Kuwait Finance House (Bahrain) B.S.C.(c)

Public Disclosure

31st December 2011

www.kfh.bh

بيت التمويل الكويتي
Kuwait Finance House
Bahrain B.S.C.(c) البحرين ش.م.ب (م)

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1. Group Structure

The public disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD–1: Annual Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Kuwait Finance House (Bahrain) B.S.C. (c) ("KFH Bahrain" or "the Bank") being a locally incorporated Bank with an Islamic retail banking license and its subsidiaries, together known as ("the Group"). All amounts presented in the document are in Bahraini Dinar and rounded off to the nearest thousand. The shareholders along with their shareholding and nationality as at 31 December 2011 are as follows:

Name	Number of shares	Nominal Value (BD '000)	%	Nationality
Kuwait Finance House K.S.C.	1,648,995,669.200	164,899.567	93.09	Kuwaiti
Mr. Imad Yousif Al Mane'e	488,401.100	48.840	0.03	Kuwaiti
Mr. Adel Ahmed Al Banwan	488,401.100	48.840	0.03	Kuwaiti
Mr. Mohammed Sulaiman Abdulaziz Ebrahim Alomar	488,401.100	48.840	0.03	Kuwaiti
Mr. Khalid Ali Almsalam	488,401.100	48.840	0.03	Kuwaiti
Themar Baytik Company B.S.C. (c)	120,455,526.400	12,045.553	6.80	Bahraini
Total	1,771,404,800	177,140.480	100	

The Board of Directors (the "Board") at KFH Bahrain seeks to optimise the Group's performance by enabling the business units to realise the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and the risk policy framework.

2. Capital Adequacy

The Group manages the capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the CBB in supervising the Bank.

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains healthy capital ratios in order to support its business and to maximise shareholders' value.

Regulatory capital consists of Tier 1 capital (core capital) and Tier 2 capital (supplementary capital). Tier 1 comprises share capital, share premium, statutory reserve, general reserve, retained earnings, foreign currency translation reserve and non-controlling stakeholders less goodwill. Tier 2 capital includes subordinated murabaha payable, collective impairment and revaluation reserves. Certain adjustments are made to the financial results and reserves, as prescribed by the CBB in order to comply with Capital Adequacy (CA) Module issued by the CBB. From the regulatory perspective, the significant amount of the Group's capital is in Tier 1.

The Group's approach to assessing capital adequacy has been in line with its risk appetite in the light of its current and future activities. To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the Standardised Approach for the Credit and Market Risk, and the Basic Indicator Approach for the Operational Risk.

The Bank's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of expectations for each business group, expected growth in off–balance sheet facilities and future sources and uses of funds. In achieving an optimum balance between risk and return, the Bank has established an Internal Capital Adequacy Assessment Program (ICAAP) which quantifies the economic capital requirements for the key risks that the Bank is exposed to including credit risk, investment risk, liquidity risk, strategic risk, profit rate risk, reputation risk, operational risk, and concentration risk. The Bank also conducts comprehensive stress tests for various portfolios and assesses the impact on the capital and profitability. In addition, the Bank's stress testing frameworks and models allow for forward-looking scenarios, which is considered for business growth strategies. The ICAAP of the Bank is driven by the Board through the Capital Adequacy Strategy and the ICAAP Policy. In case a plausible stress scenario is identified which may severely affect the capital adequacy of the Bank, the senior management decides an appropriate corrective action to be taken under such a scenario.

For the purpose of computing CAR the Bank consolidates the following entities:
1. Kuwait Finance House – Jordan;
2. Bayan Group for Property Investment W.L.L.;
3. Baytik Investment One S.P.C.; and
4. Baytik Investment Two S.P.C.

None of the Bank's investment in subsidiaries exceeds the materiality thresholds specified in Prudential Consolidation and Deduction Module hence not deducted from the available capital. All other subsidiaries (i.e. commercial subsidiaries) are risk weighted as per the requirement of CA Module.

All transfer of funds or regulatory capital within the Group is only carried out after proper approval process.

2.1 Quantitative Disclosures

Table – 1. Capital Structure **Amount in BD '000**

CAPITAL STRUCTURE	
Capital Structure (PD-1.3.12, 1.3.13,1.3.14, 1.3.15) *	
Components of Capital	
Core capital - Tier 1:	
Issued and fully paid ordinary shares	177,140
Employee stock incentive program funded by the Bank	(17,379)
Share premium	71,403
Statutory reserve	14,310
General reserve	44,460
Retained earnings	6,319
Unrealized gains arising from fair valuing equities (45% only)	20,897
Other reserves	(1,049)
Total Tier 1 Capital	316,101
Deductions from Tier 1:	
Unrealised gross gains arising from fair valuing equity securities	-
Tier 1 Capital before PCD deductions	316,101
Supplementary capital - Tier 2:	
Subordinated murabaha payable	100,186
Asset revaluation reserve - Property, plant, and equipment (45% only)	7,322
Investment risk reserve	11,743
Tier 2 Capital before PCD deductions	119,251
Total Available Capital before PCD deductions (Tier 1 & 2)	**435,352**

	Tier I	**Tier II**
Available Capital before PCD deductions	316,101	119,251
Deductions		
Investment in takaful insurance entity greater than or equal to 20% of investee's capital base	1,219	1,219
Excess amount over maximum permitted large exposure limits	57,783	57,783
Aggregate Deductions	59,002	59,002
Total eligible capital	**257,099**	**60,249**

* For the purposes of guidance we have cross referenced every table with the relevant Para number of the CBB's Public Disclosures module.

Table – 2. Capital Requirement by Type of Islamic Financing Contract.

Amount in BD '000

CAPITAL ADEQUACY	
Regulatory Capital Requirements (PD-1.3.17) by Each Type of Islamic Financing Contracts	
Type of Islamic Financing Contracts	**Capital Requirement**
Murabaha contracts with Banks	767
Financing contracts with customers	
- Murabaha	44,772
- Ijarah	9,907
- Musharakah	1,929
Total	**57,375**

Table – 3. Capital Requirement for Market and Operational Risk

Amount in BD '000

CAPITAL ADEQUACY		
Capital Requirements for Market Risk (PD-1.3.18) & Operational Risk (PD-1.3.19) & 1.3.30(a)		
Particulars	**Risk Weighted Assts**	**Capital Requirement**
Market Risk - Standardised Approach	42,133	5,267
Operational Risk - Basic indicator approach	122,055	15,257

Table – 4. Capital Ratios

Amount in BD '000

CAPITAL ADEQUACY		
Capital Adequacy Ratios (PD-1.3.20)		
Particulars	**Total Capital Ratio**	**Tier 1 Capital Ratio**
	%	
Consolidated Ratios	26.21%	21.23%

3. Risk Management

3.1 Bank Wide Risk Management Objectives

The management of the Bank believes in the proactive management of risk through the full cycle of a financial transaction including its operating circumstances from the origination stage to its final disposal from the books of the Group. The risk management objective for each area of risk is to adopt the best practices informed by Basel II and IFSB guidelines and adhering to CBB requirements. The Group is able to identify, capture, monitor and manage different dimensions of risk with the aim of protecting asset values and income streams, and hence, optimising the Group's shareholder returns, while maintaining its risk exposure within defined parameters.

The Board of Directors (BoD) are responsible for managing risk in the Bank. They do this through setting the risk appetite in the form of a comprehensive limit structure and aligning business and risk strategies to achieve overall risk adjusted returns. The Bank reviews and redefines its risk appetite according to the evolving business plans considering fluctuations in economic and market conditions and future forecasts. The Bank also assesses on a regular basis its tolerance for specific risk categories in term of limits structures for various risks and its strategy to manage these risks. The Risk Management Department compiles, analyses and presents Bank wide data to Senior Management and Board level committees to aid in the monitoring and managing of these limits. To achieve this the Bank has implemented sophisticated risk management systems, models and various other analytical tools.

3.2 Strategies, Processes & Internal Controls

3.2.1 Bank's Risk Strategy

The Bank's risk strategy, backed by appropriate limit structures, is articulated through a Risk Charter, Capital Adequacy strategy, Credit risk strategy, Investment risk strategy, Market risk strategy, Profit rate risk strategy, Liquidity risk strategy, Operational risk strategy and ICAAP policy. These strategies provide an enterprise–wide integrated risk management framework in the Bank. The Risk Charter identifies risk objectives, policies, strategies and risk governance both at the Board and the management level. The Capital Adequacy strategy and ICAAP policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses. Limit structures serve as a key component in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with their own strategies, policies and methodology documents. In addition, the Bank is in the process of implementing various risk systems to help quantify not just the regulatory capital but also the economic capital allocated to various portfolios.

The Group is exposed to various types of risk, such as market, credit, rate of return, liquidity and operational risks, all of which require comprehensive controls and on-going oversight. The risk management framework encapsulates the spirit behind Basel II, which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities, adequate information and communication channels, monitoring risk management activities and correcting deficiencies.

3.2.2 Credit Risk

The Bank manages its credit risk exposures by evaluating each new product/activity with respect to the credit risk introduced by it. The Bank uses comprehensive credit evaluation and assessment criteria and scorecard for every credit proposal and records the risks arising from each new exposure. The Bank has established a limit structure to avoid concentration of risks for counterparty, industrial sector and geographical area. The Bank also conducts stress testing for assessing the impact of adverse systematic and firm specific conditions on its credit portfolio. The Bank also maintains Credit Risk Policy and Collateral Management policy for credit risk mitigates. Please refer to section 3.5.7 for 'Credit Risk Mitigation'.

3.2.3 Market Risk

The Bank measures and monitors the market risk in its portfolio using appropriate measurement techniques such as limits on its FX open positions, stop loss limits, notional limits and VaR limits. The Bank conducts stress testing to assess the impact of adverse market conditions on its market risk sensitive portfolio.

3.2.4 Operational Risk

The Bank has established a Risk Control and Self Assessment (RCSA) process necessary for identifying and measuring and controlling its operational risks. This exercise covers the Bank's business lines and associated critical activities, exposing the Bank to operational risks.

3.2.5 Equity Risk in the Banking Book

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio. The Bank manages and monitors market risk arising out of its investment in public equity using VaR and its private equity using industrial sector, geographical areas and investment type limits. The strategy used has been effective throughout the reporting period.

3.2.6 Profit Rate Risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank manages the mismatch risk and re-pricing characteristics of the assets and liabilities by monitoring, managing and limiting its re-pricing gaps. It also manages the market value sensitivity of the portfolio to the profit rates.

3.2.7 Displaced Commercial Risk (DCR)

DCR refers to the market pressure to pay returns to Unrestricted Investment Account (URIA) holders that exceeds the rate that has been earned on the assets financed by the URIA, when the return on assets is under performing as compared with competitor's rates.

The Bank manages DCR through the Profit Sharing Investment Account (PSIA) policy approved by the Board according to which the Bank can forego its mudarib share to manage DCR. The Bank benchmarks its rates with other leading banks in the market along with performing analysis of its profitability and studies of other market indicators.

The quantitative disclosures regarding DCR are discussed in tables 28 and 39.

3.3 Structure and Organisation of Risk Management Function

The Risk Management structure at the Bank encompasses all levels of authorities, organisational structure, people and systems required for the effective functioning of risk management processes. The roles and responsibilities associated with each level of risk management structure and authorities consist of the following:

The Board retains ultimate responsibility and authority for all risk management matters, including:

a. Establishing overall policies and procedures; and
b. Delegating authority to the Executive Committee, Risk Governance and Compliance (RGC) Committee and further delegation to the management.

In order to perform its duties more efficiently, the Board have set up committees with specific responsibilities. Each committee has its respective terms of references that define its scope and powers.

RGCC is a Board level committee which is responsible for reviewing and maintaining an oversight on all the risks faced by the Bank including compliance, governance and anti-money laundering (AML). For other Board committees' objectives, please refer to table 43 in this document.

The Board and RGCC delegate the authority of the management of risk through several senior management committees including ALCO and Risk Management Committee, Basel II, Investment Committee, Credit Committee, Public Disclosure and Collection committee. Further, the different business units are the front line operators of risk management practices in the Bank and are the first line of control. Also, the overall risk framework including business units operate under the oversight and scrutiny of the internal audit function.

An independent Risk Management Department (RMD) is responsible for developing and implementing the risk management framework through the help of business units and committees as mentioned above. RMD also quantifies risk management numbers, develops reports, conducts periodic stress test and ICAAP program and reports them through a comprehensive risk management dashboard to ALCO, RGCC and the Board of Directors to seek management actions and resolutions to mitigate risk.

3. 4 Risk Measurement & Reporting Systems

The Bank measures the risk using the risk management systems and risk MIS reports. The Bank has put in place various limits based on its risk appetite. These limits have been approved by the Board. Any limit breaches are reported to the respective senior management committees and the Board by the RMD based on the limit breach procedure approved by the Board. The limits are reviewed and revised on at least an annual basis or when deemed necessary. The Bank has implemented sophisticated risk management systems such as Focus Asset and Liability Management (ALM), credit risk rating systems, stress test models, ICAAP model, VaR and various other analytical models in order to generate the MIS and monitor the limits.

3.5 Credit Risk

3.5.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from financing and treasury activities. The Bank controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by collateral in the form of mortgage of real estate properties or other tangible securities.

The Board sets the guidelines for managing the credit risk in terms of credit risk strategy, credit risk policy, credit criteria specifications, collateral management policy and credit risk limits including individual and concentration limits. Any change to these guidelines is approved by the Board.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical areas and industrial sectors. All credit proposals undergo a comprehensive risk assessment which examines the customer's financial condition, trading performance, nature of the business, quality of management, and market position, etc. Counterparty facility limits for corporate customers are established by the use of a credit risk classification system, which assigns each counterparty a risk rating in terms of obligor risk rating and the facility risk rating. The proposals are reviewed by the Credit Review and Administration Department which is separate from the risk taking business units. A comprehensive template is used to review the proposals by the credit review team. A credit approval decision is then made and terms and conditions are set.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Corporate contracts/facilities are reviewed on an annual basis by Corporate Finance and the Credit Review and Credit Administration Department.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the Bank. Risk ratings methodology is subject to regular revision by RMD.

3.5.2 Types of credit risk

The Bank's Financing contracts mainly comprise of, Ijarah/Ijarah Muntahia Bittamleek, Istisna, Murabaha, Murabaha (International Commodity), Murabaha Letter of Credit, Diminishing Musharakah and Qard Al Hassan.

Ijarah /Ijarah Muntahia Bittamleek ("IMB")
The Bank enters into a contract under which the Bank purchases and leases out an asset required by the customer for a rental fee. The duration of the lease and rental fees are agreed in advance. Ownership of the asset remains with the Bank until full payment is received from the customer where the "Ownership Transfer Agreement" is signed. The Bank provides Ijarah financing in the form of IMB.

Istisna financing
Istisna is a contract of acquisition of goods or property by specification or order, where the price is paid in advance, but the goods are manufactured and delivered at a later date. The price and necessary specifications of the goods or property must be fixed as at the time of the contract.

Murabaha
Murabaha is a contract between the Bank and its client for the sale of goods at a price which includes a profit margin agreed by both parties. As a financing technique, it involves the purchase of goods by the Bank as requested by its client. The goods are then sold to the client at a profit. Repayment, usually in instalments, is specified in the contract.

Murabaha (International Commodity)/Tawarruq
A commodity Murabaha is a contract between the Bank and its client for the sale of goods at a price plus an agreed profit margin for the Bank. The product is referred to as an International Commodity Murabaha/Tawarruq because the profits are made on the buying and selling of a Shari'a compliant commodity usually metal on international market such as copper, aluminium or lead.

Murabaha Letter of Credit
A documentary credit is an undertaking by the Bank to pay the seller of goods, subject to the conformity of contractual instructions. Pursuant to a Murabaha Letter of Credit, the Bank imports the goods in its own name. The customer then purchases the goods from the Bank at a price plus an agreed profit margin under a Murabaha arrangement.

Diminishing Musharakah
This form of financing makes the client as a "partner" in term of ownership of the asset. This arrangement allows equity participation and sharing of profit and loss on a pro rata basis. During the period of financing, the non–Bank partner makes payments to increase its equity in the subject matter with the ultimate objective that it will eventually buy the entire Bank's equity and have the title in the asset transferred solely to him.

Qard Al Hassan
The Bank provides a benevolent finance. Under this arrangement the Bank provides financing without any profit which is usually short term in nature. The recipient is obliged to repay the principal at the time of maturity.

Wakala
Wakala is a contract between the 'Muwakkil' and the 'Wakeel'. The Muwakkil places funds with the Wakeel for a fixed time period. The Wakeel invests the Muwakkil's funds and pays a profit generated there-from as per the agreed rate of return.

Musawama
A musawama is a contract for the sale of assets at a price agreed by both parties. The Bank purchases the product and assumes ownership. The assets are then sold to the client with a mark-up and the ownership of the asset is transferred to the client. However, neither the cost of acquiring the asset nor the profit to be earned from it are disclosed to the client.

3.5.3 Past Due and Impaired Islamic Financing

The Bank defines non performing facilities as the facilities that are overdue for a period of 90 or more days. These exposures, studied on a case by case basis, are placed on a non–accrual status with income being recognised to the extent that it is actually received. It is the Bank's policy that when an exposure is overdue for a period of 90 or more days, the full outstanding amount extended is considered as past due, not only the overdue instalments for that facility.

As a policy, the Bank has placed on a non–accrual status any facility where there is reasonable doubt about the collectability of the receivable irrespective of whether the customer concerned is currently in arrears or not. The past due and impaired facilities are governed by the provisioning policy of the Bank.

3.5.4 External Credit Assessment Institutions

The Bank relies on external ratings for Sovereigns and Financial Institutions (FIs) for assessing the creditworthiness of the counterparties, as they are generally rated by an external rating agency. The Bank uses Standard & Poor's, Fitch, Capital Intelligence and Moody's to provide ratings for such counterparties. In case of unrated FIs, the Bank assesses the credit risk based on the internal FI rating model based on the following parameters:

Earnings, Liquidity, Asset quality, Capital adequacy, Size and Sensitivity to benchmark profit rates and other macroeconomic variables.

3.5.5 Definition of Geographical Area

The geographic distribution of the credit exposures is monitored on an ongoing basis by the Bank's RMD and reported to the Board on a quarterly basis. The Bank's classification of geographical area is according to the distribution of its portfolios across material geographies.

3.5.6 Concentration Risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being over exposed to a single customer, industry sector or geographic region.

As per the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of related counterparties, exceeding 15% of the regulatory capital base. In order to avoid excessive concentrations of risk, the Bank's credit concentration policy and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

3.5.7Credit Risk Mitigation

3.5.7.1 Introduction

Credit risk mitigation is defined as the utilisation of a number of techniques, such as collaterals and guarantees to mitigate the credit risks that the Group is exposed to.

The Bank's first priority when establishing relationship with the customer for financing is to determine the borrower's capacity to repay and not to rely principally on security or collateral.

Acceptable forms of collateral and their valuation parameters are defined within the collateral management policy. Valuations are done conservatively and are regularly reviewed to reflect any changes in market conditions. Security structures and legal covenants are also subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice.

The Group accepts only Shari'a compliant collaterals as credit risk mitigants. Further, a representative from the Shari'a Department sits on the credit committee which takes decisions on significant collaterals.

3.5.7.2 Policy guidelines for credit risk mitigation

The Bank has policy guidelines for the following credit risk mitigants:

- Collaterals
- Guarantees

1. Policy for collaterals

Collaterals are governed by the collateral management policy of the Bank. The business units review and recommend detailed guidelines relating to collateral in consultation with RMD. These guidelines cover the following:

- Permissible collateral types – based on size, age, value, location and manufacturer.
- Maximum financing to collateral value, for secured facilities based on each type of collateral.
- Collateral verification and appraisal processes including frequency of review.
- Approved panel of solicitors, property and other valuers.
- Collateral documentation requirements, custody (for securities) and Takaful requirements.
- Ongoing processes for margin maintenance, continuation of Takaful, etc.
- Collateral valuation process
- Applicable haircuts on various types of collaterals

The majority of the Bank's financing portfolio is secured through mortgage of real estate properties. In order to avoid any adverse impact of concentration of collateral, valuations are done conservatively and are regularly to reflect any changes in market conditions. The bank may also call for additional collateral in case the collaterals become insufficient during the regular credit review process. In case of default by any customer, the Bank makes all possible efforts for the recovery of amount and only resorts to the disposal of collateral when all other efforts have been exhausted.

2. Guarantees

Guarantees supplement collateral in improving the quality of credit. It is the policy of the Bank to obtain legally enforceable, unconditional, continuing and written guarantees. In cases where a letter of guarantee from a parent company or a third party is accepted as credit risk mitigants, the Bank ensures that all guarantees are irrevocable and a legal opinion is obtained from legal counsel domiciled in the country of the guarantor (to the extent the guarantor is domiciled overseas) regarding the enforceability of the guarantee. All guarantees should be valid until full settlement of the financing contract. Also no maturity (negative) mismatch is permissible between the guarantee and exposure. The Bank considers the following guarantees as credit risk mitigants for the purpose of Capital adequacy ratio calculations - Sovereigns and central banks, Public Sector Enterprises, Multi-lateral Development Banks, International organisations/officials entities having zero risk weights, Islamic banks or conventional banks and corporate entities (including insurance and securities firms) either by the parent, subsidiary and affiliates, of a minimum ECAI rating of A-. The Bank also follows the CBB CA rulebook for the list and conditions of capital relief eligible guarantees.

3.5.8 Counterparty Credit Risk

3.5.8.1 Introduction

A counterparty is defined as an obligor (individual, company, other legal entity), a guarantor of an obligor, or person receiving funds from the Group. It also includes the issuer of a security in case of a security held by the Group, or a party with whom a contract is made by the Group for financial transactions.

The measurement of exposure reflects the maximum loss that the Group may suffer in case the counterparty fails to fulfil its commitments. The Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. Large exposure is any exposure whether direct, indirect or funded by restricted investment accounts to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Group's capital base.

The Group has adopted the Standardised Approach to allocate capital for counterparty credit risk. The Bank has put in place an internal counterparty limit structure which is based on internal/external ratings for different types of counterparties. The Bank has also set concentration limits as a percentage of portfolio exposure based on grades. In case of a counterparty rating degrade, the Bank may require further collateral or advise the counter party to reduce its exposure on a case by case basis.

The Bank has developed a provisioning policy in order to ensure that it maintains adequate provisions for past due and impaired assets.

3.5.8.2 Credit Limit Structure

Approval of counterparty exposure in excess of 10% of the Bank's capital

Exposure financed by direct, unrestricted investment accounts and/or restricted investment accounts, in excess of 10% of the Bank's Capital Base shall be approved only in exceptional cases. In such cases, Credit Review highlights the fact that the limits proposed are in excess of 10% of the Bank's capital base and valid justification for recommending such a large exposure is given by the business unit. The credit proposal is reviewed by Credit Review and Credit Administration Department and the Credit Committee and approved by the appropriate authorities within the Bank.

Reporting

The Group reports large counterparty exposures to CBB and senior management on a periodic basis. The Group reports the exposures on a gross basis without any offsetting. However, debit balances on accounts may be offset against credit balances where both are related to the same counterparty, provided the Group has a legally enforceable and Shari'a right to do so.

Early warning indicators

The Bank maintains a strong focus on identification of signs of deterioration in credit quality at an early stage in order to take remedial measures before the facility becomes non-performing.

3.5.9 Related Party Transactions:

The disclosure relating to related party transactions and balances has been made in the consolidated financial statements of the Group for the year ended 31 December 2011. All related party transactions have been made on an arm's length basis.

3.5.10 Quantitative disclosures

Table – 5. Average and Gross Credit Risk Exposure

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES				
Credit Risk Exposure (PD-1.3.23(a))				
	Self Financed		**Financed by Unrestricted Investment Accounts**	
Portfolios	**Total Gross Credit Exposure**	*** Average Gross Credit Exposure Over the Period**	**Total Gross Credit Exposure**	*** Average Gross Credit Exposure Over the Period**
Balances with Banks	4,155	2,627	6,223	5,492
Murabaha and due from Banks	-	-	102,212	119,247
Financing contracts with customers	356,669	360,411	256,299	262,303
Investments – Sukuk	-	-	48,746	46,640
Receivables	56,947	66,312	-	-
Total	**417,771**	**429,350**	**413,480**	**433,682**
Credit commitments and contingent items	43,665	41,296	-	-
Grand Total	**461,436**	**470,646**	**413,480**	**433,682**

*Gross credit exposure is reflected net of specific provisions and gross of general provisions.
Average credit exposure has been calculated using quarterly consolidated financial statements and PIRI forms submitted to CBB.

Table – 6. Portfolio Geographic Breakdown.

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES										
Geographic Breakdown (PD-1.3.23(b)										
Portfolios	**Self Financed**					**Financed by Unrestricted Investment Accounts**				
	Geographic Area					**Geographic Area**				
	Middle East	**North America**	**Europe**	**Others Countries**	**Total**	**Middle East**	**North America**	**Europe**	**Others Countries**	**Total**
Balances with Banks	2,465	870	805	15	4,155	3,693	1,302	1,205	23	6,223
Murabaha and due from Banks	-	-	-	-	-	102,212	-	-	-	102,212
Financing contracts with customers	343,682	1,708	-	11,278	356,669	246,649	1,270	-	8,380	256,299
Investments – Sukuk	-	-	-	-	-	40,263	943	-	7,540	48,746
Receivables	53,262	-	3,685	-	56,947	-	-	-	-	-
Total	**399,409**	**2,578**	**4,490**	**11,293**	**417,771**	**392,817**	**3,515**	**1,205**	**15,943**	**413,480**
Un-funded										
Credit commitments and contingent items	43,665	-	-	-	43,665	-	-	-	-	-
Grand Total	**443,074**	**2,578**	**4,490**	**11,293**	**461,436**	**392,817**	**3,515**	**1,205**	**15,943**	**413,480**

Table – 7. Industrial Sector Breakdown by Portfolio

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES										
Industry Sector Breakdown (PD-1.3.23(c))										
	Self Financed					**Financed by Unrestricted Investment Accounts**				
Portfolios	**Industry Sector**					**Industry sector**				
	Trading and Manufacturing	**Banking and Financial**	**Construction and Real Estate**	**Others**	**Total**	**Trading and Manufacturing**	**Banking and Financial**	**Construction and Real Estate**	**Others**	**Total**
Funded										
Balances with Banks	-	4,155	-	-	4,155	-	6,223	-	-	6,223
Murabaha and due from Banks	-	-	-	-	-	-	102,212	-	-	102,212
Financing contracts with customers	39,043	12,831	236,121	68,674	356,669	29,011	9,535	166,724	51,029	256,299
Investments at amortised cost	-	-	-	-	-	-	9,614	39,132	-	48,746
Receivables	4,611	-	33,339	18,997	56,947	-	-	-	-	-
Total	**43,654**	**16,986**	**269,459**	**87,671**	**417,771**	**29,011**	**127,584**	**205,856**	**51,029**	**413,480**
Un-funded										
Credit commitments and contingent items	25,692	-	17,973	-	43,665	-	-	-	-	-
Grand Total	**69,346**	**16,986**	**287,432**	**87,671**	**461,436**	**29,011**	**127,584**	**205,856**	**51,029**	**413,480**

Table – 8. Exposures in Excess of 15% Limit

CREDIT RISK: QUANTITATIVE DISCLOSURES		
Concentration of risk (PD-1.3.23(f)) Exposure as a Percentage of Capital Base		
Counterparties	**Self Financed**	**Financed by Unrestricted Investment Accounts**
	Concentration of Risk	**Concentration of Risk**
Counterparty # 1	44.54%	-
Counterparty # 2	19.84%	-

Restructured Islamic Financing Contracts:

The outstanding amount of financing contracts with customers for which financing terms have been renegotiated (restructured facilities) amounted to BD 316,617 thousand (2010: BD 169,090 thousand) and these are secured with collateral amounting to BD 547,928 thousand (2010: BD 142,817 thousand). For restructured facilities amounting to BD 99,078 thousand (2010: BD 103,891 thousand) either six months or more have elapsed since the date of restructuring and the customers have made regular payments and on a timely basis or the deals have been settled. As a condition to restructuring, the Bank has usually received partial payment from customers and/or obtained additional collateral.

The restructuring does not have any significant impact on impairment provisions and present and future earnings of the Group as most of the exposures are sufficiently collateralised and restructuring is based on the market terms. The concession provided to the restructured relationships mainly relates to the extension of the repayment dates.

Table – 9. Maturity Breakdown of Credit Exposures

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES							
Residual Contractual Maturity Breakdown (PD-1.3.23(g))							
	Self Financed						
Portfolios	**Maturity Breakdown**						
	Up to 3 Months	**3-12 Months**	**1-5 Years**	**5-10 Years**	**10-20 Years**	**Over 20 Years**	**Total**
Balances with Banks	2,078	-	-	-	-	2,077	4,155
Murabaha and due from Banks	-	-	-	-	-	-	-
Financing contracts with customers	40,740	77,569	167,083	42,664	27,592	1,021	356,669
Investments at amortised cost	-	-	-	-	-	-	-
Receivables	-	-	56,947	-	-	-	56,947
Total	**42,818**	**77,569**	**224,030**	**42,664**	**27,592**	**3,098**	**417,771**
Credit commitments and contingent items	16,650	25,015	2,000	-	-	-	43,665
Grand Total	**59,468**	**102,584**	**226,030**	**42,664**	**27,592**	**3,098**	**461,436**

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES							
Residual Contractual Maturity Breakdown (PD-1.3.23(g))							
	Financed by Unrestricted Investment Accounts						
Portfolios	**Maturity breakdown**						
	Up to 3 Months	**3-12 Month**	**1-5 Years**	**5-10 Years**	**10-20 Years**	**Over 20 Years**	**Total**
Balances with Banks	3,112	-	-	-	-	3,111	6,223
Murabaha and due from Banks	102,212	-	-	-	-	-	102,212
Financing contracts with customers	21,545	57,638	124,152	31,702	20,502	760	256,299
Investments at amortised cost	-	7,300	33,906	7,540	-	-	48,746
Receivables	-	-	-	-	-	-	-
Total	**126,869**	**64,938**	**158,058**	**39,242**	**20,502**	**3,871**	**413,480**
Credit commitments and contingent items	-	-	-	-	-	-	-
Grand Total	**126,869**	**64,938**	**158,058**	**39,242**	**20,502**	**3,871**	**413,480**

Table – 10. Break-up of Impaired Finances by Industry Sector

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES

Impaired Finances, Past Due Finances and Allowances (PD-1.3.23(h))

					Self Financed								
Industry Sector	**Total Portfolio**	**Good**	**Substandard**	**Past due but not impaired**	**Individually impaired**				**Specific Impairment**				**Collective Impairment**
						Over 3 Months	**Over 1 Year**	**Over 3 Years**	**Balance at the Beginning of the Period**	**Charges During the Period**	**Transfer from collective provision**	**Balance at the End of the Period**	
Trading and manufacturing	39,043	30,397	1,571	8,242	162	-	162	-	-	-	-	-	*
Banking and financial institutions	12,831	9,990	516	2,708	53	-	53	-	-	-	-	-	*
Construction & real estate	236,121	174,689	9,030	47,365	932	-	932	-	-	-	-	-	*
Others	68,674	53,467	2,764	14,497	285	-	285	-	960	712	-	1,672	*
Total	**356,669**	**268,543**	**13,881**	**72,812**	**1,432**	**-**	**1,432**	**-**	**960**	**712**	**-**	**1,672**	**-**

* This amounts to BD 11,743 thousand representing collective impairment against total exposures (self financed and URIA financed) which, although not specifically identified, have a greater risk of default than when originally granted.

Past due finances are stated net of specific impairment.

Amount in BD '000

Impaired Finances, Past Due Finances and Allowances (PD-1.3.23(h))													
				Financed by Unrestricted Investment Accounts									
Industry Sector	Total Portfolio	Good	Substandard	Past due but not impaired	Individually impaired				Specific Impairment				Collective Impairment
						Over 3 Months	Over 1 Year	Over 3 Years	Balance at the Beginning of the Period	Charges During the Period	Transfer from collective provision	Balance at the End of the Period	
Trading and manufacturing	29,011	21,842	1,129	5,923	117	-	117	-	-	-	-	-	*
Banking and financial institutions	9,535	7,179	371	1,946	38	-	38	-	-	-	-	-	*
Construction & real estate	166,724	125,531	6,489	34,036	670	-	670	-	-	-	-	-	*
Others	51,029	38,421	1,986	10,417	205	-	205	-		1,036	-	1,036	*
Total	**256,299**	**192,973**	**9,975**	**52,322**	**1,030**	**-**	**1,030**	**-**	**-**	**1,036**	**-**	**1,036**	**-**

* This amounts to BD 11,743 thousand representing collective impairment against total exposures (self financed and URIA financed) which, although not specifically identified, have a greater risk of default than when originally granted.

Past due finances are stated net of specific impairment.

Table – 11. Break-up of Provision by Geographic Area

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES						
Impaired Finances, Past Due Finances And Allowances (PD-1.3.23(i))						
	Own Capital and Current Account			**Unrestricted Investment Account**		
Geographic Area	**Past Due and Impaired Islamic Financing Contracts (Greater Than 90 Days)**	**Specific Impairment**	**Collective Impairment**	**Past Due and Impaired Islamic Financing Contracts (Greater Than 90 Days)**	**Specific Impairment**	**Collective Impairment**
Middle East	22,787	872	*	20,142	771	*
North America	-	-	-	-	-	-
Europe	-	-	-	-	-	-
Asia / Pacific	-	-	-	-	-	-
Others countries	3,577	800	-	531	265	-
Total	**26,364**	**1,672**	**-**	**20,673**	**1,036**	**-**

* This amounts to BD 11,743 thousand representing collective impairment against exposures which, although not specifically identified, have a greater risk of default then when originally granted.

Table – 12. Break-up of Eligible Collateral by Portfolio

Amount in BD '000

CREDIT RISK MITIGATION (CRM): DISCLOSURES FOR STANDARDISED APPROACH		
Credit Risk Exposure Covered By CRM (PD-1.3.25 (b) and (c))		
Portfolios	**Total Exposure Covered by**	
	Eligible Collateral *	**Guarantees**
Murabaha	83,707	-
Ijarah	150,438	-
Total	**234,145**	**-**

* Over and above the collateral, considered as eligible under the CA Module, the Bank maintains additional collateral in the form of mortgage of residential properties, corporate guarantees and other tangible assets, which could be invoked to claim the amount owed in the event of default.

Table –13. Counter Party Credit Risk

Amount in BD '000

DISCLOSURES FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK (CCR)							
General Disclosures (PD-1.3.26 (b))							
				Eligible Collaterals Held (after appropriate haircuts) *			
Current Credit Exposure by Type of Islamic Financing Contracts	**Gross Positive Fair Value**	**Netting Benefits**	**Netted Current Credit Exposures**	**Cash**	**Govt. Securities**	**Real Estate**	**Total**
Murabaha	360,030	-	360,030	7,127	-	76,580	83,707
Ijarah	242,604	-	242,604	29	-	150,409	150,438
Musharakah	10,334	-	10,334	-	-	-	-
Total	**612,968**	-	**612,968**	**7,156**	**-**	**226,989**	**234,145**

* Over and above the collateral, considered as eligible under the CA Module, the Bank maintains additional collateral in the form of mortgage of residential properties, corporate guarantees and other tangible assets, which could be invoked to claim the amount owed in the event of default.

3.6 Market Risk

3.6.1 Introduction

Market risk is the risk that movements in market risk factors, including foreign exchange rates, profit rates, commodity prices, equity prices and credit spreads will reduce the Group's income or the value of its portfolios. The Group is also exposed to profit rate and potential foreign exchange risks arising from financial assets and liabilities. The Group also accepts the definition of market risk as defined by the CBB as "the risk of losses in on and off–balance sheet positions arising from movements in market prices."

The Board has approved the overall market risk appetite in terms of market risk strategy and market risk limits. RMD is responsible for the market risk control framework and sets a limit framework within the context of the approved market risk appetite. The Bank separates market risk exposures into either trading or non–trading portfolios. Trading portfolios include those positions arising from market–making, proprietary position–taking and other marked–to–market positions. Non–trading portfolios include all other positions that are not included in the trading book.

Daily market risk reports are produced for the Bank's senior management covering the different risk categories. These reports are discussed with the senior management committees such as ALCO which take appropriate action to mitigate the risk.

3.6.2 Market Risk Factors

For the Group, market risk may arise from movements in profit rates, foreign exchange markets, equity markets or commodity markets. A single transaction or financial product may be subject to any number of these risks.

Profit Rate Risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments.

Foreign Exchange Risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on positions by currency. Positions are monitored on a daily basis to ensure risk is maintained within established limits using VaR methodology.

The Group is exposed to the currency risk mainly due to the Bank's banking book FX net open positions and due to the fact that the assets and liabilities of its foreign subsidiaries are denominated in their respective functional currencies. Net assets of the Group's foreign subsidiaries, located in Jordan, as at 31 December 2011 is BD 34,426 thousand (31 December 2010: BD 34,523 thousand). Net assets of the Group's foreign subsidiary, located in United Kingdom, as at 31 December 2011 is BD 15,298 thousand (31 December 2010: BD 12,222 thousand). The assets and liabilities are translated into Bahraini Dinar (presentation currency of the Group) using the closing rate at the date of statement of financial position for the purpose of consolidated financial statements. The impact of foreign currency translation is recognised in the statement of comprehensive income and will be routed to statement of income at the time of disposal of investment in subsidiaries.

Equity Risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

Commodity Price Risk is the risk arises as a result of sensitivity to changes in commodity prices. Since prices in commodity markets are determined by fundamental factors (i.e. supply and demand of the underlying commodity) these markets may be strongly correlated within a particular sector and less correlated across sectors. The Group is not exposed to material commodity price risk.

3.6.3 Market Risk Strategy

The Board is responsible for approving and reviewing the market risk strategy and policy. The Bank's senior management is responsible for implementing the market risk strategy approved by the Board, and continually enhancing the market risk policies and procedures for identifying, measuring, monitoring and controlling market risks.

In line with the Bank's risk management objectives and risk tolerance levels, the specific strategies for market risk management include:

- The Bank strives to reduce the market risk through diversification of its risk exposures across currencies, markets and sectors.
- The Bank proactively measures and monitors the market risk in all its risk exposures on a regular basis using appropriate measurement techniques.
- The Bank has established a limit structure to monitor and control the market risk in its portfolio on daily basis. These limits are monitored on a regular basis and any exceptions to the limits are immediately dealt with.
- The Bank carries out stress testing periodically to assess the effect of extreme movements in market variables.
- The Bank, at all times, holds sufficient capital in order to meet the capital requirement of the CBB as well as maintaining a cushion to cover any adverse movements in the market risk factors.
- At all times, the Bank will ensure that it follows the overall market risk strategy while taking any new market risk exposures.

3.6.4 Market Risk Measurement Methodology

The various techniques which are used by the Bank for the measurement, monitoring and control of market risk are as follows:

a) Value at Risk (VaR) Monte Carlo simulation
b) Value at Risk (VaR) Historical simulation
c) Variance covariance for FX.

3.6.5 Market Risk Monitoring and Limits Structure

The Board and ALCO set the tolerance for market risk. Based on these tolerances, RMD and Treasury Department have established appropriate risk limits that maintain the Bank's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates. The Bank has developed the following combination of limits to control its market risk:

a) Stop loss limits;
b) Value at risk (VaR) limits;
c) FX trigger at notional level;
d) Concentration limits for country, geography and sector for equity and Sukuk portfolios; and
e) Tenor limits for sukuks

The Treasury Department monitors the risk limits for each transaction and ensures that they are not exceeded. A regular limit monitoring is carried out by the market risk department within RMD to ensure adherence to approved limits. ALCO also monitors the limit adherence on a regular basis.

In case a limit is breached, the Board approved limit breach procedure is followed and the reports are provided to the ALCO, the RGC Committee and the Board depending upon materiality of the breach. The limits are reviewed at least annually or as deemed necessary.

3.6.6 Portfolio Review Process

As part of the review, RMD also monitors the Bank's overall market exposure against the risk tolerance limits set by the Board.

3.6.7 Reporting

The Bank generates a number of market risk management reports. These reports aim to provide the Bank's senior management with an up–to–date view of its market risk exposure. These include a summary of the Bank's aggregate market risk sensitive exposures, VaR and limits monitoring reports.

3.6.8 Stress Testing

Stress testing produces information summarising the Bank's exposure to extreme, but plausible, circumstances and offers a way of measuring and monitoring the portfolio against extreme price movements of this type. The Bank's RMD simulates stress scenarios such as Black Monday (1987) and September 11, 2001 (2001) to calculate the maximum loss due to extreme movements in FX rates.

3.6.9 Quantitative disclosures

Table – 14. Minimum and Maximum Capital Requirement for Market Risk

MARKET RISK: DISCLOSURES FOR BANK'S USAGE OF THE STANDARDISED APPROACH					
Level Of Market Risks In Terms Of Capital Requirements (PD-1.3.27 (b))					
Particulars	**Price Risk**	**Foreign Exchange Risk**	**Equity Position Risk**	**Market Risk on Trading Positions in Sukuks**	**Commodity Risk**
Capital requirements	80	5,187	-	-	-
Maximum value	375	6,658	-	-	-
Minimum value	80	5,187	-	-	-

This disclosure is based on the figures from the PIRI for the quarter ended 31 December 2011.

3.7 Operational Risk

3.7.1 Introduction

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all business and covers a large number of operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

The Board acknowledges that it has the ultimate responsibility for operational risk. Oversight rests with the RGC Committee. The Board has approved the operational risk framework in terms of strategy, policy and limits. The Bank has implemented Risk Controls and Self Assessment (RCSA) and departments report the incidents and Key Risk Indicators (KRIs) values to the operational risk unit for monitoring and reporting the key operational risks in the Bank.

3.7.2 Sources of Operational risk

The different sources of operational risks faced by the Group can be classified broadly into the following categories:

People Risk which may arise due to staffing inadequacy, unattractive remuneration structure, lack in staff development policies, lack in procedures for appointment, unhealthy professional working relationship and unethical environment.

Processes Risk which may arise due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting.

Systems (Technology) Risk which may arise due to the integrity of information – lacking in timelines of information, omission and duplication of data etc.; hardware failures due to power surge, obsolescence, low quality etc.; software failure due to unauthorised or incorrect modifications to software programs, computer virus, programming bug etc.

External Risk which can comprise legal / public liability, criminal activities, outsourcing / supplier risk, disasters and infra-structural utilities failures, regulatory risk and political / government risk.

3.7.3 Operational Risk Management Strategy

The Bank's Board is responsible for approving and reviewing (at least annually) the operational risk strategy and significant amendments to the operational risk policies. The Bank's senior management is responsible for implementing the operational risk strategy approved by the Board to identify measure, monitor and control the risks faced by the Bank. The Bank continuously monitors the process and controls framework surrounding all business units to assess their effectiveness and efficiency.

As a strategy the Bank will identify the sources of operational risks in coordination with each business unit. On an ongoing basis, the operational risk tolerance is determined by the RMD based on a bottom-up approach following a discussion with the business units. Operational risk tolerance will need to be approved by the RGC Committee, ratified by the Board and documented and communicated via the Board-approved policy.

The RCSA methodology enables the Bank to identify risk events within each activity, process and support unit of the Bank, document existing controls, establish quantitative measurement metrics - impact and likelihood - for each event as well as early warning indicators for key risks as defined in the risk tolerance in the form of Key Risk Indicators (KRIs) and capture operational loss data. The operational risk identification, assessment and measurement process involves the following steps:

Identification of KRI's
The Bank's RCSA process identifies the KRIs.

Incident reporting
An incident is the occurrence of an operational or compliance risk event that has caused, or has the potential to cause a financial, reputation or regulatory impact on the Bank. It includes credit or market risk events, which have been caused by an operational risk event, and non–compliance with any legal or regulatory requirement, license, internal policy or procedure or code. The incidents are reported by the business and control units as a part of the RCSA framework.

Operational Loss Database (OLD)
The OLD is a key component to enable the Bank to quantify its past operational risk exposures. The OLD contains a subset of the information captured by the incident reporting process since all incidents involving an actual or potential financial impact (including near misses) is captured.

Scenario analysis
The Bank uses scenario analysis to help it to evaluate its exposure to high–severity events. The Bank identifies the stress events and scenarios to which it is exposed and assesses its potential impact, and the probability of aggregated losses from a single event leading to other risks. Scenario analysis is conducted in a workshop format, using a combination of expert judgment; including business management representatives and external risk management experts, as well as external data relevant to the risks being evaluated.

3.7.4 Operational Risk Monitoring and Reporting

The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to senior management and the RGC Committee for the quick detection and correction of deficiencies in the policies, processes and procedures for managing operational risk through ongoing, periodic reviews.

The objective of the reporting process is to ensure relevant information is provided to senior management and the Board to enable the proactive management of operational risk. The process ensures a consistent approach for providing information that enables appropriate decision making and action taking. The KRIs and incidents are reported by the operational risk unit.

3.7.5 Operational Risk Mitigation and Control

Control activities are necessary to address the specific operational risks that the Bank has identified through the RSCA process. For the material risks identified by the Bank, the Bank decides whether to use procedures to control, mitigate, transfer, or bear the risks.

The Group has several options for controlling and/or mitigating these risks:
- Decline to accept the risk (i.e. by avoiding certain business strategies/customers)
- Accept and retain the risk but introduce mitigating internal/external controls
- Accept the risk and transfer it in part/in whole.

Key controls
The Group aims to control the operational risks it is exposed to by strengthening its internal controls, continuing its efforts to identify, assess, measure and monitor its risks, evolving in its risk management sophistication and promoting a strong control culture within the Group.

Each business unit head is responsible for ensuring that the internal controls relevant to its operations are complied with on a day to day basis in spirit as well as in letter. The Group will furthermore establish control processes and procedures and implement a system for ensuring compliance with these internal risk control processes and procedures.

3.7.6 Business Continuity Plan and Disaster Recovery Plan

In 2010, the Bank completed its Business Continuity Plan (BCP) based on a Business Impact Analysis and risk review of the Bank's activities. An Information Technology Disaster Recovery site has also been completed and is fully operational whilst undergoing a testing phase. A primary business continuity site has been completed with the option to fit out two further sites should the need arise. Every six months, the Bank tests its BCP and procedures to ensure that they are current and effective.

3.7.7 Quantitative disclosures

Table –15. Indicators of Operational Risk

Amount in BD '000

OPERATIONAL RISK : QUANTITATIVE DISCLOSURES FOR BASIC INDICATOR APPROACH	
Indicators of Operational Risk (PD-1.3.30 (b) & (c))	
Particulars	**Total**
Gross Income (average)	65,096
Amount of non-Shari'a-compliant income	-
Number of Shari'a violations that were identified and reported during the financial year	-
Material legal contingencies including pending legal actions are as follows: - A guarantee was issued by the Bank to a customer and subsequently called up by the latter. The Bank is defending the claim for payment under the guarantee and believes that no payment in this regard will be required. - An action was filed by the minority shareholders in a subsidiary company against the Bank and the subsidiary's directors appointed by the Bank for alleged mismanagement of the company. The Bank is defending the claim and believes no payment will be required. Legal cases are handled by the Bank's in-house legal team and external legal consultants are consulted on such matters.	
The Bank did not pay any penalty to the CBB during the year.	

3.8 Equity Positions in the Banking Book

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the consolidated financial statements. All of the Group's investments are intended to be for long term holdings.

3.8.1 Quantitative disclosures

Table – 16. Total and Average Gross Exposures

Amount in BD '000

EQUITY POSITION IN BANKING BOOK - DISCLOSURE REQUIREMENTS				
Total and Average Gross Exposure - (PD-1.3.31 (b) & (c))				
Type and Nature of Investment	**Total Gross Exposure**	*** Average Gross Exposure**	**Publicly Traded**	**Privately held**
Equity investments	456,507	410,152	6,389	450,118
Managed funds	8,655	19,361	-	8,655
Total	**465,162**	**429,513**	**6,389**	**458,773**

* Average exposure has been calculated using quarterly consolidated financial statements or PIRI forms submitted to CBB.

Table – 17. Break-up of Capital Requirement for Equity Groupings

Amount in BD '000

EQUITY POSITION IN BANKING BOOK - DISCLOSURE REQUIREMENTS	
Capital Requirement - (PD-1.3.31 (f))	
Equity Grouping	**Capital Requirement**
Listed	686
Unlisted	164,107
Managed Funds	1,623
Total	**166,416**

Table – 18. Gain and Loss Reported

Amount in BD '000

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS	
Gains / Losses Etc. (PD-1.3.31 (d) and (e))	
Particulars	**Total**
Total realised losses arising from sales or liquidations in the reporting period	188
Total unrealised gains recognised in statement of other comprehensive income	5,117
Unrealised gains (net) included in Tier One Capital	20,897
Unrealised gains included in Tier Two Capital	-

3.9 Equity of Investment Account Holders (URIA)

The Investment Account Holder ("IAH") authorizes the Bank to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement the Bank can commingle the IAH funds with its own funds (owner's equity) and with other funds the Bank has the right to use (e.g. current accounts or any other funds which the Bank does not receive on the basis of Mudaraba contract). The IAH and the Bank participate in the returns on the invested funds.

The Bank has developed a Profit Sharing Investment Accounts (PSIA) policy which details the manner in which the URIA funds are deployed and the way the profits are calculated for the URIA holders. The strategic objectives of the investments of the IAH funds are:

- Investment in Shari'a compliant opportunities;
- Targeted returns;
- Compliance with investment policy and overall business plan;
- Diversified portfolio; and
- Preparation and reporting of periodic management information.

URIA holders' funds are invested in short and medium term Murabaha and due from banks, Sukuks and the financing portfolio. The Bank invests these funds through various departments including Treasury, corporate, consumer, and debt capital markets. The experience of relevant department heads is mentioned in Section 4. No priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the URIA, 100% of the funds are invested after deductions of mandatory reserve and sufficient operational cash requirements. URIA funds are invested and managed in accordance with Shari'a requirements. Income generated through invested funds is allocated proportionately between URIA holders and shareholders on the basis of the average balances outstanding and share of the funds invested. The Bank does not share income from fee based services with the URIA holders. Administrative expenses incurred by the Bank are allocated to the URIA holders in the proportion of average URIA funded assets to average total assets of the Bank. The process has not changed significantly from the past years. The Bank has started allocating past due and impaired facilities to the Joint Pool of assets used for the calculation of URIA financed assets.

The mudarib share on investment accounts ranges from 20% to 40% depending on the investment period and in case of saving accounts, where there is no restriction of cash withdrawal, the mudarib share ranges from 50% to 60%. However, during the year, in addition to investors' share of profit, the Bank has distributed profit to investors from its own share of mudarib share. There is no change in mudarib share from the year ended 31 December 2010 to 31 December 2011.

The Bank has a Corporate Communications Department which is responsible for communicating new and/or extended product information through various channels of communication which may include publications, website, direct mailers, electronic mail and local media. The URIA products available to the customers can be classified broadly under two categories, 1) Term URIA and 2) Saving URIA. Term URIA are fixed term URIA having maturity of 1, 3, 6 and 12 months whereas Saving URIA can be withdrawn on demand. Detailed information about the features of various products offered by the Bank can be obtained from the website of the Bank, brochures at the branches, call centre and customer service representatives at the branches of the Bank. Branches of the Bank are the primary channel through which products are made available to the customers.

Displaced commercial risk ("DCR") refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the PSIA, when the return on assets is under performing as compared with competitors' rates. Fiduciary risk is the risk that arises from Bank's failure to perform in accordance with explicit and implicit standards applicable to their fiduciary responsibilities. Although KFHB will discourage subsidizing its URIA holders, the Bank may forgo a portion of its mudarib share from assets funded by PSIA and apportion its share to the IAH as part of smoothing returns and to mitigate potential withdrawal of funds by investment account holders.

Complete mudarib share or part thereof, based on the approval of ALCO of the Bank, can be waived to pay a competitive rate to URIA holders. There are no instances where the Bank, as Mudarib, has taken any share greater than the agreed/disclosed profit sharing ratio. There were instances where the Bank has forgone part of its profit to distribute that to the Bank's customers or investors. The bank may also forgo part of its shareholder's returns as a "hiba" to URIA holders in order to mitigate DCR.

The rate of return payable to URIA holders is decided by ALCO, keeping in view the rate of return earned on the pool of assets. A number of factors are considered while deciding the rate of return payable to URIA holders, including rates offered by peer banks, cost of funds from various sources, liquidity position of the Bank and market interest rates (LIBOR etc). The Bank does not use a fixed market benchmark rate for comparison to the returns paid to URIA holders. In order to ensure smooth returns and to mitigate the potential withdrawal of funds by URIA Investors; the Bank can use Profit Equalisation Reserve (PER). Similarly, the Bank can use an Investment Risk Reserve (IRR) to cater against future losses for URIA holders. The amount of PER and IRR as at 31 December 2011 and 2010 is Nil but the Bank may transfer an amount into PER and IRR in future after prior notice to its customers.

3.9.1 Quantitative Disclosures

Table – 19. Break-up of URIA

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (a) &(g))			
	Amount	**Financing to Total URIA %**	**Ratio of Profit Distributed**
Savings URIA	54,947	12%	8%
Term URIA	390,341	88%	92%
Total	**445,288**	**100%**	**100%**

Table – 20. Percentage of Return on Average URIA Assets

UNRESTRICTED INVESTMENT ACCOUNTS:	
Unrestricted Investment Account (PD-1.3.33 (d))	
	Percentage
Average profit paid on average URIA assets	2.63%
Average profit earned on average URIA assets	3.04%

Table – 21. Percentage of Mudarib share to Total URIA Profits

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (f))			
	URIA Return Before Mudarib shares	**Share of Profit Paid to Bank as Mudarib**	**Percentage**
Mudarib share to total URIA profits	14,172	2,048	14.45%

Table – 22. Percentage of Islamic Financing Contracts Financed by URIA to Total URIA

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (h))		
Shari'a-Compliant Contract	**Financing**	**Financing to Total URIA %**
Cash and balances with banks	24,698	5.55%
Murabaha and due from banks	102,212	22.95%
Investments – Sukuk	62,078	13.94%
Murabaha	142,718	32.05%
Ijarah Muntahia Bittamleek	113,581	25.51%
Total	**445,287**	**100.00%**

Table – 23. Percentage of Counterparty Type Contracts Financed by URIA to Total URIA

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (i))		
Counterparty Type	**Financing**	**Financing to Total URIA %**
Claims on sovereigns	33,222	7.46%
Claims on banks	115,246	25.88%
Claims on corporate	52,833	11.86%
Regulatory retail portfolio	14,961	3.36%
Mortgage	180,936	40.63%
Past due facilities	20,844	4.68%
Holding of real estate	20,848	4.68%
Others	6,398	1.45%
Total	**445,288**	**100.00%**

Table – 24. Percentage of Profit Paid to URIA Holders to Total URIA Investment

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (l) (m) & (n))			
	Share of Profit Paid to IAH Before Transfer To/From Reserves %	**Share of Profit Paid to IAH After Transfer To/From Reserves %**	**Share of Profit Paid, as a % of Funds Invested, to Bank as Mudarib %**
URIA	2.63%	2.63%	0.42%

Table – 25. Range of Declared Rate of Return

UNRESTRICTED INVESTMENT ACCOUNTS:				
Unrestricted Investment Account (PD-1.3.33 (q))				
Declared rate of return for Investments accounts	**1-Month**	**3-Month**	**6-Month**	**12-Month**
BHD denominated	2.50% - 2.80%	3.00% - 3.40%	3.25% - 3.60%	3.75% - 4.20%
USD denominated	1.78% - 2.80%	2.08% - 3.40%	2.22% - 3.60%	2.37% - 4.20%

Table – 26. Movement of URIA by Type of Assets

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (r) & (s))			
Type of Assets	**Opening Actual Allocation as at 01 July 2011**	**Net Movement During the Period**	**Closing Actual Allocation as at 31 Dec 2011**
Cash and Balance with banks and CBB	25,291	(593)	24,698
Murabaha due from banks	122,940	(20,728)	102,212
Investments – Sukuk	58,308	3,770	62,078
Murabaha due from customers	147,670	(5,063)	142,607
Ijarah Muntahia Bittamleek due from customers	117,459	(3,766)	113,693
Total	**471,668**	**(26,380)**	**445,288**

Note: There are no limits imposed on the amount that can be invested by URIA funds in any one asset. However, the Bank monitors its URIA deployment classifications so that to ensure that URIA funds are not invested in the Bank's long term Investment Portfolio (including Private Equity and Real Estate).

Table – 27. Capital Charge on URIA by Type of Claims

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (v))			
Type of Claims	**Amount**	**RWA for Capital Adequacy Purposes**	**Capital Charge**
Cash items	3,410	-	-
Claims on sovereign	33,222	-	-
Claims on MDBs	943	-	-
Claims on banks	115,246	25,651	962
Claims on corporate	52,833	30,585	1,147
Regulatory retail portfolio	14,961	11,221	421
Mortgages	180,936	61,227	2,296
Past due facilities	20,844	31,266	1,172
Claims in holdings of Real Estate	20,848	19,885	11,651
Other assets	2,045	1,625	61
Total	**445,288**	**181,460**	**17,710**

The total Risk Weighted Assets financed by Unrestricted Investment Accounts above are as per Prudential Information Report (PIRI). The difference pertains to the consolidation adjustment.

Table – 28. Percentage of Profit Earned and Profit Paid to Total URIA Funds

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:					
Unrestricted Investment Account (PD-1.3.33 (w))					
	* URIA Funds (Average)	Profit Earned **	Profit Earned as a percentage of funds invested	Profit paid	*** Profit paid as a percentage of funds invested (after smoothing)
2011	491,680	14,966	3.04%	12,918	2.63%
2010	480,308	19,104	3.97%	13,804	2.87%
2009	503,207	25,045	4.98%	20,817	4.14%
2008	211,917	10,862	5.13%	9,865	4.66%
2007	78,055	1,807	2.32%	1,662	2.13%

* Average assets funded by URIA have been calculated using monthly consolidated management accounts.

** This is the rate of return gross of mudarib share which ranges from 20% to 40% for term URIA, depending on the investment period of the Investment, and from 50% to 60% for saving URIA.

*** During the year the Bank waived its mudarib share resulting in higher return paid to URIA holders by 57% (2010: 18%)

Table – 29. Administrative Expenses Allocated to URIA

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:	
Unrestricted Investment Account (PD-1.3.33 (x))	
Unrestricted IAH	**Amount**
Amount of administrative expenses charged to URIA	6,739

3.10 Restricted Investment Accounts ("RIA")

Under RIA, the IAH has authorized the Bank to invest the funds on the basis of Mudaraba contract for investments, but imposes certain restrictions as to where, how and for what purpose this funds are to be invested. Further, the Bank may be restricted from commingling its own funds with the RIA funds for the purposes of investment. In addition, there may be other restrictions which IAHs may impose. RIA funds are invested and managed in accordance with Shari'a requirements. The funds are managed by the Bank under a fiduciary capacity as per the instructions of the RIA holders and accordingly the Bank is not liable to make good any losses occurred due to normal commercial reasons.

The Bank has developed the PSIA policy, approved by the Board, which details the manner in which the RIA funds are deployed and the way the profits are calculated for the RIA.

The Bank as fund manager (mudarib) carries out its fiduciary duties and administers the scheme in a proper, diligent and efficient manner, in accordance with the Shari'a principles and applicable laws and relevant rules and guidelines issued by the CBB.

The Bank has appropriate procedures and controls in place which commensurate with the size of its portfolio which includes:

a) Organising its internal affairs in a responsible manner, ensuring it has appropriate internal controls and risk management systems and procedures and controls designed to mitigate and manage such risk;
b) Observing high standards of integrity and fair dealing in managing the scheme to the best interest of its investors; and
c) Ensuring that the Bank has the requisite level of knowledge and experience for the tasks that is undertaken and is competent for the work undertaken.

RIA products are made available to the customers through Priority Banking and Investment Placement Department. Detailed product information about various RIA products is available in the respective RIA information pack. The detailed risks are disclosed in the respective RIA information pack for the investors to make informed decision. Such disclosure includes the disclosure on participation risks, default risks, investment risks and exchange rate risks.

3.10.1 Quantitative Disclosures

Table – 30. History of Profit Paid to RIA Holders

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:						
Restricted Investment Account (PD-1.3.35 (a) & (b))						
	2011	**2010**	**2009**	**2008**	**2007**	**2006**
Return to RIA holders	5,459	5,440	4,191	3,852	2,122	944

Table – 31. Break-up of RIA by Type of Deposits

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (a))	
	Amount
RIA funds	56,553

Table – 32. Percentage of Profit Paid to RIA Holders to RIA Assets

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (d))	
	Percentage
Return on average* RIA assets	6.99%

* Average RIA funds have been calculated using consolidated management accounts.

Table – 33. Mudarib share as a Percentage of Total RIA Profits

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (f))	
	Percentage
Mudarib share to total (gross) RIA profits	9.78%

Table – 34. Share of Islamic Financing Contracts in Total RIA Financing

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (h))		
Shari'a-Compliant Contract	**Financing**	**Financing to Total Financing %**
Murabaha	55,575	98.27%
Ijarah Muntahia Bittamleek	978	1.73%
Total	**56,553**	**100.00%**

Table – 35. Percentage of Counterparty Type Contracts Financed by RIA to Total RIA

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (i))		
Counterparty Type	**Financing**	**Financing to Total Financing %**
Claims on corporate	56,553	100.00%

Table – 36. Share of Profit Paid to RIA Holders as a Percentage of Total RIA

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:				
Restricted Investment Account (PD-1.3.33 (l) (m) (n) & (o))				
Type of RIA	**Total RIA**	**RIA Return Before Mudarib shares**	**RIA Return after Mudarib shares**	**Share of Profit Paid to Bank as Mudarib**
Murabaha	55,575	5,944	5,376	568
Ijarah Muntahia Bittamleek	978	107	83	24
Total	56,553	6,051	5,459	592

Table – 37. Declared Rate of Return of RIA

RESTRICTED INVESTMENT ACCOUNTS:				
Restricted Investment Account (PD-1.3.33 (q))				
	3-Month	**6-Month**	**12-Month**	**24-Month**
Declared rate of return	-	4.23% - 6.00%	4.55% - 6.50%	5.20% - 7.50%

Table – 38. Treatment of Assets Financed by RIA in the Calculation of RWA for Capital Adequacy Purposes

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (v))		
Type of IAH	**Exposure**	**Risk Weighted Amount While Calculating CAR**
Murabaha	55,575	6,704
Ijarah Muntahia Bittamleek	978	-
Total	**56,553**	**6,704**

Table – 39. Profit Earned and Profit Paid as a Percentage of Total RIA Funds

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:					
Restricted Investment Account (PD-1.3.33 (w))					
	*** RIA Funds (Average)**	**Profit Earned**	**Profit Earned as a Percentage of RIA Funds**	**Profit Paid**	**Profit Paid as a Percentage of RIA Funds**
2011	78,109	6,051	7.75%	5,459	6.99%
2010	87,277	5,905	6.77%	5,440	6.23%
2009	71,272	4,481	6.29%	4,191	5.88%
2008	71,729	4,839	6.75%	3,852	5.37%
2007	28,475	2,739	9.62%	2,122	7.45%
2006	14,913	1,258	8.44%	944	6.33%

* Average RIA funds have been calculated using consolidated management accounts.

3.11 Liquidity Risk

3.11.1 Introduction

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Funding risk arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

To control this risk, management has taken various measures including but not limited to arrangement of diversified funding sources in addition to its core deposit base, management of assets with liquidity in mind, and monitoring of future cash flows and liquidity gaps and needs on a daily basis.

This incorporates an assessment of expected cash flows and gaps and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has lines of credit that provide it with access to funds to meet liquidity needs. In addition, the Bank maintains a statutory deposit with the CBB equal to 5% of customer deposit denominated in Bahraini Dinar.

The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The Group maintains liquid assets to counter liquidity issues. The short–and long–term liquid assets of the Group, are listed below:

- Current account and reserves with the CBB
- Cash–in–hand and held with other financial institutions in nostro accounts
- Short–term Murabaha & wakala placements with financial institutions
- Investments in marketable sukuks and equities
- Maturing investments and financing

3.11.2 Sources of liquidity risk

Liquidity risk may arise and materialise in the following ways:

- Contractual mismatch between the cash flows of assets and liabilities
- Insufficient diversification of funding sources or concentration of funding sources
- Operating in different currencies, which creates cross currency funding and liquidity risk
- Unexpected withdrawal of funds by investment account holders
- Non–performance or late payment by customers
- Name issue, credit down grade or adverse publicity may result in mass movements of deposits to other banks
- Default of entities who are large borrowers and whose shares are held as collateral
- Unexpected funding required for off–balance sheet items, such as payments to beneficiaries under letters of credit that have been defaulted by customers
- Fall in income when the profit earned from assets are lower than the profit paid on liabilities and the profit rates revise downwards
- Loss of confidence in the banking system

3.11.3 Liquidity Risk Strategy

The Board is responsible for approving and reviewing (at least annually) the liquidity risk strategy and significant amendments to the liquidity risk policies. The Bank's senior management is responsible for implementing the liquidity risk strategy approved by the Board to identify measure, monitor and control the risks faced by the Bank.

The Bank monitors the liquidity positions and gaps by comparing maturing assets and liabilities in different time buckets of up to 1 month, 1–3 months, 3–6 months, 6 months to 1 year and 1 year and above. As a strategy the Bank maintains a large customer base and good customer relationships.

The Bank has a liquidity contingency plan to meet urgent liquidity requirements in stressed conditions that addresses how funding liquidity would be managed if either their specific financial conditions were to decline or broader conditions created a liquidity problem. The plan is reviewed and updated regularly. The plan is also tested periodically.

The Bank has also created a policy for its subsidiaries to report the liquidity needs arising from their activities via the investment team.

The Treasury Department, in conjunction with RMD periodically reviews/updates the liquidity risk strategy which is approved by ALCO and the Board.

3.11.4 Liquidity Risk Measurement Tools

The methods used by the Bank for measuring liquidity risk are:

Static gap analysis
Gap analysis refers to the maturity gap between assets and liabilities. Static gap analysis refers to the gap analysis of the current assets and liabilities of the Bank. The gap analysis involves measuring the gap between assets and liabilities maturing within a single time bucket and cumulatively over several buckets. This analysis is conducted on a stress and business as usual scenario.

These time buckets are set by Board, on recommendation of RMD within an oversight from the ALCO and RGC Committee. The buckets are in line with the nature of the markets the Bank operates in and the Bank's own risk appetite. For the purpose of analysis, the Bank also conducts core and non-core analysis for non maturing analysis using statistical methods. The results are approved by ALCO.

Dynamic gap analysis
Dynamic gap analysis refers to the gap analysis for the forecasted statement of financial position of the Bank. The statement of financial position is forecasted based on the current statement of financial position and estimates of the assets and liabilities positions from the various business heads and the Treasurer. The business heads provide the RMD with forecasts for their department's assets and liabilities. The analysis is done on a Bank wide level and on an individual currency basis for the major foreign currencies.

Liquidity Ratios
A number of liquidity ratios are monitored for assessing the risk exposures arising out of various sources of funding including the effect of concentration of particular sources. These ratios act as indicators to measure a Bank's ability to meet its liquidity needs under business as usual and stressed market conditions. Some of the ratios which the Bank monitors are the Liquid assets to Customer deposit ratio, URIA Deployment matrix, Financing to Customer deposits ratio, FX funding Ratio and Deposit Concentration ratio.

Limits
The limits are in line with the overall liquidity risk management strategy approved by the Board. The breach of the limits is reported to the Board. The Bank monitors the limits on the liquidity gaps in various tenor buckets and on the ratios.

Stress Tests
On a monthly basis, the Bank conducts stress tests on its liquidity profile. The institution specific and market wide stress tests are conducted. The gaps are created under stress conditions to understand the liquidity needs in case of stress situations.

3.12 Profit Rate Risk

3.12.1 Introduction

Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of funding due to the sources of finance. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments.

The Bank has established a Profit Rate Risk Management strategy and policy and manages the profit rate risk accordingly.

The profit rate risk in the Bank may arise due to the following transactions:
a) Murabaha transactions;
b) Mudaraba transactions;
c) Ijarah Muntahia Bittamleek; and
d) Sukuks.
e) All other rate sensitive products

3.12.2 Sources of Profit Rate Risk

The different profit rate risks faced by the Group can be classified broadly into the following categories:

Maturity mismatch
The non–alignment of maturities/re-pricing dates of assets and liabilities give rise to profit rate risk. In the case of fixed profit rates, maturities are considered whereas for floating or variable profit rates the re-pricing/rollover dates are considered.

Basis value risk
Assets and liabilities with similar maturities / re-pricing dates and highly, though imperfectly, correlated profit rate benchmarks (USD–LIBOR and BIBOR) are exposed to basis risk.

Profit rate curve risk
Changes to the values, slope and shape of the profit rate curve that impact the assets and liabilities of the Group in a dissimilar manner give rise to profit rate risk.

Risk of counterparty's options underlying assets
The availability of options, with the Group's counterparties, to make prepayments or early withdrawals can leave the Group with excess or deficit funds that need to be invested or funded again at unknown profit rates. This imposes a profit rate risk on the Group.

3.12.3 Profit Rate Risk Strategy

The Bank's Board is responsible for approving and reviewing (at least annually) the profit rate risk strategy and significant amendments to the profit rate risk policies. The Bank senior management is responsible for implementing the profit rate risk strategy approved by the Board to identify, measure, monitor and control the risks faced by the Bank.

The Bank's strategy includes taking the following steps:

- Identify and document the profit rate risk sensitive products and exposures it wishes to engage in;
- Strive to reduce the maturity / re-pricing mismatch between assets and liabilities on its statement of financial position;
- Abstain from entering into fixed price assets / liabilities with unusually long tenure / maturity e.g., Murabaha contracts of more than 5 years etc;
- Reduce the reliance on short term inter–bank borrowings to avoid short term earnings pressure. The Bank will strive to reduce the proportion of inter–bank liabilities as a percentage of total liabilities;
- Periodically review the profit rates offered on savings, VIP savings, Investment accounts and VIP Murabaha keeping in view the profit rates offered by competitors, cost of funds, market conditions etc;
- Establish a limit structure to quantify its overall profit rate risk tolerance. These limits will be monitored on a periodic basis and any exceptions to the limits will be immediately dealt with;
- Strive to maintain a minimum spread between cost of funding and profit generated from assets while simultaneously ensuring the liquidity mismatch does not exceed a certain threshold for a maturity bucket;
- Periodically review the changes in major market rates (Fed rates, LIBOR, BIBOR) and anticipated trends and their potential impact on expected rate of return on their liabilities;
- If needed, the Bank may take a natural hedge on its rate sensitive assets by raising liabilities having similar re–pricing profile;
- Conduct periodic stress tests to assess the effect of extreme movements in profit rates for all major currencies which may expose the Bank to high risks; and
- At all times, the Bank will ensure that it follows the overall profit rate risk strategy while taking any new profit rate risk exposures.

3.12.4 Profit Rate Risk Measurement Tools

The Bank is in the stage of implementing and will adopt the following methods to quantify profit rate risk in the banking book.

Re-pricing gap analysis

As part of the re-pricing gap analysis, the Bank defines certain assumptions based on the re-pricing date and profit rate sensitivity for allocating each instrument/position to a given time bucket. The periodic gap compares Rate Sensitive Assets (RSAs) with Rate Sensitive Liabilities (RSLs) across each single time bucket while the cumulative gap compares RSAs with RSLs over all time buckets from the present day through the last day in each successive time bucket. This is done for each major currency the Bank operates in. A positive gap indicates that if reference rates fall, net income will be adversely affected.

Economic value of equity (EVE)

The EVE measures the change in the Bank's market value of equity resulting from upward and/or downward movements in the yield curve. The Bank uses the analysis to measure the impact on its equity that could occur due to the yield curve movements, at a particular point of time.

Earnings-at-Risk (EaR)

Earnings-at-risk will measure the loss in earnings resulting from upward and/or downward movements in the yield curve. The Bank will use the analysis to evaluate the profit rate risk exposure of the banking book over a particular time horizon and calculate the potential impact on earnings over the specified horizon. Bank has started implementing a simplified version of EaR in 2011. The Bank has initiated implementation of EaR in 2011.

Limits

The Board specified the limits on the re-pricing gaps. The reports are regularly monitored.

Stress Testing

The Bank conducts the stress tests on the re-pricing gaps and economic value of the equity by shocking the yield curves by various amounts such as 50 basis points, 100 basis points and 200 basis points. The bank has also started stress tests based on its EaR methodology. The stress tests also included the concepts of EaR to estimate the profit rate risk.

3.12.5 Profit Rate Risk Monitoring and Reporting

The Bank is monitoring the profit rate through the Focus ALM system implemented by the Bank. The report is then presented to ALCO and the Board to review the results of gap limits and exceptions, if any, and recommend corrective actions to be taken.

3.12.6 Quantitative Disclosures

Table – 40. Profit Rate Shock

Amount in BD '000

PROFIT RATE RISK IN THE BANKING BOOK			
200bp Profit Rate Shocks (PD-1.3.40 (b)) Total			
Assets	**Amount**	**Change in Basis Points**	**Effect on Net Income for the Year**
Murabaha and due from banks	102,212	200	2,044
Financing contracts with customers	242,604	200	4,852
Investments – Sukuk	62,078	200	1,242
Liabilities			
Murabaha and due to Banks	213,441	200	(4,269)
Murabaha contracts with non-banks	290,688	200	(5,814)
Subordinated Murabaha payable	100,186	200	(2,004)
Unrestricted investments accounts	445,288	200	(8,906)
		Total	**(12,855)**

3.13 Financial Performance and Position

Table – 41. Ratios

Financial Performance and Position					
(PD-1.3.9(b))					
Quantitative Indicator	**2011**	**2010**	**2009**	**2008**	**2007**
Return on average equity	2%	2%	1%	15%	26%
Return on average assets	0.4%	0.5%	0.2%	4%	6%
Staff cost to net operating income ratio	29%	28%	31%	15%	15%

Formula is as follows:
ROAE = Net Income/average equity
ROAA= Net profit/ average Assets

4 Corporate Governance and Transparency

The Bank is committed to adopting the highest international standards and global best practices in corporate governance. The Bank has established a strong corporate governance framework that is designed to protect the interests of all stakeholders, ensure compliance with regulatory requirements, and enhance organisational efficiency.

The Bank has established a robust organisational structure that clearly segregates functions and responsibilities, and reflects a division of roles and responsibilities of the Board of Directors and Management. Clear mandates exist for the Board, Chairman of the Board, Board Committees, Managing Director and Chief Executive Officer, the Management, and Senior Management Committees.

Responsibilities

The Board of Directors is accountable to the shareholders for the creation and delivery of strong and sustainable financial performance and long–term sustainable shareholder value by providing effective governance over the Bank's affairs. It determines the strategic objectives and policies of the Bank to deliver such long term value, providing overall strategic direction to the Bank within a framework of rewards, incentives and controls. Detailed responsibilities of the Board are provided in KFH-Bahrain's Articles of Associations.

The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Executive Management, and maintaining a dialogue with the Bank's shareholders.

The Board currently has four committees: the Audit Committee, the Risk Governance & Compliance Committee; the Executive Committee and the Nomination and Remuneration Committee. Each committee has specific terms of references that define its scope and powers. Detailed responsibilities of the Board and its committees are provided in the Bank's Corporate Governance Charter.

The remuneration/incentive structure of the Managing Director and the Chief Executive Officer, Board Members and Shari'a Members is discussed at the Board level. Remuneration of the Managing Director and the Chief Executive Officer and Board Members is approved in the AGM. For all Bank staff there is a fixed bonus and a performance bonus scheme. Performance bonus is based on staff performance and recommendation of respective departmental heads. The Board approves all fixed and performance bonus schemes for staff.

Corporate Governance Charter

The Bank has developed a Corporate Governance Charter that provides the basis for promoting high standards of corporate governance in the Bank. It sets out high level guidelines and lays the foundation for the overall corporate governance system in the Bank. It outlines the key elements of an effective corporate governance framework and describes the roles and responsibilities of the Board of Directors which outlines the role of the Board in its review, approval and monitoring of the Bank's strategy and financial performance within a framework of sound corporate governance. It also contains the terms of references for all the Board and Senior Management Committees.

Board of Directors

The Bank’s Board comprises of six directors, including the Chairman of the Board and the Managing Director and the Chief Executive Officer (“MD & CEO”). The Board will periodically assess its composition and size, and where appropriate re-constitute itself and its committees. While deciding upon the composition of the Board, the Bank will ensure compliance with the requirements of the High Level Controls Module, Volume 2 issued by the CBB.

All the Directors of the Bank are adequately qualified in order to carry out the Bank’s activities efficiently and effectively. The levels of qualifications required shall be consistent to those outlined under the articles provided in the Bahrain Commercial Companies Law and the CBB. Furthermore, the Bank will constantly review the qualification requirements and take necessary actions in order to fulfil them.

Table – 42. Corporate Governance

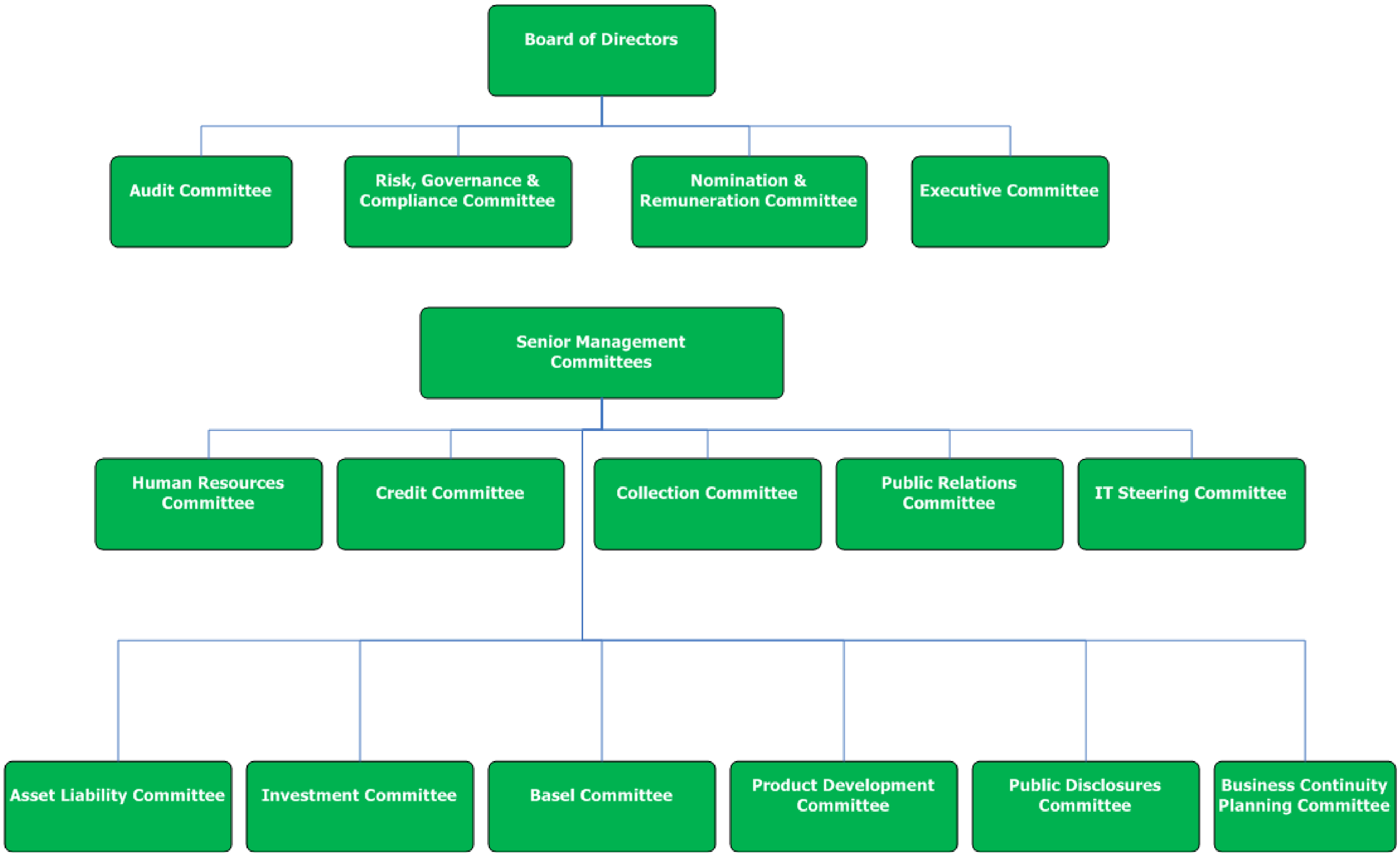
Corporate Governance and Transparency					
(PD-1.3.10(b))					
Name of Board Member	**Independency**	**Profession**	**Business Title**	**Experience in Years**	**Qualification**
Bader A.M. Mukhaizeem (Chairman)	Non-Executive	Banker	Chairman KFH – Bahrain	More than 30 years	Bachelors in Commerce
Mohammed bin Sh. Eshaq (Deputy Chairman)	Independent Non- Executive	Business	Businessman	More than 30 years	Bachelors in Economics
Mohammed Sulaiman Al Omar	Non-Executive	Banker	CEO – KFH Kuwait	More than 20 years	Bachelors in Business Administration
Yaqoob Yousaf Majeed	Independent Non- Executive	Govt. Sector	Consultant – GOSI	More than 30 years	Done various professional courses
Adel Ahmed Al Banwan	Non-Executive	Banker	Direct Investments Manager – KFH Kuwait	More than 14 years	Master of Business Administration
Abdulhakeem Y. Alkhayyat	Executive	Banker	MD and CEO KFH Bahrain	More than 17 years	CPA , BBA and Bachelors in Accounting

The Board is responsible for the overall conduct of the Bank's affairs and for filling the information gap between the shareholders and the executive management. This is done by closely monitoring the management on behalf of the stakeholders of the Bank on an on-going basis.

In order to perform its duties more efficiently (i.e. to ensure that an adequate, effective, comprehensive and transparent corporate governance process is in place), the Board and senior management have set up committees with specific responsibilities. These committees meet regularly and maintain adequate minutes to facilitate the Board carrying out its oversight responsibilities. Although the Board has delegated some of its responsibilities to specialised Board level committees, the individual directors of the Board will be accountable for the responsibilities as stated in the Bank's Corporate Governance Charter. The diagram on page 62 represents the various Board and senior management committees of the Bank. During the year 2011, an independent Risk Governance and Compliance committee was established. The objectives of this committee are included in table 43.

Information on the directorships held by the directors on other boards is as follows:

Name of Board Member	Directorships on other companies
Mohammed Bin AlShaikh Eshaq (Deputy Chairman)	Chairman - Eshaq Real Estate Chairman - Eshaq Construction Co. Chairman - Middle East Traders W.L.L
Yaqoob Yousef Majed	Vice Chairman – Joslin Diabetes Centre
Abdulhakeem Y. Alkhayyat	Chairman - Turk Capital Holdings B.S.C. (c) Chairman - Diyar Al Muharraq W.L.L. Chairman - Durrat Al Bahrain Chairman - Mena Telecom W.L.L. Chairman - Diyar Homes W.L.L.


Board of Directors
Audit Committee
Risk, Governance & Compliance Committee
Nomination & Remuneration Committee
Executive Committee
Senior Management Committees
Human Resources Committee
Credit Committee
Collection Committee
Public Relations Committee
IT Steering Committee
Asset Liability Committee
Investment Committee
Basel Committee
Product Development Committee
Public Disclosures Committee
Business Continuity Planning Committee

Board committees with their respective objectives and members are as follows:

Table – 43. Board Committee's objectives

Board Committee	Membership	Objective
Executive Committee	1. Bader A.M. Mukhaizeem 2. Mohammed bin Sh. Eshaq 3. Abdulhakeem Y. Alkhayyat	Role of this committee is to develop the strategy of the Bank, for the Board; and to guide, monitor, co-ordinate the management and the performance in line with the strategy, business plan and budget approved by the Board. The Committee assists the Board in maintaining oversight of financing requirements including raising capital and investment management, asset liability management and other financial matters. The committee is also responsible for assisting the Board in maintaining oversight of the Bank's internal controls, risk management and overall control environment.
Risk, Governance and Compliance Committee	1. Mohammed Sulaiman Al Omar 2. Adel Ahmed Al Banwan 3. Yaqoob Yousaf Majeed 4. Abdulhakeem Al Adhami	The major objectives of this committee are: Determines the key risk areas, adopts sound risk management practices that contribute to realizing the Bank's strategic corporate objectives, manages Compliance Risk and ensure compliance with local regulatory bodies and best practices, oversees whether KFH-Bahrain's management are complying with all the Bahraini rules and regulations and establishes the best practices in Corporate Governance.
Audit Commitee	1. Mohammed Sulaiman Al Omar 2. Adel Ahmed Al Banwan 3. Yaqoob Yousaf Majeed 4. Abdulhakeem Al Adhami	The Committee was established as an oversight committee to ensure the Bank complies with the requirements of the CBB and the Basel Committee of the Bank of International Settlements ("BIS"), and in particular in one of the working papers published by Basel Committee "Internal Audit in banks and the relationship between the auditors and the regulators" that was issued in August 2001 and the Internal Audit Institute Standards for the Professional Practice on Internal Auditing. The Committee assists the Board in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof, and the soundness of the internal controls of the Bank.
Nomination and Remuneration Committee	1. Bader A.M. Mukhaizeem 2. Mohammed Sulaiman Al Omar 3. Abdulhakeem Y. Alkhayyat	The primary objective of the NRC is to assist the Board in providing a formal and transparent procedure and in identifying and nominating individuals qualified to serve as Board, MD & CEO and Sub-committee members as well as the assessment of effectiveness of individual Directors and the MD & CEO. In addition, recommend the remuneration and rewards policy for the MD & CEO and for the accomplishments he has achieved for the Bank.

Meetings and attendance

*N/A: independent member only in the Audit and Risk, Governance and Compliance Committee.

Table – 44. Meetings and attendance

	Board of Directors	Executive Committee	Audit Committee	Risk, Governance & Compliance	Nomination & Remuneration Committee
Required no. of meetings in 2011	**4**	**4**	**4**	**4**	**2**
Bader Abdul Muhsen Al-Mukhaizeem	4	4	-	-	1
Mohammed Bin AlShaikh Ishaq	4	4	-	-	-
Mohammed Sulaiman Al Omar	3	-	4	5	1
Yaqoob Yousef Majed	4	-	5	5	-
Adel Ahmed Al Banwan	4	-	5	5	-
Abdulhakeem Yaqoob Alkhayyat	4	4	4	5	1
Abdul Hakim Al Adhamy	N/A	N/A	5	5	N/A

Shari'a Fatwa & Supervisory Board

The Shari'a Fatwa & Supervisory Board is responsible for ensuring that all the products, services, investments and related policies and agreements of the Bank are in compliance with Shari'a rules and principles (including AAOIFI standards). Before launching any new products or services, the related policies and agreements shall be verified by the Shari'a Fatwa & Supervisory Board in coordination with the senior management. It is the responsibility of the Shari'a Fatwa & Supervisory Board to provide guidelines, formulate policies and conduct annual Shari'a audits in order to ensure the Bank's compliance with all Shari'a principles. Brief responsibilities of the Shari'a Fatwa& Supervisory Board are outlined in the Articles of Association.

Deposit Protection Scheme

Subject to the provisions thereof, deposits held with the Bahrain office of Kuwait finance House are covered by the Deposit Protection Scheme established by the Central Bank of Bahrain regulation concerning the establishment of a Deposit Protection Scheme and a Deposit Protection Board

Appointment & Training of Board Members

The Board members were reappointed during the AGM, which was held on 20th April 2011, for a term of 3 years. The Compliance Department of the Bank prepares an annual orientation program for the members of Board of Directors.

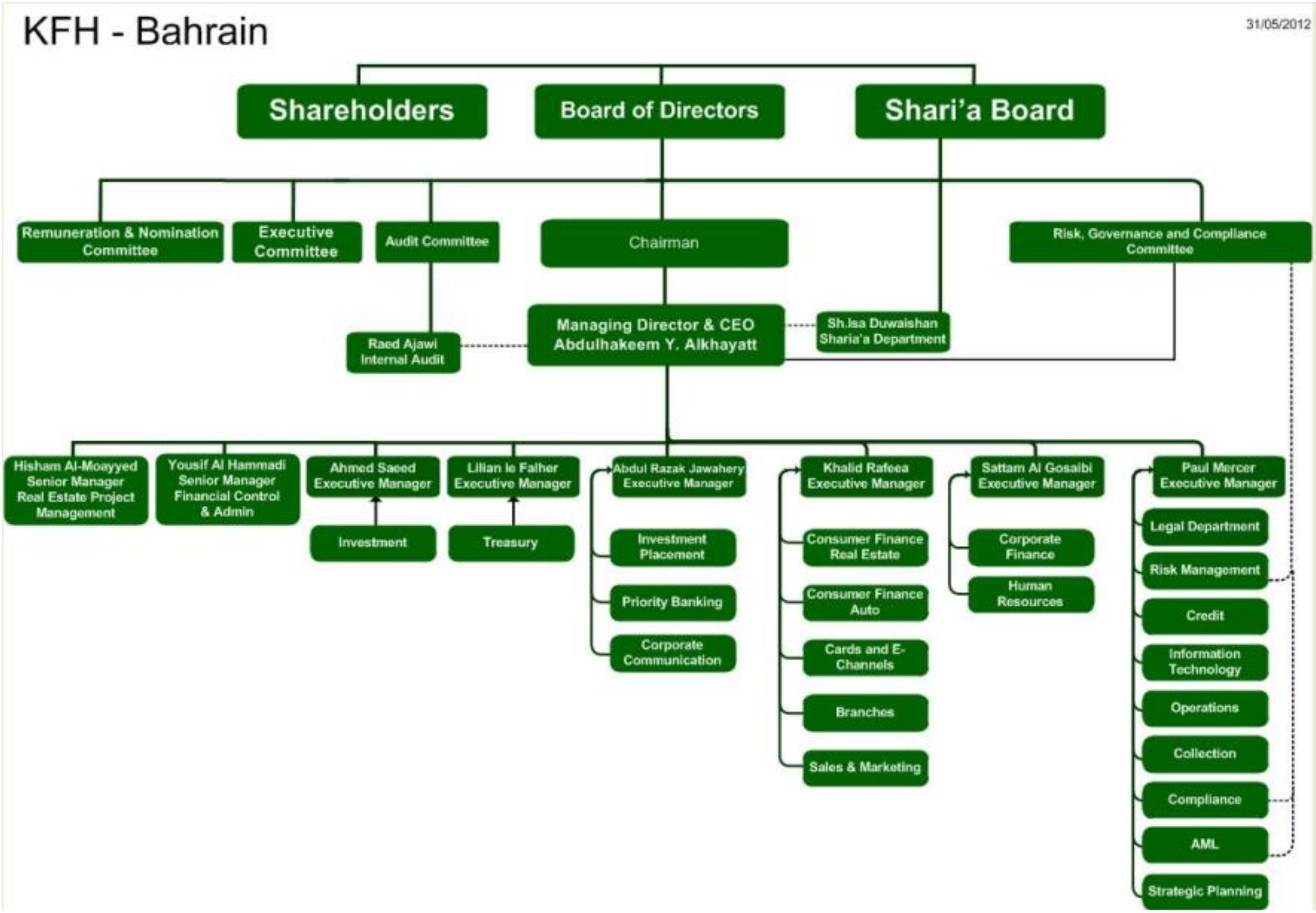

KFH - Bahrain
31/05/2012
Shareholders
Board of Directors
Shari'a Board
Remuneration & Nomination Committee
Executive Committee
Audit Committee
Chairman
Risk, Governance and Compliance Committee
Managing Director & CEO Abdulhakeem Y. Alkhayatt
Raed Ajawi Internal Audit
Sh.Isa Duwaishan Sharia'a Department
Hisham Al-Moayyed Senior Manager Real Estate Project Management
Yousif Al Hammadi Senior Manager Financial Control & Admin
Ahmed Saeed Executive Manager
Investment
Lilian le Falher Executive Manager
Treasury
Abdul Razak Jawahery Executive Manager
Investment Placement
Priority Banking
Corporate Communication
Khalid Rafeea Executive Manager
Consumer Finance Real Estate
Consumer Finance Auto
Cards and E-Channels
Branches
Sales & Marketing
Sattam Al Gosaibi Executive Manager
Corporate Finance
Human Resources
Paul Mercer Executive Manager
Legal Department
Risk Management
Credit
Information Technology
Operations
Collection
Compliance
AML
Strategic Planning

Table – 45. Senior Management

(PD-1.3.10(b))

Name	Business Title	Experience in Years	Qualification	Duties and Responsibilities
Abdul Razak Jawahery	Executive Manager	More than 23 years	MBA; and BBA.	• Priority Banking; • Corporate Communication; and • Investment Placement.
Ahmad Saeed	Executive Manager	More than 16 years	Chartered Accountant.	• Investments.
Hisham Almoayyed	Senior Manager	More than 32 years	MSc (Structural Engineering); and BSC (Civil Engineering),	• Real Estate Project Management.
Isa Duwaishan	Shari'a Advisor	More than 23 years	Masters of Islamic Banking; Bachelors of Accounting; Certified Shari'a Adviser and Auditor; and Holder of the Riwayat Hafs an Assem and Legal Accountant certificate.	• Shari'a Compliance; and • Secretary Shari'a Supervisory Board.
Khaled Al Maarafi	Executive Manager	More than 32 years	Certified Public Accountant (CPA); BSC in Accounting; Diploma in Accounting; and Diploma in Basic Supervision.	• Consumer Finance - Auto; • Consumer Real Estate – Real Estate; • Branches; • Sales & Marketing; and • Cards & e-channels

(PD-1.3.10(b))

Name	Business Title	Experience in Years	Qualification	Duties and Responsibilities
Lilian Le Falher	Executive Manager	More than 16 years	Certified Financial Analyst (Charter holder); and Masters in Management (Banking and Finance).	• Financial Institutions; • Debt Capital Markets; and • Treasury
Paul Mercer	Executive Manager	More than 17 years	MA (Law); BA (Law); Postgraduate Diploma (Law); and Officer of the Supreme Court of England and Wales.	• Legal Department; • Risk management; • Credit Review & Administration; • Information Technology; • Operations; • Compliance; • AML; • Collection; and • Strategic Planning.
Sattam Algosaibi	Executive Manager	More than 15 years	MBA; and Bachelor of Science.	• Corporate Finance; and • Human Resources.
Yousif Al Hammadi	Senior Manager	More than 22 years	MBA	• Financial Control; • Administration.
Raed Ajawi	Head of Internal Audit	More than 12 years	Certified Public Accountant (CPA); BSC in Accounting; and Certified Sharia Advisor and Auditor (CSAA).	• Internal Audit.

(PD-1.3.10(b))

Name	Business Title	Experience in Years	Qualification	Duties and Responsibilities
Alya AlShakhoory	Money Laundering Reporting Officer (MLRO)	More than 10 years	Bachelor in Chemical Engineering; Certified Anti Money Specialist (CAMS); and Master Compliance Professional.	• Anti-Money Laundering;
Mazar Jalal	Head of Compliance	More than 10 years	Bachelor in Accounting; and Advance Diploma in Islamic Banking & Insurance, UK	• Regulatory Compliance;
Enaam Mohamed	Deputy MLRO / Compliance Reviewer	More than 4 years	Bachelor in Accounting; Bahrain; and Certified Islamic Professional Accountant (CIPA)	• Support – Regulatory Compliance; and • Support – Anti-Money Laundering Unit.

Code of Conduct

The Bank has developed a Code of Conduct that covers the principles, policies and laws that govern the Bank's activities. The Code also addresses:

- Responsibility of Approved Persons to:
  - ensure confidentiality of information
  - ensure independent decision making
  - ensure that their conduct in general is in the best interests of the Bank
- Prohibition against the use of insider information
- Polices to prohibit conflicts of interest.

Compliance

The Bank is committed to conduct its business in a Shari'a compliant manner, to deliver its strategic and operational objectives with the highest professional and ethical standards and to comply fully with the spirit and letter of any applicable regulatory requirements, Kingdom of Bahrain legislation, code of best practice promoted by industry associations and internal codes of conduct.

In this context and in compliance with the Central Bank of Bahrain requirements, the Bank has appointed a Compliance Officer pursuant to the provisions of the CBB rulebook volume 2 and established an independent Compliance/Anti-Money Laundering (AML) Department that is responsible for ensuring the appropriate implementation of the Compliance Framework, and adherence to the Compliance Policies documented in the Compliance Policy Manual approved by the Board. The Compliance Framework is based upon the premise that compliance with laid down policies is intended to help the Bank to efficiently realise its goals while complying with applicable laws, rules and regulations. The primary purpose of the Compliance Policy Manual is to establish a strong compliance culture within the Bank by providing a framework of policies and guidelines that the Bank must adhere to ensure appropriate management of Compliance Risk and discharge of its duties relating to regulatory authorities' requirements. It aims at ensuring that the Bank adheres to all applicable regulations, violations if any, are identified on a timely basis and corrective action is taken at the earliest. The Manual provides the basis for the creation of the Bank's Compliance Function Infrastructure thus facilitating the optimisation of shareholder value, as well as meeting the emerging regulatory compliance and leading industry practice standards. It is envisaged that by implementing these guidelines the Bank would be able to monitor and control its Compliance Risk exposures more effectively.

The Board of Directors has the overall responsibility for ensuring that all activities of the Bank are conducted in accordance and in full compliance with applicable laws and regulations. The Board has approved the Compliance Policy. The Policy shall be reviewed as and when there is a significant change in the Bank's business model or regulatory requirements to ensure that it is in line with the Bank's current practices or any other changes introduced by the CBB and other regulatory authorities that may have an impact on the Compliance Function.

In addition to the Policy, the Bank has adopted Compliance Procedures which allow the Bank to appropriately manage compliance risk and discharge its responsibilities relating to regulatory authorities. The objective of the procedures is to ensure that:

- All regulatory requirements are adequately complied with;
- Potential non-compliance is detected, reported and rectified in a timely manner; and
- Non-compliances are reported to the appropriate statutory body and internally to the Managing Director & Chief Executive Officer and RGC Committee.

Disclosures

A Public Disclosure Policy has been developed as part of the Bank's commitment to adopting the highest standards of transparency and fairness in disclosing information for the benefit of all stakeholders. The Public Disclosure Policy provides the approach adopted towards managing and controlling the process of public disclosure of financial and non-financial communication to shareholders and the customers in order to ensure that the information disseminated complies with the CBB directives and is accurate, complete and fairly presents the Bank's financial position and results of operations in all material respects within regulatory stipulated timelines. The purpose of the policy is to assist the Board, senior management and relevant department to understand their roles and responsibilities in the Disclosure Process. The Bank is committed to disclosing information to the public in a manner consistent with guidelines provided by the CBB, and in line with Basel II Pillar III requirements.

Anti–money Laundering

The Bank has adopted detailed policies and procedures in line with the CBB's directives to combat money laundering, financing of terrorism and other financial crimes. Detailed procedures are included on account opening and customer due diligence, internal and external reporting, staff training and record keeping. It aims to assist all members of management and staff to understand:

- The legal requirements and the different penalties for non-compliance;
- What the Bank requires of all members of management and staff; and
- How to recognise money laundering and the action one must take.

It is a firm policy of the Group not to allow itself to be directly or indirectly used by any elements for unlawful activities. From the Group's perspective, the prevention of money laundering, financing of terrorism and other financial crimes has three objectives:

- **Ethical** – taking part in the fight against crime;
- **Professional** – ensuring that the Bank is not involved in recycling the proceeds of crime that could call into question its reputation, integrity and, if fraud is involved, its solvency; and
- **Legal** – complying with Bahrain legislation and regulations that impose a series of specific obligations on financial institutions and their employees.

In this context and in compliance with the CBB requirements, the Bank has appointed a Money Laundering Reporting Officer pursuant to the provisions of the CBB rulebook volume 2 and established

Compliance/AML Department that is responsible for ensuring the appropriate implementation of and adherence to the AML Policies and Procedures as approved by the Board.

Corporate Communications Strategies

The Bank maintains an effective communications strategy by means of deploying a board approved Corporate Communication Manual that enables both the Board and Management to communicate effectively with its shareholders, stakeholders and the general public. Main communications channels include the annual staff meeting, annual report, corporate website and corporate brochure, and regular announcements in the appropriate local press.

The Communications Policy has been approved by the Board. This Policy is set to ensure the disclosure of all relevant information to stakeholders on a timely basis in a timely manner and the provision of at least the last three years of financial data on the Bank's website.

The Bank has a Corporate Communications Department which is responsible for communicating new products information through various channels of communication which may include publications, website, direct mailers, electronic mail and local media.

The department supports the Compliance Officer of the Bank on any communication required to the investors and customers as set up by the Bank. The Corporate Communications Department has assisted, where required, with all business units of the Bank in support of their awareness programs or marketing of new products and services for the year 2011. The department has assisted the Bank throughout the year with its various social functions and charitable contributions. These are highlighted in the Corporate Social Responsibility section of the Annual Report.

Consumer / Investor Awareness Program

The Bank employs a range of communication channels to reach the consumer and investor, to create awareness of the Bank products, services and investments.

Communication channels for consumers normally adopt an integrated approach, depending on the level of exposure and awareness required. This can include mass media, publishing advertisements in the press and magazine publications, billboards, lamp posts, LED display Boards, direct mail, SMS messaging and emails.

The External communication program is supported by in-branch communication including; roll-ups, banners, posters, leaflets, flyers, brochures and danglers and online media via the Bank’s website, Call Centre and eBanking site.

Communication to Investors is predominantly via Private Placement Memorandums and Investor Reports. The Bank also communicates information about its investments via its website. All other Investment communication is directly via the Bank’s Investment Placement Team as part of its investor relations program.

Complaints and Feedback

The Bank has appointed a Complaints Officer to manage customer complaints and ensure that all complaints are properly addressed and issues are solved in a timely manner. After receiving a complaint, the Complaints Officer internally address the complaint to the concerned department for their response. After analysing the responses of the concerned department the Complaints Officer finds suitable solution and this will be communicated to the complainant. There are various channels in place to assist in receiving feedback/complaints from customers including the Bank's website and suggestion boxes that have been placed at each of the Bank's branches.

Other Disclosures

The information on the nature and extent of transactions with related parties is reported in consolidated financial statement of the Group.

The Bank is effectively a wholly owned subsidiary of Kuwait Finance House K.S.C and information pertaining to the appointment of the auditors and the related fees is available for the perusal of the shareholders.

Consolidated financial statements of the Group provides the information on systems and controls employed by the Bank to ensure Shari'a compliance which include the information if there was any non-Shari'a-compliant earnings and expenditure occur and the manner in which they were disposed of and the annual zakah contributions of the Bank. As per Bank's policy, all non-Shari'a compliant earnings are given away to charity.