AL SALAM BANK-BAHRAIN B.S.C.

BASEL II - PILLAR III DISCLOSURES

30th June 2011

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1. Introduction

The new Central Bank of Bahrain (CBB) requirements, which act as a common framework for the implementation of the Basel II accord in the Kingdom of Bahrain came into effect on 1 January 2008.

The Basel II accord is built on three pillars:

- **Pillar I** defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by own regulatory funds.
- **Pillar II** addresses the Bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory Review and Evaluation Process (SREP), which assesses the internal capital adequacy.
- **Pillar III** complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

In November 2007 the CBB issued directives on the Pillar III disclosures under the Basel II framework applicable to licensed Islamic banks in Bahrain. These directives set out enhanced disclosure requirements required under Basel II framework. In accordance with the above requirement, the Al Salam Bank-Bahrain B.S.C. (the "Bank" or "ASBB") developed this document which gathers all the elements of the disclosure required under Pillar III and is organized as follows:

Firstly, it provides the profile of the risk weighted assets according to the "standard portfolio" as defined by the CBB.

Secondly, an overview of risk management practices and framework at the Bank is presented with specific emphasis on credit, market and operational risks and sets out the related monitoring processes and credit mitigation initiatives.

Finally, this document provides all other disclosures required under the public disclosure module of the CBB.

The disclosures in this document are in addition to the disclosures included in the interim condensed consolidated financial statements which are prepared in accordance with Financial Accounting Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions.

2. Financial Performance and Position

The parent company Al Salam Bank-Bahrain B.S.C., (the “Bank” or “ASBB”) was incorporated on 19 January 2006 in the Kingdom of Bahrain. The Bank operates under Islamic Shari’a principles in accordance with the regulatory requirements for Islamic banks set by the Central Bank of Bahrain (CBB). The Bank is listed on Bahrain Stock Exchange and Dubai Stock Exchange and operates under an Islamic retail banking license issued by CBB.

The Bank’s subsidiary, Bahrain Saudi bank B.S.C. (BSB) is a publically listed commercial bank in the Kingdom of Bahrain. BSB operates under a retail banking license issued by the CBB. BSB has applied for an Islamic retail banking license with the CBB and is awaiting approval as of 30 June 2011. The Bank and its subsidiary, BSB, (together known as "the Group") operate through twelve retail branches in the Kingdom of Bahrain

The interim condensed consolidated financial statements and capital adequacy regulatory disclosures of the Group have been prepared on a consistent basis where applicable.

Table 2.1 ***Key Financial Indicators (PD 1.3.9 a,b,c)***

Amount in BD millions	**June 2011**	**June 2010**	**Dec 2010**	**Dec 2009**	**Dec 2008**	**Dec 2007**	**Dec 2006***
Total Operating Income	7	11.8	22.3	23.7	37.6	32.7	20.4
Net Profit	0.6	5.4	7.3	14.0	25.5	23.1	16.4
Total Assets	828.3	814.2	857.3	785.9	554.5	397.8	188.1
Total equity	200.9	200.3	201.9	201.8	172.5	159.5	136.5
Key Ratios	**June 2011**	**June 2010**	**Dec 2010**	**Dec 2009**	**Dec 2008**	**Dec 2007**	**Dec 2006***
Earnings per share (fils)	0.3	3.6	5.0	10.0	21.3	19.3	15.1
Return on average assets **(%)	0.1	1.4	0.9	2.1	4.7	7.9	11.2
Return on average equity** (%)	0.5	5.3	3.6	7.6	15.8	15.6	15.1
Cost to operating income (%)	86.1	55.7	60.6	40.6	31.3	33.5	19.6
Dividend payout ratio (%)	-	-	-	51.0	46.9	51.8	-
Dividend yield ratio (%)	-	-	-	5.4	11.4	4.9	-

* Represents the period from 19 January 2006 (date of incorporation) to 31 December 2006.

** Annualised

Table 2.2 *Financial Summary* ***(BD '000)***

Consolidated Financial Position	**June 2011**	**Dec 2010**	**Dec 2009**	**Dec 2008**	**Dec 2007**	**Dec 2006***
Cash and balances with banks and Central Bank of Bahrain	73,629	95,791	126,739	83,534	15,174	2,942
Murabaha and Wakala receivables from banks	89,422	137,299	149,304	87,167	224,451	105,090
Central Bank of Bahrain Sukuk	104,714	68,632	32,908	31,095	20,380	-
Corporate Sukuk	41,084	60,959	16,950	-	-	
Murabaha and Mudaraba financing	152,225	120,812	87,274	72,484	32,642	22,963
Ijarah Muntahia Bittamleek	77,340	69,825	46,315	41,531	10,436	10,382
Musharaka Financing	10,229	8,127	5,384	-	-	
Assets under conversion**	39,892	57,432	98,305	-	-	
Non-trading investments	222,089	212,432	184,680	116,930	62,736	32,619
Investment in an associate	-	7,578	7659	8,012	8,272	23,647
Investment properties	3,373	3,373	1,177	1,177	1,177	1,177
Assets held-for-sale	-	-	-	88,934	9,024	-
Murabaha and Wakala payables to banks	98,276	101,300	89,398	32,881	96,983	
Wakala from non-banks	436,578	456,447	317,370	289,005	106,909	-
Customers' current accounts	62,160	57,362	32,700	42,986	5,689	5,674
Liabilities under conversion**	5,092	5,171	120,402	-	-	
Equity of Investment account holders (EOIA)	12,862	18,465	9,409	6,370	19,770	20,112
Capital	**June 2011**	**Dec 2010**	**Dec 2009**	**Dec 2008**	**Dec 2007**	**Dec 2006***
Capital adequacy	24.8%	24.7%	28.6%	24.7%	48.7%	79.8%
Equity/total assets	24.3%	23.6%	25.7%	31.1%	40.10%	72.53%
Total deposits/equity (times)	2.5x	2.6x	2.3x	2.2x	1.4x	0.4x
Liquidity and Other	**June 2011**	**Dec 2010**	**Dec 2009**	**Dec 2008**	**Dec 2007**	**Dec 2006***
Islamic financing contracts/total assets	29.0%	23.2%	40.9%	41.9%	72.4%	73.6%
Investments/total assets	36.6%	33.9%	30.1%	38.6%	20.1%	19.1%
Liquid assets/total assets	32.4%	35.3%	40.2%	30.8%	60.3%	57.5%
Islamic financing contracts/customer deposits	46.9%	37.3%	70.0%	68.7%	217.5%	536.9%
Number of employees	*221*	*223*	*231*	*116*	*110*	*58*

* Represents the period from 19 January 2006 (date of incorporation) to 31 December 2006.
** These represent assets and liabilities of BSB which are under conversion to Shari'a compliant products.

3. Capital structure

The Group's capital base comprises of Tier 1 capital and Tier 2 capital which are detailed in the following table: (PD 1.3.11)

The issued and paid up share capital of the Group was BD 149,706 thousand at 30 June 2011, comprising of 1,497,064 thousand shares of BD 0.100 each. (PD 1.3.11)

The Group's eligible capital base of BD 175,648 thousand comprises Tier 1 capital and Tier 2 capital as detailed below: (PD 1.3.11)

Table 3.1 Breakdown of Capital Base (PD 1.3.12, 13, 14, 15, 16) **BD '000s**

	Tier 1	Tier 2	Total
Paid-up share capital	149,241		149,241
Legal/ Statutory reserves	8,631		8,631
Share premium	2,573		2,573
Retained earnings	4,813		4,813
Unrealized gains arising from fair valuing equities (45% only)	14,773		14,773
Minority interest	**4,077**		**4,077**
Less:			
Current interim cumulative net loss	(153)		(153)
Unrealized gross losses arising from fair valuing equity securities	(1,780)		(1,780)
Tier 1 Capital before Prudential consolidation and deduction (PCD) requirements	**182,175**		**182,175**
Unrealized gains arising from fair valuing equities (45%)	-	302	302
Investment risk reserve	-	7	7
Tier 2 Capital before PCD requirements (2.1 to 2.5 inclusive less 2.6)	**-**	**309**	**309**
Total available capital	**182,175**	**309**	**182,484**

Table 3.1 Breakdown of Capital Base (PD 1.3.12, 13, 14, 15, 16) (continued) **BD '000s**

	Tier 1	Tier 2	Total
Regulatory deductions:			
Excess amount over maximum permitted large exposure limit	(3,418)	(3,418)	(6,836)
Total Deductions	**(3,418)**	**(3,418)**	**(6,836)**
Additional deduction from Tier-1 to absorb deficiency in Tier-2	**(3,109)**	**3,109**	**-**
Total Eligible Capital (Tier 1 + Tier 2) (a) (PD 1.3.20 a)	**175,648**	**-**	**175,648**

Table 3.2 **BD '000s**

Risk Weighted Assets (RWA)	**Amount**
Credit risk	638,356
Market risk	12,397
Operational risk	58,192
Total Risk Weighted Assets (b)	**708,945**
Capital adequacy ratio for the Group (a/b) (PD 1.3.20 a)	
Tier 1 ratio (PD 1.3.20 a)	**24.8%**
Tier 2 ratio (PD 1.3.20 a)	**-**
Total ratio (PD 1.3.20 a)	**24.8%**
Minimum required by CBB regulations under Basel II (%)	**12%**

- Capital adequacy ratio for BSB is 37.08%

4. Capital Adequacy Ratios (CAR)

No impediments on the transfer of funds or reallocation of regulatory capital exist within the Group. (PD 1.3.6.c)

4.1 Capital Management

Internal Capital Adequacy Assessment Process (ICAAP)

The Group's capital management aims to maintain an optimum level of capital to enable it to pursue strategies that build long-term shareholder value, whilst always maintaining minimum regulatory ratio requirements.

The key principles driving capital management at ASBB include:

- Adequate capital is maintained as buffer for unexpected losses to protect stakeholders i.e. shareholders and depositors.
- Maximize return on capital and generate sustainable return above the cost of capital.

The adequacy of the Group's capital is monitored using, primarily, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the Central Bank of Bahrain. The primary objective of the Group's capital management is to ensure that it complies with externally imposed capital requirements. The Group complied in full with all externally imposed capital requirements during the period ended 30 June 2011.

5. Profile of Risk-weighted assets and capital charge

The Group has adopted the standardized approach for credit risk and market risk and the basic indicator approach for operational risk for regulatory reporting purposes. The Group's risk-weighted capital requirement for credit, market and operational risks are given below.

5.1 Credit risk

a) Definition of exposure classes per Standard Portfolio (PD 1.3.21 a)

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the standardized approach for credit risk.

The descriptions of the counterparty classes along with the risk weights to be used to derive the risk weighted assets are as follows:

a. Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain and GCC sovereigns are risk weighted at 0%. Claims on all other sovereigns are given a risk weighting of 0% where such claims are denominated and funded in the relevant domestic currency of that sovereign. Claims on sovereigns, other than those mentioned above are risk weighted based on their credit ratings.

b. Claims on public sector entities (PSEs)

Listed Bahrain PSEs are assigned 0% risk weight. Other sovereign PSE's, in the relevant domestic currency and for which the local regulator has assigned risk weight as 0%, are assigned 0% risk weight by the CBB. PSEs other than those mentioned above are risk weighted based on their credit ratings.

c. Claims on banks

Claims on banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims on locally incorporated banks may be assigned a risk weighting of 20% where such claims on the banks are of an original maturity of three months or less and the claims are denominated and funded in either Bahraini Dinars or US Dollars.

Preferential risk weights that are one category more favorable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain of an original maturity of three months or less denominated and funded in the relevant domestic currency. Such preferential risk weights for short-term claims on banks licensed in other jurisdictions are allowed only if the relevant supervisor also allows this preferential risk weighting to short-term claims on its banks.

5.1 Credit risk (continued)

c. Claims on banks (continued)

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation. Investment in subordinated debt of banking, securities and financial entities are risk weighted at a minimum risk weight of 100% for listed entities or 150% for unlisted entities, unless such investments exceed 20% of the eligible capital of investee entity, in which case they are deducted from the Bank's capital.

d. Claims on corporate portfolio, including insurance companies

Claims on corporate portfolio including insurance companies are risk weighted based on credit ratings. Risk weightings for unrated corporate claims are assigned at 100%.

e. Claims on regulatory retail portfolio

Retail claims that are included in the regulatory retail portfolio are assigned risk weights of 75% (except for past due Islamic financing contracts), if it meets the criteria mentioned in the CBB's rule book.

f. Mortgages

Claims secured by mortgages on commercial real estate are subject to a minimum of 100% risk weight.

g. Past due receivables (PD 1.3.22 a)

The unsecured portion of the account receivables and lease payment receivables (other than a qualifying residential mortgage financing contract) that is past due for more than 90 days, is risk-weighted as follows (net of specific provisions and including partial write-offs):

(a) 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan.
(b) 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the loan.

h. Investment in securities and sukuk

Investments in listed equities are risk weighted at 100% while unlisted equities are risk weighted at 150%.

5.1 Credit risk (continued)

i. Holding of real estate

All holdings of real estate by banks (i.e. owned directly or by way of investments in Real estate companies, subsidiaries or associate companies or other arrangements such as trusts, funds or REITs) are risk-weighted at 200%. Premises occupied by the Group are weighted at 100%

j. Underwriting of non-trading book items

Where the Group has acquired assets on its balance sheet in the banking book which it is intending to place with third parties under a formal arrangement and is underwriting the placement, the following risk weightings apply during the underwriting period (which may not last for more than 90 days). Once the underwriting period has expired, the usual risk weights should apply.

(a) For holdings of private equity, a risk weighting of 100% applies instead of the usual 150%.
(b) For holdings of Real Estate, a risk weight of 100% applies instead of the usual 200% risk weight.

k. Other assets

These are risk weighted at 100%.

5.1 Credit risk (continued)

Table 5.1 Funded and Unfunded Exposures

	Gross Credit Exposure	Average Gross Credit Exposure	Funded Exposure	Unfunded Exposure (after CCF)	Cash Collateral	Eligible Guarantees	Eligible CRM	Risk-Weighted Assets (RWA)	RWA for CAR	Minimum Capital Charge
Cash	4,824	4,392	4,824	-	-	-	-	-	-	-
Claims on sovereigns	208,985	199,854	203,615	5,370	-	-	-	3,987	3,987	478
Claims on public sector entities	4,938	4,945	4,938	-	-	-	-	4,938	4,938	593
Claims on banks	120,549	146,991	120,549	-	-	-	-	43,944	36,927	4,432
Claims on corporate portfolio	180,853	166,076	168,583	12,270	7,521	-	11,236	142,676	142,676	17,121
Claims on regulatory retail portfolio	207	278	207	-	-	-	-	155	155	19
Mortgages	52,011	56,538	51,771	240	-	-	11,832	39,101	39,101	4,692
Past due receivables over 90 days	28,347	28,243	28,347	-	-	-	7,584	29,391	29,391	3,527
Investments in Securities and Sukuk	57,478	57,025	57,478	-	-	-	-	76,520	76,520	9,182
Holding of Real Estate	117,120	118,200	117,120	-	-	-	-	234,240	234,240	28,109
Other assets and Specialized financing	68,226	70,922	67,897	329	-	-	-	70,421	70,421	8,450
Total	**843,538**	**853,464**	**825,329**	**18,209**	**7,521**	**-**	**30,652**	**645,373**	**638,356**	**76,603**

Note a: The unfunded exposure before (CCF) as of June 2011 is BD 54,647k.

Note b: The amounts in the above table are based on the exposures as reported in the respective prudential returns.

5.1 Credit risk (continued)

Following is the Gross credit exposure by Islamic financing contracts which represents the exposure on accounts receivable and lease payments receivable which are collateralized by cash or eligible guarantee: (PD 1.3.25 b, c)

Table 5.2 Portfolio by Islamic financing contracts (excluding equity contracts and assets under conversion)

BD '000s

	Gross Credit Exposure	Average Credit Exposure	Funded Exposure	Unfunded Exposure (after CCF)	Cash Collateral	Eligible Guarantees	Eligible CRM	Risk-Weighted Assets	RWA for CAR	Minimum Capital Charge
Central Bank of Bahrain Sukuk	105,162	94,451	105,162	-	-	-	-	-	-	-
Corporate Sukuk	41,291	53,539	41,291	-	-	-	-	28,518	28,518	3,422
Murabaha and Wakala receivables from banks	89,462	103,330	89,462	-	-	-	-	27,876	26,075	3,129
Murabaha and Mudaraba financing	161,564	133,159	150,603	10,961	5,239	-	4,684	135,049	135,049	16,206
Ijarah Muntahia Bittamleek	77,875	76,207	77,802	73	-	-	18,935	72,600	72,600	8,712
Musharaka Financing	10,285	9,088	10,268	17	-	-	-	10,233	10,233	1,228
Total	**485,639**	**469,774**	**474,588**	**11,051**	**5,239**	**-**	**23,619**	**274,276**	**272,475**	**32,697**

5.1 Credit risk (continued)

Excessive risk concentration (PD 1.3.26 a)

Concentrations 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 indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

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

Credit risk concentrations and thresholds

The first level of protection against undue credit risk is through country, industry and threshold limits, together with customer and customer group credit limits, set by the Risk Committee. Credit exposure to individual customers or customer groups is then controlled through a tiered hierarchy of delegated approval authorities based on the risk rating of the customer under the Group's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Group policies require collateral to mitigate the credit risk in the form of cash, securities, and legal charges over the customer's assets or third-party guarantees.

Single name concentrations are monitored on an individual basis. Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties exceeding 15 percent of the regulatory capital base.

As at 30 June 2011, the Group's exposures in excess of 15% of the obligor limits to individual counterparties, and excluding Central Bank exposures were BD 34,208 thousand. The obligor limits referred to herein reflect the eligible capital base as per CBB rules and regulations. (PD 1.3.23 f)

5.1 Credit risk (continued)

Table 5.3 (PD 1.3.23 b) **BD '000s**

	Financed by Equity and Current Account		Financed by Equity of investment account holders		
	On Balance Sheet Exposure	Off Balance Sheet Exposure	On Balance Sheet Exposure	Off Balance Sheet Exposure	Total Exposure
Counterparty A	32,598	1,610	-	-	34,208
Total	**32,598**	**1,610**	**-**	**-**	**34,208**

Risk mitigation, collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral mainly include cash, lien on property and guarantees from banks. With the exception of cash, the Group monitors the concentration of its credit risk mitigants in order to minimize exposure to one type of collaterals. As on 30 June 2011, the collaterals (after applying regulatory haircuts) amounted to BD 31 million (PD 1.3.25 a)

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses with respect to Murabaha and Ijara facilities. The Group also makes use of master netting agreements with counterparties where relevant. (PD 1.3.25 a)

The main types of guarantors include rated Groups & other financial institutions and Sovereigns which are rated by ECAI's along with personal guarantees of the Board of Directors/ key management personnel of the borrower and other high net worth individuals.

The Group obtains additional collateral as and when the value of the collateral originally obtained is assessed at lower than the minimum acceptable LTV ratio of collateral. Also where the customer is not in a position to provide additional collateral ASBB in consultation with its legal department evaluates the available legal and contractual options.

The Group ensures that at the inception of the facility, third party valuation of the tangible collaterals is obtained and performs an annual review of the facility whereby the revised collateral valuation is obtained from the third party. In line with the Basel II Pillar II regulations, the Bank performs monthly collateral value stress tests to evaluate the effect of devaluations on their collateral portfolio. The devaluation parameters differ depending on the collateral type.

In case of default, the Group will work with the counterparty to discuss how the outstanding facility can be settled. As a last resort, the counterparty's assets will be used to settle the outstanding obligation.

5.1 Credit risk (continued)

5.1.1 Geographical distribution of exposures

The exposures are allocated to individual geographic areas based on the country where the exposure risk specific to the facility exists. The Geographical distribution of exposures by exposure type and funded or unfunded by is as follows:

Table 5.4 (PD 1.3.23 b) **BD '000s**

Contribution by Equity and Current Account							
Exposure type	**GCC countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	69,880	-	608	1,303	1,838	-	73,629
Central Bank of Bahrain Sukuk	104,714	-	-	-	-	-	104,714
Murabaha and Wakala receivables from banks	76,560	-	-	-	-	-	76,560
Corporate Sukuk	36,162	-	1,149	1,888	1,885	-	41,084
Murabaha and Mudaraba financing	145,810	-	3,036	3,379		-	152,225
Ijarah Muntahia Bittamleek	77,340	-	-	-	-	-	77,340
Mushakara financing	10,229	-	-	-	-	-	10,229
Assets under conversion	36,520	5	2,497	3	867		39,892
Non-trading investments	158,156	7,578	11,089	43,813	-	1,453	222,089
Investment properties	3,373	-	-		-	-	3,373
Receivables and prepayments	12,292	-	-	530	6	-	12,828
Premises and equipment	1,439	-	-	-	-	-	1,439
Total funded exposures	**732,475**	**7,583**	**18,379**	**50,916**	**4,596**	**1,453**	**815,402**
Commitments	53,112	-	-	1,535	-	-	54,647
Total unfunded exposures	**53,112**	**-**	**-**	**1,535**	**-**	**-**	**54,647**
TOTAL	**785,587**	**7,583**	**18,379**	**52,451**	**4,596**	**1,453**	**870,049**

5.1 Credit risk (continued)

5.1.1 Geographical distribution of exposures (continued)

The Geographical distribution of exposures by exposure type and funded or unfunded by is as follows:

Table 5.5 (PD 1.3.23 b) **BD '000s**

Contribution by Equity of investment account holders							
Exposure Type	**GCC Countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	-	-	-	-	-	-	-
Central Bank of Bahrain Sukuk	-	-	-	-	-	-	-
Murabaha and Wakala receivables from banks	12,862	-	-	-	-	-	**12,862**
Corporate Sukuk	-	-	-	-	-	-	-
Murabaha and Mudaraba financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Mushakara financing	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-
Total funded exposures	**12,862**	**-**	**-**	**-**	**-**	**-**	**12,862**
Commitments	-	-	-	-	-	-	-
Total unfunded exposures	-	-	-	-	-	-	-
TOTAL	**12,862**	**-**	**-**	**-**	**-**	**-**	**12,862**

5.1 Credit risk (continued)

5.1.1 Geographical distribution of exposures (continued)

The Group has a few past due financing contracts that have not been settled as of 30 June 2011. All past due but not impaired Murabaha and Ijara financing are covered by sufficient collaterals that include cash, personal and sovereign guarantees. As of 30 June 2011, a specific provision of BD 1,508k (30 June 2010: BD nil) has been taken against past due financing contracts. Also as of 30 June 2011 a general provision of BD500K (30 June 2010: BD nil) has been maintained against the Ijarah portfolio.(PD 1.3.23 h, i)

Table 5.6 The geographical distribution of exposures including impaired assets and the related impairment provisions (PD 1.3.23 i)

BD '000s

	Contribution by Equity and Current Account					
	Gross Credit Exposure	Past Due Financing Contracts	Specific Provision Financing Contracts	General Provision Financing Contracts	Impaired Financing Contracts	Specific Provision Impaired Investments
GCC Countries	785,587	28,347	1,508	500	4,700	-
Arab World	7,583	-	-	-	-	-
Europe	18,379	-	-	-	-	-
Asia	52,451	-	-	-	-	-
America	4,596	-	-	-	-	-
Other	1,453	-	-	-	-	-
Total	**870,049**	**28,347**	**1,508**	**500**	**4,700**	**-**

5.1 Credit risk (continued)

5.1.1 Geographical distribution of exposures (continued)

Table 5.7 **BD'000s**

Contribution by Equity of investment account holders					
	Gross Credit Exposure	Impaired Financing Contracts	Specific Provision Impaired Financing Contracts	Impaired Investments	Specific Provision Impaired Investments
GCC Countries	12,862	-	-	-	
Arab World	-	-	-	-	-
Europe	-	-	-	-	-
Asia	-	-	-	-	-
America	-	-	-	-	-
Other	-	-	-	-	-
Total	**12,862**	**-**	**-**	**-**	**-**

5.1 Credit risk (continued)

5.1.2 Exposure by Industry

Table 5.8 Exposure by type of credit exposure (PD 1.3.23 c) **BD '000s**

Contribution by Equity and Current Account							
Exposure Type	**Trading & Manufacturing**	**Banks & Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Others**	***Total**
Cash and balances with banks and Central Bank of Bahrain	-	24,107	-	-	-	*49,522	73,629
Central Bank of Bahrain Sukuk	-	-	-	-	-	*104,714	104,714
Murabaha and Wakala receivables from banks	-	76,560	-	-	-	-	76,560
Corporate Sukuk	-	31,470	-	1,877	-	7,737	41,084
Murabaha and Mudaraba financing	4,972	6,032	59,140	-	28,844	**53,237	152,225
Ijarah Muntahia Bittamleek	2,551	-	34,638	2,735	17,531	+19,885	77,340
Mushakara financing	-	-	9,831	-	398	-	10,229
Assets under conversion	3,688	9,602	2,824	-	2,372	21,406	39,892
Non-trading investments	-	7,692	135,277	4,340	-	+74,780	222,089
Investment properties	-	-	3,373	-	-	-	3,373
Receivables and prepayments	19	3,128	971	8	212	8,490	12,828
Premises and equipment	-	-	-	-	-	1,439	1,439
Total funded	**11,230**	**158,591**	**246,054**	**8,960**	**49,357**	**341,210**	**815,402**
Commitments	7,211	2,488	16,096	-	2,360	26,492	54,647
Total unfunded	**7,211**	**2,488**	**16,096**	**-**	**2,360**	**26,492**	**54,647**
Total exposure	**18,441**	**161,079**	**262,150**	**8,960**	**51,717**	**367,702**	**870,049**

* Exposures with the Central Bank of Bahrain. ; **Includes mainly sovereign exposure; + includes specialized financing hospitality sector

5.1 Credit risk (continued)

5.1.2 Exposure by Industry (continued)

Table 5.9 Exposure by type of credit exposure (PD 1.3.23 c) **BD '000s**

Contribution by Equity of investment account holders							
Exposure Type	**Trading & Manufacturing**	**Banks & Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	-	-	-	-	-	-	-
Central Bank of Bahrain Sukuk	-	-	-	-	-	-	-
Murabaha and Wakala receivables from banks	-	12,862	-	-	-	-	12,862
Corporate Sukuk	-	-	-	-	-	-	-
Murabaha and Mudaraba financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Mushakara financing	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Total funded	**-**	**12,862**	**-**	**-**	**-**	**-**	**12,862**
Undrawn commitments	-	-	-	-	-	-	-
Total unfunded	-	-	-	-	-	-	-
Total exposure	**-**	**12,862**	**-**	**-**	**-**	**-**	**12,862**

5.1 Credit risk (continued)

5.1.2 Exposure by Industry (continued)

Table 5.10 The exposure by industry including impaired assets and the related impairment is as follows: **BD '000s**

Contribution by Equity and Current Account							
	Gross Exposure	**Funded Exposure**	**Unfunded Exposure**	**Impaired Financing Contracts**	**Impaired Securities**	**Specific Provision Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	**18,441**	11,230	7,211	4,700	-	-	-
Banks and financial institutions	**161,079**	158,591	2,488	-	-	1,508	-
Real estate	**262,150**	246,054	16,096	-	-	-	-
Aviation	**8,960**	8,960	-	-	-	-	-
Individuals	**51,717**	49,357	2,360	-	-	-	-
Others	**367,702**	341,210	26,492	-	-	-	-
Total	**870,049**	**815,402**	**54,647**	**4,700**	**-**	**1,508**	**-**

5.1 Credit risk (continued)

5.1.2 Exposure by Industry (continued)

Table 5.11 The exposure by industry including impaired assets and the related impairment is as follows: **BD '000s**

Contribution by Equity of investment account holders							
	Gross Exposure	**Funded Exposure**	**Unfunded Exposure**	**Impaired Islamic Financing Contracts**	**Impaired Securities**	**Specific Provision Islamic Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	-	-	-	-	-	-	-
Banks and financial institutions	12,862	12,862	-	-	-	-	-
Real estate	-	-	-	-	-	-	-
Aviation	-	-	-	-	-	-	-
Individuals	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-
Total	**12,862**	**12,862**	**-**	**-**	**-**	**-**	**-**

5.1 Credit risk (continued)

5.1.3 Exposure by external credit rating

The Group uses external ratings from Standard & Poor's', Moody's, Fitch ratings, Islamic International Rating Agency and Capital Intelligence (accredited External Credit Assessment Institutions (ECAI's). The Group follows the lowest of the above ECAI's ratings. The breakdown of the Group's exposure into rated and unrated categories is as follows: (PD 1.3.22 c, d, e)

Table 5.12 **BD '000s**

	Gross Credit Exposure	Rated Exposure	Unrated Exposure
Cash	4,824	3,665	1,159
Claims on sovereigns	208,985	70,551	138,434
Claims on public sector entities	4,938	-	4,938
Claims on banks	120,549	88,981	31,568
Claims on corporate portfolio	180,853	36,009	144,844
Claims on regulatory retail exposure	207	-	207
Mortgages	52,011	-	52,011
Past due receivables over 90 days	28,347	-	28,347
Investments in Securities and Sukuk	57,478	-	57,478
Holding of Real Estate	117,120	-	117,120
Other assets and Specialized financing	68,226	-	68,226
Total	**843,538**	**199,206**	**644,332**

Note a: The amounts in the above table are based on the exposures as reported in the respective prudential returns.

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through the internal risk rating system. As such, the Group uses risk ratings that are supported by a variety of financial analytics, combined with processed market information, to provide the main inputs for the measurement of counterparty credit risk. All internal ratings are tailored to the various categories and are derived in accordance with the Group's credit policy, and are assessed and updated regularly. Each risk rating class is mapped to grades equivalent to Standard & Poor's', Moody's, Fitch ratings and Capital Intelligence rating agencies. (PD 1.3.22 e)

5.1 Credit risk (continued)

5.1.4 Maturity analysis of exposures

Table 5.13 Residual contractual maturity of the Group's major types of funded credit exposures are as follows: (PD 1.3.23 g) (PD 1.3.24 a)

BD '000s

	within 1 month	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 – 5 years	5 - 10 years	10 - 20 years	Over 20 years	Total Over 12 months	Total
Cash	4,824	-	-	-	**4,824**	-	-	-	-	**-**	**4,824**
Claims on sovereigns	119,048	6,972	7,084	273	**133,377**	64,670	1,953	3,615	-	**70,238**	**203,615**
Claims on banks	92,544	1,055	3,067	-	**96,666**	23,883	-	-	-	**23,883**	**120,549**
Claim on public sector entities	-	-	-	-	**-**	-	4,938	-	-	**4,938**	**4,938**
Claims on corporate portfolio	12,335	2,667	3,169	39,510	**57,681**	85,332	25,502	68		**110,902**	**168,583**
Claims on regulatory retail exposures	5	2	3	6	**16**	191	-	-	-	**191**	**207**
Past due exposures	19,214	-	-	-	**19,214**	-	9,133	-	-	**9,133**	**28,347**
Mortgages portfolio	4,443	720	1,749	8,802	**15,714**	23,273	11,382	1,402	-	**36,057**	**51,771**
Equity portfolios**	-	-	14000	526	**14,526**	102,594	-	-	-	**102,594**	**117,120**
Investments in Securities and Sukuk	-	-	-	3,397	**3,397**	54,081	-	-	-	**54,081**	**57,478**
Other exposures	10,707	1,331	1,506	3,923	**17,467**	48,618	939	873	-	**50,430**	**67,897**
Total	**263,120**	**12,747**	**30,578**	**56,437**	**362,882**	**402,642**	**53,847**	**5,958**	**-**	**462,447**	**825,329**

*The amounts in the above table are based on the exposures as reported in the respective prudential returns.

**Although equity securities are undated, these are expected to mature in 15 years.

5.1 Credit risk (continued)

5.1.4 Maturity analysis of exposures (continued)

Table 5.14 The residual contractual maturity analysis of unfunded exposures is as follows: **BD '000s**

	within 1 month	1 - 3 months	3 - 6 months	6 – 12 months	Total within 12 months	1 – 5 years	5 - 10 years	10 - 20 years	Over 20 years	Total over 12 months	Total
Claims on corporate portfolio	15,156	902	1,249	3,008	**20,315**	1,143	-	-	-	**1,143**	**21,458**
Regulatory retail exposures	-	503	-	-	**503**	-	-	-	-	**-**	**503**
Other Exposures	-	534	272	30,558	**31,364**	1,322	-	-	-	**1,322**	**32,686**
Total	**15,156**	**1,939**	**1,521**	**33,566**	**52,182**	**2,465**	**-**	**-**	**-**	**2,465**	**54,647**

Unfunded exposures are divided into the following exposure types in accordance with the calculation of credit risk weighted assets in the CBB's Basel II capital adequacy framework:

Credit related contingent items: Credit related contingent items comprise undrawn contracted financing commitments and operating lease commitments etc as detailed below:

Undrawn amount on Islamic financing contracts, operating lease commitments and other commitments represent commitments that have not been drawn down or utilized at the reporting date and are due to be paid from the future use of the resources respectively. The nominal amount provides the calculation base to which a CCF is applied for calculating the exposure. CCF ranges between 20% and 50% for commitments with original maturity of up to one year and over one year respectively & 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

5.1 Credit risk (continued)

5.1.4 Maturity analysis of exposures (continued)

The table below summarizes the notional principal amounts and the relative exposure before applying credit risk mitigation:

Table 5.15 **BD '000s**

	Notional Principal	Credit Exposure*
Credit related to contingent items	8,326	3,566
Operating lease commitments	1,948	-
Undrawn Islamic financing contracts commitments and other commitments	44,373	14,643
RWA	**54,647**	**18,209**

* Credit exposure is after applying CCF.

At 30 June 2011, the Group held eligible cash collaterals in relation to credit related contingent items amounting to BD 336k

5.1 Credit risk (continued)

5.1.4 Maturity analysis of exposures

Table 5.16 Residual expected maturity analysis by major type of credit exposure - Funded **BD '000s**

Funded	within 1 months	1 - 3 months	3 - 6 months	6 - 12 months	Total within 12 months	1 – 5 years	5 - 10 years	10 - 20 years	Over 20 years	Total over 12 months	*Total
Cash and balances with banks and Central Bank of Bahrain	70,014	-	-	-	**70,014**	-	-	3,615	-	**3,615**	**73,629**
Central Bank of Bahrain Sukuk	4,440	7,940	47,960	20,000	**80,340**	24,374	-	-		**24,374**	**104,714**
Murabaha and Wakala receivables from banks	78,367	11,055	-	-	**89,422**	-	-	-	-	**-**	**89,422**
Corporate Sukuk	4	-	-	14,909	**14,913**	26,171	-	-	-	**26,171**	**41,084**
Murabaha and Mudaraba financing	12,562	2,508	49,509	6,954	**71,533**	68,741	11,883	68	-	**80,692**	**152,225**
Ijarah Muntahia Bittamleek	12,238	649	1,990	5,141	**20,018**	36,362	19,525	1,435	-	**57,322**	**77,340**
Musharaka	2,506	13	19	5,269	**7,807**	2,314	106	2	-	**2,422**	**10,229**
Assets under conversion	1,656	1,194	1,596	7,260	**11,706**	20,192	7,994	-	-	**28,186**	**39,892**
Non-trading investments	-	-	14,000	-	**14,000**	208,089	-	-	-	**208,089**	**222,089**
Investment properties	-	-	-	-	**-**	3,373	-	-	-	**3,373**	**3,373**
Receivables and prepayments	11,224	475	1,059	47	**12,805**	23	-	-	-	**23**	**12,828**
Premises and equipment	-	-	-	-	**-**	600	-	839	-	**1,439**	**1,439**
Total	**193,011**	**23,834**	**116,133**	**59,580**	**392,558**	**390,239**	**39,508**	**5,959**	**-**	**435,706**	**828,264**

*These amounts are based on the exposures as reported in the interim consolidated statement of financial position.

5.1 Credit risk (continued)

5.1.4 Maturity analysis of exposures (continued)

Table 5.16 (a) Residual maturity analysis by major type of credit exposure - Unfunded **BD '000s**

	within 1 month	1 – 3 months	3 – 6 months	6 –12 months	Total within 12 months	1 – 5 years	5 –10 years	10 – 20 years	Over 20 years	Total over 12 months	Total
Murabaha financing	15,156	1,939	1,093	5,900	**24,088**	1,143	-	-	-	**1,143**	**25,231**
Ijarah Muntahia Bittamleek	-	-	156	-	**156**	-	-	-	-	**-**	**156**
Musharaka	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Nontrading investments	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Receivables and prepayments	-	-	272	27,666	**27,938**	1,322	-	-	-	**1,322**	**29,260**
Total	**15,156**	**1,939**	**1,521**	**33,566**	**52,182**	**2,465**	**-**	**-**	**-**	**2,465**	**54,647**

5.1 Credit risk (continued)

5.1.5 (a) Maturity analysis of funding

Table 5.17 Residual maturity analysis by major type of funding **BD '000s**

	within 1 month	1 – 3 months	3 – 6 months	6 – 12 months	Total within 12 months	1 – 5 years	5 – 10 years	10 – 20 years	Over 20 years	Total over 12 months	Total
Murabaha and Wakala payables to banks	84,495	13,781	-	-	**98,276**	-	-	-	-	**-**	**98,276**
Wakala from non-banks	9,047	7,092	113,886	57,453	**187,478**	249,100	-	-	-	**249,100**	**436,578**
Customers' current accounts	34,449	1,083	1,083	1,083	**37,698**	24,462	-	-	-	**24,462**	**62,160**
Liabilities under conversion	5,092	-	-	-	**5,092**	-	-	-	-	**-**	**5,092**
Other liabilities	9,795	1,340	1,020	215	**12,370**	-	-	-	-	**-**	**12,370**
Equity of Investment account holders	9,298	92	92	92	**9,574**	3,288	-	-	-	**3,288**	**12,862**
Total	**152,176**	**23,388**	**116,081**	**58,843**	**350,488**	**276,850**	**-**	**-**	**-**	**276,850**	**627,338**

5.2 Market risk

Market risk arises from fluctuations in global yields on financial instruments and foreign exchange rates that could have an indirect effect on the Group's assets value and equity prices. The Board has set limits on the risk that may be accepted. This is monitored on a regular basis by the Group's Asset and Liability Committee. (PD 1.3.27 a)

Table 5.18 The Group's capital charge in respect of market risk in accordance with the standardized methodology is as follows:

BD '000s

	RWA	Period End Capital Charge	Capital Charge – Minimum*	Capital Charge – Maximum*
Equity position risk	-	-	-	-
Sukuk risk	-	-	-	-
Foreign exchange risk	12,397	986	814	986
Options risk	-	-	-	-
Total market risk	**12,397**	**986**	**814**	**986**

Foreign exchange positions constitute a major component of the market risk capital charge. The Group maintains a conservative market risk exposure that is focused on the foreign exchange risk coming from the Group's banking book open positions. The open positions were taken in order of running the Group's day to day operations that include private equity funding for the Group's investment portfolio. The Group monitors these open positions on a daily basis through the automated system reports. (PD 1.3.27 a)

* The information in these columns shows the minimum and maximum capital charge of each of the market risk categories on a day during the period ended 30 June 2011.

5.3 Operational risk

(PD 1.3.21 c)
Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems, or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely; however shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal, the Group has developed an operational risk framework which encompasses identification, measurement, management and monitoring of risk through risk control and mitigation. A variety of underlying processes are being deployed across the Group including risk and control self assessments, Key Risk Indicators (KRI), event management, new product review and approval processes and business contingency plans.

The Group policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions. Each business line including Operations, Information Technology, Human Resources, Legal & Compliance and Financial Control is further responsible for employing the aforementioned framework processes and control programs to manage its operational risk within the guidelines established by the policy, and to develop internal procedures that comply with these policies. To ensure that all operational risks to which the Group is exposed to are adequately managed, support functions are also involved in the identification, measurement, management, monitoring and control/mitigation of operational risk, as appropriate. (PD 1.3.28) (PD 1.3.29)

Consistent with the fundamental principle of ownership, the relevant business units are accountable and responsible for managing the operational risks relevant to their respective businesses. Consequently, business and support units have documented procedures and controls in place along with departmental instruction manuals. All changes to such procedures are subject agreement by all respective business unites and sign off by the Board of Directors, Risk Management and Compliance Group and Internal Audit. (PD 1.3.28) (PD 1.3.29)

The Group has a well established disaster recovery program, and has documented updated procedures covering all activities necessary for business continuity in case of a business disrupting event. Internal Audit also provides an independent assessment to evaluate the program's effectiveness.

Due to their independence from the business units within the Group, the Internal Audit Department have a well drafted audit program to periodically review all business areas, and communicate all exceptions and control lapses, if any, to the business unit's head. In turn, the business unit's head will amend the policies and procedures to cover the gaps identified in the audit report. In line with best practices, the Internal Audit function reports directly to the Audit Committee.

In accordance with the basic indicator approach methodology of Basel II, the total minimum capital charge in respect of operational risk was BD 7 million. This capital charge was computed by categorizing the Group's activities into its specific business lines (as defined by the Basel II framework) and multiplying the business line's average gross income for the last three financial years by a predefined beta factor. (PD 1.3.19)

5.3 Operational risk (continued)

Table 5.19 **BD '000s**

	2010 (consolidated)	2009 (consolidated)	2008
Gross Income	15,869	26,936	50,590
Number of years with positive gross income	3	3	3
Average	31,132	36,695	21,552

The Group uses the Temenos T24 core system developed by Globus, for obtaining the data needed for analysis of events and data related to credit, market and operational risk assessment. Following the data consolidation, the Group uses the Fermat integrated risk solution package that would allow for automated capital adequacy calculations, and exposure analysis for credit, market and operational risks. Together, the Temenos T24 and Fermat systems are considered an integral part of the Group's Risk Management Framework.

Non-Shari'a compliant income for the period ended 30 June 2011 amount to BD 3k (30 June 2010 :BD 2k). This has arisen primarily from Nostro accounts balances. (PD 1.3.30 a, b)

5.4 Rate of return risk

(PD 1.3.21 e)
Rate of return risk arises from the possibility that changes in return rates will affect future profitability or the fair values of financial instruments. The Group is exposed to rate of return risk as a result of mismatches of return rate repricing of assets and liabilities. In addition, rate of return risk can also affect the Group through market wide rate changes that are brought on by changes in the economy. The effect of the market rates is reflected and can be seen in the Group's pricing of contracts as they carry competitive pricing that follows the market. When risks are high, the market tends to place a higher rate of return to maintain the risk/ return profile. Accordingly, the market reduces the rate of return when it identifies a decrease in the market wide risk that would be reflected by banks decreasing their rate of return pricing.

This risk is minimized as the Group's rate sensitive assets and liabilities are mostly for short tenures. In addition, the Group's cautious asset liability strategy avoids funding short term lending facilities from long term borrowings. The Group has set limits for profit return risk and these are monitored on an ongoing basis by the Group's Asset and Liability Committee (ALCO).

The Group has implemented a system to automate the process of monitoring, measuring and reporting profit rate risk on a daily basis through the use of gap analysis based on repricing buckets. Any fixed rate assets and liabilities will be repriced at their maturity date. In addition, the system generates stress tests to analyze the effect of shock changes in profit rates on the Group's assets and liabilities. This monitoring process is independently run on a daily basis from within the Risk Management & Compliance Group. Material rate of return risks are identified and mitigated through the coordinate of the Market Risk Department and ALCO.

The below table provides a summary of the Group's profit rate of return sensitivity position based on the contractual repricing or maturity dates, whichever is earlier for the periods ended 30 June 2011 and 2010.

Table 5.20 **BD '000s**

Profit rate risk in the Banking Book			
200bp Profit Rate shocks			
Rate shock	**Currency**	**Effect on net profit 30 June 2011**	**Effect on net profit 30 June 2010**
Upward rate shocks:	USD	1,570	1,734
	BHD	3,856	2,734
Downward rate shocks:	USD	(1,570)	(1,734)
	BHD	(3,856)	(2,734)

5.5 Equity position risk

(PD 1.3.21 d) (PD 1.3.31)
Equity position risk arises from the possibility of changes in the price of equities or equity indices and the corresponding affect they will have on future profitability or the fair values of financial instruments. The Group is exposed to equity risk in the non-trading position and investment portfolio primarily in its core international and GCC markets.

Equity risk in the banking book is effectively managed by the active involvement of the Executive and Investment committees; adhering to the policies and procedures in place; involvement of competent professionals; adequate internal control environment and independent internal audit department.

Executive and Investment Committee Oversight

The Board's involvement begins with the approval of the Investment Policy which essentially determines the following: aggregate portfolio parameters, asset class restrictions, approval authorities, risk tolerance, maturity considerations, exit strategy and governance issues.

The Executive Committee has delegated authority within the overall Board authority. It provides direction to the Executive Management on all business matters and assumes the role of the Board to address matters arising between Board meetings. The Committee is responsible for business matters concerning credit and market risks, strategy review and recommendation to the Board. The Investment Committee reviews and approves all transactions related to corporate and real estate investments, as well as monitoring their performance on an ongoing basis. In addition, the Committee is responsible to oversee the performance of the fund managers and recommend exit strategies to maximize return to its investors.

The objectives are defined in terms of risks, returns & time horizon. When approved by the Board, the Investment Policy for the Group will outline the permissible investments, asset classes, limits on asset classes & lines of authority for approvals. The policy will allow the Group to deploy the Investment Committee's strategy as per the Board approved structure. The policy is to be reviewed on a yearly basis for comparison to the prevailing economic climate and expectations for the medium to long term. The Investment Committee maintains regular oversight over the investment portfolio.

Policies & Procedures

Investment Policies, as approved by the Board, are documented and communicated to the appropriate personnel. Senior management reviews and ensures the existence of adequate policies, procedures and management information systems for managing equity investment activities on regular and long term basis. Through their qualified professionals, the Investments Department is responsible for measuring, monitoring, controlling and reporting on the equity risks with respect to investments to both the Senior Management and the Investment Committee. In addition to the aforesaid policies, the Investment Procedure Manual documents the processes and procedures for all investment actions. Investment Department Responsibilities include initial due diligence of investments, periodic review of holdings, investment valuation and realization of returns. All equity investments are reviewed for their suitability in the portfolio in light of the portfolio objectives, policy allocations and risk limits defined by the Board. All of the investment portfolio is subject to independent third party valuations that are conducted periodically.

5.5 Equity position risk (continued)

Internal Controls

With regard to internal controls, the investment activity is subject to the same rigorous checks and balances in place for the commercial banking activity. Adequacy of internal controls is ensured by the recruitment of adequate qualified professionals, proper definition and communication of departmental and personnel roles, separation of responsibilities of origination and implementation, independent reporting by the Financial Controls Department, periodic internal audit of the existence and implementation of processes and controls. All recommendations of the Investment Department are documented in the form of an Investment Portfolio Reports and Investment Memorandums and are subject to independent risk review by Risk Management. Responsibility for all deployments and receipt of redemption proceeds vests with the Investment Administration Department. The Investment Department ensures transparency in valuation by sourcing pricing from the available sources and using conservative valuation principles in accordance with international accounting standards. In addition, the Investment Middle Office operates as an independent department that is responsible for undergoing the due diligence for investments proposed by the Investments Department. This way, the Investment Department can specialize in sourcing deals and performing the initial analysis, whereas the Investment Middle Office will focus on preparing the detailed due diligence analysis at the start of an investment. Moreover, the Investment Administration Department will perform the investment management duties of monitoring the investment company and preparing performance reports along with other required documentation. This set up helps streamline processes as each group will focus on a specific set of duties that result in time savings as well as having independence controls

Table 5.21 Equity positions in the Banking Book **BD '000s**

Quoted Equities	21,142
Unquoted Equities	200,946
Profit earned for EOIA before smoothing	171
Realized gains (losses) during the period	1,737
Unrealized gains (losses) during the period	672

The Group's equity positions strategy consists of investments that are expected to bring in capital gains or for strategic reasons. The strategy has been drafted after considering the Board's risk appetite and the Board approved liquidity, market risk and capital management policies. In line with the Board approved policies, the investment strategy is conservative in the sense that it avoids investments with high volatility returns.

5.6 Displaced commercial risk

(PD 1.3.41) (PD 1.3.21 f)
The Group is exposed to displaced commercial risk in the event of having Equity of investment accounts (EOIA) profit rates that are lower than market rates, thus putting the Group in risk of paying EOIA account holders from shareholder funds to cover the profit volatility risk. ASBB has mitigated this risk through the set up of an investment risk reserve that will be used in case of a drop in EOIA profit rates. The reserve is funded from the excess returns during periods of high profit returns in order to normalize profit rate drops that can arise.

5.7 Liquidity risk

(PD 1.3.36)(PD 1.3.37)
The Group monitors on an active manner its liquidity profile through analysis of the liquidity gap across specific timeframes in order to maintain the net asset liability position that is within the Board's risk appetite. The maintenance of the net asset liability position is done through the monitoring of the Bank's liquidity indicators through which the Group's liquidity profile can be assessed. In addition, the Group further mitigates its liquidity risk by establishing multiple funding sources to decrease it correlation to an individual funding counterparty. The multiple funding lines can be used to offset any shortage resulting from the Group's obligations and/ or to settle any shortage from each of the current accounts and Equity of investment accounts.

6 Equity of investment accountholders

Equity of investment accounts ("EOIA") [previously known as Unrestricted Investment Accounts] are investors' funds held by the Group to be invested as appropriate without restriction as to where, how and for what purpose the funds are invested. EOIA funds are invested in short term Murabaha with Group using specific limits assigned for each institution. Savings accounts and call accounts comprise the EOIA, payable on demand and the account holder has the right to withdraw or transfer funds without penalty. In general, EOIA provides a profit earning investment option for the risk reserve account holder.

The Group provides the Equity of investment accounts as a service to savings accounts clients. Therefore, it is not the practice of the Group to guarantee the preservation of capital through the investment risk reserves. As a result, the Group has no displaced commercial risk. (PD 1.3.32 a, i)

This allocation of assets has not changed since the last financial year. The funds are invested and managed in accordance with Shari'a principles. (PD 1.3.32 b)

Equity of investment account holders' funds are commingled with the Group's funds and invested mostly in short term highly liquid Commodity Murabahas and/or Wakala deposits. According to the terms of acceptance of the unrestricted investment accounts, 100% of the funds are invested after deducting a mandatory reserve. There were no major movements during the period in the investment risk reserve and the ending balance amounted to BD 7k. In order to avoid excessive risk concentration the Group invests the commingled funds in such a way so as to comply with the CBB's large exposures limits. All Equity of investment accounts are classified as Mudarabas where fees are deducted before profit allocation, as they there is no limit against their withdrawal. It should however be noted that Mudaraba account fees are subject to being partially or total waived in order to match investment account holder market returns. (PD 1.3.32 c, j, k)

Profit paid to the EOIA holders is based on the rate of return earned by the pool of profit bearing assets in which the EOIA have participated. The account holder participates in 45% of the profits earned in full after netting off the Mudarib fee as above. As a result, the share of profits earned by the EOIA holders for their Mudaraba accounts is equal to the share of profits paid to them. All Equity of investment accounts are carried at cost plus accrued profits less amounts repaid. Income to Equity of investment account holders is allocated on the basis of their average daily balances in proportion to shareholders' balances. The profits paid to EOIA and the rate of return earned over the previous periods are disclosed in the below table. (PD 1.3.32 d, l)

The Risk weighted assets of the Group include the contribution from EOIA which are subject to the 30% risk weight.

The Group has neither pledged any asset as collateral nor given any clean guarantee to date.

The EOIA holders and other customers can use the Group's relationship managers for any advice, mediation services, grievances and complaints. (PD 1.3.10 j)

6. Equity of investment accountholders (continued)

There is no variation between Mudarib agreed sharing and contractual agreed ratio. Profit earned and paid and rate of return comparatives for the Equity of investment account holders for the periods ended 30 June 2011 & 2010 and year ended 31 December 2010 are as follows: (PD 1.3.33 e, l, mn)

Table 6.1 **BD '000s**

Total Income	June 2011	June 2010	Dec 2010
Shareholders	94	106	216
IAH (before smoothing)	171	193	393
Total Profit	265	299	609
Profit earned for EOIA before smoothing	171	193	393
Profit paid for EOIA after smoothing	94	106	216
Balance			
PER	N/A	N/A	N/A
IRR	7	7	7
Annual Rate of Return Benchmark	3%	3%	3%
*Annual Rate of Return (EOIA)	1%	1.25%	1%
PER Amount	-	-	-
PER %	-	-	-
IRR Amount	7	7	7
IRR %	-	-	-
Mudaraba Earned Profit	171	193	393
Mudarib fees	(77)	(87)	(177)
Profit credited to EOIA accounts	94	106	216
IRR movements	-	-	-
Profit on EOIA	94	106	216
EOIA Balance	12,862	39,518	18,465
RWA as PIRI Report	2,572	7,904	3,693

* Annualised

6. Equity of investment accountholders (continued)

Table 6.2 **BD ‘000s**

Date of statement of financial position	Profit Earned and Paid to EOIA	*Rate of Return
30 June 2011 30 June 2010	**265 profit earned 94 profit paid** **299 profit earned 106 profit paid**	**1%** **1.25%**
Return on average EOIA assets (ROAA)	***June 2011:0.92%** *** June 2010:1.9%**	
Return on average equity (Total Equity) (ROAE)	***June 2011:0.10%** ***June 2010:0.10%**	

**Annualised*

Table 6.3 Equity of investment account holders by Counterparty Type and Islamic Product Murabaha (PD 1.3.33 i) **BD ‘000s**

Murabaha and Wakala receivables from banks				
Counterparty	**Total Exposures**	**Funded by EOIA**	**Funded by Self**	**% of EOIA to Total**
Sovereign	-	-	-	-
Financial Institutions	12,862	12,862	-	100%
Multinational Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	12,862	12,862	**-**	**100%**

6. Equity of investment accountholders (continued)

Table 6.4 The changes in asset allocation ratio are as follows: (PD 1.3.32 d) **BD '000s**

	Murabaha and Wakala receivables from banks		**Murabaha and Mudaraba financing**	
	EOIA	Self & Call Accounts	EOIA	Self & Call Accounts
Asset Allocation as on 30 June 2011	12,862	76,560	-	152,225
Asset Allocation as on 30 June 2010	39,518	124,900	-	115,289
Asset Allocation as on 31 December 2010	18,465	118,834	-	120,812

There are no off balance sheet exposures arising from investment decisions attributable to the EOIA holders because the EOIA are used for short term Islamic financing contracts.

7 Other disclosures

7.1 Currency risk

The Group is exposed to foreign exchange rate risk through both its foreign exchange structural positions. Foreign exchange rate risk is managed by appropriate trading limits and stop loss parameters determined by ALCO and approved by its Board Executive committee. The Group's consolidated structural balance sheet positions are reviewed regularly by ALCO in accordance with the Group's strategic plans and managed on a dynamic basis by the Treasury hedging such exposures, as appropriate.

7.2 Related party transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's Senior Management. For further details refer Note 5 titled related party transactions in the interim condensed consolidated financial statements for the period ended 30 June 2011. (PD 1.3.10 e) (PD 1.3.23 d)

7.3 Restructured facilities

During the period, BD 2,642 thousand financing facilities to individuals and corporate were renegotiated. All renegotiated facilities are performing and are fully secured. In general, facilities are renegotiated to optimize a facility's credit profile with respect to its recoverability. This can involve changing any of the profit rate, tenure or security package. There were no impact of restructured facilities on provisions and present and future earnings. (PD 1.3.23 j)

7.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the period ended 30 June 2011. (PD 1.3.23 k)

7.5 Legal risk and claims (PD 1.3.30 c)

As of 30 June 2011, legal suits amounting to BHD 1,895 thousand were pending against the Group. Based on the opinion of the Group's legal counsel, the total liability arising from these cases is not considered to be material to the Group's profit or financial position as the Group has also filed counter cases against these parties.