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

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

# RISK MANAGEMENT DISCLOSURES

## EXECUTIVE SUMMARY

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

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

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

### PILLAR I

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

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

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

### PILLAR II

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

Pillar II comprises two processes:

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

# RISK MANAGEMENT DISCLOSURES

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

**PILLAR III**

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

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

### 2.1 The risk management function

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

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

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

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

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

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

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

## 3. CAPITAL MANAGEMENT AND CAPITAL ADEQUACY RATIO

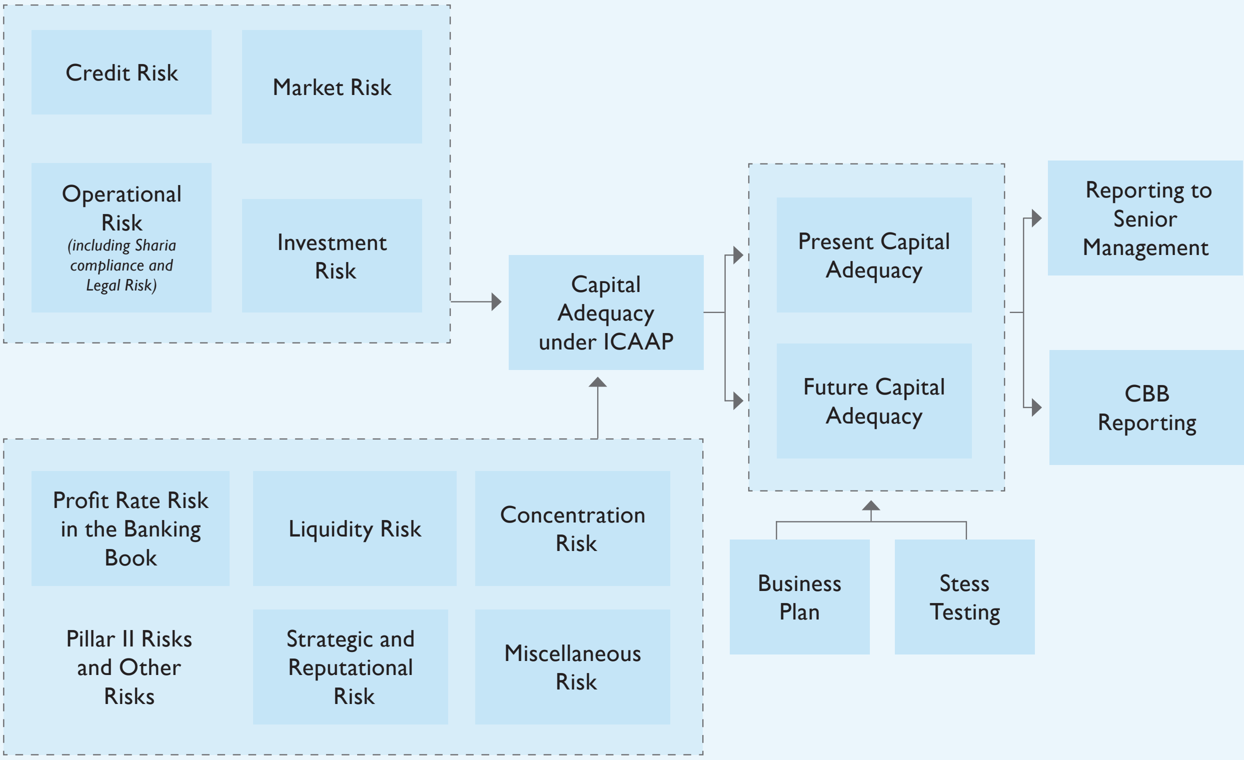
### 3.1 Capital management

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

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

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

ICAAP framework at the Bank



# RISK MANAGEMENT DISCLOSURES

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

### 3.2.1 Risk addressed by the ICAAP

| Risk Type | Metrics based on which internal capital is allocated |
|---|---|
| Credit risk<br>Market risk<br>Investment risk<br>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 vehicles (RIA's) & Large Investment Products |
| Reputational risk | Credit quality, Operational risk, Reputation related loss |
| Other Risks (strategic, Shari'a/regulatory compliance, business cycle) | Additional capital based on Pillar I risk weighted exposures |

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

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

| Net available capital | 31 December 2011 |
|---|---:|
| Issued and fully paid ordinary shares | 115,416 |
| Less: Treasury shares | (6,043) |
| Statutory reserve | 6,350 |
| Share premium | 1,485 |
| Others reserves | (300) |
| Eligible Portion of an unrealized gains arising from fair valuing equities | 2,095 |
| Retained earning | (2,695) |
| **Tier I capital** | **116,308** |
| Eligible Portion of an unrealized gains arising from fair valuing equities | 24 |
| General provision | 2,183 |
| **Tier II capital** | **2,207** |
| **Net available capital** | **118,515** |

| Risk weighted assets | 31 December 2011 |
|---|---:|
| Credit risk weight exposures | 376,508 |
| Market risk weight exposures | 15,163 |
| Operational risk weight exposures | 37,378 |
| **Total risk weighted assets** | **429,049** |
| Capital adequacy ratio (Tier I) | **27.11%** |
| Capital adequacy ratio (Total capital) | **27.62%** |

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

# RISK MANAGEMENT DISCLOSURES

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

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

**Regulatory capital components**

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

**Risk weighted assets**

*Credit risk*

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

*Market risk*

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

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

*Operational risk*

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

Break-up of capital requirement in accordance with the capital adequacy module of the CBB for the year ended 31 December 2011 is as follows (in BD 000's):

| Exposure classification | Exposure | | | Risk weighted assets* | | | Capital requirement @ 12% | | |
|---|---|---|---|---|---|---|---|---|---|
| | Self-financed | IAH | Total | Self-financed | IAH | Total | Self-financed | IAH | Total |
| Cash and collection items | 2,155 | - | 2,155 | - | - | - | - | - | - |
| Sovereigns | 2,045 | 23,324 | 25,369 | - | - | - | - | - | - |
| Banks | 2,828 | 86,069 | 88,897 | 1,414 | 7,373 | 8,787 | 170 | 885 | 1,055 |
| Corporates | 103,604 | 77,425 | 181,029 | 103,604 | 23,227 | 126,831 | 12,432 | 2,787 | 15,219 |
| Residential mortgage | 9,054 | - | 9,054 | 6,791 | - | 6,791 | 815 | - | 815 |
| Past due facilities | 27,007 | - | 27,007 | 33,931 | - | 33,931 | 4,072 | - | 4,072 |
| Investment in equities / sukuks | 29,922 | 8,548 | 38,470 | 44,778 | 3,847 | 48,625 | 5,373 | 462 | 5,835 |
| Holdings of real estate | 77,399 | - | 77,399 | 148,083 | - | 148,083 | 17,770 | - | 17,770 |
| Other assets | 3,460 | - | 3,460 | 3,460 | - | 3,460 | 415 | - | 415 |
| **Credit Risk** | **257,474** | **195,366** | **452,840** | **342,061** | **34,447** | **376,508** | **41,047** | **4,134** | **45,181** |
| **Market Risk** | **-** | **-** | **-** | **-** | **-** | **15,163** | **-** | **-** | **1,820** |
| **Operational Risk** | **-** | **-** | **-** | **-** | **-** | **37,378** | **-** | **-** | **4,485** |
| **Total** | **257,474** | **195,366** | **452,840** | **342,061** | **34,447** | **429,049** | **41,047** | **4,134** | **51,486** |

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

# RISK MANAGEMENT DISCLOSURES

## 4. CREDIT RISK

### 4.1 Credit risk management

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

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

*4. CREDIT RISK (CONTINUED)*

## 4.2 Levels of exposure

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

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

[1] Represents quarterly average balances for the year ended 31 December 2011.
[2] Includes cash balance of BD 2,155 thousand.

# RISK MANAGEMENT DISCLOSURES

4. *CREDIT RISK (CONTINUED)*

## 4.3 Concentration of credit risk

### 4.3.1 Geographical distribution

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

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

### 4.3.2 Industry / sector-wise distribution

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

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

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

# RISK MANAGEMENT DISCLOSURES

4. *CREDIT RISK (CONTINUED)*
   *4.3 Concentration of credit risk (continued)*

**4.3.3 Transactions with related counterparties**

Related counterparties are those entities which are related to the Bank through significant shareholding, control, or both. Wherever the Bank has entered into business transactions with such counterparties, such transactions have been done at an arm's length basis and on commercial terms that bring no disadvantage to the Bank. For the purpose of identification of related counterparties, the Bank strictly follows the guidelines issued by CBB for the purpose. Detailed break up is presented in note 23 of the consolidated financial statements for the year ended 31 December 2011.

**4.3.4 Exposures in excess of 15% of capital base**

Single exposures in excess of 15% of the Bank's capital base on individual counterparties require prior approval of CBB except where exempted under Para. CM 4.5 of the rule book. The Bank does not have any such large exposures as at 31 December 2011.

**4.3.5 Exposures in highly leveraged counterparties**

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

**4.3.6 Residual contractual maturity of the credit portfolio and investment in sukuks**

The Bank's policy allows exposures up to a maximum period of 7 years for corporate customers and 25 years for retail customers with any exceptions to be approved by the Board of directors. The Bank constantly monitors the residual maturity profile of its assets to ensure that any mismatch with the maturity of its liabilities is kept within acceptable limits. The contractual residual maturity profile by type of financing contract of the Bank's credit portfolio and investment in sukuks is given in the table below (in BD 000's):

| Maturity Scale | < 1 M | 1 - 3 M | 3 - 6 M | 6M - 1Y | 1 - 3Y | 3 - 5Y | 5 - 10Y | 10 - 20Y | Over 20Y | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Credit portfolio: | | | | | | | | | | |
| Murabaha | 16,263 | 6,657 | 4,596 | 2,507 | 47,754 | 54,218 | 10,583 | - | - | 142,578 |
| Musharaka | 1,747 | - | - | 5,661 | 13,111 | 7,221 | 10,698 | - | - | 38,438 |
| Wakala | 3,660 | 5,441 | 1,773 | 70 | 120 | 8,635 | - | - | - | 19,699 |
| Istisna | - | - | - | - | - | 719 | 122 | - | - | 841 |
| Ijarah | - | - | - | - | 2,020 | 3,018 | 2,789 | 4,715 | 1,116 | 13,658 |
| **Total** | **21,670** | **12,098** | **6,369** | **8,238** | **63,005** | **73,811** | **24,192** | **4,715** | **1,116** | **215,214** |
| Investment in Sukuks | 600 | 2,730 | 11,673 | 1,314 | 3,110 | 2,245 | - | - | - | 21,672 |
| **Total** | **600** | **2,730** | **11,673** | **1,314** | **3,110** | **2,245** | **-** | **-** | **-** | **21,672** |
| **Grand Total** | **22,270** | **14,828** | **18,042** | **9,552** | **66,115** | **76,056** | **24,192** | **4,715** | **1,116** | **236,886** |

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

# RISK MANAGEMENT DISCLOSURES

4. *CREDIT RISK (CONTINUED)*

*4.3 Concentration of credit risk (continued)*

### 4.3.7 Impaired loans age analysis

- By geographical area (in BD 000's)

| | 3 Months to 1 Year | 1 to 3 Years | Over 3 Years | Total |
|---|---|---|---|---|
| GCC countries | 29,720 | 3,640 | 3,199 | 36,559 |
| USA | - | 6,598 | - | 6,598 |
| **Total** | **29,720** | **10,238** | **3,199** | **43,157** |

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

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

## 4.4 Equity risk in banking book

The Bank does not have a trading book and hence all of its equity investments are classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. For regulatory capital computation purposes, the Bank's equity investments in the banking book include quoted / unquoted equity investments, and investments in associates being non-financial entities.

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

4. *CREDIT RISK (CONTINUED)*

*4.4 Equity risk in banking book (continued)*

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

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

## 4.5 Risk grading of exposures

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

4. *CREDIT RISK (CONTINUED)*

**4.6 Past dues, impaired accounts, provisions**

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

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

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

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

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

During the year 2011, the Bank has undertaken a detailed assessment of its credit portfolio and has considered specific impairment allowances where necessary. In the view of the current market conditions, Bank has maintained the collective provisions at a certain percentage based on the internal risk grades assigned to counterparties, resulting in an average of approximately 1.2% of its financing assets, assets acquired for leasing, lease rentals receivable and sukuk portfolios. This practice is in line with CBB requirements and the industry best practice in Bahrain.

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

4. *CREDIT RISK (CONTINUED)*

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

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

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

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

**4.7 Renegotiated facilities**

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

**4.8 Legal action and write off of exposures**

The Bank has policies for initiation and prosecution of legal action when all amicable avenues for settlement of dues from a customer have been exhausted. The Bank as of 31 December 2011 was involved in five litigations for recovery of dues from clients amounting to BD 11.04 million. In addition, there is a claim brought by one of the clients against the Bank for not providing a credit facility of BD 4.5 million to him which the Bank is defending. Bank has made adequate provisions for any loss that may arise from such litigations.

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

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

4. *CREDIT RISK (CONTINUED)*

**4.9 Penalties for delayed payments**

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

The Bank has a policy of creating a contribution for Charity and Zakah fund for any non-Islamic income earned. During the year ended 31 December 2011, an amount of BD 7 thousands was thus transferred to Charity and Zakah fund.

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

**4.10 Credit risk mitigation**

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

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

| Collateral Type | Murabaha | Musharaka | Wakala | Istisna | Ijara | Value of collateral[1] | Gross Exposure[2] | % of cover | % of Total |
|---|---|---|---|---|---|---|---|---|---|
| Real estate | 159,301 | 54,004 | 8,835 | 2,649 | 22,783 | 247,572 | 132,565 | 187% | 86% |
| Listed securities | 1,051 | 2,508 | - | - | - | 3,559 | 2,973 | 120% | 1% |
| Unlisted securities | 8,060 | - | - | - | - | 8,060 | 3,918 | 206% | 3% |
| Bank guarantee | 20,843 | - | - | - | - | 20,843 | 16,954 | 123% | 7% |
| Cash collateral | 3,888 | - | 346 | - | - | 4,234 | 16,463 | 26% | 2% |
| Unsecured | - | - | - | - | - | - | 40,262 | 0% | 0% |
| Others | 2,510 | 1,716 | - | - | - | 4,226 | 4,178 | 101% | 1% |
| **Total** | **195,653** | **58,228** | **9,181** | **2,649** | **22,783** | **288,494** | **217,313** | **133%** | **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 2,099 thousand and net of specific impairment allowance of BD 16,151 thousand.

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

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

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

# RISK MANAGEMENT DISCLOSURES

*4. CREDIT RISK (CONTINUED)*

*4.10 Credit risk mitigation (continued)*

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

The Bank has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the year ended 31 December 2011 there has been no such instance.

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

BD (000's)

| Equity investments in banking book | Exposure | | Credit Risk weighted exposure | | Capital requirement @12% | |
|---|---|---|---|---|---|---|
| | Self-financed | IAH | Self-financed | IAH | Self-financed | IAH |
| Murabaha | 85,251 | 57,629 | 86,005 | 17,289 | 10,321 | 2,075 |
| Ijara assets (including lease rentals receivable) | 13,658 | - | 11,395 | - | 1,367 | - |
| Musharaka | 37,844 | - | 44,014 | - | 5,282 | - |
| Wakala | - | 19,999 | - | 6,000 | - | 720 |
| Istisna | - | 833 | - | 250 | - | 30 |
| **Total** | **136,753** | **78,461** | **141,414** | **23,539** | **16,970** | **2,825** |

## 5. MARKET RISK

### 5.1 Market risk management

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

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

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

# RISK MANAGEMENT DISCLOSURES

5. *MARKET RISK (CONTINUED)*

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

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

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

6. OPERATIONAL RISK

**6.1 Operational risk management**

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

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

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

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

**6.2 Litigation**

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

**6.3 Shari'a compliance**

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

# RISK MANAGEMENT DISCLOSURES

6. *OPERATIONAL RISK (CONTINUED)*

**6.4 Regulatory capital allocation against operational risk**

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

The risk weighted assets and capital requirement for operational risk as at 31 December is as given below (in BD 000's):

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

7. OTHER RISKS

**7.1 Liquidity risk**

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

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

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

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

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

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

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

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

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis points (bps) parallel fall or rise across all yield curves and a 50 bps rise or fall of all yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market profit rates has been disclosed in note 31 of the consolidated financial statements for the year ended 31 December 2011.

# RISK MANAGEMENT DISCLOSURES

7. *OTHER RISKS (CONTINUED)*

## 7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. The Bank does not engage in proprietary trading of equity, foreign exchange or its derivatives. However, the Bank enters into Shari'a compliant foreign exchange risk/ profit rate risk transactions to hedge its risks arising out of mismatch in its asset liability portfolios. Clear policies for such transactions are in place. For other credit markets transactions (primarily interbank placements), the Bank has established a matrix of counterparty limits based on external credit rating of such counterparties. Such limits are constantly monitored by the Banks Risk Management Department. As at 31 December 2011, the Bank did not have any open position in foreign currency risk management instruments.

## 7.4 Concentration risk

Concentration risks arises when a number of obligors, counterparties or investees are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Accordingly, such concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or region. The Bank has established exposure limits to various geographic regions and industry sectors. For break-up of exposure geography and industry / sector wise, please refer to notes 4.3.1 and 4.3.2 above.

## 7.5 Reputational risk

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

## 7.6 Displaced commercial risk

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

## 7.7 Other risks

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

8. PRODUCT DISCLOSURES

## 8.1 Product descriptions & consumer awareness

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

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

# RISK MANAGEMENT DISCLOSURES

*8. PRODUCT DISCLOSURES (CONTINUED)*

*8.1 Product descriptions & consumer awareness (continued)*

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

## 8.2 Complaint handling

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

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

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

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

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

8. *PRODUCT DISCLOSURES (CONTINUED)*

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

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

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

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

[1] Represents average balance.

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

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

[1] Includes saving account and Al-Wafer account.

**Distribution of profits by type of IAH products:**

| Year | Avg. profit earned from IAH assets (%age of asset) | PER set aside as a %age of IAH assets | IRR set aside as a %age of IAH assets | Mudarib fees as a %age of IAH assets | Profit paid as a %age of IAH assets |
|---|---|---|---|---|---|
| **2011** | **4.99** | **-** | **-** | **1.22** | **3.69** |
| 2010 | 4.03 | (0.54) | (0.49) | 1.28 | 4.04 |
| 2009 | 6.09 | 0.30 | 0.24 | 0.96 | 4.58 |
| 2008 | 7.07 | 0.34 | 0.26 | 1.60 | 4.87 |
| 2007 | 7.84 | 0.38 | 0.24 | 1.47 | 5.75 |

# RISK MANAGEMENT DISCLOSURES

*8. PRODUCT DISCLOSURES (CONTINUED)*

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

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

| | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| 1 Month Mudaraba [1] | 2.51% | 3.66% | 4.00% | 4.80% |
| 3 Months Mudaraba | 4.25% | 4.13% | 4.94% | 5.25% |
| 6 Months Mudaraba | 4.52% | 3.38% | 5.30% | 5.13% |
| 12 Months Mudaraba | 5.01% | 4.94% | 5.79% | 5.40% |
| VIP Mudaraba | 3.67% | 4.35% | 4.20% | 4.52% |

[1] Includes saving account and Al-Wafer account.

**Market benchmark rates:**

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

**IAH account by type of assets:**

The following table summarises the movement in type of assets in which the IAH funds are invested and allocated among various type of assets for the year ended 31 December 2011:

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

*8. PRODUCT DISCLOSURES (CONTINUED)*

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

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

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

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

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

| RIA name | Details | Launch date | Projected returns | Return frequency | Return annualized (%) | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 2011 | 2010 | 2009 | 2008 | 2007 |
| Al-Hareth French Property Fund | An investment product designed to deliver attractive return from income producing properties in France. Approximate capital redemption of 30% was completed in April 2007 with a capital gain of 6% on the redeemed portion. | 2005 | 9.0% | Annual | - | - | 1.75 | 9.50 | 9.50 |

# RISK MANAGEMENT DISCLOSURES

*8. PRODUCT DISCLOSURES (CONTINUED)*

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

| RIA name | Details | Launch date | Projected returns | Return frequency | Return annualized (%) | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 2011 | 2010 | 2009 | 2008 | 2007 |
| RIA 1 - Safana | An investment structure designed to participate in the equity interest of Safana Investment WLL. A company established for the purpose of acquiring reclaimed land to subdivide and sell, the Bank made an offer to buy back < BD 20,000 of each investors funds in RIA 1 at par. This offer was formalized in a letter to investors dated 25 May 2011. A total of 74 of the 95 RIA 1 investors accepted the offer at a cost of BD 1,220,000 to the Bank and resulting in a total of 39 investors being fully exited from the RIA. As a result, total investors funds have reduced to BD 8.34 million. | 2007 | 61.78% over product tenor | Bullet payment on maturity | - | - | - | - | - |
| RIA 4 - Janayen | A restricted investment product designed to invest in growth and income generating real estate assets in the GCC and MENA regions. To date, RIA 4 has made distributions and redemptions to investors amounting to approximately 27.50% of investors' initial capital. These distributed funds were in the form of yields amounting to ≈ 21.1% in addition to 6.4% redemption of capital (3.7% redemption affected during Q2 2011). | 2007 | 44.33% | Quarterly | - | 0.27 | 9.62 | 10.65 | - |

# RISK MANAGEMENT DISCLOSURES

*8. PRODUCT DISCLOSURES (CONTINUED)*

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

| RIA name | Details | Launch date | Projected returns | Return frequency | Return annualized (%) 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|---|---|---|
| RIA 5 - North Gate | A restricted investment product which owns a 6.0% stake in Shaden Real Estate Investment WLL which in turn (through its subsidiaries), holds a parcel of reclaimed land measuring approximately 3.875 million Sq. Meters (located in Al-Hidd, Muharraq). The mixed-use plot will be sold to end users subsequent to the completion of infrastructure works. | 2008 | 90.66% over product tenor | Bullet return at maturity | - | - | - | - | - |
| RIA 6 - Locata | A Restricted Mudaraba product which entitles the investors beneficial ownership of 25% equity share capital of Locata Corporation Pty Ltd., a company incorporated in Australia. The Company has invented a new and patented wireless radiolocation technology and shall use this funding to scale up its production capacity, sales / marketing channels and further product enhancement capabilities. | 2009 | 110.54% over product tenor | Bullet return at maturity | - | - | - | - | - |

## 9. CORPORATE GOVERNANCE & OTHER DISCLOSURES

### 9.1 Corporate governance structure

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

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

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

### 9.2 Board of directors

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

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

*9.2 Board of directors (continued)*

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

*9.2 Board of directors (continued)*

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

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

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

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

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

*9.2 Board of directors (continued)*

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

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

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

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

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

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

*9.2 Board of directors (continued)*

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

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

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

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

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

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

**9.3 Board of directors' interests**

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

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

[1] The change is due to vesting of shares under the share-based employee incentive scheme.

[2] The change is due to transfers made to relatives during the year.

# RISK MANAGEMENT DISCLOSURES

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

## 9.4 Distribution of ownership shares by nationality

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

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

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

## 9.5 Board committees

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

| Committee | Members | Primary responsibilities |
|---|---|---|
| Board Nominations, Remunerations and Governance Committee (BNRGC) | • Abdulla Abdulkarim Showaiter.<br>• Mohammed Barrak Al-Mutair.<br>• Khalid Rashid Al-Thani. | • Human Resources.<br>• Compensation and incentives.<br>• Administration.<br>• Corporate Governance. |
| Board Audit Committee (BAC) | • Khalid Rashid Al-Thani.<br>• Abdulrahman A. Al-Kooheji.<br>• Khalid Hussain Al-Maskati. | • Internal Audit.<br>• External Audit.<br>• Compliance.<br>• Anti-Money Laundering. |
| Board Investment and Credit Committee (BICC) | • Dr. Fuad Abdulla Al-Omar.<br>• Abdulrahman M. Jamsheer.<br>• Abdulla Abdulkarim Showaiter.<br>• Ebrahim Hussain Ebrahim.<br>• Mohammed Barrak Al-Mutair.<br>• Mosobah Saif Al-Mutairy. | • Investment & credit approval.<br>• Setting limits.<br>• Investment policies.<br>• Asset Liability Management.<br>• Banking relationship.<br>• Oversight of Off-Balance Sheet Vehicles. |
| Board Risk Management Committee (BRMC) | • Abdulrahman A. Al-Kooheji.<br>• Khalid Hussain Al-Maskati.<br>• Tariq Qassim Fakhroo. | • Risk management.<br>• Policies related to risk management. |

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

## 9.6 Board committees meeting dates

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

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

* The following members joined the Board officially on 31st March 2011:

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

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

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

* The following members joined the Committee officially on 28th April 2011:

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

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

*9.6 Board committees meeting dates (continued)*

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

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

* All members joined the Committee officially on 28th April 2011.

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

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

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

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

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

* The following members joined the Committee officially on 28th April 2011:

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

**9.7 Code of conduct**

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

# RISK MANAGEMENT DISCLOSURES

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

## 9.8 Compliance with regulators

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

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

## 9.9 Shari'a Supervisory Board

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

**Dr. Fareed Yaqoob Al-Miftah**
*Chairman*
*Experience:*
- Member of the Supreme Council of Islamic Affairs.
- Undersecretary of the Ministry of Justice & Islamic Affairs - Bahrain.
- Former judge of the high Shari'a Court.
- Former Lecturer at the University of Bahrain.

*Qualification:*
- Ph.D. from the University of Edinburgh - United Kingdom.

**Dr. Fareed Mohammed Hadi**
*Executive Member*
*Experience:*
- Assistant Professor at the College of Arts, Department of Arabic and Islamic studies, University of Bahrain.
- Member of Shari'a Supervisory Board of a number of Islamic banks.

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

**Sh. Nizam Mohammed Saleh Yaqoobi**
*Member*
*Experience:*
- Executive Member of the Shari'a Supervisory Board of Abu Dhabi Islamic Bank - UAE.
- Executive Member of the Shari'a Supervisory Board of Bahrain Islamic Bank - Bahrain.
- Executive Member of the Shari'a Supervisory Board of Ithmaar Bank - Bahrain.
- Board Member of the Dow Jones Islamic index.
- Member of Shari'a Supervisory Board of a number of Islamic banks & insurance companies.

# RISK MANAGEMENT DISCLOSURES

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

## 9.10 Executive management committees

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

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

### Executive management & other senior management

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

**Ebrahim Hussain Ebrahim**
*CEO & Board Member*
*Experience:*
- Over 29 years of experience in both Islamic and conventional banks and financial institutions.
- Joined the Bank in 2004.

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

**Silvan Varghese**
*Deputy General Manager & COO*
*Experience:*
- 21 years of experience in the banking industry in India and Middle East in several areas like Risk and Credit Management, Compliance, Project Finance and Corporate Banking.
- Joined the Bank in 2007.

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

**Fuad Ali Taqi**
*Deputy General Manager, Commercial Banking*
*Experience:*
- Over 30 years of banking experience in Islamic and conventional banks.
- Joined the Bank in 2006.

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

**Mahdi Abdulnabi Mohammed**
*Assistant General Manager – Head of Operations & Administration*
*Experience:*
- Over 31 years of banking experience.
- Joined the Bank in 2005.

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

# RISK MANAGEMENT DISCLOSURES

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

*9.10 Executive management committees (continued)*

**Jasim Awadh Asghar**
*Assistant General Manager – Head of Corporate and Wholesale Banking*
Experience:
- Over 21 years of banking experience.
- Joined the Bank in February 2011.

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

**T. N. Ramesan**
*Assistant General Manager - Head of Risk & Credit Management*
Experience:
- Over 32 years of banking experience.
- Joined the Bank in 2007.

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

**Ahmed Ali Bucheeri**
*Head of Internal Audit*
Experience:
- 23 years of experience in both internal and external audit mainly in banks.
- Joined the Bank in 2007.

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

**Hussam Ghanem Saif**
*Head of Treasury*
Experience:
- Over 22 years of experience in treasury and Islamic banking.
- Joined the Bank in 2007.

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

**Yaser Ismaeel Mudhafar**
*Head of Financial Control*
Experience:
- Over 14 years of extensive experience in the Islamic banking industry and Audit.
- Joined the Bank in 2006.

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

**Fatooh Yusuf Al-Mannai**
*Head of Human Resources*
Experience:
- Over 16 years of experience in human resources, training and administration.
- Joined the Bank in 2007.

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

# RISK MANAGEMENT DISCLOSURES

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

*9.10 Executive management committees (continued)*

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

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

**Abdul-Nasser Omar Al-Mahmood**
*Head of Shari'a Compliance*
Experience:
- Over 21 years of experience in Shari'a Audit and Islamic banking.
- Joined the Bank in 2008.

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

**Mohammed Abdulla Ebrahim**
*Corporate Secretary, Head of Compliance and MLRO*
Experience:
- Over 9 years of experience working at the Office of the Assistant Undersecretary for Planning and Organisation, Ministry of Interior - Bahrain, and at the Secretariat General Office of the GCC in Riyadh as Liaison Officer for the Kingdom of Bahrain.
- Joined the Bank in 2009.

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

### 9.11 Executive and senior management interests

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

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

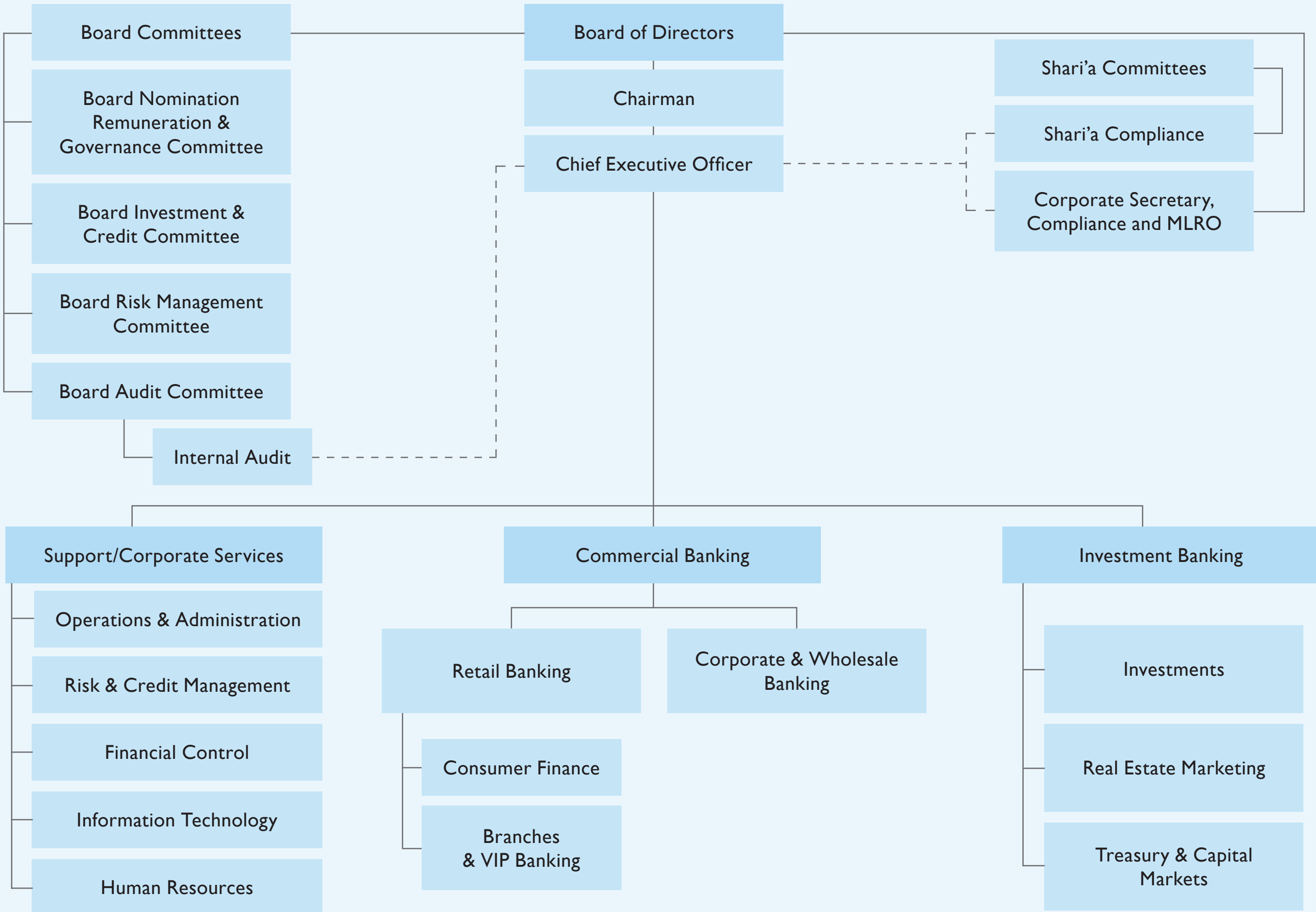
*The change in the above number of shares is due to vesting of shares under the share-based employee incentive scheme.

# RISK MANAGEMENT DISCLOSURES

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

## 9.12 Organizational chart

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




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

## 9.13 Executive compensation

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

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

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

# RISK MANAGEMENT DISCLOSURES

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

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

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

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

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

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

The Bank is currently working on the compliance with the above mentioned requirements.

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

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

**10. FINANCIAL PERFORMANCE**

Following are basic quantitative indicators of the financial performance:

| | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Return on average equity | 0.44% | - 5.18% | 2.47% | 20.00% | 23.50% |
| Return on average assets | 0.13% | - 1.59% | 0.65% | 7.40% | 11.50% |
| Finance income to finance expense | 208.06% | 240.21% | 155.66% | 154.11% | 187.97% |
| Cost-to-income* | 72.11% | 83.79% | 48.30% | 30.59% | 30.46% |

*Cost has been considered excluding impairment allowances.

For detailed discussion on the performance for the year, kindly refer to Chairman's report on the consolidated financial statement for the year ended 31 December 2011.