Kuwait Finance House (Bahrain) B.S.C.(c)

Public Disclosure

31 December 2014

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1 Group Structure

The public disclosures under this section have been prepared in accordance with the Central Bank of Bahrain ("CBB") requirements outlined in its Public Disclosure Module ("PD"), Section PD–1: Annual Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Kuwait Finance House (Bahrain) B.S.C. (c) ("KFH Bahrain" or "the Bank") being a locally incorporated Bank with an Islamic retail banking license and its subsidiaries, together known as ("the Group"). All amounts presented in the document are in Bahraini Dinar and rounded off to the nearest thousand. The shareholding structure as at 31 December 2014 is as follows:

Name	Number of shares	Nominal Value in BD '000	Sharholding Percentage	Nationality
Kuwait Finance House K.S.C.	1,650,949,273	165,095	93.200%	Kuwaiti
Treasury Shares	120,437,813	12,044	6.799%	Bahraini
Khalid Mohammed Al-Maarafi	17,714	2	0.001%	Bahraini
Total	**1,771,404,800**	**177,141**	**100%**	

The Board of Directors (the "Board") at KFH Bahrain seeks to optimise the Group's performance by enabling the business units to realise the Group's business strategy and meet agreed business performance targets by operating within the agreed capital and risk parameters and the risk policy framework.

2 Capital Adequacy

The Group manages the capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ("BIS rules/ratios") and adopted by the CBB in supervising the Bank.

The primary objectives of the Group's capital management are to ensure that the Group complies with externally imposed capital requirements and that the Group maintains healthy capital ratios in order to support its business and to maximise shareholders' value.

Regulatory capital consists of Tier 1 capital (core capital) and Tier 2 capital (supplementary capital). Tier 1 comprises share capital, share premium, statutory reserve, general reserve, retained earnings (including current year's profit), foreign currency translation reserve, unrealised net gains arising from fair valuing equities (subject to 55% discount factor for unlisted equities) and non-controlling stakeholders less goodwill and unrealised gross losses arising from fair valuing equity securities. Tier 2 capital includes subordinated murabaha payable, collective impairment reserve, unrealised gross gains (subject to 55% discount factor) and revaluation reserves. Certain adjustments are made to the financial results and reserves, as prescribed by the CBB in order to comply with Capital Adequacy (CA) Module issued by the CBB. From the regulatory perspective, the significant amount of the Group's capital is in Tier 1.

The Group's approach to assessing capital adequacy has been in line with its risk appetite in the light of its current and future activities. To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the Standardised Approach for the Credit and Market Risk, and the Basic Indicator Approach for the Operational Risk.

The Bank's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of expectations for each business group, expected growth in off–balance sheet facilities and future sources and uses of funds. In achieving an optimum balance between risk and return, the Bank has established an Internal Capital Adequacy Assessment Program (ICAAP) which quantifies the economic capital requirements for the key risks that the Bank is exposed to including credit risk, investment risk, liquidity risk, strategic risk, profit rate risk, reputation risk, operational risk, and concentration risk. The Bank also conducts comprehensive stress tests for various portfolios and assesses the impact on the capital and profitability. In addition, the Bank's stress testing frameworks and models allow for forward looking scenarios, which is considered for business growth strategies. The ICAAP of the Bank is driven by the Board through the Capital Adequacy Strategy and the ICAAP Policy. In case a plausible stress scenario is identified which may severely affect the capital adequacy of the Bank, the senior management decides an appropriate corrective action to be taken under such a scenario.

For the purpose of computing CAR the Bank consolidates the following entities:

1. Kuwait Finance House – Jordan;
2. Bayan Group for Property Investment W.L.L.;
3. Baytik Investment One S.P.C.; and
4. Baytik Investment Two S.P.C;

Investment in unconsolidated subsidiaries has not lead to any significant threshold breaches specified in Prudential Consolidation and Deduction Module of the CBB and are risk weighted as per the requirement of CA Module.

All transfer of funds within the Group is only carried out after proper approval process.

2.1 Quantitative Disclosures

Table – 1. Capital Structure | **Amount in BD '000**

CAPITAL STRUCTURE	
Capital Structure (PD-1.3.12, 1.3.13,1.3.14, 1.3.15) *	
Components of Capital	
Core capital - Tier 1:	
Issued and fully paid ordinary shares	177,140
Share premium	71,403
Statutory reserve	16,568
General reserve	28,237
Treasury shares	(21,923)
Retained earnings, unrealized gains arising from fair valuing equities (45% only) and other reserves	25,411
Total Tier 1 Capital	296,836
Deductions from Tier 1:	
Unrealised gross losses arising from fair valuing equity securities	2,243
Tier 1 Capital before Prudential consolidation and deductions (PCD)	294,593
Supplementary capital - Tier 2:	
Subordinated murabaha payable	95,349
Asset revaluation reserve - Property, plant, and equipment (45% only)	3,540
Unrealised gains arising from fair valuing equities	119
Collective impairment loss provision	5,782
Tier 2 Capital before PCD	104,790
Total Available Capital before PCD (Tier 1 & 2)	**399,383**

	Tier I	**Tier II**
Available Capital before PCD	294,593	104,790
Deductions		
Investment in insurance entity greater than or equal to 20% of investee's capital base	932	932
Excess amount over maximum permitted large exposure limits (defined in the Credit Risk Module (CM) of the CBB Rulebook)	88,900	88,900
Aggregate Deductions	89,832	89,832
Total eligible capital	**204,761**	**14,958**

* For the purposes of guidance we have cross referenced every table with the relevant Para number of the CBB's Public Disclosures module.

Table – 2. Capital Requirement by Type of Islamic Financing Contract. **Amount in BD '000**

CAPITAL ADEQUACY	
Regulatory Capital Requirements (PD-1.3.17) by Each Type of Islamic Financing Contracts	
Type of Islamic Financing Contracts	**Capital Requirement**
Murabaha contracts with Banks	938
Financing contracts with customers	
-Murabaha	95,595
-Ijarah	7,037
-Musharakah	395
Total	**103,965**

Table – 3. Capital Requirement for Market and Operational Risk **Amount in BD '000**

CAPITAL ADEQUACY		
Capital Requirements for Market Risk (PD-1.3.18) & Operational Risk (PD-1.3.19) & 1.3.30(a)		
Particulars	**Risk Weighted Assets**	**Capital Requirement**
Market Risk - Standardised Approach	41,929	5,241
Operational Risk - Basic indicator approach	137,097	17,137

Table – 4. Capital Ratios **Amount in BD '000**

CAPITAL ADEQUACY		
Capital Adequacy Ratios (PD-1.3.20)		
Particulars	**Total Capital Ratio**	**Tier 1 Capital Ratio**
	%	
Consolidated Ratios	20.1%	17.6%

3 Risk Management

3.1 Bank Wide Risk Management Objectives

The management of the Bank believes in the proactive management of risk through the full cycle of a financial transaction including its operating circumstances from the origination stage to its final disposal from the books of the Group. The risk management objective for each area of risk is to adopt the best practices informed by Basel II and IFSB guidelines and adhering to CBB requirements. The Group is able to identify, capture, monitor and manage different dimensions of risk with the aim of protecting asset values and income streams, and hence, optimising the Group's shareholder returns, while maintaining its risk exposure within defined parameters.

The Board of Directors (BoD) are responsible for managing risk in the Bank. They do this through setting the risk appetite in the form of a comprehensive limit structure and aligning business and risk strategies to achieve overall risk adjusted returns. The Bank reviews and redefines its risk appetite according to the evolving business plans considering fluctuations in economic and market conditions and future forecasts. The Bank also assesses on a regular basis its tolerance for specific risk categories in term of limits structures for various risks and its strategy to manage these risks. The Risk Management Department compiles, analyses and presents Bank wide data to Senior Management and Board level committees to aid in the monitoring and managing of these limits. To achieve this, the Bank has implemented sophisticated risk management systems, models and various other analytical tools.

3.2 Strategies, Processes and Internal Controls

3.2.1 Bank's Risk Strategy

The Bank's risk strategy, backed by appropriate limit structures, is articulated through a Risk Charter, Capital Adequacy strategy, Credit risk strategy, Investment risk strategy, Market risk strategy, Profit rate risk strategy, Liquidity risk strategy, Operational risk strategy and ICAAP policy. These strategies provide an enterprise–wide integrated risk management framework in the Bank. The Risk Charter identifies risk objectives, policies, strategies and risk governance both at the Board and the management level. The Capital Adequacy strategy and ICAAP policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses. Limit structures serve as a key component in articulating risk strategy in quantifiable risk appetite. They are further supported by a comprehensive framework for various risk silos with their own strategies, policies and methodology documents. In addition, the Bank has implemented various risk systems to help monitor and measure liquidity risk, profit rate risk and credit risks exposures.

The Group is exposed to various types of risk, such as market, credit, rate of return, liquidity and operational risks, all of which require comprehensive controls and on-going oversight. The risk management framework encapsulates the spirit behind Basel II, which includes management oversight and control, risk culture and ownership, risk recognition and assessment, control activities, adequate information and communication channels, monitoring risk management activities and correcting deficiencies.

3.2 Strategies, Processes and Internal Controls (continued)

3.2.2 Credit Risk

The Bank manages its credit risk exposures by evaluating each new product/activity with respect to the credit risk introduced by it. The Bank uses comprehensive credit evaluation and assessment criteria and scorecard for every credit proposal and records the risks arising from each new exposure. The Bank has established a limit structure to avoid concentration of risks for counterparty, industrial sector and geographical area. The Bank also conducts stress testing for assessing the impact of adverse systematic and firm specific conditions on its credit portfolio. The Bank also maintains Credit Risk Policy and Collateral Management policy for credit risk mitigants. Please refer to section 3.5.7 for 'Credit Risk Mitigation'.

3.2.3 Market Risk

The Bank measures and monitors the market risk in its portfolio using appropriate measurement techniques such as limits on its FX open positions, stop loss limits, notional limits and VaR limits. The Bank conducts stress testing to assess the impact of adverse market conditions on its market risk sensitive portfolio.

3.2.4 Operational Risk

The Bank has established a Risk Control and Self-Assessment (RCSA) process necessary for identifying and measuring and controlling its operational risks. This exercise covers the Bank's business lines and associated critical activities that exposes the Bank to material operational risks.

3.2.5 Equity Risk in the Banking Book

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio. The Bank manages and monitors market risk arising out of its investment in public equity using VaR and its private equity using industrial sector, geographical areas and investment type limits.

3.2.6 Profit Rate Risk

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank manages the mismatch risk and re-pricing characteristics of the assets and liabilities by monitoring, managing and limiting its re-pricing gaps. It also manages the market value sensitivity of the portfolio to the profit rates.

3.2 Strategies, Processes and Internal Controls (continued)

3.2.7 Displaced Commercial Risk (DCR)

DCR refers to the market pressure to pay returns to Unrestricted Investment Account (URIA) holders that exceeds the rate that has been earned on the assets financed by the URIA, when the return on assets is under performing as compared with competitor's rates.

The Bank manages DCR through the Profit Sharing Investment Account (PSIA) policy approved by the Board according to which the Bank can forego its mudarib share to manage DCR. The Bank compares its rates with the rates offered by peer Islamic banks in the market along with performing analysis of its profitability and studies of other market indicators. The Group does not use a fixed market benchmark rate for comparison to the returns paid to URIA holders.

The quantitative disclosures regarding DCR are available in tables 28 and 39.

3.3 Structure and Organisation of Risk Management Function

The Risk Management structure at the Bank encompasses all levels of authorities, organisational structure, people and systems required for the effective functioning of risk management processes. The roles and responsibilities associated with each level of risk management structure and authorities consist of the following:

The Board retains ultimate responsibility and authority for all risk management matters, including:

a. Establishing overall policies and procedures; and
b. Delegating authority to the Credit and Investment Committee (CIC), Audit, Risk Governance and Compliance (ARGC) Committee and further delegation to the management.

In order to perform its duties more efficiently, the Board have set up committees with specific responsibilities. Each committee has its respective terms of references that define its scope and powers.

ARGCC is a Board level committee which is responsible for reviewing and maintaining an oversight on all the risks faced by the Bank including compliance, governance and anti-money laundering (AML). For other Board committees' objectives, please refer to table 43 in this document.

The Board and ARGCC delegate the authority of the management of risk through several senior management committees including ALCO and Risk Management Committee, Basel II, Investment Committee, Credit Committee, Public Disclosure and Collection committee. Further, the different business units are the front line operators of risk management practices in the Bank and are the first line of control. Also, the overall risk framework including business units is subject to Internal Audit based on the Internal Audit Plan.

An independent Risk Management Department (RMD) is responsible for developing and implementing the risk management framework through the help of business units and committees as mentioned above. RMD also quantifies risk management numbers, develops reports, conducts periodic stress test and ICAAP program and reports them through a comprehensive risk management dashboard to ALCO, ARGCC and the Board of Directors to seek management actions and resolutions to mitigate risk.

3. 4 Risk Measurement and Reporting Systems

The Bank measures the risk using the risk management systems and risk MIS reports. The Bank has put in place various limits based on its risk appetite. These limits have been approved by the Board. Any limit breaches are reported to the respective senior management committees and the Board by the RMD based on the limit breach procedure approved by the Board. The limits are reviewed and revised on at least an annual basis or when deemed necessary. The Bank has implemented sophisticated risk management systems such as Focus Asset and Liability Management (ALM), credit risk rating systems, stress test models, ICAAP model, VaR and various other analytical models in order to generate the MIS and monitor the limits.

3.5 Credit Risk

3.5.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from financing and treasury activities. The Bank controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by collateral in the form of mortgage of real estate properties or other tangible securities.

The Board sets the guidelines for managing the credit risk in terms of credit risk strategy, credit risk policy, credit criteria specifications, collateral management policy and credit risk limits including individual and concentration limits. Any change to these guidelines is approved by the Board.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical areas and industrial sectors. All credit proposals undergo a comprehensive risk assessment which examines the customer's financial condition, trading performance, nature of the business, quality of management, and market position, etc. Counterparty facility limits for corporate customers are established by the use of a credit risk classification system, which assigns each counterparty a risk rating in terms of obligor risk rating and the facility risk rating. The proposals are reviewed by the Credit Review Unit which is separate from the risk taking business units. A comprehensive template is used to review the proposals by the credit review team. A credit approval decision is then made and terms and conditions are set.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Corporate contracts/facilities are reviewed on an annual basis by Corporate Finance and the Credit Review Unit.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the Bank. Risk ratings methodology is subject to regular revision by RMD.

3.5 Credit Risk (continued)

3.5.2 Types of credit risk

The Bank's Financing contracts mainly comprise of, Ijarah/Ijarah Muntahia Bittamleek, Istisna, Murabaha, Murabaha (International Commodity), Murabaha Letter of Credit, Diminishing Musharakah and Qard Al Hassan.

Ijarah /Ijarah Muntahia Bittamleek ("IMB")
The Bank enters into a contract under which the Bank purchases and leases out an asset required by the customer for a rental fee. The duration of the lease and rental fees are agreed in advance. Ownership of the asset remains with the Bank until full payment is received from the customer where the "Ownership Transfer Agreement" is signed. The Bank provides Ijarah financing in the form of IMB.

Istisna'a financing
Istisna'a refers to a contract to manufacture or build a non-existent asset, according to ultimate specifications and is to be delivered on a specified future date at a predetermined price.

Murabaha
Murabaha is a contract between the Bank and its client for the sale of goods at a price which includes a profit margin agreed by both parties. As a financing technique, it involves the purchase of goods by the Bank as requested by its client. The goods are then sold to the client at a price plus an agreed profit margin. Repayment, usually in instalments, is specified in the contract.

Murabaha (International Commodity) / Tawarruq
A commodity Murabaha is a process where the Bank purchases a Shari'a compliant commodity to be sold for its client for at a price plus an agreed profit margin through Murabaha contract. Where then, the client sells the commodity to a third party to get cash.

Murabaha Letter of Credit
A documentary credit is an undertaking by the Bank to pay the seller of goods, subject to the conformity of contractual instructions. Pursuant to a Murabaha Letter of Credit, the Bank imports the goods in its own name. The customer then purchases the goods from the Bank at a price plus an agreed profit margin under a Murabaha arrangement.

Diminishing Musharakah
This form of financing makes the client as a "partner" in term of ownership of the asset. This arrangement allows equity participation and sharing of loss on a pro rata basis and the profits are shared based on the allocation ratios. During the period of financing, the non–Bank partner makes payments to increase its equity in the subject matter with the ultimate objective that it will eventually buy the entire Bank's equity and have the title in the asset transferred solely to him.

3.5 Credit Risk (continued)

Qard Al Hassan
The Bank provides a benevolent finance. Under this arrangement the Bank provides financing without any profit which is usually short term in nature. The recipient is obliged to repay the principal at the time of maturity. Qard Al Hassan amounts to be deducted from shareholders equity.

Investment Wakala
Investment Wakala is an agreement between a "Muwakil" delegating a "Wakeel" to invest on its behalf in Shari'a compliant investments to generate a targeted rate of return as agreed in advance.

Musawama
A Musawama is a contract for the sale of assets at a price agreed by both parties.

3.5.3 Past Due and Impaired Islamic Financing

The Bank defines non performing facilities as the facilities that are overdue for a period of 90 or more days. Refer note 36.2 – 'Credit quality per class of financial assets' disclosure to the audited consolidated financial statements for the year ended 31 December 2013 for the Bank's provisioning policy and system for assessing the quality of financial assets. As a policy, the Bank has placed on a non–accrual status any facility where there is reasonable doubt about the collectability of the receivable irrespective of whether the customer concerned is currently in arrears or not.

3.5.4 External Credit Assessment Institutions

The Bank relies on external ratings for Sovereigns and Financial Institutions (FIs) for assessing the creditworthiness of the counterparties, as they are generally rated by an external rating agency. The Bank uses Standard & Poor's, Fitch, Capital Intelligence and Moody's to provide ratings for such counterparties. In case of unrated FIs, the Bank assesses the credit risk based on the internal FI rating model based on the following parameters:

Earnings, Liquidity, Asset quality, Capital adequacy, Size and Sensitivity to benchmark profit rates and other macroeconomic variables.

3.5.5 Definition of Geographical Area

The geographic distribution of the credit exposures is monitored on an ongoing basis by the Bank's RMD and reported to the Board on a quarterly basis for any limit breaches. The Bank's classification of geographical area is according to the distribution of its portfolios across material geographies.

3.5.6 Concentration Risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being over exposed to a single customer, industry sector or geographic region.

As per 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 related counterparties, exceeding 15% of the regulatory capital base. In order to avoid excessive concentrations of risk, the Bank's credit concentration policy and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

3.5 Credit Risk (continued)

3.5.7 Credit Risk Mitigation

3.5.7.1 Introduction

Credit risk mitigation is defined as the utilisation of a number of techniques, such as collaterals and guarantees to mitigate the credit risks that the Group is exposed to.

The Bank's first priority when establishing relationship with the customer for financing is to determine the borrower's capacity to repay and not to rely principally on security or collateral.

Acceptable forms of collateral and their valuation parameters are defined within the collateral management policy. Valuations are done conservatively and are regularly reviewed to reflect any changes in market conditions. The Bank has a policy to net financing facilities owed to them against funds from the same counterparty, which it applies on a case by case basis. Security structures and legal covenants are also subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice.

The Group accepts only Shari'a compliant collaterals as credit risk mitigants. Further, a representative from the Shari'a Department sits on the credit committee which takes decisions on significant collaterals. Furthermore, any non-standard deals below the requirements of the Credit Committee shall pass to the Sharia deparmtent for approval.

3.5.7.2 Policy guidelines for credit risk mitigation

The Bank has policy guidelines for the following credit risk mitigants:
- Collaterals
- Guarantees

1. Policy for collaterals

Collaterals are governed by the collateral management policy of the Bank. The business units review and recommend detailed guidelines relating to collateral in consultation with RMD. These guidelines cover the following:

- Permissible collateral types – based on size, age, value, location and manufacturer.
- Maximum financing to collateral value, for secured facilities based on each type of collateral.
- Collateral verification and appraisal processes including frequency of review.
- Approved panel of solicitors, property and other valuers.
- Collateral documentation requirements, custody (for securities) and Takaful requirements.
- Ongoing processes for margin maintenance, continuation of Takaful, etc.
- Collateral valuation process
- Applicable haircuts on various types of collaterals

The majority of the Bank's financing portfolio is secured through mortgage of real estate properties. In order to avoid any adverse impact of concentration of collateral, valuations are performed conservatively and regularly to reflect any changes in market conditions. The bank may also call for additional collateral in case the collaterals become insufficient during the regular credit review process. In case of default by any customer, the Bank makes all possible efforts for the recovery of amount and only resorts to the disposal of collateral when all other efforts have been exhausted.

3.5 Credit Risk (continued)

3.5.7.2 Policy guidelines for credit risk mitigation (continued)

2. Guarantees

Guarantees supplement collateral in improving the quality of credit. It is the policy of the Bank to obtain legally enforceable, unconditional, continuing and written guarantees. In cases where a letter of guarantee from a parent company or a third party is accepted as a credit risk mitigant, the Bank ensures that all guarantees are irrevocable and a legal opinion is obtained from legal counsel domiciled in the country of the guarantor (to the extent the guarantor is domiciled overseas) regarding the enforceability of the guarantee. All guarantees should be valid until full settlement of the financing contract. Also no maturity (negative) mismatch is permissible between the guarantee and the exposure. The Bank considers the following guarantees as credit risk mitigants for the purpose of Capital adequacy ratio calculations - Sovereigns and central banks, Public Sector Enterprises, Multi-lateral Development Banks, International organisations/officials entities having zero risk weights, Islamic banks or conventional banks and corporate entities (including insurance and securities firms) either by the parent, subsidiary and affiliates, of a minimum ECAI rating of A-. The Bank also follows the CBB CA rulebook for the list and conditions of capital relief eligible guarantees.

3.5.8 Counterparty Credit Risk

3.5.8.1 Introduction

A counterparty is defined as an obligor (individual, company, other legal entity), a guarantor of an obligor, or person receiving funds from the Group. It also includes the issuer of a security in case of a security held by the Group, or a party with whom a contract is made by the Group for financial transactions.

The measurement of exposure reflects the maximum loss that the Group may suffer in case the counterparty fails to fulfil its commitments. The Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. Large exposure is any exposure whether direct, indirect or funded by restricted investment accounts to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Group's capital base.

The Group has adopted the Standardised Approach to allocate capital for counterparty credit risk. The Bank has put in place an internal counterparty limit structure which is based on internal/external ratings for different types of counterparties. The Bank has also set concentration limits as a percentage of portfolio exposure based on grades. In case of a counterparty rating degrade, the Bank may require further collateral or advise the counter party to reduce its exposure on a case by case basis.

The Bank has developed a provisioning policy in order to ensure that it maintains adequate provisions for past due and impaired assets.

3.5 Credit Risk (continued)

3.5.8 Counterparty Credit Risk (continued)

3.5.8.2 Credit Limit Structure

Approval of counterparty exposure in excess of 10% of the Bank's capital

Exposure financed by direct, unrestricted investment accounts and/or restricted investment accounts, in excess of 10% of the Bank's Capital Base shall be approved only in exceptional cases. In such cases, Credit Review highlights the fact that the limits proposed are in excess of 10% of the Bank's capital base and valid justification for recommending such a large exposure is given by the business unit. The credit proposal is reviewed by Credit Review and Credit Administration Department and the Credit Committee and approved by the appropriate authorities within the Bank.

Reporting

The Group reports large counterparty exposures to CBB and senior management on a periodic basis. The Group reports the exposures on a gross basis without any offsetting. However, debit balances on accounts may be offset against credit balances where both are related to the same counterparty, provided the Group has a legally enforceable and Shari'a right to do so.

Early Warning Indicators

The Bank maintains a strong focus on identification of signs of deterioration in credit quality at an early stage in order to take remedial measures before the facility becomes non-performing.

3.5.9 Related Party Transactions:

During the year, the Bank has finalized the restructuring of one of its subsidiaries, Al Enma'a House for Real Estate Company B.S".C. (c) ("the Company"), in which the Bank owned 59.28% equity stake. Pursuant to restructuring, the Bank has acquired the stake of other shareholder. Subsequent to restructuring, the Company became a wholly owned subsidiary of the Bank.

Although the shareholding of the Bank in the Company has increased, the restructuring was executed in a manner that has not resulted in any increase in the overall exposure of the Bank towards the Company.

The disclosure relating to related party transactions and balances has been made available in the consolidated financial statements of the Group for the year ended 31 December 2014.

3.5.10 Quantitative disclosures

Table – 5. Average and Gross Credit Risk Exposure

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES				
Credit Risk Exposure (PD-1.3.23(a))				
	Self-Financed		**Financed by Unrestricted Investment Accounts**	
Portfolios	**Total Gross Credit Exposure**	*** Average Gross Credit Exposure Over the Period**	**Total Gross Credit Exposure**	*** Average Gross Credit Exposure Over the Period**
Balances with Banks	18,443	16,200	29,884	29,584
Murabaha and due from Banks	-	-	125,106	163,474
Financing contracts with customers	296,528	387,838	269,133	208,539
Investments at amortised cost – Sukkuk	-	-	85,887	81,911
Receivables	28,007	34,543	-	-
Total	**342,978**	**438,581**	**510,010**	**483,508**
Credit commitments and contingent items	49,192	44,641	-	-
Grand Total	**392,170**	**483,222**	**510,010**	**483,508**

* Gross credit exposure is reflected net of specific provisions and gross of general provisions.

Average credit exposure has been calculated using quarterly consolidated financial statements and PIRI forms submitted to the CBB.

Table – 6. Portfolio Geographic Breakdown. **Amount in BD '000**

CREDIT RISK: QUANTITATIVE DISCLOSURES										
Geographic Breakdown (PD-1.3.23(b)										
Portfolios	**Self-Financed Geographic Area**					**Financed by Unrestricted Investment Accounts Geographic Area**				
	Middle East	**North America**	**Europe**	**Others Countries**	**Total**	**Middle East**	**North America**	**Europe**	**Others Countries**	**Total**
Balances with Banks	16,350	1,182	905	6	18,443	26,493	1,915	1,466	10	29,884
Murabaha and due from Banks	-	-	-	-	-	123,204	-	-	1,902	125,106
Financing contracts with customers	290,008	-	6,520	-	296,528	269,133	-	-	-	269,133
Investments at amortised cost – Sukuk	-	-	-	-	-	85,887	-	-	-	85,887
Receivables	22,930	5,077	-	-	28,007	-	-	-	-	-
Total	**329,288**	**6,259**	**7,425**	**6**	**342,978**	**504,717**	**1,915**	**1,466**	**1,912**	**510,010**
Un-funded										
Credit commitments and contingent items	49,192	-	-	-	49,192	-	-	-	-	-
Grand Total	**378,480**	**6,259**	**7,425**	**6**	**392,170**	**504,717**	**1,915**	**1,466**	**1,912**	**510,010**

Table – 7. Industrial Sector Breakdown by Portfolio **Amount in BD '000**

CREDIT RISK: QUANTITATIVE DISCLOSURES										
Industry Sector Breakdown (PD-1.3.23(c))										
	Self-Financed					**Financed by Unrestricted Investment Accounts**				
Portfolios	**Industry Sector**					**Industry sector**				
	Trading and Manufacturing	**Banking and Financial**	**Construction and Real Estate**	**Others**	**Total**	**Trading and Manufacturing**	**Banking and Financial**	**Construction and Real Estate**	**Others**	**Total**
Funded										
Balances with Banks	-	18,443	-	-	18,443	-	29,884	-	-	29,884
Murabaha and due from Banks	-	-	-	-	-	-	125,106	-	-	125,106
Financing contracts with customers	28,099	4,241	246,610	17,578	296,528	25,620	3,867	181,110	58,536	269,133
Investments at amortised cost – Sukuk	-	-	-	-	-	-	23,192	62,695	-	85,887
Receivables	1,250	2,775	7,954	16,028	28,007	-	-	-	-	-
Total	**29,349**	**25,459**	**254,564**	**33,606**	**342,978**	**25,620**	**182,049**	**243,805**	**58,536**	**510,010**
Un-funded										
Credit commitments and contingent items	19,153	4	14,329	15,706	49,192	-	-	-	-	-
Grand Total	**48,502**	**25,463**	**268,893**	**49,312**	**392,170**	**25,620**	**182,049**	**243,805**	**58,536**	**510,010**

Table – 8. Exposures in Excess of 15% Limit

CREDIT RISK: QUANTITATIVE DISCLOSURES		
Concentration of risk (PD-1.3.23(f)) Exposure as a Percentage of Capital Base		
Counterparties	**Self-Financed**	**Financed by Unrestricted Investment Accounts**
	Concentration of Risk	**Concentration of Risk**
Counterparty # 1	48.58%	-
Counterparty # 2 *	19.20%	-

* Counterparty #2 is a corporate entity eligible for 0% Risk weight as per CBB.

Restructured Islamic Financing Contracts:

The outstanding amount of financing contracts with customers for which financing terms have been renegotiated during the year and six months have not elapsed amounted to BD 23,828 thousand (2013: BD 74,404 thousand) and these are secured with collateral amounting to BD 48,154 thousand (2013: BD 157,300 thousand). As a condition to restructuring, the Bank has received partial payment from customers and/or obtained additional collateral.

The restructuring does not have any significant impact on impairment provisions and present and future earnings of the Group as most of the exposures are sufficiently collateralised and restructuring is based on the market terms. The concession provided to the restructured relationships mainly relates to the extension of the repayment dates.

Foreclosed Assets

The Group has implemented a policy to deal with foreclosed assets which prescribes the procedure to be followed by business units when foreclosing assets as deemed necessary. The policy provides for the recording of foreclosed assets in the Bank's books and their management, including sale or rental.

Table – 9. Maturity Breakdown of Credit Exposures **Amount in BD '000**

CREDIT RISK: QUANTITATIVE DISCLOSURES							
Residual Contractual Maturity Breakdown (PD-1.3.23(g))							
	Self Financed						
Portfolios	**Maturity Breakdown**						
	Up to 3 Months	**3-12 Months**	**1-5 Years**	**5-10 Years**	**10-20 Years**	**Over 20 Years**	**Total**
Balances with Banks	3,370	1,838	3,679	3,406	3,406	2,744	18,443
Financing contracts with customers	17,274	36,047	176,828	37,102	26,402	2,875	296,528
Receivables	4,510	74	23,423	-	-	-	28,007
Total	**25,154**	**37,959**	**203,930**	**40,508**	**29,808**	**5,619**	**342,978**
Credit commitments and contingent items	-	34,863	14,329	-	-	-	49,192
Grand Total	**25,154**	**72,822**	**218,259**	**40,508**	**29,808**	**5,619**	**392,170**

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES							
Residual Contractual Maturity Breakdown (PD-1.3.23(g))							
	Financed by Unrestricted Investment Accounts						
Portfolios	**Maturity Breakdown**						
	Up to 3 Months	**3-12 Month**	**1-5 Years**	**5-10 Years**	**10-20 Years**	**Over 20 Years**	**Total**
Balances with Banks	5,461	2,977	5,962	5,520	5,519	4,445	29,884
Murabaha and due from Banks	125,106	-	-	-	-	-	125,106
Financing contracts with customers	61,145	32,429	115,847	33,168	23,934	2,610	269,133
Investments at amortised cost – Sukuk	18,850	-	67,037	-	-	-	85,887
Total	**210,562**	**35,406**	**188,846**	**38,688**	**29,453**	**7,055**	**510,010**
Credit commitments and contingent items	-	-	-	-	-	-	-
Grand Total	**210,562**	**35,406**	**188,846**	**38,688**	**29,453**	**7,055**	**510,010**

Table – 10. Break-up of Impaired Finances by Industry Sector **Amount in BD '000**

CREDIT RISK: QUANTITATIVE DISCLOSURES

Impaired Finances, Past Due Finances and Allowances (PD-1.3.23(h))

					Self-Financed									
								Specific Impairment						
Industry Sector	Total Portfolio	Neither past due nor impaired	Past due but not impaired	Substandard, Doubtful & loss	Over 3 Months	1 to 3 Years	Over 3 years	Balance at the beginning of the Period	Charges During the Period	Transfer from (to) collective provision	Transfer to other assets	Reversal during the Period	Balance at the End of the Period	Collective Impairment
Trading and manufacturing	28,099	22,924	2,310	2,865	2,309	556	-	122	81	(99)	(17)	-	87	*
Banking and financial institutions	4,241	3,892	349	-	-	-	-	112	-	(112)	-	-	-	*
Construction & real estate	246,610	216,111	18,392	12,107	9,754	2,353	-	278	1,372	93	(283)	-	1,460	*
Others	17,578	13,863	3,273	442	356	86	-	1,159	941	(904)	(194)	-	1,002	*
Total	**296,528**	**256,790**	**24,324**	**15,414**	**12,419**	**2,995**	-	**1,671**	**2,394**	**(1,022)**	**(494)**	**-**	**2,549**	

* This amounts to BD 5,782 thousand representing collective impairment against total exposures (self financed and URIA financed) which, although not specifically identified, have a greater risk of default than when originally granted.

Past due finances are stated net of specific impairment

Amount in BD '000

Impaired Finances, Past Due Finances and Allowances (PD-1.3.23(h))

					Financed by Unrestricted Investment Accounts								
								Specific Impairment					
Industry Sector	Total Portfolio	Neither past due nor impaired	Past due but not impaired	Substandard, Doubtful & loss	Over 3 Months	1 to 3 Years	Over 3 years	Balance at the beginning of the Period	Charges during the Period	Transfer from (to) collective provision	Reversal during the Period	Balance at the end of the Period	Collective Impairment
Trading and manufacturing	25,620	19,416	2,097	4,107	3,309	798	-	95	57	(16)	(12)	124	*
Banking and financial institutions	3,867	3,551	316	-	-	-	-	88	-	(88)	-	-	*
Construction & real estate	181,110	147,067	16,693	17,350	13,978	3,372	-	217	957	1,115	(197)	2,092	*
Others	58,536	54,932	2,971	633	510	123	-	904	657	11	(136)	1,436	*
Total	**269,133**	**224,966**	**22,077**	**22,090**	**17,797**	**4,293**	-	**1,304**	**1,671**	**1,022**	**(345)**	**3,652**	

* This amounts to BD 5,782 thousand representing collective impairment against total exposures (self financed and URIA financed) which, although not specifically identified, have a greater risk of default than when originally granted.

Past due finances are stated net of specific impairment

Table – 11. Break-up of Provision by Geographic Area — **Amount in BD '000**

CREDIT RISK: QUANTITATIVE DISCLOSURES						
Impaired Finances, Past Due Finances And Allowances (PD-1.3.23(i))						
	Own Capital and Current Account			**Unrestricted Investment Account**		
Geographic Area	**Past Due Islamic Financing Contracts**	**Specific Impairment**	**Collective Impairment**	**Past Due Islamic Financing Contracts**	**Specific Impairment**	**Collective Impairment**
Middle East	15,414	2,549	*	22,090	3,652	*
Total	**15,414**	**2,549**		**22,090**	**3,652**	

* This amounts to BD 5,782 thousand representing collective impairment against exposures which, although not specifically identified, have a greater risk of default then when originally granted.

Table – 12. Break-up of Eligible Collateral by Portfolio — **Amount in BD '000**

CREDIT RISK MITIGATION (CRM): DISCLOSURES FOR STANDARDISED APPROACH		
Credit Risk Exposure Covered By CRM (PD-1.3.25 (b) and (c))		
Portfolios	**Total Exposure Covered by**	
	Eligible Collateral(after appropriate haircuts)*	**Guarantees**
Ijarah	248,625	3,222
Total	**248,625**	**3,222**

* Over and above the collateral, considered as eligible under the CA Module, the Bank maintains additional collateral in the form of mortgage of residential properties, corporate guarantees and other tangible assets, which could be invoked to claim the amount owed in the event of default.

Table –13. Counter Party Credit Risk **Amount in BD '000**

DISCLOSURES FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK (CCR)								
General Disclosures (PD-1.3.26 (b))								
Current Credit Exposure by Type of Islamic Financing Contracts	**Gross Positive Fair Value (Net of specific provision)**	**Netting Benefits**	**Netted Current Credit Exposures**	**Eligible Collaterals Held (after appropriate haircuts) ***				
				Cash	**Govt. Securities**	**Guarantees**	**Real Estate**	**Total**
Murabaha	282,887	-	282,887	-	-	-	-	-
Ijarah	280,666	-	280,666	173	-	3,222	248,453	251,848
Musharakah	2,108	-	2,108	-	-	-	-	-
Total	**565,661**	-	**565,661**	**173**	**-**	**3,222**	**248,453**	**251,848**

* Over and above the collateral, considered as eligible under the CA Module, the Bank maintains additional collateral in the form of mortgage of residential properties, corporate guarantees and other tangible assets, which could be invoked to claim the amount owed in the event of default.

3.6 Market Risk

3.6.1 Introduction

Market risk is the risk that movements in market risk factors, including foreign exchange rates, profit rates, commodity prices, equity prices and credit spreads will reduce the Group's income or the value of its portfolios. The Group is also exposed to profit rate and potential foreign exchange risks arising from financial assets and liabilities.

The Board has approved the overall market risk appetite in terms of market risk strategy and market risk limits. RMD is responsible for the market risk control framework and sets a limit framework within the context of the approved market risk appetite. The Bank separates market risk exposures into either trading or non–trading portfolios. Trading portfolios include those positions arising from market–making, proprietary position–taking and other marked–to–market positions. Non–trading portfolios include all other positions that are not included in the trading book.

Daily market risk reports are produced for the Bank's senior management covering the different risk categories. These reports are discussed with the senior management committees such as ALCO which take appropriate action to mitigate the risk.

3.6.2 Market Risk Factors

For the Group, market risk may arise from movements in profit rates, foreign exchange markets, equity markets or commodity markets. A single transaction or financial product may be subject to any number of these risks.

Profit Rate Risk is the sensitivity of financial products to changes in the profit rates. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments.

Foreign Exchange Risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on FX Value At Risk (VAR) . Positions are monitored on a daily basis to ensure risk is maintained within established limits using VaR methodology.

The Group is exposed to the currency risk mainly due to the Bank's banking book FX net open positions and due to the fact that the assets and liabilities of its foreign subsidiaries are denominated in their respective functional currencies. Net assets of the Group's foreign subsidiary, located in Jordan, as at 31 December 2014 are BD 34,671 thousand (31 December 2013: BD 34,672 thousand). Net assets of the Group's foreign subsidiary, located in United Kingdom, as at 31 December 2014 are Nil thousand (31 December 2013: BD 21,198 thousand). The assets and liabilities are translated into Bahraini Dinar (presentation currency of the Group) using the closing rate at the date of statement of financial position for the purpose of consolidated financial statements. The impact of foreign currency translation is recognised in the statement of comprehensive income and will be routed to statement of income at the time of disposal of investment in subsidiaries.

3.6 Market Risk (continued)

Equity Risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

Commodity Price Risk is the risk that arises as a result of sensitivity to changes in commodity prices. Since prices in commodity markets are determined by fundamental factors (i.e. supply and demand of the underlying commodity) these markets may be strongly correlated within a particular sector and less correlated across sectors. The Group is not exposed to material commodity price risk.

3.6.3 Market Risk Strategy

The Board is responsible for approving and reviewing the market risk strategy and policy. The Bank's senior management is responsible for implementing the market risk strategy approved by the Board, and continually enhancing the market risk policies and procedures for identifying, measuring, monitoring and controlling market risks.

In line with the Bank's risk management objectives and risk tolerance levels, the specific strategies for market risk management include:

- The Bank strives to reduce the market risk through diversification of its risk exposures across currencies, markets and sectors.
- The Bank proactively measures and monitors the market risk in all its risk exposures on a regular basis using appropriate measurement techniques.
- The Bank has established a limit structure to monitor and control the market risk in its portfolio on daily basis. These limits are monitored on a regular basis and any exceptions to the limits are immediately dealt with.
- The Bank carries out stress testing periodically to assess the effect of extreme movements in market variables.
- The Bank, at all times, holds sufficient capital in order to meet the capital requirement of the CBB as well as maintaining a cushion to cover any adverse movements in the market risk factors.
- At all times, the Bank will ensure that it follows the overall market risk strategy while taking any new market risk exposures.

3.6.4 Market Risk Measurement Methodology

The bank adopts various techniques which are used by the Bank for the measurement, monitoring and control of market risk and include Variance covariance Value at Risk (VAR) for FX risk.

3.6 Market Risk (continued)

3.6.5 Market Risk Monitoring and Limits Structure

The Board and ALCO set the tolerance for market risk. Based on these tolerances, RMD has established appropriate risk limits that maintain the Bank's exposure within the strategic risk tolerances over a range of possible changes in market prices and rates. The Bank has developed the following combination of limits to control its market risk:

a) Stop loss limits;
b) Value at risk (VaR) limits;
c) FX trigger at notional level;
d) Concentration limits for country, geography and sector for equity and Sukuk portfolios; and
e) Tenor limits for sukuks

The Treasury Department monitors the risk limits for each transaction and ensures that they are not exceeded. A regular limit monitoring is carried out by the market risk department within RMD to ensure adherence to approved limits. ALCO also monitors the limit adherence on a regular basis.

In case a limit is breached, the Board approved limit breach procedure is followed and the reports are provided to the ALCO, the ARGC Committee and the Board depending upon materiality of the breach. The limits are reviewed at least annually or as deemed necessary.

3.6.6 Portfolio Review Process

As part of the review, RMD also monitors the Bank's overall market exposure against the risk tolerance limits set by the Board.

3.6.7 Reporting

The Bank generates a number of market risk management reports. These reports aim to provide the Bank's senior management with an up–to–date view of its market risk exposure. These include a summary of the Bank's aggregate market risk sensitive exposures, VaR and limits monitoring reports.

3.6.8 Stress Testing

Stress testing produces information summarising the Bank's exposure to extreme, but plausible, circumstances and offers a way of measuring and monitoring the portfolio against extreme price movements of this type. The Bank's RMD simulates stress scenarios such as Russian financial crisis (2008) and Greece financial crisis (2011) to calculate the maximum loss due to extreme movements in FX rates.

3.6.9 Quantitative disclosures

Table – 14. Minimum and Maximum Capital Requirement for Market Risk

MARKET RISK: DISCLOSURES FOR BANK'S USAGE OF THE STANDARDISED APPROACH					
Level Of Market Risks In Terms Of Capital Requirements (PD-1.3.27 (b))					
Particulars	**Price Risk**	**Foreign Exchange Risk**	**Equity Position Risk**	**Market Risk on Trading Positions in Sukuks**	**Commodity Risk**
Capital requirements	278	3,076	-	-	-
Maximum value	309	3,633	-	-	-
Minimum value	252	2,747	-	-	-

This disclosure is based on the figures from the PIRI for the quarter ended 31 December 2014.

3.7 Operational Risk

3.7.1 Introduction

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all business and covers a large number of operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks to an acceptable level. Controls include but are not limited to effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, and the internal audit process.

The Board acknowledges that it has the ultimate responsibility for operational risk. Oversight rests with the ARGC Committee. The Board has approved the operational risk framework in terms of strategy, policy and limits. The Bank has implemented Risk Controls and Self-Assessment (RCSA) and departments report the incidents and Key Risk Indicators (KRIs) values to the operational risk unit for monitoring and reporting the key operational risks in the Bank.

3.7.2 Sources of Operational risk

The different sources of operational risks faced by the Group can be classified broadly into the following categories:

People Risk which may arise due to staffing inadequacy, unattractive remuneration structure, lack of staff development policies, lack of procedures for appointment, unhealthy professional working relationship and unethical environment.

Processes Risk which may arise due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate/inadequate monitoring and reporting.

Systems (Technology) Risk which may arise due to inadequate integrity of information in the systems such as omission and duplication of data; hardware failures such as power surge, obsolescence and low quality equipment and software failure such as unauthorised or incorrect modifications to software programs, computer virus and programming bug.

External Risk which can comprise legal / public liability, criminal activities, outsourcing / supplier risk, disasters and infra-structural utilities failures, regulatory risk and political / government risk.

3.7 Operational Risk (continued)

3.7.3 Operational Risk Management Strategy

The Bank's Board is responsible for approving and reviewing (at least annually) the operational risk strategy and significant amendments to the operational risk policies. The Bank's senior management is responsible for implementing the operational risk strategy approved by the Board to identify measure, monitor and control the risks faced by the Bank. The Bank continuously monitors the process and controls framework surrounding all business units to assess their effectiveness and efficiency.

As a strategy the Bank will identify the sources of operational risks in coordination with each business unit. On an ongoing basis, the operational risk tolerance is determined by the RMD based on a bottom-up approach following a discussion with the business units. Operational risk tolerance will need to be approved by the ARGC Committee, ratified by the Board and documented and communicated via the Board-approved policy.

The RCSA methodology enables the Bank to identify risk events within each activity, process and support unit of the Bank, document existing controls, establish quantitative measurement metrics - impact and likelihood - for each event as well as early warning indicators for key risks as defined in the risk tolerance in the form of Key Risk Indicators (KRIs) and capture operational loss data. The operational risk identification, assessment and measurement process involves the following steps:

Identification of KRI's
The Bank's RCSA process identifies the KRIs.

Incident reporting
An incident is the occurrence of an operational or compliance risk event that has caused, or has the potential to cause a financial, reputation or regulatory impact on the Bank. It includes credit or market risk events, which have been caused by an operational risk event, and non–compliance with any legal or regulatory requirement, license, internal policy or procedure or code. The incidents are reported by the business and control units as a part of the RCSA framework.

Operational Loss Database (OLD)
The OLD is a key component to enable the Bank to quantify its past operational risk exposures. The OLD contains a subset of the information captured by the incident reporting process since all incidents involving an actual or potential financial impact (including near misses) is captured.

Scenario analysis
The Bank uses scenario analysis to help it to evaluate its exposure to high–severity events. The Bank identifies the stress events and scenarios to which it is exposed and assesses its potential impact, and the probability of aggregated losses from a single event leading to other risks. Scenario analysis is conducted in a workshop format, using a combination of expert judgment; including business management representatives and external risk management experts, as well as external data relevant to the risks being evaluated.

3.7 Operational Risk (continued)

3.7.4 Operational Risk Monitoring and Reporting

The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to senior management and the ARGC Committee for the quick detection and correction of deficiencies in the policies, processes and procedures for managing operational risk through ongoing, periodic reviews.

The objective of the reporting process is to ensure relevant information is provided to senior management and the Board to enable the proactive management of operational risk. The process ensures a consistent approach for providing information that enables appropriate decision making and action taking. The KRIs and incidents are reported by the operational risk unit.

3.7.5 Operational Risk Mitigation and Control

Control activities are necessary to address the specific operational risks that the Bank has identified through the RSCA process. For the material risks identified by the Bank, the Bank decides whether to use procedures to control, mitigate, transfer, or bear the risks.

The Group has several options for controlling and/or mitigating these risks:
- Decline to accept the risk (i.e. by avoiding certain business strategies/customers)
- Accept and retain the risk but introduce mitigating internal/external controls
- Accept the risk and transfer it in part/in whole.

Key controls

The Group aims to control the operational risks it is exposed to by strengthening its internal controls, continuing its efforts to identify, assess, measure and monitor its risks, evolving in its risk management sophistication and promoting a strong control culture within the Group.

Each business unit head is responsible for ensuring that the internal controls relevant to its operations are complied with on a day to day basis in spirit as well as in letter. The Group will furthermore establish control processes and procedures and implement a system for ensuring compliance with these internal risk control processes and procedures.

3.7.6 Business Continuity Plan and Disaster Recovery Plan

In 2010, the Bank completed its Business Continuity Plan (BCP) based on a Business Impact Analysis and risk review of the Bank's activities. An Information Technology Disaster Recovery site has been completed and is fully operational whilst periodic mandatory testing is ongoing. A primary business continuity site has been completed with the option to fit out two further sites should the need arise. Every six months, the Bank tests its BCP to ensure that they are current and effective.

3.7.7 Quantitative disclosures

Table –15. Indicators of Operational Risk **Amount in BD '000**

OPERATIONAL RISK : QUANTITATIVE DISCLOSURES FOR BASIC INDICATOR APPROACH	
Indicators of Operational Risk (PD-1.3.30 (b) & (c))	
Particulars	**Total**
Gross Income (average)	73,118
Amount of non-Shari'a-compliant income	-
Number of Shari'a violations that were identified and reported during the financial year	-

Material legal contingencies including pending legal actions are as follows:

- A guarantee was issued by the Bank to a third party and subsequently called up by the latter. The Bank has paid the guarantee amount and is bringing an action to recover the amount paid because it believes the third party wrongfully called for payment under the guarantee.

- An action was filed by the Bank against a defaulting customer for monies owed to the Bank under a facility. The Bank won the action against the customer and is seeking to enforce the judgment in the customer's home country. In response to the Bank's action, the customer has filed a frivolous claim against the Bank. The Bank is seeking to dismiss this claim and believes no payment will be required.

- An action was filed by the Bank to claim an amount held in an escrow account and the counter party alleges that the Bank is not entitled to this amount. The Bank is defending this claim and believes that the amount held in the escrow account should be released to the Bank.

Legal cases are handled by the Bank's in-house legal team and external legal consultants are consulted on such matters.

During the year 2014, the Bank paid a financial penalty of BD 20,000 to the CBB for taking an additional exposure without obtaining their prior approval. The Bank also paid BD 50 for one un-cleaned account in the Bahrain Credit Reference Bureau (BCRB) System.

Any non-Shari'a compliant earnings are immediately given away as charity.

3.8 Equity Positions in the Banking Book

Equity price risk is the risk that the fair values of equities decrease as a result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the consolidated financial statements. All of the Group's investments are intended to be for long term holdings.

3.8.1 Quantitative disclosures

Table – 16. Total and Average Gross Exposures **Amount in BD '000**

EQUITY POSITION IN BANKING BOOK - DISCLOSURE REQUIREMENTS				
Total and Average Gross Exposure - (PD-1.3.31 (b) & (c))				
Type and Nature of Investment	**Total Gross Exposure**	*** Average Gross Exposure**	**** Publicly Traded**	**Privately held**
Equity investments	377,099	434,009	15,154	361,945
Managed funds	7,122	7,962	-	7,122
Musharaka	2,108	2,284	-	-
Total	**386,329**	**444,255**	**15,154**	**369,067**

* Average exposure has been calculated using quarterly consolidated financial statements or PIRI forms submitted to CBB.

** This includes publically listed equities classified as investment in asscoiate and available for sale in the financial statements.

Table – 17. Break-up of Capital Requirement for Equity Groupings **Amount in BD '000**

EQUITY POSITION IN BANKING BOOK - DISCLOSURE REQUIREMENTS	
Capital Requirement - (PD-1.3.31 (f))	
Equity Grouping	**Capital Requirement**
Listed	1,894
Unlisted	195,951
Managed Funds	1,335
Total	**199,180**

Table – 18. Gain and Loss Reported **Amount in BD '000**

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS	
Gains / Losses Etc. (PD-1.3.31 (d) and (e))	
Particulars	**Total**
Total realised gains arising from sales or liquidations in the reporting period	2,781
Total unrealised gains (net) recognised in statement of other comprehensive income	(2,955)
Unrealised gains included in Tier 1 Capital	38,619
Unrealised gains included in Tier 2 Capital	119

3.9 Equity of Investment Account Holders (URIA)

The Investment Account Holder ("IAH") authorizes the Bank to invest the account holder's funds on the basis of Mudaraba contract in a manner which the Bank deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. Under this arrangement the Bank can commingle the IAH funds with its own funds (owner's equity) and with other funds the Bank has the right to use (e.g. current accounts or any other funds which the Bank does not receive on the basis of Mudaraba contract). The IAH and the Bank participate in the returns on the invested funds.

The Bank has developed a Profit Sharing Investment Accounts (PSIA) policy which details the manner in which the URIA funds are deployed and the way the profits are calculated for the URIA holders. The strategic objectives of the investments of the IAH funds are:

- Investment in Shari'a compliant opportunities;
- Targeted returns;
- Compliance with investment policy and overall business plan;
- Diversified portfolio; and
- Preparation and reporting of periodic management information.

URIA holders' funds are invested in short and medium term Murabaha and due from banks, Sukuks and the financing portfolio. The Bank invests these funds through various departments including Treasury, corporate, consumer, and capital markets. The experience of relevant department heads is mentioned in Section 4. No priority is granted to any party for the purpose of distribution of profits. According to the terms of acceptance of the URIA, 100% of the funds are invested after deductions of mandatory reserve and sufficient operational cash requirements. URIA funds are invested and managed in accordance with Shari'a requirements. Income generated and losses arising (including provisions) from the invested funds is allocated proportionately between URIA holders and shareholders on the basis of the average balances outstanding and share of the funds invested. The Bank does not share income from fee based services with the URIA holders. Administrative expenses incurred by the Bank are allocated to the URIA holders in the proportion of average URIA funded assets to average total pool assets of the Bank. The process has not changed significantly from the past years.

The mudarib share on investment accounts ranges from 20% to 40% depending on the investment period and in case of saving accounts, where there is no restriction of cash withdrawal, the mudarib share ranges from 50% to 60%. However, during the year, in addition to investors' share of profit, the Bank has distributed profit to investors from its own share of mudarib share. There is no change in mudarib share from the year ended 31 December 2013 to 31 December 2014.

The Bank has a Corporate Communications Department which is responsible for communicating new and/or extended product information through various channels of communication which may include publications, website, direct mailers, electronic mail and local media. The URIA products available to the customers can be classified broadly under two categories, 1) Term URIA and 2) Saving URIA. Term URIA are fixed term URIA having maturity of 1, 3, 6 and 12 months whereas Saving URIA can be withdrawn on demand. Detailed information about the features of various products offered by the Bank can be obtained from the website of the Bank, brochures at the branches, call centre and customer service representatives at the branches of the Bank. Branches of the Bank are the primary channel through which products are made available to the customers.

3.9 Equity of Investment Account Holders (URIA) (continued)

Fiduciary risk is the risk that arises from Bank's failure to perform in accordance with explicit and implicit standards applicable to their fiduciary responsibilities. Although KFHB will discourage subsidizing its URIA holders, the Bank may forgo a portion of its mudarib share from assets funded by PSIA and apportion its share to the IAH as part of smoothing returns and to mitigate potential withdrawal of funds by investment account holders.

Complete mudarib share or part thereof, based on the approval of ALCO of the Bank, can be waived to pay a competitive rate to URIA holders. There are no instances where the Bank, as Mudarib, has taken any share greater than the agreed/disclosed profit sharing ratio. There were instances where the Bank has forgone part of its profit to distribute that to the Bank's customers or investors. The bank may also forgo part of its shareholder's returns as a "hiba" to URIA holders in order to mitigate DCR.

The rate of return payable to URIA holders is decided by ALCO, keeping in view the rate of return earned on the pool of assets. Based on the results of Mudarabah, allocation will take place to the URIA holders affected by the following factors including rates offered by peer banks, cost of funds from various sources, liquidity position of the Bank and market benchmarks (LIBOR etc). The Bank compares its rates with the rates offered by peer Islamic banks in the market along with performing analysis of its profitability and studies of other market indicators. The Bank does not use a fixed market benchmark rate for comparison to the returns paid to URIA holders. In order to ensure smooth returns and to mitigate the potential withdrawal of funds by URIA Investors; the Bank can use Profit Equalisation Reserve (PER). Similarly, the Bank can use an Investment Risk Reserve (IRR) to cater against future losses for URIA holders. The amount of PER and IRR as at 31 December 2013 and 2014 is Nil but the Bank may transfer an amount into PER and IRR in future after prior notice to its customers.

3.9.1 Quantitative Disclosures

Table – 19. Break-up of URIA **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (a) &(g))			
	Amount	**Financing to Total URIA %**	**Ratio of Profit Distributed**
Savings URIA	166,863	33%	15%
Term URIA	342,181	67%	85%
Total	**509,044**	**100%**	**100%**

Table – 20. Percentage of Return on Average URIA Assets

UNRESTRICTED INVESTMENT ACCOUNTS:	
Unrestricted Investment Account (PD-1.3.33 (d))	
	Percentage
Average profit paid on average URIA assets	1.29%
Average profit earned on average URIA assets	1.29%

Table – 21. Percentage of Mudarib share to Total URIA Profits **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (f))			
	URIA Return Before Mudarib Shares	**Share of Profit Paid to Bank as Mudarib**	**Percentage**
Mudarib share to total URIA profits	6,283	-	0%

Table – 22. Percentage of Islamic Financing Contracts Financed by URIA to Total URIA **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (h))		
Shari'a-Compliant Contract	**Financing**	**Financing to Total URIA %**
Cash and balances with banks	32,324	6.35%
Murabaha and due from banks	125,106	24.58%
Investments at amortised cost – Sukuk	85,887	16.87%
Customer Murabaha	138,696	27.25%
Customer Ijarah Muntahia Bittamleek	127,031	24.95%
Total	**509,044**	**100.00%**

Table – 23. Percentage of Counterparty Type Contracts Financed by URIA to Total URIA **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (i))		
Counterparty Type	**Financing**	**Financing to Total URIA %**
Cash items	2,440	0.48%
Claims on sovereigns & MDBs	47,521	9.34%
Claims on banks	131,122	25.76%
Claims on corporate	107,912	21.20%
Regulatory retail portfolio	23,157	4.55%
Mortgage	173,232	34.03%
Past due facilities	22,090	4.34%
Others	1,570	0.31%
Total	**509,044**	**100%**

Table – 24. Percentage of Profit Paid to URIA Holders to Total URIA Investment

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (l) (m) & (n))			
	Share of Profit Paid to IAH Before Transfer To/From Reserves %	**Share of Profit Paid to IAH After Transfer To/From Reserves %**	**Share of Profit Paid, as a % of Funds Invested, to Bank as Mudarib %**
URIA	1.29%	1.29%	0.00%

Table – 25. Range of Declared Rate of Return

UNRESTRICTED INVESTMENT ACCOUNTS:				
Unrestricted Investment Account (PD-1.3.33 (q))				
Declared rate of return for Investments accounts	**1-Month**	**3-Month**	**6-Month**	**12-Month**
BHD denominated	1.00% - 1.95%	1.25% - 2.27%	1.50% - 2.45%	2.00% - 2.60%
USD denominated	0.50% - 1.94%	0.70% - 2.27%	1.00% - 2.43%	1.25% - 2.59%

Table – 26. Movement of URIA by Type of Assets **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (r) & (s))			
Type of Assets	**Opening Actual Allocation as at 01 Jan 2014**	**Net Movement During the Period**	**Closing Actual Allocation as at 31 Dec 2014**
Cash and Balance with banks and CBB	33,205	(881)	32,324
Murabaha due from banks	117,902	7,204	125,106
Investments at amortised cost – Sukuk	55,342	30,545	85,887
Murabaha due from customers	121,028	17,668	138,696
Ijarah Muntahia Bittamleek due from customers	125,027	2,004	127,031
Total	**452,504**	**56,540**	**509,044**

Note: There are no limits imposed on the amount that can be invested by URIA funds in any one asset. However, the Bank monitors its URIA deployment classifications so that to ensure that URIA funds are not invested in the Bank's long term Investment Portfolio (including Private Equity and Real Estate).

Table – 27. Capital Charge on URIA by Type of Claims **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (v))		
Type of Claims	**RWA for Capital Adequacy Purposes**	**Capital Charge**
Claims on banks	26,224	983
Claims on corporate	42,250	1,584
Regulatory retail portfolio	17,368	651
Mortgages	66,629	2,499
Past due facilities	2,246	84
Other assets	1,570	59
Total	**156,287**	**5,860**

* The RWA for Capital Adequacy Ratio Purposes is presented above prior to the application of the CBB approved 30% alpha factor which is the proportion of assets funded by URIA for RWA purposes in accordance to the CA module.

Table – 28. Percentage of Profit Earned and Profit Paid to Total Mudaraba **Amount in BD '000**

DISPLACED COMMERCIAL RISK - URIA:			
Displaced Commercial Risk Unrestricted Investment Account (PD-1.3.41 (b)			
	Total Mudaraba profits available for sharing between URIA and shareholders	**Contractual Range of Mudharib Share**	**Mudharib Share % of URIA Profit Earned**
2014	3.29%	20%-60%	-
2013	3.73%	20%-60%	26.81%
2012	3.57%	20%-60%	30.21%
2011	4.34%	20%-60%	13.49%
2010	4.78%	20%-60%	27.71%

Table – 29. Percentage rate of return to URIA and shareholders from Mudaraba Profit **Amount in BD '000**

DISPLACED COMMERCIAL RISK - URIA:	
Displaced Commercial Risk Unrestricted Investment Account (PD-1.3.41 (d))	
Type of Claims	**Shareholder Mudharaba Profit Earned as % of shareholder funds (before mudharib share)**
2014	4.33%
2013	6.64%
2012	4.92%
2011	6.77%
2010	6.47%

Table – 30. Percentage of Profit Earned and Profit Paid to Total URIA Funds **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:					
Unrestricted Investment Account (PD-1.3.33 (w))					
	*** URIA Funds (Average)**	**** Profit Earned**	**Profit Earned as a percentage of funds invested**	**Profit paid**	***** Profit paid as a percentage of funds invested (after smoothing)**
2014	488,067	5,864	1.20%	6,283	1.29%
2013	459,227	10,808	2.35%	7,894	1.72%
2012	463,540	13,327	2.88%	9,300	2.01%
2011	491,680	14,966	3.04%	12,918	2.63%
2010	480,308	19,104	3.98%	13,804	2.87%

* Average assets funded by URIA have been calculated using consolidated management accounts.

** This is the rate of return gross of mudarib share which ranges from 20% to 40% for term URIA, depending on the investment period of the Investment, and from 50% to 60% for saving URIA.

*** During the year the Bank waived its mudarib share resulting in higher return paid to URIA holders by 100.00% (2013: 15.25%).

Table – 31. Operating Expenses Allocated to URIA **Amount in BD '000**

UNRESTRICTED INVESTMENT ACCOUNTS:	
Unrestricted Investment Account (PD-1.3.33 (x))	
Unrestricted IAH	**Amount**
Amount of administrative expenses charged to URIA	10,998

3.10 Restricted Investment Accounts ("RIA")

Under RIA, the IAH has authorized the Bank to invest the funds on the basis of Mudaraba contract for investments, but imposes certain restrictions as to where, how and for what purpose this funds are to be invested. Further, the Bank may be restricted from commingling its own funds with the RIA funds for the purposes of investment. In addition, there may be other restrictions which IAHs may impose. RIA funds are invested and managed in accordance with Shari'a requirements. The funds are managed by the Bank under a fiduciary capacity as per the instructions of the RIA holders and accordingly the Bank is not liable to make good any losses occurred due to normal commercial reasons.

The Bank has developed the PSIA policy, approved by the Board, which details the manner in which the RIA funds are deployed and the way the profits are calculated for the RIA.

The Bank as fund manager (mudarib) carries out its fiduciary duties and administers the scheme in a proper, diligent and efficient manner, in accordance with the Shari'a principles and applicable laws and relevant rules and guidelines issued by the CBB.

The Bank has appropriate procedures and controls in place which commensurate with the size of its portfolio which includes:

a) Organising its internal affairs in a responsible manner, ensuring it has appropriate internal controls and management systems and procedures and controls designed to mitigate and manage such risk;
b) Observing high standards of integrity and fair dealing in managing the scheme to the best interest of its investors; and
c) Ensuring that the Bank has the requisite level of knowledge and experience for the tasks that is undertaken and is competent for the work undertaken.

RIA products are made available to the customers through Priority Banking and Investment Placement Department. Detailed product information about various RIA products is available in the respective RIA information pack. The detailed risks are disclosed in the respective RIA information pack for the investors to make informed decision. Such disclosure includes the disclosure on participation risks, default risks, investment risks and exchange rate risks.

3.10.1 Quantitative Disclosures

Table – 32. History of Profit Paid to RIA Holders **Amount in BD '000**

RESTRICTED INVESTMENT ACCOUNTS:						
Restricted Investment Account (PD-1.3.35 (a) & (b))						
	2014	**2013**	**2012**	**2011**	**2010**	**2009**
Return to RIA holders	7,377	7,455	5,476	5,459	5,440	4,191

Table – 33. Break-up of RIA by Type of Deposits **Amount in BD '000**

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (a))	
	Amount
RIA funds	107,546

Table – 34. Percentage of Profit Paid to RIA Holders to RIA Assets

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (d))	
	Percentage
Return on average* RIA assets	6.18%

* Average RIA funds have been calculated using consolidated management accounts.

Table – 35. Mudarib share as a Percentage of Total RIA Profits

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (f))	
	Percentage
Mudarib share to total (gross) RIA profits	20.04%

Table – 36. Share of Islamic Financing Contracts in Total RIA Financing **Amount in BD '000**

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (h))		
Shari'a-Compliant Contract	**Financing**	**Financing to Total Financing %**
Murabaha	107,546	100.00%
Total	**107,546**	**100.00%**

Table – 37. Percentage of Counterparty Type Contracts Financed by RIA to Total RIA **Amount in BD '000**

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (i))		
Counterparty Type	**Financing**	**Financing to Total Financing %**
Claims on corporate	107,546	100.00%

Table – 38. Share of Profit Paid to RIA Holders as a Percentage of Total RIA **Amount in BD '000**

RESTRICTED INVESTMENT ACCOUNTS:				
Restricted Investment Account (PD-1.3.33 (l) (m) (n) & (o))				
Type of RIA	**Total RIA**	**RIA Return Before Mudarib shares**	**RIA Return after Mudarib shares**	**Share of Profit Paid to Bank as Mudarib**
	A	**B**	**C**	**D**
Murabaha	107,546	9,226	7,377	1,849
Total	**107,546**	**9,226**	**7,377**	**1,849**

Table – 39. Declared Rate of Return of RIA

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (q))		
	12-Month	**24-Month**
Declared rate of return	5.70%	6.20%

Table – 40. Treatment of Assets Financed by RIA in the Calculation of RWA for Capital Adequacy Purposes

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (v))		
Type of IAH	**Exposure**	**Risk Weighted Amount While Calculating CAR***
Murabaha	107,546	-

* Due to capital deductions from exceeding one of CBB's RIA related limits.

Table – 41. Profit Earned and Profit Paid as a Percentage of Total RIA Funds

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:				
Restricted Investment Account (PD-1.3.33 (w))				
	Profit Earned	***Profit Earned as a Percentage of RIA Funds**	**Profit Paid**	***Profit Paid as a Percentage of RIA Funds**
2014	9,226	7.56%	7,377	6.18%
2013	9,013	7.33%	7,455	6.06%
2012	6,494	8.98%	5,476	7.57%
2011	6,051	7.75%	5,459	6.99%
2010	5,905	6.77%	5,440	6.23%
2009	4,481	6.29%	4,191	5.88%

* Profit earned and profit paid are based on average RIA funds and may not tally with the declared profit rates

3.11 Liquidity Risk

3.11.1 Introduction

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.

Funding risk arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

To control this risk, management has taken various measures including but not limited to arrangement of diversified funding sources in addition to its core deposit base, management of assets with liquidity in mind, and monitoring of future cash flows and liquidity gaps and needs on a daily basis.

This incorporates an assessment of expected cash flows and gaps and the availability of high grade collateral which could be used to secure additional funding if required.

The Group maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has lines of credit that provide it with access to funds to meet liquidity needs. In addition, the Bank maintains a statutory deposit with the CBB equal to 5% of customer deposit denominated in Bahraini Dinar.

The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The Group maintains liquid assets to counter liquidity issues. The liquid assets of the Group, are listed below:
- Current account and reserves with the CBB
- Cash–in–hand and held with other financial institutions in nostro accounts
- Short–term Murabaha & wakala placements with financial institutions
- Investments in marketable sukuks and equities

3.11.2 Sources of liquidity risk

Liquidity risk may arise and materialise in the following ways:
- Contractual mismatch between the cash flows of assets and liabilities
- Insufficient diversification of funding sources or concentration of funding sources
- Operating in different currencies, which creates cross currency funding and liquidity risk
- Unexpected withdrawal of funds by investment account holders
- Non–performance or late payment by customers
- Name issue, credit down grade or adverse publicity may result in mass movements of deposits to other banks
- Default of entities who are large borrowers and whose shares are held as collateral
- Unexpected funding required for off–balance sheet items, such as payments to beneficiaries under letters of credit that have been defaulted by customers
- Fall in income when the profit earned from assets are lower than the profit paid on liabilities and the profit rates revise downwards
- Loss of confidence in the banking system

3.11.3 Liquidity Risk Strategy

The Board is responsible for approving and reviewing (at least annually) the liquidity risk strategy and significant amendments to the liquidity risk policies. The Bank's senior management is responsible for implementing the liquidity risk strategy approved by the Board to identify measure, monitor and control the risks faced by the Bank.

The Bank monitors the liquidity positions and gaps by comparing maturing assets and liabilities in different time buckets of up to 1 month, 1–3 months, 3–6 months, 6 months to 1 year and 1 year and above. As a strategy the Bank maintains a large customer base and good customer relationships.

The Bank has a liquidity contingency plan to meet urgent liquidity requirements in stressed conditions that addresses how funding liquidity would be managed if either their specific financial conditions were to decline or broader conditions created a liquidity problem. The plan is reviewed and updated regularly. The plan is also tested periodically.

The Bank has also created a policy for its subsidiaries to report the liquidity needs arising from their activities via the investment team.

The Treasury Department, in conjunction with RMD periodically reviews/updates the liquidity risk strategy which is approved by ALCO and the Board.

3.11.4 Liquidity Risk Measurement Tools

The methods used by the Bank for measuring liquidity risk are:

Static gap analysis
Gap analysis refers to the maturity gap between assets and liabilities. Static gap analysis refers to the gap analysis of the current assets and liabilities of the Bank. The gap analysis involves measuring the gap between assets and liabilities maturing within a single time bucket and cumulatively over several buckets. This analysis is conducted on a stress and business as usual scenario.

These time buckets are set by Board, on recommendation of RMD with an oversight from the ALCO and ARGC Committee. The buckets are in line with the nature of the markets the Bank operates in and the Bank’s own risk appetite. For the purpose of analysis, the Bank also conducts core and non-core analysis for non maturing analysis using statistical methods. The results are approved by ALCO.

Dynamic gap analysis
Dynamic gap analysis refers to the gap analysis for the forecasted statement of financial position of the Bank. The statement of financial position is forecasted based on the current statement of financial position and estimates of the assets and liabilities positions from the various business heads and the Treasurer. The business heads provide the RMD with forecasts for their department’s assets and liabilities. The analysis is done on a Bank wide level.

Liquidity Ratios
A number of liquidity ratios are monitored for assessing the risk exposures arising out of various sources of funding including the effect of concentration of particular sources. These ratios act as indicators to measure the Bank’s ability to meet its liquidity needs under business as usual and stressed market conditions. Some of the ratios which the Bank monitors are the Liquid assets to Customer deposit ratio, URIA Deployment matrix, Financing to Customer deposits ratio, FX funding Ratio and Deposit Concentration ratio.

3.11.4 Liquidity Risk Measurement Tools (continued)

Limits
The limits are in line with the overall liquidity risk management strategy approved by the Board. The breach of the limits is reported to the Board. The Bank monitors the limits on the liquidity gaps in various tenor buckets and on the ratios.

Stress Tests
On a monthly basis, the Bank conducts stress tests on its liquidity profile. The institution specific and market wide stress tests are conducted. The gaps are created under stress conditions to understand the liquidity needs in case of stress situations.

3.12 Profit Rate Risk

3.12.1 Introduction

Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of funding due to the sources of finance. Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments.

The Bank has established a Profit Rate Risk Management strategy and policy and manages the profit rate risk accordingly.

The profit rate risk in the Bank may arise due to the following transactions:
a) Murabaha transactions;
b) Mudaraba transactions;
c) Ijarah Muntahia Bittamleek;
d) Sukuks; and
e) All other rate sensitive products

3.12.2 Sources of Profit Rate Risk

The different profit rate risks faced by the Group can be classified broadly into the following categories:

Maturity mismatch
The non–alignment of maturities/re-pricing dates of assets and liabilities give rise to profit rate risk. In the case of fixed profit rates, maturities are considered whereas for floating or variable profit rates the re-pricing/rollover dates are considered.

Basis value risk
Assets and liabilities with similar maturities / re-pricing dates and highly, though imperfectly, correlated profit rate benchmarks (USD–LIBOR and BIBOR) are exposed to basis risk.

Profit rate curve risk
Changes to the values, slope and shape of the profit rate curve that impact the assets and liabilities of the Group in a dissimilar manner give rise to profit rate risk.

Risk of counterparty's options underlying assets
The availability of options, with the Group's counterparties, to make prepayments or early withdrawals can leave the Group with excess or deficit funds that need to be invested or funded again at unknown profit rates. This imposes a profit rate risk on the Group.

3.12.3 Profit Rate Risk Strategy

The Bank's Board is responsible for approving and reviewing (at least annually) the profit rate risk strategy and significant amendments to the profit rate risk policies. The Bank senior management is responsible for implementing the profit rate risk strategy approved by the Board to identify, measure, monitor and control the risks faced by the Bank.

The Bank's strategy includes taking the following steps:

- Identify and document the profit rate risk sensitive products and exposures it wishes to engage in;
- Strive to reduce the maturity / re-pricing mismatch between assets and liabilities on its statement of financial position;
- Abstain from entering into fixed price assets / liabilities with unusually long tenure / maturity;
- Reduce the reliance on short term inter–bank borrowings to avoid short term earnings pressure. The Bank will strive to reduce the proportion of inter–bank liabilities as a percentage of total liabilities;
- Periodically review the profit rates offered on savings, VIP savings, Investment accounts and VIP Murabaha keeping in view the profit rates offered by competitors, cost of funds, market conditions etc;
- Establish a limit structure to quantify its overall profit rate risk tolerance. These limits will be monitored on a periodic basis and any exceptions to the limits will be immediately dealt with;
- Strive to maintain a minimum spread between cost of funding and profit generated from assets while simultaneously ensuring the liquidity mismatch does not exceed a certain threshold for a maturity bucket;
- Periodically review the changes in major market rates (Fed rates, LIBOR, BIBOR) and anticipated trends and their potential impact on expected rate of return on their liabilities;
- If needed, the Bank may take a natural hedge on its rate sensitive assets by raising liabilities having similar re–pricing profile;
- Conduct periodic stress tests to assess the effect of extreme movements in profit rates for all major currencies which may expose the Bank to high risks; and
- At all times, the Bank will ensure that it follows the overall profit rate risk strategy while taking any new profit rate risk exposures.

3.12.4 Profit Rate Risk Measurement Tools

The following methods are adopted by the bank to quantify profit rate risk in the banking book:

Re-pricing gap analysis
As part of the re-pricing gap analysis, the Bank defines certain assumptions based on the re-pricing date and profit rate sensitivity for allocating each instrument/position to a given time bucket. The periodic gap compares Rate Sensitive Assets (RSAs) with Rate Sensitive Liabilities (RSLs) across each single time bucket while the cumulative gap compares RSAs with RSLs over all time buckets from the present day through the last day in each successive time bucket. This is done for each major currency the Bank operates in. A positive gap indicates that if reference rates fall, net income will be adversely affected.

Economic value of equity (EVE)
The EVE measures the change in the Bank's market value of equity resulting from upward and/or downward movements in the yield curve. The Bank uses the analysis to measure the impact on its equity that could occur due to the yield curve movements, at a particular point of time.

Earnings-at-Risk (EaR)
Earnings-at-risk will measure the loss in earnings resulting from upward and/or downward movements in the yield curve. The Bank will use the analysis to evaluate the profit rate risk exposure of the banking book over a particular time horizon and calculate the potential impact on earnings over the specified horizon. Bank has implemented a simplified version of EaR in 2012.

Limits
The Board specified the limits on the re-pricing gaps. The reports are regularly monitored.

Stress Testing
The Bank conducts the stress tests on the re-pricing gaps and economic value of the equity by shocking the yield curves by various amounts such as 50 basis points, 100 basis points and 200 basis points. The bank has also started stress tests based on its EaR methodology. The stress tests also included the concepts of EaR to estimate the profit rate risk.

3.12.5 Profit Rate Risk Monitoring and Reporting

The Bank is monitoring the profit rate through the Focus ALM system implemented by the Bank. The report is then presented to ALCO and the Board to review the results of gap limits and exceptions, if any, and recommend corrective actions to be taken.

3.12.6 Quantitative Disclosures

Table – 42. Profit Rate Shock **Amount in BD '000**

PROFIT RATE RISK IN THE BANKING BOOK			
200bp Profit Rate Shocks (PD-1.3.40 (b)) Total			
Assets	**Amount**	**Change in Basis Points**	**Effect on Net Income for the Year**
Murabaha and due from banks	193,916	200	3,878
Financing contracts with customers	381,136	200	7,623
Investments at amortized cost	19,793	200	396
Liabilities			
Murabaha and due to banks	212,330	200	(4,247)
Murabaha due to non-banks	312,425	200	(6,249)
Subordinated murabaha payable	99,005	200	(1,980)
Equity of investment account holders	479,502	200	(9,590)

3.13 Financial Performance and Position

Table – 43. Ratios

Financial Performance and Position					
(PD-1.3.9(b))					
Quantitative Indicator	**2014**	**2013**	**2012**	**2011**	**2010**
Return on average equity	1.40%	1.53%	2.56%	2%	2%
Return on average assets	0.34%	0.38%	0.65%	0.4%	0.5%
Staff cost to net operating income ratio	25.83%	41.5%	33.8%	29%	28%

Formula is as follows:
ROAE = Net Income/average equity
ROAA= Net profit/ average Assets

4 Corporate Governance and Transparency

The Bank has established a strong corporate governance framework that is designed to protect the interests of all stakeholders, ensure compliance with regulatory requirements, and enhance organisational efficiency. The Bank has also established a robust organisational structure that clearly segregates functions and responsibilities, and reflects a division of roles and responsibilities of the Board of Directors and Management. Clear mandates exist for the Board, Chairman of the Board, Board Committees, Managing Director and Chief Executive Officer, the Management, and Senior Management Committees.

Board of Directors and Board Committees

The Bank's Board of Director (Board) comprises of seven directors, including the Chairman of the Board and the Managing Director and the Chief Executive Officer ("MD & CEO"). The Board periodically assesses its composition and size, and where appropriate re-constitutes itself and its committees. While deciding upon the composition of the Board, the Bank will ensure compliance with the requirements of the High Level Controls Module, Volume 2 issued by the CBB.

The Board is accountable to the shareholders for the creation and delivery of strong and sustainable financial performance and long–term sustainable shareholder value by providing effective governance over the Bank's affairs. It determines the strategic objectives and policies of the Bank to deliver such long term value, providing overall strategic direction to the Bank within a framework of rewards, incentives and controls. Detailed responsibilities of the Board are provided in their respective terms of references.
With regard to the procedures relating to conflict of Interest, the Board charter states that all transactions of the Bank shall be carried out on an arm's length basis. Any decision to enter into a transaction, under which Board members or any member of the management have conflicts of interest that are material, shall be formally and unanimously approved by the entire Board.
The Chairman is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the Executive Management, and maintaining a dialogue with the Bank's shareholders.

The Board has the following three committees: the Audit, Risk Governance & Compliance Committee; the Credit & Investment Committee and the Nomination & Remuneration Committee. Each committee has specific terms of references that define its responsibilities, scope and powers. Detailed responsibilities of the Board and its committees are provided in the Bank's Corporate Governance Charters.

The Nomination and Remuneration Committee of the Bank is charged to recommend performance based incentives for the senior management including the MD & CEO. Such recommendations are also subject to the Board approval.

The remuneration of Fatwa & Sharia Supervisory Board and the Board is subject to the AGM Approval.

Corporate Governance Charters

The Bank has developed Corporate Governance Charters that provide the basis for promoting high standards of corporate governance in the Bank. It sets out high level guidelines and lays the foundation for the overall corporate governance system in the Bank. It outlines the key elements of an effective corporate governance framework and describes the roles and responsibilities of the Board of Directors which outlines the role of the Board in its review, approval and monitoring of the Bank's strategy and financial performance within a framework of sound corporate governance. It also contains the terms of references for all the Board and Senior Management Committees.

Remuneration Policy

The HR Department of the Bank engaged an external consultant to assist them in appropriately adopting a variable remuneration policy which was also discussed with the NRC. The NRC reviews the remuneration policy on an annual basis and, when needed, appropriate changes are made.

KFHB's objectives are to maintain a Remuneration Policy that:

- Enables KFHB to attract and retain employees, and motivate them to achieve results with integrity and fairness;
- Encourages a performance culture that is based on merit, and rewards excellent performance, both in the short and long term aligned to the core values of KFHB;
- Balances the mix of Fixed Compensation and Variable Compensation in such a way that reflects KFHB's values and risk appetite;
- Is consistent with, and promotes effective risk management practices, compliance and control culture of KFHB;
- Fosters teamwork and collaboration across KFHB;
- Control and Support functions that report independently of the lines of business are compensated independently of the lines of business by:

  a) Setting total remuneration to ensure that variable pay is not significant enough to encourage inappropriate behaviours while remaining competitive with the market;

  b) The remuneration decisions are based on their respective functions and not the business units they support;

  c) Performance measures and targets are aligned to the unit and individual objectives that are specific to the function;
- Considers long term growth and shareholder value alignment; and
- Is approved by the shareholders and the Board of Directors and regularly monitored in terms of implementation by the Nomination and Remuneration Committee (NRC).

Regulatory Alignment

The remuneration policy which includes the variable pay has been re-designed to promote sound risk management. The linkage between risk and remuneration has been taken care of through the governance process, target setting process for the bank and business units, the performance evaluation measures, introduction of both deferral over a 3 year period, share linked component and with introduction of clawback and malus provisions.

The mix of salary allowances, benefits and variable pay is aligned to the nature of job and the position. Accordingly for the MD & CEO, executive management in Business units and the business unit positions, the pay mix is structured as lesser fixed pay and more of variable pay subject to achieving the targets. For staff in Control and Support functions, the pay mix is structured as more fixed and lesser variable pay. Further, the variable pay, for staff in Control and Support Functions, is based on their units target and individual performance and not linked to Bank's performance.

Deferral and share linked instruments

The Bonus for the MD & CEO, his deputies, Material Risk Takers and Approved persons whose total remuneration exceeds the regulatory threshold has a deferral element and share linked payment. The deferral arrangements are as follows:

MD & CEO, his deputies and top 5 Executive Management members (in terms of total remuneration) in Business units:

- 40% of the variable pay will be paid in cash at the end of the performance period; and
- The balance 60% will be deferred over a period of 3 years with 10% being cash deferral and 50% being shares and the entire deferred variable pay will vest equally over a 3 year period. (Year 1, Year 2 and Year 3)

For all other employees in Business and Approved persons in Control and Support Functions and whose total remuneration exceeds the regulatory threshold:

- 50% of the variable pay will be paid in cash at the end of the performance period; and
- 10% will be paid in the form of shares at the end of the performance period which has to be retained by the employee for 6 months from the date of award.
- The balance 40% will be deferred over a period of 3 years and paid in the form of shares and vests equally over the 3 year period.

Claw back and Malus

The Bank has introduced claw back and malus clauses whereby the NRC has the right to invoke these clauses under certain pre-defined circumstances wherein the Bank can clawback the vested as well as the unvested bonus paid or payable to a staff.

Key Remuneration Components

The Bank will try, at all times, to maintain pay scale and benefits appropriate to the local job market and allow for changes in the cost of living. The compensation package shall comprise of basic salary, allowances and benefits and discretionary variable pay. The following table summarises the total remuneration:

The Bonus pool is determined based on the bottom up approach i.e. by setting base multiples of monthly salary per level and aggregating the multiples per unit and then on to the bank level.

The basis of payment of bonus would be as follows:

- CEO and Executive management: not aligned to a specific Business Unit Base multiple*Bank score*Individual score
- Business units: base multiple * Bank score*Unit score*Individual score
- Control & Support units: Base multiple*Unit score*Individual score

Computation of Variable Pay – Business Units

Beginning of the performance period (financial year):
Targets are set for the Business units and is aggregated to the Bank level target. In setting targets, all Bank wide risk parameters and unit specific KPIs shall be considered.

For achieving the target, total Bonus pool is set based on multiples of base salary across the Bank. The key feature is that bonus is part of the target set (i.e. the overall target includes the bonus element as well). The different levels of targets are not just % increase in profits but profits adjusted for additional bonus.

The Summary of the Variable pay process is:

- Links reward to bank, business unit and individual performance.
- Target setting process considers risk parameters which are both quantitative and qualitative such as reputation.
- Bonus can be lesser or nil if the bank or business units do not achieve the risk adjusted targets or make losses.
- Post risk assessment is carried out to ensure that in case of material losses or realisation of less than expected income which can be attributed to employees actions the claw back or malus as appropriate is invoked.

Bonus Pool Evaluation
The actual results are evaluated against targets, considering the risk parameters matrix and adjustments if any to the unit score or the Bank's score as appropriate are made and the bonus pool is revised accordingly. The actual bonus pool is approved by the NRC and the individual Bonus payments are as per the scoring matrix.

Remuneration Details

Table – 44 **Amount in BD '000**

Members of the Board of Directors		
Total remuneration	**Unrestricted**	
	2013	**2014**
Fixed remuneration		
· Sitting Fees	75	72
· Annual Remuneration	130	141

Table – 45 **Amount in BD '000**

Approved Persons in Business Lines				
Total remuneration	**Unrestricted**		**Deferred**	
	2013	**2014**	**2013**	**2014**
Fixed remuneration				
· Cash-based	1,023	1,049		
· Shares and shares-linked instruments				
· Others				
Variable remuneration				
· Cash-based	528	226		51
· Shares and shares-linked instruments		4		273
· Others				

* The approved persons in business lines are 6 as of 31 December 2014.

Table – 46 **Amount in BD '000**

Approved persons in Support Units and Controlled Functions				
Total remuneration	**Unrestricted**		**Deferred**	
	2013	**2014**	**2013**	**2014**
Fixed remuneration				
· Cash-based	791	880		
· Shares and shares-linked instruments				
· Others				
Variable remuneration				
· Cash-based	268	183		7
· Shares and shares-linked instruments		16		101
· Others				

* The approved persons in support units and controlled functions are 10 as of 31 December 2014.

Table – 47

PD-1.3.10B (n) Number of meetings held by the NRC and aggregate remuneration paid to its members		
	2013	**2014**
Number of meetings	2	2
Aggregate remuneration paid to its members (amount in BD '000)	23	19

Table – 48. Corporate Governance

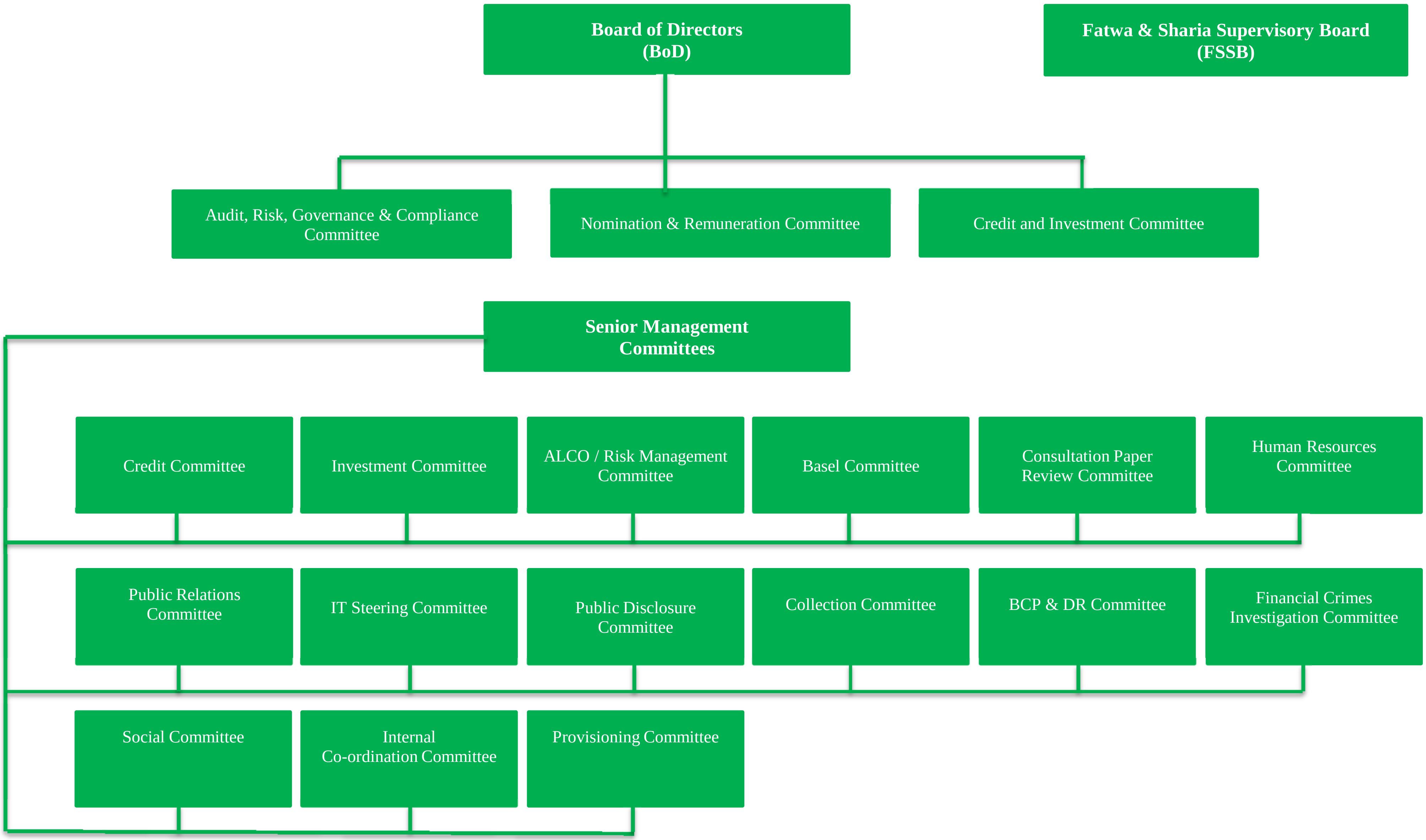
Corporate Governance and Transparency							
(PD-1.3.10(b))							
Name of Board Member	**Independence Status**	**Profession**	**Business Title**	**Experience in Years**	**Qualification**	**Director Since**	**Appointment / Reappointment Date**
Ahmed Mohammed Alaiban	Independent Non- Executive Director & Chairman	Business	Businessman	More than 42 years	Degree in Commerce	Sep-14	Sep-14
Mohammed Al Fouzan	Executive Director & Vice Chairman	Banker	AGM – Banking Sector – KFH Kuwait	More than 17 years	Bachelor of Commerce and Business Administration	Jul-12	Mar-14
Abdulwahab Issa Al-Rushood	Executive Director	Banker	General Manager - Private Banking	More than 26 years	Bachelors in Science, Mathematics	Mar-14	Mar-14
Mahmoud Difrawy	Independent Non- Executive Director	Business	Businessman	More than 40 years	BA (Economics)	Sep-14	Sep-14
Shadi Ahmed Zahran	Executive Director	Banker	Group Chief Financial Officer	More than 22 years	Master in Business Administraton, CPA, CIPA, CBA, Jordain CPA.	Sep-14	Sep-14
Abdulla A.Hammed Al Marzooq *	Executive Director	Banker	Deputy General Manager - International Banking & Investment	More than 19 years	Master in Business Administraton	Apr-14	Apr-14
Abdulhakeem Yaqoob Alkhayyat	Managing Director and CEO	Banker	MD & CEO - KFH Bahrain	More than 22 years	CPA , BBA and Bachelors in Accounting	Mar-08	Mar-14

The Board term is for a period of three years.

* The appointment of Mr. Abdulla A.Hammed Al Marzooq was resolved in the AGM of the Bank dated 27 March 2014, subject to obtaining the CBB's approval which was formally issued on 27th April 2014.

Table – 49. Corporate Governance

Information on the key directorships held by the directors on other boards is as follows:	
Name of Board Member	**Directorships on other companies**
Mohammed Al Fouzan	Director – Sharjah Islamic Bank Director - Kuwait Finance House (Malaysia)
Abdulla A.Hammed Al Marzooq	Director – Ibdar Bank (Bahrain) Director – Hayat Investment Company (Kuwait) Director - Saudi Kuwait Finance House
Abdulwahab Issa Al-Rushood	Chairman – Liquidity Management House (Bahrain) Director – ALAFCO (Kuwait) Director - Development Enterprises Company
Abdulhakeem Yaqoob Alkhayyat	Chairman - Diyar Al Muharraq W.L.L. Chairman - Durrat Al Bahrain Chairman - Diyar Homes W.L.L.
Mahmoud Difrawy	Director - Difrawy Financial Consulting Ltd (UK) Chairman- JP Morgan K.S.A


Board of Directors (BoD)
Fatwa & Sharia Supervisory Board (FSSB)
Audit, Risk, Governance & Compliance Committee
Nomination & Remuneration Committee
Credit and Investment Committee
Senior Management Committees
Credit Committee
Investment Committee
ALCO / Risk Management Committee
Basel Committee
Consultation Paper Review Committee
Human Resources Committee
Public Relations Committee
IT Steering Committee
Public Disclosure Committee
Collection Committee
BCP & DR Committee
Financial Crimes Investigation Committee
Social Committee
Internal Co-ordination Committee
Provisioning Committee

Board committees with their respective objectives and members are as follows:

Table – 50. Board Committee's objectives

Board Committee	Membership	Objective
Credit and Investment Committee (CIC)	1. Mohammed Al Fouzan 2. Shadi Ahmed Zahran 3. Mahmoud Difrawy	The general objective of the CIC is to provide an independent and objective view (approve or disapprove) of credit, treasury and investment proposals, approved by the management level Credit or Investment Committees.
Audit, Risk, Governance and Compliance Committee (ARGCC)	1. Ahmed Mohammed Alaiban 2. Abdulwahab Al-Rushood 3. Abdulla Al Marzooq	The ARGCC is a Board appointed committee which comprises of two executive directors and an independent member. The Chairman of the Committee is an independent director. For Audit related matters, the committee assists the Board in carrying out its responsibilities with respect to assessing the quality and integrity of financial reporting, the audit thereof, the soundness of the internal controls of the Bank, the measurement system of risk assessment, and methods for monitoring compliance with law, regulations and supervisory and internal policies. For Risk, Governance and Compliance related matters it has the overall responsibility for the development of risk strategy and implementing principles, frameworks, policies and limits. It is responsible for the fundamental risk issues and manages and monitors relevant risk decisions. The committee also decides the governance structure and manages the compliance and anti-financial crime requirements of the Bank.
Nomination and Remuneration Committee (NRC)	1. Ahmed Mohammed Alaiban 2. Shadi Ahmed Zahran 3. Abdulwahab Al-Rushood	The primary objective of the NRC is to assist the Board in identifying and nominating individuals qualified to serve as Board member, MD & CEO, senior management and Sub-committee members as well as the assessment of such appointees. The NRC is also responsible to make specific recommendations to both remuneration policy and remuneration packages of individual approved persons and material risk takers.

Table – 51. Meetings and attendance

	Minimum required meetings in 2014	Mohammed Ishaq (Note 2)	Yaqoob Majed (Note 2)	Adel Al Banwan (Note 2)	Mohammed Al Fouzan	Mahmoud Difrawy	Shadi Zahran	Abdulla Al Marzooq	Abdulwahab Al-Rushood (Note 3)	Ahmed Alaiban	Shaheen Al Ghanem (Note 2)	Abdulhakeem Alkhayyat	Abdulhakim Al Adhamy (Note 1)
Board of Directors	**4**												
2th February 2014		✓	✓	✓	✓				✓		✓	✓	
6th March 2014		✓	✓	✓	✓				✓			✓	
21st April 2014		✓	✓	✓	✓			✓	✓			✓	
25th June 2014		✓	✓	✓	✓			✓	✓			✓	
27th July 2014		✓	✓		✓			✓	✓			✓	
30th September 2014					✓	✓	✓	✓	✓	✓		✓	
11th November 2014					✓	✓	✓	✓	✓	✓		✓	
Credit & Investment Committee	**4**												
1st February 2014					✓						✓	✓	
25th June 2014					✓			✓				✓	
Audit Risk, Governance & Compliance Committee	**4**												
29th January 2014			✓	✓									✓
19th February 2014			✓	✓									✓
6th May 2014			✓	✓									✓
24th June 2014			✓	✓									✓
17th July 2014			✓	✓									✓
11th November 2014								✓	✓	✓			
Nomination & Remuneration Committee	**2**												
1st February 2014		✓			✓						✓		
25th December 2014									✓	✓			

Note 1: Mr. Abdul Hakim Al Adhamy was not an independent member in the Audit, Risk, Governance and Compliance Committee of the Bank in the last quarter of 2014.

Note 2: Ther resignations of Mr. Yaqoob Majed, Mr. Mohammed Ishaq and Mr. Adel Al Banwan was foramlly approved during the Ordinary General Meeting (OGM) of the Bank dated 29 September 2014. Mr. Ahmed Mohammed Alaiban, Mr. Shadi Zahran and Mr. Mahmoud Difrawy were appointed during the same OGM. Mr. Shaheen Al Ghanem was also replaced during the first quarter of 2014.

Note 3: Mr. Abdulwahab Al-Rushood attended as a guest in the first two Board meetings in 2014.

Fatwa and Shari'a Supervisory Board

The Fatwa and Shair'a Supervisory Board (FSSB) is an independent body, entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure the compliance with Islamic Shari'a rules and principles. The fatawa and rulings of the FSSB are binding. Before launching any new products or services, the related policies and agreements shall be verified by the FSSB in coordination with the senior management.The Fatwa and Shari'a Supervisory Board provides guidelines, assists in formulating policies and conducts annual Shari'a audit in order to assure the Bank's compliance with all Shari'a principles. The responsibilities of the Fatwa and Shari'a Supervisory Board are outlined in the respective terms of references.

Deposit Protection Scheme

Subject to the provisions thereof, deposits held with the Bahrain office of Kuwait Finance House are covered by the Deposit Protection Scheme established by the Central Bank of Bahrain regulation concerning the establishment of a Deposit Protection Scheme and a Deposit Protection Board.

Training and Evaluation of Board Members

The Compliance Department of the Bank prepares an annual orientation program for the members of Board of Directors.

The Board of Directors and Board committees are subject to an annual evaluation which is initiated by the Nomination & Remuneration Committee and presented to the entire Board for their review and appropriate action, where required.

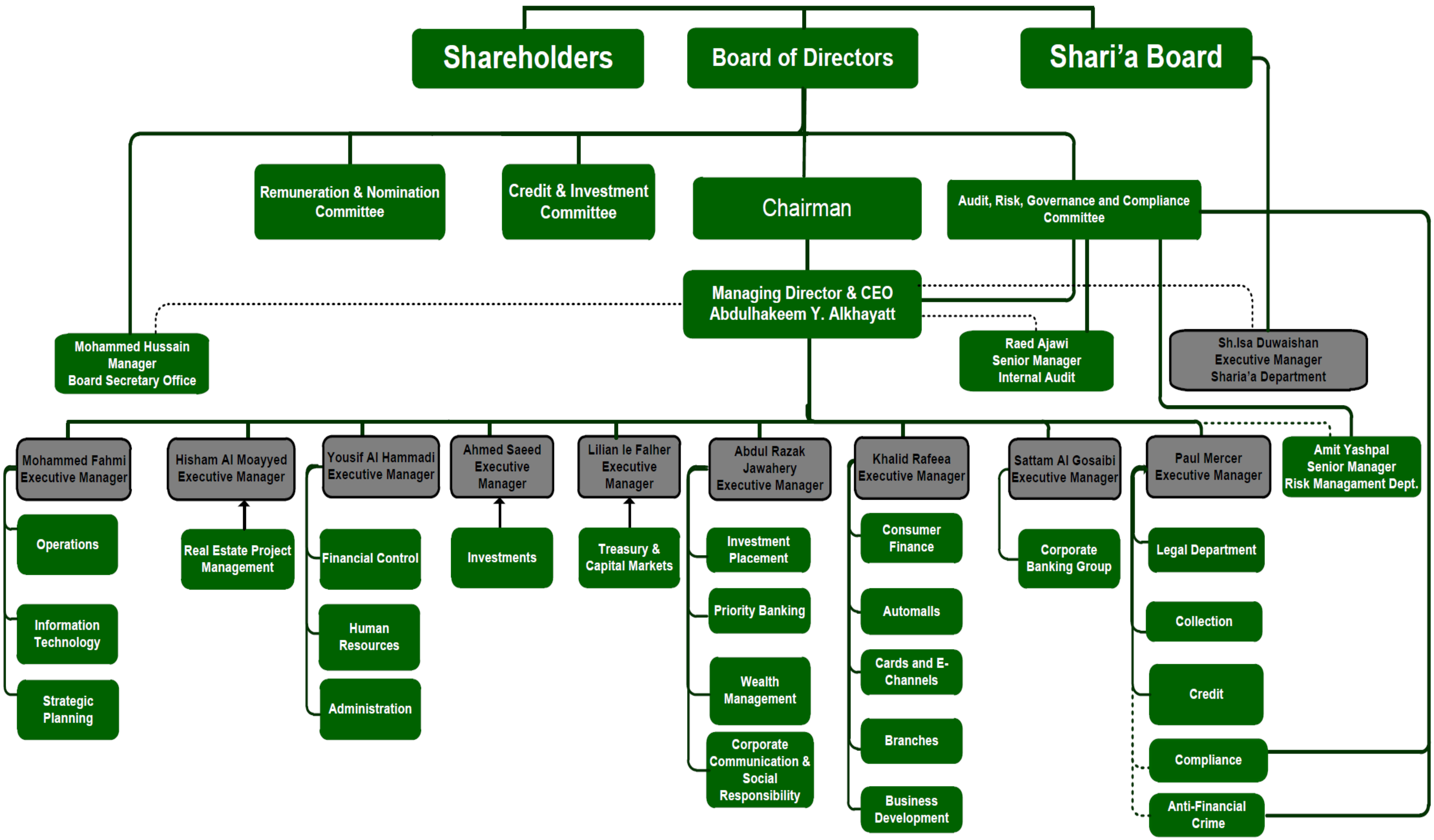
Compliance with High Level Controls (HC) Rulebook of CBB

The following are exceptions to the High Level Controls Rulebook of the CBB:

Board of Directors (Board)
The Bank is required to have 33% of the Board composed of independent directors however, the current independence ratio of the Board is 28.57%.

Audit, Risk, Governance & Compliance Committee (ARGCC)
The ARGCC is required to be composed of a majority of independent directors however, the ARGCC is currently composed of two executive directors and an independent director.

Nomination & Remuneration Committee (NRC)
The NRC must include only independent directors on alternatively only non-executive directors of whom majority must be independent. Moreover, the members of the NRC cannot be members in the Credit & Investment Committee (CIC) however, the NRC is currently composed of two executive directors and an independent director. Moreover, a member in NRC is also a member in CIC.


Shareholders
Board of Directors
Shari'a Board
Remuneration & Nomination Committee
Credit & Investment Committee
Chairman
Audit, Risk, Governance and Compliance Committee
Managing Director & CEO Abdulhakeem Y. Alkhayatt
Mohammed Hussain Manager Board Secretary Office
Raed Ajawi Senior Manager Internal Audit
Sh.Isa Duwaishan Executive Manager Sharia'a Department
Mohammed Fahmi Executive Manager
Operations
Information Technology
Strategic Planning
Hisham Al Moayyed Executive Manager
Real Estate Project Management
Yousif Al Hammadi Executive Manager
Financial Control
Human Resources
Administration
Ahmed Saeed Executive Manager
Investments
Lilian le Falher Executive Manager
Treasury & Capital Markets
Abdul Razak Jawahery Executive Manager
Investment Placement
Priority Banking
Wealth Management
Corporate Communication & Social Responsibility
Khalid Rafeea Executive Manager
Consumer Finance
Automalls
Cards and E-Channels
Branches
Business Development
Sattam Al Gosaibi Executive Manager
Corporate Banking Group
Paul Mercer Executive Manager
Legal Department
Collection
Credit
Compliance
Anti-Financial Crime
Amit Yashpal Senior Manager Risk Managament Dept.

Senior Management

Table – 52

(PD-1.3.10(b))				
Name	**Business Title**	**Experience in Years**	**Qualification**	**Duties and Responsibilities**
Abdul Razak Jawahery	Executive Manager	More than 26 years	MBA; and BBA.	▪Priority Banking; ▪Corporate Communication; and ▪Investment Placement.
Ahmad Saeed	Executive Manager	More than 19 years	Chartered Accountant.	▪Investments.
Khaled Al Maarafi	Executive Manager	More than 35 years	Certified Public Accountant (CPA); BSC in Accounting; Diploma in Accounting; and Diploma in Basic Supervision.	▪Consumer Finance - Auto; ▪Consumer Real Estate – Real Estate; ▪Branches; ▪Sales & Marketing; and ▪Cards & e-channels.
Sattam Al Gosaibi	Executive Manager	More than 18 years	MBA; and Bachelor of Science.	▪Corporate Finance
Paul Mercer	Executive Manager	More than 20 years	MA (Law); BA (Law); Postgraduate Diploma (Law); and Officer of the Supreme Court of England and Wales.	▪Legal Department; ▪Credit Review & Administration; ▪Compliance; ▪Anti-Financial Crimes; and ▪Collection.
Lilian Le Falher	Executive Manager	More than 19 years	Certified Financial Analyst (Charter holder); and Masters in Management (Banking and Finance).	▪Financial Institutions; ▪Debt Capital Markets; and ▪Treasury

(PD-1.3.10(b))				
Name	**Business Title**	**Experience in Years**	**Qualification**	**Duties and Responsibilities**
Yousif Al Hammadi	Executive Manager	More than 25 years	MBA	• Financial Control; • Administration; and • Human Resources.
Hisham Al Moayyed	Executive Manager	More than 35 years	MSc (Structural Engineering); and BSC (Civil Engineering),	• Real Estate Project Management.
Mohammed Fahmi Hamad	Executive Manager	More than 18 years	Certified Financial Analyst (CFA); and Bachelor in Accounting	• Information Technology; • Operations; and • Strategic Planning.
Isa Duwaishan	Shari'a Advisor	More than 26 years	Masters of Islamic Banking; Bachelors of Accounting; Certified Shari'a Adviser and Auditor; Legal Accountant certificate and Advance Diploma in Islamic Commercial Jurisprudence.	• Shari'a Compliance; and • Secretary of Fatwa and Shari'a Supervisory Board; and • Shari'a Supervision and Shari'a Advisory
Mohammed Hussain	Board Secretary	More than 12 years	Bachelor Degree in Banking and Finance	Board Secretary

(PD-1.3.10(b))				
Name	**Business Title**	**Experience in Years**	**Qualification**	**Duties and Responsibilities**
Raed Ajawi	Head of Internal Audit	More than 15 years	Certified Public Accountant (CPA); BSC in Accounting; and Certified Sharia Advisor and Auditor (CSAA).	▪Internal Audit.
Alya AlShakhoory	Money Laundering Reporting Officer (MLRO)	More than 13 years	Bachelor in Chemical Engineering; Certified Anti Money Specialist (CAMS); and Master Compliance Professional.	▪Anti-Financial Crimes
Mazar Jalal	Head of Compliance	More than 14 years	Bachelor in Accounting; International Diploma in Compliance; and Advance Diploma in Islamic Banking & Insurance, UK	▪Regulatory Compliance & Governance
Mohammed Mattar	Deputy MLRO	More than 11 Years	MBA in Finance; BSc in Business Information System; and CIPA.	▪Anti-Financial Crimes
Amit Yashpal	Senior Manager - Head of Risk Management	More than 22 years	Master of Information Management and Systems-specialization Financial Engineering, USA; MA in Economics- specialization econometrics; Chartered Financial Analyst (CFA charter holder), USA; Financial Risk Manager, FRM, GARP USA; Chartered Alternative Investment Analyst (CAIA charter holder), USA.	. Risk Management; . Policies & Procedures framework custodian;

Code of Ethical Business Conduct

The Bank has developed a Code of ethical business conduct that covers the principles, policies and laws that govern the Bank's activities. The Code includes (but not limited to) the following:

i) Integrity, honest and ethical Conduct

The Board and management of the Bank shall act with honesty, integrity and in good faith with a view of best interest of the Bank, its shareholders and other stakeholders. They shall ensure that proper judgment is exercised when making business decisions.

ii) Commitment to the law and best practice standards

The Board and management shall always ensure their commitment to comply with the applicable laws and regulations. This commitment should also include adopting and adhering to the leading industry practice standards.

iii) Confidentiality

The Board and management must preserve strict confidentiality of the Bank's information even after the termination of their membership except, when disclosure is required by law.

iii) Conflict of interest

The Board and management of the Bank shall act independently and avoid any conflict of interest in their decision making process. The approved persons must declare in writing all of their interests in enterprises or activities (whether as a shareholder of above 5% of the voting capital of a Company, a manager, or other form of significant participation) to Board on an annual basis.

iv) Acceptance of gifts

The Board and management of the Bank should not accept gifts or any kind of favours and services from the Bank's major customers, suppliers or other stakeholders.

v) Cooperation with regulatory bodies

The Board and the management shall ensure co-operation with the CBB and any other relevant regulatory authorities.

vi) Employment practices

The Board and management shall encourage the establishment of and adherence to policies concerning health and safety of employees, training, prohibition on the offering and acceptance of bribes and potential misuse of the Bank's assets.

Corporate Communications Strategies

The Bank maintains an effective communications strategy by means of deploying a board approved Corporate Communication Manual that enables both the Board and Management to communicate effectively with its shareholders, stakeholders and the general public. Main communications channels include the annual report, corporate website and corporate brochure, and regular announcements in local presses.

The Communications Policy has been approved by the Board. This Policy is set to ensure the disclosure of all relevant information to stakeholders on a timely basis in a timely manner and the provision of at least the last three years of financial data on the Bank's website.

The Bank has a Corporate Communications Department which is responsible for communicating new products information through various channels of communication which may include publications, website, direct mailers, electronic mail and local media.

Customers / Investor Awareness Program

The Bank employs a range of communication channels to reach the customers and investors, to create awareness of the Bank products, services and investments.

Communication channels for customers normally adopt an integrated approach, depending on the level of exposure and awareness required. This includes mass media, publishing advertisements in the press and magazine publications, billboards, lamp posts, display Boards, direct mail, SMS messaging and emails.

The external communication program is supported by in-branch communication including; roll-ups, banners, posters, leaflets, flyers, brochures and danglers and online media via the Bank’s website, Call Centre and eBanking site.

Communication to investors is predominantly via Private Placement Memorandums and Investor Reports.

Complaints and Feedback

The Bank has appointed a Complaints Officer to manage customer complaints and ensure that all complaints are properly addressed and issues are resolved in a timely manner. Upon receiving a complaint, the Complaints Officer internally addresses the complaint to the concerned department for their response. After analysing the responses of the concerned department the Complaints Officer finds suitable solution and this will be communicated to the complainant. There are various channels in place to assist in receiving feedback/complaints from customers including the Bank's website and suggestion boxes that have been placed at each of the Bank's branches.

Other Disclosures

The information on the nature and extent of transactions with related parties is reported in consolidated financial statement of the Group.

The Bank is effectively a wholly owned subsidiary of Kuwait Finance House K.S.C and information pertaining to the appointment of the external auditors and the related fees is available for the perusal of the shareholders.