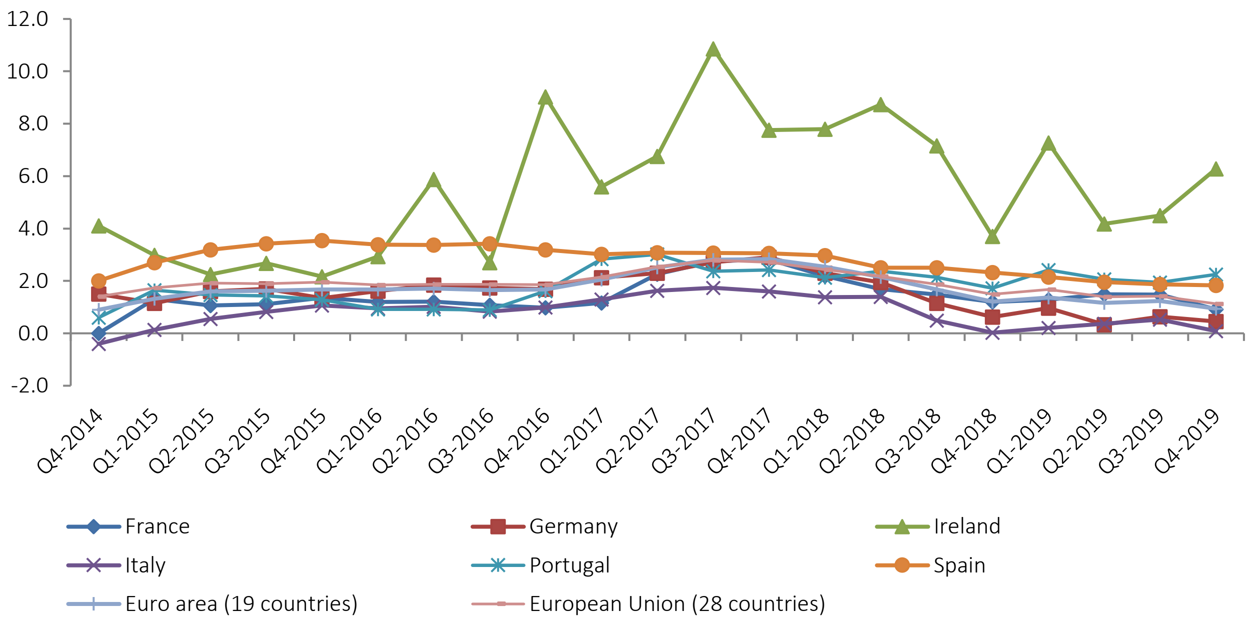
1.2.1 Economic Performance

The economic performance in Europe decelerated slightly during the second half of the year due to increased geopolitical risk and uncertainty following the Brexit, which amplified volatility and raised new concerns in the global financial markets. Political risk in Italy and the debt problem in many European countries, notably Greece and Italy, have added more pressure to the market. As Chart1-1 shows, most European countries have witnessed a slowdown of their economic growth in the second half of 2019. Spain has achieved a restrained economic performance as GDP growth moved from 2.3% in Q4/2018 to 1.8 % in Q4/2019, which was a lowest since Q2/2015. Similarly, Portugal's growth has also declined as it moved from 2.1% in Q3/2018 to 1.9% in Q3/2019. Italy has experienced a slowdown in its economic performance as its growth rate moved from 0.5% in Q4/2018 to 0.1% in Q4/2019. However, the growth rate in Ireland moved from 3.7% in Q4/20182018 to 6.3% in Q4/2019.

Regarding the two largest economies in the Eurozone, their performances have also slowed in the second half or 2019 as compared to the second half of the last year. Germany experienced weak economic activities in the fourth quarter of 2019 with GDP growth reach 0.5%, the lowest growth since Q1/2015. France also achieved growth rate of 0.9% over the same period.

Turning to the Euro Area (19 countries) and the European Union (EU) (28 countries) their growth has also experienced a slowdown as it moved from of 1.2% and 1.5% in Q4/2018 to 0.9% and 1.1% in Q4/2019, respectively.

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

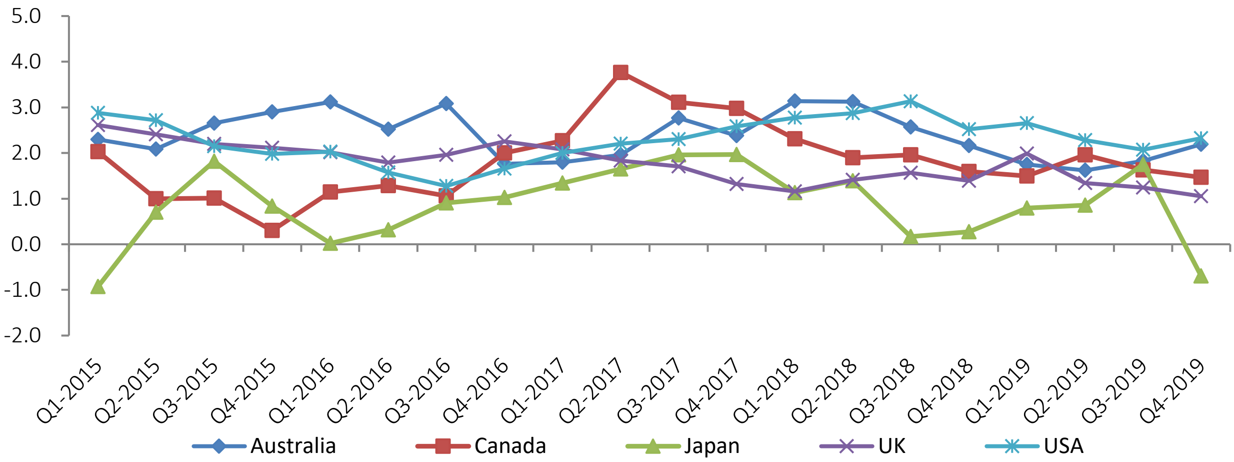


**Growth rate compared to the same quarter of previous year, seasonally adjusted.*
Source: OECD Quarterly National Accounts.

In the US as economic growth decreased to 2.5% in Q4/2019 from 2.3% in Q4/2018. The US economy was affected by the trade tension with China and the increased geopolitical uncertainty. Within the Brexit, the UK's GDP growth decreased from 1.4% in Q4/2018 to 1.1% in Q4/2019.

As for emerging economies (Chart 1-3), the BRIICS countries' growth was also decelerating as it reached the level of 3.7% in Q4/2019 from 3.9% in Q4/2018. In China, the trade tension with the US and the highly indebted local governments along with the financial sector that continues to pose a significant downside risk have affected economic growth as it decreased slightly to reach 6.0% in Q4/2019, lower than the previous quarters. 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. Moreover, the very recent Corona Virus epidemic will certainly put pressure on overall China's economy.

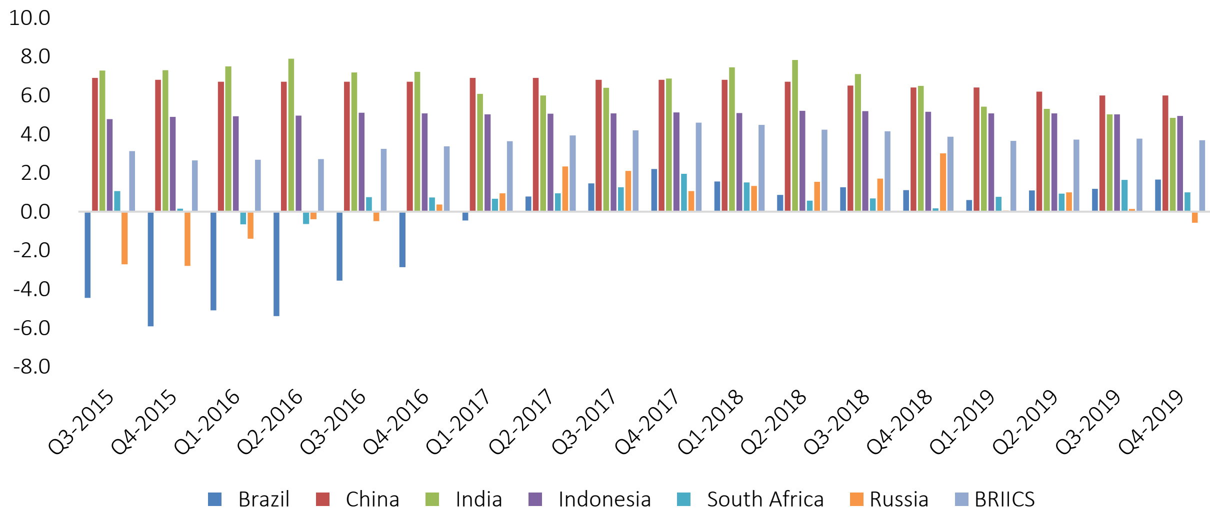
Chart 1-2: Real GDP Growth in Advanced Economies (Quaterly %)*



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

The Brazilian growth stands at 1.7% at Q4/2019 higher that 1% recorded in Q4/2018. With regards to Russia, it realized an outstanding economic performance in 2018 as its growth rate was 3% in Q4/2018, its growth then decelerated in the first half the year to reach 0.8% in Q2/2019 and then Russia went into recession in the fourth quarter as its growth was -0.6% in Q4/2019.

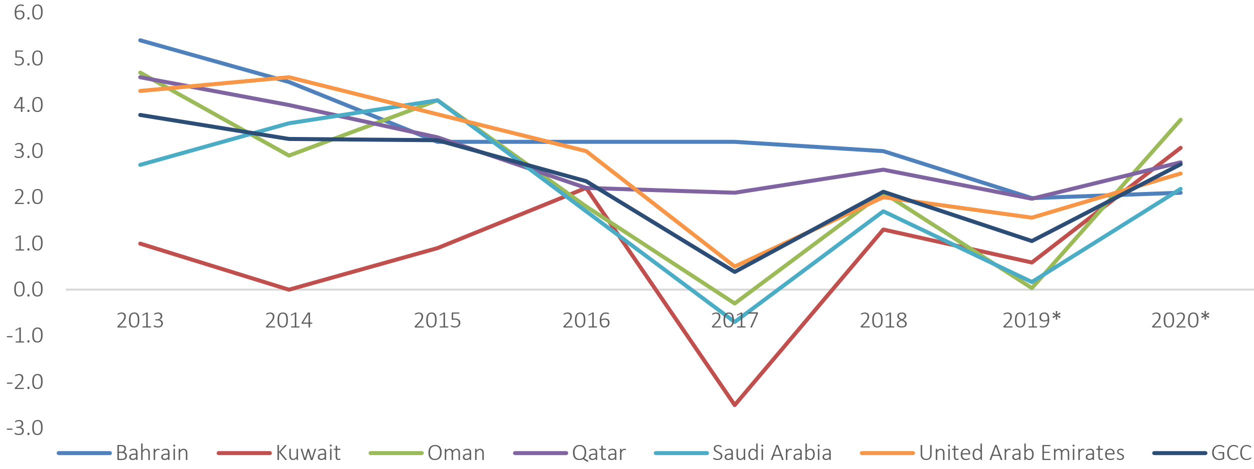
Chart 1-3: Quaterly Real GDP Growth in BRIICS (Quaterly %)*



**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. The GCC bloc has achieved a growth rate of 1.1%, lower than the 2.2% realized in 2018. However, projections for 2020 show that the economic condition will improve, and the regional economy will grow at a moderate rate of growth of 2.7%.

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

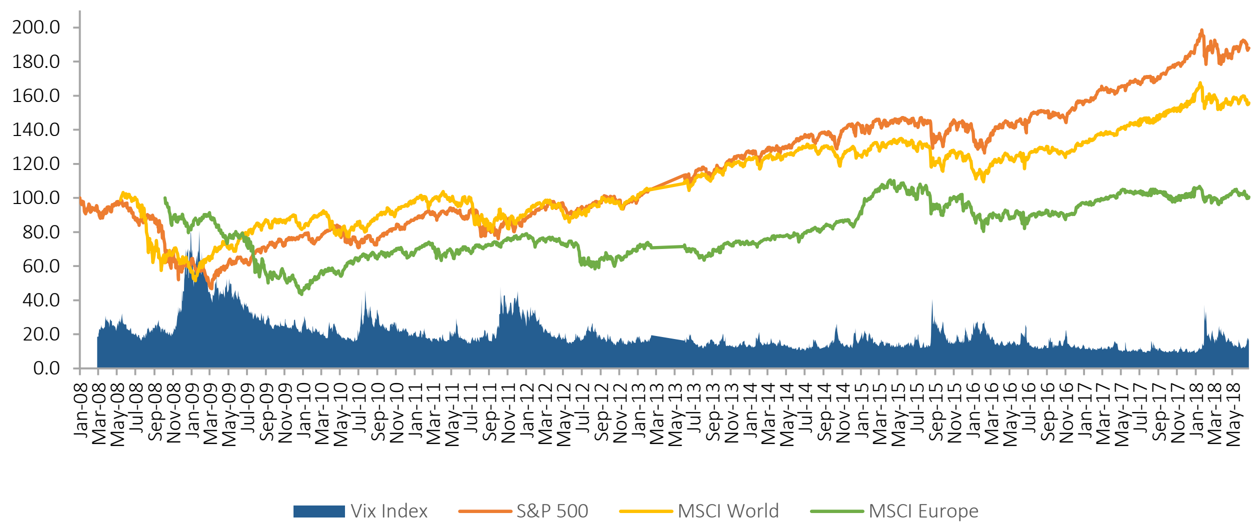


Forecasts.
Source: IMF Regional Economic Outlook, October 2017.

1.2.2 Financial Markets

Equity prices have risen across a range of advanced economies. Indices reached new record levels which can be attributed to a dramatic policy shift at the Federal Reserve. 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.

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

Key Highlights

% of GDP	Licences	Banking Assets	Retail Assets	Wholesale Assets	Islamic Assets	M2
16.5%	381	USD 204.9 bn	USD 94.1 bn	USD 110.8 bn	USD 32.1 bn	USD 32.0 bn

- The retail banking sector assets increased to USD 94.1 billion and wholesale banking sector assets decreased to USD 110.8 billion as of end-December 2019.
- The volume of credit decreased to BD 9,736.3 million in December 2019.
- Household debt and business debt ratio decreased.
- Construction permits decreased between Q2 2018 and Q4 2019.

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 September 2019 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.

Chapter 2 covers the developments in Bahrain's financial and non-financial sectors prior to the COVID-19 pandemic.

2.2 The Financial Sector

Bahrain's position as a regional financial center has been essential to the development of its economy where the financial sector has come to play a significant role in economic activity and employment creation. The financial sector is currently the largest non-oil contributor to GDP representing 16.5% of real GDP as of 2018. By the end of 2019, the financial sector represented 16.6% of real GDP showing a slight decrease of 0.3% since 2018.

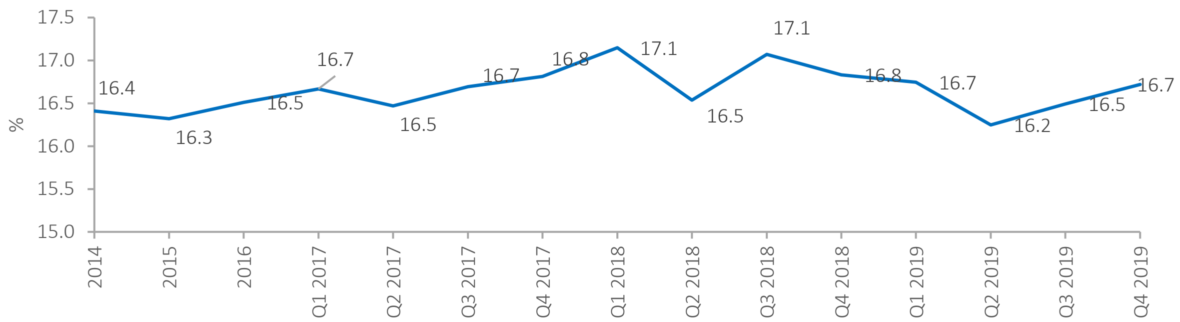
In December 2019, there were 381 licenses issued by the CBB (bank and non-bank financial institutions)

The banking sector in Bahrain was made up of 94 banks, categorized as follows:

- 31 retail banks (including 6 Islamic retail banks); 8 conventional locally incorporated and 17 conventional branches of foreign banks
- 63 wholesale banks (including 14 Islamic wholesale banks); 13 conventional locally incorporated and 36 conventional branches of foreign banks

As of December 2019, there were 287 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.

Chart 2-1: Size of the Banking Sector to Real GDP



Source: Information and e-Government Authority (IGA).

The insurance industry continued to grow during the past few years. Insurance contribution increased to 5.4% of GDP by end of 2017, 5.5% by end of 2018, and 5.4% by end of 2019. As of December 2019, the insurance market in Bahrain comprises of 23 locally-incorporated firms and 13 overseas firms carrying out insurance, reinsurance, takaful and retakaful. These institutions offer all basic and modern insurance services such as medical and health insurance and 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.

The size of the assets of the banking sector in Bahrain was USD 204.9 billion as of December 2019. The banking sector started as 5.7 times GDP in 2014 and by December 2019, the banking sector was 5.3 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 the change of the size of the various banking segments to GDP. The retail banking sector remained between 2.3 to 2.6 times of GDP over the same period. The sector has continued to grow over the years (from USD 80.0 billion in 2014 to USD 94.1 billion in 2019) along with the growth in GDP. Since 2014, the size of the wholesale banking sector started declining from USD 109.3 billion to USD 106.0 billion in 2018. It recently started to recover with an annual increase of 4.5% to reach USD 110.8 in December 2019. As for the Islamic banking sector, it grew steadily over the same period from USD 24.9 billion in 2014 to USD 32.1 billion in December 2019.

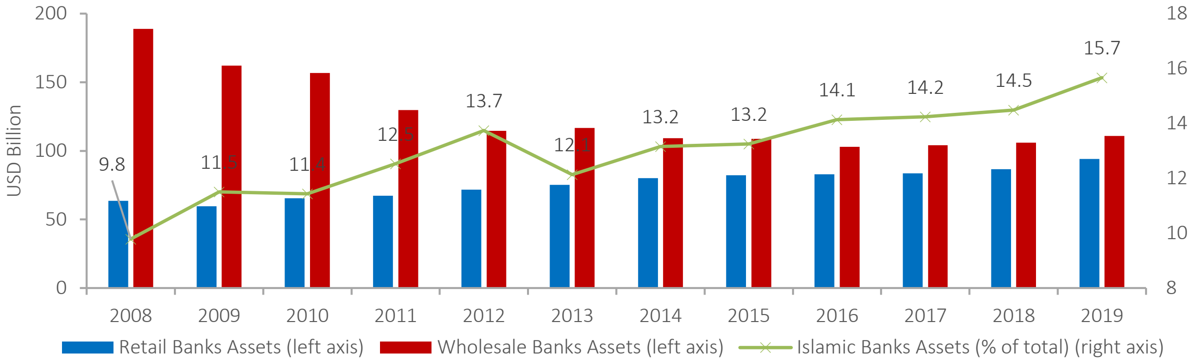
Table 2-1: Evolution of the size of the Banking sector in Bahrain

Indicator	2014	2015	2016	2017	2018	2019*
Banking Sector (USD billion)	189.3	191.0	186.1	187.4	192.6	204.9
times GDP	5.7	6.1	5.8	5.3	5.1	5.3
Retail Sector (USD billion)	80.0	82.2	83.0	83.5	86.6	94.1
times of GDP	2.4	2.6	2.6	2.4	2.3	2.4
Wholesale Sector (USD billion)	109.3	108.8	103.0	104.0	106.0	110.8
times of GDP	3.3	3.5	3.2	2.9	2.8	2.9
Islamic Sector (USD billion)	24.9	25.3	26.3	26.7	27.9	32.1
times of GDP	0.7	0.8	0.8	0.8	0.7	0.8

** Using provisional current GDP data.*

Source: CBB Monthly Statistical Bulletin.

Chart 2-2: Banking Sector Asset Composition

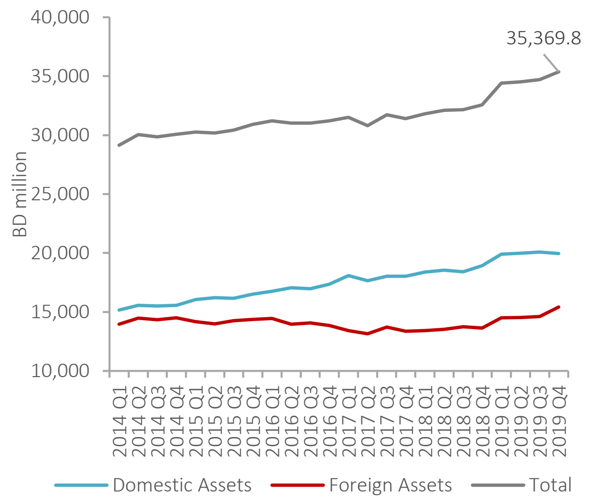


Source: CBB Monthly Statistical Bulletin.

2.2.1 The Retail Banking Sector

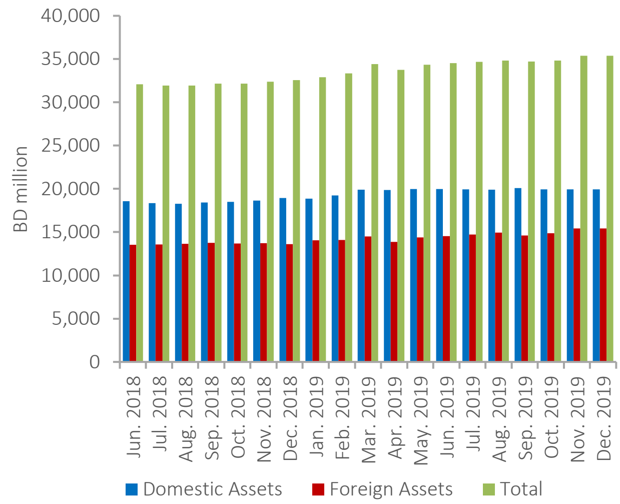
Despite the global uncertainty and the troubles in MENA region, retail banking total assets continued growing since 2014 to reach BD 35.4 billion (USD 94.1 billion) in December 2019 (see Chart 2-3).

Chart 2-3: Retail Banks' Assets



Source: CBB Monthly Statistical Bulletin.

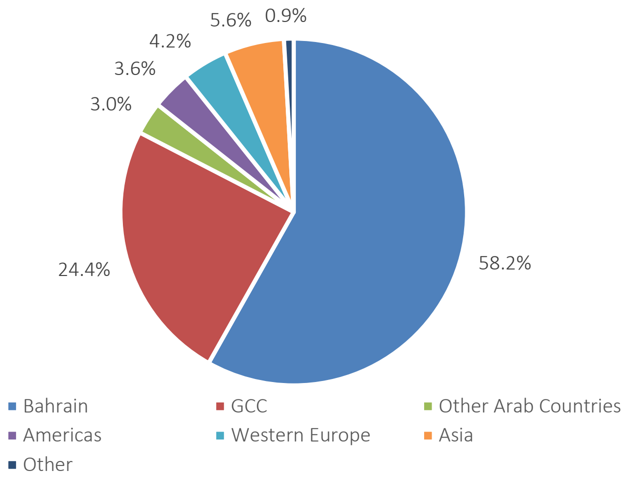
Chart 2-4: Categorization of Retail Banks' Assets



Source: CBB Monthly Statistical Bulletin.

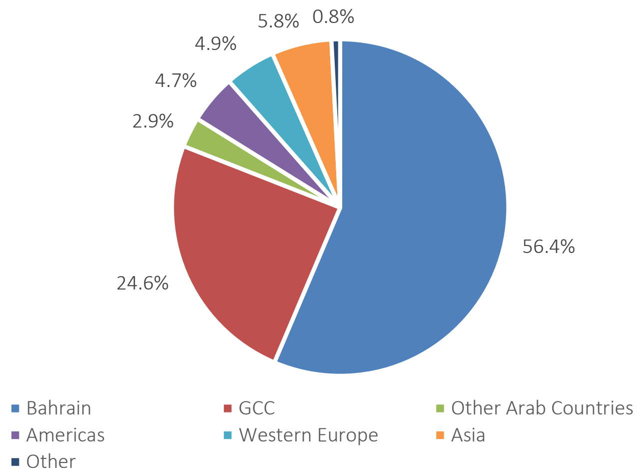
The share of GCC assets of total retail banking assets was 24.6%. The level of Europe and American contribution was 9.6%. This shows that the retail-banking sector in Bahrain is relatively exposed to foreign risk from GCC countries and lightly exposed to foreign risk from Europe and U.S.

Chart 2-5: Retail Banks' Assets (%) by Geographical Classification (Dec. 2018)*



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

Chart 2-6: Retail Banks' Assets (%) by Geographical Classification (Dec. 2019)*

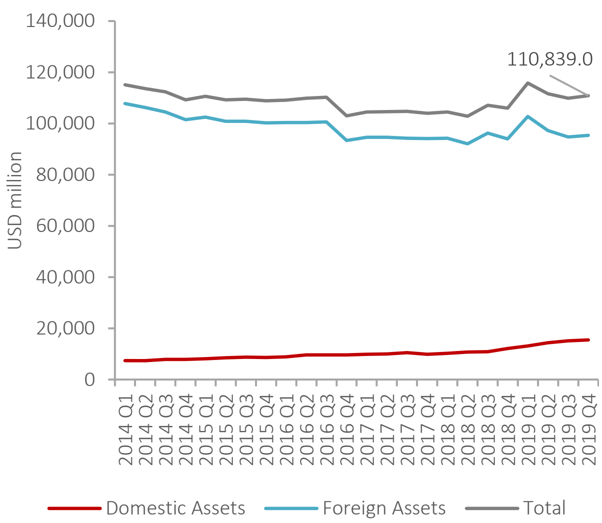


** For conventional and Islamic retail banks.*
Source: CBB Monthly Statistical Bulletin.

2.2.2 The Wholesale Banking Sector

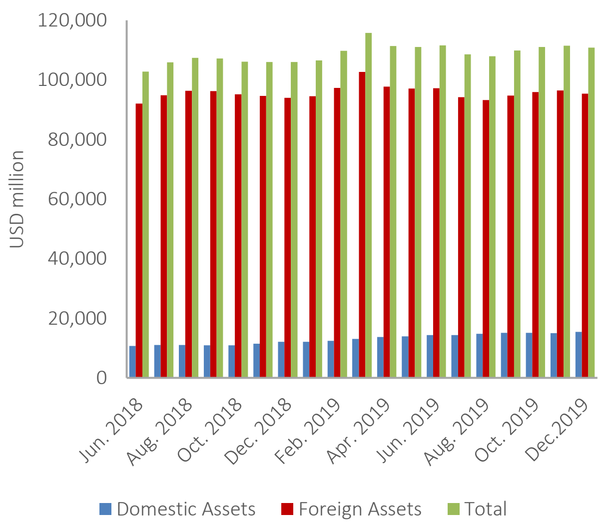
The wholesale banking sector showed a decrease to USD 110.8 billion in December 2019. Domestic assets witnessed a year-on-year (YoY) growth of 28.0% while foreign assets rose by 1.5% on a yearly basis (See Charts 2-7 and 2-8).

Chart 2-7: Wholesale Banks' Assets



Source: CBB Monthly Statistical Bulletin.

Chart 2-8: Categorization of Wholesale Banks' Assets

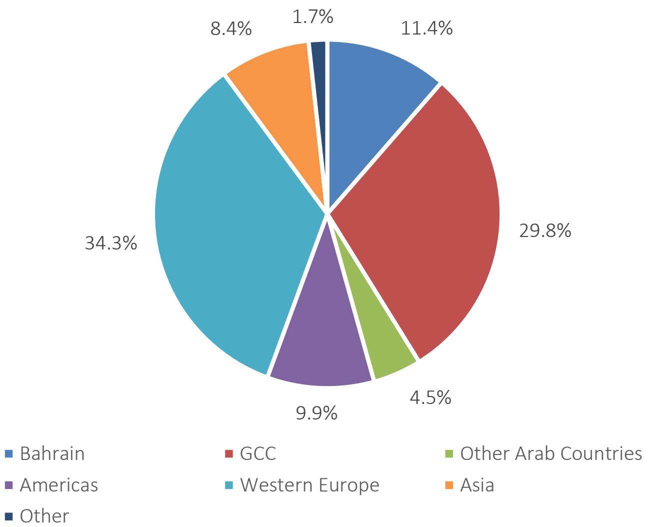


Source: CBB Monthly Statistical Bulletin.

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

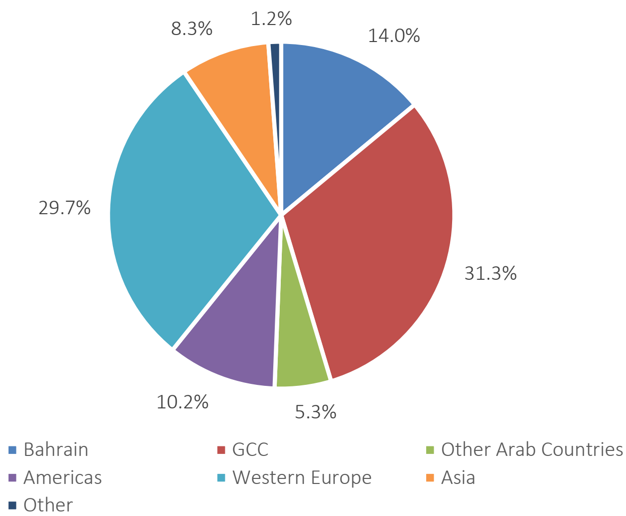
- The share of America's total assets increased from 9.9% in June 2018 to 10.2% in December 2019.
- The share of Europe's total assets decreased to 29.7%.
- Asian assets slightly decreased from 8.4% to 8.3% in December 2019.
- GCC total assets increased to 31.3% in December 2019, they represent a larger portion of Wholesale bank assets now compared to Europe.

Chart 2-9: Wholesale Banks' Assets by Geographical Classification (Dec. 2018) *



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

Chart 2-10: Wholesale Banks' Assets by Geographical Classification (Dec. 2019) *

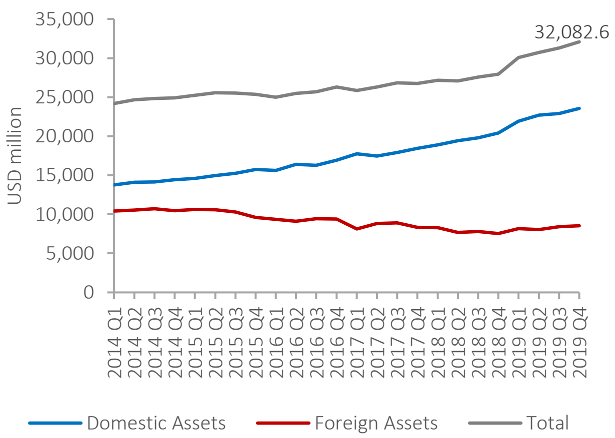


** For conventional and Islamic wholesale banks.*
Source: CBB Monthly Statistical Bulletin

2.2.3 The Islamic Banking Sector

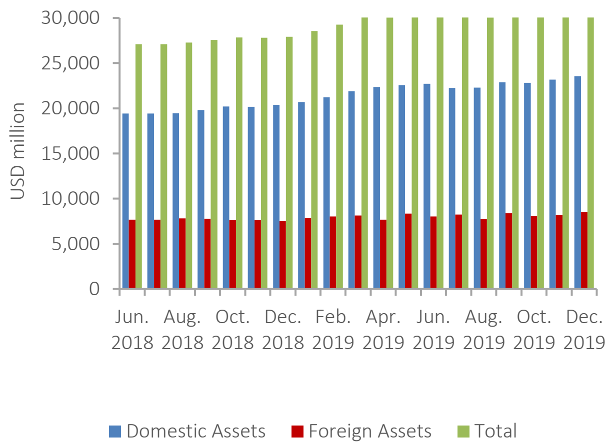
The Islamic banking sector increased from USD 24.2 billion in 2014 to USD 32.0 billion as of December 2019. On an annual basis, the domestic assets increased by 15.5% while foreign assets grew by 13.2%.

Chart 2-11: Islamic Banks' Assets



Source: CBB Monthly Statistical Bulletin.

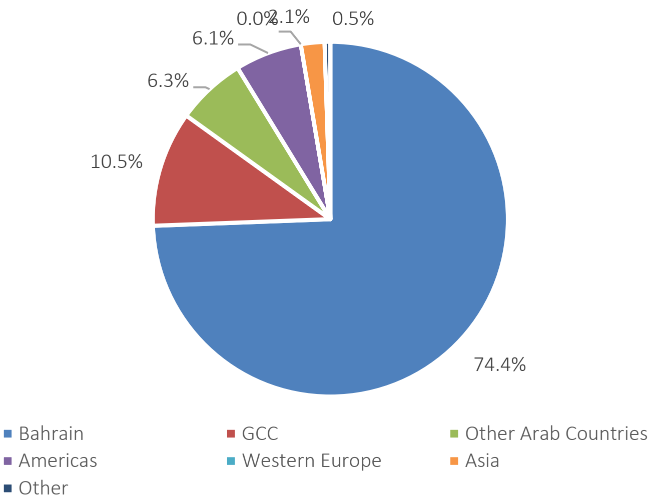
Chart 2-12: Categorization of Islamic Banks' Assets



Source: CBB Monthly Statistical Bulletin.

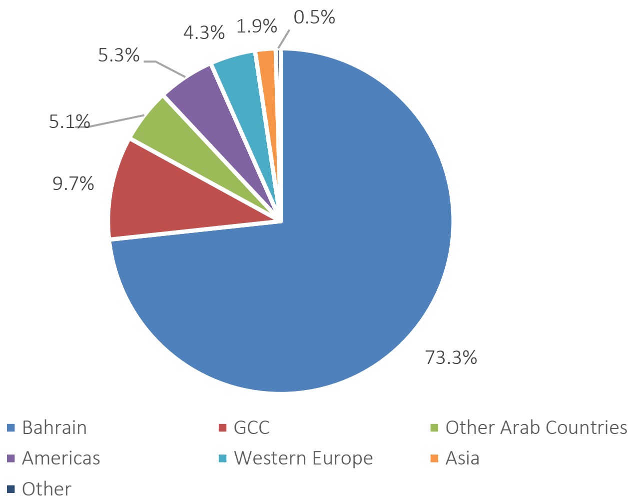
Islamic banks continue to be majorly exposed to domestic risks as the share of Bahrain's total assets decreased slightly from 74.4% in Dec 2018 to 73.3% in December 2019. GCC total assets decreased from 10.5% to 9.7% over the same period.

Chart 2-13: Islamic Banks' Assets by Geographical Classification (Dec. 2018)



Source: CBB Monthly Statistical Bulletin.

Chart 2-14: Islamic Banks' Assets by Geographical Classification (Dec. 2019)

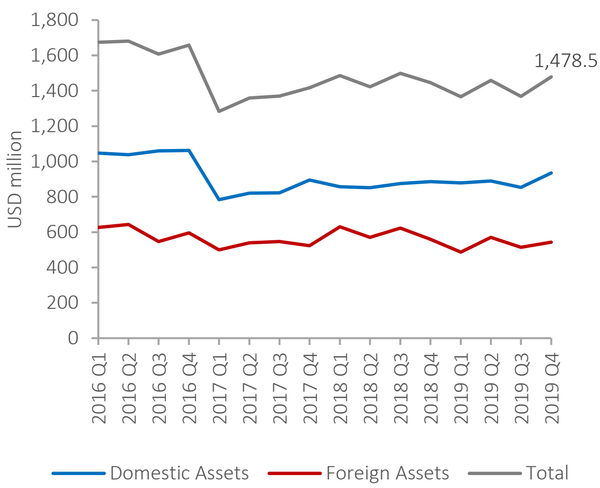


Source: CBB Monthly Statistical Bulletin.

2.2.4 Islamic Windows

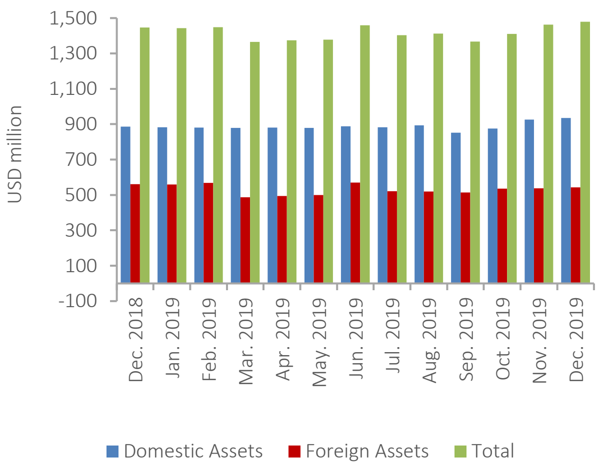
There are a number of conventional retail banks in Bahrain that maintain Islamic windows offering Islamic banking services/products to clients who are interested in completing their banking transactions in a Sharia-compliant system. As of December 2019, there were 5 Islamic windows operated by conventional retail licenses in Bahrain with total assets of USD 1.5 billion (or 1.6% of retail banking assets). As of December 2019, 63.3% of total assets were domestic (6.3% YoY increase) while 36.7% were foreign (3.1% YoY decrease).

Chart 2-15: Islamic Windows' Assets



Source: CBB Monthly Statistical Bulletin.

Chart 2-16: Categorization of Islamic Windows' Assets

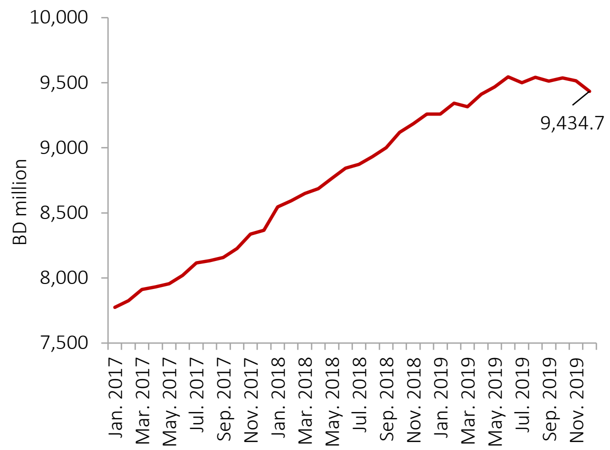


Source: CBB Monthly Statistical Bulletin.

2.2.5 Credit Developments

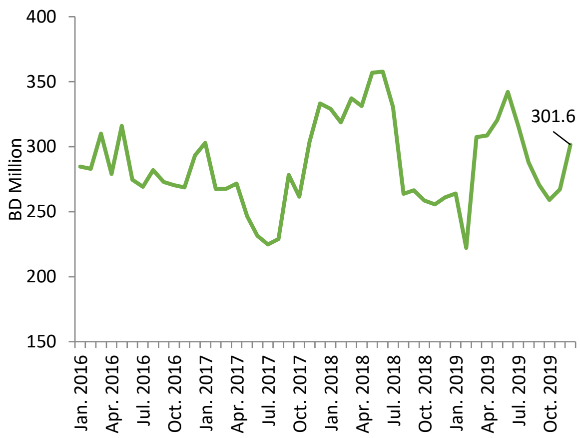
The total amount of credit given to the private sector (business and personal) by retail banks witnessed a considerable stagnation since June 2019 moving from BD 9,545.1 million to BD 9,434.7 million in December 2019 (Chart 2-15). Regarding retail banks' lending to the general government, there was an increase to BD 301.6 million at end-December 2019, from BD 261.1 million at end-December 2018 (Chart 2-16).

Chart 2-17: Loans to the Private Sector *



Source: CBB Monthly Statistical Bulletin.
Excluding securities.

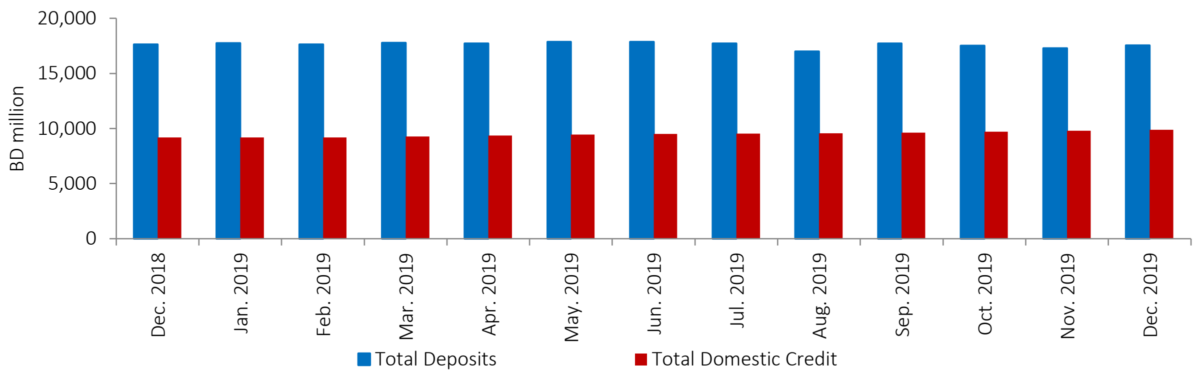
Chart 2-18: Loans to General Government*



Source: CBB Monthly Statistical Bulletin.
Excluding securities.

As for total deposits, they increased to BD 17,964.4 million in December 2019, where 73.1% of them were domestic deposits. This was parallel to the total domestic credits, which moved from BD 9,887.3 million at end-June 2019 to 9,736.3 in December 2019 (Chart 2-17).

Chart 2-19: Total Deposits and Total Domestic Credit (BD Million)



Source: CBB Monthly Statistical Bulletin.

2.2.6 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.

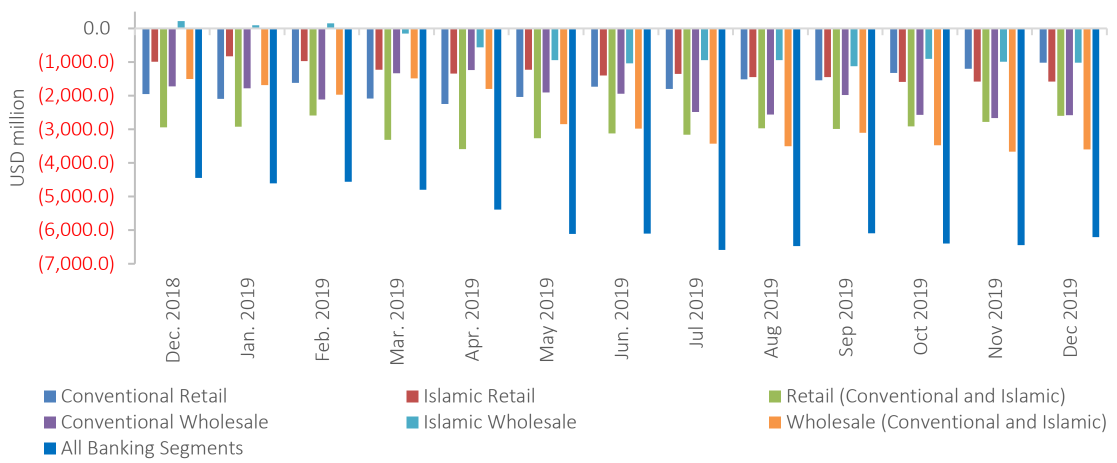
The NFA position by banking segment, as of December 2019, is negative (net borrowers) for retail banks, both conventional and Islamic, and wholesale banks, both conventional and Islamic. As of December 2019, the NFA position for retail banks was *negative* USD 2,603.6 million and for wholesale banks, the NFA position was *negative* USD 3,601.9 million.

Table 2-2: Net Foreign Assets Postion by Banking Segment (December 2019)

Banking Segment (USD million)	Foreign Assets	Foreign Liabilities	Net Foreign Assets
Conventional Retail	38,485.6	39,506.0	(1,020.4)
Islamic Retail	2,533.6	4,116.8	(1,583.2)
Retail (Conventional and Islamic)	41,019.2	43,622.8	**(2,603.6)**
Conventional Wholesale	89,375.4	91,956.9	(2,581.4)
Islamic Wholesale	5,996.6	7,017.1	(1,020.4)
Wholesale (Conventional and Islamic)	95,372.1	98,973.9	**(3,601.9)**
Total Banking Segments	136,391.3	142,596.7	**(6,205.4)**

Source: CBB.

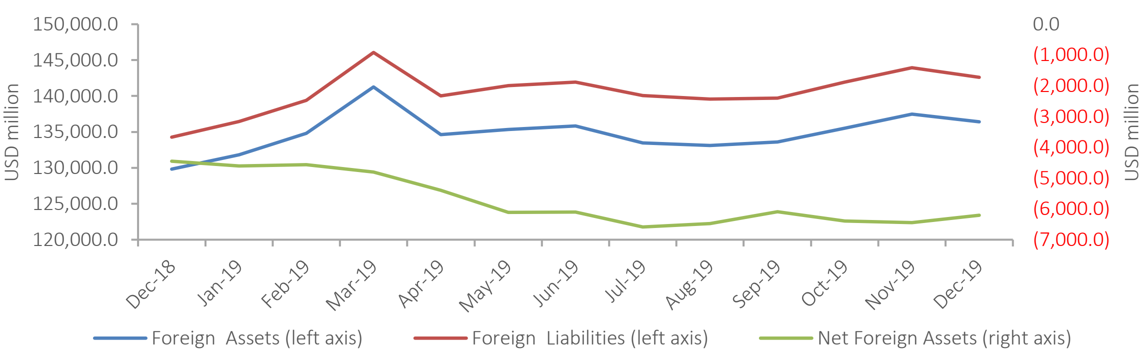
Chart 2-20: Net Foreign Assets Position by Banking Segment



Source: CBB.

While the foreign assets for some banking segments have been increasing steadily with an upward trend, there is also an increase in foreign liabilities which leads to the increasing negative NFA position. The NFA for conventional wholesale banks increased significantly in over the course of 2019. Looking at the NFA position for the overall banking sector, data shows that there is a continuous downward trend as seen in the chart below. The NFA position of every banking segment is seen in the Box below.

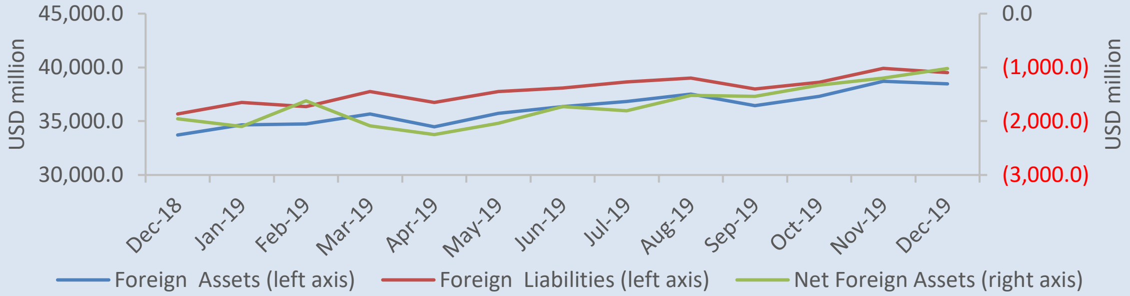
Chart 2-21: Net Foreign Assets of the Overall Banking Sector



Source: CBB.

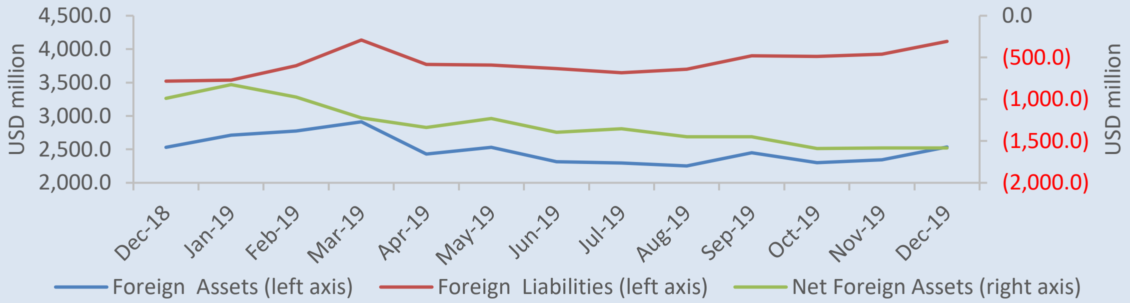
Box 1: Net Foreign Asset by Banking Segment

Box 1 Chart 1: Conventional Retail's Net Foreign Assets



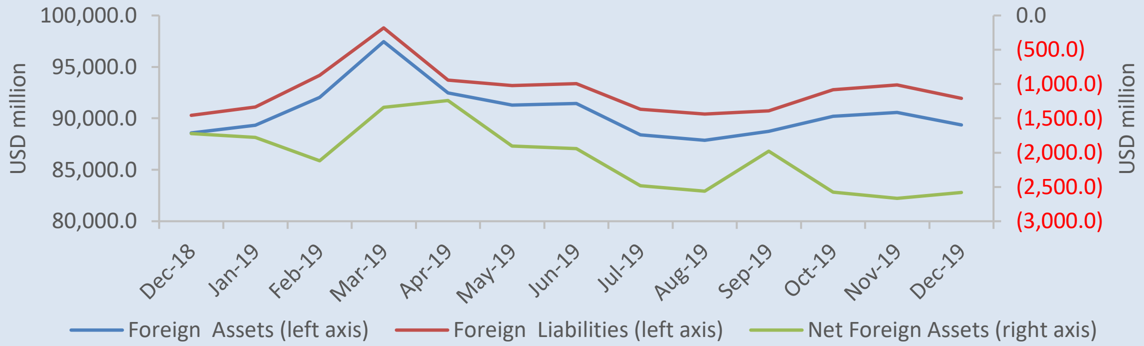
Source: CBB.

Box 1 Chart 2: Islamic Retail's Net Foreign Assets



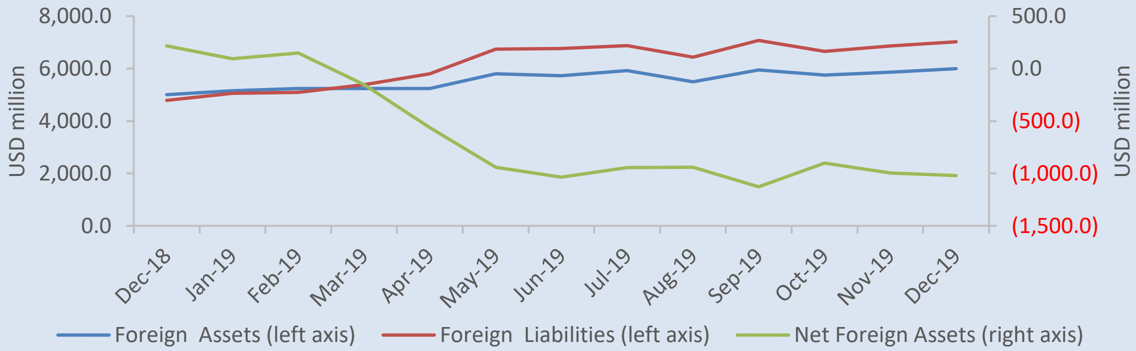
Source: CBB.

Box 1 Chart 3: Conventional Wholesale's Net Foreign Assets



Source: CBB.

Box 1 Chart 4: Islamic Wholesale's Net Foreign Assets

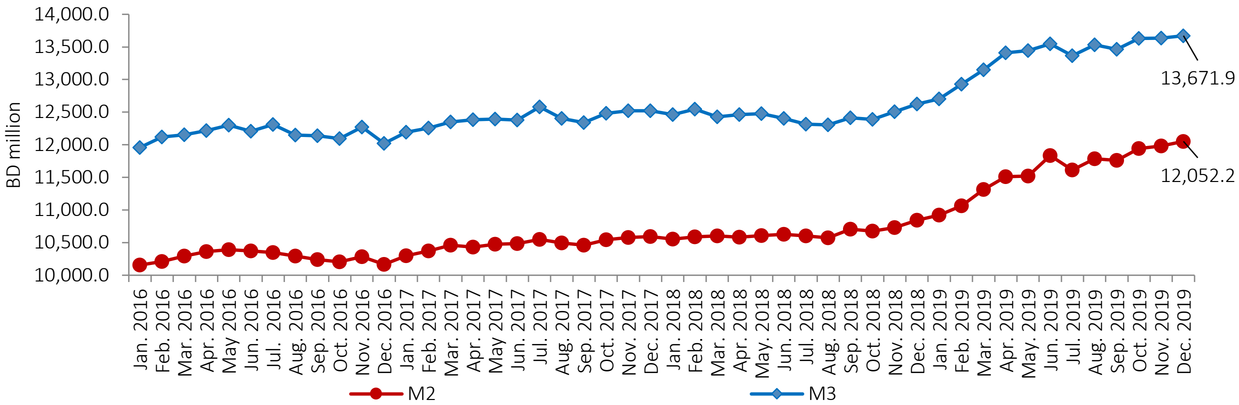


Source: CBB.

2.3 Monetary Indictors

Money supply continued to grow. M2 stood at BD 12,052.2 million in end-December 2019, 11.1% higher than its value of December 2018. M3 was at BD 13,671.9 million in end-December 2019, 8.3% higher than in December 2018 (Chart 2-20).

Chart 2-22: Money Supply (BD million) from Jan. 2016 to Dec. 2019



Source: CBB Monthly Statistical Bulletin.

Table 2-3 sets out an analysis of Bahrain's M1, M2 and M3 money supply as at the dates indicated.

Table 2-3: Money Supply Composoition

	2016		2017		2018		2019	
	BD million	(%)	BD million	(%)	BD million	(%)	BD million	(%)
Currency Outside Banks	535.3	1.9	526.8	(1.6)	528.1	0.2	535.1	1.3
Demand Deposits	2,780.6	0.4	2,828.1	1.7	2,893.9	2.3	2978.5	2.9
M1	**3,315.9**	**0.7**	**3,354.9**	**1.2**	**3,422.0**	**2.0**	**3,513.6**	**2.7**
Time and savings deposits	6,852.0	1.5	7,239.6	5.7	7,423.3	2.5	8,538.6	15.0
M2	**10,167.9**	**1.2**	**10,594.5**	**4.2**	**10,845.3**	**2.4**	**12,052.2**	**11.1**
General Government Deposits	1,853.9	0.1	1,926.8	3.9	1,776.8	(7.8)	1,619.7	(8.8)
M3	**12,021.8**	**2.9**	**12,521.3**	**1.2**	**12,622.1**	**2.0**	**13,671.9**	**8.3**

Source: CBB Monthly Statistical Bulletin.

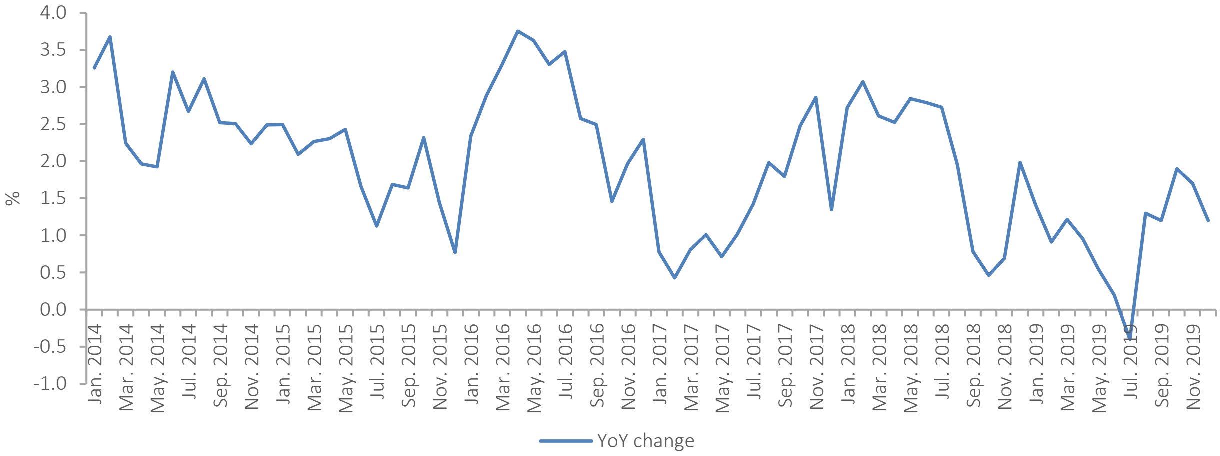
As of December 2019, the growth in money supply has been stimulated by a growth in deposits. In particular, time and savings deposits increased by 15.0% from BD 7,243.3 million in December 2018 to BD 8,538.6 million in December 2019, while demand deposits increased by 2.9%.

2.4 Inflation

The CBB maintains the Bahraini Dinar's peg against the U.S. Dollar, which has provided price stability over the years and as a result managed to keep inflation relatively stable. As Bahrain has no significant domestic production, its inflation (as measured by CPI) has been mainly affected by the cost of imports. The CPI for Bahrain includes 12 broad categories of consumer goods that are representative of consumption patterns in the economy. These components are food and non-alcoholic beverages; alcoholic beverages, tobacco and narcotics; clothing and footwear; housing, water, electricity, gas and other fuels; furnishing, household equipment and routine household maintenance; health; transport; communication; recreation and culture; education; restaurants and hotels; and miscellaneous goods and services.

The index has been rebased to April 2019=100, with effect from May 2019, which resulted in certain methodological changes which include updating the expenditure weight, revising the sample of goods and services and improving the methods of price collection. Since 2014, there was a reversal of the deflationary trend seen over the preceding three years and consumer prices increased moderately.

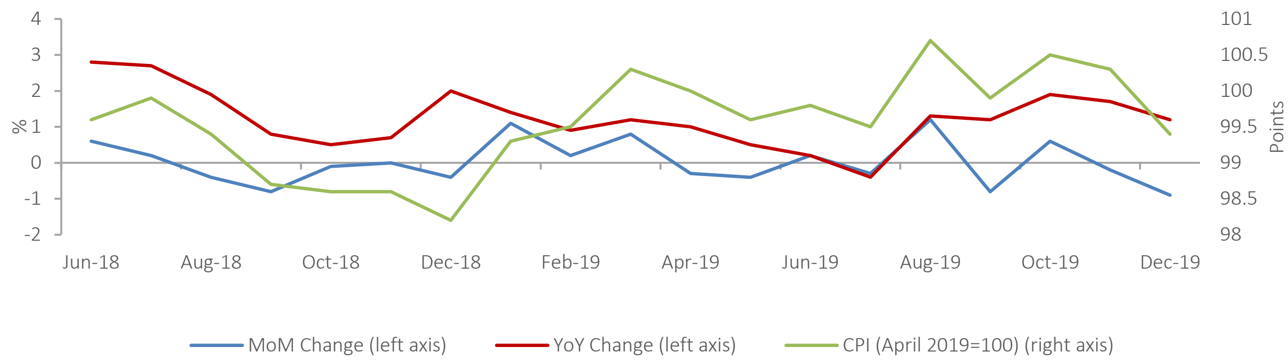
Chart 2-23: CPI Change (Jan. 2014 – Dec. 2019)



Source: IGA.

As of December 2019, the Consumer Price Index (CPI) stood at 99.4 points. Monthly inflation decreased by 0.9% and the largest increases came from food and non-alcoholic beverages, due to the increase in vegetables prices by 17.2%. On an annual basis, inflation increased by 1.2% in December 2019 as compared to December 2018.

Chart 2-24: Monthly Inflation Rate (Jun. 2018 – Jun. 2019)



Source: IGA.

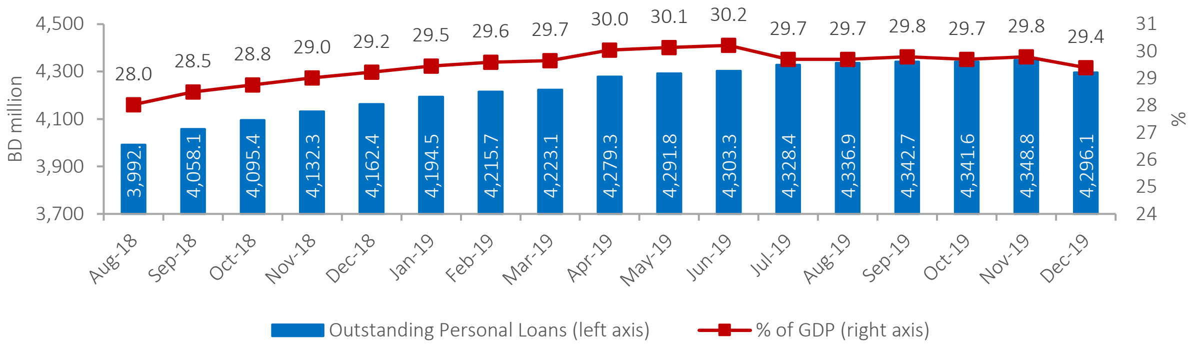
Contrary to expectations of an inflationary spike following the introduction of VAT, the Consumer Price Index (CPI) in Bahrain continued broadly in line with the trend observed over the past year. The CPI in December 2019 was 1.2% higher than a year earlier.

2.5 The Households/Personal 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.

Outstanding personal loans, used as a proxy for household borrowing, for the period shows that the household debt saw a stagnation throughout the period between June and December 2019 (Chart 2-23).

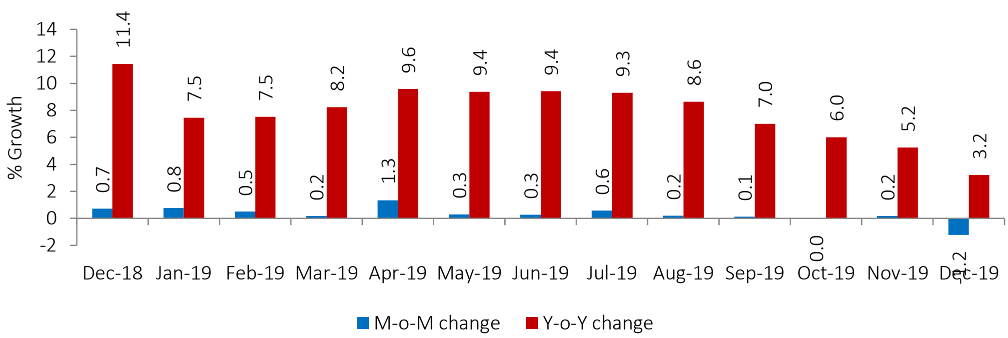
Chart 2-25: Personal Loans and Advances (Volume and % of GDP)



**Using 2018 GDP.*
Source: CBB Monthly Statistical Bulletin.

Personal loans as a percentage of GDP decreased to 29.4% by December 2019 (BD 4,296.1 milllon). There was a 0.2% decrease in outstanding personal loans between June 2019 and December 2019 (YoY increase was 3.2%).

Chart 2-26: Growth Rates of Total Personal Loans and Advances (%)



Source: CBB Monthly Statistical Bulletin.

The monthly growth rate in total personal loans and advances fluctuated between December 2018 to December 2019. Initially at 0.7% in December 2018, it rose to reach its highest level for the year of 1.3% in April 2019 and later fell to reach -1.2% in December 2019. On a yearly basis, the biggest Y-o-Y increase was in December 2018 where the personal loans and advances increased from BD 3,735.3 million in December 2017 to BD 4,162.4 million in December 2018 (11.4%).

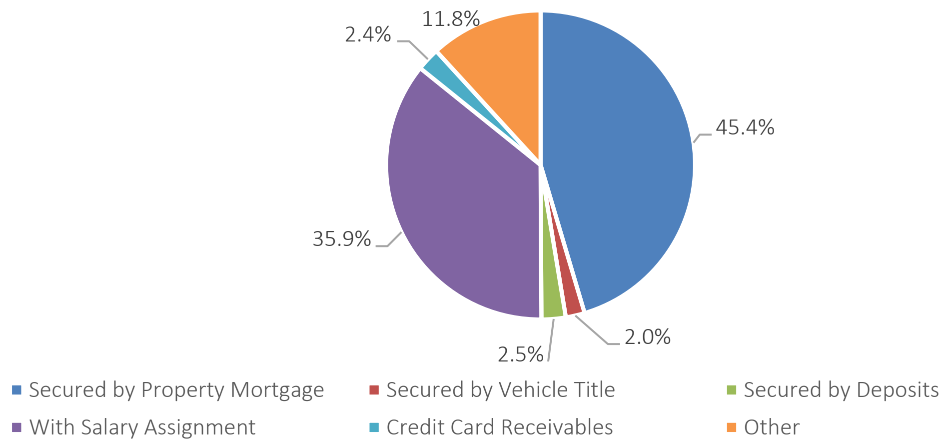
As of end of December 2019, the two main contributors to personal loans as seen in chart 2-25 were personal loans secured by property mortgages which made up 45.4% of the total personal loans followed by personal loans secured with salary assignments at 35.9% of total personal loans.

Table 2-4: Personal Loans Breakdown

BD million	Jun. 2019	Jul. 2019	Aug. 2019	Sep. 2019	Oct. 2019	Nov. 2019	Dec. 2019
Total	4,303.3	4,328.4	4,336.9	4,342.7	4,341.6	4,348.8	4,296.1
Secured by Property Mortgage	1,863.9	1,883.9	1,902.8	1,904.1	1,887.6	1,898.4	1,950.5
Secured by Vehicle Title	96.6	95.2	92.4	90.6	88.2	88.0	85.2
Secured by Deposits	175.3	178.5	174.9	162.7	166.4	153.9	108.7
With Salary Assignment	1,343.1	1,357.1	1,531.8	1,535.7	1,524.3	1,549.7	1,540.7
Credit Card Receivables	76.8	76.0	96.4	100.0	101.1	103.0	104.0
Other	747.6	737.7	538.6	549.6	574.0	555.8	507.0

Source: CBB Monthly Statistical Bulletin.

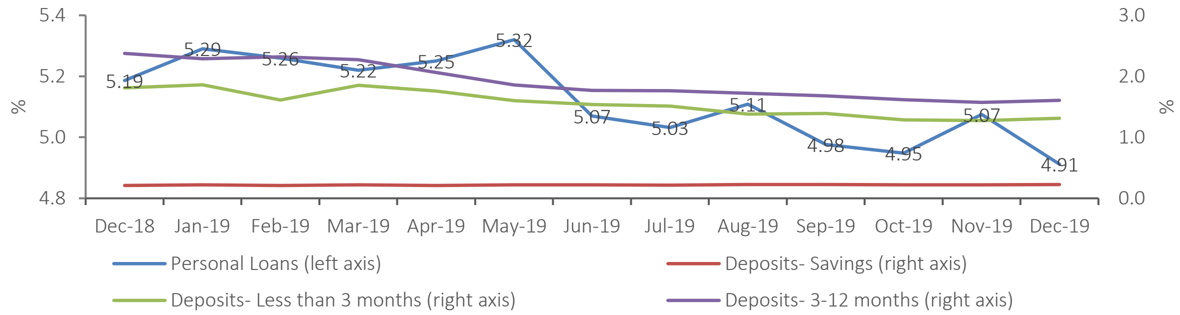
Chart 2-27: Personal Loans Breakdown (Dec. 2019)



Source: CBB Monthly Statistical Bulletin.

Interest rates on personal loans started off at 5.19% in December 2018 and decreased to 4.91% in December 2019 (Chart 2-26). 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 2-28: Retail Banks- Average Interest Rates on Personal Loans and Interest rates on Deposits (%)

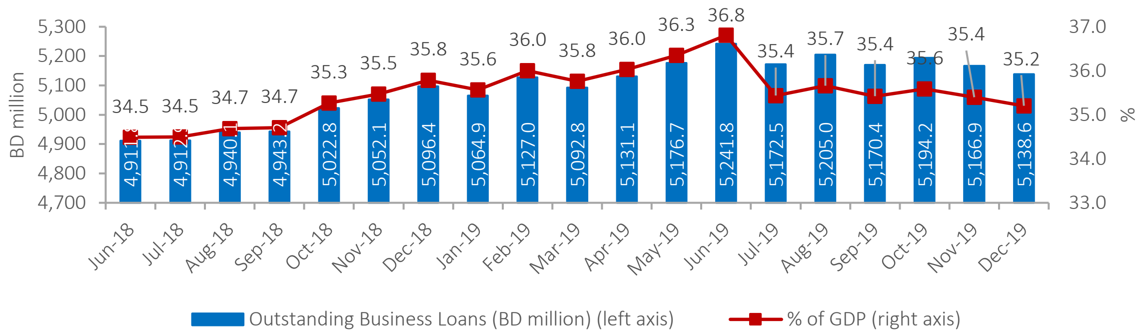


Source: CBB Monthly Statistical Bulletin.

2.6 The Bahraini Corporate/Business Sector

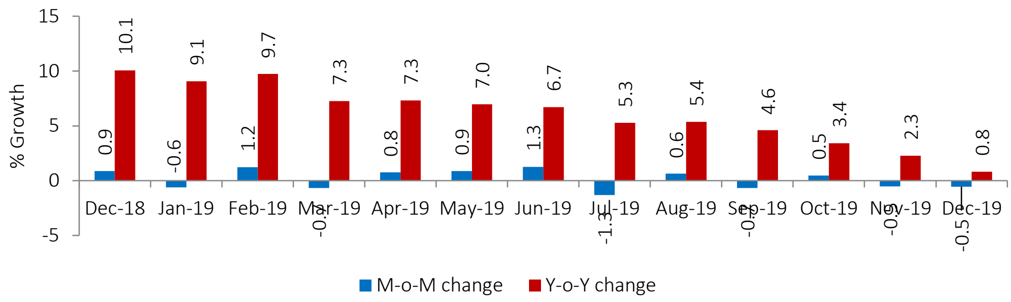
Business loans and advances contracted by 2.0% between June 2019 and December 2019 from BD 5,214.8 million in June 2019 to BD 5,138.6 million in December 2019 (Chart 2-27). In December 2019, Y-o-Y growth for business loans was 0.8%. Outstanding business loans as a percentage of GDP decreased to 35.2% in December 2019.

Chart 2-29: Business Loans and Advances (Volume and % of GDP)



Source: CBB Monthly Statistical Bulletin.

Chart 2-30: Growth Rates of Total Business Loans and Advances (%)



Source: CBB Monthly Statistical Bulletin.

The monthly growth rate in total personal loans and advances fluctuated between December 2018 to December 2019. Initially at 0.9% in December 2018, it rose to reach its highest level for the year of 1.3% in June 2019 to reach -0.5% in December 2019. The highest Y-o-Y growth was in December 2018 (10.1%)

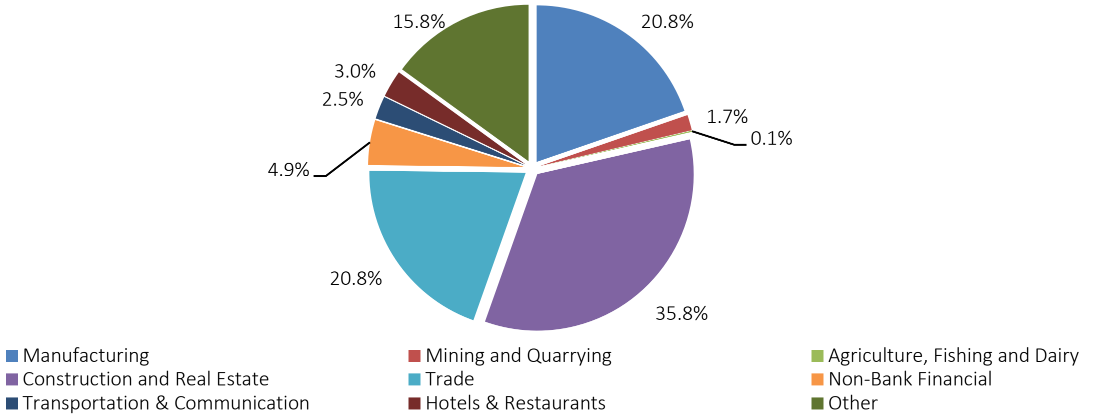
For the past six months, the main contributor to the business loans was the loans to the construction and real estate sector. The biggest contributors to business loans in December 2019 were the construction and real estate sector (35.8%) followed by trade (20.8%), manufacturing (20.8%) and then other sectors (15.8%) (Chart 2-29).

Table 2-5: Business Loans by Sector

BD million	Jun. 2019	Jul. 2019	Aug. 2019	Sep. 2019	Oct. 2019	Nov. 2019	Dec. 2019
Total	**5,241.8**	**5,172.5**	**5,205.0**	**5,170.4**	**5,194.2**	**5,166.9**	**5,138.6**
Manufacturing	1,043.1	1,062.2	1,083.9	1,075.0	1,048.7	1,060.8	1,068.1
Mining and Quarrying	124.7	52.9	53.1	67.8	69.2	69.6	86.7
Agriculture, Fishing and Dairy	4.7	5.1	5.9	6.1	7.0	7.1	6.7
Construction and Real Estate	1,872.9	1,849.8	1,850.9	1,868.0	1,887.6	1,871.8	1,841.4
Trade	1,120.3	1,120.8	1,133.4	1,090.7	1,118.2	1,095.0	1,071.0
Non-Bank Financial	239.1	239.4	240.0	240.8	251.7	251.1	251.8
Transportation & Communication	125.0	124.5	123.3	124.7	122.5	120.2	127.2
Hotels & Restaurants	141.9	145.0	144.2	142.9	142.9	142.2	151.6
Other Sectors	837.0	842.3	837.8	822.0	811.8	811.5	812.9

Source: CBB Monthly Statistical Bulletin.

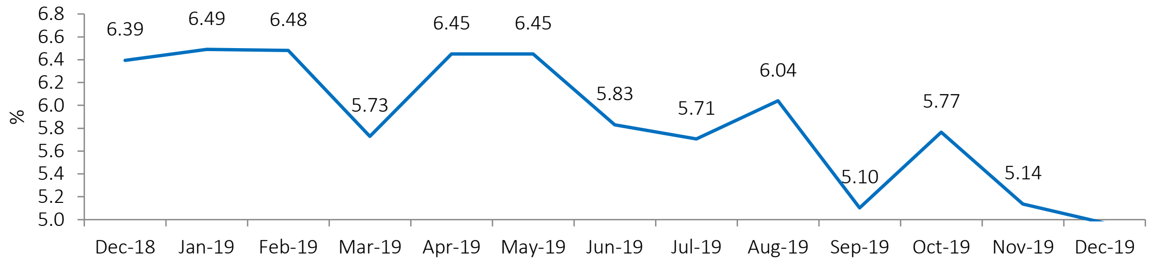
Chart 2-31: Business Loans by Sector (Dec. 2019)



Source: CBB Monthly Statistical Bulletin.

Average interest rates on business loans fluctuated throughout the period from June 2019 to December 2019. It was at its peak in January 2019 at 6.49% (Chart 2-30).

Chart 2-32: Retail Banks' Average Interest Rates on Business Loans



Source: CBB Monthly Statistical Bulletin.

2.6.1 Construction and Real Estate

The total number of construction permits issued by the Ministry of Municipality & Agricultural Affairs has seen a decrease from Q4 2018 to Q2 2019, with a total of 1,531 and 826 permits issues respectively.

Table 2-6: Selected Construction Permits by Type

Type	2017	2018:Q1	2018:Q2	2018:Q3	2018:Q4	2019:Q1	2019:Q2
Renovation	509	162	169	148	163	117	97
Reclamation	18	1	7	1	8	1	1
New Construction	2,656	613	730	596	675	371	347
Demolition and New Construction	25	10	7	8	13	6	2
Demolition	433	118	95	88	67	56	43
Addition	2,314	567	525	434	605	541	336
Total	**5,955**	**1,471**	**1,533**	**1,275**	**1,531**	**1,092**	**826**

Sources: Ministry of Works, Municipalities Affairs and Urban Planning.

2.7 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 are stableand demand for loans has stagnated 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:

Developments in the Banking Sector

Chapter 3

Overall Banking Sector

Key Highlights

CAR	NPL	Provisioning	ROA	ROE	Liquidity	Loan/Deposit
19.2% ↑	4.8% ↓	62.0% ↓	1.1↑	7.9% ↑	25.5% ↑	71.5% ↑

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

3.1 Overview

This chapter offers an assessment of the banking sector in Bahrain. Macro prudential analysis of the entire banking sector is performed based on a set of selected Financial Soundness Indicators (FSIs). 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 of the four banking segments is analysed in Chapters 4 and 5.[1] Annex 1 presents selected FSIs for the different banking segments. Annex 2 presents selected graphs showing the development of selected indicators over time.

Chapters 3, 4, and 5 cover the period between end-June 2019 and end-December 2019, unless otherwide indicated. The chapters cover the developments in Bahrain's banking sector prior to the COVID-19 pandemic.

3.2 Overall Banking Sector Performance

3.2.1 Capital Adequacy

Increase in Capital Adequacy Ratio

The capital adequacy ratio[2] (CAR) for the banking sector stood at 19.2% in December 2019. The ratio has increased from 19.0% in June 2019. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 17.7% in June 2019 to 17.9% in June 2019. Whereas the leverage ratio (ratio of assets over capital) increased to 7.8% during the same period.

[1] Chapters 3, 4, and 5 do not contain any sections 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*	Jun. 2019	Dec. 2019
CAR (%)	19.0	19.2
Tier 1 CAR (%)	17.7	17.9
Leverage (Assets/Capital) (Times)	7.6	7.8

** For Locally Incorporated Banks only.*
Source: CBB.

3.2.2 Asset Quality

Decrease in NPLs

The non-performing loans (NPLs) ratio decreased to 4.8% in December 2019 from 5.2% in June 2019. The specific provisions as a proportion of NPLs showed decrease to 62.0% in December 2019 from 64.7% in June 2019.

Table 3-2: NPL Ratios

Indicator	Jun. 2019	Dec. 2019
NPLs (% Total Loans)	5.2	4.8
Specific provisions (% of NPLs) *	64.7	62.0

** Specific provisions as a percentage of NPLs are calculated as specific provisions divided by gross impaired loans.*
Source: CBB.

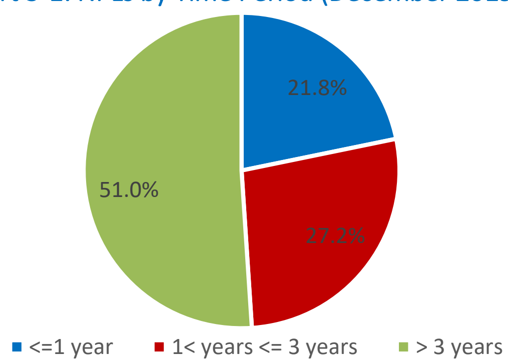
Data on NPLs by time segment (up to 1 year, 1 year to 3 years, and over 3 years) show that the majority of NPLs in the banking sector are for a period of over 3 years (51.0% of total NPLs). NPLs for over 3 years represented 2.0% of total gross loans. Specific provisioning for NPLs increases as they are non-performing for longer periods of time. As seen in Table 3-3, NPLs for a period for more than 3 years are provisioned by 75.6%.

Table 3-3: NPL Ratios and Specific Provisions by Time Period (December 2019)

Indicator	Up to 1 year	1 up to 3 years	Over 3 years	Total
NPLs (% Total Loans)	1.6	1.2	2.0	4.8
Specific Provisions (% of NPLs)	41.0	67.1	75.6	62.0

Source: CBB.

Chart 3-1: NPLs by Time Period (December 2019)

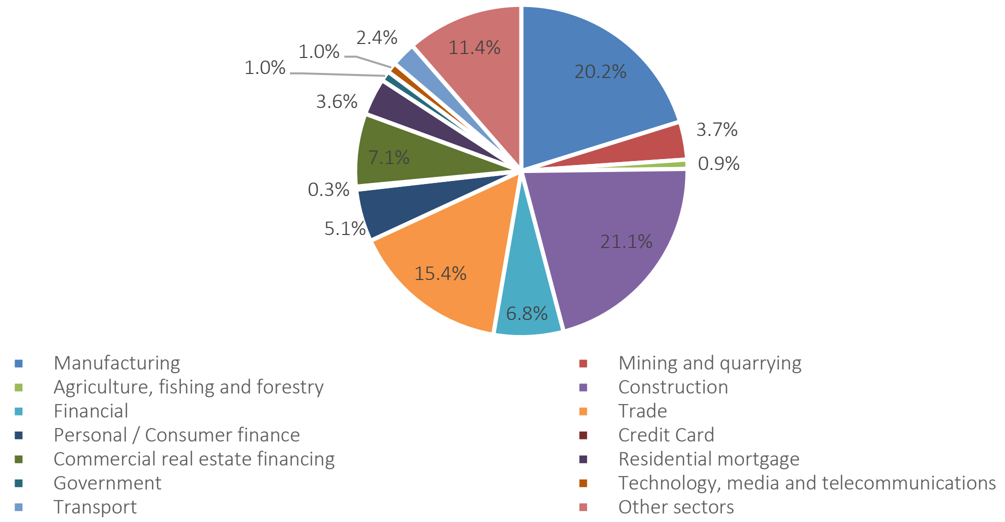


Source: CBB.

Data on the concentration of NPLs by sector shows that the majority of NPLs come from the manufacturing sector (20.2%), construction (21.1%), and trade (15.4%) as indicated in chart 3-2. [3]

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

Chart 3-2: NPLs Concentration by Sector (December 2019)



Source: CBB.

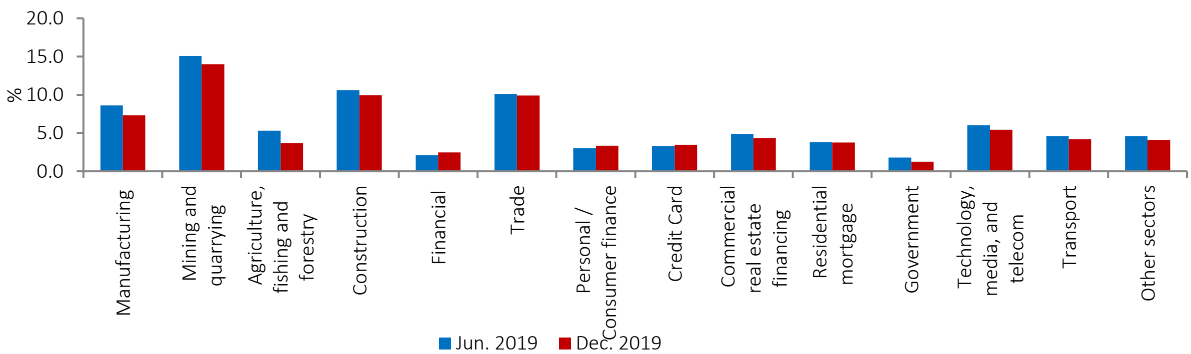
Data on the sectoral breakdown of NPLs ratios (NPLs per sector as a percentage loans in each sector) shows some sectors experiencing an increase in impairment, while some experience a decrease and others remaining unchanged (Table 3-4 and Chart 3-2). The overall changes though have been minimal. The highest increase was in the financial sector by 0.4%. The highest decrease was in manufacturing by 1.3%.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	8.6	7.3	(1.3)
Mining and quarrying	15.1	14.0	(1.1)
Agriculture, fishing and forestry	5.3	3.7	(1.6)
Construction	10.6	9.9	(0.7)
Financial	2.1	2.5	0.4
Trade	10.1	9.9	(0.2)
Personal / Consumer finance	3.0	3.3	0.3
Credit Card	3.3	3.5	0.2
Commercial real estate financing	4.9	4.3	(0.6)
Residential mortgage	3.8	3.8	0.0
Government	1.8	1.2	(0.6)
Technology, media and telecommunications	6.0	5.4	(0.6)
Transport	4.6	4.2	(0.4)
Other sectors	4.6	4.1	(0.5)

Source: CBB.

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



Source: CBB.

Loan portfolios faces slight fluctuations and concentrated in some sectors

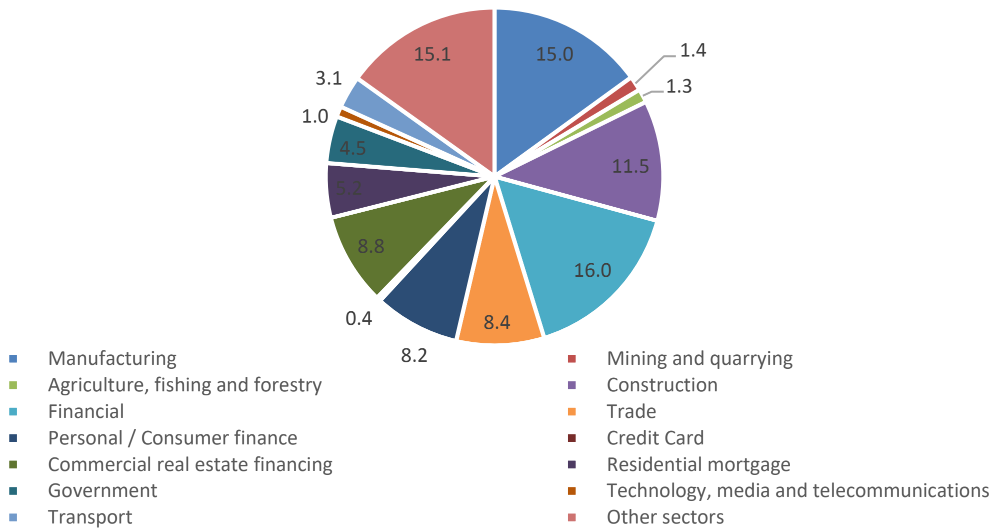
The loan portfolio of *the banking system* remains concentrated in four sectors with no major change in the exposure to the sectors and with no sector exceeding 20% of total loans. Financial represented the highest exposure with 16.0% of total loans in December 2019. Other Sectors and manufacturing was close behind, with 15.1% and 15.0% exposure in December 2019. Also, the sector with the largest decline was personal/ consumer finance after dropping from 9.1% in June 2019 to 8.2% in December 2019.

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

Sector	Jun. 2019*	Dec. 2019*	Change
Manufacturing	14.8	15.0	0.2
Mining and quarrying	1.4	1.4	0.0
Agriculture, fishing and forestry	1.3	1.3	0.0
Construction	11.6	11.5	(0.1)
Financial	15.6	16.0	0.4
Trade	8.6	8.4	(0.2)
Personal / Consumer finance	9.1	8.2	(0.9)
Credit Card	0.4	0.4	0.0
Commercial real estate financing	8.7	8.8	0.1
Residential mortgage	5.0	5.2	0.2
Government	4.4	4.5	0.1
Technology, media and telecommunications	1.0	1.0	0.0
Transport	3.2	3.1	(0.1)
Other sectors	14.9	15.1	0.2
Top Two Sectors (%)	**30.5**	**31.1**	**0.6**
Real Estate/ Construction Exposure (%) **	**25.3**	**25.5**	**0.2**

** 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.
Source: CBB.

Chart 3-4: Lending Distribution (% Total Loans)



Source: CBB.

The top two recipient sectors financial and other sectors jointly represented 31.1% of loans in December 2019, increasing from 30.5% in June 2019. Exposure to real estate/construction was 25.5% of total lending in December 2019, a slight increase from 25.3% registered in June 2019.

SME lending

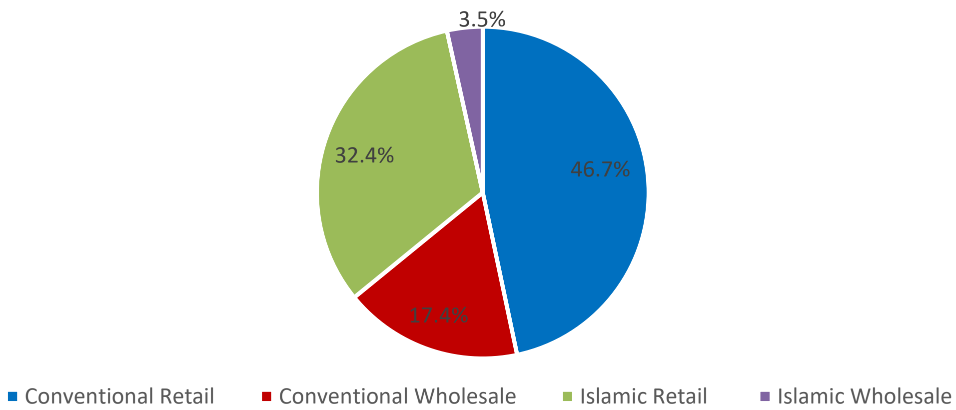
Credit extension to Small and Medium Enterprises (SMEs) showed stability between June 2019 and December 2019. SME loans (as a % of total loans) was at 1.9% in December 2019. SME NPLs increased significantly between the same periods more than doubling to reach 13.7% from 6.9%. Provisioning levels recorded a decrease from 50.9% in June 2019 to 38.8% in December 2019.

Table 3-6: SME Lending *

Indicator	Jun. 2019	Dec. 2019
SME Loans (% of total Loans)	2.0	1.9
SME NPLs (% of total SME Loans)	6.9	13.7
SME Provisioning (% of total SME NPLs)	50.9	38.8

**For Bahrain Operations Only*
Source: CBB.

Chart 3-5: SME Lending by Banking Segment (December 2019)



Source: CBB.

3.2.3 Profitability

Profitability remains stable

The overall banking sector's profitability indicators have been stable from December 2018 to December 2019 and remains robust. Return-on-assets (ROA) increased slightly from 1.0% in December 2018 to 1.1% in December 2019. As of end-December 2019, return-on-equity (ROE) increased to 7.9% from 6.6% in December 2018.

Table 3-7: Profitability

Indicator	Dec. 2018	Dec. 2019
ROA (%) *	1.0	1.1
ROE (%) **	6.6	7.9
Net Interest Income (% Total Income) ***	67.3	70.9
Operating Expenses (% Total Income)	63.7	54.8

** 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.*
Source: CBB.

Net interest income (as a % of total income) stood at 70.9% in December 2019. In addition, operating expenses as a proportion of total income was 54.8% in December 2019, a decrease from the 63.7% registered in December 2018.

3.2.4 Liquidity

Liquidity position stays resilient

Between June 2019 and December 2019, the overall loan-deposit ratio increased from 70.8% to 71.5%. Liquid assets as a proportion of total assets increased from 25.1% to 25.5%, over the same period.

Table 3-8: Liquidity

	Jun. 2019	Dec. 2019
Liquid Asset Ratio (%)	25.1	25.5
Loan-Deposit Ratio (%)	70.8	71.5

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 ratios. Capital adequacy ratios for the banking sector increased to 19.2% in December 2019 from 19.0% in June 2019. NPLs have decreased between the periods of June 2019 to December 2019, from 5.2% to 4.8%. Profitability has remained almost stable with ROA being at 1.1% and ROE at 7.9%. Liquidity improved as the liquid asset ratio increased by 0.4% between June 2019 and December 2019.

The CBB implemented new standards for capital and liquidity requirement proposed by the Basel Committee on Banking Supervision ("Basel III") in Bahrain starting from 1 January 2015, which are applicable to both conventional and to Islamic banking institutions. Local banks are required to maintain a minimum capital adequacy ratio of 12.5% which exceeds the minimum ratio requirements set by Basel III. All Bahraini banks are currently following the standardised approach to Credit Risk under Pillar One of Basel III. The basic indicator and standardised approaches are permitted for operational risk, while the standardised and internal model approaches are permitted for market risk. As part of Basel III implementation, new more extensive Pillar Three Disclosure requirements came into effect for all locally-incorporated banks' financial statements dated 30 June 2015 onward. With effect from 30 June 2019, the CBB requires all locally-incorporated banks to also report Basel III ratios on leverage and liquidity on a quarterly basis for LCR. From 31 December 2019, the CBB will also require all locally-incorporated banks to report in respect of NSFR.

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.

Chapter 4

Conventional Banks

Key Highlights

CR CAR	CR NPL	CR Provisions	CR ROA	CR ROE	CR Liquidity	CR Loan/Deposit
21.1% ↑	4.9% ↓	66.0% ↔	1.8% ↑	14.2% ↓	36% ↑	65.8% ↓

CW CAR	CW NPL	CW Provisions	CW ROA	CW ROE	CW Liquidity	CW Loan/Deposit
18.6% ↓	4.5% ↓	70.8% ↓	0.9% ↑	4.8% ↑	21.3% ↑	68.% ↑

- A slight decrease in capital positions of conventional wholesale banks.
- Non-performing loans (NPLs) for both conventional retails banks and conventional wholesale banks have decreased.
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Decrease in earnings for conventional retail banks and an increase for conventional wholesale banks.
- Liquidity improved for both conventional retail banks and conventional wholesale banks.

4.1 Overview

Chapter 4 offers macro prudential analysis of the conventional banking sector based on a set of selected FSIs. The Chapter analyses the following conventional banking segments: conventional retail (CR) banks (section 4.2), conventional wholesale (CW) 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).

4.2 Conventional Retail Banks

4.2.1 Capital Adequacy

Decrease in capital adequacy

The CAR for conventional retail increased from 19.8% in June 2019 to 21.1% in December 2019. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 18.5% in June 2019 to 19.7% in December 2019. The leverage ratio (ratio of assets over capital) decreased to 6.7% during the same period. The ratio of non-performing loans (NPLs) net provisions to capital decreased to 4.4% in December 2019 from 6.3% in June 2019.

Table 4-1: CR Banks' Capital Provisions Ratios

Indicator *	Jun. 2019	Dec. 2019
CAR (%)	19.8	21.1
Tier 1 CAR (%)	18.5	19.7
Leverage (Assets/Capital) (times)	7.0	6.7
NPLs net of Provisions to Capital (%)	6.3	4.4

** For Locally Incorporated Banks only.*

Source: CBB.

4.2.2 Asset Quality

Stability in NPLs

The NPL ratio decreased to 4.9% in December 2019 from 5.5% in June 2019. The specific provisions remained constant at 66% in December 2019. For local retail banks, the NPLs slightly decreased to 3.9% in December 2019. For overseas retail banks, the NPLs decreased from 7.3% in June 2019 to 7.0% in December 2019.

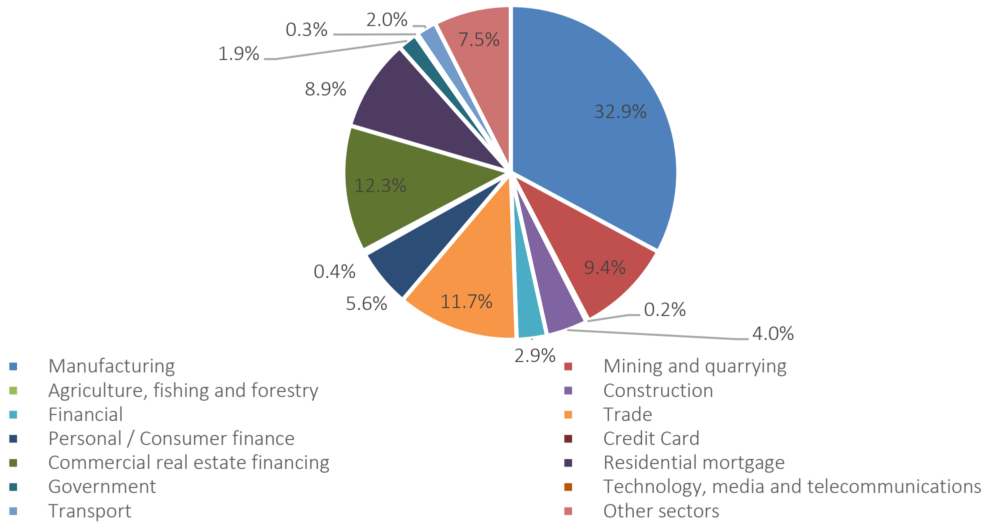
Table 4-2: CR Banks' NPL Ratios

Indicator	Jun. 2019	Dec. 2019
NPLs (% Total Loans)	5.5	4.9
NPLs Local Banks (%)	4.5	3.9
NPLs Overseas Banks (%)	7.3	7.0
Specific Provisions (% of NPLs) *	66.0	66.0

** Specific provisions as a percentage of NPLs are calculated as specific provisions divided by gross impaired loans.*
Source: CBB.

Data on the concentration of NPLs by sector shows that the majority of NPLs come from the manufacturing sector (32.9%), commercial real estate sector (12.3%), trade (11.7%) and mining (9.4%) as indicated in chart 4-1.

Chart 4-1: CR Banks' NPLs Concentration by Sector (December 2019)



Source: CBB.

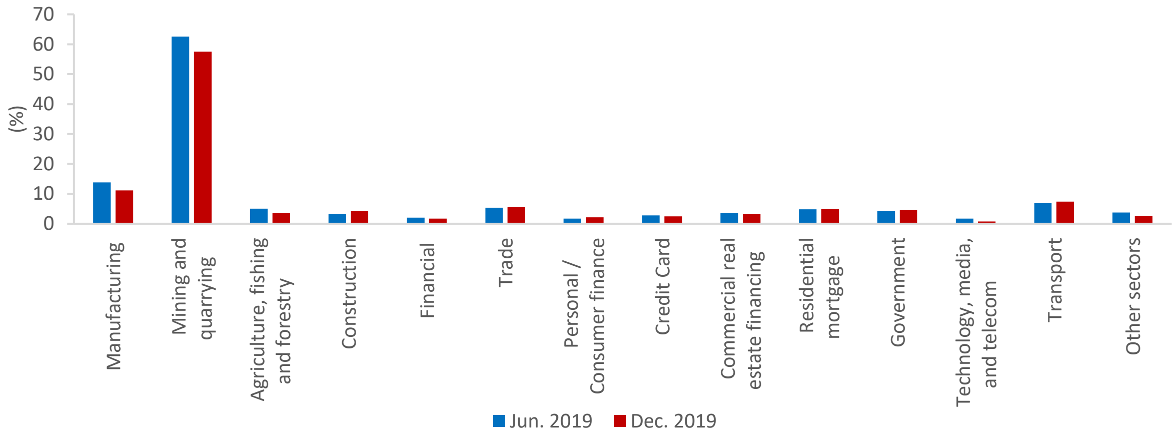
Available data on the sectoral breakdown of NPLs shows some sectors experiencing an increase in impairment, while some experience a decrease (Table 4-3 and Chart 4-1). The highest increase was in construction by 0.9%, and the highest decrease was in mining and quarrying and others sector by 5.1%.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	13.8	11.1	(2.7)
Mining and quarrying	62.6	57.5	(5.1)
Agriculture, fishing and forestry	5.0	3.5	(1.5)
Construction	3.3	4.2	0.9
Financial	2.0	1.7	(0.3)
Trade	5.4	5.6	0.2
Personal / Consumer finance	1.7	2.1	0.4
Credit Card	2.8	2.5	(0.3)
Commercial real estate financing	3.5	3.2	0.4
Residential mortgage	4.8	4.9	(0.9)
Government	4.2	4.6	0.5
Technology, media and telecommunications	1.7	0.8	(1.1)
Transport	6.9	7.4	(2.7)
Other sectors	3.7	2.6	(5.1)

Source: CBB.

Chart 4-2: CR Banks' NPL Ratios by Sector (%)



Source: CBB.

Loan portfolios remain concentrated

The loan portfolio of *retail banks* remains concentrated with fairly small, if any, changes in the composition of the loans. The top recipient of loans remains to be the commercial real estate financing sector accounting for 18.8% of total loans in December 2019, compared with 18.7% in June 2019. The manufacturing sector represented 14.5% of total loans and the personal/consumer finance sector represented 13.5%.

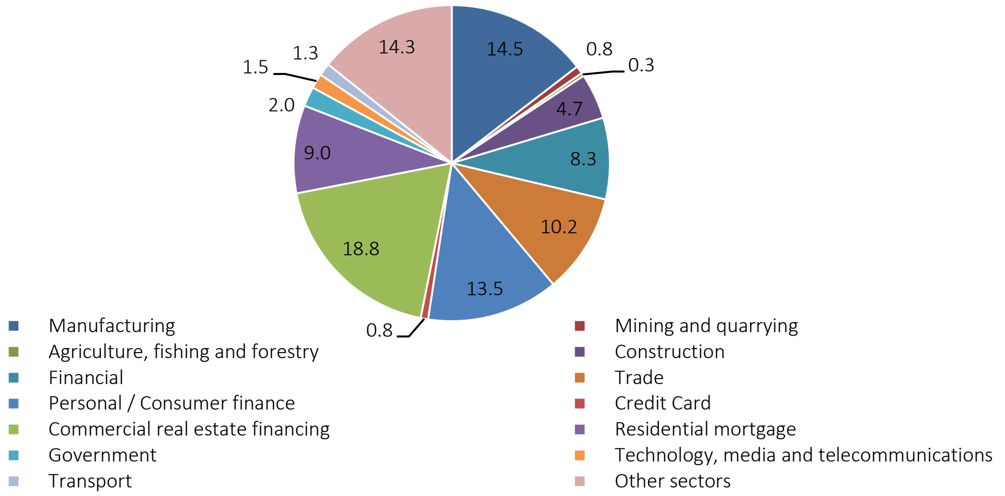
The top two recipient sectors, commercial real estate financing and personal/consumer finance, jointly represented 33.3% of loans in December 2019. Exposure to real estate/construction increased to 32.4% of total lending in December 2019.

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

Sector	Jun. 2019*	Dec. 2019*	Change
Manufacturing	14.6	14.5	(0.1)
Mining and quarrying	0.8	0.8	0.0
Agriculture, fishing and forestry	0.2	0.3	0.1
Construction	4.5	4.7	0.2
Financial	7.1	8.3	1.2
Trade	9.8	10.2	0.4
Personal / Consumer finance	15.1	13.5	(1.6)
Credit Card	0.7	0.8	0.1
Commercial real estate financing	18.7	18.8	0.1
Residential mortgage	8.5	9.0	0.5
Government	2.1	2.0	(0.1)
Technology, media and telecommunications	1.5	1.5	0.0
Transport	1.5	1.3	(0.2)
Other sectors	14.8	14.3	(0.5)
Top Two Sectors (%)	**33.8**	**33.3**	**(0.5)**
Real Estate/ Construction Exposure (%) **	**31.7**	**32.4**	**0.7**

** 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.*
Source: CBB.

Chart 4-3: 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 18.5% of total loans in December 2019.

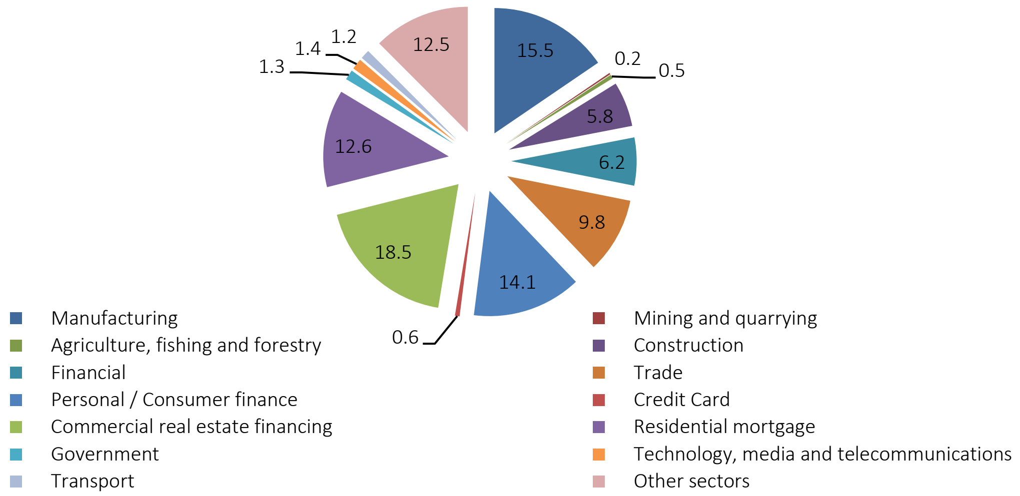
The manufacturing sector represented 15.5% of total loans over the same period, an increase from 14.3%. The top two recipient sectors commercial real estate financing and manufacturing jointly represented 29.8% of loans in December 2019, an decrease from the 34.8% in June 2019. Exposure to real estate/construction increased to 36.8% of total lending in December 2019.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	15.3	15.5	0.2
Mining and quarrying	0.2	0.2	0.0
Agriculture, fishing and forestry	0.4	0.5	0.1
Construction	5.4	5.8	0.4
Financial	5.9	6.2	0.3
Trade	9.5	9.8	0.3
Personal / Consumer finance	14.6	14.1	(0.5)
Credit Card	0.6	0.6	0.0
Commercial real estate financing	19.5	18.5	(1.0)
Residential mortgage	12.3	12.6	0.3
Government	1.5	1.3	(0.2)
Technology, media and telecommunications	1.4	1.4	0.0
Transport	1.5	1.2	(0.3)
Other sectors	12.1	12.5	0.4
Top Two Sectors (%)	**34.8**	**33.9**	**(0.9)**
Real Estate/ Construction Exposure (%) **	**37.1**	**36.8**	**(0.3)**

** 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.*
Source: CBB.

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



Source: CBB.

The numbers as of end-December 2019 continue to show high concentration of risk for *overseas retail banks* (Table 4-6 and Chart 4-4). The top recipient of loans, excluding the others sector, was the commercial real estate financing sector with 19.4% as of December 2019, an increase from 17.2 in June that same year.

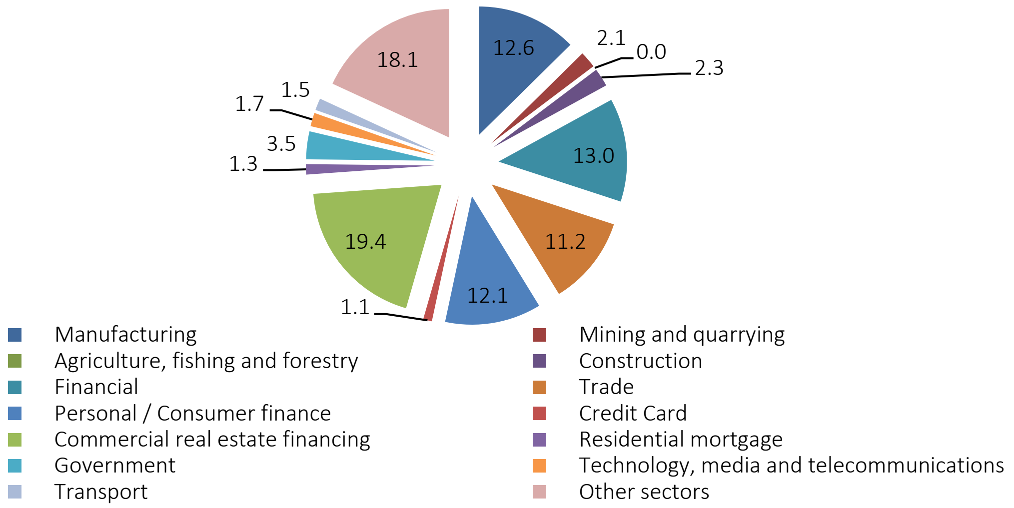
The top two recipients of loans (commercial real estate financing and other sectors) jointly accounted for 37.6% of total loans. Exposure to real estate/ construction was 23% of total lending in December 2019, increasing from 21.3% in June 2019.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	13.2	12.6	(0.6)
Mining and quarrying	2.1	2.1	0.0
Agriculture, fishing and forestry	0.0	0.0	0.0
Construction	2.9	2.3	(0.6)
Financial	9.4	13.0	3.6
Trade	10.4	11.2	0.8
Personal / Consumer finance	16.2	12.1	(4.1)
Credit Card	0.9	1.1	0.2
Commercial real estate financing	17.2	19.4	2.2
Residential mortgage	1.2	1.3	0.1
Government	3.3	3.5	0.2
Technology, media and telecommunications	1.6	1.7	0.1
Transport	1.5	1.5	0.0
Other sectors	20.1	18.1	(2.0)
Top Two Sectors (%)	**37.3**	**37.6**	**0.3**
Real Estate/ Construction Exposure (%) **	**21.3**	**23.0**	**1.7**

** 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.*
Source: CBB.

Chart 4-5: Overseas CR Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

4.2.3 Profitability

Increase in Overseas Banks' profitability

Profitability of the banks was positive, and, as at end-December 2019, ROA increased to 1.8%. ROA for *locally incorporated banks* decreased to 2.0% in December 2019. For *overseas banks*, ROA increased from 0.4% in December 2018 to 1.3% in December 2019. ROE for *locally incorporated banks* decreased to 14.2 from 14.3 during the same period. Net interest income (as a % of total income) increased from 77.2% to 77.3% during the same period as well. Operating expenses as a proportion of total income decreased from 51.6% in December 2018 to 39.3% in December 2019.

Table 4-7: CR Banks' Profitability

Indicator	Dec 2018	Dec. 2019
ROA (%) *	1.5	1.8
ROA Locally Incorporated Banks (%)	2.1	2.0
ROA Overseas Banks (%)	0.4	1.3
ROE (%) **	14.3	14.2
Net Interest Income (% Total Income)	77.2	77.3
Operating Expenses (% Total Income)	51.6	39.3

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

*** ROE = ratio of net income to tier 1 capital (for Locally Incorporated Banks only).*

Source: CBB.

4.2.4 Liquidity

Liquidity position improves

Between June 2019 and December 2019, bank deposits and non-bank deposits remained at similar level for retail banks. The overall loan-deposit ratio for the segment decreased to 65.8% in December 2019 from 67.9% in June 2019. Liquid assets as a proportion of total assets increased from 35.9% in June 2019 to 36% in December 2019. Liquid assets as a proportion of the short-term liabilities presented an increase from 44.9% from 45.8% over this period.

Table 4-8: CR Bank's Liquidity

Indicator	Jun. 2019	Dec. 2019
Liquid Asset Ratio (%)	35.9	36.0
Loan-Deposit Ratio (%)	67.9	65.8
Non-Bank Deposits (% of Total Deposits)	73.7	75.3

Source: CBB.

4.3 Conventional Wholesale Banks

4.3.1 Capital Adequacy

Increase in capital adequacy

As at end-December 2019, the CAR for locally-incorporated wholesale banks decreased to 18.6% in December 2019 from the level of 19.4% it registered in June 2019. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) decreased from 18.5% in June 2019 to 17.7% recorded in December 2019. Furthermore, the leverage ratio (ratio of assets over capital) increased to 7.9% in December 2019. Finally, the ratio of non-performing loans (NPLs) net of provisions to capital increased to 5% over the same period.

Table 4-9: CW Banks' Capital Provisions Ratios *

Indicator	Jun. 2019	Dec. 2019
CAR (%)	19.4	18.6
Tier 1 CAR (%)	18.5	17.7
Leverage (Assets/Capital) (times)	7.4	7.9
NPLs Net of Provisions to Capital (%)	4.3	5.0

** For Locally Incorporated Banks only.*
Source: CBB.

4.3.2 Asset Quality

Non-performing loans slightly increase for local banks

As at end-December 2019, loans classified as non-performing as a % of total loans decreased from 5.3% in June 2019 to 4.5% in December 2019. The NPL ratio of l*ocally-incorporated wholesale banks* decreased from 6.5% in June 2019 to 5.1% in December 2019. Additionally, *overseas wholesale* banks witnessed a decrease in its NPL ratio from 4.2% to 4.0% over the same period. Specific provisions as a proportion of NPLs also witnessed a decrease as well from 74.3% in December 2018 to 70.8% in December 2019.

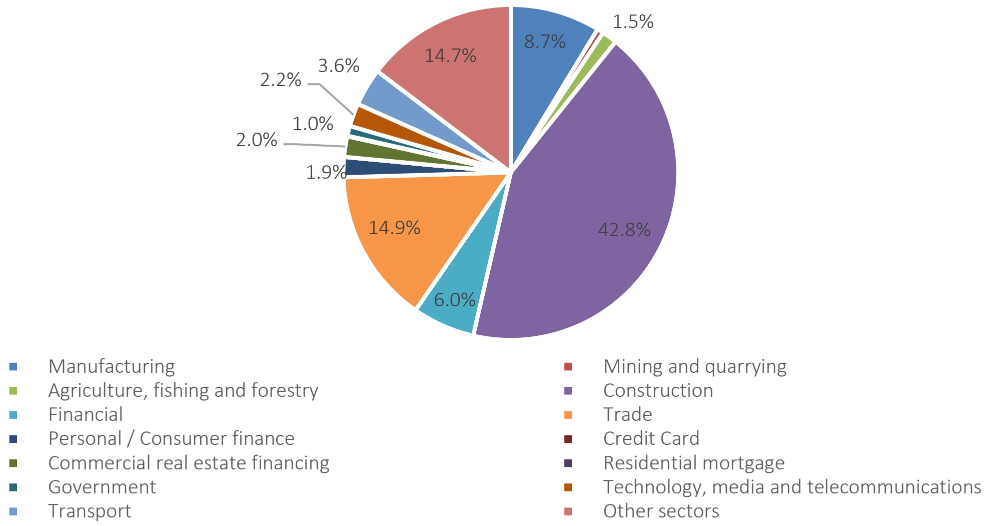
Table 4-10: CW Banks' NPL Ratios

Indicator	Jun. 2019	Dec. 2019
NPLs (% Total Loans)	5.3	4.5
NPLs Local Banks (%)	6.5	5.1
NPLs Overseas Banks (%)	4.2	4.0
Specific provisions (% of NPLs) *	74.3	70.8

** Specific provisions as a percentage of NPLs are calculated as specific provisions divided by gross impaired loans.*
Source: CBB.

Looking at the data on the concentration of NPLs by sector indicates that that the majority of NPLs are concentrated and come from the manufacturing sector (42.8%), trade (14.9%), other (14.7%) and manufacturing (8.7%) as indicated in chart 4-6.

Chart 4-6: CR Banks' NPLs Concentration by Sector (December 2019)



Source: CBB.

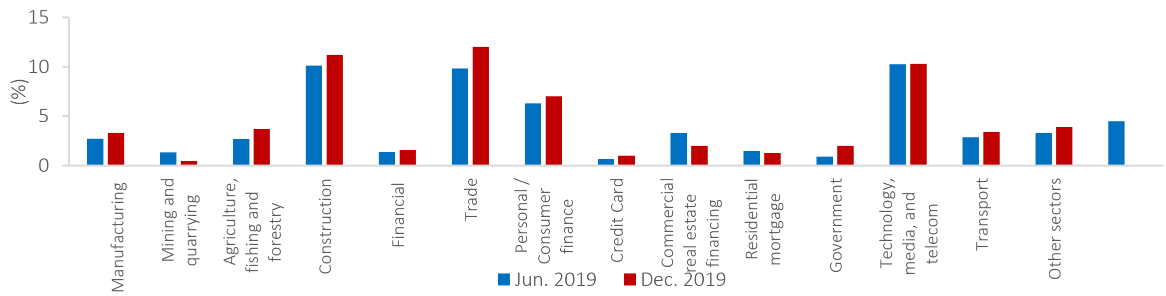
Table 4-12 depicts data on the sectoral breakdown of impaired loans, it demonstrates that impairment in technology, media and telecommunications was the highest between all sectors at 10.3%, followed by the construction sector with an impairment of 10.1%. The biggest increase was seen in the commercial real estate financing sector which increased by 1.3%. The greatest decrease in impairment was found in the trade sector with a decrease of 2.2%.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	3.3	2.7	(0.6)
Mining and quarrying	0.5	1.3	0.8
Agriculture, fishing and forestry	3.7	2.7	(1.0)
Construction	11.2	10.1	(1.1)
Financial	1.6	1.4	(0.2)
Trade	12.0	9.8	(2.2)
Personal / Consumer finance	7.0	6.3	(0.7)
Credit Card	1.0	0.7	(0.3)
Commercial real estate financing	2.0	3.3	1.3
Residential mortgage	1.3	1.5	0.2
Government	2.0	0.9	(1.1)
Technology, media and telecommunications	10.3	10.3	0.0
Transport	3.4	2.9	(0.5)
Other sectors	3.9	3.3	(0.6)

Source: CBB.

Chart 4-7: CW Banks' NPL Ratios by Sector (%)



Source: CBB.

Loan portfolios remains concentrated despite decreases in some sectors

An examination of lending patterns as at end-December 2019 shows that, for conventional wholesale banks, the top recipient of loans was the other sector, which accounted for 20% of total loans representing an increase of 0.7% compared to June 2019 (Table 4-13 and Chart 4-6).

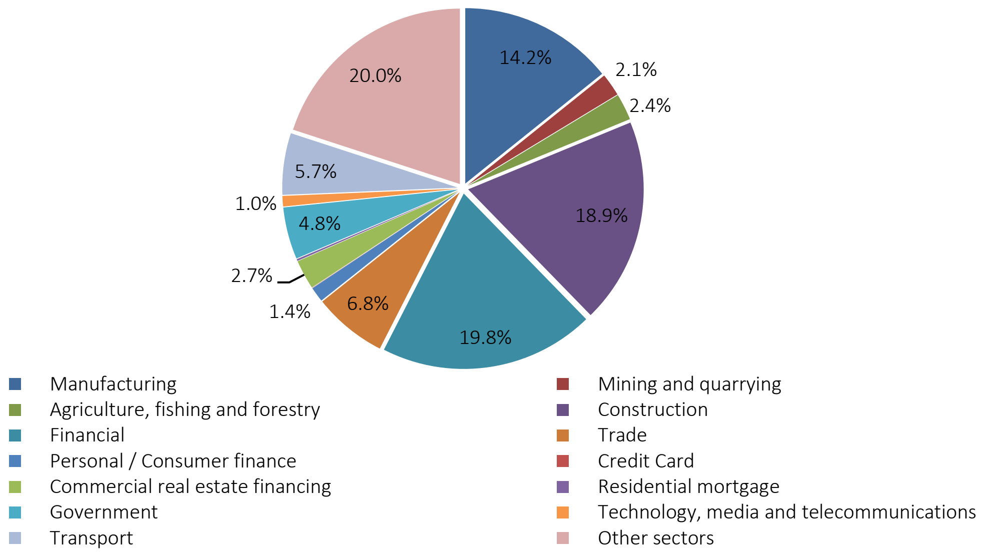
The top two sectors in conventional wholesale banks' Lending as a % of total loans are the other and financial sectors, they jointly account for 39.8% of total lending in December 2019.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	14.9	14.2	(0.7)
Mining and quarrying	2.1	2.1	0.0
Agriculture, fishing and forestry	2.5	2.4	(0.1)
Construction	19.3	18.9	(0.4)
Financial	19.0	19.8	0.8
Trade	7.2	6.8	(0.4)
Personal / Consumer finance	1.3	1.4	0.1
Credit Card	0.0	0.0	0.0
Commercial real estate financing	2.4	2.7	0.3
Residential mortgage	0.2	0.2	0.0
Government	4.8	4.8	0.0
Technology, media and telecommunications	1.0	1.0	0.0
Transport	5.9	5.7	(0.2)
Other sectors	19.3	20.0	0.7
Top Two Sectors (%)	**38.7**	**39.8**	**1.1**
Real Estate/ Construction Exposure (%) **	**22.0**	**21.8**	**(0.2)**

** 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.*
Source: CBB.

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



Source: CBB.

For *locally-incorporated wholesale banks,* the top recipient of loans is the manufacturing sector, which accounted for 20.4% of total loans in June 2019, representing an increase of 0.1% from the figure recorded in June of 2019 (Table 4-14 and Chart 4-7).

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	20.3	20.4	0.1
Mining and quarrying	1.1	1.5	0.4
Agriculture, fishing and forestry	5.4	5.4	0.0
Construction	7.5	6.8	(0.7)
Financial	19.2	17.6	(1.6)
Trade	12.5	12.0	(0.5)
Personal / Consumer finance	2.8	3.0	0.2
Credit Card	0.0	0.1	0.1
Commercial real estate financing	4.6	5.4	0.8
Residential mortgage	0.4	0.4	0.0
Government	1.6	1.5	(0.1)
Technology, media and telecommunications	2.2	1.8	(0.4)
Transport	8.2	7.7	(0.5)
Other sectors	14.1	16.4	2.3
Top Two Sectors (%)	**39.5**	**38.0**	**(1.5)**
Real Estate/ Construction Exposure (%) **	**12.6**	**12.6**	**0 .0**

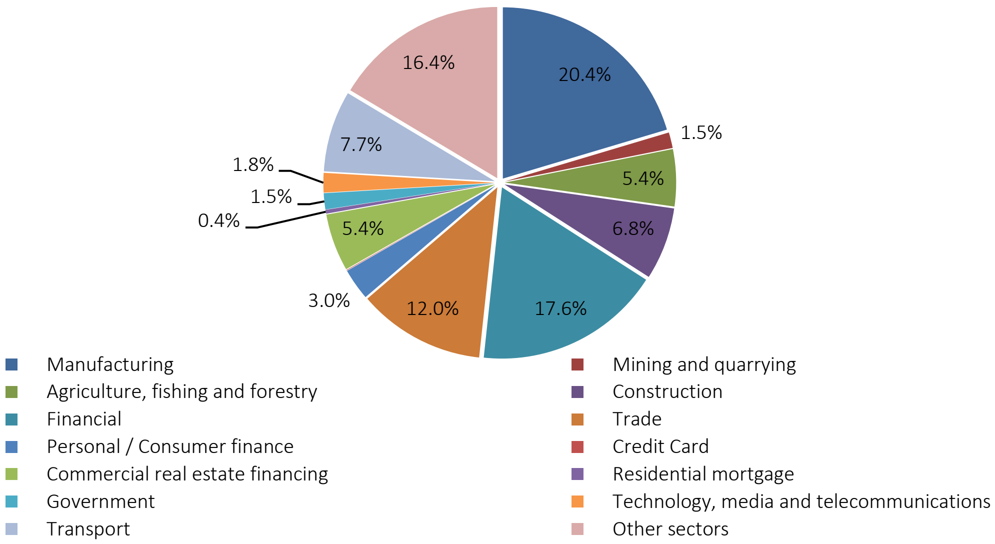
** Figures may not add to a hundred due to rounding.*

*** Real Estate/Construction exposure is calculated as the share of the construction, commercial real estate financing, and residential mortgages sectors of total lending.*

Source: CBB.

The highest two sectors continue to be the manufacturing and financial accounting for 38% of total lending in December 2019, a decrease of 1.5% from the June 2019 level. The real estate/ construction exposure remains 12.6% in the same period.

Chart 4-9: Local CW Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

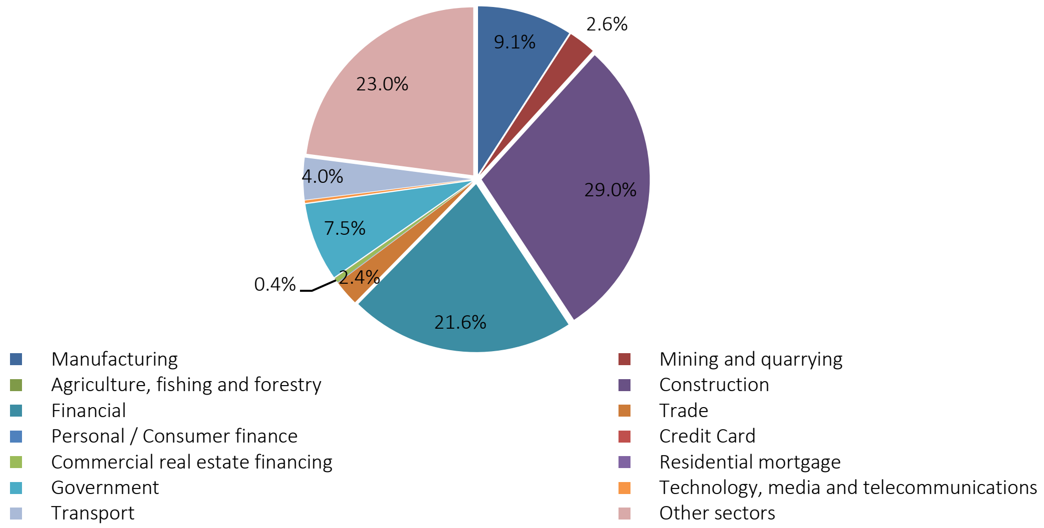
While observing *overseas wholesale banks*, the top recipient of loans in December 2019 was the construction sector, with 29% of total loans, followed by the other sectors sector, with 23% of total loans, with decreases of 0.3% and 0.7% respectively from their June 2019 levels (Table 4-15 and Chart 4-8). The top 2 sectors (Construction and Other) jointly represented 52.0% in June 2019, a decrease of 1% from June 2019. Real estate/construction exposure decreased from 29.7% in June 2019 to 29.4% in December 2019.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	10.3	9.1	(1.2)
Mining and quarrying	2.9	2.6	(0.3)
Agriculture, fishing and forestry	0.1	0.0	(0.1)
Construction	29.3	29.0	(0.3)
Financial	18.8	21.6	2.8
Trade	2.8	2.4	(0.4)
Personal / Consumer finance	0.1	0.0	(0.1)
Credit Card	0.0	0.0	0.0
Commercial real estate financing	0.5	0.4	(0.1)
Residential mortgage	0.0	0.0	0.0
Government	7.5	7.5	0.0
Technology, media and telecommunications	0.1	0.2	0.1
Transport	4.0	4.0	0.0
Other sectors	23.7	23.0	(0.7)
Top Two Sectors (%)	**53.0**	**52.0**	**(1.0)**
Real Estate/ Construction Exposure (%) **	**29.7**	**29.4**	**(0.3)**

** 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*
Source: CBB.

Chart 4-10: Overseas CW Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

4.3.3 Profitability

Growth in profitability for Locally Incorporated Banks

ROA for the conventional wholesale banking sector increased to 0.9% in December 2019 from 0.7% in June 2019. The ROA for *local wholesale banks* also increased from 0.1% to 0.6%, while *overseas* *wholesale banks* slightly decreased from 1.3% to 1.2%. ROE for *local wholesale banks* increased from 0.8% to 4.8%. Net interest income as a proportion of total income increased from 56.2% in December 2018 to 63.2% in December 2019. Operating expenses as a proportion of total income showed a decrease from 68% in December 2018 to 54.7% in December 2019.

Table 4-15: CW Banks' Profitability

Indicator	Dec.2018	Dec. 2019
ROA (%) *	0.7	0.9
ROA Locally Incorporated Banks (%)	0.1	0.6
ROA Overseas Banks (%)	1.3	1.2
ROE (%) **	0.8	4.8
Net Interest Income (% Total Income)	56.2	63.2
Operating Expenses (% Total Income)	68.0	54.7

** ROA = ratio of net income to assets.*
*** ROE = ratio of net income to tier 1 capital (for Locally Incorporated Banks only).*
Source: CBB.

4.3.4 Liquidity

Liquidity position declines

As at end-December 2019, the overall loan-deposit ratio for conventional wholesale banks stood at 68.5%, an increase from the 63.4% recorded in June 2019. The loan deposit ratio for *local wholesale banks* also increased from 55.5% in June 2019 to 61.2% in December 2019. Over the same period, the loan deposit ratio for *overseas wholesale* bank decreased slightly from 76.9% in June 2019 to 76.1% in December 2019.

Liquid assets for wholesale banks as a proportion of total assets increased to 21.3% in December 2019 from 20.9% in June 2019. Liquidity for *local wholesale banks* also declined over this period where their liquid asset ratio decreased to 27.7% from 27.2%. *Overseas wholesale banks'* liquid assets ratio increased from 13.4% in June 2019to 15% in December 2019.

The liquid assets as a proportion of short-term liabilities increased by 0.1% to be 26.3% in December 2019. Finally, non-bank deposits as a proportion of total deposits stood at 48.5%, an increase from the 43.7% level achieved in June 2019, while bank deposits decreased from 56.3% in June 2019 to 51.5% in December 2019.

Table 4-16: CW Banks' Liquidity

Indicator	Jun. 2019	Dec. 2019
Liquid Asset Ratio (%)	20.9	21.3
Loan-Deposit Ratio (%)	63.4	68.5
Non-Bank Deposits (% of Total Deposits)	43.7	48.5

Source: CBB.

4.4 Overall Assessment of the Conventional Banking Sector

The financial soundness indicators show that conventional banks witnessed a slight decrease in capital adequacy ratios. Capital adequacy ratios for conventional retail banks increased to 21.1% in December 2019. Capital adequacy ratio for conventional wholesale banks increased to 18.6% over the same period. Non-performing loans decreased to 4.9% between the periods of June 2019 to December 2019 for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing decreased from 5.3% in June 2019 to 4.5% in December 2019. Loan concentration remains high for conventional retail and for wholesale banks.

As at end-December 2019, return-on-assets (ROA) increased from 0.7% to 0.9% for conventional retail banks and increased to 0.6% for conventional wholesale banks. Return-on-equity (ROE) for *local retail banks* is 14.2 as of December 2019. ROE for *local wholesale banks* increased from 0.8% to 4.8% when compared to December 2018. For conventional retail banks, liquid assets as a proportion of total assets increased to reach 36.0% in December 2019. Liquid assets for wholesale banks as a proportion of total assets slightly decreased from 20.9% in June 2019 to 21.3% in December 2019.

Chapter 5 Islamic Banks

Key Highlights

IR CAR	IR NPL	IR Provisions	IR ROA	IR ROE	IR Liquidity	IR Loan/Deposit
18.3% ↑	10.4% ↑	36.7% ↓	0.4% ↓	4.7% ↓	17.5% ↓	92.5% ↓

IW CAR	IW NPL	IW Provisions	IW ROA	IW ROE	IW Liquidity	IW Loan/Deposit
17.4% ↓	1.1% ⇔	93.8% ↑	0.7% ↓	6.4% ↓	17.7% ↑	69.9% ↓

- Capital positions for Islamic retail banks increased.
- Non-performing facilities (NPFs) remained stable Islamic wholesale banks but increased for Islamic retail banks.
- Concentration of facilities for Islamic banks continues in specific sectors.
- Earnings declined for Islamic banks but remained positive.
- Liquidity positions improved for Islamic wholesale banks but decreased for Islamic retail banks.

5.1 Overview

Chapter 5 offers macroprudential analysis of the Islamic banking sector based on a set of selected FSIs. The chapter analyzes the banking sector under the following segments: Islamic retail (IR) banks (section 5.2) and Islamic wholesale (IW) 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).

5.2 Islamic Retail Banks

5.2.1 Capital Adequacy

increase in capital positions

The CAR of Islamic retail banks increased from 17.3% in June 2019 to 18.3% in December 2019. Tier 1 capital also increased from 14.5% in June 2019 to 15.7% in December 2019.

Table 5-1: IR Banks' Capital Provisions Ratios

Indicator	Jun. 2019	Dec. 2019
CAR (%)	17.3	18.3
Tier 1 CAR (%)	14.5	15.7
NPFs net of provisions to capital (%)	36.1	38.8

Source: CBB.

5.2.2 Asset Quality

Increase in non-performing facilities

Non-performing facilities (NPF) ratio increased to 10.4% in December 2019. Specific Provisoining decreased to 36.7% in December 2019 from 38.0% in June 2019.

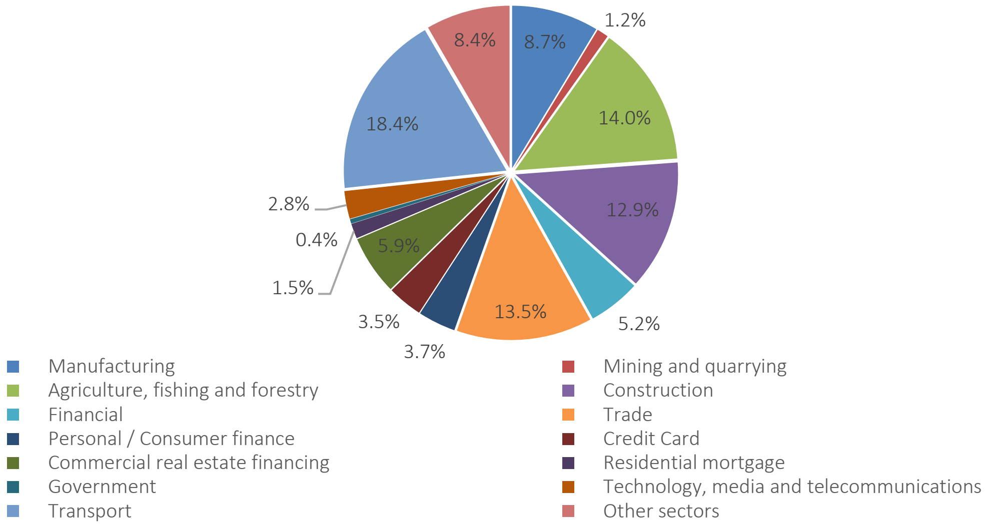
Table 5-2: IR Banks' NPF Ratios

Indicator	Jun. 2019	Dec. 2019
NPFs (% Gross Facilities)	9.5	10.4
Specific Provisions (% of NPFs)	38.0	36.7

Source: CBB.

Looking at the data on the concentration of NPFs by sector indicates that that the majority of NPLs are concentrated and come from the transportation sector (18.4%), agriculture, fishing and forestry (14.0%), trade (13.5%) and construction (12.9%) as indicated in chart 5-5.

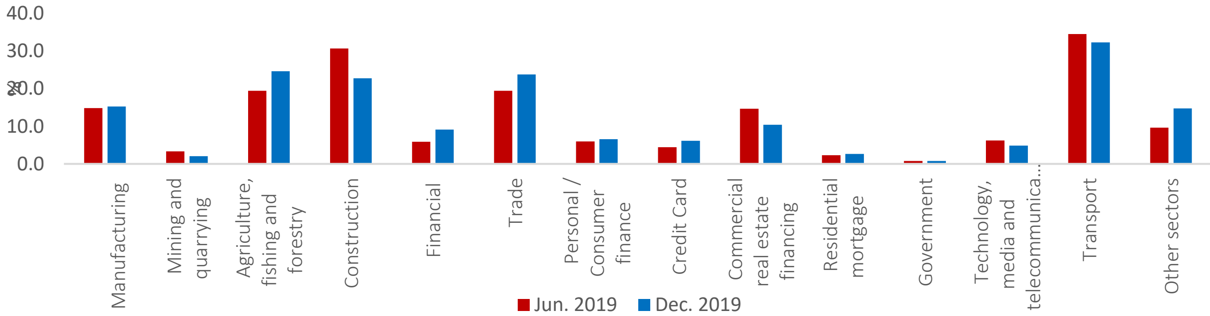
Chart 5-1: IR Banks' NPFs Concentration by Sector (December 2019)



Source: CBB.

A look at the non-performing facilities by sector indicates that the transport sector had the highest impairment of 32.3% in December 2019 followed by agriculture, fishing and forestry and trade with 24.7% and 23.8% respectively. The biggest declines in NPFs by sector was in the costraction Sector with a 8.0% decrease in NPFs from June 2019 to December 2019. The biggest increase in NPFs was the trade and other sectors with an increase of 4.3% and 5.1% respectively.

Chart 5-2: IR Banks' NPF Ratios by Sector (%)



Source: CBB.

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

Sector	June. 2019	Dec. 2019	Change
Manufacturing	14.8	15.3	0.5
Mining and quarrying	3.3	2.0	(1.3)
Agriculture, fishing and forestry	19.4	24.7	5.3
Construction	30.7	22.7	(8.0)
Financial	5.9	9.1	3.2
Trade	19.5	23.8	4.3
Personal / Consumer finance	6.0	6.6	0.6
Credit Card	4.5	6.1	1.6
Commercial real estate financing	14.7	10.4	(4.3)
Residential mortgage	2.3	2.6	0.3
Government	0.8	0.8	0.0
Technology, media and telecommunications	6.3	4.9	(1.4)
Transport	34.6	32.3	(2.3)
Other sectors	9.6	14.7	5.1

Source: CBB.

Diversification in asset concentration (loan portfolio)

There has been a diversification in the asset concentration among most of the sectors. At the end of December 2019, the top recipient of financing was personal/consumer finance at 17.6%, a decrease from 18.2% in June 2019. The top two recipients of financing (personal/consumer finance and financial) accounted for 30.6% of total facilities extended, compared to 32.4% for the top two sectors in June 2019.

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

Sector	Jun. 2019*	Dec. 2019*	Change
Manufacturing	10.1	11.2	1.1
Mining and quarrying	0.6	1.0	0.4
Agriculture, fishing and forestry	0.4	0.4	0.0
Construction	3.8	3.7	(0.1)
Financial	14.2	11.9	(2.3)
Trade	10.5	10.2	(0.3)
Personal / Consumer finance	18.2	17.6	(0.6)
Credit Card	1.0	1.1	0.1
Commercial real estate financing	9.9	11.6	1.7
Residential mortgage	13.0	13.0	0.0
Government	9.2	9.2	0.0
Technology, media and telecommunications	0.8	0.6	(0.2)
Transport	0.3	0.3	0.0
Other sectors	7.8	8.1	0.3
Top two recipient sectors	**32.4**	**30.6**	**(1.8)**
Real Estate/ Construction Exposure**	**26.8**	**28.4**	**1.6**

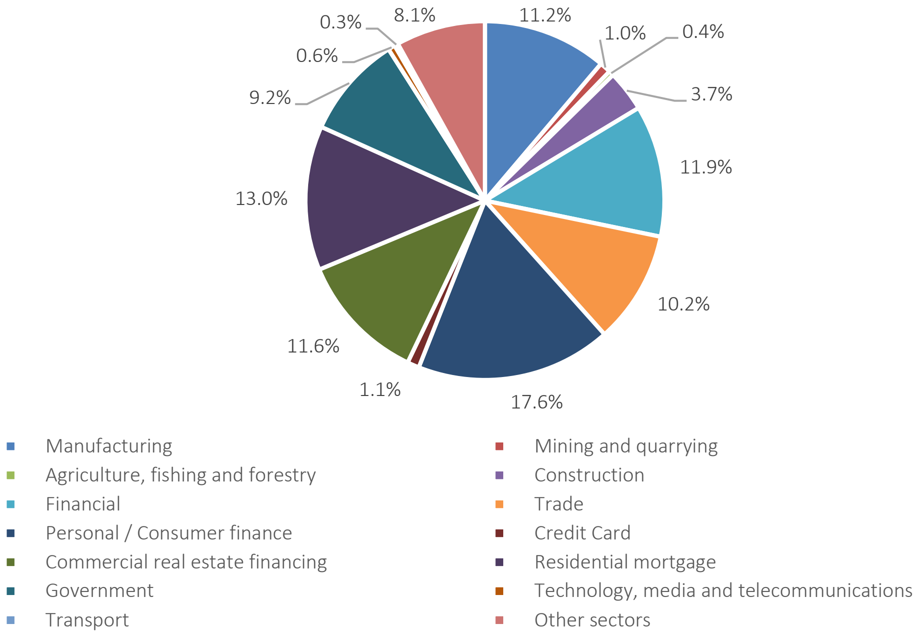
Source: CBB.

**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.*

Moreover, the share of the financial sector declined from 14.2% in June 2019 to 11.9% in December 2019. Commercial real estate financing exposure increased from 9.9% in June 2019 to 11.6% in December 2019.

Chart 5-3: IR Banks' Lending Distribution by Sector (%Total Facilities)



Source: CBB.

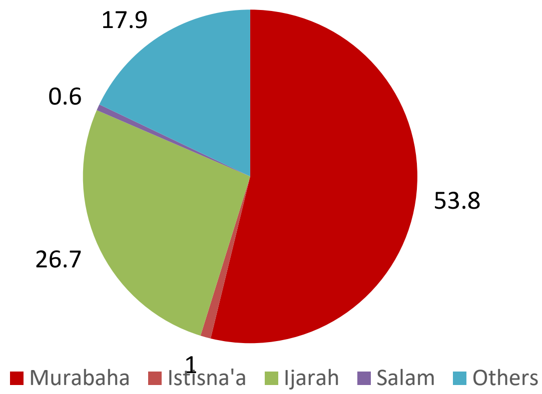
Lending distribution by Islamic instrument remained steady over the past quarter in aggregate. At the end of December 2019, the top recipient of finance was Murabaha at 53.8% down from 57.0% in June 2019. This was followed by Ijarah, which increased from 25.9% to 26.7% for the same period.

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

Instrument	Jun. 2019*	Dec. 2019*	Change
Murabaha	57.0	53.8	(3.2)
Istisna'a	0.9	1.0	0.1
Ijarah	25.9	26.7	0.8
Salam	0.5	0.6	0.1
Others	15.8	17.9	2.1

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

Chart 5-4: IR Banks' Lending Distribution by Islamic Instrument (% of Total Facilities)



Source: CBB.

5.2.3 Profitability

Decline in earnings

The return on assets (ROA) for Islamic retail banks decreased to 0.4% in December 2019 compared to 0.6% in December 2018. Return on equity (ROE) also decreased from 6.7% to 4.7% for the same period. Furthermore, operating expenses increased from 78.5% in December 2018 to 82.0% in December 2019.

Table 5-6: IR Banks' Profitability (%)

Indicator	Dec. 2018	Dec. 2019
ROA*	0.6	0.4
ROE**	6.7	4.7
Operating expenses (% total operating income)	78.5	82.0

Source: CBB.

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

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

5.2.4 Liquidity

Liquidity remains near previous levels

The volume of liquid assets available to Islamic retail banks slightly decreased from 17.7% of total assets in June 2019 to 17.5% in December 2019. The ratio of total facilities to deposits decreased from 95.9% in June 2019 to 92.5% in December 2019.

Table 5-7: IR Banks' Liquidity (%)

Indicator	Jun. 2019	Dec. 2019
Liquid Assets (% of total assets)	17.7	17.5
Facilities – deposits ratio (%)	95.9	92.5

Source: CBB.

5.3 Islamic Wholesale Banks

5.3.1 Capital Adequacy

Decrease in capital positions

As at end-December 2019, the CAR for Islamic wholesale banks decreased to 17.4% from 18.0% in June 2019. Tier 1 capital also decreased from 16.9% to 16.3% over the same period. The ratio of NPFs net of provisions to capital decreased to reach 0.3% in December 2019.

Table 5-8: IW Banks' Capital Provisions Ratios

Indicator	Jun. 2019	Dec. 2019
CAR (%)	18.0	17.4
Tier 1 CAR (%)	16.9	16.3
NPFs net of provisions to capital	0.4	0.3

Source: CBB.

5.3.2 Asset Quality

Stability in non-performing facilities (NPFs)

As of end-December 2019, NPF ratio for Islamic wholesale banks remained at 1.1%. Provisioning for NPFs increased from 91.7% to 93.8% over the same period.

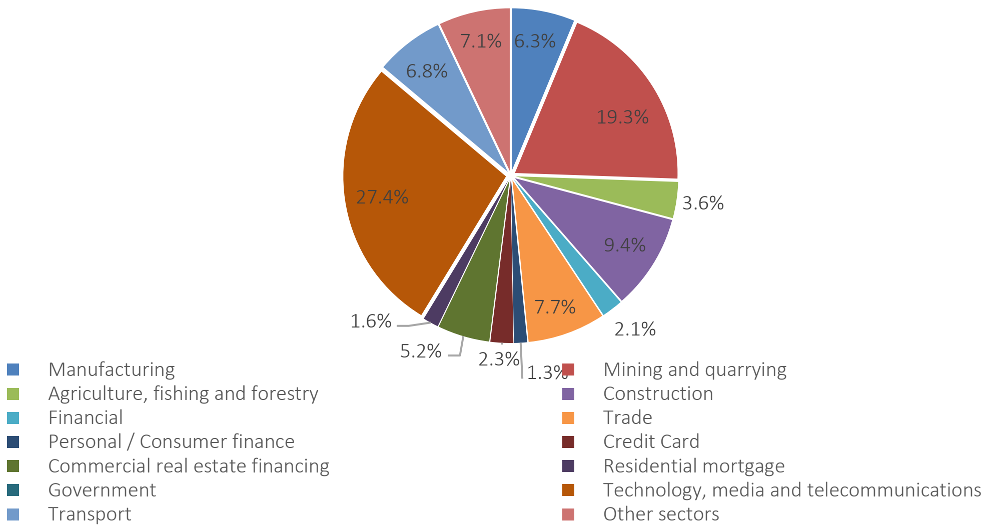
Table 5-9: IW Banks' NPF Ratios

Indicator	Jun. 2019	Dec. 2019
NPFs (% Gross Facilities)	1.1	1.1
Specific Provisioning (% of NPFs)	91.7	93.8

Source: CBB.

Looking at the data on the concentration of NPFs by sector indicates that that the majority of NPLs are concentrated and come from technology, media and telecommunications (27.4%), mining and quarrying (19.3%), and construction (9.4%) as indicated in chart 5-1.

Chart 5-5: IW Banks' NPFs Concentration by Sector (December 2019)



Source: CBB.

The sector with the highest impairment was the technology, media and telecommunications sector with 32.7% in December 2019, down from the 34.9% in June 2019. This was followed by the mining and quarrying and construction sectors with 23.0% and 11.3% respectively.

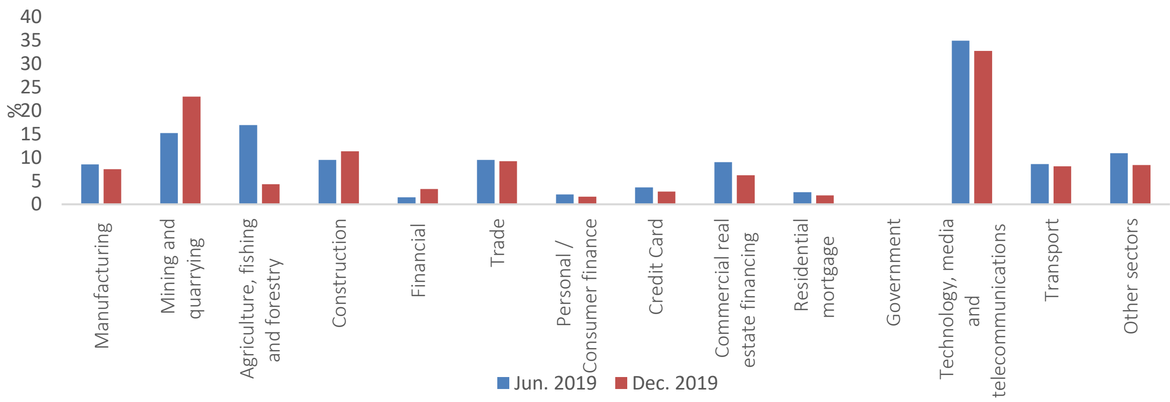
Table 5-10: IW Banks' NPF Ratios by Sector (%)

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	8.5	7.5	(1.0)
Mining and quarrying	15.2	23.0	7.8
Agriculture, fishing and forestry	16.9	4.3	(12.6)
Construction	9.5	11.3	1.8
Financial	1.5	3.3	1.8
Trade	9.5	9.2	(0.3)
Personal / Consumer finance	2.1	1.6	(0.5)
Credit Card	3.6	2.7	(0.9)
Commercial real estate financing	9.0	6.2	(2.8)
Residential mortgage	2.6	1.9	(0.7)
Government	0.0	0.0	0.0
Technology, media and telecommunications	34.9	32.7	(2.2)
Transport	8.6	8.1	(0.5)
Other sectors	10.9	8.4	(2.5)

Source: CBB.

Available data on the sectoral breakdown of non-performing facilities shows that the biggest increase was in the mining and quarrying sector with an increase of 7.8%. The biggest drop was in agriculture, fishing and forestry with a decrease of 12.6% from 16.9% in June 2019 to 4.3% in December 2019.

Chart 5-6: IW Banks' NPF Ratios by Sector (%)



Source: CBB.

Diversification in asset concentration (loan portfolio)

At end-December 2019, the financial sector was the top recipient of financing from Islamic wholesale banks, at 25.3%. The financial sector saw the largest decrease from 27.4% in June 2019 to 25.3% in December 2019. The Manufacturing sector saw the largest increase, rising by 2.0%.

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

Sector	Jun. 2019	Dec. 2019	Change
Manufacturing	19.2	21.2	2.0
Mining and quarrying	1.1	1.0	(0.1)
Agriculture, fishing and forestry	0.7	0.7	0.0
Construction	11.6	10.7	(0.9)
Financial	27.4	25.5	(1.9)
Trade	8.3	7.9	(0.4)
Personal / Consumer finance	10.8	9.8	(1.0)
Credit Card	0.4	0.4	0.0
Commercial real estate financing	2.2	2.2	0.0
Residential mortgage	4.5	5.4	0.9
Government	5.0	5.9	0.9
Technology, media and telecommunications	0.1	0.1	0.0
Transport	1.6	1.6	0.0
Other sectors	7.1	7.7	0.6
Top two recipient sectors	46.6	46.6	0.0
Real Estate/ Construction Exposure**	18.3	18.3	0.0

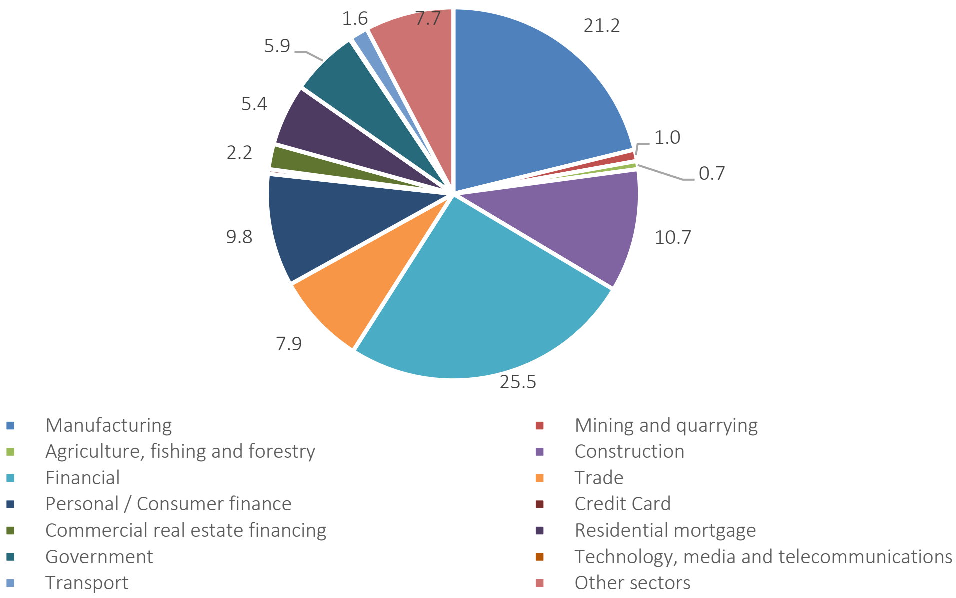
Source: CBB.

**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.*

The top two recipient sectors in December 2019 (financial and manufacturing) jointly represented 46.5% of total financing. Real estate/ construction exposure remained unchanged at 18.3% in December 2019.

Chart 5-7: IW Banks' Lending Distribution by Sector (%Total Facilities)



Source: CBB.

Lending distribution by Islamic instrument shows that at the end of December 2019, the top recipient of finance was Murabaha at 64.5%, up from 63.4% in June 2019.

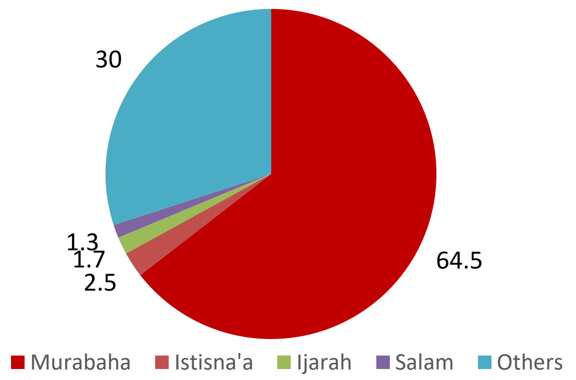
Table 5-12: IW Banks' Lending Distribution by Islamic Instrument (%Total Facilities)

Instrument	Jun. 2019	Dec. 2019	Change
Murabaha	63.4	64.5	1.1
Istisna'a	1.5	2.5	1.0
Ijarah	1.7	1.7	0.0
Salam	1.2	1.3	0.1
Others	32.3	30.0	(2.3)

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

Source: CBB.

Chart 5-8: IW Banks' Lending Distribution by Islamic Instrument (%Total Facilities)



Source: CBB.

5.3.3 Profitability

Decline in earnings

Return on assets (ROA) decreased from 0.9% in December 2018 to 0.7% in December 2019. Return on equity (ROE) also decreased from 6.9% to 6.4% in the same period. Furthermore, operating expenses (as % of total income) increased from 71.2% in December 2018 to 72.7% in December 2019.

Table 5-13: IW Banks' Profitability (%)

Indicator	Dec. 2018	Dec. 2019
ROA*	0.9	0.7
ROE**	6.9	6.4
Operating expenses (% total operating income)	71.4	72.7

Source: CBB.

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

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

5.3.4 Liquidity

Increase in Liquidity

As of end-December 2019, liquid assets of Islamic wholesale banks represented 17.7% of total assets, 0.5% higher than the 17.2% registered in June 2019. Additionally, the facilities deposit ratio decreased from 73.0% in June 2019 to 69.9% in December 2019.

Table 5-14: IW Banks' liquidity (%)

Indicator	Jun. 2019	Dec. 2019
Liquid assets (% of total)	17.2	17.7
Facilities-deposit ratio	73.0	69.9

Source: CBB.

5.4 Overall Assessment of the Islamic Banking Sector

The financial soundness indicators show that Islamic retail banks capital positions increased to 18.3% while wholesale banks decreased to 17.4% respectively during the period between June 2019 and December 2019. Non-performing facilities increased to 10.4% for Islamic retail. Facilities concentration has decreased in some sectors while increasing in others in retail Islamic banks and wholesale Islamic banks.

Earnings declined for Islamic retail banks and Islamic wholesale banks. Islamic Wholesale banks' liquidity positions showed an increase in liquid assets while Islamic retails banks showed a slight decrease for the same period. The facilities to deposit ratio for Islamic retail banks and Islamic wholesale banks decreased.

Part III:

Developments in the Non-Bank Financial Sector

Chapter 6 Insurance Sector

Key Highlights

Insurance Licenses	Contribution to GDP	Contribution to Financial	Assets of Conv. Insurance	Assets of Takaful Insurance	Gross Premiums
141	5.5%	32.8%	BD 2,311.3 mn	BD 202.4 mn	BD 213.1 mn

- Conventional firms account for 68.1% of total insurance industry with BD 145.2 million in total gross premiums as of September 2019.
- General insurance contributes for 76.4% of total gross premiums.
- Local Conventional insurance firms' performance is concentrated on Motor business line, and Takaful is concentrated in Medical and Motor business lines.
- Overseas insurance firms' performance is concentrated on Long-term (Life) and Engineering business line.

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.[4] 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.

Chapter 6 covers the period between end-September 2018 and end-September 2019, unless otherwise indicated. The chapter covers the developments in Bahrain's insurance sector prior to the COVID-19 pandemic.

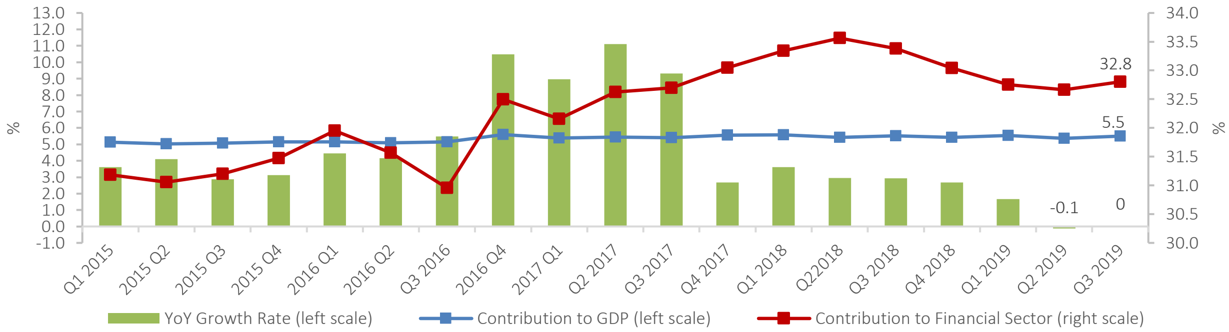
A significant number of insurance companies and organizations have established their presence in Bahrain. As of December 2019, there are a total of 141 insurance organizations licensed and registered in the Kingdom. There are 36 insurance companies: 16 conventional local, 13 conventional overseas/foreign branches, and 7 takaful. From these companies, 2 companies are conventional re-insurance firms and 2 re-takaful firms. The remaining 105 other registered insurance licenses include:

- 34 Insurance Brokers,
- 4 Insurance Managers,
- 4 Insurance Consultants,
- 18 Insurance Firms, brokers and consultants restricted to business outside Bahrain,
- 31 Registered Actuaries,
- 12 Registered loss Adjusters, and
- 2 Insurance Pools and Syndicates.

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

As of September 2019, the insurance sector represented 5.5% of the real GDP. The contribution of the Insurance sector to the overall financial sector has increased representing 32.8% as of Q3 2019. 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 Quarterly Growth to GDP (%)

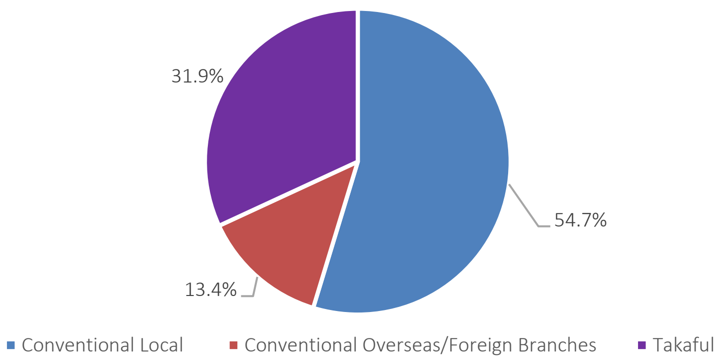


Source: IGA.

6.2 Performance of the Insurance Sector

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/branch firms. As of September 2019, conventional insurance represented 68.1% of the total gross premiums accounting for BD 145.2 million. Local conventional and branches represented 54.7% and 13.4% of total gross premiums accounting for BD 116.6 million and BD 28.6 million respectively (Chart 6-2). Takaful firms accounted for BD 68.0 million which is 31.9% of gross premiums in the industry for the same period.

Chart 6-2: Gross Premiums of Insurance Sector by Segment (%)

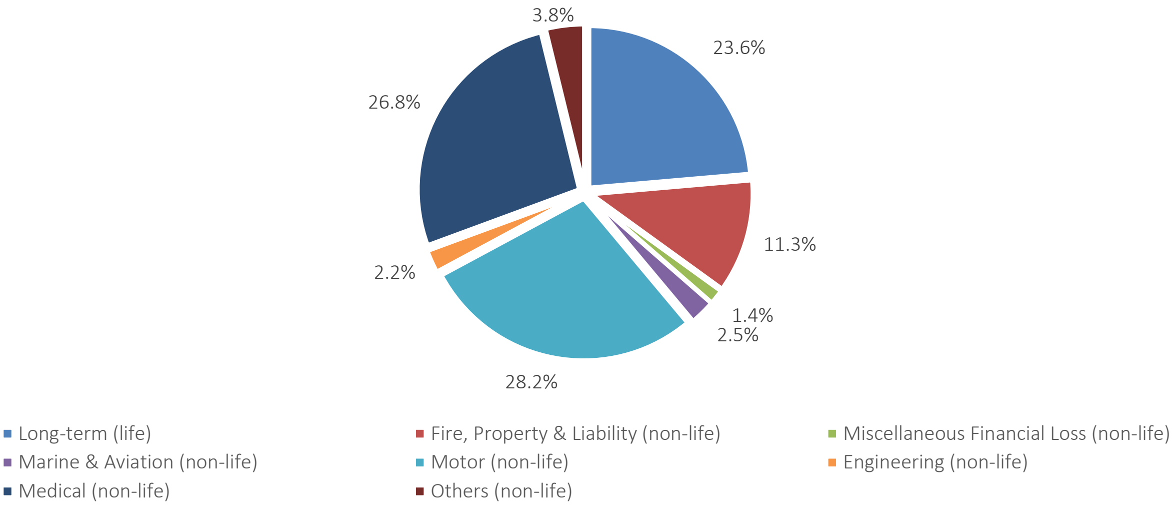


Source: CBB.

The Insurance products and services in the Kingdom are delivered via two main insurance classes: Life and non-life insurance.[5] As of September 2019, life insurance represented 23.6% of gross premiums while non-life/general insurance represented 76.4% covering the various classes (Graph 6-3).

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

Chart 6-3: Market Share of Gross Premiums by Class (%)



Source: CBB.

For non-life insurance, motor and medical insurance had the largest share in terms of their contribution to gross premiums accounting for 28.2% and 26.8% respectively. Fire, property, and liability made 11.3% of gross premiums. The top 3 business lines sectors represented 66.4% 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.
- Third party motor insurance being a mandatory requirement.
- Many institutions providing their employees with health insurance.

6.3 Financial Position and Profitability of Insurance Sector

As of September 2019, Total Assets of the Insurance sector reached BD 2,513.7 million with an increase of 4.7% compared to 2,398.8 in September 2018. Total Liabilities had an increase of 5.3% over the same period reaching BD 1,906.3 million.

Table 6-1: Total Assets, Liabilities, Capital, and Profitability of Insurance Sector by Segment

BD'000	Total Assets*		Total Liabilities*		Capital Available*		Net Profit*	
	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019
Conventional	**2,207,240**	**2,311,280**	**1,686,283**	**1,781,563**	**323,516**	**307,674**	**6,151**	**30,454**
Local	1,907,207	2,052,662	1,415,866	1,555,904	298,438	281,760	2,624	25,539
Overseas	300,033	258,618	270,417	225,659	25,078	25,914	3,527	4,915
Takaful	**191,593**	**202,403**	**123,432**	**124,773**	**54,679**	**59,974**	**2,223**	**2,889**
All Insurance	**2,398,833**	**2,513,683**	**1,809,715**	**1,906,335**	**378,195**	**367,648**	**8,373**	**33,343**

**For takaful it only includes Shareholder figures.*
Source: CBB.

Total capital on the other hand, decreased from 378.2 BD million in September 2018 to 367.7 BD million in September 2019. Profitability saw an increase between September 2018 and September 2019 reaching BD 33.3 million.

6.3.1 Conventional Insurance Firms

a. Assets: As of September 2019, total assets of the conventional insurance sector stood at BD 2,311.3 million increasing by 4.7% compared to the BD 2,207.2 million registered in September 2018.
   i. Total assets of local insurance Firms were BD 2,052.7 million (81.7% of total assets) with a growth rate of 7.2% since September 2018.
   ii. Total assets of overseas foreign branches were BD 258.6 million (10.3% of total assets) recording a decline of 13.8%.
b. Liabilities: As of September 2019, the liabilities of the conventional insurance sector registered at BD 1,781.6 million with a 5.7% increase from the BD 1,686.3 million in September 2018.
   i. The liabilities for local insurance firms registered at BD 1,555.9 million with an increase of 9.9%.
   ii. The liabilities of overseas foreign branches were BD 225.7 million in September 2019 with a decrease of 16.5%.
c. Available Capital[6]: Total capital as of September 2019 was at BD 307.7 million decreasing by 4.9% from the BD 323.5 million in the equivalent period of the year.
   i. Total available capital for local insurance was BD 281.7 with a year to year decrease of 5.6%.
   ii. Total available capital for overseas foreign branches insurance increased by 3.3%. The amount raised from BD 25.1 million in September 2018 to BD 25.9 million in September 2019.
d. Profitability: Net income increased for conventional insurance firms from BD 6.2 million in September 2018 to BD 30.5 million in September 2019.
   i. Net income for local insurance was BD 25.5 million with a year to year increase of 873.3%.
   ii. Net income for overseas insurance was BD 4.9 with a year to year increase of 40%.

6.3.2 Takaful Insurance Firms

a. Assets: Total assets in Takaful firms in September 2019 experienced an annual growth of 5.6% reaching BD 202.4 million compared to BD 191.6 million in September 2018.
b. Liabilities: The liabilities increased by 1.1% from BD 123.4 million in September 2018 to BD 124.8 million in September 2019.
c. Available Capital: Total regulatory capital experienced an annual increase of 9.7% from BD 54.7 million in September 2018 to BD 60.0 million in September 2019.
d. Profitability: Takaful companies showed a 30% increase in profits between September 2018 and September 2019 reaching BD 2.9 million.

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

6.4 Insurance Premiums and Claims Analysis by Class

6.4.1 Overall Insurance

As of September 2019, the Gross Premiums for the overall insurance sector stood at BD 213.1 million, increasing by 1.7%. Looking at the performance by class, Engineering category experienced the greatest decrease within the rest of the insurance business line, with an annual decrease of 65.2%, followed by Marine and Aviation and Miscellaneous Financial Loss, both decreasing by 6% respectively. On the other hand, Long-term and Medical insurance experienced an annual increase by 34.8% and 2.7% during the same period.

As of September 2019 Net Premiums Written increased compared to the previous period registering a value of BD 152.1 million, which is a 7.9% YoY increase from the BD 140.9 million in September 2018. The Long-term class showed the biggest increase over the period increasing by 38.9%, from BD 33.0 million in September 2018 to BD 45.9 million in September 2019. On the other hand, the biggest decline was derived Engineering class, decreasing from BD 1.4 million in September 2018 to BD 0.7 million in September 2019.

However, Gross Claims for the overall insurance industry recorded a YoY decrease of 45.9% from BD 185.5 million in September 2018 to BD 100.3 million in September 2019. The decline was mainly due to a decrease in Engineering by BD 37.1 million (111.1%) from BD 33.4 million in September 2018 to BD -3.7 million in September 2019 followed by Fire, Property & Liability decreasing by BD 43.9 million (103.4%) over the same period. The “Others” category recorded an increase of BD 1 million (57.1%) over the same period.

Net Claims for the overall insurance industry show a decrease of 6.2%, which was derived from an annual decrease in Long-term by BD 6.0 million (26.6%), followed by Fire, Property & Liability decreasing by BD 1.7 million (74.5%) over the same period. The greatest increase was recorded in Medical by BD 2.7 million (12.3%).

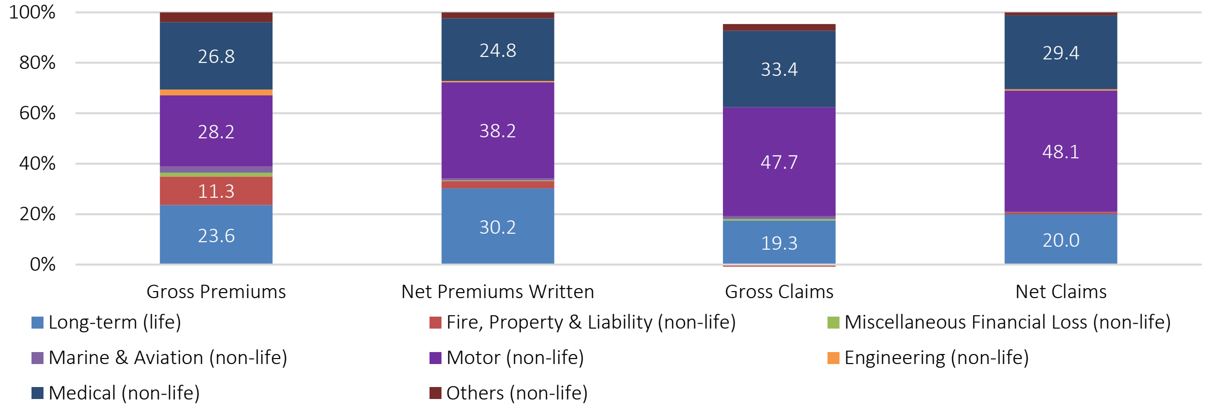
Table 6-2: Gross Premiums and Claims for all Insurance Firms by Class– Bahrain Operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019
Long-term (Life)	37,365	50,355	33,039	45,875	24,983	19,330	22,654	16,633
Fire, Property & Liability	23,929	24,147	5,577	4,355	42,405	-1,460	2,249	573
Miscellaneous Financial Loss	3,279	3,087	599	383	2,285	648	213	23
Marine & Aviation	5,672	5,330	1,196	1,141	1,390	1,225	361	221
Motor	61,897	60,190	59,054	58,055	48,693	47,873	39,123	40,060
Engineering	13,736	4,777	1,352	693	33,363	-3,696	1,996	376
Medical	55,570	57,096	36,752	37,721	30,580	33,521	21,781	24,469
Others	8,071	8,149	3,325	3,868	1,828	2,871	440	969
Total	**209,519**	**213,130**	**140,894**	**152,091**	**185,526**	**100,312**	**88,816**	**83,324**

Source: CBB.

The concentrations of premuims and claims by class are viewed in Graph 6-4. For the overall insurance indusry, the exposure in Motor was the highest in Gross Premiums (28.2%), Net Premiums Written (38.2%), Gross Claims (47.7%), and Net Claims (48.1%).

Chart 6-4: Concentrations of Gross Premiums and Claims for all Insurance Firms by Class – Bahrain Operations (Q3 2019)



Source: CBB.

6.4.2 Conventional Insurance

The Gross Premiums recorded for conventional insurance exhibited a decrease by BD 3.3 million (2.3%) based on a YoY comparison, where total gross premiums decreased from BD 148.5 million in September 2018 to BD 145.2 million in September 2019 (Table 6-3). The greatest increases were from Long-term (Life) by around BD 7.0 million (21.1%) and Medical BD 1.1 million (3.8%). The greatest annual decline was contributed by the Engineering line by BD 8.6 million (72.5%) and Miscellaneous Financial Loss BD 0.4 million (23.6%). In terms of concentration, Motor and Long-term (Life) business classes represented 28.3% and 27.7% respectively of the total gross premiums.

Net Premiums Written reflected an annual increase by 5.7% compared to September 2018. Motor insurance remained the largest in terms of Net Premiums Written concentration as well, accounting for 38.0%, decreasing by 3.2% from BD 40.8 million in September 2018 to BD 39.8 million in September 2019.

Gross Claims decreased at an annual rate of 57.1% in September 2019 due to a substantial decrease in Engineering by 111.6%, from BD 33.2 million in September 2018 declining to BD -3.9 million by September 2019. The highest share in gross claims was Motor 48.8%, followed by Medical at 28.5%.

Net Claims on the other hand, experienced an annual decrease of 15.2% from BD 65.8 million in September 2018, reaching BD 55.8 million in September 2019. Fire, property, and Liability business line decreased by 77.1%. Nonetheless, the concentration falls heavily within the Motor insurance class, accounting for 48.3% of the total net claims.

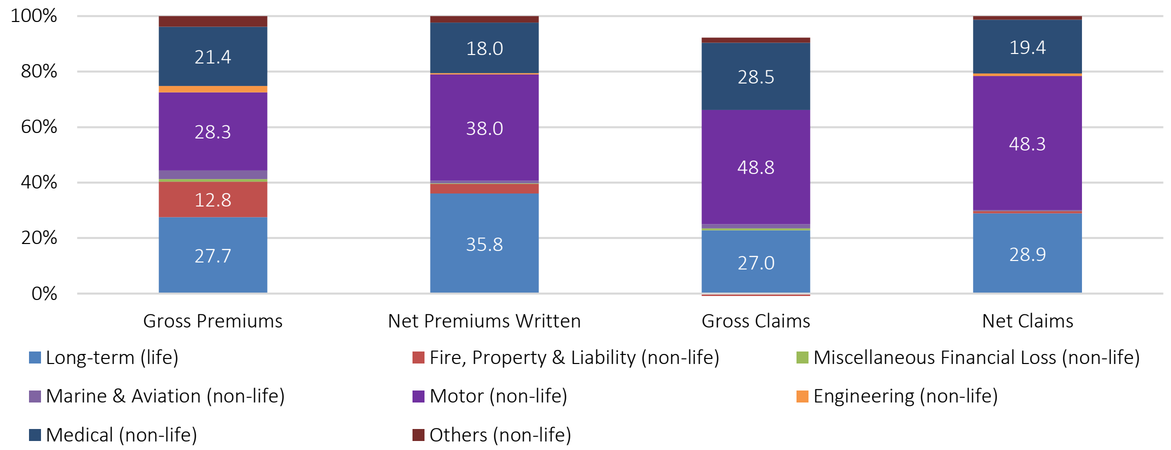
Table 6-3: Gross Premiums and Claims for Conventional Insurance by Class – Bahrain Operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019
Long-term (Life)	33,142	40,147	30,490	37,460	23,498	18,076	21,998	16,156
Fire, Property & Liability	18,789	18,624	4,930	3,628	41,245	-2,311	1,934	443
Miscellaneous Financial Loss	1,858	1,419	353	196	699	615	216	22
Marine & Aviation	4,789	4,459	1,081	1,026	1,267	1,183	305	196
Motor	42,511	41,109	40,791	39,782	36,099	32,710	28,856	26,997
Engineering	12,207	3,354	1,221	519	33,174	-3,855	1,937	463
Medical	29,885	31,027	17,372	18,836	19,069	19,138	10,123	10,859
Others	5,332	5,027	2,772	3,247	1,269	1,503	471	713
Total	**148,513**	**145,167**	**99,011**	**104,693**	**156,320**	**67,056**	**65,840**	**55,849**

Source: CBB.

Motor insurance has the highest exposure in Gross Premiums (28.3%), Net Premiums Written (38.0%), Gross Claims (48.8%), and Net Claims (48.3%).

Chart 6-5: Concentrations of Gross Premiums and Claims for Conventional Insurance by Class - Bahrain Operations (Q3 2019)



Source: CBB.

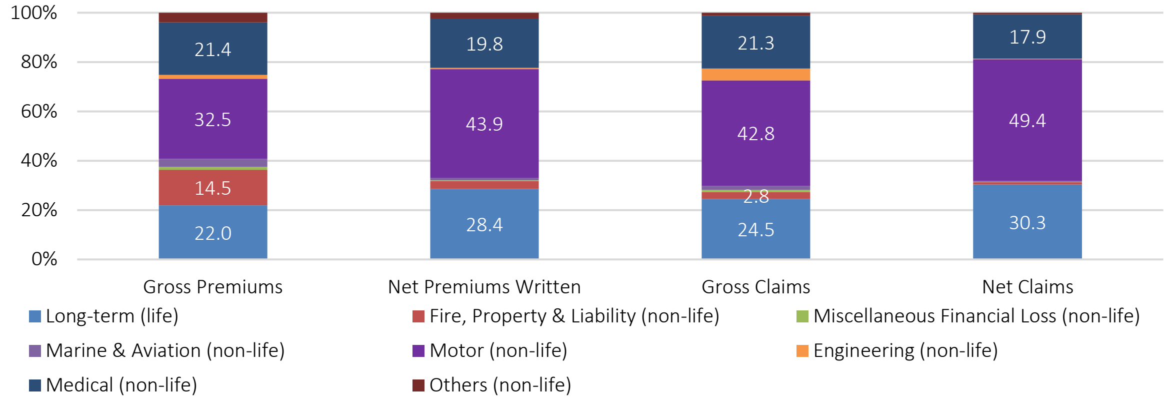
Table 6-4 below and Charts 6-6 and 6-7 shows a further division of the premiums and claims by class between Local and Overseas firms within the conventional insurance industry for September 2019. For local conventional insurance, Motor insurance has the highest concentration for Gross Premiums (32.5%), Net Premiums Written (43.9%), Gross Claims (42.8%), and Net Claims (49.4%).

Table 6-4: Gross Premiums and Claims for Conventional Local and Overseas Insurance by Class – Bahrain Operations (Q3 2019)

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)	25,646	14,501	40,147	23,730	13,730	37,460	17,419	657	18,076	15,477	679	16,156
Fire, Property & Liability	16,874	1,750	18,624	2,693	935	3,628	1,965	-4,276	-2,311	468	-25	443
Miscellaneous Financial Loss	1,227	192	1,419	134	62	196	634	-19	615	66	-44	22
Marine & Aviation	3,839	620	4,459	761	265	1,026	1,191	-8	1,183	225	-29	196
Motor	37,897	3,212	41,109	36,736	3,046	39,782	30,430	2,280	32,710	25,200	1,797	26,997
Engineering	1,843	1,511	3,354	364	155	519	3,391	-7,246	-3,855	102	361	463
Medical	24,975	6,052	31,027	16,591	2,245	18,836	15,174	3,964	19,138	9,151	1,708	10,859
Others	4,314	713	5,027	2,657	590	3,247	882	621	1,503	361	352	713
Total	**116,616**	**28,551**	**145,167**	**83,666**	**21,027**	**104,693**	**71,085**	**-4,029**	**67,056**	**51,049**	**4,800**	**55,849**

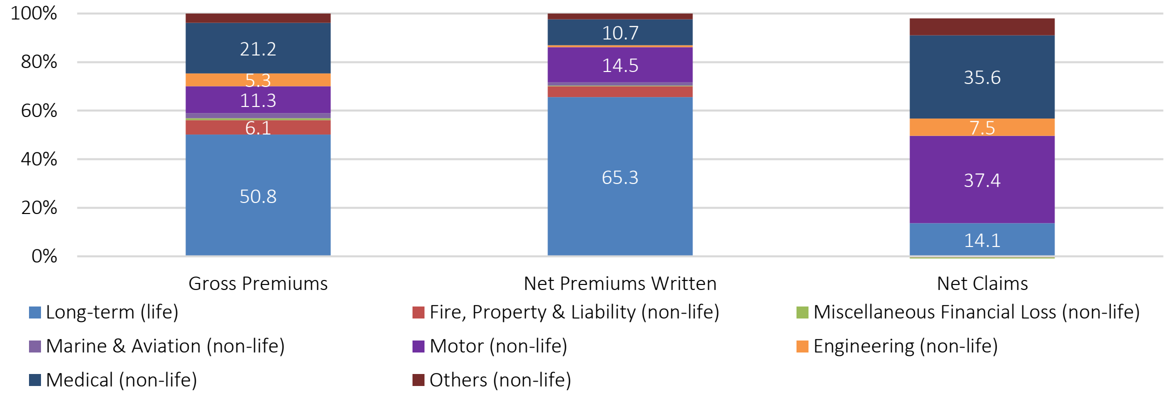
Source: CBB.

Chart 6-6: Concentrations of Gross Premiums and Claims for Conventional Local Insurance by Class - Bahrain Operations (Q3 2019)



Source: CBB.

Chart 6-7: Concentrations of Gross Premiums and Claims for Conventiaonal Overseas Insurance by Class - Bahrain Operations (Q3 2019)



Source: CBB.

6.4.3 Takaful

The Gross Premiums for Takaful companies increased on a YoY basis by 11.4%, from BD 61.0 million at September 2018 reaching BD 68.0 million in September 2019, where the highest increase was attributed to Long-term (Life) increasing by BD 6.0 million (141.7%) followed by Fire, Property & Liability increasing by BD 1.3 million (12.5%). Medical Insurance line recorded the highest contributor towards total Takaful gross premiums, accounting for 38.4% of the total.

Net Premiums Written increased by 13.2% from September 2018 to September 2019, reaching BD 47.4 million. Long-term (Life) increased on an annual basis by 230.1%, whereas Miscellaneous Financial Loss decreased by 23.7%. Motor and Medical insurance accounted for the largest components in terms of gross claims, representing 39.8% and 38.6% of the total net premiums written.

Gross Claims slightly increased by 13.9% compared to September 2018, with Motor registering the highest increase (20.7%) within the same period. Motor and Medical insurance accounted for the largest components in terms of gross claims, representing 45.6% and 43.2% of the total gross claims.

Net Claims recorded an annual increase of 19.6% at September 2019, with Motor and Medical having the highest increase of 27.2% and 16.7% respectively. Furthermore, Medical and Motor representing the largest components of net claims, accounting for 49.5% and 47.5% from the total respectively.

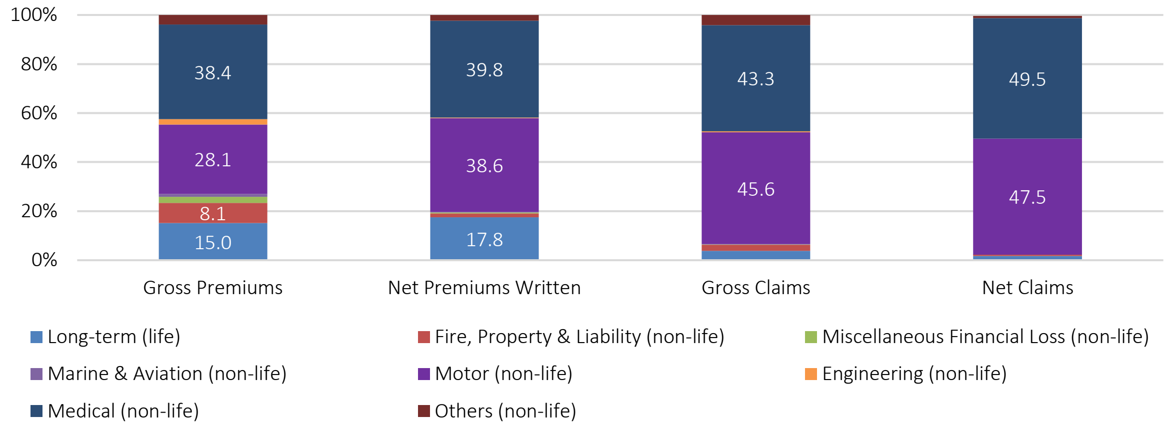
Table 6-5: Gross Premiums and Claims for Takaful Insurance Firms by Class – Bahrain Operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019	Q3 2018	Q3 2019
Long-term (Life)	4,223	10,207	2,549	8,416	1,485	1,255	656	478
Fire, Property & Liability	5,140	5,524	647	726	1,160	852	314	130
Miscellaneous Financial Loss	1,421	1,668	246	188	1,586	33	-4	2
Marine & Aviation	882	871	115	114	123	42	56	25
Motor	19,386	19,081	18,263	18,273	12,594	15,163	10,266	13,063
Engineering	1,530	1,422	131	173	188	159	60	-87
Medical	25,685	26,069	19,380	18,886	11,511	14,383	11,658	13,609
Others	2,740	3,122	553	622	559	1,369	-31	255
Total	**61,007**	**67,963**	**41,883**	**47,397**	**29,206**	**33,255**	**22,976**	**27,475**

Source: CBB.

Takaful insurance companies have very high concentration on the Medical and Motor Insurance business lines. Gross Premiums for both sectors combined represents (66.5%), Net Premiums Written (78.4%), Gross Claims (88.9%), and Net Claims (97.0%).

Chart 6-8: Concentrations of Gross Premiums and Claims for Takaful Insurance Firms by Class -Bahrain Operations (Q3 2019)



Source: CBB.

6.4.4 Retention Ratio and Loss Ratio (By Class)

Life insurance business line registered a retention ratio of 91.1 % in September 2019. Observing the non-life insurance, Motor and Medical, that accounted for 29.1%% and 26.5% of the total Gross Premiums in September 2019 respectively, registered retention ratios of 96.5% for Motor and 66.1% for Medical. Nevertheless, retention ratios were significantly lower for other business lines such as Miscellaneous Financial Loss and Engineering, registering 12.4% and 14.5% respectively.

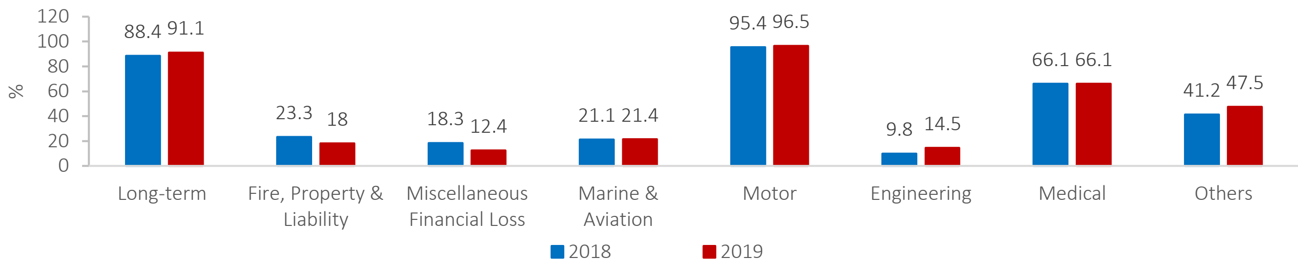
Table 6-6: Retention and Loss Ratios of Overall Insurance Sector

%	Retention Ratio[1]		Loss Ratio[2]	
	Q3 2018	Q3 2019	Q3 2018	Q3 2019
Long-term	88.4	91.1	67.0	35.9
Fire, Property & Liability	23.3	18.0	42.7	12.5
Miscellaneous Financial Loss	18.3	12.4	43.6	6.9
Marine & Aviation	21.1	21.4	30.4	20.7
Motor	95.4	96.5	70.7	68.5
Engineering	9.8	14.5	81.8	25.8
Medical	66.1	66.1	73.0	74.4
Others	41.2	47.5	18.0	45.3

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

Source: CBB.

Chart 6-9: Retention Ratios of Insurance Sector



Source: CBB.

6.5 Regulatory Changes, Market trends and Risks.

6.5.1 Regulatory development initiatives

As part of the CBB's ongoing policy in enhancing transparency and raising awareness on the CBB's regulatory development initiatives. The CBB has communicated via its circular dated 3rd January 2019 to all Insurance Licensees the expected proposed rules under Volume 3 that the CBB would issue for consultation during 2019:

1- Introducing "Training & Competency" Module;
2- The minimum insurance cover for the unified "Motor Comprehensive Policy";
3- Solvency Control Levels;
4- Enhancing the requirements of Appointed Representatives;
5- Enhancing the requirements of "Client Money" Module;
6- Enhancing the requirements of "Insurance Manager" Module; and
7- Introducing new regulatory framework for "Insurance Aggregator".

The CBB on 8th August 2019, has informed the market of the issuance of rules governing insurance aggregators (Insurance Aggregators Module - Module IA) as part of the CBB Rulebook Volume 3.

Furthermore, the CBB encourages Insurance Licensees to follow prudent practices in the conduct of their business and promptly communicate with it on relevant policy matters in the best interests of the financial stability and soundness of the sector.

6.5.2 Motor Insurance Subrogation Reconciliation

Receivables due from insurance companies arising out of motor subrogation process between insurance firms is vital to enhance the liquidity and regulatory capital of the firms when this process run efficiently.

Thus, the CBB has attempted to stimulate the process of receivables reconciliation among insurance firms and ensure all insurance receivables are valued fairly on the insurance firms' books and records.

Accordingly, through a series of efforts and through its circulars dated 6th June 2016, 27th December 2017, 1st April 2018 and 16th July 2018 along with its monitoring of the reconciliation progress, the CBB has noted considerable progress that was made by insurance companies to reconcile the outstanding balances. Furthermore, the CBB has requested insurance firms to fully set aside provisions by 30th June 2018 against any outstanding amounts that are not settled for the period of 2015 and prior for the financial statements ended 31st December 2015.

On 11th September 2019, the CBB has requested all insurance firms to reconcile motor subrogation claims with their counterparties from 1st January 2016 up to 31st December 2018 by 31st December 2019. In which insurance firms are required to fully set aside provisions against any outstanding amounts that are not settled for the period mentioned above in the financial statements for the year ending 31st December 2019.

6.5.3 Exposure to Controllers

On 25th March 2019, with a view to establishing stringent controls over licensees being used to finance their controllers, the CBB prohibited licensees from having any form of direct or indirect exposure to its controllers (including subsidiaries and associated companies of the controllers).

Licensees that already had an exposure as of the date of the circular were requested to submit a listing of all such exposures within one month from the date of the circular, together with an action plan for addressing such exposures within a timeline to be agreed with the relevant supervisory point of contact of the CBB (SPOC). The submission required the inclusion of the name of the counterparty, its relationship (business or legal) with the licensee, the amount of exposure, its maturity, if any, the purpose of the exposure and the particulars of collateral held if any together with the action plan.

6.5.4 Amendment to the Unified Compulsory Third Part Motor Insurance Policy

The CBB made an amendment to Resolution No. (23) of 2016 in respect to the Unified Compulsory Third Party Motor Insurance Policy and the procedures on dealing with claims arising from the compulsory third party motor policy. The amendment was mainly related to depreciation.

The aforementioned amendment was made through Resolution No. (50) of 2019 and its correction issued in the Official Gazette issue number 3434.

6.5.5 IFRS 17 "Insurance Contract"

The International Accounting Standard Board (IASB) has proposed the implementation of a new standard IFRS 17 "Insurance Contract" with an agreed mandatory effective date of 1st January 2022, under which Insurance Firms will be required to apply IFRS 17 for their annual accounting periods starting 1st January 2022.

The CBB on 15th October 2019, informed the market that it would like all insurance firms to fully appraise and prepare themselves on the changes of the requirements of IFRS 17 "Insurance Contract" and ensure that they are ready to adapt to the new requirements of the standard. The CBB is very keen to implement this standard efficiently with all Insurance firms operating in the Kingdom of Bahrain by 1st January 2022.

Therefore, the CBB requested all Insurance firms to follow the following phases:

First Phase: Evaluation

All Insurance firms are required to conduct a thorough gap analysis in respect to the operational and financial impact(s) of implementation of IFRS 17. The report on gap analysis should be submitted to the CBB not later than 31st May 2020.

Second Phase: Preparation and Design

All Insurance Firms are required to prepare a detailed action plan on how to implement the requirements of IFRS 17, taking into consideration the gap analysis prepared in the first phase, which should be approved by the Board of Directors and submitted to the CBB not later than 30th September 2020. This plan should include, but is not limited to, the internal rules and processes that will be designed to cope with the implementation of IFRS 17 in respect to its accounts, financial statements and other requirements.

Final Phase: Implementation

Insurance firms should initiate the implementation of the new standard and prepare its accounts, financial statements and other requirements in parallel to the required accounts and financial statements with the evaluation of the impact of implementation on a semi-annual basis starting end of June 2021.

Chapter 7 Non-Bank Financial Institutions

Key Highlights

# of Investment Businesses	# of Money Changers	Investment Businesses Assets	Money Changers Purchase	Money Changers Sale
52	19	BD 440 mn	BD 9,760 bn	BD 10,394 bn

- Total assets of Investment Businesses increased by 30.4% due to a few banks' transition to investment firms
- Profits of Investment Businesses decline by 83.7%.
- 68% of all currency transactions of money changers were in GCC currencies for Q4 2019.

7.1 Overview

This chapter highlights the overall performance of the non-banking financial industry in Bahrain by looking at two main segments: Investment businesses and money changers. The non-banking financial institutions in Bahrain are less complex relative to the size and complexity of the Bahraini banking system, but it plays an important role in meeting different needs for financial intermediation.

Chapter 7 covers the period between end-June 2019 and end-December 2019, unless otherwise indicated. The chapter covers the developments in Bahrain's non-bank financial institutions prior to the COVID-19 pandemic.

A significant number of investment businesses and money changers have established their presence in Bahrain. As of December 2019, there are a total of 52 investment business firms and 19 money changer organizations licensed and registered in the Kingdom.

Investment firms can be further broken-down into:

- 22 Category 1 firms,
- 14 Category 2 firms, and
- 16 Category 3 firms.[7]

7.2 Investment Businesses

Total assets for investment businesses peaked in June 2015 reaching BD 628.8 million, but since the beginning of 2016 have stabilized around BD 330 million (Chart 7-1). In December 2019, total assets of investment businesses increased by 30.4% to BD 439.6 million from BD 337.0 million in June 2019. This

[7] Category 1 firms may undertake any regulated investment service, as listed below: a) Dealing in financial instruments as principal; b) Dealing in financial instruments as agent; c) Arranging deals in financial instruments; d) Managing financial instruments; e) Safeguarding financial instruments (i.e. a custodian); f) Advising on financial instruments.
g) Operating a collective investment undertaking (i.e. an operator).
Category 2 firms may undertake the same regulated services except "a)".
Category 3 firms may only undertake "c)" and "f)".

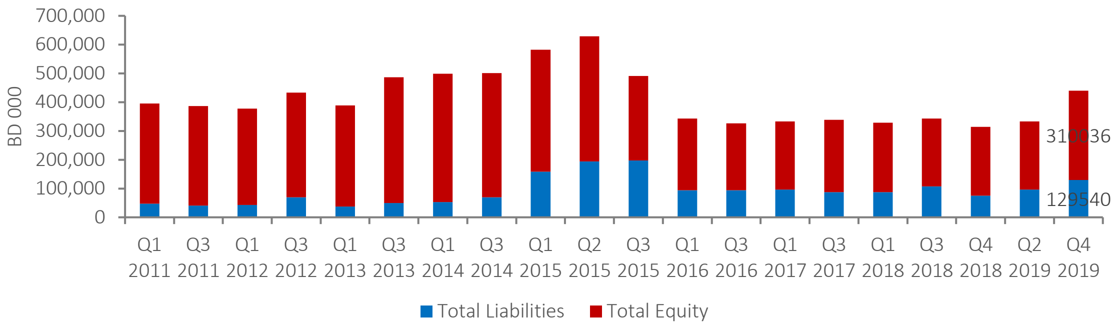
significant increase is due to a few wholesale banks changing their licenses to Category 1 investment firms. During the same period, total liabilities increased by BD 33.0 million (34.1%) and total equity increased by BD 73.8 million (31.3%).

Table 7-1: IB Total Assets by Category

BD '000	Total Assets		Total Liabilities		Total Equity	
	Q2 2019	Q4 2019	Q2 2019	Q4 2019	Q4 2019	Q4 2019
Category 1	289,296.7	391,787.3	82,907.4	116,277.0	202,491.9	275,510.3
Category 2	40,299.8	39,823.6	11,472.8	11,001.1	28,523.4	28,822.5
Category 3	7,399.6	7,966.7	2,204.2	2,262.7	5,195.4	5,704.0
Total	**336,996.1**	**439,577.6**	**96,584.5**	**129,540.8**	**236,210.6**	**310,036.8**

Source: CBB.

Chart 7-1: IB Total Assets by Time Period



Source: CBB.

7.2.1 Assets Under Management

Between June and December 2019, total assets under management increased by 35.2% from BD 8,011.6 million to BD 10,829.7 million. Assets under management of residents increased by 12.8% from BD 5,883.3 million in June 2019 to 6,636.9 million in December 2019. Non-residents' assets under management almost doubled with a substantial increase of BD 2,066.1 million (97.3%) over the same period.

Table 7-2: Assets under Management

BD '000	Q2 2019	Q4 2019	% Change
AUM - Residents	5,883,327.0	6,636,894.0	12.8
AUM – Non Residents	2,123,696.8	4,189,816.9	97.3
Total AUM	**8,011,644.6**	**10,829,710.9**	**35.2**

Source: CBB.

7.2.2 Profitability

Profits of category 1 investment businesses took a massive hit in the fourth quarter of 2019, falling by 98%. This mainly due to two individual firms that recorded major losses for the quarter. Category 2 firms' profits also decreased by 74.3% from BD 1.66 million in June 2019 to BD 0.43 million in December 2019. On the other hand, category 3 firms recorded a huge boost in profitability for the last quarter of 2019 with a 170% increase (Table 7-3).

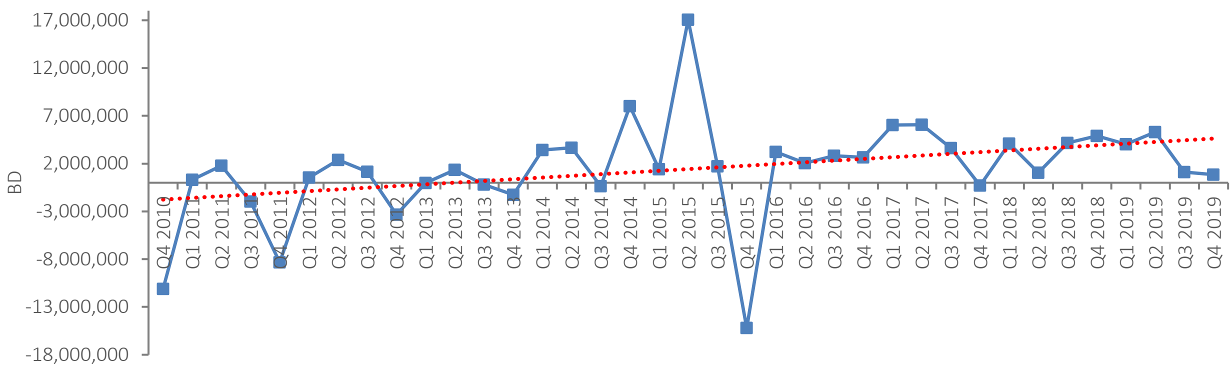
Table 7-3: IB Profitability by Category

BD '000	Q2 2019	Q4 2019	% Change
Category 1	3,514.2	69.6	(98.0)
Category 2	1,664.0	428.0	(74.3)
Category 3	135.6	366.2	170.1
Total	**5,313.8**	**863.8**	**(83.7)**

Source: CBB.

Between December 2010 and December 2015, profitability of overall investment businesses was very volatile between profits and losses. Since December 2016, investment businesses' profitability has always been positive with more stability than previous years, with the exception of December 2017. Chart 7-2 displays that overall profitability of investment business has been on a positive trend since December 2010. The second quarter of 2019 has been the most profitable quarter for investment businesses over the last two years (Chart 7-2).

Chart 7-2: IB Profitability (Q4 2010 – Q4 2019)



Source: CBB.

7.3 Money changers

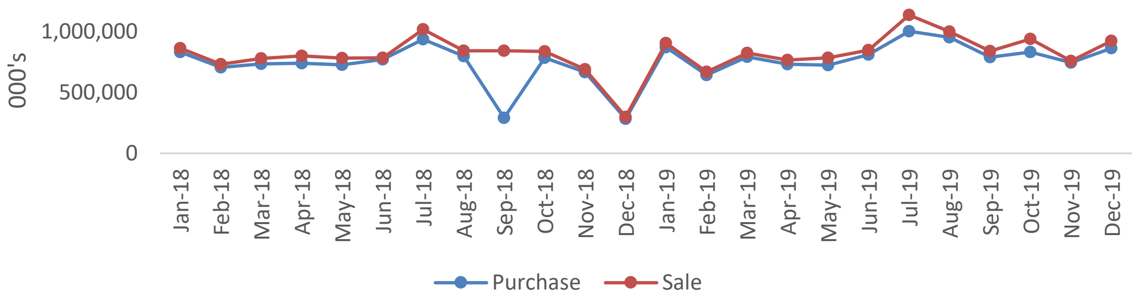
During 2019, money changers' purchase of foreign currencies amounted to 9,760.0 billion, while the sale of foreign currencies was recorded at 10,394.2 billion for the year. The month with the highest purchase and sale of currency was July, with both purchase and sale of currencies surpassing one billion. The lowest month for purchase and sale of currencies for 2019 was February (Table 7-3).

Table 7-3: Money Changers Total Turnover (Jan-Dec 2019)

000's	Purchase	Sale
Jan. 2019	871,665.8	904,887.7
Feb. 2019	643,830.8	669,113.4
Mar. 2019	791,714.6	823,580.6
Apr. 2019	730,856.8	767,475.6
May 2019	725,469.3	785,491.4
Jun. 2019	810,882.7	846,912.8
Jul. 2019	1,002,883.9	1,136,223.9
Aug. 2019	952,007.7	1,000,536.2
Sep. 2019	790,593.5	838,975.7
Oct. 2019	831,410.3	939,165.7
Nov. 2019	744,409.4	757,888.0
Dec. 2019	864,277.0	923,926.8
Total	**9,760,001.8**	**10,394,177.8**

Source: CBB.

Chart 7-4: Time series of Money Changers Total Turnover



Source: CBB.

For the fourth quarter of 2019, money changers' purchase and sale of currencies stood at BD 2,440.1 billion and 2,621.0 billion, respectively. A breakdown of Money Changers turnover indicates that "Asian" currency group recorded the highest YoY percentage increase in sales with 123.8%. The largest decline in sales, excluding Other, was the "European" currency group with 27.9%. As for purchases, the top YoY increase is also "Asia" with 81.3%. The largest decline for purchases was also the "European" currencies with 40.4%.

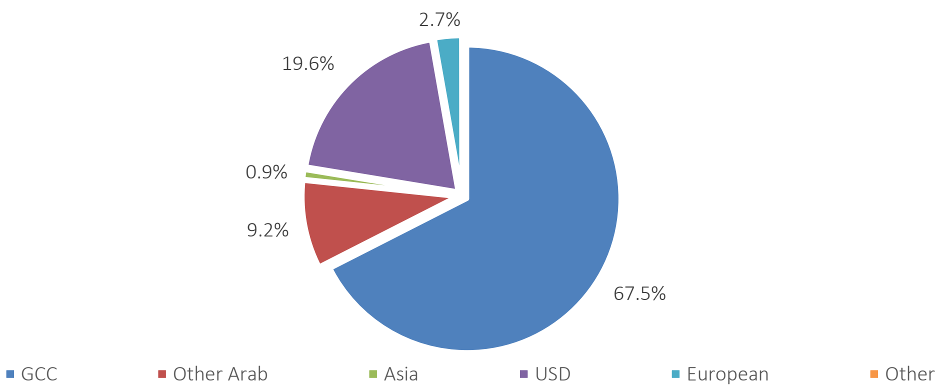
Table 7-4: MC Turnover by Currency Group

000's	Purchase			Sale		
	Q4 2018	Q2 2019	Q4 2019	Q4 2018	Q2 2019	Q4 2019
GCC	1,194,295.8	1,414,755.0	1,704,965.7	1,206,181.2	1,409,263.8	1,711,356.7
Other Arab	119,083.8	202,931.9	178,046.0	189,902.1	333,029.3	285,531.6
Asia	11,035.9	16,990.5	20,012.4	12,125.0	18,776.3	27,139.5
USD	304,693.5	535,022.1	476,746.3	307,834.0	536,557.1	517,088.9
European	100,514.9	90,499.8	59,908.9	109,913.2	95,119.1	79,212.3
Other	2,609.0	7,009.6	417.4	2,704.6	7,134.3	651.6
Total	**1,732,232.9**	**2,267,208.8**	**2,440,096.6**	**1,828,660.0**	**2,399,879.8**	**2,620,980.6**

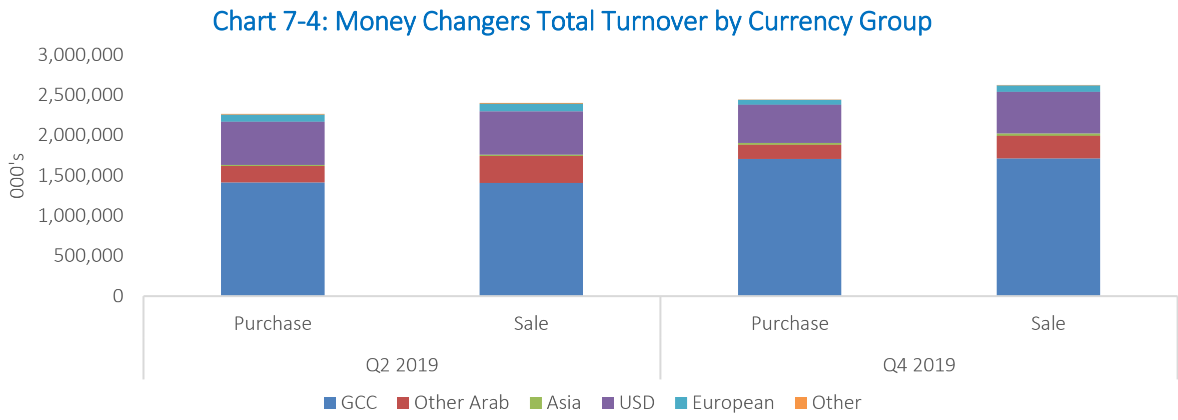
Source: CBB.

For the fourth quarter of 2019, 68% of all purchase and sale of currencies were in GCC currencies. The U.S. dollar is the second most exchanged currency with 20% of total purchase and sale of currencies.

Chart 7-3: Money Changers Currency Group Purchase & Sale, Q4 2019 (% of Total)



Source: CBB.



Source: CBB.

7.4 Challenges & Risks in Non-Banking Financial Institutions

The raise of artificial Intelligence and the digitization of information has encouraged Asset Managers and money changers to reconsider the conventional way of doing business. The usage of artificial intelligence in such sectors has given prominence to new forms of providing services through online platforms, examples of which is the Robo or digital advisory provided by the investment business firms and online remittance services provided by money changers.

The emergence of such services, offering cheaper services for more efficiency and less likelihood for errors and miscalculations, has increased competition and encouraged more companies to consider increasing their investments in technology. Funding technology and coping with the rapid changes in technology solutions is a challenge for companies working in both sectors.

Another side of the use of technology that needs to be considered is the increasing digitization of a wide range of sensitive client data that needs to be handled by companies. Such companies need to be more diligent in how information is handled, with the main threats being misappropriation of information and cybercrimes. The CBB's issuance of cyber security standards is a positive step that has set minimum standards for managing cyber security risk. However, the dynamic nature of cyber threats requires a high degree of proactive thinking by companies, making it important to either employ professionals with unique insights or outsource to service providers.

7.5 Developments in Regulation and Initiatives

The CBB is considering the below regulatory development initiatives, and is expecting to issue the same for industry consultation during 2020:

1. Revision to large exposure rules and introduction of related party transaction limits.
2. Introduction if remuneration claw back rules under the High-Level Controls Module of CBB Rulebook Volume 4.
3. Enhancement to the rules pertaining to custodians in CBB Rulebook Volume 4.

Chapter 8 Capital Markets

Key Highlights

# of Companies	All Share Index	Islamic Index	Market Capitalization	Total Value	Total Volume	PE Ratio
44	1,610.18	760.04	BHD 10,135mn	BD 286 mn	BHD 1,157 mn	11.27

- Increase in the Bahrain All Share & decrease in Islamic Index.
- Market capitalization increased by 24% driven mainly by the Commercial Banks sector.
- Commercial Banks dominated the market trading activity as it had the highest volume, value and number of transactions.
- Bahrainis represented 53% of the value of shares bought and 68% of value of shares sold during 2019.

8.1 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 of 31st December 2019, Bahrain Bourse recorded a total listing of 44 Companies, 10 Mutual funds and 14 Bonds and Sukuk. During 2019, there were 20 companies that closed the year higher and 14 closed lower and 10 remained unchanged. APM Terminals Bahrain B.S.C is the latest edition to the Bahrain Bourse mainboard and has been included under the Services sector and Bahrain All-Share Index during 2019. Commercial Banks sector remains the dominant sector in Bahrain Bourse in terms of market capitalization and trading activity accounting for 66.8% of total value traded during 2019 and making up 56.9% of the total market capitalization. Bahrain Bourse remains a highly concentrated market in terms of market capitalization as the largest 5 companies in terms of market capitalization are AUB, NBB, BBK, BATELCO and ALBH represent 64.7% of the total market.

Chapter 8 covers the period between end-December 2018 and end-December 2019, unless otherwise indicated. The chapter covers the developments in Bahrain's capital markets prior to the COVID-19 pandemic.

8.2 Bahrain Bourse

8.2.1 All Share Index and Islamic Index Overview

Increase in market index

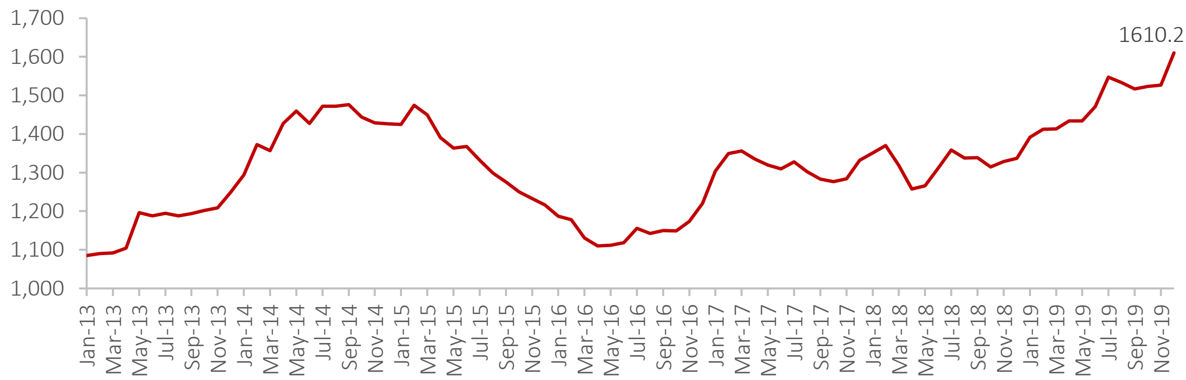
Bahrain All Share Index increased by 20% (273 points) for the year. During 2019, the index was generally rising though out the year as the lowest month-end close level was recorded in January end at 1,391 points and the highest month end close was recorded on December at 1,610 points which is a decade record high. On a month-on-month basis, the index increased the most in percentage terms during December 2019, where it increased by 5.5%.

Table 8-1: Key Indicators of Bahrain Bourse

Indicator	2013	2014	2015	2016	2017	2018	2019
All Share Index	1,248.9	1,426.6	1,215.9	1,220.5	1,331.7	1,337.3	1,610.2
Highest	1,248.9	1,476.0	1,474.8	1,220.5	1,356.0	1,369.9	1,610.2
Lowest	1,085.9	1,294.3	1,215.9	1,110.5	1,276.7	1,257.9	1,391.4
Market Cap (BD, million)	6,963.0	8,327.1	7,199.9	7,248.2	8,146.3	8,198.5	10,134
Total Value (BD, million)	225.9	269.1	110.0	124.5	211.3	323.8	286.4
Total Volume (million)	1,867.8	1,126.1	515.6	734.4	1,129.8	1,441.1	1,157.3
No. of Transactions	14,197	16,211	11,248	10,592	19,440	19,225	20,712
No. of Companies Listed	47	47	46	44	43	44	44

Source: Bahrain Bourse.

Chart 8-1: Bahrain All-Share Index (Jan. 2013 - Dec. 2019)



Source: Bahrain Bourse.

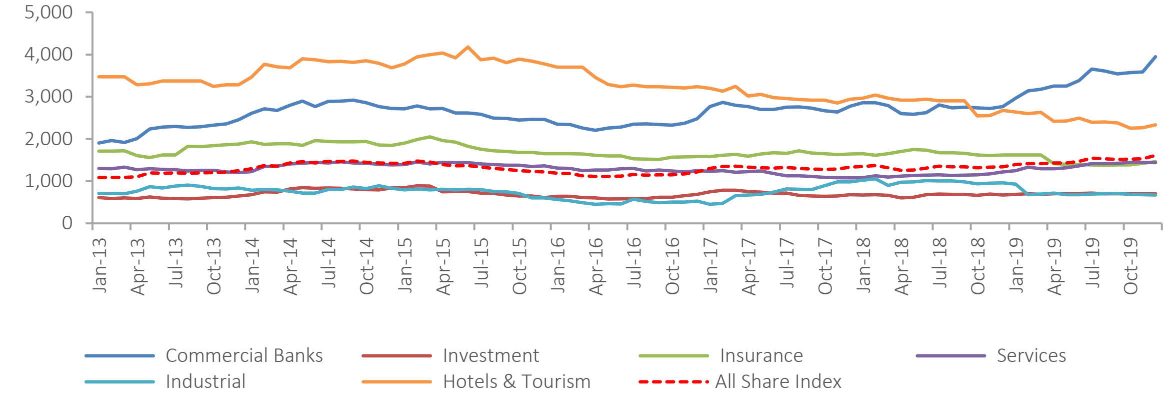
As for the sector indices, three sectors closed higher and three closed lower during 2019. The Commercial Banks sector recorded the highest increase of 42.5% followed by the Services sector with an increase of 18.4%. The industrial sector fell the most out of the sector indices with a 29.8% decline.

Table 8-2: Bahrain All Share Index by Sector

	2013	2014	2015	2016	2017	2018	2019
Commercial Banks	2,456.4	2,721.2	2,461.8	2,481.8	2,772.6	2,769.8	3,947.6
Investment	650.7	842.1	613.8	686.2	680.2	669.9	703.6
Insurance	1,876.3	1,844.7	1,653.6	1,585.6	1,645.8	1,619.9	1,458.3
Services	1,206.8	1,386.0	1,361.7	1,248.9	1,078.6	1,216.3	1,439.6
Industrial	842.5	830.9	606.1	524.3	986.5	960.8	674.1
Hotels & Tourism	3,279.9	3,687.6	3,779.2	3,237.5	2,940.3	2,677.7	2,336.1

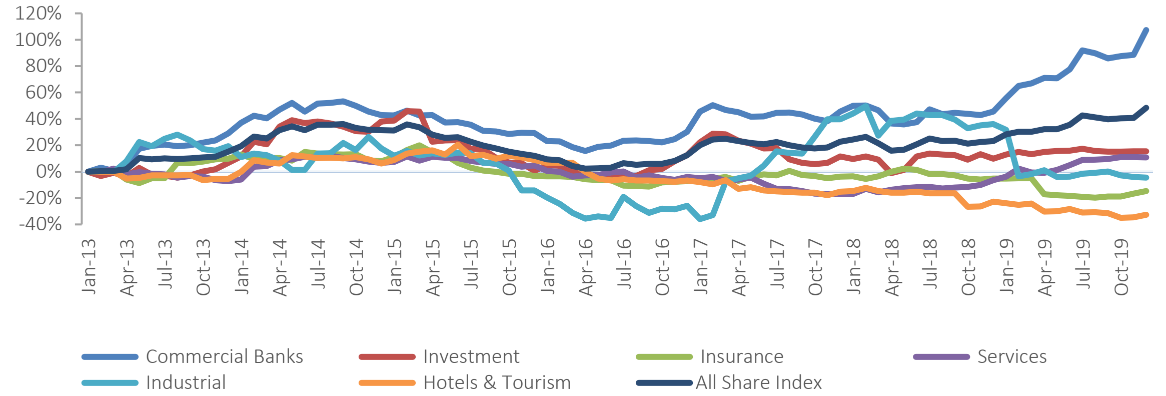
Source: Bahrain Bourse.

Chart 8-2: Sector Indices Levels & Returns (Jan. 2013 – Dec. 2019)



Source: Bahrain Bourse.

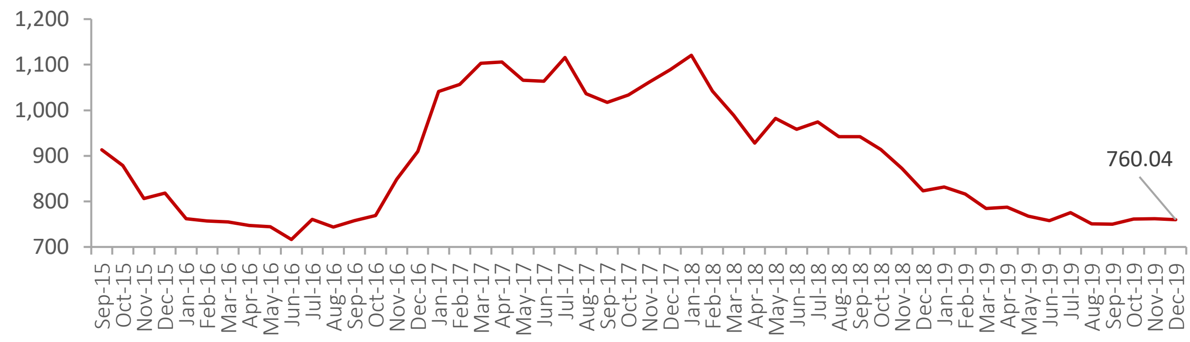
Chart 8-3: Sector Indices Returns (%) (Jan. 2013 – Dec. 2019)



Source: Bahrain Bourse.

In September 2015, Bahrain Bourse launched the Bahrain Islamic Index. It was the first Islamic finance index in the region, and 13 Shariah compliant companies are included within the index as of December 2019. YoY data demonstrates that the Bahrain Islamic Index decreased by 63 points (7.7%) between 2018 and 2019 reaching 760.04 points.

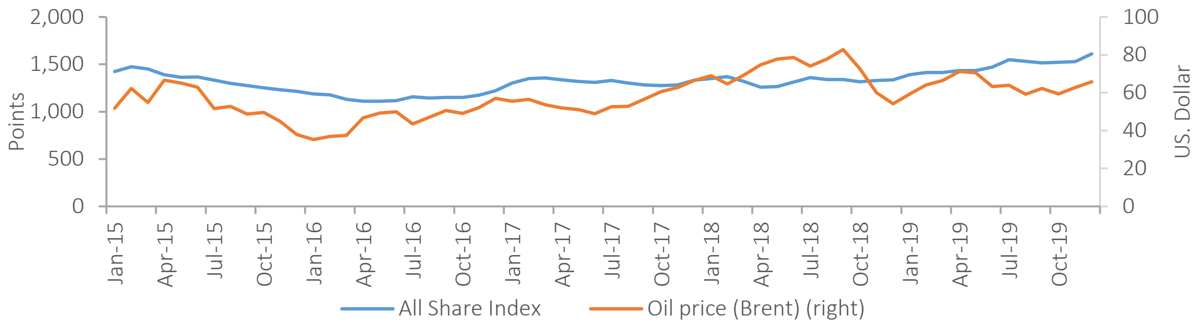
Chart 8-4: Bahrain Islamic Index (Sep. 2015 – Dec. 2019)



Source: Bahrain Bourse.

With Bahrain being an oil exporting country, it is significant to analyse the relationship between oil prices and the stock prices. Bahrain All-Share Index and the oil prices had a moderate, positive correlation at 0.52 and is evident from the movements of the prices in the chart below.

Chart 8-5: Bahrain All-Share Index and Oil price fluctuations



Source: Bahrain Bourse and the World Bank.

8.2.2 Bahrain Bourse Trading Statistics

Increase in market capitalization

As of end of 2019, market capitalization of the Bahrain Bourse stood at BD 10.13 billion. This level of market capitalization is 23.6% higher for the year.

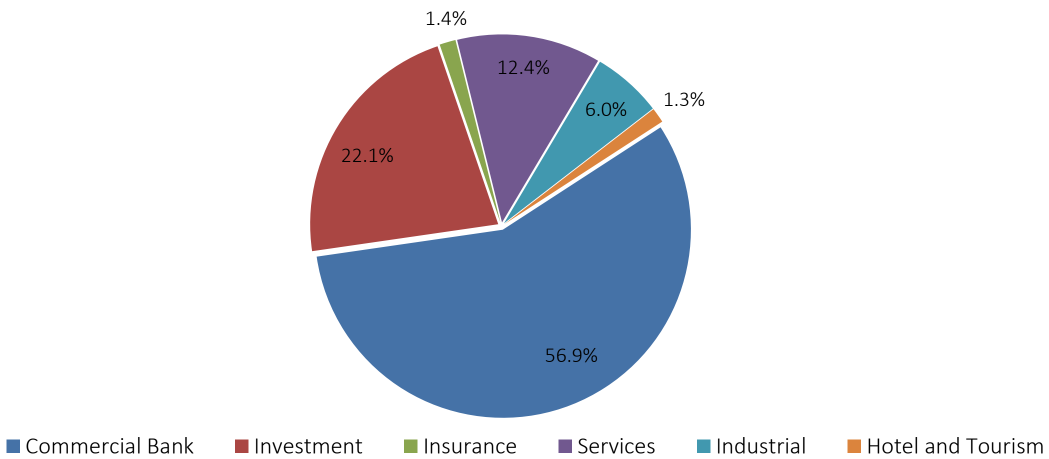
Table 8-3: Market Capitalization on the Bahrain Bourse

Sector (BD)	2018	2019	2018 - 2019 (% Change)
Commercial Banks	3,942,889,860	5,764,393,689	46.2
Investment	2,100,716,781	2,235,172,282	6.4
Insurance	156,708,100	141,073,950	(10.0)
Services	979,887,367	1,253,854,054	28.0
Industrial	868,556,113	609,308,719	(29.8)
Hotel and Tourism	149,772,214	130,822,268	(12.7)
Total	**8,198,530,435**	**10,134,624,962**	23.6

Source: Bahrain Bourse.

A breakdown of market capitalization by sector indicates that the Commercial Banks sector recorded the highest year-on-year increase in market capitalization (46.2%) followed by services (28.0%). The industrial sector scored the highest decline among other market capitalization sectors with a 29.8% decrease.

Chart 8-6: Market Capitalization by Sector, Dec. 2019



Source: Bahrain Bourse.

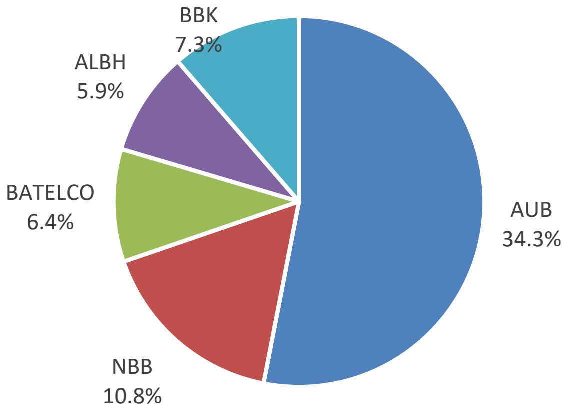
Ahli United Bank is the largest company in terms of Market Capitalization and contributes to 34.3% of the total market capitalization as of December 2019. National Bank of Bahrain has the second largest share of Market Capitalization of 10.8% and it is followed by Bank of Bahrain and Kuwait (BBK) with 7.3%, Bahrain Telecommunication Company (BATELCO) with 6.4%, and Aluminium Bahrain (ALBH) with 5.9%.

Table 8-4: Largest 5 Companies by Market Capitalization (2019)

Company	Market Capitalization (BHD)	% from Total Market
Ahli United Bank (AUB)	3,473,363,769	34.3
National Bank of Bahrain (NBB)	1,091,107,856	10.8
Bank of Bahrain and Kuwait (BBK)	743,118,970	7.3
Bahrain Telecommunication Company (BATELCO)	643,658,400	6.4
Aluminium Bahrain (ALBH)	593,560,000	5.9
Total	**6,544,808,995**	**64.7**

Source: Bahrain Bourse.

Chart 8-7: Largest 5 companies by Market Capitalization (2019)



Source: Bahrain Bourse.

Most of the value of shares traded during 2019 was in the Commercial Banks sector whose traded shares (by value) represented 67% of total value, which is a significant increase to the weight of the market in 2018.

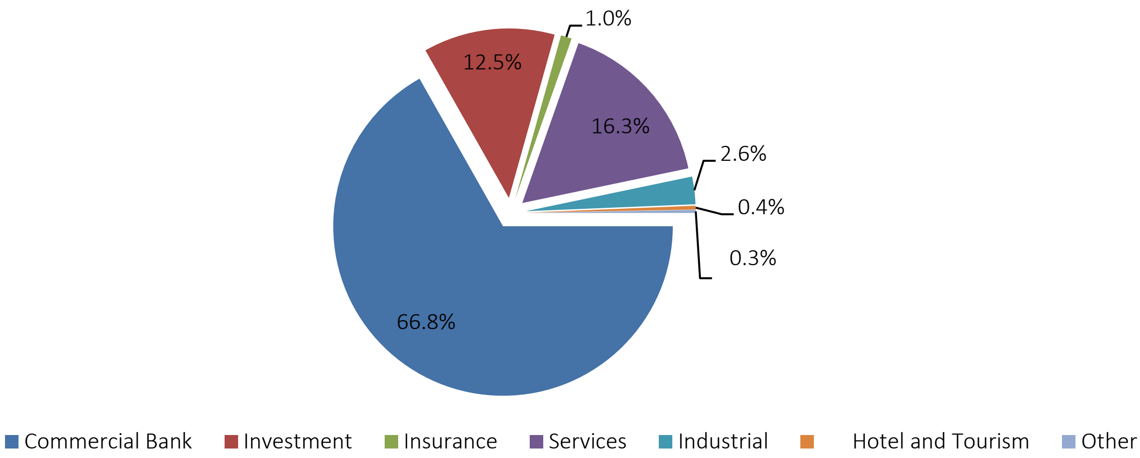
Table 8-5: Value of Shares Traded by Sector (% of Value of all shares traded)

Sector	2018	2019
Commercial Banks	52.0	66.8
Investment	30.5	12.5
Insurance	0.4	1.0
Services	9.0	16.3
Industrial	5.9	2.6
Hotel and Tourism	0.2	0.4

Source: Bahrain Bourse.

The services sector represents the second largest level at 16.3% of the total value of shares traded in 2019, which is an increase to the levels recorded in the same period last year. Investors' interest in Hotel and Tourism and Insurance sectors were the least during 2019 whose traded shares by value represented only 0.4% and 1.0% respectively of total traded shares.

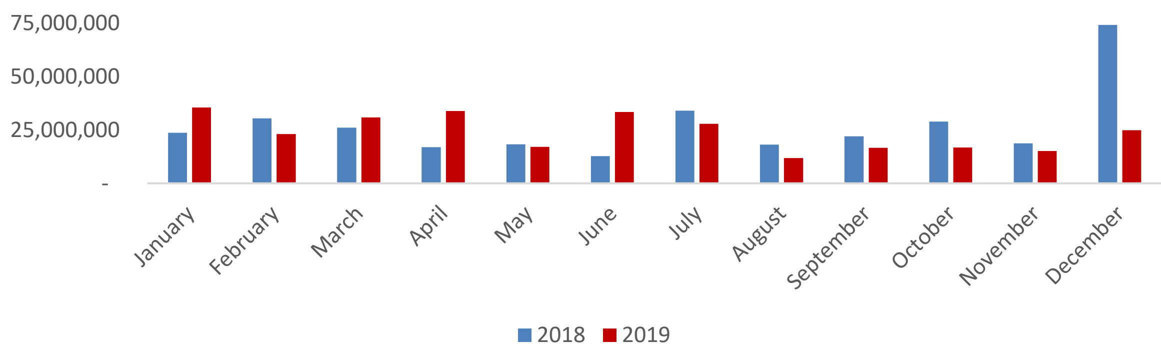
Chart 8-8: Value of Shares Traded by Sector (% of Value of all shares traded) (2019)*



** Other sector includes Closed companies, Non-Bahraini and IPOs.*
Source: Bahrain Bourse.

During 2019, the value of shares traded was highest in January and the lowest was in August, and the average value of shares traded during the year for a month was BD 23.9 million.

Chart 8-9: Value of Shares Traded YoY Comparison



Source: Bahrain Bourse.

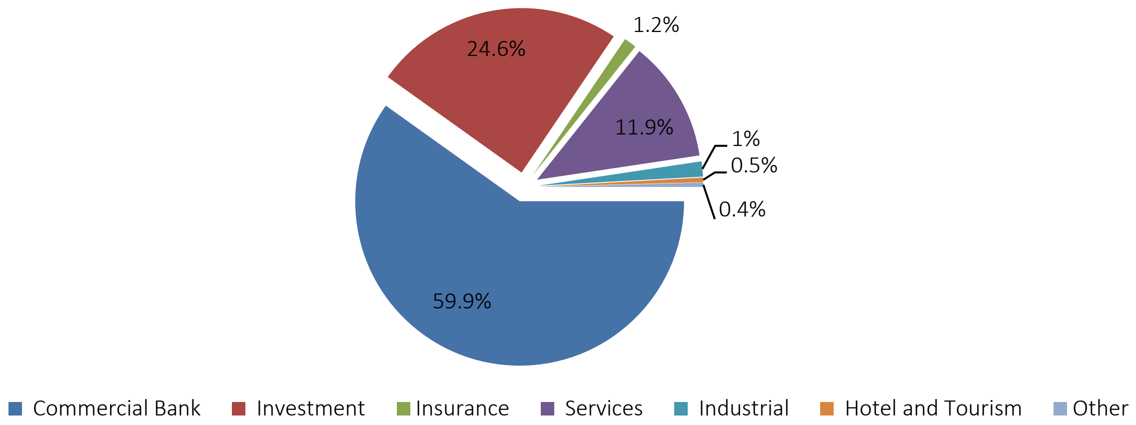
The bulk of the volume of shares traded in 2019 was also in the Commercial Banks sector representing 59.9% of the total volume of shares traded, followed by the investment sector at 24.6%. The lowest level was attained by the Hotel and Tourism sector at 0.5%.

Table 8-6: Volume of Shares Traded by Sector (% of Volume of all shares traded)

Sector	2018	2019
Commercial Banks	57.2	59.9
Investment	29.7	24.6
Insurance	0.7	1.2
Services	8.3	11.9
Industrial	2.2	1.2
Hotel and Tourism	0.1	0.5

Source: Bahrain Bourse.

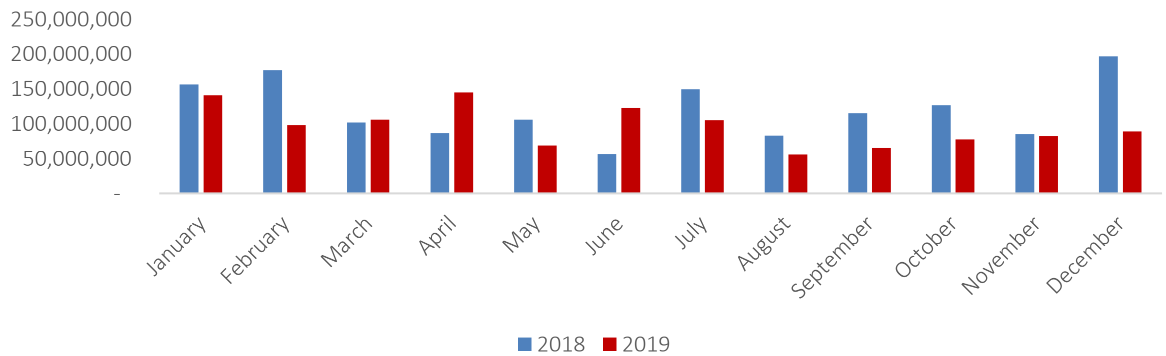
Chart 8-10: Volume of Shares traded by Sector (% of Volume of all shares traded) (2019)*



** Other sector includes Closed companies, Non-Bahraini and IPOs*
Source: Bahrain Bourse.

During 2019, the volume traded was highest in April and the lowest was in August, and the average volume traded during the year for a month was 96.4 million shares.

Chart 8-11: Volume of Shares Traded YoY comparison



Source: Bahrain Bourse.

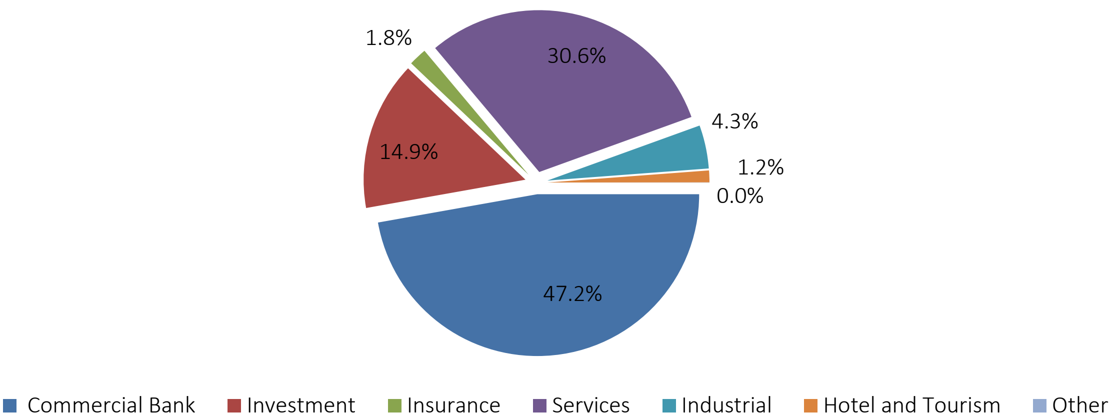
Most of the transactions were executed by the Commercial Banks sector at 9,776 transactions (47.2% of all transactions), followed by the Services Sector at 6,337 transactions (30.6%), and the Investment sector at 3,082 transactions (14.9%).

Table 8-7: Number of Transactions by Sector

Sector	2018	2019
Commercial Banks	8,603	9,776
Investment	4,250	3,082
Insurance	107	373
Services	4,655	6,337
Industrial	1,227	897
Hotel and Tourism	158	244
Closed	5	3
IPO	220	0
Total Market	**19,225**	**20,712**

Source: Bahrain Bourse.

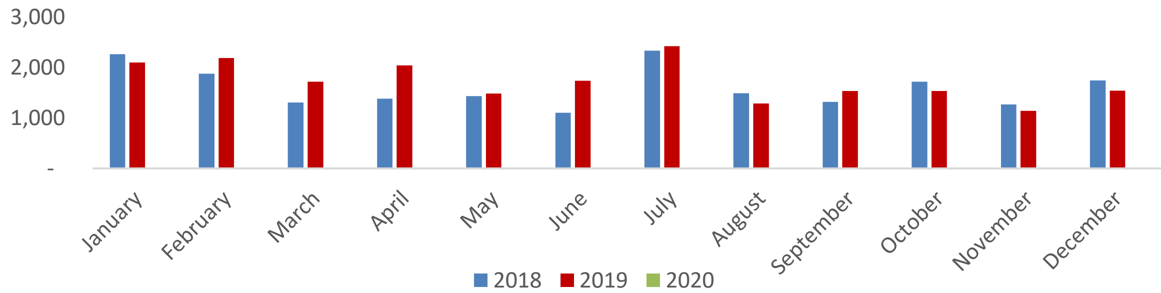
Chart 8-12: Number of Transactions (% of all transactions) (2019)*



Other sector includes Closed companies and IPOs.
Source: Bahrain Bourse.

During 2019, the market executed 20,712 transactions which is 7.7% more transactions than last year. Transactions executed was the only trading activity measure which increased during 2019 compared to 2018, as the value and volume were lower in 2019 compared to 2018.

Chart 8-13: Number of Transactions YoY comparison



Source: Bahrain Bourse.

Trading by Nationality

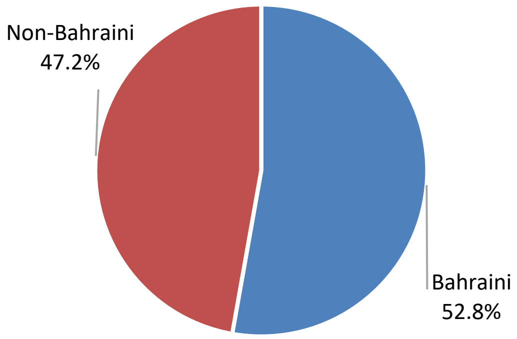
As of December 2019, Non-Bahraini nationals contributed to 47% of the value of shares bought while Bahraini nationals contributed the remaining 52.8%. As for sell-side of the transactions, Bahraini nationals comprised 67.8% of the total value of shares sold.

Table 8-8: Value of Transactions by Nationality (BD)

	2018		2019	
	Bahraini	Non-Bahraini	Bahraini	Non-Bahraini
Buy	203,061,242	120,771,546	151,227,541	135,178,545
Sell	154,366,006	169,466,782	194,082,278	92,323,808

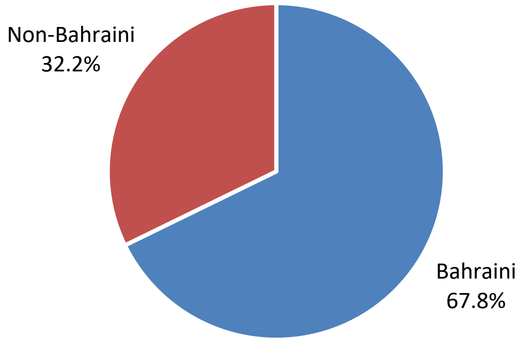
Source: Bahrain Bourse.

Chart 8-14: Share of Trading value of Buy transactions by nationality (2019)



Source: Bahrain Bourse.

Chart 8-15: Share of Trading value of Sell transactions by nationality (2019)



Source: Bahrain Bourse.

GCC Indices recover

Apart from Muscat Securities Market Index 30, the GCC major equity markets indices recorded positive returns during 2019 compared to end of year 2018. The highest increase was recorded by Kuwait All-Share Index at 23.7%, followed by Bahrain All Share Index with an increase of 20.4%.

Table 8-9: Stock Market Indices in GCC counties

Index	2018	2019	2018 - 2019 (% Change)
Bahrain All Share Index	1,337	1,610	20.4
Kuwait All Share Index	5,079	6,282	23.7
Dubai Financial Market General Index	2,529	2,764	9.3
Tadawul All Share Index	7,826	8,389	7.2
Abu Dhabi Exchange General Index	4,915	5,075	3.3
Qatar Exchange Index	10,352	10,425	0.7
Muscat Securities Market Index 30	4,323	3,981	(7.9)

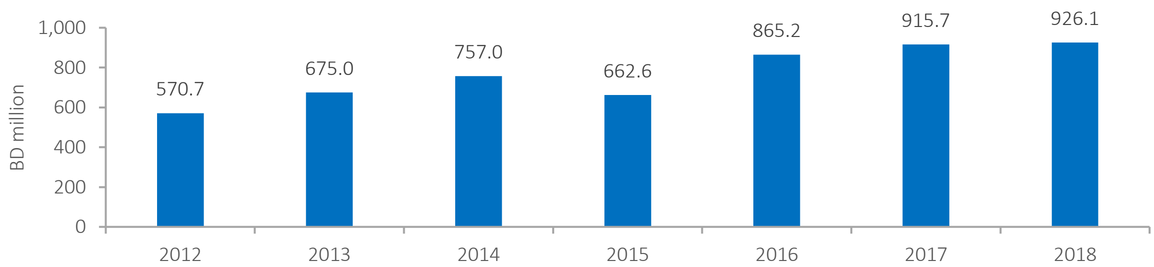
Sources: Bahrain Bourse, Saudi Stock Exchange (Tadawul), Boursa Kuwait, Qatar Stock Exchange, Dubai Financial Market, Abu Dhabi Securities Exchange and Muscat Securities Market.

8.3 Market Resilience

Increase in corporate profitability

The overall profitability of the Bahraini Bourse slightly increased by 1.1% to BD 926.1 million in 2018 from BD 915.7 million in 2017. Return on assets remained stable at 1.6% in 2018, while return on equity slightly decreased to 9.2% in 2018 compared to 9.5% in 2017.

Chart 8-16: Stock Market Net Income



Source: Bahrain Bourse.

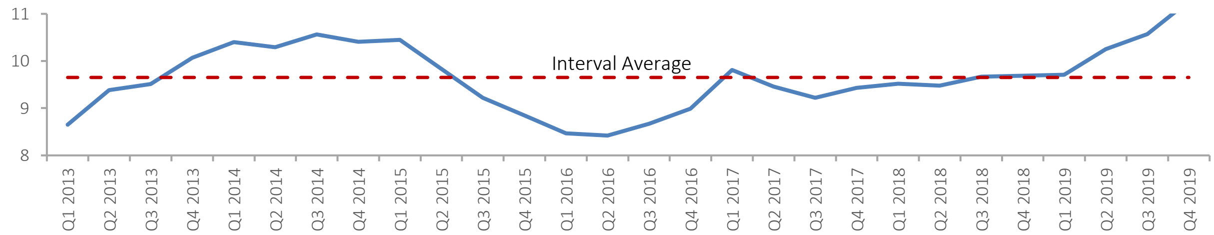
As at December 2019, half of the sectors valuation in terms of P-E ratio increased compared to December 2018. Commercial Banks, Industrial, and Hotel and Tourism sectors increased by 31.8%, 12.3%, and 53.7% respectively while Investment, Insurance and Services sectors dropped by 2.9%, 38.6% and 6.4% respectively. The total market P/E ratio in 2019 increased from 9.69 to 11.27.

Table 8-10: Price-Earnings Multiples

Sector	2018	2019
Commercial Banks	10.02	13.21
Investment	8.27	8.03
Insurance	20.06	12.32
Services	12.44	11.65
Industrial	8.80	9.88
Hotel and Tourism	9.66	14.85
Total Market	9.69	11.27

Source: Bahrain Bourse.

Chart 8-17: Total Market Price-Earnings Multiples

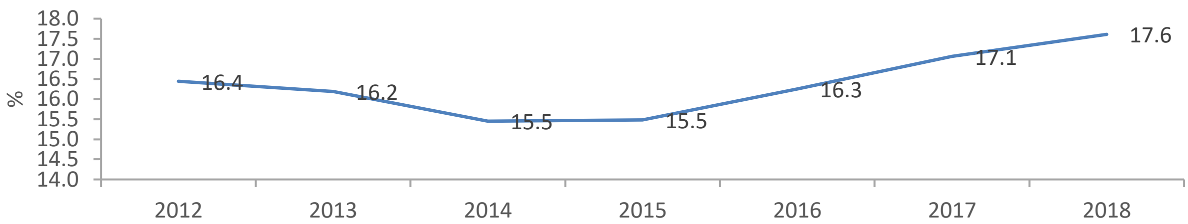


Source: Bahrain Bourse.

Corporate leverage decreased

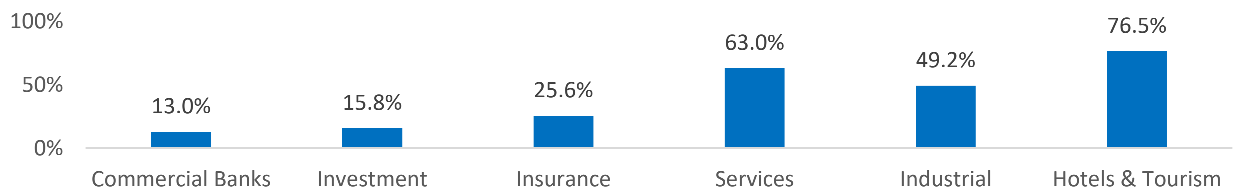
The overall equity-to-assets ratio increased to 17.6% in 2018. Most sectors contributed to the increase with the hotel and tourism sector having the highest increase. The Commercial Banks and Investment sectors have the lowest equity/assets ratio due to the high leverage nature of the sectors (Chart 8-17 and 8-18).

Chart 8-18: Total Equity to Total Assets (%)



Source: Bahrain Bourse.

Chart 8-19: Total Equity/Total Assets by Sector



Source: Bahrain Bourse.

8.4 Capital Market Activities

During 2019, the Bahrain All Share Index closed the year higher by 20.4% at 1,610 compared with 2018, with a market capitalization of BHD 10.1 billion (BHD 8.2 billion for the year end 2018), while the Bahrain Islamic Index fell by 7.7%. The value traded on Bahrain Bourse listed companies was BHD 286 million over 20,712 transactions during 2019, which is lower by 11.6% compared to 2018.

The Commercial Banks Sector Index (the largest sector with 56.9% of the weight of the total market capitalization) was the highest gaining sector recording a gain of 46.2% for the year 2019. The sector gain was mainly due to a rise of 53.3% on Ahli United Bank (AUB) the highest gainer in the Commercial Banks Sector. AUB is the largest listed company by market capitalization (34.4% of the total market capitalization) and the highest traded stock on Bahrain Bourse (55.1% of the total value traded on BHB). Adding to the sector's gain was a 26.4% price rise of Bank of Bahrain and Kuwait (BBK) shares, which is the third largest company listed by market capitalization. On the other side of the spectrum, the Industrial Sector witnessed the largest decline amongst the sectors by falling 29.9%, primarily due to a 30.3% drop Aluminium Bahrain (ALBH) shares (the fifth largest listed company in terms of market capitalization).

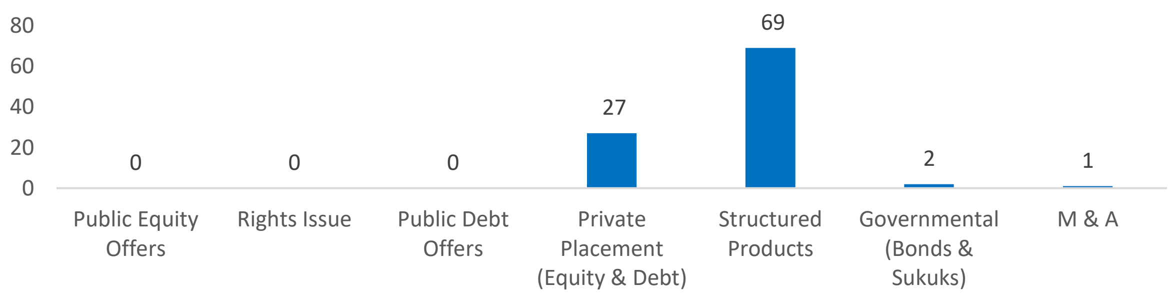
During the year 2019, APM Terminals Bahrain B.S.C. (APMTB) was the highest gainer for the year with a massive increase of 58.2% followed by Ahli United Bank (AUB) which rose by 53.3%. A total of 14 listed companies closed higher for the year 2019, and 20 companies' prices decreased.

Foreign investors activity stood at BHD 227.5 million in Bahrain Bourse decreasing by 21.6% during the year 2019 when compared with 2018 in regards to both buying and selling activity. The foreigners were net buyers by BHD 42.9 million, while locals were net sellers by the same amount.

8.4.1 Offering of Securities

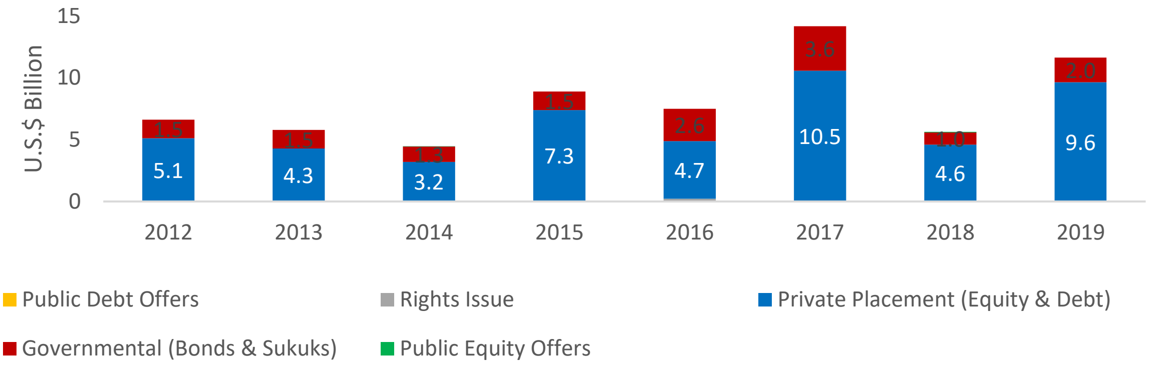
As at the end of 2019, the CBB issued its no objection to the issuance of 98 private offering documents after ensuring the completeness of all the information and details as per the CBB Law, Rules and Regulations. The total value of issuances reached USD 14.5 billion. (Chart 8-19 & 8-20).

Chart 8-20: Number of Capital Market Activities



Source: CBB.

Chart 8-21: Total Issuance Value



Source: CBB.

8.4.2 Issuance of Shares in Bahrain Car Parks Company B.S.C ("Car Parks") in respect of a Whitewash Transaction with Bahrain Real Estate Investment Company (Edamah) B.S.C. (c)

Car Parks issued 40,000,000 new ordinary shares at a price of 150 fils per share in favor of Edamah on 20th June 2019 as consideration for a 99 years automatically renewable usufruct right in the Terminal car park building located in Adliya ("Transaction").

Upon completion of the Transaction, the usufruct right in the Terminal Building was registered to Car Parks with the Survey and Land Registration Bureau and Edamah gained a controlling interest of 36.26% in the issued and paid up capital of Car Parks.

8.4.3 National Bank of Bahrain B.S.C.'s ("NBB") voluntary acquisition offer for the issued and paid up capital of Bahrain Islamic Bank B.S.C. ("BisB")

On 3rd November 2019, BisB's Board of Directors received a notice of firm intention from NBB's Board of Directors to make an offer to acquire up to 100% of the issued and paid up ordinary shares of BisB subject to a minimum acquisition of 40.94% of the issued share capital of BisB, bringing the NBB total stake in BisB to a minimum of 70% for either cash of BHD 0.117 per share or shares exchange at a share ratio of 0.167 NBB shares per BisB share at the option of each shareholder of BisB subject to the fulfilment or waiver of conditions precedent.

NBB dispatched the Offer Document to BisB's Board of Directors on 24th November 2019 pursuant to the requirements of the Takeovers, Mergers and Acquisitions ("TMA") Module of Volume 6 of the CBB Rulebook, and after receiving the CBB's no objection letter on the Offer Document on the same date. BisB's Board of Directors dispatched the Offeree Board Circular issued by the Board of BisB, the Offer Document issued by NBB and the Acceptance and Transfer Form to the shareholders of BisB on 12th December 2019, pursuant to the requirements of the TMA Module, and after receiving the CBB's no objection letter on the Offeree Board Circular on 10th December 2019. BisB shares were suspended from Bahrain Bourse on 15th December 2019. The offer opened on 18th December 2019 and set to close on the initial closing date on 2nd January 2020. The offer was announced unconditional as to acceptances on 31st December 2019, which extended the final closing date of the offer to 15th January 2020, which is 15 days from the date it was declared unconditional as to acceptances.

The transaction was completed successfully and NBB announced on 19th January 2020 its receipt of acceptances comprising 49.76% of the issued and paid up capital of BisB, bringing its total ownership in NBB to 78.81%. The settlement of the shares was executed on 22nd January 2020.

8.5 Risks & Challenges in Capital Markets

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

Moreover, the regulatory framework for capital markets recognizes the significance of cybersecurity in the area of operating an equity crowdfunding platform as well as providing crypto-asset services. Equity crowdfunding platform operators are required to ensure that cyber-security includes the conduct of an IT security penetration test semi-annually by an independent consultant while crypto-asset service providers must have an annual audit of their IT infrastructures and core systems including penetration testing undertaken by reputable third-party cyber security consultants. In addition, Capital Markets licensees are mandated to maintain relevant systems in place for mitigating and managing operational and other risks.

The FinTech solution are increasingly affecting the Capital Markets, these changes are being reflected on different areas including: the core infrastructure that connects investors/clients with the intermediaries through block chain technologies, post-trade and settlement digitization and innovative technology driven business models. These FinTech driven changes will lead to reduction in overall risks due to further transparency and reduction of systematic risk. In order to effectively reduce risks related to use of FinTech solutions, the CBB is working towards further entertaining the regulatory framework pertaining to data security, legal framework of data usage, creating robust compliance and regulatory reporting and increasing partnership between financial institutions, FinTech services providers and the regulator. Another key area of focus for the CBB is Regulatory Technology (RegTech) which could be used to regulate the FinTech in the Capital Markets.

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 aware and adhering to the rules and regulations. Meanwhile, listed companies are also aiming to increase liquidity and trading in their own shares by cross listing in multiple exchanges. Consequently, such initiatives bring about their own set of regulatory risks that the CBB tackles.

As of 2019, 9 of the 44 listed companies on Bahrain Bourse were cross-listed outside of Bahrain, leading to challenges faced by the CBB in maintaining the cross-listed companies' compliance with the capital market regulations of Bahrain. The CBB is utilizing the IOSCO MMoU and the MoU between regulators of the financial markets in the Gulf Cooperation Council States in requesting assistance in relation to cross-listed companies. Concurrently, Bahrain Bourse is in the process of issuing its new listing rules and listing guidelines which will tackle aspects of the cross-listing rules.

Due to the limited number of capital market service providers, conflict of interest issues arises when certain capital market service providers offer multiple services to a single client. As such, the CBB requires the capital market service providers to act with a high level of due diligence, provide comprehensive disclosures and detailed declarations.

It is important that the Buy-and-Hold/Passive Investment investor mentality is tackled, through the provision of tools which gives the investors a clear view of market activity. Bahrain Bourse is in collaboration with market information companies, such as Bloomberg, Thompson Reuters etc., to distribute data packages which include facilities relating to real-time market coverage, historical and end-of-day data, etc.

8.6 Developments in Regulation and Initiatives

In addition to the participation in joint work meetings of the GCC that aim to harmonize the rules and regulations for the Capital markets in the GCC. During the year 2019, the CBB's CMSD endeavoured to develop and complete the capital markets regulatory and legal frameworks, including Volume 6 of the CBB Rulebook, its main objectives being to enhance transparency, 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 2019:

8.6.1 Policy and Regulatory Developments

- **Bahrain Bourse ("BHB") Issuers' Fines Proposal:** Following the CMSD's initial approval, the Bahrain Bourse issued a consultation paper on the proposed administrative fines on Issuers on 24th November 2019. The proposed framework is being introduced in accordance with the Bahrain Bourse's Listing Rules which relates to the powers of Bahrain Bourse to impose administrative fines on issuers in the event of non-compliance with the Listing Rules and any other applicable BHB rules, regulations and directives as deemed appropriate.
- **Clearing, Settlement and Central Depository Rules:** Bahrain Clear (BHC) Clearing, Settlement and Central Depository Rules are being finalised and shall be submitted to the CMSD shortly.
- **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 produced the third issue of its Compliance & Enforcement Annual Report covering the year 2018; which provides a comparative overview of CMSD's efforts in 2016-2018 to identify and address non-compliances, negligence or misconduct, by accounting for all market participants in order to enact the word of the law, safeguard the interests of all stakeholders and ensure a stimulating environment within which the needs of members, investors and the regulator are met.
- **AUP for Testing Compliance with AML Module:** As part of the CBB's objective to establish industry leading practices, the CBB issued the Agreed Upon Procedures ("AUP") for testing compliance with the Anti-Money Laundering and Combating Financial Crime ("AML") Module of CBB Rulebook Volume 6 on 16th January 2019, with further amendments issued on 2nd

December 2019. The CBB is continuously working on updating the AUP to ensure that best international practices from the Financial Action Task Force ("FATF") regarding AML are applied.

- **Crypto-Assets Module:** In line with its initiative to continuously enhance its regulatory framework to be able to fit the financial sector's developments, the CBB issued the amended Crypto-Assets ("CRA") Module under Volume 6 of the CBB Rulebook on 19th April 2019. Further amendments have been published for consultation on 2nd October 2019; the amendments are with regards to maintenance and development systems, security measures and procedure, and cyber security requirements, amongst other areas. Generally, this regulatory framework covers rules for the licensing and supervision of crypto-asset exchanges and other crypto-asset services including trading, dealing, advisory and portfolio management in accepted crypto-assets as principal, agent or custodian.
- **Anti-money Laundering and Combating of Financial Crime Module:** In order to be in line with the FATF Recommendations and to follow best international practices, the CBB issued proposed amendments to the AML Module for industry consultation on 2nd October 2019. Amendments include the addition of sections regarding money transfer and accepted crypto-assets, enhanced due diligence for correspondent relationships, and an introduction pertaining to the CBB's risk-based approach.
- **Takeovers, Mergers and Acquisitions ("TMA") Module Updates and Amendments:** In order to ensure adherence to international best practice, and to continue to ensure investor protection and to further enhance the regulatory framework of the capital markets sector in the Kingdom of Bahrain, the CBB issued circular EDFIS/C/083/2019 dated 2nd October 2019 pertaining to the amendment of the Takeovers, Mergers and Acquisitions (TMA) Module, Volume 6 of the CBB Rulebook.
- **Deletion of paragraph in Module AML Volume 6:** In line with the CBB's efforts to maintain fairness and mobility amongst all shareholders, an amendment was issued on August 29th 2019 (Ref: EDFIS/C/74/2019), with regards to the deletion of Paragraph AML-7.1.2 of the Anti-Money Laundering & Combating of Financial Crime Module of Volume 6 of the CBB Rulebook. The deleted paragraph enforces a restriction on all substantial shareholders (owning 5% and above) to conclude all transactions on their listed security in the licensed exchange in Bahrain.
- **Change in Ownership of Substantial Shareholders Requirements**: Complementing the previous amendment relating to the deletion of AML-7.1.2, the CBB issued a circular on 21st October 2019 (Ref: CMS/C/06/19) to reiterate the listed companies' obligation to comply with AML-7.1.1, which address the obligation of substantial shareholders to immediately inform the listed company of all their executed transactions and in return the requirement on listed companies to Immediately inform the CBB and Bahrain Bourse of the same. The circular also highlights Paragraph OFS-5.1.19 under the Offering of Securities Module of Volume 6 of the CBB Rulebook, wherein listed companies are required to ensure the disclosure of equivalent information in Bahrain Bourse as opposed to other markets.
- **Corporate Action Timeline**: As part of the CBB's objective to enhance existing practices and eliminate market ambiguity, Article 32.5 of the Disclosure Standards of Volume 6 of the CBB Rulebook was amended on 22nd December 2019 (Ref: EDFIS/C/094/2019). The amendment withdraws the existing article and stipulates a new requirement where listed companies must adhere to a set dividend declaration and payment timeline that aligns the applied practice.
- **Press Release Pertaining to Financial Statements of listed companies:** As part of the CBB's objective to enhance transparency, fairness, and investor protection; a set of requirements

titled "Instructions for Publication of Press Releases Concerning Financial Results for Public Shareholding Companies" was issued on 9th January 2020 (Ref: CMS/C/008/20). The requirements are applicable to listed companies that prepare press releases pertaining to their quarterly and annual financial statements as they ensure that such public announcements are factually accurate and provide sufficient quantitative information to shareholders and investors.

8.6.2 The Capital Markets Supervision Directorate's Upcoming Initiatives

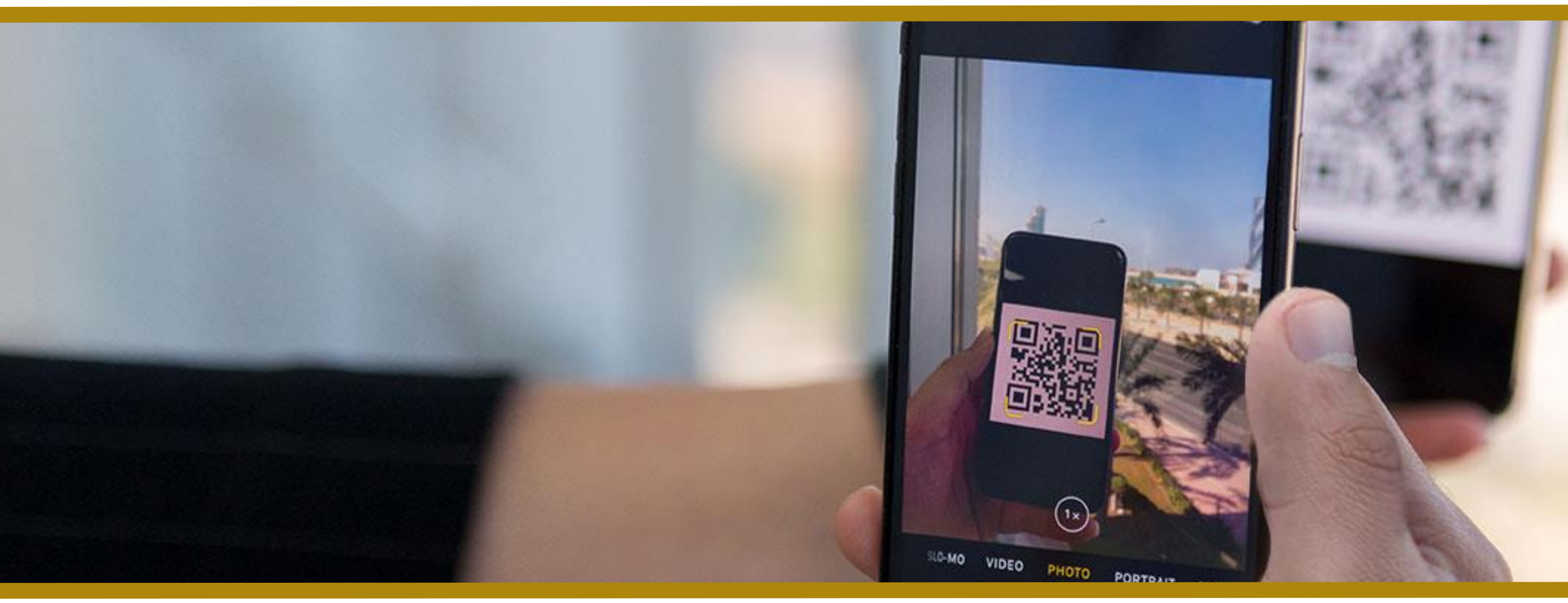
- **Offering of Securities ("OFS") Module Updates and Amendments:** The CMSD is currently drafting updates and amendments to the OFS Module of Volume 6 of the CBB Rulebook, to be in line with international best practice regarding the offering and issuing of securities in and from the Kingdom of Bahrain.
- **Treasury Shares Resolution:** Further to Article (93) of the Central Bank of Bahrain and Financial Institutions Law, the CMSD is currently in the process of introducing a resolution to regulate the purchase and sale of listed companies' treasury shares and the permitted uses for these shares.
- **Training and Competency Module**: The CMSD in cooperation with the CBB's Regulatory Policy Unit is finalising a new Training and Competency ("TC") Module as part of the CBB Rulebook Volume 6. The Module aims at presenting requirements that have to be met by capital markets licensees with respect to training and competency of individuals undertaking controlled functions.

8.6.3 Investor Protection Initiatives

- Alerts posted on the CBB's Website: As part of the CBB's objective to maintain a transparent, fair and efficient capital market for ensuring investor protection, the CBB's CMSD has published three alerts on the CBB's website during the second quarter of 2019, warning consumers against dealing with unlicensed financial institutions and market intermediaries. These warnings are a result of complaints received by the CMSD from the public and the issuance of such aims to further enhance investor protection and safeguard public interests.

Part IV:

Developments in the Payment Systems, FinTech, and Cyber Security



Chapter 9 FMI, Payment and Settlement Systems

Key Highlights

RTGS Daily avg. (Vol.)	RTGS Daily avg. (Val.)	SSSS Aggregate (Vol.)	SSSS Aggregate (Val.)	ATM Daily avg. (Vol.)	ATM Daily avg. (Val.)
165	BD 306.9mn	46	BD 3.11 bn	59,157	BD 5.2 mn

BCTS Daily avg. (Vol.)	BCTS Daily avg. (Val.)	Fawri+ Daily avg. (Vol.)	Fawri+ Daily avg. (Val.)	Fawri Daily avg. (Vol.)	Fawri Daily avg. (Val.)
11,870	BD 34.5 mn	25,912	BD 1.9 mn	30,117	BD 52.3 mn

- The Financial Market Infrastructures (FMIs) and Payment Oversight refers to a Central Bank function that aims to achieve the objectives reassuring the safety, efficiency, resiliency and reliability of the FMIs and Payments. In addition, it is a primal tool that ensures stability of the financial system and efficiency of payment transactions.
- The FMIs, Payment and Settlement Systems in the Kingdom of Bahrain continue to function in a safe and efficient manner from 1st July, 2019 to 31st December, 2019.
- FMIs and Payments have undergone crucial changes from the standpoint of products complexity and range of payment products offered in recent years.

9.1 Overview

FMIs, Payment and Settlement Systems are central to the smooth operations of the financial sector and the efficient functioning of the overall economy. Therefore, the Oversight of FMIs and Payments improve the stability of Payments, markets and the wider financial system in addition to providing a valuable measure to evaluate risks to financial stability. FMIs, Payment and Settlement Systems are a crucial part of the financial infrastructure of a country.

The current Financial Market Infrastructures 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) including the Electronic Bill Presentment and Payment (EBPP) System.

The CBB operates, manages and oversees the national Payment and Settlement Systems in the Kingdom of Bahrain. In addition, the CBB assess the all FMIs, Payment and Settlement Systems in terms of compliance with the requirements set by the Principles for Financial Market Infrastructures (PFMI), CBB Law and CBB's Directives, etc.

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, along with the CBB as a Regulator, innovative human capital, and an advanced ICT infrastructure.

The FMIs, Payment and Settlement Systems Framework continues to function safely, efficiently, resiliently and reliably from 1st July, 2019 to 31st December, 2019.This chapter describes recent trends in the FMIs, Payment and Settlement Systems.

Chapter 9 covers the developments in Bahrain's FMI, Payment and Settlment Sysrtems prior to the COVID-19 pandemic.

9.2 Real Time Gross Settlement System (RTGS)

The CBB operates and oversees the 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-nine (29) participants including the CBB.

The daily average volume of Bank transfers from 1st July, 2019 to 31st December, 2019 (second half of 2019) have decreased by 6.3% to 165 transfers compared to 176 transfers for the period from 1st January, 2019 to 30th June, 2019 (first half of 2019). Furthermore, the daily average volume of Bank transfers for 1st July, 2019 to 31st December, 2019 have decreased by 9.3% from 182 to 165 transfers when compared to 1st July, 2018 to 31st December, 2018 (first half of 2019).

As the daily average volume of Bank transfers through the RTGS have decreased, the value of those transfers has also decreased in the second half of 2019 by 9.3% when compared to the first half of 2019 from BD338.4 million to BD306.9 million. Nevertheless, the daily average value of Bank transfers for the second half of 2019 has increased by 1.6% from BD302.1 million to BD306.9 million when compared to the second half of 2018.

Table 9-1: RTGS Bank Transfers Daily Average Volume and Value

RTGS	Daily Average Volume	Daily Average Value (BD million)
1st Jan. 2016 - 30th Jun. 2016	288	226.2
1st Jul. 2016 - 31st Dec. 2016	227	259.3
1st Jan. 2017 - 30th Jun. 2017	190	268.9
1st Jul. 2017 - 31st Dec. 2018	174	318.7
1st Jan. 2018 - 30th Jun. 2018	176	318.4
1st Jul. 2018 - 31st Dec. 2018	182	302.1
1st Jan. 2019 - 30th Jun. 2019	176	338.4
1st Jul. 2019 - 31st Dec. 2019	165	306.9

Source: CBB.

9.3 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-eight (28) participants and indirect participants are thirty-four (34) members in the SSSS.

The volume of issues for 1st July, 2019 to 31st December, 2019 increased compared to 1st January, 2019 to 30th June, 2019 by 4.5% from 44 issues to 46 issues. Moreover, the volume of issues did not change in the second half of 2019 compared to the second half of 2019 where the number of issues were 46.

The aggregate value of issues for the second half of 2019 increased by 19.1% from BD2.62 billion in first half of 2019 to BD3.12billion. Additionally, the aggregate value of issues for the second half of 2019 increased when compared to the second half of 2018 by 11.0% from BD2.81billion to BD3.12billion.

Table 9-2: SSSS Aggregate Volume and Value[8]

SSSS	Aggregate Volume	Aggregate Value (BD billion)
1st Jan. 2016 - 30th Jun. 2016	41	2.65
1st Jul. 2016 - 31st Dec. 2016	43	3.06
1st Jan. 2017 - 30th Jun. 2017	38	2.44
1st Jul. 2017 - 31st Dec. 2018	51	4.43
1st Jan. 2018 - 30th Jun. 2018	45	2.99
1st Jul. 2018 - 31st Dec. 2018	46	2.81
1st Jan. 2019 - 30th Jun. 2019	44	2.62
1st Jul. 2019 – 31st Dec. 2019	46	3.11

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, 2019 to 31st December, 2019.

9.4 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 2010 to 31st December 2019 increased by 3.5% to 59,157 per day compared to 57,161 transactions per for 1st January 2019 to 30th June 2019. In addition, the daily average volume of ATM transaction increased by 10.7% when comparing the second half of 2018 with the second half of 2019.

The daily average value of ATM transactions for the second half of 2019 decreased by 1.9% from BD 5.3 million in the first half of 2018 to BD 5.2 million. Furthermore, the daily average value of ATM transactions for the second of 2019 also increased by 4.0% compared to the second half of 2018.

[8] Revised Figures as per the latest Report received from the Banking Services Directorate (BKS).

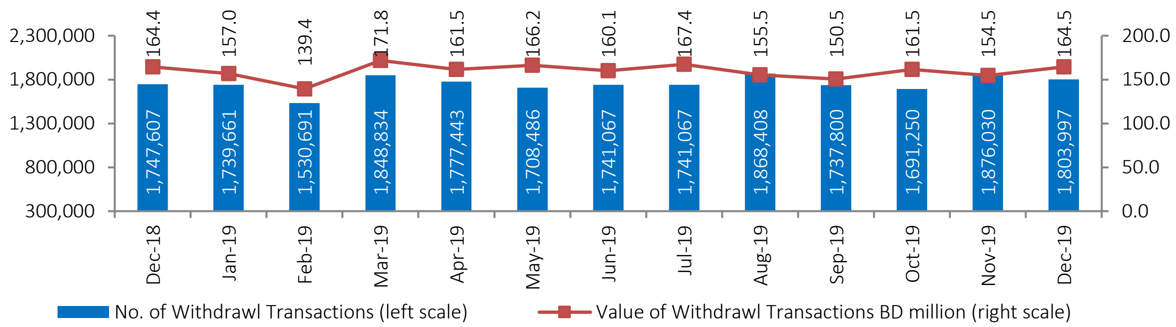
Table 9-3: ATM Transactions Daily Average and Volume

ATM Transitions	Daily Average Volume	Daily Average Value (BD million)
1st Jan. 2016 - 30th Jun. 2016	34,143	3.4
1st Jul. 2016 - 31st Dec. 2016	39,242	3.8
1st Jan. 2017 - 30th Jun. 2017	44,951	4.4
1st Jul. 2017 - 31st Dec. 2018	46,549	4.4
1st Jan. 2018 - 30th Jun. 2018	51,948	5.0
1st Jul. 2018 - 31st Dec. 2018	53,416	5.0
1st Jan. 2019 - 30th Jun. 2019	57,161	5.3
1st Jul. 2019 - 31st Dec. 2019	59,157	5.2

Source: BENEFIT.

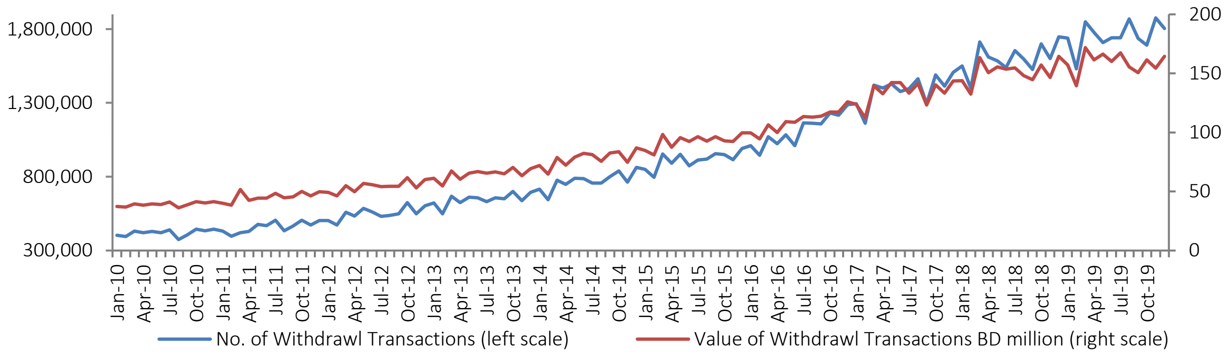
Overall, there is an upward trend in both the value and the volume of ATM transactions (Chart 9-2). For the second half of 2019, the highest value of withdrawals was witnessed in July 2019 at BD 167.4 million and the lowest value of withdrawals was in September 2019 at BD 150.5 million. The highest volume of transactions over the second six months of 2019 was in November 2019 with 1,876,030 transactions and the lowest volume of transactions was in October 2019 with 1,691,250 transactions.

Chart 9-1: Number and Value of ATM Transactions, Dec. 2018- Dec. 2019



Source: BENEFIT.

Chart 9-2: Number and Value of ATM Transactions



Source: BENEFIT.

9.5 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.

The number of participants in the BCTS are twenty-eight (28) participants. The daily average volume of cheques for the second half of 2019 decreased by 2.2% when compared to the first half of 2019 from 12,133 cheques to 11,870 cheques. In addition, the daily average volume of cheques decreased by 6.6% from 12,712 cheques for the second half of 2018 to 11,870 cheques.

Furthermore, the daily average value of cheques decreased in the second half of 2019 by 5.0% when compared to the first half of 2019 from BD36.3 million to BD34.5 million. Moreover, the daily average value of cheques for the second half of 2019 decreased by 7.8% from BD37.4 million for the second half of 2018 to BD34.5 million.

Table 9-4: BCTS Daily Average Volume and Value

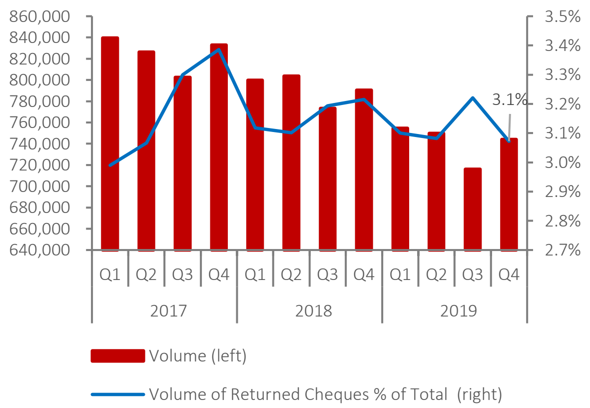
BCTS	Daily Average Volume	Daily Average Value (BD million)
1st Jan. 2016 - 30th Jun. 2016	13,320	41.6
1st Jul. 2016 - 31st Dec. 2016	13,432	40.0
1st Jan. 2017 - 30th Jun. 2017	13,326	41.1
1st Jul. 2017 - 31st Dec. 2018	13,294	40.0
1st Jan. 2018 - 30th Jun. 2018	12,827	39.0
1st Jul. 2018 - 31st Dec. 2018	12,712	37.4
1st Jan. 2019 - 30th Jun. 2019	12,133	36.3
1st Jul. 2019 – 31st Dec. 2019	11,870	34.5

Source: BENEFIT.

The BCTS continued to operate smoothly and efficiently for the period from 1st July, 2019 to 31st December, 2019. Charts 9-3 and 9-4 show the volume and value of cheques and the percentage returned cheques to the total volume and value. Between Q1 2017 and Q4 2019, returned cheques ranged between 3.0% to 3.4% as a percentage of total volume and 2.7% to 5.6% as a percentage of total value.

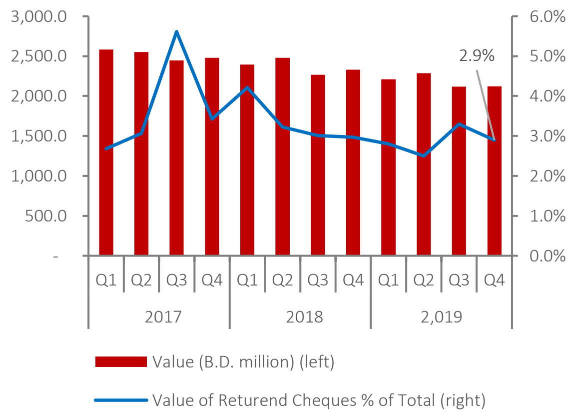
The majority of the cheques returned in terms of volume and value are returned due to financial reasons reaching 80.2% of the total volume of cheques and 74.8% of the total value of cheques in Q4 2019. Cheques returned due to technical reasons comprised 19.8% of total volume and 25.2% of total value in Q4 2019 (Charts 9-5 and 9-6).

Chart 9-3: Volume of Issued Cheques and % of Returned Cheques



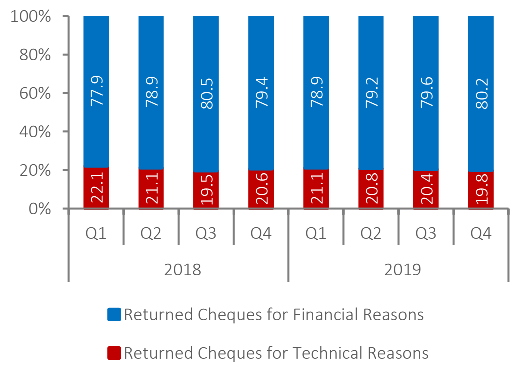
Source: BENEFIT.

Chart 9-4: Value of Issued Cheques and % of Returned Cheques (BD million)



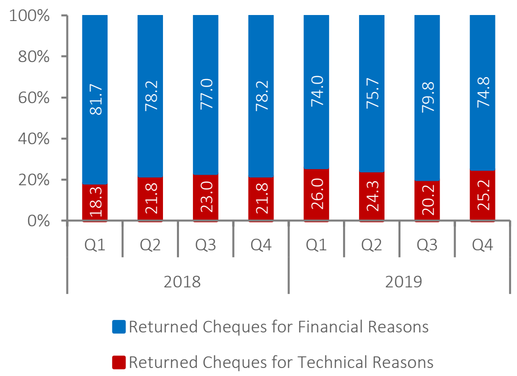
Source: BENEFIT.

Chart 9-5: Returned Cheques by Volume (% of Technical vs. Financial)



Source: BENEFIT.

Chart 9-6: Returned Cheques by Value (% of Technical vs. Financial)



Source: BENEFIT.

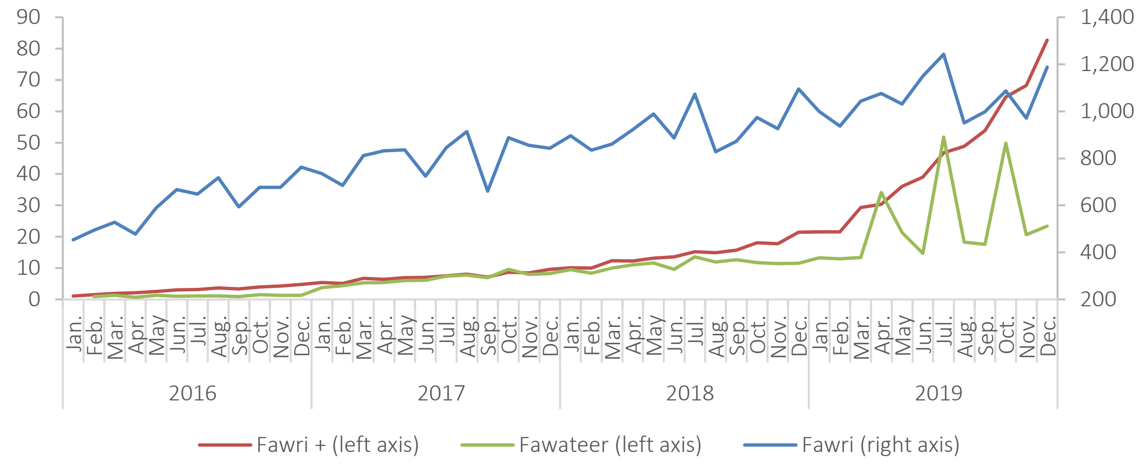
9.6 Electronic Fund Transfer System (EFTS) including Electronic Bill Presentment and Payment (EBPP) System

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 services: 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 errors. The number of participants offering outward EFTS Services has reached twenty-six (26) participants.

Chart 9-7 shows an overall increasing trend in the monthly transfers in Fawri, Fawri, plus and Fawateer. The total amounts of Fawri transfers for the second half of 2019, reached BD 6,436.8 million compared to BD 6,235.1 million for the first half of 2019. The value of Fawri+ transfers also increased from BD 177.9 million for the first half of 2019 to BD 365.0 million for the second half of 2019. In addition, the value of Fawateer payments increased from BD 109.9 million for the first half of 2019 to BD 181.6 million for the second half in 2019. The surge in Fawri+ transfers in 2018 and 2019 is due to the increasing popularity and convenience in going cashless along with the compatibility with digital wallets.

Chart 9-7: EFTS Fawri, Fawri+, and Fawateer Value (BD million)



Source: BENEFIT.

The daily average volume of Fawri+ transfers for the second half of 2019 increased significantly by 201.6% when compared to the first half of 2019 from 8,592 transfers to 25,912 transfers. Furthermore, the daily average volume of Fawri+ transfers for 1st July, 2019 to 31st December, 2019 further increased by 670.3% from 3,364 transfers to 25,912 transfers when compared to 1st July, 2018 to 31st December, 2018 (second half of 2018).

In addition, the daily average value of Fawri+ transfers increased by 101.9% from BD982,609 to BD1,983,672 for this period when compared to 1st January, 2019 to 30th June, 2019. Moreover, the daily average value of Fawri+ transfers for 1st July, 2019 to 31st December, 2019 increased by 253.4% from BD561,336 to BD1,983,672 when compared to 1st July, 2018 to 31st December, 2018.

Table 9-5: EFTS Fawri+ Daily Average Volume and Value[9]

EFTS: Fawri+	Daily Average Volume	Daily Average Value (BD)
1st Jan. 2016 - 30th Jun. 2016	229	67,064
1st Jul. 2016 - 31st Dec. 2016	488	127,777
1st Jan. 2017 - 30th Jun. 2017	840	208,990
1st Jul. 2018 - 31st Dec. 2018	1,194	270,492
1st Jan. 2018 - 30th Jun. 2018	1,900	394,737
1st Jul. 2018 - 31st Dec. 2018	3,364	561,336
1st Jan. 2019 - 30th Jun. 2019	8,592	982,609
1st Jul. 2019 - 31st Dec. 2019	25,912	1,983,672

Source: BENEFIT.

[9] Revised Figures (based on Settled Transactions only) as per the latest Report received from BENEFIT.

The daily average volume of Fawri transfers for the second half of 2019 increased by 9.6% when compared to the first half of 2019 from 27,471 transfers to 30,117 transfers. Moreover, the daily average volume of Fawri transfers for 1st July, 2019 to 31st December, 2019 increased by 21.6% from 24,776 transfers to 30,117 transfers when compared to 1st July, 2018 to 31st December, 2018.

Table 9-6: EFTS Fawri Daily Average Volume and Value [10]

EFTS: Fawri	Daily Average Volume	Daily Average Value (BD million)
1st Jan. 2016 - 30th Jun. 2016	8,584	25.1
1st Jul. 2016 - 31st Dec. 2016	12,528	34.3
1st Jan. 2017 - 30th Jun. 2017	19,271	37.0
1st Jul. 2018 - 31st Dec. 2018	20,912	40.7
1st Jan. 2018 - 30th Jun. 2018	22,273	43.1
1st Jul. 2018 - 31st Dec. 2018	24,776	46.9
1st Jan. 2019 - 30th Jun. 2019	27,471	50.3
1st Jul. 2019 - 31st Dec. 2019	30,117	52.3

Source: BENEFIT.

In addition, the daily average value of Fawri transfers increased by 4.0% from BD50.3 million to BD52.3 million when compared to 1st January, 2019 to 30th June, 2019. Furthermore, the daily average value of Fawri transfers for 1st July, 2019 to 31st December, 2019 increased by 11.5% from BD46.9 million to BD52.3 million when compared to 1st July, 2018 to 31st December, 2018 (second half of 2018).

Table 9-7: EBPP Fawateer Daily Average Volume and Value[11]

EBPP: Fawateer	Daily Average Volume	Daily Average Value (BD)
1st Jul. 2016 - 31st Dec. 2016	358	38,827
1st Jan. 2017 - 30th Jun. 2017	3,056	171,006
1st Jul. 2018 - 31st Dec. 2018	3,756	261,160
1st Jan. 2018 - 30th Jun. 2018	4,410	332,296
1st Jul. 2018 - 31st Dec. 2018	4,712	396,627
1st Jan. 2019 - 30th Jun. 2019	5,208	607,336
1st Jul. 2019 - 31st Dec. 2019	5,724	986,960

Source: BENEFIT.

The daily average volume of Fawateer transfers for the second half of 2019 increased by 9.9% when compared to the first half of 2019 from 5,208 transfers to 5,724 transfers. Moreover, the daily average volume of Fawateer transfers for 1st July, 2019 to 31st December, 2019 increased by 21.5% from 4,712 transfers to 5,724 transfers when compared to 1st July, 2018 to 31st December, 2018.

In addition, the daily average value of Fawateer transfers increased by 62.5% from BD607,336 to BD986,960 when compared to 1st January, 2019 to 30th June, 2019. Furthermore, the daily average value of Fawateer transfers for 1st July, 2019 to 31st December, 2019 increased significantly by 148.8% from BD396,627 to BD986,960 when compared to 1st July, 2018 to 31st December, 2018 (second half of 2018).

The EFTS including EBPP continued to operate in a safe, efficient, resilient and reliable manner from 1st July, 2019 to 31st December, 2019. The CBB continues to assess the EFTS including EBPP in terms of compliance with the requirements set by the Principles for Financial Market Infrastructures (PFMI), CBB Law and CBB's Directives, etc.

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10 Revised Figures (based on Settled Transactions only) as per the latest Report received from BENEFIT.
11 Revised Figures (based on Settled Transactions only) as per the latest Report received from BENEFIT.

Chapter 10 Fintech, Innovation and Financial Inclusion

Key Highlights

Regulatory Sandbox	Digital Wallets	Branches	ATMs	Debit Cards	Credit Cards	POS
35 Companies	5	173	479	1,171.7 K	322.9 K	22,939

- Bahrain's established financial services industry, its role as a leading Islamic finance hub, and the national drive for financial inclusion are supporting the growth of FinTech.
- CBB's FinTech is responsible for the approval process to participate in the Regulatory Sandbox and monitoring technical and regulatory developments in the FinTech field.
- Continued Fintech developments and within the Kingdom and the launch of a number of digital wallets were over the last year.

The Kingdom of Bahrain is an established financial hub in the Gulf Cooperation Council (GCC) and Middle East region. The Kingdom is repositioning itself to be a Financial Technology (FinTech) hub of the region combining conventional and Shariah 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.

The Kingdom is embracing and encouraging digital transformation and the adoption of innovative technology, ultimately adding value and creating a more efficient financial services sector and achieving higher financial inclusion. The 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 CBB seeks to make the Kingdom of Bahrain a key player in FinTech through the availability of (1) innovative financial solutions, (2) highly qualified national talent in finance and banking, and (3) access to supportive policies.

The aim of the chapter is to show the recent trends and developments in the FinTech industry and Financial Inclusion within the Kingdom and highlight initiatives taken by the central bank and other industry players in in this field.

Chapter 10 covers Bahrain's developments/initiatives in Fintech prior to the COVID-19 pandemic.

10.1 FinTech Developments

The CBB has issued a series of measures to strengthen its position as a regional financial centre; including guidelines on the regulatory environment to ease the implementation of FinTech's solutions. 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 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 & Innovation Unit in October 2017 to ensure an adequate regulatory framework is in place to adapt FinTech, which in turn will enhance the services provided to individual and corporate customers in the financial sector.

The FinTech Unit is responsible for 1) the approval process to participate in the Regulatory Sandbox 2) supervision of the activities and operations of the authorized Regulatory Sandbox companies' and 3) 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. The FinTech Unit helps the development of the current ecosystem in place is to encourage growth in the FinTech industry and to attract more local, regional, and international FinTech firms to the Kingdom.

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

10.1.1 Regulatory Sandbox

The CBB has launched a regulatory sandbox in June 2017 that enables both local and international emerging businesses, financial technology companies as well as existing CBB licensees, to test their innovative ideas and create pioneering solutions for the financial services sector.[12] 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 centre of FinTech and financial innovation in the region.

The sandbox provides such authorized companies with the opportunity to test and experiment their innovative financial solutions freely. Additionally, the sandbox is open to CBB licensed companies to help develop ideas until they are commercially viable. The period allowed for this arrangement is nine months and may be extended if need be by an additional three months. The Sandbox focuses on three criteria items that include:

1. Innovation: The solution should be truly innovative or significantly different from existing offerings or offer a new use for existing technologies.
2. Customer benefit: The solution should offer identifiable direct or indirect benefits to customers.
3. Technical testing for existing solutions: In case of existing solutions, results of the technical testing must be made available to the CBB.

To date, the CBB has 35 companies testing their solutions within the Regulatory Sandbox, and 2 have graduated: one receiving a license as a capital market- crypto asset service –category 3 and one as a specialized license- ancillary service provider. The solutions being tested out in the sandbox range from digital banks, crypto platforms, crypto ATMs, open-banking solutions, payment services providers, and many more.

[12] 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.

The Regulatory Sandbox framework was revised in August 2018, to replace the requirement to maintain an escrow account with having a segregated client money account.

10.1.2 Crowdfunding

The CBB issued regulations for both equity and financing based crowdfunding activities, whereby the regulations accommodate for conventional as well as Shariah compliant crowdfunding transactions. Small and medium-sized companies in Bahrain and the region are able to raise conventional financing or Shariah-compliant financing through crowdfunding platforms. Companies operating an electronic equity/financing based crowdfunding platform must be licensed in Bahrain under the instructions depicted 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.

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 Shariah compliant financing-based crowdfunding market in the region. The demand for Shariah compliant financing is already high and is expected to see it reflected in the crowdfunding market.

The Crowdfunding regulations were refined and enhanced in November 2018 to make them more enabling including reduction in minimum capital, including business-to-business and peer-to-business lending, and removal of certain restrictive conditions.

Some of the key highlights of the revised crowdfunding regulations by CBB are as follows:

- Minimum capital requirement for crowdfunding platform operators is BD 25,000.
- Only Person to Business (P2B) and Business to Business (B2B) lending / financing is permitted.
- 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.

10.1.3 Open Banking

In December 2018, the introduction of open banking to Bahrain's banking sector was laid down by the CBB when it issued its open banking regulations which facilitate the provision of a variety of innovative services for bank customers. With that, Bahrain became the first country in the Middle East to adopt open banking making access to financial information easier, faster, and tailored to the needs of customers. The open banking regulations mandated the adoption of open banking by all retail banks in the Kingdom by 30 June 2019.

The open banking regulation provides rules for the following:

- Account information services that permit customer access to aggregated bank account information through a single platform.
- Payment initiation services that allow licensed third parties to initiate payments on behalf of customers and permit seamless transfers between different accounts through a mobile-based application.

The FinTech & Innovation Unit prepared a study on Open Banking for the CBB on June 2018 which lead to the to the issuance of Open Banking regulations on December 2018 after collating feedback from the industry. The rules ensure that the CBB helps foster innovation, competition, and enhanced efficiency within the financial system keeping in view changing consumer trends. Open banking services will entail the provision of two broad categories of services: "Account information service platforms (AISP)" and "payment initiation service platforms (PISP)", which fall under "Ancillary Service Providers" of CBB Rulebook Volume 5.

Open banking allows third-party providers to develop APIs (Application Programming Interfaces) that can access a customer's bank and other financial accounts and present it in a way that is tailored to a customer's needs. For example, multiple bank accounts from multiple providers can be housed in one app, subjected to machine learning analysis, and made securely available to consumers on their mobile phones. With a high mobile phone penetration rates, Bahrain has the environment to test such solutions.

Open banking benefits customers by eliminating the need to conduct separate searches of different bank accounts through multiple portals and instead all relevant financial information can be aggregated on a single application platform. Banks, on the other hand, will benefit by competing to digitize their own services. The entrepreneurial and FinTech start-up ecosystem found in Bahrain, that encompasses accelerators, incubators, training programmes and funding schemes, can play a major part in Open Banking.

10.1.4 Crypto Assets

On February 2019, the CBB issued comprehensive regulations that covers a range of activities related to crypto-assets allowing for the licensing and regulation of trading, dealing, advisory services, portfolio management services in accepted crypto-assets as principal, as agent, as custodian and as a crypto-asset exchange. The range of activities are covered under four licensed category types.

Crypto-assets operating under block chain distributed ledger systems have drawn much regulator attention globally, and the CBB rules are aimed at ensuring that the related activities are subject to comprehensive regulatory and supervisory measures. Bahrain recognizes that the market for crypto-assets is growing both in the Kingdom and globally. The regulations are part of the CBB's initiative to develop its FinTech eco system and to help mitigate against the risk of financial crime and illegal use of crypto-assets within or from Bahrain.

The CBB Crypto-asset rules deal with the rules for licensing, governance, minimum capital, control environment, risk management, AML/CFT, standards of business conduct, avoidance of conflicts of interest, reporting, and cyber security for crypto-asset services. They also cover supervision and enforcement standards including those provided by a platform operator as a principal, agent, portfolio manager, adviser and as a custodian within or from the Kingdom of Bahrain.

In addition, for those licensed by the CBB as crypto-asset exchanges, the regulatory framework also contains rules relevant to order matching, pre and post trade transparency, measures to avoid market manipulation and market abuse, and conflicts of interest.

Recognizing the emerging nature of these activities and the risks involved, the CBB rules also specify, among other measures the following:

- Need for enhanced due diligence (EDD) when on boarding new clients;
- Requirements to ensure that no encrypted safe custody accounts or "wallets" are maintained that cannot be retrieved;
- A mandate to ensure that keyman risks are adequately managed including by having the necessary insurance covers;
- The clients are educated and given clear instructions for use of the safe custody wallets.

10.1.5 E-Wallets

Bahrain's appetite for digital wallets is growing where significant steps have been made in realizing the nation's vision to become a technology pioneer. The Kingdom has been working towards a successful digital economy by building a proper ecosystem provides a network of connected entities form the CBB to banks, to telecommunication companies, to merchants and consumers. The growth in digital wallet usage is a global trend due to 1) simplicity by having one destination to makes transactions that are 2) quicker and easier.

With a high level of mobile penetration, service and retail industries in Bahrain are quickly embracing digital solutions to further improving customer experiences, making the future of e-wallets in Bahrain promising driving us towards cashless/cardless society. The use of wallets will change dramatically the way people interact with money and will increase buying and spending due to easier payments, without neglecting the security aspect, and avoiding the hassle of cash withdrawals.

Several digital wallets were launched in the Kingdom that allows users to make instant payments via smart phones and also facilitate the collection of payments electronically through debit and credit cards. Table 10-1 shows a list of all the digital wallets in Bahrain, along with their launch date and a description of what features they provide. In September 2019, BFC Group launched BFC Pay. The digital payroll solution enables employers to securely upload wages onto payroll cards or mobile wallets through an online portal or at any BFC Bahrain branch and designated cash deposit machines (CDMs).

Table 10-1: Digital Wallets and Features in the Kingdom

Wallet	Launch	Description	Features
b-wallet	January 2018	Bahrain's digital services provider, Batelco partnered with Arab Financial Services (AFS), to introduce a digital mobile wallet and payment solution for customers in the Kingdom. The digital mobile wallet app enables quick and secure payments through a smartphone app. The user can scan the QR Code available at different merchants to make payment.	• Add money into a user's account using any debit card issued in Bahrain. • Send and receive money between b-wallet accounts. • Request money from another b-wallet account. • Make payments to merchants. • Pay with your smartphone using QR code. • Available Offers.
Benefit Pay	May 2017	Benefit Pay is an app that works using QR code scanning Technology by allowing users to make safe and secure payments. The service provides a one-time step to add a card and/or bank account and then enables the customer to scan a QR code from the merchant app and enters proper authentication to complete the transaction. Benefit Pay also allows for peer-to-peer transactions.	• Make Payments to Merchants. • Payments using Credit cards through the mobile App payments or websites. • P2P transfers through Fawri+. • Bill payments through Fawateer. • Pay with your smartphone using QR code. • Available Offers.
Max Wallet	July 2017	Max Wallet is a virtual wallet allowing customers to pay for their purchases using their mobile device without presenting their physical credit cards and paying with a smartphone using QR code. The payment solutions have been launched via a collaboration between BBK and CrediMax to focus on providing more services and payment options.	• Transferring money and sharing payments with friends and family. • Make purchase payments to merchants. • Pay with your smartphone using QR code. • Available Offers.
Viva Cash	March 2018	Viva Bahrain launched Viva Cash, a new application offering consumers secure and convenient a digital mobile wallet for payments. Viva partnered with Sadad Bahrain, licensed and regulated by the CBB. VIVA Cash is a mobile wallet that can be used to pay your day to day expenses.	• Add money to VIVA Cash account. • Send Money to friends and Family. • Pay post-paid bills & recharge prepaid Lines. • Send money internationally. • Shop at participating merchants. • Pay with your smartphone using QR code. • Make purchase payments to merchants. • Available Offers.

BFC Payments	September 2019	Launched in partnership with UnionPay International (UPI). The BFC Payments App offers BFC Pay payroll employees a platform to access salary wallet and the BFC Pay Card. Features of the BFC Payments App that employees can benefit from.	• View account balance anytime, anywhere on their BFC Payments e-wallet. • Transfer money to other BFC Payments e-wallets instantly from their BFC Pay Card or their BFC Payments e-wallet. • Request and receive money from other BFC Payments e-wallets. • Remittance services. • Top up own/other BFC Payments e-wallets or BFC Pay cards instantly from their bank account.

Source: www.batelco.com, www.credimax.com, www.benefit.bh, /www.viva.com.bh, and www.bfcpayments.com.

10.1.6 Digital Financial Advice

The CBB issued on March 2019 the Directives on "Digital Financial Advice" (also known as "Robo-advice"). For the Bahraini financial services sector, this is an important step towards digitalization by through the power of intelligent automation (financial advice) by the use of algorithms in automated tools that use the logic and methodology applied by traditional financial advisors. The Digital Financial Advice regulations rules will enable:

- specialized Fintech firms planning to offer digital financial advice obtain a license to offer such services to investors.
- banks and investment firms to introduce such services with approvals from the CBB.

The new rules focus on providing safeguards and controls governing the use of algorithms or AI which are embedded in the software programs used in the digital advisory tools. The CBB will continue to make progress in expanding the scope of role of digital financial services with a view to ensuring customers have access to smart services from banks and financial institutions. These rules are in line regulatory standards in leading financial centres and will help Bahrain maintain its position as a leading financial hub in the region.

10.1.7 FinTech Bay

Bahrain FinTech Bay (BFB) is a FinTech ecosystem launched in February 2018 by The Bahrain Economic Development Board (EDB) and Singapore-based FinTech Consortium (FTC). BFB is dedicated to further develop and accelerate FinTech firms and drive innovation in Bahrain by bringing industry leaders and new entrants to (1) drive innovation, (2) create opportunities for growth and (3) foster the interaction between players in the financial sector, investors, entrepreneurs, and government bodies. BFB provides co-working spaces and other shared infrastructure to attract FinTech start-ups to base themselves within the Kingdom.

10.1.8 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
- Benefit FinTech Lab

10.1.9 National e-KYC

In February 2019, The CBB along with Benefit and the IGA launched the new national Electronic Know Your Client (eKYC) Project, targeting retail banks, financial services providers, and money exchange networks. The Project provides an advanced state of the art electronic platform and a database for financial institutions to authenticate the identities of their clients and validate their information before granting financial services.

The Project also aspires to help FinTech companies offering financial and banking products using online applications and facilitate the launch of their products and services. This is in compliance with CBB's instructions to encourage the financial sector to use financial services technology and in line with the guidance of the Economic Development Board (EDB) to promote FinTech.

BENEIT will provide financial institutions in Bahrain with a complete web portal allowing identity authentication, as well as mobile applications, thus enhancing the Kingdom's electronic systems in line with Bahrain's Vision 2030.

The eKYC Project provides unique features to BENEFIT clients, namely the promotion of digitalization, as well as user-friendly features, lower cost and less time and effort in collecting data under a single platform, in addition to providing data from reliable government sources and thus minimizing fraud.

10.1.10 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.

10.1.11 Other Regulatory Framework Developments and Projects

As part of the Central Bank of Bahrain's ongoing initiatives towards financial digital transformation in the Kingdom and developments in digital financial services, the CBB has started pursuing the following projects:

- E-Dinar Project: The FinTech & Innovation Unit participated in the early stages of the CBB's e-Dinar project working group meetings.

- National Digital Transformation Strategy – National Economic Strategy: The FinTech & Innovation Unit is involved in supporting the national digital transformation strategy and national economic strategy in cooperation with the EDB.

The CBB has also joined a number International Agreements and Recognitions:

- The CBB has joined the Global Financial Innovation Network (GFIN) network as part of the coordination group, which is the highest tier of membership.
- Abu Dhabi Global Market (ADGM) and CBB signed a MOU to promote and facilitate innovation in financial services in November 2018.
- CBB and MAS signed a MOU to foster innovation in financial services between the two countries in November 2018.'
- The CBB is also part of the GCC Secretariat Fintech Working Group, which aims at strengthening and collaborating on FinTech initiatives amongst the GCC.

The CBB is also has made efforts to enhance financial coverage and provide financial services by:

- 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).

10.2 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.

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. The CBB closely monitors developments in the areas of financial inclusion and their impact on domestic, regional and global levels and gathers relevant financial inclusion data. The CBB 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. The figures in Table 10-2 confirm Bahrain's continued efforts to achieve a higher level of financial inclusion within its financial sector by providing easy access to financial services.

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 to 1) improving women's, SME, and young people's access to financial services 2) promoting the protection of consumers of financial services 3) improving and providing financial coverage data and statistics to support policy development, and 4) promoting awareness and financial education.

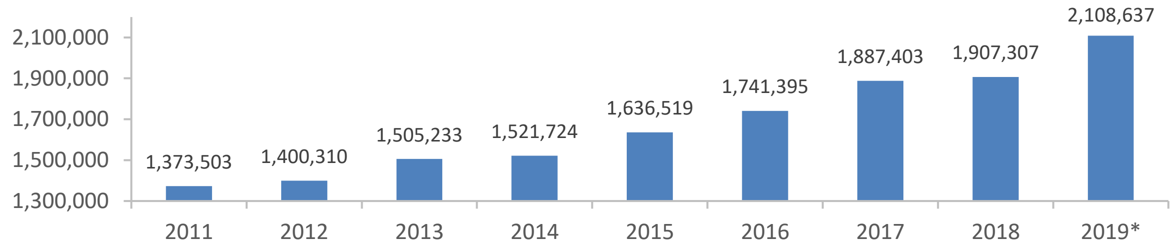
Table 10-2: Financial Inclusion Figures for the Kingdom of Bahrain

	2013	2014	2015	2016	2017	2018	2019*
Number of Banks**	27	27	27	27	26	29	29
Number of Branches	163	167	171	172	171	173	204
Number of Branches per 100,000 in population	*13*	*12.7*	*12.5*	*12.1*	*11.4*	*11.5*	*13.7*
Number of ATMs	471	452	458	*461*	*453*	*479*	515
Number of ATMs per 100,000 in population	*37.6*	*34.4*	*33.4*	*32.4*	*30.2*	*31.9*	*34.7*
Number of Accounts ***	1,505,233	1,521,724	1,636,519	1,741,395	1,887,403	1,907,307	2,108,637
Number of Accounts per 1,000 in population	*1,201*	*1,158*	*1,194*	*1,223*	*1,257*	*1,269*	*1,421*
Number of Internet/PC linked accounts	352,982	471,535	468,746	544,111	534,033	477,894	616,960
ATM Cards (thousands)	1,199.7	1,229.6	1,352.6	1,407.7	1,481.8	1,384.6	1,644.1
Debit Cards (thousands)	1,002.2	1,010.0	1,097.2	1,111.2	1,128.5	1,171.7	1,210.3
Credit Cards (thousands)	202.3	222	253.3	290.3	329.7	322.9	306.6
Population	1,253,191	1,314,562	1,370,322	1,423,726	1,501,116	1,503,091	1,483,756

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

From 2013 to 2019, figures show that access to finance measured by the number of Branches and ATM machines per 100,000 people within the Kingdom is large (table 10-2). In terms of bank branches per 100,000 people, Bahrain stands at 13.7 for 2019. As for the number of ATM machines per 100,000, Bahrain records 34.7 ATMs per 100,000 in population for 2019. The number of bank accounts within retail banks increased over the last 6 years from 1,505,233 in 2013 to 2,108,637 in 2019 demonstrating an increase of 40.1% (The 2019 increase in the number of retail bank accounts was 10.6%).

Chart 10-1: Number of Bank Accounts



**Preliminary data*
Source: CBB.

10.3 Point of Sale and Digital Wallets

10.3.1 POS Transactions

POS machines accept different financial instruments, primarily debit and credit cards. POS terminals are an essential part of financial inclusion. The increase in POS terminals and their utilities, combined with mobile POS and new age payment mechanisms helps in achieving higher financial inclusion. As of Q4 2019, there were 40,262 POS terminals in Bahrain with a 15.0% increase in terminals (5,252) than the number of terminals as of end 2018 (table 10-3).

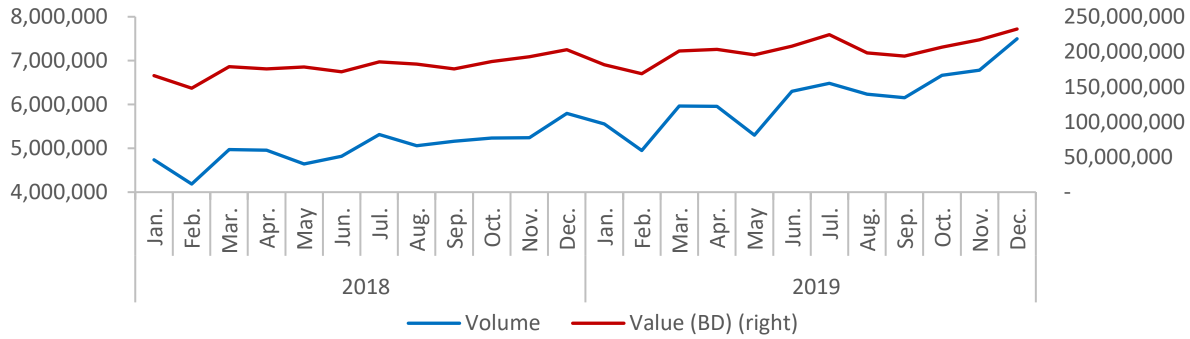
POS transactions in Bahrain have shown an increase in both in volume and value. The total number of transactions for 2019 increased by 14.3% from 64.5 million transaction to 73.7 million transactions. The total value of transactions increased also by 23.1% from BD 1,977.2 million to 2,434.4 million. As of Q4 2019, the total number of transactions performed using POS machines in Bahrain was 20.9 million which is a 11.0% increase from Q3 2019 and a 29.4% Y-o-Y increase from Q4 2018. As for the total value of transactions, the total value of transactions performed using POS machines in Bahrain in Q4 2019 was BD 656.7 million which is 6.4% increase from Q3 2019 and a 13.7 Y-o-Y increase from Q4 2018.

Table 10-3: Point of Sale (POS) Transactions in Bahrain

		Volume of transactions			Value of transactions (BD)			No. of POS terminals
		Cards issued in Bahrain	Cards issued outside Bahrain	Total	Cards issued in Bahrain	Cards issued outside Bahrain	Total	
2018		49,048,695	15,425,030	64,473,725	1,524,054,553	453,159,703	1,977,214,256	35,010
2019		58,433,552	15,246,093	73,679,645	1,877,177,353	557,218,330	2,434,395,682	40,262
2018	Q1	11,186,551	2,745,008	13,931,559	372,647,643	113,457,337	486,104,980	30,693
	Q2	12,617,936	6,188,449	18,806,385	292,813,040	83,433,455	376,246,495	33,716
	Q3	12,284,552	3,264,135	15,548,687	411,937,304	125,461,871	537,399,175	33,716
	Q4	12,959,656	3,227,438	16,187,094	446,656,567	130,807,040	577,463,606	35,010
2019	Q1	12,796,302	3,510,080	16,306,382	422,230,368	131,552,841	553,783,209	36,574
	Q2	14,033,347	3,522,845	17,556,192	473,318,809	133,581,456	606,900,264	39,808
	Q3	14,686,997	4,185,241	18,872,238	472,353,247	144,655,936	617,009,183	40,506
	Q4	16,916,906	4,027,927	20,944,833	509,274,929	147,428,096	656,703,025	40,262

Source: CBB.

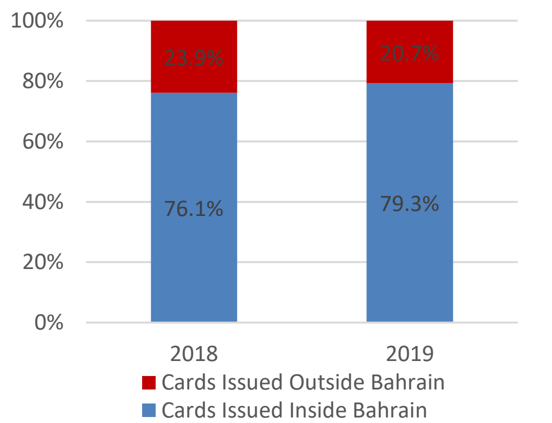
Chart 10-2: Monthly POS Transactions (Volume and Value)



Source: CBB.

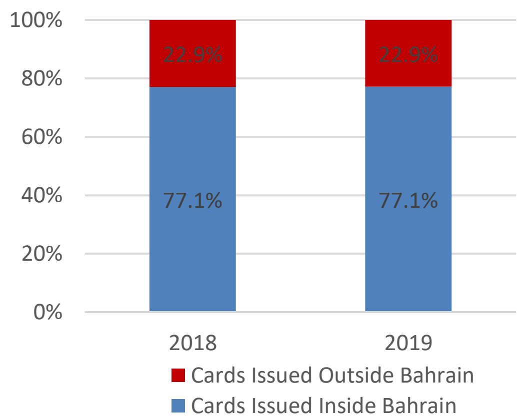
Chart 10-2 shows the monthly of POS transactions in terms of volume and value which can help identify any cyclicality in behaviour over the long run. The overall trend in increase in POS transactions shows that people prefer making direct payments to merchants through POS terminals instead of ATM/Cash withdrawals. As of 2019, 79.3% of the volume of transactions and 77.1% of the value of transactions came from cards issued inside Bahrain compared to 76.1% and 77.1% in2018 respectively (Chart 10-3 and Chart 10-4).

Chart 10-3: Volume of POS Transactions (Cards issued Inside vs. Outside Bahrain)



Source: CBB.

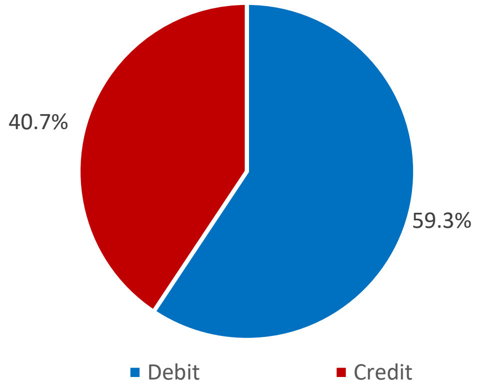
Chart 10-4: Value of POS Transactions (Cards issued Inside vs. Outside Bahrain)



Source: CBB.

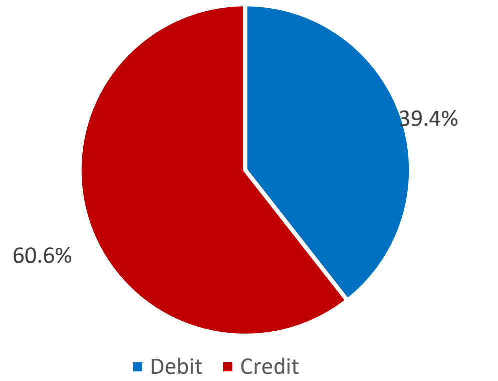
For the Second half of 2019, 59.3% the volume of transactions was from debit cards while 60.6% of the value of transactions came from credit cards (Chart 10-5 and Chart 10-6).

Chart 10-5: Volume of Transactions- H2 2019 (% of Debit Cards vs. Credit Cards)



Source: CBB.

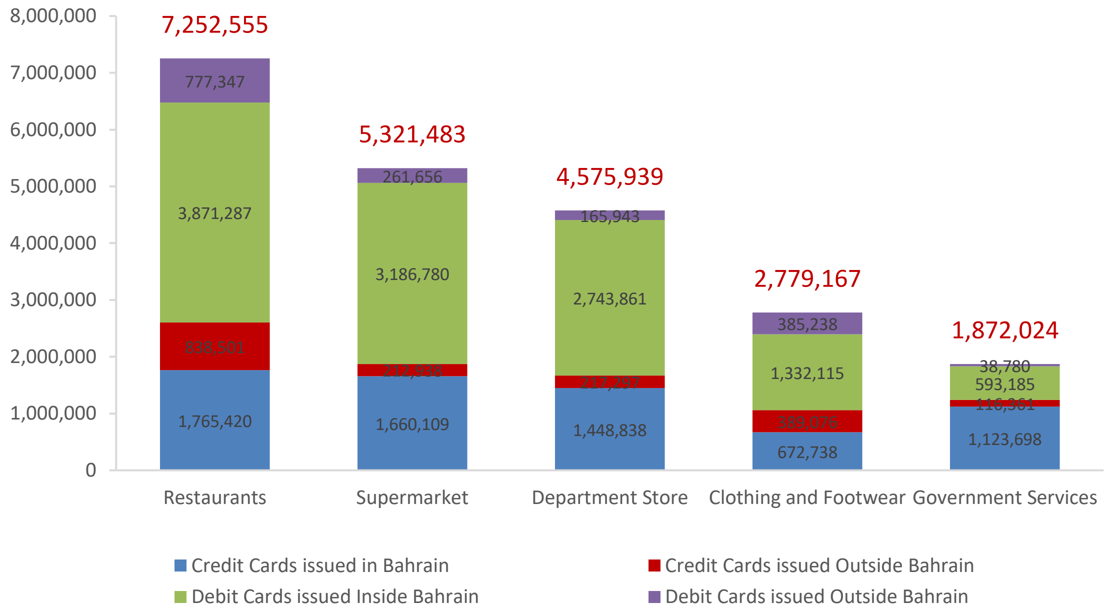
Chart 10-6: Value of Transactions- H2 2019 (% of Debit Cards vs. Credit Cards)



Source: CBB.

Charts 10-7 and Chart 10-8 show the top 5 sectors in terms of volume and value of transactions for the second half of 2019. In terms of volume the top 5 sectors were Restaurants (7,252,555 transactions), Supermarkets (5,321,483 transactions), Department Stores (4,575,939 transactions), Clothing and Footwear (2,779,167 transactions), and Government Services (1,872,024 transactions). The majority of transactions for the Restaurants, Supermarket, Department Store, and Clothing and Footwear sectors were done using debit cards issued inside Bahrain making 53.4%, 59.9%, 60.0%, and 47.3% of transactions respectively. As for Government Services 60.0% of the transactions were made by credit cards issued inside Bahrain.

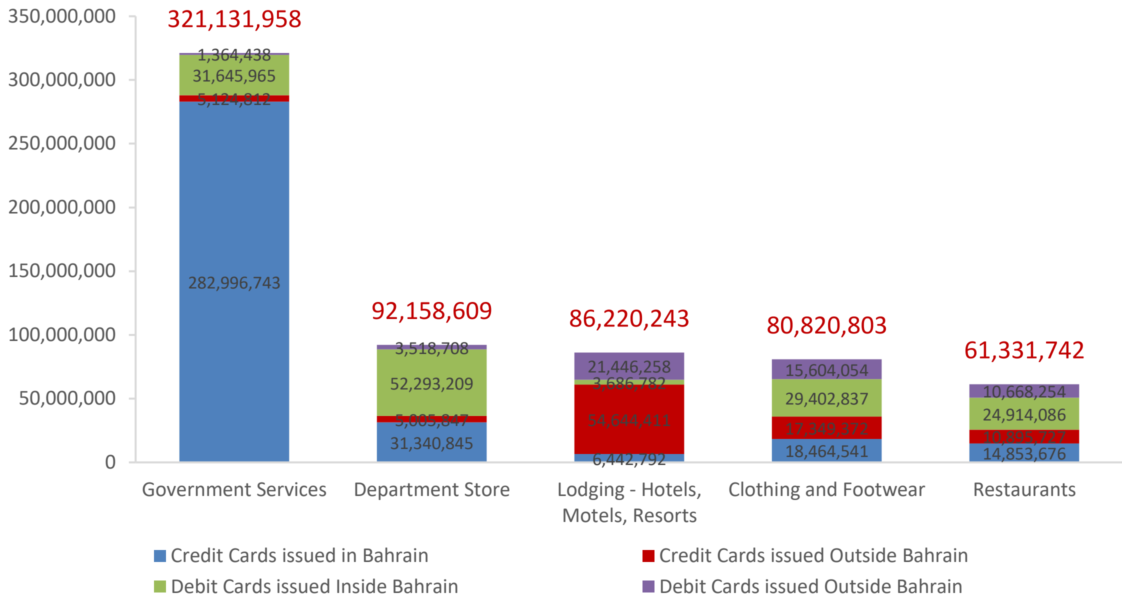
Chart 10-7: Top 5 Sectors by Volume of Transactions- H2 2019



Source: CBB.

In terms of value, the top 5 sectors were Government Services (BD 321.1 million), Department Stores (BD 92.2 million), Hotels, and Resorts (BD 86.2 million), Clothing and Footwear (BD 80.8 million), and Restaurants (BD 61.3 million). For Government Services, 88.1% of the value of transactions were made by credit cards issued inside Bahrain. As for Department Stores, Clothing and Footwear, and Restaurants, 56.7%, 36.4%, and 40.6% of the value of transactions respectively were made by debit cards issued inside Bahrain. As for Hotels and Resorts, 63.3% of the value of transactions were made by credit cards issued from outside Bahrain followed by 24.9% by debit cards issued from outside Bahrain.

Chart 10-8: Top 5 Sectors by Value of Transactions (BD)- H2 2019



Source: CBB.

10.3.2 Digital Wallets

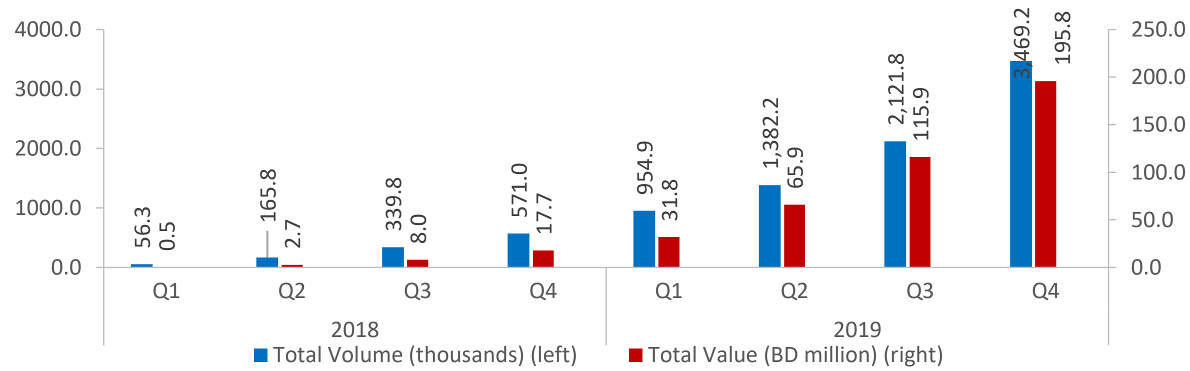
To capture the success of digital wallets in Bahrain, the volume and value of transactions through these digital solutions s provided in Table 10-4. The volume and value of transactions through e-Wallets was gradually increasing over the past year. The total volume increased from 570,970 transactions Q4 2019 to 3.5 million transactions in Q4 2019 (507.6% increase), as well as an increase in the value from BD 8.0 million to BD 195.8 million (1004.6% increase) over the same period.

Table 10-4: Volume and Value of Transactions through e-Wallet and Mobile Payments

Period		Volume	Value (BD)
2018		1,132,813	28,879,008.7
2019		7,928,056	409,412,558.9
2018	Q1	56,277	460,546.5
	Q2	165,789	2,739,701.3
	Q3	339,777	7,954,752.0
	Q4	570,970	17,724,008.9
2019	Q1	954,856	31,825,858.7
	Q2	1,382,244	65,891,371.6
	Q3	2,121,785	115,907,755.0
	Q4	3,469,171	195,787,573.7

Source: CBB.

Chart 10-9: Volume and Value of Transactions through e-Wallets and Mobile Payments



Source: CBB.

Chapter 11 Cyber Security

Key Highlights

- Cyber risk is a threat to financial stability with increasing attacks on financial institution and central banks.
- Cyber-attacks against ICT systems have financial stability implications.
- The FSD issued a survey in October 2019 to systematically important Retail Banks in Bahrain to evaluate the industry's best practices in response and recovery functions related to cyber incidents.
- The survey's scope covered: Cause, Impact and Mitigation of Cyber Incidents.
- Banking Supervision issued a second consultation which was finalized in January 2020 which covered enhancements to Section OM-6.6 of the CBB Rulebook, Volumes 1 and 2.
- The Inspection Directorate created a cyber security framework to assess the robustness of cyber controls at various licensees, including Fintech companies. Pilot and actual assessments were done in 2019 for over 20 Licensees.

11.1 Overview

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 cyber risk as a recurrent chapter in its Financial Stability Report. The aim of the chapter is to Highlight the different initiatives of the Central Bank and actively spread awareness about Cyber Risk by warning the financial industry of the large operational, financial and security risks involved with cyber security.

Chapter 11 covers CBB's developments/initiatives in cybersecurity prior to the COVID-19 pandemic.

11.2 The Central Bank of Bahrain's role in Planning for and Addressing Cyber Risks

- The Central Bank of Bahrain has more than one role in addressing Cyber Risk. Cyber Incidents are required to be reported to the Central Bank of Bahrain's Banking Supervision immediately upon such occurrence. The related rules are also being revised to seek details of remedial measures and action plans for addressing the weaknesses that led to the incident.
- The CBB's Banking Supervision receives vulnerability and penetration testing reports from financial institutions on a regular basis.

- The Inspection Directorate conducts both on-site and off-site inspections on financial institutions information technology and cyber security infrastructure, recently multiple financial institutions have been inspected. Additionally, the Inspection Directorate covers the whole cybersecurity domains that ranges from physical security, security operation, risk assessment, governance, threat intelligence, user education, and framework and standards
- The Financial Stability Directorate issued a Cyber Risk Survey which covers cyber risk relative to governance and leadership, identification, protection, detection and response and recovery. This survey focuses on analysing cyber risk at a macro level. These joint efforts aid in creating proper tools and guidelines for tackling cyber risk from a regulatory perspective

11.3 CBB Cyber Security Survey

11.3.1 Survey Scope & Objectives

As part of the CBB's continuous effort to track and assess the resilience of Bahrain's Financial Sector to cyber threats, the Central Bank of Bahrain participated in a survey issued by the Financial Stability Board in October 2019 which covers Cyber Incidence Response and Recovery by National Authorities. It has been seen observed that some entities/authorities do not differentiate between these two functions and for this purpose, the FSB specifically defines response and recovery functions as per the following:

- The **Respond function** involves the development and implementation of the appropriate activities to act regarding a detected Cyber Event.
- The **Recover function** involves the development and implementation of the appropriate activities to maintain plans for Cyber Resilience and to restore any capabilities or services that were impaired due to a Cyber Incident.

To support this initiative, the CBB's Economic Research Unit created a survey that was sent to systematically important Retail Banks in Bahrain to understand the best practices used in Response and Recovery functions used to identify the following:

1- Cause
2- Impact
3- Mitigation

11.3.2 Key Survey Findings

The survey results drew upon some major findings which included the following:

1- Effective practices observed for analysing the cause of Cyber Incidents as part of their response and recovery activities:	
Response activities	1- Retail Banks have procedures to ensure that that information security and cybersecurity incidents and weaknesses are reported, tracked, investigated and resolved in an effective and efficient manner. For the purpose of analysing an incident, the following is considered: • Evidence related to information security and cybersecurity incidents is maintained.

	• The Response and Recover team is responsible for analysing the incident, collecting evidence and providing an incident resolution. 2- The Response and Recover team also conduct post-incidents analysis on a monthly basis for all recorded incidents to improve the existing process and its related procedures and identify mitigation steps that should be to take to minimize the impact of incident.
Recovery activities	Depending on the incident itself, analysing an incident will involve the network and infrastructure components along with application logs and strings, 3rd parties might be involved in this analysis as well. There are different techniques used. The main technique involves a process of elimination (i.e. all components in the affected data flow are examined and those that are clearly not the cause are eliminated). This elimination is done to reduce the number of factors until the root cause is reached. The data used is primarily the systems logs and simulation in the test environment.

2- Effective practices observed for assessing the impact of Cyber Incidents as part of their response and recovery activities.	
Response activities	For assessing the impact, banks conduct a Business Impact Analysis that helps in identifying the impacts due to disruptions that are likely to affect the FI and identifies the time criticality of the processes. Below is the usual observed approach; • Identification of critical processes and activities. • Analysis of critical processes to identify (RTO, RPO) • Identifying resources required to perform required activities. All threats and scenarios used in the BIA are identified from the Risk Assessment to assess the potential business impact to the Financial institution processes.
Recovery activities	Assessing the incident impact is based on the bank's cyber security incident policy which includes an assessment matrix based on the Reputational, operational and technical impact. The impact is assessed from many perspectives. It is done based on the time it took to recover, the loss in working time, monetary loss, legal impact, compliance effect and customer impact among some other factors. The qualitative assessment is usually used and in some limited cases the quantitative analysis is used when the financial impact is known.

3- Effective practices observed for mitigating and containing the effects and expansion of a Cyber Incident (including criteria or metrics used) in their Cyber Incident response and recovery activities.	
Response activities	• Financial Institutions take appropriate mitigation steps in accordance with their policy and procedures in order to resolve the incident before closure of the incident. • Financial Institutions review all cyber security incidents and their root causes on monthly basis to detect any unanalyzed information security incident and to identify measures to mitigate the recurrence of information security incidents. • Activities conducted to assess an event for a disaster such as; Nature of the event, location of the event, and expected time for resuming normalcy.
Recovery activities	Depending on the incidents and the forensic analysis banks' management evaluate the impact and determine the actions required to mitigate and initiate recovery procedures. Mitigation also depends on the result of the root cause analysis. This is done by addressing the vulnerability that was exploited. Further, some banks have a cyber security insurance to cover the damages caused by such incidents. For the containment, the isolation method is used. This means that the affected area will get disconnected from the rest of the network and then the issue will be resolved.

11.4 CBB Cyber Security Initiatives and Regulatory Developments

The CBB issued its consultations in March 2019 for the Operational Risk Management Module in Volumes 1 and 2, which propose new requirements on cyber security measures for both conventional and Islamic banks. The consultation included a section on Cyber Security Risk Management which focuses on licensees preparing for the eventuality of cyber-attacks by having a cyber-attack response mechanism in place as part of the overall cyber risk strategy.

The licensee's business continuity plan must also be properly enhanced to account for all CBB requirements and must be regularly tested to ensure that the licensee is capable of dealing with cyber-attacks that will trigger the business continuity plans. A licensee should take into account and document the relevant cyber security risks. In all matters concerning business continuity management, the licensee should also address cyber incident scenarios that could potentially affect its business activity, suppliers and service providers, the availability of supporting infrastructures. The adequate management of cyber security risks requires the augmentation of the licensee's existing IT risk management framework.

The CBB has further revised the chapters on cyber security measures of the Operational Risk Management Module in Volumes 1 and 2 to comprehensively manage the bank's cyber security risk and vulnerabilities in accordance with further guidance released by Financial Stability Board and has issued it as second consultation in December 2019. The industry feedback has been received and it is currently under review. The proposed cyber security risk management framework covers the following aspects:

- Role of the Board
- Role of Senior Management
- Cyber Security Strategy
- Cyber Security Risk Policy
- Approach, Tools, and Methodology
- Cyber Risk Identification and Assessments
- Prevention Controls
- Vulnerability Management
- Cyber Incident Detection and Management
- Recovery and Response
- Cyber Security Insurance
- Training and Awareness
- Reporting to the CBB
- Cybersecurity Control Guidelines

Inspection Directorate Initiatives:

In the interest of fulfilling its supervisory mandate, the Inspection Directorate created a cyber security framework to assess the robustness of cyber controls at various licensees, including Fintech companies. Pilot and actual assessments were done in 2019 for over 20 Licensees.

This framework is built around NIST standards which measure the maturity level of cyber security at organizations by assessing their ability to prevent, detect, and respond to cyber-attacks. The outcomes of the conducted assessments assist the licensees in identifying any vulnerabilities they have in their systems and networks and also help them in stepping up their controls and risk mitigants to counteract cyber threats effectively and stave off any risks to their financial stability.

The NIST Cyber-Security Framework consists of five functions; namely Identify, Protect, Detect, Respond, and Recover. Such functions represent the key pillars of an effective and holistic cybersecurity program. The framework provides a common taxonomy and mechanism for the Inspection Directorate to:

1. Assess the current cybersecurity posture of licensees;
2. Assess their target state for cybersecurity;
3. Assess gaps and implementation progress toward the target state;
4. Communicate identified weaknesses about cybersecurity risk to the licensees.

The assessment is complemented with a rating process capturing the probability of risk events and their impact on the organization, in a financial, legal, reputational, and operational context. The rating would help in guiding the Licensees on the amount of risk mitigation they need to have through insurance cover, and in parallel, would assist the CBB in having targeted inspections.

In keeping track of IT developments, the said framework was further enhanced to tackle cloud security governance risk, where the following aspects are reviewed onsite:

- Governance of Cloud Computing Services
- Enterprise Risk Management
- Information Risk Management

- Third-party Management
- Legal and Electronic Discovery
- Legal Compliance
- Right to Audit
- Auditability
- Compliance Scope
- Certifications
- Service Transition Planning

TRMST and ITD Initiatives:

During the year 2019, the TRMST reviewed the proposed inspection manual and provided relevant feedback to the Inspection Directorate wherever applicable. The ITD also continuously enhances cyber security in keeping with industry best practices and considering the ever-changing business needs and technology evolution to ensure that information assets of the CBB are adequately protected. The initiatives focus on deployment of suitable technical solutions where required and upgrading the technical skills of the CBB IT staff.

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)

Indicator	Dec-18	Jun-19	Dec-19
Capital Adequacy			
CAR (%) *	18.9	19.0	19.2
Tier 1 CAR (%) *	17.6	17.7	17.9
Leverage (Assets/Capital) (Times) *	7.2	7.6	7.8
Asset Quality			
NPLs (% of Total Loans)	5.5	5.2	4.8
Specific Provisions (% of NPLs)	61.2	64.7	62.0
Loan Concentration (Share of Top Two Sectors) (%)	29.3	30.5	31.1
Real Estate/ Construction Exposure (%) **	25.8	25.3	25.5
Earnings			
ROA (%)	1.0	0.6	1.1
ROE (%) ***	6.7	3.9	7.9
Net Interest Income (% of Total Income) ****	67.3	58.4	70.9
Net Fees & Commissions (% of Total Income) ****	16.1	21.5	14.5
Operating Expenses (% of Total Income)	63.7	54.6	54.8
Liquidity			
Liquid Assets (% of Total Assets)	24.1	25.1	25.5
Loan-Deposit Ratio (%)	72.1	70.8	71.5

** 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)

Indicator	Dec-18	Jun-19	Dec-19
Capital Adequacy			
CAR (%) *	20.9	19.8	21.1
Tier 1 CAR (%) *	19.4	18.5	19.7
Leverage (assets/capital) (Times) *	6.4	7.0	6.7
Non-Performing Loans Net Provisions to Capital (%) *	5.8	6.3	4.4
Asset Quality			
NPLs (% of Total Loans)	5.5	5.5	4.9
Specific Provisions (% of NPLs)	63.8	66.0	66.1
Net NPL' (% of Net Loans)	2.1	2.0	1.7
Loan Concentration (Share of Top Two Sectors) (%)	33.1	33.8	33.3
Real Estate/ Construction Exposure (%) **	30.7	31.7	32.4
Earnings			
ROA (%)	1.5	0.9	1.8
ROA Local Banks (%)	2.1	1.1	2.0
ROA Overseas Banks (%)	0.4	0.5	1.3
ROE (%) ***	14.3	8.0	14.2
Net Interest Income (% of Total Income)	77.2	77.5	77.3
Net Fees & Commissions (% of Total Income)	11.7	10.4	11.3
Operating Expenses (% of Total Income)	51.6	42.9	39.4
Liquidity			
Liquid Assets (% of Total Assets)	32.9	35.9	36.0
Liquid Assets (% of Short-Term Liabilities)	41.3	44.9	45.6
Loan-Deposit Ratio (%)	69.6	67.9	65.8
Non-Bank Deposits (% of Total Deposits)	80.3	73.7	75.3

** 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 (Locally-Incorporated Banks only).*
Source: CBB.

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

(End of period)

Indicator	Dec-18	Jun-19	Dec-19
Capital Adequacy			
CAR (%) *	18.1	19.4	18.6
Tier 1 CAR (%) *	17.3	18.5	17.7
Leverage (assets/capital) (Times) *	7.4	7.4	7.9
NPLs Net Provisions to Capital (%) *	6.2	4.3	5.0
Asset Quality			
NPLs (% of Total Loans)	5.7	5.3	4.5
Specific Provisions (% of NPLs)	67.9	74.3	74.3
Net NPL' (% of Net Loans)	1.9	1.4	1.4
Loan Concentration (Share of Top Two Sectors) (%)	39.0	38.7	39.8
Real Estate/ Construction Exposure (%) **	23.2	21.9	21.8
Earnings			
ROA (%)	0.7	0.6	0.9
ROA Local Banks (%)	0.1	0.5	0.6
ROA Overseas Banks (%)	1.3	0.6	1.2
ROE (%) ***	0.8	4.1	4.8
Net Interest Income (% of Total Income)	56.2	42.0	63.2
Net Fees & Commissions (% of Total Income)	22.5	34.7	18.1
Operating Expenses (% of Total Income)	68.0	54.6	54.7
Liquidity			
Liquid Assets (% of Total Assets)	23.0	20.9	21.3
Liquid Assets (% of Short-Term Liabilities)	29.0	26.2	26.3
Loan-Deposit Ratio (%)	64.2	63.4	68.5
Non-Bank Deposits (% of Total Deposits)	49.1	43.7	48.5

** 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 (Locally-Incorporated Banks only).*
Source: CBB.

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

(End of period)

Indicator	Dec-18	Jun-19	Dec-19
Capital Adequacy			
CAR (%)	17.8	17.3	18.3
Tier 1 CAR (%)	14.9	14.5	15.7
Leverage (Assets/Capital) (Times)	9.6	10.0	9.9
NPFs Net Provisions to Capital (%)	33.9	36.1	38.8
Asset Quality			
NPFs (% of Total Facilities)	9.5	9.5	10.4
Specific Provisions (% of NPFs)	39.4	38.0	36.7
Net NPFs (% of Net Facilities)	6.1	6.2	6.9
Facilities Concentration (Share of Top Two Sectors) (%)	31.9	32.4	30.6
Real Estate/ Construction Exposure (%) *	28.0	26.8	28.4
Earnings			
ROA (%)	0.6	0.3	0.4
ROE (%) **	6.7	3.9	4.7
Net Income from Own Funds, Current Accounts and Other Banking Activities (% of Operating Income)	59.7	53.5	54.2
Net income from Jointly Financed Accounts and Mudarib Fees (% of Operating Income)	39.2	45.0	44.6
Operating Expenses (% of Total Income)	78.5	73.3	82.0
Liquidity			
Liquid Assets (% of Total Assets)	14.1	17.7	17.5
Facility-Deposit Ratio (%)	94.8	95.9	92.5
Current Accounts from Non-Banks (% of Non-Capital Liabilities, excl. URIA)	23.4	25.7	23.3

** 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 5:
Selected Financial Soundness Indicators—Islamic Wholesale Banks

(End of period)

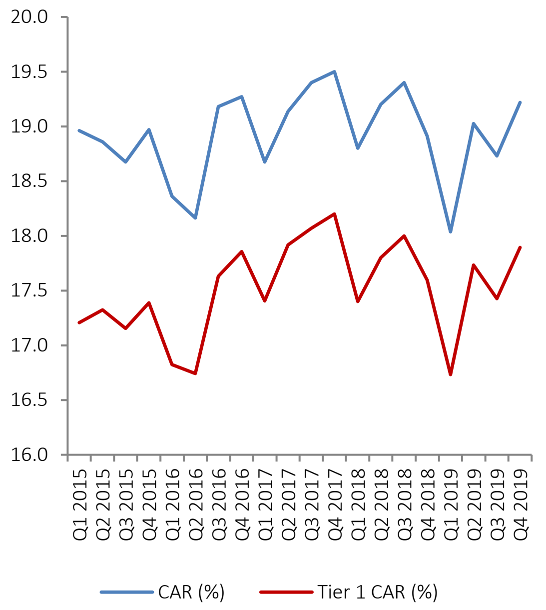
Indicator	Dec-18	Jun-19	Dec-19
Capital Adequacy			
CAR (%)	17.9	18.0	17.4
Tier 1 CAR (%)	16.9	16.9	16.3
Leverage (Assets/Capital) (Times)	7.0	7.7	8.6
NPFs Net Provisions to Capital (%)	1.0	0.4	0.3
Asset Quality			
NPFs (% of Total Facilities)	1.3	1.1	1.1
Specific Provisions (% of NPFs)	79.6	91.7	93.8
Net NPFs (% of Net Facilities)	0.3	0.1	0.1
Facilities Concentration (Share of Top Two Sectors) (%)	43.7	46.6	46.6
Real Estate/ Construction Exposure (%) **	19.7	18.3	18.3
Earnings			
ROA (%)	0.9	0.4	0.7
ROE (%) ***	6.9	2.9	6.3
Net income from own funds, current accounts and other banking activities (% of operating income)	58.2	51.2	55.5
Net income from jointly financed accounts and Mudarib fees (% of operating income)	40.6	45.4	42.0
Operating expenses (% of total income)	71.7	71.2	72.7
Liquidity			
Liquid Assets (% of Total Assets)	12.6	17.2	17.7
Facility-Deposit Ratio (%)	75.1	73.0	69.9
Current Accounts from Non-Banks (% of Non-Capital Liabilities, excl. URIA)	40.4	40.3	41.0

** 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.

Annex 2: Selected Graphs

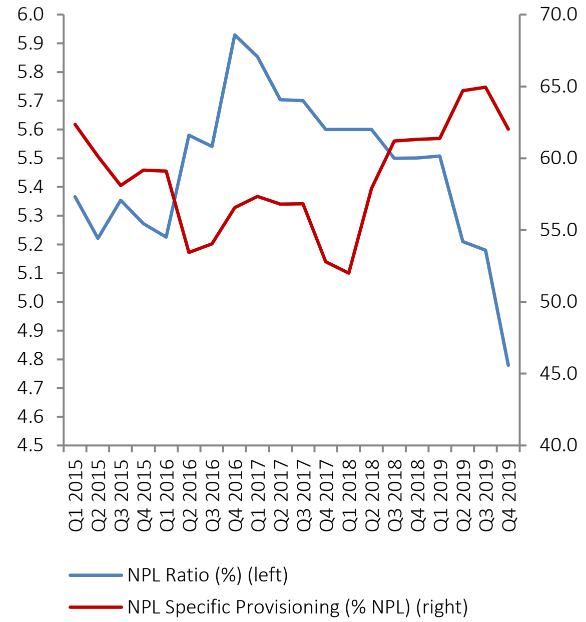
A. Overall Banking Sector

Annex 2 Graph 1: CAR (%)



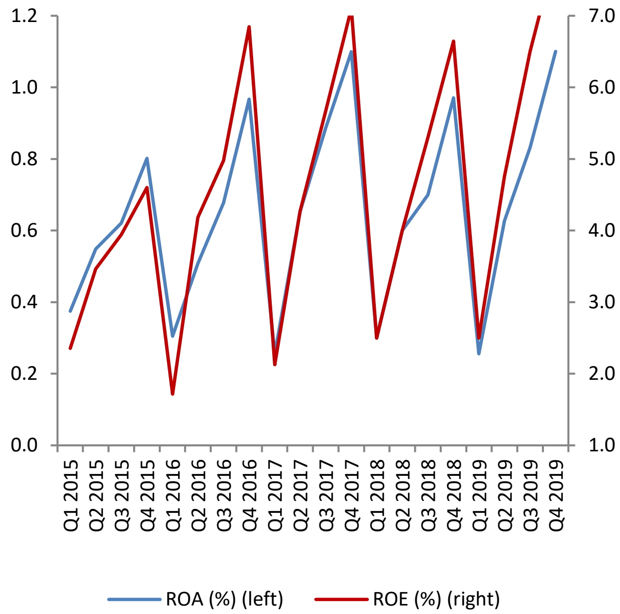
Source: CBB.

Annex 2 Graph 2: NPLs and Provisioning (%)



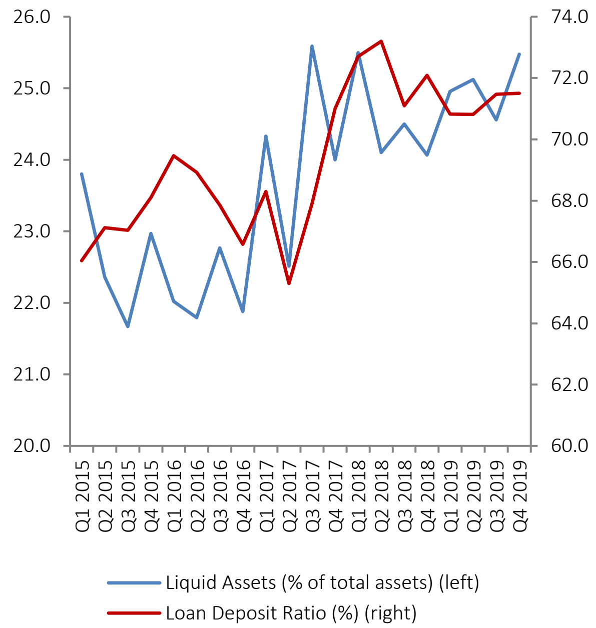
Source: CBB.

Annex 2 Graph 3: Profitability (%)



Source: CBB.

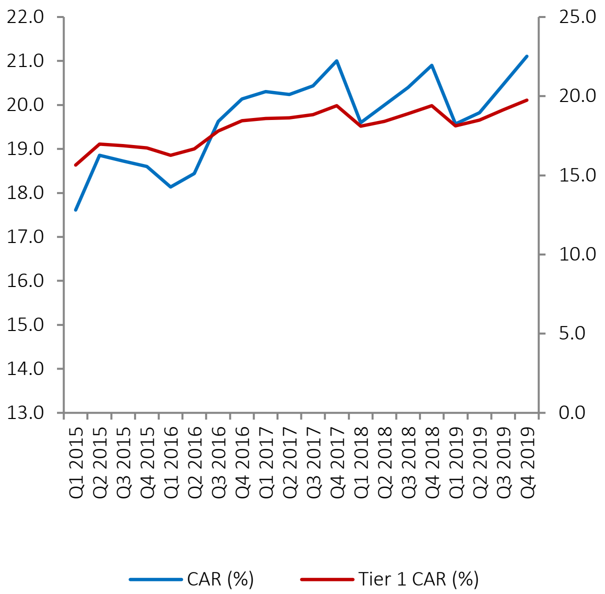
Annex 2 Graph 4: Liquidity (%)



Source: CBB.

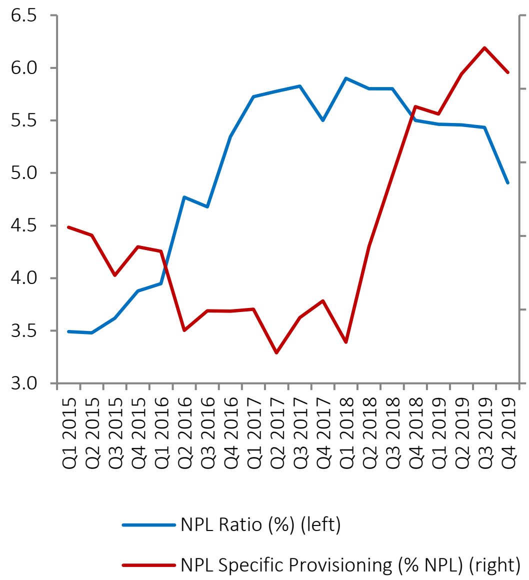
B. Conventional Retail

Annex 2 Graph 5: CR Banks' CAR (%)



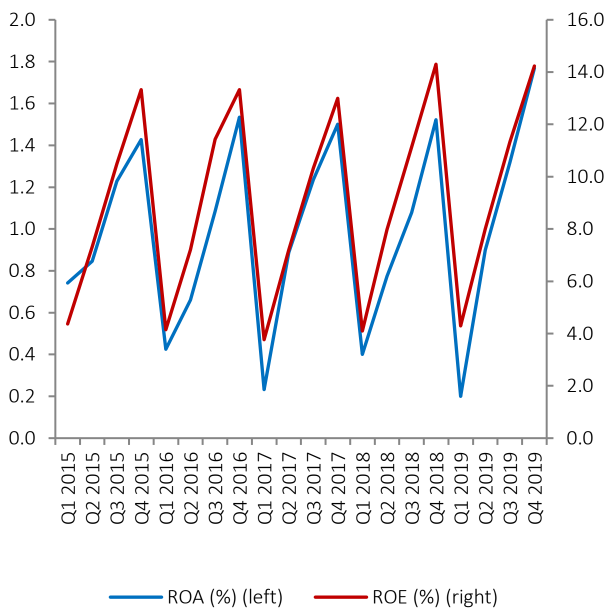
Source: CBB.

Annex 2 Graph 6: CR Banks' NPLs and Provisioning (%)



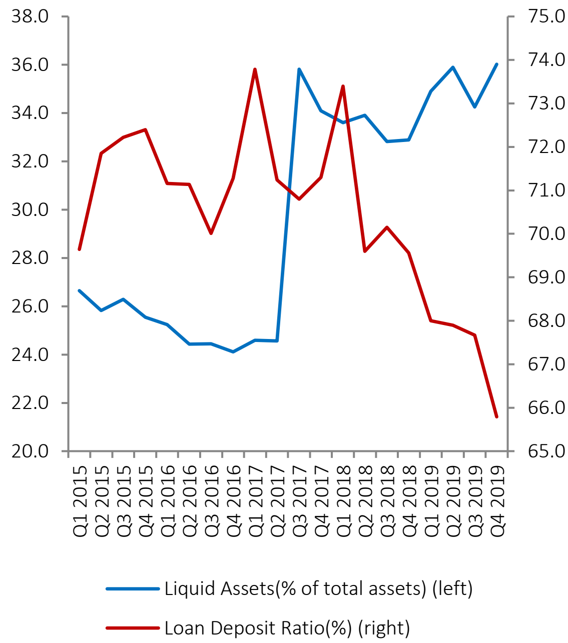
Source: CBB.

Annex 2 Graph 7: CR Banks' Profitability (%)



Source: CBB.

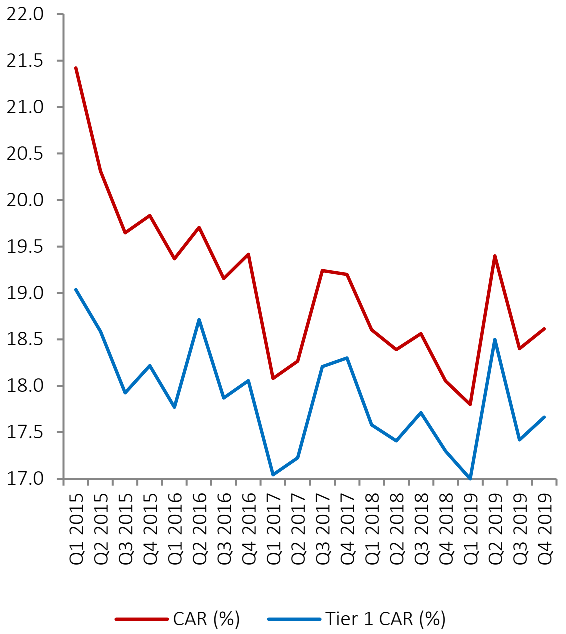
Annex 2 Graph 8: CR Bank's Liquidity (%)



Source: CBB.

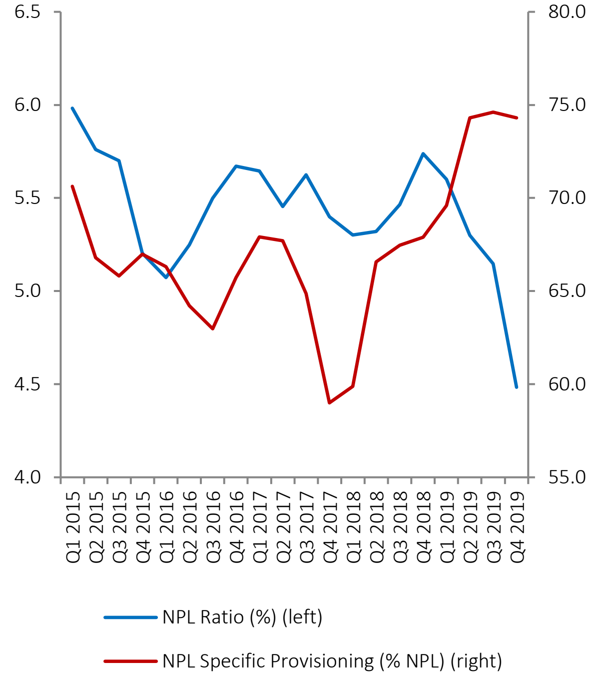
C. Conventional Wholesale

Annex 2 Graph 9: CW Banks' CAR (%)



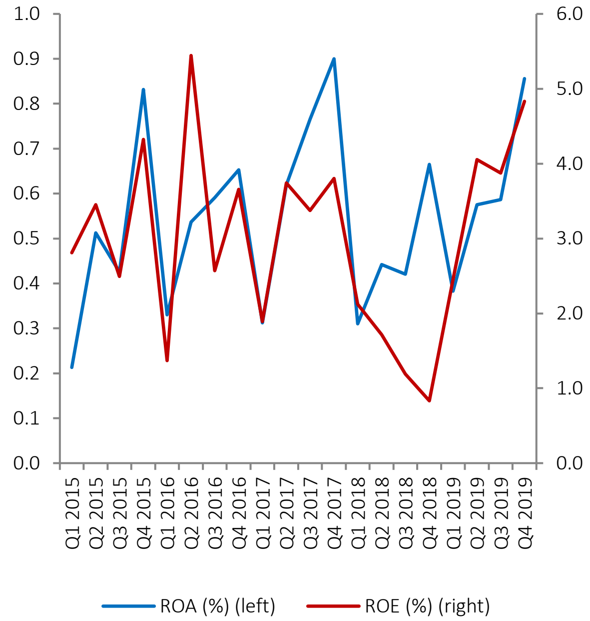
Source: CBB.

Annex 2 Graph 10: CW Banks' NPLs and Provisioning (%)



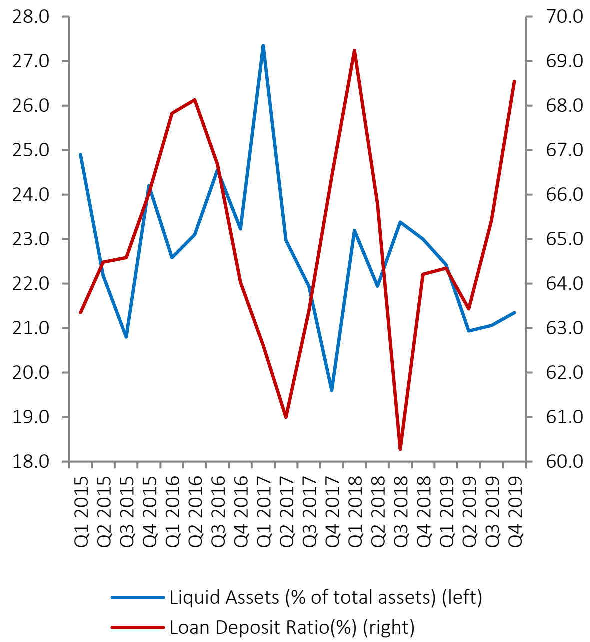
Source: CBB.

Annex 2 Graph 11: CW Banks' Profitability (%)



Source: CBB.

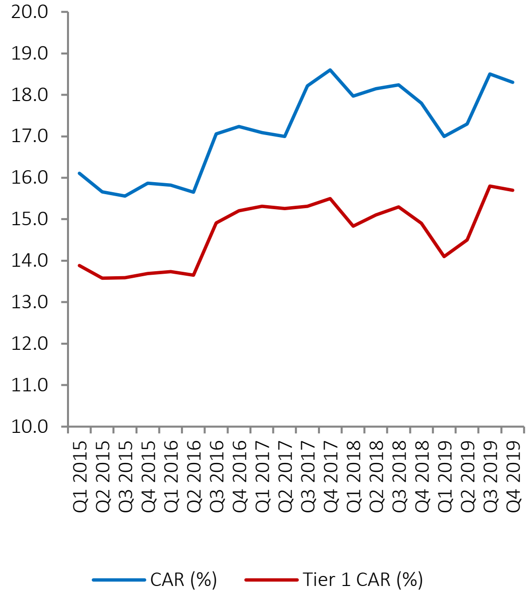
Annex 2 Graph 12: CW Banks' Liquidity (%)



Source: CBB.

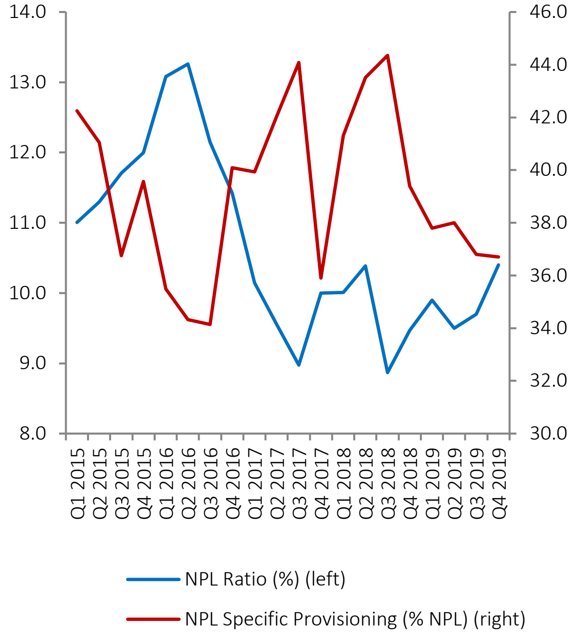
D. Islamic Retail

Annex 2 Graph 13: IR Bank's CAR (%)



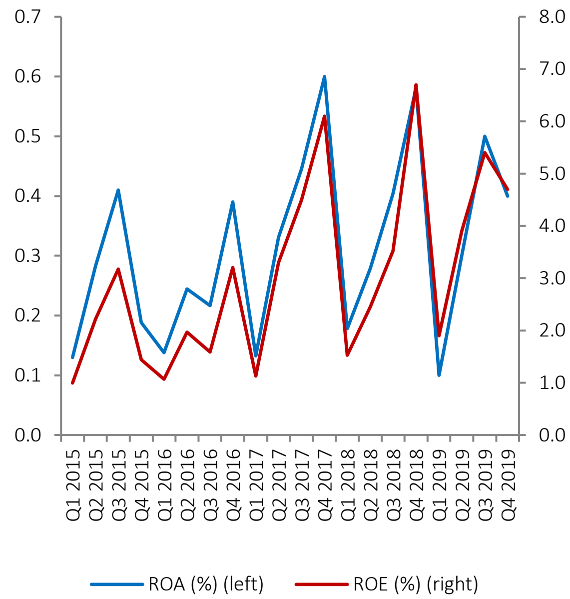
Source: CBB.

Annex 2 Graph 14: IR Banks' NPFs and Provisioning (%)



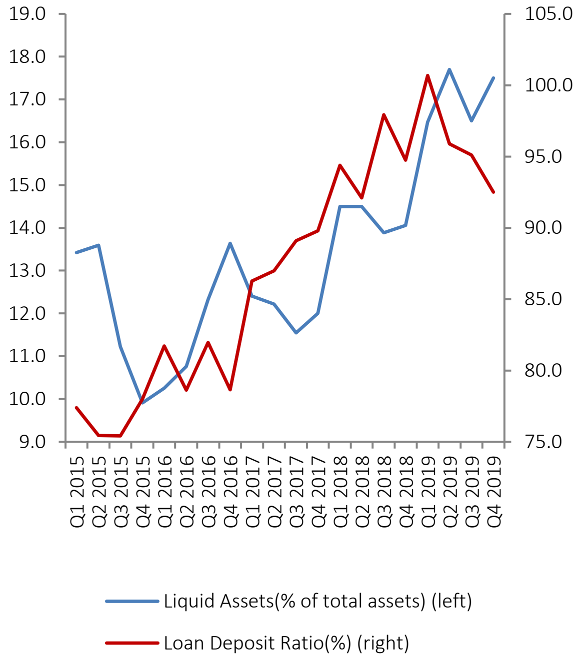
Source: CBB.

Annex 2 Graph 15: IR Bank's Profitability (%)



Source: CBB.

Annex 2 Graph 16: IR Banks' Liquidity (%)



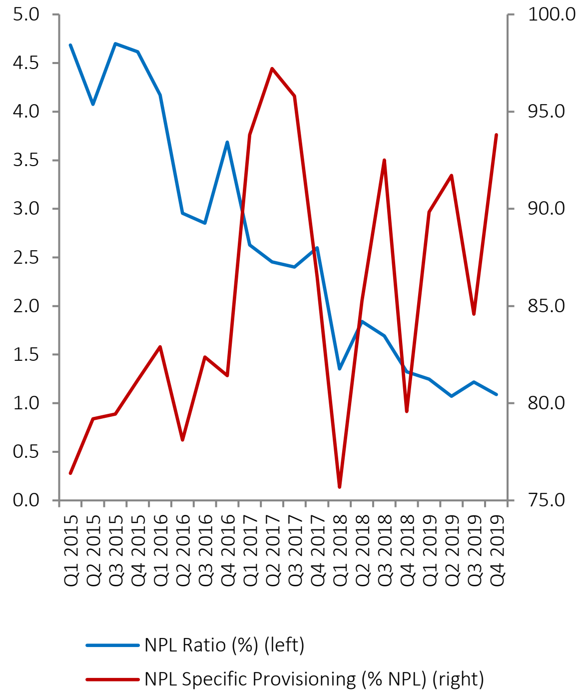
Source: CBB.

E. Islamic Wholesale

Annex 2 Graph 17: IW Banks' CAR (%)

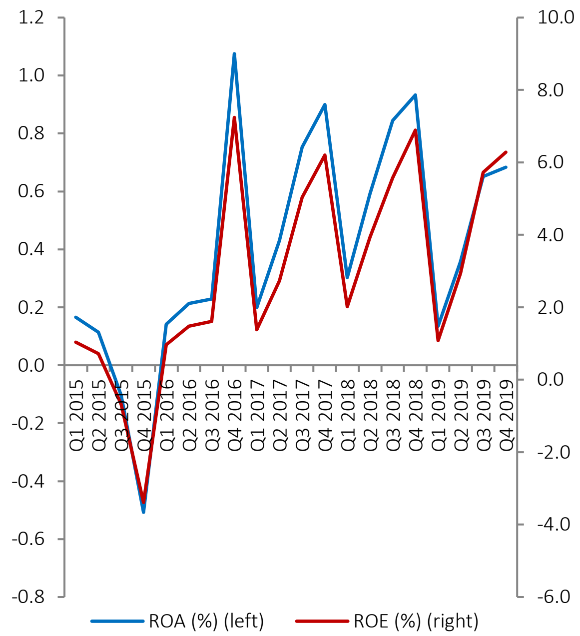
Source: CBB.

Annex 2 Graph 18: IW Banks' NPFs and Provisioning (%)



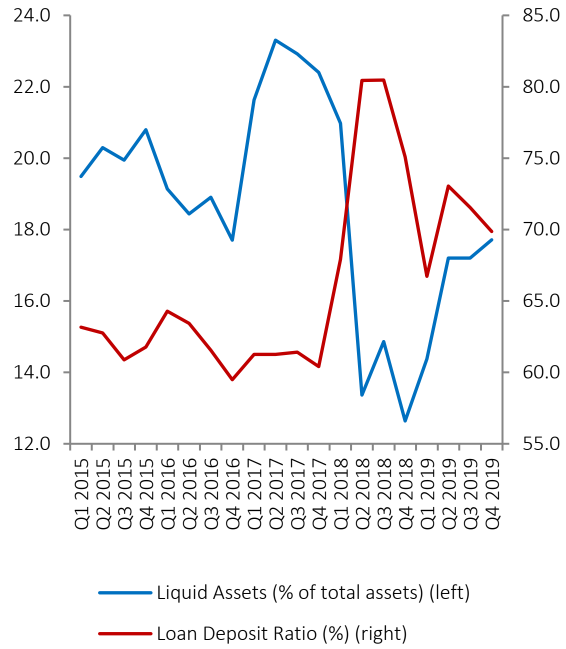
Source: CBB.

Annex 2 Graph 19: IW Banks' Profitability (%)



Source: CBB.

Annex 2 Graph 20: IW Banks' Liquidity (%)



Source: CBB.

List of Abbreviations

Acronym	Description
ATM	ATM Clearing System
BCTS	Bahrain Cheque Truncation System
BENEFIT	The Benefit Company
BFB	Bahrain Fintech Bay
BSE	Bahrain Stock Exchange
CAR	Capital Adequacy Ratio
CBB	Central Bank of Bahrain
CMSD	Capital Markets Supervision Directorate
CRB	Conventional Retail
CW	Conventional Wholesale
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
IR	Islamic Retail
IW	Islamic Wholesale
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