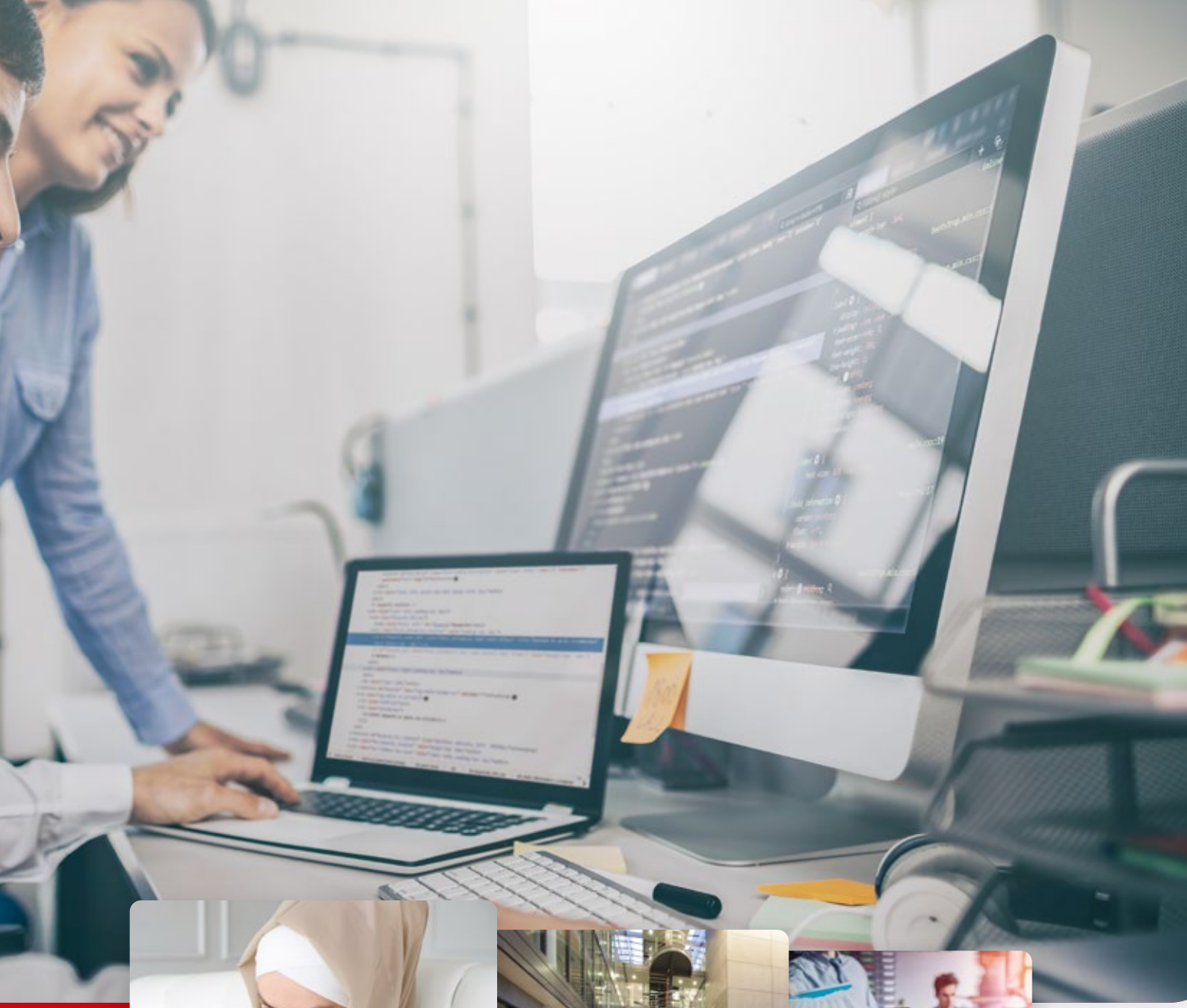
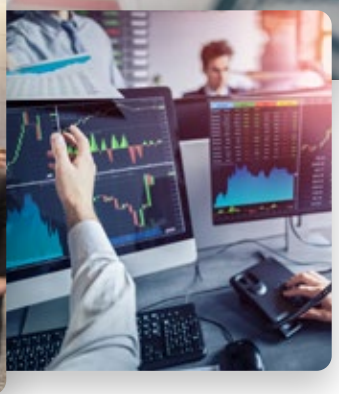
PILLAR 3 DISCLOSURES AS PER BASEL





Basel III – Pillar 3 Disclosures

FOR THE YEAR ENDED 31 DECEMBER 2019

The disclosures given below pertain to National Bank of Ras Al Khaimah P.S.C. and its 5 subsidiaries (Group) and are in accordance with Basel III, Pillar 3, Market discipline principles where Banks are required to disclose qualitative and quantitative information of its risk and capital management. These disclosures are also in compliance with Circular No 28/2018 dated 17 January 2018 issued by the Central Bank of UAE.

1. SUBSIDIARIES AND SIGNIFICANT INVESTMENTS

The National Bank of Ras Al Khaimah (P.S.C) comprises the Bank and its 5 subsidiaries. These subsidiaries are Ras Al Khaimah National insurance company PSC (RAKNIC), P.S.C, BOSS FZCO, RAK Technologies FZCO, RAK Funding Cayman Limited and RAK Global Markets Cayman Limited (together referred as the "Group").The consolidated financial statements comprises the Bank and its subsidiaries. The Bank's interests, held directly or indirectly, in the subsidiaries are as follows:

Subsidiary	Authorised and issued capital	Ownership interest	Incorporated	Principal Activities
Ras Al Khaimah National Insurance Company PSC ("RAKNIC")	AED 115.5 million	79.23%	UAE	All types of insurance business.
BOSS FZCO	AED 500,000	80%*	UAE	Back office support services to the Bank.
RAK Technologies FZCO	AED 500,000	80%*	UAE	Technological support services to the Bank.
RAKfunding Cayman Limited	Authorised USD 50,000 Issued USD 100	100%	Cayman Island	To facilitate the issue of Euro medium term notes (EMTN) and other long term borrowings.
RAK Global Markets Cayman Limited	Authorised USD 50,000 Issued USD 1	100%	Cayman Island	To facilitate Treasury transactions.

*These represent legal ownership of the Bank. However, beneficial ownership is 100% as the remaining interest is held by a related party on trust and for the benefit of the Bank.

On 19 April 2017, the shareholders at the Annual General Meeting resolved to liquidate RAK Islamic Finance Company Pvt. J.S.C, a fully owned subsidiary of the Bank and liquidation was completed during the second quarter of 2019.

Under the regulatory scope of consolidation, the investment in Ras Al Khaimah National Insurance Company PSC ("RAKNIC") not deducted from capital but is risk weighted at 250%.

Investment in RAKNIC	RWA for Investment in RAKNIC	RW%
AED 317.24 million	AED 793.10 million	250%

2. CAPITAL STRUCTURE

Quantitative disclosure

The Group's capital structure under Basel III is as indicated below:

	31 December 2019 AED'000	31 December 2018 AED'000
Capital Base		
Common Equity Tier 1 (CET 1) Capital		
Share Capital	1,676,245	1,676,245
Eligible Reserves	4,077,839	3,953,624
Retained Earnings	919,100	542,158
Audited current year profits	1,104,419	910,239
Dividend	(502,874)	(502,874)
CET 1 Capital before regulatory adjustments and threshold deductions	**7,274,729**	**6,579,392**
Less : Regulatory deductions	-	-
Less : Threshold deductions	-	-
Total CET 1 capital after regulatory adjustments and threshold deductions	**7,274,729**	**6,579,392**
Additional Tier 1 (AT 1) Capital		
Eligible AT 1 capital	-	-
Other AT 1 Capital	-	-
Total AT 1 Capital	-	-
Tier 2 Capital		
Tier 2 Instruments	-	-
Other Tier 2 capital	526,496	476,626
Total T2 Capital	**526,496**	**476,626**
Total Capital base	**7,801,225**	**7,056,018**

1. The Tier 2 Capital consists of eligable portion of general provision.

3. CAPITAL ADEQUACY

The Bank is following the Standardised Approach to assess its Pillar 1 Capital Adequacy. Also in line with the Central Bank's instructions, the Bank is required to set aside some portion of its capital as Capital Conservation Buffer (CCB). From 2019, CCB is required to be kept at 2.5% of the Capital base as per the prescribed transition arrangement.

The Pillar I RWA Calculation covers the following risks:

- Credit Risk in Banking Book (Using Standardised Approach)
- Market Risk in Trading Book (Using Standardised Approach)
- Operational Risk across the Bank (Using Alternative Standardised Approach)

RAKBANK currently maintains a Common Equity Tier 1 (CET 1) Ratio of 15.70% and a Total Capital Adequacy Ratio of 16.83%. The Tier 2 Capital in 2018 and 2019 is the eligible portion of the General Provision.

Capital structure and capital adequacy as per Basel III requirement as at 31 December 2019 and 31 December 2018 is given below:

	31 December 2019 AED'000	31 December 2018 AED'000
Tier 1 capital		
Ordinary share capital	1,676,245	1,676,245
Legal and other reserves	4,077,839	3,953,624
Retained earnings	919,100	542,158
Current year profit	1,104,419	910,239
Dividend	(502,874)	(502,874)
Tier 1 capital base	**7,274,729**	**6,579,392**
Tier 2 capital base	**526,496**	**476,626**
Total capital base	**7,801,225**	**7,056,018**
Risk weighted assets		
Credit risk	42,119,704	38,130,054
Market risk	1,178,301	464,985
Operational risk	3,044,186	2,451,565
Total risk weighted assets	**46,342,191**	**41,046,604**
Capital adequacy ratio on Tier 1 capital	15.70%	16.03%
Capital adequacy ratio on Tier 2 capital	1.13%	1.16%
Total Capital adequacy ratio	16.83%	17.19%

Qualitative disclosure

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial services business. The group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance.

The Group's risk management considers a variety of risks. These typically include credit risk, liquidity risk, concentration risk, market risk, interest rate risk, operational risk, information security risk, business continuity risk, reputational risk and regulatory and compliance risk. Policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Group regularly reviews

its risk management policies and systems to reflect changes in markets, products and emerging best practice.

RAKBANK's Board and Management believe that an effective risk department is vital to achieving the Bank's strategic growth objectives in a sustainable manner. The Board Risk Committee endorses the Bank's overall risk management strategy and appetite, providing the necessary direction concerning risk management measures undertaken by the Group. The Risk Management function of the Bank is independent of the risk taking functions which is in line with the guidelines of the UAE Central Bank and consistent with Group's model of 3 lines of defence.

As part of the ICAAP process under the Central Bank of UAE's Basel III framework, , the Bank periodically submits to the Central Bank its Internal Capital Adequacy Assessment Process (ICAAP) Report, where it sets out all the risks it is exposed to, how it measures, monitors and where possible how it mitigates these risks and how the alignment with capital is achieved. The Bank has the framework to measure the capital requirements for material risks other than Pillar 1 risks such as liquidity risk, interest rate risk in Banking Book and concentration risk under Pillar 2. The Group shall assess these risks and set aside capital if found to be material. It takes into account any feedback it gets from its regulator.

The Risk Management Department is responsible for calculation of capital requirements under the ICAAP framework. The Bank also performs an annual macro-economic stress testing exercise as per Central Bank Guidelines.

Liquidity is managed by Treasury under the guidance of the Asset and Liability Committee (ALCO) and in accordance with UAE Central Bank regulation and the Bank's internal guidelines. The Risk Management Department manages Liquidity Risk and has established a formal robust liquidity risk management framework that ensures sufficient liquidity, including a cushion of unencumbered, high quality liquid assets to withstand a range of stress events. The Bank monitors its regulatory liquidity ratios on a daily basis and has set up internal management action triggers to take suitable action when required. In addition, liquidity stress testing and scenario analysis is one of the key tools used by the Bank for measuring liquidity risk and evaluating the Bank's short-term liquidity position.

Regulatory Compliance continues to be an area of focus for the Board and Management of the Bank; the Bank continues to maintain a zero tolerance approach with respect to any regulatory breach. An Independant Compliance function oversees the Compliance Risk management framework and procedures across the Bank. The Compliance function is also responsible for actively mitigating AML and sanctions risk apart from reviewing regulatory landscape and issuance of internal policies.

The function is staffed with qualified professionals. Training and workshops are conducted at periodic intervals to maintain and enhance compliance discipline across all facets of Bank

The Bank has established an independent IT Risk function under the CRO. The IT risk team proactively monitors the cyber threat landscape and implements controls to mitigate applicable risks. The IT Risk practice of the Bank has a 24x7x365 Security Operations Centre to monitor and respond to information security threats.

The Bank has adopted the Standardised approach for calculation of credit risk and market risk. For operational risk the Group has adopted the Alternative Standardised Approach (ASA). The various risks considered in the computation of risk assets under Basel III are described below:

Credit risk

Credit risk is defined as the risk when the Group's customers, clients or counter parties fail to perform or are unwilling to pay interest, repay the principal or otherwise to fulfil their contractual obligations under loan agreements or other credit facilities, thus causing the Group to suffer a financial loss.

Credit risk also arises through the downgrading of counter parties, whose credit instruments are held by the Group, thereby resulting in the value of the assets to fall. As credit risk is the Group's most significant risk, considerable resources, expertise and controls are devoted to managing this risk within the core departments of the Group.

The Bank has centralised Credit Management functions for retail banking, business banking and wholesale banking businesses, independent from the Operations and Business departments. The Bank has implemented appropriate policies, procedures and systems separately for the Retail and Wholesale lending businesses to ensure credit exposure is taken prudently.

In the case of retail lending business, the credit risk is managed through appropriate front-end sales and credit underwriting processes, and back-end operational and collection processes. Appropriate product programmes defining customer segments, underwriting standards and security requirement are rolled-out to ensure consistency in underwriting and the on-boarding process. Retail credit portfolio is monitored centrally across products and

customer segments. For wholesale banking and business banking exposures, credit risk is managed by appropriately identifying target market segment, structured credit approval process and robust post-disbursement monitoring and remedial processes.

The Board Credit Committee and Board Risk Commitee oversees the credit management measures including portfolio, sectorial and customer level reviews as well as also quality of assets and health of large borrower accounts and borrower groups. The Executive Level Management Credit Committee and Management Risk Committee reviews major credit portfolios, non-performing loans, accounts under watch, overdue and credit sanctions.

Market risk

The Group takes on exposure to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market.

Market risks arise from open positions in interest rate, currency and equity instruments, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The Asset and Liability Committee (ALCO) is chaired by the Chief Executive Officer and comprises the Divisional Heads of Finance, Treasury, Risk, Operations, Wholesale Banking, Business Banking and Retail Banking. It meets on a regular basis to monitor and manage market risk.

Investment Committee (IC) is chaired by the Chief Executive Officer and comprises of MD - Treasury, Chief Financial Officer, Chief Risk Officer, Chief Credit Officer, Director - Risk and Head – Trading. The Committee meets on a regular basis to discuss the Investment Portfolio along with valuation changes due to changes in interest rates and credit spreads. Further it decides the investment strategy and asset allocation on an annual basis, and recommends further to the Board.

Market Risk and Treasury Middle Office functions operate within the Risk Management under the Chief Risk Officer and are responsible for day to day monitoring of market risk exposures within Board approved Policies and Market Risk Appetite. The governance framework for market risk includes internal board approved market risk policy and actively tracked market risk limits in line with existing regulations and internal policies. Risk is undertaken in the book within the Investment and Trading polices of the Bank and overall risk appetite. Market Risk ensures that all limit breaches, concentration and other relevant risks are reported to Management and the Board on a timely basis. Further "the Bank" has set up a hedging framework that elucidates how market risks arising from currencies and interest rates are hedged at a Bank wide level.

The exposures to derivatives includes forward exchange contracts, option contracts and interest rate swaps which are entered to meet customer needs and covered back to back in the interbank market. Further the Bank has executed some interest rate swaps and a cross currency swap for economic hedging purposes.

The Group, has also executed some derivatives on proprietary books as well as FVTPL Bond Investments within the Board approved risk limits for trading

Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. The Bank endeavours to effectively identify, assess, monitor and mitigate operational risk through a robust and effective control environment across the organisation.

The operational risk function is managed by Head Operational Risk and Organisation and Methods reporting to the Chief Risk Officer. The Bank has a formal Operational Risk Management (ORM) governance structure established under the aegis of Management Risk Committee and Board Risk Committee, which provides the strategic direction and oversight over ORM activities.

The risk governance structure is designed to include 3 lines of defence signifying a clear division of responsibilities between the risk owners (the business, operations and support units), the control functions (Risk Management) and Independent Assurance by the Internal Audit function for safeguarding the Bank's assets and reputation against potential operational risks arising from day-to-day business activities. The governance structure is described below:

- First Line of Defence - i.e. Business, Operations and Support Units
- Second Line of Defence - i.e. Risk Management
- Third Line of Defence - i.e. Internal Audit

The Bank's Operational Risk Management Framework includes Product Management Guideline, Risk and Control Self-Assessment process, Operational Risk Events captured in MetricStream, and Key Risk Indicators.

4. CREDIT RISK - QUANTITATIVE DISCLOSURES

Net credit exposure by currency:

At 31 December 2019 the Group had the following gross exposures

On-balance sheet items

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2019				
Assets				
Cash and balances with the UAE Central Bank	4,139,552	645,371	581	4,785,504
Due from other banks	203,367	5,592,249	797,617	6,593,233
Loans and advances	27,650,755	6,815,562	84,246	34,550,563
Insurance contract assets	335,433	-	-	335,433
Investment securities	139,406	6,871,423	1,130,604	8,141,433
Customer acceptances	35,577	384,807	3,881	424,265
Total assets	**32,504,090**	**20,309,412**	**2,016,929**	**54,830,431**

Off-balance sheet items

	AED AED'000	USD AED'000	Others AED'000	Total AED'000
At 31 December 2019				
Credit commitments	1,474,396	1,072,850	50,602	2,597,848
Letter of credit and guarantees	623,518	510,323	25,272	1,159,113
Total	**2,097,914**	**1,583,173**	**75,874**	**3,756,961**

a) Net credit exposure by geography:

Geographical risk concentration

At 31 December 2019 the Group had the following gross exposures based on geographical region.

	UAE AED'000	OECD AED'000	Others AED'000	Provision for credit loss AED'000	Total AED'000
31 December 2019					
Due from other banks, net	478,977	1,512,906	4,630,430	(29,080)	6,593,233
Loans and advances, net	33,382,118	162,984	2,717,026	(1,711,565)	34,550,563
Insurance contract assets, net	312,687	55,380	6,403	(39,037)	335,433
Customer acceptances	424,265	-	-	-	424,265
Investment securities, net	2,871,003	378,244	4,920,452	(28,266)	8,141,433
Total	**37,469,050**	**2,109,514**	**12,274,311**	**(1,807,948)**	**50,044,927**

b) Gross credit exposure by industry:

	On balance sheet items					
	Loans and advances AED'000	Investment securities AED'000	Due from other banks AED'000	Total funded AED'000	Off balance sheet Items AED'000	Total AED'000
31 December 2019						
Agriculture, fishing and related activities	6,788	-	-	6,788	135	6,923
Crude oil, gas, mining and quarrying	7,687	-	-	7,687	-	7,687
Manufacturing	1,097,744	453,110	-	1,550,854	72,398	1,623,252
Electricity and water	11,232	476,220	-	487,452	2,700	490,152
Construction and real estate	2,719,724	620,606	-	3,340,330	885,719	4,226,049
Trading	4,311,431	-	-	4,311,431	646,450	4,957,881
Transport, storage and communication	722,145	584,757		1,306,902	9,807	1,316,709
Financial institutions	2,099,629	2,439,096	6,622,313	11,161,038	598,108	11,759,146
Services	3,269,708	426,468	-	3,696,176	279,626	3,975,802
Government	2,468,890	3,169,442	-	5,638,332	432,721	6,071,053
Retail and consumer banking	19,547,150	-	-	19,547,150	829,297	20,376,447
Total exposures	**36,262,128**	**8,169,699**	**6,622,313**	**51,054,140**	**3,756,961**	**54,811,101**
Provision for credit loss	(1,711,565)	(28,266)	(29,080)	(1,768,911)	(11,138)	(1,780,049)
Net exposures	**34,550,563**	**8,141,433**	**6,593,233**	**49,285,229**	**3,745,823**	**53,031,052**

c) Gross credit exposure by residual contractual maturity:

On balance sheet items

	Up to 3 months AED'000	3 - 12 months AED'000	1 - 3 years AED'000	3 - 5 years AED'000	Over 5 years AED'000	Provision for credit loss AED'000	Total AED'000
At 31 December 2019							
Assets							
Cash and balances with the UAE Central Bank	4,485,504	300,000	-	-	-	-	4,785,504
Due from other banks	1,817,141	3,210,391	1,572,853	21,929	-	(29,081)	6,593,233
Loans and advances	7,507,057	5,862,491	8,653,526	6,841,976	7,397,078	(1,711,565)	34,550,563
Investment securities	795,765	1,541,163	1,334,519	1,791,611	2,706,641	(28,266)	8,141,433
Insurance contract assets and receivables	240,172	31,026	191,797	3,913	12,610	(39,037)	440,481
Customer acceptances	68,952	355,313	-	-	-	-	424,265
Goodwill and other intangible assets	-	-	-	-	166,386	-	166,386
Property and equipment, right of use asset and other assets	1,018,614	28,466	113,865	25,119	831,630	-	2,017,694
Total	**15,933,205**	**11,328,850**	**11,866,560**	**8,684,548**	**11,114,345**	**(1,807,949)**	**57,119,559**

Off balance sheet items

	No later than 1 year AED'000	1- 5 years AED'000	Over 5 years AED'000	Total AED'000
At 31 December 2019				
Credit commitments	2,597,848	-	-	2,597,848
Letter of credits and guarantees	888,008	271,105	-	1,159,113
Total	**3,485,856**	**271,105**	**-**	**3,756,961**

5. PROVISIONING FOR EXPECTED CREDIT LOSS – QUALITATIVE DISCLOSURES

Expected credit loss

On adoption of IFRS 9 from 1 January 2018 impairment provisioning has changed from incurred loss model under IAS 39 to expected credit loss model under IFRS 9. Under IAS 39 credit loss provisioning was done only for loans and advances but under IFRS 9 provisioning is done for all risk assets.

Measurement of ECL

The Group recognises loss allowances for expected credit losses (ECLs) on the following financial instruments that are not measured at FVTPL:

- Due from other banks;
- Debt investment securities carried at FVOCI and amortised cost;
- Loans and advances to customers;
- Insurance assets and receivables;
- Customer acceptances and other financial assets;
- Loan commitments; and
- Financial guarantees and contracts.

No impairment loss is recognised on equity investments.

With the exception of purchased or originated credit impaired (POCI) financial assets (which are considered separately below), ECLs are required to be measured through a loss allowance at an amount equal to:

- 12-month ECL, i.e. lifetime ECL that result from those default events on the financial instrument that are possible within 12 months after the reporting date, (referred to as Stage 1); or
- Full lifetime ECL, i.e. lifetime ECL that result from all possible default events over the life of the financial instrument, (referred to as Stage 2 and Stage 3).

A loss allowance for full lifetime ECL is required for a financial instrument if the credit risk on that financial instrument has increased significantly since initial recognition. For all other financial instruments, ECLs are measured at an amount equal to the 12 month ECL.

ECLs are a probability-weighted estimate of the present value of credit losses. These are measured as the present value of the difference between the cash flows due to the Group under the contract and the cash flows that the Group expects to receive arising from the weighting of multiple future economic scenarios, discounted at the asset's interest rate.

Definition of default

Group defines a non-retail, retail and investment instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

Qualitative criteria

The Bank classifies the loans as Non-Performing Account (NPA) when:

- Such loans, which may lead to incurring of some loss due to adverse factors (financial, economic, legal, political or managerial) which may hinder repayment, or due to weakening of security.
- Loans whose full recovery seems doubtful on the basis of information available, leading, generally, to a loss of part of these loans (when the financial position of the customer and securities are not sufficient).
- Loans where the Bank has exhausted all courses of action available but failed to recover anything, or where there is a possibility that nothing shall be recovered.
- For undrawn loan commitments, the ECL is the difference between the present value of the difference between the contractual cash flows that are due to the Group if the holder of the commitment draws down the loan and the cash flows that the Group expects to receive if the loan is drawn down.
- For financial guarantee contracts, the ECL is the difference between the expected payments to reimburse the holder of the guaranteed debt instrument less any amounts that the Group expects to receive from the holder, the debtor or any other party.

The Group measures ECL on an individual basis, or on a collective basis for portfolios of loans that share similar economic risk characteristics. The measurement of the loss allowance is based on the present value of the asset's expected cash flows using the asset's original interest rate whether it is measured on an individual basis or a collective basis.

The Group employs statistical models for ECL calculations. For measuring ECL under IFRS 9, the key input would be the term structure of the following variables:

- Probability of Default (PD);
- Loss Given Default (LGD); and
- Exposure at Default (EAD).

These parameters are derived from the Group's internally developed statistical models or external data, and other historical data. These are adjusted to reflect forward-looking information.

Expected life

For instruments in Stage 2 or Stage 3, loss allowances reflect expected credit losses over the expected remaining lifetime of the instrument. For most instruments, the expected life is limited to the remaining contractual life. An exemption is provided for certain instruments with the following characteristics: (a) the instrument includes both a loan and undrawn commitment component; (b) the contractual ability to demand repayment and cancel the undrawn commitment is present; and (c) the exposure to credit losses is not limited to the contractual notice period. For products in scope of this exemption, the expected life may vary from remaining contractual life and is the period over which our exposure to credit losses is not mitigated by our normal credit risk management actions. This period varies by product and risk category and is estimated based on our historical experience with similar exposures and consideration of credit risk management actions taken as part of our regular credit review cycle like credit cards, overdraft balances, etc. Determining the instruments in scope for this exemption and estimating the appropriate remaining life based on our historical experience and credit risk mitigation practices requires significant judgement.

Credit-impaired financial assets

A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Credit-impaired financial assets are referred to as Stage 3 assets. Evidence of credit-impairment includes observable data from the following events:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the disappearance of an active market for a security because of financial difficulties; or
- the purchase of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event, instead the combined effect of several events may have caused financial assets to become credit-impaired. The Group assesses whether debt instruments that are financial assets measured at amortised cost or FVOCI are credit-impaired at each reporting date. To assess if sovereign and corporate debt instruments are credit impaired, the Group considers factors such as timing of coupon payments, credit ratings and the ability of the borrower to raise funding.

A loan is considered credit-impaired when a concession is granted to the borrower due to a deterioration in the borrower's financial condition, unless there is evidence that as a result of granting the concession the risk of not receiving the contractual cash flows has reduced significantly and there are no other indicators of impairment. For financial assets where concessions are contemplated but not granted the asset is deemed credit impaired when there is observable evidence of credit-impairment including meeting the definition of default. The definition of default includes unlikeliness to pay indicators and a backstop if amounts are overdue for 90 days or more.

Purchased or originated credit-impaired (POCI) financial assets

POCI financial assets are treated differently because the asset is credit-impaired at initial recognition. For these assets, the Group recognises all changes in lifetime ECL since initial recognition as a loss allowance with any changes recognised in profit or loss. A favourable change for such assets creates an impairment gain.

Modification of financial assets

The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. Where this happens, the Group assesses whether or not the new terms are substantially different to the original terms. The Group does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share / equity based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Group derecognises the original financial asset and recognises a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in

circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in the derecognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate.

Derecognition of financial assets

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Group transfers substantially all the risks and rewards of ownerships, or (ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

The Group enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards.

These transactions are accounted for as 'pass through' transfers that result in derecognition if the Group:

- Has no obligation to make payments unless it collects equivalent amounts from the assets;
- Is prohibited from selling or pledging the assets; and
- Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Group retains a subordinated residual interest.

Write-offs

Financial assets are written off when there is no reasonable expectation of recovery, such as a debtor failing to engage in a repayment plan with the company. The Group categorises a retail loan or receivable for write-off when a debtor fails to make contractual payments exceeding a certain number of days, as per the Bank's internal policy. As regards the non retail loans, the write-off of loans is done based on the individual assessment of these loans on a case to case basis. Where loans or receivables have been written off, the Group continues to engage in enforcement activity to attempt to recover the receivable due. Where recoveries are made, these are recognised in profit or loss.

Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by a group entity are initially measured at their fair values and, if not designated as at FVTPL and not arising from a transfer of a financial asset, are subsequently measured at the higher of:

- the amount of the loss allowance determined in accordance with IFRS 9; and
- the amount initially recognised less, where appropriate, cumulative amount of income recognised in accordance with the Group's revenue recognition policies.

Financial guarantee contracts not designated at FVTPL are presented as provisions in the consolidated statement of financial position and the remeasurement is presented in provision for credit loss. The Group has not designated any financial guarantee contracts as at FVTPL.

Curing period

The Group continues to monitor such financial instruments for a minimum probationary period of 12 months to confirm if the risk of default has decreased sufficiently before upgrading such exposure from Lifetime ECL (Stage 2) to 12 months ECL (Stage 1).

The Group is observing a probationary period of a minimum of 3 instalments (for repayments which are on a quarterly basis or shorter) and 12 months (in cases where instalments are on a longer frequency than quarterly) after the restructuring, before upgrading from Stage 3 to 2.

Expected credit loss allowance

Summary of provision for credit loss and net movement on the financial instruments by category are as follows:

AED '000	1 January 2019	Net change during the year	Other movement	31 December 2019
Due from other banks	31,140	(2,060)	-	29,080
Loans and advances	1,966,612	1,399,022	(1,654,069)	1,711,565
Investment securities	38,025	(324)	(5,269)	32,432
Insurance contract assets and receivables	36,345	2,292	-	38,637
Customer acceptances	251	170	-	421
Off balance sheet items	7,611	3,106	-	10,717
Total	**2,079,984**	**1,402,206**	**(1,659,338)**	**1,822,852**

6. CREDIT RISK WEIGHTED ASSETS – QUANTITATIVE DISCLOSURES

			Credit Risk Mitigation (CRM)		On and off balance sheet	
	On and off balance sheet gross outstanding AED '000	Exposure before CRM AED '000	CRM AED '000	After CRM AED '000	Net exposure after credit conversion factors AED '000	Risk weighted assets AED '000
31 December 2019						
Claims on sovereigns	7,260,978	7,252,850	-	7,252,850	7,252,850	1,630,853
Claims on non-commercial Public Sector Enterprises (PSEs)	57,664	57,651	-	57,651	57,651	-
Claims on multilateral development banks	173,097	173,053	-	173,053	173,053	92,275
Claims on banks	11,298,033	11,278,070	-	11,278,070	10,944,560	7,679,081
Claims on corporates and Government Related Entities (GREs)	16,582,131	16,523,730	985,886	15,537,844	12,058,903	10,771,613
Claims included in the Regulatory Retail Portfolio	21,273,245	20,895,149	270,750	20,624,399	16,709,552	12,870,435
Claims secured by residential property	5,495,786	5,488,280	-	5,488,280	5,083,986	2,432,224
Claims secured by residential real estate	3,236,396	3,225,137	-	3,225,137	3,219,205	3,219,205
Past due loans	1,675,956	783,908	-	783,908	782,684	852,155
Other assets	3,714,895	3,714,895	-	3,714,895	3,714,895	2,571,863
Total claims	**70,768,181**	**69,392,723**	**1,256,636**	**68,136,087**	**59,997,339**	**42,119,704**
Of which:						
Rated exposure		19,378,774				
Unrated exposure		50,013,949				

The rated exposure mainly pertains to financial institutions, interbank placements and investments. Majority of all other exposures are unrated.

The Group has used only those External Credit Assessment Institutions (ECAIs) which are approved by the Central Bank of UAE namely Moody's, Fitch and Standard and Poor's and Capital Intelligence.

7. CREDIT RISK MITIGATION

a) Qualitative disclosure

The group manages, limits and controls concentration of credit risk wherever it is identified – in particular, to individual counterparties and groups, and to industries and countries. The group has Product Programme Guides that set limits of exposure and lending criteria. The Group also has credit limits that set out the lending and borrowing limits to/from other banks. Further mortgage loans, loans against investments, assets based finance and auto loans, which together represent a significant portion of loans and advances, are backed by collaterals.

Respective Business Heads and their teams undertake comprehensive analysis of all commercial loan applications submitted for approval, more precisely, about ownership and management, business and industry, financials, structure and collaterals. The Chief Credit Officer and the team review the loan applications, and identify and measure the credit risks involved in such applications before the same is put up to Delegated Authorities for approval. Business and Credit Units monitor the portfolio on an on-going basis to maintain a performing portfolio.

The Group stratifies the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to 1 borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on an ongoing basis.

Limits on the level of credit risk by product, industry sector and by country are approved by the Credit Committee and the Board of Directors.

The exposure to any one borrower, including banks, is further restricted by sub-limits covering on- and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored on an on-going basis.

The Bank has a strong collections and recovery team that handles the overdue and delinquent portfolio. Collection and recovery procedures are instituted based on the account ageing classification (i.e. bucket status).

b) Quantitative disclosure:

	Exposure AED '000	Risk weighted assets AED '000
Gross exposure prior to Credit Risk Mitigation	69,392,723	43,315,731
Less: Value of eligible financial collateral	(1,256,636)	(1,196,027)
Net Exposures after Credit Risk Mitigation	68,136,087	42,119,704

*The eligible financial collaterals above include cash, deposits and bonds.

8. MARKET RISK

a) Capital requirement for Market risk under standardized approach:

	Risk weighted asset AED '000	Capital charge AED '000
Interest rate risk - Trading Book	839,241	88,120
Foreign exchange risk	75,472	7,925
Equity risk - Trading Book	150,247	15,776
Commodity Risk - Trading Book	110,023	11,552
Options risk	3,318	348
Total market risk	**1,178,301**	**123,721**

Capital charge for year ended 31 December 2019 has been calculated at 10.5%

Equity risk

As at 31 December 2019, the Group has exposures in Funds which are classified as trading positions.

Foreign exchange risk

The Bank identifies foreign exchange rate risk as the risk to future cash flows from adverse foreign exchange movements. This can have an impact on both the earnings and economic value of the Bank and as a consequence the Board seeks to manage these risks to ensure the achievement of its business objectives.

The Bank has Board approved limits on Foreign Currency positions, which are monitored on an ongoing basis, and hedging strategies are also used to ensure that positions are maintained within the limits.

The Bank follows the Short Hand Method as prescribed by CBAUE for computing capital charge.

Commodity risk

The Bank has provided hedging products to customers through commodity forwards and commodity swaps and the same are covered in the interbank market. The Bank at present has net trading positions in commodities. For the purposes of capital charge; the Bank follows the Simplified Approach as prescribed by CBUAE.

Interest rate risk

Interest rate risk arises on account of movement of interest rates thereby impacting interest rates instruments in the Trading Book. This includes FVTPL bonds and trading positions in interest rate derivatives.

For assessing the capital requirements for interest rate risk in the Trading Book (as a part of Market Risk Capital), The Bank follows the Maturity method for the general interest rate risk charge. Further, The Bank applies a specific risk charge to account for issuer risk for FVTPL Bonds.

Interest rate risk in the banking book arises due to unfavourable moments in interest rates and mismatches of interest rate sensitive assets and interest rate sensitive liabilities, thereby impacting the Net Interest Income (NII) and the Economic Value of Equity (EVE). This is monitored through the use of detailed re-pricing gap report and stress testing. Refer to Note number 39 of the audited financial statement for details of interest rate risk.

Options risk

As of December 2019, the Bank has limited exposure to foreign exchange options as part of the Trading Book. Since all the trading exposures on foreign exchange options are all long positions; the Bank follows the Simplified Approach as part of CBUAE Guidelines in order to assess the capital charge for foreign exchange options exposure in the Trading Book.

9. OPERATIONAL RISK

The Bank follows Alternative Standardised Approach (ASA) for calculation of operational risk capital.

The Group has a formal Operational Risk Governance structure. The Board and Management Risk Management Committees provide strategic direction and oversight on operational risk management processes.

The Bank endeavours to monitor and minimise the operational risk exposure through a risk and constrol self-assessment process, key risk indicators, and recording and tracking of operational risk events and losses.

The calculation of capital requirement for Operational Risk under Alternative Standardised Approach is a follows:

	3 year Average AED '000	M factor	Beta factor	Capital charge AED'000	Capital charge (UAE) AED '000	RWA = Capital charge x 9.524* AED '000
Trading and sales	297,121	-	18%	53,482	70,195	668,522
Commercial banking	17,572,685	0.035	15%	92,257	121,087	1,153,207
Retail Banking	23,284,898	0.035	12%	97,797	128,358	1,222,457
Operational risk					**319,640**	**3,044,186**

* Total Risk weighted assets are determined by multiplying the Capital Charge for operational risk by 9.524 (i.e. the reciprocal of the minimum capital ratio of 10.5%) and adding the resulting figures to sum the risk weighted assets.

10. INTEREST RATE RISK IN BANKING BOOK

Interest rate risk is assessed by measuring the impact of reasonable possible change in interest rate movements. The Group assumes a fluctuation in interest rates of 25 basis points (bps) and estimates the following impact on the net profit for the year and net assets at that date:

	2019 AED'000	2018 AED'000
Fluctuation in interest rates by 25 bps	29,825	34,829