AL SALAM BANK-BAHRAIN B.S.C.

BASEL II - PILLAR III

DISCLOSURES

30 June 2014

Table of Contents

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 interim condensed consolidated financial statements which are prepared in accordance with the guidance given by International Accounting Standard 34 - "Interim Financial Reporting".

2 Financial Performance and Position

The Bank 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 CBB. The Bank's ordinary shares are listed in the Bahrain Bourse and Dubai Financial Market and operates under an Islamic retail banking license issued by CBB.

During the period, the Bank acquired 100% stake in BMI Bank B.S.C. (c) ("BMI"), a closed shareholding company in the Kingdom of Bahrain, through a share exchange explained in more details in note 3 of the interim condensed consolidated financial statements. BMI operates under a retail banking license issued by the CBB. All the legal formalities in relation to the share issuance has been completed and the process of converting BMI into fully compliant Islamic operations is in progress.

The Bank and its subsidiary BMI operate through eighteen retail branches in the Kingdom of Bahrain. The Bank together with its subsidiaries are referred to as the "Group".

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)**

(BD '000s)

	Jun-2014	Dec-2013	Dec-2012	Dec-2011	Dec-2010	Dec-2009	Dec-2008
Total operating income	21,070	26,087	23,062	12,740	22,300	23,700	37,600
Net profit	8,319	12,372	10,308	497	7,316	13,962	25,500
Total assets	1,964,732	1,088,252	942,218	923,907	856,598	785,934	554,500
Total equity	318,610	246,097	208,065	200,625	201,860	201,778	172,500
Key Ratios	**Jun-2014**	**Dec-2013**	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**
Earnings per share (fils)	4.6	8.3	6.9	0.2	5.0	10.0	21.3
Return on average assets (%)*	1.1	1.2	1.1	0.1	0.9	2.1	4.7
Return on average equity (%)*	5.9	5.9	5.1	0.2	3.6	7.6	15.8
Cost to operating income (%)	54.9	43.7	49.7	91.0	60.6	40.6	31.3
Dividend payout ratio (%)	-	60.5	72.6	-	-	51	46.9
Dividend yield ratio (%)	-	3.6	9.4	-	-	5.4	11.4

* Annualised

Table 2.2 Financial Summary

(BD '000s)

Consolidated Financial Position	**Jun-2014**	**Dec-2013**	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**
Cash and balances with banks and Central Bank of Bahrain	237,633	86,097	66,843	72,318	95,791	126,739	83,534
Central Bank of Bahrain Sukuk	108,859	102,937	117,612	125,027	68,632	32,908	31,095
Murabaha and Wakala receivables from banks	221,961	118,227	103,290	135,698	137,299	149,304	87,167
Corporate Sukuk	112,267	91,106	74,993	49,650	60,959	16,950	-
Murabaha financing	200,898	147,616	127,537	135,383	114,572	87,274	72,484
Mudaraba financing	129,943	114,084	99,572	57,706	19,309	-	-
Ijarah Muntahia Bittamleek	112,929	110,631	82,954	66,477	56,756	46,315	41,531
Musharaka	11,898	19,145	17,467	11,711	8,127	5,384	-
Assets under conversion (BMI)	446,527	-	-	-	-	-	-
Non-trading investments	149,544	125,923	204,202	223,320	212,432	184,680	116,930
Investment properties	81,323	77,736	2,500	2,500	3,373	1,177	1,177
Development properties	54,466	63,399	-	-	-	-	-
Investment in associates	11,075	8,537	7,573	-	7,578	7,659	8,012
Other assets (incl. assets under conversion of ex-BSB)	31,774	22,814	36,908	43,028	69,911	125,207	21,033
Assets held-for-sale	40,862	-	-	-	-	-	88,934
Goodwill	12,773	-	-	-	-	-	-
Murabaha and Wakala payables to banks	138,273	106,796	90,852	104,573	101,300	89,398	32,881
Wakala payables to non-banks	828,056	584,365	521,929	515,147	456,447	317,370	289,005
Customers' current accounts	218,889	70,532	83,921	66,585	57,362	32,700	42,986
Term financing	23,796	23,637	-	-	-	-	-
Liabilities under conversion (BMI)	335,360	-	-	-	-	-	-
Liabilities relating to assets held-for-sale	26,066	-	-	-	-	-	-
Other liabilities (incl. liabilities under conversion of ex-BSB)	45,180	30,979	19,175	20,721	21,164	135,279	10,756
Equity of Investment Accountholders (EOIA)	30,502	25,846	18,276	16,256	18,465	9,409	6,370
Capital	**Jun-2014**	**Dec-2013**	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**
Capital adequacy (%)*	18.8	21.4	20.9	24.9	24.7	28.6	24.7
Equity/total assets (%)	16.2	22.6	22.1	21.7	23.6	25.7	31.1
Total deposits/equity (times)	3.4x	2.8x	3.0x	3.0x	2.6x	2.3x	2.2x
Liquidity and Other Ratios	**Jun-2014**	**Dec-2013**	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**
Islamic financing contracts/total assets (%)	23.2	36.0	34.8	29.4	23.2	40.9	41.9
Investments/total assets (%)	21.1	21.3	31.2	30.4	33.9	30.1	38.6
Liquid assets/total assets (%)	28.9	28.2	30.5	36.0	35.3	40.2	30.8
Islamic financing contracts/customer deposits (%)	42.3	57.5	52.5	45.4	37.3	70.0	68.7
Number of employees	490	193	202	215	223	231	116

* Calculated based on the consolidated capital structure (refer section 3). A separate Form PIRI was submitted by the Group excluding BMI activities and a separate Form PIR was submitted by BMI to CBB. The capital adequacy ratio was calculated based on combining both the Forms PIRI and PIR submitted and were adjusted for the intercompany eliminations and other adjustments.

3 Capital Structure

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

The issued and paid up share capital of the Group was BD 214,093 thousands at 30 June 2014, comprising of 2,140,929 thousand shares of BD 0.100 each. **(PD 1.3.11)**

The Group's eligible capital base of BD 260,862 thousands comprises Tier 1 and Tier 2 capital as detailed below: **(PD 1.3.11)**

Table 3.1 Breakdown of Group Capital Base **(PD 1.3.12, 13, 14, 15, 16)**

(BD '000s)

	Tier 1	Tier 2	Total
Issued and fully paid up ordinary shares	214,093	-	**214,093**
Legal/Statutory reserves	10,926	-	**10,926**
Share premium	12,209	-	**12,209**
Others	(618)	-	**(618)**
Retained profit brought forward	13,790	-	**13,790**
Unrealized gains arising from fair valuing equities (45% only)	18,679	-	**18,679**
Minority interest in consolidated subsidiaries	7,213	-	**7,213**
Less:			
Goodwill	(12,773)	-	**(12,773)**
Unrealized gross losses arising from fair valuing equity securities	(9,565)	-	**(9,565)**
Tier 1 Capital before Prudential Consolidation and Deduction (PCD) Requirements	**253,954**	**-**	**253,954**
Current interim profits (reviewed by external auditors)	-	8,167	**8,167**
Asset revaluation reserve - Property, plant, and equipment (45% only)	-	9,746	**9,746**
Unrealized gains arising from fair valuing equities (45% only)	-	870	**870**
Collective impairment loss provision	-	5,617	**5,617**
Tier 2 Capital before PCD Requirements (2.1 to 2.5 inclusive less 2.6)	**-**	**24,400**	**24,400**
Total Available Capital	**253,954**	**24,400**	**278,354**
Regulatory Deductions:			
Significant minority investments in banking, securities and other financial entities unless pro-rata consolidated	(5,537)	(5,537)	**(11,074)**
Excess amount over maximum permitted large exposure limit	(3,209)	(3,209)	**(6,418)**
Total Deductions	**(8,746)**	**(8,746)**	**(17,492)**
Additional deduction from Tier-1 to absorb deficiency in Tier-2	-	-	**-**
Total Eligible Capital (Tier 1 and Tier 2) (a) (PD 1.3.20 a)	**245,208**	**15,654**	**260,862**

Table 3.2 (BD '000s)

Risk Weighted Assets (RWA)	**Amount**
Credit risk	1,333,043
Market risk	10,977
Operational risk	42,064
Total Risk Weighted Assets (b)	**1,386,084**
Capital Adequacy Ratio for the Group (a/b) (PD 1.3.20 a)	
Tier 1 ratio (PD 1.3.20 a)	**17.7%**
Tier 2 ratio (PD 1.3.20 a)	**1.1%**
Total ratio (PD 1.3.20 a)	**18.8%**
Minimum Required by CBB Regulations under Basel II (%)	**12%**

Table 3.3

Capital Adequacy Ratio of the Group's significant subsidiaries*:	**Tier 1**	**Total**
BMI Bank B.S.C. (c)	15.32%	15.69%

* Calculated in accordance with Capital Adequacy Module of Volume 1 issued by CBB.

4 Capital Adequacy Ratios (CAR)

No impediments on the transfer of funds or reallocation of regulatory capital exist 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 CBB. 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 2014.

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 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 favourable 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 Group'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 20% or more 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 interim condensed consolidated statement of financial position 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 Profile of Risk-Weighted Assets and Capital Charge (continued)

5.1 Credit Risk (continued)

Table 5.1 Funded and Unfunded Exposures

(BD '000s)

	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	6,800	7,148	6,800	-	-	-	-	-	-	-
Claims on sovereigns	490,667	453,743	490,668	-	-	-	-	1,642	1,642	197
Claims on public sector entities	-	-	-	-	-	-	-	-	-	-
Claims on banks	404,462	343,742	402,363	2,099	1,243	-	1,243	163,858	160,513	19,262
Claims on corporate portfolio	415,637	412,104	325,969	89,667	24,019	-	55,653	349,175	349,175	41,901
Claims on regulatory retail portfolio	40,204	40,209	40,204	-	-	-	-	30,153	30,153	3,618
Mortgages	200,996	200,640	189,899	11,097	-	-	27,811	134,485	134,485	16,138
Past due receivables over 90 days	84,296	90,889	84,296	-	-	-	8,081	100,159	100,159	12,019
Investments in Securities and Sukuk	40,770	48,222	40,770	-	-	-	-	50,398	50,398	6,048
Holding of Real Estate	187,631	169,626	186,904	728	-	-	-	375,258	375,258	45,031
Other assets and Specialized financing	145,100	140,102	145,101	-	3,115	-	3,115	131,260	131,260	15,751
Total	**2,016,563**	**1,906,425**	**1,912,974**	**103,591**	**28,377**	**-**	**95,903**	**1,336,388**	**1,333,043**	**159,965**

* The Group has calculated the average exposures based on average quarterly balances.

Note a: In accordance with the Public Disclosure requirements to disclose the regulatory capital requirements for credit risk under standardised approach, have been extracted from the workings prepared based on the Form PIRI and Form PIR submitted to the CBB by the Bank and BMI respectively.

Note b: The gross credit exposure is arrived at after considering the following:
- inclusion of unfunded exposure (after CCF);
- deduction of 55% haircut on unrealised gain relating to investments; and
- deduction of excess amount over maximum permitted large exposure limit.

Note c: The unfunded exposure before (CCF) as of 30 June 2014 is BD 205,853 thousands.

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 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
Central Bank of Bahrain Sukuk	110,653	123,002	110,653	-	-	-	-	381	381	46
Murabaha and Wakala receivables from banks	237,383	193,515	237,383	-	-	-	-	88,557	85,212	10,225
Corporate sukuk	114,218	106,833	114,218	-	-	-	-	63,230	63,230	7,588
Murabaha financing	213,229	219,288	202,312	10,916	6,204	-	6,208	187,711	187,711	22,525
Mudaraba financing	137,338	129,870	132,586	4,752	6,205	-	6,205	87,031	87,031	10,444
Ijarah Muntahia Bittamleek	112,904	110,306	111,787	1,117	1,004	-	32,234	73,853	73,853	8,862
Musharaka	12,239	17,944	11,955	284	-	-	-	11,613	11,613	1,394
Total	**937,964**	**900,758**	**920,894**	**17,069**	**13,413**	**-**	**44,647**	**512,376**	**509,031**	**61,084**

Note: The above amounts include profit accrued on these contracts.
* The Group has calculated the average exposures based on average quarterly balances.

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's 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 bank credit limits, set by the Risk Committee. Credit exposure to individual customers or customer banks 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's 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 2014, the Group's exposures in excess of 15% of the obligor limits to individual counterparties, and excluding Central Bank exposures were BD 46,511 thousands. 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 f)

(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*	46,511	-	-	-	**46,511**
Total	**46,511**	**-**	**-**	**-**	**46,511**

* Excess amount of BD 6,418 thousands over maximum permitted large exposure limit has been considered as part regulatory deduction (refer table 3.1)

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 at 30 June 2014, the collaterals eligible for CRM (after applying regulatory haircuts) amounted to BD 96 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 Bank also makes use of master netting agreements with counterparties where relevant. **(PD 1.3.25 a)**

The main types of guarantors include rated banks 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, the Group 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 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 Pacific**	**North America**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	210,977	21	16,994	70	9,571	-	**237,633**
Central Bank of Bahrain Sukuk	104,643	-	-	-	-	-	**104,643**
Murabaha and Wakala receivables from banks	179,475	-	13,134	350	1,584	1,132	**195,675**
Corporate Sukuk	107,366	-	4,901	-	-	-	**112,267**
Murabaha financing	144,318	-	26,450	30,130	-	-	**200,898**
Mudaraba financing	115,033	-	-	14,910	-	-	**129,943**
Ijarah Muntahia Bittamleek	94,332	-	-	18,597	-	-	**112,929**
Mushakara	11,898	-	-	-	-	-	**11,898**
Assets under conversion	378,939	-	10,569	44,637	-	12,382	**446,527**
Non-trading investments	130,248	-	-	19,296	-	-	**149,544**
Investment properties	44,768	-	12,540	24,015	-	-	**81,323**
Development properties	54,466	-	-	-	-	-	**54,466**
Investment in associates	-	8,443	-	-	-	2,632	**11,075**
Other assets	29,479	-	1,966	329	-	-	**31,774**
Assets held-for-sale	-	-	-	-	40,862	-	**40,862**
Goodwill	12,773	-	-	-	-	-	**12,773**
Total funded exposures	**1,618,715**	**8,464**	**86,554**	**152,334**	**52,017**	**16,146**	**1,934,230**
Contingent Liabilities & Commitments	203,163	-	-	2,663	23	4	**205,853**
Total unfunded exposures	**203,163**	**-**	**-**	**2,663**	**23**	**4**	**205,853**
Total exposures	**1,821,878**	**8,464**	**86,554**	**154,997**	**52,040**	**16,150**	**2,140,083**

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 Pacific**	**North America**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	-	-	-	-	-	-	**-**
Central Bank of Bahrain Sukuk	4,216	-	-	-	-	-	**4,216**
Murabaha and Wakala receivables from banks	26,286	-	-	-	-	-	**26,286**
Corporate Sukuk	-	-	-	-	-	-	**-**
Murabaha financing	-	-	-	-	-	-	**-**
Mudaraba financing	-	-	-	-	-	-	**-**
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	**-**
Musharaka	-	-	-	-	-	-	**-**
Assets under conversion	-	-	-	-	-	-	**-**
Non-trading investments	-	-	-	-	-	-	**-**
Investment properties	-	-	-	-	-	-	**-**
Development properties	-	-	-	-	-	-	**-**
Investment in associates	-	-	-	-	-	-	**-**
Other assets	-	-	-	-	-	-	**-**
Assets held-for-sale	-	-	-	-	-	-	**-**
Goodwill	-	-	-	-	-	-	**-**
Total funded exposures	**30,502**	**-**	**-**	**-**	**-**	**-**	**30,502**
Contingent Liabilities & Commitments	-	-	-	-	-	-	-
Total unfunded exposures	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total exposures	**30,502**	**-**	**-**	**-**	**-**	**-**	**30,502**

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 2014. All past due but not impaired Murabaha, Mudaraba and Ijarah financing are covered by sufficient collaterals that include cash, personal and sovereign guarantees. As at 30 June 2014, a specific provision of BD 54,078 thousands (31 December 2013: BD 4,580 thousands) has been taken against past due financing contracts. During the period, additional specific provisions were made amounting to BD 1,791 thousands and recoveries were made amounting to BD 588 thousands. Also as of 30 June 2014, a collective impairment provision of BD 6,453 thousands (31 December 2013: BD 1,294 thousands) has been maintained against financing contracts. During the period, additional collective impairment provision was created amounting to BD 1,093 thousands. In addition to the provisions held, the financing portfolio acquired through Bahraini Saudi Bank ("BSB") business combination was subject to specific write down of BD 3,981 thousands and collective impairment write down of BD 3,175 thousands. **(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**	**Collective Impairment Provision Financing Contracts**	**Impaired Financing Contracts**	**Specific Provision on Impaired Investments**
GCC Countries	1,821,878	159,936	49,219	6,250	102,025	4,918
Arab World	8,464	-	-	-	-	-
Europe	86,554	-	-	14	-	-
Asia Pacific	154,997	7,288	4,859	41	7,288	7
North America	52,040	-	-	-	-	-
Others	16,150	3,166	-	148	-	-
Total	**2,140,083**	**170,390**	**54,078**	**6,453**	**109,313**	**4,925**

Table 5.7 **(BD '000s)**

Contribution by Equity of Investment Accountholders						
	Gross Credit Exposure	**Past Due Financing Contracts including Impaired Financing Contracts**	**Specific Provision Financing Contracts**	**Collective Impairment Provision Financing Contracts**	**Impaired Financing Contracts**	**Specific Provision on Impaired Investments**
GCC Countries	30,502	-	-	-	-	-
Arab World	-	-	-	-	-	-
Europe	-	-	-	-	-	-
Asia Pacific	-	-	-	-	-	-
North America	-	-	-	-	-	-
Others	-	-	-	-	-	-
Total	**30,502**	**-**	**-**	**-**	**-**	**-**

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

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	-	113,015	-	-	-	124,618	-	**237,633**
Central Bank of Bahrain Sukuk	-	18,982	-	-	-	85,661	-	**104,643**
Murabaha and Wakala receivables from banks	-	195,590	-	-	-	-	85	**195,675**
Corporate Sukuk	1,955	60,137	4,824	-	-	43,283	2,068	**112,267**
Murabaha financing	69,304	9,881	35,416	-	42,569	16,616	27,112	**200,898**
Mudaraba financing	20,385	9,255	20,698	-	15,534	41,904	22,167	**129,943**
Ijarah Muntahia Bittamleek	9,062	-	30,355	20,234	39,331	2,289	11,658	**112,929**
Musharaka	-	-	4,846	-	5,088	-	1,964	**11,898**
Assets under conversion	52,197	185,935	87,716	-	84,379	-	36,300	**446,527**
Non-trading investments	9,756	179	105,037	-	-	2,454	32,118	**149,544**
Investment properties	-	-	81,323	-	-	-	-	**81,323**
Development properties	-	-	54,466	-	-	-	-	**54,466**
Investment in associates	-	11,075	-	-	-	-	-	**11,075**
Other assets	1,546	11,816	7,267	5	3,795	1,727	5,618	**31,774**
Assets held-for-sale	-	-	-	40,862	-	-	-	**40,862**
Goodwill	-	12,773	-	-	-	-	-	**12,773**
Total funded exposures	**164,205**	**628,638**	**431,948**	**61,101**	**190,696**	**318,552**	**139,090**	**1,934,230**
Contingent Liabilities & Commitments	89,244	12,682	55,688	-	5,211	1,641	41,387	**205,853**
Total unfunded exposures	**89,244**	**12,682**	**55,688**	**-**	**5,211**	**1,641**	**41,387**	**205,853**
Total exposures	**253,449**	**641,320**	**487,636**	**61,101**	**195,907**	**320,193**	**180,477**	**2,140,083**

Table 5.9 Exposure by type of credit exposure **(PD 1.3.23 c)**

(BD '000s)

Contribution by Equity of Investment Accountholders								
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	-	4,216	-	-	-	-	-	**4,216**
Murabaha and Wakala receivables from banks	-	26,286	-	-	-	-	-	**26,286**
Corporate Sukuk	-	-	-	-	-	-	-	**-**
Murabaha financing	-	-	-	-	-	-	-	**-**
Mudaraba financing	-	-	-	-	-	-	-	**-**
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-	**-**
Musharaka	-	-	-	-	-	-	-	**-**
Assets under conversion	-	-	-	-	-	-	-	**-**
Non-trading investments	-	-	-	-	-	-	-	**-**
Investment properties	-	-	-	-	-	-	-	**-**
Development properties	-	-	-	-	-	-	-	**-**
Investment in associates	-	-	-	-	-	-	-	**-**
Other assets	-	-	-	-	-	-	-	**-**
Assets held-for-sale	-	-	-	-	-	-	-	**-**
Goodwill	-	-	-	-	-	-	-	**-**
Total funded exposures	**-**	**30,502**	**-**	**-**	**-**	**-**	**-**	**30,502**
Contingent Liabilities & Commitments	-	-	-	-	-	-	-	**-**
Total unfunded exposures	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total exposures	**-**	**30,502**	**-**	**-**	**-**	**-**	**-**	**30,502**

* Includes specialised financing hospitality sector.

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 Contracts	Carrying Value of Impaired Securities	Specific Provision Islamic Financing Contracts	Specific Provision Securities
Trading and manufacturing	253,449	164,205	89,244	53,547	2,454	13,627	4,164
Banks and financial institutions	641,320	628,638	12,682	33,156	24	17,734	761
Real estate	487,636	431,948	55,688	38,823	1,319	8,054	-
Aviation	61,101	61,101	-	-	-	-	-
Individuals	195,907	190,696	5,211	32,329	-	7,125	-
Government	320,193	318,552	1,641	-	-	-	-
Others	180,477	139,090	41,387	12,535	3,631	7,538	-
Total	**2,140,083**	**1,934,230**	**205,853**	**170,390**	**7,428**	**54,078**	**4,925**

Table 5.11 The exposure by industry including impaired assets and the related impairment is as follows:

(BD '000s)

Contribution by Equity of Investment Accountholders							
	Gross Exposure	Funded Exposure	Unfunded Exposure	Past Due Financing Contracts including Impaired Financing Contracts	Carrying Value of Impaired Securities	Specific Provision Islamic Financing Contracts	Specific Provision Securities
Trading and manufacturing	-	-	-	-	-	-	-
Banks and financial institutions	30,502	30,502	-	-	-	-	-
Real estate	-	-	-	-	-	-	-
Aviation	-	-	-	-	-	-	-
Individuals	-	-	-	-	-	-	-
Government	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-
Total	**30,502**	**30,502**	**-**	**-**	**-**	**-**	**-**

5.1.3 Exposure by External Credit Rating

The Group uses public information provided by external rating agencies (accredited External Credit Assessment Institutions – ECA). The lowest of the ratings based on information available to public is used as an input in computing rated exposures. **(PD 1.3.22 c, d, e)**

Table 5.12 **(BD '000s)**

	Gross Credit Exposure*	Rated Exposure	Unrated Exposure
Cash	6,800	-	6,800
Claims on sovereigns	490,667	-	490,667
Claims on public sector entities	-	-	-
Claims on banks	404,462	192,306	212,156
Claims on corporate portfolio	415,637	27,839	387,798
Regulatory retail portfolio	40,204	-	40,204
Mortgages	200,996	-	200,996
Past due receivables over 90 days	84,296	-	84,296
Investments in Securities and Sukuk	40,770	-	40,770
Holding of Real Estate	187,631	-	187,631
Other assets and Specialized financing	145,100	-	145,100
Total	**2,016,563**	**220,145**	**1,796,418**

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 internal risk ratings that are supported by a variety of financial analytics, combined with processed market information, to provide main inputs for measurement of counterparty credit risk. All internal ratings are tailored to various categories and are derived in accordance with the Group's credit policy and are assessed and updated on a regular basis. **(PD 1.3.22 e)**

* Gross credit exposure considered for calculation of capital adequacy ratio purpose

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

5.1 Credit Risk (continued)

5.1.3 Exposure by External Credit Rating (continued)

Note a: In accordance with the Public Disclosure requirements to disclose the regulatory capital requirements for credit risk under standardised approach, the above amounts have been extracted from the workings prepared based on the Form PIRI and Form PIR submitted to the CBB by the Bank and BMI respectively.

Note b: The gross credit exposure is arrived at after considering the following:
- inclusion of unfunded exposure (after CCF);
- deduction of 55% haircut on unrealised gain relating to investments; and
- deduction of excess amount over maximum permitted large exposure limit.

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	6,800	-	-	-	**6,800**	-	-	-	-	**-**	**6,800**
Claims on sovereigns	196,962	17,806	12,399	17,694	**244,861**	149,128	96,679	-	-	**245,807**	**490,668**
Claims on public sector entities	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Claims on banks	242,550	55,263	43,292	4,492	**345,597**	43,448	13,316	-	2	**56,766**	**402,363**
Claims on corporate portfolio	34,041	31,066	18,731	34,402	**118,240**	168,511	38,655	563	-	**207,729**	**325,969**
Regulatory retail portfolio	110	-	-	97	**207**	-	-	39,997	-	**39,997**	**40,204**
Mortgages	6,593	2,242	9,115	11,097	**29,047**	64,828	49,494	5,076	41,454	**160,852**	**189,899**
Past due receivables over 90 days	17,712	206	364	2,268	**20,550**	56,773	6,627	251	95	**63,746**	**84,296**
Investments in Securities and Sukuk	40,770	-	-	-	**40,770**	-	-	-	-	**-**	**40,770**
Holding of Real Estate	182,127	-	-	-	**182,127**	4,419	-	-	358	**4,777**	**186,904**
Other assets and Specialized financing	57,561	42,206	2,525	2,048	**104,340**	31,625	9,123	8	5	**40,761**	**145,101**
Total	**785,226**	**148,789**	**86,426**	**72,098**	**1,092,539**	**518,732**	**213,894**	**45,895**	**41,914**	**820,435**	**1,912,974**

Table 5.14 The residual contractual maturity analysis of unfunded exposures after applying CCF 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 banks	2,099	-	-	-	**2,099**	-	-	-	-	**-**	**2,099**
Claims on corporate portfolio	39,922	16,762	15,678	10,403	**82,765**	5,295	944	347	316	**6,902**	**89,667**
Mortgages	2,698	1,750	2,302	2,221	**8,971**	1,781	345	-	-	**2,126**	**11,097**
Holding of Real Estate	-	728	-	-	**728**	-	-	-	-	**-**	**728**
Total	**44,719**	**19,240**	**17,980**	**12,624**	**94,563**	**7,076**	**1,289**	**347**	**316**	**9,028**	**103,591**

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 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 *
Contingent liabilities on behalf of customers	57,558	49,248
Irrevocable unutilised commitments	135,345	52,867
Forward foreign exchange contracts	7,373	1,476
Operating lease commitments	5,577	-
RWA	**205,853**	**103,591**

* Credit exposure is after applying CCF.

At 30 June 2014, the Group held eligible cash collaterals in relation to credit related contingent items amounting to BD 3,262 thousands.

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

5.1 Credit Risk (continued)

5.1.4 Maturity analysis of exposures (continued)

Table 5.16 Expected maturity analysis by major type of credit exposure - Funded

(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 and balances with banks and Central Bank of Bahrain	237,633	-	-	-	**237,633**	-	-	-	-	**-**	**237,633**
Central Bank of Bahrain Sukuk	-	6,023	-	-	**6,023**	102,836	-	-	-	**102,836**	**108,859**
Murabaha and Wakala receivables from banks	180,449	41,512	-	-	**221,961**	-	-	-	-	**-**	**221,961**
Corporate Sukuk	-	-	12,085	1,129	**13,214**	72,238	26,815	-	-	**99,053**	**112,267**
Murabaha financing	10,404	13,123	7,427	16,136	**47,090**	135,161	18,644	-	3	**153,808**	**200,898**
Mudaraba financing	1,459	9,605	13,061	31,031	**55,156**	43,867	30,920	-	-	**74,787**	**129,943**
Ijarah Muntahia Bittamleek	26,866	1,248	4,838	8,087	**41,039**	49,044	16,452	5,492	902	**71,890**	**112,929**
Mushakara	201	92	614	1,509	**2,416**	6,095	2,858	406	123	**9,482**	**11,898**
Assets under conversion	28,358	42,439	55,380	16,672	**142,849**	55,526	148,892	25,836	73,424	**303,678**	**446,527**
Non-trading investments	-	-	-	-	**-**	149,544	-	-	-	**149,544**	**149,544**
Investment properties	-	-	-	-	**-**	81,323	-	-	-	**81,323**	**81,323**
Development properties	-	-	-	-	**-**	54,466	-	-	-	**54,466**	**54,466**
Investment in associates	-	-	-	-	**-**	8,443	-	-	2,632	**11,075**	**11,075**
Other assets	22,235	1,275	1,727	966	**26,203**	1,736	-	-	3,835	**5,571**	**31,774**
Assets held-for-sale	-	40,862	-	-	**40,862**	-	-	-	-	**-**	**40,862**
Goodwill	-	-	-	-	**-**	-	-	-	12,773	**12,773**	**12,773**
Total	**507,605**	**156,179**	**95,132**	**75,530**	**834,446**	**760,279**	**244,581**	**31,734**	**93,692**	**1,130,286**	**1,964,732**

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
Contingent liabilities on behalf of customers	5,045	11,429	13,715	17,340	**47,529**	9,444	-	-	585	**10,029**	**57,558**
Irrevocable unutilised commitments	73,083	27,903	15,032	7,739	**123,757**	9,303	1,544	694	47	**11,588**	**135,345**
Forward foreign exchange contracts	7,373	-	-	-	**7,373**	-	-	-	-	**-**	**7,373**
Operating lease commitment	101	367	426	916	**1,810**	2,974	793	-	-	**3,767**	**5,577**
Total	**85,602**	**39,699**	**29,173**	**25,995**	**180,469**	**21,721**	**2,337**	**694**	**632**	**25,384**	**205,853**

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	106,687	24,561	7,025	-	**138,273**	-	-	-	-	**-**	**138,273**
Wakala payables to non-banks	192,273	176,796	135,899	230,356	**735,324**	92,632	100	-	-	**92,732**	**828,056**
Customers' current accounts	218,889	-	-	-	**218,889**	-	-	-	-	**-**	**218,889**
Term financing	-	292	-	900	**1,192**	22,604	-	-	-	**22,604**	**23,796**
Liabilities under conversion	136,570	46,981	65,432	67,132	**316,115**	19,120	125	-	-	**19,245**	**335,360**
Liabilities relating to assets held-for-sale	-	26,066	-	-	**26,066**	-	-	-	-	**-**	**26,066**
Other liabilities	29,208	1,182	729	597	**31,716**	13,464	-	-	-	**13,464**	**45,180**
Equity of Investment Accountholders	30,502	-	-	-	**30,502**	-	-	-	-	**-**	**30,502**
Total	**714,129**	**275,878**	**209,085**	**298,985**	**1,498,077**	**147,820**	**225**	**-**	**-**	**148,045**	**1,646,122**

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 of Directors 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)

	Risk Weighted Asset	Period End Capital Charge	Capital Charge –Minimum*	Capital Charge –Maximum*
Equity position risk	-	-	-	-
Sukuk risk	-	-	-	-
Foreign exchange risk	10,977	1,317	57	1,317
Options risk	-	-	-	-
Commodity risk	-	-	-	-
Total market risk	**10,977**	**1,317**	**57**	**1,317**

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 2014.

5.3 Operational Risk

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. **(PD 1.3.21 c)**

The Group's 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 to agreement by all respective business units 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 5.05 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)**

	Dec 2013	Dec 2012	Dec 2011	Dec 2010	Dec 2009	Dec 2008
Gross income	27,076	23,919	16,308	15,582	26,936	50,590
Number of years with positive gross income	3	3	3	3	3	3
Average	22,434	18,603	19,609	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 2014 amounted to BD 127 thousands (30 June 2013: BD 102 thousands). This has arisen primarily from conventional financing and investments, penalty charges from customers and income on current accounts balances held with correspondent banks. **(PD 1.3.30 a, b)**

5 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 analyse 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. Material rate of return risks are identified and mitigated through the coordination 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 2014 and 2013.

Table 5.20 **(BD '000s)**

Profit rate risk in the Banking Book			
200bp Profit Rate Shocks			
Rate shock	Currency	Effect on net profit at 30 June 2014	Effect on net profit at 30 June 2013
Upward rate shocks:	USD	3,875	4,185
	BHD	5,263	3,878
Downward rate shocks:	USD	(3,875)	(4,185)
	BHD	(5,263)	(3,878)

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 effect 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 of Director'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 recommendations 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 of Directors, 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 Profile of Risk-Weighted Assets and Capital Charge (continued)

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 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 results in time savings as well as having independence controls.

Table 5.21 Equity positions in the Banking Book

	(BD '000s)
Quoted Equities	22,273
Unquoted Equities	####### ###
Profit earned for EOIA before smoothing	170
Net realized gains during the year	2,399
Net unrealized losses during the year	2,105

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's approved liquidity, market risk and capital management policies. In line with the Board's 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 in 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 Group'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's 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 banks and CBB sukuks 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 accountholders as a service to savings account 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, CBB Sukuks 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 7 thousands. 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 there is no limit against their withdrawal. It should however be noted that Mudaraba account fees are subject to being partially or totally 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 years 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)**

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 period ended 30 June 2014 and years ended 31 December 2013, 2012, 2011, 2010, 2009 and 2008 are as follows: **(PD 1.3.33 e, l, m, n)**

Table 6.1 **(BD '000s)**

	Jun 2014	Dec 2013	Dec 2012	Dec 2011	Dec 2010	Dec 2009	Dec 2008
Shareholders	90	148	166	153	216	155	220
EOIA (before smoothing)	164	279	302	278	393	282	400
Total Profit	**254**	**427**	**468**	**431**	**609**	**437**	**620**
Profit earned for EOIA before smoothing	164	279	302	278	393	282	400
Profit paid for EOIA after smoothing	90	148	166	153	216	155	220
Balance of:							
PER	N/A	N/A	N/A	N/A	N/A	N/A	N/A
IRR	7	7	7	7	7	7	38
Annual Rate of Return Benchmark	3%	3%	3%	3%	3%	3%	5%
Annual Rate of Return (EOIA)	0.62%	0.59%	0.70%	1.00%	1.00%	1.25%	2.50%
PER Amount	-	-	-	-	-	-	-
PER %	-	-	-	-	-	-	-
IRR Amount	7	7	7	7	7	7	38
IRR %	-	-	-	-	-	-	-
Reconciliation							
Mudaraba Earned Profit	164	279	302	278	393	282	400
Mudarib fees	(74)	(131)	(135)	(125)	(177)	(152)	(180)
Profit credited to EOIA accounts	**90**	**148**	**167**	**153**	**216**	**130**	**220**
IRR movements	-	-	-	-	-	-	-
Profit on EOIA	**90**	**148**	**167**	**153**	**216**	**130**	**220**
EOIA Balance	30,502	25,846	18,276	16,256	18,465	9,409	6,370
RWA as per PIRI Report	4,778	4,394	3,655	3,251	4,285	2,440	1,274

6 Equity of Investment Accountholders (continued)

Table 6.2

Date of statement of financial position	Profit Earned and Paid to EOIA	Rate of Return
30 June 2014	**164 profit earned and 90 profit paid**	**0.62%**
31 December 2013	**279 profit earned and 148 profit paid**	**0.59%**
31 December 2012	**302 profit earned and 166 profit paid**	**0.70%**
31 December 2011	**278 profit earned and 153 profit paid**	**1.00%**
31 December 2010	**393 profit earned and 216 profit paid**	**1.00%**
31 December 2009	**382 profit earned and 155 profit paid**	**1.25%**
31 December 2008	**400 profit earned and 220 profit paid**	**2.50%**
Return on average EOIA assets (ROAA)	**June 2014: 1.12%**	
	December 2013: 1.11%	
	December 2012: 1.18%	
	December 2011: 1.53%	
	December 2010: 2.25%	
	December 2009: 1.90%	
	December 2008: 4.49%	
Return on average equity (Total Owner's Equity) (ROAE)	**June 2014: 0.12%**	
	December 2013: 0.13%	
	December 2012: 0.15%	
	December 2011: 0.14%	
	December 2010: 0.20%	
	December 2009: 0.18%	
	December 2008: 0.25%	

Table 6.3 Equity of investment accountholders by Counterparty Type and Islamic Product Murabaha **(PD 1.3.33 i)**

Murabaha and Wakala receivables from banks **(BD '000s)**

Counterparty	Total Exposures	Funded by EOIA	Funded by Self & Call Accounts	% of EOIA to Total
Sovereign	4,216	4,216	-	100%
Financial Institutions	26,286	26,286	-	100%
Multinational Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	**30,502**	**30,502**	**-**	**100%**

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		Central Bank of Bahrain Sukuk		Murabaha and Mudaraba financing	
	EOIA	Self & Call Accounts	EOIA	Self & Call Accounts	EOIA	Self & Call Accounts
Asset Allocation as on 30 June 2014	26,286	195,675	4,216	104,643	-	330,841
Asset Allocation as on 31 December 2013	21,969	96,258	3,877	99,060	-	261,700
Asset Allocation as on 31 December 2012	18,276	85,014	-	-	-	227,109
Asset Allocation as on 31 December 2011	10,759	124,939	-	-	5,497	187,592
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
Asset Allocation as on 31 December 2008	6,370	80,797	-	-	-	72,483

There are no off-balance sheet exposures arising from investment decisions attributable to the EOIA holders because 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 12 titled related party transactions in the interim condensed consolidated financial statements for the period ended 30 June 2014. **(PD 1.3.10 e) (PD 1.3.23 d)**

7.3 Restructured Facilities

As at 30 June 2014, the balance of renegotiated financing facilities to individuals and corporate was BD 32,659 thousands (31 December 2013: BD 19,873 thousands). 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 2014. **(PD 1.3.23 k)**

7.5 Legal Risk and Claims

As at 30 June 2014, legal suits amounting to BD 13,395 thousands (31 December 2013: BD 12,978 thousands) 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. **(PD 1.3.30 c)**