ANNUAL REPORT **2013**

بنك البحرين الإسلامي BisB

POISED ON THE THRESHOLD OF A NEW ERA

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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

A NEW ERA

With a number of key strategic developments taking place during 2013, Bahrain Islamic Bank stands poised on the threshold of a new era. Two prominent Bahrain-based institutions – the National Bank of Bahrain and the Social Insurance Organisation – now hold a controlling stake in the Bank; while BisB successfully met its objective to return to profitability during the year. The Bank also opened its first two purpose-designed financial malls that will provide a new concept in retail banking with an enhanced customer experience.

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.

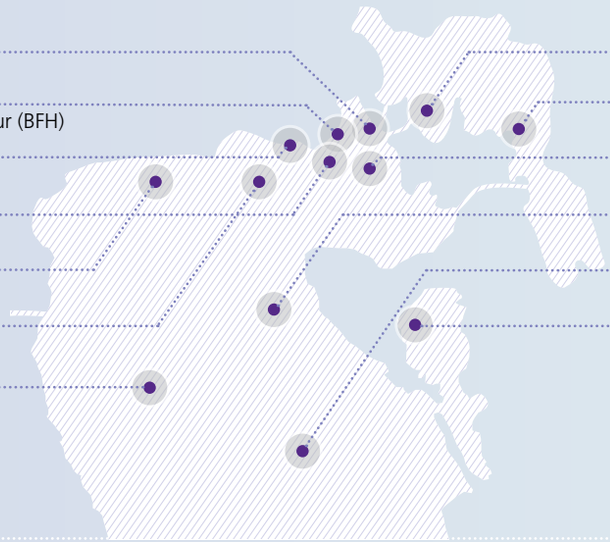
Vision

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



Bahrain Islamic Bank → **13** Branches → **2** Financial Malls → **56** ATMs

FINANCIAL HIGHLIGHTS

Total Asset
BD Million

2013: **910**
2012: **833**
2011: **839**
2010: **936**
2009: **912**

Islamic financing
BD Million

2013: **437**
2012: **415**
2011: **392**
2010: **414**
2009: **438**

Total operating income
BD Million

2013: **48**
2012: **38**
2011: **41**
2010: **35**
2009: **42**

Investors' share in income
BD Million

2013: **11**
2012: **14**
2011: **15**
2010: **18**
2009: **18**

Investments
BD Million

2013: **201**
2012: **210**
2011: **233**
2010: **239**
2009: **293**

Unrestricted investment accounts
BD Million

2013: **713**
2012: **661**
2011: **638**
2010: **741**
2009: **680**

Book value per share
BD fils

2013: **84**
2012: **75**
2011: **108**
2010: **138**
2009: **194**

Share price
BD fils

2013: **136**
2012: **82**
2011: **90**
2010: **129**
2009: **196**

OPERATIONAL HIGHLIGHTS

1 Retail Banking increases market share

BisB outperformed the CBB consumer finance index for the fifth consecutive year, with the Bank's finance portfolio growing by 16.1% compared with 11.46% for the CBB index. Other retail banking achievements include higher-than-forecast net income and lower cost of funding; growth across all main product lines; and an increase in the client base resulting in improved market share.

2 Corporate Banking grows client relationships

Key corporate banking achievements include an increase in market share resulting from the booking of substantial new assets; and growing the number of financing relationships by 45%; which led to a doubling in fee-based income. Good progress was also made in the area of project financing, with the development of a healthy pipeline of mandates.

3 New Financial Malls and eKiosks launched

Key customer service initiatives in 2013 included the opening of the first two Financial Malls, which offer a convenient 'one-stop-service' for customers, and provide the highest levels of functionality and comfort to ensure an enhanced customer experience. The Bank also launched its new eKiosks which offer convenient access to online banking and credit card payment services.

4 Bank's employment of Bahrainis recognised

BisB received a prestigious award for its outstanding role in providing employment opportunities for Bahraini nationals. The award was presented at the "12th Ceremony in Recognition of the Role of the Private Sector in the Localisation of Jobs", which took place on the sidelines of the 30th session of the GCC Ministers of Labour Council held in Bahrain in October 2013.

5 New BisB website wins further awards

The Bank's new website, which was formally launched in 2013, won three prestigious industry awards: The Interactive Media Award 2013 – Best in Class for Banking; the 2013 Award for Outstanding Achievement in Web Development from the Web Marketing Association; and the eGovernment Authority's Bahrain eContent Award 2013 for best website content for eBanking services.

6 Helping to define Islamic Finance

In 2013, BisB published an Arabic language book detailing all the fatwas issued by the Bank since inception, and which features on the Reuters Thompson website. The Bank also issued the English translation of Al Mufeed, a recent Arabic language publication that provides helpful and comprehensive coverage of Islamic Finance definitions.

CHAIRMAN'S STATEMENT

"The year 2013 proved to be pivotal for the Bank, marked by a welcome return to profitability, and a major change to our shareholder structure."

Abdul Razak Abdulla Hassan Al Qassim
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 2013. The year 2013 proved to be pivotal for the Bank, which was marked by a welcome return to profitability and a major change in our shareholding structure.

I am delighted to report that BisB met its planned objective to return to profitability during 2013. Net profit for the year was BD 6.1 million, compared with a net loss of BD 36.1 million in 2012; while total income increased to BD 36.9 million from BD 24.4 million the previous year. Earnings per share were 6.52 Bahraini fils against a loss of 38.67 fils per share in 2012.

The Bank achieved strong growth in business, with total assets increasing by 9.3 per cent to BD 910 million at the end of 2013, while shareholders' equity grew by 11.89 per cent to BD 78.1 million. The Bank's liquidity remained healthy, rising to BD 172 million by the end of the year. Pursuing a prudent and conservative approach, BisB made provisions totaling BD 11 million in 2013 which is considerably lower than the provision of BD 41.1 million made in 2012. This has been the result of measures taken during the year to address non-performing assets.

In another year of challenging market conditions, I am pleased to report that BisB improved its competitive edge in Bahrain's commercial banking sector during 2013. The Bank increased its overall market share, launched new eBanking products and introduced new customer service initiatives, including the opening of two new financial malls. At the same time, BisB continued to strengthen its corporate governance and risk management frameworks and enhance its investment in people and information technology. The Bank also maintained its enduring contribution to the economic and social well-being of the Kingdom of Bahrain and the development of the Islamic banking industry, through its enlightened corporate social responsibility programme.

In a significant strategic development during the year, National Bank of Bahrain and Social Insurance Organisation each acquired 25.8 cent in BisB from The Investment Dar Company of Kuwait. This major change in the shareholding structure, with the active involvement of new Bahrain-based strategic partners, will generate positive business synergies and financial results for the Bank and its stakeholders. At the Bank's Annual General Meeting in July 2013, a new Board of Directors was appointed, and I am honoured to have been elected as the new Chairman. I pledge my best efforts in working with my fellow Board Members to guide and sustain the future business growth and strategic development of BisB.

The Board of Directors are currently in the process of drawing up a new strategy and business model which aims to expand the Bank's activities, increase market share, grow revenues and diversify risks, in order to provide enhanced value to shareholders.

Looking ahead, the economic outlook for the Kingdom of Bahrain and the GCC remains positive. Bahrain is well-positioned to continue achieving steady and sustainable economic growth; while the GCC economies are forecasted to continue growing at a faster rate than the rest of the MENA region. Continued growth in the local and regional economy will benefit business and trade and have a strong positive effect on the banking and financial services industry. We, therefore, remain optimistic for the prospects of BisB in 2014 as we prepare to enter a new chapter in the Bank's long and pioneering history.

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 reforms; and also for their encouragement to the Islamic banking sector. Our thanks are also due to the Central Bank of Bahrain and 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.

Abdul Razak Abdulla Hassan Al Qassim
Chairman

BOARD OF DIRECTORS

1
Mr. Abdul Razak Abdulla Al Qassim
Chairman

2
Brig. Khalid Mohammed Al Mannai
Vice Chairman and Head of Executive Committee

3
Mr. Khalil Ebrahim Nooruddin
Board Member

4
Mrs. Fatima Abdulla Budhaish
Board Member

1. Mr. Abdul Razak Abdulla Al Qassim

Chairman
Non-Executive & Non-Independent Director
Appointed on 7 July 2013

Mr. Abdul Razak Al Qassim is the Chief Executive Officer and Board member of National Bank of Bahrain (NBB). He joined NBB in 1977 after nine years with Chase Manhattan Bank and Standard Chartered Bank. Abdul Razak Al Qassim is Chairman of the Board of Directors of Bahrain Islamic Bank (BisB); Chairman of Benefit Company; Chairman of Bahrain Association of Banks; Board Member, Chairman of Executive Committee, Member of Donation Committee and Member of Nomination and Remuneration Committee at Bahrain Telecommunication Company (Batelco); Board Member of Umniah Mobile Company (Jordan); Board Member of Dhivehi Raajeyge Gulhn plc (Dhiraagu), Maldives; Board Member of Sure Guernsey Limited; Board Member of Sure Jersey Limited; Board Member of Sure Isle of Man Limited; Board Member of the Crown Prince International Scholarship Programme; Board Member of Deposit and URIA Protection Board at Central Bank of Bahrain. He holds a Master's degree in Management Sciences and a Sloan Fellowship from MIT (Massachusetts Institute of Technology), USA.

2. Brig. Khalid Mohammed Al Mannai

Vice Chairman
Non-Executive &Non-Independent Director
Appointed on 7 July 2013

Brigadier Khalid Mohammed Al Mannai is the General Manager of the Bahrain Military Pension Fund, and one of the co-founders of the GCC Expanded Military Pension Coverage Committee. He joined the Military Pension Fund after spending 30 years with the Bahrain Defense Force. Brigadier Al Mannai is a Board Member of Bahrain Telecommunications Company (Batelco), the Social Insurance Organisation (SIO) and Osool Asset Management Company.. He holds a MBA from Sheffield Hallam University, UK; and has over 33 years' professional experience.

4. Mrs. Fatima Abdulla Budhaish

Board Member
Non-Executive & Non-Independent Director
Appointed on 7 July 2013

Mrs. Fatima Abdulla Budhaish is Head of Credit Risk at the National Bank of Bahrain (NBB). She joined NBB in 2004, and worked in various capacities before taking up her current position as Assistant General Manager in 2013. Prior to this, she spent five years with BBK. A Certified Public Accountant (USA), Mrs. Budhaish holds an Executive MBA from the University of Bahrain; and attended the Gulf Executive Development Programme at Darden School of Business, University of Virginia, USA. She has over 15 years' professional experience.

3. Mr. Khalil Ebrahim Nooruddin

Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Khalil Ibrahim Nooruddin is an experienced banker, at both an executive and board level. Currently, he is the Managing Partner of Capital Knowledge, a consulting and training company. Over the past five years, he has concluded several consulting assignments for financial institutions, working on strategy formulation and implementation. Prior to this, Khalil Nooruddin worked for Investcorp Bank, Bahrain; UBS Asset Management in London and Zurich; and Chase Manhattan Bank in Bahrain. He is an active member of several civil and professional societies in Bahrain, and serves as President of the Bahrain CFA Society. A Chartered Financial Analyst, Mr. Nooruddin holds an MSc in Quantitative Analysis from the Stern Business School at New York University, USA; and a BSc in Systems Engineering from the King Fahd University of Petroleum & Minerals, Saudi Arabia. He has over 35 years' professional experience.

5
Mr. Talal Ali Al Zain
Board Member

6
Mr. Othman Ebrahim Naser Al Askar
Board Member

7
Mr. Ebrahim Hussain Ebrahim Abdul Rahman
Board Member and Head of Audit Committee

8
Mr. Mohammed Ahmed Al Khaja
Board Member

5. Mr. Talal Ali Al Zain

Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Talal Ali Al Zain is Chief Executive Officer of PineBridge Investments Middle East BSC (c), and Co-Head of Alternative Investments at PineBridge Investments. Prior to this, he was Board Member and CEO of Bahrain Mumtalakat Holding Company; having previously spent 18 years with Investcorp Bank as Managing Director and Co-Head of Placement & Relationship Management. Talal was Vice President of Private Banking international and Head of Investment Banking Middle East with Chase Manhattan Bank; as well as a Corporate Banker with Citibank Bahrain. Talal Al Zain is a Board Member of the Bahrain Economic Development Board, the Bahrain Islamic Bank and the Bahrain Association of Banks. He previously chaired and served as a board member on many corporations including McLaren, Gulf Air and the Bahrain International Circuit.
He holds an MBA in Finance from Mercer University, Atlanta, USA; a BA in Business Administration (majoring in Accounting) from Oglethorpe University, Atlanta, USA.

6. Mr. Othman Ebrahim Naser Al Askar

Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Othman Ebrahim Al Askar is the Director of the Investment department of Waqf public foundation of the State of Kuwait. He joined the awqaf foundation 1995, and held various positions before taking up his current post in 2010. Prior to this, he was Head of the Investment and Banks Department at Kuwait Public Transport Company. Othman Al Askar is a Board Member of the Educational Holding Group, Kuwait; and a former Board Member of Rasameel Structured Finance Company, Kuwait. He holds a BSc in Business Administration and Economics from the Washington Center University, USA; and has over 26 years' professional experience.

8. Mr. Mohammed Ahmed Al Khaja

Board Member
Non-Executive &Non-Independent Director
Appointed on 7 July 2013

Mr. Mohammed Ahmed AlKhaja is the Head of Fund Management at Osool Asset Management Company. Prior to Osool, he held senior management positions at Credit Suisse AG-Bahrain Branch and Credit Suisse AG-Dubai. He started his career at HSBC Middle East, before moving to Merrill Lynch-Bahrain. Mohammed Al Khaja is a Board Member, Chairman of the Nomination & Remuneration Committee and Audit Committee Member at both the Medgulf Group and Medgulf Allianz Takaful. He holds a Bachelor's degree in Accounting from the University of Bahrain, and is accredited to the National Association of Securities Dealers and the National Futures Association. Mr.AlKhaja has more than 15 years' professional experience.

7. Mr. Ebrahim Hussain Ebrahim

Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Ebrahim Hussain Ebrahim was the Chief Executive Officer & Board Member of Khaleeji Commercial Bank until June 2012, and continued as Board Member until July 2013. Prior to this, he was Chief Executive Officer of the Liquidity Management Centre. Previously, at the Arab Banking Corporation, he held the positions of Vice President-Global Marketing Unit, Vice President-Treasury & Marketable Securities Department, and General Manager-ABC Securities. He has also worked for BBK Financial Services Company, and Shamil Bank. Ebrahim Hussain is a Board Member of First Energy Bank, Bahrain; and Gulf Real Estate Company, Saudi Arabia. He holds an MBA from the University of Bahrain and a Bachelor's degree in Economics from the University of Kuwait; and has over 32 years' experience in both conventional and Islamic banking

CHIEF EXECUTIVE'S REPORT

Due to our solid financial and operational achievements during 2013, and our concerted efforts over the past few years, BisB is now poised on the threshold of a new era of strategic growth and development.

"The recent acquisition of 52% of the bank shares in the Bank by NBB and SIO has strengthened our potential to expand the asset base, increase revenues, and improve shareholders' value."

Mohammed Ebrahim Mohammed
Chief Executive

In the name of Allah, the Most Beneficent, the Most Merciful.

I am pleased to report that BisB posted an excellent overall performance in 2013, despite increasingly competitive market conditions. As the result of proactive measures implemented during the year, we were successful in returning BisB to profitability; growing our core banking businesses; enhancing customer service; and strengthening the Bank's institutional capability.

Financial highlights

The key achievement of the year was the turnaround in the Bank's financial performance, illustrated by the posting of a net profit of BD 6.1 million compared to a net loss of BD 36.2 million in 2012, and with operating profit increasing by 25 per cent to BD 48.1 million from BD 38.5 million the previous year. The Bank's liquidity improved by over 5.2 per cent, while the cost of funding reduced by 21 per cent. Significantly, the contribution from fee and commission income increased by 26per cent, while net income from investments grew by 37.7 per cent. These results demonstrate that BisB is on the right track in terms of almost total dependence on earning and fees from core financing activities, which constitute more than 90 per cent of the Bank's total operating income. It should be noted that the Bank's revenues do not include any revaluations or unrealized profits.

Business growth

The Bank's core business activities recorded improved growth during the year.

BisB successfully increased its retail banking customer base by 1 per cent, grew its overall market share by 15 per cent, and reduced its cost of funding by 21 per cent. Islamic finances grew by 5.4 per cent, while customer deposits increased by 9.5 per cent. Excellent growth was

recorded by all main retail products. Corporate banking posted a significantly improved performance in 2013. This included increasing market share by booking new assets; and growing the number of borrowing relationships by 13.2 per cent, which led to fee-based income more than doubling.

Customer service

Given the increasingly competitive nature of banking sector in Bahrain, we intensified our focus on enhancing customer service, which is a key differentiator for the Bank. A major initiative in 2013 was the opening of the first two financial malls which offer a convenient 'one-stop-service' for customers, providing the highest levels of functionality and comfort to ensure an enhanced customer experience.

The Bank also continued to enhance the range of its eBanking services with the launch of new eKiosks. These offer convenient access to online banking and credit card payment services; provide information about ongoing product and services promotions; and incorporate a practical guide on how to use and benefit from eBanking, including internet banking, mobile banking, phone banking and point-of-sale services.

Institutional capability

During 2013, 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. This was recognised by receipt of a prestigious award at the 12th Ceremony in Recognition of the Role of the Private Sector in the Localisation of Jobs, which took place on the sidelines of the 30th session of the GCC Ministers of Labour Council held in Bahrain in October 2013.

At the same time, we further enhanced the Bank's corporate governance and risk management framework. BisB remains fully compliant with the latest regulatory

requirements of the Central Bank of Bahrain and the Ministry of Industry & Commerce.

Corporate responsibility

BisB is committed to contributing to the economic development and social well-being of the Kingdom of Bahrain through a comprehensive corporate social responsibility programme. This includes supporting the development of the global Islamic banking industry and the banking sector in the Kingdom of Bahrain by sponsoring and participating in a number of key industry events. We also published a book in Arabic on all the fatwas issued by the Bank since inception; and issued the English translation of Al Mufeed, which provides helpful and comprehensive coverage of Islamic finance definitions. During 2013, BisB also actively supported numerous charitable, educational, medical, cultural, sporting and social organisations; and encouraged staff to participate in community activities.

Future outlook

Looking ahead, we are confident about the future outlook for 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 the latest forecasts by the Economic Development Board, the Kingdom's GDP for 2013 is expected to be around 5 per cent, with robust economic expansion having been driven by substantial gains in the oil and gas sector, where output levels returned to capacity.

Overall growth is set to stabilize at around 4 per cent next year, but the contribution of the non-oil sector is set to increase significantly, with the prospect of a large increase in project spending. A number of significant undertakings are either starting or about to be launched.

This should have a positive impact on business and consumer confidence, which will in turn benefit the local banking sector and BisB.

Due to our solid achievements during 2013, and our concerted efforts over the past few years, BisB is now poised on the threshold of a new era of strategic growth and development. The recent acquisition of 52% of the bank shares in the Bank by NBB and SIO has strengthened our potential to expand the asset base, increase revenues, and improve shareholders' value. As such, with God's blessing, BisB is well positioned to take early advantage of new business opportunities as market conditions improve.

Acknowledgements

In conclusion, I would like to express my gratitude to the Board of Directors for its 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 2013.

Allah the Almighty is the Purveyor of all Success.

Mohammed Ebrahim Mohammed
Chief Executive

EXECUTIVE MANAGEMENT

1
Mohammed Ebrahim Mohammed
Chief Executive

2
Mohammed Ahmed Hassan
General Manager - Support Services

3
Khalid Mohammed Al Doseri
Chief Financial Officer

4
Abdulrahman Mohammed Turki
General Manager - Retail Banking

1. Mohammed Ebrahim Mohammed

Chief Executive

Mohammed Ebrahim Mohammed has over 36 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 Chase Manhattan Bank, Saudi National Commercial Bank and Bank Of Bahrain & Kuwait. Mohammed is a Board Member of the Liquidity Management Centre. He holds an MBA from the University of Glamorgan, Wales, UK; and attended the Gulf Executive Development Program at Darden School of Business, University of Virginia, USA and Management program with Harvard University, Boston, USA.

2. Mohammed Ahmed Hassan

General Manager - Support Services

Mohammed Hassan has 45 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.

4. Abdulrahman Mohammed Turki

General Manager - Retail Banking

Abdulrahman Turki has 43 years' experience in banking. He took up his current position as general manger Retail Banking at BisB in 2008. Prior to this, he was Head of Islamic Retail Banking at Commercial Bank of Qatar ; Abdul Rahman held various positions with a number of other prominent regional banks, after starting his career with Aluminium Bahrain. Abdulrahman holds an MBA degree from the University of Strathclyde, Scotland, UK.

3. Khalid Mohammed Al Doseri

Chief Financial Officer

Khalid Al Doseri has over 30 years' of professional experience in banking and accountancy. He took up his current position with BisB in 2003. Prior to this, he worked for Ithmar Bank for 13 years, and has started his career with Kuwait Asia Bank. Al Doseri is a Board Member of the Liquidity Management Centre, Member of Risk Committee and Chairman of Audit Committee, and was previously a Board Member and Managing Director of Islamic Bank of Yemen for the period from 2007 till 2009. Mr. Al Doseri is a Certified Public Accountant from Oregon Board of Accountancy, USA, he holds an MBA degree from University of Glamorgan, Wales - UK; and a graduate of the Gulf Executive Development Programme at Darden School of Business, University of Virginia, USA.

5
Khalid Mahmood Abdulla
Head of Internal Audit

6
Yousuf M A Karim
Acting General Manager - Corporate Banking

7
Dr Mohammed S. Belgami
Head of Credit and Risk Management

8
Nader Mohammed Albastaki
Head of Investment and Financial Institutions

9
Sameer Abdulaziz Ali Qaedi
Head of Treasury

5. Khalid Mahmood Abdulla

Head of Internal Audit

Khalid Mahmood has 19 years of experience in Accounting, Auditing, Banking and Sharia. He took up his current position with BisB in 2006. Prior to this, he was Head of Internal Audit at Al Baraka Islamic Bank, having started his career with Arthur Anderson. Khalid is a Certified Public Accountant (CPA) California, USA.

8. Nader Mohammed Albastaki

Head of Investment and Financial Institutions

Nader Albastaki has 14 years of 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 the University of Bahrain.

6. Yousuf M A Karim

Acting General Manager - Corporate Banking

Yousuf Karim has 41 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 Master's degree in Business Administration, Executive Management Diploma and Advance Banking Studies Diploma.

9- Sameer Abdulaziz Ali Qaedi

Head of Treasury

Sameer Qaedi has over 29 years' international and regional experience in managing, dealing and trading in money markets, foreign exchange and currency derivatives. He joined BisB in 1998, and took up his current position in 2013. Prior to this, he was a dealer with Bahrain Middle East Bank, after starting his career at Manufacturers Hanover Trust (now JP Morgan Chase Bank). Sameer holds an MBA degree from the Sacramento Regent University, USA; and an Advance Diploma in Islamic Banking.

7. Dr Mohammed S. Belgami

Head of Credit and Risk Management

Dr Mohammed Belgami has over 30 years' of international experience in the fields of credit analysis, risk management, valuation, due diligence and financial management; and research and academia. He joined BisB in 2008 and took up his current position in 2013. Prior to this, Dr Mohammed held senior management positions with the Saad Trading, Contracting & Financial Services Company, and Kuwait Finance House-Bahrain; as well as academic positions with institutions in Bahrain and India. A Financial Risk Manager from the Global Association of Risk Professionals, he holds a Doctoral degree and Master's and Bachelor's degrees in Finance & Accounting and Commerce.

REVIEW OF OPERATIONS

Business Divisions

Retail Banking

The retail banking business of BisB posted a strong overall performance in 2013, outperforming the CBB consumer finance index for the fifth consecutive year, with the Bank's finance portfolio growing by 16.1% compared with 11.46% for the CBB index. Key highlights, which are detailed below, include higher-than-forecast net income and lower cost of funding; a reduction in the number of non-performing loans; growth across all main product lines and services; and an increase in the client base resulting in improved market share. This performance was achieved despite the increasingly competitive nature of the sector in Bahrain, marked by excess liquidity in the market and growing pressure by customers for reduced rates of Financing.

The Bank successfully increased its retail customer base by 1%, grew its overall market share by 0.15%, and reduced its cost of funding by 21%. The excellent growth recorded by all main products during the year include Tas'heel Personal Finance growing by 17.3%, auto finance by 24.4%, mortgage financing by 35.3%, credit cards by 15.1%, the Vevo Youth Account by 34.2%, the Iqra Education Investment Scheme by 56.5%, and the Tejoori savings account by 12.7%. Another significant achievement was the continued success in encouraging customers to conduct their transactions online. In 2013, there was a 38% growth in registered eBanking customers, including an increase in credit card payments through the BENEFIT Payment Gateway.

Underpinning this strong performance was a continued focus on customer service, which acts as a key competitive differentiator for the Bank. A major initiative in 2013 was the opening of the first two Financial Malls in Arad and Budaiya. These purpose-designed malls offer a convenient 'one-stop-service' for customers, providing the highest levels of functionality and comfort to ensure an enhanced customer experience. At the same time, BisB increased the number of its Automated Teller Machines from 49 to 56, making its ATM network one of the largest in the Kingdom.

During the year, the Bank continued to enhance the range of its eBanking services. A Mobile version of Internet Banking was successfully introduced to enable customers to conduct transactions through their smart phones and tablets. Another key initiative was the launch of the new eKIOSK project, starting with the Arad Financial Mall and the Bahrain City Centre Branch. As well as offering convenient access to online banking and credit card payment services, eKIOSK provides information about ongoing product and services promotions; together with a practical guide on how to use and benefit from eBanking, including internet banking, mobile banking, phone banking and point-of-sale services.

Also during the year, the Bank's newly-introduced electronic process for financing applications, which enables customers' signatures to be captured at all financial malls and branches, resulted in a considerable reduction in approval times. Another new service that has proved to be popular with customers is the provision of Sharia'a-compliant bancassurance services from Takaful International through dedicated desks at BisB financial malls and branches.

To enable the Bank's staff to deliver the highest standards of customer service, priority continued to be placed on training and development, with a number of customised training programmes being conducted throughout 2013. These covered technical training courses for newly-appointed tellers; customer service-oriented sessions for sales staff in malls and branches; and special leadership seminars for retail managers.

Marketing plays a key role in raising awareness about the Bank, promoting products and services, and attracting new customers. During 2013, BisB conducted a series of advertising campaigns across different media; and continued its programme of visiting employees at Government ministries, and public and private sector companies. The Bank's marketing activities were recognised by the receipt of the Communicators Award, a leading international annual awards programme which recognises outstanding achievements in communications. In addition, BisB's new website scooped three awards: first, the Interactive Media Awards 2013 – Best in Class for Banking – for design and content; second, the 2013 Award for Outstanding Achievement in Web Development from the Web Marketing Association; and third, the eGovernment Authority's Bahrain eContent Award 2013 for best website content for eBanking services.

During 2013, the Bank continued to comply with the latest CBB retail banking regulatory requirements. Developments include conducting an impact assessment of the planned implementation of Foreign Account Tax Compliance Act (FATCA) for US entities and individuals; the provision of electronic readers for new GCC smart cards in malls and branches; and the independent handling of complaints, which BisB implements through its recently-established Complaints Resolution Unit of the Services & Quality Assurance Division.

Choice and convenience

Due to the increasingly competitive nature of retail banking sector in Bahrain, we intensified our focus on enhancing customer service during 2013, in order to provide customers with greater choice and convenience. BisB offers a diverse range of banking and insurance products, and a wide choice of delivery channels to suit all customers' preferences.

13
Branches

2
Financial Malls

A major initiative in 2013 was the opening of the Bank's first two Financial Malls in Arad and Budaiya, heralding a new concept in Islamic retail banking. These purpose-designed malls offer a convenient 'one-stop-service' for customers, providing the highest levels of functionality and comfort to ensure an enhanced customer experience.

A new concept in Islamic retail banking

Serving the business community

Corporate & Institutional Banking has been restructured into dedicated units responsible for corporate banking, structured finance, commercial banking and SME banking, in order to provide a more dedicated client service.

BisB supports the SME sector through the BD 35 million enterprise finance scheme in collaboration with Tamkeen. This scheme provides SMEs with capital and business advice to grow and expand, and thereby contribute to the national economy.

REVIEW OF OPERATIONS CONTINUED

Corporate & Institutional Banking

Following Board approval of the Bank's new corporate banking strategy in 2013, the Corporate & Institutional Banking Division was restructured into dedicated units responsible for corporate banking, structured finance, commercial banking and SME banking, in order to provide a more dedicated client service. In line with the new strategy, particular emphasis was placed on three key segments – corporate financing, sovereign and quasi-sovereign institutions, and small-to-medium enterprises.

This new focus, together with a more aggressive approach to new business development and marketing, resulted in a significantly improved performance during the year. Key highlights include an increase in market share resulting from the booking of substantial new assets; and growing the number of borrowing relationships by 35%; which led to a doubling in fee-based income. Good progress was also made in the area of project financing, with the development of a healthy pipeline of mandates.

Underlining this achievement was a continued focus on customer service, which serves as an important competitive differentiator for BisB. Key developments in 2013 include an encouraging response by customers to phase one of the new corporate internet banking service, which offers greater convenience and choice; and the first full year of operations by the recently-established Contact Centre for Corporate Banking clients, which provides an enhanced personal service by telephone and e-mail. In addition, corporate relationship officers were located in the new financial malls to offer dedicated support to commercial banking and SME clients.

Ongoing support for the SME sector was provided by the BD 35 million enterprise finance scheme between BisB and Tamkeen, from which over 150 enterprises have benefited to date. This scheme provides SMEs with capital and business advice to grow and expand, and thereby contribute to the national economy. Such support contributes to improving the skills and capabilities of Bahrainis employed in the SME sector, and to generating additional employment and career opportunities.

During the year, a dedicated task force continued to address the issue of delinquent accounts, and streamline the 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.

The changes to the Bank's shareholding structure during 2013, with NBB and the Social Insurance Organisation now jointly holding a majority stake, has resulted in improved market confidence in BisB. This will enable the Corporate & Institutional Banking division to compete more successfully in the corporate banking sector of the Kingdom, and continue to grow its market share. Plans for 2014 include focusing on new business accounts, expanding trade finance activities, and introducing new products which will provide BisB with a competitive edge over other market players. At the same time, the emphasis on customer service will be maintained, with the launch of phase two of corporate internet banking, and new quality control measures including a client satisfaction survey.

Treasury and Investments

Treasury

The Bank's Treasury business had another successful year in 2013, continuing to manage the Bank's liquidity and attracting increased deposits, with the foreign exchange business being a major contributor. Following the change to the shareholding structure of BisB, previous relationships were re-established with regional banks, 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 uses both Wakala and International Commodity Murabaha instruments in its interbank dealings.

BisB continued to adopt a cautious approach to proprietary trading, with a balanced portfolio focused primarily on public equities and Sukuk issues. At the end of 2013, the Bank's balance sheet footing stood at BD 910.3 million compared with BD 832.8 million at the end of the previous year, while the liquidity ratio was 25.9% against 21% in 2012.

Investments

Due to the Bank's cautious but proactive approach, net income from investments in 2013 declined to BD 1.9 million from BD 2.17 million the previous year. Income was derived from investments in local and regional Sukuk, GCC equities, and capital gains from the disposal of some fixed income and indirect private equity investments. The composition of the Bank's well-balanced investment portfolio consists of Sukuk, GCC equities, third-party funds and infrastructure projects, as well as private equity transactions on a case-by-case basis.

New website launched

In 2013, BisB formally launched its redesigned and re-engineered website, which features enhanced navigation and more comprehensive information. The new site was well received by customers, and also won a further three prestigious industry website awards.

REVIEW OF OPERATIONS CONTINUED

A key development during the year was the successful launch of the Bank's first fund. The BisB Money Market Fund is a Bahrain-domiciled Sharia'a-compliant open-ended fund created in accordance with the provisions of Volume 7 – Collective Investment Undertakings (CIU) of the Central Bank of Bahrain's Rule Book. The Fund aims to increase its Net Asset Value with the objective of generating returns in excess of USD fixed deposit rates by investing in low-risk quality Sharia'a-compliant money market instruments issued by banks, corporations and governments. Such investments may include short-term deposits in the inter-bank market; Sharia'a-compliant fixed-term deposits with banks; and all types of Sukuk issued by sovereign wealth funds and corporates approved by the Sharia'a Advisers.

Support Services

Human Capital

BisB maintained its headcount during 2013, with staff totalling 392 at the end of the year compared with 398 at the end of 2012. The number of Bahraini nationals employed by the Bank remained at 97 per cent of the total workforce – the highest of any bank in Bahrain – which was recognised by receipt of a special award by the GCC Ministers of Labour Council in 2013. 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. During 2013, compensation packages for branch and financial mall staff were revised to match current market rates; while benefits such as annual leave, maternity leave, nursery leave, funeral leave and Hajj leave were adjusted to comply with latest changes to the Labour Law of the Kingdom of Bahrain.

The Bank's performance management appraisal system was thoroughly reviewed, and a special training programme was developed for newly-appointed managers, covering aspects such as conducting appraisals and setting objectives. Also during the year, BisB commenced the implementation of a new HR management system.

Training and Development

BisB continued to invest in the training and development of its people during 2013. The main training focus was on leadership and customer service, and on supporting staff to gain professional qualifications. During the year, five Retail Banking staff achieved accreditation to the Chartered Institute of Insurance, while another five employees received financial services (CFA and CPA) and human resources (HRME) certifications. A number of special workshops were conducted during the year, covering customer service, quality assurance, anti-money laundering and first aid. The Bank also continued to participate in Tamkeen-sponsored seminars, workshops and conferences. The total number of training hours delivered in 2013 was over 9000, with more than 75 per cent of staff attending training during the 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 ongoing support for a number of customer services and internal processes. These include enhanced mobile banking services; the launch of new eKiosks; the opening of two new financial malls; expansion of the ATM network; and implementation of the electronic approval system, and the cheque clearance system. Also during the year, the Bank commenced the installation of new systems for HR, payables and procurement, and collections to further enhance efficiency through automation.

Particular attention continued to be paid to strengthening information security (IS). New IS policies and procedures were developed for review by Internal Audit and subsequent approval by the Board of Directors; while a new process for identifying any potential security breach in the Bank's IT environment was implemented. An external penetration test, internal vulnerability assessment, and an application penetration test were successfully carried out on the IT infrastructure, covering servers, network devices, desktops and laptops, applications, and databases. Additional enhancements to the Bank's data centre and disaster recovery site are also in the implementation stage. These developments fall under the newly-developed information security framework which is being designed in accordance with BS ISO / IEC 17799:2005 guidelines.

Central Operations

During the year, the Bank continued to enhance 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 compliance with Central Bank of Bahrain Circulars; treasury back office and inward remittances and payments; financing approvals; and cheque clearance and SWIFT transactions. The overall level of automation within the Bank increased to 74 per cent in 2013.

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 2013 include the opening of new financial malls at Arad and Budaiya; continued upgrading of the branch network; ongoing refurbishment of head office departments; and replacement of the marble cladding at Al Salam Tower with aluminium, which is both safer and maintenance-free. Designs were also approved for renovating the head office entrance area, and the planting areas and walkways around the building, to provide a more efficient and pleasant environment for visitors.

Corporate Communications

In 2013, BisB formally launched its redesigned and re-engineered website, which features enhanced information and functionality. The new site was well received by customers, and also won three prestigious industry awards: The Interactive Media Award 2013 – Best in Class for Banking; the 2013 Award for Outstanding Achievement in Web Development from the Web Marketing Association; and the eGovernment Authority's Bahrain eContent Award 2013 for best website content for eBanking services. In addition, BisB was honoured by the annual Communicators Awards for the quality of its marketing communications activities. Particular attention was paid to corporate culture and internal communications during the year, with the launch of a weekly message service for staff, the provision additional staff social programmes, and the development of social networking services for employees. The Bank continued to enhance its relationships with the media and other banks, and actively participated in industry conferences and seminars.

Delivering outstanding customer service

To enable the Bank's staff to deliver the highest standards of customer service, priority is placed on training and development. Tailored programmes cover technical training courses for newly-appointed tellers; customer service-oriented sessions for sales staff in malls and branches; and special leadership seminars for retail managers. The number of Bahraini nationals employed by BisB account for 97 per cent of the total workforce – the highest of any bank in Bahrain.

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 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.

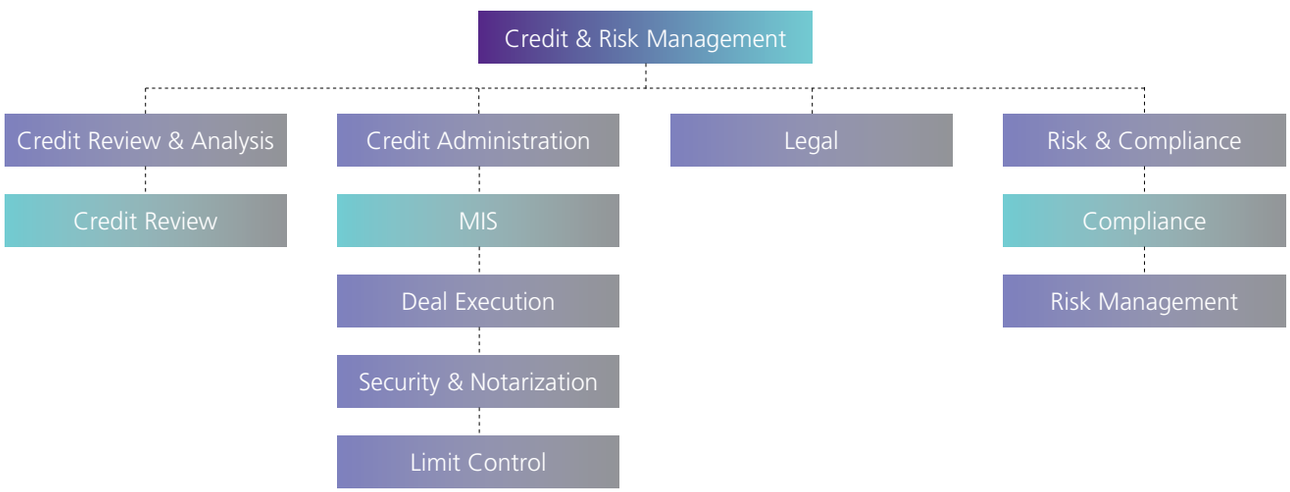
The Board of Directors retains ultimate responsibility and authority for all risk matters, including establishing overall policies and procedures. The Board is assisted in fulfilling its responsibilities by the Chief Executive, and various Board-level and Management committees.

The Credit & Risk Management (C&RM) division, headed by an Assistant 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 2013

- Implementation of approved Risk Management Framework, Credit Risk Policy & Procedures, and Provisioning Policy
- Augmentation and testing of Business Continuity and Disaster Recovery Plan
- Review of Financing Product Criteria
- Credit Reference Bureau reporting for corporate customers
- Conducted and reported to CBB on Basel III Quantitative Impact Study assessment
- Participation in the Basel III working group set up by the Central Bank of Bahrain
- Ensuring ongoing compliance with the rules and regulations of the Central Bank of Bahrain 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 development 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 during 2013 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:

- 2013 AAOIFI-World Bank Annual Conference on Islamic Banking & Finance
- 2013 World Islamic Banking Conference
- 2013 Global Islamic Finance Directory
- Bahrain Association of Banks activities

Developing Bahraini nationals

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

- Injaz Bahrain
- Waqf Fund for Islamic Banking Training and Development (BIBF)
- Enterprise Finance Scheme For SMEs in collaboration with Tamkeen
- Ministry of Education training initiatives
- Summer Internship programme for Bahraini university students.
- Students' trips to underdeveloped countries
- Youth conferences and workshops.

In 2013, BisB received a prestigious award for its outstanding role in providing employment opportunities for Bahraini citizens. The award was presented at the 12th Ceremony in Recognition of the Role of the Private Sector in the Localisation of Jobs, which took place on the sidelines of the 30th session of the GCC Ministers of Labour Council held in Bahrain in October 2013.

Increasing the awareness of Islam

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

- Rekaaz Bahrain 2013
- Hijab campaign 2013
- Ministry of Justice & Islamic Affairs Zakat Campaign
- Quran Education Centres
- Muslim Education Society
- Discover Islam

In 2013, BisB published a book in Arabic on all the fatwas issued by the Bank since inception, and which features in a special page on the Reuters Thompson website. The Bank also issued the English translation of Al Mufeed, which provides helpful and comprehensive coverage of Islamic finance definitions.

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 through:

- 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

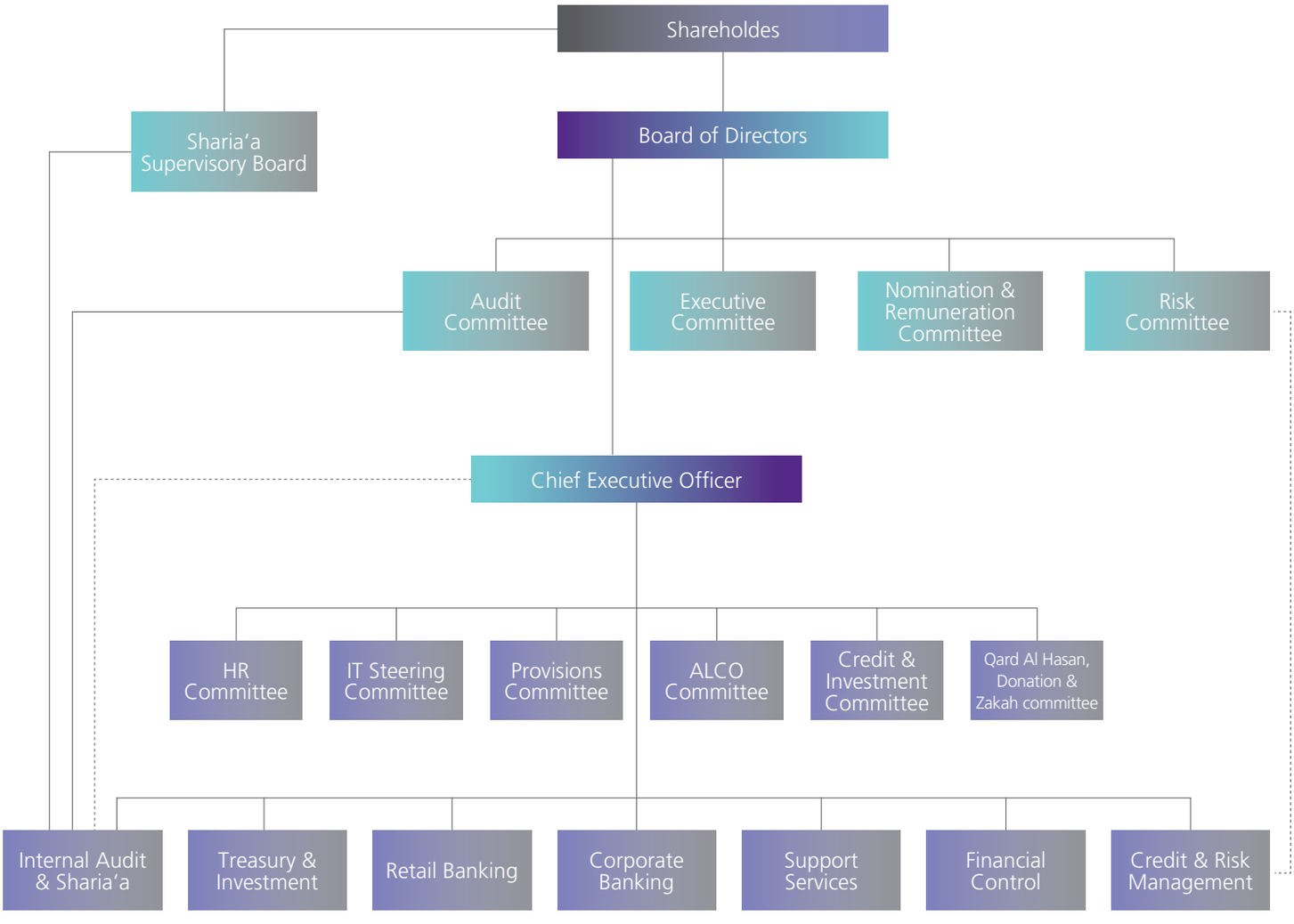
CORPORATE GOVERNANCE REVIEW

Bahrain Islamic Bank is committed to upholding the highest standards of corporate governance and the Central bank of Bahrain's highest-level control module (and its amendments). 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.

Developments In 2013

- Impact assessment of the planned implementation of Foreign Account Tax Compliance Act (FATCA)
- Provision of electronic readers for new GCC smart cards in malls and branches
- Independent handling of complaints, which BisB implements through its Complaints Resolution Unit of the Services & Quality Assurance Division.

Governance and Organisation Structure



Shareholder Ownership (5% and above) as at 31 December 2013

Shareholder	Nationality	Number of Shares	Percentage
National Bank of Bahrain	Bahrain	241,838,206	25.76%
Islamic Development Bank	Saudi Arabia	165,804,485	17.65%
Social Insurance Organisation (Military Pension Fund)	Bahrain	121,113,559	12.89%
Social Insurance Organisation (GOSI)	Bahrain	121,019,103	12.89%
Kuwait Awqaf Public Foundation	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 7 July 2013.

Profiles of Board Members

Mr. Abdul Razak Abdulla Al Qassim

Chairman
Non-Executive & Non-Independent Director
Appointed on 7 July 2013

Mr. Abdul Razak Al Qassim is the Chief Executive Officer and Board member of National Bank of Bahrain (NBB). He joined NBB in 1977 after nine years with Chase Manhattan Bank and Standard Chartered Bank. Abdul Razak Al Qassim is Chairman of the Board of Directors of Bahrain Islamic Bank (BisB); Chairman of Benefit Company; Chairman of Bahrain Association of Banks; Board Member, Chairman of Executive Committee, Member of Donation Committee and Member of Nomination and Remuneration Committee at Bahrain Telecommunication Company (Batelco); Board Member of Umniah Mobile Company (Jordan); Board Member of Dhivehi Raajeyge Gulhn plc (Dhiraagu), Maldives; Board Member of Sure Guernsey Limited; Board Member of Sure Jersey Limited; Board Member of Sure Isle of Man Limited; Board Member of the Crown Prince International Scholarship Programme; Board Member of Deposit and URIA Protection Board at Central Bank of Bahrain. He holds a Master's degree in Management Sciences and a Sloan Fellowship from MIT (Massachusetts Institute of Technology), USA.

Brig. Khalid Mohammed Al Mannai

Vice Chairman
Non-Executive &Non-Independent Director
Appointed on 7 July 2013

Brigadier Khalid Mohammed Al Mannai is the General Manager of the Bahrain Military Pension Fund, and one of the co-founders of the GCC Expanded Military Pension Coverage Committee. He joined the Military Pension Fund after spending 30 years with the Bahrain Defense Force. Brigadier Al Mannai is a Board Member of Bahrain Telecommunications Company (Batelco), the Social Insurance Organisation (SIO) and Osool Asset Management Company.. He holds a MBA from Sheffield Hallam University, UK; and has over 33 years' professional experience.

Mr. Khalil Ebrahim Nooruddin

Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Khalil Ibrahim Nooruddin is an experienced banker, at both an executive and board level. Currently, he is the Managing Partner of Capital Knowledge, a consulting and training company. Over the past five years, he has concluded several consulting assignments for financial institutions, working on strategy formulation and implementation. Prior to this, Khalil Nooruddin worked for Investcorp Bank, Bahrain; UBS Asset Management in London and Zurich; and Chase Manhattan Bank in Bahrain. He is an active member of several civil and professional societies in Bahrain, and serves as President of the Bahrain CFA Society. A Chartered Financial Analyst, Mr. Nooruddin holds an MSc in Quantitative Analysis from the Stern Business School at New York University, USA; and a BSc in Systems Engineering from the King Fahd University of Petroleum & Minerals, Saudi Arabia. He has over 35 years' professional experience.

CORPORATE GOVERNANCE REVIEW CONTINUED

Mrs. Fatima Abdulla Budhaish
Board Member
Non-Executive & Non-Independent Director
Appointed on 7 July 2013

Mrs. Fatima Abdulla Budhaish is Head of Credit Risk at the National Bank of Bahrain (NBB). She joined NBB in 2004, and worked in various capacities before taking up her current position as Assistant General Manager in 2013. Prior to this, she spent five years with BBK. A Certified Public Accountant (USA), Mrs. Budhaish holds an Executive MBA from the University of Bahrain; and attended the Gulf Executive Development Programme at Darden School of Business, University of Virginia, USA. She has over 15 years' professional experience.

Mr. Mohammed Ahmed Al Khaja
Board Member
Non-Executive &Non-Independent Director
Appointed on 7 July 2013

Mr. Mohammed Ahmed AlKhaja is the Head of Fund Management at Osool Asset Management Company. Prior to Osool, he held senior management positions at Credit Suisse AG-Bahrain Branch and Credit Suisse AG-Dubai. He started his career at HSBC Middle East, before moving to Merrill Lynch-Bahrain. Mohammed Al Khaja is a Board Member, Chairman of the Nomination & Remuneration Committee and Audit Committee Member at both the Medgulf Group and Medgulf Allianz Takaful. He holds a Bachelor's degree in Accounting from the University of Bahrain, and is accredited to the National Association of Securities Dealers and the National Futures Association. Mr.AlKhaja has more than 15 years' professional experience.

Mr. Talal Ali Al Zain
Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Talal Ali Al Zain is Chief Executive Officer of PineBridge Investments Middle East BSC (c), and Co-Head of Alternative Investments at PineBridge Investments. Prior to this, he was Board Member and CEO of Bahrain Mumtalakat Holding Company; having previously spent 18 years with Investcorp Bank as Managing Director and Co-Head of Placement & Relationship Management. Talal was Vice President of Private Banking international and Head of Investment Banking Middle East with Chase Manhattan Bank; as well as a Corporate Banker with Citibank Bahrain. Talal Al Zain is a Board Member of the Bahrain Economic Development Board, the Bahrain Islamic Bank and the Bahrain Association of Banks. He previously chaired and served as a board member on many corporations including McLaren, Gulf Air and the Bahrain International Circuit.

He holds an MBA in Finance from Mercer University, Atlanta, USA; a BA in Business Administration (majoring in Accounting) from Oglethorpe University, Atlanta, USA.

Mr. Othman Ebrahim Naser Al Askar
Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Othman Ebrahim Al Askar is the Director of the Investment department of Waqf public foundation of the State of Kuwait. He joined the awqaf foundation 1995, and held various positions before taking up his current post in 2010. Prior to this, he was Head of the Investment and Banks Department at Kuwait Public Transport Company. Othman Al Askar is a Board Member of the Educational Holding Group, Kuwait; and a former Board Member of Rasameel Structured Finance Company, Kuwait. He holds a BSc in Business Administration and Economics from the Washington Center University, USA; and has over 26 years' professional experience.

Mr. Ebrahim Hussain Ebrahim
Board Member
Non-Executive & Independent Director
Elected on 7 July 2013

Mr. Ebrahim Hussain Ebrahim was the Chief Executive Officer & Board Member of Khaleeji Commercial Bank until June 2012, and continued as Board Member until July 2013. Prior to this, he was Chief Executive Officer of the Liquidity Management Centre. Previously, at the Arab Banking Corporation, he held the positions of Vice President-Global Marketing Unit, Vice President-Treasury & Marketable Securities Department, and General Manager-ABC Securities. He has also worked for BBK Financial Services Company, and Shamil Bank. Ebrahim Hussain is a Board Member of First Energy Bank, Bahrain; and Gulf Real Estate Company, Saudi Arabia. He holds an MBA from the University of Bahrain and a Bachelor's degree in Economics from the University of Kuwait; and has over 32 years' experience in both conventional and Islamic banking

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

Due to the change in shareholders Structure, the board has reconstituted the following committee and notified the same to the CBB. Each of these committees has its own Charter that describes the responsibilities of its members.

Board Committees – Membership & Objectives

Board Committee	Members	Objectives
Executive Committee	Khalid Mohammed Al-Mannai (Chairman) Fatima Abdulla Budhaish Khalil Ebrahim Nooruddin Mohammed Ebrahim (CEO) - Non - voting member	Review of strategy and performance. Review of new investment proposals, credit proposals, and exit strategies. Review of risk, provision and impairments.
Audit Committee (including Corporate Governance Committee responsibilities)	Ebrahim Hussain Ebrahim (Chairman) Othman Ebrahim Al-Askar Mohammed Al Zarrouq Rajab	Oversight of integrity and reporting of the Bank's quarterly and annual financial statements. Review of risk, provision and impairment Compliance with legal and regulatory requirements.
Nomination and Remuneration Committee	Abdul Razaq Abdulla Al-Qassim (Chairman) Khalid Mohammed Al-Mannai Mohammed Ahmed Abdulla	Oversight of the compensation and remuneration policy. Oversight of recruitment, and promotion of key personnel and board member.
Risk Management Committee	Talal Ali Al-Zain (Chairman) Fatima Abdulla Budhaish Mohammed Ahmed Abdulla	Monitoring the enterprise-wide risk profile independently, and providing risk guidance to the Board and Management periodically.

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 Committee expressed its satisfaction with the positive results.

Directors' Remuneration

The aggregate Board sitting fees, including travel expenses, totalled BD 348 thousands in 2013.

Directors' Attendance

The Board of Directors met nine times during 2013, 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 2013. The table also shows attendance of Directors at Board Committee meetings.

CORPORATE GOVERNANCE REVIEW CONTINUED

Directors' Attendance of Board Meetings – January to December 2013

Members	11 Feb	26 Mar	18 Jun	7 Jul	16 Jul	16 Sep	17 Sep	28 Oct	19 Dec
Abdul Razaq Al-Qassim (Joined 05 June 2013)				✓	✓	✓	✓	✓	✓
Khalid Al-Mannai (Joined 11 June 2013)				✓	✓	✓	x	✓	✓
Fatima Budhaish (Joined 05 June 2013)				✓	✓	✓	✓	✓	✓
Mohammed Abdulla (Joined 11 June 2013)				✓	✓	✓	✓	✓	✓
Talal Al-Zain (Joined 07 July 2013)				✓	✓	x	x	✓	✓
Khalil Nooruddin (Joined 07 July 2013)				x	✓	✓	✓	✓	✓
Ebrahim Hussain (Joined 07 July 2013)				✓	✓	✓	✓	✓	✓
Othman Al-Askar (Joined 07 July 2013)				✓	x	✓	✓	✓	✓
Moh'd Alzarrouq Rajab	x	x	x	x	x	x	x	x	x
Khalid Al-Bassam (Resigned 07 July 2013)	✓	✓	✓						
Nabeel Amin (Resigned 20 May 2013)	✓	✓							
Khalid Najeebi (Resigned 07 July 2013)	✓	✓							
Ali Al Olaimi (Resigned 07 July 2013)	✓	✓	✓						
Ghassan Al-Baraheem (Resigned 07 July 2013)	✓	✓	✓						
Abdulla Al-Homaidhi (Resigned 20 May 2013)	✓	✓							
Adnan Al-Nisif (Resigned 20 May 2013)	✓	✓							
Ismaeel Amin (Resigned 07 July 2013)	✓	✓	✓						

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 Board members are listed in page 31 in this annual report.

Sharia'a Supervisory Board – Membership and Attendance 2013

Members	10 Mar	02 Jun	03 Dec	26 Dec
Sh. Dr. Abdulatif Al-Mahmood*	✓	✓	✓	✓
Sh. Moh'd Al-Jufairi	✓	✓	✓	✓
Sh. Adnan Al-Qattan	✓	✓	✓	✓
Sh. Nidham Yacoubi	x	x	✓	✓
Sh. Dr. Esam Al-Enizi	✓	✓	✓	✓

*Chairman

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

1- Mohammed Ebrahim Mohammed

Chief Executive

Mohammed Ebrahim Mohammed has over 36 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 Chase Manhattan Bank, Saudi National Commercial Bank and Bank Of Bahrain & Kuwait. Mohammed is a Board Member of the Liquidity Management Centre. He holds an MBA from the University of Glamorgan, Wales, UK; and attended the Gulf Executive Development Program at Darden School of Business, University of Virginia, USA and Management program with Harvard University, Boston, USA.

2- Mohammed Ahmed Hassan

General Manager - Support Services

Mohammed Hassan has 45 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 43 years' experience in banking. He took up his current position as general manger Retail Banking at BisB in 2008. Prior to this, he was Head of Islamic Retail Banking at Commercial Bank of Qatar ; Abdul Rahman held various positions with a number of other prominent regional banks, after starting his career with Aluminium Bahrain. Abdulrahman holds an MBA degree from the University of Strathclyde, Scotland, UK.

4- Yousuf M A Karim

Acting General Manager - Corporate Banking

Yousuf Karim has 41 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 Master's degree in Business Administration, Executive Management Diploma and Advance Banking Studies Diploma.

5- Khalid Mohammed Al Doseri

Chief Financial Officer

Khalid Al Doseri has over 30 years' of professional experience in banking and accountancy. He took up his current position with BisB in 2003. Prior to this, he worked for Ithmar Bank for 13 years, and has started his career with Kuwait Asia Bank. Al Doseri is a Board Member of the Liquidity Management Centre, Member of Risk Committee and Chairman of Audit Committee, and was previously a Board Member and Managing Director of Islamic Bank of Yemen for the period from 2007 till 2009. Mr. Al Doseri is a Certified Public Accountant from Oregon Board of Accountancy, USA, he holds an MBA degree from University of Glamorgan, Wales - UK; and a graduate of the Gulf Executive Development Programme at Darden School of Business, University of Virginia, USA.

6- Dr Mohammed S. Belgami

Head of Credit and Risk Management

Dr Mohammed Belgami has over 30 years' of international experience in the fields of credit analysis, risk management, valuation, due diligence and financial management; and research and academia. He joined BisB in 2008 and took up his current position in 2013. Prior to this, Dr Mohammed held senior management positions with the Saad Trading, Contracting & Financial Services Company, and Kuwait Finance House-Bahrain; as well as academic positions with institutions in Bahrain and India. A Financial Risk Manager from the Global Association of Risk Professionals, he holds a Doctoral degree and Master's and Bachelor's degrees in Finance & Accounting and Commerce,

7- Khalid Mahmood Abdulla

Head of Internal Audit

Khalid Mahmood has 19 years of experience in Accounting, Auditing, Banking and Sharia. He took up his current position with BisB in 2006. Prior to this, he was Head of Internal Audit at Al Baraka Islamic Bank, having started his career with Arthur Anderson. Khalid is a Certified Public Accountant (CPA) California, USA.

8- Nader Mohammed Albastaki

Head of Investment and Financial Institutions

Nader Albastaki has 14 years of 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 the University of Bahrain.

9- Sameer Abdulaziz Ali Qaedi

Head of Treasury

Sameer Qaedi has over 29 years' international and regional experience in managing, dealing and trading in money markets, foreign exchange and currency derivatives. He joined BisB in 1998, and took up his current position in 2013. Prior to this, he was a dealer with Bahrain Middle East Bank, after starting his career at Manufacturers Hanover Trust (now JP Morgan Chase Bank). Sameer holds an MBA degree from the Sacramento Regent University, USA; and an Advance Diploma in Islamic Banking.

CORPORATE GOVERNANCE REVIEW CONTINUED

Performance-Linked Management Incentive Structure

The Remuneration of all Directors is governed and comply with the provision of the Commercial Companies law no 21 for the year 2001 and CBB Law promulgated by decree no. (64), 2006.

The Bank remunerates Directors in a manner consistent with the prevailing best practice within banking industry. The current entitlement comprise of setting fees paid per meeting on an annual basis. Non-resident directors are also entitled to full travel expenses.

In addition, the performance of all Board members is evaluated annually by the Nomination & Remuneration Committee based on their contribution in the board meetings and Permanent Committees.

Senior Management Remuneration

The aggregate Senior Management remuneration, including basic salaries, fixed allowances and bonus distribution, totalled BD 895 thousand for 2013.

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.

Management Committees – Membership & Objectives

Board Committee	Members	Objectives
Asset & Liability Committee (ALCO)	Mohammed Ebrahim (Chairman) A. Rahman Turki Khalid Al Dossari Yusuf Abdul Kareem Dr. Mohammed Belgami Nader Al-Bastaki	To manage and monitor the liquidity risk of the Bank on a coordinated and consistent basis.
Credit & Investment Committee (C&IC)	Mohammed Ebrahim (Chairman) A. Rahman Turki Yusuf Abdul Kareem Nader Al-Bastaki Dr. Mohammed Belgami	To 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) Mohammed Hassan Khalid Al Dossari A. Rahman Turki Yusuf Abdul Kareem Dr. Mohammed Belgami Khalid Mahmood	To plan, prepare, coordinate, implement, support and follow up on all issues related to IT and new projects implementation issues.
Human Resource Committee (HR)	Mohammed Ebrahim (Chairman) Mohammed Hassan Khalid Al Dossari A. Rahman Turki Yusuf Abdul Kareem Dr. Mohammed Belgami Khalid Mahmood Nader Al-Bastaki	To monitor and assess the 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) Saleh Isa Al Mehri Ali Hassan Duaij 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) Dr. Mohammed Belgami Khalid Al Dossari Khalid Mahmood	To assist the CEO in reviewing the Bank's provisions. Also responsible for formulating provision policies with a view to maintain the strategic risk levels 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 Complaints Resolution Unit of the Quality Assurance Department is responsible for managing customer complaints. After receiving a complaint, the Unit 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. All complaints are logged and monitored, and reported to the CBB.

Code Of Conduct

BisB conducts itself in accordance with the highest standards of ethical behaviour. 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 2013, which is posted on the Bank's website: www.bisb.com.

SHARIA'A SUPERVISORY BOARD

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

2
Rev. Shaikh
Mohammed Jaffar
Al Juffairi
Vice Chairman

3
Rev. Shaikh
Adnan Abdullah
Al Qattan
Member

4
Rev. Shaikh
Dr. Nedham
Mohammed Saleh
Yacoubi
Member

5
Rev. Shaikh
Dr. Essam Khalaf
Al Enizi
Member

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, ABC Islamic Bank, London; and AlBaraka Banking Group. He is also a member of the Supreme Council for Islamic Affairs of the Kingdom of Bahrain and an Expert of the International Islamic Jurisprudence Authority. Shaikh Al Mahmood is a regular participant in a number of educational, economic, intellectual, social and cultural conferences and seminars, and a preacher of a number of mosques of the Kingdom of Bahrain since 1973 till present. He is a holder of Doctorate Degree in Sharia'a from Al-Zaytona College, Tunis.

2. Rev. Shaikh Mohammed Jaffar Al Juffairi

Vice Chairman

Shaikh Al Juffairi is a former Judge of the Supreme Jaffari Sharia'a Court of Appeal, Kingdom of Bahrain; and seconded as its President. He is a Friday Imam and speaker, and a holder of higher studies certificate in Sharia'a and Hoza Studies.

3. Rev. Shaikh Adnan Abdullah Al Qattan

Member

Shaikh Al Qattan is a member of the Sharia'a Supervisory Board of Financial Liquidity Company and Al-Salam Bank. He is a participant in a number of Islamic committees, courses, seminars and conferences. He is the Undersecretary of Supreme Sunni Sharia'a Court of Appeal, Kingdom of Bahrain, and a member of the Supreme Council for Islamic Affairs. He is a former lecturer at the Islamic Studies Department, University of Bahrain. Shaikh Al Qattan is the Chairman of the Board of Trustees of the Sanabil Society for Orphan Care, and Vice Chairman of the Royal Charity Organization. He is also the Chairman of the Pilgrimage Mission and a holder of Masters Degree in Quran and Sunna from Um Al-Quora University.

4. Rev. Shaikh Dr. Nedham Mohammed Saleh Yacoubi

Member

Shaikh Yacoubi is a member of several Sharia'a Supervisory Boards around the world, including Abu Dhabi Islamic Bank, Sharjah Islamic Bank, Ithmaar Bank, Gulf Finance House Bank, ABC Islamic Bank Kingdom of Bahrain and London, HSBC London, Wafra Bank USA, and Dow Jones Index. He is a member of the Sharia'a Supervisory Board for the Accounting & Auditing Organization of the Islamic Financial Institutions (AAOIFI).and a participant of a number of jurisprudence seminars and conferences around the world. He is a recipient of numerous awards in the field of Islamic Finance and Islamic Services, and is a holder of Doctorate Degree from Hague University Bahrain Branch.

4. Rev. Shaikh Dr. Essam Khalaf Al Enizi

Member

Shaikh Al Enizi is a member of the Sharia'a Supervisory Committee at Boubayan Bank, Al Sham Bank, Dar Company, Manar Company, and others. He is the Director of the Sharia'a Supervisory Unity of Al-Dar Investment, and a member of the Accounting & Auditing Organization of the Islamic Financial Institutions (AAOIFI).. He is a member of the Islamic Studies Faculty at the University of Kuwait and a holder of Doctorate Degree in Jurisprudence from Jordan University. He is a regular participant of a number of Islamic and jurisprudence conferences and seminars around the world.

SHARIA'A SUPERVISORY BOARD REPORT

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

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

Assalam Alaykum Wa Rahmatu Allah Wa Barakatoh.

In accordance to Articles of Association and the entrustment of the Sharia'a Board with supervising the Bank's activities from a Sharia perspective, we hereby submit the following report:

The Sharia'a Supervisory Board monitored the operations, related to the Bank throughout the year ended on 31st December 2013 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 and documentation of the 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 executed its mission of auditing the transactions and submitted its periodic reports to the Sharia'a Supervisory Board, which 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 Sharia principles and provisions of Islamic Sharia'a.

The Sharia Board held a number of meetings during the year and replied to 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 Board have reviewed the financial Statements for the year ended on 31st December 2013 with the notes and income statement and the Zakat calculation methods.

The Sharia'a Supervisory Board believes that:

1. Contracts, and transactions conducted by the Bank throughout the year ended on 31st December 2013 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. And 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).

We pray that Allah may grant all of us further success and prosperity.

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

High degree of privacy and comfort

Ladies Banking

BisB's dedicated service areas for ladies provide a high degree of privacy and comfort. They are staffed exclusively by highly-trained, knowledgeable and friendly female banking officers, offering a range of tailored products and services for lady customers.

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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 [collectively referred to as the "Group"] as of 31 December 2013, 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 2013, 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.

Except for the matter referred to in note 16 to these 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 2013 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

3 February 2014
Manama, Kingdom of Bahrain

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

	Note	2013 BD'000	Restated 2012 BD'000
ASSETS			
Cash and balances with banks and Central Bank	3	50,831	43,893
Due from banks and financial institutions	4	184,600	132,424
Murabaha receivables	5	256,038	227,757
Musharaka investments	6	90,767	90,220
Ijarah Muntahia Bittamleek	9	90,356	96,846
Investments	7	107,026	110,371
Investment in associates	8	36,236	35,215
Investment in real estate	10	58,219	64,888
Ijarah rental receivables	9	14,924	13,766
Property and equipment		17,067	15,530
Other assets	11	4,230	1,894
TOTAL ASSETS		910,294	832,804
LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY			
Liabilities			
Customers' current accounts		105,932	87,132
Other liabilities	12	13,608	14,649
Total Liabilities		119,540	101,781
EQUITY OF INVESTMENT ACCOUNTHOLDERS			
Financial institutions' investment accounts	13	95,144	87,690
Customers' investment accounts	13	617,494	573,570
Total Equity of Investment Accountholders		712,638	661,260
Owners' Equity			
Share capital	14	93,967	93,967
Treasury shares	14	(563)	(563)
Reserves		(16,530)	(23,641)
Attributable to equity holders of the parent		76,874	69,763
Non-controlling interest		1,242	-
Total Owners' Equity		78,116	69,763
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNTHOLDERS AND OWNERS' EQUITY		910,294	832,804
COMMITMENTS AND CONTINGENT LIABILITIES	15	15,991	10,285

Abdulrazaq Al Qassim
Chairman

Khalid Al Mannai
Vice Chairman

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 2013

	Note	2013 BD'000	2012 BD'000
INCOME			
Income from Islamic financing	17	32,504	27,378
Income from investment in Sukuk		4,921	3,284
		37,425	30,662
Gross return to equity of investment accountholders		32,849	28,496
Group's share as a Mudarib		(21,725)	(14,503)
Return on equity of investment accountholders		11,124	13,993
Group's share of income from joint financing and investment accounts		26,301	16,669
Net income from investments	18	1,923	2,172
Gain on sale of equity type instruments carried at fair value through equity		995	654
Gain on sale of investment in real estate		514	-
Share of results of associates	8	1,197	200
Fee and commission income		5,307	4,741
Other income		694	39
Total income		36,931	24,475
EXPENSES			
Staff costs		10,013	10,471
Depreciation		1,644	1,640
Other expenses	19	8,080	7,504
Total expenses		19,737	19,615
Net income before fair value adjustment for investment in real estate and net provision for impairment		17,194	4,860
Fair value adjustment for investment in real estate	10	(1,321)	(4,074)
Provision for impairment	20	(15,008)	(41,691)
Written back	20	5,242	4,710
NET INCOME (LOSS) FOR THE YEAR		6,107	(36,195)
ATTRIBUTABLE TO:			
Equity holders of the parent		6,069	(36,195)
Non-controlling interest		38	-
		6,107	(36,195)
BASIC AND DILUTED EARNINGS PER SHARE (fils)	22	6.52	(38.67)

Abdulrazaq Al Qassim
Chairman

Khalid Al Mannai
Vice Chairman

Mohammed Ebrahim Mohammed
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 2013

	Note	2013 BD'000	2012 BD'000
OPERATING ACTIVITIES			
Net profit (loss) for the year		6,107	(36,195)
Adjustments for non-cash items:			
Depreciation		1,644	1,640
Provision for impairment	20	15,008	35,993
Written Back	20	(5,242)	(4,710)
Fair value adjustment for investment in real estate	10	1,321	9,772
Gain on sale of equity type instruments carried at fair value through equity		(995)	(654)
Gain on sale of investment in real estate		(514)	-
Share of results of associates	8	(1,197)	(200)
Unrealised gain on equity type instruments carried at fair value through statement of income	18	(55)	(271)
Operating profit before changes in operating assets and liabilities		16,077	5,375
Working capital adjustments:			
Mandatory reserve with Central Bank of Bahrain	4	(4,485)	(2,010)
Due from banks and financial institutions		(32,826)	(26,983)
Murabaha receivables	5	(26,288)	(34,169)
Musharaka investments	6	(1,101)	(4,538)
Other assets	11	1,273	(2,389)
Customers' current accounts		18,800	2,036
Other liabilities	12	(1,031)	2,794
Net cash used in operating activities		(29,581)	(59,884)
INVESTING ACTIVITIES			
Disposal (purchase) of investment in real estate		5,348	(2,350)
Ijarah Muntahia Bittamleek	9	1,393	(7,446)
Purchase of investments	7	(37,084)	(44,256)
Purchase of property and equipment		(3,181)	-
Proceeds from disposal of investments	7	37,254	50,369
Net cash from (used in) investing activities		3,730	(3,683)
FINANCING ACTIVITIES			
Financial institutions' investment accounts	13	7,454	(21,189)
Customers' investment accounts	13	43,924	44,238
Dividends paid	12	(10)	(2,651)
Zakah paid		-	(1)
Net cash from financing activities		51,368	20,397
NET CHANGE IN CASH AND CASH EQUIVALENTS		25,517	(43,170)
Cash and cash equivalents at 1 January		119,893	163,063
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		145,410	119,893
Cash and cash equivalents at year end comprise of:			
Cash on hand	4	7,750	7,157
Balances with CBB, excluding mandatory reserve deposits	4	2,926	3,715
Balances with banks and other financial institutions	4	7,415	4,766
Due from banks and financial institutions with original maturities less than 90 days		127,319	104,255
		145,410	119,893

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 2013

				Reserves							
	Share capital BD'000	Treasury shares BD'000	Share premium BD'000	Statutory reserve BD'000	General reserve BD'000	Real estate fair value reserve BD'000	Investments fairvalue reserve BD'000	Accumulated losses BD'000	Total BD'000	Non-controlling interest BD'000	Total owners' equity BD'000
Balance at 1 January 2013	**93,967**	**(563)**	**-**	**10,268**	**1,000**	**-**	**1,286**	**(36,195)**	**69,763**	**-**	**69,763**
Changes due to adoption of FAS 26 (note 2d)	-	-	-	-	-	13,259	-	(13,259)	-	-	-
As at 1 January 2013 (restated)	93,967	(563)	-	10,268	1,000	13,259	1,286	(49,454)	69,763	-	69,763
Net income for the year	-	-	-	-	-	-	-	6,107	6,107	-	6,107
Net movement in cumulative changes in fair value of investment in real estate	-	-	-	-	-	(1,958)	-	-	(1,958)	-	(1,958)
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	2,962	-	2,962	-	2,962
Transfer of net income to statutory reserve	-	-	-	611	-	-	-	(611)	-	-	-
Non-controlling interest	-	-	-	-	-	-	-	-	-	1,242	1,242
Balance at 31 December 2013	**93,967**	**(563)**	**-**	**10,879**	**1,000**	**11,301**	**4,248**	**(43,958)**	**76,874**	**1,242**	**78,116**
Balance at 1 January 2012	93,967	(563)	43,936	10,268	1,000	-	(3,343)	(43,936)	101,329	-	101,329
Changes due to adoption of FAS 26 (note 2d)	-	-	-	-	-	9,185	-	(9,185)	-	-	-
As at 1 January 2012 (restated)	93,967	(563)	43,936	10,268	1,000	9,185	(3,343)	(53,121)	101,329	-	101,329
Net loss for the year	-	-	-	-	-	-	-	(36,195)	(36,195)	-	(36,195)
Changes due to adoption of FAS 26 (note 2d)	-	-	-	-	-	4,074	-	(4,074)	-	-	-
Net movement in cumulative changes in fair value of investments	-	-	-	-	-	-	4,629	-	4,629	-	4,629
Transfer of accumulated losses to share premium (note14)	-	-	(43,936)	-	-	-	-	43,936	-	-	-
Balance at 31 December 2012	93,967	(563)	-	10,268	1,000	13,259	1,286	(49,454)	69,763	-	69,763

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 2013

	Qard Hasan receivables BD'000	Funds available for QardHasan BD'000	Total BD'000
Balance at 1 January 2013	15	113	128
Uses of Qard fund			
Marriage	26	(26)	-
Others (Sunni Waqf)	63	(63)	-
Total uses during the year	**89**	**(89)**	**-**
Repayments	(25)	25	-
Balance at 31 December 2013	**79**	**49**	**128**
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

	2013 BD'000	2012 BD'000
Sources of Qard fund		
Contribution by the Bank	**125**	125
Donation	**3**	3
	128	128

CONSOLIDATED STATEMENT OF SOURCES AND USES OF ZAKAH AND CHARITY FUND

For the year ended 31 December 2013

	2013 BD'000	2012 BD'000
Sources of Zakah and charity funds		
Undistributed Zakah and charity funds at the beginning of the year	58	209
Non-Islamic income / late fee	687	694
Donations	150	-
Total sources of Zakah and charity funds during the year	895	903
Uses of Zakah and charity funds		
Philanthropic societies	300	462
Aid to needy families	370	383
Total uses of funds during the year	670	845
Undistributed Zakah and charity funds at the end of the year	225	58

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

31 December 2013

1 INCORPORATION AND ACTIVITIES

Bahrain Islamic Bank B.S.C. ("the Bank") was incorporated in the Kingdom of Bahrain in 1979 by Amiri Decree No.2 of 1979 and registered with the Ministry of Industry and Commerce ("MOIC") 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 is licensed and regulated by the Central Bank of Bahrain (CBB) and has a retail banking license. 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 the Bahrain Bourse.

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

The Bank has fifteen branches (2012: thirteen), all operating in the Kingdom of Bahrain.

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), and 73.16% subscription of BisB Money Market Fund ("Subsidiaries");

Abaad Real Estate Company B.S.C. (c) ("Abaad")

Abaad was incorporated in the Kingdom of Bahrain on 8 April 2003 with an authorised and fully paid-up share capital of BD 25 million. Abaad has started operations during the year 2007. The main activities of Abaad 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) ("MMF")

MMF 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 MMF is limited to establishing funds (in accordance with the Islamic Shari'a rules and principles).

BisB Money Market Fund ("Fund")

Fund is an open ended investment fund constituted by an instrument dated 12 June 2012 and commenced its activities on 9 July 2012. The fund is a Bahrain domiciled Shari'a compliant retail collective investment scheme established by Bahrain Islamic Bank B.S.C. pursuant to the Central Bank of Bahrain regulations and directives as contained in the rulebook volume 7. The fund has been established by BisB MMF Company B.S.C. (c).

The consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors issued on 3 February 2014.

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 in real estate", "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 ('IFRS') issued by International Accounting Standards Board.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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 are prepared for the same reporting year as the Bank, using consistent accounting policies.

The subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtained control, and continue 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 or 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 three fully owned subsidiaries, Abaad Real Estate Company B.S.C. (c) and BisB MMF Company B.S.C. (c) and the BisB MMF Fund which are consolidated in these financial statements.

d. Adoption of new and amended standards

Financial accounting standard (FAS 26) "Investment in real estate"

The Group has adopted FAS 26 issued by AAOIFI which is effective from 1 January 2013 and which covers the recognition, measurement, presentation and disclosure of investment in real estate that is acquired for the purpose of earning periodical income or held for future capital appreciation or both.

The adoption of FAS 26 had an effect on the classification and measurement of the Group's direct investment in real estate rather than investment in shares and other financial instruments providing indirect exposure to investment in real estate. The Group has accounted for such other investments under other standards issued by AAOIFI. As a result of the application of this new standard, the Group revisited the classification of the investment portfolio and changes if any, were made in these classifications in line with FAS 26. Before the adoption of FAS 26, the Bank was following FAS 17 'Investments' and measured its investments in real estate at fair value and this measurement continues to be followed under FAS 26.

For the changes due to the adoption of FAS 26, please refer to note 31.

e. 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.

f. 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.

g. 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 a 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.

h. 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 a difference between fair value and book value, such difference is recognised as profit or loss to the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2013

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

i. Investments

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

Debt type instruments 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 instruments 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 instruments is recognised in the consolidated statement of income when the instruments are de-recognised or impaired.

Equity type instruments 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 instruments 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.

j. 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 investments 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 terms and risk characteristics.

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

k. Investment in associates

The Group's investments 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 investments 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. 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 associates are eliminated to the extent of the Group's interest in the associates.

The Group determines at each consolidated statement of financial position date whether there is any objective evidence that the investments in associates are impaired. If this is the case the Group calculates the amount of impairment as being the difference between the fair value of the associates and the carrying value and recognises this 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 transactions and events in similar circumstances.

l. 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 an 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 their estimated useful lives. The estimated useful lives of the assets for calculation of depreciation ranges between 10 to 35 years.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

m. Investment in real estate

Properties held for rental, or for capital appreciation purposes, or both, are classified as Investment in real estate. Investments in real estate are initially recorded at cost, being the fair value of the consideration given and acquisition charges associated with the property. Subsequent to initial recognition, Investments in real estate are re-measured at fair value and changes in fair value (only gains) are recognised as property fair value reserve in the consolidated statement of changes in owners' equity.

Losses arising from changes in the fair values of investment in real estate are firstly adjusted against the property fair value reserve to the extent of the available balance and then the remaining losses are recognised in the consolidated statement of income. If there are unrealised losses that have been recognised in the consoliated statement of income in previous financial periods, the current period unrealised gain shall be recognised in the consolidated statement of income to the extent of crediting back such previous losses in the consolidated statement of income. When the property is disposed of, the cumulative gain previously transferred to the property fair value reserve, is transferred to the consolidated statement of income.

n. Equipment

Equipment is 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

o. Equity of investment accountholders

All equity of investment accountholders is 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. The 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.

p. 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 for future losses for equity of investment accountholders.

q. 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.

r. Zakah

Zakah is calculated on the Zakah base of the Group in accordance with FAS 9 issued by 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.

s. 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.

t. Dividends

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2013

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

u. 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 the asset 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.

v. 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.

w. 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.

x. 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".

y. Offsetting

Financial assets and financial liabilities are only offset 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.

z. 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 the case of losses on 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.

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 is 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Income from Ijarah assets
Rental income is accounted for on a straight-line basis over the Ijarah term.

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.

aa. 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.

bb. 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 cannot be reversed through the consolidated statement of income and are recorded as increases in cumulative changes in fair value through equity.

cc. 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 judgements 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) has 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2013

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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

ee. 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.

ff. 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 General Organisation of Social Insurance Scheme (GOSI) as a percentage of the employees' salaries. The Group's obligations are limited to these contributions, which are expensed when due.

gg. 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.

3 CASH AND BALANCES WITH BANKS AND CENTRAL BANK

	2013 BD'000	2012 BD'000
Cash on hand	7,750	7,157
Balances with CBB, excluding mandatory reserve deposits	2,926	3,715
Balances with banks and other financial institutions	7,415	4,766
	18,091	15,638
Mandatory reserve with CBB	32,740	28,255
	50,831	43,893

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 2013 BD'000	Jointly financed 2012 BD'000
Commodity Murabaha	121,566	61,589
Deferred profits	(33)	(32)
	121,533	61,557
Wakala receivables	63,067	70,867
	184,600	132,424

5 MURABAHA RECEIVABLES

	Jointly financed 2013 BD'000	Jointly financed 2012 BD'000
Tasheel	175,016	144,528
Tawarooq	93,835	103,845
Letters of credit refinance	16,713	13,275
Motor vehicles Murabaha	15,978	13,002
Credit cards	9,887	8,588
Others	414	819
	311,843	284,057
Qard fund	79	15
Gross receivables	311,922	284,072
Deferred profits	(36,814)	(35,252)
Net provision for impairment (note 20)*	(19,070)	(21,063)
	256,038	227,757

* This includes collective impairment provision of BD 4,173 thousand (2012: BD 2,688 thousand).

Non-performing Murabaha receivables outstanding as of 31 December 2013 amounted to BD 25,568 thousand (2012: BD 63,306 thousand).

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

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

	2013			2012		
	Europe BD'000	Middle East BD'000	Total BD'000	Europe BD'000	Middle East BD'000	Total BD'000
Commercial	-	81,316	81,316	-	67,703	67,703
Financial institutions	7,270	11,302	18,572	7,061	25,306	32,367
Others including retail	-	175,220	175,220	-	148,750	148,750
	7,270	267,838	275,108	7,061	241,759	248,820

6 MUSHARAKA INVESTMENTS

	Jointly financed 2013 BD'000	Jointly financed 2012 BD'000
Musharaka investment in real estate	98,788	97,687
Net provision for impairment (note 20)	(8,021)	(7,467)
	90,767	90,220

Non-performing Musharaka investments outstanding as of 31 December 2013 amounted to BD 33,369 thousand (2012: BD 33,056 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2013

7 INVESTMENTS

	2013			2012		
	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	-	44,406	44,406	-	56,851	56,851
Acquisitions	-	18,947	18,947	-	25,462	25,462
Disposals and redemptions	-	(21,648)	(21,648)	-	(37,907)	(37,907)
At 31 December	-	41,705	41,705	-	44,406	44,406
ii) Equity type instruments carried at fair value through equity						
Quoted investments						
Equity shares						
At 1 January	24,920	-	24,920	18,793	-	18,793
Acquisitions	4,586	-	4,586	10,495	-	10,495
Movement in fair market value	2,186	-	2,186	1,265	-	1,265
Disposals	(5,198)	-	(5,198)	(5,633)	-	(5,633)
At 31 December	26,494	-	26,494	24,920	-	24,920
Unquoted investments						
Equity shares						
At 1 January	34,022	-	34,022	34,022	-	34,022
Acquisitions	920	-	920	-	-	-
Disposals	-	-	-	-	-	-
Write off	(5,693)		(5,693)			
At 31 December	29,249	-	29,249	34,022	-	34,022
Managed funds						
At 1 January	41,970	-	41,970	37,643	-	37,643
Acquisitions	9,384	-	9,384	2,746	-	2,746
Movement in fair market value	-	-	-	1,851	-	1,851
Disposals	(7,546)	-	(7,546)	(270)	-	(270)
At 31 December	43,808	-	43,808	41,970	-	41,970
iii) Equity type instruments carried at fair value through statement of income						
Quoted investments						
Equity shares						
At 1 January	426	-	426	1,163	-	1,163
Acquisitions	3,247	-	3,247	5,553	-	5,553
Movement in fair market value	55	-	55	269	-	269
Disposals	(2,862)	-	(2,862)	(6,559)	-	(6,559)
At 31 December	866	-	866	426	-	426
Total investments before provision for impairment at 31 December	100,417	41,705	142,122	101,338	44,406	145,744
Net provision for impairment on						
Debt type instruments (note 20)	-	(3,340)	(3,340)	-	(3,357)	(3,357)
Equity type instruments (note 20)	(31,756)	-	(31,756)	(32,016)	-	(32,016)
	(31,756)	(3,340)	(35,096)	(32,016)	(3,357)	(35,373)
Total investments at 31 December	68,661	38,365	107,026	69,322	41,049	110,371

8 INVESTMENT IN ASSOCIATES

Investments in associates comprises the following:

	Ownership %	Country of incorporation	Self financed 2013 BD'000	Share of result 2013 BD'000	Self financed 2012 BD'000	Share of result 2012 BD'000
Quoted						
Insurance						
Takaful International Company B.S.C.*	22.75%	Bahrain	1,680	47	1,650	41
Unquoted						
Financial Institution						
Liquidity Management Centre B.S.C. (c)	25.00%	Bahrain	5,843	306	5,493	159
Unquoted						
Real Estate Company						
Arabian C Real Estate Company	19.00%	Kuwait	11,272	1,197	10,436	-
Unquoted						
Real Estate Company						
Enjaz Property Development Company B.S.C. (c)	32.76%	Bahrain	5,558	(1,412)	6,811	-
Unquoted						
Energy Company						
Al Dur Energy Investment Company	29.41%	Bahrain	11,883	1,058	10,825	-
			36,236	1,197	35,215	200

* 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 taken place on the company's shares since that date.

The following table summarises the associates' latest financial information :

	2013				
	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.	36,500	27,684	-	10,360	206
Liquidity Management Centre B.S.C. (c)	76,644	53,270	3,333	3,315	1,225
Arabian C Real Estate Company	102,173	43,421	-	7,569	5,031
Enjaz Property Development Company B.S.C. (c)	37,531	21,457	-	-	(9,929)
Al Dur Energy Investment Company	40,407	1	6,762	4,198	4,191
	293,255	145,833	10,095	25,442	723

	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
Arabian C Real Estate Company	108,929	55,208	-	2,267	(2,398)
Enjaz Property Development Company B.S.C. (c)	37,622	21,457	-	-	(12,447)
Al Dur Energy Investment Company	31,848	1	4,500	-	(79)
	276,229	143,831	10,333	14,608	(13,736)

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8 INVESTMENT IN ASSOCIATES

Takaful International Company B.S.C. was incorporated in 1989, and 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 2013 and does not represent the shareholders' revenue only.

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

Arabian C Real Estate Company is a Kuwaiti Shareholding Company incorporated in accordance with the Kuwaiti Commercial Companies law, Decree No.15 of 1960, as amended and regulated by the Ministry of Commerce & Industry of Kuwait. The company's activity focuses on real estate development and the overall management of a variety of strategic investments in the real estate and infrastructure sectors in GCC/MENA region.

Enjaz Property Development Company B.S.C.(c) is a closed joint stock company incorporated in the Kingdom of Bahrain and is registered with the Ministry of Industry and Commerce since 6 February 2008 under commercial registration number 67713-1. The company is engaged in the purchase and sale of land and property development.

Al Dur Energy Investment Company is an exempt company with limited liability incorporated in the Cayman Islands on 10 June 2009 and operates under registration number 227032. The company operates in the Kingdom of Bahrain with the sole purpose of holding a 15% indirect interest in a power and water plant project company, Al Dur Power and Water Company B.S.C.(c), in the Kingdom of Bahrain.

9 IJARAH MUNTAHIA BITTAMLEEK

	2013					2012				
	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	38,913	56,772	11,157	7,585	114,427	37,391	47,075	16,102	6,413	106,981
Additions	4,167	10,222	-	1,516	15,905	3,505	14,396	363	1,718	19,982
Disposals	(2,492)	(10,936)	(3,870)	-	(17,298)	(1,983)	(4,699)	(5,308)	(546)	(12,536)
At 31 December	40,588	56,058	7,287	9,101	113,034	38,913	56,772	11,157	7,585	114,427
Depreciation:										
At 1 January	-	10,698	2,145	923	13,766	-	6,080	1,401	392	7,873
Provided during the year	-	3,580	507	350	4,437	-	5,243	744	531	6,518
Relating to disposed assets	-	(1,872)	(1,407)	-	(3,279)	-	(625)	-	-	(625)
At 31 December	-	12,406	1,245	1,273	14,924	-	10,698	2,145	923	13,766
Net provision for impairment (note 20)	(6,133)	(1,621)	-	-	(7,754)	(2,501)	(1,314)	-	-	(3,815)
Net book value:										
As at 31 December	34,455	42,031	6,042	7,828	90,356	36,412	44,760	9,012	6,662	96,846

Non-performing Ijarah Muntahia Bittamleek as of 31 December 2013 is BD 32,516 thousand (2012: BD 32,630 thousand).

Ijarah rental receivable comprises of both rental on Ijarah assets and depreciation charge on Ijarah Muntahia Bittamleek assets which is fully receivable from the customers.

10 INVESTMENT IN REAL ESTATE

	Self financed	
	2013 BD'000	2012 BD'000
Land	**55,031**	61,700
Buildings	**3,188**	3,188
	58,219	64,888

	2013 BD'000	2012 BD'000
At 1 January	**64,888**	68,192
Acquisition	**-**	770
Disposal	**(5,348)**	-
Net loss from fair value adjustments	**(1,321)**	(4,074)
	58,219	64,888

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

Investment in real estate is stated at fair value as at 31 December each year, which has been determined based on valuations performed by independent surveyors and industry specialists in valuing these types of investment properties.

11 OTHER ASSETS

	2013 BD'000	2012 BD'000
Receivable under restructuring	**1,907**	-
Staff advances	**1,323**	864
Prepaid expenses	**608**	400
Receivables	**167**	3,912
Other	**225**	327
	4,230	5,503
Net provision for impairment (note 20)	**-**	(3,609)
	4,230	1,894

12 OTHER LIABILITIES

	2013 BD'000	2012 BD'000
Payable to vendors	**3,097**	4,566
Managers' cheques	**2,924**	1,722
Accrued expenses	**2,645**	2,582
Life insurance fees payable	**1,819**	1,644
Dividends payable	**807**	817
Zakah and charity fund	**226**	58
Other	**2,090**	3,260
	13,608	14,649

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13 EQUITY OF INVESTMENT ACCOUNTHOLDERS

The Group maintains an investment risk reserve amounting to BD 63 thousand (2012: BD 63 thousand) and maintains a profit equalisation reserve amounting to BD 295 thousand (2012: nil) .

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% (2012: 65%).

13.1 Profit Distribution by Type of Account

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

	2013		2012	
Account Type	Percentage of funds invested	Distributed profit rate	Percentage of funds invested	Distributed profit rate
Defined deposits	85%	1.81%	85%	1.91%
Specific investment deposits	85%	2.86%	85%	3.54%
Investment certificates	85%	1.98%	85%	3.93%
Savings accounts	45%	0.25%	45%	0.57%
Iqra	90%	2.72%	90%	2.88%
Tejoori	45%	0.25%	45%	0.56%
Vevo	45%	0.25%	45%	0.57%

13.2 Equity of Investment Accountholders Balances

	2013 BD'000	2012 BD'000
Type of Equity of Investment Accountholders		
Financial Institutions investment accounts		
Contractual basis*	95,117	87,669
Others	27	21
	95,144	87,690
Customer investment accounts		
Balances on demand	218,658	192,850
Contractual basis	395,256	376,643
Others	3,580	4,077
	617,494	573,570
	712,638	661,260

13.3 Equity of Investment Accountholders Reserves

	2013 BD'000	Movement BD'000	2012 BD'000
Profit equalisation reserve	295	295	-
Investment risk reserve	63	-	63

14 OWNERS' EQUITY

	2013 BD'000	2012 BD'000
(i) Share capital		
a) Authorised		
2,000,000,000 shares (2012: 2,000,000,000 shares) of BD 0.100 each	**200,000**	200,000
b) Issued and fully paid up		
939,673,499 shares (2012: 939,673,499 shares) of BD 0.100 each	**93,967**	93,967

c) Shares acquisition
National Bank of Bahrain ("NBB") and Social Insurance Organisation - Military Pension Fund and Social Insurance Organisation have acquired The Investment Dar Company ("TID"), Kuwait Investment Company ("KIC"), and other board members shares in the Group amounting to 372,632,690 shares, 110,962,471 shares, and 481,250 shares respectively representing ownership of 39.66%, 11.81%, and 0.09% respectively. As at 31 December 2013, NBB, Social Insurance Organisation - Military Pension Fund and Social Insurance Organisation own 242,038,206, 121,113,559 and 121,147,267 shares respectively, representing 25.76%, 12.89% and 12.89% ownership of the Group respectively.

d) 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 period ended 31 March 2012 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.

	2013		2012
(ii) Treasury Shares	**Number of Shares**	**BD'000**	BD'000
At 31 December	**3,620,609**	**563**	563

	2013 BD'000
Cost of treasury shares	**563**
Market value of treasury shares	**489**

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 Bank's articles of association, 10% of the net income for the year should be transferred to the statutory reserve. The Bank may resolve to discontinue such annual transfers when the reserve totals 50% of paid up share capital. A transfer has been made of BD 611 thousand (2012: nil) representing 10% of the net income for the year BD 6,107 thousand (2012: net loss of BD 36,915 thousand). 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 Bank 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 in real estate
This represents cumulative unrealised revaluation gains on investment in real estate. This reserve is transferred to the retained earnings upon sale of the investment in real estate.

Cumulative changes in fair value of investments
This represents the net unrealised gains or losses on equity investments relating to self financed investments.

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14 OWNERS' EQUITY (continued)

(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:

		2013		2012	
Names	**Nationality**	**Number of shares**	**% holding**	Number of shares	% holding
National Bank of Bahrain	Bahraini	**242,038,206**	**25.76%**	-	0.00%
Social Insurance Organisation	Bahraini	**121,147,267**	**12.89%**	94,457	0.01%
Social Insurance Organisation - Military Pension Fund	Bahraini	**121,113,559**	**12.89%**	94,457	0.01%
Islamic Development Bank	Saudi	**165,956,945**	**17.66%**	110,962,471	11.81%
General Council of Kuwaiti Awaqaf	Kuwaiti	**68,013,739**	**7.24%**	67,946,033	7.23%
The Investment Dar	Kuwaiti	**-**	**0.00%**	372,632,690	39.66%
Kuwait Investment Company	Kuwaiti	**-**	**0.00%**	110,962,471	11.81%

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:

	2013			2012		
	Number of shares	**Number of shareholders**	**% of total outstanding shares**	Number of shares	Number of shareholders	% of total outstanding shares
Less than 1%	**154,067,274**	**3,418**	**16.40%**	154,442,981	3,412	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%	**649,775,353**	**3**	**69.15%**	649,399,646	3	69.11%
	939,673,499	**3,425**	**100.00%**	939,673,499	3,419	100.00%

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

Categories:

	2013		2012	
	No. of shares	**No. of directors**	No. of shares	No. of directors
Less than 1%	**200,000**	**2**	4,042,601	9

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):

	2013		2012	
	No. of shares	**Percentage of Shareholding**	No. of shares	Percentage of Shareholding
Directors	**200,000**	**0.021%**	4,042,601	0.430%
Shari'a supervisory members	**205,725**	**0.022%**	205,725	0.022%
Senior management	**22,990**	**0.002%**	100,000	0.011%
	428,715	**0.045%**	4,348,326	0.463%

In a letter dated 30 January 2014, the Central Bank of Bahrain has advised the Bank to provide an action plan to increase its total owners' equity to BD 100,000 thousand.

15. 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:

	2013 BD'000	2012 BD'000
Letters of credit and acceptances	3,910	2,239
Guarantees	11,618	7,522
Operating lease commitments *	463	524
	15,991	10,285

* The Group has entered into commercial leases for certain branches. The remaining average period of these leases ranges between 1 month and 3 years with renewal terms included in the contracts. Renewals are at the option of the Bank. 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:

	2013 BD'000	2012 BD'000
Within one year	379	219
After one year but not more than five years	84	305
	463	524

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 issue Sukuk etc. No changes were made in the objectives, policies and processes from the previous years.

The Group's capital structure primarily consists of its paid-up capital, including share premium and reserves. From a regulatory perspective, a significant amount of the Group's capital is classified as Tier 1 as defined by the CBB, i.e. most of the capital is of a 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:

	2013 BD'000	2012 BD'000
Core capital - Tier 1:		
Issued and fully paid ordinary shares (net of treasury shares)	93,404	93,404
General reserves	1,000	1,000
Legal / statutory reserves	10,879	10,268
Share premium	-	-
Retained earnings / losses (excluding current year net income/loss)	(50,065)	-
Less:		
Net profit (loss) for the year	6,107	(36,195)
Unrealised gross losses arising from fair valuing equity securities	(331)	(638)
Tier 1 Capital before deductions	60,994	67,839

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16. CAPITAL ADEQUACY (continued)

Supplementary capital - Tier 2:		
Asset revaluation reserve (45% only)	**5,085**	-
Unrealised gains arising from fair valuing equities (45% only)	**1,407**	593
Investment risk reserve	**63**	2,751
Other reverse	**4,173**	-
Tier 2 Capital before deductions	**10,728**	3,344
Total available capital	**71,722**	71,183
Deductions		
Significant minority interest in banking, securities and financial entities	**(5,844)**	(5,493)
Excess amount over materiality threshold	**-**	-
Investment in insurance entity greater than or equal to 20%	**(1,680)**	(1,650)
Excess amount over maximum permitted large exposure limit	**-**	-
Total eligible capital	**64,198**	64,040

To assess its capital adequacy requirements in accordance with 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:

	2013 BD'000	2012 BD'000
Total Credit Risk Weighted Assets	**492,627**	459,478
Total Market Risk Weighted Assets	**18,416**	17,063
Total Operational Risk Weighted Assets	**42,133**	43,497
Total Regulatory Risk Weighted Assets	**553,176**	520,038
Capital Adequacy Ratio	**11.61%**	12.31%
Minimum requirement	**12%**	12%

The Group as of 31 December 2013 is not in compliance with the regulatory minimum capital adequacy ratio requirement, and its capital adequacy ratio stood at 11.61%.

17. INCOME FROM JOINTLY FINANCED ISLAMIC FINANCING

	2013 BD'000	2012 BD'000
Income from Islamic financing:		
Income from Murabaha receivables	**18,987**	14,679
Income on amounts due from banks and financial institutions	**895**	814
Income from Musharaka investments	**5,372**	5,321
Income from Ijarah Muntahia Bittamleek - net*	**7,250**	6,564
	32,504	**27,378**

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

	2013 BD'000	2012 BD'000
Income from Ijarah Muntahia Bittamleek – gross	**11,687**	13,082
Depreciation during the year (note 9)	**(4,437)**	(6,518)
	7,250	6,564

18. NET INCOME FROM INVESTMENTS

	2013 BD'000	2012 BD'000
Dividend income	1,494	1,487
Unrealised gain on equity type instruments carried at fair value through statement of income	55	271
Income from investment in Ijarah assets	374	414
	1,923	2,172

19. OTHER EXPENSES

	2013 BD'000	2012 BD'000
Marketing and advertisement expenses	1,692	1,623
Card Centre expenses	1,435	1,074
Premises and equipement expenses	1,053	1,038
Information technology related expenses	1,019	724
Communication expenses	816	867
Professional services	559	1,239
Board Remunerations	300	-
Donations	150	-
Board of directors sitting fees	48	210
Shari'a committee fees & remuneration	11	11
Others	997	718
	8,080	7,504

20. PROVISION FOR IMPAIRMENT

2013	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	21,063	3,815	7,467	35,378	3,609	71,332
Written off	(2,775)	-	-	(5,693)	(2,689)	(11,157)
Written back	(4,119)	(108)	(70)	(25)	(920)	(5,242)
Provided	4,901	4,047	624	5,436	-	15,008
	782	3,939	554	5,411	(920)	9,766
Net provisions at 31 December	19,070	7,754	8,021	35,096	-	69,941
Non-performing	25,568	33,369	32,519	26,926	-	118,382
Notes	5	9	6	7	11	

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20. PROVISION FOR IMPAIRMENT (continued)

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	18,322	360	41,691
	9,091	2,123	7,171	18,236	360	36,981
Net provisions at 31 December	21,063	3,815	7,467	35,378	3,609	71,332
Non-performing	63,306	32,630	33,056	51,331	3,609	183,932
Notes	5	9	6	7	11	

The fair value of collateral that the Group holds relating to non performing facilities at 31 December 2013 amounts to BD 105,892 thousand (31 December 2012: BD 142,617 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.

21. ZAKAH

The total Zakah payable as of 31 December 2013 amounted to BD 207 thousand (2012: BD 1,163 thousand) of which the Bank has no Zakah payable (2012: BD nil) based on the statutory reserve, general reserve and retained earning as at 1 January 2013. The Zakah balance amounting to BD 207 thousand or 0.2 fils per share (2012: BD 1,163 thousand or 1.2 fils per share) is due and payable by the shareholders.

22. EARNINGS PER SHARE

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

	2013	2012
Net income (loss) for the year in BD'000	6,107	(36,195)
Weighted average number of shares	936,053	936,053
Basic and diluted earnings per share (fils)	6.52	(38.67)

Basic and diluted earnings per share are the same since the Group has not issued any instruments that would have a dilutive effect.

23. RELATED PARTY TRANSACTIONS

Related parties comprise of major shareholders, directors of the Bank, senior management, close members of their families, entities owned or controlled by them and companies affiliated by virtue of common ownership or directors with that of the Bank. The transactions with these parties were made on commercial terms.

23. RELATED PARTY TRANSACTIONS (continued)

The significant balances and transactions with related parties at 31 December were as follows:

	2013				
	Shareholders BD'000	Associates and joint ventures BD'000	Directors and related entities BD'000	Senior management BD'000	Total BD'000
Assets					
Due from banks and financial institutions	-	9,481	-	-	9,481
Murabaha receivables	-	-	1,237	44	1,281
Musharaka investments	-	-	874	-	874
Investment in associates	-	36,236	-	-	36,236
Other assets	-	-	-	244	244
Liabilities and Equity of investment accountholders					
Customers' current accounts	-	714	368	-	1,082
Other liabilities	-	1,819	-	-	1,819
Customers' investment accounts	48,982	859	825	-	50,666

	2013				
	Shareholders BD'000	Associates and joint ventures BD'000	Directors and related entities BD'000	Senior management BD'000	Total BD'000
Income					
Income from Islamic financing	-	173	124	-	297
Share of results of associates	-	1,197	-	-	1,197
Return on equity of investment accountholders	**(281)**	**(10)**	**(9)**	**-**	**(300)**
Expenses					
Other expenses	-	-	(359)	-	(359)

	2012				
	Shareholders BD'000	Associates and joint ventures BD'000	Directors and related entities BD'000	Senior management BD'000	Total BD'000
Assets					
Due from banks and financial institutions	-	9,592	-	-	9,592
Murabaha receivables*	7,817	-	1,365	51	9,233
Musharaka investments	-	-	293	-	293
Investment in associates	-	35,215	-	-	35,215
Investments**	4,197	-	-	-	4,197
Investment in real estate	14,200	-	-	-	14,200
Other assets***	1,855	-	-	275	2,130
Liabilities and Equity of investment accountholders					
Customers' current accounts	-	581	459	-	1,040
Other liabilities	-	1,644	-	-	1,644
Customers' investment accounts	-	2,373	443	-	2,816

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23. RELATED PARTY TRANSACTIONS (continued)

	2012				
	Shareholders BD'000	Associates and joint ventures BD'000	Directors and related entities BD'000	Senior management BD'000	Total BD'000
Income					
Income from Islamic financing	-	61	116	-	177
Share of results of associates	-	200	-	-	200
Return on equity of investment accountholders	-	(5)	(12)	-	(17)
Expenses					
Other expenses	-	-	(221)	-	(221)

* An amount of BD 7,817 thousand was considered impaired and was partially provided for.

** An amount of BD 4,197 thousand was considered impaired and was partially provided for.

***An amount of BD 1,553 thousand was considered as impaired and was fully provided for.

Compensation of the key management personnel is as follows:

Key management personnel includes staff at the grade of assistant general manager or above.

	2013 BD'000	2012 BD'000
Short term employee benefits	**756**	921
Other long term benefits	**139**	149
	895	1,070

24 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 changed 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, 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.

24 RISK MANAGEMENT (continued)

Structure and Organization of the Risk Management Function

Risk Management Structure includes all levels of authorities, organizational structure, people and systems required for the effective functioning of risk management processes in the Group. The responsibilities associated with each level of the 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 the Executive Committee, Credit and Investment Committee, Chief Executive Officer and further delegation to the management to approve and review.

Executive Committee (EC) comprises of three designated members of the Board of Directors. The Executive Committee is delegated authority 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 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.

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 the Risk Management Department (RMD) to the Credit Committee. The limits are reviewed and revised 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.

Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, such as obtaining collateral 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.

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.

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 is properly evaluated by the Group approved surveyors (for properties) or based on publicly available quotations. Only the amount of such security equivalent to the exposure is taken into account while considering credit facilities.

The CIC periodically reviews and approves the 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.

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24 RISK MANAGEMENT (continued)

a) Credit Risk (continued)

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

	2013 BD'000	2012 BD'000
Cash and balances with the banks and Central Bank	43,081	36,736
Due from banks and financial institutions	184,600	132,424
Murabaha receivables	275,108	248,820
Musharaka investments	98,788	97,687
Ijarah Muntahia Bittamleek	98,110	100,661
Investments	41,705	44,406
Ijarah rental receivables	14,924	13,766
	756,316	674,500
Letters of credit, guarantees and acceptances	15,528	9,761

(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.

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 2013 BD'000	31 December 2012 BD'000	31 December 2013 BD'000	31 December 2012 BD'000	31 December 2013 BD'000	31 December 2012 BD'000
Geographical region						
Middle East	895,977	811,109	831,964	757,133	15,203	9,960
Rest of Asia	297	1,007	4	4	-	-
North America	1,280	2,289	183	78	-	-
Europe	12,740	18,399	27	5,826	325	325
	910,294	832,804	832,178	763,041	15,528	10,285
Industry sector						
Trading and manufacturing	77,461	40,637	17,045	28,333	7,665	3,437
Aviation	11,696	22,797	54,542	15,590	466	956
Real Estate	211,688	235,979	16,792	31,261	1,888	1,356
Banks and financial institutions	255,103	215,973	120,832	133,151	4,072	2,277
Personal / Consumer	237,957	227,597	477,706	390,405	-	274
Government Organization	47,424	28,342	63,232	84,538	-	-
Others	68,965	61,479	82,029	79,763	1,437	1,985
	910,294	832,804	832,178	763,041	15,528	10,285

24 RISK MANAGEMENT (continued)

(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. Amounts reported are gross of any provision for impairment.

	31 December 2013				
	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	4,614	209,054	35,871	25,568	275,107
Musharaka investments	1,862	53,862	9,695	33,369	98,788
Ijarah Muntahia Bittamleek	-	53,672	13,076	32,519	99,267
Ijarah rental receivables	-	11,866	2,162	896	14,924
	6,476	328,454	60,804	92,352	488,086

	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	-	10,667	1,281	1,818	13,766
	2,605	281,639	45,880	130,810	460,934

Restructured facilities during the year amounted to BD 9,571 thousand (2012: BD 35,057 thousand), and they included amounts totalling BD 3,467 thousand (2012: BD 2,341 thousand) which were past due more than 90 days.

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

2013	Less than 30 days BD'000	31 to 60 days BD'000	61 to 90 days BD'000	Total BD'000
Murabaha receivables	35,113	319	439	35,871
Musharaka investments	9,110	248	337	9,695
Ijara Muntahia Bittamleek	11,821	1,217	38	13,076
	56,044	1,784	814	58,642

2012	Less than 30 days BD'000	31 to 60 days BD'000	61 to 90 days BD'000	Total BD'000
Murabaha receivables	21,721	205	60	21,986
Musharaka investments	13,018	438	6	13,462
Ijara Muntahia Bittamleek	9,138	10	3	9,151
	43,877	653	69	44,599

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24 RISK MANAGEMENT (continued)

b) Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet its liabilities 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.

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 2013 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	18,091	-	-	-	-	-	32,740	50,831
Due from banks and financial institutions	157,659	17,996	8,945	-	-	-	-	184,600
Murabaha receivables	13,460	17,947	10,541	28,024	59,403	126,663	-	256,038
Musharaka investments	9,525	2,140	508	3,757	8,401	66,436	-	90,767
Ijarah Muntahia Bittamleek	10,556	-	196	9	10,777	68,818	-	90,356
Investments	6,741	20,861	-	-	10,259	47,035	22,130	107,026
Investment in associates	-	-	-	-	-	-	36,236	36,236
Investment in real estate	-	-	-	-	-	-	58,219	58,219
Ijarah rental receivables	3,955	57	-	329	654	9,929	-	14,924
Property and equipment	-	-	-	-	-	-	17,067	17,067
Other assets	-	1,481	834	-	-	1,915	-	4,230
Total assets	219,987	60,482	21,024	32,119	89,494	320,796	166,392	910,294
LIABILITIES AND EQUITY OF INVESTMENT ACCOUNTHOLDERS								
Customers' current accounts	105,932	-	-	-	-	-	-	105,932
Other liabilities	13,608	-	-	-	-	-	-	13,608
Equity of investment accountholders	179,465	113,696	136,759	273,981	5,850	-	2,887	712,638
Total liabilities and equity of investment accountholders	299,005	113,696	136,759	273,981	5,850	-	2,887	832,178
Liquidity gap	(79,018)	(53,214)	(115,735)	(241,862)	83,644	320,796	163,505	78,116
Cumulative liquidity gap	(79,018)	(132,232)	(247,967)	(489,829)	(406,185)	(85,389)	78,116	-

24 RISK MANAGEMENT (continued)

b) Liquidity Risk (continued)

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
Ijarah Muntahia Bittamleek	-	-	205	1,884	4,351	90,406	-	96,846
Investments	5,356	21,153	-	-	9,061	52,288	22,513	110,371
Investment in associates	-	-	-	-	-	-	35,215	35,215
Investment in real estate	-	-	-	-	-	-	64,888	64,888
Ijarah rental receivables	-	-	13,766	-	-	-	-	13,766
Property and equipment	-	-	-	-	-	-	15,530	15,530
Other assets	209	655	528	-	-	502	-	1,894
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	14,649	-	-	-	-	-	-	14,649
Equity investment accountholders	189,199	114,997	80,367	270,725	3,568	-	2,404	661,260
Total liabilities and equity of investment accountholders	290,980	114,997	80,367	270,725	3,568	-	2,404	763,041
Liquidity gap	(143,685)	(66,815)	(60,601)	(252,162)	41,586	387,443	163,997	69,763
Cumulative liquidity gap	(143,685)	(210,500)	(271,101)	(523,263)	(481,677)	(94,234)	69,763	-

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 inline with the market rates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
31 December 2013

24 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 a 10% increase of the portfolio value with all other variables remaining 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;

2013	Increase in equity price %	Sensitivity of profit or loss BD'000	Sensitivity of equity BD'000
Bahrain Bourse	+10	10	806
Saudi Stock Exchange (TADAWUL)	+10	39	425
Oman Stock Exchange	+10	16	-
Kuwait Stock Exchange	+10	-	132
Qatar Stock Exchange	+10	-	320

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

As at the consolidated statement of financial position date, the Group has unquoted (equities and sukuk) of BD 33 million (31 December 2012: BD 50 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:

Currency	Equivalent Long (short) 2013 BD '000	Equivalent Long (short) 2012 BD '000
Pound Sterling	(4,359)	(1,041)
Euro	(1,166)	(750)
Kuwaiti Dinars	(12,376)	(14,957)

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 rates against the Bahraini Dinar with other variables held constant will have an immaterial impact on the consolidated statement of income and owners' equity.

24 RISK MANAGEMENT (continued)

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.

25 DEPOSIT PROTECTION SCHEME

Deposits held with the Bank are covered by the Deposit Protection Scheme (the Scheme) established by the Central Bank of Bahrain. No upfront contribution is currently required under this scheme and no liability is due until one of the member commercial banks of the scheme is unable to meet its deposit obligations.

26 SEGMENTAL INFORMATION

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

Corporate	Principally handling equity of corporate investment accountholders', corporate current accounts, and providing Islamic financing facilities to corporate customers.
Retail	Principally handling equity of individual retail customers' investment accountholders', retail current accounts, and providing Islamic financing facilities to individual customers.
Investment	Principally handling equity of banks' and financial institutions' 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 2013			
	Corporate BD'000	Retail BD'000	Investment BD'000	Total BD'000
Total income	11,950	18,440	6,541	36,931
Total expenses	(3,021)	(13,878)	(2,838)	(19,737)
Fair value adjustment for investment in real estate	-	-	(1,321)	(1,321)
Net provision for impairment	(3,619)	(1,656)	(4,491)	(9,766)
Net income (loss) for the year	5,310	2,906	(2,109)	6,107
Other information				
Segment assets	205,594	287,777	416,923	910,294
Segment liabilities, and equity	298,522	433,083	178,689	910,294

	31 December 2012			
	Corporate BD'000	Retail BD'000	Investment 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 in real estate	-	-	(4,074)	(4,074)
Net provision for impairment	(16,331)	(2,054)	(18,596)	(36,981)
Net income (loss) 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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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27 FINANCIAL INSTRUMENTS

Fair value hierarchy

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.

Fair values of quoted securities/Sukuk are derived from quoted market prices in active markets, if available. For unquoted securities/Sukuk, fair value is estimated using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy at 31 December 2013:

	Level 1 BD'000	Level 2 BD'000	Level 3 BD'000	Total BD'000
Investments carried at fair value through statement of income				
Quoted securities				
Equities	866	-	-	866
	866	-	-	866
Investments carried at fair value through equity				
Quoted securities				
Equities	19,995	-	-	19,995
Unquoted securities				
Managed funds	-	-	25,670	25,670
Equities	-	-	22,130	22,130
	19,995	-	47,800	67,795
	20,861	-	47,800	68,661

Transfers between Level 1, Level 2 and Level 3

During the year ended 31 December 2013 there were no transfers between Level 1 and Level 2, and no transfers into or out of Level 3.

The carrying values of other financial assets and liabilities are not significantly different from their fair values at 31 December 2013, except for the Group's investments in Sukuk held at amortised cost amounting to BD 38,365 thousand (2012: BD 41,049 thousand) with fair values amounting to BD 40,033 thousand (2012: BD 85,448 thousand).

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.

	31 December 2012		
	after restatement BD'000	changes due to adoption of FAS 26 BD'000	before restatement BD'000
Consolidated Statement of Financial Position			
Investments	110,371	14,083	96,288
Investment in associates	35,215	28,072	7,143
Investment in real estate	64,888	(41,463)	106,351
Property and equipment	15,530	15,530	-
Investment in Ijarah assets	-	(10,599)	10,599
Consolidated Statement of Changes in Owners' Equity			
Real estate fair value reserve	13,259	13,259	-
Accumulated losses	(49,454)	(13,259)	(36,195)
Consolidated Statement of Income			
Fair value adjustment for investment in real estate	(4,074)	5,698	(9,772)
Provision for impairment	(41,691)	(5,698)	(35,993)

As a result of the application of FAS 26, the Group revisited the classification of the investment portfolio and changes, were made in these classifications in line with FAS 26. The effect of the adoption of FAS 26 has an impact on the opening accumulated losses for 2013 of BD 13,259 thousand (2012 : BD 9,185 thousand) and had no effect on the net result of the Group. This is due to measurement of investment in real estate on an individual property basis rather than portfolio basis.

FAS 26 only applies to the Group's direct investment in real estate that is acquired for the purpose of earning periodical income or held for future capital appreciation or both. As a result, the Group has reclassified indirect investment in real estate of BD 14,083 thousand to investments, and has reclassified indirect investment in real estate of BD 28,072 thousand having fair value adjustments of BD 5,698 thousand to investment in associates and provision for impairment respectively. Moreover, Ijarah assets of BD 692 thousand which were acquired for the purpose of earning periodical income were reclassified to investment in real estate. Head office building occupied by the Group of BD 9,907 thousand was reclassified from Investment in Ijarah asset to property and equipment.

BASEL II, PILLAR III DISCLOSURES

31 December 2013

CONTENTS

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

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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 2013 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	10,879	-
Accumulated losses brought forward	(50,065)	-
Less:		
Unrealised gross losses arising from fair valuing equity securities	(331)	-
Tier 1 Capital before PCD deductions	54,887	-
Net Profit for the year		6,107
Asset revaluation reserve - Property and equipment (45% only)		5,085
Unrealised gains arising from fair valuing equities (45% only)		1,407
Investment risk reserve		63
Collective impairment loss provision		4,173
Tier 2 Capital before PCD deductions		16,835
Total available capital		71,722
Deductions		
Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated	(2,922)	(2,922)
Investment in insurance entity greater than or equal to 20%	(840)	(840)
Total Deductions	(3,762)	(3,762)
Tier 1 and Tier 2 eligible capital before additional deduction	51,125	13,073
Additional deduction from Tier 1 to absorb deficiency in Tier 2	13,073	(13,073)
Tier 1 and Tier 2 eligible capital	64,198	-
TOTAL ELIGIBLE CAPITAL	64,198	-

	Amount of exposures BD'000
Total Credit Risk Weighted Assets	492,627
Total Market Risk Weighted Assets	18,416
Total Operational Risk Weighted Assets	42,133
TOTAL REGULATORY RISK WEIGHTED ASSETS	553,177
CAPITAL ADEQUACY RATIO	11.61%
Minimum requirement	12%

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 2013 (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		
Murabaha receivables*	84,228	10,107
Due from banks and financial institutions	33,827	4,059
Musharaka investments*	29,859	3,583
Investments	117,062	14,047
Ijarah muntahia bittamleek*	29,724	3,567
Ijarah rental receivables	5,600	672
	300,300	36,035
Other credit exposures	192,327	23,079
	492,627	59,114

*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 2013 subject to standardised approach of market risk and related capital requirements;

Market Risk - Standardised Approach Foreign exchange risk (BD'000)	
	1,473
Total of Market Risk - Standardised Approach	1,473
Multiplier	12.5
RWE for CAR Calculation (BD'000)	18,416
Total Market Risk Exposures (BD'000)	18,416
Total Market Risk Exposures - Capital Requirement (BD'000)	2,210

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2 Capital Adequacy (continued)

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 2013 subject to basic indicator approach of operational risk and related capital requirements;

Indicators of operational risk	
Average Gross income (BD'000)	22,471
Multiplier	12.5
	280,888
Eligible Portion for the purpose of the calculation	15%
Total Operational Risk Exposure (BD'000)	42,133
Total Operational Risk Exposures - Capital Requirement (BD'000)	5,056

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

The following are Capital Adequacy Ratios as of 31 December 2013 for total capital and Tier 1 capital;

	Total capital ratio	Tier 1 capital ratio
Top consolidated level	**11.61%**	**11.61%**

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 Risk Management (continued)

3.2 Strategies, Processes and Internal Controls (continued)

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.

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 inline 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.

BASEL II, PILLAR III DISCLOSURES

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3 Risk Management (continued)

3.3 Structure and Organisation of Risk Management Function

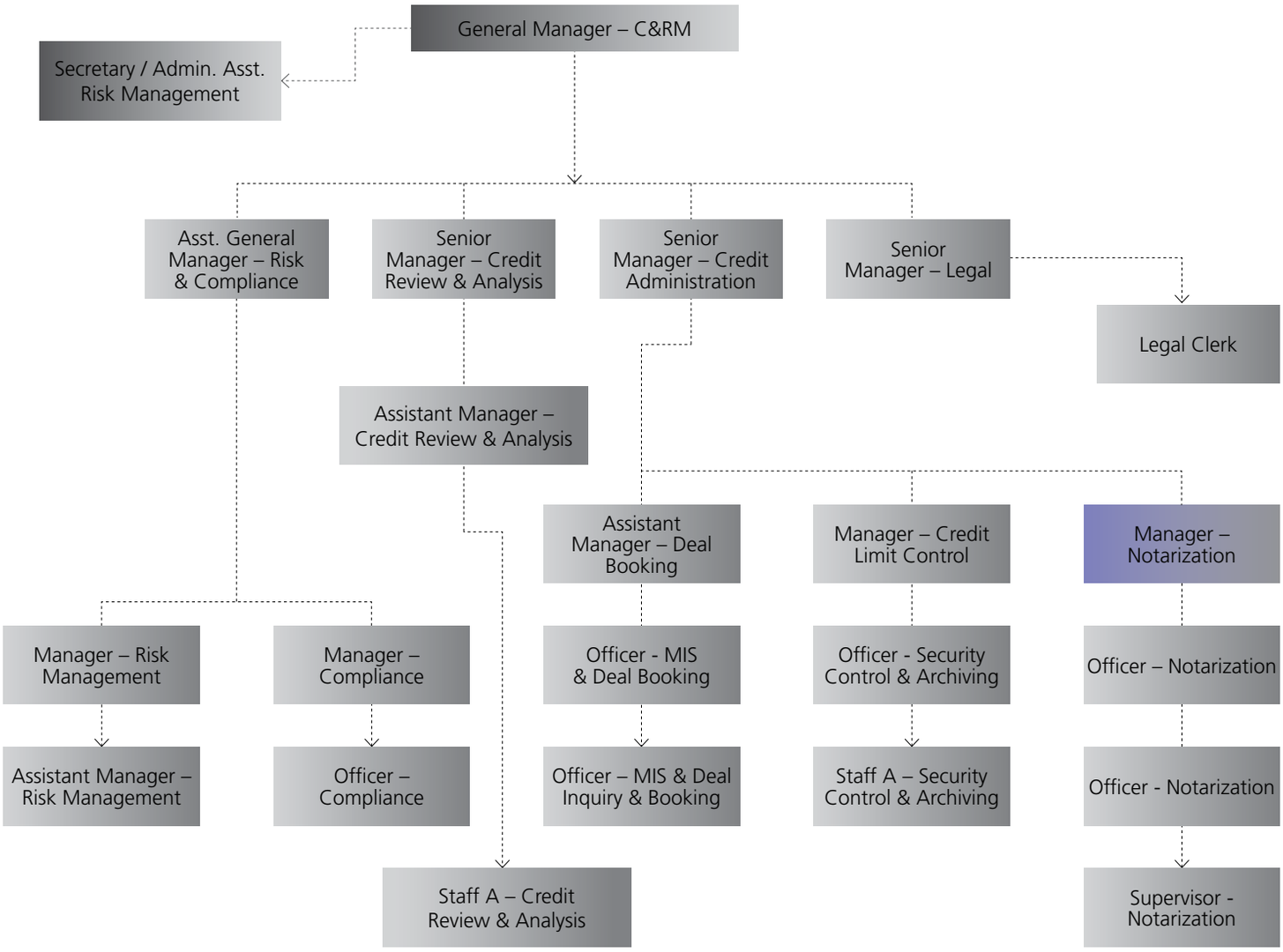
Risk Management Structure includes all levels of authorities (including Board level Risk committee), organisational structure, people and systems required for the smooth functioning of risk management processes in the Group. The responsibilities associated with each level of risk management structure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

CREDIT AND RISK MANAGEMENT ORGANISATION CHART



3 Risk Management (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.

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.

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.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

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.

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.

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.

3.5 Credit Risk (continued)

3.5.7 Credit risk mitigation (continued)

3.5.7.1 General policy guidelines of collateral management (continued)

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.

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.

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3 Risk Management (continued)

3.5 Credit Risk (continued)

3.5.8 Counterparty credit risk (continued)

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 2013. All related party transactions have been made on arm's length basis.

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 2013 and average gross funded and unfunded exposures over the year ended 31 December 2013 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	18,091	18,738	32,740	32,740
Due from banks and financial institutions	19,842	13,364	164,758	110,967
Murabaha receivables	27,521	26,162	228,517	217,235
Musharaka investments	9,757	9,628	81,010	79,945
Ijarah muntahia bittamleek	9,713	10,103	80,643	83,888
Investments	68,185	68,059	38,841	31,946
Investment in associates	36,236	35,507	-	-
Investment real estate	58,219	63,904	-	-
Ijarah rental receivables	1,604	1,490	13,320	12,373
Property and equipment	17,067	14,478	-	-
Other assets	4,230	4,709	-	-
Unfunded				
Commitments and contingent liabilities	15,991	13,916	-	-
Total	286,456	280,058	639,829	569,094

*Average balances are computed based on month end balances.

3 Risk Management (continued)

3.5 Credit Risk (continued)

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

The following table summarises the geographic distribution of exposures as of 31 December 2013, 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	1,280	36	16,775	-	18,091	-	-	32,740	-	32,740
Due from banks and financial institutions	-	-	19,842	-	19,842	-	-	164,758	-	164,758
Murabaha receivables	-	-	27,521	-	27,521	-	-	228,517	-	228,517
Musharaka investments	-	-	9,757	-	9,757	-	-	81,010	-	81,010
Ijarah muntahia bittamleek	-	-	9,713	-	9,713	-	-	80,643	-	80,643
Investments	-	2,664	65,224	297	68,185	-	10,040	28,801	-	38,841
Investment in associates	-	-	36,236	-	36,236	-	-	-	-	-
Investment real estate	-	-	58,219	-	58,219	-	-	-	-	-
Ijarah rental receivables	-	-	1,604	-	1,604	-	-	13,320	-	13,320
Property and equipment	-	-	17,067	-	17,067	-	-	-	-	-
Other assets	-	-	4,230	-	4,230	-	-	-	-	-
Total	**1,280**	**2,700**	**266,188**	**297**	**270,465**	**-**	**10,040**	**629,789**	**-**	**639,829**

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

Table – 8. Credit Risk – Industry Sector Breakdown (own capital and current account) (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2013 by industry, broken down into major types of credit exposure;

	Own Capital and Current Account Industry Sector							
	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate BD'000	Aviation BD'000	Personal & Consumer Finance BD'000	Governmental Organisation BD'000	Others BD'000	Total BD'000
Funded								
Cash and balances with banks and Central Bank	-	15,758	-	-	-	2,333	-	18,091
Due from banks and financial institutions	-	19,842	-	-	-	-	-	19,842
Murabaha receivables	4,142	1,997	3,812	518	14,873	496	1,683	27,521
Musharaka investments	2,140	-	1,829	-	4,914	264	610	9,757
Ijarah muntahia bittamleek	842	-	3,299	684	4,749	-	139	9,713
Investments	9,045	12,631	36,700	-	-	568	9,241	68,185
Investment in associates	-	7,523	16,830	-	-	-	11,883	36,236
Investment in real estate	-	-	58,219	-	-	-	-	58,219
Ijarah rental receivables	230	-	390	55	900	-	29	1,604
Property and equipment	-	-	-	-	-	-	17,067	17,067
Other assets	-	2,074	-	-	1,314	-	842	4,230
Unfunded								
Commitments and contingent liabilities	2,774	4,073	-	466	223	-	8,455	15,991
Total	**19,173**	**63,898**	**121,079**	**1,723**	**26,973**	**3,661**	**49,949**	**286,456**

BASEL II, PILLAR III DISCLOSURES

31 December 2013

3 Risk Management (continued)

3.5 Credit Risk (continued)

Table – 9. Credit Risk – Industry Sector Breakdown (profit sharing investment account) (PD-1.3.23(c))

The following table summarises the distribution of funded and unfunded exposures as of 31 December 2013 by industry, broken down into major types of credit exposure;

	Profit Sharing Investment Account Industry Sector							
	Trading and Manufacturing BD'000	Banks and Financial Institutions BD'000	Real Estate BD'000	Aviation BD'000	Personal & Consumer Finance BD'000	Governmental Organisation BD'000	Others BD'000	Total BD'000
Funded								
Cash and balances with banks and Central Bank	-	-	-	-	-	32,740	-	**32,740**
Due from banks and financial institutions	-	164,758	-	-	-	-	-	**164,758**
Murabaha receivables	34,390	16,578	31,653	4,303	123,497	4,118	13,978	**228,517**
Musharaka investments	17,773	-	15,187	-	40,802	2,190	5,058	**81,010**
Ijarah muntahia bittamleek	6,991	-	27,393	5,682	39,434	-	1,143	**80,643**
Investments	-	13,941	13,141	-	-	4,715	7,044	**38,841**
Investment in associates	-	-	-	-	-	-	-	-
Investment in real estate	-	-	-	-	-	-	-	-
Ijarah rental receivables	1,908	-	3,236	454	7,474	-	248	**13,320**
Property and equipment	-	-	-	-	-	-	-	-
Other assets	-	-	-	-	-	-	-	-
Total	**61,062**	**195,277**	**90,610**	**10,439**	**211,207**	**43,763**	**27,471**	**639,829**

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 2013;

	Own capital and current account BD'000	Profit Sharing Investment Account BD'000	Total BD'000
Counterparties			
Counterparty # 1	77	640	717
	77	**640**	**717**

3 Risk Management (continued)

3.5 Credit Risk (continued)

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 2013;

	Own capital and current account BD'000	Profit Sharing Investment Account BD'000	Total BD'000
Counterparties *			
Counterparty # 1	1,522	12,376	13,898
Counterparty # 2	14,200	-	14,200
	15,722	**12,376**	**28,098**

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

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 2013, 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	18,091	-	-	-	-	-	-	-	-	-	18,091
Due from banks and financial institutions	16,946	1,934	962	-	-	-	-	-	-	-	19,842
Murabaha receivables	1,447	1,929	1,134	3,012	6,385	6,620	6,977	6	11	-	27,521
Musharaka investments	1,024	230	56	404	903	1,961	2,774	1,984	421	-	9,757
Ijarah muntahia bittamleek	1,135	-	22	1	1,158	1,554	1,819	2,707	1,317	-	9,713
Investments	725	20,861	-	-	1,102	21,675	1,175	-	517	22,130	68,185
Investment in associates	-	-	-	-	-	-	-	-	-	36,236	36,236
Investment real estate	-	-	-	-	-	-	-	-	-	58,219	58,219
Ijarah rental receivables	425	6	-	36	71	439	232	314	81	-	1,604
Property and equipment	-	-	-	-	-	-	-	-	-	17,067	17,067
Other assets	-	1,481	834	-	-	1,915	-	-	-	-	4,230
Total Assets	**39,793**	**26,441**	**3,008**	**3,453**	**9,619**	**34,164**	**12,977**	**5,011**	**2,347**	**133,652**	**270,465**

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

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3 Risk Management (continued)

3.5 Credit Risk (continued)

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 2013, 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	-	-	-	-	-	-	-	-	-	32,740	32,740
Due from banks and financial institutions	140,713	16,062	7,983	-	-	-	-	-	-	-	164,758
Murabaha receivables	12,013	16,018	9,407	25,012	53,018	54,973	57,930	51	95	-	228,517
Musharaka investments	8,501	1,910	452	3,353	7,498	16,285	23,035	16,476	3,500	-	81,010
Ijarah muntahia bittamleek	9,421	-	174	8	9,619	12,903	15,103	22,480	10,935	-	80,643
Investments	6,016	-	-	-	9,157	9,612	9,753	-	4,303	-	38,841
Ijarah rental receivables	3,530	51	-	293	583	3,649	1,929	2,609	676	-	13,320
Total Assets	**180,194**	**34,041**	**18,016**	**28,666**	**79,875**	**97,422**	**107,750**	**41,616**	**19,509**	**32,740**	**639,829**

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

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 2013;

	Own capital and current account											
	Non-performing or past due or impaired Islamic financing contracts BD'000	Aging of non-performing or past due or impaired Islamic financing contacts				Specific allowances				* General allowances		
		Less than 3 months** BD'000	3 months to 1 year BD'000	1 to 3 years BD'000	Over 3 years BD'000	Balance at the beginning of the year BD'000	Charges during the year BD'000	Charge-offs during the year BD'000	Balance at the end of year BD'000	General allowances beginning balance BD'000	General allowances movement BD'000	General allowances ending balance BD'000
Trading and Manufacturing	2,738	1,881	3	854	-	80	140	-	221	-	-	-
Real Estate	3,996	1,537	2,136	321	2	814	1,034	61	1,787	-	-	-
Banks and Financial Institutions	161	161	-	-	-	308	-	308	-	-	-	-
Personal / Consumer Finance	6,923	5,932	57	34	900	622	693	69	1,246	-	-	-
Others	1,827	1,423	296	103	5	61	4	21	42	-	-	-
No specific sector	818	818	-	-	-	-	-	-	-	170	279	449
Total	**16,463**	**11,752**	**2,492**	**1,312**	**907**	**1,885**	**1,871**	**459**	**3,296**	**170**	**279**	**449**

* 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.

3 Risk Management (continued)

3.5 Credit Risk (continued)

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 2013;

	Profit Sharing Investment Account											
	Non-performing or past due or impaired Islamic financing contracts BD'000	Aging of non-performing or past due or impaired Islamic financing contacts				Specific allowances				* General allowances		
		Less than 3 months** BD'000	3 months to 1 year BD'000	1 to 3 years BD'000	Over 3 years BD'000	Balance at the beginning of the year BD'000	Charges during the year BD'000	Charge-offs during the year BD'000	Balance at the end of year BD'000	General allowances beginning balance BD'000	General allowances movement BD'000	General allowances ending balance BD'000
Trading and Manufacturing	22,731	15,616	25	7,090	-	1,192	742	101	1,833	-	-	-
Real Estate	33,179	12,759	17,736	2,667	16	11,984	3,678	820	14,842	-	-	-
Banks and Financial Institutions	1,333	1,333	-	-	-	4,533	-	4,533	-	-	-	-
Personal / Consumer Finance	57,486	49,259	476	281	7,471	9,158	1,765	572	10,352	-	-	-
Others	15,171	11,808	2,462	859	43	905	31	587	349	-	-	-
No specific sector	6,793	6,793	-	-	-	-	-	-	-	2,518	1,206	3,724
Total	**136,693**	**97,568**	**20,699**	**10,897**	**7,530**	**27,772**	**6,216**	**6,613**	**27,376**	**2,518**	**1,206**	**3,724**

* 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.

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 2013;

	Own capital and current account			Profit Sharing Investment Account		
	Non- performing or past due or impaired Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000	Non- performing or past due or impaired Islamic financing contracts BD'000	Specific Impairment provision BD'000	Collective Impairment provision BD'000
Middle East	16,463	3,296	449	136,693	27,376	3,724
Total	16,463	3,296	449	136,693	27,376	3,724

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3 Risk Management (continued)
3.5 Credit Risk (continued)

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 2013;

	Own capital and current account Aggregate amount BD'000	Profit Sharing Investment Account Aggregate amount BD'000
Restructured financing facilities	1,120	9,297
Total	**1,120**	**9,297**

The provision on restructured facilities is BD 276 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 2013 by type of Islamic financing contract covered by eligible collateral;

	Total exposure covered by	
	Eligible collateral BD'000	Guarantees BD'000
Murabaha receivables	8,050	13,745
Musharaka investments	10	550
Ijarah muntahia bittamleek	430	1,000
Total	**8,490**	**15,295**

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 2013;

	BD'000
Gross positive fair value of contracts	
Netting Benefits	910,294
Netted current credit exposure	910,294
Collateral held:	
-Cash	8,490
-Shares	5,810
-Real Estate	243,605
Total	**257,905**

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

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 Risk Management (continued)

3.6 Market Risk

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.

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.

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3 Risk Management (continued)

3.6 Market Risk (continued)

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.

3.6.9 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 2013;

	Foreign exchange risk BD'000
Foreign exchange risk	18,416
Foreign exchange risk capital requirement	2,210
Maximum value capital requirement	2,210
Minimum value capital requirement	1,473

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 Risk Management (continued)

3.7 Operational Risk (continued)

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.

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.

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3 Risk Management (continued)

3.7 Operational Risk (continued)

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		
	2012 BD'000	2011 BD'000	2010 BD'000
Total Gross Income	**23,780**	**24,856**	**18,777**
Indicators of operational risk			
Average Gross income (BD'000)			**22,471**
Multiplier			**12.5**
			280,888
Eligible Portion for the purpose of the calculation			**15%**
TOTAL OPERATIONAL RISK WEIGHTED EXPOSURE (BD'000)			**42,133**

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.

3.8 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 2013. 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 2013;

	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	38,365	31,303	-	38,365	11,257	1,351
Equity investments	42,991	41,778	22,996	19,995	65,243	7,829
Funds	25,670	26,924	-	25,670	40,837	4,900
Total	**107,026**	**100,005**	**22,996**	**84,030**	**117,337**	**14,080**

* 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 2013;

	BD'000
Cumulative realised gain arising from sales or liquidations in the reporting period	694
Total unrealised losses recognised in the consolidated statement of financial position	
but not through consolidated statement of income	515
Unrealised losses included in Tier 1 Capital	331
Unrealised gains included in Tier 2 Capital*	1,407

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

3 Risk Management (continued)

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.

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.

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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 2013;

	BD'000
Customers	617,494
Financial institutions' investment accounts	95,144
Total	**712,638**

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 2013;

Profit Paid on Average IAH Assets *	2.33%
Mudarib Fee to Total IAH Profits	65.00%

* 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 2013;

Account Type	Profit distributed to total IAH	Percentage to total IAH
Saving accounts (including VEVO)	2.27%	14.38%
Defined accounts - 1 month	1.06%	1.00%
Defined accounts - 3 months	0.35%	1.00%
Defined accounts - 6 months	0.58%	0.38%
Defined accounts - 9 months	0.00%	0.54%
Defined accounts - 1 year	3.07%	0.00%
Investment certificates	0.72%	1.71%
IQRA Deposits	0.82%	0.57%
Tejoori Deposit	2.46%	15.73%
Customer's deposits	86.24%	51.34%
Bank's deposits	2.44%	13.35%
	100%	100%

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

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 2013;

	Percentage of Financing to Total Financing
Due from banks and financial institutions	27.35%
Murabaha receivables	37.93%
Musharaka investments	13.45%
Investment in Sukuk	5.68%
Ijarah muntahia bittamleek	13.39%
Ijarah rental receivables	2.21%

3 Risk Management (continued)

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

	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	0.00%	27.35%	0.00%	0.00%	0.00%	0.00%	0.00%
Murabaha receivables	5.71%	2.75%	5.25%	0.71%	20.50%	0.68%	2.32%
Musharaka investments	2.95%	0.00%	2.52%	0.00%	6.77%	0.36%	0.84%
Ijarah muntahia bittamleek	1.16%	0.00%	4.55%	0.94%	6.55%	0.00%	0.19%
Investment in Sukuk	0.00%	1.55%	2.18%	0.00%	0.00%	0.78%	1.17%
Ijarah rental receivables	0.32%	0.00%	0.54%	0.08%	1.24%	0.00%	0.04%
	10.14%	**31.65%**	**15.04%**	**1.73%**	**35.06%**	**1.83%**	**4.56%**

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 2013;

Share of profit earned by IAH before transfer to/from reserves - BD '000	32,849
Percentage share of profit earned by IAH before transfer to/from reserves	30.51%
Share of profit paid to IAH after transfer to/from reserves - BD '000	11,124
Percentage share of profit paid to IAH after transfer to/from reserves	29.72%
Share of profit paid to Bank as mudarib - BD '000	21,725

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 2013;

	3 month	6 month	12 month	36 month
Percentage of average distributed rate of return to profit rate of return	1.48%	1.78%	2.16%	3.50%

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 2013;

	Opening Actual Allocation BD'000	Movement During the Period BD'000	Closing Actual Allocation BD'000
Cash and balances with banks and Central Bank	28,255	4,485	32,740
Due from banks and financial institutions	124,005	40,753	164,758
Murabaha receivables	213,276	15,241	228,517
Musharaka investments	84,484	(3,474)	81,010
Ijarah muntahia bittamleek	90,688	(10,045)	80,643
Investment in sukuk	38,438	403	38,841
Ijarah rental receivables	12,891	429	13,320
Total	**592,037**	**47,792**	**639,829**

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3 Risk Management (continued)

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

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
2013	32,849	4.98%	11,124	1.69%
2012	30,662	5.21%	13,993	2.38%
2011	33,029	5.53%	14,742	2.31%
2010	3,083	4.46%	17,721	2.39%
2009	35,694	5.27%	17,638	2.61%
2008	36,934	5.87%	17,702	2.81%

Table – 32 Treatment of assets financed by IAH (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	32,740	-	-	-
Murabaha receivables*	228,517	195,160	58,548	7,026
Due from banks and financial institutions	164,758	86,246	25,874	3,105
Musharaka investments*	81,010	69,185	20,755	2,491
Investment in sukuk	38,841	27,695	8,309	997
Ijarah muntahia bittamleek*	80,643	68,872	20,661	2,479
Ijarah rental receivables	13,320	13,320	3,996	480
	639,829	460,478	138,143	16,577

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

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 Risk Management (continued)

3.10 Liquidity Risk (continued)

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.

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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;

	2013	2012	2011	2010	2009	2008
Due from banks and financial institutions / Total Assets	20.28%	15.90%	17.73%	22.27%	12.10%	17.58%
Islamic Financing / Customer Deposits excluding banks	70.80%	72.32%	114.41%	115.46%	123.01%	144.62%
Customer Deposits / Total Assets	67.83%	68.87%	63.08%	64.13%	57.28%	48.71%
Liquid Assets / Total Assets	25.86%	21.17%	22.70%	27.02%	16.06%	23.25%
Growth in Customer Deposits	7.66%	8.36%	-11.71%	14.86%	21.98%	79.24%

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.

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 200 bp in profit rates as of 31 December 2013;

	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:	(5,636)	10,662	5,026
Downward rate shocks:	5,636	(10,662)	(5,026)

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;

	2013	2012	2011	2010	2009	2008
Return on average equity	8.26%	-42.31%	-17.23%	-33.02%	-12.64%	-12.62%
Return on average assets	0.70%	-4.33%	-1.96%	-4.30%	-2.17%	-2.91%
Cost to Income Ratio	53.44%	80.14%	74.89%	107.73%	70.66%	31.32%

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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
FX	Foreign Exchange
GM-C&RM	General Manager-Credit and Risk Management
Group	Bahraini 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