

KHALEEJI COMMERCIAL BANK BSC

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

31 DECEMBER 2014

These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, and Volume II for Islamic Banks. To avoid any duplication, information required under PD module but already disclosed in other sections of annual report has not been reproduced. These disclosures are part of the annual report for the year ended 31 December 2014 and should be read in conjunction with the consolidated financial statements for the year ended 31 December 2014 and other sections of the annual report.

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Khaleeji Commercial Bank BSC

Risk Management Disclosures

EXECUTIVE SUMMARY

The Central Bank of Bahrain's ("CBB") Basel II guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports, of the CBB Rule Book, Volume II for Islamic Banks. Section PD-1.3 reflects the requirements of Basel II - Pillar III and the Islamic Financial Services Board's ("IFSB") recommended disclosures for Islamic banks.

The disclosures in this report are in addition to or in some cases, serve to clarify the disclosures set out in the consolidated financial statements for the year ended 31 December 2014, presented in accordance with the Financial Accounting Standards ("FAS") issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"). To avoid any duplication, information required under PD module but already disclosed in other sections of the annual report has not been reproduced in these disclosures.

All figures presented in this section are reported in Bahraini Dinars (in thousand) and are as of 31 December 2014 unless otherwise stated.

Khaleeji Commercial Bank BSC ("the Bank" or "KHCB") has adopted the Standardised Approach for Credit Risk and Market Risk and the Basic Indicator Approach for Operational Risk to determine its capital requirements, details of which are given in section 2. This section contains a description of the Bank's risk management and capital adequacy policies and practices including detailed quantitative information on risk components and capital adequacy.

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

The Banks total risk weighted assets as at 31 December 2014 amounted to BD 450,894 thousand. Credit risk accounted for 89.1%, market risk 3.7%, and operational risk 7.2% of the total risk weighted assets. Tier I and total regulatory capital were BD 102,133 thousand and BD 105,130 thousand respectively as at 31 December 2014.

At 31 December 2014, Bank's Tier I and total adequacy ratios were 22.65% and 23.32% respectively.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

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 INTRODUCTION TO BASEL II & RISK MANAGEMENT

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

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

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

Pillar I

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

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

| Risk Type | Approach used by the Bank |
|------------------|----------------------------------|
| Credit Risk | Standardised Approach |
| Market Risk | Standardised Approach |
| Operational Risk | Basic Indicator Approach |

Pillar II

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

Pillar II comprises two processes:

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

The Bank has in place ICAAP procedures for computation of economic capital for all risks including those not covered under Pillar I. The Bank regularly monitors its internal capital adequacy ratio to ensure that there is adequate cover for all risks faced by the Bank.

2 INTRODUCTION TO BASEL II & RISK MANAGEMENT (continued)

Pillar III

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

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

2.1 The risk management function

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

The Board has established an Executive Risk Management Committee ("ERMC"), which is responsible for developing and monitoring Bank risk management policies in the specified areas. The committee consists of heads of business and other functional units in the Bank and reports regularly to the BARMC. The committee meets on a monthly basis as per set agenda and its Terms of Reference covering all risk issues and policy matters.

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

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

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

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

All policies having significant impact on the overall internal control framework existing in the Bank are subject to periodic review and approval by the Board of Directors.

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

3 CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO

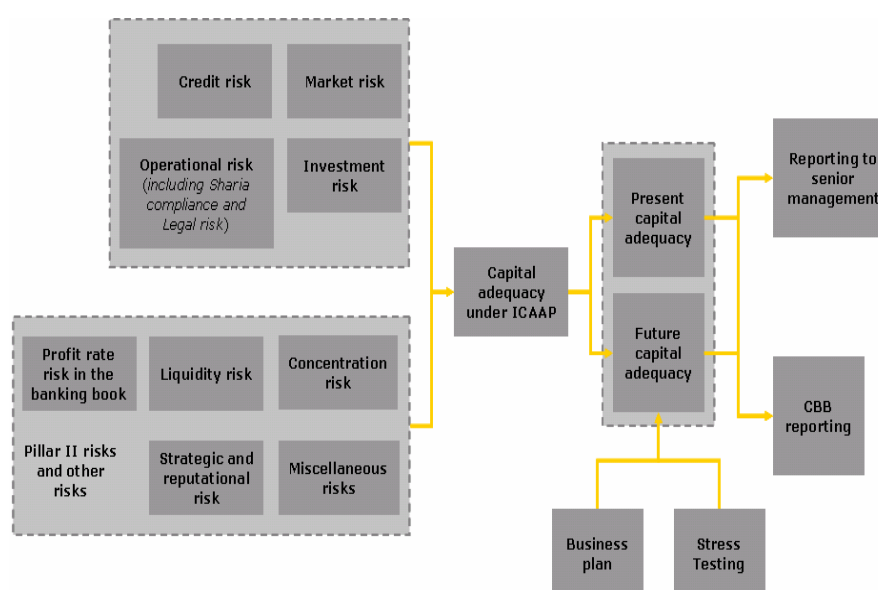
3.1 Capital management

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

3.2 Internal Capital Adequacy Assessment Process ("ICAAP")

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

ICAAP framework at the Bank



3.2.1 Risk addressed by the ICAAP

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

3 CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (continued)

3.3 Capital structure, minimum capital requirements and capital adequacy

During the year, the paid up capital of the Bank has remained the same amounting to BD 115,416 thousand. Following is the break-up of capital structure as at 31 December 2014:

| | |
|--|-------------------------|
| NET AVAILABLE CAPITAL | 31 December 2014 |
| Issued and fully paid ordinary shares | 115,416 |
| Less: Treasury shares | (6,351) |
| Statutory reserve | 6,728 |
| Share premium | 1,535 |
| Accumulated losses | (14,273) |
| Less regulatory deduction: Excess amount over maximum permitted large exposure limit | (922) |
| Tier I capital | 102,133 |
| Collective impairment loss provision | 3,919 |
| Less regulatory deduction: Excess amount over maximum permitted large exposure limit | (922) |
| Tier II capital | 2,997 |
| Net available capital | 105,130 |
| RISK WEIGHTED ASSETS | 31 December 2014 |
| Credit risk weight exposures | 401,749 |
| Market risk weight exposures | 16,486 |
| Operational risk weight exposures | 32,659 |
| Total risk weighted assets | 450,894 |
| Capital adequacy ratio (Tier I) | 22.65% |
| Capital adequacy ratio (Total capital) | 23.32% |

The above capital adequacy ratios are calculated by dividing the respective regulatory capital base by the total RWA's.

Regulatory capital components

The above components of Tier I and Tier II capital are as per the relevant CBB guidelines. According to these, Tier II capital is restricted to 100% of Tier I capital after all deductions of investments pursuant to PCD module of CBB rule book. As at 31 December 2014, the Bank has deducted BD 1,844 thousand related to excess amount over maximum permitted large exposure limit in line with the PCD module.

Risk weighted assets

Credit risk

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

3 CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (continued)

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

Market risk

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

Operational risk

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

3 CAPITAL MANAGEMENT & CAPITAL ADEQUACY RATIO (continued)

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

Break-up of capital requirement in accordance with the Capital Adequacy Module of the CBB for the year ended 31 December 2014 is as follows:

| Exposure classification | Exposure | | | Risk Weighted Assets * | | | Capital requirement @ 12% | | |
|-------------------------------|----------------|----------------|----------------|------------------------|---------------|----------------|---------------------------|--------------|---------------|
| | Self-financed | IAH | Total | Self-financed | IAH | Total | Self-financed | IAH | Total |
| Cash and collection items | 2,550 | - | 2,550 | - | - | - | - | - | - |
| Sovereigns | 5,349 | 28,151 | 33,500 | - | - | - | - | - | - |
| Banks | - | 84,303 | 84,303 | - | 8,094 | 8,094 | - | 971 | 971 |
| Corporates | 113,359 | 201,157 | 314,516 | 113,359 | 60,347 | 173,706 | 13,603 | 7,242 | 20,845 |
| Residential mortgage | 42,804 | - | 42,804 | 32,103 | - | 32,103 | 3,852 | - | 3,852 |
| Past due facilities | 18,852 | - | 18,852 | 24,848 | - | 24,848 | 2,982 | - | 2,982 |
| Investment in equities/sukuks | 26,719 | 19,964 | 46,683 | 40,079 | 8,984 | 49,063 | 4,810 | 1,078 | 5,888 |
| Holdings of real estate | 59,482 | - | 59,482 | 111,795 | - | 111,795 | 13,415 | - | 13,415 |
| Other assets | 2,140 | - | 2,140 | 2,140 | - | 2,140 | 257 | - | 257 |
| Credit Risk | 271,255 | 333,575 | 604,830 | 324,324 | 77,425 | 401,749 | 38,919 | 9,291 | 48,210 |
| Market Risk | 14,413 | 6,913 | 21,326 | 14,413 | 2,073 | 16,486 | 1,730 | 249 | 1,979 |
| Operational Risk | 32,659 | - | 32,659 | 32,659 | - | 32,659 | 3,919 | - | 3,919 |
| Total | 318,327 | 340,488 | 658,815 | 371,396 | 79,498 | 450,894 | 44,568 | 9,540 | 54,108 |

* For capital adequacy computations, 100% of the RWA's is reckoned for self-financed assets while only 30% is considered for assets funded through equity of IAH.

4 CREDIT RISK

4.1 Credit risk management

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

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

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

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

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

4 CREDIT RISK (continued)

4.1 Credit risk management (continued)

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

4.2 Levels of exposure

The table below shows gross credit exposure along with average credit exposure broken down under different exposure classes as at 31 December 2014:

| Gross/ Average Credit Exposures | Average Exposure ¹ | Gross Exposure | | |
|--|-------------------------------|----------------|----------------|----------------|
| | | Self-financed | IAH | Total |
| Cash and bank balances ² | 37,272 | 7,684 | 29,674 | 37,358 |
| Placement with financial institutions | 85,825 | - | 76,006 | 76,006 |
| Financing assets | 280,486 | 106,667 | 197,276 | 303,943 |
| Investment securities – Equity type | 66,155 | 60,945 | 4,961 | 65,906 |
| Investment securities – Debt type | 31,292 | - | 31,017 | 31,017 |
| Assets acquired for leasing (including lease rentals receivable) | 40,974 | 43,779 | - | 43,779 |
| Investments in associates | 2,636 | 2,604 | - | 2,604 |
| Investment property | 8,366 | 13,715 | - | 13,715 |
| Other assets, including property and equipment | 20,892 | 17,596 | - | 17,596 |
| Total funded exposures | 573,898 | 252,990 | 338,934 | 591,924 |
| Financial guarantees | 4,245 | 5,465 | - | 5,465 |
| Undrawn commitments to extend finance | 10,411 | 12,801 | - | 12,801 |
| Total unfunded exposures³ | 14,656 | 18,266 | - | 18,266 |

¹ Represents quarterly average balances for the year ended 31 December 2014.

² Includes cash balance of BD 2,550 thousand.

³ Unfunded exposures are reported at cash conversion factors (CCF).

4 CREDIT RISK (continued)

4.3 Concentration of credit risk

4.3.1 Geographic distribution

The geographical exposure profile as at 31 December 2014 was as follows:

| 31 December 2014 | GCC Countries | Europe | America | Asia | Australia | Total |
|--|----------------|---------------|--------------|---------------|--------------|----------------|
| Assets | | | | | | |
| Cash and bank balances | 33,833 | 1,256 | 2,251 | 18 | - | 37,358 |
| Placement with financial institutions | 76,006 | - | - | - | - | 76,006 |
| Financing assets | 272,720 | 23,158 | - | 8,065 | - | 303,943 |
| Investment securities | 71,181 | - | - | 21,824 | 3,918 | 96,923 |
| Assets acquired for leasing (including lease rentals receivable) | 43,598 | 54 | - | 127 | - | 43,779 |
| Investment in associates | 2,604 | - | - | - | - | 2,604 |
| Investment property | 13,715 | - | - | - | - | 13,715 |
| Other assets | 7,837 | 738 | - | 504 | - | 9,079 |
| Property and equipment | 8,517 | - | - | - | - | 8,517 |
| Total funded exposures | 530,011 | 25,206 | 2,251 | 30,538 | 3,918 | 591,924 |
| Financial guarantees | 14,902 | - | - | - | - | 14,902 |
| Undrawn commitments to extend finance | 41,086 | 12 | - | - | - | 41,098 |
| Total unfunded exposures | 55,988 | 12 | - | - | - | 56,000 |

4.3.2 Industry/ sector-wise distribution

The Board of Directors has stipulated maximum exposures to various industry sectors. The industry/ sector wise exposure as at 31 December 2014 was as follows:

| 31 December 2013 | Banks and financial institutions | Real estate | Others | Total |
|--|----------------------------------|----------------|----------------|----------------|
| Assets | | | | |
| Cash and bank balances | 37,358 | - | - | 37,358 |
| Placements with financial institutions | 76,006 | - | - | 76,006 |
| Financing assets * | 41,285 | 114,411 | 148,247 | 303,943 |
| Investment securities | 26,537 | 42,614 | 27,772 | 96,923 |
| Assets acquired for leasing (including lease rentals receivable) | 501 | 43,211 | 67 | 43,779 |
| Investment in associates | - | 2,604 | - | 2,604 |
| Investment property | - | 13,715 | - | 13,715 |
| Other assets | - | 1,768 | 7,311 | 9,079 |
| Property and equipment | - | 7,169 | 1,348 | 8,517 |
| Total funded exposure | 181,687 | 225,492 | 184,745 | 591,924 |
| Financial guarantees | - | 10,237 | 4,665 | 14,902 |
| Undrawn commitments to extend finance | - | 5,804 | 35,294 | 41,098 |
| Total unfunded exposures | - | 16,041 | 39,959 | 56,000 |

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

4 CREDIT RISK (continued)

4.3 Concentration of credit risk (continued)

4.3.3 Transactions with related counterparties

Related counterparties are those entities which are related to the Bank through significant shareholding, control, or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of related counterparties, the Bank strictly follows the guidelines issued by CBB for the purpose. Detailed break up is presented in note 23 of the consolidated financial statements for the year ended 31 December 2014.

4.3.4 Exposures in excess of 15% of capital base

Single exposures in excess of 15% of the Bank's capital base on individual counterparties require prior approval of the CBB except where exempted under CM 4.5 of the rule book. As at 31 December 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 | Investment | 17,158 | 16% | 1,112 |
| B | Financing | 16,779 | 16% | 732 |

4.3.5 Exposures in highly leveraged counterparties

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

4.3.6 Residual contractual maturity of the credit portfolio and investment in sukuk

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 is given in the table below:

| 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 | 3,975 | 38,940 | 13,855 | 16,833 | 44,951 | 69,012 | 43,929 | - | - | 231,495 |
| Musharaka | - | 954 | 661 | 3,503 | 27,762 | 3,949 | - | - | - | 36,829 |
| Mudharaba | - | - | - | - | - | - | - | 512 | - | 512 |
| Wakala | 3,222 | 5,573 | 8,683 | - | 913 | 16,498 | - | - | - | 34,889 |
| Istisna | - | - | - | - | 218 | - | - | - | - | 218 |
| Ijarah | - | - | - | 531 | 829 | 428 | 9,786 | 25,068 | 7,137 | 43,779 |
| Total | 7,197 | 45,467 | 23,199 | 20,867 | 74,673 | 89,887 | 53,715 | 25,580 | 7,137 | 347,722 |
| Investment in Sukuk | 35,978 | - | - | - | - | - | - | - | - | 35,978 |
| Grand Total | 43,175 | 45,467 | 23,199 | 20,867 | 74,673 | 89,887 | 53,715 | 25,580 | 7,137 | 383,700 |

The Board approved internal cap for real estate exposure at 40% of total assets. The Bank's real estate exposure as of 31 December 2014 and 2013 are within the policy limit.

4 CREDIT RISK (continued)

4.4 Equity risk in banking book

The Bank has certain equity investments classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. For regulatory capital computation purposes, the Bank's equity investments in the banking book include quoted/unquoted equity investments, and investments in associates being non-financial entities.

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

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

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

Information on equity investments

| | |
|-------------------------------|--------|
| Privately held | 60,945 |
| Dividend income | 271 |
| Realised loss during the year | 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:

| Equity investments in banking book | Gross exposure | | Risk weighted exposure | | Capital charge (@12%) | |
|------------------------------------|----------------|----------|------------------------|----------|-----------------------|----------|
| | Self-financed | IAH | Self-financed | IAH | Self-financed | IAH |
| Unquoted equity investment | 26,719 | - | 40,079 | - | 4,810 | - |
| Real estate investment | 34,226 | - | 68,452 | - | 8,214 | - |
| Total | 60,945 | - | 108,531 | - | 13,024 | - |

4.5 Risk grading of exposures

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

4 CREDIT RISK (continued)

4.5 Risk grading of exposures (continued)

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

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

Please refer to note 31 of the consolidated financial statements for the year ended 31 December 2014, for details of the grading profile of credit exposures of the Bank.

4.6 Past dues, impaired accounts, provisions

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

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

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

For a detailed policy on impairment of financial assets, please refer to note 2 (l) of the consolidated financial statements for the year ended 31 December 2014.

For the quantitative disclosures relating to exposures which were past due or impaired as of 31 December 2014, please refer to note 31 of the consolidated financial statement for the year ended 31 December 2014.

During the year 2014, the Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In addition, the Bank has maintained a collective provision at a certain percentage of unimpaired assets based on the internal risk grades assigned to counterparties. The total collective provision thus maintained works out to approximately 1.08% of its financing assets, assets acquired for leasing, and lease rentals receivable. This practice is in line with the CBB requirements and the industry best practice in Bahrain.

For movement in provisions on financing assets and investment securities, please refer to notes 5 and 6, respectively, of the consolidated financial statement for the year ended 31 December 2014.

4 CREDIT RISK (continued)

4.6 Past dues, impaired accounts, provisions (continued)

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

| | GCC Countries | Europe | Asia | Total |
|--|----------------------|---------------|-------------|---------------|
| Impaired: | | | | |
| 3 months to 1 year | 9,177 | - | - | 9,177 |
| 1 year to 3 years | 6,351 | - | - | 6,351 |
| More than 3 years | 5,007 | - | - | 5,007 |
| | 20,535 | - | - | 20,535 |
| Less: specific impairment allowance: | | | | |
| At 1 January 2014 | 12,529 | - | - | 12,529 |
| Charge during the year | 129 | - | - | 129 |
| Write back during the year | - | - | - | - |
| Write off during the year | (2,466) | - | - | (2,466) |
| At 31 December 2014 | 10,192 | - | - | 10,192 |
| Carrying amount | 10,343 | - | - | 10,343 |
| Past due but not impaired, including substandard: | | | | |
| Up to 3 months | 33,707 | - | - | 33,707 |
| 3 months to 1 year | 1,888 | - | - | 1,888 |
| More than 1 year | 190 | - | - | 190 |
| | 35,785 | - | - | 35,785 |
| Collective impairment allowance * | 3,543 | 278 | 98 | 3,919 |

| | Banks and financial institutions | Real estate | Others | Total |
|--|---|--------------------|---------------|---------------|
| Impaired: | | | | |
| 3 months to 1 year | 1,278 | 6,212 | 1,687 | 9,177 |
| 1 year to 3 years | 408 | 5,000 | 943 | 6,351 |
| More than 3 years | - | 1,004 | 4,003 | 5,007 |
| | 1,686 | 12,216 | 6,633 | 20,535 |
| Less: specific impairment allowance: | | | | |
| At 1 January 2014 | 1,454 | 6,145 | 4,930 | 12,529 |
| Charge during the year | (279) | 117 | 291 | 129 |
| Write back during the year | - | - | - | - |
| Write off during the year | - | (2,466) | - | (2,466) |
| At 31 December 2014 | 1,175 | 3,796 | 5,221 | 10,192 |
| Carrying amount | 511 | 8,420 | 1,412 | 10,343 |
| Past due but not impaired, including substandard: | | | | |
| Up to 3 months | - | 18,536 | 15,171 | 33,707 |
| 3 months to 1 year | - | 653 | 1,235 | 1,888 |
| More than 1 year | - | 190 | - | 190 |
| | - | 19,379 | 16,406 | 35,785 |
| Collective impairment allowance * | 480 | 1,742 | 1,697 | 3,919 |

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

4.7 Renegotiated facilities

For disclosure of renegotiated loans, please refer to note 31 of the consolidated financial statements for the year ended 31 December 2014.

4.8 Legal action and write-off of exposures

The Bank has policy for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. As of 31 December 2014, the Bank was involved in eleven litigations for recovery of dues from clients amounting to BD 51 thousand. In addition, there were claims by five of the clients against the Bank amounting to BD 84 thousand in relation to restricted investment accounts and customer accounts.

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.

4.9 Penalties for delayed payments

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

The Bank has a policy of creating a contribution for Charity and Zakah fund for any non-Islamic income earned. During the year ended 31 December 2014, an amount of BD 89 thousand was thus transferred to Charity and Zakah fund.

For quantitative disclosures, please refer to consolidated statement of sources and uses of charity and Zakah fund in the consolidated financial statements for the year ended 31 December 2014.

4.10 Credit risk mitigation

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

The position of collateral cover for all credit exposures categorised on the basis of the type of security as on 31 December 2014 is given in the table below:

| Collateral Type | Murabaha | Musharaka | Mudharaba | Wakala | Istisna | Ijara | Value of collateral¹ | Gross Exposure² | % of cover | % of Total |
|------------------------|-----------------|------------------|------------------|---------------|----------------|---------------|--|-----------------------------------|-------------------|-------------------|
| Real estate | 136,168 | 75,123 | 314 | 6,126 | 2,688 | 81,129 | 301,548 | 170,925 | 176% | 79% |
| Listed securities | 542 | - | - | - | - | - | 542 | 255 | 213% | 0% |
| Unlisted securities | 11,136 | - | - | - | - | - | 11,136 | 9,418 | 118% | 3% |
| Bank guarantee | 32,542 | - | - | - | - | - | 32,542 | 23,891 | 136% | 9% |
| Cash collateral | 29,756 | - | - | 597 | - | - | 30,353 | 48,397 | 63% | 8% |
| Others | - | - | - | - | - | - | - | 105,165 | 0% | 0% |
| Unsecured | 4,589 | - | - | - | - | - | 4,589 | 3,782 | 121% | 1% |
| Total | 214,733 | 75,123 | 314 | 6,723 | 2,688 | 81,129 | 380,710 | 361,833 | 105% | 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 facility.

² The amounts are gross of collective impairment allowance of BD 3,919 thousand and specific impairment allowance of BD 10,192 thousand.

4 CREDIT RISK (continued)

4.10 Credit risk mitigation (continued)

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

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

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

The declared value of exposures in all cases is the gross exposure before any provisions. The Bank does not carry out any on or off balance sheet netting for the securities held. The Bank has not claimed any capital relief for Credit Risk Mitigation under Section CA 4.7 of the Capital Adequacy Module of CBB rule book and hence all exposures are risk weighted at their gross values for the purpose of computation of capital adequacy ratio.

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the year ended 31 December 2014, the Bank repossessed and sold certain vehicles to recover an amount of BD 24 thousand. Further, in 2014, the Bank enforced collaterals of three non-performing financing facilities by transfer of ownership of three land plots and thirteen villas in the name of the Bank (refer note 9 of the financial statements).

4.11 Regulatory capital requirements by type of financing contracts

| Financing contract | Exposure | | Credit Risk Weighted Assets | | Capital Requirement @ 12% | |
|---|----------------|----------------|-----------------------------|---------------|---------------------------|--------------|
| | Self-financed | IAH | Self-financed | IAH | Self-financed | IAH |
| Murabaha | 69,610 | 160,805 | 73,705 | 48,055 | 8,845 | 5,767 |
| Ijara assets (including lease rentals receivable) | 43,779 | - | 33,078 | - | 3,969 | - |
| Musharaka | 36,545 | - | 38,446 | - | 4,614 | - |
| Mudharaba | 512 | - | 512 | - | 61 | - |
| Wakala | - | 36,256 | - | 10,877 | - | 1,305 |
| Istisna | - | 215 | - | 65 | - | 8 |
| Total | 150,446 | 197,276 | 145,741 | 58,997 | 17,489 | 7,080 |

5 MARKET RISK

5.1 Market risk management

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

Khaleeji Commercial Bank BSC

Risk Management Disclosures

5 MARKET RISK (continued)

5.1 Market risk management (continued)

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

In 2012, the Bank had commenced trading in Sukuks on a very selective basis. To begin with trading will be restricted to listed and traded sukuks issued by sovereign/ quasi sovereign entities or by other GCC issuers with an investment grade rating from Moody's or S&P. The size of the trading book at the end of the year was BD 5,359 thousand.

The sukuk risk is monitored by marking to market of the portfolio on a daily basis. The size of the portfolio and more importantly the number of instruments is too small for any statistical model to be reliable.

The Bank has formulated a comprehensive Sukuk Trading and Sukuk Fund Participation policy duly approved by the Board of Directors. The primary objective being trading in Sukuks and participation in Sukuk funds and or other fixed income Shari'a compliant structured products as a part of Treasury Business. The policy sets clear guidelines for Sukuk Trading and participation in Sukuk funds, limits, Target market, sectors, country, tenor, Stop loss triggers and actions and reporting. The portfolio is monitored on a mark to mark basis and reported to the ALCO.

In 2014, the Board of Directors have approved a comprehensive policy for Investments in listed Equity through managed 3rd party funds or discretionary portfolio with the aim of maximizing return within certain set parameters and limits. Such investments are governed by the overall risk appetite of the bank, regions, acceptable returns, target markets, sectors, stop loss limits and triggers.

The ALCO committee reviews these investments as part of the overall monitoring of cash management and treasury and investment activities of the Bank.

These sukuks are measured at fair value for the purpose of financial reporting and for trading on a mark to market basis and likewise for investments in listed equity portfolio through managed funds or discretionary portfolio.

For the purpose of computing capital charge for market risk for regulatory reporting, these sukuks form part of trading books and are subject to specific market risk (based on external ratings) and general market risks (based on residual maturity).

Details on market risk management, net exposures and sensitivities are given as part of note 31 of the consolidated financial statements for the year ended 31 December 2014.

5.2 Regulatory capital allocation against market rate risk

The table below shows the market risk position for each category of the market risk as at 31 December 2014 along with the maximum and minimum values during the period:

| | As at 31 December | Max | Min |
|---|------------------------------|--------------|--------------|
| Equity position risk | - | - | - |
| Market risk on trading positions in sukuk * | 166 | 191 | 166 |
| Foreign exchange risk | 1,153 | 1,153 | 1,117 |
| Commodity risk | - | - | - |
| Total (A) | 1,319 | 1,344 | 1,283 |
| Risk Weighted Assets (A x 12.5) | 16,488 | 16,800 | 16,038 |
| Capital requirement @ 12% | 1,979 | 2,016 | 1,925 |

* represents 30% of the exposure since these sukuk investments are allocated from IAH pool.

6 OPERATIONAL RISK

6.1 Operational risk management

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

Details on operational risk management are given as part of note 31 of the consolidated financial statements for the year ended 31 December 2014.

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

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

6.2 Litigation

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

6.3 Shari'a compliance

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

6.4 Regulatory capital allocation against operational risk

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

The risk weighted assets and capital requirement for operational risk as at 31 December 2014 is as given below:

| | |
|---|--------|
| Average gross income for 3 years (A) | 17,418 |
| Operational Risk Weighted Assets (B) = A x 15% x 12.5 | 32,659 |
| Capital requirement = B x 12% | 3,919 |

7 OTHER RISKS

7.1 Liquidity risk

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

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee (“ALCO”), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the bank, as well as gap limits under each time bucket of the maturity ladder. It is the Bank’s policy to keep adequate level of high quality liquid assets such as inter-bank placements and sukuk to ensure that funds are available to meet maturing Mudharaba deposits and other liabilities, as and when they fall due. The day to day management of liquidity risk is the responsibility of the Treasury Department, which monitors the sources and maturities of assets and liabilities closely, and ensures that limits stipulated by the ALCO are complied with. RMD and Financial Control Department (“FCD”) monitors the liquidity position and any violations are reported to ALCO, ERM and the Board of Directors.

For maturity profile of assets and liabilities, please refer to note 28 of the consolidated financial statements for the year ended 31 December 2014.

The following are the key liquidity ratios which reflect the liquidity position of the Bank:

Figures in %

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|--------|--------|-------|--------|--------|
| Interbank assets to interbank liabilities | 176.87 | 222.39 | 95.70 | 189.43 | 116.91 |
| Liquid assets to total assets | 25.23 | 27.80 | 19.81 | 27.06 | 25.00 |
| Liquid assets to total deposits | 34.69 | 38.46 | 33.33 | 43.65 | 45.94 |
| Net liquid assets to total deposits | 23.03 | 27.50 | 9.25 | 27.27 | 17.05 |

7.2 Profit rate risk in the banking book

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

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank’s financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis points (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An analysis of the Bank’s sensitivity to an increase or decrease in market profit rates has been disclosed in note 31 of the consolidated financial statements for the year ended 31 December 2014.

7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into Shari’a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit market 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 RMD. As at 31 December 2014, the Bank did not have any open position in foreign currency risk management instruments.

7 *OTHER RISKS (continued)*

7.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. To manage this risk, the Bank has established exposure limits to various geographic regions and industry sectors. Such limits are monitored by the RMD and deviations, if any, are reported to the Board on quarterly basis. As at 31 December 2014, there has been no violation of the Board approved limits under any head. For break-up of exposure geography and industry/ sector wise, please refer to notes 4.3.1 and 4.3.2 above.

7.5 Reputational risk

Reputation risk is the risk that negative perception regarding the Bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base that could have an adverse impact on liquidity or capital of the Bank. This may also lead to litigation against the bank which apart from avoidable legal expenses will also damage Bank's credibility which in turn will adversely affect business growth and profitability. Being an Islamic Bank, reputation is an important asset and one of the issues that could affect the Bank's reputation is the inability to exit from investments, lower than expected returns on investments, growth of non-performing asset portfolio and poor communication to investors. The Bank has a well-developed and coherently implemented communication strategy to cover such contingencies. The Bank also allocates additional capital for such risks under its ICAAP.

7.6 Displaced commercial risk

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

7.7 Other risks

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

8 **PRODUCT DISCLOSURES**

8.1 Product descriptions & consumer awareness

The Bank has a disclosure policy which applies to all modes of communication to the public including written, oral and electronic communications. These disclosures are made on a timely basis in a manner required by applicable local and regulatory requirements.

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

8 *PRODUCT DISCLOSURES (continued)*

8.1 *Product description & consumer awareness (continued)*

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

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

8.2 **Complaint handling**

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

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

8.3 **Equity of investment account holders (IAH’s)**

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

The Bank accepts IAH funds in Bahraini Dinar, US Dollar and other international and GCC currencies for maturity periods ranging from 1 month to 24 months. The Bank completes its full range of KYC due diligence prior to accepting any investment. The customer also signs a written agreement covering all terms and conditions of the investment including tenor, basis of profit allocation, early withdrawal, etc.

Since 2009, the Bank offers a savings account product called “Al-Waffer” which entitles the investors to certain prizes in cash and in kind, decided based on a raffle draws held on monthly, quarterly and annual basis apart from the normal share of profits declared and distributed after reducing the Mudharib fees.

IAH is a significant funding source for the Bank and the returns offered to investors are in line with the market. However, any shortfall in yield on the investments made out of these funds exposes the Bank to displaced commercial risk. The Bank regularly monitors rate of return offered by competitors to evaluate the expectations of its IAH’s. Bank’s policy also provides for whole or partial waiver of the Mudharib share of income from investments due to it, to provide a reasonable return to its investors.

The Bank comingles its own funds and IAH funds and these are invested together. The Bank has identified two pools of assets where the IAH funds are invested and the income from which is allocated to such accounts. One pool is short term in nature to meet IAH short term investment requirements. The other pool is long term in nature to meet their long term investment requirements. Out of the gross income the investor’s share is computed after deducting the Mudharib share. The profit allocation schedule signed by the customer prior to investment contains the scheme of allocation of the Mudharib share. Administrative expenses incurred for management of the funds are borne directly by the Bank and are not charged separately to investment accounts. Equity of IAH’s are carried at their book value.

8 **PRODUCT DISCLOSURES** (continued)

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

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

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

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|--|---------|---------|---------|---------|---------|
| Allocated income to IAH | 12,843 | 13,315 | 9,923 | 9,022 | 8,254 |
| Distributed profit | 8,841 | 8,719 | 6,297 | 6,629 | 5,785 |
| Mudharib fees * | 4,002 | 4,596 | 3,626 | 2,393 | 2,469 |
| As at 31 December | | | | | |
| IAH ¹ | 336,010 | 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):

| Mudharaba Tenor | Profit distribution amount in BD | | | | | Ratio of profit paid as a percentage of total | | | | |
|----------------------|----------------------------------|--------------|--------------|--------------|--------------|---|--------------|--------------|--------------|--------------|
| | 2014 | 2013 | 2012 | 2011 | 2010 | 2014 | 2013 | 2012 | 2011 | 2010 |
| 1 Month ¹ | 1,304 | 1,488 | 1,629 | 1,824 | 3,107 | 14.7 | 17.1 | 25.9 | 27.5 | 53.7 |
| 3 Months | 380 | 680 | 655 | 1,489 | 1,843 | 4.3 | 7.8 | 10.4 | 22.5 | 31.9 |
| 6 Months | 1,455 | 1,100 | 474 | 764 | 641 | 16.5 | 12.6 | 7.5 | 11.5 | 11.1 |
| 12 Months | 4,179 | 3,606 | 2,998 | 2,014 | 1,452 | 47.3 | 41.4 | 47.6 | 30.4 | 25.1 |
| 18 Months | 1 | - | - | - | - | - | - | - | - | - |
| 24 Months | 75 | 228 | 30 | - | - | 0.8 | 2.6 | 0.5 | - | - |
| VIP | 1,447 | 1,617 | 511 | 707 | 729 | 16.4 | 18.5 | 8.1 | 10.7 | 12.6 |
| PER and IRR expenses | - | - | - | (169) | (1,987) | - | - | - | (2.6) | (34.4) |
| Total | 8,841 | 8,719 | 6,297 | 6,629 | 5,785 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

¹ Includes saving account, Al-Wafer account and Call Mudharaba accounts.

Distribution of profits by type of IAH products:

| Year | Avg. profit earned from IAH assets (%age of asset) | PER set aside as a %age of IAH assets | IRR set aside as a %age of IAH assets | Mudharib fees as a %age of IAH assets | Profit paid as a %age of IAH assets |
|------|--|---------------------------------------|---------------------------------------|---------------------------------------|-------------------------------------|
| 2014 | 3.82 | - | - | 1.19 | 2.63 |
| 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 |

8 *PRODUCT DISCLOSURES (continued)*

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

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

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|--------------------------------|-------|-------|-------|-------|-------|
| 1 Month Mudharaba ¹ | 1.15% | 1.12% | 2.25% | 2.51% | 3.66% |
| 3 Months Mudharaba | 2.19% | 2.98% | 3.08% | 4.25% | 4.13% |
| 6 Months Mudharaba | 3.08% | 3.64% | 3.55% | 4.52% | 3.38% |
| 12 Months Mudharaba | 3.39% | 4.27% | 4.46% | 5.01% | 4.94% |
| 18 Months Mudharaba | 3.30% | - | - | - | - |
| 24 Months Mudharaba | 4.92% | 5.07% | 5.07% | - | - |
| VIP Mudharaba | 3.49% | 4.09% | 2.79% | 3.67% | 4.35% |

¹ Includes saving account, Al-Wafer account and Call Mudharaba accounts.

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 31 December 2014:

| Particular | Allocation at 1 January 2014 | Movement | Allocation at 31 December 2014 | Proportion of total assets (%) |
|--|------------------------------------|---------------|--------------------------------------|--------------------------------------|
| Cash and bank balances | 27,836 | 1,838 | 29,674 | 79.4% |
| Placements with financial institutions | 82,745 | (6,739) | 76,006 | 100.0% |
| Financing assets ¹ | 152,336 | 44,940 | 197,276 | 64.9% |
| Investment securities – Sukuk | 29,132 | 6,846 | 35,978 | 100.0% |
| Total | 292,049 | 46,885 | 338,934 | |

¹ Includes Murabaha, Wakala and Istisna contracts.

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

The Bank offers Restricted Investment Accounts (“RIA's”) to both small investors and high net worth individuals in the GCC. The Bank structures its RIA products to offer its customers an opportunity to choose from a wide range of returns, maturity periods, sectors, asset classes and risk levels. No RIA product was introduced/ marketed by the Bank in 2014.

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

8 *PRODUCT DISCLOSURES (continued)*

8.4 *Restricted Investment Accounts (RIA's) (continued)*

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

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

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

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

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

Khaleeji Commercial Bank BSC Risk Management Disclosures

8 PRODUCT DISCLOSURES (continued)

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

| RIA name | Details | Launch date | Projected returns | Return frequency | Return annualized (%) | | | | |
|-----------------|---|-------------|---------------------------|----------------------------|-----------------------|------|------|------|------|
| | | | | | 2014 | 2013 | 2012 | 2011 | 2010 |
| 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. In 2011, 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, RIA4 has made distributions and redemptions to depositors amounting to approximately 29.8% of the Depositors' initial capital. These distributions were in the form of yields amounting to ≈ 21.1% plus 8.74% of redeemed capital. | 2007 | 44.33% | Quarterly | - | - | - | - | 0.27 |

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8 PRODUCT DISCLOSURES (continued)

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

| RIA name | Details | Launch date | Projected returns | Return frequency | Return annualized (%) | | | | |
|--------------------|--|-------------|----------------------------|---------------------------|-----------------------|------|------|------|------|
| | | | | | 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. During the year, 479 shares were bought back from investors. | 2009 | 110.54% over product tenor | Bullet return at maturity | - | - | - | - | - |

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES

9.1 Corporate governance structure

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

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

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

9.2 Board of directors

As at 31 December 2014, the Board of the Bank comprise nine members. Members of the Board were elected for a three year renewable term during the Annual General Meeting (“AGM”) meeting held on March 2014. The current composition of the Board complies with the requirements of the Regulations, except for certain requirements stated in paragraph 9.15 below.

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

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

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

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (*continued*)

9.2 Board of directors (*continued*)

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

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

The Board of Directors of the Bank comprises of Executive and Non-Executive Directors. The Board has three independent members (out of a total of nine Directors). This is to ensure compliance with the CGC requirement that requires at least one third of the Bank’s Board to comprise independent and non-executive Directors.

Upon appointment, each Director is provided with a comprehensive, formal and tailored induction which includes, amongst other things, a review of the Board’s role and duties and the relevant Director’s roles and duties to the Bank; meetings with the bank’s senior management; visits to the Bank’s branches and other sites; presentations to explain the Bank’s strategic plans and significant financial, accounting, risk and legal issues and compliance programs; and meetings with internal and external auditors and legal counsel. In accordance with paragraph 1.9.1 of the HC module of CBB Rulebook, the Board and its committees are also individually evaluated and assessed for their performance effectiveness. The Board has conducted an evaluation of its performance and the performance of each committee and each individual director during the year 2014.

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

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.2 Board of directors (continued)

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

Dr. Ahmed Khalil Al-Mutawa *Chairman*

- **Experience:**
 - Director since June 2012 (Non-Independent and Non-Executive).
 - Over 17 years of experience in economics and financial sector.
 - Nominated by Gulf Finance House BSC.
 - Chairman of Gulf Finance House BSC.
 - Chief Executive Officer of Khalifa Fund for Enterprise Development.
 - Board Member of Dubai University College – UAE.
 - Board Member of Dunia Finance – UAE.
 - Board Member of Summit Bank – Pakistan
- **Qualification:**
 - Ph.D. in Economics from Georgetown University – USA.
 - Master in Economics from University of North Carolina – USA.
 - Bachelor in Economics from University of Cairo – Egypt.

Abdulla Abdulkarim Showaiter *Board Member*

- **Experience:**
 - Director since February 2008 (Independent and Non-Executive).
 - Over 36 years of experience in the banking industry.
 - Deputy CEO, Wholesale Banking, Emirates Islamic Bank – Dubai.
 - Board Member of First Energy Bank – Bahrain.
 - Board member of Al-Mahraab Real Estate Company – Kuwait.
- **Qualification:**
 - Attended several courses in the field of banking and finance.

Abdulrahman Mohammed Jamsheer *Vice Chairman*

- **Experience:**
 - Director since March 2011 (Independent and Non-Executive).
 - Shura Council member.
 - Over 43 years of experience in financial and commercial sector.
 - Chairman of Delmon Poultry Company.
 - Chairman of Fortuna CO. W.L.L.
 - Vice Chairman of Lona Real Estate BSC Closed.
 - Vice Chairman of United Cement Company.
 - Vice Chairman of Esterad Investment Company.
 - Board Member of Banz Group Company.
 - Board Member of Daih Real Estate Development Co. W.L.L.
 - Board member of Sanad Investment Company B.S.C. (CLOSED).
- **Qualification:**
 - Bachelor of Science in Engineering Agricole from the American University of Beirut – Lebanon.

Mr. Bashar Mohammed Al-Mutawa *Board Member*

- **Experience:**
 - Director since March 2014 (Non-Independent and Non-Executive).
 - Over 16 years of experience in Financial and Investment sector.
 - Nominated by Gulf Finance House BSC.
 - Board member of Gulf Finance House BSC.
 - Board member of Al Jazeera Tourism Company.
 - Board member of Naseej B.S.C. (CLOSED)
 - Board member of AMA University.
 - Board member of Bahrain Film Production Company B.S.C. (CLOSED).
 - Board member of Sanad Investment Company B.S.C. (CLOSED).
 - Board member of Noon investment Co. W.L.L.
 - Board member of Vaidyaratnam Ayurvedic Health Center
- **Qualification:**
 - B.Sc. in Finance and Economic from Babson College, MA.
 - International bachelorette (IB) diploma.

Khaleeji Commercial Bank BSC

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9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.2 Board of directors (continued)

Hisham Ahmed Al-Rayes

Board Member

- **Experience:**
 - Director since June 2012 (Non-Independent and Executive).
 - Over 13 years of experience in the financial and banking sector.
 - Nominated by Gulf Finance House BSC.
 - Chief Executive Officer of Gulf Finance House BSC.
 - Board Member of Cemena Holding Company (Closed) & Affiliated Companies – Bahrain.
 - Board Member of Energy City Libya Company – Libya.
 - Board Member of GFH Capital Limited.
 - Board Member of Tunisia Bay S.A.R.L. – Luxembourg.
 - Board Member of Al-Khaleej Fund and Investment Company (closed) – Bahrain.
 - Board Member of Gulf Holding Company K.S.C.C. – Kuwait.
 - Board Member of BFH Real Estate SPC x9 – Bahrain.
 - Board Member of Naseej Properties – Bahrain
- **Qualification:**
 - Master in Business Administration from University of DePaul – USA.
 - Bachelor of Science in Electrical/ Electronic Engineering from University of Bahrain.

Mohammed Barak Al-Mutair

Board Member

- **Experience:**
 - Director since August 2010 (Non-Independent and Non-Executive).
 - Over 16 years of experience in Government & Business sector.
 - Nominated by Al-Imtiaz Investment Company KSC – Kuwait.
 - Chairman of Kuwait Real Estate Holding Company – Kuwait.
 - Board member of Gulf Real Estate Development Co. – Saudi Arabia.
- **Qualification:**
 - Bachelor Degree in Business Administration from San Diego University – USA.

Khalid Rashid Al-Thani

Board Member

- **Experience:**
 - Director since February 2009 (Independent and Non-Executive).
 - Over 23 years of experience in financial and commercial sector.
 - Deputy General Secretary of Awqaf and Minors Affairs Foundation – Dubai.
 - Board Member of Noor Awqaf, Dubai.
 - Head of Finance Department, Dubai. Land Department, from 1999 to 2004 – Dubai.
 - Board Member of Dubai International Holy Quran Award 1997 to 2004 – Dubai.
- **Qualification:**
 - Bachelor in Business Accounting from University of United Arab Emirates.

Mosobah Saif Al-Mutairy

Board Member

- **Experience:**
 - Director since March 2011 (Non-Independent and Non-Executive).
 - Over 18 years of experience in Financial and Investment sector.
 - Nominated by Gulf Finance House BSC.
 - Board member of Gulf Finance House BSC.
 - Accounts Manager of Royal Guards of Oman.
 - Acting Manager of Royal Guards of Oman Pension Fund.
- **Qualification:**
 - Master in Business Administration from University of Lincolnshire & Humberside – UK.
 - Postgraduate qualification in Accounting from South Bank University, London – UK.
 - Degree in Accounting from South West College, London – UK.
 - National Diploma in Business and Finance from Bradford & Ilkley Community College – UK.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.2 Board of directors (continued)

Tariq Qassim Fakhroo

Board Member

- **Experience:**

- Director since March 2011 (Non-Independent and Non-Executive).
- Over 17 years of experience in Business, Commercial, Telecom & IT sector.
- Nominated by Gulf Finance House BSC.
- Deputy Chief Executive, Mohammed Fakhroo & Bros. – Bahrain.
- General Manager, Fakhroo IT Services – Bahrain.
- General Manager, Fakhroo IT Services Company – KSA.
- Board Member of Qasim Mohammed Fakhroo W.L.L.
- Board member of Fakhroo International Trading Agencies - Kingdom of Saudi Arabia.

- **Qualification:**

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

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

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

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.3 Board of directors' interests

The members of the Board collectively held 8,508,249 shares in the Bank as of the year ended 31 December 2014 (2013: 8,358,250 shares).

| Director's name | Number of outstanding shares at 31 December 2013 | Number of outstanding shares at 31 December 2014 | Movement during the year | % of outstanding shares |
|---------------------------------------|--|--|--------------------------|-------------------------|
| Dr. Ahmed Khalil Al-Mutawa | Nil | Nil | - | - |
| Dr. Fuad Abdulla Al-Omar ¹ | 1 | N/A | (1) | - |
| Abdulrahman Mohamed Jamsheer | Nil | Nil | - | - |
| Abdulla Abdulkarim Showaiter | 1,155,000 | 1,155,000 | - | 0.10% |
| Bashar Mohammed Al Mutawa | Nil | Nil | - | - |
| Hisham Ahmed Al-Rayes | Nil | Nil | - | - |
| Khalid Rashid Al-Thani | 100,000 | 100,000 | - | 0.01% |
| Mohammed Barak Al-Mutair | 7,103,249 | 7,103,249 | - | 0.62% |
| Mosobah Saif Al-Mutairy | Nil | Nil | - | - |
| Tariq Qassim Fakhroo | Nil | 150,000 | 150,000 | 0.013% |
| Total | 8,358,250 | 8,508,249 | 149,999 | 0.74% |

¹ Dr. Fuad Abdulla Al-Omar's term ended on 18 March 2014.

9.4 Distribution of ownership shares by nationality

The Bank's Register of Shareholders as at 31 December 2014 indicates a total of 591 shareholders who collectively owned 1,154,161,084 (One Billion One Hundred Fifty Four Million One Hundred Sixty One Thousand and Eighty Four) shares with a nominal value of BD 0.100 (One Hundred Fils) each. The breakdown of shareholders in the Bank by nationality is as follows:

| Nationality | No. of equity shares held | No. of shareholders | % of shareholders |
|--------------|---------------------------|---------------------|-------------------|
| Bahraini | 696,776,832 | 502 | 60.37 |
| Non-Bahraini | 457,384,252 | 89 | 39.63 |
| Total | 1,154,161,084 | 591 | 100.00 |

As at 31 December 2014, none of the Bank's shares were held by the Government of the Kingdom of Bahrain.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.5 Board committees

The Board of Directors has constituted three Committees with specific delegated authorities.

| Committee | Members | Primary responsibilities |
|---|---|--|
| Board Nominations, Remunerations and Governance Committee (BNRGC) | <ul style="list-style-type: none"> • Abdulrahman Mohamed Jamsheer • Bashar Mohammed Al Mutawa • Mohammed Barrak Al-Mutair • Khalid Rashid Al-Thani | <ul style="list-style-type: none"> • Human Resources. • Compensation and incentives. • Administration. • Corporate Governance. |
| Board Audit and Risk Management Committee (BARMC) * | <ul style="list-style-type: none"> • Khalid Rashid Al-Thani • Abdulrahman Mohamed Jamsheer • Tariq Qassim Fakhroo | <ul style="list-style-type: none"> • Internal Audit. • External Audit. • Compliance. • Anti-Money Laundering. • Risk management. • Policies related to risk management. |
| Board Investment and Credit Committee (BICC) | <ul style="list-style-type: none"> • Dr. Ahmed Khalil Al-Mutawa • Abdulla Abdulkarim Showaiter • Mohammed Barrak Al-Mutair • Mosobah Saif Al-Mutairy • Hisham Ahmed Al-Rayes • Khalil Ismaeel Al Meer | <ul style="list-style-type: none"> • Investment & credit approval. • Setting limits. • Investment policies. • Asset Liability Management. • Banking relationship. • Oversight of Off-Balance Sheet Vehicles. |

* During the year, the Board Audit Committee (BAC) and the Board Risk Management Committee (BRMC) were merged into one committee Board Audit and Risk Management Committee (BARMC).

Meetings of the Board and its committees are held as and when required but in accordance with the Regulations the Board meets at least once a quarter. The Board of Directors met seven times in 2014. The Bank held its AGM on 18 March 2014. In addition to physical meetings, several written resolutions were circulated to the Directors during 2014 for approval by mail and facsimile.

During the year, the Board Audit Committee (BAC) and the Board Risk Management Committee (BRMC) both held one meeting each before being merged into one committee - the Board Audit and Risk Management Committee (BARMC). The BARMC held 3 meetings subsequent to the merger, the Board Investment and Credit Committee (BICC) held 4 meetings, and the Board Nominations, Remunerations and Governance Committee (BNRGC) held 5 meetings.

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

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.6 Board committees meeting dates

- Board meetings: a total number of 7 meetings were held.

| Director's name | BOD Meeting dates during the year 2014 | | | | | | | Attendance % |
|--|--|---------|---------|---------|---------|---------|--------|---------------|
| | 16 Jan. | 30 Jan. | 18 Mar. | 24 Apr. | 16 Sep. | 13 Nov. | 5 Dec. | |
| Dr. Ahmed Khalil Al-Mutawa | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Dr. Fuad Abdulla Al-Omar ¹ | ✓ | ✓ | N/A | N/A | N/A | N/A | N/A | 100% |
| Abdulrahman Mohammed Jamsheer | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Abdulla Abdulkarim Showaiter | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Bashar Mohammed Al-Mutawa ² | N/A | N/A | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Mohammed Barak Al-Mutair | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Mosobah Saif Al-Mutairy | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Tariq Qassim Fakhroo | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | - | More than 75% |
| Khalid Rashid Al-Thani | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |
| Hisham Ahmed Al-Rayes | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | 100% |

¹ Dr. Fuad Abdulla Al-Omar's term ended on 18 March 2014.

² Mr. Bashar Mohammed Al-Mutawa joined the Board effective from 18 March 2014.

- BICC meetings: a total number of 4 meetings were held (minimum of 4 meetings a year).

| Director's name | BICC Meetings dates during the year 2014 | | | |
|---|--|---------|---------|---------|
| | 30 Jan. | 24 Apr. | 16 Sep. | 13 Nov. |
| Dr. Ahmed Khalil Al-Mutawa ¹ | N/A | ✓ | ✓ | ✓ |
| Dr. Fuad Abdulla Al-Omar ² | ✓ | N/A | N/A | N/A |
| Abdulla Abdulkarim Showaiter | ✓ | ✓ | ✓ | ✓ |
| Mohammed Barak Al-Mutair | ✓ | ✓ | ✓ | ✓ |
| Mosobah Saif Al-Mutairy | ✓ | ✓ | ✓ | ✓ |
| Hisham Ahmed Al-Rayes | ✓ | - | ✓ | ✓ |
| Khalil Ismaeel Al Meer ¹ | N/A | ✓ | ✓ | ✓ |

¹ Dr. Ahmed Al Mutawa and Mr. Khalil Al Meer joined the Committee officially in March 2014.

² Dr. Fuad Abdulla Al-Omar's term ended on 18 March 2014.

- BNRGC meetings: a total number of 5 meetings were held (minimum 2 meetings a year).

| Director's name | BNRGC Meetings dates during the year 2014 | | | | |
|---|---|---------|---------|---------|---------|
| | 30 Jan. | 24 Apr. | 16 Sep. | 30 Sep. | 10 Dec. |
| Abdulrahman Mohammed Jamsheer | ✓ | ✓ | ✓ | ✓ | ✓ |
| Abdulla Abdulkarim Showaiter ¹ | ✓ | N/A | N/A | N/A | N/A |
| Bashar Mohammed Al-Mutawa ² | N/A | ✓ | ✓ | ✓ | ✓ |
| Khalid Rashid Al-Thani | ✓ | ✓ | ✓ | ✓ | - |
| Mohammed Barak Al-Mutair | ✓ | ✓ | ✓ | ✓ | ✓ |

¹ Mr. Abdulla Abdulkarim Showaiter resigned from the Committee effective 9 April 2014.

² Mr. Bashar Mohammed Al-Mutawa joined the Committee officially on March 2014.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.6 Board committees meeting dates (continued)

- BRMC meeting: 1 meeting was held.

| Director's name | BRMC Meeting date during the year 2014 |
|-------------------------------|--|
| | 29 Jan. |
| Abdulrahman Mohammed Jamsheer | ✓ |
| Tariq Qassim Fakhroo | ✓ |
| Dr. Ahmed Khalil Al-Mutawa | ✓ |

- BAC meeting: 1 meeting was held.

| Director's name | BAC Meeting date during the year 2014 |
|----------------------------|---------------------------------------|
| | 29 Jan. |
| Khalid Rashid Al-Thani | ✓ |
| Dr. Ahmed Khalil Al-Mutawa | ✓ |
| Tariq Qassim Fakhroo | ✓ |

- BARMC meetings: a total number of 3 meetings were held (minimum of 4 meetings a year).

| Director's name | BARMC Meetings dates during the year 2014* | | |
|-------------------------------|--|---------|---------|
| | 24 Apr. | 16 Sep. | 12 Nov. |
| Khalid Rashid Al-Thani | ✓ | ✓ | ✓ |
| Abdulrahman Mohammed Jamsheer | ✓ | ✓ | ✓ |
| Tariq Qassim Fakhroo | ✓ | ✓ | ✓ |

*The Board Audit Committee (BAC) and the Board Risk Management Committee (BRMC) were merged in one committee (BARMC).

9.7 Code of conduct

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

9.8 Compliance with regulations

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

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.8 Compliance with regulations (continued)

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

9.9 Shari'a Supervisory Board

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

Dr. Fareed Yaqoob Al-Miftah
Chairman

- **Experience:**
 - Member of the Supreme Council of Islamic Affairs.
 - Undersecretary of the Ministry of Justice & Islamic Affairs – Bahrain.
 - Former judge of the high Shari'a Court.
 - Former Lecturer at the University of Bahrain.
- **Qualification:**
 - Ph.D. from the University of Edinburgh – United Kingdom.

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.

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.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.10 Executive management committees

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

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

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.11 Executive management & other senior management

During 2014, the following changes were carried out in the executive management: the appointment of Mr. Salah Khalifa Mohammed, the Head of Corporate Banking, and Mr. Vijayan Govindarajan, the Head of Risk Management. Besides, and the resignation of Mr. Silvan Varghese, the COO, and Mr. Ozan Benlioglu, the Head of Investment Banking.

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

Khalil Al Meer

Chief Executive Officer

Experience:

- Over 29 years of experience in Corporate and Retail banking that he gained from his work in the leading banks in the Kingdom of Bahrain.
- Joined the Bank in 2013.

• **Qualification:**

- B. Sc. in Business Administration from the University of Bahrain.
- Attended the Gulf Executive Development Program at Darden Graduate School of Business in University of Virginia (USA).
- Attended the Senior International Bankers Program from the International Centre for Banking and Finance Services at Manchester Business School (UK).

Mahdi Abdunabi Mohammed

Deputy General Manager, Support Services.

• **Experience:**

- Over 34 years of banking experience.
- Joined the Bank in 2005.

• **Qualification:**

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

Ahmed Ali Bucheeri

Head of Internal Audit

• **Experience:**

- Over 26 years of experience in both internal and external audit mainly in banks.
- Joined the Bank in 2007.

• **Qualification:**

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

Fuad Ali Taqi

Deputy General Manager, Commercial Banking

• **Experience:**

- Over 33 years of banking experience in Islamic and conventional banks.
- Joined the Bank in 2006.

• **Qualification:**

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

Salah Khalifa Mohammed

Head of Corporate Banking.

• **Experience:**

- Over 20 years of experience in Islamic and conventional corporate and wholesale banking, Treasury, Asset Management and structured finance.
- Joined the Bank in June 2014

• **Qualification:**

- MBA, University of Glamorgan, Wales, UK.
- Diploma in Commercial Studies, University of Bahrain
- Executive MBA from University of Bahrain.
- Diploma in Management and Information Systems, Aptech Computer Education.

Hussam Ghanem Saif

Head of Treasury & Capital Markets

• **Experience:**

- Over 25 years of experience in treasury and Islamic banking.
- Joined the Bank in 2007.

• **Qualification:**

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

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.11 Executive management & other senior management (continued)

Yaser Ismael Mudhafar *Chief Financial Officer*

- **Experience:**
 - Over 17 years of extensive experience in the Islamic banking industry and Audit.
 - Joined the Bank in 2006.
- **Qualification:**
 - Certified Public Accountant (CPA) from the American Institute of Certified Public Accountants.
 - Certified Islamic Professional Accountant (CIPA) from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).
 - Executive MBA from University of Bahrain.

Mohammed Abdulla Saleh *Corporate Secretary, Head of Compliance and MLRO*

- **Experience:**
 - Over 13 years of experience in Management, Islamic Banking, Corporate Governance, Compliance and Anti-money Laundering.
 - Joined the Bank in 2009.
- **Qualification:**
 - Master's in IT, Media and E-Commerce Law from the University of Essex – UK.
 - B.Sc. in Law from Dubai Police Academy – UAE.
 - Advanced Diploma in Islamic Finance from Bahrain Institute of Banking and Finance (BIBF).
 - Diploma in Business Management from the University of Bahrain.
 - ICA International Diploma in Compliance from the International Compliance Association ICA.

Vijayan Govindarajan *Head of Risk Management*

- **Experience:**
 - Over 34 years of experience in the banking industry in India and Bahrain in several areas like Risk and Credit Management.
 - Joined the Bank in 2014.
- **Qualification:**
 - Bachelors of Science.
 - Certified Associate, Indian Institute of Banking and Finance.

Fatooh Yusuf Al-Mannai *Head of Human Resources*

- **Experience:**
 - Over 19 years of experience in human resources, training and administration.
 - Joined the Bank in 2007.
- **Qualification:**
 - MBA and a BA (Hons.) in Human Resource Management.
 - Fellow of the Chartered Institute of Personnel & Development (Chartered FCIPD).
 - Member of Society of Human Resource Management (SHRM).
 - Member of Bahrain Society for Training and Development (BSTD).

Abdul-Nasser Omar Al-Mahmood *Head of Shari'a Compliance*

- **Experience:**
 - Over 24 years of experience in Shari'a Audit and Islamic banking.
 - Joined the Bank in 2008.
- **Qualification:**
 - Master's in Business Administration with thesis in Shari'a Control and Review in Islamic Banks.
 - B. Sc. in Shari'a and Islamic studies.
 - Associate Diploma in Shari'a Control.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.12 Executive and senior management interests

The following table indicates the executive and senior management shareholding as 31 December 2014:

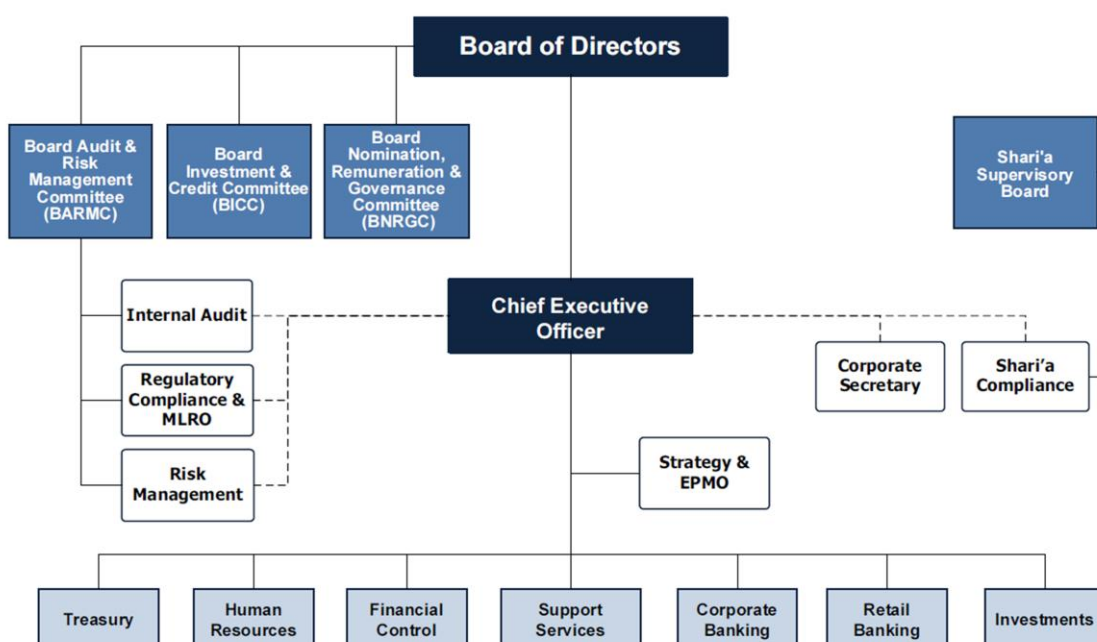
| <i>Executive and senior management</i> | Number of outstanding shares at 31 December 2013 | Number of outstanding shares at 31 December 2014 |
|--|--|--|
| Khalil Al Meer | Nil | Nil |
| Silvan Varghese * | 2,156,886 | N/A |
| Fuad Ali Taqi | 2,141,585 | 2,141,585 |
| Mahdi Abdalnabi Mohammed | 1,639,397 | 1,639,397 |
| Salah Khalifa Mohammed | Nil | Nil |
| Ahmed Ali Bucheeri | 424,850 | 500 |
| Hussam Ghanem Saif | 679,565 | 679,565 |
| Yaser Ismail Mudhafar | 526,438 | 526,438 |
| Fatooh Yusuf Al-Mannai | Nil | Nil |
| Ozan Benlioglu * | 68,994 | N/A |
| Mohammed Abdulla Saleh | 60,000 | Nil |
| Abdul-Nasser Omar Al-Mahmood | Nil | Nil |
| Vijayan Govindarajan | Nil | Nil |
| Total | 7,697,715 | 4,987,485 |

* Resigned during the year.

The change in the above number of shares is mainly due to vesting of shares under the share-based employee incentive scheme. There was no senior management's trading of the Bank's shares during the year.

9.13 Organizational chart

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



9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.14 **Executive compensation**

The Bank has both a short-term and long-term compensation structure for its executive management which has been developed based on current market surveys and industry norms. The Bank also had an incentive scheme where in eligible employees were awarded a combination of shares and cash incentives on achievement of pre-determined performance targets. For further details please refer note 23 of the consolidated financial statements for the year ended 31 December 2014. The Board of Directors is entitled to sitting fees and their annual remuneration is subject to the approval of the shareholders at the end of each year.

9.15 **Shari'a compliance, regulatory compliance and anti-money laundering**

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

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

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

- HC 1.8.2: that requires a constitution of a corporate governance committee with at least three independent members;
- HC 4.2.2: in which the Board must establish a nominating committee which would include only independent directors or only non-executive directors of whom a majority must be independent directors including the chairman;
- HC 5.3.2: in which it is requires to include only independent directors for the remuneration committee or, alternatively, only non-executive directors of whom a majority are independent directors including the chairman.
- HC 9.2.4 - in which it is requires an independent director to chair the Corporate Governance Committee.

In addition, the Bank is also non-compliant to HC 9.2.4 (b) where it requires including a Shari'a scholar who is a SSB member to the Corporate Governance Committee.

Khaleeji Commercial Bank BSC

Risk Management Disclosures

9 CORPORATE GOVERNANCE & OTHER DISCLOSURES (continued)

9.16 Audit fees charged by the external auditor and other non-audit services provided by the external auditor and fees paid

The audit fees charged and non-audit services provided by external auditors will be made available to the shareholders as and when requested. Such details will be made available to the Bank's shareholders as per their specific request provided that these disclosures would not negatively impact the Bank's interest and its competition in the market.

9.17 Penalties paid to the Central Bank of Bahrain

During the year, there was no penalty imposed by the CBB on the Bank.

10 FINANCIAL PERFORMANCE

Following are basic quantitative indicators of the financial performance:

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|-----------------------------------|---------|---------|---------|---------|---------|
| Return on average equity | 3.00% | -16.06% | 0.64% | 0.44% | - 5.24% |
| Return on average assets | 0.53% | -3.69% | 0.18% | 0.13% | - 1.67% |
| Finance income to finance expense | 197.05% | 147.77% | 201.89% | 208.06% | 240.21% |
| Cost-to-income * | 75.80% | 156.56% | 84.54% | 72.11% | 83.79% |

* Cost excludes impairment allowances.

For detailed discussion on the performance for the year, kindly refer to Chairman's report on the consolidated financial statement for the year ended 31 December 2014.

11 REMUNERATION RELATED DISCLOSURES

The Banks total compensation policy, which includes the variable remuneration policy, sets out the Banks's policy on remuneration for directors and senior management and the key factors that were taken into account in setting the policy.

During the year, the Bank has adopted the Sound Remuneration Practices issued by the Central Bank of Bahrain and has proposed revisions to its variable remuneration framework. The revised policy framework and incentive components are subject to the approval of the shareholders in the upcoming annual general meeting. Once approved, the policy will be effective for the 2014 annual performance incentives and would be fully implemented for future periods.

The key features of the proposed remuneration framework have been summarized below.

11.1 Remuneration strategy

It is the Bank's basic compensation philosophy to provide a competitive level of total compensation to attract and retain qualified and competent employees. The Bank's variable remuneration policy will be driven primarily by a performance based culture that aligns employee interests with those of the shareholders of the Bank. These elements support the achievement of our objectives through balancing reward for both short-term results and long-term sustainable performance. Our strategy is designed to share our success, and to align employees' incentives with our risk framework and risk outcomes.

The quality and long-term commitment of all of our employees is fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to maintaining a career with the Bank, and who will perform their role in the long-term interests of shareholders. The Bank's reward package comprise the following key elements:

1. fixed pay;
2. benefits;
3. annual performance bonus; and
4. the long term performance incentive plan

A robust and effective governance framework ensures that the Bank operates within clear parameters of its compensation strategy and policy. All compensation matters, and overall compliance with regulatory requirements, are overseen by the Nomination, Remuneration and Governance Committee of the Board (BNRGC).

11 REMUNERATION RELATED DISCLOSURES (continued)

11.1 Remuneration strategy (continued)

The Bank's remuneration policy in, particular, considers the role of each employee and has set guidance depending on whether an employee is a Material Risk Taker and/ or an Approved Person in business line, control or support functions. An Approved Person is an employee whose appointment would require prior regulatory approval because of the significance of the role within the Bank and an employee is considered a Material Risk Taker if they head of significant business lines and any individuals within their control who have a material impact of the Bank's risk profile

In order to ensure alignment between what we pay our people and our business strategy, we assess individual performance against annual and long-term financial and non-financial objectives summarised in line with our performance management system. This assessment also takes into account adherence to the Bank's values, risk and compliance measures above all and acting with integrity. Altogether, performance is therefore judged not only on what is achieved over the short and long-term but also importantly on how it is achieved, as the BNRGC believes the latter contributes to the long-term sustainability of the business.

11.2 **BNRGC role and focus**

The BNRGC has oversight of all reward policies for the Bank's employees. The BNRGC is the supervisory and governing body for compensation policy, practices and plans. It is responsible for determining, reviewing and proposing variable remuneration policy for approval by the Board. It is responsible for setting the principles and governance framework for all compensation decisions. The BNRGC ensures that all persons must be remunerated fairly and responsibly. The remuneration policy is reviewed on a periodic basis to reflect changes in market practices and the business plan and risk profile of the Bank.

The responsibilities of the BNRGC as regards the variable compensation policy of the Bank, as stated in its mandate, include, but are not limited to, the following:-

- Approve, monitor and review the remuneration system to ensure the system operates as intended
- Approve the remuneration policy and amounts for each Approved Person and Material Risk-Taker, as well as total variable remuneration to be distributed, taking account of total remuneration including salaries, fees, expenses, bonuses and other employee benefits.
- Ensure remuneration is adjusted for all types of risks and that the remuneration system takes into consideration employees that earn same short-run profit but take different amount of risk on behalf of the bank.
- Ensure that for Material Risk Takers, variable remuneration forms a substantial part of their total remuneration.
- Review the stress testing and back testing results before approving the total variable remuneration to be distributed including salaries, fees, expenses, bonuses and other employee benefits.
- Carefully evaluate practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. The BNRGC will question payouts for income that cannot be realized or whose likelihood of realization remains uncertain at the time of payment.
- Ensure that for approved persons in risk management, internal audit, operations, financial controls and compliance functions the mix of fixed and variable remuneration is weighted in favor of fixed remuneration
- Recommend Board member remuneration based on their attendance and performance and in compliance with Article 188 of the Bahrain Commercial Companies Law.
- Ensure appropriate compliance mechanisms are in place to ensure that employees commit themselves not to use personal hedging strategies or remuneration-and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements.

As outlined in the Corporate Governance section of the Annual Report, the Board is satisfied that all non-executive directors are independent including the BNRGC members. The BNRGC comprises of the following members:

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Risk Management Disclosures

11 REMUNERATION RELATED DISCLOSURES (continued)

11.2 BNRGC role and focus (continued)

| BNRGC Member Name | Appointment date | Number of meetings attended |
|--|-------------------------|------------------------------------|
| Abdulrahman Mohammed Jamsheer | May 2013 | 5 |
| Abdulla Abdulkarim Showaiter ¹ | March 2008 | 1 |
| Bashar Mohammed Al-Mutawa² | April 2014 | 4 |
| Khalid Rashid Al-Thani | April 2011 | 4 |
| Mohammed Barak Al-Mutair | April 2011 | 5 |

¹ Mr. Abdulla Abdulkarim Showaiter resigned from the Committee effective 9 April 2014.

² Mr. Bashar Mohammed Al-Mutawa joined the Committee officially on 24 April 2014.

The aggregate remuneration paid to the BNRGC members during the year in the form of sitting fees amounted to BHD 7 thousand [2013: BHD 4 Thousand].

11.3 External consultants

Consultants were appointed during the year to advise the Bank on amendments to its the variable remuneration policy to be in line with the CBB's Sound Remuneration Practices and industry norms. This included assistance in designing an appropriate Share-based Incentive Scheme for the Bank. The BNRGC also appointed consultants during the year to perform a pay benchmarking exercise to assist them in reviewing the total compensation offered by the Bank.

11.4 Scope of application of the remuneration policy

The remuneration policy has been adopted on a bank-wide basis and shall not apply to its non-banking subsidiaries and operations.

11.5 Board remuneration

The Bank's board remuneration is determined in line with the provisions of Article 188 of the Bahrain Commercial Companies Law, 2001. The board of directors' remuneration will be capped so that the total remuneration (excluding sitting fees) does not exceed 5% of the Bank's net profit, after all the required deductions outlined in Article 188 of the Companies law, in any financial year. The board remuneration is subject to approval of the shareholders in the Annual General Meeting. Remuneration of non-executive directors do not include performance-related elements such as grants of shares, share options or other deferred stock-related incentive schemes, bonuses or pension benefits.

11.6 Variable remuneration for staff

The variable remuneration is performance related and consists primarily of the annual performance bonus award. As a part of the staff's variable remuneration, the annual bonus rewards delivery of operational and financial targets set each year, the individual performance of the employees in achieving those targets, and their contribution to delivering the Bank's strategic objectives.

The Bank has adopted a Board approved framework to develop a transparent link between variable remuneration and performance. The framework is designed on the basis that the combination of meeting both satisfactory financial performance and achievement of other non-financial factors, would, all other things being equal, deliver a target bonus pool for the employees, prior to consideration of any allocation to business lines and employees individually. In the framework adopted in determining the variable remuneration pool, the BNRGC aims to balance the distribution of the Bank's profits between shareholders and employees.

11 REMUNERATION RELATED DISCLOSURES (continued)

11.6 Variable remuneration for staff (continued)

The key performance metrics at the bank level include a combination of short term and long term measures and include profitability, solvency, liquidity and growth indicators. The performance management process ensures that all goals are appropriately cascaded down to respective business units and employees.

In determining the amount of variable remuneration, the Bank starts from setting specific targets and other qualitative performance measures that would result in a target top—down bonus pool. The bonus pool is then adjusted to take account of risk via the use of risk-adjusted measures (including forward-looking considerations).

The BNRGC carefully evaluates practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. BNRGC demonstrates that its decisions are consistent with an assessment of the Bank's financial condition and future prospects.

The Bank uses a formalized and transparent process to adjust the bonus pool for quality of earnings. It is the Bank's objective to pay out bonuses out of realized and sustainable profits. If the quality of earnings is not strong, the profit base could be adjusted based on the discretion of the BNRGC.

For the overall Bank to have any funding for distribution of bonus pool; thresholds of financial targets have to be achieved. The performance measures ensure that the total variable remuneration is generally considerably contracted where subdued or negative financial performance of the Bank occurs. Furthermore, the target bonus pool as determined above is subject to risk adjustments in line with the risk adjustment and linkage framework.

Remuneration of control functions

The remuneration level of staff in the control and support functions allows the Bank to employ qualified and experienced personnel in these functions. The Bank ensures that the mix of fixed and variable remuneration for control and support function personnel should be weighted in favor of fixed remuneration. The variable remuneration of control functions is based on function-specific objectives and is not determined by the individual financial performance of the business area they monitor.

The Bank's performance management system plays a major role in deciding the performance of the support and control units on the basis of the objectives set for them. Such objectives are more focused on non-financial targets that include risk, control, compliance and ethical considerations as well as the market and regulatory environment apart from value adding tasks which are specific to each unit.

Variable compensation for business units

The variable compensation for the business units is primarily decided by the key performance objectives set through the performance management system of the Bank. Such objectives contain financial and non-financial targets, including risk control, compliance and ethical considerations as well as market and regulatory environment. The consideration of risk assessment in the performance evaluation of individuals ensures that any two employees who generate the same short-run profit but take different amounts of risk on behalf of the bank are treated differently by the remunerations system.

11.7 Risk assessment framework

The purpose of the risk linkages is to align variable remuneration to the risk profile of the Bank. In its endeavor to do so, the Bank considers both quantitative measures and qualitative measures in the risk assessment process. Both quantitative measures and human judgment play a role in determining risk adjustments. The risk assessment process encompasses the need to ensure that the remuneration policy designed reduces employees' incentives to take excessive and undue risk is symmetrical with risk outcomes and has an appropriate mix of remuneration that is consistent with risk alignment.

The Bank's BNRGC considers whether the variable remuneration policy is in line with the Bank's risk profile and ensures that through the Bank's ex-ante and ex-post risk assessment framework and processes, remuneration practices where potential future revenues whose timing and likelihood remain uncertain are carefully evaluated.

Risk adjustments take into account for all types of risk, including intangible and other risks such as reputation risk, liquidity risk and the cost of capital. The Bank undertakes risk assessment to review financial and operational performance against the business strategy and risk performance prior distribution of the annual bonus. The Bank ensures that total variable remuneration does not limit its ability to strengthen its capital base. The extent to which capital needs to be built up is a function of a bank's current capital position and its ICAAP.

The bonus pool takes into account the performance of the Bank which is considered within the context of the Bank's risk management framework. This ensures that the variable pay pool is shaped by risk considerations and Bank-wide notable events.

The size of the variable remuneration pool and its allocation within the bank takes into account the full range of current and potential risks, including:

- (a) The cost and quantity of capital required to support the risks taken;
- (b) The cost and quantity of the liquidity risk assumed in the conduct of business; and
- (c) Consistency with the timing and likelihood of potential future revenues incorporated into current earnings.

The BNRGC keeps itself abreast with the Bank's performance against the risk management framework. The BNRGC will use this information when considering remuneration to ensure the return, risk and remuneration are aligned.

Risk adjustments

The Bank has an ex-post risk assessment framework which is a qualitative assessment to back-test actual performance against risk assumptions.

In years where the Bank suffers material losses in the financial performance, the risk adjustment framework would work as follows:

- There would be considerable contraction of the Bank's total variable remuneration.
- At the individual level, poor performance by the Bank would mean individual KPIs are not met and hence employee performance ratings would be lower
- Reduction in value of deferred shares or awards
- Possible changes in vesting periods and additional deferral applied to unvested rewards
- Lastly, if the qualitative and quantitative impact of a loss incident is considered significant, a malus or clawback of previous bonus awards may be considered.

The BNRGC, with Board's approval, can rationalize and make the following discretionary decisions:

- Increase/ reduce the ex-post adjustment
- Consider additional deferrals or increase in the quantum of share awards
- Recovery through malus and clawback arrangements

Khaleeji Commercial Bank BSC

Risk Management Disclosures

11 REMUNERATION RELATED DISCLOSURES (continued)

11.7 Risk assessment framework (continued)

Malus and Clawback framework

The Bank's malus and clawback provisions allows the Bank's Board of Directors to determine that, if appropriate, unvested elements under the deferred bonus plan can be forfeited/ adjusted or the delivered variable compensation could be recovered in certain situations. The intention is to allow the Bank to respond appropriately if the performance factors on which reward decisions were based turn out not to reflect the corresponding performance in the longer term. All deferred compensation awards contain provisions that enable the Bank to reduce or cancel the awards of employees whose individual behavior has had a materially detrimental impact on the Bank during the concerned performance year.

Any decision to take back an individual's award can only be taken by the Bank's Board of Directors.

The Bank's malus and clawback provisions allows the Bank's Board to determine that, if appropriate, vested /unvested elements under the deferred bonus plan can be adjusted/ cancelled in certain situations. These events include the following:

- Reasonable evidence of willful misbehavior, material error, negligence or incompetence of the employee causing the Bank/the employee's business unit to suffer material loss in its financial performance, material misstatement of the Bank's financial statements, material risk management failure or reputational loss or risk due to such employee's actions, negligence, misbehavior or incompetence during the concerned performance year.
- The employee deliberately misleads the market and/or shareholders in relation to the financial performance of the Bank during the concerned performance year.
- Clawback can be used if the malus adjustment on the unvested portion is insufficient given the nature and magnitude of the issue.

11.8 Components of Variable remuneration

Variable remuneration has following main components:

| | |
|----------------------|--|
| Upfront cash | The portion of the variable compensation that is awarded and paid out in cash on conclusion of the performance evaluation process for each year. |
| Deferred Cash | The portion of variable compensation that is awarded and paid in cash on a pro-rata basis over a period of 3 years |
| Upfront share awards | The portion of variable compensation that is awarded and issued in the form of shares on conclusion of the performance evaluation process for each year. |
| Deferred shares | The portion of variable compensation that is awarded and paid in the form of shares on a pro-rata basis over a period of 3 years |

All deferred awards are subject to malus provisions. All share awards are released to the benefit of the employee after a six month retention period from the date of vesting. The number of equity share awards is linked to the Bank's share price as per the rules of the Bank's Share Incentive Scheme. Any dividend on these shares is released to the employee along with the shares (i.e. after the retention period).

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Risk Management Disclosures

11 REMUNERATION RELATED DISCLOSURES (continued)

11.9 Risk assessment framework

All employees above the grade of a Senior Manager shall be subject to deferral of variable remuneration as follows:

| Element of variable remuneration | General Manager and above | Senior Managers and above | Deferral period | Retention | Malus | Clawback |
|----------------------------------|---------------------------|---------------------------|-----------------|-----------|-------|----------|
| Upfront cash | 40% | 50% | immediate | - | - | Yes |
| Upfront shares | - | 10% | immediate | 6 months | Yes | Yes |
| Deferred cash | 10% | - | Over 3 years | - | Yes | Yes |
| Deferred share awards | 50% | 40% | Over 3 years | 6 months | Yes | Yes |

The BNRGC, based on its assessment of role profiles and risk taken by an employee could increase the coverage of employees that would subject to deferral arrangements.

11.10 Details of remuneration paid

(a) Board of directors

| | BD 000's | |
|----------------|-------------|------|
| | 2014 | 2013 |
| • Sitting Fees | 201 | 329 |
| • Remuneration | Nil | Nil |
| • Others* | 15 | 23 |

* This represents airfare, accommodation, transportation and food and beverages paid on behalf of the Board members.

11 REMUNERATION RELATED DISCLOSURES (continued)

11.10 Details of remuneration paid (continued)

(b) Employee remuneration

| | | 2014 | | | | | | | |
|----------------------------|--------------------|--------------|-----------------------|------------|----------|-----------|-----------|----------|--------------|
| Number of staff | Fixed remuneration | | Variable remuneration | | | | | Total | |
| | Cash | Others | Upfront | | Deferred | | | | |
| | | | Cash | Shares | Cash | Shares | Others | | |
| Approved persons | | | | | | | | | |
| - Business lines | 7 | 654 | 423 | 42 | - | 9 | 44 | - | 1,172 |
| - Control & support | 12 | 602 | 269 | 42 | 6 | 2 | 34 | - | 955 |
| Other material risk takers | 6 | 271 | 169 | 31 | - | 2 | 11 | - | 484 |
| Other staff | 178 | 2,234 | 1,120 | 283 | - | - | - | - | 3,637 |
| TOTAL | 203 | 3,761 | 1,981 | 398 | 6 | 13 | 89 | - | 6,248 |

The fixed remuneration was BD 4,716 thousand and the variable remuneration was BD 499 thousand for the year 2013.

(c) Deferred awards

| | | 2014 | | | |
|---|-----------|------------------|-----------|----------|------------|
| | Cash | Shares | | Others | Total |
| | (Amount) | (Number) | (Amount) | (Amount) | (Amount) |
| Opening balance | - | - | - | - | - |
| Awarded during the period | 13 | 1,966,375 | 94 | - | 107 |
| Paid out / released during the period | - | - | - | - | - |
| Service, performance and risk adjustments | - | - | - | - | - |
| Changes in value of unvested opening awards | - | - | - | - | - |
| Closing balance | 13 | 1,966,375 | 94 | - | 107 |

(d) Severance pay

During the year Bank paid BD 652 thousand as ex-gratia to 10 employees and the highest amount paid to a single person was BD 161 thousand.