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

Public Disclosure

30th June 2011

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بيت التمويل الكويتي
Kuwait Finance House
Bahrain B.S.C.(c) البحرين ش.م.ب (م)

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1. Introduction

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 3.1.6 Additional Requirements for Semi Annual Disclosures, 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 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, foreign currency translation reserve and non-controlling stakeholders less goodwill. Tier 2 capital includes subordinated murabaha payable, collective impairment, current period's profit and revaluation reserves. Certain adjustments are made to IFRS based 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. For the purpose of calculating the capital requirements, trigger minimum capital adequacy ratio of 12.5% is considered by the Bank.

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 is consolidating 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.

None of the Bank's investment in subsidiaries exceeds the materiality thresholds specified in Prudential Consolidation and Deduction Module hence not deducted from the available capital. All other subsidiaries (i.e. commercial subsidiaries) are risk weighted as per the requirement of CA Module.

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

Table – 1. Capital Structure

CAPITAL STRUCTURE	
Capital Structure (PD-1.3.12, 1.3.13,1.3.14, 1.3.15) *	
Components of Capital	**Amount BD, 000**
Core capital - Tier 1:	
Issued and fully paid ordinary shares	177,140
Employee stock incentive program funded by the Bank	(17,379)
Share premium	71,403
Statutory reserve	13,351
General reserve	46,570
Retained earnings	4,680
Unrealised gross gains arising from fair valuing equity securities	15,334
Other reserves	(6,747)
Tier 1 Capital before PCD deductions	304,352
Supplementary capital - Tier 2:	
Current interim profits (reviewed by external auditors)	12,108
Subordinated murabaha payable	101,651
Asset revaluation reserve - Property, plant, and equipment (45% only)	6,984
Collective impairment provisions	11,742
Tier 2 Capital before PCD deductions	132,485
Total Available Capital before PCD deductions (Tier 1 & 2)	**436,837**

	Tier I	**Tier II**
Available Capital before PCD deductions	304,352	132,485
Deductions		
Investment in insurance entity greater than or equal to 20% of investee's capital base	1,237	1,237
Excess amount over maximum permitted large exposure limits	66,129	66,129
Aggregate Deductions	67,366	67,366
Total eligible capital	**236,986**	**65,119**

* 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 Contracts.

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	4,664
Financing contracts with customers	
- Murabaha	44,099
- Ijarah	7,360
- Musharakah	2,590
Total	**58,713**

Table – 3. Capital Requirement for Market and Operational Risk

CAPITAL ADEQUACY		
Capital Requirements for Market Risk (PD-1.3.18) & Operational Risk (PD-1.3.19) & 1.3.30(a)		
Particulars	**Risk Weighted Assts**	**Capital Requirement**
Market Risk - Standardised Approach	50,108	6,264
Operational Risk - Basic indicator approach	96,907	12,113

Table – 4. Capital Ratios

CAPITAL ADEQUACY		
Capital Adequacy Ratios (PD-1.3.20)		
Particulars	**Total Capital Ratio**	**Tier 1 Capital Ratio**
	%	
Consolidated Ratios	23.65%	18.55%

2.1 Credit Risk

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 lending, trade finance 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 form of mortgage of real estate properties or other tangible securities.

3.5.10 Quantitative disclosures
Table – 5. Average and Gross Credit Risk Exposure

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	1,653	1,983	5,065	5,147
Murabaha and Mudaraba contracts with Banks	-	-	122,940	117,170
Financing contracts with customers	362,432	371,502	265,129	262,460
Investments – Sukuk	-	-	58,308	57,304
Receivables	75,518	66,041	-	-
Total	**439,603**	**439,526**	**451,442**	**442,081**
Credit commitments and contingent items	49,581	49,484	-	-
Grand Total	**489,184**	**489,010**	**451,442**	**442,081**

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

Table – 6. Portfolio Geographic Breakdown.

CREDIT RISK: QUANTITATIVE DISCLOSURES												
Geographic Breakdown (PD-1.3.23(b)												
Portfolios	**Self Financed**						**Financed by Unrestricted Investment Accounts**					
	Geographic Area						**Geographic Area**					
	Middle East	**North America**	**Europe**	**NZ / Australia**	**Others Countries**	**Total**	**Middle East**	**North America**	**Europe**	**NZ / Australia**	**Others Countries**	**Total**
Balances with Banks	311	1,014	314	-	14	1,653	952	3,106	962	-	45	5,065
Murabaha and Mudaraba contracts with Banks	-	-	-	-	-	-	122,940	-	-	-	-	122,940
Financing contracts with customers	360,729	1,138	-	565	-	362,432	264,326	803	-	-	-	265,129
Investments - Sukuk	-	-	-	-	-	-	55,480	943	-	-	1,885	58,308
Receivables	71,075	-	4,443	-	-	75,518	-	-	-	-	-	-
Total	**432,115**	**2,152**	**4,757**	**565**	**14**	**439,603**	**443,698**	**4,852**	**962**	**-**	**1,930**	**451,442**
Un-funded												
Credit commitments and contingent items	47,579	-	1,776	-	226	49,581	-	-	-	-	-	-
Grand Total	**479,694**	**2,152**	**6,533**	**565**	**240**	**489,184**	**443,698**	**4,852**	**962**	**-**	**1,930**	**451,442**

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. The Bank’s classification of geographical area is according to its business needs and the distribution of its portfolios.

Table – 7. Industrial Sector Breakdown by Portfolio

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	-	1,653	-	-	1,653	-	5,065	-	-	5,065
Murabaha and Mudaraba contracts with Banks	-	-	-	-	-	-	122,940	-	-	122,940
Financing contracts with customers	39,878	35,091	224,759	62,704	362,432	28,121	24,745	168,046	44,217	265,129
Investments - Sukuk	-	-	-	-	-	-	18,233	39,133	942	58,308
Receivables	4,843	380	51,241	19,054	75,518	-	-	-	-	-
Total	**44,721**	**37,124**	**276,000**	**81,758**	**439,603**	**28,121**	**170,983**	**207,179**	**45,159**	**451,442**
Un-funded										
Credit commitments and contingent items	24,234	226	18,927	6,194	49,581	-	-	-	-	-
Grand Total	**68,955**	**37,350**	**294,927**	**87,952**	**489,184**	**28,121**	**170,983**	**207,179**	**45,159**	**451,442**

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	35.35%	-
Counterparty # 2	23.70%	-

Restructured Islamic Financing Contracts:

The outstanding amount of financing contracts with customers for which financing terms have been renegotiated (restructured facilities) amounted to BD 220,757 thousand (31 December 2010: 63,336) . These facilities are secured with collateral amounting to BD 499,019 thousand (31 December 2010: BD 78,066 thousand). As a condition to restructuring, the Bank, in most cases, has received partial payment from customers and/or obtained additional collateral.

The restructuring does not have any significant impact on provision 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.

Table – 9. Maturity Breakdown of Credit Exposures

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**	**Total**
Balances with Banks	826	-	-	-	827	1,653
Murabaha and Mudaraba contracts with Banks	-	-	-	-	-	-
Financing contracts with customers	61,923	77,103	156,047	39,349	28,010	362,432
Investments - Sukuk	-	-	-	-	-	-
Receivables	6,321	7,297	61,812	88	-	75,518
Total	**69,070**	**84,400**	**217,859**	**39,437**	**28,837**	**439,603**
Credit commitments and contingent items	20,979	28,376	226	-	-	49,581
Grand Total	**90,049**	**112,776**	**218,085**	**39,439**	**28,837**	**489,184**

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**	**Total**
Balances with Banks	2,533	-	-	-	2,532	5,065
Murabaha and Mudaraba contracts with Banks	122,940	-	-	-	-	122,940
Financing contracts with customers	47,104	56,084	113,863	28,325	19,753	265,129
Investments - Sukuk	-	9,425	48,883	-	-	58,308
Receivables	-	-	-	-	-	-
Total	**172,577**	**65,509**	**162,746**	**28,325**	**22,285**	**451,442**
Credit commitments and contingent items	-	-	-	-	-	-
Grand Total	**172,577**	**65,509**	**162,746**	**28,325**	**22,285**	**451,442**

Table – 10. Break-up of Impaired Loans by Industry Sector

CREDIT RISK: QUANTITATIVE DISCLOSURES

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

					Self Financed								
									Specific Impairment				
Industry Sector	**Total Portfolio**	**Good**	**Substandard**	**Past due but not impaired**	**Past due or individually impaired**	**Over 3 Months**	**Over 1 Year**	**Over 3 Years**	**Balance at the Beginning of the Period**	**Charges During the Period**	**Transfer from collective provision**	**Balance at the End of the Period**	**Collective Impairment**
Trading and manufacturing	39,878	27,495	2,432	7,092	2,859	-	2,859	-	-	500	-	500	*
Banking and financial institutions	35,091	26,566	2,140	6,241	144	-	144	-	-	-	-	-	*
Construction & real estate	238,309	180,413	14,533	42,382	981	-	981	-	-	-	-	-	*
Others	62,704	47,471	3,824	11,151	258	-	258	-	1,807	-	-	1,807	*
Total	**375,982**	**281,945**	**22,929**	**66,866**	**4,242**	**-**	**4,242**	**-**	**1,807**	**500**	**-**	**2,307**	**-**

* This amounts to BD 11,742 thousands representing collective impairment against exposures which, although not specifically identified, have a greater risk of default then when originally granted.

Impaired Loans, Past Due Loans and Allowances (PD-1.3.23(h))													
				Financed by Unrestricted Investment Accounts									
Industry Sector	Total Portfolio	Good	Substandard	Past due but not impaired	Past due or individually impaired				Specific Impairment				Collective Impairment
						Over 3 Months	Over 1 Year	Over 3 Years	Balance at the Beginning of the Period	Charges During the Period	Transfer from collective provision	Balance at the End of the Period	
Trading and manufacturing	28,121	26,342	1,779	-	-	-	-	-	-	-	-	-	-
Banking and financial institutions	24,745	23,179	1,566	-	-	-	-	-	-	-	-	-	-
Construction & real estate	168,046	157,415	10,632	-	-	-	-	-	-	-	-	-	-
Others	44,217	41,419	2,797	-	-	-	-	-	-	-	-	-	-
Total	**265,129**	**248,355**	**16,774**	-	-	-	-	-	-	-	-	-	-

Table – 11. Break-up of Provision by Geographic Area

CREDIT RISK: QUANTITATIVE DISCLOSURES						
Impaired Loans, Past Due Loans And Allowances (PD-1.3.23(i))						
	Own Capital and Current Account			**Unrestricted Investment Account**		
Geographic Area	**Past Due and Impaired Islamic Financing Contracts (Greater Than 90 Days)**	**Specific Impairment**	**Collective Impairment**	**Past Due Islamic Financing Contracts**	**Specific Impairment**	**Collective Impairment**
Middle East	67,282	1,242	*	-	-	*
North America	-	-	-	-	-	-
Europe	-	-	-	-	-	-
Asia / Pacific	-	-	-	-	-	-
Others countries	1,131	565	-	-	-	-
Total	68,413	1,807	-	-	-	-

* This amounts to BD 11,742 thousands representing collective impairment against exposures which, although not specifically identified, have a greater risk of default than when originally granted.

Table – 12. Break-up of Eligible Collateral by Portfolio

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 *	**Guarantees**
Murabaha	102,675	-
Ijarah	147,777	-
Total	**250,452**	**-**

* 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

DISCLOSURES FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK (CCR)							
General Disclosures (PD-1.3.26 (b))							
				Eligible Collaterals Held *			
Current Credit Exposure by Type of Islamic Financing Contracts	**Gross Positive Fair Value**	**Netting Benefits**	**Netted Current Credit Exposures**	**Cash**	**Govt. Securities**	**Others**	**Total**
Murabaha	366,621	-	366,621	18,611	-	84,064	102,675
Ijarah	247,129	-	247,129	340	-	147,437	147,777
Musharakah	13,811	-	13,811	-	-	-	-
Total	**627,561**	**-**	**627,561**	**18,951**	**-**	**231,501**	**250,452**

* 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.

2.2 Market Risk

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 Group also accepts the definition of market risk as defined by the CBB as "the risk of losses in on and off–balance sheet positions arising from movements in market prices."

2.2.1 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 positions by currency. 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 subsidiaries, located in Jordan, as at 30 June 2011 is BD 34,523 (31 December 2010: BD 34,523) thousand. Net assets of the Group's foreign subsidiary, located in United Kingdom, as at 30 June 2011 is BD 15,680 (31 December 2010: BD 12,222) 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.

Equity 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.

Commodity Price Risk is the risk 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.

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

MARKET RISK: DISCLOSURES FOR BANKS USING 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	284	5,980	-	-	-
Maximum value	375	6,658	-	-	-
Minimum value	284	5,980	-	-	-

This disclosure is based on the figures from the PIRI from the two quarters of 2011.

2.3 Operational Risk

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.

Table – 15. Indicators of Operational Risk

OPERATIONAL RISK : QUANTITATIVE DISCLOSURES FOR BASIC INDICATOR APPROACH	
Indicators of Operational Risk (PD-1.3.30 (b) & (c))	
Particulars	**Total**
Gross Income (average)	51,684
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	-
No Penalties (2010 : BD 200) were paid to the CBB during 2011.	

2.4 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.

Table – 16. Total and Average Gross Exposures

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	420,211	372,131	6,229	413,982
Managed funds	29,009	29,239	-	29,009
Total	**449,220**	**401,370**	**6,229**	**442,991**

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

Table – 17. Break-up of Capital Requirement for Equity Groupings

EQUITY POSITION IN BANKING BOOK - DISCLOSURE REQUIREMENTS	
Capital Requirement - (PD-1.3.31 (f))	
Equity Grouping	**Capital Requirement**
Listed	739
Unlisted	94,321
Holding of real estate	46,942
Managed Funds	1,898
Total	**143,900**

Table – 18. Gain and Loss Reported

EQUITIES: DISCLOSURES FOR BANKING BOOK POSITIONS	
Gains / Losses Etc. (PD-1.3.31 (d) and (e))	
Particulars	**Total**
Total realised (losses) arising from sales or liquidations in the reporting period	-
Total unrealised gains (losses) recognised in statement of other comprehensive income	(582)
Unrealised gross (losses) included in Tier One Capital	15,334
Unrealised gains included in Tier Two Capital	-

2.5 Unrestricted Investment Accounts ("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 (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, Sukuks and Ijarah Muntahia Bittamleek. The Bank invests these funds through various departments including Treasury, corporate, consumer, and debt 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 through 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 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 period, 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 2010.

The Bank has a Corporate Communications Department which is responsible for communicating new and/or extended products 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.

Displaced commercial risk ("DCR") refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the PSIA, when the return on assets is under performing as compared with competitors' rates. 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 depositors.

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 smooth the rate to URIA holders by forgoing part of its shareholder's earnings as "Hiba".

The rate of return payable to URIA holders is decided by ALCO, keeping in view the rate of return earned on pool of assets. Number of factors are considered while deciding the rate of return payable to URIA holders, including rates offered by peer banks, cost of funds from various sources, liquidity position of the Bank and market interest rates (LIBOR etc). 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 Bank can use Investment Risk Reserve (IRR) to cater against future losses for URIA holders. The amount of PER and IRR as at 30 June 2011 and 30 June 2010 is Nil but the Bank may transfer amount into PER and IRR in future after prior notice to its customers.

Table – 19. Break-up of URIA

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (a) &(g))			
	Amount	**Financing to Total URIA %**	**Ratio of Profit Distributed**
Savings URIA	66,077	14%	4%
Term URIA	405,591	86%	96%
Total	**471,668**	**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	2.81%
Average profit earned on average URIA assets	3.25%

Table – 21. Percentage of Mudarib share to Total URIA Profits

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	7,731	1,040	13.5%

Table – 22. Percentage of Islamic Financing Contracts Financed by URIA to Total URIA

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (h))		
Shari'a-Compliant Contract	**Financing**	**Financing to Total URIA %**
Balances at banks	25,291	5.36%
Banks Murabaha	122,940	26.06%
Investments – Sukuk	58,308	12.36%
Murabaha	147,670	31.31%
Ijarah Muntahia Bittamleek	117,459	24.91%
Total	**471,668**	**100.00%**

Table – 23. Percentage of Counterparty Type Contracts Financed by URIA to Total URIA

UNRESTRICTED INVESTMENT ACCOUNTS:		
Unrestricted Investment Account (PD-1.3.33 (i))		
Counterparty Type	**Financing**	**Financing to Total URIA %**
Claims on sovereigns	30,011	6.36%
Claims on banks	134,793	28.58%
Claims on corporate	103,356	21.91%
Regulatory retail portfolio	15,799	3.35%
Mortgage	153,656	32.58%
Holding of real estate (sukuks)	20,848	4.42%
Others	13,205	2.80%
Total	**471,668**	**100.00%**

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	2.81%	2.81%	0.44%

Table – 25. Range of Declared Rate of Return

UNRESTRICTED INVESTMENT ACCOUNTS:				
Unrestricted Investment Account (PD-1.3.33 (q))				
	1-Month	**3-Month**	**6-Month**	**12-Month**
Declared rate of return for Investments accounts denominated in USD and BHD.	2.70% - 2.80%	3.20% - 3.40%	3.40% - 3.60%	3.70% - 4.20%

Table – 26. Movement of URIA by Type of Assets

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (r) & (s))			
Type of Assets	**Opening Actual Allocation as at 01 Jan 2011**	**Net Movement During the Period**	**Closing Actual Allocation as at 30 June 2011**
Cash and Balance with banks and CBB	23,399	1,892	25,291
Murabaha due from banks	51,370	71,570	122,940
Investments – Sukuk	53,672	4,636	58,308
Murabaha due from customers	205,070	(57,400)	147,670
Ijarah Muntahia Bittamleek due from customers	119,452	(1,993)	117,459
Total	**452,963**	**18,705**	**471,668**

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

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (v))			
Type of Claims	**Amount**	**RWA for Capital Adequacy Purposes**	**Capital Charge**
Cash items	2,982	-	-
Claims on sovereign	30,011	-	-
Claims on MDBs	943	-	-
Claims on banks	134,793	33,768	6,921
Claims on corporate	103,356	71,916	2,948
Regulatory retail portfolio	15,799	11,849	444
Mortgages	153,656	41,053	1,539
Claims in holdings of Real Estate	20,848	22,796	10,305
Other assets	9,280	9,280	348
Total	**471,668**	**190,662**	**22,505**

Table – 28. Percentage of Profit Earned and Profit Paid to Total URIA Funds

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)**
June 2011	476,415	7,731	3.25%	6,690	2.81%
2010	480,308	19,104	3.97%	13,804	2.87%
2009	503,207	25,045	4.98%	20,817	4.14%
2008	211,917	10,862	5.13%	9,865	4.66%
2007	78,055	1,807	2.32%	1,662	2.13%

** Average assets funded by URIA have been calculated using monthly 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 period, Bank waived its mudarib share resulting in higher return paid to URIA holders by 57% (2010: 18%)

Table – 29. Administrative Expenses Allocated to URIA

UNRESTRICTED INVESTMENT ACCOUNTS:	
Unrestricted Investment Account (PD-1.3.33 (x))	
Unrestricted IAH	**Amount**
Amount of administrative expenses charged to URIA	3,465

2.6 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 purposes of investment. In addition, there may be other restrictions which IAH may impose. RIA funds are invested and managed in accordance with Shari'a requirements. The funds are managed by the Bank under fiduciary capacity as per the instructions of the RIA holder 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 risk 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.

Table – 30. History of Profit Paid to RIA Holders

RESTRICTED INVESTMENT ACCOUNTS:						
Restricted Investment Account (PD-1.3.35 (a) & (b))						
	June 2011	**2010**	**2009**	**2008**	**2007**	**2006**
Return to RIA holders	2,891	5,440	4,191	3,852	2,122	944

Table – 31. Break-up of RIA by Type of Deposits

RESTRICTED INVESTMENT ACCOUNTS:	
Restricted Investment Account (PD-1.3.33 (a))	
	Amount
RIA funds	87,657

Table – 32. 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	6.31%

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

Table – 33. 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	7.22%

Table – 34. Share of Islamic Financing Contracts in Total RIA Financing

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (h))		
Shari'a-Compliant Contract	**Financing**	**Financing to Total Financing %**
Murabaha	86,610	98.81%
Ijarah Muntahia Bittamleek	1,047	1.19%
Total	**87,657**	**100.00%**

Table – 35. Percentage of Counterparty Type Contracts Financed by RIA to Total RIA

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (i))		
Counterparty Type	**Financing**	**Financing to Total Financing %**
Claims on corporate	87,657	100.00%

Table – 36. Share of Profit Paid to RIA Holders as a Percentage of Total RIA

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**	**Share of Profit Paid to IAH Before Transfer to / from Reserves %**	**Share of Profit Paid to IAH after Transfer to / from Reserves %**
	A	**B**	**C**	**D**	**E = C / A**	**F = C / A**
Murabaha	86,610	3,044	2,835	209	6.55%	6.55%
Ijarah Muntahia Bittamleek	1,047	72	56	16	10.70%	10.70%
Total	87,657	3,116	2,891	225	6.60%	6.60%

Table – 37. Average Declared Rate of Return of RIA

RESTRICTED INVESTMENT ACCOUNTS:			
Restricted Investment Account (PD-1.3.33 (q))			
	6-Month	**12-Month**	**24-Month**
Declared rate of return	6.00% - 6.50%	6.50%	7.50%

Table – 38. Treatment of Assets Financed by RIA in the Calculation of RWA for Capital Adequacy Purposes

RESTRICTED INVESTMENT ACCOUNTS:		
Restricted Investment Account (PD-1.3.33 (v))		
Type of IAH	**Exposure**	**Risk Weighted Amount While Calculating CAR**
Murabaha	86,610	254,456
Ijarah Muntahia Bittamleek	1,047	-
Total	**87,657**	**254,456**

Table – 39. Profit Earned and Profit Paid as a Percentage of Total RIA Funds

RESTRICTED INVESTMENT ACCOUNTS:					
Restricted Investment Account (PD-1.3.33 (w))					
	*** RIA Funds (Average)**	**Profit Earned**	**Profit Earned as a Percentage of RIA Funds**	**Profit Paid**	**Profit Paid as a Percentage of RIA Funds**
June 2011	91,635	3,116	6.80%	2,891	6.31%
2010	87,277	5,905	6.77%	5,440	6.23%
2009	71,272	4,481	6.29%	4,191	5.88%
2008	71,729	4,839	6.75%	3,852	5.37%
2007	28,475	2,739	9.62%	2,122	7.45%

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

2.7 Liquidity Risk

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.

Table – 40. Liquidity Risk Exposure Indicators

LIQUIDITY RISK: QUANTITATIVE DISCLOSURE	
Liquid assets to customer deposits (PD-1.3.37)	
As at 30 June 2011	25.5%
During the period:	
Average	21.8%
Highest	25.5%
Lowest	17.3%

Table – 41. Maturity Analysis

LIQUIDITY RISK: QUANTITATIVE DISCLOSURE								
Maturity Analysis by Different Maturity Buckets. (PD-1.3.38)								
	Upon One Year			**Over One Year**				**Total**
	Up to 3 Months	**3 Months to 12 Months**	**Subtotal up to 12 Months**	**1 to 5 Years**	**5 to 10 Years**	**Over 10 Years**	**Subtotal Over 1 Year**	
Assets								
Cash and balances with banks and Central Bank of Bahrain	13,588	6,806	20,394	3,930	3,930	10,685	18,545	38,939
Murabaha due from banks	122,940	-	122,940	-	-	-	-	122,940
Financing contracts with customers	109,027	133,187	242,214	269,910	67,674	47,763	385,347	627,561
Investments	24,700	10,518	35,218	114,970	111,273	-	226,243	261,461
Investment in associates	-	-	-	125,110	-	-	125,110	125,110
Investment properties	-	-	-	25,000	131,634	-	156,634	156,634
Receivables, prepayments and other assets	6,321	7,297	13,618	156,693	88	-	156,781	170,399
Goodwill and intangibles	-	-	-	24,870	4,043	-	28,913	28,913
Premises and equipment	-	-	-	-	36,905	-	36,905	36,905
Total	**276,576**	**157,808**	**434,384**	**720,483**	**355,547**	**58,448**	**1,134,478**	**1,568,862**
Liabilities and Unrestricted Investment Accounts								
Customers' current accounts	20,232	6,666	26,898	10,526	10,525	10,526	31,577	58,475
Murabaha and due to banks	51,413	265,181	316,594	11,926	-	-	11,926	328,520
Murabaha and due to non-banks	59,465	76,410	135,875	38,933	13,457	13,457	65,847	201,722
Other liabilities	8,893	4,791	13,684	28,300	-	-	28,300	41,984
Subordinated murabaha payable	-	-	-	-	101,651	-	101,651	101,651
Unrestricted investment accounts	109,370	107,301	216,671	84,999	84,999	84,999	254,997	471,668
Total	**249,373**	**460,349**	**709,722**	**174,684**	**210,632**	**108,982**	**494,298**	**1,204,020**
Net	**27,203**	**(302,541)**	**(275,338)**	**545,799**	**144,915**	**(50,534)**	**640,180**	**364,842**

2.8 Profit Rate Risk

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.

Table – 42. Profit Rate Shock

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 due from banks	122,940	200	2,459
Financing contracts with customers	247,129	200	4,943
Investments – Sukuk	58,308	200	1,166
Liabilities			
Murabaha and due to Banks	328,520	200	(6,570)
Murabaha contracts with non-banks	201,722	200	(4,034)
Subordinated Murabaha payable	101,651	200	(2,033)
Unrestricted investments accounts	471,668	200	(9,433)
		Total	**(13,502)**

2.9 Financial Performance and Position

Table – 41. Ratios

Financial Performance and Position					
(PD-1.3.9(b))					
Quantitative Indicator	**June 2011**	**2010**	**2009**	**2008**	**2007**
Return on average equity	2%	2%	1%	15%	26%
Return on average assets	0.6%	0.5%	0.2%	4%	6%
Staff cost to net operating income ratio	29%	28%	31%	15%	15%

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