

MOVING FORWARD  
Annual Report 2011

**Khaleeji Commercial Bank BSC**

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His Royal Highness  
Prime Minister Prince  
Khalifa Bin Salman  
Al-Khalifa



His Majesty King Hamad  
Bin Isa Al-Khalifa  
The King of Bahrain

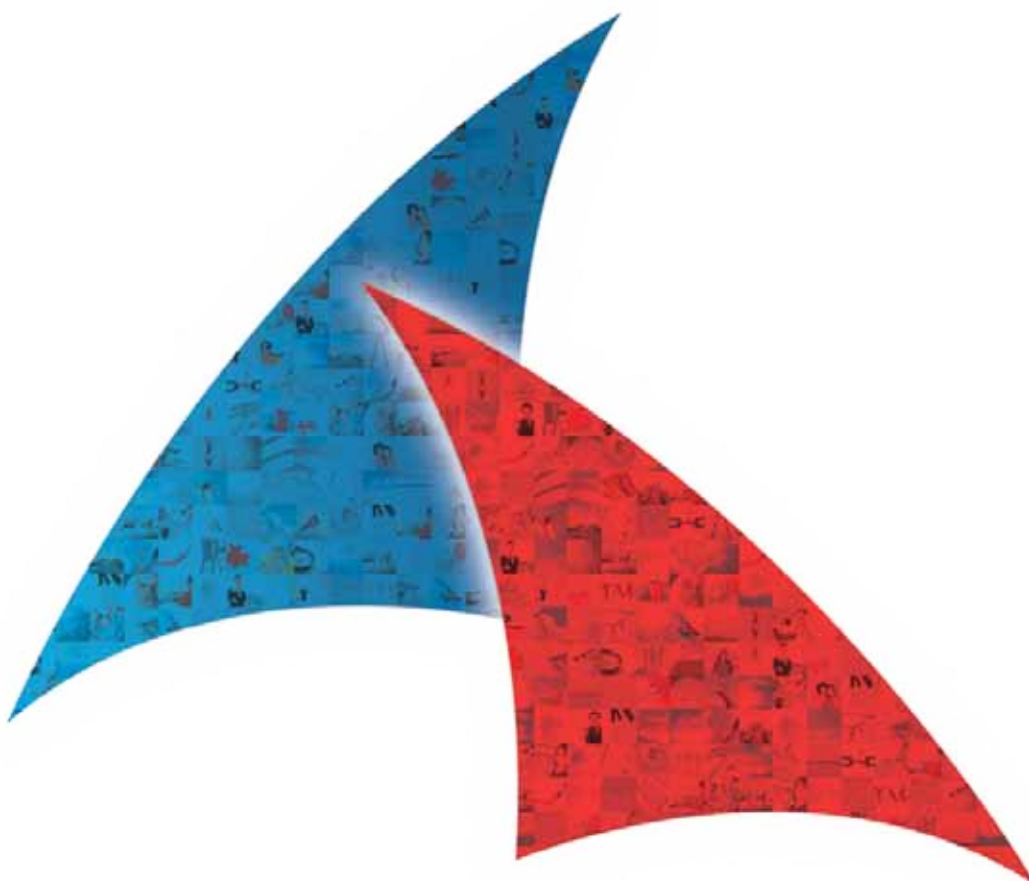


His Royal Highness Prince  
Salman Bin Hamad  
Al-Khalifa  
Crown Prince & Deputy  
Supreme Commander  
of Bahrain Defence Force



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## RELAIBLE PARTNERSHIPS

## FINANCIAL HIGHLIGHTS

	2011	2010	2009	2008	2007
Total Income	22,929	19,585	33,232	54,778	32,409
Net Profit / (Loss)	518	(6,533)	3,100	27,304	20,836
Total Assets	447,515	419,216	473,604	464,993	269,511
Total Equity	118,923	118,158	126,574	137,982	134,990
Earnings Per Share (fils)	0.46	(5.87)	3.04	26.52	25.4

 **BOARD  
OF DIRECTORS**



**Dr. Fuad Abdulla Al-Omar**  
*Chairman*



**Mr. Abdulrahman  
Mohammed Jamsheer**  
*Vice Chairman*



**Mr. Abdulla Abdulkarim  
Showaiter**  
*Director*



**Mr. Ebrahim Hussain  
Ebrahim**  
*Director & CEO*



**Mr. Khalid Hussain  
Al-Maskati**  
*Director*



**Mr. Abdulrahman  
Abdulla Al-Kooheji**  
*Director*



**Mr. Mohammed Barrak  
Al-Mutair**  
*Director*



**Mr. Mosobah Saif  
Al-Mutairy**  
*Director*



**Mr. Tariq Qasim  
Fakhroo**  
*Director*



**Mr. Khalid Rashid  
Al-Thani**  
*Director*

## SHARI'A SUPERVISORY BOARD

Khaleeji Commercial Bank is guided by a Shari'a Supervisory Board consisting of three distinguished scholars. This Board reviews the bank's activities to ensure that all products and investment transactions comply fully with the rules and principles of Islamic Shari'a.

Dr. Fareed Yaqoob Al Muftah

*Chairman*

Experience:

- Member of the Supreme Council of Islamic Affairs.
- Undersecretary of the Ministry of Justice & Islamic Affairs - Bahrain.
- Former judge of the high Shari'a Court.
- Former Lecturer at the University of Bahrain.

Qualification:

- Ph.D. from the University of Edinburgh - United Kingdom.

Dr. Fareed Mohammed Hadi

*Executive Member*

Experience:

- Assistant Professor at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain.
- Member of Shari'a Supervisory Board of a number of Islamic banks.

Qualification:

- Ph.D. in Ibn Hazm's Methodology of Jahala, University of Edinburgh - UK.
- Ph.D. in Al-Bukhari's Methodology, University of Mohammed V - Morocco.

Shaikh Nizam Mohammed

Saleh Yaquby

*Member*

Experience:

- Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank - UAE.
- Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank - Bahrain.
- Executive Member of the Shari'a Supervisory Board of Ithmaar Bank - Bahrain.
- Board Member of the Dow Jones Islamic index.
- Member of Shari'a Supervisory Board of a number of Islamic banks & insurance companies.

## ▶ CHAIRMAN'S REPORT



Dr. Fuad Abdulla Al-Omar

*Dear Shareholders,*

In the name of Allah, the beneficent, the merciful, prayers and peace upon the last apostle and messenger, our prophet Muhammad.

On behalf of the Board of Directors, it is my pleasure to present the annual report of Khaleeji Commercial Bank for the year ended 31 December 2011. This, the seventh year of operations for the Bank, has been an extremely challenging one. The regional economic and business environment continues to remain difficult against the backdrop of the continuing global financial and political crisis as well as declines in the economic activities of the target segments.

The Bank's new business model proved robust, we have successfully achieved our pre-set milestones based on the new strategic plan, which focused on expanding its commercial banking business. Key elements of the plan is growing the retail banking business in Bahrain, increasing the Bank's share of business in the local corporate and consumer finance and expanding the Bank's commercial banking business in the regional markets, while continuing to leverage on its investment banking capabilities. In line with these aims, the Bank is also looking to further expand its local branch network and electronic distribution channels in the current year.

### OVERALL PERFORMANCE

Like other financial institutions, the current market environment has had an adverse impact on the Bank, both directly and indirectly. However, I am pleased to report that by adopting a combination of prudent and conservative management, the Bank was able to navigate this difficult period successfully. The Bank has focused on diversifying and expanding its business while maintaining conservative liquidity and capital positions.

With the blessings of Allah the almighty, the Bank declared a net profit of BD 518 thousand compared to a loss of BD 6.5 million in 2010, even after the Board taking a prudent step of increasing the Bank's impairment provision by BD 3.6 million. The Bank continues to maintain strong liquidity (with 26.1% of the Bank's assets

**Despite difficult market conditions, the Bank grew its balance sheet size by 6.8% to BD 447 million and increased total income by 17.7%. The Bank also increased its consumer finance portfolio to BD 14.9 million, compared to BD 2.4 million in 2010. As a result, the income from commercial banking activities increased by 4.4%.**

being liquid) and adequate capital (the Bank has a regulatory capital adequacy ratio of 27.1%), both comfortably in excess of regulatory requirements.

Despite difficult market conditions, the Bank grew its balance sheet size by 6.8% to BD 447 million and increased total income by 17.7%. The Bank also increased its consumer finance portfolio to BD 14.9 million, compared to BD 2.4 million in 2010. As a result, the income from commercial banking activities increased by 4.4%. The customer deposits (including unrestricted investment accounts (URIA) and Murabaha from customers and current accounts) have also increased significantly by 21.6%, reaching BD 277 million, which reflects the market's confidence in the Bank's products and services.

In line with the Bank's revised business model and strategic direction, the Bank opened three new branches in Sanad, Budaiya and Muharraq. The Bank also introduced new Visa branded credit card and continued to promote and market a full suite of consumer finance products including auto finance, personal finance, travel and education finance and mortgage financing. I am happy to report that

these products were well received by the Bank's customers. The enhanced Al-Waffer savings account continued to expand and attract new customers with a growth in deposits by 38.3% compared with 2010. The Bank also launched innovative loyalty account program which helped in attracting additional customer deposits, in diversifying its customer base and managing the liquidity mismatch. The Bank's investment banking team has been actively managing the portfolio of investment products and restricted investment accounts (RIA), to enhance the value of the assets held in those products and to work towards potential exits.

#### **ORGANISATIONAL DEVELOPMENT**

The Board believes that to remain competitive in the long run, building organisational capacity, including human capital, is imperative. A committed and well trained work force is a key enabler in achieving the Bank's long term objectives. In order to achieve our expansion targets, the Bank hired 22 employees in 2011, mainly for the Bank's retail banking business. The Bank also continued to invest in the training and development of its human

resources through external and in-house training programmes and by enhancing the graduate trainees' programme. The Board takes pride in the fact that 93.1% of the Bank's employees are Bahrainis. In addition, the Bank has supported the HRD fund of the Kingdom of Bahrain, the Waqf fund and Tamkeen in addition to providing training opportunities to students from different local and international universities.

Full compliance with the rules and guidelines of the Central Bank of Bahrain and other regulatory agencies is another fundamental element of the Bank's strategy. During the year the Board undertook significant initiatives to improve the knowledge and practice of corporate governance within the Bank. The bank carried out a strategic review of the Bank's current corporate governance practices and also engaged experts to revise the framework to comply with requirements of the new code issued by the Central Bank of Bahrain. I am happy to report that the Bank has already complied with most of the requirements under the new code and the Board remains committed to taking all necessary action to ensure the Bank's continued compliance.



## CONSISTENT PERFORMANCE

## CORPORATE SOCIAL RESPONSIBILITY

The Board believes that, as a growing institution, the Bank has a responsibility to contribute towards the communities in which it operates, and in the past, the Bank has supported several initiatives that provide benefits to the local community. In 2011, a wide range of organisations involved in humanitarian, education, health and other activities received support from the Bank both in cash and in kind. The Board is committed to continuing to expand these through the Bank's ongoing programme of corporate social responsibility.

## LOOKING AHEAD

The Board believes that the recent challenges facing the banking sector will continue in 2012 and the Bank will not be immune to these challenges. However, the Board also foresees many opportunities for growing the Bank's business, not only in the primary markets of the GCC, but also in the wider MENA region. In the last two years, the Bank has taken several steps to diversify its assets, revenue streams and widening its customer base. The launch of the Bank's suite of consumer finance products and

expansion of branch network will further support this endeavour.

The key challenge in the medium term would be to build the scale necessary for the Bank to become a leading player in the local and regional market. The Bank will continue to aggressively grow its commercial and retail banking business while exploring other options including viable acquisitions of other entities and asset portfolios. The Board will also look to continue to expand the Bank's network of branches and distribution channels to reach wider and a larger number of customers.

The Board believes that the Bank has established a solid foundation from which to execute the new strategic plan and capitalise on opportunities currently available in the market.

## APPRECIATION

On behalf of the Board, I would like to express my gratitude to His Majesty King Hamad Bin Isa Al-Khalifa, His Royal Highness Prince Khalifa Bin Salman Al-Khalifa, the Prime Minister, and His Royal Highness Prince Salman Bin Hamad Al-Khalifa, the Crown Prince and Deputy Supreme

Commander of Bahrain Defence Force, for their encouragement of the growth of the private sector and the development of the banking and finance industry in Bahrain. I also extend my thanks to all government ministries and the Central Bank of Bahrain for their continued guidance and support.

Special appreciation is due to the Bank's shareholders, clients and business partners for their on-going confidence and loyalty; and to the Bank's management and staff for their hard work and dedication.

*Allah the almighty is the purveyor of all success.*



**Dr. Fuad Abdulla Al-Omar**

Chairman,

26 January 2011

## ► BUSINESS REPORT



Ebrahim H. Ebrahim

I am pleased to report that 2011 was a year that signaled positive signs of recovery for the Bank since the global financial crisis. Although the impact of the crisis continued to be felt across the region, the Bank has maintained focus on its long-term strategy, offering new products, which have been well received in the market, while increasing outreach through the opening of new branches and increasing communication and distribution channels.

While the domestic market conditions remained unsettled, the management concentrated on prudent management of the balance sheet and expansion and diversification of the business in line with the Bank's revised business model and strategy. We believe the Bank is well positioned to face any challenge and we are optimistic about the future.

### COMMERCIAL BANKING

Commercial Banking is the key focus area of expansion for the Bank and I am pleased to note that, despite operating in a difficult environment, we have progressed considerably in this regard.

Important milestones in the implementation of our commercial banking expansion plan were reached in 2011. We opened three new branches and launched a comprehensive suite of consumer finance products, targeting a new segment of customers for the Bank, which will help in diversifying the Bank's customer base and increasing market share.

2011 witnessed the rapid growth of KHCB's branch network. In line with the Bank's strategy to increase its market share, communication and distribution channels, three commercial branches were opened, ATM's installed and SMS and e-banking services were optimized. Bringing KHCB closer to its customer than ever before.

### RETAIL BANKING

In 2010, CBB removed the restrictions on the Bank's license allowing it to offer a full suite of products to retail customers. Thereafter, the Bank devised and launched a full range of products including personal, auto, and real estate financing. Different types of Visa branded credit cards including Corporate, Platinum, Gold and Classic were also launched. I am happy to report that these products were also well received in the market. The consumer finance asset portfolio of the Bank currently stands at BD 14.9 Million.

## Important milestones in the implementation of our commercial banking expansion plan where reached in 2011. We opened three new branches and launched a comprehensive suite of consumer finance products, targeting a new segment of customers for the Bank, which will help in diversifying the Banks customer base and increasing market share.



### AL WAFFER ACCOUNT STILL A WINNER

The incentive based savings scheme has proved so popular that the Bank have linked up with Nonoo Exchange to offer dedicated KHCB service desks in more locations across the Kingdom.



In line with our expansion strategy, the Bank opened three new branches, taking the total number of branches to five. Each of the new branches in Sanad, Budaiya and Muharraq are strategically located, designed and staffed, to attract a large number of potential customers and to provide a comprehensive range of banking services. The branch at Budaiya will provide our high net worth and VIP clients with exclusive service through a dedicated team. In addition to the new branches, the Bank also installed three new ATMs.

The Bank believes in providing our customers with a complete range of delivery channels, both physical and online. Our electronic banking service is world class and is complemented with our SMS banking service. To further enhance the ability of our customers to interact with the Bank, we have entered into an agreement with Bahrain's leading call centre service provider "Invita".

The Al-Waffer savings account, an unrestricted investment account that offers clients monthly, quarterly and annual prizes on their investment, completed another full year with the grand draw held in September 2011. A total cash prize of USD 1 million was distributed to 240 winners over the 12 months of the program. The incentive-based savings scheme has

proved so popular that the Bank has formed an agreement with "Nonoo Exchange" for improved customer convenience. The Bank had a dedicated KHCB service desk in Nonoo Exchange outlets allowing KHCB customers to open new accounts or top up their existing investment, taking advantage of the Exchange's wide geographical spread and convenient opening hours.

The opening of new branches during the year, as well as launch of new products, has already yielded tangible results seen in the expansion and diversification of our customer base and an increase in customer deposits. The Bank also launched a new liability product called "Loyalty Account". Loyalty Account combines the advantage of monthly returns and average higher returns to investors and provides a stable source of funding for the Bank. The product has been well received in the market, reaching its target within a very short period of time. Overall, our customer deposits including unrestricted investment accounts (URIA) grew by 21.6% to BD 277 Million. Furthermore, I am pleased to note that the deposit concentration has declined substantially over the last two years, a testimony to the success of our strategy to offer new consumer products and open more branches.

## EXECUTIVE MANAGEMENT

From left to right:

**Mr. Mahdi A. Nabi Mohammed** - AGM, Administration & Operations; **Mr. Silvan Varghese** - DGM & COO;  
**Mr. Ebrahim H. Ebrahim** - CEO & Board Member; **Mr. Jassim Awadh Asghar** - AGM, Corporate & Wholesale Banking;  
**Mr. Fuad Taqi** - DGM, Commercial Banking



In line with Central Bank of Bahrain (CBB) regulations, KHCB implemented IBAN, the standardised account numbering system. The system will increase the speed and accuracy of our customers' transactions to other banks, whether locally or internationally.

### **CORPORATE AND WHOLESALE BANKING**

2011 continued to be a challenging year for corporates and businesses in Bahrain due to the turbulent period of unrest faced by the Country and the continuing effects of the global economic climate. Key sectors such as real estate, construction and tourism continue to feel the reverberations of the financial crisis and activity levels have not yet reached pre-crisis levels.

The Real estate sector, a major contributor to the local economy, has been particularly affected, reflected in the decline in property values, limited number of transactions and low levels of activity. This to some extent contributed to deterioration in the credit quality of existing assets. During the year new transactions worth over BD 41.0 million was generated, but overall the corporate and wholesale banking assets showed a decline of 4.1% to BD 200.3 million as many customers repaid their facilities. We continue to work on nurturing existing client relationships

and building new relationships locally and regionally. Particular focus has been on identifying and developing relationships in other GCC countries. We expect these efforts to bear fruit in the coming years.

### **INVESTMENT BANKING**

The investment banking business has been key to the Bank's growth and success in the early years after the Bank was established. Over the last three years, the global financial crisis and its impact on the regional market, has had an adverse impact on the business environment. Investors have become cautious, withdrawing from the market and increasingly turning risk averse. In view of the new market environment the management's focus has been on protecting and adding value to the Bank's existing investment and working towards potential exits in 2011 and 2012. While exit dates were extended for many of the Bank's investment products, the investment team continued to pursue all opportunities for exits. Overall, asset prices continued to be distressed in the GCC as well as Europe (especially Germany) where many of the Bank's investment assets are located.

Notwithstanding the challenging market conditions, the investment team has been successful in disposing of assets held under Gulf German Residence, Eqarat Al Khaleej and Janayen. The Surooh residential villa

Add “value” to your life

Comprehensive Shari'a Compliant Financing Solutions

Auto Financing



Our hassle free auto financing scheme underscores the Bank's commitment to provide the people of Bahrain with Islamic and transparent financing solutions.

project in Bahrain has been completed and some villas have already been handed over to buyers. However, sale of the unsold villas continues to be a major challenge. Projects in which the Bank has partnered with other prominent Bahraini financial institutions, including Safana and North Gate, have incurred delays due to their scale and complexity. The investment team is actively working with the partners for expediting the project development and exit.

The prospects for the Bank's large investment products in India, Global Logistix Navi Mumbai and Danat India, New Delhi continued to be good with positive valuation fundamentals continuing during 2011. Considerable progress has been achieved on both of these projects and the Bank's investment team is actively working with local partners and advisers to develop the projects further.

Jawhara Greens, the multi-use development project in Qatar, while delayed, has now started infrastructure development and pre sales activity. The project has gone against the trend of reduced valuations for GCC real estate assets and reported a valuation increase for the 2011 calendar year.

Overall, the investment banking division will maintain a focus on achieving investor exits in 2012.

## ORGANIZATIONAL DEVELOPMENT

During 2011, the Bank continued to strengthen institutional capacity in line with the growth in size and scope of the business. Attracting, developing and retaining talented professionals to build a high performance, committed team is a key goal. Management believe that ensuring a continuous learning environment is synonymous to achieving this goal and have invested in training programs to ensure all employees are up to date with changes in the market that directly relate to their area of specialization. The bank continues to invest in employee development through training programs both internal and external using many service providers. In 2011 these included specialized sales training programs for our branch staff and introduction to Basel III for senior management, risk management and financial control staff. Beyond the development of employees, the Bank continued to support the youth of the country by providing short term training opportunities for university students. KHCB is also a major supporter of the Waqf fund's training program.

The Bank enhanced its operational systems and applications, including its core banking system, moving forward substantially in replacing middleware with an advanced IBM platform,



#### LOYALTY REACHING NEW HEIGHTS

The Capital Guaranteed Loyalty Account hit the mark with targets reached shortly after the innovative products launch. The advantage of monthly returns and average higher returns to investors continues to create a solid income for the Bank.

namely IBM Message Broker. This will enable us to integrate all our channels especially in view of new consumer finance products. The Bank successfully implemented IBAN well ahead of the go live date stipulated by the CBB and are prepared to facilitate BCTS as per CBB regulations. During the year, the Bank also tested its business continuity plan ensuring contingency plans are well rehearsed and in place in the event of a crisis.

#### CONCLUSION

As with 2010, 2011 presented complex business challenges. Set against a backdrop of political and economic volatility the financial sector in general and businesses in Bahrain in particular continue to be severely affected. Faced with these obstacles the Bank has continued to move forward and is now well positioned to capitalise on opportunities available locally and regionally. Based on the Bank's new corporate strategic plan, management will continue to focus on diversifying the Bank's revenues, assets and customer base and will grow the Bank's retail banking business by enhancing its products and services. In the medium term, plans are in place to expand the Bank's branch network, enhance the Bank's delivery channels and explore opportunities to grow in key markets in the region.

Finally, it is my pleasure to extend

my sincere thanks to our Board of Directors for their on-going support and valuable guidance, to the Central Bank of Bahrain and the Bahrain Bourse for their guidance and support, to our loyal customers for choosing the Bank for their banking needs and finally to all our dedicated staff members who worked so hard individually, and collectively, during 2011.

**Ebrahim H. Ebrahim**  
*CEO & Board Member*

## CORPORATE GOVERNANCE

### CORPORATE GOVERNANCE STRUCTURE

The Bank's corporate governance framework focuses on Board responsibility, oversight and management accountability vis-à-vis governing regulations and better practices. The framework is in line with global best practices and regulatory requirements which seek to balance entrepreneurship, control and transparency, while creating value for all stakeholders.

Corporate governance, the way the Board and Management is organised and how they operate in practice ultimately aims at leading the Bank towards successfully meeting its strategic objectives. The Board of Directors is accountable to the Bank's shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance and effective risk management.

The Bank is in compliance with the Corporate Governance Code (CGC), the Public Disclosure Module and the

Stock Exchange Disclosure Standards set by the CBB. The corporate governance philosophy of the Bank is to be fully ethical and transparent in all dealings. In pursuit of this goal, the Board of Directors have approved a Corporate Governance Framework, Director's Conflict of Interest Policy, Insiders' Trading Policy, and the Bank Key Persons' Dealing Policy. The Bank, through its Board and Committees, endeavors to deliver the highest governing standards for the benefit of its stakeholders.

The Bank is committed to continuously reviewing and developing its corporate governance standards to ensure compliance with the requirements of the revised corporate governance framework being implemented by the Central Bank of Bahrain and other regulatory bodies, and also to keep abreast with international best practice.

### BOARD OF DIRECTORS

The Board of Directors comprises of 10 members. The chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring

the performance of the CEO and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees, will oversee the management of the Bank.

### BOARD COMMITTEES STRUCTURE

The Board of Directors has constituted four committees with specific delegated authorities.

- *Board Audit Committee*, which is responsible for internal and external audit, compliance, and anti-money laundering.
- *Board Investment & Credit Committee*, which is responsible for investment and credit approval, setting limits and investment policies, asset liability management, monitoring asset impairment and creation of loss provisions, maintaining banking relationships, as well as for the oversight of the off-balance sheet vehicles.
- *Board Nominations, Remunerations and Governance Committee*, which

The Bank is committed to continuously reviewing and developing its corporate governance standards to ensure compliance to keep abreast with international best practice.

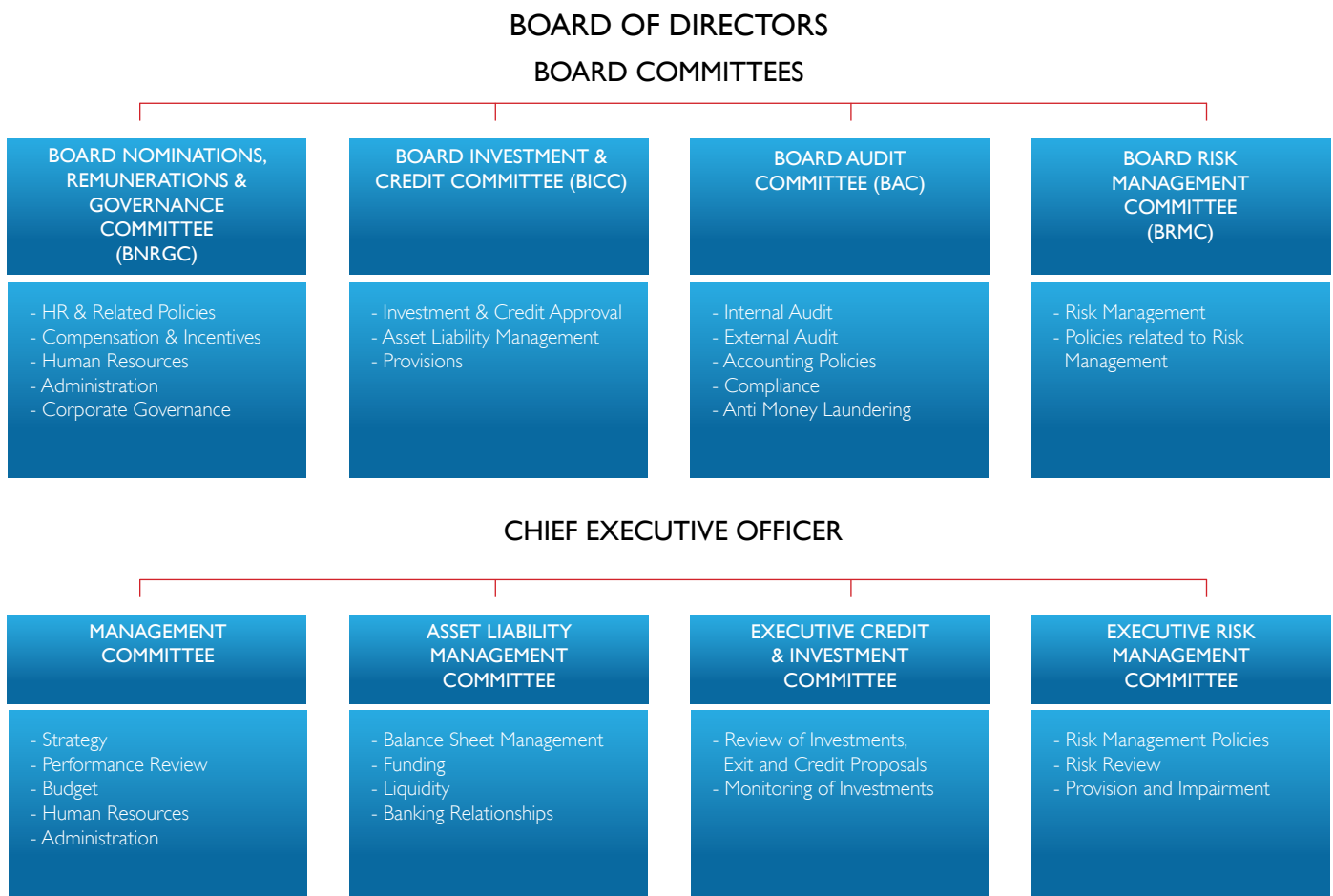
is responsible for setting policies for compensation and incentives, human resources and administration. It is also responsible for the corporate governance framework of the Bank.

- *Board Risk Management Committee*, which is responsible for ensuring that the Bank's overall risk management framework is

effective and that key risks are managed within parameters established by the Board.

The Chairman, the Board of Directors and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance and Shari'a Compliance.

During 2011, the Board of Directors held 6 meetings, the Board Investment & Credit Committee held 6 meetings, the Board Nomination, Remuneration & Governance Committee held 4 meetings, the Board Risk Management Committee held 4 meetings and the Board Audit Committee held 4 meetings.



## RISK MANAGEMENT

### RISK MANAGEMENT FRAMEWORK

Risk is inherent in the Bank's business and effective management of risk is seen as a core requirement to create shareholder value. The Board of Directors of the Bank has overall responsibility for establishing the Bank's risk culture and ensuring that an effective risk management framework is in place. The Board approves and periodically reviews the risk management policies and risk strategies of the Bank.

The assumption of risks by the Bank is guided by certain fundamental principles such as protection of investor and shareholder funds by adoption of sound credit and investment analysis, adoption of effective "risk / reward" strategy to optimize stakeholders' returns, adherence to prudent levels of exposure concentration, while focusing on the target market segments such as high net worth individuals, corporate and public sector clients and products which generate high profitability and growth.

The Board has established an Executive Risk Management Committee (ERMC), which is responsible for developing and implementing the

Bank's risk management policies in all areas of the Bank's operations. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Board Risk Management Committee.

The Risk Management Department of the Bank, independent of the business units, is responsible for the day to day oversight and management of the various risks faced by the Bank. The Risk Management Department, together with the Internal Audit and Compliance Departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

### RISK POLICIES

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor adherence to such limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, as well as products and services offered. The Bank, through its training and management interventions, aims to develop a disciplined and constructive

control environment, in which all employees understand their roles and responsibilities. The Bank's risk policies identify approval authorities, reporting requirements, and the procedures for referring risk related issues to executive management, ERMC and the Board, as appropriate. Policies are in place to address all major categories of risk including liquidity, investment and credit, currency, operational, legal and regulatory risks.

### CREDIT AND INVESTMENT RISK

The Bank has well defined policies for managing credit and investment risks. These include delegated approval authority limits, concentration limits, maximum exposure limits, etc. Credit and investment limits to clients are approved after thorough assessment of counterparty, legal and market risks associated with the project. In most cases, exposures are fully or partially secured by collateral securities. The Board of Directors has delegated responsibility for the management of credit and investment risk to its Executive Risk Management Committee (ERMC). A separate Risk and Credit Management Department independent of the business units is responsible for oversight of the Bank's credit and investment risk. The Risk



#### SUPPORTING ECONOMIC GROWTH

The Bank continue to forge partnerships that encourage the development of the Kingdom's infrastructure and economy while answering the call for affordable housing solutions.

Management Department reviews every credit and investment proposals and records its views before the same is submitted for approval. Fair valuation of the investments and impairment tests for credit exposures take place periodically as per the Bank's approved policies. This exercise is performed by Risk Management Department and is followed by a review by the external auditors. It is the Bank's policy to ensure that adequate provisions are made for expected credit or investment losses. The Bank's policy on Impairment & Provisioning lays down guidelines for the creation of adequate allowance for impairment losses that represents the estimated future loss on its portfolio.

#### MARKET RISKS

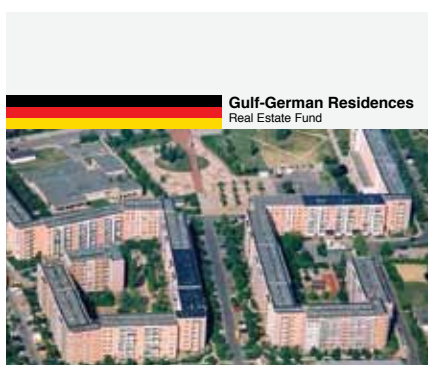
Market risk is the risk that changes in market parameters, such as profit rates, equity prices, foreign exchange rates and credit spreads, (not relating to changes in the obligor's / issuer's credit standing), will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while optimizing the return on risk. As on date, the Bank does not have an active trading book and therefore

the impact of market volatility on the Bank's revenues is minimal.

#### OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequacies or failures in systems and processes, human errors or external events. Failure to manage operational risk can result in financial and reputational loss as well as legal and regulatory consequences. The Bank manages operational risk through ongoing monitoring of predefined risk triggers and through a system of internal checks and balances. These include well defined procedures for transaction processing, hierarchical authority structure for transaction approvals, and continuous oversight by internal audit and compliance departments.

The Risk Management Department is responsible for identifying, monitoring and managing operational risk in the Bank. The Board has approved a detailed policy for this purpose and all the operational and physical infrastructure is in place. The Risk Management Department conducts Operational Risk assessment of each department of the Bank on an ongoing basis and also provides guidance to the operating staff. The department



#### PROTECTING THE VALUE OF OUR INVESTMENTS

Overall, the Investment Banking division will maintain a focus on achieving investor exits in 2012.

also submits periodical reports to the top management and the Board on operational risk events that have occurred including near misses and on corrective actions taken.

#### LIQUIDITY RISK

Liquidity risk is defined as the risk that funds will not be available to meet liabilities as and when they fall due. While the policy guidelines for management of liquidity risk are laid down by the Board of Directors, all operations regarding day to day management of balance sheet and liquidity is handled by the Financial Control and Treasury Departments. The Asset Liability Management committee (ALCO), which is chaired by the CEO and has senior executives of the Bank as members, exercises effective supervision of this process. ALCO periodically monitors the level of liquid assets maintained by the Bank and uses a maturity ladder approach for managing and monitoring the liquidity risk. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity and the right maturity profile to meet its liabilities under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

#### PROFIT RATE RISK

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of changes in market profit rates. The Bank's policy on profit rate risk management aims to enable identification, measurement, monitoring, control and reporting of profit rate risks in a timely manner. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. 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.

#### FOREIGN EXCHANGE RISK

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank's foreign exchange risk is managed on the basis of limits on net open positions set by the Board of Directors and a continuous assessment of current and expected exchange rate movements. The management of foreign exchange risk against net exposure limits is supplemented

by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. The Bank does not engage in foreign exchange trading and, where possible, matches currency exposures inherent in certain assets with liabilities in the same or correlated currency. The Risk Management Department in association with the Treasury Department is responsible for all operations related to foreign exchange risk management in the Bank.

#### **LEGAL AND REGULATORY RISK**

Legal risk includes the risk of unexpected loss from transactions and/or contracts not being enforceable under applicable laws or from unsound documentation. The Bank has a full-fledged legal department which provides necessary inputs and guidance to all other departments on any legal issues that may arise. The Bank also hires external legal advisors for advice when necessary, and to handle litigations. Regulatory risk includes the risk of non-compliance with regulatory and legal requirements. The Bank has an independent compliance department which monitors the level of compliance with regulatory requirements by other

departments of the Bank. It also acts as the focal point in all interaction with the Central Bank of Bahrain. The Compliance Department is also responsible for the Bank's anti-money laundering initiatives.

#### **CAPITAL ADEQUACY & THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)**

The Bank's regulatory capital adequacy ratio is calculated in accordance with the guidelines issued by the CBB. Under this, the Bank is expected to maintain a minimum prescribed ratio of total capital to total risk weighted assets. The CBB also requires the Bank to establish a process to monitor the overall capital adequacy of the Bank, taking into account all relevant risk factors. The Board of Directors has approved an Internal Capital Adequacy Assessment Process (ICAAP) to satisfy this requirement. The ICAAP is a requirement under Pillar 2 of the Basel II accord and seeks to ensure appropriate identification, measurement, aggregation and monitoring of all risks by the Bank and to relate the level of internal capital of the Bank to its overall risk profile and business plan. The Bank has adopted a structured approach for identifying and assessing capital required for each of

the major risk categories by employing appropriate methodologies. The total of such individual risk capitals is taken as the overall capital requirement. The ICAAP also incorporates guidelines to assess the future capital needs of the Bank in line with its business plans over its strategic time horizon.

#### **STRESS TESTING**

Regulatory and internal capital adequacy computations are based on past data. While future projections are done, these are on the assumption that the business environment continues to be normal. It is essential for the Bank to measure sensitivity of its capital to serious adverse changes in external and internal risk environment and changes in business cycles. The Bank has developed a stress testing model for the purpose which provides an estimate of capital adequacy under a variety of stress scenarios. The first step in the process is identifying relevant stress factors that can affect the bank's revenues, liquidity, asset quality, business growth etc. Each item in the Bank's balance sheet is then revalued on the basis of different combinations of these risk factors and at various levels of severity. The capital adequacy levels at these stress scenarios are computed on current as well as



#### **KHCB CREDIT CARDS ADD VALUE**

**It is the mission of KHCB to offer our customers exceptional products and services that add value to their life. The new KHCB Visa Credit Card succeeds in that mission.**

forecasted balance sheets to identify the likely worst case scenarios which will help the Bank identify preventive management actions where necessary.

#### **REPUTATIONAL RISK**

Reputational risk arises from negative public perception of the Bank arising out of losses, faulty business practices, failure of internal controls, etc. Such a perception whether true or not, can have serious impact on the Bank's business by undermining investor confidence. It may also lead to costly litigation that would in turn have an adverse impact on liquidity and capital adequacy of the Bank. The senior management, through the relevant committees, examines issues that can have adverse impact on the Bank's reputation and issues guidelines to address these. The Bank also under its ICAAP provides separate capital against this risk.

#### **DISCLOSURES**

The Bank recognizes its continuous disclosure obligations set forth by the Central Bank of Bahrain, Bahrain Bourse and other relevant regulatory bodies. The Bank has approved policies related to external communications & disclosures in line with Basel II & CBB requirements which ensure disclosure of all relevant information to stakeholders in a timely manner. The Pillar 3 disclosure and corporate governance code requirements prescribed by the Central Bank of Bahrain are part of this annual report.

## SHARI'A SUPERVISORY BOARD REPORT

For the financial year ending 31 December 2011

*In the name of Allah, the Beneficent, the Merciful*

*Prayers and Peace Upon the Last Apostle and Messenger, Our prophet Mohammed, His Family and companions.*

The Shari'a Supervisory Board ("SSB") of Khaleeji Commercial Bank has reviewed the Bank's activities through its annual review and through the Shari'a Compliance Department and compared them with the previously issued fatwas and rulings during the financial year ending 31 December 2011 and found them compatible with the already issued fatwas and rulings.

The Shari'a Compliance Department in collaboration with the SSB has audited the Shari'a aspects arising from the Bank's businesses for every three months so the audit happens on a quarterly basis, and submitted its report to the SSB, which in turn, reviewed the observations contained therein, and emphasized that the management must be in compliance with the rules and principles of Islamic Shari'a. The SSB has decided based on this report and the jobs done by Shari'a Compliance Department to supervised the Banks adherence to the decisions and fatwa's of the SSB under rules and principles of Islamic Sharia'a.

The SSB believes that it has expressed its opinion in respect of the activities carried on by the Bank and it is the responsibility of the management to ensure the implementation of such decisions. It is the duty of the SSB to express an independent opinion on the basis of its control and review of the Bank's operations and to prepare a report about them.

A representative of the Bank's management explained and clarified the contents of the consolidated financial statements for the financial year ended on 31 December 2011 to our satisfaction. The report of the SSB has been prepared based on the contents provided by the Bank.

The SSB is further satisfied that any income which is not in compliance with the Glorious Islamic Shari'a has been dispersed to charity account and that the responsibility of the payment of the Zakat lies with the shareholders in their shares.

The SSB is satisfied that the Bank's activities and services are in compliance with the Glorious Islamic Sharia'a.

*Praise be to Allah, Lord of the Worlds.*

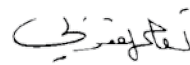
*Prayers on Prophet Mohammed (Peace Be Upon Him), all his Family and companions.*



**Dr. Fareed Yacoub Al-Muftah**  
Chairman



**Dr. Fareed Mohammed Hadi**  
Executive Member



**Sh. Nizam bin Mohammed  
Saleh Yaquby**  
Member

## INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

26 January 2012, Manama, Kingdom of Bahrain

### REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Khaleeji Commercial Bank B.S.C. ("the Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2011, and the consolidated income statement, the consolidated statement of changes in equity, the consolidated statement of cash flows, the consolidated statement of changes in restricted investment accounts and the consolidated statement of sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### RESPECTIVE RESPONSIBILITIES OF BOARD OF DIRECTORS AND AUDITORS

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

### BASIS OF OPINION

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

### OPINION

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2011 and of the consolidated results of its operations, its consolidated cash flows, consolidated changes in equity, consolidated changes in restricted investment accounts and consolidated sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

### REPORT ON OTHER REGULATORY REQUIREMENTS

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that: the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; the financial information contained in the chairman's report is consistent with the consolidated financial statements; we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests.





**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

as at 31 December 2011

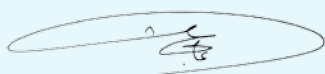
BD 000's

	Notes	31 December 2011	31 December 2010
<b>ASSETS</b>			
Cash and bank balances	3	22,642	12,290
Placements with financial institutions	4	76,787	74,959
Financing assets	5	201,556	203,210
Investment securities	6	111,806	100,279
Assets acquired for leasing	7	11,712	5,979
Lease rentals receivable	7	1,946	2,001
Investment in associates	8	2,887	4,113
Investment property	9	6,583	3,943
Other assets	10	2,190	2,476
Property and equipment	11	9,406	9,966
<b>Total assets</b>		<b>447,515</b>	419,216
<b>LIABILITIES</b>			
Placements from financial institutions		45,435	65,917
Placements from non-financial institutions and individuals	12	46,647	19,018
Customers' current accounts		35,437	10,928
Other liabilities	13	5,706	6,975
<b>Total liabilities</b>		<b>133,225</b>	102,838
<b>Equity of investment account holders</b>	14	<b>195,367</b>	198,220
<b>OWNER'S EQUITY</b>			
Share capital	15	115,416	115,416
Share premium		1,485	1,213
Statutory reserve		6,350	6,298
Treasury shares		(6,043)	(6,018)
Unvested employee incentive scheme shares		(420)	(937)
Share grant reserve		120	324
Investments fair value reserve		54	117
Retained earnings		1,961	1,745
<b>Total owner's equity (page 32)</b>		<b>118,923</b>	118,158
<b>Total liabilities, equity of investment account holders and owners' equity</b>		<b>447,515</b>	419,216

The consolidated financial statements, which consist of pages 30 to 78, were approved by the Board of directors on 26 January 2012 and signed on its behalf by:



Dr. Fuad Abdulla Al-Omar  
Chairman



Abdulrahman Mohamed Jamsheer  
Vice-Chairman



Ebrahim Hussain Ebrahim  
Chief Executive Officer  
& Board member

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED INCOME STATEMENT**

for the year ended 31 December 2011

BD 000's

	Notes	2011	2010
Income from investment banking services		-	47
Management fees		703	1,260
Income from placements with financial institutions		259	915
Income from financing assets and assets acquired for leasing		16,812	16,092
Income from investment securities	16	6,021	2,198
Share of losses from associate companies	8	(1,226)	(1,005)
Other income		360	78
<b>Total income before return to investment account holders</b>		<b>22,929</b>	19,585
Less: Return to investment account holders before Bank's share as Mudarib	14	(9,022)	(8,254)
Bank's share as a Mudarib	14	2,393	2,469
<b>Return to investment account holders</b>		<b>(6,629)</b>	(5,785)
Expense on placement from financial institutions		(420)	(320)
Expense on placement from non-financial institutions and individuals		(1,156)	(975)
<b>Total net income</b>		<b>14,724</b>	12,505
Staff cost	17	5,849	5,070
Depreciation	11	1,169	1,342
Other expenses	19	3,599	4,066
<b>Total expenses</b>		<b>10,617</b>	10,478
<b>Profit for the year before impairment allowances</b>		<b>4,107</b>	2,027
Impairment allowances	18	(3,589)	(8,560)
<b>PROFIT / (LOSS) FOR THE YEAR</b>		<b>518</b>	(6,533)
<b>Earnings per share</b>			
Basic earnings per share (fils)	24	<b>0.46</b>	(5.87)
Diluted earnings per share (fils)	24	<b>0.46</b>	(5.87)

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

for the year ended 31 December 2011

BD 000's

2011	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Investments fair value reserve	Retained earnings	Total
At 1 January 2011	115,416	1,213	6,298	(6,018)	(937)	324	117	1,745	118,158
Fair value changes	-	-	-	-	-	-	(63)	-	(63)
Profit for the year	-	-	-	-	-	-	-	518	518
<b>Total recognised income and expense for the year</b>	-	-	-	-	-	-	<b>(63)</b>	<b>518</b>	<b>455</b>
Transfer to statutory reserve	-	-	52	-	-	-	-	(52)	-
Treasury shares acquired	-	-	-	(131)	-	-	-	-	(131)
Treasury shares sold	-	-	-	106	-	-	-	-	106
Adjustment for vesting and issue of shares	-	272	-	-	517	(272)	-	-	517
Vesting charge for the year (note 20)	-	-	-	-	-	68	-	-	68
Transfer to zakah fund (2010)	-	-	-	-	-	-	-	(250)	(250)
<b>At 31 December 2011</b>	<b>115,416</b>	<b>1,485</b>	<b>6,350</b>	<b>(6,043)</b>	<b>(420)</b>	<b>120</b>	<b>54</b>	<b>1,961</b>	<b>118,923</b>

2010	Share capital	Share premium	Statutory reserve	Treasury shares	Unvested employee incentive scheme shares	Share grant reserve	Investments fair value reserve	Retained earnings	Total
At 1 January 2010	104,924	958	6,298	(5,216)	(1,648)	367	30	20,861	126,574
Fair value changes	-	-	-	-	-	-	87	-	87
Loss for the year	-	-	-	-	-	-	-	(6,533)	(6,533)
<b>Total recognised income and expense for the year</b>	-	-	-	-	-	-	<b>87</b>	<b>(6,533)</b>	<b>(6,446)</b>
Treasury shares acquired	-	-	-	(992)	-	-	-	-	(992)
Treasury shares sold	-	-	-	190	-	-	-	-	190
Vesting charge for the year (note 20)	-	-	-	-	-	212	-	-	212
Adjustment for vesting and issue of shares	-	255	-	-	711	(255)	-	-	711
Transfer to charity fund (2009)	-	-	-	-	-	-	-	(150)	(150)
Transfer to zakah fund (2009)	-	-	-	-	-	-	-	(1,941)	(1,941)
Bonus shares (2009)	10,492	-	-	-	-	-	-	(10,492)	-
<b>At 31 December 2010</b>	<b>115,416</b>	<b>1,213</b>	<b>6,298</b>	<b>(6,018)</b>	<b>(937)</b>	<b>324</b>	<b>117</b>	<b>1,745</b>	<b>118,158</b>

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**

for the year ended 31 December 2011

BD 000's

	Notes	2011	2010
<b>OPERATING ACTIVITIES</b>			
Proceeds from investment advisory services		-	3,227
Repayment of financing assets, net		13,183	871
(Payment for) / proceeds from asset acquired for leasing, net		(5,678)	5,453
Management fees received		703	1,523
Income from short-term placements received		259	915
Returns paid to investment account holders		(6,798)	(7,772)
Withdrawals by investment account holders, net		(2,465)	(5,368)
Payment for expenses		(9,981)	(8,579)
Other receipts		360	78
Payment for charity		(961)	(654)
Receipts in / (withdrawals from) customers' current accounts		24,509	(24,169)
Net payment to CBB reserve account		(809)	(1,420)
<b>Net cash generated from / (used in) operating activities</b>		<b>12,322</b>	<b>(35,895)</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of investment securities, net		(3,730)	(12,684)
Proceeds from sale of investment securities		-	8,967
Purchase of investment property		(2,640)	-
Dividend / income from investment securities received		481	781
Distributions from investment in associates received		-	1,403
Proceeds from asset held-for-sale		-	223
Purchase of equipment and capital advances made		(608)	(243)
<b>Net cash used in investing activities</b>		<b>(6,497)</b>	<b>(1,553)</b>
<b>FINANCING ACTIVITIES</b>			
Placements from financial institutions, net		(20,482)	(23,262)
Placements from non-financial institutions and individuals, net		27,629	6,467
Purchase of treasury shares, net		(25)	(802)
Expense paid on placements		(1,576)	(1,295)
<b>Net cash generated from / (used in) financing activities</b>		<b>5,546</b>	<b>(18,892)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>		<b>11,371</b>	<b>(56,340)</b>
Cash and cash equivalents at 1 January		78,893	135,233
<b>Cash and cash equivalents at 31 December</b>		<b>90,264</b>	<b>78,893</b>
<b>Cash and cash equivalents comprise:</b>			
Cash and bank balances (excluding CBB reserve)	3	13,477	3,934
Placements with financial institutions	4	76,787	74,959
		<b>90,264</b>	<b>78,893</b>

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS**

for the year ended 31 December 2011

BD 000's

2011	Balance at 1 January 2011			Movements during the year						Balance at 31 December 2011		
	No of units (000's)	Average value per share	Total	Investment (withdrawals)	Revalua- -tion	Gross income / (loss)	Dividends paid	Bank's fees as an agent	Adminis- -tration expenses	No of units (000's)	Average value per share	Total
Al Hareth French Property Fund	17.05	504.40	8,600	-	(289) <sup>1</sup>	-	-	-	-	17.05	487.45	8,311
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	(1,240) <sup>2</sup>	-	-	-	-	-	8,323	1.00	8,323
Janayen Holding Limited (RIA 4)	52,685	0.29	15,060	(765)	(3,102)	165	-	-	(1,988)	52,685	0.18	9,370
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	3,427	0.38	1,292	-	-	-	-	-	-	3,427	0.38	1,292
			<b>42,615</b>	<b>(2,005)</b>	<b>(3,391)</b>	<b>165</b>	<b>-</b>	<b>-</b>	<b>(1,988)</b>			<b>35,396</b>

2010	Balance at 1 January 2010			Movements during the year						Balance at 31 December 2010		
	No of units (000's)	Average value per share	Total	Investment (withdrawals)	Revalua- -tion	Gross income/ (loss)	Dividends paid	Bank's fees as an agent	Adminis- -tration expenses	No of units (000's)	Average value per share	Total
Al Hareth French Property Fund	17.05	539.76	9,203	-	(603) <sup>1</sup>	-	-	-	-	17.05	504.40	8,600
Safana Investment WLL (RIA 1)	9,563	1.00	9,563	-	-	-	-	-	-	9,563	1.00	9,563
Janayen Holding Limited (RIA 4)	52,685	0.36	18,805	(558)	(2,742)	(229)	(216)	-	-	52,685	0.29	15,060
Shaden Real Estate Investment WLL (RIA 5)	8,100	1.00	8,100	-	-	-	-	-	-	8,100	1.00	8,100
Locata Corporation Pty Ltd (RIA 6)	2,841	0.38	1,071	221	-	-	-	-	-	3,427	0.38	1,292
			<b>46,742</b>	<b>(337)</b>	<b>(3,345)</b>	<b>(229)</b>	<b>(216)</b>	<b>-</b>	<b>-</b>			<b>42,615</b>

<sup>1</sup> Includes gain or loss on revaluation of foreign currency balances as at the year end.<sup>2</sup> Please refer to note 23.

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND**

for the year ended 31 December 2011

BD 000's

	2011	2010
<b>Sources of charity and zakah fund</b>		
At 1 January	2,066	593
Contributions by the Bank	250	2,091
Non-Islamic income	7	36
<b>Total sources</b>	<b>2,323</b>	2,720
<b>Uses of charity and zakah fund</b>		
Contributions to charitable organisations	961	654
<b>Total uses</b>	<b>961</b>	654
<b>Undistributed charity and zakah fund at 31 December (note 13)</b>	<b>1,362</b>	2,066

The accompanying notes 1 to 35 form an integral part of these consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 1. INCORPORATION AND PRINCIPAL ACTIVITY

Khaleeji Commercial Bank BSC ("the Bank"), a public shareholding company, was incorporated on 24 November 2004 in the Kingdom of Bahrain under Commercial Registration No. 55133. The Bank operates under an Islamic retail banking license granted by the Central Bank of Bahrain ("CBB") on 20 October 2003. The Bank's shares are listed on the Bahrain Bourse.

The Bank's activities are regulated by CBB and supervised by a Religious Supervisory Board to ensure adherence to Shari'a rules and principles in its transactions and activities.

The principal activities of the Bank include providing banking and investment products and services to retail customers, high net worth individuals, corporate entities, and financial institutions. These include commercial and corporate banking, consumer finance, wealth management, structured investment products and project financing facilities which comply with Islamic Shari'a rules and principles as determined by the Bank's Shari'a Supervisory Board.

The consolidated financial statements include the financial statements of the Bank and its subsidiaries (together "the Group"). The significant subsidiaries are as follows:

Name	Country of incorporation	% holding	Nature of business
Hawafiz Khaleeji Management Company BSC (c)	Bahrain	100%	To hold shares for the beneficial interest of the management incentive scheme. (refer to note 20)
Binaa Investment I	Cayman Islands	100%	To hold investments for the beneficial interest of the Bank

#### 2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been consistently applied by the Group and are consistent with those used in the previous year, except for those changes arising from revised/new AAOIFI standard, the revised Statement of Financial Accounting No.1 *Conceptual framework for the financial reporting by Islamic financial institutions* (SFA 1) and the *Financial Accounting Standard (FAS) 25 'Investment in sukuk, shares and similar instruments'*, that are effective for annual reporting periods beginning 1 January 2011.

##### **SFA 1: Conceptual framework for the financial reporting by Islamic financial institutions**

The revised conceptual framework for financial reporting by Islamic financial Institutions was issued on 22 July 2010 and is effective from 1 January 2011 on a prospective basis and supersedes the previous SFA 1 and SFA 2. The conceptual framework has been amended to primarily reflect the following:

- Widening the scope of the framework to a broader spectrum of entities rather than limiting it to only Islamic financial institutions;
- Clarify elements of financial statements and definitions of investment accounts;
- Provide overall criteria and framework for determination of on and off balance sheet accounts; and
- Changes in terminology and editorial amendments to provide more consistency in understanding of key concepts.

The amended framework introduces and emphasises the generally accepted concept of substance and form compared to the concept of form over substance.

The framework states that it is necessary that information, transaction and other events are accounted for and presented in accordance with its substance and economic reality as well as legal form.

The revised conceptual framework has a pervasive impact on financial reporting. However, this has not resulted in any material changes to the accounting policies and the financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### FAS 25 'Investment in sukuk, shares and similar instruments'

FAS 25 was issued in July 2010 and replaced FAS 17 'Investments'. FAS 25 retains and simplifies the mixed measurement model and establishes two measurement categories for investments: amortised cost and fair value (refer to note 2 (e)). The guidance in FAS 17 on 'investment in real estate' continues to apply. The new standard requires retroactive application.

The Group has adopted the revised FAS 25 on its required application date 1 January 2011. The retroactive adoption of this standard did not result in any impact on the income statement and equity of the previous period.

On the date of application, the classification and categorisation of investments has been reassessed based on the facts and circumstances on that date. The adoption of the standard resulted in the following re-categorisation of investment securities in the statement of financial position:

1 January 2010 (Previous categorisation as per FAS 17)	Amortised cost	Revised categorisation		Total BD 000's
		Fair value through equity	Fair value through income statement	
Available-for-sale	-	63,111	-	63,111
Held-to-maturity	29,243	-	-	29,243
	29,243	63,111	-	92,354

31 December 2010 (Previous categorisation as per FAS 17)	Amortised cost	Revised categorisation		Total BD 000's
		Fair value through equity	Fair value through income statement	
Available-for-sale	310	69,922	12,796	83,028
Held-to-maturity	17,251	-	-	17,251
	17,561	69,922	12,796	100,279

##### a. Statement of compliance

The financial statements have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). In line with the requirement of AAOIFI and the CBB Rule Book, for matters that are not covered by AAOIFI standards, the Group uses guidance from the relevant International Financial Reporting Standards.

##### b. Basis of preparation

The consolidated financial statements are presented in Bahraini Dinars, being the principal currency of the Bank's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain investments carried at fair value.

The Group classifies its expenses in the income statement by the nature of expense method.

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 21.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### c. Basis of consolidation

###### (i) Subsidiaries

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries. Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the risks and rewards transferred by the SPE, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE. The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity. Information about the Group's fiduciary assets under management is set out in note 22.

###### (ii) Associates

Associates are those enterprises in which the Group holds, directly or indirectly, more than 20% of the voting power and exercises significant influence, but not control, over the financial and operating policies.

Investments in associates are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

###### (iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

##### d. Foreign currency transactions

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Bahraini Dinars, which is the Bank's functional and presentation currency.

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain equity securities measured at fair value through equity, are included in investments fair value reserve.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### d. Foreign currency transactions (continued)

The other Group companies functional currencies are either denominated in Bahraini dinars or US dollars which is effectively pegged to the Bahraini dinar. Hence, the translation of financial statements of the group entities that have a functional currency different from the presentation currency do not result in exchange differences.

##### e. Investment securities

Investment securities comprise equity investments and investments in sukuk (Islamic bonds). Investment securities exclude investments in subsidiaries and equity accounted associate companies (refer to note 2(c)).

##### (i) Classification

The Group segregates its investment securities into debt-type instruments and equity-type instruments. Debt-type instruments are investments that have terms that provide fixed or determinable payments of profits and capital. Equity-type instruments are investments that do not exhibit features of debt-type instruments and include instruments that evidence a residual interest in the assets of an entity after deducting all its liabilities.

##### *Debt-type instruments:*

Investments in debt-type instruments are classified in the following categories: 1) at amortised cost or 2) at fair value through income statement (FVTIS).

A debt-type investment is classified and measured at amortised cost only if the instrument is managed on a contractual yield basis or the instrument is not held for trading and has not been designated at FVTIS. Debt-type investments at amortised cost include investments in medium to long-term sukuk.

Debt-type investment classified and measured at FVTIS include investments held for trading or designated at FVTIS. At inception, a debt-type investment managed on a contractual yield basis, can only be designated at FVTIS if it eliminates an accounting mismatch that would otherwise arise on measuring the assets or liabilities or recognising the gains or losses on them on different bases. The Group currently does not have any investments in this category.

##### *Equity-type instruments:*

Investments in equity type instruments are classified in the following categories: 1) at fair value through income statement (FVTIS) or 2) at fair value through equity (FVTE), consistent with its investment strategy.

Equity-type investments classified and measured at FVTIS include investments held for trading or designated at FVTIS.

An investment is classified as held for trading if acquired or originated principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. Any investments that form part of a portfolio where there is an actual pattern of short-term profit taking are also classified as 'held for trading'. The Group currently does not have a trading portfolio.

Equity-type investments designated at FVTIS include investments which are managed and evaluated internally for performance on a fair value basis. This category currently includes investment in private equity and certain closed companies.

On initial recognition, the Bank makes an irrevocable election to designate certain equity instruments that are not designated at FVTIS to be classified as investments at fair value through equity. These include investments in certain quoted and unquoted equity securities.

##### (ii) Recognition and de-recognition

Investment securities are recognised at the trade date i.e. the date that the Group contracts to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument. Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### e. Investment securities (continued)

###### (iii) Measurement

Investment securities are measured initially at fair value, which is the value of the consideration given. For FVTIS investments, transaction costs are expensed in the income statement. For other investment securities, transaction costs are included as a part of the initial recognition.

Subsequent to initial recognition, investments carried at FVTIS and FVTE are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at FVTIS are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of investments carried at FVTE are recognised in the consolidated statement of changes in equity and presented in a separate fair value reserve within equity. The fair value gains / losses are recognised taking into consideration the split between portions related to owners' equity and equity of investment account holders. When the investments carried at FVTE are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Investments at FVTE where the entity is unable to determine a reliable measure of fair value on a continuing basis, such as investments that do not have a quoted market price or other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances.

Subsequent to initial recognition, debt type investments, other than those carried at FVTIS, are measured at amortised cost using the effective profit method less any impairment allowances.

###### (iv) Measurement principles

###### *Amortised cost measurement*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectability. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

###### *Fair value measurement*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. The Group measures the fair value of quoted investments using the market bid-prices in an active market for that instrument.

For certain unquoted investments, the Group uses proprietary models, which usually are developed from recognised valuation models for fair valuation. Some or all of the inputs into these models may not be market observable, but are estimated based on assumptions. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. Valuation adjustments are recorded to allow for bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state the values of these investments.

##### f. Financing assets

Financing assets comprise Shari'a compliant financing contracts with fixed or determinable payments. These include financing provided through Murabaha, Musharaka, Istisna and Wakala contracts. Financing assets are recognised on the date at which they are originated and are carried at their amortised cost less impairment allowances, if any.

##### g. Placements with and from financial institutions, non-financial institutions and individuals

These comprise inter-bank and over the counter customer placements made/received using Shari'a compliant contracts. Placements are usually for short-term and are stated at their amortised cost.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### h. Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash and bank balances (excluding CBB reserve account), and placements with financial institutions with maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

##### i. Assets acquired for leasing

Assets acquired for leasing (Ijarah Muntahia Bittamleek) are stated at cost less accumulated depreciation and any impairment in value. Under the terms of lease, the legal title of the asset passes to the lessee at the end of the lease term, provided that all lease instalments are settled. Depreciation is calculated on a straight line basis at rates that systematically reduce the cost of the leased assets over the period of the lease. The Group assesses at each statement of financial position date whether there is objective evidence that the assets acquired for leasing are impaired. Impairment losses are measured as the difference between the carrying amount of the asset (including lease rentals receivable) and the estimated recoverable amount. Impairment losses, if any, are recognised in the income statement.

##### j. Investment property

Properties held for rental, or for capital appreciation purposes, or both, are classified as investment property. Investment property are carried at cost less impairment allowances, if any. Cost includes expenditure that is directly attributable to the acquisition of the investment property. Investment property of the Group includes a plot of land held for capital appreciation purposes.

##### k. Property and equipment

Property and equipment is stated at cost, net of accumulated depreciation and impairment allowances, if any. Property includes land which is not depreciated. Other equipment is depreciated using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 3 to 5 years. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date.

##### l. Impairment of assets

The Group assesses at each statement of financial position date whether there is objective evidence that an asset is impaired. Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of financing facility or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

##### *Financial assets carried at amortised cost*

These include debt-type instruments, financing assets and receivables. For financial assets carried at amortised cost, impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the income statement. The Group considers evidence of impairment for financial assets carried at amortised cost at both a specific asset and collective level.

All individually significant financial assets are assessed for specific impairment. All individually significant financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Financial assets that are not individually significant are collectively assessed for impairment by grouping together assets with similar risk characteristics.

##### *Equity investments carried at fair value through equity (FVTE)*

In the case of investments in equity securities classified as FVTE and measured at fair value, a significant or prolonged decline in the fair value of the security below its cost is an objective evidence of impairment. If any such evidence exists, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in income statement - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are subsequently reversed through equity.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### l. Impairment of assets (continued)

###### *Equity investments carried at fair value through equity (FVTE) (continued)*

For FVTE investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

###### **Other non-financial assets**

The carrying amount of the Group's assets (other than for financial assets covered above), are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

##### m. Customers' current accounts

Balances in current (non-investment) accounts are recognised when received by the Bank. The transactions are measured at the cash equivalent amount received by the Bank at the time of contracting. At the end of the accounting period, the accounts are measured at their book value.

##### n. Equity of investment account holders

Equity of investment account holders are funds held by the Bank in unrestricted investment accounts, which it can invest at its own discretion. The investment account holder authorises the Bank to invest the account holders' funds in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The Bank charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves (Profit equalisation reserve and Investment risk reserve) and deducting the Bank's share of income as a Mudarib. The allocation of income is determined by the management of the Bank within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Bank and are not charged separately to investment accounts.

Investment accounts are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves. Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of these reserves results in an increase in the liability towards the pool of unrestricted investment accounts.

##### o. Restricted investment accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Bank as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Bank in the consolidated financial statements.

##### p. Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### q. Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised on the Group's income statement on the sale of treasury shares.

##### r. Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10% of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50% of the paid up share capital.

##### s. Revenue recognition

**Income from investment banking services** is recognised as per contractual terms when the service is provided and income is earned. This is usually when the Bank has performed all significant acts in relation to a transaction and it is highly probable that the economic benefits from the transaction will flow to the Bank. Significant acts in relation to a transaction is determined based on the terms agreed in the private placement memorandum / contracts for each transaction. Income from investment banking services received in-kind in the form of shares is measured at the fair value of the consideration received.

**Fees and commission income** that are integral to the effective profit rate on a financial asset carried at amortised cost are included in the measurement of the effective profit rate of the financial asset. Other fees and commission income, including account servicing fees, sales commission, management fees, placement and arrangement fees and syndication fees, are recognised as the related services are performed.

**Income from Murabaha and Wakala contracts** are recognised on a time-apportioned basis over the period of the contract using the effective profit method.

Profit or losses in respect of the Bank's share in **Musharaka financing** transaction that commence and end during a single financial period is recognised in the income statement at the time of liquidation (closure of the contract). Where the Musharaka financing continues for more than one financial period, profit is recognised to the extent that such profits are being distributed during that period in accordance with profit sharing ratio as stipulated in the Musharaka agreement

**Istisna'a revenue** and the associated profit margin is recognised in the Bank's books according to the percentage of completion method.

**Income from assets acquired for leasing** (Ijarah Muntahia Bittamleek) are recognised proportionately over the lease term.

**Income from sukuk** and income / expenses on placements is recognised at its effective profit rate over the term of the instrument.

**Dividend income** is recognised when the right to receive is established.

##### t. Earnings prohibited by Shari'a

The Bank is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Bank uses these funds for charitable purposes.

##### u. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 *Zakah* using the net assets method. Zakah is paid by the Group based on the statutory reserve and retained earnings balances at the end of the year and the remaining Zakah is payable by individual shareholders. The Bank calculates and notifies the shareholders of their pro-rata share of the Zakah payable annually. The calculations of Zakah is approved by the Shari'a Supervisory Board. Payment of Zakah on the unrestricted investment and other accounts is the responsibility of the investment account holders.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### v. Employee benefits

###### (i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

###### (ii) Post-employment benefits

Pensions and other social benefits for Bahraini employees are covered by the General Organisation for Social Insurance scheme, which is a "defined contribution scheme" in nature, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in income statement when they are due.

Expatriate employees on fixed contracts are entitled to leaving indemnities payable under the Bahraini Labour Law for the Private Sector of 1976, based on length of service and final remuneration. Provision for this unfunded commitment has been made by calculating the notional liability had all employees left at the statement of financial position date.

These benefits are in the nature of "defined benefit scheme" and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Bank. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

###### (iii) Share-based employee incentive scheme

The Bank operates a share-based incentive scheme for its employees (the "Scheme") whereby eligible employees are granted the Bank's shares as compensation on achievement of certain non-market based performance conditions and additional service conditions (the 'vesting conditions').

The grant date fair value of equity instruments granted to employees is recognised as an employee expense, with a corresponding increase in equity (share grant reserve), over the period in which the employees become unconditionally entitled to the share awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date.

The total share awards have been transferred to Hawafiz Khaleeji Management Company BSC (c) a special purpose entity formed to manage the scheme until the date of vesting. The unvested and forfeited shares, if any, are treated similar to treasury shares and are shown under 'Unvested employee incentive scheme shares' in equity. On the date of vesting, a transfer is made within components of equity to reflect the issue of shares to employees.

##### w. Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

##### x. Offsetting

Financial assets and liabilities are offset only when there is a legal or religious enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

##### y. Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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### 3. CASH AND BANK BALANCES

	31 December 2011	31 December 2010
Cash	2,155	1,310
Balances with banks	9,282	2,101
Balances with the Central Bank:		
- Current account	2,040	523
- Reserve account	9,165	8,356
	<b>22,642</b>	12,290

The reserve account with the Central Bank of Bahrain is not available for day-to-day operational purposes.

### 4. PLACEMENTS WITH FINANCIAL INSTITUTIONS

	31 December 2011	31 December 2010
Gross Murabaha and Wakala receivable	76,800	75,003
Less: Deferred profits	(13)	(44)
	<b>76,787</b>	74,959

The average profit rate on placement with financial institutions for 2011 was 0.62% per annum (2010: 1.77% per annum).

### 5. FINANCING ASSETS

	31 December 2011	31 December 2010
Murabaha	158,328	163,866
Musharaka	40,502	34,306
Wakala	19,999	20,392
Istisna	841	998
	<b>219,670</b>	219,562
Less: Impairment allowances - specific	(16,151)	(14,189)
Less: Impairment allowances - collective	(1,963)	(2,163)
	<b>201,556</b>	203,210

Murabaha financing receivables are net of deferred profits of BD 20,847 thousand (2010: BD 17,087 thousand).

Of the total financing asset portfolio, consumer financing receivables amounted to BD 6,044 thousand (2010: BD 1,039 thousand).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011  
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### 5. FINANCIAL ASSETS (CONTINUED)

The movement in impairment allowances are as follows:

2011	Specific	Collective	Total
At 1 January	14,189	2,163	16,352
Additions / (write back) during the year	1,962	(200)	1,762
<b>At 31 December</b>	<b>16,151</b>	<b>1,963</b>	<b>18,114</b>

2010	Specific	Collective	Total
At 1 January	7,897	2,355	10,252
Additions / (write back) during the year	6,292	(192)	6,100
At 31 December	14,189	2,163	16,352

### 6. INVESTMENT SECURITIES

	31 December 2011	31 December 2010
<b>Equity type instruments:</b>		
<i>At fair value through income statement</i>		
- Unquoted equity securities (at fair value)	17,452	12,796
<i>At fair value through equity</i>		
- Quoted equity securities (at fair value)	211	274
- Unquoted equity securities (carried at cost less impairment)	72,471	69,648
	<b>90,134</b>	<b>82,718</b>
<b>Debt type instruments:</b>		
<i>At amortised cost</i>		
- Sukuk	21,672	17,561
	<b>111,806</b>	<b>100,279</b>

Unquoted equity securities at fair value through equity comprise investments in closed companies managed by external investment managers or represent investments in projects promoted by the Group. These investments are carried at cost less impairment in the absence of a reliable measure of fair value. The Group intends to exit these investments principally by means of private placements, strategic buy outs, sale of underlying assets or through initial public offerings.

During the year impairment allowances of BD 1,795 thousand (2010: BD 1,793 thousand) was recognised on equity securities carried at cost.

Debt type instruments are net of collective impairment allowances of BD 84 thousand (2010: BD 52 thousand).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011  
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## 7. ASSETS ACQUIRED FOR LEASING

	Property	Equipment	2011	2010
<b>Cost</b>				
At 1 January	7,639	3,186	10,825	18,499
Additions during the year	8,113	-	8,113	1,340
Settlements / adjustments during the year	(436)	(3,186)	(3,622)	(9,014)
<b>At 31 December</b>	<b>15,316</b>	<b>-</b>	<b>15,316</b>	<b>10,825</b>
<b>Accumulated depreciation</b>				
At 1 January	2,385	2,461	4,846	9,955
Charge for year	1,219	725	1,944	3,905
Settlements during the year	-	(3,186)	(3,186)	(9,014)
<b>At 31 December</b>	<b>3,604</b>	<b>-</b>	<b>3,604</b>	<b>4,846</b>
<b>Net book value at 31 December</b>	<b>11,712</b>	<b>-</b>	<b>11,712</b>	<b>5,979</b>

At 31 December 2011, accrued lease rentals receivable amounted to BD 1,946 thousand (2010: BD 2,001 thousand). Lease rentals receivable is net of collective provision of BD 136 thousand (2010: BD 136 thousand).

Of the total net book value of assets acquired for leasing consumer financing amounted to BD 9,054 thousand (2010: BD 1,323 thousand).

## 8. INVESTMENT IN ASSOCIATES

	2011	2010
At 1 January	4,113	6,521
Distributions during the year	-	(1,403)
Share of losses for the year	(1,226)	(1,005)
<b>At 31 December</b>	<b>2,887</b>	<b>4,113</b>

Investment in associates comprise:

Name	Country of incorporation	% holding	Nature of business
Capital Real Estate Projects Company BSC (c)	Bahrain	30.0%	Real estate holding and development
Amlak II SPV	Cayman Islands	23.1%	Purchase and sale of real estate in Bahrain

Summarised financial information of associates that have been equity accounted not adjusted for the percentage ownership held by the Group (based on their most recent unaudited management accounts):

	2011	2010
Total assets	21,406	23,152
Total liabilities	8,192	8,185
Total revenues	631	717
Total net losses	(4,626)	(3,084)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 9. INVESTMENT PROPERTY

The Bank owns two plots of land in the Bahrain Financial Harbour project which were received in consideration for sale of an investment in 2010. Of the two plots of land received, one plot is intended for the Group's own use and has been classified under "Property and equipment" (refer to note 11). The second plot of land is held for capital appreciation purposes and hence has been classified as "Investment property".

### 10. OTHER ASSETS

	31 December 2011	31 December 2010
Income from sukuk receivable	94	800
Prepayments	650	543
Other receivables	1,446	1,133
	<b>2,190</b>	<b>2,476</b>

Other receivables is net of impairment provision of BD 773 thousand (2010: BD 773 thousand).

### 11. PROPERTY AND EQUIPMENT

	Land (note 9)	Furniture and fixtures	Computers	Motor Vehicle	Other equipment	Work-in- progress	2011 Total	2010 Total
<b>Cost</b>								
At 1 January	6,714	3,424	2,195	73	181	485	13,072	6,457
Additions / capitalisation	-	366	399	-	42	1	808	7,207
Disposal / transfers	-	-	-	-	(6)	(196)	(202)	(592)
<b>At 31 December</b>	<b>6,714</b>	<b>3,790</b>	<b>2,594</b>	<b>73</b>	<b>217</b>	<b>290</b>	<b>13,678</b>	<b>13,072</b>
<b>Accumulated Depreciation</b>								
At 1 January	-	1,314	1,670	38	85	-	3,107	2,108
Charge for year	-	717	398	15	39	-	1,169	1,342
Disposals	-	-	-	-	(4)	-	(4)	(344)
<b>At 31 December</b>	<b>-</b>	<b>2,031</b>	<b>2,068</b>	<b>53</b>	<b>120</b>	<b>-</b>	<b>4,272</b>	<b>3,106</b>
<b>Net book value</b>								
at 31 December 2011	<b>6,714</b>	<b>1,759</b>	<b>526</b>	<b>20</b>	<b>97</b>	<b>290</b>	<b>9,406</b>	<b>9,966</b>
Net book value at 31 December 2010	6,714	2,111	525	35	96	485	9,966	

### 12. PLACEMENTS FROM NON-FINANCIAL INSTITUTIONS AND INDIVIDUALS

	31 December 2011	31 December 2010
Non-financial institutions	28,424	19,018
Individuals	18,223	-
	<b>46,647</b>	<b>19,018</b>

These represent placements in the form Murabaha and Wakala contracts.

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### 13. OTHER LIABILITIES

	31 December 2011	31 December 2010
Employee related accruals	996	1,071
Mudharaba profit accrual	1,789	1,525
Charity and zakah payable (page 35)	1,362	2,066
Payable for Istisna'a contracts	128	160
Other payables and accrued expenses	1,431	2,153
	<b>5,706</b>	<b>6,975</b>

### 14. EQUITY OF INVESTMENT ACCOUNT HOLDERS

The funds received from investment account holders have been commingled and jointly invested with the Bank in the following asset class as at 31 December:

	31 December 2011	31 December 2010
Balances with banks	9,282	-
CBB reserve account	9,165	8,356
Placements with financial institutions	76,787	74,959
Debt type instruments - sukuk	21,672	17,561
Financing assets	78,461	97,344
	<b>195,367</b>	<b>198,220</b>

The investors' share of the return on jointly invested assets and distribution to investment account holders were as follows:

	31 December 2011	31 December 2010
Returns from jointly invested assets	9,022	8,254
Banks share as Mudarib	(2,393)	(2,469)
<b>Return to investment account holders'</b>	<b>6,629</b>	<b>5,785</b>
Investment risk reserve utilised, net	-	948
Profit equalisation reserve utilised, net	169	1,039
<b>Distributions to investment account holders'</b>	<b>6,798</b>	<b>7,772</b>

Approximately 3.61% (2010: 4.03%) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Investment accounts include profit equalisation reserve of Nil (2010: BD 169 thousand) and investment risk reserve of Nil (2010: Nil).

### 15. SHARE CAPITAL

	31 December 2011	31 December 2010
<b>Authorised:</b>		
3,000,000,000 ordinary shares of BD 0.100 each	<b>300,000</b>	300,000
<b>Issued and fully paid up:</b>		
1,154,161,084 ordinary shares (2010: 1,154,161,084) of BD 0.100 each	<b>115,416</b>	115,416

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### 15. SHARE CAPITAL (CONTINUED)

The Bank has only one class of equity shares and the holders of these shares have equal voting rights. At 31 December 2011, the Bank holds 28,180,132 as treasury shares (2010: 27,805,198).

*Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:*

Categories*	Number of Shares	Number of Shareholders	% of total outstanding shares
Less than 1%	180,855,823	537	15.67
1% up to less than 5% **	165,209,535	8	14.31
5% up to less than 10%	103,950,000	1	9.01
10% up to less than 20%	161,700,000	1	14.01
20% and less than 50%	542,445,726	1	47.00
	<b>1,154,161,084</b>	<b>548</b>	<b>100.00</b>

\* Expressed as a percentage of total outstanding shares of the Bank.

\*\* Includes treasury shares and unvested employee incentive scheme shares.

*Names and nationalities of the major shareholders and the number of equity shares held in which they have an interest of 5% or more of outstanding shares:*

	Nationality	Number of shares	% of total outstanding shares
Gulf Finance House BSC *	Bahrain	542,445,726	47.00
Al Imtiaz Investment Company KSCC	Kuwait	161,700,000	14.01
Emirates Islamic Bank PJSC	UAE	103,950,000	9.01

\* As at 31 December 2011, these shares representing 47.00% were held by KHCB Asset Company on behalf of Gulf Finance House BSC.

### 16. INCOME FROM INVESTMENT SECURITIES

	2011	2010
Income from equity-type investments:		
- Dividend income	373	132
- Fair value gain on investment	4,656	1,244
	<b>5,029</b>	1,376
Income from debt-type investments:		
- Income from Sukuk	583	822
- Gain on sale of Sukuk	409	-
	<b>6,021</b>	2,198

### 17. STAFF COST

	2011	2010
Salaries and benefits	4,549	3,952
Social insurance expenses	570	507
Other staff expenses	730	611
	<b>5,849</b>	5,070

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**18. IMPAIRMENT ALLOWANCES**

	2011	2010
Financing assets (note 5)	1,762	6,100
Investments at fair value through equity (note 6)	1,795	1,793
Investments at amortised cost (note 6)	32	(106)
Other receivable (note 10)	-	773
	<b>3,589</b>	<b>8,560</b>

**19. OTHER EXPENSES**

	2011	2010
Premises cost	922	905
Advertisement and marketing expenses	811	1,113
Professional fees	391	436
Information technology expenses	299	469
Distribution channel expenses	240	74
Board expenses	217	225
Communication expenses	158	157
Other administrative expenses	561	687
	<b>3,599</b>	<b>4,066</b>

**20. SHARE-BASED EMPLOYEE INCENTIVE SCHEME**

The Bank operates an equity-settled share-based incentive scheme for its employees (the "Scheme") whereby eligible employees are granted the Bank's shares as a compensation on achievement of certain non-market performance conditions.

The Group has incorporated a special purpose vehicle, Hawafiz Khaleeji Management Company BSC (c) ('Hawafiz'), to hold the shares for the beneficial interest of the Scheme until they vest.

The shares granted vest to eligible employees in a staggered manner over a 5 year vesting period ('service condition'). The shares granted shall be eligible to receive dividends. The vested shares will be settled by physical delivery on completion of vesting conditions.

In case the employee leaves before satisfying the vesting conditions, he/ she would be entitled for a cash payment for the unvested shares in accordance with the terms of the Scheme. Such unvested shares will be retained by Hawafiz and may be offered to other employees as per the terms of the Scheme.

The maximum number of shares to be issued to employees under the scheme is 30.4 million ordinary shares at an exercise price of BD 0.120 per share, to be issued over the vesting period in accordance with the terms of the Scheme. Up to 31 December 2011, on a cumulative basis, 30.4 million share grants have been awarded of which 22.903 million shares (2010: 22.591 million shares) have vested up to 31 December 2011 and 1.456 million shares (2010: 0.198 million shares) were forfeited due to failure to satisfy the service condition. No new grants have been made since 2009. The vesting expense for the year, net of reversals due to forfeitures, amounted to BD 68 thousand (2010: BD 212 thousand).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

##### **Judgements**

###### *Classification of investments*

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as debt type instruments carried at fair value through equity or amortised cost, or equity-type instruments carried at fair value through equity or fair value through income statement. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification (refer to note 2 (e)).

###### *Special purpose entities*

The Bank sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Bank provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

The Bank does not consolidate SPE's that it does not have the power to control. In determining whether the Bank has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group's intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

##### **Estimations**

###### *Impairment of equity instruments*

The Group determines that equity securities carried at fair value are impaired when there is an objective evidence of impairment and there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

In case of quoted equity securities, the Group considers a decline of more than 30% in the fair value below cost to be significant and considers a decline below cost which persists for more than 6 months as prolonged. Where fair values are not readily available and the investments are carried at cost, the recoverable amount of such investment is estimated to test for impairment.

For unquoted investments carried at cost, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the estimated recoverable amount is assessed to be below the cost of the investment.

In making this judgment, the Bank evaluates among other factors, evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

###### *Fair value of unquoted equity securities*

The Group determines the fair value of unquoted investments by using valuation techniques. This includes using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analysis or market multiples for similar instruments. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies/funds. These estimates involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 21. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (CONTINUED)

##### *Fair value of unquoted equity securities (continued)*

Significant judgment is required to be made by the Group and the Board of Directors in the selection of an approach that would reflect the best measure of fair value of the investments. The choice of the models used for valuation on each reporting period may have a significant impact on the fair value of investments and the amounts reported in the consolidated financial statements. The Bank has adopted the market approach for valuation of its unquoted equity security.

The potential effect of using reasonable possible alternative assumptions for valuing the investments resulting in 5% decrease / increase in the market multiple would increase / decrease the reported fair value by BD 873 thousands. The corresponding impact would be on the profit or loss reported by the Group.

##### *Impairment of financing assets*

Financing assets are evaluated for impairment on a basis described in accounting policy, refer to note 2 (I). Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying assets / collaterals. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

For evaluation of the portfolio for impairment on a collective basis, management, where available, uses estimates based on historical loss experience for assets and loss experience in the industry for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio. For the purposes of a collective evaluation of impairment, financing assets are grouped on the basis of similar credit risk characteristics (that is, on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The methodology and assumptions used for the grading process and estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. In view of the management, the current level of provisioning is adequate and no additional impairment allowances are required on a collective basis.

#### 22. ASSETS UNDER MANAGEMENT

The Bank provides corporate administration, investment management and advisory services to its investment entities, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the statement of financial position date, the Group had assets under management of BD 384.83 million (2010: BD 427.93 million). During the year, the Bank has charged management fees amounting to BD 618 thousands (2010: BD 1,260 thousands) for the management of these assets.

#### 23. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include the significant shareholders and entities over which the Bank and the shareholders exercises significant influence, directors and executive management of the Bank.

A significant portion of the Bank's income from investment banking services and management fees arises from entities (assets under management) over which the Bank or its significant shareholders exercises influence. Although these entities are considered related parties, the Bank administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were :

Categories*	Number of Shares	Number of Directors
Less than 1%	8,358,250	5
1% up to 10%	17,611,955	1

\* Expressed as a percentage of total outstanding shares of the Bank.

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### 23. RELATED PARTY TRANSACTIONS (CONTINUED)

The related party balances and transactions (except for compensation of key managerial personnel) included in these consolidated financial statements are as follows:

31 December 2011	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Assets</b>					
Investment securities	-	-	-	47,715	47,715
Financing assets	1,359	-	-	12,076	13,435
Investment in associates	2,887	-	-	-	2,887
Other assets	411	-	-	558	969
<b>Liabilities</b>					
Customers' current accounts	207	1	19	433	660
Equity of investment account holders	104	7	331	19,966	20,408
Other liabilities	-	421	13	-	434
Placement from financial institutions	-	-	1,132	-	1,132
<b>Transactions</b>					
Purchase of investment property	-	-	2,640	-	2,640
<b>31 December 2010</b>					
	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Assets</b>					
Investment securities	-	-	-	44,690	44,690
Financing assets	1,102	-	-	11,832	12,934
Investment in associates	4,113	-	-	-	4,113
Other assets	385	-	-	946	1,331
<b>Liabilities</b>					
Customers' current accounts	262	1	25	1,138	1,426
Equity of investment account holders	130	1,734	330	29,822	32,016
Other liabilities	-	1,649	78	-	1,727
<b>Transaction</b>					
Acquisition of investment securities	-	-	22,991	-	22,991
Disposal of investment securities	-	-	18,850	-	18,850
Purchase of properties	-	-	10,657	-	10,657

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 23. RELATED PARTY TRANSACTIONS (CONTINUED)

2011	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Income</b>					
Management fees	-	-	-	618	618
Income from financing assets and assets acquired for leasing	91	-	-	548	639
Income from investment securities	-	-	-	243	243
Share of losses from associate companies	(1,226)	-	-	-	(1,226)
<b>Expenses</b>					
Return to investment account holders	2	5	13	402	422
Expenses on placements from financial institutions	-	-	53	-	53
Other expenses	-	-	-	11	11
Impairment allowances	-	-	-	795	795

2010	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
<b>Income</b>					
Income from investment banking services	-	-	-	47	47
Management fees	-	-	-	1,260	1,260
Income from financing assets and assets acquired for leasing	95	-	-	643	738
Income from investment securities	-	-	1,244	50	1,294
Share of losses from associate companies	(1,005)	-	-	-	(1,005)
<b>Expenses</b>					
Return to investment account holders	112	-	74	992	1,178
Other expenses	-	16	-	138	154
Impairment allowances	-	-	-	1,433	1,433

#### Compensation of key management personnel

Key management personnel of the Bank comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Bank. The key management personnel compensation during the year is as follows:

	2011	2010
Board member fees	76	35
Board member allowances	120	164
Salaries and other short-term benefits	862	1,142

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### 23. RELATED PARTY TRANSACTIONS (CONTINUED)

#### Transactions with restricted investment accounts

Transactions involving transfer/sale of assets to restricted investment accounts are generally executed based on the pre-agreed values as per the terms of the contracts for each restricted investment product. During the year, in its normal course of business, the Bank has bought certain investments at agreed contractual values amounting to BD 1,240 thousands. In 2010, the Bank had sold certain investments at agreed contractual values amounting to BD 167 thousand to its restricted investment accounts at a profit of BD 55 thousand.

### 24. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year by the weighted average number of equity shares outstanding during the year. The Bank has dilutive equity instruments in the form of share grants in issue.

<b>Basic EPS</b>	<b>2011</b>	2010
Profit / (loss) for the year (BD 000's)	518	(6,533)
Weighted average number of equity shares (Nos. in 000's)	1,116,785	1,113,440
Basic earnings per share (in fils)	0.46	(5.87)
<b>Diluted EPS</b>	<b>2011</b>	2010
Profit / (loss) for the year (BD 000's)	518	(6,533)
Weighted average number of equity shares (Nos. in 000's)	1,116,785	1,113,440
Diluted earnings per share (in fils)	0.46	(5.87)

As the average market value of shares during the current year was lower than the assumed issue price of shares under the Scheme (refer to note 20), the share awards are not considered to be dilutive for the purpose of computing earnings per share.

### 25. SHARI'A SUPERVISORY BOARD

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

### 26. ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investment account holders. The Bank currently does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. During the year, the Shari'a Supervisory Board has computed Zakah payable of BD 1,853 thousand (2010: BD 2,506 thousand) of which BD 214 thousand (2010: BD 250 thousand) represents the Zakah computed on the cumulative statutory reserve and retained earnings as at 31 December 2011, payable by the Bank (refer to note 32). The remaining Zakah balance amounting to BD 1,639 thousand or 1.42 fils per share (2010: BD 2,256 thousand or 1.95 fils per share) is due and payable by the shareholders.

### 27. SEGMENT REPORTING

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the Group's chief operating decision maker (Board of Directors) to make decisions about resource allocation to each segment and assess its performance and for which discrete financial information is available. An operating segment is divided into business segment and geographic segments. For management purposes, the Group is organised into two major business segments:

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**27. SEGMENT REPORTING (CONTINUED)****Commercial banking**

Providing customer services such as accepting Mudaraba deposits, savings account and current account facilities, fund transfer facilities, bill payment facilities. It also provides financing facilities (in the form of Commodity Murabaha, Musharaka, Istisna'a and Ijarah facilities) to corporate clients and High-Networth-Individuals and consumer finance products. Provides money market and treasury services in the form of short term Commodity Murabaha to banks, financial institutions and corporate, and also used to manage funding of the Group.

**Investment banking**

Primarily relates to conceptualising of investment deals and performing roles of an arranger, lead manager, and administrator of the funds (involves structuring of deals, raising of funds through private placement and fund administration). Also offers products like Restricted Investment Accounts (RIA) and management of funds raised through the RIA structures. Also involves carrying out strategic investments in the form of equity contribution (either in the funds created and managed by the Bank or other institutions) and Sukuk investments.

Segment performance is measured based on results for each department as mentioned in the internal management reports that are reviewed by the Board of directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate in these industries.

The Bank reports directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment cost respectively. Indirect costs and corporate overheads are treated as unallocated. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures.

The Group primarily operates from Bahrain and does not have any overseas branches / divisions. The geographic concentration of assets and liabilities is disclosed in note 29 (b) to the consolidated financial statements.

These segments are the basis on which the Group reports its primary segment information. Transactions between segments if any, are conducted on an arm's length basis.

<b>31 December 2011</b>	<b>Investment Banking</b>	<b>Commercial Banking</b>	<b>Unallocated</b>	<b>Total</b>
Cash and bank balances	-	22,642	-	22,642
Placements with financial institutions	286	76,501	-	76,787
Financing assets	572	200,984	-	201,556
Investment securities	90,134	21,672	-	111,806
Assets acquired for leasing (including lease rentals receivable)	-	13,658	-	13,658
Investment in associates	2,887	-	-	2,887
Investment property	6,583	-	-	6,583
Other assets	968	94	1,128	2,190
Property and equipment	-	-	9,406	9,406
<b>Total segment assets</b>	<b>101,430</b>	<b>335,551</b>	<b>10,534</b>	<b>447,515</b>
Placements from financial institutions	45,435	-	-	45,435
Placements from non- financial institutions and individuals	-	46,647	-	46,647
Customers' current accounts	286	35,151	-	35,437
Other liabilities	-	1,789	3,917	5,706
<b>Total segment liabilities</b>	<b>45,721</b>	<b>83,587</b>	<b>3,917</b>	<b>133,225</b>
<b>Equity of investment account holders</b>	<b>-</b>	<b>195,367</b>	<b>-</b>	<b>195,367</b>
<b>Restricted investment accounts</b>	<b>35,396</b>	<b>-</b>	<b>-</b>	<b>35,396</b>

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### 27. SEGMENT REPORTING (CONTINUED)

2011	Investment Banking	Commercial Banking	Unallocated	Total
Income from investment banking services	-	-	-	-
Management fees	703	-	-	703
Income from placements with financial institutions	1	258	-	259
Income from financing assets and assets acquired for leasing	-	16,812	-	16,812
Income from investment securities	5,438	583	-	6,021
Share of losses from associate companies	(1,226)	-	-	(1,226)
Other income	258	102	-	360
<b>Total income before return to investment account holders</b>	<b>5,174</b>	<b>17,755</b>	<b>-</b>	<b>22,929</b>
Less: Return to investment account holders before Bank's share as Mudarib	-	(9,022)	-	(9,022)
Bank's share as a Mudarib	-	2,393	-	2,393
<b>Return to investment account holders</b>	<b>-</b>	<b>(6,629)</b>	<b>-</b>	<b>(6,629)</b>
Less: Expense on placement from financial institutions	(420)	-	-	(420)
Less: Expense on placement from non-financial institutions and individuals	-	(1,156)	-	(1,156)
<b>Total segment revenue</b>	<b>4,754</b>	<b>9,970</b>	<b>-</b>	<b>14,724</b>
Staff cost	877	1,754	3,218	5,849
Depreciation	-	-	1,169	1,169
Other expenses	46	-	3,553	3,599
<b>Total segment cost</b>	<b>923</b>	<b>1,754</b>	<b>7,940</b>	<b>10,617</b>
Segment results before impairment allowances	3,831	8,216	(7,940)	4,107
Impairment allowances	1,795	1,794	-	3,589
<b>Segment results</b>	<b>2,036</b>	<b>6,422</b>	<b>(7,940)</b>	<b>518</b>

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## 27. SEGMENT REPORTING (CONTINUED)

31 December 2010	Investment Banking	Commercial Banking	Unallocated	Total
Cash and bank balances	-	12,290	-	12,290
Placements with financial institutions	981	73,978	-	74,959
Financing assets	651	202,559	-	203,210
Investment securities	82,718	17,561	-	100,279
Assets acquired for leasing (including lease rentals receivable)	-	7,980	-	7,980
Investment in associates	4,113	-	-	4,113
Investment property	3,943	-	-	3,943
Other assets	909	800	767	2,476
Property and equipment	-	-	9,966	9,966
<b>Total segment assets</b>	<b>93,315</b>	<b>315,168</b>	<b>10,733</b>	<b>419,216</b>
Placements from financial institutions	65,917	-	-	65,917
Placements from non-financial institutions and individuals	-	19,018	-	19,018
Customers' current accounts	982	9,946	-	10,928
Other liabilities	-	1,525	5,450	6,975
<b>Total segment liabilities</b>	<b>66,899</b>	<b>30,489</b>	<b>5,450</b>	<b>102,838</b>
Equity of investment account holders	-	198,220	-	198,220
Restricted investment accounts	42,615	-	-	42,615

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### 27. SEGMENT REPORTING (CONTINUED)

2010	Investment Banking	Commercial Banking	Unallocated	Total
Income from investment banking services	47	-	-	47
Management fees	1,260	-	-	1,260
Income from placements with financial institutions	12	903	-	915
Income from financing assets and assets acquired for leasing	-	16,092	-	16,092
Income from investment securities	1,376	822	-	2,198
Share of losses from associate companies	(1,005)	-	-	(1,005)
Other income	(30)	108	-	78
Total income before return to investment account holders	1,660	17,925	-	19,585
Less: Return to investment account holders before Bank's share as Mudarib	-	(8,254)	-	(8,254)
Bank's share as a Mudarib	-	2,469	-	2,469
Return to investment account holders	-	(5,785)	-	(5,785)
Less: Expense on placement from financial institutions	(320)	-	-	(320)
Less: Expense on placement from non-financial institutions and individuals	-	(975)	-	(975)
Total segment revenue	1,340	11,165	-	12,505
Staff cost	1,189	1,012	2,869	5,070
Depreciation	-	-	1,342	1,342
Other expenses	285	-	3,781	4,066
Total segment cost	1,474	1,012	7,992	10,478
Segment results before impairment allowances	(134)	10,153	(7,992)	2,027
Impairment allowances	(2,566)	(5,994)	-	(8,560)
Segment results	(2,700)	4,159	(7,992)	(6,533)

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**28. MATURITY PROFILE**

The maturity profile of placements with and from financial institutions, financing assets, assets acquired for leasing, (including lease rentals receivable), investment in sukuk, and equity of investment account holders has been presented using their contractual maturity period. For other balances, maturity profile is based on expected cash flows/ settlement profile of the respective assets and liabilities.

<b>31 December 2011</b>	<b>Up to 3 months</b>	<b>3 to 6 months</b>	<b>6 months to 1 year</b>	<b>1 to 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
<b>Assets</b>						
Cash and bank balances	22,642	-	-	-	-	22,642
Placements with financial institutions	76,787	-	-	-	-	76,787
Financing assets	33,769	6,369	8,238	60,984	92,196	201,556
Investment securities	3,330	11,673	1,314	3,110	92,379	111,806
Assets acquired for leasing (including lease rentals receivable)	-	-	-	2,020	11,638	13,658
Investment in associates	-	-	-	-	2,887	2,887
Investment property	-	-	-	-	6,583	6,583
Other assets	-	-	35	2,054	101	2,190
Property and equipment	-	-	-	-	9,406	9,406
<b>Total assets</b>	<b>136,528</b>	<b>18,042</b>	<b>9,587</b>	<b>68,168</b>	<b>215,190</b>	<b>447,515</b>
<b>Liabilities</b>						
Placements from financial institutions	45,435	-	-	-	-	45,435
Placements from non-financial institutions and individuals	1,789	6,812	37,376	328	342	46,647
Customers' current accounts	35,323	114	-	-	-	35,437
Other liabilities	1,581	582	698	2,646	199	5,706
<b>Total liabilities</b>	<b>84,128</b>	<b>7,508</b>	<b>38,074</b>	<b>2,974</b>	<b>541</b>	<b>133,225</b>
<b>Equity of investment account holders</b>	<b>133,437</b>	<b>24,363</b>	<b>36,950</b>	<b>617</b>	<b>-</b>	<b>195,367</b>
<b>Restricted investment accounts</b>	<b>9,370</b>	<b>16,635</b>	<b>9,391</b>	<b>-</b>	<b>-</b>	<b>35,396</b>
<b>Commitments</b>	<b>2,245</b>	<b>827</b>	<b>8,670</b>	<b>5,955</b>	<b>-</b>	<b>17,697</b>

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### 28. MATURITY PROFILE (CONTINUED)

31 December 2010	Up to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	Over 3 years	Total
<b>Assets</b>						
Cash and bank balances	12,290	-	-	-	-	12,290
Placements with financial institutions	74,959	-	-	-	-	74,959
Financing assets	21,909	17,997	31,152	92,064	40,088	203,210
Investment securities	3,765	1,609	18,520	45,996	30,389	100,279
Assets acquired for leasing (including lease rentals receivable)	441	-	725	5,925	889	7,980
Investment in associates	-	-	1,168	-	2,945	4,113
Investment property	-	-	-	3,943	-	3,943
Other assets	271	-	476	853	876	2,476
Property and equipment	-	-	-	-	9,966	9,966
<b>Total assets</b>	<b>113,635</b>	<b>19,606</b>	<b>52,041</b>	<b>148,781</b>	<b>85,153</b>	<b>419,216</b>
<b>Liabilities</b>						
Placements from financial institutions	65,917	-	-	-	-	65,917
Placements from non-financial institutions and individuals	12,436	1,409	5,110	24	39	19,018
Customers' current accounts	10,928	-	-	-	-	10,928
Other liabilities	487	268	45	5,897	278	6,975
<b>Total liabilities</b>	<b>89,768</b>	<b>1,677</b>	<b>5,155</b>	<b>5,921</b>	<b>317</b>	<b>102,838</b>
Equity of investment account holders	35,949	29,756	48,657	77,943	5,915	198,220
Restricted investment accounts	23,160	18,163	-	-	1,292	42,615
Commitments	6,012	4,737	4,815	20	6	15,590

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### 29. CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS

#### (a) Industry sector

31 December 2011	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and bank balances	22,642	-	-	22,642
Placements with financial institutions	76,787	-	-	76,787
Financing assets	16,708	92,487	92,361	201,556
Investments securities	24,389	62,944	24,473	111,806
Assets acquired for leasing (including lease rentals receivable)	2,103	11,555	-	13,658
Investment in associates	-	2,887	-	2,887
Investment property	-	6,583	-	6,583
Other assets	638	950	602	2,190
Property and equipment	-	6,715	2,691	9,406
<b>Total assets</b>	<b>143,267</b>	<b>184,121</b>	<b>120,127</b>	<b>447,515</b>
<b>Liabilities</b>				
Placements from financial institutions	45,435	-	-	45,435
Placements from non-financial institutions and individuals	-	8,781	37,866	46,647
Customers' current accounts	23,437	1,955	10,045	35,437
Other liabilities	-	-	5,706	5,706
<b>Total liabilities</b>	<b>68,872</b>	<b>10,736</b>	<b>53,617</b>	<b>133,225</b>
<b>Equity of investment account holders</b>	<b>7,105</b>	<b>13,970</b>	<b>174,292</b>	<b>195,367</b>
Restricted investment accounts	-	34,104	1,292	<b>35,396</b>
Commitments	5,655	6,120	5,922	<b>17,697</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 29 CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (CONTINUED)

(a) Industry sector (continued)

31 December 2010	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and bank balances	12,290	-	-	12,290
Placements with financial institutions	74,959	-	-	74,959
Financing assets	14,169	105,303	83,738	203,210
Investments securities	20,986	59,113	20,180	100,279
Assets acquired for leasing (including lease rentals receivable)	2,504	4,065	1,411	7,980
Investment in associates	-	4,113	-	4,113
Investment property	-	3,943	-	3,943
Other assets	673	936	867	2,476
Property and equipment	-	-	9,966	9,966
<b>Total assets</b>	<b>125,581</b>	<b>177,473</b>	<b>116,162</b>	<b>419,216</b>
<b>Liabilities</b>				
Placements from financial institutions	65,917	-	-	65,917
Placements from non-financial institutions and individuals	-	-	19,018	19,018
Customers' current accounts	-	-	10,928	10,928
Other liabilities	-	-	6,975	6,975
<b>Total liabilities</b>	<b>65,917</b>	<b>-</b>	<b>36,921</b>	<b>102,838</b>
Equity of investment account holders	24,635	52,095	121,490	198,220
Restricted investment accounts	-	41,323	1,292	42,615
Commitments	-	4,318	11,272	15,590

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### 29 CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (CONTINUED)

#### (b) Geographic sector

31 December 2011	GCC countries	Europe	USA	Asia	Australia	Africa	Total
<b>Assets</b>							
Cash and bank balances	14,515	663	7,333	7	124	-	22,642
Placements with financial institutions	61,098	15,689	-	-	-	-	76,787
Financing assets	191,539	9,366	651	-	-	-	201,556
Investment securities	79,003	2,927	-	24,008	4,605	1,263	111,806
Assets acquired for leasing (including lease rentals receivable)	13,658	-	-	-	-	-	13,658
Investment in associates	2,887	-	-	-	-	-	2,887
Investment property	6,583	-	-	-	-	-	6,583
Other assets	1,933	39	-	175	43	-	2,190
Property and equipment	9,406	-	-	-	-	-	9,406
<b>Total assets</b>	<b>380,622</b>	<b>28,684</b>	<b>7,984</b>	<b>24,190</b>	<b>4,772</b>	<b>1,263</b>	<b>447,515</b>
<b>Liabilities</b>							
Placements from financial institutions	43,171	-	-	2,264	-	-	45,435
Placements from non-financial institutions and individuals	46,647	-	-	-	-	-	46,647
Customers' current accounts	35,052	360	-	25	-	-	35,437
Other liabilities	5,706	-	-	-	-	-	5,706
<b>Total liabilities</b>	<b>130,576</b>	<b>360</b>	<b>-</b>	<b>2,289</b>	<b>-</b>	<b>-</b>	<b>133,225</b>
<b>Equity of investment account holders</b>	<b>185,114</b>	<b>354</b>	<b>-</b>	<b>9,899</b>	<b>-</b>	<b>-</b>	<b>195,367</b>
<b>Restricted investment accounts</b>	<b>25,792</b>	<b>8,312</b>	<b>-</b>	<b>-</b>	<b>1,292</b>	<b>-</b>	<b>35,396</b>
<b>Commitments</b>	<b>14,628</b>	<b>3,069</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17,697</b>

Concentration by location for financing assets is measured based on the location of the counterparty, which has a high correlation with the location of the collateral for the exposure.

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### 29 CONCENTRATION OF ASSETS, LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND RESTRICTED INVESTMENT ACCOUNTS (CONTINUED)

(b) Geographic sector (continued)

31 December 2010	GCC	Europe countries	USA	Asia	Australia	Africa	Total
<b>Assets</b>							
Cash and bank balances	10,630	1,642	-	-	18	-	12,290
Placements with financial institutions	64,026	7,540	-	-	-	3,393	74,959
Financing assets	188,202	11,194	651	3,163	-	-	203,210
Investment securities	64,656	2,927	-	26,333	4,685	1,678	100,279
Assets acquired for leasing (including lease rentals receivable)	7,980	-	-	-	-	-	7,980
Investment in associates	4,113	-	-	-	-	-	4,113
Investment property	3,943	-	-	-	-	-	3,943
Other assets	2,341	-	-	135	-	-	2,476
Property and equipment	9,966	-	-	-	-	-	9,966
<b>Total assets</b>	<b>355,857</b>	<b>23,303</b>	<b>651</b>	<b>29,631</b>	<b>4,703</b>	<b>5,071</b>	<b>419,216</b>
<b>Liabilities</b>							
Placements from financial institutions	65,917	-	-	-	-	-	65,917
Placements from non-financial institutions and individuals	19,018	-	-	-	-	-	19,018
Customers' current accounts	9,848	463	-	617	-	-	10,928
Other liabilities	6,975	-	-	-	-	-	6,975
<b>Total liabilities</b>	<b>101,758</b>	<b>463</b>	<b>-</b>	<b>617</b>	<b>-</b>	<b>-</b>	<b>102,838</b>
Equity of investment account holders	182,508	321	-	15,391	-	-	198,220
Restricted investment accounts	32,723	8,600	-	-	1,292	-	42,615
Commitments	15,588	2	-	-	-	-	15,590

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### 30. FAIR VALUE

#### a) Fair value of financial instruments

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair values of quoted Sukuk carried at amortised cost of BD 8,209 thousand (2010: BD 10,240 thousand) amounts to BD 7,899 thousand as at 31 December 2011 (2010: BD 9,076 thousand).

Other than equity investments carried at cost of BD 72,741 thousand (2010: BD 69,648 thousand), the estimated fair values of the Bank's other financial instruments are not significantly different from their carrying values.

#### b) Fair value hierarchy

The table below analyses the financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31 December 2011	Level 1	Level 2	Level 3	Total
Investment securities				
Equity type instruments carried at fair value through income statement	-	-	17,452	17,452
Equity type instruments carried at fair value through equity	211	-	-	211
	<b>211</b>	<b>-</b>	<b>17,452</b>	<b>17,663</b>

31 December 2010	Level 1	Level 2	Level 3	Total
Investment securities				
Equity type instruments carried at fair value through income statement	-	-	12,796	12,796
Equity type instruments carried at fair value through equity	274	-	-	274
	<b>274</b>	<b>-</b>	<b>12,796</b>	<b>13,070</b>

The table below shows the reconciliation of movements in value of investments measured using Level 3 inputs:

	2011	2010
At 1 January	12,796	-
Total gains or losses:		
- In profit or loss	4,656	-
Purchases	-	12,796
<b>At 31 December</b>	<b>17,452</b>	<b>12,796</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 31. RISK MANAGEMENT

##### Introduction and overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the Group's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

##### Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established an Executive Risk Management Committee, which is responsible for developing and monitoring the Bank's risk management policies in the specified areas. The committee also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations, if any, to the Board. The committee consists of heads of business and other functional units in the Bank and reports regularly to the Risk Management Committee of the Board.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Audit Committee is responsible for monitoring compliance with the risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

##### CREDIT RISK

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's exposures to placements with financial institutions, financing assets, outstanding assets acquired for leasing, investment in sukuk and receivables classified under other assets. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual and group exposure risk, country and sector concentration risk, related party exposure, etc.). The Bank monitors the total exposure to assets acquired for leasing (including lease rentals receivable) on a cumulative basis for monitoring of market risk and credit risk.

The Board of Directors has delegated responsibility for the management of credit risk to its Executive Risk Management Committee (ERMC). A separate Risk and Credit Management Department (RMD), reporting to the ERMC is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements and submitting the same for approval to the Board of Directors.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are not at present allocated to business units. Smaller exposures are approved by the Executive Credit & Investment Committee consisting of heads of business units and the Chief Operating Officer. Larger facilities require approval by the Chief Executive Officer, Chairman, Board Investment and Credit Committee or the full Board, as the case may be.
- Reviewing and assessing credit risk. RMD assesses all credit exposures and signs off on the relevant proposals prior to approval of the facilities by the appropriate authorities. Renewal and review of facilities are subject to the same process.

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## 31. RISK MANAGEMENT (CONTINUED)

## CREDIT RISK (CONTINUED)

- Limiting concentrations of exposure to counterparties, countries and industries in respect of financing assets, assets acquired for leasing as well as investments.
- Developing and maintaining the Bank's risk grading's in order to categorise exposures according to the degree of probable risk of financial loss to focus management on the attendant risks. The risk grading system is also used to identify specific exposures for which impairment provisions may be required. The risk grading framework for the Bank's financing portfolio consists of ten grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Investments in equity securities are not currently being graded and are evaluated individually on a case-by-case basis. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate on the recommendations of the RMD. Risk grades are subject to regular reviews by RMD.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are submitted to the Board on the compliance levels. RMD also provides advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.
- Each business unit is required to implement the Bank credit policies and procedures in respect of exposures assumed by them and are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, irrespective of the approving authority for the exposure. Regular audits of business units and Bank credit processes are undertaken by Internal Audit.

## Exposure to credit risk

31 December 2011	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rentals receivable	Investment securities - Sukuk	Other financial assets	Total
<b>Impaired</b>						
Grade 9: Impaired	-	41,137	2,020	-	-	43,157
Unrated	-	-	-	-	773	773
Allowance for impairment	-	(16,151)	-	-	(773)	(16,924)
<b>Carrying amount</b>	-	<b>24,986</b>	<b>2,020</b>	-	-	<b>27,006</b>
<b>Past due but not impaired</b>						
Grade 1-6: Low-Fair Risk	-	19,896	1,457	-	-	21,353
Grade 7-8: Watch list	-	16,876	-	1,314	-	18,190
Past due comprises:						
0-30 days	-	28,250	1,166	-	-	29,416
30-60 days	-	921	291	-	-	1,212
60-90 days	-	1,061	-	-	-	1,061
90-180 days	-	3,119	-	-	-	3,119
180 days +	-	3,421	-	1,314	-	4,735
<b>Carrying amount</b>	-	<b>36,772</b>	<b>1,457</b>	<b>1,314</b>	-	<b>39,543</b>
<b>Neither past due nor impaired</b>						
Grade 1-6: Low-Fair Risk	76,787	140,581	10,317	20,441	-	248,126
Grade 7-8: Watch list	-	1,180	-	-	-	1,180
Unrated	-	-	-	-	2,190	2,190
<b>Carrying amount</b>	<b>76,787</b>	<b>141,761</b>	<b>10,317</b>	<b>20,441</b>	<b>2,190</b>	<b>251,496</b>
Less:						
Collective impairment provisions	-	(1,963)	(136)	(83)	-	(2,182)
<b>Total</b>	<b>76,787</b>	<b>201,556</b>	<b>13,658</b>	<b>21,672</b>	<b>2,190</b>	<b>315,863</b>

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31. RISK MANAGEMENT (CONTINUED)  
CREDIT RISK (CONTINUED)

31 December 2010	Placements with financial institutions	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Investment securities - Sukuk	Other financial assets	Total
Impaired						
Grade 9: <i>impaired</i>	-	28,548	-	-	-	28,548
Unrated	-	-	-	-	773	773
Allowance for impairment	-	(14,189)	-	-	(773)	(14,962)
<i>Carrying amount</i>	-	14,359	-	-	-	14,359
Past Due but not impaired						
Grade 1-6: <i>Low-Fair Risk</i>	-	3,356	-	-	-	3,356
Grade 7-8: <i>Watch list</i>	-	15,377	-	-	-	15,377
Past due comprises:						
0-30 days	-	1,854	-	-	-	1,854
30-60 days	-	2,832	-	-	-	2,832
60-90 days	-	3,788	-	-	-	3,788
90-180 days	-	1,945	-	-	-	1,945
180 days +	-	8,314	-	-	-	8,314
<i>Carrying amount</i>	-	18,733	-	-	-	18,733
Neither past due nor impaired						
Grade 1-6: <i>Low-Fair Risk</i>	74,959	151,400	6,208	17,613	-	250,180
Grade 7-8: <i>Watch list</i>	-	20,881	1,908	-	-	22,789
Unrated	-	-	-	-	1,948	1,948
<i>Carrying amount</i>	74,959	172,281	8,116	17,613	1,948	274,917
Less:						
Collective impairment provisions	-	(2,163)	(136)	(52)	-	(2,351)
<b>Total</b>	<b>74,959</b>	<b>203,210</b>	<b>7,980</b>	<b>17,561</b>	<b>1,948</b>	<b>305,658</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 31. RISK MANAGEMENT (CONTINUED)

##### **Impaired financial assets**

Impaired financial assets are those for which the Bank determines that it is probable that it will be unable to collect all or part of the principal and profit due according to the contractual terms of the exposure. Generally these assets fall under risk grades 9 or 10, for other financial assets impairment is assessed on an individual basis for each exposure under the Bank's internal credit risk grading system.

##### **Past due but not impaired exposures**

The exposure pertains to financing assets where contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of subsequent collections, the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

##### **Renegotiated facilities**

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the year amounting to BD 41,209 thousand (2010: BD 30,474 thousand) that would otherwise be past due as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and/or part payment 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. Of the total past due facilities of BD 39,543 thousands (2010: BD 18,733 thousand) only instalments of BD 6,696 thousands (2010: BD 7,307 thousand) are past due as at 31 December 2011.

##### **Allowances for impairment**

The Bank makes provisions for impairment on individual assets classified under grades 9 and 10. This is done on the basis of the present value of projected future cash flows from the assets themselves and consideration of the value of the collateral securities available. On a collective basis, the Bank has provided for impairment losses based on management's judgment of the extent of losses incurred but not identified based on the current economic and credit conditions.

##### **Write-off policy**

The Bank writes off an asset / security balance (net of any related allowances for impairment losses) when it determines that the asset / security are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that he can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. As on date the Bank has not made any write off.

##### **Collaterals**

The Bank holds collateral against financing assets and receivables from assets acquired for leasing in the form of mortgage / pledge over property, listed / unlisted securities, other assets and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and updated periodically, generally at annual intervals. Collateral generally is not held against exposure to other banks and financial institutions. An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below. This includes the value of financial guarantees from banks, but not corporate and personal guarantees as the values thereof are not readily quantifiable. The collateral values considered for disclosure are restricted to the extent of the outstanding exposures.

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## 31. RISK MANAGEMENT (CONTINUED)

Collaterals (continued)

	As at 31 December 2011			As at 31 December 2010		
	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total	Financing assets	Assets acquired for leasing (including lease rentals receivable)	Total
<b>Against impaired</b>						
Property	15,362	1,431	16,793	7,176	-	7,176
Equities	2,114	-	2,114	1,979	-	1,979
Other	2,485	-	2,485	-	-	-
<b>Against past due but not impaired</b>						
Property	19,668	1,705	21,373	16,454	-	16,454
Equities	4,060	-	4,060	1,579	-	1,579
Other	465	-	465	-	-	-
<b>Against neither past due nor impaired</b>						
Property	79,906	10,061	89,967	85,881	10,182	96,063
Equities	267	-	267	3,333	-	3,333
Other	20,529	-	20,529	28,009	725	28,734
<b>Total</b>	<b>144,856</b>	<b>13,197</b>	<b>158,053</b>	<b>144,411</b>	<b>10,907</b>	<b>155,318</b>

The average collateral coverage ratio on secured facilities is 90.20% at 31 December 2011 (2010: 89.77%).

For analysis of concentration of total assets and liabilities refer to note 29.

Further, for financing assets and assets acquired for leasing, the Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk at the reporting date is shown below:

Concentration by sector	As at 31 December 2011			As at 31 December 2010		
	Financing assets	Assets acquired for leasing	Total	Financing assets	Assets acquired for leasing	Total
Banking and finance	16,708	2,103	18,811	8,332	2,504	10,836
Real estate:						
- Property	61,146	11,555	72,701	70,037	4,065	74,102
- Infrastructure development	17,200	-	17,200	35,266	-	35,266
- Land	14,142	-	14,142	15,761	-	15,761
Construction	12,173	-	12,173	5,094	725	5,819
Trading	52,539	-	52,539	31,525	-	31,525
Manufacturing	4,459	-	4,459	5,880	-	5,880
Others	23,189	-	23,189	31,315	686	32,001
<b>Total carrying amount</b>	<b>201,556</b>	<b>13,658</b>	<b>215,214</b>	<b>203,210</b>	<b>7,980</b>	<b>211,190</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 31. RISK MANAGEMENT (CONTINUED)

##### Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from RMD.

##### LIQUIDITY RISK

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

##### Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Financial Control Department (FCD) collates data from treasury and other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. FCD communicates the information to the treasury who manages the Bank's portfolio of short-term liquid assets, largely made up of short-term placements with other banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The daily liquidity position is monitored by FCD. The Bank has in place a Liquidity Contingency Plan, the elements of which are periodically tested. Tools for implementation of regular stress testing under various scenarios are in place. All liquidity policies and procedures are subject to review by ALCO and approval by appropriate authorities. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO members.

##### Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For computation of this, net liquid assets are considered as including cash and bank balances and placements with financial Institutions less placements from financial institution, and deposits comprise current accounts, placements from non-financial institutions and individuals, and equity of investment account holders.

Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2011 %	2010 %
At 31 December	23.21	10.52
Average for the period	11.68	15.79
Maximum for the period	23.21	19.44
Minimum for the period	6.54	10.52

For maturity profile of assets and liabilities refer to note 28.

##### MARKET RISK

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads will affect the Bank's income, future cash flows or the value of its holdings of financial instruments. Market risk comprises three types of risk: currency risk, profit rate risk and other price risk. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 31. RISK MANAGEMENT (CONTINUED) MARKET RISK (CONTINUED)

#### Management of market risks

The Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure and profit rate gap.

The Bank does not do any trading in foreign exchange. The Bank does not engage in proprietary trading of foreign exchange derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk management transactions to hedge economic risks to cover significant open positions under its risk management guidelines. All foreign exchange income / losses arising out of customer transactions and revaluation of statement of financial position assets and liabilities are booked by the treasury operations. The responsibility for monitoring and managing the related risks also rests with the Treasury department.

Overall authority for market risk management is vested with ALCO. The RMD is responsible for the development of detailed risk management policies (subject to review and approval by appropriate approval authorities) and the Financial Control Department is responsible for the day-to-day review of their implementation.

#### Exposure to profit rate risk-non-trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

A summary of the Bank's profit rate gap position at 31 December 2011 is as follows:

31 December 2011	Up to 3 months	3 - 6 months	6 months to 1 year	1 - 3 years	More than 3 years	Total
<b>Assets</b>						
Placements with financial institutions	76,787	-	-	-	-	76,787
Financing assets	26,538	6,515	4,328	72,118	92,057	201,556
Assets acquired for leasing (including lease rentals receivable)	366	-	-	1,745	11,547	13,658
Investments securities (sukuk)	4,067	8,221	3,664	3,110	2,610	21,672
<b>Total profit rate sensitive assets</b>	<b>107,758</b>	<b>14,736</b>	<b>7,992</b>	<b>76,973</b>	<b>106,214</b>	<b>313,673</b>
<b>Liabilities and investment accounts</b>						
Placements from financial institutions	45,435	-	-	-	-	45,435
Placements from non-financial institutions and individuals	44,965	-	83	72	1,527	46,647
Customers' current accounts	286	-	-	-	-	286
Equity of investments account holders	128,269	24,601	42,467	30	-	195,367
<b>Total profit rate sensitive liabilities and investment accounts</b>	<b>218,955</b>	<b>24,601</b>	<b>42,550</b>	<b>102</b>	<b>1,527</b>	<b>287,735</b>
<b>Profit rate gap</b>	<b>(111,197)</b>	<b>(9,865)</b>	<b>(34,558)</b>	<b>76,871</b>	<b>104,687</b>	<b>25,938</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 31. RISK MANAGEMENT (CONTINUED) MARKET RISK (CONTINUED)

31 December 2010	Up to 3 months	3 - 6 months	6 months to 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	74,959	-	-	-	-	74,959
Financing assets	39,360	27,390	2,882	88,961	44,617	203,210
Assets acquired for leasing (including lease rentals receivable)	4,042	2,504	-	79	1,355	7,980
Investments securities (sukuk)	7,082	4,141	-	4,713	1,625	17,561
Total profit rate sensitive assets	125,443	34,035	2,882	93,753	47,597	303,710
Liabilities and investment accounts						
Placements from financial institutions	65,917	-	-	-	-	65,917
Placements from non-financial institutions and individuals	12,436	1,409	5,110	24	39	19,018
Customers' current accounts	981	-	-	-	-	981
Equity of investments account holders	154,804	27,714	15,113	220	369	198,220
Total profit rate sensitive liabilities and investment accounts	234,138	29,123	20,223	244	408	284,136
Profit rate gap	(108,695)	4,912	(17,341)	93,509	47,189	19,574

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. Standard scenarios that are considered on a monthly basis include a 100 basis point parallel fall or rise across all yield curves and a 50 bp rise or fall of all yield curves.

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 statement of financial position) is as follows:

	100bp parallel increase / decrease	50bp increase / decrease
At 31 December 2011	± 257	± 128
At 31 December 2010	± 196	± 98

Overall non-trading profit rate risk positions are managed by Treasury department, which uses short term investment securities, placement with banks and placement from banks to manage the overall position arising from the Bank's non-trading activities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 31. RISK MANAGEMENT (CONTINUED) MARKET RISK (CONTINUED)

#### Exposure to foreign exchange risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group had the following significant net exposures denominated in foreign currency as of 31 December:

	2011 BHD Equivalent	2010 BHD Equivalent
Sterling Pounds	1,477	2,695
Euros	5,860	5,787
US Dollars*	89,140	78,539
Kuwaiti Dinars	3,083	2,941
Other GCC Currencies*	8,363	30,577
Indian Rupee	7	60
Australian Dollars	4,730	4,703

(\*) The exposure in US dollars and other GCC currencies does not create any foreign exchange risk for the Bank since Bahraini Dinars and other GCC currencies are effectively pegged to the US Dollars.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered on a monthly basis include a 5% plus/minus increase in exchange rates, for currencies other than US Dollars, other GCC currencies.

An analysis of the Bank's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

	2011 BHD Equivalent	2010 BHD Equivalent
Sterling Pounds	±74	±135
Kuwaiti Dinars	±154	±147
Euros	±293	±289
Indian Rupees	±0.35	±3
Australian Dollars	±237	±235

#### Exposure to other price risks-non-trading portfolios

Credit spread risk on debt securities is subject to regular monitoring by RMD, but is not currently significant in relation to the overall results and financial position of the Bank.

The Group's unquoted equity securities carried at cost are exposed to risk of changes in equity values. Refer to note 21 for significant estimates and judgments in relation to impairment assessment of unquoted equity investments carried at cost. The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a quarterly basis and is reported to the Board Investment Committee.

#### OPERATIONAL RISK

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Bank manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department is in charge of identifying, monitoring and managing operational risk in the bank. The Bank already has an approved policy for doing this and all required organisational and physical infrastructure are in place.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 31. RISK MANAGEMENT (CONTINUED)

##### OPERATIONAL RISK (CONTINUED)

The Bank has completed conducting one cycle of Risk Control Self-Assessment (RCSA) of Operational risk for majority of the departments of the Bank to identify the important Key Risk Areas, Key Risk Indicators and Key Risk Triggers: the RCSA process is a continuous process and will be conducted at regular frequencies across the Bank. A software for monitoring these triggers and recording actual and near miss losses is already in place. The medium term objective of the Bank is to generate statistically reliable data to upgrade to more sophisticated modes of Operational Risk Control both to manage the risk better and to reduce capital commitment.

#### CAPITAL MANAGEMENT

The Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Bank as a whole. In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. Capital adequacy regulations of CBB is based on the principles of Basel II of the IFSB guidelines.

The Bank's regulatory capital is analysed into two tiers:

- *Tier 1 capital*, includes ordinary share capital, disclosed reserves including share premium, general reserves, legal / statutory reserve as well as retained earnings after deductions for goodwill and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. As on 31 December 2011, the deductions to Tier 1 were Nil.
- *Tier 2 capital*, includes interim retained profits reviewed by the auditors and an allowed portion profit equalisation reserve (PER) and investment risk reserves (IRR). As per CBB, the PER & IRR can be up to a maximum amount equal to the capital charge pertaining to 30% of the risk weighted assets financed by equity of investment account holders.

Certain limits are applied to elements of the capital base in line with regulatory requirements. Tier 1 capital should represent at least half of the total eligible capital, i.e. Tier 2 capital is limited to 100% of Tier 1 capital. The limit on Tier 2 capital is based on the amount of Tier 1 capital after all deductions of investments pursuant to Prudential Consolidation and Deduction Requirements (PCD) Module of the CBB. The PCD Module sets out the regulatory rules for prudential consolidation, pro-rata consolidation or deduction where the own controlling or significant minority stakes in regulated financial entities, insurance entities and have significant exposures to investment in commercial entities. It also sets out the framework for the prudential deductions from capital for various instances including exposures to counterparties exceeding the large exposure limits as set out by CBB. As on 31 December 2011, the Bank was not required to make any deductions under the requirements of the PCD Module.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

For computation of credit risk on assets financed by equity of investment account holders, 30% of risk weight assets are considered as against 100% for assets self-financed.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank has adopted the standardised approach to credit and basic indicator approach for management of operational risk under the CBB capital adequacy framework. The Bank on a conservative basis for capital management does not claim any of the benefits for permissible credit risk mitigants against credit exposure.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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### 31. RISK MANAGEMENT (CONTINUED) CAPITAL MANAGEMENT (CONTINUED)

The Bank's regulatory capital position at 31 December was as follows:

	31 December 2011	31 December 2010
<b>Total risk weighted assets</b>	<b>429,049</b>	416,941
Tier 1 capital	116,308	118,041
Tier 2 capital	2,207	222
<b>Total regulatory capital</b>	<b>118,515</b>	118,263
<b>Total regulatory capital expressed as a percentage of total risk weighted assets</b>	<b>27.62</b>	28.36

The Bank has complied with all externally imposed capital requirements throughout the year.

#### Capital allocation

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on risk adjusted while satisfying all the regulatory requirements. The Bank's policy on capital allocation is subject to regular review by the Board.

### 32. PROPOSED APPROPRIATIONS

The Board of Directors propose the following appropriations for 2011 which are subject to shareholders approval in the ensuing Annual General Meeting:

	2011	2010
Directors' remuneration	-	-
Charity	-	-
Zakah	214	250

### 33. COMMITMENTS

The commitments contracted in the normal course of business of the Bank:

	2011	2010
Undrawn commitments to extend finance	4,619	13,923
Financial guarantees	7,423	1,667
Commitment to investments	5,655	-
	<b>17,697</b>	15,590

#### Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of certain of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2011 due to the performance of any of its projects.

### 34. SOCIAL RESPONSIBILITY

The Bank discharges its social responsibilities through donations to charitable causes and organisations.

### 35. COMPARITIVES

Certain prior period amounts have been regrouped to conform to current year's presentation. Such regrouping did not affect previously reported profit or equity.

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

*These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, and Volume II for Islamic Banks. To avoid any duplication, information required under PD module but already disclosed in other sections of annual report has not been reproduced. These disclosures are part of the annual report for the year ended 31 December 2011 and should be read in conjunction with the consolidated financial statements for the year ended 31 December 2011 and other sections of the annual report.*

## RISK MANAGEMENT DISCLOSURES

### EXECUTIVE SUMMARY

The Central Bank of Bahrain's ("CBB") Basel II 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. Section PD-1.3 reflects the requirements of Basel II - Pillar III and the Islamic Financial Services Board's ("IFSB") recommended disclosures for Islamic banks.

The disclosures in this report are in addition to or in some cases, serve to clarify the disclosures set out in the consolidated financial statements for the year ended 31 December 2011, presented in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"). To avoid any duplication, information required under PD module but already disclosed in other sections of the annual report has not been reproduced in these disclosures.

All figures presented in this section are reported in Bahraini Dinars (in thousands) and are as of 31 December 2011 unless otherwise stated.

Khaleeji Commercial Bank BSC ("the Bank" or "KHCB") has adopted the Standardised Approach for Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk to determine its capital requirements, details of which are given in section 2. 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 II framework.

The Bank's total risk weighted assets as at 31 December 2011 amounted to BD 429,049 thousand. Credit risk accounted for 87.8%, market risk 3.5%, and operational risk 8.7% of the total risk weighted assets. Tier I and total regulatory capital were BD 116,308 thousand and BD 118,515 thousand respectively as at 31 December 2011.

At 31 December 2011, Bank's Tier I and total adequacy ratios were 27.11% and 27.62% respectively.

## RISK MANAGEMENT DISCLOSURES

### I. 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. INTRODUCTION TO BASEL II & RISK MANAGEMENT

The CBB has mandated that the Basel Committee on Banking Supervision's ("Basel Committee") Basel II capital adequacy framework is applicable to all banks incorporated in the Kingdom of Bahrain from 1 January 2008. The Bank has accordingly taken steps to comply with these requirements. The Basel II framework is intended to strengthen risk management practices and processes within the financial institutions.

CBB's capital adequacy framework is based on three pillars, consistent with the Basel II framework adopted by the Basel Committee, as follows:

- Pillar I: calculation of the risk weighted assets (RWAs) and capital requirement.
- Pillar II: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar III: rules for disclosure of risk management and capital adequacy information.

#### PILLAR I

Pillar I defines the regulatory minimum capital requirements for each bank to cover the credit risk, market risk and operational risk inherent in its business model. It also defines the methodology for measurement of these risks and the various elements of qualifying capital. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total Risk Weighted Assets ("RWAs"). CBB has mandated that the ratio be maintained at a minimum of 12% and has set a trigger ratio of 12.5%. If the capital adequacy ratio falls below 12.5%, additional prudential reporting requirements apply, and a formal action plan to restore the ratio above the trigger level is to be formulated and submitted to the CBB.

The table below summarizes the Pillar I risks and the approach used by the Bank to calculate the RWAs in each case in accordance with the CBB's Basel II capital adequacy framework:

Risk Type	Approach used by KHCB
Credit Risk	Standardised Approach
Market Risk	Standardised Approach
Operational Risk	Basic Indicator Approach

#### PILLAR II

Pillar II defines the process of supervisory review of an institution's risk management framework and, ultimately its capital adequacy.

Pillar II comprises two processes:

- An Internal Capital Adequacy Assessment Process (ICAAP), and
- A supervisory review and evaluation process.

## RISK MANAGEMENT DISCLOSURES

### 2. INTRODUCTION TO BASEL II & RISK MANAGEMENT (CONTINUED)

#### PILLAR III

Pillar III complements the other two pillars and focuses on enhanced transparency in disclosure of information by the Banks to promote better market discipline. The information to be disclosed covers all areas including business performance, capital adequacy, risk management, etc. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move towards more advanced forms of risk management.

In April 2008, the Central Bank published a paper covering the detailed disclosure requirements to be followed by licensed banks in Bahrain to be in compliance with Pillar III under the Basel II framework. This document is prepared in accordance with these directives.

#### 2.1 The risk management function

The Board of Directors has overall responsibility for risk management in the Bank. The Board lays down the risk management policies of the Bank and quantifies its risk appetite through appropriate definitions of various risk limits and tolerances. The Board discharges its risk management responsibilities through the Board Risk Management Committee ("BRMC").

The Board has established an Executive Risk Management Committee ("ERMC"), which is responsible for developing and monitoring Bank risk management policies in the specified areas. The committee consists of heads of business and other functional units in the Bank and reports regularly to the BRMC.

The day to day risk management functions are performed by the Risk Management Department ("RMD") of the Bank. RMD is responsible to ensure that the policies laid down by the Board are consistently implemented across the Bank and to review the adequacy of these policies periodically. It monitors all risk taking activities and ensures that the risk limits defined by the Board are complied with. The department has specialized personnel dealing with Credit, Market, and Operational Risks. It is independent of all risk taking functions in the Bank and reports to the BRMC through the ERMC chaired by the Chief Executive Officer ("CEO").

The Asset Liability Management Committee ("ALCO") of the Bank acting through the treasury department monitors the Bank's liquidity position and recommends appropriate action to the Board where necessary. There is a high level of coordination between the RMD, ERMC and ALCO.

The RMD prepares a risk overview report which covers in detail the various risks faced by the Bank and the same is discussed at the ERMC, BRMC and the Board on a quarterly basis.

The Bank considers that its overall risk management strategies used has been effective throughout the reporting period.

The RMD, together with the Internal Audit and Compliance departments, provides independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

## RISK MANAGEMENT DISCLOSURES

### 3. CAPITAL MANAGEMENT AND CAPITAL ADEQUACY RATIO

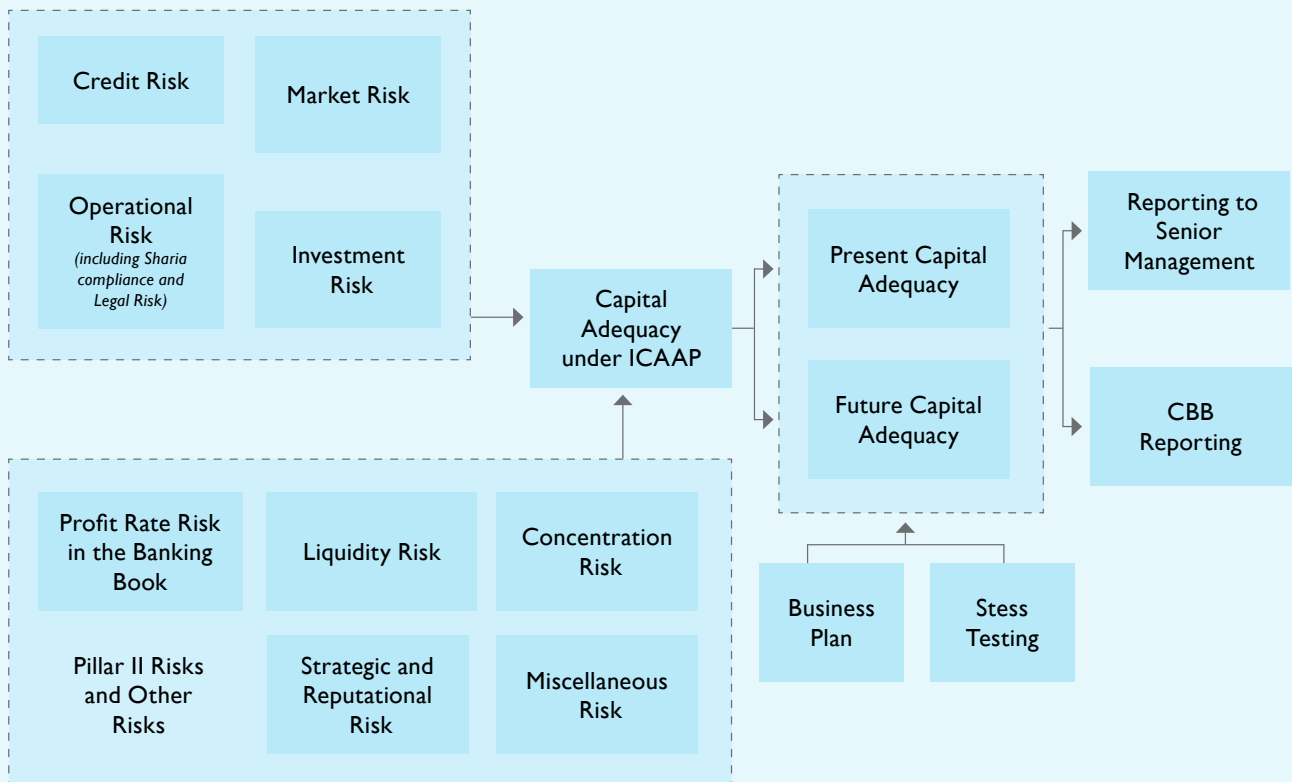
#### 3.1 Capital management

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.

#### 3.2 Internal Capital Adequacy Assessment Process ("ICAAP")

The Bank has an established ICAAP as per the requirements under Pillar II of Basel II. ICAAP prescribes procedures and measures designed to ensure appropriate identification, measurement, aggregation and monitoring of the Bank's risks. It also defines an appropriate level of internal capital in relation to the Bank's overall risk profile and business plan.

ICAAP framework at the Bank



## RISK MANAGEMENT DISCLOSURES

## 3. CAPITAL MANAGEMENT AND CAPITAL ADEQUACY RATIO (CONTINUED)

## 3.2.1 Risk addressed by the ICAAP

Risk Type	Metrics based on which internal capital is allocated
Credit risk	Regulatory capital adequacy guidelines to be used as proxy for internal capital for Pillar I risks
Market risk	
Investment risk	
Operational risk	
Liquidity risk	Maximum cumulative maturity gap, Liquidity ratio, Financing to deposit ratio
Profit rate risk (banking book)	Revaluation / sensitivity of the re-pricing gaps
Credit concentration risk	Thresholds for counterparty, country, sector exposures
Fiduciary Risk	Size of off balance sheet vehicles (RIA's) & Large Investment Products
Reputational risk	Credit quality, Operational risk, Reputation related loss
Other Risks (strategic, Shari'a/regulatory compliance, business cycle)	Additional capital based on Pillar I risk weighted exposures

## 3.3 Capital structure, minimum capital requirements and capital adequacy

During the year, the paid up capital of the Bank has remained the same amounting to BD 115,416 thousand. Following is the break-up of capital structure as at 31 December 2011 (in BD 000's):

Net available capital	31 December 2011
Issued and fully paid ordinary shares	115,416
Less: Treasury shares	(6,043)
Statutory reserve	6,350
Share premium	1,485
Others reserves	(300)
Eligible Portion of an unrealized gains arising from fair valuing equities	2,095
Retained earning	(2,695)
<b>Tier I capital</b>	<b>116,308</b>
Eligible Portion of an unrealized gains arising from fair valuing equities	24
General provision	2,183
<b>Tier II capital</b>	<b>2,207</b>
<b>Net available capital</b>	<b>118,515</b>
Risk weighted assets	31 December 2011
Credit risk weight exposures	376,508
Market risk weight exposures	15,163
Operational risk weight exposures	37,378
<b>Total risk weighted assets</b>	<b>429,049</b>
<b>Capital adequacy ratio (Tier I)</b>	<b>27.11%</b>
<b>Capital adequacy ratio (Total capital)</b>	<b>27.62%</b>

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

## RISK MANAGEMENT DISCLOSURES

### 3. CAPITAL MANAGEMENT AND CAPITAL ADEQUACY RATIO (CONTINUED)

#### 3.3 Capital structure, minimum capital requirements and capital adequacy (continued)

##### Regulatory capital components

The above components of Tier I and Tier II capital are as per the relevant CBB guidelines. According to these, Tier II capital is restricted to 100% of Tier I capital after all deductions of investments pursuant to PCD module of CBB rule book. As at 31 December 2011, the Bank was not required to make any prudential deduction from its regulatory capital base.

##### Risk weighted assets

###### Credit risk

For regulatory reporting purposes, the Bank calculates the capital requirements for credit risk based on the standardised approach. Under this approach, the on and off-balance sheet credit exposures are assigned risk weights based on the type of counterparty, type of the exposure, and source of funding (equity of investment account holders or own funds). Further for capital adequacy computations, 100% of the RWA's is reckoned for self-financed assets while only 30% is considered for assets funded through equity of IAH. The risk weights for types of counterparties and exposures are prescribed by CBB.

###### Market risk

The Bank uses the standardised approach to measure market risk. Market risk at KHCB is primarily on account of the foreign exchange exposures that are considered as specific risks. As per the CBB guidelines, capital for foreign exchange risk is computed at 8% of overall net open foreign currency positions of the Bank and this is multiplied by 12.5 to derive the market RWA's.

The Bank does not have a trading book and hence all market risk exposures are part of the banking book for the purpose of assessing the applicable capital treatment.

###### Operational risk

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the CBB capital adequacy module for Islamic Banks. According to this approach, Bank's average gross income for past three financial years is multiplied by a fixed coefficient alpha of 15% set by CBB to arrive at the capital required and a multiple of 12.5 is used to arrive at the risk weighted assets that are subject to capital charge.

Break-up of capital requirement in accordance with the capital adequacy module of the CBB for the year ended 31 December 2011 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	2,155	-	2,155	-	-	-	-	-	-
Sovereigns	2,045	23,324	25,369	-	-	-	-	-	-
Banks	2,828	86,069	88,897	1,414	7,373	8,787	170	885	1,055
Corporates	103,604	77,425	181,029	103,604	23,227	126,831	12,432	2,787	15,219
Residential mortgage	9,054	-	9,054	6,791	-	6,791	815	-	815
Past due facilities	27,007	-	27,007	33,931	-	33,931	4,072	-	4,072
Investment in equities / sukuks	29,922	8,548	38,470	44,778	3,847	48,625	5,373	462	5,835
Holdings of real estate	77,399	-	77,399	148,083	-	148,083	17,770	-	17,770
Other assets	3,460	-	3,460	3,460	-	3,460	415	-	415
<b>Credit Risk</b>	<b>257,474</b>	<b>195,366</b>	<b>452,840</b>	<b>342,061</b>	<b>34,447</b>	<b>376,508</b>	<b>41,047</b>	<b>4,134</b>	<b>45,181</b>
<b>Market Risk</b>	-	-	-	-	-	<b>15,163</b>	-	-	<b>1,820</b>
<b>Operational Risk</b>	-	-	-	-	-	<b>37,378</b>	-	-	<b>4,485</b>
<b>Total</b>	<b>257,474</b>	<b>195,366</b>	<b>452,840</b>	<b>342,061</b>	<b>34,447</b>	<b>429,049</b>	<b>41,047</b>	<b>4,134</b>	<b>51,486</b>

\* 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 IAH.

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK

#### 4.1 Credit risk management

Credit Risk is the risk that counterparty fails to meet its obligations in accordance with agreed terms and conditions. The major sources of credit risk in the Bank are under the following classes of assets:

- Placements with financial institutions,
- Financing assets,
- Assets acquired for leasing (including lease rentals receivable),
- Investments in Sukuk.

For the purpose of capital adequacy computation (as well as certain other tables below) the following have also been considered as a part of credit risk:

- Investments in quoted and unquoted equity,
- Investment in associates,
- Investment property,
- Other assets (including property and equipment).

The Bank has the necessary internal processes for assessing, monitoring and controlling credit risk both at the individual credit and portfolio levels. Credit limits are approved after a thorough assessment which takes into account the financial strength of the counterparty, the technical feasibility and economic viability of the business being financed, the adequacy and quality of the cash flow available for repayment, etc. in addition to availability of collateral security by way of physical assets or guarantees. The RMD reviews every credit proposal and incorporates its remarks on the proposal before the same is considered by the appropriate authority as per delegated approval levels granted by the Board of Directors.

At the portfolio level, the Board has established risk concentration limits for single counterparties and related counterparties forming a business group, geographical and economic sectors as well as exposures to counterparties related to the Bank and/or its major shareholders. The RMD regularly monitors compliance with these limits and deviations if any are reported regularly to the Senior Management, Risk Management Committees and the Board of Directors.

## RISK MANAGEMENT DISCLOSURES

## 4. CREDIT RISK (CONTINUED)

## 4.2 Levels of exposure

The year 2011 saw a modest growth in overall credit exposure levels. The table below shows gross credit exposure along with average credit exposure broken down under different exposure classes as at 31 December 2011 (in BD 000's):

Gross / Average Credit Exposures	Average Exposure <sup>1</sup>	Self-financed	Gross Exposure IAH	Total
Cash and bank balances <sup>2</sup>	24,265	4,195	18,447	22,642
Placement with financial institutions	53,588	-	76,787	76,787
Financing assets	201,126	123,095	78,461	201,556
Investment securities - Equity securities	88,003	90,134	-	90,134
Investment securities - Sukuks	17,329	-	21,672	21,672
Assets acquired for leasing (including lease rentals receivable)	10,643	13,658	-	13,658
Investments in associates	3,438	2,887	-	2,887
Investment property	6,583	6,583	-	6,583
Other assets, including property and equipment	11,739	11,596	-	11,596
<b>Total funded exposures</b>	<b>416,714</b>	<b>252,148</b>	<b>195,367</b>	<b>447,515</b>
Guarantees	6,721	7,423	-	7,423
Undrawn financing facilities	8,820	4,619	-	4,619
Commitments to invest	6,145	5,655	-	5,655
<b>Total unfunded exposures</b>	<b>21,686</b>	<b>17,697</b>	<b>-</b>	<b>17,697</b>

<sup>1</sup> Represents quarterly average balances for the year ended 31 December 2011.

<sup>2</sup> Includes cash balance of BD 2,155 thousand.

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.3 Concentration of credit risk

##### 4.3.1 Geographic distribution

The geographical exposure profile as at 31 December 2011 was as follows (in BD 000's):

2011	GCC Countries	Europe	USA	Asia	Australia	Africa	Total
<b>Assets</b>							
Cash and bank balances	14,515	663	7,333	7	124	-	22,642
Placement with financial institutions	61,098	15,689	-	-	-	-	76,787
Financing assets	191,539	9,366	651	-	-	-	201,556
Investment securities	79,003	2,927	-	24,008	4,605	1,263	111,806
Assets acquired for leasing (including lease rentals receivable)	13,658	-	-	-	-	-	13,658
Investment in associates	2,887	-	-	-	-	-	2,887
Investment property	6,583	-	-	-	-	-	6,583
Other assets	1,933	39	-	175	43	-	2,190
Property and equipment	9,406	-	-	-	-	-	9,406
<b>Total funded exposures</b>	<b>380,622</b>	<b>28,684</b>	<b>7,984</b>	<b>24,190</b>	<b>4,772</b>	<b>1,263</b>	<b>447,515</b>
Undrawn financing facilities	4,418	201	-	-	-	-	4,619
Commitment to invest	5,655	-	-	-	-	-	5,655
Guarantees	4,555	2,868	-	-	-	-	7,423
<b>Total unfunded exposures</b>	<b>14,628</b>	<b>3,069</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17,697</b>

##### 4.3.2 Industry / sector-wise distribution

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry / sector wise exposure as at 31 December 2011 was as follows (in BD 000's):

2011	Banks and financial institutions	Real estate	Others	Total
<b>Assets</b>				
Cash and bank balances	22,642	-	-	22,642
Placements with financial institutions	76,787	-	-	76,787
Financing assets	16,708	92,487	92,361	201,556
Investment securities	24,389	62,944	24,473	111,806
Assets acquired for leasing (including lease rentals receivable)	2,103	11,555	-	13,658
Investment in associates	-	2,887	-	2,887
Investment property	-	6,583	-	6,583
Other assets	638	950	602	2,190
Property and equipment	-	6,715	2,691	9,406
<b>Total funded exposure</b>	<b>143,267</b>	<b>184,121</b>	<b>120,127</b>	<b>447,515</b>
Undrawn financing facilities	-	300	4,319	4,619
Commitment to invest	5,655	-	-	5,655
Guarantees	-	5,820	1,603	7,423
<b>Total unfunded exposures</b>	<b>5,655</b>	<b>6,120</b>	<b>5,922</b>	<b>17,697</b>

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

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.3 Concentration of credit risk (continued)

##### 4.3.3 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. Detailed break up is presented in note 23 of the consolidated financial statements for the year ended 31 December 2011.

##### 4.3.4 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 31 December 2011.

##### 4.3.5 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.

##### 4.3.6 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	16,263	6,657	4,596	2,507	47,754	54,218	10,583	-	-	142,578
Musharaka	1,747	-	-	5,661	13,111	7,221	10,698	-	-	38,438
Wakala	3,660	5,441	1,773	70	120	8,635	-	-	-	19,699
Istisna	-	-	-	-	-	719	122	-	-	841
Ijarah	-	-	-	-	2,020	3,018	2,789	4,715	1,116	13,658
<b>Total</b>	<b>21,670</b>	<b>12,098</b>	<b>6,369</b>	<b>8,238</b>	<b>63,005</b>	<b>73,811</b>	<b>24,192</b>	<b>4,715</b>	<b>1,116</b>	<b>215,214</b>
Investment in										
Sukuks	600	2,730	11,673	1,314	3,110	2,245	-	-	-	21,672
<b>Total</b>	<b>600</b>	<b>2,730</b>	<b>11,673</b>	<b>1,314</b>	<b>3,110</b>	<b>2,245</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>21,672</b>
<b>Grand Total</b>	<b>22,270</b>	<b>14,828</b>	<b>18,042</b>	<b>9,552</b>	<b>66,115</b>	<b>76,056</b>	<b>24,192</b>	<b>4,715</b>	<b>1,116</b>	<b>236,886</b>

The Board approved internal cap for real estate exposure has been 40% of total assets. Due to some large investment, this cap was exceeded in the early part to 2011 for which the Board had provided special approval. The exposure was brought under the original limit by end of the year.

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.3 Concentration of credit risk (continued)

##### 4.3.7 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	29,720	3,640	3,199	36,559
USA	-	6,598	-	6,598
<b>Total</b>	<b>29,720</b>	<b>10,238</b>	<b>3,199</b>	<b>43,157</b>

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

	3 Months to 1 Year	1 to 3 Years	Over 3 Years	Total
Banks and financial institutions	1,808	-	-	1,808
Real estate	23,742	10,238	-	33,980
Others	4,170	-	3,199	7,369
<b>Total</b>	<b>29,720</b>	<b>10,238</b>	<b>3,199</b>	<b>43,157</b>

#### 4.4 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 quoted / unquoted equity investments, and investments in associates being non-financial entities.

Please refer to notes 2 and 21 of the consolidated financial statements for policies covering the accounting of equity holdings, including the accounting policies and valuation methodologies used, key assumptions and practices affecting valuation.

The RMD works alongside the Investment Department at all stages of the deal cycle, from pre-investment due diligence to exit, and provides an independent review of every transaction. An impairment assessment of investments takes place every quarter with inputs from the Investment department and RMD. Quarterly updates of investments are reviewed by the Board of Directors and are submitted to the CBB. Regular audits of business units and processes are undertaken by Internal Audit.

The Bank's equity investments are predominantly in its own products, which include private equity and infrastructure development projects. The intent of such investments is a later stage exit along with the investors, by means of strategic sell outs at the project level or through initial public offerings. The Bank also has a strategic investment portfolio which is aligned with the long term investment objectives of the Bank.

Information on equity investments	(BD 000's)
Privately held	89,923
Quoted in an active market	211
Realised gain during the year	373
Unrealised gain in equity (Tier II)	24

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.4 Equity risk in banking book (continued)

The following are the categories under which equity investments are included in the capital adequacy computations as per the requirements of the CBB rules (in BD 000's):

Equity investments in banking book	Gross exposure		Risk weighted exposure		Capital charge	
	Self- financed	IAH	Self- financed	IAH	Self- financed	IAH
Quoted equity investment	211	-	211	-	25	-
Unquoted equity investment	29,711	-	44,567	-	5,348	-
Real estate investment	60,212	-	120,424	-	14,451	-
<b>Total</b>	<b>90,134</b>	<b>-</b>	<b>165,202</b>	<b>-</b>	<b>19,824</b>	<b>-</b>

#### 4.5 Risk grading of exposures

The Bank has an internal risk grading system for credit exposures based on a 10 point scale in which grades 8 through 10 are non-performing with grades 9 and 10 classified as impaired exposures. Each counterparty credit exposure is assigned a risk grade based on several quantitative and qualitative factors, including financial strength, past record and availability of collateral security. The grading is done at the time of assuming an exposure and on each renewal of the same. The grading sheets are prepared by the Business Department and reviewed by the RMD. Grades are continuously monitored by the Bank's credit administration department within RMD and exposures are downgraded as and when the quality of the exposure is found to have deteriorated, based on clear criteria laid out in the Bank's credit policy.

For exposures or potential exposures on banks and financial institutions, the Bank has established internal ratings with a six point scale from A to F, in descending order of creditworthiness. These ratings are derived on the basis of the external credit ratings provided by Moody's, Standard & Poor (S&P), Capital Intelligence (CI) & Fitch. When the ratings of S&P and/or Moody's are available, those ratings will be used. In case of differences in ratings of these agencies, the more conservative rating is used for classification. The ratings of these agencies have been mapped to internal categories as follows:

External rating agencies	Internal Rating					
	A	B	C	D	E	F
S & P	>= AA-	>=A-	>=BBB-	>=B-	Below B-	Unrated
Moody's	>=aa3	>=A3	>=Baa3	>=B3	C & D	Unrated
CI	>= AA-	>=A-	>=BBB-	>=B-	C & D	Unrated
Fitch	>= AA-	>=A-	>=BBB-	>=B-	Below B-	Unrated

Please refer to note 31 of the consolidated financial statements for the year ended 31 December 2011, for details of the rating profile of exposures of the Bank.

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.6 Past dues, impaired accounts, provisions

Customers may occasionally fail to meet their obligations to the Bank on due dates. Any amount not paid when due is classified as past due and the Bank initiates focused recovery efforts on such accounts. Any account which is past due for 30 days or more are classified as "Watch List"/ Grade 7 and clearly defined procedures are in place for follow up and monitoring of such accounts.

However, if the account remains past due for a continuous period of 90 days it is considered as non-performing and classified as Grade 8. The Bank conducts a comprehensive review of all such accounts on a quarterly basis and where provisions are necessary; those exposures are classified as impaired (Grade 9/10). Provisions are created through income statement where necessary. Such provisions are made on the basis of expected shortfall in present value of projected future cash flows from the assets / securities and the estimates of such cash flows are done on a conservative basis.

On each year-end, the Bank reviews all financial assets classified as fair value through equity for any objective evidence that the financial assets are impaired. In case of any such evidence the asset is revalued at lower of cost of acquisition and its estimated recoverable amount and a provision is created for the difference amount through the income statement.

For a detailed policy on impairment of financial assets, please refer to note 2 (l) of the consolidated financial statements for the year ended 31 December 2011.

For the quantitative disclosures relating to exposures which were past due or impaired as of 31 December 2011, please refer to note 31 of the consolidated financial statement for the year ended 31 December 2011.

During the year 2011, the Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In the view of the current market conditions, 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 financing assets, assets acquired for leasing, lease rentals receivable and sukuk portfolios. This practice is in line with CBB requirements and the industry best practice in Bahrain.

For movement in provisions on financing assets and investment securities, please refer to notes 5 and 6, respectively, of the consolidated financial statement for the year ended 31 December 2011.

#### 4.6.1 Geographical and sector-wise break up of impairment allowances and impaired / past due accounts

	GCC Countries	Europe	USA	Africa	(BD 000's) Total
Impaired:					
90 - 365 days	29,720	-	-	-	29,720
365 - 1,095 days	3,640	773	6,598	-	11,011
Over 1,095 days	3,199	-	-	-	3,199
	36,559	773	6,598	-	43,930
Allowance for impairment	(10,205)	(773)	(5,946)	-	(16,924)
Carrying amount	26,354	-	652	-	27,006
Past due but not impaired:					
0 - 90 days	22,321	9,366	-	-	31,687
90 - 365 days	4,866	-	-	-	4,866
365 - 1,095 days	2,990	-	-	-	2,990
Over 1,095 days	-	-	-	-	-
	30,177	9,366	-	-	39,543
Collective allowance*	(2,063)	(106)	-	(13)	(2,182)

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

## RISK MANAGEMENT DISCLOSURES

## 4. CREDIT RISK (CONTINUED)

## 4.6 Past dues, impaired accounts, provisions (continued)

## 4.6.1 Geographical and sector-wise break up of impairment allowances and impaired / past due accounts (continued)

	Banks and financial institutions	Real estate	Others	(BD 000's) Total
Impaired:				
90 - 365 days	1,808	23,742	4,170	29,720
365 - 1,095 days	-	11,011	-	11,011
Over 1,095 days	-	-	3,199	3,199
	1,808	34,753	7,369	43,930
Allowance for impairment	(300)	(12,172)	(4,452)	(16,924)
Carrying amount	1,508	22,581	2,917	27,006
Past due but not impaired:				
0 - 90 days	-	12,323	19,364	31,687
90 - 365 days	1,747	2,167	952	4,866
365 - 1,095 days	-	2,990	-	2,990
Over 1,095 days	-	-	-	-
	1,747	17,480	20,316	39,543
<b>Collective allowance*</b>	<b>(210)</b>	<b>(881)</b>	<b>(1,091)</b>	<b>(2,182)</b>

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

## 4.7 Renegotiated facilities

For disclosure of renegotiated loans, please refer to note 31 of the consolidated financial statements for the year ended 31 December 2011.

## 4.8 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 31 December 2011 was involved in five litigations for recovery of dues from clients amounting to BD 11.04 million. In addition, there is a claim brought by one of the clients against the Bank for not providing a credit facility of BD 4.5 million to him which the Bank is defending. Bank has made adequate provisions for any loss that may arise from such litigations.

In addition, there are two cases where SPV's of the Bank are involved. These are not expected to bring any liabilities to the Bank.

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.

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.9 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 year ended 31 December 2011, an amount of BD 7 thousands was thus transferred to Charity and Zakah fund.

For quantitative disclosures, please refer to consolidated statement of sources and uses of charity and Zakah fund in the consolidated financial statements for the year ended 31 December 2011.

#### 4.10 Credit risk mitigation

The Bank uses a variety of tools to mitigate its credit risk, the primary one being that of securing the exposure by suitable collateral security. While existence of collateral security is not a policy precondition for financing, in practice a large part of existing exposures are at least partially supported by collateralised security. The Bank has clear policies on the type of assets that can be accepted as collateral security and the mode of valuation of these assets. In general all assets accepted as collateral are valued at least once in a year. The legal validity and enforceability of the documents used for creating these collaterals have been established by external legal experts.

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 31 December 2011 is given in the table below (in BD 000's):

Collateral Type	Murabaha	Musharaka	Wakala	Istisna	Ijara	Value of collateral <sup>1</sup>	Gross Exposure <sup>2</sup>	% of cover	% of Total
Real estate	159,301	54,004	8,835	2,649	22,783	247,572	132,565	187%	86%
Listed securities	1,051	2,508	-	-	-	3,559	2,973	120%	1%
Unlisted securities	8,060	-	-	-	-	8,060	3,918	206%	3%
Bank guarantee	20,843	-	-	-	-	20,843	16,954	123%	7%
Cash collateral	3,888	-	346	-	-	4,234	16,463	26%	2%
Unsecured	-	-	-	-	-	-	40,262	0%	0%
Others	2,510	1,716	-	-	-	4,226	4,178	101%	1%
<b>Total</b>	<b>195,653</b>	<b>58,228</b>	<b>9,181</b>	<b>2,649</b>	<b>22,783</b>	<b>288,494</b>	<b>217,313</b>	<b>133%</b>	<b>100%</b>

<sup>1</sup> 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 facility.

<sup>2</sup> The amounts are gross of collective impairment allowance of BD 2,099 thousand and net of specific impairment allowance of BD 16,151 thousand.

Real estate properties are reckoned at values certified by qualified valuers. Other physical assets like machinery are valued at book value, invoice value or as certified by an outside expert. Listed securities are valued at market price while unlisted ones are carried at cost less impairment. The Bank has an approved panel of valuers for real estate property. Valuation exercise is supervised by the Risk Management Department of the Bank, independent of the business units.

Facilities are also often secured by personal/ corporate guarantees, assignment of contract proceeds, assignment of insurance policies etc. However under the Bank's credit policy these are not treated as tangible securities and the value of such guarantees/ assignments though significant in many cases are taken as nil for the purpose of the above analysis.

Assets financed under Ijara Muntahia Bittamleek are considered at par with physical collateral and included under Real Estate or Others in the above calculations.

## RISK MANAGEMENT DISCLOSURES

### 4. CREDIT RISK (CONTINUED)

#### 4.10 Credit risk mitigation (continued)

The declared value of exposures in all cases is the gross exposure net of specific provision. 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 4.7 of the Capital Adequacy module of CBB rule book and hence all exposures are risk weighted at their gross values for the purpose of computation of capital adequacy ratio.

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 year ended 31 December 2011 there has been no such instance.

#### 4.11 Regulatory capital requirements by type of financing contracts

Equity investments in banking book	Exposure		Credit Risk weighted exposure		BD (000's) Capital requirement @12%	
	Self- financed	IAH	Self- financed	IAH	Self- financed	IAH
	Murabaha	85,251	57,629	86,005	17,289	10,321
Ijara assets (including lease rentals receivable)	13,658	-	11,395	-	1,367	-
Musharaka	37,844	-	44,014	-	5,282	-
Wakala	-	19,999	-	6,000	-	720
Istisna	-	833	-	250	-	30
<b>Total</b>	<b>136,753</b>	<b>78,461</b>	<b>141,414</b>	<b>23,539</b>	<b>16,970</b>	<b>2,825</b>

## 5. MARKET RISK

### 5.1 Market risk management

Market risk is the risk that changes in market prices, such as foreign exchange rates, profit rates, equity prices, and commodity prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

CBB rules require that the Bank separates its exposure to market risk between trading and non-trading portfolios. The Bank has no trading positions in equity or commodities and the main source of market risk for the Bank is its foreign exchange exposure, although this is quite limited. There is also an extent of profit rate risk arising out of mismatches in its asset liability structure. The Bank has well defined policies approved by the Board with clear risk limits and thresholds to effectively manage its market risk.

Details on market risk management, net exposures and sensitivities are given as part of note 31 of the consolidated financial statements for the year ended 31 December 2011.

## RISK MANAGEMENT DISCLOSURES

### 5. MARKET RISK (CONTINUED)

#### 5.2 Regulatory capital allocation against market rate risk

The table below shows the market risk position for each category of the market risk as at year ended 31 December 2011 along with the maximum and minimum values during the period (BD 000's):

	As at 31 December 2011	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	-	-	-
Foreign exchange risk	1,213	1,213	771
Commodity risk	-	-	-
<b>Total (A)</b>	<b>1,213</b>	<b>1,213</b>	<b>771</b>
Risk Weighted Assets (A x 12.5)	15,163	15,163	9,638
Capital requirement @ 12%	1,820	1,820	1,157

### 6. OPERATIONAL RISK

#### 6.1 Operational risk management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people, systems and/or from external events which includes but is not limited to, legal risk and Shari'a compliance risk. Operational risk is an inherent part of normal business operations. Whilst operational risk cannot be eliminated entirely, the Bank endeavors to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. Various procedures and processes used to manage operational risk including effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting.

Details on operational risk management are given as part of note 31 of the consolidated financial statements for the year ended 31 December 2011.

The Risk Management Department monitors all operational processes to ensure that the Board directives are fully implemented and also reports deviations if any to the Senior Management and the Board. The department has specialised personnel engaged in this process. The Bank has implemented an Operational Risk Management system which monitors Key Risk Indicators and controls across all major areas of operation and generates appropriate triggers as and when predefined risk events occur (through breach of triggers set) and also generates periodical update report to the Board and Management. In addition, the Bank's policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions.

The Bank's operational risk management framework includes components such as Key Risk Indicators (KRI's), operational loss data and Risk & Control Self-Assessment across the Bank. These are monitored periodically which helps in quickly detecting and correcting deficiencies in processes and procedures. The collected data is maintained to create a loss database which could be the starting point for a more advanced operational risk measurement approach in future.

#### 6.2 Litigation

As of the reporting date, the Bank has no material legal contingencies including pending legal actions except as reported in note 4.8 above. The Bank has a dedicated legal team which provides legal advice and services to all units of the Bank.

#### 6.3 Shari'a compliance

The Shari'a Supervisory Board ("SSB") is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that they are in compliance with the rules and principles of Islamic Shari'a. The Bank also has a dedicated internal Shari'a reviewer, who performs an ongoing review of the compliance with the fatwas and rulings of the SSB on products and processes and also reviews compliance with the requirements of the Shari'a standards prescribed by AAOIFI. The SSB reviews and approves all products and services before launching and offering to the customers and also conducts periodic reviews of the transactions of the Bank. An annual audit report is issued by the SSB confirming the Bank's compliance with Shari'a rules and principles.

## RISK MANAGEMENT DISCLOSURES

### 6. OPERATIONAL RISK (CONTINUED)

#### 6.4 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 31 December is as given below (in BD 000's):

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

### 7. OTHER RISKS

#### 7.1 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.

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee ("ALCO"), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the bank, as well as gap limits under each time bucket of the maturity ladder. It is the Bank's policy to keep adequate level of high quality liquid assets such as inter-bank placements, CBB sukuks to ensure that funds are available to meet maturing deposits and other liabilities, as and when they fall due.

The day to day management of liquidity risk is the responsibility of the Treasury Department, which monitors the sources and maturities of assets and liabilities closely, and ensures that limits stipulated by the ALCO are complied with. RMD and Financial Control Department ("FCD") monitors the liquidity position and any violations are reported to ALCO, ERM and the Board of Directors.

For maturity profile of assets and liabilities, please refer to note 28 of the consolidated financial statements for the year ended 31 December 2011.

The following are the key liquidity ratios which reflect the liquidity position of the Bank (Figures in %):

	2011	2010	2009	2008	2007
Interbank assets to interbank liabilities	218.84	113.72	137.02	436.50	190.24
Liquid assets to total assets	26.04	20.81	30.02	37.04	31.63
Liquid assets to total deposits	42.01	41.72	59.56	60.39	98.22
Net liquid assets to total deposits	25.63	10.50	22.00	49.79	50.33

#### 7.2 Profit rate risk in the banking book

The other principal risk to which the banking book is exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for re-pricing bands. The ALCO is the monitoring body for compliance with these limits and is assisted by the Bank's Risk Management Department in its day-to-day monitoring activities.

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. Standard scenarios that are considered on a monthly basis include a 100 basis points (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market profit rates has been disclosed in note 31 of the consolidated financial statements for the year ended 31 December 2011.

## RISK MANAGEMENT DISCLOSURES

### 7. OTHER RISKS (CONTINUED)

#### 7.3 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 31 December 2011, the Bank did not have any open position in foreign currency risk management instruments.

#### 7.4 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 to notes 4.3.1 and 4.3.2 above.

#### 7.5 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.

#### 7.6 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.

#### 7.7 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.

### 8. PRODUCT DISCLOSURES

#### 8.1 Product descriptions & consumer awareness

The Bank offers a comprehensive mix of Shari'a compliant commercial and investment banking products. This include, apart from traditional financing products, a range of innovative structured investment products like funds, repackaged investments and restricted Murabaha's. The investment department of the Bank has expertise in creating innovative high end and value added products offering a wide range of structures, expected returns, tenors and risk profiles.

Proposal for any new product is initiated by individual business lines within the Bank. The Executive Risk Management Committee ("ERMC") of the Bank reviews such proposal to ensure that the new product/ business are in line with the Bank's business and risk strategy. All new products will need the approval of the Board of Directors and the Shari'a Supervisory Board of the Bank.

## RISK MANAGEMENT DISCLOSURES

### 8. PRODUCT DISCLOSURES (CONTINUED)

#### 8.1 Product descriptions & consumer awareness (continued)

Information on new products or any change in existing products will be placed on the Bank's website [www.khcbonline.com](http://www.khcbonline.com) and/or published in the media. Product details are also shared with customers and the general public through brochures and/or advertisements.

#### 8.2 Complaint handling

The Bank takes disputes and complaints from all customers very seriously. These have the potential for a breakdown in relationships and can adversely affect the Bank's reputation. Left unattended these can also lead to litigation and possible censure by the regulatory authorities. The Bank has a comprehensive policy on handling of external complaints, approved by the Board. All employees of the Bank are aware of and abide by this policy.

The Bank has a designated nodal officer for handling of all external complaints and his contact details are displayed on the website and also at the Branch and in all printed publicity materials. Complaints are normally investigated by persons not directly related to the subject matter of the complaint. The Bank endeavors to address all complaints within five working days. Wherever this is not possible, the customer is contacted directly and a time frame for rectification of his complaint advised. A periodical report on status of complaints is also submitted to the Board.

#### 8.3 Equity of investment account holders (IAH's)

The Bank accepts funds in the form of Mudaraba from small investors and high net worth individuals. Equity of investment account holders ("IAH") represents funds offered by customers to the Bank to be invested in a Shari'a compliant manner; at the Bank's discretion as Mudarib. All IAH accounts are on profit sharing basis, but the Bank does not guarantee any particular level of return. Any loss arising from the investment will be borne by the customer except in the case of the Bank's negligence. The Bank charges a Mudarib fee as its share of profit.

The Bank accepts IAH funds in Bahraini Dinar, US Dollar and Euro for maturity periods ranging from 1 month to 12 months. The Bank completes its full range of KYC due diligence prior to accepting any investment. The customer also signs a written agreement covering all terms and conditions of the investment including tenor, basis of profit allocation, early withdrawal, etc.

In 2009, Bank has launched a savings account product called "Al-Waffer" which entitles the investors to certain cash prizes, decided based on a raffle draws held on monthly, quarterly and annual basis apart from the normal share of profits declared and distributed after reducing the Mudarib fees.

IAH is a significant funding source for the Bank. However, the failure to pay the expected return to IAH holders exposes the Bank to displaced commercial risk leading to loss of reputation and business. The Bank regularly monitors rate of return offered by competitors to evaluate the expectations of its Investment Account Holders. Bank's policy also provides for whole or partial waiver of the Mudarib share of income from investments due to it, to provide a reasonable return to its investors. Bank further mitigates this risk by setting up and maintaining an appropriate level of Profit Equalisation Reserve ("PER") and Investment Risk Reserve ("IRR") to smoothen return to IAH holders.

The Bank commingles its own funds and IAH funds which are invested together. The Bank has an identified pool of assets where the IAH funds are invested and the income from which is allocated to such accounts. Out of the gross income the investor's share is computed after deducting the Mudarib share and contribution to PER and IRR. The profit allocation schedule signed by the customer prior to investment contains the scheme of allocation of the Mudarib share and reserves. Administrative expenses incurred for management of the funds are borne directly by the Bank and are not charged separately to investment accounts. Bank has allocated impairment losses on its credit portfolio to the investors; (i.e. assets financed by IAH funds). During the year, such allocation was absorbed by utilisation of the Profit Equalisation Reserve.

Equity of IAH's are carried at their book values and include amounts retained towards PER and IRR. Creation of these reserves results in an increase in the liability towards the pool of IAHs.

## RISK MANAGEMENT DISCLOSURES

## 8. PRODUCT DISCLOSURES (CONTINUED)

## 8.3 Equity of investment account holders (IAH's) (continued)

Subject to the provisions thereof, deposits held with the Bahrain office of KHCB are covered by the Deposit Protection Scheme established by the CBB regulation concerning the establishment of a Deposit Protection Scheme and a Deposit Protection Board.

The details of income distribution to IAH holders for the last five years are given below (in BD 000's):

	2011	2010	2009	2008	2007
Allocated income to IAH	9,022	8,254	11,103	8,953	3,012
Distributed profit	6,629	5,785	9,331	7,050	2,446
Mudarib fees	2,393	2,469	1,772	1,903	566
<b>As at 31 December</b>					
IAH <sup>1</sup>	183,915	192,439	184,394	128,814	38,405
Profit Equalisation Reserve (PER)	-	169	1,209	649	206
Investment Risk Reserve (IRR)	-	-	925	473	134
Profit Equalisation Reserve-to-IAH (%)	-	0.09%	0.66%	0.50%	0.54%
Investment Risk Reserve-to-IAH (%)	-	-	0.50%	0.37%	0.35%

<sup>1</sup> Represents average balance.

## Ratio of profit distributed to PSIA by type of IAH (based on tenor in BD 000's):

Mudaraba Tenor	Profit distribution amount in BD					Ratio of profit paid as a percentage of total				
	2011	2010	2009	2008	2007	2011	2010	2009	2008	2007
1 Month <sup>1</sup>	1,824	3,107	4,271	3,346	1,576	27.5	53.7	45.8	47.5	64.4
3 Months	1,489	1,843	1,443	1,314	148	22.5	31.9	15.5	18.6	6.1
6 Months	764	641	736	373	71	11.5	11.1	7.9	5.3	2.9
12 Months	2,014	1,452	1,196	690	106	30.4	25.1	12.8	9.8	4.3
VIP	707	729	673	545	309	10.7	12.6	7.2	7.7	12.6
PER and IRR expenses	(169)	(1,987)	1,012	782	236	(2.6)	(34.4)	10.8	11.1	9.7
<b>Total</b>	<b>6,629</b>	<b>5,785</b>	<b>9,331</b>	<b>7,050</b>	<b>2,446</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>1</sup> Includes saving account and Al-Wafer account.

## Distribution of profits by type of IAH products:

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	Mudarib fees as a %age of IAH assets	Profit paid as a %age of IAH assets
<b>2011</b>	<b>4.99</b>	<b>-</b>	<b>-</b>	<b>1.22</b>	<b>3.69</b>
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
2007	7.84	0.38	0.24	1.47	5.75

## RISK MANAGEMENT DISCLOSURES

### 8. PRODUCT DISCLOSURES (CONTINUED)

#### 8.3 Equity of investment account holders (IAH's) (continued)

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

	2011	2010	2009	2008
1 Month Mudaraba <sup>1</sup>	2.51%	3.66%	4.00%	4.80%
3 Months Mudaraba	4.25%	4.13%	4.94%	5.25%
6 Months Mudaraba	4.52%	3.38%	5.30%	5.13%
12 Months Mudaraba	5.01%	4.94%	5.79%	5.40%
VIP Mudaraba	3.67%	4.35%	4.20%	4.52%

<sup>1</sup> Includes saving account and Al-Wafer account.

#### 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 types of assets for the year ended 31 December 2011:

Particular	Opening allocation	Movement	Closing allocation	Proportion of total assets
<b>Balances with banks</b>	8,356	10,091	18,447	81%
<b>Placements with financial institutions</b>	74,959	1,828	76,787	100%
<b>Financing assets</b>				
• Murabaha	75,954	(18,334)	57,620	39%
• Wakala	20,392	(393)	19,999	100%
• Istisna	998	(156)	842	100%
<b>Investment securities</b>				
• Sukuk	17,561	4,111	21,672	100%
<b>Total</b>	<b>198,220</b>	<b>(2,853)</b>	<b>195,367</b>	

#### 8.4 Restricted Investment Accounts (RIA's)

The Bank offers Restricted Investment Accounts ("RIA's") to both small investors and high net worth individuals in the GCC. The Bank structures its RIA products to offer its customers an opportunity to choose from a wide range of returns, maturity periods, sectors, asset classes and risk levels. No RIA product was introduced/ marketed by the Bank in 2011.

All RIA offering documents ("Offering Document") are drafted and issued with input from the Bank's Investment Banking, Shari'a, Financial Control, Legal and Risk Management Departments to ensure that the Investors have sufficient information to make an informed decision after considering all relevant risk factors.

The Board of Directors is responsible for providing clear guidelines for the development, management and risk mitigation of its' RIA investments and to ensure that there exist sound management and internal control systems to ensure that the interests of the investment account holders are protected at all times. Wherever it is necessary for the Bank to establish Special Purpose Vehicles ("SPV's") for management of the investment, the Board ensures that the management of such SPV's is conducted in a professional and transparent manner by a duly appointed Board.

## RISK MANAGEMENT DISCLOSURES

### 8. PRODUCT DISCLOSURES (CONTINUED)

#### 8.4 Restricted Investment Accounts (RIAs) (continued)

The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities. The Bank's Policy regarding its fiduciary responsibilities to the RIA investors and their funds, includes the following:

- Ensuring that the investment structure, Offering Documents and the investment itself are fully compliant with Islamic Shari'a principles and the CBB regulations;
- Appropriately advising Investors, as part of the RIA Offering Document, of all the relevant and known risk factors and making it clear that the investment risk is to be borne by the Investor before accepting the investment funds;
- Completing all necessary legal and financial due diligence on investments undertaken on behalf of the Investors with the same level of rigor as the Bank requires for its' own investments;
- Ensuring that the funds are invested strictly in accordance with the provisions outlined in the Offering Documents;
- Putting in place suitable resources and systems to manage and administer the investment and any necessary RIA SPV(s) and to proactively manage all risks;
- Preparing and disseminating periodical investment updates to Investors on a regular basis during the tenor of the investment;
- Distributing the capital and profits to the Investor in a just and equitable manner as Mudarib; and
- In all matters related to the RIA, RIA SPV(s) and the investment, act with the same level of care, good faith and diligence as the Bank would apply in managing its own investments.

Within the Bank, the abovementioned responsibilities and functions are provided, managed and monitored by qualified and experienced professionals from the Investment Banking, Shari'a, Financial Control, Legal, Investment Administration and the Risk Management Departments.

Investment update reports are prepared and disseminated by the Bank to the RIA Investors on a periodic (at least on a half yearly) basis outlining any material contracts / decisions, investment performance, distribution (if any) or exit criteria / information.

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					2011	2010	2009	2008	2007
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	9.50

## RISK MANAGEMENT DISCLOSURES

8. PRODUCT DISCLOSURES (CONTINUED)  
8.4 Restricted Investment Accounts (RIAs) (continued)

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					2011	2010	2009	2008	2007
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	10.65	-

## RISK MANAGEMENT DISCLOSURES

## 8. PRODUCT DISCLOSURES (CONTINUED)

## 8.4 Restricted Investment Accounts (RIAs) (continued)

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					2011	2010	2009	2008	2007
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	-	-	-	-	-

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES

#### 9.1 Corporate governance structure

The Bank is governed by the Commercial Companies Law No. 21 of 2001 (the "Companies Law"), the Kingdom of Bahrain Corporate Governance Code (the "CGC"), volume 2 of the Rulebook of the CBB (and in particular the High-Level Controls ("HC Module")), and the Bahrain Stock Exchange Law of 1987 (collectively, the "Regulations").

The Bank acknowledges its responsibility to all of its stakeholders and is committed to the highest standards of corporate governance. The Bank believes good corporate governance enhances stakeholder value and provides an appropriate guidance to the Board, its committees, and the Bank's executive management to carry out their duties in the best interest of the Bank and its stakeholders. The Bank maintains the highest levels of transparency, accountability and good management through the adoption and monitoring of corporate strategies, goals and policies to comply with its regulatory and ethical responsibilities.

In 2011, the Bank has adopted the CGC which is effective from January 2011. The Bank has also aligned its corporate governance policies with the HC Module of the CBB Rulebook which was introduced in October 2010 (built on the provisions of the CGC).

#### 9.2 Board of directors

As at 31 December 2011, the Board of the Bank comprised ten members. Members of the Board are elected for a three year renewable term. The current composition of the Board complies with the requirements of the Regulations.

The Board Nominations, Remunerations and Governance Committee ("BNRGC") reviews the skills and qualifications required of directors on periodic basis for potential nominee director. A nominee director may be elected by the Board upon receiving majority of votes during the election process. Positions at the Board are filled in compliance with the Bank's Articles of Association and the Commercial Companies Law. A Director's membership to the Board shall terminate in the event that, amongst other things, the Director is convicted of an offence of dishonor or breach of trust or is declared bankrupt.

The Chairman of the Board of Directors is charged with regular supervision and assessment of executive management and is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the CEO and maintaining a dialogue with the Bank's stakeholders. The Board has constituted certain committees with specific delegated authorities to oversee and guide the management in specific areas of the Bank's operations and decision-making. The Board, either directly or through its various committees, will oversee the management of the Bank.

The Board has formalized the division of work responsibilities between the Board and the Bank's management. Working in consultation with the Bank's management team, the Board provides oversight for the overall management of the Bank's business. The Board reviews and approves the corporate strategy for the Bank and has overall responsibility for risk management, financial reporting and corporate governance issues. Matters that specifically require Board approval include, amongst other things, the financial statements and the acquisition and disposal of companies. The Board also ensures that the Bank upholds the Bank's core values including the values set out in the Bank's internal policies.

The Board Risk Management Committee ("BRMC") ensures that all policies prescribed are reviewed and updated on annual basis. The Risk management department in conjunction with the Internal Control unit ensures the policies and procedures are updated and adhered to under the oversight of the related management committees. The Board is also responsible for approving any related party transaction as per the Bank's authority matrix. Related party transactions concerning a Board member should be minimally approved by the Board Investment and Credit Committee ("BICC"). In addition, any material transaction defined by the Bank (10% of the Banks' capital) should be approved by the Board. The preparation of the consolidated financial statements of the Bank is the responsibility of the Board of Directors. The duties, functions, and responsibilities are detailed in the Bank's Corporate Governance Framework.

Members of the Board have access to the Bank's management at all times. The CEO together with the Bank's senior management monitors the Bank's performance against pre-set corporate objectives and manages the Bank's day-to-day affairs based upon the policies, objectives, strategies and guidelines lay down and approved by the Board from time to time.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.2 Board of directors (continued)

The Board of Directors of the Bank comprises Executive and Non-Executive Directors. The Board has three independent members (including the Chairman) out of a total of ten Directors. This is to ensure compliance with the CGC requirement that requires at least one third of the Bank's Board to comprise independent and non-executive Directors. The Bank has only one executive Director, namely the Chief Executive Officer (CEO) of the Bank.

Upon appointment, each Director is provided with a comprehensive, formal and tailored induction which includes, amongst other things, a review of the Board's role and duties and the relevant Director's roles and duties to the Bank; meetings with the bank's senior management; visits to the Bank's branches and other sites; presentations to explain the Bank's strategic plans and significant financial, accounting, risk and legal issues and compliance programs; and meetings with internal and external auditors and legal counsel. The Board and its committees are also individually evaluated and assessed for their performance effectiveness. Since the Bank's Board has been recently elected the next evaluation will occur by end of 2012.

Each independent Director of the bank is a professional in their field and possesses a background in the financial and banking field.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.2 Board of directors (continued)

The names, title, and other positions held by the Board of Directors are set out below:

#### **Dr. Fuad Abdulla Al-Omar**

*Chairman*

Experience:

- Director since 2004 (Independent and Non-Executive).
- Over 31 years of experience in financial and commercial sector.
- Chairman of MENA Real Estate Company - Kuwait.
- Vice Chairman of Gulf Real Estate Development Co. - Saudi Arabia.
- Director of Gulf North Africa Holding Company - Kuwait.

Qualification:

- Ph.D. in Public Administration from University of Leicester - UK.
- Master in Business Administration from University of Boston College - USA.
- Bachelor of Science in Chemical Engineering from Worcester Polytechnic Ins. - USA.

#### **Abdulla Abdulkarim Showaiter**

*Board Member*

Experience:

- Director since February 2008 (Independent and Non-Executive).
- Over 33 years' experience in the banking industry.
- Deputy Chief Executive Officer, Emirates Islamic Bank - Dubai.
- Board Member of First Energy Bank - Bahrain.
- Board Member of Ethmar Real Estate Company - Dubai.
- Board member of Al-Salam Bank – Sudan.
- Board member of Al-Mahraab Real Estate Company - Kuwait.
- Board member of Waqf Trust Service, Government of Dubai - Dubai.
- Board member of Madaan Real Estate Co. - Dubai.

Qualification:

- Attended several courses in the field of banking and finance.

#### **Abdulrahman Mohammed Jamsheer**

*Vice Chairman*

Experience:

- Director since March 2011 (Independent and Non-Executive).
- Shura Council member.
- Over 40 years of experience in financial and commercial sector.
- Chairman of Fortuna CO. W.L.L.
- Vice Chairman of Lona Real Estate BSC Closed.
- Board Member and Managing Director of Esterad Investment Company.
- Board Member and Managing Director of United Cement Company.
- Board Member of Delmon Poultry Company.
- Board Member of Banz Group Company.
- Board Member of Daih Real Estate Development Co. W.L.L.

Qualification:

- Bachelor of Science in Engineering Agricole from the American University of Beirut - Lebanon.

#### **Ebrahim Hussain Ebrahim**

*CEO & Board Member*

Experience:

- Director since February 2008 (Executive).
- Over 29 years of experience in financial sector.
- Board Member and CEO of Khaleeji Commercial Bank.
- Chairman of Capital Real Estate Company - Bahrain.
- Board member of First Energy Bank - Bahrain.
- Board member of Gulf Real Estate Development Co. - Saudi Arabia.
- Serves as Chairman and member of the board of several subsidiaries of the bank.

Qualification:

- Master in Business Administration from University of Bahrain.
- Bachelor of Science in Economics from University of Kuwait.
- Advanced Diploma in Islamic Banking from Bahrain Institute of Banking and Finance (BIBF).

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.2 Board of directors (continued)

##### **Khalid Hussain Al-Maskati**

###### *Board Member*

###### Experience:

- Director since March 2011 (Non-Executive and Non-Independent).
- Shura Council member.
- Over 30 years of experience in commercial sector.
- Nominated by Gulf Finance House BSC.
- Deputy Chairman of Maskati Brothers & Company - Bahrain.
- Director of Hussain Mahdi Al-Maskati & Sons Co. BSC (c).
- Director of Maskati Commercial Services BSC (c).
- Director of General Trading and Food Processing Co.
- Director of Gulf Union Insurance & Reinsurance Co. BSC (c).

###### Qualification:

- Bachelor of Art in Business Administration & Industrial Management from University of Texas - USA.

##### **Mohammed Barak Al-Mutair**

###### *Board Member*

###### Experience:

- Director since August 2010 (Non-Executive and Non-Independent).
- Over 13 years of experience in Government & Business sector.
- Nominated by Al-Imtiaz Investment Company KSC - Kuwait.
- Member of the Kuwaiti Parliament.
- Chairman of Kuwait Real Estate Holding Company - Kuwait.
- Board member of Gulf Real Estate Development Co. - Saudi Arabia.
- Board Member of Al-Imtiaz Investment Company KSC - Kuwait.

###### Qualification:

- Bachelor Degree in Business Administration from San Diego University - USA.

##### **Abdulrahman Abdulla Al-Kooheji**

###### *Board Member*

###### Experience:

- Director since March 2011 (Non-Executive and Non-Independent).
- Over 30 years of experience in the financial and banking sector.
- Nominated by Gulf Finance House BSC.
- Chairman and Managing Director of Rasan Catering - Kuwait.
- Vice Chairman of Rasan Real Estate - Kuwait.
- Vice Chairman of Rasan Holding - Kuwait.
- Director of Muharraq Mall - Bahrain.

###### Qualification:

- Executive Management Diploma from University of Bahrain.
- Diploma in Banking from Bahrain Institute for Banking and Finance (BIBF).

##### **Mosobah Saif Al-Mutairy**

###### *Board Member*

###### Experience:

- Director since March 2011 (Non-Executive and Non-Independent).
- Over 15 years of experience in Financial and Investment sector.
- Nominated by Gulf Finance House BSC.
- Board member of Gulf Finance House BSC.
- Accounts Manager of Royal Guards of Oman.
- Acting Manager of Royal Guards of Oman Pension Fund.

###### Qualification:

- Master in Business Administration from University of Lincolnshire & Humberside - UK.
- Postgraduate qualification in Accounting from South Bank University, London - UK.
- Degree in Accounting from South West College, London - UK.
- National Diploma in Business and Finance from Bradford & Ilkley Community College - UK.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.2 Board of directors (continued)

##### Tariq Qassim Fakhroo

###### Board Member

###### Experience:

- Director since March 2011 (Non-Executive and Non-Independent).
- Over 10 years of experience in Business, Commercial, & IT sector.
- Nominated by Gulf Finance House BSC.
- Deputy Chief Executive, Mohammed Fakhroo & Bros. - Bahrain.
- General Manager, Fakhroo IT Services - Bahrain.

###### Qualification:

- Master of Science in Electrical Engineering from University of Central Florida – USA.
- Master in Business Administration from University of Bahrain.
- Bachelor of Science in Electrical Engineering from University of Bahrain.

##### Khalid Rashid Al-Thani

###### Board Member

###### Experience:

- Director since February 2009 (Independent and Non-Executive).
- Over 20 years of experience in financial and commercial sector.
- Deputy General Secretary of Awqaf and Minors Affairs Foundation – Dubai.
- Head of Finance Department, Dubai Land Department, from 1999 to 2004 - Dubai.
- Board Member of Dubai International Holy Quran Award 1997 to 2004 - Dubai.

###### Qualification:

- Bachelor in Business Accounting from University of United Arab Emirates.

\* The qualifying criteria for 'Independent' Directors are as per the Corporate Governance guidelines of the CBB.

The Chairman, the Board of Directors, and the Board Committees have direct access to the heads of Internal Audit, Risk Management, Regulatory Compliance and Shari'a Compliance.

#### 9.3 Board of directors' interests

The non-executive members of the Board collectively held 8,358,249 shares in the Bank as of the year ended 31 December 2011 (2010: 8,715,500 shares).

Director's name	Number of outstanding shares at 31 December 2010	Number of outstanding shares at 31 December 2011	Movement during the year	% of outstanding shares
Dr. Fuad Abdulla Al-Omar	1	1	0	0
Abdulrahman Mohamed Jamsheer	Nil	Nil	Nil	Nil
Abdulla Abdulkarim Showaiter	1,155,000	1,155,000	Nil	0.10%
Ebrahim Hussain Ebrahim	14,005,641	17,611,955	3,606,314 <sup>1</sup>	1.52%
Khalid Hussain Al-Maskati	Nil	Nil	Nil	Nil
Abdulrahman Abdulla Al-Kooheji	Nil	Nil	Nil	Nil
Mohammed Barak Al-Mutair	7,560,500	7,103,249	(457,251) <sup>2</sup>	0.62%
Mosobah Saif Al-Mutairy	Nil	Nil	Nil	Nil
Tariq Qassim Fakhroo	Nil	Nil	Nil	Nil
Khalid Rashid Al-Thani	Nil	100,000	Nil	0.01%
<b>Total</b>	<b>22,721,142</b>	<b>25,970,205</b>	<b>3,149,063</b>	<b>2.25%</b>

<sup>1</sup> The change is due to vesting of shares under the share-based employee incentive scheme.

<sup>2</sup> The change is due to transfers made to relatives during the year.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.4 Distribution of ownership shares by nationality

The Bank's Register of Shareholders as at 31 December 2011 indicates a total of 548 shareholders who collectively owned 1,154,161,084 (One Billion One Hundred Fifty Four Million One Hundred Sixty One Thousand and Eighty Four) shares with a nominal value of BD 0.100 (One Hundred Fils) each. The breakdown of shareholders in the Bank by nationality is as follows:

Nationality	No. of equity shares held	No. of shareholders	% of shareholders
Bahraini	681,306,490	450	59.03
Non-Bahraini	472,854,594	98	40.97
<b>Total</b>	<b>1,154,161,084</b>	<b>548</b>	<b>100.00</b>

As at 31 December 2011, none of the Bank's shares were held by the Government of the Kingdom of Bahrain.

#### 9.5 Board committees

The Board of Directors has constituted four Committees with specific delegated authorities:

Committee	Members	Primary responsibilities
Board Nominations, Remunerations and Governance Committee (BNRGC)	<ul style="list-style-type: none"> <li>Abdulla Abdulkarim Showaiter.</li> <li>Mohammed Barrak Al-Mutair.</li> <li>Khalid Rashid Al-Thani.</li> </ul>	<ul style="list-style-type: none"> <li>Human Resources.</li> <li>Compensation and incentives.</li> <li>Administration.</li> <li>Corporate Governance.</li> </ul>
Board Audit Committee (BAC)	<ul style="list-style-type: none"> <li>Khalid Rashid Al-Thani.</li> <li>Abdulrahman A. Al-Kooheji.</li> <li>Khalid Hussain Al-Maskati.</li> </ul>	<ul style="list-style-type: none"> <li>Internal Audit.</li> <li>External Audit.</li> <li>Compliance.</li> <li>Anti-Money Laundering.</li> </ul>
Board Investment and Credit Committee (BICC)	<ul style="list-style-type: none"> <li>Dr. Fuad Abdulla Al-Omar.</li> <li>Abdulrahman M. Jamsheer.</li> <li>Abdulla Abdulkarim Showaiter.</li> <li>Ebrahim Hussain Ebrahim.</li> <li>Mohammed Barrak Al-Mutair.</li> <li>Mosobah Saif Al-Mutairy.</li> </ul>	<ul style="list-style-type: none"> <li>Investment &amp; credit approval.</li> <li>Setting limits.</li> <li>Investment policies.</li> <li>Asset Liability Management.</li> <li>Banking relationship.</li> <li>Oversight of Off-Balance Sheet Vehicles.</li> </ul>
Board Risk Management Committee (BRMC)	<ul style="list-style-type: none"> <li>Abdulrahman A. Al-Kooheji.</li> <li>Khalid Hussain Al-Maskati.</li> <li>Tariq Qassim Fakhroo.</li> </ul>	<ul style="list-style-type: none"> <li>Risk management.</li> <li>Policies related to risk management.</li> </ul>

Meetings of the Board and its committees are held as and when required but in accordance with the Regulations the Board meets at least once a quarter. The Board of Directors met six times in 2011. The Bank held its Annual General Meeting ("AGM") on 31 March 2011. In addition to physical meetings, several written resolutions were circulated to the Directors during 2011 for approval by mail and facsimile.

In addition, the Board Audit Committee (BAC) held 4 meetings, the Board Investment and Credit Committee (BICC) held 6 meetings, the Board Nominations, Remunerations and Governance Committee (BNRGC) held 4 meetings and the Board Risk Management Committee (BRMC) held 4 meetings.

The Board of Directors and its committees receive regular reports on various aspects of the Bank's business from senior management as well as from Internal Audit, Risk Management, Financial Control, and Operations Departments.

## RISK MANAGEMENT DISCLOSURES

## 9. CORPORATE GOVERNANCE &amp; OTHER DISCLOSURES (CONTINUED)

## 9.6 Board committees meeting dates

- Board meetings: a total number of 6 meetings were held.

Director's name	Meeting dates during the year 2011						Attendance %*
	26 <sup>th</sup> January *	14 <sup>th</sup> April	28 <sup>th</sup> April	4 <sup>th</sup> August	28 <sup>th</sup> September	27 <sup>th</sup> October	
Dr. Fuad Abdulla Al-Omar	✓	✓	✓	✓	✓	✓	100%
Abdulrahman Mohamed Jamsheer	N/A	✓	✓	✓	✓	✓	100%
Abdulla Abdulkarim Showaiter	✓	✓	✓	✓	-	✓	More than 75%
Ebrahim Hussain Ebrahim	✓	✓	✓	✓	✓	✓	100%
Khalid Hussain Al-Maskati	N/A	✓	✓	-	-	✓	Less than 75%
Abdulrahman Abdulla Al-Kooheji	N/A	✓	✓	✓	-	✓	More than 75%
Mohammed Barak Al-Mutair	-	-	-	✓	✓	-	Less than 75%
Mosobah Saif Al-Mutairy	N/A	✓	✓	✓	✓	✓	100%
Tariq Qassim Fakhroo	N/A	✓	✓	✓	-	✓	More than 75%
Khalid Rashid Al-Thani	✓	✓	✓	✓	-	✓	More than 75%

\*The following members joined the Board officially on 31<sup>st</sup> March 2011:

- Abdulrahman Mohammed Jamsheer,
- Khalid Hussain Al-Maskati,
- Abdulrahman Abdulla Al-Kooheji,
- Mosobah Saif Al-Mutairy,
- Tariq Qassim Fakhroo.

- BICC meetings: a total number of 6 meetings were held.

Director's name	Meeting dates during the year 2011					
	26 <sup>th</sup> January *	28 <sup>th</sup> April	26 <sup>th</sup> May	30 <sup>th</sup> June	4 <sup>th</sup> August	27 <sup>th</sup> October
Dr. Fuad Abdulla Al-Omar	✓	✓	✓	✓	✓	✓
Abdulrahman Mohamed Jamsheer	N/A	✓	✓	✓	✓	✓
Abdulla Abdulkarim Showaiter	✓	✓	✓	-	✓	✓
Ebrahim Hussain Ebrahim	✓	✓	✓	✓	✓	✓
Mohammed Barak Al-Mutair	-	-	✓	✓	-	-
Mosobah Saif Al-Mutairy	N/A	✓	✓	✓	✓	✓

\*The following members joined the Committee officially on 28<sup>th</sup> April 2011:

- Abdulrahman Mohammed Jamsheer,
- Mosobah Saif Al-Mutairy.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.6 Board committees meeting dates (continued)

- BRMC meetings: a total number of 4 meetings were held.

Director's name	Meeting dates during the year 2011			
	26 <sup>th</sup> January*	28 <sup>th</sup> April	4 <sup>th</sup> August	27 <sup>th</sup> October
Abdulrahman Abdulla Al-Kooheji	N/A	✓	✓	✓
Khalid Hussain Al-Maskati	N/A	✓	✓	✓
Tariq Qassim Fakhroo	N/A	✓	✓	✓

\* All members joined the Committee officially on 28<sup>th</sup> April 2011.

- BNRGC meetings: a total number of 4 meetings were held.

Director's name	Meeting dates during the year 2011			
	26 <sup>th</sup> January*	9 <sup>th</sup> February	28 <sup>th</sup> April	26 <sup>th</sup> October
Abdulla Abdulkarim Showaiter	✓	✓	✓	✓
Mohammed Barak Al-Mutair	-	✓	-	-
Khalid Rashid Al-Thani	N/A	N/A	✓	✓

\* Mr. Khalid Rashid Al-Thani joined the Committee officially on 28th April 2011.

- BAC meetings: a total number of 4 meetings were held.

Director's name	Meeting dates during the year 2011			
	25 <sup>th</sup> January*	27 <sup>th</sup> April	4 <sup>th</sup> August	26 <sup>th</sup> October
Khalid Rashid Al-Thani	✓	✓	✓	✓
Khalid Hussain Al-Maskati	N/A	✓	-	✓
Abdulrahman Abdulla Al-Kooheji	N/A	-	✓	✓

\* The following members joined the Committee officially on 28<sup>th</sup> April 2011:

- Khalid Hussain Al-Maskati,
- Abdulrahman Abdulla Al-Kooheji.

#### 9.7 Code of conduct

The Board has approved a code of conduct for all staff of the Bank and the Board members. The Code includes the process of dealing with conflict of interests. It also binds the Directors, Executive Management and staff to the highest standard of professionalism and diligence on discharging their duties. All Board members and senior management of the Bank have affirmed compliance with the Code of Conduct. A declaration is made by the Board members prior to each Board meeting confirming that they have disclosed all external appointments and notified the Chairman if there have been any changes to their external appointments since the previous meeting. Board members are excluded from dealings in matters related to an external entity where they hold an appointment at that entity.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.8 Compliance with regulators

The Bank ensures compliance with the regulators as an Islamic licensed bank at all times. It would report any non-compliance with the guidelines should there be any. The Bank's obligations to comply with the Regulations have been addressed through enhancing the current Corporate Governance Framework and the adoption of a new comprehensive Corporate Governance Handbook in accordance with the corporate governance ("CG") and the High-Level Controls Module of the CBB Rulebook. The new CG Handbook was developed to manage the Board and committees Charter, Management Committee Charters, Board and Management Code of Conduct, Conflict of Interest Policy, Whistle Blowing Policy, Corporate Governance Guidelines, Social Responsibility, Directors' Appointment Agreement, Board and Directors' Evaluation, and a Key Persons' Dealing Policy.

The Bank is committed to continuously review and develop its corporate governance policies to ensure compliance with the changing requirements of the Regulations and to ensure compliance with the international corporate governance best practice. The Bank, through its Board and Board Committees, endeavors to deliver the highest standards of governance for the benefit of its stakeholders.

#### 9.9 Shari'a Supervisory Board

The Bank's Shari'a Supervisory Board consists of three Islamic scholars who review the Bank's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Bank to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

##### Dr. Fareed Yaqoob Al-Miftah

###### Chairman

###### Experience:

- Member of the Supreme Council of Islamic Affairs.
- Undersecretary of the Ministry of Justice & Islamic Affairs - Bahrain.
- Former judge of the high Shari'a Court.
- Former Lecturer at the University of Bahrain.

###### Qualification:

- Ph.D. from the University of Edinburgh - United Kingdom.

##### Dr. Fareed Mohammed Hadi

###### Executive Member

###### Experience:

- Assistant Professor at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain.
- Member of Shari'a Supervisory Board of a number of Islamic banks.

###### Qualification:

- Ph.D. in Ibn Hazm's Methodology of Jahala, University of Edinburgh - UK.
- Ph.D. in Al-Bukhari's Methodology, University of Mohammed V - Morocco.

##### Sh. Nizam Mohammed Saleh Yaqoobi

###### Member

###### Experience:

- Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank - UAE.
- Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank - Bahrain.
- Executive Member of the Shari'a Supervisory Board of Ithmaar Bank - Bahrain.
- Board Member of the Dow Jones Islamic index.
- Member of Shari'a Supervisory Board of a number of Islamic banks & insurance companies.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.10 Executive management committees

The Board of Directors delegates the authority for day-to-day management of the business to the Chief Executive Officer (CEO) who is responsible for implementing the Bank's strategic plan. The CEO manages the Bank through the following management committees:

Committee	Primary responsibilities
Management Committee	Strategy, Performance review, Budget, Human Resources, Administration
Asset Liability Management Committee	Balance sheet management, Funding, Liquidity, Banking Relationships
Executive Credit & Investment Committee	Review of investments, Exit and credit proposals, Monitoring of investments
Executive Risk Management Committee	Risk Management policies, Risk review, Provisions and impairment

#### Executive management & other senior management

The names and title of each member of executive and other Senior Management are set out below:

##### **Ebrahim Hussain Ebrahim**

*CEO & Board Member*

Experience:

- Over 29 years of experience in both Islamic and conventional banks and financial institutions.
- Joined the Bank in 2004.

Qualification:

- Master in Business Administration from University of Bahrain.
- Bachelor of Science in Economics from University of Kuwait.
- Advanced Diploma in Islamic Banking from Bahrain Institute of Banking and Finance (BIBF).

##### **Fuad Ali Taqi**

*Deputy General Manager, Commercial Banking*

Experience:

- Over 30 years of banking experience in Islamic and conventional banks.
- Joined the Bank in 2006.

Qualification:

- Business Studies Diploma.
- MBA from the University of Glamorgan - United Kingdom.

##### **Silvan Varghese**

*Deputy General Manager & COO*

Experience:

- 21 years of experience in the banking industry in India and Middle East in several areas like Risk and Credit Management, Compliance, Project Finance and Corporate Banking.
- Joined the Bank in 2007.

Qualification:

- B. Sc. in Chemical Engineering from BITS, Pilani, India.
- MBA from the Indian Institute of Management (IIM), Lucknow.
- General Management Program (GMP) at the Harvard Business School.
- Certified Financial Risk Manager (FRM) by Global Association of Risk Professionals (GARP).

##### **Mahdi Abdulnabi Mohammed**

*Assistant General Manager – Head of Operations & Administration*

Experience:

- Over 31 years of banking experience.
- Joined the Bank in 2005.

Qualification:

- Certified Diploma in Accounting & Finance from The Chartered Association of Certified Accountants (ACCA).
- MBA from the University of Strathclyde - United Kingdom.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.10 Executive management committees (continued)

##### **Jasim Awadh Asghar**

*Assistant General Manager – Head of Corporate and Wholesale Banking*

Experience:

- Over 21 years of banking experience.
- Joined the Bank in February 2011.

Qualification:

- MBA.
- M. Sc. in Electronic Engineering from University of Wales - UK.

##### **Ahmed Ali Bucheeri**

*Head of Internal Audit*

Experience:

- 23 years of experience in both internal and external audit mainly in banks.
- Joined the Bank in 2007.

Qualification:

- Certified Internal Auditor (CIA) from the Institute of Internal Audit - USA.
- B.Sc. in Accounting from King Fahad University of Petroleum and Minerals - Saudi Arabia.

##### **Yaser Ismaeel Mudhafar**

*Head of Financial Control*

Experience:

- Over 14 years of extensive experience in the Islamic banking industry and Audit.
- Joined the Bank in 2006.

Qualification:

- Certified Public Accountant (CPA) from the American Institute of Certified Public Accountants.
- Certified Islamic Professional Accountant (CIPA) from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).
- Executive MBA from University of Bahrain.

##### **T. N. Ramesan**

*Assistant General Manager - Head of Risk & Credit Management*

Experience:

- Over 32 years of banking experience.
- Joined the Bank in 2007.

Qualification:

- M. Sc. in Physics from the Indian Institute of Technology, Madras - India.
- Diploma in International Finance & Investment from Hong Kong Management Association.
- Certified Associate of the Indian Institute of Bankers.

##### **Hussam Ghanem Saif**

*Head of Treasury*

Experience:

- Over 22 years of experience in treasury and Islamic banking.
- Joined the Bank in 2007.

Qualification:

- Graduate with a degree in Business Administration & Management from Western International University, London - UK.

##### **Fatooh Yusuf Al-Mannai**

*Head of Human Resources*

Experience:

- Over 16 years of experience in human resources, training and administration.
- Joined the Bank in 2007.

Qualification:

- MBA and a BA (Hons.) in Human Resource Management.
- Fellow of the Chartered Institute of Personnel & Development (Chartered FCIPD).
- Member of Society of Human Resource Management (SHRM).
- Member of Bahrain Society for Training and Development (BSTD).

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.10 Executive management committees (continued)

##### **Christopher Ware**

*Head of Legal Department*

Experience:

- Over 13 years of experience, including more than 8 years as a qualified lawyer, gained through roles with various institutions in the UK, Japan, Australia and Bahrain. Experience extends to capital markets, structured finance, banking, Islamic finance, acquisitions, private equity and real estate work.
- Joined the Bank in December 2010.

Qualification:

- LLB degree from King's College, University of London - UK.
- Post-Graduate Diploma in Law from the College of Law, London - UK.
- Admitted to practice law as solicitor of the Supreme Court of England & Wales since 2003.

##### **Mohammed Abdulla Ebrahim**

*Corporate Secretary, Head of Compliance and MLRO*

Experience:

- Over 9 years of experience working at the Office of the Assistant Undersecretary for Planning and Organisation, Ministry of Interior - Bahrain, and at the Secretariat General Office of the GCC in Riyadh as Liaison Officer for the Kingdom of Bahrain.
- Joined the Bank in 2009.

Qualification:

- Master's in IT, Media and E-Commerce Law from the University of Essex - UK.
- B.Sc. in Law from Dubai Police Academy - UAE.
- Advanced Diploma in Islamic Finance by the Bahrain Institute of Banking and Finance (BIBF).
- Diploma in Business Management from the University of Bahrain.

##### **Abdul-Nasser Omar Al-Mahmood**

*Head of Shari'a Compliance*

Experience:

- Over 21 years of experience in Shari'a Audit and Islamic banking.
- Joined the Bank in 2008.

Qualification:

- Master's in Business Administration with thesis in Shari'a Control and Review in Islamic Banks.
- B. Sc. in Shari'a and Islamic studies.
- Associate Diploma in Shari'a Control.

#### 9.11 Executive and senior management interests

The following table indicates the executive and senior management shareholding as 31 December 2011:

Executive and senior management	Number of outstanding shares at 31 December 2010	Number of outstanding shares at 31 December 2011
Ebrahim Hussain Ebrahim	14,005,641	17,611,955
Silvan Varghese	1,253,656	1,614,948
Fuad Ali Taqi	1,272,165	1,641,881
Mahdi Abdalnabi Mohammed	1,059,435	1,328,897
T. N. Ramesan	98,151	147,014
Jassim Awadh Asghar	Nil	Nil
<b>Total</b>	<b>17,689,048</b>	<b>22,344,695</b>

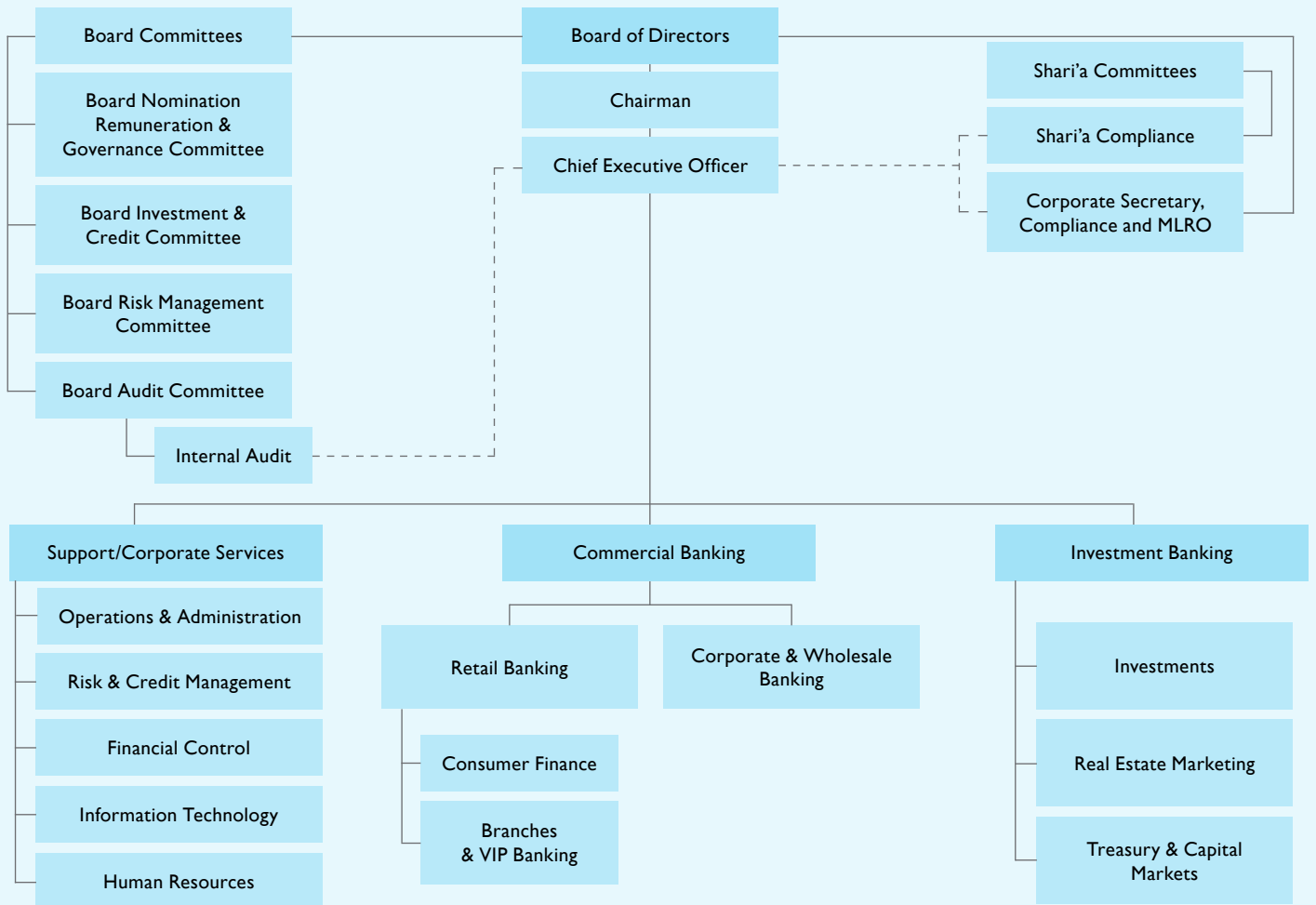
\*The change in the above number of shares is due to vesting of shares under the share-based employee incentive scheme.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.12 Organizational chart

Set out below is the Bank's organization chart, which outlines the different committees and the lines of reporting.



There have been no major structural changes to the organisation structure from the previous year.

#### 9.13 Executive compensation

The Bank has both a short-term and long-term compensation structure for its executive management which has been developed based on current market surveys and industry norms. The Bank also operates an incentive scheme where in eligible employees are awarded a combination of shares and cash incentives on achievement of pre-determined performance targets. For further details please refer note 23 of the consolidated financial statements for the year ended 31 December 2011. The Board of Directors is entitled to sitting fees and their annual remuneration is subject to the approval of the shareholders at the end of each year.

#### 9.14 Shari'a compliance, regulatory compliance and anti-money laundering

Compliance with Shari'a laws, regulatory and statutory requirements is an ongoing process and the Bank is conscious of its responsibilities in observing all applicable provisions and best international practices in its functioning. The Bank has established the Shari'a Compliance Function and the Regulatory Compliance Function in keeping with Basel and CBB guidelines. The respective units act as a focal point for all Shari'a and regulatory compliance and for adapting other best practice compliance principles.

## RISK MANAGEMENT DISCLOSURES

### 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES (CONTINUED)

#### 9.14 Shari'a compliance, regulatory compliance and anti-money laundering (continued)

Anti-Money Laundering measures form an important area of the Compliance Function. The Bank has an Anti-Money Laundering and Combating Terrorist Financing Policy and Procedure approved by the Board, which contains sound customer due diligence measures, procedure for identifying and reporting suspicious transactions, a program for periodic awareness training to staff, record-keeping, and a designated Money Laundering Reporting Officer (MLRO). The Bank's Anti-Money Laundering measures are reviewed by independent external auditors every year and their report is submitted to the CBB. The Bank is committed to combating money laundering and is in compliance with the guidelines issued by the CBB in relation to Anti-Money Laundering requirements.

The Bank is in compliance with the HC Module of the CBB Rulebook. However, due to the limited number of independent board members to chair the BNRGC and the BAC, the Bank has not been able to completely comply with following requirements:

- HC 1.8.2: that requires a constitution of a corporate governance committee with at least three independent members;
- HC 3.2.1: which sets out a development of a board audit committee of at least three directors with a majority of independent directors including the chairman;
- HC 4.2.2: in which the Board must establish a nominating committee which would include only independent directors or only non-executive directors of whom a majority must be independent directors including the chairman;
- HC 5.3.2: in which it is requires to include only independent directors for the remuneration committee or, alternatively, only non-executive directors of whom a majority are independent directors including the chairman.

Further, in accordance with HC 1.3.4 and HC 1.3.6 of the CBB Rulebook, all retail banks are required to notify the CBB in the event that a Board member does not attended at least 75% of Board meetings in any given financial year. Certain directors of the Bank could not comply with the attendance requirements hence the Bank had notified the CBB as indicated in section 9.6 of this report.

The Bank is currently working on the compliance with the above mentioned requirements.

#### 9.15 Audit fees charged by the external auditor and other non-audit services provided by the external auditor and fees paid

The audit fees charged and non-audit services provided by external auditors will be made available to the shareholders as and when requested. Such details will be made available to the Bank's shareholders as per their specific request provided that these disclosures would not negatively impact the Bank's interest and its competition in the market.

### 10. FINANCIAL PERFORMANCE

Following are basic quantitative indicators of the financial performance:

	2011	2010	2009	2008	2007
Return on average equity	0.44%	- 5.18%	2.47%	20.00%	23.50%
Return on average assets	0.13%	- 1.59%	0.65%	7.40%	11.50%
Finance income to finance expense	208.06%	240.21%	155.66%	154.11%	187.97%
Cost-to-income*	72.11%	83.79%	48.30%	30.59%	30.46%

\*Cost has been considered excluding impairment allowances.

For detailed discussion on the performance for the year, kindly refer to Chairman's report on the consolidated financial statement for the year ended 31 December 2011.