



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 according to the opinion of the Bank’s Shari’a Supervisory Board

The CBB Basel II guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2008. These semi-annual disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module (“PD”), Section PD-3.1.6: *Additional Requirements for Semi Annual Disclosures*, CBB Rule Book, Volume II for Islamic Banks. These semi-annual quantitative disclosure requirements follow the requirements of Basel II - Pillar 3 and the Islamic Financial Services Board’s (IFSB) recommended disclosures for Islamic banks. These disclosures should be read in conjunction with the detailed Risk and Capital Management Disclosures made in Bank’s Annual Report for the year ended 31 December 2009 and the interim financial information for the six months ended 30 June 2010.

2 Group Structure

The interim financial information comprise of the financial statements of the Bank and its subsidiaries (together referred to as the “Group”) as at and for the six months ended 30 June 2010.

The principal subsidiaries and associates as at 30 June 2010 and their treatment for capital adequacy purposes are as follows:

Entity name	Entity classification as per PCD Module	Treatment by the Bank
Subsidiaries		
Al Areen Leisure and Tourism Company – The Lost Paradise of Dilmun SPC (“Water Park”)	Commercial entity	Risk weighted
GFH Sukuk Limited	Financial entity	Fully consolidated
Legends Development Company LLC (“Legends”)	Significant commercial entity	Risk weighting of investment exposure
Hawafiz BSC (c)	Commercial entity	Risk weighting of investment exposure
Injazat Capital Limited	Financial entity	Fully consolidated
Associates		
Khaleeji Commercial Bank BSC (“KHCB”)	Significant financial entity	Pro-rata consolidated
Bahrain Financial Harbor Limited	Commercial entity	Risk weighted
Balexco BSC (c)	Commercial entity	Risk weighted
Injazat Technology Fund BSC (c)	Commercial entity	Risk weighted
Al Barakah Takaful	Insurance entity	Deducted from regulatory capital
Cemena Investment Company	Commercial entity	Risk weighted

Generally, there are no restrictions on the transfer of funds or regulatory capital within the Group.

3 Capital structure and capital adequacy ratio

The PD Module requires disclosure of the Bank's exposure to risks on its banking and trading book. As the Bank does not have a trading book, all its disclosures are limited to the risks faced on its banking book. The Bank has adopted the Standardised Approach for Credit Risk and Market Risk and follows the Basic Indicator Approach for Operational Risk to determine its capital requirements.

As at 30 June 2010, the Bank's total risk weighted assets amounted to US\$ 2,811,417 thousand and Tier 1 and total regulatory capital amounted to US\$ 363,226 thousand. Accordingly, Tier 1 and Total Capital Adequacy Ratio was 12.92%. These ratios exceed the minimum capital requirements under the CBB's Basel 2 framework.

The Bank's regulatory capital position at 30 June 2010 was as follows:

USD 000's

	Tier 1	Tier 2	Total
Share capital	625,790	-	625,790
Treasury shares	(23,298)	-	(23,298)
Share premium	206,203	-	206,203
Statutory reserve	85,268	-	85,268
Other reserves	2,054	-	2,054
Retained profit brought forward	(432,677)	-	(432,677)
Current interim cumulative net losses	(47,677)	-	(47,677)
Investments fair value reserve	439	-	439
Profit equalization reserves	-	4	4
Investment risk reserves	-	2	2
Tier 1 and Tier 2 capital before general deductions	416,102	6	416,108
Excess amount over maximum permitted large exposure limit	(46,742)	-	(46,742)
Investment in insurance entity greater than or equal to 20%	(6,140)	-	(6,140)
Total eligible capital base	363,220	6	363,226

USD 000's

Risk weighted exposures	Risk weighted exposure	Capital requirement @ 12%
Credit risk weighted exposures	1,979,668	237,560
Market risk weighted exposures	114,475	13,737
Operational risk weighted exposures	717,274	86,073
Tier 1 and Tier 2 capital base	2,811,417	337,370

Tier 1 and Total Capital Adequacy ratio

12.92%

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.

4 Credit risk

4.1 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 corporates 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.

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 for capital adequacy computations.

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

USD 000's

Asset categories for credit risk	Gross credit exposures	Average risk weights	Total credit risk weighted exposure
Self financed assets			
Cash items	1,411	0%	-
Total claims on sovereigns	10,240	0%	-
Standard Risk Weights for Claims on Banks	170,361	49%	83,740
Preferential Risk Weight for Claims on Locally Incorporated Banks	40,939	20%	8,188
Short-term Claims on Banks	9,325	20%	1,865
Claims on Corporates including Takaful Companies and Category 3 Investment Firms	360,575	100%	360,575
Past Due Facilities	145,501	114%	165,771
Investments in Securities and Sukuk	264,345	150%	396,185
Holding of Real Estate	439,210	200%	878,419
Others Assets	22,047	100%	22,047
Total self financed assets (A)	1,463,954	110%	1,916,790
Total regulatory capital required (A x 12%)			230,015
Financed by URIA			
Total claims on sovereigns	3,196	0%	-
Standard Risk Weights for Claims on Banks	1,874	20%	375
Claims on Corporates	166,130	100%	166,130
Past Due Facilities	10,283	150%	15,424
Investments in Securities	18,446	150%	27,669
Total financed by URIA (B)	199,929	98%	209,598
Considered for credit risk (C) = (B x 30%)			62,879
Total regulatory capital required (C x 12%)		12%	7,545
TOTAL RISK WEIGHTED EXPOSURE			2,126,388
TOTAL REGULATORY CAPITAL REQUIRED			237,560

4.2 Quantitative information on credit risk

4.2.1 Gross and average credit exposure

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

Balance sheet items	Funded exposure	Unfunded exposure	Total gross credit exposure	Average gross credit exposure*
Cash and bank balances	13,248	-	13,248	9,339
Placements with financial and other institutions	121,411	-	121,411	139,056
Financing receivables	15,000	-	15,000	15,000
Assets held-for-sale	260,000	-	260,000	130,000
Investment in associates	199,952	-	199,952	287,207
Investment in securities	340,207	6,613	346,820	331,609
Receivable from investment banking services	40,481	-	40,481	62,876
Other assets	392,821	22,074	414,895	367,058
Total credit exposure	1,383,120	28,687	1,411,807	1,342,145

* Average gross credit exposures have been calculated based on the average of balances outstanding on a quarterly basis for six months period ended 30 June 2010

4.2.2 Credit exposure by geography

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

	GCC countries	Other MENA	Other Asia	UK	Europe (excluding UK)	USA	Total
Assets							
Cash and bank balances	4,289	1	-	344	-	8,614	13,248
Placements with financial and other institutions	121,411	-	-	-	-	-	121,411
Financing receivables	15,000	-	-	-	-	-	15,000
Assets held-for-sale	260,000	-	-	-	-	-	260,000
Investment in associates	199,952	-	-	-	-	-	199,952
Investment securities	234,079	64,774	36,573	-	1,631	3,150	340,207
Receivable from investment banking services	-	40,481	-	-	-	-	40,481
Other assets	310,148	46,156	36,517	-	-	-	392,821
Total	1,144,879	151,412	73,090	344	1,631	11,764	1,383,120
Off-Balance sheet							
Commitments	28,074	613	-	-	-	-	28,687
Restricted investment accounts	18,697	51	-	-	26,965	-	45,713

4.2.3 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
Assets						
Cash and bank balances	-	13,248	-	-	-	13,248
Placements with financial and other institutions	-	121,411	-	-	-	121,411
Financing receivables	-	15,000	-	-	-	15,000
Assets held-for-sale	-	-	260,000	-	-	260,000
Investment in associates	66,997	132,955	-	-	-	199,952
Investment securities	23,370	70,430	180,654	5,000	60,753	340,207
Receivable from investment banking services	-	-	40,481	-	-	40,481
Other assets	358	96	346,195	-	46,172	392,821
	90,725	353,140	827,330	5,000	106,925	1,383,120
Off-Balance sheet items						
Commitments	-	613	22,074	-	6,000	28,687
Restricted investment accounts	-	-	45,713	-	-	45,713

4.2.4 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
Assets						
Cash and bank balances	13,248	-	-	-	-	13,248
Placements with financial and other institutions	11,356	-	-	110,055	-	121,411
Financing receivables	-	15,000	-	-	-	15,000
Assets held-for-sale	40,000	-	220,000	-	-	260,000
Investment in associates	-	-	-	199,952	-	199,952
Investment securities	-	20,219	25,000	294,988	-	340,207
Receivable from investment banking services	-	40,481	-	-	-	40,481
Other financial assets	6	411	258,099	95,512	-	354,028
Total assets	64,610	76,111	503,099	700,507	-	1,344,327
Off-Balance sheet items						
Commitments	5,354	16,500	6,000	613	-	28,467
Restricted investment accounts	-	-	-	45,713	-	45,713

4.2.5 Exposures in excess of regulatory limits

The CBB has set a 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. The capital base for computation of exposure limits has been agreed with the CBB and the capital base for this purpose is gross of the impairment allowances recognized in 2009.

The following exposure (funded and unfunded) was in excess of 15% of the regulatory large exposure capital base limit agreed with the CBB:

	% of capital base	Exposure (US\$ 000’s)
Non-financial institutions		
Counterparty A	57.82%	210,000

4.2.6 Impaired facilities and past due exposures

As the Bank is not engaged in granting credit facilities in its normal course of business, it does not use a detailed internal credit “grading” model. The current risk assessment process classifies credit exposures into two broad categories “Unimpaired” and “Impaired”, reflecting risk of default and the availability of collateral or other credit risk mitigation. 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.

Movement in impairment provisions during the period:

US\$ 000's

30 June 2010	Financing receivables	Financing to projects	Receivable from investment banking services	Other receivables	Investments
At 1 January	70,150	77,382	86,646	38,523	432,190
Charge for the period	-	-	20,000	-	-
At 30 June	70,150	77,382	106,646	38,523	432,190

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

US\$ 000's

As at 30 June 2010

	Past due but not impaired amounts *	Gross impaired amounts
Up to 3 months	-	-
Over 3 months to 1 year	40,540	83,600
1 to 3 years	-	-
Over 3 years	-	304,028
Total	40,540	387,628

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

Geographical concentration of impaired and past due receivables:

US\$ 000's

	Past due but not impaired amounts	Gross impaired amounts	Specific impairment allowance
As at 30 June 2010			
GCC Countries	-	239,914	101,056
Other MENA	40,540	1,074	1,074
Other Asia	-	83,600	83,600
Europe	-	63,040	63,040
Total	40,540	387,628	248,770

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

US\$ 000's

	Past due but not impaired amounts	Gross impaired amounts	Specific impairment allowance
As at 30 June 2010			
Development Infrastructure	40,540	386,308	247,450
Banks and financial institution	-	1,286	1,286
Others	-	34	34
Total	40,540	387,628	248,770

4.2.7 Credit risk mitigation

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

4.2.8 Related party and intra-group transactions

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

The Bank has entered into business transactions with such counterparties in the normal course of its business. For the purpose of identification of related parties the Bank follows the guidelines issued by Central Bank of Bahrain and definitions as per IFRS and AAOIFI. Detailed break up of exposure to related parties as at and for the six months period ended 30 June 2010 are as follows:

US\$ 000's

30 June 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	3,022	-	35	-	3,057
Placements with financial and other institutions	-	-	5,356	-	5,356
Financing receivables	-	-	15,000	-	15,000
Assets held-for-sale	210,000	-	-	-	210,000
Investment in associates	199,952	-	-	-	199,952
Investment securities	31,360	-	94,258	175,594	301,212
Receivable from investment banking services	-	-	-	40,481	40,481
Other assets	451	-	36,052	295,693	332,196
Liabilities					
Investors' funds	29,953	-	-	158,949	188,902
Placements from financial and other institutions	25	-	24,000	-	24,025
Financing liabilities	-	-	53,490	16,632	70,122

US\$ 000's

	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management (including special purpose entities)	Total
30 June 2010					
Income					
Income from investment banking services	1,000	-		4,161	5,161
Placement, arrangement and management fees	2,760	-		2,300	5,060
Income from placements with financial and other institutions	28	-	52	-	80
Share of losses from investment in associates	(1,473)	-	-	-	(1,473)
Income from investment securities	-	-	-	1,960	1,960
Other income, net	1,667	-	499	3,802	5,968
Expenses					
Impairment allowance	-	-	-	20,000	20,000
Finance cost	-	-	1,543	227	1,770
Commitments					
Financial guarantees	-	-	5,354	-	5,354
Commitment to finance	-	-	-	16,500	16,500

4.2.9 Exposure to highly leveraged and other high risk counterparties

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

4.2.10 Renegotiated facilities

As at 30 June 2010, other assets which are neither past due nor impaired include certain financing to projects which were renegotiated during the period. In certain cases, on a need basis, the Bank supports its project vehicles by providing short-term liquidity facilities. These facilities are provided based on assessment of cash flow requirements of the projects and the projects ability to repay the financing amounts based on its operating cash flows. The assessment is independently reviewed by the management of the Bank. Although no specific collateral is provided, such exposures are usually adequately covered by the value of the underlying project 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.

4.2.11 Equity investments held in banking book

The Bank does not have a trading book and hence all of its equity investments are classified in the banking book and are subject to credit risk weighting under the capital adequacy framework. 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 associates, investments in non-significant financial and non-financial entities (i.e. significant financial entities which qualify as associates are treated separately for regulatory purposes).

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	564,520
Quoted in an active market	139,571
Managed funds	11,068
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 @12%
Equity investments - Listed	663	100%	663	80
Equity investments - Unlisted	257,307	150%	385,960	46,315
Investments in funds	6,375	150%	9,562	1,147
Holding of real estate	439,210	200%	878,419	105,410
Total	703,555		1,274,604	152,952

5 Market risk

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

	Risk weighted assets	Capital requirement @ 12%	Maximum during the year	Minimum during the year
Foreign exchange risk	114,475	13,737	14,734	13,737

6 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 CBB and a multiple of 12.5x 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	382,546	717,274	86,073

7 Other types of risk

7.1 Liquidity risk

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

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

Liquidity ratios	30 June 2010	Maximum	Minimum
Liquid assets : Total assets	1.87%	2.16%	1.87%
Liquid assets : Total deposits	7.80%	7.80%	7.68%
Short-term assets : Short-term liabilities	7.99%	7.99%	3.22%
Illiquid assets : Total assets	95.72%	98.35%	95.72%

At 30 June 2010, the Group's current contractual liabilities exceeded its liquid assets. The Bank has put in an asset disposal plan and liquidity plan that would generate liquidity to meet its obligation when due.

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

US\$'000's

	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Carrying amount
Investors' funds	22,079	119,834	46,989	-	-	188,902
Placements from financial and other institutions	132,789	-	10,076	-	-	142,865
Financing liabilities	100,776	17,894	70,123	223,130	-	411,923
Other liabilities	220,918	-	-	-	-	220,918
Total liabilities	476,562	137,728	127,188	223,130	-	964,608
Unrestricted investment accounts	1,874	-	-	-	-	1,874
Off-Balance sheet items						
Commitments	5,354	16,500	6,000	613	-	28,467

As at 30 June 2010, the Group's current contractual obligations exceeded its liquid assets. The ability of the Group to meet its obligations when due depends on its ability to achieve a timely disposal of assets (refer note 1 in the interim financial information). Subsequent to 30 June 2010, the Group was able to renegotiate the terms of financing facility of US\$ 100 million by extending the repayment terms for a further period of 2 years (extendable by 1 year at the option of the Bank) and by reducing the profit rate to 3.75% over the benchmark rate (LIBOR) (refer note 9 in the interim financial information).

7.2 Management of profit rate risk in the banking book

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

US\$'000's

	Up to 3 months	3 to 6 months	6 months -1 year	1 to 3 years	Over 3 years	Total
30 June 2010 Assets						
Placements with financial and other institutions	121,411	-	-	-	-	121,411
Financing receivables	-	15,000	-	-	-	15,000
Total assets	121,411	15,000	-	-	-	136,411
Liabilities						
Investors' funds	22,079	119,834	46,989	-	-	188,902
Placements from financial and other institutions	132,789	-	10,076	-	-	142,865
Financing liabilities	100,776	17,894	70,123	223,130	-	411,923
Total liabilities	255,644	137,728	127,188	223,130	-	743,690
Unrestricted investment accounts	1,874	-	-	-	-	1,874
Profit rate sensitivity gap	(136,107)	(122,728)	(127,188)	(223,130)	-	(609,153)

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 on a monthly basis include a 100 basis point (bp) parallel fall or rise in all yield curves worldwide. An analysis of the Group’s sensitivity to an increase or decrease in market profit rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

	US\$ 000’s
100 bps parallel increase / (decrease)	2010
At 30 June 2010	± 6,091
Average for the period	± 6,014
Maximum for the period	± 6,091
Minimum for the period	± 5,937

7.3 Concentration risk

This risk arises from exposure to a common set of factors that can produce losses large enough to threaten the Bank’s health or ability to maintain its core business. Concentration risk can arise from exposure to specific classes of assets, sector, country, revenue streams, counterparty, a group of counterparties, etc. Concentration risk is mitigated by limits, diversification by assets, geography counterparty quality etc. As part of ICAAP, thresholds for exposure concentrations will be set up which will trigger additional capital requirements. The geographical and sector concentration of credit exposures has been disclosed in paragraphs 6.4.2 and 6.4.3.

7.4 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. 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.

7.5 Reputational risk (non-performance risk)

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

7.6 Displaced commercial risk

Displaced Commercial Risk (DCR) refers to the market pressure to pay returns that exceeds the rate that has been earned on the assets financed by the liabilities, when the return on assets is under performing as compared with competitor's rates. The Bank's DCR primarily arises from the funds accepted in the form of 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.

7.7 Other risks

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

8 Product disclosures

8.1 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.

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 withdrawals 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:

US\$ 000's

	30 June 2010	31 December 2009	31 December 2008
Total URIA as at 30 June / 31 December	1874	2,875	1,945
Average URIA balance	3,878	2,618	3,311
Average rate of return earned (%)	0.29%	0.76%	2.75%
Total profits on URIA assets earned	11	20	91
Distributed to investor	10	18	82
Allocated to IRR	0.2	0.3	2
Allocated to PER	0.3	0.5	3
Bank's share of profits	0.6	0.8	4
Average declared rate of return (%)	0.59%	0.69%	2.48%

8.2 Restricted investment accounts

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

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;

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

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

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

Company	Cumulative distributions %	Half yearly distribution for six months ended 30 June 2010	Annual Distributions				
			2009	2008	2007	2006	2005
Mena Real Estate Company KSCC	29.83%	-	-	-	31.13%	NA	NA
Kuwait National Real Estate Investment & Services Co. KSCC	21.07%	-	-	-	-	-	43.19%
Gulf Holding Company Gulf North Africa Holding Company KSCC	0.80%	-	9.41%	-	-	-	NA
Gulf Real Estate Development Company	3.86%	-	10.12%	7.55%	-	-	NA
Pan European Fund	4.18%	-	9.57%	6.76%	-	NA	NA
Al Basha'er Fund	5.31%	-	-	5.36%	10.48%	23.06%	NA
Oman Development Company	-	-	-	-	-	-	NA
Bayan Holding Co KSCC	-	-	-	NA	NA	-	NA
Gulf Atlantic FZ LLC	3.50%	-	NA	NA	NA	-	6.56%
Mena Jet Energy City Qatar Holding Company	-	-	NA	NA	NA	-	-
Saudi Real Estate Co Al Hareth French Property Fund	-	-	NA	NA	NA	NA	NA
Gulf Atlantic Real Estate Company Limited	9.94%	-	NA	NA	4.91%	11.09%	-
Gulf Development Real Estate Company KSCC	3.19%	-	NA	NA	NA	-	6.05%
	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.