**Ibdar Bank B.S.C (c)**

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

**For the year ended 31 December 2013**

| | Marketable equity securities portfolio | Unlisted securities portfolio | Real estate portfolio | Total |
|---|---|---|---|---|
| | USD | USD | USD | USD |
| Balance at 1 January 2013 | 1,756,161 | 66,250,381 | 42,724,729 | 110,731,271 |
| Deposits | - | 613,031 | - | 613,031 |
| Withdrawals | (442,838) | - | (186,693) | (629,531) |
| Revaluations | 1,518,909 | 180,317 | - | 1,699,226 |
| Balance at 31 December 2013 | **2,832,232** | **67,043,729** | **42,538,036** | **112,413,997** |
| Balance at 1 January 2012 | - | - | - | - |
| Additions by amalgamation (note 1) | 1,756,161 | 66,250,381 | 42,724,729 | 110,731,271 |
| Balance at 31 December 2012 | 1,756,161 | 66,250,381 | 42,724,729 | 110,731,271 |

# Basel II, Pillar III Disclosures 31 December 2013 Un-audited

# 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 Rule Book, Volume II for Islamic Banks. Rules concerning the disclosures under this section are applicable to Ibdar 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 CBB 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 standardised 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.

**Content**

## 1 INTRODUCTION (continued)

### 1.4 Overall Risk and Capital Management (continued)

determined by the Shari'a 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, Thus all subsidaries are not consolidated.

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))

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.

# 1 INTRODUCTION (continued)

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

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

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 2013.

### 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) Properties 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 the 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 Shari'a Rules and Principles as

## 2 RISK MANAGEMENT STRUCTURE (continued)

### 2.1 Board of Directors (PD - 1.3.10 (n) and PD - 1.3.10 (o)) (continued)

The Board of Directors has delegated the management of the Bank to the Executive Management, comprising of Mr. Paul Mercer - Chairman Board of Directors, Mr. Mohammad Aljasim - Chief Investment Officer and Mr. Sameeh Al Khan - Chief Operating Officer, which meets on a regular basis to discuss any issues and updates regarding operations and business 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.

| 2.2.1.2 Members | Independent / Non Independent |
|---|---|
| Mohamed AlAdsani | Non-Independent / Executive |
| Zeyad AlMukhaizeem | Non-Independent / Executive |
| Abdullah AlMarzouq | Non-Independent / Executive |
| Khalid Najibi | Independent / Non-Executive |
| Saleh AlAfaleq | Independent / Non-Executive |

#### 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 |
|---|---|
| Abdulhakim Aladhamy | Independent / Non-Executive |
| Khalid AlBassam | Independent / Non-Executive |
| Mishari AlKhalid | Non-Independent / Non-Executive |

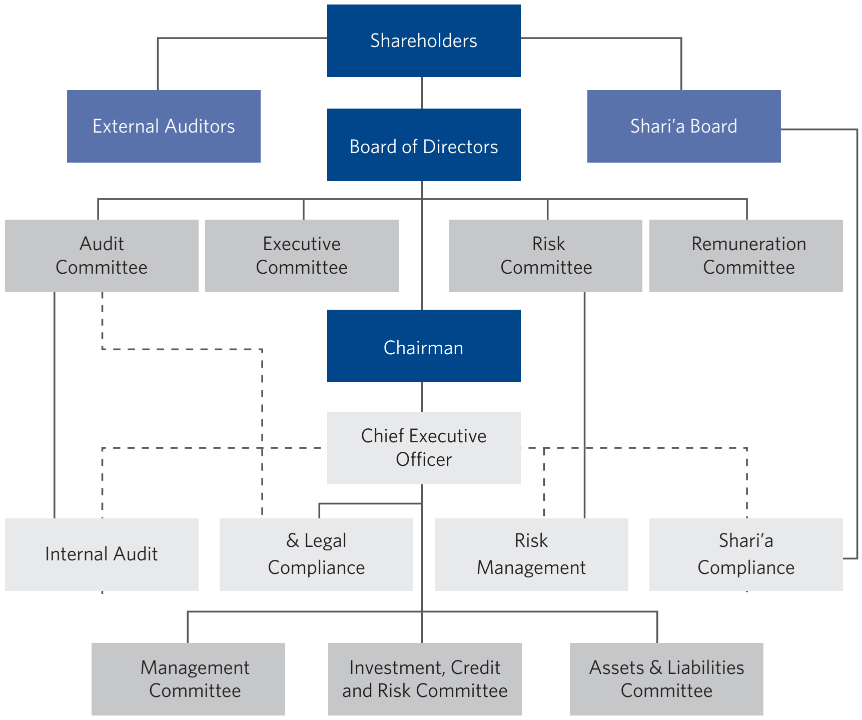
#### 2.2.3 Remuneration & Nomination Committee

##### 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 RISK MANAGEMENT STRUCTURE (continued)

Figure 1 Group Organisation Structure (PD-1.3.10(a))




As at 31 December 2013 Chief Executive officer, Chief Financial Officer and Chief Risk Officer positions are Vacant.

### 2.1 Board of Directors (PD - 1.3.10 (n) and PD - 1.3.10 (o))

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. The Board is in process of reviewing and approving the Bank's strategy document which 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 shall: (PD-1.3.10(n, o)):

a. Review 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.
g. Approved financial statements of the Bank.

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

The Board has approved authority matrix which authorises the senior management committees to approve certain transactions. However, transactions which are beyond the authority matrix require Board or Excom approval.

## 2 RISK MANAGEMENT STRUCTURE (continued)

### 2.3 Management Committees (continued)

#### 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

| | |
|---|---|
| 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 |

## 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 healthy capital ratio in order to support its business and maximise 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, general reserve , statutory reserves, share premium retained profit/losses brought forward and unrealised gross losses arising from fair valuing equity securities. Tier 2 capital includes unrealised gains arising from fair valuing equities (45% only) and asset revaluation reserve (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 Standardised 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 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.

## 2 RISK MANAGEMENT STRUCTURE (continued)

### 2.2 Board Committees (continued)

#### 2.2.3 Remuneration & Nomination Committee (continued)

| 2.2.3.2 Members | Independent / Non Independent |
|---|---|
| Khalid AlAboodi | Independent / Non-Executive |
| Mishari AlKhalid | Non-Independent / Non-Executive |

#### 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 |
|---|---|
| Abdulhakim Aladhamy | Independent / Non-Executive |
| Paul Mercer | Non-Independent / Executive |
| Khalid AlBassam | Independent / Non-Executive |

### 2.3 Management Committees

The following committees are the two management committees at Ibdar that support the Executive Management Committee 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

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

## 3 CAPITAL ADEQUACY (continued)

### 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 2013 | |
|---|---|---|
| | **Risk Weighted Amount (USD '000)** | **Capital requirements (USD '000)** |
| **Type of Islamic financing contracts** | | |
| Due from financial institutions | 15,591 | 1,871 |
| Financing receivables | 12,232 | 1,468 |
| Musharaka financing | 787 | 94 |
| Ijarah muntahia bittamleek | 1,283 | 154 |
| Investment in securities - Sukuk | 79,863 | 9,584 |
| | **109,756** | **13,171** |

| | 31 December 2013 | |
|---|---|---|
| | **Risk Weighted Amount (USD '000)** | **Capital requirements (USD '000)** |
| Notes and Coins | - | - |
| Claims on Sovereigns | - | - |
| Claims on PSE | - | - |
| Claim on banks | 16,262 | 1,951 |
| Claim on Corporations | 27,071 | 3,249 |
| Investment in securities | 107,492 | 12,899 |
| Holding of Real Estate | 353,106 | 42,373 |
| Other assets | 63,986 | 7,678 |
| | **567,917** | **68,150** |

### Table – 3. Capital requirement for Market risk (PD–1.3.18)

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

| | **31 December 2013 (USD '000)** |
|---|---|
| Market Risk - Standardised Approach Foreign exchange risk | 1,325 |
| **Total of market risk - standardised approach** | **1,325** |
| Multiplier | 12.5 |
| **Total Market Risk Weighted Exposures** | **16,563** |
| **Minimum capital requirement (%12)** | **1,988** |

## 3 CAPITAL ADEQUACY (continued)

### 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 the CBB rule book 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.

For regulatory purposes and as instructed by CBB the Bank consolidates Ijara 9 in the PIRI

The Bank does not hold any interest in insurance entities.

### Table – 1. Capital structure (PD-1.3.12, PD-1.3.13, PD-1.3.14 and PD-1.3.15)

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

| | 2013 December 31 | |
|---|---|---|
| | **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 | 4,618 | |
| Legal / statutory reserves | 676 | |
| Share Premium | 16,385 | |
| Others | 22,145 | |
| Retained profit brought forward | (3,815) | |
| **Total Tier 1 Capital** | **340,009** | |
| **Deductions from Tier 1** | | |
| Unrealized gross losses arising from fair valuing equity securities | 618 | |
| **Tier 1 Capital before PCD deductions** | **339,391** | |
| **Supplementary Capital - Tier 2** | | |
| Current interim profits | | - |
| Asset revaluation reserve - Property, plant, and equipment (%45 only) | | 940 |
| Unrealized gains arising from fair valuing equities (%45 only) | | 1,785 |
| **Tier 2 Capital before PCD deductions** | | 2,725 |
| **Total Available Capital before PCD deductions (Tier 1 and Tier 2)** | | **342,116** |
| **Deductions** | | |
| Capital shortfall of non-consolidated entities subsidiaries * | 3 | 3 |
| Excess amount over maximum permitted large exposure limit ** | 932 | 932 |
| Additional deduction from Tier 1 to absorb deficiency in Tier 2 | - | |
| **Total Deductions** | **935** | 935 |
| **Net Available Capital (1.10 and 2.9 less 3.11) (Tier 2 up to %100 of Tier 1)** | **338,456** | 1,790 |
| **Total Eligible Capital** | | **340,246** |

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

## 4 RISK MANAGEMENT (continued)

### 4.1 Overview (continued)

#### 4.1.2 Strategies Processes and Internal Controls (continued)

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.

## 3 CAPITAL ADEQUACY (continued)

**Table - 4. Capital Requirements for Operational risk (PD-1.3.19 and PD-1.3.30)**

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

| | 31 December 2013 (USD '000) |
|---|---|
| **Indicators of operational risk** | |
| Average gross income | **11,660** |
| | **12.5** |
| | **145,750** |
| Eligible Portion for the purpose of the calculation | **%15** |
| **Total operational RWE** | **21,863** |
| **Minimum capital requirement (%12)** | **2,624** |

**Table - 5. Capital Adequacy Ratios (PD-1.3.20)**

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

| | 31 December 2013 | |
|---|---|---|
| | **Total capital ratio** | **Tier 1 capital ratio** |
| **Top consolidated group in Bahrain** | **%56.11** | **%56.11** |

## 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 optimise 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.

#### 4.1.2 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

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

#### 4.2.1 Introduction (continued)

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.

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. Investments are reviewed on regular basis by the respective departments 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 Murabaha because the profits are made on the international buying and selling of a commodity, usually metal, such as copper, aluminum 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 recognised to the extent that it is actually received. It is the Group's

## 4 RISK MANAGEMENT (continued)

### 4.1 Overview (continued)

#### 4.1.2 Strategies Processes and Internal Controls (continued)

**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.

**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 Executive Management Committee on the utilisation 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

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

#### 4.2.5 Definition of Geographical Area

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.

#### 4.2.6 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.

#### 4.2.7 Credit Risk Mitigation

Credit risk mitigation is defined as the utilisation of a number of techniques, such as collaterals and guarantees to mitigate the credit risks that the Group 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 Group 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 Group. It also includes the issuer of a security in case of a security held by the Group, or a party with whom a contract is made by the Group for financial transactions.

The measure of exposure reflects the maximum loss that the Group 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 Group's Capital Base. The Group has adopted Standardised Approach to allocate capital for counterparty credit risk.

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

#### 4.2.3 Past Due and Impaired Islamic Financing (continued)

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 Group 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. 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 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.

As of 31 December 2013, an amount of USD 12,232,440 has been outstanding for over 6 months. This amount is receivable from various individuals and corporates based in the GCC region.

#### 4.2.4 External Credit Assessment Institutions

To assess the creditworthiness of Financial Institutions ("FI") the Group relies on external ratings by external credit assessment institutions like Standard & Poor's, Fitch and Moody's. In case of unrated FIs, the Group will assess the credit risk on the basis of its internally developed approach & methodology. The Bank uses ECAI's for due from financial institutions and its sukuk portfolio.

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

#### 4.2.8 Counterparty Credit Risk (continued)

##### 4.2.8.5 Restructuring of Credit Facilities (continued)

PT. Indonesia Air Transport, Tbk. ijara financing facility amounting to USD 4,792 thousand was restructured during 2013 till June 2014. There is no significant impact of the restructured facilities on the provision and present and future earnings.

##### 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 6 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.

**Table – 6. Credit Risk Exposure (PD-1.3.23(a))**

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

| | 31 December 2013 | |
|---|---|---|
| | Total gross credit exposure (USD '000) | *Average gross credit exposure over the year (USD '000) |
| **Funded exposure** | | |
| Balances with banks | 16,239 | 14,501 |
| Due from financial institutions | 15,591 | 21,330 |
| Financing receivables | 12,232 | 12,232 |
| Musharaka financing | 787 | 1,099 |
| Receivable from Ijara investors | 14,801 | 14,801 |
| Investment in securities | 79,863 | 78,084 |
| Other assets | 2,913 | 3,327 |
| **Unfunded exposure** | | |
| Uncalled capital commitments in respect of investment | 9,169 | 10,253 |
| Promise to purchase foreign currency commitment | - | 112 |
| Operating lease commitments - expiring within one year | 80 | 90 |
| Operating lease commitments - expiring in one to three years | 36 | 25 |
| Commitment related to project developments | 133 | 133 |
| | **151,844** | **155,988** |

# 4 RISK MANAGEMENT (continued)

## 4.2 Credit risk (continued)

### 4.2.8 Counterparty Credit Risk (continued)

#### 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 shareholders equity. 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 control or shareholding or otherwise), Directors and their associates (whether such association is due to control, family links or otherwise), members of the Shari'a 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 Shari'a 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 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

**Table - 8. Credit risk - Industry Sector Breakdown (PD-1.3.23(c))**

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 2013 | | | | |
|---|---|---|---|---|---|
| | 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 | - | 16,239 | - | - | 16,239 |
| Due from financial institutions | - | 15,591 | - | - | 15,591 |
| Financing receivables | - | - | - | 12,232 | 12,232 |
| Musharaka financing | - | - | - | 787 | 787 |
| Receivable from Ijara investors | - | - | - | 14,801 | 14,801 |
| Investment in securities | 6,696 | 15,751 | 30,696 | 26,720 | 79,863 |
| Other assets | 72 | 206 | 512 | 2,123 | 2,913 |
| Unfunded exposure | | | | | |
| Uncalled capital commitments in respect of investment | - | - | - | 9,169 | 9,169 |
| Promise to purchase foreign currency commitment | - | - | - | - | - |
| Operating lease commitments - expiring within one year | - | - | - | 80 | 80 |
| Operating lease commitments - expiring in one to three years | - | - | - | 36 | 36 |
| Commitment related to project developments | - | - | - | 133 | 133 |
| | **6,768** | **47,787** | **31,208** | **66,081** | **151,844** |

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

**Table - 7. Credit Risk - Geographic Breakdown (PD-1.3.23(b))**

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 2013 | | | | |
|---|---|---|---|---|---|
| | Middle East USD (USD '000) | Europe USD (USD '000) | Africa USD (USD '000) | South East Asia USD (USD '000) | Total USD (USD '000) |
| Funded exposure | | | | | |
| Balances with banks | 6,956 | 7,576 | - | 1,707 | 16,239 |
| Due from financial institutions | 15,591 | - | - | - | 15,591 |
| Financing receivables | 12,232 | - | - | - | 12,232 |
| Musharaka financing | - | - | - | 787 | 787 |
| Receivable from Ijara investors | 14,801 | - | - | - | 14,801 |
| Investment in securities | 71,980 | 7,883 | - | - | 79,863 |
| Other assets | 2,107 | 67 | 53 | 686 | 2,913 |
| Unfunded exposure | | | | | |
| Uncalled capital commitments in respect of investment | 9,169 | - | - | - | 9,169 |
| Promise to purchase foreign currency commitment | - | - | - | - | - |
| Operating lease commitments - expiring within one year | - | - | - | 80 | 80 |
| Operating lease commitments - expiring in one to three years | - | - | - | 36 | 36 |
| Commitment related to project developments | 133 | - | - | - | 133 |
| | **132,969** | **15,526** | **53** | **3,296** | **151,844** |

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 - 10. Maturity breakdown of credit exposures (PD-1.3.23(g))**

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 2013:

| | 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 | - | 16,239 | - | - | - | - | 16,239 |
| Due from financial institutions | - | 11,055 | 4,536 | - | - | - | 15,591 |
| Financing receivables | - | - | 12,232 | - | - | - | 12,232 |
| Musharaka financing | - | - | - | 787 | - | - | 787 |
| Receivable from Ijara investors | - | - | 14,801 | - | - | - | 14,801 |
| Investment in securities | - | - | - | 54,519 | 25,344 | 149,004 | 79,863 |
| Other assets | - | 836 | 1,700 | 377 | - | 212 | 2,913 |
| **Unfunded exposure** | | | | | | | |
| Uncalled capital commitments in respect of investment | - | - | - | 9,169 | - | - | 9,169 |
| Promise to purchase foreign currency commitment | - | - | - | - | - | - | - |
| Operating lease commitments - expiring within one year | - | - | 80 | - | - | - | 80 |
| Operating lease commitments - expiring in one to three years | - | - | - | 36 | - | - | 36 |
| Commitment related to project developments | - | - | - | 133 | - | - | 133 |
| | - | 28,130 | 33,349 | 65,021 | 25,344 | 149,216 | 151,844 |

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

**Table – 9. Credit Risk – Concentration of Risk**

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

The following are the balances representing the concentration of risk to individual counterparties as of 31 December 2013:

| Counterparties | Own capital and current account Concentration risk % |
|---|---|
| Counterparty # 1 | **%11.27** |
| Counterparty # 2 | **%6.31** |

No penalties were charged to customers with regards to defaults during the year.

## 4 RISK MANAGEMENT (continued)

### 4.2 Credit risk (continued)

**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) | Collective impairment (USD '000) | Total (USD '000) |
|---|---|---|---|
| **South East Asia** | 1,904 | 291 | **2,195** |

**Breakup of provision by counterparty (PD-1.3.23(h & i)) and (PD-1.3.24(c))**

| | Speciific | | |
|---|---|---|---|
| | OPENING (USD '000) | Charged during the year (USD '000) | Closing (USD '000) |
| Corporate | 56 | 222 | **278** |

Only an amount of US$ 222 thousand of musharaka financing was impaired as of 31 December 2013 2012): US$ 56 thousand ).

### 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.

#### 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:

## 4 RISK MANAGEMENT (continued)

### 4.3 Market risk (continued)

#### 4.3.3 Market Risk Strategy (continued)

- 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 RC and the Board;
- The Bank will at all times hold sufficient capital in line with the Pillar 1 regulatory capital requirements of the CBB
- 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 hence uses measurements involving a combination of limits to control market risk exposures. For calculating the market risk capital charge, the Group applies the Standardised 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 2013 | |
|---|---|---|
| | **Weighted risk exposures (USD '000)** | **Market risk capital requirement (USD '000)** |
| Capital requirements - Foreign Exchange Risk | **16,563** | **1,988** |
| Maximum value of RWE | 45,066 | 5,408 |
| Minimum value of RWE | 16,563 | 1,988 |

## 4 RISK MANAGEMENT (continued)

### 4.4 Operational risk

#### 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.

**Management and Reporting of KRIs**

The Bank plans to integrate the process of KRIs into the RCSA process and then start reporting KRIs to senior management.

**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 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.

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

## 4 RISK MANAGEMENT (continued)

### 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, authorisation 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 CBB based on Basel II principles related to operational risk management. During the year 2013 the Group decided to postpone the RCSA exercise to 2014 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.

#### 4.4.2 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 RISK MANAGEMENT (continued)

### 4.5 Equity price risk (continued)

#### 4.5.1 Equity price risk management (continued)

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 recognised 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 (PD1.3.31-(b), (c) & (f))**

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 2013:

| | **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 | 79,863 | 78,084 | 79,863 | - | 9,310 |
| Fair value through statement of income | 17,271 | 19,579 | - | 17,271 | 4,717 |
| Fair value through equity | 131,733 | 134,425 | 34,803 | 96,930 | 25,495 |
| Investment in associates | 11,372 | 8,136 | - | 11,372 | 1,877 |
| | 240,239 | 240,224 | 114,666 | 125,573 | 41,399 |

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

**Table – 14. Equity gains or losses in the Banking Book (PD1.3.31-(d) to (e))**

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

| | 31 December 2013 USD ('000) |
|---|---|
| Cumulative realised gains arising from sales or liquidations in the reporting year | - |
| Total unrealized gains recognised in the consolidated statement of financial position but not through consolidated statement of income | - |
| Unrealised gross losses included in Tier 1 Capital | 618 |
| Unrealised gains included in Tier 2 Capital (%45 only) | 1,785 |

### 4.6 Rate of return risk

#### 4.6.1 Rate of return risk management

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:

## 4 RISK MANAGEMENT (continued)

### 4.4 Operational risk (continued)

#### 4.4.4 Operational Risk Mitigation and Control (continued)

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.

#### 4.4.5 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 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.

## 4 RISK MANAGEMENT (continued)

### 4.6 Rate of return risk

#### 4.6.1 Rate of return risk management (continued)

**Table – 13. Equity Position Risk in the Banking Book (PD1.3.31-(b), (c) & (f))**

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 2013:

| 2013 | Up to 3 Months (USD '000) | 3 months to 1 year (USD '000) | 1 to 5 years (USD '000) | Above 5 Years (USD '000) | No fixed maturity (USD '000) | Total (USD '000) |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Due from financial institutions | 11,055 | 4,536 | - | - | - | 15,591 |
| Financing receivable | 12,232 | - | - | - | - | 12,232 |
| Investments in securities | - | - | 53,615 | 26,248 | - | 79,863 |
| **Total profit rate sensitive assets** | 23,287 | 4,536 | 53,615 | 26,248 | - | 107,686 |
| Liabilities | | | | | | |
| Due to financial institutions | 6,596 | 16,189 | - | - | - | 22,785 |
| **Total profit rate sensitive liabilities** | 6,596 | 16,189 | - | - | - | 22,785 |
| **Profit rate sensitivity gap** | 16,691 | (11,653) | 53,615 | 26,248 | - | 84,901 |

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

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 US$ 1,242 thousand (2012:US$ 862 thousand).

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 RISK MANAGEMENT (continued)

### 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. The Treasury provides a monthly report to the ALCO regarding 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:

**Funding Risk** – Inability to replace net outflows due to unanticipated withdrawal of capital or deposits;
**Call Risk** – Crystallisation of a contingent liability; and
**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 realise 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›s 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.

## 4 RISK MANAGEMENT (continued)

### 4.7 Liquidity risk

#### 4.7.4 Liquidity Risk Measurement Tools (continued)

**Table – 16. Liquidity ratios (PD1.3.37-)**

The following table summarises the liquidity ratios as of:

| | 31 December 2013 |
|---|---|
| Liquid assets to total assets | **8.84%** |
| Short term assets to short term liabilities | **232.99%** |

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

**Table – 17. Quantitative indicators of financial performance and position (PD-1.3.9)**

| | Dec 2013 | Dec 2012 | Dec 2011* | Dec 2010* | Dec 2009* |
|---|---|---|---|---|---|
| Return on average equity (ROAE) | **0.01%** | -5.14% | -2.66% | -11.92% | -14.43% |
| Return on average assets (ROAA) | **0.01%** | -4.55% | -2.60% | -11.88% | -14.36% |
| Total cost to Income ratio | **83.32%** | 76.73% | 92.66% | 90.39% | 133.02% |

* Ratios are based on pre-merger financials

Formula is as follows:
ROAE = Net Income/Average Equity
ROAA= Net profit/ Average Assets

#### 4.7.5 Bank›s Financial Performance (PD1.3.9- (a))

2013 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 23 thousand compared to USD 12.4 million loss in 2012, the total revenues stood at USD 13.3 million compared to USD 11.9 million in 2012, while total assets summed up to USD 360 million compared to USD 382.8 million in 2012. Moreover, Shareholders' equity recorded USD 328.2 million compared to USD 326.4 million in 2012.

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 328 million and total assets in excess of USD 360 million as at 31 December 2013 spanning the Middle East and North Africa (Mena), Europe and Asia.

## 4 RISK MANAGEMENT (continued)

### 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 1$ million due as fees for establishing the joint venture. The local promoter also raised 3 other claims in court and all three cases have ended in our favour. Our expectation is this will like wise 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 600,000$ was obtained, and is currently in the process of being executed upon.

3. Ensign – Our Libyan investment vehicle TAB Energy's subsidiary Etelaf has been served with a claim by a lessor of a rig in the amount of 700,000$.

*materiality involves disputes involving potential liabilities in excess of 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.

### 4.9 Equity of Investment Account Holders

The CBB requires the Group to maintain capital to cover the price risk arising from %30 of the assets funded by equity of investment account holders on a pro-rata basis. The Group is currently in the process of developing written policies and procedures applicable to equity of investment account holders. Funds are intended to be invested and managed in accordance with Shari'a requirements.

The total equity of investment account holders deposit as of December 2013 ,31 is USD 497 thousand. The Group does not maintain PER and IRR for equity of investment account holders. No profit was distributed to equity of investment account holders. No management fee or other administrative expenses was charged during the year 2013 from the equity of investment account holders. No financing was provided to equity of investment account holders. No assets related to equity of investment account holders were pledge during the year 2014. The equity of investment account holders funds have not been invested.

## 4 RISK MANAGEMENT (continued)

### 4.10 Off Balance Sheet Equity of Investment Account Holders

The Group holds Investments of portfolio customers under fiduciary relationship and thus RIA assets and liabilities, are held Off- Balance sheet and separate portfolio accounts are maintained for each client.

Although the underlying investments are held in the name of the Bank, these assets are not consolidated in the Group's financial statements and the aggregated exposures as at 31 December 2013 is USD 112,413 thousand. The Group is currently in the process of developing written policies and procedures applicable to Restricted Investment Accounts.

## 4 RISK MANAGEMENT (continued)

### Table - 18. Maturity Profile (PD-1.3.38)

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 2013 was as follows:

| 2013 | Up to 3 months US$ | 3 months to 1 year US$ | Sub total US$ | 1 to 5 years US$ | 5 to 10 years US$ | No fixed maturity US$ | Total US$ |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with banks | 16,239,464 | - | 16,239,464 | - | - | - | 16,239,464 |
| Due from financial institutions | 11,055,014 | 4,536,313 | 15,591,327 | - | - | - | 15,591,327 |
| Financing receivables | - | 12,232,440 | 12,232,440 | - | - | - | 12,232,440 |
| Musharaka financing | - | - | - | 786,630 | - | - | 786,630 |
| Receivable from ijarah investors | - | 14,800,849 | 14,800,849 | - | - | - | 14,800,849 |
| Investment in ijarah asset | 174,111 | 4,617,609 | 4,791,720 | - | - | - | 4,791,720 |
| Ijarah muntahia bittamleek | 208,333 | 625,000 | 833,333 | 449,201 | - | - | 1,282,534 |
| Investment in securities | - | - | - | 54,519,491 | 25,343,479 | 149,004,142 | 228,867,112 |
| Investment in associates | - | - | - | - | - | 11,372,412 | 11,372,412 |
| Investment in real estate | - | - | - | - | - | 44,079,522 | 44,079,522 |
| Development properties | - | - | - | - | - | 6,164,051 | 6,164,051 |
| Fixed assets | - | - | - | - | - | 726,393 | 726,393 |
| Other assets | 836,646 | 1,700,290 | 2,536,936 | 377,527 | - | 211,527 | 3,125,990 |
| **Total assets** | **28,513,568** | **38,512,501** | **67,026,069** | **56,132,849** | **25,343,479** | **211,558,047** | **360,060,444** |
| Liabilities | | | | | | | |
| Due to financial institutions | 6,595,590 | 16,189,243 | 22,784,833 | - | - | - | 22,784,833 |
| Due to non financial institutions | - | 164,576 | 164,576 | - | - | - | 164,576 |
| Other liabilities | 1,361,485 | 3,958,759 | 5,320,244 | 2,844,631 | - | 291,284 | 8,456,159 |
| **Total liabilities** | **7,957,075** | **20,312,578** | **28,269,653** | **2,844,631** | **-** | **291,284** | **31,405,568** |
| Equity of investment accountholders | 497,535 | - | 497,535 | - | - | - | 497,535 |
| **Total liabilities and equity of investment accountholders** | 8,454,610 | 20,312,578 | 28,767,188 | 2,844,631 | - | 291,284 | 31,903,103 |
| **Net liquidity gap** | 20,058,958 | 18,199,923 | 38,258,881 | 53,288,218 | 25,343,479 | 211,266,763 | 328,157,341 |
| **Cumulative net liquidity gap** | 20,058,958 | 38,258,881 | | 91,547,099 | 116,890,578 | 328,157,341 | - |
| Commitments | - | 9,381,693 | 9,381,693 | 35,810 | - | - | 9,417,503 |

## 4 RISK MANAGEMENT (continued)

### 4.10 Off Balance Sheet Equity of Investment Account Holders

The Group holds Investments of portfolio customers under fiduciary relationship and thus RIA assets and liabilities, are held Off- Balance sheet and separate portfolio accounts are maintained for each client.

Although the underlying investments are held in the name of the Bank, these assets are not consolidated in the Group's financial statements and the aggregated exposures as at 31 December 2013 is USD 112,413 thousand. The Group is currently in the process of developing written policies and procedures applicable to Restricted Investment Accounts.

## 5 CORPORATE GOVERNANCE AND TRANSPARENCY

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.

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 Senior Management Committees.

The Bank has only one class of equity shares and the shareholders are from the following nationalities (PD1.3.10-(i)):

| Country | Percentage |
|---|---|
| 1- State of Kuwait | 50.52% |
| 2- Kingdom of Bahrain | 23.48% |
| 3- Kingdom of Saudi Arabia | 15.06% |
| 4- Qatar | 4.71% |
| 5- United Arab Emirates | 4.00% |
| 6- Oman | 2.03% |
| 7- Jordan | 0.13% |
| 8- Yemen | 0.05% |
| 9- Sri Lanka | 0.01% |
| 10- Canada | 0.01% |

The distribution of ownership of shares by size of shareholder is provided below (PD1.3.10-(I)):

| Size of Ownership | No. of Shareholders |
|---|---|
| Less than 5 % | 133 |
| 10 - 5 % | 2 |
| %20 to less than %50 | 1 |
| | 136 |

### 5.1 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.

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:

## 5 CORPORATE GOVERNANCE AND TRANSPARENCY (continued)

### 5.1 Board Members› Profile (continued)

**Table – 19. Corporate Governance and Transparency – Board Members' Profile (PD1.3.10-(b,c,p,q))**

Ibdar's Board of Directors' structure constitutes of 10 members as of December 2013 ,31.

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

| 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 / Executive | Over 16 | July 2011, 3 years from January 2013 | M.A. Law - Cambridge University |
| **Mohammad Khalifa Al Adsani** | Accountant | CEO, Aref Investment Group | Non-Independent / Executive | Over 20 | July 2011, 3 years from January 2013 | MBA - University of Leicester |
| **Abdulla A. Al Marzouq** | Banker | Deputy Dept Manager, International Investments, Kuwait Finance House - Kuwait | Non-Independent / Executive | Over 17 | July 2011, 3 years from January 2013 | MBA - MIT Sloan School of Management |
| **Zeyad Tareq Al Mukhaizeem** | Banker | Executive Director - International Investments, Aref Investment Group | Non-Independent / Executive | Over 10 | January 2013, 3 years | MBA - Depaul University |
| **Mishari Z. Al Khalid** | Banker | Deputy Chairman - Kuwait Investment Company | Non-Independent / Non-Executive | Over 27 | January 2013, 3 years | Bachelor of Commerce-Business Management - Cairo University |
| **Khalid Mohammed Najibi** | Accountant | Executive Director - Najibi Investment Company | Independent / Non-Executive | Over 20 | January 2013, 3 years | Bachelor - Schiller International, CPA |
| **Khalid Abdullah Al Bassam** | Banker | Chairman - AlBassam Investment Company | Independent / Non-Executive | Over 25 | January 2013, 3 years | Bachelor - Eastern New Mexico University |
| **Khalid Mohammed Al Aboodi** | Banker | CEO - Islamic Corporation for the Development of the Private Sector | Independent / Non-Executive | Over 25 | January 2013, 3 years | Masters - Economics - Northeastern University |
| **Saleh Hassan Al Afaleq** | Banker | CEO - AlKifah Holding | Independent / Non-Executive | Over 24 | January 2013, 3 years | Masters - Human Resource Development - Seattle University |
| **Abdulhakim Al Adhamy** | Accountant | Retired | Independent / Non-Executive | Over 35 | September 2013, 3 years | Bachelors - Commerce - Baghdad University, ICA |

## 5 Corporate Governance and Transparency (continued)

### 5.1 Board Members› Profile (continued)

The Board shall meet on a quarterly basis, or otherwise at least four times in every financial year. During the year ended 31 December 7 ,2013 Board meetings were held. The following table summarises the information about Board of Directors meeting dates and attendance of directors at each meeting;

**Table - 20. Corporate Governance and Transparency - Board of Directors meetings in 2013 (PD-1.3.10(t and u))**

| Date | Names of Directors Present (Physical) | Names of Directors who participated by phone/ video link | Names of Directors not Present |
|---|---|---|---|
| 29-Jan-13 | Paul Mercer<br>Mohamed AlAdsani<br>Abdullah AlMarzouq<br>Mishari AlKhalid<br>Khalid Najibi<br>Khalid AlBassam<br>Saleh AlAfaleq<br>Nasser AlMutawa | Zeyad AlMukhaizeem | Khalid AlAboodi |
| 7-Mar-13 | Paul Mercer<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Mishari AlKhalid<br>Khalid Najibi<br>Khalid AlBassam<br>Khalid AlAboodi<br>Saleh AlAfaleq | | Nasser AlMutawa<br>Mohamed AlAdsani |
| 14-May-13 | Paul Mercer<br>Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Mishari AlKhalid<br>Khalid Najibi<br>Khalid AlBassam<br>Saleh AlAfaleq<br>Nasser AlMutawa | | Khalid AlAboodi |
| 18-Jul-13 | Paul Mercer<br>Abdullah AlMarzouq<br>Mishari AlKhalid<br>Khalid Najibi<br>Khalid AlAboodi<br>Khalid AlBassam<br>Saleh AlAfaleq<br>Nasser AlMutawa | | Mohamed AlAdsani<br>Zeyad AlMukhaizeem |

## 5 Corporate Governance and Transparency (continued)

### 5.1 Board Members› Profile (continued)

**Table – 20. Corporate Governance and Transparency – Board of Directors meetings in 2013 (PD-1.3.10(t and u)) (continued)**

| Date | Names of Directors Present (Physical) | Names of Directors who participated by phone/ video link | Names of Directors not Present |
|---|---|---|---|
| 12-Sep-13 | Paul Mercer<br>Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Mishari AlKhalid<br>Khalid Najibi<br>Khalid AlBassam<br>Saleh AlAfaleq | | Khalid AlAboodi |
| 31-Oct-13 | Paul Mercer<br>Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Mishari AlKhalid<br>Khalid Najibi<br>Khalid AlBassam<br>Saleh AlAfaleq<br>Khalid AlAboodi<br>Abdulhakim AlAdhamy | | |
| 4-Dec-13 | Paul Mercer<br>Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Khalid Najibi<br>Khalid AlBassam<br>Saleh AlAfaleq<br>Khalid AlAboodi<br>Abdulhakim AlAdhamy | Abdullah AlMarzouq | Mishari AlKhalid |

## 5 Corporate Governance and Transparency (continued)

### 5.2 Changes in Board Structure

The Board was elected on January 2013 ,29 during the Ordinary General Meeting. At the Extraordinary General Meeting on September 2013 ,5, the shareholders appointed Mr. AbdulHakim AlAdhamy to serve on the Board. On September 2013 ,10, Mr. Nasser AlMutawa resigned from the Board.

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

## 5 Corporate Governance and Transparency (continued)

### 5.2 Changes in Board Structure

**Table – 21. 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 | Baytik International Investments Advisory Ltd<br>Fernas Investors Ltd<br>Liberty Aerospace, Inc.<br>Liberty Aerospace Holdings, Inc.<br>Liberty Assets, LLC.<br>Liberty XL2 Holdings LLC<br>Motherwell Bridge Group Limited<br>Motherwell Bridge Limited | Themar Baytik B.S.C. (c)<br>Turkapital Holdings B.S.C. (c)<br>Menatelecom WLL<br>Menatelecom Holdings B.S.C. © |
| Mohammad Khalifa Al Adsani | Al Masar for Leasing & Investment Company, Kuwait<br>Kuwait International Fair Company, Kuwait<br>Kuwait Investment Company, Kuwait | - |
| Abdulla A. Al Marzouq | Hayat Investment Company, Kuwait | - |
| Zeyad Al Mukhaizeem | Munshaat Real Estate Projects Company<br>Bank of London and Middle East<br>EURX Fund | - |
| Mishari Al Khalid | Kuwait Investment Company | National Hotels Company |
| Saleh Al Afaleq | AlKifah Holding<br>Al-Ahsa Amusement and Tourism Company<br>Arbah Capital<br>Noor Capital<br>Saudi Industrial Property Authority<br>General Authority of Civil Aviation<br>Council of Saudi Chambers of Commerce<br>National Cenre of Palm and Dates<br>Al-Ahsa Irrigation and Drainage Authority | - |
| Khalid Najibi | Arbah Capital<br>Tab Energy | Najibi Investment Company<br>Skaugen Gulf Petchem Carriers |
| Khalid Al Bassam | Gulf Investment Corporation<br>Islamic Bank of Asia | AlBassam Investment Company WLL<br>Foulath Holding, Bahrain BSC<br>Sulb BSC<br>Bahrain Steel BSC<br>Skaugen Gulf Petchem Carriers |
| Khalid Al Aboodi | Africa Finance Corporation<br>Anfaal Capital<br>Arab Fisheries Company<br>Bosna Bank International's Real Estate Company<br>Burj Bank<br>Mauritania Investment Group | |
| Abdulhakim Al Adhamy | Amwaj Property Limited BVI<br>Commercial Bank of Dubai PSC | Ebrahim Khalil Kanoo BSC<br>Kuwait Finance House BSC |

## 5 Corporate Governance and Transparency (continued)

### 5.3 Board Committees

The minimum number of Board Committee meetings per year, per committee, should be four as per the Bank›s policies and procedures. However, as the committes were approved by the CBB during the second half of the year so the minimum number of meetings during the year has not been complied with. The following tables summarises the information about Board Committee meeting dates and attendance of directors at each meeting;

**Table – 22. Corporate Governance and Transparency – Audit Committee meetings in 2013 (PD-1.3.10(w))**

| Date | Names of Directors Present | Names of Directors Not Present |
|---|---|---|
| 25-Jul-13 | Abdulhakim Aladhamy<br>Khalid AlBassam<br>Mishari AlKhalid | None |
| 22-Oct-13 | Abdulhakim Aladhamy<br>Khalid AlBassam<br>Mishari AlKhalid | None |
| 1-Dec-13 | Abdulhakim Aladhamy<br>Khalid AlBassam<br>Mishari AlKhalid | None |

**Table – 23. Corporate Governance and Transparency – Executive Committee meetings in 2013 (PD-1.3.10(w))**

| Date | Names of Directors Present | Names of Directors Not Present |
|---|---|---|
| 30-May-13 | Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Khalid Najibi<br>Saleh AlAfaleq | None |
| 18-Jun-13 | Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Khalid Najibi<br>Saleh AlAfaleq | Abdullah AlMarzouq |
| 18-Jul-13 | Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Khalid Najibi<br>Saleh AlAfaleq | None |
| 12-Sep-13 | Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Khalid Najibi<br>Saleh AlAfaleq | None |
| 4-Dec-13 | Mohamed AlAdsani<br>Zeyad AlMukhaizeem<br>Abdullah AlMarzouq<br>Khalid Najibi<br>Saleh AlAfaleq | None |

## 5 Corporate governance and transparency (continued)

### 5.3 Board Committees (continued)

**Table - 24. Corporate Governance and Transparency - Risk Committee meetings in 2013 (PD-1.3.10(w))**

| Date | Names of Directors Present | Names of Directors Not Present |
|---|---|---|
| 10-Sep-13 | Abdulhakim Aladhamy<br>Paul Mercer<br>Khalid AlBassam | None |
| 23-Oct-13 | Abdulhakim Aladhamy<br>Paul Mercer<br>Khalid AlBassam | None |

**Table - 25. Corporate Governance and Transparency - Remuneration and Nomination Committee meetings in 2013 (PD-1.3.10(w))**

| Date | Names of Directors Present | Names of Directors Not Present |
|---|---|---|
| 20-May-13 | Nasser AlMutawa | None |
| 29-May-13 | Nasser AlMutawa<br>Khalid AlAboodi<br>Mishari AlKhalid | None |
| 8-Jul-13 | Nasser AlMutawa<br>Khalid AlAboodi<br>Mishari AlKhalid | None |
| 17-Jul-13 | Nasser AlMutawa<br>Khalid AlAboodi<br>Mishari AlKhalid | None |
| 9-Oct-13 | Khalid AlAboodi<br>Mishari AlKhalid | None |
| 30-Oct-13 | Khalid AlAboodi<br>Mishari AlKhalid | None |
| 21-Nov-13 | Khalid AlAboodi<br>Mishari AlKhalid | None |

### 5.4 Changes in the Corporate Governance Structures (PD-1.3.10(g))

No changes to the Corporate Governance Structures occurred in 2013.

### 5.5 Remuneration Policy and Aggregate Remuneration Paid to Senior Management and Board (PD-1.3.10(d, ii, jj and kk))

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 2013 was USD 935 thousand (this includes salaries, allowances, other benefit and bonuses for the year ended 31 December 2013 that were disbursed after the closing of the financial year).

## 5 Corporate governance and transparency (continued)

### 5.5 Remuneration Policy and Aggregate Remuneration Paid to Senior Management and Board (PD-1.3.10(d, ii, jj and kk)) (continued)

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 2013 was USD 655 thousand.

### 5.6 A. Ownership of Shares by government (PD-1.3.10(m))

| 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))**

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

### 5.7 Ownership of Shares by Directors / Senior Managers (PD-1.3.10(k))

| Name of Director / Senior Manager | On Behalf of | No. of Shares | Percentage% |
|---|---|---|---|
| Khalid AlBassam | Al-Bassam Investment Company | 11,601,431 | 3.867% |
| 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% |

### 5.8 Type of Material Transactions that require Board approval (PD-1.3.10(o))

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.

## 5 Corporate governance and transparency (continued)

### 5.9 Induction, Education and Orientation of New Directors (PD-1.3.10(r))

All new Directors participate in an orientation exercise that is administered by the Directors and members of the Management at Ibdar. This orientation includes presentations by the Chairman and senior management to familiarize new Directors with Ibdar›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 Ibdar headquarter and, to the extent practical, Ibdar›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 Ibdar operates in.
(b) A clear understanding of Ibdar's business operations.
(c) A clear understanding of Ibdar's financial circumstances.
(d) A clear understanding of Ibdar'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 by the Chief Operating Officer.
(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 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.

## 5 Corporate governance and transparency (continued)

### 5.10 Executive Members' Profile

Delegated by the Board with the authority for managing the Bank's operations, 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 comprises:

**Table – 26. Corporate Governance and Transparency – Executive Members' Profile (PD-1.3.10(b))**

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 16 | M.A. Law - Cambridge University |
| Mohamed AlJasim | Chief Investment Officer | Banker | Executive | Over 14 | B.A. (Hons) Accounting |
| Sameeh AlKhan | Chief Operating Officer | Banker | Executive | Over 29 | Advanced Management Diploma |

### 5.11 Bank's Performance Linked Incentive Structure (PD-1.3.10(d))

The remuneration & incentive structure of the Board Members and Shari'a 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.

### 5.12 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:

## 5 Corporate governance and transparency (continued)

### 5.12 Related Party Transactions (PD-1.3.10(f)) (continued)

(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.

### 5.13 Assessment of Board of Directors Effectiveness & Contribution (PD-1.3.10(aa))

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

### 5.14 Review of internal control processes and procedures (PD-1.3.10(y))

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.

### 5.15 Governance arrangements, systems and controls employed by the bank to ensure Shari'a compliance (PD-1.3.10(ff))

"Shari'a compliance department conducts review of all business financing and investment proposals together with audit of all executed transactions of Ibdar Bank and its affiliates to confirm compliance with Shari'a rules and principles, and also with specific rulings and guidelines issued by the Shari'a Supervisory Board.

The Shari'a review and audit are conducted internally by the Shari'a Compliance Department, which includes examining all transactions without exception, with all its the relevant documentation and execution procedures adopted by Ibdar Bank.

## 5 Corporate governance and transparency (continued)

### 5.15 Governance arrangements, systems and controls employed by the bank to ensure Shari'a compliance (PD-1.3.10(ff)) (continued)

The Shari'a 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 Ibdar Bank and its affiliates are in compliance with Islamic Shari'a rules and principles.

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

### 5.16 Handling of Non Shari'a compliance earnings and expenditures (PD-1.3.10(gg))

Any amount that has been identified as being non Shari'a compliant are fully reimbursed to a charity organisation or a Bahraini Non-Profit organization.

### 5.17 Information on mediation, advise and complaint procedures at the bank (PD-1.3.10(dd))

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.

### 5.18 Election system of directors and any termination arrangements (PD-1.3.10(s))

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. The termination arrangements of the Board of Directors are as stated in the Memorandum of Articles of Association (Articles 24, 25 & 27).

### 5.19 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

## 5 Corporate governance and transparency (continued)

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

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.

### 5.20 Bank's Code of Ethical Business Conduct and Conflict of Interest (PD-1.3.10(v) & PD-6.1.1 (j))

The Board establishes corporate values for itself, senior management, and employees. 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 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 Board (or the Audit Committees / Corporate Officer) on an annual basis;
5 - Absent themselves from any discussions or decision-making that involves a subject where they are incapable of providing objective advise, or which involves a subject or proposed transaction where a conflict of interest exists; and
6 - Ensure, collectively with the Board, that systems are in place to ensure that necessary client confidentiality is maintained and the privacy or the organization itself is not violated, and that clients' rights and assets are properly safeguarded.

During 2013, there has not been any cases of conflict of interest in the Bank.

### 5.21 Monitoring Compliance to and Enforcement of Code of Conduct

The matters covered in the Code of Conduct are of the utmost importance to the Bank, its stakeholders and its business partners and are essential to the Bank's ability to conduct its business in accordance with its stated values. The Bank clearly communicates to all of its employees that they are expected to adhere to these rules in carrying out their duties for the Bank.

## 5 Corporate governance and transparency (continued)

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

The Board, through independent evaluators (i.e. Internal Auditor) and Senior Management, continuously monitor adherence to the set Code of Conduct and take appropriate action against any employee whose actions are found to violate these policies or any other policies of the Bank. Disciplinary actions may include immediate termination of employment or business relationship at the Bank's sole discretion. Employees are prohibited from participating in or concealing criminal activity or illegal behavior. Periodic reports and assessments of compliance to Code of Conduct will be presented to the board to report any incident of non compliance.

### 5.22 Auditor's Fees and Non-Audit Services (PD–6.1.1 (g), (h) & (i))

Disclosed below are the fees charged by the external auditor, in compliance with CBB's requirement to disclosure additional information to the shareholders:

| Service | Fees in USD |
|---|---|
| Annual fees | 84,881 |
| Public disclosure-semi annual | 11,538 |
| Public disclosure-annual | 15,915 |
| PIRI review | 44,562 |
| Quarter review | 41,379 |
| Money laundry | 10,610 |
| CBB licnce fees | 1,326 |
| Total of Bank fees | 210,212 |
| Total Subsidiaries Fees | 38,064 |

The Auditors for 2014 were changed in line with good corporate governance practice.

### 5.23 Social Functions and Charitable contributions of the Bank

The Group discharges its social resobsabilties through donations to chartiable causes and organisations.

### 5.24 Penalties or Fines by Central Bank of Bahrain

In 2013 the bank paid a financial penalty amounting to BHD 500 for submitting the annual report five dates late and BHD 700 for submitting the audited financials statements of the bank's subsidiaries seven days late due to the merger process that took longer than expected.

### 5.25 Penalties charged to Customers for Default

No penalties were charged to customers with regards to defaults during 2013