AL SALAM BANK-BAHRAIN B.S.C.

BASEL II - PILLAR III

DISCLOSURES

31 December 2012

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 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

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 Bourse and Dubai Stock Exchange and operates under an Islamic retail banking license issued by CBB.

In 2009, the Bank acquired a 90.31% stake in Bahraini Saudi Bank B.S.C. ("BSB"), a publicly listed commercial bank in the Kingdom of Bahrain engaged in retail banking. In January 2012, BSB shares were delisted from Bahrain Stock Exchange. On 26 February 2012, approval was granted by the CBB to convert BSB's license from retail conventional bank to retail Islamic bank. On 24 April 2012, the Commercial Registration of BSB was cancelled by MOIC. Following this, the Bank acquired all the assets, and assumed all the liabilities of BSB, with effect from 25 April 2012 and integrated BSB's operations with those of the Bank. The Bank operate through ten retail branches in the Kingdom of Bahrain.

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

Table 2.1 Key Financial Indicators (PD 1.3.9 a,b,c) **(BD '000s)**

	Dec-2012	Dec-2011	Dec-2010	Dec-2009	Dec-2008	Dec-2007	Dec-2006*
Total operating Income	23,062	12,740	22,300	23,700	37,600	32,700	20,400
Net profit	10,308	497	7,316	13,962	25,500	23,100	16,400
Total assets	942,218	923,907	856,598	785,934	554,500	397,800	188,100
Total equity	208,065	200,625	201,860	201,778	172,500	159,500	136,500
Key Ratios	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006***
Earnings per share (fils)	6.9	0.2	5	10	21.3	19.3	15.1
Return on average assets (%)	1.1	0.1	0.9	2.1	4.7	7.9	11.2
Return on average equity (%)	5.1	0.2	3.6	7.6	15.8	15.6	15.1
Cost to operating income (%)	49.7	91	60.6	40.6	31.3	33.5	19.6
Dividend payout ratio (%)	72.6	-	-	51	46.9	51.8	-
Dividend yield ratio (%)	9.4	-	-	5.4	11.4	4.9	-

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

Consolidated Financial Position	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006**
Cash and balances with banks and Central Bank of Bahrain	66,843	72,318	95,791	126,739	83,534	15,174	2,942
Murabaha and Wakala receivables from banks	103,290	135,698	137,299	149,304	87,167	224,451	105,090
Central Bank of Bahrain Sukuk	117,612	125,027	68,632	32,908	31,095	20,380	-
Corporate Sukuk	74,993	49,650	60,959	16,950	-	-	-
Murabaha financing	127,537	135,383	114,572	87,274	72,484	32,642	22,963
Mudaraba financing	99,572	57,706	19,309	-	-	-	-
Ijarah Muntahia Bittamleek	82,954	66,477	56,756	46,315	41,531	10,436	10,382
Musharaka Financing	17,467	11,711	8,127	5,384	-	-	-
Non-trading investments	204,202	223,320	212,432	184,680	116,930	62,736	32,619
Investment in an associate	7,573	-	7,578	7659	8,012	8,272	23,647
Investment properties	2,500	2,500	3,373	1,177	1,177	1,177	1,177
Assets held-for-sale	-	-	-	-	88,934	9,024	-
Other assets (including assets under conversion)	36,908	43,028	69,911	125,207	21,033	10,505	10,858
Murabaha and Wakala payables to banks	90,852	104,573	101,300	89,398	32,881	96,983	-
Wakala payables to non-banks	521,929	515,147	456,447	317,370	289,005	106,909	-
Customers' current accounts	83,921	66,585	57,362	32,700	42,986	5,689	5,674
Other liabilities (incl. liabilities under conversion)	19,175	20,721	21,164	135,279	10756	8876	2224
Equity of Investment account holders (EOIA)	18,276	16,256	18,465	9,409	6,370	19,770	20,112
Capital	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006**
Capital adequacy (%)	20.9	24.9	24.7	28.6	24.7	48.7	79.8
Equity/total assets (%)	22.1	21.7	23.6	25.7	31.1	40.1	72.5
Total deposits/equity (times)	3.0x	3.0x	2.6x	2.3x	2.2x	1.4x	0.4x
Liquidity and Other ratios	**Dec-2012**	**Dec-2011**	**Dec-2010**	**Dec-2009**	**Dec-2008**	**Dec-2007**	**Dec-2006**
Islamic financing contracts/total assets (%)	34.8	29.4	23.2	40.9	41.9	72.4	73.6
Investments/total assets (%)	31.2	30.4	33.9	30.1	38.6	20.1	19.1
Liquid assets/total assets (%)	30.5	36.0	35.3	40.2	30.8	60.3	57.5
Islamic financing contracts/customer deposits (%)	52.5	45.4	37.3	70.0	68.7	217.5	536.9
Number of employees	202	215	223	231	116	110	58

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

3. Capital structure

The Bank'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 Bank was BD 149,706 thousand at 31 December 2012, comprising of 1,497,064 thousand shares of BD 0.100 each. (PD 1.3.11)

The Bank's eligible capital base of BD 145,974 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	149,214	-	149,214
Legal/ Statutory reserves	9,689	-	9,689
Share premium	2,573	-	2,573
Others	(571)	-	(571)
Retained profit brought forward	8,815	-	8,815
Unrealized gains arising from fair valuing equities (45% only)	10,334	-	10,334
Less:			
Unrealized gross losses arising from fair valuing equity securities	(1,018)	-	(1,018)
Tier 1 Capital before Prudential consolidation and deduction (PCD) requirements	**179,036**	-	**179,036**
Unrealized gains arising from fair valuing equities (45% only)	-	508	508
Tier 2 Capital before PCD requirements (2.1 to 2.5 inclusive less 2.6)	**-**	**508**	**508**
Total available capital	**179,036**	**508**	**179,544**

Regulatory deductions:			
Significant minority investments in banking and other financial entities unless prorata consolidated.	(3,787)	(3,787)	(7,574)
Excess amount over maximum permitted large exposure limit	(12,998)	(12,998)	(25,996)
Total Deductions	**(16,785)**	**(16,785)**	**(33,570)**
Additional deduction from Tier-1 to absorb deficiency in Tier-2	**(16,277)**	**16,277**	**-**
Total Eligible Capital (Tier 1) (a) (PD 1.3.20 a)	**145,974**	**-**	**145,974**

Table 3.2

(BD '000s)

Risk Weighted Assets (RWA)	**Amount**
Credit risk	662,977
Market risk	1,213
Operational risk	34,881
Total Risk Weighted Assets (b)	**699,071**
Capital adequacy ratio for the Bank (a/b) (PD 1.3.20 a)	
Tier 1 ratio (PD 1.3.20 a)	**20.9%**
Tier 2 ratio (PD 1.3.20 a)	**-**
Total ratio (PD 1.3.20 a)	**20.9%**
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 and the Bank has adequate capital to support the current and future activities of the Bank. (PD 1.3.6.c and PD 1.3.16)

4.1 Capital Management

Internal Capital Adequacy Assessment Process (ICAAP)

The Bank'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 Bank'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 Bank's capital management is to ensure that it complies with externally imposed capital requirements. The Bank complied in full with all externally imposed capital requirements during the period ended 31 December 2012.

5. Profile of Risk-weighted assets and capital charge

The Bank has adopted the standardized approach for credit risk and market risk and the basic indicator approach for operational risk for regulatory reporting purposes. The Bank'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 Bank 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 Bank are weighted at 100%

j. Underwriting of non-trading book items

Where the Bank 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

(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	3,271	4,425	3,271	-	-	-	-	-	-	-
Claims on sovereigns	240,350	273,552	240,350	-	-	-	-	15,564	15,564	1,868
Claims on public sector entities	3,685	4,981	3,685	-	-	-	-	3,685	3,685	442
Claims on banks	154,641	189,443	154,641	-	-	-	-	54,641	52,083	6,250
Claims on corporate portfolio	182,357	212,181	159,169	23,188	3,141		734	161,650	161,650	19,398
Claims on regulatory retail portfolio	-	254	-	-	-	-	-	-	-	-
Mortgages	61,536	60,956	61,536	-	-	-	13,728	44,699	44,699	5,364
Past due receivables over 90 days	28,360	28,503	28,360	-	-	-	-	39,234	39,234	4,708
Investments in Securities and Sukuk	49,382	54,211	49,382	-	-	-	-	63,756	63,756	7,651
Holding of Real Estate	101,433	104,760	100,737	696	-	-	-	202,866	202,866	24,344
Other assets and Specialized financing	95,607	77,393	95,607		-	-	4,142	79,442	79,442	9,533
Total	**920,622**	**1,010,659**	**896,738**	**23,884**	**3,141**	**-**	**18,604**	**665,537**	**662,979**	**79,558**

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 revised PIRI submitted to the CBB.

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 31 December 2012 is BD40,468k.

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	118,724	124,238	118,724	-	-	-	-	6,148	6,148	738
Murabaha and Wakala receivables from banks	103,297	123,104	103,297	-	-	-	-	32,009	29,451	3,534
Corporate sukuk	75,765	71,477	75,765				-	51,542	51,542	6,185
Murabaha financing	151,393	131,825	129,866	21,527	3,141		3,118	90,984	90,984	10,918
Mudaraba financing	99,572	84,692	99,572	-	-	-	6,383	56,211	56,211	6,745
Ijarah Muntahia Bittamleek	84,046	73,317	83,392	654	-	-	8,771	73,136	73,136	8,776
Musharaka Financing	18,563	15,043	17,556	1,007	-	-	81	17,394	17,394	2,088
Total	**651,360**	**623,696**	**628,172**	**23,188**	**3,141**	**-**	**18,353**	**327,424**	**324,866**	**38,984**

Note: The above amounts include profit accrued on these contracts.

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 Bank 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 Bank's internal credit rating system. Where unsecured facilities sought are considered to be beyond prudential limits, Bank 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 2012, the Bank's exposures in excess of 15% of the obligor limits to individual counterparties, and excluding Central Bank exposures were BD 79,859 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 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	34,250	-	-	-	34,250
Counterparty B	40,457	5,152	-	-	45,609
Total	**74,707**	**5,152**	**-**	**-**	**79,859**

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 Bank monitors the concentration of its credit risk mitigants in order to minimize exposure to one type of collaterals. As on 31 December 2012, the collaterals eligible for CRM (after applying regulatory haircuts) amounted to BD 19 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 Bank 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 Bank 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 Bank 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	56,868	28	6,485	660	2,802	-	66,843
Central Bank of Bahrain Sukuk	117,612	-	-	-	-	-	117,612
Murabaha and Wakala receivables from banks	79,736	-	5,278	-	-	-	85,014
Corporate Sukuk	74,993	-			-	-	74,993
Murabaha financing	96,367	-	10,436	20,734	-	-	127,537
Mudaraba financing	87,604	-	-	11,214	754	-	99,572
Ijarah Muntahia Bittamleek	82,954	-	-		-	-	82,954
Mushakara financing	17,467	-	-		-	-	17,467
Non-trading investments	159,631	-	14,251	29,894	-	426	204,202
Investment in an associate	-	7,573	-	-	-	-	7,573
Investment properties	2,500	.	-	-	-	-	2,500
Other assets	34,583	9	1,685	631	-	-	36,908
Premises and equipment	766	-	-	1	-	-	767
Total funded exposures	**811,081**	**7,610**	**38,135**	**63,134**	**3,556**	**426**	**923,942**
Commitments	25,379	-	-	15,089	-	-	40,468
Total unfunded exposures	**25,379**	**-**	**-**	**15,089**	**-**	-	**40,468**
TOTAL	**836,460**	**7,610**	**38,135**	**78,223**	**3,556**	**426**	**964,410**

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

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

Contribution by Equity of investment account holders							
Exposure type	**GCC countries**	**Arab World**	**Europe**	**Asia**	**America**	**Others**	**Total**
Cash and balances with banks and Central Bank of Bahrain	-	-	-	-	-	-	-
Central Bank of Bahrain Sukuk	-	-	-	-	-	-	-
Murabaha and Wakala receivables from banks	18,276	-	-	-	-	-	18,276
Corporate Sukuk	-	-	-	-	-	-	-
Murabaha financing	-	-	-	-	-	-	-
Mudaraba financing	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-
Mushakara financing	-	-	-	-	-	-	-
Assets under conversion	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-
Investment in an associate	-	-	-	-	-	-	
Investment properties	-	-	-	-	-	-	-
Other assets	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-
Total funded exposures	**18,276**	-	-	-	-	-	**18,276**
Commitments	-	-	-	-	-	-	-
Total unfunded exposures	**-**	**-**	**-**	**-**	**-**	-	**-**
TOTAL	**18,276**	**-**	**-**	**-**	**-**	**-**	**18,276**

5.1 Credit risk (continued)

5.1.1 Geographical distribution of exposures (cont'd)

The Bank has a few past due financing contracts that have not been settled as of 31 December 2012. 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 2012, a specific provision of BD 3,721k (31December 2011: BD 1,653 k) has been taken against past due financing contracts. Also as of 31 December 2012 a general provision of BD500k (31 December 2011: BD 500 k) has been maintained against financing contracts. There is no movement in general provision during the year. In addition to the provisions held, the financing portfolio acquired through BSB business combination was subject to specific write down of BD2,965 thousands and collective impairment write down of BD3,175 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	General Provision Financing Contracts	Impaired Financing Contracts	Specific Provision on Impaired Investments
GCC Countries	836,460	32,945	3,721	500	10,508	3,053
Arab World	7,610	-	-	-	-	-
Europe	38,135	-	-	-	-	-
Asia	78,223	-	-	-	-	-
America	3,556	-	-	-	-	-
Other	426	-	-	-	-	-
Total	**964,410**	**32,945**	**3,721**	**500**	**10,508**	**3,053**

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	18,276	-	-	-	-
Arab World	-	-	-	-	-
Europe	-	-	-	-	-
Asia	-	-	-	-	-
America	-	-	-	-	-
Other	-	-	-	-	-
Total	**18,276**	-	-	-	-

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	-	10,865	-	-	-	55,978	-	66,843
Central Bank of Bahrain Sukuk	-	-	-	-	-	117,612	-	117,612
Murabaha and Wakala receivables from banks	-	83,959	-	-	-	-	1,055	85,014
Corporate Sukuk	1,955	47,900	421	-	-	24,717	-	74,993
Murabaha financing	23,688	2,450	26,118	1,037	30,242	28,915	15,087	127,537
Mudaraba financing	14,955	-	28,679	-	8,827	26,888	20,223	99,572
Ijarah Muntahia Bittamleek	2,285	-	38,323	2,310	26,953	3,041	10,042	82,954
Mushakara financing	-	-	12,630	-	2,870	-	1,967	17,467
Non-trading investments	13,479	535	145,461	9,773	-	2,388	32,566	204,202
Investment in an associate	-	7,573		-	-	-	-	7,573
Investment properties	-	-	2,500	-	-	-	-	2,500
Other assets	2,036	11,179	3,203	5	3,921	6,177	10,387	36,908
Premises and equipment	-	-	-	-	-	-	767	767
Total funded	**58,398**	**164,461**	**257,335**	**13,125**	**72,813**	**265,716**	**92,094**	**923,942**
Commitments	17,255	-	-	8,679	1,829	-	12,705	40,468
Total unfunded	**17,255**	**-**	**-**	**8,679**	**1,829**	**-**	**12,705**	**40,468**
Total exposure	**75,653**	**164,461**	**257,335**	**21,804**	**74,642**	**265,716**	**104,799**	**964,410**

*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	-	18,276	-	-	-	-	-	18,276
Corporate Sukuk	-	-	-	-	-	-	-	-
Murabaha financing	-	-	-	-	-	-	-	-
Mudaraba financing	-	-	-	-	-	-	-	-
Ijarah Muntahia Bittamleek	-	-	-	-	-	-	-	-
Mushakara financing	-	-	-	-	-	-	-	-
Non-trading investments	-	-	-	-	-	-	-	-
Investment in an associate	-	-	-	-	-	-	-	-
Investment properties	-	-	-	-	-	-	-	-
Other assets	-	-	-	-	-	-	-	-
Premises and equipment	-	-	-	-	-	-	-	-
Total funded	-	**18,276**	-	-	-	-	-	**18,276**
Undrawn commitments	-	-	-	-	-	-	-	-
Total unfunded	-	**-**	-	-	-	-	-	**-**
Total exposure	-	**18,276**	-	-	-	-	-	**18,276**

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	75,653	58,398	17,255	3,717	2,388	312	2,418
Banks and financial institutions	164,461	164,461	-	-	90	3,016	31
Real estate	257,335	257,335	-	5,969	4,573	248	392
Aviation	21,804	13,125	8,679	2,310	-	-	-
Individuals	74,642	72,813	1,829	13,269	-	-	-
Government	265,716	265,716	-	-	-	-	-
Others	104,799	92,094	12,705	7,680	-	145	212
Total	**964,410**	**923,942**	**40,468**	**32,945**	**7,051**	**3,721**	**3,053**

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

(BD '000s)

Contribution by Equity of investment account holders							
	Gross Exposure	**Funded Exposure**	**Unfunded Exposure**	**Past due financing contracts including Impaired financing**	**Carrying value of Impaired Securities**	**Specific Provision Islamic Financing Contracts**	**Specific Provision Securities**
Trading and manufacturing	-	-	-	-	-	-	-
Banks and financial institutions	18,276	18,276	-	-	-	-	-
Real estate	-	-	-	-	-	-	-
Aviation	-	-	-	-	-	-	-
Individuals	-	-	-	-	-	-	-
Others	-	-	-	-	-	-	-
Total	**18,276**	**18,276**	**-**	**-**	**-**	**-**	**-**

5.1 Credit risk (continued)

5.1.3 Exposure by external credit rating

The Bank 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	3,271	-	3,271
Claims on sovereigns	240,350	-	240,350
Claims on public sector entities	3,685	-	3,685
Claims on banks	154,641	37,200	117,441
Claims on corporate portfolio	182,357	17,195	165,162
Mortgages	61,536	-	61,536
Past due receivables over 90 days	28,360	-	28,360
Investments in Securities and Sukuk	49,382	-	49,382
Holding of Real Estate	101,433	-	101,433
Other assets and Specialized financing	95,607	-	95,607
Total	**920,622**	**54,395**	**866,227**

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio through the internal risk rating system. As such, the Bank 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 Bank's credit policy and are assessed and updated on a regular basis. (PD 1.3.22 e)

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 revised PIRI submitted to
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 Bank'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	3,271	-	-	-	**3,271**	-	-	-	-	**-**	**3,271**
Claims on sovereigns	54,028	9,776	9,588	4,158	**77,550**	111,960	50,840	-	-	**162,800**	**240,350**
Claim on public sector entities	-	-	-	-	**-**	0	3,685	-	-	**3,685**	**3,685**
Claims on banks	114,218	0	167	-	**114,385**	36,859	1,512	1,885	-	**40,256**	**154,641**
Claims on corporate portfolio	9,773	7,558	6,994	33,059	**57,384**	85,661	14,925	1,199	-	**101,785**	**159,169**
Mortgages portfolio	1,855	4,724	3,943	10,319	**20,841**	35,827	2,481	1,928	459	**40,695**	**61,536**
Past due exposures	15,960	870	2,249	1,064	**20,143**	3,459	4,386	228	144	**8,217**	**28,360**
Investments in Securities and Sukuk	-	-	-	10,631	**10,631**	38,751	-	-	-	**38,751**	**49,382**
Holding of Real estate	-	-	-	-	**-**	98,237	2,500	-	-	**100,737**	**100,737**
Other exposures	37,906	2,940	1,054	4,179	**46,079**	46,890	2,007	434	197	**49,528**	**95,607**
Total	**237,011**	**25,868**	**23,995**	**63,410**	**350,284**	**457,644**	**82,336**	**5,674**	**800**	**546,455**	**896,738**

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	-	-	-	-	**-**	-	-	-	-	**-**	**-**
Claims on corporate portfolio	24,161	4,675	1,001	3,595	**33,432**	3,479	537	-	-	**4,016**	**37,448**
Holding of Real Estate	-	-	-	-	**-**	1,391	-	-	-	**1,391**	**1,391**
Other assets	59	119	179	357	**714**	915	-	-	-	**915**	**1,629**
Total	**24,220**	**4,794**	**1,180**	**3,952**	**34,146**	**5,785**	**537**	**-**	**-**	**6,322**	**40,468**

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	10,833	7,226
Operating lease commitments	1,629	-
Undrawn Islamic financing contracts commitments and other commitments	28,006	16,658
RWA	**40,468**	**23,884**

* Credit exposure is after applying CCF.

At 31 December 2012, the Bank held eligible cash collaterals in relation to credit related contingent items amounting to BD 2,246 k.

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	57,733	-	4,255	-	**61,988**	4,855	-	-	-	**4,855**	**66,843**
Central Bank of Bahrain Sukuk	-	8,897	6,143	-	**15,040**	80,715	21,857	-	-	**102,572**	**117,612**
Murabaha and Wakala receivables from banks	102,235	1,055	-	-	**103,290**	-	-	-	-	**-**	**103,290**
Corporate Sukuk	-	-	-	3,770	**3,770**	57,813	11,525	1,885	-	**71,223**	**74,993**
Murabaha financing	21,705	8,160	4,608	23,171	**57,644**	55,375	14,518	-	-	**69,893**	**127,537**
Mudaraba financing	20,456	4,446	6,256	13,363	**44,521**	34,545	20,506	-	-	**55,051**	**99,572**
Ijarah Muntahia Bittamleek	8,491	1,980	2,464	5,278	**18,213**	56,852	3,536	3,633	720	**64,741**	**82,954**
Musharaka financing	5,347	27	2,421	2,338	**10,133**	6,960	138	155	81	**7,334**	**17,467**
Non-trading investments	-	-	-	11,034	**11,034**	193,168	-	-	-	**193,168**	**204,202**
Investment in an associate	-	-	-	-	**-**	7,573	-	-	-	**7,573**	**7,573**
Investment properties	-	-	-	-	**-**	-	2,500	-	-	**2,500**	**2,500**
Other assets	10,990	1,179	2,103	6,267	**20,539**	8,685	7,684	-	-	**16,369**	**36,908**
Premises and equipment	-	-	-	-	**-**	767	-	-	-	**767**	**767**
Total	**226,957**	**25,744**	**28,250**	**65,221**	**346,172**	**507,308**	**82,264**	**5,673**	**801**	**596,046**	**942,218**

*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	14,238	4,026	1,001	3,595	**22,860**	3,218	537	-	-	**3,755**	**26,615**
Unutilised capital commitments	-	-	-	-	**-**	1,391	-	-	-	**1,391**	**1,391**
Contingent liabilities	9,923	649	-	-	**10,572**	261	-	-	-	**261**	**10,833**
Operating lease commitments	59	119	179	357	**714**	915	-	-	-	**915**	**1,629**
Total	**24,220**	**4,794**	**1,180**	**3,952**	**34,146**	**5,785**	**537**	**-**	**-**	**6,322**	**40,468**

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	-	-	9,085	-	**9,085**	81,767	-	-	-	**81,767**	**90,852**
Wakala payables to non-banks	-	-	88,318	86,808	**175,126**	346,803	-	-	-	**346,803**	**521,929**
Customers' current accounts	83,921	-	-	-	**83,921**	-	-	-	-	**-**	**83,921**
Other liabilities	6,361	945	2,415	8,811	**18,532**	197	446	-	-	**643**	**19,175**
Equity of Investment account holders	-	5,483	-	3,655	**9,138**	9,138	-	-	-	**9,138**	**18,276**
Total	**90,282**	**6,428**	**99,818**	**99,274**	**295,802**	**437,905**	**446**	**-**	**-**	**438,351**	**734,153**

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 Bank'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 Bank's Asset and Liability Committee. (PD 1.3.27 a)

Table 5.18 The Bank'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	1,213	97	66	292
Options risk	-	-	-	-
Total market risk	**1,213**	**97**	**66**	**292**

Foreign exchange positions constitute a major component of the market risk capital charge. The Bank maintains a conservative market risk exposure that is focused on the foreign exchange risk coming from the Bank's banking book open positions. The open positions were taken in order of running the Bank's day to day operations that include private equity funding for the Bank's investment portfolio. The Bank 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 31 December 2012.

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 Bank 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 Bank including risk and control self assessments, Key Risk Indicators (KRI), event management, new product review and approval processes and business contingency plans.

The Bank 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 Bank 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 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 Bank 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 Bank, 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 4.2 million. This capital charge was computed by categorizing the Bank'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). During 2012, an amount of BD 6,800/- was paid as penalty to the Central Bank which was imposed for delay in submission of the Bank's annual report and the Pillar-3 disclosure document.

Table 5.19 **(BD '000s)**

	2012	2011	2010	2009	2008
Gross income	23,919	16,308	15,582	26,936	50,590
Number of years with positive gross income	3	3	3	3	3
Average	18,603	19,609	31,132	36,695	21,552

The Bank 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 Bank 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 Bank's Risk Management Framework.

Non-Shari'a compliant income for the year ended 31 December 2012 amounted to BD 236k (31 December 2011: BD 4k). This has arisen primarily from conventional financing and investments, penalty charges from customers and income on 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 Bank 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 Bank 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 Bank'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 Bank's rate sensitive assets and liabilities are mostly for short tenures. In addition, the Bank's cautious asset liability strategy avoids funding short term lending facilities from long term borrowings. The Bank has set limits for profit return risk and these are monitored on an ongoing basis by the Bank's Asset and Liability Committee (ALCO).

The Bank 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 Bank's assets and liabilities. This monitoring process is independently run on a daily basis from within the Risk Management & Compliance Bank. 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 Bank's profit rate of return sensitivity position based on the contractual repricing or maturity dates, whichever is earlier for the period ended 31 December 2012 and 2011.

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

Profit rate risk in the Banking Book			
200bp Profit Rate shocks			
Rate shock	**Currency**	**Effect on net profit at 31 Dec 2012**	**Effect on net profit at 31 Dec 2011**
Upward rate shocks:	USD	3,976	1,616
	BHD	2,856	3,272
Downward rate shocks:	USD	(3,976)	(1,616)
	BHD	(2,856)	(3,272)

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 Bank 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 Bank will outline the permissible investments, asset classes, limits on asset classes & lines of authority for approvals. The policy will allow the Bank 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	20,770
Unquoted Equities	183,432
Profit earned for EOIA before smoothing	301
Net realized gains during the year	10,876
Net unrealized losses during the year	(7,021)

The Bank'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 Bank 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 Bank 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 Bank 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 Bank's liquidity profile can be assessed. In addition, the Bank 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 Bank'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 Bank 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 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 Bank provides the Equity of investment accounts as a service to savings accounts clients. Therefore, it is not the practice of the Bank to guarantee the preservation of capital through the investment risk reserves. As a result, the Bank 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 Bank'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 period in the investment risk reserve and the ending balance amounted to BD 7k. In order to avoid excessive risk concentration the Bank 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 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 Bank include the contribution from EOIA which are subject to the 30% risk weight.

The EOIA holders and other customers can use the Bank'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 period ended 31 December 2012, 2011, 2010 and 2009 are as follows: (PD 1.3.33 e, l, m, n)

6. Equity of investment accountholders (continued)

Table 6.1

(BD '000s)

Description	Dec-12	Dec-11	Dec-10	Dec-09	Dec-08
Shareholders	166	153	216	155	220
EOIA (before smoothing)	301	278	393	338	400
Total Profit	**467**	**431**	**609**	**493**	**620**
Profit earned for EOIA before smoothing	301	278	393	338	400
Profit paid for EOIA after smoothing	166	153	216	155	220
Balance of:					
PER	N/A	N/A	N/A	N/A	N/A
IRR	7	7	7	7	38
Annual Rate of Return Benchmark	3%	3%	3%	3%	4.5%
Annual Rate of Return (EOIA)	1%	1%	1%	1.25%	2.5%
PER Amount		-	-	-	-
PER %		-	-	-	-
IRR Amount	7	7	7	7	38
IRR %	-	-	-	-	-
Reconciliation					
Mudaraba Earned Profit	301	278	393	338	400
Mudarib fees	(135)	(125)	(177)	(152)	(180)
Profit credited to EOIA accounts	**166**	**153**	**216**	**186**	**220**
IRR movements	-	-	-	-31	33
Profit on EOIA	**166**	**153**	**216**	**155**	**253**
EOIA Balance	18,276	16,256	18,465	9,409	6,370
RWA as PIRI Report	3,655	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-12	**301 profit earned and 166 profit paid**	**0.7%**
31-Dec-11	**278 profit earned and 153 profit paid**	**1%**
31-Dec-10	**393 profit earned and 216 profit paid**	**1%**
31-Dec-09	**338 profit earned and 155 profit paid**	**1.25%**
31-Dec-08	**402 profit earned and 220 profit paid**	**2.50%**
Return on average EOIA assets (ROAA)	**December 2012: 1.18%**	
	December 2011: 1.53%	
	December 2010: 2.25%	
	December 2009: 1.9%	
	December 2008: 4.49%	
Return on average equity (Total Owner's Equity) (ROAE)	**December 2012: 0.15%**	
	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 i)

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

Counterparty	Total Exposures	Funded by EOIA	Funded by Self	% of EOIA to Total
Sovereign	-	-	-	100%
Financial Institutions	18,276	18,276	-	100%
Multinational Development Bank	-	-	-	-
Investment Firms	-	-	-	-
Corporate	-	-	-	-
Retail	-	-	-	-
Total	**18,276**	**18,276**	**-**	**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		Murabaha and Mudaraba financing	
	EOIA	Self & Call Accounts	EOIA	Self & Call Accounts
Asset Allocation as on 31 December 2012	18,276	85,014	-	227,109
Asset Allocation as on 31 December 2011	10,759	124,939	5497	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 EOI
term Islamic financing contracts.

7. Other disclosures

7.1 Currency risk

The Bank 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 Bank's consolidated structural financial positions are reviewed regularly by ALCO in accordance with the Bank's strategic plans and managed on a dynamic basis by the Treasury hedging such exposures, as

7.2 Related party transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of the Bank and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Bank's Senior Management. For further details refer Note 19 titled related party transactions in the consolidated financial statements for the year ended 31 December 2012. (PD 1.3.10 e) (PD 1.3.23 d)

7.3 Restructured facilities

During the year, BD 23,725 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 Bank has not entered into any recourse agreement during the year ended 31 December 2012. (PD 1.3.23 k)

7.5 Legal risk and claims (PD 1.3.30 c)

As of 31 December 2012, legal suits amounting to BD 1,978 thousand were pending against the Bank. Based on the opinion of the Bank's legal counsel, the total liability arising from these cases is not considered to be material to the Bank's profit or financial position as the Bank has also filed counter cases against these parties.