Dubai Islamic Bank P.J.S.C.

Basel II – Pillar III Disclosures

For the year ended 31 December 2012

بنك دبي الإسلامي
Dubai Islamic Bank

1. OVERVIEW AND INTRODUCTION

The Central Bank of the United Arab Emirates ("CBUAE") issued guidelines for implementation of Basel II Capital Accord in the banks in UAE in November 2009. The CBUAE Basel II framework clearly addresses the importance of developing and using better risk management techniques in monitoring and managing banks' risks.

The Basel II Accord is based on three pillars as follows:

- **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 can be used as a tool to assess the internal capital adequacy of any organization.

- **Pillar III -** complements the other two pillars and focuses on enhanced transparency in information disclosure, covering risk and capital management, including capital adequacy. The aim of these disclosures is to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess certain specified information on the scope of application of Basel II, capital, particular risk exposures and risk assessment processes, and hence the capital adequacy of the institution.

In compliance with the CBUAE guidelines and Basel II Accord; these disclosures include information about Dubai Islamic Bank PJSC and its subsidiaries (collectively referred to as the "Bank") relating to the Bank's structure, capital structure, capital adequacy and requirements, risk management objectives and policies, and various supporting quantitative and qualitative disclosures.

Future Developments

The regulation and supervision of financial institutions is currently undergoing a period of significant change in response to the global financial crisis. Increased capital requirements and regulatory focus on Liquidity Risk have been announced by the Basel Committee in December 2010, commonly known as Basel III. These developments are being tracked by the Bank and necessary dialogue conducted with the regulators, for timely changes to the Capital Management and Disclosure regimes.

Implementation of Basel II guidelines

The Bank is compliant with Standardized Approach for Credit, Market and Operational Risk (Pillar I) with effect from December 2007.

The Bank also assigns capital on other than Pillar I risk categories, within the Pillar II framework. Details on Pillar II methodologies are contained in section – "Capital Management and Stress Testing" of this report.

2. BANK STRUCTURE

The Bank consists of Dubai Islamic Bank P.J.S.C. and its subsidiaries. As of 31 December 2012, the Bank's interest held directly or indirectly in its subsidiaries is as follows:

	Subsidiaries	Principal activity	Country of incorporation	Percentage of equity
1.	DIB Capital Limited	Investments & financial Services	U.A.E.	95.5%
2.	Dubai Islamic Bank Pakistan Ltd.	Banking	Pakistan	100.0%
3.	Tamweel P.J.S.C.	Financing and investment	U.A.E.	58.3%
4.	Dubai Islamic Financial Services L.L.C.	Brokerage services	U.A.E.	95.5%
5.	Dar al Shariah Financial & Legal Consultancy L.L.C.	Financial and legal advisory	U.A.E.	60.0%
6.	Al Tanmyah Services L.L.C.	Labour services	U.A.E.	99.5%
7.	Emirates Automotive Leasing Company (dormant company)	Trading in motor vehicles	U.A.E.	100.0%
8.	Al Tatweer Al Hadith Real Estate	Real estate development	Egypt	100.0%
9.	Al Tameer Modern Real Estate Investment	Real estate development	Egypt	100.0%
10.	Al Tanmia Modern Real Estate Investment	Real estate development	Egypt	100.0%
11.	Naseej Fabric Manufacturing L.L.C.	Textile Manufacturing	U.A.E.	99.0%
12.	DIB Printing Press L.L.C.	Printing	U.A.E.	99.5%
13.	Levant One Investment Limited	Investments	U.A.E.	100.0%
14.	Petra Limited	Investments	Cayman Islands	100.0%
15.	Al Islami Real Estate Investments Ltd.	Investments	U.A.E.	100.0%
16.	Tamweel Funding Limited	Sukuk	Jersey	58.3%
17.	Tamweel Sukuk Limited	Sukuk	Cayman Islands	58.3%
18.	Tamweel ESOT Limited	Employees share options	British Virgin Islands	58.3%
19.	Tamweel Properties & Investments L.L.C	Real estate development	U.A.E	58.3%
20.	Tahfeez Middle East Limited	General trading	U.A.E	58.3%

The following Special Purpose Vehicles ("SPV") were formed to manage specific transactions including funds, and are expected to be closed upon completion of transactions:

	SPV	Principal activity	Country of incorporation	Percentage of equity
21.	HoldInvest Real Estate Sarl	Investments	Luxembourg	Controlling interest
22.	France Invest Real Estate SAS	Investments	France	Controlling interest
23.	SARL Barbanniers	Investments	France	Controlling interest
24.	SCI le Sevine	Investments	France	Controlling interest
25.	Findi Real Estate SAS	Investments	France	Controlling interest
26.	PASR Einudzwanzigste Beteiligunsverwaltung GMBH	Investments	Austria	Controlling interest
27.	Al Islami German Holding Co. GMBH	Investments	Germany	Controlling interest
28.	Rhein Logistics GMBH	Investments	Germany	Controlling interest
29.	Jef Holdings BV	Investments	Netherlands	Controlling interest
30.	Zone Two Real Estate Management Co.	Investments	Cayman Islands	Controlling interest
31.	Zone One Real Estate Management Co.	Investments	Cayman Islands	100.0%
32.	Al Islami Trade Finance FZ L.L.C.	Investments	U.A.E.	100.0%
33.	DIB Lease One Ltd.	Investments	Bahamas	100.0%
34.	DIB Lease One (Dublin) Ltd.	Investments	Ireland	100.0%
35.	Gulf Atlantic FZ L.L.C.	Investments	U.A.E.	100.0%
36.	Al Islami Oceanic Shipping Co FZ L.L.C.	Investments	U.A.E.	100.0%
37.	Sequia Investments L.L.C.	Investments	U.A.E.	99.0%
38.	Mount Sinai Investments L.L.C.	Investments	U.A.E.	99.0%
39.	Blue Nile Investments L.L.C.	Investments	U.A.E.	99.0%

The remaining equity in entities 1, 4, 6, 11, 12, 37, 38 and 39 are also beneficially held by the Bank through nominee arrangements.

3. CAPITAL STRUCTURE AND REQUIREMENTS

The Bank's regulatory capital is calculated as per the guidelines issued by CBUAE and it comprises of:

Tier 1 Capital - which includes share capital, statutory reserves, donated land reserve, general reserve, retained earnings, exchange translation reserve and non-controlling interests, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy calculation purposes; and

Tier 2 Capital - which includes qualifying subordinated liabilities (i.e. Medium term wakala finance), collective impairment allowance and investment fair value reserve relating to unrealized gain/loss on equity instruments measured as fair value through other comprehensive income ("FVTOCI"),

The detailed breakdown of the capital structure of the Bank as of 31 December 2012 is as follows:

	AED'000
Tier 1 Capital	
Share capital	**3,797,054**
Other reserves	**5,348,964**
Retained earnings	**725,192**
Non-controlling interest	**965,971**
	10,837,181
Less: Cumulative deferred exchange losses	**(197,192)**
Total Tier 1 Capital	**10,639,989**
Tier 2 Capital	
Investment fair value reserve	**(820,130)**
Collective impairment allowance	**696,179**
Medium term wakala finance	**3,002,034**
Deductions for associates	**(477,491)**
Total Tier 2 Capital	**2,400,592**
Total capital base	**13,040,581**

3. CAPITAL STRUCTURE AND REQUIREMENTS (continued)

3.1 Capital Adequacy

The Bank's capital adequacy ratios as of 31 December 2012 were calculated by using the standardized approach as permitted by CBUAE:

	AED'000
Risk weighted assets	
Credit Risk	**69,353,608**
Market Risk	**1,910,767**
Operational Risk	**3,840,839**
Total risk weighted assets	**75,105,214**
Capital Adequacy Ratios:	
Capital adequacy ratio	**17.4%**
Tier 1 capital ratio	**13.9%**

The Bank's Capital Adequacy ratio as at 31 December 2012 was 17.4% and Tier 1 ratio was 13.9% against the regulatory requirement of minimum of 12% and 8%, respectively. The Bank ensures adherence to CBUAE requirements by monitoring its Capital Adequacy against higher internal limits.

The banking subsidiaries of the Bank are regulated by their local banking supervisors who set and monitor their capital adequacy requirements. CBUAE monitors the capital adequacy requirements of the Bank P.J.S.C. at the bank level.

3.1.1. Credit Risk Weighted Assets

The details of Credit Risk Weighted Assets as of 31 December 2012 are as follows:

	Credit Converted Equivalent Exposure AED'000	Risk Weighted Assets AED'000
Claims on sovereigns	**21,350,493**	**90,409**
Claims on non-central government public sector entities	**8,051,833**	**4,152,978**
Claims on banks	**3,737,143**	**1,236,301**
Claims on securities firms	**29,822**	**29,822**
Claims on corporate	**23,320,899**	**23,780,019**
Claims included in the regulatory retail portfolio	**11,801,440**	**8,683,676**
Claims secured by residential property	**11,920,241**	**8,678,430**
Claims secured by commercial real estate	**6,890,295**	**6,830,128**
Past due loans	**5,659,768**	**7,075,343**
Higher-risk categories	**1,583,449**	**2,375,173**
Other assets	**8,224,686**	**6,421,329**
Total	**102,570,069**	**69,353,608**

3. CAPITAL STRUCTURE AND REQUIREMENTS (continued)

3.1. Capital Adequacy (continued)

3.1.2. Market Risk Weighted Assets

Market risk weighted assets subject to capital charge are as follows:

- Profit Rate Risk;
- Equity Exposure Risk; and
- Foreign Exchange Risk.

The scope of capital charges on market risk weighted assets is restricted to 'trading book' only for the profit rate risk and equity positions. Foreign exchange risk is applicable to the Bank's overall positions.

As of 31 December 2012, the capital requirement for market risk as per standardized approach was as follows:

	AED'000
Profit rate risk	**514**
Equity position risk	**10,145**
Foreign exchange risk	**142,202**

Total capital requirement	**152,861**
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3.1.3. Operational Risk Weighted Assets

This charge is computed, (as defined by Basel II guidelines) by multiplying the three year average gross income by beta factor, as required by the Basic Indicator Approach. The total capital requirement for Operational Risk as at 31 December 2012 is AED 461 million.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES

4.1. Risk management framework

The complexity in the Bank's business operations and diversity of geographical locations requires identification, measurement, aggregation and effective management of risk. The Bank manages its risks through a comprehensive risk management framework which incorporates organizational structure, risk measurement and monitoring processes.

4.2. Risk management structure

The Board of Directors, supported by the Risk Management Committee and Risk Management Department, is ultimately responsible for identifying and controlling risks; however, there are separate independent bodies responsible for managing and monitoring risks.

4.2.1 Board of Directors

The Board of Directors is responsible for the overall risk management approach and for approving the risk strategies and policies.

4.2.2 Board Risk Management Committee

The Board Risk Management Committee has the overall responsibility for the development of the risk strategies, frameworks, policies and limits, and for recommending these strategies and policies to the Board of Directors. It is responsible for the fundamental risk issues, and manages and monitors relevant risk decisions.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.2. Risk management structure (continued)

4.2.3 Risk Management Committee

The day-to-day management of risk has been delegated to Risk Management Committee which is headed by the Chief Executive Officer ("CEO"). Execution of risk management practices is assigned to a dedicated Risk Management Department directly reporting to CEO.

The Risk Management Committee has the overall responsibility to support the Board Risk Management Committee for the development and formulation of the risk strategy, frameworks, policies and limits. It is responsible for ensuring the compliance with all risk limits, monitoring risk exposures and implementing the regulatory guidelines issued by the regulatory bodies (e.g. The Central Bank of the U.A.E.).

4.2.4 Risk Management Department

The Risk Management Department is responsible for implementing and maintaining risk related procedures to ensure risk remains within the acceptable range as approved by the Board Risk Management Committee and the Board of Directors. The department is responsible for credit approval, credit administration, portfolio management, credit risk, market risk, operational risk and overall risk control.

4.2.5 Asset and Liability Management Committee

Asset and Liability Management Committee ("ALCO") is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

4.2.6 Bank Internal Audit Department

Risk management processes throughout the Bank are audited periodically by the Bank Internal Audit Department which examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit Bank Department comments the results of their assessments with management, and reports its findings and recommendations to the Bank's Audit Committee.

4.3. Risk Measurement and Reporting Systems

The Bank measures risks using conventional qualitative methods for credit, market liquidity and operational risks. Further, the Bank also uses quantitative analysis and methods to support revisions in business and risk strategies as and when required. These analysis and methods reflect both the expected loss likely to arise in normal course of business or unexpected losses in an unforeseen event based on simple statistical techniques and probabilities derived from historical experience. The Bank also runs stress scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Board of Directors and management. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries.

Information compiled from all the businesses is examined and processed in order to analyse the risk profile and identify early risks. This information is presented and explained to the management, management committees, Board Risk Management Committee, and the Risk Management Committee. Specialized reports are presented to the pertinent heads of business and are delivered with a frequency suited to the volatility of the risk. The report includes aggregate credit exposure, limit exceptions, liquidity, operational loss incidents and other risk profile changes. On a monthly basis, detailed reporting of industry, customer and geographic risks takes place. Senior management assesses the appropriateness of the provision for impairment losses on a quarterly basis.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.4. Risk Mitigation

As part of its overall risk management, the Bank uses various methods to manage exposures resulting from changes in credit risks, liquidity risks, market risks (including profit rate risk, foreign exchange risk, and equity price risk), and operational risks.

The Bank seeks to manage its credit risk exposures through diversification of financing and investing activities to avoid undue concentration of risk with individuals and groups of customers in specific locations or businesses. The Bank actively uses collateral to reduce its credit risks.

In order to guard against liquidity risk, management has diversified funding sources and assets are managed with overall Bank liquidity in consideration maintaining a healthy balance of liquid assets (i.e. cash and cash equivalents).

The market risks are managed on the basis of predetermined asset allocation across various asset categories and continuous appraisal of market conditions for movement and expectation of foreign currencies rate, bench mark profit rates and equity houses.

To manage all other risks, the Bank has developed a detailed risk management framework to identify and apply resources to mitigate the risks.

Through the risk management framework, transactions and outstanding risk exposures are quantified and compared against authorized limits, whereas non quantifiable risks are monitored against policy guidelines and key risk and control indicators. Any discrepancies, excesses or deviations, are escalated to the management for appropriate and timely action.

4.5. 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 Bank's performance to developments affecting a particular industry or geographical location.

4.6. Credit Risk Management

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

4.6.1 Credit Risk Measurement

The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparties. Whilst some of the models for assessment of Real Estate projects are internally developed, others for the Corporate, Contracting and SME businesses have been acquired from Moody's and calibrated to the Bank's internal rating scale. The models are housed with the Moody's Risk Analyst rating tool.

The rating tools are kept under review and upgraded as necessary. The Bank regularly validates the performance of the rating and their predictive power with regard to default events.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.2 Collateral

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of securities for facilities provided, which is a common practice. The Bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for Islamic financing and investing assets are:

- Mortgages over residential and commercial properties;
- Corporate guarantees;
- Charges over business assets such as premises, machinery, vehicles and inventory; and
- Charges over financial instruments such as deposits and equity investments.

4.6.3 Islamic derivative financial instruments

Credit risk arising from Islamic derivative financial instruments is, at any time, dependent upon its positive fair values, as recorded in the consolidated financial position and their PFE (as per Basel guidelines).

4.6.4 Gross Credit Risk Exposures

The table below shows the maximum exposure to credit risk by class of financial asset, including Islamic derivatives, as of 31 December 2012. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

AED'000	**Gross maximum Exposure**
Balances with central banks	**13,741,965**
Due from banks and financial institutions	**3,169,114**
Islamic financing and investing assets	**59,259,525**
Investment in Islamic sukuk measured at amortised cost	**11,088,662**
Other investments	**2,144,871**
Receivables and other assets	**3,386,029**
Total of on-balance sheet exposures	**92,790,166**
Contingent liabilities	**9,763,216**
Commitments	**10,660,579**
Total	**113,213,961**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.5 Risk concentrations of the maximum exposure to credit risk

Concentration of risk is managed by customer/counterparty, by geographical region and by industry sector. The Bank's financial assets as of 31 December 2012, before taking into account any collateral held or other credit enhancements can be analysed by the following geographical regions:

AED'000	Retail and business banking	Wholesale banking	Total
The U.A.E.	26,676,833	80,294,488	106,971,321
Other Gulf Cooperation Council (GCC) countries	-	2,172,038	2,172,038
South Asia	420,184	2,118,716	2,538,900
Europe	3,866	990,405	994,271
Africa	-	292,603	292,603
Other	70	244,758	244,828
Total	**27,100,953**	**86,113,008**	**113,213,961**

An industry sector analysis of the Bank's financial assets as of 31 December 2012, before taking into account collateral held or other credit enhancement is as follows:

AED'000	Gross maximum exposure
Financial Institutions	24,893,794
Real estate	28,637,719
Manufacturing and services	16,879,112
Consumer financing	14,089,656
Consumer home finance	13,509,830
Government	9,606,045
Trade	5,597,805
Total	**113,213,961**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.6 Gross Credit Risk Exposures as per Standardized Approach

The gross credit exposure as per standardized approach with the effect of CRM as of 31 December 2012 is detailed below:

				Credit Risk Mitigation (CRM)			
AED'000	On Balance Sheet Gross Outstanding	Off Balance Sheet Net Exposure after Credit Conversion Factors (CCF)	Total exposure after CCF	Exposure Before CRM	CRM	After CRM	Risk Weighted Assets
Claims on sovereigns	**21,350,481**	**12**	**21,350,493**	**21,350,493**	**-**	**21,350,493**	**90,409**
Claims on non-central government public sector entities	**8,012,464**	**39,369**	**8,051,833**	**8,051,833**	**-**	**8,051,833**	**4,152,978**
Claims on banks	**3,602,108**	**135,035**	**3,737,143**	**3,737,143**	**-**	**3,737,143**	**1,236,301**
Claims on securities firms	**29,822**	**-**	**29,822**	**29,822**	**-**	**29,822**	**29,822**
Claims on corporate	**16,951,010**	**6,369,889**	**23,320,899**	**23,320,899**	**-**	**23,320,899**	**23,780,019**
Claims included in the regulatory retail portfolio	**11,028,512**	**772,928**	**11,801,440**	**11,801,440**	**-**	**11,801,440**	**8,683,676**
Claims secured by residential property	**11,706,506**	**213,735**	**11,920,241**	**11,920,241**	**-**	**11,920,241**	**8,678,430**
Claims secured by commercial real estate	**6,866,818**	**23,477**	**6,890,295**	**6,890,295**	**-**	**6,890,295**	**6,830,128**
Past due loans	**9,893,912**	**-**	**9,893,912**	**5,659,768**	**-**	**5,659,768**	**7,075,343**
Higher-risk categories	**1,583,449**	**-**	**1,583,449**	**1,583,449**	**-**	**1,583,449**	**2,375,173**
Other assets	**7,957,115**	**267,571**	**8,224,686**	**8,224,686**	**-**	**8,224,686**	**6,421,329**
Total	**98,982,197**	**7,822,016**	**106,804,213**	**102,570,069**	**-**	**102,570,069**	**69,353,608**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.6 Gross Credit Risk Exposures as per Standardized Approach (continued)

The gross credit exposures as per standardized approach in terms of rated/unrated assets as of 31 December 2012 is detailed below:

AED'000	Rated	Unrated	Total exposure after CCF	Exposure Before CRM	After CRM	Risk Weighted Assets
Claims on sovereigns	809,134	20,541,359	21,350,493	21,350,493	21,350,493	90,409
Claims on non-central government public sector entities	-	8,051,833	8,051,833	8,051,833	8,051,833	4,152,978
Claims on banks	2,698,422	1,038,721	3,737,143	3,737,143	3,737,143	1,236,301
Claims on securities firms	-	29,822	29,822	29,822	29,822	29,822
Claims on corporate	2,800,119	20,520,780	23,320,899	23,320,899	23,320,899	23,780,019
Claims included in the regulatory retail portfolio	-	11,801,440	11,801,440	11,801,440	11,801,440	8,683,676
Claims secured by residential property	-	11,920,241	11,920,241	11,920,241	11,920,241	8,678,430
Claims secured by commercial real estate	-	6,890,295	6,890,295	6,890,295	6,890,295	6,830,128
Other assets	-	19,702,047	19,702,047	15,467,903	15,467,903	15,871,845
Total	6,307,675	100,496,538	106,804,213	102,570,069	102,570,069	69,353,608

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.7 Credit Quality and Impairment assessment

The main considerations for the impairment assessment include whether any payments of principal or profit are overdue by more than 90 days (in line with the U.A.E. Central Bank guidelines) or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

4.6.7.1 Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant Islamic financing or investing asset on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend pay-outs should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

4.6.7.2 Collectively assessed allowances

Allowances are assessed collectively for losses on Islamic financing and investing assets that are not individually significant (including Islamic credit cards, vehicles murabahat, and unsecured retail financing assets) where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is not yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. The impairment allowance is reviewed by credit management to ensure alignment with the Bank's overall policy.

Acceptances and contingent liabilities are assessed and provisions made in a similar manner as for Islamic financing and investing assets.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.8 Credit quality per class of financial assets

AED'000	Balances with central banks and due from banks and financial institutions	Islamic financing and investing assets	Investments in Islamic sukuk and other investments	Receivables and other assets	Contingent liabilities and commitments	Total
Individually impaired						
Gross amount	**-**	**6,118,079**	**-**	**1,295,434**	**-**	**7,413,513**
Non-impaired exposures						
Neither past due nor impaired	**16,911,079**	**47,783,732**	**13,233,533**	**2,036,740**	**20,423,795**	**100,388,879**
Past due by less than 30 days	**-**	**1,924,924**	**-**	**53,855**	**-**	**1,978,779**
Past due by more than 30 days but less than 90 days	**-**	**1,460,583**	**-**	**-**	**-**	**1,460,583**
Past due by more than 90 days	**-**	**1,972,207**	**-**	**-**	**-**	**1,972,207**
Gross amount	**16,911,079**	**53,141,446**	**13,233,533**	**2,090,595**	**20,423,795**	**105,800,448**
Total gross maximum exposure	**16,911,079**	**59,259,525**	**13,233,533**	**3,386,029**	**20,423,795**	**113,213,961**
Allowances for impairment	**-**	**(3,699,422)**	**-**	**(581,616)**	**-**	**(4,281,038)**
Net carrying amount	**16,911,079**	**55,560,103**	**13,233,533**	**2,804,413**	**20,423,795**	**108,932,923**

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.8 Credit quality per class of financial assets (continued)

Analysis of credit risk exposure of the Bank's financial assets for each internal risk rating as of 31 December 2012 is as follows:

	Moody's equivalent grades	Total AED'000
Low risk		
Risk rating class 1	Aaa	**17,230,877**
Risk rating classes 2 and 3	Aa1-A3	**18,491,785**
Fair risk		
Risk rating class 4	Baa1-Baa3	**20,499,230**
Risk rating classes 5 and 6	Ba1-B3	**33,555,932**
Risk rating class 7	Caa1-Caa3	**14,098,843**
High risk		
Risk rating classes 8 to11		**9,337,294**
		113,213,961

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of financing exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly. The Moody's equivalent grades are relevant only for certain of the exposures in each risk rating class.

The details of non performing financing and investing assets as of 31 December 2012 by economic activity and geography are as below:

By economic activity

AED'000	Overdue by less than 90 days	Overdue by 90 days and above	Total	Specific provision	Total Impaired Assets
Manufacturing and services	13,083	111,861	124,944	(114,127)	10,817
Trade	60,748	26,462	87,210	(86,314)	896
Financial institutions	-	1,129,900	1,129,900	(167,267)	962,633
Real estate	1,375,843	3,716,647	5,092,490	(1,855,369)	3,237,121
Consumer home finance	6,485	1,155,495	1,161,980	(430,239)	731,741
Retail and consumer Financing	17,822	475,939	493,761	(349,927)	143,834
Total	1,473,981	6,616,304	8,090,285	(3,003,243)	5,087,042
General provision	-	-	-	-	(696,179)
	1,473,981	6,616,304	8,090,285	(3,003,243)	4,390,863

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

4.6. Credit Risk Management (continued)

4.6.8 Credit quality per class of financial assets (continued)

By geography

AED'000	Overdue by less than 90 days	Overdue by 90 days and above	Total	Specific provision	Total Impaired Assets
United Arab Emirates	1,473,981	6,414,416	7,888,397	(2,916,504)	4,971,893
GCC excluding UAE	-	86,515	86,515	(43,153)	43,362
Asia	-	97,257	97,257	(34,080)	63,177
Others	-	18,116	18,116	(9,506)	8,610
Total	1,473,981	6,616,304	8,090,285	(3,003,243)	5,087,042
General provision	-	-	-	-	(696,179)
	1,473,981	6,616,304	8,090,285	(3,003,243)	4,390,863

4.6.9 Movements in the provision for impairment during the years ended 31 December 2012

	AED'000
Balance at 1 January	3,508,874
Charge for the year	1,163,674
Release to the profit or loss	(279,280)
Write-offs during the year	(691,332)
Other	(2,514)
Balance at 31 December	3,699,422

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.7. Market risk management

4.7.1. Profit margin risk

The Bank is not significantly exposed to risk in terms of re-pricing of its customer deposits since, in accordance with Islamic Sharia'a, the Bank does not provide contractual rates of return to its depositors or investment account holders. The return payable to depositors and investment account holders is based on the principle of the Mudaraba by which the depositors and investment account holders agree to share the profit or loss made by the Bank's Mudaraba asset pool over a given period.

4.7.2. Profit Rate Risk in Banking Book

Profit rate risk arises from the possibility that changes in profit rates will affect future profitability or the fair values of financial instruments. The Bank is exposed to profit rate risk as a result of mismatches or gaps in the amounts of assets and liabilities and off-balance sheet instruments that mature or re-price in a given period. The Bank manages this risk through risk management strategies.

The effective profit rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The rate is a historical rate for a fixed rate instrument carried at amortised cost and a current rate for a floating rate instrument or an instrument carried at fair value.

The sensitivity of the consolidated income statement is the effect of the assumed changes in profit rates on the net income for one year, based on the variable profit rate non-trading financial assets and financial liabilities held at 31 December 2012.

The following table demonstrates the sensitivity to a reasonable possible change in profit rates, with all other variables held constant, of the Bank's consolidated income statement.

Currency	**Increase in basis points**	**Sensitivity of profit on Islamic financing and investing assets 2012 AED'000**
AED	**50**	**48,575**
USD	**50**	**5,850**

4.7.3. Foreign exchange risk

The Bank has significant income recorded in its overseas subsidiaries and is therefore exposed to movements in the foreign currency rates used to convert income into the Bank's presentation currency, the U.A.E. Dirham.

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2012. Included in the table are the Bank's financial instruments at their carrying amounts, categorised by currency.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.7. Market risk management (continued)

4.7.3. Foreign exchange risk (continued)

AED'000	AED	USD	Other G.C.C.	GBP	Euro	Other	Total
Financial Assets:							
Cash and balances with central banks	15,200,459	203,004	-	-	-	70,086	15,473,549
Due from banks and financial institutions	848,034	2,108,489	66,362	71,630	50,805	23,794	3,169,114
Islamic financing and investing assets, net	50,013,671	4,180,344	200,374	7,243	-	1,158,471	55,560,103
Investment in Islamic sukuk measured at amortised cost	2,132,513	8,103,600	-	-	-	852,549	11,088,662
Other investments	1,073,635	777,895	149,064	74,919	3,486	65,872	2,144,871
Receivables and other assets	2,694,053	39,859	653	12,816	-	57,032	2,804,413
Total	71,962,365	15,413,191	416,453	166,608	54,291	2,227,804	90,240,712
Financial Liabilities:							
Customers' deposits	61,383,375	3,187,854	7,510	220,251	45,038	1,956,824	66,800,852
Due to banks and other financial institutions	4,975,530	1,104,029	-	435	11,419	66,876	6,158,289
Sukuk financing instruments	639,810	4,034,150	-	-	-	-	4,673,960
Medium term wakala finance	3,752,543	-	-	-	-	-	3,752,543
Payables and other liabilities	2,709,692	327,198	11,436	1,617	574	53,967	3,104,484
Total	73,460,950	8,653,231	18,946	222,303	57,031	2,077,667	84,490,128
Net on balance sheet	(1,498,585)	6,759,960	397,507	(55,695)	(2,740)	150,137	5,750,584
Unilateral promise to buy/sell currencies	9,809,055	(9,628,614)	(291,934)	3,196	12,489	95,808	-
Currency position - long/(short)	8,310,470	(2,868,654)	105,573	(52,499)	9,749	245,945	5,750,584

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.7. Market risk management (continued)

4.7.3. Foreign exchange risk (continued)

The tables below indicate the extent to which the Bank was exposed to currency risk at 31 December 2012 on its non-trading monetary assets and liabilities, and forecast cash flows. The analysis is performed for a reasonable possible movement of the currency rate against the AED with all other variables held constant on the consolidated income statement (due to the changes in the fair values of currency sensitive non-trading monetary assets and liabilities) and equity (due to the change in fair value of foreign currency denominated available-for-sale equity instruments). A negative amount in the table reflects a potential net reduction in consolidated income statement and equity, while a positive amount reflects a net potential increase. The sensitivity analysis does not take account of actions by the Bank that might be taken to mitigate the effect of such changes.

Currency	Increase in currency rate in %	Effect on profit before tax 2012 AED'000
GBP	+2	1,049
EURO	+2	(195)

Currency	Decrease in currency rate in %	Effect on profit before tax 2012 AED'000
GBP	-2	(1,049)
EURO	-2	195

4.7.4. Foreign investment

The Bank has significant income recorded in its overseas subsidiaries and is therefore exposed to movements in the foreign currency rates used to convert income into the Bank's presentation currency, the U.A.E. Dirham.

The table below indicates the change in recorded profit before tax and equity had the result for the year ended 31 December 2012 been translated at exchange rates against the AED adjusted, with all other variables held constant, by the assumed changes below. The sensitivity analyses do not take account of actions by the Bank that might be taken to mitigate the effect of such changes.

Currency	Increase in currency rate in %	Effect on profit before tax AED'000	Effect on equity AED'000
Pak Rupees	+5	1,025	13,551
Egypt Sterling	+5	1,075	8,975

Currency	Decrease in currency rate in %	Effect on profit before tax AED'000	Effect on equity AED'000
Pak Rupees	-5	(156)	(12,261)
Egypt Sterling	-5	(254)	(8,122)

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.7. Market risk management (continued)

4.7.5. Equity price risk

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 non-trading equity price risk exposure arises from the Bank's investment portfolio.

The effect on equity (as a result of a change in the fair value of equity instruments held as fair value through other comprehensive income (FVTOCI) at 31 December 2012) due to a reasonably possible change in equity indices, with all other variables held constant, is as follows:

	Change in market Indices %	Effect on consolidated income statement 2012 AED'000	Effect on equity 2012 AED'000
Market indices			
Dubai Financial Market	**± 5%**	**112**	**16,522**
Abu Dhabi Exchange	**± 5%**	**-**	**3,794**
Bahrain Stock Exchange	**± 5%**	**-**	**1,970**
Saudi Stock Exchange	**± 5%**	**-**	**3,417**
Doha Stock Exchange	**± 5%**	**-**	**2,041**
Other	**± 5%**	**-**	**2,304**

As of 31 December 2012, the details of equity position by industry:

	AED'000
Manufacturing and services	**1,195,801**
Financial institutions	**548,031**
Real estate	**401,039**
Total	**2,144,871**

4.8. Operational Risk Management

Operational risk is the potential exposure to financial or other damage arising from inadequate or failed internal processes, people or systems.

The Bank has developed a detailed operational risk framework. The framework clearly defines roles and responsibilities of individuals/units across different functions of the Bank that are involved in performing various operational risk management tasks. Operational Risk Management Framework will ensure that operational risks within the Bank are properly identified, monitored, managed and reported. Key elements of the framework include process mapping, setting up loss data base, setting up of KRIs, risk analysis and risk management reporting.

Business and support units are responsible for managing operations risk in their respective functional areas. They operate within the Bank's operational risk management framework and ensure that risk is being managed within their respective business units. The day-to-day management of operations risk is through the maintenance of a comprehensive system of internal controls, supported by robust systems and procedure to monitor transaction positions and documentation, as well as maintenance of key backup procedures and business contingency planning.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.9. Liquidity and Funding Risk Management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of highly marketable and diverse assets that can be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In addition, the Bank maintains statutory deposits with the central banks. The liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank.

The high quality of the asset portfolio ensures its liquidity and coupled with the Bank's own funds and "evergreen" customer deposits help form a stable funding source. Even under adverse conditions, the Bank has access to the funds necessary to cover customer needs and meet its funding requirements.

The primary tool for monitoring liquidity is the maturity mismatch analysis, which is monitored over successive time bands and across functional currencies. Guidelines are established for the cumulative negative cash flow over successive time bands.

4.9.1. Liquidity risk management process

The Bank's liquidity risk management process, as carried out within the Bank and monitored by a separate team in Bank's Treasury department, includes:

- Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are financed by customers;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Monitoring financial position liquidity ratios against internal and regulatory requirements; and
- Managing the concentration and profile of financing and investing exposures maturities.

Based on the internal guidelines, the liquidity ratios at the end of each quarter during the year were as follows:

	March	**June**	**September**	**December**
2012	**21%**	**25%**	**23%**	**22%**

4.9.2. Funding approach

Sources of liquidity are regularly reviewed by management to maintain a wide diversification by currency, geography, provider, product and term.

During the year ended 31 December 2012, the Bank issued a five-year sukuk AED 1,837 million (USD 500 million) sukuk to diversify sources of funding to support business growth going forward.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.9. Liquidity and Funding Risk Management (continued)

4.9.3. Non-derivative cash flows

The table below summarises the maturity profile of the gross cash flows of the Bank’s financial assets and liabilities as at 31 December 2012. The amounts disclosed in the table are the contractual gross cash flows, whereas the Bank manages the inherent liquidity risk based on expected gross cash flows.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the management expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank’s deposit retention history.

AED’000	On demand	Less than 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Balances with central banks	3,123,315	4,186,484	8,240,797	97,315	-	15,647,911
Due from banks and financial institutions	528,113	2,641,207	-	-	-	3,169,320
Islamic financing and investing assets, net	5,613,187	10,358,216	9,493,686	27,046,938	21,804,536	74,316,563
Investment in Islamic sukuk	5,295	40,879	2,216,941	9,986,142	1,119,821	13,369,078
Other investments	-	-	613,061	1,531,810	-	2,144,871
Receivables and other assets	142,583	66,875	1,787,507	1,044,175	2,751	3,043,891
Total assets	**9,412,493**	**17,293,661**	**22,351,992**	**39,706,380**	**22,927,108**	**111,691,634**
Customers’ deposits	23,219,576	18,259,290	11,247,196	17,168,237	79,095	69,973,394
Due to banks and other financial institutions	743,830	174,029	3,365,259	2,323,038	-	6,606,156
Sukuk financing instruments	-	1,102,187	1,119,559	3,533,591	-	5,755,337
Medium term wakala finance	-	-	-	4,052,746	-	4,052,746
Payables and other liabilities	894,555	1,228,508	541,878	589,281	1,406	3,255,628
Zakat payable	-	-	163,572	-	-	163,572
Total liabilities	**24,857,961**	**20,764,014**	**16,437,464**	**27,666,893**	**80,501**	**89,806,833**

Assets available to meet all of the liabilities and to cover outstanding commitments include cash and balances with central banks, Islamic investing and financing assets, other investments and items in the course of collection.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.10. Capital Management Policies and Stress Testing

The Bank adheres to the regulations set out by the Central Bank of the United Arab Emirates which has confirmed the requirements in relation to Basel II / Pillar 2 in its circular 27/2009, dated 17 November 2009. Further, the Bank is an active member in the CBUAE working group revising the supervisory guidelines on Basel II / Pillar 2.

According to the guidelines issued by the Central Bank of the United Arab Emirates, all banks are required to prepare and submit annual forward-looking capital adequacy assessment to CBUAE. Whilst the Bank has a robust capital adequacy assessment, monitoring and reporting process, it is pro-actively advancing its internal capital adequacy assessment framework along the lines of Basel III.

The Bank’s forward-looking internal capital adequacy assessment process is based on base-case assumptions, reflecting the Bank’s current financial budget and business expectations under conservative business under normal conditions.

The Bank’s implemented internal capital adequacy assessment process is based on quantification models that have been subject to external scrutiny, especially with a focus on credit risk, risk concentrations and correlations.

The Capital demand management is based on the following set of risk models:

- Credit risk – based on Basel II / Standardized Approach;
- Market risk - Market Value at Risk complemented by Basel II / Maturity Risk Based approach;
- Operational risk - Basel II / Basic Indicator Approach;
- Business risk – Reverse Stress Scenario based models;
- Profit Rate Risk / Banking book – Net profit income volatility/sensitivity model; and
- Concentration Risk / Funding Liquidity – based on Value at Risk / Herfindahl Index (HI) models.

The results of the internal capital adequacy assessment process, quarterly the actual assessment as well as the annual multi-year forward-looking forecast are monitored against the Bank’s Risk Strategy.

The Bank employs an Integrated Stress Testing Framework to assess the potential implications of adverse financial conditions and the development of key ratios under stressful conditions. The outcomes of the Integrated Stress Testing Framework influence the setting of the Bank’s risk appetite as part of the Bank’s periodical Risk Strategy review. Furthermore the outcomes support the development and adjustment of the Bank’s capital contingency plans and planning.

The Integrated Stress Testing Framework encompasses:

- the forward-looking assessment of economic scenarios, including potential feedback loops and second round effects;
- the measurement of sensitivities against key risk drivers and parameters; and
- the analysis of reverse stress tests modeling events that could cause a significant impact on the Bank, and provides by that a comprehensive analysis on the potential impact in terms of balance sheet structure, financial performance, capitalization levels and funding profile.

Stress tests rely on the Bank’s Risk Rating model. Risk Ratings have been assigned to customers based on financial and non-financial factors. Under a stress scenario both these factors will be affected, consequently impacting the final Risk Rating.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.11. Regulatory/Compliance Risk

The risk of legal or regulatory sanctions and/or material financial loss and/or a loss of reputation as a result of failure to comply with laws, regulations, license conditions, supervisory requirements, self-regulatory industry codes of conduct and related internal policies, procedures and organizational standards.

Given the broad regulatory requirements placed on the Bank's businesses, Boards and Governance Structures, any failure in policy, systems, processes, procedures or internal controls can adversely impact a regulatory requirement. Accordingly, proper monitoring of compliance with internal requirements underpins the effective management of regulatory compliance risk across the Bank.

Regulatory compliance losses generally lead to more adverse reputation impacts than other types of operational risk losses of a similar financial magnitude and as a consequence adverse events in one part of the Bank may have a long lasting impact on the entire Bank.

Regulatory risk increases during regulatory change and crystallizes when there is a failure to meet requirements of law, regulation or code applicable to the financial services industry. Noncompliance can lead to fines, public reprimands, damage to reputation, enforced suspension of operations or, in extreme cases, withdrawal of authorizations to operate.

This risk also refers to those risks which are related to meeting regulatory guidelines. It is the risk that a change in laws and regulations will materially impact a security, business, sector or market. Changes in laws or regulations made by the government or a regulatory body can increase the costs of operating a business, reduce the attractiveness of investment and/or change the competitive landscape.

The Bank has a relationship with multiple regulators worldwide. The Bank has compliance and regulatory relationship frameworks in place which act to ensure that regulatory non-compliance or unexpected regulatory actions do not impact strategic outcomes.

The Bank has mainly two operational centers - UAE & Pakistan. Therefore, the Bank's primary regulators in these jurisdictions are:
- UAE Central Bank;
- Securities & Commodities Authority;
- Dubai Financial Services Authority; and
- State Bank of Pakistan.

4.12. Reputation Risk

Reputation risk is the current and prospective impact on earnings and capital arising from negative public opinion. This affects the institution's ability to establish new relationships or services or to continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with its customers and community.

The safeguarding of DIB's reputation is of paramount importance to its continued prosperity and is the responsibility of every member of staff. DIB regularly reviews its policies and procedures for safe guarding against reputational and operational risks. This is an evolutionary process which takes account of relevant developments and industry guidance.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

4.12. Reputation Risk (continued)

DIB has always aspired to the highest standards of conduct and, as a matter of routine, takes account of reputational risks to its business. Reputational risks can arise from a wide variety of causes; including ESG (Environmental, Social & Governance) issues and operational risk events.

As a banking group, DIB’s good reputation depends upon the way in which it conducts its business, but it can also be affected by the way in which Clients, to whom it provides financial services, conduct themselves.

As evidence of good reputation risk management the Bank’s customer base has increased to more than a million customers which is an indicator of the increased level of confidence of its customers.

Furthermore, it has been described as the best Islamic bank in UAE by Islamic Finance News Award. It has also been given the award for ‘Corporate Social Responsibility’ by EMEA finance magazine.

Despite the changes in the economic scenario DIB has been able to maintain its brand equity and brand image with considerable success. The risk appetite therefore, can be described as modest.