Annual Report 2012

# GREATER CHOICE AND CONVENIENCE

بنك البحرين الإسلامي BisB

## SECTION 1



## SECTION 2



## SECTION 3



Bahrain Islamic Bank B.S.C
PO Box 5240, Manama - Kingdom of Bahrain
Tel: (+973) 17 546 111
Fax: (+973) 17 535 808
E-mail: info@bisb.com
Website: www.bisb.com

His Royal Highness
Prince Khalifa bin Salman
Al Khalifa

The Prime Minister of
the Kingdom of Bahrain

His Majesty King
Hamad bin Isa
Al Khalifa

The King of the Kingdom
of Bahrain

His Royal Highness
Prince Salman bin Hamad
Al Khalifa

The Crown Prince,
Deputy Supreme Commander
and First Deputy Prime
Minister

# PROFILE, VISION AND MISSION

Bahrain Islamic Bank (BisB) is uniquely distinguished as being the first Islamic bank in the Kingdom of Bahrain, and the third in the world. Incorporated in 1979, BisB operates under an Islamic Retail Banking Licence from the Central Bank of Bahrain, and is listed on the Bahrain Bourse. At the end of 2012, the Bank's paid-up capital was BD 94 million, while total assets stood at BD 833 million.

By combining its unique heritage and tradition with the adoption of modern banking practices, underscored by technology and innovation, BisB has maintained its status as the leading Islamic commercial bank in Bahrain.

## VISION

To be the best Sharia'a-compliant financial solutions provider.

## MISSION

To leverage our core competencies of customer intimacy, service, leadership and product innovation, in order to exceed the expectations of our stakeholders.

### Around the Kingdom

48 ATMs

13 branches

| | |
|---|---|
| Main Office | Sitra |
| Muharraq | Bahrain City Centre |
| Gudaibiya | Hamad Town |
| Riffa | Budaiya |
| Jidhafs | Bahrain Financial |
| Manama | Harbour (BFH) |
| Isa Town | Hidd |

## CUSTOMER SERVICE


### CHOICE & CONVENIENCE

Due to the increasingly competitive nature of retail and corporate banking sectors in Bahrain during 2012, BisB intensified its focus on enhancing customer service, which acts as a key competitive differentiator for the Bank. A range of new innovative products, delivery channels and service-oriented initiatives were introduced to provide customers with greater choice and convenience.

### NEW PRODUCTS

New launches include a MasterCard credit card to complement the existing VISA card; bancassurance services in collaboration with Takaful International, a leading Sharia'a compliant insurance company; and a Tejoori savings scheme gift certificate.

### NEW SERVICES

New initiatives include the launch of BisB's new website; enhancing the functionality of ATMs; a new electronic process for financing applications; extending the working hours of the Call Centre; phase one of a new mobile banking service; and construction of four new financial malls.

# FINANCIAL AND OPERATIONAL HIGHLIGHTS

## TOTAL ASSET

### BD 833 million

| | |
|---|---|
| **2012** | **833** |
| 2011 | 839 |
| 2010 | 936 |
| 2009 | 912 |
| 2008 | 874 |

## ISLAMIC FINANCING

### BD 429 million

| | |
|---|---|
| **2012** | **429** |
| 2011 | 400 |
| 2010 | 422 |
| 2009 | 438 |
| 2008 | 385 |

## TOTAL OPERATING INCOME

### BD 38 million

| | |
|---|---|
| **2012** | **38** |
| 2011 | 41 |
| 2010 | 35 |
| 2009 | 42 |
| 2008 | 73 |

## INVESTORS' SHARE IN INCOME

### BD 14 million

| | |
|---|---|
| **2012** | **14** |
| 2011 | 15 |
| 2010 | 18 |
| 2009 | 18 |
| 2008 | 18 |

## OPERATIONAL HIGHLIGHTS

### 1_

BisB grew its overall market share, launched new products, and introduced new customer service initiatives. At the same time, The Bank continued to enhance its institutional capability – further strengthening its corporate governance and risk management framework – while enhancing its substantial investment in people and information technology.

### 2_

BisB signed a new BD 10 million agreement with Tamkeen as part of the Enterprise Finance Scheme that enables small-to-medium enterprises to acquire capital needed for growth and expansion.

### 3_

New service-oriented initiatives include enhancing the functionality of ATMs to enable a wider range of transactions; introducing a new electronic process for financing applications to speed up approval times; and extending the working hours of the Call Centre.

## INVESTMENTS

### BD 220 million

| | |
|---|---|
| 2012 | 220 |
| 2011 | 242 |
| 2010 | 249 |
| 2009 | 303 |
| 2008 | 265 |

## UNRESTRICTED INVESTMENT ACCOUNTS

### BD 661 million

| | |
|---|---|
| 2012 | 661 |
| 2011 | 638 |
| 2010 | 741 |
| 2009 | 680 |
| 2008 | 624 |

## BOOK VALUE PER SHARE

### BD 74 fils

| | |
|---|---|
| 2012 | 74 |
| 2011 | 108 |
| 2010 | 138 |
| 2009 | 194 |
| 2008 | 251 |

## SHARE PRICE

### BD 82 fils

| | |
|---|---|
| 2012 | 82 |
| 2011 | 90 |
| 2010 | 129 |
| 2009 | 196 |
| 2008 | 290 |

## 4_

A key development during the year was completion of the construction of four new financial malls at Arad, Riffa, Budaiya and Hamad Town. Following final fitting-out, they will become operational during 2013.

## 5_

A number of key products recorded substantial growth, including the Vevo Youth Account, Tas'heel Personal Finance, Iqra Education Investment Scheme, and Tejoori Savings Account; together with significant increases in vehicle and mortgage financing.

## 6_

BisB's ongoing investment in ICT enabled the development of new innovative products, services and delivery channels in 2012; and also supported the further streamlining of back office operational processes and procedures.

CHAIRMAN'S STATEMENT

# "I WOULD LIKE TO STRESS THAT BisB REMAINS FINANCIALLY SOLID, HIGHLY LIQUID AND NOT LEVERAGED."

**Khalid Abdulla Al Bassam**
Chairman

**In the name of Allah, the Most Beneficent, the Most Merciful. Prayers and Peace be upon the Last Apostle and Messenger, Our Prophet Mohammed, His Comrades and Relatives.**

On behalf of the Board of Directors, it is my privilege to present the annual report and consolidated financial statements of Bahrain Islamic Bank (BisB) for the year ended 31 December 2012. This proved to be another challenging year, marked by continued economic and market volatility. However, I am pleased to report that the Bank achieved a strong overall operating performance in 2012, backed by a continued improvement in our core banking operations.

Despite difficult market conditions, we maintained our competitive edge in Bahrain's commercial banking sector during 2012. BisB grew its overall market share, launched new products, and introduced new customer service initiatives. At the same time, BisB continued to enhance its institutional capability – further strengthening our corporate governance and risk management framework – while enhancing our substantial investment in people and information technology.

I am pleased to report that BisB posted total income of BD 24.75 million for 2012 compared with BD 26.19 million the previous year; while operating income was BD 4.86 million versus BD 6.62 million in 2011. The Bank maintained a strong balance sheet footing, which stood at BD 832.80 million at the end of 2012; while liquidity remained healthy, growing to BD 43.89 million by the end of the year.

In the light of continued challenging market conditions, the Bank maintained its prudent and conservative approach, and increased the provisions portfolio to BD 41.05 million, which resulted in BisB reporting a net loss of BD 36.19 million for 2012. God willing, this will be the last year to witness provisioning of such a nature, and thereby mark the end of a difficult period for the Bank, which emanated from the impact of the financial crisis that started in 2008, and the subsequent unfortunate events in Bahrain during 2011.

I would like to stress that BisB remains financially solid, highly liquid and not leveraged. Significantly, recurring income from core retail and corporate banking operations now constitutes over 97 per cent of total income. With such strong fundamentals in place, the Board looks forward with optimism to the Bank returning to profitability and enhancing shareholders' equity.

Key elements of the Bank's current three-year strategy include growing our core operating income, improving asset quality, enhancing liquidity, rationalising costs, and reducing the cost of funding. We will also continue to further enhance customer service in order to capture a greater market share of the retail and corporate banking segments in Bahrain; and strengthen our focus on the small-to-medium enterprise (SME) sector. At the same time, we will maintain a well-balanced and diversified investment portfolio; while actively supporting key Government infrastructure and strategic projects in Bahrain.

During 2012, the Kingdom's Social Insurance Organisation and the National Bank of Bahrain expressed their interest in acquiring the 51.5 per cent direct and indirect shareholding of The Investment Dar Company in BisB. By the end of the year, the various due diligence and related activities had reached their final stages, with a decision expected during the first quarter of 2013. Such a change in shareholding, with the active involvement of new Bahrain-based strategic partners, would generate positive financial and business synergies for the Bank and its stakeholders.

As Bahrain's oldest Islamic bank, we have an enduring commitment to contribute to the economic prosperity and social well-being of the Kingdom of Bahrain, and the development of the Islamic banking industry. In 2012, BisB signed a new BD 10 million agreement with Tamkeen as part of the Enterprise Finance Scheme that enables small-to-medium enterprises to acquire capital needed for growth and expansion. We also continued to encourage entrepreneurship, and nurture tomorrow's business leaders, by supporting a number of key initiatives. At the same time, we provided financial and practical support for a wide range of charitable, medical, educational, cultural, sporting and community organisations and events.

Looking ahead, the economic outlook for Bahrain and the GCC remains positive. According to the latest Economic Quarterly Report from the Bahrain Economic Development Board, 2012 was a year of steady consolidation for the Kingdom.

Overall growth for the year is estimated at 3.9 per cent, with all main sectors of the economy recording positive growth. Bahrain is well-positioned to continue to achieve steady and sustainable expansion in 2013 and beyond; which is reflected in Standard & Poor's having revised its outlook on the Kingdom from negative to stable.

The GCC economies have shown their ability to weather the worst consequences of the global financial crisis, and have grown at a faster rate than the global average. Continued high oil prices have strengthened the robust underlying macroeconomic fundamentals of the region; and the medium-to-long-term economic and market outlook remains positive. The GCC is forecast to grow by 4.6 per cent in 2013, with aggregate nominal GDP expected to reach US$ 1.5 trillion, having achieved a 6 per cent compound average growth rate (CAGR) over the past five years.

Any strong recovery in the local economy will have a strong positive effect on the banking and financial services industry in general, and BisB in particular, since we have substantial assets and exposures in Bahrain, which is our main market. We remain optimistic for the future. BisB has the core fundamentals in place to return to profitability and take advantage of new business opportunities arising from improved market conditions. Importantly, this will further strengthen our ability to continue contributing to the social, economic and business activities that will lead to greater prosperity for the Kingdom of Bahrain.

On behalf of the Board of Directors, I would like to extend my sincere appreciation to His Majesty the King of Bahrain, His Royal Highness the Prime Minister, and His Royal Highness the Crown Prince, for their wise leadership and visionary reform programme; and also for their encouragement for the Islamic banking sector. Our thanks are also due to various Government institutions for their continued guidance and cooperation.

Finally, I would like to take this opportunity to express our gratitude to the Bank's shareholders and clients for their loyalty and support; to our Sharia'a Supervisory Board for their advice and supervision; and to the management and staff of BisB for their highly-valued dedication and professionalism.

Khalid Abdulla Al Bassam
Chairman

# BOARD OF DIRECTORS









| | | |
|---|---|---|
| 1 | 2 | 3 |
| 4 | 5 | 6 |
| 7 | 8 | 9 |

### 1. Khalid Abdulla Al Sulaiman Bassam

Chairman
Non-Executive and Independent
Re-elected 8 February 2011

Khalid Bassam is currently Chairman of Al Bassam Investment Company and Capital Management House. He is a Board Member of Gulf Investment Corporation, Kuwait; and Islamic Bank of Asia, Singapore. He was previously Deputy Governor of Bahrain Monetary Agency (now Central Bank of Bahrain) and Vice Chairman of the Bahrain Stock Exchange (now Bahrain Bourse). Khalid Bassam holds a Bachelor's degree in Business Administration. He has over 24 years' professional experience.

### 2.Nabil Ahmed Mohammed Ameen

Vice Chairman
Non-executive and Independent
Re-elected 8 February 2011

Nabil Ameen is currently Chairman & Managing Director of Almadar Finance and Investment Company, Kuwait; and Vice Chairman of Al Wethaq Takaful Insurance Company, Kuwait. He has held previous senior executive positions at Kuwait Finance House in Kuwait and Turkey; and at The International Investor, Kuwait. Nabil Ameen holds a Bachelor's degree in International Business Administration. He has 33 years' professional experience.

### 3. Khalid Mohamed Yusuf Najibi

Board Member
Non-executive and Independent
Re-elected 8 February 2011

Khalid Najibi is currently Managing Director & CEO of Capital Management House. He is a Founding Member and Executive Director of Najibi Investment Company. He is a Board Member of First Energy Bank and Arbah Capital (Saudi Arabia); and a Founding Member of Young Arab Leaders (YAL) Bahrain Chapter. A Certified Public Accountant, USA, Khalid Najibi holds a BA in Business Administration (majoring in Finance) from Schiller International, UK. He has over 21 years' experience in finance and investment.

### 4. Ali Mohammed Ali Al Olimi

Board Member
Non-executive and Independent
Re-elected 8 February 2011

Ali Al Olimi is currently General Manager, Public Authority for Minors' Affairs, Kuwait. He is a Board Member of Al Reem Real Estate Services, and was previously Board Member of National Real Estate Company, Kuwait. Ali Al Olimi holds a Bachelor's degree in Accounting. He has over 31 years' professional experience.

### 5. Mohammed Zarrouq Rajab

Board Member
Non-executive and Independent
Re-elected 8 February 2011

Mohammed Rajab currently works for the Libyan Foreign Investment Board. His previous senior government posts in Libya include Auditor-General, Minister of Treasury, Head of the Libyan Peoples' Congress, Prime Minister from 1983 to 1985, and Convener of the Libyan Central Bank. A Fellow of the Institute of Chartered Accountants in England & Wales, he holds a Bachelor's degree in Accountancy. Mohammed Rajab has over 45 years' professional experience.

### 6. Ghassan Hamad Al-Saleh Al-Baraheem

Board Member
Non-executive and Independent
Re-elected 8 February 2011

Ghassan Al-Baraheem is currently Deputy Secretary General, Kuwait Awqaf Public Foundation. He previously held senior positions at Kuwait Investment Authority, Kuwait Investment Office - London, Morgan Stanley & Company, and JP Morgan. Ghassan Al-Baraheem holds an MBA degree. He has over 31 years' professional experience.

### 7. Abdulla Meshari Ahmed Al-Homaidhi

Board Member
Non-executive and Independent
Elected 1 December 2011

Abdulla Al-Homaidhi is currently Chief Executive Officer, Investment Dar Company; and General Manager, Al-Dar Al- Aula Real Estate Co. Ltd. He is Chairman of Credit Rating & Collection; and Vice Chairman of Wethaq Takaful Insurance Company and Investment Dar Bank. He is a Board member of Wethaq Takaful Insurance Company - Egypt, and Stehwaz Holding; and a Supervisory Board Member of Al Dar Fund of Funds. He has over 34 years' professional experience.

### 8. Adnan Abdul-Wahab Al Nisif

Board Member
Non-Executive and Non-independent
Elected 2 April 2012

Adnan Abdul-Wahab Al Nisif started his career at the Kuwait Stock Exchange in 1987. He is Chairman and General Manager of Manazel Real Estate Development, Kuwait; and a Board Member of Investment Dar Company and Al-Dar Asset Management, Kuwait. Adnan Al Nisif holds a Business degree from AZUSA Pacific University, USA. He has over 25 years' professional experience.

### 9. Ismaeel Mohamed Amin Hasan

Board Member
Non-Executive and Independent
Elected 2 April 2012

Ismaeel Mohamed Amin Hasan joined Ernst & Young in 1967 and served in London, Bahrain, Saudi Arabia, Qatar and the UAE. He was elected a Partner in 1976, and served as Chairman and Chief Executive from 1985 to 1999. He is a Board Member and Chairman of the Audit Committees in the SKAB Group, Najran Cement Company, and Masane Al Khobar Mining Company. Ismaeel Hasan has over 40 years' professional experience in Accounting and Business Consulting.

CHIEF EXECUTIVE REPORT

# "WE INTENSIFIED OUR FOCUS TO PROVIDE CUSTOMERS WITH GREATER CHOICE AND CONVENIENCE."

**Mohammed Ebrahim Mohammed**
Chief Executive Officer

**In the name of Allah, the Most Beneficent, the Most Merciful. Prayers and Peace be upon the Last Apostle and Messenger, Our Prophet Mohammed, His Comrades and Relatives.**

Despite 2012 proving to be another challenging year, highlighted by continued volatile and unpredictable market conditions, I am pleased to report that BisB posted a strong overall performance. As the result of proactive measures implemented during the year, we were successful in enhancing market share and growing our core retail banking business; maintaining adequate liquidity and reducing the cost of funding; improving restructured facilities and minimising non-performing loans; and strengthening the institutional capability of the Bank.

## Customer service

Due to the increasingly competitive nature of retail banking sector in Bahrain, we intensified our focus on enhancing customer service during the year, in order to provide customers with greater choice and convenience. New products introduced in 2012 include a MasterCard credit card to complement the existing VISA card, and Sharia'a compliant insurance in collaboration with Takaful International.

New service-oriented initiatives include enhancing the functionality of ATMs to enable a wider range of transactions; introducing a new electronic process for financing applications to speed up approval times; and extending the working hours of the Call Centre. In addition, the Bank's new re-engineered and redesigned website was launched; while phase one of a new mobile banking service was successfully tested in readiness for introduction in 2013.

A key development during the year was completion of the construction of four new financial malls at Arad, Riffa, Budaiya and Hamad Town. Following final fitting-out, they will become operational during 2013. These purpose-designed malls will offer a convenient 'one-stop-service' for customers, with the highest levels of functionality and comfort, to ensure an enhanced overall customer experience. BisB also continued to revamp its branch network in 2012, with the total refurbishment of the Head Office and Muharraq branches. These developments, supported by concerted awareness and promotional campaigns during the year, resulted in BisB growing its overall market share by 10 per cent and expanding its retail customer base by over 15 per cent. A number of key products recorded substantial growth, including the Vevo Youth Account, Tas'heel Personal Finance, Iqra Education Investment Scheme, and Tejoori Savings Account; together with significant increases in vehicle and mortgage financing.

## Institutional capability

During 2012, we continued to strengthen the Bank's operating infrastructure – with particular emphasis on human capital, information and communications technology (ICT) and operations – which are the basic constituents of business success. BisB continued to take a leading role in recruiting and developing local talent, with Bahraini nationals now comprising over 97 per cent of total employees, the highest of any bank in the Kingdom. Our ongoing investment in ICT enabled the development of new innovative products, services and delivery channels in 2012; and also supported the further streamlining of back office operational processes and procedures.

At the same time, we further enhanced the Bank's corporate governance and risk management framework. BisB is fully compliant with the latest requirements of the Central Bank of Bahrain, and the Corporate Governance Code of the Kingdom of Bahrain issued by the Ministry of Industry & Commerce. The establishment of a high-level task force in 2012 to address the issue of non-performing assets has resulted in a reduction in non-performing loans (NPLs) and an improvement in the performance of restructured facilities.

## Financial highlights

The success of our business achievements and operational developments during the year is reflected in certain key financial indicators for BisB in 2012 compared with the previous year. In the retail sector, Islamic finances grew by 27 per cent, and customer deposits increased by 7.5 per cent. The Bank's liquidity improved by over 5 per cent, and the cost of funding reduced by 31 per cent; while liquidity improved by more than 5 per cent.

BisB reported an operating profit of BD 4.9 million for the year compared with BD 6.6 million in 2011. The contribution from fee and commission income increased by 21 per cent, while net income from investments grew by 153 per cent. Significantly, income and fees from core financing activities constitute more than 97 per cent of the Bank's total operating income which, it should be noted, is free of any revaluations or unrealised profits. Total expenses for the year increased slightly to BD 19.61 million, reflecting the continued investment by BisB in strengthening its human capital and technology, enhancing customer service, and introducing new products over the past few years. Such a high level of expenditure will not be necessary in the future, which will assist the Bank in improving its performance ratios and increasing its profitability. Despite the net loss of BD 36 million reported in 2012 due to very prudent provisioning for impairments of BD 41 million, the underlying financial fundamentals of the Bank remain solid.

## Corporate responsibility

During 2012, BisB continued to play its role in contributing to Bahrain's Economic Vision 2030 in a number of different ways. Through its participation in Tamkeen's Enterprise Finance Scheme, which now totals BD 30 million, the Bank provides financial and practical support for entrepreneurs and small enterprises, who act as the key engines of economic growth. In addition, BisB is a founding shareholder of the landmark US$ 2.1 billion Al Dur Independent Water and Power Plant, which became fully operational in 2012, and will help in supplying Bahrain's growing needs for electricity and water.

The Bank continued to support the development of the Islamic banking sector by sponsoring and participating in a number of key industry events; and supporting key training initiatives. We are also committed to contributing to the social well-being of the local community. During 2012, BisB actively supported numerous charitable, educational, medical, cultural, sporting and social organisations; and encouraged staff to participate in community activities.

## Future outlook

Looking ahead, it is our sincere aim to return the Bank to profitability in 2013 and beyond. Our clearly-defined strategic direction will involve continuing to grow the core financing book, while planning an orderly exit route for selected real estate and private equity assets. At the same time, we will focus on building our retail banking business to capture greater market share; and improve asset quality by reducing non-performing loans. Such endeavours will be supported by a continued focus on controlling costs and minimising all unnecessary expenditure. We remain open for the involvement of new strategic partners that would result in mutually-beneficial financial and business synergies. Looking ahead, we have a cautiously optimistic outlook for the future of Bahrain, which is our core market. The Government continues to demonstrate its commitment to ongoing social, political and economic reforms; and increased investment in infrastructure projects. According to recent forecasts, Bahrain's real GDP is set to grow by six per cent in 2013. This will help to improve the overall business and investment environment, which will in turn benefit the local banking sector. Due to our concerted efforts over the past few years, BisB is a solid financial institution with strong underlying core fundamentals. As such, with God's blessing, we are well positioned to take early advantage of new business opportunities as market conditions improve.

## Acknowledgements

I would like to express my gratitude to the Bank's Board of Directors for its continued confidence and encouragement; and the Sharia'a Supervisory Board for its guidance and supervision. Sincere appreciation is also due to our customers for their trust and loyalty; and our business partners for their positive and constructive cooperation. Finally, I would like to pay a special tribute to our management and staff for their continued dedication, innovation and professionalism during 2012.

Allah the Almighty is the Purveyor of all Success.

Mohammed Ebrahim Mohammed
Chief Executive Officer

# EXECUTIVE MANAGEMENT








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### 1. Mohammed Ebrahim Mohammed

Chief Executive

Mohammed Ebrahim Mohammed has over 35 years' experience in banking and financial services. He took up his current position with BisB in 2007. Prior to this, he was the Chief Executive Officer of CrediMax, having started his banking career with Saudi National Commercial Bank. Mohammed is a Board Member of the Liquidity Management Centre and Takaful International. He holds an MBA from the University of Glamorgan, Wales, UK; and attended the Gulf Executive Development Programme at Darden School of Business, University of Virginia, USA.

### 2. Mohammed Ahmed Hassan

General Manager - Support Services

Mohammed Hassan has 44 years' extensive experience in banking operations and finance. He took up his current position with BisB in 2007. Prior to this, he held high-level executive positions with the National Bank of Bahrain, Al Baraka Bank and Gulf Air, in the Kingdom of Bahrain.

### 3. Abdulrahman Mohammed Turki

General Manager - Retail Banking

Abdulrahman Turki has 40 years' experience in banking. He took up his current position at BisB in 2008. Prior to this, he was Head of Retail Banking at Qatar National Bank; and held various positions with a number of other prominent banks, after starting his career with Aluminium Bahrain. Abdulrahman holds an MBA from the University of Strathclyde, Scotland, UK.

### 4. Dr Salahudin Abdul Qader

General Manager - Credit & Risk Management

Dr Salahudin A. Qader has 37 years' experience in corporate banking, risk management, and credit review and administration. He took up his current position with BisB in 2007. Dr Salahudin holds both a PhD and Master's degree in Business Administration from the University of Hull, UK; and a BSc honours degree in Mechanical Engineering from the UK.

### 5. Yousuf M A Karim

Acting General Manager - Corporate Banking

Yousuf Karim has 40 years' experience in banking operations and marketing. He took up his current position with BisB in 2012. Prior to this, he was General Manager of the Riyadh branch of the National Bank of Bahrain. Yousuf holds a Masters degree in Business Administration.

### 6. Khalid Mohammed Al Dossari

Chief Financial Officer

Khalid Al Dossari has 29 years' experience in banking and accountancy. He took up his current position with BisB in 2003. Prior to this, he worked for Shamil Bank, having started his career with Kuwait Asia Bank. Khalid is a Board Member of the Liquidity Management Centre. A Certified Public Accountant from the US-based AICPA, he attended the Gulf Executive Development Programme at Darden School of Business, University of Virginia, USA.

### 7. Khalid Mahmoud Abdulla

Head of Internal Audit

Khalid Abdulla has 16 years' experience in accountancy and banking. He took up his current position with BisB in 2004. Prior to this, he was Head of Internal Audit at Al Baraka Banking Group, having started his career with Arthur Anderson. Khalid is a Certified Public Accountant from the US-based AICPA.

### 8. Nader Mohammed Bastaki

Head of Investments & Financial Institutions

Nader Bastaki has 13 years' experience in banking. He joined BisB in 2008, and took up his current position in 2012. Previously, he worked with Gulf International Bank, having started his banking career at the Arab Banking Corporation. Nader holds a Bachelor's degree in Accounting & Finance from Bahrain University, and an MBA from the University of Glamorgan, Wales, UK.

## REVIEW OF OPERATIONS continued

### Business Divisions

#### Retail Banking

The retail banking business of BisB posted another strong performance in 2012, substantially outperforming the CBB consumer finance index, despite the increasingly competitive nature of the sector in Bahrain. The Bank increased its retail customer base by over 15%, grew its overall market share by more than 10%, and reduced its cost of funding by 11%. BisB achieved full compliance with the latest CBB requirements, including bancassurance, early settlement of financing, SMS Alerts, and independent complaints procedures. The Bank also implemented the new Bahrain Cheque Truncation System, and the International Bank Account Numbers.

Substantial growth was recorded for a number of key products and services during the year. These include the Vevo Youth Account, which grew by 33%, Tas'heel Personal Finance by 30%, the Iqra Education Investment Scheme by 11%, auto finance by 71%, and mortgage financing by 41%. The Tejoori savings account also attracted increased interest during the year.


**13**
Branches

**5**
Financial Malls


#### Financial malls

Construction has been completed for the first four financial malls at Arad, Riffa, Budaiya and Hamad Town. These purpose-designed malls offer a convenient 'one-stop-service' for customers, featuring the highest levels of functionality and comfort, to ensure an enhanced customer experience.

## Website

BisB launched its new re-engineered and redesigned website in 2012. The new site is easier to use, featuring enhanced navigation and more comprehensive information about BisB. In addition, it provides customers with the choice and added convenience of conducting transactions online.


Another significant achievement was the success in encouraging additional customers to migrate to eBanking. Over 60% of customers registered for eBanking are now conducting their banking transactions online. Underlining this strong performance was a renewed focus on customer service, which acts as a key competitive differentiator for the Bank. Key initiatives in 2012 include enabling customers to pay their utility bills through ATMs via the Payment Gateway; the acceptance of cheques and cash by branch-based ATMs; a new electronic process for financing applications, which considerably speeds up approval times; the installation of Smart CPR card readers in branches, which makes it easier and quicker to capture customer information; and extending the working hours of the Call Centre from 7 am to 10 pm.

During the year, the Bank's new re-engineered and redesigned website was launched, which offers enhanced navigation and more comprehensive information; while phase one of the new mobile banking service was successfully tested in readiness for introduction in 2013. BisB also continued to revamp its existing branch network, with the total refurbishment of the Head Office and Muharraq branches; and finalised completion of four new financial malls at Arad, Riffa, Budaiya and Hamad Town, which will become operational during 2013. These purpose-designed malls will offer a convenient 'one-stop-service' for customers, with the highest levels of functionality and comfort, to ensure an enhanced customer experience. To enable BisB staff to deliver the highest standards of customer service, a number of specially-designed training sessions were conducted during the year. These covered critical areas such as customer service and satisfaction; product knowledge; and the use of new automated systems, with all forms and procedural documentation being immediately available via the Bank's intranet. New products and services introduced during 2012 include a MasterCard credit card to complement the existing VISA card; bancassurance services in collaboration with Takaful International, a leading Sharia'a compliant insurance company; the Tejoori savings scheme gift certificate; and further enhancement of the BisB Shopper Discount programme, with the addition of new top-end retailers, offering discounts from 5% to 50% on a variety of merchandise.

In addition, the implementation of the VISA Acquiring service now enables other banks' customers to use their credit cards for withdrawing cash at BisB ATM machines. The launch of all new products and customer-centric services was supported by campaigns to improve awareness of the Bank in the local community. In partnership with the Bank's Corporate & Institutional Banking business, Retail Banking offers dedicated services for entrepreneurs and small-to-medium enterprises (SMEs). In 2012, BisB and Tamkeen signed a new BD 10 million agreement, which raises the value of the Enterprise Finance Scheme between Tamkeen and the Bank to BD 30 million.

This underlines the Bank's enduring commitment to support SMEs by enabling them to acquire capital needed for growth and expansion, and thereby contribute to the national economy.

## Corporate & Institutional Banking

With the local economy recovering from the events of the previous year, commercial activity in the Kingdom of Bahrain witnessed modest growth in 2012, which had a positive impact on the corporate banking sector. BisB responded proactively, stepping up its marketing and new business development activities to take advantage of improving corporate sentiment and investor confidence. Despite the highly competitive nature of this sector, the Corporate & Institutional Banking team was successful in expanding its client base, with over 57 new business relationships being added during the year. Underlining this achievement was an enhanced focus on customer service, which serves as a key competitive differentiator for BisB.

Key initiatives in 2012 included the soft launch of a new corporate internet banking service, offering greater convenience and choice; and the establishment of a new dedicated Contact Centre for Corporate Banking clients, providing an enhanced service by telephone and e-mail. Particular emphasis was placed on two key segments – sovereign and quasi-sovereign institutions; and trade finance.

The Bank developed tailored packages for the employees of public sector organisations, which provides cross-selling opportunities for Retail Banking; and also expanded its trade finance portfolio through an increase in the number of Letters of Credit (LCs) issued, which provides an important source of fee-based income. BisB also continued to provide real estate financing on a prudent and selective basis.

## REVIEW OF OPERATIONS continued

Small and medium enterprises (SMEs) constitute another key target segment for the Bank. In 2012, BisB and Tamkeen signed a new BD 10 million agreement, which raises the value of the enterprise finance scheme between Tamkeen and the Bank to BD 30 million, from which more than 150 enterprises have benefited to date. This latest agreement illustrates the commitment of BisB to support SMEs by enabling them to acquire capital needed for growth and expansion, and thereby contribute to the national economy.

Such support contributes to improving the skills and capabilities of Bahrainis employed in this sector, and to generating additional employment opportunities in the private sector. During the year, a dedicated task force was created to directly address the issue of delinquent accounts. The Task Force has streamlined the existing process of managing bad and doubtful accounts by the Bank. This resulted in a reduction in the number of delinquencies, and an improvement in collections; with non-performing loans (NPLs) remaining under control. With market conditions likely to remain volatile and unpredictable in the future, BisB reviewed its strategy and business plan for Corporate & Institutional Banking.


### eBanking

Over 60% of BisB customers registered for eBanking are now conducting their banking transactions online. The Bank further enhanced its eBanking services in 2012 with the introduction of SMS Alerts. Also during the year, phase one of BisB's new mobile banking service was successfully tested in readiness for introduction in 2013.

### Smartphone Application

Through our mobile application, clients can make account inquiries and transact over the phone together with making utility payments, etc.

### Call Centre

During the year, BisB extended the working hours of the Call Centre from 7 am to 10 pm, Saturday through Thursday; while the Card Centre operates on a 24/7 basis. **A new dedicated Contact Centre for Corporate Banking clients was also established in 2012, providing an enhanced service by telephone and e-mail.**

This involves growing its market share of the corporate banking sector in Bahrain; increasing income without compromising asset quality; enhancing existing key client relationships while further diversifying its client, sectoral and geographic base; and strengthening its mandated lead arranger (MLA) and underwriting role through syndications, sukuk issues, and commercial financing deals. In addition, BisB plans to continue increasing fee-based income from trade finance and structured finance activities to support balance sheet growth; and to grow its reciprocal business by taking greater advantage of cross-selling products and services through its growing network of relationships.

## Treasury and Investments

### Treasury

The treasury business of BisB had another good year in 2012, successfully managing the Bank's liquidity, and generating foreign exchange income. New relationships with regional banks were established, complementing the numerous relationships maintained over the years with Gulf-based and international banks.

These interbank affiliations are essential in managing the Bank's liquidity and short-term funding requirements. BisB plans to further expand relationships with Gulf-based and other regional banks, and engage with them in alternative treasury transactions. At the end of 2012, the Bank's balance sheet footing stood at BD 832.8 million compared with BD 839.1 million at the end of the previous year, while the liquidity ratio was 21% (2011: 22%).

The treasury book remained healthy, maintaining its interbank lines and customer deposits, while the forex business also performed well. The Bank continued to adopt a cautious approach to proprietary trading, with a balanced portfolio focused primarily on public equities and Sukuk issues. In 2012, BisB received approval from the Central Bank of Bahrain for a new open-ended fund, which will be launched in 2013, thereby providing the Bank with an important source of off-balance sheet fee income.

### Investments

Due to the Bank's cautious but proactive approach, net income from investments in 2012 increased to BD 2.17 million from BD 858 thousand the previous year. Income was derived from investments in local and regional Sukuks, GCC equities, and capital gains from disposal of some fixed income and equity investments.

The composition of the Bank's well-balanced investment portfolio consists of Sukuks, GCC equities, third-party funds, and infrastructure projects. BisB also engages in private equity transactions on a case-by-case basis.

In line with its commitment to support the economic development of Bahrain, the Bank is a founding shareholder of the US$ 2.1 billion Al Dur Independent Water and Power Plant. The plant has an electricity output of 1,234 megawatts, and a production capacity of 48 million gallons per day of desalinated water.

## Support Services

### Financial Malls

All Support Services departments were closely involved in progressing the Financial Malls project during the year. Construction was completed for the first four financial malls at Arad, Riffa, Budaiya and Hamad Town, which are now in the final stages of fitting out.

The Arad mall will be the first to open in March 2013, followed by the other three at monthly intervals. In addition, planning permission was received for the Isa Town mall; and land was purchased for a sixth mall at Muharraq. Designed by a leading UK architect, these financial malls will offer a convenient 'one-stop-service' for customers, featuring the highest levels of functionality and comfort, to ensure an enhanced customer experience.

The malls will be staffed from within the Bank, providing continuity of service for customers. In addition, a pool of additional staff has been recruited, and is undergoing specialised training, to ensure the seamless staffing of additional malls when they become operational.

## Special Incentives

The Bank has introduced special incentives for customers using BisB credit cards. These include three monthly prizes – a BD 1,000 bonus, a special holiday package, and BD 500 salary for a year. In addition, BisB further enhanced its Shopper Discount programme, with the addition of new top-end retailers, offering discounts from 5% to 50% on a variety of merchandise.

# REVIEW OF OPERATIONS continued

## Human Capital

BisB maintained recruitment during 2012. At the end of the year, the headcount stood at 385 compared with 390 at the end of 2011. The number of Bahraini nationals employed by the Bank now totals over 97% of the total workforce, which remains the highest of any bank in Bahrain. The validity of BisB's succession planning policy was illustrated during the year by the immediate replacement within the Bank of three General Managers who resigned in 2012. With staff attrition remaining a challenge for all commercial banks in the Kingdom, BisB strives to offer staff attractive remuneration and benefit packages, while providing a stimulating work environment in which all employees can reach their full potential, and benefit from meaningful career progression opportunities.

## Training and Development

BisB continued to invest in the training and development of its people during 2012. The main training focus was on retail sales, customer service, product knowledge, and soft skills. To support the introduction of bancassurance services in collaboration with Takaful International, 15 Retail Banking employees undertook a professional study course leading to certification with the Chartered Institute of Insurance. This is in line with the Bank's encouragement and support for staff to obtain professional finance qualifications, which include CFA and CPA certification.

A number of special workshops were conducted during the year, including 'Creating a Perfect Sales Team' which was delivered by a leading sales trainer from the UK; and Anti-Money Laundering by a specialised training institute.

In addition, workshops on Stress Management and Positive Thinking were conducted in-house. The Bank also continued to participate in Tamkeen-sponsored seminars, workshops and conferences. The total number of training hours delivered in 2012, and the number of staff receiving training, both increased by 50% over the previous year.

## Information Technology

The Bank views the utilisation of leading-edge information and communications technology (ICT) as a critical strategic driver and business enabler, and a key competitive differentiator.

ICT developments during the year included the installation of new systems for Treasury and Risk Management; a comprehensive upgrade of all servers; enhanced functionality for the Data Centre; and successful testing of the Disaster Recovery Site.

A new digital archiving system was commissioned; the inward remittances process was fully automated; and a profit calculation module (PCM) was introduced. Also during the year, the Bank's Information Security policies were reviewed and updated, involving both internal and external audits, for Board approval. ICT also supported the introduction of new products and customer service initiatives. These include development of the first phase of a new mobile banking service; Tejoori Gift Certificates; the use of ATMs to pay utility bills, and deposit cheques and cash; and an electronic approval system (EAS) to reduce paper-based processes.

In addition, CPR Smart Card data capture machines were installed in branches; and the VISA Acquiring system was implemented to enable other banks' customers to use their credit cards for withdrawing cash at BisB ATMs.


## Credit Cards

The Bank enhanced its credit and debit cards suite in 2012, with the launch of a new BisB MasterCard Classic, Gold and Platinum credit card, which complements the existing VISA credit cards. BisB also offers a convenient eCard for online transactions, as well as Corporate credit cards for businesses.

## Tejoori Gift Certificate

Launched five years ago, Tejoori Al Islami is the first Shari'a-compliant savings account in Bahrain that offers customers the chance to win monthly prizes totalling over US$ 2 million. **In 2012, BisB introduced the Tejoori Al Islami Gift Certificate, which provides a rewarding and enduring present for all occasions.**

### Support for SMEs

The Bank offers dedicated services for entrepreneurs and small-to-medium enterprises (SMEs). In 2012, BisB and Tamkeen signed a new BD 10 million agreement, which raises the value of the Enterprise Finance Scheme between Tamkeen and the Bank to BD 30 million. This underlines BisB's enduring commitment to support SMEs by enabling them to acquire capital needed for growth and expansion, and thereby contribute to the national economy.

### Central Operations

During the year, the Bank significantly enhanced its operational efficiency through identifying and implementing new ways of better utilising its resources. BisB continued to streamline its operational processes and procedures, with a focus on treasury back office, inward remittances and payments, financing approval, and cheque clearance.

The overall level of automation within the Bank reached 70% in 2012. Key developments during the year include implementation of the first phase of the Quantum Treasury Back Office system, which has reduced processing time by almost 70% while also reducing risk exposure; and the automation of inward SWIFT remittances, resulting in inward payment to clients in real time.

The approval process for Tas'heel Personal Finance and auto loans was also fully automated, enabling quicker turnaround at a branch level; while the new Bahrain Cheque Truncation System (BCTS) was successfully implemented, with all clearing now being processed in real time.

### General Services

The role of General Services is to ensure the smooth day-to-day functioning of the Bank. The department's responsibilities cover procurement, quality control, utilities, transport, property management, branch renovations, maintenance and security.

Key activities in 2012 include the continued upgrading of the branch network, with refurbishment of the Head Office and Muharraq branches; the construction of four new financial malls; and the relocation and refurbishment of some departments at the head office to provide greater operational efficiency.

During the year, a tender was awarded to replace the marble cladding at Al Salam Tower – the Bank's head office building that is over 10 years old – with an aluminium product, which is both safer and maintenance-free. Designs were also studied for renovating the head office entrance area to provide a more efficient and pleasant environment for visitors.

### Corporate Communications

A major undertaking during the year was the comprehensive re-engineering and redesigning of the Bank's website with enhanced features and functionality, in collaboration with other Bank departments. The quality of the new website was recognised by the Web Marketing Association Web Awards and the Pan Arab Web Awards in 2012. The responsibilities of the Corporate Communications department include the issue of press releases and organising the Bank's participation in industry conferences and seminars, as well as providing practical assistance and consultancy services for other departments.

# RISK MANAGEMENT REVIEW

**As an inherent part of the Bank's activities, risk is managed through a process of ongoing identification, measurement, monitoring and reporting in line with the risk appetite of the Bank, which is set and guided by the Board of Directors. This process of risk management is critical to the continued profitability of BisB; and all individuals within the institution are personally accountable for the risk exposures relating to their specific responsibilities.**

The Bank is exposed primarily to credit risk, liquidity risk, market risk (including profit rate, equity price and currency risks), operational risk, reputational risk and Sharia'a compliant risk.

## Risk management philosophy

The risk management philosophy of BisB is to identify, capture, monitor and manage the various dimensions of risk. The objective is to protect asset values and income streams so that the interests of the Bank's stakeholders are safeguarded, while optimising shareholders' returns and maintaining risk exposure within the parameters set by the Board.

The Bank has defined its risk appetite within the broad framework of its Risk Strategy. BisB reviews and aligns its risk appetite in line with its evolving business plan, and changing economic and market scenarios. The Bank also assesses its tolerance for specific risk categories, and its strategy to manage these risks.

## Risk management framework

BisB has in place a comprehensive enterprise-wide integrated risk management framework (Risk Governance). This embraces all levels of authorities, organisational structure, people and systems required for the smooth functioning of risk management policies within the Bank.

The Board of Directors retains ultimate responsibility and authority for all risk matters, including establishing overall policies and procedures. The Board is assisted in fulfilling its responsibilities by the Chief Executive; and various Board level and Management committees.

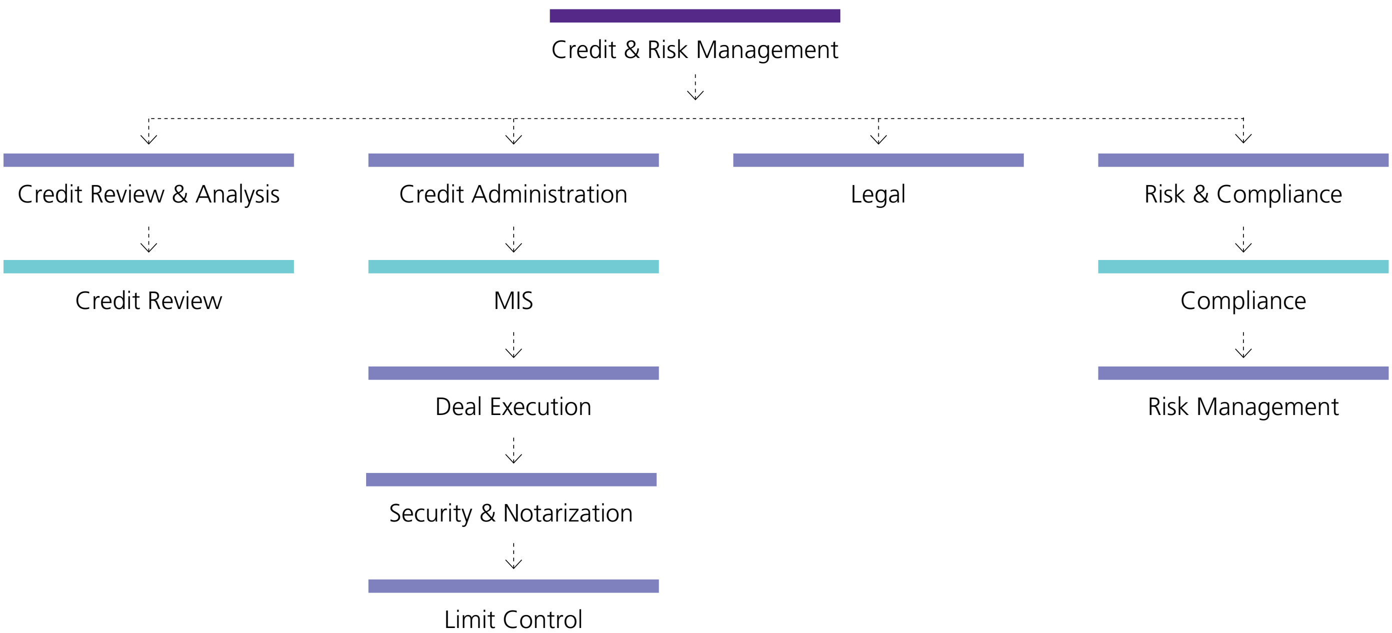
The Credit & Risk Management (C&RM) division, headed by a General Manager reporting to the Chief Executive on a day-to-day administrative basis and the Board Risk Committee, has responsibility for managing the risks involved across all areas of the Bank. C&RM provides independent identification, measurement, monitoring and control of all risk parameters, while liaising with the business divisions that ultimately own the risks. C&RM comprises a number of specialist units, including Risk Management & Compliance, Credit Review & Analysis, Credit Administration, and Legal Affairs.

## Developments in 2012

In the light of prevailing global and regional challenging conditions, the Bank placed the highest priority on further strengthening its risk management infrastructure during 2012. Key initiatives and achievements include:

- Implementing Enterprise-wide Risk Management System (SunGard)
- Implementing Treasury System (AvantGard)
- Implementing approved Provisioning Policy
- Conducting and reporting to the Central Bank of Bahrain (CBB) on Basel III Quantitative Impact Study Assessment
- Participating as a member of the Basel III Working Group set up by the CBB
- Ensuring ongoing compliance with CBB rules and regulations, and Basel II requirements
- Monitoring Sharia'a compliant risk as well as the other risks to which BisB is exposed

Note: Additional information on the Bank's risk management framework, policies, processes and procedures is included in the Notes to the Consolidated Financial Statements and the Basel II Pillar 3 Public Disclosure sections of this annual report.



# CORPORATE SOCIAL RESPONSIBILITY

**Since inception, BisB has been committed to contributing to the economic and social well-being of the Kingdom of Bahrain. Our comprehensive corporate social responsibility (CSR) programme underlines the importance that the Bank places on its role as a responsible and caring corporate citizen. Some of the key activities of the Bank's CSR programme in 2012 are listed below.**

## Industry Sponsorships

By sponsoring and participating in major financial industry conferences and events, and supporting other initiatives, BisB actively contributes to the development of the global Islamic banking industry and the banking sector in the Kingdom of Bahrain:

- 2012 AAOIFI-World Bank Annual Conference on Islamic Banking & Finance
- 2012 Global Islamic Finance Directory
- Bahrain Association of Banks – various activities and initiatives.

## Developing Bahraini nationals

BisB not only leads the way in providing employment and career opportunities for Bahraini nationals, who comprise over 97 per cent of the Bank's total staff; but also encourages entrepreneurship, and nurtures tomorrow's business leaders, by supporting the following initiatives:

- Injaz Bahrain
- The Crown Prince's International Scholarship Programme
- Waqf Fund for Islamic Banking Training and Development (BIBF)
- Enterprise Finance Scheme in collaboration with Tamkeen
- Ministry of Education training initiatives
- Summer Internship programme for Bahraini university students
- Youth camping activities
- Youth conferences and workshops
- Students' trips to underdeveloped countries

## Increasing the awareness of Islam

As a leading Sharia'a compliant financial institution, BisB is committed to raising awareness of Islam through support for national institutions such as the following:

- Rekaaz Bahrain
- Hijab campaign
- Ministry of Justice & Islamic Affairs
- Quran Education Centres
- Muslim Education Society
- Discover Islam

## Improving the well-being of the local community

Through donations and other philanthropic activities, BisB contributes to improving the well-being and quality of life of the local community:

- Support for a wide range of charitable, medical, educational, cultural, sporting and community organisations and events, including the Royal Charity Organisation
- Financial assistance to needy families, individuals and deserving causes

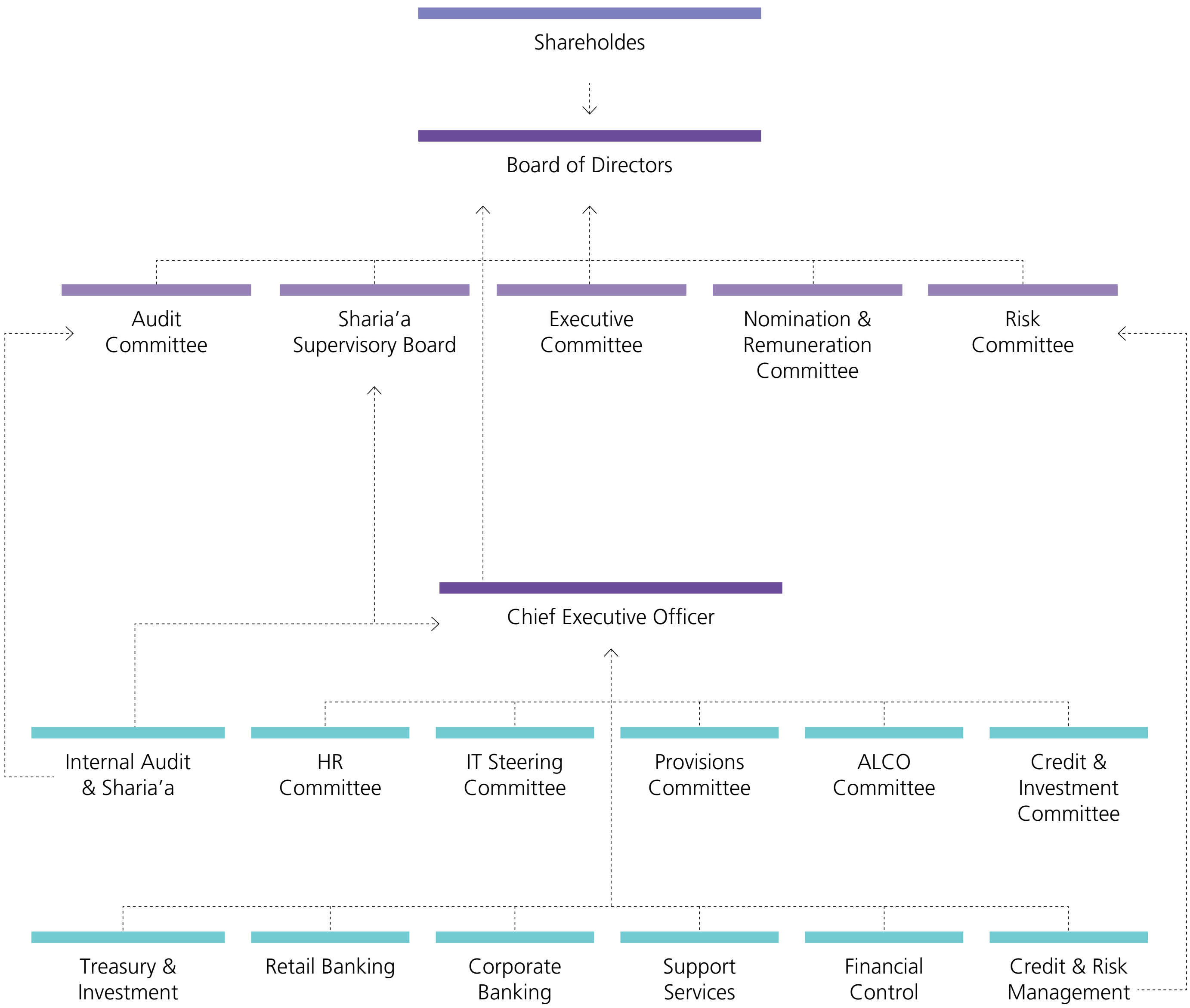
The Bank also contributed to relief programmes for the people of Gaza in Palestine, and also Syria, in 2012.

# CORPORATE GOVERNANCE

## Corporate Governance

BisB is committed to upholding the highest standards of corporate governance. The Bank seeks to balance entrepreneurship, compliance, and industry best practices, while creating value for all stakeholders. This includes, but is not limited to, conducting the policy and affairs of BisB in compliance with regulatory requirements. It also involves having the right checks and balances in place throughout the organisation to ensure that the right things are always done in the right way.

## Governance and Organisation Structure



### Shareholder Ownership (5% And Above)

| Shareholder | Nationality | Number of Shares | Percentage |
|---|---|---|---|
| Investment Dar (including Kuwait Investment Company) | Kuwait | 373,476,940 | 51.56% |
| Islamic Development Bank | Saudi Arabia | 165,804,485 | 17.64% |
| Kuwait Investment Company | Kuwait | 110,962,471 | 11.81% |
| General Council of Kuwaiti Awqaf | Kuwait | 67,946,033 | 7.23% |

## Board of Directors

### Role And Responsibilities of The Board

The primary responsibility of the Board of Directors is to provide effective governance over the Bank's affairs for the benefit of the shareholders; and to balance the interests of BisB's diverse constituencies, including associated concerns, employees and other stakeholders. In all actions taken by the Board, the Directors are expected to exercise their business judgement in what they reasonably believe to be in the best interests of the Bank.

The Board approves and oversees the implementation of the Bank's strategies; and reviews and approves the Bank's strategic plan. As part of its strategic review process, the Board reviews major plans of action and business plans; sets performance objectives; and oversees major investments, divestitures and acquisitions. Every year, at an annual Board strategy session, the Board formally reassesses the Bank's objectives, strategies and plans. The Board's responsibilities are described in more detail in the Corporate Governance Report published on the Bank's website, and in the Charter of the Board of Directors.

### Composition

The Board of Directors of BisB comprises nine Non-executive Directors, of which five are Independent Directors. Each term of the Board of Directors consists of three years. The last re-election of the Bank's Board of Directors was held at the Bank's Annual General Meeting (AGM) on 8 February 2011.

## Profiles of Board Members

### Khalid Abdulla Al Bassam

Chairman
Non-Executive and Independent
Re-elected 8 February 2011

Khalid Al Bassam is Chairman of Al Bassam Investment Company and Capital Management House. He is a Board Member of Gulf Investment Corporation, Kuwait; and the Islamic Bank of Asia, Singapore. Previously, he was Deputy Governor of the Bahrain Monetary Agency (now the Central Bank of Bahrain) and Vice Chairman of the Bahrain Stock Exchange (now the Bahrain Bourse). Khalid Al Bassam holds a Bachelor's degree in Business Administration. He has over 25 years' professional experience.

### Nabil Ahmed Ameen

Vice Chairman
Non-Executive and Non-independent
Re-elected 8 February 2011

Nabeel Ameen is Chairman & Managing Director of Almadar Finance and Investment Company, Kuwait; and Vice Chairman of Al Wethaq Takaful Insurance Company, Kuwait. Previously, he held senior executive positions at Kuwait Finance House in Kuwait and Turkey; and at The International Investor, Kuwait. Nabeel Ameen holds a Bachelor's degree in International Business Administration. He has over 34 years' professional experience.

### Khalid Mohammed Najibi

Board Member
Non-Executive and Independent
Re-elected 8 February 2011

Khalid Najibi is Managing Director & CEO of Capital Management House. He is a Founding Member and Executive Director of Najibi Investment Company, Bahrain. He is a Board Member of First Energy Bank, Bahrain; and Arbah Capital, Saudi Arabia; and a Founding Member of Young Arab Leaders (YAL) Bahrain Chapter. A Certified Public Accountant, USA, Khalid Najibi holds a BA in Business Administration (majoring in Finance) from Schiller International, UK. He has over 22 years' experience in finance and investment.

# CORPORATE GOVERNANCE

Ali Mohammed Al Olimi
Board Member
Non-Executive and Independent
Re-elected 8 February 2011

Ali Al Olimi is General Manager, Public Authority for Minors' Affairs, Kuwait. He is a Board Member of Al Reem Real Estate Services, and was previously a Board Member of National Real Estate Company, Kuwait. Ali Al Olimi holds a Bachelor's degree in Accounting. He has over 32 years' professional experience.

Mohammed Alzarooq Rajab
Board Member
Non-Executive and Non-independent
Re-elected 8 February 2011

Mohammed Rajab works for the Libyan Foreign Investment Board. His previous senior government posts in Libya include Auditor-General, Minster of Treasury, Head of the Libyan Peoples' Congress, Prime Minister from 1983 to 1985, and Convener of the Libyan Central Bank. A Fellow of the Institute of Chartered Accountants in England & Wales, Mohammed Rajab holds a Bachelor's degree in Accountancy. He has over 46 years' professional experience.

Ghassan Hamad Al-Baraheem
Board Member
Non-Executive and Independent
Re-elected 8 February 2011

Ghassan Al-Baraheem is Deputy Secretary-General, Kuwait Awqaf Public Foundation. He previously held senior positions at Kuwait Investment Authority, Kuwait Investment Office - London, Morgan Stanley & Company, and JP Morgan. Ghassan Al-Baraheem holds a Masters in Business Administration degree. He has over 32 years' professional experience.

Abdulla Meshari Al-Homaidhi
Board Member
Non-Executive and Non-independent
Elected 1 December 2011

Abdullah M. Al-Homaidhi is Chief Executive Officer, Investment Dar Company; and General Manager, Al-Dar Al-Aula Real Estate Company. He is Chairman of Credit Rating & Collection; and Vice Chairman of Wethaq Takaful Insurance Company and Investment Dar Bank. He is a Board Member of Wethaq Takaful Insurance Company – Egypt, and Stehwaz Holding; and a Supervisory Board Member of Al Dar Fund of Funds. Abdullah Al-Homaidhi has over 35 years' professional experience.

Adnan Al Nisif
Board Member
Non-Executive and Non-independent
Elected 2 April 2012

Adnan Al Nisif started his career at the Kuwait Stock Exchange in 1987. He is Chairman and General Manager of Manazel Real Estate Development, Kuwait; and a Board Member of Investment Dar Company and Al-Dar Asset Management, Kuwait. Adnan Al Nisif holds a Business degree from AZUSA Pacific University, USA. He has over 25 years' professional experience.

Ismaeel Amin
Board Member
Non-Executive and Independent
Elected 2 April 2012

Ismaeel Amin joined Ernst & Young in 1967 and served in London, Bahrain, Saudi Arabia, Qatar and the UAE. He was elected a Partner in 1976, and served as Chairman and Chief Executive from 1985 to 1999. He is a Board Member and Chairman of the Audit Committees in the SKAB Group, Najran Cement Company, and Masane Al Khobar Mining Company. Ismaeel Amin has over 40 years' professional experience in Accounting and Business Consulting.

*Note: Mr Abdulrahman Al-Dawood resigned from the Board on 2 April 2012.*

## Induction of New Directors

The Board-approved Corporate Governance Policy requires each new Director to receive a formal and tailored induction from the Chairman and Senior Management, with respect to BisB's vision and strategic direction; core values including ethics; corporate governance practices; and financial matters and business operations.

## Board Committees

The Board has constituted four Committees – the Executive Committee, the Audit Committee, the Remuneration & Nomination Committee, and the Risk Management Committee. Each of these committees has its own Charter that describes the responsibilities of its members.

## Board Committees – Membership & Objectives

| Board Committees | Members | Objectives |
|---|---|---|
| Executive Committee | Khalid Mohammed Najibi (Chairman)<br>Nabil Ahmed Ameen<br>Ghassan Hamad Al-Baraheem<br>Mohammed Ebrahim Mohammed | Review strategy and performance; new investment proposals, credit proposals and exit strategies; and risks, provisions and impairments. |
| Audit Committee | Mohammed Alzarooq Rajab (Chairman)<br>Ali Mohammed Al Olimi<br>Abdulla Meshari Al-Homaidhi<br>Ismaeel Amin | Oversight of integrity; reporting of Bank's quarterly and annual financial statements; and compliance with legal and regulatory requirements. |
| Risk Management Committee | Khalid Mohammed Najibi (Chairman)<br>Nabil Ahmed Ameen<br>Ghassan Hamad Al-Baraheem<br>Mohammed Ebrahim Mohammed | Provide independent monitoring of enterprise-wide risk profile; and periodic risk guidance to Board and Management. |
| Nomination & Remuneration Committee | Khalid Abdulla Al Bassam (Chairman)<br>Khalid Mohammed Najibi<br>Nabil Ahmed Ameen | Oversight of compensation and bonus policy; and recruitment and promotion of key personnel. |

## Evaluation of The Board and its Committees

The Nomination and Remuneration Committee carried out an evaluation of the Board and its Committees through the distribution of questionnaires to each Board Member, followed by an assessment of the Committees and Members. The Nomination and Remuneration Committee expressed its satisfaction with the positive results.

## Directors' Remuneration

The aggregate Board sitting fees, including travel expenses, totalled BD 210,000 in 2012.

## Directors' Attendance

The Board of Directors met six times during 2012, details of which are given in the following table. This exceeds the minimum requirement of having at least four meetings in any given year, as stipulated by the Central Bank of Bahrain. The regulatory requirement that individual Board Members must attend at least 75% of all Board meetings in a given financial year to enable the Board to discharge its responsibilities effectively, was met by all Directors during 2012. The table also shows attendance of Directors at Board Committee meetings.

# CORPORATE GOVERNANCE

## Directors' Attendance – January to December 2012

| Board Members | Board Meetings | Executive Committee Meetings | Audit Committee Meetings | Risk Management Committee Meetings | Nomination & Remuneration Committee Meetings |
|---|---|---|---|---|---|
| Khalid Abdulla Al Bassam - Chairman | 6 (6) | | | 2 (2) ¥ | 3 (3)¥ |
| Nabil Ahmed Ameen - Vice Chairman | 4 (6) | 9 (9) | | | |
| Khalid Mohammed Najibi | 5 (6) | 9 (9) ¥ | | | 3 (3) |
| Ali Mohammed Al Olimi | 5 (6) | | 6 (8) | | |
| Mohammed Alzarooq Rajab | 5 (6) | | 7 (8) ¥ | | |
| Ghassan Hamad Al-Baraheem | 6 (6) | 8 (9) | | | |
| Abdulla Meshari Al-Homaidhi | 6 (6) | | 5 (8) | 2 (2) | |
| Abdulrahman Ali Al-Dawood* | 2 (6) | | | | |
| Adnan Al-Nisif** | 3 (6) | | | 1 (2) | |
| Ismaeel Amin** | 4 (6) | | 4 (8) | | 3 (3) |
| | | | | | |
| Mohammed Ebrahim Mohammed (CEO) | | 9 (9) | | | |

*Figures in brackets indicate number of Board and Committee meetings held during 2012*
*¥ Denotes Committee Chairman*
**Resigned from Board 2 April 2012  **Joined Board 2 April 2012*

## Sharia'a Supervisory Board

The Sharia'a Supervisory Board of BisB comprises five eminent and highly-experienced Sharia'a scholars. The Board's main responsibility is to advise the Bank's business units on any Sharia'a-related matters, and to ensure compliance with the tenets and requirements of Islamic Sharia'a in their operations. The Sharia'a Supervisory Board is also entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure full compliance by BisB with Sharia'a rules and AAOIFI standards. Profiles of the Sharia'a Supervisory Board members are listed on page X of this annual report.

### Sharia'a Supervisory Board – Membership And Attendance

| Members | Attendance |
|---|---|
| Rev. Shaikh Dr. Abdul Latif Mahmood Al Mahmood Chairman | 4 (4) |
| Rev. Shaikh Mohammed Jaffar Al Juffairi  Vice Chairman | 3 (4) |
| Rev. Shaikh Adnan Abdullah Al Qattan | 4 (4) |
| Rev. Shaikh Nedham Mohammed Saleh Yacoubi | 4 (4) |
| Rev. Shaikh Dr. Essam Khalaf Al Enizi | 4 (4) |

*Figures in brackets indicate total number of Board meetings held during 2012.*

## Executive Management

The Executive Management of BisB is headed by the Chief Executive Officer (CEO), who is responsible for the day-to-day conduct of the Bank's business in line with policies and procedures approved by the Board of Directors. The CEO is assisted by a highly-qualified and experienced Management Team.

## Executive Management Profiles

| Name | Designation | Profession | Experience | Qualification |
|---|---|---|---|---|
| Mohammed Ebrahim Mohammed | Chief Executive | Banker | 35 years | MBA from University of Glamorgan, Wales, UK |
| Mohammed Ahmed Hassan | GM – Support Services | Banker | 44 years | Advance Management for Senior Decision Makers |
| Abdul Rahman Mohammed Turki | GM - Retail Banking | Banker | 40 years | MBA from University of Strathclyde, Scotland, UK |
| Dr. Salahuddin A. Qudder | GM – Credit & Risk Management | Banker | 37 years | PhD, Master degree Business Administration |
| Yousif M A Karim | Acting GM - Corporate Banking | Banker | 40 years | MBA from University of Glamorgan, Wales, UK |
| Khalid Mohammed Al Dossari | Chief Financial Officer | Accountant | 29 years | CPA from American Institute of Certified Public Accountants |
| Khalid Mahmood Abdulla | Head of Internal Audit & Sharia'a | Accountant | 19 years | CPA from American Institute of Certified Public Accountants |
| Nader Al Bastaki | Head of Investment | Banker | 13 years | MBA from University of Glamorgan, Wales, UK |

*Note:*

- *Dr. Salahudin A. Qader, GM - Credit & Risk Management, retired on 31st December 2012.*
- *Mohammed Fikree, GM - Treasury & Investment, and Nader Ebrahim, GM – Corporate Banking, were part of the managment team until November 2012;*

## Performance-Linked Management Incentive Structure

BisB implements a Performance Management Scheme, which is linked to incentives and competencies on an annual basis, for management and staff. The Bank pays monthly salaries, allowances and bonuses for the following job categories:

| Category | Remuneration Package |
|---|---|
| Chief Executive | • Basic Salary<br>• Bank Car<br>• Full Telephone Bill Reimbursement (Business Calls only)<br>• 3 additional fixed Cash Bonus (Basic Salary) per year<br>• Reimbursement of Education Allowance<br>• Annual Performance Bonus decided by Nomination & Remuneration Committee |
| General Managers | • Basic Salary<br>• Car Allowance<br>• Telephone Allowance<br>• 2 additional fixed Cash Bonus (Basic Salary) per year<br>• Annual Performance Bonus decided by Nomination & Remuneration Committee |

## Senior Management Remuneration

The aggregate Senior Management remuneration, including basic salaries, fixed allowances and bonus distribution, totalled BD 1,069,890 for 2012.

## Management Committees

A number of Management Committees have been established to assist the CEO and Management Team in carrying out their duties, and to ensure that there is adequate supervision of the Bank's activities.

## CORPORATE GOVERNANCE

### Management Committees – Membership & Objectives

| Committee | Members | Objectives |
|---|---|---|
| **Asset & Liability Committee** | Mohammed Ebrahim (Chairman)<br>A. Rahman Turki<br>Dr. Salahudin A. Qader (Retired 31 Dec 2012)<br>Nader Ebrahim (Resigned 19 Nov 2012)<br>Mohammed Fikree (Resigned 19 Nov 2012)<br>Yousif A. Karim (Joined the committee on 13 Dec 2012)<br>Nader Al Bastaki (Joined the committee on 13 Dec 2012)<br>Dr. Mohammed Belgami | Manage and monitor the liquidity risk of the Bank on a coordinated and consistent basis. |
| **Credit & Investment Committee** | Mohammed Ebrahim (Chairman)<br>A. Rahman Turki<br>Dr. Salahudin A. Qader (Retired 31 Dec 2012)<br>Nader Ebrahim (Resigned 19 Nov 2012)<br>Mohammed Fikree (Resigned 19 Nov 2012)<br>Yousif A. Karim (Joined the committee on 13 Dec 2012)<br>Nader Al Bastaki (Joined the committee on 13 Dec 2012)<br>Dr. Mohammed Belgami | Exercise due care, diligence and skill to oversee, direct and review the management of credit risk within the financing portfolio of the Bank; and review policies and strategies for achieving investment objectives. |
| **Information Technology Steering Committee** | Mohammed Ebrahim (Chairman)<br>Mohammed Hassan<br>Dr. Salahudin A. Qader (Retired 31 Dec 2012)<br>Khalid Al Dossari<br>Khalid Mahmood<br>Nader Ebrahim (Resigned 19 Nov 2012)<br>A. Rahman Turki | Plan, prepare, coordinate, implement, support and follow-up on all issues related to IT and new projects implementation. |
| **Human Resource Committee** | Mohammed Ebrahim (Chairman)<br>A. Rahman Turki<br>Mohammed Hassan<br>Dr. Salahudin A. Qader (retired 31 Dec 2012)<br>Khalid Al Dossari<br>Khalid Mahmood<br>Nader Ebrahim (Resigned 19th Nov 2012)<br>Yousif A. Karim (Joined the committee on 13 Dec 2012) | Monitor and assess the employee workforce regarding human resources issues; and monitor, review and analyse legislative and/or administrative changes related to human resources. |
| **Qard Al Hassan, Donation & Zakah Committee** | Mohammed Hassan (Chairman)<br>Saleh Isa Al Mehri<br>Ali Hassan Duaij<br>Hamed Farooq | The main objective of Qard Al Hassan and Zakah Committee is to discharge the Bank's social responsibilities toward society through distributing Zakah, charity funds, donations and good faith Qard for marriage, medical treatments, etc. |
| **Provisioning Committee** | Mohammed Ebrahim (Chairman)<br>Dr. Salahudin A. Qader (retired 31 Dec 2012)<br>Khalid Al Dossari<br>Dr. Mohammed Belgami<br>Khalid Mahmood | The main objective of Provisioning Committee is to assist the CEO in reviewing the Bank's provisions. In addition, the Committee is responsible for formulating provision policies with a view to maintaining the strategic risk objectives of the Bank. |

## Succession Planning

In compliance with CBB requirements, the Nomination & Remuneration Committee reviews and endorses the Bank's succession plan on an annual basis. The objective of the plan is to identify, develop and promote personnel to ensure that there are no disruptions to the functioning of the Bank, in an event that key personnel choose to leave BisB.

## Compliance

In accordance with CBB guidelines, the Bank has a designated Head of Compliance, who is independent and reports directly to the Board of Directors; and has direct access to Senior Management and all confidential information of the Bank. The Compliance function acts as the central coordinator for all regulatory matters relating to the CBB, Bahrain Bourse, and Ministry of the Interior. BisB has in place comprehensive policies and procedures to ensure full compliance with the relevant rules and regulations of the Central Bank of Bahrain, including appropriate anti-money laundering procedures.

## Anti-Money Laundering

BisB has a designated Money Laundering Reporting Officer (MLRO). The Bank has implemented an anti-money laundering and terrorism financing policy, and periodically trains its staff on the identification and reporting of suspicious transactions. BisB follows prudent practices related to 'Customer Due Diligence', 'Beneficial Ownership' and 'Know Your Customer' principles. In accordance with CBB requirements, the MLRO regularly reviews the effectiveness of the Bank's AML/CFT procedures, systems and controls.

## Customer Complaints

The Bank has a Quality Assurance Department (QAD) which is responsible for managing customer complaints. After receiving a complaint, QAD routes it to the concerned department for their response. After analysing the response, the customer is contacted accordingly. BisB customers may use the Bank's website or the call centre for lodging a complaint.

## Code Of Conduct

BisB conducts itself in accordance with the highest standards of ethical behavior. A Code of Business Conduct has been developed to govern the personal and professional conduct of all stakeholders The Code applies to Directors, management, staff and temporary workers; and independent contractors and consultants, whether engaged by or otherwise representing the Bank and its interests.

## Disclosure And Communications

BisB conducts all communications with its stakeholders in a professional, honest, transparent, understandable, accurate and timely manner. Main communications channels include an annual report, corporate brochure and website, and regular announcements in the appropriate local media. As part of its disclosure and communication strategy, the Bank's website (www.bisb.com) is the repository of financial information, together with Board of Directors' reports and financial commentary, financial statements, relevant information on BisB such as its key products and services, and press releases that are issued periodically to the media.

*Note: Additional information is included in the BisB Corporate Governance report 2012, which is posted on the Bank's website: www.bisb.com.*

# SHARIA'A SUPERVISORY BOARD

| | | |
|---|---|---|
| 1 | 2 | 3 |
| 4 | 5 | |

### 1. Rev. Shaikh
### Dr. Abdul Latif Mahmood Al Mahmood

Chairman

Shaikh Al Mahmood is a Member of the Sharia'a Supervisory Board of Takaful International and ABC Islamic Bank, Kingdom of Bahrain; ABC Islamic Bank, London; and the Joint Sharia'a Supervisory Board of AlBaraka Group. He has been a Preacher at a number of Bahrain's mosques since 1973; and a lecturer in Quran interpretation, jurisprudence and preaching. Shaikh Al Mahmood is a regular participant in jurisprudence, educational, economic, intellectual, social and cultural conferences and seminars.

### 2. Rev. Shaikh
### Mohammed Jaffar Al Juffairi

Vice Chairman

Shaikh Aljuffairi is a former Judge of the High Sharia'a Court of Appeal, Kingdom of Bahrain; and seconded as President of the High Sharia'a Court, Ministry of Justice. He is a Friday Imam and speaker.

### 3. Rev. Shaikh
### Adnan Abdullah Al Qattan

Member

Shaikh Al Qattan is a Preacher at the Ahmed Al Fateh Islamic Mosque. He is a Judge of the High Sharia'a, Ministry of Justice, Kingdom of Bahrain; a Puisne Justice of the High Sharia'a Court; and a lecturer at the Islamic Studies Department, University of Bahrain. Shaikh Al Qattan is Chairman of the Orphans and Widows Care Committee of the Royal Court; and the Pilgrimage Mission; and a Member of the Board of Directors of Sanabil for Orphan Care. He is a regular participant in Islamic committees, courses, seminars and conferences.

### 4. Rev. Shaikh
### Dr. Nedham Mohammed Saleh Yacoubi

Member

Shaikh Yacoubi is a Member of several Sharia'a Supervisory Boards around the world, including Bahrain Islamic Bank, Ithmaar Bank, Gulf Finance House and ABC Islamic Bank, Kingdom of Bahrain; Abu Dhabi Islamic Bank and Sharjah Islamic Bank, UAE; ABC Islamic Bank, London; and the Islamic Accounting Standards Organization, Bahrain. He is the recipient of numerous awards in the field of Islamic Finance.

### 5. Rev. Shaikh
### Dr. Essam Khalaf Al Enizi

Member

Shaikh Al Enizi is a Member of Sharia'a and Islamic Studies Faculty at the University of Kuwait. He is a Member of the Sharia'a Supervisory Committee at Boubayan Bank, Al Sham Bank, and Investment Dar, Kuwait; and the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

# SHARIA'A SUPERVISORY BOARD REPORT

To the shareholders of Bahrain Islamic Bank B.S.C.

In The Name of Allah, most Gracious, most Merciful.
Peace and Blessings Be Upon His Messenger.

Assalam Alaykum Wa Rahmatu Allah Wa Barakatoh Pursuant to the powers entrusted to the Sharia'a Supervisory Board to supervise the Bank's activities, we hereby submit the following report.

The Sharia'a Supervisory Board monitored the operations, related to the Bank throughout the year end 31 December 2011 to express opinion on the Bank's adherence to the provisions and principles of Islamic Sharia'a in its activities by following the guidelines and decisions issued by the Sharia'a Supervisory Board. The Sharia'a Supervisory Board believes that ensuring the conformity of its activities and investments with the provisions of Islamic Sharia'a is the sole responsibility of the Bank's Management while the Sharia'a Supervisory Board is only responsible for expressing an independent opinion and preparing a report thereabout.

The Sharia'a Supervisory Board's monitoring function included the checking of documents and procedures to scrutinize each operation carried out by the Bank, whether directly or through the Sharia'a Internal Audit department. We planned with the Sharia'a Internal Audit department to carry out monitoring functions by obtaining all the information and clarifications that were deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a.

The Sharia'a Internal Audit department audited the Bank's transactions and submitted a report to the Sharia'a Supervisory Board. The report confirmed the Bank's commitment and conformity to the Sharia'a Supervisory Board's opinions.

The Sharia'a Supervisory Board obtained data and clarifications it deemed necessary to confirm that the Bank did not violate the principles and provisions of Islamic Sharia'a. It held several meetings throughout the year ended 31 December 2011 and replied to the inquiries, in addition to approving a number of new products presented by the Management. The Sharia'a Supervisory Board discussed with the Bank's officials all transactions carried out by the Management throughout the year and reviewed the Bank's conformity with the provisions and principles of Islamic Sharia'a as well as the resolutions and guidelines of the Sharia'a Supervisory Board.

The Sharia'a Supervisory Board believes that:

1. Contracts, operations and transactions conducted by the Bank throughout the year ended 31 December 2011 were in accordance with the standard contracts pre-approved by the Sharia'a Supervisory Board.
2. The distribution of profit on investment accounts was in line with the basis and principles approved by the Sharia'a Supervisory Board.
3. Any gains resulted from sources or means prohibited by the provisions and principles of Islamic Sharia'a, have been directed to the Charity and Donations Account according to SSB's resolution.
4. Zakah was calculated according to the provisions and principles of Islamic Sharia'a. The Bank distributed Zakah on the statutory reserve, general reserve and retained earnings. The shareholders should pay their portion of Zakah on their shares as stated in the financial report.
5. The Bank was committed to the Sharia'a standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI).

Shaikh Dr. Abdul Latif Mahmood Al Mahmood
Chairman

Shaikh Mohammed Jaffer Al Juffairi
Vice Chairman

Shaikh Adnan Abdulla Al Qattan
Board Member

Shaikh Nedham Mohamed Saleh Yacoubi
Board Member

Rev. Shaikh Dr. Essam Khalaf Al Onazi
Board Member

# FINANCIAL STATEMENTS 2012

## Contents

# INDEPENDENT AUDITORS' REPORT

To the Shareholders of BAHRAIN ISLAMIC BANK B.S.C.

We have audited the accompanying consolidated statement of financial position of Bahrain Islamic Bank B.S.C. ["the Bank"] and its subsidiaries ["the Group"] as of 31 December 2012, and the related consolidated statements of income, cash flows, changes in owners' equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a Rules and Principles are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2012, the results of its operations, its cash flows, changes in owners' equity, sources and uses of good faith qard fund and sources and uses of zakah and charity fund for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

## Other Matters

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and

b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2 and applicable provisions of Volume 6), CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2012 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Bank.

Ernst & Young

12 February 2013

Manama, Kingdom of Bahrain

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 December 2012

| | Notes | 2012 BD'000 | 2011 BD'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with banks and Central Bank | 3 | 43,893 | 41,681 |
| Due from banks and financial institutions | 4 | 132,424 | 148,813 |
| Murabaha receivables | 5 | 227,757 | 201,972 |
| Musharaka investments | 6 | 90,220 | 92,853 |
| Investments | 7 | 96,288 | 109,922 |
| Investment in associates | 8 | 7,143 | 7,151 |
| Investment in Ijarah assets | 9 | 10,599 | 9,496 |
| Ijarah muntahia bittamleek | 10 | 96,846 | 97,416 |
| Investment properties | 11 | 106,351 | 115,008 |
| Ijarah rental receivables | | 13,766 | 7,873 |
| Other assets | 12 | 7,517 | 6,958 |
| **TOTAL ASSETS** | | 832,804 | 839,143 |
| **LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY** | | | |
| **Liabilities** | | | |
| Customers' current accounts | | 87,132 | 85,096 |
| Other liabilities | 13 | 14,649 | 14,507 |
| **Total Liabilities** | | 101,781 | 99,603 |
| **EQUITY OF INVESTMENT ACCOUNTHOLDERS** | | | |
| Financial institutions' investment accounts | 14 | 87,690 | 108,879 |
| Customers' investment accounts | 14 | 573,570 | 529,332 |
| **Total Equity of Investment Accountholders** | | 661,260 | 638,211 |
| **Owners' Equity** | | | |
| Share capital | 15 | 93,967 | 93,967 |
| Treasury shares | | (563) | (563) |
| Share premium | | - | 43,936 |
| Reserves | | (23,641) | (36,011) |
| **Total Owners' Equity** | | 69,763 | 101,329 |
| **TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY** | | 832,804 | 839,143 |
| **COMMITMENTS AND CONTINGENT LIABILITIES** | 17 | 10,285 | 10,099 |

Khalid Abdulla Al Bassam
Chairman

Nabil Ahmed Ameen
Board Member

Mohammed Ebrahim Mohammed
Chief Executive Officer

The attached notes 1 to 31 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2012

| | Notes | 2012 BD'000 | 2011 BD'000 |
|---|---|---|---|
| **INCOME** | | | |
| Income from Islamic finances | 18 | 27,378 | 29,676 |
| Income from investment in sukuk | | 3,284 | 3,353 |
| | | 30,662 | 33,029 |
| Gross return to equity of investment accountholders | | 28,496 | 26,688 |
| Group's share as a Mudarib | | (14,503) | (11,946) |
| Return on equity of investment accountholders | | 13,993 | 14,742 |
| Group's share of income from joint financing and investment accounts | | 16,669 | 18,287 |
| Net income from investments | 19 | 2,172 | 858 |
| Gain on sale of equity type instruments carried at fair value through equity | | 654 | 1,315 |
| Share of results of associates | | 200 | 165 |
| Fee and commission income | | 4,741 | 3,930 |
| Other income | | 39 | 1,637 |
| **Total income** | | 24,475 | 26,192 |
| **EXPENSES** | | | |
| Staff costs | | 10,471 | 9,959 |
| Depreciation | | 1,640 | 1,690 |
| Other expenses | 20 | 7,504 | 7,919 |
| **Total expenses** | | 19,615 | 19,568 |
| **Net income before fair value adjustment for investment properties and net provision for impairment** | | 4,860 | 6,624 |
| Fair value adjustment for investment properties | 11 | (9,772) | (2,570) |
| Net provision for impairment | 21 | (31,283) | (21,406) |
| **NET LOSS FOR THE YEAR** | | (36,195) | (17,352) |
| **BASIC AND DILUTED EARNINGS PER SHARE (fils)** | 23 | (38.67) | (20.71) |

| Khalid Abdulla Al Bassam | Nabil Ahmed Ameen | Mohammed Ebrahim Mohammed |
|---|---|---|
| Chairman | Board Member | Chief Executive Officer |

The attached notes 1 to 31 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

| | Notes | 2012 BD'000 | 2011 BD'000 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Net loss for the year | | (36,195) | (17,352) |
| Adjustments for non-cash items: | | | |
| Depreciation | | 1,640 | 1,690 |
| Net provision for impairment | 21 | 31,283 | 21,406 |
| Fair value adjustment for investment properties | | 9,772 | 2,570 |
| Gain on sale of equity type instruments carried at fair value through equity | | (654) | (1,315) |
| Share of results of associates | 8 | (200) | (165) |
| Unrealised loss on equity type instruments carried at fair value through statement of income | | (271) | 293 |
| Operating profit before changes in operating assets and liabilities | | 5,375 | 7,127 |
| Working capital adjustments: | | | |
| Mandatory reserve with Central Bank of Bahrain | | (2,010) | 625 |
| Due from banks and financial institutions | | (26,983) | (815) |
| Murabaha receivables | | (34,169) | 7,820 |
| Musharaka investments | | (4,538) | (8,627) |
| Investment in Ijarah assets | | (1,234) | - |
| Other assets | | (2,389) | 2,809 |
| Customers' current accounts | | 2,036 | 3,436 |
| Other liabilities | | 2,794 | 1,963 |
| Net cash (used in) from operating activities | | (61,118) | 14,338 |
| **INVESTING ACTIVITIES** | | | |
| Purchase of investment properties | | (1,116) | (9,815) |
| Ijarah Muntahia Bittamleek | | (7,446) | 2,354 |
| Purchase of investments | | (44,256) | (28,848) |
| Proceeds from disposal of investments | | 50,369 | 40,951 |
| Net cash (used in) from investing activities | | (2,449) | 4,642 |
| **FINANCING ACTIVITIES** | | | |
| Rights Issue | | - | 21,108 |
| Purchase of treasury shares | | - | (256) |
| Financial institutions' investment accounts | | (21,189) | (32,980) |
| Customers' investment accounts | | 44,238 | (70,191) |
| Dividends paid | | (2,651) | (9) |
| Zakah paid | | (1) | (185) |
| Net cash from (used in) financing activities | | 20,397 | (82,513) |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | | (43,170) | (63,533) |
| Cash and cash equivalents at 1 January | | 163,063 | 226,596 |
| **CASH AND CASH EQUIVALENTS AT 31 DECEMBER** | | 119,893 | 163,063 |
| Cash and cash equivalents at year end comprise of: | | | |
| Cash on hand | | 7,157 | 7,120 |
| Balances with CBB, excluding mandatory reserve deposits | | 3,715 | 2,736 |
| Balances with banks and other financial institutions | | 4,766 | 5,580 |
| Due from banks and financial institutions with original maturities less than 90 days | | 104,255 | 147,627 |
| | | 119,893 | 163,063 |

The attached notes 1 to 31 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2012

| | | | | Reserves | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital BD'000 | Treasury shares BD'000 | Share premium BD'000 | Statutory reserve BD'000 | General reserve BD'000 | Fair value reserve on investment properties BD'000 | Cumulative changes in fair value of investments BD'000 | Accumulated losses BD'000 | Proposed appropria-tions BD'000 | Total owners' equity BD'000 |
| Balance at 1 January 2012 | 93,967 | (563) | 43,936 | 10,268 | 1,000 | - | (3,343) | (43,936) | - | 101,329 |
| Net loss for the year | - | - | - | - | - | - | - | (36,195) | - | (36,195) |
| Net movement in cumulative Changes in fair value of investments | - | - | - | - | - | - | 4,629 | - | - | 4,629 |
| Transfer of accumulated losses to share premium (note 15) | - | - | (43,936) | - | - | - | - | 43,936 | - | - |
| **Balance at 31 December 2012** | **93,967** | **(563)** | **-** | **10,268** | **1,000** | **-** | **1,286** | **(36,195)** | **-** | **69,763** |
| Balance at 1 January 2011 | 72,859 | (307) | 43,936 | 10,268 | 1,000 | 42 | (1,278) | (26,626) | 167 | 100,061 |
| Right Issue | 21,108 | - | - | - | - | - | - | - | - | 21,108 |
| Purchase of treasury shares (note 15) | - | (256) | - | - | - | - | - | - | - | (256) |
| Zakah paid | - | - | - | - | - | - | - | - | (167) | (167) |
| Net loss for the year | - | - | - | - | - | - | - | (17,352) | - | (17,352) |
| Transfer from fair value reserve on investment properties | - | - | - | - | - | (42) | - | 42 | - | - |
| Net movement in cumulative changes in fair value of investments | - | - | - | - | - | - | (2,065) | - | - | (2,065) |
| Transfer of accumulated losses to share premium (note 15) | - | - | - | - | - | - | - | - | - | - |
| Balance at 31 December 2011 | 93,967 | (563) | 43,936 | 10,268 | 1,000 | - | (3,343) | (43,936) | - | 101,329 |

The attached notes 1 to 31 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF SOURCES AND USES OF GOOD FAITH QARD FUND

For the year ended 31 December 2012

| | Qard hasan receivables BD'000 | Funds available for qard hasan BD'000 | Total BD'000 |
|---|---|---|---|
| **Balance at 1 January 2012** | 2 | 126 | 128 |
| Uses of qard fund | | | |
| Marriage | 53 | (53) | - |
| Refurbishment | 11 | (11) | - |
| Medical treatment | 15 | (15) | - |
| Others | 6 | (6) | - |
| **Total uses during the year** | **85** | **(85)** | - |
| Repayments | (72) | 72 | - |
| **Balance at 31 December 2012** | **15** | **113** | **128** |
| Balance at 1 January 2011 | 4 | 124 | 128 |
| Uses of qard fund | | | |
| Marriage | 27 | (27) | - |
| Refurbishment | 16 | (16) | - |
| Medical treatment | 14 | (14) | - |
| Others | 11 | (11) | - |
| Total uses during the year | 68 | (68) | - |
| Repayments | (70) | 70 | - |
| Balance at 31 December 2011 | 2 | 126 | 128 |

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| **Sources of qard fund** | | |
| Contribution by the Bank | **125** | 125 |
| Donation | **3** | 3 |
| | **128** | 128 |

The attached notes 1 to 31 form part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND

For the year ended 31 December 2012

| | 2012<br>BD'000 | 2011<br>BD'000 |
|---|---|---|
| **Sources of zakah and charity funds** | | |
| Undistributed zakah and charity funds at the beginning of the year | 209 | 541 |
| Zakah due from the Bank for the year | - | - |
| Non-Islamic income / late fee | 694 | 67 |
| Donations | - | 200 |
| Total sources of zakah and charity funds during the year | 903 | 808 |
| **Uses of zakah and charity funds** | | |
| Philanthropic societies | 462 | 311 |
| Aid to needy families | 383 | 288 |
| Total uses of funds during the year | 845 | 599 |
| Undistributed zakah and charity funds at the end of the year | 58 | 209 |

The attached notes 1 to 31 form part of these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 1 INCORPORATION AND ACTIVITIES

Bahrain Islamic Bank B.S.C. (the "Bank") was incorporated in the Kingdom of Bahrain in the year 1979 by Amiri Decree No.2 of 1979, under Commercial Registration (CR) number 9900, to carry out banking and other financial trading activities in accordance with the teachings of Islam (Shari'a). The Bank operates under a retail banking license issued by the Central Bank of Bahrain (CBB). The Bank's Shari'a Supervisory Board is entrusted to ensure the Bank's adherence to Shari'a rules and principles in its transactions and activities. The Bank is listed on Bahrain Bourse.

The Bank holds 100% of the share capital of both Abaad Real Estate Company B.S.C. (c) and BisB MMF Company B.S.C. (c) ("Subsidiaries");

Abaad Real Estate Company B.S.C. (c) ("Subsidiary")
The Subsidiary was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorised and fully paid-up share capital of BD 25 million. The Subsidiary has started operations during the year 2007. The main activities of the Subsidiary are the management and development of real estate (in accordance with the Islamic Shari'a rules and principles).

BisB MMF Company B.S.C. (c) ("Subsidiary")
The Subsidiary was incorporated in the Kingdom of Bahrain as a closed joint stock company and registered with the Ministry of Industry and Commerce under Commercial Registration (CR) number 81322-1. The postal address of the Company is registered at, Building 722, Road 1708, Block 317, Diplomatic Area, Kingdom of Bahrain. The purpose of the Subsidiary is limited to establishing funds (in accordance with the Islamic Shari'a rules and principles).

The Bank's registered office is at Building 722, Road 1708, Block 317, Manama, Kingdom of Bahrain.

The Bank has thirteen branches (2011: thirteen branches), all operating in the Kingdom of Bahrain.

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 12 February 2013.

## 2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

### a. Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for "investment properties", "equity type instruments carried at fair value through equity" and "equity type instruments carried at fair value through statement of income" that have been measured at fair value.

The consolidated financial statements have been presented in Bahraini Dinars ("BD"), being the functional currency of the Group's operations. All the values are rounded to the nearest BD thousand except when otherwise indicated.

### b. Statement of Compliance

The consolidated financial statements are prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI'), the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Group, the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law and the CBB Rule Book (Volume 2 and applicable provisions of Volume 6) and CBB directives, regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association in accordance with the requirements of AAOIFI. For matters for which no AAOIFI standard exists, the Group uses the relevant International Financial Reporting Standards ('the IFRS') issued by International Accounting Standards Board.

### c. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries (together referred to as the "Group") as at 31 December each year. A subsidiary is an entity over which the Bank has power to control, which is other than fiduciary in nature. The financial statements of the subsidiaries is prepared for the same reporting year as the Bank, using consistent accounting policies.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### c. Basis of consolidation (continued)

The subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtained control, and continues to be consolidated until the date that such control ceases. Control is achieved where the Group has direct ownership of more than 50% of the voting rights over the subsidiaries. Where the Group has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to obtain benefits from its activities.

Losses within the subsidiaries are attributed to the non-controlling interest even if that results in a deficit balance.

The results of the subsidiaries acquired or disposed off during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate. All intra-group balances, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full.

The Bank has two fully owned subsidiaries, Abaad Real Estate Company B.S.C. (c) and BisB MMF Company B.S.C. (c) which are consolidated in these financial statements.

### d. Cash and cash equivalents

For the purpose of the consolidated cash flows statement, "cash and cash equivalents" consist of cash on hand, balances with the Central Bank of Bahrain, balances with banks and other financial institutions, with original maturities of 90 days or less.

### e. Due from banks and financial institutions

Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables. Commodity murabaha receivables are stated net of deferred profits and provision for impairment, if any. Wakala receivables are stated at cost less provision for impairment, if any.

### f. Murabaha receivables

Murabaha receivables consist mainly of deferred sales transactions (Murabaha) which are stated net of deferred profits and provisions for impairment, if any.

Murabaha receivables are sales on deferred terms. The Group arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus profit margin) is repaid in instalments by the Murabeh over the agreed period.

### g. Musharaka

Musharaka is stated at the fair value of consideration given less impairment, if any.

Musharaka is a form of capital partnership. These are stated at fair value of consideration given less any impairment. Musharaka capital provided by the Group at inception in kind (if other than cash) is measured at the fair value of the assets. If the valuation of the assets results in difference between fair value and book value, such difference is recognised as profit or loss to the Group.

### h. Investments

Investments comprise of debt type instrument carried at amortised cost, equity type instrument carried at fair value through equity and equity type instrument carried at fair value through statement of income.

All investments, are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment, except in the case of investment carried at fair value through statement of income.

*Debt type instrument carried at amortised cost*

Investments which have fixed or determinable payments and where the Group has both the intent and ability to hold to maturity are classified as debt type instrument carried at amortised cost. Such investments are carried at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such type instruments recognised in the consolidated statement of income, when the type instruments de-recognised or impaired.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### h. Investments (continued)

*Equity type instrument carried at fair value through equity*

Subsequent to acquisition, equity type instruments are remeasured at fair value, with unrealised gains and losses recognised in a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously recorded in equity is recognised in the consolidated statement of income for the year.

Impairment losses on equity type instruments carried at fair value through equity are not reversed through the consolidated statement of income and increases in their fair value after impairment are recognised directly in owners' equity.

*Equity type instrument carried at fair value through statement of income*

These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the consolidated statement of income.

### i. Determination of fair value

For investments traded in organised financial markets, fair value is determined by reference to quoted market bid prices at the close of business on the consolidated statement of financial position date.

For investment where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument, which is substantially the same or is based on the assessment of future cash flows. The cash equivalent values are determined by the Group at current profit rates for contracts with similar term and risk characteristics.

For Murabaha receivables the fair value is determined at the Bank at the end of the financial period at their cash equivalent value.

### j. Investment in associates

The Group's investment in associates are accounted for under the equity method of accounting. Associates are entities over which the Group exercises significant influence but not control and which are neither subsidiaries nor joint ventures. Under the equity method, the investment in associates are carried in the consolidated statement of financial position at cost, plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The consolidated statement of income reflects the Group's share of the results of its associates. Where there has been a change recognised directly in the equity of the associates, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in owners' equity. Unrealised profits and losses resulting from transactions between the Group and its associate are eliminated to the extent of the Group's interest in the associate.

The Group determines at each consolidated statement of financial position date whether there is any objective evidence that the investment in associate is impaired. If this is the case the Group calculates the amount of impairment as being the difference between the fair value of the associate and the carrying value and recognises the amount in the consolidated statement of income.

The reporting dates of the associates and the Group are identical and the associates accounting policies conform to those used by the Group for like transaction and events in similar circumstances.

### k. Ijarah assets, Ijarah Muntahia Bittamleek

These are initially recorded at cost. Ijarah assets and Ijarah Muntahia Bittamleek mainly comprise of land and buildings and certain other assets. Ijarah Muntahia Bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the ijarah (lease term), provided that all ijarah instalments are settled.

Depreciation is calculated using the straight-line method on all Ijarah Muntahia Bittamleek other than land (which is deemed to have indefinite life), at rates calculated to write off the cost of each asset over its useful life.

For Ijarah assets, the depreciation is calculated using the straight-line method, at rates calculated to write off the cost of the assets over its estimated useful life. The estimated useful lives of the assets for calculation of depreciation ranges between 10 to 35 years.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### l. Investment properties

Properties held for rental, or for capital appreciation purposes, or both, are classified as Investment properties. Investment properties are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, Investment properties are re-measured at fair value and changes in fair value are recognised in the consolidated statement of income.

In accordance with AAOIFI, such gains or losses are appropriated to fair value reserve on investment properties at year end. Upon realisation, these gains/losses are transferred to retained earnings from fair value reserve on investment properties.

### m. Equipment

Equipment are initially recognised at cost. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated statement of income as incurred. Gains or losses on disposal are reflected in other income. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets.

The calculation of depreciation is on the following basis:

| | |
|---|---|
| Office furniture and equipment | 3 to 5 years |
| Vehicles | 3 years |
| Others | 1 to 3 years |

### n. Equity of investment accountholders

All equity of investment accountholders are carried at cost plus profit and related reserves less amounts settled.

Equity of investment accountholders share of income is calculated based on the income generated from investment accounts after deducting Mudarib share. Operating expenses are charged to shareholders' funds and not included in the calculation.

The basis applied by the Group in arriving at the equity of investment accountholders' share of income is (total income from jointly financed Islamic finances less shareholders' "Bank" income). Portion of the income generated from equity of investment accountholders will be deducted as Mudarib share and the remaining will be distributed to the equity of investment accountholders.

### o. Investment risk reserve

Investment risk reserves are amounts appropriated out of the income of equity of investment accountholders, after allocating the Mudarib share, in order to cater against future losses for equity of investment accountholders.

### p. Profit equalisation reserve

The Group appropriates a certain amount in excess of the profit to be distributed to equity of investment accountholders after taking into consideration the Mudarib share of income. This is used to maintain a certain level of return on investment for equity of investment accountholders.

### q. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 issued by the AAOIFI using the net invested funds method. Zakah is paid by the Group based on the consolidated figures of statutory reserve, general reserve and retained earning balances at the beginning of the year. The remaining Zakah is payable by individual shareholders. Payment of Zakah on equity of investment accountholders and other accounts is the responsibility of investment accountholders.

### r. Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) arising from a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of obligation.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### s. Dividends

Dividends to shareholders are recognised as liabilities in the year in which they are declared.

### t. Derecognition of financial assets and liabilities

*Financial assets*

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the right to receive cash flows from the asset have expired;
- the Group has transferred its rights to receive cash flows from and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the assets, but has transferred control of the asset; or
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset.

*Financial liabilities*

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

### u. Treasury shares

These are own equity instruments of the Group which are reacquired through its own broker. Treasury shares are deducted from equity and accounted for at weighted average cost. Consideration paid or received on the purchase, sale, issue or cancellation of the Group's own equity instruments is recognised directly in equity. No gain or loss is recognised in consolidated statement of income on the purchase, sale, issue or cancellation of own equity instruments.

### v. Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where the Group uses these funds for social welfare activities.

### w. Joint and self financed

Investments, financing and receivables that are jointly funded by the Group and the equity of investment accountsholders are classified under the caption "jointly financed" in the consolidated financial statements. Investments, financing and receivables that are funded solely by the Bank are classified under "self financed".

### x. Offsetting

Financial assets and financial liabilities are only offsetted and the net amount reported in the consolidated statement of financial position when there is a legal or religious enforceable right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

### y. Revenue recognition

*Murabaha receivables*

Income is recognised by proportionately allocating the attributable profits over the deferred period whereby each financial period carries its portion of profits irrespective of when cash is received. Income related to accounts that are 90 days overdue is excluded from the consolidated statement of income.

*Musharaka investments*

Income on musharaka is recognised when the right to receive payment is established or on distribution. In case of losses in musharaka, the Group's share of losses is recognised to the extent that such losses are being deducted from its share of the musharaka capital.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### y. Revenue recognition (continued)

*Due from banks and financial institutions*

Income on amounts due from banks and financial institutions is recognised on a time apportioned basis over the period of the contract based on the principal amounts outstanding and the profit agreed with clients.

*Ijarah Muntahia Bittamleek*

Income from Ijarah Muntahia Bittamleek are recognised on a time-apportioned basis over the lease term. The Ijarah Muntahia Bittamleek Income is net of depreciation. Income related to non performing Ijarah Muntahia Bittamleek is excluded from the consolidated statement of income.

*Dividends income*

Dividends are recognised when the right to receive payment is established.

*Income from Ijarah assets*

Rental income is accounted for on a straight-line basis over the Ijarah terms.

*Fee and commission income*

Fee and commission income is recognised when earned.

*Group's share as a Mudarib*

The Group's share as a Mudarib for managing equity of investment accountholders is accrued based on the terms and conditions of the related mudaraba agreements.

*Income allocation*

Income is allocated proportionately between equity of investment accountholders and shareholders on the basis of the average balances outstanding during the year.

### z. Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Bahraini Dinars at the rate of exchange ruling at the consolidated statement of financial position date. All differences are taken to the consolidated statement of income.

Translation gains or losses on non-monetary items carried at fair value are included in owners' equity as part of the fair value adjustment.

### aa. Impairment of financial assets

An assessment is made at each consolidated financial position date to determine whether there is objective evidence that a specific financial asset or a group of financial assets may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss, based on the assessment by the Group of the estimated cash equivalent value, is recognised in the consolidated statement of income. Specific provisions are created to reduce all impaired financial contracts to their realisable cash equivalent value. Financial assets are written off only in circumstances where effectively all possible means of recovery have been exhausted. Impairment is determined as follows:

(a) For assets carried at fair value, impairment is the difference between cost and fair value, less any impairment loss previously recognised in the consolidated statement of income;

(b) For assets carried at cost, impairment is the difference between carrying value and the present value of future cash flows discounted at the current market rate of return for a similar financial asset; and

(c) For assets carried at amortised cost, impairment is the difference between carrying amount and the present value of future cash flows discounted at the original effective profit rate.

For equity type instruments carried at fair value through equity, impairment losses recognised in the consolidated statement of income for an investment equity instrument shall not be reversed through the consolidated statement of income and should be recorded as increases in cumulative changes in fair value through equity.

## 2 SIGNIFICANT ACCOUNTING POLICIES (continued)

### bb. Use of estimates and judgements in preparation of the consolidated financial statements

In the process of applying the Group's accounting policies, management has made estimates and judgements in determining the amounts recognised in the consolidated financial statements. The most significant use of judgments and estimates are as follows:

*Going concern*

The Bank's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the management is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

*Impairment*

The Group assesses at each consolidated statement of financial position date whether there is objective evidence that a specific asset or a group of assets may be impaired. An asset or a group of assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred "loss event") and that loss event(s) have an impact on the estimated future cash flows of the asset or the group of the assets that can be reliably estimated.

*Collective impairment provision*

Impairment is assessed collectively for losses on Islamic financing facilities that are not individually significant and for individually significant facilities where there is not yet objective evidence of individual impairment. Collective impairment is evaluated on each reporting date with each portfolio receiving a separate review.

*Fair valuation of investments*

The determination of fair values of unquoted investments requires management to make estimates and assumptions that may affect the reported amount of assets at the date of the consolidated financial statements. The valuation of such investments is based on the fair value criteria explained in note 2.k above. Nonetheless, the actual amount that is realised in a future transaction may differ from the current estimate of fair value and may still be outside management estimates, given the inherent uncertainty surrounding valuation of unquoted investments.

*Classification of investments*

Management decides on acquisition of a financial asset whether it should be classified as equity type instrument carried at fair value through equity or through statement of income.

*Fair value of investment properties*

The fair value of investment properties are determined by independent real estate valuation experts based on recent real estate transactions with similar characteristics and locations.

### cc. Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

### dd. Employees' end of service benefits

Provision is made for amounts payable under the Bahrain Labour law applicable to non-Bahraini employees' accumulated periods of service at the date of the consolidated statement of financial position, subject to completion of a minimum period of employment.

Bahraini employees of the Group are covered by contributions made to the Social Insurance Organisation Scheme (SIO) as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due.

### ee. Shari'a supervisory board

The Group's business activities are subject to the supervision of a Shari'a Supervisory Board consisting of five members appointed by the general assembly.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 3 CASH AND BALANCES WITH BANKS AND CENTRAL BANK

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Cash on hand | 7,157 | 6,550 |
| Balances with CBB, excluding mandatory reserve deposits | 3,715 | 2,736 |
| Balances with banks and other financial institutions | 4,766 | 6,150 |
| | 15,638 | 15,436 |
| Mandatory reserve with CBB | 28,255 | 26,245 |
| | 43,893 | 41,681 |

The mandatory reserve with CBB is not available for use in the day-to-day operations.

## 4 DUE FROM BANKS AND FINANCIAL INSTITUTIONS

| | Jointly financed 2012 BD'000 | Jointly financed 2011 BD'000 |
|---|---|---|
| Commodity murabaha | 61,589 | 112,408 |
| Deferred profits | (32) | (37) |
| | 61,557 | 112,371 |
| Wakala receivables | 70,867 | 36,442 |
| | 132,424 | 148,813 |

## 5 MURABAHA RECEIVABLES

| | Jointly financed 2012 BD'000 | Jointly financed 2011 BD'000 |
|---|---|---|
| Tawarooq | 103,845 | 108,207 |
| Tasheel | 144,528 | 101,105 |
| Letters of credit | 13,275 | 53,829 |
| Motor vehicles | 13,002 | 11,965 |
| Credit cards | 8,588 | 6,092 |
| Building | 339 | 592 |
| Building materials | 144 | 348 |
| Land | 182 | 298 |
| Furniture | 154 | 159 |
| | 284,057 | 282,595 |
| Qard fund | 15 | 2 |
| Gross receivables | 284,072 | 282,597 |
| Deferred profits | (35,252) | (28,207) |
| Net provision for impairment (note 21)* | (21,063) | (52,418) |
| | 227,757 | 201,972 |

Non-performing Murabaha receivables outstanding as of 31 December 2012 amounted to BD 63,306 thousand (2011: BD 92,697 thousand).

The Group considers the promise made in the Murabaha to the purchase orderer as obligatory.

* This includes collective impairment provision of BD 2,688 thousand (2011: BD 5,513 thousand).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 5 MURABAHA RECEIVABLES (continued)

The composition of the gross Murabaha receivables portfolio before provision for impairment geographically and by sector is as follows:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Europe BD'000 | Middle East BD'000 | Total BD'000 | Europe BD'000 | Middle East BD'000 | Total BD'000 |
| Commercial | - | 67,703 | 67,703 | - | 120,016 | 120,016 |
| Financial institutions | 7,061 | 25,306 | 32,367 | - | 24,914 | 24,914 |
| Others including retail | - | 148,750 | 148,750 | - | 109,460 | 109,460 |
| | 7,061 | 241,759 | 248,820 | - | 254,390 | 254,390 |

## 6 MUSHARAKA INVESTMENTS

| | Jointly financed 2012 BD'000 | Jointly financed 2011 BD'000 |
|---|---|---|
| Musharaka investment in real estate | 97,687 | 93,149 |
| Net provision for impairment (note 21) | (7,467) | (296) |
| | 90,220 | 92,853 |

Non-performing Musharaka investments outstanding as of 31 December 2012 amounted to BD 33,056 thousand (2011: BD 25,650 thousand).

## 7 INVESTMENTS

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Self financed BD'000 | Jointly financed BD'000 | Total BD'000 | Self financed BD'000 | Jointly financed BD'000 | Total BD'000 |
| i) Debt type instruments carried at amortised cost | | | | | | |
| *Unquoted investments* | | | | | | |
| Sukuk | | | | | | |
| At 1 January | - | 56,851 | 56,851 | - | 65,075 | 65,075 |
| Acquisitions | - | 25,462 | 25,462 | - | 22,833 | 22,833 |
| Disposals and redemptions | - | (37,907) | (37,907) | - | (31,057) | (31,057) |
| At 31 December | - | 44,406 | 44,406 | - | 56,851 | 56,851 |
| ii) Equity type instruments carried at fair value through equity | | | | | | |
| *Quoted investments* | | | | | | |
| Equity shares | | | | | | |
| At 1 January | 18,793 | - | 18,793 | 20,309 | - | 20,309 |
| Acquisitions | 10,495 | - | 10,495 | 3,837 | - | 3,837 |
| Movement in fair market value | 1,265 | - | 1,265 | (1,173) | - | (1,173) |
| Disposals | (5,633) | - | (5,633) | (4,180) | - | (4,180) |
| At 31 December | 24,920 | - | 24,920 | 18,793 | - | 18,793 |
| *Unquoted investments* | | | | | | |
| Equity shares | | | | | | |
| At 1 January | 14,129 | - | 14,129 | 14,320 | - | 14,320 |
| Disposals | - | - | - | (191) | - | (191) |
| At 31 December | 14,129 | - | 14,129 | 14,129 | - | 14,129 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 7 INVESTMENTS (continued)

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Self financed BD'000 | Jointly financed BD'000 | Total BD'000 | Self financed BD'000 | Jointly financed BD'000 | Total BD'000 |
| ii) Equity type instruments carried at fair value through equity (continued) | | | | | | |
| *Marged Funds* | | | | | | |
| At 1 January | 37,760 | - | 37,760 | 40,025 | - | 40,025 |
| Acquisitions | 2,746 | - | 2,746 | 188 | - | 188 |
| Movement in fair market value | 1,851 | - | 1,851 | - | - | - |
| Disposals | (270) | - | (270) | (2,453) | - | (2,453) |
| At 31 December | 42,087 | - | 42,087 | 37,760 | - | 37,760 |
| iii) Equity type instruments carried at fair value through statement of income | | | | | | |
| *Quoted investments* | | | | | | |
| Equity shares | | | | | | |
| At 1 January | 1,163 | - | 1,163 | 1,191 | - | 1,191 |
| Acquisitions | 5,553 | - | 5,553 | 413 | - | 413 |
| Movement in fair market value | 269 | - | 269 | - | - | - |
| Disposals | (6,559) | - | (6,559) | (441) | - | (441) |
| At 31 December | 426 | - | 426 | 1,163 | - | 1,163 |
| Total investment before provision for impairment at 31 December | 81,562 | 44,406 | 125,968 | 71,845 | 56,851 | 128,696 |
| Net provision for impairment on Debt type instruments (note 21) | - | (3,357) | (3,357) | - | (153) | (153) |
| Equity type instruments (note 21) | (26,323) | - | (26,323) | (18,621) | - | (18,621) |
| | (26,323) | (3,357) | (29,680) | (18,621) | (153) | (18,774) |
| | 55,239 | 41,049 | 96,288 | 53,224 | 56,698 | 109,922 |

## 8 INVESTMENT IN ASSOCIATES

Investments in associates comprise the following:

| | Ownership % | Country of incorporation | Self financed 2012 BD'000 | Self financed 2011 BD'000 |
|---|---|---|---|---|
| **Quoted** | | | | |
| Insurance | | | | |
| Takaful International Company B.S.C.* | 22.75% | Kingdom of Bahrain | 1,650 | 1,830 |
| **Unquoted** | | | | |
| Financial Institution | | | | |
| Liquidity Management Centre B.S.C. (c) | 25.00% | Kingdom of Bahrain | 5,493 | 5,321 |
| | | | 7,143 | 7,151 |

* Takaful International Company B.S.C. is a listed company on the Bahrain Bourse. The latest available quoted price of BD 0.290 per share was as of 10 January 2010, no further trades have commenced on the company's shares since this date.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 8 INVESTMENT IN ASSOCIATES (continued)

The following table summarises the latest associates' financial information:

| | 2012 | | | | |
|---|---|---|---|---|---|
| | Total assets BD'000 | Total liabilities BD'000 | Total contingent liabilities BD'000 | Total revenue BD'000 | Net profit BD'000 |
| Takaful International Company B.S.C. | 34,878 | 26,184 | - | 9,299 | 552 |
| Liquidity Management Centre B.S.C. (c) | 62,952 | 40,981 | 5,833 | 3,042 | 636 |

| | 2011 | | | | |
|---|---|---|---|---|---|
| | Total assets BD'000 | Total liabilities BD'000 | Total contingent liabilities BD'000 | Total revenue BD'000 | Net profit BD'000 |
| Takaful International Company B.S.C. | 31,058 | 23,013 | - | 8,524 | 608 |
| Liquidity Management Centre B.S.C. (c) | 77,025 | 55,741 | 7,500 | 2,733 | 123 |

Takaful International Company B.S.C. was incorporated in 1989, it carries out takaful and retakaful activities in accordance with the teachings of Islamic Shari'a. The total revenue represents both the revenue of the General Takaful and Family Takaful for the year ended 31 December 2012 and does not represent the shareholders' revenue only.

Liquidity Management Centre B.S.C. (c) was incorporated in 2002 to facilitate the creation of an Islamic inter-bank market that will allow Islamic financial services institutions to effectively manage their assets and liabilities.

## 9 INVESTMENT IN IJARAH ASSETS

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Self financed | | | Self financed | | |
| | Land BD'000 | Buildings BD'000 | Total BD'000 | Land BD'000 | Buildings BD'000 | Total BD'000 |
| Book value: | | | | | | |
| At 1 January | 6,600 | 5,640 | 12,240 | 6,600 | 5,640 | 12,240 |
| Acquisition during the year | 1,234 | - | 1,234 | - | - | - |
| At 31 December | 7,834 | 5,640 | 13,474 | 6,600 | 5,640 | 12,240 |
| Depreciation: | | | | | | |
| At 1 January | - | 2,744 | 2,744 | - | 2,605 | 2,605 |
| Provided during the year | - | 131 | 131 | - | 139 | 139 |
| At 31 December | - | 2,875 | 2,875 | - | 2,744 | 2,744 |
| Net book value: | | | | | | |
| At 31 December | 7,834 | 2,765 | 10,599 | 6,600 | 2,896 | 9,496 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 10 IJARAH MUNTAHIA BITTAMLEEK

| | 2012 | | | | | 2011 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Jointly financed | | | | | Jointly financed | | | | |
| | Land BD'000 | Buildings BD'000 | Aviation related assets BD'000 | Others BD'000 | Total BD'000 | Land BD'000 | Buildings BD'000 | Aviation related assets BD'000 | Others BD'000 | Total BD'000 |
| Cost: | | | | | | | | | | |
| At 1 January | 37,391 | 47,075 | 16,102 | 6,413 | 106,981 | 36,420 | 58,370 | 11,833 | 6,332 | 112,955 |
| Additions | 3,505 | 14,396 | 363 | 1,718 | 19,982 | 2,629 | 11,591 | 13,962 | 81 | 28,263 |
| Disposals | (1,983) | (4,699) | (5,308) | (546) | (12,536) | (1,658) | (22,886) | (9,693) | - | (34,237) |
| At 31 December | 38,913 | 56,772 | 11,157 | 7,585 | 114,427 | 37,391 | 47,075 | 16,102 | 6,413 | 106,981 |
| Depreciation: | | | | | | | | | | |
| At 1 January | - | 6,080 | 1,401 | 392 | 7,873 | - | 6,315 | 1,254 | - | 7,569 |
| Provided during the year | - | 5,243 | 744 | 531 | 6,518 | - | 2,781 | 590 | 392 | 3,763 |
| Relating to disposed assets | - | (625) | - | - | (625) | - | (3,016) | (443) | - | (3,459) |
| At 31 December | - | 10,698 | 2,145 | 923 | 13,766 | - | 6,080 | 1,401 | 392 | 7,873 |
| Net provision for impairment (note 21) | (2,501) | (1,314) | - | - | (3,815) | - | (1,692) | - | - | (1,692) |
| Net book value: | | | | | | | | | | |
| As at 31 December | 36,412 | 44,760 | 9,012 | 6,662 | 96,846 | 37,391 | 39,303 | 14,701 | 6,021 | 97,416 |

Impaired Ijarah Muntahia Bittamleek as of 31 December 2012 is BD 32,630 thousand (2011: BD 29,549 thousand).

## 11 INVESTMENT PROPERTIES

| | Self financed 2012 BD'000 | Self financed 2011 BD'000 |
|---|---|---|
| Book value: | | |
| At 1 January | 115,008 | 105,150 |
| Additions | 1,115 | 12,386 |
| Book value at 31 December | 116,123 | 117,536 |
| Fair value adjustment for investment properties | (9,772) | (2,570) |
| Transfer from fair value reserve on investment properties | - | 42 |
| **Fair value at 31 December** | 106,351 | 115,008 |

Investment properties comprises of properties located in the Kingdom of Bahrain and United Arab Emirates.

Investment properties are stated at fair value, which have been determined based on valuations performed by independent valuators and industry specialists in valuing these types of investment properties.

## 12 OTHER ASSETS

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Fixed assets (net) | 5,623 | 4,590 |
| Receivables from related parties | 1,855 | 2,130 |
| Staff advances | 864 | 1,123 |
| Other Receivables | 756 | 756 |
| Prepaid expenses | 400 | 407 |
| Income receivable | 388 | 355 |
| Receivables under letter of credit | 196 | 196 |
| Others | 1,044 | 650 |
| | 11,126 | 10,207 |
| Net provision for impairment (note 21) | (3,609) | (3,249) |
| | 7,517 | 6,958 |

## 13 OTHER LIABILITIES

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Payable to vendors | 4,566 | 2,328 |
| Accrued expenses | 2,582 | 2,318 |
| Unearned income | 1,829 | 1,050 |
| Managers' cheques | 1,722 | 1,580 |
| Life insurance fees payable | 1,644 | 1,635 |
| Dividends payable | 817 | 3,468 |
| Provision for employees' end of service benefits and leave | 564 | 546 |
| Zakah and charity fund | 58 | 209 |
| Margin on letters of credit | 44 | 47 |
| Others | 823 | 1,326 |
| | 14,649 | 14,507 |

## 14 EQUITY OF INVESTMENT ACCOUNTHOLDERS

The Group maintains an investment risk reserve amounted to BD 63 thousand (2011: nil) and did not maintain a profit equalisation reserve throughout the year ended 31 December 2012 and 2011 respectively.

As equity of investment accountholders' funds are commingled with the Group's funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits.

The Group's share, as Mudarib, in the profits of equity of investment accountholders is up to a maximum of 65% (2011: 65%).

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## 14 EQUITY OF INVESTMENT ACCOUNTHOLDERS (continued)

### 14.1 Profit Distribution by Type of Account

The following table represents the distribution of profit by type of equity of investment accountholders:

| Account Type | 2012 Percentage of funds invested | 2012 Distributed profit rate | 2011 Percentage of funds invested | 2011 Distributed profit rate |
|---|---|---|---|---|
| Defined deposits | 85% | 1.91% | 87% | 1.95% |
| Specific investment deposits | 85% | 3.54% | 95% | 3.49% |
| Investment certificates | 85% | 3.93% | 90% | 4.00% |
| Savings accounts | 45% | 0.57% | 45% | 0.70% |
| Iqra | 90% | 2.88% | 85% | 3.00% |
| Tejoori | 45% | 0.56% | 45% | 0.70% |
| Vevo | 45% | 0.57% | 45% | 0.70% |

### 14.2 Equity of Investment Accountholders Balances

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| **Type of Equity of Investment Accountholders** | | |
| Financial Institutions investment accounts | | |
| Contractual basis* | 87,669 | 108,773 |
| Others | 21 | 106 |
| | 87,690 | 108,879 |
| Customer investment accounts | | |
| Balances on demand | 192,850 | 170,624 |
| Contractual basis* | 376,643 | 355,281 |
| Others | 4,077 | 3,427 |
| | 573,570 | 529,332 |
| | 661,260 | 638,211 |

* These can be withdrawn subject to a monetary penalty

## 15 OWNERS' EQUITY

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| (i) Share capital | | |
| *a) Authorised* | | |
| 2,000,000,000 shares (2011: 2,000,000,000 shares) of BD 0.100 each | 200,000 | 200,000 |
| *b) Issued and fully paid up* | | |
| 939,673,499 shares (2011: 939,673,499 shares) of BD 0.100 each | 93,967 | 93,967 |

### a) Authorised Share Capital

The shareholders in their extra-ordinary general meeting held on 8 February 2011 resolved to increase the Bank's authorised share capital from 1,000,000,000 shares of BD 0.100 each to 2,000,000,000 shares of BD 0.100 each.

## 15 OWNERS' EQUITY (continued)

### (i) Share capital (continued)

### b) Share Capital

The shareholders in their extra-ordinary general meeting held on 8 February 2011 resolved to increase the Bank's paid up capital by BD 54.64 million through rights issue to existing shareholders at a price of BD 0.100 per share. The Bank collected subscriptions of BD 21.11 million up to 22 June 2011, and the Board of Directors has decided to close the capital increase at this amount. The total number of shares issued and fully paid as of 31 December 2012 is 939,673,499 shares (31 December 2011: 939,673,499 shares).

### c) Share premium

Amounts collected in excess of the par value of the issued share capital during any new issue of shares, net of issue expenses, are treated as share premium. This amount is not available for distribution, but can be utilised as stipulated by the Bahrain Commercial Companies Law.

During the year the Bank has proposed netting accumulated losses amounting to BD 43,936 thousand against the share premium. This proposed netting was approved by the shareholders in their annual general meeting held on 21 March 2012.

| (ii) Treasury Shares | 2012 Number of Shares | 2012 BD'000 | 2011 BD'000 |
|---|---|---|---|
| At 1 January | 3,620,609 | 563 | 307 |
| Purchase of treasury shares | - | - | 256 |
| At 31 December | 3,620,609 | 563 | 563 |

| | 2012 BD'000 |
|---|---|
| Cost of treasury shares | 563 |
| Market value of treasury shares | 297 |

The treasury shares as a percentage of total shares in issue is 0.39%

Owners' equity instruments which are reacquired are deducted from equity. No gain or loss is recognised in the consolidated statement of income on the purchase, sale, issue or cancellation of the Group's own equity instruments.

### (iii) Reserves

*Statutory reserve*

As required by Bahrain Commercial Companies Law and the Group's articles of association, 10% of the net income for the year should be transferred to the statutory reserve. The Group may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. No transfer has been made for the current year as there was a net loss for the year. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of CBB.

*General reserve*

The general reserve is established in accordance with the articles of association of the Group and is distributable following a resolution of shareholders at a general meeting and the approval of CBB. The Group may transfer any amount to the general reserve, as approved by the shareholders at a general meeting, out of the net income for the year after appropriating statutory reserve.

*Fair value reserve on investment properties*

This represents cumulative unrealised revaluation gains or losses on investment properties. This reserve is transferred to the retained earnings upon sale of the investment properties.

## 15 OWNERS' EQUITY (continued)

### (iii) Reserves (continued)

*Cumulative changes in Fair value of investments*

This represents the net unrealised gains or losses on equity investments relating to self financed investments.

### (iv) Additional information on shareholding pattern

1) Names and nationalities of the major shareholders and the number of shares in which they have an interest of 5% or more of outstanding shares:

| | | 2012 | | 2011 | |
|---|---|---|---|---|---|
| Names | Nationality | Number of shares | % holding | Number of shares | % holding |
| The Investment Dar Company | Kuwait | 372,632,690 | 39.66% | 372,632,690 | 39.66% |
| Islamic Development Bank | Saudi | 165,804,485 | 17.64% | 165,804,485 | 17.64% |
| Kuwait Investment Company S.A.K | Kuwait | 110,962,471 | 11.81% | 110,962,471 | 11.81% |
| General Council of Kuwaiti Awaqaf | Kuwait | 67,946,033 | 7.23% | 67,946,033 | 7.23% |

2) The Group has only one class of shares and the holders of these shares have equal voting rights.

3) Distribution schedule of shares, setting out the number and percentage of holders in the following categories:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Number of shares | Number of shareholders | % of total outstanding shares | Number of shares | Number of shareholders | % of total outstanding shares |
| Less than 1% | 154,442,981 | 3,412 | 16.44% | 154,442,981 | 3,441 | 16.44% |
| 1% up to less than 5% | 67,884,839 | 3 | 7.22% | 67,884,839 | 3 | 7.22% |
| 5% up to less than 10% | 67,946,033 | 1 | 7.23% | 67,946,033 | 1 | 7.23% |
| 10% up to less than 50% | 649,399,646 | 3 | 69.11% | 649,399,646 | 3 | 69.11% |
| | 939,673,499 | 3,419 | 100.00% | 939,673,499 | 3,448 | 100.00% |

Details of Directors' interests in the Group's shares as at the end of the year were:

**Categories:**

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | No. of shares | No. of directors | No. of shares | No. of directors |
| Less than 1% | 4,042,601 | 9 | 3,854,371 | 6 |

The following is the number of shares, and percentage of shareholding of Directors, Shari'a supervisory members and Senior management (Assistant General Managers and above):

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | No. of shares | Percentage of Shareholding | No. of shares | Percentage of Shareholding |
| Directors | 4,042,601 | 0.43% | 3,854,371 | 0.41% |
| Shari'a supervisory members | 205,725 | 0.02% | 205,725 | 0.02% |
| Senior management | 100,000 | 0.01% | 161,687 | 0.02% |
| | 4,348,326 | 0.46% | 4,221,783 | 0.45% |

## 16 CAPITAL ADEQUACY

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issuing sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

The Group's capital structure is primarily made of its paid-up capital, including share premium and reserves. From regulation's perspective, the significant amount of the Group's capital are in Tier 1 form as defined by the CBB, i.e. most of the capital are of permanent nature.

The Group'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 financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds.

The classification of the Group's capital in accordance with the regulatory requirements is as follows:

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| **Core capital - Tier 1:** | | |
| Issued and fully paid ordinary shares | 93,404 | 93,404 |
| General reserves | 1,000 | 1,000 |
| Legal / statutory reserves | 10,267 | 10,268 |
| Share premium | - | 43,936 |
| Retained earnings / losses (excluding current year net income/loss) | - | (25,000) |
| Less: | | |
| Net loss for the year | (36,195) | (17,100) |
| Unrealised gross losses arising from fair valuing equity securities | (638) | (4,611) |
| Tier 1 Capital before deductions | 67,838 | 101,897 |
| **Supplementary capital - Tier 2:** | | |
| Asset revaluation reserve (45% only) | - | - |
| Unrealised gains arising from fair valuing equities (45% only) | 593 | 315 |
| Investment risk reserve | 63 | 315 |
| Other reverse | 2,688 | - |
| Tier 2 Capital before deductions | 3,344 | 630 |
| Total available capital | 71,182 | 102,527 |
| **Deductions** | | |
| Significant minority interest in banking, securities and financial entities | (5,493) | (5,321) |
| Excess amount over materiality threshold | - | (10,741) |
| Investment in insurance entity greater than or equal to 20% | (1,650) | (1,830) |
| Excess amount over maximum permitted large exposure limit | - | (12,057) |
| Total eligible capital | 64,039 | 72,578 |

## 16 CAPITAL ADEQUACY (continued)

To assess its capital adequacy requirements in accordance to the CBB requirements, the Group adopts the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardised Measurement Approach for its Market Risk. The Capital requirements for these risks are as follows:

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Total Credit Risk Weighted Assets | 459,478 | 467,064 |
| Total Market Risk Weighted Assets | 17,063 | 14,288 |
| Total Operational Risk Weighted Assets | 43,497 | 52,968 |
| **Total Regulatory Risk Weighted Assets** | 520,038 | 534,320 |
| **Capital Adequacy Ratio** | 12.31% | 13.58% |
| Minimum requirement | 12% | 12% |

## 17 COMMITMENTS AND CONTINGENT LIABILITIES

### Credit related commitments

These include commitments to enter into financing contracts which are designed to meet the requirements of the Group's customers.

Letters of credit and guarantees commit the Group to make payments on behalf of customers.

The Group has the following credit related commitments and contingent liabilities on behalf of customers:

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Letters of credit and acceptances | 2,239 | 1,650 |
| Guarantees | 7,522 | 7,934 |
| Operating lease commitments * | 524 | 515 |
| | 10,285 | 10,099 |

* The Group has entered into commercial leases for certain branches. These leases have an average life of between 4 months and 5 years with renewal terms included in the contracts. Renewals are at the option of the specific entity that holds the lease. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 December are as follows:

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Within one year | 219 | 289 |
| After one year but not more than five years | 305 | 226 |
| | 524 | 515 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 18 INCOME FROM ISLAMIC FINANCES

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Income from Murabaha receivables | 14,679 | 14,687 |
| Income on amounts due from banks and financial institutions | 814 | 1,028 |
| Income from Musharaka investments | 5,321 | 6,240 |
| Income from Ijarah Muntahia Bittamleek - net * | 6,564 | 7,721 |
| | 27,378 | 29,676 |

* The details of Income from Ijarah Muntahia Bittamleek is as follows:

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Income from Ijarah Muntahia Bittamleek – gross | 13,082 | 11,484 |
| Depreciation during the year (note 10) | (6,518) | (3,763) |
| | 6,564 | 7,721 |

## 19 NET INCOME FROM INVESTMENTS

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Dividend income | 1,487 | 865 |
| Unrealised gain / (loss) on equity type instruments carried at fair value through statement of income | 271 | (293) |
| Income from investment in ijarah assets | 414 | 286 |
| | 2,172 | 858 |

## 20 OTHER EXPENSES

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Marketing and advertisement expenses | 1,623 | 1,688 |
| Professional, consultancy, and lawyer fees | 1,199 | 650 |
| Credit and debit cards expenses and charges | 1,074 | 641 |
| Communication expenses | 867 | 874 |
| Information technology related expenses | 724 | 1,077 |
| Premises Expenses | 624 | 593 |
| Expenses on Ijarah assets | 414 | 415 |
| Travelling and transportation expenses | 241 | 186 |
| Board of directors sitting fees | 210 | 240 |
| Stationary expenses | 175 | 237 |
| Brokerage fees and commission | 40 | 76 |
| Gifts and donations | 24 | 224 |
| Shari'a supervisory board fees | 11 | 38 |
| Shari'a supervisory board remuneration | - | 34 |
| Other miscellaneous expenses | 278 | 946 |
| | 7,504 | 7,919 |

## 21 PROVISION FOR IMPAIRMENT

| 2012 | Murabaha receivables BD'000 | Ijarah muntahia bittamleek BD'000 | Musharaka investments BD'000 | Investments BD'000 | Other assets BD'000 | Total BD'000 |
|---|---|---|---|---|---|---|
| Provisions at 1 January | 52,418 | 1,692 | 296 | 18,774 | 3,249 | 76,429 |
| Written off | (40,446) | - | - | (1,632) | - | (42,078) |
| Written back | (3,955) | (669) | - | (86) | - | (4,710) |
| Provided | 13,046 | 2,792 | 7,171 | 12,624 | 360 | 35,993 |
| | 9,091 | 2,123 | 7,171 | 12,538 | 360 | 31,283 |
| **Net provisions at 31 December** | 21,063 | 3,815 | 7,467 | 29,680 | 3,609 | 65,634 |
| Non-performing | 63,306 | 32,630 | 33,056 | 51,331 | 3,609 | 183,932 |
| Notes | 5 | 10 | 6 | 7 | 12 | |

| 2011 | Murabaha receivables BD'000 | Ijarah muntahia bittamleek BD'000 | Musharaka investments BD'000 | Investments BD'000 | Other assets BD'000 | Total BD'000 |
|---|---|---|---|---|---|---|
| Provisions at 1 January | 31,608 | 3,502 | 3,363 | 13,537 | 3,249 | 55,259 |
| Written off | (236) | - | - | - | - | (236) |
| Written back | (2,375) | (1,939) | (3,126) | (2,373) | - | (9,813) |
| Provided | 23,421 | 129 | 59 | 7,610 | - | 31,219 |
| | 21,046 | (1,810) | (3,067) | 5,237 | - | 21,406 |
| Net provisions at 31 December | 52,418 | 1,692 | 296 | 18,774 | 3,249 | 76,429 |
| Non-performing | 92,697 | 29,549 | 25,650 | 23,582 | 3,249 | 174,727 |
| Notes | 5 | 10 | 6 | 7 | 12 | |

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2012 amounts to BD 142,617 thousand (31 December 2011: BD 97,573 thousand). The collateral consists of cash, securities and properties. The utilisation of the above collaterals will be on a customer by customer basis and will be limited to the customer's total exposure.

The Group has taken all the provision allocated to the non performing assets to their own capital. Hence the equity of investment accountholders was not charged for any of the provision for impairment.

## 22 ZAKAH

The total Zakah payable as of 31 December 2012 amounted to BD 1,163 thousand (2011: BD 2,188 thousand) of which the Bank has no Zakah payable (2011: BD nil) on the statutory reserve, general reserve and retained earning as at 1 January 2011. The Zakah balance amounting to BD 1,163 thousand or 1.2 fils per share (2011: BD 2,188 thousand or 2.3 fils per share) is due and payable by the shareholders.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 23 EARNINGS PER SHARE

Basic and diluted earnings per share is calculated by dividing the net loss for the year by the weighted average number of shares during the year as follows:

| | 2012 | 2011 |
|---|---|---|
| Net loss for the year in BD'000 | (36,195) | (17,352) |
| Weighted average number of shares | 936,053 | 837,718 |
| Basic and diluted earnings per share (fils) | (38.67) | (20.71) |

There have been no transactions during the year which caused dilution of the earnings per share.

## 24 RELATED PARTY TRANSACTIONS

Related parties represent associated companies, major shareholders, directors, key management personnel of the Group and Shari'a Supervisory Board members.

The balances and values of major transactions with the related parties are as follows:

| | | Income (expense) | | Balances at 31 December | |
|---|---|---|---|---|---|
| Related party | Transaction | 2012 BD'000 | 2011 BD'000 | 2012 BD'000 | 2011 BD'000 |
| Shareholders* | Sukuk | - | - | 4,197 | 4,197 |
| Shareholders** | Tawarooq | - | 509 | 7,817 | 7,817 |
| Shareholders | Investment properties | - | - | 14,200 | 15,693 |
| Shareholders*** | Receivable | - | - | 1,855 | 2,130 |
| Associate | Wakala | 61 | 57 | 9,592 | 3,533 |
| Associate | Investment | 200 | 165 | 7,143 | 7,151 |
| Board of Directors | Musharaka | 3 | 24 | - | 79 |
| Board of Directors | Expenses | (210) | (240) | - | - |
| Board of Directors | Tawarooq | - | - | 24 | - |
| Shari'a Supervisory Board | Expenses | (11) | (72) | - | - |
| Shari'a Supervisory Board | Murabaha | 4 | 41 | 39 | 594 |
| Shari'a Supervisory Board | Musharaka | 10 | 13 | 293 | 148 |
| Shari'a Supervisory Board | Tawarooq | 50 | 47 | 596 | 675 |
| Shari'a Supervisory Board | Letter of credit | 49 | 38 | 668 | 564 |
| Key management personnel | Staff advances | - | - | 275 | 332 |
| Key Management personnel | Staff - Credit Cards | - | - | 47 | 38 |
| Board of Directors | Credit Cards | - | - | 26 | 195 |
| Shari'a Supervisory Board | Credit Cards | - | - | 12 | 9 |
| Associate | Customers' investment accounts | (5) | (6) | 2,373 | 252 |
| Associate | Current accounts | - | - | 581 | 1,164 |
| Associate | Life Insurance - Liabilities | - | - | 1,644 | 1,635 |
| Board of Directors | Customers' current accounts | - | - | 38 | 2 |
| Board of Directors | Customers' investment accounts | (9) | - | 363 | - |
| Shari'a Supervisory Board | Customers' investment accounts | (3) | - | 80 | 44 |
| Shari'a Supervisory Board | Customers' current accounts | - | - | 421 | 181 |

* An amount of BD 4,197 thousand (2011: BD 4,197 thousand) is considered as impaired for which provision of BD 3,357 (2011: BD nil) has been made.

** An amount of BD 7,817 thousand (2011: BD 7,817 thousand) is considered as impaired for which provision of BD 3,428 thousand (2011: BD 2,052 thousand) has been made.

*** An amount of BD 1,553 (2011: BD 1,553 thousand) is considered as impaired for which provision of BD 1,553 (2011: BD 1,553 thousand) has been made.

## 24 RELATED PARTY TRANSACTIONS (continued)

**Compensation of the key management personnel is as follows:**

Key management personnel includes the staff in grade of assistant general manager and above.

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Short term employees benefits | 921 | 959 |
| Other long term benefits | 149 | 116 |
| | 1,070 | 1,075 |

## 25 RISK MANAGEMENT

### Introduction

Risk is inherent in the Group's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Group's continuing profitability and each individual within the Group is accountable for the risk exposures relating to his or her responsibilities. These risks and the processes to mitigate these risks have not significantly altered from the previous year.

The Group is exposed mainly to credit, liquidity, market and operational risks.

### Risk management objectives

The risk management philosophy of the Group is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximising the returns intended to optimise the Group's shareholder return while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its risk strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

Risk appetite of the Group is articulated in terms of the following dimensions:

1. Adequate capital level;
2. Stable profitability and growth;
3. Sufficient liquidity; and
4. Sound reputation.

### Structure and Organization of Risk Management Function

Risk Management Structure includes all levels of authorities, organizational structure, people and systems required for the smooth functioning of risk management processes in the Group. The responsibilities associated with each level of risk management structure and authorities include the following:

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

a. Establishing overall policies and procedures; and
b. Delegating authority to Executive Committee, Credit Committee, Chief Executive Officer and further delegation to the management to approve and review.

Executive Committee (EC) comprises three designated members of the Board of Directors. The Executive Committee is delegated authorities by the Board to manage the ongoing activities of the Group. Decisions are taken by the Executive Committee either at periodic meetings or if the need arises, by circulation.

Credit and Investment Committee (CIC): As delegated by the Board of Directors and as per approved terms of reference, the Committee has been delegated with the authorities and responsibilities including, approving extension or renewal of credit facilities, granting temporary excesses to customers with credit facilities approved by the Board, approving early repayments of facilities, monitoring the performance and quality of the Group's credit portfolio and overseeing the administration and effectiveness of and compliance with, the Group's credit policies through the review of such processes, reports and other information as it deems appropriate.

## 25 RISK MANAGEMENT (continued)

### Risk Measurement and Reporting Systems

Based on the risk appetite, the Group has put in place various limits. These limits have been approved by the Board. Any limit breach is reported by Risk Management Department (RMD) to the Credit Committee. The limits are reviewed and revised, if necessary at least annually (or earlier if required).

### a) Credit Risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss.

Type of credit risk

Financing contracts mainly comprise of commodity Murabaha, Wakala receivables, Murabaha receivables, Musharaka investments and Ijarah Muntahia Bittamleek.

*Due from banks and financial institutions*
Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables.

*Murabaha receivables*
The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then resells this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in instalments by the Murabeh over the agreed period. The transactions are secured at times by the object of the Murabaha contract (in case of real estate finance) and other times by a total collateral package securing the facilities given to the Murabeh.

*Musharaka investments*
Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

*Ijarah Muntahia Bittamleek*
The legal title of the assets under Ijarah Muntahia Bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration or gradual sale, provided that all Ijarah instalments are settled.

### Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals, guarantees and credit derivatives (Shari'a compliant protection) to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements, guarantees and credit derivatives (Shari'a compliant protection).

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured supported by assignments, guarantees, etc. as appropriate. Name lending (i.e. lending without audited financial statements and tangible collateral security) is discouraged and is approved only on an exceptional basis after careful analysis of the quality of the customer, market reputation, approximate personal net worth etc.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

## 25 RISK MANAGEMENT (continued)

### a) Credit Risk (continued)

### Credit Risk Mitigation (continued)

Notwithstanding the above, when facilities are extended to family owned limited liability entities, the following is normally obtained;

a. Collateral security, fully covering the exposure; or
b. Joint and several guarantees of shareholders directly involved in managing the entity as well as of shareholders owing at least 80% of the shares of the entity.

Third party guarantees in support of credit facilities are accepted only after review and approval of appropriate guarantor lines.

### (i) Gross maximum exposure to credit risk

The market value of tangible collateral security are properly evaluated by the Group approved valuators (for properties) or based on publicly available quotations. Only the Loan-able Value of such security are taken into account while considering credit facilities.

From time to time, the CIC reviews and approves the Loan-able Value of securities. It has also approved a list of acceptable securities.

The table below shows the gross maximum exposure to credit risk for the components of the consolidated statement of financial position, including credit related commitments. The figures represent gross exposure, without taking account of any collateral held or other credit enhancements.

| | 2012 BD'000 | 2011 BD'000 |
|---|---|---|
| Cash and balances with the banks and Central Bank | 36,736 | 35,131 |
| Due from banks and financial institutions | 132,424 | 148,813 |
| Murabaha receivables | 227,757 | 201,972 |
| Musharaka investments | 90,220 | 92,853 |
| Investments | 96,288 | 109,922 |
| Ijarah muntahia bittamleek | 96,846 | 97,416 |
| Ijarah rental receivables | 13,766 | 7,873 |
| Other assets | 1,166 | 1,968 |
| | 695,203 | 695,948 |
| Letters of credit, guarantees and acceptances | 9,761 | 9,584 |

### (ii) Risk concentrations of the maximum exposure to credit risk

Concentrations of credit risk arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations of credit risk indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographic location. The Group seeks to manage its credit risk exposure through diversification of financing activities to avoid undue concentrations of risks with individuals or groups of customers in specific locations or businesses.

## 25 RISK MANAGEMENT (continued)

### a) Credit Risk (continued)

### (ii) Risk concentrations of the maximum exposure to credit risk (continued)

The distribution of the Group's assets, liabilities, equity of investment accountholders, commitments and contingent liabilities by geographic region and industry sector is as follows:

| | Assets | | Liabilities and equity of investment accountholders | | Commitments and contingent liabilities | |
|---|---|---|---|---|---|---|
| | 31 December 2012 BD'000 | 31 December 2011 BD'000 | 31 December 2012 BD'000 | 31 December 2011 BD'000 | 31 December 2012 BD'000 | 31 December 2011 BD'000 |
| **Geographical region** | | | | | | |
| North America | 2,289 | 2,194 | 78 | - | - | - |
| Europe | 18,399 | 24,306 | 5,826 | 5,587 | 325 | 325 |
| Middle East | 811,109 | 811,081 | 757,133 | 732,223 | 9,960 | 9,774 |
| Rest of Asia | 1,007 | 1,562 | 4 | 4 | - | - |
| | 832,804 | 839,143 | 763,041 | 737,814 | 10,285 | 10,099 |
| **Industry sector** | | | | | | |
| Trading and manufacturing | 40,637 | 59,925 | 28,333 | 54,902 | 3,437 | 3,132 |
| Aviation | 22,797 | 22,944 | 15,590 | 22,891 | 956 | 731 |
| Real Estate | 235,979 | 242,611 | 31,261 | 13,070 | 1,356 | 1,017 |
| Banks and financial institutions | 215,973 | 231,269 | 133,151 | 154,308 | 2,277 | 2,307 |
| Personal / Consumer | 227,597 | 181,964 | 390,405 | 345,294 | 274 | 663 |
| Government Organization | 28,342 | 39,451 | 84,538 | 83,604 | - | - |
| Others | 61,479 | 60,979 | 79,763 | 63,745 | 1,985 | 2,249 |
| | 832,804 | 839,143 | 763,041 | 737,814 | 10,285 | 10,099 |

### (iii) Credit quality per class of financial assets

The credit quality of financial assets is managed by the Group using internal credit ratings. The table below shows the credit quality by class of asset, based on the Group's credit rating system.

| | 31 December 2012 | | | | |
|---|---|---|---|---|---|
| | Neither past due nor impaired | | | | |
| | High grade BD'000 | Standard grade BD'000 | Past due but not impaired BD'000 | Individually impaired BD'000 | Total BD'000 |
| Murabaha receivables | - | 163,528 | 21,986 | 63,306 | 248,820 |
| Musharaka investments | 2,605 | 48,564 | 13,462 | 33,056 | 97,687 |
| Ijarah muntahia bittamleek | - | 58,880 | 9,151 | 32,630 | 100,661 |
| Ijarah rental receivables | - | 13,766 | - | - | 13,766 |
| | 2,605 | 284,738 | 44,599 | 128,992 | 460,934 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 25 RISK MANAGEMENT (continued)

### a) Credit Risk (continued)

### (iii) Credit quality per class of financial assets (continued)

| | 31 December 2011 | | | | |
|---|---|---|---|---|---|
| | Neither past due nor impaired | | | | |
| | High grade BD'000 | Standard grade BD'000 | Past due but not impaired BD'000 | Individually impaired BD'000 | Total BD'000 |
| Murabaha receivables | 8,590 | 127,386 | 25,717 | 92,697 | 254,390 |
| Musharaka investments | 3,359 | 52,214 | 11,926 | 25,650 | 93,149 |
| Ijarah muntahia bittamleek | - | 55,714 | 13,845 | 29,549 | 99,108 |
| Ijarah rental receivables | - | 7,873 | - | - | 7,873 |
| | 11,949 | 243,187 | 51,488 | 147,896 | 454,520 |

* Restructured facilities during the year amounting to BD 35,057 thousand (2011: BD 72,040 thousand), the facilities restructured include BD 2,341 thousand (2011: BD 23,080 thousand) past due more than 90 days.

### (iv) Aging analysis of past due but not impaired Islamic financing facilities per class of financial assets

| 2012 | Less than 30 days BD'000 | 31 to 60 days BD'000 | 61 to 90 days BD'000 | Total BD'000 |
|---|---|---|---|---|
| Murabaha receivable | 21,721 | 205 | 60 | 21,986 |
| Musharaka investments | 13,018 | 438 | 6 | 13,462 |
| Ijarah muntahia bittamleek | 9,138 | 10 | 3 | 9,151 |
| | 43,877 | 653 | 69 | 44,599 |

| 2011 | Lessthan 30days BD'000 | 31to60 days BD'000 | 61to90 days BD'000 | Total BD'000 |
|---|---|---|---|---|
| Murabaha receivable | 17,570 | 5,708 | 2,439 | 25,717 |
| Musharaka investments | 11,697 | 77 | 152 | 11,926 |
| Ijarah muntahia bittamleek | 5,238 | 8,389 | 218 | 13,845 |
| | 34,505 | 14,174 | 2,809 | 51,488 |

### b) Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its net funding requirements when they fall due. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to cease immediately. To guard against this risk, the Group has a large customer base and assets are managed with liquidity in mind, maintaining a healthy balance of cash, cash equivalents, commodity Murabaha, Wakala receivables, credit lines and quoted investments.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 25 RISK MANAGEMENT (continued)

### b) Liquidity Risk (continued)

#### Maturity profile of Group's assets and liabilities

The table below summarises the maturity profile of the Group's assets and liabilities. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the consolidated statement of financial position date to the contractual maturity date and do not take account of the effective maturities as indicated by the Group's retention history of its equity of investment accountholders.

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2012 was as follows:

| | Up to 1 month BD'000 | 1 to 3 months BD'000 | 3 to 6 months BD'000 | 6 months to 1 year BD'000 | 1 to 3 years BD'000 | Over 3 years BD'000 | No fixed maturity BD'000 | Total BD'000 |
|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | |
| Cash and balances with the banks and Central Bank | 15,638 | - | - | - | - | - | 28,255 | 43,893 |
| Due from banks and financial institutions | 119,992 | 8,863 | 912 | 2,657 | - | - | - | 132,424 |
| Murabaha receivables | 2,054 | 14,892 | 4,102 | 13,254 | 20,394 | 173,061 | - | 227,757 |
| Musharaka investments | 4,046 | 2,619 | 253 | 768 | 11,348 | 71,186 | - | 90,220 |
| Investments | 5,356 | 21,153 | - | - | 9,061 | 52,288 | 8,430 | 96,288 |
| Investment in associates | - | - | - | - | - | - | 7,143 | 7,143 |
| Investment in Ijarah assets | - | - | - | - | - | - | 10,599 | 10,599 |
| Ijarah Muntahia Bittamleek | - | - | 205 | 1,884 | 4,351 | 90,406 | - | 96,846 |
| Investment properties | - | - | - | - | - | - | 106,351 | 106,351 |
| Ijarah rental receivables | - | - | 13,766 | - | - | - | - | 13,766 |
| Other assets | 209 | 655 | 528 | - | - | 502 | 5,623 | 7,517 |
| Total assets | 147,295 | 48,182 | 19,766 | 18,563 | 45,154 | 387,443 | 166,401 | 832,804 |
| **LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS** | | | | | | | | |
| Customers' current accounts | 87,132 | - | - | - | - | - | - | 87,132 |
| Other liabilities | 14,650 | - | - | - | - | - | - | 14,650 |
| Equity of investment accountholders | 189,199 | 114,997 | 80,367 | 270,725 | 3,568 | - | 2,404 | 661,260 |
| Total liabilities and equity of investment accountholders | 290,981 | 114,997 | 80,367 | 270,725 | 3,568 | - | 2,404 | 763,042 |
| Liquidity gap | (143,686) | (66,815) | (60,601) | (252,162) | 41,586 | 387,443 | 163,997 | 69,762 |
| Cumulative liquidity gap | (143,686) | (210,501) | (271,102) | (523,264) | (481,678) | (94,235) | 69,762 | - |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 25 RISK MANAGEMENT (continued)

### b) Liquidity Risk (continued)

The maturity profile of assets, liabilities and equity of investment accountholders at 31 December 2011 was as follows:

| | Up to 1 month BD'000 | 1 to 3 months BD'000 | 3 to 6 months BD'000 | 6 months to 1 year BD'000 | 1 to 3 years BD'000 | Over 3 years BD'000 | No fixed maturity BD'000 | Total BD'000 |
|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | |
| Cash and balances with the banks and Central Bank | 15,436 | - | - | - | - | - | 26,245 | 41,681 |
| Due from banks and financial institutions | 121,418 | 26,209 | 1,186 | - | - | - | - | 148,813 |
| Murabaha receivables | 911 | 8,367 | 7,717 | 22,974 | 20,921 | 141,082 | - | 201,972 |
| Musharaka investments | 3,245 | 3,359 | 49 | 411 | 12,007 | 73,782 | - | 92,853 |
| Investments | - | 14,493 | 1,131 | 9,966 | 13,322 | 60,043 | 10,967 | 109,922 |
| Investment in associates | - | - | - | - | - | - | 7,151 | 7,151 |
| Investment in Ijarah assets | - | - | - | - | - | - | 9,496 | 9,496 |
| Ijarah Muntahia Bittamleek | 66 | - | 4 | - | 11,190 | 86,156 | - | 97,416 |
| Investment properties | - | - | - | - | - | - | 115,008 | 115,008 |
| Ijarah rental receivables | - | - | 7,873 | - | - | - | - | 7,873 |
| Other assets | - | - | 2,368 | - | - | - | 4,590 | 6,958 |
| Total assets | 141,076 | 52,428 | 20,328 | 33,351 | 57,440 | 361,063 | 173,457 | 839,143 |
| **LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS** | | | | | | | | |
| Customers' current accounts | 85,096 | - | - | - | - | - | - | 85,096 |
| Other liabilities | 14,507 | - | - | - | - | - | - | 14,507 |
| Equity investment accountholders | 185,682 | 135,438 | 79,133 | 227,182 | 8,963 | 5 | 1,808 | 638,211 |
| Total liabilities and equity of investment accountholders | 285,285 | 135,438 | 79,133 | 227,182 | 8,963 | 5 | 1,808 | 737,814 |
| Liquidity gap | (144,209) | (83,010) | (58,805) | (193,831) | 48,477 | 361,058 | 171,649 | 101,329 |
| Cumulative liquidity gap | (144,209) | (227,219) | (286,024) | (479,855) | (431,378) | (70,320) | 101,329 | - |

### c) Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as profit rates, equity prices, and foreign exchange rates.

#### (i) 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 Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. The profit distribution to equity of investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits in-line with the market rates.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 25 RISK MANAGEMENT (continued)

### c) Market Risk (continued)

### (ii) Equity price risk

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 investment portfolio. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

In order to measure the risk of equity on its financial positions, the Group adopts a sensitivity analysis on its quoted equity portfolio for 10% increase of the portfolio value with all other variables remain constant. The effect of a similar decrease in equity prices is expected to be equal and opposite to the effect of the increase shown.

Equity price risk variation as of 31 December is as follows;

| 2012 | Increase in equity price % | Sensitivity of profit or loss BD'000 | Sensitivity of equity BD'000 |
|---|---|---|---|
| Bahrain Bourse | +10 | 12 | 588 |
| Saudi Stock Exchange (TADAWUL) | +10 | 14 | 610 |
| Oman Stock Exchange | +10 | 16 | 394 |
| Kuwait Stock Exchange | +10 | - | - |
| Qatar Stock Exchange | +10 | - | 407 |

| 2011 | Increase in equity price % | Sensitivity of profit or loss BD'000 | Sensitivity of equity BD'000 |
|---|---|---|---|
| Bahrain Bourse | +10 | 29 | 671 |
| Saudi Stock Exchange (TADAWUL) | +10 | 69 | 311 |
| Oman Stock Exchange | +10 | 14 | 351 |
| Kuwait Stock Exchange | +10 | 5 | - |
| Qatar Stock Exchange | +10 | - | - |

As at consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 50 million (31 December 2011: BD 68 million). The impact of changes in the value of these unquoted equities and sukuk and the related impact on equity will only be reflected when the financial instrument is sold or deemed to be impaired.

### (iii) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group views the Bahraini Dinar as its functional currency. The Board has set limits on positions by currency. Positions are monitored on a daily basis to ensure they are maintained within established limits.

The Group had the following significant net exposures denominated in foreign currencies as of 31 December:

| | Equivalent Long (short) 2012 BD'000 | Equivalent Long (short) 2011 BD'000 |
|---|---|---|
| Currency | | |
| Pound Sterling | (1,041) | (1,040) |
| Euro | (750) | (886) |
| Kuwaiti Dinars | (14,957) | (12,257) |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2012

## 25 RISK MANAGEMENT (continued)

### c) Market Risk (continued)

### (iii) Currency risk (continued)

As the Bahraini Dinar is pegged to the US Dollar, positions in US Dollars are not considered to represent significant currency risk. Moreover, as the Group does not have significant exposure to other currencies, movement of the currency exchange risk against the Bahraini Dinar with other variables held constant will have an immaterial impact on the consolidated statement of income and owners' equity.

### d) Operational Risk

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. 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.

## 26 SEGMENTAL INFORMATION

For management purposes, the Group is organised into three major business segments;

| | |
|---|---|
| **Corporate** | Principally handling corporates' equity of investment accountholders', current accounts, and providing islamic financing facilities. |
| **Retail** | Principally handling individual customers' equity of investment accountholders', current accounts, and providing islamic financing facilities. |
| **Investments** | Principally handling banks' and financial institutions' equity of investment accountholders, providing money market, trading and treasury services as well as the management of the Group's investment activities. Investment activities involve handling investments in local and international markets and investment in properties. |

These segments are the basis on which the Group reports its primary segment information. Transactions between segments are conducted at estimated market rates on an arm's length basis. Transfer charges are based on a pool rate which approximates the cost of funds.

Segment information is disclosed as follows:

| | 31 December 2012 | | | |
|---|---|---|---|---|
| | Corporate BD'000 | Retail BD'000 | Investments BD'000 | Total BD'000 |
| Total income | 6,146 | 16,176 | 2,153 | 24,475 |
| Total expenses | (3,139) | (13,463) | (3,013) | (19,615) |
| Fair value adjustment for investment properties | - | - | (9,772) | (9,772) |
| Net provision for impairment | (16,331) | (2,054) | (12,898) | (31,283) |
| Net (loss) income for the year | (13,324) | 659 | (23,530) | (36,195) |
| **Other information** | | | | |
| Segment assets | 213,284 | 249,645 | 369,875 | 832,804 |
| Segment liabilities, and equity | 243,967 | 427,159 | 161,678 | 832,804 |

## 26 SEGMENTAL INFORMATION (continued)

Segment information is disclosed as follows:

| | 31 December 2011 | | | |
|---|---|---|---|---|
| | Corporate BD'000 | Retail BD'000 | Investments BD'000 | Total BD'000 |
| Total income | 9,723 | 12,885 | 3,776 | 26,384 |
| Total expenses | (3,371) | (13,258) | (3,131) | (19,760) |
| Fair value adjustment for investment properties | - | - | (2,570) | (2,570) |
| Net provision for impairment | (19,708) | 3,538 | (5,236) | (21,406) |
| Net income (loss) for the year | (13,356) | 3,165 | (7,161) | (17,352) |
| Other information | | | | |
| Segment assets | 228,799 | 203,450 | 406,894 | 839,143 |
| Segment liabilities, and equity | 229,284 | 387,410 | 222,449 | 839,143 |

The Group operates solely in the Kingdom of Bahrain and, as such, no geographical segment information is presented.

## 27 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction. Consequently, differences can arise between carrying values and fair value estimates. Included under investments are equity type instruments carried at fair value through equity amounting to BD 8,842 thousand (2011: BD 10,967 thousand) which are carried at cost due to lack of other reliable methods for arriving at a reliable fair value for these investments.

The estimated fair value of the Group's financial instruments are not significantly different from their book values as at the consolidated statement of financial position.

## 28 EARNINGS AND EXPENSES PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a qard fund account where the Group uses these funds for various social welfare activities. The movements in these funds is shown in statement of sources and uses of good faith qard fund. The non-Islamic income includes the penalties charged on late repayments for Islamic facilities.

## 29 SHARI'A SUPERVISORY BOARD

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

## 30 SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through zakah and charity fund's expenditures and donations to good faith qard fund for marriage, refurbishment, medical treatments, etc.

## 31 COMPARATIVE FIGURES

Certain of the prior year's figures have been reclassified to conform to the presentation adopted in the current year. Such reclassification did not affect previously reported net income or owners' equity.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## Contents

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 1 BACKGROUND

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 Bahrain Islamic Bank B.S.C. (the "Bank") being a locally incorporated Bank with a retail banking license, and its subsidiaries together known as (the "Group").

The Board of Directors seeks to optimise the Group's performance by enabling the various Group 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 Group risk policy framework.

## 2 CAPITAL ADEQUACY

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

The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issuing sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

The Group's capital structure is primarily made up of its paid-up capital, and including reserves. From a regulatory perspective, the significant amount of the Group's capital is in Tier 1 form as defined by the CBB, i.e., most of the capital is of permanent nature.

The Group'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 financing facilities growth expectations for each business group, expected growth in off-balance sheet facilities and future sources and uses of funds. To assess its capital adequacy requirements in accordance with CBB requirements, the Group adopts the Standardised Approach for its Credit Risk, Basic Indicator Approach for its Operational Risk and Standardised Measurement Approach for its Market Risk. All assets funded by profit sharing investment accounts are subject to Board approval.

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

As part of the risk management practice, the Group has already implemented Sunguard system to be Basel II compliant as prescribed by CBB.

For the purposes of guidance every table was cross referenced with the relevant paragraph number of the Central Bank of Bahrain's Public Disclosures Module.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 2 CAPITAL ADEQUACY (continued)

### Table – 1. Capital Structure (PD-1.3.12, 1.3.13, 1.3.14 and 1.3.15)

The following table summarises the eligible capital as of 31 December 2012 after deductions for Capital Adequacy Ratio (CAR) calculation;;

| | Tier 1 BD'000 | Tier 2 BD'000 |
|---|---|---|
| **Components of capital** | | |
| Issued and fully paid ordinary shares | 93,404 | - |
| General reserves | 1,000 | - |
| Legal / statutory reserves | 10,267 | - |
| **Less:** | | |
| Net Losses for the year | (36,195) | - |
| Unrealised gross losses arising from fair valuing equity securities | (638) | - |
| **Tier 1 Capital before PCD deductions** | 67,838 | - |
| | | |
| Unrealised gains arising from fair valuing equities (45% only) | | 593 |
| Investment risk reserve | | 63 |
| Other reverse | | 2,688 |
| **Tier 2 Capital before PCD deductions** | | 3,344 |
| **Total available capital** | | 71,182 |
| | | |
| **Deductions** | | |
| Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated | (2,747) | (2,747) |
| Investment in insurance entity greater than or equal to 20% | (825) | (825) |
| **Total Deductions** | (3,572) | (3,572) |
| | | |
| **Tier 1 and Tier 2 eligible capital before additional deduction** | 64,266 | (228) |
| **Additional deduction from Tier 1 to absorb deficiency in Tier 2** | (228) | 228 |
| **Tier 1 and Tier 2 eligible capital** | 64,038 | - |
| **TOTAL ELIGIBLE CAPITAL** | 64,038 | - |

| | Amount of exposures BD'000 |
|---|---|
| Total Credit Risk Weighted Assets | 461,056 |
| Total Market Risk Weighted Assets | 17,063 |
| Total Operational Risk Weighted Assets | 43,497 |
| **TOTAL REGULATORY RISK WEIGHTED ASSETS** | 521,616 |
| **CAPITAL ADEQUACY RATIO** | 12.28% |
| Minimum requirement | 12% |

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 2 CAPITAL ADEQUACY (continued)

### Table – 2. Capital requirements by type of Islamic financing contracts (PD-1.3.17)

The following table summarises the amount of exposures as of 31 December 2012 (gross of deductions) subject to standardised approach of credit risk and related capital requirements by type of Islamic financing contracts;

| | Risk Weighted Assets BD'000 | Capital requirements BD'000 |
|---|---|---|
| **Type of Islamic Financing Contracts** | | |
| Murabaha receivables* | 74,291 | 8,915 |
| Due from banks and financial institutions | 12,065 | 1,448 |
| Musharaka investments* | 29,428 | 3,531 |
| Investments | 84,239 | 10,109 |
| Ijarah muntahia bittamleek* | 31,590 | 3,791 |
| Ijarah rental receivables | 4,743 | 569 |
| | **236,356** | **28,363** |
| **Other credit exposures** | **224,700** | **26,964** |
| | **461,056** | **55,327** |

* The risk weighted assets have been allocated on pro-rata basis due to system limitation.

### Table – 3. Capital requirements for market risk (PD-1.3.18)

The following table summarises the amount of exposures as of 31 December 2012 subject to standardised approach of market risk and related capital requirements;

| | |
|---|---|
| Market Risk - Standardised Approach Foreign exchange risk (BD'000) | **1,365** |
| **Total of Market Risk - Standardised Approach** | **1,365** |
| Multiplier | 12.5 |
| **RWE for CAR Calculation (BD'000)** | **17,063** |
| **Total Market Risk Exposures (BD'000)** | **17,063** |
| **Total Market Risk Exposures - Capital Requirement (BD'000)** | **2,048** |

### Table – 4. Capital requirements for operational risk (PD-1.3.30 (a & b) and PD-1.3.19)

The following table summarises the amount of exposures as of 31 December 2012 subject to basic indicator approach of operational risk and related capital requirements;

| **Indicators of operational risk** | |
|---|---|
| Average Gross income ( BD'000 ) | 23,198 |
| Multiplier | 12.5 |
| | 289,979 |
| Eligible Portion for the purpose of the calculation | 15% |
| **Total Operational Risk Exposure ( BD'000 )** | **43,497** |
| **Total Operational Risk Exposures - Capital Requirement ( BD'000 )** | **5,220** |

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 2 CAPITAL ADEQUACY (continued)

### Table – 5. Capital Adequacy Ratios (PD-1.3.20)

The following are Capital Adequacy Ratios as of 31 December 2012 for total capital and Tier 1 capital;

| | Total capital ratio | Tier 1 capital ratio |
|---|---|---|
| Top consolidated level | **12.28%** | **12.28%** |

## 3 RISK MANAGEMENT

### 3.1 Bank-wide Risk Management Objectives

The risk management philosophy of the Group is to identify, capture, monitor and manage the various dimensions of risk with the objective of protecting asset values and income streams such that the interest of the Group's shareholders (and others to whom the Group owes a liability) are safeguarded, while maximising the returns intended to optimise the Group's shareholder return while maintaining it's risk exposure within self-imposed parameters.

The Group has defined its risk appetite within the parameters of its Risk Strategy. The Group reviews and realigns its risk appetite as per the evolving business plan of the Group with changing economic and market scenarios. The Group also assesses its tolerance for specific risk categories and its strategy to manage these risks.

In addition to satisfying the minimum regulatory capital requirements of CBB, the Group seeks to constantly identify and quantify, to the extent possible, the various risks that are inherent in the normal course of its business and maintain appropriate internal capital levels as per the ICAAP framework. The main objective of the Group's ICAAP is to ensure that adequate capital is retained at all times to support the risks the Group undertakes in the course of its business.

The Group has an established internal capital adequacy assessment process (ICAAP) as per the requirements under Pillar III of the Basel II. ICAAP prescribed measures are designed to ensure appropriate identification, measurement, aggregation and monitoring of the Group's risk. It also defines an appropriate level of internal capital in relation to the Group's overall risk profile and business plan.

### 3.2 Strategies, Processes and Internal Controls

#### 3.2.1. Group's risk strategy

Capital Management policies and Risk Charter define the Group's risk strategy. Comprehensive Risk Management Policy Framework is approved by the Board. These are also supported by appropriate limit structures. These policies provide an enterprise-wide integrated risk management framework in the Group.

The risk charter identifies risk objectives, policies, strategies and risk governance both at the Board and the management level. The capital management policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses.
Limit structures serve as key components in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with its own policies and methodology documents. In addition, the Group 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, profit rate, liquidity and operational, all of which require the comprehensive controls and ongoing oversight. The risk management framework summarises the spirit behind Basel II, which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities and segregation of duties, adequate information and communication channels, monitoring risk management activities and correcting deficiencies..

#### 3.2.2 Credit risk

The Group manages its credit risk exposure by evaluating each new product/activity with respect to the credit risk introduced by it. The Group has established a limit structure to avoid concentration of risks for counterparty, sector and geography.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.2 Strategies, Processes and Internal Controls (continued)

#### 3.2.3 Market risk

The Group proactively measures and monitors the market risk in its portfolio using appropriate measurement techniques such as limits on its foreign exchange open positions although they are insignificant. The Group regularly carries out stress testing to assess the impact of adverse market conditions on its market risk sensitive portfolio.

The Group has established a limit structure to monitor and control the market risk in its equity type instruments portfolio. These limits include maximum Stop-loss limits, position limits, VaR limits and maturity limits.

#### 3.2.4 Operational risk

The Group has implemented SunGuard's Operational Risk Management system 'SWORD' for recording the potential risks, controls and events on a continuous basis. As part of implementation, the Group has carried out Risk Control Self Assessment ("RCSA") exercise on a regular basis. The system also measures the Operational risk appetite based on the predefined limits/thresholds.

The Group has established a clear segregation of duties, through documentation and implementation of policies and procedures. This ensures objectivity, security and avoids conflicts of interest. Maker checker concept and dual eye principles are applied across the Group, where possible.

#### 3.2.5 Equity price risk

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 investment portfolio. The Group manages this risk through diversification of investments in terms of geographical distribution and industry concentration.

#### 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 Group's management believes that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and equity of investment accountholders. The profit distribution to investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

However, the profit sharing agreements will result in displaced commercial risk when the Group's results do not allow the Group to distribute profits in line with the market rates.

#### 3.2.7 Displaced Commercial Risk

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 liabilities, when the return on assets is under performing as compared with competitor's rates.

The Group manages its displaced commercial risk by placing gap limits between the returns paid to investors and market returns.

The Group manages its displaced commercial risk as outlined in the Risk Charter of the Group. The Group may forego its fee in case displaced commercial risk arises. The Group benchmarks its rates with other leading banks in the market.

All the above strategies used have been effective throughout the reporting year.

### 3.3 Structure and Organisation of Risk Management Function

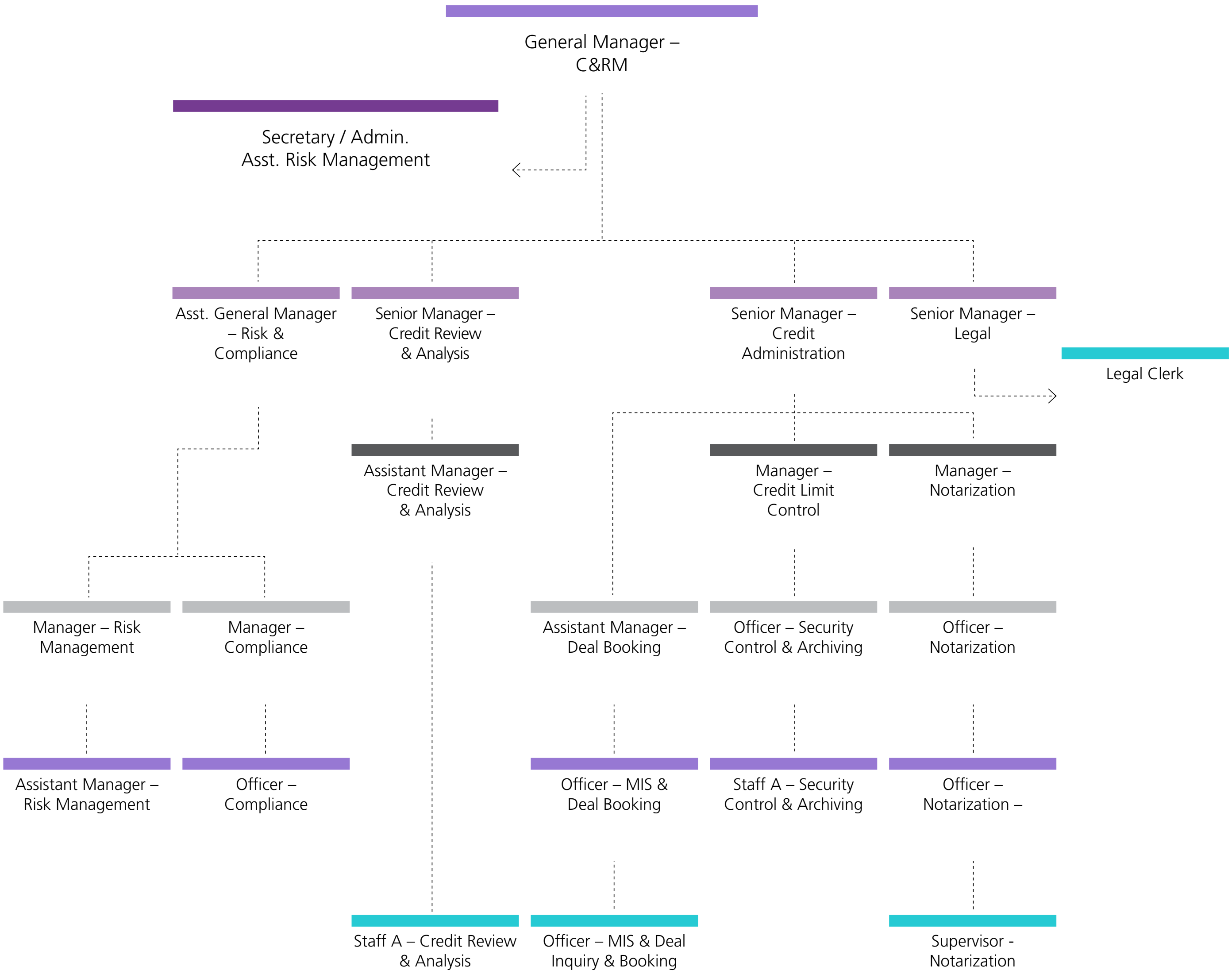
Risk Management Structure includes all levels of authorities (including Board level Risk committee), organisational structure, people and systems required for the smooth functioning of risk management processes in the Group. The responsibilities associated with each level of risk management structure and authorities include the following:

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

a. Establishing overall policies and procedures, and
b. Delegating authority to Executive Committee, Credit Committee, the Chief Executive Officer and further delegation to the management to approve and review.

## 3 RISK MANAGEMENT (continued)

### 3.3 Structure and Organisation of Risk Management Function (continued)




### 3.4 Risk Measurement and Reporting Systems

Based on risk appetite of the Group, the Group has put in place various limits. These limits have been approved by the Board of Directors. Any limit breaches are reported to the respective senior management committees and the Board by the Credit and Risk Management Department ("CRMD"). The limits are reviewed and revised at least on an annual basis or when is deemed required.

The Group has developed a risk measurement and reporting system that generates various types of reports which has enhanced the monitoring process of the Group.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 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 lending and investment activities. The Group 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 financed or other tangible securities.

The Group 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 area and industry sector. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision by the Credit Review and Analysis Department ("CR&AD"). Any changes to the Credit Risk Policy will be approved by the Board.

All credit proposals undergo a comprehensive risk assessment examining the customer's financial condition, trading performance, nature of the business, quality of management, and market position, etc. In addition, the Group's internal risk rating model scores these quantitative and qualitative factors. The credit approval decision is then made and terms and conditions are set.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the Group. Corporate contracts/ facilities are reviewed on an annual basis by CR&AD.

#### 3.5.2 Types of credit risk

Financing contracts mainly comprise Due from banks and financial institutions, Murabaha receivables, Musharaka investments and Ijarah muntahia bittamleek.

*Due from banks and financial institutions*

Due from banks and financial institutions comprise commodity murabaha receivables and wakala receivables.

*Murabaha receivables*

The Group finances these transactions through buying the commodity which represents the object of the Murabaha contract and then resells this commodity to the Murabeh (beneficiary) at a profit. The sale price (cost plus profit margin) is repaid in instalments by the Murabeh over the agreed period. The transactions are secured at times by the object of the Murabaha contract (in case of real estate finance) and other times by a total collateral package securing the facilities given to the Murabeh.

*Musharaka investments*

Musharaka is a form of partnership between the Group and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, whereby each of the parties becomes an owner of the capital on a permanent or declining basis. Profits are shared in an agreed ratio, but losses are shared in proportion to the amount of capital contributed.

*Ijarah Muntahia Bittamleek*

The legal title of the assets under Ijarah muntahia bittamleek only passes to the lessee at the end of the Ijarah term, through gift, consideration or gradual sale, provided that all Ijarah instalments are settled.

#### 3.5.3 Past Due and impaired Islamic financing

The Group defines non-performing facilities as the facilities that are overdue for period of 90 days or more. These exposures are placed on a non-accrual status with income being recognised to the extent that it is actually received. It is the Group's policy that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as non performing, not only the overdue instalments/payments.

As a policy the Group places on a non-accrual basis 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.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

#### 3.5.4 External credit assessment institutions

The Group relies on external ratings for rated corporate customers and counterparties. The Group uses Standard & Poor's, Fitch, Moody's and Capital Intelligence to provide ratings for such counterparties. In case of unrated counterparties, the Group will assess the credit risk on the basis of defined parameters. These ratings are used for risk assessment and calculation of risk weighted equivalents.

#### 3.5.5 Definition of Geographical distribution

The geographic distribution of the credit exposures is monitored on an ongoing basis by Group's Risk Management Department and reported to the Board on a quarterly basis. The Group's classification of geographical area is according to its business needs and the distribution of its portfolios.

#### 3.5.6 Concentration risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being overexposed to a single customer, industry sector or geographic region. As per CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's prior approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15% of the regulatory capital base.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

#### 3.5.7 Credit risk mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals and guarantees to mitigate the credit risks that the Group is exposed to. Credit risk mitigants reduce the credit risk by allowing the Group to protect against counterparty non-performance of credit contracts through collaterals, netting agreements and guarantees.

Generally, the Group extends credit facilities only where supported by adequate tangible collateral security and/or audited financial statements. Facilities may be considered without adequate tangible collateral security, when audited financial statements reveal satisfactory financial position/repayment ability and the facilities are properly structured and supported by assignments, guarantees, etc. as appropriate. Name lending (i.e. lending without audited financial statements and tangible collateral security) is discouraged and is approved only on an exceptional basis after careful analysis of the quality of the customer, market reputation, approximate personal net worth etc.

In general, personal guarantees of the partners/promoters/directors of the borrowing entity are obtained in support of credit facilities. In all cases, a statement of net worth of the guarantor is to be compiled by the Account Officer, so that adequate information is available at a future date in case the guarantees need to be enforced.

The market value of tangible collateral security are properly evaluated by the Group approved valuers (for properties) or based on publicly available quotations. Only the Loan-able Value of such security is taken into account while considering credit facilities.

From time to time, the Credit and Investment Committee reviews and approves the loan-able value of securities. It has also approved a list of acceptable securities.

The majority of the Group's current credit portfolio is secured through mortgage of commercial real estate properties. The Group may dispose off the assets as a last resort after carrying out due legal process.

##### 3.5.7.1 General policy guidelines of collateral management

**Acceptable Collaterals:** The Group has developed guidelines for acceptable collaterals. Assets offered by customers must meet the following criteria to quantify as acceptable collateral:

a. Assets must be maintaining their value, at the level prevalent at inception, until maturity date of the facility granted;
b. Such assets should be easily convertible into cash, if required (liquidity);
c. There should be a reasonable market for the assets (marketability); and
d. The Group should be able to enforce its rights over the asset if necessary (enforceability).

**Ownership:** Prior to valuation or further follow up on the offered collateral, Credit Administration ensures satisfactory evidence of the borrower's ownership of the assets.

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

#### 3.5.7.1 General policy guidelines of collateral management (continued)

**Valuation:** All assets offered as collateral are valued by an appropriate source either in-house (through another department in the Group) or by an external appraiser (real estate related collateral). The Group maintains a list of independent appraisers, approved by management.

a. **Valuation of shares and goods:** Where competent staff is available within the Group, the valuation is conducted in-house. The Group performs in-house valuation on the following types of securities:
   - Pledge of shares of local companies;
   - Pledge of international marketable shares and securities; and
   - Pledge and hypothecation of goods.

   International shares are valued at the quotes available from stock exchanges, periodicals, etc.

b. **Valuation of real estate and others:** Besides assets mentioned above the valuation of following securities are also conducted:
   - Real Estate;
   - Equipment and machinery; and
   - Precious metals and jewellers.

The Credit Administration requests the concerned department to arrange for the valuation from approved valuators.

The following additional guidelines are also followed by the Group:

a. No facility should be disbursed until credit documentation is properly signed and security/guarantees required have been signed and registered, where required. Exceptional cases can be considered by sanctioning authorities; and

b. All documents received as security or support for credit facilities will be lodged in the safe custody through the Credit Administration and should be kept under dual control. Group must ascertain that collateral providers are authorised and acting within their capacity.

#### 3.5.7.2 Guarantees

In cases where a letter of guarantee from parent company or a third party is accepted as credit risk mitigants, the Group ensures that all guarantees are irrevocable, legal opinion has been obtained from a legal counsellor domiciled in the country of guarantor (overseas) regarding the enforceability of the guarantee, if the guarantor / prime obligor is domiciled outside Bahrain and all guarantees should be valid until full settlement of the facilities. Also no maturity (negative) mismatch is permissible between the guarantee and exposure.

#### 3.5.7.3 Custody/ collateral management

The assets, or title to the asset, will be maintained in the Group's custody or with custodian approved by the Group. The Credit Administration will obtain confirmation of the assets held with each custodian on an annual basis.

The release of collateral without full repayment of all related financial obligations requires authorisation of the same level that originally approved and sanctioned the facility. Substitution of collateral is permitted if the new collateral would further minimise the Group's risk exposure.

When collateral is released to the customer, the Head of Credit Administration obtains and maintains in his records acknowledgement of receipt from the customer or his/her authorised representative.

#### 3.5.8 Counterparty credit risk

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

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

### 3.5.8 Counterparty credit risk (continued)

#### 3.5.8.1 Exposure

The measure of exposure reflects the maximum loss that the Group may suffer in case counterparty fails to fulfil its commitments. Exposure shall always be calculated on the basis of approved limits or actual outstanding exposure (Financing facilities, Investments or others), whichever is higher.

#### 3.5.8.2 Counterparty

A counterparty is defined as an obligor (individual/company/other legal entity), a guarantor of an obligor, or a person receiving funds from the Group, 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.

#### 3.5.8.3 Group exposure

Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. For this purpose, Group is two or more counterparties related in such a way that financial soundness of one may affect the financial soundness of the other(s) and one of them has a direct or indirect control over other(s).

#### 3.5.8.4 Connected counterparties

Connected counterparties are companies or individuals connected with the Group or its subsidiaries and associated companies (whether such association is due to control or shareholding or otherwise), Directors and their associates (whether such association is due to control, family links or otherwise), members of the Shari'a Supervisory Board, management and other staff and shareholders holding more than 10% or more of the equity voting rights in the Group.

#### 3.5.8.5 Large exposure

Large exposure is any exposure whether direct, indirect or funded by equity of investment accountholders to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Group's capital base.

Prior written approval from the CBB is required in the following cases:

a. If any counterparty (single/group) exposure exceeds 15% of Group's Capital Base; and
b. If any facility (new/extended) to an employee is equal or above BD100, 000 (or equivalent).

#### 3.5.8.6 Maximum exposure

The Group has set an internal maximum exposure limit in the light of CBB guidelines.

#### 3.5.8.7 Reporting

The Group reports large counterparty exposures (as defined above) to CBB on periodic basis. The Group reports the exposures on a gross basis without any set-off. 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 right to do so.

#### 3.5.8.8 Other matters

As a Group's strategy exposure to connected counterparties may be undertaken only when negotiated and agreed on an arm's length basis.

The Group shall not assume any exposure to its external auditors.

### 3.5.9 Related party transactions

The disclosure relating to related party transactions has been made in the consolidated financial statements as of 31 December 2012. All related party transactions have been made on arm's length basis.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

#### Table – 6. Credit Risk Exposure (PD-1.3.23(a))

The following table summarises the amount of gross funded and unfunded credit exposure as of 31 December 2012 and average gross funded and unfunded exposures over the year ended 31 December 2012 allocated to own capital and current account and profit sharing investment account (PSIA);

| | Own capital and current account | | Profit Sharing Investment Account | |
|---|---|---|---|---|
| | Total gross credit exposure BD'000 | *Average gross credit exposure over the year BD'000 | Total gross credit exposure BD'000 | *Average gross credit exposure over the year BD'000 |
| **Funded** | | | | |
| Cash and balances with banks and Central Bank | 15,638 | 21,210 | 28,255 | 27,340 |
| Due from banks and financial institutions | 8,419 | 7,733 | 124,005 | 113,882 |
| Murabaha receivables | 14,481 | 13,962 | 213,276 | 205,621 |
| Musharaka investments | 5,736 | 5,975 | 84,484 | 88,003 |
| Investments | 57,850 | 60,123 | 38,438 | 42,296 |
| Investment in associates | 7,143 | 7,028 | - | - |
| Investment in Ijarah assets | 10,599 | 10,553 | - | - |
| Ijarah muntahia bittamleek | 6,158 | 6,356 | 90,688 | 93,606 |
| Investment properties | 106,351 | 111,361 | - | - |
| Ijarah rental receivables | 875 | 514 | 12,891 | 7,571 |
| Other assets | 7,517 | 8,296 | - | - |
| **Unfunded** | | | | |
| Commitments and contingent liabilities | 9,761 | 10,473 | - | - |
| Total | 250,528 | 263,584 | 592,037 | 578,319 |

* Average balances are computed based on month end balances.

#### Table – 7. Credit Risk – Geographic Breakdown (PD-1.3.23(b))

The following table summarises the geographic distribution of exposures as of 31 December 2012, broken down into significant areas by major types of credit exposure;

| | Own capital and current account * Geographic area | | | | | Profit Sharing Investment Account * Geographic area | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | North America BD'000 | Europe BD'000 | Middle East BD'000 | Rest of Asia BD'000 | Total BD'000 | North America BD'000 | Europe BD'000 | Middle East BD'000 | Rest of Asia BD'000 | Total BD'000 |
| Cash and balances with banks and Central Bank | 1,435 | 280 | 13,822 | 101 | 15,638 | - | - | 28,255 | - | 28,255 |
| Due from banks and financial institutions | - | 395 | 8,024 | - | 8,419 | - | 5,814 | 118,191 | - | 124,005 |
| Murabaha receivables | - | 449 | 14,032 | - | 14,481 | - | 6,613 | 206,663 | - | 213,276 |
| Musharaka investments | - | - | 5,736 | - | 5,736 | - | - | 84,484 | - | 84,484 |
| Investments | 854 | 4,848 | 51,242 | 906 | 57,850 | - | - | 38,438 | - | 38,438 |
| Investment in associates | - | - | 7,143 | - | 7,143 | - | - | - | - | - |
| Investment in Ijarah assets | - | - | 10,599 | - | 10,599 | - | - | - | - | - |
| Ijarah muntahia bittamleek | - | - | 6,158 | - | 6,158 | - | - | 90,688 | - | 90,688 |
| Investment properties | - | - | 106,351 | - | 106,351 | - | - | - | - | - |
| Ijarah rental receivables | - | - | 875 | - | 875 | - | - | 12,891 | - | 12,891 |
| Other assets | - | - | 7,517 | - | 7,517 | - | - | - | - | - |
| Total | 2,289 | 5,972 | 231,499 | 1,007 | 240,767 | - | 12,427 | 579,610 | - | 592,037 |

* Geographical distribution of exposure into significant areas by major type of credit exposure is based on counterparty's country of incorporation.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

Table – 8. Credit Risk – Industry Sector Breakdown (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2012 by industry, broken down into major types of credit exposure;

| | Own Capital and Current Account Industry Sector | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Trading and Manufacturing | Banks and Financial Institutions | Real Estate | Aviation | Personal & Consumer Finance | Governmental Organisation | Others | Total |
| | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 |
| **Funded** | | | | | | | | |
| Cash and balances with banks and Central Bank | - | 8,481 | - | - | - | - | 7,157 | 15,638 |
| Due from banks and financial institutions | - | 8,419 | - | - | - | - | - | 8,419 |
| Murabaha receivables | 1,351 | 1,750 | 1,731 | 740 | 8,138 | - | 771 | 14,481 |
| Musharaka investments | 204 | - | 1,492 | - | 3,386 | 166 | 488 | 5,736 |
| Investments | 4,774 | 10,066 | 13,840 | - | - | 1,636 | 27,534 | 57,850 |
| Investment in associates | - | 7,143 | - | - | - | - | - | 7,143 |
| Investment in Ijarah assets | - | - | 10,599 | - | - | - | - | 10,599 |
| Ijarah muntahia bittamleek | 628 | 8 | 2,411 | 573 | 2,523 | - | 15 | 6,158 |
| Investment properties | - | - | 106,351 | - | - | - | - | 106,351 |
| Ijarah rental receivables | 98 | 8 | 246 | 136 | 373 | - | 14 | 875 |
| Other assets | - | 200 | - | - | 798 | - | 6,519 | 7,517 |
| **Unfunded** | | | | | | | | |
| Commitments and contingent liabilities | 3,437 | 2,277 | 1,356 | 957 | 274 | - | 1,460 | 9,761 |
| **Total** | **10,492** | **38,352** | **138,026** | **2,406** | **15,492** | **1,802** | **43,958** | **250,528** |

Table – 8. Credit Risk – Industry Sector Breakdown (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2012 by industry, broken down into major types of credit exposure;

| | Profit Sharing Investment Account Industry Sector | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Trading and Manufacturing | Banks and Financial Institutions | Real Estate | Aviation | Personal & Consumer Finance | Governmental Organisation | Others | Total |
| | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 |
| **Funded** | | | | | | | | |
| Cash and balances with banks and Central Bank | - | 28,255 | - | - | - | - | - | 28,255 |
| Due from banks and financial institutions | - | 124,005 | - | - | - | - | - | 124,005 |
| Murabaha receivables | 19,896 | 25,777 | 25,495 | 10,901 | 119,858 | - | 11,349 | 213,276 |
| Musharaka investments | 2,999 | - | 21,972 | - | 49,872 | 2,439 | 7,202 | 84,484 |
| Investments | - | 1,629 | 12,708 | - | - | 24,101 | - | 38,438 |
| Investment in associates | - | - | - | - | - | - | - | - |
| Investment in Ijarah assets | - | - | - | - | - | - | - | - |
| Ijarah muntahia bittamleek | 9,243 | 118 | 35,510 | 8,439 | 37,151 | - | 227 | 90,688 |
| Investment properties | - | - | - | - | - | - | - | - |
| Ijarah rental receivables | 1,444 | 114 | 3,624 | 2,008 | 5,498 | - | 203 | 12,891 |
| Other assets | - | - | - | - | - | - | - | - |
| **Unfunded** | | | | | | | | |
| Commitments and contingent liabilities | - | - | - | - | - | - | - | - |
| **Total** | **33,582** | **179,898** | **99,309** | **21,348** | **212,379** | **26,540** | **18,981** | **592,037** |

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

#### Table – 9. Credit Risk – Intra-group transactions (PD-1.3.23(d))

The balances and transactions with the related parties are disclosed in the consolidated financial statements as of 31 December 2012 and all related party transactions have been made on an arms' length basis.

The balances of major transactions with the subsidiaries are as follows:

| | Own Capital and Current Account BD'000 | Profit Sharing Investment Account BD'000 | Total BD'000 |
|---|---|---|---|
| Customers' current accounts | 151 | - | 151 |
| Other liabilities | 5,242 | - | 5,242 |
| Other assets | 66 | - | 66 |
| Investment in subsidiaries | 25,001 | - | 25,001 |

The income and expenses arising from dealing with the subsidiaries which we eliminated in the consolidated statement of income are as follows:

| | Own Capital and Current Account BD'000 | Profit Sharing Investment Account BD'000 | Total BD'000 |
|---|---|---|---|
| Income from Ijarah assets | 414 | - | 414 |

#### Table – 10. Credit Risk – Financing Facilities to Highly Leveraged or Other High Risk Counterparties (PD-1.3.23(e))

The following balances representing the financing facilities to highly leveraged or other high risk counterparties as of 31 December 2012;

| Counterparties | Own capital and current account BD'000 | Profit Sharing Investment Account BD'000 | Total BD'000 |
|---|---|---|---|
| Counterparty # 1 | 717 | - | 717 |
| | 717 | - | 717 |

#### Table – 11. Credit Risk – Concentration of Risk (PD-1.3.23(f))

Following balances representing the concentration of risk to individual counterparties as of 31 December 2012;

| Counterparties | Own capital and current account BD'000 | Profit Sharing Investment Account BD'000 | Total BD'000 |
|---|---|---|---|
| Counterparty # 1 | 1,101 | 16,209 | 17,310 |
| Counterparty # 2 | 14,200 | - | 14,200 |
| Counterparty # 3 | 813 | 11,968 | 12,781 |
| Counterparty # 4 | 10,825 | - | 10,825 |
| Counterparty # 5 | 677 | 9,974 | 10,651 |
| Counterparty # 6 | 10,436 | - | 10,436 |
| Counterparty # 7 | 638 | 9,391 | 10,029 |
| | 38,690 | 47,542 | 86,232 |

* The exposures are in excess of the 15% individual obligor limit and exempted from deduction from eligible capital.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

Table – 12. Credit Risk – Residual Contractual Maturity Breakdown (Own Capital and Current Account) (PD-1.3.23(g) PD-1.3.38)

The following table summarises the residual contractual maturity of own capital and current account breakdown of the whole credit portfolio as of 31 December 2012, broken down by major types of credit exposure;

| | Own capital and current account | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Up to One months BD'000 | 1-3 months BD'000 | 3-6 months BD'000 | 6-12 months BD'000 | 1-3 years BD'000 | 3-5 years BD'000 | 5-10 years BD'000 | 10-20 years BD'000 | Over 20 years* BD'000 | No fixed maturity BD'000 | Total BD'000 |
| **Assets** | | | | | | | | | | | |
| Cash and balances with banks and Central Bank | 15,638 | - | - | - | - | - | - | - | - | - | 15,638 |
| Due from banks and financial institutions | 7,628 | 564 | 58 | 169 | - | - | - | - | - | - | 8,419 |
| Murabaha receivables | 131 | 947 | 261 | 842 | 1,297 | 3,111 | 4,788 | 25 | 3,079 | - | 14,481 |
| Musharaka investments | 258 | 167 | 16 | 48 | 722 | 570 | 1,308 | 807 | 1,840 | - | 5,736 |
| Investments | 340 | 20,289 | - | - | 3,632 | 23,597 | 1,320 | - | 242 | 8,430 | 57,850 |
| Investment in associates | - | - | - | - | - | - | - | - | - | 7,143 | 7,143 |
| Investment in Ijarah assets | - | - | - | - | - | - | - | - | - | 10,599 | 10,599 |
| Ijarah muntahia bittamleek | - | - | 13 | 119 | 277 | 858 | 654 | 1,106 | 3,131 | - | 6,158 |
| Investment properties | - | - | - | - | - | - | - | - | - | 106,351 | 106,351 |
| Ijarah rental receivables | - | - | 875 | - | - | - | - | - | - | - | 875 |
| Other assets | 209 | 655 | 528 | - | - | - | - | - | 502 | 5,623 | 7,517 |
| **Total Assets** | **24,204** | **22,622** | **1,751** | **1,178** | **5,928** | **28,136** | **8,070** | **1,938** | **8,794** | **138,146** | **240,767** |

* All non performing facilities have been classified as over 20 years.

Table – 13. Credit Risk – Residual Contractual Maturity Breakdown (Profit Sharing Investment Account) (PD-1.3.23(g) PD-1.3.38)

The following table summarises the residual contractual maturity of profit sharing investment account breakdown of the whole credit portfolio as of 31 December 2012, broken down by major types of credit exposure;

| | Profit Sharing Investment Account | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Up to One months BD'000 | 1-3 months BD'000 | 3-6 months BD'000 | 6-12 months BD'000 | 1-3 years BD'000 | 3-5 years BD'000 | 5-10 years BD'000 | 10-20 years BD'000 | Over 20 years* BD'000 | No fixed maturity BD'000 | Total BD'000 |
| **Assets** | | | | | | | | | | | |
| Cash and balances with banks and Central Bank | - | - | - | - | - | - | - | - | - | 28,255 | 28,255 |
| Due from banks and financial institutions | 112,364 | 8,299 | 854 | 2,488 | - | - | - | - | - | - | 124,005 |
| Murabaha receivables | 1,923 | 13,945 | 3,841 | 12,412 | 19,097 | 45,825 | 70,523 | 366 | 45,344 | - | 213,276 |
| Musharaka investments | 3,788 | 2,452 | 237 | 720 | 10,626 | 8,389 | 19,261 | 11,884 | 27,127 | - | 84,484 |
| Investments | 5,016 | 864 | - | - | 5,429 | 4,128 | 19,443 | - | 3,558 | - | 38,438 |
| Ijarah muntahia bittamleek | - | - | 192 | 1,765 | 4,074 | 12,646 | 9,634 | 16,295 | 46,082 | - | 90,688 |
| Ijarah rental receivables | - | - | 12,891 | - | - | - | - | - | - | - | 12,891 |
| **Total Assets** | **123,091** | **25,560** | **18,015** | **17,385** | **39,226** | **70,988** | **118,861** | **28,545** | **122,111** | **28,255** | **592,037** |

* All non performing facilities have been classified as over 20 years.

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

Table – 14. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (Own capital and current account by industry sector) (PD-1.3.23(h) PD-1.3.24(b) PD-1.3.24(d))

The following table summarises the impaired facilities, past due facilities and allowances financed by own capital and current account disclosed by major industry sector as of 31 December 2012;

| | Own capital and current account | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Non-performing or past due or impaired Islamic financing contracts | Aging of non-performing or past due or impaired Islamic financing contacts | | | | Specific allowances | | | | * General allowances | | |
| | | Less than 3 months** | 3 months to 1 year | 1 to 3 years | Over 3 years | Balance at the beginning of the year | Charges during the year | Charge-offs during the year | Balance at the end of year | General allowances beginning balance | General allowances movement | General allowances ending balance |
| | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 |
| Trading and Manufacturing | 203 | 174 | 12 | 4 | 13 | 2,449 | 115 | (2,484) | 80 | - | - | - |
| Real Estate | 4,711 | 2,227 | 250 | 1,730 | 504 | 173 | 641 | - | 814 | - | - | - |
| Banks and Financial Institutions | 1,220 | 1,095 | 4 | 120 | 1 | 217 | 91 | - | 308 | - | - | - |
| Personal / Consumer Finance | 2,383 | 1,341 | 236 | 761 | 45 | 269 | 512 | (159) | 622 | - | - | - |
| Others | 35 | 25 | 5 | 5 | - | - | 61 | - | 61 | - | - | - |
| No specific sector | - | - | - | - | - | - | - | - | - | 350 | (180) | 170 |
| **Total** | **8,552** | **4,862** | **507** | **2,620** | **563** | **3,108** | **1,420** | **(2,643)** | **1,885** | **350** | **(180)** | **170** |

* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

** This includes amounts not due and amounts past due less than 90 days relating to non-performing or past due or impaired Islamic financing contracts.

Table – 15. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (profit sharing investment account by industry sector) (PD-1.3.23(h))

The following table summarises the impaired facilities, past due facilities and allowances financed by profit sharing investment account disclosed by major industry sector as of 31 December 2012;

| | Profit Sharing Investment Account | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Non-performing or past due or impaired Islamic financing contracts | Aging of non-performing or past due or impaired Islamic financing contacts | | | | Specific allowances | | | | * General allowances | | |
| | | Less than 3 months** | 3 months to 1 year | 1 to 3 years | Over 3 years | Balance at the beginning of the year | Charges during the year | Charge-offs during the year | Balance at the end of year | General allowances beginning balance | General allowances movement | General allowances ending balance |
| | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 |
| Trading and Manufacturing | 2,986 | 2,560 | 184 | 58 | 184 | 36,083 | 1,699 | (36,590) | 1,192 | - | - | - |
| Real Estate | 69,404 | 32,827 | 3,682 | 25,472 | 7,423 | 2,542 | 9,442 | - | 11,984 | - | - | - |
| Banks and Financial Institutions | 17,964 | 16,112 | 65 | 1,774 | 13 | 3,194 | 1,339 | - | 4,533 | - | - | - |
| Personal / Consumer Finance | 35,095 | 19,744 | 3,475 | 11,208 | 668 | 3,966 | 7,537 | (2,345) | 9,158 | - | - | - |
| Others | 520 | 377 | 66 | 77 | - | - | 905 | - | 905 | - | - | - |
| No specific sector | - | - | - | - | - | - | - | - | - | 5,163 | (2,645) | 2,518 |
| **Total** | **125,969** | **71,620** | **7,472** | **38,589** | **8,288** | **45,785** | **20,922** | **(38,935)** | **27,772** | **5,163** | **(2,645)** | **2,518** |

* General allowance represents collective impairment provision against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

** This includes amounts not due and amounts past due less than 90 days relating to non-performing or past due or impaired Islamic financing contracts.

Although the above table shows the portion of impairment provision related to PSIA, the Group has taken all the provision to their own capital. Hence the PSIA were not charged for any of the impairment provision.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

Table – 16. Credit Risk – Impaired Exposures, Past Due Exposures and Allowances (own capital and current account and profit sharing investment account by geographic area) (PD-1.3.23(i) PD-1.3.24(c))

The following table summarises the past due facilities and allowances financed by own capital and current account and profit sharing investment account disclosed by geographical area as of 31 December 2012;

| | Own capital and current account | | | Profit Sharing Investment Account | | |
|---|---|---|---|---|---|---|
| | Non-performing or past due or impaired Islamic financing contracts | Specific Impairment provision | Collective Impairment provision | Non-performing or past due or impaired Islamic financing contracts | Specific Impairment provision | Collective Impairment provision |
| | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 | BD'000 |
| Middle East | 8,552 | 1,885 | 170 | 125,969 | 27,772 | 2,518 |
| **Total** | **8,552** | **1,885** | **170** | **125,969** | **27,772** | **2,518** |

Table – 17. Credit Risk – Restructured Financing Facilities (PD-1.3.23(j))

The following table summarises the aggregate amount of restructured financing facilities during the year financed by own capital and current account and profit sharing investment account as of 31 December 2012;

| | Own capital and current account | Profit Sharing Investment Account |
|---|---|---|
| | Aggregate amount | Aggregate amount |
| | BD'000 | BD'000 |
| Restructured financing facilities | 2,228 | 32,829 |
| **Total** | **2,228** | **32,829** |

The provision on restructured facilities is BD 6,161 thousand and the impact on present and future earnings is not significant.

Table – 18. Credit Risk Mitigation (PD-1.3.25 (b) and (c))

The following table summarises the exposure as of 31 December 2012 by type of Islamic financing contract covered by eligible collateral;

| | Total exposure covered by | |
|---|---|---|
| | Eligible collateral | Guarantees |
| | BD'000 | BD'000 |
| Murabaha receivables | 25,800 | 9,188 |
| Musharaka investments | 200 | 125 |
| Ijarah muntahia bittamleek | 5,537 | 1,125 |
| **Total** | **31,537** | **10,438** |

## 3 RISK MANAGEMENT (continued)

### 3.5 Credit Risk (continued)

#### Table – 19. Counterparty Credit (PD-1.3.26 (b))

The following table summarises the counterparty credit risk exposure covered by collateral after the application of haircuts as of 31 December 2012;

| | BD'000 |
|---|---|
| Gross positive fair value of contracts | 832,804 |
| Netting Benefits | - |
| Netted current credit exposure | 832,804 |
| Collateral held: | |
| -Cash | 31,537 |
| -Shares | 5,720 |
| -Real Estate | 217,918 |
| **Total** | 255,175 |

A haircut of 30% is applied on the Real Estate collateral.

### 3.6 Market Risk

#### 3.6.1 Introduction

The Group has accepted the definition of market risk as defined by CBB as "the risk of losses in on- and off-balance-sheet positions arising from movements in market prices."

#### 3.6.2 Sources of market risk

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. The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. The profit distribution to equity of investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

Foreign exchange risk is the sensitivity of financial products to changes in spot foreign exchange rates. The value of the Group's portfolio which is denominated in a number of currencies may be exposed to these risks when converted back to the Group's base currency.

Equity price risk is the sensitivity of financial products to the changes in equity prices. Equity risk arises from holding open positions in equities or equity based instruments, thereby creating exposure to a change in the market price of the equity. In addition to Group performance expectations, equity prices are also susceptible to general economic data and sector performance expectations.

Commodity risk; products may have an inherent risk 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 particular sector and less correlated across sectors.

#### 3.6.3 Market risk strategy

The Group's Board is responsible for approving and reviewing (at least annually), the risk strategy and significant amendments to the risk policies. The Group's senior management is responsible for implementing the risk strategy approved by the Board, and continually enhancing the policies and procedures for identifying, measuring, monitoring and controlling risks.

# BASEL II, PILLAR III DISCLOSURES

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## 3 RISK MANAGEMENT (continued)

### 3.6 Market Risk (continued)

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

1 The Group will manage its market risk exposure by evaluating each new product/ activity with respect to the market risk introduced by it;
2 The Group will proactively measure and continually monitor the market risk in its portfolio;
3 The Group will at all time hold sufficient capital in line with the CBB Pillar 1 regulatory capital requirements;
4 The Group will establish a market risk appetite which will be quantified in terms of a market risk limit structure;
5 The Group will establish a limit structure to monitor and control the market risk in its portfolio. These limits will include position limits, maximum/stop loss limits, factor sensitivity limits, VaR limits and maturity limits;
6 The Group will carry out stress testing periodically using the worst case scenarios to assess the effects of changes in the market value due to changing market conditions;
7 The Group will periodically carry out back testing of market risk assessment models in order to evaluate their accuracy and the inherent model risk;
8 The Group will match the amount of floating rate assets with floating rate liabilities; and
9 The Group will clearly identify the foreign currencies in which it wishes to deal in and actively manage its market risk in all foreign currencies in which it has significant exposure.

#### 3.6.4 Market risk measurement methodology

Market risk measurement techniques includes the use of a number of techniques for market risk measurement. The risk measurement techniques mentioned in this section are used for measuring market risk in both trading book as well as banking book.

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

a. Overnight open positions;
b. Stop loss limits;
c. Factor sensitivity limits;
d. VaR limits; and
e. Profit rate risk gap analysis.

#### 3.6.5 Market risk monitoring and limits structure

The Asset and Liability Committee (ALCO) proposes through the Executive Committee and Board the tolerance for market risk. Based on these tolerances, Risk and Compliance Unit and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates.

#### 3.6.6 Limits monitoring

The Treasury Department and Risk and Compliance Unit monitor the risk limits for each transaction, ensure that the limits are well within set parameters and report periodically to top management.

#### 3.6.7 Breach of limits

In case a limit is breached, an approval from the CEO is required to continue with the transaction. An immediate report is provided to the ALCO after every significant limit breach. This breach is also reported to and approved by the Executive Committee (EXCOM). The limits are revised at least bi-annually or when deemed required.

#### 3.6.8 Portfolio review process

On a monthly basis, Risk and Compliance Unit reviews the Group's assets and liabilities portfolio to evaluate the overall corporate exposure to market risk. As part of the review, Risk and Compliance Unit also monitors the Group's overall market exposure against the risk tolerance limits set by the Board. Risk and Compliance Unit also reviews the adherence to approved limits to control the market risk. Changes, if any, in market risk limits are communicated to business units after review by the GM-C&RM/CEO and approval by the ALCO or EXCOM, as per the delegated authorities approved by the Board. Balance sheet exposure is being reviewed on a quarterly basis by the Board level Audit and Risk committees.

## 3 RISK MANAGEMENT (continued)

### 3.6 Market Risk (continued)

#### 3.6.9 Reporting

Risk and Compliance Unit generates at regular periodic intervals market risk management reports. These reports aim to provide the Group's senior management with an up-to-date view of its market risk exposure.

#### 3.6.10 Stress testing

Stress tests produce information summarising the Group's exposure to extreme, but possible, circumstances and offer a way of measuring and monitoring the portfolio against extreme price movements of this type. The Group's Risk and Compliance Unit employs four stress categories: profit rates, foreign exchange rates, equity prices and commodity prices. For each stress category, the worst possible stress shocks that might realistically occur in the market are defined.

#### 3.6.11 Foreign subsidiary

The Group does not have any foreign subsidiary.

#### Table – 20. Market Risk Capital Requirements (PD-1.3.27 (b))

The following table summarises the capital requirement for foreign exchange risk as of 31 December 2012;

| | Foreign exchange risk BD'000 |
|---|---|
| Foreign exchange risk | **17,063** |
| Foreign exchange risk capital requirement | **2,048** |
| Maximum value capital requirement | **2,048** |
| Minimum value capital requirement | **1,365** |

### 3.7 Operational Risk

#### 3.7.1 Introduction

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. 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.

#### 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 arises 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 arises due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting; and

Systems (Technology) risk which arise due to integrity of information - lacking in timelines of information, omission and duplication of data; hardware failures due to power surge, obsolescence or low quality.

#### 3.7.3 Operational risk management strategy

As a strategy the Group will identify the sources of operational risks in coordination with each business unit. The Group carried out Risk Control Self-Assessments ("RCSA"), and plans to do a continuous and on-going exercise, to identify the operational risks it is exposed to.

## 3 RISK MANAGEMENT (continued)

### 3.7 Operational Risk (continued)

#### 3.7.3 Operational risk management strategy (continued)

The Group on a continuous basis will:

a. assess the effectiveness of controls associated with identified risks;
b. regularly monitor operational risk profiles and material exposures to losses; and
c. identify stress events and scenarios to which it is vulnerable and assess their potential impact, and the probability of aggregated losses from a single event leading to other risks.

#### 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 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.

#### 3.7.5 Operational risk mitigation and control

The business units, in consultation with Risk and Compliance Unit will determine all material operational risks and decide the appropriate procedures to be used to control and/or mitigate the risks.

For those risks that cannot be controlled, the business units in conjunction with Risk and Compliance Unit will decide whether to accept the risks, reduce the level of business activity involved, transfer the risk outside the Group or withdraw from the associated activity completely. Risk and Compliance Unit facilitates the business units in co-developing the mitigation plans.

#### 3.7.6 Business Continuity Plan (BCP)

The Group has also developed a comprehensive business continuity plan detailing the steps to be taken in the event of extreme conditions to resume the Group's operations with minimum delay and disturbance. The plan is in implementation stage. Elements of contingency plans and disaster recovery processes include operating systems, physical space, telecommunications and resources.

### 3.7 Operational Risk

#### Table - 21. Operational Risk Exposure (PD-1.3.30 (a), (b) & (c))

The following table summarises the amount of exposure subject to basic indicator approach of operational risk and related capital requirements:

| | Gross income | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| | BD'000 | BD'000 | BD'000 |
| **Total Gross Income** | 24,856 | 18,777 | 25,962 |
| **Indicators of operational risk** | | | |
| Average Gross income | - | - | 23,198 |
| **Multiplier** | - | - | 12.5 |
| | - | - | 289,979 |
| Eligible Portion for the purpose of the calculation | - | - | 15% |
| **TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE** | - | - | 43,497 |

Risk and Compliance Unit ensures that the BCP is kept up to date and tested once a year in a simulated environment to ensure that it can be implemented in emergency situations and that the management and staff understand how it is to be executed. Results of this testing conducted by Risk and Compliance Unit is evaluated by the GM-C&RM and presented to the EXCOM/Board for evaluation.

## 3 RISK MANAGEMENT (continued)

### 3.8 Equity Position 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 as of 31 December 2012. Equity type instruments carried at fair value through equity and investment properties are kept for capital gain purposes, all other investments including investments in associates are kept for strategic long term holdings.

#### Table – 22. Equity Position Risk in Banking Book (PD-1.3.31 (b) (c) & (f))

The following table summarises the amount of total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2012;

| | Total gross exposure BD'000 | *Average gross exposure BD'000 | Publicly traded BD'000 | Privately held BD'000 | Risk weighted assets BD'000 | Capital Requirements BD'000 |
|---|---|---|---|---|---|---|
| Sukuk | 41,049 | 45,168 | - | 41,049 | 4,270 | 512 |
| Equity investments | 28,660 | 29,519 | 20,230 | 8,430 | 35,562 | 4,267 |
| Funds | 26,579 | 27,732 | - | 26,580 | 44,407 | 5,329 |
| **Total** | **96,288** | **102,419** | **20,230** | **76,059** | **84,239** | **10,108** |

* Average balances are computed based on month end balances.

#### Table – 23. Equity Gains or Losses in Banking Book (PD-1.3.31 (d) & (e))

The following table summarises the cumulative realised and unrealised gains or (losses) during the year ended 31 December 2012;

| | BD'000 |
|---|---|
| Cumulative realised gain arising from sales or liquidations in the reporting period | 654 |
| Total unrealised losses recognised in the consolidated statement of financial position but not through consolidated statement of income | 377 |
| Unrealised losses included in Tier 1 Capital | 638 |
| Unrealised gains included in Tier 2 Capital* | 1,318 |

* This unrealised gain is discounted by 55% before including it in Tier 2 Capital

### 3.9 Equity of Investment Accountholders ("IAH")

The Group may require to decrease or increase loses or profit on certain IAH accounts for the purpose of income smoothing. Thus the Group is exposed to some of the price risk on assets funded by equity of Investment Accountholders ("IAH"). The CBB requires the Group to maintain capital to cover the price risk arising from 30% of assets funded by IAH on a pro-rata basis.

The Group is authorised by the IAH to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement the Group can commingle the equity of investment accountholders investment funds with its own funds (owner's equity) or with other funds the Group has the right to use (e.g. current accounts or any other funds which the Group does not receive on the basis of Mudaraba contract). The IAH and the Group generally participate in the returns on the invested funds. In such type of contract, the Group is not liable for any losses incurred on the joint pool other than the loss resulting from gross negligence or wilful misconduct on the part of the Group or due to the Group's violation of the terms and conditions as agreed between the Group and the IAH.

## 3 RISK MANAGEMENT (continued)

### 3.9 Equity of Investment Accountholders ("IAH") (continued)

The amount received from the customer on account of equity of investment accountholders is not invested completely in the portfolio of selected investments as the Group is required to maintain a cash reserve with CBB, in addition, the Group requires to set aside certain amount to meet operational requirements. The income allocated to the equity of investment accountholders deposits being received is in accordance with the utilisation of such deposits. The utilisation rate is determined by the ALCO with the approval of Shari'a Supervisory Board.

If at any point of time in a particular pool the funds of IAH exceed the assets, the excess amount shall be treated to be invested in commodity Murabaha and earn the average rate of profit on Commodity Murabaha earned during the excess period. There should be no inter-pool financing at any point of time. The Group should establish a control to avoid excess fund in any pool to be used in other pool.

Proposal for new products is initiated by the business lines within the Group, ALCO review such proposal to ensure that the new product is in line with the Group's business and risk strategy. All new products require the approval of the Shari'a Supervisory Board of the Bank. The business lines of the Group have expertise in creating high end value added products offering a wide range of products, expected return, tenors and risk profile.

Information on new products or any change in the existing products will be placed on the Group's website or published in the media.

The Group has designed special quality assurance units whom reports complaints directly to the CEO. The complaints are investigated by personnel not directly related to the subject matter of the complaints.

The Group offers equity of investment accountholders in different currencies for maturity periods ranging from 1 month, 3 month, 6 month, 9 month, 12 month and 36 month. The customer signs written contract covering all terms and conditions of the investment, including tenor, basis of profit allocation, and early withdrawal.

Because equity of investment accountholders is a significant funding source for the Group, the Group regularly monitors rate of return offered by competitors to evaluate the expectation of its IAH. The Group's policy provide whole or partial waiver of the Mudarab share of income from investment in order to provide a reasonable return to its investors.

The Group comingles its own funds and equity of investment accountholders funds which are invested together. The Group has identified two pools of assets where the equity of investment accountholders funds are invested and income from which is allocated to such is account.

The Group has already developed a written policies and procedures applicable to its portfolio of equity of investment accountholders. equity of investment accountholders funds are invested and managed in accordance with Shari'a requirements.

- Pool A: Low risk assets or generating low yield.
- Pool B: High risk assets or generating high yield.

Profits of an investment jointly financed by the Group and the equity of investment accountholders holders shall be allocated between them according to the contribution of each of the Group and the IAH in the jointly financed investment separately for each Joint pool A and B. Operating expenses incurred by the Group are not charged to investment account. In case of the loss resulting from the transactions in a jointly financed investment, such loss shall first be deducted from undistributed profits, if any. Any excess of such loss shall be deducted from Investment Risk Reserve (IRR). Any remaining of such loss shall be deducted from the total balance of fund available in the Joint pool, as at that date, in the respective ratio of the Group's and IAH's respective contribution to the joint fund. Impairment provisions shall only be allocated to Pool B in the ratio of capital contribution by Bank and IAH of Pool B. The reversal of this provision in future year shall be allocated between Bank and IAH of Pool B in the ratio of capital contribution at the time the reversal is made. The loss can be entirely borne by the shareholders of the Group subject to the approval of the Board. Equity of investment accountholders deposits are measured at their book value.

In case of early withdrawal of IAH fund before completion of the term, the effective utilisation method will be applied.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.9 Equity of Investment Accountholders ("IAH") (continued)

#### Table – 24. Equity of Investment Accountholders by Type (PD-1.3.33 (a))

The following table summarises the breakdown of equity of investment accountholders accounts as of 31 December 2012;

| | BD'000 |
|---|---|
| Customers | 573,570 |
| Financial institutions' investment accounts | 87,690 |
| **Total** | **661,260** |

#### Table – 25. Equity of Investment Accountholders Ratios (PD-1.3.33 (d) & (f))

The following table summarises the return on average assets and mudarib share as a percentage of the total investment profit for the year ended 31 December 2012;

| | |
|---|---|
| Profit Paid on Average IAH Assets * | 2.34% |
| Mudarib Fee to Total IAH Profits | 45.00% |

* Average assets funded by IAH have been calculated using month end balances.

#### Table – 26. Equity of Investment Accountholders Ratios (PD-1.3.33 (e) & (g))

The following table summarises the profit distributed to IAH and financing ratios to the total of IAH by type of investment account holder for the year ended 31 December 2012;

| Account Type | Profit distributed to total IAH | Percentage to total IAH |
|---|---|---|
| Saving accounts (including VEVO) | 2.62% | 13.68% |
| Defined accounts - 1 month | 1.36% | 1.39% |
| Defined accounts - 3 months | 0.38% | 0.46% |
| Defined accounts - 6 months | 0.52% | 0.59% |
| Defined accounts - 9 months | 0.00% | 0.00% |
| Defined accounts - 1 year | 2.66% | 2.72% |
| Investment certificates | 0.61% | 0.32% |
| IQRA Deposits | 0.44% | 0.39% |
| Tejoori Deposits | 2.80% | 14.99% |
| Customer's deposits | 84.97% | 52.25% |
| Bank's deposits | 3.64% | 13.21% |
| | **100%** | **100%** |

The calculation and distribution of profits was based on average balances.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.9 Equity of Investment Accountholders ("IAH") (continued)

#### Table – 27. Equity of Investment Accountholders to Total Financing (PD-1.3.33 (h) & (i))

The following table summarises the percentage of counterparty type to total financing for each type of Shari'a-compliant contract to total financing as of 31 December 2012;

| | Percentage of Financing to Total Financing |
|---|---|
| Due from banks and financial institutions | 22.00% |
| Murabaha receivables | 37.81% |
| Musharaka investments | 14.99% |
| Investment in Sukuk | 6.82% |
| Ijarah muntahia bittamleek | 16.09% |
| Ijarah rental receivables | 2.29% |

| | Percentage of Counterparty Type to Total Financing | | | | | | |
|---|---|---|---|---|---|---|---|
| | Trading and Manufacturing | Banks and Financial Institutions | Real Estate | Aviation | Personal & Consumer Finance | Governmental Organisation | Others |
| Due from banks and financial institutions | - | 22.00% | - | - | - | - | - |
| Murabaha receivables | 3.53% | 4.57% | 4.52% | 1.93% | 21.25% | - | 2.01% |
| Musharaka investments | 0.53% | - | 3.90% | - | 8.85% | 0.43% | 1.28% |
| Investment in Sukuk | - | 0.29% | 2.25% | - | - | 4.28% | - |
| Ijarah muntahia bittamleek | 1.64% | 0.02% | 6.30% | 1.50% | 6.59% | - | 0.04% |
| Ijarah rental receivables | 0.26% | 0.02% | 0.64% | 0.36% | 0.97% | - | 0.04% |
| | 5.96% | 26.90% | 17.61% | 3.79% | 37.66% | 4.71% | 3.37% |

#### Table – 28. Equity of Investment Accountholders Share of Profit (PD-1.3.33 (l) (m) & (n))

The following table summarises the share of profits earned by and paid out to profit sharing investment accounts and the Group as Mudarib for the year ended 31 December 2012;

| | |
|---|---|
| Share of profit earned by IAH before transfer to/from reserves - BD '000 | 14,056 |
| Percentage share of profit earned by IAH before transfer to/from reserves | 49.33% |
| Share of profit paid to IAH after transfer to/from reserves - BD '000 | 13,993 |
| Percentage share of profit paid to IAH after transfer to/from reserves | 49.33% |
| Share of profit paid to Bank as mudarib - BD '000 | 14,503 |

#### Table – 29. Equity of Investment Accountholders Percentage Return to Profit Rate of Return (PD-1.3.33 (q))

The following table summarises the average distributed rate of return or profit rate on profit sharing investment accounts for the year ended 31 December 2012;

| | 3 month | 6 month | 12 month | 36 month |
|---|---|---|---|---|
| Percentage of average distributed rate of return to profit rate of return | 2.25% | 3.47% | 3.49% | 3.89% |

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.9 Equity of Investment Accountholders ("IAH") (continued)

Table – 30. Equity of Investment Accountholders Type of Assets (PD-1.3.33 (r ) & (s))

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets for the year ended 31 December 2012;

| | Opening Actual Allocation BD'000 | Movements During the Period BD'000 | Closing Actual Allocation BD'000 |
|---|---|---|---|
| Cash and balances with banks and Central Bank | 27,009 | 1,246 | 28,255 |
| Due from banks and financial institutions | 90,244 | 33,761 | 124,005 |
| Murabaha receivables | 232,950 | (19,674) | 213,276 |
| Musharaka investments | 80,273 | 4,211 | 84,484 |
| Investment in sukuk | 53,553 | (15,115) | 38,438 |
| Ijarah muntahia bittamleek | 95,094 | (4,406) | 90,688 |
| Ijarah rental receivables | 6,815 | 6,076 | 12,891 |
| **Total** | **585,938** | **6,099** | **592,037** |

Table – 31. Equity of Investment Accountholders Profit Earned and Paid (PD-1.3.33 (w))

The following table summarises the amount and rate of return of profits earned by the Group and paid out to equity of investment accountholders over the past five years;

| | Profit Earned (jointly financed) | | Profit Paid to (IAH) | |
|---|---|---|---|---|
| | BD'000 | % age | BD'000 | % age |
| **2012** | **30,662** | 5.21% | **13,993** | **2.38%** |
| 2011 | 33,029 | 5.53% | 14,742 | 2.31% |
| 2010 | 33,083 | 4.46% | 17,721 | 2.39% |
| 2009 | 35,694 | 5.27% | 17,638 | 2.61% |
| 2008 | 36,934 | 5.87% | 17,702 | 2.81% |
| 2007 | 31,463 | 7.80% | 15,609 | 3.87% |

Table – 32 Treatment of assets financed by Investment Account Holder (PD-1.3.33 (v))

| | Assets BD'000 | RWA BD'000 | RWA for Capital Adequacy Purposes BD'000 | Capital Requirements BD'000 |
|---|---|---|---|---|
| Cash and balances with banks and Central Bank | 28,255 | - | - | - |
| Murabaha receivables* | 213,276 | 201,932 | 60,580 | 7,270 |
| Due from banks and financial institutions | 124,005 | 32,794 | 9,838 | 1,181 |
| Musharaka investments* | 84,484 | 79,990 | 23,997 | 2,880 |
| Investment in sukuk | 38,438 | 11,605 | 3,482 | 418 |
| Ijarah muntahia bittamleek* | 90,688 | 85,865 | 25,760 | 3,091 |
| Ijarah rental receivables | 12,891 | 12,891 | 3,867 | 464 |
| | **592,037** | **425,077** | **127,524** | **15,304** |

* The amounts have been allocated on pro-rata basis due to system limitation.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.10 Liquidity Risk

#### 3.10.1 Introduction

Liquidity risk is defined as "the risk that the Group will be unable to meet its obligations as they come due because of an inability to obtain adequate funding or to liquidate assets".

#### 3.10.2 Sources of liquidity risk

The sources of liquidity risk can broadly be categorised in the following:

a. Funding risk is the risk of not being able to fund net outflows due to unanticipated withdrawal of capital or deposits;
b. Call risk is the risk of crystallisation of a contingent liability; and
c. Event risk is the risk of rating downgrades or other negative public news leading to a loss of market confidence in the Group.

#### 3.10.3 Bank's funding strategy

The Board reviews the funding strategy on an annual basis and amends the existing strategy, as deemed necessary. For this purpose, all business units advise the Treasurer of their projected liquidity requirements and contributions at the start of each year as part of annual budgeting process.

The funding strategy highlights any anticipated liquidity shortfalls, the funding requirements to finance these shortfalls and their impact on the statement of financial position. The Group's Risk Charter and Liquidity Policy address liquidity contingency plan to deal with stressed scenarios and outline an action plan that can be taken in the event of liquidity stress situation.

#### 3.10.4 Liquidity risk strategy

The Group monitors the liquidity position by comparing maturing assets and liabilities over different time buckets of up to 1 month, 1-3 months, 3-6 months, 6 months to 1 year, 1-3 years, and over 3 years. The Group carries out stress testing periodically using the worst case scenarios to assess the effects of changes in market conditions on the liquidity of the Group. As a strategy the Group maintains a large customer base and good customer relationships.

The Treasury Department, in conjunction with Risk and Compliance Unit periodically reviews/updates (at least annually) the liquidity risk strategy which is evaluated by ALCO before presenting to the EXCOM and the Board for approval.

#### 3.10.5 Liquidity risk measurement tools

The Group uses a combination of techniques for measurement of its liquidity risk. These include liquidity gap analysis, liquidity ratio limits and minimum liquidity guidelines.

#### 3.10.6 Liquidity risk monitoring

The Group has set the tolerance for liquidity risk which are communicated to the Risk and Compliance Unit and Treasury Department. Based on these tolerances, Risk and Compliance Unit and Treasury have established appropriate risk limits that maintain the Group's exposure within the strategic risk tolerances over a range of possible changes in liquidity situations.

#### 3.10.7 Liquidity limits structure

The Group uses a combination of different limits to ensure that liquidity is managed and controlled in an optimal manner. The Group has set the following limits for monitoring liquidity risks:

a. Liquidity Gap limits;
b. Liquidity Ratio limits; and
c. Minimum Liquidity Guideline ("MLG").

#### 3.10.8 Liquidity risk stress testing

To evaluate whether the Group is sufficiently liquid, behavior of the Group's cash flows under different conditions are observed.

#### 3.10.9 Contingency funding plan

The Group does contingency funding exercises which details procedures to be followed by the Group, in the event of a liquidity crisis or a situation where the Group faces stressed liquidity conditions. The contingency funding plan will be an extension of day to day liquidity management and involves maintenance of an adequate amount of liquid assets and management of access to funding resources. The ALCO members discuss and monitor the situation over regular time-intervals to ensure sufficient liquidity in the Group.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.10 Liquidity Risk (continued)

Table – 33. Liquidity Ratios (PD-1.3.37)

The following table summarises the liquidity ratios for the past five years;

| | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| Due from banks and financial institutions / Total Assets | 15.90% | 17.73% | 22.27% | 12.10% | 17.58% | 29.62% |
| Islamic Financing / Customer Deposits excluding banks | 72.32% | 114.41% | 115.46% | 123.01% | 144.62% | 171.72% |
| Customers Deposits / Total Assets | 68.87% | 63.08% | 64.13% | 57.28% | 48.71% | 36.04% |
| Liquid Assets / Total Assets | 21.17% | 22.70% | 27.02% | 16.06% | 23.25% | 46.29% |
| Growth in Customers Deposits | 8.36% | (11.71%) | 14.86% | 21.98% | 79.24% | 55.50% |

### 3.11 Profit Rate Risk

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.

Senior management identifies the sources of profit rate risk exposures based upon the current as well as forecasted balance sheet structure of the Group. The profit rate risk in the Group may arise due to the following transactions:

a. Murabaha transactions;

b. Wakala transactions;

c. Ijarah muntahia bittamleek;

d. Sukuk; and

e. Musharaka investments.

The Group's management believe that the Group is not exposed to material profit rate risk as a result of mismatches of profit rate repricing of assets, liabilities and equity of investment accountholders as the repricing of assets, liabilities and equity of investment accountholders occur at similar intervals. The profit distribution to equity of investment accountholders is based on profit sharing agreements. Therefore, the Group is not subject to any significant profit rate risk.

#### 3.11.1 Sources of Profit Rate Risk

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

a. Re-pricing risk which arises from timing differences in the maturity (for fixed rate) and re-pricing (for floating rate) of assets, liabilities and off balance sheet positions. As profit rates vary, these re-pricing mismatches expose the Group's income and underlying economic value to unanticipated fluctuations;

b. Yield curve risk which arises when unanticipated shifts of the yield curve have adverse effects on the Group's income and/or underlying economic value;

c. Basis risk which arises from imperfect correlation in the adjustment in the rate earned on products priced and the rate paid on different instruments with otherwise similar re-pricing characteristics. When profit rates change, these differences can give rise to unexpected changes in the cash flows and earnings spread between assets, liabilities, and off balance sheet instruments of similar maturities or re-pricing frequencies; and

d. Displaced Commercial Risk refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the liabilities, when the return on assets is under performing as compared with competitors rates.

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 3 RISK MANAGEMENT (continued)

### 3.11 Profit Rate Risk (continued)

#### 3.11.2 Profit rate risk strategy

The Group is not exposed to interest rate risk on its financial assets as no interest is charged. However, the fair value of financial assets may be affected by current market forces including interest rates. The Group recognises income on certain of its financial assets on a time-apportioned basis. As a strategy the Group:

a. has identified the profit rate sensitive products and activities it wishes to engage in;
b. has established a limit structure to monitor and control the profit rate risk of the Group;
c. measures profit rate risk through establishing maturity/re-pricing schedule that distributes profit rate sensitive assets, liabilities and off-balance sheet items in pre-defined time bands according to their maturity; and
d. makes efforts to match the amount of floating rate assets with floating rate liabilities in the banking book.

#### 3.11.3 Profit rate risk measurement tools

The Group uses the following tools for profit rate risk measurement in the banking book:

a. Re-pricing gap analysis which measures the arithmetic difference between the profit-sensitive assets and liabilities of the banking book in absolute terms; and
b. Basis Point Value ("BPV") analysis which is the sensitivity measure for all profit rate priced products and positions. The BPV is the change in net present value of a position arising from a 1 basis point shift in the yield curve. This quantifies the sensitivity of the position or portfolio to changes in profit rates.

#### 3.11.4 Profit rate risk monitoring and reporting

The Group has implemented information systems for monitoring, controlling and reporting profit rate risk. Reports are provided on a timely basis to EXCOM and the Board of Directors. The Risk and Compliance Unit monitors these limits regularly. GM-C&RM reviews the results of gap limits and exceptions, if any, and recommends corrective action to be taken which is approved by ALCO or EXCOM, according to authority parameters approved by the Board.

#### Table – 34. Profit Rate Risk in Banking Book (PD-1.3.40 (b))

The following table summarises the effect on the value of assets, liabilities and economic capital for a benchmark change of 200bp in profit rates as of 31 December 2012;

| | Effect on value of Asset BD'000 | Effect on value of Liability BD'000 | Effect on value of Economic Capital BD'000 |
|---|---|---|---|
| Upward rate shocks: | (3,958) | 9,814 | 5,856 |
| Downward rate shocks: | 3,958 | (9,814) | (5,856) |

#### Table – 35. Quantitative Indicators of Financial Performance and Position (PD-1.3.9 (b) PD-1.3.33 (d))

The following table summarises the basic quantitative indicators of financial performance for the past 5 years;

| | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| Return on average equity | (42.31%) | (17.23%) | (33.02%) | (12.64%) | 12.62% | 19.10% |
| Return on average assets | (4.33%) | (1.96%) | (4.30%) | (2.17%) | 2.91% | 4.57% |
| Cost to Income Ratio | 80.14% | 74.89% | 107.73% | 70.66% | 31.32% | 32.41% |

# BASEL II, PILLAR III DISCLOSURES

31 December 2012

## 4 GLOSSARY OF TERMS

| | |
|---|---|
| ALCO | Assets and Liabilities Committee |
| BCP | Business Continuity Plan |
| BisB | Bahrain Islamic Bank B.S.C. |
| BPV | Basis Point Value |
| CA Module | Capital Adequacy Module |
| CAR | Capital Adequacy Ratio |
| CBB | Central Bank of Bahrain |
| CRMD | Credit and Risk Management Department |
| CR & AD | Credit Review and Analysis Department |
| C&IC | Credit and Investment Committee |
| DCR | Displaced Commercial Risk |
| Excom | Executive Committee |
| CBB | Central Bank of Bahrain |
| FX | Foreign Exchange |
| GM-C&RM | General Manager-Credit and Risk Management |
| Group | Bahrain Islamic Bank B.S.C. and its subsidiaries |
| HR Committee | Human Resource Committee |
| IAH | Investment Account Holder |
| ICAAP | Internal Capital Adequacy Assessment Process |
| IFRS | International Financial Reporting Standards |
| IT Committee | Information Technology Committee |
| IRR | Investment Risk Reserve |
| MLG | Minimum Liquidity Guidelines |
| PCD | Prudential Consolidation and Deduction Requirements Module |
| PD | Public Disclosure |
| PER | Profit Equalisation Reserve |
| PSIA | Profit Sharing Investment Account |
| RCSA | Risk and Control Self-Assessment |
| RMC | Risk Management Committee |
| RWE | Risk Weighted Exposures |
| VaR | Value-at-Risk |
| L/C | Letter of Credit |
| L/G | Letter of Guarantee |