Annual Report 2012

بنك إيلاف
ELAF BANK

Elaf Bank B.S.C (c) Licensed as a Wholesale Islamic Bank by the Central Bank of Bahrain
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His Royal Highness Prince
Khalifa bin Salman Al Khalifa

The Prime Minister

His Majesty King
Hamad bin Isa Al Khalifa

The King of the Kingdom of Bahrain

His Royal Highness Prince
Salman bin Hamad Al Khalifa

The Crown Prince, Deputy Supreme Commander of Bahrain Defence Force & First Deputy Prime Minister

Contents

Vision

Our vision is to become a renowned, leading and global quality-integrated wholesale Islamic banking institution; bringing value-added solutions to identified gaps and niches, within our target markets.

Mission

Our mission is to create a dynamic banking environment guided by Sharia principles, characterized by innovation, dedication and professionalism.

This environment will maximize value to the shareholders and will elevate Elaf Bank to be a contributor to the Islamic financial industry.

The Bank

Elaf Bank was incorporated in 2007 as Bahraini Shareholding Company licensed and regulated as a wholesale Islamic investment bank by the Central Bank of Bahrain.

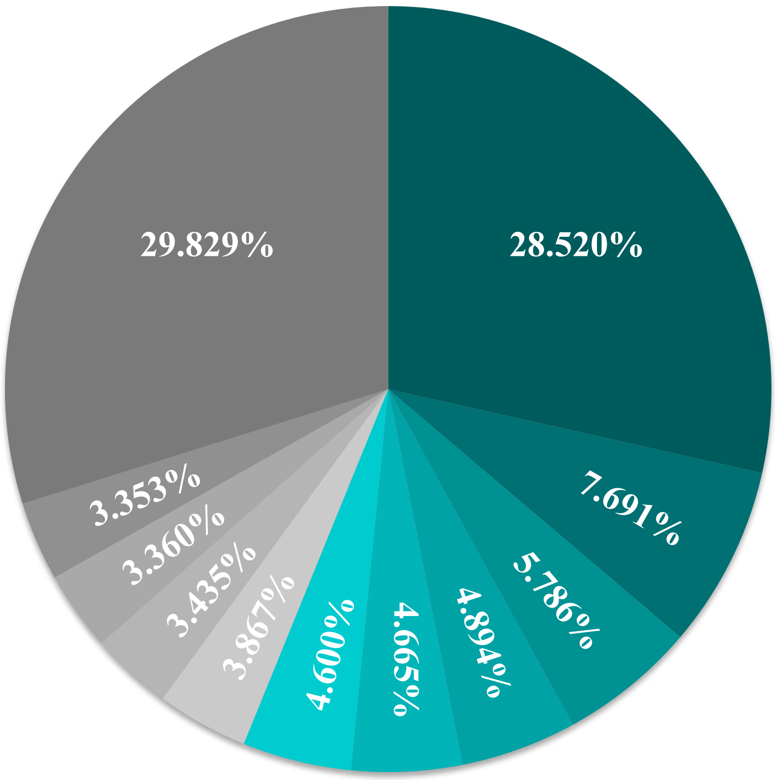
The Bank completed a three-way merger with Capital Management House B.S.C (c) and CAPIVEST B.S.C (c) on 31 December 2012.

This merger has strengthened the banks capital base, diversified its portfolio and created new income streams.

Subsequent to the merger, the Bank intends to provide a full spectrum of investment products and services.

Shareholders

The shareholders of the Bank, which form a solid base to achieve growth, include government agencies, prominent financial institutions, corporations, family offices and high net-worth individuals across the Gulf Cooperation Council (GCC).



- Aref Investment Group (Kuwait)
- Kuwait Investment Company (Kuwait)
- Gulf Investment House (Kuwait)
- Sokouk Holding Company (Kuwait)
- Kuwait Finance House (Bahrain)
- Qatar Islamic Bank (Qatar)
- Al-Bassam Investment Company (Bahrain)
- Overseas Investment (Oman)
- Bahrain Islamic Bank (Bahrain)
- Samama Global Corporation (BVI)
- Others

Chairman's Statement

In the name of Allah, the Most Merciful, the Most Compassionate, praise be to Allah, and Peace and Prayers upon the Last Prophet and Messenger Mohammed.

Dear Ladies and Gentlemen,

It is my pleasure to present the annual report of Elaf Bank for the year ended 31 December 2012. In what was another challenging year in terms of continued global economic uncertainty and major social political upheaval in certain areas of the Middle East, I am pleased to report to you on the performance of Elaf Bank during 2012, the highlight of which was the successful completion of the merger of Elaf Bank with Capital Management House and CAPIVEST.

With the merger comes, the hope of a more efficient bank, which will have greater size and scale making it better equipped to compete and deliver enhanced value.

FINANCIAL RESULTS

The bank's financial results for 2012 show some positive signs but unfortunately there were losses. Net income for 2012 amounted to USD 2.8 million; however, after provisions, merger expenses and impairments from legacy assets the net loss amounted to USD 12.4 million.

Total revenues stood at USD 11.9 million, while total assets amounted to USD 382.8 million with shareholders' equity at USD 326.4 million.

Total revenues	***USD 11.9 million***
Total assets	***USD 382.8 million***
Shareholders' equity	***USD 326.4 million***

FUTURE OUTLOOK – POST MERGER

We hope that the merger signifies the start of a new beginning for Elaf Bank. We plan to build on the momentum and immediately extract merger synergies and integrate the three legacy banks. Indeed, our first item of business will be to look at the merged bank's assets and then review our strategy so that we can focus on a course that will deliver value. I am very optimistic about the future of Elaf Bank.

Following the merger, Elaf Bank has an authorized capital of USD 500,000,000 and a paid up capital of USD 300,000,000 and as a result Elaf Bank is strengthened with a total equity of approximately USD 326 million and total assets in excess of USD 382 million spanning the GCC, wider MENA region, Europe and Asia. This is a tremendous platform for us to build on.

We will be looking to adopt an aggressive but realistic strategy, which will look to grow the bank's assets and -In sha'a Allah- make it a leading investment bank in terms of enhancing shareholder value, adopting transparent and open business practices in line with best practice for corporate governance.

Chairman's Statement

AKNOWLEDGEMENT

On behalf of the bank's board of directors and executive management, I would like to thank his Majesty King Hamad Bin Isa Al Khalifa, His Royal Highness Prince Khalifa Bin Salman Al Khalifa, the Prime Minister and His Royal Highness Prince Salman Bin Hamad Al Khalifa, the Crown Prince and First Deputy Prime Minister.

I would also like to extend our sincere appreciation to the Central Bank of Bahrain and Ministry of Industry and Commerce for their valuable direction and assistance throughout the year.

Finally, I would like to thank our shareholders and business partners for their support, and last but not least, the management and staff for their dedication and professionalism who ensured the smooth running of the bank despite the volatile economic conditions and the uncertainties of the merger process.

Paul Andrew Mercer
Chairman

Board of Directors

Board of Directors

The primary responsibility of the Board is to provide effective governance over the Bank's affairs, and promote and achieve sustainable performance that has long-term growth potential for the benefit of its shareholders. The Board also has the duty of balancing the interests of all its stakeholders, including its clientele, business partners, employees, and local communities, while maintaining high standards of transparency and accountability.

In all actions taken by the Board, the directors are expected to exercise their business judgment in what they reasonably believe to be in the Bank's best interest. In discharging this obligation, they may rely on the honesty and professional integrity of the Bank's senior executives, as well as its external advisors and auditors.

Subsequent to the successful completion of the merger of Elaf Bank, CAPIVEST and Capital Management House, the shareholders appointed a new Board of Directors. For a term of three years starts Jan 2013 and ends Jan 2016.

The new Board Composed of the following:

Paul Andrew Mercer
Chairman of Elaf Bank

Mr. Paul Andrew Mercer joined the Board in 2011 and was re-elected Chairman of Elaf Bank in January 2013. He holds a Post Graduate Diploma in Law from Chester Law School, UK and Bachelor and Master Degrees in Law from Cambridge University, UK, and has an extensive experience of 18 years in Law and Banking.

Mr. Mercer is an Executive Manager at Kuwait Finance House (Bahrain) and heads up the Legal, Compliance & AML, Risk Management, Strategic Planning & Governance, Credit, Operations, Collections and IT departments.

He is also the Vice Chairman of Bahrain-based Menatelecom and a Board member of Turkapital Holding, Bahrain, and Motherwell Bridge, UK.

From 1995 until 2003, he worked as a private practice lawyer with leading UK law firms Clifford Chance, Norton Rose and Macfarlanes.

Mohammad Khalifa Al-Adsani
Vice Chairman of Elaf Bank

Mr. Mohammad Khalifa Al-Adsani joined the Board in 2011. He holds a Bachelor's degree in Accounting, and is a Certified Investments and Derivatives Auditor (CIDA), Certified Internal Audit (CIA), Certified Management Accountant (CMA), Certified Financial Manager (CFM), Certified Financial Planner (CFP), Certified Mutual Fund Specialist (CMFS) – NISCA, and Certified Risk Analyst (CRA). He has been involved in the banking, investment and finance industry and business management for over 21 years.

Mr. Al Adasani is the Chief Executive Officer of Aref Investment Group. Before his appointment as CEO, Mr. Al Adasani handled the responsibility of Operation Director at Aref Investment Group, Senior Vice President – Operation at Aayan Leasing & Investment Co., Chief Auditor at Touristic Enterprises Company and Internal Auditor at Kuwait Airways.

Board of Directors

Abdullah Almarzouq
Board Member

Mr. Abdullah Almarzouq joined the Board in 2011. He holds an MBA from MIT Sloan School of Management, USA 2002, and a BSC degree in Mechanical Engineering from Tufts University, USA. He has been involved in the banking industry and business management for over 17 years.

Mr. Almarzouq heads the International Investment Department at Kuwait Finance House (KFH) and represents KFH in various boards in Kuwait, the Kingdom of Saudi Arabia and Bahrain. Before his appointment at KFH, Mr. Almarzouq handled the responsibility of Investment Banking at HSBC – Middle East, Manager of Stocklord Hedge Fund with a focus on energy and commodities, and Head of Corporate Finance at National Bank of Kuwait.

Khalid Abdulla Al Bassam
Board Member

Mr. Khalid Abdulla Al Bassam joined the Board in 2013. He graduated with a Bachelor degree in Business Administration, from Eastern New Mexico University, U.S.A. in May. His 24-year career includes extensive experience in management, banking and investments.

Mr. Al Bassam is the Chairman of Al Bassam Investment Company W.L.L, and Chairman of Bahrain Islamic Bank B.S.C. He is also a Board member of Gulf Investment Corporation, Kuwait, and Islamic Bank of Asia, Singapore. He is also a Board Member of the Unit Investment Fund of the Islamic Development Bank-Jeddah, Saudi Arabia and a Board member of Skaugen Gulf Petchem Carriers, Bahrain.

Previously, he was the Deputy Governor of the Central Bank of Bahrain, Vice Chairman of the Bahrain Stock Exchange and a Board member of the General Organization for Social Insurance ("GOSI") Bahrain.

Mr. Al Bassam received the Islamic Banker of the year award in 2002 presented during the World Islamic Banking Conference.

Khalid bin Mohammed Alaboodi
Board Member

Mr. Khalid bin Mohammed Alaboodi joined the Board in 2013. He holds a Bachelor Degree in Economics from King Saud University, KSA, and a Master Degree in Economics from the Northeastern University, USA. He has been involved in the economics, banking industry and business management for almost 30 years.

Mr. Alaboodi has been the Chief Executive Officer and General Manager of the Islamic Cooperation for the Development of the Private Sector (ICD) since 2007. He started his tenure with the Ministry of Finance & National Economy of Saudi Arabia as an Economic Researcher and also served as Director of the Environment Unit and Acting Director of the International Financial Institutions Department. Then he moved to Washington DC to serve as Assistant to the Saudi Executive Director at the World Bank; and was later appointed Alternate Executive Director for Saudi Arabia at the World Bank Board. He Also joined the Saudi Public Investment Fund (Ministry of Finance) as a Senior Economist where he was in charge of several privatization operations.

Currently, Mr. Alaboodi is serving as the Chairman of Bosna Bank International's Real Estate Company, Bosna, Arab Fisheries Company, Saudi Arabia, Burj Bank, Pakistan, Africa Finance Corporation, Senegal, and Mauritania investment group, Mauritania.

Khalid Mohamed Yusuf Najibi
Board Member

Mr. Khalid Mohammed Najibi joined the Board in 2013. He holds a Bachelor's degree in Business Administration with a major in Finance from Schiller International, UK, and is a Certified Public Accountant (CPA) since

1993. He has been involved in the banking, investment and finance industry and business management for over 22 years.

Mr. Najibi is the Founding Member and Executive Director of Najibi Investment Company, Board Member and Chairman of the Executive Committee of Bahrain Islamic Bank, Board Member and Member of the Executive Committee of Arbah Capital, regulated by the CMA in the Kingdom of Saudi Arabia, and Board Member of Skaugen Gulf Petchem Carriers.

Previously, Mr. Najibi was a Board Member and Managing Director of Capital Management House in Bahrain, the Chairman of Risk Committee, and Member of Nomination & Remuneration Committee of First Energy Bank in Bahrain, Board Member and Chairman of the Nomination & Remuneration Committee of QInvest in Qatar, Board Member and Member of the Executive Committee of LONA Real Estate, Board Member and Member of the Audit & Risk Committee of Gulf Finance House in Bahrain, and Board Member and Chairman of the Executive Committee of Crown Industries.

Mishari Zaid Al Khalid
Board Member

Mr. Mishari Zaid Al Khalid joined the Board in 2013. He holds a Bachelors Degree in Business Administration from the University of Cairo, Egypt. All through his career of over 36 years, he gained extensive experience in banking, investment and business management.

Mr. Al Khalid is the General Manager of Al Khalid International Group in Kuwait. Before that, he served as the Chairman and Managing Director of Al-Safat Real Estate Company in Kuwait, General Manager of Kuwaiti Real Estate Investment Group in Kuwait, Executive Committee Member at Egyptian Gulf Bank in Egypt, and Director of Investment Affairs Office of the General Organization for Social Insurance in Kuwait.
He is also the Vice Chairman of Kuwait Investment Company, and a member of the Board of Directors of National Hotels Company in Bahrain. In addition, he served as a member of the Board of Directors of CAPIVEST in Bahrain, Al-Safat Investment Company in Kuwait, and Kuwaiti Egyptian Investment Company in Egypt.

Nasser bin Mohammed Almutawa Alotaibi
Board Member

Shaikh Nasser Mohammed Almutawa Alotaibi joined the Board in 2013. He holds a Bachelor's degree in civil engineering from the United States of America, and has an extensive experience of 33 years in business management.

Shaikh Alotaibi is also the Chairman of the Board of Samama Group of Companies in Saudi Arabia, as well as co-founder of numerous financial, commercial, and industrial institutions and companies in the Gulf countries, including Arabian Shield Insurance Company in Saudi Arabia and Bahrain, Kingdom Hotel Investments Company in United Arab Emirates, Almarai Dairy Company in Saudi Arabia, Al-Jazira Establishment for Press, Printing and Publishing in Saudi Arabia, Testa Rossa Caffe in United Arab Emirates and Austria, Al-Tayyar for Travel and Tourism Group in Saudi Arabia, Souhoub Company International, and Souhoub Company for Security Services in Saudi Arabia. In addition, he served as chairman of CAPIVEST and member of Riyadh Chamber of Commerce and Industry in Saudi Arabia.

Shaikh Alotaibi is involved in various public service activities. He is a founding member of several charitable organizations in Saudi Arabia, including Sick People Friends, Disabled Children's Association, Prince Salman Center for Handicapped Research, Orphans Association, Red Crescent Friends Committee, National Committee for Prisoners and their Families, as well as Religions for Peace Organization in the United States of America. Furthermore, he is the founder and Chairman of the Board of Saudi Disabled Adults–Harakiya.

Board of Directors

Saleh Hassan Al Afaleq

Board Member

Mr. Saleh Hassan Al Afaleq joined the Board in 2013. He holds a Bachelor's degree in Management Information System from King Faisal University, Saudi Arabia, and a Master degree in Human Resource Development from Seattle University, USA, and has extensive experience of 23 years in business management.

Mr. Al Afaleq is Director and CEO of Al-Kifah Holding Company and its subsidiaries, Chairman and Founding Member of Al-Ahsa Amusement and Tourism Company, Vice Chairman of Arbah Capital (KSA), and Member of the Board of Noor Capital (Abu Dhabi), Member of the Board of Saudi Industrial Property Authority (MODON), and Member of the Board of General Authority of Civil Aviation.

He is also the Chairman of Al Ahsa Chamber of Commerce & Industry (Saudi Arabia) and a Board Member of The Council of Saudi Chambers of Commerce.

Zeyad Tareq Al Mukhaizeem

Board Member

Mr. Zeyad Tareq Al Mukhaizeem joined the Board in 2013. He graduated with a Bachelor of Science in Civil Engineering, from the University of the Pacific, USA, and MBA from DePaul University, USA – Bahrain Campus. His career has an extensive experience in banking, investments, real-estate, and project management.

Mr. Al Mukhaizeem is an Executive Director of the International Investment Division at Aref Investment Group in Kuwait. He also serves as a member of the Board of Directors of Al Enma Real Estate Company in Kuwait and member of Investment Advisory Board of EURX Fund and he is a member of numerous corporate boards in the US, Middle East, and Europe.

Prior to that, Mr. Al Mukhaizeem worked as Project Manager at the Kuwaiti Manager Company and Bovis Lend Lease, Kuwait, and Investment Manager at the Direct Investment Department at Kuwait Finance House, Kuwait.

He has also been a member of the Project Management Institute (PMI) since 2004, and the International Association of Consultants Valuators and Analysts since 2009.

Board's Committees

The Board is supported by four Board sub committees with specific delegated authorities. These committees assist in the execution of the Board's responsibilities. They report to the Board on their activities based on approved charters setting forth their roles and duties.

Audit Committee

Role

The Committee performs the following functions:

- Review accounting and financial policies and procedures.
- Review the integrity of the Bank financials and internal controls.
- Recommend appointment of external auditors.
- Review and assess external and internal audit work.
- Ensure that management has appropriate controls for identifying and monitoring of risk, compliance and practice standards.
- Oversee the internal audit function
- Encourage culture of accountability in the bank and, particularly, for financial matters.

Executive Committee

Role

The Committee performs the following functions:

- The Committee plays an effective supervisory role in Elaf Bank's business decisions.
- It oversees the Bank's long term policy objectives of the Bank and its activities and has among other, the duties of developing and reviewing strategies, framework, policies and procedures for the approval of the Board.
- The Committee reviews the plans and annual budgets of the Bank and monitors performance of the Bank against these plans and budgets.
- The Committee assesses and approves new product or activities proposed by the business units. It identifies business opportunities both in terms of products, acquisition or disposals.
- The Committee decides on all investments within its authoritative limits delegated by the Board.

Nomination and Remuneration Committee

Role

The Committee performs the following functions:

- The Committee identifies and recommends members of the Board and senior management.
- Recommends remuneration for duties and for senior management.
- Reviews the Bank's remuneration policy for approved persons.
- Recommends Board members remuneration based on attendance and performance.
- Monitors compliance of the bank with the CBB relevant corporate rules.
- Monitors evolution of the bank corporate structure.

Board's Committees

Risk Committee

Role

The Committee performs the following functions:

- The Committee plays a key role in advising and assisting the Board in the implementation of risk management framework keeping in view the recommended Basel II framework.
- The Committee is responsible to oversee the Bank's risk management framework, and ensure that the procedures for identification, assessment, monitoring, mitigating, and managing risks are in place and operating effectively to reach compliance with internal risk management guidelines and Basel II.

Executive Management

Executive Management

Elaf Bank has an Executive Management team delegated by the Board to manage the overall activities of the Bank, and reinforce its financial and operational performance. The Executive Management takes the responsibility of operating the Bank in an effective, ethical and legal manner designed to produce significant and consistent value for its shareholders with the Bank's policies and standards.

The executive management team comprises:

Mohamed A. Aljasim
Chief Investment Officer

Mr. Mohamed A. Aljasim was appointed Chief Investment Officer of Elaf Bank in 2013 subsequent to the merger of Elaf Bank, Capital Management House (CMH) and CAPIVEST. He has over 13 years of extensive experience in venture capital, private equity, real estate, asset management and fund raising within various industry segments.

Before his appointment at Elaf, Mr. Aljasim handled the responsibility of Chief Investment Officer at CMH, Senior Executive Director and Head of Investment Banking at Gulf Finance House BSC (c), and held directorships in other companies.

He graduated from the University of Portsmouth, UK with a BA (Hons) Accounting in 1999.

Sameeh Abdulla Al Khan
Chief Operating Officer

Mr. Sameeh Al Khan joined Elaf Bank in 2013 as a Chief Operating Officer following the successful merger of Elaf Bank with CAPIVEST and Capital Management House. Mr. Al Khan has over 28 years of industry experience in different strategic positions, in both conventional and Islamic banking.

Prior to his appointment at Elaf Bank, Mr. Al Khan served as Chief Operating Officer at CAPIVEST, Vice President, Head of Operation at Ithmar Bank and Assistant Manager – Retail Services at National Bank of Bahrain

Mr. Al Khan holds an Advanced Management Diploma from the Bahrain Institute of Banking and Finance.

Management's Committees

In 2013, Elaf Bank appointed two Management Committees to support in managing and overseeing the Bank's activities, and in proposing new strategies, policies, and procedures to the Board.

Asset and Liability Committee (ALCO)

Function

The Committee is responsible for monitoring the balance sheet, liquidity management and capital adequacy of the Bank. The Committee, in coordination with others, develops policies on diversification and liquidity.

Members

Chairman until the appointment of CEO	Chairman
Chief Operating Officer	Member
Chief Investment Officer	Member
Head of Financial Control	Member
Head of Treasury & Capital Market	Member
Head of Risk Management	Member

Investment, Credit and Risk Committee

Function

The Committee is responsible for the oversight of day-to-day operations of the Bank. It monitors the performance of all business lines and departments in relation to the Bank's strategies, policies, targets and limits. It also has the overall responsibility of managing the assets and liabilities of the Bank, as well as oversees the Bank's risk management policies to ensure compliance with various regulatory requirements.

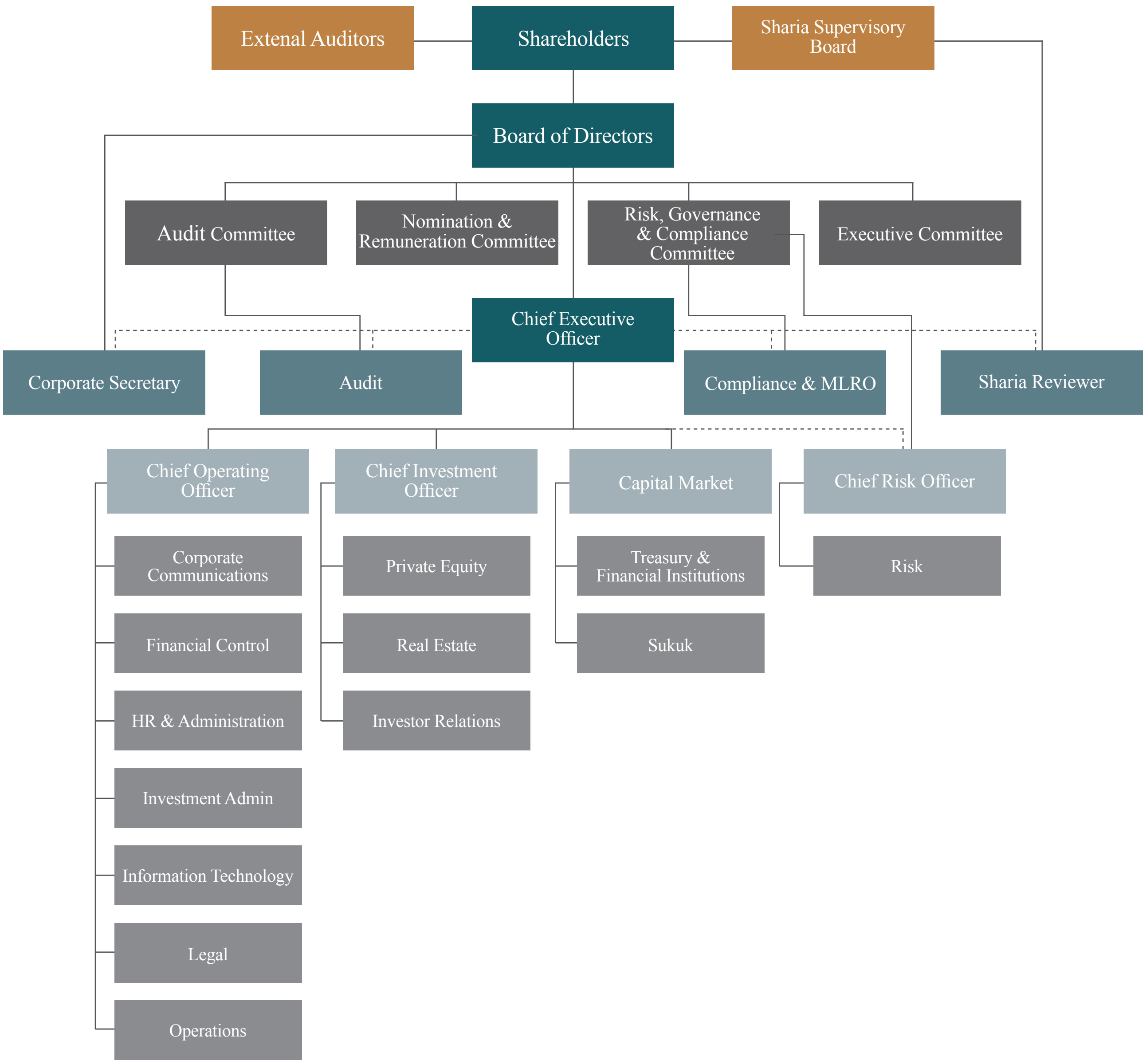
Members

Chairman until the appointment of CEO	Chairman
Chief Operating Officer	Member
Chief Investment Officer	Member
Head of Risk Management	Non Voting Member
Head of Legal	Non Voting Member

Organizational Structure

As at 1 January 2013

The new Board of Directors approved a revised organizational structure post the three way merger as depicted below:



Risk Management and Compliance

RISK MANAGEMENT

Elaf Bank has always been committed to improve its risk management. Therefore, the Bank developed an integrated risk management framework aimed at setting the best course of action under uncertainty by identifying, measuring, prioritizing, monitoring and managing the Bank specific and market wide (systemic) risks. The Bank manages risk through a framework of sound risk principles that include an optimum organizational structure, well defined policies and procedures, risk review and monitoring process that are closely aligned with our long term business strategy.

The Bank strives on a continuous basis to reinforce and improve its risk policies and procedures. The decision-making process at Elaf Bank always includes risk assessment, risk audit, and risk control. The Bank has a stringent approach to risk management, and strives to effectively manage and control exposures to risk.

All through 2012, Elaf Bank has implemented additional plans and programs in line with recommended Basel II risk management framework, and based on the lessons learnt in the market from the global financial crises. These plans and programs have proven to be effective in identifying, measuring, monitoring, and controlling investment activity and operational risks. They also reinforced the Bank's adherence to the Sharia principles and its full compliance with all laws and regulations pertaining to Islamic financial institutions.

Roles' Distribution

Board of Directors

The Board at Elaf Bank has the responsibility and obligation to approve and adopt Risk Management and Compliance policies and procedures, which are reviewed and evaluated on a regular basis. These policies and procedures establish clear goals, risk limits and risk tolerance based upon the Board investment orientations and strategies and the market general environment. They also identify approval authorities, and reporting requirements. Furthermore, the Board reviews the Executive Management's periodic reports regarding the on-going and in-the-pipeline investments and investment opportunities. Accordingly, necessary actions and measures are taken in order to ensure that all activities are in full respect to the Board risk policies and procedures, as well as related regulations.

Risk Management Committee

The Board Risk Management Committee plays a key role in advising and assisting the Board in the implementation of a risk management framework keeping in view of the recommended Basel II framework and Central Bank of Bahrain requirements. The Committee assists the Board in discharging its accountability and responsibility for risk management of the Bank-wide risk management systems, practices, and procedures including credit, market, and operational risk, and providing recommendations for improvement.

COMPLIANCE

Elaf Bank is keen to comply with the principles of Islamic Sharia, regulations and guidelines of the Central Bank of Bahrain, Commercial Companies and Labor laws applied in Bahrain, Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions, and Basel II requirements. Elaf Bank has reinforced in 2012 its compliance process, and has taken all necessary measures to guarantee the conformity of its banking activities and staff with the requirements of the regulatory and statutory Boardies, and industry standards and codes. The Bank has also established clear standards to protect its subsidiaries, special purpose vehicles, and joint ventures, and make sure they do not breach any law or regulation inside and outside Bahrain.

Elaf Bank has a strict "know-your-customer" process, and it only establishes business relationships after thorough screening to clearly identify each counter party. All the Bank's employees received in 2012 a training related to the anti-money laundering laws and practices in the Kingdom of Bahrain.

Sharia Supervisory Board

Sharia Supervisory Board

The Sharia Supervisory Board at Elaf Bank is a key player in the overall performance of the Bank. It forms an integral part of the operations as it reviews all the transactions and projects to ensure that they are fully compliant, and in accordance, with the rules and principles of the Islamic Sharia.

On 29 January 2013, the Ordinary General Meeting of Elaf Bank appointed a new Sharia'ah Supervisory Board comprises of most leading, prominent and distinguished scholars and experts who possess both academic excellence and practical experience in the application of Sharia principles, gained through their positions as professors at Islamic universities and Sharia colleges or as consultants in the public and private sectors.

Elaf Bank's Sharia Supervisory Board members are:

His Eminence Dr. Abdul-Sattar Abdul-Kareem Abu-Ghuddah
Chairman

Dr. Abu Ghuddah is a Syrian national holding two Bachelor degrees in Law and Sharia from the University of Damascus; and two Master Degrees in Sharia and Hadith, and a PhD in Comparative Fiqh from the Al-Azhar University in Egypt. Dr. Abu Ghuddah is an active member of the Islamic Fiqh Academy, which evolved from the Organization of Islamic Conference in Jeddah, KSA. He is also a member of the Accounting Standards Board and Sharia Board of AAOIFI in Bahrain. Dr. Abdul Sattar teaches Fiqh, Islamic studies and Arabic in Riyadh and has performed the valuable task of researching information for the Fiqh Encyclopaedia complied by the Ministry of Awqaf and Islamic Affairs in Kuwait.

He is currently the chairman and member of the Sharia supervisory boards of numerous international Islamic banks and financial institutions and specifically in the Gulf region, and a member in the Sharia Board of the Central Bank of Bahrain. In addition to his participation in Islamic finance conferences, Dr. Abdul Sattar Abou Ghuddah is also very prominent for his publications in the various topics of Islamic banking.

His Eminence Shaikh Adnan Abdulla Al Qattan
Board Member

Shaikh Adnan Abdulla Al Qattan a Bahraini national holding a Bachelor's degree in Islamic Sharia from the Islamic University, Madinah, Saudi Arabia, and a Master's degree in Quran and Sunnah from the University of Um Al-Qura, Makkah, Saudi Arabia.

Shaikh Al Qattan is the Chairman of Bahrain's Hajj Mission, President of the Supreme Sharia Appeal Court, and a member of the Supreme Council for Islamic Affairs. He is also the President of the Board of Trustees of Al Sanabel Orphans Care and Vice-President of the Royal Charity Organization.

Shaikh Al Qattan serves in the Sharia Supervisory Board of various Islamic banks and financial and investment institutions, beside being Friday sermon orator at Al-Fatih Grand Mosque in Manama (Bahrain).

Sharia Supervisory Board

His Eminence Shaikh Nidham Mohammed Saleh Yaquby
Board Member

Shaikh Nidham Mohammed Saleh Yaquby is a Bahraini national holding a Bachelor's degree in Economics and Comparative Religion from McGill University, Montreal and PhD from Lahaye University. Shaikh Nidham obtained his Sharia knowledge and teachings from prominent Sharia scholars in the Gulf region and achieved their highest valuation. Shaikh Nidham is the chairman and member in numerous Sharia supervisory boards of international Islamic banks and financial institutions including the Dow Jones Islamic Index. He is a member of the Sharia board of Central Bank of Bahrain, the AAOIFI Sharia Board, and the Islamic Rating Agency Sharia Board. Shaikh Nidham is also very prominent for his participation, contribution in international Islamic finance conferences, and offering financial solutions and instruments for contemporary financing schemes.

Shaikh Yaquby is a visiting professor at the International Islamic University, Malaysia.

Report of the Sharia Supervisory Board

بنك إيلاف
ELAF BANK

To the Shareholders of ELAF Bank,

Assalam Alaykum Wa Rahmatul-Allah,

In compliance with the letter of appointment, we are required to submit the following report:

We have reviewed the principles and contracts relating to the transactions and applications introduced by ELAF Bank and its affiliates during **the year ending December 31, 2012**. We have also conducted our review to form an opinion as to whether ELAF Bank and its affiliates have complied with Shari'a rules and principles, and also with specific "fatwa" rulings, and guidelines issued by the Shari'a Supervisory Board.

We conducted our review directly, or through the Internal Shari'a Compliance Department, which included examining, on sample basis of each type of transactions, the relevant documentation and procedures adopted by ELAF Bank. We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that ELAF Bank and its affiliates have not violated Islamic Shari'a rules and principles.

Our responsibility is restricted to provide an independent opinion, based on our review of the operations of ELAF Bank and its affiliates, and report to you. The management of ELAF Bank is responsible to ensure that the financial institution conducts its business in accordance with Islamic Shari'a rules and principles.

Based on the above, the Shari'a Supervisory Board discloses the following opinion:

A) the contracts, transactions and dealings entered into by ELAF Bank and its affiliates during **the year ending December 31, 2012**, which we have reviewed, are in compliance with Islamic Shari'a rules and principles;

B) the allocation of profit and charging of losses relating to investment accounts conform to the basis that have been approved by the Shari'a Supervisory Board and in accordance with Islamic Shari'a rules and principles;

C) all earnings have been realized from sources or by means permitted by Islamic Shari'a rules and principles;

D) the calculation, and payment of Zakat is the responsibility of the shareholders.

We pray to Allah the Almighty to grant us all the success and straight-forwardness.

Dr. Abdul-Sattar Abou Ghuddah Shari'a Board Member	Shaikh Adnan Alqattan Shari'a Board member	Shaikh Nizam Ya'aqubi Shari'a Board member

Kingdom of Bahrain , 12 /5/1434 Hijri , 24/3/2013 .

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Elaf Bank B.S.C.(c) is a CBB Licensed Wholesale Islamic Bank

بنك إيلاف ش.م.ب.(م) مرخص من قبل مصرف البحرين المركزي كبنك جملة إسلامي

“With the merger comes, the hope of a more efficient bank, which will have greater size and scale making it better equipped to compete and deliver enhanced value.”

Paul Andrew Mercer

Financial Performance

Report of the External Auditor

ERNST & YOUNG

We have audited the accompanying consolidated statement of financial position of Elaf Bank B.S.C. (c) ("the Bank") and its subsidiaries ("the Group") as of 31 December 2012, and the related consolidated statements of income, cash flows, changes in owners' equity and changes in off-balance sheet equity of investment accountholders for the year then ended. These consolidated financial statements and the Group's undertaking to operate in accordance with Islamic Sharia Rules and Principles are the responsibility of the Group's Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2012, the results of its operations, its cash flows, changes in owners' equity and changes in off-balance sheet equity of investment accountholders for the year then ended in accordance with the Financial Accounting Standards issued by AAOIFI.

Other Matters

As required by the Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) Rulebook (Volume 2), we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith; and
b) the financial information contained in the Report of the Board of Directors is consistent with the consolidated financial statements.

We are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rulebook (Volume 2 and applicable provisions of Volume 6) and CBB directives or the terms of the Bank's memorandum and articles of association having occurred during the year ended 31 December 2012 that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests. The Bank has also complied with the Islamic Sharia Rules and Principles as determined by the Sharia Supervisory Board of the Group.

Ernst + Young

27 March 2013
Manama, Kingdom of Bahrain

ELAF BANK B.S.C. (c)
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
At 31 December 2012

	Notes	2012 USD	2011 USD
ASSETS			
Cash and balances with banks	4	**12,986,997**	2,354,933
Due from financial institutions	5	**35,083,388**	14,206,052
Financing receivable	6	**13,698,448**	3,272,458
Musharaka financing	7	**1,902,720**	958,810
Receivable from Ijarah investors	8	**14,800,849**	-
Investment in ijarah asset	9	**4,961,974**	7,650,409
Ijarah muntahia bittamleek	10	**1,905,822**	-
Investments in securities	11	**232,067,260**	109,957,281
Investment in associates	12	**5,046,963**	3,444,085
Investment in real estate	13	**38,441,871**	15,842,773
Development properties	14	**16,173,111**	-
Non-current asset held for sale	15	**1,326,260**	-
Fixed assets	16	**433,070**	1,566,186
Other assets	17	**3,938,566**	1,704,978
TOTAL ASSETS		**382,767,299**	160,957,965
LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNER'S EQUITY			
Liabilities			
Due to financial institutions	18	**39,036,923**	4,543,500
Due to non financial institutions	19	**435,408**	-
Other liabilities	20	**15,641,883**	1,646,066
Total liabilities		**55,114,214**	6,189,566
EQUITY OF INVESTMENT ACCOUNTHOLDERS	21	**1,263,633**	-
OWNERS' EQUITY			
Share capital	22	**300,000,000**	200,000,000
Share premium	22	**16,385,368**	-
Statutory reserve	22	**676,313**	676,313
Accumulated losses	22	**-**	(45,011,717)
Investment fair value reserves	22	**796,081**	(896,197)
General reserve	22	**4,618,036**	-
Equity attributable to parent's shareholders		**322,475,798**	154,768,399
Non-controlling interest		3,913,654	-
Total owners' equity		**326,389,452**	154,768,399
TOTAL LIABILITIES, EQUITY OF INVESTMENT ACCOUNT HOLDERS AND OWNER'S EQUITY		**382,767,299**	160,957,965
OFF BALANCE SHEET:			
EQUITY OF INVESTMENT ACCOUNT HOLDERS		**111,994,905**	-
COMMITMENTS	34	**14,277,462**	3,266,472

Paul Mercer Chairman	Mohamed Al Adsani Vice Chairman

The attached notes from 1 to 38 form part of these consolidated financial statements.

ELAF BANK B.S.C. (c)

CONSOLIDATED STATEMENT OF INCOME

For the year ended 31 December 2012

	Notes	2012 USD	2011 USD
INCOME			
Profit from Islamic financing	23	**2,575,200**	2,781,574
Profit on Islamic financing		**(170,704)**	(59,333)
Net income on Islamic financing		**2,404,496**	2,722,241
Income from investment in securities	24	**9,263,830**	6,979,459
Income from investment banking services		**218,760**	20,000
Other income - net		**6,208**	67,047
Total income		**11,893,294**	9,788,747
EXPENSES			
Staff cost	25	**4,280,076**	5,130,200
Depreciation and amortisation	26	**1,268,853**	1,110,599
Other expenses	27	**3,577,206**	2,829,350
Total expenses		**9,126,135**	9,070,149
NET INCOME BEFORE ACQUISITION EXPENSES, PROVISION AND IMPAIRMENT		**2,767,159**	718,598
Provision and impairment	28	**(6,621,795)**	(4,888,684)
Acquisition expenses	29	**(8,515,611)**	-
NET LOSS FOR THE YEAR		**(12,370,247)**	(4,170,086)

Paul Mercer
Chairman

Mohamed Al Adsani
Vice Chairman

The attached notes from 1 to 38 form part of these consolidated financial statements.

ELAF BANK B.S.C. (c)
CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31 December 2012

	Notes	2012 USD	2011 USD
OPERATING ACTIVITIES			
Net loss for the year		**(12,370,247)**	(4,170,086)
Adjustment for non cash items:			
Depreciation and amortisation	26	**1,268,853**	1,110,599
Fixed assets write off	27	**765,320**	-
Gain on sale of investments	24	**(3,642,144)**	(852,707)
Gain on amalgamation	3	**(32,524)**	-
Gain on sale of fixed assets		**(17,560)**	-
Net amortisation of discount and premium		**(594,762)**	(1,433,016)
Impairment and provision	28	**6,621,795**	4,888,684
Operating profit (loss) before changes in operating assets and liabilities		**(8,001,269)**	(456,526)
Changes in operating assets and liabilities:			
Financing receivable		**1,946,072**	11,829,650
Musharaka financing		**(75,951)**	(965,834)
Ijarah muntahia bittamleek		**(1,905,822)**	-
Other assets		**(462,267)**	(275,628)
Other liabilities		**7,212,176**	869,312
Net cash (used in) from operating activities		**(1,287,061)**	11,000,974
INVESTMENT ACTIVITIES			
Purchase of investment in securities		**(91,788,574)**	(48,385,029)
Proceeds from sale of investment in securities		**94,190,008**	38,682,496
Purchase of fixed assets		**(88,091)**	(598,262)
Proceeds from sale of fixed assets		**17,560**	-
Net cash from (used in) investing activities		**2,330,903**	(10,300,795)
FINANCING ACTIVITY			
Due to financial institutions		**9,484,438**	4,543,500
Net cash from financing activity		**9,484,438**	4,543,500
NET INCREASE IN CASH AND CASH EQUIVALENTS		**10,528,280**	5,243,679
Cash and cash equivalents at 1 January		**16,560,985**	11,317,306
Cash and cash equivalents received on amalgamation		**16,444,807**	-
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		**43,534,072**	16,560,985
CASH AND CASH EQUIVALENTS COMPRISE:			
Cash and balances with banks	4	**12,986,997**	2,354,933
Due from financial institutions with original maturity of 90 days or less	5	**30,547,075**	14,206,052
		43,534,072	16,560,985

The attached notes from 1 to 38 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

For the year ended 31 December 2012

	Notes	Share capital	Share premium	Statutory reserve	Accumulated losses	Investment fair value reserve	General reserve	Total	Non - controlling interest	Total owners' equity
		USD	USD	USD	USD	USD	USD	USD	USD	USD
Balance at 1 January 2012		200,000,000	-	676,313	(45,011,717)	(896,197)	-	154,768,399	-	154,768,399
Reduction of share capital	22.a	(62,000,000)	-	-	45,011,717	-	16,988,283	-	-	-
Issue of shares	22.b	162,000,000	16,385,368	-	-	-	-	178,385,368	-	178,385,368
Net loss for the year		-	-	-	(12,370,247)	-	-	(12,370,247)	-	(12,370,247)
Transfer to other reserve	22.a	-	-	-	12,370,247	-	(12,370,247)	-	-	-
Acquisition of non-controlling interests		-	-	-	-	-	-	-	3,913,654	3,913,654
Cumulative changes in fair values		-	-	-	-	367,776	-	367,776	-	367,776
Transfer to statement of income on imapirment	22.b	-	-	-	-	1,324,502	-	1,324,502	-	1,324,502
Balance at 31 December 2012		**300,000,000**	**16,385,368**	**676,313**	**-**	**796,081**	**4,618,036**	**322,475,798**	**3,913,654**	**326,389,452**
Balance at 1 January 2011		200,000,000	-	676,313	(40,841,631)	(1,201,823)	-	158,632,859	-	158,632,859
Net loss for the year		-	-	-	(4,170,086)	-	-	(4,170,086)	-	(4,170,086)
Cumulative changes in fair values		-	-	-	-	305,626	-	305,626	-	305,626
Balance at 31 December 2011		200,000,000	-	676,313	(45,011,717)	(896,197)	-	154,768,399	-	154,768,399

The attached notes from 1 to 38 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN OFF-BALANCE SHEET EQUITY OF INVESTMENT ACCOUNT HOLDERS

For the year ended 31 December 2012

	Cash	Marketable equity securities portfolio	Unlisted securities portfolio	Real estate portfolio	Total
	USD	USD	USD	USD	USD
Balance at 1 January 2012	-	-	-	-	**-**
Additions by amalgamation (note 3)	1,263,634	1,756,161	66,250,381	42,724,729	**111,994,905**
Balance at 31 December 2012	**1,263,634**	**1,756,161**	**66,250,381**	**42,724,729**	**111,994,905**

On 31 December 2012, via letter no. EDBS/KH/337/2012, CBB approved the legal amalgamation of Capivest and CMH operations into the Bank in respect to which the net identifiable assets of CMH and Capivest as of 31 December 2012 were assumed by the Bank along with the off-balance sheet equity of investment accountholders.

The attached notes from 1 to 38 form part of these consolidated financial statements.

1 INCORPORATION AND ACTIVITIES

Elaf Bank B.S.C. (c) ("the Bank"), is a closed shareholding company incorporated in the Kingdom of Bahrain on 12 June 2007 under commercial registration (CR) number 65549. The Bank operates as an Islamic Wholesale Investment Bank under a license issued by the Central Bank of Bahrain ("the CBB"). The Bank's registered office is Zamil Tower, 6th Floor, Al Khalifa Avenue, Block 305, Manama, Kingdom of Bahrain.

During the year, the shareholders of the Bank approved the merger of the Bank with Capivest B.S.C (c) (Capivest) and Capital Management House B.S.C. (CMH) where Capivest and CMH operations were amalgamated into the Bank's operations to form the Merged Entity in accordance with Article 312 (a) (1) of the Bahrain Commercial Companies Law. The merger was approved by the CBB and the Ministry of Industry and Commerce on 13 September 2012 and 11 October 2012 respectively subject to a 90 days no objection period. On 31 December 2012, via letter no. EDBS/KH/337/2012, CBB approved the legal amalgamation of Capivest and CMH operations into the Bank in respect to which the assets of CMH and Capivest as of 31 December 2012 were takenover and liabilites of CMH and Capivest as of 31 December 2012 were assumed by the Bank along with the off-balance sheet equity of investment accountholders. As a consideration for the above amalgamation the Bank issued 162,000 thousand shares to the shareholders of Capivest and CMH for a shareholding of 23% and 31% respectively in the merged entity. This transaction is considered as acquisition of CMH and Capivest by the Bank and has been accounted for accordingly. As the acquisition took place on the last day of the financial year of the Bank (31 December 2012), the statement of financial position has been consolidated and there is no impact on the statement of income due to the acquisition of CMH and Capivest by the Bank.

The Bank's activities are regulated by the CBB and supervised by a Sharia Supervisory Board whose role is defined in the Bank's Memorandum and Articles of Association.

The principal activities of the Bank and its subsidiaries ("the Group") include investment advisory services and investment transactions, which comply with Islamic rules and principles according to the opinion of the Bank's Sharia Supervisory Board.

The Bank carries out its business activities through its head office in the Kingdom of Bahrain and its branch in Malaysia. The branch was granted a license to perform Islamic banking business on 15 June 2011 under Islamic Banking Act 1983.

These consolidated financial statements were authorised for issue in accordance with a resolution of the Board of Directors on 27 March 2013.

2 ACCOUNTING POLICIES

2.1 Basis of preparation

The consolidated financial statements have been prepared on a historical cost basis, except for equity-type instruments at fair value through statement of income, equity-type instruments through equity, investment in real estate and non-current asset held for sale that have been measured at fair value. The consolidated financial statements are presented in United States Dollars, being the functional and reporting currency of the Group. All values are rounded to the nearest US Dollar thousands unless otherwise indicated.

Statement of Compliance

The consolidated financial statements are prepared in accordance with the Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("the AAOIFI"), the Sharia Rules and Principles as determined by the Sharia Supervisory Board of the Group, the Bahrain Commercial Companies Law, the CBB and Financial Institutions Law, and the CBB regulations (as contained in Volume 2 and applicable provisions of Volume 6 of CBB rulebook) and directives. In accordance with the requirements of AAOIFI, for matters which are not covered by the AAOIFI standards including "Interim Financial Reporting," the Group uses the relevant International Financial Reporting Standards ("the IFRS") issued by International Accounting Standards Board ("the IASB").

2 ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at and for the year ended 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that control ceases. Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Special Purpose Vehicles (SPVs) for holding investments which are intended to be marketed within twelve months from their acquisition to portfolio customers are not consolidated in the financial statements and are presented as “Non-current assets held for sale”.

Non-controlling interest represents the portion of net income and net assets not held, directly or indirectly, by the Group and are presented separately in the consolidated statement of income and within owners’ equity in the consolidated statement of financial position, separately from the parent shareholders’ equity.

The following are the principal subsidiaries of the Bank, which are consolidated in these consolidated financial statements:

2 ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

	Company Subsidiaries	Activities	Year of incorporation	Country of incorporation	Ownership 2012	Ownership 2011
1	Elaf Bahrain Real Estate Company B.S.C. (c)	Subsidiary to purchase and sale all kinds of real estate properties	2008	Kingdom of Bahrain	100%	100%
2	Elaf Corporate Services Limited	Subsidiary to manage its affiliated companies	2008	British Virgin Islands	100%	100%
3	Sokouk Exchange Centre – Tadawul Holding W.L.L.	Subsidiary to manage its affiliated companies	2008	Kingdom of Bahrain	100%	100%
4	Tamkeen Investment Company B.S.C. (c)	Subsidiary to administer Management Incentive Program ("MIP")	2008	Kingdom of Bahrain	100%	-
5	Suffun Bahrain W.L.L. **	SPV for an associated company investment	2010	Kingdom of Bahrain	100%	-
6	Suffun Investment Company *	SPV for investors investment in an associated company	2010	Cayman Island	100%	-
7	GCC Balanced Growth Fund Company B.S.C.(c)	SPV for GCC Balanced Growth Fund	2010	Kingdom of Bahrain	100%	-
8	Medical Management Group SPC	SPV to Investment in health care	2005	Kingdom of Bahrain	100%	-
9	Omavest Holding W.L.L.	SPV to Investment in various projects	2009	Kingdom of Bahrain	100%	-
10	Capivest Real Estate Fund	SPV to Investment in various projects	2010	Kingdom of Bahrain	100%	-
11	Sakan Development Company Limited	SPV to Investment in real estate	2006	Cayman Island	70.91%	-

* Subsidiary not operational at 31 December 2012.

** Subsidiary is held as "Non-current assets held for sale"

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies

The significant accounting policies adopted in the preparation of the consolidated financial statements are set out below:

a. Cash and cash equivalent

Cash and cash equivalents as referred to in the consolidated statement of cash flows comprise cash and balances with banks and amounts due from financial institutions with original maturities of 90 days or less.

b. Due from financial institutions

Commodity murabaha receivables

Commodity murabaha receivables are sales on deferred terms. The Group arranges a murabaha transaction by buying a commodity (which represents the object of the murabaha) and then resells this commodity to a Murabeh (beneficiary) after computing a margin of profit over cost. The sale price (cost plus the profit margin) is repaid in instalments by the Murabeh over the agreed period.

These are stated net of deferred profits, and provision for doubtful debts, if any. The Group considers the promise made by the purchase orderer in a Murabaha contract as obligatory.

Mudaraba investments

Mudaraba investments are stated at the fair value of consideration given less impairment, if any.

A Mudaraba investment is a partnership where the Group ("Rabbalmal") gives money to another ("Mudarib") for investing in a commercial enterprise for a definite period of time.

Mudaraba capital provided by the Group at inception in kind (if other than cash) is measured at the fair value of the assets. If the valuation of assets results in a difference between fair value and book value, such difference is recognized as profit or loss to the group.

In case Mudaraba capital is lost or damaged prior to the inception of work without misconduct or negligence on the part of the mudarib, then such losses are deducted from mudaraba capital and are treated as a loss to the Group. In the case of termination or liquidation, the unpaid portion by the mudarib is recognized as receivable due from the mudarib.

c. Financing receivables

Financing receivables are stated at cost net of deferred profit and provision for impairment, if any. The Group considers the promise made by the purchase orderer in a financing contract as obligatory. Specific provisions are created for impairment where losses are expected to arise on non-performing contracts. The receivables are written off when they are considered to be uncollectible to reduce all impaired financing receivables to their expected realisable values.

d. Musharaka financing

Musharaka is a form of capital partnership. These are stated at the fair value of consideration given less any impairment. Musharaka capital provided by the Group at inception in kind (if other than cash) is measured at the fair value of the assets. If the valuation of assets results in difference between fair value and book value, such difference is recognized as profit or loss to the Group.

e. Investment in ijarah assets and ijarah muntahia bittamleek

These are initially recorded at cost including initial direct costs. Ijarah muntahia bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the ijarah (lease term),

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

e. Investment in ijarah assets and ijarah muntahia bittamleek (continued)

provided that all ijarah installments are settled. These assets are stated at cost less accumulated depreciation.

Depreciation is calculated using the straight-line method on Ijarah muntahia bittamleek assets at rates calculated to write off the cost of each asset over its lease term. For Ijarah assets, the depreciation is calculated using the straight-line method, at rates calculated to write off the cost of the assets over its estimated useful life.

f. Investments in securities

Investments comprise equity-type instruments at fair value through statement of income, equity-type instruments at fair value through equity and debt-type instruments at amortised cost.

Investments are recognised on the acquisition date at their fair value plus transaction costs, except for "investments at fair value through statement of income". Transaction costs relating to "investments at fair value through statement of income" are charged to the consolidated statement of income when incurred.

Equity-type instruments at fair value through statement of income

This includes instruments held for the purpose of generating profits from the short term market fluctuations. These are initially recognised at cost, being the fair value of the consideration given excluding acquisition costs. These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the consolidated statement of income.

All other investments are initially recognised at cost, being the fair value of the consideration given including transaction costs.

Equity-type instruments at fair value through equity

These include all equity-type instruments that are not fair valued through statement of income. Subsequent to acquisition, these are re-measured at fair value with unrealised gains or losses recognised directly in owners' equity under "Investment fair value reserve" until the investment is derecognised or determined to be impaired at which time the cumulative gain or loss previously recorded in owners' equity is recognised in consolidated statement of income.

Instruments which do not have a quoted market price or other appropriate methods from which to derive reliable fair values are stated at cost less impairment.

The losses arising from impairing fair value through equity investments are recycled in the consolidated statement of income in "provision for impairment" and removed from the cumulative changes in fair value reserve. Subsequent increases in the fair value of investments at fair value through equity are not reversed through the consolidated statement of income.

Debt-type instruments at amortised cost

These are managed on a contractual yield basis and are not held for trading and has not been designated at fair value through statement of income are classified as debt-type instruments at amortised cost. Such investments are carried at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such investment is recognised in the consolidated statement of income, when the investment is de-recognised or impaired.

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

g. Investment in associates

The Group's investment in its associates is accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture. Under the equity method, the investment in the associate is carried in the consolidated statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the associate. Where there has been a change recognised directly in the equity of the associate. The Group recognises its share of any changes and discloses this when applicable, in the statement of changes in owners' equity. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortised. The consolidated statement of income reflects the Group's share of the results of operations of the associate. If the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

h. Investment in real estate

All properties held for rental or for capital appreciation purposes, or both, are classified as investment in real estate. These are initially recognised at cost and subsequently re-measured at fair value with the resulting unrealized gains being recognised in the consolidated statement of changes in owners' equity under investment fair value reserves. Unrealized losses are recognised in equity to the extent of the available balance. In case cumulative losses exceed the available balance under equity, the excess is recognised in the consolidated statement of income under "provision for impairment".

i. Development properties

"Properties constructed and held for sale are classified as development properties. Unsold properties are stated at the lower of cost or net realisable value. The cost of development properties includes the cost of land and other related expenditure which are capitalised as and when activities that are necessary to get the properties ready for sale are in progress. Net realisable value represents the estimated selling price less costs to be incurred in selling the property."

j. Non-current assets held for sale

Subsidiaries/associates acquired with a view to subsequent disposal within 12 months are classified as non current assets "held-for-sale" when the sale is highly probable. Related assets and liabilities of the subsidiary/associate are shown separately on the consolidated statement of financial position as "Assets held-for-sale" and "Liabilities relating to assets held-for-sale". Assets that are classified as held-for-sale are measured at the lower of carrying amount or fair value less costs to sell. Any resulting impairment loss reduces the carrying amount of the assets. Assets that are classified as held-for-sale are not depreciated. Any impairment loss is recognised in the consolidated statement of income for any initial and subsequent write down of these assets to fair value, less costs to sell. A gain for any subsequent increase in the fair value, less costs to sell, is recognised to the extent that it is not in excess of the cumulative impairment loss that was previously recognised.

k. Fixed assets

Fixed assets are stated at cost, net of accumulated depreciation and impairment, if any. The cost of additions and major improvements are capitalised; maintenance and repairs are charged to the consolidated statement of income as incurred. Gains or losses on disposal are reflected in other income. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets.

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

k. Fixed assets (continued)

The calculation of depreciation and amortisation is on the following basis:

· Leasehold improvements	10 years*
· Computer hardware and software	3 years
· Furniture and fixture	5 years
· Office and electric equipment	5 years
· Motor vehicles	4 years

* The calculation of depreciation on leasehold improvements is calculated over the life of lease if less than 10 years.

l. Fair values

Fair value is determined for each financial asset individually in accordance with the valuation policies set out below:

(i) For investments that are traded in organised financial markets, fair value is determined by reference to the quoted market bid prices prevailing on the consolidated statement of financial position date.

(ii) For unquoted investments, fair value is determined by reference to recent significant buy or sell transactions with third parties that are either completed or are in progress. Where no recent significant transactions have been completed or are in progress, fair value is determined by reference to the current market value of similar investments or applying relevant valuation techniques including net present value of estimated future cash flows, comparison to similar instruments for which market observable prices exist and other relevant valuation models.

(iii) For investments that have fixed or determinable cash flows, fair value is based on the net present value of estimated future cash flows determined by the Group using current profit rates for investments with similar terms and risk characteristics.

(iv) Investments which cannot be remeasured to fair value using any of the above techniques are carried at cost, less provision for impairment.

m. Business combination

Business combinations are accounted for using the purchase method of accounting. This involves recognising identifiable assets and liabilities (including contingent liabilities) of the acquired business at fair value. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair values of the identifiable net assets acquired, the discount on acquisition is recognised directly in the consolidated statement of income in the year of acquisition.

n. Impairment of financial assets

The Group assesses at each financial position date whether there is objective evidence that a financial asset is impaired. In the case of equity-type instruments at fair value through equity, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for equity-type instruments at fair value through equity, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in consolidated statement of income) is removed from owners' equity and recognised in the consolidated statement of income. Impairment losses recognised in the consolidated statement of income on equity instruments are not subsequently reversed through the consolidated statement of income.

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

n. Impairment of financial assets (continued)

Impairment losses on financing receivables and debt-type instruments at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses, if any, are recognised in the consolidated statement of income and reflected in an allowance account against murabaha receivables and debt-type instruments at amortised cost. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the consolidated statement of income.

o. Due to financial institutions

These comprise placements received in the form of wakala and murabaha contracts. These arecarried at their amortised cost.

p. Equity of investment account holders

Equity of investment account holders are carried at fair value of consideration received plus accrued profits less amounts settled.

Total income pertaining to investment account holders is allocated to individual investment accounts on their daily weighted average balances.

q. Foreign currency transactions

Functional and presentation currency

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

Transactions and balances

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

Group companies

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

r. Revenue recognition

Profit from Islamic finances

Income from murabaha receivable is recognised when the income is quantifiable and contractually determined at the commencement of the contract, the income is recognised proportionately over the period of the contract.

Income on mudaraba is recognised when the right to receive payment is established or on distribution by the mudarib, where as losses are charged to income on declaration by the mudarib.

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

r. Revenue recognition (continued)

Income on musharaka financing is recognised when the right to receive payment is established. Income related to accounts that are 90 days overdue is excluded from the consolidated statement of income.

Income from investments

Income from debt-type instruments at amortised cost (investment in Sukuk) is recognised on a time-apportioned basis using the effective profit method.

Dividend income from equity-type instruments at fair value through equity is recognised when the right to receive is established. This is usually the ex-dividend date for equity securities.

Income from investment banking services

Income from investment banking services is recognised when the service is provided and income is earned. This is usually when the Group has performed all significant acts in relations to the service being rendered and it is highly probable that the economic benefits from the transaction will flow to the Group.

Other income

Other income on investments is recognised when the right to receive payment is established.

s. Employee's end of service benefits

Provision is made for leaving indemnity payable under the Bahraini Labour Law applicable to non-Bahraini employees' accumulated periods of service at the financial position date. Moreover provision for indemnity payable is also made for Bahraini employees.

Bahraini employees of the Group are covered by contributions made to the Social Insurance Organisation (SIO) as a percentage of the employees' salaries. the Group's obligations are limited to these contributions, which are expensed when due.

The Bank provides end of service benefits to its expatriate employees. Entitlement to these benefits is based upon the employees final salary and length of service, subject to completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment.

t. Provisions

A provision is recognised in the consolidated statement of financial position when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

u. Dividends

Dividends to shareholders are recognised as a liability when it is approved by the shareholders.

v. Off balance sheet equity of investment account holders

This represents funds received by the Group to be invested in specified products as directed by the investment account holders. The assets funded by these funds are managed in a fiduciary capacity by the Bank and are not included in the consolidated statement of financial position since the Group does not have the right to use or dispose these assets.

w. Zakah

In accordance with the instructions of Sharia Supervisory Board, payment of Zakah is the responsibility of the shareholders of the Group. Accordingly, no Zakah has been charged to the consolidated financial statements.

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

x. Fiduciary assets

The Group provides fiduciary services that result in holding or investing of assets on behalf of its employees. Assets held in a fiduciary capacity are not reported in the consolidated financial statements, as they are not the asset of the Group.

y. Social responsibility

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

z. Judgments and estimates

The preparation of the Group's financial statements requires management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated financial statements. The most significant uses of judgments and estimates are as follows:

Going concern

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Furthermore, the Board of Directors is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern. Therefore, the consolidated financial statements continue to be prepared on a going concern basis.

Classification of investments

Real estate investments acquired to earn rentals or for capital appreciation are classified as investment properties.

Management decides on acquisition of an investment whether it should be classified as an equity-type instrument at fair value through statement of income, an equity-type instrument at fair value through a equity or debt-type instrument at amortised cost.

Fair value of unquoted investments at fair value through equity

Where the fair value of the Group's investment portfolio cannot be derived from an organised market, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment by management is required to establish fair values. The judgments include consideration of comparable assets, discount rates and the assumptions used to forecast cash flows.

Fair value of investment in real estate

The fair value of investment in real estate is determined by independent real estate valuation experts. The determination of the fair value of such assets requires the use of judgment based on estimates by independent valuation experts that are based on local market conditions existing at the date of the statement of financial position.

Impairment

The Group treats investments classified as fair value through equity as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment. In making this judgment, the Group evaluates, among other factors, normal volatility in share price and duration and the extent to which the fair value of quoted equities is less than its cost and the future cash flows and the discount factors for unquoted equities.

2 ACCOUNTING POLICIES (continued)

2.2 Summary of significant accounting policies (continued)

z. Judgments and estimates (continued)

The Group reviews its doubtful financial contracts on each reporting date to assess whether a provision for impairment should be recorded in the statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

aa. Derecognition

A financial asset (or, where applicable a part of a financial asset or part of a Group of similar financial assets) is derecognised when:

(i) the right to receive cash flows from the asset have expired;

(ii) the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement;

or

(iii) the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

bb. Offsetting financial instruments

Financial assets and financial liabilities are only offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable or religious right to set off the recognised amounts and the Group intends to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

cc. Trade date accounting

All "regular way" purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset.

dd. Sharia supervisory board

The Group's business activities are subject to the supervision of a Sharia supervisory board consisting of three members appointed by the general assembly.

3 BUSSINESS COMBINATION

During the year, the shareholders of the Bank approved the merger of the Bank with Capivest and CMH where Capivest and CMH operations will be amalgamated into the Bank's operations to form the Merged Entity in accordance with Article 312 (a) (1) of the Bahrain Commercial Companies Law.

The merger was approved by the CBB and the Ministry of Industry and Commerce on 13 September 2012 and 11 October 2012 respectively subject to a 90 days no objection period. On 31 December 2012, via letter no. EDBS/KH/337/2012, CBB approved the legal amalgamation of Capivest and CMH operations into the Bank in respect to which the assets of CMH and Capivest as of 31 December 2012 were takenover and liabilites of CMH and Capivest as of 31 December 2012 were assumed by

3 BUSSINESS COMBINATION

the Bank along with the off-balance sheet equity of investment accountholders. As a consideration for the above amalgamation the Bank issued 162,000 thousand shares to the shareholders of Capivest and CMH for a shareholding of 23% and 31% respectively in the merged entity. This transaction is considered as acquisition of CMH and Capivest by the Bank and has been accounted for accordingly.

The following table sets out the net assets acquired and gain arising from the amalgamation:

	USD
Shares issued on amalgamation at fair value	**178,385,368**
Net identifiable assets at fair value	
Capivest	**84,250,410**
CMH	**94,167,482**
	178,417,892
GAIN ARISING ON AMALGAMATION	**32,524**

Assets acquired and liabilities assumed

The fair value of the identifiable assets and liabilities of Capivest and CMH as at the merger date 31 December 2012 were as follows:

	CAPIVEST USD	CMH USD	TOTAL USD
Assets			
Cash and balances with banks	7,674,533	1,392,088	9,066,621
Due from financial institutions	5,650,499	6,264,000	11,914,499
Financing receivable	12,372,062	-	12,372,062
Musharaka financing	-	916,916	916,916
Receivable from ijara investors	14,800,849	-	14,800,849
Investment in securities	42,623,515	80,627,365	123,250,880
Investment in associate	1,602,878	-	1,602,878
Investment in real estate	17,193,261	5,405,837	22,599,098
Development properties	16,173,111	-	16,173,111
Non current asset held for sale	-	1,326,260	1,326,260
Fixed assets	28,098	-	28,098
Other assets	1,501,442	270,499	1,771,941
Total assets	119,620,248	96,202,965	215,823,213
Liabilities			
Due to financial institutions	25,008,985	-	25,008,985
Due to non financial institutions	435,408	-	435,408
Other liabilities	6,011,791	771,850	6,783,641
Total liabilities	31,456,184	771,850	32,228,034
Equity of investment accountholders	-	1,263,633	1,263,633
Non-controlling interest	3,913,654	-	3,913,654
Total identifiable net assets at fair value	84,250,410	94,167,482	178,417,892

If the acquisition had taken place at the beginning of the year, revenue contributed would have been USD 5,500 thousand and the loss of the Group would have increased by USD 28,913 thousand.

4 CASH AND BALANCES WITH BANKS

	2012 USD	2011 USD
Cash	**7,542**	2,723
Balances with banks	**12,979,455**	2,352,210
	12,986,997	2,354,933

5 DUE FROM FINANCIAL INSTITUTIONS

	2012 USD	2011 USD
Mudaraba investments	**27,445,106**	14,206,052
Wakala investments	**2,000,014**	-
COMMODITY MURABAHA	**5,640,268**	-
	35,085,388	14,206,052
LESS: DEFERRED PROFITS	**(2,000)**	-
	35,083,388	14,206,052

Mudaraba investments include USD 1,264 thousands representing investments on behalf of Equity of Investment Accountholders.

As at 31 December 2012, CMH had a wakala investment of USD 2,000 thousand which was fully provided for and transferred to the Bank at its net book value being it's fair value. (note 3)

The original maturity of commodity murabahas receivables and mudaraba investments are as follows:

	2012 USD	2011 USD
Original maturity of 90 days or less	**30,547,075**	14,206,052
Original maturity of more than 90 days	**4,536,313**	-
	35,083,388	14,206,052

6 FINANCING RECEIVABLE

	2012 USD	2011 USD
Murabaha receivables	**14,044,503**	3,852,268
Less: Deferred profits	**(346,055)**	(579,810)
	13,698,448	3,272,458

As at 31 December 2012, Capivest had financing receivables of USD 1,323 thousand which were fully provided for and transferred to the Bank at its net book value being it's fair value. (note 3)

There were no past due nor impaired financing receivables as of 31 December 2012 (2011: Nil).

7 MUSHARAKA RECEIVABLE

	2012 USD	2011 USD
Musharaka financing	1,958,701	965,834
Less: Provision for impairment (note 28)	(55,981)	(7,024)
	1,902,720	958,810

An amount of USD 82 thousand of musharaka financing was impaired as of 31 December 2012 (2011: Nil).

8 RECEIVABLES FROM IJARA INVESTORS

Receivables from Ijara investors represent balances due from investors who participated in the Group's Ijara series products. The balance outstanding as of 31 December 2012 relates to amounts due from Ijara 9 investors of USD 11,408 thousand and Ijara 6 investors of USD 3,393 thousand which will be settled in accordance with the Ijara product structures. As of 31 December 2012, these receivables were neither past due nor impaired.

9 INVESTMENT IN IJARAH ASSETS

	2012	2011
	USD	USD
Cost:		
At 1 January	**8,616,025**	8,616,025
At 31 December	**8,616,025**	8,616,025
Depreciation:		
At 1 January	**965,616**	570,803
Charge for the year	**784,868**	394,813
At 31 December	**1,750,484**	965,616
Less: Provision for impairment (note 28)	**(1,903,567)**	-
Net book value:		
As at 31 December	**4,961,974**	**7,650,409**

The amount of future Ijarah instalments receivable as of 31 December 2012 is USD 1,638 thousand (2011: USD 1,940 thousand).

10 IJARA MUNTAHIA BITTAMLEEK

	2012	2011
	USD	USD
Equipment		
Cost:		
At 1 January	**-**	-
Addition for the year	**2,500,000**	-
At 31 December	**2,500,000**	-
Depreciation:		
At 1 January	**-**	-
Charge for the year	**594,178**	-
At 31 December	**594,178**	-
Net book value:		
As at 31 December	**1,905,822**	-

11 INVESTMENT IN SECURITIES

At 31 December 2012

	Amortised Cost USD	Fair value through equity USD	Fair value through statement of income USD	Total USD
Debt type				
Quoted sukuk	72,752,595	-	-	72,752,595
Equity type				
Quoted shares	-	13,665,212	-	13,665,212
Unquoted shares	-	128,645,865	20,347,737	148,993,602
Less: Impairment (note 28)	(371,342)	(2,972,807)	-	(3,344,149)
	72,381,253	139,338,270	20,347,737	232,067,260

At 31 December 2011

	Amortised Cost USD	Fair value through equity USD	Fair value through statement of income USD	Total USD
Debt type				
Quoted sukuk	58,720,579	-	-	58,720,579
Unquoted sukuk	16,791,279	-	-	16,791,279
Equity type				
Quoted shares	-	4,411,988	-	4,411,988
Unquoted shares	-	30,954,402	-	30,954,402
Less: Impairment (note 28)	-	(920,967)	-	(920,967)
	75,511,858	34,445,423	-	109,957,281

12 INVESTMENT IN ASSOCIATES

	2012 USD	2011 USD
At 1 January	3,444,085	3,444,085
Additions by amalgamation (note 3)	1,602,878	-
	5,046,963	3,444,085

Investment in associates comprise the following:

Name	Country of incorporation	%holding
Ali Iskandar Al Ansari and Partners W.L.L. *	State of Qatar	35%
Aqari Real Estate Company B.S.C. (c)	Kingdom of Bahrain	31.88%
Alpha Lease and Finance Holding Company B.S.C. (c) **	Kingdom of Bahrain	30%
Apex Real Estate Company B.S.C.(c) *	Kingdom of Bahrain	30%

* These associates are fully provided for and the financial information below does not include their financial information.

** The financial information below includes the information based on 30 September 2012 unaudited management accounts for this associate.

12 INVESTMENT IN ASSOCIATES (continued)

Summarised financial information of associates:

	2012	2011
	USD	USD
Total assets	**44,759,183**	21,160,250
Total liabilities	**14,506,911**	3,053,690

13 INVESTMENT IN REAL ESTATE

	2012	2011
	USD	USD
At 1 January	**15,842,773**	19,803,466
Addition by amalgamation (note 3)	**22,599,098**	-
Less: Provision for impairment (note 28)	**-**	(3,960,693)
	38,441,871	15,842,773

14 DEVELOPMENT PROPERTIES

	2012	2011
	USD	USD
Land	**5,943,959**	-
Development Cost	**10,229,152**	-
	16,173,111	-

15 NON-CURRENT ASSETS HELD FOR SALE

	2012	2011
	USD	USD
Suffun Bahrain W.L.L.	**1,326,260**	-
	1,326,260	-

The Bank's total commitment under Suffun Bahrain W.L.L. ("Suffun") is USD 11,406 thousand is included under uncalled capital commitments (note 33). Suffun continues to be designated as held for sale as the Bank is actively seeking to sell a majority stake in this investment to the investors.

16 FIXED ASSETS

	Lease hold improvements USD	Computer hardware and software USD	Furniture and equipment USD	Vehicles USD	Total USD
Cost:					
At 1 January 2011	1,115,707	1,588,653	236,119	150,716	3,091,195
Additions	302,941	295,321	-	-	598,262
At 31 December 2011	1,418,648	1,883,974	236,119	150,716	3,689,457
Additions	-	18,922	69,169	-	88,091
Additions by amalgamation (note 3)	-	28,098	-	-	28,098
Disposal	-	-	-	(83,872)	(83,872)
Less: Write off (note 27)	(1,115,707)	(1,789,597)	(236,119)	-	(3,141,423)
At 31 December 2012	**302,941**	**141,397**	**69,169**	**66,844**	**580,351**
Depreciation and amortisation:					
At 1 January 2011	230,772	910,474	129,260	136,979	1,407,485
Charge for the year	111,571	543,497	46,981	13,737	715,786
At 31 December 2011	342,343	1,453,971	176,241	150,716	2,123,271
Charge for the year	141,851	287,891	54,243	-	483,985
Disposal	-	-	-	(83,872)	(83,872)
Less: Write off (note 27)	(453,913)	(1,700,858)	(221,332)	-	(2,376,103)
At 31 December 2012	**30,281**	**41,004**	**9,152**	**66,844**	**147,281**
Net book values:					
At 31 December 2012	**272,660**	**100,393**	**60,017**	**-**	**433,070**
At 31 December 2011	1,076,305	430,003	59,878	-	1,566,186

17 OTHER ASSETS

	2012 USD	2011 USD
Sales proceeds receivables	**1,302,935**	-
Prepaid expenses	**307,087**	190,866
Income receivable	**1,159,201**	1,315,168
Ijarah receivable	**630,133**	-
Staff receivable	**61,432**	11,514
Others	**477,778**	187,430
	3,938,566	1,704,978

18 DUE TO FINANCIAL INSTITUTIONS

	2012 USD	2011 USD
Murabaha payable	**21,355,038**	-
Wakala payable	**17,681,885**	4,543,500
	39,036,923	4,543,500

19 DUE TO NON FINANCIAL INSTITUTIONS

These mainly represent funds received from investors to be invested in entities to be set up or promoted by the Group.

20 OTHER LIABILITIES

	2012 USD	2011 USD
Acquisition payables	**8,017,873**	-
Provision for employee benefits	**1,609,222**	789,121
Due to Ijara investors	**1,073,424**	-
Directors' fee accrual	**520,823**	538,482
Accounts payables	**442,595**	121,991
Bonus accruals	**268,786**	-
Others	**3,709,160**	196,472
	15,641,883	1,646,066

21 EQUITY OF INVESTMENT ACCOUNT HOLDERS

Equity of investment account holders are funds of investees held by the Bank which it can invest as it deems appropriate without restriction as to where, how and for what purpose the funds are invested. These accounts are payable on demand and the account holder has the right to withdraw or transfer funds without penalty.

The Bank provides these accounts as an added service to investees who have idle cash and does not market these accounts as a product. Therefore, it is not the practice of the Bank to guarantee the preservation of capital or competitive rate of return through the creation of profit equalization reserves or investment risk reserves. As a result, the Bank has minimal displaced commercial risk.

These funds are invested in short term interbank placements with reputed financial institutions, thus making allowance for short-term liquidity requirements as well as reducing risk for the investment account holders. The funds are invested and managed in accordance with Sharia principles.

Profit paid to the investment account holders is based on the profit earned by the profit bearing assets.

22 OWNERS' EQUITY

(i) Share capital	2012 USD	2011 USD
Authorized:		
500,000,000 (2011: 500,000,000) ordinary shares at USD 1 per share	**500,000,000**	500,000,000
Issued, subscribed and paid up capital:		
At beginning of year:		
200,000,000 (2011: 200,000,000) shares at USD 1 per share	**200,000,000**	200,000,000
Reduction of share capital 62,000,000 shares (2011:nil)	**(62,000,000)**	-
Issued during the period :		
162,000,000 (2011:nil) ordinary shares of USD 1 each	**162,000,000**	-
Issued and paid up share capital at end of the year:		
300,000,000 (2011: 200,000,000) ordinary shares of USD 1 each	**300,000,000**	200,000,000

Following resolutions passed by the shareholders of the Bank at the Extraordinary General Meeting (EGM) held during the year and in compliance with the guidance of Ministry of Industry and Commerce:

22.a Reduced the issued and paid up share capital from USD 200,000 thousand to USD 138,000 thousand by offsetting accumulated losses of USD 45,012 thousand that resulted in a general reserve of USD 16,988 thousand. Further, current year losses of USD 12,370 thousand were offset against the general reseve which is subject to necessary regulatory approvals and will be submitted for formal approval at the Annual General Meeting. This resulted in a general reserve of USD 4,618 thousand as of 31 December 2012.

22.b Issued additional 162,000 thousand ordinary shares amounting to USD 162,000 thousand at a value of USD 1 per share including a premium of 0.1011 per share (USD 16,385 thousand).

22 OWNERS' EQUITY (continued)

Additional information on shareholding pattern

(a) Names and nationalities of the major shareholders and the number of shares in which they have an interest of 5% or more of outstanding shares as of 31 December:

	Country of incorporation	2012 % of holding	2012 Share capital
Aref Investment Group	Kuwait	**28.52%**	**85,560,000**
Kuwait Investment Company	Kuwait	**7.69%**	**23,072,427**
Gulf Investment House	Kuwait	**5.79%**	**17,357,403**

	Country of incorporation	2011 % of holding	2011 Share capital
Aref Investment Group	Kuwait	62.00%	124,000,000
Kuwait Investment Company	Kuwait	11.86%	23,720,000
Sokouk Holding Company	Kuwait	10.64%	21,280,000
Qatar Islamic Bank	Qatar	10.00%	20,000,000
Islamic Corporation for the Development of the Private Sector	Saudi Arabia	5.00%	10,000,000

(b) Distribution schedule of equity shares, setting out the number of holders and percentage in the following categories as of 31 December:

	2012		
Categories	***Number of shares***	***Number of shareholders***	***% of total outstanding shares***
Less than 5%	174,010,170	133	58.00%
5% up to less than 10%	40,429,830	2	13.48%
20% up to less than 50%	85,560,000	1	28.52%
	300,000,000	136	100.00%

	2011		
Categories	Number of shares	Number of shareholders	% of total outstanding shares
Less than 5%	1,000,000	1	0.50%
5% up to less than 10%	10,000,000	1	5.00%
10% up to less than 20%	65,000,000	3	32.50%
More than 50%	124,000,000	1	62.00%
	200,000,000	6	100.00%

(ii) *Share premium*
Amounts collected in excess of the par value of the issued share capital during any new issue of shares, net of issue expenses, are treated as share premium. This amount is not available for distribution, but can be utilised as stipulated by the Bahrain Commercial Companies Law and following the approval of CBB. (note:22.b)

22 OWNERS' EQUITY (continued)

(iii) *Reserves*

Statutory reserve
In accordance with the Bahrain Commercial Companies Law and the Bank's articles of association, 10% of the net profit for the year is transferred to the statutory reserve until such time as the reserve reaches 50% of the Bank's paid-up share capital. The reserve is not distributable except in such circumstances as stipulated in the Bahrain Commercial Companies Law and following the approval of the CBB. No transfer has been made for the current year as the Bank incurred losses of USD 12,370 thousand (2011: USD 4,170 thousand).

Investments fair value reserve
This represents cumulative unrealized fair value changes on investments and the net foreign exchange gain (loss) arising from translating the investments carried at fair value other than the investments carried at fair value through profit and loss. This reserve is transferred to the consolidated statement of income upon sale or impairment of the investments.

General reserve
This represents the reserve arising on the reduction of the Bank's share capital from USD 2,000 thousand to USD 138,000 thousand. (note:22.a)

23 PROFIT FROM ISLAMIC FINANCING

	2012	2011
	USD	USD
Income from mudaraba financing	**520,740**	440,787
Income from musharaka financing	**84,657**	8,156
Income from murabaha receivables	**387,391**	919,796
Income from ijarah asset	**1,580,195**	1,412,835
Wakala income	**2,217**	-
	2,575,200	2,781,574

24 INCOME FROM INVESTMENT IN SECURITIES

	2012	2011
	USD	USD
Profit earned on debt-type instruments at amortised cost	**5,493,534**	5,956,514
Dividends on equity-type instruments at fair value through equity	**128,152**	170,238
Gain on disposal of debt-type instruments at amortised cost	**2,522,533**	852,707
Gain on disposal of investments at fair value through equity	**1,119,611**	-
	9,263,830	6,979,459

25 STAFF COST

	2012	2011
	USD	USD
Salaries and benefits	**3,302,159**	3,944,154
Social insurance expenses	**114,928**	165,342
Other staff expenses	**862,989**	1,020,704
	4,280,076	5,130,200

26 DEPRECIATION AND AMORTISATION

	2012	2011
	USD	USD
Depreciation and amortisation - fixed assets (note 16)	**483,985**	715,786
Depreciation - investment in ijarah asset (note 9)	**784,868**	394,813
	1,268,853	1,110,599

27 OTHER EXPENSES

	2012 USD	2011 USD
Professional expenses	**411,091**	221,215
Travel and accommodation	**152,076**	371,544
Premises Cost	**751,997**	691,267
Fixed assets write off (note 16)	**765,320**	-
Directors remuneration	**343,785**	451,668
Board of directors sitting fee and expenses	**180,764**	155,098
Other administrative expenses	**972,173**	938,558
	3,577,206	2,829,350

28 PROVISION FOR IMPAIRMENT

	Musharaka financing USD	Investment in ijarah assets USD	2012 Total USD	Musharaka financing USD	Investment in ijarah assets USD	2011 Total USD
Provision at beginning of the year	**7,024**	**-**	**7,024**	-	-	-
Charged during the year	**49,577**	**1,903,567**	**1,953,144**	7,024	-	7,024
Foreign exchange translation	**(620)**	**-**	**-**	-	-	-
Provision at end of the year	**55,981**	**1,903,567**	**1,960,168**	7,024	-	7,024
Notes	**7**	**9**		7	9	

(b) The following table shows the provision and impairment charge during the year ended 31 December:

	2012 USD	2011 USD
Musharaka financing	**49,577**	7,024
Investment in ijarah asset	**1,903,567**	-
Investment in real estate (note 13)	**-**	3,960,693
Investments in securities Impairment (note 11)	**3,344,149**	920,967
Transfer from investment fair value reserves	**1,324,502**	-
	6,621,795	4,888,684

29 ACQUISITION EXPENSES

	2012 USD	2011 USD
Merger expenses	**5,615,611**	-
Redundancy expenses *	**2,900,000**	-
	8,515,611	-

* During the year, the shareholders of the Bank approved the merger of the Bank with Capivest and CMH, where the Board of Directors of the Bank has decided to reduce the workforce of the Group, in relation to which an amount of USD 2,900 thousand was provided at the year end.

30 SEGMENT INFORMATION

a) Geographic sector

The geographical distribution of the Group's assets and liabilities is as follows:

2012	***Middle East USD***	***Europe USD***	***Africa USD***	***South East Asia USD***	***Total USD***
Assets					
Cash and balances with banks	8,770,393	4,182,524	-	34,080	12,986,997
Due from financial institutions	35,083,388	-	-	-	35,083,388
Financing receivable	12,372,062	1,326,386	-	-	13,698,448
Musharaka financing	916,916	-	-	985,804	1,902,720
Receivable from Ijarah investors	14,800,849	-	-	-	14,800,849
Investment in ijarah asset	-	-	-	4,961,974	4,961,974
Ijarah muntahia bittamleek	-	-	-	1,905,822	1,905,822
Investments in securities	180,471,731	34,870,121	16,725,408	-	232,067,260
Investment in associates	5,046,963	-	-	-	5,046,963
Investment in real estate	38,441,871	-	-	-	38,441,871
Development properties	16,173,111	-	-	-	16,173,111
Non-current asset held for sale	1,326,260	-	-	-	1,326,260
Fixed assets	433,070	-	-	-	433,070
Other assets	2,958,842	45,515	133,808	800,401	3,938,566
Total assets	**316,795,456**	**40,424,546**	**16,859,216**	**8,688,081**	**382,767,299**
Liabilities					
Due to financial institutions	25,008,985	-	-	14,027,938	39,036,923
Due to non financial institutions	435,408	-	-	-	435,408
Other liabilities	15,579,539	-	62,344	-	15,641,883
Total liabilities	**41,023,932**	**-**	**62,344**	**14,027,938**	**55,114,214**
Equity of investment accountholders	**125,836**	**-**	**1,137,797**	**-**	**1,263,633**

2011	*Middle East USD*	*Europe USD*	*Africa USD*	*South East Asia USD*	*Total USD*
Assets					
Cash and balances with banks	2,354,933	-	-	-	2,354,933
Due from financial institutions	14,206,052	-	-	-	14,206,052
Financing receivable		3,272,458			3,272,458
Musharaka financing	-	-	-	958,810	958,810
Investment in ijarah asset	-	-	-	7,650,409	7,650,409
Investments in securities	67,057,576	22,762,166	20,137,539	-	109,957,281
Investment in associates	3,444,085	-	-	-	3,444,085
Investment in real estate	15,842,773	-	-	-	15,842,773
Fixed assets	1,566,186	-	-	-	1,566,186
Other assets	1,704,978	-	-	-	1,704,978
Total assets	106,176,583	26,034,624	20,137,539	8,609,219	160,957,965
Liabilities					
Due to financial institutions	-	-	-	4,543,500	4,543,500
Other liabilities	1,646,066	-	-	-	1,646,066
Total liabilities	1,646,066	-	-	4,543,500	6,189,566

30 SEGMENT INFORMATION (continued)

b) Industry sector

The industrial distribution of the Group's assets and liabilities is as follows:

2012	*Trading and manufacturing* USD	*Banks and financial institutions* USD	*Real Estate* USD	*Others* USD	*Total* USD
Assets					
Cash and balances with banks	-	12,986,997	-	-	12,986,997
Due from financial institutions	-	35,083,388	-	-	35,083,388
Financing receivable	-	-	1,326,386	12,372,062	13,698,448
Musharaka financing	-	985,804	-	916,916	1,902,720
Receivable from Ijarah investors	-	-	-	14,800,849	14,800,849
Investment in ijarah asset	-	-	-	4,961,974	4,961,974
Ijarah muntahia bittamleek	-	-	-	1,905,822	1,905,822
Investments in securities	15,695,096	82,000,945	91,654,476	42,716,743	232,067,260
Investment in associates	-	3,444,085	1,602,878	-	5,046,963
Investment in real estate	-	-	38,441,871	-	38,441,871
Development properties	-	-	16,173,111	-	16,173,111
Non-current asset held for sale	-	-	-	1,326,260	1,326,260
Fixed assets	-	-	-	433,070	433,070
Other assets	12,819	421,706	689,210	2,814,831	3,938,566
Total assets	**15,707,915**	**134,922,925**	**149,887,932**	**82,248,527**	**382,767,299**
Liabilities					
Due to financial institutions	-	39,036,923	-	-	39,036,923
Due to non financial institutions	268,679	-	-	166,729	435,408
Other liabilities	247,834	163,192	300,275	14,930,582	15,641,883
Total liabilities	**516,513**	**39,200,115**	**300,275**	**15,097,311**	**55,114,214**
Equity of investment accountholders	**1,137,797**	**-**	**-**	**125,836**	**1,263,633**

2011	*Trading and manufacturing* USD	*Banks and financial institutions* USD	*Real Estate* USD	*Others* USD	*Total* USD
Assets					
Cash and balances with banks	-	2,354,933	-	-	2,354,933
Due from financial institutions	-	14,206,052	-	-	14,206,052
Murabaha receivable	-	-	3,272,458	-	3,272,458
Musharaka financing	-	958,810	-	-	958,810
Investment in ijarah asset	-	-	-	7,650,409	7,650,409
Investments in securities	16,791,279	45,788,251	31,911,805	15,465,946	109,957,281
Investment in associates	-	3,444,085	-	-	3,444,085
Investment in real estate	-	-	15,842,773	-	15,842,773
Fixed assets	-	-	-	1,566,186	1,566,186
Other assets	-	-	-	1,704,978	1,704,978
Total assets	16,791,279	66,752,131	51,027,036	26,387,519	160,957,965
Liabilities					
Due to financial institutions	-	4,543,500	-	-	4,543,500
Other liabilities	-	-	-	1,646,066	1,646,066
Total liabilities	-	4,543,500	-	1,646,066	6,189,566

The Group's revenue and expenses are reviewed at a Group level and therefore no separate operating segment results and other disclosures are provided in these consolidated financial statements.

31 RELATED PARTY BALANCES AND TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence or joint control over the other party in making financial and operating decisions. Related parties comprise major shareholders, directors, sharia supervisory board and executive management of the Group and/or entities over which they excercise control and/or significant influence.

The related party balances and transactions included in these consolidated financial statements are as follows:

	Associated companies USD	***Directors/ key management personnel Sharia board members USD***	***Major shareholders / entities in which directors are interested USD***	***2012 USD***	*Associated companies USD*	*Directors/ key management personnel Sharia board members USD*	*Major shareholders / entities in which directors are interested USD*	*2011 USD*
Assets								
Cash and balances with banks	-	-	5,911,922	5,911,922	-	-	1,990	1,990
Due from financial institutions	-	-	5,650,499	5,650,499	-	-	-	-
Investments in securities	-	25,723,626	12,286,966	38,010,592	-	-	9,500,000	9,500,000
Investment in associates	5,046,963	-	-	5,046,963	3,444,085	-	-	3,444,085
Other assets	-	78,818	1,061	79,879	-	-	-	-
	5,046,963	25,802,444	23,850,448	54,699,855	3,444,085	-	9,501,990	12,946,075
Liabilities								
Due to financial institutions	-	-	13,242,584	13,242,584	-	-	-	-
Due to non financial institutions	-	-	250,004	250,004	-	-	-	-
Other liabilities	79,576	2,166,890	5,336,519	7,582,985	-	700,648	-	700,648
	79,576	2,166,890	18,829,107	21,075,573	-	700,648	-	700,648
Equity of investment accountholders	-	1,137,797	-	1,137,797	-	-	-	-
Commitments	-	11,405,836	-	11,405,836	-	-	-	-
Income								
Income from investment in securities	-	-	382,591	382,591	-	-	226,152	226,152
Expenses								
Staff cost	-	2,446,452	-	2,446,452	-	3,382,758	-	3,382,758
Other expenses	-	670,198	-	670,198	-	579,394	-	579,394
Acquisition expenses	-	-	5,615,611	5,615,611				

Compensation of key management personnel of the Bank, included in consolidated statement of income, is as follows:

	2012 USD	*2011 USD*
Short term employee benefits	2,080,153	2,990,969
Long term employee benefits	366,299	391,789

Director's remuneration, sitting fee and expenses for the year ended 31 December 2012 amounted to USD 525 thousand (2011: USD 607 thousand).

32 Sharia SUPERVISORY BOARD

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

33 MATURITY PROFILE

The maturity profile of the Group's assets and liabilities are based on contractual repayment arrangements. The contractual maturities of assets and liabilities have been determined on the basis of the remaining period at the financial position date to the contractual maturity date. The consolidated maturity profile at 31 December 2012 was as follows:

33 MATURITY PROFILE (continued)

2012	Up to 3 month USD	3 months to 1 year USD	1 to 5 years USD	5 to 10 years USD	No fixed maturity USD	Total USD
Assets						
Cash and balances with banks	12,986,997	-	-	-	-	12,986,997
Due from financial institutions	30,547,075	4,536,313	-	-	-	35,083,388
Financing receivable	1,326,386	12,372,062	-	-	-	13,698,448
Musharaka financing	776,521	770,395	355,804	-	-	1,902,720
Receivable from Ijarah investors	-	11,407,546	-	-	3,393,303	14,800,849
Investment in ijarah asset	4,961,974	-	-	-	-	4,961,974
Ijarah muntahia bittamleek	-	30,822	1,875,000	-	-	1,905,822
Investments in securities	9,788,909	-	33,840,582	28,751,762	159,686,007	232,067,260
Investment in associates	-	-	-	-	5,046,963	5,046,963
Investment in real estate	-	-	-	-	38,441,871	38,441,871
Development properties	-	-	-	-	16,173,111	16,173,111
Non-current asset held for sale	-	1,326,260	-	-	-	1,326,260
Fixed assets	-	-	-	-	433,070	433,070
Other assets	1,968,864	1,054,610	355,729	-	559,363	3,938,566
Total assets	62,356,726	31,498,008	36,427,115	28,751,762	223,733,688	382,767,299
Liabilities						
Due to financial institutions	14,529,316	8,082,867	16,424,740	-	-	39,036,923
Due to non financial institutions	-	-	435,408	-	-	435,408
Other liabilities	11,058,014	1,838,591	1,920,580	86,934	737,764	15,641,883
Total liabilities	25,587,330	9,921,458	18,780,728	86,934	737,764	55,114,214
Equity of investment accountholders	1,263,634	-	-	-	-	1,263,634
Total liabilities and equity of investment accountholders	26,850,964	9,921,458	18,780,728	86,934	737,764	56,377,848
Net liquidity gap	35,505,762	21,576,550	17,646,387	28,664,827	222,995,924	326,389,451
Cumulative net liquidity gap	35,505,762	57,082,312	74,728,699	103,393,527	326,389,451	-
Commitments	6,344,051	7,876,023	57,388	-	-	14,277,462

33 MATURITY PROFILE (continued)

The consolidated maturity profile at 31 December 2011 was as follows:

2011	Up to 3 month USD	3 months to 1 year USD	1 to 5 years USD	5 to 10 years USD	No fixed maturity USD	Restated Total USD
Assets						
Cash and balances with banks	2,354,933	-	-	-	-	2,354,933
Due from financial institutions	14,206,052	-	-			14,206,052
Financing receivable	440,000	1,980,000	852,458			3,272,458
Musharaka financing	-	-	461,612	-	497,198	958,810
Investment in ijarah asset	280,628	1,132,204	6,237,577	-	-	7,650,409
Investments in securities	3,250,000	20,089,247	40,974,446	11,198,165	34,445,423	109,957,281
Investment in associates	-	-	-	-	3,444,085	3,444,085
Investment in real estate	-	-	-	-	15,842,773	15,842,773
Fixed assets	-	-	-	-	1,566,186	1,566,186
Other assets	-	1,588,575	-	-	116,403	1,704,978
Total assets	20,531,613	24,790,026	48,526,093	11,198,165	55,912,068	160,957,965
Liabilities						
Wakala payable	4,543,500	-	-	-	-	4,543,500
Other liabilities	-	1,646,066	-	-	-	1,646,066
Total liabilities	4,543,500	1,646,066	-	-	-	6,189,566
Net liquidity gap	15,988,113	23,143,960	48,526,093	11,198,165	55,912,068	154,768,399
Cumulative net liquidity gap	15,988,113	39,132,073	87,658,166	98,856,331	154,768,399	
Commitments	3,012,567	97,666	156,239	-	-	3,266,472

The Group does not have assets and liabilities with contractual maturities beyond 10 years.

34 COMMITMENTS

	2012 USD	2011 USD
Uncalled capital commitments in respect of investment	**13,505,836**	-
Promise to purchase foreign currency commitment	**484,140**	-
Commitment realted to project developments	**132,626**	-
Commitment to finance	**-**	2,500,000
Operating lease commitments - expiring within one year	**97,472**	610,233
Operating lease commitments - expiring in one to three years	**57,388**	156,239
	14,277,462	3,266,472

35 RISK MANAGEMENT

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

- credit risk;
- liquidity risk;
- market risks;
- profit rate in banking book; and
- operational risk

The Group has a risk management and governance framework which is intended to integrate risk management in its strategic thinking and business practices.

Furthermore, the Group has taken several initiatives to implement a comprehensive Basel II framework. These initiatives involve steps to identify all the risk areas that it manages and has particularly strengthened its risk management policies and procedures.

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

Risk Management and Governance Structure

Board of Directors
The Board of Directors of the Group has overall responsibility for establishing the Group's approach to risk and ensuring that an effective risk management framework is in place. The Board approves and periodically reviews the risk management policies and strategies of the Group. The Bank's Board of Directors' structure constitute of 7 members as of 31 December 2012, however, this has increased to 10 after the amalgamation and during the Ordinary General Meeting dated 29 January 2013.

Audit Committee
The mandate of the Audit Committee requires it to assist the Board in fulfilling its statutory and fiduciary responsibilities with respect to internal controls, accounting policies, auditing and financial reporting practices. The committee is responsible to assist the Board in its oversight of (i) the integrity and reporting of the Group's quarterly and annual consolidated financial statements, (ii) compliance with legal and regulatory requirements; and (iii) the independence and performance of the Group's internal and external auditors. The Committee also reviews the activities and performance of the internal audit function.

Risk Committee
The Risk Committee ("RC") is a sub-committee of the Board of Directors and assists the Board in fulfilling its oversight responsibilities with regards to the development of risk management framework across all spectrums of business and operational activities conducted by the Group. The mandate of this committee is to develop and implement risk management strategies and policies. The committee is also responsible for the assessment of the efficiency of overall risk management function of the Group and the compliance with regulatory requirements relating to risk management. The committee also ensures the transparency and timeliness of internal and external disclosures on risk matters.

35 RISK MANAGEMENT (continued)

Risk Management and Governance Structure (continued)

Sharia Supervisory Board
The Group's compliance with Sharia principles is overseen by an external and independent Sharia Supervisory Board, fully supported by the Group's internal Sharia and other departments. The Sharia department is responsible for ensuring that there is an ongoing process of reviewing and auditing for Sharia compliance in accordance with AAOIFI standards for existing and new investments. The Sharia Board ensures that all investments undertaken by the lines of business are structured in such a manner that investments comply strictly with Sharia principles.

Asset and Liability Committee
The Asset and Liability Committee ("ALCO") establishes policy and objectives for the asset and liability management of the Group's statement of financial position in terms of structure, distribution, risk and return and its impact on profitability. It also monitors the cash flows, tenor and cost/yield profiles of assets and liabilities and evaluates the Group's balance sheet both from profit rate sensitivity and liquidity points of view, makes corrective adjustments based upon perceived trends and market conditions, monitors liquidity and foreign exchange exposures and positions.

Investment, Credit & Risk Committee
The Investment Credit & Risk Committee ("ICRC") comprises the CEO and the Heads of Risk Management, Investment Banking, Treasury Capital Markets and Legal & Compliance. In addition to facilitating the credit and investment decisions, the ICRC's mission is to establish and maintain a risk management framework throughout the Group to best manage Bank's shareholders and client interests. Its mandate is to identify, assess and measure risks arising from the Group's activities, and to define the appropriate course of action to mitigate or manage them.

Risk Management Department
The Risk Management Department ("RMD") is responsible for implementing and maintaining risk related policies & procedures to ensure an independent control processes. It provides oversight compliance with risk principles, policies and limits across the Group. The department is also responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This department also ensures complete capture of the risks in risk measurement and reporting systems.

Internal Audit
Internal Audit is responsible for carrying out a risk-based program of work designed to provide assurance that assets are being safeguarded. This involves ensuring that controls are in place and working effectively in accordance with Group policies and procedures as well as with laws and regulations. The work carried out by Internal Audit includes providing assurance on the effectiveness of the risk management functions as well as that of controls operated by the business units. The Audit Committee approves the annual audit plan and also receives regular reports of the results of audit work.

Risk Management and Reporting Structure
The Group identifies, measures, controls and monitors its material risks on a periodic basis. The Group has established relevant risk limit structures to quantify its risk appetite. RC reviews and recommends the limits, suggested by the ICRC to the Board which is ultimately responsible for the final approval of the limit. The monitoring and controlling of risks is managed through limits set by the ICRC. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept.

The Risk Management Department presents reports to the Board of Directors through ICRC

35 RISK MANAGEMENT (continued)

Risk Management and Governance Structure (continued)

Risk Management and Reporting Structure (continued)
and RC. These reports include risk and investment review of Group's portfolio and its impact on Group's capital adequacy.

As part of the Risk Management's reporting framework, tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. A periodic briefing is given to the Chief Executive Officer and all other relevant members of the Group on the utilization of market limits, proprietary investments and liquidity, plus any other risk developments.

(a) Credit Risk

Credit risk is the risk that the Group will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. Being a wholesale investment bank, the Group is involved in investment advisory services and investment transactions which comply with Islamic rules and principles according to the opinion of the Sharia Board. Credit risk arises largely through short-term placements of excess cash through Mudaraba contracts in a conservative manner.

The Group manages and controls its credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits. Counterparty limits are established with the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to revision at the time of renewal of the facility.

Investment risk is a major component of the Group's overall risk profile. The Group seeks to manage its investment risks through each stage of the investment process, including deal sourcing, acquisition, post investment monitoring.

The Board has delegated responsibility for the management of investment and credit risk to its ICRC. ICRC is the highest management-level authority on all investment exposures. The overall role of ICRC is to facilitate the investment business of the Group in the most effective and efficient manner within the risk guidelines specified by the Board or its designated RC. Prior to funding an investment, and regardless of its size, the ICRC provides an independent assessment of the opportunity, highlighting key risks prior to commitment.

Day-to-day management of the Group's investments is overseen by Investment Banking and Treasury Capital Markets Division. Additionally, the ALCO reviews all investments from the perspective of the Group's financial position.

The RMD regularly monitors the level of risk within the investment portfolio to ensure that appropriate level of economic capital is maintained. This process ensures that the required risk capital is below the available equity, which results in a positive equity cushion. The RMD ensures that Elaf maintains appropriate asset diversification by geography, industry and investment type.

Maximum exposure to credit risk
The table below shows the gross maximum exposure to credit risk for the components of the consolidated statement of financial position. The figures represent gross exposure net of any provision for impairment, without taking into account any collateral held and other credit mitigants**.**

35 RISK MANAGEMENT (continued)

Risk Management and Governance Structure (continued)

(a) Credit Risk (continued)

	Maximum exposure	
	2012	2011
	USD	USD
Balances with banks	**12,979,455**	2,352,210
Due from financial institutions	**35,083,388**	14,206,052
Financing receivable	**13,698,448**	3,272,458
Musharaka financing	**1,902,720**	958,810
Receivable from Ijarah investors	**14,800,849**	-
Investments in securities	**72,381,253**	75,511,858
Other assets	**3,631,479**	1,514,112
	154,477,592	97,815,500

Concentration risk

Concentration of risk arises when a number of counterparties are engaged in similar economic activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly effected by changes in economic, political or other conditions. The Group seeks to manage the concentration of risk by establishing and constantly monitoring geographic and industry wise concentration. The Group seeks to manage its concentration risk by establishing geographic and industry wise concentration limits. The geographic and industry wise distribution of assets and liabilities are set out in note 30.

(b) 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.

The main action to manage the Group's liquidity is through the adherence to limits on liquidity mismatches. These include the limits of the cumulative excess of maturing liabilities over assets in the short-term and limits on dependence on short-dated funds.

Treasury department is overall responsible for ensuring that the limits enacted are adhered to, on a day-to-day basis and managing excess liquidity of the Group through short term placements and investments. Treasury maintains a constant communication with the banks which have extended a committed short term financing line to the Group. The Treasury provides a monthly report to the ALCO regarding the dependability and reliability of these banks. Treasury also monitors the market conditions and generates watch reports which would monitor the spreads and the volatilities of the asset prices and as such the exogenous liquidity risk the Group is exposed to.

The asset and liability maturity profile shown in note 33 is based on management's assessment of the Group's right and ability to liquidate these instruments based on their underlying liquidity characteristics.

(c) Market Risk

Market risk is the risk that changes in market prices, such as profit rates, equity prices, foreign exchange rates and commodity prices will affect the Group's income or the value of its holdings of financial instruments. Market risk comprises equity position risk, profit rate risk, commodities risk, currency risk and other price risk.

35 RISK MANAGEMENT (continued)

(c) Market Risk (continued)

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Group does not have a trading portfolio and hence is not exposed to market risk in relation to such instruments. The Group is not exposed to commodities or price risk as there is no commodity holding either in the banking or trading book. Market risk for the Group arises only on account of its foreign exchange exposure in the banking book.

The Group manages its market risk exposures by evaluating each new product and activity with respect to the market risk introduced by it.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Most of the transactions completed by the Group are in US Dollars. However, in the normal course of business certain non-trading monetary assets and liabilities are in other currencies and give rise to currency risk.

Positions are monitored regularly to ensure that they are maintained within established limits and guidelines. The Group is not exposed to any significant currency risk.

Equity price risk

Equity price risk is the risk that the fair value of equity investments decreases as a result of fluctuations in the respective stock market indices. The Bank has investments at fair value through equity quoted on stock exchanges. Based on the values at 31 December 2012, a change in the quoted price of plus or minus 5% would change the value of these investments by plus or minus USD 683 thousand (2011: USD 221 thousand) with a corresponding increase or decrease in equity, except in case of impairment which will result in loss being taken to consolidated statement of income.

The Bank also has unquoted investments carried at fair value using either net asset value or valuations from independent valuers. Based on the values at 31 December 2012, a change in the valuation of 5% would change the value of these investments by plus or minus USD 6,284 thousand (2011: USD 1,502 thousand) with a corresponding increase or decrease in equity, except in case of further decline on impaired investments which will result in loss being taken to consolidated statement of income.

Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its counterparties repay or request repayment earlier or later than expected. The Bank is not exposed to any significant prepayment risk.

(d) Profit rate risk in 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 finance. The table below analyses the Group’s profit rate risk exposure on non-trading financial assets and liabilities. The Group’s assets and liabilities are included at carrying amount and categorised based on contractual repayment arrangements:

35 RISK MANAGEMENT (continued)

(d) Profit rate risk in banking book (continued)

2012	*Up to 3 Month USD*	*3 months to 1 year USD*	*1 to 5 years USD*	*Above 5 Years USD*	*Total USD*
Assets					
Due from financial institutions	30,547,075	4,536,313	-	-	35,083,388
Financing receivable	1,326,386	12,372,062	-	-	13,698,448
Investments in securities	9,788,909	-	33,840,582	28,751,762	72,381,253
Total profit rate sensitive assets	41,662,370	16,908,375	33,840,582	28,751,762	121,163,089
Liabilities					
Due to financial institutions	14,529,316	8,082,867	16,424,740	-	39,036,923
Total profit rate sensitive liabilities	**14,529,316**	**8,082,867**	**16,424,740**	**-**	**39,036,923**
Profit rate sensitivity gap	**27,133,054**	**8,825,508**	**17,415,842**	**28,751,762**	**82,126,166**

2011	*Up to 3 Month USD*	*3 months to 1 year USD*	*1 to 5 years USD*	*Above 5 Years USD*	*Total USD*
Assets					
Due from financial institutions	14,206,052	-	-	-	14,206,052
Financing receivable	440,000	1,980,000	852,458		3,272,458
Investments in securities	3,250,000	20,089,247	40,974,446	11,198,165	75,511,858
Total profit rate sensitive assets	17,896,052	22,069,247	41,826,904	11,198,165	92,990,368
Liabilities					
Due to financial institutions	4,543,500	-	-	-	4,543,500
Total profit rate sensitive liabilities	4,543,500	-	-	-	4,543,500
Profit rate sensitivity gap	13,352,552	22,069,247	41,826,904	11,198,165	88,446,868

The sensitivity of the Group's consolidated statement of income to a 200 basis points parallel increase (decrease) in market profit rates (assuming no asymmetrical movement in yield curves and a constant statement of financial position) on floating rate non trading financial assets and liabilities, would be an increase (decrease) of profit by USD 345 thousand (2011:USD 655 thousand).

(e) Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all business and covers a large number of operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

Risk and Control Self Assessment ("RCSA") is an annual exercise as per Bank's policy and is a requirement by Central Bank of Bahrain based on Basel II principles related to operational risk

35 RISK MANAGEMENT (continued)

(e) Operational Risk (continued)

management. During the year 2012 the Group decided to postpone the RCSA exercise to 2013 due to the merger process.

The Group has developed a Disaster Recovery and Business Continuity Plan ("DR&BCP") to enable the Group to survive a disaster and to reestablish normal business operations. The DR&BCP will enable the Group to minimize interruptions to business service operations, resume critical operations within a specified time after a disaster, minimize financial loss due to disruptions, limit the severity of the disruption, expedite the restoration of services and maintain a positive public image of the Bank.

36 FAIR VALUE OF FINANCIAL INSTRUMENTS

The Group uses the following hierarchy for determining and disclosing fair values of financial assets by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets;
Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial assets recorded at fair value by level of the fair value hierarchy:

	Level 1 USD	***Level 2 USD***	***Level 3 USD***	***Total USD***
2012				
Quoted shares	**13,665,212**	**-**	**-**	**13,665,212**
Unquoted shares	**-**	**-**	**146,020,795**	**146,020,795**
	13,665,212	**-**	**146,020,795**	**159,686,007**

	Level 1 USD	*Level 2 USD*	*Level 3 USD*	*Total USD*
2011				
Quoted shares	4,411,988	-	-	4,411,988
Unquoted shares	-	-	30,033,435	30,033,435
	4,411,988	-	30,033,435	34,445,423

37 EARNINGS PROHIBITED BY Sharia

Earnings prohibited by Sharia, if earned are set aside for charitable purposes or otherwise dealt with in accordance with directions of the Sharia supervisory Board.

38 COMPARATIVES

Certain prior year amounts have been regrouped to conform to the current year's presentation. Such reclassification did not affect previously reported consolidated statement of income or consolidated owners' equity.

Basel II,
Pillar III Disclosures

For the year ended 31 December 2012

Content

1 INTRODUCTION

The Central Bank of Bahrain (the CBB) Basel II Guidelines, based upon the Bank for International Settlements (BIS) Revised Framework – 'International Convergence of Capital Measurement and Capital Standards', were introduced on 1 January 2008. Basel II is structured around three 'pillars': Pillar I - Minimum Capital Requirements; Pillar II – the Supervisory Review Process and the Internal Capital Adequacy Assessment Process (ICAAP); and Pillar III - Market Discipline.

The public disclosures under this section have been prepared in accordance with the CBB requirements outlined in its Public Disclosure Module (PD), Section PD–1: Annual Disclosure requirements, CBB Rulebook, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Elaf Bank B.S.C. (c) (the Bank) being a locally incorporated Bank with a wholesale Islamic Investment banking license, and its branch and subsidiaries (together known as the Group).

1.1 Pillar I – Minimum Capital Requirements

Pillar I deals with the rules for the computation of regulatory capital requirements in respect of credit, market and operational risk. It defines the various classes of assets and the calculation of Risk Weighted Assets (RWAs) in respect of each class of assets. The capital adequacy ratio is calculated as the ratio of the Bank's regulatory capital to its total risk weighted assets. All Bahrain incorporated banks are currently required to maintain a minimum capital adequacy ratio of 12%. In addition, the Central Bank of Bahrain requires banks to maintain an additional 0.5% buffer above the minimum capital adequacy ratio.

1.1.1 Credit risk

Basel II provides three approaches to the calculation of credit risk regulatory capital. The Bank has adopted the standardized approach under which on and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. Under the standardised approach, the risk weightings are provided by the CBB and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the CBB.

1.1.2 Market risk

The Bank has adopted the Standardised approach for determining the market risk capital requirement.

1.1.3 Operational risk

The Bank has adopted the basic indicator approach for operational risk. It is calculated by applying a co-efficient of 15 percent to the average gross income for the preceding three financial years.

1.2 Pillar II – The Supervisory Review and Evaluation Process

Pillar II involves the process of supervisory review of Bank's risk management framework and capital adequacy. It requires banks to hold additional capital for risks not covered by Pillar 1. Other risk types which are not covered by the minimum capital requirements in Pillar 1 include liquidity risk, interest rate risk in the banking book, business risk and concentration risk.

Pillar II comprises of an Internal Capital Adequacy Assessment Process (ICAAP) and supervisory review and evaluation process.

1 INTRODUCTION (continued)

1.2 Pillar II – The Supervisory Review and Evaluation Process (continued)

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. The Bank has established an ICAAP which quantifies the capital requirements for the key risks that the Bank is exposed to including credit, investment, liquidity, strategic, reputation, operational, and concentration risks. The Bank also conducts comprehensive stress tests for various portfolios and assesses the impact on the capital and profitability. In addition, the Bank's stress testing frameworks and models allow for forward looking scenarios, which are considered for business growth strategies. The ICAAP of the Bank is driven by the Board through the Capital Adequacy Strategy and the ICAAP Policy. In case a plausible stress scenario is identified which may severely affect the capital adequacy of the Bank, the senior management decides an appropriate corrective action to be taken under such a scenario.

As part of the CBB's Pillar II guidelines, each bank is required to be individually reviewed and assessed by the CBB with the intention of setting individual minimum capital adequacy ratios. The CBB is currently in the process of individually assessing the financial strength and risk management practices of each institution. Until finalised, we will be required to continue to maintain a 12 percent minimum capital adequacy ratio.

1.3 Pillar III – Market Discipline

Pillar III is related to market discipline and requires the Bank to publish detailed qualitative and quantitative information of its risk management and capital adequacy policies and processes to complement the first two pillars and the associated supervisory review process. The disclosures in this report are in addition to the disclosures set out in the audited consolidated financial statements of the Bank for the year ended 31 December 2012.

1.3.1 Pillar II quantitative and qualitative disclosures

For the purpose of computing regulatory minimum capital requirements, the Bank follows the rules as laid out under the CBB Rulebook module PCD: Prudential Consolidation and Deduction Requirements, PCD-1 & PCD-2 and the Capital Adequacy (CA) Module. Accordingly,

a) Unrealized gains arising from fair valuing equities is reported only to the extent of 45%; and
b) Property revaluation reserve is included under Tier 2 capital to the extent of 45%.

There are no restrictions on the transfer of funds or regulatory capital within the group and all investments are made fully complying with CBB approval instructions.

1.4 Overall Risk and Capital Management

The consolidated financial statements of the Bank and its subsidiaries have been prepared in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Sharia Rules and Principles as determined by the Sharia Supervisory Board of the Bank, the Bahrain Commercial Companies Law, CBB and Financial Institutions Law.

For the purpose of computing the Capital Adequacy Ratio (CAR) the Bank is not consolidating subsidiaries that are Commercial Entities, however, the Financial Entities are fully consolidated as per CBB's Prudential Consolidation and Deduction (PCD) Module requirements.

1 INTRODUCTION (continued)

1.4 Overall Risk and Capital Management (continued)

In the consolidated financial statements, subsidiaries are fully consolidated from the date of acquisition, being the date on which the Bank obtains control, and continues to be consolidated until the date that control ceases.

The bank does not hold any interest in insurance entities.

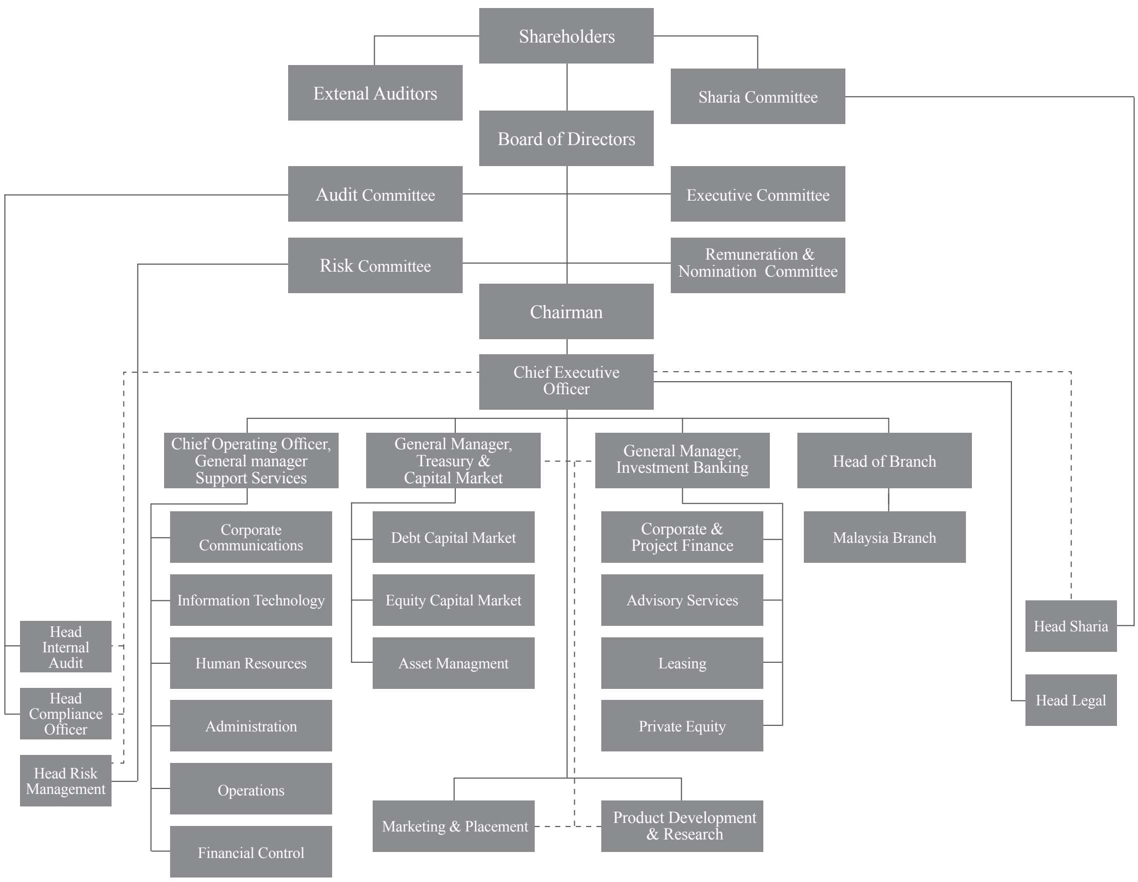
1.5 Compliance with Module (HC) high level control (PD-1.3.10(x)) - As per the CBB Rulebook

In October 2010, CBB introduced new requirements to Module HC that have to be met by all licensees with respect to, corporate governance principles to be in line with the Principles relating to the Corporate Governance Code issued by the Ministry of Industry and Commerce; International best practice corporate governance standards set by bodies such as the Basel Committee for Banking Supervision; and related high-level controls and policies. The Group made detailed self-assessments on the revised content of Module HC to ensure compliance with the new requirements with specific milestones for implementation of any shortfalls. The Group's Board of Directors and senior management were fully apprised the subject amendments.

2 RISK MANAGEMENT STRUCTURE

The Board has the ultimate responsibility for understanding the nature and level of risk taken by the Bank. The Board is responsible for reviewing the strategy and objectives of the Bank with respect to various risks and ensures that there is a clear guidance regarding the level of risks acceptable to the Bank.

Figure 1 Group Organisation Structure (PD-1.3.10(a)) - As per the CBB Rulebook *



* the organizational structure was revised by the Board of Directors on 29 January 2013.

2 RISK MANAGEMENT STRUCTURE (continued)

2.1 Board of Directors (PD - 1.3.10 (n) and PD - 1.3.10 (o)) - As per the CBB Rulebook

The Board is responsible for establishing objectives for the Bank and developing the strategies that direct the ongoing activities of the Bank to achieve those objectives. By approving the Bank's strategy document, the Board demonstrates that it is able to proactively identify and understand the risks that the Bank faces in achieving its business objectives through its business strategies and plans.

As part of its strategy review process, the Board at the minimum: (PD-1.3.10(n, o)) - As per the CBB Rulebook:

a. Reviews major strategy papers and business plans;
b. Set performance objectives;
c. Oversees major capital expenditures and acquisitions;
d. Reassesses annually the Bank's objectives, strategies and plans;
e. Demonstrates its responsibility to supervisors, shareholders, employees & other stakeholders; and
f. Monitors the control environment and risk profile of the Bank.

Detailed responsibilities of the Board are provided in the Bank's Articles of Associations.

The Board has approved certain policies and procedures which authorizes the senior management to approve certain transactions. However the following types of material transactions require Board approval if suggested by the approved policies:

a. Conclude loan agreements with certain limits;
b. Sell the company's assets;
c. Mortgage the Company's properties;
d. Grant guarantees to third parties;
e. Discharge the Company's debts; and
f. Engage in any other acts which may be integral to the company's objects as set out in the Memorandum of Association

The Board of Directors has delegated the management of the Bank to the Chief Executive Officer and has appointed Executive and Management Level committees to manage the risk associated with the business and operations of the Bank. During the first quarter of 2012, Dr. Jamil Jaroudi, CEO - Elaf Bank, resigned and Mr. Sohail Niazi became the acting CEO of the Bank. The following committees are involved in managing the risk and ensuring the compliance with the Bank's policies and risk management framework.

2.2 Board Committees

Board committees with their respective objectives and members are as follows:

2.2.1 Executive Committee

2.2.1.1 Objective/Function

Consider specific matters delegated to it by the full Board and make recommendations thereon to the Board or decisions based on authorities specifically delegated by the Board.

2 RISK MANAGEMENT STRUCTURE (continued)

2.2 Board Committees (continued)

2.2.1 Executive Committee (continued)

2.2.1.2 Members	Independent / Non Independent
Jamal Al Saleem	Non Independent
Saeed Al Kayareen	Non Independent
Mohammad Al Adsani	Non Independent
Abdulla Al Marzouq	Non Independent

2.2.2 Audit Committee

2.2.2.1 Objective/Function

To review the Banks financial reporting process, internal controls, and process for monitoring compliance with policies, procedures, laws and regulations and the Bank's own Code of Business Conduct.

2.2.2.2 Members	Independent / Non Independent
Mohamad Douaidy	Independent
Isa Mohamed Habib	Independent
Paul Mercer	Non Independent

2.2.3 Remuneration & Nomination Committee

2.2.3.1 Objective/Function

The Remuneration Committee reviews and approves (according to the guidelines set by the Board) policies and procedures for the remuneration of Board members, Committees members, executive and non-executive employees.

2.2.3.2 Members	Independent / Non Independent
Jamal Al Saleem	Non Independent
Isa Mohamed Habib	Independent
Mohammad Al Adsani	Non Independent
Sohail Niazi	Acting CEO

2.2.4 Risk Committee

2.2.4.1 Objective/Function

To assist the Board of Directors in discharging its accountability and responsibility for risk management of the Bank-wide risk management systems, practices, and procedures including Credit, Market, and Operational Risk, and providing recommendations for improvement.

2.2.4.2 Members	Independent / Non Independent
Saeed Al Kayareen	Non Independent
Paul Mercer	Non Independent
Abdulla Al Marzouq	Non Independent

2 RISK MANAGEMENT STRUCTURE (continued)

2.3 Management Committees

The following committees are the two management committees at Elaf that support the Chief Executive Officer in managing and overseeing the Bank's activities, and in proposing new strategies, policies, and procedures to the Board. These Committees are:

2.3.1 Asset and Liability Committee

2.3.1.1 Objective/Function

The Asset and Liability Committee determines the appropriate levels of liquidity, and ensures that all future commitments are funded in the most appropriate and cost-efficient manner. The Committee also ensures that the Bank fully adheres to the requirements of the CBB regarding capital, liquidity, and mismatched risk. It ascertains that approved investment deposits limits are not exceeded, and Treasury management and dealing activities are within the policy guidelines set by the Board. Furthermore, it monitors and supervises the overall balance sheet structure.

2.3.1.2 Members

Chief Executive Officer	Chairman
General Manager — Treasury & Capital Market	Vice Chairman
Chief Operating Officer	Member
General Manager — Investment Banking	Member
Head of Risk Management	Member
Legal & Compliance Officer	Member
Financial Controller	Member
Head of Internal Audit	Non Voting Member

2.3.2 Investment, Credit and Risk Committee

2.3.2.1 Objective/Function

The Investment, Credit and Risk Committee is a senior management committee responsible for managing and supervising all activities related to investments, credit and risk management.

2.3.2.2 Members

Chief Executive Officer	Chairman
General Manager — Investment Banking	Member
General Manager — Treasury & Capital Market	Member
General Manager/Deputy Support Services Division	Member
Head of Marketing and Distribution	Member
Head of Risk Management	Non Voting Member
Head of Legal & Compliance	Non Voting Member

3 CAPITAL ADEQUACY

The primary objective of the Group's capital management is to ensure that the Group maintains adequate risk capital, complies with the capital requirements laid down by the CBB and maintains a

3 CAPITAL ADEQUACY (continued)

healthy capital ratio in order to support its business and maximize shareholder value.

The Group manages the capital base to cover risks inherent in the business. The adequacy of the Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the CBB in supervising the Bank.

Regulatory capital consists of Tier 1 capital (core capital) and Tier 2 capital (supplementary capital). The Group's Tier 1 comprises share capital, statutory reserves, retained profit/losses brought forward and unrealized gross losses arising from fair valuing equity securities. Tier 2 capital includes unrealized gains arising from fair valuing equities (45% only).

The Group's approach to assessing capital adequacy has been in line with its risk appetite aligned with its current and future activities. To assess its capital adequacy requirements in accordance with the CBB requirements, the Group adopts the Standardized Approaches for its Credit Risk and Market Risk, and the Basic Indicator Approach for its Operational Risk.

The Group's capital adequacy policy is to maintain a strong capital base to support the development and growth of the business. Current and future capital requirements are determined on the basis of expectations for each business group, expected growth in future sources and uses of funds.

Further the Bank monitors the CAR against an Internal Trigger Ratio of 167% of the CBB minimum required capital adequacy ratio of 12 % (which will currently be 20 %). If the ICAAP CAR touches the Internal Trigger Ratio, the Bank will initiate action to reduce its risk or increase capital before the Internal Target Ratio is breached.

Basis of Consolidation for Accounting and Regulatory Purposes

The Bank consolidates all subsidiaries which are fully owned or exercises significant control over them. These subsidiaries are consolidated from date of acquisition being the date on which the group obtains control and continues until the control ceases. Control is achieved when the group has the power to govern the financial and operating policy of an entity to obtain benefits from its activities. For regulatory reporting purposes and according to CBB Rulebook the Bank should consolidate all banking and other relevant financial entities which are considered to be subsidiaries of the Bank. However, the bank de-consolidates non financial entities for Capital adequacy ratio calculation. The Bank does not have any financial or banking subsidiaries thus all subsidiaries are de-consolidated.

3 CAPITAL ADEQUACY (continued)

Table – 1. Capital structure (PD–1.3.12, PD–1.3.13, PD–1.3.14 and PD–1.3.15) - As per the CBB Rulebook

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

	31 December 2012	
	Tier 1 (USD '000)	*Tier 2 (USD '000)*
Components of capital		
Core Capital - Tier 1		
Issued and fully paid ordinary shares	300,000	
General reserves	26,957	
Legal / statutory reserves	676	
Share Premium	16,385	
Total Tier 1 Capital	**344,018**	
Deductions from Tier 1		
Unrealized gross losses arising from fair valuing equity securities	(456)	
Tier 1 Capital before PCD deductions	**343,562**	
Supplementary Capital - Tier 2		
Unrealized gains arising from fair valuing equities (45% only)		563
Tier 2 Capital before PCD deductions		**563**
Total Available Capital before PCD deductions (Tier 1 and Tier 2)		**344,125**
Deductions		
Capital shortfall of non-consolidated entities subsidiaries *	(2)	(2)
Excess amount over maximum permitted large exposure limit **	(25,173)	(25,173)
Additional deduction from Tier 1 to absorb deficiency in Tier 2	(24,612)	
Total Deductions	**49,787**	**-**
Total Eligible Capital	**293,775**	**-**

* This represents capital shortfall in Medical Management Group SPC.
** This represents aggregate exposure to connected counterparty exceeding 25%.

Table – 2. Capital requirement by type of Islamic financing contracts (PD - 1.3.17)

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

	31 December 2012	
	Risk Weighted Amount (USD '000)	**Capital requirements (USD '000)**
Type of Islamic financing contracts		
Due from financial institutions	**7,617**	**914**
Financing receivables	**15,025**	**1,803**
Musharaka financing	**1,903**	**228**
	24,545	**2,945**

3 CAPITAL ADEQUACY (continued)

Table – 3. Capital requirement for Market risk (PD–1.3.18) - As per the CBB Rulebook

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

	31 December 2012 (USD '000)
Market Risk - Standardised ApproachForeign exchange risk	4,949
Total of market risk - standardised approach	**4,949**
Multiplier	12.5
Total Market Risk Weighted Exposures	**61,863**
Minimum capital requirement (12%)	**7,424**

Table – 4. Capital Requirements for Operational risk (PD–1.3.19 and PD–1.3.30) - As per the CBB Rulebook

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

	31 December 2012 (USD '000)
Indicators of operational risk	
Average gross income	10,520
Multiplier	12.5
	131,500
Eligible Portion for the purpose of the calculation	15%
Total operational RWE	**19,725**
Minimum capital requirement (12%)	**2,367**

Table – 5. Capital Adequacy Ratios (PD–1.3.20) - As per the CBB Rulebook

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

	31 December 2012	
	Total capital ratio	**Tier 1 capital ratio**
Top consolidated group in Bahrain	**51.83%**	**51.83%**

4 RISK MANAGEMENT

4.1 Overview

4.1.1 Bank-wide Risk Management Objectives

The risk management objective for each area of risk is to adopt the industry best practices and adhere to Basel II and CBB requirements. The Bank identifies, captures, monitors and manages different dimensions of risk with the aim to protect asset values and income streams, and to optimize the Bank's shareholder return, while maintaining its risk exposure within defined parameters. The Bank's management believes in the proactive management of risk in the full cycle of a financial transaction including its operating circumstances from the origination stage to its final disposal from the books of the Bank.

The Bank reviews and redefines its risk appetite according to the evolving business plan of the Bank, which includes fluctuations in economic and market conditions and future forecasts.

4 RISK MANAGEMENT (continued)

4.1 Overview (continued)

4.1.2 Strategies Processes and Internal Controls

The Bank's risk strategy, backed by appropriate limit structures, is articulated through risk management policies and procedures. These policies and procedures are an integral part of an enterprise–wide integrated risk management framework at the Bank. These policies and procedures identify risk objectives, processes, strategies and risk governance both at the board and the management level. The capital management policy is aimed at ensuring financial stability by allocating enough capital to cover unexpected losses. Limit structures serve as a key component in articulating risk strategy in quantifiable risk appetite. In addition, the Bank intends to implement various risk systems to help quantify not just the regulatory capital but also the economic capital allocated to various portfolios.

The Bank is exposed to various types of risk, such as market, credit, profit rate, liquidity and operational, all of which require the comprehensive controls and ongoing oversight. The risk management framework encapsulates the spirit behind Basel II, which includes management oversight & control, risk culture & ownership, risk recognition & assessment, control activities, adequate information & communication channels, monitoring risk management activities and correcting deficiencies.

Credit Risk
The Bank manages its credit risk exposures by assessing the credit worthiness of all customers & counterparties. For each new product & activity, the Bank evaluates credit risk introduced by it. The Bank has established a limit structure to avoid concentration of risks for counterparty, sector and geography.

Market Risk
The Bank is not exposed to significant market risk due to the nature of its activities and its limited market risk exposure is managed through combination of limits, internal controls & processes. The Group manages its market risk exposures by evaluating each new product and activity with respect to the market risk introduced by it.

Operational Risk
The Bank has established a Risk Control and Self Assessment (RCSA) process necessary for identifying and measuring and controlling its operational risks. This exercise covers the Bank's business lines and associated critical activities, exposing the Bank to operational risks.

Equity Risk in the Banking Book
Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The equity price risk exposure arises from the Group's investment portfolio. The Group manages and monitors its equity risk using sector, geography and investment type limits.

The strategy used has been effective throughout the reporting period.

Profit Rate Risk
Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Group manages its profit rate risk using various risk management tools and methodologies.

4 RISK MANAGEMENT (continued)

4.1 Overview (continued)

4.1.2 Strategies Processes and Internal Controls (continued)

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 manages DCR through the Asset Liability Committee (ALCO). The Bank is currently in the process of developing written policies and procedures for Displaced Commercial Risk. The bank will forego its fee in case DCR arises. The Bank benchmarks its rates with other leading banks in the market.

4.1.3 Risk Measurement and Reporting System

The Group identifies, measures, controls and monitors its material risks on a periodic basis. The Group has established relevant risk limit structures to quantify its risk appetite. Risk Committee (RC) reviews and recommends the limits, suggested by the Investment, Credit and Risk Committee (ICRC) to the Board which is ultimately responsible for the final approval of the limit. The monitoring and controlling of risks is managed through limits approved by the Board. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept.

The Risk Management Department (RMD) presents reports to the Board of Directors through ICRC and RC. These reports include risk and investment review of Group's portfolio and its impact on Group's capital adequacy.

As part of the Risk Management reporting framework, tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up-to-date information. A periodic briefing is given to the CEO and all other relevant members of the Group on the utilization of market limits, proprietary investments, and liquidity, plus any other risk developments.

4.2 Credit risk

4.2.1 Introduction

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. The Group controls credit risk by monitoring credit exposures, and continually assessing the creditworthiness of counterparties.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept in terms of counterparties, product types, geographical and industry. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions.

Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision by the Bank. Any changes to the Credit Rating Methodology will be approved by the Board.

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

4.2.1 Introduction (continued)

All credit proposals undergo a comprehensive risk assessment which examines the customer's financial condition, performance, nature of the business, quality of management, and market position, etc. The credit approval decision is then made and terms and conditions are established.

Exposure limits are based on the aggregate exposure to counterparty and any connected entities across the group. Corporate contracts & facilities are reviewed on regular basis by Investment Banking Division (IBD) and Treasury and Capital Markets (TCM) and ICRC.

4.2.2 Types of Credit Risk

Financing receivables mainly comprise of Murabaha (International Commodity), Mudaraba and Musharaka.

4.2.2.1 Murabaha (International Commodity)

A commodity Murabaha is a contract between the Bank and its client for the sale of goods at a price plus an agreed profit margin for the Bank. The instrument is called an international commodity Murabahah because the profits are made on the international buying and selling of a commodity, usually metal, such as copper, aluminium or lead.

4.2.2.2 Mudaraba

The Group enters into Mudaraba contracts by investing in funds operated by other banks and financial institutions for a definite period of time.

4.2.2.3 Musharaka

Musharaka financing is partnership in which the Group contributes capital. These are stated at the fair value of consideration given less impairment.

4.2.3 Past Due and Impaired Islamic Financing

The Group defines non–performing facilities as the facilities that are overdue for a period of 90 days or more. These exposures are placed on a non–accrual status with income being recognized to the extent that it is actually received. It is the Group's policy 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 and payments.

As a policy, the Bank has placed on a non–accrual status any facility where there is reasonable doubt about the collectability of the receivable irrespective of whether the customer concerned is currently in arrears or not.

Islamic financing assets are stated at cost less impairment allowances. Specific provisions are created for impairment where losses are expected to arise on non-performing contracts.

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

4.2.3 Past Due and Impaired Islamic Financing (continued)

These assets are written off when they are considered to be uncollectable to reduce all impaired assets to their expected realisable values. Deferred income and provision for impairment are netted off against the related receivables. The Group assesses at each statement of financial position date whether there is objective evidence that a financial asset is impaired. The Group assesses at each financial position date whether there is objective evidence that a financial asset is impaired. In the case of equity-type instruments at fair value through equity, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired.

If any such evidence exists for equity-type instruments at fair value through equity, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in consolidated statement of income) is removed from owners' equity and recognised in the consolidated statement of income. Impairment losses recognised in the consolidated statement of income on equity instruments are not subsequently reversed through the consolidated statement of income.

Impairment losses on murabaha receivables and debt-type instruments at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the assets' original effective profit rate. Losses, if any, are recognised in the consolidated statement of income and reflected in an allowance account against murabaha receivables and debt-type instruments at amortised cost. When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the consolidated statement of income.

4.2.4 External Credit Assessment Institutions

To assess the creditworthiness of Financial Institutions (FI) the Bank relies on external ratings by external credit assessment institutions like Standard & Poor's, Fitch and Moody's. In case of unrated FIs, the Bank will assess the credit risk on the basis of its internally developed credit rating approach & methodology.

4.2.5 Definition of Geographical Area

The geographic distribution of the credit exposures is monitored and reported on ongoing and regular basis. The Bank's classification of geographical area is according to its business needs and the distribution of its portfolios.

4.2.6 Concentration Risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. being overexposed to a single customer, industry sector or geographic region. As per CBB's single obligor regulations, Banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15% of the regulatory capital base.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. In case any exposure exceeds the CBB's prescribed limits, Group obtains approval from the CBB.

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

4.2.7 Credit Risk Mitigation

Credit risk mitigation is defined as the utilization of a number of techniques, such as collaterals and guarantees to mitigate the credit risks that the Bank is exposed to. The group's first priority when establishing Islamic financing is to determine the borrower's capacity to repay and not to rely principally on security or collateral. Nonetheless, the Bank is in the process of developing its collateral management policy which would be in line with its business activities.

4.2.8 Counterparty Credit Risk

4.2.8.1 Introduction

A counterparty is defined as an obligor (individual, company, other legal entity), a guarantor of an obligor, or person receiving funds from the Bank. It also includes the issuer of a security in case of a security held by the Bank, or a party with whom a contract is made by the Bank for financial transactions.

The measure of exposure reflects the maximum loss that the Bank may suffer in case the counterparty fails to fulfill its commitments. Group exposure is defined as the total exposure to all counterparties closely related or connected to each other. Large exposure is any exposure whether direct, indirect or funded by restricted investment accounts to a counterparty or a group of closely related counterparties which is greater than or equal to 10% of the Bank's Capital Base. The Bank has adopted Standardized Approach to allocate capital for counterparty credit risk.

4.2.8.2 Credit Limit Structure

The bank has put in place an internal counterparty limit structure which is based on internal or external ratings for different types of counterparties. The bank has also set concentration limits as a percentage of investment and financing portfolio. In case of a counterparty rating degrade, the bank may require further collateral or advise the counter party to reduce its exposure on a case by case basis.

Reporting
The Bank reports large counterparty exposures to CBB and senior management on periodic basis. The Bank reports the exposures on a gross basis without any offset. However, debit balances on accounts may be offset against credit balances where both are related to the same counterparty, provided the Bank has a legally enforceable right to do so.

Early warning indicators
The Bank maintains a strong focus on identification of signs of deterioration in credit quality at an early stage in order to take remedial measures before the facility becomes substandard or doubtful.

4.2.8.3 Connected counterparties

Connected counterparties are companies or individuals connected with the Bank or its subsidiaries and associated companies (whether such association is due to

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

4.2.8 Counterparty Credit Risk (continued)

4.2.8.3 Connected counterparties (continued)

control or shareholding or otherwise), Directors and their associates (whether such association is due to control, family links or otherwise), members of the Sharia Supervisory Board, management and other staff and shareholders holding more than 10% or more of the equity voting rights in the Bank.

As a Bank's strategy exposure to connected counterparties may be undertaken only when negotiated and agreed on an arm's length basis. The Bank shall not assume any exposure to its external auditors or members of Sharia Supervisory Board. The disclosure relating to related party transactions has been made in the consolidated financial statements. All related party transactions have been made on arm's length basis.

4.2.8.4 Highly Leverage Counterparties

The Bank assess counterparties through financial and non-financial due diligence and uses CBB's definition of Highly Leveraged Counterparties to determine exposure to them. As per CBB's definition the Bank is not exposed to any Highly Leveraged Counterparties.

4.2.8.5 Restructuring of Credit Facilities

There has not been any restructured credit facilities (according to the definition in the Prudential Information Return instructions) during 2012.

4.2.8.6 Recourse Transactions

The Bank does not currently have any obligations with respect to recourse transactions.

4.2.9 Credit Risk Mitigation

The credit exposure information presented in table 7 of this report represents gross exposures prior to the application of any credit risk mitigation techniques. Collateral items and guarantees which can be used for credit risk mitigation under the capital adequacy framework are referred to as eligible collateral. However, extending credit facilities is not a part of the Bank's core business activities. The Bank's credit risk mainly arises from its investment transactions.

Nonetheless, the Bank intends to develop its collateral management policy and provisioning policy which would be in line with its business activities.

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

Table – 6. Credit Risk Exposure (PD–1.3.23(a)) - As per the CBB Rulebook

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

	31 December 2012	
	Total gross credit exposure (USD '000)	*Average gross credit exposure over the year (USD '000)
Funded exposure		
Balances with banks	12,979	6,055
Due from financial institutions	35,083	26,676
Financing receivables	13,698	5,263
Musharaka financing	1,903	1,222
Receivable from Ijara investors	14,801	3,700
Investment in securities	72,381	75,568
Other assets	3,631	1,598
Unfunded exposure		
Uncalled capital commitments in respect of investment	13,506	3,376
Promise to purchase foreign currency commitment	484	121
Commitment related to project developments	133	33
	168,599	**123,612**

*Average balances are computed based on quarter-end balances.

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

Table – 7. Credit Risk – Geographic Breakdown (PD–1.3.23(b)) - As per the CBB Rulebook

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

	31 December 2012				
	Middle East	Europe	Africa	South East Asia	Total
	(USD '000)	(USD '000)	(USD '000)	(USD '000)	(USD '000)
Funded exposure					
Balances with banks	8,762	4,183	-	34	12,979
Due from financial institutions	35,083	-	-	-	35,083
Financing receivables	12,372	1,326	-	-	13,698
Musharaka financing	917	-	-	986	1,903
Receivable from Ijara investors	14,801	-	-	-	14,801
Investment in securities	67,594	4,787	-	-	72,381
Other assets	2,651	46	134	800	3,631
Unfunded exposure					
Uncalled capital commitments in respect of investment	13,506	-	-	-	13,506
Promise to purchase foreign currency commitment	-	484	-	-	484
Commitment related to project developments	133	-	-	-	133
	155,819	10,826	134	1,820	168,599

The Group allocates exposures to a particular geographical area based on the risk domicile concept, which could be either the location of the asset or on the location of the counterparty.

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

Table – 8. Credit risk – Industry Sector Breakdown (PD–1.3.23(c)) - As per the CBB Rulebook

The following table summarises the distribution of funded and unfunded exposure by industry type broken down by major types of credit exposure as of:

	31 December 2012				
	Trading and manufacturing (USD '000)	Banks and financial institutions (USD '000)	Real Estate (USD '000)	Others (USD '000)	Total (USD '000)
Funded exposure					
Balances with banks	-	12,979	-	-	12,979
Due from financial institutions	-	35,083	-	-	35,083
Financing receivables	-	-	1,326	12,372	13,698
Musharaka financing	-	986	-	917	1,903
Receivable from Ijara investors	-	-	-	14,801	14,801
Investment in securities	-	12,495	39,461	20,425	72,381
Other assets	13	422	689	2,507	3,631
Unfunded exposure					
Uncalled capital commitments in respect of investment	-	-	-	13,506	13,506
Promise to purchase foreign currency commitment	-	484	-	-	484
Commitment related to project developments	-	-	-	133	133
	13	62,449	41,476	64,661	168,599

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

Table – 9. Credit Risk – Concentration of Risk - As per the CBB Rulebook

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	Own capital and current account Concentration risk %
Counterparty # 1	12.30%
Counterparty # 2	11.20%

4 RISK MANAGEMENT (continued)

4.2 Credit risk (continued)

Table – 10. Maturity breakdown of credit exposures (PD–1.3.23(g)) - As per the CBB Rulebook

The following table summarises the residual contractual maturity breakdown of the whole credit portfolio, broken down by major types of credit exposure as of 31 December 2012:

	Up to 1 month (USD '000)	1 month to 3 months (USD '000)	3 months to 1 year (USD '000)	1 to 5 years (USD '000)	5 to 10 years (USD '000)	No fixed maturity (USD '000)	Total (USD '000)
Funded exposure							
Balances with banks	12,979	-	-	-	-	-	12,979
Due from financial institutions	30,547	-	4,536	-	-	-	35,083
Financing receivables	1,326	-	12,372	-	-	-	13,698
Musharaka financing	481	296	770	356	-	-	1,903
Receivable from Ijara investors	-	-	11,408	-	-	3,393	14,801
Investment in securities	9,789	-	-	33,840	28,752	-	72,381
Other assets	1,661	-	1,055	356	-	559	3,631
Unfunded exposure							
Uncalled capital commitments in respect of investment	-	5,703	7,803	-	-	-	13,506
Promise to purchase foreign currency commitment	484	-	-	-	-	-	484
Commitment related to project developments	-	133	-	-	-	-	133
	57,267	6,132	37,944	34,552	28,752	3,952	168,599

Table – 11. Breakup of provision by geographic area (PD-1.3.23(h & i)) and (PD-1.3.24(c))

	Specific impairment provision (USD '000)
South East Asia	56

Only an amount of USUSD 82 thousand of musharaka financing was impaired as of 31 December 2012 (2011: Nil).

4 RISK MANAGEMENT (continued)

4.3 Market risk

4.3.1 Introduction

Market risk is defined as the risk of losses in on-balance sheet and off-balance-sheet positions arising from movements in market prices. The risks subject to this requirement are:

- The risks pertaining to profit rate related instruments and equities in the trading book; and
- Foreign exchange risk and commodities risk throughout the bank.

The Group manages its market risk exposures by evaluating each new product and activity with respect to the market risk introduced by it.

4.3.2 Market Risk Factor

For the Bank, market risk may arise from movements in foreign exchange rates. A single transaction or financial product may be subject to foreign exchange risk.

The Board has set stop loss limits for fx trading activities. Positions are monitored on a regular basis to ensure risk is maintained within established limits.

4.3.3 Market Risk Strategy

The Board is responsible for approving and reviewing the market risk strategy. The Bank's senior management is responsible for implementing the market risk strategy approved by the Board, and continually enhancing the market policies and procedures for identifying, measuring, monitoring and controlling market risks.

In line with the Bank's Risk Management objectives and risk tolerance levels, the specific strategies for market risk management include:

- The Bank will proactively monitor and manage the market risk in its portfolio using a Board approved limit structure;
- The Bank will establish a market risk appetite which will be quantified in terms of a market risk limit structure for monitoring its market risk. This will be approved by the Risk Committee and the Board;
- The Bank will at all times hold sufficient capital in line with the Pillar 1 regulatory capital requirements of the Central Bank of Bahrain;
- The Bank will carry out stress testing periodically to assess the effect of extreme movements in market variables which may expose the Bank to high risks;
- The Bank will clearly identify the foreign currencies in which it wishes to deal in. The Bank will manage its market risk in all foreign currencies in which it has significant exposure; and
- The Bank will manage its market risk exposure by evaluating each new product or activity with respect to the market risk introduced by it.

4.3.4 Market Risk Measurement Methodology

The Group is not exposed to significant market risk due to the nature of its activities and

4 RISK MANAGEMENT (continued)

4.3 Market risk (continued)

4.3.4 Market Risk Measurement Methodology (continued)

hence uses measurements involving a combination of limits to control market risk exposures. For calculating the market risk capital charge, the Group applies the Standardized Approach.

4.3.5 Market Risk Monitoring & Reporting and Limits Structure

The Bank uses a combination of limits to control its market risk exposures. Positions are monitored on a regular basis to ensure risk is maintained within established limits.

Table – 12. Market Risk Capital Requirements

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

	31 December 2012	
	Weighted risk exposures (USD '000)	**Market risk capital requirement** (USD '000)
Capital requirements - Foreign Exchange Risk	**61,863**	**7,424**
Maximum value of RWE	61,863	7,424
Minimum value of RWE	38,917	4,670

4.4 Operational risk

4.4.1 Introduction

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all business and covers a large number of operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

The Group cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Group is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

The Board has the ultimate responsibility for operational risk. Oversight rests with the RC, ICRC and RMD. Risk and Control Self Assessment (RCSA) is an annual exercise as per Bank’s policy and is a requirement by Central Bank of Bahrain based on Basel II principles related to operational risk management. During the year 2012 the Group decided to postpone the RCSA exercise to 2013 due to the merger process.

The Group has developed a Disaster Recovery and Business Continuity Plan (DR&BCP) to enable the Group to survive a disaster and to re-establish normal business operations. The DR&BCP will enable the Group to minimize interruptions to business service operations, resume critical operations within a specified time after a disaster, minimize financial loss due to disruptions, limit the severity of the disruption, expedite the restoration of services and maintain a positive public image of the Bank.

4 RISK MANAGEMENT (continued)

4.4 Operational risk (continued)

4.4.2 Sources of Operational Risk

The different sources of operational risks faced by the Bank can be classified broadly into the following categories:

People Risk which arise due to staffing inadequacy, unattractive remuneration structure, lack of staff training, lack in procedures for appointment, unhealthy professional working relationship and unethical environment;

Processes Risk which arise due to inadequate general controls, inadequate application controls, improper business and market practices and procedures, inappropriate or inadequate monitoring and reporting; and

Systems (Technology) Risk which arise due to the Integrity of information, hardware failures due to power surge, obsolescence, low quality and software failure due to unauthorized or incorrect modifications to software programs, computer virus, programming bug.

4.4.3 Operational Risk Management Strategy

The Bank's Board is responsible for approving and reviewing (at least annually), the operational risk strategy and significant amendments to the operational risk policies. The Bank's senior management is responsible for implementing the operational risk strategy approved by the Board to identify, measure, monitor and control the risks faced by the Bank. The Bank continuously monitors the process and controls framework surrounding all business units to assess their effectiveness and efficiency.

As a strategy the Bank will identify the sources of operational risks in coordination with each business unit. The operational risk identification, assessment and measurement process will involve the following steps:

Management and Reporting of KRIs
The Bank has integrated the process of KRIs into the RCSA process and the reporting of KRIs has started bank-wide.

Incident reporting
An incident is the occurrence of an operational risk event that has caused, or has the potential to cause a financial, reputation or regulatory impact on the Bank. It includes credit or market risk events, which have been caused by an operational risk event, and non–compliance with any legal or regulatory requirement, license, internal policy or procedure or code.

Operational Loss Database
The Operational Loss Database (OLD) is a key component to quantify past operational risk exposures. The OLD contains a subset of the information captured by the incident reporting process since all incidents involving an actual or potential financial impact (including near misses) is captured.

4.4.4 Operational Risk Monitoring and Reporting

The internal monitoring and reporting process ensures a consistent approach for providing pertinent information to Senior Management and the RC for the quick detection

4 RISK MANAGEMENT (continued)

4.4 Operational risk (continued)

4.4.4 Operational Risk Monitoring and Reporting

and correction of deficiencies in the policies, processes and procedures for managing operational risk through ongoing, periodic reviews.

The objective of the reporting process is to ensure relevant information is provided to senior management and the Board to enable the proactive management of operational risk. The process ensures a consistent approach for providing information that enables appropriate decision making and action taking.

4.4.5 Operational Risk Mitigation and Control

Control activities are necessary to address the specific operational risks that the Bank has identified through the RSCA process. For the material risks identified by the Bank, the Bank decides whether to use procedures to control, mitigate, transfer, or accept the risks.

The Bank has several options for controlling and/or mitigating these risks:

- Decline to accept the risk (i.e. by avoiding certain business strategies or customers)
- Accept and retain the risk but introduce mitigating internal or external controls
- Accept the risk and transfer it in part or in whole.

Key controls
The Bank aims to control the operational risks it is exposed to by strengthening its internal controls, continuing its efforts to identify, assess, measure and monitor its risks, evolving in its risk management sophistication and promoting a strong control culture within the Bank.

Each business unit head is responsible for ensuring that the internal controls relevant to its operations are complied with on a day to day basis in spirit as well as in letter. The Bank will furthermore establish control processes and procedures and implement a system for ensuring compliance with these internal risk control processes and procedures.

4.4.6 Disaster Recovery and Business Continuity Plan (DR&BCP)

The Bank has developed a Disaster Recovery and Business Continuity Plan (DR&BCP) based on risk review of the banks activities. The Bank ensures that business recovery & contingency plans are reviewed and updated periodically. The DR&BCP is in the implementation stage.

In particular, the DR&BCP will satisfy the following:

- it will cover incidents related to IT, communication and premises;
- testing will include critical business processes; and
- testing will cover critical types of plausible scenarios to which the Bank may be vulnerable.

4.5 Equity price risk

4.5.1 Equity price risk management

Equity price risk is the risk that the fair value of equities decreases as the result of adverse changes in equity prices or indices, or fair value in the case of unquoted equities. Equity

4 RISK MANAGEMENT (continued)

4.5 Equity price risk (continued)

4.5.1 Equity price risk management (continued)

price risk arises from the Bank's investment portfolio. The Bank does not have an active trading book and all its equities are in the banking book. A 100% risk weight is assigned to listed equities. Unlisted equities and unrated funds are risk weighted at 150%.

The accounting policies, including valuation methodologies and their related key assumptions, are disclosed in the consolidated financial statements.

An assessment is made at each year-end to determine whether there is any objective evidence that equity investments may be impaired. Any impairment for significant and prolonged decline in the value of investments is reflected as a write down of investments. Any subsequent increase in their fair value is recognized directly in equity. Investments are managed within maximum concentration risk limits, approved by the Board of Directors of the Bank.

Table – 13. Equity Position Risk in the Banking Book (PD-1.3.31(b), (c) & (f)) - As per The CBB Rule 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 (USD '000)	* Average gross exposure over the period (USD '000)	Publicly Traded (USD '000)	Privately held (USD '000)	Capital requirement (USD '000)
Amortized cost	72,381	75,568	72,381	-	12,101
Fair value through statement of income	20,348	5,087	-	20,348	5,591
Fair value through equity	139,338	60,557	13,665	125,673	27,824
Investment in associates	5,047	3,845	-	5,047	385
	237,114	145,057	86,046	151,068	45,901

*Average balances are computed based on quarter-end balances.

Table – 14. Equity gains or losses in the Banking Book (PD-1.3.31(d) to (e))

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

	31 December 2012 USD ('000)
Cumulative realised gains arising from sales or liquidations in the reporting year	3,642
Total unrealized gains recognised in the consolidated statement of financial position but not through consolidated statement of income	796
Unrealised gross losses included in Tier 1 Capital	(456)
Unrealised gains included in Tier 2 Capital (45% only)	563

4 RISK MANAGEMENT (continued)

4.6 Rate of return risk

4.6.1 Rate of return risk management

The rate of return risk is generally associated with overall balance sheet exposures where mismatches arise between assets and balances from fund providers. The Group is not exposed to any significant rate of return risk and is aware of the factors that give rise to rate of return risk. Factors that possibly will affect rate of return may include an increase in long-term fixed rates in the market. The Bank is also aware of the fact that in general, profit rates earned on assets reflect the benchmark of the previous period and do not correspond immediately to changes in increased benchmark rates.

The Bank uses a combination of mismatch gap limits to measure and control its rate of return risk. Mismatched positions are regularly monitored to ensure that mismatch is maintained within established limits.

The profit rate shock will have a negative impact in the case of a downward movement.

Displaced commercial risk (DCR) refers to the market pressure to pay returns that exceed 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 manages DCR through the Asset Liability Committee (ALCO). The Bank is currently in the process of developing written policies and procedures for Displaced Commercial Risk. The bank will forego its fee in case DCR arises. The bank benchmarks its rates with other leading banks in the market.

4.7 Liquidity risk

4.7.1 Introduction

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.

The main action to manage the Group's liquidity is through the adherence to limits on liquidity mismatches. These include the limits of the cumulative excess of maturing liabilities over assets in the short-term and limits on dependence on short-dated funds.

Treasury department is overall responsible for ensuring that the limits enacted are adhered to, on a day-to-day basis and managing excess liquidity of the Group through short term placements and investments. Treasury maintains a constant communication with the banks which have extended a committed short term financing line to the Group. The Treasury provides a monthly report to the ALCO regarding the dependability and reliability of these banks. Treasury also monitors the market conditions and the volatilities of the asset prices and as such the exogenous liquidity risk the Group is exposed to.

4.7.2 Sources of Liquidity Risk

Broadly, sources of liquidity risk can be listed as:

a) **Funding Risk** – Inability to replace net outflows due to unanticipated withdrawal of capital or deposits;

4 RISK MANAGEMENT (continued)

4.7 Liquidity risk (continued)

4.7.2 Sources of Liquidity Risk (continued)

b) Call Risk – Crystallization of a contingent liability; and
c) Event Risk – Rating downgrades or other negative news leading to a loss of market confidence in the Bank.

Liquidity risk may also arise if certain inter-bank funding lines are withdrawn or assets do not realize cash as expected and when anticipated.

4.7.3 Liquidity Risk Strategy

The Board is overall responsible for approving and reviewing (at least annually), the liquidity risk strategy and significant amendments to the liquidity risk policies. The Bank senior management is responsible for implementing the liquidity risk strategy to identify, measure, monitor and control the risks faced by the Bank.

The Bank monitors the liquidity positions by comparing maturing assets and liabilities in different time buckets.

To mitigate the liquidity risk, the Group works with diversified funding sources, manages its assets with liquidity in mind and closely monitors periodic cash forecasts which take into account the Group's maturity profile."

4.7.4 Liquidity Risk Measurement Tools

The bank has developed risk management policies and procedures including liquidity risk management framework. The Bank will use a combination of techniques for measurement of its liquidity risk. These would include Liquidity Gap Analysis and monitoring of liquidity ratios.

Table – 15. Liquidity ratios (PD-1.3.37) - As per the CBB Rulebook

The following table summarises the liquidity ratios as of:

	31 December 2012
Liquid assets to total assets	**12.56%**
Short term assets to short term liabilities	**255.23%**

Formula is as follows:

Liquid Assets to total assets = (Cash and bank balances + due from financial institutions)/total assets

Short term assets to short term liabilities = Assets with up to one year maturity/liabilities with up to one year maturity

4 RISK MANAGEMENT (continued)

4.7 Liquidity risk (continued)

Table – 16. Quantitative indicators of financial performance and position (PD–1.3.9) - As per The CBB Rulebook

	Dec 2012	***Dec 2011****	***Dec 2010****	***Dec 2009****	***Dec 2008****
Return on average equity (ROAE)	**-5.14%**	-2.66%	-11.92%	-14.43%	1.17%
Return on average assets (ROAA)	**-4.55%**	-2.60%	-11.88%	-14.36%	1.16%
Total cost to Income ratio	**76.73%**	92.66%	90.39%	133.02%	66.01%

* Ratios are based on pre-merger financials

Formula is as follows:

ROAE = Net Income/Average Equity
ROAA= Net profit/ Average Assets

Bank's Financial Performance (PD-1.3.9 (a)) - As per the CBB Rulebook

2012 was a year of weak economic growth for the global economy with the sovereign debt crisis in Europe and policy uncertainties in the U.S impacting investment and business sentiment. The general challenging environment made it very difficult for the Group to achieve rewarding financial returns. Although the net income stood at USD 2.8 million compared to USD 0.7 in 2011, the recorded net loss stood at USD 12.4 million compared to USD 4.2 million in 2011 after provision and impairment. The total revenues stood at USD 11.9 million compared to USD 9.8 million in 2011, while total assets summed up to USD 382.8 million compared to USD 160.96 million in 2011. Moreover, Shareholders' equity recorded USD 326.4 million compared to USD 154.77 million in 2011.

As a result of sharp vision, hard work and team effort, the Bank has successfully merged with Capivest B.S.C (c) and Capital Management House B.S.C.(c) in 2012 to create a new leader in Bahrain and the broader region, as well as sowing the seeds of what will become a significant international banking group.

With an authorized capital of USD 500 million and paid up capital of USD 300 million, the Group is strengthened with a total equity of approximately USD 326 million and total assets in excess of USD 383 million spanning the Middle East and North Africa (Mena), Europe and Asia.

The merger of the banks is just the beginning. We aim to build on the momentum to become a leading regional financial institution, with an increasing international presence. We will leverage financial strength, scale and market positioning to capture domestic and regional opportunities. We will become the partner of choice for wholesale, investment, treasury and Islamic banking Clients seeking financial services in the region.

4.8 Legal Contingencies

The following are the material* current or pending legal actions which involve potential liability to the Bank:

1. Ali Iskandar Ansari and Partners - We are defendants to a claim in a private equity in Qatar whereby the local promoter is claiming approximately USD 1 million due as fees for establishing the joint venture. The local promoter also raised 3 other claims in court and all three

4 RISK MANAGEMENT (continued)

4.8 Legal Contingencies (continued)

cases have ended in our favour. Our expectation is this will likewise result in our favour. Additionally, we may be pursuing our own claim against the promoter in the near future to recover our investment in the joint venture.

2. Transweld - Our Libyan investment vehicle TAB Energy's subsidiary Etelaf was sued by a service provider relating to the oil rigs owned by the company. A judgment in the amount of USD 600,000 was obtained, and is currently in the process of being executed upon.

*materiality involves disputes involving potential liabilities in excess of USD 300,000, or 0.1% of our capital.

4.8.1 Managing and Controlling Legal Risks

As a general policy, the Bank seeks to resolve any potential conflict amicably to the extent practicable. In cases where we are faced with circumstances in which resolution may not be reached for a variety of reasons, we attempt to mitigate the risks involved by ensuring at the outset that we are fully aware of the risks involved and obtain an expert legal opinion on the matter and expected outcome. The bank also attempts to ensure that disputes are handled efficiently and expeditiously by sophisticated capable arbiters. As such, and in accordance with the guidance of the CBB, our preferred venue for dispute resolution is mediation followed by arbitration and lastly litigation in the traditional courts.

Corporate Governance

Corporate Governance

The Bank is committed to adopting the best international standards and global leading practices in corporate governance. The Bank has established a strong corporate governance framework that is designed to protect the interests of all stakeholders, ensure compliance with regulatory requirements, and enhance organisational efficiency.

As the merger was officially completed on 31 December 2012, this section primarily related to items pre-merger. The main changes post mergers are:

- Recomposition of the Board.
- Organization Chart
- Management team and Committees

The Bank has established a concrete organisational structure that clearly segregates functions and responsibilities, and reflects a division of roles and responsibilities of the Board of Directors and Management. Clear mandates exist for the Board, Chairman of the Board, Board Committees, Chief Executive Officer, the Management, and Management Committees.

The Bank has only one class of equity shares and the shareholders are from the following nationalities (PD-1.3.10(i)) - As per the CBB Rulebook:

Country	Percentage
1- State of Kuwait	51.37%
2- Kingdom of Bahrain	23.60%
3- Kingdom of Saudi Arabia	14.67%
4- Qatar	4.60%
5- United Arab Emirates	3.62%
6- Oman	2.01%
7- Jordan	0.13%

The distribution of ownership of shares by size of shareholder is provided below (PD-1.3.10(l)) - As per the CBB Rulebook: :

Size of Ownership	No. of Shareholders
25 - 30 %	1
5 - 10 %	2
1 - 5 %	18
Less than 1 %	115
	136

Board Members' Profile

The primary responsibility of the Board is to provide effective governance over the Bank's affairs and promote and achieve sustainable performance that has long-term growth potential for the benefit of its shareholders. The Board also has the duty of balancing interest of all its stakeholders, including its clientele, business partners, correspondents, employees, suppliers and local communities, all the time maintaining standards of transparency and accountability.

Elaf strives to be consistent with the Central Bank of Bahrain (CBB) Rulebook and the international best practices of Corporate Governance. The Bank endeavors to observe all of the requirements of the corporate governance code to the letter and spirit. Recommendations such as having an independent chairman, forming a corporate governance committee, and compositions of the committees are taken into consideration at each applicable cycle, and any non-application is done so with full consideration of the rules, regulations and international best practices. The Bank will continue to seek comprehensive conformity to the requirements and recommendations on an ongoing basis.

In all actions taken by the Board, the Directors are expected to exercise their business judgment in what they reasonably believe to be in the Bank's best interest. In discharging this obligation, they may rely on the professional integrity of the Bank's Senior Executives, as well as its external advisors and auditors. The Board of directors members are summarized in the next page.

Elaf's Board of Directors' structure constitute of 7 members as of December 31, 2012, however, this number has increased to 10 after the merger with changes in some board members and during the Ordinary General Meeting which took place on 29 January 2013.

The following table summarises the information about the profession, business title, experience in years, start date and the qualifications of the Board members of 31 December 2013;

Name of Board Member	Profession	Business Title	Executive / Non Executive Independent / Non Independent	Experience in years	Start date and term	Qualification
Paul Mercer	Lawyer	Executive Manager, Kuwait Finance House – Bahrain	Non-Independent / Non-Executive	Over 18	July 2011, 3 years	M.A. Law Cambridge University
Jamal Abdulla Al Saleem	Accountant	Deputy General Manager, Privatization Holding Company	Non-Independent / Non-Executive	Over 32	July 2011, 3 years	B.A. Accounting- Kuwait University M.S Accounting Oklahoma City University
Saeed Abdal Hadi Al Kayareen	Banker	Assistant General Manager, QIB Capital & International Business Group	Non-Independent / Non-Executive	Over 15	July 2011, 3 years	Bachelor of Science Certified Lender Business Banker
Mohammad Khalifa Al Adsani	Accountant	Operations Director, Aref Investment Group	Non-Independent / Non-Executive	Over 21	July 2011, 3 years	MBA - University of Leicester
Abdulla A. Al Marzouq	Banker	Deputy Dept Manager, International Investments	Non-Independent / Non-Executive	Over 17	July 2011, 3 years	MBA -MIT Sloan School of Management
Isa Mohamed Habib	Banker	Financial Advisor, Ghanim Bin Saad Al Saad & Sons Group-Holdings	Independent / Non-Executive	Over 33	July 2011, 3 years	Banking Diploma from Bahrain Institute of Banking & Finance
Mohamed Douaidy	Accountant	Businessman	Independent / Non-Executive	Over 60	July 2011, 3 years	The Association of Certified Public Accountants (International) England, Fellow Member since 1997 FCPA

Corporate Governance

The Board shall meet on a quarterly basis, or otherwise at least four times in every financial year. During the year ended 31 December 2012 eight Board meetings were held. The following table summarises the information about Board of Directors meeting dates and attendance of directors at each meeting;

Table – 1. Corporate Governance and Transparency – Board of Directors meetings in 2012 (PD-1.3.10(t and u)) - As per the CBB Rulebook

Corporate Governance

Date	Names of Directors Present (Physical)	Names of Directors who participated by phone/video link	Names of Directors not Present
4-Jan-12	Jamal Abdulla Al-Saleem Saeed Abdal Hadi Al-Kayareen Isa Mohamed Habib Paul Mercer Mohammed Al Adsani Abdulla Al Marzouq		Mohamed Douaidy
12-Feb-12	Jamal Abdulla Al-Saleem Saeed Abdal Hadi Al-Kayareen Isa Mohamed Habib Paul Mercer Mohammed Al Adsani Mohamed Douaidy		Abdulla Al Marzouq
22-Feb-2012 (by circulation)		Jamal Al-Saleem Saeed Al-Kayareen Mohamed Douaidy Isa Habib Paul Mercer Mohammed Al Adsani Abdulla Al Marzouq	
11-Mar-12	Jamal Al-Saleem Saeed Al-Kayareen Mohamed Douaidy Isa Habib Paul Mercer Mohammed Al Adsani Abdulla Al Marzouq		
7-May-12	Saeed Al-Kayareen Mohamed Douaidy Isa Habib Paul Mercer Abdulla Al Marzouq		Jamal Al-Saleem Mohammed Al Adsani
16-May-12	Jamal Al-Saleem Saeed Al-Kayareen Mohamed Douaidy Isa Habib Paul Mercer Mohammed Al Adsani Abdulla Al Marzouq		
6-Aug-12	Jamal Al-Saleem Saeed Al-Kayareen Mohamed Douaidy Isa Habib Paul Mercer Abdulla Al Marzouq		Mohammed Al Adsani
8-Nov-12	Jamal Al-Saleem Saeed Al-Kayareen Mohamed Douaidy Isa Habib Paul Mercer Abdulla Al Marzouq		Mohammed Al Adsani

Corporate Governance

No changes occurred to the Board Structure during 2012. However, due to merger between Elaf, Capivest and CMH on 31 December 2012 the shareholders elected new board members on January 29, 2013 during the Ordinary General Meeting.

The following table summarises the information about the directorships held by the pre-merger directors in other boards:

Table – 2. Information on the directorships held by the directors on other boards;

Name of Board Member	Directorship in other companies - based outside Bahrain	Directorship in other companies - based in Bahrain
Paul Mercer	Liberty Aerospace Inc., US (Delaware) Sinwan Limited, Cayman Motherwell Bridge Limited, UK Elydale Limited, UK Motherwell Bridge Group Limited, Cayman Radius Health Group Limited, New Zealand Fernas Investors Ltd., Cayman Baytik International Investments Advisory Ltd, Cayman Fernas Europe II ehf, Iceland Fernas Europe slf, Iceland Liberty Aerospace Holdings Inc., US (Delaware)	Baytik Capital Holding BSC New Zealand Australia Private Equity Company BSC
Jamal Abdulla Al Saleem	Al Masar for Leasing & Investment Company, Kuwait Kuwait International Fair Company, Kuwait Kuwait Investment Company, Kuwait	
Saeed Abdal Hadi Al Kayareen	Detaman Bank, Yemen	-
Mohammad Khalifa Al Adsani	-	-
Abdulla A. Al Marzouq	-	-
Isa Mohamed Habib	Emtiaz Engineering & Energy Triple E Holding Company, Kuwait GSSG Holdings, Qatar Century Banking Corporation, Mauritius GSSG Holdings Asia Pacific Pte Ltd, Singapore Zait for Petroleum- Singapore Pte Ltd, Singapore Zait Oil & Gas Pte Ltd, Singapore World Bridges Trading Pte Ltd, Singapore	Nuzul Holdings BSC
Mohamed Douaidy	-	-

Boards Committees

The minimum number of Board Committee meetings per year, per committee, should be four as per the Bank's policies and procedures. The following tables summarises the information about Board Committee meeting dates and attendance of directors at each meeting;

Corporate Governance

Table – 3. Corporate Governance and Transparency – Audit Committee meetings in 2012 (PD-1.3.10(w)) - As per the CBB Rulebook

Date	Names of Directors Present	Names of Directors Not Present
11-Mar-12	Mohamed Douaidy Isa Habib Paul Mercer	None
7-May-12	Mohamed Douaidy Isa Habib Paul Mercer	None
6-Aug-12	Mohamed Douaidy Isa Habib Paul Mercer	None
8-Nov-12	Mohamed Douaidy Isa Habib Paul Mercer	None

Table – 4. Corporate Governance and Transparency – Executive Committee meetings in 2012 (PD-1.3.10(w)) - As per the CBB Rulebook

Since the Board of Directors met 8 times during the year ended Dec 31st, 2012; no Executive Committee meetings were held.

Table – 5. Corporate Governance and Transparency – Risk Committee meetings in 2012 (PD-1.3.10(w)) - As per the CBB Rulebook

Date	Names of Directors Present	Names of Directors Not Present
11-Mar-12	Saeed Al-Kayareen Paul Mercer Abdulla Al Marzouq	None
7-May-12	Saeed Al-Kayareen Paul Mercer Abdulla Al Marzouq	None
6-Aug-12	Saeed Al-Kayareen Paul Mercer Abdulla Al Marzouq	None
8-Nov-12	Saeed Al-Kayareen Paul Mercer Abdulla Al Marzouq	None

Table – 6. Corporate Governance and Transparency – Remuneration and Nomination Committee meetings in 2012 (PD-1.3.10(w)) - As per the CBB Rulebook

Date	Names of Directors Present	Names of Directors Not Present
11-Mar-12	Jamal Al-Saleem Isa Habib Mohammed Al Adsani Sohail Niazi	None
5-Aug-12	Jamal Al-Saleem Isa Habib Sohail Niazi	Mohammed Al Adsani
6-Aug-12	Jamal Al-Saleem Isa Habib Sohail Niazi	Mohammed Al Adsani

Corporate Governance

The Remuneration Committee is combined with the Nomination Committee. A part from the Acting CEO the majority of the directors of the Remuneration & Nomination Committee are non-executive directors, including one independent director. The Chairman of the committee is non-executive director but not independent and has been selected for his seniority.

Changes in the Corporate Governance Structures (PD-1.3.10(g)) - As per the CBB Rulebook

No changes to the Corporate Governance Structures occurred in 2012.

Remuneration Policy and Aggregate Remuneration Paid to Senior Management and Board (PD-1.3.10(d, ii, jj and kk)) - As per the CBB Rulebook

The bank's remuneration policy for Senior Management is to provide competitive remuneration structure to attract and retain highly skilled personnel.

Aggregate remuneration paid to senior management during 2012 was USD 2,446 thousand (this includes salaries, allowances, other benefit and bonuses for the year ended 31 December 2012 that were disbursed after the closing of the financial year).

The bank's remuneration policy for Board Members is to appropriately compensate and remunerate board members for their active participation in board meetings. Based on this policy the Board of Directors remuneration was structured to comprise the following:

(a) Sitting fees
(b) Perdiem for members attending Board and sub-committee meetings
(c) Daily Allowance
(d) First class air tickets

Aggregate remuneration paid to Board Members during 2012 was USD 395 thousand.

A. Ownership of Shares by government (PD-1.3.10(m)) - As per the CBB Rulebook

Name of Government Authority	Country	No. of Shares	Percentage %
Social Insurance Organization	Kingdom of Bahrain	4,693,951	1.565%
The Public Authority for Minor Affairs	State of Kuwait	1,642,877	0.548%
Awqaf Public Foundation	State of Kuwait	1,642,877	0.548%
Directorate of Minors Affairs	Kingdom of Bahrain	259,880	0.087%

B. Director's trading of the bank's shares during the year (PD–6.1.1 (c)) - As per the CBB Rulebook

Directors have not made any trade of the Group's shares during the year.

Ownership of Shares by Directors / Senior Managers (PD-1.3.10(k)) - As per the CBB Rulebook

Name of Director / Senior Manager	On Behalf of	No. of Shares	Percentage %
Khalid AlBassam	Al-Bassam Investment Company	11,601,431	3.867%
Nasser AlMutawa	Samama Global Corporation	10,058,440	3.353%
Saleh AlAfaleq	Al-Kifah Holding Company	6,804,413	2.268%
Khalid Najibi	Najibi Investment Co. W.L.L.	5,223,800	1.741%
Mohamed AlJasim	Individual	646,631	0.216%
Sameeh AlKhan	Individual	291,561	0.097%

Corporate Governance

Type of Material Transactions that require Board approval (PD-1.3.10(o)) - As per CBB Rulebook

The following types of material transactions require Board approval if suggested by the approved policies:

(a) Conclude loan agreements with certain limit;
(b) Sell the company's assets;
(c) Mortgage the Company's properties;
(d) Grant guarantees to third parties;
(e) Discharge the Company's debts; and
(f) Engage in any other acts which may be integral to the company's objects as set out in the Memorandum of Association.

Induction, Education and Orientation of New Directors (PD-1.3.10(r)) - As per the CBB Rulebook

All new Directors participate in an orientation exercise that is administered by the Directors and members of the Management at Elaf. This orientation includes presentations by the Chairman, CEO and senior management to familiarize new Directors with Elaf's strategic plans, significant financial, accounting and risk management issues, compliance programs, the Code of Conduct, its principal officers, and internal and independent auditors.

In addition, the orientation includes visits to Elaf headquarter and, to the extent practical, Elaf's significant facilities. It is emphasized that Directors stay up-to date in relation to matters relevant to the Bank, the industry and the particular areas of expertise for which they have been invited on to the BOD in the first place. In particular the induction/orientation process will aim for a Director to have:

(a) An appropriate level of knowledge of the industry Elaf operates in.
(b) A clear understanding of Elaf's business operations.
(c) A clear understanding of Elaf's financial circumstances.
(d) A clear understanding of Elaf's strategy and direction.
(e) A high level knowledge of the business risks that may affect its success.
(f) Access to relevant background information on key employees and the other members of the BOD.
(g) In addition, new Directors are provided an Induction Package

The process of director induction is critical to having the new directors effectively and efficiently contributing to the Board of Directors. As part of this process, specifically, the new director shall:

(a) Be welcomed formally by the Chairman of the Board, who shall brief him generally on the Bank, the Board, the other directors, and the culture and operation of the Board.
(b) Meet with the Chief Executive Officer onsite at the Bank office to discuss the Bank strategy and plan and be introduced to key management staff.
(c) Be briefed on the history and legacy of the Bank and its key shareholders, clients, and partners.
(d) Be briefed by the Board Secretary on the general operations of the Board.
(e) Be provided all of the pertinent documentation, including but not limited to:

    i. Applicable laws and regulations, including the Commercial Companies Law, the CBB Rulebook and regulations
    ii. The Memorandum and Articles of Association
    iii. The Corporate Governance Manual
    iv. Organization Chart
    v. Business Plan
    vi. Schedule for Upcoming Board and Committee Meetings
    vii. The Board Minutes for the last 12 months (including the audio recording of the last meeting, if available)
    viii. The Board Packs for the last 12 months
    ix. The Board Committee Minutes for the respective committee he will be appointed to for the

x. The Annual Reports for the last 2 years

last 12 months (including the audio recording of the last meeting, if available)
x. The Annual Reports for the last 2 years
xi. The Quarterly Financials for the last 12 months

(f) Be provided any other documentation on the Bank, its products, services, market or competition, upon his request.

(g) Be afforded the opportunity to meet with any staff, consultants, or advisors, including the external auditor, upon his request.

Executive Members' Profile

Delegated by the Board with the authority for managing the Bank's operations, the Chief Executive Officer and the Executive Management Team of the Bank are responsible for implementing decisions, policies, procedures, and strategies approved by the Board of Directors. The Executive Management Team is comprised of:

Table – 7. Corporate Governance and Transparency – Executive Members' Profile (PD-1.3.10(b)) - As per the CBB Rulebook

The following table summarises the information about the profession, business title, experience in years and the qualifications of each Executive member;

Name of Executive Member	Designation	Profession	Business Title	Experience in year	Qualification
Paul Mercer	Chairman	Lawyer	Non Executive	Over 18	M.A. Law - Cambridge University
Sohail Niazi *	Acting Chief Executive Officer	Banker	Acting Chief Executive Officer	17 years in Advisory and Banking Sector	BSc in Industrial Technology MBA in International Management MSc in Finance
Akhtar Ali *	Head of Internal Audit	Auditor	Head of Department	12 years in Internal Audit	ICAEW, CIA, CIPA, BSc in Accountancy

* The above executive members have left the Bank subsequent to the year ended 31 December 2012**.**

Bank's Performance Linked Incentive Structure (PD-1.3.10(d)) - As per the CBB Rulebook

The remuneration & incentive structure of the Chief Executive Officer (CEO), Board Members and Sharia Members is discussed at the Board level. Remuneration of Board Members is approved in the Annual General Meeting (AGM). Bonuses are based on Bank's performance, division or department performance and individual staff performance. The board approves all performance bonus schemes for staff.

Related Party Transactions (PD-1.3.10(f))

Related party transactions are governed by the Group corporate governance policy. All related party transactions were concluded at arm's length.

Where the bank proposes to enter into a related party transaction the following procedures apply:

1- The relevant responsible officer involved in the transaction makes appropriate disclosure to the Compliance Officer of the bank. The Compliance Officer will review the transaction and send his/her comments to the Investment, Credit & Risk Committee (ICRC or the Committee) about the proposed transaction. This disclosure should include the following:

(a) Details of the proposed transaction;
(b) Proposed transaction parties and how they are related;
(c) How arm's length may be evidenced

2- The committee will consider the information provided in order to determine whether and how to proceed with the proposed transaction. The committee may confer with risk management and legal department or may take external legal advice, in reaching this determination.
3- The Committee shall review the material facts of the transactions that require the Committee's approval and either approve or disapprove of the entry into the related party transaction.

Assessment of Board of Directors Effectiveness & Contribution (PD-1.3.10(aa)) - As per the CBB Rulebook

The Board and the management of the Bank are committed to the highest standards of corporate governance and risk management, therefore the Bank has developed a methodology which incorporates a process to self-assess the performance of the Board by the Board members on ongoing basis. This methodology and performance criteria is developed and recommended in line with the Board approved corporate governance policy and terms of reference. Self assessment shall help the board to establish clear expectations and goals to measure against these standards. The areas covered by the self assessment process are:

- Objective and strategy
- Selecting and retaining competent management
- Monitoring and assessing operations
- Efficient operations
- General assessment

Review of internal control processes and procedures (PD-1.3.10(y)) - As per CBB Rulebook

Internal control processes and procedures are regularly reviewed by the Bank's Internal Auditor in line with the internal audit plan approved by the Board's Audit Committee.

Governance arrangements, systems and controls employed by the bank to ensure Sharia compliance (PD-1.3.10(ff)) - As per CBB Rulebook

Sharia compliance department conducts review of all business financing and investment proposals together with audit of all executed transactions of Elaf Bank and its affiliates to confirm compliance with Sharia rules and principles, and also with specific rulings and guidelines issued by the Sharia Supervisory Board. The Sharia review and audit are conducted internally by the Sharia Compliance Department, which includes examining all transactions without exception, with all its the relevant documentation and execution procedures adopted by Elaf Bank.

The Sharia review and audit are planned and performed after obtaining all the information and explanations which are considered necessary to provide sufficient evidence and give reasonable assurance that Elaf Bank and its affiliates are in compliance with Islamic Sharia rules and principles.

The findings are reported to the Sharia Supervisory Board during the periodic meeting, which is held on quarterly basis or at any other time as the case may require. The Sharia Supervisory Board reviews the review and audit reports of the Sharia Compliance Department and provides the necessary recommendations in this regard, if needed, and issues the official opinion by means of the Sharia Compliance Certificate after each meeting.

Handling of Non Sharia compliance earnings and expenditures (PD-1.3.10(gg)) - As per CBB Rulebook

Any amount that has been identified as being non Sharia compliant are fully reimbursed to a charity organization or a Bahraini Non-Profit organization. However, Elaf Bank did not have any such cases in 2012.

Information on mediation, advise and complaint procedures at the bank (PD-1.3.10(dd)) - As per CBB The Rulebook

The investors may use the Bank's website for logging a query or a complaint, which is managed by the Corporate Communications Department (CCD) through the "Contact Us" page including a drop-down menu of all the Bank's divisions/departments available on the website. After receiving a query or a complaint through the email address associated with the "Contact Us" page, CCD channels the query or a complaint to the concerned department to follow up with a response. The investor's query is addressed accordingly by the appropriate department or person who was asked to handle the issue.

Election system of directors and any termination arrangements (PD-1.3.10(s)) - As per the CBB Rulebook

As per the Memorandum and Articles of Association of the Bank, the Board shall be elected by the shareholders for a period of three years. The Board shall meet and elect its Chairman and Vice Chairman for a period equivalent to the term of the Board.

Bank's Communication Strategy (PD-1.3.10(h and cc))

The CCD is responsible for preparing marketing materials in liaison with other Business Departments, which are used to communicate new product information and inform the investors of the Bank's activities. The various channels of communication may include corporate publications, website, direct mailers, electronic mail and local & regional media (through press releases). All marketing materials & corporate documents are approved by Senior Management prior to disclosing to the public.

The Bank adopted an open policy for communication where it uses all available suitable channels to communicate with its stakeholders, in line with the principle of transparency and disclosure that is integral to good corporate governance. This includes wide use of the media for the purposes of providing information on the Bank's progress.

Furthermore, the Bank provides information on all events that merit announcement, either on its website or through other communication channels. The Bank's annual report and previous years financial statements are also published on the website, as well as the Corporate Governance reports. The Bank's quarterly results are also published in both Arabic and English newspapers, and are posted on the Bank's website.

The Board attaches a high degree of importance to continuous communication with shareholders, especially direct dialogue with them at the Bank's annual general meetings. Shareholders are therefore encouraged to actively participate at such meetings.

Bank's Code of Ethical Business Conduct and Conflict of Interest (PD-1.3.10(v) & PD–6.1.1 (j)) - As per CBB The Rulebook

The Board establishes corporate values for itself, senior management, and employees and has codified them by means of Code of Conduct policy document. These values have been communicated throughout the Bank, so that the Board and senior management and staff understand their accountabilities to the various stakeholders and fulfill their fiduciary responsibilities to them.

Bank's ethics and code of Conduct dictate that a Board Member should:

1 - Not enter competition with the Bank;
2 - Not demand or accept substantial gifts for himself or his associates;
3 - Not take advantage of business opportunities to which the Bank is entitled for himself or his associates;
4 - Report to the Board any conflict of interest in their activities with, and commitments to other organizations. In any case, all Board Members declare in writing all of their other interest in other enterprises or activities (whether as a shareholder, manager, or other form of participation) to the