Al Baraka Islamic Bank B.S.C. (c)

Basel II, Pillar III Disclosures
31 December 2012

(Unaudited)

Content | **Page**

1 INTRODUCTION

Al Baraka Islamic Bank B.S.C. (c) (the "Bank") is a closed shareholding company incorporated in the Kingdom of Bahrain on 21 February 1984. The Commercial Registration of the Bank was renewed on 7 January 2008 to change the status from exempt closed joint stock company to closed joint stock company. The Bank operates under a Retail Bank's licence number RB/025 issued by the Central Bank of Bahrain (CBB). The Bank has six commercial branches in the Kingdom of Bahrain.

The principal activities of the Bank and its subsidiaries (the "Group") are taking demand, saving and investment accounts, providing Murabaha finance, Ijara financing and other Shari'a compliant forms of financing as well as managing investors' money on the basis of Mudaraba or agency for a fee, providing commercial banking services and other investment activities. The Bank's registered office is at Building 238, Road 1704, Block 317, Manama, Kingdom of Bahrain.

For details on the Group's subsidiaries as of 31 December 2012, refer note 2 of the consolidated financial statements of the Group.

The public disclosures under this section have been prepared in accordance with the Central Bank of Bahrain (“CBB”) requirements outlined in its Public Disclosure Module (“PD”), Section PD-3: Quarterly Disclosure requirements, CBB Rule Book, Volume II for Islamic Banks.

2 CAPITAL ADEQUACY

To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the standardised approach for its credit risk, basic indicator approach for its operational risk and standardised measurement approach for its market risk. The CBB capital adequacy requirement is minimum accepted level for capital adequacy. The credit committee of the Group identify and approve assets suitable for funding by equity of Investment Accountholders ("AIH").

For the purpose of computing the Capital Adequacy Ratio (“CAR”) the Group is not consolidating its Subsidiary (Delmon properties company S.A.L) as being a commercial entity and it is risk weighted as per the requirement of the CA Module. Further, the Group's financial subsidiary (Al Baraka Bank (Pakistan) Limited) is consolidated as per the requirement of the CA Module.

Table – 1. Capital structure

The following table summarises the eligible capital after deductions for Capital Adequacy Ratio (CAR) calculation as of:

	31 December 2012		*31 December 2011*	
	Tier 1	***Tier 2***	*Tier 1*	*Tier 2*
	US $	***US $***	*US $*	*US $*
Components of capital				
Issued and fully paid ordinary shares	**122,457,800**	-	122,457,800	-
General reserves	**8,687,143**	-	8,687,143	-
Legal / statutory reserves	**21,748,828**	-	21,748,828	-
Others	**(7,821,732)**	-	(3,305,494)	-
Retained profit brought forward	**6,369,122**	-	14,976,863	-
Minority interest in consolidated subsidiaries	**18,171,801**	-	21,816,108	-
Less:				
Goodwill	**19,038,642**	-	20,563,499	-
Unrealised gross losses arising from fair valuing equity securities	**2,148,174**	-	7,542,916	-
Tier 1 Capital before PCD deductions	**148,426,146**	**-**	158,274,833	-

2 CAPITAL ADEQUACY (continued)

Table – 1. Capital structure (continued)

Unrealised gain arising from fair valuing equities (45% only)		**585,681**		-
Profit equalisation reserve		**544,632**		524,542
Investment risk reserve		**2,604,947**		2,737,120
Tier 2 Capital before PCD deductions		**3,735,260**		3,261,662
Total available capital		**152,161,406**		161,536,495
Deductions				
Unconsolidated majority-owned or -controlled banking, securities or other financial entities	**(13,838,160)**	**(13,838,160)**	-	-
Excess amount over maximum permitted large exposure limit	**(10,844,723)**	**(10,844,723)**	(25,150,759)	(25,150,759)
Additional deduction from Tier 1 to absorb deficiency in Tier 2	**(20,947,623)**	**-**	(21,889,097)	-
Total Deductions	**(45,630,506)**	**(24,682,883)**	(47,039,856)	(25,150,759)
Tier 1 and Tier 2 eligible capital	**102,795,640**	**-**	111,234,977	-
Total eligible capital		**102,795,640**		111,234,977

Table – 2. Capital requirement by type of islamic financing contracts

The following table summarises the capital requirements by type of islamic financing contracts:

	31 December 2012 Capital requirements US $	*31 December 2011 Capital requirements US $*
Type of islamic financing contracts		
Sales receivables	**23,516,744**	19,838,787
Ijara Muntahia Bittamleek & Ijara income receivable	**4,341,875**	3,124,817
Musharaka	**2,875,781**	2,269,668
Mudaraba financing	**4,183,311**	1,564,570
	34,917,711	26,797,842

Table – 3. Capital requirement for market risk

The following table summarises the amount of exposures subject to standardised approach of market risk and related capital requirements as of:

	31 December 2012		*31 December 2011*	
	Self Financed US $	***URIA US $***	*Self Financed US $*	*URIA US $*
Market risk - standardised approach				
Equity position risk	**-**	**-**	71,040	-
Foreign exchange risk	**5,931,906**	**170,249**	6,167,963	261,282
Total of market risk - standardised approach	**5,931,906**	**170,249**	6,239,003	261,282
Multiplier	**12.50**	**12.50**	12.50	12.50
	74,148,825	**2,128,113**	77,987,538	3,266,025
Eligible Portion for the purpose of the calculation	**100%**	**30%**	100%	30%
Risk Weighted Exposures ("RWE") for CAR Calculation	**74,148,825**	**638,434**	77,987,538	979,808
Total market RWE		**74,787,259**		78,967,345
Minimum capital requirement (12%)		**8,974,471**		9,476,081

2 CAPITAL ADEQUACY (continued)

Table – 4. Capital Requirements for operational risk

The following table summarises the amount of exposures subject to basic indicator approach of operational risk and related capital requirements as of:

	31 December 2012	*31 December 2011*
	US $	*US $*
Indicators of operational risk		
Average gross income	**61,985,696**	54,585,907
Multiplier	**12.5**	12.5
	774,821,200	682,323,838
Eligible Portion for the purpose of the calculation	**15%**	15%
Total operational RWE	**116,223,180**	102,348,576
Minimum capital requirement (12%)	**13,946,782**	12,281,829

2 CAPITAL ADEQUACY (continued)

Table – 5. Capital adequacy ratios

The following are capital adequacy ratios for total capital and tier 1 capital as of:

	31 December 2012		*31 December 2011*	
	US $	***US $***	*US $*	*US $*
	Total capital ratio	**Tier 1 capital ratio**	Total capital ratio	Tier 1 capital ratio
Capital adequacy ratio	**17%**	**17%**	17%	17%

Legal restrictions on capital and income mobility

Distributing profits by subsidiary to the parent is subject to compliance with applicable laws and regulations in Pakistan. Such distribution should go through the legal and regulatory channels applicable in relevant jurisdiction (i.e. Pakistan). Mobilsation of capital, reserves and equivalent funds out of the subsidiary to the parent is subject to the local rules and regulations. The parent is not subject to any restriction to support its subsidiary in the form of deposits or capital. However, as a procedure, a prior written approval has to be obtained from the CBB for increasing investment in subsidiary.

Table - 6. The Group's subsidiary capital adequacy ratios

The following is the Group's subsidiary capital adequacy ratio prepared on the basis of SBP requirements, which may differ from the CBB requirements, as of:

	31 December 2012		*31 December 2011*	
	US $	***US $***	*US $*	*US $*
	Total capital ratio	**Tier 1 capital ratio**	Total capital ratio	Tier 1 capital ratio
Capital adequacy ratio	**11%**	**11%**	15%	15%

The subsidiary's capital adequacy ratio is below the minimum capital adequacy ratio (CAR) of 15% required by the State Bank of Pakistan for which the subsidiary has obtained separate exemption. Further, the subsidiary's CAR computed in accordance with the CBB requirements is 22% which is above the minimum CAR threshold set by the CBB.

3 RISK MANAGEMENT

Risk management is an integral part of the Group's decision-making process. The risk management committee and executive committees, guide and assist with overall management of the Group's consolidated statement of financial position risks. The Group manages exposures by setting limits approved by the Board of Directors. The Group risk management strategies have been effectively implemented during the year in line with the objective defined.

a) Credit risk

Credit risk is the risk that one party to a financial contract will fail to discharge an obligation and cause the other party to incur a financial loss. The Group controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties. Financing contracts are mostly secured by the personal guarantees of the counterparty, by collateral in form of mortgage of the objects financed or other tangible security.

Table – 7. Credit risk exposure

The following table summarises the amount of gross funded and unfunded credit exposures and average gross funded and unfunded exposures as of:

	31 December 2012				*31 December 2011*			
	Self financed		***Financed by IAH***		*Self financed*		*Financed by IAH*	
	Total gross credit exposure US $	****Average gross exposure over the period US $***	***Total gross credit exposure US $***	****Average gross credit risk exposure over the period US $***	*Total gross credit exposure US $*	**Average gross credit exposure over the period US $*	*Total gross credit exposure US $*	**Average gross credit exposure over the period US $*
Funded								
Cash and balances with banks and financial institutic	189,788,235	151,261,573	16,033,463	30,822,550	227,821,125	171,538,306	25,213,075	25,904,581
Sales receivables	32,178,777	19,924,765	454,604,373	446,806,956	113,597,068	29,640,734	493,760,773	544,792,870
Mudaraba financing	5,318,913	7,033,749	29,542,013	21,374,830	7,672,998	8,221,221	17,883,626	20,937,289
Ijara Muntahia Bittamleek	-	-	113,232,535	108,775,756	-	42,963	102,557,275	93,810,585
Musharaka	4,480,000	4,480,000	58,012,371	59,336,533	4,480,000	4,480,000	58,488,432	55,265,741
Investments	142,048,157	135,570,348	258,687,874	272,439,437	122,122,322	128,943,473	299,810,645	255,932,185
Investment in real estate	3,204,488	3,204,488	-	-	2,941,826	2,576,288	-	-
Ijara income receivables	1,080,657	1,196,886	21,242,837	23,095,059	1,374,289	1,052,441	24,076,119	22,890,868
Premises and equipment	22,056,788	22,696,767	-		24,647,941	25,514,433	-	-
Other assets	31,696,869	34,637,432	16,182,546	16,791,776	16,182,041	19,736,744	34,591,810	24,577,598
Unfunded exposure								
Contingencies and commitments	132,232,783	165,905,937	-	-	289,272,304	207,912,890	-	-
	564,085,667	**545,911,945**	**967,538,012**	**979,442,897**	810,111,914	599,659,493	1,056,381,755	1,044,111,717

*Average balances are computed based on quarter end balances.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 8. Credit risk – geographic breakdown

The following table summarises the geographic distribution of exposures, broken down into significant areas by major types of credit exposure as of:

	31 December 2012				*31 December 2011*			
	Self financed		***Financed by IAH***		*Self financed*		*Financed by IAH*	
	****geographic area***		****geographic area***		**geographic area*		**geographic area*	
	Middle East US $	***Other Asian countries US $***	***Middle East US $***	***Other Asian countries US $***	*Middle East US $*	*Other Asian countries US $*	*Middle East US $*	*Other Asian countries US $*
Cash and balances with banks	**82,199,490**	**107,588,745**	**11,075,716**	**4,957,747**	118,756,715	109,064,410	6,170,549	19,042,526
Sales receivables	**32,178,777**	**-**	**242,240,449**	**212,363,924**	113,597,068	-	268,980,599	224,780,174
Mudaraba financing	**5,318,913**	**-**	**29,542,013**	**-**	7,672,998	-	17,883,626	-
Ijara Muntahia Bittamleek	**-**	**-**	**85,038,850**	**28,193,685**	-	-	73,107,622	29,449,653
Musharaka	**4,480,000**	**-**	**3,099,445**	**54,912,926**	4,480,000	-	6,072,140	52,416,292
Investments	**99,790,739**	**42,257,418**	**16,802,902**	**241,884,972**	79,721,853	42,400,469	44,154,276	255,656,369
Investment in real estate	**3,204,488**	**-**	**-**	**-**	2,941,826	-	-	-
Ijara income receivables	**1,080,657**	**-**	**16,030,695**	**5,212,142**	1,374,289	-	18,239,003	5,837,116
Premises and equipment	**10,131,233**	**11,925,555**	**-**	**-**	11,186,733	13,461,208	-	-
Other assets	**7,222,157**	**24,474,712**	**186,702**	**15,995,844**	-	16,182,041	12,260,051	22,331,759
	245,606,454	**186,246,430**	**404,016,772**	**563,521,240**	339,731,482	181,108,128	446,867,866	609,513,889

*The Group operates to provide products and services in separate economic environments having risk and rewards that are different for each economic environment. The two geographical areas are Middle East and Other Asian Countries. Other Asian Countries predominantly includes subsidiary's operations in Pakistan.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 9. Credit risk – counterparty type breakdown

The following table summarises the distribution of funded and unfunded exposure by counterparty type as of:

	31 December 2012				*31 December 2011*			
	Self financed		***Financed by IAH***		*Self financed*		*Financed by IAH*	
	Funded	***Unfunded***	***Funded***	***Unfunded***	*Funded*	*Unfunded*	*Funded*	*Unfunded*
	US $	***US $***	***US $***	***US $***	*US $*	*US $*	*US $*	*US $*
Cash items	16,940,017	-	-	-	10,327,229	-	6,489,020	-
Claims on Sovereigns	110,708,344	8,208,660	239,627,962	-	92,737,897	-	269,196,778	-
Claims on Public Sector Entities	-	-	75,227,887	-	8,540,639	-	66,167,280	-
Claims on banks	159,662,674	19,656,442	134,648,010	-	274,449,174	169,437,835	146,774,256	-
Claims on corporate	6,390,978	104,367,681	377,165,278	-	16,314,249	119,834,469	433,716,426	-
Mortgage	-	-	54,229,575	-	-	-	38,859,105	-
Past dues receivables	3,308,885	-	54,376,725	-	-	-	45,019,435	-
Equity investment	63,840,675	-	551,726	-	64,493,950	-	281,261	-
Investment in Funds	10,777,742	-	5,012,194	-	9,928,754	-	5,000,000	-
Holding of Real Estate	35,985,231	-	10,702,810	-	21,973,116	-	10,481,302	-
Other assets	24,238,338	-	15,995,845	-	22,074,602	-	34,396,892	-
	431,852,884	**132,232,783**	**967,538,012**	-	520,839,610	289,272,304	1,056,381,755	-

For the purpose of rating, the Group is using External Credit Assessment Institutions (ECAIs) Standard & Poors, Moodys, Capital Intelligence and Fitch for assigning risk weight to assets.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 10. Credit risk – related party transactions

The following table summarises the balances with related parties as of:

	31 December 2012		*31 December 2011*	
	Self financed Funded US $	***Financed by IAH Funded US $***	*Self financed Funded US $*	*Financed by IAH Funded US $*
Cash and balances with bank	**-**	**98,781**	-	306,344
Sales Receivable	**-**	**15,391,289**	-	30,362,685
Musharaka	**-**	**739,510**	-	339,394
Mudaraba Financing	**5,318,913**	**29,542,013**	7,672,998	17,883,627
Ijara Muntahia Bittamleek	**-**	**5,011,117**	-	6,095,406
Investments	**63,840,664**	**255,746**	63,673,835	260,808
Ijara Income Receivable	**-**	**13,748**	-	29,968
Other Assets	**53,332**	**757,416**	1,328	655,560
	69,212,909	**51,809,620**	71,348,161	55,933,792

All transactions with related parties have been made on arms length basis.

The Group's intra-group transactions as of 31 December 2012 is its investment in subsidiary of USD 61,961 thousand (31 December 2011: USD 61,961 thousand) and amount receivable of USD 985 thousand (31 December 2011: USD 1,064 thousand) by the Bank from its subsidiary in Pakistan.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 11. Credit risk – concentration of risk

The Group follows the Central Bank of Bahrain's guidelines with respect to the definition and measurement of large exposures at the consolidated level as stipulated in the Central Bank of Bahrain Rulebook for Islamic Banks.

The following are the balances representing the concentration of risk to individual counterparties as of 31 December 2012:

Counterparties *	***Funded US $***
Counterparty # 1	**219,373,303**
Counterparty # 2	**43,941,366**
Counterparty # 3	**37,123,161**
Counterparty # 4	**36,549,449**
Counterparty # 5	**31,666,519**
Counterparty # 6	**29,377,398**
Counterparty # 7	**27,676,320**
Counterparty # 8	**24,870,011**

* The exposure is in excess of the 15% individual obligor limit.
Counterparty 1,3,4,5,6 & 8 are exempt from large exposure deduction as per the CBB rules or separate exemption have been obtained from the CBB.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 11. Credit risk – concentration of risk (continued)

The following are the balances representing the concentration of risk to individual counterparties as of 31 December 2011:

Counterparties *	*Funded* *US $*
Counterparty # 1	244,784,588
Counterparty # 2	24,355,645
Counterparty # 3	74,120,767
Counterparty # 4	62,465,746
Counterparty # 5	43,826,097
Counterparty # 6	41,415,688
Counterparty # 7	35,119,438
Counterparty # 8	25,797,250

* The exposure is in excess of the 15% individual obligor limit.
Counterparty 1,2,4,5,6,7 & 8 are exempt from large exposure deduction as per the CBB rules or separate exemption have been obtained from the CBB.

Past due and non-performing facilities

Past due represents installments that are not received on the contractual repayments date. The Group defines non-performing facilities as the facilities that are overdue for period of 90 days or more. These exposures are placed on a non-accrual status with income being recognised to the extent that it is actually received/distributed. It is the Group's policy, except for the subsidiary which is following their local regulations, that when an exposure is overdue for a period of 90 days or more, the whole financing facility extended is considered as past due, not only the overdue installments/payments.

Highly leveraged counter parties

Highly leveraged counter parties are determined by the Credit and Risk Management Department on case by case basis according to industry types and credit policies and procedures of the Group. Each industry has clear established leverage ratios set in place internally which are considered threshold for measuring how leveraged is our counterpart (Low, Medium/Acceptable or High). Any excess over such determined ratios, the customer is classified as highly leveraged with high risk. This ratio will have a big impact on Internal Rating / Grading of the customer.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 12. Credit risk – credit quality of Islamic financing contracts by counterparty type

The following table summarises the aging of non performing facilities disclosed by counterparty type as of:

	31 December 2012					*31 December 2011*				
			Aging of non performing facilities					*Aging of non performing facilities*		
	Past due but performing US $	***Non-performing Islamic financing contracts US $***	***90 days to 1 year US $***	***1 year to 3 years US $***	***Over 3 years US $***	*Past due but performing US $*	*Non-performing Islamic financing contracts US $*	*90 days to 1 year US $*	*1 year to 3 years US $*	*Over 3 years US $*
Banks	**53,333**	**3,051,045**	**3,051,045**	**-**	**-**	-	-	-	-	-
Corporates	**8,928,999**	**64,884,058**	**28,739,698**	**15,633,236**	**20,511,124**	11,936,203	60,781,019	21,214,237	23,481,556	16,085,226
Investment Firms	**-**	**36,996,685**	**-**	**-**	**36,996,685**	-	37,384,463	-	37,384,463	-
Individuals	**124,235**	**4,357,501**	**2,302,596**	**324,869**	**1,730,036**	749,941	2,264,018	302,384	732,339	1,229,295
Others	**1,659,770**	**4,348,161**	**1,093,242**	**1,597,391**	**1,657,528**	1,818,156	3,718,389	898,687	2,379,676	440,026
	10,766,337	**113,637,450**	**35,186,581**	**17,555,496**	**60,895,373**	14,504,300	104,147,889	22,415,308	63,978,034	17,754,547

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 13. Credit Risk – provision against financing facilities by counterparty type

The following table summarises the total provisions against financing facilities disclosed by counterparty type as of 31 December 2012:

	Specific allowances						
	Opening Balance	***Charges during the year***	***Write-Back during the year***	***Write-offs during the year***	***Transferred to investment risk reserve***	***Exchange difference on opening balance***	***Balance at the end of the year***
	US $	***US $***	***US $***	***US $***	***US $***	***US $***	***US $***
Corporates	26,297,297	10,045,179	(3,255,300)	(1,484,413)	-	(1,482,389)	30,120,374
Investment Firms	22,556,464	-	-	-	-	(192,734)	22,363,730
Individuals	1,352,926	108,935	(5,555)	-	132,387	(33,594)	1,555,099
Others	1,693,072	548,669	(74,428)	-	-	(125,547)	2,041,766
	51,899,759	**10,702,783**	**(3,335,283)**	**(1,484,413)**	**132,387**	**(1,834,264)**	**56,080,969**

A collective provision of US $ 600 thousand is being maintained against financing facilities as at 31 December 2012.

The following table summarises the total provisions against non performing financing facilities disclosed by counterparty type as of 31 December 2011:

	Specific allowances						
	Opening Balance	*Charges during the year*	*Write-Back during the year*	*Write-offs during the year*	*Transferred from investment risk reserve*	*Exchange difference on opening balance*	*Balance at the end of the year*
	US $	*US $*	*US $*	*US $*	*US $*	*US $*	*US $*
Corporates	38,297,608	12,452,050	(14,541,044)	(7,344,875)	(1,339,857)	(1,226,585)	26,297,297
Investment Firms	22,556,464	-	-	-	-	-	22,556,464
Individual	1,402,526	14,230	(39,750)	-	-	(24,080)	1,352,926
Others	1,803,559	284,295	(308,379)	-	-	(86,403)	1,693,072
	64,060,157	12,750,575	(14,889,173)	(7,344,875)	(1,339,857)	(1,337,068)	51,899,759

A collective provision of US $ 500 thousand is being maintained against financing facilities as at 31 December 2011.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 14. Credit risk – non performing facilities and provisions

The following table summarises the total non performing facilities and provisions disclosed by geographical area as of:

	31 December 2012			*31 December 2011*		
	Non-performing Islamic financing contracts US $	***Specific provision US $***	***Collective provision* US $***	*Non-performing Islamic financing contracts US $*	*Specific provision US $*	*Collective provision US $*
Middle East	50,919,533	28,363,724	600,000	52,531,660	29,896,875	500,000
Other Asian countries	62,717,917	27,717,245	-	51,616,229	22,002,884	-
	113,637,450	**56,080,969**	**600,000**	104,147,889	51,899,759	500,000

* Collective provision is calculated based on estimates by the management keeping in view general economic and market conditions, effecting investment and financing portfolio of the Group.

Table – 15. Credit risk – restructured Islamic financing contracts

The following table summarises the total outstanding Islamic financing contracts that were restructured during the year as of:

	31 December 2012 Total US $	*31 December 2011 Total US $*
Restructured Islamic financing contracts	**11,486,817**	11,957,182

There is no significant impact of the renegotiated Islamic financing contracts on the provisions as well as present and future earnings. In addition, the magnitude of the restructuring activities is immaterial.

3 RISK MANAGEMENT (continued)

a) Credit risk (continued)

Table – 16. Counterparty credit risk exposure

The following table summarises the counterparty credit risk exposure covered by collateral as of:

	31 December 2012		31 December 2011	
	Gross positive FV of contracts US $	**** Collateral held US $***	Gross positive FV of contracts *US $*	** Collateral held US $*
Cash and balances with banks and financial institution	**205,821,698**	**-**	253,034,200	-
Sales receivables	**486,783,150**	**285,207,600**	607,357,841	344,478,068
Mudaraba financing	**34,860,926**	**-**	25,556,624	-
Ijara Muntahia Bittamleek	**113,232,535**	**75,932,029**	102,557,275	73,892,946
Musharaka	**62,492,371**	**59,460,764**	62,968,432	56,974,137
Investments	**400,736,031**	**-**	421,932,967	-
Investment in real estate	**3,204,488**	**-**	2,941,826	-
Ijara income receivables	**22,323,494**	**-**	25,450,408	-
Premises and equipment	**22,056,788**	**-**	24,647,941	-
Other assets	**47,879,415**	**-**	50,773,851	-
	1,399,390,896	**420,600,394**	1,577,221,365	475,345,151

* Collaterals have been restricted to outstanding exposure of financing facilities.

Table – 17. Counterparty credit risk exposure

The following table summarises exposure by type of Islamic financing contract that is covered by eligible collateral after the application of haircuts as of:

	31 December 2012		31 December 2011	
	Gross positive FV of contracts US $	***Collateral held US $***	*Gross positive FV of contracts US $*	*Collateral held US $*
Ijara Muntahia Bittamleek & Ijara income receivable	**135,556,029**	**56,043,459**	128,007,683	54,614,444

b) Market risk

Market risk arises from fluctuations in profit rates, equity prices and foreign exchange rates.

Table – 18. Market risk capital requirements

The following table summarises the capital requirement for each category of market risk as of:

	31 December 2012		31 December 2011	
	Equity position risk US $	***Foreign exchange risk US $***	*Equity position risk US $*	*Foreign exchange risk US $*
RWE	**-**	**74,787,259**	888,000	78,079,345
Capital requirements (12%)	**-**	**8,974,471**	106,560	9,369,521
Maximum value of RWE	**1,752,000**	**75,246,956**	6,986,290	91,018,980
Minimum value of RWE	**-**	**62,113,705**	888,000	67,004,080

3 RISK MANAGEMENT (continued)

b) Market Risk (continued)

Table – 19. Equity position risk in Banking Book

The following table summarises the total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2012:

	Total gross exposure US $	***Average gross exposure over the period US $***	***Publicly held US $***	***Privately held US $***	***Capital requirement US $***
Sukuk	**318,518,419**	**332,572,863**	**14,667,388**	**303,851,031**	**3,882,644**
Managed funds	**9,727,742**	**9,016,379**	**9,727,742**	**-**	**1,167,329**
Private equity	**64,442,390**	**2,311,381**	**295,981**	**64,146,409**	**11,509,526**
Real estate related	**2,035,286**	**6,376,558**	**-**	**2,035,286**	**488,469**
Others	**6,012,194**	**64,432,681**	**-**	**6,012,194**	**625,463**
	400,736,031	**414,709,862**	**24,691,111**	**376,044,920**	**17,673,431**

The following table summarises the total and average gross exposure of equity based financing structures by types of financing contracts and investments as of 31 December 2011:

	Total gross exposure US $	*Average gross exposure over the period US $*	*Publicly held US $*	*Privately held US $*	*Capital requirement US $*
Sukuk	340,488,817	303,410,571	18,127,479	322,361,338	1,905,814
Managed funds	7,129,153	9,756,071	7,129,153	-	855,498
Private equity	64,974,638	64,747,028	20,435	64,954,203	11,618,587
Real estate related	2,403,412	2,247,169	-	2,403,412	374,723
Others	6,492,948	2,741,427	-	6,492,948	329,456
	421,488,968	382,902,266	25,277,067	396,211,901	15,084,078

Table – 20. Equity gains or losses in Banking Book

The following table summarises the cumulative realised and unrealised gains or (losses) during the year ended:

	31 December 2012 US $	*31 December 2011 US $*
Cummulative realised gains arising from sale or liquidation	**(156,744)**	2,239,967
Total unrealised losses recognised in the balance sheet but not through P&L	**(846,661)**	(7,542,916)
Unrealised gross losses included in Tier One Capital	**(2,148,174)**	(7,542,916)
Unrealised gains included in Tier Two Capital (45% only)	**585,681**	-

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders

The Group manages and deploys Equity of IAH according to its Article of Association – Chapter 3 on Rules of Business. The Bank holds and maintain two separate pools of funds, one for its own funds and another for Equity of Investment accountholders. Both of these pools are managed in accordance with Shari' a requirements and standard of prudence is applied in the context of managing the overall portfolios to enable the Bank to exercise its fiduciary responsibilities. The Group is authorised by Equity of Investment accountholders to invest the funds on the basis of Mudaraba, Murabaha, Salam, Ijara transactions and other forms of contract in a manner which the Group deems appropriate without laying down any restrictions as to where, how and for what purpose the funds should be invested.

The composition, characteristics, diversification, and concentration of portfolios are monitored within appropriate risk limits and indicators detailed in the Group's credit risk, liquidity risk, and other risks policies of the group. The strategic objectives of the investments of the funds are:

a) Investment in Shari' a compliant opportunities;
b) Targeted returns;
c) Compliance with credit and Investment policy and overall business plan; and
d) Diversified portfolio.

Funds are invested in Shari' a compliant commercial or consumer financing as well as short, medium, and long term investments excluding strategic investments. A due diligence process is in place which is consistent with business and risk policy guidelines of the Group after deduction of mandatory reserves and making allowance for short-term liquidity requirements.

Under all the aforesaid arrangement the Group can commingle the IAH funds with its own funds (Self-Financed). Some of the assets right from inception is designated exclusively as Self Financed by the Group. These self financed assets are deducted from total assets to arrive at "Jointly Financed Assets". To segregate the Jointly Financed Assets into self financed and Investment accountholders (IAH), the Group applies formula to identify the proportional share of each fund's in the Jointly Financed Assets .

The Group's share of profit as a Mudarib for managing equity of IAH and their share of income is based on the terms and conditions of the related Mudarib agreements. These funds are invested in Islamic modes of financing and investments including murabaha, musharaka, mudaraba and ijara. The Group is offering these accounts for saving and term accounts ranging from 3 months to 5 years. There are no separate designations for portfolio managers, investment advisors and trustee. IAH accounts are managed at Head Office and subsidiary levels by relevant departments.

Investors' share of income is calculated based on the income generated from joint investment accounts after deducting the expenses related to investment pool "mudarib expenses". Mudarib expenses include all expenses incurred by the Group, including specific provisions, but excluding staff cost and depreciation. The Group's "mudarib profit" is deducted from investors' share of income before distributing such income. In some cases, equity of IAH withdrawn before maturity and without completing three months are not entitled to any income. Equity of IAH held for more than three months and withdrawn before their maturity are entitled to income only after deducting a penalty charge equivalent to three months income.

The basis applied by the Group in arriving at the investment accountholders share of income is [total investment income less investment pool expenses] divided by [average funds generating income (shareholders and equity of investment accountholders) times average funds of equity of IAH].

Investment risk reserve

The Group deducts investment risk reserve as per approved policy from the profit distributable to equity of investment accountholders of its Bahrain operations, after allocating the Mudarib share in order to cater against future losses for equity of IAH.

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Profit equalisation reserve
The Group appropriates a certain amount in excess of the profit to be distributed to equity of investment accountholders before taking into consideration the mudarib share of income. This is used to maintain a certain level of return on investment for equity of IAH.

Displaced commercial risk
The Group is exposed to displaced commercial risk in the event of having equity of IAH profit rates that are lower than market rates. The Group has mitigated this risk through the setting up of reserves that will be used in case of a drop in IAH profit rates. The policies and procedures for displaced commercial risk are formulated and implemented at the segment level (Pakistan, Bahrain offshore, Bahrain Commercial).

Complaint procedure / awareness programs
A complaint management system is established; procedures on handling complaints have been developed, new Complaints form has been introduced, a number of complaints channels where customers can communicate through branches, call centre, email, dedicated staff number and web-site. Monitoring procedures have been developed as well.

The Group uses it's website, print and electronic media for consumer awareness program and to inform about new products.

Penalty charges
A financial penalty of USD 635 (2011: USD 1.5 thousand) was charged by SBP to the Group's subsidiary in Pakistan during the year ended 31 December 2012.

Non-Shari'a complaint income
The Group charged USD 426 thousand (2011: USD 34 thousand) to customers as penalty for default which was disposed through charity contribution.

Table – 21. Equity of Investment Accountholders

The following table summarises the breakdown of equity of IAH and the analysis of profit equalisation reserve, investment risk reserve and return on equity of IAH as of:

	31 December 2012 US $	*31 December 2011 US $*
IAH - Banks	**145,465,301**	237,334,854
IAH - Non-banks	**818,923,132**	815,785,239
Profit equalisation reserve	**544,632**	524,542
Investment risk reserve	**2,604,947**	2,737,120
	967,538,012	1,056,381,755

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 22. Ratio of reserves to total IAH

The following table summarises the ratio of reserves to the total amount of equity of IAH as of:

	31 December 2012	*31 December 2011*
	US $	*US $*
PER to IAH (%)	**0.06%**	0.05%
IRR to IAH (%)	**0.27%**	0.26%

Table – 23. Equity of Investment Accountholders by Islamic financing product type

The following table summarises the percentage of IAH financing for each type of Shari's-compliant contract to total equity of IAH financing as of:

	31 December 2012	*31 December 2011*
Sales receivable	**67.19%**	70.86%
Mudaraba investments	**4.37%**	2.57%
Musharaka	**8.57%**	8.39%
Ijara Muntahia Bittamleek & Ijara income receivable	**19.87%**	18.17%

Table – 24. Equity of Investment Accountholders by Counterparty Type

The following table summarises the percentage of financing for each category of counterparty to total financing as of:

Counterparty type

	31 December 2012	*31 December 2011*
Banks	**15.11%**	22.54%
Investment Firms	**4.30%**	2.72%
Corporates	**31.92%**	24.40%
Residentials	**47.41%**	49.58%
Others	**1.27%**	0.77%

Table – 25. Investment Accountholders share of profit

The following table summarises the share of profits earned by and paid out to equity of IAH and the Group as Mudarib for the year ended:

	31 December 2012	*31 December 2011*
Administrative expenses charged to equity of investment accountholders	**2,451,390**	2,090,090
Share of profits earned by IAH, before transfers to/from reserves	**75,886,460**	86,984,643
Percentage share of profit earned by IAH before transfer to/from reserves	**7.75%**	8.33%
Share of profit paid out to IAH after Mudarib fee and transfer to/from reserves	**61,441,021**	68,601,248
Percentage share of profit paid out to IAH after Mudarib fee and transfer to/from reserves	**6.27%**	6.57%
Share of profit paid out to Bank as mudarib	**14,425,135**	18,583,863
Mudarib Fee to total Investment Profits	**19.01%**	21.36%

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 26. Movement in profit equalisation reserve

The following table summarises the movement in profit equilisation reserve during the year ended:

	31 December 2012 US $	*31 December 2011 US $*
Balance at 1 January	**524,542**	965,311
Amount apportioned from income allocable to equity of Investment accountholders	**20,090**	19,331
Amount utilised during the year	**-**	(460,100)
	544,632	524,542
Percentage of the profit earned on equity of investment accountholders appropriated to profit equilisation reserve	**0.03%**	0.02%

Table – 27. Movement in investment risk reserve

The following table summarises the movement in investment risk reserve during the year ended:

	31 December 2012 US $	*31 December 2011 US $*
Balance at 1 January	**2,737,120**	1,156,962
Amount apportioned from income allocable to equity of Investment accountholders	**214**	240,301
Amount apportioned (to) / from provision	**(132,387)**	1,339,857
	2,604,947	2,737,120
Percentage of the profit earned on equity of investment accountholders appropriated to investment risk reserve	**0.0003%**	0.28%

The profit equalisation reserve and investment risk reserve will revert to IAH as per terms and conditions of the Mudaraba contract.

As IAH funds are commingled with the Group's funds for investment, no priority is granted to any party for the purpose of investments and distribution of profits.

The Group's share, as Mudarib, in the profits of IAH is up to a maximum of 70% (31 December 2011: up to 70%) as per the terms of IAH agreements.

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 28. Equity of Investment Accountholders by type of assets

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets and the changes in the asset allocation for the year ended 31 December 2012:

	Opening Actual Allocation US$	***Movement US$***	***Closing Actual Allocation US$***
Cash and balances with banks	**25,213,075**	**(9,179,612)**	**16,033,463**
Sales receivable	**493,760,773**	**(39,156,400)**	**454,604,373**
Mudaraba financing	**17,883,626**	**11,658,387**	**29,542,013**
Ijara Muntahia Bittamleek	**102,557,275**	**10,675,260**	**113,232,535**
Musharaka	**58,488,432**	**(476,061)**	**58,012,371**
Investments	**299,810,645**	**(41,122,771)**	**258,687,874**
Ijara income receivables	**24,076,119**	**(2,833,282)**	**21,242,837**
Other assets	**34,591,810**	**(18,409,264)**	**16,182,546**
	1,056,381,755	**(88,843,743)**	**967,538,012**

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets for the year ended 31 December 2011:

	Opening actual allocation US$	*Movement US$*	*Closing actual allocation US$*
Cash and balances with banks	110,886,672	(85,673,597)	25,213,075
Sales receivable	531,631,398	(37,870,625)	493,760,773
Mudaraba financing	15,102,600	2,781,026	17,883,626
Ijarah Muntahia Bittamleek	93,046,568	9,510,707	102,557,275
Musharaka	51,111,079	7,377,353	58,488,432
Investments	93,413,981	206,396,664	299,810,645
Ijarah income receivables	17,887,273	6,188,846	24,076,119
	957,948,322	98,433,433	1,056,381,755

3 RISK MANAGEMENT (continued)

c) Equity of Investment Accountholders (continued)

Table – 29. Equity of Investment Accountholders profit earned and paid

The following table summarises the amount and percentage of profits earned and paid out to profit sharing investment accounts over the past five years:

	Profit earned		*Profit paid to IAH*	
	US$	*%age*	*US$*	*%age*
2012	**75,886,460**	**7.75%**	**61,441,021**	**6.27%**
2011	86,984,643	8.33%	68,601,248	6.57%
2010	45,896,366	6.11%	29,786,963	4.05%
2009	46,278,164	6.90%	35,740,826	5.30%
2008	42,843,699	6.00%	36,367,056	5.06%
2007	47,762,553	6.65%	41,047,490	5.72%

Table - 30. Treatment of assets financed by Equity of Investment Accountholders

The following table summarises the treatment of assets financed by IAH in the calculation of risk weighted assets (RWA) for capital adequacy purposes as of 31 December 2012:

	RWA US$ '000	*RWA for capital adequacy purposes US$ '000*	*Capital charges US$ '000*
Type of Claims			
Claims on Sovereign	**29,924,213**	**8,977,264**	**1,077,272**
Claims on PSEs	**3,411,578**	**1,023,473**	**122,817**
Claims on Banks	**68,115,866**	**20,434,760**	**2,452,171**
Claims on Corporates	**325,887,054**	**97,766,116**	**11,731,934**
Mortgage	**53,612,820**	**16,083,846**	**1,930,062**
Past due facilities	**65,403,951**	**19,621,185**	**2,354,542**
Investment in securities	**5,691,794**	**1,707,538**	**204,905**
Holding of Real Estates	**21,405,621**	**6,421,686**	**770,602**
Other Assets	**15,995,844**	**4,798,753**	**575,850**
	589,448,741	**176,834,621**	**21,220,155**

The following table summarises the treatment of assets financed by IAH in the calculation of risk weighted assets (RWA) for capital adequacy purposes as of 31 December 2011:

	RWA US$ '000	*RWA for capital adequacy purposes US$ '000*	*Capital charges US$ '000*
Type of Claims			
Claims on Sovereign	6,990,556	2,097,167	251,660
Claims on PSEs	3,227,005	968,102	116,172
Claims on Banks	54,697,184	16,409,155	1,969,099
Claims on Corporates	413,238,429	123,971,529	14,876,583
Mortgage	39,780,488	11,934,146	1,432,098
Past due facilities	52,208,069	15,662,421	1,879,491
Investment in securities	7,911,665	2,373,500	284,820
Holding of Real Estates	20,962,603	6,288,781	754,654
Other Assets	34,396,893	10,319,068	1,238,288
	633,412,892	190,023,869	22,802,865

3 RISK MANAGEMENT (continued)

d) Off-balance sheet equity of Investment Accountholders

Off-balance sheet equity of Investment accountholders is invested and managed in accordance with Shari'a requirements.

The Group as fund manager will manage and administer the investment account in a proper, diligent and efficient manner in accordance with applicable laws and local regulations.

The Group has appropriate procedures and controls in place commensurate to the size of its portfolio which includes:

(a) Organizing its internal affairs in a responsible manner, ensuring it has appropriate internal controls and risk management systems and procedures and controls designed to mitigate and manage such risks;

(b) Observing high standards of integrity and fair dealing in managing the scheme to the best interest of its investors; and

(c) Ensuring that the Group has the requisite level of knowledge and experience for the tasks that is undertaken and is competent for the work undertaken.

Table – 31. Off-balance sheet equity of Investment Accountholders by Islamic product type

The following table summarises the breakdown of Off-balance sheet equity of IAH by type of islamic financing contracts as of:

Islamic products

	31 December 2012	*31 December 2011*
Sales receivables	**80.56%**	90.54%
Mudaraba financing	**10.40%**	5.15%
Investments	**9.04%**	4.32%

Table – 32. Off-balance sheet equity of Investment Accountholders by counterparty type

The following table summarises the percentage of financing for each category of counterparty to total financing as of:

Counterparty type

	31 December 2012	*31 December 2011*
Banks	**13.44%**	49.76%
Corporate	**86.56%**	50.24%

3 RISK MANAGEMENT (continued)

d) Off-balance sheet equity of Investment Accountholders (continued)

Table – 33. Off-balance sheet equity of Investment Accountholders by type of assets

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets and the changes in the asset allocation for the year ended 31 December 2012:

	Opening actual allocation US$	***Movement US$***	***Closing actual allocation US$***
Sales receivables	**235,360,992**	**(127,431,927)**	**107,929,065**
Mudaraba financing	**13,375,235**	**563,559**	**13,938,794**
Investments	**11,225,283**	**882,045**	**12,107,328**
	259,961,510	**(125,986,323)**	**133,975,187**

The following table summarises the types of assets in which the funds are invested and the actual allocation among various types of assets for the year ended 31 December 2011:

	Opening actual allocation US$	*Movement US$*	*Closing actual allocation US$*
Sales receivables	157,477,950	77,883,042	235,360,992
Mudaraba financing	13,520,253	(145,018)	13,375,235
Investments	11,902,902	(677,619)	11,225,283
	182,901,105	77,060,405	259,961,510

Table – 34. Off-balance sheet equity of Investment Accountholders historical returns

The following table summarises the historical returns over the past five year:

	Dec 2012	*Dec 2011*	*Dec 2010*	*Dec 2009*	*Dec 2008*
Gross Income	**1,208,812**	458,674	2,756,802	1,116,995	5,736,106
Mudarib Fee	**168,172**	110,062	261,157	195,459	403,207

The Group’s share of profit as a Mudarib for managing Off-balance sheet equity of Investment accountholders and their share of income is based on the terms and conditions of the related mudarib agreements. These mudarib agreements are done at the individual Counter party level.

3 RISK MANAGEMENT (continued)

e) Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources, manages assets with liquidity in mind, and monitors liquidity on regular basis. The liquidity management policy at a minimum includes the following:

a. Provide clear guidance on the composition and role of the asset/liability committee or such other committee or department responsible for managing liquidity.

b. Establish approval processes to ensure adherence to liquidity risk management processes.

c. Require periodic calculations to determine the extent to which the segments are funding long-term assets with short-term liabilities.

d. Establish liquidity ratio benchmarks, e.g. parameters for the funding of long-term assets with short-term liabilities to guide liquidity management and the method for computing liquidity indicators.

e. Establish limits on the degree of concentrations that are deemed acceptable. This should:

i) Ensure diversification of funding by origin and term structure by, for example, guarding against concentration by individuals or groups of depositors, types of deposit instruments, market sources of deposit, geographical sources, term to maturity, and deposit currencies. Where concentrations occur, the segments manage their assets and liquidity profile to mitigate the risk; and

ii) Set procedures for the orderly restoration of the liquidity position in the event of loss of funding where such concentrations are unavoidable. In addition, the segments conduct an impact analysis on its dependency on any such concentrations.

f. Provide for periodic review of the deposit structure. The review should include the volume and trend of various types of deposits offered, maturity distributions of time deposits, profit rate paid on each type of deposit, prevailing market profit rate, limits on large time deposits, public funds, and non-resident deposits.

g. Provide for the review of alternate funding sources including stand-by facilities and lines of credit.

h. Establish a framework for the composition of assets.

i. Assess the acceptable mismatch in combination with currency commitments. The segments undertake separate analysis of their strategy for each currency individually. They set and regularly review limits on the size of cash flow mismatches over particular time horizons for foreign currencies in aggregate, and for each significant currency.

3 RISK MANAGEMENT (continued)

e) Liquidity risk (continued)

Table – 35. Liquidity ratios

The following table summarises the liquidity ratios as of:

	31 December 2012	*31 December 2011*
Liquid assets to total assets	**19.51%**	29.22%
Short term assets to short term liabilities	**68.60%**	64.38%

Table – 36. Quantitative indicators of financial performance and position

	Dec 2012	*Dec 2011**	*Dec 2010*	*Dec 2009*	*Dec 2008*
Return on average equity	**-6.1%**	1.4%	2.8%	-15.5%	1.3%
Return on average assets	**-0.8%**	0.2%	0.5%	-2.7%	0.2%
Cost to Income Ratio	**98.4%**	91.0%	75.3%	103.5%	80.1%

* Return based on total income and equity (including non-controlling interest)

4 OTHERS

The responsibility for payment of Zakat is on individual shareholders and investment accountholders. However, in Pakistan Zakah is deducted at source from the Equity of Investment accountholders as required by local laws.