KHALEEJI COMMERCIAL BANK BSC

RISK MANAGEMENT DISCLOSURES

(Based on Basel 2 and IFSB guidelines)

30 June 2012

These disclosures have been prepared in accordance with the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports and PD-3.1.6 Semi-annual Disclosures, 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 2011, and the condensed consolidated interim financial information for the six months ended 30 June 2012

TABLE OF CONTENTS

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 2012 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 2012 amounted to BD 418,663 thousand. Credit risk accounted for 88 per cent, operational risk 9 per cent, and market risk 3 per cent of the total risk weighted assets. Tier I and total regulatory capital were BD 118,465 thousand and BD 121,040 thousand respectively as at 30 June 2012.

At 30 June 2012, Bank's Tier I capital and total capital adequacy ratios were 28.30 per cent and 28.91 per cent respectively.

1 Group Structure

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

Following is the break-up of capital structure as at 30th June 2012:

BD 000's

Net available capital	**30 June 2012**
Issued and fully paid ordinary shares	115,416
Less: Treasury shares	(6,060)
Statutory reserve	6,350
Share premium	1,485
Others reserves	(344)
Retained earning	1,747
Current interim cumulative net losses	(129)
Tier 1 capital	**118,465**
Collective provision	2,575
Eligible portion of unrealised gains arising from fair valuing equities	-
Profit equalisation reserve	-
Investment risk reserve	-
Tier 2 capital	**2,575**
Net available capital	**121,040**

	30 June 2012
Credit risk weight exposures	367,410
Market risk weight exposures	13,875
Operational risk weight exposures	37,378
Total risk weighted assets	**418,663**

Capital adequacy ratio (Tier 1 capital)	**28.30%**
Capital adequacy ratio (Total capital)	**28.91%**

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 2012 is as follows (in BD 000's):

Exposure classification	Exposure			Risk weighted assets*			Capital requirement @ 12%		
	Self – Financed	IAH	Total	Self – Financed	IAH	Total	Self – Financed	IAH	Total
Cash and collection items	2,114	-	2,114	-	-	-	-	-	-
Sovereigns	899	17,919	18,818	-	-	-	-	-	-
Banks	2,828	57,792	60,620	1,414	3,512	4,926	170	421	591
Corporates	89,306	107,620	196,926	89,306	32,286	121,592	10,717	3,874	14,591
Residential mortgage eligible for 75% RW	14,542	-	14,542	10,907	-	10,907	1,309	-	1,309
Past due facilities	25,151	-	25,151	31,807	-	31,807	3,817	-	3,817
Investments in equities/sukuk	29,558	4,673	34,231	44,337	2,103	46,440	5,320	252	5,572
Holdings of real estate	77,575	-	77,575	148,434	-	148,434	17,812	-	17,812
Other assets	3,304	-	3,304	3,304	-	3,304	396	-	396
Credit Risk	**245,277**	**188,004**	**433,281**	**329,509**	**37,901**	**367,410**	**39,541**	**4,547**	**44,088**
Market Risk	-	-	**-**	-	-	**13,875**	-	-	**1,665**
Operational Risk	-	-	**-**	-	-	**37,378**	-	-	**4,485**
Total	**245,277**	**188,004**	**433,281**	**329,509**	**37,901**	**418,663**	**39,541**	**4,547**	**50,238**

* For capital adequacy computations, 100% of the RWAs is reckoned for self-financed assets while only 30% is considered for assets funded through equity of investment account holders (IAH).

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 2012 is as follows:

BD 000's

	Average Exposure [1]	Gross Exposure		
		Self – Financed	IAH	Total
Cash and bank balances	22,889	3,008	25,110	28,118
Placement with financial institutions	39,564	-	42,232	42,232
Financing assets	215,435	105,015	108,587	213,602
Investment securities – Equity	89,672	89,546	-	89,546
Assets acquired for leasing (including lease rental receivables)	17,459	19,076	-	19,076
Investment securities – Sukuks	16,118	-	12,075	12,075
Investments in associates	3,227	3,215	-	3,215
Investment property	6,583	6,583	-	6,583
Other assets, including property and equipment	11,200	11,366	-	11,366
Total funded Credit Exposure	**422,147**	**237,809**	**188,004**	**425,813**
Undrawn commitments to extend finance	9,859	10,863	-	10,863
Commitments to invest	5,655	5,655	-	5,655
Financial guarantees	11,236	11,620	-	11,620
Total unfunded Credit Exposure	**26,750**	**28,138**	**-**	**28,138**

[1] Represents quarterly average balances for the six months period ended 30 June 2012.

3.2 Concentration of credit risk

3.2.1 Geographic distribution

The geographical exposure profile as at 30 June 2012 was as follows:

BD 000's

2012	GCC Countries	Europe	USA	Asia	Australia	Africa	Total
Assets							
Cash and bank balances	14,661	6,506	6,910	18	23	-	28,118
Placement with financial institutions	42,232		-	-	-	-	42,232
Financing assets	203,677	9,544	381	-	-	-	213,602
Investment securities	70,119	1,985	-	24,008	4,453	1,056	101,621
Assets acquired for leasing (including lease rentals receivable)	19,076	-	-	-	-	-	19,076
Investment in associates	3,215	-	-	-	-	-	3,215
Investment property	6,583	-	-	-	-	-	6583
Other assets	1,678	-	-	376	43	-	2,097
Property and equipment	9,269	-	-	-	-	-	9,269
Total funded exposures	**370,510**	**18,035**	**7,291**	**24,402**	**4,519**	**1,056**	**425,813**
Undrawn financing facilities	10,861	2	-	-	-	-	10,863
Commitment to invest	5,655	-	-	-	-	-	5,655
Guarantees	8,751	2,869	-	-	-	-	11,620
Total unfunded exposures	**25,267**	**2,871**	**-**	**-**	**-**	**-**	**28,138**

3.2.2 Industry/ sector-wise distribution

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry/ sector wise exposure as at 30 June 2012 was as follows:

BD 000's

2012	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	28,118	-	-	28,118
Placements with financial institutions	42,232	-	-	42,232
Financing assets	30,406	83,946	99,250	213,602
Investment securities	21,714	61,703	18,204	101,621
Assets acquired for leasing (including lease rentals receivable)	1,939	17,137	-	19,076
Investment in associates	-	3,215	-	3,215
Investment property	-	6,583	-	6,583
Other assets	214	998	885	2,097
Property and equipment	-	6,715	2,554	9,269
Total funded exposure	**124,623**	**180,297**	**120,893**	**425,813**
Undrawn financing facilities	-		10,863	10,863
Commitment to invest	5,655	-	-	5,655
Guarantees	-	5,775	5,845	11,620
Total unfunded exposures	**5,655**	**5775**	**16,708**	**28,138**

* Financing asset exposures have been classified based on the purpose of financing.

3.2.3 Transactions with related counterparties

Related counterparties are those entities which are related to the Bank through significant shareholding, 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 CBB for the purpose. Transactions with related parties during the six months period ended 30 June 2012 and balances outstanding pertaining to related parties is as follows:

Transactions	**30 June 2012**
Management fees	83
Income from financing assets and assets acquired for leasing	318
Income from investment securities	134
Share of profit from associate companies	215
Return to investment account holders	176
Staff cost	288
Other expenses	19

Balances	**30 June 2012**
Investment securities	46,543
Financing assets	13,233
Investment in associates	3,215
Other assets	1,037
Customers' current accounts	939
Equity of investment account holders	16,335

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 as at 30 June 2012.

3.2.5 Exposures in highly leveraged counterparties

The Bank has no exposure to a highly leveraged and other high risk counterparties as per definition provided in the CBB rule book PD 1.3.24 (e).

3.2.6 Residual contractual maturity of the credit portfolio and investment in sukuks

The Bank's policy allows exposures up to a maximum period of 7 years for corporate customers and 25 years for retail customers with any exceptions to be approved by the Board of directors. 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 sukuks is given in the table below (in BD 000's):

Maturity Scale	**< 1 M**	**1 - 3 M**	**3 - 6 M**	**6M - 1Y**	**1 - 3Y**	**3 – 5Y**	**5 - 10Y**	**10 - 20Y**	**Over 20Y**	**Total**
Credit portfolio:										
Murabaha	7,831	873	2,758	11,610	51,112	47,403	19,527	-	-	141,114
Musharaka	1,747	-	1,881	9,234	23,838	6,332	9,443	-	-	52,475
Wakala	3,278	4,292	3,442	-	6,146	2,096	-	-	-	19,254
Istisna	-	-	-	-	-	760	-	-	-	760
Ijarah	-	-	-	-	1,884	3,341	3,864	8,135	1,852	19,076
Total	**12,856**	**5,165**	**8,081**	**20,844**	**82,980**	**59,932**	**32,834**	**8,135**	**1,852**	**232,679**
Investment in Sukuks	687	1,485	2,350	2,218	1,056	2,660	1,619	-	-	12,075
Total	**687**	**1,485**	**2,350**	**2,218**	**1,056**	**2,660**	**1,619**	**-**	**-**	**12,075**
Grand Total	**13,543**	**6,650**	**10,431**	**23,062**	**84,036**	**62,592**	**34,453**	**8,135**	**1,852**	**244,754**

3.2.7 Impaired loans age analysis

- By geographical area (in BD 000's):

	3 Months to 1 Year	1 to 3 Years	Over 3 Years	Total
GCC countries	28,489	3,372	3,096	34,957
USA	-	-	6,518	6,518
Total	**28,489**	**3,372**	**9,614**	**41,475**

- By industry sector (in BD 000's):

	3 Months to 1 Year	1 to 3 Years	Over 3 Years	Total
Banks and financial institutions	-	1,732	-	1,732
Real estate	24,334	1,640	6,518	32,492
Others	4,155	-	3,096	7,251
Total	**28,489**	**3,372**	**9,614**	**41,475**

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.

Information on equity investments	BD 000's
Privately held	89,546
Quoted in an active market	-
Realised gain during the year	71
Unrealised gain in equity (Tier II)	-

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	**IAH**	**Self-financed**	**IAH**	**Self-financed**	**IAH**
Unquoted equity investment	29,558	-	44,337	-	5,320	-
Real estate investment	59,988	-	119,976	-	14,397	-
Total	**89,546**	**-**	**164,313**	**-**	**19,717**	**-**

3.4 Geographical and sector wise break up of impairment allowances and impaired and past due accounts

BD 000's

	GCC Countries	Europe	USA	Africa	Total
Impaired	34,957	-	6,518	-	41,475
Allowance for impairment:					
At 1 January 2012	10,205	-	5,946	-	16,151
Charge during the period	32	-	191	-	223
Reversal during the period	(48)	-	-	-	(48)
At 30 June 2012	10,189	-	6,137	-	16,326
Carrying amount	**24,768**	**-**	**381**	**-**	**25,149**
Past due but not impaired, including substandard:					
Up to 3 months	29,271	-	-	-	29,271
3 months to 1 year	10,009	-	-	-	10,009
1 year to 3 years	4,714	-	-	-	4,714
More than 3 years	-	-	-	-	-
	43,994	-	-	-	43,994
Collective allowance *	**(2,461)**	**(103)**	**-**	**(11)**	**(2,575)**

BD 000's

	Banks and financial institutions	Real estate	Others	Total
Impaired	1,731	32,493	7,251	41,475
Allowance for impairment:				
At 1 January 2012	300	11,398	4,453	16,151
Charge during the period	-	191	32	223
Reversal during the period	-	-	(48)	(48)
At 30 June 2012	300	11,589	4,437	16,326
Carrying amount	**1,431**	**20,904**	**2,814**	**25,149**
Past due but not impaired, including substandard:				
Up to 3 months	-	15,334	13,937	29,271
3 months to 1 year	3,552	6,104	353	10,009
1 year to 3 years	1,747	2,967	-	4,714
More than 3 years	-	-	-	-
	5,299	**24,405**	**14,290**	**43,994**
Collective allowance *	**(338)**	**(899)**	**(1,338)**	**(2,575)**

* Collective impairment allowance is allocated based on gross exposure excluding impaired exposures on which specific provision is maintained.

3.5 Renegotiated facilities

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the period ended 30 June 2012 amounting to BD 23,738 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.

3.6 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 as of 30 June 2012 was involved in four litigations for recovery of dues from clients amounting to BD 5,465,817. In addition, there is a claim brought by one of the clients against the Bank of BD 1,675,982 million which the Bank is defending. The Bank has made adequate provisions for any loss that may arise from such litigations.

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. So far there have not been any such write-offs.

3.7 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 Charity and Zakah fund for any non-Islamic income earned. During the six months period ended 30 June 2012, an amount of BD 6 thousands was thus transferred to Charity and Zakah fund.

3.8 Credit risk mitigation

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 30 June 2012 is given in the table below:

BD 000's

Collateral Type	Murabaha	Musharaka	Wakala	Istisna	Ijara	Value of collateral[1]	Gross Exposure[2]	% of cover	% of Total
Real estate	137,874	77,059	7,882	2,646	33,501	258,962	141,143	183%	82%
Listed securities	542	3,971	-	-	-	4,513	1,993	226%	1%
Unlisted securities	8,023	-	-	-	-	8,023	3,980	202%	3%
Bank guarantee	36,830	-	-	-	-	36,830	32,195	114%	12%
Cash collateral	1,505	-	346	-	-	1,851	11,974	15%	1%
Unsecured	-	-	-	-	-	-	39,804	0%	0%
Others	5,254	1,716	-	-	-	6,970	4,098	170%	2%
Total	**190,028**	**82,746**	**8,228**	**2,646**	**33,501**	**317,149**	**235,187**	**135%**	**100%**

[1] Represents collateral values based on the last valuation carried out based on the Bank's valuation policy including collaterals which exceed the book value of the facility.

[2] The amounts are gross of collective impairment allowance of BD 2,508 thousand and net of specific allowance of BD 16,325 thousand.

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 half year ended 30 June 2012 there has been no such instance.

3.9 Regulatory capital requirements by type of financing contracts

BD 000's

Financing contracts	Exposure		Credit Risk Weighted Assets		Capital Requirement @ 12%	
	Self-financed	IAH	Self-financed	IAH	Self-financed	IAH
Murabaha	53,145	88,285	53,861	26,485	6,463	3,178
Ijara assets (including lease rentals receivable)	19,076	-	15,441	-	1,853	-
Musharaka	51,870	-	57,810	-	6,937	-
Wakala	-	19,553	-	5,866	-	704
Istisna	-	750	-	225	-	27
Total	**124,091**	**108,588**	**127,112**	**32,576**	**15,253**	**3,909**

4 Market Risk

4.1 Regulatory capital allocation against market rate risk

The table below shows the market risk position for each category of the market risk as at period ended 30 June 2012 along with the maximum and minimum values during the period:

BD 000's

	As at 30 June	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	-	-	-
Foreign exchange risk	1,110	1,110	1,107
Commodity risk	-	-	-
Total (A)	**1,110**	**1,110**	**1,107**
Risk Weighted Assets (A x 12.5)	13,875	13,875	13,838
Capital requirement @ 12%	1,665	1,665	1,661

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 2012 is as given below:

BD 000's

Average gross income for 3 years (A)	19,935
Operational Risk Weighted Assets B = (A x 15% x 12.5)	37,378
Capital requirement (B x 12%)	4,485

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.

Maturity profile of assets and liabilities as at 30 June 2012 is as follows:

BD 000's

30 June 2011	**Up to 3 months**	**3 to 6 months**	**6 months-1 year**	**1 to 3 years**	**Over 3 years**	**Total**
Assets						
Cash and bank balances	28,118	-	-	-	-	**28,118**
Placements with financial institutions	42,232	-	-	-	-	**42,232**
Financing assets	18,021	8,081	20,844	81,096	85,560	**213,602**
Investment securities	24,678	35,168	2,410	18,972	20,393	**101,621**
Assets acquired for leasing (including lease rental receivables)	-	-	-	1,884	17,192	**19,076**
Investment in associates	-	-	-	-	3,215	**3,215**
Investment properties	-	-	-	-	6583	**6,583**
Other assets	2,097	-	-	-	-	**2,097**
Property and equipment	-	-	-	-	9,269	**9,269**
Total assets	**115,146**	**43,249**	**23,254**	**101,952**	**142,212**	**425,813**

Liabilities	**Up to 3 months**	**3 to 6 months**	**6 months-1 year**	**1 to 3 years**	**Over 3 years**	**Total**
Placements from financial institutions	40,028	-	-	-	-	**40,028**
Placements from non-financial institutions and individuals	20,491	20,248	11,415	30	330	**52,514**
Customer current account	20,679	384	-	137	144	**21,344**
Other liabilities	-	-	-	5,458	-	**5,458**
Total liabilities	81,198	20,632	11,415	5,625	474	**119,344**
Equity of Investment Account Holders	124,515	19,583	43,822	84	-	**188,004**
Restricted Investment accounts	-	-	9,290	25,766	-	**35,056**
Commitments	7,814	9,737	10,107	376	104	**28,138**

Following are the key liquidity ratios which reflect the liquidity position of the Bank for the past 5 years:

Figures in %

	2012	2011	2010	2009	2008
Interbank assets to interbank liabilities	175.75	218.84	113.72	137.02	436.50
Liquid assets to total assets	18.26	26.04	20.81	30.02	37.04
Liquid assets to total deposits	31.18	42.01	41.72	59.56	60.39
Net liquid assets to total deposits	14.41	25.63	10.50	22.00	49.79

6.2 Profit rate risk in the banking book

A summary of the Bank's profit rate gap position at 30 June 2012 is as follows:

BD 000's

30 June 2011	**Up to 3 months**	**3 - 6 months**	**6 months - 1 year**	**1 - 3 years**	**More than 3 years**	**Total**
Assets						
Placements with financial institutions	42,232	-	-	-	-	42,232
Financing assets	18,021	8,081	20,844	81,096	85,560	213,602
Assets acquired for leasing (including lease rental receivables)	582	-	-	1,849	16,645	19,076
Investments securities (sukuks)	2,172	2,350	1,314	1,960	4,279	12,075
Total profit rate sensitive assets	**63,007**	**10,431**	**22,158**	**84,905**	**106,484**	**286,985**
Liabilities						
Placements from financial institutions	40,028	-	-	-	-	40,028
Placements from non-financial institutions and individuals	20,491	20,248	11,415	30	330	52,514
Investors funds	397	-	-	-	-	397
Equity of investment account holders	124,515	19,583	43,822	84	-	188,004
Total profit rate sensitive liabilities	**185,431**	**39,831**	**55,237**	**114**	**330**	**280,943**
Profit rate gap	**(122,424)**	**(29,400)**	**(33,079)**	**84,791**	**106,154**	**6,042**

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.

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:

	50 bp increase/ decrease	**100 bp parallel increase/ decrease**
At 31 June 2012	± 30	± 60
At 31 December 2011	± 128	± 257

6.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit markets transactions (primarily interbank placements), the Bank has established a matrix of counterparty limits based on external credit rating of such counterparties. Such limits are constantly monitored by the Banks Risk Management Department. As at 30 June 2011, the Bank did not have any open position in foreign currency risk management instruments.

6.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. The Bank has established exposure limits to various geographic regions and industry sectors. For break-up of exposure geography and industry/ sector wise, please refer points 3.2.1 and 3.2.2 above.

6.5 Reputational risk

Reputation risk is the risk that negative perception regarding the Bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base, lead to costly litigation that could have an adverse impact on liquidity or capital of the Bank. Being an Islamic Bank, reputation is an important asset and among the issues that could affect the Bank's reputation is the inability to exit from investments, lower than expected returns on investments and poor communication to investors. The Bank has a well-developed and coherently implemented communication strategy to cover such contingencies. The Bank also allocates additional capital for such risks under its ICAAP.

6.6 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 equity of investment account holders. 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 IAH for further details.

6.7 Other risks

Other risks include strategic risk, fiduciary risks, and 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 Financial Performance

Following are basic quantitative indicators of the financial performance:

	2012	2011	2010	2009	2008
Return on average equity	**(0.21)%**	0.44%	(5.53)%	2.47%	20.00%
Return on average assets	**(0.06)%**	0.13%	(1.56)%	0.65%	7.40%
Cost-to-Income-Ratio*	**91.51%**	72.11%	83.79%	48.30%	30.59%

* Cost has been considered excluding impairment allowances.

8 Product Disclosures

8.1 Equity of investment account holders (IAH's)

The details of income distribution to IAH holders for the last five years are given below:

BD 000's

	June 2012	2011	2010	2009	2008
Allocated income to IAH	4,578	9,022	8,254	11,103	8,953
Distributed profit	3,015	6,629	5,785	9,331	7,050
Mudarib fees	1,563	2,393	2,469	1,772	1,903
As at 30 June					
IAH [1]	182,884	183,915	192,439	184,394	128,814
Profit Equalisation Reserve (PER)	-	-	169	1,209	649
Investment Risk Reserve (IRR)	-	-	-	925	473
Profit Equalisation Reserve-to-IAH (%)	-	-	0.09%	0.66%	0.50%
Investment Risk Reserve-to-IAH (%)	-	-	-	0.50%	0.37%

[1] Represents average balance

Ratio of profit distributed to PSIA by type of IAH (based on tenor):

BD 000's

Mudaraba Tenor	Profit distribution amount in BD					Ratio of profit paid as a percentage of total				
	30 June 2012	**2011**	**2010**	**2009**	**2008**	**30 June 2012**	**2011**	**2010**	**2009**	**2008**
1 Month [2]	775	1,824	3,107	4,271	3,346	25.7	27.5	53.7	45.8	47.5
3 Months	337	1,489	1,843	1,443	1,314	11.2	22.5	31.9	15.5	18.6
6 Months	243	764	641	736	373	8.1	11.5	11.1	7.9	5.3
12 Months	1,394	2,014	1,452	1,196	690	46.2	30.4	25.1	12.8	9.8
VIP	265	707	729	673	545	8.8	10.7	12.6	7.2	7.7
24 Month Mudaraba	1	-	-	-	-	-	-	-	-	-
PER and IRR expenses	-	(169)	(1,987)	1,012	782	-	(2.6)	(34.4)	10.8	11.1
Total	**3,015**	**6,629**	**5,785**	**9,331**	**7,050**	**100.00**	**100.0**	**100.0**	**100.0**	**100.0**

[2] Includes saving account products.

Distribution of profits by type of IAH products:

(Annualised rates)

Year	Avg. profit earned from IAH assets (%age of asset)	PER set aside as a %age of IAH assets	IRR set aside as a %age of IAH assets	Mudharib fees as a %age of IAH assets	Profit paid as a %age of IAH assets
2012	5.84	0.00	0.00	0.83	1.92
2011	4.99	0.00	0.00	1.85	0.68
2010	4.03	(0.54)	(0.49)	1.28	4.04
2009	6.09	0.30	0.24	0.96	4.58
2008	7.07	0.34	0.26	1.60	4.87

Following are the average profit rates declared and distributed to the investors by the Bank:

(Annualised rates)

Type of deposit	2012	2011	2010	2009	2008
1 month Mudharaba[2]	2.25	2.53	3.66	4.00	4.80
3 months Mudharaba	3.10	4.38	4.13	4.94	5.25
6 months Mudharaba	3.70	4.53	3.38	5.30	5.13
12 months Mudharaba	4.64	4.98	4.94	5.79	5.40
VIP Mudharaba	2.76	3.59	4.35	4.20	4.52
24 months Mudharaba	5.06	-	-	-	-

[2] Includes saving account products.

Market benchmark rates:

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

IAH account by type of assets:

The following table summarises the movement in type of assets in which the IAH funds are invested and allocated among various type of assets for the year ended 30 June 2012:

Particular	Opening allocation	Movement	Closing allocation	Proportion of total assets
Balances with banks	18,447	6,663	25,110	97%
Placements with financial institutions	76,787	(34,555)	42,232	100%
Financing assets				
• Murabaha	75,629	30,655	88,284	55%
• Wakala	19,999	(446)	19,553	100%
• Istisna	842	(83)	750	100%
Investment securities				
• Sukuk	21,672	(9,597)	12,075	100%
Total	**195,376**	**(7,363)**	**188,004**	

8.2 Restricted Investment Accounts (RIA's)

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					June 2012	2011	2010	2009	2008
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	9.0%	Annual	-	-	-	1.75	9.50
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, the Bank made an offer to buy back < BD 20,000 of each investors funds in RIA 1 at par. This offer was formalized in a letter to investors dated 25 May 2011. A total of 74 of the 95 RIA 1 investors accepted the offer at a cost of BD 1,220,000 to the Bank and resulting in a total of 39 investors being fully exited from the RIA. As a result, total investors funds have reduced to BD 8.34 million.	2007	61.78% over product tenor	Bullet payment on maturity	-	-	-	-	-
RIA 4 - Janayen	A restricted investment product designed to invest in growth and income generating real estate assets in the GCC and MENA regions. To date, RIA 4 has made distributions and redemptions to investors amounting to approximately 27.50% of investors' initial capital. These distributed funds were in the form of yields amounting to ≈ 21.1% in addition to 6.4% redemption of capital (3.7% redemption affected during Q2 2011).	2007	44.33%	Quarterly	-	-	0.27	9.62	1.65

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					June 2012	2011	2010	2009	2008
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 Mudaraba 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	-	-	-	-	-