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

Public Disclosure

30th June 2012

www.kfh.bh

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

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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 disclosers made available in the half yearly reviewed consolidated financial statements form part of the overall public disclosures. The shareholders along with their shareholding and nationality as at 30 June 2012 are as follows:

Name	Number of shares	Nominal Value (BD '000)	%	Nationality
Kuwait Finance House K.S.C.	1,648,995,669	164,899,567	93.08	Kuwaiti
Mr. Imad Yousif Al Mane'e	488,401	48,840	0.03	Kuwaiti
Mr. Adel Ahmed Al Banwan	488,401	48,840	0.03	Kuwaiti
Mr. Mohammed Sulaiman Abdulaziz Ebrahim Alomar	488,401	48,840	0.03	Kuwaiti
Mr. Khalid Ali Almsalam	488,401	48,840	0.03	Kuwaiti
Themar Baytik Company B.S.C. (c)	120,455,527	12,045,553	6.80	Bahraini
Total	1,771,404,800	177,140,480	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, foreign currency translation reserve and non-controlling stakeholders less goodwill. Tier 2 capital includes subordinated murabaha payable, collective impairment reserve, current year's profit and revaluation reserves. Certain adjustments are made to 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 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.

Investment in subsidiaries has not lead to any significant threshold breaches 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 **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
Employee stock incentive program funded by the Bank	(17,379)
Share premium	71,403
Statutory reserve	14,310
General reserve	48,734
Retained earnings	2,169
Unrealised gains arising from fair valuing equities (45% only)	21,033
Other reserves	(1,143)
Total Tier 1 Capital	316,267
Deductions from Tier 1:	
Unrealised gross losses arising from fair valuing equity securities	727
Tier 1 Capital before Prudential consolidation and deductions (PCD)	315,540
Supplementary capital - Tier 2:	
Subordinated murabaha payable	102,072
Asset revaluation reserve - Property, plant, and equipment	6,793
Unrealised gains arising from fair valuing equities	112
General provisions	7,868
Tier 2 Capital before PCD	116,845
Total Available Capital before PCD deductions (Tier 1 & 2)	**432,385**

	Tier I	**Tier II**
Available Capital before PCD		
Deductions		
Investment in insurance entity greater than or equal to 20% of investee's capital base	1,212	1,212
Excess amount over maximum permitted large exposure limits	73,673	73,673
Aggregate Deductions	74,885	74,885
Total eligible capital	**240,655**	**41,960**

* 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. **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	407
Financing contracts with customers	
- Murabaha	57,302
- Ijarah	9,957
- Musharakah	1,657
Total	**69,323**

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	45,919	5,740
Operational Risk - Basic indicator approach	122,055	15,257

Table – 4. Capital Ratios

CAPITAL ADEQUACY		
Capital Adequacy Ratios (PD-1.3.20)		
Particulars	**Total Capital Ratio**	**Tier 1 Capital Ratio**
	%	
Consolidated Ratios	24.43%	20.80%

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

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	979	543	4,700	4,716
Murabaha and due from Banks	-	-	54,203	56,011
Financing contracts with customers	331,329	331,771	300,615	293,433
Investments – Sukuk	-	-	50,631	49,689
Receivables	48,321	52,096	-	-
Total	**380,629**	**384,410**	**410,149**	**403,849**
Credit commitments and contingent items	51,054	49,308	-	-
Grand Total	**431,683**	**433,718**	**410,149**	**403,849**

*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 CBB.

Table – 6. Portfolio Geographic Breakdown.

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES										
Geographic Breakdown (PD-1.3.23(b)										
	Self-Financed					**Financed by Unrestricted Investment Accounts**				
Portfolios	**Geographic Area**					**Geographic Area**				
	Middle East	**North America**	**Europe**	**Others Countries**	**Total**	**Middle East**	**North America**	**Europe**	**Others Countries**	**Total**
Balances with Banks	408	244	325	2	979	1,959	1,173	1,559	9	4,700
Murabaha and due from Banks	-	-	-	-	-	54,203	-	-	-	54,203
Financing contracts with customers	319,206	1,788	-	10,335	331,329	289,348	1,661	-	9,606	300,615
Investments - Sukuk	-	-	-	-	-	42,148	943	-	7,540	50,631
Receivables	43,649	-	4,672	-	48,321	-	-	-	-	-
Total	**363,263**	**2,032**	**4,997**	**10,337**	**380,629**	**387,658**	**3,777**	**1,559**	**17,155**	**410,149**
Un-funded										
Credit commitments and contingent items	51,054	-	-	-	51,054	-	-	-	-	-
Grand Total	**414,317**	**2,032**	**4,997**	**10,337**	**431,683**	**387,658**	**3,777**	**1,559**	**17,155**	**410,149**

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	-	979	-	-	979	-	4,700	-	-	4,700
Murabaha and due from Banks	-	-	-	-	-	-	54,203	-	-	54,203
Financing contracts with customers	33,145	11,070	220,136	66,978	331,329	30,804	10,288	197,275	62,248	300,615
Investments - Sukuk	-	-	-	-	-	-	9,614	41,017	-	50,631
Receivables	5,572		13,664	29,085	48,321	-	-	-	-	-
Total	**38,717**	**12,049**	**233,800**	**96,063**	**380,629**	**30,804**	**78,805**	**238,292**	**62,248**	**410,149**
Unfunded										
Credit commitments and contingent items	42,054	-	9,000	-	51,054	-	-	-	-	-
Grand Total	**80,771**	**12,049**	**242,800**	**96,063**	**431,683**	**30,804**	**78,805**	**238,292**	**62,248**	**410,149**

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	43%	-
Counterparty # 2	21%	-

Restructured Islamic Financing Contracts:

Total outstanding amount of financing contracts with customers for which financing terms have been renegotiated restructured facilities amounted to BD 332,178 thousand (31 December 2011: BD 316,617 thousand) and these are secured with collateral amounting to BD 610,523 thousand (31 December 2011: BD 585,382 thousand). Outstanding restructured facilities excluding those which are classified as past due and impaired amounted to BD 181,414 thousand (31 December 2011: BD 240,008 thousand) and these are secured with collateral amounting to BD 276,810 thousand (31 December 2011: BD 292,284 thousand). For restructured facilities amounting to BD 143,596 (31 December 2011: BD 99,078) either six months or more have elapsed since the date of restructuring and the customers have made regular payments on a timely basis or the deals have been settled. 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 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

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES						
Residual Contractual Maturity Breakdown (PD-1.3.23(g))						
Portfolios	**Self-Financed**					
	Maturity Breakdown					
	Up to 3 Months	**3-12 Months**	**1-5 Years**	**5-10 Years**	**10-20 Years**	**Over 20 Years**
Balances with Banks	489	-	-	-	-	490
Murabaha and due from Banks	-	-	-	-	-	-
Financing contracts with customers	37,141	44,616	182,636	40,656	25,279	1,001
Investments - Sukuk	-	-	-	-	-	-
Receivables	13,422	126	34,773	-	-	-
Total	**51,052**	**44,742**	**217,409**	**40,656**	**25,279**	**1,491**
Credit commitments and contingent items *	-	-	9,000	-	-	-
Grand Total	**51,052**	**44,742**	**226,409**	**40,656**	**25,279**	**1,491**

* The Bank expects an amount of BD 42,054 thousand as cash (in and out) flows to occur in bucket 3-12 months.

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**
Balances with Banks	2,350	-	-	-	-	2,350
Murabaha and due from Banks	54,203	-	-	-	-	-
Financing contracts with customers	27,206	41,464	169,736	37,784	23,494	931
Investments - Sukuk	3,770	-	46,861	-	-	-
Receivables	-	-	-	-	-	-
Total	**87,529**	**41,464**	**216,597**	**37,784**	**23,494**	**3,281**
Credit commitments and contingent items	-	-	-	-	-	-
Grand Total	**87,529**	**41,464**	**216,597**	**37,784**	**23,494**	**3,281**

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

Amount in BD '000

CREDIT RISK: QUANTITATIVE DISCLOSURES

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

					Self-Financed								
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	33,145	23,838	2,584	5,005	1,718	-	1,718	-	-	-	-	-	*
Banking and financial institutions	11,070	7,961	863	1,671	575	-	575	-	-	-	-	-	*
Construction & real estate	220,136	160,528	16,550	32,051	11,007	-	11,007	-	-	-	-	-	*
Others	66,978	48,170	5,222	10,113	3,473	-	3,473	-	1,672	1,326	-	2,998	*
Total	**331,329**	**240,497**	**25,219**	**48,840**	**16,773**	-	**16,773**	-	**1,672**	**1,326**	-	**2,998**	**-**

* This amounts to BD 7,868 thousands representing collective impairment against total exposures (self-financed and URIA financed) which, although not specifically identified, have a greater risk of default then when originally granted.

Past due finances are stated net of specific impairment.

Amount in BD '000

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	30,804	22,359	2,345	4,541	1,559	-	1,559	-	-	-	-	-	*
Banking and financial institutions	10,288	7,467	783	1,517	521	-	521	-	-	-	-	-	*
Construction & real estate	197,275	143,193	15,016	29,080	9,986	-	9,986	-	-	-	-	-	*
Others	62,248	45,183	4,738	9,176	3,151	-	3,151	-	1,036	2,550	-	3,586	*
Total	**300,615**	**218,202**	**22,882**	**44,314**	**15,217**	-	**15,217**	-	**1,036**	**2,550**	-	**3,586**	**-**

* This amounts to BD 7,868 thousands representing collective impairment against total exposures (self-financed and URIA financed) which, although not specifically identified, have a greater risk of default then when originally granted.

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

Amount in BD '000

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	16,890	2,770	*	20,203	3,314	*
Others countries	1,570	228	*	1,878	272	*
Total	**18,460**	**2,998**	-	**22,081**	**3,586**	-

* This amounts to BD 7,868 thousands 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**	**Guarantees**
Murabaha	80,223	-
Ijarah	160,978	-
Total	**241,201**	-

* 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))							
				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**	**Real Estate**	**Total**
Murabaha	370,366	-	370,366	4,200	-	76,023	80,223
Ijarah	252,655	-	252,655	29	-	160,949	160,978
Musharakah	8,923	-	8,923	-	-	-	-
Total	**631,944**	-	**631,944**	**4,229**	-	**236,972**	**241,201**

* 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."

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.

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 2012 is BD 34,523 thousand (31 December 2011: BD 34,426 thousand). Net assets of the Group's foreign subsidiary, located in United Kingdom, as at 30 June 2012 is BD 15,680 thousand (31 December 2011: BD 15,298 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 interim condensed consolidated financial statements. The impact of foreign currency translation is recognised in the statement of comprehensive income and will be routed to interim consolidated 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	459	5,281	-	-	-
Maximum value	459	5,875	-	-	-
Minimum value	270	5,281	-	-	-

This disclosure is based on the figures from the PIRI for the quarter ended 30 June 2012.

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

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)	65,096
Amount of non-Shari'a-compliant income	-
Number of Shari'a violations that were identified and reported during the financial year	-

Material Legal Cases:

Material legal contingencies including pending legal actions are as follows:

- A guarantee was issued by the Bank to a customer and subsequently called up by the latter. The Bank is defending the claim for payment under the guarantee and believes that no payment should be made to the customer.

- An action was filed by the minority shareholders in a subsidiary company against the Bank and the subsidiary's directors appointed by the Bank for alleged mismanagement of the company. The Bank is defending the claim and believes no payment will be required.

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

Moreover, the Bank did not pay any penalty to the CBB during the period.

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.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the interim condensed consolidated financial statements. Except for a few public equities, the remaining investments are intended to be for long term holdings.

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	470,302	470,388	2,462	467,840
Managed funds	8,846	8,749	-	8,846
Total	**479,148**	**479,137**	**2,462**	**476,686**

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

** This includes publically listed equities classified as 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	308
Unlisted	170,526
Managed Funds	1,659
Total	**172,493**

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 losses arising from sales or liquidations in the reporting period	(1,177)
Total unrealised losses recognised in statement of other comprehensive income	(812)
Unrealised gross gains included in Tier One Capital	20,306
Unrealised gains included in Tier Two Capital	-

2.5 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 (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 debt capital markets.. 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 Bank has started allocating past due and impaired facilities to the Joint Pool of assets used for the calculation of URIA financed assets.

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 since last year.

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 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 rate of return payable to URIA holders is decided by ALCO, keeping in view the rate of return earned on pool of assets. A number of factors are considered while deciding 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 2012 and 31 December 2011 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

Amount in BD '000

UNRESTRICTED INVESTMENT ACCOUNTS:			
Unrestricted Investment Account (PD-1.3.33 (a), (e) &(g))			
	Amount	**Financing to Total URIA %**	**Ratio of Profit Distributed**
Savings URIA	42,596	10%	8%
Term URIA	400,318	90%	92%
Total	**442,914**	**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	2.01%
Average profit earned on average URIA assets	2.14%

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	4,870	296	6.08%

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	24,133	5.45%
Murabaha and due from banks	54,203	12.24%
Investments - Sukuk	63,963	14.44%
Murabaha	164,757	37.20%
Ijarah Muntahia Bittamleek	135,858	30.67%
Total	**442,914**	**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 %**
Claims on sovereigns	33,898	7.65%
Claims on banks	65,747	14.84%
Claims on corporate	55,657	12.57%
Regulatory retail portfolio	16,348	3.69%
Mortgage	228,686	51.63%
Past due facilities	18,495	4.18%
Holding of real estate	15,822	3.57%
Others	8,261	1.87%
Total	**442,914**	**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	2.02%	2.02%	0.13%

Table – 25. Range of Declared Rate of Return

Amount in BD '000

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	2.00% - 2.40%	2.35% - 2.90%	2.50% - 3.15%	3.00% - 3.65%
USD denominated	1.94% - 1.99%	2.26% - 2.32%	2.42% - 2.49%	2.58% - 2.66%

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 2012**	**Net Movement During the Period**	**Closing Actual Allocation as at 30 June 2012**
Cash and Balance with banks and CBB	24,698	(565)	24,133
Murabaha and due from banks	102,212	(48,009)	54,203
Investments – Sukuk	62,078	1,885	63,963
Murabaha due from customers	142,607	22,150	164,757
Ijarah Muntahia Bittamleek due from customers	113,693	22,165	135,858
Total	**445,288**	**(2,374)**	**442,914**

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**
Cash items	-	-
Claims on sovereign	-	-
Claims on MDBs	-	-
Claims on banks	15,647	587
Claims on corporate	27,446	1,029
Regulatory retail portfolio	12,261	460
Mortgages	88,840	3,332
Past due facilities	19,859	745
Claims in holdings of Real Estate	19,241	11,950
Other assets	3,880	146
Total	**187,174**	**18,249**

*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.

The total Risk Weighted Assets financed by Unrestricted Investment Accounts above are as per Prudential Information Report (PIRI). The difference pertains to the consolidation adjustment.

Table – 28. 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)**	**Percentage returns to shareholders**
June 2012	455,108	4,870	2.14%	4,574	2.01%	0.13%
2011	491,680	14,966	3.04%	12,918	2.63%	0.41%
2010	480,308	19,104	3.97%	13,804	2.87%	1.10%
2009	503,207	25,045	4.98%	20,817	4.14%	0.84%
2008	211,917	10,862	5.13%	9,865	4.66%	0.47%

* 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 the Bank waived its mudarib share resulting in higher return paid to URIA holders by 86.25% (2011: 57%)

Table – 29. Administrative 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	3,719

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

Amount in BD '000

RESTRICTED INVESTMENT ACCOUNTS:						
Restricted Investment Account (PD-1.3.35 (a) & (b))						
	June 2012	**2011**	**2010**	**2009**	**2008**	**2007**
Return to RIA holders	2,094	5,459	5,440	4,191	3,852	2,122

Table – 31. 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	64,459

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	7.87%

* 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	21.28%

Table – 34. 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	63,545	98.58%
Ijarah Muntahia Bittamleek	914	1.42%
Total	**64,459**	**100.00%**

Table – 35. 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	64,459	100.00%

Table – 36. 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	63,545	2,628	2,070	558
Ijarah Muntahia Bittamleek	914	32	24	8
Total	**64,459**	**2,660**	**2,094**	**566**

Table – 37. Average 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	4.70% - 5.70%	5.20% - 7.50%

Table – 38. 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	63,545	42,002
Ijarah Muntahia Bittamleek	914	-
Total	**64,459**	**42,002**

Table – 39. 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))					
	*** RIA Funds (Average)**	**Profit Earned**	**** Profit Earned as a Percentage of Average RIA Funds**	**Profit Paid**	**** Profit Paid as a Percentage of Average RIA Funds**
June 2012	53,187	2,660	10.00%	2,094	7.87%
2011	78,109	6,051	7.75%	5,459	6.99%
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.
** Profit earned and profit paid are based on average RIA funds.

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 2012	16.9%
During the period:	
Average	17.8%
Highest	19.9%
Lowest	16.9%

Table – 41. Maturity Analysis

Amount in BD '000

LIQUIDITY RISK: QUANTITATIVE DISCLOSURE								
Maturity Analysis by Different Maturity Buckets. (PD-1.3.38)								
	Upon One Year			**Over One Year**				
	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**	**Total**
Assets								
Cash and balances with banks and Central Bank of Bahrain	16,105	5,911	22,016	6,746	3,906	11,740	22,392	44,408
Murabaha due from banks	54,203	-	54,203	-	-	-	-	54,203
Financing contracts with customers	56,478	86,080	142,558	352,372	78,440	50,706	481,518	624,076
Investments	13,159	3,530	16,689	78,049	190,827	-	268,876	285,565
Investment in associates	-	-	-	122,691	-	-	122,691	122,691
Investment properties	-	-	-	25,000	118,183	-	143,183	143,183
Receivables, prepayments and other assets	16,404	126	16,530	123,102	-	-	123,102	139,632
Goodwill and intangibles	-	-	-	23,637	3,992	-	27,629	27,629
Premises and equipment	-	-	-	-	46,321	-	46,321	46,321
Total	**156,349**	**95,647**	**251,996**	**731,597**	**441,669**	**62,446**	**1,235,712**	**1,487,708**
Liabilities and Unrestricted Investment Accounts								
Customers' current accounts	24,730	5,783	30,513	13,654	13,654	13,654	40,962	71,475
Murabaha and due to banks	39,963	40,279	80,242	122,033	-	-	122,033	202,275
Murabaha and due to non-banks	64,241	36,566	100,807	130,440	16,269	16,269	162,978	263,785
Other liabilities	8,726	2,522	11,248	19,553	-	-	19,553	30,801
Unrestricted investment accounts	125,088	112,101	237,189	68,575	68,575	68,575	205,725	442,914
Subordinated murabaha payable	-	-	-	99,663	-	-	99,663	99,663
Total	**262,748**	**197,251**	**459,999**	**453,918**	**98,498**	**98,498**	**650,914**	**1,110,913**
Net	**(106,399)**	**(101,604)**	**(208,003)**	**277,679**	**343,171**	**(36,052)**	**584,798**	**376,795**

All RIA related cash flows are tenor matched, hence, not included above. Total RIA amounts to BD 64,459 thousand as of 30 June 2012.

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

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 Period**
Murabaha due from banks	54,203	200	542
Financing contracts with customers	408,533	200	4,085
Investments – Sukuk	17,102	200	171
Liabilities			
Murabaha and due to Banks	202,275	200	(2,023)
Murabaha contracts with non-banks	238,384	200	(2,384)
Subordinated Murabaha payable	99,663	200	(997)
Unrestricted investments accounts	442,914	200	(4,429)

2.9 Financial Performance and Position

Table – 43. Ratios

Financial Performance and Position					
(PD-1.3.9(b))					
Quantitative Indicator	**June 2012**	**2011**	**2010**	**2009**	**2008**
Return on average equity	2%	2%	2%	1%	15%
Return on average assets	0.6%	0.4%	0.5%	0.2%	4%
Cost to net operating income ratio	53%	52%	56%	44%	26%

Formula is as follows:
ROAE = Net Income/average equity
ROAA= Net profit/ average assets
Cost to net operating income ratio= (Operating expenses less provisions) / Total operating income