



Annual Report 2011



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Gulf Finance House (GFH) Profile

Since its foundation in 1999, Gulf Finance House (GFH) has established itself as one of the world's most innovative Islamic investment banks. For more than a decade now, GFH has been unlocking value in some of the world's most dynamic emerging economies. Its strategy is based on identifying and delivering investment opportunities in the Islamic financial services and infrastructure sectors of the Middle East, The Levant, North Africa and Asia. This has seen GFH raise funding of more than US\$5 billion to invest in Islamic financial institutions and infrastructure projects harnessing the enormous potential offered by the region's dynamic economies.

What sets GFH apart is its long track record and specialization in creating new financial institutions and the conception of high value economic infrastructure projects.

GFH has established some of the region's leading financial institutions including First Energy Bank, the world's first Islamic investment bank focused exclusively on the energy sector. Other financial institutions founded by GFH include Khaleeji Commercial Bank in Bahrain, QInvest in Qatar, Arab Finance House in Lebanon, First Leasing Bank in Bahrain and Asia Finance Bank in Malaysia.

Flagship infrastructure projects include GFH's Financial Harbours in the Kingdom of Bahrain and Tunisia, Energy Cities in Qatar, Libya and India, which are complemented by as well as innovative lifestyle developments such as the Royal Ranches of Marrakech in Morocco. GFH also led the conception and delivery of Jordan's biggest commercial infrastructure project, the Jordan Gate in Amman.

GFH's ordinary shares are listed on the Bahrain Stock Exchange, the Kuwait Stock Exchange and the Dubai Financial Market. Since 2007, its GDRs have been listed on the London Stock Exchange.

GFH's innovation in Islamic finance has been recognized consistently by the industry, with GFH receiving numerous awards including Euromoney's Best Islamic Investment Bank 2005, Best Investment Bank 2005, 2006 and 2007 from Banker Middle East and Deal of the Year 2008 from Banker Middle East.



Previous Board of Directors

Esam Yousif Janahi

*Executive Chairman (A member since July 2004)
Executive Director*

One of the main founding members of Gulf Finance House (GFH), Mr. Janahi successfully led the organization as Chief Executive and Board Member until he was elected Chairman in 2007. With 23 years of banking experience, Mr. Janahi has been instrumental in the strong growth and success of the bank and continues to play a key and active role in driving the business forward.

As Executive Chairman, Mr. Janahi sets the strategic direction for the long term and advises on operational matters for the short and medium term. He also governs the Board and ensures effective communication with shareholders as part of his responsibilities. He was appointed as Executive Chairman on 15 August 2010.

Mr. Janahi holds a number of directorship including: Chairman of Energy City Qatar, Chairman of Vision 3 and board member of Abu Dhabi Investment House.

As for his educational background, Mr. Janahi holds a Master's Degree in Business Administration from Hull University in the UK and a Bachelor's Degree in Industrial Management (with Honors) from the University of Petroleum and Minerals in the Kingdom of Saudi Arabia.

Hamad A. Aziz Al Shaya

*Vice Chairman (A member since October 1999)
Non-Executive Director*

Mr. Al Shaya represents Abdul Latif Al Shaya's and Abdul Aziz Al Shaya's stake in GFH. He is the Chairman and Managing Director of the Al Shaya Group, one of the leading retail commercial groups in the Middle East.

With over 38 years of experience, Mr. Al Shaya is currently the Chairman of Injazzat Real Estate Development Company in Kuwait and a board member of QInvest in Qatar.

Mr. Al Shaya holds a Bachelor's Degree in Business Administration from San Francisco State University, USA.

Dr. A. Aziz Mohammed Al Hinai

*(A member since 2009)
Non-Executive Director*

Dr. Al Hinai is the Vice President of Islamic Development Bank, which he represents on the Board since 2009. Dr. Al Hinai is also a member of several leading banking bodies in Oman and across the region, such as the Banking and Investment Committee at the Omani Chamber of Commerce and Industry, Agriculture and Fisheries Fund, Omani Economic Association, and Inter-Arab Investment Guarantee Corporation.

He brings to the board 22 years of experience and holds two Master's Degrees in Banking and Economics from American University and Claremont Graduate University, an undergraduate degree in Economics and Finance from New Hampshire College, USA this is in addition to his Ph.D. in Economics and Public Policy.

Abdullah Ali Al Hamli

*(A member since March 2009)
Non-Executive Director*

Mr. Al Hamli is the CEO of Dubai Islamic Bank (DIB), which he represents on the Board. Prior to his appointment as CEO he held the position of IT Director in 1999.

Previous to moving to DIB, Mr. Al Hamli was Executive Director of IT and member of the Supreme Council for Dubai Ports and Free Zone.

Mr. Al Hamli has 23 years of professional experience and holds a Bachelor's Degree in Mathematics and Economics with honors from UAE University.

A.Latif Abdulla Al Meer
(A member since March 2003)
Independent Director

Mr. Al Meer is representing Qatar Islamic Bank's stake in GFH and is the Managing Director of QInvest. He previously was the Business Group Assistant General Manager at Qatar Islamic Bank.

He also holds a number of directorships at several companies and financial institutions.

Mr. Al Meer holds a PhD in International Business Administration from the University of Nova, Florida and has over 35 years of experience in the finance industry.

Adel Dawood Al Ohali
(A member since October 2003)
Non-Executive Director

Mr. Al Ohali is currently the CEO and Managing Director of Al Ohali Holding in Saudi Arabia, a leading regional company specializing in finance, real estate and auto motors.

He is a board member of several regional investment and financial institutions, including Gulf Real Estate Development Co., MENA Real estate Co. and Capital Holding Co. He represents his own investments in GFH and has over 31 years' experience.

Mr. Al Ohali holds a Diploma in Commerce from the Commercial Studies College in Kuwait and represents Al Ohali Group on the Board.

Anthony Travis
(A member of since March 2009)
Independent Director

Mr. Travis is a private consultant specializing in providing expert advice and information on strategic risk management and corporate governance. Until his retirement from PWC in 2005, Mr. Travis was a Swiss federal auditor.

He is a former Chairman of the British-Swiss Chamber of Commerce in Geneva, and co-founder of the Family Business Network in Lausanne, where he was a board member from 1989 to 2004.

He also served as a board member or advisory board member in several renowned organizations, such as L'Observatoire de la Finance, Forum Suisse de la Politique Internationale, the International Peace Building Alliance and OMCT, and acted as the technical consultant on risk management issues to the Islamic Financial Services Board in Kuala Lumpur, among others.

Bader Naser Al Subaiee
(A member since March 2009)
Independent Director (Resigned on 6 May 2010)

Mr. Al Subaiee joined Kuwait Investment Company (KIC) in 2000 as Chairman & Managing Director. Prior to this he served at the Kuwait Investment Authority (KIA) from 1993 to 2000, his last position there being General Manager, Operations.

Mr. Al Subaiee enjoys a wealth of experience spanning 29 years and is currently the Board Member of the Kuwait Clearing Company, Union of Investment Companies, Kuwait; Vice Chairman of Ithra Capital, Saudi Arabia; Chairman of Instrata Capital, Bahrain and Member of the Advisory Committee for Kuwaiti Shareholders' Companies, organized by the Kuwait Foundation for the Advancement of Science.

Mr. Al Subaiee graduated from Cairo University, Egypt, in 1980 with a Degree in Accounting, and went on to receive his MBA in Finance from American International College in Massachusetts, USA in 1983. He was awarded his CPA license from Kuwait in 1989.

Mohammed Ebrahim Mohammed
(A Member since March 2009)
Non-Executive Director

Mr. Mohammed is the CEO of Bahrain Islamic Bank, having joined in 2007 as GM of Retail Banking. Prior to this, he spent 9 years as CEO of CrediMax, a fully owned subsidiary of Bank of Bahrain and Kuwait (BBK), after spending 8 years at the bank itself.

Besides representing BISB on the Board of GFH, he also sits on the Board of Abbad Real Estate Company and Bahrain Association of Banks.

With 21 years of experience he holds an Executive Management Diploma from University of Bahrain and Master's Degree in Business Administration from the University of Glamorgan in Wales.

He is also a graduate of the Gulf Executive Development Program from the University of Virginia in the USA, and General Management Program from Harvard Business School.

Mosabah Saif Al Mutairy
(A Member since March 2009)
Non-Executive Director

Mr. Mutairy has 16 years of experience in the areas of investment, finance, and accounting and is currently Royal Guard of Oman Accounts Manager and Pension Fund Acting Manager.

Mr. Al Mutairy is a member of several boards including member of the Investment Committee of Royal Guard of Oman Pension Fund, a member of the Board of Directors at Hotels Management Co. Int and Dhofar Power Company.

He is also a member of the Investment Committee in GCC Fund of National Fund, India Entertainment City and Mena Resident. He holds a Masters in Financial Affairs, from the UK.

Yousuf Mohammed Khayat
(A member since October 1999)
Independent Director

Mr. Khayat represents the Saudi Economic Development Company (SEDCO)'s stake in GFH as their First Deputy Chairman and Managing Director.

Mr. Khayat is a board member of several investment and financial companies, including Al Fanar Investment Holding in Holland.

He has over 26 years of experience in the finance industry and holds a Bachelor's and Master's Degrees in Business Economics from the University of California, Santa Barbara in addition to attending various high level seminars and training programs, including the Columbia University Executive Education program.

P.S.

Some of the Board members were replaced by new members in May 2011



Current Board of Directors



Esam Yousif Janahi
Executive Chairman
Executive Director

One of the main founding members of Gulf Finance House (GFH), Mr. Janahi successfully led the organization as Chief Executive and Board Member until he was elected Chairman in 2007. With 24 years of banking experience, Mr. Janahi has been instrumental in the strong growth and success of the bank and continues to play a key and active role in driving the business forward.

As Executive Chairman, Mr. Janahi sets the strategic direction for the long term and advises on operational matters for the short and medium term. He also governs the Board and ensures effective communication with shareholders as part of his responsibilities.

He was appointed as Executive Chairman on 15 August 2010. Mr. Janahi holds a number of directorships including: Chairman of Energy City Qatar, Chairman of Vision 3 and board member of Abu Dhabi Investment House.

As for his educational background, Mr. Janahi holds a Master's Degree in Business Administration from Hull University in the UK and a Bachelor's Degree in Industrial Management (with Honors) from the University of Petroleum and Minerals in the Kingdom of Saudi Arabia.



Ahmed Al-Mutawa
Vice Chairman
Independent

Dr. Ahmed Al-Mutawa, Deputy Chairman of Gulf Finance House, brings almost 33 years of financial and economic experience to the bank. With numerous papers appearing in international publications and journals, he is an established and respected researcher and economics academic.

Dr. Al-Mutawa currently serves as the Chief Executive Officer of Khalifa Fund for Enterprise Development, and he has a wealth of experience in advising and consulting. He has served as a board member in some of the region's largest and most reputable universities and organizations, namely Majid Al Futtaim Properties, Abu Dhabi Basic Industries Company (ADBIC), and Dubai University College among others.

He began his career as a teaching assistant at the UAE University, and went on to become a well-known professor and director at the University. He has also spoken and presented at a number of key finance and economics conferences throughout the region.

Dr. Al-Mutawa holds a PhD in Economics from Georgetown University, Washington DC, and a Masters degree in Economics from the University of North Carolina, USA. He also holds a Bachelors degree in Economics from Cairo University in Egypt.



Azzam Al Felaj
Member
Independent

Mr. Azzam Al Felaj holds 22 years of experience in the banking industry which he brings to the Gulf Finance house where he is serving as a member, through his work with a number of financial institutions mainly the Kuwait Finance House.

Mr. Al Felaj currently a Member the Board for a number of different companies including of Al Safa investment, Al Mabani Wel Ta'meer and Heavy Engineering and Ship building. Mr. Azzam also owns a number of companies which include; The Year two Thousand trading and contracting establishment, the glass dome Décor and Contracting, American Touch Furniture, Azzam Al Felaj Real estate establishment.

Additionally, Mr. Al Felaj is the General Manager of both Abdulaziz Al Felaj trade and contracting and Bu Bayan fishing Company.

Mr. Azzam holds a Bachelors degree in Business Administration from the Grand View College (U.S.).



Mosabah Al-Mutairy
Member
Non-Executive Director

Mr. Mosabah Al-Mutairy, Board Member of Gulf Finance House, brings extensive financial expertise amassed throughout his 16 -year career in the fields of investment, finance, and accounting.

He is currently a member of several boards across different organizations including the Investment Committee of Royal Guard of Oman Pension Fund, in which he plays a pivotal role in managing funds. He is also a member of the Board of Directors at the Hotels Management Co. Int and Dhofar Power Company and a member of India Entertainment City and Mena Resident among others.

Mr. Al-Mutairy currently holds a Master of Business Administration (Finance) from the University Of Humberside & Lincolnshire and a Bachelors degree in Accounting from South West London College in the UK. In addition, he holds several internationally recognized accounting qualifications.



Naif Al-Ali
Member
Independent

Mr. Naif Al-Ali brings over 11 years of experience to Gulf Finance House where he has joined as a Board Member.

He also serves as a Non-Executive Board Member of Abdulla A. M. Al Khodari Sons Company since 2008 one of Saudi Arabia's leading construction companies where he also served as Project Site Supervisor from 2000 until 2007.

He holds a Bachelor's Degree in Business Management from the San Joaquin Delta College in Stockton, California, USA.



Said Al Malki
Member
Executive Director

Mr. Said Al Malki brings over 20 years of financial experience to Gulf Finance House where he serves as a Board Member. He is also a Board Member of the Oman Housing Bank Board and the Royal Guard of Oman Pension Fund Board.

Currently the Director of Purchasing at The Royal Guard of Oman, Mr. Al Malki has served in this position for almost 17 years where he amassed in-depth financial expertise. Mr. Al Malki has played a leading role in several financial deals and transitions, namely the transition of Al Burj Trading & Consumers LLC to EMKE Group in addition to contributing to the overall financial success of the company.

He has also previously held positions in leading organizations such as Al Burj Trading & Consumers LLC and Souq Technia LLC.

Mr. Al Malki holds a Master of Business Administration (MBA) and a Diploma of Advance Studies in Business Administration from the University of Salford in England.



Abdullah Ali Al Hamli
Member
Non-Executive Director

Mr. Abdullah Al Hamli brings 21 years of experience to Gulf Finance House where he serves on the Board of Directors as a Board Member.

Mr. Al Hamli is also a Board Member and the Chief Executive Officer of Dubai Islamic Bank (DIB), where he began his career as a manager in the Bank's Information Systems department, and then as a Senior Executive Vice President in the Bank's Business Services department.

During this period, he was also a member of a number of DIB committees, including the Senior Management Committee, the Credit and Risk Committee, the Assets and Liabilities Committee.

Additionally, Mr. Al Hamli was regularly invited to sit in on the Board of Director's meetings and acted as Dubai Islamic Bank's representative to the Development Investment Company. In 2008, Mr. Al Hamli was selected to be DIB's Chief Executive Officer, and following that in 2011, he was selected as a Member of the Board of Directors.

Mr. Al Hamli holds a Masters degree in Economics and Mathematics (Hons) from Dubai University.

Mr. Al Hamli has resigned from the board on 23 December 2011.



Shaikh Abdulla bin Sulaiman Al-Manie

Chairman

Consultant to His Majesty the Custodian of the Two Holy Mosques with the rank of Minister, member of Grand Scholars Panel, Kingdom of Saudi Arabia and an expert of the Islamic Fiqh Academy.

He is also a retired judge of the Supreme Court in Makkah Al-Mukarramah in the Kingdom of Saudi Arabia, and a member of the Sharia'a supervisory boards of a number of Islamic banks and financial institutions.

Shaikh Nedham Mohammed Saleh Yaquby

Executive Member

Sh. Nedham holds a number of memberships on different sharia'a board of different institutions such as: executive member of Abu Dhabi Islamic Bank, member of Bahrain Islamic Bank, Shamil Bank, a board member of the Dow Jones Islamic Index and a member of a number of other leading Islamic banks.

Dr. Fareed Mohammed Hadi

Executive Member and Secretary of the Board

Dr. Hadi is Assistant Professor at the College of Arts in the Department of Arabic and Islamic Studies at the University of Bahrain. He holds a PhD in Ibn Hazm's Methodology of Jahala from Edinburgh University and a PhD in Al-Bukhari's Methodology from the University of Mohammed V in Morocco. Dr Hadi is also a member of the Sharia'a supervisory boards of a number of leading Islamic banks.

Dr. Abdulaziz Khalifa Al-Qassar

Member

A Professor at the College of Fiqh and Department of Sharia'a and Islamic Studies at the University of Kuwait, Dr. Al Qassar holds a PhD in law and Sharia'a from Al-Azhar University in Cairo. He is also a member of the Fatwa and Sharia'a supervisory boards of a number of institutions in Kuwait.



Executive Management



Esam Yousif Janahi,
Executive Chairman, Gulf Finance House

Esam Janahi is the Executive Chairman and founder of Gulf Finance House ("GFH"), which he established in 1999. Following its inception, GFH rapidly became one of the Middle East's leading Islamic financial institutions as it led the development of a range of innovative and pioneering investment models and opportunities across the Middle East and North Africa region. For more than a decade now, GFH has been unlocking value in some of the world's most dynamic emerging economies.

Mr. Janahi started his career at Arthur Anderson & Co in 1988 and following a series of senior roles in regional Islamic and Conventional financial institutions, founded GFH. Under his leadership, GFH went on to create some of the region's most innovative financial institutions, such as First Energy Bank, QInvest, Asian Finance Bank, Innovest, Khaleeji Commercial Bank and Arab Finance House. In addition, GFH pursued a strategy of devising and creating a wide range of significant infrastructure projects across the region, designed to support the economic growth of local economies. These projects include: Financial Harbours in the Kingdom of Bahrain and Tunisia, Energy Cities in Qatar, Libya and India, which are complemented by as well as innovative lifestyle developments such as the Royal Ranches of Marrakech in Morocco. Through his conception of Energy Cities, Financial Harbours and associated specialist financial institutions, Mr. Janahi has played a central role in conception of the high value, asset backed Middle Eastern investment opportunities that incubate the economic and socio-economic success stories of the future.

Mr. Janahi's experience of both conventional and Islamic finance in the Middle East has seen him established as a leading figure of the regional financial services industry. His board membership of investment companies across the region has given him a unique insight into the sector and to regional business, which he applies to many of his external commitments such as the Young Arab Leaders and the Clinton Global Initiative.

A much sought-after expert on Islamic economics as well as on the Middle Eastern economy, Mr. Janahi is a regular speaker at global and regional economic forums, and was named the 'Islamic Banker of the Year' in 2003 at the World Islamic Banking Conference in Bahrain.

Mr. Janahi was honored by HH the Prime Minister of Bahrain and by Sheikh Mohammed Bin Rashid Al Maktoum for his contributions of development the region, and was also voted 'The Top CEO in the GCC' and 'The 5th Most Powerful Arab' by the Arabian Business Magazine. He was listed amongst the "Gulf Power 25" by the Times London.

Mr. Janahi holds a Master in Business Administration from Hull University, United Kingdom and a Bachelors degree (Honors) in Industrial Management from the University of Petroleum and Minerals, Kingdom of Saudi Arabia. He also holds numeral directorships such as: Chairman, Vision 3, Chairman, Energy City Qatar, Board member, Abu Dhabi Investment House, Member of Young Arab Leaders (YAL), and Member of the Clinton Global Initiative, Delegate and Co-Chair, World Economic Forum.



Hisham Alrayes
Chief Investment Officer

Gulf Finance House's Chief Investment Officer, Mr. Hisham Alrayes, has extensive experience gained over more than 14 years working in the banking industry, specifically focused on start-up investment projects. He currently heads up GFH's Venture Capital, Private Equity, Real Estate and Asset Management investment practices, in addition to leading the Bank's investment in industrials, financial institutions and natural resources.

Prior to joining GFH, Mr. Alrayes founded and acted as General Manager of Invita B.S.C., a business process outsource (BPO) company where he was recognized for developing the companies investment opportunities through establishing key alliances with leading technology and consultancy providers in the United States and Europe, thereby supporting operations and future company growth. Additionally, he played a significant role in the building of a state-of-art technology centre, as well as the first On-Demand Multi-Channel platform in the region.

As a Chief Investment Officer at GFH Mr. Alrayes is responsible for building, growing and maintaining GFH's investment banking brand internationally and regionally, in addition to identifying investment opportunities, sourcing and negotiating various investment deals and overseeing the execution of due diligence, private placement memorandum development and fund raising processes.

In addition to his current role at GFH, Mr. Alrayes also holds directorships in several companies including Chairman of Cemena Holding Company, Gulf Holding Company and Al Khaleej Fund & Investment Company, Board member Balexico, Naseej, G Capital and a number of other companies.

Mr. Alrayes holds a Bachelors degree with Honours in Electrical / Electronic Engineering from the University of Bahrain and a Masters degree with Honours in Business Administration from the University of De Paul, Chicago, USA.

Mr. Alrayes has assumed the position of Acting CEO of the Bank from April 2012.



Mohammad H. Al Nusuf
Deputy CEO - Placement

Gulf Finance House's Deputy CEO Mr. Mohammed Al-Nusuf boasts a wealth of experience and successful track record spanning 15 years in the structuring of Islamic financial transactions and in the arrangement of syndications between some of the region's largest and most reputable financial institutions.

Since joining in his current role in 2010, Mr. Al-Nusuf has worked closely with GFH's Chairman and Executive Management to formulate and execute the bank's new strategic direction, drawing on his expertise on the structuring of Islamic financial transactions and his close involvement in the arrangement of high-profile syndications between some of the region's biggest financial institutions. This is in addition to directing the Placement team and supervising the Corporate Communications and Treasury activities.

Mr. Al-Nusuf's accumulated knowledge focuses on all aspects of private placement transactions over his career; from originating to structuring and execution, as well as the evaluation of client opportunities and originating innovative concepts and ideas. Along the way, he also acquired a diverse client base of high net worth individuals, family-owned conglomerates, financial institutions and sovereign wealth funds based throughout the GCC and wider MENA region.

During his tenure as GFH's Senior Executive Director responsible for the UAE, Oman, and Yemen markets, Mr. Al-Nusuf spearheaded the growth of liquidity, investment placement business and marketing the bank's products and services in those countries. His efforts resulted in raising in excess of US\$2 billion for the bank.

In addition to his current role within GFH, Mr. Al-Nusuf also oversees the strategic direction of several leading institutions and companies. At present, he serves as the Chairman of Balexico, Tunis Financial Harbor, Royal Ranches Marrakech, and India project.

Mr. Mohammed Al-Nusuf graduated from American University (Washington, DC) in 1996 with a Bachelor of Science (Major in Finance). He also completed several professional courses at BIBF including Islamic Banking, Islamic Structuring and Working Capital Management amongst others.

Mr. Mohammed Al-Nusuf has resigned from the Bank on March 1st 2012.



Dr. Haider Majali
Chief Strategy Officer

Since joining GFH in early 2005 as a Corporate Secretary and General Counsel, Dr. Majali has become the focal point of communication with the Board of Directors, Senior Management and Shareholders in addition to being the advisor to the Chairman, CEO and other Members of Senior Management. He covered different functions in the bank including Board affairs, Sharia'a coordination, managing investments and representing the bank in a number on the board of several companies in multiple countries.

Dr. Haider has 22 years of work experience. Under his recent capacity as Chief Strategy Officer, he assists in planning the overall bank strategy and provides advice on corporate governance principles and practices and ensures GFH's compliance with corporate governance guidelines. In addition, he is responsible for supervising all back office and operational related activities in the bank ensuring that they are functioning with maximum efficiency and productivity. This includes supervising the performance of: Human Resources and Development function, Legal Department, Risk and Compliance, Operations, Finance, Internal Audit, Admin and the Sharia'a Department.

Dr. Majali is also responsible for identifying attractive investment opportunities for GFH clients in the infrastructure and utilities arena. Additionally, he is tasked with maintaining professional awareness of relevant external technical and business developments in the relevant markets, while dealing closely with High Net Worth Individuals, Institutional Investors and Government Bodies.

Dr. Haider Majali has a PhD in International Law and a Masters in International and European law from the University of Aberdeen, Scotland – UK. He also holds a Bachelors of Science (LLB) from Mu'tah University in Jordan.

Furthermore, he attends a number on International Economic Conferences and Exhibitions. i.e International Economic Forum in Davos - Switzerland and the Dead Sea. He also holds a number of directorships including: Board member of Gulf Holding Company, CEMENA Holding Company, Tunis Financial Harbour , Royal Ranches Marrakech , Takaful Al Baraka and General Manager of Legends Development Company - UAE.



Chandan Gupta
Chief Financial Officer

Chandan Gupta was appointed Group Chief Financial Officer of GFH in 2009, where he is responsible for handling the finance, accounting, capital management and treasury functions of the Bank. Previously Mr. Gupta was Executive Director of Origination & Structuring where he co-leads the investment feasibility, due diligence exercise and investment structuring process for various investment projects of the Bank. Mr. Gupta joined the Bank in 2005 in the Financial Control function.

Prior to joining GFH, Mr. Gupta has worked at HSBC, Mumbai as Vice President of Financial Reporting and Price Waterhouse Coopers, Mumbai in the Assurance and Business Advisory Services Division. Mr. Gupta has also worked at KPMG as a Financial Auditor.

Mr. Gupta has 15 years of experience in Audit, Finance and Investment. He is a Certified Public Accountant (CPA) from the American Institute of Certified Public Accountants, a Certified Financial Analyst (CFA) from the Institute of Certified Financial Analysts of India, a Chartered Accountant (CA) from the Institute of Chartered Accountants of India, and holds a Bachelor of Commerce from the University of Mumbai.



Ajay Subramanian
Acting Head of Risk Management

Gulf Finance House's Acting Head of Risk Management, Mr. Ajay Subramanian is a key player as a member of the core group at the bank with a notable track record of 11 years of service in leading multinational banks and Big Four consulting firms, having a wealth of experience in Risk Management, Business Process Improvement and Transition (project) Management.

Despite the challenges of the financial crisis, at the time of his appointment, drawing on his extensive experience, he was instrumental in providing crucial advice on how to minimize and mitigate business risks in the volatile economic environment. As Acting Head of Risk Management he works closely with the Executive Chairman and other members of senior executive management and reports independently to the Board of Directors of GFH.

Mr. Subramanian began his career as Process Manager with JP Morgan Chase based in Singapore and later in Hong Kong and was a part of the key group responsible for migrating core banking processes to India. He then moved to ABN Amro as a lead Financial Analyst and working from the head office in Amsterdam, led multiple off shoring projects from Netherlands and the United Kingdom (UK) to India. Mr. Subramanian also has significant risk consulting experience having worked with two of the Big Four consulting firms advising large multinational banks in India and regional banks in Bahrain.

Mr. Ajay Subramanian is a qualified Chartered Accountant (ACA) from the Institute of Chartered Accountants of India (ICAI) and has graduated from the University of Mumbai, India with a Bachelor of Commerce degree. He also holds an international certification from Global Association of Risk Professionals (GARP).



IN THE NAME OF ALLAH, THE BENEFICIENT, THE MERCIFUL, PRAYERS AND PEACE BE UPON THE LAST APOSTLE AND MESSENGER, OUR PROPHET MOHAMMED.

Dear Shareholders,

On behalf of the Board of Directors, it is my privilege to present the financial statements of Gulf Finance House (GFH) for the financial year ended 31st December 2011.

Despite yet another challenging year for the Middle East and North Africa region underscored by shortfalls in market liquidity and rising political tension throughout the region, the year ended positively for GFH with a return to profitability.

This came as a direct result of strong shareholder support, investor loyalty, a dedicated management team committed to seeing through the significant restructuring and recapitalization plan that was set in motion in 2010 and hardworking employees.

GFH turned a net profit of US\$381 thousand in 2011 compared to a net loss of US\$349 million in 2010, with operating profit before provisions valued at US\$ 9 million compared to a loss of US\$ 93 million in 2010, signalling a restart in GFH income. Additionally, the Bank saw a 37% reduction in operating costs during 2011 as a result of various measures undertaken to help clean up the Bank's balance sheet.

We can now see the positive long-term results of our bold actions as part of the strategy we have put in action early on during the global economic downturn. Our continued adherence to reducing the Bank's liabilities and cleaning up our balance sheet have seen us successfully clear out most of the Bank's remaining debts in 2011.

Additionally, the recapitalization plan we had enacted in 2010 targeting GCC sovereign funds and investors was prioritized, and those targeted with these efforts have shown their trust in GFH as an institution with their continued optimism and support.

Furthermore, 2011 saw promising progress made on a number of key projects and investments, highlighting the Bank's commitment to existing infrastructure projects and achieving successful investor exits from said projects.

To this end, we began the year by signing with the Wadhwa Group in Mumbai, India for the development of the Mumbai Economic Development Zone (MEDZ) project to the next phase of development. This encompasses core infrastructure of the MEDZ, as well as developing the project vertically and aiming for investors' exit.

This was followed by the announcement of Tunis Financial Harbour (TFH) project beginning the prequalification process for prospective contractors, after the Government of Tunisia announced its support of the project with the allocation of TD 50 million for the completion of major and strategic infrastructure work in relation to access and roads to TFH.

The project, which will be a boon for the growing Tunisian financial sector and the country's economy as a whole, includes a variety of quality commercial infrastructure, an array of modern waterfront living and state-of-the-art office space. Additionally, we entered into the Turkish market, which is growing by leaps and bounds with enormous untapped potential, with the successful tender to acquire Adabank through a partnership between G Capital – a GFH subsidiary – and the Turkish Gürmen Group.

This is a significant achievement for us as it opens the doors to further collaboration within the promising Turkish financial sector and demonstrates our seriousness in continuing to add to our impressive track record of creating other financial institutions.

GFH has come through all of the challenges of the past few years, if not unscathed, at least stronger for the experience. Difficult decisions, trying economic conditions, political tension and the loss of investor confidence as a whole in the banking sector has required us to take a very detailed look at our operations and our procedures.

Based on that assessment, we have endeavoured to improve our institution at its most basic level, strengthening our foundations in order to cope with the rapidly changing business environment we now find ourselves in.

We have focused our efforts on realising the value of our existing investment portfolios, making extracting value out of those a priority and identifying unique opportunities in the market to secure consistent sources of income for the Bank and for our shareholders.

Throughout 2012, we are planning to keep up the momentum with our infrastructure projects and sign similar strategic partnership agreements to the one signed for MEDZ with the aim of moving vertically at the earliest time possible.

We also intend to continue the momentum on the creation and acquisition of other financial institutions where opportunities present themselves. As for the markets of focus for 2012, we will keep an eye on the GCC specifically Saudi and Oman for possible opportunities of entry and will keep a look for further opportunities in the booming Turkish market.

As we look forward to 2012, I am confident that, from the position we now find ourselves in, having returned to profitability at the end of 2011 and building upon our strong track record of excellence, we will continue to provide even greater value to our investors and shareholders.

In conclusion, and on behalf of the Board of Directors, I would like to take this opportunity to extend my utmost gratitude and deepest appreciation to the rulers and the government of the Kingdom of Bahrain for their support of Gulf Finance House and our operations through these challenging times.

I would also like to thank the leadership and respective governments of the Kingdom of Saudi Arabia, Kuwait, Oman, Qatar, United Arab Emirates, India, Turkey, Tunisia and Morocco for their strong economic policies and political governance, as well as for their valued relationships and continued contribution to our achievements.

Additionally, I would like to thank the individual regulators in each of these geographies, specifically the Central Bank of Bahrain for their continued support and assistance to the financial sector as a whole.

Last but not least, I would like to sincerely thank all of our valued shareholders, investors and strategic partners for their dedication, loyal support and their trust in GFH over the years, as well as to the Bank's management team and employees for their much appreciated efforts and commitment throughout 2011 and the rough years before it.

We were able, by the Grace of Allah and the efforts of all our stakeholders, to achieve an excellent year for the Bank, returning to profitability and overcoming all the obstacles faced by the industry throughout the year.

We are confident that 2012 will be a better year for us and that we are cut out to better meet any challenges we may face, and maintain – and increase! – Our newly achieved profitability.

Best regards,



Esam Yousif Janahi
Executive Chairman



Business Activities

Development Infrastructure / Real Estate

Gulf Finance House (GFH) has successfully launched a number of key infrastructure development projects across the MENASA region, with a total aggregate estimated development value exceeding US\$20 billion. GFH takes a very unique view in the investment world when approaching these large scale economic infrastructure projects, and this has played an instrumental role in encouraging a paradigm change in the economic landscape of the GCC, North Africa and other parts of the world.

The GFH approach focuses on delving into the details of an investment, following due diligence, conceptualizing the project, securing land for the project, injecting cash into the project to start the ball moving, in addition to developing the primary infrastructure work. These projects, which are by necessity due to their scale and proposed concepts, have been coordinated in partnership with various governments, and aim to contribute positively to the socio-economic development of the countries hosting the Bank's initiatives.

These initiatives include major infrastructure investments such as financial harbours and districts, energy cities, out of town expansions and leisure and entertainment facilities. Some examples of the types of projects GFH has been involved in include:

- Al Areen
- Bahrain Financial Harbour
- Jordan Gate
- Royal Ranches Marrakech
- Energy City Qatar
- GFH Mumbai Economic Development Zone
- Energy City Libya
- Tunis Financial Harbor

Asset Management

GFH prides itself on the level and quality of service that the Bank's Asset Management Department provides to clients interested in Islamic asset management services, and considers it best in class. GFH Asset Management Department focuses on managing monies in through two key strategies to enhance investor's wealth: GCC equities and property investments. Our aim is to ensure that all of our clients' needs, both current and future, are met. This drives our Asset Management team to constantly explore new opportunities and work to provide outstanding investment returns.

GFH's Asset Management Funds include:

- Al Basha'er GCC Equity Fund
- Aqaar Fund

Private Equity / Venture Capital

GFH's Venture Capital (VC) employs a philosophy that combines the opinions of leading industry experts and taps into GFH's extensive network of professional relationships to identify market opportunities and create unique value propositions for our investors.

In accordance with GFH's reputation for innovation, the VC team carefully researches opportunities matching products to specific market needs. A keen example of the diligence that the VC employs in its research of opportunities, and an example of the success that it has enjoyed, was the creation of First Energy Bank (FEB) in February of 2008, the only investment bank of its kind offering intelligent finance specific to the needs of the energy sector clients.

Another such investment was the creation of Cemena, a company focusing on building materials in the GCC and MENA region. This came as a direct response to the serious shortfalls in key building materials as a result of the ongoing construction boom across the MENA region. That cement is among the most prevalent of these building materials is unquestioned, and accordingly, following extensive due diligence in consultation with experienced industry partners, the decision was reached to tap into this niche market.

The VC team has a strong and proven track record already; however, the team is always exploring new options in response to market conditions, aiming to create many more high value investment opportunities that leverage qualified market demand and offer solid returns to investors. Currently, the VC team is focusing its attention on the financial services and technology markets.

Below is a list of investments that have been successfully launched by GFH's VC team:

- Injazat Technology Fund
- Rawaj Holding Company
- The Royal University for Women
- Oman Development Company
- First Energy Bank
- Cemena

Treasury

The Islamic banking treasury sector has become increasingly competitive and sophisticated over the years, with demand fuelled by clients and investors looking for and expecting Islamic products to provide the same features and benefits as conventional investment and hedging products. GFH has a proven track record in catering to this fast growing niche group of Islamic products and their skyrocketing demand, and offers a wide range of sharia'a compliant products that are designed to meet the varying needs clients and investors, all of which are managed by a team of experienced and dedicated personnel. These products include:

- Mudharba
- Wakala
- Commodity Murabaha



5-Year Financial Highlights

| Year | Return On Ave Equity | Return On Ave Assets | Cost to income |
|------|----------------------|----------------------|----------------|
| 2007 | 43.96% | 18.16% | 32.32% |
| 2008 | 31.62% | 10.19% | 35.91% |
| 2009 | -104.04% | -28.41% | 490.56% |
| 2010 | -127.15% | -25.62% | N/A |
| 2011 | 0.16% | 0.04% | 79.20% |

* Cost does not include provision for impairment. Income is net of Finance Expenses

Executive Management Review

Despite forecasts at the beginning of 2011 predicting steady recovery of the global financial markets, the year proved itself to be yet another challenging year for the Middle East and North Africa region. Chief amongst those challenges was shortfalls in market liquidity, rising political tension throughout the region and the subsequent damage to investor confidence in the region because of that political tension. In spite of these challenges, GFH managed to accomplish significant forward momentum on many of its projects, and ended the year positively with a return to profitability.

Financial Review

Back in 2010, GFH enacted a bold and comprehensive recovery plan to solidify the bank's financial and operational standing within the market, and ultimately to return the bank to profitability. The results of this recovery plan can be seen in the financial results of the Bank for 2011, which recorded a net profit of US\$381 thousand for the year, compared to a net loss of US\$349 million in 2010.

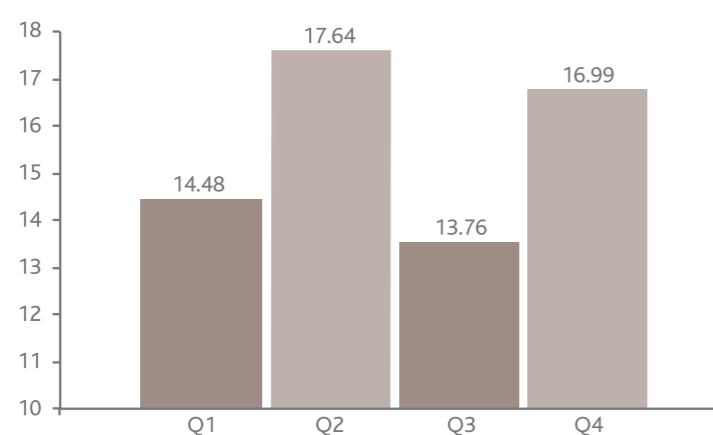
Additionally, 2011 was witness to GFH achieving an operating profit before provisions of US\$ 9 million in 2011, as compared to a loss of US\$ 93 million in 2010, while income from fees amounted to US\$ 7 million for services rendered and US\$ 12 million from dividends and profit on sale of investments. Balance of GFH income primarily constituted of employee incentive reversal from previous years. The Bank also saw a 37% reduction in its operating costs during 2011 as a result of the various measures undertaken as part of the comprehensive recovery plan to restructure the Bank's operations.

GFH has also remained committed to reducing its liabilities and cleaning up its balance sheet since the early days of the financial downturn, and this commitment continued throughout 2011 during which time the Bank successfully cleared much of its debts. To this end, GFH reduced its liabilities by 34% in 2011 to US\$ 590 million in 2011 from US\$ 900 million in 2010, which also led directly to a reduction in finance expenses of 39% during the year.

Furthermore, GFH continued to pursue its recapitalization plan, targeting GCC sovereign funds and investors. These efforts have borne fruitful results to date, with those who have been targeted thus far showing their continued trust in GFH as an institution, leading to the successful increase of GFH's paid up capital from US\$146 million to US\$321 million.

Despite the challenging environment of 2011, GFH focused its efforts on returning to profitability by following the bold and comprehensive recovery plan that was conceived and implemented early on in the global financial crisis. With its redefined operating strategy and re-envisioned business model, and with the continued efforts of GFH's management team and staff, the support of GFH's loyal investor base and the guidance of the Central Bank of Bahrain, GFH will look at a profitable year ahead.

Operational Cost 2011 – US\$ million



GFH Team

In 2010, GFH adapted and streamlined its teams to cope with the continuing market conditions and execute its internal recovery and restructuring plan. This move helped place GFH in a position of strength at the outset of 2011, as the Bank's tried and tested team structure was well suited to meeting and overcoming the challenges faced in 2011. This fact is highlighted by GFH's return to profitability in 2011, a result that was achieved because the right team was in place at GFH to continue delivering powerful results for investors and shareholders throughout the challenging times of 2011.

The New Reality of the Global Financial Industry

Analyst forecasts and projections at the beginning of 2011 predicted slow but steady recovery for most industries and across most geographies, with the effects of the global financial crisis fading slowly as recovery took hold.

These projections were proven sorely mistaken however as social and political unrest swept through the Arab world, stunting growth and stalling the recovery process. Natural disasters in Asia, a worsening debt situation in the European Union and other global factors all contributed their own challenges to the suddenly negative global outlook.

Adapting to the New Reality of the Global Financial Industry

GFH met these challenges head on, both at home in Bahrain and in the global markets it operates in, by focusing on its re-envisioned business model and following through with its redefined operating strategy. In 2011, efforts were focused on completing existing infrastructure projects with the intent of successfully exiting existing investors as amicably and quickly as possible, while at the same time ensuring the project continues its forward momentum.

To this end significant progress was made developing and moving the Mumbai Economic Development Zone project to the next phase with partners Wadhwa Group in Mumbai, India. This was followed by the Tunis Financial Harbour (TFH) project beginning the prequalification process for prospective contractors following an announcement made by the Government of Tunisia in support of the project's external infrastructure work.

Another facet of the redefined operating strategy was to focus on the Bank's strong track record developing financial institutions. This manifested through the undertaking of a deal through the GFH subsidiary: G Capital (formerly known as Injazat Capital) in partnership with the Turkish Gürmen Group. This deal saw G Capital successfully tender to acquire Adabank, representing a foothold in the growing Turkish banking sector and a platform for further cooperation between the GCC and Turkey.

The effort expended re-orientating GFH to the new business model and strategy showed dividends at the close of the year, with GFH successfully reporting a return to profitability. With the right team now in place, and the rightly adapted business model guiding the Bank's direction going forward, continued profits are expected for 2012 and beyond.

2012 & Beyond

GFH will focus its efforts in the coming year and beyond on continuing to meet its obligations as they come due or extend them as necessary, thereby reducing liabilities and improving the Bank's financial position within the market. This is in addition to further aligning GFH's operations with the re-envisioned business model and the redefined operating strategy, ensuring that existing projects are progressed and investors are exited from said projects to their benefit, extracting the utmost value from our unique commercial, industrial and real estate assets portfolio. Additionally, we will pursue the Bank's core strength of creating and acquiring regional financial institutions, thereby building a sustainable recurring income for GFH.

Corporate Governance

for the fiscal year ended 31st December 2011

The Board

Board's Functions

The board consists of 10 members that have been voted for by the shareholders during the AGM held on in May 2011 for a period of 3 years (renewable). Every shareholder that has 10% or more ownership of the capital has the right to appoint a representative by the same percentage of holding.

Board Structure

| Board Member Name & Position | Date of Appointment | Executive/ Non-Executive/ Independent | Representation |
|--|---------------------------|---------------------------------------|---|
| Esam Yousif Janahi (Executive Chairman) | Member since July 2004 | Executive | Self |
| Hamad A.Aziz Al Shaya (Vice Chairman) | Member since October 1999 | Non-Executive | A.Latif Ali Al-Shaya & A.Aziz AL-Shaya |
| Dr. A.Aziz Moh'd Al Hinai (Member) | Member since 2009 | Non-Executive | Islamic Development Bank |
| Abdullah Ali Al Hamli (Member) | Member since March 2009 | Non-Executive | Dubai Islamic Bank |
| A.Latif Abdulla Al Meer (Member) | Member since March 2003 | Non-Executive | Qatar Islamic Bank |
| Adel Dawood Al Ohali (Member) | Member since October 2003 | Non-Executive | Al Ohali Trading Group |
| Anthony Travis (Member) | Member since March 2009 | Independent | None |
| Moh'd Ebrahim Moh'd (Member) | Member since March 2009 | Non-Executive | Bahrain Islamic Bank |
| Mosabah Saif Al Mutairy (Member) | Member since March 2009 | Non-Executive | None |
| Yousuf Moh'd Khayat (Member) | Member since October 1999 | Non-Executive | Saudi Economic & Development Co. Ltd. (SEDCO) |

Board Committees

| Board Nomination, Remuneration and Governance Committee | Board Investment Committee | Board Audit Committee | Board Risk Management Committee |
|--|---|---|---|
| <p>Policies Compensation and Incentives Human Resources Administration Corporate Governance Annual Budget</p> <p>Board Committee Members Hamad A.Aziz Al Shaya <i>(Chairman)</i> A.Latif Abdulla Al Meer <i>(Member)</i> Abdulla Ali Al Hamli <i>(Member)</i> Moh'd Ebrahim Moh'd <i>(Member)</i></p> | <p>Investment and Credit Approval Limits Investment Policies Asset Liability Management</p> <p>Board Committee Members Esam Yousif Janahi <i>(Chairman)</i> Hamad A.Aziz Al Shaya <i>(Vice. Chairman)</i> A.Latif Abdulla Al Meer <i>(Member)</i> Adel Dawood Al Ohali <i>(Member)</i> Moh'd Ebrahim Moh'd <i>(Member)</i> Dr. A.Aziz Moh'd Al Hinai <i>(Member)</i> Bader Naser Al Subaiee* <i>(Member)</i></p> | <p>Internal Controls Financial Reporting Internal Audit Compliance Anti Money Laundering</p> <p>Board Committee Members Anthony Travis <i>(Chairman)</i> Mosabah Saif Al Mutairy <i>(Vice. Chairman)</i> A.Latif Abdulla Al Meer <i>(Member)</i></p> | <p>Risk Policies Risk Management Framework</p> <p>Board Committee Members Yousuf Moh'd Khayat <i>(Chairman)</i> Anthony Travis <i>(Member)</i> Abdulla Ali Al Hamli <i>(Member)</i> Mosabah Saif Al Mutairy* <i>(Member)</i></p> |

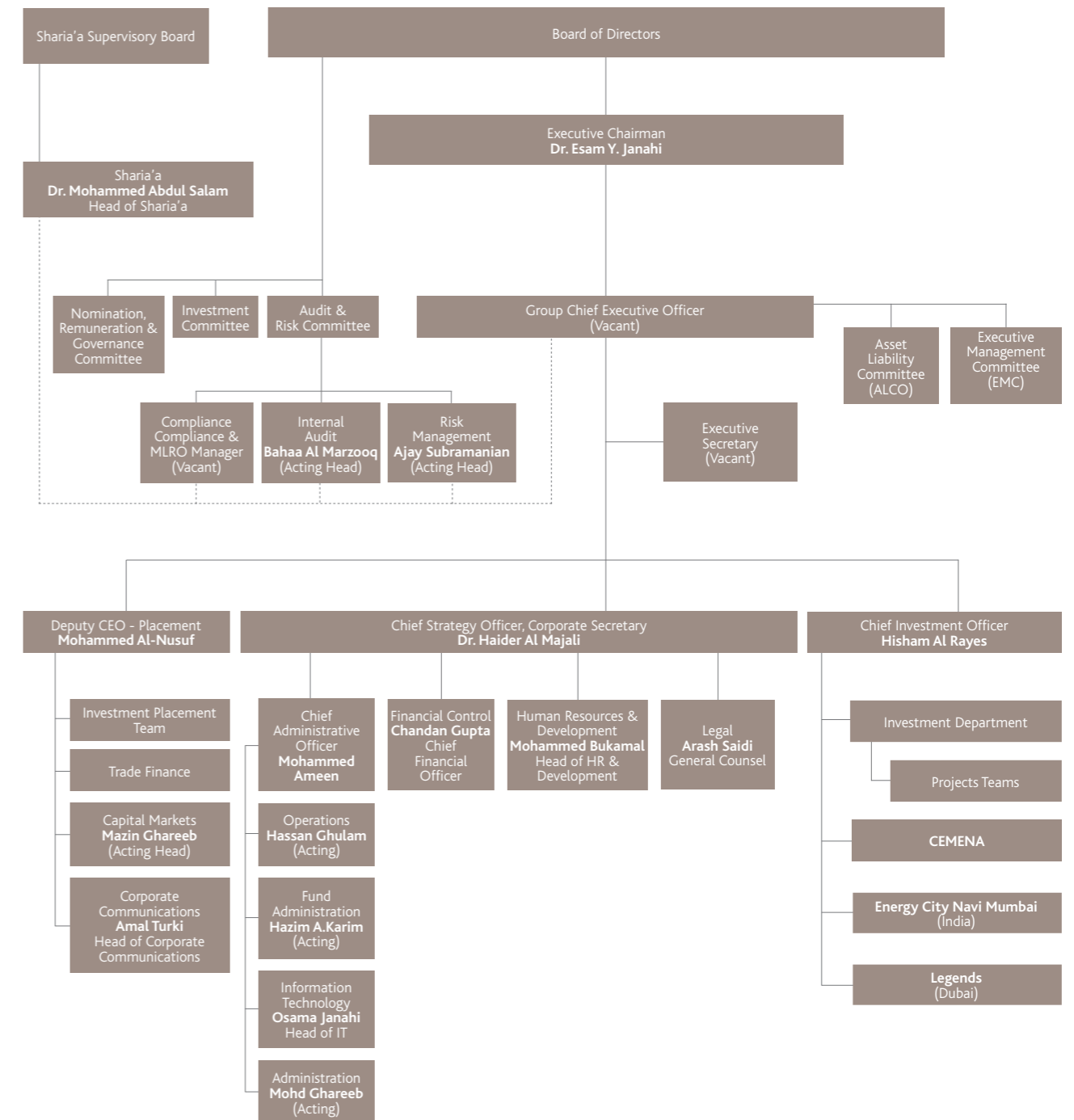
Executive Management

The Board delegates the authority for day-to-day management of the business to the Executive Chairman, who is responsible for long term creation of value for shareholders through financial and non-financial performance. The Executive Chairman recommends and executes the bank's strategy and budget, and uses a highly consultative approach through several general and specific cross functional committees.

Management Committee Table

| | Management Investment and Credit Committee |
|---------------------------|--|
| Committee Chairman | CEO |
| Members | CEO, COO, Heads of Investment, Placement, Operations, Finance and Risk Management |
| Responsibility | <ul style="list-style-type: none"> Review of Investment Exit and Credit Proposals Monitoring of Investments |

Organizational structure



Gulf Finance House is an Islamic investment bank that was established in the Kingdom of Bahrain in 1999. The bank carries on its business activities in accordance with the principles of Islamic Sharia, including financial services, investment and commercial transactions, negotiable financial instruments, real estate, infrastructure, in addition to structured finance, securities and liquidity management designed to achieve profitable returns for investors.

Gulf Finance House was transferred to a Public Shareholding Company in 2004 with its shares being listed on the Bahrain Stock Exchange, Kuwait Stock Exchange and Dubai Financial Market. In 2007, GFH listed its GDR's in the London Stock Exchange.

As a Public Shareholding Company, GFH's corporate governance framework is based on the guidelines of corporate governance of Islamic banks and financial banks and institutions issued under the Bahrain Commercial Companies Law promulgated by Decree No. (21) for the year 2001 ("Companies Law"), and the regulations of corporate governance of companies in the Kingdom of Bahrain ("Governance Regulations"), and the instructions issued by the Central Bank of Bahrain and the Bahrain Stock Exchange Law ("the Regulations").

GFH's Corporate Governance Philosophy

The corporate governance framework – the way in which the Board and management are organized and how they operate in practice – is focused on assisting GFH to successfully meet its strategic objectives and maintain steady growth whilst remaining fully cognisant of our clients' and shareholders' interests.

GFH believes that compliance with corporate governance principles enhances its value through providing a suitable framework for the Board of Directors, board committees and executive management to perform their duties in a manner that serves the interests of the bank and its shareholders. For this reason, GFH strives to achieve the highest levels of transparency, accountability and management by adopting and executing the strategy, goals, policies that are aimed at complying with the Bank's regulatory and supervisory responsibilities.

The Board of Directors is accountable to shareholders for the creation and delivery of strong sustainable financial performance and long-term shareholder value. To achieve this, the Board approves and monitors the Bank's strategy and financial performance, within a framework of sound corporate governance.

The Chairman of the board is responsible for leading the Board, ensuring its effectiveness, monitoring the performance of the CEO and maintaining a dialogue with the bank's stakeholders. The Internal Audit and Risk Management teams in GFH report directly to the Board Audit and Risk Committee.

Compliance with regulations

In 2011, GFH started implementing the regulations of the Corporate Governance Law that became effective from 1st January 2011, in addition to compliance with the HC Module, issued by the Central Bank of Bahrain.

Additionally in 2011, GFH developed a new corporate governance framework in accordance with the principles and recommendations indicated in the corporate governance law and the HC Module issued by the CBB. The new framework included the following:

Board of Directors' Charter, Code of Ethics of Board members, Code of Ethics of management and staff, conflict of interest policy, appointment agreement of board members, mechanism of evaluation of Board of Directors, Board Committees and Board members, in addition to developing and updating all the related policies of the Bank to be in compliance with the new regulations.

As part of the disclosure requirements indicated in HC Module issued by the CBB, GFH presents the following facts:

a. Ownership of shares

a.1. Distribution of shareholdings according to nationality

As at December 2011, the shareholders Register shows that there are 7,239 shareholders who own 1,044,004,808 shares at a nominal value of US\$0.31 per share as follows:

| Nationality | Number of shares | Number of shareholders | Percentage of ownership % |
|--------------|----------------------|------------------------|---------------------------|
| Bahraini | 414,006,294 | 588 | 39.66 |
| Kuwaiti | 484,972,700 | 5,509 | 46.45 |
| Saudi Arabia | 46,337,128 | 136 | 4.44 |
| Others | 98,688,686 | 1,006 | 9.45 |
| Total | 1,044,004,808 | 7,239 | 100 |

a.2. Distribution of ownership according to the percentage of shareholding:

The below table shows the distribution of ownership according to the percentage of shareholding as at 31 December 2011:

| Percentage of ownership % | Number of shares owned | Number of shareholders | Percentage of ownership of the total number % |
|---------------------------|------------------------|------------------------|---|
| Less than 1% | 495,254,254 | 7,228 | 47.44 |
| 1% - less than 5% | 265,655,611 | 9 | 18.14 |
| 5% - less than 10% | - | - | - |
| 10% - less than 20% | 283,094,943 | 2 | 34.42 |
| Total | 1,044,004,808 | 7,239 | 100 |

a.3. Names of shareholders who own 5% or more:

| Shareholder's name | Number of shares | Percentage % |
|---------------------|------------------|--------------|
| Royal Guard of Oman | 127,412,612 | 12.20 |
| Esam Yusuf Janahi | 155,682,331 | 14.91 |

b. Board of Directors, board members and executive management

1. Formation of the Board of Directors

At the General Meeting of Gulf Finance House, which was held on 8th May, 2011 and as the term of office of members of the Board of Directors, appointed in 2008, ended in 2011, it was decided to form the Board of Directors of the next three years, from 2011 to 2014 (renewable) by reducing the number of Board members from 10 to 6 members, which is consistent with the requirements of the regulations and the Articles of Association of Gulf Finance House.

In compliance with the regulations which require that one third of the members of the Board of Directors should be independent and non-executive members, the BOD includes four independent and non-executives members, including the Chairman of the Audit and Risk Committee and the Chairman of the Nomination, Remuneration and Governance Committee.

According to article HC-A.1.8 of the chapter on HC Module issued by the Central Bank of Bahrain with respect to the principle of the interpretation of non-compliance (Comply or Explain Principle), which stipulates the need to do the interpretation of cases of non-compliance as stated in the recommendations of the regulations, Gulf Finance House wishes to clarify the following facts:

- The BOD includes one executive member only who is the Chairman of the BOD who was appointed upon the approval of the Central Bank of Bahrain.
- The Risk Committee has been merged with the Audit Committee to form one committee called the Audit and Risk Committee because this merger poses no conflict of interest.

2. Separation between the position of Chairman and Chief Executive Officer

In compliance with the requirements and regulations, the posts of Chairman and Chief Executive Officer may not be filled by the same person. Accordingly, Gulf Finance House received the prior approval of the Central Bank of Bahrain to entrust the Chairman of the Board of Directors with specific executive tasks. It is worth mentioning that Gulf Finance House will shortly appoint a new CEO. Mr. Hisham Al Rayes has been appointed as Acting CEO in 2012.

3. Function of BOD and responsibilities of the Board members

The Articles of Association of Gulf Finance House stipulate the responsibilities of the Chairman and members of the BOD as well as the guidelines of corporate governance with respect to the distribution of responsibilities between the Board of Directors and executive management. The BOD oversees all the business activities in consultation with the executive management team. The BOD also discusses and agrees Gulf Finance House's business strategy. Additionally, the BOD is responsible for risk management and the audit of financial statements and corporate governance issues. The matters which require the approval of the Board include, for example, among other things, the approval of the financial statements, acquisitions and exit from companies. This is along with the main role of the Board which is to ensure adherence to the values of Gulf Finance House, including the values set forth in its internal regulations.

The consolidated financial statements and the Group's undertaking to operate in accordance with the Islamic Shari'a rules and principles are the responsibility of the Board of Directors of the Bank. All material transactions approved by the Board are governed by the Bank's Delegated Authority Limits (DAL).

When appointed, Board members are provided with the necessary detailed information to enable them to effectively perform their main role of overseeing the strategic, operational, financial and compliance affairs as well as corporate governance controls in the Gulf Finance House. The corporate governance framework allows a member of the BOD to seek independent advice when necessary.

With respect to the channels of communication between the BOD and executive management, the Board members can contact and request information from the executive management at all times.

4. Independence of board members

Independent members represent the majority of board members, with one executive member only. To ensure independence of members, all Board members are required to inform the Board of Directors about any changes or additions that occur on their positions and executive functions and may affect the assessment of their independence by the BOD. They should also ensure that their membership of the Board of Directors is not in conflict with any of their other interests and enable them to devote time and attention to the BOD. Before starting any Board meeting, the Chairman of the BOD instructs the Board members not to participate in the vote on the resolutions that may involve a conflict of interests, this is in addition to the annual disclosure submitted by the Board members in compliance with the conflict of interest policy. No conflicts of interest were identified during the year 2011.

The Nomination, Remuneration and Governance Committee of the BOD is responsible, along with its role in the identification, assessment and selection of candidates for membership of the Board of Directors, for the verification of the independence of members through the controls established by the regulations in this regard. In the selection process, the Committee ensures that the executive and non-executive candidates have a wide expertise in different fields of business and support services. Independent members are chosen from different sectors to ensure diversity of views and experiences in the BOD, as the current independent members come from financial, commercial and government sectors.

The following table shows the classification of members of the BOD as at December 31, 2011:

| Classification of members | Number |
|---------------------------|----------|
| Independent | 3 |
| non-executive | 1 |
| Executive | 2 |
| Total | 6 |

5. Letter of appointment

GFH has prepared a written agreement (letter of appointment) that was signed between GFH and the board members who are appointed or elected during the year. The agreement contains details of the responsibilities and powers of the member as well as the information required by the regulations. Upon appointment, Board members are presented with a comprehensive official introduction specifically designed for this purpose. It includes, among other things, review of the BOD's role in general and the duties and roles of the Board members in particular, in addition to meeting with the executive management, presentation of GFH's strategy, financial performance, risks and legal issues and other related matters.

During the term of membership, a member of the BOD must be fully aware of all aspects of the business, including the Bank's policies relating to corporate governance.

6. The right of shareholders to appoint members of the Board of Directors

Under Article 175 of the Companies Law and Article 27-a of the Articles of Association of the Bank, each shareholder who owns 10% or more of the capital is entitled to appoint his representative in the BOD in proportion to the number of members of the BOD. Accordingly, the shareholders practiced such right through the appointment of their representatives.

7. Board members and their other memberships

The table below shows the composition of the BOD, the other memberships of the Board member and membership of committees as at December 31, 2011:

| Name and position of Board member | Date of first appointment in BOD | Executive/ Non-executive/ Independent | Representation | Date of resignation | Number of memberships in other boards of Directors | Number of memberships in other boards of Directors in Bahrain | Number of memberships in other boards of banks in Bahrain | Number of memberships in Board Committees |
|--|----------------------------------|---------------------------------------|--|---------------------|--|---|---|---|
| Esam Yusuf Janahi (Executive Chairman) | July 2004 | Executive | Himself | NA | 6 | 1 | - | 1 |
| Dr. Ahmed Khalil Al Mutawa (Vice Chairman) | May 2011 | Independent | NA | NA | 6 | 1 | - | 2 |
| Musabah Saif Al Mutaury (Member) | March 2009 | Non-executive | NA | NA | 2 | 1 | 1 | 2 |
| Saed Hamad Al Malki (Member) | May 2011 | Executive | Royal Guard of Oman Pension Fund | NA | 2 | - | - | 1 |
| Azzam Abdul Aziz Al Flajj | May 2011 | Independent | NA | NA | 2 | - | - | 1 |
| Naif Abdulla Al Ali | May 2011 | Independent | NA | NA | 1 | - | - | 2 |
| *Abdulla Ali Al Hamli | March 2009 | Non-executive | Dubai Islamic Bank | 23 Dec 2011 | - | - | - | - |
| Hamad A. Aziz Al-Shaya | 16 Oct 1999 | Non-executive | A.Latif Ali Al-Shaya & A.Aziz AL-Shaya | 8 May 2011 | - | - | - | - |
| Adel Dawood Al-Ohali | 17 March 2003 | Non-executive | Al Ohali Trading Group | 8 May 2011 | - | - | - | - |
| Mohammed Ebrahim Mohammed | 18 Feb 2009 | Non-executive | Bahrain Islamic Bank | 8 May 2011 | - | - | - | - |

| Name and position of Board member | Date of first appointment in BOD | Executive/ Non-executive/ Independent | Representation | Date of resignation | Number of memberships in other boards of Directors | Number of memberships in other boards of Directors in Bahrain | Number of memberships in other boards of Directors of banks in Bahrain | Number of memberships in Board Committees |
|-----------------------------------|----------------------------------|---------------------------------------|--------------------------|---------------------|--|---|--|---|
| Yousuf Mohammed Khayat | 16 Oct 1999 | Non-executive | SEDCO | 8 May 2011 | - | - | - | - |
| Anthony Travis | 18 Feb 2009 | Independent | None | 8 May 2011 | - | - | - | - |
| Abdul Aziz Mohammed Al Hanai | 18 Feb 2009 | Non-executive | Islamic Development Bank | 8 May 2011 | - | - | - | - |
| A.Latif Al Meer | 17 March 2003 | Non-executive | Qatar Islamic Bank | 8 May 2011 | - | - | - | - |

*Mr. Abdulla Al Hamli resigned on 23rd Dec 2011.

- None of the independent members of the Board of Directors has any financial relationship or dealings with Gulf Finance House, with the exception of the relationship arising from being a member of the Board of Directors.
- The BOD's Audit and Risk Committee is chaired by Vice-Chairman of the Board, an independent member who has experience and academic qualification.

8. Ownership of shares of members of the Board of Directors

The table below shows the change in the ownership of members of the Board of Directors of the shares of Gulf Finance House, as at December 31, 2011 compared to that of December 31, 2010:

| Member's name | Shares owned as at Dec 31, 2010 | Shares owned as at 31 Dec, 2011 | Percentage of ownership as at 31 Dec, 2011 |
|--------------------------------|---------------------------------|---------------------------------|--|
| Esam Yusuf Janahi | 488,158 | 155,682,331 | 14.91 |
| Dr. Ahmed Khalil Al Mutawa | NA | NA | - |
| Musabah Saif Al Mutairy | NA | 3,669,354 | 0.35 |
| Saed Hamad Al Malki | NA | NA | - |
| Azzam Abdul Aziz Al Felaij | NA | NA | - |
| Naif Abdulla Al Ali | NA | NA | - |
| *Abdulla Ali Al Hamli | NA | NA | - |
| **Hamad A. Aziz Al-Shaya | NA | NA | - |
| **A.Latif Al Meer | NA | NA | - |
| **Adel Dawood Al-Ohali | NA | NA | - |
| **Yousuf Mohammed Khayat | NA | NA | - |
| **Mohammed Ebrahim Mohammed | NA | NA | - |
| **Anthony Travis | NA | NA | - |
| **Abdul Aziz Mohammed Al Hanai | NA | NA | - |
| Total | 488,158 | 159,351,685 | 15.26 |

*Mr. Abdulla Al Hamli resigned on 23rd Dec 2011

**Resigned from the Board on 8th May 2011.

9. Directors' and Senior Manager's trading of the Bank's shares and distribution of ownership on an individual basis during the year

| Name of shareholders | Period | Nature of transaction | Number of shares | Total no. of shares held as at 31st Dec 2011 | % of ownership |
|--------------------------------------|-------------------------|-----------------------|------------------|--|----------------|
| Esam Yusuf Abdulla Abdulkarim Janahi | 1st Jan - 31st Dec 2011 | Bought | 247,568,774 | 155,682,331 | 14.9120 |
| | | Sold | 51,255,674 | | |
| Mosobah Saif Mosobah Al Mutairy | 1st Jan - 31st Dec 2011 | Bought | 17,879,353 | 3,669,354 | 0.3515 |
| | | Sold | 14,209,999 | | |
| Mohamed Hasan Ali AlNusuf | 1st Jan - 31st Dec 2011 | Bought | - | - | - |
| | | Sold | - | | |
| Haider AbdulRahman Abdulla AlMajali | 1st Jan - 31st Dec 2011 | Bought | - | 1,202 | 0.0001 |
| | | Sold | - | | |
| Hisham Ahmed Noor AbdulQader AlRays | 1st Jan - 31st Dec 2011 | Bought | - | 10,102 | 0.0010 |
| | | Sold | - | | |
| Chandan Rajkamal Gupta | 1st Jan - 31st Dec 2011 | Bought | - | - | - |
| | | Sold | - | | |
| Ajay Shivram Subramanian | 1st Jan - 31st Dec 2011 | Bought | - | 2,194 | 0.0002 |
| | | Sold | - | | |

10. Meetings of the Board of Director during 2011

The meetings of the Board of Directors and its committees are held whenever the need arises, but under the regulations, the BOD should meet at least four times during a single fiscal year. The BOD held seven meetings during 2011 (three meetings held by the former BOD and 4 meetings held by the new BOD). The AGM was held on May 8, 2011.

In addition to official meetings, a number of urgent resolutions were also passed by circulation in 2011 through e-mails to Board members.

As for the agenda of the meetings of the BOD, it is sent to the members at a suitable time before the date of the meeting, to provide the members with all the necessary information, reports and documents for their information and review. The BOD is also notified of all the topics and key events that arise and need approvals. The executive management is responsible for informing the BOD on the performance of GFH in each meeting.

Dates of Board meetings held during the fiscal year 2011 are as follows:

Dates of meetings of former BOD:

2nd February 2011, 10th March 2011, 7th April 2011.

Dates of meetings of new BOD:

29th May 2011, 11th August 2011, 20th October 2011, 8th December 2011.

Board members attendance in 2011

| Members | 2 Feb | 10 Mar | *7 Apr | *29 May | 11 Aug | 20 Oct | 8 Dec |
|----------------------------|-------|--------|--------|---------|--------|--------|-------|
| Esam Yousuf Janahi | √ | √ | √ | √ | √ | √ | √ |
| Hamad A.Aziz Al Shaya | √ | √ | √ | √ | - | - | - |
| Anthony Travis | √ | √ | √ | X | - | - | - |
| Adel Dawood Al Ohali | √ | √ | √ | √ | - | - | - |
| Abdulla Ali Al Hamli | √ | X | X | X | X | X | X |
| Abdul Aziz Al Hanai | √ | √ | X | √ | - | - | - |
| Mohammed Ebrahim Mohammed | √ | √ | √ | √ | - | - | - |
| Mosabah Saif Al Mutaairy | √ | √ | √ | √ | √ | √ | √ |
| Yusuf Mohammed Khayat | √ | √ | √ | √ | - | - | - |
| A Latif Abdulla Al Meer | X | X | X | X | - | - | - |
| Dr. Ahmed Khalil Al Mutawa | - | - | - | - | √ | √ | √ |
| Saed Hamad Al Malki | - | - | - | - | √ | √ | √ |
| Azzam Abdul Aziz Al Flajj | - | - | - | - | √ | √ | √ |
| Naif Abdulla Al Ali | - | - | - | - | X | √ | √ |

*Meetings held through phone/ video link

11. Quorum required for adoption of Board resolutions

The required quorum for the meetings of the BOD and AGM shall be in accordance with the provisions of the Articles of Association of GFH. The BOD may pass its resolutions by post, e-mail, fax, conference calls, video calls or any other means of audio or video communication pursuant to the provisions of Article 33-e of the Articles of Association of the Bank.

12. Board members profiles

Please refer to page 11

a. Compensation and remuneration of board members and executive directors:

Details are listed in Note 26 of the consolidated financial statements for the fiscal year ended 31st December, 2011.

During 2011 the remuneration paid to the Sharia'a Supervisory Board was US\$ 151,000.

b. Audit fees and other services provided by the external auditor

Details will be available at the request of the regulatory authorities of the CBB. It will also be available for the shareholders upon an official written request to GFH provided that such matters shall not affect the interests of the bank or its competitiveness in the market.

c. Board Committees

The BOD has established three subordinate committees and has delegated specific powers to each committee as follows:

1. The Audit and Risk Committee

The Audit and Risk Committee is responsible for following up on the internal and external audit, as well as compliance with anti-money laundering laws. The Committee must meet at least four times a year, and during the fiscal year 2011, the Committee held five meetings, two of those meetings with the former BOD and three with the new BOD. The meetings with the former Board of Directors took place on 2nd Feb 2011, 10th March 2011, 27th May 2011 and with the current Board of Directors on 20th October 2011 and 7th December 2011.

The formation of the Audit and Risk Committee and the Committee members who attended the meetings during 2011 were as follows:

| Member's name | Committee | Position | Classification | Number of meetings attended by the member |
|----------------------------|--------------|-----------------|----------------|---|
| Esam Yousuf Janahi | Risk | Former Chairman | Executive | 1 |
| Mosabah Saif Al Mutaairy | Risk | Member | Non-executive | 1 |
| **Yusuf Mohammed Khayat | Risk | Member | Non-executive | 1 |
| ***Abdulla Ali Al Hamli | Risk | Member | Non-executive | - |
| *Anthony Travis | Risk | Member | Independent | 1 |
| *Anthony Travis | Audit | Former Chairman | Independent | 2 |
| Mosabah Saif Al Mutaairy | Audit | Member | Non-executive | 2 |
| **A Latif Abdulla Al -Meer | Audit | Member | Non-executive | - |
| Dr. Ahmed Al Mutawa | Audit & Risk | Chairman | Independent | 3 |
| Mr. Azzam Al Felajj | Audit & Risk | Member | Independent | 3 |
| Mr. Saed Al Malki | Audit & Risk | Member | Executive | 3 |

*Participated in the meeting through phone/video link

**Resigned from the Board on 8th May 2011

***Resigned from the Board on 23rd December 2011

2. Investment Committee

The Investment Committee's responsibility is to approve the investment and funding requests, prepare the investment policies and controls, determine the credit limits of the Bank, manage assets and liabilities, organize banking relationships, as well as oversee the items that are not included in the budget. The Committee must meet at least four times each fiscal year. The Committee held one meeting only during the fiscal year 2011 on 20th October 2011.

The formation of the Investment Committee and the Committee members who attended meetings during 2011 were as follows:

| Member's name | Position | Classification | Number of meetings attended by the member |
|---------------------------|----------|----------------|---|
| Mr. Esam Janahi | Chairman | Executive | 1 |
| Mr. Naif Abdulla Al Ali | Member | Independent | 1 |
| Mr. Musabah Al Mutaairy | Member | Non-executive | 1 |
| *Mr. Abdulla Ali Al Hamli | Member | Non-executive | - |

*Resigned from the Board on 23rd December 2011

3. Nomination, Remuneration & Governance Committee

The Nomination, Remuneration & Governance Committee is responsible for recruitment, rewards, incentive compensation of employees and the preparation of internal policies to manage human resources and other administrative matters. It is also responsible for overseeing the governance framework of Gulf Finance House. The Committee must meet at least four times a year. The Committee held four meetings during fiscal year 2011, on the following dates: 10th March 2011, 20th October 2011, 17th November 2011, and 8th December 2011.

The formation of the Nomination, Remuneration & Governance Committee and the Committee members who attended meetings during 2011 were as follows:

| Member's name | Position | Classification | Number of meetings attended by the member |
|-----------------------------|----------|----------------|---|
| *Hamad A.Aziz Al-Shaya | Member | Non-executive | 1 |
| *A.Latif Abdulla Al-Meer | Member | Non-executive | - |
| **Abdulla Ali Obaid Alhamli | Member | Non-executive | 1 |
| *Mohammed Ebrahim Mohammed | Member | Non-executive | 1 |
| Dr. Ahmed Al Mutawa | Chairman | Independent | 2 |
| Mr. Naif Al Ali | Member | Independent | 3 |
| Mr. Musabah Al Mutairy | Member | Non-executive | 3 |

*Resigned from the Board on 8th May 2011

**Resigned from the Board on 23rd Dec 2011

d. System of protection of whistle-blowers on corruption

As part of its governance framework, GFH has launched a system to protect whistle-blowers on corruption as already referred to under the regulations, which enable staff to raise their comments and concerns about possible irregularities in the financial reports or any other matters. Therefore, to comply with the requirements of the corporate governance law, the BOD will seek the adoption of this system in the near future, which will allow the opportunity for staff to report their concerns and comments on any suspected issues.

e. Other topics

Compensation of the Board of Directors and Executive Management

Compensation of the Board of Directors and Executive Management is recommended to the Board of Directors by the Nomination, Remuneration & Governance Committee and the Board of Directors then makes the recommendation to the shareholders at the annual general meeting.

The Board of Directors' remuneration takes into consideration the performance of the Bank as well as an assessment of compliance of individual members with their performance agreement and individual responsibilities. During the year 2011, the Board was paid only sitting fees.

Executive Management are entitled to a fixed remuneration as per their contractual agreements, and any other performance-related incentives/bonuses must be approved by the Board.

Refer note 26 of the consolidated financial statements for details of the remuneration to Board of Directors and Executive Management.

Continuous development of the Board and Board Committees

The Board approved Charter of the Board of Directors has been prepared to serve as a reference point for Board activities. The Charter outlines the demarcation of the roles, functions, responsibilities and powers of the Board, various Board committees of GFH and matters reserved for final decision –making or pre approval by the Board and the policies and practices of the Board in respect of matters such as conflicts of interest and convening of Board meetings. The Charter effective for the year 2011 was approved by the Board. The Board Charter has been revised and the new version is in draft form which is yet to be presented to the Board for Approval. The same also includes a code of conduct to be adopted by the Board.

The Board Charter sets up a detailed Board Training guide which provides a framework for induction/orientation of new Board members. The new Board of Directors are provided with a presentation pack containing overview/highlights of GFH.

All the members of the Board at the time of appointment should sign a Non executive Directors contract, which contains the terms of the appointment, duties and responsibilities of the members, membership and time commitment, conflicts of interest, resignation and termination, confidentiality of information and other details which the members have to abide by during their tenure of being member of the Board.

Board's performance evaluation

The Board Charter also contains a section on the Board Performance Evaluation, which provides a framework for the annual self assessment process by the Board and Board sub committees. The Nomination Remuneration and Governance Committee is responsible for developing a programme for the self –assessment of the Board and the Board sub-committees for review and approval of the Board collectively. The charter provides a step by step process of performing the annual Board Effectiveness Assessment in detail.

Transactions with related parties

Details of transactions with related parties are indicated in detail in Note 26 of the consolidated financial statements for the fiscal year ended 31 December, 2011.

Approval process for related party transactions

All connected party exposures (within the CBB defined limits) will be approved by the appropriate approving authority as per the Delegate Authority Limit (DAL). Where the approving authority as per DAL is connected / interested, the approval authority shall move to the next level. All connected party exposures will be submitted to the BARC quarterly for their ratification.

In determining whether to approve a Connected Party Transaction, the requesting and approving authority will consider, among other factors, the following factors to the extent relevant to the Connected Party Transaction:

- Exposures to connected counterparties may be justified only when undertaken for the clear commercial advantage of the bank, when negotiated and agreed on an arm's length basis, and when included in the policy statement agreed with the Central Bank.
- No Islamic facilities provided by a bank to its own external auditors shall be permitted (External auditors include firm/partnership, the partners, the directors and managers of the audit firm). In addition, unless provided for in the contract, off-balance sheet restricted investment accounts will not be permitted to participate in on-balance sheet corporate funding and vice versa and movement within restricted investment accounts is not permitted without the Central Bank's prior written approval.
- whether the terms of the Connected Party Transaction are fair to the Bank and on the same basis as would apply if the transaction did not involve a Connected Party;
- whether there are business reasons for the Bank to enter into the Connected Party Transaction;
- whether the Connected Party Transaction would impair the independence of an outside director; and
- whether the Connected Party Transaction would present an improper conflict of interests for any director or executive officer of the Bank, taking into account the size of the transaction, the overall financial position of the director, executive officer or Connected Party, the direct or indirect nature of the director's, executive officer's or Connected Party's interest in the transaction and the ongoing nature of any proposed relationship, and any other factors the BARC deems relevant.
- Shareholders with significant ownership of the bank's capital (i.e. 10% and above) are not allowed to obtain financing facilities from the bank (i.e. a 0% limit), however smaller shareholders will be subject to the normal exposure limits outlined in section CM-4.4.5. Directors who are also shareholders (or their appointed board representatives) with significant ownership (i.e. above 10% or above) are subject to the 0% limit mentioned above.
- The Central Bank's prior written consent should be obtained for any credit facilities provided to an employee where the amount of such facility, either singly or when added to an existing facility/existing facilities outstanding to that employee at that date, would be equal to or in excess of BD 100,000 (Bahrain Dinars One Hundred Thousand), or its equivalent in foreign currency. Banks must notify the Central Bank in writing of any senior employee who fails to discharge his repayment obligations.

Reciprocal cross-holdings of capital between a bank and its "controllers", which artificially inflate the capital of licensee concerned, are not permitted. Any cross-holdings that occur due to acquisitions or takeovers must be deducted from the concerned bank's capital. Any member of the Board Audit & Risk Committee who has an interest in the transaction under discussion will abstain from voting on the approval of the Connected Party Transaction, but may, if so requested by the Chairperson of the Committee, participate in some or all of the committee's discussions of the Connected Party Transaction. Upon completion of its review of the transaction, the BARC may determine to permit or to prohibit the Connected Party transaction.

Ownership of shares by government entity

Royal Guard of Oman is the only government entity which holds shares of GFH.

Review of internal control and processes

Internal control is a process effected by the board of directors, senior management and all levels of personnel. It is not solely a procedure or policy that is performed at a certain point in time, but rather it is continually operating at all levels within the Bank. The board of directors and senior management are responsible for establishing the appropriate culture to facilitate an effective internal control process and for monitoring its effectiveness on an ongoing basis; however, each individual within an organization must participate in the process. The main objectives of the internal control process can be categorized as follows:

1. efficiency and effectiveness of activities (performance objectives);
2. reliability, completeness and timeliness of financial and management information (information objectives); and
3. compliance with applicable laws and regulations (compliance objectives).

Also, the internal control system of the Bank consists of five interrelated elements:

1. management oversight and the control culture;
2. risk recognition and assessment;
3. control activities and segregation of duties;
4. information and communication; and
5. monitoring activities and correcting deficiencies.

Disclosure requirements of HC Module (HC 8.2.1 (c))

As per the amendments to the HC Module made by the CBB in 2011, the Bank has performed a Gap analysis to assess compliance with the amendments. The Gaps are enumerated below:

| Module Code | Summary of Changes | Current State | Proposed Plan to Close Gap |
|-------------|--|---------------|--------------------------------------|
| HC | HC-1.2.3 The precise functions reserved for the Board, and those delegated to management and committees will vary, dependent upon the business of the institution, its size and ownership structure. However, as a minimum, the Board must establish and maintain a statement of its responsibilities for: a) The adoption and annual review of strategy; b) The adoption and review of management structure and responsibilities; c) The adoption and review of the systems and controls framework; and d) Monitoring the implementation of strategy by management. | Gap | Need to be implemented going forward |
| HC | HC-1.2.4 The directors are responsible both individually and collectively for performing the responsibilities outlined in HC-1.2.1 to HC-1.2.3. Although the Board may delegate certain functions to committees or management, it may not delegate its ultimate responsibility to ensure that an adequate, effective, comprehensive and transparent corporate governance framework is in place. | Gap | Need to be implemented going forward |
| HC | HC-1.2.5 In its strategy review process under Paragraphs HC-1.2.3 a) and d), the Board must: a) Review the bank's business plans and the inherent level of risk in these plans; b) Assess the adequacy of capital to support the business risks of the bank; c) Set performance objectives; and d) Oversee major capital expenditures, divestitures and acquisitions. | Gap | Need to be implemented going forward |
| HC | HC-1.2.6 Banks must notify the CBB in writing of all major proposed changes to the strategy and/or corporate plan of the bank prior to implementation. | Gap | Need to be implemented going forward |
| HC | HC-1.9.2 The evaluation process must include: (a) Assessing how the Board operates, especially in light of Chapter HC-1; (b) Evaluating the performance of each committee in light of its specific purposes and responsibilities, which shall include review of the self-evaluations undertaken by each committee; (c) Reviewing each director's work, his attendance at Board and committee meetings, and his constructive involvement in discussions and decision making; (d) Reviewing the Board's current composition against its desired composition with a view toward maintaining an appropriate balance of skills and experience and a view toward planned and progressive refreshing of the Board; and (e) Recommendations for new Directors to replace long-standing members or those members whose contribution to the bank or its committees (such as the audit committee) is not adequate. | Gap | |
| HC | HC-2.5.1 The Islamic bank licensee must disclose to its shareholders in the Annual Report any abstention from voting motivated by a conflict of interest and must disclose to its shareholders any authorisation of a conflict of interest contract or transaction in accordance with the Company Law. | Gap | Going forward |

GFH complaint handling process

GFH is dedicated to providing a high standard of service and to maintaining its reputation for honesty and integrity in all its dealings. If our level of service has failed to meet your expectations, we would like you to tell us. GFH takes all disputes and complaints from its customers and business partners very seriously and as such all complaints will be dealt with promptly and fairly.

GFH will endeavor to address all complaints within five working days, however, where this is not possible we will contact you outlining when we expect to be able to formally respond to your complaint.

Communication Strategy

The Bank has developed a robust communication strategy. The same is pending Board approval.

Systems and controls for compliance with Shari'a and AAOIFI standards

In pursuance with the provisions of its Articles of Association, Gulf Finance House has always carried out its banking activities in compliance with Islamic Sharia principles that constitute an integral part of the entire policies of the Bank. Sharia Function:

- Ensuring that the necessary approvals of the SSB have been obtained for each project.
- Ensuring compliance of projects with the Sharia provisions indicated in the Prospectus and the approved structure of the project.
- Reviewing the financial statements and other issues related to the projects and ensuring that they are in compliance with the Sharia principles.
- Ensuring that the projects are in compliance with Fatwas and recommendations of the SSB of GFH and the other Sharia Boards, if any.
- Ensuring that the approval of the SSB is obtained for each financial instrument (such as sale transactions, financing, currency conversion, Sukuks, deposits, etc.), including the approved and concluded contracts and agreements.
- Reviewing the financial statement to ensure full compliance with the Sharia principles and the requirements and provisions of the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI).
- Ensuring that all the products and the structures thereof are in compliance with AAOIFI's standards.

Refer note 2 (t) of the consolidated financial statements for earnings prohibited by Shari'a.

Details of penalties paid

During 2011, GFH has paid penalty of BHD 4,500/- to the Central Bank of Bahrain for late filing of its "Prudential Information Return" (PIR) for the period ended 30 June 2011.



Consolidated Financial Statements

For the year ended 31 December 2011

Sharia Supervisory Board Report

On The Activities Of Gulf Finance House Bsc For The Financial Year Ending 31 December 2011

In the name of Allah, the Beneficent, the Merciful

Prayers and Peace Upon the Last Apostle and Messenger, Our prophet Mohammed, His Comrades and Relatives.

The Sharia Supervisory Board of Gulf Finance House have reviewed the Bank's investment activities and compared them with the previously issued fatawas and rulings during the financial year 31st December 2011 and found them compatible with the already issued fatawas and rulings.

The Board believes that it has expressed its opinion in respect of the activities carried on by the Bank and it is the responsibility of the management to ensure the implementation of such decisions. It is the duty of the Board to express an independent opinion on the basis of its control and review of the Bank's operations and to prepare a report about them.

A representative of the Bank's management explained and clarified the contents of consolidated Balance Sheet. Attached notes and Consolidated Income Statement for the financial year ended on 31st December 2011 to our satisfaction. The report of the Board has been prepared based on the contents provided by the bank.

The Board is further satisfied that any income which is not in compliance with the Glorious Islamic Sharia has been dispersed to charitable organizations and that the responsibility of the payment of the Zakah lies with the shareholders in their shares.

The Board is satisfied that the investment activities and banking services are in compliance with the Glorious Islamic Sharia.

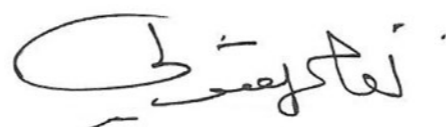
Praise be to Allah, Lord of the Worlds.

Prayer on Prophet Mohammed (Peace Be Upon Him), all his family and Companions.

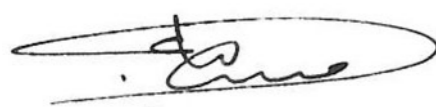
Reviewed and signed on 6th February 2012 by:



Sh. Abdulla bin Sulaiman Al-Manie



Sh. Nidham Mohammed Yaquby



Dr. Fareed Mohammed Hadi



Dr. Abdulaziz Khalifa Al-Qassar

Independent Auditors' Report To The Shareholders

Gulf Finance House Bsc

29 February 2012

Manama, Kingdom of Bahrain

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Gulf Finance House BSC (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated statement of financial position as at 31 December 2011, and the consolidated statements of income, changes in owners' equity, cash flows, changes in restricted investment accounts and sources and uses of charity and zakah fund for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Respective responsibilities of board of directors and auditors

These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Shari'a rules and principles are the responsibility of the board of directors of the Bank. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by Accounting and Auditing Organisation for Islamic Financial Institutions. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion


In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2011 and of the consolidated results of its operations, its consolidated cash flows, consolidated changes in equity, consolidated changes in restricted investment accounts and consolidated sources and uses of charity and zakah fund for the year then ended in accordance with Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions and the Shari'a rules and principles as determined by the Shari'a Supervisory Board of the Bank.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 2 (b) in the consolidated financial statements which discusses material uncertainties relating to the Group's liquidity position and regulatory capital adequacy, which, may cast significant doubt about the appropriateness of the going concern assumption used in the preparation of the consolidated financial statements

Report on other regulatory requirements

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rule Book (Volume 2), we report that: the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; the financial information contained in the chairman's report is consistent with the consolidated financial statements; we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 2, applicable provisions of Volume 6 and CBB directives), the CBB Capital Markets Regulations and associated resolutions, rules and procedures of the Bahrain Bourse or the terms of the Bank's memorandum and articles of association having occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position; and satisfactory explanations and information have been provided to us by the management in response to all our requests.



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2011

US\$ 000's

| | Note | 31 December 2011 | 31 December 2010 |
|---|------|---------------------|---------------------|
| ASSETS | | | |
| Cash and bank balances | 4 | 3,820 | 3,770 |
| Placements with financial institutions | 5 | 3,001 | 56,868 |
| Financing receivables | 6 | - | 14,400 |
| Investment in associates | 7 | 230,442 | 224,847 |
| Investment securities | 8 | 220,265 | 248,794 |
| Investment property | 9 | 259,404 | 266,412 |
| Other assets | 10 | 108,913 | 203,150 |
| Total assets | | 825,845 | 1,018,241 |
| LIABILITIES | | | |
| Investors' funds | 12 | 58,887 | 138,798 |
| Placements from financial and other institutions | 13 | 116,713 | 126,241 |
| Financing liabilities | 14 | 331,077 | 439,504 |
| Other liabilities | 15 | 83,882 | 195,535 |
| Total liabilities | | 590,559 | 900,078 |
| Equity of investment account holders | 16 | 1,898 | 1,880 |
| OWNERS' EQUITY | | | |
| Share capital | 17 | 321,031 | 145,780 |
| Treasury shares | | (12,852) | (24,674) |
| Share premium | | 145,708 | 206,203 |
| Statutory reserve | | 79,408 | 88,298 |
| Accumulated losses | | (301,687) | (302,068) |
| Investments fair value reserve | | 403 | 975 |
| Other reserves | 18 | 1,377 | 1,769 |
| Total owners' equity (page 54) | | 233,388 | 116,283 |
| Total liabilities, equity of investment account holders and owners' equity | | 825,845 | 1,018,241 |

The consolidated financial statements consisting of pages 52 to 107 were approved by the Board of Directors on 28 February 2012 and signed on its behalf by:



Esam Yousif A. Janahi
Chairman



Mosabah Saif Al Mautairy
Director

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2011

US\$ 000's

| | Note | 2011 | 2010 |
|--|------|---------------|------------------|
| Income from investment banking services | | 4,320 | 5,032 |
| Management and other fees | | 3,601 | 7,085 |
| Finance income | 22 | 2,091 | 1,799 |
| Share of profits / (loss) from investment in associates | 7 | 2,595 | (11,729) |
| Income / (loss) from investment securities | 19 | 11,841 | (1,380) |
| Net foreign exchange gain / (loss) | | 2,120 | (426) |
| Other income, net | 20 | 44,810 | 7,300 |
| Total income | | 71,378 | 7,681 |
| Staff cost | 21 | 10,513 | 17,635 |
| Investment advisory expenses | | 6,000 | 6,990 |
| Finance expense | 22 | 30,501 | 50,035 |
| Other expenses | 23 | 15,863 | 25,781 |
| Total expenses | | 62,877 | 100,441 |
| Profit / (loss) before provision for impairment | | 8,501 | (92,760) |
| Impairment allowances | 24 | (8,120) | (256,119) |
| Profit / (loss) for the year from continuing operations | | 381 | (348,879) |
| Discontinued operations | | | |
| Loss from discontinued operations | | - | (522) |
| Profit / (loss) for the year | | 381 | (349,401) |
| Basic and Diluted Earnings per share (US cents) | | | |
| Continuing operations | 27 | 0.04 | (76.84) |
| Discontinued operations | | - | (0.11) |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

for the year ended 31 December 2011

US\$ 000's

| 2011 | Share capital | Treasury shares | Share premium | Statutory reserve | Accumulated losses | Other reserves (note 18) | Investments fair value reserve | Total |
|--|----------------|-----------------|----------------|-------------------|--------------------|--------------------------|--------------------------------|----------------|
| Balance at 1 January 2011 | 145,780 | (24,674) | 206,203 | 88,298 | (302,068) | 1,769 | 975 | 116,283 |
| Profit for the year | - | - | - | - | 381 | - | - | 381 |
| Changes in fair value of investment securities | - | - | - | - | - | - | (572) | (572) |
| Total recognised income and expense | - | - | - | - | 381 | - | (572) | (191) |
| Conversion of Murabaha to capital (notes 17,18) | 175,251 | - | (60,495) | - | - | (253) | - | 114,503 |
| Share grants vesting expense, net of forfeitures (note 21) | - | - | - | - | - | (139) | - | (139) |
| Sale of treasury shares | - | 11,822 | - | - | - | - | - | 11,822 |
| Loss on sale of treasury shares | - | - | - | (8,890) | - | - | - | (8,890) |
| Balance at 31 December 2011 | 321,031 | (12,852) | 145,708 | 79,408 | (301,687) | 1,377 | 403 | 233,388 |

| 2010 | Share capital | Treasury shares | Share premium | Statutory reserve | Accumulated losses | Investments fair value reserve | Other reserves (note 18) | Total |
|--|----------------|-----------------|----------------|-------------------|--------------------|--------------------------------|--------------------------|----------------|
| Balance at 1 January 2010 | 604,079 | (52,371) | 202,316 | 106,700 | (432,677) | 975 | 4,300 | 433,322 |
| Loss for the year | - | - | - | - | (349,401) | - | - | (349,401) |
| Total recognised income and expense | - | - | - | - | (349,401) | - | - | (349,401) |
| Conversion of Murabaha to capital (note 17) | 21,711 | - | 3,922 | - | - | - | (633) | 25,000 |
| Adjustment of accumulated losses against share capital (note 17) | (480,010) | - | - | - | 480,010 | - | - | - |
| Share issue expenses | - | - | (35) | - | - | - | - | (35) |
| Share grants vesting expense, net of forfeitures (note 21) | - | - | - | - | - | - | (1,898) | (1,898) |
| Sale of treasury shares | - | 27,697 | - | - | - | - | - | 27,697 |
| Loss on sale of treasury shares | - | - | - | (18,402) | - | - | - | (18,402) |
| Balance at 31 December 2010 | 145,780 | (24,674) | 206,203 | 88,298 | (302,068) | 975 | 1,769 | 116,283 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December 2011

US\$ 000's

| | 2011 | 2010 |
|---|-----------------|------------------|
| OPERATING ACTIVITIES | | |
| Receipts from investment banking services | - | 5,032 |
| Placements with financial institutions (more than 90 days), net | (7,145) | (22,643) |
| Cash receipts from discontinued operations | - | 4,902 |
| Disbursement for projects, net | (2,975) | (12,424) |
| Receipts from financing receivables | 450 | - |
| Investors' funds paid, net | (3,566) | (40,726) |
| Management fees received | 343 | 7,085 |
| Income from placements and financing received | 893 | 1,597 |
| Payments for expenses and project costs | (20,434) | (63,917) |
| Cash used in operating activities | (32,434) | (121,094) |
| INVESTING ACTIVITIES | | |
| Purchase of investment securities | - | (6,882) |
| Advance for purchase of investment securities | (3,770) | - |
| Proceeds from sale of investment securities | 3,500 | 35,647 |
| Proceeds from sale of investment in associates | - | 40,000 |
| Dividends received | 4,860 | 2,230 |
| Net cash flows from disposal of a subsidiary | - | (1,309) |
| Payments for acquisition of equipment | - | (116) |
| Cash generated from investing activities | 4,590 | 69,570 |
| FINANCING ACTIVITIES | | |
| Financing liabilities, net | (1,045) | (180,449) |
| Proceeds from issue of ordinary shares | 10,491 | - |
| Finance expense paid | (23,001) | (40,350) |
| Payment for share issue expenses | (11,740) | - |
| Proceeds from sale of treasury shares | - | 9,295 |
| Cash paid to charitable organisations | (130) | (631) |
| Dividends paid | (548) | (262) |
| Payments to investment account holders, net | - | (993) |
| Cash used in financing activities | (25,973) | (213,390) |
| DECREASE IN CASH AND CASH EQUIVALENTS | (53,817) | (264,914) |
| Cash and cash equivalents at 1 January | 60,638 | 325,552 |
| CASH AND CASH EQUIVALENTS at 31 December | 6,821 | 60,638 |
| Cash and cash equivalents comprise: | | |
| Cash and bank balances | 3,820 | 3,770 |
| Placements with financial institutions | 3,001 | 56,868 |
| | 6,821 | 60,638 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN RESTRICTED INVESTMENT ACCOUNTS

for the year ended 31 December 2011

| 2011 | Balance at 1 January 2011 | | | Movements during the year | | | | | | Balance at 31 December 2011 | | |
|---|---------------------------|------------------------------|------------------|-----------------------------------|------------------------|-------------------------|---------------------------|------------------------------------|------------------------------------|-----------------------------|------------------------------|------------------|
| | No of units (000) | Average value per share US\$ | Total US\$ 000's | Investment/ withdrawal US\$ 000's | Revaluation US\$ 000's | Gross income US\$ 000's | Dividends paid US\$ 000's | Bank's fees as an agent US\$ 000's | Administration expenses US\$ 000's | No of units (000) | Average value per share US\$ | Total US\$ 000's |
| Mena Real Estate Company KSCC | 150 | 0.35 | 53 | - | - | - | - | - | - | 150 | 0.35 | 53 |
| Kuwait National Real Estate Investment & Services Co. KSCC* | 250 | 0.35 | 88 | (88) | - | - | - | - | - | - | - | - |
| Gulf Holding Company* | 10,000 | 0.25 | 2,455 | (2,455) | - | - | - | - | - | - | - | - |
| Gulf North Africa Holding Company KSCC* | 11,500 | 0.24 | 2,794 | (2,794) | - | - | - | - | - | - | - | - |
| Gulf Real Estate Development Company* | 936 | 12.05 | 11,272 | (11,272) | - | - | - | - | - | - | - | - |
| Al Basha'er Fund | 93 | 7.59 | 704 | - | (87) | - | - | - | - | 93 | 6.63 | 617 |
| Pan European Fund | 35.85 | 815.39 | 29,233 | - | (636) | - | - | - | - | 35.85 | 797.67 | 28,597 |
| Oman Development Company | 522.50 | 3.12 | 1,628 | - | - | - | - | - | - | 522.50 | 3.12 | 1,628 |
| | | | 48,227 | (16,609) | (723) | - | - | - | - | | | 30,895 |

Revaluation changes of US\$ 644 thousand (2010: US\$ 1,815 thousand) is on account of loss on foreign exchange translation differences.

*The investments in these accounts have been directly registered in the names of the investors and hence have been withdrawn from the statement of changes in restricted investment accounts.

| 2010 | Balance at 1 January 2010 | | | Movements during the year | | | | | | Balance at 31 December 2010 | | |
|--|---------------------------|------------------------------|------------------|---------------------------|------------------------|-------------------------|---------------------------|------------------------------------|------------------------------------|-----------------------------|------------------------------|------------------|
| | No of units (000) | Average value per share US\$ | Total US\$ 000's | Investment US\$ 000's | Revaluation US\$ 000's | Gross income US\$ 000's | Dividends paid US\$ 000's | Bank's fees as an agent US\$ 000's | Administration expenses US\$ 000's | No of units (000) | Average value per share US\$ | Total US\$ 000's |
| Mena Real Estate Company KSCC | 150 | 0.35 | 52 | - | 1 | - | - | - | - | 150 | 0.35 | 53 |
| Kuwait National Real Estate Investment & Services Co. KSCC | 250 | 0.35 | 87 | - | 1 | - | - | - | - | 250 | 0.35 | 88 |
| Gulf Holding Company | 10,000 | 0.24 | 2,417 | - | 38 | - | - | - | - | 10,000 | 0.25 | 2,455 |
| Gulf North Africa Holding Company KSCC | 11,500 | 0.24 | 2,751 | - | 43 | - | - | - | - | 11,500 | 0.24 | 2,794 |
| Gulf Real Estate Development Company | 936 | 12.05 | 11,271 | - | 1 | - | - | - | - | 936 | 12.05 | 11,272 |
| Al Basha'er Fund | 93 | 7.22 | 671 | - | 33 | - | - | - | - | 93 | 7.59 | 704 |
| Pan European Fund | 35.85 | 869.32 | 31,165 | - | (1,932) | - | - | - | - | 35.85 | 815.39 | 29,233 |
| Oman Development Company | 522.50 | 3.12 | 1,628 | - | - | - | - | - | - | 522.50 | 3.12 | 1,628 |
| | | | 50,042 | - | (1,815) | - | - | - | - | | | 48,227 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENT OF SOURCES AND USES OF CHARITY AND ZAKAH FUND

for the year ended 31 December 2011

US\$ 000's

| | 2011 | 2010 |
|---|---------------|--------------|
| Sources of charity and zakah fund | | |
| Non-Islamic income (note 29) | 2 | 6 |
| Total sources | 2 | 6 |
| Uses of charity fund and zakah fund | | |
| Contributions to charitable organisations | (130) | (631) |
| Total uses | (128) | (631) |
| Deficit of uses over sources | (128) | (625) |
| Undistributed charity and zakah fund at 1 January | 10,631 | 11,256 |
| Undistributed charity and zakah fund at 31 December (note 15) | 10,503 | 10,631 |
| Represented by: | | |
| Charity fund | 7,702 | 7,830 |
| Zakah payable | 2,801 | 2,801 |
| | 10,503 | 10,631 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

1 INCORPORATION AND PRINCIPAL ACTIVITY

Gulf Finance House BSC ("the Bank") was incorporated in 1999 in the Kingdom of Bahrain under Commercial Registration No. 44136. The Bank's shares are listed on the Bahrain, Kuwait and Dubai Financial Market Stock Exchanges. The Bank's Global Depository Receipts ('GDR') are listed in the London Stock Exchange. 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 Religious 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 according to the opinion of the Bank's Shari'a Supervisory Board.

Consolidated financial statements

The consolidated financial statements for the year comprise the financial statements of the Bank and its subsidiaries (together referred to as "the Group"). The significant subsidiaries of the Bank include GFH Sukuk Limited, KHCB Asset Company and G Capital Limited (formerly Injazat Capital Limited), which are wholly owned.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these consolidated financial statements are set out below. These accounting policies have been applied consistently to all periods presented in the consolidated financial statements, and have been consistently applied by Group entities, except for the changes resulting from amendments made to the accounting standards (note 2(c)).

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with the Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions. In line with the requirement of AAOIFI and the CBB Rule Book, for matters that are not covered by FAS, the Group uses guidance from the relevant International Financial Reporting Standard (IFRS).

(b) Basis of preparation

The consolidated financial statements are presented in US Dollars, being the principal currency of the Group's operations. They are prepared on the historical cost basis except for the measurement at fair value of certain investment securities. The Group classifies its expenses in the consolidated income statement by the nature of expense method.

Except for changes resulting from the adoption of Statement of Financial Accounting No.1 'Conceptual framework for the financial reporting by Islamic financial institutions' (SFA 1) and FAS 25 'Investment in sukuk, shares and similar instruments', the accounting policies and methods of computation applied by the Group in the preparation of the interim financial information are the same as those used in the preparation of the audited consolidated financial statements for the year ended 31 December 2010.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of preparation (continued)

The preparation of consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the Group's accounting policies. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Management believes that the underlying assumptions are appropriate and the Group's consolidated financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 3.

Going concern

There are two main reasons why the Group is facing a going concern problem, liquidity and regulatory capital adequacy. Due to lack of sufficient liquid assets, and inability of the Group to generate sufficient liquidity from its operations, the ability of the Group to meet its obligations when due is dependent on a timely disposal of assets. Further, the Group's capital adequacy ratio as at 31 December 2011 stood at 12.41% with certain CBB dispensations (compared to the minimum regulatory requirement ratio of 12%), which restricts the Group's ability to absorb further losses or undertake additional exposures. These factors indicate the existence of material uncertainties which may cast doubt, about the Group's ability to continue as a going concern. To address these two issues, the Group has undertaken a number of initiatives. The Group has embarked on a program of assets sale to generate liquidity as well as approach other institutions for banking lines. The Group has also started the process of constructive negotiation with all its lenders to restructure its debts and has received positive response.

During 2011, holders of convertible murabaha notes of US\$ 175 million exercised their option and converted the notes into ordinary shares, thus strengthening the Group's capital position (note 14)

These steps are expected to improve the Group's liquidity position and its capital adequacy ratio. The Board of Directors have reviewed the Group's future plans and are satisfied with the appropriateness of the going concern assumption used in the preparation of the consolidated financial statements.

(c) New standards, amendments and interpretations effective from 1 January 2011

The following standards, amendments and interpretations, which became effective in 2011 are relevant to the Group:

1) SFA 1: Conceptual framework for the financial reporting by Islamic financial institutions

The revised conceptual framework for Financial Reporting by Islamic Financial Institutions was issued on 22 July 2010 and is effective from 1 January 2011 on a prospective basis and supersedes the previous SFA 1 and SFA 2.

The conceptual framework has been amended to primarily reflect the following:

- Widening the scope of the framework to a broader spectrum of entities rather than limiting it to only Islamic financial institutions;
- Clarify elements of financial statements and definitions of investment accounts;

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) New standards, amendments and interpretations effective from 1 January 2011 (continued)

- Provide overall criteria and framework for determination of on and off balance sheet accounts; and
- Changes in terminology and editorial amendments to provide more consistency in understanding of key concepts.

The amended framework introduces and emphasises the generally accepted concept of substance and form compared to the concept of form over substance. The framework states that it is necessary that information, transaction and other events are accounted for and presented in accordance with its substance and economic reality as well as legal form.

The revised conceptual framework has a pervasive impact on financial reporting. However, this has not resulted in any material changes to the accounting policies and the consolidated financial statements of the Group.

2) FAS 25 'Investment in sukuk, shares and similar instruments'

FAS 25 was issued in July 2010 and replaced FAS 17 'Investments'. FAS 25 retains and simplifies the mixed measurement model and establishes two measurement categories for investments: amortised cost and fair value. The standard requires each investment to be first segregated as either debt-type or equity type instruments, and the basis of classification depends on the entity's business model and the contractual cash flow characteristics of the investment. For equity-type investments, an irrevocable election can be made at initial recognition, to recognise unrealised fair value gains and losses (other than impairment) through equity rather than through the income statement. Equity investments at fair value through equity are assessed for impairment if any. Impairment losses are recognised in the income statement. For debt-type investments, based on the cash flow characteristics of the investments, an election can be made at initial recognition to measure the instruments at either amortised cost or fair value. Reclassification between categories is not permitted. The guidance in FAS 17 on 'investment in real estate' continues to apply. The new standard requires retroactive application.

The Group has adopted the revised FAS 25 on its required application date of 1 January 2011. The retroactive adoption of this standard did not result in any impact on the consolidated income statement and owners' equity of the previous period.

On the date of application, the classification and categorisation of investments has been reassessed based on the facts and circumstances on that date. The adoption of the standard resulted in the following re-categorisation of investment securities in the statement of financial position:

US\$ 000's

| 1 January 2010 | Revised categorisation | | |
|---------------------------------------|-------------------------------------|---------------------------|---------|
| | Fair value through income statement | Fair value through equity | Total |
| Previous categorisation as per FAS 17 | | | |
| Fair value through income statement | 33,976 | - | 33,976 |
| Available-for-sale | - | 315,423 | 315,423 |
| | 33,976 | 315,423 | 349,399 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) New standards, amendments and interpretations effective from 1 January 2011 (continued)

| 31 December 2010 | Revised categorisation | | |
|---------------------------------------|-------------------------------------|---------------------------|---------|
| | Fair value through income statement | Fair value through equity | Total |
| Previous categorisation as per FAS 17 | | | |
| Fair value through income statement | 25,860 | - | 25,860 |
| Available-for-sale | - | 222,934 | 222,934 |
| | 25,860 | 222,934 | 248,794 |

(d) Basis of consolidation

(i) Subsidiaries

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries. Subsidiaries are those enterprises (including special purpose entities) controlled by the Bank. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases.

(ii) Special purpose entities

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or investment transaction. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the risks and rewards transferred by the SPE, the Group concludes that it controls the SPE. The assessment of whether the Group has control over an SPE is carried out at inception and normally no further reassessment of control is carried out in the absence of changes in the structure or terms of the SPE, or additional transactions between the Group and the SPE. Where the Group's voluntary actions, such as lending amounts in excess of existing liquidity facilities or extending terms beyond those established originally, change the relationship between the Group and an SPE, the Group performs a reassessment of control over the SPE.

The Group in its fiduciary capacity manages and administers assets held in trust and other investment vehicles on behalf of investors. The financial statements of these entities are usually not included in these consolidated financial statements. Information about the Group's fiduciary assets under management is set out in note 25.

(iii) Associates

Associates are those enterprises in which the Group holds, directly or indirectly, more than 20% of the voting power or exercises significant influence, but not control, over the financial and operating policies. On initial recognition of investment in each associate, the Group makes an accounting policy choice as to whether the associate shall be equity accounted or designated as an investment at fair value through income statement. The Group, being a venture capital organisation, designates certain of its investments in associates, as 'investments carried at fair value through income statement. These are managed, evaluated and reported on internally on a fair value basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Basis of consolidation (continued)

If the equity accounting method is chosen for an associate, the investments are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in the consolidated income statement. The same policy is followed for any incremental stake acquired while maintaining significant influence.

(iv) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions with subsidiaries are eliminated in preparing the consolidated financial statements. Intra-group gains on transactions between the Group and its equity accounted associates are eliminated to the extent of the Group's interest in the investees. Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Accounting policies of the subsidiaries and associates that are equity accounted have been changed where necessary to ensure consistency with the policies adopted by the Group.

(e) Foreign currency transactions

(i) Functional and presentation currency

Items included in the consolidated financial statements are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in US dollars, which is the Group's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items carried at their fair value, such as certain equity securities measured at fair value through equity, are included in investments fair value reserve.

(iii) Group companies

The other Group companies functional currencies are either denominated in US dollars or currencies which are effectively pegged to the US dollars, and hence, the translation of financial statements of the group companies that have a functional currency different from the presentation currency do not result in exchange differences.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Offsetting of financing instruments

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expense are presented on a net basis only when permitted under AAOIFI, or for gains and losses arising from a group of similar transactions.

(g) Investment securities

Investment securities may comprise of debt and equity instruments, but exclude investment in subsidiaries and equity accounted associates (note 2 (d)).

(i) Classification

The Group segregates its investment securities into debt-type instruments and equity-type instruments. Debt-type instruments are investments that provide fixed or determinable payments of profits and capital to the holder of the instrument. Equity-type instruments are investments that do not exhibit features of debt type instruments and evidence a residual interest in the assets of an entity after deducting its liabilities.

Investment in debt-type instruments are classified as investment at fair value through income statement (FVTIS) or investments carried at amortised cost. The Group currently does not hold any debt type instruments as investment securities.

Investments in equity-type instruments are classified in the following categories: 1) at fair value through income statement (FVTIS) or 2) at fair value through equity (FVTE), consistent with the Group's investment strategy.

Equity-type instruments classified and measured at FVTIS include investments held-for-trading or designated at FVTIS.

Investments are classified as held-for-trading if acquired or originated principally for the purpose of generating a profit from short-term fluctuations in price or dealers margin or that form part of a portfolio where there is an actual pattern of short-term profit taking. The Group currently does not have any of its investments classified as investments held-for-trading purposes.

On initial recognition, an equity-type instrument is designated as FVTIS only if the investment is managed and its performance is evaluated and reported on internally by the management on a fair value basis. This category currently includes investment in private equity, funds and certain listed associate companies.

Equity-type instruments other than those designated at fair value through income statement are classified as fair value through equity. These include investments in certain quoted and unquoted equity securities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Investment securities (continued)

(ii) Recognition and de-recognition

Investment securities are recognised at the trade date i.e. the date that the Group commits to purchase or sell the asset, at which date the Group becomes party to the contractual provisions of the instrument. Investment securities are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risk and rewards of ownership.

(iii) Measurement

Investment securities are measured initially at fair value, which is the value of the consideration given. For FVTIS investments transaction costs are expensed in the income statement. For other investment securities, transaction costs are included as a part of the initial recognition.

Subsequent to initial recognition, investments carried at FVTIS and FVTE are re-measured to fair value. Gains and losses arising from a change in the fair value of investments carried at FVTIS are recognised in the income statement in the period in which they arise. Gains and losses arising from a change in the fair value of investments carried at FVTE are recognised in the consolidated statement of changes in equity and presented in a separate fair value reserve within equity. The fair value gains / (losses) are recognised taking into consideration the split between portions related to owners' equity and equity of investment account holders. When the investments carried at FVTE are sold, impaired, collected or otherwise disposed of, the cumulative gain or loss previously recognised in the statement of changes in equity is transferred to the income statement.

Investments at FVTE where the entity is unable to determine a reliable measure of fair value on a continuing basis, such as investments that do not have a quoted market price or there are no other appropriate methods from which to derive reliable fair values, are stated at cost less impairment allowances.

(iv) Measurement principles

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus capital repayments, plus or minus the cumulative amortisation using the effective profit method of any difference between the initial amount recognised and the maturity amount, minus any reduction (directly or through use of an allowance account) for impairment or uncollectibility. The calculation of the effective profit rate includes all fees and points paid or received that are an integral part of the effective profit rate.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), discounted cash flow analyses and other valuation models with accepted economic methodologies for pricing financial instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Placements with and from financial and other institutions

These comprise inter-bank placements made or received under shari'a compliant contracts. Placements are usually short term in nature and are stated at their amortised cost.

(i) Financing receivables

Financing receivables comprise shari'a compliant financing provided to Group's projects which are stated at amortised cost.

(j) Cash and cash equivalents

For the purpose of consolidated statement of cash flows, cash and cash equivalents comprise cash in hand, bank balances and short-term highly liquid assets (placements with financial institutions) with maturities of three months or less when acquired which are subject to insignificant risk of changes in fair value and are used by the Group in the management of its short-term commitments.

(k) Investment property

Investment property comprise land plots. Investment property is property held to earn rentals and/or for capital appreciation. Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is carried at cost less accumulated impairment allowances (if any). Cost includes expenditure that is directly attributable to the acquisition of the investment property.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the period in which the property is derecognised.

(l) Equipment

Equipment are stated at cost, net of accumulated depreciation and impairment, if any. Depreciation is computed using the straight-line method to write-off the cost of the assets over their estimated useful lives ranging from 1 to 5 years for furniture, fixtures and equipments, motor vehicles and computers. The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

(m) Impairment of assets

The Group assesses at each reporting date whether there is objective evidence that a asset is impaired. Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Impairment of assets (continued)

Financial assets carried at amortised cost

For financial assets carried at amortised cost, impairment is measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in consolidated income statement and reflected in an allowance account. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the consolidated income statement.

Investments carried at fair value through equity (FVTE)

In the case of equity type instruments carried at fair value through equity, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in recognition of an impairment loss. If any such evidence exists for equity type instruments, the unrealised re-measurement loss shall be transferred from equity to the income statement. Impairment losses recognised in income statement for an equity investment are reversed directly through equity.

For equity type instruments carried at cost due to the absence of reliable fair value, the Group makes an assessment of whether there is an objective evidence of impairment for each investment by assessment of financial and other operating and economic indicators. Impairment is recognised if the expected recoverable amount is assessed to be below the carrying amount of the investment. All impairment losses are recognised through the income statement and is not reversed.

Other non-financial assets

The carrying amount of the Group's assets or its cash generating unit, other than financial assets, are reviewed at each reporting date to determine whether there is any indication of impairment. A cash generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other asset and groups. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amount of an asset or a cash generating unit is the greater of its value in use or fair value less costs to sell. An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses are reversed only if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount. Separately recognised goodwill is not amortised and is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed.

(n) Financing liabilities

Financing liabilities comprise shari'a compliant financing facilities from financial institutions, financing raised through issue of Sukuk and the liability component of financing from convertible murabaha instruments. Financing liabilities are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective profit rate method. Financing cost, dividends, losses and gains relating to the financial liabilities are recognised in the income statement as finance expense. The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Financing liabilities (continued)

If any financing liability is extinguished by issuing the Bank's ordinary shares, the Group recognises the difference between the carrying amount of the financing liability extinguished and fair value of the shares issued in the income statement.

Financing liabilities include compound financial instrument in the form of 'convertible murabaha' issued by the Group that can be converted to share capital at the option of the holder. The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognised initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of the convertible murabaha is measured at amortised cost using the effective profit rate method. The equity component of a compound financial instrument is not remeasured subsequent to initial recognition.

(o) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. A financial guarantee contract is recognised from the date of its issue. The liability arising from a financial guarantee contract is recognised at the present value of any expected payment, when a payment under the guarantee has become probable. The Group has issued financial guarantees to support its development projects (refer note 36 for details).

(p) Dividends and board remuneration

Dividends to shareholders and board remuneration are recognised as liabilities in the period in which they are declared.

(q) Share capital and reserves

Ordinary shares are classified as equity. The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Equity instruments of the group comprise ordinary shares and equity component of share-based payments and convertible instruments. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

Treasury shares

The amount of consideration paid including all directly attributable costs incurred in connection with the acquisition of the treasury shares are recognised in equity. Consideration received on sale of treasury shares is presented in the financial statements as a change in equity. No gain or loss is recognised on the Group's income statement on the sale of treasury shares.

Statutory reserve

The Bahrain Commercial Companies Law 2001 requires that 10 percent of the annual net profit be appropriated to a statutory reserve which is normally distributable only on dissolution. Appropriations may cease when the reserve reaches 50 percent of the paid up share capital.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) Equity of investment account holders

Equity of investment account holders are funds held by the Group, which it can invest at its own discretion. The investment account holder authorises the Group to invest the account holders' funds in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested. The Group charges management fee (Mudarib fees) to investment account holders. Of the total income from investment accounts, the income attributable to customers is allocated to investment accounts after setting aside provisions, reserves and deducting the Group's share of income. The allocation of income is determined by the management of the Group within the allowed profit sharing limits as per the terms and conditions of the investment accounts. Administrative expenses incurred in connection with the management of the funds are borne directly by the Group and are not charged separately to investment accounts. Equity of Investment account holders are carried at their book values and include amounts retained towards profit equalisation and investment risk reserves.

Profit equalisation reserve is the amount appropriated by the Bank out of the Mudaraba income, before allocating the Mudarib share, in order to maintain a certain level of return to the deposit holders on the investments. Investment risk reserve is the amount appropriated by the Bank out of the income of investment account holders, after allocating the Mudarib share, in order to cater against future losses for investment account holders. Creation of an these reserves results in an increase in the liability towards the pool of investment accounts holders.

Restricted investment accounts

Restricted investment accounts represents assets acquired by funds provided by holders of restricted investment accounts and their equivalent and managed by the Group as an investment manager based on either a Mudaraba contract or agency contract. The restricted investment accounts are exclusively restricted for investment in specified projects as directed by the investments account holders. Assets that are held in such capacity are not included as assets of the Group in the consolidated financial statements.

(s) Revenue recognition

Income from investment banking services is recognised at the fair value of consideration received / receivable and when the service is provided and income is earned. This is usually when the Group has performed all significant acts in relation to a transaction and it is highly probable that the economic benefits from the transaction will flow to the Group. Significant acts in relation to a transaction are determined based on the terms for each transaction.

Management and other fees are recognised as income when earned and the related services are performed.

Income from placements with / from financial institutions are recognised on a time-apportioned basis over the period of the related contract using the effective profit rate.

Income from financing receivables is recognised using the effective profit rates of the receivables over the period of the contract.

Dividend income from investment securities is recognised when the right to receive is established. This is usually the ex-dividend date for equity securities.

(t) Earnings prohibited by Shari'a

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Group uses these funds for charitable means.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(u) Zakah

Pursuant to the decision of the shareholders', the Group is required to pay Zakah on its undistributed profits. The Group is also required to calculate and notify, under a separate report, individual shareholders of their pro-rata share of the Zakah payable by them on distributed profits. These calculations are approved by the Group's Shari'a Supervisory Board.

(v) Employees benefits

(i) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably. Termination benefits are recognised as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy.

(ii) Post employment benefits

Pensions and other social benefits for Bahraini employees are covered by the Social Insurance Organisation scheme, which is a "defined contribution scheme" in nature under, and to which employees and employers contribute monthly on a fixed-percentage-of-salaries basis. Contributions by the Bank are recognised as an expense in consolidated income statement when they are due.

Expatriate and certain Bahraini employees on fixed contracts are entitled to leaving indemnities payable, based on length of service and final remuneration. Provision for this unfunded commitment, has been made by calculating the notional liability had all employees left at the reporting date. These benefits are in the nature of a "defined benefit scheme" and any increase or decrease in the benefit obligation is recognised in the income statement.

The Bank also operates a voluntary employees saving scheme under which the Bank and the employee contribute monthly on a fixed percentage of salaries basis. The scheme is managed and administered by a board of trustees who are employees of the Bank. The scheme is in the nature of a defined contribution scheme and contributions by the Bank are recognised as an expense in the income statement when they are due.

(iii) Share-based employee incentive scheme

The Bank operates a share-based incentive scheme for its employees (the "Scheme") whereby employee are granted the Bank's shares as compensation on achievement of certain non-market based performance conditions and service conditions (the 'vesting conditions').

The grant date fair value of equity instruments granted to employees is recognised as an employee expense, with a corresponding increase in equity over the period in which the employees become unconditionally entitled to the share awards.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

v) Employee benefits (continued)

Non-vesting conditions are taken into account when estimating the fair value of the equity instrument but are not considered for the purpose of estimating the number of equity instruments that will vest. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value but are considered for the purpose of estimating the number of equity instruments that will vest. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date. Amount recognised as expense are not trued-up for failure to satisfy a market condition.

(w) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that effect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances.

Judgements

(i) Classification of investments

In the process of applying the Group's accounting policies, management decides on acquisition of an investment whether it should be classified as investments at fair value through income statement or investments carried at fair value through equity or investments carried at amortised cost. The classification of each investment reflects the management's intention in relation to each investment and is subject to different accounting treatments based on such classification [note 2 (g)].

(ii) Special purpose entities

The Group sponsors the formation of special purpose entities (SPE's) primarily for the purpose of allowing clients to hold investments. The Group provides corporate administration, investment management and advisory services to these SPE's, which involve the Group making decisions on behalf of such entities. The Group administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments. The Group does not consolidate SPE's that it does not have the power to control. In determining whether the Group has the power to control an SPE, judgements are made about the objectives of the SPE's activities, its exposure to the risks and rewards, as well as about the Group intention and ability to make operational decisions for the SPE and whether the Group derives benefits from such decisions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Estimations

(i) Fair value of investments

The Group determines fair value of investments designated at fair value that are not quoted in active markets by using valuation techniques such as discounted cash flows and recent transaction prices. Fair value estimates are made at a specific point in time, based on market conditions and information about the investee companies. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore, cannot be determined with precision. There is no certainty about future events (such as continued operating profits and financial strengths). It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the investments. In case where discounted cash flow models have been used to estimate fair values, the future cash flows have been estimated by the management based on information from and discussions with representatives of the management of the investee companies, and based on the latest available audited and un-audited financial statements. The basis of valuation have been reviewed by the Management in terms of the appropriateness of the methodology, soundness of assumptions and correctness of calculations and have been approved by the Board of Directors for inclusion in the consolidated financial statements.

(ii) Impairment on investments carried at fair value through equity

Equity-type instruments classified as investments at FVTE but carried at cost less impairment due to the absence of reliable measure of fair value are tested for impairment. A significant portion of the Group's equity-type investments comprise investments in long-term real estate and infrastructure development projects. In making an assessment of impairment, the Group evaluates among other factors, liquidity of the project, evidence of a deterioration in the financial health of the project, impacts of delays in execution, industry and sector performance, changes in technology, and operational and financing cash flows. The Group has exposures to investments and projects that operate in countries and geographies where business and political environment are subject to rapid changes. The performance of the investments and recoverability of exposures is based on condition prevailing and information available with management as at the reporting date. It is the management's opinion that the current level of provisions are adequate and reflect prevailing conditions and available information. It is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of the investments within the next financial year due to significant changes in the assumptions underlying such assessments.

(iii) Investment property

The Group conducts valuation of its investment property periodically using external independent valuers to assess for impairment. The fair value is determined based on the market value of the property through the comparable method, analysing the land rates in the vicinity for similar assumed zoning regulations. All of the Group's investment property is situated in Bahrain. Given the dislocation in the local property market and infrequent property transactions, it is reasonably possible, based on existing knowledge, that the current assessment of impairment could require a material adjustment to the carrying amount of these assets within the next financial year due to significant changes in assumptions underlying such assessments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

(iv) Impairment of receivables

Each counterparty exposure is evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently evaluated by the Risk Management Department.

(v) Impairment of cash generating units

Cash generating includes the Group's investments in certain subsidiaries and investment in equity accounted associates that generate cash flows that are largely independent from other assets and activities of the Group. The basis of impairment assessment for such cash generating units is described in accounting policy 2 (m). For investments in associates with indicators of impairment, the recoverable amounts of have been determined based on value in use calculations.

Value in use for the investment in associate was determined by discounting the future cash flows expected to be generated from the continuing operations. The calculation of the value in use was based on the following key assumptions.

- Cash flows were projected based on past experience, actual operating results for 2011 and the 4-year business plan with a growth rate of 2%. The forecast period is based on the Group's long-term perspective with respect to the investment; and
- Discount rates of 15.2% percent was applied in determining the recoverable amounts for the investment in associate. These discount rates were estimated based on past experience and the weighted average cost of capital, size of the investment and risk associated with implementation of new strategy.

The key assumptions described above may change as economic and market conditions change. The Group estimates that reasonably possible changes in these assumptions are not expected to cause the recoverable amount to decline below the carrying amount.

4 CASH AND BANK BALANCES

| | 31 December 2011 | 31 December 2010 |
|---------------|---------------------|---------------------|
| Cash on hand | 16 | 8 |
| Bank balances | 3,804 | 3,762 |
| | 3,820 | 3,770 |

5 PLACEMENTS WITH FINANCIAL INSTITUTIONS

| | 31 December 2011 | 31 December 2010 |
|------------------------|---------------------|---------------------|
| Gross placements | 3,002 | 56,870 |
| Less: Deferred profits | (1) | (2) |
| | 3,001 | 56,868 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

6 FINANCING RECEIVABLES

| | 31 December 2011 | 31 December 2010 |
|--------------------------------|---------------------|---------------------|
| Murabaha financing receivables | - | 14,400 |
| Wakala financing receivables | 62,650 | 62,650 |
| | 62,650 | 77,050 |
| | - | - |
| Less: Provision for impairment | (62,650) | (62,650) |
| | - | 14,400 |

Murabaha financing receivables are net of deferred profits of US\$ NIL (2010: US\$ 1,832 thousand).

7 INVESTMENT IN ASSOCIATES

Investment in associates comprise:

| Name | Country of incorporation | % holding | Nature of business |
|-------------------------------------|--------------------------|-----------|---|
| Khaleeji Commercial Bank BSC (KHCB) | Bahrain | 46.965% | Islamic retail bank |
| Cemena Investment Company (CIC) | Cayman Islands | 38.97% | Investment Holding Company for cement manufacturing |

The movement in investment in associates is given below:

| | 2011 | 2010 |
|--|----------------|----------------|
| At 1 January | 224,847 | 376,424 |
| Acquisitions during the year | 3,000 | 35,152 |
| Share of profits / (losses) from associates | 2,595 | (11,729) |
| Disposals during the year, at carrying value | - | (175,000) |
| At 31 December | 230,442 | 224,847 |

The investment in KHCB has a carrying value of US\$ 162,629 thousand (31 December 2010: US\$ 158,550 thousand) and a fair value based on a quoted price of US\$ 57,554 thousand (31 December 2010: US\$ 93,457 thousand). Based on an assessment of the value-in-use of the associate, the Group has concluded that the investment is not impaired (note 2(m)).

The Group's investment in KHCB is pledged towards a Murabaha financing facility and the investment in CIC is allocated against the asset pool of the Sukuk certificates (refer note 14).

Summarised financial information of associates that have been equity accounted not adjusted for the percentage ownership held by the Group (based on most recent audited financial statements):

| | 2011 | 2010 |
|------------------------------|-----------|-----------|
| Total assets | 1,590,555 | 1,417,983 |
| Total liabilities | 498,089 | 363,381 |
| Total revenues | 124,826 | 62,839 |
| Total net profits / (losses) | 5,812 | (66,466) |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

8 INVESTMENT SECURITIES

| | 31 December 2011 | 31 December 2010 |
|--|---------------------|---------------------|
| Equity type instruments | | |
| <i>Fair value through income statement</i> | | |
| - Quoted securities | 990 | 3,140 |
| - Unquoted funds | 4,202 | 2,500 |
| - Unquoted securities | - | 20,220 |
| <i>Fair value through equity</i> | | |
| - Quoted securities | 475 | 475 |
| - Unquoted securities | 214,598 | 222,459 |
| | 220,265 | 248,794 |

a) At fair value through equity

| | 2011 | 2010 |
|--|----------------|----------------|
| At 1 January | 222,934 | 315,423 |
| Acquisitions during the year | 8,907 | 155,265 |
| Changes in fair value of investments | (521) | - |
| Disposals during the year, at carrying value | (8,127) | (103,233) |
| Provision for impairment during the year | (8,120) | (144,521) |
| At 31 December | 215,073 | 222,934 |

Investments at fair value through equity include private equity investments managed by external investment managers or investments in projects promoted by the Group. Investments at fair value through equity of US\$ 214,598 (31 December 2010: 222,459 thousand) are carried at cost less impairment in the absence of a reliable measure of fair value. The Group plans to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

Investments at fair value through equity are primarily in unlisted equities in various real estate and infrastructure development projects in different countries. Impairment allowance has been established based on management's assessment of the current market conditions, the marketability of the investments and the assessment of recoverable amounts.

b) At fair value through income statement

| | 2011 | 2010 |
|--|--------------|---------------|
| At 1 January | 25,860 | 33,976 |
| Acquisitions during the year | - | 1,617 |
| Disposals during the year, at carrying value | (20,220) | (4,233) |
| Fair value changes during the year | (448) | (5,500) |
| At 31 December | 5,192 | 25,860 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

8 INVESTMENT SECURITIES (continued)

Summarised financial information of associates designated at fair value through income statement not adjusted for the percentage ownership held by the Group (based on most recent audited / unaudited management accounts):

| | 2011 | 2010 |
|------------------------------|---------|---------|
| Total assets | 26,063 | 112,969 |
| Total liabilities | 9,079 | 25,826 |
| Total revenues | 8,590 | 76,838 |
| Total (losses) / net profits | (1,785) | 4,865 |

9 INVESTMENT PROPERTY

In 2010, the Group received plots of land in exchange for the Group's investment in an associate and settlement of certain receivables. The Group has classified the plots of land as investment property and follows the cost model for measurement. Investment property of carrying amount of US\$ 203 million (2010: US\$ 203 million) is pledged against a Wakala facility (note 14) and any proceeds from the investment property would be first applied towards the repayment of the facility.

During 2011, the Group recognised an impairment allowance of US\$ Nil thousand (2010: US\$ 12 million) against the investment property based on assessment of its recoverable amount. The fair value of the Group's investment property at 31 December 2011 was US\$ 261,199 thousand (31 December 2010: US\$ 276,627 thousand) based on a valuation carried out by an independent external valuer.

10 OTHER ASSETS

| | 31 December 2011 | 31 December 2010 |
|----------------------------------|------------------|------------------|
| Financing to projects * | 66,970 | 73,716 |
| Equipment (note 11) | 2,454 | 7,137 |
| Reimbursement right (note 36) | 35,000 | 121,111 |
| Prepayment and other receivables | 4,489 | 1,186 |
| | 108,913 | 203,150 |

* Financing to projects represents working capital and other funding facilities provided to projects promoted by the Group in the normal course of business. The financing is expected to be recovered from the operating cash flows of the underlying project assets. Financing to projects and other receivables are net of impairment allowance of US\$ 135,907 thousand (31 December 2010: US\$ 135,907 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

11 EQUIPMENT

| | Furniture | Fixtures and equipment | Motor vehicles | Computers | 2011 Total | 2010 Total |
|--|--------------|------------------------|----------------|--------------|---------------|---------------|
| Cost | | | | | | |
| At 1 January | 2,023 | 15,475 | 160 | 11,450 | 29,108 | 29,086 |
| Additions | - | 1 | - | 2 | 3 | 609 |
| Disposals | - | (145) | (93) | (2,374) | (2,612) | (587) |
| Impairment allowances | - | (3,000) | - | - | (3,000) | - |
| At 31 December | 2,023 | 12,331 | 67 | 9,078 | 23,499 | 29,108 |
| Depreciation | | | | | | |
| At 1 January | 1,064 | 7,779 | 96 | 10,032 | 18,971 | 13,459 |
| Charge for year | 387 | 2,956 | 6 | 1,224 | 4,573 | 5,896 |
| Disposals | - | (138) | (62) | (2,299) | (2,499) | (384) |
| At 31 December | 1,451 | 10,597 | 40 | 8,957 | 21,045 | 18,971 |
| Provision for impairment during the year | - | - | - | - | - | (3,000) |
| Net book value At 31 December | 572 | 1,734 | 27 | 121 | 2,454 | 7,137 |

12 INVESTORS' FUNDS

These represent funds of projects set-up and promoted by the Bank and placed with the Bank pending disbursement to the projects concerned.

13 PLACEMENTS FROM FINANCIAL AND OTHER INSTITUTIONS

These comprise placements (murabaha and wakala) accepted from financial and other institutions (including corporates) as part of the Group's treasury activities.

14 FINANCING LIABILITIES

| | 31 December 2011 | 31 December 2010 |
|--|------------------|------------------|
| Murabaha financing | 102,832 | 101,796 |
| Wakala financing | 51,535 | 66,288 |
| Sukuk liability | 162,190 | 152,123 |
| Convertible murabaha (2009) | 14,520 | 23,437 |
| Advance received for convertible murabaha (2010) | - | 95,860 |
| | 331,077 | 439,504 |

Murabaha financing

Murabaha financing comprise a medium-term financing from a syndicate of banks of US\$ 100 million (31 December 2010: US\$ 100 million). The financing is repayable in July 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 Murabaha financing facilities are secured by a pledge over the Group's investment in an associate of carrying value of US\$ 162.63 million (note 7).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

14 FINANCING LIABILITIES (continued)

Wakala financing

Wakala financing is a syndicate facility from a number of financial institutions. During the year, the Group renegotiated the facility. As per the revised terms, the balance is repayable over a period of two years till April 2013 at an agreed profit rate of 8%. The Wakala financing facility is secured by a pledge over the Group's investment property of carrying value of US\$ 203 million. The Group is currently negotiating to restructure the facility and has also deferred the payment pertaining to September 2011 instalment.

Sukuk

The Sukuk have a tenure of 5 years maturing in June 2012 and returns based on an agreed spread of 175 bps over the benchmark rate (LIBOR). The Sukuk are backed by a pool of assets of the Group and has a liquidity facility provided by the Bank to support timely payments of distributions. The Sukuk are traded on the London Stock Exchange's Gilt Edged and Fixed Interest Market. The Sukuk Certificates are backed by the Group's investment securities with carrying values of US\$ 199,669 thousand (31 December 2010: US\$ 183,923 thousand).

During the year, the Group was in technical breach of certain financial covenants of the Sukuk programme and the Group is currently in discussion with the sukuk note holders for revising the covenant terms. Subsequent to the year end, the Bank has commenced negotiation with the lenders for extension of the repayment terms.

During 2011, the Group repurchased Sukuk Certificates of nominal value US\$ 2 million (2010: US\$ 15 million) and resold Sukuk Certificates of face value US\$ 12 million and incurred a loss of US\$ 4.8 million due to amortised cost remeasurement which has been included under "Finance expense" (note 22).

Convertible murabaha 2009

During 2009, the Group issued a compound financial instrument ("Notes") in the form of unsecured convertible murabaha facility. The Notes had tenure of 3 years maturing in October 2012 unless converted into ordinary shares of the Bank at the option of the holder, at an exchange price of US\$ 1.52 per share (adjusted for the 2010 share consolidation). The Notes provide for returns of 8% p.a. payable quarterly to the holder. During 2011, Note holders amounting to US\$ 10 million exchanged the 2009 Notes with the 2010 series of the convertible murabaha (see below).

Convertible Murabaha 2010

In 2010, the Group launched a new series of convertible murabaha to raise additional capital. The new series of convertible murabaha provide for returns of 12% p.a. payable quarterly to the holder and has a tenure of 3.5 years from the date of issue, unless converted into ordinary shares of the Bank at the option of the holder, at an exchange price of US\$ 0.31 per share. During the year, Note holders of US\$ 175.25 million exercised their option to convert resulting in the issue of 569,921 thousand ordinary shares as per the terms of the convertible murabaha (refer note 17).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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15 OTHER LIABILITIES

| | 31 December 2011 | 31 December 2010 |
|--|---------------------|---------------------|
| Employee related accruals (note 21) | 2,252 | 22,898 |
| Unclaimed dividends | 7,592 | 8,140 |
| Provision for employees' leaving indemnities | 945 | 472 |
| Charity and zakah fund (page 12) | 10,503 | 10,631 |
| Provision against financial guarantees (note 36) | 35,000 | 121,111 |
| Accounts payable | 14,694 | 3,053 |
| Accrued expenses and other payables | 12,896 | 29,230 |
| | 83,882 | 195,535 |

16 EQUITY OF INVESTMENT ACCOUNT HOLDERS

Unrestricted investment accounts comprise Mudarabah deposits accepted by the Bank. The average gross rate of return in respect of unrestricted investment accounts was 0.27% for 2011 (2010: 0.67%). Approximately 0.27% / US\$ 19 thousand (2010: 0.67% / US\$ 14 thousand) was distributed to investors and the balance was either set aside for provisions and/or retained by the Bank as a Mudarib fee. Unrestricted investment accounts include profit equalisation reserve of US\$ 5 thousand (2010: US\$ 4 thousand) and investment risks reserve of US\$ 3 thousand (2010: US\$ 2 thousand). The funds received from equity of investment account holders have been commingled and jointly invested with the Group in placements with financial institutions.

17 SHARE CAPITAL

| | 31 December 2011 | 31 December 2010 |
|---|---------------------|---------------------|
| Authorised: | | |
| 4,878,048,780 shares of US\$ 0.3075 each (2010: 4,878,048,780 shares of US\$ 0.3075 each) | 1,500,000 | 1,500,000 |
| Issued and fully paid up: | | |
| 1,044,004,808 shares of US\$ 0.3075 each (2010: 474,083,141 shares of US\$ 0.3075 each) | 321,031 | 145,780 |

The movement in the share capital during the year ended 31 December 2011 is as follows:

| | 2011 | 2010 |
|--|----------------|-----------|
| At 1 January | 145,780 | 604,079 |
| Conversion of murabaha to share capital (note 14) | 175,251 | 21,711 |
| Adjustment of accumulated losses for capital reduction | | (480,010) |
| At 31 December | 321,031 | 145,780 |

During the year, the paid up capital of the Bank was increased from US\$ 145,780 thousand to US\$ 321,031 thousand as a result of exercise of conversion option by the holders of the convertible murabaha (note 14). As per the terms of the convertible murabaha, 569,921 thousand shares of par value US\$ 0.3075 thousand has been issued on conversion. The effective conversion price is below the par value per share and the resulting difference and the related share issue expenses has been adjusted against the share premium account (note 14).

At 31 December 2011, the Bank held 6,404,016 (31 December 2010: 2,803,305) treasury shares. Treasury shares disposed during the year, represent shares transferred at market price towards settlement of a payable to a related party towards acquisition of additional stake in an associate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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17 Share capital (continued)

During 2010, pursuant to the approval of the shareholders in the Extraordinary general meeting on 14 November 2010, the paid -up capital of the Bank decreased from US\$ 625,790 thousand to US\$ 145,780 thousand as a result of the following:

- consolidation of issued and fully paid -up shares of the Bank at a ratio of 4:1 thereby reducing number of shares from 1,896,332,565 to 474,083,141;
- adjustment of accumulated losses to the extent of US\$ 480 million against the paid up share capital of the Bank; and
- reduction of par value per share from US\$ 0.33 to US\$ 0.3075 per share.

Additional information on shareholding pattern

- The Bank has only one class of equity shares and the holders of these shares have equal voting rights.
- Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories:

| Categories* | Number of shares | Number of shareholders | % of total outstanding shares |
|-----------------------|----------------------|------------------------|-------------------------------|
| Less than 1% | 495,254,254 | 7,228 | 47.44 |
| 1% up to less than 5% | 265,655,611 | 9 | 25.45 |
| More than 10% | 283,094,943 | 2 | 27.12 |
| | 1,044,004,808 | 7,239 | 100 |

* Expressed as a percentage of total outstanding shares of the Bank.

- Shareholders who hold more than 5% are as follows:

| Name | Nationality | No. Of shares |
|-----------------------------------|-------------|---------------|
| Royal Guard of Oman | Omani | 127,412,612 |
| Dr. Esam Yousif Abdulkarim Janahi | Bahraini | 155,682,331 |

18 OTHER RESERVES

| | 2011 | | | 2010 | | |
|--|---------------------|--|--------------|---------------------|--|--------------|
| | Share grant reserve | Equity component of convertible murabaha | Total | Share grant reserve | Equity component of convertible murabaha | Total |
| At 1 January | 1,136 | 633 | 1,769 | 3,034 | 1,266 | 4,300 |
| Transfer on conversion | - | (253) | (253) | - | (633) | (633) |
| Vesting expense, net of forfeiture (note 21) | (139) | - | (139) | (1,898) | - | (1,898) |
| At 31 December | 997 | 380 | 1,377 | 1,136 | 633 | 1,769 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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19 INCOME / (LOSS) FROM INVESTMENT SECURITIES

| | 2011 | 2010 |
|---|---------------|----------------|
| Dividend income | 7,492 | 2,230 |
| Profit on disposal of investment securities | 4,797 | 1,890 |
| Fair value changes of investments designated at fair value through income statement | (448) | (5,500) |
| | 11,841 | (1,380) |

20 OTHER INCOME

Other income includes US\$ 20.33 million of 2008 employee incentive scheme accruals written back on the directive of the regulator, US\$ 17.94 million of excess board fees and other accruals written back and US\$ 6.525 million of profit on sale of a land purchased and sold during the year.

21 STAFF COST

| | 2011 | 2010 |
|---------------------------|---------------|---------------|
| Salaries and benefits | 10,019 | 16,904 |
| Social insurance expenses | 494 | 731 |
| | 10,513 | 17,635 |

The Bank operates a share incentive scheme for its employees. The share awards granted under the scheme have an initial lock-in period of 3 years and shall vest rateably over varied vesting periods of up to 10 years as per the terms of the scheme. Of the cumulative 16.09 million (2010: 16.09 million) share awards granted under the terms of the scheme, 12.6 million were forfeited (2010: 11.15 million) due to failure to satisfy service conditions specified at grant date. At 31 December 2011, 3.49 million (31 December 2010: 4.94 million) share awards are outstanding to be exercised at a price of US\$ 0.75 per share in future periods on satisfaction of the vesting conditions. A net reversal of vesting charge amounting to US\$ 139 thousand (2010: US\$ 1,898 thousand) was recognised during the year primarily due to the forfeitures of share awards on non-satisfaction of service conditions (note 18).

22 TOTAL FINANCE INCOME AND EXPENSE

| | 2011 | 2010 |
|--|-----------------|-----------------|
| TOTAL FINANCE INCOME | | |
| Income from placements with financial institutions | 893 | 1,148 |
| Income from financing receivables | 1,198 | 651 |
| | 2,091 | 1,799 |
| TOTAL FINANCE EXPENSE | | |
| Investors' funds | 3,040 | 5,585 |
| Placements from financial and other institutions | 3,060 | 10,753 |
| Financing liabilities | 19,582 | 29,460 |
| Loss on disposal of sukuk (note 14) | 4,800 | 4,223 |
| Equity of investment account holders (note 16) | 19 | 14 |
| | 30,501 | 50,035 |
| | (28,410) | (48,236) |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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23 OTHER EXPENSES

| | 2011 | 2010 |
|----------------------------------|---------------|---------------|
| Rent | 2,989 | 3,149 |
| Professional and consultancy fee | 3,240 | 7,025 |
| Legal expenses | 1,004 | 2,307 |
| Depreciation | 4,573 | 5,896 |
| Other operating expenses | 4,057 | 7,404 |
| | 15,863 | 25,781 |

24 IMPAIRMENT ALLOWANCES

| | 2011 | 2010 |
|---|--------------|----------------|
| Investment securities (note 8) | 8,120 | 144,521 |
| Investment property (note 9) | - | 12,000 |
| Receivable from investment banking services | - | 60,540 |
| Other receivables | - | 36,058 |
| Equipment (note 11) | - | 3,000 |
| | 8,120 | 256,119 |

25 ASSETS UNDER MANAGEMENT

The Group provides corporate administration, investment management and advisory services to its project companies, which involve the Group making decisions on behalf of such entities. Assets that are held in such capacity are not included in these consolidated financial statements. At the reporting date, the Group had assets under management of US\$ 2,180,529 thousand (31 December 2010: US\$ 2,282,415 thousand). During the year, the Group has charged management fees amounting to US\$ 1,476 thousand (2010: US\$ 7,085 thousand) for the activities related to management of assets.

26 RELATED PARTY 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.

A significant portion of the Group's income from investment banking services and management fees are from entities over which the Group exercises influence (assets under management). Although these entities are considered related parties, the Group administers and manages these entities on behalf of its clients, who are by and large third parties and are the economic beneficiaries of the underlying investments. The transactions with these entities are based on agreed terms.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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26 RELATED PARTY TRANSACTIONS (continued)

The significant related party balances and transactions (excluding compensation to key management personnel) included in these consolidated financial statements are as follows:

| 2011 | Associates | Key management personnel | Significant shareholders / entities in which directors are interested | Assets under management including special purpose entities and other entities | Total |
|--|------------|--------------------------|---|---|---------|
| Assets | | | | | |
| Cash and bank balances | 708 | - | - | - | 708 |
| Placements with financial institutions | 3,001 | - | - | - | 3,001 |
| Investment in associates | 230,442 | - | - | - | 230,442 |
| Investment securities | 5,192 | - | 63,165 | 122,563 | 190,920 |
| Other assets | - | - | - | 80,626 | 80,626 |
| Liabilities | | | | | |
| Investors' funds | 26,691 | - | - | 32,146 | 58,837 |
| Placements from financial and other institutions | 27 | - | - | 11,955 | 11,982 |
| Other liabilities | - | - | - | 35,000 | 35,000 |
| Income | | | | | |
| Income from investment banking services | - | - | - | 4,320 | 4,320 |
| Management fees | 535 | - | - | 2,775 | 3,310 |
| Income from financing receivables | - | - | 1,198 | - | 1,198 |
| Share of profit from investment in associates | 2,595 | - | - | - | 2,595 |
| Income from investment securities, net | 13,555 | - | - | - | 13,555 |
| Other Income | 270 | - | 344 | 3,000 | 3,614 |
| Expenses | | | | | |
| Impairment allowances | - | - | - | 6,345 | 6,345 |
| Equity | | | | | |
| Sale of Treasury shares | - | 2,932 | - | - | 2,932 |
| Commitments | | | | | |
| Commitment to extend finance | - | - | - | 82,636 | 82,636 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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26 RELATED PARTY TRANSACTIONS (continued)

| 2010 | 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 | 583 | - | - | - | 583 |
| Financing receivables | - | - | 14,400 | - | 14,400 |
| Investment in associates | 224,847 | - | - | - | 224,847 |
| Investment securities | 25,860 | - | 55,897 | 121,314 | 203,071 |
| Other assets | 93 | - | - | 194,706 | 194,799 |
| Liabilities | | | | | |
| Investors' funds | 60,762 | - | - | 77,837 | 138,599 |
| Placements from financial and other institutions | 27 | - | 13,392 | - | 13,419 |
| Financing liabilities | - | 50,492 | - | - | 50,492 |
| Other liabilities | - | - | - | 121,111 | 121,111 |
| Income | | | | | |
| Income from investment banking services | - | - | - | 4,982 | 4,982 |
| Management fees | - | - | - | 7,085 | 7,085 |
| Income from financing receivables | - | - | 415 | - | 415 |
| Loss from investment in associates | (11,729) | - | - | - | (11,729) |
| Loss from investment securities, net | (5,500) | - | - | 6,811 | 1,311 |
| Other Income | 1,760 | - | 498 | 3,740 | 5,998 |
| Expenses | | | | | |
| Finance expense | - | 334 | 606 | 2,296 | 3,236 |
| Impairment allowances | - | - | - | 197,561 | 197,561 |
| Commitments | | | | | |
| Commitment to extend finance | 16,500 | - | - | - | 16,500 |

Key management personnel

Key management personnel of the Group comprise of the Board of Directors and key members of management having authority and responsibility for planning, directing and controlling the activities of the Group.

Details of Directors' interests in the Bank's ordinary shares as at the end of the year were:

| Categories* | Number of Shares | Number of Directors |
|------------------------|------------------|---------------------|
| 10% upto less than 20% | 155,682,331 | 1 |

* Expressed as a percentage of total outstanding shares of the Bank.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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26 RELATED PARTY TRANSACTIONS (continued)

Details of material contracts involving directors' include:

| | 2011 | 2010 |
|---|------|-------|
| Directors' participation in investments promoted by the Group | - | 7,160 |

The key management personnel compensation is as follows:

| | 2011 | 2010 |
|--|-------|-------|
| Board member fees | 27 | 2,477 |
| Salaries and other short-term benefits | 2,550 | 2,625 |
| Post employment benefits | 392 | 54 |

27 EARNINGS PER SHARE

Basic earnings per share

Basic earnings per share is calculated by dividing the profit / (loss) for the year by the weighted average number of equity shares outstanding during the year.

| | 2011 | 2010 |
|---|---------|-----------|
| Profit / (loss) for the year from continuing operations (US\$ 000's) | 381 | (348,879) |
| Loss for the year from discontinued operations (US\$ 000's) | - | (522) |
| Weighted average number of ordinary shares (Nos. in 000's) | 912,166 | 454,021 |
| Basic and diluted earnings per share from continuing operations (in US cents) | 0.04 | (76.84) |
| Basic and diluted earnings per share from discontinued operations (in US cents) | - | (0.11) |

The weighted average number of ordinary equity shares for the comparative periods presented are adjusted for the issue of shares during the year without corresponding change in resources.

Diluted earnings per share

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. Potential ordinary shares are considered to be dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase the loss per share. The Bank has two categories of dilutive potential ordinary shares: convertible murabaha notes (note 14) and share awards granted to employees (note 21).

During the year, all the note holders of the convertible murabaha facility 2010 have exercised their rights to convert the notes to equity shares of the Bank. Further, in case of the share awards granted to employees, as the average market value of shares during the current year was lower than the assumed issue price of shares under the scheme, the share awards are not considered to be dilutive as at 31 December 2011. Also, in case of the convertible murabaha series issued in 2009, the average market value of shares during the year was lower than the convertible price as per the convertible murabaha series 2009. Accordingly, no adjustment for dilution has been made for the purposes of computation of diluted earnings per share.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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28 ZAKAH

Zakah is directly borne by the shareholders on distributed profits and investors in restricted investment accounts. The Bank does not collect or pay Zakah on behalf of its shareholders and investors in restricted investment accounts. Zakah payable by the shareholders is computed by the Bank on the basis of the method prescribed by the Bank's Shari'a Supervisory Board and notified to shareholders annually. Zakah payable by the shareholders for the year ended 31 December 2011 is US\$ Nil (2010: Nil).

29 EARNINGS PROHIBITED BY SHARI'A

The Group is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity account where the Group uses these funds for charitable means. Movements in non-Islamic funds are shown in the statement of sources and uses of charity funds.

The Group receives interest from deposits placed with the Central Bank of Bahrain and other incidental or required deposits. These earnings are utilised exclusively for charitable purposes and amounts to US\$ 2 thousand (2010: US\$ 6 thousand).

30 SHARI'A SUPERVISORY BOARD

The Group's Shari'a Supervisory Board consists of four Islamic scholars who review the Group's compliance with general Shari'a principles and specific fatwas, rulings and guidelines issued. Their review includes examination of evidence relating to the documentation and procedures adopted by the Group to ensure that its activities are conducted in accordance with Islamic Shari'a principles.

31 SOCIAL RESPONSIBILITY

The Group discharges its social responsibilities through donations to charitable causes and social organisations.

32 MATURITY PROFILE

The table below shows the maturity profile of the Group's assets and liabilities and unrecognised commitments on the basis of their expected realisation/ payment and the Group's contractual maturity and amount of cash flows on these instruments may vary significantly from this analysis. For contractual maturity of financial liabilities refer note 37 (b).

| 31 December 2011 | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total |
|--|----------------|---------------|-----------------|----------------|--------------|----------------|
| Assets | | | | | | |
| Bank balances | 3,804 | - | - | - | - | 3,804 |
| Placements with financial institutions | 3,001 | - | - | - | - | 3,001 |
| Investment in associates | - | - | - | 230,442 | - | 230,442 |
| Investment securities | 25,000 | 20,140 | - | 175,125 | - | 220,265 |
| Investment property | - | - | - | 259,404 | - | 259,404 |
| Other financial assets | - | 2,312 | - | 63,421 | 1,251 | 66,984 |
| Total assets | 31,805 | 22,452 | - | 728,392 | 1,251 | 783,900 |

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for the year ended 31 December 2011

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32 MATURITY PROFILE (continued)

| 31 December 2011 | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total |
|--|----------------|---------------|-----------------|----------------|--------------|----------------|
| Financial liabilities | | | | | | |
| Investors' funds | 41,781 | - | 17,106 | - | - | 58,887 |
| Placements from financial and other institutions | 12,734 | 13,687 | 716 | 89,576 | - | 116,713 |
| Financing liabilities | 5,500 | - | 42,021 | 283,556 | - | 331,077 |
| Other financial liabilities | 40,041 | - | - | 43,841 | - | 83,882 |
| Total liabilities | 100,056 | 13,687 | 59,843 | 416,973 | - | 590,559 |
| Equity of Investment account holders | 1,898 | - | - | - | - | 1,898 |
| Off-balance sheet items | | | | | | |
| Restricted investment accounts | - | - | - | 30,895 | - | 30,895 |
| Commitments | - | - | - | 83,249 | - | 83,249 |

| 31 December 2010 | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total |
|--|----------------|---------------|-----------------|----------------|----------------|------------------|
| Assets | | | | | | |
| Bank balances | 3,762 | - | - | - | - | 3,762 |
| Placements with financial institutions | 56,868 | - | - | - | - | 56,868 |
| Financing receivables | 2,000 | - | 4,000 | 8,400 | - | 14,400 |
| Investment in associates | - | - | - | - | 224,847 | 224,847 |
| Investment securities | 20,220 | - | - | 228,574 | - | 248,794 |
| Investment property | 18,000 | - | - | 248,412 | - | 266,412 |
| Other financial assets | - | 4,944 | - | 189,825 | 1,244 | 196,013 |
| Total assets | 100,850 | 4,944 | 4,000 | 675,211 | 226,091 | 1,011,096 |
| Financial liabilities | | | | | | |
| Investors' funds | 21,063 | 17,197 | 6,514 | 94,024 | - | 138,798 |
| Placements from financial and other institutions | 9,949 | 946 | 104,861 | 10,485 | - | 126,241 |
| Financing liabilities | 32,179 | - | 20,000 | 291,466 | 95,859 | 439,504 |
| Other financial liabilities | 71,911 | - | - | 123,624 | - | 195,535 |
| Total liabilities | 135,102 | 18,143 | 131,375 | 519,599 | 95,859 | 900,078 |
| Equity of Investment account holders | 1,880 | - | - | - | - | 1,880 |
| Off-balance sheet items | | | | | | |
| Restricted investment accounts | - | - | - | 48,227 | - | 48,227 |
| Commitments | 16,500 | 6,000 | - | 613 | - | 23,113 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

33 CONCENTRATION OF ASSETS, LIABILITIES AND EQUITY OF INVESTMENT ACCOUNT HOLDER

(a) Industry sector

| 31 December 2011 | Trading and manufacturing | Banks and financial institutions | Development Infrastructure | Technology | Others | Total |
|--|---------------------------|----------------------------------|----------------------------|--------------|----------------|----------------|
| Assets | | | | | | |
| Cash and bank balances | - | 3,809 | - | - | 11 | 3,820 |
| Placements with financial institutions | - | 3,001 | - | - | - | 3,001 |
| Investment in associates | 67,811 | 162,631 | - | - | - | 230,442 |
| Investment securities | - | 7,482 | 199,640 | 4,202 | 8,941 | 220,265 |
| Investment property | - | - | 259,404 | - | - | 259,404 |
| Other assets | 17 | 1,287 | 102,339 | - | 5,270 | 108,913 |
| Total assets | 67,828 | 178,210 | 561,383 | 4,202 | 14,222 | 825,845 |
| Liabilities | | | | | | |
| Investors' funds | 30,984 | - | 27,903 | - | - | 58,887 |
| Placements from financial and other institutions | - | 11,982 | - | - | 104,731 | 116,713 |
| Financing liabilities | - | 331,077 | - | - | - | 331,077 |
| Other liabilities | - | 741 | 38,670 | - | 44,471 | 83,882 |
| Total liabilities | 30,984 | 343,800 | 66,573 | - | 149,202 | 590,559 |
| Equity of Investment account holders | | | | | | |
| | | | | | 1,898 | 1,898 |
| Off-Balance sheet items | | | | | | |
| Restricted investment accounts | - | - | 30,895 | - | - | 30,895 |
| Commitments | - | - | 83,249 | - | - | 83,249 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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33 Concentration of assets, liabilities and equity of investment account holders (continued)

(a) Industry sector (continued)

| 31 December 2010 | Trading and manufacturing | Banks and financial institutions | Development Infrastructure | Technology | Others | Total |
|--|---------------------------|----------------------------------|----------------------------|--------------|----------------|------------------|
| Assets | | | | | | |
| Cash and bank balances | - | 3,770 | - | - | - | 3,770 |
| Placements with financial institutions | - | 56,868 | - | - | - | 56,868 |
| Financing receivables | - | 14,400 | - | - | - | 14,400 |
| Investment in associates | 66,297 | 158,550 | - | - | - | 224,847 |
| Investment securities | 23,370 | 13,548 | 200,190 | 2,500 | 9,186 | 248,794 |
| Investment property | - | - | 266,412 | - | - | 266,412 |
| Other assets | 17 | 95 | 192,073 | - | 10,965 | 203,150 |
| Total assets | 89,684 | 247,231 | 658,675 | 2,500 | 20,151 | 1,018,241 |
| Liabilities | | | | | | |
| Investors' funds | 63,106 | - | 75,692 | - | - | 138,798 |
| Placements from financial and other institutions | - | 20,865 | - | - | 105,376 | 126,241 |
| Financing liabilities | - | 439,504 | - | - | - | 439,504 |
| Other liabilities | - | 413 | - | - | 195,122 | 195,535 |
| Total liabilities | 63,106 | 460,782 | 75,692 | - | 300,498 | 900,078 |
| Equity of investment account holders | | | | | | |
| | - | - | - | - | 1,880 | 1,880 |
| Off-Balance sheet items | | | | | | |
| Restricted investment accounts | - | - | 48,227 | - | - | 48,227 |
| Commitments | - | 16,500 | 613 | - | 6,000 | 23,113 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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33 Concentration of assets, liabilities and equity of investment account holders (continued)

(b) Geographic region

| 31 December 2011 | GCC countries | Other MENA | Other Asia | UK (excluding UK) | Europe (excluding UK) | USA | Total |
|--|----------------|----------------|---------------|-------------------|-----------------------|------------|----------------|
| Assets | | | | | | | |
| Cash and bank balances | 3,021 | - | - | 82 | - | 717 | 3,820 |
| Placements with financial institutions | 3,001 | - | - | - | - | - | 3,001 |
| Investment in associates | 230,442 | - | - | - | - | - | 230,442 |
| Investment securities | 133,694 | 48,117 | 36,823 | - | 1,631 | - | 220,265 |
| Investment property | 259,404 | - | - | - | - | - | 259,404 |
| Other assets | 50,683 | 29,129 | 29,101 | - | - | - | 108,913 |
| Total assets | 680,245 | 77,426 | 65,924 | 82 | 1,631 | 717 | 825,845 |
| Liabilities | | | | | | | |
| Investors' funds | 34,622 | 24,201 | - | - | 64 | - | 58,887 |
| Placements from financial and other institutions | 27,137 | 89,576 | - | - | - | - | 116,713 |
| Financing liabilities | 213,723 | - | - | 117,354 | - | - | 331,077 |
| Other liabilities | 83,882 | - | - | - | - | - | 83,882 |
| Total liabilities | 359,364 | 113,777 | - | 117,354 | 64 | - | 590,559 |
| Equity of investment account holders | 1,898 | | | | | | 1,898 |
| Off-Balance sheet items | | | | | | | |
| Restricted investment accounts | 30,895 | - | - | - | - | - | 30,895 |
| Commitments | 82,636 | 613 | - | - | - | - | 83,249 |

Concentration by location for financial assets is measured based on the location of the underlying operating assets, and not based on the location of the investment (which is generally based in tax efficient jurisdictions).

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33 Concentration of assets, liabilities and equity of investment account holders (continued)

(b) Geographic region (continued)

| 31 December 2010 | GCC countries | Other MENA | Other Asia | UK (excluding UK) | Europe (excluding UK) | USA | Total |
|--|----------------|----------------|---------------|-------------------|-----------------------|--------------|------------------|
| Assets | | | | | | | |
| Cash and bank balances | 3,105 | 7 | 1 | 205 | 5 | 447 | 3,770 |
| Placements with financial institutions | 31,868 | - | - | - | 25,000 | - | 56,868 |
| Financing receivables | 14,400 | - | - | - | - | - | 14,400 |
| Investment in associates | 224,847 | - | - | - | - | - | 224,847 |
| Investment securities | 154,851 | 52,590 | 36,572 | - | 1,631 | 3,150 | 248,794 |
| Investment property | 266,412 | - | - | - | - | - | 266,412 |
| Other assets | 141,207 | 25,157 | 36,786 | - | - | - | 203,150 |
| Total assets | 836,690 | 77,754 | 73,359 | 205 | 26,636 | 3,597 | 1,018,241 |
| Liabilities | | | | | | | |
| Investors' funds | 96,863 | 33,319 | 8,417 | - | 199 | - | 138,798 |
| Placements from financial and other institutions | 35,018 | 91,223 | - | - | - | - | 126,241 |
| Financing liabilities | 314,270 | - | - | 125,234 | - | - | 439,504 |
| Other liabilities | 195,535 | - | - | - | - | - | 195,535 |
| Total liabilities | 641,686 | 124,542 | 8,417 | 125,234 | 199 | - | 900,078 |
| Equity of investment account holders | 1,880 | | | | | | 1,880 |
| Off-Balance sheet items | | | | | | | |
| Restricted investment accounts | 48,227 | - | - | - | - | - | 48,227 |
| Commitments | 22,500 | 613 | - | - | - | - | 23,113 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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34 OPERATING SEGMENTS

The Group has two distinct operating segments, Development infrastructure and Banking, which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately because they require different strategies for management and resource allocation within the Group. For each of the strategic business units, the Group's Board of Directors (chief operating decision makers) review internal management reports on a quarterly basis.

The following summary describes the operations in each of the Group's operating reportable segments:

- **Development infrastructure:** This business unit primarily is involved in origination and management of large scale economic infrastructure projects. The business unit also covers the Group's investment in real estate and related assets.
- **Banking:** The Banking segment of the Group is focused on private equity, commercial and investment banking domains. The private equity activities include acquisition of interests in unlisted or listed businesses at prices lower than anticipated values. The commercial banking activities focuses on establish new banks in the MENA region, and exploring external partnerships or acquisitions to extend GFH's capabilities. The investment banking activities focuses on providing structuring capabilities in Islamic asset-backed and equity capital markets, Islamic financial advisory and mid-sized mergers and acquisition transactions. This segment also includes the Group's investment in the water park.

The performance of each operating segment is measured based on segment results and are reviewed by the management committee and the Board of Directors on a quarterly basis. Segment results is used to measure performance as management believes that such information is most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. Inter-segment pricing, if any is determined on an arm's length basis.

The Group classifies directly attributable revenue and cost relating to transactions originating from respective segments as segment revenue and segment expenses respectively. Indirect costs is allocated based on cost drivers/factors that can be identified with the segment and/ or the related activities. The internal management reports are designed to reflect revenue and cost for respective segments which are measured against the budgeted figures. The unallocated revenues, expenses, assets and liabilities related to entity-wide corporate activities and treasury activities at the Group level.

The Group has primary operations in Bahrain and the Group does not have any significant overseas branches/divisions. The geographic concentration of assets and liabilities is disclosed in note 34 (b) to the consolidated financial statements.

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34 OPERATING SEGMENTS (continued)

Information regarding the results of each reportable segment is included below:

| 2011 | Development infrastructure | Banking | Unallocated | Total |
|---|----------------------------|----------|-------------|---------|
| Segment revenue | 16,176 | 20,090 | 35,112 | 71,378 |
| Segment expenses | 32,127 | 30,378 | 8,492 | 70,997 |
| Segment result | (15,951) | (10,288) | 26,620 | 381 |
| Segment assets | 553,797 | 267,039 | 5,009 | 825,845 |
| Segment liabilities | 381,650 | 160,523 | 48,386 | 590,559 |
| Other material items: | | | | |
| Finance income | - | 2,091 | - | 2,091 |
| Finance expense | 20,578 | 9,923 | - | 30,501 |
| Share of profit from investment in associates | - | 2,595 | - | 2,595 |
| Depreciation | - | - | 4,573 | 4,573 |
| Impairment allowances | 7,937 | 183 | - | 8,120 |
| Investment in associates (equity accounted) | - | 230,442 | - | 230,442 |
| Commitments | 83,249 | - | - | 83,249 |
| Restricted investment accounts | 30,278 | 617 | - | 30,895 |

| 2010 | Development infrastructure | Banking | Unallocated | Total |
|---|----------------------------|----------|-------------|-----------|
| Segment revenue | 10,056 | (4,325) | 2,376 | 8,107 |
| Segment expenses | 286,218 | 56,826 | 14,464 | 357,508 |
| Segment result | (276,162) | (61,151) | (12,088) | (349,401) |
| Segment assets | 656,282 | 349,815 | 12,144 | 1,018,241 |
| Segment liabilities | 580,418 | 236,986 | 82,674 | 900,078 |
| Other material items: | | | | |
| Finance income | - | - | 1,799 | 1,799 |
| Finance expense | 32,638 | 17,397 | - | 50,035 |
| Loss from investment in associates | - | (11,729) | - | (11,729) |
| Depreciation | - | - | 5,896 | 5,896 |
| Impairment allowances | 250,619 | 2,500 | 3,000 | 256,119 |
| Capital expenditure | - | - | - | - |
| Investment in associates (equity accounted) | - | 224,847 | - | 224,847 |
| Commitments | 16,500 | 6,613 | - | 23,113 |
| Restricted investment accounts | 47,523 | 704 | - | 48,227 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

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35 FINANCIAL INSTRUMENTS

a) FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value is an amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Other than certain investments carried at cost of US\$ 214,598 thousand (31 December 2010: US\$ 222,459 thousand) (note 8) and sukuk of US\$ 162,190 thousand (31 December 2010: US\$ 152,123 thousand) carried at amortised cost, the estimated fair values of the Group's other financial instruments are not significantly different from their book values as at 31 December 2011.

Investments amounting to US\$ 214,598 thousand (31 December 2010: US\$ 222,459 thousand) in unquoted equity securities are carried at cost less impairment in the absence of a reliable measure of fair value. Such investments are either private equity investments managed by external investment managers or represent investments in development infrastructure projects promoted by the Group for which a reliable estimate of fair value cannot be determined. The Group intends to exit these investments principally by means of strategic sell outs, sale of underlying assets or through initial public offerings.

The Group has Sukuk liability of US\$ 162,192 thousand (31 December 2010: US\$ 152,123 thousand) with a fair value based on quoted price of US\$ 92,891 thousand as of 31 December 2011 (31 December 2010: USD\$ 79,300 thousand)

b) FAIR VALUE HIERARCHY

The table below analyses the financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- **Level 1:** quoted prices (unadjusted) in active markets for identical assets and liabilities
- **Level 2:** inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- **Level 3:** inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| 31 December 2011 | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|-------|
| Investment securities | | | | |
| - designated at fair value through income statement | - | - | 5,192 | 5,192 |
| - designated at fair value through equity | 475 | - | - | 475 |
| | 475 | - | 5,192 | 5,667 |

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35 FINANCIAL INSTRUMENTS (continued)

b) FAIR VALUE HIERARCHY (continued)

| 31 December 2010 | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|--------|
| Investment securities | | | | |
| - designated at fair value through income statement | | | 25,860 | 25,860 |
| - designated at fair value through equity | 475 | - | - | 475 |
| | 475 | - | 25,860 | 26,335 |

The table below shows the reconciliation of movements in value of investments measured using Level 3 inputs:

| | 2011 | 2010 |
|-----------------------|--------------|---------------|
| At 1 January | 25,860 | 33,976 |
| Total gains or losses | | |
| - In income statement | 6,161 | (5,500) |
| Purchases | - | 1,617 |
| Disposals | (26,829) | (4,233) |
| At 31 December | 5,192 | 25,860 |

36 COMMITMENTS AND CONTINGENCIES

The commitments contracted in the normal course of business of the Group are as follows:

| | 31 December 2011 | 31 December 2010 |
|-------------------------------|------------------|------------------|
| Commitments to invest | 613 | 6,613 |
| Commitments to extend finance | 82,636 | 16,500 |
| Capital commitments | - | - |

The Group potentially has a commitment under a constructive obligation to extend finance to one of its projects of up to US\$ 23 million (31 December 2010: US\$ 150 million).

During the year, one of the Group's project company had successfully renegotiated the terms of its facility with its lenders. As a result the Group has reversed the provision recognised earlier to the extent of US\$ 86.11 million included in other liabilities and also an equivalent amount of "reimbursement right" included in 'other assets'. However, the Group is continuing to act as a guarantor for the lenders until the repayment of the facility by its project company and this has been included under commitments.

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36 COMMITMENTS AND CONTINGENCIES (continued)

Further, based on the Group's assessment of the likelihood that another project will not be able to meet the financing obligation when they fall due, the Group has estimated that its financial guarantee of US\$ 35 million may be enforced. The Group has recognised a provision of US\$ 35 million (31 December 2010: US\$ 121.11) towards these liabilities until revised / renegotiated terms are agreed with the lenders of the project companies and included in other liabilities and recognised an equivalent amount of 'reimbursement right' receivable included in 'other assets' (note 10).

In the opinion of the management, all facilities that are due are being renegotiated and based on the current status of discussions, it is not expected that the Group will have to make payments against any of these guarantees. In the event any payment is required to be made, the Group will repay the existing lenders and the amounts will be recovered from the future cash flows generated from the operation of the relevant project.

Performance obligations

During the ordinary course of business, the Group may enter into performance obligations in respect of its infrastructure development projects. It is the usual practice of the Group to pass these performance obligations, wherever possible, on to the companies that own the projects. In the opinion of the management, no liabilities are expected to materialise on the Group at 31 December 2011 due to the performance of any of its projects.

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 defense 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.

37 FINANCIAL RISK MANAGEMENT

Overview

Financial assets of the Group comprise bank balances, placements with financial and other institutions, investment securities, financing receivables, receivable from investment banking services and other receivable balances. Financial liabilities of the Group comprise investors' funds, placements from financial and other institutions, financing liabilities and other payable balances. Accounting policies for financial assets and liabilities are set out in note 2.

The Group has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risks; and
- operational risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

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37 FINANCIAL RISK MANAGEMENT (continued)

Risk management framework

The key element of our risk management philosophy is for the Risk Management Department ('RMD') to provide independent monitoring and control while working closely with the business units which ultimately own the risks. The Head of Group Risk Operations reports to the Board Audit and Risk Committee.

During the year 2011, the Bank appointed its new Board of Directors. The Board of Directors has overall responsibility for establishing our risk culture and ensuring that an effective risk management framework is in place. The Board has delegated its authority to the Board Audit and Risk Committee, which is responsible for implementing risk management policies, guidelines and limits and ensuring that monitoring processes are in place. The RMD, together with the Internal Audit and Compliance Departments, provide independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors.

The RMD submits a quarterly Risk Overview Report along with a detailed Liquidity Risk Report to the Board Audit and Risk Committee. The Risk Overview Report describes the potential issues for a wide range of risk factors and classifies the risk factors from low to high. The report also provides comments as to how risk factors are being addressed by the Group and the change in risk rating from the previous quarter. The Liquidity Risk Report measure the Group's liquidity risk profile against policy guidelines and regulatory benchmarks. An additional report is prepared by the respective investment units that give updated status and impairment assessment of each investment, a description of significant developments on projects or issues as well as an update on the strategy and exit plan for each project.

a) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's, placements with financial institutions, financing assets and other receivables from project companies. For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

Management of investment and credit risk

The Board of Directors has delegated responsibility for the management of credit risk to its Board Investment Committee (BIC). This committee establishes operating guidelines and reviews and endorses the Management Investment and Credit Committee recommendations for investment strategies, products and services. Its actions are in accordance with the investment policies adopted by the Board of Directors.

The RMD is responsible for oversight of the Group's credit risk, including:

- Ensuring that the Group has in place investment and credit policies, covering credit assessment, risk reporting, documentary and legal procedures, whilst the Compliance Department is responsible for ensuring compliance with regulatory and statutory requirements.
- Overseeing the establishment of the authorisation structure for the approval and renewal of investment and credit facilities. Authorisation limits are also allocated to the Management Investment and Credit Committee. Larger facilities require approval by BIC and the Board of Directors based on the authority limits structure of the Group.
- Reviewing and assessing credit risk. Risk Management department assesses all investment and credit exposures in excess of designated limits, prior to investments / facilities being committed. Renewals and reviews of investments / facilities are subject to the same review process.

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37 FINANCIAL RISK MANAGEMENT (continued)

- Monitoring concentrations of exposure to counterparties, geographies and industries.
- Ongoing review of credit exposures. The risk assessment approach is used in determining where impairment provisions may be required against specific investment / credit exposures. 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. Risk is assessed on an individual basis for each investment / receivable and is reviewed at least once a year. The Group does not perform a collective assessment of impairment for its credit exposures as the credit characteristics of each exposure is considered to be different. Risk profile of exposures are subject to regular reviews.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Providing advice, guidance and specialist skills to business units to promote best practice throughout the Group in the management of investment / credit risk.

The Risk Management Department works alongside the Investment Department at all stages of the deal cycle, from pre-investment due diligence to exit, and provides an independent review of every transaction. A fair evaluation of investments takes place periodically with inputs from the Investment department. Quarterly updates of investments are presented to the Board of Directors or their respective committees. Regular audits of business units and Group Credit processes are undertaken by Internal Audit.

The Group's maximum exposure to risk at 31 December 2011 is as follows:

Exposure to credit risk

| 31 December 2011 | Bank balances | Placement with financial institutions | Financing receivables | Other financial assets |
|--|---------------|---------------------------------------|-----------------------|------------------------|
| Neither past due nor impaired - Carrying amount | 3,804 | 3,001 | - | 33,634 |
| Impaired | | | | |
| Gross amount | - | - | 62,650 | 413,298 |
| Allowance for impairment | - | - | (62,650) | (375,473) |
| Carrying amount – Impaired | - | - | - | 37,825 |
| Carrying amount | 3,804 | 3,001 | - | 71,459 |
| 31 December 2010 | | | | |
| Neither past due nor impaired | | | | |
| Carrying amount | 3,762 | 56,868 | 12,400 | 162,203 |
| Past due but not impaired (30 – 60 days) | - | - | 2,000 | - |
| Carrying amount – Past due but not impaired | - | - | 2,000 | - |
| Impaired | | | | |
| Gross amount | - | - | 62,650 | 409,283 |
| Allowance for impairment | - | - | (62,650) | (375,473) |
| Carrying amount – Impaired | - | - | - | 33,810 |
| Carrying amount | 3,762 | 56,868 | 14,400 | 196,013 |

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

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37 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Impaired receivables

Impaired receivables are those for which the Group determines that it is probable that it will be unable to collect all or a portion of payments due according to the contractual terms of the receivables agreement(s). These exposures are graded "Impaired" in the Group's assessment process.

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in its receivables. This allowance is a specific loss component that relates to individually significant exposures based on individual assessment for impairment.

The movement in the impairment allowances for investment in associates, investment securities and investment property are given in notes 7, 8 and 9 respectively. The movement in impairment allowance for other financial assets are as given below:

| 2011 | Financing receivables | Financing to projects | Receivable from investment banking services | Other receivables | Total |
|--------------------------------------|-----------------------|-----------------------|---|-------------------|----------------|
| At 1 January | 70,150 | 77,382 | 147,186 | 74,311 | 369,029 |
| Impairment allowance during the year | - | - | - | - | - |
| At 31 December | 70,150 | 77,382 | 147,186 | 74,311 | 369,029 |

| 2010 | Financing receivables | Financing to projects | Receivable from investment banking services | Other receivables | Total |
|--------------------------------------|-----------------------|-----------------------|---|-------------------|----------------|
| At 1 January | 70,150 | 77,382 | 86,646 | 38,253 | 272,431 |
| Impairment allowance during the year | - | - | 60,540 | 36,058 | 96,598 |
| At 31 December | 70,150 | 77,382 | 147,186 | 74,311 | 369,029 |

Receivables with renegotiated terms

During the year, the Group has renegotiated certain financing receivables and financing to projects due to changes in the financial position of the borrower. The financing receivables were renegotiated for terms and condition similar to original terms. Financing to projects of US\$ 62.95 million (31 December 2010: US\$ 70.22 million) were renegotiated for an extended period and do not have specified terms of repayment. The Group assesses the recoverability and timing of collection based on underlying stream of cash flows that will be generated by its projects.

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

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37 FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Write-off policy

The Group writes off a receivable (and any related allowances for impairment losses) when it is determined that the receivables are uncollectible and after obtaining approval from the CBB where required. This determination is reached after considering information such as the occurrence of significant changes in the payee / issuer's financial position such that the payee / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. No amounts have been written off during the year.

Concentration risk

Concentration risk arises when a number of counterparties are engaged in similar economic activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. The Group seeks to manage its concentration risk by establishing and constantly monitoring geographic and industry wise concentration limits.

The geographical and industry wise distribution of assets and liabilities are set out in note 34 (a) and (b).

b) 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.

Management of liquidity risk

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. Whilst this is the policy, the Group's current position is under severe stress with contractual liabilities exceeding liquid assets. Focus has therefore been on extending the maturity of liabilities and raising capital in the form of debt or equity.

Treasury receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Treasury then aims to maintain a portfolio of short-term liquid assets, largely made up of short-term placements with financial and other institutions and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole. The liquidity requirements of business units are met through treasury to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements. Whilst this is the policy and normal process followed, the Group's position as highlighted above is under severe stress.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by the Board Audit and Risk Committee. Daily reports cover the liquidity position of the Bank and is circulated to ALCO. Moreover, quarterly reports are submitted to the Board of Directors on the liquidity position by RMD.

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37 FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

The table below shows the undiscounted cash flows on the Group's financial liabilities, including issued financial guarantee contracts, and unrecognised financing commitments on the basis of their earliest possible contractual maturity. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called. The Group's expected cash flows on these instruments vary significantly from this analysis. Refer note 32 for the expected maturity profile of assets and liabilities.

| 31 December 2011 | Gross undiscounted cash flows | | | | | Total | Carrying amount |
|---|-------------------------------|----------------|-----------------|----------------|--------------|----------------|-----------------|
| | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | | |
| Financial liabilities | | | | | | | |
| Investors' funds | 41,781 | - | 17,106 | - | - | 58,887 | 58,887 |
| Placements from financial institutions | 102,356 | 14,123 | 745 | - | - | 117,224 | 116,713 |
| Financing liabilities | 8,948 | 210,802 | 51,175 | 108,577 | - | 379,502 | 331,077 |
| Other financial liabilities | 40,040 | - | - | 43,842 | - | 83,882 | 83,882 |
| Total financial liabilities | 193,125 | 224,925 | 69,026 | 152,419 | - | 639,495 | 590,559 |
| Equity of investment account holders | | | | | | | |
| | 1,898 | - | - | - | - | 1,898 | 1,898 |
| Off-balance sheet items | | | | | | | |
| Commitments | - | - | - | 83,249 | - | - | - |

To manage the liquidity risk arising from financial liabilities, the Group aims to hold liquid assets comprising cash and cash equivalents, placements with financial institutions and treasury shares for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements. At 31 December 2011, the Group's current contractual liabilities exceeded its liquid assets.

The Group has focussed on strengthening its liquidity position in 2011 by undertaking an asset sale programme; restructuring of its financing liabilities and raising additional capital through the convertible murabaha (note 14). The Group plans to further strengthen its liquidity in 2012 by undertaking a wider asset sale program and target additional capital raising that will target to provide the necessary additional liquidity needed to support the Group's funding requirements. These initiatives will help to improve the liquidity profile of the Group. Also, the Group has commenced renegotiations with lenders for the dues repayable in 2012. The Group is confident of its ability to meet its future contractual liabilities when due.

Further, the Group is focussed on developing a pipeline of steady revenues and has undertaken cost reduction exercises that would improve its operating cash flows. The Group is also evaluating other options to arrange liquidity with the support of its major shareholders and strengthen its position over the next twelve months.

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37 FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

| 31 December 2010 | Gross undiscounted cash flows | | | | | | Carrying amount |
|--|-------------------------------|---------------|-----------------|----------------|---------------|----------------|-----------------|
| | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total | |
| Financial liabilities | | | | | | | |
| Investors' funds | 139,798 | - | - | - | - | 139,798 | 138,798 |
| Placements from financial institutions | 114,952 | 982 | 10,730 | - | - | 126,664 | 126,241 |
| Financing liabilities | 31,064 | 3,460 | 26,070 | 353,377 | 95,859 | 509,830 | 439,504 |
| Other financial liabilities | 71,911 | - | - | 123,624 | - | 195,535 | 195,535 |
| Total financial liabilities | 357,725 | 4,442 | 36,800 | 477,001 | 95,859 | 971,827 | 900,078 |
| Equity of investment account holders | 1,880 | - | - | - | - | 1,880 | 1,880 |
| Off-balance sheet items | | | | | | | |
| Commitments | 16,500 | 6,000 | - | 43,133 | - | 65,633 | |

Measures of liquidity

The Group has recently introduced new measures of liquidity. These revised metrics are intended to better reflect the liquidity position from a cash flow perspective and provide a target for the Group. These are liquidity coverage ratio, net stable funding ratio (both based on the consultative paper of Basel 3) and stock of liquid assets.

For this purpose, the liquidity coverage ratio identifies the amount of unencumbered, high quality liquid assets the Group holds that can be used to offset the net cash outflows it would encounter under an acute short-term stress scenario (30, 60 and 90 days time horizon). The net stable funding ratio measures the amount of long-term, stable sources of funding employed by an institution relative to the liquidity profiles of the assets funded and the potential for contingent calls on funding liquidity arising from off-balance sheet commitments and obligations.

| Liquidity coverage ratio | 2011 | 2010 |
|--------------------------|------|------|
| 30 days | 0.29 | 0.45 |
| 60 days | 0.21 | 0.42 |
| 90 days | 0.16 | 0.35 |

The Group also holds certain listed equities and treasury shares which can be sold to meet the liquidity requirements.

| Net stable funding ratio | 2011 | 2010 |
|--------------------------|------|------|
| | 0.42 | 0.56 |

Details of the ratio of liquid assets to total assets at the reporting date and during the year were as follows:

| | Liquid asset / Total asset | |
|----------------------|----------------------------|-------|
| | 2011 | 2010 |
| At 31 December | 0.83% | 6.15% |
| Average for the year | 2.73% | 3.22% |
| Maximum for the year | 4.16% | 6.15% |
| Minimum for the year | 0.83% | 1.99% |

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37 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Group's income, future cash flows or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

As a matter of general policy, the Group shall not assume trading positions on its assets and liabilities, and hence the entire balance sheet is a non-trading portfolio. All foreign exchange risk within the Group is transferred to Treasury. The Group seeks to manage currency risk by continually monitoring exchange rates. Profit rate risk is managed principally through monitoring profit rate gaps and by having pre-approved limits for repricing bands. Overall authority for market risk is vested in the Board Audit and Risk Committee. RMD is responsible for the development of detailed risk management policies (subject to review by ALCO and approval the Board Audit and Risk Committee).

Exposure to profit rate risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market profit rates. Majority of the Group's profit based asset and liabilities are short term in nature, except for certain long term liabilities which have been utilised to fund the Group's strategic investments in its associates.

A summary of the Group's profit rate gap position on non-trading portfolios is as follows:

| 31 December 2011 | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total |
|--|-----------------|-----------------|-----------------|------------------|--------------|------------------|
| Assets | | | | | | |
| Placements with financial institutions | 3,001 | - | - | - | - | 3,001 |
| Total assets | 3,001 | - | - | - | - | 3,001 |
| Liabilities | | | | | | |
| Investors' funds | 41,781 | - | 17,106 | - | - | 58,887 |
| Placements from financial and other institutions | 12,734 | 13,687 | 716 | 89,576 | - | 116,713 |
| Financing liabilities | 5,500 | - | 42,021 | 283,556 | - | 331,077 |
| Total liabilities | 60,015 | 13,687 | 59,843 | 373,132 | - | 506,677 |
| Equity of investment account holders | 1,898 | - | - | - | - | 1,898 |
| Profit rate sensitivity gap | (58,912) | (13,687) | (59,843) | (373,132) | - | (505,574) |

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37 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (continued)

| 31 December 2010 | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total |
|--|------------------|---------------|-----------------|------------------|-----------------|------------------|
| Assets | | | | | | |
| Placements with financial institutions | 56,868 | - | - | - | - | 56,868 |
| Financing receivables | 2,000 | - | 4,000 | 8,400 | - | 14,400 |
| Total assets | 58,868 | - | 4,000 | 8,400 | - | 71,268 |
| Liabilities | | | | | | |
| Investors' funds | 138,798 | - | - | - | - | 138,798 |
| Placements from financial and other institutions | 114,530 | 981 | 10,730 | - | - | 126,241 |
| Financing liabilities | 32,180 | - | 20,000 | 291,465 | 95,859 | 439,504 |
| Total liabilities | 285,508 | 981 | 30,730 | 291,465 | 95,859 | 704,543 |
| Equity of investment account holders | 1,880 | - | - | - | - | 1,880 |
| Profit rate sensitivity gap | (228,520) | (981) | (26,730) | (283,065) | (95,859) | (635,155) |

The management of profit rate risk against profit rate gap limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various standard and non-standard profit rate scenarios. Standard scenarios that are considered 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 (assuming no asymmetrical movement in yield curves and a constant statement of financial position) is as follows:

| 100 bps parallel increase / (decrease) | 2011 | 2010 |
|--|---------|---------|
| At 31 December | ± 5,056 | ± 6,351 |
| Average for the year | ± 5,118 | ± 6,092 |
| Maximum for the year | ± 5,433 | ± 6,351 |
| Minimum for the year | ± 4,834 | ± 5,937 |

Overall, profit rate risk positions are managed by Treasury, which uses placements from / with financial institutions to manage the overall position arising from the Group's activities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ '000's

37 FINANCIAL RISK MANAGEMENT (continued)

c) Market risks (continued)

The effective average profit rates on the financial assets, liabilities and unrestricted investment accounts are as follows:

| | 2011 | 2010 |
|--|-------|-------|
| Placements with financial institutions | 1.49% | 0.68% |
| Financing receivables | 5.70% | 2.88% |
| Investors' funds | - | 0.72% |
| Placements from financial and other institutions | 4.12% | 4.72% |
| Financing liabilities | 5.63% | 6.84% |
| Equity of investment account holders | 0.27% | 0.67% |

Exposure to foreign exchange risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group's major exposure is in GCC currencies, which are primarily pegged to the US Dollar. The Group had the following significant net exposures denominated in foreign currency as of 31 December:

| | 2011 US\$ '000 Equivalent | 2010 US\$ '000 Equivalent |
|--------------------------|---------------------------------|---------------------------------|
| Sterling Pounds | 1,007 | - |
| Euros | (68,975) | (69,645) |
| Jordanian Dinar | 2,268 | 17,438 |
| Kuwaiti Dinars | 12,832 | 16,778 |
| Other GCC Currencies (*) | (45,420) | (247,871) |

(*) These currencies are pegged to the US Dollar.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Group's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered include a 5% plus / minus increase in exchange rates, other than GCC pegged currencies. An analysis of the Group's sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) is as follows:

| | 2011 US\$ '000 Equivalent | 2010 US\$ '000 Equivalent |
|-----------------|---------------------------------|---------------------------------|
| Sterling Pounds | ±50 | - |
| Euros | ±3,448 | ±3,482 |
| Jordanian Dinar | ±113 | ±872 |
| Kuwaiti Dinars | ±641 | ±839 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

37 FINANCIAL RISK MANAGEMENT (continued)

Exposure to foreign exchange risk (continued)

Exposure to other market risks

Equity price risk on quoted investments is subject to regular monitoring by the Group. The Group's equity type instruments securities carried at cost are exposed to risk of changes in equity values. The significant estimates and judgements in relation to impairment assessment of fair value through equity investments carried at cost are included in note 3 (ii). The Group manages exposure to other price risks by actively monitoring the performance of the equity securities. The performance assessment is performed on a semi-annual basis and is reported to the Board Investment Committee.

d) Operational risk

Operational risk is the risk of loss arising from systems and control failures, fraud and human errors, which can result in financial and reputation loss, and legal and regulatory consequences. The Group manages operational risk through appropriate controls, instituting segregation of duties and internal checks and balances, including internal audit and compliance. The Risk Management Department facilitates the management of Operational Risk by way of assisting in the identification of, monitoring and managing of operational risk in the Group. The Group has finalized the risk and control assessments for majority of its departments and has identified the important Key Risk Indicators.

38 CAPITAL MANAGEMENT

The Group's regulator Central Bank of Bahrain (CBB) sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements CBB requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The total regulatory capital base is net of prudential deductions for large exposures based on specific limits agreed with the regulator. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. The Group does not have a trading book.

The Group aims to maintain strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Group is required to comply with the provisions of the Capital Adequacy Module of the CBB (which is based on the Basel II and IFSB framework) in respect of regulatory capital. The Group has adopted the standardised approach to credit risk and market risk and basic indicator approach for operational risk management under the revised framework. During 2011, the Group's capital adequacy ratio has been deteriorating and the Group is in constant communication with its regulator in relation to its capital adequacy plan.

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Group's capital management policy seeks to maximise return on risk adjusted capital while satisfying all the regulatory requirements. The Group's policy on capital allocation is subject to regular review by the Board of Directors.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the year ended 31 December 2011

US\$ 000's

38 CAPITAL MANAGEMENT (continued)

The Group's regulatory capital position at 31 December was as follows:

| | 2011 | 2010 |
|---|------------------|-----------|
| Total risk weighted assets | 1,879,341 | 1,931,686 |
| Tier 1 capital | 232,608 | 204,746 |
| Tier 2 capital | 568 | 6 |
| Total regulatory capital base | 233,176 | 204,752 |
| Total regulatory capital expressed as a percentage of total risk weighted assets | 12.41% | 10.60% |

The capital adequacy ratio as at 31 December 2011 was close to the minimum regulatory capital requirement of 12%. Based on the planned asset sales program and operating plans, the Group expects to improve its risk weighted assets profile and capital adequacy ratio.

39 COMPARATIVES

Certain prior year amounts have been regrouped to conform to the current year's presentation. Such regrouping did not affect previously reported loss or equity except that arising from adoption of new standards as given in note 2.

Risk and Capital Management

Basel II - Pillar III Disclosures

Contents of Risk and Capital Management

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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 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.

The CBB Basel II guidelines became effective on 1 January 2008 as the common framework for the implementation of Basel II capital adequacy framework for Banks incorporated in the Kingdom of Bahrain. The disclosures in this report have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports, CBB Rule Book, Volume II for Islamic Banks. The requirements of Section PD 1.3 follow the requirements of Basel II - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks. Capital Adequacy Ratio in this report refers to the consolidated CAR (hereafter "CAR").

This report contains a description of the Bank's risk management and capital adequacy practices and processes, including detailed information on the capital adequacy process.

As at 31 December 2011 the Group CAR stood at 12.41%. The Bank has obtained a dispensation from the CBB, wherein the large exposures have been allowed to be calculated on pre-provisioning capital base. This dispensation remained in effect throughout the year. The bank is in constant discussion with its regulator in relation to its capital position & its plan to improve its regulatory capital ratio.

The disclosures in this report are in addition to or in some cases, serve to clarify the disclosures set out in the consolidated financial statements for the year ended 31 December 2011, presented in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). To avoid any duplication, information required under PD module but already disclosed in other sections of Annual report has not been reproduced. These disclosures should be read in conjunction with the Group's consolidated financial statements for the year ended 31 December 2011.

2- Introduction

The Basel II framework introduced by CBB with effect from 2008, provides a more risk sensitive approach to assessment of risk and the calculation of regulatory capital i.e. the minimum capital that a bank is required to maintain. The framework intends to strengthen the risk management practices and processes within financial institutions. GFH has accordingly taken steps to comply with these requirements. The CBB's capital management framework, consistent with the Basel II accord, is built on three pillars:

- **Pillar 1:** calculation of the risk weighted amounts and capital requirement.
- **Pillar 2:** the supervisory review process, including the Internal Capital Adequacy Assessment Process.
- **Pillar 3:** rules for the disclosure of risk management and capital adequacy information.

2.1 Pillar 1

Pillar 1 prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar 1 defines the regulatory minimum capital requirements for each bank to cover the credit risk, market risk and operational risk inherent in its business model. It also defines the methodology for measurement of these risks and the various elements of qualifying capital. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total Risk Weighted Assets (RWAs).

The resultant ratio is to be maintained above a predetermined and communicated level. The CBB also requires banks incorporated in Bahrain to maintain a buffer of 0.5 per cent above the minimum capital adequacy ratio. In the event that the capital adequacy ratio falls below 12.5 per cent, additional prudential reporting requirements apply, and a formal action plan setting out the measures to be taken to restore the ratio above the target level is to be formulated and submitted to the CBB. Consequently, the CBB requires GFH to maintain a minimum capital adequacy ratio of 12.5 per cent.

The table below summarizes the Pillar 1 risks and the approaches used by the Bank to calculating the RWAs in accordance with the CBB's Basel II capital adequacy framework.

| Risk Type | Approach used by GFH |
|------------------|--------------------------|
| Credit risk | Standardised Approach |
| Market risk | Standardised Approach |
| Operational risk | Basic Indicator Approach |

2.2 Pillar 2

Pillar 2 deals with the Supervisory Review and Evaluation Process (SREP). It also addresses the Internal Capital Adequacy Assessment Process (ICAAP) to be followed by Banks to assess the overall capital requirements to cover all relevant risks (including those covered under Pillar 1).

Under the CBB's Pillar II guidelines, each bank is to be individually assessed by the CBB and an individual minimum capital adequacy ratio is to be determined for each bank.

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. GFH has developed an ICAAP around its economic capital framework which involves identification and measurement of risks to maintain an appropriate level of internal capital in alignment to the Bank's overall risk profile and business plan. An ICAAP document has been developed to address major components of the Bank's risk management, from the daily management of material risks including risk types which are not covered under Pillar I including liquidity risk, profit rate risk in the banking book, concentration risk, and reputational risk. The Bank has been through several structural changes since 2009 / 2010 and is currently focused on the ongoing recapitalization program in order to enhance its capital base. Given the current capital resources and the tight liquidity position of the Bank, no additional capital is being allocated to these risk components. However, the Bank monitors and reports on these risks to the Board Audit & Risk Committee periodically.

2.3 Pillar 3

In the CBB's Basel II framework, the Pillar III prescribes how, when, and at what level information should be publicly disclosed about an institution's risk management, governance and capital adequacy practices. The disclosures comprise detailed qualitative and quantitative information.

The purpose of the Pillar III disclosure requirements is to complement the first two Pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move towards more advanced forms of risk management.

The current regulations require partial disclosure consisting mainly of quantitative analysis during half year reporting and fuller disclosure during year end to coincide with the financial year-end reporting.

2.4 Recent developments

CBB have made certain amendments in the Credit Risk Management and Prudential Consolidation and Deduction modules with effect from 1 January 2011.

The amendment introduces new restrictions on investments in other commercial entities held through ownership of equity capital through limits on what are termed as "Qualifying Holdings" ("QH"). The new amendments are not applicable for the investments existing before 1 January 2011. New investment holdings greater than QH will have to be approved by the CBB.

There have also been reduction in the exposure limits to Connected party including on- balance sheet, off-balance sheet and aggregate limits for connected parties.

The Group continues to assess the impact of the above amendments and will comply with these requirements while undertaking any new exposures in future.

3- Overall risk and capital management

3.1 Risk management charter

GFH perceives strong risk management capabilities to be the foundation in delivering results to customers, investors and shareholders. The Bank will continue to endeavor to enhance its existing framework and adopt international best practices of risk management, corporate governance and the highest level of market discipline.

The primary objectives of the risk management charter of the Bank are to:

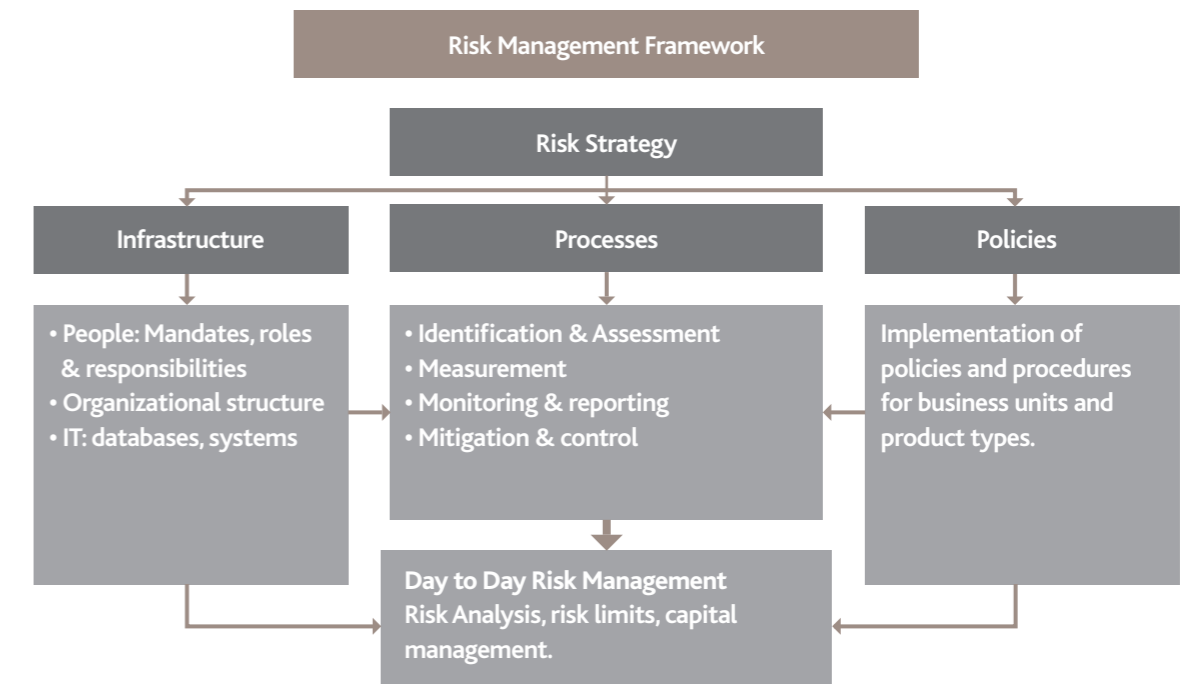
- Manage risks inherent in the Bank's activities in line with the risk appetite of the Bank;
- Strengthen the Bank's risk management practices to reflect the industry best practices; and
- Align internal capital requirements with risk materiality.

The risk strategy is articulated through the limit structures for individual risks. These limits are based on the Bank's business plans and guided by regulatory requirements and guidance in this regard. By setting the risk appetite, the Bank links its individual risks to its strategy. The risk limits reflects the level of risk that GFH is prepared to take in order to achieve its objectives. The Bank reviews and realigns its risk limits as per the evolving business plan of the Bank with changing economic and market scenarios. The Bank will also assess its tolerance for specific risk categories and its strategy to manage these risks. The risk appetite outlines the Bank's risk exposures and defines its tolerance levels towards accepting or rejecting these risks. Tolerance levels are reflected in the limits defined by the Bank for each risk area.

3.2 Risk management framework

Our Board of Directors has overall responsibility for establishing our risk culture and ensuring that an effective risk management framework is in place.

The diagram below represents the Bank's overall risk management framework and its components:



The risk management framework of the Bank encapsulates the spirit of the following key principles for Risk Management as articulated by Basel II:

- Management oversight and control
- Risk culture and ownership
- Risk recognition and assessment
- Control activities and segregation of duties
- Information and communication
- Monitoring Risk Management activities and correcting deficiencies.

3.3 Risk governance structure

The Risk Governance structure of the Bank is depicted by the following diagram:

| Risk Governance Structure of GFH | |
|----------------------------------|--|
| Level 1 | Board Sharia'a Board |
| Level 2 | Board Committees - Board Nomination, Remuneration and Governance Committee - Board Investment Committee - Audit Committee* - Risk Management Committee* |
| Level 3 | Senior Management Committees - Management Committee (MANCOM) - Management Investment Committee (MANICOM) - Asset Liability Committee (ALCO) - Risk Management Committee |
| Level 4 | Risk Management Department - Operational Risk - Credit Risk - Liquidity Risk - Market & Investment Risk |
| Level 5 | Desktop level procedures, systems and controls in day to day business |

Internal Audit

* The Audit and Risk Management Committees have been merged during the year to form Audit and Risk Committee.

Our Board of Directors has overall responsibility for establishing our risk culture and ensuring that an effective risk management framework is in place. The Board of Directors approves and periodically reviews our risk management policies and strategies. The Board Audit & Risk Management Committee is responsible for implementing risk management policies, guidelines and limits and ensuring that monitoring processes are in place. The Management Committees are responsible for continuously monitoring the implementation of the Board approved policies in the Bank. The committees consists of heads of business and other functional units in the Bank.

The key element of our risk management philosophy is for the Risk Management Department ('RMD') to provide independent monitoring and control while working closely with the business units which ultimately own the risks. The Head of Risk Management reports to Board Audit & Risk Committee and administratively to the Executive Chairman.

The RMD plays a pivotal role in monitoring the risks associated with various activities of the Bank. The principal responsibilities of the department are:

- Determining the Bank's appetite for risk is in line with the limits and submitting the same to the RMC and Board for approval.
- Developing and reviewing risk management policies in accordance with the risk management guidelines issued by the CBB, Basel II, IFSB and international best practices.
- Acting as the principal coordinator in Basel II implementation as required by the CBB and facilitating the performance of key Basel II activities.
- Identifying and recommending risk analysis tools and techniques as required under Basel II, guidelines issued by the CBB and IFSB.
- Reviewing the adequacy of the risk limits and providing feed back to the relevant approving authorities.
- Preparing quarterly Risk Packs for review by the Board Audit & Risk Committee.
- Preparing MIS Reports for review by the Board Audit & Risk Committee, where necessary.
- Developing systems and resources to review the key risk exposures of the Bank and communicating the planned/ executed corrective actions to the Board Risk Committee.

3.4 Capital management

The Bank's policy is to maintain a strong capital base and meet the capital requirements imposed by the regulator (CBB), so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The allocation of capital between specific operations and activities is primarily driven by regulatory requirements. The Bank's capital management policy seeks to maximise return on capital while satisfying all the regulatory requirements.

The Bank has put in place a comprehensive Internal Capital Adequacy Assessment Process (ICAAP) that includes Board and senior management oversight, monitoring, reporting and internal control reviews, to identify and measure the various risks that are not covered under Pillar 1 risks and to regularly assess the overall capital adequacy considering the risks and the Bank's planned business strategies. The non Pillar 1 risks covered under the ICAAP process include concentration risk, liquidity risk, profit rate risk in the banking book and other miscellaneous risks. The Bank has been facing a liquidity crunch for more than a year owing to the effects of the ongoing financial crisis. Various alternatives have been pursued by the Bank to shore up its liquidity position including restructuring of its debts and asset sales. The Bank is currently in the midst of a recapitalization program to enhance its capital base and improve the liquidity position. Till such time the recapitalization exercise is completed, no additional capital is being allocated to the Pillar 2 risk components. However, the Bank monitors and reports on these risks to the Board Audit & Risk Committee periodically.

As at 31 December 2011, the Group's CAR stood at 12.41%. 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.

3.5 Risk types

The Bank is exposed to various types of risk.

| | |
|--------------------------|--|
| Risks in Pillar 1 | <ul style="list-style-type: none"> • Credit risk • Market risk • Operational risk |
| Risks in Pillar 2 | <ul style="list-style-type: none"> • Liquidity risk • Concentration risk • Profit rate risk in banking book • Reputational risk (earnings at risk) • Other risks – including strategic risk, regulatory risk etc. |

The details of components of risks and how they are managed are discussed in the following sections of this document.

3.6 Monitoring and reporting

The RMD, together with the Internal Audit, provide independent assurance that all types of risk are being measured and managed in accordance with the policies and guidelines set by the Board of Directors. The RMD submits a quarterly Risk Review report to the Board Audit & Risk Committee. The Risk Review report describes the potential issues for a wide range of risk factors and classifies the risk factors from low to high. The Risk Review report also provides comments as to how risk factors are being addressed by the Bank and the change in risk classification from the previous quarter. The Bank has established an adequate system for monitoring and reporting risk exposures and capital adequacy requirements. These reports include periodic risk reviews, quarterly risk reports etc. These reports aim to provide the senior management with an up-to-date view of the risk profile of the Bank. Moreover, external consultants are also engaged where deemed necessary to enhance and improve the risk management standard procedures.

4- Group structure

The consolidated financial statements for the year comprise of the financial statements of the Bank and its subsidiaries (together referred to as "the Group") as at 31 December 2011. The Group's financial statements are prepared and published on a full consolidation basis, with all material subsidiaries being consolidated in accordance with AAOIFI. Please refer to notes 2(d) and 2(g) in the consolidated financial statements for more details on the accounting policies for investments, including subsidiaries and associates of the Bank.

For capital adequacy purposes, all subsidiaries are included within the Group structure. However, the CBB's capital adequacy methodology and prudential consolidation and deduction (PCD) module of the CBB rule book accommodates both full consolidation and aggregation treatment for certain financial subsidiaries and requires risk weighting and deduction treatment for certain significant commercial entity subsidiaries.

The PCD module also requires pro-rata consolidation for significant financial entities which qualify as associates under IFRS which are usually 'equity accounted' or 'designated at fair value through profit or loss' in the consolidated financial statements. In case of significant equity holdings of 20% or more of the Bank's capital in insurance entities, the PCD module requires a full deduction from the Bank's regulatory capital. For investments in significant commercial entities (subsidiaries and associates), the PCD module prescribes a risk weighting treatment for each investment and requires deduction of investment amounts in excess of 15% of the capital base of the Bank. The regulatory treatment for each of the investments discussed in the below mentioned table has been agreed with CBB.

The principal subsidiaries and associates as at 31 December 2011 and their treatment for capital adequacy purposes are as follows:

| Entity name and accounting classification | Domicile | Investment classification as per PCD | Regulatory treatment as per PCD (consolidated) |
|---|----------|--------------------------------------|--|
|---|----------|--------------------------------------|--|

| 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 Harbour North 1 Real Estate S.P.C Harbour North 2a Real Estate S.P.C Harbour North 2b Real Estate S.P.C Harbour North 3 Real Estate S.P.C Harbour Row 1 Real Estate S.P.C Harbour Row 2 Real Estate S.P.C Harbour Row 3 Real Estate S.P.C Harbour Row 4 Real Estate S.P.C | Bahrain | Commercial entities | Fully consolidated |

| Associates | | | |
|---------------------------------|----------------|------------------------------|-----------------------|
| Khaleeji Commercial Bank BSC | 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 counter party 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.

5- Capital structure and capital adequacy ratio

5.1 Capital adequacy

The Bank's regulator CBB sets and monitors capital requirements for the Bank as a whole (i.e. at a consolidated level). In implementing current capital requirements CBB requires the Bank to maintain a prescribed ratio of 12% and 8% of total regulatory capital to total risk-weighted assets on consolidated and solo basis respectively. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures. The CBB also requires banks incorporated in Bahrain to maintain a buffer of 0.5 per cent above the minimum capital adequacy ratio.

The Bank's policy is to maintain strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

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 Bank has adopted the standardised approach to credit and market risk and basic indicator approach for operational risk management under the revised framework.

As at 31 December 2011, the Group's CAR stood at 12.41% with certain CBB dispensations (compared to the minimum regulatory requirement ratio of 12%), which restricts the Group's ability to absorb further losses or undertake additional exposures. The Bank is in constant discussion with its regulator in relation to its capital position & its plan to improve its regulatory capital ratio. The Group plan to strengthen the capital position is discussed in Note 2(b) of the consolidated financial statements. The Bank has complied with the capital requirements set by the regulator throughout the year.

The Bank's regulatory capital position at 31 December 2011 was as follows:

| | USD 000's | | |
|--|----------------|------------|----------------|
| | Tier 1 | Tier 2 | Total |
| Share capital | 321,031 | - | 321,031 |
| Treasury shares | (12,852) | - | (12,852) |
| Share premium | 145,708 | - | 145,708 |
| Statutory reserve | 79,408 | - | 79,408 |
| Other reserves | 1,377 | - | 1,377 |
| Accumulated losses | (301,687) | - | (301,687) |
| Unrealized gain arise from fair valuing equities | - | 181 | 181 |
| Investments fair value reserve | - | - | - |
| Profit equalization reserves | - | 5 | 5 |
| Investment risk reserves | - | 3 | 3 |
| Tier 1 and Tier 2 capital before general deductions | 232,985 | 189 | 233,174 |
| Excess amount over materiality thresholds in case of investment in commercial entities | - | - | - |
| Investment in insurance entity greater than or equal to 20% | - | - | - |
| Total eligible capital base | 232,985 | 189 | 233,174 |

5- Capital structure and capital adequacy ratio *(continued)*

USD 000's

| Risk weighted exposure | Risk weighted exposure | Capital requirement @ 12% |
|---------------------------------------|------------------------|---------------------------|
| Credit Risk | 1,718,591 | 206,231 |
| Market risk | 84,013 | 10,082 |
| Operational | 76,622 | 9,195 |
| Tier 1 and Tier 2 capital base | 1,879,225 | 225,508 |

| Risk weighted exposure | Capital requirement @ 12% |
|--------------------------------------|---------------------------|
| Capital Adequacy ratio | 12.41% |
| Tier 1 capital adequacy ratio | 12.40% |

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

The Bank's regulatory capital is analysed into two tiers:

Tier 1 capital includes ordinary share capital, disclosed reserves including share premium, general reserves, legal / statutory reserve as well as retained earnings after deductions for goodwill and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes. The eligible reserves in Tier 1 exclude revaluation gains arising on the re-measurement to fair value of available-for-sale investments.

Tier 2 capital comprises 45 per cent of unrealised gains arising on the re-measurement to fair value of equity investments classified as available-for-sale and the profit equalization and investment risk reserve attributable to unrestricted investment accounts. Under the CBB rules, the aggregate amount of Tier 2 capital eligible for inclusion in the regulatory capital is limited to no more than 100% of Tier 1 Capital.

The limit on Tier 2 capital is based on the amount of Tier 1 capital after all deductions of investments pursuant to PCD Module of the CBB. The PCD Module sets out the regulatory rules for prudential consolidation and pro-rata consolidation for banks where they own controlling or significant minority stakes in regulated financial entities and have significant exposures to investment in commercial entities. It also sets out the framework for the prudential deductions from capital for various instances including exposures to counterparties exceeding the large exposure limits as set out by CBB. At 31 December 2011, there were no deductions required by the regulator to be made from the regulatory capital base.

5.2 ICAAP considerations

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. GFH has developed an ICAAP around its economic capital framework which involves identification and measurement of risks to maintain an appropriate level of internal capital in alignment to the Bank's overall risk profile and business plan. An ICAAP document has been developed to address major components of the Bank's risk management, from the daily management of material risks including risk types which are not covered under Pillar I including liquidity risk, profit rate risk in the banking book, concentration risk, and reputational risk.

The Bank's current focus is to enhance its capital base and improve the liquidity position. Till such time the recapitalization exercise is completed, no additional capital is being allocated to the Pillar 2 risk components. However, the Bank continues to monitor these risk components and reports the same periodically to the Board of Directors.

6- Credit risk

6.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's, placements with financial institutions, financing receivables, and other receivables balances. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

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. For regulatory capital computation purposes, the Bank's equity investments in the banking book include investments carried at fair value through equity, investments designated at fair value through profit or loss, significant and majority investments in commercial entities/approved insurance entities and associate investments in non-significant financial and non-financial entities (as significant financial entities which qualify as associates are treated separately for regulatory purposes).

6.2 Credit risk management

The Bank is not involved in the granting of credit facilities in the normal course of its business activities. The Bank is primarily exposed to credit risk from its own short term liquidity related to placements with other financial institutions, receivables from its investment banking services and in respect of funding made (both in the form of financing and short-term liquidity facilities) to its projects. These exposures arise in the ordinary course of its investment banking activities and are generally transacted without any collateral or other credit risk mitigants.

The Bank has an established internal process for assessing credit risk. The Bank has established investment and credit policies developed in consultation with business units, covering credit assessment, risk reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements. The policies are supplemented by an internal authorisation structure for the approval and renewal of investment and credit facilities. Authorisation limits for credit facilities are as per the Board approved Delegated Authority Limits (DAL). The RMD assesses all investment and credit proposals prior to investments / facilities being committed. RMD lists down its concerns and comments on all applications prior to circulation for sign off. Renewals and reviews of investments / facilities are subject to the same review process. Investment updates are periodically reviewed by the Board of Directors. Regular audits of business units and credit processes are undertaken by Internal Audit.

Please refer Note 37, to the consolidated financial statements for additional details on the processes for measuring and managing credit risk.

6.3 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 unrestricted investment account holders are required to be included.

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

6- Credit risk (continued)

Following is the analysis for credit risk as computed for regulatory capital adequacy purposes:

US \$000's

| Exposure class | Gross credit exposures | Average risk weights | Total credit risk weighted exposure |
|---|------------------------|----------------------|-------------------------------------|
| Self financed assets | | | |
| Cash items | 2,938 | 0% | - |
| Total claims on sovereign | 2,601 | 0% | - |
| Standard Risk Weights for Claims on Banks | 54 | 20% | 11 |
| Preferential Risk Weight for Claims on Locally Incorporated Banks | 5,157 | 20% | 1,031 |
| Short-Term Claims on Banks | 815 | 20% | 163 |
| Claims on Corporates | 177,571 | 100% | 177,571 |
| Past Due Facilities | 100,614 | 137% | 138,263 |
| Investments in Securities and Sukuk | 175,424 | 150% | 262,262 |
| Holding of Real Estate | 506,058 | 198% | 1,003,750 |
| Others Assets | 92,631 | 100% | 92,631 |
| Total self financed assets (A) | 1,063,863 | 158% | 1,675,682 |
| Total regulatory capital required (A x 12%) | | 12% | 201,082 |
| Financed by EIAH | | | |
| Cash item | 1,898 | 0% | - |
| Total claims on sovereign | 29,056 | 0% | - |
| Standard Risk Weights for Claims on Banks | 41,881 | 42% | 17,551 |
| Preferential Risk Weight for Claims on Locally Incorporated Banks | 65,340 | 20% | 13,068 |
| Claims on Corporates | 96,488 | 100% | 96,488 |
| Investments in Securities and Sukuk | 10,615 | 150% | 15,923 |
| Total financed by EIAH (B) | 245,278 | 58% | 143,029 |
| Considered for credit risk (C) = (B x 30%) | | 30% | 42,909 |
| Total regulatory capital required (C x 12%) | | 12% | 5,149 |
| TOTAL RISK WEIGHTED EXPOSURE | | | 1,718,591 |
| TOTAL REGULATORY CAPITAL REQUIRED | | | 206,231 |

6- Credit risk (continued)

6.4 Quantitative information on credit risk

6.4.1 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 consolidated financial statements:

US \$000's

| Balance sheet items | Funded exposure | Unfunded exposure# | Total gross credit exposure | Average gross credit exposure* |
|--|-----------------|--------------------|-----------------------------|--------------------------------|
| Bank balances | 3,820 | - | 3,820 | 4,346 |
| Placements with financial and other institutions | 3,001 | - | 3,001 | 19,891 |
| Financing receivables | - | - | - | 10,762 |
| Investment in associates | 230,442 | - | 230,442 | 227,660 |
| Investment securities | 220,265 | 83,249 | 303,514 | 227,820 |
| Investment property | 259,404 | - | 259,404 | 259,404 |
| Other assets | 108,913 | - | 108,913 | 137,055 |
| Total credit exposure | 825,845 | 83,249 | 909,094 | 886,937 |

* Average gross credit exposures have been calculated based on the average of balances outstanding on a quarterly basis during the year ended 31 December 2011.

Certain unfunded exposures reported in the consolidated financial statements do not qualify for consideration as Risk Weighted exposures for CAR calculation purposes.

6- Credit risk (continued)

6.4.2 Credit exposure by geography

The classification of credit exposure by geography, based on the location of the counterparty, was as follows:

| | US \$000's | | | | | | |
|--|----------------|---------------|---------------|-----------|-----------------------|------------|----------------|
| | GCC countries | Other MENA | Other Asia | UK | Europe (excluding UK) | USA | Total |
| Assets | | | | | | | |
| Bank balances | 3,021 | - | - | 82 | - | 717 | 3,820 |
| Placements with financial institutions | 3,001 | - | - | - | - | - | 3,001 |
| Investment in associates | 230,442 | - | - | - | - | - | 230,442 |
| Investment securities | 133,694 | 48,117 | 36,823 | - | 1,631 | - | 220,265 |
| Investment property | 259,404 | - | - | - | - | - | 259,404 |
| Other assets | 50,683 | 29,129 | 29,101 | - | - | - | 108,913 |
| | 680,245 | 77,246 | 65,924 | 82 | 1,631 | 717 | 825,845 |
| Off-Balance sheet items | | | | | | | |
| Commitments and guarantees | 82,636 | 613 | - | - | - | - | 83,249 |
| Restricted investment accounts | 30,895 | - | - | - | - | - | 30,895 |

6- Credit risk (continued)

6.4.3 Credit exposure by industry

The classification of credit exposure by industry was as follows:

| | US \$000's | | | | | |
|--|---------------------------|----------------------------------|----------------------------|--------------|---------------|----------------|
| | Trading and manufacturing | Banks and financial institutions | Development Infrastructure | Technology | Others | Total |
| Assets | | | | | | |
| Cash and bank balances | - | 3,809 | - | - | 11 | 3,820 |
| Placements with financial institutions | - | 3,001 | - | - | - | 3,001 |
| Investment in associates | 67,811 | 162,631 | - | - | - | 230,442 |
| Investment securities | - | 7,482 | 199,640 | 4,202 | 8,941 | 220,265 |
| Investment property | - | - | 259,404 | - | - | 259,404 |
| Other assets | 17 | 1,287 | 102,339 | - | 5,270 | 108,913 |
| | 67,828 | 178,210 | 561,383 | 4,202 | 14,222 | 825,845 |
| Off-Balance sheet items | | | | | | |
| Commitments and guarantees | - | - | 83,249 | - | - | 83,249 |
| Restricted investment accounts | - | - | 30,895 | - | - | 30,895 |

6- Credit risk (continued)

6.4.4 Credit exposure by maturity

The maturity profile of credit exposures based on expected maturity was as follows:

US \$000's

| | Up to 3 months | 3 to 6 months | 6 months-1 year | 1 to 3 years | Over 3 years | Total |
|--|----------------|---------------|-----------------|----------------|--------------|----------------|
| Assets | | | | | | |
| Cash and bank balances | 3,804 | - | - | - | - | 3,804 |
| Placements with financial institutions | 3,001 | - | - | - | - | 3,001 |
| Financing receivables | - | - | - | - | - | - |
| Investment in associates | - | - | - | 230,442 | - | 230,442 |
| Investment in securities | 25,000 | 20,140 | - | 175,125 | - | 220,265 |
| Investment property | - | - | - | 259,404 | - | 259,404 |
| Other financial assets | - | 2,312 | - | 63,421 | 1,251 | 66,984 |
| Total assets | 31,805 | 22,452 | - | 728,392 | 1,251 | 783,900 |
| Off balance sheet items | | | | | | |
| Commitments and guarantees | - | - | - | 83,249 | - | 83,249 |
| Restricted investment accounts | - | - | - | 30,895 | - | 30,895 |

6.5 Exposures in excess of 15% of capital base

The following exposure (funded and unfunded) was in excess of 15% of the capital base of the Bank as at 31 December 2011:

| | % of capital base | Exposure (US\$ 000's) |
|-----------------------------------|-------------------|-----------------------|
| Non-financial institutions | | |
| Counterparty A | 36.04% | 84,029 |
| Counterparty B | 29.08% | 67,811 |
| Counterparty C | 24.14% | 56,277 |
| Counterparty D | 21.90% | 51,062 |
| Counterparty E | 17.13% | 39,932 |
| Counterparty F | 15.30% | 35,666 |

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 and as per the prudential rules prior approval of the CBB is required for assuming such exposures, 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 deductions.

6- Credit risk (continued)

6.6 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 RMD. Quarterly updates on the investments / facilities are prepared by the investment unit reviewed by management and sent to the Board for review.

The definition and details of impaired assets, past due but not impaired exposures and policy for establishing an allowance account and write-off of an exposure is provided for in Note 37 to the consolidated financial statements. The details of changes in impairment allowances for financial assets are provided for in the notes to the consolidated financial statements.

All impaired and past due credit exposures at 31 December 2011 mainly relate to the real estate and development infrastructure sectors.

6.7 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.

6.8 Related party and intra-group transactions

Related counterparties are those entities which are connected to the Bank through significant shareholding or control or both. 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 strictly follows the guidelines issued by Central Bank of Bahrain and definitions as per FAS issued by AAOIFI. Detailed break up of exposure to related parties has been presented in Note 26 to the consolidated financial statements.

6.9 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.

6.10 Renegotiated facilities

As at 31 December 2011, other assets which are neither past due nor impaired include certain short-term financing to projects which were renegotiated during the year (refer note 37 to the consolidated financial statements). 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 assets. 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.

6- Credit risk (continued)

6.11 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.

Please refer to the notes to the consolidated financial statements for policies covering the valuation and accounting of equity holdings, including the accounting policies and valuation methodologies used, key assumptions and practices affecting valuation.

The RMD provides an independent review of all transactions. A fair evaluation and impairment assessment of investments takes place every quarter with inputs from the Investment department and RMD. Investment updates are periodically reviewed by the Board of Directors. Regular audits of business units and processes are undertaken by Internal Audit.

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.

US\$ 000's

| Information on equity investments (including Associates) | |
|--|---------|
| Privately held | 450,707 |
| Quoted in an active market | 164,095 |
| Realised gain/ (loss) during the year | 6,161 |
| Unrealised gain/(loss) in equity | (403) |

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 |
|------------------------------|----------------|-------------|------------------------|----------------|
| Quoted equity investment | 1,749 | 100% | 1,749 | 210 |
| Unquoted equity investment | 169,076 | 150% | 253,614 | 30,434 |
| Investments in managed funds | 4,600 | 150% | 6,900 | 828 |
| Total | 175,425 | | 262,263 | 31,472 |

7- Market risk

7.1 Introduction

Market risk is the risk that changes in market prices, such as foreign exchange rates, profit rates, equity prices, and commodity prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk. As a matter of general policy, the Bank shall not assume trading positions on its assets and liabilities, and hence the entire balance sheet is a non-trading portfolio (banking book). The Bank has adopted a standardized approach for measurement of market risk under the CBB capital adequacy framework. The CBB's standardized approach capital computation framework requires risk weighted assets to be computed for price risk, equities position risk, Sukuk risk, foreign exchange risk and commodities risk. Hence, from a capital computation perspective the Bank's market risk measurement is limited to foreign exchange risk in the banking book. The Bank is also exposed to profit rate risk on the banking book which is managed separately.

7.2 Foreign exchange risk management

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. All foreign exchange (FX) risk within the Bank is transferred to Treasury. The Bank seeks to manage currency risk by continually monitoring exchange rates. The Board of Directors approves policies and strategies related to the management of FX risk. The Management and Investment Committee ('MANICOM') supports the Board in managing FX risk by recommending policies, setting limits and guidelines and monitoring the FX risk of the Bank on a regular basis. The MANICOM provides guidance for day to day management of FX risk and also approves hedging programs. The management of the day-to-day FX position of the Bank is the responsibility of the Treasury/Liquidity Management Department. The department shall ensure adequate FX liquidity to meet the maturing obligations and growth in assets while ensuring that all limits and guidelines set by the Board and MANICOM are complied with; and shall implement hedging and other approved strategies for managing the risk. The Risk Management Department on an ongoing basis reviews the limits set and ensure that the concerned department(s) is complying with all limits set as per this policy.

The management of foreign exchange risk against net exposure limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various foreign exchange scenarios. Standard scenarios that are considered include a 5% plus / minus increase in exchange rates, other than GCC pegged currencies. An analysis of the Bank's net foreign exchange position and its sensitivity to an increase or decrease in foreign exchange rates (assuming all other variables, primarily profit rates, remain constant) has been presented in Note 37 to the consolidated financial statements.

7.3 Capital requirements for 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

| | Risk weighted assets | Capital requirement @ 12% | Maximum during the year | Minimum during the year |
|-----------------------|----------------------|---------------------------|-------------------------|-------------------------|
| Foreign exchange risk | 84,013 | 10,082 | 8,771 | 6,483 |

8- Operational risk

8.1 Introduction

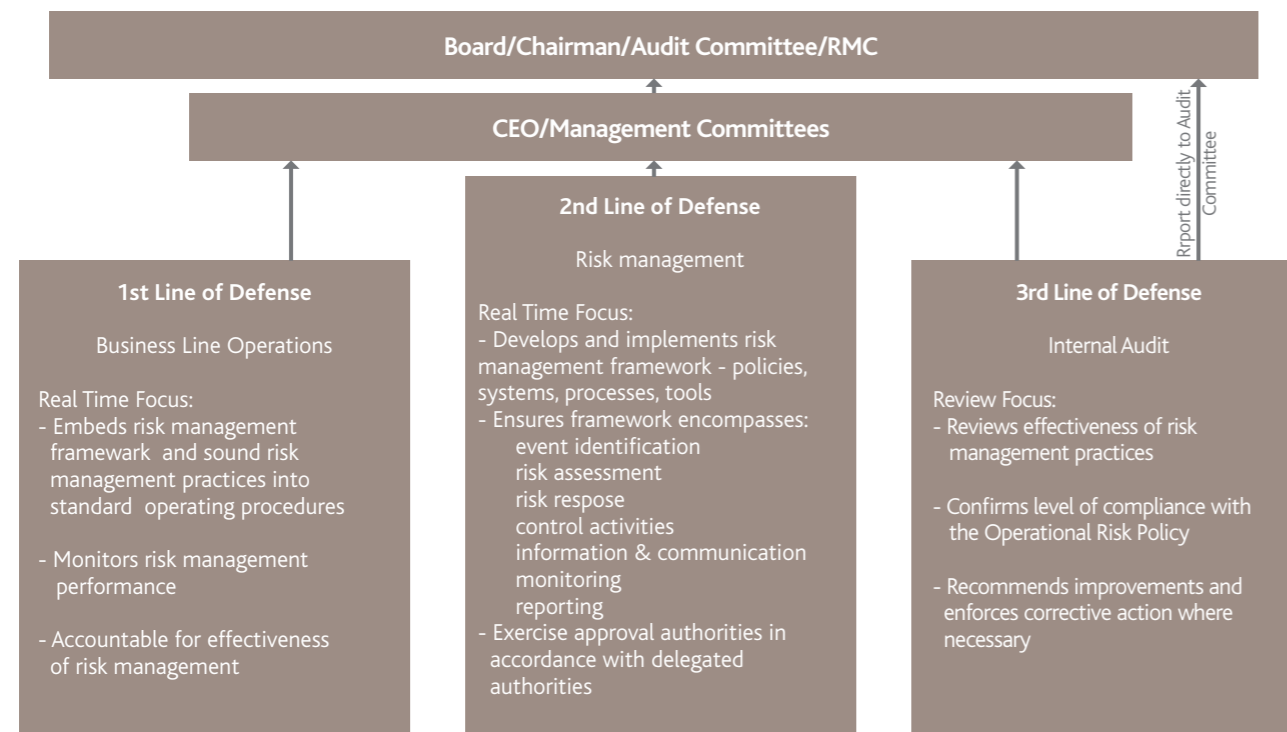
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk is an inherent part of normal business operations. The Bank has adopted the Basic Indicator Approach for measurement of operational risk under the Basel II and CBB capital computation framework.

8.2 Operational risk management

Whilst operational risk cannot be eliminated entirely, the Bank endeavors to minimize it by ensuring that a strong control infrastructure is in place throughout the organization. Various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. The Risk Management Department manages the framework and facilitates the process of operational risk management.

The Bank has an operational risk management framework manual which includes components such as Key Risk Indicators (KRIs), operational loss data and Risk & Control Self Assessment (RCSA) across the Bank. The Bank has completed the process of conducting RCSA of operational risk in all departments of the Bank to identify the important KRIs and key risk triggers. The Bank is currently in the process of reviewing its risk registers to reflect the operational risk profile post the restructuring exercise. Going forward the Bank will quantify its operational risk exposures and will roll out the incident reporting framework. This process will also assist the Bank in the long term to create a loss data base which will provide the basis for introducing more advanced approaches for computation of capital for operational risk.

To ensure effective governance across all processes and functions, GFH has adopted a 'Three Lines of Defense' approach, as illustrated below. The structure clearly reflects the requisite independence between the three functions.



Operational risk (continued)

The rationale behind the 3 Lines of Defense sees that the Executive Chairman is ultimately accountable for all 3 Lines of Defense. In addition:

- The Business Unit heads are ultimately accountable for the 1st Line of Defense in their business areas;
- The Risk Management function is ultimately accountable for the 2nd Line of Defense for the Bank; and
- The Head of Internal Audit is ultimately accountable for the 3rd Line of Defense for the Bank.

The Bank's definition of operational risk incorporates legal and Shari'a compliance risk. This is defined as an operational risk facing Islamic banks which can lead to, loss of reputation, non-recognition of income and loss of revenue. This definition excludes strategic, liquidity, credit, market and reputational risks. However, operational risk that has a direct impact upon reputation (and by default a subsequent impact on profit and / or performance) is formally considered and reported upon. Whilst operational risk excludes losses attributable to traditional banking risk (credit, market and liquidity), the Bank recognises that operational risk is attached to the management of those traditional risks. For example operational risk includes legal and compliance related risks attached to the management of credit and market risk. Operational risks are attached to the management of business as usual as well as to changes such as the introduction of new products, projects or program activities.

8.3 Legal compliance and litigation

The Bank has an in-house legal counsel who is consulted on all major activities conducted by the Bank. All contracts, documents, etc have to be reviewed by the legal department as well. For information on contingencies, refer note 36 to the consolidated financial statements. The Group was not involved in any significant litigation as at 31 December 2011.

8.4 Shari'a compliance

The Shari'a Supervisory Board (SSB) is entrusted with the duty of directing, reviewing and supervising the activities of the Bank in order to ensure that they are in compliance with the rules and principles of Islamic Shari'a. The Bank also has a dedicated internal Shari'a reviewer, who performs an ongoing review of the compliance with the fatwas and rulings of the SSB on products and processes and also reviews compliance with the requirements of the Shari'a standards prescribed by AAOIFI. The SSB reviews and approves all products and services before launching and offering to the customers and also conducts periodic reviews of the transactions of the Bank. An annual audit report is issued by the SSB confirming the Bank's compliance with Shari'a rules and principles.

8.5 Capital requirements for 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 12.5 is used to arrive at the risk weighted assets that are subject to capital charge.

| | Average gross income | Risk weighted assets | Capital charge at 12% |
|------------------|----------------------|----------------------|-----------------------|
| Operational risk | 40,865 | 76,622 | 9,195 |

US\$ '000's

9- Other types of risk

9.1 Introduction

Apart from the risks listed in the previous sections, the Bank is also exposed to other types of risks which it identifies and manages as part of its risk management framework. Although these risks do not directly form part of the Tier 1 risks, they are identified and captured by the ICAAP.

9.2 Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting its financial obligations on account of a maturity mismatch between assets and liabilities. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. Whilst this is the policy, the Group's current position is under severe stress with contractual liabilities exceeding liquid assets. Focus has therefore been on extending the maturity of liabilities and raising capital in the form of debt or equity.

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee (MANICOM), Treasury and other concerned departments in management of liquidity. It also stipulates various liquidity ratios to be maintained by the Bank, as well as gap limits under each time bucket of the maturity ladder. The ongoing financial crisis has caused a squeeze in the liquidity position of the Bank and the management has been pursuing various alternatives to enhance the liquidity situation which includes restructuring of its term debts and asset sales. The Bank is also currently in the midst of a recapitalization program with an objective to enhance the capital base.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by the Board Audit & Risk Committee. Daily reports cover the liquidity position of the Bank. Moreover, periodic reports are submitted to the Board of Directors on the liquidity position. For maturity profile of assets and liabilities refer Note 32 of the consolidated financial statements.

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

| Liquidity ratios | 31 December 2011 | Maximum | Minimum |
|--|------------------|---------|---------|
| Liquid assets : Total assets | 0.83% | 4.16% | 0.83% |
| Liquid assets : Total deposits | 3.88% | 15.98% | 3.88% |
| Short-term assets : Short-term liabilities | 1.71% | 15.25% | 1.71% |
| Illiquid assets : Total assets | 99.17% | 99.17% | 95.84% |

At 31 December 2011, the Group's current contractual liabilities exceeded its liquid assets. The Group's plan to manage and strengthen its liquidity position is discussed in note 2(b) of the consolidated financial statements.

Other types of risk (continued)

9.3 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.

The MANICOM is responsible for the overall management of the profit rate risk. MANICOM also determines the borrowing and funding strategy of the Bank in order to optimize risk return trade off. It supports the Board in managing profit rate risk by recommending policies, setting limits and guidelines and monitoring the risk on a regular basis.

The objective of profit rate risk measurement is to maintain the Bank's profit rate risk exposure within self-imposed parameters over a range of possible changes in profit rates. The process of establishing profit rate risk limits and describing the risk taking guidelines provides the means for achieving the objective. Such a process defines the boundaries for the level of profit rate risk for the Bank and, where appropriate, also provides the capability to allocate limits to individual portfolios, activities, or business units. The limit structure also ensures that positions that exceed certain predetermined levels receive prompt management attention. The limit system enables management to control profit rate risk exposures, initiate discussion about opportunities and risks, and monitor actual risk taking against predetermined risk tolerance. As part of ICAAP, thresholds for exposure concentrations will be set up which will trigger additional capital requirements.

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 include a 100 basis point (bp) parallel fall or rise in yield curves. For details of the Bank's profit rate gap position as at 31 December 2011 and analysis of the Bank's sensitivity to an increase or decrease in market profit rates, refer Note 37 to the consolidated financial statements. An analysis of the Group's sensitivity to an increase or decrease in market profit rates for a 200bps parallel increase / (decrease) is as below:

| | US\$'000's |
|---|------------|
| 200 bps parallel increase / (decrease) | |
| At 31 December | ± 10,112 |
| Average for the year | ± 10,236 |
| Maximum for the year | ± 10,866 |
| Minimum for the year | ±9,668 |

9.4 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 industry sector concentration of credit exposures has been disclosed in paragraphs 6.4.2 and 6.4.3.

9.5 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. As at 31 December 2011, the Bank did not have any open positions on foreign exchange contracts.

Other types of risk *(continued)*

9.6 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 put together an Internal Capital Adequacy Assessment Process (ICAAP) Policy to effectively assess and measure all non Pillar 1 risks.

9.7 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 Investment Account Holders (IAH) 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.

9.8 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 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.

10- Product disclosures

10.1 Product descriptions and consumer awareness

The Bank offers a comprehensive mix of Shari'a compliant investment banking products primarily to high net worth and sophisticated investors. This includes a range of innovative structured investment products like funds, repackaged products and structured restricted investment accounts. The investment department of the Bank has expertise in creating innovative high end and value added products offering a wide range of structures, expected returns, tenors and risk profiles.

Proposal for any new product is initiated by individual business lines within the Bank. The Management Committee of the Bank reviews such proposal to ensure that the new product/ business is in line with the Bank's business and risk strategy. All new products will need the approval of the respective authorities as per the Delegated Authority Limits (DAL) as well as the Board of Directors and the Shari'a Supervisory Board of the Bank.

10.2 Customer complaints

GFH is dedicated to providing a high standard of service and to maintaining its reputation for honesty and integrity in all its dealings. The Bank takes all disputes and complaints from its customers and business partners very seriously. The Bank has a comprehensive policy on handling of external complaints, approved by the Board. All employees of the Bank are aware of and abide by this policy. The complaint handling process is disclosed in the Bank's website and also in all printed prospecting materials. Complaints are normally investigated by persons not directly related to the subject matter of the complaint.

10.3 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.

The EIAH holder authorises the Bank to invest the funds in any investments approved by the Bank's Shari'a Board without any preconditions. All EIAH accounts are on profit sharing basis, but the Bank does not guarantee any particular level of return. In accordance with the principles of Shari'a, the entire investment risk is on the investor. Any loss arising from the investment will be borne by the customer except in the case of the Bank's negligence. The Bank charges a Mudarib fee as its share of profit. Early withdrawal is at the discretion of the Bank and is subject to the customer giving reasonable notice for such withdrawal and agreeing to forfeit a share of the profit earned on such account.

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.

Product disclosures *(continued)*

The historical returns data on EIAH is as follows:

| | 2011 | | 2010 | |
|-------------------------------------|----------------|---------------|----------------|---------------|
| | Expressed in % | In US\$ 000's | Expressed in % | In US\$ 000's |
| Total EIAH as at 31 December | - | 1,898 | - | 1,880 |
| Average EIAH balance | - | 3,720 | - | 3,948 |
| Average rate of return earned (%) | | 0.78% | | 0.63% |
| Total profits on EIAH assets earned | | 29 | | 25 |
| Distributed to investor | | 19 | | 17 |
| Allocated to IRR | | 3 | | 2 |
| Allocated to PER | | 5 | | 4 |
| Bank's share of profits | | 2 | | 1 |
| Average declared rate of return (%) | | 0.51% | | 0.44% |

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

10.4 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 with Internal Audit oversight.

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.

Product disclosures *(continued)*

10.4 Restricted investment accounts *(continued)*

| Company | Cumulative distributions % | Annual Distributions | | | | |
|--|----------------------------|----------------------|------|--------|-------|--------|
| | | 2011 | 2010 | 2009 | 2008 | 2007 |
| Mena Real Estate Company KSCC | 29.43% | - | - | - | - | 31.13% |
| Kuwait National Real Estate Investment & Services Co. KSCC | - | - | - | - | - | - |
| Gulf Holding Company | - | - | - | 9.41% | - | - |
| Gulf North Africa Holding Company KSCC | 1.78% | - | - | 10.12% | 7.55% | - |
| Gulf Real Estate Development Company | 1.41% | - | - | 9.57% | 6.76% | - |
| Pan European Fund | 3.69% | - | - | - | 5.36% | 10.48% |
| Al Basha'er Fund | 13.68% | - | - | - | - | - |
| Oman Development Company | - | - | - | - | NA | NA |
| Bayan Holding Co KSCC | - | NA | NA | NA | NA | - |
| Gulf Atlantic FZ LLC | - | NA | NA | NA | NA | NA |
| Mena Jet | - | NA | NA | NA | NA | NA |
| Energy City Qatar Holding Company | - | NA | NA | NA | NA | - |
| Saudi Real Estate Co | - | NA | NA | NA | NA | NA |
| Al Hareth French Property Fund | 17.40% | NA | NA | NA | NA | 4.91% |
| Gulf Atlantic Real Estate Company Limited | - | NA | NA | NA | NA | NA |
| Gulf Development Real Estate Company KSCC | - | NA | NA | NA | NA | NA |

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 since 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.

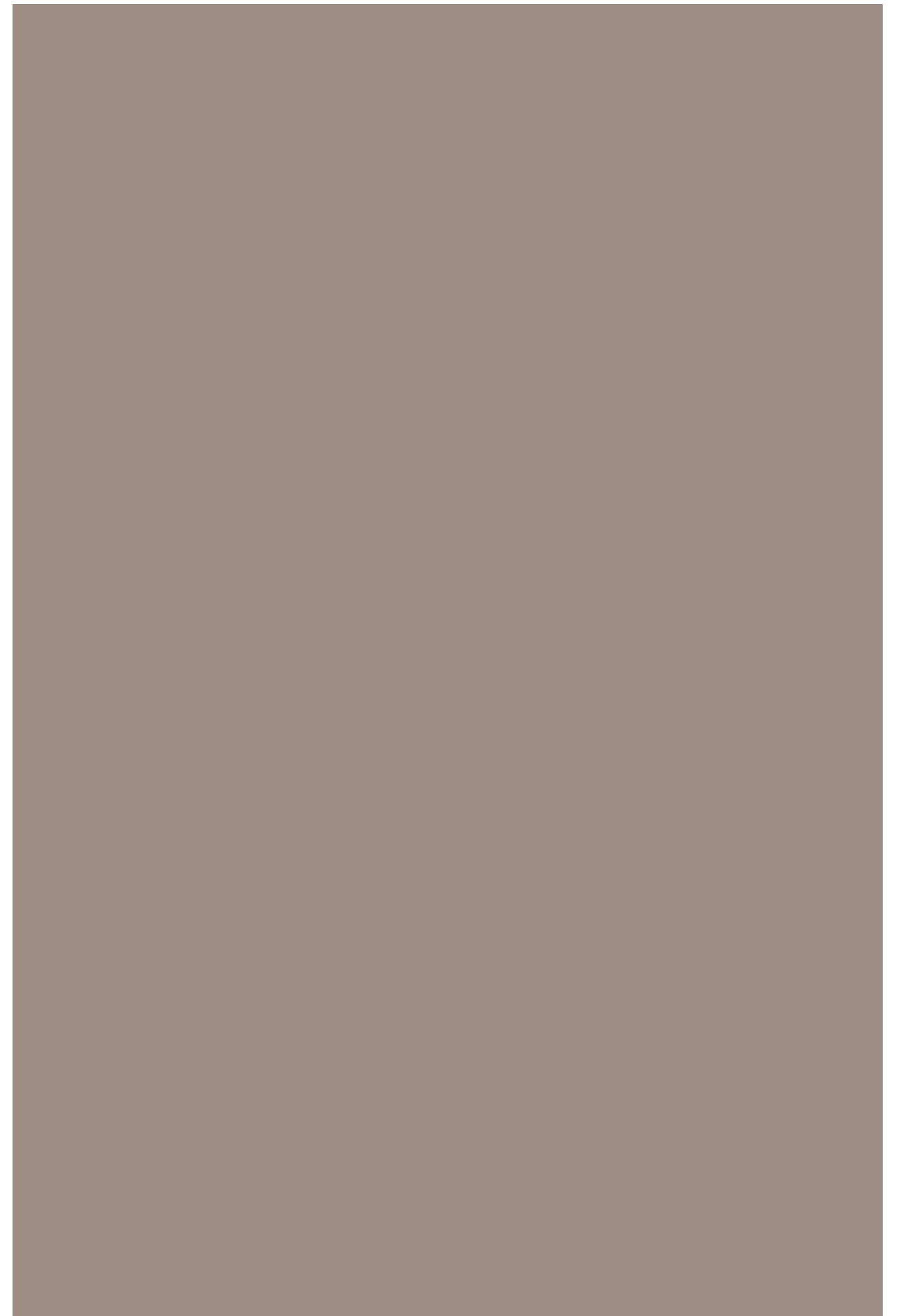
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