

European Islamic Investment Bank Plc

**Pillar 3 Disclosures
December 2009**

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1. Overview

Background

The European Union Capital Requirements Directive came into effect on 1 January 2007. This was introduced in the UK by the Financial Services Authority (FSA) based on the Basel 2 rules.

Pillar 3 requirements are designed to promote market discipline and disclosure by providing information on a firm's risk exposures and risk management processes.

European Islamic Investment Bank Plc (EIIB) commenced using the Standardised approach to risk and capital management on 19 December 2007.

Basis and frequency of disclosures

Disclosures have been prepared by EIIB in accordance with Pillar 3. All figures relate to the 31 December 2009 Annual Report for the Company and are in GBP 000 unless otherwise stated.

Disclosures are on an annual basis or more frequently in the event of material changes.

Scope

EIIB is an EEA parent institution and is regulated by the FSA.

There is a requirement to calculate, maintain and report regulatory capital ratios on an unconsolidated basis. Full details of subsidiary undertakings are included in Note 30 of the Annual Report.

Location and verification

These disclosures are subject to review by the Executive Management Committee following Board approval of the financial statements and are published on the company website. These disclosures are not subject to audit although certain disclosures are included in the audited or reviewed financial statements.

2. Risk management objectives and policies

Strategies and processes to manage risk

The Bank is an Islamic Finance Institution which operates in accordance with Sharia'a law. The Board has set risk appetite and tolerances within the overall risk framework, documented within a set of risk management policies which are approved by mandated Risk Committees. Ultimate responsibility for risk resides with the Board of Directors.

Risk management framework

Primary responsibility for the identification, control, monitoring and mitigation of risk lies with the business origination and operational support areas. A specialist risk support function independently identifies, measures, monitors, controls and reports risk with oversight provided by a number of committees covering various aspects of risk. Assurance is provided by Internal Audit with governance provided by the Audit Committee.

Risks are reviewed at least annually via the Internal Capital Adequacy Assessment Process (ICAAP). The most significant risks are considered to be credit risk, market risk, operational risk and liquidity risk. Risk management practices include risk policies, risk measurement, risk monitoring and control, risk reporting, and risk mitigation.

Risk is managed by a set of comprehensive limits, triggers and processes. Internal risk ratings are assigned to exposures which are assessed using quantitative and qualitative methodologies. All exposures are reviewed at least annually. Risk mitigation techniques are used where permitted and are also considered when losses may materialise.

Risk is measured and reported against capital and liquidity requirements, limits, triggers and mandates as contained in the various policy statements. Information is provided to management and risk committees via daily and monthly risk reports and includes stress testing using an appropriate level of severity. Summary information is provided quarterly to the Board.

Structure and organisation of risk management

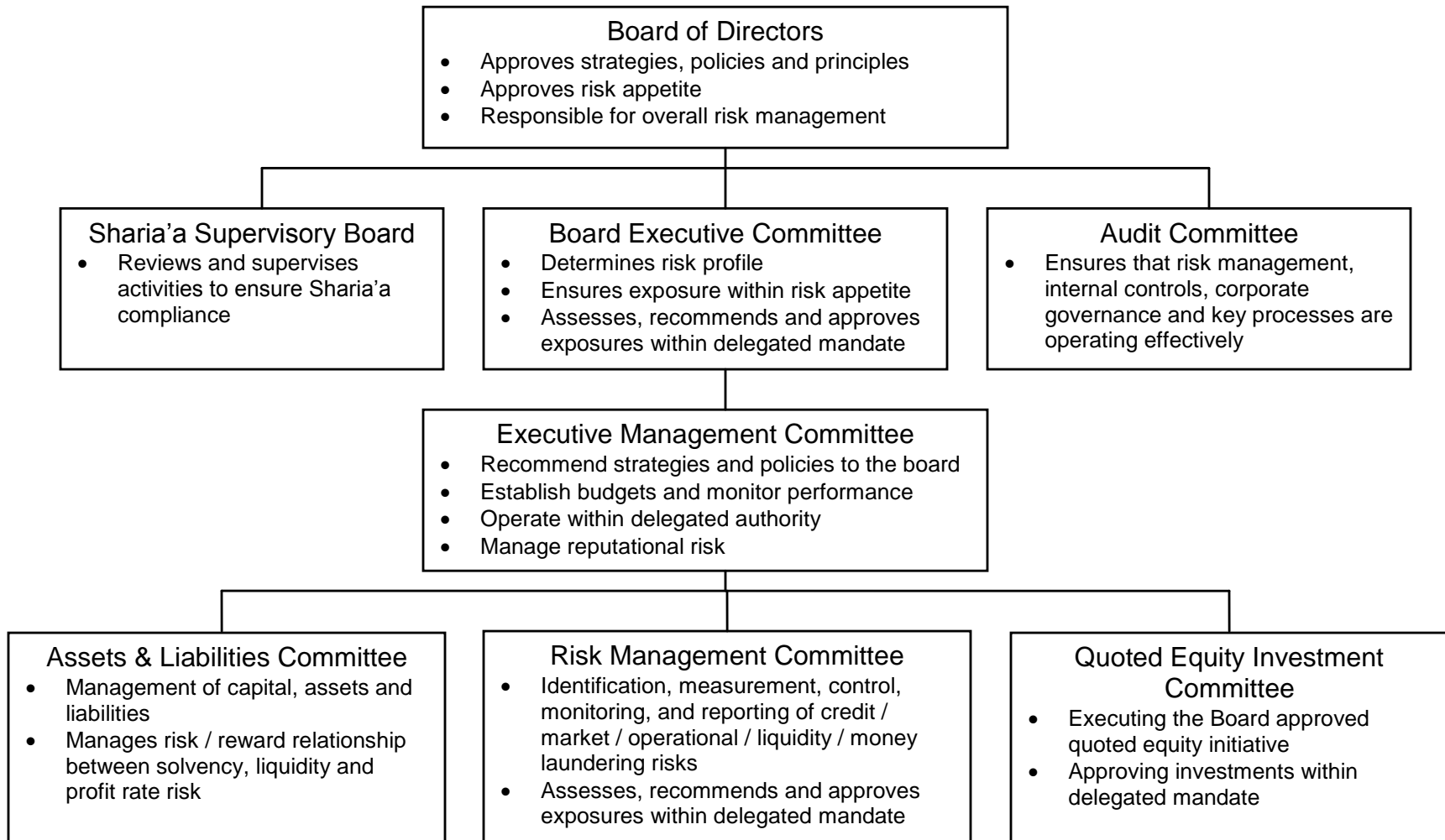
Responsibilities for the main risks are allocated as follows:

Key Risk	Risk Management	Risk Oversight	Risk Governance
Credit / Investment risk	Treasury & Capital Markets and Private Equity	Risk Department	Risk Management Committee
Market risk	Treasury & Capital Markets and Private Equity	Risk Department	Risk Management Committee
Operational risk	All business areas	Operations Dept and Risk Dept	Risk Management Committee
Liquidity risk	Treasury & Capital Markets	Risk Department	ALCO

The Board Executive Committee oversees all Risk Committees.

Internal Audit is responsible for scheduling a program of reviews to provide assurance that internal controls are in place, assets are safeguarded, compliance with policies and procedures as well as regulations and laws, and accuracy and reliability of records and reports. The Audit Committee approves the annual audit plan and considers subsequent audit reports.

The Risk Committees structure is as follows:



3. Capital resources

Total available capital

The Bank complied with the capital requirements set out by the FSA. Total available capital at 31 December 2009 was:

	Unconsolidated
Tier 1	
Share capital	17,657
Share premium	116,220
Profit & loss account and other reserves	6,664
Investments that are not material or qualifying holdings	(6,345)
Fair value reserve	(161)
Intangible and fixed assets	(608)
Total Tier 1 Capital	133,427
Total capital available	133,427

Tier 1 capital

Intangibles comprise mainly of software and licences.

Other investments in subsidiaries that are not deducted as Material Holdings or Qualifying Holdings due to threshold limits are deducted from capital resources.

Tier 2 and Tier 3 capital

No part of available capital comprises Tier 2 or Tier 3 capital.

4. Capital adequacy

Capital management

The Bank has adopted the Standardised Approach to credit risk and market risk, and the Basic Indicator Approach to operational risk for calculation of the Basel 2 Pillar 1 minimum capital requirement.

Capital is managed with a view to balancing prudence and efficiency. The Board has decided to adopt a cautious approach to date given the Bank's recent incorporation, recent market turmoil, and the need to establish a reputation in the financial services industry. Improving capital efficiency will receive greater attention over the longer term.

Regulatory capital covers all Pillar 1 risks. The minimum Capital Resource Requirement (CRR) is determined in accordance with BIPRU rules.

Economic capital covers other material risks (Pillar 2 risks) in addition to Pillar 1 risks. A Standard Approach is used to determine an economic value for these risks.

Regulatory capital is reported daily and economic capital is reported monthly to management and risk committees.

Internal capital adequacy assessment process

An internal assessment of capital needs (Internal Capital Adequacy Assessment Process) (ICAAP) is undertaken at least annually.

The outcome of the ICAAP is used to present the Internal Capital Assessment (ICA) document. The ICA covers all material risks to determine the capital requirement over a three year horizon and includes stress testing to satisfy regulatory requirements. The ICA is presented to the Board for review. The FSA assesses the ICA and sets Individual Capital Guidance (ICG) for the Bank.

Minimum capital requirement: credit risk

The overall minimum capital requirement for credit risk using the Standardised Approach (8 % of the risk weighted exposure amounts for each exposure class) at 31 December 2009 was:

	Unconsolidated
Exposure class	
Sovereigns	77
Financial Institutions	2,527
Corporates and other	1,916
Equity	205
Credit risk minimum capital requirement	4,725

Minimum capital requirement: Pillar 1

The overall minimum capital requirement under Pillar 1 is determined by adding the credit capital requirement above to that required for market and operational risk. Market risk includes a Position Risk Requirement (PRR) being the regulatory capital required to cover the risk of losses on profit rate, foreign currency and equity positions calculated in accordance with FSA rules.

The overall minimum capital requirement under Pillar 1 at 31 December 2009 was:

	Unconsolidated
Credit risk	4,725
Market risk	1,157
Operational risk	1,705
Pillar 1 minimum capital requirement	7,587
Total capital available	133,427
Excess over Pillar 1 minimum capital requirement	125,840

5. Credit risk

Credit risk overview

Credit risk is the risk of loss arising from counterparty failure to pay capital or income or failure to perform on due date. For disclosure purposes credit risk is sub divided into sovereign, financial institutions, corporate, and private equity.

Risk arising from changes in credit quality and the recoverability of advances are inherent in the Bank's activities. Adverse changes in the credit quality of counterparties and in the economies where the Bank takes risk can affect the value of assets. Risk management processes have been established as part of the overall risk framework to measure, manage and mitigate risk.

Private Equity investments are held for medium term capital gain. Investments held as part of the investment portfolio are usually held at fair value even though there may be significant influence over these companies. Unrealised gains or losses are disclosed in the Fair Value Reserve and are taken into account for the Tier 1 Capital calculation.

The gross credit risk exposures were as follows:

	31 December 2009	31 December 2008
Sovereigns	5,909	19,806
Financial institutions	126,296	151,530
Corporate and other	23,742	60,299
Private equity	6,976	4,885
	162,923	236,520

The geographical distribution of these exposures was as follows:

	Europe	Middle East	Rest of world	Total
Sovereigns	-	5,909	-	5,909
Financial institutions	59,928	64,368	2,000	126,296
Corporate and other	11,415	12,327	-	23,742
Private equity	-	-	6,976	6,976
	71,343	82,604	8,976	162,923

The residual maturity of exposures was as follows:

	0 – 1 months	2 – 3 months	4 – 6 months	7 – 12 months	1 - 5 years	5+ years	Total
Sovereigns	-	-	-	1,045	4,864	-	5,909
Financial institutions	120,952	-	1,599	-	3,745	-	126,296
Corporate and other	-	6,008	-	-	15,251	2,483	23,742
Private equity	-	-	-	6,226	750	-	6,976
	120,952	6,008	1,599	7,271	24,610	2,483	162,923

The industry sector distribution of these exposures was as follows:

	Unconsolidated
Sovereigns	5,909
Financial institutions	126,296
Property	12,326
Manufacturing	11,415
Basic Materials	750
Oil & Gas	6,227
	162,923

Credit risks are managed in accordance with the Credit Policy approved by the Board. Limits are placed on business volumes, industry sector, geography and size of exposures. Exposure limits are subjected to both objective and subjective analysis criteria with the primary focus placed on the ability and willingness to repay, track record, financial strength and transaction structure.

Security may be taken to add comfort where required although no exposures are based solely on security provided. Security may cover various forms, is valued at regular intervals and is assessed for concentration risk. Other credit risk mitigants may be used such as third party guarantees and netting, supported by robust legal documentation. Guarantors are assessed for creditworthiness. Sharia'a Law does not permit the use of derivatives.

Ratings by External Credit Assessment Institutions (ECAIs), comprising Moody's, Standard and Poor's and Fitch, are taken into account where applicable. All exposures are given an internal rating which is used in the calculation of internal capital.

Transactions are priced in accordance with the level of risk taken.

The Board delegates authority to approve exposures by means of a formal mandate taking ratings, type of risk and tenors into account.

Ongoing monitoring of credit exposures is undertaken by the Business Units, with separate monitoring by Operations Department and Risk Department with monthly reports to management and the Risk Management Committee. In the event of adverse trends, covenant breaches or arrears, Risk Department becomes actively involved to resolve the situation.

The table below shows the value of exposures for each credit quality step:

Sovereigns:

Credit quality step	Risk weight %	S&P Rating	Exposure Value	Exposure Value after mitigation
1	0	AAA to AA-	1,045	1,045
2	20	A+ to A-	2,343	2,343
Not Rated	50	Not Rated	2,521	2,521

Financial Institutions:

Credit quality step	Risk weight %	Rating	Exposure Value	Exposure Value after mitigation
1	20	AAA to AA-	44,347	44,347
2	20 (under 3 months) 50 (over 3 months)	A+ to A-	19,226	19,226
3	20 (under 3 months) 50 (over 3 months)	BBB+ to BBB-	27,780	27,780
Not Rated	20 (under 3 months) 50 (over 3 months)	Not Rated	34,943	34,943

Corporates and other:

Credit quality step	Risk weight %	Rating	Exposure Value	Exposure Value after mitigation
1	20	AAA to AA-	128	128
2	50	A+ to A-	-	-
3	100	BBB+ to BBB-	2,545	2,545
4	100	BB+ to BB-	-	-
Not Rated	100	Not Rated	20,273	20,273
Default	150	Default	796	796

Private Equity:

Credit quality step	Risk weight %	Exposure Value	Exposure Value after mitigation
Sufficiently diversified Portfolios	100	-	-
Quoted	290	6,226	6,226
Unquoted	370	750	750

Impairment provisions

At each reporting date an objective assessment is made whether a financial asset or group of assets are impaired. Evidence will include financial difficulties, default in payments, breach of financial covenants and restructuring.

If there is evidence that an impairment loss has been incurred, the amount of the impairment is measured as the difference between the carrying value of the asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairments have been deducted from the corresponding asset value in the balance sheet. Where subsequent events indicate the impairment allowance is not required, or not required in full, the allowance is reversed.

Where an exposure is not recoverable it is written off against the related impairment provision after all actions have been taken and the amount of the loss has been determined. Subsequent recoveries are recognised in the income statement.

The table below shows the past due loans and impairments and charges to the income statement for the year ending 31 December 2009:

	Sovereign	Financial Institutions	Corporate and other	Private equity	Total
Not past due:	5,909	126,296	22,946	6,976	162,127
Past due:					
Up to 3 months	-	-	796	-	796
3 to 6 months	-	-	-	-	-
6 to 12 months	-	-	-	-	-
Over 12 months	-	-	-	-	-
Total exposures	5,909	126,296	23,742	6,976	162,923
Provisions:					
Opening balance at 1 January 2009	381	464	6,134	-	6,979
Charge / (credit) for the period:					
Impairment allowances	-	-	13,383	5,942	19,325
AFS fair value adjustments	(209)	(356)	(2,503)	-	(3,068)
Closing balance at 31 Dec 2009	172	108	17,014	5,942	23,236

Past due amounts are defined as one day overdue and include the full amount outstanding.

Available for sale assets (AFS)

At each reporting date, the AFS financial assets are assessed for fair value. If there is evidence of a credit loss embedded in the reduced value, the credit loss is accounted for in the income statement as an impairment charge, and the balance fair value loss is charged to the AFS Reserve.

Factors taken into account in assessing impairments include volatility in markets, deterioration in financial position and cash flows, and industry and sector performance.

Credit risk concentrations

Concentration limits are set within policy. Limits for geographic, industry sector and large exposures to counterparty or connected counterparty concentrations are set and monitored.

Credit risk mitigation

Credit risk is mitigated where possible using collateral, netting, third party guarantees, securitisations and syndications. Most financing structures are unsecured although certain securities have recourse to pools of tangible assets. Robust and enforceable documentation is maintained with standard documentation subject to internal legal review and bespoke documentation prepared by independent solicitors.

No derivatives are permitted in terms of Sharia'a law.

6. Market risk

Market risk overview

Market risk is defined as the risk of loss arising from adverse changes in market prices.

Profit rate risk arises from changes in profit rates and credit spreads. The Bank is not exposed to interest rate risk on its financial assets as no interest is charged or earned. However the fair value of financial instruments may be affected by market forces including interest rates. Profit rate risk is mainly allocated between GBP and USD.

Foreign exchange risk arises from assets and liabilities denominated in foreign currency where the value or net income changes as a result of changes in foreign exchange rates.

Equity risk arises from movements in equity prices.

Financial instruments are carried at fair value under the Calculation of Counterparty Risk ('CCR') mark to market method.

All market risks are monitored and regularly considered by ALCO and the Risk Management Committee.

Monitoring market risks

The following metrics are used to monitor market risk:

Value at Risk (VaR). This technique estimates the potential losses as a result of movements in market rates and prices over a specified time horizon and a given level of confidence. A 10 day horizon and a 99 % confidence level are used. The VaR model used incorporates underlying volatilities and correlations. Potential movements in market prices are calculated by reference to daily market data from the last two years equally weighted. Results are reviewed daily by management. Actual outcomes are monitored periodically to test the validity of assumptions used. VaR methodology is limited by historical data not necessarily being a guide to the future, changes beyond the level of confidence used, and no account taken of intra day positions.

Sensitivity analysis (PV01). This is used to assess the change in value of net worth against a one basis point (0.01 %) rise in profit rates and credit spreads. Results are reported on a daily basis.

Stress Testing (PV200). This is a similar calculation to PV01 but against a more severe 200 basis point (2.0 %) rise in profit rates. Results are reported daily.

Trigger limits. These limits are set to allow a certain pre-determined movement in the investment portfolio and equity prices. Movements in excess of the trigger limits must be reported to the relevant committee for further decision. Trigger limits are monitored daily.

A set of limits and triggers to cover market risks has been set by the Board and are reported daily.

Profit rate and foreign exchange rate risk summary:

	Average 2009	High 2009	Low 2009
Gross profit rate exposure	3	3	2
Gross foreign exchange exposure	341	1,996	15

The Net Open Foreign Exchange position on 31 December 2009 was GBP 1,968,381.
There are no contractual obligations to provide collateral.

7. Operational risk

Operational risk overview

Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

The Basic Indicator Approach to operational risk is followed. Gross income is used as a proxy for operational risk exposure with the capital charge based on gross income over the preceding three years.

Monitoring and control

Oversight and governance for setting and managing operational risk policy and culture are the responsibility of the Board, the Executive Management Committee and the Risk Management Committee with oversight in the following key risk areas:

- Financial management
- Information technology
- Premises and safeguarding of physical assets.
- Internal and external fraud
- People
- Employment practices and workplace safety
- Business continuity

Information security
Legal & regulatory
Clients, products and business practices
Execution, delivery and process management
Third parties

Responsibility for each area is allocated to a risk owner being a senior member of management. Management includes monitoring and control of regular quality self assessments, incident reporting and analysis, material losses and control failures.

8. Liquidity risk

Liquidity risk overview

Liquidity risk is defined as the inability to repay liabilities when due at an acceptable cost within a reasonable time period.

Monitoring and control

Cash flows are managed on a daily basis and a portfolio of liquid assets is maintained consisting of cash and short term bank deposits. Liquidity risk management is the responsibility of ALCO.

An internal assessment of liquidity (Internal Liquidity Adequacy Assessment) (ILAA) is currently being implemented.

Liquidity is managed within the FSA's prudential limits as follows:

Limit	Sight: 0 %	Sight to 1 month: - 5%
31 December 2009	159 %	361 %
31 December 2008	20 %	48 %