بنك المؤسسة العربية المصرفية الإسلامي (ش.م.ب.م)

ABC Islamic Bank (E.C.)

PUBLIC DISCLOSURES
30 June 2012

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1. Introduction

This document gathers together all the elements of the disclosures required under Pillar III, which are not covered in the interim condensed consolidated financial statements for the period ended 30 June 2012, and is organized as follows:

Firstly, it gives an overview of the approach taken by ABC Islamic Bank (E.C.) [the Bank] to Pillar I and provides the profile of the risk-weighted assets according to the "standard portfolio" as defined by the Central Bank of Bahrain [the CBB].

Secondly, an overview of risk management practices and framework at the Bank is presented with specific emphasis on credit, market and operational risks and the related monitoring processes and credit mitigation initiatives are set out.

Finally, this document provides all other disclosures required under the Public Disclosure Requirements Module of the CBB.

The disclosures in this section are in addition to the interim condensed consolidated financial statements and are presented in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions [AAOIFI] and the relevant provisions of the CBB and Financial Institutions Law. For matters which are not covered by AAOIFI standards, the Bank and its subsidiary [together the Group] uses the International Financial Reporting Standards [IFRS] and other sections of the interim condensed consolidated financial statements. However, the credit risk exposures considered in this section differ from the credit risk exposures reported in the interim condensed consolidated financial statements due to the application of different methodologies between Basel II and AAOIFI, primarily on account of the following:

- Under the Basel II framework, for credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor (CCF). The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off-statement of financial position notional amounts into an equivalent statement of financial position exposure. In the consolidated financial statements, the nominal values of credit-related contingent items are considered off-statement of financial position.

- Under this section, the credit exposures are classified as per the 'Standard Portfolio' approach set out in the CBB's Basel II capital adequacy framework covering the 'Standardised Approach' for credit risk. In the case of guaranteed exposures, the exposures would normally be reported based on the guarantor. However, in the consolidated financial statements the assets are presented based on asset class (i.e Islamic financing facilities, securities, etc.).

- Eligible collateral is taken into consideration in arriving at the net exposure under the Basel II framework, whereas collateral is not netted in the consolidated financial statements.

- Equity investments are considered at cost under the Basel II framework, whereas they are considered at fair value in the consolidated financial statements.

- Under the Basel II framework, certain items are considered as a part of the regulatory capital base, whereas these items are netted off against assets in the consolidated financial statements.

2. Group structure

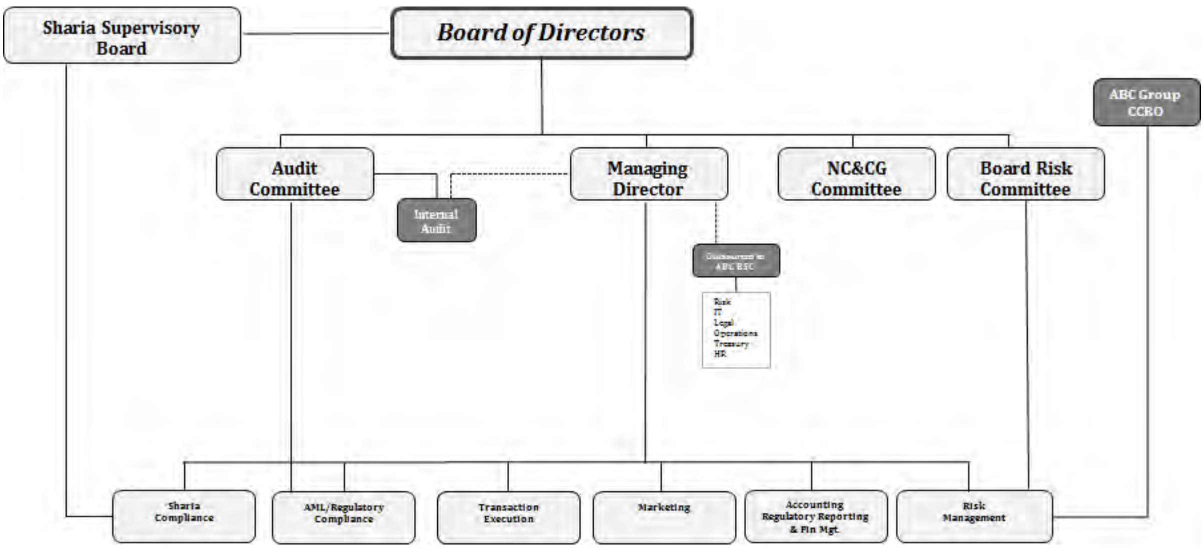
The Bank is an exempt joint stock company incorporated in the Kingdom of Bahrain on 10 December 1985 and registered with the Ministry of Industry and Commerce under commercial registration number 16864. The Group operates under a wholesale Islamic banking licence issued by the CBB and are engaged in financial trading in accordance with the teachings of Islam [Shari'a].
Arab Banking Corporation B.S.C. [ABC], which operates under a wholesale banking licence issued by the CBB, holds 100% of the share capital of the Bank.

The consolidated financial statements and capital adequacy regulatory reports of the Group have been prepared and consolidated on a consistent basis.

The ownership in the subsidiary as at 30 June 2012 is as follows:

Name	Nature of business	Country of incorporation	Amount and % of holding
ABC Clearing Company	Islamic Investment Company	Cayman Islands	US$ 2,000 and 100% management shares

Whilst the Board of Directors [BOD] supervise the overall activities of the Bank, the BOD, Audit Committee, Risk Committee and the Nomination, Compensation and Corporate Governance Committee are tasked with overseeing the respective areas. The following chart shows the organisational structure of the Bank, including the reporting lines to the various BOD committees.



The Bank has in place comprehensive policies regarding the remuneration and benefits provided to members of the BOD and its committees, senior management and staff. With regard to directors, compensation comprises fixed annual remuneration and related expenses, while for senior management and staff, compensation comprises a number of fixed elements, covering salary, allowances and benefits, in addition to variable, performance-related elements.

The Group is committed to best practice Corporate Governance Principles and Guidelines and as such, communicates all relevant information to its stakeholders on time, clearly and through a variety of channels, including maintaining an up-to-date website.

3. Shari'a compliance

Shari'a compliance risk is an operational risk facing Islamic banks which may lead to non-recognition of income, reputational loss and resulting franchise risk on grounds of non-Shari'a compliance. To manage such risks, the Shari'a Compliance Officer of the Group has been tasked to conduct regular Shari'a compliance reviews to ensure that documentation, procedures and execution of transactions are in accordance with the Shari'a Standards issued by AAOIFI and Shari'a rules and principles as determined by the SSB. The results of such reviews are regularly reported to the SSB. Cases of Shari'a non-compliance (if any) are thoroughly investigated to establish their causes and to introduce adequate controls to avoid their recurrence in the future.

There is no non-Shari'a compliant earned during the period ended 30 June 2012.

The SSB of the Group consists of three Shari'a scholars (Chairman and two members). The SSB meets periodically or as and when there is a need to hold a meeting. The members receive a fixed sum of money as attendance fee for every meeting they attend, in addition to a fixed amount paid annually to each member as remuneration, irrespective of the number of meetings held during the period or the financial results of the Group.

4. Capital structure

The Group's capital base comprises of (a) Tier 1 capital which includes share capital, reserves and retained earnings, and (b) Tier 2 capital which consists of the current period profit and unrealized gains arising from fair valuing equities.

The issued and paid-up share capital of the Bank was US$ 132.5 million at 30 June 2012, comprising of 1,325,000 shares of US$ 100 each.

The Group's capital base of US$ 231.5 million comprises Tier 1 capital of US$ 227.3 million and Tier 2 capital of US$ 4.2 million as detailed below:

Breakdown of capital base

US$ million	Tier 1	Tier 2	Total
Issued and fully paid ordinary shares	132.5	-	132.5
Legal / statutory reserves	14.0	-	14.0
Retained profit brought forward	80.8	-	80.8
Profit for the period	-	4.0	4.0
Unrealized gains arising from fair valuing equities	-	0.2	0.2
Capital base	**227.3**	**4.2**	**231.5**
Risk weighted assets [RWA]			
Credit risk			840.7
Market risk			-
Operational risk			33.3
			874.0
Tier 1 ratio			**26.0%**
Capital adequacy ratio			**26.5%**

5. Capital adequacy ratios [CAR]

The purpose of capital management at the Group is to ensure the efficient utilisation of capital in relation to business requirements and growth, risk profile and shareholders' returns and expectations. The Group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may issue capital / Tier 2 securities and / or adjust the amount of dividend payment to shareholders. No changes have been made in the objectives, policies and processes of the Group from the previous years.

The Group's total capital adequacy ratio as at 30 June 2012 was 26.5% compared with the minimum regulatory requirement of 12%. The Tier 1 ratio was 26.0% for the Group. The Group ensures adherence to the CBB's requirements by monitoring its capital adequacy against higher internal limits.

6. Profile of risk-weighted assets and capital charge

The Group has adopted the standardised approach for credit, market and operational risks for regulatory reporting purposes. The Group's risk-weighted capital requirements for credit, market and operational risks are given below:

6.1 Credit risk

i) Definition of exposure classes per Standard Portfolio

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard Portfolio approach mentioned under the CBB's Basel II capital adequacy framework covering the standardised approach for credit risk.

The descriptions of the counterparty classes along with the risk weights to be used to derive the risk-weighted assets are as follows:

a. Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on Bahrain and GCC sovereigns are risk weighted at 0%. Claims on all other sovereigns are given a risk weighting of 0% where such claims are denominated and funded in the relevant domestic currency of that sovereign. Claims on sovereigns, other than the aforementioned, are risk-weighted based on their credit ratings.

b. Claims on public sector entities [PSEs]

Listed Bahrain PSEs are assigned 0% risk weight. Other sovereign PSEs, in the relevant domestic currency and for which the local regulator has assigned risk weight as 0%, are assigned 0% risk weight by the CBB. PSEs other than the aforementioned are risk-weighted based on their credit ratings.

c. Claims on multilateral development banks [MDBs]

All MDBs are risk-weighted in accordance with their credit rating, except for banks part of the World Bank Group which is risk-weighted at 0%.

d. Claims on banks

Claims on banks are risk-weighted based on the ratings assigned to them by external rating agencies. However, short term claims on locally incorporated banks may be assigned a risk weighting of 20% where such claims on the banks are of an original maturity of three months or less and the claims are denominated and funded in either Bahraini Dinars or US Dollars.

Preferential risk weights that are one category more favourable than the standard risk weighting are assigned to claims on foreign banks licensed in Bahrain of an original maturity of three months or less denominated and funded in the relevant domestic currency. Such preferential risk weights for short-term claims on banks licensed in other jurisdictions are allowed only if the relevant supervisor also allows this preferential risk weighting to short-term claims on its banks.

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation.

e. Claims on corporates

Claims on corporates are risk-weighted based on credit ratings. Risk weights for unrated corporate claims are assigned at 100%.

f. Past due exposures

The unsecured portion of any facility (other than a qualifying residential mortgage facility) that is past due for more than 90 days, net of specific provisions (including partial write-offs), is risk-weighted as follows:

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the facility.

- 100% risk weight when specific provisions are greater than 20% of the outstanding amount of the facility.

g. Equity portfolios

Investments in listed equities are risk-weighted at 100% while unlisted equities are risk weighted at 150%.

h. Project finance exposures

Exposures on project finance are risk-weighted according to the Regulatory Slotting Criteria, in which the risk weighting ranges between 70% and 250%.

i. Other exposures

These are risk-weighted at 100%.

ii) Credit exposure and risk-weighted assets

US$ Thousands	Gross credit exposure	Funded Exposure	Un-Funded Exposure	Risk-weighted assets for Funded Exposures	Risk-weighted assets for Un-Funded Exposures	Total Risk Weighted Assets	Capital Charge (12%)
Sovereigns	61,593	61,593	-	-	-	-	-
Claims on banks	155,028	154,295	733	140,237	-	140,237	16,828
Claims on Corporates	594,261	526,927	67,334	442,374	67,334	509,708	61,165
Past due exposures	111,407	111,407	-	55,704	-	55,704	6,684
Project finance	191,733	191,733	-	134,213	-	134,213	16,106
Other	841	841	-	841	-	841	101
Total	**1,114,863**	**1,046,796**	**68,067**	**773,369**	**67,334**	**840,703**	**100,884**

Since the period end position is representative of the risk positions of the Group during the period, average gross exposures are not disclosed separately.

Breakdown of capital requirements for credit risk per type of Islamic financing contract is as follows:

US$ Thousands **Type of Financing**	Gross credit exposure	Funded Exposure	Un-Funded Exposure	Risk-weighted assets for Funded Exposures	Risk-weighted assets for Un-Funded Exposures	Total Risk Weighted Assets	Capital Charge (12%)
Murabaha	525,078	476,923	48,155	333,549	48,155	381,704	45,804
Ijara	309,287	309,287	-	204,140	-	204,140	24,497
Ijara Rec	901	901	-	641	-	641	77
Sukuk	250,925	250,925	-	230,268	-	230,268	27,632
Mudaraba	863	863	-	863	-	863	104
Equity	1,955	1,955	-	1,955	-	1,955	235
LC	19,912	-	19,912	-	19,179	19,179	2,301
Other	5,942	5,942	-	1,953	-	1,953	234
Total	**1,114,863**	**1,046,796**	**68,067**	**773,369**	**67,334**	**840,703**	**100,884**

6.2 Market risk

The Group, with assistance from ABC, minimizes its market risk through:

(i) match-funding its assets to reduce its profit rate risk;
(ii) not taking commodity price risk by squaring position on transaction by transaction basis;
(iii) funding exposures in the same currency and, hence, avoiding any foreign exchange currency risk; and
(iv) maintaining no sukuk trading position.

Accordingly, the Group maintains no capital charge for market risk.

6.3 Operational risk

In accordance with the standardised methodology, the total capital charge in respect of operational risk was US$ 33.3 million. This capital charge was computed by categorising the Group's activities into two business lines (out of the eight business lines defined by the Basel II framework) and multiplying the business line's three-year average gross income by a pre-defined beta factor.

Indicators of operational risk exposures:

Gross income *US$ thousands*	7,403
Amount of non-Shari'a compliant income *US$ thousands*	Nil
Number of Shari'a violations	Nil

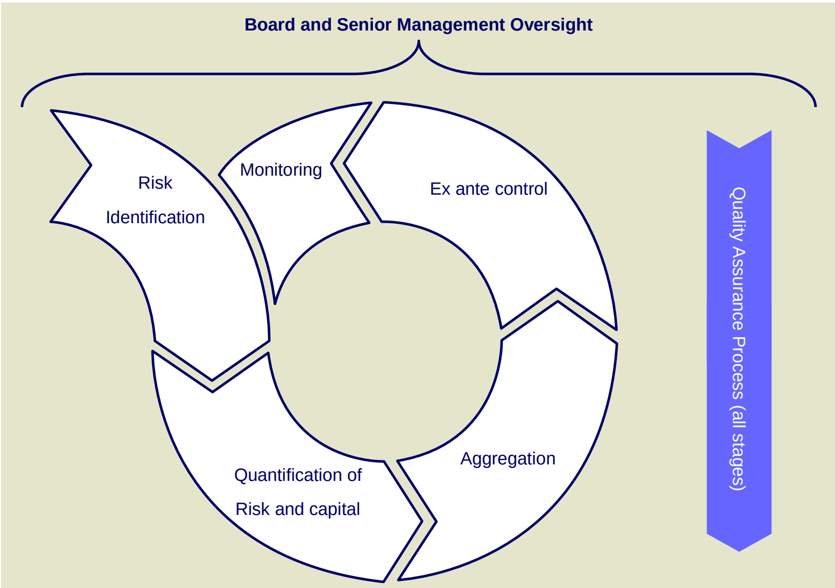
7. Risk management

7.1 Introduction

Risk is inherent in the Group's activities and is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. The Group is exposed to credit risk, market risk, liquidity risk, operational risk, legal and strategic risk, as well as other forms of risk inherent in its financial operations.

Over the last few years, ABC has invested heavily into developing a comprehensive and robust risk management infrastructure. This includes risk identification processes under credit, market and operational risk spectrums, risk measurement models and rating systems, as well as a strong business process to monitor and control these risks. Figure 1 outlines the various congruous stages of the risk process.

Figure 1:



7.2 Risk management structure

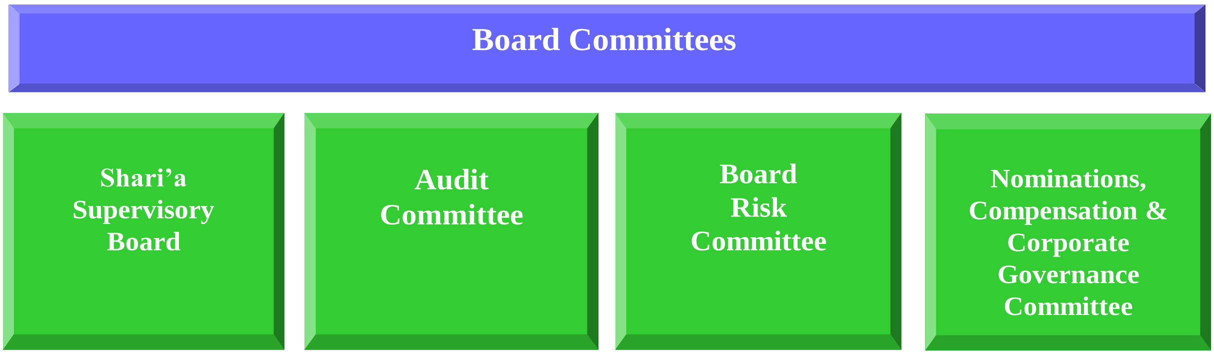
ABC's Executive Management is responsible for implementing the risk strategy / appetite and policy guidelines set by the Board Risk Committee [BRC], including the identification and evaluation on a continuous basis of all significant risks to the business and the design and implementation of appropriate internal controls to minimise them. This is done through the BRC, senior management committees and the Credit & Risk Group of the Head Office, as follows:

Figure 2: Risk management structure

Within the broader governance infrastructure, the Board Committees carry the main responsibility of best practice management and risk oversight. At this level, the BRC oversees the definition of risk appetite, risk tolerance standards and risk process standards to be kept in place. The BRC is also responsible for co-ordinating with other Board Committees for monitoring compliance with the requirements of the regulatory authorities in the various countries in which ABC operates.

At the second level, the Head Office Credit Committee [HOCC] is responsible for credit decisions at the higher levels of ABC's lending portfolio, setting country and other high level ABC limits, dealing with impaired assets and general credit policy matters.

In addition to being part of the above structure, through the outsourcing of the support functions including the credit approval, the Group has the following risk management structure:



ABC's Asset and Liability Committee (ALCO) is responsible for defining long-term strategic plans and policy, as well as short-term tactical initiatives for prudently directing asset and liability allocation. ALCO monitors ABC's liquidity and market risks, and the risk profile, in the context of economic developments and market fluctuations.

ABC's Operational Risk Management Committee (ORCO) is responsible for defining long-term strategic plans and short-term tactical initiatives for the identification, prudent management, control and measurement of ABC's exposure to operational risk and other non-financial risks. ORCO frames policy and oversees the operational risk function.

The **Credit & Risk Group (CRG)** is responsible for centralised credit policy and procedure formulation, country risk and counterparty analysis, approval/review and exposure reporting, control and risk-related regulatory compliance, remedial loans management and the provision of analytical resources to senior management. Additionally, it identifies market and operational risks arising from ABC's activities, recommending to the relevant central committees appropriate policies and procedures for managing exposure.

Under the single obligor regulations of the CBB and other host regulators, the CRG and its local equivalents have to obtain approval for any planned exposures above specific thresholds to single counterparties, or groups of connected counterparties.

Credit risk

ABC's portfolio and credit exposures are managed in accordance with the Group Credit Policy, which applies ABC Group-wide qualitative and quantitative guidelines, with particular emphasis on avoiding undue concentrations or aggregations of risk. ABC's banking subsidiaries are governed by specific credit policies that are aligned with the Group Credit Policy, but may be adapted to suit local regulatory requirements as well as individual units' product and sectoral needs.

The first level of protection against undue credit risk is through ABC's counterparty, country, industry and other risk threshold limits, together with customer and customer group credit limits. The BRC and the HOCC sets these limits and allocates them between ABC and its banking subsidiaries. A tiered hierarchy of delegated approval authorities, based on the risk rating of the customer under ABC's internal credit rating system, controls credit exposure to individual customers or customer groups. Credit limits are prudent, and ABC uses standard mitigation and credit control technologies.

ABC employs a Risk-Adjusted Return on Capital (RAROC) measure to evaluate risk/reward at the transaction approval stage. This is aggregated for each business segment and business unit, and for ABC as a whole. It is upgraded when appropriate.

Business unit account officers are responsible for day-to-day management of existing credit exposures, and for periodic review of the client and associated risks, within the framework developed and maintained by the CRG. ABC Group Audit, meanwhile, carries out separate risk asset reviews of business units, to provide an independent opinion on the quality of their credit exposures, and adherence to credit policies and procedures. These measures, collectively, constitute the main lines of defence against undue risk for ABC.

Credit exposures that have significantly deteriorated are segregated and supervised more actively by the CRG's Remedial Loans Unit (RLU). Subject to minimum loan loss provision levels mandated under the Group Credit Policy, specific provisions in respect of impaired assets are based on estimated potential losses, through a quarterly portfolio review and adequacy of provisioning exercise, which complies with IAS 39 reporting. (Collective impairment provision) is also maintained to cover unidentified possible future losses.

As at 30 June 2012, the Group's three largest exposures in excess of 15% of the capital base are shown below:

US$ Thousands	**On and off- Balance Sheet Exposure**
Counterparty [A]	75,905
Counterparty [B]	74,966
Counterparty [C]	56,599

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities or activities in the same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the ABC Group policies and procedures include specific guidelines to focus on country and counterparty limits and maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

Single name concentrations are monitored on an individual basis. ABC's internal economic capital methodology for credit risk addresses concentration risk through the application of single-name concentration add-on. Under the 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 percent of the regulatory capital base. This restriction applies only at the consolidated level of the ABC Group and, hence, the Bank has several exposures that exceed 15% of its capital base. However, none of these exposures exceed 15% of ABC's capital base.

Risk mitigation, collateral and other credit enhancements

The amount and type of collateral depends on an assessment of the credit risk of the counterparty. The types of collateral held by the Group mainly include cash, guarantees from banks and guarantees from ABC.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

Exposures by type of Islamic financing contract that are covered by guarantees or by eligible collaterals are as follows:

US$ thousands	**Exposures**	**Guaranteed**	**Collateral**	**Net exposure**
Funded Exposures (Murabaha)	111,407	111,407	2,662	108,745
Unfunded Exposures (LCs/LGs)	42,020	-	3,663	38,357

7.3 Geographical distribution of exposures

The Bank's nature of business, being an Islamic Bank, results in concentration of exposures in the Muslim world. Moreover, the Bank's approved concentration of activities, which is also in line with its role within the ABC Group, has large concentration in the GCC countries, as illustrated in the table below:

US$ Thousands **Country / Region**	**Gross Exposure**	**Percentage of Exposure**
Saudi Arabia	367,881	33.00%
Europe (including Turkey)	162,465	14.57%
UAE	139,840	12.54%
Kuwait	135,127	12.12%
Bahrain	118,459	10.63%
USA	75,000	6.73%
Qatar	62,652	5.62%
Other MENA Countries	20,841	1.87%
Oman	17,432	1.56%
Other Asia	15,166	1.36%
Total	**1,114,863**	**100.00%**

The geographical distribution of gross credit exposures by major type of credit exposures can be analysed as follows:

US$ Thousands **Type of Financing / Region**	**Bahrain**	**Saudi Arabia**	**Kuwait**	**Qatar**	**UAE**	**Oman**	**Other MENA countries**	**Other Asia**	**Europe (Including Turkey)**	**USA**	**Total**
Sovereigns	31,847	-	-	-	29,746	-	-	-	-	-	**61,593**
Claims on banks	7,003	-	-	5,076	-	-	733	15,166	127,050	-	**155,028**
Claims on Corporates	74,699	206,843	31,402	40,700	110,094	-	20,108	-	35,415	75,000	**594,261**
Past due exposures	4,069	29,391	77,947	-	-	-	-	-	-	-	**111,407**
Project finance	-	131,647	25,778	16,876	-	17,432	-	-	-	-	**191,733**
Other	841		-	-	-	-	-	-	-	-	**841**
Total	**118,459**	**367,881**	**135,127**	**62,652**	**139,840**	**17,432**	**20,841**	**15,166**	**162,465**	**75,000**	**1,114,863**

7.4 Industrial sector analysis of the exposures

The industrial sector analysis of exposures is as follows:

US$ Thousands	**Gross Exposure**	**Funded Exposure**	**Un funded Exposure**
Financial Institutions	360,433	359,700	733
Commercial real estate	188,472	188,472	-
Manufacturing	411,224	366,831	44,393
Construction	37,421	18,242	19,179
Trading	47,729	43,967	3,762
Government	29,746	29,746	-
Transportation	18,523	18,523	-
Tourism	20,474	20,474	-
Other	841	841	-
Total	**1,114,863**	**1,046,796**	**68,067**

The industrial sector analysis of gross credit exposures by major types of credit exposures can be analysed as follows:

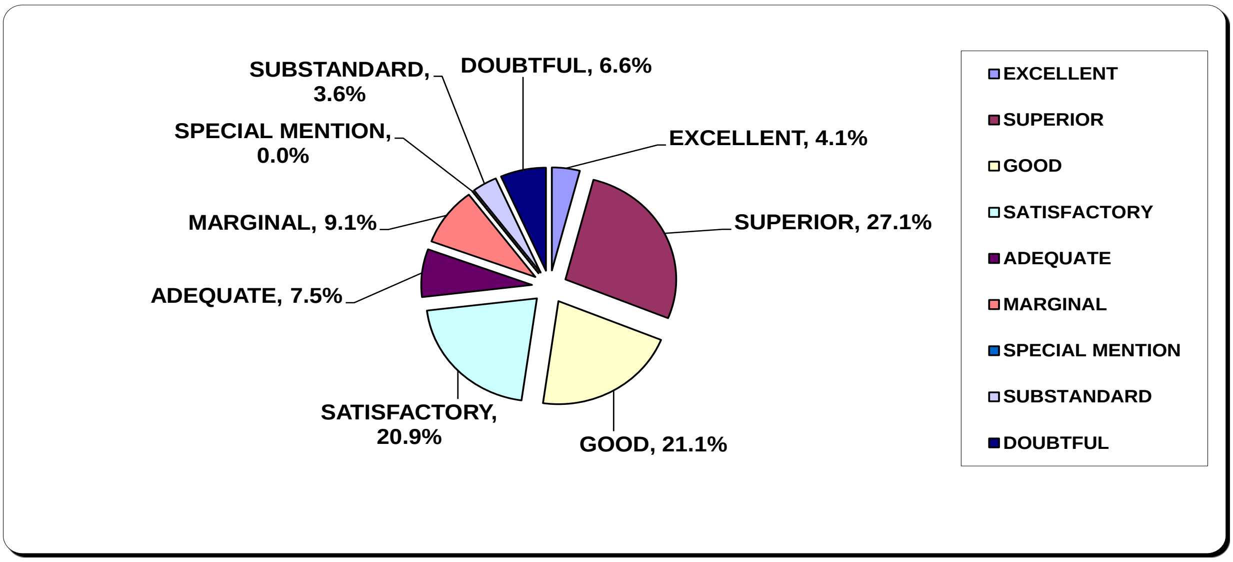
US$ Thousands *Type of Financing/Industry*	Financial Institutions	Commercial real estate	Manu-facturing	Con-struction	Trading	Govern-ment	Trans-portation	Tourism	Other	Total
Sovereigns	31,847	-	-	-	-	29,746	-	-	-	61,593
Claims on banks	155,028	-	-	-	-	-	-	-	-	155,028
Claims on Corporates	102,491	177,523	219,492	37,420	18,338	-	18,523	20,474	-	594,261
Past due exposures	71,067	10,949	-	-	29,391	-	-	-	-	111,407
Project finance	-	-	191,733	-	-	-	-	-	-	191,733
Other	-	-	-	-	-	-	-	-	841	841
Total	**360,433**	**188,472**	**411,225**	**37,420**	**47,729**	**29,746**	**18,523**	**20,474**	**841**	**1,114,863**

7.5 Exposure by external credit rating

The Group uses external ratings from Standard & Poor’s, Moody’s, Fitch Ratings and Capital Intelligence [accredited External Credit Assessment Institutions (ECAI’s)]. The breakdown of the Group’s exposure into rated and unrated categories is as follows:

US$ Thousands	Gross credit exposure	Rated Exposure	Unrated Exposure
Sovereigns	61,593	61,593	-
Claims on banks	155,028	154,295	733
Claims on Corporates	594,261	296,378	297,883
Past due exposures	111,407	-	111,407
Project finance	191,733	-	191,733
Other	841	-	841
Total	**1,114,863**	**512,266**	**602,597**

It is the Group's policy to maintain accurate and consistent risk ratings across the credit portfolio through its internal risk rating system. Risk ratings are supported by a variety of financial analytics, combined with processed market information, to provide the main inputs for the measurement of counterparty credit risk. All internal ratings are tailored to the various categories, are derived in accordance with ABC's credit policy, and are assessed and updated regularly. Each risk rating class is mapped to grades equivalent to Standard & Poor’s, Moody’s, Fitch Ratings and Capital Intelligence.



Percentages have been calculated internally based on the sum of funded counterparty exposure and unfunded exposures before applying credit conversion factors.

7.6 Maturity analysis of funded exposures

Residual contractual maturity analysis of the Group's major types of funded credit exposures are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	5-10 years	10-20 years	Total over 12 months	Undated	Total
Sovereigns	-	1,759	1,458	34,573	37,790	23,750	-	-	23,750	53	61,593
Claims on banks	5,339	25,289	5,284	95,565	131,477	20,863	-	-	20,863	1,955	154,295
Claims on Corporates	29,689	99,046	15,843	84,397	228,975	276,745	18,225	-	294,970	2,982	526,927
Past due exposures	-	-	-	-	-	-	-	-	-	111,407	111,407
Project finance	1,109	-	6,253	7,242	14,604	77,118	86,547	13,464	177,129	-	191,733
Other	-	291	228	227	746	-	-	-	-	95	841
Total	**36,137**	**126,385**	**29,066**	**222,004**	**413,592**	**398,476**	**104,772**	**13,464**	**516,712**	**116,492**	**1,046,796**

Residual contractual maturity analysis of the Group's funded credit exposures per type of Islamic financing contract are as follows:

US$ Thousands	Within 1 month	1-3 months	3-6 months	6-12 months	Total within 12 months	1-5 years	5-10 years	10-20 years	Total over 12 months	Undated	Total
Murabaha	3,602	64,534	16,237	171,091	255,464	110,052	-	-	110,052	111,407	476,923
Mudaraba	-	-	-	-	-	863	-	-	863	-	863
Sukuk	24,942	55,982	1,125	32,906	114,955	132,988	-	-	132,988	2,982	250,925
Equity	-	-	-	-	-	-	-	-	-	1,955	1,955
Other	5,048	291	228	227	5,794	-	-	-	-	148	5,942
Ijara Rec	526	284	91	-	901	-	-	-	-	-	901
Ijara	2,019	5,294	11,385	17,780	36,478	154,573	104,772	13,464	272,809	-	309,287
Total	**36,137**	**126,385**	**29,066**	**222,004**	**413,592**	**398,476**	**104,772**	**13,464**	**516,712**	**116,492**	**1,046,796**

7.7 Maturity analysis of unfunded exposures

Residual contractual maturity analysis of the Group's major types of unfunded credit exposures are as follows:

US$ Thousands	6-12 months	Total within 12 months	1-5 years	Total over 12 months	Total
Claims on banks	733	733	-	-	733
Claims on Corporates	49,209	49,209	18,125	18,125	67,334
Project finance	-	-	-	-	-
Total	**49,942**	**49,942**	**18,125**	**18,125**	**68,067**

Residual contractual maturity analysis of the Group's unfunded credit exposures per type of Islamic financing contract are as follows:

US$ Thousands	6-12 months	Total within 12 months	1-5 years	Total over 12 months	Total
Murabaha	48,155	48,155	-	-	48,155
LC	1,787	1,787	18,125	18,125	19,912
Total	**49,942**	**49,942**	**18,125**	**18,125**	**68,067**

Unfunded exposures include credit-related financial instruments, comprising of letters of credit, guarantees and commitments.

For credit-related contingent items, the nominal value is converted to an exposure through the application of a credit conversion factor [CCF]. The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off-Balance sheet notional amounts into an equivalent on-Balance sheet exposure.

Undrawn facilities and other commitments represent commitments that have not been drawn down or utilised at the reporting date. The nominal amount provides the calculation base to which a CCF is applied for calculating the exposure. CCF ranges between 20% and 50% for commitments with original maturity of up to one year and over one year respectively and 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

The table below summarises the notional principal amounts and the relative exposures before applying credit risk mitigation:

US$ thousands	Notional Principal	Credit Exposure*
Trade-related contingent items	3,663	-
Transaction-related contingent items	38,357	19,179
Undrawn facilities and other commitments	107,597	48,155
RWA for contingent items		**67,334**

* Credit exposure is after applying CCF.

At 30 June 2012, the Group held cash collaterals in relation to credit-related contingent items amounting to US$ 3,663 thousand.

7.8 Penalties imposed on customers

During the period, no penalties were imposed on customers.

7.9 Impairment of assets

Impairment and un-collectability of financial assets

An assessment is made at each quarter end to determine whether there is objective evidence that a specific financial asset or group of financial assets may be impaired. If such evidence exists, an impairment loss is recognised in the consolidated statement of income.

Evidence of impairment may include indications that the counterparty or a group of counterparties is experiencing significant financial difficulty, default or delinquency in profit or principal payments, the probability that they will enter bankruptcy or other financial re-organisation and, where observable data indicates, that there is a measurable decrease in the estimated future cash flows such as changes in arrears or economic conditions that correlate with defaults.

Impairment is determined as follows:

(a) for assets carried at amortised cost, impairment is based on the present value of estimated future cash flows discounted at the original effective profit rate;
(b) for assets carried at fair value, impairment is the difference between cost and fair value; and
(c) for assets carried at cost, impairment is based on the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

The Group uses the provision account to record impairments except for equity and similar investments, which are written down, with future increases in their fair value being recognised directly in equity.

On a quarterly basis the Group assesses whether any provision for impairment should be recorded in the consolidated statement of income. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provision required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes in such provisions.

Impairment against specific groups of financial assets

In addition to specific provisions against individually significant facilities and investments, the Group also makes a provision to cover impairment against specific group of financial assets where there is a measurable decrease in estimated future cash flows. This provision is based on any deterioration in the internal grade of the financial asset since it was granted. The amount of provision is based on the historical loss pattern for facilities within each grading and is adjusted to reflect current economic changes.

The internal grading process takes into consideration factors such as collateral held, deterioration in country risk, industry and technological obsolescence, as well as identified structural weakness or deterioration in cash flows.

7.10Market risk

Market risk is the risk that the Group's earnings or capital, or its ability to support its business strategy, will be impacted by changes in market rates or prices related to profit rates, equity prices, credit spreads, foreign exchange rates and commodity prices.

ABC has established risk management policies and limits within which exposure to market risk is monitored, measured and controlled by the Market Risk Management [MRM] with strategic oversight exercised by ABC's ALCO. MRM is responsible for developing and implementing market risk policy and risk measuring / monitoring methodology and for reviewing all new trading and investment products and product limits prior to ALCO approval. MRM's core responsibility is to measure, report, monitor and control market risk.

The Group classifies market risk into the following:

- **Non-trading market risk in securities**
  Non-trading market risk arises from market factors impacting securities that are held for long-term investment.

- **Asset and liability risk**
  Non-trading asset and liability risk exposures arise where the re-pricing characteristics of the Group's assets do not match with those of liabilities.

- **Liquidity Risk**
  Liquidity risk is the risk that maturing and encashable assets may not cover cash flow obligations (liabilities). In this respect, the Group is supported by ABC, through the provision of a line of credit to cover any shortfall in liquidity. Accordingly, the Group's liquidity needs are taken into consideration in ABC's liquidity management.

As there is no specific measure that reflects all aspects of market risk, ABC analyses risk using various risk measures, reporting results to senior management.

The measurement techniques used to measure and control market risk are:

- Value-at-Risk [VaR]
- Basis Point Value [BPV]
- Stress Testing
- Non-Technical Risk Measures

On an annual basis, ABC's BRC reviews and approves VaR trading limits, BPV trading and investment Limits, and Non-Technical Trading and Investment Limits.

It should be noted that the Bank applies BPV on the sukuk portfolio and the non-technical risk measures in its liquidity management at the Bank level. For the non-technical measures, notional limits are set for investment products, which are approved by the Board Risk Committee.

- **Currency risk**

The Group is exposed to foreign exchange rate risk through its structural positions. In general, the Group uses matched currency funding to eliminate such a risk.

- **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 is exposed to profit rate risk as a result of mismatches of profit rate re-pricing of assets and liabilities. The most prominent market risk factor for the Bank is profit rates. This risk is minimised as the Group's rate sensitive assets and liabilities are mostly floating rate, where the duration risk is lower. In general, the Group translates fixed rate instruments to floating rate to better manage the duration in the asset book.

- **Commodity risk (price risk)**

The Group would be exposed to commodity risk if it holds commodity for its Murabaha transactions. However, in order to minimise or eliminate this risk, the Group limits its holding of commodity to the day of the transaction and it settles its position for each specific transaction, hence eliminating overnight price risk in the commodities traded.

- **Profit Rate Risk in the Banking Book [PRRBB]**

The Bank uses the BPV approach to control PRRBB. BPV measures changes in economic value resulting from changes in profit rates. In the BPV methodology, the modified duration approach and, for some products, the effective duration approach is used to measure the PRRBB. Modified duration is a good measure of linear risk for profit rate sensitive products.

The BPV measure incorporates the entire rate sensitive segment of the statement of financial position for the Group and is classified into appropriate buckets. Non-maturity profit rate sensitive assets and liabilities are bucketed in the short term. Equity is excluded from these computations.

As at 30 June 2012, an immediate shift by 200 basis points in profit rates would potentially impact the Group's economic value by US$ 1,418 thousand.

At the period end, the Group was exposed to profit rate risk on its financial assets and financial liabilities. The following table indicates the profit rates during the period expressed as a percentage of the principal outstanding.

US$ thousands

	%
Investments	1.16 – 4.95
Murabaha receivables	0.30 – 4.63
Ijara	1.14 – 6.19
Murabaha payables	0.60 – 2.13

7.11 Equity position risk

Equity position risk arises from the possibility that changes in the price of equities or equity indices will affect future profitability or the fair values of financial instruments. As of the reporting date, the Bank had an equity position amounting to US$ 1,955 thousand.

7.12 Business risk

Business risk represents the earnings volatility inherent in all business activities due to the uncertainty of revenues and costs associated with changes in the economic and competitive environment. Business risk is evaluated through a Business and Strategy Development Process. A Risk Budget is developed at the start of each year along with a Business Plan. Subsequently, the actual quarterly performance is compared with budget, including the historical volatility in earnings, and the detailed financial budget, which supports both the decision making and the planning process.

7.13 Liquidity risk

The Group's principal sources of liquidity are deposits placed with the subsidiary funds raised through commodity Murabahas. However, for any shortfall in liquidity, the Bank relies on ABC; hence, the Group's liquidity needs are taken into consideration in ABC's liquidity management process. ABC maintains liquid assets at prudential levels to ensure that cash can quickly be made available to honour all its obligations, even under adverse conditions. ABC is generally in a position of excess liquidity, its principal sources of liquidity being its deposit base, liquidity derived from its operations and inter-bank borrowings. The Minimum Liquidity Guideline [MLG] is used to manage and monitor daily liquidity. The MLG represents the minimum number of days ABC can survive the combined outflow of all deposits and contractual draw-downs under market value driven encashability scenarios.

In addition, an internal liquidity / maturity profile is generated to summarise the actual liquidity gaps versus the revised gaps based on internal assumptions.

The following table summarises the liquidity ratios as at 30 June 2012:

Liquid assets ratio	24.5%
Short-term assets to short-term liabilities	44.7%

7.14 Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes or systems, or from external events. Operational risk is inherent in all business activities and can never be eliminated entirely; however, shareholder value can be preserved and enhanced by managing, mitigating and, in some cases, insuring against operational risk. To achieve this goal, ABC has developed an operational risk framework, which includes identification, measurement, management, monitoring and risk control / mitigation elements. A variety of underlying processes are being deployed across ABC including risk and control self-assessments, Key Risk Indicators [KRI], event management, new product review, approval processes and business contingency plans.

ABC intends to make operational risk transparent throughout the enterprise, to which end processes are being developed to provide for regular reporting of relevant operational risk management information to business management, senior management, the Operational Risk Committee of ABC, the BRC of ABC and the Board of Directors.

ABC's policy dictates that the operational functions of booking, recording and monitoring of transactions are carried out by staff that are independent of the individuals initiating the transactions. Each business line – including Operations, Information Technology, Human Resources, Legal & Compliance and Financial Control - is further responsible for employing the aforementioned framework processes and control programmes to manage its operational risk within the guidelines established by the Group's policy, and to develop internal procedures that comply with these policies. To ensure that all operational risks to which the Group is exposed are adequately managed, support functions are also involved in the identification, measurement, management, monitoring and control / mitigation of operational risk, as appropriate.

7.15 Legal risk

Inadequate documentation, legal and regulatory incapacity, insufficient authority of a counterparty and contract invalidity or unenforceability are all examples of legal risk. Identification and management of this risk are the responsibilities of the Head Office Legal & Compliance Department [LCD] and are carried out through consultation with internal and external legal counsels, together with close monitoring of the litigation cases involving the Group, as well as ABC. The Group have no material contingencies.

8. Capital management

Internal Capital Adequacy Assessment Process [ICAAP]

The Group's capital management aims to maintain an optimum level of capital to enable it to pursue strategies that build long-term shareholder value, whilst always meeting minimum regulatory ratio requirements. The diagram below illustrates this concept:

The key principles driving capital management at the Group include:

- Adequate capital is maintained as buffer for unexpected losses to protect stakeholders, i.e. shareholders and depositors; and
- Maximise return on capital and generate sustainable returns above the cost of capital.

The Group seeks to achieve the following goals by implementing an effective capital management framework:

- Effective internal capital adequacy;
- Meet the regulatory capital adequacy ratios and have a prudent buffer;
- Generate sufficient capital to support overall business strategy; and
- Integrate capital allocation decisions with strategic and financial planning process.

In addition, to prepare itself for compliance with the Foundation Internal Ratings-Based [FIRB] requirements, the Group has developed an ICAAP framework. The purpose of the ICAAP framework is to document the Group's structured process for the ongoing assessment of the Group's overall capital adequacy in relation to the Group's risk profile and a strategy for capital management as set out in Principle 1 of Basel II Pillar II.

This framework outlines the Group's risk strategy, capital objectives, methodology used to measure internal capital, the related assumptions underpinning the methodologies and a set of processes for capital management such as reviewing, monitoring and controlling capital usage and allocation, including:

- In January 2008, the CBB issued ICAAP guidelines for capital management. Within this framework the risk strategy as approved by the Board is incorporated, underscoring Board and senior management responsibility and oversight. The risk strategy document outlines the Group's risk appetite, capital adequacy goals and risk targets.

- The Group has an integrated approach to risk strategy and business strategy which analyses current and future capital requirements in relation to strategic objectives as part of the annual business planning process. The Business Plan is used in estimating the economic capital projections. In addition, throughout the period, as part of the process, actual usage is monitored against the projections.

- Comprehensive assessment of economic capital, i.e. credit, market and operational risks, and processes relating to other risks such as liquidity, profit rate risk in the banking book, strategic and reputational risks.

- The processes in place for monitoring, reporting and internal audit review.

The methodologies for internally estimating capital for the Group's key risks are as follows:

a. **Credit Risk:** Assessed on the basis of FIRB Risk Weights (as set out in the table under Annexure 3 of the Basel II Accord – *Illustrative IRB Risk Weights*) for Unexpected Loss [UL]. This supports the internal estimation of Economic Capital per Business Segment and Business Unit, and aggregated at the Group level.

b. **Market Risk:** Computed for the banking book using the Internal Model approach.

c. **Operational Risk:** Applied on the Standardised Approach basis.

Other risks such as **Liquidity, Strategic and Reputational risks** are currently captured providing a capital buffer.

The results of the ICAAP process are subject to stress testing to take account of the breakdown of the underlying assumptions. Specific stress tests have been developed to focus on the key risks the Group faces based on its risk exposure, portfolio and strategic objectives.

The output of the ICAAP gives senior management and the Board an improved view of the risks the Group faces and the impact of these risks.

ABC has implemented an advanced Economic Capital Management System, which is now being implemented at the Bank. This tool will allow, at all levels of granularity, estimation of Economic Capital, RAROC, Sharpe Ratios, Risk Contributions, and effects of component accounts and counterparties for the effects of diversification benefits and concentration risks. This system will also allow an advanced capability for estimating economic capital under stress scenarios.

Supervisory Review and Evaluation Process [SERP]

The CBB is the lead regulator for the Group and sets and monitors capital requirements on both a consolidated and solo basis. The CBB requires each Bahrain-based bank or banking group to maintain a minimum ratio of total capital to risk-weighted assets of 12%, taking into account both on and off-Balance sheet transactions. However, under the SERP guidelines, the CBB would also make an individual risk profile assessment of all banks and, instead of applying a standard minimum capital adequacy requirement, the supervisor may allow a lower capital adequacy ratio in excess of 8% for a bank with sound risk management capabilities. The CBB initiated this assessment process in the first quarter of 2008. The Group's capital management strategy is to currently maintain a buffer over the 12% minimum regulatory capital requirement while enhancing its risk management and risk control infrastructure. This would ultimately allow the Group to achieve a successful assessment and pursue possible lower capital requirements from the CBB. At the same time, senior management strongly believes in the economic value of capital and is committed to maximise intrinsic value for all stakeholders.

9 Other disclosures

9.1 Related party transactions

Related parties represent associated companies, major shareholders, directors and key management personnel of the Group and entities controlled, jointly controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Group's senior management and are at arm's length basis.

a. Exposures to related parties

US$ thousands	
Claims on shareholders	118,849
Claims on Directors and senior management	587
Claims on staff	95

b. Liabilities to related parties

US$ thousands	
Connected deposits	687,445

c. Income and expenses arising from dealing with related parties

US$ thousands	
Income from Murabaha receivables	13
Profit on Murabaha payables	3,834
Charges by ABC (B.S.C.)	396
Fees paid to ABC (B.S.C.)	350

9.2 Ageing analysis of non-performing / impaired Islamic financing and securities

In accordance with the guidelines issued by the CBB, credit facilities are placed on non-accrual status and profit suspended when either principal or profit is overdue by 90 days, whereupon profit credited to income is reversed. Following an assessment of impairment, specific provision is established if there is objective evidence that a credit facility is impaired.

An ageing analysis of all non-performing Islamic financing facilities on non-accrual basis, together with their related provisions, is as follows:

Islamic financing

US$ thousands	**Principal***	**Provisions**	**Net book value**
1 to 3 years	40,340	-	40,340
Over 3 years	71,067	-	71,067
Total	**111,407**	**-**	**111,407**

* Carrying values of US$ 111,407 thousand have been guaranteed by ABC which also have provided a provision of US$ 92,387 thousand against the guaranteed exposure. All past due financing facilities are from GCC countries.

Securities

The Group has specific impairment provisions of US$ 17,577 thousand on its securities portfolio, all of the securities are from GCC countries.

9.3 Restructured assets

As of 30 June 2012, there were no financial assets whose terms were renegotiated during the period.

9.4 Assets sold under recourse agreements

The Group has not entered into any recourse agreement during the period ended 30 June 2012.

9.5 Movement in specific and collective impairment provisions

US$ thousands	**Specific provision for securities**
As at 1 January 2012	17,092
Additional provisions made	500
Foreign exchange translation adjustment	(15)
As at 30 June 2012	**17,577**

9.6 Industry sector analysis of the specific impairment provisions charges

Impairment of US$ 9,077 thousand is in the financial institution sector and US$ 8,500 thousand in the construction and real estate sector.

9.7 Equity positions in the banking book

As at 30 June 2012, the equity position of the Group amounted to US$ 1,955 thousand, all of which is quoted.

9.8 Quantitative indicators of financial performance, position and liquidity risk

	2008	2009	2010	2011	June 2012
Cost / income ratio %	14.7	24.5	30.8	40.8	37.0
Return on average equity %	13.1	6.6	1.2	3.6	3.5*
Return on average assets %	1.8	0.7	0.2	0.7	0.8*
Liquidity assets ratio %	24.6	31.9	30.6	25.9	24.5
Short term assets to short term liabilities %	29.5	26.8	39.1	43.2	44.7
Risk asset ratio – Tier 1 %	15.4	23.0	24.2	26.5	26.0
Risk asset ratio – Total %	17.6	24.1	24.5	27.5	26.5

* Annualised