

## **KHALEEJI COMMERCIAL BANK BSC**

### **RISK MANAGEMENT DISCLOSURES** *(based on Basel 2 and IFSB guidelines)*

**30 June 2010**

*These disclosures have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, Volume II for Islamic Banks. These disclosures should be read in conjunction with the detailed risk management disclosures made in the annual report for the year ended 31 December 2009, and the Interim financial information for the six months ended 30 June 2010.*

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**Risk and Capital Management Disclosures**

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### **Executive Summary**

The Central Bank of Bahrain's (CBB) Basel 2 guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports of the CBB Rule Book, Volume II for Islamic Banks and Section PD-3.1.6: Publication of reviewed (Unaudited) quarterly financial statements for locally incorporated banks. Section PD-1.3 reflect the requirements of Basel 2 - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks and PD 3.1.6 highlights the requirement to make quantitative disclosures described in PD-1.3 on their web site along with the half yearly financial statements.

All figures presented in this section are reported in BD thousands and are as of 30 June 2010 unless otherwise stated.

Khaleeji Commercial Bank BSC (the "Bank") has adopted the Standardised Approach for Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk to determine its capital requirements. This section contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on risk components and capital adequacy.

The Bank's Tier I and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 2 framework.

The Banks total risk weighted assets as at 30 June 2010 amounted to BD 404,199 thousand. Credit risk accounted for 81 per cent, operational risk 16 per cent, and market risk 3 per cent of the total risk weighted assets. Tier I and total regulatory capital were BD 124,010 thousand and BD 126,370 thousand respectively as at 30 June 2010.

At 30 June 2010, Bank's Tier I and total adequacy ratios were 30.68 per cent and 31.26 per cent respectively.

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### 1 Group Structure

The Bank operates under a retail banking license granted by the Central Bank of Bahrain (“CBB”) on 20 October 2003. The Bank does not have significant operating subsidiaries. The subsidiaries set-up are primarily special purpose entities with nominal capital to execute specific investment transactions. The subsidiaries qualify as commercial entities as per the CBB capital computation guidelines and are risk weighted as investments for capital adequacy purposes.

### 2 Capital Management and Capital Adequacy ratio

#### 2.1 Capital management

The Bank’s policy is to maintain a strong capital base to develop and retain investor, creditor and market confidence and to sustain business growth. The Bank recognizes the impact of a high level of capital on shareholders’ returns, while not losing sight of the security and market confidence afforded by a sound capital base. The Bank aims to maintain a minimum total capital adequacy ratio significantly in excess of that mandated by the CBB.

#### 2.2 Capital Structure, minimum capital requirements and capital adequacy

During the period, the paid up capital of the Bank increased from BD 104,924 thousand to BD 115,416 thousand as a result of issue of bonus shares (one share for every ten shares held) for 2010 amounting to BD 10,492 thousand. Following is the break-up of capital structure as at 30 June 2010:

	BD 000's
<b>Net available capital</b>	<b>30 June 2010</b>
Issued and fully paid ordinary shares	115,416
Less: Treasury shares	(5,765)
Less: ESOP shares	(1,648)
Statutory reserve	6,298
Share premium	958
Others reserves	473
Retained earning	8,278
<b>Tier 1 capital</b>	<b>124,010</b>
Current interim profits	1,020
Eligible portion of unrealised gains arising from fair valuing equities	15
Profit equalisation reserve	1,208
Investment risk reserve	117
<b>Tier 2 capital</b>	<b>2,360</b>
<b>Net available capital</b>	<b>126,370</b>

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<b>Risk weighted assets</b>	<b>30 June 2010</b>
Credit risk weight exposures	329,354
Market risk weight exposures	11,350
Operational risk weight exposures	63,495
<b>Total risk weighted assets</b>	<b>404,199</b>

<b>Capital adequacy ratio ( Tier 1 )</b>	<b>30.68%</b>
<b>Capital adequacy ratio ( Total capital)</b>	<b>31.26%</b>

The above capital adequacy ratios are calculated by dividing the respective regulatory capital base by the total Risk Weighted Assets (RWAs).

Break up of capital requirement in accordance with the Capital Adequacy Module of the CBB for the period ended 30 June 2010:

BD 000's

<b>Exposure classification</b>	<b>Exposure</b>			<b>Risk weighted assets*</b>			<b>Capital requirement @ 12%</b>		
	<b>Self – Financed</b>	<b>URIA</b>	<b>Total</b>	<b>Self – Financed</b>	<b>URIA</b>	<b>Total</b>	<b>Self – Financed</b>	<b>URIA</b>	<b>Total</b>
Cash and collection items	1,372	-	1,372	-	-	-	-	-	-
Sovereigns	10,390	3,260	13,650	-	-	-	-	-	-
Banks	74,922	-	74,922	27,377	-	27,377	3,285	-	3,285
Corporates	46,294	161,397	207,691	46,294	48,419	94,713	5,555	5,810	11,365
Past due facilities	1,899	8,036	9,935	1,899	3,616	5,515	228	434	662
Investments in equities/sukuk	8,759	18,813	27,572	13,043	8,466	21,509	1,565	1,016	2,581
Holdings of real estate	87,791	-	87,791	175,582	-	175,582	21,070	-	21,070
Other assets	4,658	-	4,658	4,658	-	4,658	559	-	559
<b>Credit Risk</b>	<b>236,085</b>	<b>191,506</b>	<b>427,591</b>	<b>268,853</b>	<b>60,501</b>	<b>329,354</b>	<b>32,262</b>	<b>7,260</b>	<b>39,522</b>
<b>Market Risk</b>	-	-	-	-	-	<b>11,350</b>	-	-	<b>1,362</b>
<b>Operational Risk</b>	-	-	-	-	-	<b>63,495</b>	-	-	<b>7,619</b>
<b>Total</b>	<b>236,085</b>	<b>191,506</b>	<b>427,591</b>	<b>268,853</b>	<b>60,501</b>	<b>404,199</b>	<b>32,262</b>	<b>7,260</b>	<b>48,503</b>

\*For capital adequacy computations, 100% of the RWAs is reckoned for self financed assets while only 30 % is considered for assets funded through URIA

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**3 Credit Risk**

**3.1 Levels of Exposure**

Gross credit exposure along with average credit exposure broken down under different exposure classes as at 30 June 2010 is as follows:

BD'000

	Average <sup>[1]</sup> Exposure	Gross Exposure		
		Self	URIA	Total
Cash and bank balances <sup>[2]</sup>	13,823	14,177	-	14,177
Placement with banks/FIs	82,300	72,485	-	72,485
Islamic financing assets	200,348	31,085	169,433	200,518
Investments in equity securities	83,720	83,633	-	83,633
Assets acquired for leasing (including ijarah rental receivable)	12,282	11,803	-	11,803
Investment in sukuku	22,385	-	22,073	22,073
Investments in associates	6,397	6,272	-	6,272
Assets held-for-sale	4,769	4,685	-	4,685
Other assets	7,334	7,171	-	7,171
<b>Total On Balance Sheet Credit Exposure</b>	<b>433,358</b>	<b>231,311</b>	<b>191,506</b>	<b>422,817</b>
Undrawn financing facilities	11,132	16,112	-	16,112
Commitments to invest	4,178	4,178	-	4,178
Guarantees	1,414	1,432	-	1,432
<b>Total Off Balance Sheet Credit Exposure</b>	<b>16,724</b>	<b>21,722</b>	<b>-</b>	<b>21,722</b>

<sup>[1]</sup> Represents quarterly average balances for the six months period ended 30 June 2010.

<sup>[2]</sup> Includes cash balance of BD 1,373 thousand

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**3.2 Concentration of credit risk**

**3.2.1 Geographic distribution**

The geographical exposure profile as at 30 June 2010 was as follows:

BD 000's

	<b>GCC Countries</b>	<b>Europe</b>	<b>USA</b>	<b>Asia</b>	<b>Australia</b>	<b>Africa</b>	<b>Total</b>
<b>Assets</b>							
Cash and bank balances	13,634	79	379	61	24	-	14,177
Placement with financial institutions	72,485	-	-	-	-	-	72,485
Islamic financing assets	186,095	10,679	660	3,084	-	-	200,518
Investment securities	64,816	2,216	-	29,249	-	9,425	105,706
Assets acquired for leasing (including ijarah rental receivable)	11,803	-	-	-	-	-	11,803
Investment in associates	6,272	-	-	-	-	-	6,272
Asset held-for-sale	-	-	-	-	4,685	-	4,685
Other assets	3,268	31	-	178	-	-	3,477
Equipment	3,694	-	-	-	-	-	3,694
<b>Total funded exposures</b>	<b>362,067</b>	<b>13,005</b>	<b>1,039</b>	<b>32,572</b>	<b>4,709</b>	<b>9,425</b>	<b>422,817</b>
Undrawn financing facilities	15,760	352	-	-	-	-	16,112
Commitment to invest	4,178	-	-	-	-	-	4,178
Guarantees	1,432	-	-	-	-	-	1,432
<b>Total unfunded exposures</b>	<b>21,370</b>	<b>352</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>21,722</b>

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**3.2.2 Industry/ sector wise distribution of exposure**

The industry sector wise exposure as at 30 June 2010 was as follows:

BD 000's

<b>2010</b>	<b>Banks and financial institutions</b>	<b>Real estate</b>	<b>Others</b>	<b>Total</b>
<b>Assets</b>				
Cash and bank balances	14,177	-	-	14,177
Placements with financial institutions	72,485	-	-	72,485
Islamic financing assets	15,371	105,590	79,557	200,518
Investments securities	8,092	73,927	23,687	105,706
Assets acquired for leasing (including ijarah rental receivable)	2,755	6,815	2,233	11,803
Investment in associates	-	6,272	-	6,272
Asset held-for-sale	-	-	4,685	4,685
Other assets	7	1,569	1,901	3,477
Equipment	-	-	3,694	3,694
<b>Total funded exposure</b>	<b>112,887</b>	<b>194,173</b>	<b>115,757</b>	<b>422,817</b>
Undrawn financing facilities	5,655	4,350	6,107	16,112
Commitment to invest	-	4,178	-	4,178
Guarantees	-	32	1,400	1,432
<b>Total unfunded exposures</b>	<b>5,655</b>	<b>8,560</b>	<b>7,507</b>	<b>21,722</b>



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### 3.2.3 Transactions with related counterparties

Related counterparties are those entities which are related to the Bank through significant shareholding or control or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of related counterparties the Bank strictly follows the guidelines issued by Central Bank of Bahrain for the purpose.

Transactions with related parties during the six months period ended 30 June 2010 and balances outstanding pertaining to related parties as at 30 June 2010 is as follows:

	BD 000's
<b>Transactions</b>	<b>30 June 2010</b>
Placement, management and arrangement fees	694
Income from Islamic assets and assets acquired on leasing	369
Income from investment securities	1,269
Share of losses from associate companies	(249)
Return on unrestricted investment accounts	682
Investment related expenses	70
<b>Balances</b>	<b>30 June 2010</b>
Investment securities	45,869
Islamic financing assets	11,417
Assets-held-for-sale	4,685
Investment in associates	6,272
Other assets	1,327
Customers' current accounts	2,831
Unrestricted investment accounts	35,009
Other liabilities	1,648

### 3.2.4 Exposures in excess of 15% of capital base

Single exposures in excess of 15 % of the Bank's capital base on individual counterparties require prior approval of CBB except where exempted under para CM 4.5 of the rule book. The Bank does not have any such 'large exposures' that are not exempted and which therefore require prior approval of CBB.

Exposures exceeding single exposure limits as of 30 June 2010

	BD 000's
<b>Banks</b>	<b>Amount</b>
Bank A	23,789
<b>Total</b>	<b>23,789</b>

### 3.2.5 Exposures in highly leveraged counterparties

The Bank has no financing exposures to highly leveraged and other high risk counterparties as per definition provided in the CBB rule book PD 1.3.24.

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**3.2.6 Residual contractual maturity of the credit portfolio and investment in sukuk**

The Bank's policy allows exposures up to a maximum period of 7 years with any exception to be approved by the Board of Directors. However, most of the Bank's exposures are limited to an original maturity of 5 years. The Bank constantly monitors the residual maturity profile of its assets to ensure that any mismatch with the maturity of its liabilities is kept within acceptable limits. The contractual residual maturity profile by type of financing contract of the Bank's credit portfolio and investment in sukuk is given in the table below.

BD 000's

<b>Maturity Scale</b>	<b>&lt; 1 M</b>	<b>1 - 3 M</b>	<b>3 - 6 M</b>	<b>6M - 1 Y</b>	<b>1 - 3 Y</b>	<b>&gt; 3 Y</b>	<b>Total</b>
<b>Credit Portfolio*</b>							
Murabaha	5,254	17,056	8,171	25,435	51,933	41,074	<b>148,923</b>
Musharaka	-	2,931	6,388	1,829	8,223	3,089	<b>22,460</b>
Wakala	4,800	4,732	3,021	-	176	15,335	<b>28,064</b>
Istisna	-	-	-	-	-	1,071	<b>1,071</b>
Ijarah	4,688	187	264	-	1,368	5,296	<b>11,803</b>
<b>Total</b>	<b>14,742</b>	<b>24,906</b>	<b>17,844</b>	<b>27,264</b>	<b>61,700</b>	<b>65,865</b>	<b>212,321</b>
Investments in sukuk	3,983	910	2,350	-	12,356	2,474	<b>22,073</b>
<b>Total</b>	<b>3,983</b>	<b>910</b>	<b>2,350</b>	<b>-</b>	<b>12,356</b>	<b>2,474</b>	<b>22,073</b>
<b>Grand Total</b>	<b>18,725</b>	<b>25,816</b>	<b>20,194</b>	<b>27,264</b>	<b>74,056</b>	<b>68,339</b>	<b>234,394</b>

\* Credit Portfolio includes Islamic financing assets, assets acquired for leasing and lease rental receivable

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### 3.3 Equity risk in banking book

The Bank does not have a trading book and hence all of its equity investments are classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. For regulatory capital computation purposes, the Bank's equity investments in the banking book include available-for-sale investments and associate investments in non-financial entities.

BD 000's	
<b>Information on equity investments</b>	
Privately held	96,168
Quoted in an active market	191
Realised gain/ (loss) during the period	-
Unrealised gain/ (loss) in equity (Tier 2)	34

The following are the categories under which equity investments are included in the capital adequacy computations as per the requirements of the CBB rules:

BD 000's						
Equity investments in banking book	Gross exposure		Risk weighted exposure		Capital charge	
	Self financed	URIA	Self financed	URIA	Self financed	URIA
Quoted equity investment	191	-	191	-	23	-
Unquoted equity investment	8,568	-	12,852	-	1,542	-
Investments in managed funds	-	-	-	-	-	-
Real estate investments	* 87,791	-	175,582	-	21,070	-
<b>Total</b>	<b>96,550</b>	<b>-</b>	<b>188,625</b>	<b>-</b>	<b>22,635</b>	<b>-</b>

\* Includes commitments to invest of BD 836 thousands

### 3.4 Past dues, impaired accounts, provisions

Exposure which were past due or impaired as of 30 June 2010:

BD 000's						
30 June 2010	Placements with financial institutions	Islamic financing assets	Assets acquired for leasing	Investment securities-Sukuks	Other assets	Total
<b>Impaired</b>						
Grade 9: Impaired	-	9,796	-	-	-	9,796
Allowance for impairment	-	(7,897)	-	-	-	(7,897)
<b>Impaired comprises:</b>						
180 days+		1,899				1,899
<b>Carrying amount</b>	<b>-</b>	<b>1,899</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,899</b>

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	<b>Placements with financial institutions</b>	<b>Islamic financing assets</b>	<b>Assets acquired for leasing</b>	<b>Investment securities-Sukuks</b>	<b>Other assets</b>	<b>Total</b>
<b><u>Past Due but not impaired</u></b>						
Grade 1-6 Low-Fair Risk	-	27,978	-	-	-	27,978
Grade 7-8 Watch list	-	19,407	-	-	-	19,407
Unrated	-	-	-	-	-	-
<b><u>Past due comprises:</u></b>						
0-30 days	-	20,084	-	-	-	20,084
30-60 days	-	3,960	-	-	-	3,960
60-90 days	-	10,256	-	-	-	10,256
90-180days	-	8,036	-	-	-	8,036
180 days +	-	5,049	-	-	-	5,049
<b><i>Carrying amount</i></b>	<b>-</b>	<b>47,385</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>47,385</b>
<b><u>Neither past due nor impaired</u></b>						
Grade 1-6 Low-Fair Risk	72,485	131,627	10,149	22,174	-	236,435
Grade 7,8: Watch list	-	22,265	1,790	-	-	24,056
Unrated	-	-	-	-	3,477	3,477
<b><i>Carrying amount</i></b>	<b>72,485</b>	<b>153,892</b>	<b>11,939</b>	<b>22,174</b>	<b>3,477</b>	<b>263,968</b>
<b><i>Less: Collective impairment provisions</i></b>						
		(2,658)	(136)	(101)		(2,895)
<b>Total</b>	<b>72,485</b>	<b>200,518</b>	<b>11,803</b>	<b>22,073</b>	<b>3,477</b>	<b>310,357</b>

During the six month period ended 30 June 2010, the Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In view of the current market conditions, the Bank has maintained the collective provisions at a certain percentage based on the internal risk grades assigned to counterparties, resulting in an average of approximately 1.2% of its Islamic financing assets, assets acquired for leasing, lease rental receivables and Sukuk portfolios. The Bank is in the process of developing a detailed risk and ratings based model to identify and maintain collective provision on portfolio basis going forward. Of the total past due facilities of BD 47,385, only installments of BD 10,487 are currently past due.

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**3.5 Geographical and sector-wise break-up of impairment allowances and impaired/past due accounts**

BD 000's

	<b>GCC countries</b>	<b>Europe</b>	<b>USA</b>	<b>Asia</b>	<b>Australia</b>	<b>Africa</b>	<b>Total</b>
Impaired	3,199	-	6,597	-	-	-	9,796
Allowance for impairment	(1,959)	-	(5,938)	-	-	-	(7,897)
Carrying amount	1,240	-	659	-	-	-	1,899
Past due but not impaired	47,385	-	-	-	-	-	47,385
Collective impairment	(2,654)	(118)	-	(100)	-	(23)	(2,895)

BD 000's

	<b>Banks and financial institutions</b>	<b>Real estate</b>	<b>Others</b>	<b>Total</b>
Impaired	-	6,597	3,199	9,796
Allowance for impairment	-	(5,938)	(1,959)	(7,897)
Carrying amount	-	659	1,240	1,899
Past due but not impaired	-	46,150	1,235	47,385
Collective impairment	(186)	(1,803)	(906)	(2,895)

**3.6 Renegotiated facilities**

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the period ended 30 June 2010 amounting to BD 11,764 thousand that otherwise might have become past due in future as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and / or part of the principal and / or obtaining of additional collateral coverage. The renegotiated facilities are subject to revised credit assessments and independent review by the RMD.

**3.7 Legal Action and Write off of exposures**

The Bank has policies for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. The Bank has, as of date, initiated legal action against one client involving a claim of BD 3,199 thousand.

The Bank has a policy that permits write off of exposures when there is no possibility of recovery of the dues through legal and other means. However the Bank has so far not written off any such dues or exposures.

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### 3.8 Penalties for Delayed Payments

In cases where customers delay the payments of dues to the Bank, the Bank has the right to collect penalties, subject to the provisions of the agreement between the customer and the Bank. The Bank recovers such penalties from customers when the amounts are significant. As per policy such penalties are maintained in a separate account and used for charity purposes approved by the Bank's Shari'a Board.

The Bank has a policy of creating a contribution for Zakah and Charity fund for any non-Islamic income earned. During the six months period ended 30 June 2010 BD 30 thousand of non-Islamic income was transferred to Zakah & Charity fund.

### 3.9 Credit Risk Mitigation

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 30<sup>th</sup> June 2010 is given in the table below.

BD 000's

Collateral Type	Murabaha	Musharaka	Wakala	Istisna'a	Ijara	Value of Collateral <sup>[1]</sup>	Total Gross Exposure <sup>[2]</sup>	% of cover	% of Total
Real Estate	173,019	35,403	3,559	2,680	30,791	245,452	113,574	216	75
Listed Securities	1,273	1,542				2,815	3,447	82	1
Unlisted Securities	7,921					7,921	7,087	112	2
Bank Guarantee	10,839					10,839	7,244	150	3
Cash									
Collateral	8,018		283			8,301	22,358	37	2
Unsecured						-	40,072	0	0
Others	10,758	30,984	5,639		10,188	57,569	18,539	311	17
<b>Total</b>	<b>211,828</b>	<b>67,929</b>	<b>9,481</b>	<b>2,680</b>	<b>40,979</b>	<b>332,897</b>	<b>212,321</b>	<b>157</b>	<b>100</b>

<sup>[1]</sup> (Represents the last valuation carried out based on the Bank's valuation policy)

<sup>[2]</sup> (Excludes collective provisions of BD 2,895 thousand)

The Bank does not carry out any on balance sheet or off balance sheet netting for the securities held. The Bank has not claimed any capital relief for Credit Risk Mitigation under Section CA 4 of the Capital Adequacy module of CBB rule book and hence all exposures are risk weighted at their gross values.

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the six months period ended 30 June 2010 there has been no such instance.

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**3.10 Regulatory Capital Requirements by type of Islamic financing contracts**

BD 000's

Islamic financing contracts	Exposures		Credit Risk Weighted Assets		Capital requirement @ 12%	
	Self	URIA	Self	URIA	Self	URIA
Murabaha	31,085	123,194	31,085	36,958	3,730	4,435
Ijarah assets (including lease rental receivables)	11,803	-	11,803	-	1,416	-
Mudaraba	-	-	-	-	587	-
Musharaka	-	22,167	-	6,650	-	798
Wakala	-	23,014	-	6,904	-	829
Istisna'a	-	1,058	-	317	-	38
<b>Total</b>	<b>42,888</b>	<b>169,433</b>	<b>42,888</b>	<b>50,829</b>	<b>5,733</b>	<b>6,100</b>

**4 Market Risk**

**4.1 Regulatory Capital Allocation against Market Rate Risk**

Table below shows the market risk position for each category of the market risk as at 30 June 2010 along with the maximum and minimum values during the six month period:

BHD 000's

	As at 30 June	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	-	-	-
Foreign exchange risk	908	1,032	908
Commodity risk	-	-	-
<b>Total</b>	<b>908</b>	<b>1,032</b>	<b>908</b>
Risk weighted assets (A x 12.5)	11,350	12,900	11,350
Capital requirement @ 12%	1,362	1,548	1,362

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## 5 Operational Risk

### 5.1 Regulatory Capital Allocation against Operational Risk

The Bank uses the Basic Indicator Approach (BIA) in calculating its regulatory capital requirement for operational risk.

The risk weighted assets and capital requirement for operational risk as at 30 June 2010 is as given below:

	BD 000's
Average gross income for 3 years (A)	33,864
Operational Risk Weighted Assets B = (A * 15%*12.5)	63,495
Capital requirement (B * 12%)	7,619

## 6 Other risks

### 6.1 Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its financial obligations on account of a maturity mismatch between assets and liabilities. The Bank's approach to managing liquidity is to ensure, that it will always have sufficient funds to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation.



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Maturity profile of assets and liabilities as at 30 June 2010 is as follows:

	BD 000's					
<b>30 June 2010</b>	<b>Up to 3 months</b>	<b>3 to 6 months</b>	<b>6 months-1 year</b>	<b>1 to 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
<b>Assets</b>						
Cash and bank balances	14,177	-	-	-	-	<b>14,177</b>
Placements with financial institutions	72,485	-	-	-	-	<b>72,485</b>
Islamic financing assets	34,773	17,580	27,264	60,332	60,569	<b>200,518</b>
Investment securities	4,893	-	23,689	46,428	30,696	<b>105,706</b>
Assets acquired for leasing	4,875	264	-	1,368	5,296	<b>11,803</b>
Investment in associates	-	-	2,571	611	3,090	<b>6,272</b>
Asset held for sale	-	-	-	-	4,685	<b>4,685</b>
Other assets	3,477	-	-	-	-	<b>3,477</b>
Equipment	-	-	-	-	3,694	<b>3,694</b>
<b>Total assets</b>	<b>134,680</b>	<b>17,844</b>	<b>53,524</b>	<b>108,739</b>	<b>108,030</b>	<b>422,817</b>
<b>Liabilities</b>						
Placements with financial institutions and others	68,611	-	9,473	1,409	-	<b>79,493</b>
Customer current account	16,950	-	-	-	-	<b>16,950</b>
Other liabilities	-	-	-	-	8,479	<b>8,479</b>
<b>Total liabilities</b>	<b>85,561</b>	<b>-</b>	<b>9,473</b>	<b>1,409</b>	<b>8,479</b>	<b>104,922</b>
<b>Unrestricted Investment accounts</b>	<b>156,196</b>	<b>14,365</b>	<b>22,270</b>	<b>-</b>	<b>-</b>	<b>192,831</b>
<b>Restricted Investment accounts</b>	<b>-</b>	<b>-</b>	<b>32,885</b>	<b>9,393</b>	<b>-</b>	<b>42,278</b>
<b>Commitments</b>	<b>-</b>	<b>-</b>	<b>20,290</b>	<b>1,432</b>	<b>-</b>	<b>21,722</b>

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The following are the key liquidity ratios which reflect the liquidity position of the Bank:

	Figures in %
	30 June 10
Interbank assets to interbank liabilities	91.18
Liquid assets to total assets	20.71
Liquid assets to total deposits	41.74
Net liquid assets to total deposits	3.85

### 6.2 Profit rate risk in the banking book

A summary of the Bank's profit rate gap position at 30 June 2010 is as follows:

	BD 000's					
30 June 2010	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
<b>Assets</b>						
Placements with financial institutions	72,485	-	-	-	-	72,485
Islamic Financing assets	43,390	21,129	27,250	58,266	50,483	200,518
Assets acquired for leasing	8,824	2,754	-	90	135	11,803
Investments securities (sukuks)	11,099	5,319	-	3,770	1,885	22,073
<b>Total profit rate sensitive assets</b>	<b>135,798</b>	<b>29,202</b>	<b>27,250</b>	<b>62,126</b>	<b>52,503</b>	<b>306,879</b>
<b>Liabilities</b>						
Placements from financial institutions and others	68,611	9,473	1,409	-	-	79,493
Investors funds (note 12)	1,852	-	-	-	-	1,852
Unrestricted investments accounts	143,060	28,778	17,949	1,170	1,874	192,831
<b>Total profit rate sensitive liabilities</b>	<b>213,523</b>	<b>38,251</b>	<b>19,358</b>	<b>1,170</b>	<b>1,874</b>	<b>274,176</b>
<b>Profit rate gap</b>	<b>(77,725)</b>	<b>(9,049)</b>	<b>7,892</b>	<b>60,956</b>	<b>50,629</b>	<b>32,703</b>

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios.

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An analysis of the Bank's sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

At 31 June 2010  
At 31 December 2009

<b>200 bp parallel increase/ decrease</b>
± 654
± 874

### 6.3 Displaced commercial risk

Displaced Commercial Risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by Unrestricted Investment Accounts. This can be due to the return on such assets being lower than that of competitors. The Bank has adequate policies and procedures in place to identify, monitor and address all potential risks that may arise from such activities. Please refer to the section on URIA for further details.

### 6.4 Other risks

Other risks include strategic risk, fiduciary risks, regulatory risks etc. which are inherent in all business and are not easily measurable or quantifiable. The Bank's Board has overall responsibility for approving and reviewing the risk strategies and amendments to the risk policies. The Bank senior management is responsible for implementing the risk strategy approved by the Board. The management also ensures that internal systems of corporate governance and regulatory compliance for management of fiduciary and reputational risks are robust and effective. The Bank also allocates additional capital for such risks under its ICAAP.

## 7 Unrestricted Investment Accounts (URIAs)

The detail of income distribution to URIA holders is given below.

	BD 000's				
	30 June 2010	2009	2008	2007	2006
Allocated Income to URIA	4,304	11,103	8,953	3,012	917
Distributed Profit	3,128	9,331	7,050	2,446	628
Mudarib Fees	1,176	1,772	1,903	566	289
<b>As at period end</b>					
URIA <sup>[1]</sup>	194,458	184,394	128,814	38,405	12,803
Profit Equalisation Reserve (PER)	1,209	1,209	649	206	60
Investment Risk Reserve (IRR)	117	925	473	134	43
Profit Equalisation Reserve-to-URIA	0.62%	0.66%	0.50%	0.54%	0.50%
Investment Risk Reserve-to-URIA	0.06%	0.50%	0.37%	0.35%	0.36%

<sup>[1]</sup> Represents average balance

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**Ratio of profit distributed to PSIA by type of URIA (based on tenor)**

BD 000's

Tenor	Profit distribution amount in BD					Ratio of profit paid as a percentage of total				
	30 June 2010	2009	2008	2007	2006	30 June 2010	2009	2008	2007	2006
1 Month Mudaraba <sup>[2]</sup>	1,749	4,271	3,346	1,576	335	55.9	45.8	47.5	64.4	53.4
3 Months Mudaraba	817	1,443	1,314	148	78	26.1	15.5	18.6	6.1	12.4
6 Months Mudaraba	293	736	373	71	26	9.4	7.9	5.3	2.9	4.1
12 Months Mudaraba	687	1,196	690	106	45	22.0	12.8	9.8	4.3	7.1
VIP Mudaraba	390	673	545	309	64	12.5	7.2	7.7	12.6	10.2
PER and IRR expenses	20	1,012	782	236	80	0.64	10.8	11.1	9.7	12.8
Utilization of IRR	(828)	-	-	-	-	(26.5)	-	-	-	-
<b>Total</b>	<b>3,128</b>	<b>9,331</b>	<b>7,050</b>	<b>2,446</b>	<b>628</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>[2]</sup> Includes saving account products.

(Annualised rates)

Year	Avg. profit earned from URIA assets (%age of asset)	PER set aside as a %age of URIA assets	IRR set aside as a %age of URIA assets	Mudharib fees as a %age of URIA assets	Profit paid as a %age of URIA assets
HY ended June 2010	5.28	0.00	0.02	1.21	4.05
2009	6.09	0.30	0.24	0.96	4.58
2008	7.07	0.34	0.26	1.60	4.87
2007	7.84	0.38	0.24	1.47	5.75
2006	7.59	0.38	0.29	2.39	4.53

**Distribution of profits by type of URIA products:**

(Annualised rates)

Type of deposit	Period ended 30 June 2010	2009	2008	2007
1 month Mudharaba <sup>[2]</sup>	3.46	4.00	4.80	6.30
3 months Mudharaba	4.58	4.94	5.25	5.20
6 months Mudharaba	4.77	5.30	5.13	5.15
12 months Mudharaba	5.44	5.79	5.40	5.30
VIP Mudharaba	3.94	4.20	4.52	5.09

<sup>[2]</sup> Includes saving account products

**Market bench mark rates:**

The Bank refers to the group of commercial Islamic banks incorporated in the Kingdom of Bahrain so as to bench mark the rate of return on URIA.

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### URIA account by type of assets

The following table summarises the movement in type of assets in which the URIA funds are invested and allocation among various type of assets for the period ended 30 June 2010:

Particulars	Opening allocation	Movement	Closing allocation	Proportion of total asset
<b>Islamic financing assets</b>				
Murabaha	122,803	391	123,194	76%
Musharaka	24,389	(2,222)	22,167	100%
Wakala	23,505	(491)	23,014	100%
Istisna'a	1,514	(456)	1,058	100%
<b>Investment securities</b>				
Sukuk	29,243	(7,170)	22,073	100%
<b>Total</b>	<b>201,455</b>	<b>(9,949)</b>	<b>191,506</b>	

### 7.1 Restricted Investment Accounts (RIAs)

RIA Name	Details	Launch Date	Projecte d Returns	Return Frequen cy	Returns annualised				
					Period ended 30 June 2010	2009	2008	2007	2006
Al Hareth French Property Fund	An investment product designed to deliver attractive return from income producing properties in France. Approximate capital redemption of 30% was completed in April 2007 with a capital gain of 6% on the redeemed portion.	2005	9%	Annual	-	1.75%	9.5%	9.5%	9.5%
RIA-1 Safana	An investment structure designed to participate in the equity interest of Safana Investment WLL. A company established for the purpose of acquiring reclaimed land to subdivide and sell.	2007	61.78% over the product tenor	Bullet payment on maturity	-	-	-	-	-
RIA-2 Hajer Tower	An investment structure designed to participate in a product with the principal purpose of acquiring the 21st floor of Al-Hajer Tower in the Holy City of Mecca. The exit of this product was completed June 2008 as per the expected return on investment of 14.9%.	2007	14.90%	Bullet payment on maturity	-	-	14.9%	-	-
RIA-3	Participation in Murabaha	2007	3 month	Quarterly	-	-	7.50%	7.72%	6.34%

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Aramis	backed by a promissory issued by a guarantor SPV with BBB+ rating. KHCB offered this as a short-term investment to investors with 3 month term on a renewal option and successfully exited all investors from this project during quarter ended 31 March 2008		USD Libor+18 7 bps per quarter						
RIA-4 Janayen	A restricted investment product designed to invest in growth and income generating real estate assets in the GCC and MENA regions. It should be noted that the distribution percentage made to date exceeds the forecasted yield outlined under the original Janayen Offering Documents and the revised distribution calendar provided in the first Investment Update	2007	44.33%	Quarterly	0.8%	9.25%	10.65%	-	-
RIA-5 North Gate	A restricted investment product which owns a 6.0% stake in Shaden Real Estate Investment WLL which in turn (through its subsidiaries), holds a parcel of reclaimed land measuring approximately 3.875 million sq. meters (located in Al Hidd, Muharraq). The mixed-use plot will be sold to end-users subsequent to the completion of infrastructure works.	2008	90.66% over product tenor	Bullet return at maturity	-	-	-	-	-
RIA-6 Locata	A Restricted Mudharabah product which entitles the investors beneficial ownership of 25% equity share capital of Locata Corporation Pty Ltd., a company incorporated in Australia. The Company has invented a new and patented wireless radiolocation technology and shall use this funding to scale up its production capacity, sales/marketing channels and further product enhancement capabilities.	2009	110.54% over product tenor	Bullet return at maturity	-	-	-	-	-