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Production: Financial Stability Directorate
Central Bank of Bahrain
P.O. Box 27, Manama, Kingdom of Bahrain
Tel: (+973) 1754 7777 | Fax: (+973) 1753 0399
www.cbb.gov.bh

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

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, though 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:
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  - 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- Update

It has been over six months since the World Health Organization (WHO) declared COVID-19 as a pandemic. The pandemic brought substantial human suffering and major economic disruption around the world. With COVID-19 case numbers continuing to climb dramatically in some countries, policy makers are realizing the crisis will last longer than expected and re-assessing the impact of the pandemic on individuals, societies, and economies. 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 with the economic impact lasting even after the pandemic is over.

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 (IMF) 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.

In this rapidly changing environment, it is extremely difficult to quantify the exact magnitude of the impact on GDP growth, but sharp contractions in the level of output, household spending, corporate investment and international trade were projected. 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. Containment and protective measures such as quarantines, travel bans, border closures, curfews and social distancing remain despite some easing of restrictions in some countries due to fears of a spike in the number of cases.

Authorities have continued to pro-actively intervene to calm markets by making necessary policies to mitigate the impact, which come with difficult economic and financial trade-offs while making sure that health care systems are adequately resourced. These policies varied as the pandemic is not playing out in the same way from one country to another. As the situation continues, more action will be required, which may require father coordination at the national and international levels. Monitoring, containing and mitigating the effects of the corona virus should remain the top priorities to provide stability to the global economy and financial markets, boost confidence, and prevent deep and prolonged economic effects.

Six months into the pandemic, the focus has shifted into re-evaluating and maintaining effective policy measures in the short run based on timely information in a rapidly evolving environment. With uncertainty remaining about the evolution of the COVID-19 pandemic, jurisdictions are trying to assess to the global impact of the pandemic on the real economic activity and the financial system, and the constraints to economic activity/ recovery. Jurisdictions must keep monitoring efforts during the COVID-19 crisis focusing on the challenges and risks that the current environment presents such as operations, the use of technology, capital adequacy, asset quality, and liquidity.

Policy measures are bound to evolve further. Adjustments to policy measures may reflect a desire to enhance the effectiveness of existing measures in light of experiences gained with responses. More policies adjustment is based on the underlying conditions, including deteriorating credit quality and changing assessments of real economy funding needs and the path of recovery. Such adjustments will have to take into account that the recovery path depends on the impact of policy actions taken. Many central banks have provided loan deferral schemes at the beginning of the pandemic, enabling customers to defer interest or principal payments for a period of time, with the deferral period reassessed. At a later stage, jurisdictions must address when to exit from temporary financial policy measures.

With regards to regulatory and supervisory authorities, the aim must remain to preserve financial stability and the soundness of the financial systems while sustaining economic activity. Supportive Extraordinary monetary and fiscal actions are needed to restore confidence and aid the recovery of any disruptions to boost economies:

1. Central banks must continue to support demand and confidence by preventing a tightening of financial conditions, lowering borrowing costs for households and firms, and ensuring market liquidity.
2. 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.
3. 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.
4. 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.
5. 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, the CBB issued a number of directives to preserve the health and safety of citizens, residents, and workers in the financial sector. A number of key policy responses (including fiscal, monetary, and macro-financial) 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 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 the 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 to preserve the health and safety of citizens and residents, the CBB Bahrain urged 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.
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.
20th September 2020	• The CBB announced that banks will defer loan payments to their customers until the end of the current year in a manner that does not affect the banks' liquidity and financial solvency, provided that interest rates and fees prescribed by banks on these loans are calculated during the deferral period. • The CBB's announcement followed directives by the Cabinet in its weekly session to help offset the negative impact of Covid-19, without affecting banks' liquidity and financial solvency to contribute in providing liquidity in supporting citizens and various economic sectors to alleviate the economic effects of the pandemic.
22nd September 2020	• The CBB has clarified that no fees, except insurance, can be charged by lenders on the four-month loan deferral for Bahrainis and local companies. • No fees must be charged to customers for providing loan deferment option, except for additional insurance fees resulting from extension of the loan tenor. No late payment fees must be charged on credit cards' outstanding balance due for payment this month.

Source: 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.
29th June 2020	• Bahrain's Minister of Finance and National Economy announced the extension of stimulus measures to support private sector jobs and citizens. In line with Royal Directives, the Government has decided to take additional stimulus measures following consultation with the Legislative Authority and the Bahrain Chamber of Commerce & Industry. • Over a three-month period starting from July 2020, the Government will support 50% of salaries for insured citizens employed in the private sector working for companies most affected by the coronavirus (COVID-19), under a scheme administrated by the Ministry of Labour and in cooperation with relevant entities. • For the same three-month period the Government will meet citizens' domestic electricity costs for primary residences, up to the full cost of the same period the preceding year. Economic sectors most adversely affected by the repercussions of COVID-19 will be further supported by the Labour Fund (Tamkeen) according to the controls and conditions approved by its Board of Directors.

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	Measures to Mitigate the Impact of Coronavirus

	Payment International Enterprises Sadad Electronic Payment System The Benefit Company	
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
16th March 2020 EDBS/KH/C/28/2020	All Banks All Financing Companies All Micro-Finance Institutions All Ancillary Services All Representative Offices	Disinfection Instructions
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/32/2020	All Retail Banks All Financing Companies All Microfinance Companies	Re: Implementation Guidelines Regarding the 6th Months Deferral
24th March 2020 EDFIS/C/030/2020	All Insurance Licensees	Sub: Services Continuity Measures
26th 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	Agreed Upon Procedures for Financial Crime (FC) Module

	Ancillary Services Providers- Third Party Administrators	
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/011/2020	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
26th April 2020 EDBS/C/41/2020	All Bank Licensees All Financing Companies All Microfinance Companies	Financial Impact Assessment of the Six Months Instalment Deferral
27th May 2020 EDFIS/C/052/2020	All Licensees	Money Laundering & Terrorist Financing Risks & Practices during COVID-19
21st June 2020 OG/226/2020	All Bahraini Bank Licensees All Financing Companies All Microfinance Institutions	Regulatory Concessionary Measures
1st July 2020 OG/249/2020	All Branches of Foreign Banks	Regulatory Concessionary Measures
14th July 2020 OG/259/2020	All Listed companies All Licensees	Reporting of Financial Impact of COVID-19
24th August 2020 EDBS/KH/C/54/2020	All Banks Al Financing Companies ALL Microfinance Companies	Exemptions from Submission of Agreed Upon Procedures on PIR/PIRI/PIRFM (Volumes 1, 2, and 5)
OG/296/2020 26th August 2020	All Banks Al Financing Companies ALL Microfinance Companies All Payment Services Providers All Cards Processing Services Providers	Status Update on COVID-19 Policy Measures
21st September 2020 OG/318/2020	All Retail Banks Financing Companies Micro-Finance Companies	Further Deferment of Loan Instalments
22st September 2020 OG/321/2020	All Retail Banks Financing Companies Micro-Finance Companies	Further Deferment of Loan Instalments

Source: CBB.

Be-Aware Campaign and App

Bahrain set up a National Taskforce for Combating the Coronavirus to handle the spread of the virus and to take measures to guarantee that proper testing and safety measures are taken. With one of the highest testing rates per capita the aim is to be prepared to initiate further actions to avoid the spreading of the virus. The Information & eGovernment Authority (iGA), in collaboration with the National Taskforce for Combating the Coronavirus (COVID-19), launched the "BeAware Bahrain" application. The goal of the be-aware campaign an and app is to assists efforts to contain the spread of COVID-19 virus.

The BeAware Bahrain provides the following features:

1. **Contact Tracing:** Alerts users to get tested once they have been in contact with a positive case.
2. **Coronavirus (COVID-19) Test Results:** View Coronavirus lab test results once released by the test center.
3. **COVID-19 Test Appointment:** This service enables individuals directed by Ministry of Health to book Coronavirus (COVID-19) tests appointments three days prior to self-isolation end date.
4. **PCR (COVID-19) Test Certificate:** It enables travelers from the Kingdom of Bahrain to view and print their (Polymerase Chain Reaction) PCR test certificate that is valid for one month from the last COVID-19 test.
5. **Payment for Arrivals Test:** This service enables the individuals entering Bahrain to pay for their Coronavirus (COVID-19) test.
6. **Declaration for Exiting Bahrain:** This service enables Bahraini citizens to declare their responsibility for traveling abroad before leaving the country.
7. **Announcements:** Provides updates from the National Taskforce for Combatting the Coronavirus (COVID-19).
8. **Decision Lists:** Provides a list of all released decisions regarding the Coronavirus from Kingdom of Bahrain officials.
9. **General Guidelines:** Provides protective instructions about the Coronavirus such as methods to prevent virus spread, self-isolation instructions, and disinfection methods.
10. **Official Statistics:** Provides a summary of cases including total tests conducted, active cases, stable cases, critical cases, discharged cases, and deaths.
11. **Global Statistics:** provides statistics from the World Health Organization (WHO) on confirmed cases, recoveries and deaths in total and for selected countries.
12. **National Coronavirus Hotline:** Allows users to call the National Coronavirus Hotline 444 directly from the App to get advice or clarifications from dedicated agents.

Executive Summary

Global Macro Financial Environment Overview

In its recent World Economic Outlook, the International Monetary Fund (IMF) forecasted -4.9% growth in 2020 compared to the 2.9% growth realized last 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 0.3% in Q1/2020 from 2.3% in Q4/2019. The economic performance in Europe decelerated slightly during the first half of the year due to increased geopolitical risk and uncertainty following the Brexit, which amplified volatility. The Euro Area (19 countries) and the European Union's (EU) (27 countries) growth has also experienced a slowdown as it moved from of 2.3% and 1.1% in Q4/2019 to -3.2% and -14.4% in Q2/2020 respectively. Within the Brexit, the UK's GDP growth decreased from 1.1% in Q4/2019 to -1.7% in Q1/2020. BRIICS countries' growth was also decelerating as it reached the level of 0.43% in Q1/2020 from 3.21% in Q4/2019.

Financial Sector Overview

The size of the assets of the banking sector in Bahrain was USD 210.7 billion as of June 2020 (6.1 times of GDP). Retail banking total assets continued growing to reach BD 35.8 billion (USD 95.2 billion) in June 2020 with GCC assets at 24.8% and Western Europe and American assets at 8.9%. The wholesale banking sector showed a decrease to USD 115.5 in June 2020, with concentrations in the GCC (31.6%) and Western Europe (30.5%). The Islamic banking sector assets (which represent 15.4% of the total banking sector assets) increased to USD 32.5 billion in June 2020 with concentrations in Bahrain (74.8%) and GCC (7.5%).

The total amount of credit given to the private sector (business and personal) by retail banks witnessed stagnation since June 2019 moving from BD 9,434.7 million to BD 9,852.8 million in June 2020. Total deposits increased to BD 17,444.9 million in June 2020, where 77.7% of them were domestic deposits. Money supply continued to grow. M2 stood at BD 12,893.3million in end-June 2020 and M3 was at BD 14,179.2 million in end-June 2020. Personal loans as a percentage of GDP increased to 30.8% by June 2020 (BD 4,466.4milllon) and business loans were at BD 5,386.9 million in December 2019 and 37.1% of GDP.

Banking Sector

The capital adequacy ratio (CAR) for the banking sector stood at 18.5% in June 2020. The NPL ratio decreased to 4.5% in June 2020.

Return-on-assets (ROA) decreased to 0.4% from June 2019 to June 2020, return-on-equity (ROE) decreased to 1.5% from 4.8% over the same period. Between December 2019 and June 2020, the overall loan-deposit ratio decreased from 71.5% to 69.5% and liquid assets as a proportion of total assets also decreased from 25.5% to 24.6%, over the same period.

Conventional Banks

The CAR for conventional retail decreased from 21.1% in December 2019 to 18.8% in June 2020. The NPL ratio decreased to 4.6% in June 2020 from 4.9% in December 2019 while specific provisions increased to 66.2%. NPLs for local retail banks and overseas retail banks decreased to 3.8% and 6.6% in respectively in June 2020.

as at end-June 2020, ROA decreased to 0.6%. ROE for locally incorporated banks decreased to 6.0 from 8.0 during the same period. The overall loan-deposit ratio for the segment increased to 66.4% in June 2020 from 65.8% in December 2019. Liquid assets as a proportion of total assets decreased from 36.0% in December 2019 to 32.8% in June 2020.

As for wholesale banks the CAR for locally-incorporated wholesale banks decreased to 17.9% in June 2020. The NPL ratio increased slightly to 4.7% in June 2020. The NPL ratio of locally-incorporated wholesale banks increased to from 5.1% in December 2019 to 6.3% in June 2020 while decreasing for overseas banks from 4.0% to 3.5% over the same period. Specific provisions as a proportion of NPLs also witnessed an increase to 72.3% in June 2020.

ROA for the conventional wholesale banking sector decreased to 0.4% in June 2020 and ROE for local wholesale banks decreased to -2.3%. The overall loan-deposit ratio stood at 67.1%. Liquid assets for wholesale banks as a proportion of total assets increased to 22.2% in June 2020.

Islamic Banks

The CAR of Islamic retail banks increased from 18.3% in December 2019 to 20.6% in June 2020. Non-performing facilities (NPF) ratio decreased to 7.5% in June 2020 while specific provisioning increased to 40.7%.

ROA for Islamic retail banks decreased from 0.3% to 0.2% in June 2020 and ROE also decreased from 3.9% to 2.1% for the same period. Liquid assets available to Islamic retail banks slightly decreased from 17.5% of total assets in December 2019 to 17.3% in June 2020. The ratio of total facilities to deposits decreased from 92.5% in December 2019 to 79.1% in June 2020.

The CAR for Islamic wholesale banks increased to 17.6% in June 2020. The NPF ratio for Islamic wholesale banks increased to 1.4%. Provisioning for NPFs decreased from 93.8% to 78.6% over the same period.

ROA decreased from 0.4% in June 2019 to 0.0% in June 2020 and ROE similarly decreased from 3.0% to -0.5% over the same period. As of end-June 2020, liquid assets of Islamic wholesale banks represented 16.5% of total assets. Additionally, the facilities deposit ratio decreased from 69.9% in December 2019 to 65.6% in June 2020.

Insurance Sector

The Insurance sector in Bahrain is made up of two main segments: conventional and takaful. Total gross premiums registered BD 75.6 million as of March 2020. The conventional local firms accounted for the largest segment of total gross premiums (51.0%), followed by Takaful (33.4%) and conventional overseas branches (15.6%).

As of March 2020, total assets of conventional insurance firms were BD 2,295.3 million, a YoY decrease of 4.2%. Takaful firms' assets experienced an annual growth by 5.3% reaching BD 207.8 million.

Viewing the concertation of the overall insurance industry, motor records the highest concentration in Gross Premiums (26.5.2%), Net Premiums Written (37.8%), Gross Claims (36.9%), and Net Claims (47.3%). Similarly, for conventional insurance, motor insurance has the highest concentration for Gross Premiums (27.0%), Net Premiums Written (38.5%), Gross Claims (36.6%) and Net Claims (49.0%).

Takaful insurance companies have very high concentration on the medical and motor Insurance business lines. Gross Premiums for both sectors represented (85.3%), Net Premiums Written (78.4%), Gross Claims (88.5%), and Net Claims (96.9%).

Non-Bank Financial Institutions

The two main segments of the non-Bank Financial Institutions sector are investment businesses and money changers. In June 2020, total assets of investment businesses decreased by 7.5% to BD 406 million. This significant decrease is due to a few wholesale banks changing their licenses to Category 1 investment firms. Investment business firms' profit increased by 70.1% reaching BD (180.8) million in Q2 2020. Profits of Category 1 firms decreased by 47.8%.

During 2019, money changers' purchase of foreign currencies amounted to 8,647.4 billion, while the sale of foreign currencies was recorded at 10,045.7 billion for the year. A breakdown of Money Changers turnover indicates that "Asia" currency group recorded the highest YoY percentage increase in sales with 4305%. The largest decline in sales, excluding Other, was the "USD" currency group with 97.3%. As for purchases, the top YoY increase is also "Asia" with 3521%. The largest decline for purchases was also the "European" currencies with 99.9%.

Capital markets

As of 31st June 2020, Bahrain Bourse recorded a total listing of 43 Companies, 9 Mutual funds and 14 Bonds and Sukuk. During the first half of 2020, there were 11 companies that closed higher and 22 closed lower and 11 remained unchanged. Bahrain All Share Index increased by 20% (332.6 points) for the year reaching 1,277.61 points, while the Bahrain Islamic Index reached 596.73 points. As of end of June 2020, market capitalization of the Bahrain Bourse stood at BD 9.22 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 54.6% and by volume represented 44.0% of total shares. The majority of the number of transactions in June 2020 (3645 transactions) was attained by the commercial banks sector representing 41.2% of total transactions. As of June 2020, there was 47 private offerings with a total value of USD 5.53 billion.

Payments and Settlement Systems

The RTGS System provides for Payment and Settlement of Customer transactions as a value addition. The daily average volume of Bank transfers for the first half of 2020 (from 1st January to 31st June 2020) decreased to 153 transfers compared to 165 transfers for the second half of 2019.

The daily average volume of cheques for the first half of 2020 decreased compared to the second half of 2019 from 11,870 cheques to 9,651 cheques. The daily average value of cheques decreased in the first half of 2020 by 12.8% when compared to the second half of 2019 from BD34.5 million to BD30.1 million.

The daily average volume of ATM transactions for the first half of 2020 decreased by 8.7% to 54,022 transactions per day compared to 59,157 transactions per day for the second half of 2019. The daily average value of ATM transactions for the first half of 2020 reached 4.7 million.

As of end of June 2020, Point of Sale (POS) transactions reached 16.7 million in terms of volume and BD 470 million in terms of value with a 20.9% and 28.4% decrease respectively. As of 2019, 95.1% of the volume of transactions and 93.8% of the value of transactions came from cards issued inside Bahrain compared to 80.1% and 75.8% in 2019 respectively.

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 of 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 30 companies as of end of August 2020.

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 recognized risk by all financial institutions. Cyber Incidents are required to be reported to the CBB's Banking Supervision immediately upon such occurrence. The Inspection Directorate conducts both on-site and off-site inspections on financial institutions information technology and cyber security infrastructure.

As part of the CBB's continuous effort to track and assess the resilience of Bahrain's Financial Sector to cyber threats, a Cyber Security Survey for 2020 was issued by the Economic Research Unit to understand financial institutions' first cyber related responses to the COVID-19 Pandemic and actions taken by IT Security Officers.

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	Emerging Market Growth
-3%	-8%	0.9%	-8.9%	-7.9%	-5.6%

- The COVID-19 pandemic has dramatically affected global economic activity since early 2020.
- The global economic conditions deteriorated and the risks to the global outlook have increased during the first half of the year.
- Uncertainty and geopolitical tensions have put downward pressure on financial sector in Europe and Asia leading to significant deceleration in growth.
- Central banks have committed to keep rates low, enabling an unprecedented fiscal stimulus.
- Stock markets indices drop in the first half of the year and Equity markets in Europe have endured a volatile couple of months.

1.1 Overview

Since the last Financial Stability Report (FSR), global economic activity has taken a huge hit from the COVID-19 pandemic. The pandemic has led to an unprecedented global crisis, accompanied by dropping oil prices, plunge in stock market indices, and significant depreciation in exchange rates of many emerging market economies (EMEs).

With the UK exit from the Euro Area, the overall environment showed some uncertainty in the beginning of the first half of 2020. Global economic growth is expected to slow down to a record level across almost all major economies in this current year.

Monetary policy remains accommodative in the US and other advanced economies to support economic growth where central banks have committed to keep rates low along with providing unprecedented fiscal stimulus through fiscal policy as crucial tool during the ongoing crisis.

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.

1.2 Global Macro-financial Environment

The global economic and financial conditions deteriorated considerably, and risks associated to this environment increased in the first half of 2020. The emergence of COVID-19 has added new risks and tension to the global economy and has already led to significant volatility in financial markets. Central banks have committed to keep rates low which will keep bond yields low.

In its recent World Economic Outlook update, the International Monetary Fund (IMF) forecasted a recession with global growth of -4.9% in 2020 (1.9 percentage points below the April 2020 World Economic Outlook) from the 2.9% realized last year and the gradual recovery will be achieved in 2021 where growth rate will reach 5.4%.

1.2.1 Economic Performance

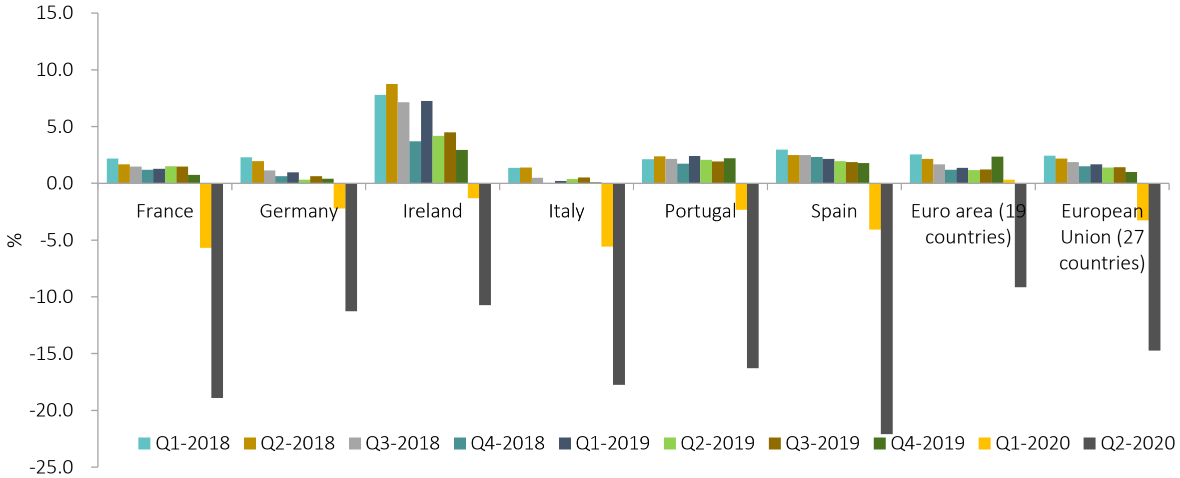
The economic performance in Europe has witnessed a deep and uneven recession during the first half of the year due to the coronavirus (COVID-19) pandemic that has dramatically affected Europe' economic activity. Uncertainty and geopolitical tensions have put additional downward pressure on financial sector in Europe which in turn amplified volatility and raised new concerns in the global financial markets. As chart 1.1 shows, most European countries have witnessed negative growth in the first half of 2020 impacted by lockdowns and business closures in the national economies.

In the first half of the year, the Covid-19 crisis raised significant challenges for Spain and Italy as they were the two countries that were affected the most by the pandemic. In fact, both countries have placed restrictions on travel and public transport, and prolonged closures of many work places. As a result, economic activity decelerated drastically, and unemployment rates surged to an unprecedent levels. Since mid-February Financial market sentiment has deteriorated in both countries as concerns about the global spread of COVID-19 and its economic fallout have grown. In the first quarter of 2020, Spain economy has witnessed a recession by 4.07% and the situation get worsened in the second quarter as the recession hits 22.1%. Similarly, for Italy, contraction in GDP was 5.56% in Q1/2020 and it reached -17.7% in Q2/2020.According to the OECD, there were strict rules around increasing fiscal deficits, and high-debt countries like Italy were at risk of a re-run of the 2012 debt crisis. As for Portugal, growth rate was also negative as it moved from 2.2% in Q4/2019 to -2.3% in Q1/2020 and -16.2% in Q2/2020.

Regarding the two largest economies in the Eurozone, their performances was also hugely affected by the Pandemic crisis. Germany experienced weak economic activities in the first half of 2020 with a recession of 2.2% in Q1/2020 to a deeper one in Q2/2020 where GDP reached -11.2%. France also hit severely by the pandemic crisis and the French economy recorded a recession by 5.6% in Q1/2020 and 18.9% in Q2/2020. Recently, the two neighboring countries have decided to implement urgent policies to cope with the pandemic crisis. They agreed to launch a recovery fund by a €750 billion (6% of GDP) that would be financed by the issuance of bonds jointly guaranteed by all 27 members of the European Union.

Turning to the Euro Area (19 countries) and the European Union (EU) (27 countries) their growth has also experienced a recession as it moved from of 2.3% and 1.1% in Q4/2019 to -3.2% and -14.14% in Q2/2020, respectively.

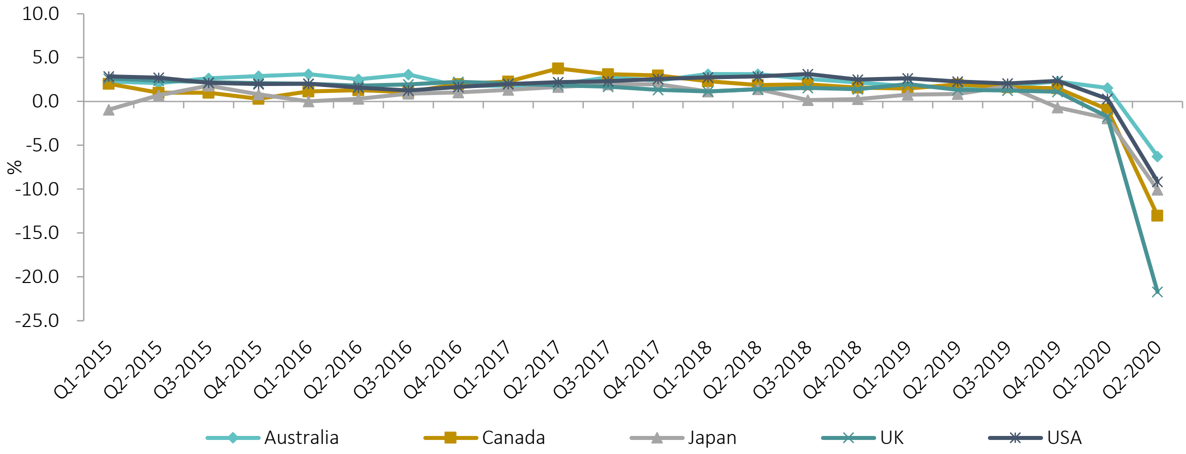
Chart 1.1: Real GDP Growth in Selected Europeans Countries (Quaterly %) Seasonally Adjusted*



**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 0.3% in Q1/2020 from 2.3% in Q4/2019 and a deep recession was recorded in Q2/2020 as growth hits 9.1%. The US economy was also affected by the pandemic crisis along with the never-ending trade tension with China and the increased geopolitical uncertainty. Within the Brexit, the UK's GDP growth decreased from 1.1% in Q4/2019 to a negative growth of 1.7% in Q1/2020 and the situation get worsen in the second quarter as the recession hits 21.7%.

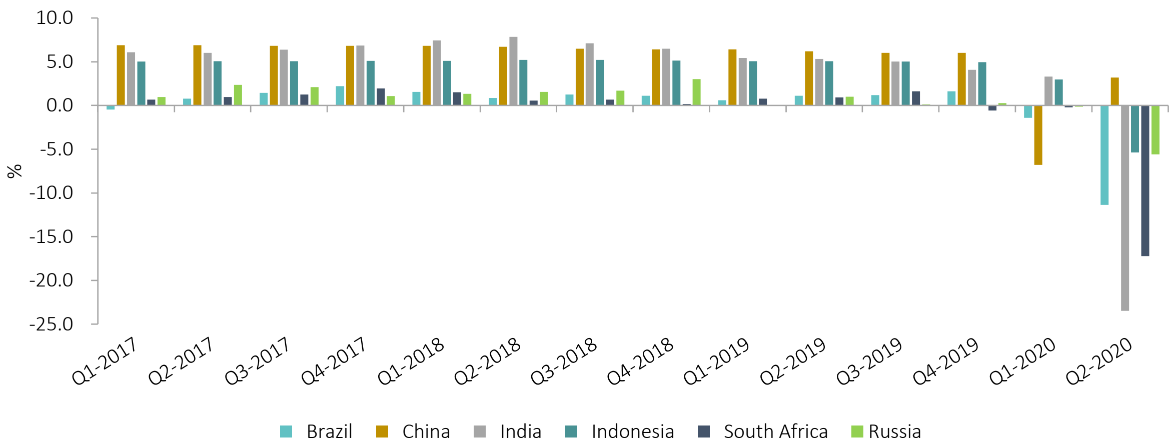
Chart 1.2: Real GDP Growth in Advanced Economies (Quaterly %) *



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

As for emerging economies (Chart 1.3), the BRIICS countries' growth was also decelerating as it reached the level of negative 0.43% in Q1/2020 and negative 10.8% in Q2/2020 from 3.21% in Q4/2019. Recent data shows that only Indonesia and India have witnessed positive economic growth by 3.3% and 3% respectively. However, in the second quarter the situation gets worsen as all BRIICS countries went into recession except China which experienced a positive growth rate by 3.2%. Nevertheless, 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.

Chart 1.3: Quaterly Real GDP Growth in BRIICS (Quaterly %) *

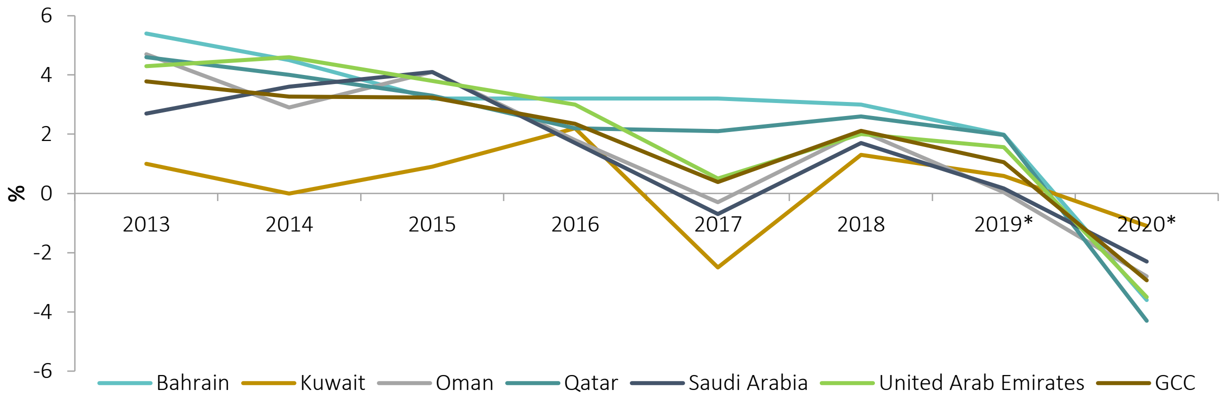


**Growth rate compared to the same quarter of previous year, seasonally adjusted.*
Source: OECD Quarterly National Accounts.

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 ongoing pandemic crisis will certainly put pressure on overall China's economy.

Regionally, since the beginning of 2020, oil prices have been falling, and, in early March, there was a substantial drop in global oil prices (by approximately U.S.$11.00 per barrel), following Saudi Arabia's decision to cut export oil prices, as well as Russia and OPEC failing to reach an agreement over proposed oil production cuts. The drop in oil prices caused volatility in the global financial markets and is expected to have a significant negative effect on GCC public finances. According to the IMF World Economic Outlook, the GCC bloc is expected to achieve a negative growth rate of 2.9% in 2020.

Chart 1.4: Real GDP Growth in GCC Countries (Annual percent change)

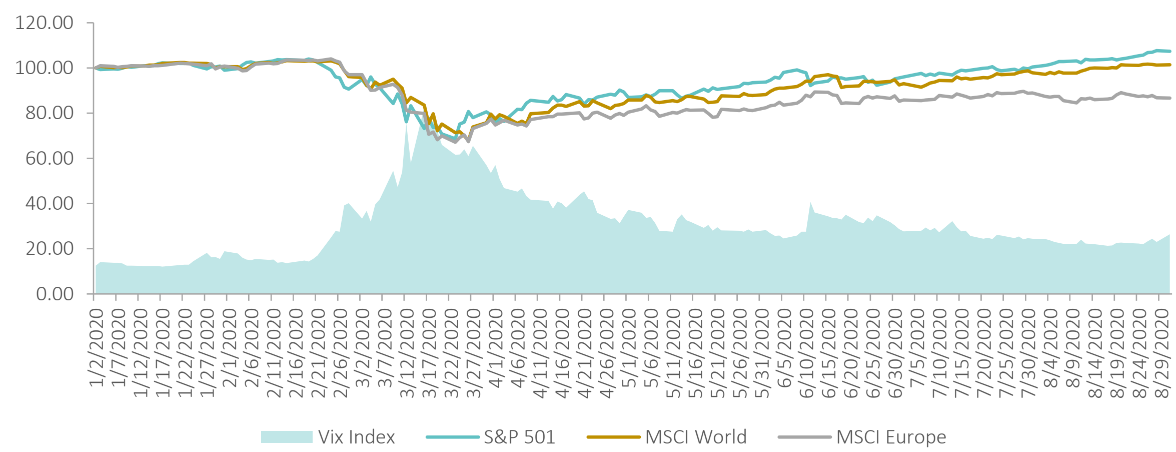


**Forecasts. Source: IMF Regional Economic Outlook, April 2020.*

1.2.2 Financial Markets

Equity prices across a range of advanced economies was stable during the first two months of 2020. In the beginning of March, all indices plumped significantly to new record levels which can be attributed to a dramatic concern of the Covid-19 pandemic. Equity prices in the Euro Area recovered progressively, supported by fiscal stimulus and Central Banks supports. It is worth mentioning that the ECB has increased its asset-purchase program by more than 12% of GDP and rules on fiscal deficits have been temporarily relaxed, resulting in fiscal stimulus of around 3.5% of GDP across the region. Similarly, after a sharp decrease, the S&P 500 has risen by around 10% since April 2020, reaching the pre-pandemic level.

Chart 1.5: Global Equity Market Indices (Re-indexed to January 2020)



Source: Bloomberg.

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

Key Highlights

% of GDP	Licenses	Banking Assets	Retail Assets	Wholesale Assets	Islamic Assets	M2
16.7%	377	USD 210.7 bn	USD 95.2 bn	USD 115.5 bn	USD 32.5 bn	USD 12.8 bn

- The retail banking sector assets increased to USD 95.2 billion and wholesale banking sector assets increased to USD 115.5 billion as of end-June 2020.
- The volume of credit increased to BD 10,181.7 million in June 2020.
- 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 since the last FSR. The financial condition and performance of financial institutions depend to a large extent on the financial condition of their customers (households and enterprises) and their vulnerabilities to changes in the economic environment.

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

2.2 The Financial Sector

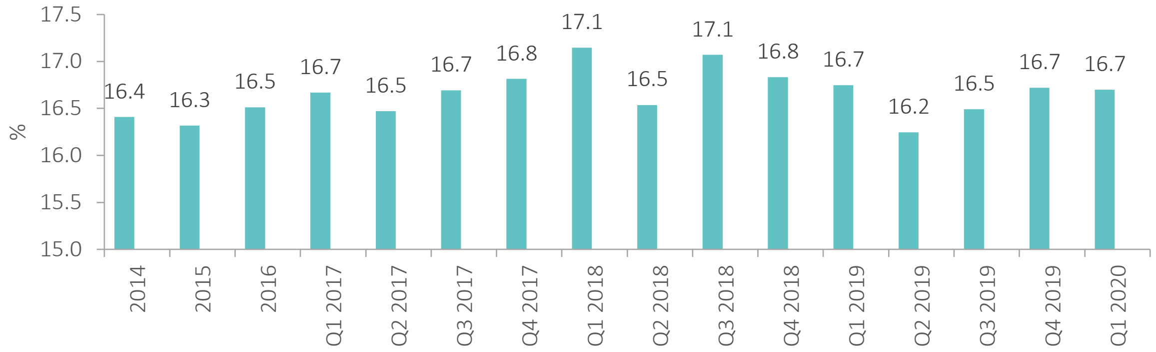
Bahrain's position as a regional financial center has been essential to the development of its economy where the financial sector has come to play a significant role in economic activity and employment creation. The financial sector is currently the largest non-oil contributor to GDP representing 16.6% of real GDP in 2019 showing a slight decrease of 0.3% since 2018. In the first quarter of 2020, the financial sector represented 16.7% of real GDP.

In June 2020, there were 377 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:

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

As of June 2020, there were 275 non-banking financial institutions operating in Bahrain including investment business firms, insurance companies (including Takaful and Re-Takaful firms), representative offices and specialized licenses.

Chart 2.1: Size of the Financial Sector to Real GDP



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

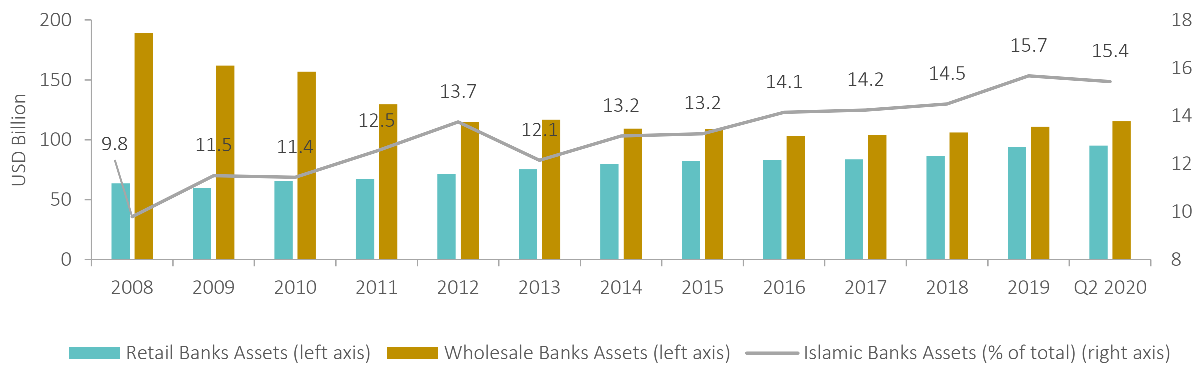
The size of the assets of the banking sector in Bahrain was USD 210.7 billion as of June 2020. Table 2.1 shows the change of the size of the various banking segments to GDP. The retail banking continued to grow over the years (from USD 80.0 billion in 2014 to USD 95.2 billion by Q2 2020) along with the growth in GDP. The size of the wholesale banking sector started declining from USD 109.3 billion in 2014 to USD 104.0 billion in 2017. It started to increase afterwards with an annual increase of 2.0% in 2018, 4.5% in 2019 and 4.2% for the first six months of 2020 to reach USD 115.5 billion. As for the Islamic banking sector, it grew steadily over the same period from USD 24.9 billion in 2014 to USD 32.5 billion in June 2020.

Table 2.1: Evolution of the size of the Banking sector in Bahrain

Indicator	2014	2015	2016	2017	2018	2019	Q2 2020*
Banking Sector (USD billion)	189.3	191.0	186.1	187.4	192.6	204.9	210.7
times GDP	5.7	6.1	5.8	5.3	5.1	5.3	6.1
Retail Sector (USD billion)	80.0	82.2	83.0	**83.5**	86.6	94.1	95.2
times of GDP	2.4	2.6	2.6	2.4	2.3	2.4	2.8
Wholesale Sector (USD billion)	109.3	108.8	103.0	104.0	106.0	110.8	115.5
times of GDP	3.3	3.5	3.2	2.9	2.8	2.9	3.4
Islamic Sector (USD billion)	24.9	25.3	26.3	26.7	27.9	32.1	32.5
times of GDP	0.7	0.8	0.8	0.8	0.7	0.8	0.9

** Using provisional current GDP data.*
Source: CBB Monthly Statistical Bulletin.

Chart 2.2: Banking Sector Asset Composition

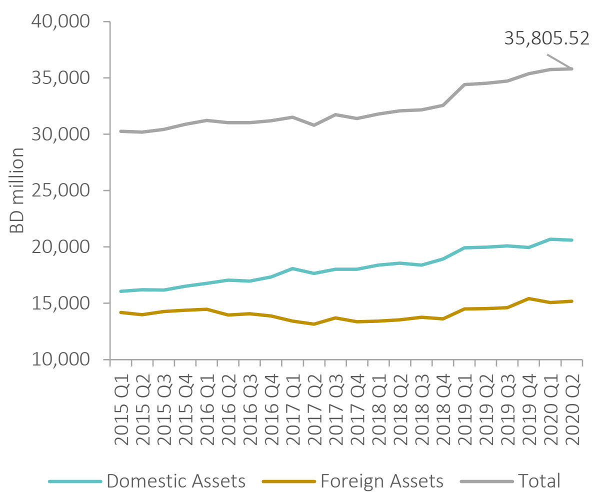


Source: CBB Monthly Statistical Bulletin.

2.2.1 The Retail Banking Sector

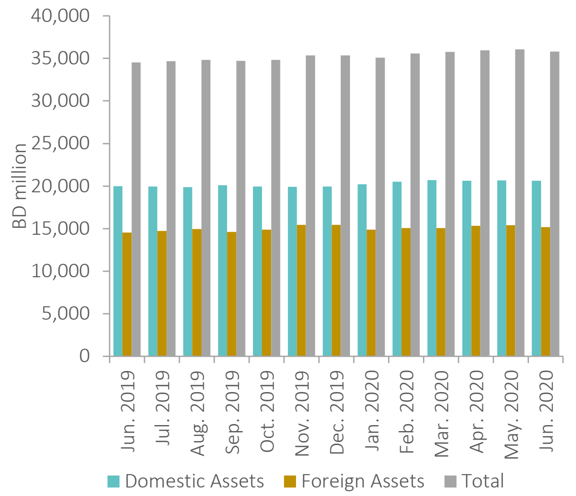
Despite the global uncertainty and the troubles in MENA region, retail banking total assets continued growing to reach BD 35.8 billion (USD 95.2 billion) in June 2020 with a 3.7% year-on-year (YoY) increase (see Chart 2.3). As of June 2020, domestic assets comprised 57.6% of total assets with YoY growth of 3.2% while foreign assets comprised 42.4% of total assets with a YoY growth of 4.4%.

Chart 2.3: Retail Banks' Assets



Source: CBB Monthly Statistical Bulletin.

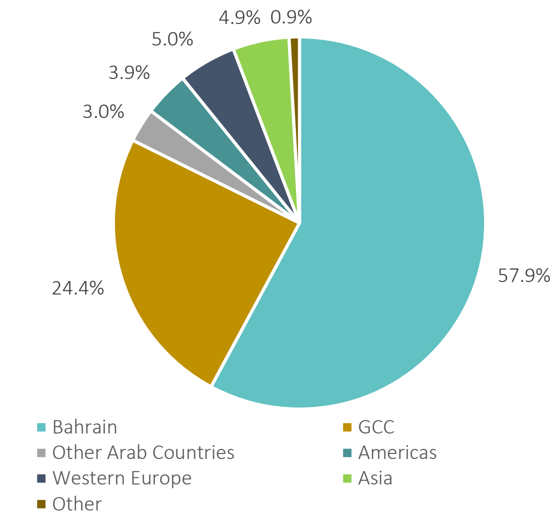
Chart 2.4: Categorization of Retail Banks' Assets



Source: CBB Monthly Statistical Bulletin.

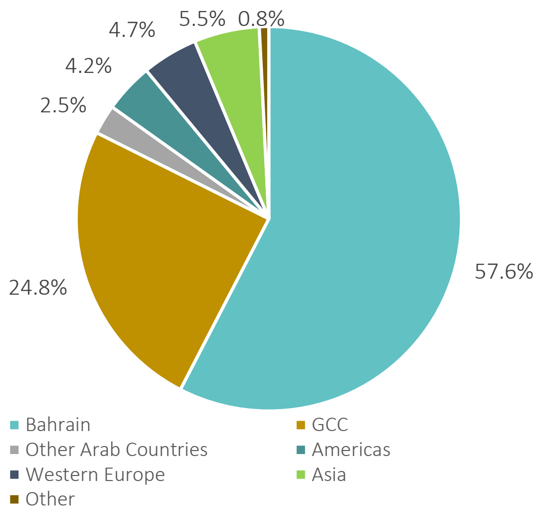
The share of GCC assets of total retail banking assets was 24.8%. The level of Europe and American contribution was 8.9%. This shows that the retail-banking sector in Bahrain is relatively exposed to foreign risk regionally from GCC countries and lightly exposed to foreign risk from Europe and U.S.

Chart 2.5: Retail Banks' Assets (%) by Geographical Classification (June 2019) *



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

Chart 2.6: Retail Banks' Assets (%) by Geographical Classification (June 2020) *

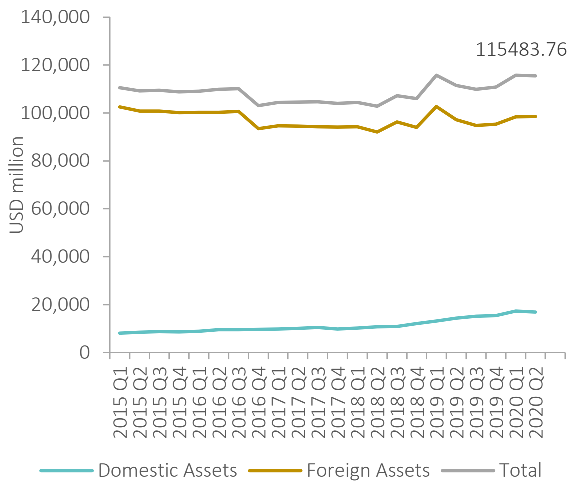


** For conventional and Islamic retail banks.*
Source: CBB Monthly Statistical Bulletin.

2.2.2 The Wholesale Banking Sector

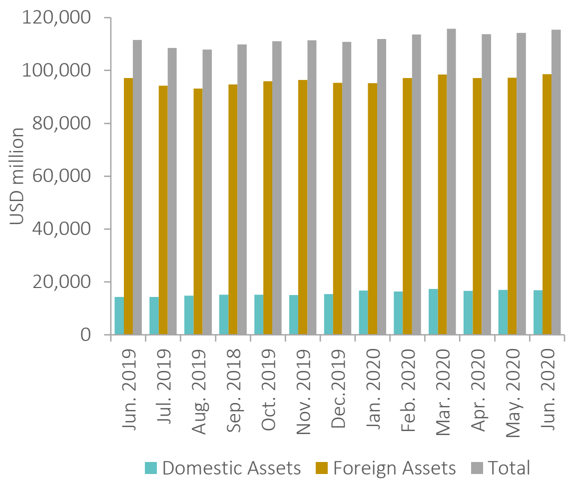
The wholesale banking sector increased to USD 115.5 billion in June 2020 with a YoY growth of 3.5%. As of June 2020, domestic assets, which represented 14.6% of total assets, witnessed a YoY growth of 17.4% while foreign assets made 85.4% of total assets and rose by 1.5% on a yearly basis (See Charts 2.7 and 2.8).

Chart 2.7: Wholesale Banks' Assets



Source: CBB Monthly Statistical Bulletin.

Chart 2.8: Categorization of Wholesale Banks' Assets

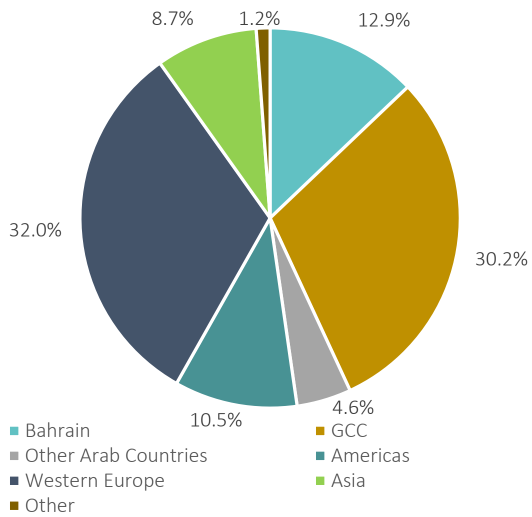


Source: CBB Monthly Statistical Bulletin.

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

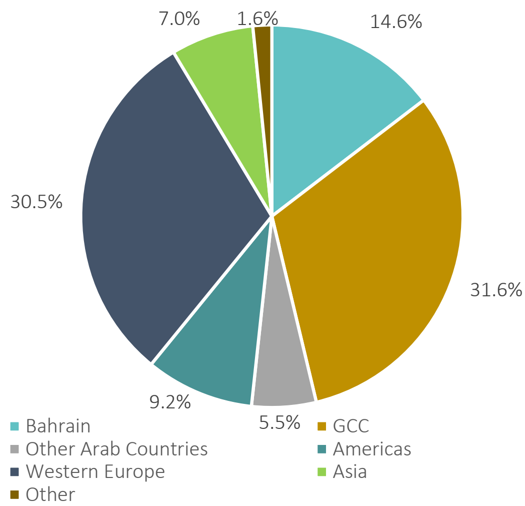
- The share of GCC assets increased to 31.6% in June 2020, representing the larger portion of wholesale bank assets now compared to Europe.
- The share of Europe's total assets decreased to 30.5%.
- The share of America's total assets decreased from 10.5% in June 2019 to 9.2% in June 2020.
- Asian assets slightly decreased from 8.7% to 7.0% in June 2020.

Chart 2.9: Wholesale Banks' Assets by Geographical Classification (June 2019) *



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

Chart 2.10: Wholesale Banks' Assets by Geographical Classification (June 2020) *

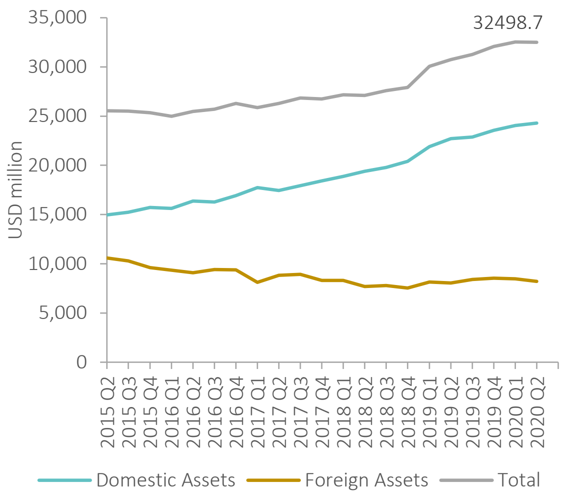


* *For conventional and Islamic wholesale banks.*
Source: CBB Monthly Statistical Bulletin.

2.2.3 The Islamic Banking Sector

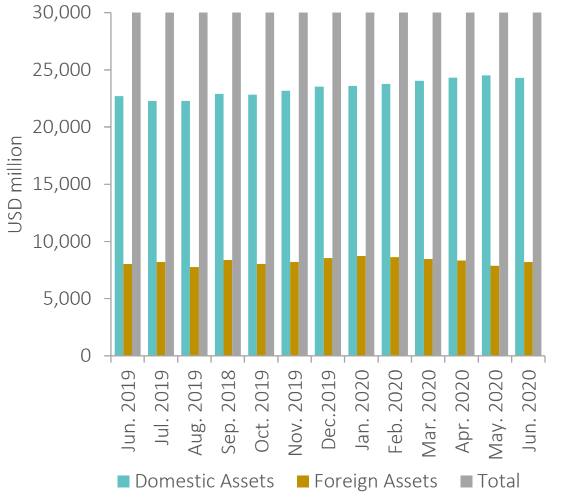
The Islamic banking sector increased from USD 24.2 billion in 2014 to USD 32.5 billion as of June 2020 indicating a 5.7% YoY increase. Domestic assets represented 74.8% of total Islamic banking assets in the sector (7.0% YoY increase) while foreign assets represented 25.2% of total Islamic banking assets (2.1% YoY increase).

Chart 2.11: Islamic Banks' Assets



Source: CBB Monthly Statistical Bulletin.

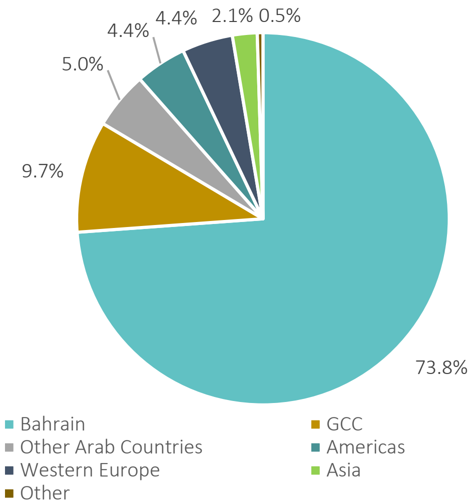
Chart 2.12: Categorization of Islamic Banks' Assets



Source: CBB Monthly Statistical Bulletin.

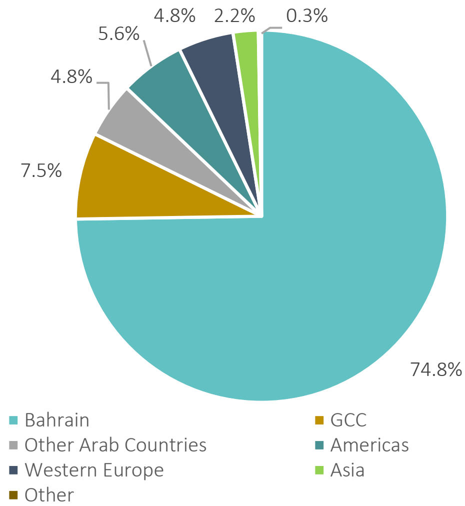
Islamic banks continue to be majorly exposed to domestic risks as the share of Bahrain's total assets increased slightly from 73.8% in June 2019 to 74.8% in June 2020. GCC total assets decreased from 9.7% to 7.5%% over the same period.

Chart 2.13: Islamic Banks' Assets by Geographical Classification (June 2019)



Source: CBB Monthly Statistical Bulletin.

Chart 2.14: Islamic Banks' Assets by Geographical Classification (June 2020)

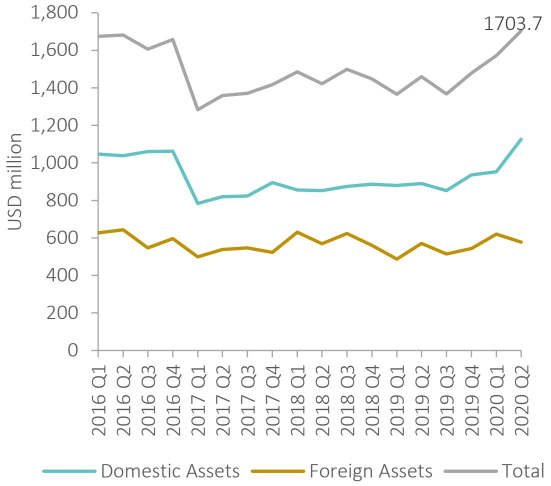


Source: CBB Monthly Statistical Bulletin.

2.2.4 Islamic Windows

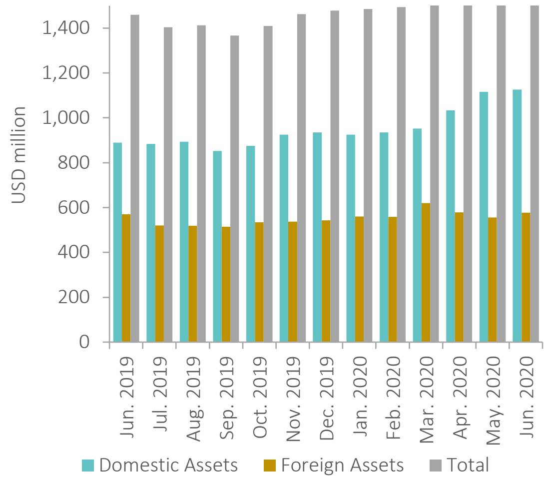
There are a number of conventional retail banks in Bahrain that maintain Islamic windows offering Islamic banking services/products to clients who are interested in completing their banking transactions in a Sharia-compliant system. As of June 2020, there were 5 Islamic windows operating by conventional retail licenses in Bahrain with total assets of BHD 1.7 billion (4.7% of retail banking assets). As of June 2020, 66.1% of total assets were domestic (26.6% YoY increase) while 33.9% were foreign (1.3% YoY decrease).

Chart 2.15: Islamic Windows' Assets



Source: *CBB Monthly Statistical Bulletin.*

Chart 2.16: Categorization of Islamic Windows' Assets

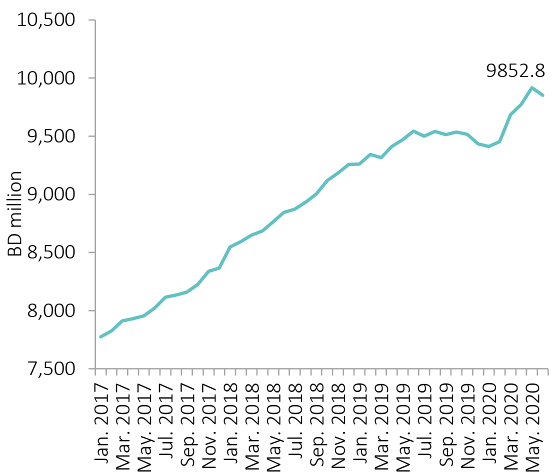


Source: CBB Monthly Statistical Bulletin.

2.2.5 Credit Developments

The total amount of credit given to the private sector (business and personal) by retail banks witnessed an 3.2% increase since December 2019 moving from BD 9,434.7 million to BD 9,852.8 million in June 2020 with a YoY increase of 3.2% and a 4.2% increase since December 2019 (Chart 2.17). Regarding retail banks' lending to the general government, there was an increase to BD 328.9 million at end-June 2020, from BD 301.6 million at end-December 2019 (Chart 2.18).

Chart 2.17: Loans to the Private Sector *



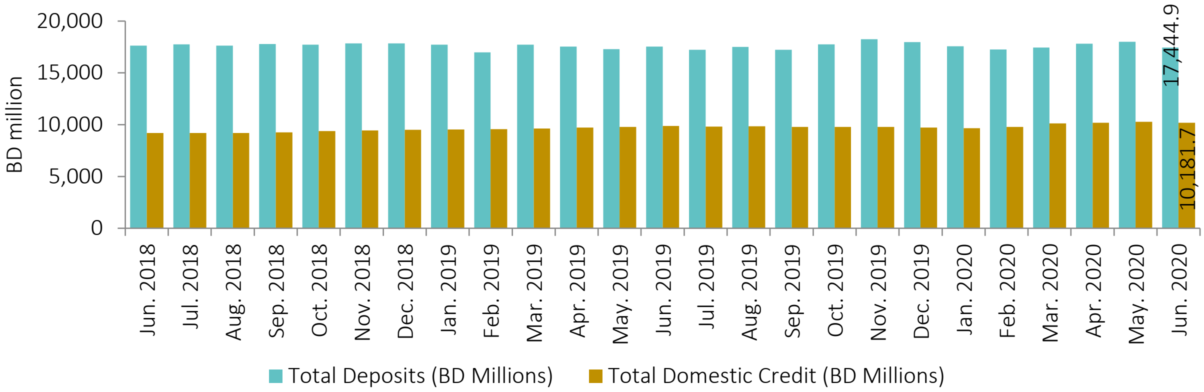
Source: CBB Monthly Statistical Bulletin.
***** *Excluding securities.*

Chart 2.18: Loans to General Government *

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

Total deposits reached BD 17,444.9 million in June 2020 with a -0.5% YoY change (where domestic assets represent 77.7% of total assets and had a YoY increase of 4.0%). Domestic credits increased from BD 9,736.3 in December 2019 to 10,181.7 in June 2020 with a 3.0% YoY increase (Chart 2.18).

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.

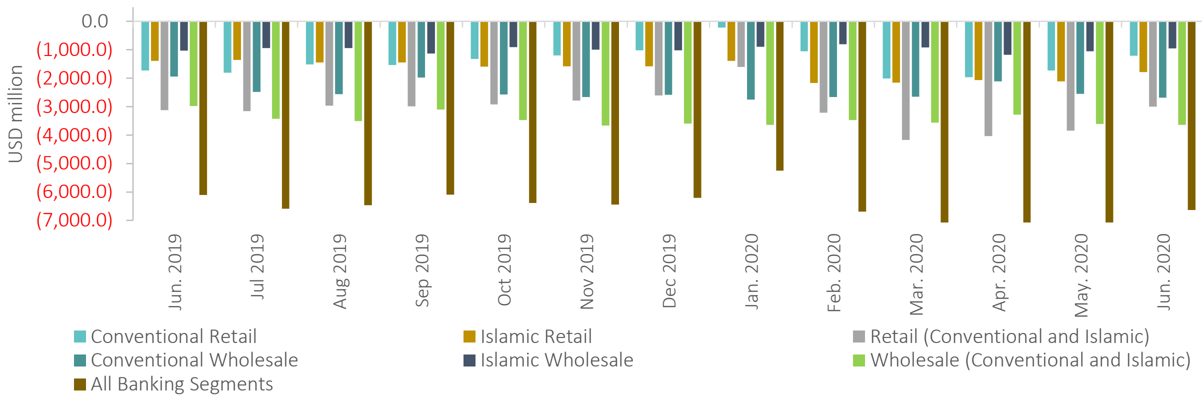
The NFA position by banking segment, as of June 2020, is negative (net borrowers) for retail banks, both conventional and Islamic, and all wholesale banks, both conventional and Islamic. As of June 2020, the NFA position for retail banks was *negative* USD 2,996.8 million and for wholesale banks, the NFA position was *negative* USD 60,120.9 million.

Table 2.2: Net Foreign Assets Postion by Banking Segment (June 2020)

Banking Segment (USD million)	Foreign Assets	Foreign Liabilities	Net Foreign Assets
Conventional Retail	37,870.5	39,083.9	-1,213.3
Islamic Retail	2,510.8	4,294.3	-1,783.5
Retail (Conventional and Islamic)	**40,381.3**	**43,378.1**	**-2,996.8**
Conventional Wholesale	92,907.7	95,588.8	-2,681.1
Islamic Wholesale	5,693.5	6,649.5	-955.5
Wholesale (Conventional and Islamic)	**98,601.2**	**102,237.8**	**-3,636.6**
Total Banking Segments	**138,982.5**	**145,615.9**	**-6,633.4**

Source: CBB.

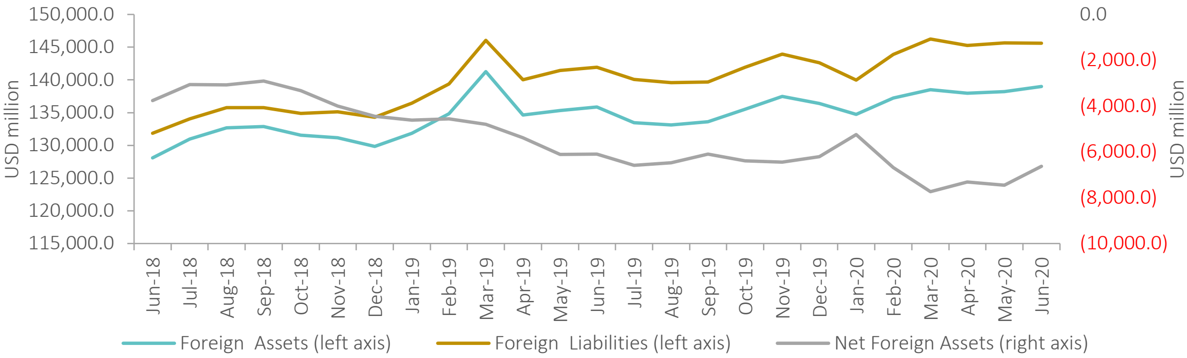
Chart 2.20: Net Foreign Assets Position by Banking Segment



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 decreased significantly over the course of the first half of 2020. Looking at the NFA position for the overall banking sector, data shows that there was a continuous downward trend as seen in the chart below. The NFA position of every banking segment is seen in the Box below.

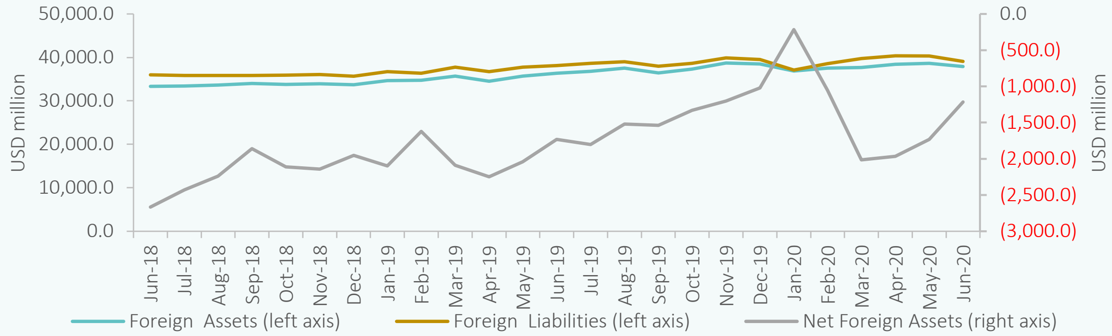
Chart 2.21: Net Foreign Assets of the Overall Banking Sector



Source: CBB.

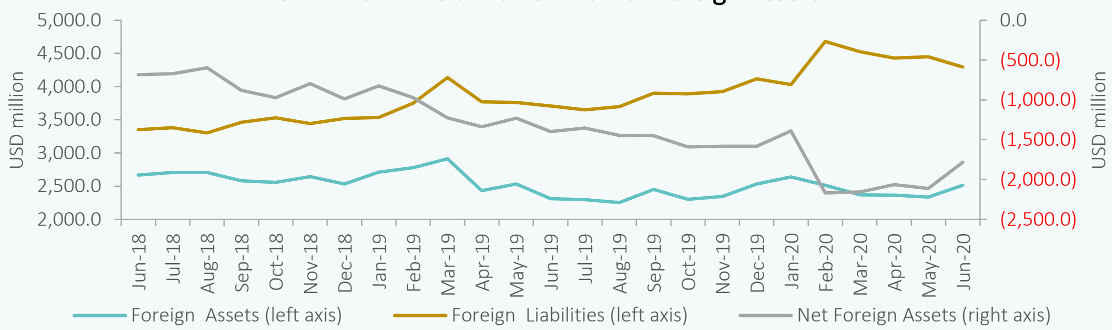
Box 1: Net Foreign Asset by Banking Segment

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



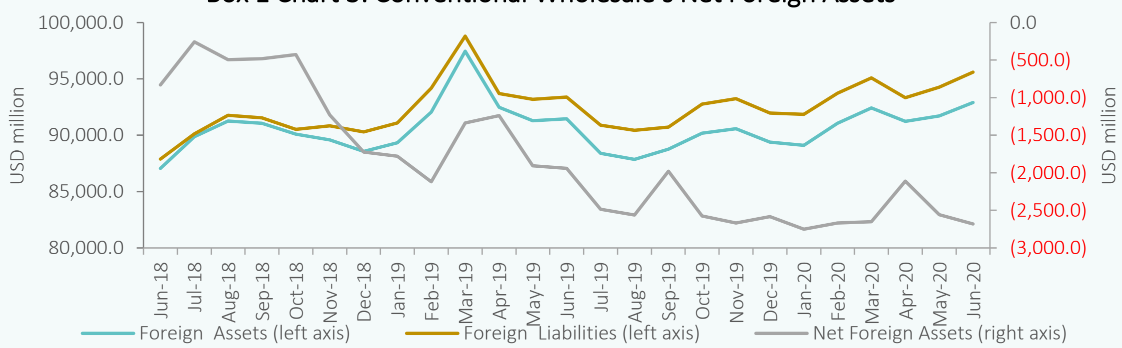
Source: CBB.

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



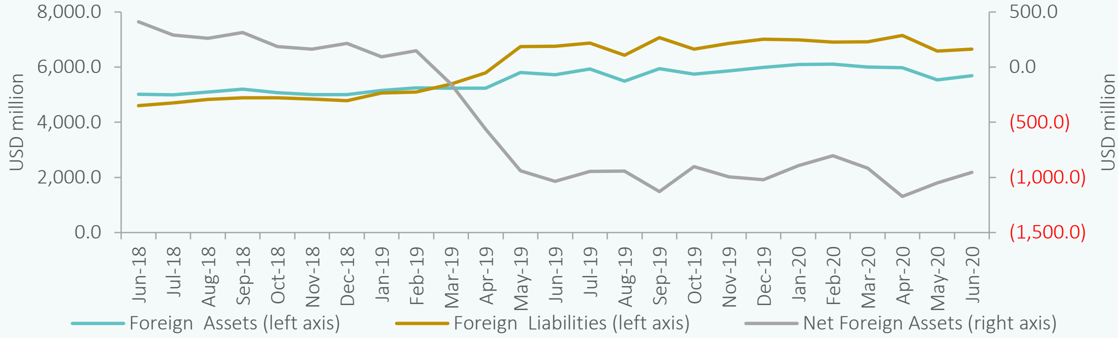
Source: CBB.

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



Source: CBB.

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

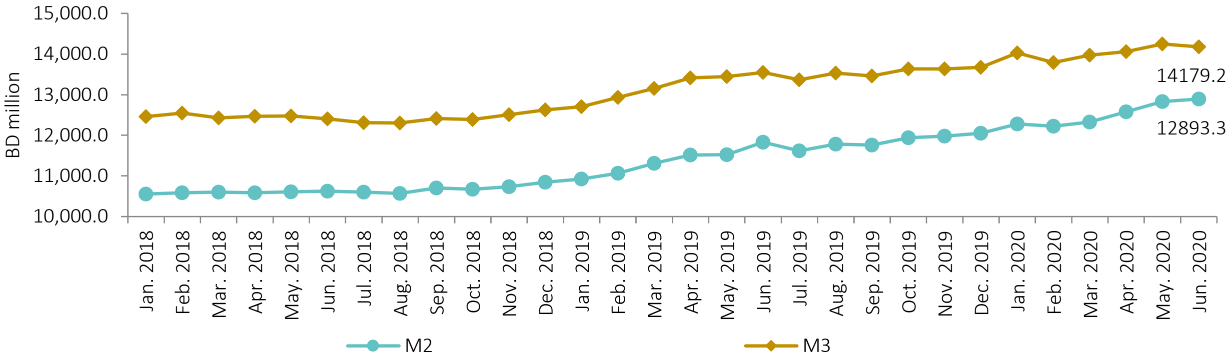


Source: CBB.

2.3 Monetary Indictors

Money supply continued to grow. M2 stood at BD 12,893.3 million in end-June 2020, 9.0% higher than its value of June 2019. M3 was at BD 14,179.2 million in end-June 2020, 4.7% higher than in December 2018 (Chart 2-22).

Chart 2.22: Money Supply (BD million) from Jan. 2018 to Jun. 2020



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

	2017		2018		2019		Q2 2020	
	BD million	% Change	BD million	% Change	BD million	% Change	BD million	% Change
Currency Outside Banks	526.8	-1.6	528.1	0.2	535.1	1.3	630.8	17.9
Demand Deposits	2,828.1	1.7	2,893.9	2.3	2978.5	2.9	3.333.7	11.9
M1	**3,354.9**	**1.2**	**3,422.0**	**2.0**	**3,513.6**	**2.7**	**3,964.5**	**12.8**
Time and savings deposits	7,239.6	5.7	7,423.3	2.5	8,538.6	15.0	8,928.8	4.6
M2	**10,594.5**	**4.2**	**10,845.3**	**2.4**	**12,052.2**	**11.1**	**12,893.3**	**7.0**
General Government Deposits	1,926.8	3.9	1,776.8	-7.8	1,619.7	-8.8	1,285.9	-20.6
M3	**12,521.3**	**1.2**	**12,622.1**	**2.0**	**13,671.9**	**8.3**	**14,179.2**	**3.7**

Source: CBB Monthly Statistical Bulletin.

As of June 2020, the growth in money supply has been stimulated by a growth in currency outside banks and deposits. In particular, demand deposits increased by 11.9% from BD 2,978.5 million in December 2019 to BD 3,333.7 million in June 2020, while time and savings deposits increased by 4.6%.

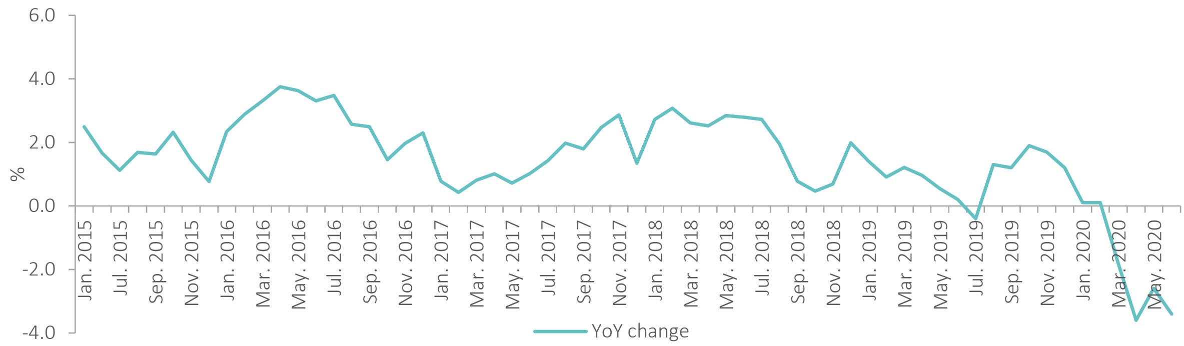
2.4 Inflation

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.

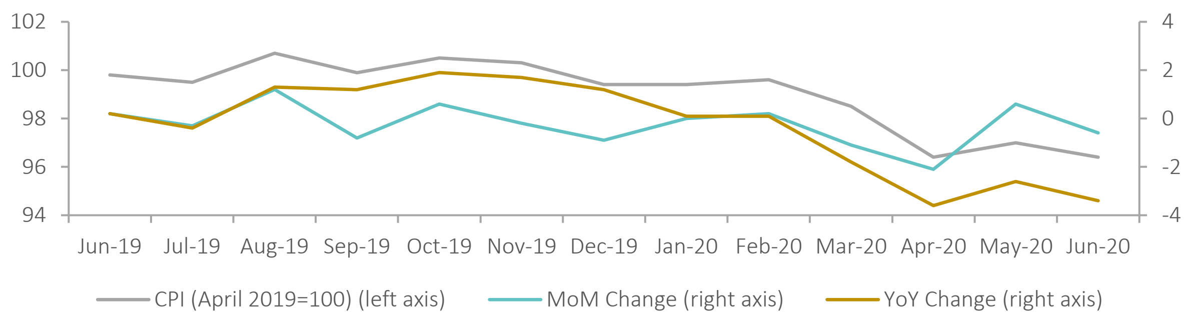
Chart 2.23: CPI Change (Jan. 2014 – Jun. 2020)



Source: IGA.

As of June 2020, the Consumer Price Index (CPI) stood at 96.4 points. Monthly inflation decreased by 0.6% and the largest decreases came from housing, water, electricity, gas and other fuels, due to the decrease on electricity, gas and other fuels by 69.8% due to subsidy support by the government. On an annual basis, inflation decreased by 3.4% in June 2020 as compared to June 2019.

Chart 2.24: Monthly Inflation Rate (Jun. 2019 – Jun. 2020)



Source: IGA.

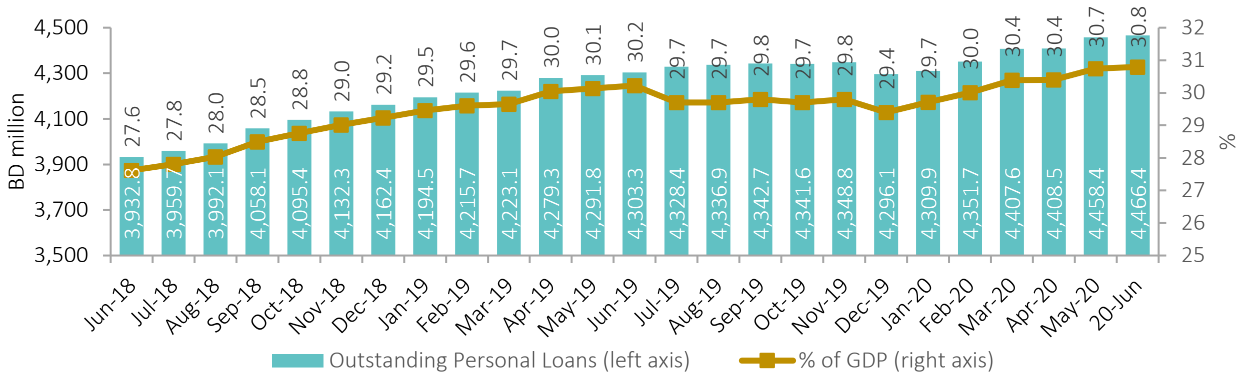
Contrary to expectations of an inflationary spike following the introduction of VAT, the Consumer Price Index (CPI) in Bahrain continued broadly in line with the trend observed over the past year. The CPI in June 2020 was 3.4% lower than a year earlier due to the effects of the COVID-19 pandemic in addition to the economic stimulus package released by the government to support households and businesses.

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 slight increase in personal credit throughout the period between December 2019 and June 2020 (Chart 2.25).

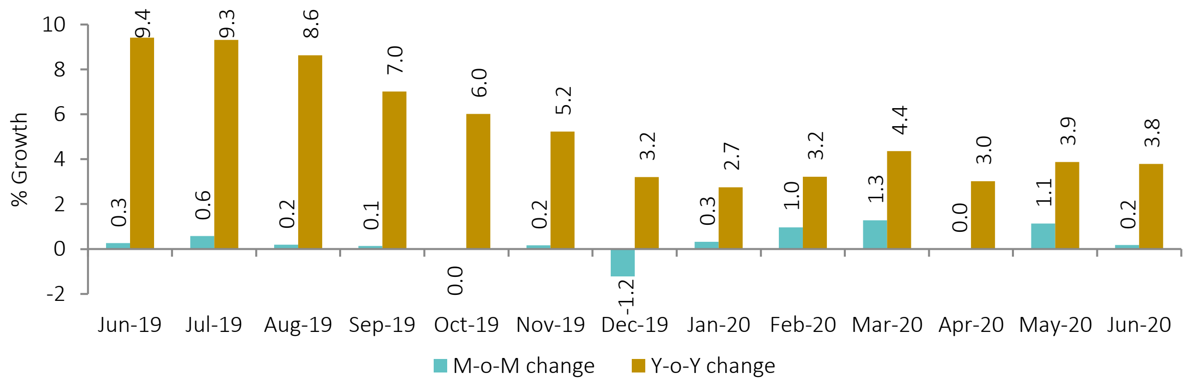
Chart 2.25: Personal Loans and Advances (Volume and % of GDP)



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

Personal loans as a percentage of GDP increased to 30.8% by June 2020 (BD 4,466.4millIon). There was a 4.0% increase in outstanding personal loans between December 2019 and June 2020 (YoY increase was 3.8%).

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 June 2019 to June 2020. Initially at 0.3% in June 2019, it rose to reach its highest level for the year of 1.3% in March 2020 and later fell to reach 0.2% in June 2020. On a yearly basis, the biggest Y-o-Y increase was in June 2019 where the personal loans and advances were at 9.4% increase year-on-year.

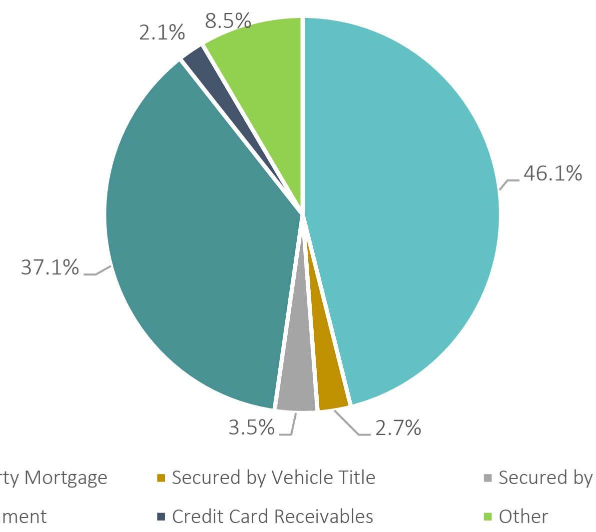
As of end of June 2020, the two main contributors to personal loans as seen in chart 2.27 were personal loans secured by property mortgages which made up 45.4% of the total personal loans followed by personal loans secured with salary assignments at 35.9% of total personal loans.

Table 2.4: Personal Loans Breakdown

BD million	Dec. 2019	Jan. 2020	Feb. 2020	Mar. 2020	Apr. 2020	May 2020	Jun. 2020
Total	**4,296.1**	**4,309.9**	**4,351.7**	**4,407.6**	**4,408.5**	**4,458.4**	**4,466.4**
Secured by Property Mortgage	1,950.5	1,982.6	2,003.2	1,999.3	2,016.7	2,044.1	2,058.2
Secured by Vehicle Title	85.2	121.9	120.0	118.6	117.5	117.8	121.2
Secured by Deposits	108.7	153.6	166.1	159.3	156.2	165.5	155.2
With Salary Assignment	1,540.7	1,586.9	1,599.4	1,637.8	1,646.8	1,659.4	1,657.3
Credit Card Receivables	104.0	102.1	108.0	100.2	95.6	96.4	95.5
Other	507.0	362.8	355.0	392.4	375.7	375.2	379.0

Source: CBB Monthly Statistical Bulletin.

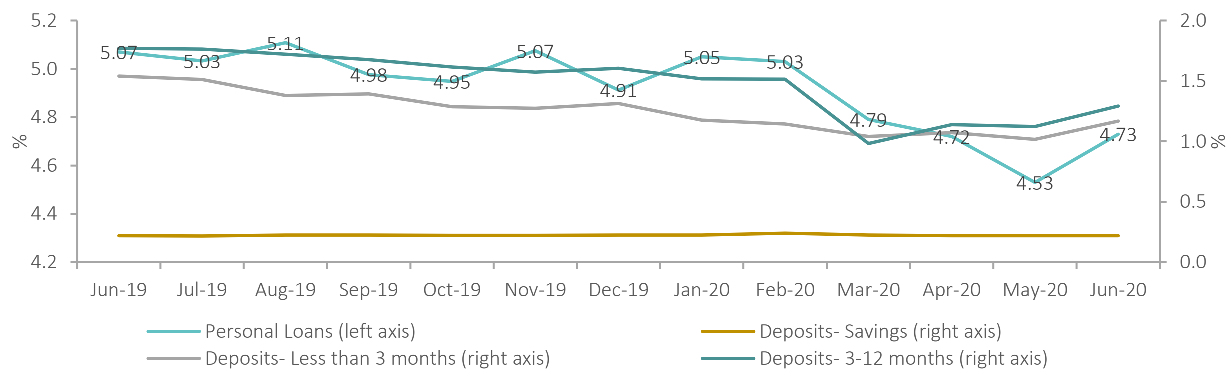
Chart 2.27: Personal Loans Breakdown (June 2020)



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 2.28). 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 (%)

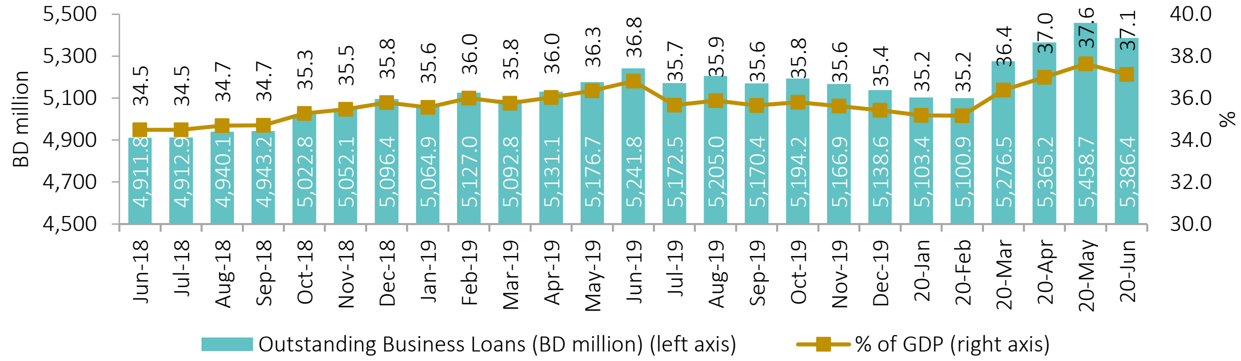


Source: CBB Monthly Statistical Bulletin.

2.6 The Bahraini Corporate/Business Sector

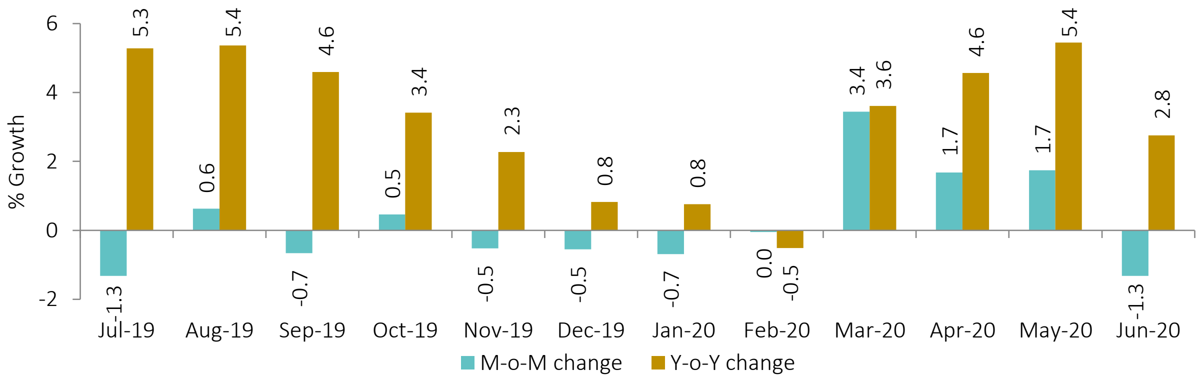
Business loans and advances expanded by 4.8% between December 2019 and June 2020 from BD 5,138.6 million in December 2019 to BD million 5,386.9 in June 2020 (Chart 2.29). June 2020, Y-o-Y growth for business loans was 2.8%. Outstanding business loans as a percentage of GDP decreased to 37.1% in June 2020.

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 2019 June 2020. Initially at -0.5% in December 2019, it rose to reach its highest level for the year of 3.4% in March 2020 to reach -1.3% in June 2020. The highest Y-o-Y growth was in May 2020 (5.4%)

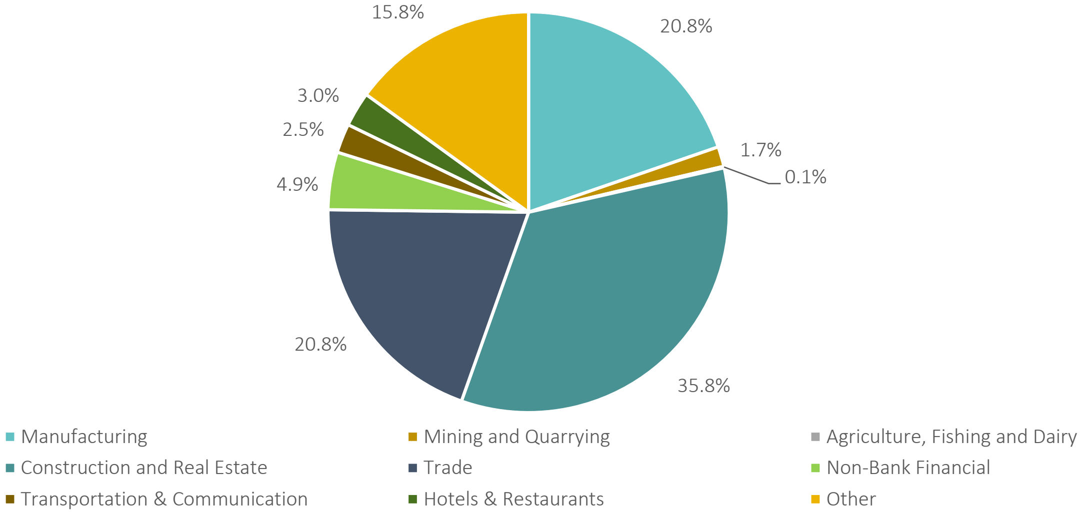
For the past six months, the main contributor to the business loans was the loans to the construction and real estate sector. The biggest contributors to business loans in June 2020 were the construction and real estate sector (35.1%) followed by manufacturing (23.5%), trade (18.8%), and then other sectors (16.0%) (Chart 2.31).

Table 2.5: Business Loans by Sector

	Dec. 2019	Jan. 2020	Feb. 2020	Mar. 2020	Apr. 2020	May 2020	Jun. 2020
Total	**5,138.6**	**5,103.4**	**5,100.9**	**5,276.5**	**5,365.2**	**5,458.7**	**5,386.4**
Manufacturing	1,068.1	1,083.1	1,098.8	1,211.1	1,226.0	1,303.3	1,264.6
Mining and Quarrying	86.7	73.3	74.0	107.2	106.8	106.6	105.3
Agriculture, Fishing and Dairy	6.7	6.8	6.3	6.1	6.4	6.7	7.4
Construction and Real Estate	1,841.4	1,826.6	1,827.7	1,842.8	1,854.7	1,875.3	1,889.0
Trade	1,071.0	1,059.0	1,066.6	1,047.6	1,048.1	1,055.6	1,019.0
Non-Bank Financial	251.8	248.7	245.9	254.6	248.5	235.2	241.2
Transportation & Communication	127.2	128.0	121.7	119.2	161.8	158.8	158.2
Hotels & Restaurants	15136	161.4	161.2	171.3	167.7	168.0	167.8
Other Sectors	812.9	805.9	781.6	807.1	847.7	876.0	859.9

Source: CBB Monthly Statistical Bulletin.

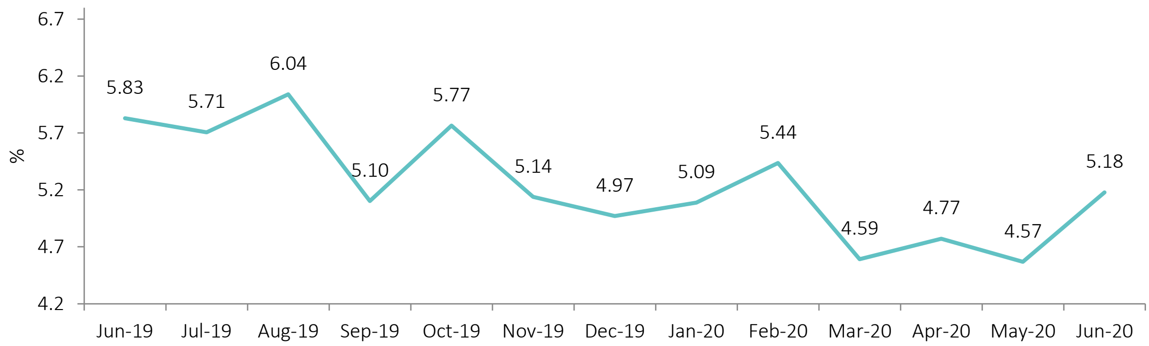
Chart 2.31: Business Loans by Sector (June 2020)



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 2.32).

Chart 2.32: Retail Banks' Average Interest Rates on Business Loans



Source: CBB Monthly Statistical Bulletin.

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 stable and demand for loans has increased in Bahrain. Banks operating in Bahrain are well capitalized, funding and liquidity buffers are well above minimum required standards despite the COVID-19 pandemic, and non-performing loans continue to be in low manageable levels. 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

Part II:

Developments in the Banking Sector

Chapter 3 Performance of the Overall Banking Sector

Key Highlights

CAR	NPL	Provisioning	ROA	ROE	Liquidity	Loan/Deposit
18.5% ↓	4.5% ↓	64.8% ↑	0.4↓	1.5%↓	24.6% ↓	69.5% ↓

- Slight decrease 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.
- A decrease in 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 analyzed 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-December 2019 (Q4 2019) and end-June 2020 (Q2 2020), unless otherwide indicated.

3.2 Overall Banking Sector Performance

3.2.1 Capital Adequacy

Decrease in Capital Adequacy Ratio

The capital adequacy ratio[2] (CAR) for the banking sector stood at 18.5% in June 2020 decreasing from 19.4% in December 2019. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed a decrease from 18.1% in December 2019 to 17.1% in June 2020. Whereas the leverage ratio (ratio of assets over capital) increased to 8.2% during the same period.

Table 3.1: Capital Provision Ratios

Indicator*	Q4 2019	Q2 2020	Change
CAR (%)	19.4	18.5	-0.9
Tier 1 CAR (%)	18.1	17.1	-1.0
Leverage (Assets/Capital) (Times)	7.7	8.2	0.5

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

[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 impact of hypothetical scenarios on selected Bahraini banks including 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.

3.2.2 Asset Quality

Decrease in NPLs

The non-performing loans (NPLs) ratio decreased to 4.5% in June 2020 from 4.8% in December 2019. The specific provisions as a proportion of NPLs showed an increase to 64.8% in June 2020 from 62.0% in December 2019.

Table 3.2: NPL Ratios

Indicator	Q4 2019	Q2 2020	Change
NPLs (% Total Loans)	4.8	4.5	-0.3
Specific provisions (% of NPLs) *	62.0	64.8	2.8

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

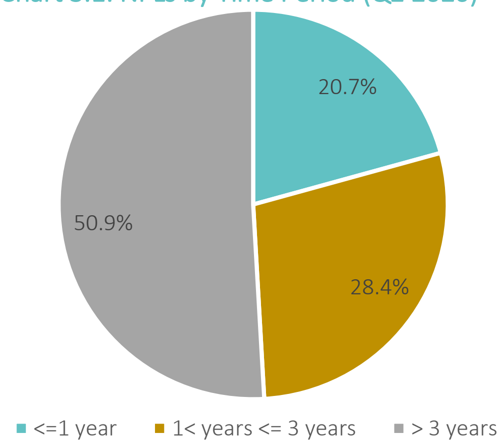
Data on NPLs by time segment (up to 1 year, 1 year to 3 years, and over 3 years) show that the majority of NPLs in the banking sector are for a period of over 3 years (50.9% of total NPLs). NPLs for over 3 years represented 1.9% of total gross loans. Specific provisioning for NPLs increases as they are 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 78.8%.

Table 3.3: NPL Ratios and Specific Provisions by Time Period (Q2 2020)

Indicator	Up to 1 year	1 up to 3 years	Over 3 years	Total
NPLs (% Total Loans)	1.4	1.2	1.9	4.5
Specific Provisions (% of NPLs)	43.3	67.7	78.8	64.8

Source: CBB.

Chart 3.1: NPLs by Time Period (Q2 2020)



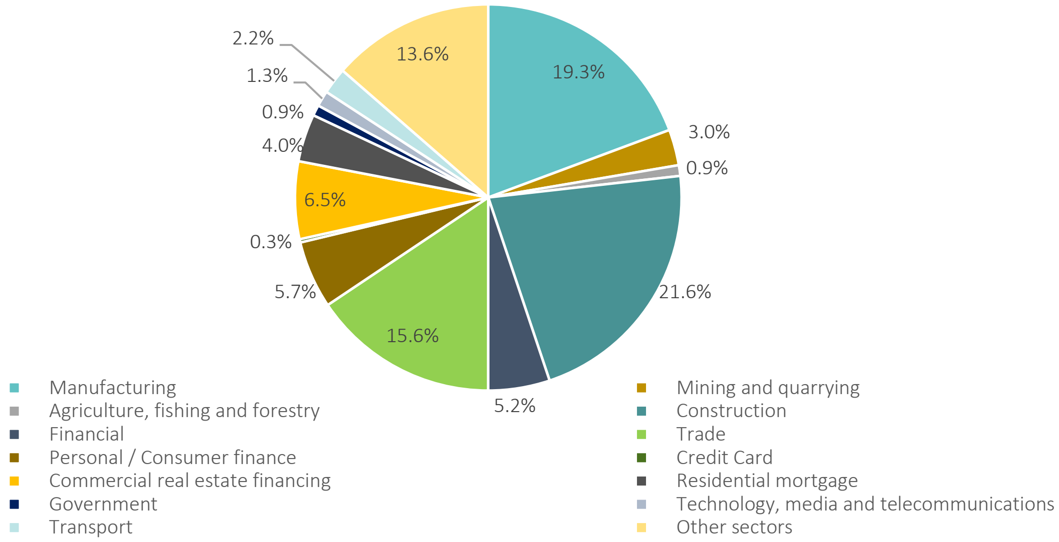
Source: CBB.

Data on the concentration of NPLs by sector shows that the majority of NPLs come from the construction (21.6%), manufacturing sector (19.3%), and trade (15.6%) as indicated in chart 3.2. [3]

Data on the sectoral breakdown of NPLs ratios (NPLs per sector as a percentage gross 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 construction by 0.5%. The highest decrease was in the mining and quarrying sector which was 3.1%.

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

Chart 3.2: NPLs Concentration by Sector (Q2 2020)



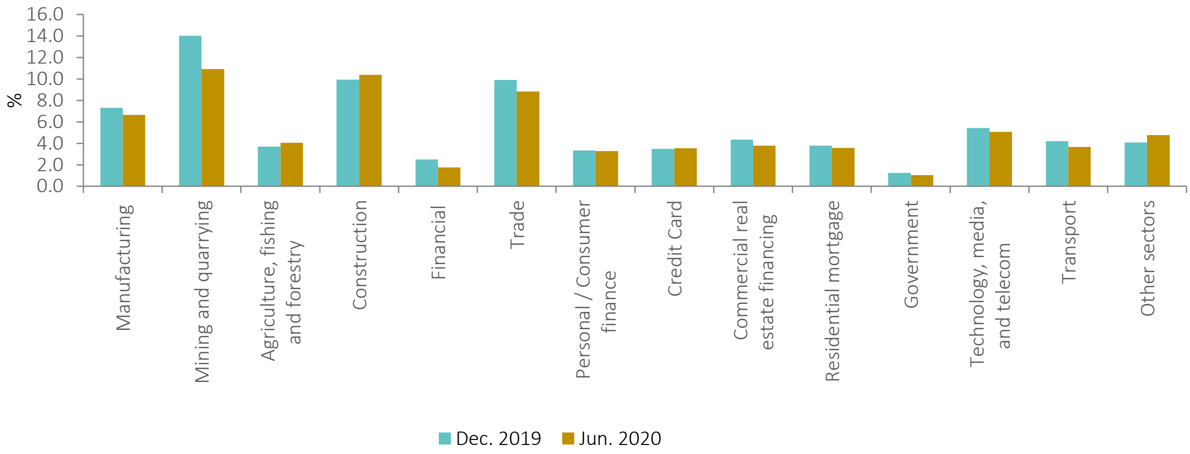
Source: CBB.

Table 3.4: NPL Ratios by Sector (%)

Sector	Q4 2019	Q2 2020	Change
Manufacturing	7.3	6.7	-0.6
Mining and quarrying	14.0	10.9	-3.1
Agriculture, fishing and forestry	3.7	4.0	0.3
Construction	9.9	10.4	0.5
Financial	2.5	1.7	-0.8
Trade	9.9	8.8	-1.1
Personal / Consumer finance	3.3	3.3	0.0
Credit Card	3.5	3.5	0.0
Commercial real estate financing	4.3	3.8	-0.5
Residential mortgage	3.8	3.6	-0.2
Government	1.2	1.0	-0.2
Technology, media and telecommunications	5.4	5.1	-0.3
Transport	4.2	3.6	-0.8
Other sectors	4.1	4.8	0.7

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 15.2% of total loans in June 2020. Other sectors and manufacturing were close behind, with 14.7%

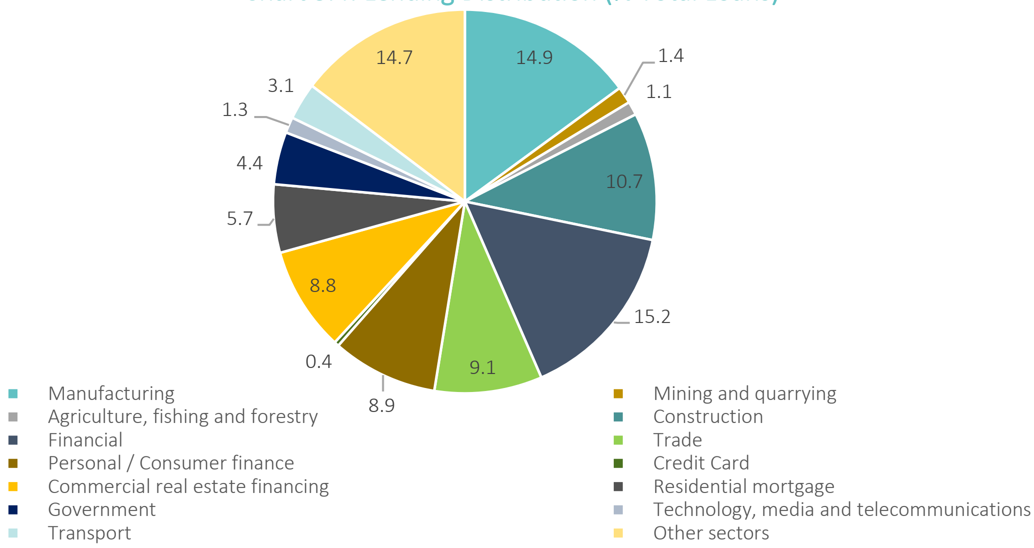
and 14.9% exposure in June 2020. The sector with the largest decline was both financial and construction with both dropping 0.8% from 16% and 11.5% in December 2019 to 15.2% and 10.7% in June 2020 respectively.

Table 3.5: Lending Distribution (% Total Loans)

Sector	Q4 2019 *	Q2 2020 *	Change
Manufacturing	15.0	14.9	-0.10
Mining and quarrying	1.4	1.4	0.00
Agriculture, fishing and forestry	1.3	1.1	-0.20
Construction	11.5	10.7	-0.80
Financial	16.0	15.2	-0.80
Trade	8.4	9.1	0.70
Personal / Consumer finance	8.2	8.9	0.70
Credit Card	0.4	0.4	0.00
Commercial real estate financing	8.8	8.8	0.00
Residential mortgage	5.2	5.7	0.50
Government	4.5	4.4	-0.10
Technology, media and telecommunications	1.0	1.3	0.30
Transport	3.1	3.1	0.00
Other sectors	15.1	14.7	-0.40
Top Two Sectors (%)	31.1	30.2	-0.90
Real Estate/ Construction Exposure (%) **	25.5	25.3	-0.20

** 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 manufacturing jointly represented 31.1% of loans in June 2020, increasing from 30.2% in December 2019. Exposure to real estate/construction was 25.3% of total lending in June 2020, a slight decrease from 25.5% registered in December 2019.

SME lending remains low

Credit extension to Small and Medium Enterprises (SMEs) remained unchanged between December 2019 and June 2020. SME loans (as a % of total loans) stood at 1.9% in June 2020. SME NPLs decreased slightly between the same periods from 13.7% from 12.6%. Provisioning levels recorded a decrease from 38.8% in December 2019 to 35.1% in June 2020.

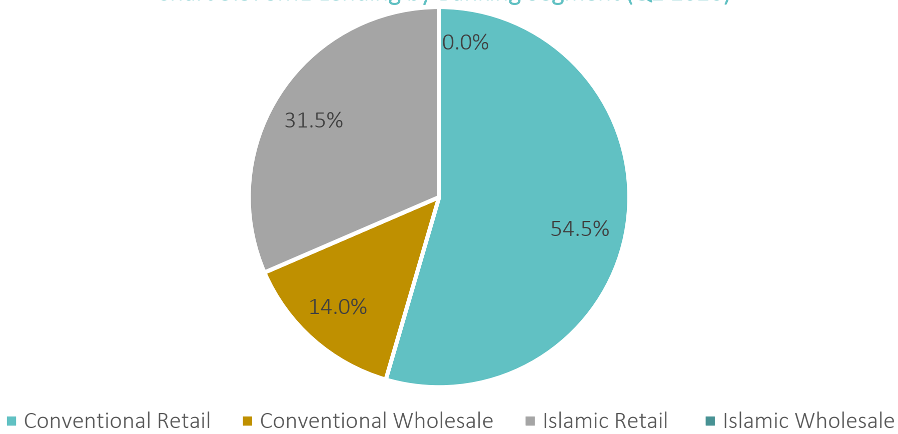
Table 3.6: SME Lending *

Indicator	Q4 2019	Q2 2020	Change
SME Loans (% of total Loans)	1.9	1.9	0.0
SME NPLs (% of total SME Loans)	13.7	12.6	-1.1
SME Provisioning (% of total SME NPLs)	38.8	35.1	-3.7

**For Bahrain Operations Only*

Source: CBB.

Chart 3.5: SME Lending by Banking Segment (Q2 2020)



Source: CBB.

3.2.3 Profitability

Profitability remains stable

The overall banking sector's profitability indicators have been stable between June 2019 to June 2020 and remain robust. Return-on-assets (ROA) decreased slightly from 0.6% in June 2019 to 0.4% in June 2020. As of end-June 2020, return-on-equity (ROE) decreased to 1.5% from 4.8% in June 2019.

Table 3.7: Profitability

Indicator	Q4 2019	Q2 2020	Change
ROA (%) *	0.6	0.4	-0.2
ROE (%) **	4.8	1.5	-3.3
Net Interest Income (% Total Income) ***	58.4	70.9	12.5
Operating Expenses (% Total Income)	54.6	70.2	15.6

** 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 June 2020. In addition, operating expenses as a proportion of total income was 70.2% in June 2020, an increase from the 54.6% registered in December 2019.

3.2.4 Liquidity

Liquidity position stays resilient

Between December 2019 and June 2019, the overall loan-deposit ratio decreased from 71.5% to 69.5%. Liquid assets as a proportion of total assets decreased from 25.5% to 24.6%, over the same period.

Table 3.8: Liquidity

	Q4 2019	Q2 2020	Change
Liquid Asset Ratio (%)	25.5	24.6	-0.9
Loan-Deposit Ratio (%)	71.5	69.5	-2.0

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 decreased to 18.5% in June 2020 from 19.2% in December 2019. NPLs have decreased between the periods of December 2019 to June 2020, from 4.8% to 4.5%. Profitability has decreased with ROA being at 0.4% and ROE at 1.5%. Liquidity decreased as the liquid asset ratio decreased by 0.9% between December 2019 and June 2020.

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 standardized approach to Credit Risk under Pillar One of Basel III. The basic indicator and standardized approaches are permitted for operational risk, while the standardized 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 analyzed to assess the performance of the sectors in the banking system in Bahrain.

Box 2: Regulatory Concessionary Measures During COVID-19 Pandemic and Stress Testing

I. Regulatory Concessionary Measures During COVID-19 Pandemic:

The CBB measures taken aimed to provide more liquidity and flexibility in order to enable the banking sector banks to continue providing financing to their customers and to contain any financial repercussions on customers. The measures taken are to be reviewed by the CBB at the end of this period in consultation with the banking sector.

The CBB issued several circulars with specific reference to credit exposures impacted by the current COVID-19 crisis and CBB requirement to defer loan and financing repayment instalments by six months. Looking at the accounting policy implications of the instalment deferral, together with the external audit firms, and keeping in view the principles of consistent treatment across the industry, level playing field, prudence, and consumer and investor protection, CBB directed the licensees to apply requirements on the following:

For Bahraini Bank Licensees, Financing Companies, and microfinance Institutions:

A. Accounting treatment of “Modification Loss”: The modification of the terms of the credit exposures to defer the repayment of instalments would require licensees to quantify the net present value of the credit exposures and treat the difference between the carrying amounts and net present value as loss at the date of such modification (i.e. with effect from 1st March 2020). Necessary quantitative and qualitative disclosures must be made to describe the basis of computation and the assumptions used in the said computation.

B. Expected Credit Loss (ECL) provisions: Licensees were required to make a detailed assessment for accurate classification of credit exposures under the three ECL stages and compute ECL based on such staging assessments as per IFRS 9/FAS30 for the purposes of income statement reporting. Licensees had to be more prudent in determining the additional provision required for the period from 1st April to 31st December 2020 considering the economic and financial impact of COVID-19 on customers.

C. Regulatory capital treatment:
   1. For the purposes of capital adequacy computations and for prudential reporting to CBB, Bahraini Bank licensees adopted requirements on the modification loss and the aggregate ECL provision amount relating to exposures classified as stage 1 and stage 2 computed for the period from 31st March to 31st December 2020.
   2. For the purposes of gearing ratios and capital adequacy computations, as applicable, and for prudential reporting to CBB, Financing Companies and Microfinance Institutions adopted requirements related to the modification loss and the aggregate ECL provision amount relating to exposures classified as stage 1 and stage 2 computed for the period from 31st March to 31st December 2020.

D. ECL Model External Validation: Considering the COVID-19 impact and to allow licensees to focus on activities to recover from its impacts, CBB exempted the licensees from external validation of the ECL models for 2020. Licensees were nonetheless, required to subject their models to an internal validation and ensure model integrity through sound model governance policies.

E. Action Required After the deferral period: By the end of the six-month deferral period, licensees should assess the financial situation, burden and needs of customers affected by COVID-19 crisis and should proactively develop and adopt the best possible credit recovery strategies to reduce any possible financial difficulties to both retail and corporate customers.

For All Branches of Foreign Banks:

A. ECL provisions
B. ECL Model External Validation
C. Actions Required after the deferral period

The Licensees must ensure that their financial reporting process as well as their prudential reporting processes are accordingly modified in consultation with their external auditors to ensure a high degree of accuracy in computations and reporting.

II. Stress Testing

In March 2020, the CBB required retail banks, financing companies and microfinance institutions to postpone instalments for borrowers or credit card holders affected by the economic repercussions of the COVID-19 situation without fees or interest on interest or increase in the percentage of profit / interest for a period of six months, unless the borrowers agree to pay within a shorter period. A stress test/sensitivity test was conducted to see the effect of the six months deferral program on Bahraini deposit taking institutions. The goal was to translate the macroeconomic forecasts into predictions for the CARs and NPL ratios of these institutions during the six months deferral period and after the period is over.

The exercise recognized that the NPLs can increase from two sources:

- An increase in NPLs from existing performing loans (non-deferred loans) due to slowdown in economy and slowdown in business activity because of the COVID-19 pandemic.
- An increase in impairment in deferred loans after the 6 months are over. This will start to accumulate 1 month after the deferral period is over as payments are due.

The effects of the COVID-19 situation were seen follows:

- Period t, at end of deferral period of 6 months.
- Period t+1, 1 month after the end of the deferral period.
- Period t+2, 2 months after the end of the deferral period.
- Period t+3, 3 months after the end of the deferral period.
- Period t+n, n months after the end of the deferral period

The shocks were created to be moderate to severe due to the potential disruption level by the COVID-19 situation. Since the goal was to see the effect on the domestic performance, only Bahrain Operations figures were considered (local capital, RWA, loans, NPLs, and specific provisioning and not consolidated). Below were the scenarios that were created for the exercise:

Scenario	Description	Shock 1: Moderate	Shock 2: Severe
Scenario 1	How the effect of the slowdown in economy on loans and deferred loans for 6 months will impact banks' CAR and NPLs? The effect due to: - Assumed % level of deferred loans. - Assumed % increase in NPLs. - Assumed % increase in impairment of deferred loans.	 Bank Specific* 5% 5%	 Bank Specific* 10% 10%
Scenario 2	How the effect of the slowdown in economy on loans and deferred loans for 6 months in <u>specific sectors</u> will impact banks' CAR and NPLs? The effect due to: - Assumed % level of deferred loans. - Assumed % increase in NPLs. - Assumed % increase in impairment of deferred loans. *Sectors: Manufacturing, Construction, Commercial real estate financing, Personal Consumer Finance, Trade, Transport, and credit cards.*	 Bank Specific* 5% 5%	 Bank Specific* 10% 10%
Measure	CAR (%) NPL (%)		
Banks	All Local Conventional Retail Banks All Local Islamic Retail Banks		

** The % of deferred loans is calculated by total exposure to customers who availed differed payments divided total loan portfolio of banks times 100.*

Below were additional assumptions that were made to conduct the exercise:

General Assumptions	
Assumed min CAR (%)	12.5%
Assumed specific provisioning on NPLs (not from deferred loans) (%).	Bank Specific*
Assumed specific provisioning on impairment of deferred loans (%).	20% up to 3 months 50% up to 6 months 100% up to 1 year.
Assumed Impact on RWA/ Impact on Capital (%).	100%
The increase in NPL is proportional to (%):	- % Increase in Existing NPLs. - % impairment in deferred loans.
Collateral: - Assumed collateral haircut - Assumed % of collateral used	Moderate: Yes Severe: No 50% 25%
Time period: - After 6 months deferral - 3 months after	t-1= Pre-shock before the deferral period starts. t = End of six months deferral period. t+1= 1 month after end of deferral period. t+2= 2 months after end of deferral period. t+3= 3 months after end of deferral period.
Earnings Modification loss: Incurred immediate loss called "Day one/Modification loss" at period t.	Bank Specific**
Data Source	March 2020 Prudential Returns
Capital, Loans, and NPLs Data	Bahrain Operations

**Existing banks' specific provisioning levels.*
***Loss to be taken from banks' equity, specifically from banks' retained earnings.*

Chapter 4 Performance of Conventional Banks

Key Highlights

CR CAR	CR NPL	CR Provisions	CR ROA	CR ROE	CR Liquidity	CR Loan/Deposit
18.8% ↓	4.6% ↓	66.2% ↑	0.6% ↓	6.0% ↓	32.8% ↓	66.4% ↑
CW CAR	**CW NPL**	**CW Provisions**	**CW ROA**	**CW ROE**	**CW Liquidity**	**CW Loan/Deposit**
17.9% ↓	4.7% ↑	72.3% ↑	0.4% ↓	-2.3% ↓	22.2% ↑	67.1% ↓

- Decrease in capital positions of conventional retail and wholesale banks.
- Non-performing loans (NPLs) for both conventional retails banks decreased and conventional wholesale banks have increased.
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Decrease in earnings for conventional retail banks and conventional wholesale banks.
- Liquidity improved for 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 decreased from 21.1% in December 2019 to 18.8% in June 2020. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed a decrease from 19.7% in December 2019 to 17.5% in June 2020. The leverage ratio (ratio of assets over capital) increased to 7.5% during the same period. The NPLs net provisions to capital increased to 5.1% in June 2020 from 4.4% in December 2019.

Table 4.1: CR Banks' Capital Provisions Ratios

Indicator *	Q4 2019	Q2 2020	Change
CAR (%)	21.1	18.8	-2.3
Tier 1 CAR (%)	19.7	17.5	-2.2
Leverage (Assets/Capital) (times)	6.7	7.5	0.8
NPLs net of Provisions to Capital (%)	4.4	5.1	0.7

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

4.2.2 Asset Quality

Slight decrease in NPLs

The NPL ratio decreased to 4.6% in June 2020 from 4.9% in December 2019. The specific provisions increased slightly to 66.2% in June 2020. For local retail banks, the NPL ratio slightly decreased to 3.8%

in June 2020. For overseas retail banks, the NPL ratio decreased from 7.0% in December 2019 to 6.6% in June 2020.

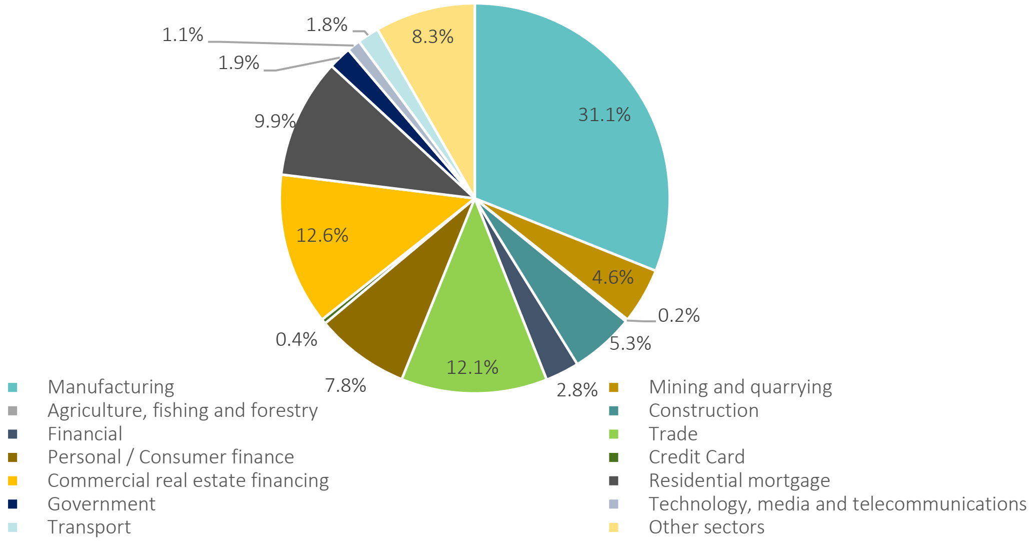
Table 4.2: CR Banks' NPL Ratios

Indicator	Q4 2019	Q2 2020	Change
NPLs (% Total Loans)	4.9	4.6	-0.3
NPLs Local Banks (%)	3.9	3.8	-0.1
NPLs Overseas Banks (%)	7.0	6.6	-0.4
Specific Provisions (% of NPLs) *	66.0	66.2	0.2

** 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 (31.0%), commercial real estate sector (12.6%), trade (12.1%) and construction (5.3%) as indicated in chart 4.1.

Chart 4.1: CR Banks' NPLs Concentration by Sector (December 2019)



Source: CBB.

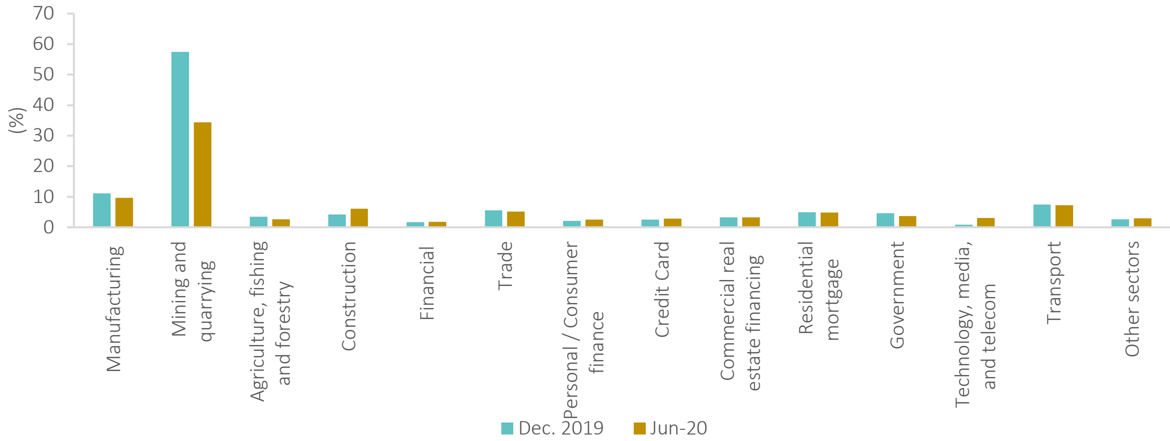
Available data on the sectoral breakdown of NPLs shows some sectors experiencing an increase in impairment, while some experience a decrease (Table 4.3 and Chart 4.1). The highest increase was in technology, media, and telecommunications by 2.2% while the highest decrease was in mining and quarrying by 23.1%.

Table 4.3: CR Banks' NPL Ratios by Sector (%)

Sector	Q4 2019	Q2 2020	Change
Manufacturing	11.1	9.6	-1.5
Mining and quarrying	57.5	34.4	-23.1
Agriculture, fishing and forestry	3.5	2.6	-0.9
Construction	4.2	6.1	1.9
Financial	1.7	1.8	0.1
Trade	5.6	5.1	-0.5
Personal / Consumer finance	2.1	2.5	0.4
Credit Card	2.5	2.8	0.3
Commercial real estate financing	3.2	3.2	0
Residential mortgage	4.9	4.8	-0.1
Government	4.6	3.7	-0.9
Technology, media and telecommunications	0.8	3.0	2.2
Transport	7.4	7.2	-0.2
Other sectors	2.6	2.9	0.3

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 minimal changes in the composition of the loans. The top recipient of loans remains to be the commercial real estate financing sector accounting for 18.4% of total loans in June 2020, compared with 18.8% in December 2019. The manufacturing sector represented 15.0% of total loans and the personal/consumer finance sector represented 14.6%.

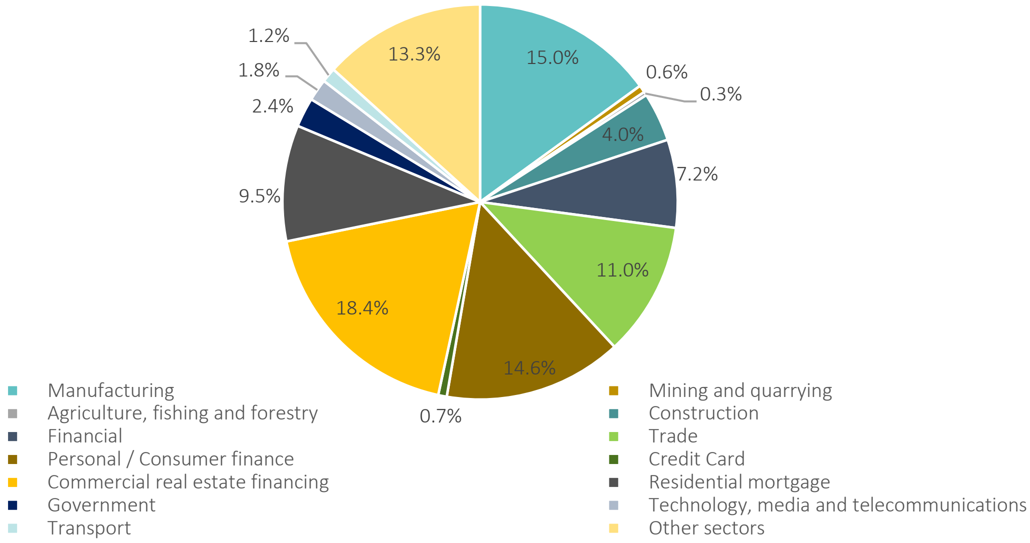
The top two recipient sectors, commercial real estate financing and personal/consumer finance, jointly represented 33.4% of loans in June 2020. Exposure to real estate/construction decreased to 31.9% of total lending in June 2020.

Table 4.4: CR Banks' Lending Distribution by Sector (% Total Loans)

Sector	Q4 2019 *	Q2 2020 *	Change
Manufacturing	14.5	15.0	0.5
Mining and quarrying	0.8	0.6	-0.2
Agriculture, fishing and forestry	0.3	0.3	0
Construction	4.7	4.0	-0.7
Financial	8.3	7.2	-1.1
Trade	10.2	11.0	0.8
Personal / Consumer finance	13.5	14.6	1.1
Credit Card	0.8	0.7	-1.1
Commercial real estate financing	18.8	18.4	-0.4
Residential mortgage	9.0	9.5	0.5
Government	2.0	2.4	0.4
Technology, media and telecommunications	1.5	1.8	0.3
Transport	1.3	1.2	-0.1
Other sectors	14.3	13.3	-1.0
Top Two Sectors (%)	33.3	33.4	0.1
Real Estate/ Construction Exposure (%) **	32.4	31.9	-0.5

** 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 17.9% of total loans in June 2020. The manufacturing sector represented 15.0% of total loans over the same period, a decrease from 15.5%. The top two recipient sectors commercial real estate financing and personal/consumer finance jointly represented 33.8% of loans in June 2020, a decrease from the 33.9% in December 2019. Exposure to real estate/construction decreased to 35.5% of total lending in June 2020.

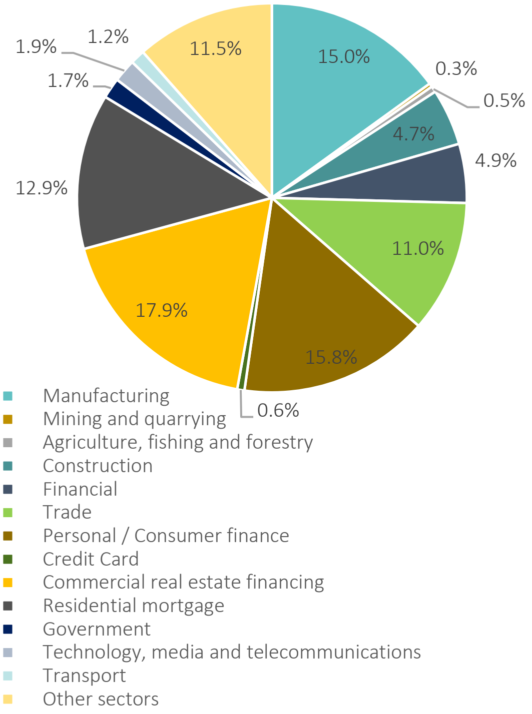
Similarly, the numbers as of end-June 2020 continue to show high concentration for overseas retail banks (Table 4.6 and Chart 4.4). The top recipient of loans, excluding the others sector, was the commercial real estate financing sector with 19.7% as of June 2020, an increase from 19.4 in December 2019. The top two recipients of loans (commercial real estate financing and other sectors) jointly accounted for 37.2% of total loans. Exposure to real estate/ construction was 23.4% of total lending in June 2020, increasing from 23.4% in December 2019.

Table 4.5: Local and Overseas CR Banks' Lending Distribution by Sector (% Total Loans)

Sector	Locally Incorporated CR Banks *			Overseas CR Banks *		
	Q4 2019	Q2 2020	Change	Q4 2019	Q2 2020	Change
Manufacturing	15.5	15.0	-0.5	12.6	14.8	2.2
Mining and quarrying	0.2	0.3	0.1	2.1	1.4	-0.7
Agriculture, fishing and forestry	0.5	0.5	0.0	0.0	0.0	0.0
Construction	5.8	4.7	-1.1	2.3	2.4	0.1
Financial	6.2	4.9	-1.3	13.0	12.7	-0.3
Trade	9.8	11.0	1.2	11.2	10.8	-0.4
Personal / Consumer finance	14.1	15.8	1.7	12.1	11.7	-0.4
Credit Card	0.6	0.6	0.0	1.1	1.0	-0.1
Commercial real estate financing	18.5	17.9	-0.6	19.4	19.7	0.3
Residential mortgage	12.6	12.9	0.3	1.3	1.3	0.0
Government	1.3	1.7	0.4	3.5	3.8	0.3
Technology, media and telecommunications	1.4	1.9	0.5	1.7	1.5	-0.2
Transport	1.2	1.2	0.0	1.5	1.2	-0.3
Other sectors	12.5	11.5	-1.0	18.1	17.6	-0.5
Top Two Sectors (%)	33.9	33.8	-0.1	37.6	37.2	-0.4
Real Estate/ Construction Exposure (%) **	36.8	35.5	-1.3	23.0	23.4	0.4

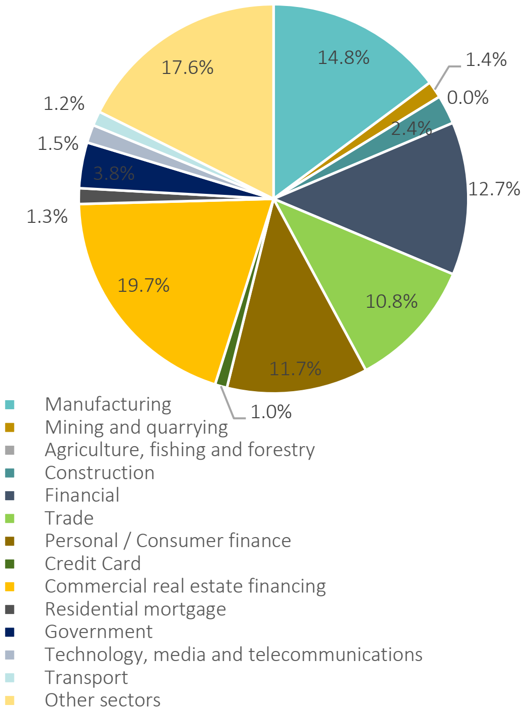
** Figures may not add to a hundred due to rounding.*
*** Real Estate/Construction exposure is calculated as the share of the construction, commercial real estate financing, and residential mortgages sectors of total lending.*
Source: CBB.

Chart 4.4: Local CR Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

Chart 4.5: Overseas CR Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

4.2.3 Profitability

Banks' profitability decreases yet remains positive

Profitability of the banks was positive, and, as at end-June 2020, ROA decreased to 0.6%. ROA for locally incorporated banks decreased to 0.8% in June 2020. For overseas banks, ROA decreased from 0.5% in June 2019 to 0.2% in June 2020. ROE for locally incorporated banks decreased to 6.0% from 8.0% during the same period. Net interest income (as a % of total income) decreased from 75.7% to 74.6% during the same period as well. Operating expenses as a proportion of total income increased from 38.0% in June 2019 to 54.9% in June 2020.

Table 4.6: CR Banks' Profitability

Indicator	Q2 2019	Q2 2020	Change
ROA (%) *	0.9	0.6	-0.3
ROA Locally Incorporated Banks (%)	1.1	0.8	-0.3
ROA Overseas Banks (%)	0.5	0.2	-0.3
ROE (%) **	8.0	6.0	-2.0
Net Interest Income (% Total Income)	75.7	74.6	-1.1
Operating Expenses (% Total Income)	38.0	54.9	-0.3

** 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 declines slightly

Between December 2019 and June 2020, bank deposits and non-bank deposits remained at similar level for retail banks. The overall loan-deposit ratio for the segment increased to 66.4% in June 2020 from 65.8% in December 2019. Liquid assets as a proportion of total assets decreased from 36.0% in

December 2019 to 32.8% in June 2020. Liquid assets as a proportion of the short-term liabilities presented an increase from 45.8% to 41.2% over this period.

Table 4.7: CR Bank's Liquidity

Indicator	Q4 2019	Q2 2020	Change
Liquid Asset Ratio (%)	36.0	32.8	-3.2
Loan-Deposit Ratio (%)	65.8	66.4	0.6
Non-Bank Deposits (% of Total Deposits)	75.3	73.3	-2.0

Source: CBB.

4.3 Conventional Wholesale Banks

4.3.1 Capital Adequacy

Slight decrease in capital adequacy

As at end-June 2020, the CAR for locally-incorporated wholesale banks decreased to 17.9% in June 2020 from the level of 18.6% it registered in December 2019. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) decreased from 17.7% in December 2019 to 17.0% recorded in June 2020. Furthermore, the leverage ratio (ratio of assets over capital) increased to 8.2% in June 2020. Finally, the ratio of NPLs net of provisions to capital increased to 6.2% over the same period.

Table 4.8: CW Banks' Capital Provisions Ratios *

Indicator	Q4 2019	Q2 2020	Change
CAR (%)	18.6	17.9	-0.7
Tier 1 CAR (%)	17.7	17.0	-0.7
Leverage (Assets/Capital) (times)	7.9	8.2	0.3
NPLs Net of Provisions to Capital (%)	5.0	6.2	1.2

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

4.3.2 Asset Quality

NPLs slightly increase due to an increase in local banks' NPLs

As at end-June 2020, the NPL ratio for conventional wholesale banks increased from 4.5% in December 2019 to 4.7% in June 2020. The NPL ratio of locally-incorporated wholesale banks increased from 5.1% in December 2019 to 6.3% in June 2020. Additionally, overseas wholesale banks witnessed a decrease in its NPL ratio from 4.0% to 3.5% over the same period. Specific provisions as a proportion of NPLs witnessed an increase of 1.5% from 70.8% in December 2019 to 72.3% in June 2020.

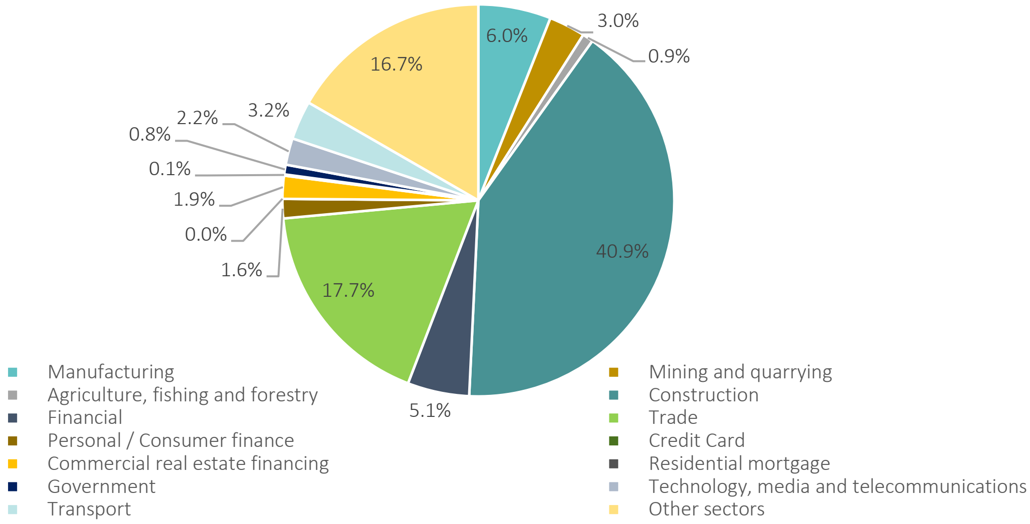
Table 4.9: CW Banks' NPL Ratios

Indicator	Q4 2019	Q2 2020	Change
NPLs (% Total Loans)	4.5	4.7	0.2
NPLs Local Banks (%)	5.1	6.3	1.2
NPLs Overseas Banks (%)	4.0	3.5	-0.5
Specific provisions (% of NPLs) *	70.8	72.3	1.5

** 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 construction sector (40.9%), trade (17.7%), other (14.7%) and others (16.7%) as indicated in chart 4.6.

Chart 4.6: CR Banks' NPLs Concentration by Sector (June 2020)



Source: CBB.

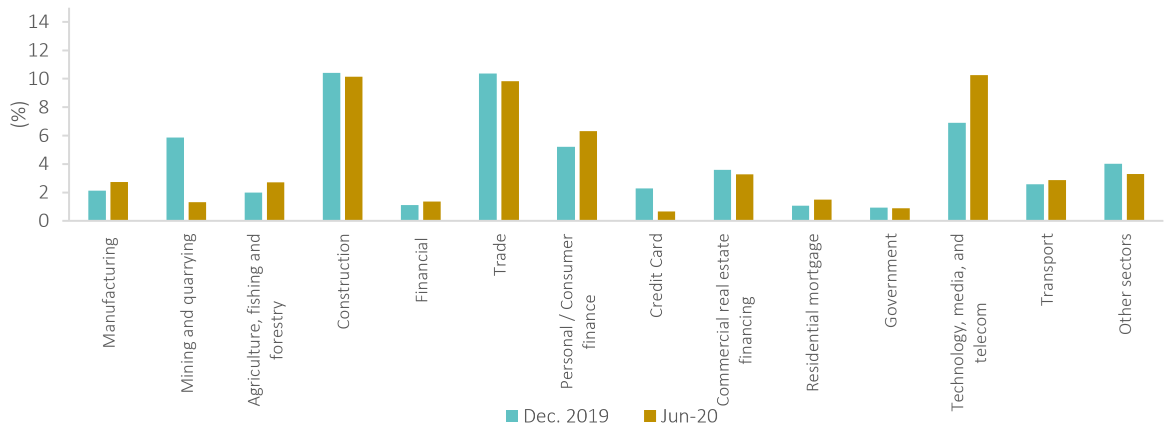
Table 4.12 depicts data on the sectoral breakdown of impaired loans and demonstrates that impairment in trade and construction were the highest between all sectors at 10.4%, followed by the technology, media and telecommunications sector with an impairment of 6.9%. The biggest increase was seen in the mining and quarrying sector which increased by 4.6%. The biggest decrease in impairment was found in the technology, media and telecommunications sector with a decrease of 3.4%.

Table 4.10: CW Banks' NPL Ratios by Sector (%)

Sector	Q4 2019	Q2 2020	Change
Manufacturing	2.7	2.1	-0.6
Mining and quarrying	1.3	5.9	4.6
Agriculture, fishing and forestry	2.7	2.0	-0.7
Construction	10.1	10.4	0.3
Financial	1.4	1.1	-0.3
Trade	9.8	10.4	0.6
Personal / Consumer finance	6.3	5.2	-0.9
Credit Card	0.7	2.3	1.6
Commercial real estate financing	3.3	3.6	0.3
Residential mortgage	1.5	1.1	-0.4
Government	0.9	0.9	0.0
Technology, media and telecommunications	10.3	6.9	-3.4
Transport	2.9	2.6	-0.3
Other sectors	3.3	4.0	0.7

Source: CBB.

Chart 4.7: CW Banks' NPL Ratios by Sector (%)



Source: CBB.

Loan portfolios remains concentrated

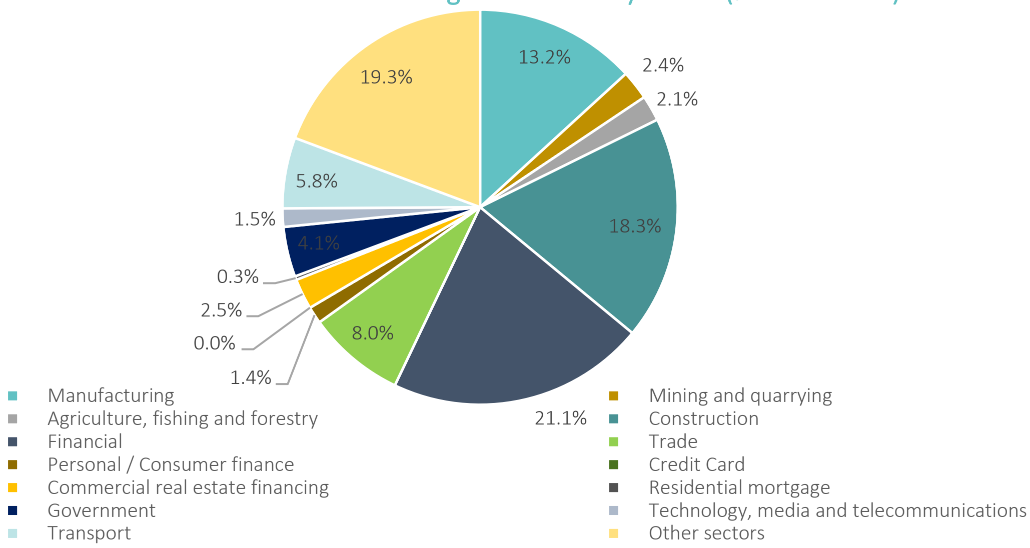
An examination of lending patterns as at end-June 2020 shows that, for conventional wholesale banks, the top recipient of loans was the financial sector, which accounted for 21.1% of total loans representing an increase of 1.3% compared to December 2019 (Table 4.13 and Chart 4.6). The top two sectors in conventional wholesale banks' lending as a % of total loans are the other and financial sectors, as they jointly account for 40.4% of total lending in June 2020. Exposure to real estate/ construction was 21.1% of total lending in June 2020, decreasing form 21.8% in December 2019.

Table 4.11: CW Banks' Lending Distribution by Sector (% Total Loans)

Sector	Q4 2019 *	June 2020 *	Change
Manufacturing	14.2	13.2	-1.0
Mining and quarrying	2.1	2.4	0.3
Agriculture, fishing and forestry	2.4	2.1	-0.3
Construction	18.9	18.3	-0.6
Financial	19.8	21.1	1.3
Trade	6.8	8.0	1.2
Personal / Consumer finance	1.4	1.4	0.0
Credit Card	0.0	0.0	0.0
Commercial real estate financing	2.7	2.5	-0.2
Residential mortgage	0.2	0.3	0.1
Government	4.8	4.1	-0.7
Technology, media and telecommunications	1.0	1.5	0.5
Transport	5.7	5.8	0.1
Other sectors	20.0	19.3	-0.7
Top Two Sectors (%)	39.8	40.4	0.6
Real Estate/ Construction Exposure (%) **	21.8	21.1	-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 4.8: 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 20.6% of total loans in June 2020, representing an increase of 0.2% from December 2019 (Table 4.14 and Chart 4.7). The highest two sectors continue to be the manufacturing and financial accounting for 40% of total lending in June 2020, an increase of 2.0% from the December 2019 level. The real estate/ construction exposure is 12.9% for the same period.

While observing overseas wholesale banks, the top recipient of loans in June 2020 was the construction sector, with 26.8% of total loans, followed by the other sectors sector, with 24.5% of total loans, with increases of 0.9% and 1.8% respectively from their December 2019 levels (Table 4.15 and Chart 4.8). The top 2 sectors (Construction and Other) jointly represented 51.7% in December 2019, a decrease of 0.3% from December 2019. Real estate/construction exposure decreased from 29.4% in December 2019 to 27.2% in June 2020.

Table 4.12: Local and Overseas CW Bank's Lending Distribution by Sector (% Total Loans)

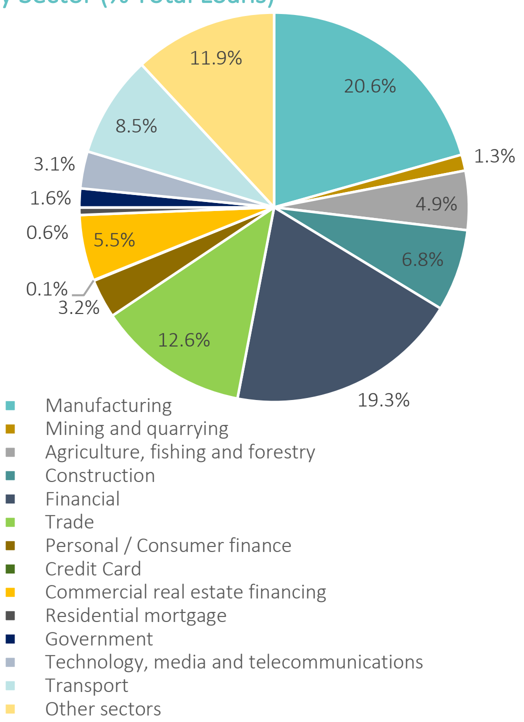
Sector	Locally Incorporated CR Banks*			Overseas CR Banks*		
	Q4 2019	Q2 2020	Change	Q4 2019	Q2 2020	Change
Manufacturing	20.4	20.6	0.2	9.1	7.6	-1.5
Mining and quarrying	1.5	1.3	-0.2	2.6	3.1	0.5
Agriculture, fishing and forestry	5.4	4.9	-0.5	0.0	0.0	0
Construction	6.8	6.8	0.0	29.0	26.8	-2.2
Financial	17.6	19.3	1.7	21.6	22.5	0.9
Trade	12.0	12.6	0.6	2.4	4.5	2.1
Personal / Consumer finance	3.0	3.2	0.2	0.0	0.0	0
Credit Card	0.1	0.1	0.0	0.0	0.0	0
Commercial real estate financing	5.4	5.5	0.1	0.4	0.3	-0.1
Residential mortgage	0.4	0.6	0.2	0.0	0.0	0
Government	1.5	1.6	0.1	7.5	6.0	-1.5
Technology, media and telecommunications	1.8	3.1	1.3	0.2	0.3	0.1
Transport	7.7	8.4	0.7	4.0	3.9	-0.1
Other sectors	16.4	11.9	-4.5	23.0	24.8	1.8
Top Two Sectors (%)	38.0	40.0	2.0	52.0	51.7	-0.3
Real Estate/ Construction Exposure (%) **	12.6	12.9	0 .3	29.4	27.2	-2.2

** 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.*

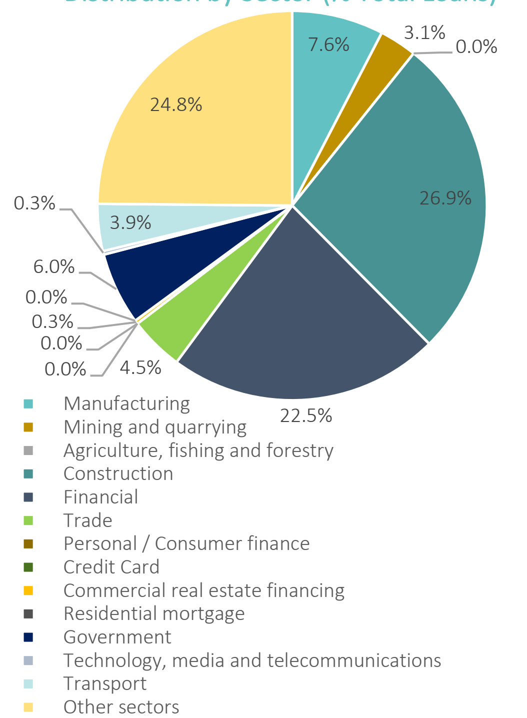
Source: CBB.

Chart 4.9: Local CW Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

Chart 4.10: Overseas CW Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

4.3.3 Profitability

Decline in profitability for Locally Incorporated Banks

ROA for the conventional wholesale banking sector decreased to 0.4% in June 2020 from 0.6% in December 2019. The ROA for *local wholesale banks* decreased from 0.5% to -0.3%, while *overseas wholesale banks* increased from 0.6% to 1.1%. ROE for *local wholesale banks* decreased from 4.1% to -2.3%. Net interest income as a proportion of total income increased from 42.0% in June 2019 to 66.9% in June 2020. Operating expenses as a proportion of total income showed an increase from 54.6% in June 2019 to 68.5% in June 2020.

Table 4.13: CW Banks' Profitability

Indicator	Q2 2019	Q2 2020	Change
ROA (%) *	0.6	0.4	-0.2
ROA Locally Incorporated Banks (%)	0.5	-0.3	-0.8
ROA Overseas Banks (%)	0.6	1.1	0.5
ROE (%) **	4.1	-2.3	-6.4
Net Interest Income (% Total Income)	42.0	66.9	24.9
Operating Expenses (% Total Income)	54.6	68.5	-0.2

** 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-June 2020, the overall loan-deposit ratio for conventional wholesale banks stood at 67.1%, a decrease from the 68.5% recorded in December 2019. The loan deposit ratio for *local wholesale banks* also increased from 61.2% in December 2019 to 59.8% in June 2020. Over the same period, the loan deposit ratio for *overseas wholesale* bank decreased slightly from 76.1% in December 2019 to 73.7% in June 2020.

Liquid assets for wholesale banks as a proportion of total assets increased to 22.2% in June 2020 from 21.3% in December 2019. Liquidity for *local wholesale banks* also declined over this period where their liquid asset ratio increased from 27.7% from 28.3%. *Overseas wholesale banks'* liquid assets ratio increased from 15.0% in December 2019 to 16.2% in June 2020.

The liquid assets as a proportion of short-term liabilities increased by 0.9% to be 27.2% in June 2020. Finally, non-bank deposits as a proportion of total deposits stood at 48.1%, a decrease from the 48.5% level achieved in December 2019, while bank deposits increased from 51.5% in December 2019 to 51.9% in June 2020.

Table 4.14: CW Banks' Liquidity

Indicator	Q4 2019	Q2 2020	Change
Liquid Asset Ratio (%)	21.3	22.2	0.9
Loan-Deposit Ratio (%)	68.5	67.1	-1.4
Non-Bank Deposits (% of Total Deposits)	48.5	48.1	-0.4

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 decreased to 18.8% in June 2020.

Capital adequacy ratio for conventional wholesale banks decreased to 17.9% over the same period. Non-performing loans decreased to 4.6% between the periods of December 2019 to June 2020 for conventional retail banks. As for conventional wholesale banks, loans classified as non-performing increased to 4.7% June 2020. Loan concentration remains high for conventional retail and for wholesale banks.

As at end-June 2020, return-on-assets (ROA) decreased from 0.9% to 0.6% for conventional retail banks and decreased to 0.4% for conventional wholesale banks. Return-on-equity (ROE) for *local retail banks* is 6.0% as of June 2020. ROE for *local wholesale banks* decreased from 4.8% to -2.3% when compared to December 2019. For conventional retail banks, liquid assets as a proportion of total assets decreased to reach 32.8% in June 2020. Liquid assets for wholesale banks as a proportion of total assets slightly increased from 21.3% in December 2019 to 22.2% in June 2020.

Chapter 5

Islamic Banks

Key Highlights

IR CAR	IR NPF	IR Provisions	IR ROA	IR ROE	IR Liquidity	IR Loan/Deposit
20.6% ↑	7.5% ↓	40.7% ↑	0.3% ↓	3.9% ↓	17.3% ↓	79.1% ↓
IW CAR	**IW NPF**	**IW Provisions**	**IW ROA**	**IW ROE**	**IW Liquidity**	**IW Loan/Deposit**
17.6% ↓	1.4% ↑	78.6%↓	0.4↓	-0.5% ↓	16.5% ↓	65.6% ↓

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

5.1 Overview

Chapter 5 offers macro-prudential 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 18.3% in December 2019 to 20.6% in June 2020. Tier 1 capital also increased from 15.7% in December 2019 to 17.8% in June 2020.

Table 5.1: IR Banks' Capital Provisions Ratios

Indicator	Q4 2019	June 2020	Change
CAR (%)	18.3	20.6	2.3
Tier 1 CAR (%)	15.7	17.8	2.1
NPFs net of provisions to capital (%)	38.8	25.7	-13.1

Source: CBB.

5.2.2 Asset Quality

Decrease in non-performing facilities

Non-performing facilities (NPF) ratio decreased to 7.5% in June 2020. Specific provisoining increased to 40.7% in June 2020 from 36.7% in December 2019.

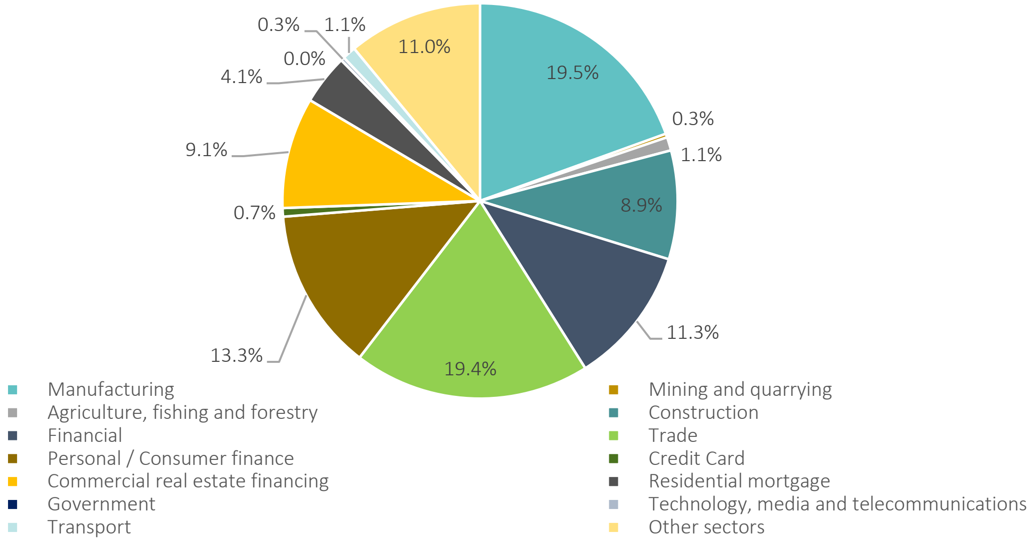
Table 5.2: IR Banks' NPF Ratios

Indicator	Q4 2019	Q2 2020	Change
NPFs (% Gross Facilities)	10.4	7.5	-2.9
Specific Provisions (% of NPFs)	36.7	40.7	4.0

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 manufacturing sector (19.5), Trade (19.4), personal/consumer finance (13.3) as indicated in chart 5.1.

Chart 5.1: IR Banks' NPFs Concentration by Sector (June 2020)



Source: CBB.

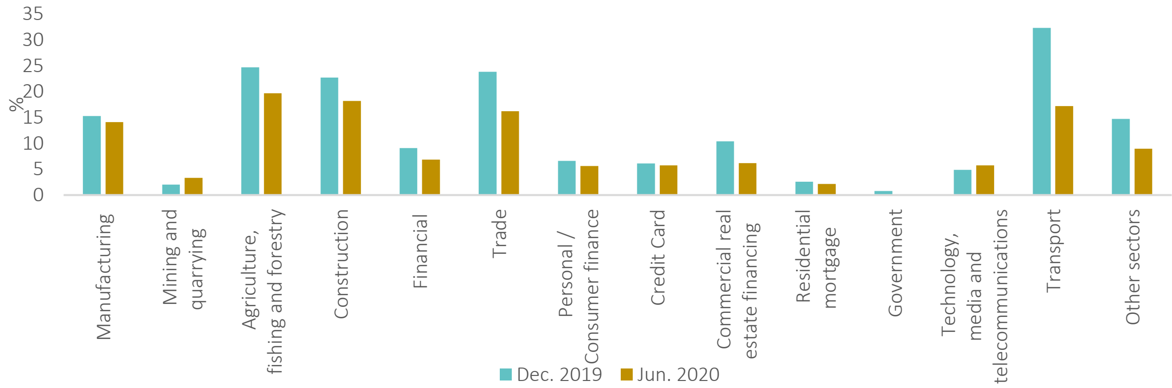
A look at the non-performing facilities by sector indicates that the agriculture, fishing and forestry sector had the highest impairment of 19.6% in June 2020 followed by construction and transport with 18.2% and 17.23% respectively. The biggest declines in NPFs by sector was in the trade sector which went down by 7.7%. The biggest increase in NPFs was the mining and quarrying and technology sectors with an increase of 1.3% and 0.8% respectively as indicated in table 5.3).

Table 5.3: IR Banks' NPF Ratios by Sector (%)

Sector	Q4 2019	Q2 2020	Change
Manufacturing	15.3	14.1	-1.2
Mining and quarrying	2.0	3.3	1.3
Agriculture, fishing and forestry	24.7	19.6	-5.3
Construction	22.7	18.2	-4.5
Financial	9.1	6.8	-2.3
Trade	23.8	16.2	-7.7
Personal / Consumer finance	6.6	5.6	-1.0
Credit Card	6.1	5.8	-0.3
Commercial real estate financing	10.4	6.2	-4.2
Residential mortgage	2.6	2.1	-0.5
Government	0.8	0.0	-0.8
Technology, media and telecommunications	4.9	5.7	0.8
Transport	32.3	17.2	-2.3
Other sectors	14.7	9.0	-5.7

Source: CBB.

Chart 5.2: IR Banks' NPF Ratios by Sector (%)



Source: CBB.

Loan portfolios remain concentrated

There has been a diversification in the asset concentration among most of the sectors. At the end of June 2020, the top recipient of financing was personal/consumer finance at 17.7%, a slight increase from 17.6% in December 2019. The top two recipients of financing (personal/consumer finance and residential mortgage) accounted for 32.3% of total facilities extended, compared to 30.6% for the top two sectors in December 2019. Real estate/construction exposure decreased increased slightly to 29.3% in June 2020.

Table 5.4: IR Banks' Lending Distribution by Sector (% Total Facilities)

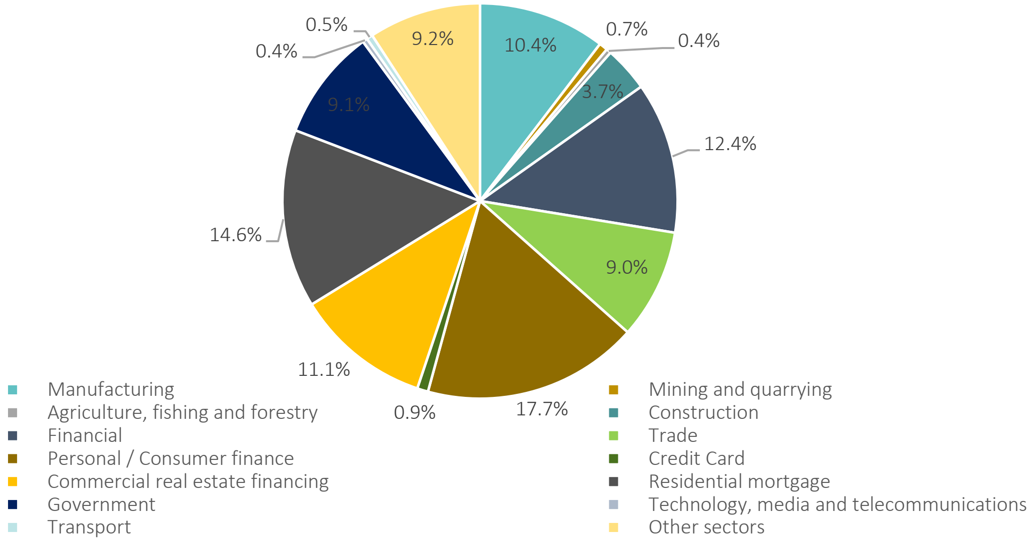
Sector	Q4 2019 *	Q2 2020 *	Change
Manufacturing	11.2	10.4	-0.8
Mining and quarrying	1.0	0.7	-0.3
Agriculture, fishing and forestry	0.4	0.4	0
Construction	3.7	3.7	0
Financial	11.9	12.4	0.5
Trade	10.2	9.0	-1.2
Personal / Consumer finance	17.6	17.7	-0.6
Credit Card	1.1	0.9	-0.2
Commercial real estate financing	11.6	11.1	-0.4
Residential mortgage	13.0	14.6	1.6
Government	9.2	9.1	-0.1
Technology, media and telecommunications	0.6	0.4	-0.2
Transport	0.3	0.5	0.2
Other sectors	8.1	9.2	1.1
Top two recipient sectors	30.6	32.3	1.7
Real Estate/ Construction Exposure**	28.4	29.3	0.9

Source: CBB.

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

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

Chart 5.3: IR Banks' Lending Distribution by Sector (%Total Facilities)



Source: CBB.

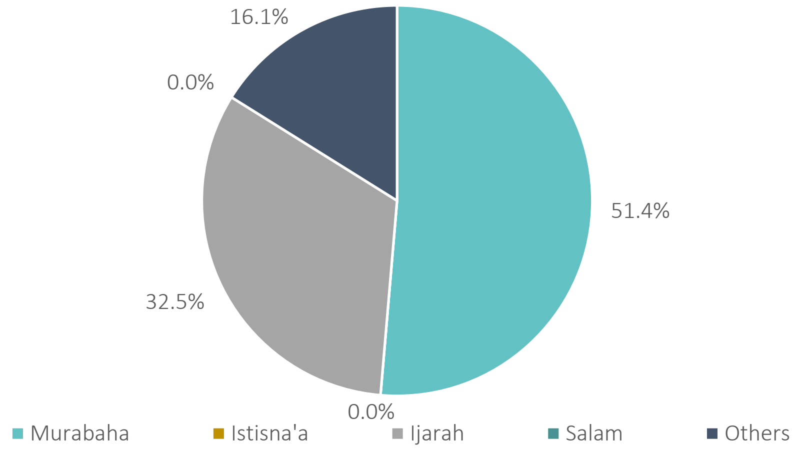
The concentration of lending distribution by Islamic instrument remained the same over the past quarter. At the end of June 2020, the top recipient of finance was Murabaha at 51.3% in June 2020 down from 53.8% in December 2019. This was followed by Ijarah, which increased from 26.7% to 32.5% for the same period.

Table 5.5: IR Banks' Lending Distribution by Islamic Instrument (%Total Facilities)

Instrument	Q4 2019*	Q2 2020*	Change
Murabaha	53.8	51.3	-2.5
Istisna'a	1.0	0.0	-1.0
Ijarah	26.7	32.5	5.8
Salam	0.6	0.0	-0.6
Others	17.9	16.1	-1.8

**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

ROA for Islamic retail banks decreased to 0.2% in June 2020 compared to 0.3% in June 2019. ROE also decreased from 3.9% to 2.1% for the same period. Furthermore, operating expenses increased from 73.3% in June 2019 to 83.7% in June 2020.

Table 5.6: IR Banks' Profitability (%)

Indicator	Q2 2019	Q2 2020	Change
ROA*	0.3	0.2	-0.1
ROE**	3.9	2.1	-1.8
Operating expenses (% total operating income)	73.3	83.7	10.4

Source: CBB.
** ROA = ratio of net income to assets.*
***ROE = ratio of net income to tier 1 capital.*

5.2.4 Liquidity

Liquidity remains remain stable

The volume of liquid assets available to Islamic retail banks slightly decreased from 17.5% of total assets in December 2019 to 17.3% in June 2020. The ratio of total facilities to deposits decreased from 92.5% in December 2019 to 79.1% in June 2020.

Table 5.7: IR Banks' Liquidity (%)

Indicator	Q4 2019	Q2 2020	Change
Liquid Assets (% of total assets)	17.5	17.3	-0.2
Facilities – deposits ratio (%)	92.5	79.1	-13.4

Source: CBB.

5.3 Islamic Wholesale Banks

5.3.1 Capital Adequacy

Capital positions remain stable with slight increase

As at end-June 2020, the CAR for Islamic wholesale banks increased from 17.4% from 17.6% in June 2020. Tier 1 capital also decreased slightly 16.3% to 16.2% over the same period. The ratio of NPFs net of provisions to capital increased to reach 1.3% in June 2020.

Table 5.8: IW Banks' Capital Provisions Ratios

Indicator	Q4 2019	Q2 2020	Change
CAR (%)	17.4	17.6	0.2
Tier 1 CAR (%)	16.3	16.2	-0.1
NPFs net of provisions to capital	0.3	1.3	1.0

Source: CBB.

5.3.2 Asset Quality

NPFs remain stable with little increase

As of end-June 2020, NPF ratio for Islamic wholesale banks rose to 1.4%. Provisioning for NPFs decreased from 93.8% to 78.6% over the same period.

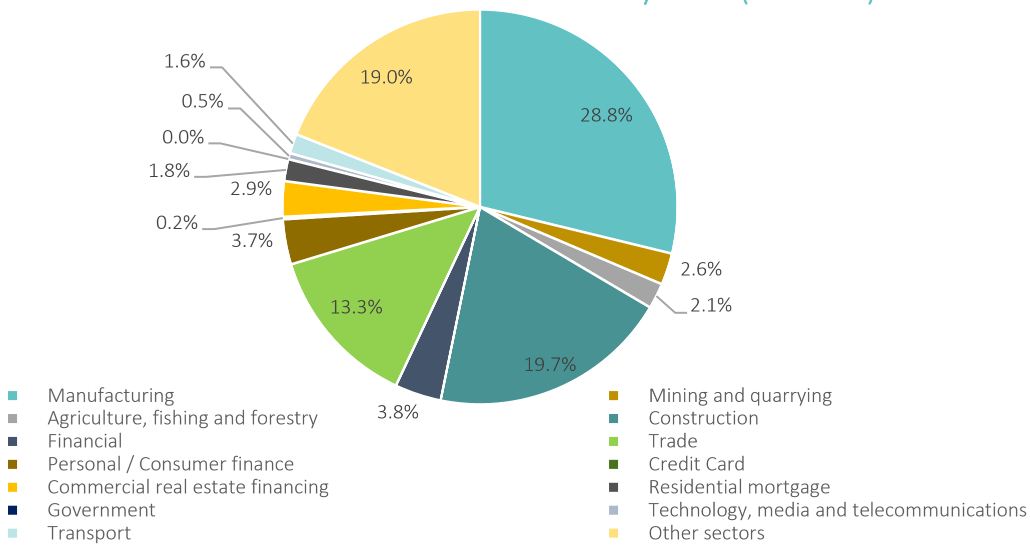
Table 5.9: IW Banks' NPF Ratios

Indicator	Q4 2019	Q2 2020	Change
NPFs (% Gross Facilities)	1.1	1.4	0.3
Specific Provisioning (% of NPFs)	93.8	78.6	-15.2

Source: CBB.

Looking at the data on the concentration of NPFs by sector indicates that that the majority of NPFs are concentrated and come from manufacturing (28.8%), construction (19.7%), and other sectors (19%) as indicated in chart 5.5.

Chart 5.5: IW Banks' NPFs Concentration by Sector (June 2020)



Source: CBB.

The sector with the highest impairment was the agriculture, fishing and forestry sector with 16.1% in June 2020, up from the 4.3% in December 2019. This was followed by the mining and quarrying and other sectors with 16.0% and 14.5% respectively.

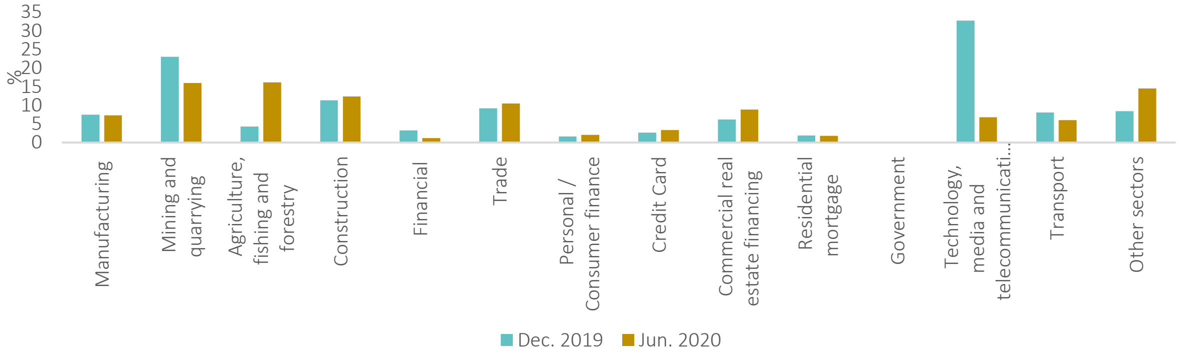
Available data on the sectoral breakdown of non-performing facilities shows that the biggest increase was in the agriculture, fishing and forestry sector with an increase of 11.8%. The biggest drop was in technology, media and telecommunications sector with a decrease of 25.9% from 32.7% in December 2019 to 6.8% in June 2020.

Table 5.10: IW Banks' NPF Ratios by Sector (%)

Sector	Q4 2019	Q2 2020	Change
Manufacturing	7.5	7.3	-0.2
Mining and quarrying	23.0	16.0	-7.0
Agriculture, fishing and forestry	4.3	16.1	11.8
Construction	11.3	12.4	1.1
Financial	3.3	1.2	-2.1
Trade	9.2	10.5	-1.3
Personal / Consumer finance	1.6	2.1	0.5
Credit Card	2.7	3.4	0.7
Commercial real estate financing	6.2	8.8	2.6
Residential mortgage	1.9	1.8	-0.1
Government	0.0	0.0	0.0
Technology, media and telecommunications	32.7	6.8	-25.9
Transport	8.1	6.0	-2.1
Other sectors	8.4	14.5	6.1

Source: CBB.

Chart 5.6: IW Banks' NPF Ratios by Sector (%)



Source: CBB.

Loan portfolios remain concentrated

At End-June 2020, the manufacturing was the top recipient of financing from Islamic wholesale banks, at 24.3%. The financial sector saw the largest decrease from 25.3% in December 2019 to 19.75 in June 2020. The Manufacturing sector saw the largest increase by 3.1%.

Table 5.11: IW Banks' Lending Distribution by Sector (%Total Facilities) *

Sector	Q4 2019	Q2 2020	Change
Manufacturing	21.2	24.3	3.1
Mining and quarrying	1.0	1.0	0.0
Agriculture, fishing and forestry	0.7	0.8	0.1
Construction	10.7	9.8	-0.9
Financial	25.5	19.7	-5.3
Trade	7.9	7.8	-0.1
Personal / Consumer finance	9.8	10.9	1.1
Credit Card	0.4	0.3	-0.1
Commercial real estate financing	2.2	2.1	-0.1
Residential mortgage	5.4	6.3	0.9
Government	5.9	6.9	1.0
Technology, media and telecommunications	0.1	0.4	0.3
Transport	1.6	1.6	0.0
Other sectors	7.7	8.1	0.4
Top two recipient sectors	46.6	44.0	-2.6
Real Estate/ Construction Exposure**	18.3	18.1	-0.2

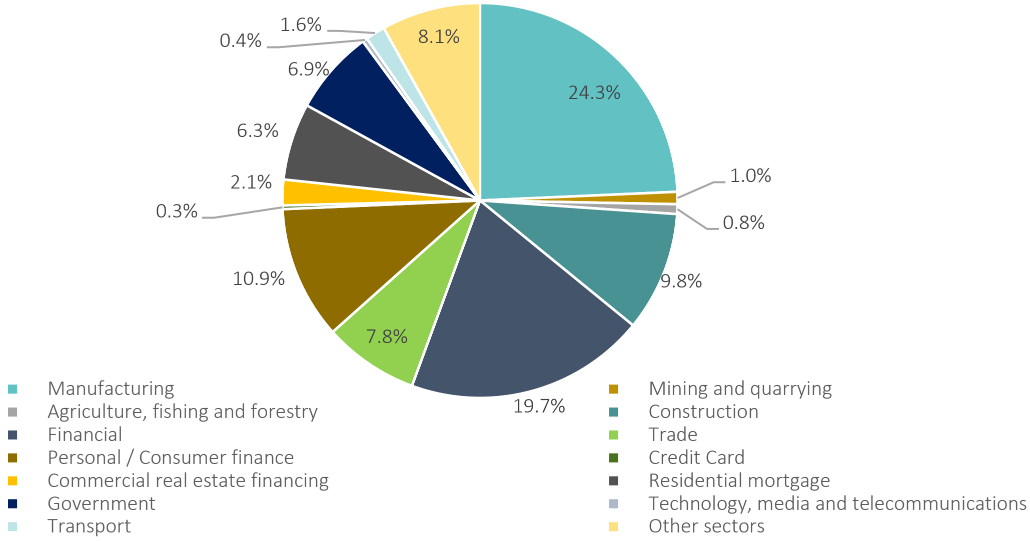
Source: CBB.

**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 June 2020 (financial and manufacturing) jointly represented 44.0% of total financing. Real estate/ construction exposure slightly decreased from 18.3% in December 2019 to 18.1% in June 2020.

Chart 5.7: IW Banks' Lending Distribution by Sector (%Total Facilities)



Source: CBB.

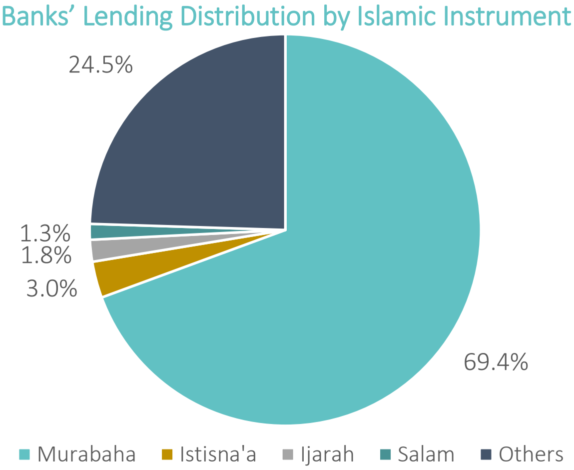
Lending distribution by Islamic instrument shows that at the end of June 2020, the top recipient of finance was Murabaha at 69.4%, up from 64.45 in December 2019.

Table 5.12: IW Banks' Lending Distribution by Islamic Instrument (%Total Facilities)

Instrument	Q4 2019	Q2 2020	Change
Murabaha	64.5	69.4	4.9
Istisna'a	2.5	3.0	0.5
Ijarah	1.7	1.8	0.1
Salam	1.3	1.3	0.0
Others	30.0	24.5	-5.5

**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

ROA decreased from 0.4% in June 2019 to 0.0% in June 2020. ROE also decreased from 3.0% to -0.5% in the same period. Furthermore, operating expenses (as % of total income) increased from 70.2% in June 2019 to 94.3% in June 2020.

Table 5.13: IW Banks' Profitability (%)

Indicator	Q2 2019	Q2 2020	Change
ROA*	0.4	0.0	-0.4
ROE**	3.0	-0.5	-3.5
Operating expenses (% total operating income)	70.2	94.3	24.1

Source: CBB.
** ROA = ratio of net income to assets.*
***ROE = ratio of net income to tier 1 capital.*

5.3.4 Liquidity

Liquidity levels remain stable

As of end-June 2020, liquid assets of Islamic wholesale banks represented 16.5% of total assets, 1.2% lower than the 17.7% registered in December 2019. Additionally, the facilities deposit ratio decreased from 69.9% in December 2019 to 65.6% in June 2020.

Table 5.14: IW Banks' liquidity (%)

Indicator	Q4 2019	Q2 2020	Change
Liquid assets (% of total)	17.7	16.5	-1.2
Facilities-deposit ratio	69.9	65.6	-4.3

Source: CBB.

5.4 Overall Assessment of the Islamic Banking Sector

The financial soundness indicators show that Islamic retail banks capital positions increased to 20.6% while wholesale banks increased to 17.6% respectively during the period between December 2019 and June 2020. Non-performing facilities decreased to 7.5% 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 a decrease 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

Performance of the Insurance Sector

Key Highlights

Insurance Licenses	Contribution to GDP	Contribution to Financial	Assets of Conv. Insurance	Assets of Takaful Insurance	Gross Premiums
138	5.6%	33.2%	BD 2,295.3 mn	BD 207.8 mn	BD 75.6 mn

- Conventional firms account for 66.6% of total insurance industry with BD 50.3 million in total gross premiums as of March 2020.
- General insurance contributes for 73.5% 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), Medical and Motor business lines.

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-March 2019 (Q1 2019) and end-March 2020 (Q1 2020), unless otherwise indicated.

A significant number of insurance companies and organizations have established their presence in Bahrain. As of June 2020, there are a total of 138 insurance organizations licensed and registered in the Kingdom. There are 35 insurance companies: 16 conventional local, 12 conventional overseas/foreign branches, and 6 takaful. From these companies, 2 companies are conventional re-insurance firms and 2 re-takaful firms. These institutions offer all basic and modern insurance services such as medical and health insurance and long-term insurance (life and savings products). The remaining 105 other registered insurance licenses include:

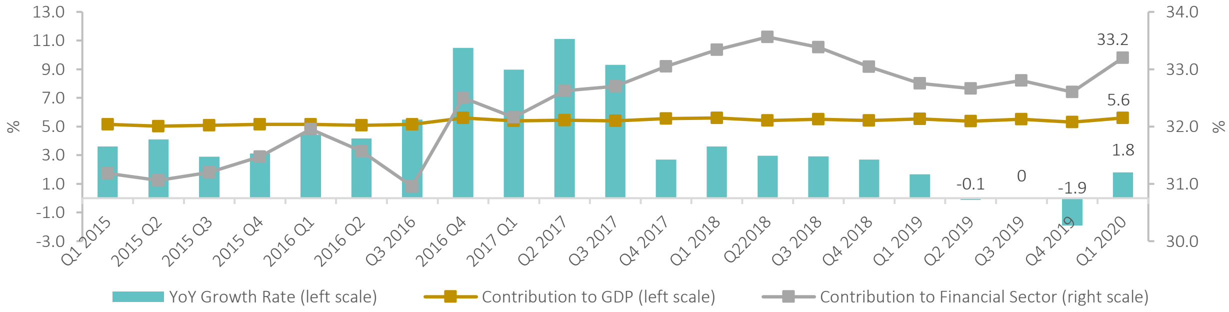
- 34 Insurance Brokers,
- 4 Insurance Managers,
- 3 Insurance Consultants,
- 17 Insurance Firms, brokers and consultants restricted to business outside Bahrain,
- 32 Registered Actuaries,
- 12 Registered loss Adjusters, and
- 2 Insurance Pools and Syndicates.

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, 5.4% by end of 2019. As of March 2020, the insurance sector represented 5.6% of the real GDP. The contribution of the Insurance sector to the overall financial sector has increased representing 33.2% as of Q1 2020. Chart 6.1 shows the

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

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 (%)



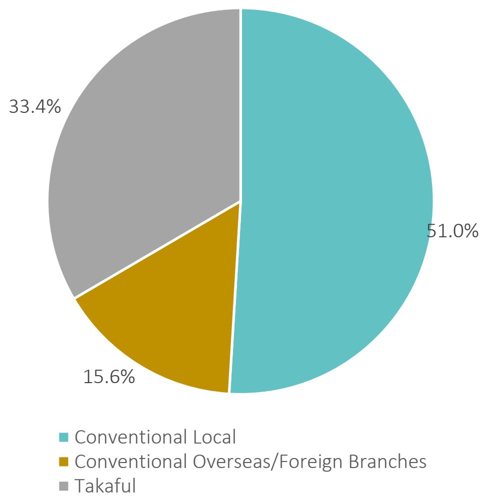
Source: IGA.

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 March 2020, conventional insurance represented 66.6% of the total gross premiums accounting for BD 50.3 million. Local conventional and branches represented 51.0% and 15.6% of total gross premiums accounting for BD 38.5 million and BD 11.8 million respectively (Chart 6.2). Takaful firms accounted for 33.4% of gross premiums (BD 25.2 million) in the industry for the same period.

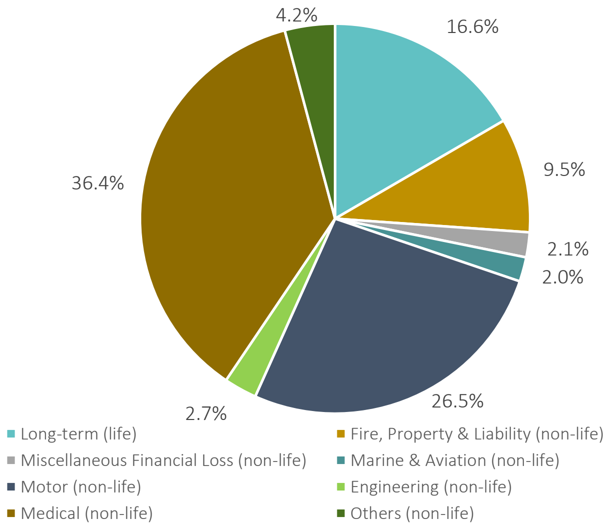
The Insurance products and services in the Kingdom are delivered via two main insurance classes: Life and non-life insurance.[5] As of March 2020, life insurance represented 16.6% of gross premiums while non-life/general insurance represented 83.4% covering the various classes (Graph 6.3).

Chart 6.2: Gross Premiums of Insurance Sector by Segment (%)



Source: CBB.

Chart 6.3: Market Share of Gross Premiums by Class (%)



Source: CBB.

For non-life insurance, medical and motor insurance had the largest share in terms of their contribution to gross premiums accounting for 36.4% and 26.5% respectively. Fire, property, and liability made 9.5%

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

of gross premiums. The top 3 business lines sectors represented 72.4% 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 March 2020, total assets of the Insurance sector reached BD 2,503.1 million with a decrease of 3.5% compared to BD 2,594.9 million in March 2019. Total liabilities had a decrease of 0.4% over the same period reaching BD 1,853.1 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*	
	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020
Conventional	**2,397,484**	**2,295,348**	**1,734,110**	**1,721,116**	**338,968**	**355,443**	**12,293**	**-500**
Local	2,027,954	2,044,394	1,489,431	1,508,486	316,464	321,876	10,098	-2,774
Overseas	369,530	250,954	244,679	212,630	22,504	33,567	2,195	2,274
Takaful	**197,391**	**207,794**	**127,089**	**131,950**	**55,293**	**59,336**	**1,560**	**1,289**
All Insurance	**2,594,876**	**2,503,142**	**1,861,198**	**1,853,066**	**394,261**	**414,778**	**13,853**	**789**

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

Total capital on the other hand, increased from 394.3 BD million in March 2019 to 414.8 BD million in March 2020. Profitability declined between March 2019 and March 2020 reaching BD 0.8 million due to a decline in profits in conventional local insurance firms.

6.3.1 Conventional Insurance Firms

a. Assets: As of March 2020, total assets of the conventional insurance sector stood at BD 2,295.3 million decreasing by 4.3% compared to the BD 2,397.5 million registered in March 2019.
    i. Total assets of local insurance Firms were BD 2,044.4 million (89.1% of total assets) with a growth rate of 0.8% since March 2019.
    ii. Total assets of overseas foreign branches were BD 251 million (10.9% of total assets) recording a decline of 32.1%.
b. Liabilities: As of March 2020, the liabilities of the conventional insurance sector registered at BD 1,721.1 million with a 0.7% decrease from the BD 1,734.1 million in March 2019.
    i. The liabilities for local insurance firms registered at BD 1,508.5 million with an increase of 1.3%.
    ii. The liabilities of overseas foreign branches were BD 212.6 million in March 2020 with a decrease of 13.1%.
c. Available Capital[6]: Total capital as of March 2020 was at BD 355.5 million increasing by 4.9% from the BD 339.0 million in the equivalent period of the previous year.
    i. Total available capital for local insurance was BD 321.9 with a YoY increase of 1.7%.
    ii. Total available capital for overseas foreign branches insurance increased by 49.2%. The amount raised from BD 22.5 million in March 2019 to BD 33.6 million in March 2020.
d. Profitability: Net profit decreased for conventional insurance firms from BD 12.3 million in March 2019 to a loss of BD 0.5 million in March 2020.

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

i. Net loss for local insurance was BD 2.8 million with a YoY decrease of 127.5% from a profit.
ii. Net profit for overseas insurance was BD 2.3 with a year to year increase of 3.6%.

6.3.2 Takaful Insurance Firms

a. Assets: Total assets in Takaful firms in March 2020 experienced an annual growth of 5.3% reaching BD 207.8 million compared to BD 197.4 million in March 2019.
b. Liabilities: The liabilities increased by 3.8% from BD 127.1 million in March 2019 to BD 132 million in March 2020.
c. Available Capital: Total regulatory capital experienced an annual increase of 7.3% from BD 55.3 million in March 2019 to BD 59.3 million in March 2020.
d. Profitability: Takaful companies showed a 17.4% decrease in profits between March 2019 and March 2020 reaching BD 1.3 million.

6.4 Insurance Premiums and Claims Analysis by Class

6.4.1 Overall Insurance

As of March 2020, the Gross Premiums for the overall insurance sector stood at BD 75.6 million, increasing by 0.8% YoY. Looking at the performance by class, Marine and Aviation category experienced the greatest decline within the rest of the insurance business line, with an annual decrease of 35.0%, followed by Engineering and Long-term (Life), decreasing by 26.0% and 12.6% respectively. On the other hand, Miscellaneous and Financial Loss and Other insurance experienced an annual increase by 41.4% and 19.9% during the same period.

As of March 2020, Net Premiums Written remained at similar level compared to the previous period registering a value of BD 51.3 million. The Medical class showed the biggest increase over the period increasing by 10.2%, from BD 15.7 million in March 2019 to BD 17.3 million in March 2020. On the other hand, the biggest decline was derived Miscellaneous Financial Loss class, decreasing from BD 123 million in March 2019 to BD -13 million in March 2020.

However, Gross Claims for the overall insurance industry recorded a YoY increase of 16.0% from BD 33.4 million in March 2019 to BD 38.8 million in March 2020. The increase was mainly due to an increase in Fire, Property and Liability by BD 7.1 million from BD -2.0 million in March 2019 to BD 5.1 million in March 2020.

Net Claims for the overall insurance industry show a decrease of 5.7%, which was derived from an annual decrease in Long-term (Life) by BD 1.7 million (27.2%), followed by Motor by BD 1.5 million (10.7%) over the same period. The greatest increase was recorded in Medical by BD 1.3 million (16.9%).

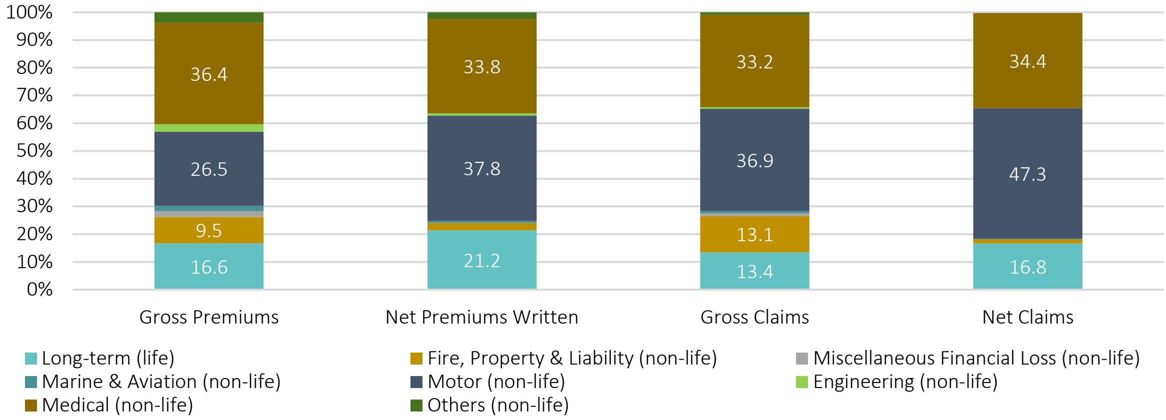
Table 6.2: Gross Premiums and Claims for all Insurance Firms by Class– Bahrain Operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020
Long-term (Life)	14,367	12,556.5	12,824	10,878	6,980	5,204	6,209	4,519
Fire, Property & Liability	6,762	7,189	1,521	1,349	-1,952	5,098	-311	409
Miscellaneous Financial Loss	1,105	1,562	123	-13	412	348	9	4
Marine & Aviation	2,354	1,531	360	358	606	321	93	62
Motor	19,970	20,027	19,180	19,384	16,816	14,308	14,280	12,753
Engineering	2,787	2,062	432	385	-1,382	242	69	-74
Medical	24,995	27,514	15,726	17,331	10,809	12,892	7,924	9,267
Others	2,622	3,143	1,381	1,579	1,134	369	327	29
Total	**74,962**	**75,586**	**51,547**	**51,251**	**33,423**	**38,782**	**28,601**	**26,968**

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 Net Premiums Written (37.8%), Gross Claims (36.9%), and Net Claims (47.3%). Whereas, the highest exposure in Gross Premiums was Medical representing (36.4%).

Chart 6.4: Concentrations of Gross Premiums and Claims for all Insurance Firms by Class – Bahrain Operations (Q1 2020)



Source: CBB.

6.4.2 Conventional Insurance

The Gross Premiums recorded for conventional insurance showed a YOY increase by BD 1.1 million (2.3%), where total gross premiums increased from BD 49.2 million in March 2019 to BD 50.3 million in March 2020 (Table 6.3). The greatest increases, excluding Others, were from Miscellaneous Financial Loss by around BD 0.3 million (41.4%) and Medical BD 2.3 million (15.3%). The largest YoY decline was by Marine & Aviation with BD 0.9 million (44.3%). In terms of concentration, Medical and Motor business classes represented 33.8% and 27.0% respectively of the total gross premiums.

Net Premiums Written reflected an annual increase by 1.3% compared to March 2019. Motor insurance remained the largest in terms of Net Premiums Written concentration as well, accounting for 38.5%, increasing by 0.5% from BD 13.1 million in March 2019 to BD 13.2 million in March 2020.

Gross Claims increased by 27.8% YoY in March 2020 due to an increase in Fire, Property & Liability from BD -2.2 million in March 2019 to BD 4.9 million by March 2020. The highest share in gross claims was Motor 36.6%, followed by Medical at 26.7%.

Net Claims on the other hand, experienced an annual decrease of 9.2% from BD 19.3 million in March 2019, reaching BD 17.5 million in March 2020. Fire, property, and Liability business line decreased by 207.2%. Nonetheless, the concentration falls heavily within the Motor insurance class, accounting for 49.0% of the total net claims.

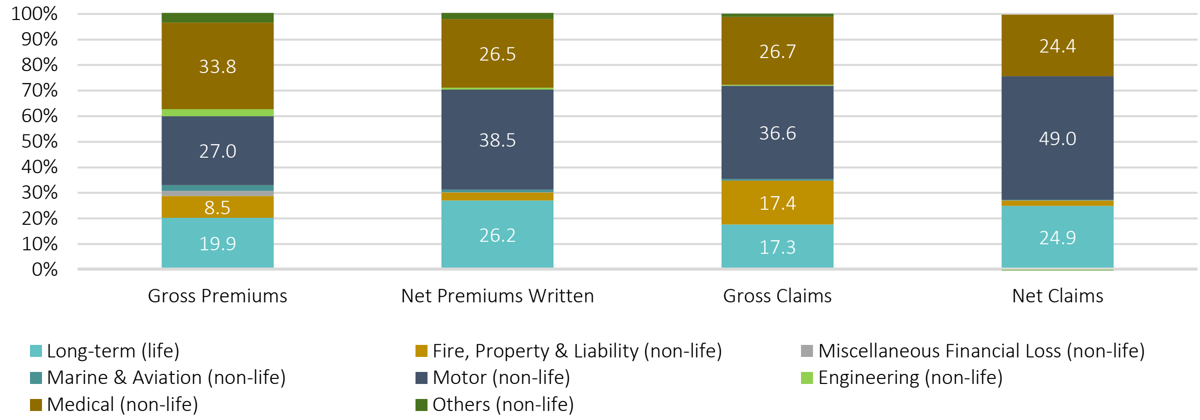
Table 6.3: Gross Premiums and Claims for Conventional Insurance by Class – Bahrain Operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020
Long-term (Life)	10,263	10,007	9,305	9,001	6,341	4,869	5,934	4,354
Fire, Property & Liability	3,972	4,298	1,216	1,089	-2,226	4,900	345	370
Miscellaneous Financial Loss	691	977	46	32	378	-72	0	5
Marine & Aviation	2,087	1,162	312	341	597	162	85	51
Motor	13,679	13,585	13,149	13,213	11,370	10,324	9,847	8,573
Engineering	2,152	1,366	366	263	-1,429	118	-2	-108
Medical	14,760	17,018	8,375	9,091	6,297	7,524	3,502	4,263
Others	1,582	1,901	1,153	1,319	739	383	246	14
Total	**49,187**	**50,314**	**33,921**	**34,349**	**22,067**	**28,208**	**19,267**	**17,485**

Source: CBB.

Motor insurance has the highest exposure in Net Premiums Written (38.5%), Gross Claims (36.6%), and Net Claims (49.0%).

Chart 6.5: Concentrations of Gross Premiums and Claims for Conventional Insurance by Class - Bahrain Operations (Q1 2020)



Source: CBB.

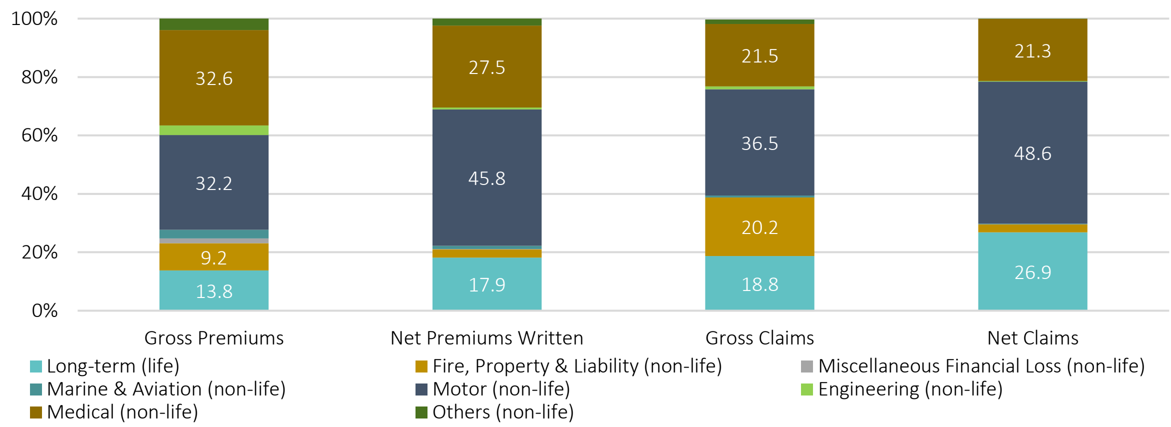
Table 6.4 below and Charts 6.6 and 6.7 shows a further division of the premiums and claims by class between Local and Overseas firms within the conventional insurance industry for March 2020. For local conventional insurance, Motor insurance has the highest concentration for Net Premiums Written (45.8%), Gross Claims (36.5%), and Net Claims (48.6%).

Table 6.4: Gross Premiums and Claims for Conventional Local and Overseas Insurance by Class – Bahrain Operations (Q1 2020)

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)	5,296	4,711	10,007	4,708	4,293	9,001	4,858	11	4,869	4,326	27	4,354
Fire, Property & Liability	3,537	761	4,298	736	353	1,089	5,228	-328	4,900	429	-59	370
Miscellaneous Financial Loss	653	324	977	13	19	32	-72	0	-72	-5	0	-5
Marine & Aviation	1,120	42	1,162	301	40	341	163	-1	162	52	-1	51
Motor	12,417	1,168	13,585	12,062	1,151	13,213	9,446	878	10,324	7,822	751	8,573
Engineering	1,261	105	1,366	164	99	263	259	-140	118	33	-141	-108
Medical	12,547	4,471	17,018	7,236	1,855	9,091	5,560	1,964	7,524	3,435	828	4,263
Others	1,680	221	1,901	1,112	208	1,319	406	-23	383	6	-20	-14
Total	**38,512**	**11,801**	**50,314**	**26,332**	**8,017**	**34,349**	**25,847**	**2,361**	**28,208**	**16,099**	**1,386**	**17,485**

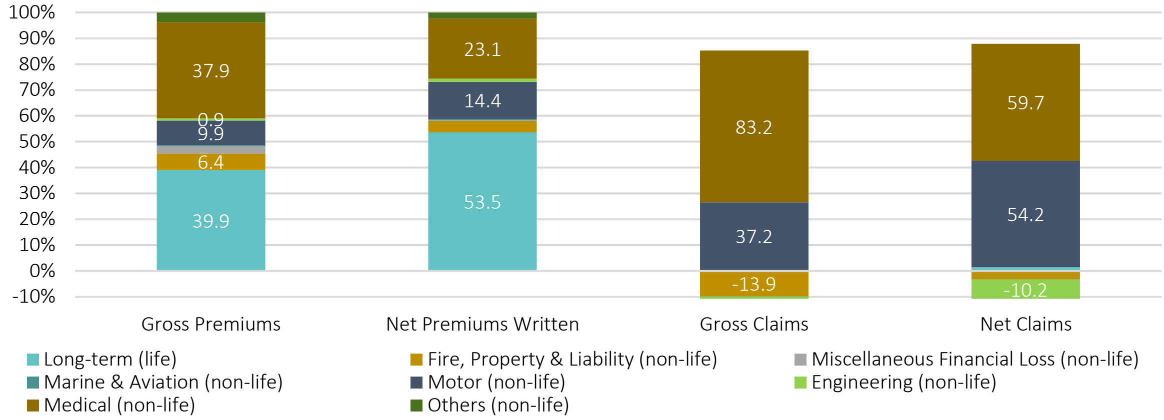
Source: CBB.

Chart 6.6: Concentrations of Gross Premiums and Claims for Conventional Local Insurance by Class - Bahrain Operations (Q1 2020)



Source: CBB.

Chart 6.7: Concentrations of Gross Premiums and Claims for Conventional Overseas Insurance by Class - Bahrain Operations (Q1 2020)



Source: CBB.

6.4.3 Takaful

The Gross Premiums for Takaful companies decreased on a YoY basis by 2.0%, from BD 25.8 million at March 2019 reaching BD 25.3 million in March 2020. The largest decrease was attributed to Long-term (Life) decreasing by BD 1.5 million (37.9%). Medical Insurance line recorded the highest contributor towards total Takaful gross premiums, accounting for 41.5% of the total.

Net Premiums Written decreased by 4.1% from March 2019 to March 2020, reaching BD 16.9 million. Medical and Motor insurance accounted for the largest components in terms of gross claims, representing 48.8% and 36.5% of the total net premiums written.

Gross Claims decreased by 6.9% compared from March 2019 to March 2020, with Motor registering the largest decrease (26.9%) within the same period. Medical and Motor insurance accounted for the largest components in terms of gross claims, representing 50.8% and 37.7% of the total gross claims.

Net Claims recorded an annual increase of 1.6% at March 2020, with Medical having the highest increase of 13.2% respectively. Furthermore, Medical and Motor representing the largest components of net claims, accounting for 52.8% and 44.1% from the total respectively.

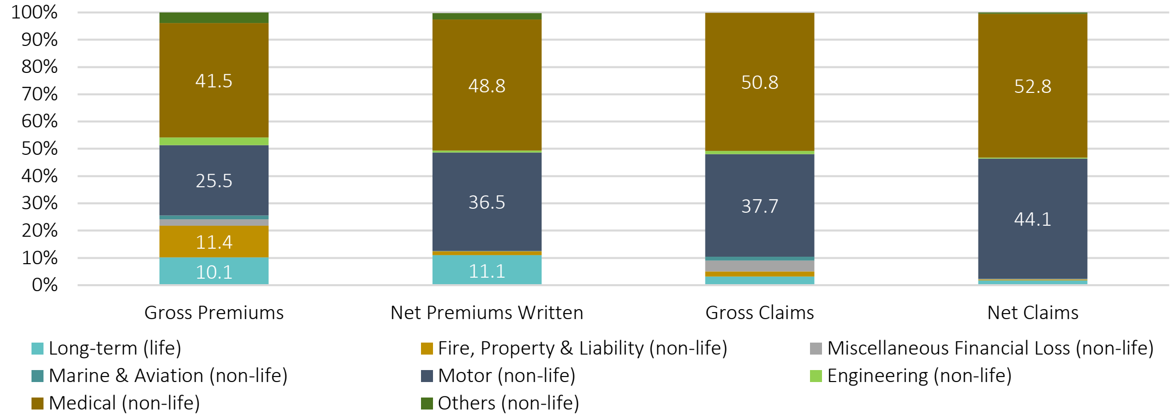
Table 6.5: Gross Premiums and Claims for Takaful Insurance Firms by Class – Bahrain Operations

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020	Q1 2019	Q1 2020
Long-term (Life)	4,104	2,550	3,519	1,878	638	335	275	165
Fire, Property & Liability	2,790	2,891	305	260	274	198	34	39
Miscellaneous Financial Loss	413	585	77	-44	34	420	10	9
Marine & Aviation	267	370	48	17	10	158	8	10
Motor	6,291	6,442	6,031	6,170	5,446	3,984	4,433	4,180
Engineering	635	697	66	122	47	123	71	34
Medical	10,235	10,496	7,351	8,240	4,512	5,368	4,422	5,004
Others	1,040	1,242	228	259	395	-14	81	42
Total	**25,776**	**25,272**	**17,626**	**16,902**	**11,356**	**10,574**	**9,334**	**9,483**

Source: CBB.

Takaful insurance companies have very high concentration on the Medical and Motor Insurance business lines. Gross Premiums for both sectors combined represents (67.0%), Net Premiums Written (85.3%), Gross Claims (88.5%), and Net Claims (96.9%).

Chart 6.8: Concentrations of Gross Premiums and Claims for Takaful Insurance Firms by Class -Bahrain Operations (Q1 2020)



Source: CBB.

6.4.4 Retention Ratio and Loss Ratio (By Class)

Life insurance business line registered a retention ratio of 86.6% in March 2020. Observing the non-life insurance, Motor and Medical, that accounted for 26.5% and 36.4% of the total Gross Premiums in March 2020 respectively, registered retention ratios of 96.8% for Motor and 63% for Medical. Nevertheless, retention ratios were significantly lower for other business lines such as Miscellaneous Financial Loss and Engineering, registering -0.8% and 18.7% respectively.

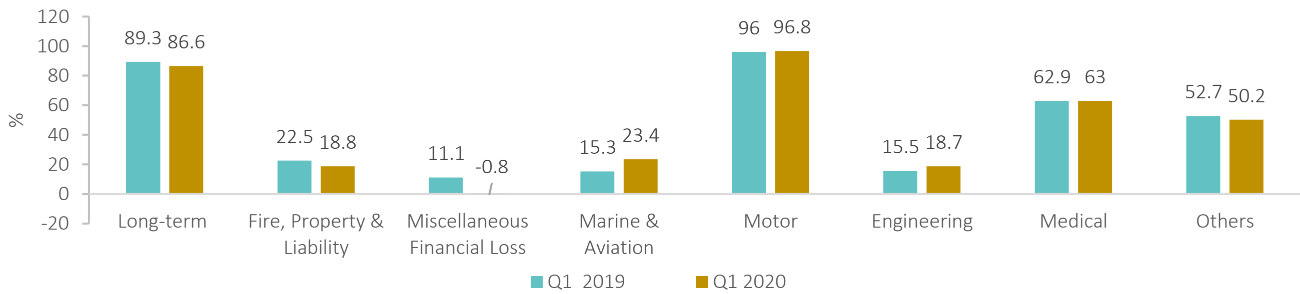
Table 6.6: Retention and Loss Ratios of Overall Insurance Sector

%	Retention Ratio [1]		Loss Ratio [2]	
	Q1 2019	Q1 2020	Q1 2019	Q1 2020
Long-term	89.3	86.6	48.2	46.5
Fire, Property & Liability	22.5	18.8	-22.5	25.0
Miscellaneous Financial Loss	11.1	-0.8	11.9	4.5
Marine & Aviation	15.3	23.4	28.9	17.7
Motor	96.0	96.8	72.6	67.3
Engineering	15.5	18.7	22.8	-24.4
Medical	62.9	63.0	70.8	78.3
Others	52.7	50.2	50.3	4.1

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

Performance of Non-Bank Financial Institutions

Key Highlights

# of Investment Businesses	# of Money Changers	Investment Businesses Assets	Money Changers Purchase	Money Changers Sale
52	19	BD 406 mn	BD 8,647 mn	BD 10,046 mn

- Total assets of Investment Businesses decreased by 7.5% due to Covid-19 impact.
- Category 1 Investment Business recorded major losses, while Category 2 & 3 remained profitable.
- 51% of all currency transactions of money changers were in non-GCC Arab currencies for Q2 2020.

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-December 2019 and end-June 2020, unless otherwise indicated.

A significant number of investment businesses and money changers have established their presence in Bahrain. As of June 2020, 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 June 2020, total assets of investment businesses decreased by 7.5% to BD 406.5 million from BD 439.6 million in December 2019. During the same period, total liabilities decreased by BD 28.2 million (21.8%) and total equity decreased by BD 11.6 million (3.7%).

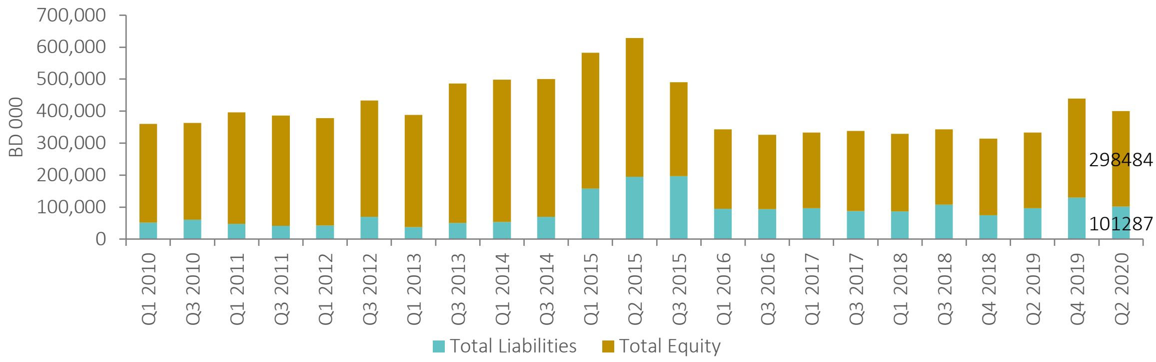
[7] Category 1 firms may undertake any regulated investment service, as listed below: a) Dealing in financial instruments as principal; b) Dealing in financial instruments as agent; c) Arranging deals in financial instruments; d) Managing financial instruments; e) Safeguarding financial instruments (i.e. 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)".

Table 7.1: IB Total Assets by Category

BD '000	Total Assets		Total Liabilities		Total Equity	
	Q2 2020	Q2 2020	Q2 2020	Q2 2020	Q2 2020	Q2 2020
Category 1	391,787.3	358,951.2	116,277.0	92,401.6	275,510.3	261,627.0
Category 2	39,823.6	35,705.4	11,001.1	6,689.9	28,822.5	30,965.0
Category 3	7,966.7	11,828.4	2,262.7	2,195.9	5,704.0	5,892.7
Total	**439,577.6**	**406,485.0**	**129,540.8**	**101,287.4**	**310,036.8**	**298,484.7**

Source: CBB.

Chart 7.1: IB Total Assets by Time Period



Source: CBB.

7.2.1 Assets Under Management

Between December 2019 and June 2020, total assets under management declined by 9.8% from BD 10,829.7 million to BD 9,772.4 million. Assets under management of residents decreased by 16.7% from BD 6,636.9 million in June 2019 to 5,527.1 million in June 2020. Non-residents' assets under management remained stable and recorded a 1.3% increase from December 2019.

Table 7.2: Assets under Management

BD '000	Q4 2019	Q2 2020	% Change
AUM - Residents	6,636,894.0	5,527,132.1	-16.7
AUM - Non-Residents	4,189,816.9	4,245,272.2	1.3
Total AUM	**10,829,710.9**	**9,772,377.2**	**-9.8**

Source: CBB.

7.2.2 Profitability

Profits of category 1 investment businesses took a massive hit in the second quarter of 2020 and recorded huge losses. This is mainly due to an individual firm that recorded a major loss for the quarter. Category 2 firms' profits increased by 8.9% from BD 0.43 million in December 2019 to BD 0.47 million in June 2020. Category 3 firms also recorded a boost in profitability for the second quarter of 2020 with a 7.1% increase (Table 7.3).

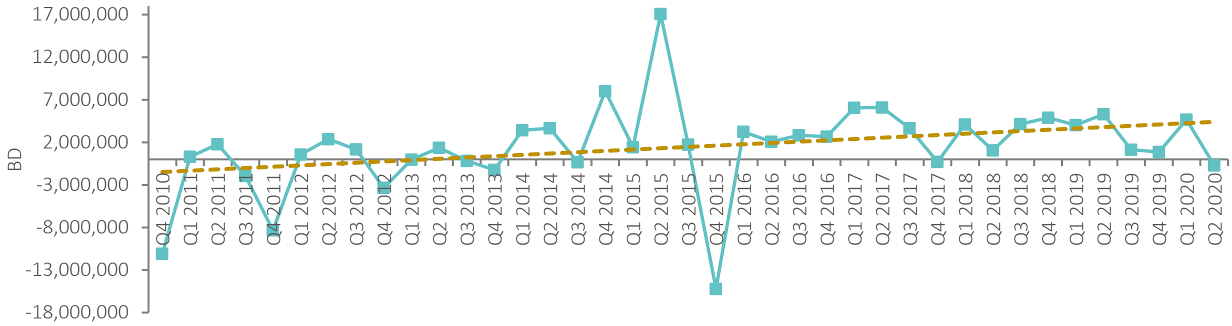
Table 7.3: IB Profitability by Category

BD '000	Q4 2019	Q2 2020	% Change
Category 1	69.6	-1,555.90	-2300
Category 2	428.0	466.2	8.9
Category 3	366.2	392.2	7.1
Total	**863.8**	**-697.6**	**-180.8**

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 and, more recently, June 2020. 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 – Q2 2020)



Source: CBB.

7.3 Money changers

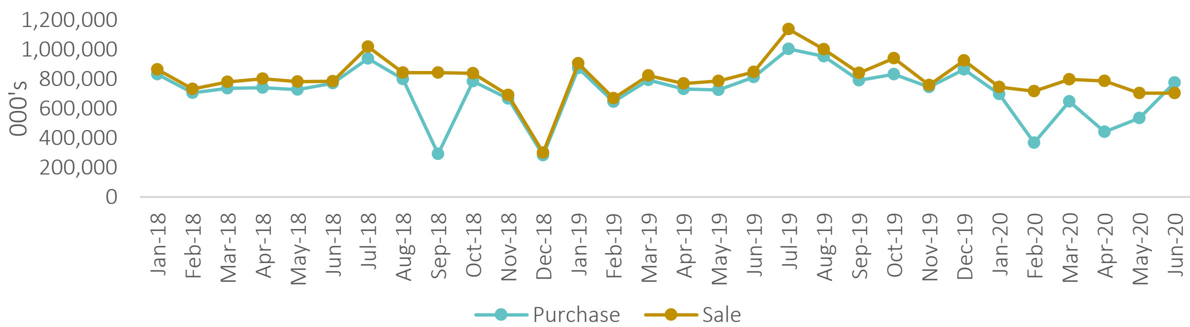
Between July 2019 and June 2020, money changers' purchase of foreign currencies amounted to 8,647.4 billion, while the sale of foreign currencies was recorded at 10,045.7 billion for the year. The month with the highest purchase and sale of currency was July 2019, with both purchase and sale of currencies surpassing one billion. The lowest month for sale of currencies was June 2020 (Table 7.3).

Table 7-3: Money Changers Total Turnover (Jul 2019 - Jun 2020)

000's	Purchase	Sale
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
Jan. 2020	697,699.3	744,924.8
Feb. 2020	367,262.5	715,987.9
Mar. 2020	646,079.1	796,727.9
Apr. 2020	441,459.7	784,798.5
May 2020	534,265.6	703,513.5
Jun. 2020	775,031.4	703,013.3
Total	**8,647,379.4**	**10,045,682.2**

Source: CBB.

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



Source: CBB.

For the second quarter of 2020, money changers' purchase and sale of currencies stood at BD 1.75 billion and BD 2.19 billion, respectively. A breakdown of Money Changers turnover indicates that "Asian" currency group recorded the highest YoY percentage increase in sales with 4000%. The largest decline in sales was the "GCC" currency group recording a drop of more than one billion BD. As for purchases, the top YoY increase is also "Asia" with 3500%, followed by "Other Arab" with 420%. All the other currency groups had a 95%+ drop in purchases.

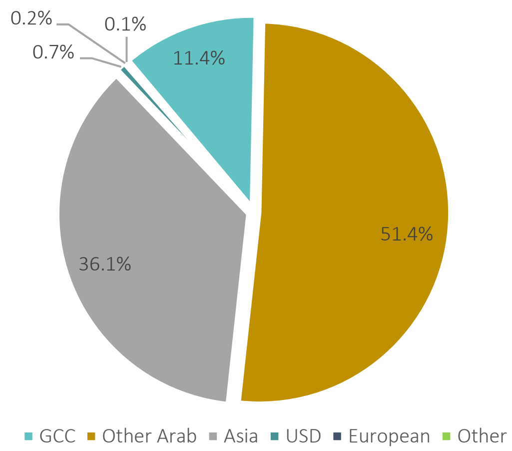
Table 7.4: MC Turnover by Currency Group

000's	Purchase			Sale		
	Q2 2019	Q4 2019	Q2 2020	Q2 2019	Q4 2019	Q2 2020
GCC	1,414,755.0	1,704,965.7	66,046.0	1,409,263.8	1,711,356.7	267,056.0
Other Arab	202,931.9	178,046.0	1,054,669.9	333,029.3	285,531.6	1,069,674.8
Asia	16,990.5	20,012.4	615,223.1	18,776.3	27,139.5	827,094.3
USD	535,022.1	476,746.3	14,424.8	536,557.1	517,088.9	14,371.3
European	90,499.8	59,908.9	103.9	95,119.1	79,212.3	7,594.0
Other	7,009.6	417.4	288.9	7,134.3	651.6	5,534.9
Total	**2,267,208.8**	**2,440,096.6**	**1,750,756.7**	**2,399,879.8**	**2,620,980.6**	**2,191,325.3**

Source: CBB.

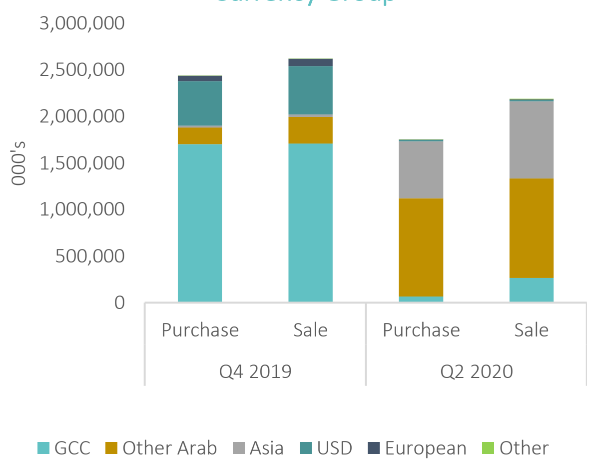
For the second quarter of 2020, only 11% of all purchase and sale of currencies were in GCC currencies, a significant decline from the 68% recorded in Q4 2019. Other Arab currencies was the most exchanged currency group with 51% of total purchase and sale of currencies in Q2 2020.

Chart 7.3: Money Changers Currency Group Purchase & Sale, Q2 2020 (% of Total)



Source: CBB.

Chart 7.4: Money Changers Total Turnover by Currency Group



Source: CBB.

7.4 Challenges & Risks in Non-Banking Financial Institutions

Like all other financial institutions within the financial sector, Investment business firms and money changers have suffered from the impact of Covid-19 pandemic. Declining business and trying to operate safely and protect clients as well as staff members were main challenges. While many of the licensees have been investing in technology prior to the pandemic, smaller scale licensees, like some of the money changers, have been considering increasing their investments in technology, and building up client interface platforms where clients can avail the services online. Funding technology and coping with the rapid changes in technology solutions was a huge burden for companies recently.

To ensure the sector operates in a manner that protects the interest of staff and clients, the CBB issued several circulars regarding maintaining safety at the workplace, reminding licensees to follow the disinfection instructions issued by the Ministry of Health and encouraging them to work remotely. Given that money changers deal with retail walk in retail clients extensively, and use physical cash very often, they were issues specific instructions in relation to maintaining social distancing measures for customers and the measures to be taken to ensure the disinfection of currency notes before circulation to customers.

As for supervision over licensees, the CBB has extended the deadline for certain reporting requirements and has been flexible with licensees considering the exceptional circumstances of the pandemic. Discussions and meetings continued, though not in a physical form. Moreover, requests to distribute dividends were looked at very carefully, taking into consideration the unpredicted effect of the pandemic, and ensuring the licensees have the required liquidity to continue operating.

7.5 Developments in Regulation and Initiatives

One of the major regulatory developments during 2020 is the addition of the activity of "Arranging Credit and Advising on Credit" to the list of permissible activities of investment business firms. The new activity was introduced after discussions with a few licensees that have shown interest in providing the activity in Bahrain. The activity will provide an opportunity to licensees to expand the range of activities they can offer to clients and thereby improving their income. The activity will also help SMEs and similar institutions that find it difficult to obtain financing from banks in Bahrain to seek the help of investment firms to obtain the required financing.

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

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

Chapter 8 Performance of Capital Markets

Key Highlights

# of Companies	All Share Index	Islamic Index	Market Capitalization	Total Value	Total Volume	PE Ratio
43	1,277.6	596.7	BHD 9.22bn	BD 114.4 mn	587.1mn	11.54

- Decrease in both the Bahrain All Share & Bahrain Islamic Index.
- Bahrain Bourse's market capitalization stood at BHD 7.93 bn by the end of the quarter, decreasing from BHD 9.22 bn in 2Q 19, with a decrease of 14.0%.
- Commercial Banks dominated the market trading activity as it had the highest volume and value traded.
- Bahrainis represented 51% of the value of shares bought and 49% of value of shares sold during First Half 2020.

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 30th June 2020, Bahrain Bourse recorded a total listing of 43 Companies, 9 Mutual funds and 14 Bonds and Sukuk. During First Half 2020, there were 11 companies that closed higher and 22 closed lower and 11 remained unchanged. Commercial Banks sector remains the dominant sector in Bahrain Bourse in terms of market capitalization and trading activity accounting for 54.6% of total value traded during first half 2020 and making up 53.7% 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 UGH represent 63.8% of the total market.

8.2 Bahrain Bourse

8.2.1 All Share Index and Islamic Index Overview

Decline in market index

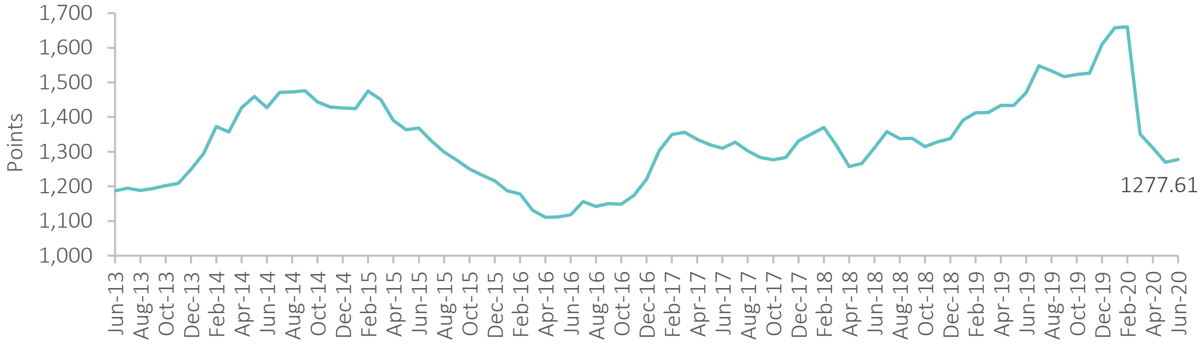
Bahrain All Share Index decreased by 20% for the first half of 2020. During 2020, the index was generally decreasing throughout the year as the lowest month-end close level was recorded in May at 1,269 points, and the highest month end close was recorded on February at 1,660 points.

Table 8.1: Key Indicators of Bahrain Bourse

Indicator	2013	2014	2015	2016	2017	2018	2019	June
All Share Index	1,248.9	1,426.6	1,215.9	1,220.5	1,331.7	1,337.3	1,610.2	1,277.61
Highest	1,248.9	1,476.0	1,474.8	1,220.5	1,356.0	1,369.9	1,610.2	1,660.48
Lowest	1,085.9	1,294.3	1,215.9	1,110.5	1,276.7	1,257.9	1,391.4	1,269.63
Market Cap (BD,	6,963.0	8,327.1	7,199.9	7,248.2	8,146.3	8,198.5	10,134	7,928
Total Value (BD, million)	225.9	269.1	110.0	124.5	211.3	323.8	286.4	114
Total Volume (million)	1,867.8	1,126.1	515.6	734.4	1,129.8	1,441.1	1,157.3	587
No. of Transactions	14,197	16,211	11,248	10,592	19,440	19,225	20,712	8,837
No. of Companies	47	47	46	44	43	44	44	43

Source: Bahrain Bourse.

Chart 8.1: Bahrain All-Share Index, Jun. 2013 – Jun. 2020



Source: Bahrain Bourse.

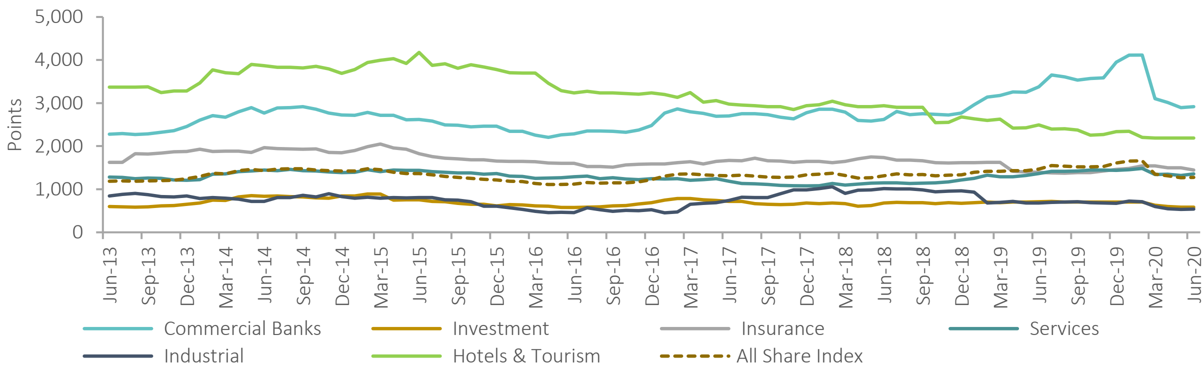
As for the sector indices, all sectors closed lower in June 2020 compared to the end of 2019. The Commercial Banks sector recorded the highest decrease of 26.2% followed by the Industrial sector with a decrease of 20.5%.

Table 8.2: Bahrain All Share Index by Sector

	2013	2014	2015	2016	2017	2018	2019	June 2020
Commercial Banks	2,456.4	2,721.2	2,461.8	2,481.8	2,772.6	2,769.8	3,947.6	2,913.8
Investment	650.7	842.1	613.8	686.2	680.2	669.9	703.6	584. 3
Insurance	1,876.3	1,844.7	1,653.6	1,585.6	1,645.8	1,619.9	1,458.3	1,445.5
Services	1,206.8	1,386.0	1,361.7	1,248.9	1,078.6	1,216.3	1,439.6	1,358.7
Industrial	842.5	830.9	606.1	524.3	986.5	960.8	674.1	535.7
Hotels & Tourism	3,279.9	3,687.6	3,779.2	3,237.5	2,940.3	2,677.7	2,336.1	2,188.8

Source: Bahrain Bourse.

Chart 8.2: Sector Indices Levels & Returns, Jun. 2013 – Jun. 2020

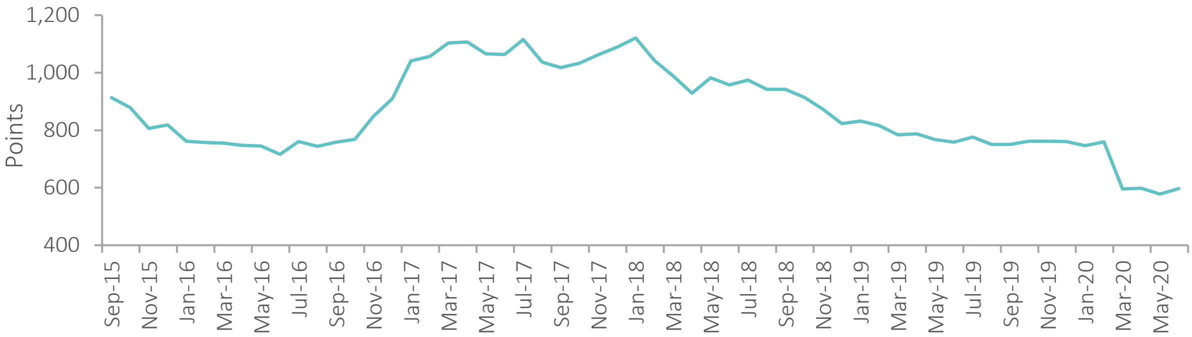


Source: Bahrain Bourse.

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 June 2020.

YoY data demonstrates that the Bahrain Islamic Index decreased by 21.5% between December 2019 and June 2020 reaching 596.7 points.

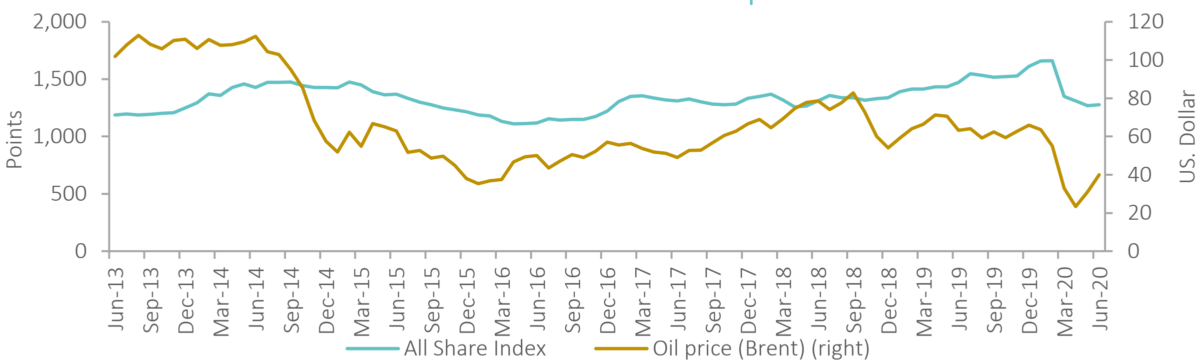
Chart 8.3: Bahrain Islamic Index, Sep. 2015 – June 2020



Source: Bahrain Bourse.

With Bahrain being an oil exporting country, it is significant to analyze the relationship between oil prices and the stock prices. Bahrain All-Share Index and the oil prices had a moderate, positive correlation at 0.42 and is evident from the movements of the prices in the chart below.

Chart 8.4: 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 June 2020, market capitalization of the Bahrain Bourse stood at BD 7.9 billion. This level of market capitalization is 21.8% lower for the year.

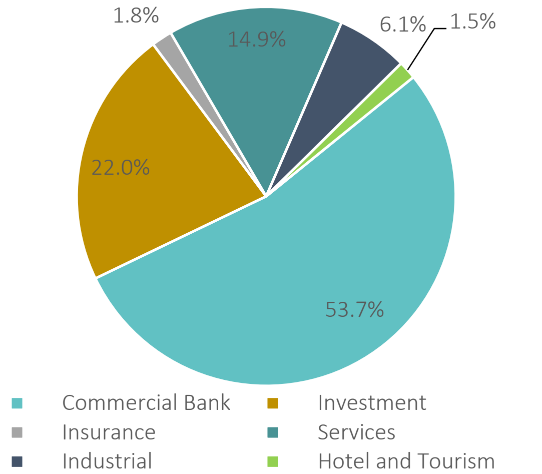
Table 8.3: Market Capitalization on the Bahrain Bourse

Sector (BD)	2019	June 2020	2019 – June 2020 (% Change)
Commercial Banks	5,764,393,689	4,257,809,788	-26.1
Investment	2,235,172,282	1,740,600,477	-22.1
Insurance	141,073,950	139,835,900	-0.9
Services	1,253,854,054	1,183,352,523	-5.6
Industrial	609,308,719	484,210,454	-20.5
Hotel and Tourism	130,822,268	122,553,715	-6.3
Total	**10,134,624,962**	**7,928,362,857.00**	**-21.8**

Source: Bahrain Bourse.

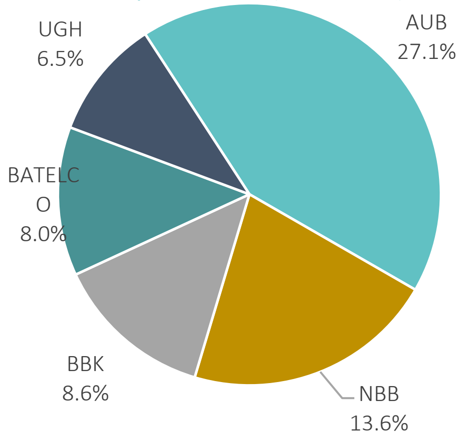
A breakdown of market capitalization by sector indicates that the Commercial Banks sector recorded the highest year-on-year decrease in market capitalization (-26.1%) followed by Investment (-22.1%). The Insurance sector scored the lowest decline among other market capitalization sectors with a 0.9% decrease.

Chart 8.5: Market Capitalization by Sector (June 2020)



Source: Bahrain Bourse.

Chart 8.6: Largest 5 companies by Market Capitalization (June 2020)



Source: Bahrain Bourse.

Ahli United Bank is the largest company in terms of Market Capitalization and contributes to 27.1% of the total market capitalization as of June 2020. National Bank of Bahrain has the second largest share of Market Capitalization of 13.6% and it is followed by Bank of Bahrain and Kuwait (BBK) with 8.6%, Bahrain Telecommunication Company (BATELCO) with 8.0%, and United Gulf Holding Company (UGH) with 6.5%.

Table 8.4: Largest 5 Companies by Market Capitalization (June 2020)

Company	Market Capitalization (BHD)	% from Total Market
Ahli United Bank (AUB)	2,146,869,606	27.1
National Bank of Bahrain (NBB)	1,076,002,583	13.6
Bank of Bahrain and Kuwait (BBK)	680,868,166	8.6
Bahrain Telecommunication Company (BATELCO)	637,005,600	8.0
United Gulf Holding Company (UGH)	512,088,567	6.5
Total	**5,052,834,522**	**63.8**

Source: Bahrain Bourse.

Most of the value of shares traded during 2020 was in the Commercial Banks sector whose traded shares (by value) represented 54.6% of total value.

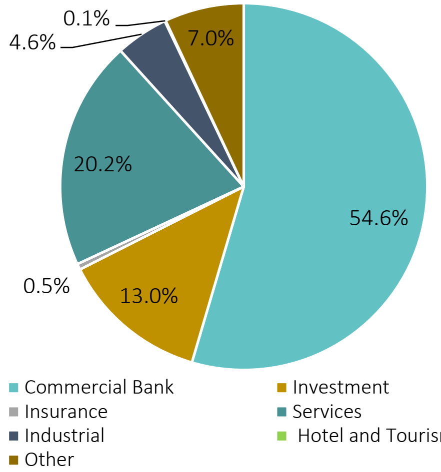
Table 8.5: Value of Shares Traded by Sector (% of Value of all shares traded)

Sector	2019	H1 2020
Commercial Banks	66.8	54.6
Investment	12.5	13.0
Insurance	1.0	0.5
Services	16.3	20.2
Industrial	2.6	4.6
Hotel and Tourism	0.4	0.1

Source: Bahrain Bourse.

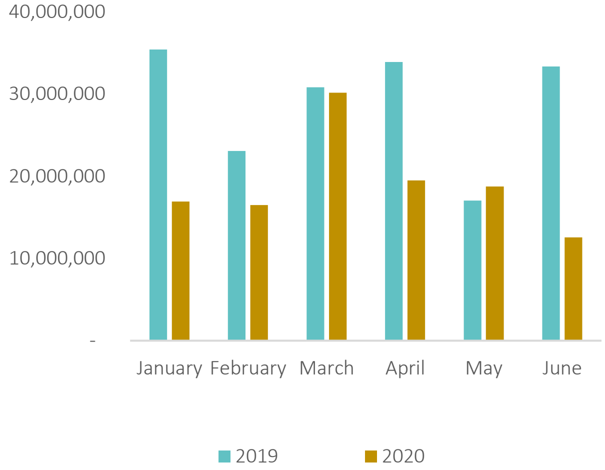
The services sector represents the second largest level at 20.2% of the total value of shares traded in 2020. Investors interest in Hotel and Tourism and Insurance sectors were the least during 2020 whose traded shares by value represented only 0.4% and 0.5% respectively of total traded shares. During 2020, the value of shares traded was highest in March and the lowest was in June, and the average value of shares traded during the year for a month was BD 19.1 million.

Chart 8.7: Value of Shares Traded by Sector (% of Value of all shares traded) (2020) *



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

Chart 8.8: Value of Shares Traded YoY Comparison



Source: Bahrain Bourse.

The bulk of the volume of shares traded in 2020 was also in the Commercial Banks sector representing 44.0% of the total volume of shares traded, followed by the investment sector at 32.8%. The lowest level was attained by the Hotel and Tourism sector at 0.1%.

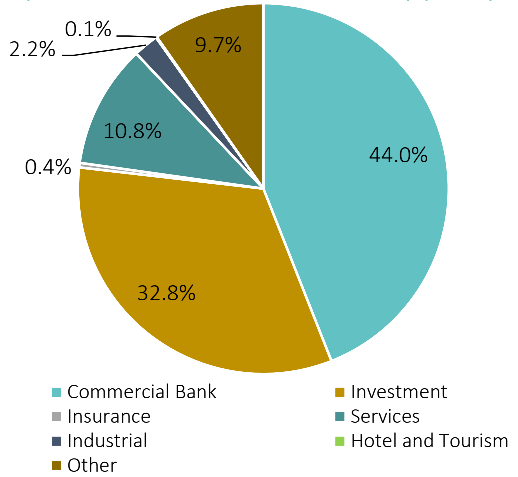
Table 8.6: Volume of Shares Traded by Sector (% of Volume of all shares traded)

Sector	2019	2020
Commercial Banks	59.9	44.0
Investment	24.6	32.8
Insurance	1.2	0.4
Services	11.9	10.8
Industrial	1.2	2.2
Hotel and Tourism	0.5	0.1

Source: Bahrain Bourse.

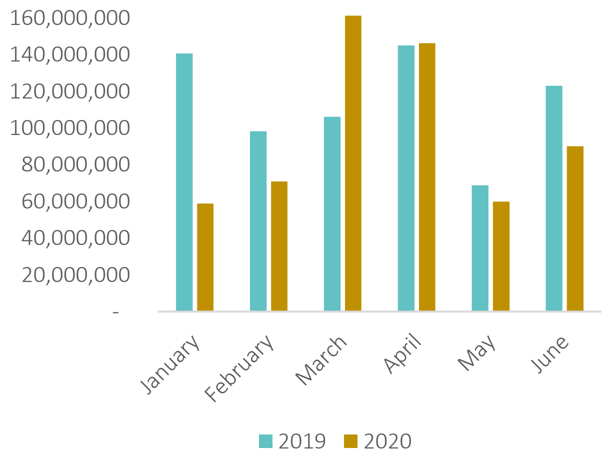
During 2020, the volume traded was highest in March and the lowest was in January, and the average volume traded during the year for a month was 97.8 million shares.

Chart 8.9: Volume of Shares traded by Sector (% of Volume of all shares traded) (2020) *



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

Chart 8.10: Volume of Shares Traded YoY Comparison



Source: Bahrain Bourse.

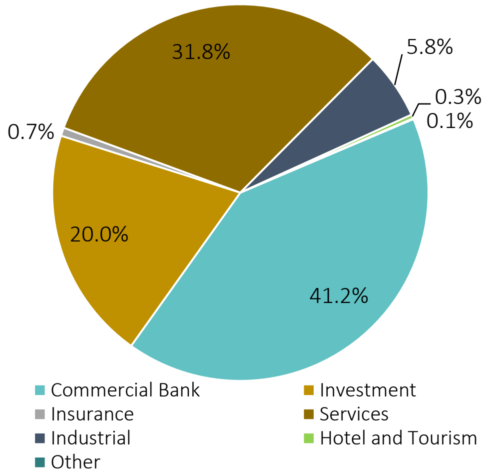
Most of the transactions were executed by the Commercial Banks sector at 3,645 transactions (41.2% of all transactions), followed by the Services Sector at 2,814 transactions (31.8%), and the Investment sector at 1,770 transactions (20.0%). During 2020, the market executed 8,837 transactions.

Table 8.7: Number of Transactions by Sector

Sector	2019	June 2020
Commercial Banks	9,776	3645
Investment	3,082	1770
Insurance	373	63
Services	6,337	2814
Industrial	897	509
Hotel and Tourism	244	30
Closed	3	6
IPO	0	0
Total Market	**20,712**	**8,837**

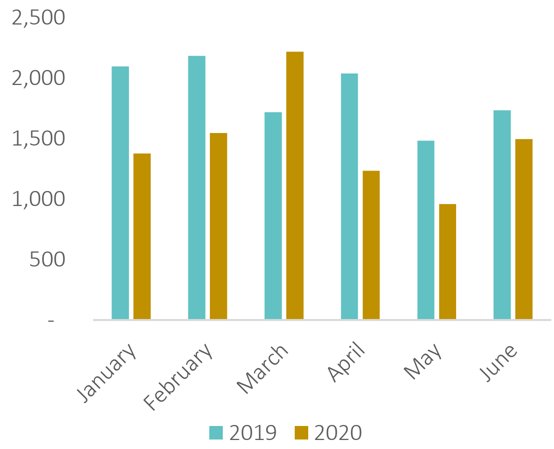
Source: Bahrain Bourse.

Chart 8.11: Number of Transactions (% of all transactions) (2020) *



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

Chart 8.12: Number of Transactions YoY Comparison



Source: Bahrain Bourse.

Trading by Nationality

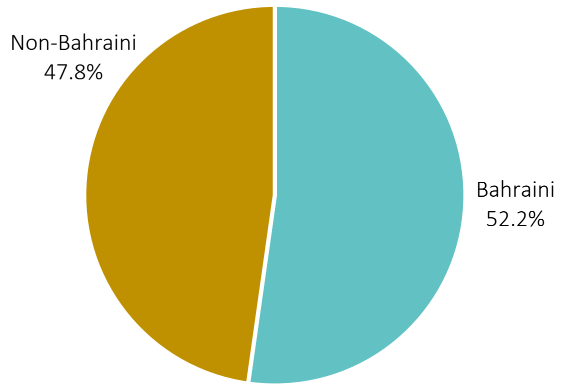
As of June 2020, Non-Bahraini nationals contributed to 47.8% of the value of shares bought while Bahraini nationals contributed the remaining 52.2% of the value of shares bought. As for sell-side of the transactions, Non-Bahraini nationals contributed to 51.0% of the value of shares sold while Bahraini nationals contributed to 49.0% of the remaining value of shares sold.

Table 8.8: Value of Transactions by Nationality (BD)

	2019		2020	
	Bahraini	Non-Bahraini	Bahraini	Non-Bahraini
Buy	151,227,541	135,178,545	79,787,443	34,598,630
Sell	151,227,541	135,178,545	76,542,191	37,843,881

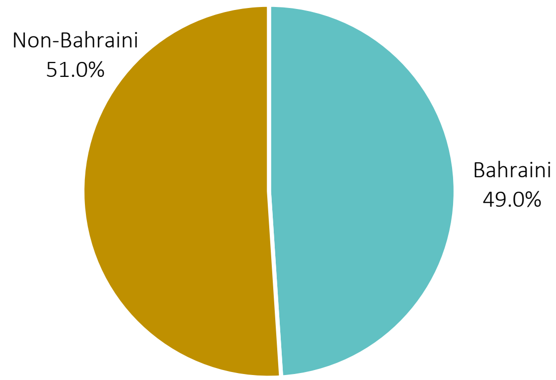
Source: Bahrain Bourse.

Chart 8.13: Share of Trading Value of Buy transactions by nationality (2020)



Source: Bahrain Bourse.

Chart 8.14: Share of Trading Value of Sell transactions by nationality (2020)



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

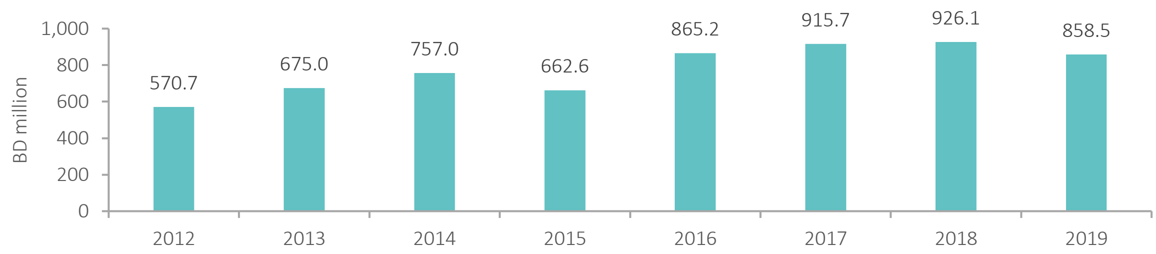
Sources: Bahrain Bourse, Saudi Stock Exchange (Tadawul), Boursa Kuwait, Qatar Stock Exchange, Dubai Financial Market, Abu Dhabi Securities Exchange and Muscat Securities Market.

8.3 Market Resilience

Decline 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 8.15: Stock Market Net Income



Source: Bahrain Bourse.

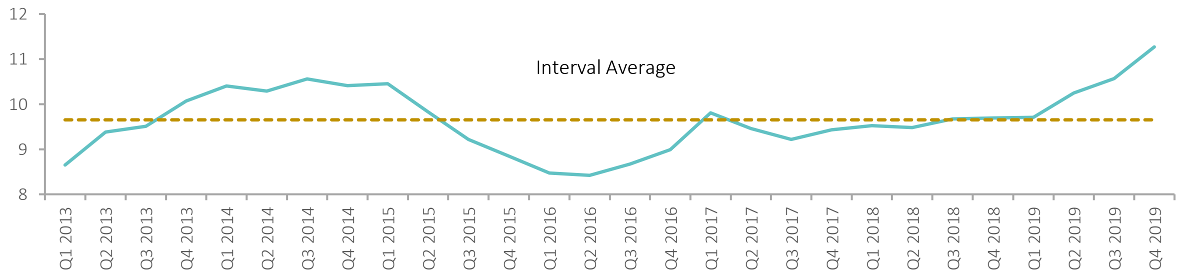
As at December 2019, more than half of the sectors valuation in terms of P-E ratio increased compared to December 2018. Commercial Banks, Investment, Services, and Industrial sectors increased by 43.6%, 23.7%, 22.2%, and 500% respectively while Insurance and Hotel and Tourism sectors dropped by 17.2% and 5.0% respectively. The total market P/E ratio in 2019 increased from 9.69 to 11.54.

Table 8.10: Price-Earnings Multiples

Sector	2018	2019
Commercial Banks	9.08	13.04
Investment	5.69	7.04
Insurance	10.87	9.00
Services	10.04	12.27
Industrial	14.10	85.95
Hotel and Tourism	16.71	15.87
Total Market	9.69	11.54

Source: Bahrain Bourse.

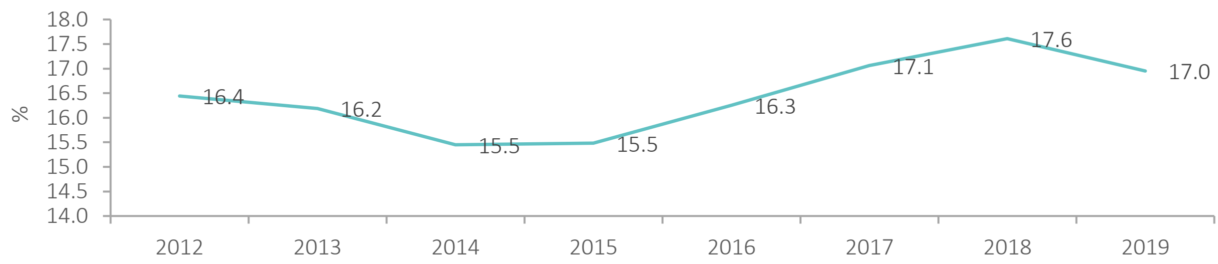
Chart 8.16: Total Market Price-Earnings Multiples



Source: Bahrain Bourse.

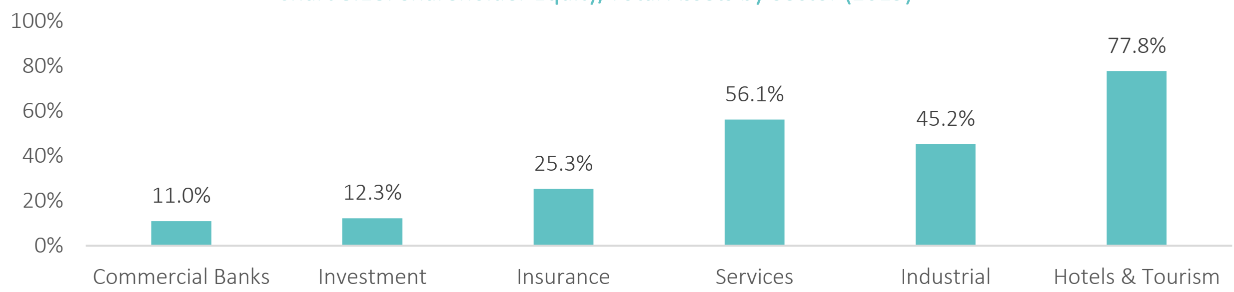
The overall equity-to-assets ratio decreased to 17.0% in 2019. Most sectors contributed to the increase with the hotel and tourism sector having the highest increase. The Commercial Banks and Investment sectors have the lowest equity/assets ratio due to the high leverage nature of the sectors (Chart 8.17 & 8.18).

Chart 8.17: Shareholder Equity to Total Assets (%)



Source: Bahrain Bourse.

Chart 8.18: Shareholder Equity/Total Assets by Sector (2019)



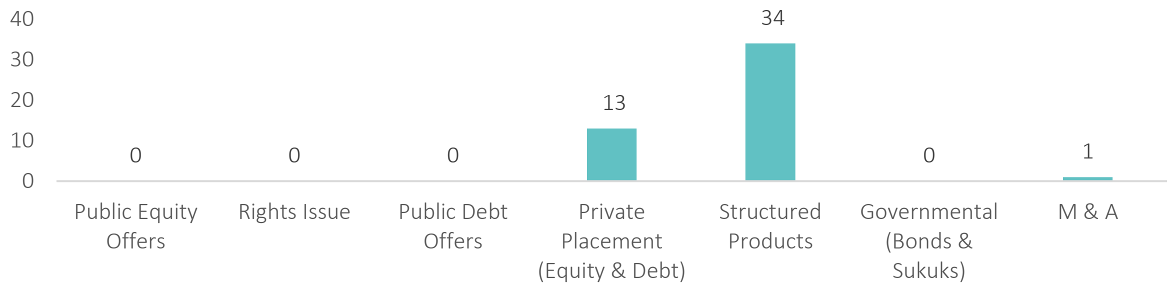
Source: Bahrain Bourse.

8.4 Capital Market Activities

8.4.1 Offering of Securities

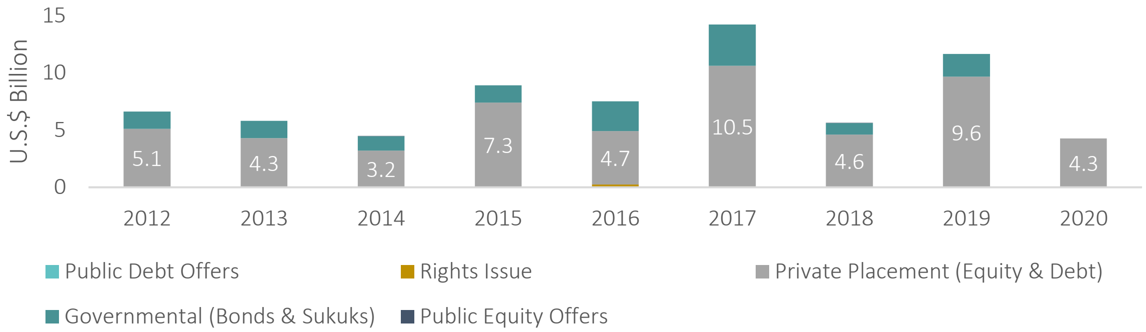
As at June 2020, the CBB issued its no objection to the issuance of 47 private offering documents after ensuring the completeness of all the information and details as per the CBB Law, Rules and Regulations. The total value of issuances reached USD 5.53 billion. (Chart 8.19 & 8.20).

Chart 8.19: Number of Capital Market Activities



Source: CBB.

Chart 8.20: Total Issuance Value



Source: CBB.

8.4.2 Kuwait Finance House ("KFH") offer to acquire 100% of Ahli United Bank B.S.C.'s ("AUB") issued and paid up capital

On 5th February 2020, AUB's Board of Directors received a notice of firm intention from KFH's Board of Directors to make an offer to acquire 100% of the issued and paid up ordinary shares of AUB through shares exchange at a share ratio of 2.325581 AUB shares for every KFH share subject to the fulfilment or waiver of conditions precedent.

KFH dispatched the Offer Document to AUB's Board of Directors on 24th February 2020 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. AUB's Board of Directors dispatched the Offeree Board Circular issued by the Board of AUB, the Offer Document issued by KFH and the Acceptance and Transfer Form to the shareholders of AUB on 16th March 2020, pursuant to the requirements of the TMA Module, and after receiving the CBB's no objection letter on the Offeree Board Circular on 15th March 2020.

In light of the current conditions imposed by the Coronavirus pandemic (Covid-19), the Board of Directors of AUB in coordination with KFH agreed to temporarily suspend the implementation of the procedures of the acquisition offer in the State of Kuwait and the Kingdom of Bahrain until December

2020, after KFH obtained the approval of the Central Bank of Bahrain to postpone the procedures for the acquisition offer until December 2020. The same was announced to the shareholders of AUB and the market on 12th April 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. 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 June 2020, 9 of the 43 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.

Risks and challenges have also risen under the impact of the global pandemic, Coronavirus (COVID-19). The evolving situation has led to an increase in volatility and risk levels in the capital markets, affecting both the trading activity and investors. Furthermore, it creates opportunities for fraudulent actors and scammers to inject inaccurate information into the market. As such, the CBB has issued a number of circulars to guide market participants to be mindful towards the market amid the pandemic, such as disclaiming current market risks, monitoring and reporting fraudulent and suspicious activity, and strengthening lines of communication with all marker institutions, participants, and the CBB. The CBB has also emphasized on the importance of listed companies' compliance with its requirements and has implemented various relief measures including the exemption from the preparation and publication of the quarterly reviewed financial results.

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 2020, the CBB's CMSD endeavored 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 2020:

8.6.1 Policy and Regulatory Developments

- **Amendment of the CBB Law:** The King of Bahrain issued the CBB Law Amendment No. (14) of 2020 amending some provisions of the Central Bank of Bahrain and Financial Institutions Law promulgated by Decree No. (64) of 2006 ("the Law"), whereby a new article was added to the Law giving the Central Bank of Bahrain the authority to regulate mergers and acquisitions of listed companies. The amendment states the following:
  Article (93 bis): The Central Bank shall issue a resolution of the rules and procedures for the acquisition of shares of listed companies. It is prohibited for any listed company to merge with any other entity without obtaining a written approval from the Central Bank, subject to the provisions stipulated in the Commercial Companies Law promulgated by Decree No. (21) of 2001. The Central Bank shall issue a resolution of the rules and procedures for the merger process.
- **Bahrain Bourse ("BHB") Issuers' Fines Proposal:** Following Bahrain Bourse's issuance of its consultation paper on the proposed administrative fines applicable to issuers (in the event of non-compliance with the Listing Rules and any other Bahrain Bourse applicable rules, regulations and directives as deemed appropriate), in March 2020, the CMSD provided its comments to the Bahrain Bourse on the Industry Consultation Feedback Statement. Following the Bahrain Bourse's submission of the composition of the proposed Bahrain Bourse Violations Committee (responsible for reviewing and evaluating high-frequency violations of the Bahrain Bourse's rules and regulations and determining penalties to be imposed on issuers and ultimately also members in a timely and cost-effective manner), in June 2020, the CMSD provided its no-objection, subject to a Board-approved proposal on the same.

- **Dispute Resolution, Arbitration & Disciplinary Proceedings ("DRA") Module:** Given that the Central Bank of Bahrain strives to continuously better address issues pertaining to on-going regulation and supervision of licensees and the overall financial and capital markets, the CMSD issued its first update to the Dispute Resolution, Arbitration and Disciplinary Proceedings Module of Volume 6 of the CBB Rulebook in March 2020 (after it had first been issued on 29th June 2010). The Module sets out CBB's regulatory framework governing dispute resolution, complaints handling and arbitration mechanism in the capital markets, as well as the disciplinary mechanism at Self-Regulatory Organizations ("SRO"). The said March 2020 amendment mainly related to stipulations on the Disciplinary Committee and the Disciplinary Appeals Committee established at the SRO-level.
- **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 fourth issue of its Compliance & Enforcement Annual Report covering the year 2019; which provides a comparative overview of CMSD's efforts in 2018-2019 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.
- **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..
- **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 CMSD is currently working on updating the AUP to ensure its applicability on licensees regulated under the Market Intermediaries and Representatives (MIR) Module as well as the Crypto-asset (CRA) Module. The update will also ensure standardization of processes and report formats across the CBB and will consider the best international practices from the Financial Action Task Force (FATF) regarding AML.
- **Crypto-Assets Module:** In line with its initiative to continuously enhance its regulatory framework to be able to fit the financial sector's developments, amendments to the Crypto-asset (CRA) Module under Volume 6 of the CBB Rulebook have been issued via circular EDFIS/C/003/2020 dated 16th January 2020. 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, amendments to the AML Module have been issued via circular EDFIS/C/003/2020 dated 16th January 2020. The 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.
- **Safety Guidelines For Listed Companies General Meetings:** Pursuant to the preventive measures implemented by the Government of Bahrain to combat the outbreak of the coronavirus

(COVID-19), the Central Bank of Bahrain issued through its circular (Ref: OG/108/2020) dated 19 March 2020 a set of guidelines for companies that will have Annual General Meetings to discuss and approve the financial results for the year ended 31 December 2019.

- **Exemption for First Quarter Financial Results Preparation and Publication:** Due to the development with regards to the outbreak of the novel coronavirus (COVID-19), the Central Bank of Bahrain exempted all public shareholding companies from the preparation and publication of their quarterly reviewed financial results for the first quarter of 2020, and accordingly the first reviewed financial statements that must be prepared and published in 2020 would be the June 2020 six months period statements.
- **Market Fairness and Integrity Amid COVID-19 Developments:** The Capital Markets Supervision Directorate issued a circular (Ref: CMS/C/011/2020) dated 1 April 2020 addressed to all listed companies to emphasize the importance of compliance with the requirements of Corporate Governance and Controls, Disclosure Standards, and the Prohibition of Market Abuse and Manipulation ("MAM") Module of the CBB Rulebook.
- **Reporting of Financial Impact of COVID-19**: As part of the CBB's objective to maintain transparency amidst the current implications of coronavirus (COVID-19) and given that businesses have increasingly become vulnerable to financial losses, it has become important for CBB and other stakeholders to understand and assess the financial impact of the COVID-19 pandemic on listed companies and CBB licensees. A circular was issued (Ref: OG/259/2020) dated 14 July 2020 for all listed companies and licensees to disclose the financial impact of COVID-19 in their interim and annual financial statements. For listed companies, such disclosures must be made through a supplementary disclosure that must be published on Bahrain Bourse website in addition to the inclusion of such disclosure in the financial statements.
- **Update to Part B of CBB Rulebook Volume 6:** In line with its initiative to continuously enhance its regulatory framework and in an effort of standardization across the CBB, the CMSD has updated its authorization Forms relating to the Markets and Exchanges (MAE) Module, Clearing, Settlement and Depository (CSD) Module, Market Intermediaries and Representatives (MIR) Module via circular EDFIS/C/069/2020 dated 14 July 2020. Furthermore, authorization forms related to the Crypto-asset (CRA) Module have been newly issued, along with the Direct Debit Authorization (DDA) Form and the Professional Indemnity Insurance Return (PIIR) Form.
- **BHC Protection Guarantee Fund and Cash Dividend Distribution:** As part of the CBB's objective to enhance existing practices and increase investor protection, the CBB has provided its initial approval for BHC to act as paying agent and distribute cash dividends on behalf of listed companies. The CBB is currently working with BHC to fulfil all the necessary requirements. Following the issuance of Resolution 48-2/2020 by the Government's Ministerial Committee for Financial and Economic Affairs and Fiscal Balance, BHB have issued Resolution 3/2020 pertaining to the establishment of the Unclaimed Cash Dividends Fund and the Annual Cash Dividends Fund.
- **Listed Companies with Accumulated Losses:** Following the CMSD's approval, BHB have issued procedures related to listed companies with accumulated losses of 20% or more of their share capital. The procedures include public disclosures and suspension of trading, subject to the percentage of accumulated losses.

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. As a result of the witnessed growth and development in several capital market products including the wide range of Structured Products, the CMSD is currently studying the international best practices regarding appropriate regulatory tools concerning the behaviour of issuers and intermediaries within the capital market and the extent of the regulator's involvement in pre-approving the products and setting products standards and disclosure requirements, in addition to the significant ramifications associated with the offering and marketing the products. Furthermore, the CMSD is also undergoing updates to the fees payable to the CBB pertaining to applications under the OFS module.

- **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.
- **Takeovers, Mergers and Acquisition Resolution:** Further to Article (93 bis) of the CBB Law Amendment No. (14) of 2020, the CMSD is currently in the process of introducing a resolution to regulate the process and procedures of mergers and acquisitions of listed companies.
- **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.
- **Market Surveillance, Investigation & Enforcement ("MIE") Module Updates and Amendments:** The CMSD is currently reviewing suggested updates and amendments to the MIE Module of Volume 6 of the CBB Rulebook, generally to be in line with international best practices in various areas of investigation and enforcement. The amendments will further include a new chapter for Financial Penalties, and also reflect the June 2020 CBB Law amendments, among other things.
- **Further Updates and Amendments to the Dispute Resolution, Arbitration & Disciplinary Proceedings Module:** Following the aforementioned March 2020 revision of the DRA Module, in April 2020, the CMSD proposed additional amendments mainly in relation to the structure and functioning of an SRO's Arbitration Committee, to ensure that regulatory responsibilities are discharged in an effective manner and in line with international best practices. The same is currently being considered by the CBB's Legal Unit.

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, Point of Sale, FinTech, and Cyber Security

Chapter 9

FMI, Payment and Settlement Systems, Point of Sale, and Digital Wallets

Key Highlights

RTGS Daily Avg. Volume	RTGS Daily Avg. Value	SSSS Aggregate Volume	SSSS Aggregate Value	ATM Daily Avg. Volume	ATM Daily Avg. Value
153	BD 284.3mn	45	BD 2.92 bn	54,022	BD 4.7 mn
BCTS Daily Avg. Volume	**BCTS Daily Avg. Value**	**Fawri+ Daily Avg. Volume**	**Fawri+ Daily Avg. Value**	**Fawri Daily Avg. Volume**	**Fawri Daily Avg. Value**
9,651	BD 30.1 mn	74,500	BD 4.5 mn	34,251	BD 55.0 mn
Fawateer Daily Avg. Volume	**Fawateer Daily Avg. Value**	**POS Volume**	**POS Value**	**Digital Wallets Volume**	**Digital Wallets Value**
6,934	BD 1.2 mn	16.7 mn	BD 470.0 mn	9.7 mn	BD 518.8 mn

- Daily average (volume and value) of bank transfers, ATM transactions, and cheques declined in H1 2020 compared to H2 2019.
- Daily average of volume and value of Fawri+ transactions increased by 187.5% and 767.1% respectively in H1 2020 compared to H2 2019.Daily average of volume and value of Fawri transactions increased by 13.7% and 5.2% in H1 2020 compared to H2 2019.
- POS transactions volume and value decreased by 19.1% and 23.9% decrease in Q1 compared to Q2 2020. Cards issued inside Bahrain made 95.1% volume and 93.8% value of POS transactions in Q2 2020. Debit Cards represented 66.3% of the volume and 50.1% of the value of POS transactions in Q2 2020.
- Transactions through e-wallets continue to increase with 9.7 million transactions worth BD 518.8 million in Q2 2020.

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 January, 2020 to 30th June, 2020.

Point of Sale (POS) terminals and digital payments are seen as new methods that enhance a customer's shopping experience by acknowledging their spending habits and preferences, in line with the Bank's efforts to remain closer to the needs of its customers. The POS system in Bahrain is equipped with different features users get the ability to efficiently perform different tasks by providing payment solutions that support international and domestic payment schemes and fintech payment options such as contactless cards. Bahrain's fintech ecosystem has been able to introduce a number of digital wallets that offer various payment solutions that come with value-added benefits such as acceptance of all major card schemes, easy payments to be made digitally without the use of cash or cards. While cash and card payments are still seen as dominant payment method, seamless contactless and digital payments transactions are projected to be the prominent payment methods in the future.

This chapter describes recent trends in the FMIs, Payment and Settlement Systems, POS, and digital wallet transactions.

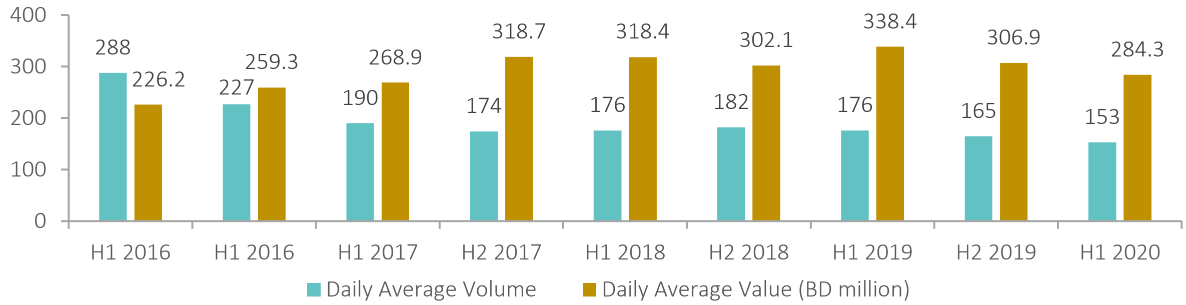
9.2 Real Time Gross Settlement System (RTGS)

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 for H1 2020 (first half of 2020) decreased by 7.3% to 153 transfers compared to 165 transfers for H2 2019 (second half of 2019).[8] Furthermore, the daily average volume of Bank transfers for H1 2020 has decreased by 13.1% from 176 to 153 transfers when compared to H1 2019.

As the daily average volume of Bank transfers through the RTGS have decreased, the value of those transfers has also decreased in H1 2020 by 7.4% when compared to H2 2019 from BD306.9 million to BD 284.3 million. Nevertheless, the daily average value of Bank transfers for H1 2020 decreased by 16.0% from BD 338.4 million to BD 284.3 million when compared H1 2019.

Chart 9.1: RTGS Bank Transfers Daily Average Volume and Value



Source: CBB.

Table 9.1: RTGS Bank Transfers Daily Average Volume and Value

RTGS	Daily Average Volume	Daily Average Value (BD million)
H1 2019	176	338.4
H2 2019	165	306.9
H1 2020	153	284.3

Source: CBB.

[8] H1 data is from 1st January until 30th June; H2 data is from 1st July to 31st December.

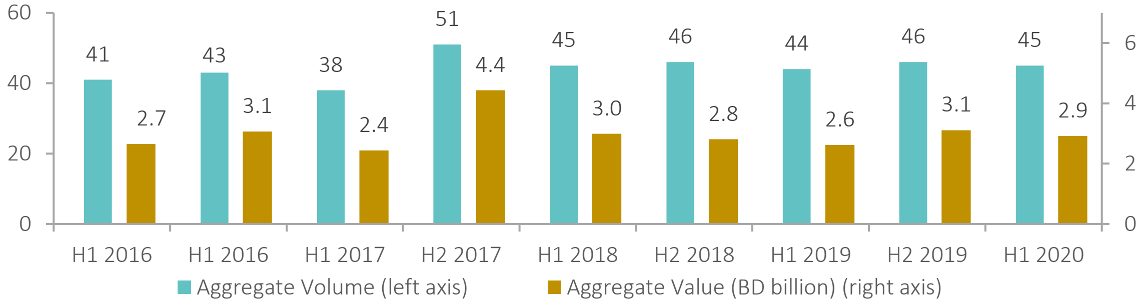
9.3 Scripless Securities Settlement System (SSSS)

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-two (32) members in the SSSS.

The volume of issues H1 2020 decreased compared to H2 2019 by 2.2% from 46 issues to 45 issues. Moreover, the volume of issues increased H11 2020 compared H1 2019 by 2.3% from 44 issues to 45 issues.

The aggregate value of issues in H1 2020 decreased by 6.1% to BD 2.92 billion from the BD 3.11 billion in H2 2019 and increased by 11.5% from the BD 2.62 billion in H1 2019.

Chart 9.2: SSSS Aggregate Volume and Value [9]



Source: CBB.

Table 9.2: SSSS Aggregate Volume and Value

SSSS	Aggregate Volume	Aggregate Value (BD billion)
H1 2019	44	2.62
H2 2019	46	3.11
H1 2020	45	2.92

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 January 2020 to 30th June, 2020.

9.4 ATM Clearing System (ATM)

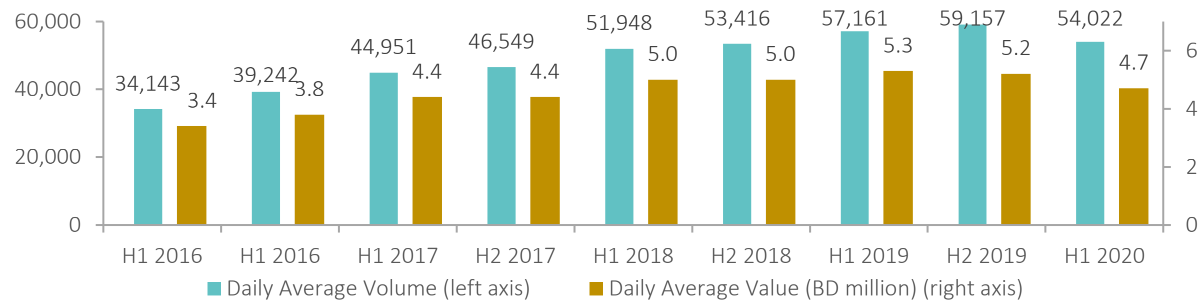
ATM clearing is based on a Deferred Net Settlement (DNS) system. The Benefit Company (BENEFIT) in Bahrain receives and processes all the ATM transactions. The GCC net, a leased line network across the GCC countries, provides for the communication backbone for the transmission of all the ATM transactions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

The daily average volume of ATM transactions for H1 2020 decreased by 8.7% to 54,022 per day compared to 59,157 transactions per day for H2 2019. In addition, the daily average volume of ATM transaction increased by 5.5% in H1 2020 compared to H1 2019 (57,161 transactions per day).

The daily average value of ATM transactions for the H1 2020 decreased by 10.6% to reach BD 4.7 million when compared to the BD 5.2 million in H2 2019 and decreased by 0.6% when compared H1 2019 (BD 5.3 million).

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

Chart 9.3: ATM Transactions Daily Average and Volume



Source: BENEFIT.

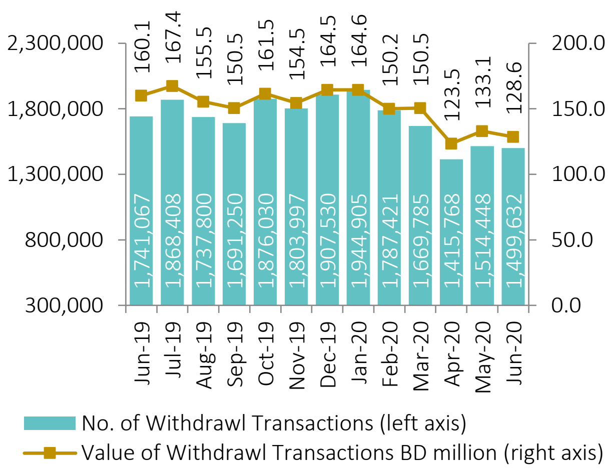
Table 9.3: ATM Transactions Daily Average and Volume

ATM Transitions	Daily Average Volume	Daily Average Value (BD million)
H1 2019	57,161	5.3
H2 2019	59,157	5.2
H1 2020	54,022	4.7

Source: BENEFIT.

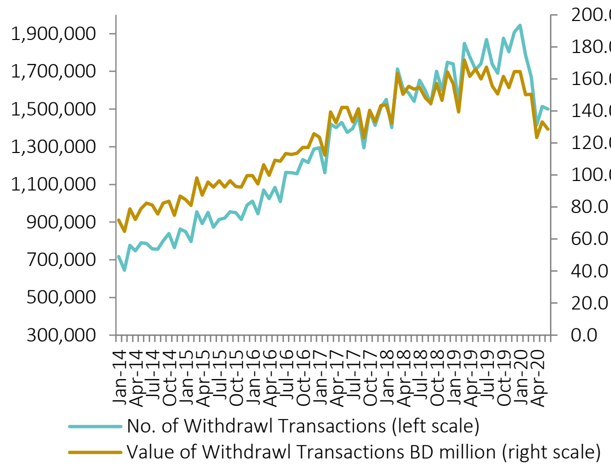
Overall, there was a downward trend in both the value and the volume of ATM transactions (Chart 9.2). H1 2020, the lowest value of withdrawals was witnessed in April 2020 at BD 123.5 million (15.2% decrease from previous month and 20.3% YoY). The lowest volume of transactions was also in April 2020 with 1,415,768 transactions (27.0% decrease from previous month and 23.5% YoY).

Chart 9.4: Number and Value of ATM Transactions, June 2019 – June 2020



Source: BENEFIT.

Chart 9.5: 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 H1 2020 decreased by 18.7% when compared to the H2 2019 from 11,870 cheques to 9,651 cheques. In addition, the daily average volume of cheques in H1 2010 decreased by 20.5% from 12,133 cheques in H1 2019.

Furthermore, the daily average value of cheques decreased in the first half of 2020 by 12.8% when compared to the second half of 2019 from BD34.5 million to BD30.1 million. Moreover, the daily average value of cheques for the first half of 2020 decreased by 17.1% from BD36.3 million for the first half of 2019 to BD30.1 million.

Chart 9.6: BCTS Daily Average Volume and Value

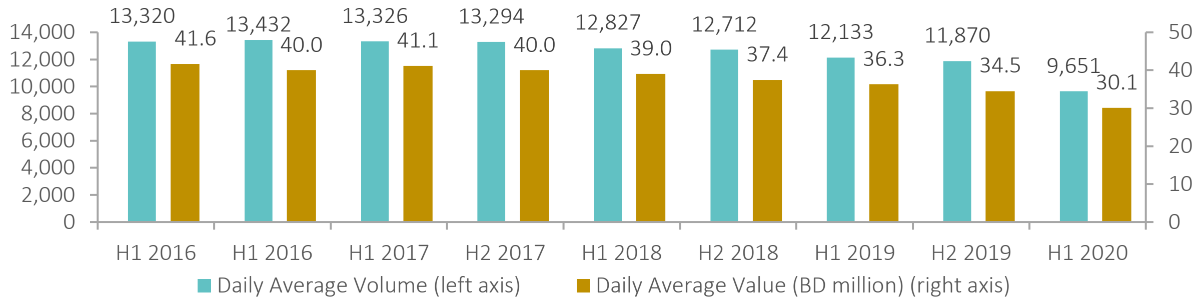


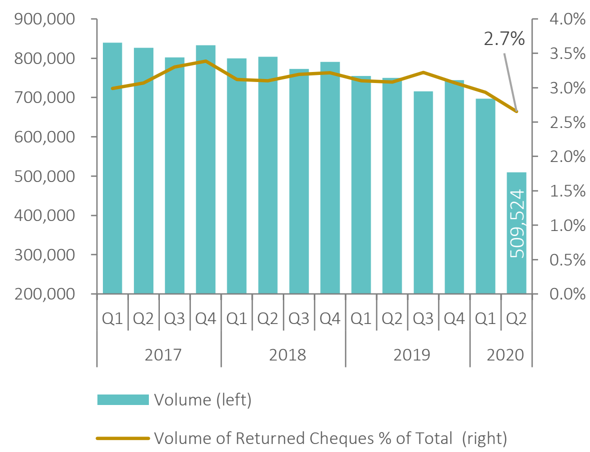
Table 9.4: BCTS Daily Average Volume and Value

BCTS	Daily Average Volume	Daily Average Value (BD million)
H1 2019	12,133	36.3
H2 2019	11,870	34.5
H1 2020	9,651	30.1

Source: BENEFIT.

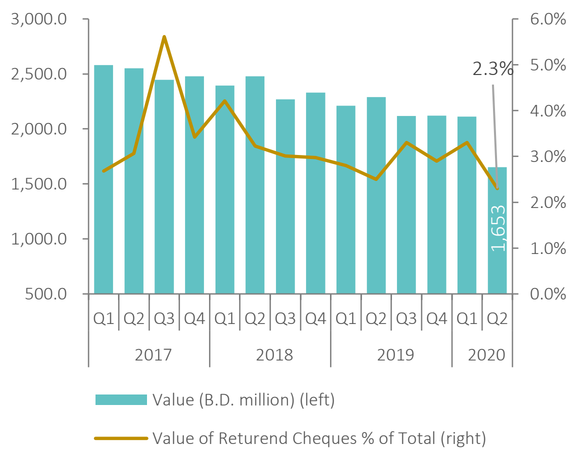
The BCTS continued to operate smoothly and efficiently for the period from 1st January, 2020 to 30th June, 2020. Charts 9.3 and 9.4 show the volume and value of cheques and the percentage returned cheques to the total volume and value. Between Q1 2017 and Q2 2020, returned cheques ranged between 2.7% to 3.4% as a percentage of total volume and 2.3% to 5.6% as a percentage of total value.

Chart 9.7: Volume of Issued Cheques and % of Returned Cheques



Source: BENEFIT.

Chart 9.8: Value of Issued Cheques and % of Returned Cheques (BD million)

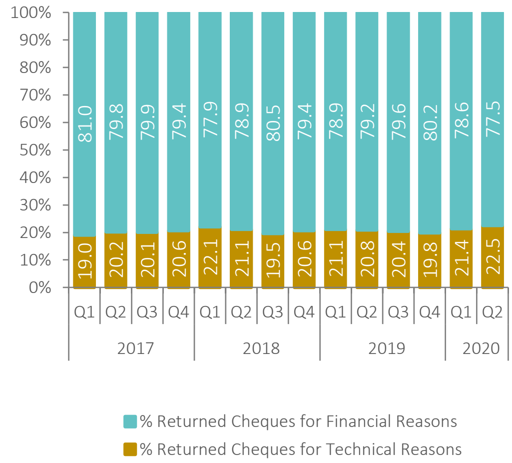


Source: BENEFIT.

The majority of the cheques returned in terms of volume and value are returned due to financial reasons reaching 77.5% of the total volume of cheques and 65.7% of the total value of cheques in Q2

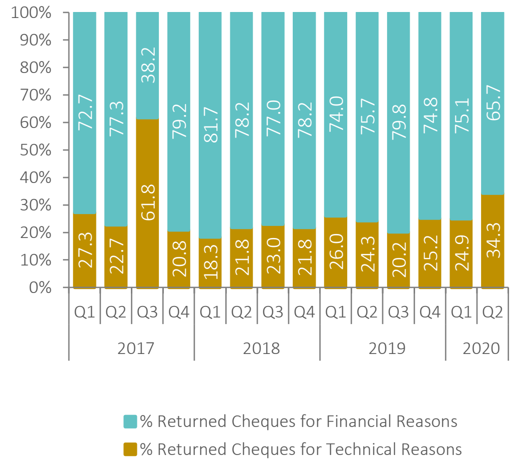
2020. Cheques returned due to technical reasons comprised 22.5% of total volume and 34.3% of total value in Q2 2020 (Charts 9.5 and 9.6).

Chart 9.9: Returned Cheques by Volume (% of Technical vs. Financial)



Source: BENEFIT.

Chart 9.10: Returned Cheques by Value (% of Technical vs. Financial)



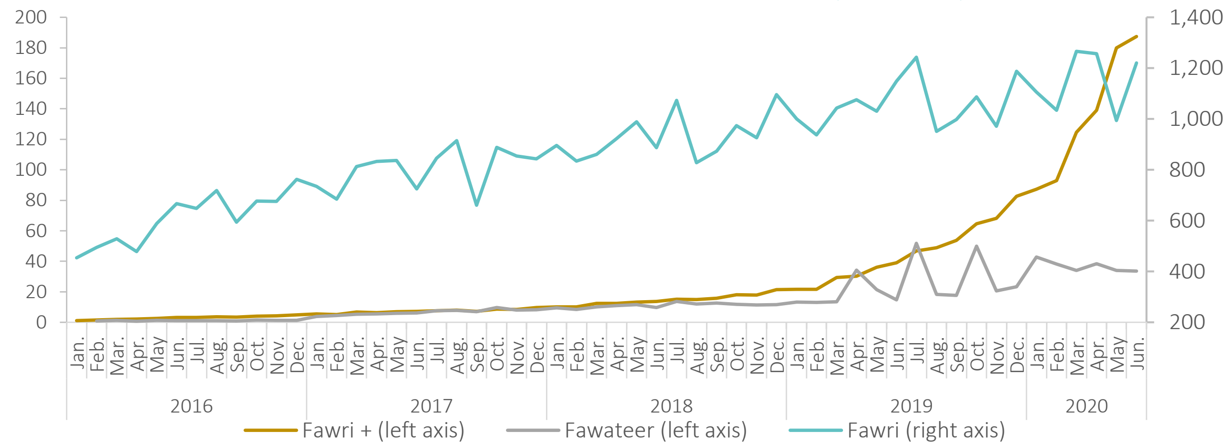
Source: BENEFIT.

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 utilized. 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 9.11: EFTS Fawri, Fawri+, and Fawateer Value (BD million)



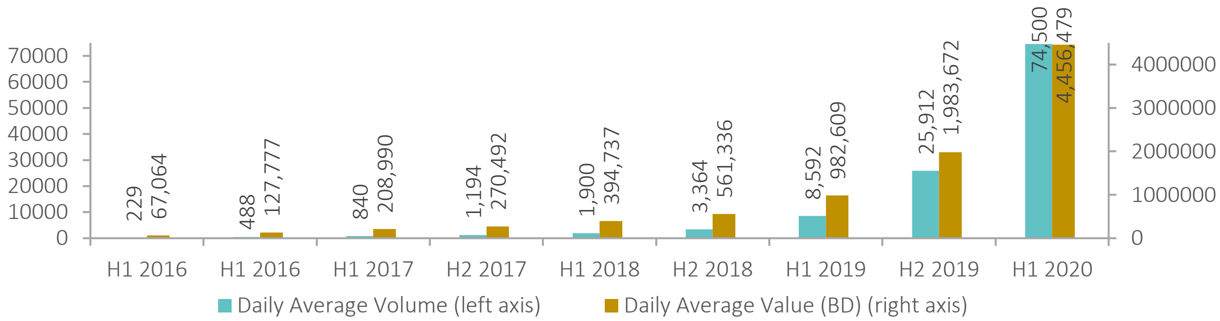
Source: BENEFIT.

Chart 9.11 shows an overall increasing trend in the monthly transfers in Fawri+, Fawri, and Fawateer. The total value of Fawri transfers for H1 2020, reached BD 6,875.9 million compared to BD 6,436.8 million for H2 2019. The value of Fawri+ transfers also increased from BD 365.0 million in H2 2019 to BD 811.1 million for H1 2020. In addition, the value of Fawateer payments increased from BD 181.6 million in H2 2019 to BD 221.0 million in H1 2020. The surge in Fawri+ transfers in 2019 and 2020 is due to the increasing popularity and convenience in going cashless along with the compatibility with digital wallets.

The daily average volume of Fawri+ transfers for H1 2020 increased significantly by 187.5% when compared to H2 2019 from 25,912 transfers to 74,500 transfers. Furthermore, the daily average volume of Fawri+ transfers for H1 2020 increased by 767.1% from 8,592 transfers in H1 2019. The daily average value of Fawri+ transfers increased by 124.7% from BD 1,983,672 in H2 2019 to BD 4,456,479 in H2 2020. The daily average value also increased by 353.5% in H1 2020 when compared to the from BD982,609 in H1 2019.

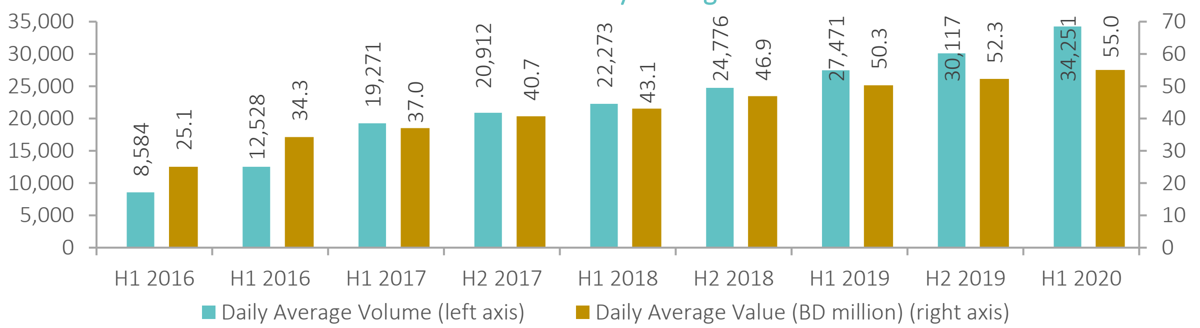
The daily average volume of Fawri transfers in H1 2020 increased by 13.7% when compared H2 2019 from 30,117 transfers to 34,251 transfers. Moreover, the daily average volume of Fawri transfers in H1 2020 increased by 24.7% from the 27,471 transfers in H1 2019. In addition, the daily average value of Fawri transfers increased by 5.2% from BD52.3 million in H2 2019 to BD55.0 million in H1 2020. Furthermore, the daily average value of Fawri transfers increased by 9.3% from BD 50.3 million in H1 2019.

Chart 9.12: EFTS Fawri +Daily Average Volume and Value



Source: BENEFIT.

Chart 9.13: EFTS Fawri Daily Average Volume and Value



Source: BENEFIT.

Table 9.5: EFTS (Fawri+, Fawri) Daily Average Volume and Value [10]

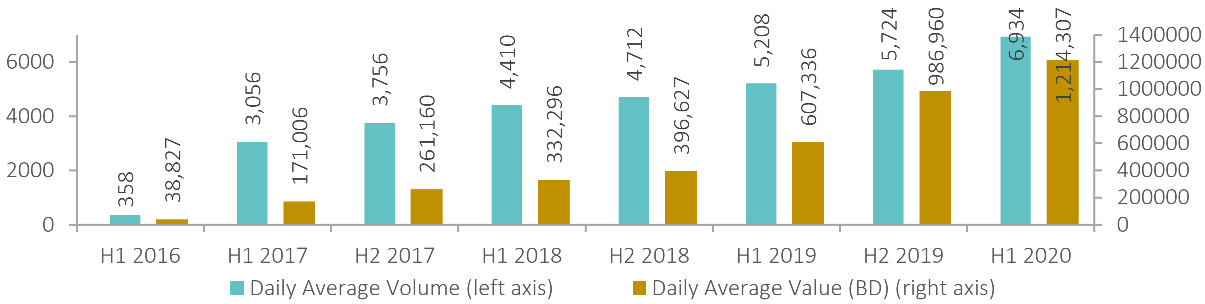
EFTS	Fawri +		Fawri	
	Daily Average Volume	Daily Average Value (BD)	Daily Average Volume	Daily Average Value (BD million)
H1 2019	8,592	982,609	27,471	50.3
H2 2019	25,912	1,983,672	30,117	52.3
H1 2020	74,500	4,456,479	34,251	55.0

Source: BENEFIT.

[10] Settled Transactions only as per Report received from BENEFIT.

The daily average volume of Fawateer transfers for the first half of 2020 increased by 21.1% when compared to H2 2019 from 5,724 transfers to 6,934 transfers and increased by 33.1% from the 5,208 transfers in H1 2019. In addition, the daily average value of Fawateer reached BD 1,214,307 in H1 2020 increasing by 23.0% when compared to H2 2019 (BD 986,960) and by 99.9% compared to H1 2019 (BD 607,336).

Chart 9.14: EBPP Fawateer Daily Average Volume and Value



Source: BENEFIT.

Table 9.6: EBPP Fawateer Daily Average Volume and Value [11]

EBPP	Daily Average Volume	Daily Average Value (BD)
H1 2019	5,208	607,336
H2 2019	5,724	986,960
H1 2020	6,934	1,214,307

Source: BENEFIT.

The EFTS including EBPP continued to operate in a safe, efficient, resilient and reliable manner from 1st January 2020 to 30th June, 2020. 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.

9.7 Point of Sale (POS)

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 Q2 2020, there were 43,538 POS terminals in Bahrain with a 8.2% increase in terminals (5,252) than the number of terminals as of end 2019 (Table 9.7).

Table 9.7: 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
2020	Q1	17,265,204	3,404,020	20,669,224	505,694,558	111,904,396	617,598,954	42,768
	Q2	15,897,111	817,692	16,714,803	441,050,782	28,968,320	470,019,102	43,538

Source: CBB.

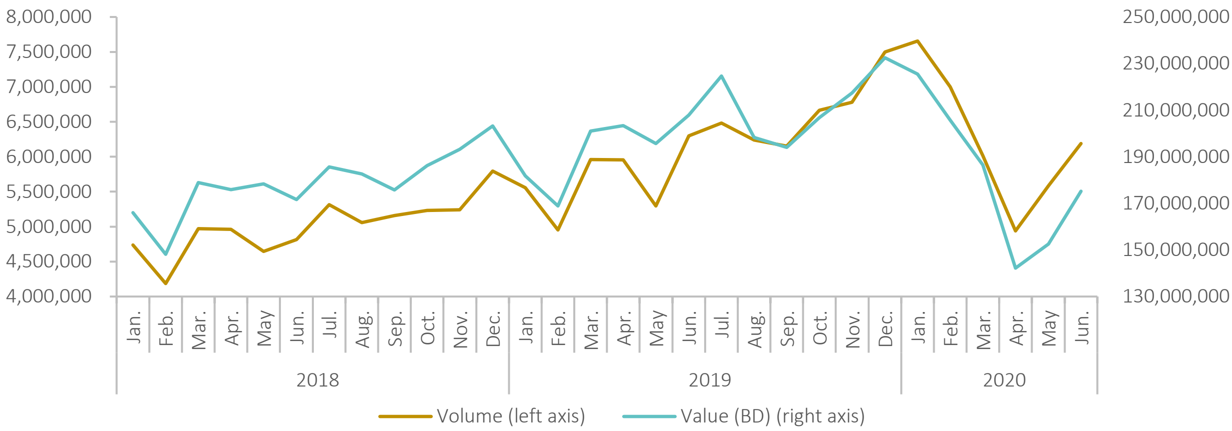
[11] Settled Transactions only as per Report received from BENEFIT.

POS transactions in Bahrain have shown a steady increase in both in volume and value. The total number of transactions for 2019 increased by 14.3% to reach 73.7 million transactions from the 64.5 million transaction in 2018. The total value of transactions increased also by 23.1% from BD 1,977.2 million to 2,434.4 million over the same period. As of Q2 2020, the total number of transactions performed using POS machines in Bahrain was 16.7 million which is a 19.1% decrease from Q1 2020 and 4.7% YoY decrease from Q2 2020. As for the total value of transactions, the total value of transactions performed using POS machines in Bahrain in Q2 2020 was BD 470 million which is 23.9% decrease from Q1 2020, and 22.6% YoY decrease from Q2 2019. The decrease in spending in volume and value of POS transactions in Q2 2020 is a reflection of the impact of the COVID-19 pandemic on consumer spending.

Chart 9.15 shows the monthly of POS transactions in terms of volume and value which can help identify any cyclicality in behavior over the long run. The overall trend in increase in POS transactions until end of 2019 shows that people prefer making direct payments to merchants through POS terminals instead of ATM/Cash withdrawals.

The COVID-19 health crisis impacted the nature of POS transactions shifting towards contactless as consumers are developing new habits. Although contactless adoption is accelerating, POS transaction values are expected to take time to reach the pre-COVID levels. The longer lockdown/precautionary measures period the more the pandemic will have a lasting impact on consumer behavior. POS transactions are expected to be driven by contact payments; however, contactless transactions will continue to grow faster than before the pandemic.

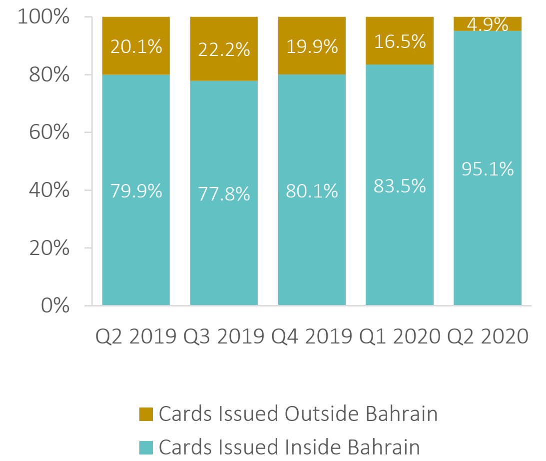
Chart 9.15: Monthly POS Transactions (Volume and Value)



Source: CBB.

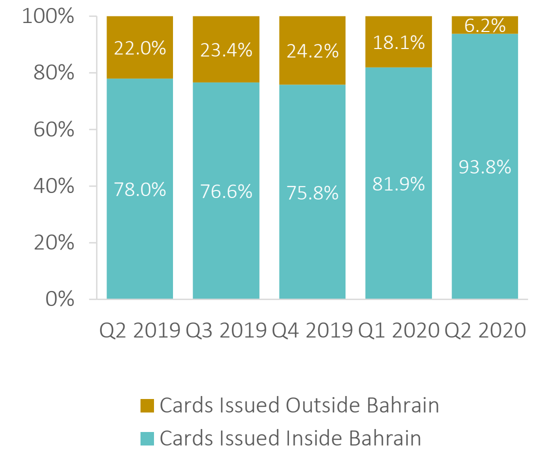
As of Q2 2020, 95.1% of the volume of transactions and 93.8% of the value of transactions came from cards issued inside Bahrain compared to 83.5% and 81.9% in Q1 2020 respectively (Chart 9.16 and Chart 9.17). The decrease in share of cards issued outside Bahrain is due to the decrease in number of foreigners visiting Bahrain due to travel restrictions during the COVID-19 pandemic. The share of cards issued outside Bahrain is expected to increase in the upcoming quarters as travel restrictions are eased.

Chart 9.16: Volume of POS Transactions (% of Cards Issued Inside vs. Outside Bahrain)



Source: CBB.

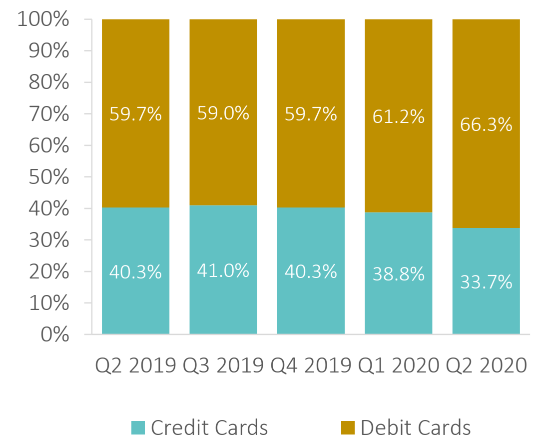
Chart 9.17: Value of POS Transactions (% of Cards Issued Inside vs. Outside Bahrain)



Source: CBB.

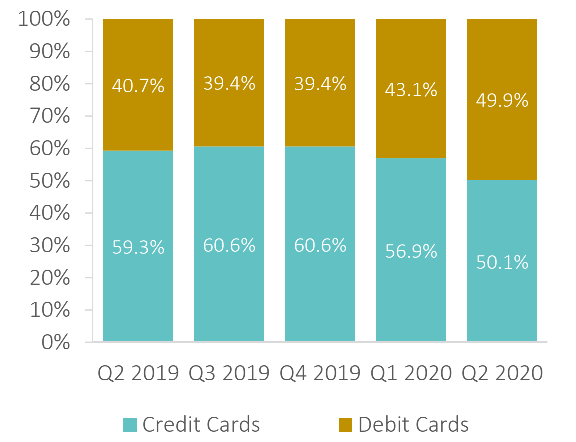
For the Second half of 2020, 66.3% the volume of transactions was from debit cards while 50.1% of the value of transactions came from credit cards (Chart 9.18 and Chart 9.19). The share of debit cards increased for both volume and value in Q2 2020 due to a change in consumer spending habits.

Chart 9.18: Volume of Transactions (% of Debit Cards vs. Credit Cards)



Source: CBB.

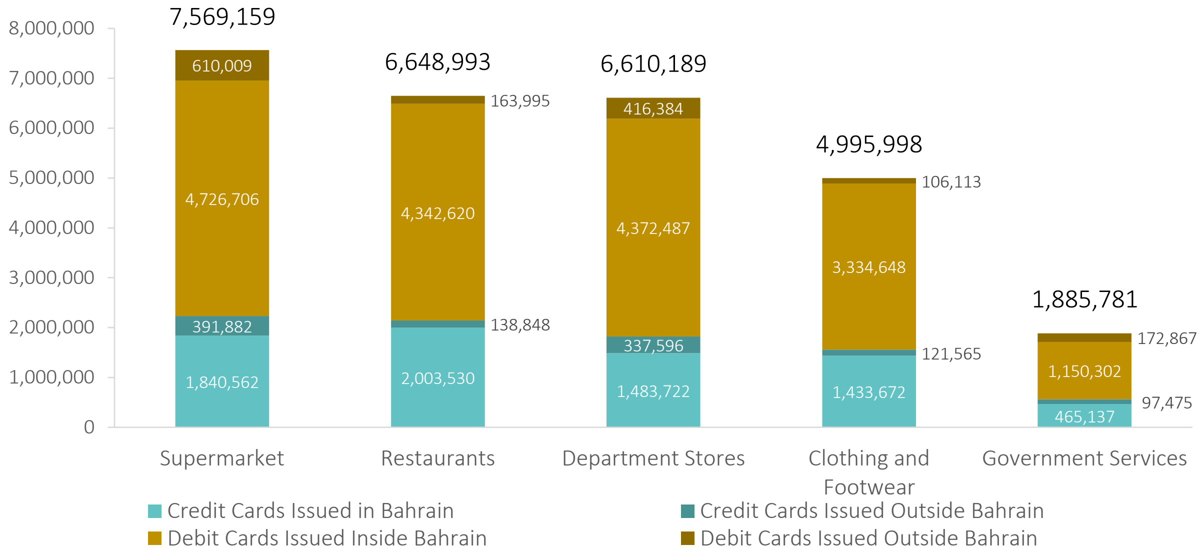
Chart 9.19: Value of Transaction (% of Debit Cards vs. Credit Cards)



Source: CBB.

Charts 9.20 and 9.21 show the top 5 sectors in terms of volume and value of transactions for the first half of 2020. In terms of volume the top 5 sectors were supermarkets (7,569,159 transactions), restaurants (6,648,993 transactions), department stores (6,610,189 transactions), clothing and footwear (4,995,998 transactions), and government services (1,885,781transactions). The majority of the number of transactions for the supermarket, restaurants, department stores, clothing and footwear, and government services sectors were done using debit cards issued inside Bahrain making 62.4%, 65.3%, 66.1%, 66.7%, and 61.0% of the transactions respectively.

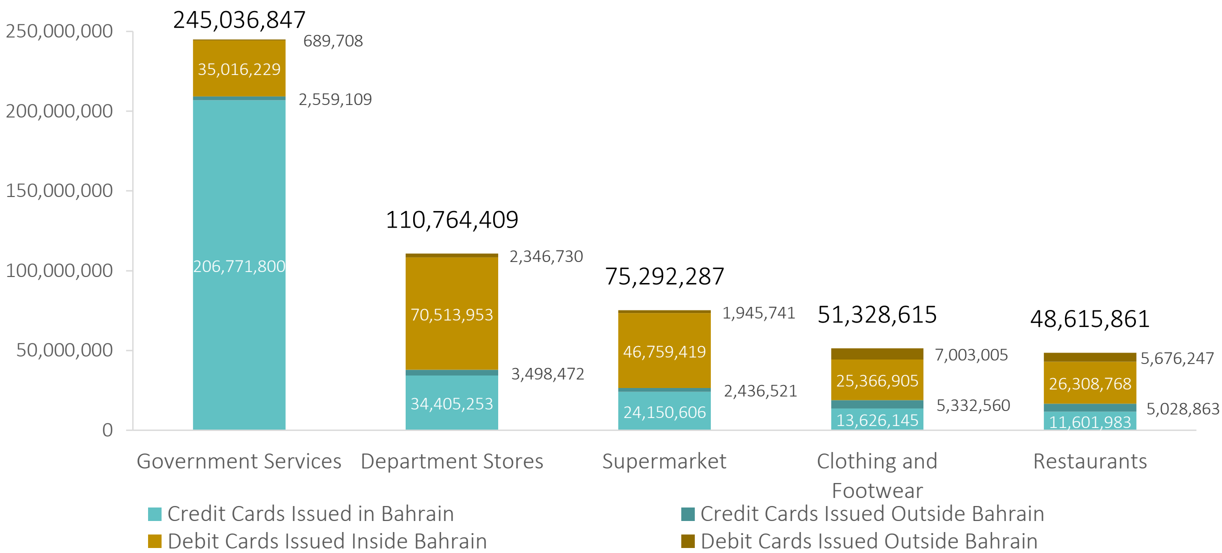
Chart 9.20: Top 5 Sectors by Volume of Transactions- H1 2020



Source: CBB.

In terms of value, the top 5 sectors were Government Services (BD 245.0 million), Department Stores (BD 110.8 million), supermarket (BD 75.3 million), clothing and footwear (BD 51.3 million), and restaurants (BD 48.6 million). For government services, 84.4% of the value of transactions were made by credit cards issued inside Bahrain. As for department stores, supermarket, clothing and footwear, and restaurants sectors, 63.7%, 62.1%, 49.4%, and 54.1% of the value of transactions respectively were made by debit cards issued inside Bahrain.

Chart 9.21: Top 5 Sectors by Value of Transactions (BD)- H1 2020



Source: CBB.

9.8 Digital 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.

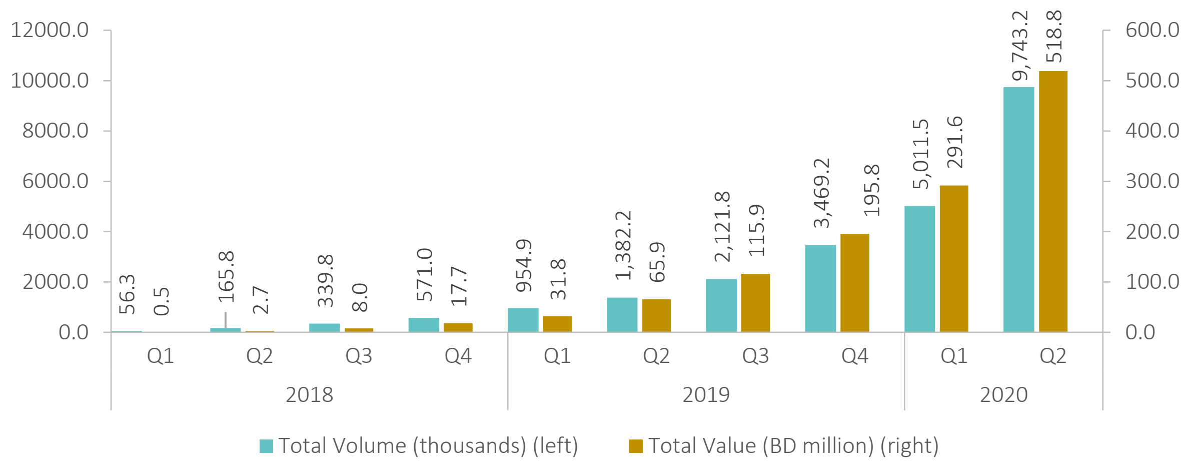
The volume and value of transactions through digital wallets has been increasing over the past year, as provided in Table 9.8, with an increasing trend in both the volume and value of transactions, indicating the success of adoption of these digital solutions. The total volume increased to 9.7 million transactions in Q2 2020, a 94.4% increase from the 5.0 million transactions in Q1 2020 and 604.9% YoY increase from the 1.4 million in Q2 2019. to 3.5 million transactions in Q4 2019 (507.6% increase). The value of transactions increased to BD 518.8 million in Q2 2020, a 78.0% increase from Q2 (BD 291.6 million) and 687.4% YoY increase from Q2 2019 (BD 65.9 million).

Table 9.8: 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
2020	Q1	5,011,540	291,554,820.0
	Q2	9,743,196	518,836,255.1

Source: CBB.

Chart 9.22: Volume and Value of Transactions through e-Wallets and Mobile Payments



Source: CBB.

Chapter 10 Fintech, Innovation and Financial Inclusion

Key Highlights

Regulatory Sandbox	Bank Branches	ATMs	ATM Cards	Debit Cards	Credit Cards
30 Companies	204	515	1,664.1 K	1,210.3 K	306.6 K

- 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 making recommendations on the necessary regulatory reforms to encourage innovation within the financial services sector via the use of FinTech solutions, supervising and overseeing the progress of companies participating in the Regulatory Sandbox and monitoring technical and regulatory developments within the FinTech field.
- Continued Fintech developments within the Kingdom and the launch of a number of digital wallets over the last year.

10.1 Overview

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.

10.2 FinTech Developments

The CBB has issued a series of measures to strengthen its position as a regional financial center; including guidelines on the regulatory environment to ease the implementation of FinTech's 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 a conducive ecosystem 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.

10.2.1 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 center 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.

As of August 31st 2020, the CBB had 30 companies testing their solutions within the Regulatory Sandbox, and 6 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 maintaining a segregated client money account.

10.2.2 Hub 973: The CBB Digital Lab

The CBB is partnering with Fintech Galaxy, a UAE-based digital crowdsourcing platform that empowers FinTech entrepreneurs and connects them to financial institutions, consultants, tech companies, mentors and investors; to develop an open innovation platform for the Kingdom of Bahrain, that connects local financial institutions with FinTech startups and developers to test and build products that solve real consumer problems. This platform will be powered by data and analytics, allowing startups to engage in tests before commercial and production agreements with financial institutions. The platform, named Hub 973: The CBB Digital Lab, will allow for the integration of technical testing with the regulatory framework of the CBB. Hub 973 will also connect, screen, and qualify global FinTechs on one centralized marketplace for collaboration and co-creation with the Bahraini sector including virtual hackathons. Hub 973 will launch in mid-October 2020.

10.2.3 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.

10.2.4 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 programs and funding schemes, can play a major part in Open Banking. The CBB is currently working with a consultant to come up with Bahrain specific Open Banking technical and governance standards.

10.2.5 E-Wallet Developments

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.

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 Pay	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.

10.2.6 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.

10.2.7 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.

10.2.8 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.

10.2.9 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

10.2.10 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.

10.2.11 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.

10.2.12 Tokenization for Contactless Payments

In collaboration with the Benefit company, retail banks and Bahrain Credit Services, the CBB launched the payment tokenization service that enables contactless ('tap&go') payments at POS terminals via Android smart phones. The service works by tokenization debit and credit cards on the Android mobile devices, enabling the use of the mobile for contactless payments at POS terminals.

This service is characterized by the ease of completing payment transactions, as it is done through the use of the Benefit B app by placing the customer's smart mobile device close to the point of sale device and completing the transaction without the need to use a plastic bank card, which strengthens the preventive measures and precautionary measures taken by the Central Bank of Bahrain. For ease and speed of payment completion, as well as to contain and prevent the spread of Coronavirus (COVID-19).

The encryption service is also characterized by the highest levels of security, as it blocks the card's data from the other party's visibility and prevents any party from accessing it, thus the customer is protected from the risk of misuse of the data available on the card and those stored in it. The service does not require any additional data to be stored on the Benefit B app, and all that is required from the customer to activate the service is to update the Benefit B app and specify the card stored in the Benefit B app to activate the service.

10.2.13 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:

- 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.
- CBB Digital Strategic Study project: CBB has engaged a consultant to assist in assessing the current and emerging business models across the financial services industry, how they will shape both the incumbent and new entrants into the market and also help to understand CBB's anticipated role in regulating these business models and to identify cross cutting themes that need to be addressed to furbish digital transformation.
- Bahrain Open Banking Framework Project: The CBB is working with a consultant to come up with Bahrain specific technical and governance standards for Open Banking.

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 has joined the AMF Fintech Working Group.
- The CBB is acting as an observer on R3's CBDC Working Group.

The CBB is involved in Digital Currency Governance Consortium ("DCGC") Working Group of the World Economic Forum. This invitation only consortium will focus in 2020 on key questions and governance gaps in relation to digital currencies, as well as other topics that may arise. Throughout the course of the year, the consortium members will meet to discuss and develop proposed global frameworks for digital currency governance.
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).

10.3 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.

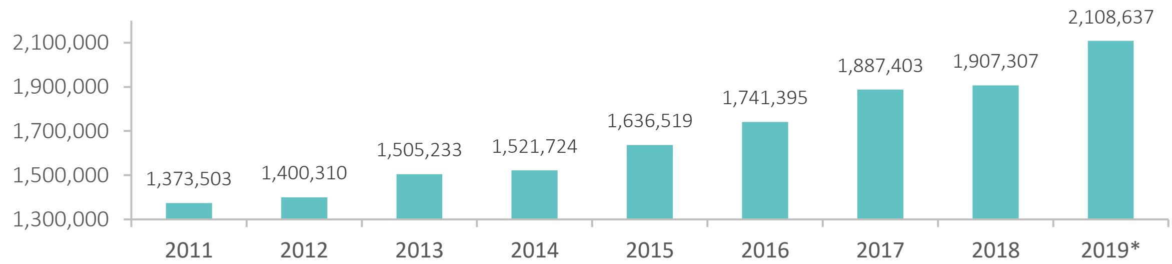
Table 10.2: Financial Inclusion Figures for the Kingdom of Bahrain

	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.

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 Economic Research Division issued a survey in September 2020 to evaluate the immediate response of financial institutions to the COVID-19 Pandemic
- The survey's scope covered: investments made prior to COVID-19 and their impact during the pandemic in addition to the areas of cyber related threats which have significantly increased since Feb 2020.

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 recognized 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.

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

The CBB has more than one role in addressing Cyber Risk. Cyber Incidents are required to be reported to the CBB'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 Economic Research Division at the Financial Stability Directorate issues a yearly Cyber Risk Survey which covers cyber risk relative to governance and leadership, identification, protection, detection, response and recovery. These studies focus on analysing cyber risk at a macro level. The CBB's joint efforts aid in creating proper tools and guidelines for tackling cyber risk from a regulatory perspective

11.3 CBB COVID-19 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 Economic Research Division issued a new edition of the Cyber Security Survey for 2020 to understand the first cyber related responses of financial institutions to the COVID-19 Pandemic and actions taken by IT Security Officers. The survey was addressed to all IT Security Officers at Retail Banks, Wholesale Banks and Financing Companies. Responses were collected and consolidated from a total of 48 respondents to understand the effect of COVID-19 on Cyber Security and how financial institutions are rethinking their cyber related strategies and reprioritizing their investments going forward.

11.3.2 Key Survey Findings

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

1- The most significant cyber security-related areas where investments were made prior to COVID-19 (in the past 2-3 years) included Endpoint Security Options (95.8%), Business Continuity or Disaster Recovery planning (85.4%), Security Awareness training and cross training (83.3%) and Virtual Private Network (VPN) (79.2%). On the other hand, the lowest investments were made in the Use of Data Analytics and AI in Cyber (only 31.3% of respondents made investments in this area prior to COVID-19).

2- The investments made in the past 2-3 years were found positively impactful during the COVID-19 pandemic in a number of areas such as: Endpoint Security Solutions (81.3%), VPN (81.3%), Business Continuity and disaster recovery planning (77.1%) and Realtime threat intelligence (64.6%).

3- During COID-19, the highest increase in cyber-related risks and attacks was found in phishing attacks across all financial institutions who took part of the survey (with an increase of 62.5% in phishing attacks). Compliance and regulatory risks arising from moving to new models increased by 22.9%, while risks from using non-enterprise devices and software due to work from home policies increased by 14.6%. Additionally, risks coming from inadequately secured third-parties increased by 14.6%.

4- Going forward, IT-Security Officers expect some risks to increase or change over the next 6 months. Increased risks are expected in phishing attacks by 70.8%, Ransomware attacks are expected to increase by 50%.

5- Threats originating from cybercriminals are expected to increase by 83.3%, threats from hackers are expected to increase by 87.5%.

6- During the COVID-19 Pandemic, IT Security officers allocated 54.2% of their time for crisis management activities, 31.3% of their time was allocated for business-as-usual operational tasks and 14.6% of their time was allocated for strategic cyber projects.

7- During the COVID-19 Pandemic, IT Security Officers were significantly involved in a number of activities and tasks. There was significant involvement of IT Security Officers in enabling remote work or work-from home for the institution's employees (by 89.6%); significant involvements by 79.2% was also seen in setting up additional controls and security for remote workforce in addition to planning for and coordinating return-to-work solutions for essential workers (by 58.3%).

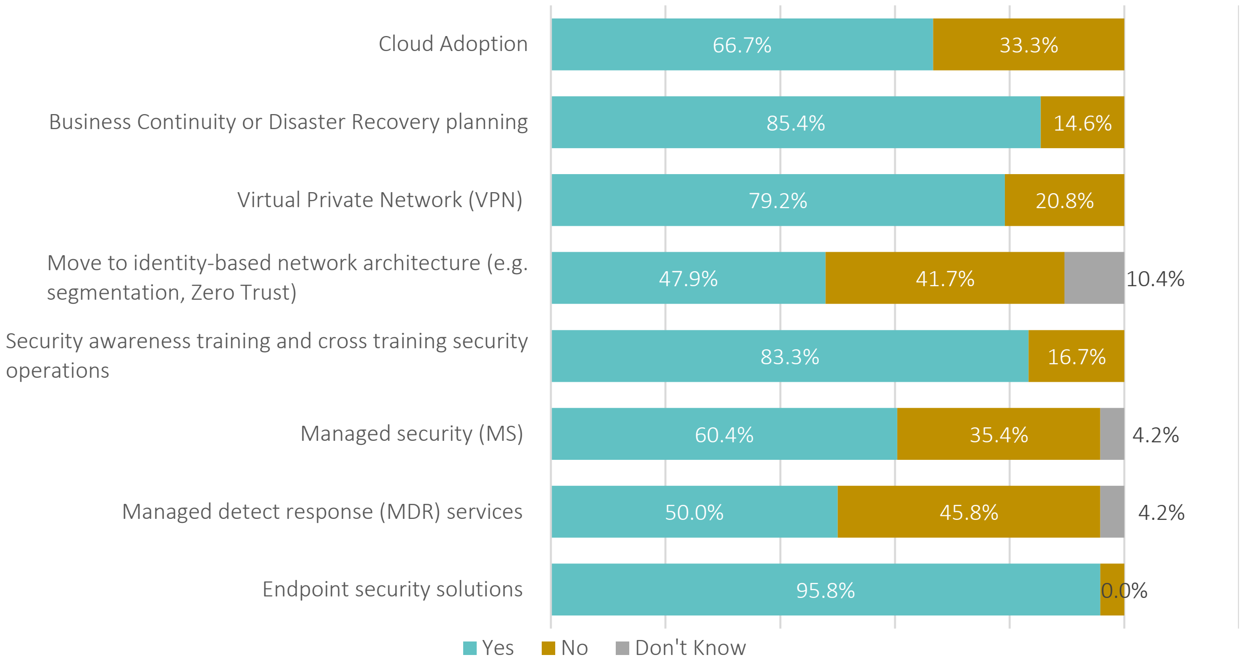
8- Given the lessons learned from the crisis, IT Security Officers see that future investments should be prioritized in a number of areas, the highest being the automation of more processes in the cyber function (92%), Quantifying cyber risks better (90%), Increasing the resilience of financial institutions to severe events (83%) , increase the IT Security team's digital skills (81%) and to integrate cyber risks more with the overall enterprise risk management (81%).

9- Given the lessons learned from the crisis, IT Security Officers see that the main future investments in network/infrastructure should be in cloud adoption by 39.6% and Business Continuity or disaster recovery planning by 33.3%. As for investments in People, priority should be given to investments in real-time threat intelligence capabilities by 56.3% and managed security by 29.2%. Regarding tech-solutions, priority should be made for investments in modern mobile device management (MDM) and Development of enterprise-wide information governance standards and frameworks (37.5%). As for frameworks and processes, priority should be given to investments in the use of data analytics and AI in cyber by 52.1% and the quantification of cyber risk by 25%.

10- In the 12 months prior to COVID-19, interaction between IT Security Officers with the Board and CEO was either not available or remained unchanged (75% of financial institutions interaction with the Board remained unchanged/not available and 62.5% of interaction with the CEO remained unchanged/not available).

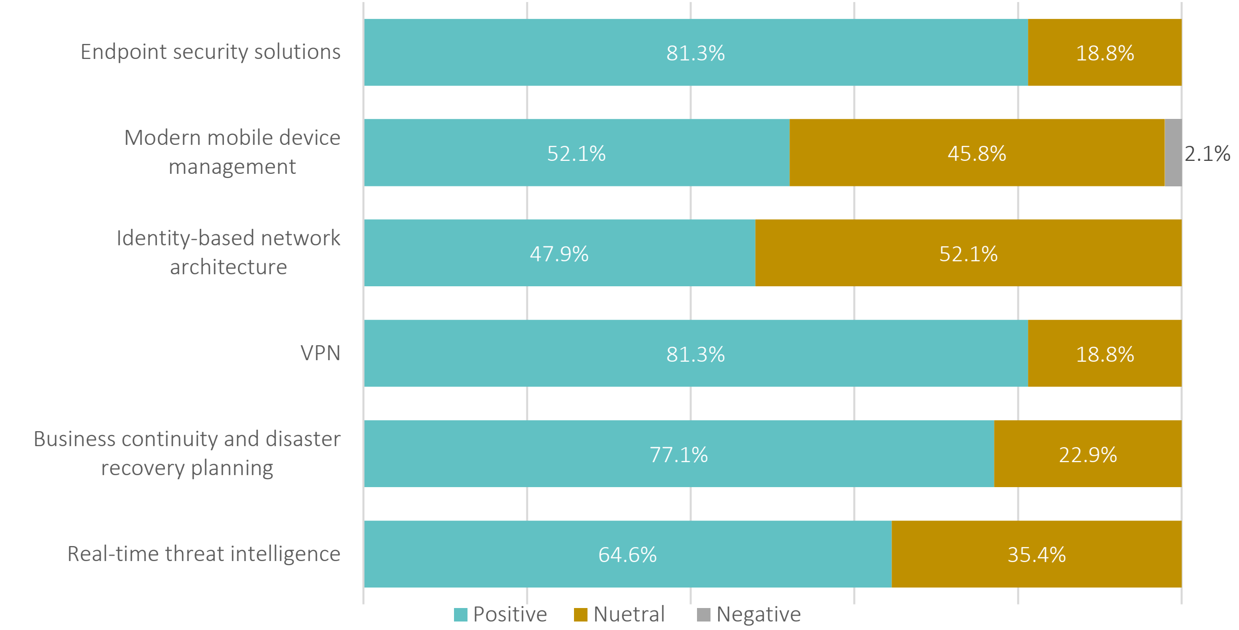
11.3.3 Survey Results

Chart 11.1: Significant investments made within the past 2-3 years in the following areas (e.g. upgrades, modernization or integration across the enterprise)



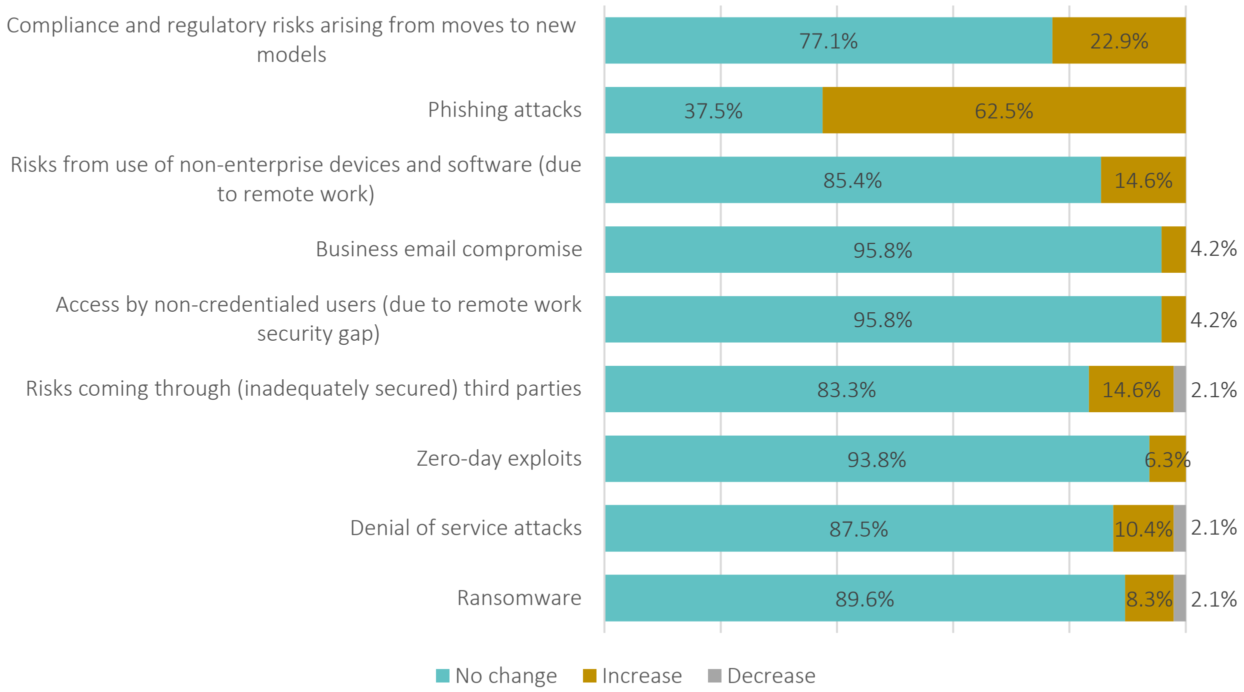
Source: CBB Survey.

Chart 11.2: The impact of investments made in the past 2–3 years during the COVID-19 crisis to-date



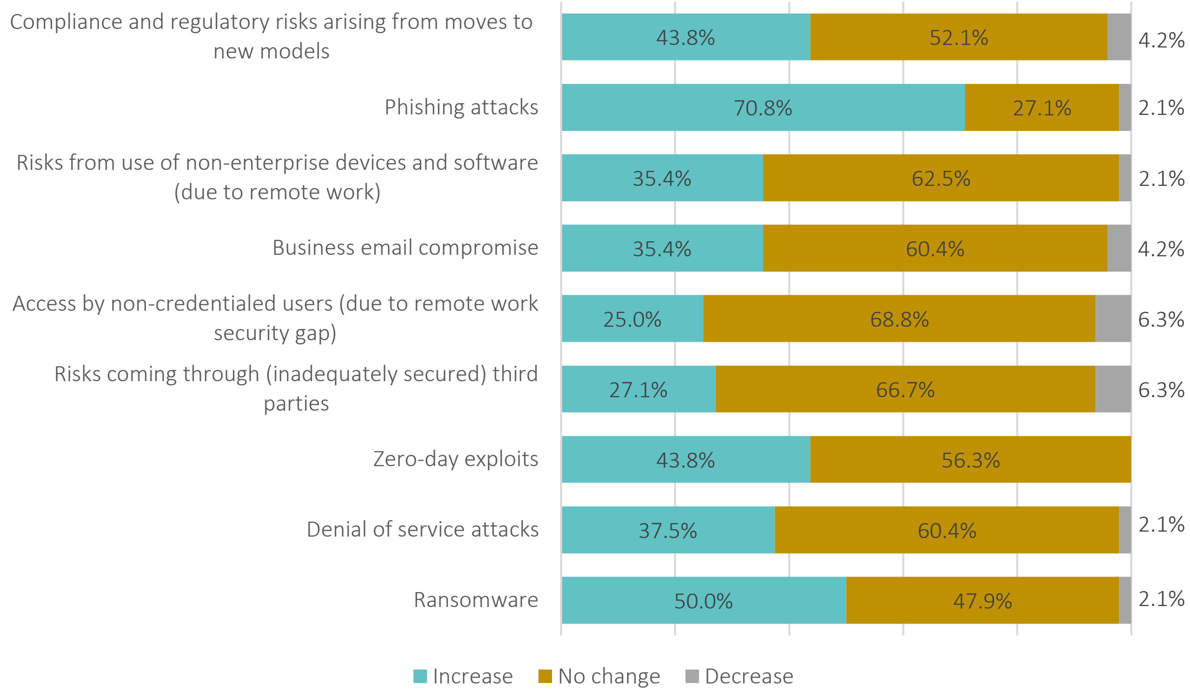
Source: CBB Survey.

Chart 11.3: Changes seen in any of the following risks or attacks related to COVID-19, since February 2020



Source: CBB Survey.

Chart 11.4: And now looking ahead, in what way do you expect the incidence of COVID-19 related risks or attacks to change over the next 6 months?



Source: CBB Survey.

11.4 CBB Cyber Security Initiatives and Regulatory Developments

The CBB continues to develop its regulations on cybersecurity in an effort to strengthen the cyber resilience of its financial institutions.

CBB Rulebook:

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. Licensee's business continuity plan must be 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 CBB 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.

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.

The 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 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 framework was further enhanced to tackle cloud security governance risk.

TRMST and ITD Initiatives:

The Technology Risk Management Security Team (TRMST) reviewed the proposed inspection manual and provided relevant feedback to the Inspection Directorate wherever applicable. The IT Directorate (ITD) 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 Table 1: Selected Financial Soundness Indicators - Overall Banking System

Indicator	Q2 2019	Q4 2019	Q2 2020
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.*
***Conventional Banks only.*
Source: CBB.

Annex 1 Table 2: Selected Financial Soundness Indicators - Conventional Banks

Indicator	Conventional Retail			Conventional Wholesale		
	Q2 2019	Q4 2019	Q2 2020	Q2 2019	Q4 2019	Q2 2020
Capital Adequacy						
CAR (%) *	19.8	21.1	18.8	19.4	18.6	17.9
Tier 1 CAR (%) *	18.5	19.7	17.5	18.5	17.7	17.0
Leverage (assets/capital) (Times) *	7.0	6.7	7.5	7.4	7.9	8.2
Non-Performing Loans Net Provisions to Capital	6.3	4.4	5.1	4.3	5.0	6.2
Asset Quality						
NPLs (% of Total Loans)	5.5	4.9	4.6	5.3	4.5	4.7
Specific Provisions (% of NPLs)	66.0	66.1	66.2	74.3	74.3	72.3
Net NPL' (% of Net Loans)	2.0	1.7	1.6	1.4	1.4	1.3
Loan Concentration (Share of Top Two Sectors)	33.8	33.3	33.4	38.7	39.8	40.4
Real Estate/ Construction Exposure (%)	31.7	32.4	31.9	21.9	21.8	21.1
Earnings						
ROA (%)	0.9	1.8	0.6	0.6	0.9	0.4
ROA Local Banks (%)	1.1	2.0	0.8	0.5	0.6	-0.3
ROA Overseas Banks (%)	0.5	1.3	0.2	0.6	1.2	1.1
ROE (%) *	8.0	14.2	6.0	4.1	4.8	-2.3
Net Interest Income (% of Total Income)	77.5	77.3	74.6	42.0	63.2	66.9
Net Fees & Commissions (% of Total Income)	10.4	11.3	10.4	34.7	18.1	15.7
Operating Expenses (% of Total Income)	42.9	39.4	54.9	54.6	54.7	68.5
Liquidity						
Liquid Assets (% of Total Assets)	35.9	36.0	32.8	20.9	21.3	22.2
Liquid Assets (% of Short-Term Liabilities)	44.9	45.6	41.2	26.2	26.3	27.2
Loan-Deposit Ratio (%)	67.9	65.8	66.4	63.4	68.5	67.1
Non-Bank Deposits (% of Total Deposits)	73.7	75.3	73.3	43.7	48.5	48.1

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

Annex 1 Table 3: Selected Financial Soundness Indicators - Islamic Banks

Indicator	Islamic Retail			Islamic Wholesale		
	Q2 2019	Q4 2019	Q2 2020	Q2 2019	Q4 2019	Q2 2020
Capital Adequacy						
CAR (%) *	17.3	18.3	20.6	18.7	18.2	17.6
Tier 1 CAR (%) *	14.5	15.7	17.8	17.6	17.1	16.2
Leverage (Assets/Capital) (Times)	10.0	9.9	9.9	7.5	8.3	8.7
NPFs Net Provisions to Capital (%)	36.1	38.8	25.7	0.4	0.3	1.3
Asset Quality						
NPFs (% of Total Facilities)	9.5	10.4	7.5	1.1	1.1	1.4
Specific Provisions (% of NPFs)	38.0	36.7	40.7	91.7	93.8	78.6
Net NPFs (% of Net Facilities)	6.2	6.9	4.8	0.1	0.1	0.3
Facilities Concentration (Share of Top Two	32.4	30.6	32.3	47.0	46.7	44.0
Real Estate/ Construction Exposure (%)	26.8	28.4	29.3	18.1	18.3	18.1
Earnings						
ROA (%)	0.3	0.4	0.2	0.4	0.7	0.0
ROE (%) *	3.9	4.7	2.1	3.0	6.4	-0.5
Net Income from Own Funds, Current Accounts and Other Banking Activities (% of Operating Income)	53.5	54.2	53.9	51.1	55.4	46.7
Net income from Jointly Financed Accounts and Mudarib Fees (% of Operating Income)	45.0	44.6	44.3	45.5	42.2	50.6
Operating Expenses (% of Total Income)	73.3	82.0	83.7	70.2	71.9	94.3
Liquidity						
Liquid Assets (% of Total Assets)	17.7	17.5	17.3	17.4	17.9	16.5
Facility-Deposit Ratio (%)	95.9	92.5	79.1	68.7	69.9	65.6
Current Accounts from Non-Banks (% of Non-Capital Liabilities, excl. URIA)	25.7	23.3	31.6	41.0	41.7	43.9

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

Annex 2: Selected Graphs

A. Capital Adequacy

Annex 2 Graph 1: Conventional Retail

Source: CBB.

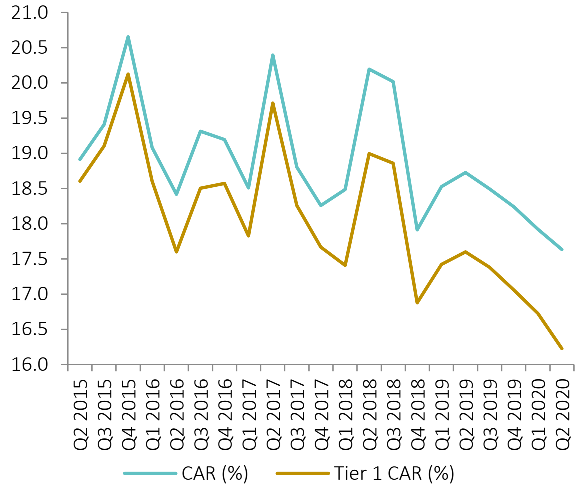
Annex 2 Graph 2 : Conventional Wholesale

Source: CBB.

Annex 2 Graph 3: Islamic Retail

Source: CBB.

Annex 2 Graph 4: Islamic Wholesale



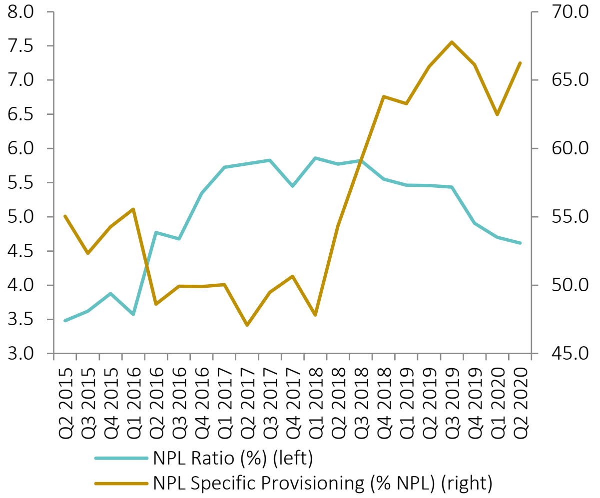
Source: CBB.

Annex 2 Graph 5: All Banking

Source: CBB.

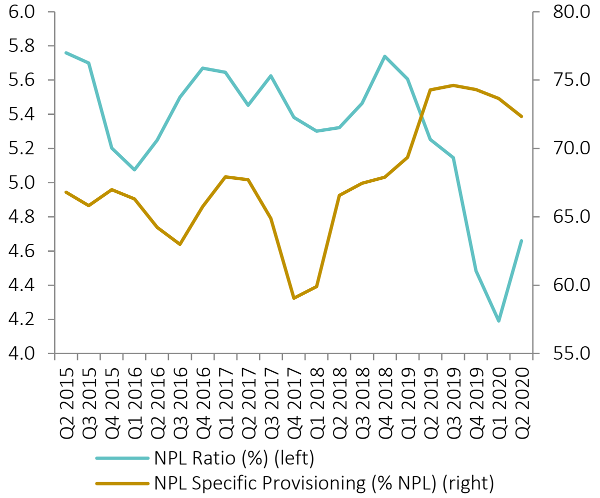
B. Asset Quality

Annex 2 Graph 6: Conventional Retail



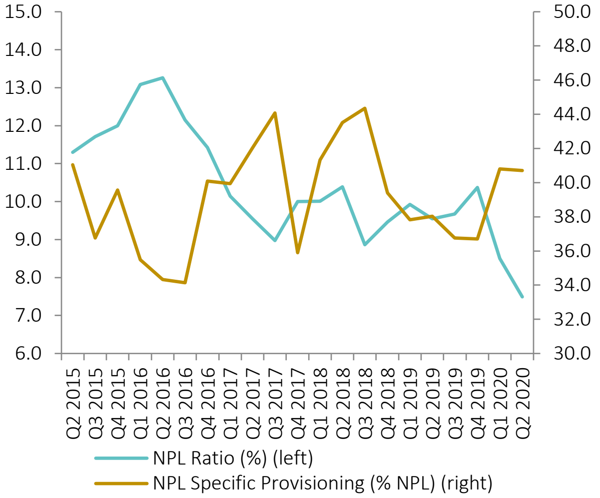
Source: CBB.

Annex 2 Graph 7: Conventional Wholesale



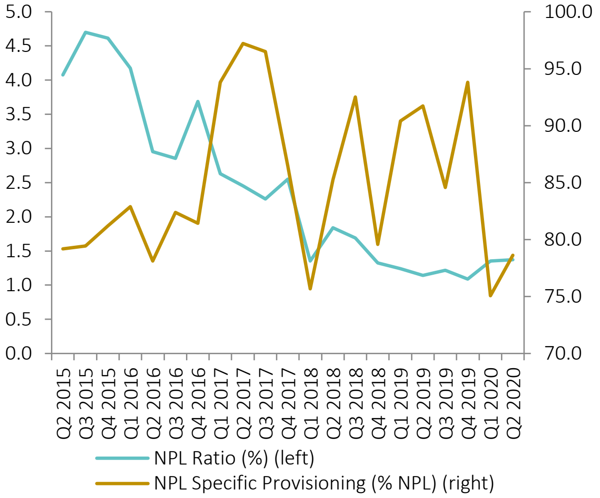
Source: CBB.

Annex 2 Graph 8: Islamic Retail



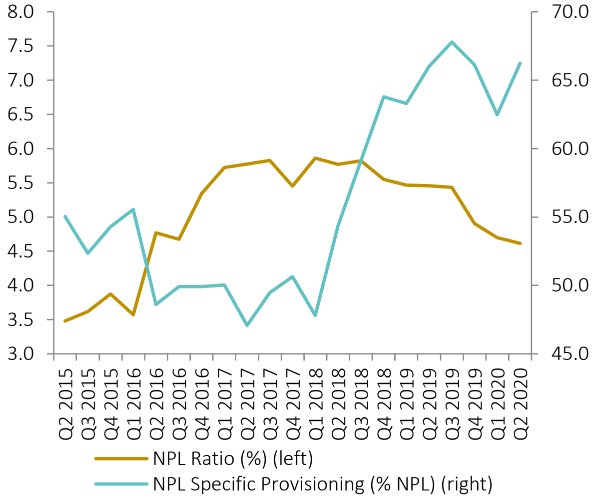
Source: CBB.

Annex 2 Graph 9: Islamic Wholesale



Source: CBB.

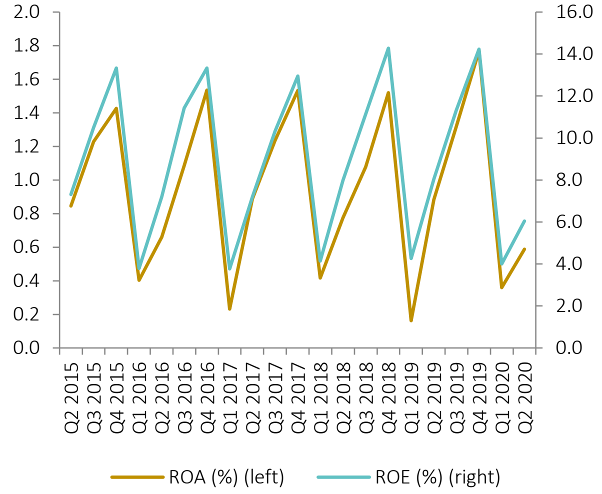
Annex 2 Graph 10: All Banking



Source: CBB.

C. Profitability

Annex 2 Graph 11: Conventional Retail

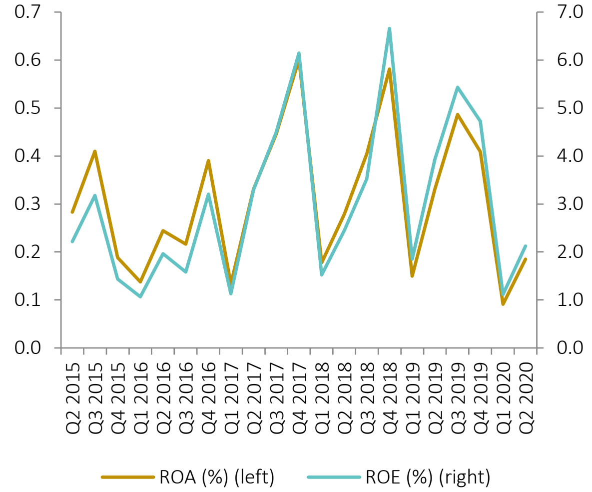


Source: CBB.

Annex 2 Graph 12: Wholesale

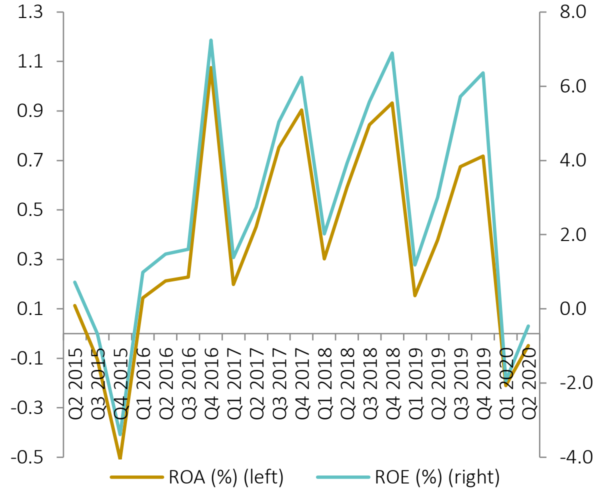
Source: CBB.

Annex 2 Graph 13: Islamic Retail



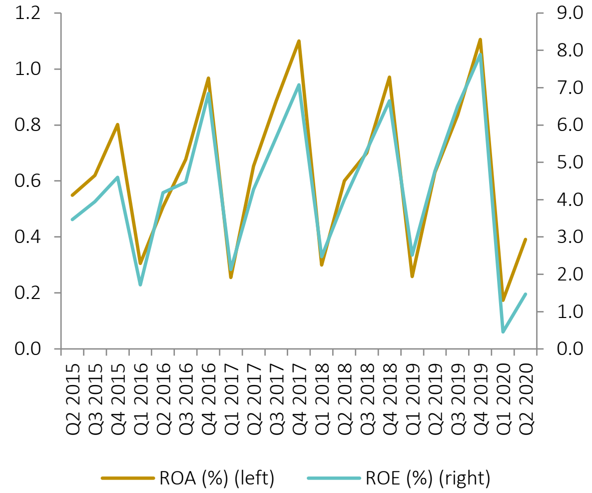
Source: CBB.

Annex 2 Graph 14: Islamic Wholesale



Source: CBB.

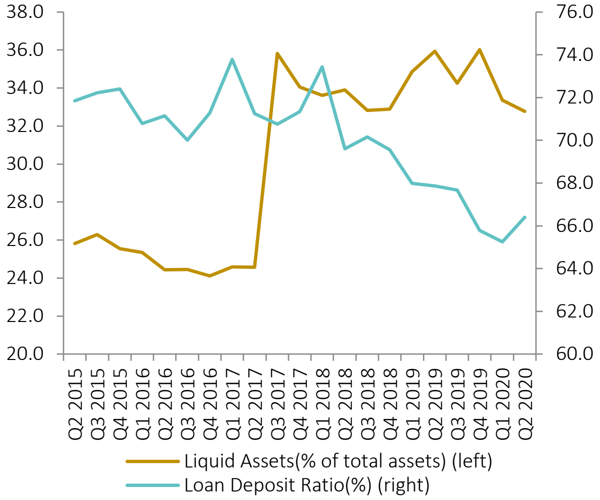
Annex 2 Graph 15: All Banking



Source: CBB.

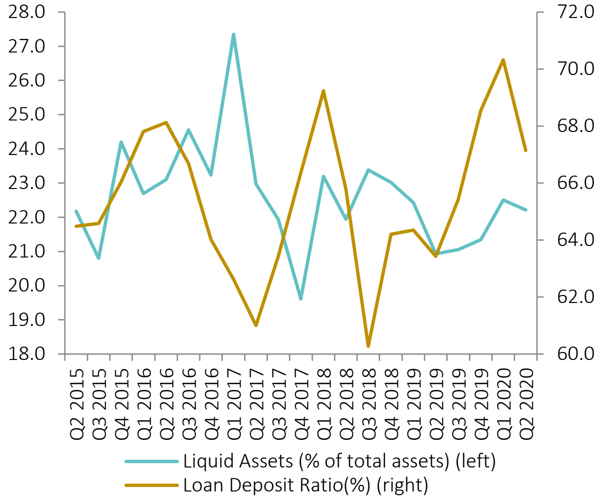
D. Liquidity

Annex 2 Graph 16: Conventional Retail



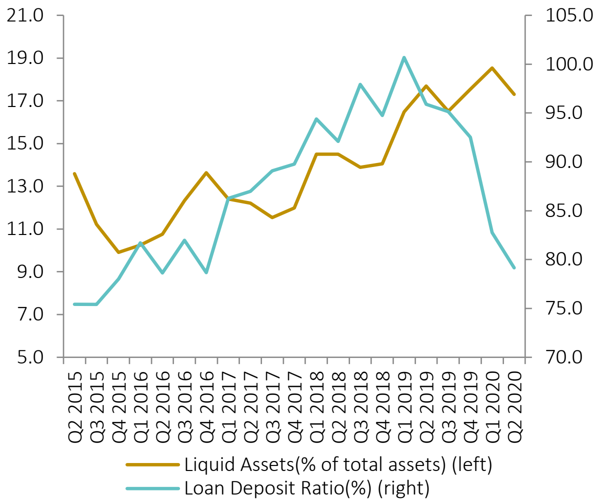
Source: CBB.

Annex 2 Graph 17: Conventional Wholesale



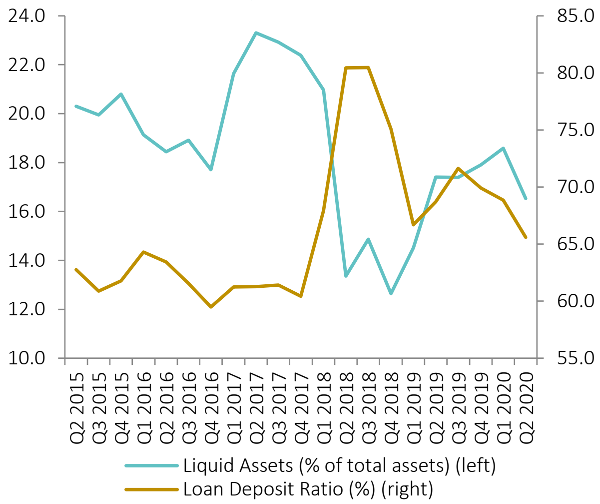
Source: CBB.

Annex 2 Graph 18: Islamic Retail



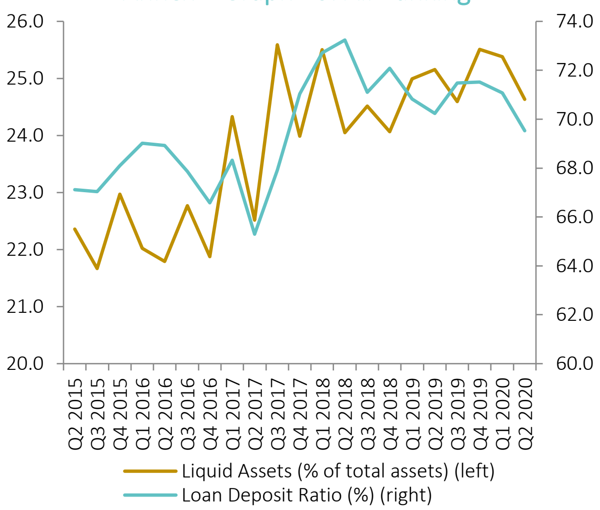
Source: CBB.

Annex 2 Graph 19: Islamic Wholesale



Source: CBB.

Annex 2 Graph 20: All Banking



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
CR	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