Risk and Capital Management

Basel II – Pillar III Disclosures (Quantitative)

As at 30 June 2014

Index

1. Executive summary

Investment Dar Bank B.S.C. (c) ("the Bank") is a Bahraini closed shareholding company registered with the Ministry of Industry and Commerce in the Kingdom of Bahrain and operates under commercial registration number 66163 obtained on 8 August 2007. The "Parent Company" of the Bank is The Investment Dar K.S.C., a Kuwaiti incorporated Company listed on Kuwait Stock Exchange, which owns directly and indirectly more than 50% of the share capital of the Bank.

The Bank operates as an Islamic Wholesale Bank under a license granted by the Central Bank of Bahrain ("CBB") and accordingly activities are regulated by the CBB and supervised by a Religious Supervisory Board ("the Shari'a Board").

The principal activities of the Bank include investment banking services, which comply with the Islamic rules and principles according to the opinion of the Bank's Shari'a Board.

The CBB Basel II guidelines became effective on 1 January 2008 as the common framework for the implementation of Basel II capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

These semi-annual disclosures have been prepared in accordance with the CBB requirements outlined in the Public Disclosure Module ("PD"), Section PD-3.1.6: *Additional Requirements for Semi Annual Disclosures*, CBB Rule Book, Volume II for Islamic Banks. These semi-annual quantitative disclosure requirements follow the requirements of Basel II - Pillar 3 and the Islamic Financial Services Board's (IFSB) recommended disclosures for Islamic banks. These disclosures should be read in conjunction with the detailed Risk and Capital Management Disclosures made in Bank's Annual Report for the year ended 31 December 2013 and the condensed consolidated interim financial information for the six months ended 30 June 2014.

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

As at 30 June 2014 the Bank's CAR stood at a healthy 51.64%. The Bank is in constant discussion with its regulator in relation to its capital position & its plan to further improve its regulatory capital ratio.

Basel II Framework

The Basel II framework introduced by CBB with effect from 2008, provides a more risk sensitive approach to the assessment of risk and the calculation of regulatory capital i.e. the minimum capital that a bank is required to maintain. The framework intends to strengthen the risk management practices and processes within financial institutions. The Bank has accordingly taken steps to comply with these requirements. The CBB's capital management framework, consistent with the Basel II accord, is built on three pillars:

- **Pillar I** defines the regulatory minimum capital requirements by providing rules and regulations for measurement of credit risk, market risk and operational risk. The requirement of capital has to be covered by the Bank's own regulatory funds.

- **Pillar II** addresses a bank's internal processes for assessing overall capital adequacy in relation to risks (ICAAP). Pillar II also introduces the Supervisory Review and Evaluation Process (SREP), which assesses the internal capital adequacy.

- **Pillar III** complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy.

2. Group structure

The condensed consolidated interim financial information comprise the financial information of the Bank and its subsidiaries (together referred to as the "Group") as at and for the six months ended 30 June 2014.

As at 30 June 2014, the Bank owned the following subsidiaries:

Name	Country of incorporation	Ownership interest	Principal activity
Darco Real Estate Investment Co. W.L.L.	Kingdom of Bahrain	100%	Buying and selling properties, shares and securities, management and development of private property, investment in local industries and promotion of foreign products and services
Al Honaniya Real Estate Co. W.L.L.	Kuwait	100%- Indirect holding	Real estate
North Victoria Limited *	Jersey,Channel Islands	100%	Real estate
Gibson North Limited *	Jersey, Channel Islands	77.425%	Real estate

(*) The Bank acquired the shares of North Victoria Limited and Gibson North Limited ("these companies") as part of a settlement of a Murabaha placement with a related party of the Parent Company during 2012. As per the settlement contract, the liabilities as on the date of settlement in the books of these companies were not transferred to the Bank. The main asset in the books of these companies was the value of islands in "The World" which have been treated as investment properties on consolidation. The value of the investment properties was restricted to the value of the Murabaha carried in the books of the Bank prior to settlement. The value of the island held by Gibson North Limited has been consolidated as the Bank's share of 77.425% of the net assets, net of minority interest at the time of consolidation.

3. Capital structure and capital adequacy

The Bank's equity position as at 30 June 2014 and 31 December 2013 is as follows:

	30 June 2014	USD'000 31 December 2013
Share capital	200,000,000	200,000,000
Statutory reserve	851,737	851,737
Property fair value reserve	1,225,164	1,225,164
Fair value reserve	884,919	1,322,946
Accumulated losses	(100,533,784)	(99,830,258)
	102,428,036	103,569,589

The Bank's regulatory capital position at 30 June 2014 was as follows:

USD' 000

	Tier 1	Tier 2	Total
Share capital	200,000	-	200,000
Treasury shares	-	-	-
Share premium	-	-	-
Statutory reserve	852	-	852
Other reserves	-	-	-
Accumulated losses brought forward	(99,830)	-	(99,830)
Current interim losses	(704)	-	(704)
Asset revaluation reserve – property, plant and equipment (45% only)	-	551	551
Unrealized gains arising from fair valuing equities (45% only)	-	398	398
Collective impairment loss provision	-	786	786
Tier 1 and Tier 2 capital before general deductions	**100,318**	**1,735**	**102,053**
Excess amount over maximum permitted large exposure limit	(57,059)	-	(57,059)
Total eligible capital base	**43,259**	**1,735**	**44,994**

Risk weighted exposures	Risk weighted exposure	Capital requirement @12%
Credit risk	64,975	7,797
Market risk	408	49
Operational risk	21,743	2,609
Tier 1 and Tier 2 capital base	**87,126**	**10,455**
Tier 1 Capital Adequacy Ratio		**49.65%**
Total Capital Adequacy Ratio		**51.64%**

The Bank's paid up capital consists of only ordinary shares which have proportionate voting rights.

4. Credit risk

4.1 Capital requirements for credit risk

To assess its capital adequacy requirements for credit risk in accordance with the CBB requirements, the Bank adopts the standardized approach. According to the standardized approach, on and off balance sheet credit exposures are assigned to various defined categories based on the type of counterparty or underlying exposure. The main relevant categories are claims on banks, claims on investment firms, investment in equities, holdings in real estate, claims on corporate portfolio and other assets. Risk Weighted Assets (RWAs) are calculated based on prescribed risk weights by CBB relevant to the standard categories and counterparty's external credit ratings, where available

Following is the analysis for credit risk as computed for regulatory capital adequacy purposes:

USD '000

Asset categories for credit risk	Gross credit exposures	Average risk weights	Total credit risk weighted exposure
Self financed assets			
Cash items	1	0%	0
Standard risk weights for claims on banks	8,239	20%	1,648
Preferential risk weight for claims on locally incorporated banks – BD & USD	197	20%	39
Short term claims on banks	408	20%	82
Past due facilities where specific provision is 20% or more	23,211	100%	23,211
Listed equity investment	3,559	100%	3,559
Unlisted equity investment	1,264	150%	1,896
Holding of real estate	8,614	200%	17,228
Other assets	17,312	100%	17,312
Total risk weighted exposure (A)	**62,805**	**103%**	**64,975**
Total regulatory capital required (A x 12%)			**7,797**

4.2 Quantitative information on credit risk

4.2.1 Gross and average credit exposure

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

USD '000

Balance sheet items	Self financed exposure	Total gross credit exposure	* Average gross credit exposure
Cash and bank balances	8,846	8,846	9,016
Prepayments and other assets	712	712	707
Investment securities	4,823	4,823	4,823
Wakala and Murabaha placements	29,475	29,475	29,475
Investment in real estate held-for-use	43,895	43,895	43,895
	87,751	87,751	87,916

* Average gross credit exposures have been calculated based on the average of balances outstanding on a quarterly basis for six months period ended 30 June 2014.

4.2.2 Credit exposure by geography

The Classification of credit exposures by geography, based on the location of the counterparty, was as follows:

USD '000

	GCC Countries	Europe	Total
Balance sheet items			
Cash and bank balances	607	8,239	8,846
Prepayments and other assets	712	-	712
Investment securities	4,823	-	4,823
Wakala and Murabaha placements	29,475	-	29,475
Investment in real estate held-for-use	43,895	-	43,895
	79,512	8,239	87,751
Off-Balance sheet items			
Restricted Investment Accounts	481,103	-	481,103

4.2.3 Credit exposure by industry

The classification of credit exposures by industry was as follows:

USD'000

	Banks and financial institutions	Real estate	Others	Total
Balance sheet items				
Cash and bank balances	8,846	-	-	8,846
Prepayments and other assets	-	-	712	712
Investment securities	1,234	3,589	-	4,823
Wakala and Murabaha placements	29,475	-	-	29,475
Investment in real estate held-for-use	-	43,895	-	43,895
	39,555	47,484	712	87,751
Off-Balance sheet items				
Restricted Investment Accounts	-	-	481,103	481,103

4.2.4 Credit exposure by maturity

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

USD'000

	Up to 3 months	3 to 6 months	6 to 12 months	1 to 3 years	3 to 5 years	5 to 10 years	Above 10 years	Overdue	Total
Balance sheet items									
Cash and bank balances	8,846	-	-	-	-	-	-	-	8,846
Prepayments and other assets	-	44	-	-	-	-	-	668	712
Investment securities	-	-	-	-	4,823	-	-	-	4,823
Wakala and Murabaha placements	-	-	-	21,619	-	-	-	7,856	29,475
Total assets	8,846	44	-	21,619	12,679	-	-	668	43,856
Accruals and other payables	-	-	-	(189)	-	-	-	(2,297)	(2,486)
Net liquidity gap	8,890	-	-	21,430	12,679	-	-	(1,629)	41,370
Off-Balance sheet items									
Restricted Investment Accounts	-	-	-	-	453,907	-	-	27,196	481,103

4.2.5 Impaired facilities and past due exposures

Movement in impairment provisions during the period: USD'000

	Specific Provisions Against			
	Financing facilities	Investments	Other assets and off-Balance sheet items	General provision allocated to self investment a/c
At beginning of the year	61,037	658	2,870	14,950
New provisions made	-	-	-	-
Amounts written off	-	-	-	-
Recoveries/write backs	-	-	13	-
Balance at 30 June 2014	61,037	658	2,884	14,950

The movement of impairment provisions during the year by industry is as follows:

	Specific Provisions Against			General Provision Allocated to Self Investment a/c
	Banks and financial institutions	Real estate	Others	
At beginning of the year	61,037	-	-	14,950
New provisions made	-	-	-	
Amounts written off	-	-	-	
Recoveries / Write backs	-	-	-	-
Balance at 30 June 2014	61,037	-	-	14,950

Gross impaired facilities as at 30 June 2014 USD'000

	Gross impaired facilities/receivables
Up to 3 months	-
Over 3 months to 1 Year	-
1 to 3 Years	1,000
Over 3 Years	142,534
Total	143,534

Analysis of all facilities/receivables by industry

	Amount outstanding	Non-performing amounts	Specific provisions
Financial	92,423	92,423	47,332
Other sectors	51,110	51,110	15,829
Total facilities/receivables by industry	**143,534**	**143,534**	**63,161**

4.2.6 Exposure to connected counterparties (including off-Balance sheet items) - consolidated

Claims on staff	-
Claims on senior management	-
Exposures to the directors and their associates	-
Exposures to unconsolidated subsidiaries	-
Exposures to consolidated subsidiaries	5,261
Exposures to bank's associates	-
Exposures to significant shareholders	491,040
Total exposures to connected counterparties	**496,300**

5. Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to adverse changes in profit rates, foreign exchange rates, equity, and commodity prices. Under the CBB standarised approach, market risk exposures are calculated for the five categories shown in the table below. Apart from limited foreign exchange, which is mainly transaction-driven, and long-term foreign currency exposure on private equity investments, the Bank has limited exposure to short-term market risks.

The details of the Bank's market risk capital charges and the equivalent market risk-weighted exposure as at 30 June 2014 and 31 December 2013 are:

	30 June 2014	31 December 2013
Price risk	-	-
Equities position risk	-	-
Sukuk risk	-	-
Foreign exchange risk	33	19
Commodities risk	-	-
Total capital requirement for market risk	33	19
Multiplier	12.5	12.5
Total market risk-weighted exposure	408	235

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the approach agreed with the CBB. The bank's average gross income for the last two financial years is multiplied by a fixed coefficient alpha of 15% set by CBB and a multiple of 12.5x is used to arrive at the risk weighted assets that are subject to capital charge.

6. Operational risk - Basic Indicator Approach

The Bank adopts the Basic Indicator Approach to evaluate operational risk charge in accordance with the approach agreed with the CBB. The bank's average gross income for the last three financial years is multiplied by a fixed coefficient alpha of 15% set by CBB and a multiple of 12.5x is used to arrive at the risk weighted assets that are subject to capital charge.

	Average gross income	Risk weighted assets	Capital charge at 12%
Operational risk	11,596	21,743	2,609

7. Regulatory Capital requirements for Credit Risk by type of Islamic Financing Contract

USD'000

Asset Categories for Credit Risk	Credit exposure	Risk weights	Credit Risk weighted asset
Murabha Where Specific Provision is 20% or more	23,211	100%	23,211
Wakala Where Specific Provision is 20% or more	-	-	-

8. Past Due Islamic financing Contracts

8.1 Past due Islamic financing contracts by industry

USD'000

Exposure	Country	Banks & financial institutions	Real estate	Others	Total
Murabha Placement	Kuwait	13,255	50,987	-	64,242
Provision for Impairment Murabha	Kuwait	(5,399)	(15,706)	-	(21,105)
Net Murabha Placement	Kuwait	7,856	35,281	-	43,137
Wakala Placement	Kuwait	75,915	-	-	75,915
Provision for Impairment Wakala	Kuwait	(39,347)	-	-	(39,347)
Net Wakala Placement	Kuwait	36,568	-	-	36,568
General Provision for Impairment wakala & Murabha	Kuwait			(14,950)	(14,950)
		44,424	35,281	(14,950)	64,755

8.2 Ageing of past due financing contracts - Wakala and Murabaha placements

USD'000

	Over 3 months	Over 1 years	Over 3 years
Past due (gross exposure)	-	-	89,170
Impaired	-	-	(59,695)
Non-performing (net exposure)	-	-	29,475

8.3 Ageing of past due other assets

USD'000

	Over 3 months	Over 1 years	Over 3 years
Past due (gross exposure)	-	-	1,987
Impaired	-	-	(4,695)
Nonperforming (Net exposure)	-	-	(1,253)

8.4 Other Assets Provision breakup

USD'000

	Provision	Amount
Counterparty #1	(2,000)	2,000
Counterparty #2	(124)	124
Counterparty #3	(734)	734
Counterparty #4	(586)	1,150
Counterparty #5	-	104
Investment securities	(658)	688
	(4,102)	4,880

8.5 Gross value of contracts netted off by provisions and collaterals

USD'000

Financing Contracts	Amount outstanding	Specific provisions	Collateral	Net
Wakala	75,915	39,347	-	36,568
Murabha	13,255	5,399	12,822	(4,966)
Total Facilities / Receivables by Sector	89,170	44,746	12,822	31,602

General Provision on total Wakala & Murabha is USD14,950

9. Restricted Investment Accounts

USD'000

	2014 (6months)	2013 (12 months)	2012 (12 months)	2011 (12 months)	2010 (12 months)	2009 (12 months)
Historical returns over the last 5 years	-	-	-	-	21	437

10. Investments in foreign subsidiaries

Nature of the related currency exposure and how it changed from year to year

Nature of currency exposure	Investment in real estate held for rent
Fair value of the asset in 2013	8,614
Fair value of the asset in 2012	7,389

Foreign exchange translation effects

	Change in currency rate	Effect on profit 2013 USD	Effect on Equity 2013 USD	Effect on profit 2012USD	Effect on Equity 2012 USD
KWD	+20%	487	487	416	416

11. Financial performance and position

	2014 (6months)	2013 (12 months)	2012 (12 months)	2011 (12 months)	2010 (12 months)	2009 (12 months)
Return on average equity	-0.68%	-9.79%	0.71%	3.80%	-29.84%	-17.64%
Return on average assets	-0.67%	-9.58%	0.69%	3.71%	-24.75%	-13.16%
Cost-to-income ratio	-458.97%	-146.60%	-68.87%	-57.28%	-839.21%	-420.22%

12. Other disclosures

Audit and other services fees

	USD
Audit fees and other related services	64,987
FATCA compliance fees	7,958
	72,945

Sensitivity analysis on rate of returns on quoted equity investments:

	Change in Profit rate	Effect on profit 2013 USD	Effect on equity 2013 USD	Effect on profit 2012 USD	Effect on equity 2012 USD
Listed investment security	+10%	211,841	211,841	186,161	186,161