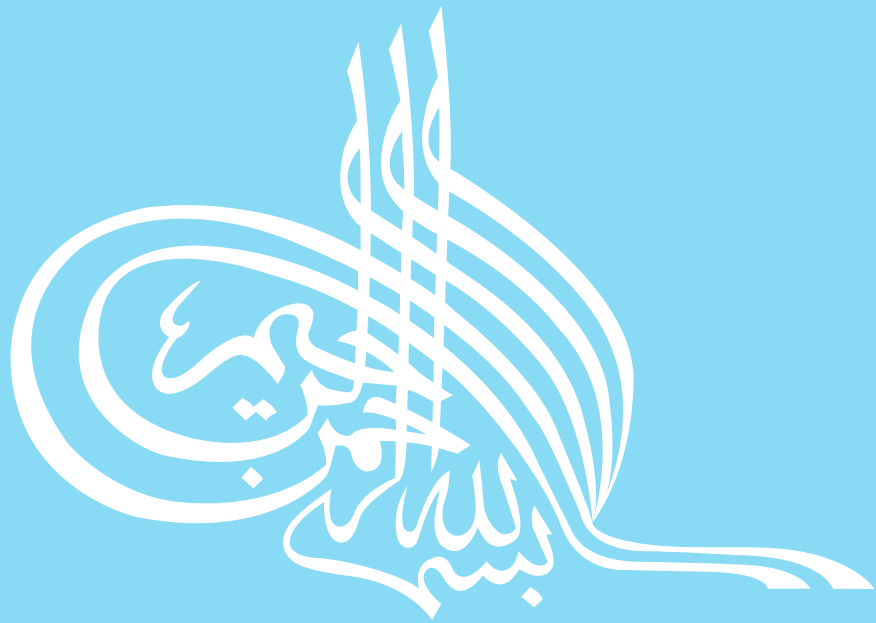




KHALEEJI  
COMMERCIAL  
BANK | المصرف  
الخليجي  
التجاري









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



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



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

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## FINANCIAL HIGHLIGHTS

	2012	2011	2010	2009	2008
Total Income	19,817	22,929	19,585	33,232	54,778
Net Profit / (Loss)	751	518	(6,533)	3,100	27,304
Total Assets	473,159	447,515	419,216	473,604	464,993
Total Equity	119,448	118,923	118,158	126,574	137,982
Earnings Per Share (fils)	0.67	0.46	(5.87)	3.04	26.52

## BOARD OF DIRECTORS



Dr. Fuad Abdulla Al-Omar  
*Chairman*



Mr. Abdulrahman  
Mohammed Jamsheer  
*Vice Chairman*



Mr. Ebrahim Hussain  
Ebrahim  
*Board Member*



Mr. Khalid Rashid  
Al-Thani  
*Board Member*



Mr. Tariq Qasim  
Fakhroo  
*Board Member*



Mr. Abdulla Abdulkarim  
Showaiter  
*Board Member*



Mr. Mohammed Barrak  
Al-Mutair  
*Board Member*



Mr. Mosobah Saif  
Al-Mutairy  
*Board Member*



Dr. Ahmed Khalil  
Al Mutawa  
*Board Member*



Mr. Hisham Ahmed  
Al Rayes  
*Board Member*

## 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-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 of Jurisprudence (Fiqh) and Hadeeth at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain.
- Bachelor program Manager in Shari'a for Banking and Finance, University of Bahrain.
- Vice President of the Association of Shari'a scholars in GCC.
- 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:

- Member of the Shari'a council of Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI).
- Member of the Shari'a Board of the Central Bank of Bahrain - Bahrain.
- Member of Shari'a Supervisory Board of the Dow Jones Islamic index.
- Member of Shari'a Supervisory Board of a number of Islamic banks & insurance companies.

## CHAIRMAN'S REPORT



### 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 financial statements of Khaleeji Commercial Bank for the year ended 31 December 2012. This, the eighth 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 crisis as well as declining economic activity in the local market segments.

The Bank continues to execute its articulated business model based on the new strategic plan, which focuses on expanding its retail and commercial banking business. Key elements of the plan are growing the retail banking business in Bahrain; increasing the Bank's share of business in the local corporate and consumer finance markets; and expanding the Bank's commercial banking business into the regional markets. While the overall business volumes have not reached our expectations, I am pleased to report that we have achieved considerable progress in accomplishing key milestones including opening new branches, launching new retail banking products and expanding our consumer finance business.

### 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 751 thousand compared to a profit of BD 518 thousand in 2011. The Bank continues to maintain strong liquidity (with 19.2% of the Bank's assets being liquid) and adequate capital (the Bank has a regulatory capital adequacy ratio of 28.4%), both comfortably in excess of regulatory requirements.

Despite difficult market conditions, the Bank grew its Balance Sheet size by 5.8% from BD 447 million to BD 473 million. Total income from commercial banking increased by 8.8%; with a significant 71.7% increase in income from consumer finance activities. Commercial Banking assets overall increased by 25.3%; with consumer finance portfolio reaching BD 31.2 million, a 108.9% growth over 2011. Customer Deposits (including Equity of investment account holders and Murabaha from customers and current accounts) have also increased reaching BD 281.2 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 two new branches in Hidd and Riffa, taking the total number of branches to seven. The Bank continued to promote and market a full suite of Consumer Finance products including auto finance, personal finance, mortgage finance and visa branded credit cards. 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 of BD 2.5 million compared to 2011. Continuing a line of successful liability products, the Bank launched "Thabet" and "Advance Murabaha" accounts, which helped in attracting additional customer deposits, and 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 11 employees in 2012, 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 95.0% 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. Based on recommendations of experts the Bank made necessary changes to its corporate governance 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.

#### **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 2012, 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 has a continued commitment to expand these through the Bank's on-going programme of Corporate Social Responsibility.

#### **LOOKING AHEAD**

The Board believes that the recent challenges facing the banking sector will continue in 2013 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 four years, the Bank has taken several steps to diversify its assets, revenue streams and widen its customer base. The launch of the Bank's suite of consumer finance products and expansion of the 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; which includes viable acquisitions of other entities and asset portfolios as well

as forming strategic alliances or merger with other financial institutions. The Board will also 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 and First Deputy Prime Minister 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

## EXECUTIVE MANAGEMENT REPORT



**Mr. Silvan Varghese**  
Acting Chief Executive Officer  
& COO

**Mr. Fuad Ali Taqi**  
Deputy General Manager,  
Commercial Banking

**Mr. Mahdi Abdulnabi Mohammed**  
Assistant General Manager - Head  
of Operations & Administration

**Mr. T. N. Ramesan**  
Assistant General Manager - Head  
of Risk & Credit Management

2012 was a year that signaled positive signs of recovery for the Bank post 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, and reaching new customers through the opening of new branches 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

Despite operating in a difficult environment, we have progressed considerably in expanding our commercial banking business, the key focus area of growth for the Bank. We continued to build on

important milestones achieved in 2010 and 2011. We opened two more branches and expanded our retail product offering. We also expanded our retail and wholesale banking portfolios.

### RETAIL BANKING

The Bank now has a full range of retail products including personal, auto, and home financing as well as Visa branded credit and debit cards on the asset side and a range of liability products with varying tenor and risk characteristics. I am happy to report that these products were well received in the market and the consumer finance asset portfolio of the Bank currently stands at BD 31.2 Million, a growth of 108.9% over 2011.

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 2012. A total cash prize of USD 1 million was distributed to 240 winners over the 12

months of the program. In 2012, in addition to the cash prizes, a lucky investor also won a car as an additional prize.

During the year, we witnessed the expansion and diversification of our customer base and an increase in customer deposits. The Bank also launched new liability products called "Thabet" and "Advance Murabaha" Accounts both of which have been well received in the market, reaching targets within a very short period of time. Overall, our customer deposits including unrestricted investment accounts (URIA) grew by 1.4% to BD 281.2 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 to reach a new segment of the market

In line with our expansion strategy, the Bank opened two new branches, taking the total number of branches to seven. Each of the new branches in Rifa'a and Hidd's Lulu

market are strategically located, designed and staffed, to attract a large number of potential customers and to provide a comprehensive range of banking services.

### **CORPORATE AND WHOLESALE BANKING**

2012 continued to be a challenging year for corporates and businesses in Bahrain due to continuing effects of the global financial crisis. Key sectors such as real estate, construction and tourism continue to feel the reverberations of the crises and activity levels have not yet reached previous levels. Nevertheless, we continued to expand our business and the total corporate and whole sale banking assets stood at BD 238.3 Million a growth of 19.0% over 2011. During the year, we continued to nurture existing relationships while building new relationships and expanding business in the GCC especially UAE and Kuwait. In Bahrain we have actively promoted the Tamkeen scheme which we believe will provide us new opportunities in the future.

### **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 2013. While exit dates were extended for many of the Bank's investment products, the investment team continued to pursue all opportunities for exits.

### **ORGANIZATIONAL DEVELOPMENT**

During 2012, 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

believes 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.

Beyond the training of employees, the Bank continued to support the youth of the Bahrain by providing short term training opportunities for university and INJAZ students. KHCB is also a contributor and supporter to the Waqf Fund and INJAZ Bahrain.

### **CONCLUSION**

As with recent past, 2012 presented complex business challenges. Set against a backdrop of economic volatility, the financial sector in general and businesses in Bahrain in particular continue to be severely affected. However, in spite of these, the Bank has continued to move forward and is now well positioned to capitalize 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 a pleasure to extend our 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 2012.

## 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 organized 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, 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 approvals, setting limits and tolerances for different risks, 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 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.

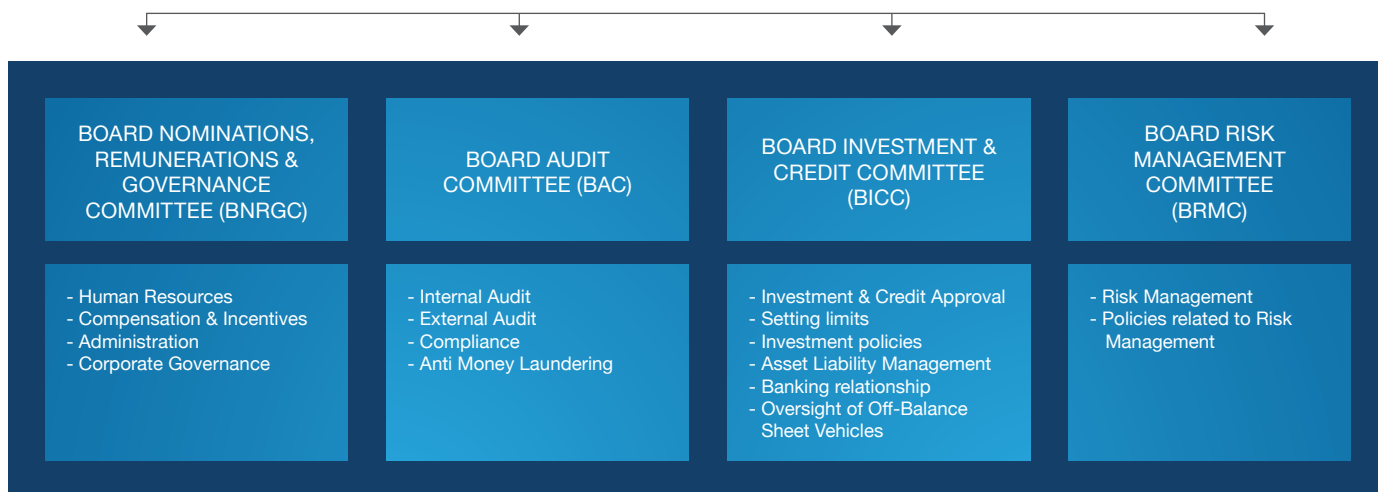
During 2012, the Board of Directors held 6 meetings, the Board Investment & Credit Committee held 7 meetings, the Board Nomination, Remuneration & Governance Committee held 4 meetings; the Board Risk Management Committee held 2 meetings and the Board Audit Committee held 2 meetings.

### EXECUTIVE MANAGEMENT COMMITTEES

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

**BOARD OF DIRECTORS**

**BOARD COMMITTEES**



**EXECUTIVE MANAGEMENT COMMITTEES**



## 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 retail clients, 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's past track record and financial position as well as 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 Management Department reviews every credit and investment proposal 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 a large 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 operations risk in the Bank. The Board has approved a detailed policy for the 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 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,

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\*Subject to terms and conditions and until quantity last



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\*Subject to Terms & Conditions

Thabet Murabaha Account



# 4.0%

Fixed Monthly Profit


Advance Murabaha Account

# 3.5%

Profit Before Capital

### Earn Falconflyer miles with our KHCB Credit Cards





KHCB in partnership with Gulf Air offers exclusive rewards to **earn Falconflyer miles** for every dinar you spend using KHCB's Credit Card.


Accumulate miles with your KHCB's card as follows:

Types of Card	Miles Earned
Classic	1 mile for every BD 1,500
Gold	1 mile for every BD 1,000
Platinum	1 mile for every BD 0,750

Enjoy the rewards your membership brings you.


- Shari'a compliant
- Lowest service fee
- Accepted worldwide
- Travel insurance coverage
- High security features



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 nonstandard 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 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. Such risk may also arise from litigation initiated by clients against the Bank and certain transactions. 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 forecasted balance sheets to identify the likely worst case scenarios which will help the Bank identify preventive management actions where necessary. The Risk Management Department conducts such stress tests twice in a year and the results are reported to the Board of Directors along with suggested remedial actions if 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 (CBB), Bahrain Stock Exchange 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 (CBB) are part of this annual report.

## SHARI'A SUPERVISORY BOARD REPORT

For the financial year ending 31 December 2012

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 31st December 2012 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 Balance Sheet, attached notes and Income Statement for the financial year ended on 31st December 2012 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.

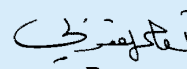
Prayers on Prophet Mohammed (Peace Be Upon Him), all his Family and companions.



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

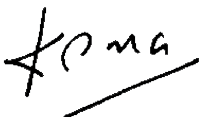
We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial 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.







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