AL SALAM BANK-BAHRAIN B.S.C.

BASEL II - PILLAR III

DISCLOSURES

31 DECEMBER 2011

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1 Introduction

The 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 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 31 December 2012. The Bank and its subsidiary, BSB, (together known as "the Group") operate through eleven retail branches in the Kingdom of Bahrain.

On 20 November 2011, the shareholders' of BSB have resolved to delist BSB from Bahrain Bourse. On 22 December 2011 the shareholders resolved to merge its operations with the parent subject to regulatory approval.

The 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) **(BD '000)**

	Dec-2011	Dec-2010	Dec-2009	Dec-2008	Dec-2007	Dec-2006*
Total operating Income	12,740	22,300	23,700	37,600	32,700	20,400
Net profit	497	7,316	13,962	25,500	23,100	16,400
Total assets	923,907	856,598	785,934	554,500	397,800	188,100
Total equity	200,625	201,860	201,778	172,500	159,500	136,500
Key Ratios	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006***
Earnings per share (fils)	0.2	5	10	21.3	19.3	15.1
Return on average assets (%)	0.1	0.9	2.1	4.7	7.9	11.2
Return on average equity (%)	0.2	3.6	7.6	15.8	15.6	15.1
Cost to operating income (%)	91	60.6	40.6	31.3	33.5	19.6
Dividend payout ratio (%)	-	-	51	46.9	51.8	-
Dividend yield ratio (%)	-	-	5.4	11.4	4.9	-

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

Consolidated Financial Position	Dec-2011	Dec-2010	Dec-2009	Dec-2008	Dec-2007	Dec-2006
Cash and balances with banks and Central Bank of Bahrain	72,318	95,791	126,739	83,534	15,174	2,942
Murabaha and Wakala receivables from banks	135,698	137,299	149,304	87,167	224,451	105,090
Central Bank of Bahrain Sukuk	125,027	68,632	32,908	31,095	20,380	-
Corporate Sukuk	49,650	60,959	16,950	-	-	
Murabaha financing	135,383	114,572	87,274	72,484	32,642	22,963
Mudaraba financing	57,706	19,309	-	-	-	-
Ijarah Muntahia Bittamleek	66,477	56,756	46,315	41,531	10,436	10,382
Musharaka Financing	11,711	8,127	5,384	-	-	
Assets under conversion**	27,750	57,432	98,305	-	-	
Non-trading investments	223,320	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	2,500	3,373	1,177	1,177	1,177	1,177
Assets held-for-sale	-	-	-	88,934	9,024	-
Murabaha and Wakala payables to banks	104,573	101,300	89,398	32,881	96,983	
Wakala payables to non-banks	515,147	456,447	317,370	289,005	106,909	-
Customers' current accounts	66,585	57,362	32,700	42,986	5,689	5,674
Liabilities under conversion**	7,633	5,171	120,402	-	-	
Equity of Investment account holders (EOIA)	16,256	18,465	9,409	6,370	19,770	20,112
Capital	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006**
Capital adequacy (%)	24.9	24.7	28.6	24.7	48.7	79.8
Equity/total assets (%)	21.7	23.6	25.7	31.1	40.1	72.5
Total deposits/equity (times)	3.0x	2.6x	2.3x	2.2x	1.4x	0.4x
Liquidity and Other ratios	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006**
Islamic financing contracts/total assets (%)	29.4	23.2	40.9	41.9	72.4	73.6
Investments/total assets (%)	30.4	33.9	30.1	38.6	20.1	19.1
Liquid assets/total assets (%)	36.0	35.3	40.2	30.8	60.3	57.5
Islamic financing contracts/customer deposits (%)	45.4	37.3	70.0	68.7	217.5	536.9
Number of employees	215	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.

3. Capital structure

The Group's capital base comprises of Tier 1 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 31 December 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 172,872 thousand comprises Tier 1 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	8,662	-	8,662
Share premium	2,573	-	2,573
Retained earnings	4,616	-	4,616
Others	(4,236)	-	(4,236)
Unrealized gains arising from fair valuing equities (45% only)	16,849	-	16,849
Minority interest	**4,156**	-	**4,156**
Less:			
Current interim cumulative net loss	-	-	-
Unrealized gross losses arising from fair valuing equity securities	(1,844)	-	(1,844)
Tier 1 Capital before Prudential consolidation and deduction (PCD) requirements	**180,017**		**180,017**
Unrealized gains arising from fair valuing equities (45%)	-	-	-
Investment risk reserve	-	7	7
Tier 2 Capital before PCD requirements (2.1 to 2.5 inclusive less 2.6)	-	**7**	**7**
Total available capital	**180,017**	**7**	**180,024**
Regulatory deductions:			
Excess amount over maximum permitted large exposure limit	(3,576)	(3,576)	(7,152)
Total Deductions	(3,576)	(3,576)	(7,152)
Additional deduction from Tier-1 to absorb deficiency in Tier-2	**(3,569)**	**3,569**	**-**
Total Eligible Capital (Tier 1) (a) (PD 1.3.20 a)	**172,872**	**-**	**172,872**

Table 3.2 ***BD '000s***

Risk Weighted Assets (RWA)	Amount
Credit risk	653,391
Market risk	3,416
Operational risk	36,767
Total Risk Weighted Assets (b)	**693,574**
Capital adequacy ratio for the Group (a/b) (PD 1.3.20 a)	
Tier 1 ratio (PD 1.3.20 a)	**24.9%**
Tier 2 ratio (PD 1.3.20 a)	**-**
Total ratio (PD 1.3.20 a)	**24.9%**
Minimum required by CBB regulations under Basel II (%)	**12%**

4. Capital Adequacy Ratios (CAR)

No impediments on the transfer of funds or reallocation of regulatory capital exist within the Group and the Group has adequate capital to support the current and future activities of the Group. (PD 1.3.6.c and PD 1.3.16)

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 year ended 31 December 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.

5.1 Credit risk (continued)

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.

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%.

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	4,988	4,881	4,988	-	-	-	-	-	-	-
Claims on sovereigns	231,662	212,582	227,072	4,590	-	-	-	3,987	3,987	478
Claims on public sector entities	4,938	4,941	4,938	-	-	-	-	4,938	4,938	593
Claims on banks	160,743	139,989	160,743	-	-	-	-	45,908	44,401	5,328
Claims on corporate portfolio	195,811	172,726	184,858	12,364	3,124	-	10,920	163,728	163,728	19,647
Claims on regulatory retail portfolio	290	304	290	-	-	-	-	218	218	26
Mortgages	57,071	57,042	57,071	160	-	-	12,013	43,682	43,682	5,242
Past due receivables over 90 days	26,031	27,408	26,031	-	-	-	5,266	26,300	26,300	3,156
Investments in Securities and Sukuk	54,090	52,883	54,090	-	-	-	-	71,774	71,774	8,613
Holding of Real Estate	107,542	119,797	106,085	1,457	-	-	-	215,084	215,084	25,810
Other assets and Specialized financing	83,308	69,894	81,575	162	-	-	68	79,279	79,279	9,513
Total	**926,474**	**862,447**	**907,741**	**18,733**	**3,124**	**-**	**28,267**	**654,898**	**653,391**	**78,406**

Note a: The unfunded exposure before (CCF) as of December 2011 is BD 44,028k.
Note b: The amounts in the above table are based on the exposures as reported in the respective prudential returns.

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	125,553	107,241	125,553	-	-	-	-	-	-	-
Corporate Sukuk	49,959	49,745	49,959	-	-	-	-	38,728	38,728	4,647
Murabaha and Wakala receivables from banks	143,154	101,278	143,154	-	-	-	-	40,046	38,539	4,625
Murabaha financing	151,971	116,512	136,495	15,476	1,029	-	68	114,439	114,439	13,733
Mudaraba financing	57,894	36,147	57,894	-	1,019	-	-	52,593	52,593	6,311
Ijarah Muntahia Bittamleek	67,390	71,686	66,830	560	-	-	17,279	66,430	66,430	7,972
Musharaka Financing	12,991	10,762	11,751	1,240	-	-	-	12,944	12,944	1,553
Total	**608,912**	**493,371**	**591,636**	**17,276**	**2,048**	**-**	**17,347**	**325,180**	**323,673**	**38,841**

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 31 December 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)

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	33,996	159	-	-	34,208
Total	**33,996**	**159**	**-**	**-**	**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 31 December 2011, the collaterals eligible for CRM (after applying regulatory haircuts) amounted to BD 29 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 Ijarah 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 and 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 Loan to Value (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 Accounts							
Exposure type	**GCC countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	69,088	-	594	87	2,549	-	72,318
Central Bank of Bahrain Sukuk	125,027	-	-	-	-	-	125,027
Murabaha and Wakala receivables from banks	117,557	-	1,885	-	-	-	119,442
Corporate Sukuk	34,027	-	9,224	2,642	3,758	-	49,650
Murabaha financing	121,917	-	2,912	9,786	767	-	135,383
Mudaraba financing	54,992	-	-	2,714	-	-	57,706
Ijarah Muntahia Bittamleek	66,477	-	-	-	-	-	66,477
Mushakara financing	11,711	-	-	-	-	-	11,711
Assets under conversion	21,273	4	3,396	5	3,072	-	27,750
Non-trading investments	166,886	5,278	10,662	39,129	-	1,365	223,320
Investment properties	2,500	-	-	-	-	-	2,500
Receivables and prepayments	11,284	0	3,890	91	13	-	15,278
Premises and equipment	1,084	-	-	5	-	-	1,089
Total funded exposures	**803,823**	**5,282**	**32,563**	**54,459**	**10,159**	**1,365**	**907,651**
Commitments	42,607	-	-	1,421	-	-	44,028
Total unfunded exposures	**42,607**	**-**	**-**	**1,421**	**-**	-	**44,028**
TOTAL	**846,430**	**5,282**	**32,563**	**55,880**	**10,159**	**1,365**	**951,679**

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 and Current Account							
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	16,256	-	-	-	-	-	16,256
Corporate Sukuk	-	-	-	-	-	-	-
Murabaha financing	-	-	-	-	-	-	-
Mudaraba financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Mushakara financing	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-
Total funded exposures	**16,256**	-	**-**	**-**	**-**	-	**16,256**
Commitments						-	-
Total unfunded exposures	**-**	**-**	**-**	**-**	**-**	-	**-**
TOTAL	**16,256**	**-**	**-**	**-**	**-**	-	**16,256**

5.1 Credit risk (continued)

5.1.1 Geographical distribution of exposures (cont'd)

The Group has a few past due financing contracts that have not been settled as of 31 December 2011. All past due but not impaired Murabaha and Ijarah financing are covered by sufficient collaterals that include cash, personal and sovereign guarantees. As of 31 December 2011, a specific provision of BD 2,153k (31 December 2010: BD 1,508k) has been taken against past due financing contracts. Also as of 31 December 2011 a general provision of BD500K (31 December 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 including impaired financing contracts	Specific Provision Financing Contracts	General Provision Financing Contracts	Impaired Financing Contracts	Specific Provision on Impaired
GCC Countries	846,430	27,263	2,153	500	3,974	1,494
Arab World	5,282	-	-	-	-	2,300
Europe	32,563	-	-	-	-	-
Asia	55,880	-	-	-	-	1,531
America	10,159	-	-	-	-	-
Other	1,365	-	-	-	-	-
Total	**951,679**	**27,263**	**2,153**	**500**	**3,974**	**5,325**

Table 5.7 BD '000s

Contribution by Equity of investment account holders					
	Gross Credit Exposure	Past Due Financing Contracts including impaired financing contracts	Specific Provision Financing Contracts	General Provision Financing Contracts	Specific Provision Impaired Investments
GCC Countries	16,256	-	-	-	-
Arab World	-	-	-	-	-
Europe	-	-	-	-	-
Asia	-	-	-	-	-
America	-	-	-	-	-
Other	-	-	-	-	-
Total	**16,256**	-	-	-	-

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 and Manufacturing**	**Banks and Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Government**	**Others**	***Total**
Cash and balances with banks and Central Bank of Bahrain	-	12,632	-	-	-	59,686	-	72,318
Central Bank of Bahrain Sukuk	-	-	-	-	-	125,027	-	125,027
Murabaha and Wakala receivables from banks	-	119,442	-	-	-	-	-	119,442
Corporate Sukuk	-	34,171	-	1,879	-	13,600	-	49,650
Murabahafinancing	2,896	6,032	46,574	-	27,542	36,199	16,140	135,383
Mudaraba financing	2,022	-	22,382	-	2,488	6,051	+24,763	57,706
Ijarah Muntahia Bittamleek	2,348	-	31,629	2,735	20,834	3,200	5,731	66,477
Mushakara financing	-	-	10,714	-	997	-	-	11,711
Assets under conversion	2,781	8,943	(3,615)	-	896	10,920	7,825	27,750
Non-trading investments	-	5,377	145,012	7,952	-	3,648	+61,331	223,320
Investment properties	-	-	2,500	-	-	-	-	2,500
Receivables and prepayments	961	3,687	979	7	422	380	8,842	15,278
Premises and equipment	-	-	-	-	-	-	1,089	1,089
Total funded	**11,008**	**190,284**	**256,175**	**12,573**	**53,179**	**258,711**	**125,721**	**907,651**
Commitments	9,828	263	11,190	-	1,853	9,180	11,714	44,028
Total unfunded	**9,828**	**263**	**11,190**	**-**	**1,853**	**9,180**	**11,714**	**44,028**
Total exposure	**20,836**	**190,547**	**267,365**	**12,573**	**55,032**	**267,891**	**137,435**	**951,679**

*Includes specialised financing hospitality sector

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 and Manufacturing**	**Banks and Financial Institutions**	**Real Estate**	**Aviation**	**Individuals**	**Government**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	-	-	-	-	-	-	-	-
Central Bank of Bahrain Sukuk	-	-	-	-	-	-	-	-
Murabaha and Wakala receivables from banks	-	16,256	-	-	-	-	-	16,256
Corporate Sukuk	-	-	-	-	-	-	-	-
Murabaha financing	-	-	-	-	-	-	-	-
Mudaraba financing	-	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-	-
Mushakara financing	-	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-	-
Receivables and prepayments	-	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-	-
Total funded	**-**	**16,256**	**-**	**-**	**-**	**-**	**-**	**16,256**
Undrawn commitments	-	-	-	-	-	-	-	-
Total unfunded	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total exposure	**-**	**16,256**	**-**	**-**	**-**	**-**	**-**	**16,256**

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**	**Past due financing contracts including Impaired financing**	**Carrying value of Impaired Securities**	**Specific Provision Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	**20,836**	11,008	9,828	**-**	3,648	-	1,437
Banks and financial institutions	**190,547**	190,284	263	6,032	5,377	2,153	2,323
Real estate	**267,365**	256,175	11,190	15,707	7,181	-	1,531
Aviation	**12,573**	12,573	-	-	-	-	-
Individuals	**55,032**	53,179	1,853	4,785	-	-	-
Government	**267,891**	258,711	9,180	-	-	-	-
Others	**137,435**	125,721	11,714	739	-	-	34
Total	**951,679**	**907,651**	**44,028**	**27,263**	**16,206**	**2,153**	**5,325**

Table 5.11 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**	**Past due financing contracts including Impaired**	**Impaired Securities**	**Specific Provision Islamic Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	-	-	-	-	-	-	-
Banks and financial institutions	16,256	16,256	-	-	-	-	-
Real estate	-	-	-	-	-	-	-
Aviation	-	-	-	-	-	-	-
Individuals	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-
Total	**16,256**	**16,256**	**-**	**-**	-	-	**-**

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	4,988	4,372	616
Claims on sovereigns	231,662	85,491	146,171
Claims on public sector entities	4,938	-	4,938
Claims on banks	160,743	119,951	40,792
Claims on corporate portfolio	195,811	25,385	170,426
Claims on regulatory retail exposure	290	-	290
Mortgages	26,031	-	26,031
Past due receivables over 90 days	57,071	-	57,071
Investments in Securities and Sukuk	54,090	-	54,090
Holding of Real Estate	107,542	-	107,542
Other assets and Specialized financing	83,308	-	83,308
Total	**926,474**	**235,199**	**691,275**

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)

5.1.4 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)

	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	4,988	-	-	-	**4,988**	-	-	-	-	-	**4,988**
Claims on sovereigns	58,662	9,326	6,484	34,246	**108,718**	100,725	13,529	4,100	-	**118,354**	**227,072**
Claim on public sector entities	-	-	-	-	**-**	4,938	-	-	-	**4,938**	**4,938**
Claims on banks	147,377	1,019	45	2,900	**151,341**	9,402	-	-	-	**9,402**	**160,743**
Claims on corporate portfolio	17,463	5,276	29,905	8,294	**60,938**	94,825	28,762	327	6	**123,920**	**184,858**
Claims on regulatory retail exposures	-	2	2	2	**6**	284	-	-	-	**284**	**290**
Mortgages portfolio	1,158	4241	2,903	5,067	**13,369**	30,080	11,574	1,556	492	**43,702**	**57,071**
Past due exposures	17,020	-	-	-	**17,020**	9,011	-	-	-	**9,011**	**26,031**
Investments in Securities and Sukuk	-	-	-	17,100	**17,100**	36,990	-	-	-	**36,990**	**54,090**
Equity portfolios	-	-	-	638	**638**	102,997	-	2,450	-	**105,447**	**106,085**
Other exposures	15,548	1,662	2,825	1,030	**21,065**	58,800	1,007	508	195	**60,510**	**81,575**
Total	**262,216**	**21,526**	**42,164**	**69,277**	**395,183**	**448,052**	**54,872**	**8,941**	**693**	**512,558**	**907,741**

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

5.1 Credit risk (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 sovereigns	-	9,180	-	-	**9,180**	-	-	-	-	**-**	**9,180**
Claims on corporate portfolio	16,441	7,339	4,877	1,570	**30,227**	170	-	-	-	**170**	**30,397**
Holding of Real Estate	-	-	-	274	**274**	1,422	-	-	-	**1,422**	**1,696**
Other assets and Specialised financing	575	318	-	754	**1,647**	1,108	-	-	-	**1,108**	**2,755**
Total	**17,016**	**16,837**	**4,877**	**2,598**	**41,329**	**2,700**	**-**	**-**	**-**	**2,700**	**44,028**

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.

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	6,977	3,150
Operating lease commitments	1,779	-
Undrawn Islamic financing contracts commitments and other commitments	35,272	15,583
RWA	**44,028**	**18,733**

* Credit exposure is after applying CCF.

At 31 December 2011, the Group held eligible cash collaterals in relation to credit related contingent items amounting to BD 300k

Table 5.16 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	68,218	-	-		**68,218**	4,100	-	-	-	**4,100**	**72,318**
Central Bank of Bahrain Sukuk	3,200	8,870	-	24,600	**36,670**	77,039	11,318	-	-	**88,357**	**125,027**
Murabaha and Wakala receivables from banks	118,426	17,272	-	-	**135,698**	-	-	-	-	**-**	**135,698**
Corporate Sukuk	-	-	-	-	-	49,650	-	-	-	**49,650**	**49,650**
Murabaha and Mudaraba financing	26,183	6,992	32,803	25,904	**91,882**	81,933	18,512	762.00	-	**101,207**	**193,089**
Ijarah Muntahia Bittamleek	8,201	1,108	2,287	6,566	**18,162**	29,096	17,382	1,636	201	**48,315**	**66,477**
Musharaka	5,234	547	15	392	**6,188**	5,329	194	-	-	**5,523**	**11,711**
Assets under conversion	5,384	658	415	5,833	**12,290**	12,000	3,460		-	**15,460**	**27,750**
Non-trading investments	-	-	-	14,105	**14,105**	201,262	7,953	-	-	**209,215**	**223,320**
Investment properties	-	-	-	-	**-**	-	-	2,500	-	**2,500**	**2,500**
Receivables and prepayments	14,585	301	392	-	**15,278**	-	-	-	-	**-**	**15,278**
Premises and equipment	-	-	-	-	**-**	1,089	-	-	-	**1,089**	**1,089**
Total	**249,431**	**35,748**	**35,912**	**77,400**	**398,491**	**461,498**	**58,819**	**4,898**	**201**	**525,416**	**923,907**

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

5.1 Credit risk (continued)

Table 5.16 (a) Expected 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
Unutilised commitments	14,576	901	4,877	484	**20,838**	3,578	9,458	-	-	**13,036**	**33,874**
Unutilised capital commitments	-	-	-	-	**-**	1,398	-	-	-	**1,398**	**1,398**
Contingent liabilities	6,145	342	-	490	**6,977**	-	-	-	-	**-**	**6,977**
Operating lease commitments	-	-	-	646	**646**	1,133	-	-	-	**1,133**	**1,779**
Total	**20,721**	**1,243**	**4,877**	**1,620**	**28,461**	**6,109**	**9,458**	**-**	**-**	**15,567**	**44,028**

5.1.5 (a) Maturity analysis of funding
Table 5.17 Expected 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	-	-	3,442	7,015	**10,457**	94,116	-	-	-	**94,116**	**104,573**
Wakala from non-banks	-	-	284,748	-	**284,748**	230,399	-	-	-	**230,399**	**515,147**
Customers' current accounts	66,585	-	-	-	**66,585**	-	-	-	-	**-**	**66,585**
Liabilities under conversion	-	7,633	-	-	**7,633**	-	-	-	-	**-**	**7,633**
Other liabilities	-	10,848	976	1,125	**12,949**	139	-	-	-	**139**	**13,088**
Equity of Investment account holders	-	-	-	-	**-**	16,256	-	-	-	**16,256**	**16,256**
Total	**66,585**	**18,481**	**289,166**	**8,140**	**382,372**	**340,910**	**-**	**-**	**-**	**340,910**	**723,282**

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	3,416	273	68	992
Options risk	-	-	-	-
Total market risk	**3,416**	**273**	**68**	**992**

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 year ended 31 December 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)

5.3 Operational risk (continued)

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 4.4 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)

Table 5.19 **BD '000s**

	2011	2010	2009	2008
	(consolidated)	(consolidated		
Gross Income	16,308	15,869	26,936	50,590
Number of years with positive gross income	3	3	3	3
Average	19,704	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 year ended 31 December 2011 amount to BD 7k (31 December 2010 :BD 8k). 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 year ended 31 December 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 31 December 2011**	**Effect on net profit 31 December 2010**
Upward rate shocks:	USD	1,616	1,968
	BHD	3,272	3,864
Downward rate shocks:	USD	(1,616)	(1,968)
	BHD	(3,272)	(3,864)

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.

5.5 Equity position risk (continued)

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

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.

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

5.5 Equity position risk (continued)

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

Quoted Equities	18,840
Unquoted Equities	204,480
Profit earned for EOIA before smoothing	278
Realized gains (losses) during the year	2,849
Unrealized gains (losses) during the year	5189

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)

6. Equity of investment accountholders (continued)

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 movements during the year 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 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)

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 years ended 31 December 2011,2010,2009 and 2008 are as follows: (PD 1.3.33 e, l, mn)

6. Equity of investment accountholders (continued)

Table 6.1 **BD '000s**

Description	Dec-11	Dec-10	Dec-09	Dec-08
Shareholders	153	216	155	220
IAH (before smoothing)	278	393	338	400
Total Profit	**431**	**609**	**493**	**620**
Profit earned for EOIA before smoothing	278	393	338	400
Profit paid for EOIA after smoothing	153	216	155	220
Balance of:				
PER	N/A	N/A	N/A	N/A
IRR	7	7	7	38
Annual Rate of Return Benchmark	3%	3%	3%	4.5%
Annual Rate of Return (EOIA)	1%	1%	1.25%	2.5%
PER Amount	-	-	-	-
PER %	-	-	-	-
IRR Amount	7	7	7	38
IRR %	-	-	-	-
Reconciliation				
Mudaraba Earned Profit	278	393	338	400
Mudarib fees	(125)	(177)	(152)	(180)
Profit credited to EOIA accounts	**153**	**216**	**186**	**220**
IRR movements	-	-	(31)	33
Profit on EOIA	**153**	**216**	**155**	**253**
EOIA Balance	16,256	18,465	9,409	6,370
RWA as PIRI Report	3,251	4,285	2,440	1,274

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
31-Dec-11	**278 profit earned 153 profit paid**	**1%**
31-Dec-10	**393 profit earned 216 profit paid**	**1%**
31-Dec-09	**338 profit earned 155 profit paid**	**1.25%**
31-Dec-08	**402 profit earned 220 profit paid**	**2.50%**
Return on average EOIA assets (ROAA)	**December 2011:1.53%**	
	December 2010:2.25%	
	December 2009:1.9%	
	December 2009:4.49%	
Return on average equity (Total Equity) (ROAE)	**December 2011:0.14%**	
	December 2010:0.2%	
	December 2009:0.18%	
	December 2008:0.25%	

Table 6.3 Equity of investment account holders by Counterparty Type and Islamic Product Murabaha (PD 1.3.33

Murabaha and Wakala receivables from banks				
Counterparty	**Total Exposures**	**Funded by EOIA**	**Funded by Self**	**% of EOIA to Total**
Sovereign		-	-	-
Financial Institutions	16,256	16,256	-	100%
Multinational Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	**16,256**	**16,256**	**-**	**100%**

Table 6.4 The changes in asset allocation ratio are as follows: (PD 1.3.32 d)

	Murabaha and Wakala receivables from banks		**Murabaha and Mudaraba financing**	
	EOIA	Self & Call Accounts	EOIA	Self & Call Accounts
Asset Allocation as on 31 December 2011	16,256	119,442	-	135,383
Asset Allocation as on 31 December 2010	18,465	118,834	-	133,881
Asset Allocation as on 31 December 2009	9,409	139,894	-	87,273

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 financial 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 18 titled related party transactions in the consolidated financial statements for the year ended 31 December 2011. (PD 1.3.10 e) (PD 1.3.23 d)

7.3 Restructured facilities

During the year ended, BD 30,039 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 year ended 31 December 2011. (PD 1.3.23 k)

7.5 Legal risk and claims (PD 1.3.30 c)

As of 31 December 2011, legal suits amounting to BHD 2,030 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.