KHALEEJI COMMERCIAL BANK BSC

RISK MANAGEMENT DISCLOSURES

(Based on Basel 2 and IFSB guidelines)

30 June 2014

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 2013, and the condensed consolidated interim financial information for the six months ended 30 June 2014.

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Executive Summary

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

All figures presented in this section are reported in BD thousands and are as of 30 June 2014 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 2014 amounted to BD 426,871 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 98,560 thousand and BD 102,655 thousand, respectively, as at 30 June 2014.

At 30 June 2014, Bank's Tier I capital and total capital adequacy ratios were 23.09 percent and 24.05 percent, respectively.

1 Group Structure

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

2 Capital Management and Capital Adequacy Ratio

2.1 Capital management

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

2.2 Capital structure, minimum capital requirements and capital adequacy

Following is the break-up of capital structure as at 30 June 2014:

BD 000's

Eligible capital	**30 June 2014**
Issued and fully paid ordinary shares	115,416
Less: Treasury shares	(6,060)
Statutory reserve	6,425
Share premium	1,535
Other reserves	(291)
Accumulated losses	(17,015)
Excess amount over maximum permitted large exposure limit	(1,450)
Tier 1 capital	**98,560**
Current interim cumulative net profit	1,201
Collective provision	4,344
Excess amount over maximum permitted large exposure limit	(1,450)
Tier 2 capital	**4,095**
Total eligible capital	**102,655**

	30 June 2014
Credit risk weight exposures	382,292
Market risk weight exposures	16,423
Operational risk weight exposures	28,156
Total risk weighted assets	**426,871**

Capital adequacy ratio (Tier 1 capital)	**23.09%**
Capital adequacy ratio (Total capital)	**24.05%**

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

Break-up of capital requirement in accordance with the capital adequacy module of the CBB for the period ended 30 June 2014 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	3,202	-	3,202	-	-	-	-	-	-
Sovereigns	4,840	36,153	40,993	-	-	-	-	-	-
Banks	-	88,892	88,892	-	7,746	7,746	-	930	930
Corporates	112,368	157,663	270,031	112,368	47,299	159,667	13,484	5,676	19,160
Residential mortgage eligible for 75% RW	34,721	-	34,721	26,041	-	26,041	3,125	-	3,125
Past due facilities	30,673	-	30,673	41,825	-	41,825	5,019	-	5,019
Investments in equities/sukuk	26,945	15,352	42,297	40,418	6,908	47,326	4,850	829	5,679
Holdings of real estate	52,507	-	52,507	97,835	-	97,835	11,740	-	11,740
Other assets	1,852	-	1,852	1,852	-	1,852	222	-	222
Credit Risk	**267,108**	**298,060**	**565,168**	**320,339**	**61,953**	**382,292**	**38,440**	**7,435**	**45,875**
Market Risk	14,038	7,950	**21,988**	14,038	2,385	**16,423**	1,685	286	**1,971**
Operational Risk	28,156	-	**28,156**	28,156	-	**28,156**	3,379	-	**3,379**
Total	**309,302**	**306,010**	**615,312**	**362,533**	**64,338**	**426,871**	**43,504**	**7,721**	**51,225**

*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 2014 is as follows:

BD000's

	Average [1] Exposure	Gross Exposure		
		Self – Financed	IAH	Total
Cash and bank balances	33,831	8,037	29,247	37,284
Placement with financial institutions	91,469	-	76,110	76,110
Financing assets	272,079	119,715	158,353	278,068
Investment securities – Equity type	66,216	61,362	4,949	66,311
Investment securities – Debt type	31,575	-	35,387	35,387
Assets acquired for leasing(including lease rental receivables)	38,759	39,187	-	39,187
Investments in associates	2,681	2,681	-	2,681
Investment property	6,718	6,583	-	6,583
Other assets, including property and equipment	24,476	17,373	-	17,373
Total funded Credit Exposure	**567,804**	**254,938**	**304,046**	**558,984**
Financial guarantees [2]	3,608	3,914	-	3,914
Undrawn commitments to extend finance [2]	9,125	8,256	-	8,256
Total unfunded Credit Exposure	**12,733**	**12,170**	**-**	**12,170**

[1] Represents quarterly average balances for the six month period ended 30 June 2014.
[2] Represents unfunded exposures amounts after considering their credit conversion factors.

3.2 Concentration of credit risk

3.2.1 Geographic distribution

The geographical exposure profile as at 30 June 2014 was as follows:

BD 000's

30 June 2014	GCC Countries	Europe	USA	Asia	Australia	Total
Assets						
Cash and bank balances	35,235	1,642	386	21	-	37,284
Placement with financial institutions	76,110	-	-	-	-	76,110
Financing assets	265,648	12,420	-	-	-	278,068
Investment securities	76,773	-	-	20,781	4,144	101,698
Assets acquired for leasing (including lease rentals receivable)	39,187	-	-	-	-	39,187
Investment in associates	2,681	-	-	-	-	2,681
Investment property	6,583	-	-	-	-	6,583
Other assets	8,673	-	-	418	-	9,091
Property and equipment	8,282	-	-	-	-	8,282
Total funded exposures	**519,172**	**14,062**	**386**	**21,220**	**4,144**	**558,984**
Guarantees	10,979	-	-	-	-	10,979
Undrawn financing facilities	28,591	-	-	-	-	28,591
Total unfunded exposures	**39,570**	**-**	**-**	**-**	**-**	**39,570**

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 30June 2014 was as follows:

BD 000's

30 June 2014	Banks and financial institutions	Real estate	Others	Total
Assets				
Cash and bank balances	37,284	-	-	37,284
Placements with financial institutions	76,110	-	-	76,110
Financing assets [1]	42,252	86,117	149,699	278,068
Investment securities	27,067	41,709	32,922	101,698
Assets acquired for leasing (including lease rentals receivable)	752	37,485	950	39,187
Investment in associates	-	2,681	-	2,681
Investment property	-	6,583	-	6,583
Other assets	-	1,646	7,445	9,091
Property and equipment	-	7,179	1,103	8,282
Total funded exposure	**183,465**	**183,400**	**192,119**	**558,984**
Guarantees	-	5,037	5,942	10,979
Undrawn financing facilities	-	7,541	21,050	28,591
Total unfunded exposures	**-**	**12,578**	**26,992**	**39,570**

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

3.2.3 Transactions with related counterparties

Related counterparties are those entities which are related to the Bank through significant shareholding, control, or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of related counterparties, the Bank strictly follows the guidelines issued by CBB for this purpose. Transactions with related parties during the six months period ended 30 June 2014 and outstanding balances pertaining to related parties are as follows:

BD 000's

30 June 2014	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Assets					
Financing assets	694	-	-	9,223	9,917
Investment securities	-	-	-	24,925	24,925
Investment in associates	2,681	-	-	-	2,681
Other assets	100	-	-	2,241	2,341
Liabilities					
Customers' current accounts	301	-	273	1,379	1,953
Equity of investment account holders	453	381	1,576	11,666	14,076

BD 000's

30 June 2014	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	-	-	-	705	705
Income from financing assets and assets acquired for leasing	51	-	-	190	241
Income from investment securities	-	-	-	(36)	(36)
Expenses					
Return to investment account holders	8	4	21	133	166
Staff cost	-	338	-	-	338
Other expenses	-	-	-	29	29

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 the CBB except where exempted under CM 4.5 of the rule book. As at 30 June 2014, the Bank had two large exposures that have been communicated to CBB:

Counterparty	Exposure type	Total exposure	Exposure as a % of eligible capital	Capital deduction amount
A	Financing	17,434	17%	1,600
B	Investment	17,133	16%	1,300

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).

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	7,488	20,675	6,177	36,272	43,846	63,958	32,194	-	-	210,610
Musharaka	4,344	-	-	1,930	27,880	11,684	947	-	-	46,785
Wakala	2,380	5,895	6,251	4,671	1,148	-	-	-	-	20,345
Istisna	-	-	-	-	328	-	-	-	-	328
Ijarah	-	1,840	-	-	1,128	2,434	8,491	20,432	4,862	39,187
Total	**14,212**	**28,410**	**12,428**	**42,873**	**74,330**	**78,076**	**41,632**	**20,432**	**4,862**	**317,255**
Investment in sukuk– banking book	3,338	6,920	6,880	-	2,092	4,608	8,627	1,885	-	34,350
Total	**3,338**	**6,920**	**6,880**	**-**	**2,092**	**4,608**	**8,627**	**1,885**	**-**	**34,350**
Grand Total	**17,550**	**35,330**	**19,308**	**42,873**	**76,422**	**82,684**	**50,259**	**22,317**	**4,862**	**351,605**

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	61,362
Dividend income	271
Realised loss during the period	(171)

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	26,945	-	40,418	-	4,850	-
Real estate investment	34,417	-	68,834	-	8,260	-
Total	**61,362**	**-**	**109,252**	**-**	**13,110**	**-**

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	4,491	-	-	**4,491**
1 year to 3 years	20,503	-	-	**20,503**
More than 3 years	2,739	-	-	**2,739**
	27,733	-	-	**27,733**
Allowance for impairment:				
At 1 January 2014	12,529	-	-	**12,529**
Charge during the period	(63)	-	-	**(63)**
At 30 June 2014	12,466	-	-	**12,466**
Carrying amount	**15,267**	**-**	**-**	**15,267**
Past due but not impaired, including substandard:				
Up to 3 months	17,247	-	-	**17,247**
3 months to 1 year	12,468	-	-	**12,468**
More than 1 year	913	-	-	**913**
	30,628	**-**	**-**	**30,628**
Collective allowance *	**4,168**	**176**	**-**	**4,344**

BD 000's

	Banks and financial institutions	Real estate	Others	Total
Impaired:				
3 months to 1 year	-	4,060	431	**4,491**
1 year to 3 years	408	12,207	7,888	**20,503**
More than 3 years	1,711	1,028	-	**2,739**
	2,119	17,295	8,319	**27,733**
Allowance for impairment:				
At 1 January 2014	1,454	4,005	7,070	**12,529**
Charge/ (reversal) during the period	-	-	(63)	**(63)**
At 30 June 2014	1,454	4,005	7,007	**12,466**
Carrying amount	**665**	**13,290**	**1,312**	**15,267**
Past due but not impaired, including substandard:				
Up to 3 months	-	4,598	12,649	**17,247**
3 months to 1 year	-	1,645	10,823	**12,468**
More than 1 year	-	913	-	**913**
	-	**7,155**	**23,472**	**30,628**
Collective allowance *	**-**	**101**	**4,243**	**4,344**

* 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 2014 amounting to BD 25,377 thousand that otherwise might have become past due in future as per their original repayment terms. The renegotiated terms usually require settlement of profits accrued till date on the facility and / or part of the principal and / or obtaining of additional collateral coverage.

3.6 Legal action and write off of exposures

The Bank has policies for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. As at 30 June 2014, the Bank was involved in twenty two litigations for recovery of dues from clients amounting to BD 7 million. In addition, there were four claims brought by four of the clients against the Bank of BD 58 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 2014, an amount of BD 65 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 2014 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	126,285	89,897	6,522	2,301	70,148	295,153	177,540	166%	77%
Listed securities	542	-	-	-	-	542	223	243%	0%
Unlisted securities	11,293	-	7,540	-	-	18,833	14,633	129%	5%
Bank guarantee	32,542	-	-	-	-	32,542	26,041	125%	8%
Cash collateral	27,257	-	584	-	380	28,221	41,418	68%	7%
Others	8,235	-	-	-	-	8,235	7,194	114%	2%
Unsecured	-	-	-	-	-	-	67,016	0%	0%
Total	**206,153**	**89,897**	**14,646**	**2,301**	**70,528**	**383,526**	**334,065**	**115%**	**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 4,344 thousand and specific allowance of BD 12,466 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 2014, the Bank repossessed and sold collateral of BD 22 thousand.

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	73,574	136,018	77,789	40,598	9,335	4,872
Ijara assets (including lease rentals receivable)	39,187	-	30,507	-	3,661	-
Musharaka	46,141	-	41,333	-	4,960	-
Wakala	-	22,012	-	7,201	-	864
Istisna	-	323	-	97	-	12
Total	**158,902**	**158,353**	**149,629**	**47,896**	**17,956**	**5,748**

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 2014 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	191	191	191
Foreign exchange risk	1,123	1,128	1,123
Commodity risk	-	-	-
Total (A)	**1,314**	**1,319**	**1,314**
Risk Weighted Assets (A x 12.5)	16,423	16,489	16,423
Capital requirement @ 12%	1,971	1,979	1,971

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 2014 is as given below:

BD 000's

Average gross income for 3 years (A)	15,016
Operational Risk Weighted Assets B = (A x 15% x 12.5)	28,156
Capital requirement (B x 12%)	3,379

6 Other Risks

6.1 Liquidity risk

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

Maturity profile of assets and liabilities as at 30 June 2014 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	37,284	-	-	-	-	**37,284**
Placements with financial institutions	76,110	-	-	-	-	**76,110**
Financing assets	40,782	12,428	42,873	73,202	108,783	**278,068**
Investment securities	10,258	6,880	12,628	2,471	69,461	**101,698**
Assets acquired for leasing (including lease rental receivables)	1,840	-	-	1,128	36,219	**39,187**
Investment in associates	-	-	-	1,038	1,643	**2,681**
Investment properties	-	-	-	-	6,583	**6,583**
Other assets	1,737	-	-	7,354	-	**9,091**
Property and equipment	-	-	-	-	8,282	**8,282**
Total assets	**168,011**	**19,308**	**55,501**	**85,193**	**230,971**	**558,984**

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	31,987	-	155	17,484	-	**49,626**
Placements from non-financial institutions and individuals	27,265	6,333	18,769	3,175	1,196	**56,738**
Customers' current accounts	41,054	424	-	-	-	**41,478**
Other liabilities	2,050	822	910	2,103	-	**5,885**
Total liabilities	**102,356**	**7,579**	**19,834**	**22,762**	**1,196**	**153,727**
Equity of Investment Account Holders	**129,072**	**49,909**	**124,716**	**349**	**-**	**304,046**
Restricted Investment accounts	**5,252**	**-**	**997**	**25,195**	**-**	**31,444**
Commitments	**17,612**	**4,665**	**14,741**	**943**	**1,609**	**39,570**

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

Figures in %

	June 2014	2013	2012	2011	2010
Interbank assets to interbank liabilities	179.12	222.39	95.70	189.43	113.72
Liquid assets to total assets	24.79	26.04	19.21	26.04	20.81
Liquid assets to total deposits	34.45	36.03	32.31	42.01	41.72
Net liquid assets to total deposits	22.12	25.08	8.23	25.63	10.50

6.2 Profit rate risk in the banking book

A summary of the Bank's profit rate gap position at 30 June 2014 is as follows:

BD 000's

30 June 2014	Up to 3 months	3 - 6 months	6 months - 1 year	1 - 3 years	More than 3 years	Total
Assets						
Placements with financial institutions	76,110	-	-	-	-	**76,110**
Financing assets	40,782	12,428	42,873	73,202	108,783	**278,068**
Assets acquired for leasing (including lease rental receivables)	1,840	-	-	1,128	36,219	**39,187**
Investments securities (sukuks)	10,258	6,880	-	2,471	20,726	**40,335**
Total profit rate sensitive assets	**128,990**	**19,308**	**42,873**	**76,801**	**165,728**	**433,700**
Liabilities						
Placements from financial institutions	31,987	-	155	17,484	-	**49,626**
Placements from non-financial institutions and individuals	27,265	6,333	18,769	3,175	1,196	**56,738**
Customers' current accounts *	635	424	-	-	-	**1,059**
Equity of investment account holders	129,072	49,909	124,716	349	-	**304,046**
Total profit rate sensitive liabilities	**188,959**	**56,666**	**143,640**	**21,008**	**1,196**	**411,469**
Profit rate gap	**(59,969)**	**(37,358)**	**(100,767)**	**55,793**	**164,532**	**22,231**

* Represents investors funds

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 2014	± 111	± 222
At 31 December 2013	± 77	± 153

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 2014, 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, there were no penalties imposed by the CBB.

8 Financial Performance

Following are basic quantitative indicators of the financial performance:

(Annualised rates)

	June 2014	2013	2012	2011	2010
Return on average equity	**2.38%**	(16.06)%	0.64%	0.44%	(5.24)%
Return on average assets	**0.41%**	(3.69)%	0.18%	0.13%	(1.67)%
Finance income to finance expense	**159.23%**	147.77%	201.89%	208.06%	240.21%
Cost-to-Income-Ratio*	**77.63%**	156.56%	84.54%	72.11%	83.79%

* 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 2014	2013	2012	2011	2010
Allocated income to IAH	5,910	13,315	9,923	9,022	8,254
Distributed profit *	4,819	8,719	6,297	6,629	5,785
Mudarib fees	1,091	4,596	3,626	2,393	2,469
As at 30 June					
IAH [1]	324,241	260,609	193,245	183,915	192,439
Profit Equalisation Reserve (PER)	-	-	-	-	169
Investment Risk Reserve (IRR)	-	-	-	-	-
Profit Equalisation Reserve-to-IAH (%)	-	-	-	-	0.09%
Investment Risk Reserve-to-IAH (%)	-	-	-	-	-

[1] Represents average balance
* Includes contribution towards deposit protection scheme

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 2014	**2013**	**2012**	**2011**	**2010**	**June 2014**	**2013**	**2012**	**2011**	**2010**
1 Month [2]	591	1,488	1,629	1,824	3,107	12.3	17.1	25.9	27.5	53.7
3 Months	233	680	655	1,489	1,843	4.8	7.8	10.4	22.5	31.9
6 Months	738	1,100	474	764	641	15.3	12.6	7.5	11.5	11.1
12 Months	2,326	3,606	2,998	2,014	1,452	48.3	41.4	47.6	30.4	25.1
18 Months	1	-	-	-	-	0.0	-	-	-	-
24 Month	46	228	30	-	-	0.9	2.6	0.5	-	-
VIP Mudaraba	884	1,617	511	707	729	18.4	18.5	8.1	10.7	12.6
PER and IRR expenses	-	-	-	(169)	(1,987)	-	-	-	(2.6)	(34.4)
Total	**4,819**	**8,719**	**6,297**	**6,629**	**5,785**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[2] Includes saving account and call mudaraba

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 2014	3.65	-	-	0.67	2.97
2013	5.11	-	-	1.76	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

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

(Annualised rates)

Type of deposit	June 2014	2013	2012	2011	2010
1 month Mudharaba [3]	1.38%	1.12%	2.25%	2.51%	3.66%
3 months Mudharaba	2.42%	2.98%	3.08%	4.25%	4.13%
6 months Mudharaba	3.20%	3.64%	3.55%	4.52%	3.38%
12 months Mudharaba	3.73%	4.27%	4.46%	5.01%	4.94%
18 months Mudharaba	3.30%	-	-	-	-
24 months Mudharaba	4.98%	5.07%	5.07%	-	-
VIP Mudharaba	3.78%	4.09%	2.79%	3.67%	4.35%

[3] Includes saving account and call mudaraba

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 2014:

Particular	Opening allocation	Movement	Closing allocation	Proportion of total assets (%)
Cash and bank balances	27,836	1,411	29,247	78.4%
Placements with financial institutions	82,745	(6,635)	76,110	100.0%
Financing assets [4]	152,336	6,017	158,353	56.9%
Investment securities - Sukuk	29,132	11,204	40,336	100.0%
Total	**292,049**	**11,997**	**304,046**	

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

9.2 Restricted Investment Accounts (RIA's)

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					June 2014	2013	2012	2011	2010
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	-	-	-	-	-
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 - J anayen	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

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					June 2014	2013	2012	2011	2010
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	-	-	-	-	-