FINANCIAL STABILITY REPORT

MARCH 2023

ISSUE NO. 34

مصرف البحرين المركزي

Central Bank of Bahrain

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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 CBB's website at http://www.cbb.gov.bh.

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PREFACE

Financial stability risks have risen as the resilience of the global financial system has faced several shocks with growing concerns about global economic and financial fragmentation. The financial system during 2022 was being tested by higher inflation, rising interest rates, and the rising geopolitical tensions among major economies. Supply chain disruptions and commodity markets price spikes had further adverse implications on financial stability.

Rising inflation globally has accelerated monetary policy normalization throughout 2022. Many central banks increased their key policy interest rates since the the first quarter of 2022, in order to offset global inflationary pressures.

March 2023 witnessed the biggest banking collapse in the United States since 2008 triggering a sharp decline in global bank stock prices and swift response by regulators to prevent potential global contagion. The recent turmoil in the banking sector has raised financial stability concerns and highlighted supervisory failures in internal risk management practices with respect to interest rate and liquidity risks at banks.

Achieving strong, sustainable growth will require policymakers to stay agile and ready to contain financial market strains to minimize risks and address challenges posed by the interaction between tighter monetary conditions and built-up vulnerabilities. Banks and nonbank financial institutions need to hold adequate capital and liquidity buffers to mitigate continued adverse consequences of rising risks.

Locally, the Central Bank of Bahrain (CBB) raised interest rates in line with rising rates globally. CBB raised its policy interest rates 7 times between March 2022 and end of 2022 to maintain financial and monetary stability.

The Bahraini banking system demonstrated resilience in weathering the pandemic's effects and provided relief to affected retail and corporate customers. The banking system maintained adequate capital adequacy and liquidity buffers during 2022 and remained resilient due to strong pre-pandemic capital and liquidity positions. Credit growth in the banking sector was instrumental in supporting the private sector.

Moving forward, the CBB remains focused on monitoring asset quality post pandemic, continued commitment to digital transformation, development of best practices related to Environmental, Social and Governance (ESG) risks, climate related risks to the financial sector, AML/CFT compliance and increased cyber risks.

FINANCIAL STABILITY REPORT COVERAGE

A key objective of CBB is to maintain monetary and financial stability in the Kingdom of Bahrain. As the single regulator for the financial system, CBB attaches utmost importance in fostering the soundness and stability of financial institutions and markets. CBB recognizes that financial stability is critical to contribute to growth, employment, and development in Bahrain.

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

The Financial Stability Report (FSR) is one of the key components of CBB's financial sector surveillance framework. The principal purpose of this report is macro-prudential surveillance, assessing the safety and soundness of the financial system (intermediaries, markets, and payments/settlement systems), identifying potential risks to financial stability and mitigate them before they develop into systemic financial turbulence.

This FSR primarily examines the performance of the key components of the Bahraini financial system up to end of December 2022. The Baking sector analysis covers the sector on a consolidated basis (including subsidiaries and branches abroad).

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

- Part I: International and national developments:
    - Chapter 1: International financial developments.
    - Chapter 2: Developments in Bahrain's financial sector and household sector.
- Part II: Developments in the banking sector:
    - Chapter 3: Performance of the banking sector.
    - Chapter 4: Performance of conventional banks.
    - Chapter 5: Performance of Islamic banks.
- Part III: Developments in the non-banking financial sector:
    - Chapter 6: Performance of the insurance sector.
    - Chapter 7: Performance of capital markets.
- Part IV: Developments in the payments and settlement systems, fintech, and cyber security:
    - Chapter 8: Performance of payment and settlement systems, point of sale, and digital wallets.
    - Chapter 9: FinTech developments and financial inclusion.

FINANCIAL STABILITY

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.

EXECUTIVE SUMMARY

Global Macro Financial Environment Overview

The global economy is experiencing several challenges due to the cumulative effects of the shocks faced in the past few years from the COVID-19 pandemic to Russia's invasion of Ukraine. Supply disruptions, commodity price spikes, and inflation reaching high levels in 2022 led many central banks to tighten their monetary policy aggressively in efforts to lower inflation. Monetary policy tightening remains with the US and other advanced economies.

High Inflation, high interest rates, and the geopolitical climate have affected the global outlook.

Economic growth in 2022 slowed down compared to 2021. Across major economies, the US economic growth was 2.1%, China had a growth of 3.0%, the Euro Area (19 countries) and the European Union (EU) (27 countries) experienced growths of 3.5% and 3.7% respectively for 2022.

Financial Sector Overview

The size of the assets of the banking sector in Bahrain was USD 224.1 billion as of December 2022 (6.6 times of GDP). Retail banking total assets continued growing to reach BD 38.2 billion (USD 101.7 billion) in December 2022, wholesale banking sector showed an increase to USD 122.4 billion, and Islamic banking sector assets (which represent 15.8% of the total banking sector assets) increased to USD 35.3 billion.

The total amount of credit to the private sector (business and personal) by retail banks increased to BD 10.7 billion, a growth of 4.7%. The deposit base also witnessed growth to BD 19.0 billion in December 2022 with 76.9% being domestic deposits that had a 3.5% YoY increase.

Banking Sector

The banking sector was able to weather recent challenges brought by the COVID-19 pandemic and the distress on from the ongoing financial sector turbulence. The capital adequacy ratio (CAR) for the banking sector stood at 19.5% in December 2022. The NPL ratio continued decreasing to 3.0% in December 2022 with a healthy coverage level of provisioning of 68.5%.

Return-on-assets (ROA) remained stable at 1.2% and return-on-equity (ROE) increased to 8.4% from 7.8% over the same period. Liquidity positions remained strong as liquid assets as a proportion of total assets stood at 25.3%.

Conventional Banks

The CAR for conventional retail increased to 21.5% by December 2022. Asset quality improved as NPL ratio decreased to 3.3% in December 2022 with coverage increasing to 74.3%. The profitability of retail banks remained positive as ROA increased to 1.4% and ROE to 11.0%. Liquidity position decreased to 32.7% in December 2022.

As for wholesale banks, capital adequacy stood at 17.5% in December 2022. The NPL ratio dropped to 2.3% in December 2022 while specific provisions witnessed a decrease to 67.0%. Profitability was positive as ROA for the conventional wholesale banking remained stable at 1.2% and ROE increased to 4.5% in December 2022. Liquid assets for wholesale banks as a proportion of total assets decreased to 22.9% in December 2022.

Islamic Banks

The CAR of Islamic retail banks stood at 21.1% in December 2022. Asset quality improved as non-performing facilities (NPF) ratio decreased by 0.2% to 4.8% in December 2022 while specific provisioning decreased to 54.8%. ROA for Islamic retail banks increased to 0.9% in December 2022 and ROE to 10.6%. Liquidity position to Islamic retail banks decreased as liquid assets available to Islamic retail banks decreased from 19.5% of total assets in December 2021 to 17.0% in December 2022.

On the other hand, capital adequacy Islamic wholesale banks increased to 16.9% in December 2022. The NPF ratio for Islamic wholesale banks increased to 4.8% with provisioning for NPFs increasing to 94.9%. Islamic wholesale banks registered positive profitability ROA has reached 1.1% in December 2022 and ROE similarly increased from 10.0% to 10.3%. Liquidity assets decreased for Islamic wholesale to 13.8% of total assets.

Insurance Sector

The insurance sector in Bahrain holds promise for growth, as demonstrated by the industry's performance for the period ended September 2022. The sector is expected to continue to grow due to the increase in the public awareness on the importance of the insurance products as well as due to the soundness of regulatory and supervisory framework of the insurance sector in Bahrain.

The Insurance sector in Bahrain is made up of two main segments: conventional and takaful. Total gross premiums registered BD 204.9 million as of September 2022. Total assets of conventional insurance firms were BD 2,071 million, a YoY decrease of 5.7%. Takaful firms' assets were stable at BD 193.3 million.

Viewing the concertation of the overall insurance industry, medical records the highest concentration in Gross Premiums (29.9%) and Gross Claims (34.6%). Conventional local firms accounted for the largest segment of total gross premiums (55.7%), followed by Takaful (28.4%) and conventional overseas branches (16.0%).

For conventional insurance, medical insurance remained to have the highest concentration for Gross Premiums (26.8%) and Gross Claims (30.7%), while motor has the highest concentration in Net Premiums Written (41.0%) and Net Claims (41.6%). Takaful companies remain having high concentrations in the medical and motor Insurance business lines as gross Premiums for both sectors represented (65.4%), Net Premiums Written (86.0%), Gross Claims (84.3%), and Net Claims (94.5%).

Capital markets

As of 30th December 2022, Bahrain Bourse recorded a total listing of 42 Companies, 3 Mutual funds and 18 Bonds and Sukuk. During the second half of 2022, there were 11 companies that closed higher and 20 closed lower and 10 remained unchanged. Bahrain All Share Index increased by 5.5% for the year reaching 1,895.3 points, while the Bahrain Islamic Index decreased by 11.8% reaching 663.1 points. As of end-December of 2022, market capitalization of the Bahrain Bourse stood at BD 11.4 billion.

Most of the value and the volume of shares traded in H2 2022 was in the financial sector representing 39.4% and 72.7% respectively. Most of the number of transactions in H2 2022 (6,355 transactions) was attained by the financial sector representing 47.0% of total transactions. As of December 2022, there were 53 offerings with a total value of USD 7.6 billion.

Payments and Settlement Systems and Point of Sale and E-Commerce

The CBB's payment systems remained robust during 2022. CBB continues to further enhance its steps towards digital transformation. The demand for online transactions continues its upward trend based on the performance of the Electronic Fund Transfer System (EFTS) that enables electronic fund transfers within Bahrain with three services: Fawri+ Fawri, and Fawateer.

Daily average volume of Fawri+ transfers in H2 2022 increased significantly by

22.4% compared to H1 2022 reaching 732,608 transfers. The value of Fawri+ transfers increased by 7.4% in H2 2022 compared to H1 2022 to reached BD 3,184.3 million with the daily average increasing by 6.2% reaching BD 17.3 million compared to H1 2022.

The daily average volume and value of ATM transactions for H2 2022 decreased by 2.6 and 6.1% respectively compared to H1 2022 indicating a continued trend of declining cash withdrawals.

Point of Sale (POS) and E-commerce transactions reached 162.8 million in terms of volume and BD 3,844.6 million in terms of value in 2022 with a 29.7% and 22.0% YoY increase respectively. Contactless POS payments continue to show an increasing trend reaching 76.8% and 49.6% of the volume and value of the transactions in 2022.

FinTech, Innovation, and Financial Inclusion

Bahrain continues its efforts in repositioning itself as a Fintech hub in the region combining conventional and Shariah compliant FinTech solutions. CBB established a dedicated Fintech Unit on the 22nd of October 2017 to ensure the best services provided to individual and corporate customers in the financial sector. CBB continues its Fintech initiatives as part of its digital transformation strategy to further facilitate a more efficient provision of banking services to customers. As of end of 2022, CBB's Regulatory Sandbox includes 20 companies.

PART I:
DEVELOPMENTS IN THE INTERNATIONAL AND DOMESTIC FINANCIAL MARKETS

1 DEVELOPMENTS IN INTERNATIONAL FINANCIAL MARKET

HIGHLIGHTS

Global Growth	USA Growth	Euro Area Growth
3.4%	2.1%	3.5%
MENA Growth	**Advanced Economies Growth**	**Emerging Market Growth**
5.3%	2.7%	4.0%

- The global economy has faced multiple economic and financial challenges and pressure from various complex crises highlighted by high Inflation, geopolitical tension, and climate crisis.
- The world's three largest economies (US, Euro Area, China) are expected to slow significantly in 2022 and 2023.
- After a year of the Russia-Ukraine war, substantial side-effects on the global commodity markets and global value chains emerged.
- The rise in inflationary pressures has triggered an almost universal tightening in monetary policy.
- Many Central Banks have been raising interest rates in order to put inflation under control and anchor inflation expectations.
- Financial conditions are tightening, borrowing costs are rising and liquidity is shrinking.
- Stock markets indices worsened in the second half of 2022.

1.1 Overview

The global economy experienced several challenges with high Inflation, tightening monetary policy in most regions, and the geopolitical climate with Russia's invasion of Ukraine affecting the outlook. As a result, food, energy and commodity prices were high, affecting household's income and generating a global cost-of-living crisis, especially in low-income countries. Global economic activity experienced a slowdown with inflation levels not seen in decades with countries continuing towards monetary and fiscal policy normalization to dampen inflation.

According to the recent update of the IMF's World Economic Outlook (WEO) in April 2023, global growth was 3.4% in 2022 and 2.8% in 2023. Advanced Economies grew by 2.7% in 2023 and Emerging Market and Developing Economies by 4.0%. Regarding the world largest three economies, the 2022 USA growth was 2.1%, Euro Area was 3.5%, and China was 3.0%.

Global inflation remained elevated for longer than previously expected reaching 8.7% for 2022. Commodity prices increases led inflation to reach 7.3% in advanced economies and 9.8% in emerging market and developing economies. To contain inflation, the Federal Reserve raised the interest rates aggressively in 2022. IMF projects that Inflation's return to targeted levels is unlikely before 2025 in most cases and to persist longer than previously expected.

Inflation has proven to be higher and more persistent than expected and remains a global challenge as consumers are feeling the highest inflation in decades due to a rise in food and energy prices. Inflation was significantly above targets in most advanced economies and emerging markets coupled with inventories suffering from supply chain disruption.

Continued lockdowns and mobility restrictions led to severe disruptions in various supply chains, causing short-term supply shortages. The geopolitical situation due to Russia's invasion of Ukraine that has changed the outlook for the global economy by causing a surge in energy and food prices that affected consumers and businesses. Impact will likely be bigger for low-income countries and emerging markets, where food and energy are a larger share of consumption.

In the following sections, recent trends in the global economy are highlighted and the major financial and economic indicators during the second half of 2022.

1.2 Global Macro-financial Environment

The global economic and financial conditions have deteriorated remarkably during the second half of 2022. The Russia-Ukraine war has weighted on the world economy as It is disrupting trade, leading to shortages of materials and contributing to soaring energy and commodity prices. Therefore, after a long period of price stability, inflation has returned in developing and developed countries affecting household's purchasing power and generating a worldwide cost-of-living crisis. In its April 2023 WEO, the IMF indicated growth in the global economy in 2022 to be 3.4%.

1.2.1 Economic Performance

The economic performance in Europe was robust during the second semester of 2022 thanks to the relaxation of COVID-19 restrictions, and to the back to normal economic activity. However, uncertainty and geopolitical tensions have put additional downward pressure on the financial sector in Europe which in turn amplified volatility and raised new concerns in the global financial markets.

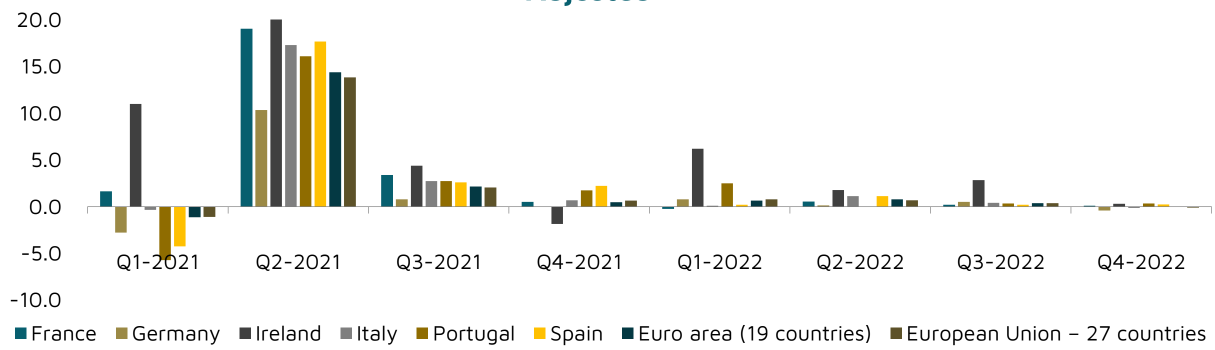
As Chart 1.1 shows, after witnessing negative growth in 2020, most European economies were performing better all over 2021 due to normalization of economic activities as vaccine rollout proceeds and governments additional fiscal support reflecting tighter restrictions in the second semester of the year. As a result, European countries recovered faster than expected in 2021. However, a slowdown of economic activities has been recorded since the beginning of 2022. For example, growth rate in Spain moved from 2.2% in Q4/2021 to 0.2% in Q4/2022. Similarly, Italy, GDP moved from 2.7% in Q4/2021 to 0.2% in Q4/2022. As for Portugal, growth rate decreased from 1.7% in Q4/2021 to 0.3% in Q4/2022.

Regarding the two largest economies in the Eurozone, their performances slowed down in the beginning of the year 2022. Germany economic recovery took a temporary pause despite the recovery from the waves of the COVID-19 pandemic. High inflation, the Russia-Ukraine war and continued bottlenecks are the main results of the slowdown of the German economy. In 2022, the annual inflation rate for Germany reached 8.7%. German economic growth according to the IMF was 1.8% in 2022 and expected to have a recession by 0.1% in 2023 due to elevated energy import prices and weak consumer confidence.

For France, tensions gradually emerged in commodity prices, combined with increasing supply disruptions. In the third quarter of 2022, GDP dropped by 0.2% (QoQ), reflecting a marked 1.5% decline in household consumption and weaker than expected exports. In the fourth quarter, GDP growth decelerated further to reach 0.1%. France is currently facing stronger inflationary pressures on energy and food prices which in turn will affect household's purchasing power, consumption, production and growth.

Turning to the Euro Area (19 countries) and the European Union (EU) (27 countries) their economies have experienced a better-than-expected recovery in 2021 with growth rates reached of 5.4% and 5.1% respectively. This performance is due to the gradual normalization of economic activity of many European countries that supported the recovery. However, the Russia-Ukraine war continues to negatively affect the EU economy, setting it on a path of lower growth and higher inflation. Growth in the Euro Area was 3.5% in 2022 with a projected growth of 0.8% in 2023. The European Union registered a growth of 3.7% in 2022 with a projected growth of 0.7% for 2023. Annual average inflation is projected to peak at historical highs in 2022, at 8.4% in the Euro Area and 9.3% in the EU, before easing in 2023 to 5.3% and 6.3%, respectively.

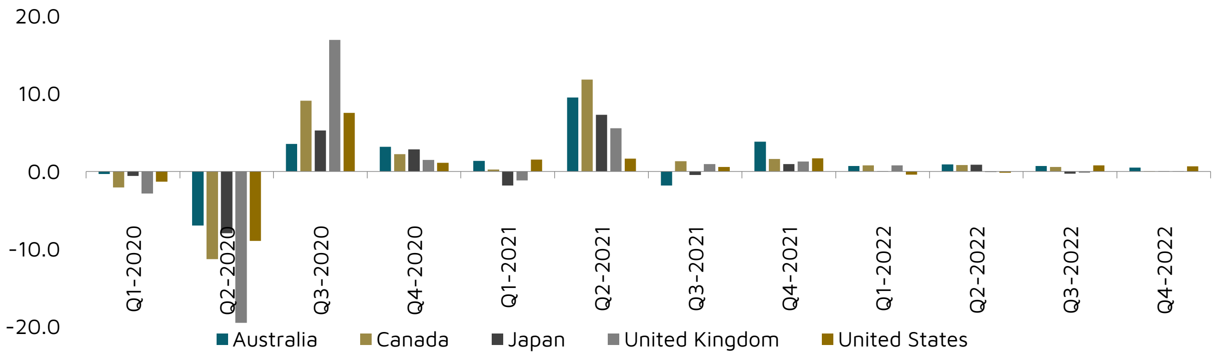
Chart 1.1: Real GDP Growth in Selected Europeans Countries (Quaterly %) Seasonally Adjusted*



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

In the United Kingdom, after the economic activity returned to its pre-pandemic level in the beginning of 2022, new shocks hit the UK economy. The Russia-Ukraine war negatively impacted the UK economy. The annual rate of inflation reached 11.1% in October 2022, a 41-year high, before easing in subsequent months to 10.1% in January 2023. Furthermore, the rising tax burden has led to a fall in consumer confidence which is set to drag on discretionary spending. These issues could lead to a significant deceleration in economic growth. In 2022, UK economic growth reached 4.0% slower than the 7.4% recorded in 2021 and is projected to have a recession by 0.3% in 2023.

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



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

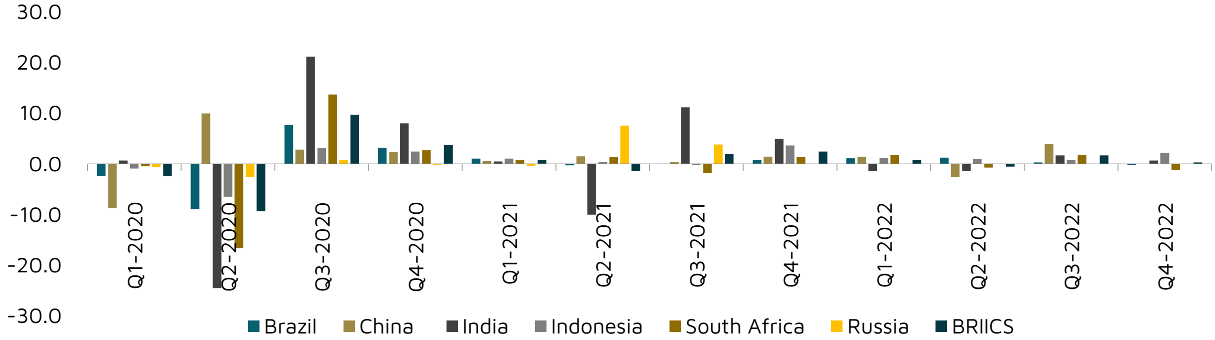
The economic outlook for the United States has deteriorated considerably amid soaring energy and commodity prices, tighter labor market conditions and aggressive monetary tightening by the Federal Reserve. After expanding by 5.4% in 2021, GDP growth reached 2.1% in 2022 with a projected growth of 1.6% for 2023.

Japan's economy returned to pre-pandemic levels but may slow down again. Gross domestic product grew by 0.5% in the fourth quarter of 2022, but inflation is beginning to weigh on household consumption and economic activity. According to the IMF's world Economic Outlook, Japan had steady growth of 1.1% for 2022 and is projected to have 1.3% growth for 2023.

As for emerging economies (Chart 1.3), the BRIICS countries' growth was weaker than expected as it reached the level of 0.3% in Q4/2022 from 2.4% achieved in Q4/2021. Recent data shows that China economy slowed to about 3.0% in 2022 from 8.4% achieved in 2021. This slowdown is mainly caused by the multiple lockdowns and the rising concerns about the property sector which is currently facing a crisis. In Q4/2022, GDP growth fell to a two-year low of 0.1% as China's zero-tolerance COVID-19 measures were introduced to control the rise of the Omicron Variant of COVID-19. The growth is expected to gain momentum in 2023 where GDP is expected to reach 5.2% as per the IMF forecast (WEO, April 2023).

Similarly, India witnessed a growth rate of 6.8% in 2022, lower than the 9.1% achieved in 2021. As for Brazil and South Africa, they are looking to rebuild fiscal buffers and have also begun normalizing monetary policy to head off upward price pressures. Brazil and South Africa achieved growth rates by 2.9 and 2.0% respectively in 2022 (IMF WEO, April 2023).

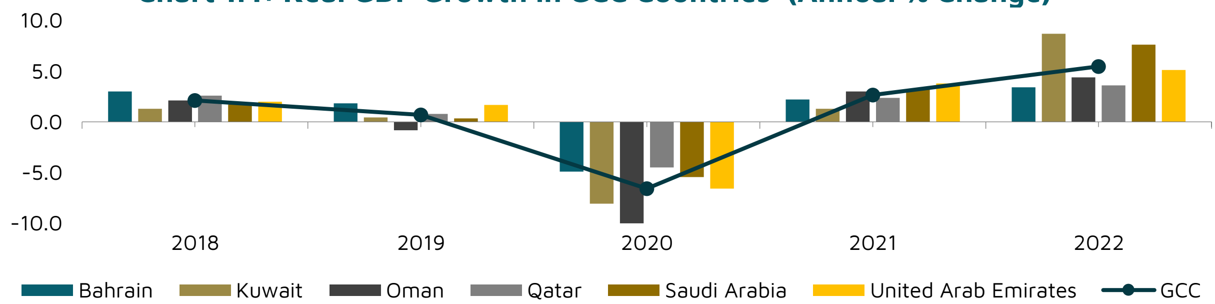
Chart 1.3: Quaterly Real GDP Growth in BRIICS (Quaterly %)*



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

Since the beginning of 2022, the pandemic was under control and economic activity went back to normal thanks to the release of the measures imposed by the governments. The rise in oil and energy prices have helped GCC country to build buffers and to improve their fiscal unbalances that the GCC countries have witnessed during the past few years. The drop of oil prices later in 2022 added pressure on GCC public finance condition and caused a decline in their external and fiscal balances. The economies of the Gulf Cooperation Council (GCC) are projected to expand by 6.5% overall in 2022, with this recovery likely to continue in the medium-term, driven by the hydrocarbon and non-hydrocarbon sectors.

Chart 1.4: Real GDP Growth in GCC Countries (Annual % Change)

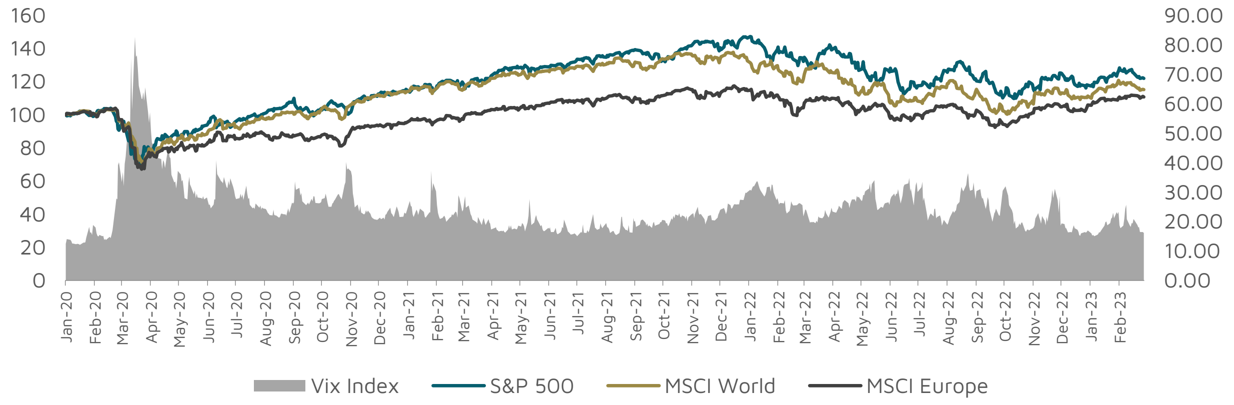


**Forecasts. Source: IMF Regional Economic Outlook, October 2022.*

1.2.2 Financial Markets

Despite all the pandemic challenges, financial conditions have remained supportive in the first and second quarter of 2021. Financial market sentiment has remained positive on balance given the expected global recovery. However, the increasing number of concerns such as the new COVID-19 lockdowns in early 2022, the economic slowdown in China, the Russia/Ukraine war, surging inflation and central-bank tightening have triggered a chaos in the equity market. In fact, all three major U.S. stock indexes finished the second quarter of 2022 in negative territory, with the S&P 500 notching its steepest first-half percentage drop since 1970, down 20.6%. The MSCI global stock index notched its biggest first-half of a year percentage drop on record on June 2022.

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



Source: Bloomberg.

2 DEVELOPMENTS IN THE FINANCIAL AND NON-FINANCIAL SECTORS

HIGHLIGHTS

As at end-December 2022

Financial Sector % of GDP	Number of Licenses	Banking Sector
17.5% 2022	364 Dec. 2022	USD 224.1 bn 3.0% YoY
Retail Banking	**Wholesale Banking**	**Islamic Banking**
USD 101.7 bn ▲ 2.3% YoY	USD 122.4 bn ▲ 3.6% YoY	USD 35.3 bn ▲ 4.4% YoY
M2	**Personal Credit**	**Business Credit**
BD 13.8bn ▲ 3.9% YoY	BD 5.7 bn ▲ 11.9% YoY	BD 5.0 bn ▼ 7.3% YoY

- The size of the assets of the banking sector in Bahrain continued to grow reaching USD 224.1 billion as of December 2022.
- The retail banking sector assets increased to USD 101.7 billion and wholesale banking sector assets increased to USD 122.4 billion representing 45.4% and 54.6% respectively.
- The volume of credit increased by 3.6% to BD 11.3 billion in December 2022
- Household debt ratio witnesses an increase while business debt decreases.

2.1 Overview

This chapter assesses the recent developments of the Bahraini financial and non-financial sectors. The financial condition and performance of financial institutions depend on the their customers (households and business enterprises) and their vulnerabilities to changes in the economic environment. Not only are they sources of deposits, they represent major sources of demand for financial sector products and services.

2.2 Financial Sector Developments

Bahrain's position as a regional financial center is essential to the development of its economy where the financial sector plays a significant role in economic activity and employment creation. The financial sector is the largest non-oil contributor to GDP representing 17.5% of real GDP in 2022 (compared to 17.7% in 2021, 17.1% in 2020).

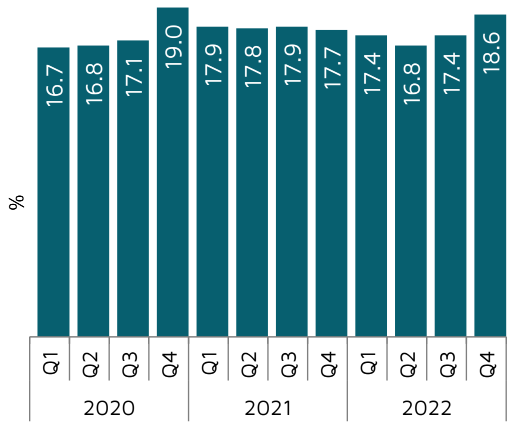
As of end of December 2022, there were 364 licenses issued by CBB (bank and non-bank financial institutions). The banking sector in Bahrain was made up of 86 banks, categorized as follows:

- Retail banks: 30 retail banks that include 24 conventional (7 locally incorporated and 17 branches) and 6 Islamic retail banks.
- Wholesale banks: 56 wholesale banks that include 48 conventional (12 locally incorporated and 36 branches) and 8 Islamic wholesale banks.

The 270 non-banking financial institutions operating in Bahrain include investment business firms, insurance companies (including Takaful and Re-Takaful firms), representative offices and specialized licenses.

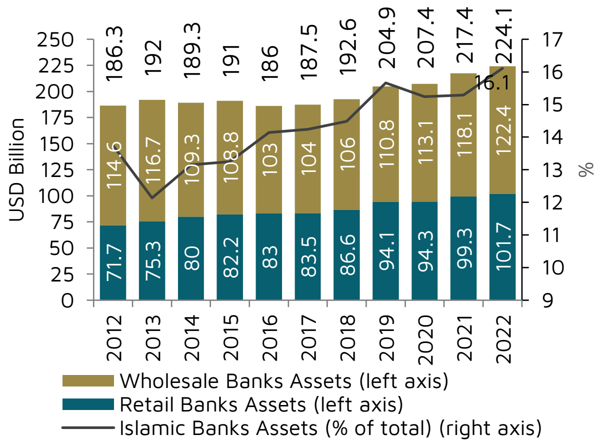
The size of the assets of the banking sector in Bahrain was USD 224.1 billion as of December 2022 (3.0% YoY increase). Growth in Retail and Wholesale banking continued in 2022 with YoY growth of 2.3% and 3.6% respectively. As for the Islamic banking sector, it grew steadily with a 4.4% YoY growth and represented 16.1% of the size of the banking sector.

Chart 2.1: Size of the Financial Sector to Real GDP



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

Chart 2.2: Banking Sector Asset Composition



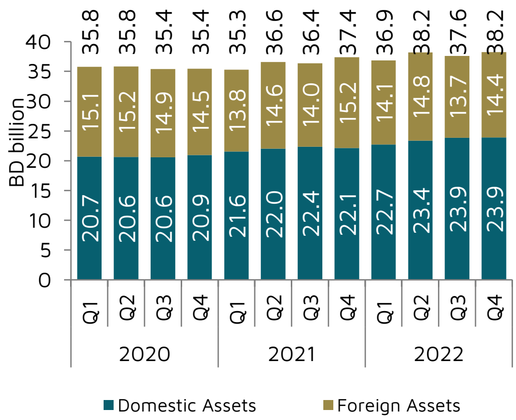
Source: CBB Monthly Statistical Bulletin.

2.2.1 The Retail Banking Sector

Retail banking assets continued to grow reaching BD 38.2 billion (USD 101.7 billion) in December 2022 with a 2.3% year-on-year (YoY) increase (see Chart 2.3). As of December 2022, domestic assets comprised 62.4% of total assets with a YoY growth of 7.9% while foreign assets comprised 37.6% of total assets with a YoY decline of 5.8%.

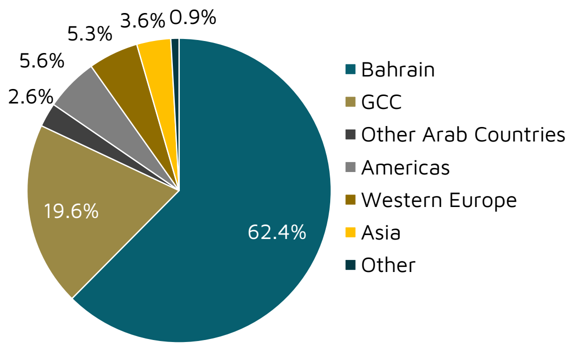
According to the geographical classification of the retail banking sector in Bahrain, the sector is exposed to foreign risk regionally from GCC countries and lightly exposed to Western Europe and U.S as the share of GCC assets of total retail banking assets was 19.6% and European and the Americas contribution was 10.9%.

Chart 2.3: Retail Banks' Assets



Source: CBB Monthly Statistical Bulletin.

Chart 2.4: Retail Banks' Assets (%) by Geographical Classification (Dec. 2022) *



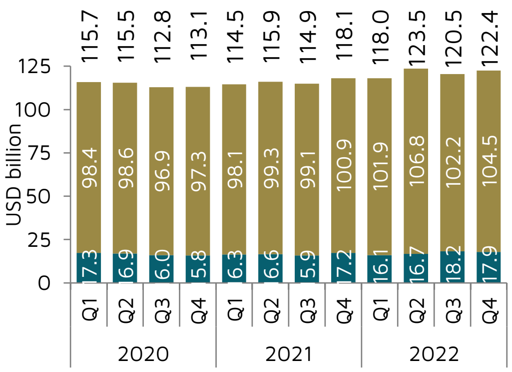
** For conventional and Islamic retail banks.*
Source: CBB Monthly Statistical Bulletin.

2.2.2 The Wholesale Banking Sector

The size of the wholesale banking sector increased to USD 122.4 billion in December 2022 with a YoY growth of 3.6%. As of December 2022, domestic assets represented 17.2% of total assets and witnessed a YoY growth of 4.0% while foreign assets made 85.4% of total assets with a 3.6% YoY growth (See Charts 2.5).

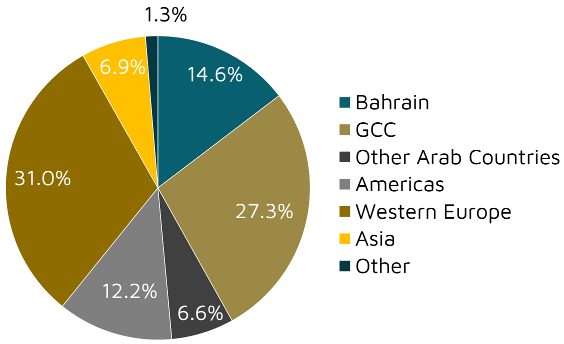
According to the geographical classification of wholesale banks' assets, wholesale banks are exposed to foreign risk from Western Europe and GCC countries. The share of GCC assets decreased to 27.3% in December 2022, which used to represent the larger portion of wholesale bank assets. The share of Western Europe's total assets increased to 31.0%, making it the largest portion of wholesale bank assets. The share of America's total assets remained at 12.2% and Asian assets decreased to 6.9% in December 2022.

Chart 2.5: Wholesale Banks' Assets



Source: CBB Monthly Statistical Bulletin.

Chart 2.6: Wholesale Banks' Assets by Geographical Classification (Dec. 2022) *

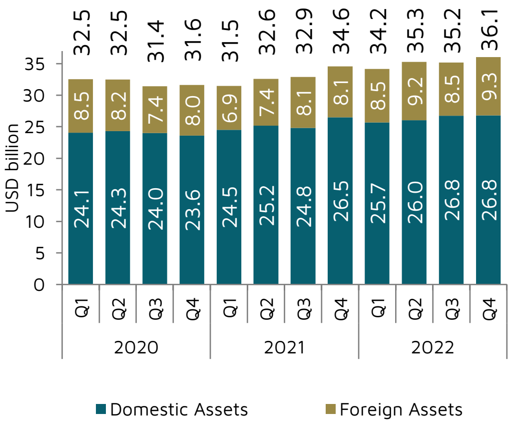


** For conventional and Islamic wholesale banks.*
Source: CBB Monthly Statistical Bulletin.

2.2.3 The Islamic Banking Sector

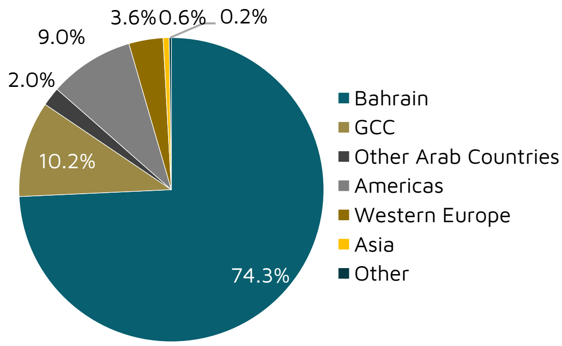
The size of the Islamic banking sector increased to USD 36.1 billion as of December 2022 indicating a 4.4% YoY increase. Domestic assets represented 74.3% of total Islamic banking assets in the sector (1.1% YoY increase) while foreign assets represented 25.7% of total Islamic banking assets (14.8% YoY increase). Islamic banks continue to be majorly exposed to domestic risks as the share of Bahrain's total assets decreased to 74.3% in December 2022 followed by the GCC (10.2%).

Chart 2.7: Islamic Banks' Assets



Source: CBB Monthly Statistical Bulletin.

Chart 2.8: Islamic Banks' Assets by Geographical Classification (Dec. 2022)



Source: CBB Monthly Statistical Bulletin.

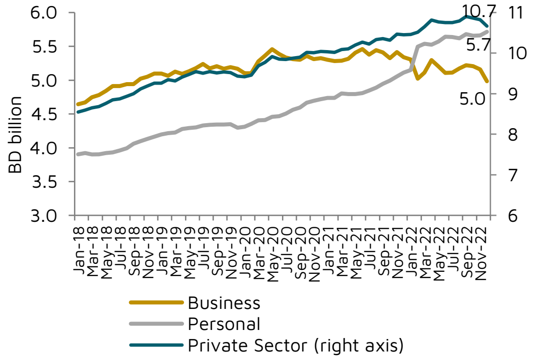
2.2.4 Islamic Windows

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 Sharia-compliant banking. As of December 2022, there were 5 Islamic windows operating by conventional retail licenses in Bahrain with total assets of BHD 2.1 billion (5.8% of retail banking assets). As of December 2022, 80.5% of total assets were domestic (46.6% YoY increase) while 19.5% were foreign (0.7% YoY increase).

2.3 Credit Developments

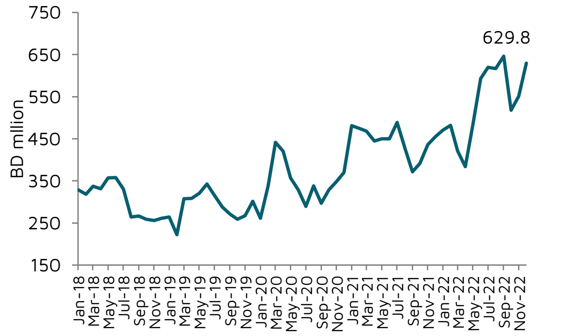
Domestic credit by retail banks increased from BD 10.9 billion in December 2021 to BD 11.3 billion in December 2022 with 3.6% YoY increase. Credit given to the private sector (business and personal) witnessed a YoY increase of 4.7% moving from BD 10.4 billion in December 2021 to BD 10.7 billion in December 2022 (Chart 2.9). Business lending contributed 43.8% of total lending and personal lending contributed 50.6%. The Personal sector was the main driver of the growth in credit financing in 2022 led mainly by mortgage lending. Regarding retail banks' lending to the general government, there was an increase of BD 175.4 million (38.6% YoY increase) at end-December 2022 reaching BD 629.8 million (Chart 2.10).

Chart 2.9: Loans to the Private Sector*



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

Chart 2.10: Loans to General Government*

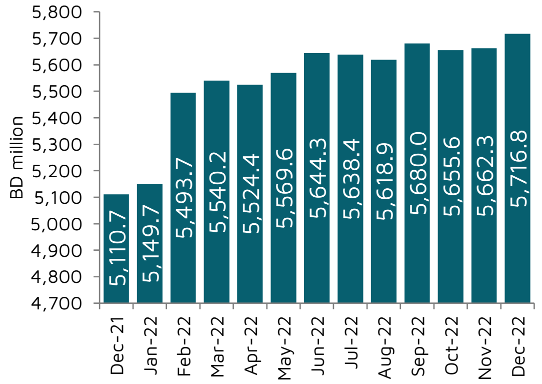


Source: CBB Monthly Statistical Bulletin.
** Excluding securities.*

2.3.1 The Households/Personal Sector

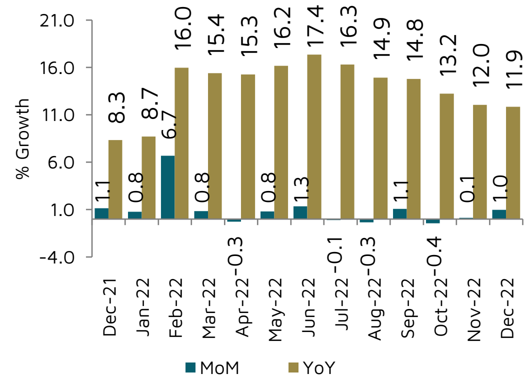
The household/personal sector in Bahrain plays an important role in financial stability and the overall economy. Outstanding personal loans, used as a proxy for household borrowing, shows an increase ogf 11.9% in 2022 reaching BD 5.7 bilion (Chart 2.11). Personal loans as a percentage of GDP increased to 38.2% by December 2022.

Chart 2.11: Personal Loans



**Using 2022 forecasted GDP.*
Source: CBB Monthly Statistical Bulletin.

Chart 2.12: Growth Rates of Total Personal Loans and Advances (%)



Source: CBB Monthly Statistical Bulletin.

The monthly growth rate in total personal loans and advances fluctuated in 2022. It rose to reach its highest level for the year of 6.7% in Febuary 2022 and later fell to reach 1.0% in December 2022. On a yearly basis, the biggest YoY increase was in June 2022 where the personal loans and advances were at 17.4% which then dropped to 11.9% in December 2022.

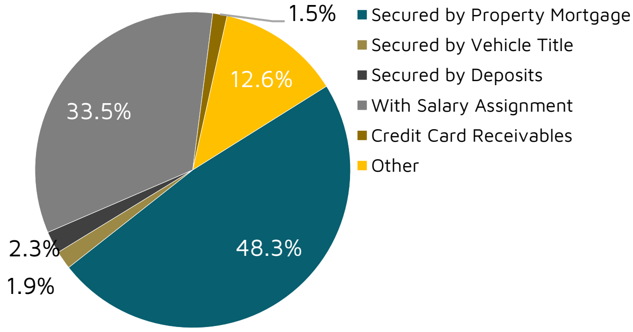
The two main contributors to personal loans remain to be personal loans secured by property mortgages which made up 48.3% of the total personal loans followed by personal loans secured with salary assignments at 33.5% of total personal loans.

Table 2.1: Personal Loans Breakdown

BD million	2018	2019	2020	2021	2022	% 2022 YoY
Total	**4,162.4**	**4,296.2**	**4,717.3**	**5,110.7**	**5,716.8**	**11.9**
Secured by Property Mortgage	1,796.7	1,953.2	2,197.9	2,261.5	2,760.8	22.1
Secured by Vehicle Title	103.0	123.0	118.1	109.2	106.6	-2.4
Secured by Deposits	134.1	140.1	187.6	133.7	129.4	-3.2
With Salary Assignment	1,325.1	1,577.4	1,700.4	1,933.0	1,915.0	-0.9
Credit Card Receivables	72.5	104.0	92.2	99.5	84.2	-15.4
Other	731.0	398.5	421.1	573.8	720.8	25.6

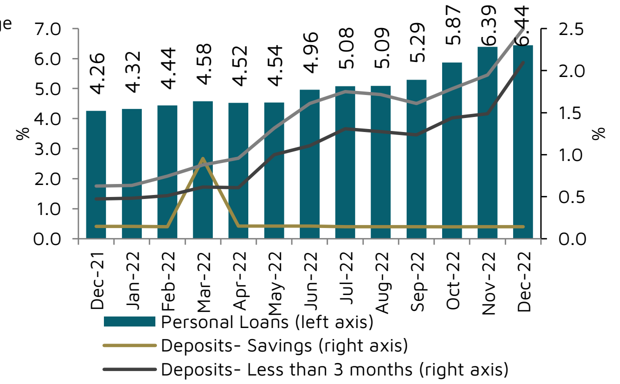
Source: CBB Monthly Statistical Bulletin.

Chart 2.13: Personal Loans Breakdown (Dec. 2022)



Source: CBB Monthly Statistical Bulletin.

Chart 2.14: Retail Banks- Average Interest Rates on Personal Loans and Deposits (%)



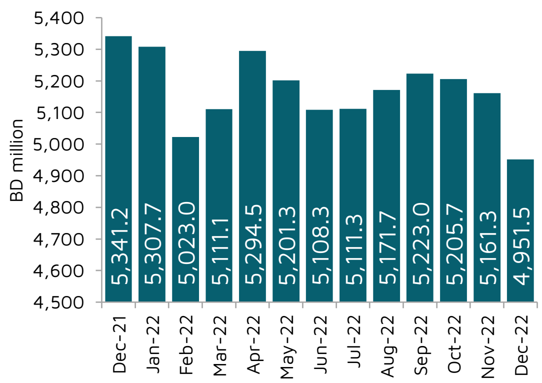
Source: CBB Monthly Statistical Bulletin.

Interest rates on personal loans started off at 4.96% in June 2022 and increased to 6.44% in December 2022 (Chart 2.17). 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. The increase in rates is a reflection the CBB raising its key policy interest rate multiple times throughout 2022.

2.3.2 The Bahraini Corporate/Business Sector

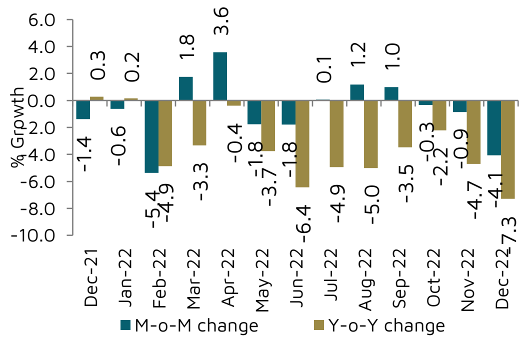
Business loans and advances contracted by 3.1% between June 2022 and December 2022 from BD million 5,108.3 in June 2022 to BD million 4,951.5 (Chart 2.18). As of December 2022, YoY business loans contracted by 7.3%. Outstanding business loans as a percentage of GDP decreased to 33.1% in December 2022.

Chart 2.15: Business Loans



Source: CBB Monthly Statistical Bulletin.

Chart 2.16: 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 2021 and December 2022. Initially -1.4% in December 2021, it increased to reach its highest level for the year of 3.6% in March 2022 before falling to -4.1% in December 2022. The highest YoY growth was January 2022 (0.2%).

The biggest contributors to business loans in December 2022 were the construction and real estate sector (31.4%) followed by manufacturing (23.5%), and then trade (15.5%) (Chart 2.20).

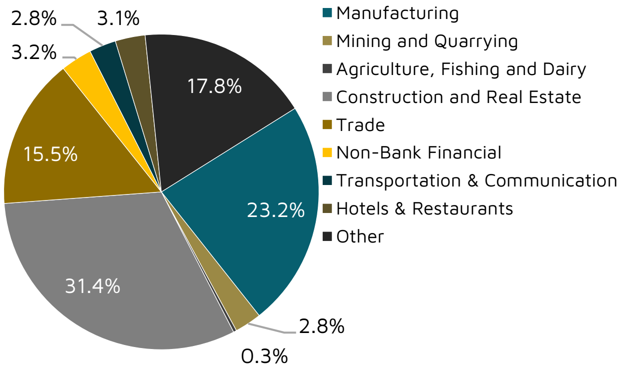
Table 2.2: Business Loans by Sector

BD million	2018	2019	2020	2021	2022	% 2022 YoY
Total	**5,096.4**	**5,138.6**	**5,326.9**	**5,341.2**	**4,951.5**	**-7.3**
Manufacturing	916.3	1,068.1	1,173.8	1,292.3	1,221.3	-5.5
Mining and Quarrying	96.5	86.7	150.8	74.7	145.1	94.2
Agriculture, Fishing and Dairy	2.3	6.7	12.1	13.2	16.6	25.8
Construction and Real Estate	1,866.8	1,841.4	1,932.0	2,009.6	1,651.7	-17.8
Trade	1,132.1	1,071.0	934.4	903.9	814.0	-9.9
Non-Bank Financial	228.1	251.8	227.5	169.5	169.2	-0.2
Transportation & Communication	143.4	127.2	209.0	147.5	144.7	-1.9
Hotels & Restaurants	177.3	151.6	188.1	196.1	161.4	-17.7
Other Sectors	533.5	534.1	499.2	534.4	627.5	17.4

Source: CBB Monthly Statistical Bulletin.

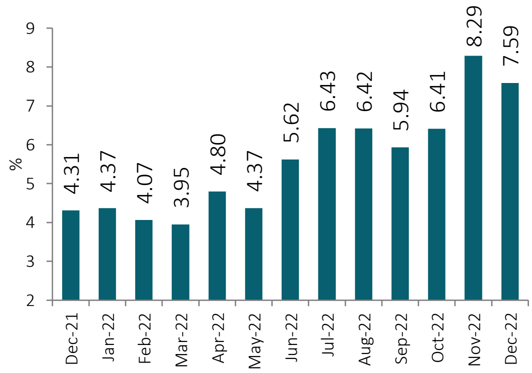
Average interest rates on business loans fluctuated throughout 2022, but had an overall increasing trend . It was at its peak in November 2022 at 8.29% and reached 7.59% in December 2022 (Chart 2.21).

Chart 2.17: Business Loans by Sector (Dec. 2022)



Source: CBB Monthly Statistical Bulletin.

Chart 2.18: Retail Banks' Average Interest Rates on Business Loans



Source: CBB Monthly Statistical Bulletin.

2.4 Monetary Indictors

Money supply continued to grow in 2022. M2 stood at BD 13,984.8 million in December 2022, 3.9% higher than its value of December 2021. M3 was at BD 15,135.4 million in end-December 2022, 1.7% higher than in December 2021 (Table 2.1). Table 2.3 sets out an analysis of Bahrain's M1, M2 and M3 money supply as at the dates indicated.

As of December 2022, growth in money supply was stimulated by a growth in savings deposits. Time and savings deposits increased by 12.6% from BD 8,955.4 million in December 2021 to BD 10,079.7 million in December 2022, while demand deposits decreased below December 2021 levels.

Table 2.3: Money Supply Composoition

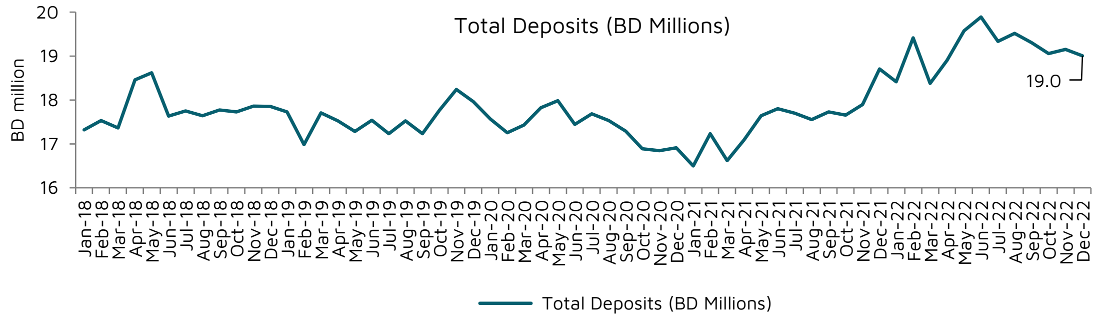
BD million	2018	2019	2020	2021	2022	% 2022 YoY
Currency Outside Banks	528.1	535.1	593.0	558.0	506.5	(9.2)
Demand Deposits	2,893.9	2978.5	3.288.0	3,952.0	3,398.5	(14.0)
M1	**2,662.1**	**3,513.6**	**3,880.9**	**4,510.0**	**4,214.0**	**8.3**
Time & savings deposits	7,423.3	8,538.6	8,959.0	8,955.4	10,079.7	12.6
M2	**10,845.3**	**12,052.2**	**12,840.0**	**13,465.4**	**13,802.4**	**3.9**
General Government Deposits	1,776.8	1,619.7	1,311.3	1,418.8	1,150.6	(18.9)
M3	**12,622.1**	**13,671.9**	**14,151.3**	**14,884.2**	**15,135.4**	**1.7**

Source: CBB Monthly Statistical Bulletin.

Total deposits reached BD 19.0 billion in December 2022 with a 1.6% YoY growth (where domestic deposits represent 76.9% of total deposits and had a YoY increase of 3.5%).

During the pandemic, Households boosted their savings as a precautionary measure with extra savings due to the loan deferrals that were flowing into bank deposits. During 2022, savings were boosted with increases in time deposits as customers were benefiting from the higher interest rates on deposits. Deposits continued a gradual upwards trajectory in line with the growth of the economy.

Chart 2.19: Total Deposits (BD billion)



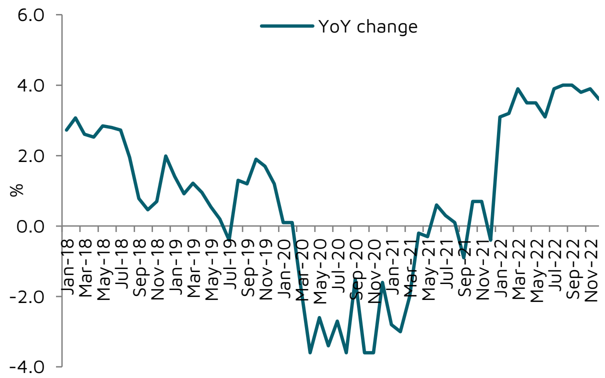
Source: CBB Monthly Statistical Bulletin.

2.5 Inflation

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. Bahrain's inflation is measured by its Consumer Price Index (CPI) and includes 12 broad categories of consumer goods that are representative of consumption patterns in the economy.[1].

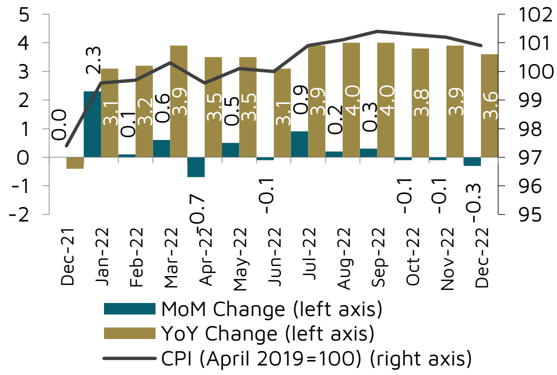
As of December 2022, the Consumer Price Index (CPI) increased to 100.9 points. The annual average rate of inflation in 2022 was 3.6% (compared to a decrease of 0.6% for 2021 and decrease of 2.3% for 2020). The largest year-on-year price increase was recorded in August and September 2022 when prices increased by 4% compared to August and September 2021.

Chart 2.20: CPI Change (Jan. 2018 – Dec. 2022)



Source: IGA.

Chart 2.21: Monthly Inflation Rate (Dec. 2021 –Dec 2022)



Source: IGA.

The divisions which made the largest upward contribution to the CPI in 2022 were food and non-alcoholic beverages group (+11.5) and hotel and restaurants (+9.2). The increase

[1] 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. 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.

in food and beverages is reflection of how supply chain disruptions due to the geopolitical events impacted the price of imported goods.

Box 1: CBB Key Interest Rates

Central banks around the world have started increasing their key policy interest rates since the beginning of 2022, in order to offset global inflationary pressures. The geopolitical situation, the continued lockdowns due to the pandemic in some markets, the spike in energy prices, and the disruption in supply chains, have caused central banks to raise their key interest rates in a bid to tame increasing inflation. In line with global rising rates the CBB raised the key policy interest rate 1-week deposit facility seven times in 2022 as seen below.

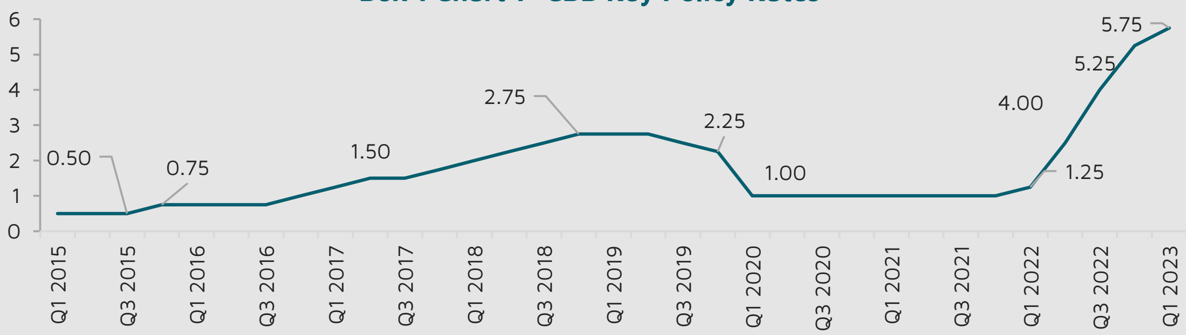
Box 1 Table 1- CBB Policy Rates

	1- Night	1- week	4- weeks	Lending Rate
Mar. 16,2022	1.00%	1.25%	1.75%	2.50%
May 4, 2022	1.50%	1.75%	2.50%	3.00%
Jun. 15 2022	2.25%	2.50%	3.25%	3.75%
Jul. 27 2022	3.00%	3.25%	4.00%	4.50%
Sep. 21, 2022	3.75%	4.00%	4.75%	5.25%
Nov. 2, 2022	4.50%	4.75%	5.50%	6.00%
Dec. 14, 2022	5.00%	5.25%	6.00%	6.50%

Source: CBB.

The move by the Bahrain was to maintain their currency's pegs to the US dollar. The exchange rate peg provides an anchor for monetary policy, which contributes to controlling inflation and protecting the external value of the currency.

Box 1 Chart 1- CBB Key Policy Rates



Source: CBB.

By raising the benchmark interest rate that banks use in lending money to each other, tighter monetary policy makes consumer and business loans more expensive and harder to get. Lowers demand for credit-financed goods and services, and in time also lowers inflation. Looking forward, unsustainable trends, such as the continued expansion in retail lending, is expected to reverse as we enter into an era of higher interest rates and costlier borrowing.

CBB continues to monitor how the high-rate environment might impact borrowers' creditworthiness and their ability to repay. Banking system is well capitalized with stable non-performing facilities.

PART II:
DEVELOPMENTS IN THE BANKING SECTOR

3 PERFORMANCE OF THE BANKING SECTOR

HIGHLIGHTS

Q4 2022

CAR	Tier 1 CAR	Assets-to-Capital
19.5% ▲ 0.8% YoY	18.1% ▲ 0.9% YoY	8.2 ▼ 0.5 YoY
NPL	**Specific Provisions**	**ROA**
3.0% ▼ 0.2% YoY	68.5% ▼ 1.6% YoY	1.2% ▲ 0.1% YoY
ROE	**Liquidity**	**Loan/Deposit**
8.4% ▲ 0.6% YoY	25.3% ▼ 0.9% YoY	68.5% ▼ 1.3% YoY

- Increase in capital positions.
- Non-performing loans continue to decrease.
- Loan portfolios remain concentrated in some sectors with no significant change from the previous quarter.
- Stability in earnings for banks.
- Liquidity position remains resilient.

3.1 Overview

This chapter offers an assessment of the banking sector in Bahrain.[2] 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 performances of conventional and Islamic banking segments are analyzed separately in in Chapters 4 and 5.[3] Annex 1 presents selected FSIs for the different banking segments. Annex 2 presents selected graphs showing the development of selected FSIs over time.

Capital and liquid positions remained strong during the peak of COVID-19 related volatility and Bahraini banks' profitability continued to improve post-COVID. The financial soundness indicators continued to show ample levels of capital and liquidity, low levels of defaults and adequate levels of provisions coverage, which reflect the banking sector's resiliency during 2022.

[2] Chapters 3, 4, and 5 cover the period between Q4 2021 and Q4 2022, unless otherwise indicated.

[3] Chapters 3, 4, and 5 do not contain any sections on stress testing. Stress testing exercises are performed separately in an internal report on selected Bahraini banks including Domestically Systemically Important Banks (DSIB's).

3.2 Overall Banking Sector Performance

3.2.1 Capital Adequacy

Strong capital position with an increasing trend

The capital adequacy ratio[4] (CAR) for the banking sector stood at 19.5% in December 2022 increasing by 0.8% compared to December 2021. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) showed an increase from 17.2% in December 2021 to 18.1% in December 2022. Whereas the leverage ratio (ratio of assets over capital) decreased to 8.2% during the same period.

Table 3.1: Capital Provision Ratios

Indicator*	Q4 2021	Q2 2022	Q4 2022	YoY Change
CAR (%)	18.7	19.1	19.5	0.8
Tier 1 CAR (%)	17.2	17.7	18.1	0.9
Assets/Capital (Times)	8.7	8.7	8.2	-0.5

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

3.2.2 Asset Quality

Continued improvement in asset quality with decreasing NPL and strong provisions

The non-performing loans (NPLs) ratio continued its decrease reaching 3.0% in December 2022 from 3.2% in December 2021. The CBB monitored the impact of the pandemic on NPL ratios as pressures on asset quality continued due to the global pandemic and after a contraction in economic activity in 2021. CBB's loan deferments managed to prevent defaults by individuals and businesses that suffered temporary cash-flow concerns preventing any deterioration in asset quality.

With the expected economic recovery to continue, banks need to remain prudent in monitoring any deteriorations in lending portfolios once the loan deferral program ends due to concerns of a lagged effect on NPLs. The specific provisions as a proportion of NPLs continued to fall, decreasing to 68.5% in December 2022 from 70.1% in December 2021. Licensees were required to make an assessment on credit exposures and requested to be more prudent in determining any additional provision required considering the economic and financial impact of COVID-19 on customers.

Table 3.2: NPL Ratios (Q4 2022)

Indicator	Q4 2021	Q2 2022	Q4 2022	YoY Change
NPLs (% Total Loans)	3.2	3.3	3.0	-0.2
Specific provisions (% of NPLs)*	70.1	69.9	68.5	-1.6

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 (55.2% of total NPLs). NPLs for over 3 years represented 1.5% of total gross loans. Specific provisioning for NPLs decreases as they are non-performing for longer periods of time. As seen in Table 3.3, NPLs for a period of more than 3 years are provisioned by 77.8%.

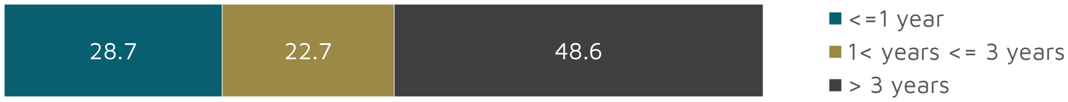
Table 3.3: NPL Ratios and Specific Provisions by Time Period (Q4 2022)

Indicator	Up to 1 year	1 up to 3 years	Over 3 years	Total
NPLs (% Total Loans)	0.9	0.7	1.5	3.3
Specific Provisions (% of NPLs)	50.9	70.8	77.8	68.5

Source: CBB.

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

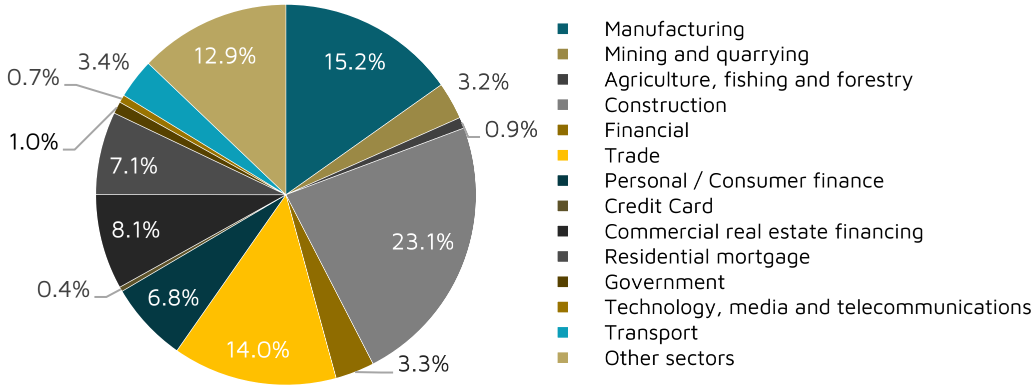
Chart 3.1: NPLs by Time Period (%)



Source: CBB.

Concentration of NPLs by sector shows that the majority of NPLs come from financial (15.0%), manufacturing (12.3%) and other sectors (15.3%) as indicated in chart 3.2. [5]

Chart 3.2: NPLs Concentration by Sector (Q4 2022)



Source: CBB.

Data on the sectoral breakdown of NPLs ratios (NPLs per sector as a percentage of gross loans in each sector) shows increase in impairment in some sectors, while some experience a decrease and others remaining unchanged (Table 3.4). The highest increase was in construction by 1.7%. The highest decrease was in the mining and quarrying sector which was 6.7%.

Table 3.4: NPL Ratios by Sector (%)

Sector	Q4 2021	Q2 2022	Q4 2022	YoY Change
Manufacturing	5.6	4.9	3.8	-1.8
Mining and quarrying	12.6	11.7	5.9	-6.7
Agriculture, fishing and forestry	1.9	1.6	2.0	0.1
Construction	5.3	5.6	7.0	1.7
Financial	1.3	1.3	0.7	-0.6
Trade	7.6	7.8	6.6	-1.0
Personal / Consumer finance	2.3	2.4	2.2	-0.1
Credit Card	3.0	5.1	2.6	-0.4
Commercial real estate financing	3.1	2.8	2.7	-0.4
Residential mortgage	4.3	4.3	3.5	-0.8
Government	0.6	0.6	0.4	-0.2
Technology, media and telecommunications	1.5	0.9	1.1	-0.4
Transport	3.1	3.2	3.5	0.4
Other sectors	4.2	2.7	2.6	-1.6

Source: CBB.

Loan portfolios faces slight fluctuations and remain concentrated in some sectors

The loan portfolio of the banking system remains concentrated with no sector exceeding 20% of total loans. Other sectors represented the highest exposure with 15.3% of total loans in December 2022. Financial and manufacturing followed with 15.0% and 12.3% respectively. Personal/consumer finance stood at 9.7% of total loans. The sector with the largest decline was manufacturing dropping 2.5%.

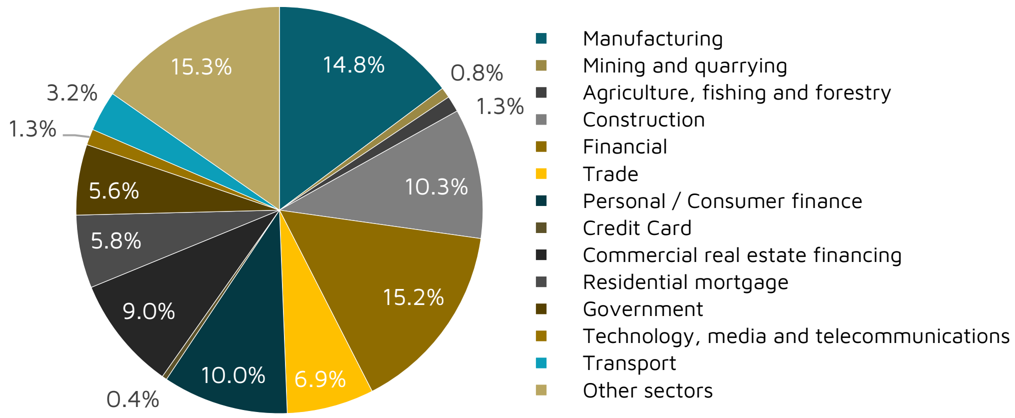
[5] The other sectors category includes sectors such as private banking, services, tourism, and utilities.

Table 3.5: Lending Distribution (% Total Loans)

Sector	Q4 2021*	Q2 2022*	Q4 2022*	YoY Change
Manufacturing	14.8	13.1	12.3	-2.5
Mining and quarrying	0.8	1.1	1.6	0.8
Agriculture, fishing and forestry	1.3	1.5	1.4	0.1
Construction	10.3	10.0	10.1	-0.2
Financial	15.2	14.8	15.0	-0.2
Trade	6.9	6.6	6.5	-0.4
Personal / Consumer finance	10.0	9.8	9.7	-0.3
Credit Card	0.4	0.4	0.5	0.1
Commercial real estate financing	9.0	9.4	9.2	0.2
Residential mortgage	5.8	6.0	6.2	0.4
Government	5.6	6.6	7.3	1.7
Technology, media and telecommunications	1.3	1.7	1.8	0.5
Transport	3.2	3.1	2.9	-0.3
Other sectors	15.3	15.9	15.3	0.0
Top Two Sectors (%)	30.5	30.8	30.3	-0.2
Real Estate/ Construction Exposure (%) **	25.2	25.4	25.6	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 3.3: Lending Distribution (% Total Loans)



Source: CBB.

The top two recipient sectors, financial and other sectors, jointly represented 30.3% of loans in December 2022, decreasing from 30.5% in December 2021. Exposure to real estate/construction was 25.6% of total lending in December 2022, a moderate increase from 25.2% registered in December 2021.

3.2.3 Profitability

Profitability remains positive.

The overall banking sector's profitability indicators have been stable between December 2021 to December 2022 and remain robust. Return-on-assets (ROA) increased to 1.2% in December 2022 from 1.1% in December 2021. As of End-December 2022, return-on-equity (ROE) increased to 8.4% from 7.8% in December 2021.

Table 3.6: Profitability

Indicator	Q4 2021	Q4 2022	YoY Change
ROA (%) *	1.1	1.2	0.1
ROE (%) **	7.8	8.4	0.6
Net Interest Income (% Total Income) ***	70.3	70.3	0.0
Operating Expenses (% Total Income)	52.4	50.4	-2.0

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

Net interest income (as a % of total income) stood at 70.3% in December 2021. In addition, operating expenses as a proportion of total income was 50.4% in December 2022, a decrease from the 52.4% registered in December 2021.

3.2.4 Liquidity

Liquidity positions remains comfortable

Between December 2021 and December 2022, the overall loan-deposit ratio decreased from 69.8% to 68.5%. Liquid assets as a proportion of total assets decreased from 26.2% to 25.3%, over the same period.

Table 3.7: Liquidity

Indicator	Q4 2021	Q2 2022	Q4 2022	YoY Change
Liquid Asset Ratio (%)	26.2	25.7	25.3	-0.9
Loan-Deposit Ratio (%)	69.8	65.7	68.5	-1.3

Source: CBB.

3.3 Developments in Regulation and Initiatives

The following section sheds light on the regulatory and policy initiatives that took place during 2022 for the banking and financial sector that are related to financial stability:

Table 3.8: Key Banking Sector Regulatory and Policy Developments 2022

Item	*Description*
Amendments to Requirements on Promotion of Financial Products and Services	The CBB in January 2022, limited the requirement for independent verification and monitoring/witnessing by the bank's external auditors to draws of the raffle/lottery involving prizes of BD 10,000 or above in aggregate.
Amendments to Take-overs, Mergers and Acquisitions (TMA) Module	As part of the Central Bank of Bahrain's objectives to further enhance its regulatory framework and pursuant to the latest amendments to the Bahrain Commercial Companies Law, Decree Law No. 21 of 2001, on compulsory acquisition and sell-out rights, the CBB introduced certain amendments to the TMA Module in January 2022.
Amendments to the CBB Rulebook Volume 5 (Type 3: Financing Companies)	The CBB in February 2022, issued amendments to financing company regulations to cater to financing companies with limited scope of short-term instalment credit activities such as Buy Now Pay Later (BNPL). The amendments eased the authorization, capital adequacy and controller requirements, among others.
Requirements to Enhance Representation of Payment Transactions	The CBB in February 2022, required financing companies and payment service providers providing acquiring services to include Merchant Category Codes (MCC) consistent with ISO 18245, in the customer transaction data to be shared with the issuers.
Amendments to Module GR of the CBB Rulebook Volumes 1 and 2	As part of the CBB's objective to ensure better transparency with regards to payments transactions and customer account activities which is necessary for proper implementation of open banking, the CBB issued amendments to the General Requirements Module (Module GR) within CBB Rulebook Volumes 1 and 2 mandating access and sharing of the Merchant Category Code (MCC), consistent with ISO 18245, relevant to customer account activity/transactions in February 2022.
Climate-Related Risks	Further to CBB's circular dated 8th November 2021, the CBB issued to all licensees a guidance note on climate-related risks in March 2022 with the objective of ensuring that the licensees regulated and supervised by the CBB are kept abreast of the developments and practices in the area of climate-related risks management as it will shape business models in years to come.
Issuance of new Collective Investment Undertakings Module	Further to the consultation issued on 17th January 2022, the CBB issued in March 2022 a new CIU Module that replaced all existing CIU regulations in Volume 7. The new regulations intended to rationalize and simplify the CBB's CIU regime.
Amendments to Requirements on Reporting Cyber Security Incidents	As part of CBB's initiative to enhance its regulatory framework, the CBB updated the cyber security incident reporting requirements in March 2022, by introducing a one-hour deadline to report a cyber incident by phone and a two-hour deadline to report essential details by email.

Caps on Fees and Charges for Standard Services applicable to Microfinance Institutions	Further to the CBB's consultation letter dated 11th January 2022, the CBB in March 2022, introduced new caps on fees and charges for certain standard services provided by microfinance institutions.
Amendments to the Authorization Module (Module AU) – Volume 5 Type 7: Ancillary Service Providers	The CBB in March 2022, increased the limit of the amount that can be held in any multi-purpose, electronic or otherwise, pre-paid card, from BD 1,000 to BD 2,500.
Issuance of new Crowdfunding Platform Operators' Regulations	Further to the CBB's consultation dated 23rd February 2022, the CBB issued a new consolidated Crowdfunding Platform Operators Module (Module CFP) in April 2022 replacing existing regulations for both financing-based and equity-based crowdfunding. The new rules rationalized and simplified the requirements for crowdfunding platforms.
Discrepancies in BCRB Reporting	The CBB required all retail banks, financing companies and micro-finance institutions in April 2022, to conduct a data cleansing exercise of its clients' data to ensure accurate reporting to BCRB including a quarterly comparison to verify core system data with BCRB.
Bahrain Open Banking Framework – Developer Portal	The CBB is May 2022, introduced a requirement for retail banks to extend access to their developer portals (testing facilities) to open banking service providers operating in the regulatory sandbox and AISPs/PISPs granted in-principle confirmation to proceed with the CBB's licensing process.
Amendments to the Financial Crime Module (Module FC)	The CBB in June 2022, allowed banks in Bahrain to open accounts for Bahraini nationals residing outside Bahrain through a digital onboarding process using the National E-KYC system.
Directive: Employment of In-house Bahraini Actuaries	The CBB in June 2022, required all insurance firms to establish an internal actuarial unit within their organization structure for which all insurance firms must appoint an in-house Bahraini Qualified Actuary (by 30th June 2029) and an in-house Bahraini Actuarial Analyst (by 30th June 2023).

Box 2: ESG Disclosure Guidelines

As part of CBB's objective to maintain disclosure transparency and high corporate governance standards, in addition to its commitment to social and climate related goals, the CBB is currently developing Environmental, Social, and Governance ("ESG") disclosure guidelines to assist companies with ESG integration and reporting against a broad range of environmental, social, and corporate governance factors.

The CBB views ESG reports as effective tools for all stakeholders to better examine a company's efficiency, sustainability, and risk exposure. Given the impact of ESG factors on a company's capacity to execute its business plan and produce value in the long run, the CBB is placing great emphasis on integrating disclosure guidelines within the CBB's regulatory framework. The guidelines are aimed at ensuring progressive adoption of ESG disclosures that are relevant, specific, comprehensive, clear, verifiable, balanced, and consistent.

The guidelines will be based on international best practices, frameworks and initiatives, and taking into consideration the responses to the ESG Reporting Survey released earlier this year by the CBB to all listed companies, insurance firms, banks and category 1 investment firms.

The survey was designed to examine market attitudes towards ESG. Key results for listed companies included: 70% of respondents declaring ESG issues as 'relevant' to their Business Model and Strategy, 85% of respondents who are not reporting any ESG factors are currently evaluating and/or planning on ESG adoption in the near future and 54% of respondents declared ESG disclosures as significant means of communication with stakeholders.

As for Banks, majority of the respondents declared ESG issues as 'relevant' to their Business Model and Strategy, have a management level committee to oversee sustainability related goals and objectives and declared ESG disclosures as significant means of communication with stakeholders. Further, insurance and investment firms displayed a similar acknowledgment for the relevancy of ESG disclosure to their Business Model and Strategy, with 63% and 56% respectively stating that ESGs are considered relevant to their strategy.

The CBB issued a circular to all licensees in November 2021 to raise awareness on climate-related risks which was followed by a detailed Guidance Note in March 2022 aimed at ensuring licensees regulated by the CBB are kept abreast of the developments and practices in the area of climate-related risk management as it will shape business models and business operations across different geographies in years to come.

Box Table 1: Key Survey Results

70%	Declared ESG issues as "relevant to their Business Model and Strategy
>49%	Of respondents cited "lack of information/data" and "insufficient knowledge on how to consider ESG issues" as important reasons hindering ESG reporting.
85%	Of respondents who are not reporting any ESG factors are currently evaluating and/or planning on ESB adoption in the near future.
54%	Declared ESG disclosures as significant means of communication with stakeholders.
60%	Have a management-level committee to oversee sustainability objectives and goals.

Source: CBB's ESG Reporting Survey.

The CBB seeks periodic feedback from the licensees on their preparedness to potentially implement a framework to identify and manage climate-related risks and also capitalise on climate-related opportunities. The ESG disclosure guideline underway is envisaged to align the objectives of climate-related risks circular besides being an exhaustive reference of ESG factors.

The CBB continues its efforts to highlight the need to mitigate risks related to ESG matters and encourage relevant disclosures aligned with Bahrain Economic Vision 2030 and the UN Sustainable Development Goals (SDGs) in accordance with the commitment of the Government of Bahrain to achieve the global climate goals.

The CBB anticipates the issuance of the ESG disclosure guidelines in the first half of 2023 that will be addressed to listed companies and relevant CBB licensees.

Box Table 2: Key Survey Results (Banks, Insurance Firms, and Investment Firm Licenses/Category 1)

	Declared ESG Disclosures as "significant" means of communication with stakeholders	Have an Environmental policy in place	Report Corporate Social Responsibility (CSR)
Banks	67%	39%	67%
Insurance Firms	65%	63%	50%
Investment Firm Licenses/Category 1	50%	33%	33%

CBB's ESG Reporting Survey.

4 PERFORMANCE OF CONVENTIONAL BANKS

HIGHLIGHTS

Q4 2022

	Retail		Wholesale	
CAR	21.5%	▲ 0.9% YoY	17.5%	▲ 0.4% YoY
Tier 1 CAR	20.1%	▲ 0.9% YoY	15.9%	▲ 0.3% YoY
Assets-to-Capital	6.8	▼ 0.1 YoY	8.8	▼ 0.2 YoY
NPL	3.3%	▼ 0.6% YoY	2.3%	▼ 0.5% YoY
Specific Provisions	74.3%	▲ 2.4% YoY	67.0%	▼ 5.8% YoY
ROA	1.4%	▲ 0.1% YoY	1.2%	▼ 0.1% YoY
ROE	11.0%	▲ 0.1% YoY	4.5%	▲ 1.0% YoY
Liquidity	32.7%	▼ 0.9% YoY	22.9%	▼ 1.8% YoY
Loan/Deposit	68.8%	▼ 0.5% YoY	68.3%	▼ 0.4% YoY

- Capital position of conventional banks improves.
- Asset quality of conventional banks improves with decreasing NPLs.
- Loan portfolios in conventional retail and wholesale banks remain concentrated despite the decrease in some sectors.
- Stability in earnings for conventional retail banks and conventional wholesale banks.
- Liquidity declined for conventional banks but remail to have ample liquidity levels.

3.4 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 (retail and wholesale): capital adequacy (section 4.2), asset quality (section 4.3), profitability (section 4.4), and liquidity (section 4.5). Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations).

3.5 Capital Adequacy

Conventional banks remain well capitalized

The CAR for conventional retail increased from 20.6% in December 2021 to 21.5% in December 2022. The core capital ratio (ratio of Tier 1 capital to risk-weighted assets) also increased from 19.2% in December 2021 to 20.1% in December 2022. The leverage ratio (ratio of assets over capital) remained stable at 6.8% during the same period. The NPLs net provisions to capital decreased to 3.3% in December 2022 from 4.3% in December 2021.

As for wholesale banks, CAR increased to 17.5% in December 2022 from the level of 17.1% it registered in December 2021. Tier 1 capital increased to 15.9% in December 2022 from the level of 15.6 it recorded in December 2021. Furthermore, the leverage ratio (ratio of assets over capital) slightly decreased to 8.8% in December 2022. Finally, the ratio of NPLs net of provisions to capital slightly increased to 3.3% over the same period.

Table 4.1: Conventional Banks' Capital Provisions Ratios

Indicator *	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
CAR (%)	20.6	21.5	0.9	17.1	17.5	0.4
Tier 1 CAR (%)	19.2	20.1	0.9	15.6	15.9	0.3
Assets/Capital (Times)	6.9	6.8	-0.1	9.0	8.8	-0.2
NPLs net of Provisions to Capital (%)	4.3	3.3	-1.0	3.1	3.3	0.2

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

3.6 Asset Quality

3.6.1 Non-Performing Loans

Drop in NPLs for conventional banks with high provisioning position for retail banks

The NPL ratio decreased to 3.3% in December 2022 from 3.9% in December 2021 for conventional retail banks. Specific provisions as a proportion of NPLs increased to 74.3% in December 2022. As for conventional wholesale banks, the NPL ratio decreased from 2.8% in December 2021 to 2.3% in December 2022. Specific provisions witnessed a decrease of 5.8% from 72.8% in December 2021 to 67.0% in December 2022.

Table 4.2: Conventional Banks' NPL Ratios

Indicator *	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
NPLs (% Total Loans)	3.9	3.3	-0.6	2.8	2.3	-0.5
NPLs Local Banks (%)	3.7	3.0	-0.7	3.8	2.9	-0.9
NPLs Overseas Banks (%)	4.4	4.1	-0.3	2.0	1.8	-0.2
Specific Provisions (% of NPLs) *	71.9	74.3	2.4	72.8	67.0	-5.8

Source: CBB.

Available data on the sectoral breakdown of NPLs shows some sectors experiencing an increase in impairment, while most experience a decrease (Table 4.3). For conventional retail banks, the highest increase was in mining and quarrying by 19.0% while the largest decrease was in manufacturing by 2.8%.

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

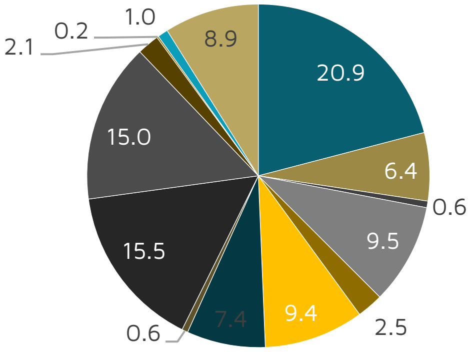
Sector	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Manufacturing	8.1	5.3	-2.8	1.6	1.6	0.0
Mining and quarrying	42.7	61.7	19.0	4.2	0.8	-3.4
Agriculture, fishing and forestry	2.1	4.3	2.2	0.9	0.7	-0.2
Construction	5.9	8.5	2.6	4.4	5.2	0.8
Financial	1.1	1.0	-0.1	0.8	0.6	-0.2
Trade	4.6	3.6	-1.0	6.8	6.2	-0.6
Personal / Consumer finance	1.7	1.7	0.0	3.6	3.5	-0.1
Credit Card	2.9	2.2	-0.7	4.4	0.4	-4.0
Commercial real estate financing	2.8	2.7	-0.1	2.6	1.8	-0.8
Residential mortgage	6.2	4.5	-1.7	0.9	1.0	0.1
Government	2.9	1.4	-1.5	0.3	0.2	-0.1
Technology, media and telecommunications	0.2	0.2	0.0	2.4	1.9	-0.5
Transport	1.3	2.0	0.7	3.4	3.8	0.4
Other sectors	2.6	2.6	0.0	3.9	2.1	-1.8

Source: CBB.

As for wholesale banks, sectoral breakdown of impaired loans demonstrates that impairment in trade was the highest between all sectors at 6.2%, followed by construction with an impairment of 5.2%. The biggest decrease in impairment was found in the credit card sector with a decrease of 4.0%.

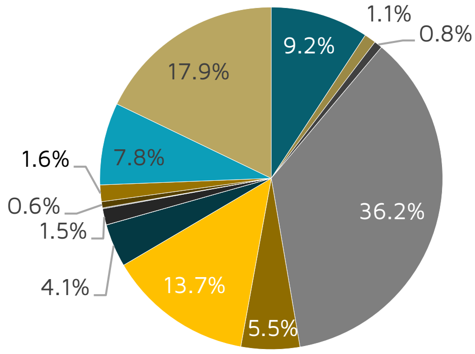
Data on the concentration of NPLs by sector for conventional retail banks shows that the majority of NPLs come from the manufacturing sector (20.9%), residential mortgage (15.0%), commercial real estate sector (15.5%) and construction (9.5%). On the other hand, the data on the concentration of NPLs by sector for wholesale banks indicates that that the majority of NPLs are concentrated and come from the construction sector (36.2%), trade (13.7%), and others (17.9%).

Chart 4.1: CR Banks' NPLs Concentration by Sector (December 2022)



Source: CBB.

Chart 4.2: CW Banks' NPLs Concentration by Sector (December 2022)



Source: CBB.

- Manufacturing
- Agriculture, fishing and forestry
- Financial
- Personal / Consumer finance
- Commercial real estate financing
- Government
- Transport
- Mining and quarrying
- Construction
- Trade
- Credit Card
- Residential mortgage
- Technology, media and telecommunications
- Other sectors

3.6.2 Loan Concentrations

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 retail loans remains to be the commercial real estate financing sector accounting for 19.0% of total loans in December 2022 followed by personal/consumer finance representing 14.7%. Exposure to real estate/construction remained at 33.1% of total lending in December 2022. As for wholesale banks, lending remains concentrated in the financial sector and construction sector accounting for 20.9% and 15.9% respectively. Exposure to real estate/construction decreased to 18.0% of total lending in December 2022.

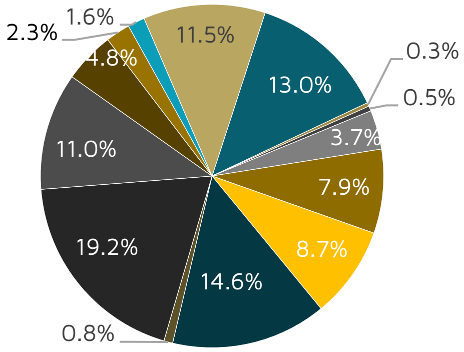
Table 4.4: Conventional Banks' Lending Distribution by Sector (% Total Loans)

Sector	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Manufacturing	14.0	13.0	-1.0	14.7	13.1	-1.6
Mining and quarrying	0.5	0.3	-0.2	1.2	3.0	1.8
Agriculture, fishing and forestry	0.4	0.5	0.1	2.5	2.4	-0.1
Construction	3.6	3.7	0.1	17.0	15.9	-1.1
Financial	8.6	7.9	-0.7	19.7	20.9	1.2
Trade	8.7	8.7	0.0	5.6	5.0	-0.6
Personal / Consumer finance	14.7	14.6	-0.1	2.0	2.7	0.7
Credit Card	0.7	0.8	0.1	0.0	0.1	0.1
Commercial real estate financing	19.6	19.2	-0.4	2.3	1.9	-0.4
Residential mortgage	10.2	11.0	0.8	0.1	0.2	0.1
Government	2.9	4.8	1.9	6.2	8.7	2.5
Technology, media and telecommunications	2.0	2.3	0.3	1.2	1.9	0.7
Transport	2.1	1.6	-0.5	5.4	4.6	-0.8
Other sectors	12.0	11.5	-0.5	22.2	19.7	-2.5
Top Two Sectors (%)	34.2	33.9	-0.3	41.9	40.6	-1.3
Real Estate/ Construction Exposure (%) **	33.4	34.0	0.6	19.4	18.0	-1.4

** 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.

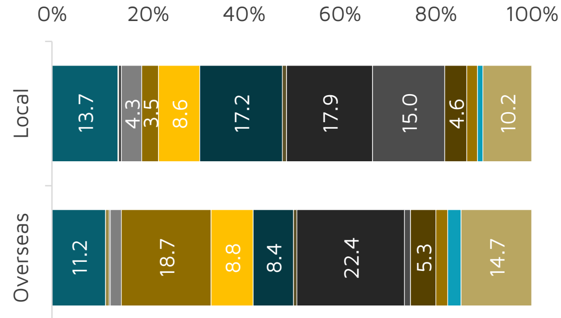
The loan portfolio of locally incorporated retail banks remains concentrated in some sector with the top recipient of loans being the commercial real estate financing sector (17.9%). Real estate/construction exposure decreased to 37.2%. Similarly, the overseas retail banks loan portfolio shows commercial real estate financing sector as the top sector (22.4%) and the exposure to real estate/ construction was 26.0% of total lending in December 2022.

Chart 4.3: CR Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

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

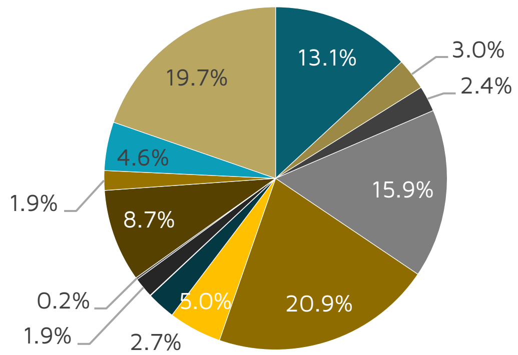


Source: CBB.

- Manufacturing
- Agriculture, fishing and forestry
- Financial
- Personal / Consumer finance
- Commercial real estate financing
- Government
- Transport
- Mining and quarrying
- Construction
- Trade
- Credit Card
- Residential mortgage
- Technology, media and telecommunications
- Other sectors

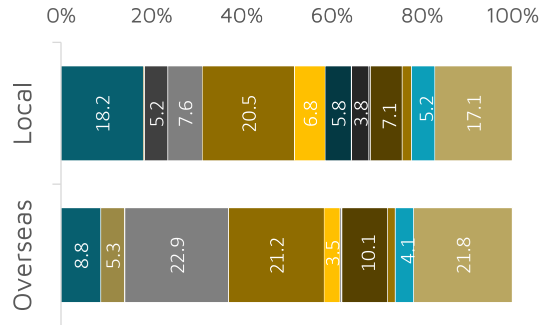
As for locally-incorporated wholesale banks, the top recipient of loans is the manufacturing sector (20.3%) and the real estate/ construction exposure was 11.8% for the same period. For overseas wholesale banks, the top recipient of loans in December 2022 was the construction sector (23.0%) and real estate/construction exposure decreased from 29.5% in December 2021 to 23.3% in December 2022.

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



Source: CBB.

Chart 4.6: Local and Overseas CW Banks' Lending Distribution by Sector (% Total Loans)



Source: CBB.

- Manufacturing
- Agriculture, fishing and forestry
- Financial
- Personal / Consumer finance
- Commercial real estate financing
- Government
- Transport
- Mining and quarrying
- Construction
- Trade
- Credit Card
- Residential mortgage
- Technology, media and telecommunications
- Other sectors

3.7 Profitability

Banks' profitability remains positive and at similar levels as last year

Profitability for conventional retail banks was positive, and, as at end-December 2022, ROA slightly increased to 1.4%. ROA for locally incorporated banks remained at 1.5% in December 2022. For overseas banks, ROA increased to 1.3% in December 2022. ROE for locally incorporated banks slightly increased to 11.0% from 10.9% during the same period. Net interest income (as a % of total income) decreased from 78.9% to 76.8% during the same period as well. Operating expenses as a proportion of total income decreased from 49.4% in December 2021 to 48.5% in December 2022.

Table 4.5: Conventional Banks' Profitability

Indicator	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
ROA (%) *	1.3	1.4	0.1	1.3	1.2	-0.1
ROA Locally Incorporated Banks (%)	1.5	1.5	0.0	0.4	0.5	0.1
ROA Overseas Banks (%)	0.9	1.3	0.4	2.2	2.0	-0.2
ROE (%) **	10.9	11.0	0.1	3.5	4.5	1.0
Net Interest Income (% Total Income)	78.9	76.8	-2.1	62.8	64.4	1.6
Operating Expenses (% Total Income)	49.4	48.5	-0.9	42.7	47.0	4.3

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

As for conventional wholesale banking sector, ROA slightly decreased to 1.2% in December 2022 from 1.3% in December 2021. The ROA for local wholesale banks increased slightly to 0.5%, while overseas wholesale banks decreased from 2.2% to 2.0%. ROE for local wholesale banks increased from 3.5% to 4.5%. Net interest income as a proportion of total income increased from 62.8% in December 2021 to 64.4% in December 2022. Operating expenses as a proportion of total income showed an increase from 42.7% in December 2021 to 47.0% in December 2022.

3.8 Liquidity

Liquidity position is strong but declines for conventional banks.

Between December 2021 and December 2022, non-bank deposits increased by 2.1% for conventional retail banks. The overall loan-deposit ratio for the segment decreased to 68.8% in December 2022 from 69.3% in December 2021. Liquid assets as a proportion of total assets decreased to 32.7% in December 2022. Liquid assets as a proportion of the short-term liabilities also decreased to 41.9% over this period.

As at end-December 2022, the overall loan-deposit ratio for conventional wholesale banks stood at 68.3 %, a decrease from the 68.7% recorded in December 2021. Liquid assets for wholesale banks as a proportion of total assets decreased to 22.9% in December 2022 from 24.7% in December 2021. The liquid assets as a proportion of short-term liabilities decreased by 2.2% to 28.6% in December 2022. Non-bank deposits as a proportion of total deposits stood at 54.1%, an increase from the 50.3% level achieved in December 2021, while bank deposits decreased from 49.7% in December 2021 to 45.9% in December 2022.

Table 4.6: Conventional Bank's Liquidity

Indicator	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Liquid Asset Ratio (%)	33.6	32.7	-0.9	24.7	22.9	-1.8
Loan-Deposit Ratio (%)	69.3	68.8	-0.5	68.7	68.3	-0.4
Non-Bank Deposits (% of Total Deposits)	73.9	76.0	2.1	50.3	54.1	3.8

Source: CBB.

5 PERFORMANCE OF ISLAMIC BANKS

HIGHLIGHTS

Q4 2022

CAR		Tier 1 CAR		Assets-to-Capital	
Retail	Wholesale	Retail	Wholesale	Retail	Wholesale
21.1%	16.9	19.7%	16.2%	11.3	8.9
0.6% YoY	1.1% YoY	0.2% YoY	1.8% YoY	0.3 YoY	2.2 YoY

NPL		Specific Provisions		ROA	
Retail	Wholesale	Retail	Wholesale	Retail	Wholesale
4.8%	4.8%	54.8%	94.9%	0.9%	1.1%
0.2%	4.1% YoY	1.6% YoY	2.9% YoY	0.3% YoY	0.3% YoY

ROE		Liquidity		Loan/Deposit	
Retail	Wholesale	Retail	Wholesale	Retail	Wholesale
10.6%	10.3%	17.0%	13.8%	71.6%	33.5%
3.3% YoY	0.3% YoY	2.5% YoY	4.2% YoY	1.7% YoY	29.5%

- Sector remains well capitalized despite decrease in capital position for Islamic retail and increased for Islamic wholesale banks.
- Non-performing facilities (NPFs) decreased for Islamic retail banks but increased for wholesale.
- Concentration of facilities for Islamic banks continues in specific sectors.
- Earnings for Islamic banks slightly increased.
- Liquidity positions decreased for retail and wholesale banks.

4.1 Overview

Chapter 5 offers macro-prudential analysis of the Islamic banking sector based on a set of selected FSIs. The Chapter analyses the following conventional banking segments (retail and wholesale): capital adequacy (section 5.2), asset quality (section 5.3), profitability (section 5.4), and liquidity (section 5.5). Unless specified otherwise, the analysis in this chapter is based on consolidated financial data (Bahraini and non-Bahraini operations).

4.2 Capital Adequacy

Islamic retail and wholesale banks remain well-capitalized despite slight decrease in retail

The CAR of Islamic retail banks slightly decreased from 21.7% in December 2021 to 21.1% in December 2022. Tier 1 capital decreased from 19.9% to 19.7% during this period. As at end- December 2022, the CAR for Islamic wholesale banks increased to 16.9% from 15.8% in December 2021. Tier 1 capital also increased from 14.4% to 16.2% over the same period. The ratio of NPFs net of provisions to capital increased to 0.5% in December 2022.

Table 4.7: Islamic Banks' Banks' Capital Provisions Ratios

Indicator	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
CAR (%)	21.7	21.1	-0.6	15.8	16.9	1.1
Tier 1 CAR (%)	19.9	19.7	-0.2	14.4	16.2	1.8
Assets/Capital (Times)	11.0	11.3	0.3	11.1	8.9	-2.2
NPFs Net Provisions to Capital (%)	13.7	13.2	-0.5	0.3	0.5	0.2

Source: CBB.

4.3 Asset Quality

4.3.1 Non-Performing Facilities

Decrease in retail NPFs for Islamic retail banks

Non-performing facilities (NPF) ratio for Islamic retail banks decreased to 4.8% in December 2022. Specific provisoining decreased to 54.8% in December 2022 from 56.4% in December 2021. As of end- December 2022, NPF ratio for Islamic wholesale banks increased to 4.8%. Provisioning for NPFs increased to 94.9% over the same period.

Table 4.8: Islamic Banks' NPF Ratios

Indicator	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
NPFs (% Gross Facilities)	5.0	4.8	-0.2	0.7	4.8	4.1
Specific Provisions (% of NPFs)	56.4	54.8	-1.6	92.0	94.9	2.9

Source: CBB.

A look at the non-performing facilities by sector for Islamic retail banks indicates that the trade sector had the highest impairment (19.9%) in December 2022 followed by agriculture, fishing and forestry and construction with 16.3% and 14.5% respectively. The biggest declines in NPFs by sector was in the agriculture, fishing and forestry sector which went down by 17.6%. The biggest increase in NPFs was in mining and quarrying sector with an increase of 8.8% as indicated in table 5.3.

Table 4.9: Islamic Banks' NPF Ratios by Sector (%)

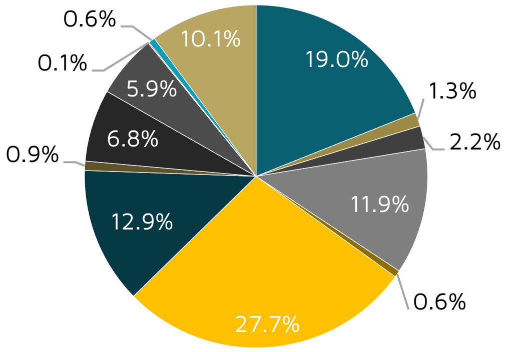
Sector	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Manufacturing	11.9	10.8	-1.1	7.7	1.2	-6.5
Mining and quarrying	4.2	13.0	8.8	9.9	0.0	-9.9
Agriculture, fishing and forestry	33.9	16.3	-17.6	5.4	3.4	-2.0
Construction	6.9	14.5	7.6	8.8	25.8	17.0
Financial	3.5	0.4	-3.1	1.7	0.8	-0.9
Trade	19.5	19.9	0.4	10.3	4.7	-5.6
Personal / Consumer finance	2.9	2.5	-0.4	2.1	0.0	-2.1
Credit Card	3.4	4.0	0.6	2.5	0.0	-2.5
Commercial real estate financing	3.7	3.4	-0.3	11.8	7.4	-4.4
Residential mortgage	1.6	1.7	0.1	1.9	0.0	-1.9
Government	0.0	0.0	0.0	0.0	0.0	0.0
Technology, media and telecommunications	3.8	1.1	-2.7	42.9	9.0	-33.9
Transport	5.2	7.0	1.8	5.4	3.9	-1.5
Other sectors	6.3	5.7	-0.6	10.7	7.4	-3.3

Source: CBB.

On the other hand, the sector with the highest impairment for Islamic wholesale banks was the construction sector with 25.8% in December 2022. This was followed by technology, media and telecommunications and commercial real estate financing sectors with 9.0% and 7.4% respectively. Available data on the sectoral breakdown of non-performing facilities shows that the biggest increase was in the construction sector with an increase of 17.0%. The biggest drop was in the technology, media and telecommunications sector with a decrease of 33.9%. The mining and quarrying sector went down from 9.9% in December 2021 to 0.0% in December 2022. Also, technology, media, and telecommunications went down from the 42.9% recorded in December 2021 to 9.0 in December 2022.

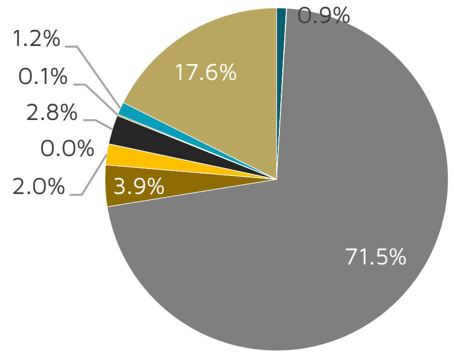
Looking at the data on the concentration of NPFs for Islamic retail banks by sector indicates that the majority of NPLs are concentrated and come from the trade sector (27.7%), manufacturing (19.0%), personal/consumer finance (12.9%) as indicated in chart 5.1. As for Islamic wholesale banks, the majority of NPFs are concentrated and come from construction (71.5%), and other sectors (17.6%) as indicated in chart 5.2.

Chart 4.7: IR Banks' NPLs Concentration by Sector (December 2022)



Source: CBB.

Chart 4.8: IW Banks' NPLs Concentration by Sector (December 2022)



Source: CBB.

- Manufacturing
- Agriculture, fishing and forestry
- Financial
- Personal / Consumer finance
- Commercial real estate financing
- Government
- Transport
- Mining and quarrying
- Construction
- Trade
- Credit Card
- Residential mortgage
- Technology, media and telecommunications
- Other sectors

4.3.2 Facilities Concentrations

Loan portfolios remain concentrated

There has been some diversification in the asset concentration among most of the sectors in Islamic retail banks. At the end of December 2022, the top recipient of financing was personal/consumer finance (24.9%), an increase from 24.6% recorded in December 2021. The top two recipients of financing (personal/consumer finance and residential mortgage) accounted for 41.5% of total facilities extended, compared to 38.2% for the top two sectors in December 2021. Real estate/construction exposure decreased to 30.3% in December 2022.

Table 4.10: Islamic Banks' Lending Distribution by Sector (% Total Facilities)

Sector	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Manufacturing	10.1	8.5	-1.6	21.1	6.0	-15.1
Mining and quarrying	0.4	0.5	0.1	0.9	0.0	-0.9
Agriculture, fishing and forestry	0.2	0.6	0.4	0.7	0.1	-0.6
Construction	3.2	3.9	0.7	12.3	21.5	9.2
Financial	11.2	8.1	-3.1	21.4	39.1	17.7
Trade	6.4	6.7	0.3	7.1	3.2	-3.9
Personal / Consumer finance	24.6	24.9	0.3	11.2	0.0	-11.2
Credit Card	0.9	1.1	0.2	0.3	0.0	-0.3
Commercial real estate financing	11.5	9.7	-1.8	1.7	2.9	1.2
Residential mortgage	13.6	16.6	3.0	6.1	2.4	-3.7
Government	9.4	10.0	0.6	7.5	2.9	-4.6
Technology, media and telecommunications	0.5	0.4	-0.1	0.1	0.1	0.0
Transport	0.5	0.4	-0.1	1.4	2.4	1.0
Other sectors	7.6	8.5	0.9	8.3	18.3	10.0
Top two recipient sectors	38.2	41.5	3.3	42.5	60.6	18.1
Real Estate/ Construction Exposure**	28.4	30.3	1.9	20.1	26.7	6.6

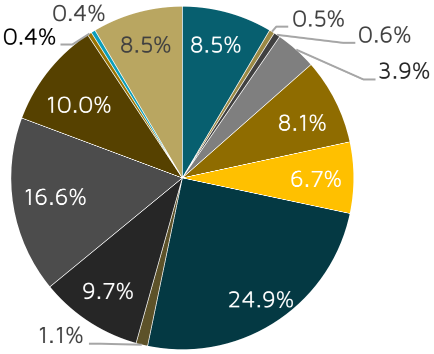
Source: CBB.

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

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

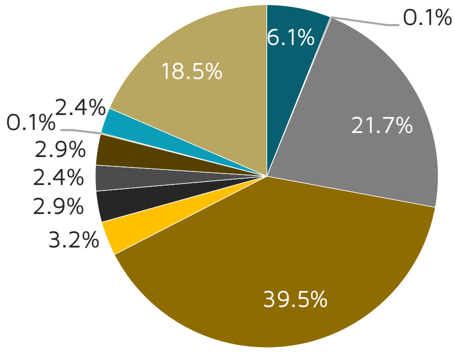
At End- December 2022, the financial sector was the top recipient of financing from Islamic wholesale banks, at 39.1%, increasing by 17.7% from December 2021. The manufacturing sector saw the largest decrease from 21.1% in December 2021 to 6.0% in December 2022. Real estate/ construction exposure increased from 20.1% in December 2021 to 26.7% in December 2022.

Chart 4.9: IR Banks' Lending Distribution by Sector (% of Total Facilities)



Source: CBB.

Chart 4.10: IW Banks' Lending Distribution by Sector (% of Total Facilities)



Source: CBB

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- Manufacturing
- Agriculture, fishing and forestry
- Financial
- Personal / Consumer finance
- Commercial real estate financing
- Government
- Transport
- Mining and quarrying
- Construction
- Trade
- Credit Card
- Residential mortgage
- Technology, media and telecommunications
- Other sectors

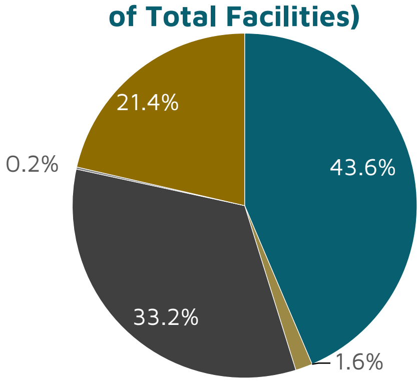
The concentration of lending distribution by Islamic instrument remained the same over the past. At the end of December 2022, the top recipient of finance for Islamic retail banks was Murabaha at 43.6% followed by Ijarah 33.2%. As for wholesale banks, the top recipient of finance was Murabaha at 52.2%.

Table 4.11: Islamic Banks' Lending Distribution by Islamic Instrument (% of Total Facilities)

Instrument	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Murabaha	49.6	43.6	-6.0	65.7	52.2	-13.5
Istisna'a	1.8	1.6	-0.2	3.2	13.4	10.2
Ijarah	29.7	33.2	3.5	0.9	7.0	6.1
Salam	0.3	0.2	-0.1	1.2	0.0	-1.2
Others	18.6	21.4	2.8	29.0	27.4	-1.6

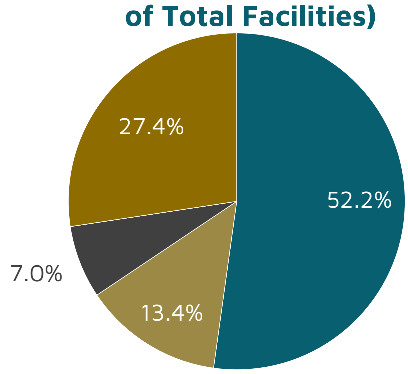
**Figures may not add to a hundred due to rounding.*
Source: CBB.

Chart 4.11: IR Banks' Lending Distribution by Islamic Instrument (% of Total Facilities)



Source: CBB.

Chart 4.12: IW Banks' Lending Distribution by Islamic Instrument (% of Total Facilities)



Source: CBB.

■ Murabaha ■ Istisna'a ■ Ijarah ■ Salam ■ Others

4.4 Profitability

Improvement in earnings for Islamic banks

ROA for Islamic retail banks increased to 0.9% in December 2022 compared to 0.6% in December 2021. ROE also increased from 7.3% to 10.6% for the same period. Furthermore, operating expenses decreased from 73.9% in December 2021 to 65.8% in December 2022. As for Islamic wholesale banks, ROA increased from 0.8% in December 2021 to 1.1% in December 2022. ROE also increased from 10.0% to 10.3% in the same period. Furthermore, operating expenses (as % of total income) decreased from 67.6% in December 2021 to 55.2% in December 2022.

Table 4.12: Islamic Banks' Profitability (%)

Indicator	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
ROA*	0.6	0.9	0.3	0.8	1.1	0.3
ROE**	7.3	10.6	3.3	10.0	10.3	0.3
Operating Expenses (% Total Operating Income)	73.9	65.8	-8.1	67.6	55.2	-12.4

Source: CBB.

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

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

4.5 Liquidity

Liquidity remains at stable levels for Islamic retail and wholesale banks despite decrease

The volume of liquid assets available to Islamic retail banks decreased from 19.5% of total assets in December 2021 to 17.0% in December 2022. The ratio of total facilities to deposits decreased from 73.3% in December 2021 to 71.6% in December 2022.As of end- December 2022, liquid assets of Islamic wholesale banks represented 13.8% of total assets, 4.2% lower than the 18.0% registered in December 2021. Additionally, the facilities deposit ratio decreased from 63.0% in December 2021 to 33.5% in December 2022.

Table 4.13: Islamic Banks' Liquidity (%)

Indicator	Retail			Wholesale		
	Q4 2021	Q4 2022	Change	Q4 2021	Q4 2022	Change
Liquid Assets (% of total assets)	19.5	17.0	-2.5	18.0	13.8	-4.2
Facilities – deposits ratio (%)	73.3	71.6	-1.7	63.0	33.5	-29.5

Source: CBB.

PART III:
DEVELOPMENT IN THE NON-BANKING FINANCING SECTOR

6 PERFORMANCE OF THE INSURANCE SECTOR

HIGHLIGHTS

Insurance Licenses	Contribution to GDP	Contribution to Financial Sector
130 EY 2022	5.6% EY 2022	32.6% EY 2022
Asset of Conv. Insurance	**Assets of Takaful Insurance**	**Gross Premiums**
BD 2,070 mn Q3 2022	BD 193.3 mn Q3 2022	BD 204.9 mn Q3 2022

- Conventional firms account for 71.6% of total insurance industry with BD 146.8 million in total gross premiums as of September 2022. General insurance contributes 84.3% of total gross premiums.
- Local Conventional insurance firms' performance is concentrated on Motor and Long-term (Life) business lines, and Takaful is concentrated in Motor and Medical business lines.
- Overseas insurance firms' performance is concentrated on Medical and Long-term (Life) 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.[6] The conventional sector is further divided into local and overseas/branch firms.[7]

A significant number of insurance companies and organizations have established their presence in Bahrain. As of December 2022, there are a total of 130 insurance organizations licensed and registered in the Kingdom. There are 31 insurance companies: 16 conventional local, 10 conventional overseas/foreign branches, and 5 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 98 other registered insurance licenses include 32 Insurance Brokers, 3 Insurance Managers, 3 Insurance Consultants, 16 Insurance Firms, brokers and consultants restricted to business outside Bahrain, 30 Registered Actuaries, 13 Registered loss Adjusters, and 2 Insurance Pools and Syndicates.

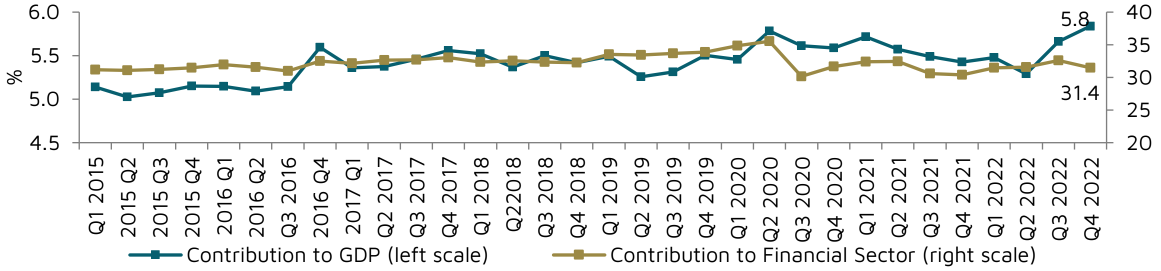
The insurance industry continued to grow during the past few years mirroring the growth of Bahrain's financial sector. The increased access to financial services and products has led to demand for insurance services. Insurance contribution increased to 5.6% of GDP by end of 2022 (compared to 5.8% by end of 2020 and 5.5% by end of 2021). The contribution

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

[7] Chapter 6 covers the period between Q3 2021 and Q3 2022, unless otherwise indicated.

of the Insurance sector to the overall financial sector has increased representing 31.8%. Chart 6.1 shows the quarterly contribution of the Insurance sector to GDP along with 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 Financial Position and Profitability of Insurance Sectors

As of September 2022, total assets of the Insurance sector reached BD 2,263.8 million with a decrease of 5.6% compared to BD 2,399.4 million in September 2021. Total liabilities decreased by 4.7% over the same period reaching BD 1,595.8 million.

Total available capital[8] increased from 414.6 BD million in September 2021 to 417.9 BD million in September 2022. Profitability on the other hand, decreased significantly between September 2021 and September 2022 reaching BD 13.8 million.

Table 6.1: Total Assets, Liabilities, Capital, and Profitability of Insurance Sector by Segment

BD 000	Total Assets*		Total Liabilities*		Capital Available*		Net Profit*	
	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022
Conventional	2,194,657	2,070,510	1,550,483	1,468,454	358,671	375,469	28,179	13,765
Local	1,975,167	1,885,260	1,368,062	1,315,789	323,635	344,571	23,172	10,403
Overseas	219,490	185,250	182,420	152,665	35,037	30,899	5,007	3,363
Takaful	204,726	193,317	123,783	127,386	55,945	42,431	3,599	3,694
All Insurance	**2,399,383**	**2,263,827**	**1,674,265**	**1,595,840**	**414,617**	**417,901**	**28,179**	**13,765**

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

6.2.1 Conventional Insurance Firms

As of September 2022, total assets of the conventional insurance sector stood at BD 2,070.5 million decreasing by 5.7% compared to the BD 2,194.7 million registered in September 2021. Assets of local insurance firms were BD 1,885.3 million (91.1% of total assets) with a negative growth rate of 4.6% since September 2021. Total assets of overseas foreign branches were BD 185.3 million (8.9% of total assets) recording a decline of 15.6%.

The liabilities of the conventional insurance sector registered at BD 1,468.5 million with a 5.3% decrease from BD 1,550.5 million in September 2021. Liabilities for local insurance firms registered at BD 1,315.8 million decreasing by 3.8%. Liabilities of overseas foreign branches were BD 152.7 million in September 2022 with a decrease of 16.3%.

Available Capital: Total capital as of September 2022 was at BD 375.5 million increasing by 4.7% from BD 358.7 million in the equivalent period of the previous year. Total available capital for local insurance was BD 344.6 with a YoY increase of 6.5%. Total available capital for overseas foreign branches decreased by 11.8% from BD 35.0 million in September 2021 to BD 30.9 million in September 2022.

Net profit decreased for conventional insurance firms from BD 28.2 million in September 2021 to a profit of BD 13.8 million in September 2022. Net profit for local insurance was BD 10.4 million with a YoY decrease of 55.1%. Net profit for overseas insurance was BD 3.4 with a year-to-year decrease of 32.8%.

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

6.2.2 Takaful Insurance Firms

Total assets in Takaful firms in September 2022 decreased by 5.6% to BD 193.3 million. The liabilities increased by 2.9% from BD 123.8 million in September 2021 to BD 127.4 million in September 2022. Total regulatory capital experienced an annual decrease of 24.2% from BD 56.0 million in September 2021 to BD 42.4 million in September 2022. As for net profits, Takaful companies showed a 2.6% increase in profits between September 2021 and September 2022 recording BD 3.7 million.

6.3 Insurance Premiums and Claims Analysis

The Insurance products and services in the Kingdom are delivered via two main insurance classes: Life and non-life insurance.[9]

Gross Premiums for the insurance sector stood at BD 205.0 million, increasing by 0.8% YoY. Conventional insurance represented 71.7% of total gross premiums (local and branches represented 55.7% and 16.0% respectively) while takaful accounted for 28.4% of gross premiums. As of September 2022, life insurance represented 15.7% of gross premiums while non-life/general insurance was 84.3% covering the various classes.

Looking at the performance by class, Long-term (Life) category experienced the only decline within the rest of the insurance business line, with an annual decrease of 24.5%. On the other hand, the Medical and Motor business lines experienced an annual increase of 5.2% and 4.2% respectively during the same period. The top 3 business lines sectors represented 72.5% of total gross premiums.

As of September 2022, Net Premiums Written decreased by 5.9% compared to the previous period registering a value of BD 127.1 million. Motor showed the biggest increase over the period increasing from BD 50.9 million in September 2021 to BD 53.2 million in September 2022. On the other hand, the biggest decline was derived from Long-term (Life) class, decreasing by 31.0% from BD 37.3 million in September 2021 to BD 25.7 million in September 2022.

Gross Claims for the insurance industry recorded a YoY increase of 2.2% from BD 106.2 million in September 2021 to BD 108.5 million in September 2022. The increase was mainly in the Motor class increasing by 20.9% from BD 30.8 million in September 2021 to BD 37.3 million in September 2022 and Engineering by 349.1% from BD 0.7 million to BD 3.1 million.

Net Claims for the insurance industry show an increase of 6.5%, which was derived from an annual increase in Motor of BD 5.6 million (20.7%). The largest drop was recorded in Long-term (Life) by BD 4.2 million (21.8%) reaching BD 15.1 million.

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

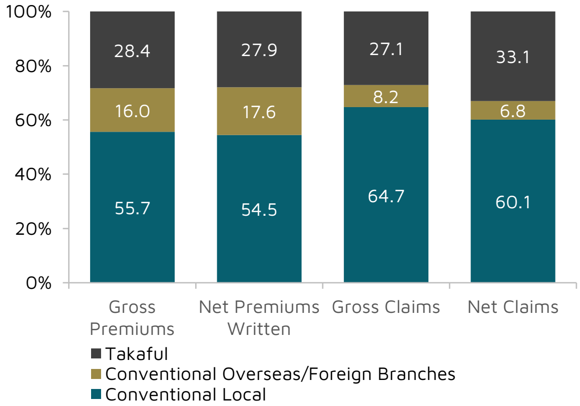
BD 000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022
Long-term (Life)	42,682	32,242	37,266	25,711	25,738	18,526	19,278	15,078
Fire, Property & Liability	28,841	29,584	3,652	4,301	7,318	7,311	188	1,714
Miscellaneous Financial Loss	3,791	5,314	285	552	406	409	-62	-37
Marine & Aviation	4,460	5,019	1,187	1,180	1,604	889	139	-44
Motor	52,799	55,033	50,947	53,161	30,846	37,298	27,123	32,741
Engineering	4,740	6,829	959	842	690	3,099	-19	271
Medical	58,173	61,185	38,719	38,483	35,293	37,520	25,060	26,317
Others	7,817	9,738	2,119	2,878	4,296	3,435	897	1,271
Total	**203,304**	**204,944**	**135,133**	**127,108**	**106,190**	**108,487**	**72,605**	**77,311**

Source: CBB.

The concentrations of premuims and claims by class are viewed in Graph 6.3:

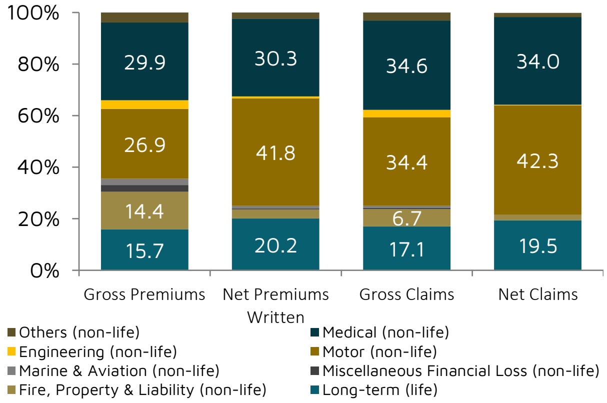
[9] Non-life or general insurance includes: Fire, Property & Liability, Miscellaneous Financial Loss, Marine & Aviation, Motor, Engineering, Medical and Others.

Chart 6.2: Premiums and Claims of Insurance Sector by Segment (%) (Q3 2022)



Source: CBB.

Chart 6.3: Concentrations of Premiums and Claims for Insurance Firms by Class (Q3 2022)



Source: CBB.

6.3.1 Conventional Insurance Firms

Gross Premiums for conventional insurance recorded a YoY increase by BD 4.7 million (3.3%) increasing from BD 142.2 million in September 2021 to BD 146.8 million in September 2022 (Table 6.3). The greatest increase was from Medical insurance by around BD 4.6 million (13.1%). The largest YoY decline was from Long-term (Life) by BD 9.8 million (26.0%). In terms of concentration, Long-term (Life), Medical and Motor business classes represented 19.0%, 26.8% and 26.4% respectively of the total gross premiums.

Net Premiums Written reflected a YoY decrease by 3.9%. The Motor class had an increase of BD 3.5 million (10.4%). On the other hand, Long term (Life) net premiums written decreased by BD 10.7 million (31.4%). Long-term (Life), Motor and Medical insurance remained the largest in terms of Net Premiums Written concentration, accounting for 25.6%, 41.0% and 25.7%.

Gross Claims decreased by 0.4% YoY in September 2022 due to a decrease in Long-term (Life) business class from BD 24.2 million in September 2021 to BD 17.3 million by September 2022. The highest share in gross claims was Motor 32.6 %, followed by Medical at 30.7%.

Net Claims on the other hand, experienced an annual increase of 5.6% from BD 49.0 million in September 2021, reaching BD 51.8 million in September 2022. Net claims for Motor insurance increased by BD 4.5 million (26.9%) and decreased for Long term (Life) by BD 4.1 million (21.9%). The concentration falls heavily within the Motor insurance class, accounting for 41.6% of the total net claims.

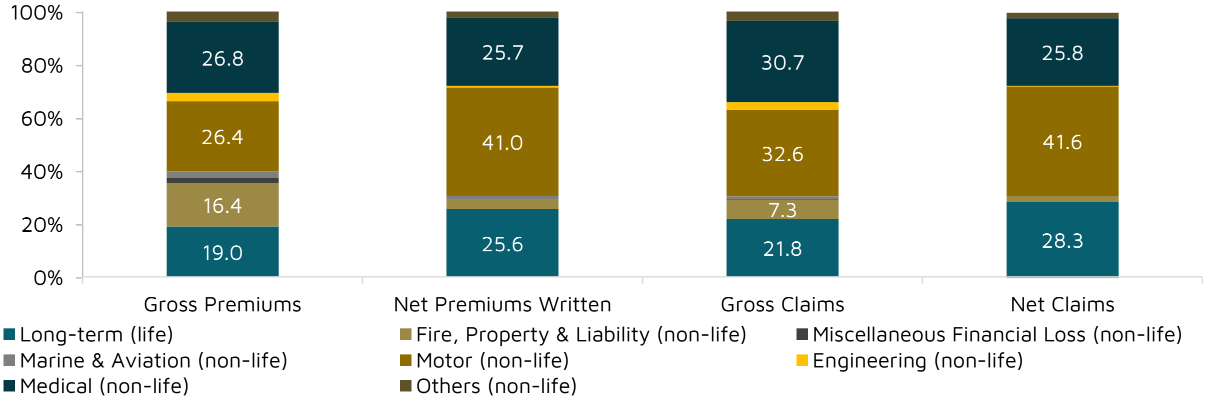
Table 6.3: Premiums and Claims for Conventional Insurance by Class

BD 000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022
Long-term (Life)	37,705	27,916	34,175	23,445	24,155	17,257	18,792	14,671
Fire, Property & Liability	22,514	24,032	2,806	3,413	7,241	5,760	23	1,217
Miscellaneous Financial Loss	1,645	2,634	56	201	297	224	31	-103
Marine & Aviation	3,305	3,808	1,057	1,035	1,521	787	87	-117
Motor	35,116	38,835	34,029	37,554	20,066	25,760	16,976	21,536
Engineering	2,664	4,576	794	643	478	2,275	-115	133
Medical	34,808	39,379	21,023	23,572	22,718	24,293	12,580	13,350
Others	4,420	5,660	1,377	1,779	2,895	2,734	627	1,067
Total	**142,177**	**146,839**	**95,318**	**91,641**	**79,370**	**79,090**	**49,002**	**51,754**

Source: CBB.

Medical had the highest exposure in Gross Premiums (26.8%). Whereas Motor insurance had the highest exposure in Net Premiums Written (25.7%), Gross Claims (32.6%) and Net Claims (41.6%).

Chart 6.4: Concentrations of Premiums and Claims for Conventional Insurance by Class (Q3 2022)



Source: CBB.

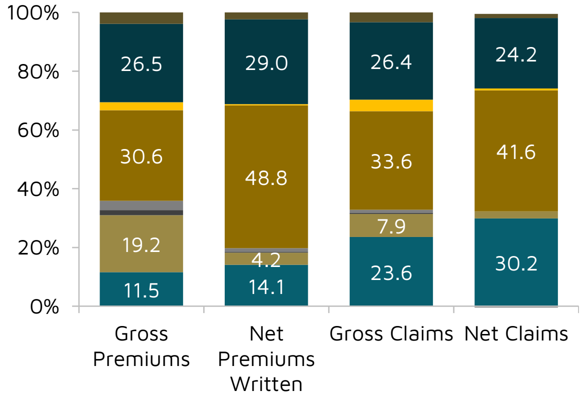
Table 6.4 below and Charts 6.5 and 6.6 shows a further division of the premiums and claims by class between Local and Overseas firms within the conventional insurance industry for September 2022.

Table 6.4: Premiums and Claims for Conventional Local and Overseas Insurance by Class (Q3 2022)

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Local	Overseas	Local	Overseas	Local	Overseas	Local	Overseas
Long-term (Life)	13,138	14,777	9,773	13,672	16,532	725	14,024	648
Fire, Property & Liability	21,967	2,065	2,892	521	5,512	248	1,105	112
Miscellaneous Financial Loss	1,958	676	174	28	219	5	-108	5
Marine & Aviation	3,637	171	884	151	785	3	-113	-4
Motor	34,971	3,864	33,811	3,743	23,548	2,212	19,341	2,196
Engineering	3,106	1,470	356	287	2,697	-422	330	-197
Medical	30,251	9,127	20,074	3,498	18,556	5,738	11,248	2,101
Others	5,087	572	1,298	481	2,323	411	658	409
Total	**114,116**	**32,723**	**69,260**	**22,381**	**70,170**	**8,920**	**46,485**	**5,270**

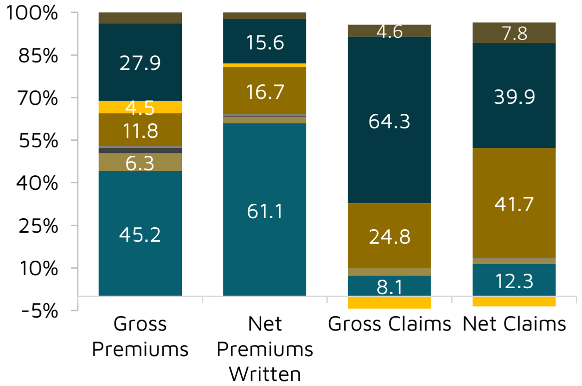
Source: CBB.

Chart 6.5: Concentrations of Premiums and Claims by Class for Local Insurance (Q3 2022)



Source: CBB.

Chart 6.6: Concentrations of Premiums and Claims by Class for Overseas Insurance (Q3 2022)



Source: CBB.

6.3.2 Takaful Insurance Firms

The Gross Premiums for Takaful companies decreased on a YoY basis by 4.9%, from BD 61.1 million at September 2021 reaching BD 58.1 million in September 2022. The largest

increase was attributed to Miscellaneous Financial Loss increasing by BD 0.5 million (24.9%). Medical insurance had a decline of BD 1.6 million (6.7%). Medical insurance line was the highest contributor towards Takaful gross premiums, accounting for 37.5% of gross premiums.
Net Premiums Written decreased by 10.9% from September 2021 to September 2022, reaching BD 35.5 million. Motor and Medical insurance accounted for the largest components in terms of gross claims, representing 44.0% and 42.0%of the total net premiums written.

Gross Claims increased by 9.6% compared from September 2021 to September 2022, with Fire, Property & Liability registering the largest increase (BD 1.5 million) within the same period. Medical and Motor insurance accounted for the largest components in terms of gross claims, representing 45.0% and 39.3% of the total gross claims.

Net Claims recorded an annual increase of 8.3% at September 2022, with Motor insurance having the largest increase recorded at 10.4%. Furthermore, Medical and Motor represent the largest components of net claims, accounting for 50.7% and 43.8% from the total respectively.

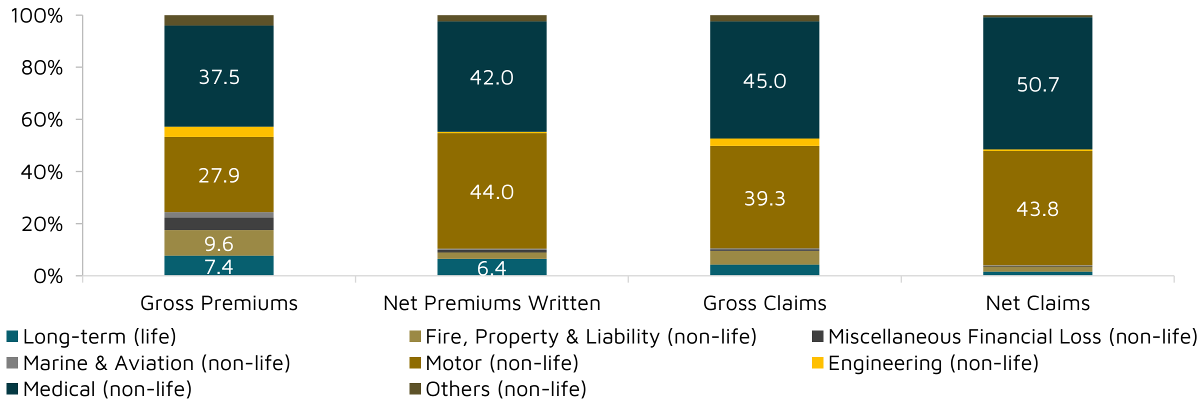
Table 6.5: Premiums and Claims by Class for Takaful Insurance Firms

BD '000	Gross Premiums		Net Premiums Written		Gross Claims		Net Claims	
	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022	Q3 2021	Q3 2022
Long-term (Life)	4,977	4,327	3,090	2,266	1,583	1,269	486	406
Fire, Property & Liability	6,327	5,551	846	888	77	1,552	164	497
Miscellaneous Financial Loss	2,146	2,680	229	351	109	185	(93)	66
Marine & Aviation	1,155	1,211	130	145	84	101	52	73
Motor	17,683	16,198	16,918	15,607	10,780	11,538	10,147	11,205
Engineering	2,076	2,253	164	199	212	824	96	138
Medical	23,365	21,806	17,696	14,911	12,575	13,226	12,480	12,967
Others	3,397	4,079	741	1,100	1,401	701	270	204
Total	**61,127**	**58,104**	**39,815**	**35,467**	**26,820**	**29,396**	**23,603**	**25,557**

Source: CBB.

Takaful insurance companies have very high concentration on the Medical and Motor Insurance business lines. Gross Premiums for both sectors combined represent (65.4%), Net Premiums Written (86.0%), Gross Claims (84.3%), and Net Claims (94.5%).

Chart 6.7: Concentrations of Premiums and Claims by Class for Takaful Insurance Firms (Q3 2022)



Source: CBB.

6.3.3 Retention Ratio and Loss Ratio (By Class)

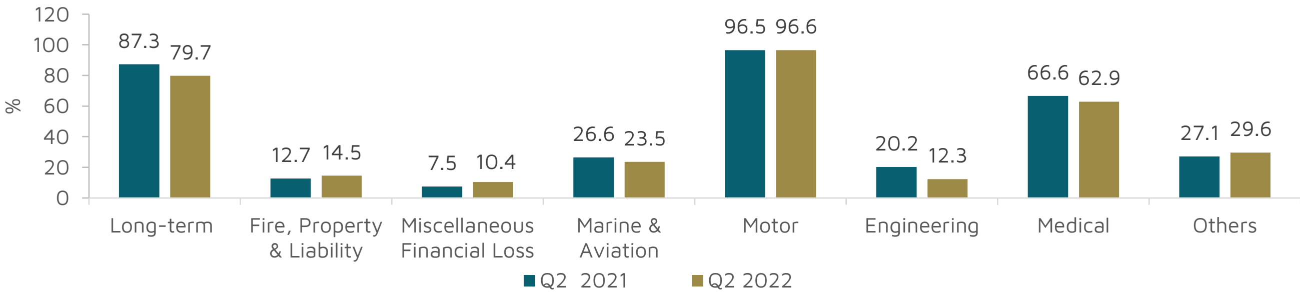
Life insurance business line registered a retention ratio of 79.7% in September 2022. Observing the non-life insurance, Medical and Motor, that accounted for 56.8% of the total Gross Premiums in September 2022 respectively, registered retention ratios of 96.6% for Motor and 62.9% for Medical. Nevertheless, retention ratios were significantly lower for other business lines such as Miscellaneous Financial Loss and Engineering, registering 10.4% and 12.3 % respectively.

Table 6.6: Retention and Loss Ratios of Overall Insurance Sector

%	Retention Ratio [1]		Loss Ratio [2]	
	Q3 2021	Q3 2022	Q3 2021	Q3 2022
Long-term	87.3	79.7	56.0	65.5
Fire, Property & Liability	12.7	14.5	5.0	37.1
Miscellaneous Financial Loss	7.5	10.4	-18.2	-9.4
Marine & Aviation	26.6	23.5	13.0	-3.8
Motor	96.5	96.6	52.4	60.8
Engineering	20.2	12.3	-2.7	35.8
Medical	66.6	62.9	72.3	73.2
Others	27.1	29.6	46.8	54.5

1. *Net Premiums Written / Gross Premiums*
2. *Net Claims Incurred / Net Premiums Earned*
Source: CBB.

Chart 6.8: Retention Ratios of Insurance Sector



Source: CBB.

6.4 Regulatory Changes, Market trends and Risks.

The CBB has continued to take proactive approach towards achieving its mandated objectives towards the Insurance Sector with consideration of all stakeholders. The below demonstrates the list of initiatives taken to further develop the market for the benefit of all stakeholders:

- Reducing Outsourcing requirements to bolster business dealings and innovation;
- Strengthened Cybersecurity requirements, in light of recent cyber security risks;
- Proactively monitoring the implementation of International Financial Reporting Standard (IFRS) 17;
- Amended CBB Reporting Requirement, in order to obtain timely prudential data;
- Employment of In-House Bahraini Actuaries, in order to anchor the important of the function & enhance local human capital wealth;
- Digitalizing Motor Insurance Process, in order to elevate people's experience;
- Digitalization of Medical Claim Process, in order to elevate people's experience;
- Assessing customers' feedback and experience post the implementation of assigning the Mutually Resolved Minor Accident to the Insurance Firms in order to elevate their experience.
- Reviewing the existing requirements of the Appointed Representatives to efficiently facilitate their registration process.

7 PERFORMANCE OF CAPITAL MARKETS

HIGHLIGHTS

# of Companies	All Share Index	Islamic Index
42 EY 2022	1,895.27 ▲ 5.5% H2 2022	663.13 ▼ 11.8% H2 2022
Market Capitalization	**Value of Transactions**	**Volume of Transactions**
BD 11.4 bn ▲ 3.0% YoY	BD 57.9 mn H2 2022	189.0 mn H2 2022

- Increase in Bahrain All Share & decrease in Bahrain Islamic Index.
- Bahrain Bourse's market capitalization stood at BHD 11.4 billion in H2 2022, increasing by 5.5%.
- Financials Sector dominated the market trading activity as it had the highest value traded.
- Bahrainis represented 65.1% of the value of shares bought and 66.8% of value of shares sold during second half 2022.

7.1 Overview

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

In 2002, Bahrain expanded and centralized the scope of the financial sector regulatory supervision to encompass capital markets under 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", CBB became responsible for Bahrain's capital markets with a combination of rule and principle based regulatory framework.

As of end of second half 2022, Bahrain Bourse recorded a total listing of 42 Companies, 3 Mutual Funds, 18 Bonds and Sukuk and one REIT. During the second half of 2022, there were 11 companies that closed higher and 20 closed lower and 10 remained unchanged. Financials sector remains the dominant sector in Bahrain Bourse in terms of market capitalization and trading activity accounting for 46% of total value traded during second half 2022 and making up 74% 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, ALBH BATELCO, and BBK represent 75% of the total market.

7.2 Bahrain Bourse

7.2.1 All Share Index and Islamic Index Overview

Increase in market index

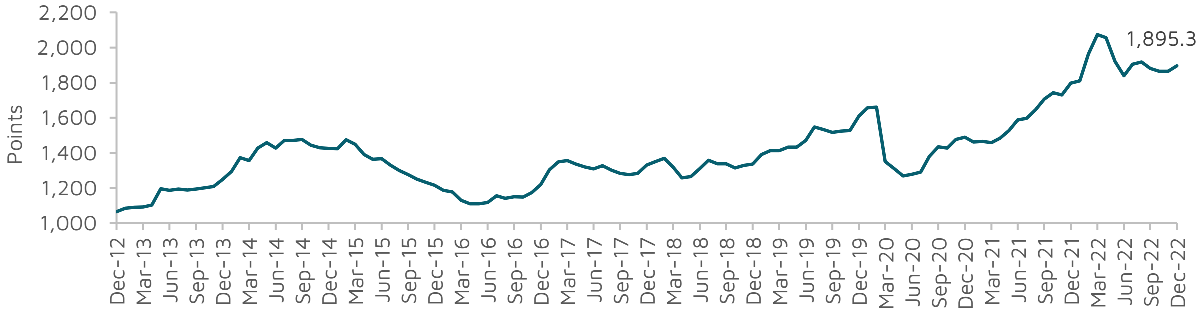
Bahrain All Share Index increased by 5.5% during second half 2022 year to date. The index increased during the second half of the year with the lowest month-end close level recorded being in October, and the highest month end close was recorded in August.

Table 7.1: Key Indicators of Bahrain Bourse

Indicator	2018	2019	2020	2021	2022
All Share Index	**1,337.3**	**1,610.2**	**1,489.8**	**1,797.3**	**1,895.3**
Highest	1,369.9	1,610.2	1,668.7	1,797.3	1,918.0
Lowest	1,257.9	1,391.4	1,232.4	1,447.6	1,839.6
Market Capitalization (BD, million)	8,198.5	10,134.6	9,277.3	10,815.5	11,408.9
Total Value (BD million)	323.8	286.4	212.8	195.7	160.6
Total Volume (million)	1,441.1	1,157.3	1,209.3	1,018.3	517.3
No. of Transactions	19,225	20,712	19,309	21,001	17,190
No. of Companies Listed	43	44	44	42	43

Source: Bahrain Bourse.

Chart 7.1: Bahrain All-Share Index, Dec. 2012 – Dec. 2022



Source: Bahrain Bourse.

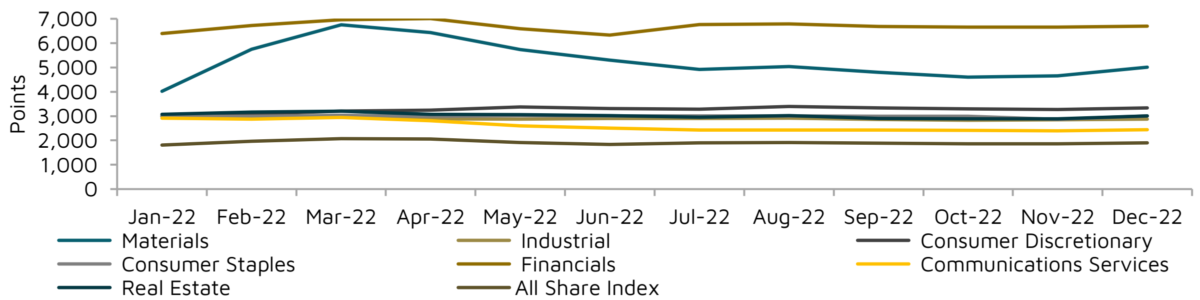
Bahrain Bourse's earlier sector industry classification had been in place since the establishment of Bahrain Bourse in 1987. The decision to reclassify current industrial sectors aims to enhance transparency and provide more reliable information on sector performance that is aligned to international best practices.

Table 7.2: Bahrain All Share Index by Sector

	H1 2022	H2 2022
Materials	5,306.3	5,007.7
Industrials	2,908.5	2,871.2
Consumer Discretionary	3,312.8	3,333.0
Consumer Staples	3,003.1	3,003.9
Financials	6,329.9	6,691.2
Communications Services	2,507.1	2,437.1
Real Estate	3,025.4	3,008.3

Source: Bahrain Bourse.

Chart 7.2: Sector Indices Levels & Returns, Jan. 2022 – Dec. 2022

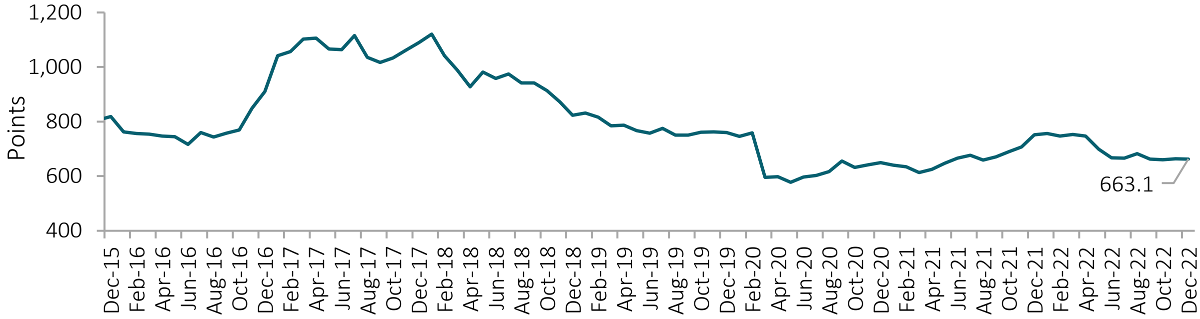


Source: Bahrain Bourse.

PERFORMANCE OF CAPITAL MARKETS

In September 2015, Bahrain Bourse launched the Bahrain Islamic Index. It was the first Islamic finance index in the region, and 14 Shariah compliant companies are included within the index as of second half of 2022. YTD data demonstrates that the Bahrain Islamic Index decreased by 0.7% between July 2022 and December 2022 reaching 663.13 points.

Chart 7.3: Bahrain Islamic Index, Dec. 2015 – Dec. 2022



Source: Bahrain Bourse.

7.2.2 Bahrain Bourse Trading Statistics

Increase in market capitalization

As of second half of 2022, market capitalization of the Bahrain Bourse stood at BD 11.4 billion. This level of market capitalization is 3.0% higher from the first half of 2022.

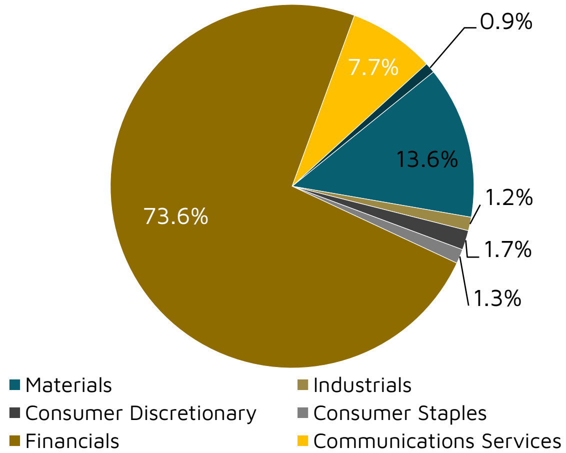
Table 7.3: Market Capitalization on the Bahrain Bourse

Sector (BD)	H1 2022	H2 2022	(% Change)
Materials	1,640,100,000	1,547,800,000	-5.6
Industrials	138,880,000	137,100,000	-1.3
Consumer Discretionary	197,055,918	198,256,972	0.6
Consumer Staples	146,218,178	146,255,232	0.0
Financials	7,945,112,635	8,398,661,786	5.7
Communications Services	901,602,966	876,430,856	-2.8
Real Estate	104,975,971	104,381,971	-0.6
Total	**11,073,945,668**	**11,408,886,817**	**3.0**

Source: Bahrain Bourse.

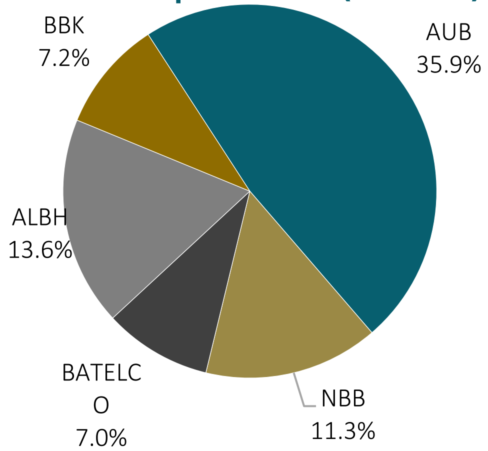
A breakdown of market capitalization by sector indicates that the Financials sector scored the highest increase in market capitalization (5.7%) during the second half of 2022. The Materials sector recorded the highest percentage decrease in market capitalization with a 5.6% decrease during the second half of 2022.

Chart 7.4: Market Capitalization by Sector (H2 2022)



Source: Bahrain Bourse.

Chart 7.5: Largest 5 companies by Market Capitalization (H2 2022)



Source: Bahrain Bourse.

Ahli United Bank is the largest company in terms of Market Capitalization and contributes 35.9% of the total market capitalization as of second half 2022. Aluminum Bahrain has the second largest share of Market Capitalization of 13.6% and it is followed by National Bank of Bahrain with 11.3%, Bank of Bahrain and Kuwait with 7.2% and Bahrain Telecommunication Company with 7%.

Table 7.4: Largest 5 Companies by Market Capitalization (H2 2022)

Company	Market Capitalization (BHD)	% from Total Market
Ahli United Bank (AUB)	4,093,498,136	35.88
Aluminum Bahrain (ALBH)	1,547,800,000	13.57
National Bank of Bahrain (NBB)	1,293,722,852	11.34
Bank of Bahrain and Kuwait (BBK)	823,850,481	7.22
Bahrain Telecommunication Company (BATELCO)	798,336,000	7.00
Total	**8,557,207,469**	**75.00**

Source: Bahrain Bourse.

Most of the value of shares traded during the second half of 2022 was in the Financial sector whose traded shares (by value) represented 39.4% of total value.

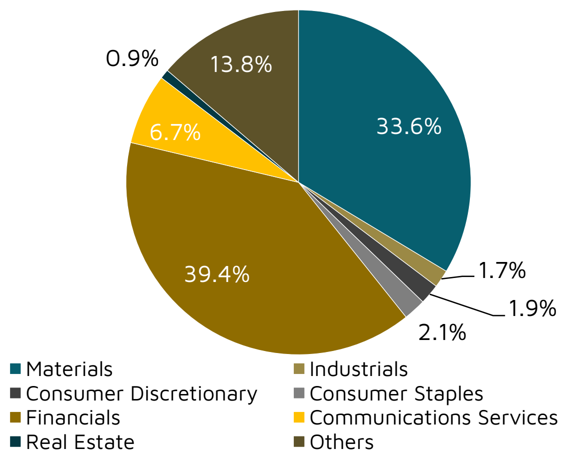
Table 7.5: Value of Shares Traded by Sector (% of Value of all shares traded)

Sector	H1 2022	H2 2022
Materials	39.4	33.6
Industrials	1.4	1.7
Consumer Discretionary	1.0	1.9
Consumer Staples	0.3	2.1
Financials	49.3	39.4
Communications Services	7.6	6.7
Real Estate	1.0	0.9

Source: Bahrain Bourse.

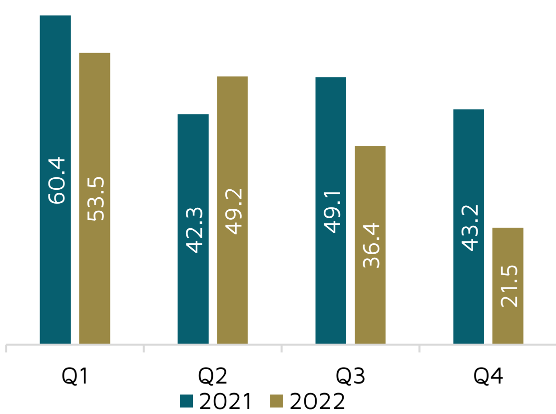
The Materials sector represents the second largest level at 33.6% of the total value of shares traded in the second half of 2022. Investors' interest in Real Estate sector was the least during this period with traded shares by value represented only 0.9% of the total value of traded shares. During the second half of 2022, the value of shares traded was highest in August and the lowest was in December, and the average value of shares traded during the year for a month was BD 9.6 million.

Chart 7.6: Value of Shares Traded by Sector (% of Value of all shares traded) (H2 2022) *



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

Chart 7.7: Value of Shares Traded Comparison



Source: Bahrain Bourse.

The bulk of the volume of shares traded in second half 2022 was also in the Financial sector representing 72.7% of the total volume of shares traded, followed by the Materials sector at 11.2%. The lowest level was attained by the Consumer Discretionary sector at 2.1%.

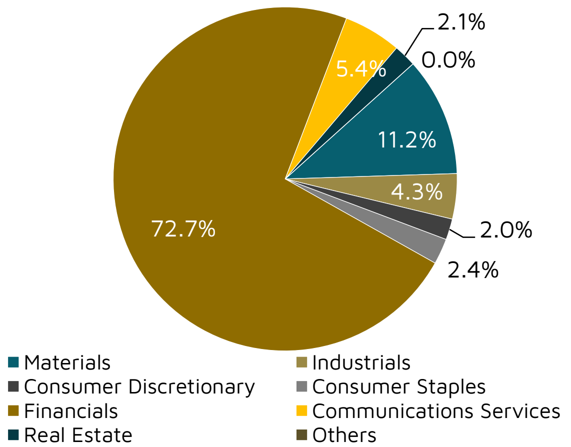
Table 7.6: Volume of Shares Traded by Sector (% of Volume of all shares traded)

Sector	H1 2022	H2 2022
Materials	10.0	11.2
Industrials	1.0	4.3
Consumer Discretionary	0.9	2.0
Consumer Staples	0.2	2.4
Financials	80.4	72.7
Communications Services	5.8	5.4
Real Estate	1.8	2.1

Source: Bahrain Bourse.

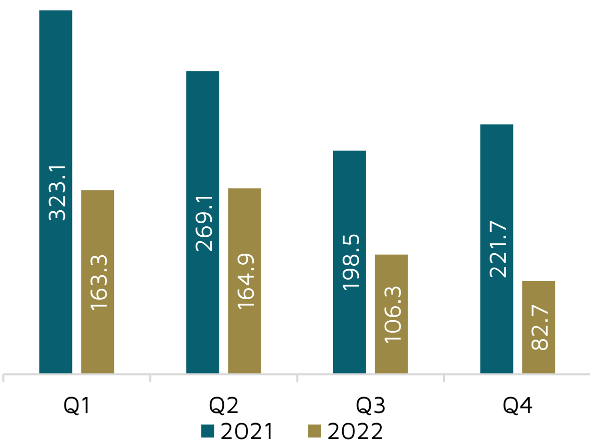
During the second half of 2022, the volume traded was highest in October and the lowest was in December, and the average volume traded during the year for a month was 34.2 million shares.

Chart 7.8: Volume of Shares traded by Sector (% of Volume of all shares traded) (H2 2022) *



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

Chart 7.9: Volume of Shares Traded Comparison



Source: Bahrain Bourse.

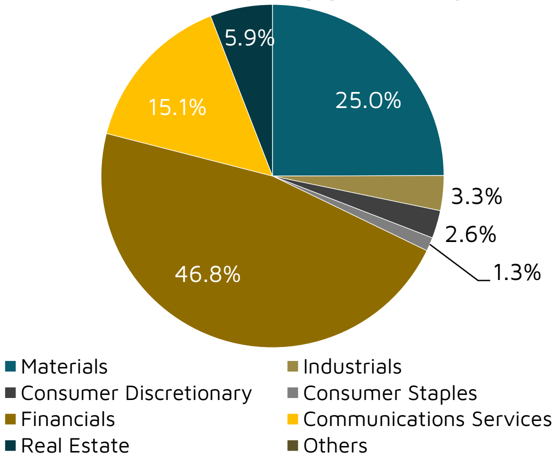
During the second half of 2022, the market executed 6,355 transactions. Most of the transactions were executed by the Financials sector at 2,976 transactions (47% of all transactions), followed by the Materials at 1,586 transactions (25%), and the Communications Services sector at 961 transactions (15%).

Table 7.7: Number of Transactions by Sector

Sector	H1 2022	H2 2022
Materials	2,996	1,586
Industrials	245	209
Consumer Discretionary	219	167
Consumer Staples	111	82
Financials	5,323	2,976
Communications Services	1,501	961
Real Estate	440	374
Total Market	10,835	6,355

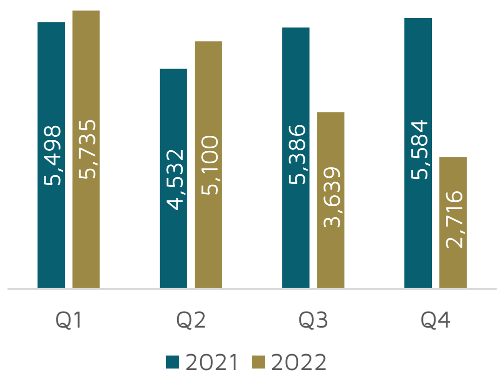
Source: Bahrain Bourse.

Chart 7.10: Number of Transactions (% of all transactions) (H2 2022) *



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

Chart 7.11: Number of Transactions Comparison



Source: Bahrain Bourse.

Trading by nationality

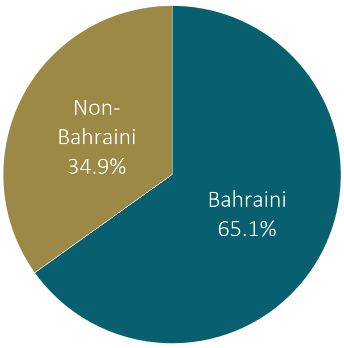
As of second half 2022, non-Bahraini nationals contributed to 35% of the value of shares bought while Bahraini nationals contributed the remaining 65% of the value of shares bought. As for sell-side of the transactions, Non-Bahraini nationals contributed to 33% of the value of shares sold while Bahraini nationals contributed to 67% of the remaining value of shares sold.

Table 7.8: Value of Transactions by Nationality (BD million)

	H1 2022		H2 2022	
	Bahraini	Non-Bahraini	Bahraini	Non-Bahraini
Buy	73.0	29.6	43.7	23.4
Sell	66.5	36.1	44.9	22.3

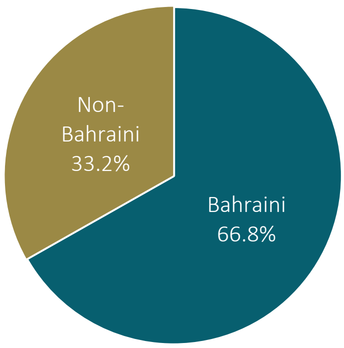
Source: Bahrain Bourse.

Chart 7.12: Share of Trading Value of Buy transactions by nationality (H2 2022)



Source: Bahrain Bourse.

Chart 7.13: Share of Trading Value of Sell transactions by nationality (H2 2022)



Source: Bahrain Bourse.

GCC Indices

Only half of the GCC major equity markets indices recorded positive returns during second half of 2022 compared to the first half of 2022. The largest increase was recorded by Muscat Securities Market Index 30 at 17.8%, followed by Abu Dhabi Exchange General Index with an increase of 8.9%.

Table 7.9: Stock Market Indices in GCC Counties

Index	H1 2022	H2 2022	(% Change)
Bahrain All Share Index	1,839	1,895	3.0
Kuwait All Share Index	7,409	7,292	-1.6
Dubai Financial Market General Index	3,223	3,336	3.5
Tadawul All Share Index	11,523	10,478	-9.1
Abu Dhabi Exchange General Index	9,375	10,211	8.9
Qatar Exchange Index	12,191	10,681	-12.4
Muscat Securities Market Index 30	4,123	4,857	17.8

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

7.2.3 Economic Recovery Plan and Capital Markets Development Strategy

In December 2021, the Government of Bahrain has initiated the economic recovery plan, part of which aims to greatly contribute in making Bahrain Bourse a regional financial market. With the support of the CBB, Bahrain Bourse continues to develop its operations in order to develop the financial services sector, benefit the national economy, provide more quality job opportunities, and attract investments.

The CBB is working with Bahrain Bourse to implement a set of priorities and initiatives in partnership with the relevant parties, specifically in areas that will develop the performance of the financial market sector. The initiatives include encouraging initial public offerings and listing of companies, including government-owned companies, and enhancing ways for coordination of dual listing with other GCC countries. Efforts are also focused on encouraging small and medium-sized companies to list in the Bahrain Investment Market (BIM), where the main performance indicator specified for this initiative is the listing of 5 new companies on the BIM during the next five years.

The strategy also aims to develop the financial market by supporting Bahrain in joining the emerging markets index, which would stimulate investment and support intermediaries in a way that contributes to expanding the number of investors and improving liquidity levels. It is also worth noting that the CBB is currently working with Bahrain Clear to enhance ways of coordinating and linking clearing, settlement and central depository systems regionally and internationally, which aims to facilitate and enable investors to access the market of both parties by removing borders as much as possible. Further, Bahrain Bourse and Bahrain Clear are currently working on various areas to automate the services provided to investors, including the application of the digital onboarding mechanism to attract investors and facilitate the trading process and its related services.

7.2.4 Tabadul Project

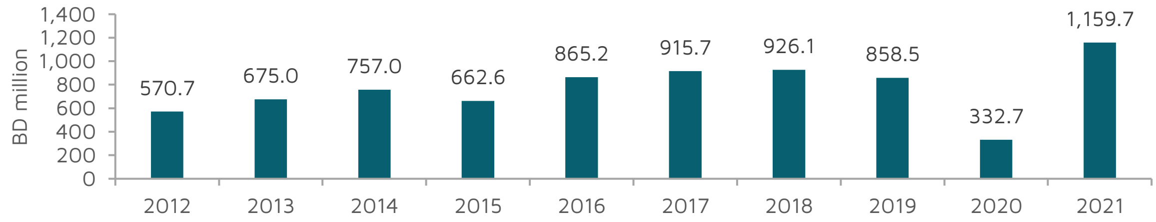
In July 2022, Bahrain Bourse, in cooperation with Abu Dhabi Securities Exchange, has launched "Tabadul", a digital exchange hub. Tabadul was the result of the signed strategic partnership agreement in November 2021 between the two parties to implement a cross-border plan in trading and post-trading environments. Based on the mutual market access model, Tabadul will allow investments across Bahrain Bourse and Abu Dhabi and enable investors to trade directly on both exchanges through licensed brokers in both markets, aiming to result in synergies, enhanced market liquidity and promoting innovative products and services as well as facilitate trading of investors in both markets and support sustainable growth. In October 2022, a cooperation agreement was also signed between Bahrain Bourse and Muscat Stock Exchange, in which Muscat Stock Exchange will join "Tabadul" platform to link both markets and enable direct trading on Bahrain Bourse and Muscat Stock Exchange.

7.3 Market Resilience

Boost in corporate profitability

The overall profitability of the Bahraini Bourse increased by 249% to BD 1,159.7 million in 2021 from BD 332.7 million in 2020. Return on assets increased to 1.7% in 2021, while return on equity increased to 11.2% in 2021 compared to 3.4% in 2020.

Chart 7.14: Stock Market Net Income



Source: Bahrain Bourse.

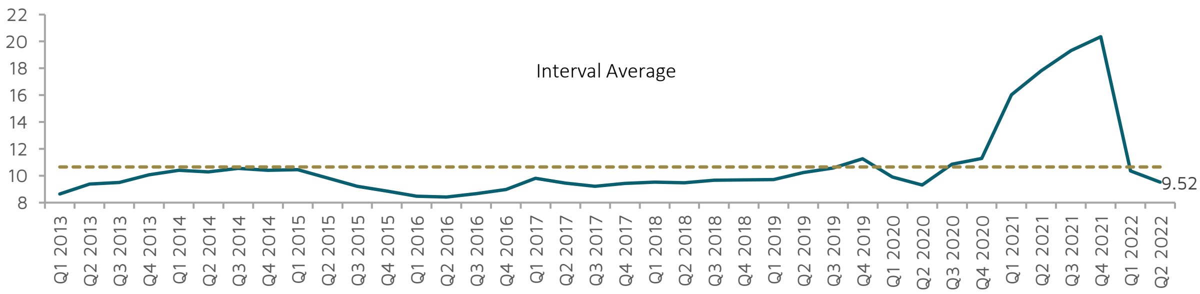
As at December 2021, the total market P/E ratio increased to 20.35 from 16.40 in 2020.

Table 7.10: Price-Earnings Multiples

Sector	2020	2021
Materials	N/A	2.51
Industrials	N/A	-57.97
Consumer Discretionary	N/A	27.79
Consumer Staples	N/A	12.98
Financials	N/A	14.36
Communications Services	N/A	13.38
Real Estate	N/A	20.32
Total Market	**16.40**	**20.35**

Source: Bahrain Bourse.

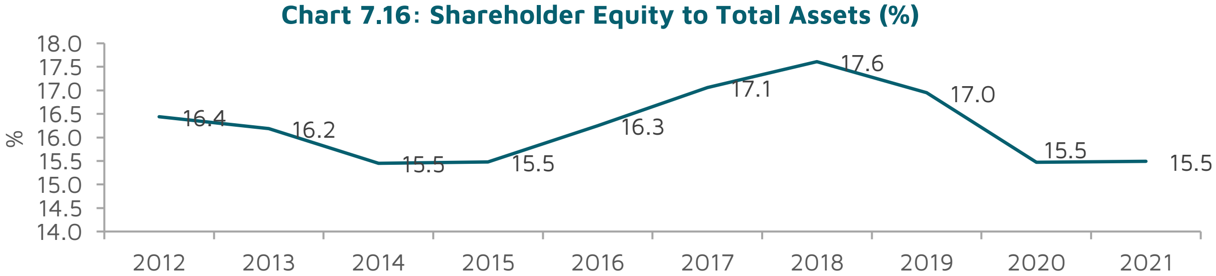
Chart 7.15: Total Market Price-Earnings Multiples



Source: Bahrain Bourse.

The overall equity-to-assets ratio remained at 15.5% in 2021. The Financials sector has the lowest equity/assets ratio due to the high leverage nature of the sector (Chart 7.17 & 7.18).

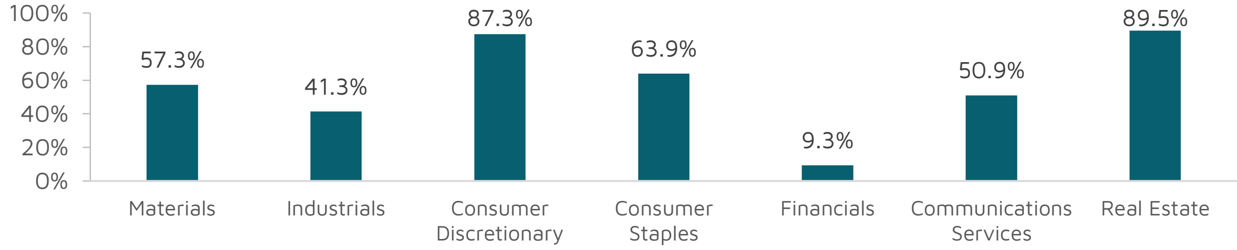
Chart 7.16: Shareholder Equity to Total Assets (%)



Source: Bahrain Bourse.

PERFORMANCE OF CAPITAL MARKETS

Chart 7.17: Shareholder Equity/Total Assets by Sector (2021)



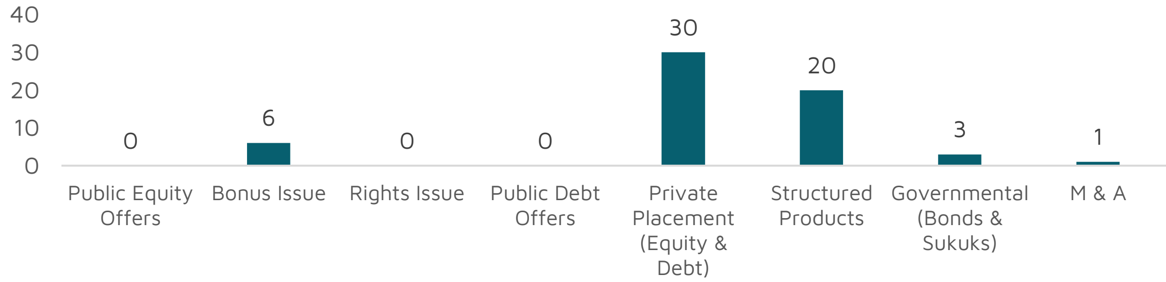
Source: Bahrain Bourse.

7.4 Capital Market Activities

7.4.1 Offering of Securities

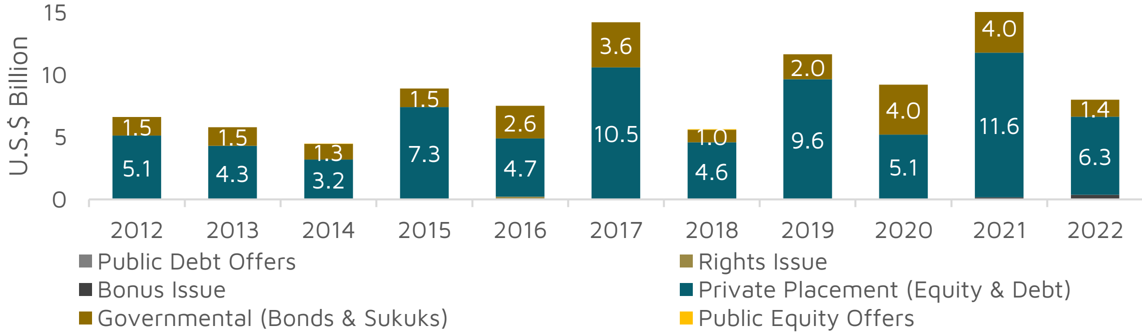
As at December 2022, CBB issued its no objection to the issuance of 53 offering documents. The total value of issuances reached USD 7.6 billion. (Chart 7.18 & 7.19).

Chart 7.18: Number of Capital Market Activities



Source: CBB.

Chart 7.19: Total Issuance Value



Source: CBB.

7.4.2 Mergers and Acquisitions

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

KFH announced on 25th July 2022 its firm intention to make an offer to acquire up to 100% of the issued and paid-up ordinary shares of AUB, by way of a share exchange at a ratio of 2.695 AUB shares for each KFH share. KFH also published its offer document on the same date.

The Offer Documents, which include the Offer Document issued by KFH, the Offeree Board Circular issued by AUB's Board of Directors, and the report of the independent professional advisor, were sent to AUB's shareholders and were published on the websites of AUB, KFH, Bahrain Bourse and Boursa Kuwait on 15th August 2022 in accordance with the requirements of the Takeovers, Mergers and Acquisitions (TMA) Module, Volume 6 of the CBB Rulebook.

The Offer opened for acceptances on 24th August 2022 for an initial offer period ending on 7th September 2022. KFH announced the Offer unconditional in all respects on 8th September 2022, having received acceptances representing 96.107% and that the offer will remain open for acceptances until 23rd September 2022 in accordance with the requirements of the TMA Module.

The CMSD provided its no objection to proceed with the settlement of the offer to KFH on 29th September 2022, and upon completing and obtaining all the necessary procedures and approvals, KFH was cross-listed on Bahrain Bourse on 6th October 2022.

Moreover, upon the expiry of the regulatory 60-day objection period given to the dissenting shareholders to object to the compulsory acquisition of their shares, and considering that no such objections were made, KFH settled the offer on 20th November 2022 after obtaining the CMSD no objection on 16th November 2022. Accordingly, KFH completed the acquisition of 100% of the issued ordinary shares of AUB.

7.5 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, CBB; through the requirements stipulated under Module of CBB Rulebook Volume 6 requires Licensees to have in place a well-designed Disaster Recovery Plan and 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 crypto-asset services. Crypto-asset service providers are required to test their IT infrastructures and core systems to verify the robustness of the security control measure that is in place to prevent security breaches, including penetration testing and vulnerability assessment undertaken by reputable third-party cyber security consultants to be conducted each year in June and December. In addition, Capital Markets licensees are mandated to maintain relevant systems in place for mitigating and managing operational and other risks.

FinTech solutions 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, 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.

Among the shared goals of CBB and the Bahrain Bourse presently 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 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 CBB tackles.

As of December 2022, 6 of the 42 listed companies on Bahrain Bourse were cross-listed outside of Bahrain, leading to challenges faced by CBB in maintaining the cross-listed companies' compliance with the capital market regulations of Bahrain. 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.

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.

7.6 Developments in Regulation and Initiatives

The CBB actively takes part in joint work meetings of the GCC Council's Capital Market Authorities (or their equivalent) that aim to harmonize the rules and regulations for the capital markets in the GCC and actively participates in the organization and management of a number of bilateral economic cooperation initiatives between the Kingdom of Bahrain and the Kingdom of Saudi Arabia as approved by the Saudi-Bahraini Coordination Council. In addition, CBB manages its international cooperation within the capital markets. Such international cooperation enables the CBB to better protect investors, promote investor confidence, maintain fair, efficient, and transparent markets and address systemic risks; by utilizing information exchange to cooperate in developing, implementing, and promoting adherence to internationally recognized and consistent standards of regulation, oversight, and enforcement.

During 2022, CBB endeavored to develop and complete the capital markets regulatory and legal frameworks, including Volume 6 of 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 during 2022:

7.6.1 Policy and Regulatory Developments

- **Amendments to the Takeovers, Mergers and Acquisitions ("TMA") Module of Volume 6 of the CBB Rulebook**: CBB issued a circular (Ref. OG/34/2022) dated 19 January 2022 addressed to all listed companies in relation to the amendments to the Takeovers, Mergers and Acquisitions (TMA) Module, Volume 6 of the CBB Rulebook. Such amendments are in relation to the compulsory acquisition in accordance with the amendments to the Commercial Companies Law by Decree Law No. (28) of 2020 amending some provisions of the Commercial Companies Law promulgated by Decree Law No. (21) of 2001
- **The Anti-Money Laundering and Combating Financial Crime ("AML") Module of Volume 6 of the CBB Rulebook:** The AML Module has been amended in January 2022 to include updates pertaining to customer due diligence requirements, digital on-boarding, and risk-based approach, amongst other areas.
- **The Markets and Exchanges ("MAE") Module of Volume 6 of the CBB Rulebook**: Amendments have been issued to the MAE Module in April 2022 to reflect the shift in equity crowdfunding operators' requirements following the issuance the Crowdfunding Platform Operators (CPO) Module under Volume 5 of the CBB Rulebook.
- **Crypto-Asset ("CRA") Module of Volume 6 of the CBB Rulebook**: The CRA Module has been issued for consultation in August 2022 with amendments made to strengthen the regulatory framework in line with developments in the sector and international best practices, including the introduction of requirements relating to digital token offerings and amendments to crypto-asset listing requirements.

7.6.2 Investor Protection Initiatives

- The Capital Market Authorities in the GCC formed the investor awareness program 'Mulim', which was launched as long-term Gulf program to raise Capital Market awareness. The program commenced in February 2022 and aims to raise awareness of the culture of financial transactions and investment in the capital markets, through a number of awareness programs and events. Two of the initiatives of the program are the Gulf investor week and the GCC Smart Investor Award, which opens the door for participation to citizens and residents of the GCC countries in order to establish creative ideas related to the culture of financial and investment transactions.

PART IV:
DEVELOPMENTS IN PAYMENT SYSTEMS, FINTECH, AND CYBER SECURITY

8 FINANCIAL MARKET INFRASTRUCTURES, PAYMENT AND SETTELEMENT SYSTEMS, POINT OF SALE, AND DIGITAL PAYMENTS

HIGHLIGHTS

Indicator	Volume	Value
RTGS Daily Average	178	BD 315.5 mn
SSSS Aggregate	45	BD 2.82 bn
ATM Daily Average	42,305	BD 4.3 mn
BCTS Daily Average	8,624	BD 30.4 mn
Fawri + Daily Average	732,608	BD 17.3 mn
Fawri Daily Average	46,019	BD 77.0 mn
Fawateer Daily Average	50,443	BD 3.9 mn
POS Transactions	77.9 mn	BD 1.9 bn

- Daily average (volume and value) for ATM Transactions decreased by 2.6% and 6.1% compared to H1 2022 continuing a decreasing trend for cash transactions.
- Daily average volume and value of cheques increased over same period by 1.2 % and 1.4% respectively.
- Daily average of volume and value of Fawri+ transactions increased by 21.08% and 6.22% respectively in H2 2022 compared to H1 2022. Daily average of volume and value of Fawri Transactions increased by 6.81% and 7.23% in H2 2022 compared to H1 2022.
- Daily average of volume and value of Fawateer Transactions increased by 10.99% and 10.33% respectively in H2 2022 compared to H1 2022.
- POS and Ecommerce transactions (volume and value) increased by 29.7% and 22.0% respectively in 2022 with contactless transactions representing 76.8% and 49.6% respectively.

8.1 Overview

The payment landscape has moved from traditional systems to digital alternatives. Technologies have been introduced that address consumer and market dynamics and support the drive towards greater autonomy and flexibility. As a regulator and facilitator, CBB has supported the introduction and structured development of advanced payment systems that have enabled the growing digitalization of the financial sector. In Bahrain and around the world, the pandemic served as a catalyst to accelerate the rapid digitalization of the payments as consumer preferences began to shift towards contactless payment.

Financial Market Infrastructures (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 in the country.

The current FMIs 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.

CBB operates, manages and oversees the national Payment and Settlement Systems in the Kingdom of Bahrain[10].In addition, CBB assess 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. The FMIs, Payment and Settlement Systems Framework continues to operate smoothly and function safely, efficiently, resiliently, and reliably, assuring to maintain the financial stability during the second half of 2022 (from 1st July 2022 to 31st December 2022).

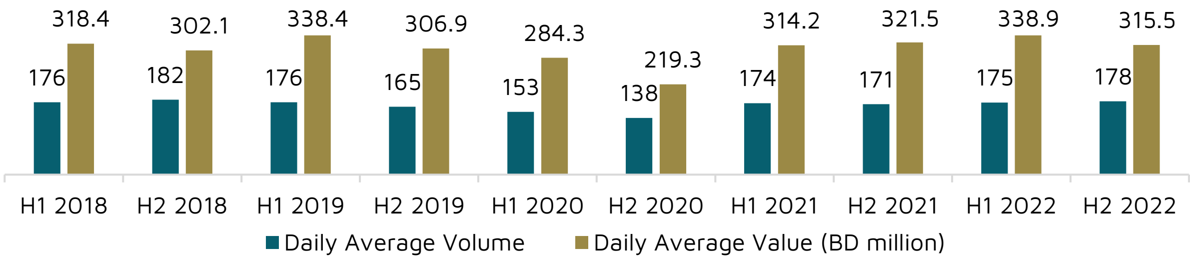
Point of Sale (POS) terminals, E-Commence and digital payments are other methods that enhance a customer's payment experience in Bahrain by providing payment solutions that support international and domestic payment schemes. Several digital wallets are established in Bahrain's FinTech ecosystem that offer various payment solutions. Seamless contactless and digital payments transactions are projected to be the prominent payment methods in the future.

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

8.2 Real Time Gross Settlement System (RTGS)

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 and 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 thirty-two (32) Participants including CBB. On Monday, 17th October 2022, Central Bank of UAE (CBUAE) joined the RTGS System as part of AFAQ.

Chart 8.1: RTGS Bank Transfers Daily Average Volume and Value



Source: CBB.

The daily average volume of Bank Transfers for H2 2022 increased slightly by 1.7% to 178 Transfers compared to 175 Transfers for H1 2022.[11] Furthermore, the daily average volume

[10] CBB operates the Real Time Gross Settlement System (RTGS) and the Scripless Securities Settlement System (SSSS), whereas BENEFIT operates the ATM Clearing System (ATM), the Bahrain Cheque Truncation System (BCTS) and the Electronic Fund Transfer System (EFTS) including the Electronic Bill Presentment and Payment (EBPP) System on behalf of CBB.

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

of Bank Transfers for H2 2022 has increased by 4.1% from 171 to 178 Transfers when compared to H2 2021.

The value of those transfers has decreased in H2 2022 by 6.9% when compared to H1 2022 from BD 338.9 million to BD 315.5 million. In addition, the daily average value of Bank Transfers for H2 2022 had decreased by 1.9% from BD 321.5 million to BD 315.5 million when compared H2 2021

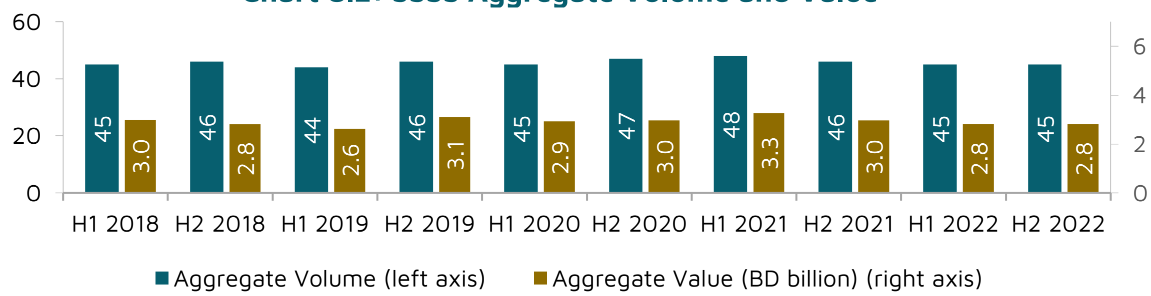
8.3 Scripless Securities Settlement System (SSSS)

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 14th June 2007 along with the RTGS System. The number of direct participants is thirty (30) participants whereas the indirect participants are twenty-nine (29) members in the SSSS.

The volume of issues H2 2022 remained the same compared to H1 2022 from 45 which is 45 issues. Moreover, the volume of issues decreased in H2 2022 compared H2 2021 by 2.17% from 46 issues to 45 issues.

The aggregate value of issues in H2 2022 remained the same which is BD 2.8 billion in H1 2022 and compared to H2 2022 value decreased by 6.7% from BD 3.0 billion.

Chart 8.2: SSSS Aggregate Volume and Value



Source: CBB.

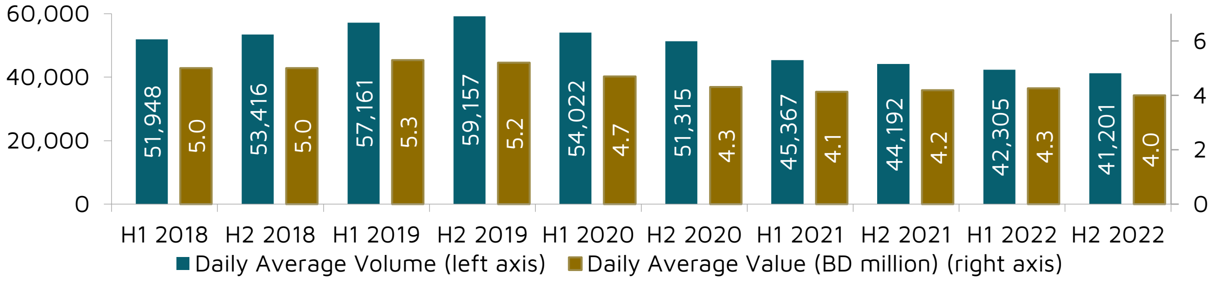
The volume of issues was within the normal range of issues which did not pose additional burden to the System's processing capacity and the risk of significant participant's failure is minimised due to executing and settling in Real Time Gross Settlement System (RTGS). The SSSS continued to operate smoothly and efficiently during the period from 1st July 2022 to 31st December 2022.

8.4 ATM Clearing System (ATM)

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

The daily average volume of ATM Transactions for H2 2022 decreased by 2.6% to 41,201 per day compared to 42,305 per day in H1 2022. In addition, the daily average volume of ATM transactions decreased by 6.7% in H2 2022 compared to H2 2021 (44,192 transactions per day). The daily average value of ATM Transactions for H2 2022 decreased by 6.1% to reach BD 4.0 million compared to the BD 4.3 million in H1 2022 and decreased by 4.5% when compared H2 2021 (BD 4.2 million).

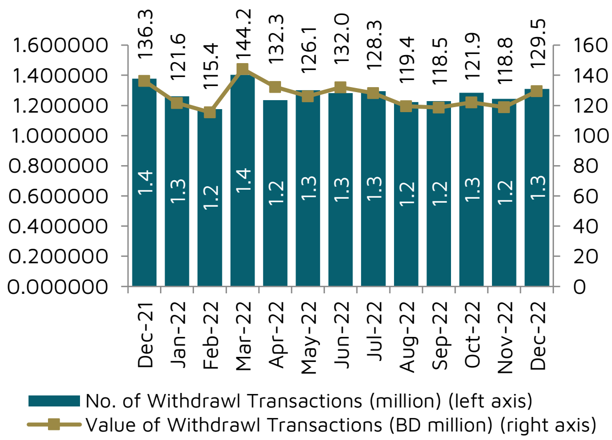
Chart 8.3: ATM Transactions Daily Average and Volume



Source: BENEFIT.

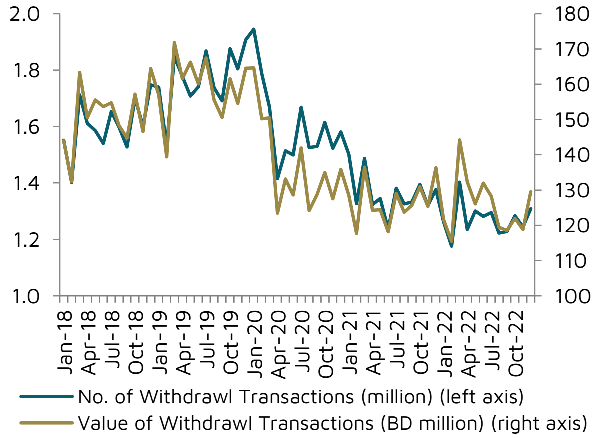
Overall, there is a continued downward trend in both the value and the volume of ATM transactions (Chart 8.5). In 2022, monthly volume of ATM transactions ranged between 1.2 and 1.4 million transactions while the value of ATM transactions ranged between BD 115.4 million and BD 144.2 million.

Chart 8.4: Number and Value of ATM Transactions, June 2021 – June 2022



Source: BENEFIT.

Chart 8.5: Number and Value of ATM Transactions



Source: BENEFIT.

8.5 Bahrain Cheque Truncation System (BCTS)

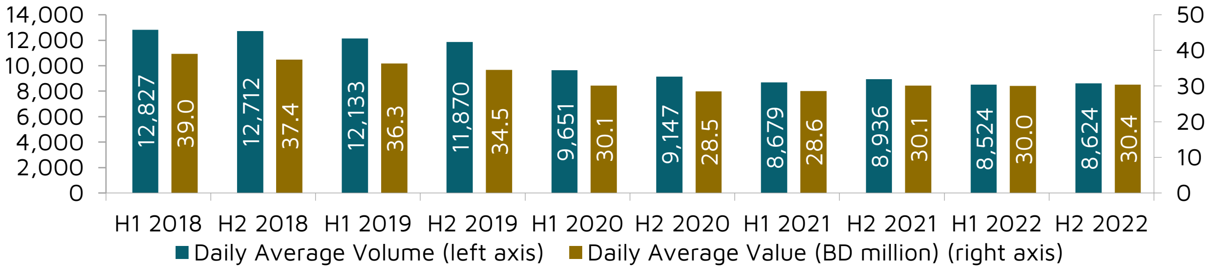
Cheques is one of the most popular instruments in use among Retail and Corporate Customers. As part of CBB vision to replace the paper based Automated Cheque Clearing System operated by CBB, the Bahrain Cheque Truncation System (BCTS) commenced its operations in co-operation with the BENEFIT Company (BENEFIT) on the 13th May 2012.

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 is 30 participants. The daily average volume of cheques for H2 2022 increased by 1.2% when compared to H1 2022 from 8,524 cheques to 8,624 cheques. However, the daily average volume of cheques in H2 2022 decreased by 3.5% from 8,936 cheques in H1 2021 to 8,624 cheques in H2 2022.

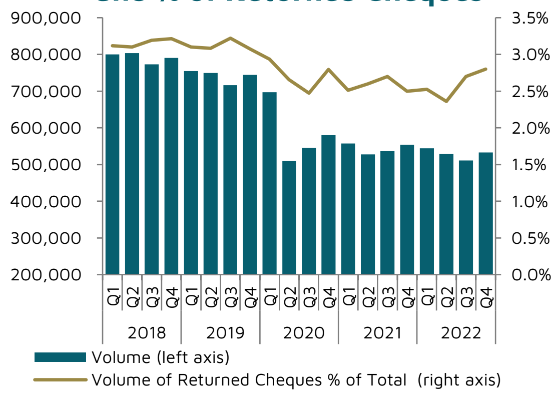
Furthermore, the daily average value of cheques increased slightly in H2 2022 by 1.4% when compared to H1 2022 from BD 30.0 million to BD 30.4 million. In addition, the daily average value of cheques for H2 2022 increased by 1.0% from BD 30.1 million for the H2 2021 to BD 30.4 million.

Chart 8.6: BCTS Daily Average Volume and Value



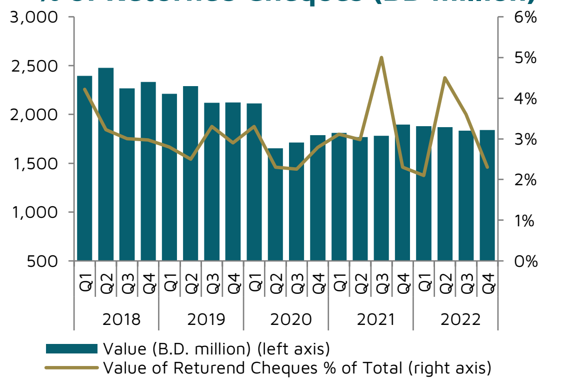
The BCTS continued to operate smoothly and efficiently for the period from 1st July 2022 to 31st December 2022. Charts 8.7 and 8.8 show the volume and value of cheques and the percentage returned cheques to the total volume and value. Between Q3 2022 and Q4 2022, returned cheques have risen from 2.7% to 2.8% as a percentage of total volume and the value decreased from 3.6% to 2.3% as a percentage of total value.

Chart 8.7: Volume of Issued Cheques and % of Returned Cheques



Source: BENEFIT.

Chart 8.8: Value of Issued Cheques and % of Returned Cheques (BD million)



Source: BENEFIT.

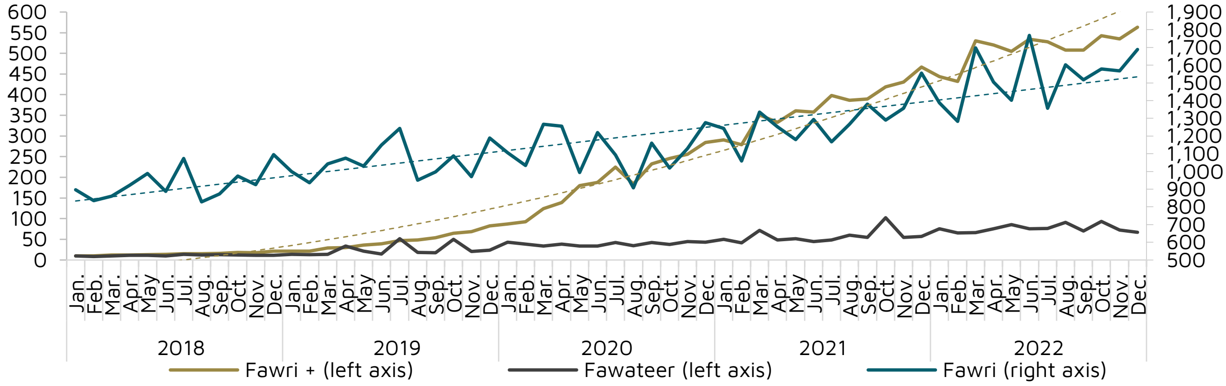
8.6 Electronic Fund Transfer System (EFTS) including Electronic Bill Presentment and Payment (EBPP) System

With the introduction of International Bank Account Number (IBAN) in January 2012, transfers became easier, less time consuming, and more secured for both customers and banks. The Electronic Fund Transfer System (EFTS) was launched on 5th November 2015 and the Electronic Bill Presentment and Payment (EBPP) System was launched on the 3rd October 2016, operated by the Benefit Company (BENEFIT) and overseen by 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 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+ and Fawri provide fund transfers service to individuals and corporates, where Fawateer provides real-time bill payments offering the public easier access and faster processes. The number of participants offering outward EFTS Services has reached twenty-six (26) participants.

Chart 8.9 shows an overall increasing trend in the monthly transfers in Fawri+, Fawri and Fawateer. The value of Fawri+ transfers increased by 7.39% from BD 2,965.3 million for H1 2022 to BD 3,184.3 million for H2 2022. The total value of Fawri transfers for H2 2022, increased by 2.97% from BD 9,041.41 million for H1 2022 to BD 9,310.1 million for H2 2022. In addition, the value of Fawateer payments increased by 5.95% from BD 443.4 million in H1 2022 to BD 469.8 million in H2 2022.

Chart 8.9: EFTS Fawri, Fawri+, and Fawateer Value (BD million)

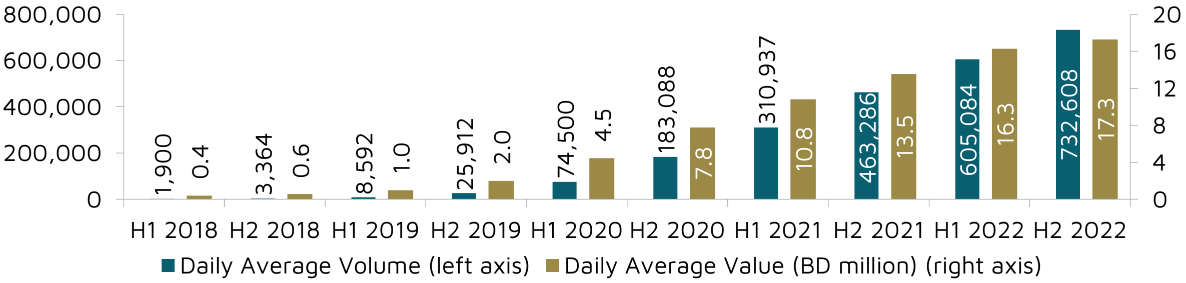


Source: BENEFIT.

The Fawri+ transfers in addition to Fawateer payments in all electronic channels including internet banking, mobile banking and BenefitPay surged during 2020, 2021 and 2022 is due to the increasing popularity and convenience in going cashless during and after the COVID-19 pandemic.

The daily average volume of Fawri+ transfers of H2 2022 when compared to H1 2022 increased significantly by 22.4% from 605,084 transfers to 732,608 transfers. Furthermore, the daily average volume of Fawri+ transfers for H2 2022 increased by 58.1% from 463,286 transfers in H2 2021. The daily average value of Fawri+ transfers increased by 6.2% from BD 16.3 million in H1 2022 to BD 17.3 million in H2 2022 and increased by 27.8% in H2 2022 when compared to H2 2021 from (BD 13.5 million).

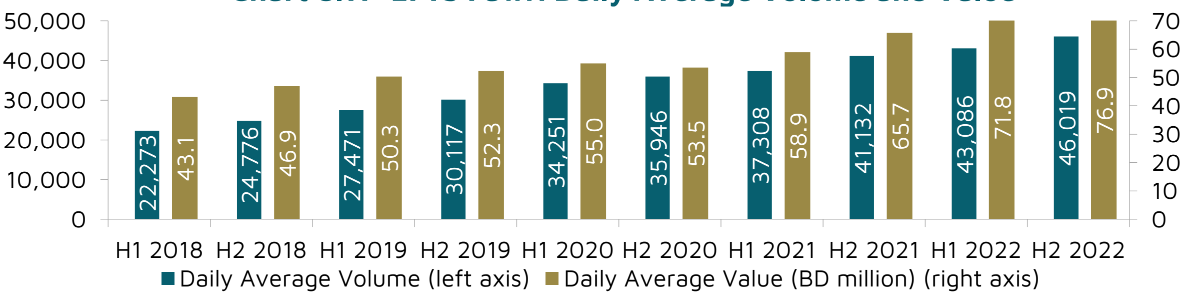
Chart 8.10: EFTS Fawri+ Daily Average Volume and Value



Source: BENEFIT.

The daily average volume of Fawri transfers in H2 2022 increased by 6.8% when compared H1 2022 from 43,086 transfers to 46,019 transfers. Moreover, the daily average volume of Fawri transfers in H2 2022 increased by 11.9% from the 41,132 transfers in H2 2021. In addition, the daily average value of Fawri transfers increased by 7.3% from BD 71.8 million in H1 2022 to BD 76.9 million in H2 2022. Furthermore, the daily average value of Fawri transfers increased by 17.1% in H2 2022, from BD 65.7 million in H2 2021 to BD 76.9 million in H2 2022.

Chart 8.11: EFTS Fawri Daily Average Volume and Value

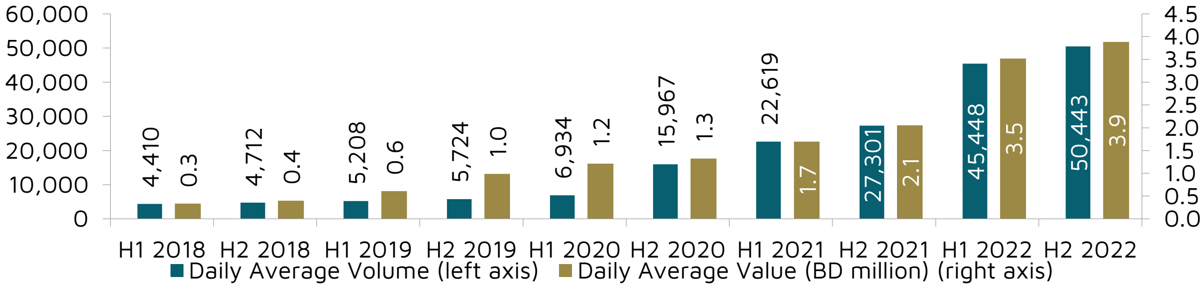


Source: BENEFIT.

The daily average volume of Fawateer Payments for the second half of 2022 increased significantly by 10.99% when compared to H1 2022 from 45,448 payments to 50,443 payments and increased by 84.8% from the 27,301 payments in H2 2021. In addition, the daily average value of Fawateer reached BD 3,882,789.950 in H2 2022 increasing by 10.33% when compared to H1 2022 (BD 3,519,374.361) and increased by 89.4% compared to H2 2021 (BD 2,050,391.525).

The EFTS including EBPP continued to operate in a safe, efficient, resilient and reliable manner from 1st July 2022 to 31st December 2022. 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.

Chart 8.12: EBPP Fawateer Daily Average Volume and Value



Source: BENEFIT.

8.7 Point of Sale (POS) and E-Commerce

POS terminals are available at most business outlets in Bahrain to create a seamless payment experience for customers for effective digital transactions. The increase in POS terminals and their utilities, combined with mobile POS helps in achieving higher financial inclusion. POS transactions in Bahrain continue to show a steady increase in both in volume and value, an indicator of strong business and economic activity within the Kingdom.
The total number of transactions for 2022 has reached 162.8 million transactions (29.7% increase compared to 2021). Similarly, the total value of transactions for 2022 increased to BD 3,844.6 million (22.0% increase compared to 2021). Both the volume and value of cards issues in Bahrain had increased in 2022 (20.1% and 14.2%) respectively when compared to 2021. The volume and value of transactions by cards issued outside Bahrain showed a significant increase in 2022 compared 2021 (91.9% and 69.8% respectively) indicating a recovery in the tourism industry and a recovery as a result of the removal of travel restrictions due to COVID-19 pandemic.

Table 8.1: Point of Sale (POS) and E-Commerce Transactions in Bahrain

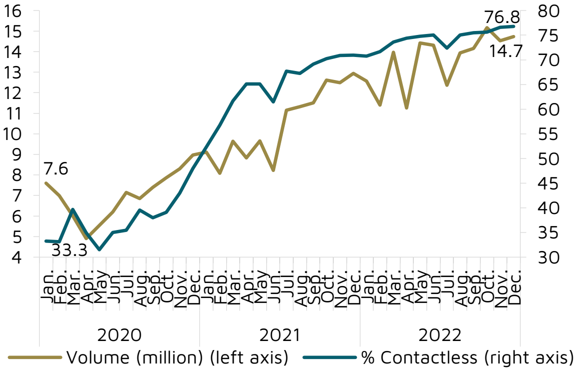
		Volume of transactions (million)			Value of transactions (BD million)		
		Cards issued in Bahrain	Cards issued outside Bahrain	Total	Cards issued in Bahrain	Cards issued outside Bahrain	Total
2018		49.0	15.4	**64.5**	1,524.1	453.2	**1,977.2**
2019		58.4	15.2	**73.7**	1,877.2	557.2	**2,434.4**
2020		77.3	6.4	**83.8**	2,124.9	217.0	**2,341.9**
2021		109.5	16.0	**125.5**	2,707.2	444.0	**3,151.2**
2022		132.1	30.7	**162.8**	3,090.8	753.8	**3,844.6**
2020	Q1	17.2	3.4	**20.6**	502.3	111.8	**614.1**
	Q2	15.9	0.8	**16.6**	447.3	25.0	**472.3**
	Q3	20.5	0.9	**21.4**	554.9	33.2	**588.1**
	Q4	23.8	1.4	**25.1**	620.5	46.9	**667.4**
2021	Q1	25.2	1.6	**26.8**	639.4	53.6	**693.0**
	Q2	24.9	1.8	**26.7**	615.3	59.0	**674.3**
	Q3	29.1	4.9	**34.0**	698.4	138.4	**836.9**
	Q4	30.4	7.7	**38.0**	754.1	193.0	**947.0**
2022	Q1	31.2	6.7	**37.9**	734.8	169.3	**904.2**
	Q2	33.1	6.9	**40.0**	800.0	175.5	**975.4**
	Q3	32.2	8.2	**40.4**	764.4	198.5	**962.9**
	Q4	35.6	8.9	**44.5**	791.5	210.5	**1,002.0**

Source: CBB.

Chart 8.13 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 continued increase in POS transactions in the second half of 2022 shows the continued trend of people preferring to make direct payments to merchants through POS terminals instead of ATM/Cash withdrawals.

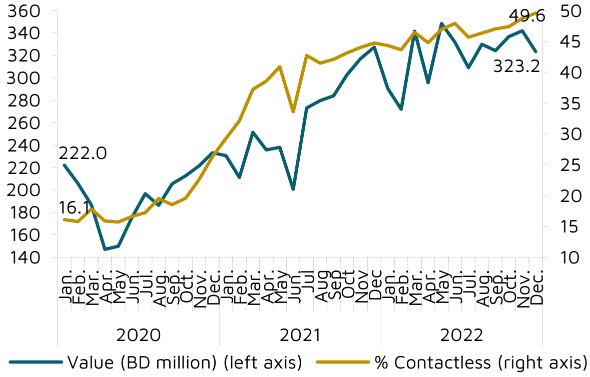
Contactless adoption has accelerated in the Kingdom and will continue to grow due to the change in consumer spending habits with the use of Near Field Communication (NFC) technology for contactless payments. The percentage of contactless transactions in terms of volume increased from 33.3% in January 2020 to 76.8% in June 2022. Similarly, in terms of value, the percentage of contactless transactions increased from 16.1% in January 2020 to 49.6% in June 2022.

Chart 8.13: Volume of Monthly POS and E-Commerce Transactions (millions)



Source: CBB.

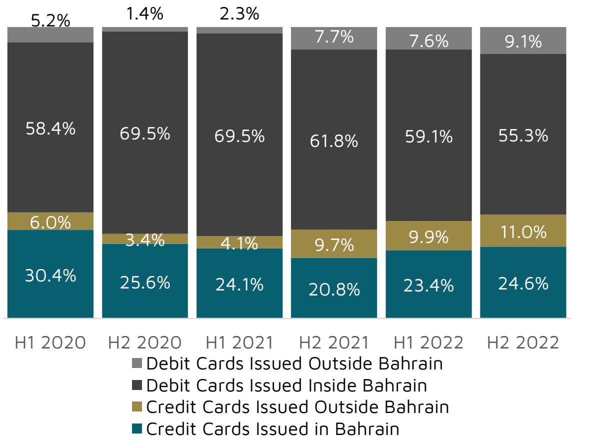
Chart 8.14: Value of Monthly POS and E-Commerce Transactions (BD million)



Source: CBB.

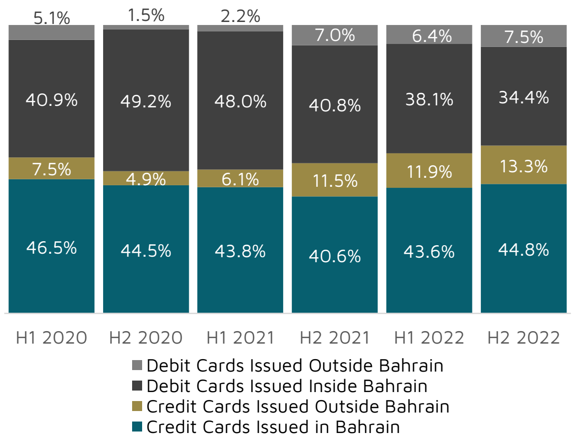
As of H2 2022, 79.9% of the volume of transactions and 79.2% of the value of transactions came from cards issued inside Bahrain (Chart 8.15 and Chart 8.17). The increase in share of cards issued outside Bahrain which is noticeable from H2 2021 is due to increase in number of foreigners visiting Bahrain.

Chart 8.15: Volume of POS and E-Commerce Transactions (% by Card Type)



Source: CBB.

Chart 8.16: Value of POS and E-Commerce Transactions (% by Card Type)

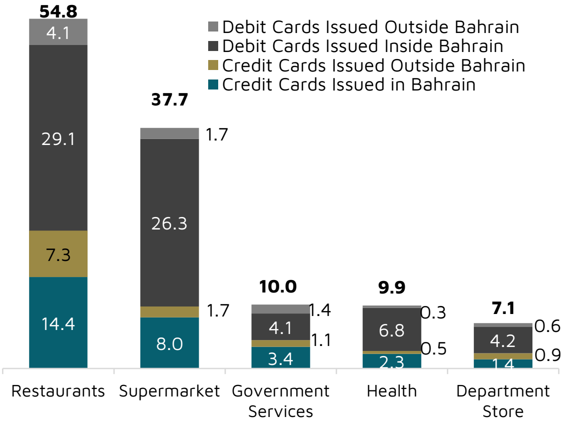


Source: CBB.

For H2 2022, most of the volume and of transactions remained to be from debit cards (representing 64.4%) while most of the value of transactions were from credit cards (representing 58.1%). The share of transactions by credit cards (both issued form inside and outside of Bahrain) is steadily increasing since H2 2021.

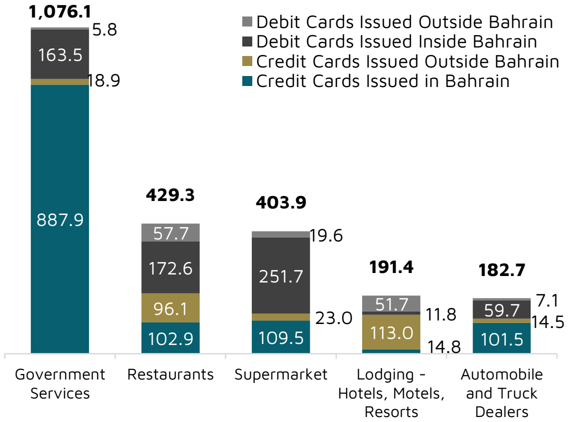
Charts 8.19 and 8.20 show the top 5 sectors in terms of volume and value of transactions for 2022. In terms of volume the top 5 sectors represented 73.4% of all the transactions for 2022 and were: restaurants (54.8 million), supermarkets (37.7 million), government services (10.0 million), health (9.9 million), and department stores (7.1 million). The majority of the number of transactions for the restaurants, supermarket, government services, health, and department stores were made using debit cards issued inside Bahrain making 53.1%, 69.6%, 41.4%, 68.6% and 58.8% of the transactions respectively.

Chart 8.17: Top 5 Sectors by Volume of POS and E-Commerce – 2022 (million)



Source: CBB.

Chart 8.18: Top 5 Sectors by Value of POS and E-Commerce –2022 (BD million)

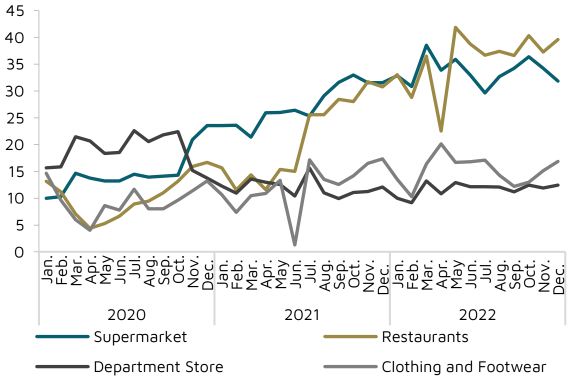


Source: CBB.

In terms of value, the top 5 sectors represented 59.2% of all transactions and were: government services (BD 1,076.1 million), restaurants (BD 429.3 million), supermarkets (BD 403.9 million), hotels and resorts (BD 191.4 million), automobile dealers (BD 182.7 million), and health (BD 89.5 million). For government services and automobile dealers, 82.5% and 55.5% of the value of transactions respectively were made by credit cards issued inside Bahrain. As for restaurants and supermarkets, 40.2% and 62.3% of the value of transactions respectively were made by debit cards issued inside Bahrain. For hotels and resorts, 59.1% of the value of transactions were made by credit cards issued outside Bahrain.

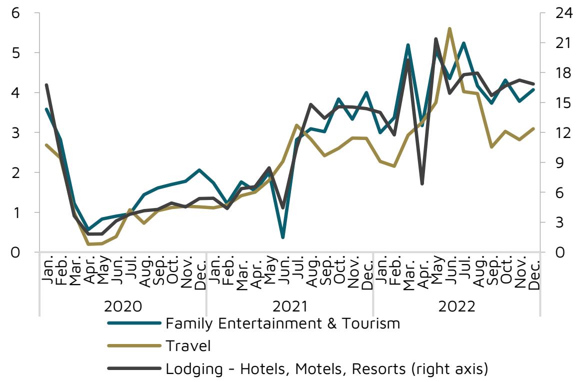
Charts 8.19 and 8.20 shows the monthly value of POS transactions for from January 2020 to June 2022 in selected sectors that have witnessed a change in consumer during the pandemic and sow continuous recovery and growth.

Chart 8.19: Monthly Value of POS and E-Commerce of Selected Indicators (BD million)



Source: CBB.

Chart 8.20: Monthly Value of POS and E-Commerce of Selected Indicators (BD million)

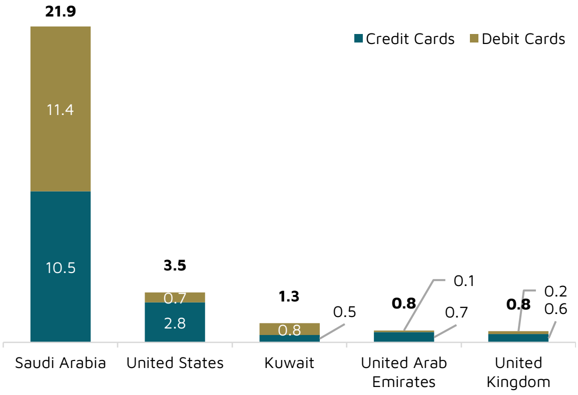


Source: CBB.

Charts 8.21 and 8.22 show the top 5 countries in terms of volume and value of foreign transactions for H1 2022. In terms of volume the top 5 countries represented 92.1% of total foreign transactions and were: Saudi Arabia (21.9 million), United States (3.1 million), Kuwait (1.3 million), United Arab Emirates (0.8 million), and United Kingdom (0.8 million).

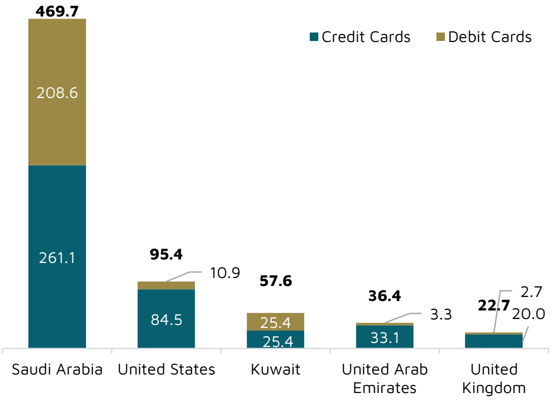
In terms of value, the top 5 countries represented 90.5% of the total value of foreign transaction and were: Saudi Arabia (BD 469.7 million), United States (BD 95.4 million), Kuwait (BD 57.6 million), United Arab Emirates (BD 36.1 million), and United Kingdom (BD 22.7 million).

Chart 8.21: Top 5 Nationalities by Volume of POS and E-Commerce – 2022 (million)



Source: CBB.

Chart 8.22: Top 5 Sectors by Value of POS and E-Commerce – 2022 (BD million)



Source: CBB.

9 FINTECH, INNOVATION AND FINANCIAL INCLUSION

HIGHLIGHTS

Regulatory Sandbox	Bank Branches	ATMS
20	204	515
ATM Cards	**Debit Cards**	**Credit Cards**
1,664.1 thousand	1,210.3 thousand	306.6 thousand

- 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 in Open Banking, e-KYC, and contactless payments.

9.1 Overview

Bahrain is repositioning itself to be a Financial Technology (FinTech) hub in the region offering conventional and Shariah compliant FinTech solutions. The Kingdom is encouraging digital transformation and the adoption of innovative technology to create a more efficient financial services sector and achieve higher financial inclusion. 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 CBB and other industry players within the Kingdom.

9.2 FinTech Developments

The CBB has developed its digital transformation strategy with a vision to develop projects that introduce latest electronic payment and settlement products and FinTech projects to gradually shift to digital systems and reduce the use of cash in financial transactions facilitating a more efficient provision of banking services to individuals. The digital transformation initiatives also focus on working with financial institutions to encourage and accelerate their transition with technological developments to ultimately benefit the national economy and be in line with international best practices. The CBB established a FinTech & Innovation Unit in October 2017, to ensure an adequate regulatory framework is in place to adapt FinTech solutions that will enhance the services provided to individual and corporate customers.

9.2.1 Regulatory Sandbox

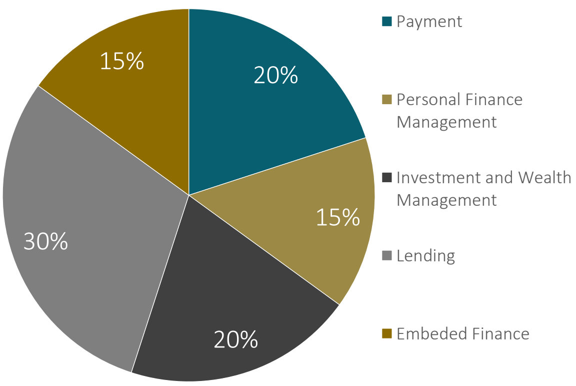
CBB launched a regulatory sandbox in June 2017 to attract both local and international emerging FinTech companies as well as existing CBB licensees to enable them to test their innovative ideas and expand their business in the region.[12] The sandbox provides authorized companies with the opportunity to test and experiment their innovative financial solutions freely until they are commercially viable. The Sandbox focuses on the following Innovation, Customer benefit, Identification of Major Risks, Compliance with CDD and AML/CFT Requirements, and Confidentiality Requirements.

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 4) collaborate with other regulators and policy makers to exchange ideas, share experiences and learnings.

The CBB announced its new Regulatory Sandbox Framework in December 2021 to allow FinTech firms to test and experiment with their ideas and solutions related to the sector in a more efficient and effective environment. The new Framework enhances the eligibility criteria for participation in the Regulatory Sandbox, as well as streamlines the entire Sandbox process to ensure a more phased and consistent approach to support testing.

The Sandbox has gained significant interest from local, regional and global start-ups and a number of companies have successfully completed testing their solutions. As of December 30, 2022, CBB had 20 companies testing their solutions within the Regulatory Sandbox with a wide range of solutions.

Chart 9.1: Regulatory Sandbox Statistics- Company Types (%)



Payment	▪ Digitizing Payment Workflow ▪ Providing cashless and automated payments
Personal Finance Management	▪ Aggregates end-user's financial information into single interface ▪ Enhances finance management
Investments and Wealth Management	▪ Provides holistic financial advice. ▪ Aims to increase investments/returns
Lending	▪ Streamlines and automates lending process ▪ Includes short-term financing.
Embedded Finance	▪ Provides financial services through non-financial products ▪ Offered by non-financial firms

Source: CBB.

Table 9.1: Regulatory Sandbox Statistics- Classification by Region

Region	No. of Sandbox Companies
MENA	16
Americas	2
Europe	1
Asia	1
Total	**20**

Source: CBB.

[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.

9.2.2 Open Banking

In October 2020, CBB launched the Bahrain Open Banking Framework (BOBF) to ensure holistic implementation of Open Banking services by the industry. The framework includes detailed operational guidelines, cyber security standards and guidelines for adoption, customer experience guidelines, technical open Application Programming Interface (API) specifications and the overall governance framework needed to protect customer data. These standards follow the comprehensive rules on Open Banking which were previously issued in December 2018. The open banking regulations mandated the adoption of open banking by all retail banks in the Kingdom by 30 June 2019. 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.

Open Banking services entail the provision of two broad categories of services:

- The first is "account information service" which provides customers with access to all bank account information in an aggregated manner through a single platform.
- The second category is "payment initiation service" which allows licensed third parties to initiate payments on behalf of customers while allowing seamless transfers between different customer accounts through a mobile based application.

Open Banking aims to improve the reach and quality of services offered by retail banks through digital online and mobile channels and enhance efficiency of the financial system adapting to changing consumer trends.

CBB also issued a circular regarding the second phase of the OBF directing retail banks and financial institutions to implement the requirements for the second phase of the framework by 30 June 2022.

9.2.3 The Arabian Gulf System for Financial Automated Quick Payment Transfer (AFAQ)

The Arabian Gulf System for financial Automated Quick Payment Transfer (AFAQ) is a Real Time Gross Settlement service for cross-currency cross-border payments between GCC countries. The system is operated by the Gulf payment Company (GPC) which is owned and funded by the GCC central Banks including the CBB. The AFAQ system allows its participants to transfer payments from one local currency to another local currency in real time within the business day schedule.

The AFAQ cross-currency service was launched on 10th December 2020 with the CBB and Saudi Central Bank (SAMA) as its first participants, and in March 2022, The Central Bank of Kuwait has also joined the service. The CBB has successfully managed to onboard all Retail Banks (27 banks) during the Year 2022 and becoming the first central bank in the GCC to accomplish this milestone

9.3 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. The importance of financial inclusion come 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. 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. 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. Efforts have been made by 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.

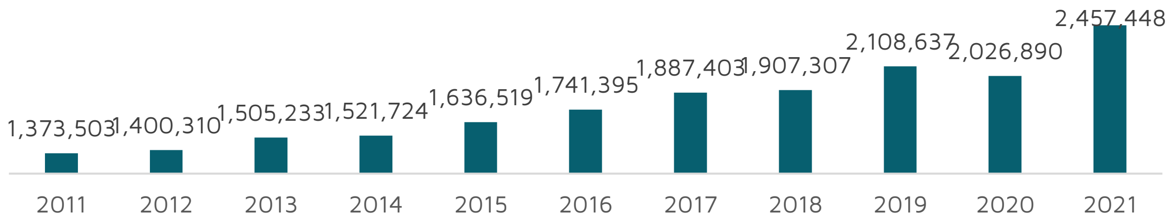
Table 9.2: Financial Inclusion Figures for the Kingdom of Bahrain

Indicator	2016	2017	2018	2019	2020	2021
Number of Banks **	27	26	29	29	29	29
Number of Branches	172	171	173	204	175	151
Number of Branches per 100,000 in population	*12.1*	*11.4*	*11.5*	*13.7*	11.9	10.1
Number of ATMs	*461*	*453*	*479*	515	505	461
Number of ATMs per 100,000 in population	*32.4*	*30.2*	*31.9*	*34.7*	34.3	30.6
Number of Accounts ***	1,741,395	1,887,403	1,907,307	2,108,637	2,026,890	2,457,448
Number of Accounts per 1,000 in population	*1,223*	*1,257*	*1,269*	*1,421*	1,376.8	1,633.6
Number of Internet/PC linked accounts	544,111	534,033	477,894	616,960	707,794	1,107,994
ATM Cards (thousands)	1,407.7	1,481.8	1,384.6	1,644.1	1,733.7	1,808.3
Debit Cards (thousands)	1,111.2	1,128.5	1,171.7	1,210.3	1,363.4	1,557.5
Credit Cards (thousands)	290.3	329.7	322.9	306.6	402.2	312.0
Population	1,423,726	1,501,116	1,503,091	1,483,756	1,472,204	1,504,365

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

From 2015 to 2020, 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 11.9 for 2020. As for the number of ATM machines per 100,000, Bahrain records 34.3 ATMs per 100,000 in population for 2020. The number of bank accounts within retail banks increased over the last 5 years from 1,636,519 in 2015 to 2,026,890 in 2020 demonstrating an increase of 23.9% (The 2020 decrease in the number of retail bank accounts was 3.9%).

Chart 9.2: Number of Bank Accounts



**Preliminary data.*
Source: CBB.

9.4 Cyber Security Initiatives

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 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 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 FSD issued Cyber Risk Surveys to cover cyber risk relative to governance and leadership, identification, protection, detection, response and recovery.

The CBB continues to develop its regulations on cybersecurity in an effort to strengthen the cyber resilience of its financial institutions. The following developments can be highlighted:

1. The CBB introduced more stringent cyber incident reporting to the CBB in March 2022, by introducing a one-hour deadline to report a cyber incident by phone and a two-hour deadline to report essential details by email.
2. The CBB consulted the industry on the requirements related to email domains used to communicate with customers and URLs in messages sent to customers during May and June 2022. Subsequent to the consultation, amended requirements were issued in August 2022 enhancing the requirements and clarifying the exceptions.
3. While the CBB has issued cyber security requirements for banks, insurance licensees, investment business firms, money changers and ancillary service providers, the CBB is currently working on introducing cyber security requirements for other specialized licensees.

On 9th February 2023, the CBB organized a training workshop on cybersecurity for the banking sector, in the presence of CEOs, C-level executives and cybersecurity and technical staff. The event is part of the CBB's strategy to enhance cyber security practices and systems in the financial services sector, and its continuous efforts to maintain financial stability and ensure providing a safe environment for banking transactions.

The risks of emerging technologies are witnessing rapid developments and are getting more complex, alongside the rapid growth of the financial services sector and digital transformation. This exercise aimed to enhance and develop cooperation between all parties involved and to rely on the adoption of international best practices to tackle cyber risks and to continue to develop the skills and competencies of the national workforce in cybersecurity through such workshops.

The training workshop included an exercise in cyber resilience for the banking sector, with more than 80 participants from the CBB, participating local banks and The Benefit Company.

ANNEX:

FINANCIAL SOUNDESS INDICATORS AND SELECTED GRAPHS

ANNEX 1: SELECTED FINANCIAL SOUNDNESS INDICATORS (FSIs)

Annex 1 Table 1: Selected Financial Soundness Indicators – All Banking System

Indicator	Q4 2021	Q2 2022	Q4 2022
Capital Adequacy			
CAR (%) *	18.7	19.1	19.5
Tier 1 CAR (%) *	17.2	17.7	18.1
Assets-to-Capital (Times) *	8.7	8.7	8.2
Asset Quality			
NPLs (% of Total Loans)	3.2	3.3	3.0
Specific Provisions (% of NPLs)	70.1	69.8	68.5
Loan Concentration (Share of Top Two Sectors) (%)	30.5	30.8	30.3
Real Estate/ Construction Exposure (%)	25.2	25.4	25.6
Earnings			
ROA (%)	1.1	0.6	1.2
ROE (%) *	7.8	4.6	8.4
Net Interest Income (% of Total Income) **	70.3	68.6	70.3
Net Fees & Commissions (% of Total Income) **	13.0	13.3	12.0
Operating Expenses (% of Total Income)	52.4	46.1	50.4
Liquidity			
Liquid Assets (% of Total Assets)	26.2	25.7	25.3
Loan-Deposit Ratio (%)	69.8	65.7	68.5

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

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

Indicator	Conventional Retail			Conventional Wholesale		
	Q4 2021	Q2 2022	Q4 2022	Q4 2021	Q2 2022	Q4 2022
Capital Adequacy						
CAR (%) *	20.6	20.4	21.5	17.1	17.7	17.5
Tier 1 CAR (%) *	19.2	19.0	20.1	15.6	16.2	15.9
Assets-to-Capital (Times) *	6.9	7.3	6.8	9.0	9.5	8.8
NPLs Net Provisions to Capital (%) *	4.3	4.3	3.3	3.1	3.4	3.3
Asset Quality						
NPLs (% of Total Loans)	3.9	3.8	3.3	2.8	2.5	2.3
Specific Provisions (% of NPLs)	71.9	73.2	74.3	72.8	69.6	67.0
Net NPL' (% of Net Loans)	1.2	1.1	0.9	0.8	0.8	0.8
Loan Concentration (Share of Top Two Sectors) (%)	34.2	33.7	33.9	41.9	41.2	40.6
Real Estate/ Construction Exposure (%)	33.4	33.1	34.0	19.4	18.3	18.0
Earnings						
ROA (%)	1.3	0.8	1.4	1.3	0.6	1.2
ROA Local Banks (%)	1.5	0.8	1.5	0.4	0.2	0.5
ROA Overseas Banks (%)	0.9	0.6	1.3	2.2	1.0	2.0
ROE (%) *	10.9	6.6	11.0	3.5	2.3	4.5
Net Interest Income (% of Total Income)	78.9	74.5	76.8	62.8	63.5	64.4
Net Fees & Commissions (% of Total Income)	10.2	10.0	9.2	15.2	17.2	15.1
Operating Expenses (% of Total Income)	49.4	42.1	48.5	42.7	44.1	47.0
Liquidity						
Liquid Assets (% of Total Assets)	33.6	34.1	32.7	24.7	21.9	22.9
Liquid Assets (% of Short-Term Liabilities)	42.4	42.7	41.9	30.8	26.8	28.6
Loan-Deposit Ratio (%)	69.3	68.1	68.8	68.7	61.8	68.3
Non-Bank Deposits (% of Total Deposits)	73.9	76.6	76.0	50.3	52.3	54.1

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

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

Indicator	Islamic Retail			Islamic Wholesale		
	Q4 2021	Q2 2022	Q4 2022	Q4 2021	Q2 2022	Q4 2022
Capital Adequacy						
CAR (%) *	21.7	21.5	21.2	15.8	15.3	16.9
Tier 1 CAR (%) *	19.9	19.9	19.7	14.4	14.7	16.2
Assets-to-Capital (Times) *	11.0	11.4	11.3	11.1	8.6	8.9
NPFs Net Provisions to Capital (%) *	13.7	12.0	13.2	0.3	1.5	0.5
Asset Quality						
NPFs (% of Total Facilities)	5.0	4.4	4.8	0.7	6.3	4.8
Specific Provisions (% of NPFs)	56.4	59.0	54.8	92.0	86.7	94.9
Net NPFs (% of Net Facilities)	2.6	2.0	2.3	0.1	0.7	0.6
Facilities Concentration (Share of Top Two Sectors) (%)	38.2	39.8	41.5	42.5	61.1	60.6
Real Estate/ Construction Exposure (%)	28.4	28.8	30.3	20.1	25.9	26.7
Earnings						
ROA (%)	0.6	0.4	0.9	0.8	0.6	1.1
ROE (%) *	7.3	5.4	10.6	10.0	5.0	10.3
Net Income from Own Funds, Current Accounts and Other Banking Activities (% of Operating Income)	38.5	28.0	24.3	41.8	44.3	57.7
Net income from Jointly Financed Accounts and Mudarib Fees (% of Operating Income)	60.6	70.9	72.7	56.0	48.0	38.3
Operating Expenses (% of Total Income)	73.9	64.5	65.8	67.6	50.8	55.2
Liquidity						
Liquid Assets (% of Total Assets)	19.5	18.9	17.0	18.0	17.4	13.8
Facility-Deposit Ratio (%)	73.3	73.5	71.6	63.0	35.2	33.5
Current Accounts from Non-Banks (% of Non-Capital Liabilities, excl. URIA)	37.2	42.2	36.5	46.8	5.8	3.5

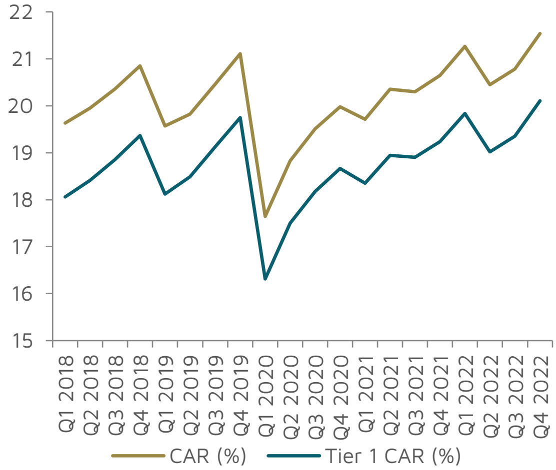
** Locally-Incorporated Banks only.*

Source: CBB.

ANNEX 2: SELECTED FSIs GRAPHS

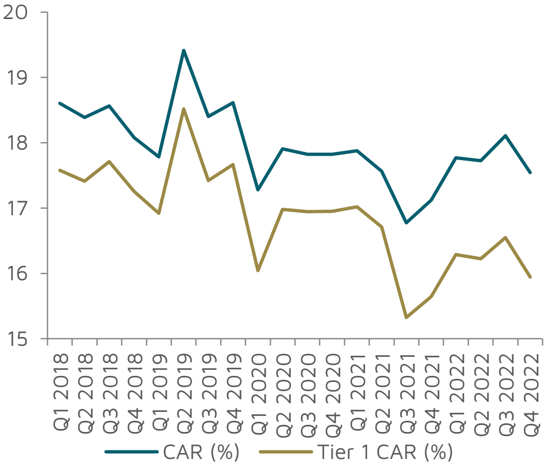
A. Capital Adequacy

Annex 2 Graph 1: Conventional Retail



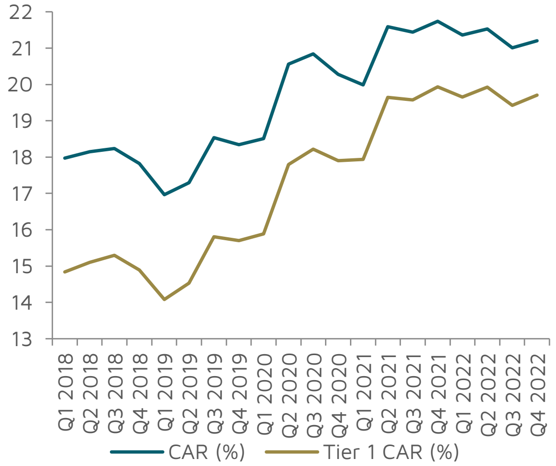
Source: CBB.

Annex 2 Graph 2 : Conventional Wholesale



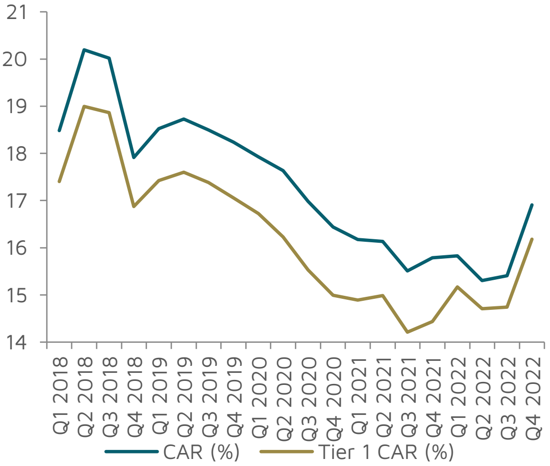
Source: CBB.

Annex 2 Graph 3: Islamic Retail



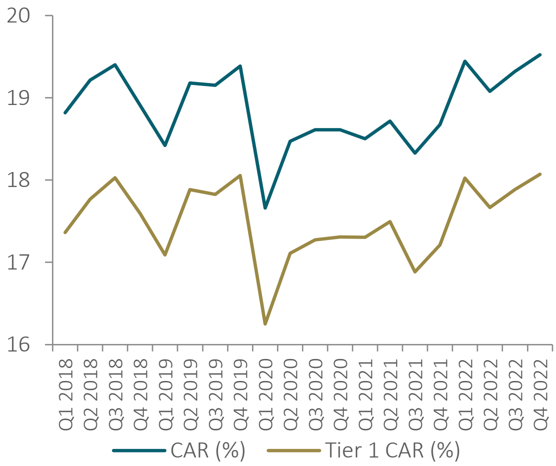
Source: CBB.

Annex 2 Graph 4: Islamic Wholesale



Source: CBB.

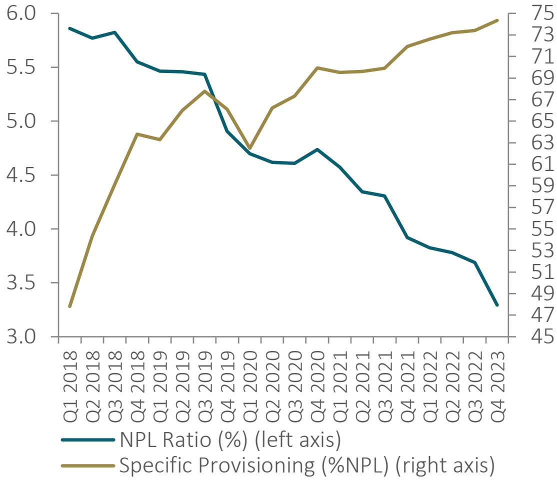
Annex 2 Graph 5: All Banking



Source: CBB.

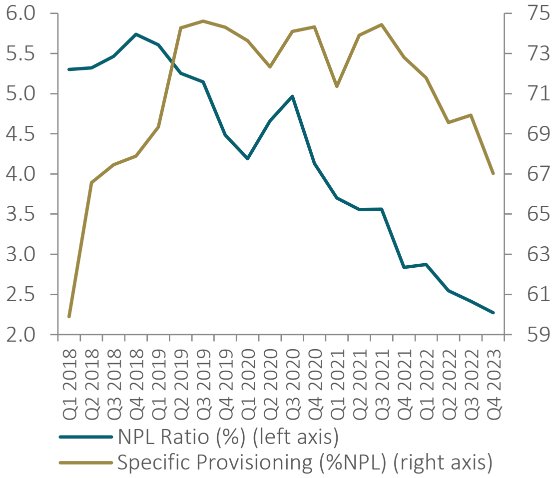
B. Asset Quality

Annex 2 Graph 6: Conventional Retail



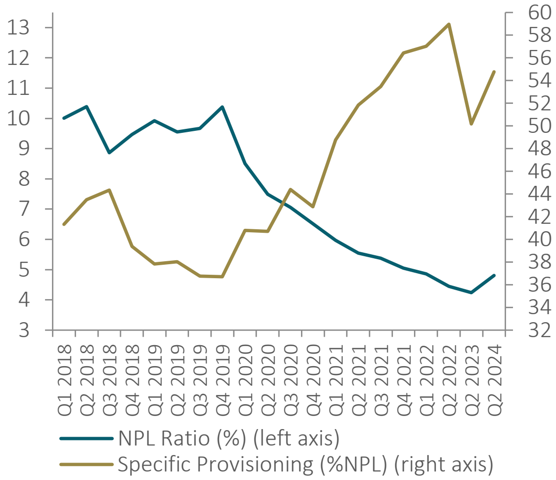
Source: CBB.

Annex 2 Graph 7: Conventional Wholesale



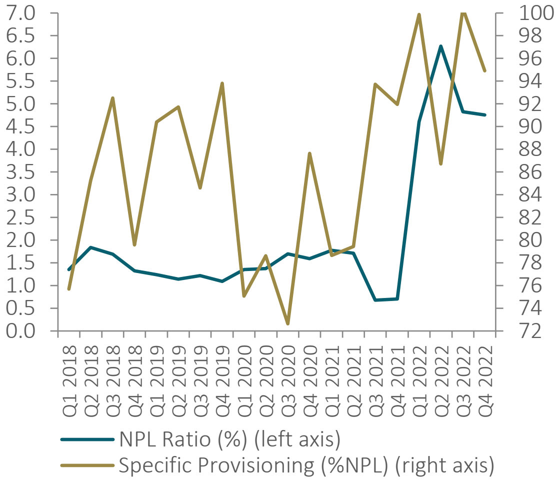
Source: CBB.

Annex 2 Graph 8: Islamic Retail



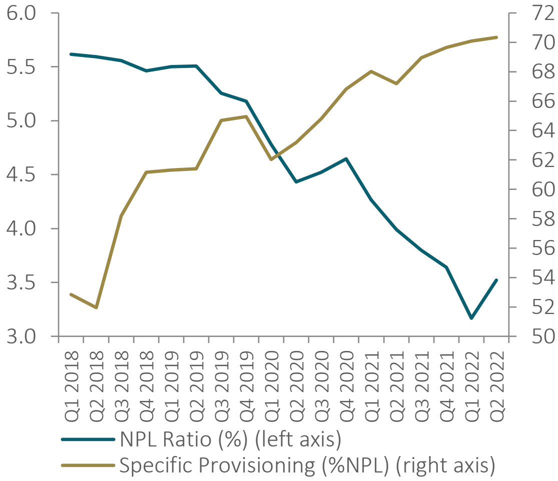
Source: CBB.

Annex 2 Graph 9: Islamic Wholesale



Source: CBB.

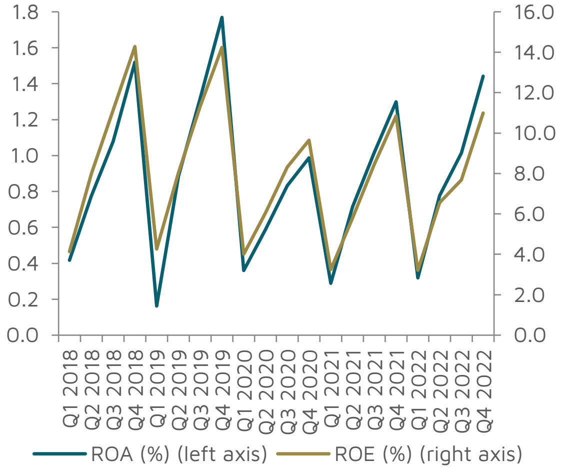
Annex 2 Graph 10: All Banking



Source: CBB.

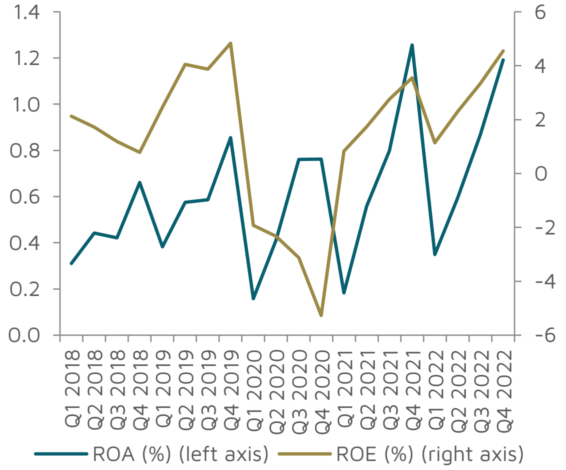
C. Profitability

Annex 2 Graph 11: Conventional Retail



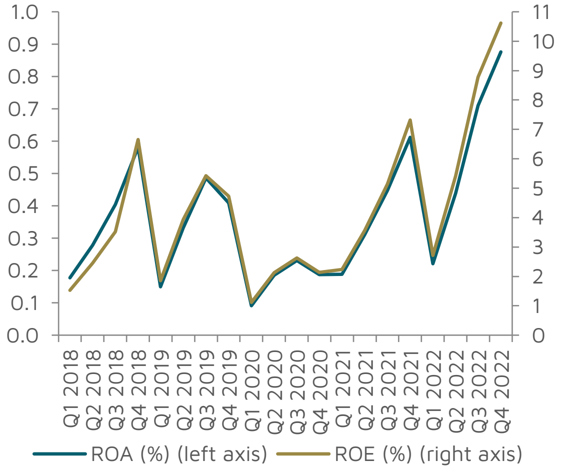
Source: CBB.

Annex 2 Graph 12: Conventional Wholesale



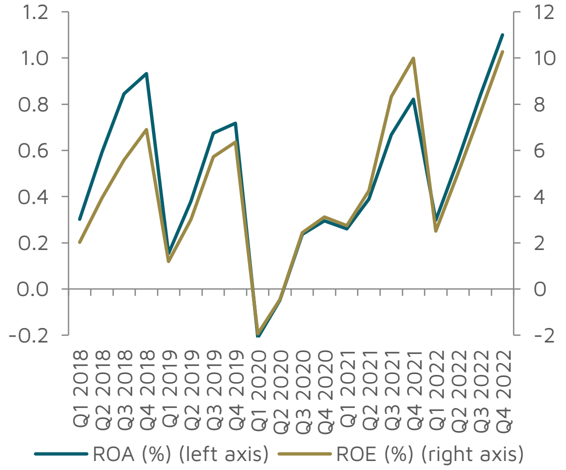
Source: CBB.

Annex 2 Graph 13: Islamic Retail



Source: CBB.

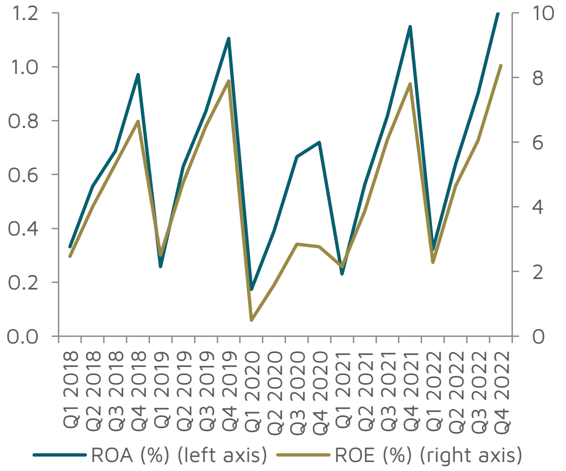
Annex 2 Graph 14: Islamic Wholesale



z

Source: CBB.

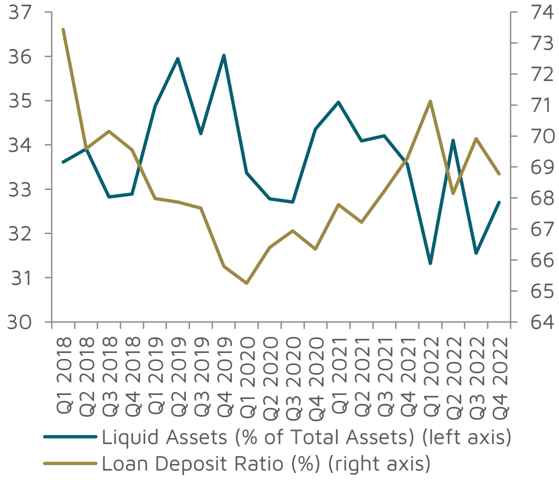
Annex 2 Graph 15: All Banking



Source: CBB.

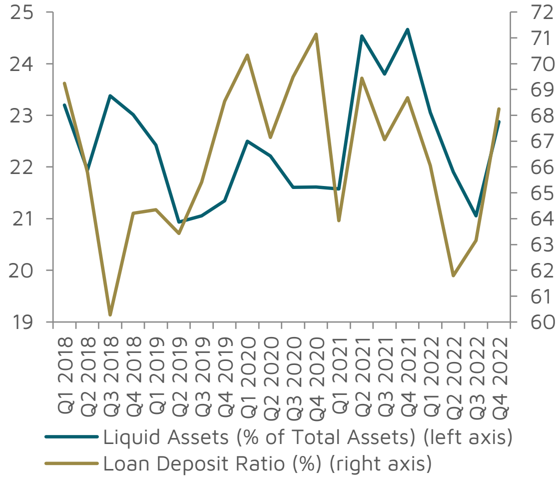
D. Liquidity

Annex 2 Graph 16: Conventional Retail



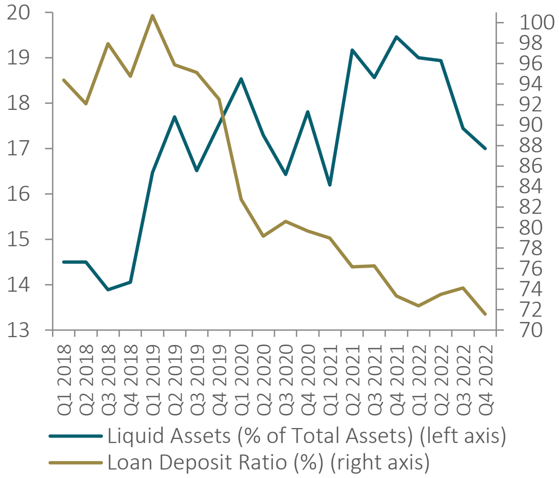
Source: CBB.

Annex 2 Graph 17: Conventional Wholesale



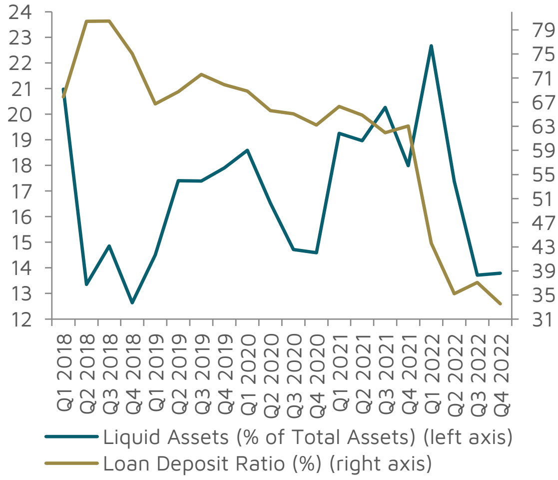
Source: CBB.

Annex 2 Graph 18: Islamic Retail



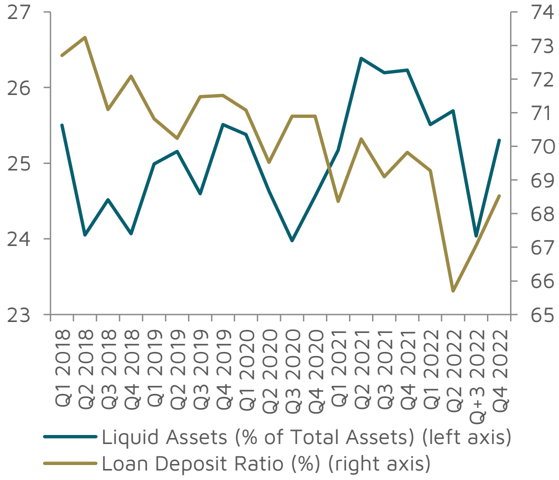
Source: CBB.

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
API	Application Programming Interface
BCTS	Bahrain Cheque Truncation System
BECS	Bahrain Electronic Cheque System
BENEFIT	The Benefit Company
BFB	Bahrain Fintech Bay
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
FMI	Financial Market Infrastructure
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
NFA	Net Foreign Assets
NPW	Net Premiums Written
NPF	Non-performing Facilities
NPL	Non-performing Loans
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
WEO	World Economic Outlook