

KHALEEJI COMMERCIAL BANK BSC

RISK MANAGEMENT DISCLOSURES

(Based on Basel 2 and IFSB guidelines)

30 June 2013

These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), Section PD-1.3: Disclosures in Annual Reports and PD-3.1.6 Semi-annual Disclosures, CBB Rule Book, Volume II for Islamic Banks. These disclosures should be read in conjunction with the detailed risk management disclosures made in the annual report for the year ended 31 December 2012, and the condensed consolidated interim financial information for the six months ended 30 June 2013.

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Khaleeji Commercial Bank BSC

Risk Management Disclosures for the six months ended 30 June 2013

Executive Summary

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

All figures presented in this section are reported in BD thousands and are as of 30 June 2013 unless otherwise stated.

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

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

The Banks total risk weighted assets as at 30 June 2013 amounted to BD 452,887 thousand. Credit risk accounted for 90 percent, operational risk 6 percent, and market risk 4 percent of the total risk weighted assets. Tier I and total regulatory capital were BD 119,219 thousand and BD 122,955 thousand, respectively, as at 30 June 2013.

At 30 June 2013, Bank's Tier I capital and total capital adequacy ratios were 26.32 percent and 27.15 percent, respectively.

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1 Group Structure

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

2 Capital Management and Capital Adequacy Ratio

2.1 Capital management

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

2.2 Capital structure, minimum capital requirements and capital adequacy

Following is the break-up of capital structure as at 30 June 2013:

BD 000's	
Net available capital	30 June 2013
Issued and fully paid ordinary shares	115,416
Less: Treasury shares	(6,060)
Statutory reserve	6,425
Share premium	1,535
Others reserves	(291)
Retained earning	2,194
Tier 1 capital	119,219
Current interim cumulative net profit	450
Collective provision	3,286
Tier 2 capital	3,736
Net available capital	122,955

	30 June 2013
Credit risk weight exposures	406,030
Market risk weight exposures	17,014
Operational risk weight exposures	29,843
Total risk weighted assets	452,887

Capital adequacy ratio (Tier 1 capital)	26.32%
Capital adequacy ratio (Total capital)	27.15%

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

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Break-up of capital requirement in accordance with the capital adequacy module of the CBB for the period ended 30 June 2013 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	3,313	-	3,313	-	-	-	-	-	-
Sovereigns	2,981	21,217	24,198	-	-	-	-	-	-
Banks	316	85,332	85,648	98	6,573	6,671	12	789	801
Corporates	79,582	141,302	220,884	79,582	42,391	121,973	9,550	5,087	14,637
Residential mortgage eligible for 75% RW	28,823	-	28,823	21,617	-	21,617	2,594	-	2,594
Past due facilities	41,159	-	41,159	56,985	-	56,985	6,838	-	6,838
Investments in equities/sukuk	29,706	9,858	39,564	44,559	4,436	48,995	5,347	532	5,879
Holdings of real estate	77,312	-	77,312	147,435	-	147,435	17,692	-	17,692
Other assets	2,354	-	2,354	2,354	-	2,354	282	-	282
Credit Risk	265,546	257,709	523,255	352,630	53,400	406,030	42,315	6,408	48,723
Market Risk	14,625	7,963	22,588	14,625	2,389	17,014	1,755	287	2,042
Operational Risk	29,843	-	29,843	29,843	-	29,843	3,581	-	3,581
Total	310,014	265,672	575,686	397,098	55,789	452,887	47,651	6,695	54,346

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

3 Credit Risk

3.1 Levels of exposure

Gross credit exposure along with average credit exposure broken down under different exposure classes as at 30 June 2013 is as follows:

	Average ^[1] Exposure	Gross Exposure		
		Self – Financed	IAH	Total
Cash and bank balances	27,807	6,289	26,557	32,846
Placement with financial institutions	72,835	-	71,980	71,980
Financing assets	245,631	108,584	141,431	250,015
Investment securities – Equity type	78,566	69,619	-	69,619
Investment securities – Debt type	12,270	-	17,740	17,740
Assets acquired for leasing(including lease rental receivables)	30,372	33,987	-	33,987
Investments in associates	2,887	2,887	-	2,887
Investment property	6,583	6,583	-	6,583
Other assets, including property and equipment	21,404	30,994	-	30,994
Total funded Credit Exposure	498,355	258,943	257,708	516,651
Financial guarantees	2,440	3,032	-	3,032
Undrawn commitments to extend finance	3,409	3,572	-	3,572
Total unfunded Credit Exposure	5,849	6,604	-	6,604

^[1] Represents quarterly average balances for the six months period ended 30 June 2013.

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Risk Management Disclosures for the six months ended 30 June 2013

3.2 Concentration of credit risk

3.2.1 Geographic distribution

The geographical exposure profile as at 30 June 2013 was as follows:

BD 000's

2013	GCC Countries	Europe	USA	Asia	Australia	Total
Assets						
Cash and bank balances	24,474	711	7,602	59	-	32,846
Placement with financial institutions	71,980	-	-	-	-	71,980
Financing assets	239,051	10,964	-	-	-	250,015
Investment securities	57,374	1,376	-	24,008	4,601	87,359
Assets acquired for leasing (including lease rentals receivable)	33,987	-	-	-	-	33,987
Investment in associates	2,887	-	-	-	-	2,887
Investment property	6,583	-	-	-	-	6,583
Other assets	21,230	765	-	357	43	22,395
Property and equipment	8,599	-	-	-	-	8,599
Total funded exposures	466,165	13,816	7,602	24,424	4,644	516,651
Guarantees	2,793	239	-	-	-	3,032
Undrawn financing facilities	3,412	160	-	-	-	3,572
Total unfunded exposures	6,205	399	-	-	-	6,604

3.2.2 Industry/ sector-wise distribution

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry/ sector wise exposure as at 30 June 2013 was as follows:

BD 000's

2013	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	32,846	-	-	32,846
Placements with financial institutions	71,980	-	-	71,980
Financing assets ^[1]	43,116	72,820	134,079	250,015
Investment securities	23,409	41,533	22,417	87,359
Assets acquired for leasing (including lease rentals receivable)	1,307	31,537	1,143	33,987
Investment in associates	-	2,887	-	2,887
Investment property	-	6,583	-	6,583
Other assets	316	20,741	1,338	22,395
Property and equipment	-	7,189	1,410	8,599
Total funded exposure	172,974	183,290	160,387	516,651
Guarantees	-	353	2,679	3,032
Undrawn financing facilities	-	793	2,779	3,572
Total unfunded exposures	-	1,146	5,458	6,604

^[1] Financing asset exposures have been classified based on the purpose of financing.

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3.2.3 Transactions with related counterparties

Related counterparties are those entities which are related to the Bank through significant shareholding, control, or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of related counterparties, the Bank strictly follows the guidelines issued by CBB for the purpose. Transactions with related parties during the six months period ended 30 June 2013 and balances outstanding pertaining to related parties is as follows:

	BD 000's				
30 June 2013	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	892	-	-	10,916	11,808
Investment securities	-	-	-	28,262	28,262
Investment in associates	2,887	-	-	-	2,887
Other assets	298	-	-	20,488	20,786
Liabilities					
Customers' current accounts	589	2	104	662	1,357
Equity of investment account holders	108	228	2,796	8,468	11,600

	BD 000's				
June 2013	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Management and other fees	-	-	-	800	800
Income from financing assets and assets acquired for leasing	51	-	-	231	282
Income from investment securities	-	-	-	1,109	1,109
Expenses					
Return to investment account holders	1	4	43	81	129
Staff cost	-	338	-	-	338
Other expenses	-	-	-	41	41

3.2.4 Exposures in excess of 15% of capital base

Single exposures in excess of 15% of the Bank's capital base on individual counterparties require prior approval of CBB except where exempted under Para. CM 4.5 of the rule book. The Bank does not have any such large exposures as at 30 June 2013.

3.2.5 Exposures in highly leveraged counterparties

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

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

The Bank's policy allows exposures up to a maximum period of 7 years for corporate customers and 25 years for retail customers with any exceptions to be approved by the Board of directors. The Bank constantly monitors the residual maturity profile of its assets to ensure that any mismatch with the maturity of its liabilities is kept within acceptable limits. The contractual residual maturity profile by type of financing contract of the Bank's credit portfolio and investment in sukuk in banking book 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	14,410	21,549	4,828	7,483	51,134	47,091	26,443	-	-	172,938
Musharaka	1,670	-	1,253	15,171	15,220	17,608	1,839	-	-	52,761
Wakala	4,155	4,851	3,377	44	9,925	1,479	-	-	-	23,831
Istisna	-	-	-	-	485	-	-	-	-	485
Ijarah	-	-	11	-	3,440	1,260	8,223	17,129	3,924	33,987
Total	20,235	26,400	9,469	22,698	80,204	67,438	36,505	17,129	3,924	284,002
Investment in sukuk- banking book	1,904	2,905	2,222	-	1,880	4,180	4,649	-	-	17,740
Total	1,904	2,905	2,222	-	1,880	4,180	4,649	-	-	17,740
Grand Total	22,139	29,305	11,691	22,698	82,084	71,618	41,154	17,129	3,924	301,742

3.3 Equity risk in banking book

The Bank has certain equity investments in the Banking book and they are subject to credit risk weighting under the capital adequacy framework.

Information on equity investments

BD 000's

Privately held

69,619

Dividend income

202

Realised gain during the period

1,909

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

BD 000's

Equity investments in banking book	Gross exposure		Risk weighted exposure		Capital requirement @ 12%	
	Self-financed	IAH	Self-financed	IAH	Self-financed	IAH
Unquoted equity investment	29,706	-	44,559	-	5,347	-
Real estate investment	39,913	-	79,826	-	9,579	-
Total	69,619	-	124,385	-	14,926	-

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

BD 000's

	GCC Countries	Europe	USA	Total
Impaired:				
3 months to 1 year	187	-	-	187
1 year to 3 years	19,781	-	-	19,781
More than 3 years	1,128	-	6,518	7,646
	21,096	-	6,518	27,614
Allowance for impairment:				
At 1 January 2013	7,128	-	6,518	13,646
Charge during the period	207	-	-	207
At 30 June 2013	7,335	-	6,518	13,853
Carrying amount	13,761	-	-	13,761
Past due but not impaired, including substandard:				
Up to 3 months	28,291	-	-	28,291
3 months to 1 year	2,573	-	-	2,573
More than 1 year	7,468	-	-	7,468
	38,332	-	-	38,332
Collective allowance *	3,095	129	-	3,224

BD 000's

	Banks and financial institutions	Real estate	Others	Total
Impaired:				
3 months to 1 year	-	-	187	187
1 year to 3 years	4,634	5,979	9,168	19,781
More than 3 years	-	7,646	-	7,646
	4,634	13,625	9,355	27,614
Allowance for impairment:				
At 1 January 2013	650	9,117	3,879	13,646
Charge/ (reversal) during the period	-	(485)	692	207
At 30 June 2013	650	8,632	4,571	13,853
Carrying amount	3,984	4,993	4,784	13,761
Past due but not impaired, including substandard:				
Up to 3 months	-	15,938	12,353	28,291
3 months to 1 year	-	1,292	1,281	2,573
More than 1 year	1,633	5,835	-	7,468
	1,633	23,065	13,634	38,332
Collective allowance *	477	1,172	1,575	3,224

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

3.5 Renegotiated facilities

Exposures classified as neither past due nor impaired financing facilities include facilities renegotiated during the period ended 30 June 2013 amounting to BD 19,137 thousand that otherwise might have become past due in future as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and / or part of the principal and / or obtaining of additional collateral coverage.

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3.6 Legal action and write off of exposures

The Bank has policies for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. The Bank as of 30 June 2013 was involved in four litigations for recovery of dues from clients amounting to BD 5,466 thousand. In addition, there are three claims brought by three of the clients against the Bank of BD 71 thousand which the Bank is defending. The Bank has made adequate provisions for any loss that may arise from such litigations.

The Bank has a policy that permits write-off of exposures when there is no possibility of recovery of the dues through legal and other means. So far there have not been any such write-offs.

3.7 Penalties for delayed payments

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

The Bank has a policy of creating a contribution for Charity and Zakah fund for any non-Islamic income earned. During the six months period ended 30 June 2013, an amount of BD 54 thousands was transferred to Charity and Zakah fund.

3.8 Credit risk mitigation

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 30 June 2013 is given in the table below:

BD 000's

Collateral Type	Murabaha	Musharaka	Wakala	Istisna	Ijara	Value of collateral ^[1]	Gross Exposure ^[2]	% of cover	% of Total
Real estate	144,920	89,219	7,981	2,301	55,570	299,991	161,495	186%	77%
Listed securities	493	5,091	-	-	-	5,584	1,892	295%	1%
Unlisted securities	5,166	-	7,540	-	-	12,706	8,752	145%	3%
Bank guarantee	34,996	-	-	-	-	34,996	30,438	115%	9%
Cash collateral	25,028	-	557	-	1,251	26,836	37,914	71%	7%
Others	9,269	1,716	-	-	-	10,985	7,754	142%	3%
Unsecured	-	-	-	-	-	-	52,834	0%	0%
Total	219,872	96,026	16,078	2,301	56,821	391,098	301,079	130%	100%

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

^[2] The amounts are gross of collective impairment allowance of BD 3,224 thousand and specific allowance of BD 13,853 thousand.

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the half year ended 30 June 2013 the Bank repossessed and sold collateral of BD 5 thousand.

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3.9 Regulatory capital requirements by type of financing contracts

BD 000's

Financing contracts	Exposure		Credit Risk Weighted Assets		Capital Requirement @ 12%	
	Self-financed	IAH	Self-financed	IAH	Self-financed	IAH
Murabaha	56,410	116,821	58,537	35,046	7,024	4,206
Ijara assets (including lease rentals receivable)	33,987	-	26,781	-	3,214	-
Musharaka	52,174	-	52,174	-	6,261	-
Wakala	-	24,131	-	7,239	-	869
Istisna	-	479	-	144	-	17
Total	142,571	141,431	137,492	42,429	16,499	5,092

4 Market Risk

4.1 Regulatory capital allocation against market rate risk

The table below shows the market risk position for each category of the market risk as at period ended 30 June 2013 along with the maximum and minimum values during the period:

BD 000's

	As at 30 June	Max	Min
Equity position risk	-	-	-
Market risk on trading positions in sukuk	637	1,151	637
Foreign exchange risk	1,170	1,170	1,140
Commodity risk	-	-	-
Total (A)	1,807	2,321	1,777
Risk Weighted Assets (A x 12.5)	17,014	18,941	16,639
Capital requirement @ 12%	2,042	2,273	1,997

5 Operational Risk

5.1 Regulatory capital allocation against operational risk

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

The risk weighted assets and capital requirement for operational risk as at 30 June 2013 is as given below:

BD 000's

Average gross income for 3 years (A)	15,916
Operational Risk Weighted Assets B = (A x 15% x 12.5)	29,843
Capital requirement (B x 12%)	3,581

6 Other Risks

6.1 Liquidity risk

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

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Maturity profile of assets and liabilities as at 30 June 2013 is as follows:

BD 000's

30 June 2013	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Assets						
Cash and bank balances	32,846	-	-	-	-	32,846
Placements with financial institutions	71,980	-	-	-	-	71,980
Financing assets	46,635	9,458	22,698	76,764	94,460	250,015
Investment securities	4,809	4,138	12,484	57,099	14,552	93,082
Assets acquired for leasing (including lease rental receivables)	-	11	-	3,440	30,536	33,987
Investment in associates	-	-	1,129	-	1,758	2,887
Investment properties	-	-	-	-	6,583	6,583
Other assets	20,086	-	-	2,309	-	22,395
Property and equipment	-	-	-	-	8,599	8,599
Total assets	176,356	13,607	36,311	139,612	156,488	522,374

Liabilities	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	Total
Placements from financial institutions	6,977	-	-	17,262	-	24,239
Placements from non-financial institutions and individuals	24,140	10,121	42,437	5,718	1,408	83,824
Customers' current accounts	25,813	61	-	-	-	25,874
Other liabilities	739	650	605	751	2,590	5,335
Total liabilities	57,669	10,832	43,042	23,731	3,998	139,272
Equity of Investment Account Holders	131,740	53,277	70,092	8,323	-	263,432
Restricted Investment accounts	-	-	21,892	9,212	-	31,104
Commitments	8,291	4,148	8,101	1,420	182	22,142

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

	June 2013	2012	2011	2010	2009
Interbank assets to interbank liabilities	354.93	95.70	189.43	113.72	137.02
Liquid assets to total assets	22.73	19.21	26.04	20.81	30.02
Liquid assets to total deposits	31.82	32.31	42.01	41.72	59.56
Net liquid assets to total deposits	25.33	8.23	25.63	10.50	22.00

Figures in %

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6.2 Profit rate risk in the banking book

A summary of the Bank's profit rate gap position at 30 June 2013 is as follows:

BD 000's

30 June 2013	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	71,980	-	-	-	-	71,980
Financing assets	46,635	9,458	22,698	76,764	94,460	250,015
Assets acquired for leasing (including lease rental receivables)	-	11	-	3,440	30,536	33,987
Investments securities (sukuks)	4,809	2,222	-	1,880	14,552	23,463
Total profit rate sensitive assets	123,424	11,691	22,698	82,084	139,548	379,445
Liabilities						
Placements from financial institutions	6,977	-	-	17,262	-	24,239
Placements from non-financial institutions and individuals	24,140	10,121	42,437	5,718	1,408	83,824
Investors funds	92	61	-	-	-	153
Equity of investment account holders	131,740	53,277	70,092	8,323	-	263,432
Total profit rate sensitive liabilities	162,949	63,459	112,529	31,303	1,408	371,648
Profit rate gap	(39,525)	(51,768)	(89,831)	50,781	138,140	7,797

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

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

	50 bp increase/ decrease	100 bp parallel increase/ decrease
At 31 June 2013		± 78
At 31 December 2012	± 39	± 18
	± 9	

6.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit markets transactions (primarily interbank placements), the Bank has established a matrix of counterparty limits based on external credit rating of such counterparties. Such limits are constantly monitored by the Banks Risk Management Department. As at 30 June 2013, the Bank did not have any open position in foreign currency risk management instruments.

6.4 Concentration risk

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

6.5 Reputational risk

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

6.6 Displaced commercial risk

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

6.7 Other risks

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

7 Compliance Disclosure

During the period, a penalty of BD 900 was imposed by the CBB for delay in submission of management letter and for certain erroneously opened accounts in the Bahrain Credit Reference Bureau system.

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8 Financial Performance

Following are basic quantitative indicators of the financial performance:

(Annualised rates)

	June 2013	2012	2011	2010	2009
Return on average equity	0.42%	0.64%	0.44%	(5.24)%	2.39%
Return on average assets	0.20%	0.18%	0.13%	(1.67)%	0.70%
Finance income to finance expense	172.51%	201.89%	208.06%	240.21%	155.66%
Cost-to-Income-Ratio*	80.34%	84.54%	72.11%	83.79%	48.30%

* Cost has been considered excluding impairment allowances.

9 Product Disclosures

9.1 Equity of investment account holders (IAH's)

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

BD 000's

	June 2013	2012	2011	2010	2009
Allocated income to IAH	5,583	9,923	9,022	8,254	11,103
Distributed profit	3,595	6,297	6,629	5,785	9,331
Mudarib fees	1,988	3,626	2,393	2,469	1,772
As at 30 June					
IAH ^[1]	214,851	193,245	183,915	192,439	184,394
Profit Equalisation Reserve (PER)	-	-	-	169	1,209
Investment Risk Reserve (IRR)	-	-	-	-	925
Profit Equalisation Reserve-to-IAH (%)	-	-	-	0.09%	0.66%
Investment Risk Reserve-to-IAH (%)	-	-	-	-	0.50%

^[1] Represents average balance

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

BD 000's

Mudaraba Tenor	Profit distribution amount in BD					Ratio of profit paid as a percentage of total				
	June 2013	2012	2011	2010	2009	June 2013	2012	2011	2010	2009
1 Month ^[2]	676	1,629	1,824	3,107	4,271	18.8	25.9	27.5	53.7	45.8
3 Months	320	655	1,489	1,843	1,443	8.9	10.4	22.5	31.9	15.5
6 Months	320	474	764	641	736	8.9	7.5	11.5	11.1	7.9
12 Months	1,561	2,998	2,014	1,452	1,196	43.4	47.6	30.4	25.1	12.8
24 Month Mudaraba	142	30	-	-	-	4.0	0.5	-	-	-
VIP	576	511	707	729	673	16.0	8.1	10.7	12.6	7.2
PER and IRR expenses	-	-	(169)	(1,987)	1,012	-	-	(2.6)	(34.4)	10.8
Total	3,595	6,297	6,629	5,785	9,331	100.0	100.0	100.0	100.0	100.0

^[2] Includes saving account products.

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Distribution of profits by type of IAH products:

(Annualised rates)

Year	Avg. profit earned from IAH assets (%age of asset)	PER set aside as a %age of IAH assets	IRR set aside as a %age of IAH assets	Mudharib fees as a %age of IAH assets	Profit paid as a %age of IAH assets
June 2013	5.20	-	-	1.85	3.35
2012	5.13	-	-	1.88	3.26
2011	4.99	-	-	1.22	3.69
2010	4.03	(0.54)	(0.49)	1.28	4.04
2009	6.09	0.30	0.24	0.96	4.58

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

(Annualised rates)

Type of deposit	June 2013	2012	2011	2010	2009
1 month Mudharaba ^[3]	2.07%	2.25%	2.51%	3.66%	4.00%
3 months Mudharaba	3.06%	3.08%	4.25%	4.13%	4.94%
6 months Mudharaba	3.49%	3.55%	4.52%	3.38%	5.30%
12 months Mudharaba	4.18%	4.46%	5.01%	4.94%	5.79%
24 months Mudharaba	5.02%	5.07%	-	-	-
VIP Mudharaba	3.85%	2.79%	3.67%	4.35%	4.20%

^[3] Includes saving account products.

Market benchmark rates:

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

IAH account by type of assets:

The following table summarises the movement in type of assets in which the IAH funds are invested and allocated among various type of assets for the year ended 30 June 2013:

Particular	Opening allocation	Movement	Closing allocation	Proportion of total assets (%)
Cash and bank balances	17,589	8,968	26,557	80.9%
Placements with financial institutions	57,525	14,455	71,980	100.0%
Financing assets ^[4]	128,948	12,484	141,432	56.6%
Investment securities - Sukuk	12,367	11,096	23,463	100.0%
Total	216,429	47,003	263,432	

^[4] Includes Murabaha, Wakala, and Istisna contracts.

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9.2 Restricted Investment Accounts (RIA's)

RIA name	Details	Launch date	Projecte d returns	Return frequenc y	Return annualized (%)				
					June 2013	201 2	2011	2010	2009
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
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 \approx 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

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RIA name	Details	Launch date	Projecte d returns	Return frequenc y	Return annualized (%)				
					June 2013	201 2	2011	2010	2009
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	-	-	-	-	-