



RISK AND CAPITAL MANAGEMENT DISCLOSURES

These disclosures have been prepared in accordance with the Public Disclosure Module (“PD”), Section PD-1.3: Disclosures in Annual Reports and PD-3.1.6 Semi-annual Disclosures, CBB Rule Book, Volume II for Islamic Banks. This document should be read in conjunction with the condensed consolidated interim financial information for the six months period ended 30 June 2016 and the qualitative disclosures in the annual report for the year ended 31 December 2015. Information already included in the condensed consolidated financial information are not repeated.



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1 Executive summary

The Central Bank of Bahrain's ("CBB") Basel 3 guidelines outlining the capital adequacy framework for banks incorporated in the Kingdom of Bahrain became effective from 1 January 2015. These disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-1.3: Disclosures in Annual Reports of the CBB Rule Book, Volume II for Islamic Banks and Section PD-3.1.6: Publication of reviewed (Unaudited) quarterly financial statements for locally incorporated banks. Section PD-1.3 reflect the requirements of Basel 2 - Pillar 3 and the Islamic Financial Services Board's ("IFSB") recommended disclosures for Islamic banks and PD 3.1.6 highlights the requirement to make quantitative disclosures described in PD-1.3 on their web site along with the half yearly financial statements.

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

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

As at 30 June 2016 the Group's total capital ratio stood at a healthy 24.58%.

The Bank's Tier I and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 3 / IFSB for Islamic financial institutions framework.

The Banks total risk weighted assets as at 30 June 2016 amounted to USD 3,435,305 thousand. Credit risk accounted for 93 percent, operational risk 4 percent, and market risk 3 percent of the total risk weighted assets respectively. Tier I and total regulatory capital were USD 825,643 thousand and USD 844,552 thousand respectively, as at 30 June 2016.

At 30 June 2016, Group's CET1 and T1 capital and total capital adequacy ratios were 23.89%, 24.03% and 24.58% respectively.

2 Group Structure

The Bank along with its subsidiaries is together referred to as the "Group". The principal material subsidiaries and associates as at 30 June 2016 and their treatment for consolidated capital adequacy purposes are as follows:



Subsidiaries	Entity classification as per PCD Module for consolidated capital adequacy	Treatment by the Bank	
		Consolidated	Solo basis
Khaleeji Commercial Bank BSC ('KHCB')	Banking subsidiary	Full consolidation [i]	Full deduction from capital
GFH Sukuk Limited	Financial entity	Full consolidation	No impact as no direct investment by the Bank and the entity is a securitisation vehicle.
Morocco Gateway Investment Company	Commercial entity	Risk weighting of investment exposure	
Capital Real Estate Projects BSC (c)	Commercial entity	Risk weighting of investment exposure	
GFH Capital Limited	Financial entity	Full consolidation	Full deduction from capital
KHCB Asset Company	Financial entity	Full consolidation	No impact as no direct investment by the Bank and the entity is a securitisation vehicle.
RES	Commercial entity	Risk weighting (look through approach)	
Injazat Technology Fund BSC (c)	Financial entity	Risk weighting of investment exposure	
Leeds United Football Club	Commercial entity	Risk weighting of investment exposure	
Falcon Cement Company BSC (c)	Commercial entity	Risk weighting of investment exposure	
United Arab Cement Company PJSC	Commercial entity	Risk weighting of investment exposure	
Bahrain Aluminium Extrusion Company BSC (c)	Commercial entity	Risk weighting of investment exposure	
Libya Investment Company	Commercial entity	Risk weighting of investment exposure	

The investments in unconsolidated subsidiaries and associates are subject to large exposure and connected counterparty limits and guidelines set by the CBB.

These guidelines are considered for transfer of funds or regulatory capital within the Group. The investment in subsidiaries should be generally deducted from the capital of the Bank.

In the opinion of the Bank, certain investments / asset holding vehicles are pass-through entities and hence the underlying investments are risk weighted.

KHCB, a banking subsidiary of the Bank, is a locally incorporated commercial bank and the specific quantitative and qualitative disclosures pertaining to all the risks of KHCB have been disclosed in the Risk Management Disclosures of KHCB as at 30 June 2016, which can be accessed through the following link [<http://www.khcbonline.com/main/Investor-Relations/Financial-Reports/>]. This documents intends to combine the risk and capital management disclosures of the parent bank and its involvement with its subsidiaries and associates. The quantitative disclosures in these documents provide further details of the exposures used for capital calculation purposes (where some entities are consolidated and some may be risk weighted) and accordingly will not match with the consolidated financial statements of the Group.

There are no restrictions for transfer of capital other than those applicable to licensed financial entities and process of commercial companies law of respective jurisdictions.

3 Capital structure and capital adequacy ratio

The Bank's regulator CBB sets and monitors capital requirements for the Bank as a whole (i.e. at a consolidated level). The banks are required to maintain minimum capital adequacy ratio of 12.5% on a consolidated basis [i.e. CET1 – 6.5%, AT1-1.5%, Tier 2 – 2% and CCB – 2.5%] and a capital adequacy ratio of 8% on a solo basis [i.e. CET1 – 4.5%, AT1 – 1.5% and Tier 2 – 2%].

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

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



The Bank's regulatory capital position at 30 June 2016 was as follows:

	<i>USD 000's</i>
Eligible Capital	30 June 2016
Common Equity Tier 1 (CET 1)	
Issue and fully paid ordinary shares	597,995
Statutory reserve	72,056
Retained earnings	6,581
Current interim cumulative net profit	11,525
Accumulated other comprehensive income and losses (and other reserves)	23,490
Total CET1 capital before minority interest	711,647
Total minority interest in banking subsidiaries given recognition in CET1 capital	117,484
Total CET 1 capital prior to regulatory adjustments	829,131
Less: Investment in own shares	(8,467)
Total Common Equity Tier 1 capital after to the regulatory adjustments	820,664
Other capital (AT1 & T2)	
Instruments issued by banking subsidiaries to third parties	
- AT1	4,979
Total Tier 1 Capital	825,643
Instruments issued by banking subsidiaries to third parties	
- T2	6,638
- General financing loss provisions	12,271
Total Capital	844,552



USD 000 's

Risk weighted exposures	30 June 2016
Credit risk:	
- Self-financed assets	3,010,332
- Assets financed by EIAH (30%)	197,017
Market risk	82,550
Operational risk	145,407
Total capital base	3,435,306

CET1	23.89%
T1	24.03%
Total Capital Adequacy ratio (Total Capital)	24.58%

The Bank's paid up capital consists only of one class of shares with voting rights.

4 Credit risk

4.1 Capital requirements for credit risk

To assess its capital adequacy requirements for credit risk in accordance with the CBB requirements, the Bank adopts the standardized approach. According to the standardized approach, on and off balance sheet credit exposures are assigned to various defined categories based on the type of counterparty or underlying exposure. The main relevant categories are claims on banks, claims on investment firms, past due facilities, investment in equities, holdings of 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 Standard & Poors, Fitch and Capital Intelligence to derive risk weights for the purpose of capital adequacy computations. However, preferential risk weight of 20% is used which is applicable to short term claims on locally incorporated banks where the original maturity of these claims are three months or less and these claims are in Bahraini Dinar or US Dollar. The other exposures are primarily classified as ‘unrated exposure’ for the purposes of capital adequacy computations.

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

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	13,993	0%	-
Total claims on sovereigns	695	0%	-
Standard Risk Weights for Claims on Banks	2,012	20%	402
Preferential Risk Weight for Claims on Locally Incorporated Banks	6,492	20%	1,298
Short-term Claims on Banks	2,454	20% - 50%	492
Claims on Corporates including Takaful Companies and Category 3 Investment Firms (Unsecured portion after Credit Risk Mitigant)	461,863	100%	461,863
Past Due Facilities	137,065	100% - 150%	191,159
Investments in Securities and Sukuk	201,370	150% - 250%	304,110
Holdings of Real Estate	692,335	100% - 400%	2,022,015
Others Assets	28,993	100%	28,993
Total self financed assets (A)	1,547,272	194%	3,010,332
Total regulatory capital required (A x 12.5%)		12.5%	376,291
Financed by EIAH			
Total claims on sovereigns	190,926	0%	-
Standard Risk Weights for Claims on Banks	44,757	20% - 50%	21,351
Preferential Risk Weight for Claims on Locally Incorporated Banks	51,910	20%	10,382
Claims on Corporates including Takaful Companies and Category 3 Investment Firms (Unsecured portion after Credit Risk Mitigant)	627,496	50% - 100%	624,989
Total financed by EIAH (B)	915,089	72%	656,722
Considered for credit risk (C) = (B x 30%)		30%	197,017
Total regulatory capital required (C x 12.5%)		12.5%	24,627
TOTAL GROSS CREDIT EXPOSURES	2,462,361	-	-
TOTAL RISK WEIGHTED EXPOSURE	-	-	3,207,349
TOTAL REGULATORY CAPITAL REQUIRED			400,918

4.2 Quantitative information on credit risk

4.2.1 Gross and average credit exposure

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

USD 000's

	Average ^[1] Exposure	Gross Exposure		
		Self – Financed	Financed by EIAH	Total
Bank balances	80,988	17,991	59,607	77,598
Placements with financial institutions	120,572	5,002	92,501	97,503
Financing receivables	921,512	283,367	662,600	945,967
Investment securities	561,975	394,037	146,934	540,971
Assets acquired for leasing	218,183	236,137	-	236,137
Investment properties	296,988	282,581	-	282,581
Development properties	178,841	178,228	-	178,228
Equity-accounted investees	81,398	81,398	-	81,398
Property, plant and equipment	25,356	25,240	-	25,240
Other assets	216,858	237,420	-	237,420
Total funded Credit Exposure	2,702,671	1,741,401	961,642	2,703,043
Financial guarantees	73,707	71,297	-	71,297
Commitments	22,000	22,000	-	22,000
Undrawn commitments to extend finance	178,514	165,844	-	165,844
Total unfunded Credit Exposure	274,221	259,141		259,141

[1] 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 2016. Assets funded by EIAH are geographically classified in GCC countries, and are placed with Banks and financial institutions having maturity profile of up to 3 months.

4.2.2 Credit exposure by geography

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

USD 000's

	GCC countries	MENA	Asia	UK	Europe (excluding UK)	USA	Australia	Total
Assets								
Bank balances	72,381	184	80	79	235	4,639	-	77,598
Placements with financial institutions	97,503	-	-	-	-	-	-	97,503
Financing receivables	895,824	-	-	-	50,143	-	-	945,967
Investment securities	315,198	30,310	171,093	12,791	-	1,850	9,729	540,971
Assets acquired for leasing	236,137	-	-	-	-	-	-	236,137
Investment properties	282,581	-	-	-	-	-	-	282,581
Development properties	114,111	64,117	-	-	-	-	-	178,228
Equity-accounted investees	81,398	-	-	-	-	-	-	81,398
Property, plant and equipment	22,717	2,523	-	-	-	-	-	25,240
Other assets	193,212	5,359	5,457	23,377	(7)	10,022	-	237,420
Total	2,311,062	102,493	176,630	36,247	50,371	16,511	9,729	2,703,043
Off-Balance sheet								
Restricted investment accounts	34,817	50	-	-	-	-	-	34,867
Commitments	22,000	-	-	-	-	-	-	22,000
Financial guarantees	56,297	-	-	-	-	-	-	56,297
Undrawn financing facilities	179,533	1,310	-	-	-	-	-	180,844

*The geographical exposures of total assets are reconciled to the gross credit exposures considered for risk weighting for capital adequacy computation purposes.

4.2.3 Credit exposure by sector

The classification of credit exposure by industry was as follows:

USD 000's

	Trading and manufacturing	Banks and financial institutions	Commercial Banking	Development Infrastructure	Technology	Others	Total
Assets							
Bank balances	-	77,410	-	185	-	3	77,598
Placements with financial institutions	-	97,503	-	-	-	-	97,503
Financing receivables	-	33,679	-	249,169	-	663,119	945,967
Investment securities	-	47,810	-	314,143	2,050	176,968	540,971
Assets acquired for leasing	-	-	-	233,739	-	2,398	236,137
Investment properties	-	-	-	282,581	-	-	282,581
Development properties	-	-	-	178,228	-	-	178,228
Equity-accounted investees	81,398	-	-	-	-	-	81,398
Property, plant and equipment	-	-	-	17,830	-	7,410	25,240
Other assets	3,358	4,830	-	115,472	-	113,760	237,420
Total	84,756	261,232	-	1,391,347	2,050	963,658	2,703,043
Off-Balance sheet items							
Restricted investment accounts	-	-	-	34,867	-	-	34,867
Commitments	-	-	-	22,000	-	-	22,000
Financial guarantees	-	1,918	-	22,024	-	32,355	56,297
Undrawn financing facilities	-	-	-	42,932	-	137,912	180,844

*The sector exposures of total assets are reconciled to the gross credit exposures considered for risk weighting for capital adequacy computation purposes.

4.2.4 Exposure by maturity

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

USD 000's

	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Maturity not stated	Total
Assets							
Bank balances	77,530	-	-	-	-	68	77,598
Placements with financial institutions	97,079	424	-	-	-	-	97,503
Financing Receivables	86,826	56,947	85,806	227,671	488,717	-	945,967
Investment securities	146,933	301	16,229	203,711	173,797	-	540,971
Assets acquired for leasing	98	-	302	1,936	233,801	-	236,137
Investment properties	-	-	-	227,104	55,477	-	282,581
Development properties	-	-	-	97,347	80,881	-	178,228
Equity-accounted investees	-	-	-	76,963	4,435	-	81,398
Property, plant and equipment	-	-	-	-	25,240	-	25,240
Other assets	22,057	6,311	32,096	123,556	53,400	-	237,420
Total assets	430,523	63,983	134,433	958,288	1,115,748	68	2,703,043
Off-Balance sheet items							
Restricted investment accounts	-	-	24,684	10,183	-	-	34,867
Commitments	-	-	-	22,000	-	-	22,000
Financial guarantees	1,849	3,220	4,923	30,859	15,446	-	56,297
Undrawn financing facilities	-	2,876	30,447	117,400	30,121	-	180,844

The table above shows the maturity profile of the Group's assets and unrecognized commitments on the basis of their contractual maturity, here available. For other items, (including past due receivables), the maturity profile is on the basis of their expected realization. The total assets are reconciled to the gross credit exposures considered for capital adequacy computation purposes.

4.2.5 Exposures in excess of regulatory limits

The CBB has set single exposure 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.

There were no exposures in excess of 15% of capital base as at 30 June 2016.

4.2.6 Impaired facilities and past due exposures

The commercial and credit granting is done by KHCB and for the specific qualitative disclosures pertaining to KHCB please refer Risk Management Disclosures of KHCB [*Refer section 2 of this document*].

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. The collective assessment of impairment in the disclosure is from KHCB. Credit and investment exposures are subject to regular reviews by the Investment units and Risk Management Department. Quarterly updates on the investments / facilities are prepared by the investment unit reviewed by the management and sent to the Board for review. The

All impaired and past due credit exposures at 30 June 2016 mainly relate to the development infrastructure sector.

Movement in impairment provisions during the period:

	Financing receivables	Financing to projects	Receivable from investment banking services	Other receivables
30 June 2016				
At 1 January	70,150	90,088	153,630	75,311
Charge for the period	-	-	-	-
Write back during the period	-	-	-	-
Write off during the period	-	-	(144,666)	(24,651)
At 30 June	70,150	90,088	8,964	50,660

USD 000's

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

USD 000's

As at 30 June 2016	Past due but not impaired amounts *	Gross impaired amounts
Up to 3 months	58,292	-
Over 3 months to 1 year	49,639	27,560
1 to 3 years	838	31,264
Over 3 years	30,816	210,392
Total	139,585	269,215

* The Bank believes that the past due exposures are not further 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:

USD 000's

As at 30 June 2016	Gross impaired amounts	Specific impairment allowance	Net exposure				Collective impairment
			Net impaired	Past due but not impaired	Neither past due nor impaired	Total	
GCC Countries	184,363	144,742	39,621	107,757	524,468	671,847	11,408
Other MENA	-	-	-	-	1,906	1,906	-
Other Asia	-	-	-	30,199	4,574	34,773	-
Europe	84,852	67,561	17,291	1,629	18,289	37,209	520
UK	-	-	-	-	-	-	-
USA	-	-	-	-	16,167	16,167	-
Total	269,215	212,302	56,913	139,585	565,404	761,902	11,928

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

USD 000's

As at 30 June 2016	Gross impaired amounts	Specific impairment allowance	Net exposure				Collective impairment
			Net impaired	Past due but not impaired	Neither past due nor impaired	Total	
Development Infrastructure Banks and financial institution	205,117	187,836	17,281	90,942	206,122	314,344	4,950
Others	-	-	-	-	36,922	36,922	360
Others	64,098	24,466	39,632	48,643	322,360	410,635	6,618
Total	269,215	212,302	56,913	139,585	565,404	761,902	11,928

4.2.6.1 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. The position of collateral cover for all credit

exposures of KHCB categorized on the basis of the type of security as on 30 June 2016 is given in the table below:

Collateral Type	BD 000's									
	Murabaha	Musharaka	Mudaraba	Wakala	Istisna	Ijara	Value of collateral ^[1]	Gross Exposure	% of cover	% of Total
Real estate	220,380	27,710	325	15,707	2,844	161,045	428,011	238,918	179%	89%
Listed securities	542	-	-	-	-	-	542	256	212%	0%
Bank guarantee	2,454	-	-	-	-	-	2,454	2,254	109%	1%
Cash collateral	27,577	-	-	635	-	11	28,223	57,082	49%	6%
Others	22,961	-	-	-	-	-	22,961	30,576	75%	5%
Unsecured	-	-	-	-	-	-	-	133,364	-	0%
Total	273,914	27,710	325	16,342	2,844	161,056	482,191	462,450	104%	100%

^[1] Represents collateral values based on the last valuation carried out based on the Bank's valuation policy including collaterals which exceed the book value of the facility.

KHCB has a policy of disposal of asset held as collateral not readily convertible into cash, after completion of necessary legal formalities. During the half year ended 30 June 2016, the Bank repossessed and sold nothing.

4.2.7 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 follows the guidelines issued by Central Bank of Bahrain and definitions as per FAS issued by AAOIFI. Detailed break up of related parties transactions and exposures as at and for the six months period ended 30 June 2016 are as follows:

30 June 2016	USD 000's				
	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
Assets					
Financing assets	-	-	-	15,901	15,901
Equity-accounted investees	85,832	-	-	-	6,907
Investment securities	14,840	-	6,058	228,810	249,709
Other assets	20,725	-	6,145	30,637	57,507
Property, plant and equipment	-	-	-	2,554	2,554
Liabilities					
Investors' funds	210	-	886	16,419	17,515
Customer current accounts	-	-	-	-	-
Financing liabilities	-	-	-	9,819	9,819

Other liabilities	-	-	-	28,188	28,188
Equity of investment holders	294	398	5,329	2,523	8,544

	Associates	Key management personnel	Significant shareholders / entities in which directors are interested	Assets under management including special purpose entities	Total
30 June 2016					
Income					
Management and other fees	-	-	6,000	947	6,947
Income from investment securities	(5,313)	-	-	-	(5,313)
Share of profit of equity-accounted investees	125	-	-	-	125
Other income	16	-	-	504	520
Expenses					
Return to investment account holders	2	2	50	21	75
Staff cost	-	3,352	-	-	3,352
Other expenses	-	-	11	310	321

4.2.8 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.

4.2.9 Renegotiated facilities

As at 30 June 2016, other assets which are neither past due nor impaired include certain short-term financing to projects which were renegotiated. In certain cases, on a need basis, the Bank supports its project vehicles by providing short-term liquidity facilities. These facilities are provided based on assessment of cash flow requirements of the projects and the projects ability to repay the financing amounts based on its operating cash flows. The assessment is independently reviewed by the management of the Bank. Although no specific collateral is provided, such exposures are usually adequately covered by the value of the underlying project asset cash flows. The terms of the renegotiation primarily include extension of the repayment period. The facilities are provided for as viewed necessary based on periodic impairment assessments.

4.2.10 Equity investments held in banking book

For qualitative disclosures pertaining to KHCB, kindly refer the Risk Management Disclosures for KHCB for the six months period ended 30 June 2016 [*Refer section 2 of this document*].

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 unquoted equity securities and significant investments in commercial entities.

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

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

Information on equity investments (including significant commercial entities)	USD 000's
Privately held	169,687
Quoted in an active market	301
Managed funds	2,055
Realised gain/ (loss) during the period	1,133
Unrealised gain recognized in the balance sheet not through income statement	(5,313)

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

USD 000's

	Gross exposure*	Risk weight	Risk weighted exposure	Capital charge @12.5%
Listed equity investments	-	100%	-	-
Unlisted equity investments	169,687	150%	254,530	31,816
Significant investment in the common shares of financial entities >10%	2,055	250%	5,138	642
Significant investment in the common shares of commercial entities	-	100%	-	-
Investment in listed unrated funds	-	100%	-	-
Premises occupied by the Bank	17,830	100%	17,830	2,299
All other holdings of real estate	346,766	200%	693,531	86,691
Investments in listed real estate companies	301	300%	903	113
Investment in unlisted real estate companies	327,438	400%	1,309,751	163,719
Total	864,076		2,281,683	285,280

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

5 Market risk

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

USD 000's

	30 June 2016	Maximum during the period	Minimum during the period
Foreign exchange risk – A	6,604	7,469	6,604
Risk weighted assets – B (A*12.5)	82,552	93,364	82,552
Capital requirement – (B*12.5%)	10,319	11,671	10,319



6 Operational risk

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the approach agreed with the CBB. The bank's average gross income for the last 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.

USD 000's

	Average gross income	Risk weighted assets	Capital charge at 12%
Operational risk	77,550	145,407	18,176

Litigations and claims

The Group is currently a plaintiff or a defendant in a number of claims and litigations in connection with investments promoted by the Bank in the past and other transactions. Further, the Group has filed claims against former employees. The court cases are in various stages of progress and the Bank in certain cases undertakes negotiations and settlements that are in the best interest of the Bank. As a result, the Bank may agree to take over/ deliver a combination of cash and non-cash assets as part of these arrangements over a period of time. Where it is highly probable that a legal case would materialise against the Bank, a provision is recognised for likely settlement. Where it is virtually certain that an asset will be recovered in a legal case or through settlement, a right to recover or equivalent reimbursement right is recognised separately under 'other assets'. No further disclosures regarding additional contingent liabilities or assets arising from any of such cases are being made by the Bank as the directors of the Bank believe that such disclosures may be prejudicial to the Bank's other on-going legal cases.

7 Other types of risk

7.1 Liquidity risk

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

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

Liquidity ratios	30 June 2016	Maximum	Minimum
Liquid assets : Total assets	6.48%	8.44%	6.48%
Liquid assets : Total deposits	30.62%	40.42%	30.62%
Short term assets : Short term liabilities*	91.60%	91.60%	64.41%
Illiquid assets : Total assets	93.52%	93.52%	91.56%

* Based on maturity profile of assets and liabilities of one year or less of the Group.

The maturity profile of the Group's financial liabilities based on contractual cash flows are as follows:

USD 000's

	Up to 3 months	3 to 6 months	6 months- 1 year	1 to 3 years	Over 3 years	Total
Investors' funds	9,761	-	-	10,212	-	19,973
Placements from financial and other institutions	159,659	42,602	64,607	143,349	4,311	414,528
Customer current accounts	82,812	21,472	12,273	7,188	4,309	137,304
Financing liabilities	48,000	-	6,400	100,834	12,347	167,580
Other liabilities	17,479	5,137	16,156	64,696	13,673	117,142
Total liabilities	317,710	69,211	99,436	326,277	43,890	856,524
Equity of investment account holders	368,888	93,440	127,395	63,889	285,103	938,716

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. The following disclosures are of the Group.

US\$ 000's

30 June 2016	Up to 3 months	3 to 6 months	6 months - 1 year	1 to 3 years	Over 3 years	Total
Assets						
Placement with financial institutions	97,077	425	-	-	-	97,502
Financing assets	86,844	56,947	85,806	227,671	488,699	945,967
Asset acquired for leasing (including lease rental)	98	302	1,936	233,800	-	236,136
Investment securities	146,933	-	-	-	-	146,933



Total assets	330,952	57,674	87,742	461,471	488,699	1,426,538
Liabilities						
Investors' funds	9,761	-	-	10,212	-	19,973
Placements from financial and other institutions	159,658	42,602	64,607	143,349	4,312	414,528
Customer current accounts	82,812	21,472	12,273	7,188	13,559	137,304
Financing liabilities	48,000	-	6,400	100,834	12,346	167,580
Total liabilities	300,231	64,074	83,280	261,583	30,217	739,385
Equity of investment account holders	392,961	93,440	127,395	63,889	261,031	938,716
Profit rate sensitivity gap	(362,240)	(99,840)	(122,933)	135,999	197,451	(251,563)

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

US\$ 000's

200 bps parallel increase / (decrease)

At 30 June 2016
Average for the period
Maximum for the period
Minimum for the period

2016
± 1,258
± 1,323
± 1,387
± 1,258

7.3 Concentration risk

This risk arises from exposure to a common set of factors that can produce losses large enough to threaten the Bank's health or ability to maintain its core business.

Concentration risk can arise from exposure to specific classes of assets, sector, country, revenue streams, counterparty, a group of counterparties, etc. Concentration risk is mitigated by limits, diversification by assets, geography counterparty quality etc. As part of ICAAP, thresholds for exposure concentrations will be set up which will trigger additional capital requirements. The geographical and sector concentration of credit exposures has been disclosed in paragraphs 4.2.2 and 4.2.3.

7.4 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the profit rate, foreign exchange, equity and credit markets defaults prior to maturity of the contract. In addition to the identified credit risk exposures the Bank's counterparty credit risk from markets as such is limited to the fair value of contracts of foreign exchange risk management instruments the overall exposure to which is usually not significant. For other credit market transactions (primarily inter-bank placements), the Bank has established a limit structure based on the

credit quality (assessed based on external rating) of each counter party bank to avoid concentration of risks for counterparty, sector and geography.

The Bank is constantly reviewing and monitoring the position to ensure proper adherence to the limits and defined policies of the Bank. As at 30 June 2016, the Bank did not have any open positions on foreign exchange contracts.

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

7.7 Other risks

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

8 Product disclosures

8.1 Equity of Investment Account Holders (EIAH)

The Bank does not have significant amount under EIAH and does not use EIAH as a main source of its funding. The Bank does not, as a focused product proposition, offer EIAH products to its clients. The current EIAH deposits have been accepted on a case-by-case basis considering the Bank's relationship with its customers. The EIAH holder authorises the Bank to invest the funds in any investments approved by the Bank's Sharia'a Board without any preconditions. All EIAH accounts are on profit sharing basis, but the Bank does not guarantee any particular level of return. In accordance with the principles of Sharia'a, the entire investment risk is on the investor. Any loss arising from the investment will be borne by the customer except in the case of the Bank's negligence. The Bank charges a Mudarib fee as its share of profit. Early withdrawal is at the discretion of the Bank and is subject to the customer giving reasonable notice for such withdrawal and agreeing to forfeit a share of the profit earned on such account.

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

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

	USD 000's	
	30 June 2016	31 December 2015
Total EIAH as at 30 June / 31 December	1,147	1,656
Average EIAH balance	1,410	1,656
Average rate of return earned (%)	0.44%	0.89%
Total profits on EIAH assets earned	7	16
Distributed to investor	6	15
Allocated to IRR	0.1	0.3
Allocated to PER	0.2	0.5
Bank's share of profits	0.3	0.8
Average declared rate of return (%)	0.44%	0.89%

The information disclosed above pertains to EIAH directly promoted by the Bank..

The disclosures below are pertaining to the EIAH from KHCB.

The details of income distribution to IAH holders for the last five years are given below:

	USD 000's				
	June 2016	2015	2014	2013	2012
Allocated income to IAH	21,719	44,915	34,066	35,318	26,321
Distributed profit *	9,125	19,581	23,451	23,127	16,703
Mudarib fees	12,597	25,334	10,615	12,191	9,618
As at 30 June					
IAH ^[1]	985,743	1,004,233	891,273	691,271	512,586
Profit Equalisation Reserve (PER)	-	-	-	-	-
Investment Risk Reserve (IRR)	-	-	-	-	-
Profit Equalisation Reserve-to-IAH (%)	-	-	-	-	-
Investment Risk Reserve-to-IAH (%)	-	-	-	-	-

^[1] Represents average balance and includes inter-company balances.

* Includes contribution towards deposit protection scheme

Ratio of profit distributed to PSIA by type of IAH (based on tenor):

Mudaraba Tenor	Profit distribution amount					Ratio of profit paid as a percentage of total				
	June 2016	2015	2014	2013	2012	June 2016	2015	2014	2013	2012
	1 Month ^[2]	401	1,009	1,304	1,488	1,629	11.7	13.7	14.7	17.1
3 Months	163	350	380	680	655	4.7	4.7	4.3	7.8	10.4
6 Months	679	1,330	1,455	1,100	474	19.7	18.0	16.5	12.6	7.5
12 Months	1,525	3,667	4,179	3,606	2,998	44.3	49.7	47.3	41.4	47.6
18 Months	4	2	1	-	-	0.1	-	0.0	-	-
24 Month	8	5	75	228	30	0.2	0.1	0.8	2.6	0.5
VIP Mudaraba PER and IRR expenses	659	1,019	1,447	1,617	511	19.2	13.8	16.4	18.5	8.1
Total	3,439	7,382	8,841	8,719	6,297	100.0	100.0	100.0	100.0	100.0

^[2] Includes saving account and call mudaraba

Distribution of profits by type of IAH products:

(Annualised rates)

Year	Avg. profit earned from IAH assets (%age of asset)	PER set aside as a %age of IAH assets	IRR set aside as a %age of IAH assets	Mudharib fees as a %age of IAH assets	Profit paid as a %age of IAH assets
June 2016	2.20	-	-	1.28	0.93
2015	1.95	-	-	2.57	1.99
2014	3.82	-	-	1.19	2.63
2013	5.11	-	-	1.76	3.35
2012	5.13	-	-	1.88	3.26

Following are the average profit rates declared and distributed to the investors by the Bank:

(Annualised rates)

Type of deposit	June 2016	2015	2014	2013	2012
1 month Mudharaba ^[3]	0.63%	0.78%	1.15%	1.12%	2.25%
3 months Mudharaba	1.43%	1.75%	2.19%	2.98%	3.08%
6 months Mudharaba	2.88%	2.69%	3.08%	3.64%	3.55%
12 months Mudharaba	2.63%	2.75%	3.39%	4.27%	4.46%
18 months Mudharaba	2.62%	2.80%	3.30%	-	-
24 months Mudharaba	3.03%	2.91%	4.92%	5.07%	5.07%
VIP Mudharaba	2.12%	2.00%	3.49%	4.09%	2.79%

^[3] Includes saving account and call mudaraba

Market benchmark rates:

The Bank refers to the group of commercial Islamic banks incorporated in the Kingdom of Bahrain so as to benchmark the rate of return on IAH.

IAH account by type of assets:

The following table summarises the movement in type of assets in which the IAH funds are invested and allocated among various type of assets for the year ended 30 June 2016:

Particular	BD 000's			
	Allocation at 1 January 2016	Movement	Allocation at 30 June 2016	Proportion of total assets (%)
Cash and bank balances	29,256	(6,784)	22,472	81.80%
Placements with financial institutions	43,953	(9,080)	34,873	100.00%
Financing assets ^[4]	234,529	15,271	249,800	70.52%
Investment securities - Sukuk	63,533	(8,139)	55,394	100.00%
Total	371,271	(8,732)	362,539	

^[4] Includes Murabaha, Wakala, and Istisna contracts.

8.2 Restricted investment accounts

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

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

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

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

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

The RIA products offered by the Bank had no distributions made in the past five years. The disclosures pertaining to RIA of KHCB are as under.

RIA name	Details	Launch date	Projected returns	Return frequency	Return annualized (%)				
					June 2016	2015	2014	2013	2012
RIA 1 - Safana	An investment structure designed to participate in the equity interest of Safana Investment WLL. A company established for the purpose of acquiring reclaimed land to subdivide and sell, the Bank made an offer to buy back < BD 20,000 of each investors funds in RIA 1 at par. This offer was formalized in a letter to investors dated 25 May 2011. A total of 74 of the 95 RIA 1 investors accepted the offer at a cost of BD 1,220,000 to the Bank and resulting in a total of 39 investors being fully exited from the RIA. As a result, total investors funds have reduced to BD 8.34 million.	2007	61.78% over product tenor	Bullet payment on maturity	-	-	-	-	-
RIA 5 - North Gate	A restricted investment product which owns a 6.0% stake in Shaden Real Estate Investment WLL which in turn (through its subsidiaries), holds a parcel of reclaimed land measuring approximately 3.875 million Sq. Meters (located in Al-Hidd, Muharraq). The mixed-use plot will be sold to end users subsequent to the completion of infrastructure works. During the period, the Bank has bought back 4,040,000 shares (50%) from its investors at BD 4,242,000 at a profit of 5%.	2008	90.66% over product tenor	Bullet return at maturity	-	-	-	-	-
RIA 6 - Locata	A Restricted Mudaraba product which entitles the investors beneficial ownership of 25% equity share capital of Locata Corporation Pty Ltd., a company incorporated in	2009	110.54% over product tenor	Bullet return at maturity	-	-	-	-	-

	Australia. The Company has invented a new and patented wireless radiolocation technology and shall use this funding to scale up its production capacity, sales/marketing channels and further product enhancement capabilities. During 2014, 479 shares were bought back from its investors.							
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9 Financial performance and position

Following are basic quantitative indicators of the financial performance:

	2016 (6 months)	2015 (12 months)	2014 (12 months)	2013 (12 months)	2012 (12 months)
Return on average equity	2.00%	1.26%	3.60%	-4.00%	3.26%
Return on average assets	0.67%	0.44%	1.49%	-1.99%	1.17%
Cost-to-Income-Ratio*	56.54%	73.10%	65.27%	257.00%	67.87%

* Cost has been considered excluding impairment allowances.