RISK AND CAPITAL MANAGEMENT

BASEL II - PILLAR III DISCLOSURES

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1 Executive summary

Gulf Finance House BSC ("GFH/ the Bank") was incorporated in 1999 in the Kingdom of Bahrain under Commercial Registration No. 44136. The Bank operates as an Islamic Wholesale Investment Bank under a license granted by the Central Bank of Bahrain ("CBB"). The Bank's activities are regulated by the CBB and supervised by a Shari'a Supervisory Board whose role is defined in the Bank's Memorandum and Articles of Association. The principal activities of the Bank include investment advisory services and investment transactions which comply with Islamic rules and principles.

These semi-annual disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-3.1.6: *Additional Requirements for Semi Annual Disclosures*, CBB Rule Book, Volume II for Islamic Banks. These semi-annual quantitative disclosure requirements follow the requirements of Basel II - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks. These disclosures should be read in conjunction with the detailed Risk and Capital Management Disclosures made in Bank's Annual Report for the year ended 31 December 2011 and the condensed consolidated interim financial information for the six months ended 30 June 2012.

Basel II Framework

CBB has issued Basel II guidelines for the implementation of Basel II capital adequacy framework for the banks incorporated in the Kingdom of Bahrain.

The Basel II framework provides a risk based approach for calculation of regulatory capital and strengthens the risk management practices across the financial institutions.

The Basel II framework is based on three pillars as follows:

- **Pillar I** defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by the bank's own regulatory funds.

- **Pillar II** addresses a bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory Review and Evaluation Process (SREP), which assesses the internal capital adequacy.

- **Pillar III** complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

2 Group Structure

The condensed consolidated interim financial information comprise the financial statements of the Bank and its subsidiaries (together referred to as the "Group") as at and for the six months ended 30 June 2012.

The principal subsidiaries and associates as at 30 June 2012 and their treatment for consolidated capital adequacy purposes are as follows:

Entity name	Domicile	Investment classification as per Prudential Consolidation and Deduction ("PCD")	Regulatory treatment as per PCD
Subsidiaries			
GFH Sukuk Limited	Cayman Islands	Financial entity	Fully consolidated
Legends Development Company LLC ("Legends")	UAE	Significant commercial entity	Risk weighting of investment exposure
Hawafiz BSC (c)	Bahrain	Commercial entity	Risk weighting of investment exposure
G Capital Limited (formerly known as Injazat Capital Limited)	UAE	Financial entity	Fully consolidated
KHCB Asset Company	Cayman Islands	Financial entity	Fully consolidated
Harbour East 3 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour North 1 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour North 2a Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour North 2b Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour North 3 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour Row 1 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour Row 2 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour Row 3 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure
Harbour Row 4 Real Estate S.P.C.	Bahrain	Commercial entities	Risk weighting of investment exposure

Entity name	**Domicile**	**Investment classification as per Prudential Consolidation and Deduction ("PCD")**	**Regulatory treatment as per PCD**
Associates			
Khaleeji Commercial Bank BSC ("KHCB")	Bahrain	Significant financial entity	Pro-rata consolidated
Injazat Technology Fund BSC (c)	Bahrain	Commercial entity	Risk weighted
Al Barakah Takaful	Jordan	Insurance entity	Risk weighted
Cemena Investment Company	Cayman Islands	Commercial entity	Risk weighted

The investments in subsidiaries and associates are subject to large exposure and connected counterparty limits and guidelines set by the CBB. These guidelines are considered for transfer of funds or regulatory capital within the Group.

There are no restrictions for transfer of capital.

3 Capital structure and capital adequacy ratio

The Bank's regulator CBB sets and monitors capital requirements for the bank as a whole (i.e. at a consolidated level). The Bank is required to comply with the provisions of the revised Capital Adequacy Module of the CBB (which is based on the Basel II and IFSB framework) in respect of regulatory capital. The PD Module requires disclosure of the Bank's exposure to risks on its banking and trading book. As the Bank does not have a trading book, all its disclosures are limited to the risks faced on its banking book. The Bank has adopted the Standardised Approach for Credit Risk and Market Risk and follows the Basic Indicator Approach for Operational Risk to determine its capital requirements.

As at 30 June 2012, the Bank's total risk weighted assets amounted to US$ 1,868,840 thousand, Tier 1 regulatory capital amounted to 322,221 thousand and total regulatory capital amounted to US$ 327,975 thousand. Accordingly, the Group's Capital Adequacy Ratio as at 30 June 2012 stood at 17.55%. This ratio is after considering the various dispensations obtained from the regulator for basis of measurement of capital base and computation of Risk Weighted Assets. The Bank is in constant discussion with its regulator in relation to its capital position and its plan to improve its regulatory capital ratio.

The Bank's regulatory capital position at 30 June 2012 was as follows:

USD 000's

	Tier 1	Tier 2	Total
Share capital	473,462	-	473,462
Treasury shares	(2,716)	-	(2,716)
Share premium	86,155	-	86,155
Statutory reserve	65,592	-	65,592
Other reserves	1,035	-	1,035
Accumulated losses brought forward	(301,307)	-	(301,307)
Current interim profits	-	5,744	5,744
Unrealized gains arising from fair valuing equities (45% only)			
Investments fair value reserve	-	-	-
Profit equalization reserves	-	6	6
Investment risk reserves	-	4	4
Tier 1 and Tier 2 capital before general deductions	**322,221**	**5,754**	**327,975**
Excess amount over maximum permitted large exposure limit	-	-	-
Investment in insurance entity greater than or equal to 20%	-	-	-
Total eligible capital base	**322,221**	**5,754**	**327,975**

USD 000's

Risk weighted exposures	**Risk weighted exposure**	**Capital requirement @ 12%**
Credit risk weighted exposures	1,682,295	201,875
Market risk weighted exposures	85,430	10,252
Operational risk weighted exposures	101,115	12,134
Tier 1 and Tier 2 capital base	**1,868,840**	**224,261**

Tier 1 Capital Adequacy ratio	**17.24%**
Total Capital Adequacy ratio	**17.55%**

The Bank's paid up capital consists only of ordinary shares which have proportionate voting rights.

4 Credit risk

4.1 Capital requirements for credit risk

To assess its capital adequacy requirements for credit risk in accordance with the CBB requirements, the Bank adopts the standardized approach. According to the standardized approach, on and off balance sheet credit exposures are assigned to various defined categories based on the type of counterparty or underlying exposure. The main relevant categories are claims on banks, claims on investment firms, investment in equities, holdings in real estate, claims on corporate portfolio and other assets. Risk Weighted Assets (RWAs) are calculated based on prescribed risk weights by CBB relevant to the standard categories and counterparty's external credit ratings, where available.

Rating of exposures and risk weighting

As the Bank is not engaged in granting credit facilities in its normal course of business, it does not use a detailed internal credit "grading" model. The use of external rating agencies is limited to assigning of risk weights for placements with financial institutions. The Bank uses ratings by Standards & Poors Moody's, Fitch and Capital Intelligence to derive risk weights for the purpose of capital adequacy computations. However, preferential risk weight of 20% is used which is applicable to short term claims on locally incorporated banks where the original maturity of these claims are three months or less and these claims are in Bahraini Dinar or US Dollar. The other exposures are primarily classified as 'unrated exposure' for the purposes of capital adequacy computations.

As per CBB guidelines, 100% of the RWA's financed by owners' equity (i.e. self financed) are included for the purpose of capital adequacy computations whereas only 30% of the RWA's financed by equity of investment account holders [EIAH] are required to be included.

The investment in associate for a significant financial entity has been prorata consolidated for regulatory capital adequacy purposes.

Following is the analysis for credit risk as computed for regulatory capital adequacy purposes: *USD 000's*

Asset categories for credit risk	Gross credit exposures	Average risk weights	Total credit risk weighted exposure
Self financed assets			
Cash items	2,635	0%	-
Total claims on sovereigns	1,173	0%	-
Standard Risk Weights for Claims on Banks	1,411	50%	705
Preferential Risk Weight for Claims on Locally Incorporated Banks	2,721	20%	544
Short-term Claims on Banks	736	20%	147
Claims on Corporates including Takaful Companies and Category 3 Investment Firms	168,176	100%	168,176
Mortgage	18,116	75%	13,587
Past Due Facilities	99,604	138%	137,213
Investments in Securities and Sukuk	143,644	149%	214,696
Holding of Real Estate	505,028	198%	1,001,691
Others Assets	98,320	100%	98,320
Total self financed assets (A)	**1,041,564**	**157%**	**1,635,079**
Total regulatory capital required (A x 12%)			**196,209**
Financed by EIAH			
Cash items	2,318	0%	-
Total claims on sovereigns	22,323	0%	-
Standard Risk Weights for Claims on Banks	19,304	21%	4,047
Preferential Risk Weight for Claims on Locally Incorporated Banks	52,690	20%	10,538
Claims on Corporates	134,068	100%	134,068
Investments in Securities	5,821	150%	8,732
Total financed by EIAH (B)	**236,525**	**67%**	**157,385**
Considered for credit risk (C) = (B x 30%)			**47,216**
Total regulatory capital required (C x 12%)		**12%**	**5,666**
TOTAL RISK WEIGHTED EXPOSURE			**1,682,295**
TOTAL REGULATORY CAPITAL REQUIRED			**201,875**

4.2 Quantitative information on credit risk

4.2.1 Gross and average credit exposure

The following are gross credit risk exposures considered for Capital Adequacy Ratio calculations of the Bank classified as per disclosure in the condensed consolidated interim financial information:

USD 000's

Balance sheet items	Self Finance exposure	Financed by EIAH	Total Funded exposure	Unfunded exposure	Total gross credit exposure	Average gross credit exposure*
Cash and bank balances	3,514	2,318	5,832	-	5,832	6,128
Investment in associates	-	-	231,258	-	231,258	230,839
Investment securities	-	-	186,633	613	187,246	189,971
Investment property	-	-	259,404	-	259,404	259,404
Other assets	-	-	136,680	82,636	219,316	123,086
Total credit exposure	**3,514**	**2,318**	**819,807**	**83,249**	**903,056**	**809,428**

* Average gross credit exposures have been calculated based on the average of balances outstanding on a quarterly basis for six months period ended 30 June 2012.. Assets funded by EIAH are geographically classified in GCC countries, and are placed with Banks and financial institutions having maturity profile of up to3 months.

4.2.2 Credit exposure by geography

The classification of credit exposure by geography, based on the location of the counterparty, was as follows: *USD 000's*

	GCC countries	MENA	Asia	UK	Europe (excluding UK)	USA	Total
Assets							
Cash and bank balances	5,124	3		-	29	676	5,832
Investment in associates	231,258	-	-	-	-	-	231,258
Investment securities	100,745	47,865	36,392	-	1,631	-	186,633
Investment property	259,404	-	-	-	-	-	259,404
Other assets	78,460	29,129	29,091	-	-	-	136,680
Total	**674,991**	**76,997**	**65,483**	**-**	**1,660**	**676**	**819,807**
Off-Balance sheet							
Commitments	82,636	613	-	-	-	-	83,249
Restricted investment accounts	2,321	-	-	-	27,967	-	30,288

4.2.3 Credit exposure by industry

The classification of credit exposure by industry was as follows: *USD 000's*

	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
Assets						
Cash and bank balances	-	5,821	-	-	11	5,832
Investment in associates	68,864	162,394	-	-	-	231,258
Investment securities	-	6,937	173,174	3,750	2,772	186,633
Investment property	-	-	259,404	-	-	259,404
Other assets	17	26,728	102,329	-	7,606	136,680
	68,881	**201,880**	**534,907**	**3,750**	**10,389**	**819,807**
Off-Balance sheet items						
Commitments	-	-	83,249	-	-	83,249
Restricted investment accounts	-	-	30,288	-	-	30,288

4.2.4 Exposure by maturity

The maturity profile of exposures based on maturity was as follows: *USD 000's*

	Up to 3 months	3 to 6 months	6 months-1 year	1 to 3 years	Over 3 years	No stated maturity	Total
Assets							
Cash and bank balances	5,779	-	-	-	53		5,832
Investment in associates	-	-	-	-	231,258		231,258
Investment property	-	-	-	-	-	259,404	259,404
Investment securities	-	-	-	186,633	-	-	186,633
Other assets	22,500	-	-	110,729	510	2,941	136,680
Total assets	**28,279**	**-**	**-**	**297,362**	**231,821**	**262,345**	**819,807**
Off-Balance sheet items							
Commitments	-	-	-	83,249	-		83,249
Restricted investment accounts	-	-	-	30,288	-		30,288

The table above shows the maturity profile of the Group's assets and unrecognized commitments on the basis of their contractual maturity, here available. For other items, (including past due receivables), the maturity profile is on the basis of their expected realization.

4.2.5 Exposures in excess of regulatory limits

The following exposure (funded and unfunded) were in excess of 15% of the regulatory capital base as at 30 June 2012:

Non-financial institutions	**% of capital base**	**Exposure (US$ 000's)**
Counterparty A	25.62%	84,029
Counterparty B	21.00%	68,863
Counterparty C	17.16%	56,277
Counterparty D	15.57%	51,062

The Bank has agreed with the CBB a single exposure limit based on the Bank's capital base on exposures to individual or a group of closely related counterparties. As per the prudential rules prior approval of the CBB is required for assuming such exposure, except in cases of certain categories of exposure which are exempted by CBB. In case of non-exempt exposures, a deduction from capital is required for the amount in excess of the single exposure limits.

The Bank did not have any large exposures that would be subject to regulatory approvals

4.2.6 Impaired facilities and past due exposures

As the Bank is not engaged in granting credit facilities in its normal course of business, it does not use a detailed internal credit "grading" model. The current risk assessment process classifies credit exposures into two broad categories "Unimpaired" and "Impaired", reflecting risk of default and the availability of collateral or other credit risk mitigation. Currently, the Bank does not have any exposures that are collateralized. The Bank does not perform a collective assessment of impairment for its credit exposures as the credit characteristics of each exposure is considered to be different. Credit and investment exposures are subject to regular reviews by the Investment units and Risk Management Department. Quarterly updates on the investments / facilities are prepared by the investment unit reviewed by the management and sent to the Board for review.

Movement in impairment provisions during the period:

US$ 000's

30 June 2012	**Financing receivables**	**Financing to projects**	**Receivable from investment banking services**	**Other receivables**
At 1 January	70,150	77,382	147,186	74,311
Charge for the period	-	-	-	-
At 30 June	**70,150**	**77,382**	**147,186**	**74,311**

Analysis of past due and impaired and past due but not impaired receivables:

US$ 000's

As at 30 June 2012	**Past due but not impaired amounts ***	**Gross impaired amounts**
Up to 3 months	-	-
Over 3 months to 1 year	-	-
1 to 3 years	58,304	322,281
Over 3 years	-	5,748
Total	**58,304**	**328,029**

* The Bank believes that the past due exposures are not impaired on the basis of the assessment of the level of future expected cash flows from the counterparty and / or the stage of collection of amounts owed to the Bank.

Geographical concentration of impaired and past due receivables:

US$ 000's

As at 30 June 2012	**Past due but not impaired amounts**	**Gross impaired amounts**	**Specific impairment allowance**
GCC Countries	257	130,845	86,959
Other MENA	28,948	41,826	41,826
Other Asia	29,099	83,603	83,606
Europe	-	71,755	71,756
Total	**58,304**	**328,029**	**284,147**

Industry/sector wise breakdown of impaired and past due receivables:

US$ 000's

As at 30 June 2012	**Past due but not impaired amounts**	**Gross impaired amounts**	**Specific impairment allowance**
Development Infrastructure	58,304	326,656	282,774
Banks and financial institution	-	1,339	1,339
Others	-	34	34
Total	**58,304**	**328.029**	**284,147**

4.2.7 Credit risk mitigation

The credit risk exposures faced by the Bank are primarily in respect of its own short term liquidity related to placements with other financial institutions, and in respect of investment related funding made to its project vehicles. The funding made to the project vehicles are based on the assessment of the underlying value of the assets and the expected streams of cash flows. Since these exposures arise in the ordinary course of the Bank's investment banking activities and are with the project vehicles promoted by the Bank, they are generally transacted without any collateral or other credit risk mitigants.

4.2.8 Related party and intra-group transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties include entities over which the Group exercises significant influence, major shareholders, directors and executive management of the Group.

The Bank has entered into business transactions with such counterparties in the normal course of its business. For the purpose of identification of related parties the Bank follows the guidelines issued by Central Bank of Bahrain and definitions as per FAS issued by AAOIFI. Detailed break up of related parties transactions and exposures as at and for the six months period ended 30 June 2012 are as follows:

US$ 000's

30 June 2012	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
Assets					
Cash and bank balances	2,735	-	-	-	2,735
Placements with financial and other institutions	-	-	-	-	-
Financing receivables	-	-	-	-	-
Investment in associates	231,258	-	-	-	231,258
Investment securities	4,722	-	41,632	118,801	165,155
Other assets	-	-	-	80,316	80,316
Liabilities					
Investors' funds	7	-	-	27,030	27,037
Other Liabilities	-	-	-	35,000	35,000

US$ 000's

30 June 2012	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
Income					
Management and other fees	88	-		1,522	1,610
Income from placements with financial and other institutions	-	-	-	-	-
Share of losses from investment in associates	812	-	-	-	812
Income from investment securities	(56)	-	-	-	(56)
Expenses					
Staff cost	-	454	-	-	454
Commitments					
Commitment to extend finance	-	-	-	83,249	83,249

4.2.9 Exposure to highly leveraged and other high risk counterparties

The Bank has no exposure to highly leveraged and other high risk counterparties as per definition provided in the CBB rule book PD 1.3.24.

4.2.10 Renegotiated facilities

As at 30 June 2012, other assets which are neither past due nor impaired include certain short–term financing to projects amounting to US$ 62,950 thousand which were renegotiated during the period. In certain cases, on a need basis, the Bank supports its project vehicles by providing short-term liquidity facilities. These facilities are provided based on assessment of cash flow requirements of the projects and the projects ability to repay the financing amounts based on its operating cash flows. The assessment is independently reviewed by the management of the Bank. Although no specific collateral is provided, such exposures are usually adequately covered by the value of the underlying project asset cash flows. The terms of the renegotiation primarily include extension of the repayment period. The facilities are provided for as viewed necessary based on periodic impairment assessments.

4.2.11 Equity investments held in banking book

The Bank does not have a trading book and hence all of its equity investments are classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. The Bank's equity investments in the banking book include fair value through equity investments, significant and majority investments in commercial entities and associate investments.

The Bank's equity investments are predominantly in its own projects, which include venture capital, private equity and development infrastructure investment products. The intent of such investments is a later stage exit along with the investors principally by means of sell outs at the project level or through initial public offerings. The Bank also has a strategic financial institutions investment portfolio which is aligned with the long term investment objectives of the Bank.

Information on equity investments(including associates)	US$ 000's
Privately held	245,917
Quoted in an active market	163,931
Managed funds	8,043
Realised gain/ (loss) during the year	-
Unrealised gain/(loss) in equity	-

The following are the categories under which equity investments are included in the capital adequacy computations as per the requirements of the CBB rules:

US$ 000's

	Gross exposure*	**Risk weight**	**Risk weighted exposure**	**Capital charge @12%**
Equity investments - Listed	1,539	100%	1,539	185
Equity investments - Unlisted	137,505	150%	206,258	24,751
Investments in funds	4,600	150%	6,900	828
Total	**143,644**		**214,697**	**25,764**

*Includes amounts of risk weighted assets arising from pro rata consolidation of certain investments.

5 Market risk

To assess its capital adequacy requirements for market risk in accordance with the CBB capital adequacy module for Islamic Banks, the Bank adopts the standardised approach. Foreign exchange risk charge is computed based on 8% of overall net open foreign currency position of the Bank.

US$ 000's

	30 June 2012	**Maximum during the period**	**Minimum during the period**
Foreign exchange risk - A	6,834	6,849	6,834
Risk weighted assets - B= (A*12.5)	85,430	-	-
Capital requirement – (B*12%)	10,252	-	-

6 Operational risk

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the approach agreed with the CBB. The bank's average gross income for the last two financial years is multiplied by a fixed coefficient alpha of 15% set by CBB and a multiple of 12.5x is used to arrive at the risk weighted assets that are subject to capital charge.

US$ 000's

	Average gross income	**Risk weighted assets**	**Capital charge at 12%**
Operational risk	53,928	101,115	12,134

Contingencies

The Group has contingent claims arising from the decision to not proceed with a project development agreement. The Group is currently negotiating with the counter party for an amicable settlement. While liability is not admitted, if defence against the action is unsuccessful, the claim and associated costs could amount to approximately US$ 36 million. The management do not expect any significant liability to arise on final closure.

The Bank has an in-house legal counsel who is consulted on all major legal and related activities conducted by the Bank. All contracts, documents, etc have to be reviewed by the legal department as well. The Group was not involved in any significant litigation as at 30 June 2012.

7 Other types of risk

7.1 Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The Bank's approach to managing liquidity is to ensure, that it will always have sufficient funds to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation.

The following are the key liquidity ratios which reflect the liquidity position of the Bank.

Liquidity ratios	**30 June 2012**	**Maximum**	**Minimum**
Liquid assets : Total assets	0.71%	0.80%	0.71%
Liquid assets : Total deposits	3.74%	4.00%	3.74%
Illiquid assets : Total assets	99.29%	99.29%	99.20%

The maturity profile of the Bank's financial liabilities is as follows:

USD'000's

	Up to 3 months	**3 to 6 months**	**6 months- 1 year**	**1 to 3 years**	**Over 3 years**	**Carrying amount**
Investors' funds	27,088	-	-	-	-	27,088
Placements from financial and other institutions	11,122	-	29,685	87,871	-	128,678
Financing liabilities	37,849	-	-	74,721	138,991	251,561
Other liabilities	36,038	-	-	46,159	-	82,197
Total liabilities	**112,097**	**-**	**29,685**	**208,751**	**138,991**	**489,524**
Unrestricted investment accounts	2,318	-	-	-	-	**2,318**

As at 30 June 2012, the Group's current contractual obligations exceeded its liquid assets. The ability of the Group to meet its obligations when due depends on its ability to achieve a timely disposal of assets (refer note 2 in the condensed consolidated interim financial information). The Group is currently in discussions with its lenders to restructure and extend the tenure of a substantial potion of its obligations. The Group is under negotiations to restructure the terms of Murabaha financing facility of US$ 100 million. As per the current terms the financing is repayable in August 2013 (extendable by 1 year provided 25% of the facility is repaid in 2012) and carries a profit rate of 2.50% over the benchmark rate (LIBOR) payable semi annually and an additional profit mark up of 1.25% payable at maturity. The Group was able to renegotiate the Wakala financing facility during the six months period and as per the revised terms the balance is repayable over a period of six years till April 2018 at an greed profit rate of 8% (refer note 7 in the condensed consolidated interim financial information). The Group also obtained approval of the Sukuk holders to restructure the facility to 2018. The Group is in the process of finalising the documentation of the restructuring. The revised terms include the extension of the tenure for a period of 6 years with periodic repayment starting July 2014, with final installment in July 2018. The revised profit rate would be LIBOR plus a margin with a minimum rate of 5% and the differential between the profit rate and the minimum rate being payable at the maturity date.

Also to improve its liquidity positions the Group is in the process of issuing additional capital through the issue of convertible murabaha.

7.2 Management of profit rate risk in the banking book

Profit rate risk is the potential impact of the mismatch between the rate of return on assets and the expected rate of return of the sources of funding. Majority of the Bank's profit based asset and liabilities are short-term in nature, except for certain long term liabilities which have been utilised to fund the Bank's strategic investments in its associates.

US$'000's

30 June 2012	**Up to 3 months**	**3 to 6 months**	**6 months - 1 year**	**1 to 3 years**	**Over 3 years**	**Total**
Assets						
Placements with financial and other institutions	-	-	-	-	-	-
Financing receivables	-	-	-	-	-	-
Total assets	**-**	**-**	**-**	**-**	**-**	**-**
Liabilities						
Investors' funds	-	-	27,088	-	-	27,088
Placements from financial and other institutions	11,122	-	29,685	87,871	-	128,678
Financing liabilities	37,849	-	-	74,721	138,991	251,561
Total liabilities	**48,971**	**-**	**56,773**	**162,592**	**138,991**	**407,327**
Equity of investment account holders	**2,318**	**-**	**-**	**-**	**-**	**2,318**
Profit rate sensitivity gap	**(51,289)**	**-**	**(56,773)**	**(162,592)**	**(138,991)**	**(409,645)**

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel fall or rise in all yield curves worldwide. An analysis of the Group's sensitivity to an increase or decrease in market profit rates for a 200bps increase / (decrease) is as below: (assuming no asymmetrical movement in yield curves and a constant balance sheet position)

US$ 000's

200 bps parallel increase / (decrease)	**2012**
At 30 June 2012	± 8,192
Average for the period	± 8,615
Maximum for the period	± 9,038
Minimum for the period	± 8,192

7.3 Concentration risk

This risk arises from exposure to a common set of factors that can produce losses large enough to threaten the Bank's health or ability to maintain its core business. Concentration risk can arise from exposure to specific classes of assets, sector, country, revenue streams, counterparty, a group of counterparties, etc. Concentration risk is mitigated by limits, diversification by assets, geography counterparty quality etc. As part of ICAAP, thresholds for exposure concentrations will be set up which will trigger additional capital requirements. The geographical and sector concentration of credit exposures has been disclosed in paragraphs 4.2.2 and 4.2.3.

7.4 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. In addition to the identified credit risk exposures the Bank's counterparty credit risk from markets as such is limited to the fair value of contracts of foreign exchange risk management instruments the overall exposure to which is usually not significant. For other credit market transactions (primarily inter-bank placements), the Bank has established a limit structure based on the credit quality (assessed based on external rating) of each counter party bank to avoid concentration of risks for counterparty, sector and geography. The Bank is constantly reviewing and monitoring the position to ensure proper adherence to the limits and defined policies of the Bank.

7.5 Reputational risk (non-performance risk)

Reputation risk is the risk that negative perception regarding the Bank's business practices or internal controls, whether true or not, will cause a decline in the Bank's investor base, lead to costly litigation that could have an adverse impact on liquidity or capital of the Bank. Being an Islamic Investment Bank, reputation is an important asset and among the issues that could affect the Bank's reputation is the inability to exit from investments, lower than expected returns on investments and poor communication to investors. A well developed and coherently implemented communication strategy helps the Bank to mitigate reputational risks. Additionally, the RMD has recently put together an Internal Capital Adequacy Assessment Process (ICAAP) Policy to effectively assess and measure all non Pillar 1 risks.

7.6 Displaced commercial risk

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 liabilities, when the return on assets is under performing as compared with competitor's rates. The Bank's DCR primarily arises from the funds accepted in the form of Equity of Investment Account Holders (EIAH) which is currently not very significant in terms of its size and in comparison to the overall activities of the Bank. The returns to investors on the funds are based on returns earned from short-term placements and hence the Bank is not exposed to a significant repricing risk or maturity mismatch risk in relation to these accounts. In relation to the DCR that may arise from its investment banking and restricted investment account products, the risk is considered limited as the Bank does not have any obligation to provide fixed or determinable returns to its investors. The Bank constantly monitors all potential risks that may arise from all such activities as part of its reputational risk management.

7.7 Other risks

Other risks include strategic, fiduciary risks, regulation risks etc. which are inherent in all business activities and are not easily measurable or quantifiable. However, the Bank has proper policies and procedure to mitigate and monitor these risks. The Bank's Board is overall responsible for approving and reviewing the risk strategies and significant amendments to the risk policies. The Bank senior management is responsible for implementing the risk strategy approved by the Board to identify, measure, monitor and control the risks faced by the Bank. The Bank as a matter of policy regularly reviews and monitors financial and marketing strategies, business performance, new legal and regulatory developments and its potential impact on the Bank's business activities and practices.

8 Product disclosures

8.1 Equity of Investment Account Holders (EIAH)

The Bank does not have significant amount under EIAH and does not use EIAH as a main source of its funding. The Bank does not, as a focused product proposition, offer EIAH products to its clients. The current EIAH deposits have been accepted on a case-by-case basis considering the Bank's relationship with its customers.

Currently, the Bank comingles the EIAH funds with its funds for investments only into interbank placements and hence is not subject to any significant profit re-pricing or maturity mismatch risks. The Bank has an element of displaced commercial risk on EIAH which is mitigated by setting up and maintaining an appropriate level of Profit Equalisation Reserve (PER) and Investment Risk Reserve (IRR) to smoothen return to EIAH holders.

Profit Equalisation reserve (PER) is created by allocations from gross income of the Mudarabah before adjusting the Mudarib (Bank) share. Investment Risk Reserves (IRR) comprises amounts appropriated out of the income of investment account holders after deduction of the Mudarib share of income. Administrative expenses incurred for management of the funds are borne directly by the Bank and are not charged separately to investment accounts. All terms of the EIAH are agreed upfront with the customers and form part of the agreement with the customer. Till date, the Bank has not made any withdrawals on PER or IRR. Any movements on these accounts are therefore only on account of additional reserves added.

The historical returns data on EIAH is as follows:

US$ 000's

	30 June 2012	31 December 2011	31 December 2010
Total EIAH as at 30 June / 31 December	2,318	1,898	1,880
Average EIAH balance	5,669	3,720	3,948
Average rate of return earned (%)	0.45%	0.78%	0.63%
Total profits on EIAH assets earned	25	29	25
Distributed to investor	15	19	17
Allocated to IRR	4	3	2
Allocated to PER	6	5	4
Bank's share of profits	1.2	2	1
Average declared rate of return (%)	0.26%	0.51%	0.44%

The information disclosed above pertains to EIAH managed by the Bank and does not include the historical return data of similar products of its subsidiaries which are no longer consolidated in 2008 due to sale of controlling interests.

8.2 Restricted investment accounts

The Bank offers Restricted Investment Accounts ("RIAs") to both financial institutions and high net worth individuals in the GCC. All RIA product offering documents ("Offering Document") are drafted and issued with input from the Bank's Investment Banking, Shari'a, Financial Control, Legal and Risk Management Departments to ensure that the Investors have sufficient information to make an informed decision after considering all relevant risk factors. The Bank has guidelines for the development, management and risk mitigation of its' RIA investments and for establishment of sound management and internal control systems to ensure that the interests of the investment account holders are protected at all times.

Wherever it is necessary for the Bank establishes Special Purpose Vehicles (SPVs) for management of the investment. The Bank has a Board approved SPV Governance framework in place to equip the Board in ensuring that the management of such SPVs are conducted in a professional and transparent manner.

The Bank is aware of its fiduciary responsibilities in management of the RIA investments and has clear policies on discharge of these responsibilities. The Bank considers the following in discharge of its fiduciary responsibilities:

- Ensuring that the investment structure, Offering Documents and the investment itself are fully compliant with Islamic Shari'a principles and the CBB regulations;

- Appropriately highlighting to the Investors, as part of the RIA Offering Document, of all the relevant and known risk factors and making it clear that the investment risk is to be borne by the Investor before accepting the investment funds;

- Completing all necessary legal and financial due diligence on investments undertaken on behalf of the Investors with the same level of rigor as the Bank requires for its' own investments;

- Ensuring that the funds are invested strictly in accordance with the provisions outlined in the Offering Documents;

- Preparing and disseminating periodical investment updates to Investors on a regular basis during the tenor of the investment;

- Distributing the capital and profits to the Investor in accordance with the terms of the offering document; and

- In all matters related to the RIA, RIA SPV(s) and the investment, act with the same level of care, good faith and diligence as the Bank would apply in managing its own investments.

Within the Bank, the abovementioned responsibilities and functions are provided, managed and monitored by qualified and experienced professionals from the Investment Banking, Shari'a, Financial Control, Legal, Investment Administration and the Risk Management Departments.

The restricted investment accounts primarily represents the investments in the projects promoted by the Bank and managed on a portfolio basis on behalf of investors.

Company	Cumulative distributions %	Half yearly distribution for six months ended 30 June 2012	Annual Distributions				
			2011	2010	2009	2008	2007
Mena Real Estate Company KSCC	29.05%	-	-	-	-	-	31.13%
Gulf Holding Company	1.67%	-	-	-	9.41%	-	-
Gulf North Africa Holding Company KSCC	4.13%	-	-	-	10.12%	7.55%	-
Gulf Real Estate Development Company	3.40%	-	-	-	9.57%	6.76%	-
Pan European Fund	3.25%	-	-	-	-	5.36%	10.48%
Al Hareth French Property Fund	4.91%	-	NA	NA	NA	NA	4.91%

NA – Not applicable

The information disclosed above pertains to RIA managed by the Bank and does not include the historical return data of similar products of its subsidiaries which are no longer consolidated in 2008 due to sale of controlling interests.

The annual distributions represents the percentage of return based on the distributions made during each year and the opening balances of the investments.

The cumulative distribution represents the cumulative return based on distributions made during the investment period and the average opening balances of the investments.

9 Financial performance and position

Following are basic quantitative indicators of the financial performance:

	2012 (6 months)	2011 (12 months)	2010 (12 months)	2009 (12months)	2008 (12 months)	2007 (12months)
Return on average equity	1.75%	0.16%	-127.15%	-104.40%	31.62%	43.96%
Return on average assets	0.68%	0.04%	-25.62%	-28.41%	10.19%	18.16%
Cost-to-Income-Ratio*	72.19%	79.20%	-	490.56%	35.91%	32.32%

* Cost has been considered excluding impairment allowances. Income is net of finance expense.