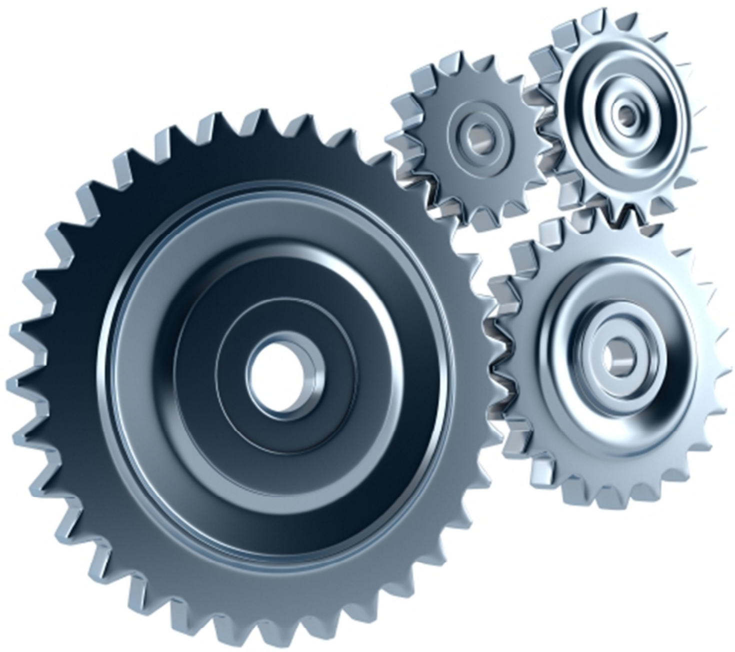
INVESTCORP



Risk Management Public Disclosures

31 December 2011

Contents

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EXECUTIVE SUMMARY

Investcorp Bank B.S.C. (Investcorp) is domiciled in Bahrain as a wholesale bank, under regulatory oversight of the Central Bank of Bahrain, with shares listed and traded on the Bahrain Bourse. Investcorp takes an enterprise-wide approach to risk management, and the proactive identification and mitigation of all embedded risks is an integral part of the corporate decision-making process. Investcorp is a multi-faceted bank and asset-management company involved in several investment activities which include Corporate Investments (CI), Real Estate (RE), Hedge Funds (HF) and Corporate Treasury.

In this "Risk Management Public Disclosures" document Investcorp is complying with the Basel 2 Pillar 3 requirement as prescribed by the Central Bank of Bahrain (CBB) Rulebook which prescribes the kind of information that should be disclosed about an institution's risk management and capital adequacy practices.

Our Tier 1 capital adequacy ratio stands at 23.0% (compared to 25.7% as of June-2011), which is 287% of the BIS capital adequacy guideline of 8% and 192% of the Central Bank of Bahrain's minimum requirement of 12%. This puts Investcorp amongst a group of very well capitalized banks and provides an ideal platform to benefit from any recovery in global economies and markets. Crucially, we have protected the balance sheet by raising capital, reducing investment risk and mitigating re-financing risk by holding high levels of cash liquidity while, at the same time, de-leveraging the balance sheet.

All figures presented in this report are as of December 31st 2011 unless otherwise stated.

Investcorp and its consolidated subsidiaries are from time to time referred to herein as "the Investcorp Group" or "the Group".

1. OVERVIEW OF THE BASEL 2 FRAMEWORK AND CBB RULEBOOK

The CBB Rulebook, which is based on the Basel 2 framework, adopts a risk based approach to the assessment of the adequacy of both internal and regulatory capital. This framework is intended to provide a strong base for risk management practices and processes within Bahrain financial institutions and a mechanism to ensure a comprehensive supervisory oversight role. The CBB's Rulebook which is consistent with the Basel 2 framework outlines the three Basel 2 pillars developed by the Basel Committee, as follows:

Pillar 1 prescribes the risk based methodology applied in the calculation of the risk weighted amounts (RWAs) and capital requirement for the major asset classes

Pillar 2 provides the foundation for a comprehensive supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP)

Pillar 3 covers the disclosure of risk management and capital adequacy requirements and guidelines.

1.1 Pillar 1

Pillar 1 provides the definition and calculations of the RWAs for different asset classes. A capital adequacy ratio (CAR) is then calculated by dividing the regulatory capital base by the total RWAs. All financial institutions domiciled in Bahrain that fall under the regulatory oversight of the CBB are required to maintain a minimum CAR above 12 per cent which compares to the Basel Committee's minimum ratio of 8 per cent. The CBB also requires banks incorporated in Bahrain to maintain a CAR ratio above the target level of 12 per cent and to report any breaches as soon as possible.

The table below summarizes the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel 2 capital adequacy framework:

CBB Rulebook regulatory capital approaches		
Credit Risk	**Market Risk**	**Operational Risk**
Standardized Approach	Standardized Approach	Basic Indicator Approach
Foundation Internal Ratings Based Approach (FIRB)	Internal Models Approach	Standardized Approach

Investcorp has adopted the following approaches, outlined in the table, for the calculation of the RWA for each asset class.

Asset class segment	Basel II Methodology Dec'11	Basel II risk weight H1-FY12
Corporate Investments	Standardized approach ('STA')	150%
Real Estate	Standardized approach ('STA')	200%
Hedge Funds	Standardized approach ('STA')	150%
CI and RE underwriting	Standardized approach ('STA')	100%
Operational risk	Basic indicator approach ('BIA')	15% (α)

i) Credit Risk: Investcorp is using the standardized approach for credit risk regulatory capital reporting. The RWAs are calculated by multiplying the credit exposure by a risk weight factor dependent on the type of asset exposure and counterparty's external rating. This approach is applied to its Corporate Investment (CI), Real estate Investment (REI) and Hedge Funds (HF) lines of business and its CI/REI underwriting.

ii) Market Risk: Investcorp is using the internal models approach based on Value-at-Risk (VaR) models for determining the capital requirement for FX exposures with a multiplier factor of 4. The use of the internal models approach for the calculation of regulatory market risk capital has been approved by the CBB.

iii) Operational Risk (OR): Under the CBB's Basel 2 capital adequacy framework, all banks incorporated in Bahrain are required to apply the basic indicator approach for operational risk unless approval is granted by the CBB to use the standardized approach. Under the basic indicator approach, the regulatory capital requirement is calculated by applying an alpha factor of 15 per cent to the average gross income for the preceding three financial years.

1.2 Pillar 2

Pillar 2 sets out the supervisory review process of an institution's risk management framework and accordingly its capital adequacy. Under the CBB's Pillar 2 guidelines, a CBB-appointed independent auditor will assess the institution's risk management framework and processes and the results of this assessment will be used to determine the appropriate minimum capital adequacy ratio for each bank. Pillar 2 also comprises an Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed.

1.3 Pillar 3

The third pillar of the CBB's Rulebook, describes the level of qualitative and quantitative information required to be disclosed about an institution's risk management and capital adequacy practices. Using the current regulations, disclosure is required during half year reporting, whereas complete disclosure is required to coincide with the financial year end reporting. The disclosures in this report are critical in helping to address any questions arising from the disclosures set out in the interim consolidated financial statements presented in accordance with the International Financial Reporting Standards (IFRS).

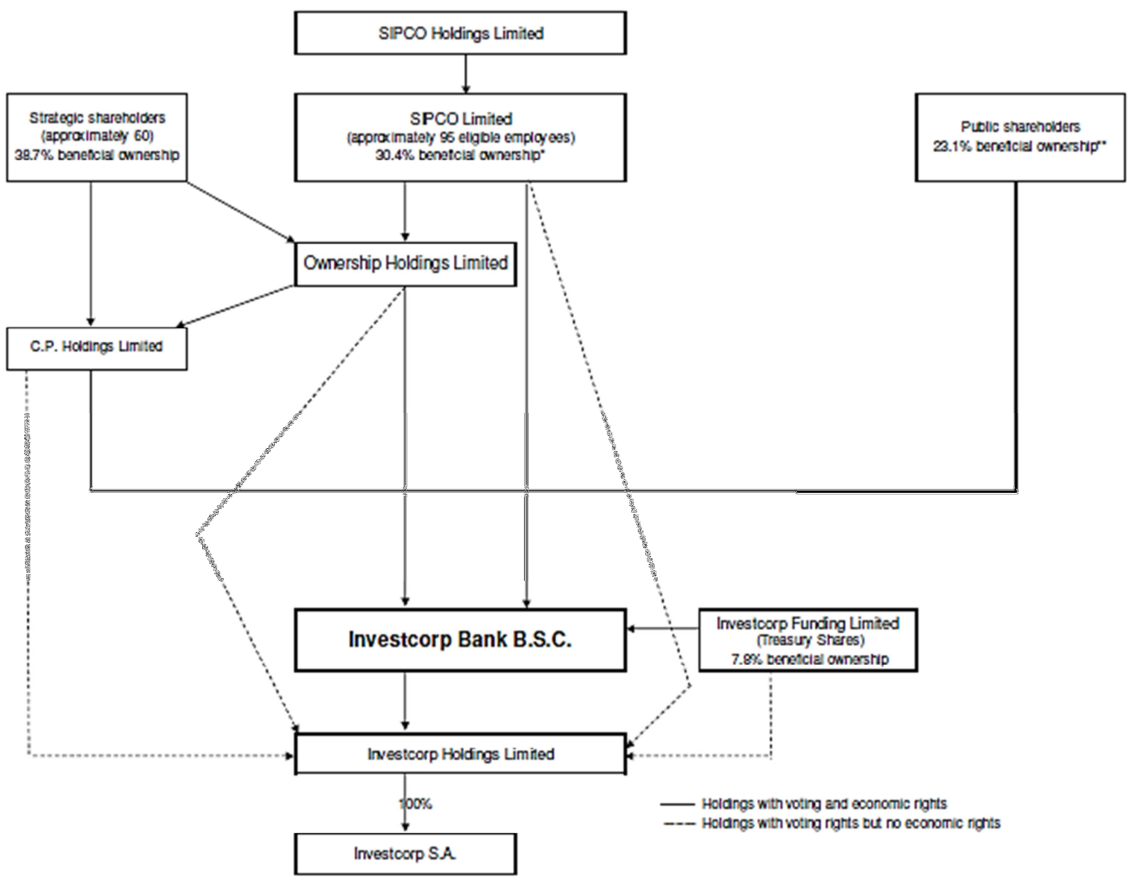
2. INVESTCORP GROUP STRUCTURE AND RISK AND CAPITAL MANAGEMENT

In this section, we review Investcorp's group structure and the principles and polices applied in the management and control of risk and capital.

2.1 Investcorp Bank Group structure

The Bank is controlled by Ownership Holdings Limited ('OHL'), through its shareholding directly, and through C.P. Holdings Limited ('CPHL'), of the issued ordinary shares of the Bank. OHL is, in turn, ultimately controlled by SIPCO Holdings Limited ('SHL'). SIPCO Limited ('SIPCO'), an SHL subsidiary, is the entity through which employees own beneficial interests in the Bank's ordinary shares. The Bank is, therefore, controlled by its employees through their beneficial ownership as a group via SHL, SIPCO, OHL and CPHL. SHL, SIPCO, OHL and CPHL are companies incorporated in the Cayman Islands.

The overall ownership structure is as below:



* Includes 13.7% in shares that are held for future sale to management and 3% shares allocated but not vested under the SIP Plan . The Group has approval from the Central Bank of Bahrain ("CBB") to hold up to 40% of shares for the SIP Plan. On the balance sheet these shares are accounted for as the equivalent of treasury shares.

** Includes 0.3% beneficial ownership held in the form of unlisted Global Depositary Receipts.

2.2 Risk Oversight Committees

Investcorp takes an enterprise-wide approach to risk management, and the proactive identification and mitigation of all embedded risks is an integral part of the corporate decision-making process. This includes the Financial and Risk Management Committee (FRMC), the Asset Liability Council (ALCO), the Investment Committees (IC), the Risk Committee (RC) and the Placement Committee (PC).

The FRMC, comprising members of senior management drawn from all key areas of the Group, guides and assists with overall management of the Group's risk profile on an enterprise wide basis. The FRMC which includes the Chief Financial Officer (CFO), the heads of several lines of business (LOBs), the head of Treasury and the head of Risk Management, performs a review of balance sheet risks from a company-wide perspective. The committee evaluates ALCO's Asset and Liability Management plans and discusses all major actions undertaken to manage risks from the standpoint of Investcorp's business model, capital base and balance sheet.

The ALCO assesses and reviews various balance sheet risks arising from asset and liability treasury activities on an ongoing basis and decides on mitigation strategies for these risks, operating under the guidelines agreed by the FRMC. The ALCO is comprised of the CFO, the head of Risk Management, head of Treasury and other senior members of the corporate financial management group. The ALCO debates and decides whether to pursue tactical hedging initiatives to protect against or reduce undesired levels of these balance sheet risks in order to manage Investcorp's overall risk profile in sync with ex-ante targets and the evolving outlook on business conditions.

The ICs are drawn from senior management of the respective business line. The purpose of each IC is to evaluate current investment opportunities, the risk and return profile and recommend due-diligence actions to be undertaken in the evaluation process. Each IC submits investment proposals to the CC for funding approval.

The RC is drawn from senior members of the management team including the Head of Risk Management and will evaluate and approve any proposed investment by any of the investing LoBs based on its risk-return profile on a stand-alone as well as portfolio basis. This includes any CINA/CIE, RE, CI-TECH, CI-MENA deals irrespective of whether they are in a fund or intended to be placed with retail investors. It includes any Special Opportunity Portfolios or deals originated by Hedge Funds or any of the other LoBs comprising equity or debt or hybrid investments, as well as any new fund or product launches by any LoB. It includes any proposed add-on investments that require additional capital from the Bank and/or clients or divestments.

The PC is drawn from senior members of the Placement team (PRM). The PC is responsible for assessing the ability to place any deal that is targeted for retail placement with investors in the Gulf. This will cover any CINA/CIE deals and RE deals, as well as any CI-TECH or CI-MENA deals that are intended to be placed on a deal by deal basis rather than through their respective funds, as well as any

Special Opportunity Portfolios or deals originated by Hedge Funds or any of the other LoBs comprising equity or debt or hybrid investments intended for retail placement.

The Corporate Governance Code of Bahrain became applicable to Bahrain banks, including Investcorp, on January 1, 2011 and the CBB has incorporated the provisions of the Governance Code in the CBB's rulebook. Investcorp is substantially in compliance these corporate governance requirements.

In addition, in line with CBB requirements the BoD has adopted a Public Disclosure Policy and Procedures Statement (the 'Public Disclosure Statement') that (i) states that it is the policy of Investcorp to provide to its shareholders, clients, creditors, depositors and employees public disclosures that are fair, transparent, comprehensive and timely and (ii) sets forth Investcorp's internal controls over the public disclosure process. The Public Disclosure Statement requires that all information regarding Investcorp that is publicly disclosed be made available on Investcorp's website promptly after the information is disclosed and that at least three years of Investcorp's audited annual financial statements be maintained on the website. The disclosures in this report are in addition to the disclosures set out in the interim consolidated financial statements which are presented in accordance with the International Financial Reporting Standards (IFRS).

Board of Directors (BoD)

The functions of the BoD and the four Executive Committees of the BoD that have been established by the BoD (the Audit Committee (BAC), the Corporate Governance Committee, the Executive Committee for Administrative Policy and the Executive Committee for Investment Policy) are described in detail in Investcorp's Annual Report for Fiscal Year 2011.

The following executive officers of Investcorp play key roles in defining the Enterprise Risk Management framework and overseeing the risk management function:

Chief Executive Officer (CEO) – The primary role of the CEO is to provide leadership and manage Investcorp under the guidance and direction of the BoD. The CEO reports directly to the BoD

Chief Financial Officer (CFO) – The CFO is responsible for the overall financial management of Investcorp.

Head of Treasury (Treasurer) – The Treasurer is responsible for banking relationships, implementation of treasury products and programs and the overall supervision of day-to-day treasury activities, including IR and FX hedging

Head of Risk Management Department (Risk Manager) – The Risk Manager is independent from the business lines reporting to the BAC and administratively to the CFO. He is responsible for identification, measurement, monitoring, reporting and management of risks arising from investment related activities undertaken by Investcorp's lines of business and Treasury which have an impact on Investcorp's balance sheet. The Risk Manager is responsible for the implementation of the CBB's regulatory capital requirements. The Risk Manager also presents to the BAC an update on all risk issues for the whole bank.

3. REVIEW OF PILLAR ONE AND PILLAR TWO RISKS

Investcorp takes an enterprise-wide approach to risk management, and the proactive identification and mitigation of all embedded risks is an integral part of the corporate decision-making process. Risk management is an integral part of the Group's corporate decision-making process. The Group's primary risk management objective is to support its business objectives with sufficient risk capital. The Group employs internal risk models to determine the capital needed to cover unexpected loss from investment or other risks. This capital amount is known as economic capital which complements the regulatory capital framework as defined by the CBB under the Basel Accord.

Investcorp has developed sophisticated tools to perform detailed risk analyses that address investment and concentration risks of each individual line of business. The principal risks associated with the Group's business, and the related risk management processes are explained below in light of the Basel 2 framework:

3.1 Pillar 1 Risks

Pillar 1, which forms the basis for the calculation of the regulatory capital requirement, addresses three specific risk types: credit, market and operational risk.

i) Credit risk

Counterparty credit risk:

The Group is exposed to counterparty credit risk on its short term funds, placements, fair value of derivatives, receivables, loans and advances, debt investments and guarantees. The Group manages credit risk by setting limits for all counterparties. The Group also monitors credit exposures, and continually assesses the creditworthiness of counterparties. Counterparty credit risk in respect of derivative financial instruments is limited to those with positive fair values. With respect to the counterparty credit risk exposure arising from other financial assets the Group has a maximum exposure equal to the carrying value of these instruments. The Group also actively attempts to mitigate counterparty credit risks through documented netting and margin arrangements with counterparties, where possible, via ISDA and CSA agreements.

Risk Management maintains an overall external rating-based methodology for setting counterparty limits. For rated counterparties, credit ratings from at least two rating agencies are used for developing counterparty limits. All non-rated counterparties will be screened through detailed due diligence and credit analysis prior to assumption of credit exposures on them by Investcorp. Exposure limits for all counterparties will be subject to evaluation by the ALCO and will be presented to the Audit Committee of the Board of Directors and the Board of Directors for approval.

In order to assess the impact an Investcorp credit rating downgrade will have on its liquidity position due to increased collateral requirements, risk management includes such a scenario in the quarterly cash flow projections under normal and stressed conditions.

The table below shows the relationship between Investcorp's internal rating[1] and the category of external rating grades:

Internal rating	External rating by S&P and Moody's
High	AAA to A
Standard	A- to B-

[1] The internal rating is used by Financial Controls to determine provisions and impairments

Internal rating categories are summarized as follows:

High - there is a very high likelihood of the asset being recovered in full and collateral may be available.

Standard – whilst there is a high likelihood that the asset will be recovered and therefore, represents low risk to the Group, the asset may not be collateralized.

A counterparty credit is considered as past due when payment is due according to the contractual terms but is not received.

Short term funds, placements and derivatives are only with those counterparties that meet the High external rating and hence carry a minimal counterparty credit risk.

The table below analyses the Group's maximum counterparty credit risk exposures at the balance sheet date without taking into account any collateral or credit enhancements.

	Dec 31, 2011						
US$000s	**Neither past due nor impaired (a)**		**Past due but not impaired (b)**	**Impaired* (c)**	**Provisions (d)**	**Maximum credit risk (a+b+c+d)**	**Average monthly balance**
	Credit risk rating						
	High	Standard					
Short-term funds	47,166					47,166	32,564
Placements with financial institutions and other liquid assets	202,386					202,386	365,344
Positive fair value of derivatives	96,666					96,666	81,262
Receivables and prepayments		144,146	77,189	43,626	(43,560)	221,401	213,322
Loans and advances		202,915		49,997	(49,796)	203,116	202,850
Co-investments - debt		117,790				117,790	95,370
Guarantees		271,529				271,529	209,122
Total	**346,218**	**736,380**	**77,189**	**93,623**	**(93,356)**	**1,160,054**	

* Fair value for collaterals relating to impaired exposures is nil

The aging analysis of the past due but not impaired is given in the table below:

US$000s	**Dec 31, 2011**
Up to 1 month	42,200
>1 up to 3 months	3,831
>3 up to 6 months	2,574
>6 months up to 1 year	8,931
Over 1 year	19,653
Total	**77,189**

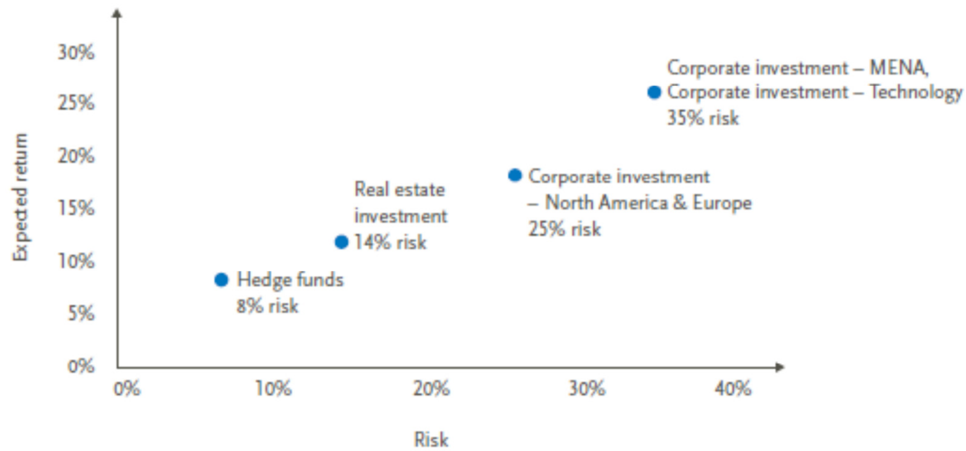
The financial assets that are past due but not impaired mainly relate to subscriptions receivable from clients. These assets are over-collateralized by all other assets under management on behalf of these clients.

ii) Market risk

(a) Investment Equity Price Risk

Following the CBB's Rulebook guidelines, Investcorp lists CI, RE and HF as part of the credit risk framework and applies a standardized regulatory credit capital charge. For its internal purposes, Investcorp has devised sophisticated tools to assess the investment risks of these assets both on a deal by deal basis and on a portfolio basis.

The following graph summarizes the risk and return profiles of investments within each line of business based on internal analysis. The risk/return statistics are all ex-ante, reflecting the future expected return environment and the specific risks of existing investments. These specific risks are impacted by sector diversification and relative size of investments.



Co-investments in Hedge Funds

Investcorp manages its HF portfolio risk both from a market strategy and manager selection perspective. The most prevalent market risks emanate from an unfavorable market environment or from strategy-specific risks such as illiquidity. Manager risks include style drift, underperformance, excessive risk taking, fraud/valuation errors and legal/documentation errors. Investcorp mitigates these risks through manager due diligence and selection, diversification, use of separate accounts, monitoring, stress testing, transparency and control of leverage. The availability of portfolio details, through the use of separate accounts and pre-negotiated transparency with HF managers, enables a more complete VaR analysis, as well as meaningful strategy-specific exposure and profit attribution analyses.

Investcorp manages the market risk in its HF portfolio through its market risk management framework that uses historical 'Value-at-Risk' (VaR) techniques in addition to risk factor assessments. VaR techniques produce estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels.

The table below sets out the VaR, at a 99% confidence level and a one-month time horizon, for the Group's HF exposure.

US$000s	**H1-FY2012**
Average VaR	40,828
Period end VaR	41,282
Maximum VaR	41,598
Minimum VaR	39,560

The various risks related to the HF portfolio are monitored and managed through a well-developed process and infrastructure that provide significant mitigants. These include:

strategic asset allocation—generating a core portfolio range with expected volatility within guidelines for the program

tactical asset allocation—ensuring flexibility to adjust within a range set by the strategic allocation process in light of prevailing macro-economic opportunities

Investcorp's risk management philosophy is to diversify the HF portfolio across managers and strategies. Allocations to individual managers are capped at less than 10% of the portfolio to protect against manager concentration risks. Manager selection is based on extensive due diligence with an emphasis on investment style, philosophy and risk management discipline. Each manager's track record is analyzed, focusing on performance in periods of market volatility, while the manager's operating infrastructure is also reviewed regularly to ensure the presence of appropriate controls and procedures. Investcorp maintains a 'watch list' for those managers whose risk profiles or performance levels deviate from targeted guidelines, with a view to redeeming the investment with such managers if the deviations are not corrected. One of Investcorp's competitive strengths is the process by which it increases transparency. For example, it establishes separate accounts with managers, thereby controlling leverage and undesirable exposures. Almost two-thirds of invested assets are transparent, either by way of separate accounts or position-level details, which are accessible by the HF team's quality assurance unit. This unit monitors manager adherence to investment guidelines and independently verifies valuations. While investment in HF is designed to have a low level of correlation to various markets, liquidity can temporarily decrease during periods of extreme stress, where correlations between previously independent strategies can increase dramatically. The HF team is mindful of these risks and has incorporated specific actions in its asset allocation, monitoring guidelines and separate accounts in order to cushion or mitigate these risks during periods of extreme market volatility and stress.

Co-investments in Corporate Investments and Real Estate

The Group manages the equity price risk of its co-investments in CI and RE on a portfolio basis as well as at the individual investment level.

CI-North America and CI-Europe (CI-NA and CI-E) investment risk is a significant component of the balance sheet and is, therefore, a key focus of analysis for the Risk Management team. The investment risk that is particular to the CI-NA and CI-E business is mitigated by a set of tools that are used at all stages of the investment process. At pre-acquisition, the Risk Management team works alongside the deal team to implement a risk analysis based on the target company's business plan. This enables identification of how the target company might perform under various scenarios, focusing, where appropriate, on specific characteristics of the deal. Sensitivity analysis and risk contribution of identified drivers to the main outcomes (EBITDA, IRR) are essential elements of the risk assessment. The analysis complements the extensive due diligence undertaken by the CI-NA and CI-E team and enables the measurement of the target company's risk compared to previous deals undertaken by Investcorp, as well as the fit of the target company from a client portfolio and balance sheet retention perspective.

Post acquisition, Investcorp takes a portfolio approach to evaluate the risk impact of the investment on the balance sheet. The Risk Management team regularly performs these risk analyses to ascertain how the risks of the portfolio change over time and how it relates to internal limits and guidelines. Correlation analysis among the portfolio holdings is conducted in order to identify any over-concentration in a specific sector and evaluate hedging of any undue downside risk. Finally, when exiting a portfolio company, hedging strategies may be used to mitigate risks associated with the exit process and to protect the expected realization proceeds from foreign exchange (FX) or other downside risks.

As in Investcorp's CI-NA and CI-E business, the goal in Investcorp's Corporate Investment-Technology Investment business (CI-Tech) and its Corporate Investment-MENA business (CI-MENA) is to seek returns that justify the risk being taken. The higher risks of small-cap technology and Gulf growth capital investing are alleviated through the following:

- fund approach to investment;
- smaller investment exposures in a broad range of investments;
- seeking out later-stage or pre-IPO investments, rather than providing early-stage seed capital;
- working in conjunction with recognized and proven partners;
- focusing on proven business prospects, rather than concepts;
- taking board-level representation with appropriate minority protections; and
- establishing protection in the financing structure with liquidation preference.

Throughout the investment cycle, there is a strong emphasis on due diligence and proactive post-investment management. In addition to risk-mitigating processes, all investment proposals are scrutinized rigorously by the relevant IC and the CC prior to final approval.

Risk Management strategies used for CI investment are also employed to mitigate risks associated with the acquisition and retention of RE investments. In addition, the Real Estate team further mitigates specific risk in three ways:

- concentration on high quality, income producing properties with high occupancy rates;
- establishment of partnerships with regional professionals, enabling access to local knowledge and reputation; and
- use of conservative capital structures aimed at protecting properties against the negative impact of interest rate and/or occupancy fluctuations.

To this end, the team monitors interest rate and occupancy sensitivities on each property, both prior to acquisition and during the ownership phase. This process serves to identify and assess conditions and levels that may cause the property to incur cash flow difficulties.

The team is proactive in managing properties that show signs of potential difficulties. Risk management tools are used at all stages of the RE investment process from pre-acquisition through to realization. For larger size or opportunistic property investments, the Risk Management team works during pre-acquisition alongside the RE deal team to implement a proprietary risk model based on the target investment's financial projections. This allows identification of how the property might perform under various scenarios, focusing, where appropriate, on specific characteristics of the investment. In addition to this analysis, the extensive due diligence undertaken by the RE team allows Investcorp to gauge the target property's risk compared to previous deals undertaken, as well as to gauge the fit of the target property from both client portfolio and balance sheet retention perspectives. Once an investment is made, Investcorp takes a portfolio approach to evaluate the risk impact of the investment on the balance sheet. The Risk Management team regularly performs such risk analyses to ascertain how the risks of the portfolio change over time and how they relate to internal limits and guidelines.

(b) Foreign currency risk

The Group's overall policy is generally to hedge all non-US dollar denominated monetary assets, liabilities and commitments into US dollars utilizing currency risk management products. In the normal course of its business the Group utilizes forward foreign exchange contracts and foreign exchange derivatives to manage its exposure to fluctuations in foreign exchange rates. Positions are monitored on a daily basis and hedging strategies are used to ensure positions are maintained within established risk limits.

The Group's significant net hedged and unhedged foreign currency positions are set out below.

US$000s	Dec 31, 2011	
Long (Short)	**Net hedged exposure**	**Net unhedged exposure**
Bahraini Dinar*	-	39,893
Euro	381,690	92
Pounds Sterling	18,072	25
Japanese Yen	(420,340)	93
	(20,578)	**40,103**

* Currency exchange rate currently pegged against the US Dollar.

Incidental unhedged positions are subjected to market risk calculation based on their VaR. VaR estimates the potential loss due to market movement of foreign exchange rates or volatility of these rates within a 99% confidence level over a 10-day holding period. Potential market movements of foreign exchange rates are derived from a study of their historical volatility. The risk methodology is based on the assumption that changes in foreign exchange rates follow a normal probability distribution over time. The characteristics of normal distribution are then used to assess portfolio risk. Back testing is carried out for foreign exchange risk by comparing VaR based on a ten-day holding period with the profit and loss actual performance. The objective is to ensure that the assumptions used for computing VaR are reasonable and result in a VaR number that does not understate economic and regulatory risk capital requirements. Given recent market turmoil, the Normal-VaR model showed statistically significant exceptions that required we either improve the model or increase the multiplier factor from 3 to 4 in accordance with the CBB's guidelines. Since Investcorp continues to impose strict limits on FX exposures and has therefore immaterial FX exposures, Investcorp has decided to apply the higher factor of 4 when calculating the regulatory capital requirement.

The following table summarizes the VaR during the year for the Group's foreign currency exposures.

US$000s	**H1-FY2012**
Average FX VaR	6.0
Period end FX VaR	4.6
Maximum FX VaR	27.9
Minimum FX VaR	0.7

(c) Interest rate risk

The Group closely monitors interest rate movements, and seeks to limit its exposure to such movements by managing the interest rate repricing structure of its assets and liabilities The Group actively manages its interest rate repricing gap exposure, with a bias towards floating rates and with strict exposure limits that are approved by the Board of Directors. The Group also utilizes interest rate related derivative financial instruments to manage its exposure to fluctuations in interest rates for specific transactions or a group of transactions. Please refer to the “Interest Rate in the Banking Book” section under Pillar 2, for full details.

(d) Credit spread risk

The Group has used the standardized approach to calculate the credit spread risk arising from credit derivative instruments such as credit linked notes (CLN) and funded credit default swaps (Funded CDS) where the referenced risk is highly rated sovereigns.

The following table summarizes the risk during the year for Group’s CLN exposures.

US$000s	Dec 31, 2011	
	Specific Risk Capital	**General Risk Capital**
CLN underlying MTM risk*	0	36

*using STA approach

iii) Operational risk

Operational risk is the risk of unexpected losses resulting from inadequate or failed internal controls or procedures, systems failures, fraud, business interruption, compliance breaches, human error, management failure or inadequate staffing.

While operational risks cannot be entirely eliminated, they are managed and mitigated by ensuring that appropriate infrastructure, controls, systems, procedures and trained and competent people are in place throughout the Group. Internal audit makes regular, independent appraisals of the control environment in all identified risk areas. Contingency arrangements, which are tested from time to time, are also in place to support operations in the event of a range of possible disaster scenarios.

Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events (such as natural disasters, changes in regulation or outsourcing of operations). Investcorp includes in this definition all legal and reputation risks, but excludes strategic and business risks.

As a part of Basel 2 implementation, Investcorp has put an operational risk framework in place. Under this framework Investcorp applies the Basic Indicator Approach ('BIA') to measure operational risk. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by a fixed alpha coefficient which has been set at 15 per cent in the CBB's Basel 2 capital adequacy framework.

Investcorp's operational risk framework, which is based on the BIA for regulatory reporting, is being reviewed to include, in the first and second phases, a maker/checker process, an updated review of Risk Control Self-Assessment (RCSA) and a tracker of material losses by its lines of business. Subsequently, monitoring and reporting processes of operational risk exposures will be implemented for upward reporting to senior management and the board of directors.

3.2 Pillar 2 Risks

Pillar 2 risks include funding liquidity risk, interest rate risk in the banking book, and concentration risk.

i) Funding liquidity risk

Funding liquidity risk is the possibility that Investcorp will not be able to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses. Funding liquidity risk refers to Investcorp's potential inability to meet both expected and unexpected current and future cash flows and collateral needs without affecting daily operations or its financial condition. This is in contrast to Market Liquidity Risk which refers to a bank's potential inability to easily offset or eliminate a position without significantly affecting the market price, because of inadequate depth or market disruption. In many cases, the same factors may trigger both types of liquidity risk.

As a general principle, liquidity derived from assets, as opposed to incremental committed or uncommitted liabilities, is the most reliable source of funding in a liquidity event. Thus, a significant aspect of the liquidity risk management process of a financial institution involves an assessment of its ability to access secured-financing sources. It should be noted, however, that funding liquidity risk is mainly a second-order risk. That is, material liquidity risk issues typically arise as a result of problems with the management of other risks. Although funding liquidity risk could accelerate the failure of a financial institution, particularly if it initially had a high level of unmitigated liquidity risk, it will rarely be the root cause of a bank-specific crisis. For this reason, regulatory and economic capital ought not to be tied directly to funding liquidity risk.

The Group’s liquidity management policies include the following:-

The funding liquidity risk management framework is vital to maintaining adequate liquidity within the Group, and safeguarding the ability of the Group to meet all payment obligations. Investcorp has ensured the implementation of effective frameworks that are consistent with CBB policies and incorporate efficient oversight by the Board of Directors and senior management. The Group’s liquidity risk management framework covers its Bahrain, London and New York operations.

Investcorp defines the different forms of liquidity risk to which it is exposed, identifies where risks fit in the enterprise risk universe and communicates these definitions across the Group so that a common understanding is applied when identifying and evaluating liquidity risk related to existing LOBs, new businesses, products or initiatives. Investcorp works to identify and measure the full range of liquidity risks, examining the risks posed by individual products and business lines and properly aligning incentives with the risk tolerance of the Group. Investcorp monitors and manages funding liquidity risk primarily through the use of risk limits, monitoring systems, and scenario analyses that are incorporated into a contingency funding plan (CFP). All such plans, and mitigants to cope with stress situations, are initiated by Treasury and Risk Management, reviewed and approved by ALCO and FRMC and then presented to the BoD for final approval.

The Basel 2 requirement to take liquidity into consideration for purposes of Pillar 2 (Supervisory Review Process) is met through the CBB’s assessment of Investcorp’s liquidity positions and risk-management practices; an assessment that considers Investcorp’s various liquidity risk metrics and levels of acceptable risk tolerance in light of its internal and external environment and circumstances. On a periodic basis, Investcorp updates the CBB with its liquidity position which includes detailed cash flow projections.

The table below summarizes the maturity profile of the Group's assets and liabilities based on expected realizations.

	Dec 31, 2011						
US$000s	**Up to 3 months**	**>3 months up to 1 year**	**>1 year up to 5 years**	**>5 years up to 10 years**	**>10 years up to 20 years**	**Over 20 years**	**Total**
ASSETS							
Cash and short term funds	47,308	-	-	-	-	-	47,308
Placement with financial institutions and other liquid assets	199,386	-	3,000	-	-	-	202,386
Positive fair value of derivatives	10,716	4,202	11,366	722	50,775	18,884	96,665
Receivables and prepayments	111,594	36,004	96,080	8,497	-	-	252,175
Loans and advances	9,136	52,860	141,120	-	-	-	203,116
Co-investments in Hedge Funds	424,837	133,161	65,434	-	-	-	623,432
Corporate investment	-	81,711	955,242	-	-	-	1,036,953
Real estate investment	1,164	27,927	197,520	-	-	-	226,611
Premises, equipment and other assets	641	-	17,740	39,078	-	-	57,459
Total assets	**804,782**	**335,865**	**1,487,502**	**48,297**	**50,775**	**18,884**	**2,746,105**
LIABILITIES							
Deposits from clients - short-term	301,899	-		-	-	-	301,899
Negative fair value of derivatives	17,011	3,566	678	218	13,948	18,713	54,134
Payables and accrued expenses	39,983	18,547	5,786	-	-	-	64,316
Deposits from clients - medium-term	-	-	82 724	-	-	-	82,724
Medium-term debt*	61,625	19,000	575,789	-	-	-	656,414
Long-term debt	-	32,789	45,844	-	471,286	47,196	597,115
Total liabilities	**420,518**	**73,902**	**710,821**	**218**	**485,234**	**65,909**	**1,756,602**
Net gap	**384,264**	**261,963**	**776,681**	**48,079**	**(434,459)**	**(47,025)**	
Cumulative liquidity gap	**384,264**	**646,227**	**1,422,908**	**1,470,987**	**1,036,528**	**989,503**	

* Does not take to account the $231 million undrawn revolvers with a maturity profile over 12 months

Contractual maturity of financial liabilities on an undiscounted basis

The table below presents the cash flows payable by the Group relating to its financial liabilities and derivatives upon their respective contractual maturities at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows (i.e. nominal plus interest) determined by using the forward yield curve for the relevant periods. However, the Group manages the inherent funding liquidity risk based on future cash flows discounted to present values.

	Dec 31, 2011						
US$000s	**Up to 3 months**	**>3 months up to 1 year**	**>1 year up to 5 years**	**>5 years up to 10 years**	**>10 years up to 20 years**	**Over 20 years**	**Total**
Financial liabilities							
Deposits from clients	302,458	502	83,657	-	-	-	**386,617**
Payable and accrued expenses	39,983	18,547	5,787	-	-	-	**64,317**
Medium-term debt	66,438	40,357	610,699	-	-	-	**717,494**
Long-term debt	10,514	51,193	111,462	103,846	660,572	54,040	**991,627**
	419,393	**110,599**	**811,605**	**103,846**	**660,572**	**54,040**	**2,160,055**
Derivatives							
Contracts settled on a gross basis:							
Contractual amounts payable	1,018,537	46,545	266,109	-	-	-	**1,331,191**
Contractual amounts receivable	(1,011,473)	(45,515)	(274,267)	-	-	-	**(1,331,255)**
Contracts settled on a net basis:							
Contractual amounts payable (receivable)	(3,296)	(4,183)	(27,422)	(23,759)	1,914	(174)	**(56,920)**
Commitments	1,894	37,027	155,744	15,299			**209,964**
Guarantees	107,743	10,000	-	153,786			**271,529**
Total undiscounted financial liabilities	**532,798**	**154,473**	**931,769**	**249,172**	**662,486**	**53,866**	**2,584,564**

ii) Interest rate risk in the banking book

Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within interest rate repricing risk limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates.

The Group closely monitors interest rate movements, and seeks to limit its exposure to such movements by managing the interest rate re-pricing structure of its assets and liabilities. The Group does not take interest rate trading positions and all its interest rate risk is typically in the banking book where hedge accounting applies. The Group utilizes interest rate related derivative financial instruments to manage its exposure to fluctuations in interest rates for specific transactions or a group of transactions.

A majority of the Group's interest earning assets and interest bearing liabilities carry floating rates of interest or if they carry fixed rates they have been hedged to floating rates of interest, except for the following:

- Investments amounting to $84.5 million which earn interest at an effective rate approximating 12.29% per annum.
- Deposits from clients amounting to $7.2 million on which interest is paid at an effective rate of 0.9% per annum reflecting the underlying maturity structure.
- Long term debt amounting to $725 million on which interest is paid at an effective rate of 1.25% per annum reflecting the underlying maturity structure.

The following table depicts the sensitivity of the Group's net income to a 200 basis points possible change in interest rates, with all other variables held constant. The sensitivity is based on the floating rate financial assets and financial liabilities (including items hedged back to floating rate) held at the balance sheet date.

US$000s	**Sensitive to net income for +200 basis points**	**Sensitive to net income for -200 basis points**
Currency	**Dec 31, 2011**	
Euro	(7,224)	4,730
Pounds Sterling	(698)	284
Japanese Yen	1,239	(211)
US Dollar	(7,962)	3,228
Others	116	(1)
Total	**(14,529)**	**8,030**

(a) Figures in parenthesis above represent loss

(b) The downside case of -200bps impact is calculated with assumption that the yield curve will not go below 0%

USD 3M & 6M libor rates have doubled since June 2011. This has impacted the downside case mainly due to the MT & LT funding in USD.

Potentially significant variances in interest rate sensitivity may exist at dates other than the year end.

iii) Concentration risk

Concentration risk arises 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 geographic location.

The Group's policies and procedures and the broad geographical and industry spread of its activities limit its exposure to any concentration risk. Additionally management has established credit limits for geographic and counterparty exposures, which are monitored on a daily basis.

The distribution of assets and off-balance sheet items by geographical region and industry sector is as follows:

	Dec 31, 2011		
US$ 000s	**Assets exposed to credit risk**	**Off-balance sheet exposed to credit risk**	**Total credit risk exposure**
GEOGRAPHICAL REGION			
North America	666,009	271,529	937,538
Europe	201,542	-	201,542
Middle East	20,890	-	20,890
Other	84	-	84
Total	**888,525**	**271,529**	**1,160,054**

	Dec 31, 2011		
US$ 000s	**Assets exposed to credit risk**	**Off-balance sheet exposed to credit risk**	**Total credit risk exposure**
INDUSTRY SECTOR			
Banking and finance	420,437	50,116	470,553
Consumer products	103,318	377	103,695
Consumer services	55,203	-	55,203
Distribution	26,375	-	26,375
Industrial products	62,233	-	62,233
Real Estate	179,030	211,036	390,066
Technology and telecom	29,525	-	29,525
Others	12,404	10,000	22,404
Total	**888,525**	**271,529**	**1,160,054**

3.3 Pillar 3 Related Party Transaction Disclosure

The tables below provide the income earned, expenses incurred and the balance sheet exposures in connection with related party transactions included in the consolidated financial statements as of Dec 31, 2011.

$000s		Dec 31, 2011
Management fees	Investee companies	8,139
	Client companies	18,281
	Client companies associated with the HFP	13,230
Activity fees	Investee companies	8,845
Performance fees	Client companies associated with the HFP	7,550
	Client companies	487
Asset based income	Investee companies	11,054
	Client companies	941
Interest expense	Client companies	(127)
Provisions	Employee investment programs	-

	Dec 31, 2011		
$000s	Assets	Liabilities	Off-balance sheet
Outstanding balances			
Strategic shareholders	4,806	11,658	
Investee companies	78,444		
Investment holding companies	97,715	4,101	153,515
Client fund companies associated with the HFP	13,113		
Directors and senior management	1,067	901	
Total	**195,145**	**16,660**	**153,515**

4. ENTERPRISE RISK MANAGEMENT OVERVIEW

Investcorp maintains and supports an Enterprise Wide Risk Management ("ERM") culture that integrates best practice risk methodologies across the Group. Risk Management plays the major role of defining risk policy and controlling risk across the Group with attention to risk adjusted returns to enhance shareholders' value and maintain the long term competitive edge of the Group. The following elements of ERM have already been discussed herein:

- Risk Governance and independence of the Risk Management function
- Market Risk policy and risk control process
- Credit Risk policy and risk control process
- Liquidity and Funding policy and risk control process.

4.1 Portfolio Risk Management

Investcorp applies portfolio diversification techniques to control exposure concentration. A portfolio risk measure is obtained for each asset class and an aggregate multifactor measure of portfolio risk is applied to assess the major risk factor exposures for all investments.

4.2 Risk infrastructure

Risk Management has worked with Investcorp's Technology Department to develop appropriate risk management systems in order to monitor all aspects of the risk function including, market risk, credit risk, and operational risk. Risk Management evaluates all risk Infrastructure needs at least annually and presents to ALCO for review and FRMC for approval. Risk Management strives to have best in class systems subject to well defined cost-benefit analyses performed by the Head of Risk Management.

4.3 Monitoring and reporting

Risk management monitors and reports market, liquidity and counterparty credit risk on a regular basis to senior management and the BAC, which, in turn, reports to the BoD. Capital management, including regulatory and internal economic capital ratios, is reported to senior management and the BAC which, in turn reports to the BoD, on a quarterly basis.

The Risk Management team has developed Group wide risk limits and a risk capital limits framework for Investcorp. This framework allocates risk capital by considering the risk / returns characteristics of each asset class and provides sufficient flexibility to pursue business objectives.

5. GUIDELINES FOR RISK AND CAPITAL ADEQUACY

In order to conduct business over the long run in varying economic environments, Investcorp Risk Management evaluates how risks taken by the various business lines may impact overall balance sheet earnings. There should be enough allocatable capital taken to allow Investcorp to be in a position to conduct its activities even though unfavorable investment environments may adversely impact earnings or balance sheet valuations. The capital required to sustain this activity within a determined risk tolerance level is denoted as the “risk or economic capital”. Risk Management uses a proprietary model for this capital planning that will then provide a measure of risk adjusted performance. Risk capital allocation and planning represent a complement to the regulatory capital requirements as determined by the regulator. The Group’s risk management policy has been effective during H1-2012 in achieving its objectives.

The Economic Capital methodology shall address the following:

- Assess that the Group has adequate capital for its size and complexity of business under normal and stress case environments and determine how much current and future capital is necessary.
- Provides an assessment of the risks that are not adequately covered by Pillar 1 and determine a capital treatment for capitalized-risks and mitigation treatment for non-capitalized-risks.
- Outline the corporate risk management process for defining the risk appetite and risk-reward framework and informs the board of the ongoing assessment of the firm's risks
- Demonstrate the firm's internal capital adequacy assessment process to the regulators

The Risk Capital methodology details the capital allocation for the Group’s risks covered under Pillar 1 as following:

- Credit Risk will cover CI/REI and HF
- Market Risk will cover FX
- Operational Risk (including Legal risk)

And Group’s risks not adequately covered by Pillar 1 as following:

- Capitalized-risks:
  - Interest Rate Risk in the Banking Book
- Non-Capitalized-risks:
  - Liquidity Risk: focus is on Funding Liquidity Risk which refers to the Bank’s potential inability to meet both expected and unexpected current and future cash flows and collateral needs without affecting daily operations or its financial condition. Market Liquidity Risk which refers to the Bank’s potential inability to easily offset or eliminate a position without significantly affecting the market price, because of inadequate depth or market disruption is captured through our full valuation mechanism.

- Reputation Risk: The effect of negative publicity on market/public confidence in a bank.
- Strategic Risk; this is broadly the effect of major strategic changes in the bank or of changes in the business environment, or of adverse business decisions on the earnings of the bank;

5.1 Economic Capital

Investcorp uses a risk-based capital allocation approach as the main tool to manage internal economic capital. Over the years Investcorp has been continuously assessing its economic capital methodology to take into account any increased risk premium, volatility and correlation for all asset classes. In designing the risk capital methodology, Investcorp maintains a risk capital allocation that is independent of any specific market recovery expectations, accounting rule changes and correlation assumptions. The economic capital charge, which is updated quarterly, is based on market volatility, risk premiums and correlations. Also, Investcorp continues to use the conservative assumption of 100% correlation between asset classes to provide an embedded cushion for protection against model risk inherent in model choice, model parameters estimation and model errors. Most importantly, the correlation constraint allows for an embedded cushion that is anti-cyclical, since that it is set for crisis like situations when asset correlation goes to one. Investcorp also applies the requirement of an explicit equity capital cushion (equal to total book equity capital minus total economic capital charges) that is set and monitored by ALCO. This equity capital cushion provides a buffer against potential exposures, as opposed to existing exposures, under normal and stress market conditions. Even though the current equity cushion methodology will continue to be used to cover the aforementioned risks, explicitly outlining the risks that are intended to be covered by the equity capital cushion will enable a regular review process of these risks and also the suitability of the equity capital cushion.

Investcorp uses two complementary approaches to determine economic capital:

- Economic capital over one year : The aggregate Economic Capital requirement over a one-year horizon given by a risk-based multifactor and credit models for the CI and RE lines of business and a Monte Carlo simulation for the HF co-investment,

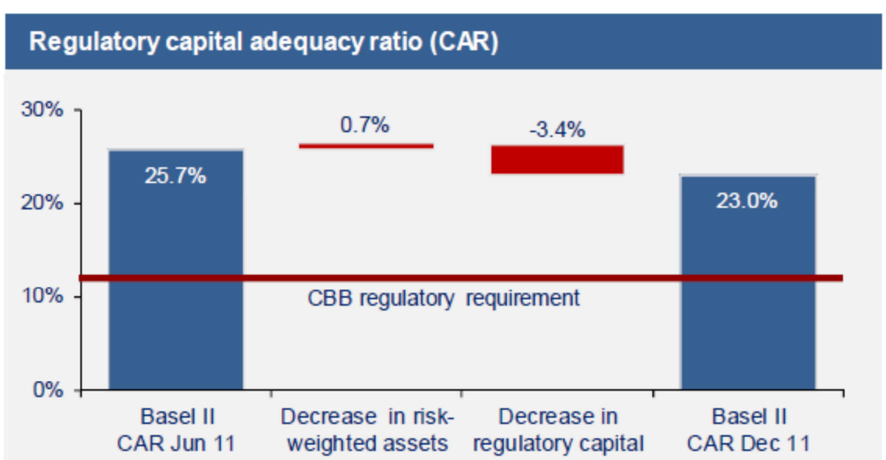
- Long-term economic capital: dynamically modeled by considering organic business objectives and capital requirements to support them. Based on a Monte Carlo based proprietary Long Range Plan model which estimates the equity capital cushion at the 99th percentile loss over a five-year horizon across varying economic / operating environments. The model which incorporates bottom-up input from all businesses regarding base case expectations and variability is used to project the financial condition of the company at the end of each of the next five years. The Monte Carlo simulations, then, project several thousand P&L and balance sheet scenarios, with the focus being on the amount of economic capital cushion in the bottom 1% of simulated projections (termed the ‘stress-case’). A stress-case scenario represents multiple and simultaneous stressed conditions across all lines of business over an extended period of time. The objective is to maintain a capital cushion, even in such stress-case scenarios, that will ensure solvency and flexibility for business initiatives.

5.2 Regulatory Capital

From a regulatory capital perspective, Investcorp applies the Basel 2 framework regulations, as adopted by the CBB, on a consolidated basis to Investcorp Bank B.S.C. which is the entity licensed and regulated by the CBB. For the measurement of risk weighted exposures, Investcorp has chosen the credit risk standardized approach of all investment exposures, the VaR model for FX market risk, Standardized approach for credit spreads, and the basic indicator approach for operational risk. During Fiscal Year 2009 the Bank changed the classification of its Hedge Funds exposure from trading book to banking book as per the directives of the CBB. This has resulted in measurement of the risk weighted exposure for Hedge Funds based on the standardized approach for credit risk rather than the VaR model used for market risk.

The Basel 2 Capital Adequacy Ratio ('CAR') at Dec 31, 2011 was 23.0%, comfortably in excess of the CBB's regulatory minimum requirement of 12% and also in excess of Investcorp's stated target levels for regulatory capital of 14–16%.The increase in the Basel 2 ratio reflects successful balance sheet de-leveraging as a result of the issue of regulatory Tier1 capital and the managed reduction in risk weighted assets. During 2010, Basel 3 introduced two liquidity risk standards: a Liquidity Coverage Ratio (LCR) and a Net Stable Funding Ratio (NFSR), which were 433% and 126%, respectively, as of Dec 31, 2011. Currently, Investcorp is undergoing a full review of the potential impact of Basel 3 on capital and liquidity positions.

The following graph shows a bridge analysis of the current regulatory CAR:



The tables below summarize the regulatory capital and the risk asset ratio calculation in line with the CBB Rulebook:

Breakdown of the regulatory capital base for Investcorp

US$000s	**Dec 31, 2011**
Gross Tier 1 capital	979,451
Less: regulatory deductions	(83,161)
Tier 1 capital – net (a)	**896,290**
Gross Tier 2 capital	10,052
Less: regulatory deductions	(10,052)
Tier 2 capital – net (b)	**-**
Regulatory capital base under Basel II (a)+(b)	**896,290**

Risk Weighted Exposures for Investcorp's balance sheet items

	Dec 31, 2011		
Risk weighted exposure US$000s	**Principal/ notional amounts**	**Risk weighted equivalents**	**Capital requirement @ 12%**
Credit risk			
Claims on sovereigns	67	-	-
Claims on non-central government public sector entities	8,958	-	-
Claims on banks	171,052	35,110	4,213
Claims on corporates	467,194	411,068	49,328
Co-investments (including Hedge Funds)	1,186,995	2,675,504	321,060
Other assets	72,116	72,116	8,654
Off-balance sheet items			
Commitments and contingent liabilities	481,492	261,067	31,328
Derivative financial instruments	3,000,214	56,897	6,828
Credit risk weighted exposure		**3,511,762**	**421,411**
Market risk			
Market risk weighted exposure (excluding Hedge Funds)		736	88
Operational risk			
Operational risk weighted exposure		386,890	46,427
Total risk weighted exposure (b)		**3,899,388**	**467,926**
Risk asset ratio (a)/(b)		**23.0%**	

	Dec 31, 2011		
Risk weighted exposure US$000s	**Principal/ notional amounts**	**Risk weighted equivalents**	**Capital requirement @ 12%**
Minimum required as per CBB regulatory guidelines under Basel 2		**12.0%**	
Capital cushion over minimum required as per CBB guidelines		**428,363**	

Investcorp uses the Value-at-Risk (VaR) model to calculate the regulatory capital requirements relating to FX currency exposure The VaR calculated by the internal model is subject to a multiplication factor of 4 determined by the CBB.

Investcorp has no trading book interest rate risk exposures and since it is carrying a negative re-pricing gap on its balance sheet exposures, it takes a +200 basis points (bps) stress test to assess the possible impact of increasing interest rate-as discussed above.

The large balance sheet exposures are monitored and presented to the BAC and the BoD on a regular basis. Telepacific Communications (at 18.4%) is a large exposure exceeding the 15% obligor limit as of Dec 31, 2011.

Capital requirements for operational risk

For regulatory reporting purposes, the capital requirement for operational risk is calculated according to the basic indicator approach. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by a fixed alpha coefficient. The capital requirement for operational risk at 31st Dec 2011 amounted to US$46.4 million.

Regulatory capital base

The regulatory capital base is set out in the table above "Breakdown of the regulatory capital base for Investcorp".

The CBB Rulebook outlines what constitutes Tier 1, Tier 2 capital etc. Tier 1 capital comprises share capital, share premium, retained earnings and reserves. Retained losses, including any loss for the current period, are included in Tier 1. Reserves excludes revaluation gains and losses arising on the re-measurement to fair value of available-for-sale securities and derivative cash flow hedging transactions with the exception of unrealized gains and losses arising on the re-measurement to fair value of equity securities classified as available-for-sale. Unrealized gains on equity securities classified as available-for-sale are included in Tier 2 capital.

Tier 2 capital comprises qualifying subordinated term finance, collective impairment provisions and 45 per cent of unrealized gains arising on the re-measurement to fair value of equity securities classified as available-for-sale.

The CBB applies various limits to elements of the regulatory capital base. The amount of innovative Tier 1 securities cannot exceed 15 per cent of total Tier 1 capital; qualifying Tier 2 capital cannot exceed Tier 1 capital; and qualifying subordinated term finance cannot exceed 50 per cent of Tier 1 capital. There are also restrictions on the amount of collective impairment provisions that may be included as part of Tier 2 capital. Investcorp takes an enterprise-wide approach to risk management, and the proactive identification and mitigation of all embedded risks is an integral part of the corporate decision-making process. Risk Management plays an integral role in Investcorp's corporate decision-making process. Investcorp's primary risk management objective is to support its business objectives with sufficient risk capital. Investcorp employs internal risk models to determine the capital needed to cover unexpected loss from investment or other risks. This capital amount is known as economic capital which complements the regulatory capital framework as defined by the CBB under the Basel Accord.

6. GLOSSARY OF ABBREVIATIONS

ALCO	Assets and Liabilities Committee
ALM	Asset and Liability Management
Basel	Committee Basel Committee for Banking Supervision
CBB	Central Bank of Bahrain
CEO	Chief Executive Officer
CFO	Chief Financial Officer
FIRB	Foundation Internal Ratings Based Approach
FRMC	Financial and Risk Management Committee
GCC	Gulf Cooperation Council
HF	Hedge Funds
IA	Internal Audit
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IVC	Investcorp Bank B.S.C.
LOB	Line of Business
PD	Probability of Default
PRM	Placement and Relationship Management
CI	Corporate Investments
RE	Real Estate
RM	Risk Management Team
RWA	Risk Weighted Amount
The Group	Investcorp Bank B.S.C. and subsidiaries
VaR	Value-at-Risk