



# **RISK AND CAPITAL MANAGEMENT**

## **BASEL II - PILLAR III DISCLOSURES**

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## **1 Executive summary**

Gulf Finance House BSC (“GFH/ the Bank”) was incorporated in 1999 in the Kingdom of Bahrain under Commercial Registration No. 44136. The Bank operates as an Islamic Wholesale Investment Bank under a license granted by the Central Bank of Bahrain (“CBB”). The Bank’s activities are regulated by the CBB and supervised by a 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.

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.

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. The Bank has been in compliance with the minimum capital adequacy ratios prescribed by the CBB throughout 2009.

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 2009, presented in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and International Financial Reporting Standards (IFRS). 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 2009.

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## **2 Introduction**

The new capital adequacy module of the CBB rule book was introduced with effect from 1 January 2008. The new Basel II based framework 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 new 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. Under the previously applied Basel I Capital Accord, the minimum capital adequacy ratio for banks incorporated in Bahrain was 12 per cent compared to the Basel Committee's minimum ratio of 8 per cent. 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 an effective minimum capital adequacy ratio of 12.5 per cent.

Under the CBB's Basel II capital adequacy framework, the RWAs are calculated using more sophisticated and risk sensitive methods than under the previous Basel I regulations. 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.

<b>Risk Type</b>	<b>Approach used by GFH</b>
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 CBB is currently assessing the financial strength and risk management practices of institutions, which will allow them to set minimum capital ratios in excess of 8 per cent on unconsolidated basis. Pending finalization of the assessment process, all banks incorporated in Bahrain are required to continue to maintain the existing 12 per cent and 8% minimum capital adequacy ratio as under the previous Basel I framework.

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. Given the current capital resources and 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 of Directors on a quarterly basis.

### **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.

In April 2008, the Central Bank revised the PD module to cover the detailed disclosure requirements to be followed by licensed banks in Bahrain to be in compliance with Pillar 3 of Basel II. Under the current regulations, partial disclosure consisting mainly of quantitative analysis is required during half year reporting, whereas fuller disclosure is required to coincide with the financial year-end reporting.

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### **3 Overall risk and capital management**

#### **3.1 Risk management strategy**

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 adopt international best practices of risk management, superior corporate governance and the highest level of market discipline.

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

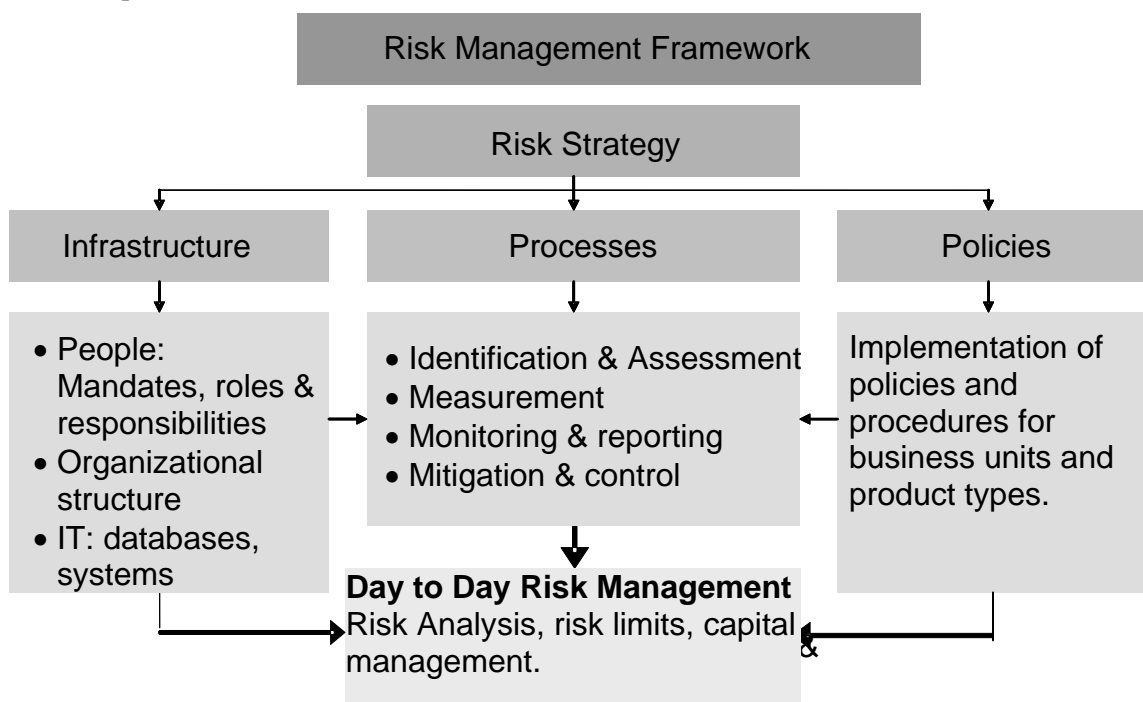
- Manage risks inherent in the Bank's activities in line with the risk appetite of the Bank;
- Strengthen the Bank's risk management practices to reflect the industry best practices; and
- Align internal capital requirements with risk materiality.

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 appetite 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.

### **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:



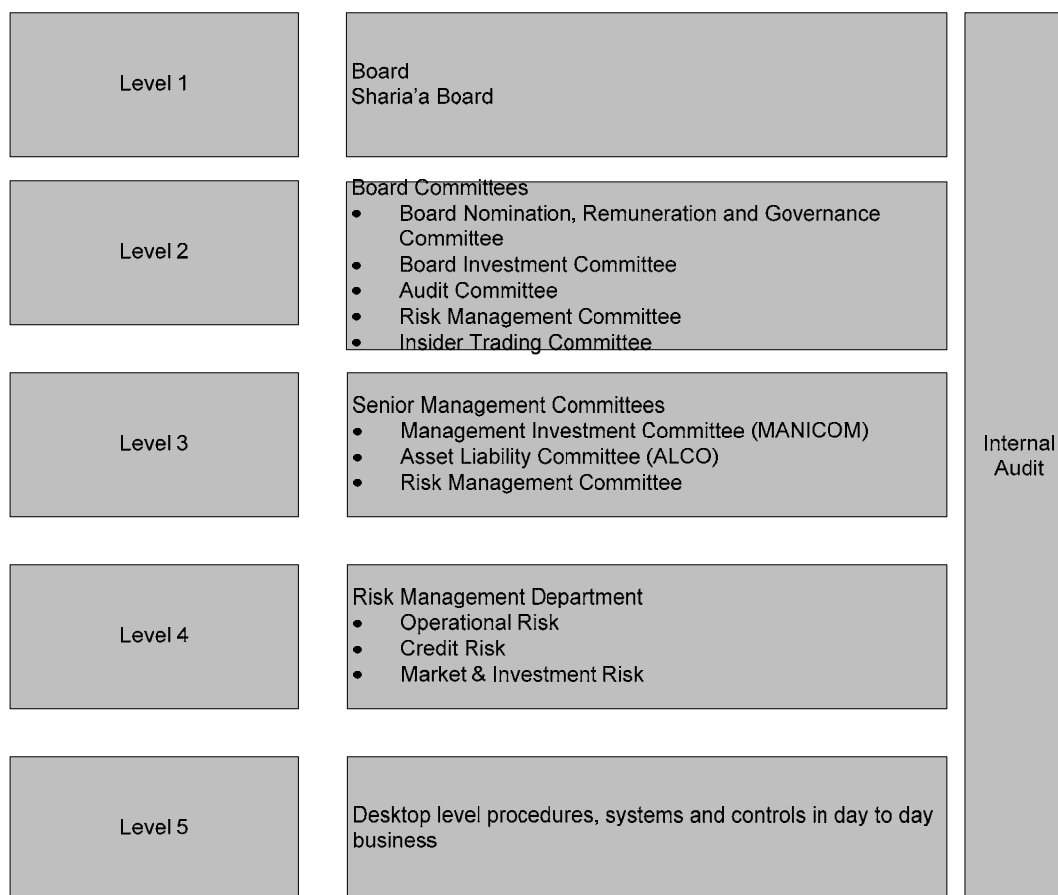
The risk management framework of the Bank encapsulates the spirit of the following key principles for Risk Management as articulated by Basel II:

- 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.

### 3.2 Risk governance structure

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

#### Risk Governance Structure of GFH



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 Risk Management Committee is responsible for implementing risk management policies, guidelines and limits and ensuring that monitoring processes are in place. The Executive Risk Management Committee of the management also continuously monitors consistent implementation of the Board approved policies in the Bank and reports deviations if any to

the Risk Management Committee of the Board. The committee 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 Group Risk Operations reports to Board Risk Management Committee and has access to the Chairman and the Board of Directors.

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

- Determining the Bank's appetite for risk 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.
- Reviewing operating policy manuals and ensuring that such policy manuals are in accordance with the risk management policies and appropriately addresses all the key risks embedded in the related processes/ products.
- 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 MIS Reports for review by the RMC and the Board, where necessary.

- Developing systems and resources to review the key risk exposures of the Bank and communicating the planned/ executed corrective actions to the Risk Management Committee.

### **3.3 Capital management**

The Bank's policy is to maintain a strong capital base and meet the minimum 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 risk adjusted 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 ensures that the capital adequacy requirements are met and comply with regulatory capital requirements at all times. A prior approval of the CBB is obtained by the Bank before submitting a proposal for distribution of profits (i.e. dividend) for shareholders approval.

### 3.4 Risk types

The Bank is exposed to various types of risk.

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

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

### 3.5 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 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, monthly reports, 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 to enhance and improve the risk management standard procedures.

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## **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 2009. The Group’s financial statements are prepared and published on a full consolidation basis, with all material subsidiaries being consolidated in accordance with IFRS. Please refer to Note 2 in the notes to 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 type of the investments discussed above is in accordance with the requirements of PCD and as agreed with the CBB.

The principal subsidiaries and associates as at 31 December 2009 and their treatment for capital adequacy purposes are as follows:

<b>Entity name and accounting classification</b>	<b>Domicile</b>	<b>Investment classification as per PCD</b>	<b>Regulatory treatment as per PCD</b>
<b>Subsidiaries</b>			
Al Areen Leisure and Tourism Company- TheLost Paradise of Dilmun SPC- (“Water Park”)	Bahrain	Commercial entity	Risk weighting of net investment
GFH Sukuk Limited	Cayman Islands	Financial entity	Fully consolidated
Legends Development Company LLC (“Legends”)	UAE	Significant commercial entity	Risk weighting of net investment
Hawafiz BSC (c)	Bahrain	Commercial entity	Risk weighting of net investment
Injazat Capital Limited	UAE	Financial entity	Fully consolidated
<b>Associates</b>			
Khaleeji Commercial Bank BSC	Bahrain	Significant financial entity	Pro-rata consolidated
Bahrain Financial Harbor Limited	Cayman Islands	Commercial entity	Risk weighting of net investment and deduction of excess
Balexco BSC (c)	Bahrain	Commercial entity	Risk weighting of net investment
Injazat Technology Fund BSC (c)	Bahrain	Commercial entity	Risk weighting of net investment
Al Barakah Takaful	Jordan	Significant insurance entity	Deduction
Cemena Investment Company	Cayman Islands	Commercial entity	Risk weighting of net investment

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.

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## **5 Capital structure and capital adequacy ratio**

### **5.1 Capital adequacy**

The Bank's regulator, the CBB, sets and monitors capital requirements for the Bank as a whole (i.e. at a consolidated level). In implementing current capital requirements the 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 a 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. The Bank has complied with the capital requirements set by the regulator throughout the year.

The capital adequacy ratio of the Group as at 31 December 2009 was too close to the minimum regulatory capital requirement of 12% which restricts the Group's ability to absorb further losses or undertake additional exposures. The Group plan to strengthen the capital position is discussed in note 41 to the consolidated financial statements.

The Bank's regulatory capital position at 31 December 2009 was as follows:

USD 000's

	<b>Tier 1</b>	<b>Tier 2</b>	<b>Total</b>
Share capital	604,079	-	604,079
Treasury shares	(52,371)	-	(52,371)
Share premium	202,316	-	202,316
Statutory reserve	106,700	-	106,700
Other reserves	4,300	-	4,300
Accumulated losses	(432,677)	-	(432,677)
Investments fair value reserve	-	441	439
Profit equalization reserves	-	3	3
Investment risk reserves	-	2	2
<b>Tier 1 and Tier 2 capital before general deductions</b>	<b>432,347</b>	<b>446</b>	<b>432,793</b>
Excess amount over materiality thresholds in case of investment in commercial entities	(46,296)	(446)	(46,742)
Investment in insurance entity greater than or equal to 20%	(4,523)	-	(4,523)
<b>Total eligible capital base</b>	<b>381,528</b>	<b>-</b>	<b>381,528</b>

USD 000's

**Risk weighted exposure**

Credit Risk  
Market risk  
Operational

	<b>Risk weighted exposure</b>	<b>Capital requirement @ 12%</b>
Credit Risk	2,154,562	258,547
Market risk	69,913	8,390
Operational	730,593	87,671
<b>Tier 1 and Tier 2 capital base</b>	<b>2,955,068</b>	<b>354,608</b>

**Capital Adequacy ratio**

**12.91%**

**Tier 1 capital adequacy ratio**

**12.91%**

The Bank's paid up capital consists only of ordinary shares which have proportionate voting rights. The Bank does not have any other type instruments which qualify for inclusion in regulatory capital.

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. Equity holdings in an insurance entity of 20% or more of the investee's capital is required to be deducted from Bank's capital for regulatory capital purposes. Holdings of less than 20% of the investee's capital are risk weighted under the applicable credit risk weighting rules.

At 31 December 2009, the following deductions from regulatory capital were made:

- General deductions as per the PCD module for investment in a commercial entity exceeding 15% of the capital base; and
- Deduction of significant (> 20%) investment in an insurance entity

## **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. Although currently no additional capital is being allocated to these risk components, the Bank monitors and reports on these risks on a quarterly basis to the Board of Directors.

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## **6 Credit risk**

### **6.1 Introduction**

Credit risk is the risk of financial loss to the Bank 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, receivable from investment banking services 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 available-for-sale investments, investments designated at fair value through profit or loss, significant and majority investments in commercial 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 are also allocated to Executive Management and larger facilities require approval by Board Investment Committee and the Board of Directors. The RMD assesses all investment and credit proposals prior to investments / facilities being committed. Renewals and reviews of investments / facilities are subject to the same review process. Quarterly updates of investments are reviewed by the Board of Directors. Regular audits of business units and credit processes are undertaken by Internal Audit.

Please refer Note 40 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 capital adequacy module for Islamic Banks, 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.

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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.

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

USD 000's

Exposure class	Gross credit exposures	Average risk weights	Total credit risk weighted exposure
<b>Self financed assets</b>			
Cash items	788	0%	-
Total claims on sovereign	9,407	0%	-
Standard Risk Weights for Claims on Banks	317,370	40%	125,707
Preferential Risk Weight for Claims on Locally Incorporated Banks	172,142	20%	34,428
Short-Term Claims on Banks	52,101	20%	10,420
Claims on Corporates	597,723	100%	597,783
Past Due Facilities	40,540	150%	60,810
Investments in Securities and Sukuk	300,212	150%	449,989
Holding of Real Estate	396,856	200%	793,712
Others Assets	22,974	100%	22,974
<b>Total self financed assets (A)</b>	<b>1,910,113</b>	<b>110%</b>	<b>2,095,823</b>
<b>Total regulatory capital required (A x 12%)</b>		<b>12%</b>	<b>251,498</b>
<b>Financed by URIA</b>			
Total claims on sovereign	2,304	0%	-
Standard Risk Weights for Claims on Banks	2,875	20%	575
Claims on Corporates	168,699	100%	168,699
Investments in Securities and Sukuk	26,523	100%	26,523
<b>Total financed by URIA (B)</b>	<b>200,401</b>	<b>98%</b>	<b>195,797</b>
<b>Considered for credit risk (C) = (B x 30%)</b>			<b>58,739</b>
<b>Total regulatory capital required (C x 12%)</b>		<b>12%</b>	<b>7,049</b>
<b>TOTAL RISK WEIGHTED EXPOSURE</b>			<b>2,154,562</b>
<b>TOTAL REGULATORY CAPITAL REQUIRED</b>			<b>258,547</b>

## 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:

Balance sheet items	Funded exposure	Unfunded exposure	Total gross credit exposure	Average gross credit exposure*
Bank balances	10,174	-	10,174	10,329
Placements with financial and other institutions	454,966	-	454,966	561,235
Financing receivables	29,173	-	29,173	64,971
Assets held-for-sale	-	-	-	431,373
Investment in associates	376,424	-	376,424	470,538
Investment in securities	349,399	200,067	549,466	416,217
Receivable from investment banking services	85,270	-	85,270	156,113
Other assets	336,930	283	337,213	446,128
<b>Total credit exposure</b>	<b>1,642,336</b>	<b>200,350</b>	<b>1,842,686</b>	<b>2,556,904</b>

\* Average gross credit exposures have been calculated based on the average of balances outstanding on a quarterly basis during the year ended 31 December 2009

#### 6.4.2 Credit exposure by geography

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

	<b>GCC countries</b>	<b>Other MENA</b>	<b>Other Asia</b>	<b>UK</b>	<b>Europe (excluding UK)</b>	<b>USA</b>	<b>Total</b>
<b>Assets</b>							
Bank balances	8,693	319	-	933	-	229	10,174
Placements with financial institutions	454,966	-	-	-	-	-	454,966
Financing receivables	29,173	-	-	-	-	-	29,173
Investment in associates	376,424	-	-	-	-	-	376,424
Investment in securities	253,387	43,808	47,572	-	1,632	3,000	349,399
Receivable from investment banking services	-	65,270	20,000	-	-	-	85,270
Other assets	246,734	53,739	36,457	-	-	-	336,930
	<b>1,369,377</b>	<b>163,136</b>	<b>104,029</b>	<b>933</b>	<b>1,632</b>	<b>3,229</b>	<b>1,642,336</b>
<b>Off-Balance sheet items</b>							
Commitments and guarantees	169,737	30,613	-	-	-	-	<b>200,350</b>
Restricted investment accounts	18,877	-	-	-	31,165	-	<b>50,042</b>

### 6.4.3 Credit exposure by industry

The classification of credit exposure by industry was as follows:

	Trading and manufacturing	Banks and financial institutions	Development Infrastructure	Technology	Others	Total
<b>Assets</b>						
Cash and bank balances	-	10,174	-	-	-	<b>10,174</b>
Placements with financial institutions	-	454,966	-	-	-	<b>454,966</b>
Financing receivables	-	15,000	14,173	-	-	<b>29,173</b>
Investment in associates	69,450	131,974	175,000	-	-	<b>376,424</b>
Investment in securities	24,452	94,576	140,421	5,000	84,950	<b>349,399</b>
Receivable from investment banking services	-	-	85,270	-	-	<b>85,270</b>
Other assets	-	639	154,539	-	181,752	<b>336,930</b>
	<b>93,902</b>	<b>707,329</b>	<b>569,403</b>	<b>5,000</b>	<b>266,702</b>	<b>1,642,336</b>
<b>Off-Balance sheet items</b>						
Commitments and guarantees	-	-	200,350	-	-	<b>200,350</b>
Restricted investment accounts	-	-	50,042	-	-	<b>50,042</b>

#### 6.4.4 Credit exposure by maturity

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

	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total	Carrying amount
<b>Assets</b>							
Cash and bank balances	10,174	-	-	-	-	10,174	10,174
Placements with financial institutions	454,966	-	-	-	-	454,966	454,966
Financing receivables	14,173	15,000	-	-	-	29,173	29,173
Investment in associates	-	131,566	-	244,858	-	376,424	376,424
Investment in securities	117,881	9,523	25,000	196,995	-	349,399	349,399
Receivable from investment banking services	40,540	44,730	-	-	-	85,270	85,270
Other financial assets	33,004	8,854	55,000	190,684	-	287,542	287,542
<b>Total assets</b>	<b>670,738</b>	<b>209,673</b>	<b>80,000</b>	<b>632,537</b>	<b>-</b>	<b>1,592,948</b>	<b>1,592,948</b>
<b>Off balance sheet items</b>							
Restricted investment accounts	-	-	-	50,042	-	-	50,042
Commitments and guarantees	32,388	58,552	73,797	35,613	-	-	200,350

## 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 2009:

	<b>% of capital base</b>	<b>Exposure (US\$ 000's)</b>
<b>Non-financial institutions</b>		
Counterparty A	19.29%	210,000

The CBB has set single exposures limit of 15 % of 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.

## 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. 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.

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 are provided in Note 40 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 2009 mainly relate to the real estate and development infrastructure sectors.

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## **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 IFRS and AAOIFI. Detailed break up of exposure to related parties has been presented in Note 29 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 2009, other assets which are neither past due nor impaired include certain short-term financing to projects which were renegotiated during the year (refer note 40 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. In the view of the management, additional impairment on these renegotiated facilities is not appropriate on the basis of the assessment of the level of future expected cash flows from the project and / or the stage of collection of amounts owed to the Bank.

#### **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. For regulatory capital computation purposes, the Bank's equity investments in the banking book include available-for-sale investments, significant and majority investments in commercial entities and associate investments in non-significant financial and non-financial entities (i.e. significant financial entities which qualify as associates are treated separately for regulatory purposes).

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. Quarterly updates of investments are 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.

Information on equity investments	US\$ 000's
Privately held	696,409
Quoted in an active market	659
Realised gain/ (loss) during the year	-
Unrealised gain/( loss) in equity	975

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	659	100%	659	79
Unquoted equity investment	289,364	150%	434,046	52,086
Investments in managed funds	10,189	150%	15,284	1,834
Real estate holdings	396,856	200%	793,712	95,245
<b>Total</b>	<b>697,068</b>		<b>1,243,701</b>	<b>149,244</b>

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## **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 Asset Liability Committee ('ALCO') 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 ALCO provides guidance for day today 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 ALCO 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 40 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.

	<b>Risk weighted assets</b>	<b>Capital requirement @ 12%</b>	<b>Maximum during the year</b>	<b>Minimum during the year</b>
Foreign exchange risk	69,913	8,390	6,806	5,598

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## **8 Operational risk**

### **8.1 Introduction**

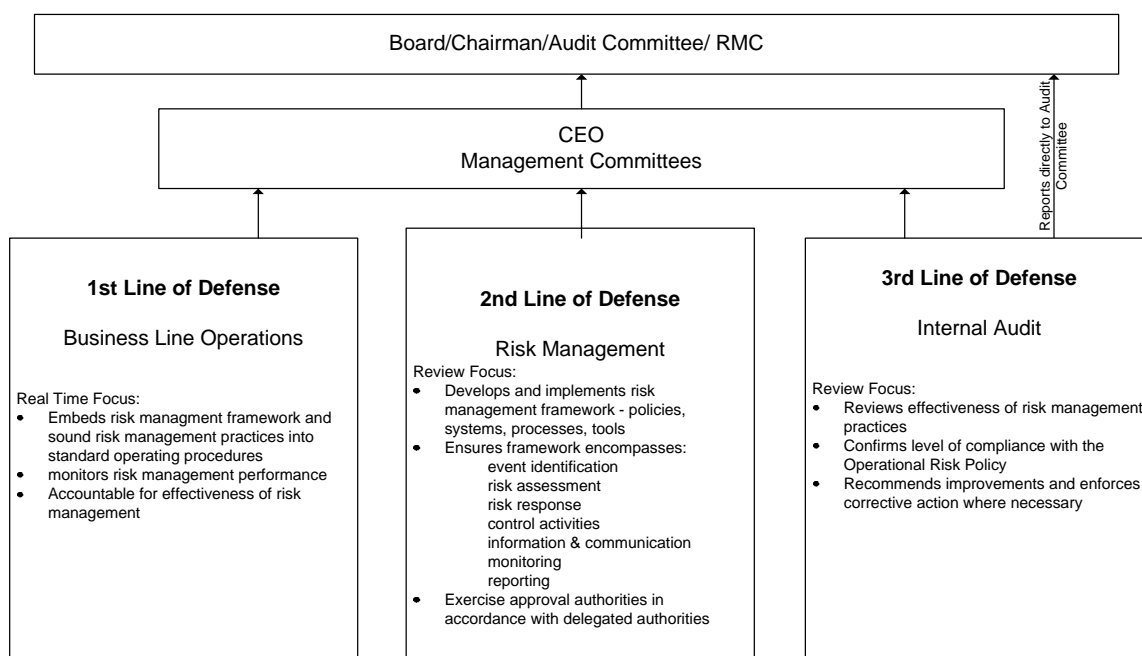
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk is an inherent part of normal business operations. The Bank has adopted the Basic Indicator Approach for measurement of operational risk under the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

The Bank has recently developed an operational risk management framework 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. As per the plan, the RCSAs and KRIs are done and quantification and incident reporting will be rolled out as Phase 2 in 2010. 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.



The rationale behind the 3 Lines of Defense sees that the CEO 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 Sharia’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)

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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 a dedicated legal team 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 39 to the consolidated financial statements. The Group was not involved in any significant litigation as at 31 December 2009.

### **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 CBB capital adequacy module for Islamic Banks. According to this approach, Bank's average gross income for three financial years is multiplied by a fixed coefficient alpha of 15% set by the CBB and a multiple of 12.5x is used to arrive at the risk weighted assets that are subject to capital charge.

	<b>Average gross income</b>	<b>Risk weighted assets</b>	<b>Capital charge at 12%</b>
Operational risk	389,649	730,593	87,671

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## **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 Bank's approach to managing liquidity is to ensure, that it will always have sufficient funds to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation.

The Bank has a liquidity risk policy in place, which describes the roles and responsibilities of the Asset Liability Management Committee (ALCO), 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. It is the Bank's policy to keep adequate levels of high quality liquid assets, such as inter-bank placements, to ensure that funds are available to meet maturing deposits and other liabilities, as and when they fall due.

The day to day management of liquidity risk is the responsibility of the Treasury Department, which monitors the sources and maturities of assets and liabilities closely, and ensures that limits stipulated by the ALCO are complied with. RMD monitors the liquidity position and any violations are reported to ALCO, Management Committee and the Board of Directors.

For maturity profile of assets and liabilities refer Note 40 of the consolidated financial statements.

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

<b>Liquidity ratios</b>	<b>31 December 2009</b>	<b>Maximum</b>	<b>Minimum</b>
Liquid assets : Total assets	19.82%	25.90%	16.43%
Liquid assets : Total deposits	70.79%	77.12%	58.77%
Short-term assets : Short-term liabilities	138.47%	138.47%	104.58%
Illiquid assets : Total assets	80.18%	83.57%	74.10%

At 31 December 2009, 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 40 of the consolidated financial statements.

### **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 ALCO is responsible for the overall management of the profit rate risk. ALCO 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 on a monthly basis 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 2009 and analysis of the Bank's sensitivity to an increase or decrease in market profit rates, refer Note 40 to the consolidated financial statements.

#### **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 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. The Bank's counterparty credit risk 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 2009, the Bank did not have any open positions on foreign exchange contracts.

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## **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 recently 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 Unrestricted Investment Accounts (URIA) 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 proper policies and procedure to mitigate and monitor these risks. The Bank's Board is overall responsible for approving and reviewing the risk strategies and significant amendments to the risk policies. The Bank senior management is responsible for

implementing the risk strategy approved by the Board to identify, measure, monitor and control the risks faced by the Bank. The Bank as a matter of policy regularly reviews and monitors financial and marketing strategies, business performance, new legal and regulatory developments and its potential impact on the Bank's business activities and practices.

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## **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 Unrestricted investment accounts (URIA)**

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

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The URIA holder authorises the Bank to invest the funds in any investments approved by the Bank's Shari'a Board without any preconditions. All URIA 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 URIA 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 URIA 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 URIA 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 URIA are agreed upfront with the customers and form part of the agreement with the customer. Till date, the Bank has not made any drawals on PER or IRR. Any movements on these accounts are therefore only on account of additional reserves added.

The historical returns data on URIA is as follows:

	2009		2008	
	Expressed in %	In USD 000's	Expressed in %	In USD 000's
Total URIA as at 31 December	-	2,875	-	1,940
Average URIA balance	-	2,618	-	3,311
Average rate of return earned (%)		0.76%		2.75%
Total profits on URIA assets earned		20		91
Distributed to investor		18		82
Allocated to IRR		0.3		2
Allocated to PER		0.5		3
Bank's share of profits		0.8		4
Average declared rate of return (%)		0.69%		2.48%

*The information disclosed above pertains to URIA 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 in 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 to establish Special Purpose Vehicles for management of the investment, the Board ensures that the management of such SPVs are conducted in a professional and transparent manner by a duly appointed Board.

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

- Ensuring that the investment structure, Offering Documents and the investment itself are fully compliant with Islamic Shari'a principles and the CBB regulations;
- Appropriately highlighting to the Investors, as part of the RIA Offering Document, of all the relevant and known risk factors and making it clear that the investment risk is to be borne by the Investor before accepting the investment funds;
- Completing all necessary legal and financial due diligence on investments undertaken on behalf of the Investors with the same level of rigor as the Bank requires for its' own investments;
- Ensuring that the funds are invested strictly in accordance with the provisions outlined in the Offering Documents;
- Preparing and disseminating periodical investment updates to Investors on a regular basis during the tenor of the investment;
- Distributing the capital and profits to the Investor in accordance with the terms of the offering document; and
- In all matters related to the RIA, RIA SPV(s) and the investment, act with the same level of care, good faith and diligence as the Bank would apply in managing its own investments.

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

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

Company	Cumulative distributions %	Annual Distributions				
		2009	2008	2007	2006	2005
Mena Real Estate Company KSCC	30.23%	-	-	31.13%	NA	NA
Kuwait National Real Estate Investment & Services Co. KSCC	21.25%	-	-	-	-	43.19%
Gulf Holding Company	0.84%	9.41%	-	-	-	NA
Gulf North Africa Holding Company KSCC	4.51%	10.12%	7.55%	-	-	NA
Gulf Real Estate Development Company	5.44%	9.57%	6.76%	-	NA	NA
Pan European Fund	6.34%	-	5.36%	10.48%	23.06%	NA
Al Basha'er Fund	-	-	-	-	-	NA
Oman Development Company	-	-	NA	NA	NA	NA
Bayan Holding Co KSCC	-	NA	NA	-	-	NA
Gulf Atlantic FZ LLC	3.50%	NA	NA	NA	-	6.56%
Mena Jet	-	NA	NA	NA	-	-
Energy City Qatar Holding Company	-	NA	NA	-	NA	NA
Saudi Real Estate Co	-	NA	NA	NA	-	NA
Al Hareth French Property Fund	9.94%	NA	NA	4.91%	11.09%	-

Gulf Atlantic Real Estate Company Limited	3.19%	NA	NA	NA	-	6.05%
Gulf Development Real Estate Company KSCC	3.69%	NA	NA	NA	6.99%	-

NA – Not applicable

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

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

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